



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
PENSION TRUST FUNDS OF THE STATE OF TENNESSEE

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM



Maria

Featuring Tennessee images by artist H.R. Lovell.

**Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2004
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

Featured in this report are paintings by H.R. Lovell, Tennessee's 2001-2003 Artist-in-Residence. His works of beauty and grace draw viewers into peaceful, relaxing settings, usually nostalgic in tone. Lovell's scenes truly express the spirit and assets of Tennessee.

Lovell primarily utilizes watercolor and egg tempera in his creations. Watercolor is used for brushed, pliable strokes, and egg tempera for intense depth of color and illumination. His paintings are often characterized by strong composition, late afternoon sunlight, and deep shadows. His meticulous attention to detail gives his paintings photo-realism.

Born and raised in Cheatham County, Tennessee, Lovell developed an awareness of his surroundings long before he picked up his first paintbrush. He is completely self taught and has been called, "The Andrew Wyeth of the South."

Lovell has painted commissioned pieces for Mel Tillis, Randy Travis, Don Light, and Mario Pasin, President of Radio Flyer. He was a featured artist at the first Farm Aid, "Colors of the Heartland," with John Mellencamp.

H.R. Lovell's gallery, Muzart, is located in the historic White Elephant Saloon in downtown Charlotte, Tennessee. Gallery director Maria Cherry proudly displays his paintings and prints. For more information, call (615) 789-6655.

Featured on the cover: Pinegrove

TABLE OF CONTENTS

INTRODUCTORY SECTION

GFOA Certificate of Achievement	1
Public Pension Standards Award	2
Chairman of the Board's Letter	3
Letter of Transmittal	4
Administration and Mission	8
The Council on Pensions and Insurance	9
The Board of Trustees	11
Professional Consultants	13
Treasury Department Executive Staff	15
Organization Chart	16

FINANCIAL SECTION

Independent Auditor's Report	17
Management's Discussion and Analysis	19
Financial Statements:	
Comparative Statements of Plan Net Assets	24
Comparative Statements of Changes in Plan Net Assets	26
Notes to the Financial Statements	28
Required Supplementary Information:	
Schedules of Funding Progress	33
Schedules of Employer Contributions	34
Notes to Required Supplementary Information	35
Supporting Schedules:	
Schedules of Administrative Expenses	36
Schedules of Investment Expenses	38
Schedules of Expenses for Consultants	40

INVESTMENT SECTION

Report by Investment Consultant	41
Letter from TCRS Chief Investment Officer	42
Statutory Investment Authority	43
Investment Performance Review	44
Asset Allocation	45
Largest Holdings	46
Investment Summary	47
Schedules of Investment Fees and Commissions	48

(continued)

TABLE OF CONTENTS (CONTINUED)

ACTUARIAL SECTION

Actuarial Introduction	49
Actuary's Certification Letter	50
Summary of Actuarial Assumptions and Methods	52
Actuarial Data	54
Actuarial Balance Sheet	55
Short-Term Solvency Test	56
Summary of Accrued and Unfunded Accrued Liabilities	57
Selected Actuarial Funding Information	58
Analysis of Financial Experience	59
Plan Summary	60
Services for Active and Retired Members	62
Sample Benefit Calculations	63
Major Legislative Improvements	64

STATISTICAL SECTION

Membership:

Schedules of Active Members	65
Schedules of Retired Members	68
Retired Members by Geographical Distribution	71
Retired Members on Payroll and Prior Service Established	72
Treasury Retirement Installment Plan	73
Refund Activity and Political Subdivision Participation	74

Actuarial:

Historical Employer Contribution Rates	75
--	----

Financial:

Historical Fair Value	76
Analysis of Member and Employer Reserves	77
Average Benefit Payments Schedule	78
Annual Benefit Payments	78
Schedules of Benefit Expenses	79
Schedules of Expenses by Type and Revenue by Source	80

Political Subdivision Participation:

Introduction to Political Subdivision Participation	81
Optional Provisions for Political Subdivisions	82
Political Subdivision Participants	83

INTRODUCTORY SECTION



Christmas

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, 2003

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.



Nancy L. Ziehl

President

Jeffrey R. Emmer

Executive Director

PUBLIC PENSION COORDINATING COUNCIL AWARD



Public Pension Coordinating Council
**Public Pension Standards
2004 Award**

Presented to

Tennessee Consolidated Retirement System

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in black ink, reading "Alan H. Winkle". The signature is fluid and cursive, with the first name "Alan" being particularly prominent.

Alan H. Winkle
Program Administrator

CHAIRMAN OF THE BOARD'S LETTER

STATE OF TENNESSEE

**TREASURY DEPARTMENT**
STATE CAPITOL
NASHVILLE, TENNESSEE 37243

December 15, 2004

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 seventeenth 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 386,000 benefit projections, with 160,000 occurring in fiscal year 2004. Further, TCRS forms and up-to-date information is available on-line to assist our members and participating employers.

Investments: The domestic and international stock market rally during the last quarter of the 2002-03 fiscal year continued during the 2003-04 fiscal year with the S&P 500 index gaining 19.11% and the EAFE index 32.37%. The domestic bond market, which had outperformed the stock market during the three previous fiscal years, retreated and produced returns of only .32%. Real estate and the international bond market had positive returns of 9.71% and 7.74%, respectively. Once again, the benefit of a diversified portfolio is evident. For the fiscal year the total portfolio returned 9.32%, which exceeded the actuarial assumption of 7.5%. This is the first time in the last four years that the marketplace has enabled the portfolio to earn more than the assumption used in financing the pension program.

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 offered significant challenges when considering the difficult investment environment we have experienced. The contribution rates from the 2003 valuation went into effect July 1, 2004.

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,

A handwritten signature in cursive script that reads "Dale Sims".

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, 2004

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, 2004. 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, 2004, active membership in TCRS totaled 200,686: 44,646 state employees; 17,041 higher education employees; 66,910 teachers; and 72,089 political subdivision employees. A total of 86,205 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 430 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.

(continued)

**LETTER OF TRANSMITTAL
(CONTINUED)**

Five sections comprise the 2004 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.

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, AND OVERALL OUTLOOK

Overall, fiscal year 2004 ended in a positive note with a total portfolio return of 9.32%, a return greater than our actuarial assumption of 7.50%. A detailed discussion of investment performance can be found in the Management's Discussion and Analysis section of this report.

