

A scenic photograph of a lake at sunset. The sky is a vibrant orange and yellow, with the sun low on the horizon. In the foreground, several tall, thin trees with bare branches stand in the water, their silhouettes reflected in the calm surface. The overall mood is peaceful and serene.

Tennessee Consolidated Retirement System

**Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2003
Pension Trust Funds of the State of Tennessee**

Tennessee Consolidated Retirement System



Open Lake

*Photographs of Tennessee lakes were provided by
the State of Tennessee's Photographic Services*

Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2003 Pension Trust Funds of the State of Tennessee

Prepared by: State of Tennessee Treasury Department
10th Floor Andrew Jackson Building
Nashville, Tennessee 37243-0230
(615) 741-7063
www.treasury.state.tn.us/tcrs
Dale Sims, State Treasurer
Ed Hennessee, TCRS Director

This report is available in its entirety on the Internet at: www.treasury.state.tn.us/tcrs/ann-report.htm.

The Tennessee Department of Treasury operates all programs and activities free from discrimination on the basis of sex, race, or any other classification protected by federal or Tennessee state law. Individuals with disabilities who may require an alternative communication format for this or other Treasury Department publications, please contact the Treasury ADA coordinator at 615-741-2956.



Treasury Department, December 2003, Authorization No. 309079, 520 copies.
This public document was printed at a cost of \$6.71 each.

Introductory Section



Radnor Lake

GFOA CERTIFICATE OF ACHIEVEMENT

Certificate of
Achievement
for Excellence
in Financial
Reporting

Presented to

Tennessee Consolidated
Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



William Patrick Bate

President

Jeffrey R. Enen

Executive Director

CHAIRMAN OF THE BOARD'S LETTER

STATE OF TENNESSEE

TREASURY DEPARTMENT
STATE CAPITOL
NASHVILLE, TENNESSEE 37243

December 15, 2003

Dear Members of the Tennessee Consolidated Retirement System:

It is my pleasure to submit this annual financial report of the Tennessee Consolidated Retirement System. This is the sixteenth consecutive year that the financial report is being submitted to the Government Finance Officers Association for review. All previous reports have received the Certificate of Achievement for Excellence in Financial Reporting.

Administration: To better serve our members, the TCRS web site (located at www.treasury.state.tn.us/tcrs) includes a benefit calculation module which allows members to input a limited amount of data to obtain a retirement benefit estimate. The benefit estimate reflects the regular plan amount and the survivorship options. Since its inception, the calculator returned more than 286,000 benefit projections, with 137,000 occurring in fiscal year 2003. Further, TCRS forms and up-to-date information is available on-line to assist our members and participating employers.

Investments: The financial marketplace rallied during the last quarter of the fiscal year. Stocks had a negative return until the S&P 500 had a 15.3% return in the final quarter, resulting in a small but positive return of .25% for the year. Although the EAFE index returned 19.27% in the final quarter, the return for the year was still negative at 6.46%. Bonds earned 2.50% in the final quarter to end the year with a return of 10.40%. Overall, TCRS earned 4.90% for the year, which was accomplished in the final quarter where earnings of 6.26% eliminated a negative return through the first three quarters. Despite a weak stock market during the last three years, TCRS had an annualized return of 7.44% during the last 10 years, which nearly equaled our investment assumptions of 7.5%.

Financial Soundness of the Plan: Members of the retirement system should be assured that the benefits that have been promised will be paid. TCRS is considered one of the strongest funded pension plans in the nation. TCRS has received an AAA long-term rating and an A-1(+) short-term rating by Standard and Poor's (S&P), the highest possible ratings issued by this nationally recognized rating agency. The actuarial valuation for July 1, 2003 will offer significant challenges when considering the difficult investment environment we have experienced.

Recognition: The retirement division dedicates this annual report to former Treasurer Steve Adams. Mr. Adams had more than 30 years of public service with the State of Tennessee. He was Director of TCRS for seven years and served as Treasurer for seventeen years. We recognize and appreciate his lasting contributions to the retirement system.

The Legislature, the Board of Trustees and the TCRS staff have worked diligently to provide the best possible management of the system, to invest the system assets in a prudent manner without undue risk, to fund the system on an actuarially strong basis, and to provide the best possible services to the members in the system.

Sincerely,

Dale Sims, State Treasurer
Chairman of the Board

LETTER OF TRANSMITTAL

STATE OF TENNESSEE



TREASURY DEPARTMENT
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
10TH FLOOR ANDREW JACKSON STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243

December 15, 2003

Board of Trustees
Tennessee Consolidated Retirement System
Nashville, TN 37243

Ladies and Gentlemen:

We are pleased to present to you the Tennessee Consolidated Retirement System (TCRS) comprehensive annual financial report for the fiscal year ended June 30, 2003. Responsibility for the accuracy of the data and the fairness and completeness of this presentation, including all disclosures, rests with the management of TCRS. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to provide a precise representation of the financial position and results of operations of the system.

TCRS was established in 1972 with the consolidation of seven separate retirement systems for state employees, public higher education institution employees, public school teachers, and employees of political subdivisions electing to participate in TCRS. As of June 30, 2003, active membership in TCRS totaled 198,917: 43,820 state employees; 17,512 higher education employees; 66,265 teachers; and 71,320 political subdivision employees. A total of 83,121 retirees and beneficiaries were receiving monthly retirement annuities. The state of Tennessee is responsible for the pension benefits of state employees and higher education employees, and funds a significant portion of the retirement liability for teachers through the Basic Education Program. Each of the 418 participating political subdivisions are responsible for the pension benefits of its employees. The TCRS is a qualified pension plan under Section 401(a) of the Internal Revenue Code. As such, the system is exempt from federal income taxation on its investment earnings. Since January 1, 1987, member contributions have been tax deferred under Section 414(h) of the Internal Revenue Code.

The TCRS was established as a retirement program for the public employees of Tennessee. A variety of services are provided for the membership including: investing assets; counseling of rights and benefits; publishing newsletters, booklets, pamphlets, and financial statements; processing deductions for retiree insurance programs and federal income tax; calculating death, disability, and retirement benefits; and processing refund and prior service requests.

Five sections comprise the 2003 report: (1) an Introductory Section, which includes this letter of transmittal, an administrative overview of TCRS, and an operational outline of the system conveying the TCRS commitment to its long-term mission; (2) a Financial Section, containing the independent auditor's report, TCRS financial statements, and supplementary financial information; (3) an Investment Section, including a summary of investment results and various investment schedules; (4) an Actuarial Section, consisting of the report from the independent actuary, the actuarial balance sheet, a summary of actuarial assumptions, a plan summary, services offered to active and retired members, sample benefit calculations, and major legislative improvements; and (5) a Statistical Section reflecting membership, retiree, and financial statistical data.

(continued)

**LETTER OF TRANSMITTAL
(CONTINUED)**

ECONOMIC CONDITION AND OUTLOOK

TCRS continued its strong relative performance for the fiscal year ended June 30, 2003. Due to a strongly funded pension plan, TCRS has a conservative investment strategy as demonstrated by a high quality bond portfolio and a somewhat lower equity exposure than other plans. TCRS returns for the last three years have been 4.90%, (1.92)%, and (1.57)% despite double digit negative returns in the domestic and international stock markets.

The domestic stock portfolio for TCRS outperformed the S&P 500 benchmark, .31% versus .25%. Bonds barely exceeded the Lehman Brothers Aggregate benchmark of 10.40% with a return of 10.41%. The international stock return was (5.6)%, significantly better than the EAFE index benchmark of (6.46)%. Overall, the total return for the TCRS was 4.90%, exceeding the Callan public plan sponsor database median return of 3.74%.

TCRS does not envision any significant investment policy or strategy changes. Increased strategic allocations to real estate, which was added as a new asset class in 1999, will continue over the next several years to attain a target of 5%. Real estate currently represents 1.56% of the portfolio.

MAJOR INITIATIVES

During fiscal year 2003, TCRS initiated a disability validation review. The purpose of the review was to identify recipients who may be inappropriately receiving disability retirement benefits from TCRS. A contract was awarded in May 2003 for an initial review of TCRS disability retirees living out-of-state to be followed by an in-state review.

TCRS continues the conversion of the active member system to a DB2 database with completion expected in the summer of 2004. Using this new format will allow TCRS the capability to pursue its goals of having member information available 24 hours a day, seven days a week through the Internet and will extend the life of the active member system.

FINANCIAL INFORMATION

This report has been prepared in accordance with generally accepted accounting principles as promulgated or adopted by the Government Accounting Standards Board and the American Institute of Certified Public Accountants. Specific accounting treatments are detailed in the Notes to the Financial Statements found in the Financial Section of this report. Management is responsible for establishing and maintaining internal controls for TCRS. The accounting systems are designed to include internal controls to provide reasonable assurances regarding safekeeping of assets and the reliability of financial records.

For additional discussion regarding financial information, please review Management's Discussion and Analysis located in the Financial Section of this report.

Funding of TCRS is provided through employee and employer contributions plus earnings from the invested assets. A standard actuarial "advanced funding" method is used to provide for the accumulation of assets to fund the cost of retirement, disability, and death benefits provided by the system. The funding objective of TCRS is being met as the state and political subdivisions continue to make contributions to the plan at the rate established by the Board of Trustees. The Board is utilizing a strong actuarial method and has adopted reasonable actuarial assumptions for the determination of the appropriate employer contribution rates.

(continued)

**LETTER OF TRANSMITTAL
(CONTINUED)**

An actuarial valuation of TCRS is performed by an independent actuarial firm every two years to determine the funding requirements for the employers participating in TCRS. At July 1, 2001, the latest valuation date, the unfunded accrued liability for the entire system totaled \$421.4 million. Unfunded accrued liability of \$81.2 million associated with a closed group of state judges, attorneys general, and county officials is funded over a 14-year period, while the remainder is attributable to political subdivisions. There is no unfunded accrued liability attributable to state employees and teachers. The next actuarial valuation will be performed as of July 1, 2003.

The funds of TCRS are invested by the Investment Division of the Treasury Department in stocks, bonds, real estate, and short-term securities. Investment policy is established by the Board of Trustees upon receiving and considering the advice of the Investment Advisory Council. These members are appointed by the Treasurer with the consent of the Board of Trustees.

OTHER INFORMATION

By statute, the Comptroller of the Treasury serves as the independent auditor for the system. The Board of Trustees utilizes the actuarial and consulting firm of Bryan, Pendleton, Swats and McAllister to provide actuarial services for the system. The firm of Callan Associates, Inc. is employed as the investment consultant for TCRS.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Tennessee Consolidated Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2002. This was the fifteenth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The TCRS is a recipient of the Public Pension Principles Achievement Award. This program, administered by the Public Pension Coordinating Council, recognizing the professional achievements of public employee retirement systems.

ACKNOWLEDGMENTS

The dedicated effort of the Treasury Department team to assemble the information contained in this publication is hereby acknowledged with our sincerest appreciation. The report will be provided to state legislators, members of the Board of Trustees, state officials, participating employers, and other interested parties.



Ed W. Hennessee, TCRS Director



Thomas G. Milne, TCRS Chief Investment Officer

ADMINISTRATION AND MISSION

ADMINISTRATION

The State Treasurer is a constitutional officer elected every two years by a joint session of the General Assembly. He serves as the Chief Executive Officer of the Treasury Department, a part of the legislative branch of state government. The administration and operation of TCRS is one of the primary responsibilities of the State Treasurer. In order to meet the statutory requirements and fiduciary responsibilities of administering TCRS, the Treasurer appoints two executive officers: the Director of TCRS and the Chief Investment Officer.

The Director of TCRS is responsible for the daily operation of the retirement system which includes providing counseling services for the active and retired members; issuance of payments to retired members, disabled members, beneficiaries of deceased members, and refunds to terminated employees; enrollment of members; maintenance of member account balances and records; establishment of service credit; and issuance of various publications to inform members of their rights and benefits.

The Chief Investment Officer is responsible for the investment and oversight of TCRS assets in accordance with statutory guidelines and the investment policies and strategies established by the Board of Trustees.

Other divisions within the Treasury Department which support the operations of TCRS include Information Systems, Accounting, Management Services, Internal Audit and Personnel. Through these divisions, data processing services, accounting services, records maintenance, control reviews and personnel services are provided.

The administrative budget of TCRS is subject to approval by the General Assembly and is part of the overall annual budget process of the state of Tennessee. Funding for the operation of TCRS is provided by two sources. The state of Tennessee is responsible for the operation cost associated with state employees and higher education employees; the state and local education agencies share the cost related to K-12 teachers; political subdivisions are responsible for the operation cost associated with their employees.

MISSION

The mission of the Tennessee Consolidated Retirement System is to provide superior services to constituents in a cost-effective manner through qualified personnel while maintaining the highest ethical standards. The mission will be accomplished by TCRS in cooperation with the Board of Trustees, the Council on Pensions and Insurance, and the TCRS membership through the following objectives:

- ❖ **Exemplary Service** — To provide accurate, courteous and prompt service to members of TCRS.
- ❖ **Benefit Standards** — To provide retirement coverage through TCRS, social security and personal savings vehicles which will allow public employees to maintain their standard of living after retirement.
- ❖ **Funding Standards** — To provide for the long-term funding of TCRS on an actuarial basis which will ensure that sufficient assets will be accumulated to pay the statutory benefits of current and future retirees.
- ❖ **Staffing** — To attract and retain professional, highly-trained staff in an atmosphere conducive to innovation, challenges and a high level of performance.
- ❖ **Research** — To continuously perform studies on pension issues and to compare the TCRS plan with other public and private pension systems.
- ❖ **Management** — To manage by leading, planning, organizing and controlling the operation of TCRS in a cost-effective manner for the benefit of members and Tennessee taxpayers utilizing personnel, technology and capital efficiently, while providing the highest level of service.
- ❖ **Ethical Standards** — To maintain the highest ethical standards.
- ❖ **Investment Return** — To obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay benefits when due.

THE COUNCIL ON PENSIONS AND INSURANCE

THE COUNCIL ON PENSIONS AND INSURANCE

Created as a legislative oversight committee, the Council on Pensions and Insurance develops, recommends, and establishes pension and retirement standards and maintains a progressive state policy on retirement. Additionally, the Council reviews legislation affecting state provided insurance programs for both active and retired members of the Tennessee Consolidated Retirement System.

The Council periodically reviews Tennessee's retirement and state provided insurance provisions and recommends changes in state law as deemed necessary. Since its creation, the Council has continuously performed studies and comparisons of other pension systems including those of other states and private industry and the federal government's social security program. All proposed legislation affecting Tennessee's retirement laws must be reviewed by the Council before the legislature may take action. The Council is authorized to prepare and propose amendments which are then forwarded to the standing committees to which the bills are referred. Information regarding the actuarial cost or impact of proposed legislation is provided by the Council to the other members of the legislature. The staff of the TCRS director also serves as staff to the Council.

The voting membership of the Council consists of the Speaker of each house of the General Assembly; the officers of the House and the Senate Committees on Finance, Ways and Means; and three additional members of each finance committee. The Speaker of the Senate may designate a member of the Senate and the Speaker of the House of Representatives may designate a member of the House to serve as alternates to vote or otherwise act at Council meetings in absence of the respective speaker. Nonvoting members include the Commissioner of Personnel, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, and the Director of TCRS.

VOTING MEMBERS - SENATORS



Ben Atchley
Council Chairman



William Clabough
Finance, Ways & Means Secretary



Jerry Cooper



Ward Crutchfield



John Ford



Douglas Henry
Finance, Ways & Means Chairman



James Kyle
Finance, Ways & Means Vice-Chairman



John S. Wilder
Lieutenant Governor

(continued)

**THE COUNCIL ON PENSIONS AND INSURANCE
(CONTINUED)**

VOTING MEMBERS — REPRESENTATIVES



Stratton Bone



Craig Fitzhugh
*Council Vice-Chairman
Finance, Ways & Means
Vice-Chairman*



Tommy Head
*Finance, Ways & Means
Chairman*



Joe Kent



Steve McDaniel



Jimmy Naifeh
Speaker of the House



Harry Tindell
*Finance, Ways &
Means Secretary*

NON-VOTING MEMBERS



Randy Camp
Commissioner of Personnel



Dave Goetz
*Commissioner of Finance
& Administration*



Ed Hennessee
TCRS Director



John Morgan
Comptroller of the Treasury



Dale Sims
State Treasurer

THE BOARD OF TRUSTEES**THE BOARD OF TRUSTEES**

The Tennessee Consolidated Retirement System Board of Trustees is responsible for the general administration and proper operation of TCRS within the requirements and provisions of state statute (*T.C.A.*, Title 8, Chapters 34-37). The 18-member Board meets quarterly and is subject to the call of the chairman for special meetings. Nine voting members constitute a quorum, and nine affirmative votes are needed for decision making.

The Board consists of nine *ex-officio* members, eight representatives of the active TCRS membership, and one representative for retirees. *Ex-officio* members include the chairman and vice-chairman of the Legislative Council on Pensions and Insurance as nonvoting members, the Commissioner of Personnel, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Secretary of State, and the Administrative Director of the Courts. In addition, the State Treasurer sits as Chairman of the Board, and the Director of TCRS serves as Secretary.

Employee representation consists of three teachers, one from each grand division of the state, two state employees from departments other than those represented by *ex-officio* members, and three representatives of local governments. The three teachers are elected for three-year terms by the Representative Assembly of the Tennessee Education Association; state employees elect two representatives who also serve three-year terms.

One representative is appointed for a two-year term by each of the following organizations: The Tennessee County Services Association, the Tennessee Municipal League and the Tennessee County Officials Association.

All employee representatives must be vested members of TCRS. The retiree representative is appointed by the Governor.

ELECTED MEMBERS

Rebecca Collins
*West Tennessee Regional
Health Office*
Term Expires: June 30, 2004



Florestine Evans
West Tennessee Teacher
Term Expires: June 30, 2005



Rebecca Reel
East Tennessee Teacher
Term Expires: June 30, 2004



Michael Fort
*Department of Employment
Security*
Term Expires: June 30, 2004



Brian Randy Wright
Middle Tennessee Teacher
Term Expires: June 30, 2006

(continued)

THE BOARD OF TRUSTEES
(CONTINUED)

APPOINTED MEMBERS



Leonard Bradley
Retired Member
Term Expires: June 30, 2004



James Crumley
Tenn. Municipal League
Term Expires: June 30, 2005



Bill Kemp
Sumner County Clerk
Term Expires: June 30, 2005



Bob Wormsley
Tenn. County Services Assoc.
Term Expires: June 30, 2005

EX-OFFICIO MEMBERS



Ben Atchley, Senator
*Council on Pensions &
Insurance Chairman*



Randy Camp
Commissioner of Personnel



Cornelia Clark
*Administrative Director
of the Courts*



Riley Darnell
Secretary of State



Craig Fitzhugh
Council Vice-Chairman



Dave Goetz
*Commissioner of Finance
& Administration*



Ed Hennessee
TCRS Director



John Morgan
Comptroller of the Treasury



Dale Sims
State Treasurer

PROFESSIONAL CONSULTANTS**PROFESSIONAL CONSULTANTS**

Independent professional consultants are appointed by the Board of Trustees to advise the Board and the TCRS staff on investment, medical and actuarial issues. Service fees related to investment professionals may be found on page 46.

INVESTMENT ADVISORY COUNCIL

The Investment Advisory Council (IAC) was established to assist both the Board of Trustees and the TCRS investment staff. The investment professionals on the IAC serve five-year terms, meet quarterly and are available to the TCRS staff for consultation. IAC members include:

Frederick S. Crown, CFA
AmSouth Bank
Nashville, Tennessee

David Fussel, CFA
Provident Companies, Inc.
Chattanooga, Tennessee

Susan Huffman, CFA
Reliant Investment Management, LLC
Memphis, Tennessee

Joseph Lee, III
City of Memphis
Memphis, Tennessee

George B. Stadler, CFA
SunTrust Bank, Nashville
Nashville, Tennessee

C. Stephen Temple, CPA
Investment Limited Partner
Brentwood, Tennessee

INTERNATIONAL EQUITY INVESTMENT MANAGERS

The international investment managers are responsible for purchasing stock of companies domiciled in foreign countries as set out in the investment policy.

Brenda Walker
J.P. Morgan Investment Management
522 Fifth Avenue
New York, New York 10036

Paul Mackey
Putnam Investments
One Post Office Square
Boston, Massachusetts 02109

John Lowman
SG Yamaichi
c/o Trust Co. of the West
200 Park Avenue, 22nd Fl.
New York, New York 10166

Judith Timoll
Newgate LLP
1 Sound Shore Drive
Greenwich, Connecticut 06830

Wilson Phillips
Marathon Asset Management
Orion House
5 Upper St. Martin's Lane
London WC2H 9EA
England

Marilyn Harrison
Walter Scott & Partners Ltd.
Millburn Tower
Gogar, Edinburgh EH12 9BS
Scotland

Gene Waldron
Capital International
3000 K Street N.W.
Suite 230
Washington, D.C. 20007

GENERAL INVESTMENT CONSULTANT

An investment consultant is employed to assist in the long-term financial planning process, to evaluate various investment strategies, to measure investment performance, to determine whether the system's objectives are being met, to research investment proposals regarding the use of new asset classes or variations of existing asset classes and to provide investment information on various issues which may arise.

