

STATE OF WEST VIRGINIA
AUDIT REPORT
OF

WEST VIRGINIA STATE BOARD OF INVESTMENTS
DECEMBER 31, 1989



OFFICE OF LEGISLATIVE AUDITOR

CAPITOL BUILDING

CHARLESTON 5, WEST VIRGINIA

WEST VIRGINIA STATE BOARD OF INVESTMENTS

DECEMBER 31, 1989

WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance



LEGISLATIVE AUDITOR
Room 441, Main Unit
STATE CAPITOL


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AREA CODE 304

CHARLESTON, WEST VIRGINIA 25305
February 1, 1990

To Members of the West Virginia Legislature:

In compliance with the West Virginia Code, Chapter 12, Article 6, Section 15, one thousand nine hundred thirty-one, as amended, transmitted herewith is the report of the balance sheet of the West Virginia State Board of Investments. This report covers the calendar year 1989 and other matters.

Respectfully submitted,


Theodford L. Shanklin, CPA, Director
Legislative Postaudit Division

TLS/ela

WEST VIRGINIA STATE BOARD OF INVESTMENTS

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WEST VIRGINIA STATE BOARD OF INVESTMENTS

INTRODUCTION

The West Virginia State Board of Investments was created on March 11, 1967 by the passage of Senate Bill Number 300 by the 1967 Regular Session of the West Virginia Legislature. As stated in Chapter 12, Article 6, Section 1 of the West Virginia Code, the original legislation stated the purpose of the Board was,

"... to provide a centralization of the investment responsibility for state funds and to enlarge the classes of securities in which public funds may be invested."

Consisted with this objective, Chapter 12, Article 6, Section 7 of the Code stated in part,

"All duties vested by law in any agency or board of the state relating to the investment or reinvestment of moneys, and the purchase, sale or exchange of any investment or securities, of and for any funds, are hereby transferred to and shall be exercised and performed for such fund by the board: . . ."

The 1978 Regular Session of the West Virginia Legislature made major revisions to the investment law by establishing the "Consolidated Fund" and "Consolidated Pension Fund" and allowing for investment by political subdivisions. These changes were detailed in Chapter 12, Article 6, Section 8 of the Code which stated,

(a) There is hereby established a special investment fund to be managed by the board and designated as the "consolidated pension fund" for the common investment of pension funds. All administrators, custodians or trustees of the various pension funds are hereby authorized to make moneys available to the board for investment. Pension funds received by the board shall be deposited in the consolidated pension fund. Any security deposited by the various pension funds shall be valued at the prevailing market price on the day of deposit.

(b) There is hereby also established a special investment fund to be managed by the board and designated as the "consolidated fund". The consolidated fund shall consist of a special account for the common investment of state funds designated as the "state account" and a special account for the common investment of local government funds designated as the "local government account". Moneys in both accounts may be combined for the common investment of the consolidated fund on an equitable basis.

(c) Each board, commission, department, official or agency charged with the administration of state funds is hereby authorized to make moneys available to the board for investment. State funds received by the board shall be deposited in the state account.

(d) Each political subdivision of this state through its treasurer or equivalent financial officer is hereby authorized to enter into agreements with the board for the investment of moneys of such political subdivision: *Provided*, That it first be determined by the treasurer for such political subdivision that the available interest rate offered by an acceptable depository in such treasurer's county be less than the interest rate, net of administrative fees referred to in article six, chapter twelve of this code, offered it through the state board of investments. Local government funds received by the board pursuant to such agreements shall be deposited in the local government account.

(e) Each county board of education through its treasurer is hereby authorized to enter into agreements with the board of investments for the investment of moneys of such county board of education: *Provided, however*, That it first be determined by the treasurer for such county board of education that the available interest rate offered by an acceptable depository in such treasurer's county be less than the interest rate, net of administrative fees referred to in article six, chapter twelve of this code, offered it through the state board of investments.

(f) Moneys held in the various funds and accounts administered by the board shall be invested as permitted in section nine and subject to the restrictions contained in section ten of this article. The board shall maintain records of the deposits and withdrawals of each participant and the performance of the various funds and accounts. The board shall also establish such rules and regulations for the administration of the various funds and accounts established by this section as it shall deem necessary for the administration thereof, including but not limited to (1) the specification of minimum amounts which may be deposited in any fund or account and minimum periods of time for which deposits will be retained; (2) creation of reserves for losses; (3) provision for payment of expenses from earnings; and (4) distribution of the earnings in excess of such expenses or allocation of losses to the several participants in an equitable manner: *Provided*, That in the event any moneys made available to the board may not lawfully be combined for investment or deposited in the consolidated funds established by this section, the board may create special accounts and may administer and invest such moneys in accordance with the restrictions specially applicable thereto. "

Major revisions were made to the State Board of Investments as a result of the passage of Senate Bill Number 621 by the 1989 Regular Session of the West Virginia Legislature. Whereas, the Board had consisted of three ex-officio members, the Governor, the State Auditor and State Treasurer, four additional members were added to make a total of seven members. Other changes involved other areas of the Board's organization, operation of the Board's management service fee account, restrictions on and authorizations of investments and additional audit requirements. The text of the various amendments to the West Virginia Code are as follows:

§ 12-6-4. Officers; organization; surety bonds for members and employees.

(a) The governor shall be the chairman and the custodian of all funds, securities and assets held by the board and the board shall elect an executive secretary to serve for a term of six years, such election to be held at the board's first meeting after the effective date of this article (April 8, 1989). The office of the state treasurer shall act as a depository for all funds, that may, from time to time, from whatever source, be made available to the board for investment. The office of the state treasurer shall act as staff agency for the board.

(b) The board shall meet quarterly and may include in its bylaws procedures for the calling and holding of additional meetings.

(c) Each member of the board shall give a separate and additional fidelity bond from a surety company qualified to do business within this state in a penalty amount of two hundred fifty thousand dollars for the faithful performance of his duties as a member of the board. In addition, the board will purchase a blanket bond for the faithful performance of its duties in the amount of five million dollars excess of the two hundred fifty thousand dollar individual bond required of each member by the provisions of this section. The board may require a fidelity bond from a surety company qualified to do business in this state for any person who has charge of, or access to, any securities, funds or other moneys held by the board, and the amount of such fidelity bond shall be fixed by the board. The premiums payable on all fidelity bonds shall be an expense of the board.

§ 12-6-3. State board of investments continued; body corporate; members; appointment of certain members; qualifications and term of office.

(a) The state board of investments is hereby continued as a body corporate of the state authorized to exercise all of the powers and functions granted to it pursuant to this article. There shall be seven members of the State Board of Investments. The governor, or his designee, state treasurer and state auditor shall be the members of the board. There shall be four members appointed by the governor: Provided, That no more than three such appointed members may belong to the same political party.

(b) The members appointed by the governor shall be appointed from a list of twelve persons submitted jointly by the governor, the state treasurer, and the state auditor. No more than two names submitted by the governor may be appointed as members to the board. Of the members appointed by the governor, two shall be members of the financial community, one shall be a certified public accountant, and one shall be an attorney with experience in finance and investment matters. Appointments shall be made by the governor with the advice and consent of the Senate.

(c) Appointed members shall serve for a term of six years and may be reappointed at the expiration of their terms. In the event of a vacancy among appointed members, an appointment shall be made to fill the unexpired term.

(d) Appointed members of the board shall serve without compensation, but shall be entitled to their reasonable and necessary expenses actually incurred in discharging their duties under this article.

§ 12-6-6. Costs and expenses; fees for services.

(a) The board shall make a charge against the earnings of the various funds managed by the board for all necessary expenses of the board. Such charge shall be on a pro rata basis of actual earnings of the various funds managed by the board. Such charge shall be payable into a special revenue account hereby created in the state treasury and named the "board management account." The board is authorized to expend the moneys deposited in this account for all costs and expenses of the board, including fees of professional consultants, advisors and auditors, brokerage commissions, and all other necessary expenses of the board incurred in the performance of its functions: Provided, That during any fiscal year in which the board anticipates spending any money from the special account, it shall submit to the executive department during the budget preparation period prior to the Legislature convening, before that fiscal year for inclusion in the executive budget document and budget bill, the request for appropriations: Provided, however, That no funds may be expended from this account unless appropriated by the Legislature.

(b) The board shall make an annual report to the Legislature on the status of the board management account, including the previous year's expenditures and projected expenditures for the next year. Any amounts remaining in the special account after yearly appropriations by the Legislature shall be distributed on a pro-rata basis, taking into account average daily balances, to the participants of the various funds managed by the board.

§ 12-6-9c. Authorization of additional investments.