New employer contribution rates resulting from the July 1, 2003 actuarial valuation were implemented July 1, 2004. The next actuarial valuation will be performed July 1, 2005 with the resulting employer contribution rates becoming effective July 1, 2006. The July 1, 2005 actuarial valuation will utilize the assumptions generated from the June 30, 2004 experience study.

Because TCRS is a strongly funded pension plan, volatility in investment income will cause employer contribution rates to fluctuate. Investment strategies have been adopted that somewhat reduce, but do not eliminate, this volatility. As an additional safeguard for this multi-billion dollar pension fund, the Board of Trustees is in the process of establishing an audit committee of the Board.

MAJOR INITIATIVES

During fiscal year 2004, TCRS expanded its disability validation review. The purpose of the review was to identify recipients who may be inappropriately receiving disability retirement benefits from TCRS. The disability retirees living out-of-state were validated and a review of in-state retirees is in progress.

TCRS led a widely acclaimed study on workforce patterns of public school teachers and state employees. The components of the study included identifying current and potential shortages, projected retirements of baby boomers, initiatives to retain quality teachers and state employees in the critical first five years of employment, and a review of possible solutions. The study will serve as a guide for maintaining a viable workforce in the future.

During fiscal year 2004, the Board of Trustees engaged in a major review of the TCRS investment policy. This review included updating the policy based on the Government Finance Officers Association's (GFOA) publication entitled "*Investment Policy Checklist for Pension Fund Assets.*" Other significant changes included updating benchmarks for certain asset classes, defining the total TCRS performance benchmark, establishing minimum and maximum allocation ranges for each asset class, and providing an asset class rebalancing guideline.

(continued)

**LETTER OF TRANSMITTAL
(CONTINUED)**

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.

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, 2003, the latest valuation date, the unfunded accrued liability for the entire system totaled \$370.4 million. Unfunded accrued liability of \$52.5 million associated with a closed group of state judges, attorneys general, and county officials is funded over a 12-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, 2005.

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, 2003. This was the sixteenth 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 comprehen-

(continued)

**LETTER OF TRANSMITTAL
(CONTINUED)**

sive 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, recognizes 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 19-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 two representatives 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 state retiree representative is appointed by the Governor. New to the Board in a non-voting capacity, is a retired teacher, selected by the Tennessee Retired Teachers Association.

ELECTED MEMBERS



Michael Barker
Tennessee Retired Teacher Association
Term Expires: June 30, 2005



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



Michael Fort
Department of Employment Security
Term Expires: June 30, 2007



Rebecca Reel
East Tennessee Teacher
Term Expires: June 30, 2007



Judy Wahlstrom
Department of Children's Services
Term Expires: June 30, 2007



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, 2006



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

Henry Delicata
Vanderbilt University
Nashville, Tennessee

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

Joseph Lee, III
Memphis Light, Gas and Water
Memphis, Tennessee

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

Chuck Webb, CFA
Weaver C. Barksdale & Associates
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.

Marilyn Harrison
Walter Scott & Partners Ltd.
One Charlotte Square
Edinburgh EH2 4DZ
Scotland

Lofton Holder
J.P. Morgan Investment Management
522 Fifth Avenue
New York, New York 10036

John Lowman
SG Asset Management (Singapore)
c/o Trust Co. of the West
200 Park Avenue, 22nd Fl.
New York, New York 10166

Alec McAuley
Putnam Investments
One Post Office Square
Boston, Massachusetts 02109

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

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

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
Skylight Office Tower
1660 West Second Street
Suite 450
Cleveland, Ohio 44113

REAL ESTATE INVESTMENT ADVISORS

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

Joseph Azelby
J.P. Morgan Fleming Asset Management, Inc.
522 Fifth Avenue, 9th Floor
New York, New York 10036

Alan Connor
Cornerstone Real Estate Advisers LLC
One Financial Plaza, Suite 1700
Hartford, Connecticut 06103

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

Michael A. Ruane
TA Associates Realty
28 State Street, 10th Floor
Boston, Massachusetts 02109

Frank E. Schmitz
Principal Global Investors
801 Grand Avenue
Des Moines, Iowa 50392

MASTER CUSTODIAN BANK

The Master Custodian bank settles all financial investment transactions and provides custody services for TCRS assets.

John P. Roth
The Bank of New York
1 Wall Street
New York, New York 10286

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
 Staff Assistant to the Treasurer Nathan Burton