Charles Mathis
Callan Associates, Inc.
Six Concourse Parkway
Suite 2900
Atlanta, Georgia 30328-6111

(continued)

**PROFESSIONAL CONSULTANTS
(CONTINUED)**

REAL ESTATE INVESTMENT CONSULTANT

The real estate consultant provides general market advice relative to real estate, measures performance of real estate properties, assists in the formulation of policy and assists in the selection of real estate advisors.

Frank L. Blaschka
The Townsend Group
M.K. Ferguson Plaza
1500 West Third Street
Suite 410
Cleveland, Ohio 44113

REAL ESTATE INVESTMENT ADVISORS

The real estate investment advisors identify potential co-investors as well as prospective real estate transactions.

Stephen J. Furnary
Clarion Partners
335 Madison Avenue
New York, New York 10017

Charles H. Wurtzebach
Henderson Global Investors North America
737 N. Michigan Avenue
Chicago, Illinois 60611

Larry Goodman
Lend Lease Real Estate Investments
3424 Peachtree Road
Atlanta, Georgia 30326

THE MEDICAL BOARD

The physicians serving on the Medical Board evaluate applications for disability retirement to determine whether the applicants are totally and permanently disabled and unable to engage in gainful employment. Additionally, the panel reviews medical data submitted by disabled retirees who are subject to periodic evaluation. The Medical Board consists of the following:

Suzanne Fletcher, M.D.
Brentwood, Tennessee

Barry R. Siegel, M.D.
Memphis, Tennessee

Jeffrey Summers, M.D.
Knoxville, Tennessee

CONSULTING ACTUARY

An independent consulting actuarial firm performs an actuarial valuation every two years to determine the funding status of the system and recommend employer contribution rates. The actuary also conducts an experience study every four years to evaluate and adjust actuarial assumptions and methods.

Anthony S. Johnston
Bryan, Pendleton, Swats & McAllister, LLC
5301 Virginia Way
Suite 400
Brentwood, Tennessee 37027

OTHER PROFESSIONAL SERVICES

State statute provides that the state Attorney General and Reporter will be the legal advisor of the Board and that the Office of the Comptroller of the Treasury will conduct an annual audit of the TCRS. These government officers are as follows:

Paul G. Summers
Attorney General/Reporter
Nashville, Tennessee

John G. Morgan
Comptroller of the Treasury
Nashville, Tennessee

TREASURY DEPARTMENT EXECUTIVE STAFF

TREASURER’S OFFICE

Treasurer Dale Sims
 Executive Assistant Janice H. Cunningham
 Treasurer Assistant Steven Curry, CPA-inactive, CEBS, CCM

TCRS ADMINISTRATION

TCRS Director Ed Hennessee, CFP
 TCRS Assistant Director Jill Bachus, CPA
 Counseling Services Manager Donna Finley
 Member Services Manager Velva Booker
 Financial Services Manager Connie Gibson, CPA
 Benefit Services Supervisor Charlotte Fuller
 Prior Service Supervisor Robert Smith
 Counseling Services Supervisor Sandra Sewell
 Membership and Field Services Supervisor Susanna Wassom
 Retired Payroll Supervisor Bernard Gentry
 Disbursements Supervisor Fred Marshall, CPA
 Insurance & General Changes Supervisor Jennifer Brown

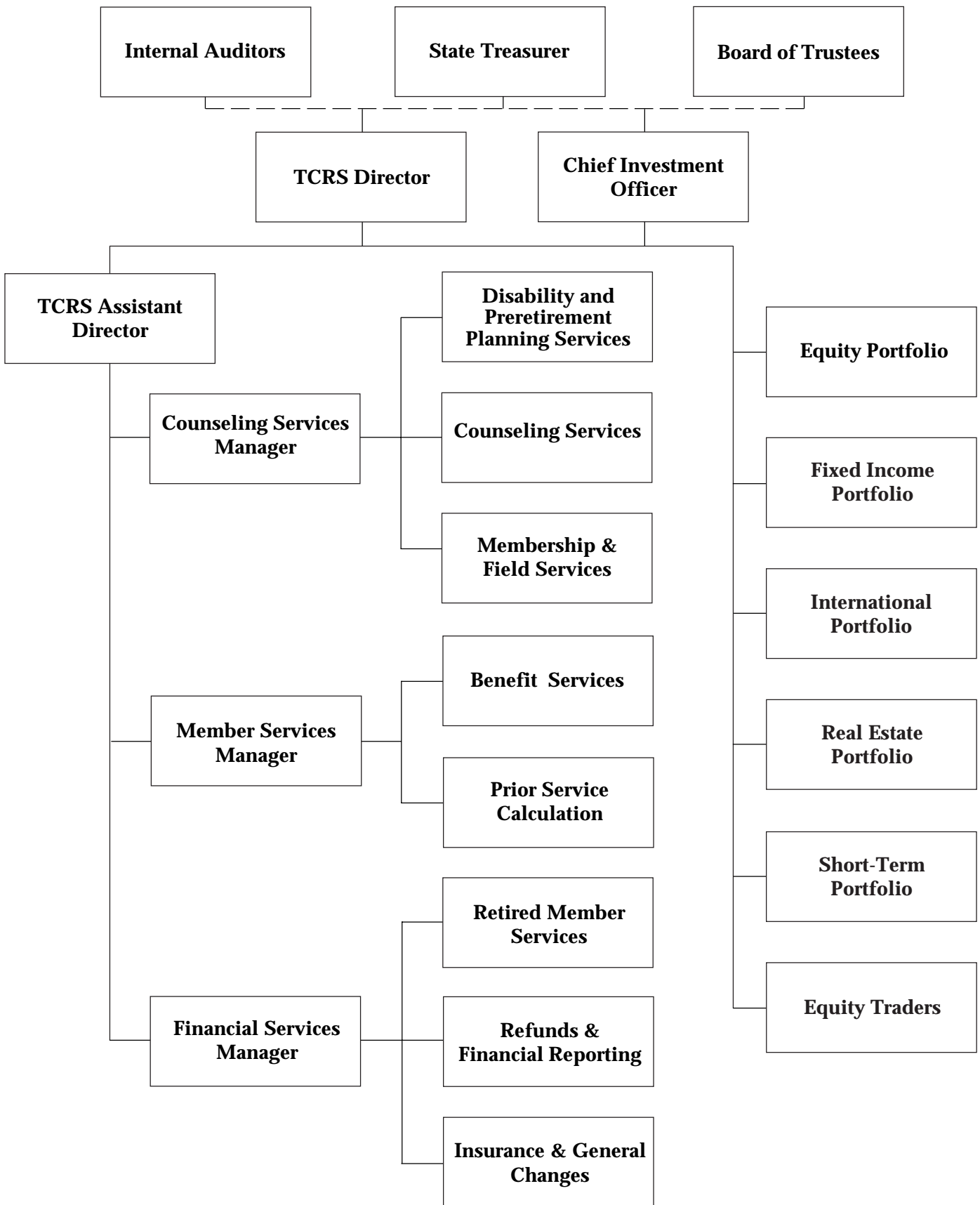
TCRS INVESTMENT

Chief Investment Officer Thomas Milne, CFA
 Equity Director Michael Keeler, CFA
 Senior Equity Portfolio Manager Jeremy Conlin, CLU, ChFC, CFA
 Senior Equity Portfolio Manager Jim Robinson, CFA
 Senior Equity Portfolio Manager Roy Wellington, CFA
 Equity Portfolio Manager Rachel Roberts, CPA-inactive, CFA
 Associate Portfolio Manager William Redmond
 Associate Portfolio Manager Daniel Crews
 Associate Portfolio Manager Mike Moulder, CGFM
 Senior Fixed Income Portfolio Manager Leighton Shantz, CFA
 Senior Fixed Income Portfolio Manager Terry Davis, CFA
 Real Estate Director Peter Katseff
 Senior Short-Term Portfolio Manager Randy Graves, CPA-inactive
 Short-Term Portfolio Manager Tim McClure, CCM
 Senior Equity Trader Dianne Willocks
 Equity Trader Jenny King
 Operations Manager Sharon Harris

SUPPORTING DIVISIONS

Information Systems Director Newton Molloy III, CDP
 Accounting Director Rick DuBray, CPA
 Accounting Assistant Director Kim Morrow, CPA
 Retirement Accounting Supervisor Tom Jordan
 Investment Accounting Supervisor Karen Baumgartel
 Treasury Operations Manager Gaylon Bandy
 State Trust Anita Smith
 Human Resource Director Ann Taylor-Tharpe
 Internal Audit Director Jamie Wayman, CPA
 Research and Publications Director Deana Reed Hannah, CRC, CRA
 Publications Editor/Web Designer Janice Reilly
 Publications Officer Shirley Chatman
 General Counsel Mary Roberts-Krause, JD
 Counsel Vernon G. Bush, JD
 Administrative Services Manager Brian Derrick, CPA

ORGANIZATION CHART



Financial Section



Nickajack Lake

INDEPENDENT AUDITOR'S REPORT



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

**SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

Independent Auditor's Report

December 15, 2003

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

Dear Mr. Morgan:

We have audited the accompanying statements of plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2003, and June 30, 2002, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Tennessee Consolidated Retirement System's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

(continued)

**INDEPENDENT AUDITOR'S REPORT
(CONTINUED)**

The Honorable John G. Morgan
December 15, 2003
Page Two

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

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

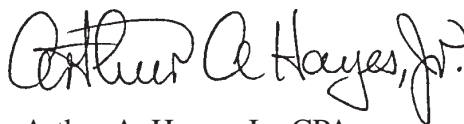
The management's discussion and analysis and the schedules of funding progress and employer contributions, as listed in the table of contents, are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying financial information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

The introductory, investment, actuarial, and statistical sections, as listed in the table of contents, are presented for purposes of additional analysis and are not required parts of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

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

Sincerely,



Arthur A. Hayes, Jr., CPA
Director

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2003 & JUNE 30, 2002**

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

FINANCIAL HIGHLIGHTS

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

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

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

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

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

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2003 & JUNE 30, 2002 (CONTINUED)**

PLAN NET ASSETS

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

ANALYSIS OF REVENUES AND EXPENSES

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

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

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

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2003 & JUNE 30, 2002 (CONTINUED)**

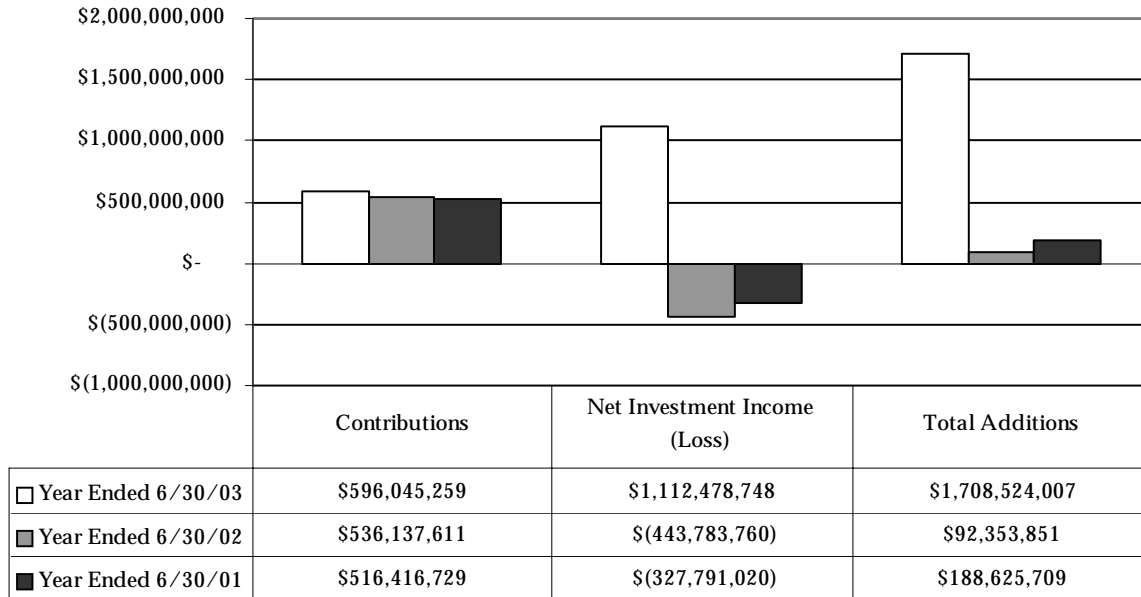
CHANGES IN PLAN NET ASSETS

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

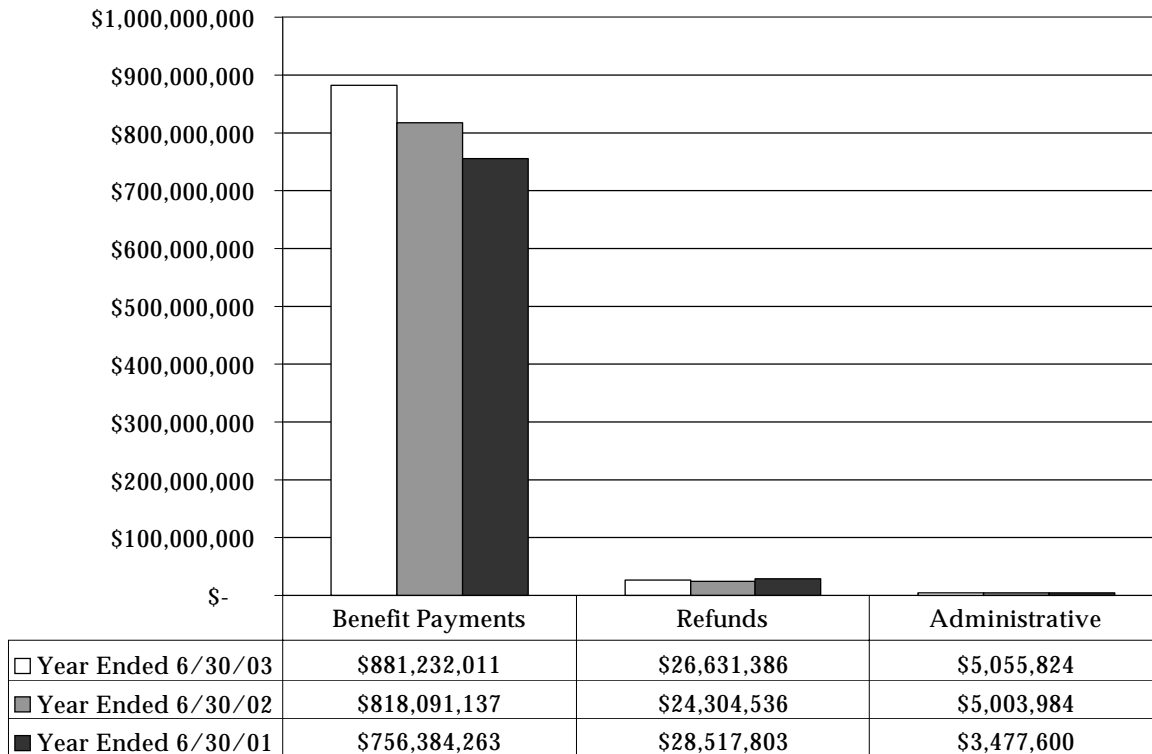
(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2003 & JUNE 30, 2002 (CONTINUED)**

REVENUES BY TYPE



EXPENSES BY TYPE



(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2003 & JUNE 30, 2002 (CONTINUED)**

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

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

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

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

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

CONTACTING THE TCRS

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
COMPARATIVE STATEMENTS OF PLAN NET ASSETS
AS OF JUNE 30, 2003 AND JUNE 30, 2002

Expressed in Thousands

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

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
COMPARATIVE STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

Expressed in Thousands

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

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002

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

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- 1. Reporting Entity** - The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report*.
- 2. Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The TCRS follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

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

- 3. Cash and Cash Equivalents** - Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the TCRS that cannot be invested immediately in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 2003 and June 30, 2002. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund at June 30, 2003, and cash held in a custody account at June 30, 2002, under the contractual arrangements for master custody services. The cash balance held at June 30, 2002 with the custodial agent is not classified into credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.
- 4. Method Used to Value Investments** - Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Short-term investments that do not have an established market are reported at cost plus accrued interest which approximates fair value. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002 (CONTINUED)**

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

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

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

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

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

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

State Employees, Teachers and Higher Education Employees Pension Plan

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002 (CONTINUED)

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

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

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

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

Political Subdivisions Pension Plan

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

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

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002 (CONTINUED)

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

C. INVESTMENTS

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

- a. The total sum invested in common and preferred stocks shall not exceed seventy-five percent (75 percent) of the total of the funds of the retirement system.
- b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75 percent) of the total funds of the retirement system. Private Placements are limited to 15 percent of the total fixed income portfolio.
- c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15 percent) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries.
- d. The total amount of securities loaned under a securities lending program cannot exceed thirty percent (30 percent) of total assets.
- e. The total sum invested in real estate shall not exceed five percent (5 percent) of the total of the funds of the retirement system.

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002 (CONTINUED)

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

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

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

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 AND JUNE 30, 2002 (CONTINUED)

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

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

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

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

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

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

D. COMMITMENTS

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

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS**

SCHEDULES OF FUNDING PROGRESS

Expressed in Thousands

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

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

See accompanying Notes to Required Supplementary Information

SCHEDULES OF EMPLOYER CONTRIBUTIONS

Expressed in Thousands

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

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

See accompanying Notes to Required Supplementary Information

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
AS OF JUNE 30, 2003 AND JUNE 30, 2002**

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

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

- (1) The length of the amortization period varies by political subdivision. For political subdivisions entering the plan on or after July 1, 1994, the amortization period does not exceed 20 years.
- (2) No explicit assumption is made regarding the portion attributable to the effect of inflation on salaries.
- (3) Uniform rate that approximates the effect of a graded salary scale.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
SCHEDULES OF ADMINISTRATIVE EXPENSES
FOR THE YEAR ENDED JUNE 30, 2003

	SETHEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 946,197	\$ 872,327	\$ 1,818,524
Employee benefits	255,457	235,513	490,970
TOTAL PERSONNEL SERVICES	<u>1,201,654</u>	<u>1,107,840</u>	<u>2,309,494</u>
PROFESSIONAL SERVICES			
Accounting	84,646	78,038	162,684
Actuarial services	75,434	69,544	144,978
Data processing	237,013	218,510	455,523
Information systems	304,492	280,720	585,212
Management services	154,686	142,609	297,295
Medical review	11,137	10,268	21,405
Administrative, Internal Audit, Legal, Personnel	273,088	251,769	524,857
TOTAL PROFESSIONAL SERVICES	<u>1,140,496</u>	<u>1,051,458</u>	<u>2,191,954</u>
COMMUNICATION			
Travel	11,509	10,611	22,120
Telephone	23,751	21,896	45,647
Printing	29,630	27,316	56,946
Postage	97,553	89,937	187,490
TOTAL COMMUNICATION	<u>162,443</u>	<u>149,760</u>	<u>312,203</u>
MISCELLANEOUS			
Office space	81,128	74,795	155,923
Supplies and maintenance	20,156	18,583	38,739
Equipment	9,751	8,992	18,743
Other services and charges	14,968	13,800	28,768
TOTAL MISCELLANEOUS	<u>126,003</u>	<u>116,170</u>	<u>242,173</u>
TOTAL ADMINISTRATIVE EXPENSES	<u><u>\$2,630,596</u></u>	<u><u>\$2,425,228</u></u>	<u><u>\$5,055,824</u></u>

With 198,917 active members and 83,121 retired members, the operating cost per member was \$17.93 for the year ended June 30, 2003.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
SCHEDULES OF ADMINISTRATIVE EXPENSES
FOR THE YEAR ENDED JUNE 30, 2002

	SETHEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 933,885	\$ 788,139	\$ 1,722,024
Employee benefits	223,297	188,449	411,746
TOTAL PERSONNEL SERVICES	<u>1,157,182</u>	<u>976,588</u>	<u>2,133,770</u>
PROFESSIONAL SERVICES			
Accounting	84,235	71,089	155,324
Actuarial services	174,861	147,572	322,433
Data processing	276,653	233,477	510,130
Information systems	285,235	240,720	525,955
Management services	149,323	126,018	275,341
Medical review	13,262	11,193	24,455
Administrative, Internal Audit, Legal, Personnel	298,508	251,922	550,430
TOTAL PROFESSIONAL SERVICES	<u>1,282,077</u>	<u>1,081,991</u>	<u>2,364,068</u>
COMMUNICATION			
Travel	10,568	8,919	19,487
Telephone	21,088	17,797	38,885
Printing	26,194	22,106	48,300
Postage	104,799	88,444	193,243
TOTAL COMMUNICATION	<u>162,649</u>	<u>137,266</u>	<u>299,915</u>
MISCELLANEOUS			
Office space	79,730	67,287	147,017
Supplies and maintenance	24,974	21,076	46,050
Equipment	0	0	0
Other services and charges	7,139	6,025	13,164
TOTAL MISCELLANEOUS	<u>111,843</u>	<u>94,388</u>	<u>206,231</u>
TOTAL ADMINISTRATIVE EXPENSES	<u>\$ 2,713,751</u>	<u>\$ 2,290,233</u>	<u>\$ 5,003,984</u>

With 197,971 active members and 80,426 retired members, the operating cost per member was \$17.97 for the year ended June 30, 2002.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
SCHEDULES OF INVESTMENT EXPENSES
FOR THE YEAR ENDED JUNE 30, 2003

	SETHEEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 1,176,540	\$ 189,134	\$ 1,365,674
Employee benefits	275,525	44,292	319,817
TOTAL PERSONNEL SERVICES	<u>1,452,065</u>	<u>233,426</u>	<u>1,685,491</u>
PROFESSIONAL SERVICES			
Accounting	153,528	24,680	178,208
Legal services	95,562	15,362	110,924
Data processing	105,468	16,954	122,422
Information systems	122,356	19,669	142,025
Management services	11,906	1,914	13,820
External investment manager fees	6,273,092	1,008,430	7,281,522
Investment consulting fees	190,393	30,607	221,000
Investment custodian fees	760,587	122,268	882,855
Real estate manager fees	2,047,283	329,111	2,376,394
Administrative, Internal Audit, Personnel	262,698	42,230	304,928
TOTAL PROFESSIONAL SERVICES	<u>10,022,873</u>	<u>1,611,225</u>	<u>11,634,098</u>
COMMUNICATION			
Travel	9,990	1,606	11,596
Telephone	15,638	2,514	18,152
Printing	1,395	224	1,619
Postage	5,464	878	6,342
TOTAL COMMUNICATION	<u>32,487</u>	<u>5,222</u>	<u>37,709</u>
MISCELLANEOUS			
Office space	64,601	10,385	74,986
Supplies and maintenance	12,461	2,003	14,464
Other services and charges	315,546	50,726	366,272
TOTAL MISCELLANEOUS	<u>392,608</u>	<u>63,114</u>	<u>455,722</u>
TOTAL INVESTMENT EXPENSES	<u>\$ 11,900,033</u>	<u>\$ 1,912,987</u>	<u>\$ 13,813,020</u>

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
SCHEDULES OF INVESTMENT EXPENSES
FOR THE YEAR ENDED JUNE 30, 2002**

	SETHEEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 1,159,528	\$ 181,126	\$ 1,340,654
Employee benefits	235,176	36,736	271,912
TOTAL PERSONNEL SERVICES	<u>1,394,704</u>	<u>217,862</u>	<u>1,612,566</u>
PROFESSIONAL SERVICES			
Accounting	147,159	22,987	170,146
Legal services	101,844	15,909	117,753
Data processing	93,032	14,532	107,564
Information systems	110,475	17,257	127,732
Management services	11,070	1,729	12,799
External investment manager fees	6,976,823	1,089,825	8,066,648
Investment consulting fees	197,197	30,803	228,000
Investment custodian fees	842,603	131,620	974,223
Real estate manager fees	1,832,145	286,194	2,118,339
Administrative, Internal Audit, Personnel	235,348	36,763	272,111
TOTAL PROFESSIONAL SERVICES	<u>10,547,696</u>	<u>1,647,619</u>	<u>12,195,315</u>
COMMUNICATION			
Travel	11,824	1,847	13,671
Telephone	22,582	3,527	26,109
Printing	2,161	337	2,498
Postage	8,121	1,268	9,389
TOTAL COMMUNICATION	<u>44,688</u>	<u>6,979</u>	<u>51,667</u>
MISCELLANEOUS			
Office space	61,151	9,552	70,703
Supplies and maintenance	35,038	5,473	40,511
Other services and charges	106,587	16,650	123,237
TOTAL MISCELLANEOUS	<u>202,776</u>	<u>31,675</u>	<u>234,451</u>
TOTAL INVESTMENT EXPENSES	<u>\$ 12,189,864</u>	<u>\$ 1,904,135</u>	<u>\$ 14,093,999</u>

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
SCHEDULES OF EXPENSES FOR CONSULTANTS
FOR THE YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002**

FOR THE YEAR ENDED JUNE 30, 2003

	SETHEEPP	PSPP	Total
ACTUARIAL SERVICES			
Bryan, Pendleton, Swats and McAllister	<u>\$ 75,434</u>	<u>\$ 69,544</u>	<u>\$ 144,978</u>
MEDICAL REVIEW SERVICES			
Suzanne Fletcher, M.D.	4,562	4,208	8,770
Marshall Koonce, M.D.	2,012	1,854	3,866
Barry Siegel, M.D.	1,521	1,402	2,923
Jeffrey Summers, M.D.	<u>3,042</u>	<u>2,804</u>	<u>5,846</u>
TOTAL MEDICAL REVIEW SERVICES	<u>11,137</u>	<u>10,268</u>	<u>21,405</u>
TOTAL EXPENSES FOR CONSULTANTS	<u><u>\$ 86,571</u></u>	<u><u>\$ 79,812</u></u>	<u><u>\$ 166,383</u></u>

Note: For information regarding fees paid to investment professionals, refer to the Investment Section of this report.

FOR THE YEAR ENDED JUNE 30, 2002

	SETHEEPP	PSPP	Total
ACTUARIAL SERVICES			
Bryan, Pendleton, Swats and McAllister	<u>\$ 174,861</u>	<u>\$ 147,572</u>	<u>\$ 322,433</u>
MEDICAL REVIEW SERVICES			
Sarada Misra, M.D.	3,900	3,293	7,193
Suzanne M. Fletcher, M.D.	4,681	3,950	8,631
Marshall L. Koonce, M.D.	<u>4,681</u>	<u>3,950</u>	<u>8,631</u>
TOTAL MEDICAL REVIEW SERVICES	<u>13,262</u>	<u>11,193</u>	<u>24,455</u>
TOTAL EXPENSES FOR CONSULTANTS	<u><u>\$ 188,123</u></u>	<u><u>\$ 158,765</u></u>	<u><u>\$ 346,888</u></u>

Note: For information regarding fees paid to investment professionals, refer to the Investment Section of this report.

Investment Section



Reelfoot Lake

REPORT BY INVESTMENT CONSULTANT

CALLAN ASSOCIATES^{INC.}

November 5, 2003

Mr. Eddie W. Hennessee
Executive Director
Tennessee Consolidated Retirement System
Fifth and Deadrick, 10th Floor
Andrew Jackson Building
Nashville, TN 37243-0230

CHARLES L. MATHIS
SENIOR VICE PRESIDENT



SAN FRANCISCO

NEW YORK

CHICAGO

ATLANTA

DENVER

Dear Ed:

The quarterly performance reports are prepared by Callan Associates in full compliance with AIMR standards. The year ended June 30, 2003 was extremely positive for fixed-income markets all over the world as falling interest rates increased the market value of the bonds. Equity markets across the planet continued to struggle until March of 2003. The relatively high (in comparison to other retirement funds) fixed-income allocation of the TCRS resulted in a very favorable comparative overall return for the year ended June 30, 2003.

As of June 30, 2003, the System's asset allocation and one year respective returns were:

<u>Asset Class</u>	<u>% of Assets</u>	<u>One-Year Return</u>
Domestic Equities	27.42%	0.31%
Traditional Domestic Fixed Income	45.15%	10.41%
International Equities	9.29%	(5.60%)
International Fixed-Income	2.83%	16.10%
Cash and Equivalents	7.61%	1.51%
Real Estate	1.56%	5.54%
Inflation Hedged Bond	6.14%	9.64%
Total	100.0%	4.90%

The median fund in the Callan Associates Public Plan Sponsor Database earned 3.74% for the year ended June 30, 2003. As aforementioned, the relatively high fixed-income allocation of the System was a contributing factor to the favorable relative results.

Since March of 2003, the equity markets across the world have recovered handsomely from the carnage of 2000 through 2003. We suspect that the equity markets will continue to perform fairly well over the course of the next year, but that the likelihood of moderately rising interest rates worldwide in 2004 will temper fixed-income returns.

Callan Associates is a thirty year old firm and has been the System's investment consultant since 1988. Among the services provided by Callan are performance evaluation, manager search, and asset allocation. Callan is a national consulting firm with five regional offices and well over 200 clients. The System is one of almost twenty state retirement systems that Callan serves.

Please give me a call should you have any questions or comments.

Sincerely,

Charles L. Mathis

Charles L. Mathis

LETTER FROM TCRS CHIEF INVESTMENT OFFICER

STATE OF TENNESSEE

DALE SIMS
STATE TREASURERTHOMAS G. MILNE
CHIEF INVESTMENT
OFFICER**TREASURY DEPARTMENT**
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
11TH FLOOR ANDREW JACKSON STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243

December 15, 2003

Dear Members:

I am pleased to present the Investment Section of the TCRS Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003.

With over \$23 billion in assets, TCRS is one of the largest public pension plans in the United States. TCRS assets are invested to preserve principal value, to achieve a superior rate of return within acceptable risk levels, and to provide the liquidity necessary to pay beneficiaries in a timely manner.

The TCRS portfolio is diversified among domestic and international stocks and bonds, real estate, and short-term securities. A diversified portfolio is used to manage risk and minimize significant exposure to unpredictable events. The TCRS consultant periodically prepares an asset allocation study to determine the optimal long-term mix of assets to best meet the plans investment objectives. TCRS has adopted a conservative investment strategy that has yielded excellent returns with a low level of risk.

The financial markets continue to be volatile. During these difficult times, the benefits of a conservative, diversified investment portfolio are proven.

I am proud to report that the TCRS achieved excellent returns for the year ended June 30, 2003. The fund earned 4.90% for the year while the average large pension fund returned 3.74%.

The experienced TCRS investment staff is committed to providing superior investment returns in a financially sound manner with the highest ethical and professional standards. With the leadership of our Board and the work of our dedicated staff, this goal will be met.

Sincerely,

A handwritten signature in cursive script that reads "Thomas G. Milne".

Thomas G. Milne

STATUTORY INVESTMENT AUTHORITY

STATUTORY INVESTMENT AUTHORITY

The investment authority of TCRS is prescribed in the *Tennessee Code Annotated*, Title 8, Chapter 37. This chapter provides that, with certain enumerated exceptions, investments of TCRS assets are subject to the same terms, conditions and limitations imposed on domestic life insurance companies as set forth in *T.C.A.*, Section 56, Chapter 3. The Board of Trustees of TCRS adopts investment policy relative to the investment of TCRS assets. The investment objective is to obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay beneficiaries in a timely manner. A summary of statutory and policy provisions follow.

DOMESTIC STOCKS

- ❖ No more than 75% of the TCRS portfolio may be invested in common stock, preferred stock and convertible bonds.
- ❖ No more than 4.99% of the outstanding shares of any one company may be purchased.

DOMESTIC FIXED INCOME

- ❖ No more than 75% of the TCRS portfolio may be invested in fixed income securities exceeding one year.
- ❖ Only issues that are investment grade securities (four highest ratings) may be purchased.
- ❖ Triple B bonds are limited to 7% of the domestic fixed income portfolio.
- ❖ Private placements are limited to 15% of the domestic fixed income portfolio. Private placements may be purchased if staff evaluation determines that the credit quality is equivalent to double A.

INTERNATIONAL EQUITY

- ❖ No more than 15% of the TCRS portfolio may be invested in international securities, including international fixed income.
- ❖ Canadian securities shall be treated as domestic securities for policy purposes.
- ❖ Thirty-nine countries have been approved by the Board for international investing.

INTERNATIONAL FIXED INCOME

- ❖ No more than 15% of TCRS portfolio may be invested in international securities, including international equity.
- ❖ Investments are limited to seven major developed countries.

SHORT-TERM SECURITIES

- ❖ Commercial paper should be rated A1 or P1.

STOCK OPTIONS AND BOND FUTURES

- ❖ Limited to 10% of the portfolio.
- ❖ Only covered call options may be written.

DOMESTIC STOCK INDEX FUTURES

- ❖ Contracts shall not exceed 5% of the TCRS portfolio.
- ❖ Shall only be used for asset allocation purposes and not for speculative leveraging. The system's cash and short-term securities must exceed the amount of the contract obligation.

SECURITIES LENDING

- ❖ May not lend more than 30% of the portfolio.
- ❖ Collateral, other than cash, must have a market value of 102% of the security loaned.

STANDBY NOTE PURCHASE AGREEMENT

- ❖ TCRS may enter into contracts to serve as a standby note purchaser for the Tennessee State School Bond Authority, the Tennessee State Funding Board and the Tennessee Local Development Authority.

FOREIGN CURRENCY HEDGING

- ❖ May not exceed 80% of the international securities.

REAL ESTATE

- ❖ No more than 5% of the TCRS portfolio may be invested in real estate.

PROXY VOTING

- ❖ Shall vote proxies in a manner which will provide the best ultimate value to shareholders.

INVESTMENT PERFORMANCE REVIEW

INVESTMENT PERFORMANCE REVIEW

Periods Ending June 30, 2003

	Annualized Returns		
	Current Year	3-Year	5-Year
Pension Plan Portfolio			
TCRS Performance	4.90 %	0.41 %	3.65 %
Benchmark - Public Fund Index Median	3.74 %	(1.66)%	2.93 %
Domestic Equity			
TCRS Performance	0.31 %	(10.96)%	(1.00)%
Benchmark - S & P 500	0.25 %	(11.20)%	(1.61)%
- Dow Jones Industrial Average	(0.43)%	(2.99)%	1.93 %
- Russell 2000	(1.64)%	(3.30)%	0.97 %
Domestic Fixed Income			
TCRS Performance	10.41 %	10.06 %	7.36 %
Benchmark - Lehman Aggregate	10.40 %	10.08 %	7.54 %
Inflation Hedged Bonds			
	9.64 %	-	-
International Equity			
TCRS Performance	(5.60)%	(11.21)%	(0.60)%
Benchmark - MSCI EAFE Index	(6.46)%	(13.52)%	(4.00)%
Benchmark - MSCI EAFE & Emerging Markets	(4.96)%	(12.71)%	(2.98)%
International Fixed Income			
TCRS Performance	16.10 %	5.88 %	5.55 %
Benchmark - Soloman Brothers Non-US Government Bond Index	17.10 %	8.10 %	6.29 %
Real Estate			
TCRS Performance	5.54 %	7.14 %	-
Short-term Securities			
TCRS Performance	1.51 %	3.34 %	4.21 %
Benchmark - Three month Treasury Bill	1.53 %	3.33 %	4.08 %

Callan Public Plan Sponsor Database

Percentile Rankings

Risk Adjusted Basis

Ranking of TCRS Portfolio	
Last ten years	18
Last fifteen years	6

The percentile ranking is the position of the TCRS portfolio as compared with other public funds with 1 being the best and 100 being the worst. The investment performance for TCRS was computed using a market, time weighted rate of return by an independent investment consultant for TCRS in accordance with the AIMR standards.

ASSET ALLOCATION

ASSET ALLOCATION
as of June 30, 2003
Expressed in Thousands

Asset Class	Fair Value	Percentage
Domestic Equity	\$ 6,499,577	27.0%
Domestic Fixed	12,089,730	50.5%
International Equity	2,116,223	8.8%
International Fixed Income	659,110	2.8%
Short-term Securities	2,218,830	9.3%
Real Estate	372,308	1.6%
Total	\$ 23,955,778	100.0%

This schedule classifies convertible bonds as fixed income securities and preferred stock as fixed income securities. For investment purposes, convertible bonds and preferred stock are considered equity securities. In addition, inflation hedged bonds are not presented as a separate asset class on the above schedule. Accordingly, the asset allocation percentages in this schedule will vary from the investment consultant's asset allocation percentages.

LARGEST HOLDINGS

JUNE 30, 2003

LARGEST STOCK HOLDINGS

as of June 30, 2003

by Fair Value

Shares	Security Name	Fair Value
8,192,000	MICROSOFT CORPORATION	\$ 210,042,880
5,968,420	PFIZER INCORPORATED	203,821,543
7,043,000	GENERAL ELECTRIC COMPANY	201,993,240
3,277,000	WAL-MART STORES INCORPORATED	175,876,590
4,874,594	EXXON MOBIL CORPORATION	175,046,671
3,659,004	CITIGROUP INCORPORATED	156,605,371
2,310,000	JOHNSON & JOHNSON	119,427,000
1,355,000	INTERNATIONAL BUSINESS MACHINES CORPORATION	111,787,500
4,897,000	INTEL CORPORATION	101,906,570
1,269,743	BANK OF AMERICA CORPORATION	100,347,789

LARGEST BOND HOLDINGS

as of June 30, 2003

by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
1,250,000,000	U.S. TREASURY NOTES	1.48%	6/30/2004	Aaa	\$ 1,272,656,250
485,000,000	U.S. TREASURY NOTES	1.66%	5/15/2006	Aaa	555,779,688
400,000,000	U.S. TREASURY NOTES	1.22%	2/28/2005	Aaa	401,875,000
300,000,000	U.S. TREASURY BONDS	4.64%	5/15/2030	Aaa	373,500,000
167,000,000	U.S. TREASURY BONDS	4.38%	5/15/2021	Aaa	243,872,188
150,000,000	U.S. TREASURY BONDS	5.81%	8/15/2014	Aaa	231,375,000
155,000,000	U.S. TREASURY BONDS	5.97%	8/15/2013	Aaa	225,234,375
195,000,000	FEDERAL NATL MTG ASSN	1.67%	2/15/2006	Aaa	214,073,438
160,000,000	U.S. TREASURY BONDS	3.95%	5/15/2016	Aaa	212,800,000
200,000,000	FNMA TBA 30YR 5.50% JUL	3.81%	7/1/2033	Aaa	207,468,750

A complete portfolio listing is available upon request.

Key to Ratings: All ratings presented are from Moody's Investors Service with the exception of some of the government agency securities. Moody's does not rate these securities. Standard & Poor's does provide ratings for the securities (AAA is Standard & Poor's highest rating.) Government Securities are not rated per se' but are considered the best quality securities.

Moody's rates securities as follows:

- Aaa: Best Quality
- Aa: High Quality
- A: Upper Medium Quality
- Baa: Medium Quality

INVESTMENT SUMMARY

INVESTMENT SUMMARY

as of June 30, 2003

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	\$ 9,962,888,150	41.59%	\$ 450,583,321	1.88%	\$ 10,413,471,471	43.47%
Corporate Bonds	2,103,126,185	8.78%	208,526,972	0.87%	2,311,653,157	9.65%
Convertible Bonds	111,720	0.00%	0	0.00%	111,720	0.00%
Total Bonds	<u>12,066,126,055</u>	<u>50.37%</u>	<u>659,110,293</u>	<u>2.75%</u>	<u>12,725,236,348</u>	<u>53.12%</u>
Preferred Stock	23,603,622	0.10%	0	0.00%	23,603,622	0.10%
Total Fixed Income	<u>12,089,729,677</u>	<u>50.47%</u>	<u>659,110,293</u>	<u>2.75%</u>	<u>12,748,839,970</u>	<u>53.22%</u>
Common Stock						
Capital Goods & Services	100,249,220	0.42%	51,700,661	0.22%	151,949,881	0.64%
Comingled Equity Funds	0	0.00%	1,190,063	0.00%	1,190,063	0.00%
Consumer Durables	118,390,500	0.50%	66,894,071	0.28%	185,284,571	0.78%
Consumer Non-Durables	1,518,796,242	6.34%	285,641,325	1.19%	1,804,437,567	7.53%
Energy	408,631,738	1.71%	60,329,324	0.25%	468,961,062	1.96%
Financial	1,266,361,128	5.29%	1,028,992,632	4.30%	2,295,353,760	9.59%
Materials & Services	1,502,666,874	6.27%	266,983,993	1.11%	1,769,650,867	7.38%
Miscellaneous						
Common Stock	0	0.00%	7,730,527	0.03%	7,730,527	0.03%
Real Estate Investment						
Trust	11,708,300	0.05%	0	0.00%	11,708,300	0.05%
Technology	1,045,400,223	4.36%	202,661,700	0.85%	1,248,061,923	5.21%
Transportation	108,675,638	0.45%	34,603,550	0.14%	143,279,188	0.59%
Utilities	418,697,030	1.75%	109,495,776	0.46%	528,192,806	2.21%
Total Common Stock	<u>6,499,576,893</u>	<u>27.14%</u>	<u>2,116,223,622</u>	<u>8.83%</u>	<u>8,615,800,515</u>	<u>35.97%</u>
Short-term Investments						
Commercial Paper	717,396,850	2.99%	0	0.00%	717,396,850	2.99%
Pooled Funds and Mutual Funds	108,761	0.00%	0	0.00%	108,761	0.00%
U.S. Gov't Securities	1,501,324,431	6.27%	0	0.00%	1,501,324,431	6.27%
Total Short-term Investments	<u>2,218,830,042</u>	<u>9.26%</u>	<u>0</u>	<u>0.00%</u>	<u>2,218,830,042</u>	<u>9.26%</u>
Real Estate	372,307,597	1.55%	0	0.00%	372,307,597	1.55%
Total Investments	<u>21,180,444,209</u>	<u>88.42%</u>	<u>2,775,333,915</u>	<u>11.58%</u>	<u>23,955,778,124</u>	<u>100.00%</u>
Short-term Investments Classified as Cash Equivalents	<u>(1,720,252,917)</u>		<u>0</u>		<u>(1,720,252,917)</u>	
Total Investments as Shown on the Statement of Plan Net Assets	<u>\$ 19,460,191,292</u>		<u>\$ 2,775,333,915</u>		<u>\$ 22,235,525,207</u>	

This schedule classifies Canadian investments as domestic securities, convertible bonds as fixed income securities, and preferred stock as fixed income securities. For investment purposes convertible bonds and preferred stock are considered equity securities. Accordingly, the asset allocation percentages in this schedule will vary from the investment consultant's asset allocation percentages.