Notwithstanding the restrictions which may otherwise be provided by law with respect to the investment of funds, each board, commission, department, official or agency charged with the administration of state funds, all administrators, custodians or trustees of pension funds, each political subdivision of this state and each county board of education is authorized to invest funds in the securities of or any other interest in any investment company or investment trust registered under the Investment Company Act of 1940, 15 U.S.C. § 80a, the portfolio of which is limited to direct obligations of or obligations guaranteed as to the payment of both principal and interest by the United States of America and to repurchase agreements fully collateralized by United States Government obligations: Provided, That the investment company or investment trust takes delivery of the collateral either directly or through an authorized custodian.

§ 12-6-10. Restrictions on investments.

Moneys on deposit in the consolidated fund and the consolidated pension fund shall be invested as permitted by section nine of this article subject to the restrictions and conditions contained in this section:

(1) At no time shall more than seventy-five percent of the portfolio of either fund be invested in securities described in subdivision (g) of said section nine:

(2) At no time shall more than twenty percent of the portfolio of either fund be invested in securities described in said subdivision (g) which mature within one year from the date of issuance thereof;

(3) At no time shall more than three percent of the portfolio of either fund be invested in securities issued by a single private corporation or association.

For the purpose of making the computations required by this section, securities shall be valued in accordance with generally accepted accounting principles.

§ 12-6-15. Audits.

There shall be a continuous postaudit conducted by the legislative auditor of the investment transactions of the board, and a copy thereof for the preceding calendar year shall be furnished to each member of the Legislature on or before the first day of February of each year. The board shall further cause to be conducted a semiannual internal audit of all investment transactions of the board and an annual external audit of all investment transactions of the board: Provided, That the board shall on a monthly basis provide to each political subdivision, state agency and any other entity investing moneys in the consolidated investment fund an itemized account reflecting the portfolio value of each said political subdivision, state agency and any other entities investments in the consolidated investment fund. The board shall further provide a monthly statement reflecting the interest earned by each said political subdivision, state agency or other investing entity and the method by which said interest has been calculated. "

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BOARD MEMBERS AND STAFF

Board Members

W. Gaston Caperton III
Governor
Charleston Chairman

Thomas E. Loehr
State Treasurer
Charleston Member

Glen B. Gainer, Jr.
State Auditor
Charleston Member

John Poffenbarger
Executive Secretary
Charleston Member

William T. Tracy
Huntington Member

Dwight Keating
Clarksburg Member

Richard K. Riederer
Weirton Member

Staff

Robert Jones Assistant Treasurer for Asset Management

Diana Will Director of Investments

Mary J. Coffey Investment Clerk

Mary J. Lopez Investment Clerk

Susan P. Guthrie Investment Clerk

Delores Humbles Secretary

WEST VIRGINIA STATE BOARD OF INVESTMENTS

GENERAL REMARKS

Background

The requirements of corporations to be eligible for investment purchases by the Board are set out by the West Virginia Code, Chapter 12, Article 6, Section 9, as follows:

". . . (g) Any bond, note, debenture, commercial paper or other evidence of indebtedness of any private corporation or association organized and operating in the United States: Provided, that any such security is, at the time of its acquisition, rated in one of the three highest rating grades by an agency which is nationally known in the field of rating corporate securities: Provided, however, that if any commercial paper and/or any such security will mature within one year from the date of its issuance, it shall, at the time of its acquisition, be rated in one of the two highest rating grades by such an agency: Provided further, that any such security not rated in one of the two highest rating grades by any such agency and commercial paper or other evidence of indebtedness of any private corporation or association shall be purchased only upon the written recommendation from an investment adviser that has over three hundred million dollars in other funds under its management; . . ."

The West Virginia Code, Chapter 12, Article 6, Section 10, as amended states in part:

". . . (1) At no time shall more than seventy-five percent of the portfolio of either fund be invested in securities described in subdivision (g) of said section nine; (2) At no time shall more than twenty percent of the portfolio of either fund be invested in securities described in said subdivision (g) which mature within one year from the date of issuance thereof; (3) At no time shall more than three percent of the portfolio of either fund be invested in securities issued by a single private corporation or association. . . ."

Pursuant to authorization given by House Bill Number 1321, effective July 1, 1978, Administrative Rules and Regulations filed with the Secretary of State on October 13, 1978, and portfolio policy guidelines adopted by the Board of Investments, the State Treasurer's Office completed the conversion of State agency

short-term investments to the Consolidated Fund (Short-Term Pools) on October 15, 1978 and all State retirement system funds to the Consolidated Pension Fund (Long-Term Pool) on March 17, 1979.

The Consolidated Fund was composed of 33 "pools" during 1989 which are identified below. Pool 0100 contain investments from agencies which are unrestricted by type, i.e., not restricted by instrument. Pool 0140 contains investments from agencies which may only be government instruments. The remaining 31 pools contain specific investments for individual agencies due to constitutional or bonding restrictions prohibiting commingling with Pools 0100 and 0140.

1. Consolidated Investment Pool No. 100

This Pool consists of the operating funds of State agencies.

2. State Agency Trust Fund Pool No. 101

Money held in trust by State agencies including such money as Performance Bonds and State Hospital Patient Funds. The account was created November 1, 1989.

3. Local Government Pool No. 102

This pool contains only money deposited by local governments. The Fund is to be run as a money market type fund with a weighted average maturity of no more than 120 days. The account was created November 1, 1989.

4. Workers' Compensation Operating Fund Pool No. 110

This Pool consisted of operating funds from the Workers' Compensation Fund and the Coal Pneumoconiosis Fund.

5. Local Government Pension Fund Pool No. 115

This Pool consisted of funds from the local government pension systems.

6. Construction Trust Fund - Huntington Toll Bridge Pool No. 120

This Construction Trust Fund is restricted to investments made solely on the behalf of the Huntington Toll Bridge and may only be invested in U.S. Treasury obligations.

7. The School Fund Pool No. 130

The School Fund is not an investment Pool within the Consolidated Fund. The Office of the Treasurer of State serves as the staff agency for the "Board of the School Fund". The Fund is restricted to investments in securities of the United States Government or of the State of West Virginia.

8. Restricted Consolidated Pool No. 140

This Pool is limited to investments made in securities offered by U.S. Treasury, U.S. Government Agencies, or investments collateralized by U.S. Treasury securities.

9. Pool 140 Amortization Pool No. 141

This pool contains zero coupon bonds bought to amortize the losses in Pool 140. At the maturity date of the bonds, the funds will be transferred to Pool 140.

10. Municipal Bond Commission - County Revenue Pool No. 152

This Municipal Bond Commission Account is for the investment of county revenues. No purchases or sales of investments may occur without the authorization of the Municipal Bond Commission.

11. Municipal Bond Commission - General Obligation Pool No. 156

This Municipal Bond Commission Account is for the defeasance of general obligations of municipalities, only U.S. Treasury Securities may be purchased.

12. Municipal Bond Commission - WVU Project 11 Escrow Pool No. 160

This Escrow Account is for West Virginia University's Project 11. No purchases or sales of investments may occur without the authorization of the Municipal Bond Commission.

13. Municipal Bond Commission - County Schools Pool No. 162

This Pool is for the investment of funds held by county schools systems. No purchases or sales of investments may occur in Pool No. 162 without Municipal Bond Commission authorization.

14. Municipal Bond Commission - Public Service Districts Pool No. 164

This Pool is for the investment of Public Service District Funds. No purchases or sales of investments may occur in Pool No. 164 without Municipal Bond Commission authorization.

15. Municipal Bond Commission Pool No. 166

No purchases or sales of investments may occur in Pool No. 166 without Municipal Bond Commission authorization.

16. Municipal Bond Commission - Huntington Bridge 65 Revenue Pool No. 400

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This account is for the Huntington Toll Bridge obligation. No purchases or sales of investments may occur in Pool No. 400 without Municipal Bond Commission authorization. This account replaces Pool No. 150.

17. Municipal Bond Commission - Combined Revenue Account Pool No. 401

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This account is for the investment of State Building Commission Funds. No purchases or sales of Investments may occur in Pool No. 401 without Municipal Bond Commission authorization. This account replaces Pool No. 170.

18. Municipal Bond Commission - Hancock County Schools 83G/0 Pool No. 402

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This newly created account contains investments originally held in Pool No. 162. These investments are escrowed for the retirement of Hancock County Schools general obligation bonds. No purchases or sales of investments may occur in Pool No. 402 without Municipal Bond Commission authorization.