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 Wooten

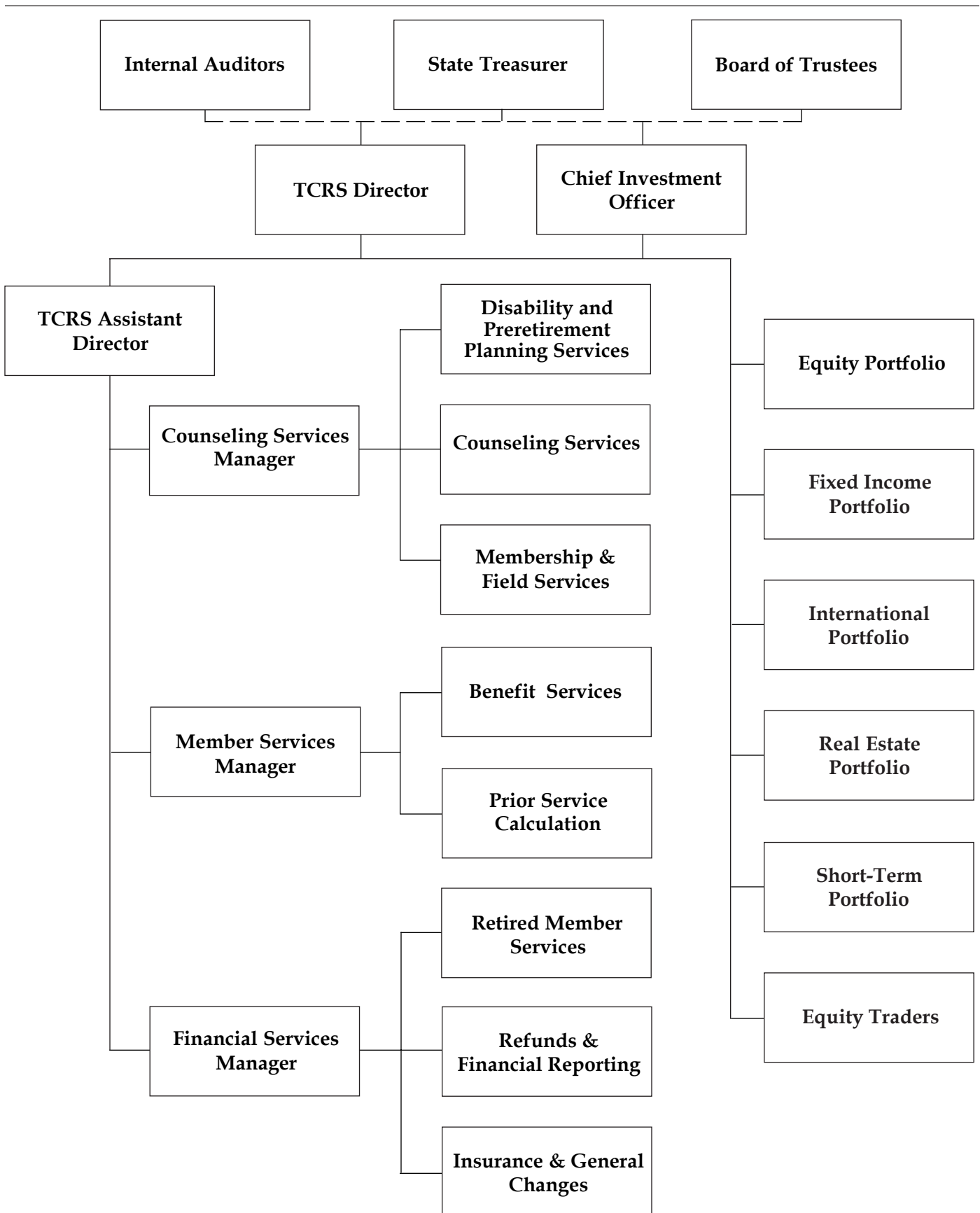
TCRS INVESTMENT

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, CFA
 Associate Portfolio Manager Mike Moulder, CGFM
 Associate Portfolio Manager Carrie Green
 Senior Fixed Income Portfolio Manager Leighton Shantz, CFA
 Senior Fixed Income Portfolio Manager Terry Davis, CFA
 Associate Portfolio Manager Matthew Hedges
 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
 Banking Services Manager 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



Johnston Brothers' Ranch

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 3, 2004

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, 2004, and June 30, 2003, and the related statements of changes in plan net assets for the years then ended. These basic 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the Tennessee Consolidated Retirement System; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements 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, 2004, and June 30, 2003, 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 3, 2004
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, 2004, and June 30, 2003, 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.

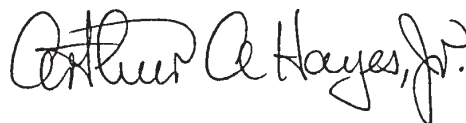
The management's discussion and analysis and the schedules of funding progress and employer contributions, as listed in the table of contents, are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United 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 stated 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 3, 2004, on our consideration of the Tennessee Consolidated Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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, 2004 & JUNE 30, 2003**

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, 2004 and June 30, 2003.

FINANCIAL HIGHLIGHTS

- ◆ The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2004 were nearly \$25.6 billion, increasing over \$1.8 billion (7.6 percent) from the plan net assets at June 30, 2003. 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, 2003, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.8 percent for the SETHEEPP group and 91.9 percent for the PSPP group.
- ◆ Contribution revenue for fiscal year 2004 totaled \$616,089,783 – an increase of 3.4 percent compared to fiscal year 2003.
- ◆ Net investment income for fiscal year 2004 was \$2,181,853,628. During fiscal year 2004, the TCRS received an investment return on its portfolio of 9.3 percent, compared to 4.9 percent for fiscal year 2003.
- ◆ Total benefits and refunds paid for fiscal year 2004 were \$984,377,076 – an increase of 8.4 percent over fiscal year 2003 total benefits and refunds paid of \$907,863,397.
- ◆ Total administrative expenses for fiscal year 2004 were \$5,534,441 – an increase of 9.5 percent over fiscal year 2003 administrative expenses of \$5,055,824.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets* (on pages 24 through 25), the *Statement of Changes in Plan Net Assets* (on pages 26 through 27), and the *Notes to the Financial Statements* (on pages 28 through 32). In addition, *Required Supplementary Information* is presented, which includes this *Management's Discussion and Analysis*, as well as the schedules and notes on pages 33 through 35.

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, 2004, the TCRS had plan net assets (total assets in excess of total liabilities) of nearly \$25.6 billion, an increase of over \$1.8 billion (7.6 percent) from \$23.8 billion at June 30, 2003. The assets of the TCRS consist primarily of investments. During fiscal year 2004, the domestic and international equity markets provided double-digit positive returns, thus contributing to a nearly \$1.1 billion increase in net investment income over fiscal year 2003. 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, 2004 & JUNE 30, 2003 (CONTINUED)**

PLAN NET ASSETS

			FY04 - FY03		FY03 - FY02	
	June 30, 2004	June 30, 2003	Percentage		Percentage	
			Change	June 30, 2002	Change	
ASSETS						
Cash and cash equivalents	\$ 1,287,694,472	\$ 1,717,734,541	(25.0) %	\$ 1,621,359,545	5.9 %	
Contributions receivable	52,655,042	46,850,736	12.4 %	46,238,224	1.3 %	
Investment income						
receivables	136,353,991	134,284,002	1.5 %	147,069,784	(8.7) %	
Investments sold	84,576,463	59,060,030	43.2 %	31,817,111	85.6 %	
Foreign currency receivable	46,030,024	523,209,732	(91.2) %	899,292,837	(41.8) %	
Short-term securities	564,645,773	498,577,125	13.3 %	317,388,429	57.1 %	
Long-term investments	23,486,279,358	21,736,948,082	8.0 %	21,015,023,754	3.4 %	
TOTAL ASSETS	25,658,235,123	24,716,664,248	3.8 %	24,078,189,684	2.7 %	
LIABILITIES						
Death benefits, refunds and						
other payables	2,350,420	1,244,060	88.9 %	1,141,905	8.9 %	
Investments purchased	20,722,128	387,262,530	(94.6) %	127,034,613	204.8 %	
Other investment payables	2,127,641	2,154,173	(1.2) %	2,633,994	(18.2) %	
Foreign currency payable	46,518,682	547,519,127	(91.5) %	964,499,600	(43.2) %	
TOTAL LIABILITIES	71,718,871	938,179,890	(92.4) %	1,095,310,112	(14.3) %	
NET ASSETS HELD IN TRUST						
FOR PENSION BENEFITS	\$ 25,586,516,252	\$ 23,778,484,358	7.6 %	\$ 22,982,879,572	3.5 %	

