

STATE OF WEST VIRGINIA

AUDIT REPORT

OF

WEST VIRGINIA STATE BOARD OF INVESTMENTS

DECEMBER 31, 1994



OFFICE OF LEGISLATIVE AUDITOR

Legislative Post Audit Division

CAPITOL BUILDING

CHARLESTON, WEST VIRGINIA 25305

WEST VIRGINIA STATE BOARD OF INVESTMENTS

DECEMBER 31, 1994

WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance



Legislative Post Audit Division
Building 5, Room 751A
Capitol Complex

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CHARLESTON, WEST VIRGINIA 25305

February 1, 1995

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 1994.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Theford L. Shanklin".

Theford L. Shanklin, CPA, Director
Legislative Post Audit Division

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WEST VIRGINIA STATE BOARD OF INVESTMENTS

TABLE OF CONTENTS

Introduction	1
Board Members and Senior Staff	5
Summary of Findings and Recommendations	6
General Remarks	8
Independent Auditors' Opinion	22
Balance Sheet	23
Notes to Financial Statement	24
Certificate of Director, Legislative Post Audit Division	31

WEST VIRGINIA STATE BOARD OF INVESTMENTS

INTRODUCTION

The West Virginia State Board of Investments was created by the West Virginia Legislature on March 11, 1967. It is governed by Chapter 12, Article 6, Sections 1-18 inclusive of the West Virginia Code. The State Board of Investments has been continued until July 1, 1996, by Chapter 12, Article 6, Section 18.

The State Board of Investments consists of seven members (West Virginia Code, Chapter 12, Article 6, Section 3). The Governor is the Chairman. The West Virginia State Auditor and State Treasurer are the other two members designated by the code. The other four members are selected from a list of twelve persons submitted jointly by the Governor, State Treasurer and the State Auditor. Only two of the four appointed members can be chosen from the names submitted by the governor. These appointed members serve for a term of six years. The members serve without compensation, but are entitled to reasonable and necessary expenses actually incurred in discharging their duties.

The State Board of Investments has an executive director and three basic departments each with a chief officer. There is a chief operating officer, chief investment officer and chief financial officer. Each chief officer has his own support staff.

The West Virginia Code sections are specific in detailing the types of investment that can be utilized. Chapter 12, Article 6, Section 9 details permissible investment. Chapter 12, Article 6, Section 10, places restrictions on the percentages of each portfolio which may be invested in certain types of securities.

Chapter 12, Article 6, Section 9a, specifies amounts that can be transferred to the state's general revenue account. Chapter 12, Article 6, Section 6 deals with the establishment of a special revenue account to handle investigation of claims against third parties for investment losses, for consulting services regarding the restructuring of the office of the State Treasurer and costs of implementing the changes in the restructuring. The special revenue account is funded by securities lending income and recoveries from third parties. The account is scheduled to expire on June 30, 1995. The Board is authorized to deposit into the special revenue account and to expend a maximum of \$2 million annually from the account. Other Sections of Chapter 12, Article 6 deal with apportionments of interest earnings among state depositories and the standard of care to be exercised by the Board in making investments.

The investment pools are divided into two basic funds, the Consolidated Pension Fund and the Consolidated Fund. The Consolidated Pension Fund consists of four retirement accounts, two West Virginia Workers' Compensation accounts and a Pneumoconiosis account. The Consolidated Fund consists of accounts that are described below.

The Unrestricted Pool consisted of the operating funds of the state and certain state agencies. Its purpose was to provide for the investment of all surplus funds and supply the daily cash needs of the state. The State Agency Trust Pool was comprised of funds held in trust by state agencies. The Local Government Pool was available for investment of funds from any local government

that desires the opportunity to invest with the State of West Virginia. On July 1, 1994, the assets of the Unrestricted Pool, State Agency Trust Pool, Local Government Pool and Bank Compensation Pool were combined into a new pool named the Cash Liquidity Pool. The new pool consists of the operating funds of the State, funds held in trust by State agencies and funds invested by local governments. In addition, the Enhanced Yield Pool was created on July 1, 1994 consisting of those operating funds of the State which the Board's staff have determined are not immediately needed to fund the State's liquidity requirements. The Government Money Market Pool is available for the investment of unexpended bond proceeds, debt service funds and amounts escrowed under the requirements of bond issuances. The Loss Amortization Fund was created to account for those participant claims of the general operating funds of the state which exceeded the underlying assets of the other funds. This excess of participant claims on net assets over underlying assets occurred as a result of the distribution of earnings to participants in various Board investment funds principally in the Unrestricted Pool, in excess of the true investment income experience of the funds in 1987 and 1988. West Virginia Code Chapter 12, Article 6, Section 5a, prohibits the State of West Virginia, the State Board of Investments or any other state officer to seek, or attempt to recover any monies that were over apportioned to those participants. As of December 31, 1994, stripped securities whose book value is \$49,963,797.53 with a maturity value of \$183,415,000.00, were being held in the Loss Amortization Account.