**SCHEDULES OF INVESTMENT FEES AND COMMISSIONS
FOR THE YEAR ENDED JUNE 30, 2003**

SCHEDULE OF FEES

Asset Management	Assets Under Management	Fees
International Investment Manager Fees	\$ 2.1 Billion	\$ 7,281,522
Real Estate Asset Management	372 Million	2,376,394
Total Asset Management		\$ 9,657,916
Other Investment Services Fees		
Custodian Bank	\$ 24 Billion	\$ 882,855
General Investment Consultant	24 Billion	121,000
Real Estate Investment Consultant	372 Million	100,000
Total Investment Services Fees		\$ 1,103,855

SCHEDULES OF COMMISSIONS

Domestic Exchange Traded Shares

Broker	Shares Traded	Domestic Commissions	Commission per Share
Banc of America Securities LLC	9,902,896	\$ 455,071	\$ 0.0460
Bear Stearns Securities Corporation	19,964,956	803,798	0.0403
BNY Brokerage Incorporated	9,917,853	226,317	0.0228
Bridge Trading Company	2,548,800	117,970	0.0463
Capital Institutional Svcs., Inc.	15,483,421	751,515	0.0485
CitiGroup Global Markets Incorporated	2,452,700	107,995	0.0440
Credit Suisse First Boston	5,052,749	226,430	0.0448
Deutsche Banc Alex Brown	2,182,913	103,889	0.0476
Edwards, A.G., & Sons, Incorporated	4,137,500	192,890	0.0466
Instinet Corporation New York	9,806,266	159,385	0.0163
Jefferies & Company, Incorporated	5,574,000	242,913	0.0436
Lehman Brothers Incorporated	12,320,824	543,853	0.0441
Merrill Lynch Pierce Fenner & Smith	6,467,700	292,085	0.0452
Morgan Keegan & Company, Incorporated	2,309,200	109,880	0.0476
Pershing & Company	3,445,357	142,468	0.0414
Prudential Securities Incorporated	6,909,233	282,690	0.0409
Salomon Smith Barney Incorporated	3,376,892	160,035	0.0474
Other Brokers*	16,347,602	700,925	0.0429
Totals	138,200,862	\$ 5,620,109	

Program Trades where total commission cost includes trading commission, liquidity fees, and market impact fees.

Broker	Shares Traded	Domestic Commissions	Commission per Share
Deutsche Banc Alex Brown	17,660,333	\$ 876,555	\$ 0.0496
Goldman Sachs & Company	8,151,440	350,512	0.0430
Merrill Lynch Pierce Fenner & Smith	10,067,115	483,221	0.0480
Totals	35,878,888	\$ 1,710,288	

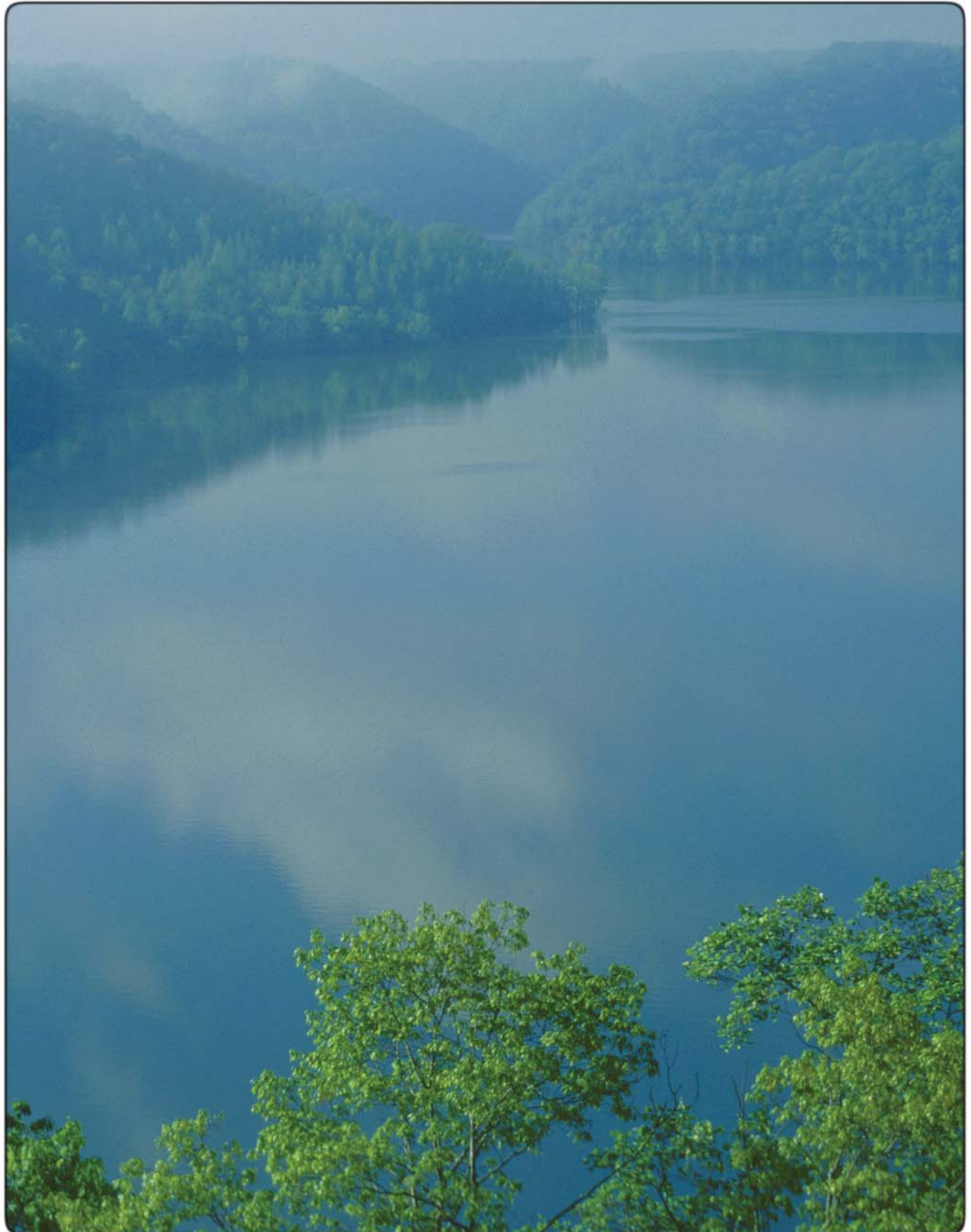
International Exchange Traded Shares

Broker	Shares Traded	International Commissions	Commission per Share
Credit Suisse First Boston Corporation	51,226,179	\$ 254,237	\$ 0.0050
Deutsche Banc Alex Brown Incorporated	87,202,555	121,619	0.0014
Goldman Sachs & Company	157,758,107	422,323	0.0027
JP Morgan Securities	33,637,957	180,922	0.0054
Jefferies and Company	3,818,041	188,947	0.0495
Lehman Brothers Incorporated	7,814,205	110,623	0.0142
Merrill Lynch Pierce Fenner & Smith	110,472,794	377,992	0.0034
Morgan Stanley Co Incorporated	63,622,733	287,725	0.0045
Teather and Greenwood	9,543,513	101,512	0.0106
UBS AG	281,088,737	107,961	0.0004
UBS Warburg LLC	163,304,194	206,554	0.0013
Other Brokers*	713,440,541	1,425,720	0.0020
Totals	1,682,929,556	\$ 3,786,135	

Shares for international stocks are based on the actual foreign shares traded while the commission is expressed in U.S. dollars. Therefore, commissions per share between domestic and international are not comparable.

*Less than \$100,000 total commission per brokerage firm.

Actuarial Section



Centerhill Lake

ACTUARIAL INTRODUCTION**BIENNIAL ACTUARIAL VALUATIONS**

Biennial actuarial valuations of the TCRS are performed by an independent actuarial consulting firm to assess the funding status of the system and to determine employer contribution rates for its various components. The latest valuation, performed as of July 1, 2001, set new employer rates effective July 1, 2002. The Board of Trustees of the system is responsible for adopting the employer contribution rates after reviewing the actuarial results. The next valuation is scheduled to be performed as of July 1, 2003.

FUNDING OF PENSIONS

It is the policy of the state to fund pensions by actuarially determined contributions which are intended to provide funding for both the normal liability cost and the unfunded actuarial accrued liability cost. This policy seeks to ensure that sufficient assets will be available to pay benefits as they are due.

ACCRUED LIABILITY

With the 2001 actuarial valuation, the accrued liability, which was frozen in 1981 was again reestablished. This was accomplished by setting the unfunded accrued liability equal to the excess of the Entry Age Normal Past Service Liability over the valuation assets for each group. This action affected local government employers and two minor closed groups.

SPECIFICS

Valuations are based on demographic data (employee ages, salaries and service credits), economic projections (salary increases, interest rates and investment earnings), and decrement estimates (mortality and disability rates).

The economic projections and decrement estimates used for valuation purposes utilized the assumptions recommended by the actuary and adopted by the Board of Trustees based on an actuarial experience study conducted every four

years. The earnings rate assumption adopted by the Board is subject to the approval of the Council on Pensions and Insurance.

QUADRENNIAL EXPERIENCE STUDY

A quadrennial experience study was conducted as of June 30, 2000. A number of changes were made to the economic and decrement assumptions. The salary assumption was changed to a graded scale that reflects plan experience, while the increase in the Social Security wage base assumption was reduced to three and one-half percent. Preretirement and post-retirement mortality assumptions were also modified to more closely reflect past experience.

ACTUARY'S CERTIFICATION LETTER



Bryan, Pendleton, Swats & McAllister, LLC
A Wells Fargo Company

October 30, 2003

Mr. Dale Sims
Chairman, Board of Trustees
Tennessee Consolidated Retirement System
Tenth Floor
Andrew Jackson State Office Building
Nashville, Tennessee 37243-0230

Dear Mr. Sims:

Re: Actuary's Certification Letter

The purpose of this letter is to certify the actuarial adequacy of contributions being made by the State of Tennessee and participating Political Subdivisions to the Tennessee Consolidated Retirement System and to discuss the approach currently being taken toward meeting the financing objectives of the Plan.

The most recent biennial actuarial valuation of the Tennessee Consolidated Retirement System was performed as of July 1, 2001. That valuation was based on a set of actuarial assumptions (described in detail in the section headed "Summary of Actuarial Methods and Assumptions") which was adopted by the Board of Trustees on the recommendation of the actuary, as a result of a study of actual experience under the TCRS during the four year period ending June 30, 2000. The experience study concluded that the assumed rate of return and inflation assumption should remain unchanged. Modifications were recommended for many of the demographic assumptions including changes to more conservative mortality, termination and retirement rates. For Consolidated State and Political Subdivision groups, one third of the effect of termination/retirement rates was recognized as of July 1, 2001 with the remainder to be recognized in succeeding actuarial valuations. The salary increase rate was altered from a uniform 5.5% annual rate to a graded scale that reflects the plan experience pattern of declining escalation rates as participant ages increase. The aggregate effect of recommended assumption changes as of July 1, 2001 is a contribution rate increase of 0.31% and 1.07%, respectively, for the Contributory Teachers and Consolidated State groups.

There have been no significant changes in the level of benefits provided by the plan since the date of the preceding valuation.

The Board of Trustees in 1975 established as its financing objective the amortization of unfunded accrued liabilities over the ensuing 40-year period. In the years since then, the implementation of that general goal has involved a gradual strengthening of the methods utilized in computing required annual contributions. This has been accomplished by such steps as (1) taking advance funding of expected cost-of-living increases into account, (2) placing all amortization payments on a "level dollar" basis—a stronger basis than the "percentage of payroll" method previously utilized and (3) elimination of the unfunded accrued liability for the major contribution classes, primarily as a result of actuarial gains attributable to favorable investment performance.

5301 Virginia Way, Suite 400

Brentwood, Tennessee 37027

(continued)

**ACTUARY'S CERTIFICATION LETTER
(CONTINUED)**

Mr. Dale Sims
October 30, 2003
Page Two

In performing the 2001 valuation, we relied on employee data and asset information provided by the administrative staff of the Tennessee Consolidated Retirement System. In the case of employee data, each individual record was audited thoroughly for reasonableness and internal consistency, although the validity of the information was not traced to source documents or compared with data for the same participants utilized in prior valuations. With respect to plan assets, a general review for consistency with the information furnished for prior valuations was performed.

Certain tables presented in the Comprehensive Financial Annual Report are derived from the July 1, 2001 actuarial valuation report prepared by Bryan, Pendleton, Swats and McAllister, LLC. The tables were prepared by the staff of the Tennessee Consolidated Retirement System and examined by our firm. These tables include the following –

Financial Section

- Schedules of Funding Progress

Actuarial Section

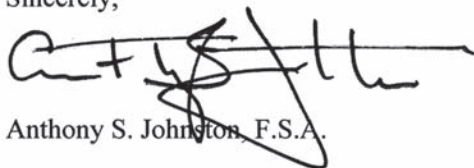
- Summary of Actuarial Assumptions and Methods
- Actuarial Data (current year data)
- Actuarial Balance Sheet
- Short-Term Solvency Test
- Summary of Unfunded Accrued Liabilities and Selected Funding Information
- Analysis of Financial Experience

The Schedule of Retired Member Activity in the Actuarial Section of the report was prepared by our firm using information gathered from the 1995, 1997, 1999 and 2001 actuarial valuations.

The 2001 valuation was prepared in accordance with accepted actuarial principles of practice prescribed by the Actuarial Standards Board and the principles of Governmental Accounting Standards Board Statement 25. I am a Member of the American Academy of Actuaries with experience in performing valuations for public retirement systems; all calculations were performed either by me or by other qualified actuaries under my direct supervision.

Based upon the valuation results and the contribution rates adopted by the Board of Trustees, it is our opinion that the Tennessee Consolidated Retirement System continues to fund its liabilities in accordance with standard actuarial principles of advance funding, continuing a program first adopted in 1975.

Sincerely,



Anthony S. Johnston, F.S.A.

g:\1---\6--100\2003\actuarialcertification.doc

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

The following assumptions were adopted by the Board of Trustees for use beginning with the July 1, 2001 valuation based on the consulting actuary’s recommendations resulting from the June 30, 2000 actuarial experience study.

GENERAL ACTUARIAL METHODS

- ❖ **Actuarial Cost Method** (Frozen Entry Age)—Unfunded accrued liabilities are being funded over a 40-year period commencing in 1975. The unfunded accrued liability was reestablished as part of the July 1, 2001 valuation. This was accomplished by setting the unfunded accrued liability equal to the excess (if any) of the Entry Age Normal Past Service Liability over the valuation assets for each group or zero.
- ❖ **Treatment of Actuarial Gains and Losses**—Under the Frozen Entry Age Method, any actuarial gains or losses are absorbed into the normal cost.
- ❖ **Asset Valuation Method**—Assets are valued on a basis which reflects a five-year moving average of the fair market value. Investment losses are applied to offset accumulated investment gains prior to determining the amount of earnings to be phased in.
- ❖ **Valuation Data**—The administrative staff of TCRS furnishes the actuary with demographic data relating to the active life members and the retired life members. The fair value of system assets are also provided by retirement system staff. All data is reviewed for reasonableness and consistency from year to year, but is not audited by the actuary.
- ❖ **Post-Retirement Adjustments**—Retirement benefits are assumed to increase at the maximum geometric rate of 3% annually, reflecting the 1997 adoption of compounded cost-of-living adjustments.

ECONOMIC ASSUMPTIONS

- ❖ **Investment Return Rate**—Seven and one-half percent per annum, compounded annually.
- ❖ **Employee Salary Increases**—Graded scale that reflects the plan experience pattern of declining escalation rates as participant ages increase. No explicit assumption is made regarding the portion attributable to the effects of inflation on salaries. Active membership is assumed to remain constant.
- ❖ **Increase in Social Security Wage Base**—Three and one-half percent annual increase.

DECREMENT ASSUMPTIONS

- ❖ **Post-Retirement Mortality**—Annuity mortality tables previously used are no longer compatible with TCRS results. Specifically adopted tables have been created to more accurately reflect patterns that occur among TCRS retirees. Sample rates are below.

	Male	Female
Teachers		
Age 50	0.3%	0.2%
Age 60	0.7%	0.5%
Age 70	2.1%	1.3%
State & Political Subdivisions		
Age 50	0.4%	0.2%
Age 60	1.2%	0.6%
Age 70	3.2%	1.7%

- ❖ **Preretirement Mortality**—The 1994 Group Annuity mortality table is used for state employees and political subdivision employees. For teachers, the 1983 Group Annuity Mortality Table is used with an adjustment of 60% for females and 50% for males.

- ❖ **Withdrawal Due to Disability**—Sample rates of disability based on experience:

	Male	Female
Teachers		
Age 30	0.03%	0.03%
Age 40	0.09%	0.09%
Age 50	0.17%	0.17%
State		
Age 30	0.05%	0.05%
Age 40	0.16%	0.17%
Age 50	0.35%	0.37%
Political Subdivisions		
Age 30	0.05%	0.04%
Age 40	0.14%	0.08%
Age 50	0.53%	0.36%

- ❖ **Turnover Assumption**—Tables for probabilities of separation due to termination of employment are developed utilizing a “two-year select and ultimate” approach.

(continued)

**SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS
(CONTINUED)**

Teachers				Retirement —The probabilities of retirement for members eligible to retire:			
	1st Year Employment	2nd Year Employment	Ultimate	Age	Teachers	State	P.S.
<i>Male</i>				Age 60	15.0%	9.0%	10.0%
Age 30	15.0%	12.0%	5.6%	Age 61	22.0%	12.0%	17.0%
Age 40	15.0%	12.0%	1.5%	Age 62	26.0%	23.0%	26.0%
Age 50	15.0%	12.0%	2.0%	Age 63	22.0%	15.0%	17.0%
<i>Female</i>				Age 64	31.0%	18.0%	19.0%
Age 30	15.0%	12.0%	8.1%	Age 65	43.0%	34.0%	29.0%
Age 40	15.0%	12.0%	1.8%	Age 70	100.0%	21.0%	20.0%
Age 50	15.0%	12.0%	1.8%	Age 75	100.0%	100.0%	100.0%
State Employees				In addition, for members younger than age 60, a loading factor of 10 percent is added during the year the member is first eligible for unreduced retirement. After age 60, for those members with 15 or more years of service, a 10% load is added for teachers and 5% for state employees and political subdivision employees.			
	1st Year Employment	2nd Year Employment	Ultimate				
<i>Male</i>							
Age 30	27.2%	23.1%	10.7%				
Age 40	23.1%	16.7%	4.8%				
Age 50	16.5%	14.0%	2.9%				
<i>Female</i>							
Age 30	27.2%	23.1%	10.7%				
Age 40	23.1%	16.7%	4.8%				
Age 50	16.5%	14.0%	2.9%				
Political Subdivision Employees							
	1st Year Employment	2nd Year Employment	Ultimate				
<i>Male</i>							
Age 30	24.8%	21.0%	10.3%				
Age 40	21.0%	15.2%	7.2%				
Age 50	15.0%	12.8%	5.5%				
<i>Female</i>							
Age 30	24.8%	21.0%	11.8%				
Age 40	21.0%	15.2%	8.1%				
Age 50	15.0%	12.8%	5.9%				

ACTUARIAL DATA

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Valuation Year	Number	Annual Payroll In Thousands	Average Annual Pay	Average Annual Percentage Increase In Average Annual Pay
1983	137,054	\$ 2,040,979	\$ 14,892	6.58%
1985	140,744	2,377,928	16,895	6.51%
1987	147,779	2,800,035	18,947	5.90%
1989	153,664	3,215,050	20,922	5.08%
1991	158,820	3,636,495	22,897	4.61%
1993	166,443	3,943,079	23,690	1.72%
1995	175,584	4,580,041	26,085	4.93%
1997	180,637	4,940,816	27,352	2.40%
1999	189,592	5,473,772	28,871	2.74%
2001	195,946	5,997,047	30,606	2.96%

SCHEDULE OF RETIRED MEMBER VALUATION DATA

Valuation Year	Number	Annual Allowances In Thousands	Average Annual Allowances	Average Annual Percentage Increase In Average Annual Allowances
1983	39,952	\$ 153,817	\$ 3,850	5.00%
1985	46,171	195,435	4,233	4.86%
1987	49,386	234,163	4,741	5.83%
1989	51,836	264,479	5,102	3.74%
1991	55,146	315,248	5,717	5.86%
1993	58,268	367,844	6,313	5.08%
1995	61,992	449,310	7,248	7.15%
1997	66,908	535,485	8,003	5.08%
1999	71,812	663,140	9,234	7.42%
2001	77,831	795,676	10,223	5.22%

SCHEDULE OF RETIRED MEMBER ACTIVITY

Expressed in Thousands

2-year period June 30	Added to Rolls		Removed from Rolls		Rolls - End of Year		% Increase in Annual Allowances	Average Annual Allowances
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances		
1995	7,505	\$100,453	3,781	\$18,988	61,992	\$449,310	22.15%	\$7,248
1997	9,118	115,447	4,202	29,272	66,908	535,485	19.18%	8,003
1999	10,001	162,709	5,097	35,054	71,812	663,140	23.84%	9,234
2001	10,526	163,723	4,507	31,187	77,831	795,676	19.99%	10,223

Note: Timing differences exist between the data utilized for statistical information and that used for actuarial valuation purposes. Data is not available to present the required six year history on this schedule. Additional years will be added in future reports.

ACTUAL VS. RECOMMENDED CONTRIBUTION RATES

The Board adopted the contribution rates as recommended by the actuary.