ANALYSIS OF REVENUES AND EXPENSES

Contributions for fiscal year 2004 increased by \$20.0 million (3.4 percent) over contributions for fiscal year 2003 as the employer contribution rates remained constant. An increase in employer contribution rates adopted pursuant to the actuarial valuation performed as of July 1, 2001 and effective for fiscal years 2003 and 2004, resulted in contributions for fiscal year 2003 increasing by \$59.9 million (11.2 percent) over contributions for fiscal year 2002. As mentioned in the *Analysis of Assets, Liabilities and Plan Net Assets* section above, the continued recovery of the equity investment markets contributed to increases in net investment income. Net investment income for the year ended June 30, 2004 totaled \$2,181,853,628, an increase of \$1.1 billion versus fiscal year 2003. Net investment income for the year ended June 30, 2003 totaled \$1,112,478,748, an increase of \$1.6 billion versus fiscal year 2002. Market conditions have resulted in a return to the TCRS portfolio of 9.3 percent during fiscal year 2004 and 4.9 percent during fiscal year 2003.

Total benefits and refunds paid during the year ended June 30, 2004 were \$984,377,076, an increase of 8.4 percent over fiscal year 2003 total benefits and refunds paid. Total refunds and benefits paid during the year ended June 30, 2003 of \$907,863,397 increased 7.8 percent over fiscal year 2002 total benefits and refunds paid. The increase in benefit expenses can be attributed to 2.4 percent and 1.6 percent cost of living adjustments awarded to retirees on July 1, 2003 and July 1, 2002, respectively. In addition, more retirees were added to payroll than removed during these fiscal years.

In addition, administrative expenses for the year ended June 30, 2004 were \$5,534,441, an increase of 9.5 percent over fiscal year 2003 administrative expenses. This increase was due primarily to additional expenses relating to the actuarial valuation and experience studies performed during fiscal year 2004. Administrative expenses for fiscal year 2003 of \$5,055,824 increased 1.0 percent over administrative expenses for fiscal year 2002.

Condensed financial information comparing the TCRS' revenues and expenses for the past three fiscal years follows.
(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003 (CONTINUED)**

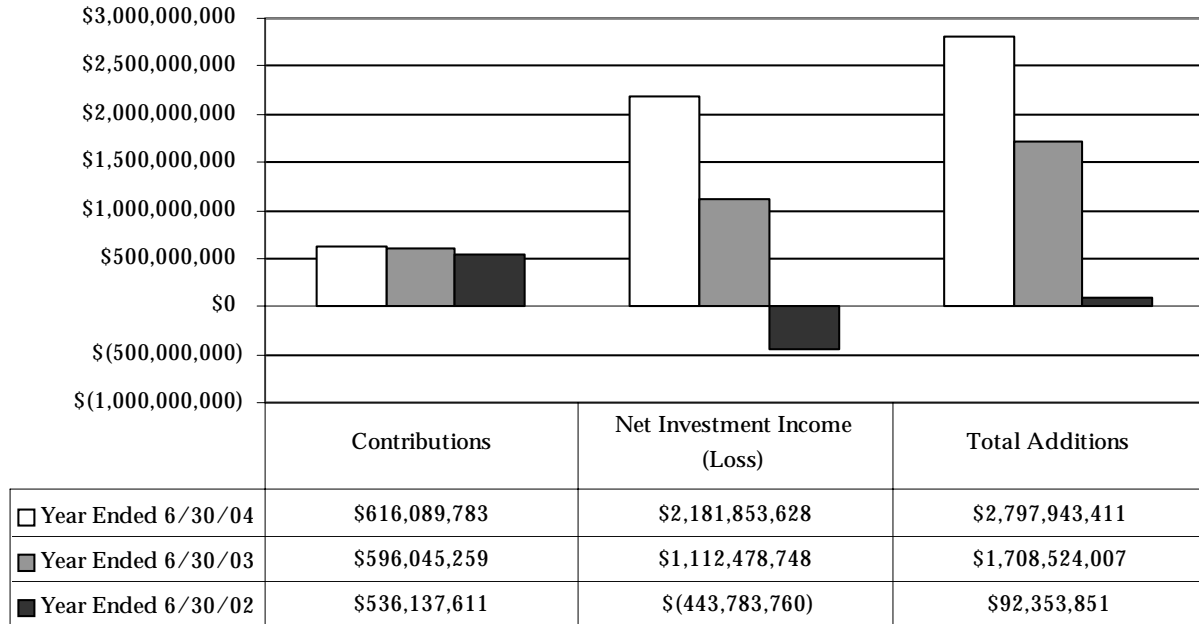
CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003	FY04 - FY03 Percentage Change	For the Year Ended June 30, 2002	FY03 - FY02 Percentage Change
ADDITIONS					
Contributions	\$ 616,089,783	\$ 596,045,259	3.4 %	\$ 536,137,611	11.2 %
Investment income					
Net appreciation (depreciation) in fair value of investments	1,310,811,851	268,965,778	387.4 %	(1,354,960,400)	119.9 %
Interest, dividends and other investment income	885,509,528	857,325,990	3.3 %	924,647,372	(7.3) %
Less: Investment expense	(14,467,751)	(13,813,020)	4.7 %	(14,093,999)	(2.0) %
Net income from securities lending activities	0	0	0.0 %	623,267	(100.0) %
Net investment income	2,181,853,628	1,112,478,748	96.1 %	(443,783,760)	350.7 %
TOTAL ADDITIONS	2,797,943,411	1,708,524,007	63.8 %	92,353,851	1,750.0 %
DEDUCTIONS					
Annuity benefits					
Retirement benefits	716,339,066	662,075,122	8.2 %	610,554,871	8.4 %
Survivor benefits	46,416,539	42,638,112	8.9 %	38,723,935	10.1 %
Disability benefits	23,590,867	21,781,588	8.3 %	20,109,341	8.3 %
Cost of living	163,627,253	150,690,914	8.6 %	145,335,114	3.7 %
Death benefits	4,477,589	4,046,275	10.7 %	3,367,877	20.1 %
Refunds	29,925,762	26,631,386	12.4 %	24,304,536	9.6 %
Administrative expenses	5,534,441	5,055,824	9.5 %	5,003,984	1.0 %
TOTAL DEDUCTIONS	989,911,517	912,919,221	8.4 %	847,399,658	7.7 %
NET INCREASE (DECREASE)	1,808,031,894	795,604,786	127.3 %	(755,045,807)	205.4 %
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS					
BEGINNING OF YEAR	23,778,484,358	22,982,879,572	3.5 %	23,737,925,379	(3.2) %
END OF YEAR	\$ 25,586,516,252	\$ 23,778,484,358	7.6 %	\$ 22,982,879,572	3.5 %