19. Municipal Bond Commission - Fairmont 85 Sewer Revenue Pool No. 403.

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This account contains investments originally held in Pool No. 166. These investments are escrowed for the retirement of Fairmont Sewer Revenue Bonds. No purchases or sales of investments may occur in Pool No. 403 without Municipal Bond Commission authorization.

20. Municipal Bond Commission - Fairmont 85 Water Revenue Esc Pool No. 404.

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This account contains investments originally held in Pool No. 166. These investments are escrowed for the retirement of Fairmont Water Revenue Bonds. No purchases or sales of investments may occur in Pool No. 404 without Municipal Bond Commission authorization.

21. Municipal Bond Commission - Huntington 80 Sewer Revenue Pool No. 405.

This account was created December 29, 1988 to hold escrowed investments for the Municipal Bond Commission. This account contains investments originally held in Pool No. 166. These investments are escrowed for the retirement of Huntington Sewer Revenue Bonds. No purchases or sales of investments may occur in Pool No. 405 without Municipal Bond Commission authorization.

22. Municipal Bond Commission - Escrow Agent For Board of Regents -
Pool No. 406

This account was created January 26, 1989 to hold escrowed investments for the Municipal Bond Commission. No purchases or sales of investments may occur in Pool No. 406 without Municipal Bond Commission authorization.

23. Retirement Systems' Operation Fund Pool No. 3300

This Pool was designed to accommodate the investment needs of the individual retirement systems. The participating systems are the Judges' Retirement System, Public Employees' Retirement System, Public Safety Retirement System and Teachers' Retirement System.

24. Workers' Compensation Fund Housing Development Loan Fund Pool No. 4900

Pool No. 4900 was established by statute (Chapter 31, Article 18B, Section 2, West Virginia Code, June 11, 1982) to track the Workers' Compensation Fund Loan to the Housing Development Fund.

25. Workers' Compensation Fund - Economic Development Authority Loan
Pool No. 5100

Pool No. 5100 was established by statute (Chapter 31, Article 18B, Section 2, West Virginia Code, June 11, 1982) to track the Workers' Compensation Fund Loan to the West Virginia Economic Development Authority.

26. Department of Highways - Pool No. 6840

This Pool consists of proceeds from Special Highway Obligation Notes. The proceeds have arbitrage restrictions and can only be used to buy SLUGS through the Federal Reserve.

27. Lottery Defeasance Pool No. 8013

This Pool was established October 1987. This Pool is used to annuitize the lottery winners by buying U.S. Treasury Zero Coupon Bonds.

28. Governor's Office Redemption of Previous Liabilities Pool No. 8427

This pool was used to account for loans made to the Governor's Office.

29. Higher Education Central Office Pool No. 8845

Opened January 25, 1989 for the proceeds from Registration Fee Revenue Bond. A Flex Repo with a fixed-rate and a five-year maturity was bought. Interest compounds monthly on these investments and withdrawals are made by letter from the Higher Education Central Office.

30. Department of Transportation Special Highway Fund Pool No. 9312

The proceeds from the bond issue are invested in repurchase agreements.

31. Department of Transportation Zero Coupon Pool No. 9313

The funds represent the investments of the special highway fund set up by Chapter 17, Article 16A, Section 23 of the West Virginia Code.

32. Finance and Administration - Reserve Restricted Fund Pool No. 9523

The Department of Finance and Administration invests its issuance in this restricted Pool.

33. Revenue Sharing Fund Pool No. 9700

All Federal Revenue Sharing Funds received by the State are invested through this Pool until they are needed to pay appropriated obligations.

INVESTMENT POLICY

At a regular meeting of the West Virginia State Board of Investments on February 19, 1985, a new investment policy was adopted. The proposal was introduced by the Treasurer and second by the Governor. The proposal was approved with the Auditor opposing. The proposal, as adopted, contained three broad policy guidelines:

"(1) The Treasurer of State, as staff agency for the Board, shall administer the Consolidated Funds in accordance with the following guidelines for diversification of the portfolio according to the kind of investment instrument, the quality of investment instrument, and the maturity of investment instrument;

(2) No investment may be made with a maturity date beyond ten (10) years, without approval of the majority of the Board, for those funds managed by and within the Treasurer of State's Office; and,

(3) The Treasurer of State, as staff agency for the Board, shall be authorized to sell any investment within the Board's portfolio regardless of the maturity that he deems prudent and in the best interest of maintaining the financial integrity of the Consolidated Funds."

"General Investment Policies (Board Approved)

(1) Purpose

To invest and protect the assets of the Consolidated funds for the benefit of the citizens of the State of West Virginia. To seek the highest investment return consistent with the fiduciary standards established under State and Federal law, the regulations of the State of West Virginia and the guidelines of the Board of Investments.

(2) Standard of Care

All investments are to be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which people of experience, prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

(3) Diversification

To diversify the investment of the assets of the Fund so as to minimize the risk of large losses.

(4) Permissible Investments

The Fund shall abide by Section 12.6.9 of the West Virginia Code with regard to permissible investments.

(5) Social Responsibility

To the extent that investments are consistent with all other standards established by the Board of Investments, selection of investments should consider the interests of the people of the State of West Virginia.

(6) Supervision

The sole responsibility in the supervision of the assets of the Fund shall be with the Board of Investments of the State of West Virginia.

(7) Custody

The Board of Investments shall designate and maintain custodian arrangements in its sole discretion and no investment advisor shall maintain custody of the securities of the Fund.

(8) Investment Advisors

The Board of Investments will select and maintain investment advisors who shall act in accordance with the terms and conditions specified by the Board of Investments' Advisory Agreement.

Investment Objectives

(1) Preservation of Capital

To preserve the capital investment in Funds.

(2) Stability

To maintain a high level security in the Funds by minimizing risk and volatility insofar as possible within the rate of return objectives.

(3) Liquidity

To maintain sufficient liquidity to provide for all anticipated withdrawals or transfers and to invest in issues with sufficient marketability to provide for unexpected withdrawals.

(4) Turnover

To minimize transaction costs.

(5) Rate of Return

- a. The Fund shall seek an investment return from income which should exceed the inflation rate by at least three percentage points, using the annual GNP deflator, measured over a three to five year period.
- b. The Fund shall seek a total investment return which exceeds the Shearson-Lehman Government Bond Index, measured over a one to three year period.
- c. The Fund shall seek total investment performance which would place it in the top one-third of comparable funds, measured over each one year period by SEI.

Investment Restrictions

(1) West Virginia Code

The Fund shall abide by the quality restrictions of Section 12.6.9 of the West Virginia Code.

(2) Diversification

- a. Not more than 20% of the Fund's value at market may be invested in any single industry sector. (The utility industry shall be separated for the purpose of this restriction between telephone, electric, gas distribution and similar segments.)
- b. Not more than 3% of the Fund's value at market may be invested in the securities issued by a single private corporation or association.
- c. The Fund shall maintain a reasonable balance between the various classes of fixed income securities, without over concentration.

(3) Quality

The Fund shall abide by the quality restrictions of Section 12.6.9 of the West Virginia Code.

(4) Equity Investments

The Fund shall not invest in equity securities or equity equivalent securities."

Changes in Policy Guidelines - Calendar Year 1986

In addition, at the regular meeting of the West Virginia Board of Investments on May 14, 1986, new policy guidelines were adopted concerning the divestiture of investments from companies and/or financial institutions doing

business with the Republic of South Africa or Namibia. The proposal was introduced by the Treasurer and seconded by the Auditor. The proposal was approved unanimously. The proposal, as adopted, contains these new guidelines:

"Whereas, the policy of Apartheid as maintained by the present government of the Republic of South Africa is not only morally repugnant to all who believe in the inherent rights of individual freedom and equal treatment under the law and has resulted in the systematic enslavement and subjugation of the nonwhite majority of South Africa and Namibia but casts doubt on the safety and stability of investment in companies doing business with, operating in, or making loans to the Republic of South Africa or Namibia;

Now, Therefore, Be It Resolved That:

1. No monies under the control of the West Virginia Board of Investments shall remain invested in or hereinafter be invested in the securities or other obligations of any company doing business directly in or with the Republic of South Africa or of Namibia.
2. No monies under the control of the West Virginia Board of Investments shall be deposited in any bank or financial institution which makes loans directly to the Republic of South Africa or Namibia or a governmental enterprise thereof.
3. It is the expressed goal of the West Virginia Board of Investments that the divestiture required by Section 1 be completed within three years of approval of this resolution so that no less than one-third the value of said investments be sold in any one year. However, consistent with the Board's fiduciary responsibilities and fiscal prudence, the three-year time period may be extended to complete the divestiture program so as to minimize financial market disturbances and to avoid absorbing any realized capital (market) losses within the portfolio.