ACTUARIAL BALANCE SHEET

ACTUARIAL BALANCE SHEET
as of July 1, 2001

ASSETS	Political Subdivision Pension Plan (PSPP)	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Total
Present assets creditable to			
Employer accumulation fund	\$ 2,595,966,677	\$ 18,122,409,253	\$ 20,718,375,930
Members' accumulation fund	592,023,782	2,638,579,836	3,230,603,618
Total present assets	<u>3,187,990,459</u>	<u>20,760,989,089</u>	<u>23,948,979,548</u>
Present value of prospective contributions payable to Employer accumulation fund			
Normal	562,004,620	1,858,475,622	2,420,480,242
Accrued liability	<u>340,147,400</u>	<u>81,226,933</u>	<u>421,374,333</u>
Total employer accumulation	<u>902,152,020</u>	<u>1,939,702,555</u>	<u>2,841,854,575</u>
Members' accumulation fund	<u>322,137,337</u>	<u>1,219,837,846</u>	<u>1,541,975,183</u>
Total prospective contributions	1,224,289,357	3,159,540,401	4,383,829,758
TOTAL ASSETS	<u>\$ 4,412,279,816</u>	<u>\$ 23,920,529,490</u>	<u>\$ 28,332,809,306</u>
LIABILITIES			
Present value of prospective benefits payable on account of Present retired members and beneficiaries	1,104,213,183	7,837,600,100	8,941,813,283
Present active members	3,223,007,501	15,723,108,792	18,946,116,293
Former members	<u>85,059,132</u>	<u>359,820,598</u>	<u>444,879,730</u>
TOTAL LIABILITIES	<u>\$ 4,412,279,816</u>	<u>\$ 23,920,529,490</u>	<u>\$ 28,332,809,306</u>

UNAUDITED

SHORT-TERM SOLVENCY TEST

<p>SHORT-TERMSOLVENCYTEST</p> <p>The financing objective of the Tennessee Consolidated Retirement System is to pay for the benefits provided by the plan through contributions that remain approximately level from year to year as a percentage of payroll, except that the strategy to fund the unfunded accrued liability is to make level-dollar payments over an established amortization period. A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired</p>	<p>lives; and (3) the liabilities for service already rendered by active members. In a system that has been following the approach of level percent of payroll financing for some time, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) should be fully covered by present assets. In addition, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. Generally, if the system has been using level cost financing, the funded portion of liability 3 will increase over time.</p>
---	---

Solvency Test

Dollar Amounts Expressed in Millions

Actuarial Valuation Year	Actuarial Accrued Liabilities for:			Valuation Assets	Portion of Actuarial Accrued Liabilities Covered by Assets		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed)		(1)	(2)	(3)
1991 SETHEEPP	\$ 1,452.0	\$ 2,784.0	\$ 5,728.8	\$ 8,307.7	100%	100%	71%
PSPP	260.2	329.8	511.6	1,101.7	100%	100%	100%
Total	\$ 1,712.2	\$ 3,113.8	\$ 6,240.4	\$ 9,409.4	100%	100%	73%
1993 SETHEEPP (1)	\$ 1,720.4	\$ 3,384.2	\$ 5,800.6	\$ 10,404.3	100%	100%	91%
PSPP (1)	321.6	426.1	696.1	1,400.9	100%	100%	94%
Total	\$ 2,042.0	\$ 3,810.3	\$ 6,496.7	\$ 11,805.2	100%	100%	92%
1995 SETHEEPP	\$ 1,995.7	\$ 3,958.4	\$ 6,731.6	\$ 12,319.2	100%	100%	95%
PSPP	384.8	534.2	830.1	1,707.8	100%	100%	95%
Total	\$ 2,380.5	\$ 4,492.6	\$ 7,561.7	\$ 14,027.0	100%	100%	95%
1997 SETHEEPP (2)	\$ 2,141.7	\$ 5,456.1	\$ 8,185.1	\$ 15,671.7	100%	100%	99%
PSPP (2)	426.4	743.6	1,117.9	2,226.9	100%	100%	95%
Total	\$ 2,568.1	\$ 6,199.7	\$ 9,303.0	\$ 17,898.6	100%	100%	98%
1999 SETHEEPP	\$ 2,396.6	\$ 6,401.8	\$ 9,621.8	\$ 18,327.1	100%	100%	99%
PSPP	501.4	877.1	1,512.4	2,690.8	100%	100%	87%
Total	\$ 2,898.0	\$ 7,278.9	\$ 11,134.2	\$ 21,017.9	100%	100%	97%
2001 SETHEEPP	\$ 2,638.6	\$ 7,837.6	\$ 10,366.1	\$ 20,761.0	100%	100%	99%
PSPP	592.0	1,104.2	1,831.9	3,188.0	100%	100%	81%
Total	\$ 3,230.6	\$ 8,941.8	\$ 12,198.0	\$ 23,949.0	100%	100%	97%

(1) Includes effect of five percent benefit improvement which became effective January 1, 1994.

(2) Includes effect of compound COLA and 3.6% indexing improvements.

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

<p>SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES</p> <p>The unfunded accrued liability represents the excess of the accrued actuarial liability over the actuarial value of assets. For funding purposes, the Board of Trustees of TCRS has adopted the frozen initial liability method.</p> <p>Under this method, the unfunded accrued liability is being funded by level-dollar contributions during an amortization period which ends in the year 2015. Also, actuarial gains and losses are absorbed in normal cost rather than as part of the unfunded liability. The statute governing TCRS allows the Board of Trustees to reestablish the unfunded accrued liability for actuarial gains and losses.</p> <p>For the July 1, 2001 actuarial valuation, the Board reestablished the unfunded accrued liability. In an inflationary</p>	<p>economy where the covered payroll continues to grow, the level-dollar amounts which are being contributed to fund the unfunded accrued liability will, if expressed as a percentage of payroll, continue to decrease.</p> <p>While concern is generally expressed regarding the dollar amount of the unfunded accrued liability, an analysis should also include the method being used to fund this liability as well as a review of this liability expressed as a percentage of active member payroll. The smaller the ratio of unfunded liabilities to the active member payroll, the stronger the system. A review of this ratio over a period of years will give an indication of whether the system is becoming financially stronger or weaker with respect to its unfunded liabilities.</p>
---	--

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

Dollar Amounts Expressed in Millions

Actuarial Valuation Year	Actuarial Accrued Liabilities (AAL)	Valuation Assets	Ratio Assets to AAL	Unfunded Actuarial Accrued Liabilities (UAAL)	Active Member Payroll	UAAL as a Percentage of Active Member Payroll
1991	\$ 11,066.4	\$ 9,409.4	85%	\$ 1,657.0	\$ 3,636.5	46%
1993 (3)	12,349.0	11,805.2	96%	543.8	3,943.1	14%
1995	14,434.8	14,027.0	97%	407.8	4,580.0	9%
1997 (4)	18,070.8	17,898.6	99%	172.2 (1) (2)	4,940.8	3%
1999	21,311.1	21,017.9	99%	293.2 (1)	5,473.8	5%
2001	24,370.4	23,949.0	98%	421.4 (1) (2)	5,997.0	7%

- Notes:
- (1) Unfunded accrued liability was reestablished.
 - (2) Includes adjustments for changes in actuarial assumptions.
 - (3) Includes effect of five percent benefit improvement effective January 1, 1994.
 - (4) Includes effect of compound COLA and 3.6% indexing improvement.

SELECTED ACTUARIAL FUNDING INFORMATION

SELECTED ACTUARIAL FUNDING INFORMATION

Actuarial Valuation Year	Earnings Assumption	Salary Assumption	Unfunded Liability		State Amortization Period (3)
			SETHEPP	PSPP	
1991	8.0%	7.00%	\$ 1,657,057,111	\$ 0	24
1993 (1)	8.0%	7.00%	500,933,773	42,897,901	10/22 (2)
1995	8.0%	7.00%	366,528,134	41,288,942	20
1997 (4)	7.5%	5.50%	111,172,072	61,012,975	18
1999	7.5%	5.50%	93,022,745	200,161,388	16
2001	7.5%	4.75% (5)	81,226,933	340,147,400	14

- Notes:
- (1) Includes effect of five percent benefit improvement which became effective January 1, 1994.
 - (2) \$436.8 million is funded over 10 years and \$107 is funded over 22 years.
 - (3) The amortization period varies among political subdivisions participating in TCRS with the maximum period limited to 30 years.
 - (4) Includes effect of compound COLA and 3.6% indexing improvement.
 - (5) Approximates the effect of a graded salary scale.

ANALYSIS OF FINANCIAL EXPERIENCE

GAIN AND LOSS ANALYSIS, JULY 1, 2001 VALUATION

	State and Higher Education	Teacher
Normal Cost		
Effective Employer Normal Cost Rate Pursuant to 1999 Valuation	6.19%	3.72%
Investment Results and asset valuation method change	(0.54%)	(0.48%)
Salary Increases: If there are smaller pay increases than assumed, the normal cost is reduced; if there are greater increases than assumed, the normal cost is increased.	(0.87%)	(0.71%)
New Entrants: Includes the effect where normal cost for new entrants since the previous evaluation differs from the normal cost of the group.	0.42%	0.61%
Social Security Changes: More rapid increases in the Social Security wage base	(0.02%)	(0.03%)
Cost of Living Escalation: COLA in 2000 was 2.70%, 2001 was 3.00%, 2002 was 1.60%	(0.05%)	(0.05%)
Retiree Mortality (estimated)	0.10%	-
Prior Service Purchases : Employee purchases of prior service credits result in liabilities to the plan that are not fully offset by related employee contributions	0.12%	0.08%
Contribution rate change delay	0.10%	(0.17%)
Changes in Actuarial Assumptions	1.07%	0.31%
Other	0.78%	0.12%
Effective Employer Normal Cost Rate Pursuant to 2001 Valuation	7.30%	3.40%

RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITIES STATE EMPLOYEES, TEACHERS, AND HIGHER EDUCATION EMPLOYEES

Unfunded Actuarial Liabilities at June 30, 2002*	\$	77,750,633
Interest Accrual Fiscal Year 2002-2003		5,163,740
Contributions Made toward Unfunded Actuarial Liabilities (Fiscal Year 2002-2003)		(8,900,763)
Unfunded Actuarial Liabilities at June 30, 2003	\$	74,013,610

*The remaining unfunded actuarial liabilities relates to two small closed plans for certain elected state and county officials. The two major plans for state employees and teachers do not have an unfunded liability.

PLAN SUMMARY

HISTORY AND ADMINISTRATION

The TCRS was established in 1972 by an Act of the Tennessee General Assembly. Seven existing retirement systems were consolidated to provide retirement, disability and death benefits to state employees, public school teachers, higher education employees and the employees of participating local governments. State laws governing the plan may be found in Chapters 34-37, 39 of Title 8, *Tennessee Code Annotated*. Amendments to the plan can only be made by legislation enacted by the General Assembly of the State of Tennessee.

A 17-member Board of Trustees has the responsibility to manage and oversee the operation of the consolidated system. The Board consists of nine ex-officio members from the executive, legislative, and judicial branches of state government and eight representatives of the active TCRS membership. Employee representation consists of three teachers, one from each grand division of the state, two state employees from departments other than those represented by ex-officio members, and three representatives of local governments. Local government representatives are appointed for two-year terms by each of the following organizations: the Tennessee County Services Association, the Tennessee Municipal League and the Tennessee County Officials Association. All employee representatives must be vested members of TCRS.

TCRS is administered by the Treasury Department under the legislative branch of state government. By state law, the State Treasurer serves as chairman of the Board of Trustees and as custodian of the funds of the system. The Director of the retirement system is appointed by the Treasurer and serves as the chief administrative officer of the plan.

The state is responsible for the pension cost of state employees and teachers; costs for the participation of local government employees are paid by political subdivisions. Administrative expenses are paid from employers' account balance. The operating budget is funded by local governments on a per member fee basis and by state government as part of the employer contribution rate.

MEMBERSHIP

Membership in the retirement system is a condition of employment for full-time state employees, K-12 teachers, higher education general employees and the employees of participating local governments. Membership is optional for part-time state employees and the part-time employees of political subdivisions which have authorized such coverage.

Interim teachers and part-time teachers have optional membership. The faculty employees of institutions of higher education may elect participation in either TCRS or an optional retirement program (ORP), a defined contribution plan for higher education faculty.

CONTRIBUTIONS

TCRS membership became noncontributory on July 1, 1981 for most state employees, teachers in state supported institutions of higher education and teachers employed in the Department of Education. At that time, the contributions, up to five percent of compensation payable to these employees, were assumed by the state, but this amount continued to be credited to the individual member's accounts from employer funds. State employees hired after July 1, 1981 join TCRS as noncontributory members with no funds credited to their individual accounts.

Participating political subdivisions may either adopt non-contributory retirement provisions or require employee contributions. The contribution rate for local government employees is five percent up to the social security wage base and 5.5 percent above that base, unless the employing government has authorized a level five percent rate. Public school teachers contribute at a rate of five percent of gross salary.

Individual accounts are maintained for all contributory members with interest credited annually at a rate of five percent. Since the TCRS is a defined benefit plan, benefits are based upon the member's average final compensation and years of creditable service. The member's account balance including interest accrued has no bearing on the monthly benefit amount payable at retirement. Account balances plus interest are fully refundable upon termination of service or death.

(continued)

**PLAN SUMMARY
(CONTINUED)**

Contributory members are now covered by Section 414(h) of the Internal Revenue Code. Under this provision, retirement contributions are made on a tax-deferred basis, with income tax due only when contributions are returned to members as benefits or refunds. Political subdivisions may adopt the 414(h) provision for their employees.

The state also makes contributions on behalf of higher education faculty members who select membership in the ORP. These contributions are equal to 10 percent of salary up to social security wage base and 11 percent of any excess salary.

BENEFITS

TCRS provides three valuable benefits to its members: disability, death and service retirement. Disability benefits are available to qualified TCRS members who become totally disabled before meeting the requirements for service retirement. Two types of disability retirement are available: ordinary and accidental.

To qualify for ordinary disability, a member must have a minimum of five years of TCRS service credit. The ordinary disability benefit is equal to 90 percent of what the member would receive under service retirement. If a disabled retiree has less than 20 years of service credit, the service is projected to age 60 or 20 years, whichever comes first. When service is projected, the actual and projected service combined cannot exceed 20 years. If the member's actual service credit exceeds 20 years, the benefit is based on actual service only.

There is no minimum service requirement to qualify for an accidental disability benefit. However, the disability must be the result of a job-related accident that occurs without negligence on the part of the member, during the performance of duty. Prior to the onset of social security benefits, an accidental disability benefit is equal to 50 percent of the member's average final compensation (AFC). Once social security benefits begin, the accidental benefit is 33.3 percent of AFC. For members joining TCRS on or after July 1, 1997, accidental disability benefits are determined in the same manner as ordinary disability using the projection of service method. Disability benefits are increased by five percent for state employees, teachers and employees of participating political subdivisions which have authorized the five percent benefit improvement. The accidental benefit is adjusted if the

member's combined benefits from social security and/or workers' compensation exceed 75 percent of his AFC.

One of several death benefits may be payable to the designated beneficiary of an active member who dies prior to retirement. The type of death benefit payable will be determined by whether or not death occurred while in service, who is named as beneficiary, and the member's length of service.

A member may designate one or more persons, his estate, an institution, or any combination of such as his beneficiary. However, estates, institutions, and/or multiple beneficiaries are only eligible for a lump-sum refund of the member's accumulated contributions and interest unless one of the beneficiaries named is the surviving spouse. Other death benefits offered by TCRS include a 100 percent Joint and Surviving Spouse Annuity after 10 Years Service, a 100 percent Joint and Survivor Annuity for Any Beneficiary and a Line of Duty Benefit. Any beneficiary of a member who had 10 years of service and who is eligible for a lump-sum death benefit may elect a benefit to be paid over 10 years.

All members, with the exception of state judges, joining TCRS after 1976 enter the same membership group. The benefit formula for this group provides 1.5 percent of AFC computed over five years for each year of service credit. If a member's AFC exceeds the social security integration level (SSIL) applicable at retirement, the formula provides an additional 0.25 percent of the amount of the excess for each service year. These benefits are increased by five percent for state employees, teachers, and employees of participating political subdivisions which have authorized the five percent benefit improvement. State judges joining TCRS after September 1, 1990 become Group IV members.

Members become eligible for regular service retirement at age 60 and vested or at any age with 30 years. Vested members are eligible for reduced early retirement benefits when they have reached age 55 or have completed 25 years of service. Members joining TCRS after June 30, 1979 attain vesting rights after five years of service; the vesting period for members who joined prior to July 1, 1979 is four years. Five-year vesting and 25-year retirement are benefits that are optional to local governments. Otherwise, vesting for local governments is 10 years of service.

SERVICES FOR ACTIVE AND RETIRED MEMBERS

SERVICES FOR ACTIVE MEMBERS

TCRS provides a number of services for active members through its various sections.

Field Services

- ❖ TCRS staff is available to conduct employee presentations on all aspects of the retirement system.
- ❖ Employer seminars are conducted annually to educate retirement officers on legislation affecting TCRS.

Membership

- ❖ Comprehensive membership statements are provided to all members annually.
- ❖ Computer generated membership letters and membership pamphlets are mailed to all new members.
- ❖ Membership booklets are provided to all members periodically.
- ❖ The members' newsletter, *TCRS Report*, is sent to members semiannually.

Prior Service

- ❖ An automated calculation and eligibility system generates billings for members who wish to establish prior service.
- ❖ An installment program is available to purchase certain types of prior service.
- ❖ Prior Service may be purchased with a rollover from a tax-deferred 401(k) plan, 403(b) plan, 457 plan or an IRA.
- ❖ TCRS staff is available for personal counseling on an individual basis at their Nashville office.

Benefits

- ❖ Interactive benefit calculator via Internet.
- ❖ Computer generated benefit estimates are available for those members approaching retirement age.
- ❖ Annual regional employee benefit counseling workshops are available to educate potential retirees.
- ❖ TCRS staff is available for personal counseling on an individual basis at their Nashville office.
- ❖ Preretirement planning seminars, which explain all facets of post-career retirement planning, are provided for members.

SERVICES FOR RETIRED MEMBERS

A number of services are made available to TCRS retirees.

- ❖ A toll-free telephone line.
- ❖ Retiree identification cards.
- ❖ Semiannual retiree newsletter: *The Retiree Advisor*.
- ❖ Direct deposit service.
- ❖ Continuation of medical insurance.
- ❖ Medicare supplement coverage.
- ❖ Income tax information.
- ❖ Certification of monthly benefits.
- ❖ Certification of student discounts.
- ❖ Credit Union deductions.
- ❖ Tennessee State Employee Association deductions.
- ❖ Tennessee Retired Teachers Association deductions.

SAMPLE BENEFIT CALCULATIONS

**TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS
for Calendar Year 2003**

Five-Year AFC*	Projected Annual Retirement Income	15 Years Service	% of AFC	20 Years Service	% of AFC	25 Years Service	% of AFC	30 Years Service	% of AFC	35 Years Service	% of AFC
\$15,000	TCRS Social Security Total	\$ 3,544 8,712 \$ 12,256	 81.7%	\$ 4,725 8,712 \$ 13,437	 89.6%	\$ 5,906 8,712 \$ 14,618	 97.5%	\$ 7,088 8,712 \$ 15,800	 105.3%	\$ 8,269 8,712 \$ 16,981	 113.2%
\$20,000	TCRS Social Security Total	\$ 4,725 10,296 \$ 15,021	 75.1%	\$ 6,300 10,296 \$ 16,596	 83.0%	\$ 7,875 10,296 \$ 18,171	 90.9%	\$ 9,450 10,296 \$ 19,746	 98.7%	\$ 11,025 10,296 \$ 21,321	 106.6%
\$25,000	TCRS Social Security Total	\$ 5,906 11,892 \$ 17,798	 71.2%	\$ 7,875 11,892 \$ 19,767	 79.1%	\$ 9,844 11,892 \$ 21,736	 86.9%	\$ 11,813 11,892 \$ 23,705	 94.8%	\$ 13,781 11,892 \$ 25,673	 102.7%
\$30,000	TCRS Social Security Total	\$ 7,088 13,476 \$ 20,564	 68.5%	\$ 9,450 13,476 \$ 22,926	 76.4%	\$ 11,813 13,476 \$ 25,289	 84.3%	\$ 14,175 13,476 \$ 27,651	 92.2%	\$ 16,538 13,476 \$ 30,014	 100.0%
\$35,000	TCRS Social Security Total	\$ 8,269 15,072 \$ 23,341	 66.7%	\$ 11,025 15,072 \$ 26,097	 74.6%	\$ 13,781 15,072 \$ 28,853	 82.4%	\$ 16,538 15,072 \$ 31,610	 90.3%	\$ 19,294 15,072 \$ 34,366	 98.2%
\$40,000	TCRS Social Security Total	\$ 9,466 16,656 \$ 26,122	 65.3%	\$ 12,621 16,656 \$ 29,277	 73.2%	\$ 15,776 16,656 \$ 32,432	 81.1%	\$ 18,932 16,656 \$ 35,588	 89.0%	\$ 22,087 16,656 \$ 38,743	 96.9%
\$45,000	TCRS Social Security Total	\$ 10,844 17,568 \$ 28,412	 63.1%	\$ 14,459 17,568 \$ 32,027	 71.2%	\$ 18,073 17,568 \$ 35,641	 79.2%	\$ 21,688 17,568 \$ 39,256	 87.2%	\$ 25,302 17,568 \$ 42,870	 95.3%
\$50,000	TCRS Social Security Total	\$ 12,222 18,192 \$ 30,414	 60.8%	\$ 16,296 18,192 \$ 34,488	 69.0%	\$ 20,370 18,192 \$ 38,562	 77.1%	\$ 24,444 18,192 \$ 42,636	 85.3%	\$ 28,518 18,192 \$ 46,710	 93.4%
\$55,000	TCRS Social Security Total	\$ 13,600 18,756 \$ 32,356	 58.8%	\$ 18,134 18,756 \$ 36,890	 67.1%	\$ 22,667 18,756 \$ 41,423	 75.3%	\$ 27,200 18,756 \$ 45,956	 83.6%	\$ 31,734 18,756 \$ 50,490	 91.8%
\$60,000	TCRS Social Security Total	\$ 14,978 19,272 \$ 34,250	 57.1%	\$ 19,971 19,272 \$ 39,243	 65.4%	\$ 24,964 19,272 \$ 44,236	 73.7%	\$ 29,957 19,272 \$ 49,229	 82.0%	\$ 34,949 19,272 \$ 54,221	 90.4%

* Average Final Compensation (AFC) is the average of the member's five highest consecutive years of salary.