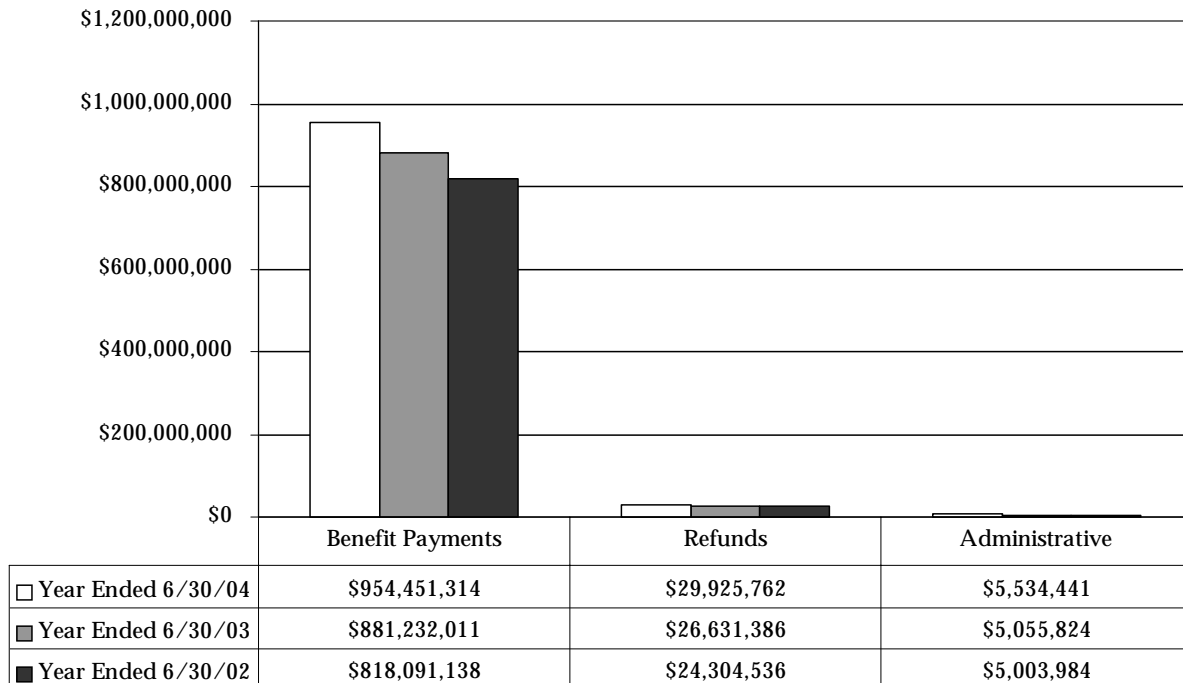
(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003 (CONTINUED)**

REVENUES BY TYPE



EXPENSES BY TYPE



(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003 (CONTINUED)**

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

There were dramatic improvements in both the domestic and international stock markets for the year ended June 30, 2004 after two years of sub par returns. The S&P 500, TCRS' domestic equity benchmark, had a double digit negative return of 17.99 % for the fiscal year ended June 30, 2002, followed by a small positive return of .25% for fiscal year 2003, and then a double digit positive return of 19.11% for fiscal year 2004. The international equity market, as represented by the EAFE index, had negative returns of 6.46% and 9.49% for fiscal years 2003 and 2002, respectively. Fortunately, the international markets rebounded nicely for the year ended June 30, 2004 with a 32.37 % return. On the other hand, the domestic bond market, as measured by the Lehman Aggregate index, had an annual return of only .32% at June 30, 2004 compared with 10.40% and 8.63% in the previous two years. The international bond market return of 7.74% and real estate at 9.71% represent positive market returns.

The past three years reflect the benefits of a diversified portfolio where the weak stock market was countered by a positive bond market during fiscal years 2002 and 2003. In 2004 the opposite occurred where a strong stock market balanced an under-performing bond market.

The employer contribution rate increased July 1, 2004 for most of the employers participating in TCRS. The increase was the result of the July 1, 2003 actuarial valuation that took into consideration that investment results were less than the earnings assumptions for the two years since the last actuarial valuation. With the asset smoothing method utilized for valuation purposes that recognized only a portion of the underperformance of investment income, upward pressure on the employer rate is expected for the next actuarial valuation to be performed effective July 1, 2005. However, some upward pressure will be mitigated by the positive return of 9.32% realized for the year ended June 30, 2004. It was refreshing to realize such a return after three straight years where returns were less than the actuarial assumption of 7.5%. With TCRS being such a strongly funded plan, volatility in investment income will cause employer contribution rates to fluctuate.

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, 2004 AND JUNE 30, 2003

Expressed in Thousands

	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ASSETS		
Cash and cash equivalents	\$ 1,102,224	\$ 185,470
Receivables		
Member contributions receivable	17,687	3,954
Employer contributions receivable	19,905	11,109
Accrued interest receivable	100,996	16,995
Accrued dividends receivable	15,719	2,644
Other investment receivable	0	0
Foreign currency receivable	39,400	6,630
Investments sold	72,395	12,182
Total receivables	<u>266,102</u>	<u>53,514</u>
Investments, at fair value		
Short-term securities	483,319	81,327
Government bonds	9,302,636	1,565,340
Corporate bonds	1,607,676	270,521
Corporate stocks	8,796,542	1,480,181
Real estate	396,641	66,742
Total investments	<u>20,586,814</u>	<u>3,464,111</u>
TOTAL ASSETS	<u>21,955,140</u>	<u>3,703,095</u>
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	1,038	1,267
Other	45	0
Investments purchased	17,737	2,985
Foreign currency payable	39,819	6,700
Other investment payables	1,821	307
TOTAL LIABILITIES	<u>60,460</u>	<u>11,259</u>
NET ASSETS HELD IN TRUST FOR PENSION		
BENEFITS (Schedules of funding progress for the plans are presented on page 33)	<u>\$ 21,894,680</u>	<u>\$ 3,691,836</u>