NOTE: This policy shall be in effect so long as apartheid remains the official policy of the government of South Africa."

Also, at a regular meeting of the West Virginia Board of Investments on July 24, 1986, the Treasurer proposed that the investment policy established by the Board on July 3, 1984 be rescinded. The investment policy established by the Board on July 3, 1984 regarding investment in real estate or real estate related trust investments stipulated that the Board's participation could not exceed either 50% of the project or the participation level of the lead lender. The

proposal was seconded by the Auditor and was passed unanimously. The investment policy established by the Board of July 3, 1984 contained these guidelines:

"The West Virginia Board of Investments will invest in real estate or real estate related trust investments under the following conditions:

1. The project supporting the security will be located in West Virginia: real estate, shopping center and other property investments outside the State will not qualify.
2. The West Virginia State Board of Investments will not be the 'lead lender'. The West Virginia Board of Investments will participate only with a lead lender.
3. The maximum participation by the Board of Investments will not exceed either 50% of the project or the participation level of the lead lender.
4. The participation by the State Board of Investments will include full and proportionate participation in all conditions of the security agreement.
5. The total yield to the State Board of Investments will be at least equal to such yield as would be available through investments in Treasury securities of like term.
6. At no time shall more than 25% of any individual fund be invested in real estate related trust investments."

Also, at a regular meeting of the West Virginia State Board of Investments on December 29, 1986, a policy guideline regarding options was adopted. Following is the Board minutes adopting the policy:

"Mr. Margolin distributed a copy of an opinion from the Office of the Attorney General regarding the legality of investing in financial futures and a recommended policy guideline to be considered by the Board for adoption . . . Auditor Gainer suggested that language be added to the recommended policy that advance unanimous approval of the Board be obtained of each transaction relating to futures and options. After further discussion, Auditor Gainer moved the adoption of the policy guideline as amended. Treasurer Manchin seconded the motion which was passed unanimously."

The proposal, as adopted, contains this new guideline:

"The Treasurer of State, as staff agency for the Board, shall be authorized to invest in financial futures contracts, options and other similar instruments for the sole purpose of performing hedges in order to reduce the risk associated with fluctuations in interest rates or market prices of investments made by the Board. Such investments shall be limited to direct obligations of, or obligations guaranteed as to the

payment of both principal and interest by the United States of America; namely, treasury bills, notes and bonds. for purposes of this guideline, the word 'hedge' mean taking a position in the futures market which is opposite and approximately equal to the one held in the cash market. This policy guideline shall only be used as a defensive strategy in order to protect the overall values of our portfolios. Advance unanimous approval of the Board must be obtained prior to each transaction enacted under this guideline."

Changes in Policy Guidelines - Calendar Year 1989

The West Virginia State Board of Investments unanimously approved a plan at its January 27, 1989 meeting calling for the State Treasurer's Office to enter into new securities lending agreements at 30 basis points versus the prior rate of 40 basis points. Throughout 1989, the Board suspended the guideline for investments requiring that at least ten percent of the portfolio must mature within 91 days. The suspension of this Board guideline was created by the liquidity difficulties encountered by the Consolidated Fund. At the June 5, 1989 meeting, the State Board of Investments authorized the establishment of a subcommittee consisting of the ex-officio members of the Board and Dwight Keating to review and approve all recommendations made by the Board's staff concerning purchases and sales of investments with maturities longer than 90 days for those pools without advisors. The staff was authorized to execute any purchases with maturities of 90 days or less for those pools that do not have advisors. Further, the Assistant Treasurer of Investments and the Director of Investments are authorized to execute the recommendations of the investment advisors concerning investment purchases and sales. The advisors are required to communicate these recommendations by letter to each Board member.

Management of the Funds

The State Treasurer's Office administered the activities of the Pneumoconiosis Fund within the Consolidated Pension Fund during calendar year

1989. The activities of the other pension funds were administered by the following advisors during calendar year 1989:

Investment Advisers, Inc.:
Public Employees' Retirement System
Workers' Compensation Fund .

Charleston National Bank:
Public Safety Retirement System
Judges' Retirement System

Duff and Phelps Investment Management Company:
Teachers' Retirement System .

The State Treasurer's Office administered the activities of all "pools" making up the Consolidated Investment Fund during calendar year 1989.

CONSOLIDATED FUND

Our prior audit report of the West Virginia State Board of Investments for calendar year 1988 disclosed several areas of noncompliance with the provisions of the West Virginia Code regarding investments and the rules and regulations of the West Virginia State Board of Investment, as well as the existence of a substantial deficit in the Consolidated Fund. In our current report, we will address corrective action taken by the West Virginia State Board of Investments in 1989 to prevent violations of the West Virginia Code and established a mechanism to fund the deficit in the Consolidated Fund.

Fund Deficit

For purposes of determining the deficit, within the Consolidated Fund, the Consolidated Fund's assets were \$231,369,625.24 less than the liabilities on January 31, 1989. At the Board meeting on April 26, 1989, the Board approved a plan whereby Pool 110 - Workers' Compensation Fund Operating Account and Pool 3300 - Retirement System Operating Account would be closed on July 1, 1989 and the applicable deficits would accrue to the individual pension funds, in effect an immediate recognition of the deficits incurred by the pension funds. The pools

closed on July 1, 1989 and the deficits were credited as follows: Judges' Retirement System - \$39,541.82; Public Safety Retirement System - \$1,562,781.78; Workers' Compensation Fund - \$3,164,597.31; Pneumoconiosis Fund - \$24,853,333.90; Public Employees' Retirement System - \$11,007,338.92; and Teachers' Retirement Board - \$329,415.97 resulting in the recognition of deficits totaling \$40,957,009.70. As a result, the deficit in the Consolidated Fund was reduced to \$190,412,615.54. At the April 26, 1989 meeting, the Board also voted to close Pool 105 - Local Housing Development Pool, Pool 115 - Local Government Pension Fund and Pool 145 - National Credit Union Administration and consolidate the deficits in these pools with the deficit in Pool 100 - Consolidate Investment Fund. After this action was taken, the Consolidated Fund deficit consisted of Pool 100 - Consolidated Investment Fund, \$163,847,548.40 and Pool 140 - Restricted Consolidated Pool, \$26,565,067.14 for a total of \$190,412,615.54.

After an intensive review of available options to remove the deficit in the Consolidated Fund, the State Board of Investments approved a plan at the October 26, 1989 meeting calling for the utilization of zero coupon bonds. The plan calls for approximately \$32,000,000.00 to be accumulated from interest income and securities lending income over a period of 18 months to 26 months. These funds would be used to purchase zero coupon bonds which will mature over a period of 15 to 20 years. The maturity value of the discounted bonds would be sufficient to fund the deficit. As of December 31, 1989, zero coupon bonds totaling \$6,570,960.00 with a maturity value of \$22,000,000.00 have been purchased for Pool 140 - Restricted Consolidated Pool. Currently, no zero coupon bonds have been purchased for Pool 100 - Consolidated Investment Fund.

Reverse Repurchase Agreements

We noted in our prior audit report, the State Treasurer's Office, the Board's staff agency utilized reverse repurchase agreements during April 1987 in amounts which exceeded the Board's policy guidelines for diversification of the

investment portfolio adopted at the Board meeting on February 19, 1985. We reviewed the use of reverse repurchase agreements during 1989 to ensure the maximum level of 15% of moneys making up the Consolidated Fund was not exceeded. We noted reverse repurchase agreements were utilized throughout the year; however, the amounts did not exceed the allowable limit. The amount of the reverse repurchase agreement on January 1, 1989 was \$75,525,000.00. The amount reached its lowest point on October 4-11, 1989 at \$51,998,750.00. The amount of the reverse repurchase agreement on December 31, 1989 was \$68,065,000.00. The total interest paid by the State Board of Investments in 1989 including accrued interest payable on December 31, 1989 in connection with reverse repurchase agreements was \$6,055,425.77.

Other Board Action

Our review of the minutes of meetings of the West Virginia State Board of Investments for calendar year 1989 shows the Board adopted guidelines at the June 5, 1989 meeting to improve the Board's review over purchases and sales activities. The Board approved a plan whereby the Assistant Treasurer of Investments and the Director of Investments are authorized to execute the recommendations of the investment advisors concerning purchases and sales in those funds which have advisors. The investment advisor is required to communicate all recommendations by letter to each Board member. Also, the Board authorized the establishment of a subcommittee consisting of the ex-officio Board members and Dwight Keating to review and approve all recommendations made by the Board's staff concerning purchases and sales of investments with maturities longer than 90 days for those without investment advisors. The staff is authorized to execute any purchases with maturities of 90 days or less for those pools without investment advisors.