This chart is based on a date of retirement in 2003. Social security benefits have been calculated by Bryan, Pendleton, Swats & McAllister, actuarial consultants for the TCRS, utilizing the following assumptions:

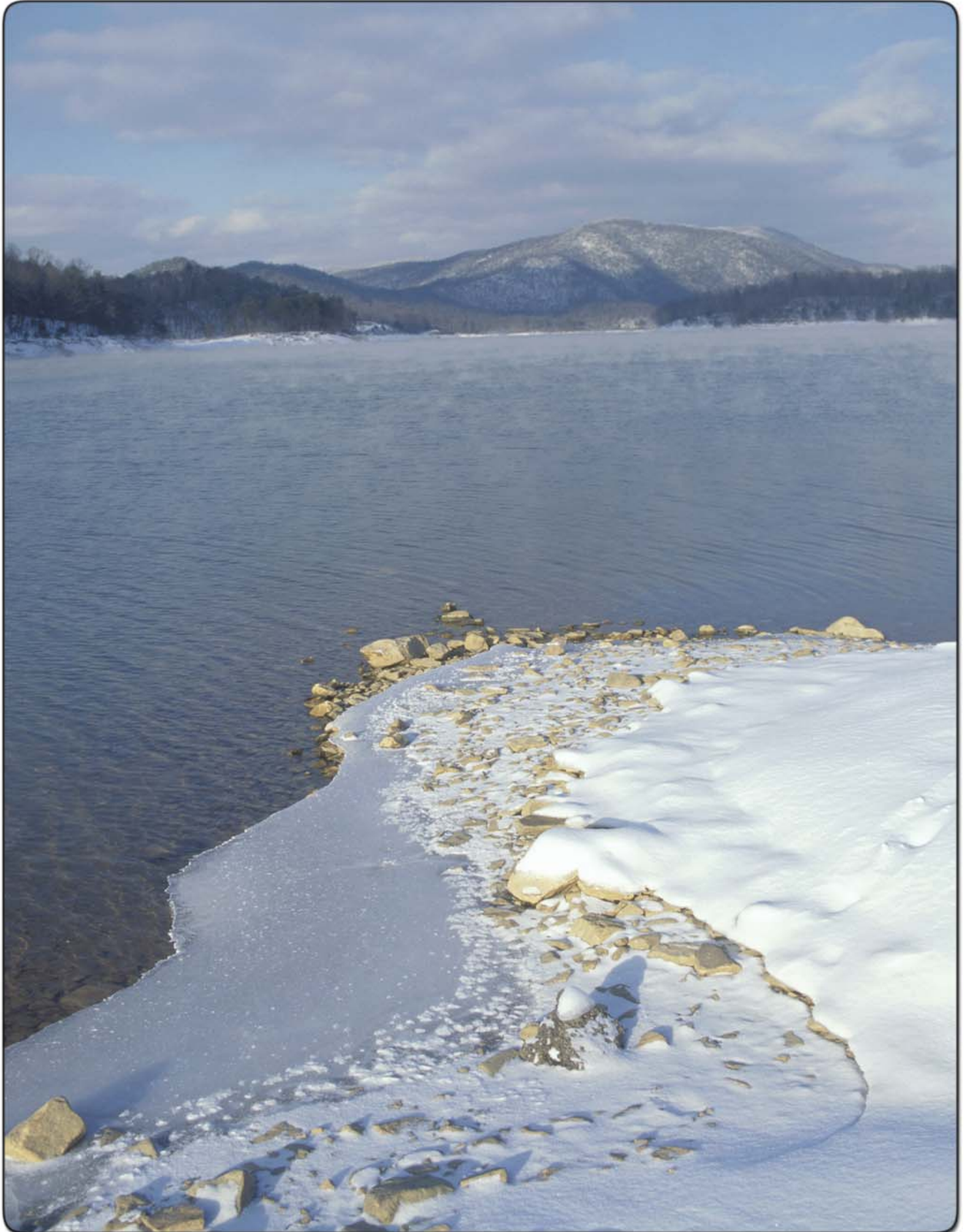
- (1) Retirement is taking place at age 65 in 2003;
- (2) The retiree has worked a full career (TCRS plus other employers, if necessary) of 35 years or more; and
- (3) Salary increases throughout the retiree's career have followed the same pattern as National Average Earnings.

The department's Internet benefits calculator allows members to receive an immediate estimate: www.treasury.state.tn.us/tcrs/

MAJOR LEGISLATIVE IMPROVEMENTS

<p>1972 Benefit formula improved from 1.12% of salary up to the SSIL to 1.5% of salary up to the SSIL.</p> <p>1973 Annual cost-of-living increase based on the CPI with a cap of 1.5% adopted for retirees.</p> <p>1974 Disability retirement eligibility requirement reduced from 10 years to 5 years of service.</p> <p>Minimum benefit increased from \$5.34 to \$7 per month per year of service.</p> <p>Maximum annual cost-of-living increase raised to 3%.</p> <p>Provision to increase retirees' benefits whenever the benefit formula is improved.</p> <p>Service credit authorized for unused accumulated sick leave.</p> <p>1976 Service retirement eligibility requirements reduced from age 65 or 35 years of service to age 60 or 30 years of service.</p> <p>Early retirement eligibility requirements reduced from age 60 or 30 years of service to age 55.</p> <p>1978 A bonus cost-of-living increase granted to retirees at a lump-sum cost of \$15.3 million.</p> <p>An optional retirement plan established for teachers in the Board of Regents system.</p> <p>1980 Death benefits for members dying in-service with 10 years of service improved by offering a 100% joint and survivor annuity of the member's accrued benefit for the spouse.</p> <p>1981 Noncontributory retirement for state employees and higher education employees adopted. Employees' contributions, up to 5%, were assumed by the state.</p> <p>1983 An actuarially reduced retirement benefit at any age with 25 years of service authorized.</p> <p>1984 Credit for out-of-state service for the purpose of determining retirement eligibility authorized.</p> <p>Retirement credit for armed conflict approved.</p> <p>Minimum benefit increased from \$7 to \$8 per month per year of service.</p> <p>Part-time employees permitted to participate in TCRS and members allowed to establish credit for previous part-time employment.</p>	<p>1985 \$22 million ad-hoc increase granted to retirees.</p> <p>Death benefits for spouse and children were provided when member's death is in the line of duty.</p> <p>1987 Service credit for half of peacetime military service made available.</p> <p>\$17 million ad-hoc increase granted to retirees.</p> <p>Retirement incentive for state employees.</p> <p>Section 414(h) of the IRC adopted, allowing employee contributions to be made on a tax-deferred basis.</p> <p>1990 Retirement incentive for state employees.</p> <p>1991 3.6% indexing of salaries for noncontributory employees extended one year. Each succeeding year up to 1997, the 3.6% indexing was extended. In 1997, it was extended indefinitely.</p> <p>1992 Minimum number of years required to qualify for retirement was reduced from 10 to 5 years.</p> <p>1993 Salary portability for service in different classifications authorized effective January 1, 1994.</p> <p>Benefit improvement up to 5% authorized.</p> <p>1994 Retirees permitted to work 100 days per year for a covered employer without loss of benefits.</p> <p>1997 Compounded COLA for retirees approved.</p> <p>Beginning date for armed conflict military service credit during the Vietnam Era was changed from August 4, 1964 to February 28, 1961.</p> <p>1998 Group 2 and 3 service requirements amended to permit service retirement with 30 years of service, regardless of age.</p> <p>Group 1 and Prior Class C benefit limitations increased to 80%.</p> <p>Mandatory retirement established with supplemental bridge benefit for all state public safety officers.</p> <p>1999 Group 1 benefit maximum increased to 90%.</p> <p>2000 Group 2 benefit maximum increased to 80%.</p> <p>2001 Line of Duty Death Benefits improved to guarantee a minimum \$50,000 death benefit.</p>
---	---

Statistical Section



Watauga Lake

SCHEDULES OF ACTIVE MEMBERS

SCHEDULE OF ACTIVE MEMBERS

by Service Credit

Years of Service	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
0 - 4	14,682	17,570	5,505	29,466	67,223
5 - 9	7,371	13,645	2,886	17,528	41,430
10 - 14	5,304	8,965	2,426	9,978	26,673
15 - 19	6,239	7,706	2,156	6,686	22,787
20 - 24	3,933	6,051	1,818	3,948	15,750
25 - 29	3,699	7,232	1,537	2,420	14,888
30 - 34	1,785	3,951	847	969	7,552
35 - 39	594	963	275	258	2,090
40 - 44	156	140	44	46	386
Over 44	57	42	18	21	138
Total	43,820	66,265	17,512	71,320	198,917

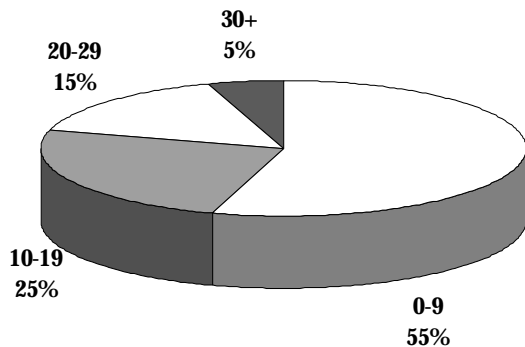
SCHEDULE OF ACTIVE MEMBERS

by Enrollment Date

Date of Membership	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1940s	3	9	4	0	16
1950s	73	63	14	12	162
1960s	1,012	2,289	332	159	3,792
1970s	6,238	12,663	2,975	3,961	25,837
1980s	11,933	13,904	4,611	12,253	42,701
1990s	14,151	25,250	5,790	32,906	78,097
2000s	10,410	12,087	3,786	22,029	48,312
Total	43,820	66,265	17,512	71,320	198,917

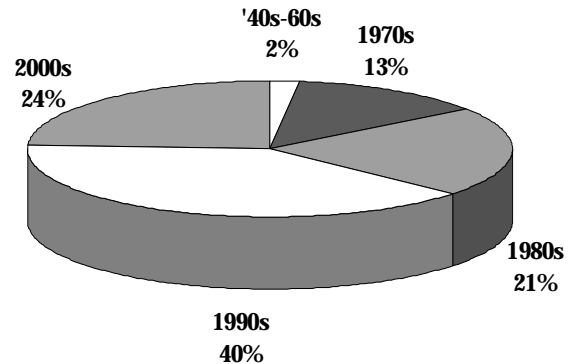
PERCENTAGE OF ACTIVE MEMBERS

by Service Credit



PERCENTAGE OF ACTIVE MEMBERS

by Enrollment Date



SCHEDULES OF ACTIVE MEMBERS

SCHEDULE OF ACTIVE MEMBERS

by Current Age

Current Age	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than 20	65	1	6	55	127
20-29	4,855	8,605	1,391	6,582	21,433
30-39	8,180	15,688	2,971	16,095	42,934
40-49	12,944	17,270	5,212	21,886	57,312
50-54	7,417	12,304	2,976	10,158	32,855
55-59	6,043	8,785	2,588	8,326	25,742
60-64	2,864	2,977	1,600	5,142	12,583
65-69	1,022	507	566	1,996	4,091
Over 69	430	128	202	1,080	1,840
Total	43,820	66,265	17,512	71,320	198,917

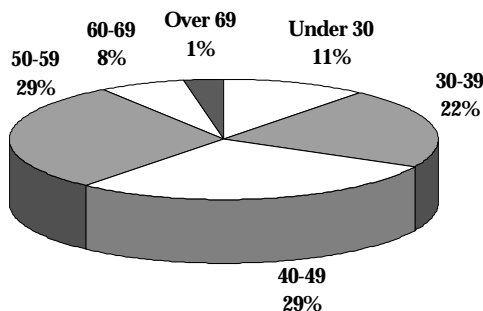
SCHEDULE OF ACTIVE MEMBERS

by Age at Enrollment

Age at Enrollment	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than 20	1,698	115	333	1,091	3,237
20 - 24	9,442	23,765	2,965	8,831	45,003
25 - 29	9,193	15,853	3,431	10,667	39,144
30 - 34	6,658	8,741	3,057	11,696	30,152
35 - 39	5,579	7,085	2,774	12,183	27,621
40 - 44	4,400	5,264	2,114	10,239	22,017
45 - 49	3,258	3,178	1,438	7,137	15,011
50 - 54	2,053	1,568	864	4,829	9,314
55 - 59	1,150	574	369	2,843	4,936
60 - 64	290	94	117	1,146	1,647
65 - 69	77	24	38	480	619
Over 69	22	4	12	178	216
Total	43,820	66,265	17,512	71,320	198,917

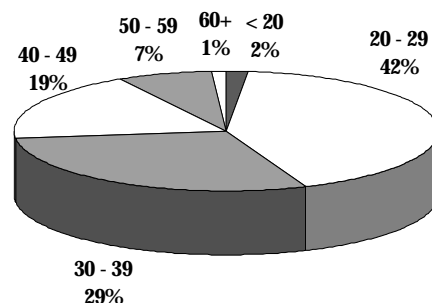
PERCENTAGE OF ACTIVE MEMBERS

by Current Age



PERCENTAGE OF ACTIVE MEMBERS

by Age at Enrollment



SCHEDULES OF ACTIVE MEMBERS

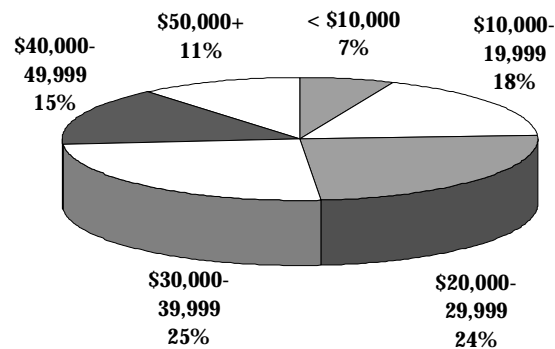
SCHEDULE OF ACTIVE MEMBERS

by Salary

Annual Salary	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than \$10,000	2,054	253	821	9,558	12,686
\$10,000-19,999	7,305	1,028	3,531	23,457	35,321
\$20,000-29,999	15,683	7,036	5,818	20,088	48,625
\$30,000-39,999	9,696	26,355	2,851	10,842	49,744
\$40,000-49,999	4,911	19,615	1,692	4,207	30,425
\$50,000+	4,171	11,978	2,799	3,168	22,116
Total	43,820	66,265	17,512	71,320	198,917

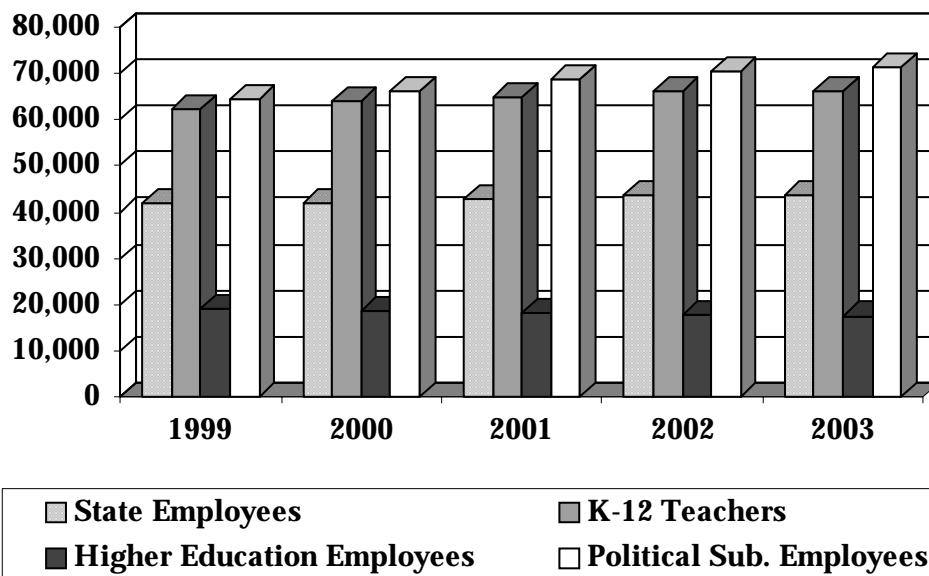
PERCENTAGE OF ACTIVE MEMBERS

by Salary



ACTIVE MEMBERS

Fiscal Years 1999-2003



SCHEDULES OF RETIRED MEMBERS

SCHEDULE OF RETIRED MEMBERS

by Type of Benefit Plan

Benefit Plan*	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Regular	10,895	18,468	5,569	15,211	50,143
Option I	1,528	1,370	1,234	1,693	5,825
Option II	800	712	514	589	2,615
Option III	1,905	2,064	985	1,732	6,686
Option IV	1,500	1,982	818	965	5,265
S.S. Leveling	1,239	2,767	301	981	5,288
Subtotal	17,867	27,363	9,421	21,171	75,822
Survivors	2,481	1,650	1,177	1,991	7,299
Total	20,348	29,013	10,598	23,162	83,121

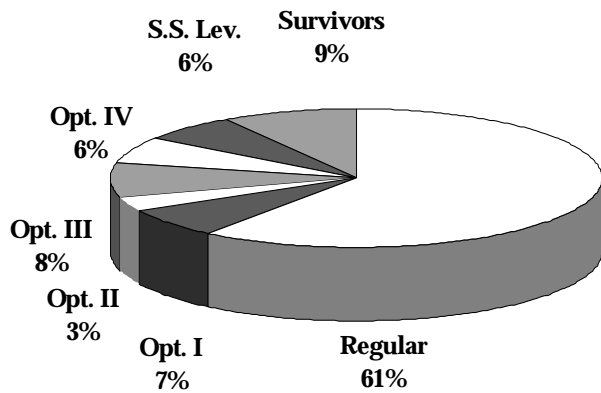
- * Regular Maximum Plan - No Survivor Benefits
- * Option I 100% Joint and Survivor Annuity
- * Option II 50% Joint and Survivor Annuity
- * Option III 100% Joint and Survivor Annuity with Pop-up Feature
- * Option IV 50% Joint and Survivor Annuity with Pop-up Feature
- * S.S. Leveling Benefit Level Coordinated with Social Security

SCHEDULE OF RETIRED MEMBERS

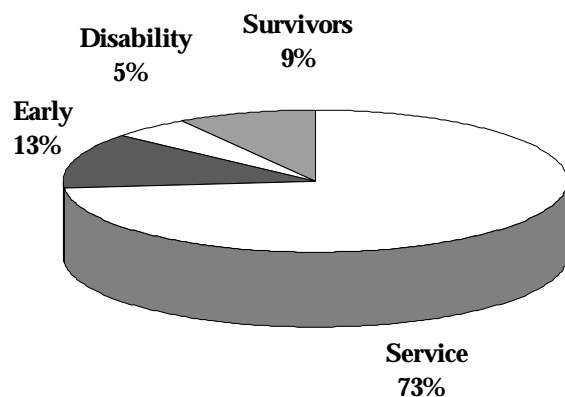
by Type of Retirement

Type of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Retirees:					
Service	14,236	22,826	7,496	16,450	61,008
Early	2,317	3,708	1,417	3,145	10,587
Disability	1,314	829	508	1,576	4,227
Total Retirees	17,867	27,363	9,421	21,171	75,822
Survivors	2,481	1,650	1,177	1,991	7,299
Total	20,348	29,013	10,598	23,162	83,121