These stripped securities mature at various times between February 15, 2005 and October 15, 2019. The Participant-Directed-Accounts are comprised of funds from individual state agencies with specific investment needs. The funds held by the participant directed accounts are not co-mingled, but rather each agency has 100% ownership of the underlying investments in a dedicated single account.

Each pool in the Consolidated Fund has its' own policy regarding the types of investments that may be utilized. For example, the Municipal Bond Commission mandates that no purchases or sales of investment can occur in accounts under their authority without their authorization. The Loss Amortization Account can only be invested in zero coupon bonds.

Each fund with the exception of the Loss Amortization Fund and the Participant-Directed-Accounts, has its own investment advisor who makes investment decisions within the parameters provided in the administrative regulations of the West Virginia Board of Investments and the West Virginia Code.

At the date of the writing of this report, there is some indecision regarding the legality of the investment of the Consolidated Pension Fund in equity (stock) securities. Attorney General Darrell McGraw has issued an opinion that the state constitution prohibits the investment of pension funds in the stocks of private associations and corporations.

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BOARD MEMBERS AND SENIOR STAFF

DECEMBER 31, 1994

Board Members

W. Gaston Caperton, III
Governor
Charleston Chairman

Larrie Bailey
State Treasurer
Charleston Member

Glen B. Gainer, III
State Auditor
Charleston Member

John Poffenbarger
Executive Secretary
Charleston Member

William T. Tracy
Huntington Member

Dwight Keating
Clarksburg Member

Richard K. Riederer
Weirton Member

Senior Staff

H. Craig Slaughter Executive Director

D. Jerry Simpson Chief Operating Officer

Matthew E. Jones Chief Financial Officer

Diana Will Chief Investment Officer

Mark E. N. Asaad Chief Counsel

WEST VIRGINIA STATE BOARD OF INVESTMENTS
SUMMARY OF FINDINGS AND RECOMMENDATIONS

Permissible Collateral Not Defined By Statute

1. We noted underlying securities obligated to the Board as collateral supporting repurchase agreements between the State Board of Investments and various brokers during 1994, showed instances where such underlying securities were apparently not permissible investments by law had they been owned by the Board. However, the investment law does not state what types of securities constitute acceptable collateral.

We recommend the Legislature consider changes in Chapter 12, Article 6 of the West Virginia Code, as amended, to specify those types of securities which could be accepted by the West Virginia State Board of Investments as collateral. (See pages 15 and 16.)

Underlying Securities Supporting Repurchase Agreements

2. We noted the Board's investment officers generally do not receive the collateral listing of underlying securities supporting a repurchase agreement until after the repurchase agreement has matured. We noted several instances in 1994, where the collateral did not meet the specifications of the master repurchase agreement between the Board and several of the brokers, as well, as fall among permissible investments in the investment law.

We recommend the State Board of Investments require brokers to transmit collateral listings detailing underlying securities to the investment officers for review on the same day that repurchase agreements are executed. (See pages 16 and 17.)

3. We noted that the West Virginia State Board of Investments continues to allow only specific agencies to invest special revenue funds, that is, only those agencies having specific code authority to invest their special revenue monies. We believe that the West Virginia Code Chapter 12, Article 6, Section 8(c) permits the agency to invest their special revenue funds regardless of whether or not they have specific code authorization.

We recommend that the Board comply with Chapter 12, Article 6, Section 8(c) of the West Virginia Code and allow all agencies to invest their special revenue funds upon request. (See pages 17 - 19.)

WEST VIRGINIA STATE BOARD OF INVESTMENT

GENERAL REMARKS

We have completed an audit of the investment activity of the West Virginia State Board of Investments as required by West Virginia Code Chapter 12, Article 6, Section 15. Our audit covers the year ended December 31, 1994. However, due to the legal deadline of the report, February 1, 1995, we were unable to examine some transactions of the investment activity as set forth in our Independent Auditors' Opinion.

The Consolidated Pension Fund was composed of seven accounts during calendar year 1994 as listed below:

<u>Fund</u>	<u>State Street Account</u>	<u>West Virginia FIMS Number</u>
Judges' Retirement System	V301	8580
Public Safety Retirement System	V302	8581
Workers' Compensation Fund	V303	8582
Workers' Compensation Fund II	V304	8583
Pneumoconiosis Fund	V305	8584
Public Employees' Retirement System	V306	8585
Teachers' Retirement System	V307	8586

The Consolidated Fund was composed of 32 "pools" during 1994 which are identified below. The Unrestricted Pool (State Street Bank No. V324) contained investments from agencies which were unrestricted by type, i.e. not restricted by instrument. The State Agency Trust Pool (State Street Bank No. V331) contained investments made from monies held in trust for State agencies. The Local Government Pool (State Street Bank No. V332) contained investments made from funds held in trust for local governmental units. The Government Money Market Pool (State Street Bank No.

V330) contains investments from agencies which may only be government securities. On July 1, 1994, the assets of the Unrestricted Pool, State Agency Trust Pool, Local Government Pool and Bank Compensation Pool were combined into a new pool named the Cash Liquidity Pool (State Street Bank No. V36C). In addition, the State's General Revenue Fund effective July 1, 1994 has the available balance invested through the newly created Enhanced Yield Pool (State Street Bank No. V363). The remaining pools contain specific investments for individual agencies due to constitutional or bonding restrictions prohibiting commingling with the Cash Liquidity Pool and Enhanced Yield Pool.