Write-off of Industrial Assistance Loan

Chapter 14, Article 1, Section 18 of the West Virginia Code states,

"The commissioner of finance and administration, auditor or other officer or official body having authority to collect the same may, with the advice of the attorney general, adjust and settle upon just and equitable principles without regard to strict legal rules any account or claim, in favor of the State, which may at the time have been standing upon the books of his or its office more than five years; and, with the like advice, may dismiss any proceeding instituted by him or it."

Our examination of the investment portfolio of the State Board of Investments shows an industrial assistance loan made to Mid-Atlantic Fuels on December 30, 1987 with a book value of \$4,694,974.58 was written-off by the State Treasurer's Office on December 31, 1989. We could find no evidence where the write-off of the loan was approved by the West Virginia State Board of Investments. The loan was funded with moneys borrowed from the Public Employees' Retirement System.

The loan was reported as being in serious default at the meeting of the West Virginia State Board of Investments held on December 6, 1988. The Board adopted the following resolution on December 6, 1988 regarding the protection of the Board's rights concerning the Mid-Atlantic Fuels loan:

The West Virginia State Board of Investments (the "Board") hereby adopts the following Resolution:

"WHEREAS, by promissory notes (the "Notes") dated December 30, 1987, the Board loaned Mid-Atlantic Fuels, Inc. ("Mid-Atlantic") the aggregate sum of \$5,493,514.98, said Notes being secured by security interests in specified collateral (the "Collateral") and being further secured by the execution of guarantee agreements (the "Guarantees") by Charles T. Lazzell and Dorothy P. Lazzell (hereinafter referred to as the "Lazzells").

WHEREAS, Mid-Atlantic has defaulted with respect to the terms of the Notes because of its failure to pay several installments of principal and interest.

WHEREAS, the Board desires to collect the outstanding principal and accrued interest on the Notes by assigning any and all of its rights with respect to the enforcement of the Notes to the West Virginia Industrial and Trade Jobs Development Corporation (the "Corporation").

NOW, THEREFORE, BE IT:

RESOLVED, that the Board hereby assigns to Ann Shabb in her capacity as agent for the Corporation the following rights:

(a) The right to enforce the Notes, including, among others, the right to declare the Notes in default; the right to initiate and prosecute an action in an appropriate judicial or administrative forum and the right to collect the unpaid principal and accrued interest on the Notes;

(b) The right to take all necessary steps to protect the Board's security interest in the Collateral and the right to foreclose, sell or otherwise dispose of the Collateral to recover the unpaid principal and accrued interest on the Notes;

(c) the right to initiate and prosecute an action in an appropriate judicial or administrative forum to enforce the Board's rights under the Guarantees and the right to collect the unpaid principal and accrued interest under the terms of the Guarantees;

(d) any and all further rights necessary to collect the unpaid principal and accrued interest on the Notes."

Based on our discussions with personnel within the Governors' Office of Community and Industrial Development, it appears a final determination as to potential recovery of principal and accrued interest in connection with the Mid-Atlantic Fuels loan has not yet been reached. We believe any action regarding write-off of the loan or reclassification of the loan into a reserve for losses category as allowed by Section 6.01 of "Rules for the Administration of the Consolidated Fund by the West Virginia State Board of Investments," 1983 amendment is an action requiring a vote of the Board members.

Section 6.01 states,

"The board may create a reserve for losses in the Consolidated Fund if the board determines that the one-year amortization of gains and losses is inappropriate or inadequate for unusual losses."

It appears the establishment of a reserve for losses related to non-performing loans would be a proper function of the State Board of Investments as allowed by Section 6.01 of the Consolidated Fund's operating rules. We believe a reserve for losses related to non-performing loans would be in conformity with generally

accepted accounting principles and the provisions of Chapter 14, Article 1, Section 18 of the West Virginia Code.

EVALUATION OF THE CONSOLIDATED PENSION FUND

We obtained copies of the rating service's evaluation of the Consolidated Pension Funds' performance for the quarters ended December 31, 1988, March 31, 1989, June 30, 1989 and September 30, 1989 as prepared by SEI Funds Evaluation, Inc. The rating service's evaluation of the quarter ended December 31, 1989 was not yet available at the conclusion of our current fieldwork (January 31, 1990). We reviewed the rating services' reports and noted the following observations:

<u>Fund</u>	Rate of Return for Quarter Ended			
	<u>Time-Weighted</u> <u>09/30/89</u>	<u>06/30/89</u>	<u>03/31/89</u>	<u>12/31/88</u>
Judges'	1.3%	8.0%	1.0%	0.6%
Public Safety	(1.9%)	8.5%	1.0%	0.5%
Workers' Compensation	0.4%	9.4%	1.3%	1.0%
Pneumoconiosis	(0.9%)	8.2%	1.9%	0.3%
Public Employees'	(0.1%)	9.1%	0.9%	1.2%
Teachers'	0.7%	9.1%	0.5%	0.5%

The asset allocation was ranked against SEI's bond fund universe. The results reported by the rating service concerning asset allocation for the quarters ended December 31, 1988, March 31, 1989, June 30, 1989 and September 30, 1989 were as follows:

Fund	09/30/89	Quarter Ended		12/31/88
		06/30/89	03/31/89	
Judges':				
Bonds	91.1%	96.5%	92.9%	95.5%
Cash Equivalents and Cash	8.7%	3.5%	7.1%	4.5%
Private Placements	0.2%	0.0%	0.0%	0.0%
Public Safety:				
Bonds	93.9%	97.9%	95.6%	97.8%
Cash Equivalents and Cash	6.1%	2.1%	4.4%	2.2%
Workers' Compensation:				
Bonds	96.3%	96.9%	96.3%	96.8%
Cash Equivalents and Cash	1.7%	1.0%	1.4%	0.8%
Private Placements	2.0%	2.1%	2.3%	2.4%
Pneumoconiosis:				
Bonds	79.1%	88.9%	94.3%	97.7%
Cash Equivalents and Cash	15.0%	9.1%	3.6%	0.1%
Private Placements	5.9%	2.1%	2.2%	2.2%
Public Employees:				
Bonds	96.2%	94.6%	94.5%	94.9%
Cash Equivalents and Cash	0.5%	1.6%	1.2%	0.6%
Private Placements	3.4%	3.8%	4.2%	4.5%
Teachers':				
Bonds	97.9%	96.5%	97.8%	97.9%
Cash Equivalents and Cash	2.1%	3.5%	2.2%	2.1%

Relative conditions in the financial market are subject to change within the year. As a result, certain aspects of portfolio diversification while aiding overall performance of the fund in one quarter of the year may be detrimental to performance in another quarter of the year. The rating service made the following statements relative to asset allocation of the various funds:

Public Employees'

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalent hurt performance". For the quarter ended March 31, 1989, "The low commitment to cash equivalents hurt

performance". For the quarter ended June 30, 1989, "Asset allocation had little effect on performance" and regarding marketable bonds, "Long maturity helped performance". For the quarter ended September 30, 1989, "The low commitment to cash equivalents hurt performance" and regarding marketable bonds, "Long maturity hurt performance".

Workers' Compensation

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalents hurt performance". For the quarter ended March 30, 1989, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalents hurt performance". For the quarter ended June 30, 1989, "The high commitment to bonds helped performance" and "The low commitment to cash equivalents helped performance" and regarding marketable bonds, "Long maturity helped performance". For the quarter ended September 30, 1989, "Asset allocation had little effect on performance" and regarding marketable bonds, "Long maturity hurt performance".

Teachers'

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalents hurt performance" and regarding marketable bonds, "High quality hurt performance". For the quarter ended March 31, 1989, "The high commitment to bonds hurt performance". For the quarter ended June 30, 1989, "The high commitment to bonds helped performance". For the quarter ended September 30, 1989, "The high commitment to bonds hurt performance".

Pneumoconiosis

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalents hurt performance". For the quarter ended March 31, 1989, "Asset allocation had little effect on performance". For the quarter ended June 30, 1989, "Asset allocation had little

effect on performance". For the quarter ended September 30, 1989, "The low commitment to bonds helped performance" and "The high commitment to cash equivalents helped performance".

Public Safety

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance" and "The low commitment to cash equivalents hurt performance". For the quarter ended March 31, 1989, "The high commitment to bonds hurt performances". For the quarter ended June 30, 1989, "The high commitment to bonds helped performance". For the quarter ended September 30, 1989, "Asset allocation had little effect on performance".

Judges'

For the quarter ended December 31, 1988, "The high commitment to bonds hurt performance". For the quarter ended March 31, 1989, "Asset allocation had little effect on performance". For the quarter ended June 30, 1989, "The high commitment to bonds helped performance". For the quarter ended September 30, 1989, "Asset allocation had little effect on performance".