**PERCENTAGE OF RETIRED MEMBERS
by Type of Benefit Plan**



**PERCENTAGE OF RETIRED MEMBERS
by Type of Retirement**



SCHEDULES OF RETIRED MEMBERS

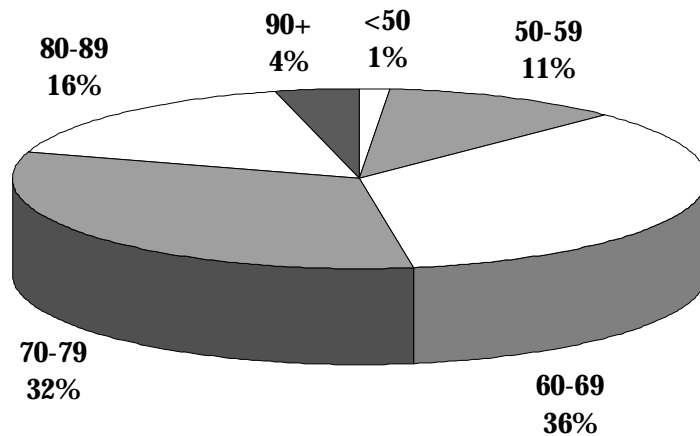
SCHEDULE OF RETIRED MEMBERS

by Current Age

Current Age	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 40	96	71	34	61	262
40-44	116	54	48	73	291
45-49	245	114	83	206	648
50-54	683	748	212	527	2,170
55-59	1,727	3,181	701	1,431	7,040
60-64	3,015	4,656	1,571	3,373	12,615
65-69	3,954	5,091	2,192	5,137	16,374
70-74	3,628	4,670	2,122	4,525	14,945
75-79	3,072	3,665	1,718	3,448	11,903
80-84	2,128	2,687	1,148	2,491	8,454
85-89	1,160	2,147	550	1,331	5,188
90-94	430	1,384	173	479	2,466
95-99	87	480	40	69	676
Over 99	7	65	6	11	89
Total	20,348	29,013	10,598	23,162	83,121

PERCENTAGE OF TOTAL RETIRED MEMBERS

by Current Age



SCHEDULES OF RETIRED MEMBERS

SCHEDULE OF RETIRED MEMBERS

by Date of Retirement

Date of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1950s	2	25	0	3	30
1960s	35	226	11	10	282
1970s	1,451	3,519	519	1,471	6,960
1980s	4,644	7,089	2,398	5,164	19,295
1990s	9,896	11,880	5,404	11,012	38,192
2000s	4,320	6,274	2,266	5,502	18,362
Total	20,348	29,013	10,598	23,162	83,121

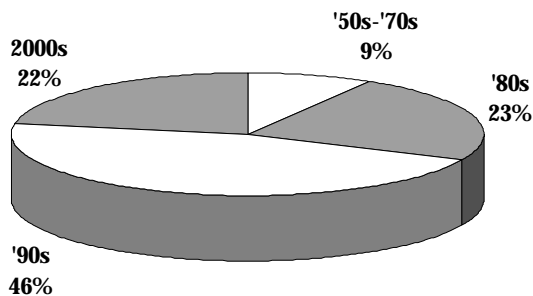
SCHEDULE OF RETIRED MEMBERS

by Service Credit at Retirement

Years of Service	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 10	4,225	2,195	1,990	5,072	13,482
10-14	2,990	1,740	1,640	4,851	11,221
15-19	2,702	2,211	1,546	4,160	10,619
20-24	2,743	3,243	1,419	3,611	11,016
25-29	2,296	4,426	1,247	2,519	10,488
30-34	3,522	9,452	1,704	2,134	16,812
35-39	1,214	3,780	680	577	6,251
40-44	530	1,668	281	198	2,677
Over 44	126	298	91	40	555
Total	20,348	29,013	10,598	23,162	83,121

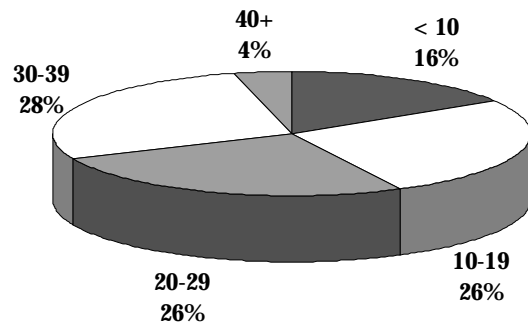
PERCENTAGE OF RETIRED MEMBERS

by Date of Retirement



PERCENTAGE OF RETIRED MEMBERS

by Service Credit at Retirement



RETIRED MEMBERS BY GEOGRAPHICAL DISTRIBUTION

UNITED STATES

Alabama	376	Kentucky	353
Alaska	12	Louisiana	51
Arizona	97	Maine	11
Arkansas	243	Maryland	51
California	126	Massachusetts	12
Colorado	53	Michigan	69
Connecticut	8	Minnesota	15
Delaware	10	Mississippi	701
Dist. of Columbia	6	Missouri	88
Florida	897	Montana	3
Georgia	620	Nebraska	4
Hawaii	16	Nevada	30
Idaho	16	New Hampshire	9
Illinois	86	New Jersey	12
Indiana	77	New Mexico	25
Iowa	10	New York	39
Kansas	23	North Carolina	315

INTERNATIONAL COUNTRIES

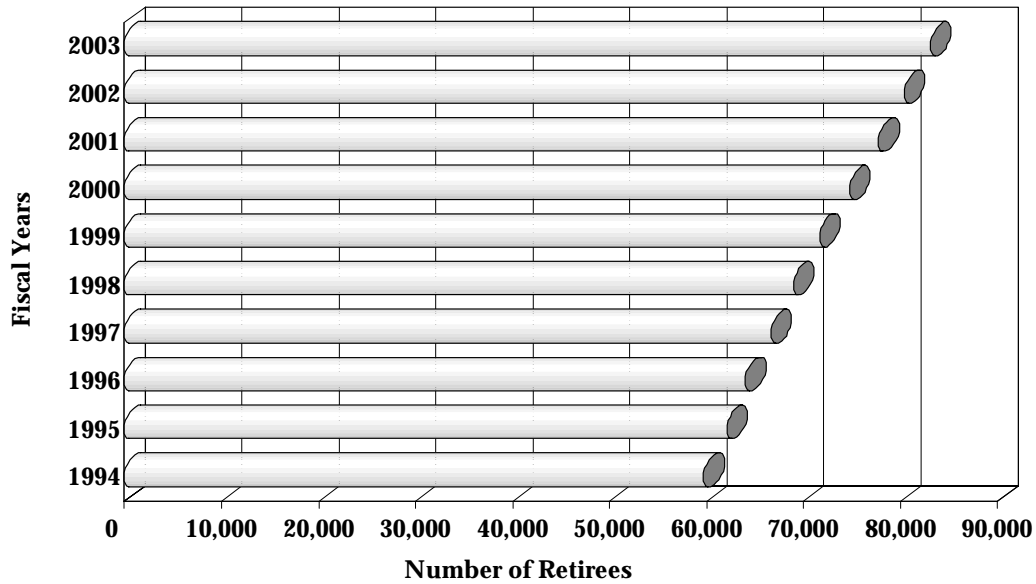
North Dakota	3	Australia	2
Ohio	101	Canada	5
Oklahoma	41	England	2
Oregon	25	France	1
Pennsylvania	45	Germany	2
Rhode Island	2	Greece	2
South Carolina	135	Ireland	1
South Dakota	6	Israel	1
Tennessee	77,546	Japan	1
Texas	268	Kenya	1
Utah	9	Kuwait	1
Vermont	7	Mexico	2
Virginia	356	Total Foreign Countries	21
Washington	44	Overseas Military Bases	7
West Virginia	19	Total U.S.	83,093
Wisconsin	20	Total	83,121
Wyoming	2		
Total U.S.	83,093		

TENNESSEE

Anderson	1,218	Fentress	254	Lauderdale	544	Roane	1,029
Bedford	501	Franklin	590	Lawrence	561	Robertson	717
Benton	251	Gibson	859	Lewis	210	Rutherford	2,160
Bledsoe	286	Giles	388	Lincoln	444	Scott	354
Blount	1,892	Grainger	208	Loudon	554	Sequatchie	198
Bradley	1,010	Greene	1,448	McMinn	649	Sevier	686
Campbell	614	Grundy	233	McNairy	392	Shelby	8,893
Cannon	225	Hamblen	870	Macon	173	Smith	292
Carroll	505	Hamilton	3,827	Madison	1,718	Stewart	142
Carter	1,127	Hancock	64	Marion	362	Sullivan	2,473
Cheatham	487	Hardeman	714	Marshall	378	Sumner	1,488
Chester	320	Hardin	415	Mauzy	639	Tipton	503
Claiborne	482	Hawkins	691	Meigs	114	Trousdale	142
Clay	111	Haywood	433	Monroe	490	Unicoi	314
Cocke	433	Henderson	239	Montgomery	1,591	Union	214
Coffee	643	Henry	614	Moore	75	VanBuren	111
Crockett	255	Hickman	395	Morgan	462	Warren	599
Cumberland	636	Houston	71	Obion	599	Washington	2,041
Davidson	6,658	Humphreys	296	Overton	338	Wayne	238
Decatur	166	Jackson	162	Perry	186	Weakley	814
Dekalb	242	Jefferson	609	Pickett	94	White	478
Dickson	510	Johnson	250	Polk	167	Williamson	1,356
Dyer	372	Knox	5,213	Putnam	1,378	Wilson	1,231
Fayette	601	Lake	196	Rhea	371	Total Tennessee	77,546

**RETIRED MEMBERS ON PAYROLL
AND PRIOR SERVICE ESTABLISHED**

NUMBER OF RETIREES ON PAYROLL
Fiscal Years 1994-2003



PRIOR SERVICE ESTABLISHED
for the Year Ended June 30, 2003

Type of Service	Members	Years of Service	Payments
State:			
Backpayment	173	234	\$ 275,138
Military	151	301	31,512
Redeposit	162	758	1,832,467
Total	486	1,293	\$ 2,139,117
Teachers:			
Backpayment	85	134	\$ 405,823
Military	45	77	0
Redeposit	219	1,061	2,515,868
Total	349	1,272	\$ 2,921,691
Higher Education:			
Backpayment	201	303	\$ 289,108
Military	41	102	38,917
Redeposit	43	181	446,229
Total	285	586	\$ 774,254
Political Subdivisions:			
Backpayment	834	2,243	\$ 761,082
Military	155	346	1,858
Redeposit	80	383	580,632
Total	1,069	2,972	\$ 1,343,572
Totals by Category:			
Backpayment	1,293	2,914	\$ 1,731,151
Military	392	826	72,287
Redeposit	504	2,383	5,375,196
Total	2,189	6,123	\$ 7,178,634

TREASURY RETIREMENT INSTALLMENT PLAN

The Treasury Retirement Installment Plan, known as TRIP, was established in 1996 to be an alternative for members who have prior service to be established. Previously, prior service payments were required to be made in a lump sum payment. TRIP has allowed these members to establish their prior service by making monthly installment payments in the form of Automated Clearing House (ACH) withdrawals from a designated bank account. Prior service may be financed over a period not to exceed five years.

Examples of service types which are eligible to be included on TRIP are previously withdrawn service, peacetime military service, educational leave and enrollment service for new participating employers. When a member is billed for their prior service, a statement is generated showing a lump sum payment. In addition, TRIP information is given with regard to financing over 6 to 60 months. The member may elect to finance the entire amount or elect to make a down payment and finance the balance.

Annual statements are also generated as of the fiscal year ending June 30. Statements reflect the principle and interest payments made and remaining balance. The member may choose at any time to pay off the remaining balance.

TREASURY RETIREMENT INSTALLMENT PLAN Payments Received for the Year Ended June 30, 2003

Type of Service	Members	Years of Service	Payments
State:			
Backpayment	13	35	\$ 25,092
Military	0	0	0
Redeposit	130	792	424,393
Total	143	827	\$ 449,485
Teachers:			
Backpayment	29	85	\$ 52,196
Military	0	0	0
Redeposit	222	1,162	720,687
Total	251	1,247	\$ 772,883
Higher Education:			
Backpayment	25	139	\$ 47,389
Military	0	0	0
Redeposit	30	165	80,136
Total	55	304	\$ 127,525
Political Subdivisions:			
Backpayment	77	430	\$ 138,499
Military	0	0	0
Redeposit	85	483	243,472
Total	162	913	\$ 381,971
Totals by Category:			
Backpayment	144	689	\$ 263,176
Military	0	0	0
Redeposit	467	2,602	1,468,688
Total	611	3,291	\$ 1,731,864

REFUND ACTIVITY AND POLITICAL SUBDIVISION PARTICIPATION

REFUND ACTIVITY

For the Year Ended June 30	Number of Refunds Processed	Amount Refunded
1994	4,449	\$ 17,636,340
1995	4,788	20,914,496
1996	4,663	20,721,711
1997	4,632	23,833,152
1998	4,571	24,649,359
1999	4,874	25,634,380
2000	5,029	28,562,230
2001	4,771	28,517,803
2002	4,259	24,304,536
2003	4,540	26,631,386

The TCRS became noncontributory July 1, 1981 for state employees, higher education employees, and certain political subdivisions, resulting in fewer refunds for members withdrawing from the system.

POLITICAL SUBDIVISION PARTICIPATION

Schedule by Category

Year Ended June 30	Number of Cities	Number of Counties	Miscellaneous Political Subdivisions	Total
1994	118	83	137	338
1995	123	83	140	346
1996	128	84	144	356
1997	134	84	156	374
1998	142	86	160	388
1999	147	87	170	404
2000	151	87	158	396
2001	156	87	161	404
2002	158	87	166	411
2003	160	88	170	418

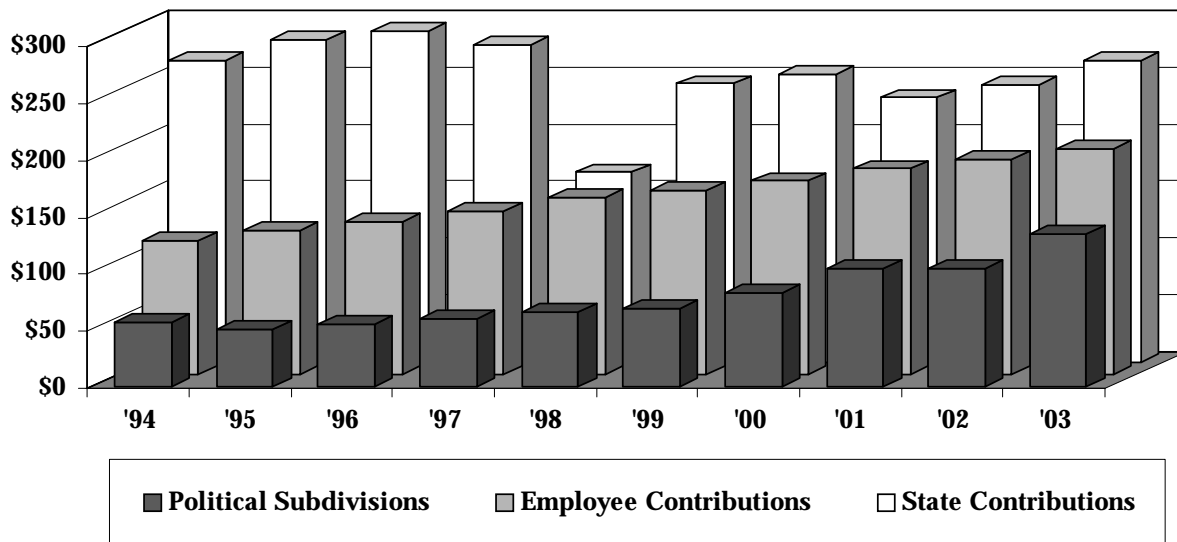
HISTORICAL EMPLOYER CONTRIBUTION RATES

HISTORICAL EMPLOYER CONTRIBUTION RATES *Expressed as a Percentage of Salary*

Year Ended June 30	State Employees	Teachers	Higher Education Employees Faculty	General
1994	6.69%	8.70%	6.69%	6.69%
1995	6.33	8.51	6.33	6.33
1996	6.33	8.51	6.33	6.33
1997	7.36	6.50	7.36	7.36
1998	3.65	3.89	3.65	3.65
1999	5.43	5.47	5.43	5.43
2000	5.43	5.47	5.43	5.43
2001	6.19	3.72	6.19	6.19
2002	6.19	3.72	6.19	6.19
2003	7.30	3.40	7.30	7.30

The employer contribution rates for political subdivisions are individually determined based on the biennial actuarial valuation of each political subdivision.

RETIREMENT CONTRIBUTIONS *Fiscal Years 1994-2003*



HISTORICAL FAIR VALUE

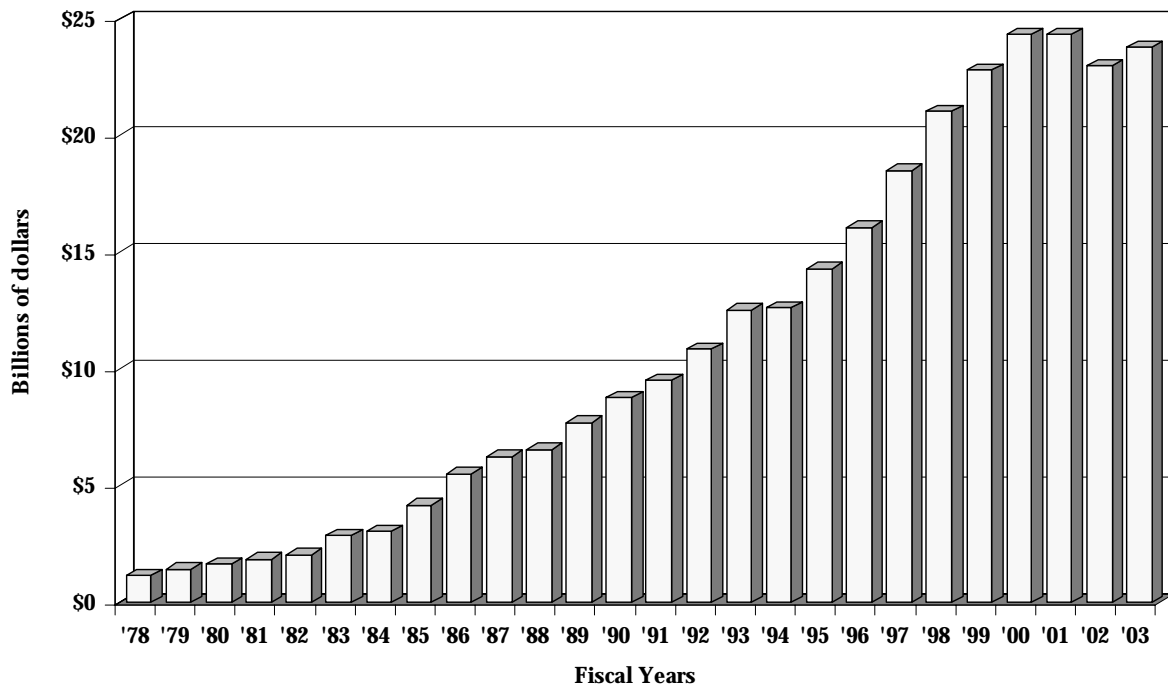
HISTORICAL FAIR VALUE

*Fiscal Years 1978-2003
Expressed in Thousands*

As of June 30	Fair Value	As of June 30	Fair Value
1978	\$ 1,146,321	1991	\$ 9,499,347
1979	1,415,959	1992	10,850,328
1980	1,651,664	1993	12,524,434
1981	1,854,588	1994	12,632,853
1982	2,024,415	1995	14,293,461
1983	2,837,842	1996	16,072,177
1984	3,057,519	1997	18,519,341
1985	4,167,052	1998	21,057,487
1986	5,507,372	1999	22,797,512
1987	6,242,556	2000	24,337,679
1988	6,541,570	2001	23,737,926
1989	7,710,790	2002	22,982,880
1990	8,757,167	2003	23,778,484

HISTORICAL FAIR VALUE

Fiscal Years 1978-2003



**ANALYSIS OF MEMBER AND EMPLOYER RESERVES
FOR THE YEAR ENDED JUNE 30, 2003**

MEMBER RESERVE FUND

The legislation which created the TCRS established two funds, the Member Reserve Fund and the Employer Reserve Fund, to account for the financial transactions of the pension plans. The Member Reserve Fund represents the accumulation of employee contributions plus interest.

	SETHEEPP	PSPP	Total
June 30, 2002 Member Reserve Fund	\$ 2,781,904,504	\$ 643,693,431	\$ 3,425,597,935
Member contributions	148,492,733	49,218,080	197,710,813
Employer provided contributions	25,619,312	11,823,975	37,443,287
Interest	131,306,256	30,464,940	161,771,196
Refunded account balances	(14,250,712)	(12,380,674)	(26,631,386)
Transfers to employer fund of retiring members'	(163,724,674)	(31,650,129)	(195,374,803)
June 30, 2003 Member Reserve Fund	\$ 2,909,347,419	\$ 691,169,623	\$ 3,600,517,042

EMPLOYER RESERVE FUND

The Employer Reserve Fund represents the accumulation of employer contributions, investment income and transfers from the Member Reserve Fund for retirees. Benefit payments and interest credited to members' accounts are reductions to the Employer Reserve Fund.