1. Unrestricted Pool - State Street Bank No. V324

This pool consisted of the operating funds of State agencies. This pool was restructured in February 1993 by transferring all Economic Authority Loans and mortgages to a State Loan Pool. This pool was closed on June 30, 1994.

2. State Agency Trust Pool - State Street Bank No. V331

Money held in trust by State agencies including such money as Performance Bonds and State Hospital Patient Funds. The Fund was ran as a money type fund with a weighted average maturity of no more than 59 days. The account was created November 1, 1989. This pool was closed on June 30, 1994.

3. Local Government Pool - State Street Bank No. V332

This pool contained only money deposited by local governments. The Fund was ran as a money market type fund with a weighted average maturity of no more than 59 days. The account was created November 1, 1989. This pool was closed on June 30, 1994.

4. Cash Liquidity Pool - State Street Bank No. V36C

This investment pool is composed of the operating funds of the State, funds held in trust by State agencies, and funds invested by local governments. This pool is limited to securities with remaining maturities of not greater than three hundred ninety-seven (397) days and the dollar weighted-average-maturity of the securities in the portfolio may not exceed ninety (90) days. The pool is made up of two

portfolios known as Cash Liquidity Pool (State Street Bank No. V361) and Cash Liquidity Pool (State Street Bank No. V362).

5. Enhanced Yield Pool - State Street Bank No. V363

This investment pool is composed of the operating funds of the State which the Board's staff have determined are not immediately needed to fund the State's liquidity requirements. This pool is limited to securities with remaining maturities of not greater than (3.0) three years and the dollar weighted-average-maturity of the securities in the portfolio may not exceed (1.0) one year.

6. Construction Trust Fund - Huntington Toll Bridge - State Street Bank No. V321

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 - State Street Bank No. V322

The School Fund is not an investment pool within the Consolidated Fund. The Office of the State Treasurer 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 the State of West Virginia.

8. Government Money Market Pool - State Street Bank No. V330

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. State Loan Pool - State Street Bank No. V329

A new pool established February 1993. All mortgage and Economic Development Authority loans were transferred from the Unrestricted Pool to this pool.

10. Loss Amortization - State Street Bank No. V333

This pool contains zero coupon bonds bought to amortize the losses in Pool 100 and 140. At the maturity date of the bonds, the funds will be transferred to Pools 100 and 140.

11. Municipal Bond Restricted Pool - State Street Bank No. V340

This fund was opened July 1, 1992 for the Municipal Bond Commission to address their accounting requirements. Securities and cash were transferred out of the Government Money Market Pool - State Street Bank No. V330.

12. Municipal Bond Commission - County Revenue - State Street Bank No. V341

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.

13. Municipal Bond Commission - General Obligation - State Street Bank No. V342

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

14. Municipal Bond Commission - WVU Project 11 Escrow - State Street Bank No. V336

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.

15. Municipal Bond Commission - County Schools - State Street Bank No. V337

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

16. Municipal Bond Commission - Public Services Districts - State Street Bank No. V338

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

17. Municipal Bond Commission - State Street Bank No. V339

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

18. Municipal Bond Commission - Huntington Bridge 65 Revenue - State Street Bank No. V335

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 without Municipal Bond Commission authorization.

19. Municipal Bond Commission - Combined Revenue Account - State Street Bank No. V343

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 without Municipal Bond Commission authorization.

20. Municipal Bond Commission - Hancock County Schools 83G/0 - State Street Bank No. V344

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

21. Municipal Bond Commission - Fairmont 85 Sewer Revenue - State Street Bank No. V345

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

22. Municipal Bond Commission - Fairmont 85 Water Revenue Esc - State Street Bank No. V334

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

23. Municipal Bond Commission - Escrow Agent For Board of Regents - State Street Bank No. V346

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

24. Municipal Bond Commission - Wetzel City Schools - State Street Bank No. V347

This account was opened in October 1993. No purchases or sales may occur without Municipal Bond Commission authorization.

25. Municipal Bond Commission - Wayne County Board of Education - State Street Bank No. V352

This account was opened on December 28, 1993. No purchases or sales may occur without Municipal Bond Commission authorization.

26. Bank Compensation Pool - State Street Bank No. V327

The interest earned in this account was used to pay all banking charges. This pool was closed on June 30, 1994.

27. Lottery Defeasance - State Street Bank No. V323

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

28. Department of Transportation Special Highway Fund - State Street Bank No. V348

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

29. Department of Transportation Zero Coupon - State Street Bank No. V349

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

30. West Virginia Economic Development Authority Insurance Fund - State Street Bank No. V350

This fund was opened July 29, 1992 for the West Virginia Economic Development Authority. The securities in this fund are used to insure payment on bond issues.

31. DOH - Parkway Authority - State Street Bank No. V351

The funds represent investments made from funds transferred to the Division of Highways as allowed by Chapter 17, Article 16A, Section 22 of the West Virginia Code.