INVESTMENT ACTIVITIES

The following schedule is a comparative analysis of the activities of the State long-term trust funds for calendar years 1989 and 1988:

	<u>Judges'</u>	<u>Public Safety</u>	<u>Workers' Compensation</u>
Sales 1989:			
Number	13	7	18
Average Years Held	1.13	1.66	1.82
Average Years to Maturity from Sale Date	6.44	7.66	5.86
Average Rate of Return	6.279%	22.303%	15.612%
Average Approximate Yield to Maturity	8.107%	11.633%	7.533%
Par Value	\$ 3,160,000	\$ 5,631,054	\$157,764,884
Book Value	\$ 3,150,632	\$ 4,925,328	\$157,016,771
Sale Proceeds	\$ 3,104,759	\$ 4,822,895	\$160,214,863
Net Gain (Loss)	(\$ 45,873)	(\$ 102,432)	\$ 3,198,092
Interest Earnings	\$ 569,941	\$ 1,050,175	\$ 23,202,231
Total Earned	\$ 524,069	\$ 947,743	\$ 26,400,323
Sales 1988:			
Number	4	4	13
Average Years Held	1.47	1.07	2.55
Average Years to Maturity from Sale Date	10.28	10.67	2.86
Average Rate of Return	5.510%	2.750%	22.910%
Average Approximate Yield to Maturity	8.170%	0.410%	5.150%
Par Value	\$ 1,996,656	\$ 3,172,124	\$130,225,000
Book Value	\$ 2,001,846	\$ 3,180,696	\$129,870,112
Sale Proceeds	\$ 1,980,003	\$ 3,171,087	\$131,096,739
Net Gain (Loss)	(\$ 21,843)	(\$ 9,608)	\$ 1,226,627
Interest Earnings	\$ 131,814	\$ 113,872	\$ 14,922,925
Total Earned	\$ 109,972	\$ 104,264	\$ 16,149,552
Purchases 1989:			
Number	15	19	9
Average Years to Maturity	8.44	8.67	23.74
Approximate Yield at Maturity	13.924%	16.954%	7.861%
Total:			
Par Value	\$ 4,430,000	\$33,456,014	\$242,000,000
Purchase Price	\$ 4,449,149	\$33,178,541	\$160,061,237
Purchases 1988:			
Number	8	5	5
Average Years to Maturity	6.39	8.63	14.84
Approximate Yield at Maturity	8.300%	8.810%	8.710%
Total:			
Par Value	\$ 4,250,000	\$ 5,000,000	\$ 92,500,000
Purchase Price	\$ 4,278,225	\$ 5,028,821	\$ 90,725,684

<u>Pneumoconiosis</u>	<u>Public Employees'</u>	<u>Teachers'</u>
0	19	2
0.00	2.29	2.50
0.00	4.66	10.55
0.000%	21.154%	6.415%
0.000%	8.960%	10.352%
\$ -0-	\$245,215,936	\$30,000,000
\$ -0-	\$244,318,124	\$31,684,353
\$ -0-	\$244,907,582	\$29,764,788
\$ -0-	\$ 589,458	(\$ 1,919,565)
\$ -0-	\$ 52,366,953	\$ 6,910,714
\$ -0-	\$ 52,956,411	\$ 4,991,149
263	12	6
0.022	1.94	2.51
8.345	3.24	10.62
0.274%	19.618%	13.033%
8.614%	4.138%	9.167%
\$2,131,537,500	\$105,250,000	\$21,957,650
\$2,131,718,504	\$105,354,859	\$22,271,878
\$2,132,271,568	\$106,859,631	\$22,334,231
\$ 553,064	\$ 1,504,772	\$ 62,353
\$ 432,337	\$ 23,786,492	\$ 2,034,242
\$ 985,400	\$ 25,291,264	\$ 2,096,595
24	36	1
14.96	18.06	26.55
11.575%	8.810%	9.645%
\$ 161,847,850	\$944,054,522	\$ 4,875,005
\$ 159,836,065	\$670,242,152	\$ 4,792,739
290	5	1
9.338	16.63	9.13
8.931%	7.530%	9.320%
\$2,454,401,333	\$165,000,000	\$ 3,000,000
\$2,442,613,011	\$162,311,328	\$ 2,707,500

Items of Note

The trust funds experienced net gains (losses) on sale of investments during 1989 as follows: Judges' (\$45,873); Public Safety (\$102,432); Workers' Compensation \$3,198,092; Public Employees' \$589,458; and, Teachers' (\$1,919,565). The total net gain on sale of investments for all funds in 1989 was \$1,719,680.00. We noted there were no sales in the Pneumoconiosis Fund in 1989.

Also, the trust funds achieved interest earnings from investments sold during 1989 as follows: Judges' \$569,941; Public Safety \$1,050,175; Workers' Compensation \$23,202,231; Public Employees' \$52,366,953; and Teachers' \$6,910,714. The total interest earnings from investments sold for all funds in 1989 was \$84,100,014.00.

The total earnings generated by the sale of investments is the sum of the net gain on sale of investments and interest earnings. The trust funds had total earnings from investments sold during 1989 as follows: Judges' \$524,068; Public Safety \$947,743; Workers' Compensation \$26,400,323; Public Employees' \$52,956,411; and, Teachers' \$4,991,149. The total earnings generated by the sale of investments for all funds in 1989 was \$85,819,694.00.

There were 59 investments sold during 1989 compared to 302 investments sold during 1988. The following is a comparative schedule of the number of investments sold during these years:

<u>Fund</u>	<u>1989</u>	<u>1988</u>	<u>Increase (Decrease)</u>
Judges'	13	4	9
Public Safety	7	4	3
Workers' Compensation	18	13	5
Pneumoconiosis	0	263	(263)
Public Employees'	19	12	7
Teachers'	<u>2</u>	<u>6</u>	<u>(4)</u>
	<u>59</u>	<u>302</u>	<u>(243)</u>

Overall, the sales activity decreased by 80% from 1988 sales.

There were 104 purchases in 1989 compared to 314 purchases in 1988. The total par value of 1989 purchases was \$1,390,663,391 while the total purchase price of 1989 purchases was \$1,032,559,883 resulting in a discount of \$358,103,508.00. The following is a comparative schedule of the number of investments purchased during these years:

<u>Fund</u>	<u>1989</u>	<u>1988</u>	<u>Increase (Decrease)</u>
Judges'	15	8	7
Public Safety	19	5	14
Workers' Compensation	9	5	4
Pneumoconiosis	24	290	(266)
Public Employees'	36	5	31
Teachers'	<u>1</u>	<u>1</u>	<u>-0-</u>
	<u>104</u>	<u>314</u>	<u>(210)</u>

Overall, the purchase activity decreased by 66% from 1988 levels.

We noted the following changes in the amount of repurchase agreements on hand at December 31, 1989:

<u>Fund</u>	<u>1989</u>	<u>1988</u>	<u>(Over) Under 1988</u>
Judges'	\$ 504,400	\$ 460,000	\$ 44,400
Public Safety	1,378,800	390,000	988,800
Workers' Compensation	3,398,400	4,065,000	(666,600)
Pneumoconiosis	54,866,300	75,000	54,791,300
Public Employees'	4,378,500	4,900,000	(521,500)
Teachers'	<u>8,973,600</u>	<u>5,110,000</u>	<u>3,863,600</u>
	<u>\$73,500,000</u>	<u>\$15,000,000</u>	<u>\$58,500,000</u>

The amount of repurchase agreements increased by \$58,500,000 at December 31, 1989 over the amount invested on December 31, 1988.

INDEPENDENT AUDITORS' OPINION

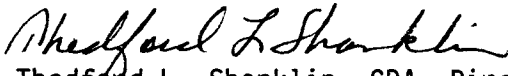
Members of the West Virginia Legislature
State Capitol
Charleston, West Virginia

We have audited the accompanying balance sheet of the West Virginia State Board of Investments as of December 31, 1989. The financial statement is the responsibility of the management of the West Virginia State Treasurer's Office, staff agency for the West Virginia State Board of Investments. Our responsibility is to express an opinion on the financial statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the balance sheet. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall balance sheet presentation. We believe that our audit of the balance sheet provides a reasonable basis for our opinion.

In our opinion, the balance sheet referred to above presents fairly, in all material respects, the financial position of the West Virginia State Board of Investments as of December 31, 1989, in conformity with generally accepted accounting principles.