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2004 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2003 Total
\$ 1,287,694	\$ 1,477,468	\$ 240,266	\$ 1,717,734
21,641	14,863	3,586	18,449
31,014	18,194	10,208	28,402
117,991	104,068	16,938	121,006
18,363	11,418	1,859	13,277
0	1	0	1
46,030	449,823	73,387	523,210
84,577	50,790	8,270	59,060
<u>319,616</u>	<u>649,157</u>	<u>114,248</u>	<u>763,405</u>
564,646	428,785	69,792	498,577
10,867,976	8,955,774	1,457,697	10,413,471
1,878,197	1,988,160	323,605	2,311,765
10,276,723	7,430,045	1,209,359	8,639,404
463,383	320,192	52,116	372,308
<u>24,050,925</u>	<u>19,122,956</u>	<u>3,112,569</u>	<u>22,235,525</u>
<u>25,658,235</u>	<u>21,249,581</u>	<u>3,467,083</u>	<u>24,716,664</u>
2,305	686	542	1,228
45	16	0	16
20,722	333,050	54,213	387,263
46,519	470,723	76,796	547,519
2,128	1,852	302	2,154
<u>71,719</u>	<u>806,327</u>	<u>131,853</u>	<u>938,180</u>
<u>\$ 25,586,516</u>	<u>\$ 20,443,254</u>	<u>\$ 3,335,230</u>	<u>\$ 23,778,484</u>

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
COMPARATIVE STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2003

Expressed in Thousands

	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEPP)	Political Subdivisions Pension Plan (PSPP)
ADDITIONS		
Contributions		
Member contributions	\$ 154,334	\$ 50,650
Employer contributions	271,298	139,808
Total contributions	<u>425,632</u>	<u>190,458</u>
Investment income		
Net appreciation in fair value of investments	1,124,041	186,771
Interest	579,747	96,331
Dividends	157,233	26,126
Real estate income, net of operating expenses	22,357	3,715
Total investment income	<u>1,883,378</u>	<u>312,943</u>
Less: Investment expense	<u>(12,406)</u>	<u>(2,062)</u>
Net investment income	<u>1,870,972</u>	<u>310,881</u>
TOTAL ADDITIONS	<u>2,296,604</u>	<u>501,339</u>
DEDUCTIONS		
Annuity benefits		
Retirement benefits	617,659	98,680
Survivor benefits	40,022	6,394
Disability benefits	20,341	3,250
Cost of living	145,767	17,860
Death benefits	3,149	1,329
Refunds	15,305	14,621
Administrative expense	2,935	2,599
TOTAL DEDUCTIONS	<u>845,178</u>	<u>144,733</u>
NET INCREASE	1,451,426	356,606
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	<u>20,443,254</u>	<u>3,335,230</u>
END OF YEAR	<u><u>\$ 21,894,680</u></u>	<u><u>\$ 3,691,836</u></u>

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 2004 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2003 Total
\$ 204,984	\$ 148,493	\$ 49,218	\$ 197,711
<u>411,106</u>	<u>264,320</u>	<u>134,014</u>	<u>398,334</u>
<u>616,090</u>	<u>412,813</u>	<u>183,232</u>	<u>596,045</u>
1,310,812	232,015	36,950	268,965
676,078	577,854	92,529	670,383
183,359	137,167	21,963	159,130
26,072	23,974	3,839	27,813
<u>2,196,321</u>	<u>971,010</u>	<u>155,281</u>	<u>1,126,291</u>
(14,468)	(11,900)	(1,913)	(13,813)
<u>2,181,853</u>	<u>959,110</u>	<u>153,368</u>	<u>1,112,478</u>
<u>2,797,943</u>	<u>1,371,923</u>	<u>336,600</u>	<u>1,708,523</u>
716,339	571,703	90,372	662,075
46,416	36,818	5,820	42,638
23,591	18,809	2,973	21,782
163,627	134,455	16,236	150,691
4,478	3,052	994	4,046
29,926	14,250	12,381	26,631
5,534	2,631	2,425	5,056
<u>989,911</u>	<u>781,718</u>	<u>131,201</u>	<u>912,919</u>
1,808,032	590,205	205,399	795,604
23,778,484	19,853,049	3,129,831	22,982,880
<u>\$ 25,586,516</u>	<u>\$ 20,443,254</u>	<u>\$ 3,335,230</u>	<u>\$ 23,778,484</u>

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

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 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*. 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 under the contractual arrangement for master custody services.
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. 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.
5. **Receivables** - Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 2004 consist of member contributions of \$17.7 million and \$3.9 million due to SETHEEPP and PSPP respectively, and employer contributions of \$19.9 million and \$11.1 million due to SETHEEPP and PSPP respectively. 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.

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)**

6. **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 Changes in Plan Net Assets.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2003, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	59,959	23,162
Terminated members entitled to but not receiving benefits	16,721	3,972
Current active members	<u>127,597</u>	<u>71,320</u>
Total	204,277	98,454
Number of participating employers	140	418

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 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, 2004, the plan's Member Reserve and Employer Reserve were fully funded with balances of \$3,059.2 million and \$18,835.5 million, respectively. 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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

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 Employer Reserve. At June 30, 2004, the plan's Member Reserve and Employer Reserve were fully funded with balances of \$746.9 million and \$2,944.9 million, respectively. 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.

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, but subject to the following statutory 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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

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, 2004 and June 30, 2003 included SEC-registered open-end mutual funds of \$106,167 and \$108,761, respectively.

<i>Expressed in Thousands</i>	Fair Value	Fair Value
	June 30, 2004	June 30, 2003
Investments - Category 1		
Cash equivalents and short-term securities		
Commercial paper	\$ 550,108	\$ 717,397
Government bonds	1,299,409	1,501,324
Long-term investments		
Government bonds	10,867,976	10,081,502
Corporate bonds	1,876,185	2,293,728
Corporate stocks	10,258,064	8,613,755
Total Investments - Category 1	<u>24,851,742</u>	<u>23,207,706</u>
Investments - Category 2	<u>0</u>	<u>0</u>
Investments - Category 3	<u>0</u>	<u>0</u>
Investments - Not Categorized		
Investment in open-end mutual fund	106	109
Real estate	463,383	372,308
Unsettled investment acquisitions		
Government bonds	0	331,969
Corporate bonds	2,012	18,037
Corporate stocks	18,659	25,649
Total Investments - Not Categorized	<u>484,160</u>	<u>748,072</u>
Total investments	25,335,902	23,955,778
Less: Short-term investments classified as cash equivalents on the Statements of Plan Net Assets	<u>(1,284,977)</u>	<u>(1,720,253)</u>
Total investments as shown on the Statements of Plan Net Assets	<u>\$ 24,050,925</u>	<u>\$ 22,235,525</u>

As of June 30, 2004 and June 30, 2003, 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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

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 securities loans, the securities on loan can be terminated on demand by either the TCRS or the borrower. As of June 30, 2004 and June 30, 2003, there were no securities on loan.