32. School Building Authority - State Street Bank No. V326

This single agency pool was set up in February 1990 to invest the proceeds from the School Building Authority Capitol Improvement Revenue Bonds. The money is held in this account until the funds are allocated to the county school systems.

Management of The Funds

The activities of the pension funds were administered by the following advisors during calendar year 1994:

Judges' Retirement System:

Kemper Asset Management Company

Public Safety Retirement System:

Kemper Asset Management Company

Workers' Compensation Fund:

Investment Advisors, Inc.

Workers' Compensation Fund II:

Duff and Phelps Investment Management Company
(01/01/94-08/31/94)

Kemper Asset Management Company (09/01/94-12/31/94)

Pneumoconiosis Fund:

Duff and Phelps Investment Management Company
(01/01/94-08/31/94)

Kemper Asset Management Company (09/01/94-12/31/94)

Public Employees' Retirement System:

Investment Advisors, Inc.

Teachers' Retirement System:

Duff and Phelps Investment Management Company
(01/01/94-08/31/94)

Kemper Asset Management Company (09/01/94-12/31/94)

Also, the activities of the account "pools" in the Consolidated Fund were administered by the following advisors during calendar year 1994:

Unrestricted Pool - State Street Bank No. V324:

Bank One, West Virginia, Charleston, N.A.
(01/01/94-06/30/94)

United National Bank (01/01/94-06/30/94)

State Agency Trust Pool - State Street Bank No. V331:

Commerce Bank (01/01/94-06/30/94)

Local Government Pool - State Street Bank No. V332:

T. Rowe Price Associates, Inc. (01/01/94-06/30/94)

Government Money Market Pool - State Street Bank No. V330:

Brinson Partners, Inc.

Cash Liquidity Pool - State Street Bank No. V36C:
Commerce Bank (07/01/94-12/31/94)
Bank One, West Virginia, Charleston, N.A.
(07/01/94-12/31/94)

Enhanced Yield Pool - State Street Bank No. V363:
Bank One, West Virginia, Charleston, N.A.
(07/01/94-12/31/94)

Bank Compensation Pool - State Street Bank No. V327:
Bank One, West Virginia, Charleston, N.A.
(01/01/94-06/30/94)

During calendar year 1994, all other account "pools" in the Consolidated Fund commonly referred to as "single account pools" were administered by the staff of the State Board of Investments. However, the activities of these accounts were directed by the management of the individual agencies.

COLLATERAL

Permissible Collateral Not Defined By Statute

Our examination of the confirmations detailing the underlying securities obligated to the Board as collateral supporting repurchase agreements between the State Board of Investments and various brokers during 1994, showed several instances where such underlying securities did not appear to be a permissible investment under Chapter 12, Article 6, Section 9 of the West Virginia Code, as amended.

We noted the State suffered no loss of principal or interest in 1994 regarding any repurchase agreements. However, in the event of nonperformance by a broker, the State would become the owner of the underlying securities and in the event these securities were not permissible investments under law, the State Board of Investments could be required to sell such securities at the then prevailing market price. The necessity of selling

securities at prevailing market prices could subject the Board to risk of loss of principal and interest.

Our review of Chapter 12, Article 6 of the West Virginia Code shows no references to those securities which the Board should require as collateral. We believe an amendment to the investment law should be considered which would spell out the specific types of securities making up permissible investments in Chapter 12, Article 6, Section 9 of the West Virginia Code, as amended, which could be accepted by the Board as collateral.

We recommend the Legislature consider changes in Chapter 12, Article 6 of the West Virginia Code, as amended, to specify those types of securities which could be accepted by the West Virginia State Board of Investments as collateral.

Underlying Securities Supporting Repurchase Agreements

The State Board of Investments is allowed to invest in repurchase agreements with brokers through Chapter 12, Article 6, Section 5 of the West Virginia Code which states in part,

"...The board may...(9) Engage in financial transactions whereby securities are purchased by the board under an agreement providing for the resale of such securities to the original seller at a stated price;..."

Based on our discussions with the Board's investment officers, the Board does not receive the collateral listing of the underlying securities supporting a repurchase agreement usually until at least three days after the repurchase agreement has been executed with the brokers. Since these investments are very short-term investments which generally mature the following day, the Board's investment officers would not be aware of any problems in the

underlying securities until after the repurchase agreements had matured and the brokers had repurchased these securities by transferring the principal and accrued interest back to the Board.

Our examination of collateral supporting repurchase agreements in 1994 showed instances where such collateral did not meet the specifications of the master repurchase agreement between the Board and several of the brokers. Also, in a limited number of instances, the collateral did not appear to fall among permissible investments set forth in Chapter 12, Article 6, Section 9 of the West Virginia Code, as amended.

We recommend the State Board of Investments require brokers to transmit collateral listings detailing underlying securities to the investment officers for review on the same day that repurchase agreements are executed.

INVESTMENT POLICY

Investment of Special Revenue Funds

Chapter 12, Article 6, Section 8(c) of the West Virginia Code, as amended, dealing with the State Board of Investments states,

"(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...."