Respectfully submitted,


Thedford L. Shanklin, CPA, Director
Legislative Postaudit Division

January 31, 1990

Auditors: Michael E. Sizemore, CPA, Supervisor
Andrea L. Lane
Ralph W. Laton

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BALANCE SHEET

DECEMBER 31, 1989

	<u>Consolidated Fund</u>	<u>Consolidated Pension Fund</u>	<u>Combined Totals (Memorandum Only)</u>
Assets:			
Investments - Net (Par Value \$930,507,342.59 - Consolidated Fund, \$2,285,149,158.61 - Consolidated Pension Fund) (Allowance for Uncollectible Loans - \$4,694,974.58 - Con- solidated Pension Fund. See Note 1, Section F)	\$ 812,939,161.01	\$2,312,210,117.31	\$3,125,149,278.32
Interest Receivable	<u>8,231,010.21</u>	<u>42,298,275.87</u>	<u>50,529,286.08</u>
	<u>\$ 821,170,171.22</u>	<u>\$2,354,508,393.18</u>	<u>\$3,175,678,564.40</u>
Liabilities and Fund Balances:			
Due to Investors	<u>\$1,005,011,826.76</u>	<u>\$2,354,508,393.18</u>	<u>\$3,359,520,219.94</u>
Total Liabilities	1,005,011,826.76	\$2,354,508,393.18	\$3,359,520,219.94
Fund Balance (Deficit) See Note 1, Section E	<u>(183,841,655.54)</u>	<u>-0-</u>	<u>(183,841,655.54)</u>
	<u>\$ 821,170,171.22</u>	<u>\$2,354,508,393.18</u>	<u>\$3,175,678,564.40</u>

See Notes to Financial Statement

WEST VIRGINIA STATE BOARD OF INVESTMENTS

NOTES TO FINANCIAL STATEMENT

DECEMBER 31, 1989

Note 1 - Summary of Significant Accounting Policies

The balance sheet of the West Virginia State Board of Investments has been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard - setting body for establishing government accounting and financial reporting principles. The more significant of the Board's accounting policies are described below.

A. Fund Accounting

The West Virginia State Board of Investments operates two trust funds for investment purposes, the Consolidated Fund and Consolidated Pension Fund. The trust funds were established by Chapter 12, Article 6, Section 8, Subsections (a) and (b) of the West Virginia Code, which state,

" (a) There is hereby established a special investment fund to be managed by the board and designated as the "consolidated pension fund" for the common investment of pension funds. All administrators, custodians or trustees of the various pension funds are hereby authorized to make moneys available to the board for investment. Pension funds received by the board shall be deposited in the consolidated pension fund. Any security deposited by the various pension funds shall be valued at the prevailing market price on the day of deposit.

(b) There is hereby also established a special investment fund to be managed by the board and designated as the "consolidated fund." The consolidated fund shall consist of a special account for the common investment of state funds designated as the "state account" and a special account for the common investment of local government funds designated as the "local government account." Moneys in both accounts may be combined for the common investment of the consolidated fund on an equitable basis."

By definition, all assets of the West Virginia State Board of Investments are assets held on behalf of outside parties, such as other governments, or on behalf of other agencies within State government.

B. Basis of Accounting

The accrual basis of accounting is utilized by the West Virginia State Board of Investments. Under this method, investments are accounted for in accordance with the provisions set forth in Section C entitled "Investments".

C. Investments

Short-term investments are stated at cost. Long-term investments are stated at cost, less amortization of premiums, plus accretions of discount. In relation to investments shown in Note 2, only investments in United States Treasury Notes and Bonds have a readily determinable market value for

inclusion in the calculation of market value and book value in the Consolidated Fund. However, in relation to investments as shown in Note 2 below, only repurchase agreements and any investments maturing within one year from the schedule of investment date do not have a readily determinable market value for inclusion in the calculation of market value and book value in the Consolidated Pension Fund.

D. Memorandum Only - Total Column

Total column on the balance sheet is captioned "memorandum only" to indicate that it is presented only to facilitate financial analysis. It does not indicate the combined totals are available for use in any manner other than that provided by applicable laws, rules and regulations.

E. Fund Deficit

As of December 31, 1989, a deficit of \$183,841,655.54 exists in the Consolidated Fund managed by the West Virginia State Board of Investments. The components of the deficit are found in the following pools and amounts:

Pool 100 - Consolidated Investment Fund	\$163,847,548.40
Pool 140 - Restricted Consolidated Pool	<u>19,994,107.14</u>
Total	<u>\$183,841,655.54</u>

F. Allowance For Uncollectible Loans

The statutory guidelines for the write-off of uncollectible amounts is set forth in Chapter 14, Article 1, Section 18a of the West Virginia Code, which states,

" Any account, claim or debt that an agency of this State is not able to collect within three months after trying with due diligence to do so may be referred to the commissioner of finance and administration for consignment by the commissioner to a responsible licensed and bonded debt collection agency or similar other responsible agent for collection. The commissioner shall not handle or consign any such account, claim or debt unless he is satisfied that the referring agency has made a diligent effort to collect the debt on its own; that the account or claim is justly, properly and clearly due the State; and that the collection of any such debt would not impose an undue, unjust, unfair or unreasonable hardship or burden upon the health or general welfare of the party owing the debt. In any such case of undue, unjust, unfair or unreasonable hardship or burden, the commissioner may, in his discretion, and with the review and approval of the attorney general, compromise, settle or dismiss the debt or claim. If he is satisfied that the aforesaid terms of any conditions for collectibility have been met, the commissioner may consign the account, claim or debt to a responsible licensed and bonded debt collection agency or similar other responsible agent for collection. In any such case, the collection agency or other agent shall stand in the place of the State as creditor and shall have the same claims, rights and remedies against the debtor as the State has, and the debtor shall have the same rights, claims, defenses and setoffs against the collection agency or other agent as he has against the State. (1981, c. 50.)"

An allowance for an uncollectible loan totaling \$4,694,974.58 has been set up for the Consolidated Pension Fund as of December 31, 1989.

Note 2 - Investments

Investments in the State of West Virginia's consolidated cash and investment pool are stated at cost or amortized cost.

	<u>Carrying Amount</u>	<u>Market Value</u>
Repurchase Agreements:		
Consolidated	\$ 161,322,922.99	\$ 161,322,922.99
Consolidated Pension	<u>73,500,000.00</u>	<u>73,500,000.00</u>
Total Repurchase Agreements	<u>234,229,922.99</u>	<u>284,229,022.99</u>
Other Investments:		
U.S. Treasury Notes/Bonds		
Consolidated	71,649,619.18	69,207,270.05
Consolidated Pension	<u>1,164,395,204.53</u>	<u>1,191,121,501.50</u>
	1,236,044,823.71	1,260,328,771.55
U.S. Agency Notes/Bonds:		
Consolidated Pension	270,321,126.20	259,424,970.31
State and Local Government Units:		
Consolidated	64,791,100.00	64,791,100.00
Zero Coupon Bonds:		
Consolidated	149,759,872.45	164,175,407.05
Consolidated Pension	<u>194,746,005.10</u>	<u>206,075,986.80</u>
	344,505,877.55	370,251,393.85
Governmental National Mortgage Association:		
Consolidated	105,517,455.47	100,718,794.47
Consolidated Pension	<u>107,105,919.91</u>	<u>104,507,946.28</u>
	212,623,375.38	205,226,740.75
Farmers' Home Administration/ Veterans' Administration Mortgages:		
Consolidated Pension	35,744,801.66	36,923,298.74
Board of Investments Mortgage Program:		
Consolidated Pension	8,053,351.23	8,053,351.73
West Virginia Housing Development Fund Program:		
Consolidated	33,992,153.76	33,992,153.76

Collateralized Mortgage Obligation Earnings Pools: Consolidated Pension	49,896,174.25	47,701,767.42
Municipal Bonds: Consolidated	16,949.01	24,000.00
Corporate Bonds: Consolidated	14,963,440.15	13,200,000.00
Consolidated Pension	<u>346,151,141.93</u>	<u>333,331,684.19</u>
	361,114,582.08	346,531,684.19
Industrial Loans: Consolidated	114,332,622.11	114,332,622.11
Consolidated Pension	<u>37,221,731.07</u>	<u>37,221,731.07</u>
	151,554,353.18	151,554,353.18
Certificates of Deposit: Consolidated	164,658,025.89	164,658,025.89
Intergovernmental Loans: Consolidated Pension	25,074,661.43	25,074,661.43
Reverse Repurchase Agreement: Consolidated	<u>(68,065,000.00)</u>	<u>(68,065,000.00)</u>
Total Other Investments	<u>2,890,326,355.33</u>	<u>2,906,471,272.30</u>
Total Investments	<u>\$3,125,149,278.32</u>	<u>\$3,141,294,195.29</u>