Derivatives – The TCRS may buy or sell equity index futures contracts for the purposes 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. 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. As of June 30, 2004 and June 30, 2003, the TCRS was not under any futures contracts.

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. The fair value of foreign currency forward contracts outstanding as of June 30, 2004 and June 30, 2003 has been reflected in 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, 2004 and June 30, 2003.

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 mortgages, which may result from a decline in interest rates. There were no CMOs held at June 30, 2004. The fair value of CMOs at June 30, 2003 was \$9,715,380. The TCRS also invests in various asset-backed securities, representing ownership interests in trust 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**

SCHEDULES OF FUNDING PROGRESS*Expressed in Thousands*

	Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial 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	7/1/2003	\$ 22,099,252	\$ 22,151,745	\$ 52,493	99.76%	\$ 4,773,297	1.10%
	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%
PSPP	7/1/2003	3,605,529	3,923,475	317,946	91.90%	1,731,135	18.37%
	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%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of \$52.5 million at July 1, 2003 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 418 participating entities at July 1, 2003. The unfunded liability of \$317.9 million is attributable to 353 of the 418 entities.

See accompanying Notes to Required Supplementary Information

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

SCHEDULES OF EMPLOYER CONTRIBUTIONS

Expressed in Thousands

Year Ended June 30	SETHEEPP		PSPP	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2004	\$ 271,298	100%	\$ 139,808	100%
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%

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2005.

See accompanying Notes to Required Supplementary Information

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
AS OF JUNE 30, 2004 AND JUNE 30, 2003

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, 2003 actuarial valuation follows.

	<u>SETHEEPP</u>	<u>PSPP</u>
Valuation Date	July 1, 2003	July 1, 2003
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	12 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, not to exceed 30 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, 2004

	SETHEEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 1,004,164	\$ 889,379	\$ 1,893,543
Employee benefits	273,641	242,362	516,003
TOTAL PERSONNEL SERVICES	<u>1,277,805</u>	<u>1,131,741</u>	<u>2,409,546</u>
PROFESSIONAL SERVICES			
Accounting	89,405	79,186	168,591
Actuarial services	208,815	184,946	393,761
Data processing	223,427	197,888	421,315
Disability review	55,682	49,318	105,000
Information systems	295,163	261,424	556,587
Management services	157,067	139,114	296,181
Medical review	17,871	15,829	33,700
Administrative, Internal Audit, Legal, Personnel	294,668	260,985	555,653
TOTAL PROFESSIONAL SERVICES	<u>1,342,098</u>	<u>1,188,690</u>	<u>2,530,788</u>
COMMUNICATION			
Travel	13,628	12,070	25,698
Telephone	25,524	22,606	48,130
Printing	32,295	28,604	60,899
Postage	106,224	94,081	200,305
TOTAL COMMUNICATION	<u>177,671</u>	<u>157,361</u>	<u>335,032</u>
MISCELLANEOUS			
Office space	96,981	85,896	182,877
Supplies and maintenance	31,470	27,872	59,342
Equipment	0	0	0
Other services and charges	8,939	7,917	16,856
TOTAL MISCELLANEOUS	<u>137,390</u>	<u>121,685</u>	<u>259,075</u>
TOTAL ADMINISTRATIVE EXPENSES	<u>\$2,934,964</u>	<u>\$2,599,477</u>	<u>\$5,534,441</u>

With 200,686 active members and 86,205 retired members, the operating cost per member was \$19.29 for the year ended June 30, 2004.

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

	SETHEEP	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
Disability review	0	0	0
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 INVESTMENT EXPENSES
FOR THE YEAR ENDED JUNE 30, 2004

	SETHEEPP	PSPP	Total
PERSONNEL SERVICES			
Salaries and wages	\$ 1,177,425	\$ 195,709	\$ 1,373,134
Employee benefits	274,961	45,703	320,664
TOTAL PERSONNEL SERVICES	<u>1,452,386</u>	<u>241,412</u>	<u>1,693,798</u>
PROFESSIONAL SERVICES			
Accounting	126,320	20,997	147,317
Legal services	83,233	13,835	97,068
Data processing	80,826	13,435	94,261
Information systems	111,078	18,463	129,541
Management services	8,743	1,453	10,196
External investment manager fees	6,902,631	1,147,344	8,049,975
Investment consulting fees	242,585	40,322	282,907
Investment custodian fees	713,210	118,548	831,758
Real estate manager fees	2,038,144	338,777	2,376,921
Administrative, Internal Audit, Personnel	238,491	39,641	278,132
TOTAL PROFESSIONAL SERVICES	<u>10,545,261</u>	<u>1,752,815</u>	<u>12,298,076</u>
COMMUNICATION			
Travel	11,319	1,881	13,200
Telephone	15,731	2,615	18,346
Printing	3,081	512	3,593
Postage	3,309	550	3,859
TOTAL COMMUNICATION	<u>33,440</u>	<u>5,558</u>	<u>38,998</u>
MISCELLANEOUS			
Office space	72,322	12,021	84,343
Supplies and maintenance	8,884	1,477	10,361
Other services and charges	293,406	48,769	342,175
TOTAL MISCELLANEOUS	<u>374,612</u>	<u>62,267</u>	<u>436,879</u>
TOTAL INVESTMENT EXPENSES	<u>\$ 12,405,699</u>	<u>\$ 2,062,052</u>	<u>\$ 14,467,751</u>

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 EXPENSES FOR CONSULTANTS
FOR THE YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2004**

FOR THE YEAR ENDED JUNE 30, 2004

	SETHEEPP	PSPP	Total
ACTUARIAL SERVICES			
Bryan, Pendleton, Swats and McAllister	<u>\$ 208,815</u>	<u>\$ 184,946</u>	<u>\$ 393,761</u>
MEDICAL REVIEW SERVICES			
William Bailey, M.D.	370	330	700
Suzanne Fletcher, M.D.	6,364	5,636	12,000
Barry Siegel, M.D.	6,364	5,636	12,000
Jeffrey Summers, M.D.	<u>4,773</u>	<u>4,227</u>	<u>9,000</u>
TOTAL MEDICAL REVIEW SERVICES	<u><u>17,871</u></u>	<u><u>15,829</u></u>	<u><u>33,700</u></u>
DISABILITY REVIEW SERVICES			
Kroll Background America	<u>55,682</u>	<u>49,318</u>	<u>105,000</u>
TOTAL EXPENSES FOR CONSULTANTS	<u><u>\$ 282,368</u></u>	<u><u>\$ 250,093</u></u>	<u><u>\$ 532,461</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, 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><u>11,137</u></u>	<u><u>10,268</u></u>	<u><u>21,405</u></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.