On or about November 1, 1989, the State Treasurer's Office, which acted at that time in the capacity of staff agency for the State Board of Investments, began allowing only specific agencies to invest special revenue funds. Only agencies having specific Code authority allowing the agency to invest special

revenue collections were allowed to remain in the Cash Liquidity Pool. Any agency lacking specific legislative authorization to invest monies was required to transfer invested funds back into the special revenue account on the books of the State Treasury commonly referred to as the "cash account".

Since the practice of the State of West Virginia is to fully invest all available cash balances, the effect of this policy change was to allow interest earnings on these special revenue funds to accrue to the General Revenue Fund of West Virginia. Since special revenue accounts generally contain user fees collected for specific programs, the Board's policy effectively diverts funding away from legislatively mandated programs. While it is not possible to determine the amount of interest earning on special revenue monies which accrued to the General Revenue Fund as a result of this policy, the following schedule for calendar years 1989-1994 shows the amount of interest apportioned to the General Revenue Fund as a part of the Cash Liquidity Pool, the total amount of the interest apportioned in the Cash Liquidity Pool and the proportional share of interest credited to the General Revenue Fund as a part of the total interest apportioned:

<u>Calendar Year</u>	<u>(a) Apportioned Interest General Revenue</u>	<u>(b) Total Apportioned Interest</u>	<u>Percentage (a - b)</u>
1989	\$ 6,769,390.16	\$ 9,378,320.33	72.18%
1990	13,523,917.89	16,743,780.93	80.77%
1991	10,591,076.15	12,948,822.34	81.79%
1992	7,555,888.83	11,616,418.16	65.04%
1993	4,992,581.96	11,710,968.67	42.63%
1994	<u>6,075,875.63</u>	<u>16,489,934.93</u>	36.85%
	<u>\$49,508,730.62</u>	<u>\$78,888,245.36</u>	

At a Board meeting on March 27, 1992, the issue of the investment of special revenue moneys was discussed at which time the Board was in agreement to disallow any State agency to invest special revenue moneys unless that agency had a specific statutory provision to invest those funds. However, our review of the Board's formally adopted Administrative Rules and Regulations does not indicate a rule disallowing the investment of special revenue funds, therefore it would appear that the Board's policy has not been subjected to the formal Legislative Rule Making process. We believe the provisions contained in Chapter 12, Article 6, Section 8(c) of the West Virginia Code, as amended, authorize special revenue funds to be invested at the discretion of the entity administering those funds.

We recommend that the Board comply with Chapter 12, Article 6, Section 8(c) of the West Virginia Code.

EVALUATION OF THE CONSOLIDATED PENSION FUND

We obtained copies of the rating service's evaluation of the Consolidated Pension Fund's performance for the quarters ended December 31, 1993, March 31, 1994, June 30, 1994 and September 30, 1994 as prepared by Hewitt Associates. The rating service's evaluation for the quarter ended December 31, 1994 was not yet available at the conclusion of our current fieldwork (January 27, 1995). We reviewed the rating services' reports and noted the following observations:

<u>Fund</u>	<u>Time Weighted Rate of Return for Quarter Ended</u>			
	<u>09/30/94</u>	<u>06/30/94</u>	<u>03/31/94</u>	<u>12/31/93</u>
Judges'	0.68%	(1.02%)	(2.83%)	(0.09%)
Public Safety	0.67%	(0.74%)	(2.85%)	0.04%

Workers' Compensation	0.63%	(1.07%)	(2.99%)	(0.49%)
Workers' Compensation II	0.50%	(0.89%)	(3.25%)	(0.18%)
Pneumoconiosis	0.66%	(1.07%)	(3.24%)	(0.24%)
Public Employees'	0.46%	(1.26%)	(3.33%)	(0.75%)
Teachers'	0.52%	(1.27%)	(3.25%)	(0.36%)

The asset allocation reported by Hewitt Associates for the quarters ended December 31, 1993, March 31, 1994, June 30, 1994 and September 30, 1994 were as follows:

<u>Fund</u>	<u>Quarter Ended</u>			
	<u>09/30/94</u>	<u>06/30/94</u>	<u>03/31/94</u>	<u>12/31/93</u>
Judges' Retirement:				
Bonds	95.1%	98.0%	96.1%	95.1%
Cash Equivalents and Cash	4.9%	2.0%	3.9%	4.9%
Public Safety:				
Bonds	98.6%	97.7%	98.7%	95.7%
Cash Equivalents and Cash	1.4%	2.3%	1.3%	4.3%
Workers' Compensation I:				
Bonds	88.0%	80.1%	81.3%	88.7%
Cash Equivalents and Cash	11.7%	19.5%	14.4%	4.6%
Private Placements	0.3%	0.4%	4.3%	6.7%
Workers' Compensation II:				
Bonds	88.2%	90.9%	93.5%	98.5%
Cash Equivalents and Cash	11.8%	9.1%	6.5%	1.5%
Pneumoconiosis:				
Bonds	85.7%	93.4%	93.5%	98.5%
Cash Equivalents and Cash	14.3%	6.6%	6.5%	1.5%
Public Employees':				
Bonds	87.5%	82.1%	87.0%	97.3%
Cash Equivalents and Cash	12.5%	17.2%	12.5%	2.2%
Private Placements	0.0%	0.7%	0.5%	0.5%
Teachers' :				
Bonds	93.8%	79.1%	93.5%	94.0%
Cash Equivalents and Cash	6.2%	20.7%	6.2%	5.8%
Private Placements	0.0%	0.2%	0.3%	0.2%