Reverse Repurchase Agreements:

\$68,065,000.00 received to be repaid with interest of 8.625% on 01/03/90	\$ 8,000,000	USTN Maturing 01/15/94
	\$ 8,063,231	Carrying Amount,
	\$ 7,737,500	Market Value
	\$ 5,000,000	USTN Maturing 02/15/96
	\$ 5,665,625	Carrying Amount
	\$ 5,195,312	Market Value
	\$ 5,000,000	USTN Maturing 02/15/96
	\$ 5,485,962	Carrying Amount,
	\$ 5,195,312	Market Value
	\$25,000,000	USTN Maturing 11/15/96
	\$25,007,812	Carrying Amount
	\$23,984,375	Market Value
	\$10,000,000	USTN Maturing 11/15/96
	\$10,026,314	Carrying Amount
	\$ 9,593,750	Market Value
	\$20,000,000	USTN Maturing 02/15/96
	\$11,697,800	Carrying Amount
	\$12,346,200	Market Value

\$ 5,000,000 USTN Maturing 02/15/96
 \$ 2,550,600 Carrying Amount
 \$ 3,086,550 Market Value

<u>Total Agreements</u>		<u>Total Underlying Securities</u>	
Proceeds	\$68,065,000	Market Value	\$67,138,999
Accrued Interest	<u>309,838</u>	Accrued Interest	<u>923,374</u>
Obligation	<u>\$68,374,838</u>	Market Value plus Accrued Interest	<u>\$68,062,373</u>

Note 3 - Equity in Pooled Cash, Pooled Investments and Investments

Chapter 12, Article 6, Section 8, Subsections (a) through (f) of the West Virginia Code describe the management of the Consolidated Fund and Consolidated Pension Fund, as well as identify those governmental units that may invest funds. Chapter 12, Article 6, Section 8, Subsections (a) through (f) state:

"(a) There is hereby established a special investment fund to be managed by the board and designated as the "consolidated pension fund" for the common investment of pension funds. All administrators, custodians or trustees of the various pension funds are hereby authorized to make moneys available to the board for investment. Pension funds received by the board shall be deposited in the consolidated pension fund. Any security deposited by the various pension funds shall be valued at the prevailing market price on the day of deposit.

(b) There is hereby also established a special investment fund to be managed by the board and designated as the "consolidated fund." The consolidated fund shall consist of a special account for the common investment of state funds designated as the "state account" and a special account for the common investment of local government funds designated as the "local government account." Moneys in both accounts may be combined for the common investment of the consolidated fund on an equitable basis.

(c) Each board, commission, department, official or agency charged with the administration of state funds is hereby authorized to make moneys available to the board for investment. State funds received by the board shall be deposited in the state account.

(d) Each political subdivision of this State through its treasurer or equivalent financial officer is hereby authorized to enter into agreements with the board for the investment of moneys of such political subdivision: Provided, that it first be determined by the treasurer for such political subdivision that the available interest rate offered by an acceptable depository in such treasurer's county be less than the interest rate, net of administrative fees referred to in article six [§ 12-6-1 et seq.], chapter twelve of this Code, offered it through the state board of investments. Local government funds received by the board

pursuant to such agreements shall be deposited in the local government account. Any political subdivision may enter into an agreement with any state agency from which it receives funds to allow such funds to be transferred to their investment account with the state board of investments.

(e) Each county board of education through its treasurer is hereby authorized to enter into agreements with the board of investments for the investment of moneys of such county board of education: Provided, however, that it first be determined by the treasurer for such county board of education that the available interest rate offered by an acceptable depository in such treasurer's county be less than the interest rate, net of administrative fees referred to in article six [§ 12-6-1 et seq.], chapter twelve of this Code, offered it through the state board of investments.

(f) Moneys held in the various funds and accounts administered by the board shall be invested as permitted in section nine [§ 12-6-9] and subject to the restrictions contained in section ten [§ 12-6-10] of this article. The board shall maintain records of the deposits and withdrawals of each participant and the performance of the various funds and accounts. The board shall also establish such rules and regulations for the administration of the various funds and accounts established by this section as it shall deem necessary for the administration thereof, including, but not limited to: (1) The specification of minimum amounts which may be deposited in any fund or account and minimum periods of time for which deposits will be retained; (2) creation of reserves for losses; (3) provision for payment of expenses from earnings; and (4) distribution of the earnings in excess of such expenses or allocation of losses to the several participants in an equitable manner: Provided, that in the event any moneys made available to the board may not lawfully be combined for investment or deposited in the consolidated funds established by this section, the board may create special accounts and may administer and invest such moneys in accordance with the restrictions specially applicable thereto. . . ."

Investments - Chapter 12, Article 6, Section 9 of the West Virginia Code describes the permissible investments. Chapter 12, Article 6, Section 9 states:

"Notwithstanding the restrictions which may otherwise be provided by law as to the investment of funds, the board may invest funds made available to it in any of the following:

(a) Any direct obligation of, or obligation guaranteed as to the payment of both principal and interest by, the United States of America;

(b) Any evidence of indebtedness issued by any of the following agencies: Government National Mortgage Association, federal land banks, federal home loan banks, federal intermediate credit banks, banks for cooperatives, Tennessee valley authority, United States postal service, farmers home administration, export-import bank, federal financing bank, Federal Home Loan Mortgage Corporation, Student Loan Marketing Association and Federal Farm Credit Banks;

(c) Any evidence of indebtedness issued by the Federal National Mortgage Association to the extent such indebtedness is guaranteed by the Government National Mortgage Association;

(d) Any evidence of indebtedness that is secured by a first lien deed of trust or mortgage upon real property situate within this State, if the payment thereof is substantially insured or guaranteed by the United States of America or any agency thereof;

(e) Direct and general obligations of this State;

(f) Any undivided interest in a trust, the corpus of which is restricted to mortgages on real property and, unless all of such property is situate within the State and insured, such trust at the time of the acquisition of such undivided interest, is rated in one of the three highest rating grades by an agency which is nationally known in the field of rating pooled mortgage trusts;

(g) Any bond, note, debenture, commercial paper or other evidence of indebtedness of any private corporation or association organized and operating in the United States: Provided, that any such security is, at the time of its acquisition, rated in one of the three highest rating grades by an agency which is nationally known in the field of rating corporate securities: Provided, however, that if any commercial paper and/or any such security will mature within one year from the date of its issuance, it shall, at the time of its acquisition, be rated in one of the two highest rating grades by such an agency: Provided further, that any such security not rated in one of the two highest rating grades by any such agency and commercial paper or other evidence of indebtedness of any private corporation or association shall be purchased only upon the written recommendation from an investment adviser that has over three hundred million dollars in other funds under its management;

(h) Negotiable certificates of deposit issued by any bank, trust company, national banking association or savings institution organized and operating in the United States, which mature in less than one year and are fully collateralized; and

(i) Interest earning deposits including certificates of deposit, with any duly designated state depository, which deposits are fully secured by a collaterally secured bond as provided in section four [§ 12-1-4], article one of this chapter."

Also, Chapter 12, Article 6, Section 9c of the West Virginia Code states,

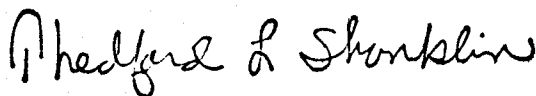
"Notwithstanding the restrictions which may otherwise be provided by law with respect to the investment of funds, each board, commission, department, official or agency charged with the administration of state funds, all administrators, custodians or trustees of pension funds, each political subdivision of this state and each county board of education is authorized to invest funds in the securities of or any other interest in any investment company or investment trust registered under the Investment Company Act of 1940, 15 U.S.C. § 80a, the portfolio of which is limited to direct obligations of or obligations guaranteed as to the payment of both principal and interest by the United States of America and to repurchase agreements fully collateralized by United States Government obligations: Provided, That the investment company or investment trust takes delivery of the collateral either directly or through an authorized custodian."

STATE OF WEST VIRGINIA

OFFICE OF LEGISLATIVE AUDITOR, TO WIT:

I, Thedford L. Shanklin, CPA, Director of the Legislative Postaudit Division, do hereby certify that the report appended hereto was made under my direction and supervision, under the provisions of the West Virginia Code, Chapter 12, Article 6, Section 15, as amended, and that the same is a true and correct copy of said report

Given under my hand this 1st day of FEBRUARY,
1990.



Thedford L. Shanklin, CPA, Director
Legislative Postaudit Division

Copy forwarded to each member of the Legislature, each member of the Board and the Attorney General.