	SETHEEPP	PSPP	Total
June 30, 2002 Employer Reserve Fund	\$ 17,127,470,671	\$ 2,495,017,729	\$ 19,622,488,400
Adjustment - Accounting Change	(56,326,841)	(8,879,922)	(65,206,763)
June 30, 2002 Employer Reserve Fund, restated	17,071,143,830	2,486,137,807	19,557,281,637
Employer contributions	264,320,617	134,013,829	398,334,446
Investment income	959,110,283	153,368,465	1,112,478,748
Transfers from retiring members' account	163,724,674	31,650,129	195,374,803
Employer provided contributions	(25,619,312)	(11,823,975)	(37,443,287)
Interest credited to members' account	(131,306,256)	(30,464,940)	(161,771,196)
Lump-Sum death benefits	(3,052,424)	(993,851)	(4,046,275)
Retirement and survivors annuities	(761,783,891)	(115,401,845)	(877,185,736)
Administrative expenses	(2,630,596)	(2,425,228)	(5,055,824)
June 30, 2003 Employer Reserve Fund	\$ 17,533,906,925	\$ 2,644,060,391	\$ 20,177,967,316
June 30, 2003 Assets Held in Trust for Pension Benefits	\$ 20,443,254,344	\$ 3,335,230,014	\$ 23,778,484,358

AVERAGE BENEFIT PAYMENTS SCHEDULE

AVERAGE BENEFIT PAYMENTS SCHEDULE

Fiscal Year of Retirement

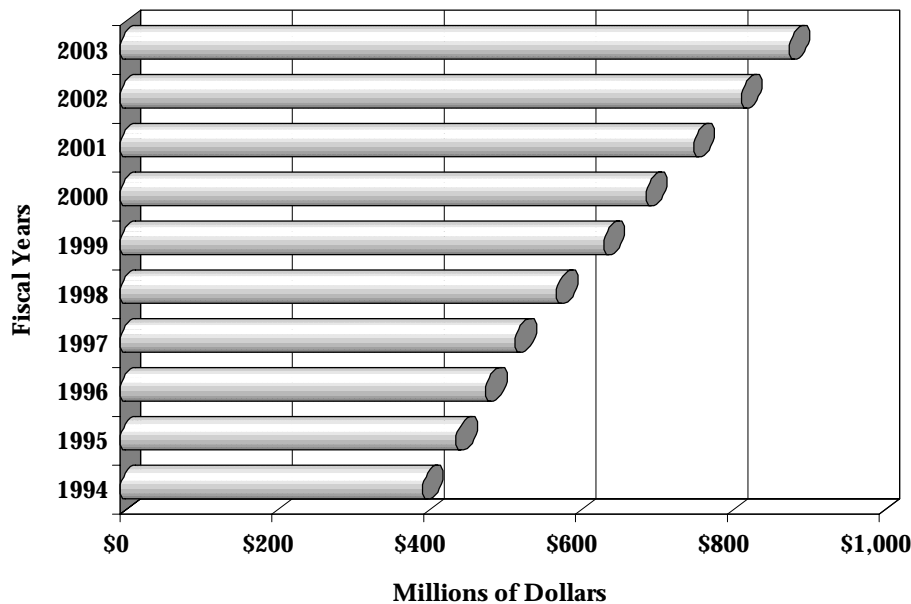
Years of Service Credit

	10 - 14	15 - 19	20 - 24	25 - 29	30 or more
2003 Average Monthly Benefit	\$ 491	\$ 713	\$ 962	\$ 1,383	\$ 2,096
Number of Retirees	363	352	332	371	1,463
Average Final Salary	\$ 29,112	\$ 29,942	\$ 32,140	\$ 37,253	\$ 45,026
2002 Average Monthly Benefit	\$ 442	\$ 693	\$ 976	\$ 1,417	\$ 2,092
Number of Retirees	347	331	346	370	1,537
Average Final Salary	\$ 25,923	\$ 29,913	\$ 31,628	\$ 38,091	\$ 45,015
2001 Average Monthly Benefit	\$ 421	\$ 722	\$ 1,035	\$ 1,420	\$ 2,064
Number of Retirees	375	323	376	391	1,440
Average Final Salary	\$ 25,291	\$ 31,157	\$ 33,609	\$ 37,869	\$ 44,220
2000 Average Monthly Benefit	\$ 397	\$ 703	\$ 970	\$ 1,369	\$ 2,041
Number of Retirees	443	321	367	425	1,312
Average Final Salary	\$ 24,289	\$ 28,880	\$ 31,562	\$ 36,242	\$ 42,795
1999 Average Monthly Benefit	\$ 452	\$ 735	\$ 1,024	\$ 1,399	\$ 2,092
Number of Retirees	422	326	399	384	1,197
Average Final Salary	\$ 26,001	\$ 30,189	\$ 31,930	\$ 35,899	\$ 43,034
1998 Average Monthly Benefit	\$ 386	\$ 673	\$ 918	\$ 1,358	\$ 1,932
Number of Retirees	401	344	430	379	1,153
Average Final Salary	\$ 23,347	\$ 27,627	\$ 30,058	\$ 35,104	\$ 39,957

Note: This schedule represents the average monthly benefits under the maximum plan of members retiring with an unreduced service retirement benefit. It excludes members retiring with a reduced early retirement benefit or under disability.

ANNUAL BENEFIT PAYMENTS

Fiscal Years 1994-2003



SCHEDULES OF BENEFIT EXPENSES**SCHEDULES OF BENEFIT EXPENSES***Expressed in Thousands*

Year Ending	Base Annuity	Disability Annuity	Survivor Annuity	Cost of Living	Lump-Sum Death Benefits	Total Benefits	Refunds	Total
SETHEEPP								
6/30/1998	\$ 378,485	\$ 12,694	\$ 24,127	\$ 88,435	\$ 2,557	\$ 506,298	\$ 14,311	\$ 520,609
6/30/1999	414,149	13,948	25,934	99,823	2,616	556,470	13,491	569,961
6/30/2000	450,919	15,089	28,839	106,542	2,658	604,047	15,474	619,521
6/30/2001	491,204	16,094	31,224	116,892	3,720	659,134	16,484	675,618
6/30/2002	528,471	17,405	33,518	129,918	2,225	711,537	12,689	724,226
6/30/2003	571,703	18,809	36,818	134,455	3,052	764,837	14,250	779,087
PSPP								
6/30/1998	\$ 53,991	\$ 1,811	\$ 3,441	\$ 12,615	\$ 746	\$ 72,604	\$ 10,338	\$ 82,942
6/30/1999	60,182	2,027	3,769	14,506	778	81,262	12,143	93,405
6/30/2000	69,164	2,315	4,423	11,933	852	88,687	13,088	101,775
6/30/2001	75,517	2,474	4,800	13,477	982	97,250	12,034	109,284
6/30/2002	82,084	2,704	5,206	15,417	1,143	106,554	11,616	118,170
6/30/2003	90,372	2,973	5,820	16,236	994	116,395	12,381	128,776

**SCHEDULES OF EXPENSES BY TYPE AND REVENUE BY SOURCE
FOR THE YEAR ENDED JUNE 30, 2003**

SCHEDULES OF EXPENSES BY TYPE

Expressed in Thousands

Year Ending	Benefit Payments	Administrative Expenses	Refunds	Total
SETHEEPP				
6/30/1998	\$ 506,298	\$ 2,191	\$ 14,311	\$ 522,800
6/30/1999	556,470	2,350	13,491	572,311
6/30/2000	604,047	2,363	15,474	621,884
6/30/2001	659,134	1,795	16,484	677,413
6/30/2002	711,537	2,714	12,689	726,940
6/30/2003	764,837	2,631	14,250	781,718

PSPP

6/30/1998	\$ 72,604	\$ 1,694	\$ 10,338	\$ 84,636
6/30/1999	81,262	1,840	12,143	95,245
6/30/2000	88,687	1,990	13,088	103,765
6/30/2001	97,250	1,683	12,034	110,967
6/30/2002	106,554	2,290	11,616	120,460
6/30/2003	116,395	2,425	12,381	131,201

SCHEDULES OF REVENUE BY SOURCE

Expressed in Thousands

Year Ending	Member Contributions	Employer Contributions		Investment Income (Loss)	Total
		Dollars	% of Annual Covered Payroll		
SETHEEPP					
6/30/1998	\$ 116,196	\$ 166,756	4.19%	\$ 2,410,112	\$ 2,693,064
6/30/1999	122,565	244,453	5.88%	1,685,780	2,052,798
6/30/2000	129,925	252,162	5.93%	1,533,113	1,915,200
6/30/2001	135,154	232,149	5.20%	(284,167)	83,136
6/30/2002	142,126	243,498	5.19%	(383,371)	2,253
6/30/2003	148,493	264,320	5.48%	959,110	1,371,923
PSPP					
6/30/1998	\$ 39,086	\$ 65,276	5.28%	\$ 348,156	\$ 452,518
6/30/1999	38,618	69,230	5.15%	246,936	354,784
6/30/2000	39,906	82,749	5.69%	227,961	350,616
6/30/2001	45,433	103,681	6.65%	(43,623)	105,491
6/30/2002	47,139	103,374	6.15%	(60,412)	90,101
6/30/2003	49,218	134,014	7.58%	153,368	336,600

INTRODUCTION TO POLITICAL SUBDIVISION PARTICIPATION

PARTICIPANTS

TCRS has established pension plans for four groups of public employees: state employees, higher education employees, teachers and the employees of governmental entities (political subdivisions). Employees of political subdivisions may participate in TCRS if the entity's governing body authorizes participation and accepts all liability associated with coverage for their employees.

Participation is subject to the approval of the Board of Trustees. As of June 30, 2003, 418 political subdivisions were participating in TCRS.

Participation as of June 30, 2003:

Cities	160
Counties	88
Utility Districts	40
Special School Districts	19
Joint Ventures	23
Development Agencies	12
Housing Authorities	9
911 Emergency Communication Districts	32
Miscellaneous Authorities	35
Total	<u>418</u>

ADMINISTRATION

TCRS administers the pension plan for political subdivisions in accordance with state statute. Each employer is responsible for the pension cost for its employees. The cost is not shared with other political subdivisions nor with the state. A separate fund balance is maintained by the retirement system for each participating political subdivision and employer contribution rates are determined individually.

APPLICATION

To apply for TCRS participation, the chief governing body of the political subdivision must first pass a resolution authorizing an actuarial study to estimate the potential cost of participation. Once the governing body has had an opportunity to review the estimated pension cost and liability, a second resolution must then be passed in order to authorize TCRS participation. Political subdivisions electing TCRS coverage accept the liability for pension benefits to be accrued by their employees.

COVERAGE

A political subdivision is required to offer coverage under the same terms and conditions to all the employees of each of its departments and agencies.

Political subdivisions have the option of purchasing, or allowing their employees to purchase, retirement credit for service rendered prior to the employer's date of participation. The amount of prior service allowed may be limited.

Political subdivisions opting to join TCRS do so under the plan provisions that exist at the time of their participation. Subsequent legislative changes, however, are optional if they result in increased cost to the political subdivision. These optional improvements may be adopted by resolutions approved by the chief governing body.

**THE TCRS PROVIDES
THE ADMINISTRATION
OF A RETIREMENT
PROGRAM FOR 418
LOCAL GOVERNMENTS.**

OPTIONAL PROVISIONS FOR POLITICAL SUBDIVISIONS

<p>MEMBERSHIP</p> <ul style="list-style-type: none"> ❖ Optional membership for part-time employees ❖ Probationary period of up to six months during which the employees are not eligible for membership in TCRS and no contributions to TCRS are required of either the employees or the employer ❖ Reduce vesting requirement to qualify for retirement benefits from 10 years to five years <p>CONTRIBUTIONS</p> <ul style="list-style-type: none"> ❖ Employee contributions at a level five percent both below and above the social security wage base ❖ Exclusion of employee contributions from taxable income under 414(h) provisions of the Internal Revenue Code ❖ Noncontributory retirement plan ❖ Extension of 3.6 percent indexing feature for non-contributory members' salaries used in calculating the average final compensation component of a benefit calculation <p>CREDITABLE SERVICE</p> <ul style="list-style-type: none"> ❖ Credit for service credit lost as a result of advanced age ❖ Service credit for unused sick leave ❖ Service credit for military service during periods of armed conflict at no cost to the employee ❖ Service credit for periods of temporary disability during which the employee was receiving workers' compensation payments based on covered employment ❖ Service credit purchase for peacetime military service between October 15, 1940 and May 7, 1975 ❖ Purchase of service credit for probation period 	<p>SURVIVOR BENEFITS</p> <ul style="list-style-type: none"> ❖ 100 percent joint and survivor spouse death benefit for members with 10 years of service ❖ Provide inactive members with certain death and disability benefits ❖ 50 percent of 5 year average salary benefits for surviving spouse for members killed in the line of duty. <p>RETIREMENT BENEFITS</p> <ul style="list-style-type: none"> ❖ Provide current retirees and members a five percent increase in base retirement benefit ❖ The actuarial equivalent of an age 65 benefit for employees retiring after age 65 ❖ 25-year retirement with actuarially reduced benefits ❖ Minimum benefit level increase to \$8 per year of service ❖ Mandatory retirement with supplemental bridge benefit for public safety officers. <p>RETIRED MEMBERS</p> <ul style="list-style-type: none"> ❖ Exclusion of cost-of-living benefit increases at the date of participation for all employees or at a later date for new employees ❖ Inclusion of compounded cost-of-living adjustment (COLA) to current and future retirees of employers now providing a simple COLA or employers who previously elected not to provide a COLA. <p>MISCELLANEOUS</p> <ul style="list-style-type: none"> ❖ A participating entity may voluntarily withdraw from TCRS by submitting written notice one year in advance. At the time of withdrawal, TCRS membership ceases to be open to new employees. The political subdivision's retirement responsibility to current TCRS members remains, however, contribution obligations and benefit and service credit accruals continue.
--	--

POLITICAL SUBDIVISION PARTICIPANTS

911 EMERGENCY COMMUNICATION DISTRICTS

Campbell County	Fentress Co.	Hardeman Co.	Madison County	Roane County	Tipton County
Carroll County	Gibson County	Hawkins County	Monroe County	Robertson Co.	Warren County
Carter County	Greene County	Johnson Co.	McNairy Co.	Rutherford Co.	Washington Co.
Cheatham Co.	Hamilton County	Lauderdale Co.	Montgomery Co.	Sevier County	Weakley County
Claiborne County	Hamblen County	Lawrence County	Overton County	Shelby County	White County
				Sullivan County	Wilson County

CITIES

Adams	Clinton	Friendsville	Lakewood	Mt. Juliet	Signal Mountain
Alamo	Collegedale	Gainesboro	Lawrenceburg	Munford	Soddy Daisy
Alcoa	Collierville	Gatlinburg	Lebanon	Murfreesboro*	Somerville
Ashland City	Collinwood	Gleason	Lenoir City*	New Johnsonville	South Carthage
Athens*	Cookeville	Goodlettsville	Linden	New Tazewell	Sparta
Atoka	Cornersville	Gordonsville	Livingston	Newport	Spencer
Atwood	Covington*	Greenbrier	Lobelville	Nolensville	Spring Hill
Belle Meade	Cowan	Greeneville	Lookout Mountain	Norris	Spring City
Bells	Crossville	Greenfield	Loretto	Oak Ridge	Springfield
Benton	Dandridge	Harriman	Loudon	Oakland	Sweetwater
Big Sandy	Dayton	Hartsville	Luttrell	Obion	Tazewell
Bluff City	Decaturville	Henderson	Madisonville	Oliver Springs	Tellico Plains
Bolivar	Dickson	Hendersonville	Martin	Paris	Townsend
Brentwood	Dover	Hohenwald	Maryville	Parsons	Trenton
Bristol	Dunlap	Humboldt	Maury City	Pikeville	Tusculum
Brownsville	Dyer	Jacksboro	Maynardville	Pittman Center	Unicoi
Byrdstown	East Ridge	Jackson	McEwen	Pleasant View	Union City
Camden	Elizabethton	Jamestown	McMinnville	Portland	Waynesboro
Carthage	Elkton	Jefferson City	Middleton	Puryear	Waverly
Caryville	Erin	Johnson City	Milan	Red Bank	Westmoreland
Centerville	Erwin	Jonesborough	Millersville	Ripley	White House
Charleston	Estill Springs	Kenton	Millington	Rockwood	White Pine
Charlotte	Etowah	Kingsport	Morrison	Rogersville*	Whiteville
Church Hill	Fairview	Kingston Springs	Morristown	Rutledge	Whitwell
Clarksville	Fayetteville	Lafayette	Moscow	Savannah	Woodbury
Cleveland	Forest Hills	Lafollette	Mountain City	Selmer	
Clifton	Friendship	Lake City	Mt. Carmel	Sevierville	

COUNTIES

Anderson	Coffee	Hamilton	Lewis*	Overton	Sumner
Bedford	Crockett	Hardeman	Lincoln	Perry	Tipton
Benton	Cumberland	Hardin	Loudon	Pickett	Trousdale
Bledsoe	Decatur	Hawkins	Macon	Polk	Unicoi
Blount	DeKalb	Haywood	Madison	Putnam	Union
Bradley	Dickson	Henderson	Marion	Rhea	Van Buren
Campbell	Fayette	Henry	Marshall	Roane	Warren
Cannon	Fentress	Hickman	Mauzy	Robertson	Washington
Carroll	Franklin	Humphreys	McMinn	Rutherford	Wayne
Carter	Gibson	Jackson	McNairy	Scott	Weakley
Cheatham	Giles	Jefferson	Monroe	Sequatchie	White
Chester	Grainger	Johnson	Montgomery	Sevier	Williamson
Claiborne	Greene	Lake	Moore*	Shelby*	Wilson
Clay	Grundy	Lauderdale	Morgan	Smith	
Cocke	Hamblen	Lawrence	Obion	Sullivan	

HOUSING AUTHORITIES

Bristol	Cookeville	Hohenwald	Memphis	Sweetwater
Clinton	Hartsville	Lawrenceburg	Morristown	

* All departments not covered by TCRS.

(continued)

**POLITICAL SUBDIVISION PARTICIPANTS
(CONTINUED)**

DEVELOPMENT AGENCIES

Beech River Watershed	First Tenn. Dev. District	Southeast Tenn. Dev. District
Bristol/Kingsport/Sullivan Co. Industrial Commission Dist.	First Tenn. Human Resource Agency	Southeast Tenn. Human Res. Agency
Delta Human Resource Agency	Greater Nashville Regional Council	Southwest Tenn. Dev. District
	Sequatchie Valley Plan. & Dev. Dist.	Southwest Tenn. Human Res. Agency
		Upper East Tenn. Human Dev. Agency

JOINT VENTURES

Argie Cooper Public Library	Edward Gauche Fisher Public Library	Sevier Solid Waste
Bradley-Cleveland Civil Defense	Fayetteville/Lincoln Co. Public	Smyrna/Rutherford Co. Airport
Bradley-Cleveland Community	Library	Authority
Services Agency	Gorham/MacBane Public Library	Tellico Area Services System
Clarksville/Montgomery County	Jackson/Madison County Library	Tri-City Airport Commission
Public Library	Johnson City/Washington Co. EMS	Tri-County Vocational School
Clarksville/Montgomery County	Kinser Park	W. G. Rhea Public Library
Regional Planning Commission	Lawrence Co. Library	Washington County/Johnson City
Cleveland/Bradley Communications	Linebaugh Public Library	Animal Control Center
Center Committee	Morristown/Hamblen Co. Landfill	Wilson Emergency Mgt. Agency

MISCELLANEOUS

Blount County Fire Protection Dist.	Northwest Tennessee Community	Tenn. County Services Assoc.
Blount County Library	Services Agency	Tenn. Education Assoc.
Cookeville Reg. Medical Center Auth.	Shelby Co. Community Svc. Agency	Tenn. Historical Society
County Officials Assoc. of Tenn.	South Central Tennessee Community	Tenn. Municipal Bond Fund
Douglas Cherokee Economic Auth.	Services Agency	Tenn. Municipal League
East Tenn. Community Svc. Agency	Southeast Tennessee Community	Tenn. Mun. League Risk Mgt. Pool
Hamilton County Community Services	Services Agency	Tenn. Org. of School Superintendents
Agency	Southwest Tennessee Community	Tenn. School Board Assoc.
Hardin County General Hospital	Services Agency	Tenn. Secondary Sch. Athletic Assoc.
Knox Co. Community Services Agency	Tenn. Assoc. of Assessing Officers	Tenn. Sheriffs Assoc.
Mid-Cumberland Community Services	Tenn. Assoc. of County Mayors	Tenn. State Employees Assoc.
Agency	Tenn. Athletic Coaches Assoc.	Tenn. Veterans Home Board
Northeast Community Svc. Agency	Tenn. Co. Commissioners Assoc.	Upper Cumberland Community
	Tenn. Co. Highway Officials Assoc.	Services Agency
		Workforce Solutions

SPECIAL SCHOOL DISTRICTS

Bradford	Huntingdon	Oak Ridge Board of Education
Clinch Powell Education Coop.	Lebanon	Oneida
Elizabethton Board of Education	Little Tenn. Valley Education Coop.	Paris
Franklin	McKenzie	South Carroll Special School District
Gibson County Schools District	Memphis	Trenton
Hollow Rock-Bruceton	Milan	Union City Board of Education
		West Carroll County

UTILITY DISTRICTS

Alpha-Talbott	Gladeville	Northeast Henry County
Arthur Shawnee	Glen Hills	Oak Ridge
Big Creek	Greeneville Light & Power	Old Hickory
Bloomington	Hampton	Poplar Grove
Bristol Electric System	Hardeman-Fayette County	Riceville
County Wide	Hendersonville	Savannah Valley
Cumberland Utility District of Roane	Hixson	Sevier County
and Morgan Counties	Jackson County	Sylvia-Tennessee City Pond Water
Dyersburg Suburban	Johnson City Power Bd.	Sneedville
East Side	Lake County	Soddy Daisy-Falling Water
Fall Creek Falls	Lincoln Co. Board of Public Utilities	Smith
First Carter County	Middle Tennessee	South Elizabethton
First Tipton County	North Utility District of Decatur and	Weakley Co. Municipal Electric
First Hawkins County	Benton Counties	Wolfe Branch

* All departments not covered by TCRS.