Relative conditions in the financial markets are subject to change within the year. As a result, certain aspects of portfolio diversification while aiding performance of the fund in one quarter of the year may be detrimental to performance in another quarter of the year. The performance rankings are shown on a scale where the 99th percentile is the best performing 1% of the peer group, while the 1st percentile is the worst performing 1% of the peer group. The rankings of the performance of the trust funds were as follows:

<u>Fund</u>	<u>Performance Ranking for Quarter Ended</u>			
	<u>09/30/94</u>	<u>06/30/94</u>	<u>03/31/94</u>	<u>12/31/93</u>
Judges'	53	43	43	41
Public Safety	51	70	42	49
Workers' Compensation	44	41	37	17
Workers' Compensation II	29	59	26	33
Pneumoconiosis	48	41	21	30
Public Employees'	25	28	21	11
Teachers'	32	28	26	22

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, 1994. The financial statement is the responsibility of the management of the West Virginia State Board of Investments. Our responsibility is to express an opinion on the financial statement based on our audit.

Except as discussed in the following paragraph, 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 financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Due to the report date set forth in Chapter 12, Article 6, Section 15 of the West Virginia Code, we were unable to perform auditing procedures regarding security lending income in both the Consolidated Fund and Consolidated Pension Fund.

In our opinion, except for the effects of the matters discussed in paragraph three above, if any, as might have been determined if these additional auditing procedures had been performed, the balance sheet referred to in the first paragraph above presents fairly, in all material respects, the financial position of the West Virginia State Board of Investments as of December 31, 1994, in conformity with generally accepted accounting principles.

Respectfully submitted,



Thedford L. Shanklin, CPA, Director
Legislative Post Audit Division

January 27, 1995

Auditors: Michael E. Sizemore, CPA, Supervisor
Timothy C. Butler, CPA
Kristi Ernest

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BALANCE SHEET

DECEMBER 31, 1994

	<u>CONSOLIDATED</u> <u>FUND</u>	<u>CONSOLIDATED</u> <u>PENSION FUND</u>	<u>COMBINED TOTALS</u> <u>(MEMORANDUM ONLY)</u>
Assets:			
Cash	\$ -0-	\$ -0-	\$ -0-
Investments at Book Value			
Notes 3 and 4 (Par Value \$1,559,437,625.95 Consolidated Fund)	1,403,833,708.46	-0-	1,403,833,708.46
Market Value			
Notes 3 and 4 (Par Value \$25,825,046.03 Consolidated Fund, \$3,657,217,388.62 Consolidated Pension Fund)	25,477,986.03	3,221,526,525.41	3,247,004,511.44
Other Assets Note 4	4,397,429.95	-0-	4,397,429.95
Interest Receivable	<u>5,526,983.09</u>	<u>44,397,640.63</u>	<u>49,924,623.72</u>
Total Assets	<u>\$1,439,236,107.53</u>	<u>\$3,265,924,166.04</u>	<u>\$4,705,160,273.57</u>
Liabilities and Fund Balances:			
Due Investors	\$1,572,597,467.96	\$3,256,761,147.20	\$4,829,358,615.16
Payable for Investments Purchased	-0-	8,926,845.77	8,926,845.77
Due West Virginia State General Fund	<u>82,505.74</u>	<u>236,173.07</u>	<u>318,678.81</u>
Total Liabilities	1,572,679,973.70	3,265,924,166.04	4,838,604,139.74
Fund Balance (Deficit) Note 5	<u>(133,443,866.17)</u>	<u>-0-</u>	<u>(133,443,866.17)</u>
Total Liabilities and Fund Balances	<u>\$1,439,236,107.53</u>	<u>\$3,265,924,166.04</u>	<u>\$4,705,160,273.57</u>

See Notes to Financial Statement

WEST VIRGINIA STATE BOARD OF INVESTMENTS
CONSOLIDATED FUND AND CONSOLIDATED PENSION FUND

NOTES TO FINANCIAL STATEMENT

DECEMBER 31, 1994

1. DESCRIPTION OF THE ENTITY

The accompanying financial statements reflect the investment balances of the Consolidated Fund and the Consolidated Pension Fund (the "Funds") under the management of the Board of Investments (the Board) as provided in the West Virginia Code Chapter 12-6-8(a) and (b). The Code established these funds to provide for the investment of State funds, the investment of local government funds and the investment of the State's pension funds. These financial statements reflect only the investments of the pools under the management of the Board and do not reflect any other assets or liabilities of the various pool participants.

The individual pools within the Funds and a brief description of each follows.

Consolidated Fund

Cash Liquidity Pool - This pool is composed of the operating funds of the State, funds held in trust by State Agencies, and funds invested by local government.

Enhanced Yield Pool - This pool is composed of the operating funds of the State which the Board's staff have determined are not immediately needed to fund the State's liquidity requirements.

Government Money Market Pool - This pool is available for the investment of unexpended bond proceeds, debt service funds and amounts escrowed under the requirements of bond issuances.

Loss Amortization Pool - This pool was created to account for those participant claims of the general operating funds of the State which exceeded the underlying assets of the other pools. This excess of participant claims on net assets over underlying assets occurred as a result of the distributions of earnings to participants in various Board investment pools, principally the unrestricted pool, in excess of the true investment income experience of the pools, principally in 1987 and 1988.

Participant Directed Accounts (PAD) - The (PAD) are comprised of funds from individual State agencies with specific investment needs. The funds held by the PAD are not commingled, but rather each agency has 100% ownership of the underlying investments in a dedicated, single account pool.

Each pool, with the exception of the Loss Amortization Pool and PAD, has its own investment advisor who makes investment decisions within the parameters provided in the administrative regulations of the West Virginia State Board of Investments. All investment decisions are then executed by the Board.

Consolidated Pension Fund

The various investment funds which comprise the Consolidated Pension Fund have been established to provide for the investment of funds of the Public Employees' Retirement System, Teachers' Retirement System, Public Safety Retirement System, Judges' Retirement System, Workers' Compensation Fund, Workers' Compensation Fund II and Pneumoconiosis Fund. Assets of each of these pools are maintained separately. Each pool has its own investment advisor who makes investment decisions within the parameters provided in the Administrative regulations of the West Virginia State Board of Investments.

2. SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of Accounting - The Board is the investment vehicle of the State of West Virginia and its component units, all of which are governmental entities. As a result, as permitted within governmental accounting standards, the Board carries investments in the Consolidated Pension Fund at fair market value while in the Consolidated Fund, investments are recorded at cost, adjusted for amortization of premium and accretion of discount, except for the Enhanced Yield Pool for which investments are recorded at fair market value. Commissions on purchases of securities by the Board are generally an unidentified component of the security price quoted by the seller and are included in the investment cost or carrying value.
- b. Investment Transactions - Investment transactions are accounted for on a trade date basis.
- c. Investment Gains and Losses - Gains and losses on sales of investment securities are recognized at the time of sale by the specific identification method.
- d. Interest Income - Interest income is recognized as earned on the accrual method.

- e. Allowance for Possible Loan Losses - The allowance for possible loan losses is available to absorb future loan charge-offs. The allowance is increased by provisions charged to operations and reduced by losses or charge-offs, net of recoveries. The amount charged to operations is based on several factors including: analytical reviews of loan loss experience in relationship to outstanding loans; a continuing review of problem loans and overall portfolio quality, including analysis of the quality of the underlying collateral; and management's judgment on the impact of current and expected economic conditions on the portfolio.
- f. Expenses - All the expenses of the Funds, except for fees paid for banking services and a service fee, are paid by the Board of Investments from appropriations granted by the State Legislature. Fees for banking services are paid by the Board through the use of a portion of the investment earnings of the Cash Liquidity Pool. The pools are assessed a management service fee by the Board. The service fee ranges from a flat fee to 1¼% of the monthly earnings of the pool. This service fee is remitted to the general funds of the State on a monthly basis.

3. INVESTMENTS

Risk Categorization - In accordance with the provisions of Statement No. 3 of the Governmental Accounting standards Board, investments are classified as to level of risk by the three categories described below:

Category 1 - Insured or registered, or securities held by the State or its agent in the State's name.

Category 2 - Uninsured and unregistered, or securities held by the counterparty's trust department or agent in the State's name.

Category 3 - Uninsured and unregistered, or securities held by the counterparty's trust department or agency but not in the State's name.

Investments at December 31, 1994, by security type and level of risk category, are as follows:

<u>Security Type</u>	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUND</u>	<u>TOTAL</u>	<u>CATEGORY 1</u>	<u>CATEGORY 2</u>
U.S. government and government agency obligations	\$ 606,157,992.66	\$2,858,066,588.26	\$3,464,224,580.92	\$3,464,224,580.92	\$ -0-
State & local government securities	18,018,800.00	-0-	18,018,800.00	18,018,800.00	-0-
Corporate bonds and notes	-0-	199,441,870.09	199,441,870.09	199,441,870.09	-0-
Repurchase agreements	686,574,696.58	84,392,029.57	770,966,726.15	136,096,457.12	634,870,269.03
Collateralized mortgage obligations	-0-	35,709,590.00	35,709,590.00	35,709,590.00	-0-
Loans - net of allowance for possible loan losses	117,193,515.07	43,916,447.49	161,109,962.56	161,109,962.56	-0-
Other	<u>1,366,690.18</u>	<u>-0-</u>	<u>1,366,690.18</u>	<u>1,366,690.18</u>	<u>-0-</u>
	<u>\$1,429,311,694.49</u>	<u>\$3,221,526,525.41</u>	<u>\$4,650,838,219.90</u>	<u>\$4,015,967,950.87</u>	<u>\$634,870,269.03</u>

The repurchase agreements included in Category 1 are owned by the Participant Directed Accounts. All other repurchase agreements for all pools in both funds are included in Category 2.

COMPARISON OF BOOK AND MARKET
 WEST VIRGINIA STATE BOARD OF INVESTMENTS
 DECEMBER 31, 1994

<u>DESCRIPTION</u>	<u>CONSOLIDATED FUND</u>		<u>CONSOLIDATED PENSION FUND</u>	
	<u>BOOK</u>	<u>MARKET</u>	<u>BOOK</u>	<u>MARKET</u>
U.S. government and government agency obligations	\$ 606,241,604.01	\$ 608,331,908.10	\$3,014,898,077.75	\$2,858,066,588.26
State & local government securities	18,018,800.00	N/A	-0-	-0-
Corporate bonds and notes	-0-	-0-	219,540,901.79	199,441,870.09
Repurchase agreement	686,574,696.58	686,574,696.58	84,392,029.57	84,392,029.57
Collateralized mortgage obligations	-0-	-0-	36,312,661.31	35,709,590.00
Loans - net of allowance for possible loan losses	117,193,515.07	N/A	43,916,447.49	N/A
Other	<u>1,366,690.18</u>	<u>N/A</u>	<u>-0-</u>	<u>-0-</u>
	<u>\$1,429,395,305.84</u>	<u>\$1,294,906,604.68</u>	<u>\$3,399,060,117.91</u>	<u>\$3,177,610,077.92</u>

N/A - Market Values - Investments held by the Funds at December 31, 1994 include loans consisting primarily of economic development and mortgage loans. These loans have no ready market values and, therefore, no market value is reported. State and local government securities (SLGS) are direct obligations of the U.S. government, issued to State and local government entities to provide those governments with required cash flows at yields which do not exceed IRS arbitrage limits. As the SLGS are issued to retire debt investments, market values is not a meaningful measure.

4. LOANS AND ALLOWANCE FOR POSSIBLE LOAN LOSSES

As occasionally required by the Legislature, the pools will originate loans, loan funds to other State agencies for the purpose of originating loans and purchase loans originated by other State agencies. These loans are generally limited to economic development loans and mortgage loan programs within the State of West Virginia.

In 1991, the Board implemented a policy to review its loan portfolio for purposes of the establishment of an allowance for possible loan losses. This allowance in the aggregate amounted to \$1,848,392.12 at December 31, 1994.

The composition of loans and the allowance for possible loan losses at December 31, 1994 are as follows:

	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUND</u>
Loans:		
West Virginia Economic Development Authority	\$103,965,283.47	\$19,785,067.86
Other	<u>15,026,623.72</u>	<u>24,181,379.63</u>
	118,991,907.19	43,966,447.49
Less allowance for possible loan losses	<u>1,798,392.12</u>	<u>50,000.00</u>
	<u>\$117,193,515.07</u>	<u>\$43,916,447.49</u>

The following loans, Franklin Theater Building, Greenbrier Building, Opera House, Fairmont Avenue Apartments, Susan Lawson, Elizabeth Apartments and St. James Apartments were previously reported in nonaccrual status. These properties have been acquired by the Board through foreclosure proceedings and are now recorded as Other Assets.

5. SCHEDULE FOR STATUS OF INVESTMENT DIFFERENCE
 WEST VIRGINIA STATE BOARD OF INVESTMENTS
 DECEMBER 31, 1994

The following schedule updates as of December 31, 1994, the carrying cost and market value of the securities purchases to fund the investment difference.

Investment difference from the Unrestricted and Restricted pools.	\$183,407,663.70
Additional fund transfers to purchase securities.	<u>7,336.30</u>
Total Fund balance to be accounted for.	<u>\$183,415,000.00</u>

Securities Held to Offset the Difference:

<u>DESCRIPTION</u>	<u>MATURITY</u>	<u>CARRYING COST</u>	<u>MARKET VALUE</u>	<u>FACE VALUE</u>
Zero Coupon Bonds	02/15/2005	\$ 9,867,663.45	\$10,002,300.00	\$ 22,000,000.00
Zero Coupon Bonds	08/15/2005	11,874,874.42	13,548,860.00	31,000,000.00
Zero Coupon Bonds	02/15/2010	5,109,669.58	6,065,800.00	20,000,000.00
Zero Coupon Bonds	11/15/2011	19,792,497.13	21,147,808.00	80,300,000.00
Zero Coupon Bonds	10/15/2019	<u>3,319,092.95</u>	<u>4,140,210.20</u>	<u>30,115,000.00</u>
Total Zero Coupon Bonds		<u>\$49,963,797.53</u>	<u>\$54,904,978.20</u>	<u>\$183,415,000.00</u>
Current difference (Fund Balance less Carrying Cost)		<u>\$133,443,866.17</u>		

STATE OF WEST VIRGINIA

OFFICE OF THE LEGISLATIVE AUDITOR, TO WIT:

I, Thedford L. Shanklin, CPA, Director of the Legislative Post Audit Division, do hereby certify that the report of audit 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,
1995.

Thedford L. Shanklin

Thedford L. Shanklin, CPA, Director
Legislative Post Audit Division

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