INVESTMENT SECTION



Ladderback

REPORT BY INVESTMENT CONSULTANT

CALLAN ASSOCIATES^{INC.}

October 14, 2004

Charles L. Mathis
Senior Vice President

SAN FRANCISCO

NEW YORK

CHICAGO

ATLANTA

DENVER

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

Dear Ed:

Callan Associates prepares the quarterly performance reports in full compliance with AIMR standards. The year ended June 30, 2004 was extremely rewarding for both United States and overseas equity markets as the TCRS equity portfolio earned 19.16%. Fixed Income markets were not as rewarding, although non U.S. markets did generate close to double digit returns, in large part due to the boost of a declining U.S. dollar.

As of June 30, 2004 the System's asset allocation and one year respective returns were:

Asset Class	% of Assets	One Year Return
Domestic Equities	29.75%	19.16%
Traditional Fixed Income	39.99%	0.36%
International Equities	11.12%	34.99%
International Fixed Income	2.46%	9.06%
Cash and Equivalents	7.12%	1.03%
Real Estate	1.52%	9.92%
Inflation Hedged Fixed Income	8.04%	0.54%
Total	100.00%	9.32%

The System's relatively high Fixed Income allocation caused it to underperform the median fund in the Callan Associates Public Plan Sponsor database for the year ended June 30, 2004. The prior year's relative results were outstanding, however, as the Fixed Income allocation served the System well. The longer term performance is very good and the overall asset allocation is geared to the System's favorable funded status.

The next five years or so are expected to be challenging for capital market returns. We do not expect any disasters as the equity markets experienced from March 2000 until March 2003, for example, but mid to high single digit returns for many asset classes may be reasonable expectations.

Callan Associates is a thirty one 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 TREASURER



THOMAS G. MILNE
CHIEF INVESTMENT
OFFICER

TREASURY DEPARTMENT
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
11TH FLOOR ANDREW JACKSON STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243

December 1, 2004

Dear Members:

I am pleased to present the Investment Section of the TCRS Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004.

With over \$25 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.

I am proud to report that the TCRS earned 9.32% for the year ended June 30, and earned 8.29% annually for the ten year period ended June 30, 2004.

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 50% 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.
- ❖ 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

- ❖ Combined International equity and fixed income investments are limited to 25% of the TCRS portfolio.

INTERNATIONAL EQUITY

- ❖ No more than 25% of the TCRS portfolio may be invested in international equity securities.
- ❖ Canadian securities shall be treated as domestic securities for policy purposes.
- ❖ The countries in the Morgan Stanley Capital International EAFE index have been approved by the Board for international investing.

INTERNATIONAL FIXED INCOME

- ❖ No more than 10% of TCRS portfolio may be invested in international fixed income securities.
- ❖ 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, 2004

	Annualized Returns		
	Current Year	3-Year	5-Year
Pension Plan Portfolio			
TCRS Performance	9.32 %	4.00 %	3.62 %
Benchmark - Public Fund Index Median	10.19 %	4.57 %	3.44 %
Domestic Equity			
TCRS Performance	19.16 %	(0.17)%	(1.45)%
Benchmark - S & P 500	19.11 %	(0.70)%	(2.20)%
- Dow Jones Industrial Average	18.57 %	1.94 %	0.92 %
- S & P 1500	20.38 %	0.19 %	(1.06)%
Domestic Fixed Income			
TCRS Performance	0.36 %	6.36 %	6.89 %
Benchmark - Lehman Aggregate (excluding BBB)	0.21 %	6.17 %	6.86 %
Inflation Hedged Bonds	0.54 %	-	-
International Equity			
TCRS Performance	34.99 %	6.48 %	3.07 %
Benchmark - MSCI EAFE Index	32.37 %	3.87 %	0.06 %
Benchmark - MSCI EAFE & Emerging Markets	32.88 %	5.03 %	0.65 %
International Fixed Income			
TCRS Performance	9.06 %	11.92 %	6.24 %
Benchmark - Custom International Fixed Income Index	7.74 %	11.14 %	5.82 %
Real Estate			
TCRS Performance	9.92 %	7.13 %	-
Short-term Securities			
TCRS Performance	1.03 %	1.73 %	3.36 %
Benchmark - Three month Treasury Bill	0.98 %	1.71 %	3.29 %

**Callan Public Plan Sponsor Database
Percentile Rankings
Risk Adjusted Basis**

Ranking of TCRS Portfolio	
Last ten years	14
Last fifteen years	9

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, 2004**Expressed in Thousands*

Asset Class	Fair Value	Percentage
Domestic Equity	\$ 7,567,709	30%
Domestic Fixed	12,127,652	48%
International Equity	2,697,335	11%
International Fixed Income	630,200	2%
Short-term Securities	1,849,623	7%
Real Estate	463,383	2%
Total	<u>\$ 25,335,902</u>	<u>100%</u>

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, 2004

LARGEST STOCK HOLDINGS

as of June 30, 2004

by Fair Value

Shares	Security Name	Fair Value
8,007,000	MICROSOFT CORPORATION	\$ 228,679,920
6,966,000	GENERAL ELECTRIC COMPANY	225,698,400
4,713,594	EXXON MOBIL CORPORATION	209,330,710
5,562,420	PFIZER INCORPORATED	190,679,758
4,026,004	CITIGROUP INCORPORATED	187,209,186
2,978,800	WAL-MART STORES INC	157,161,488
4,908,000	INTEL CORPORATION	135,460,800
1,878,104	AMERICAN INTL GROUP INC	133,871,253
1,496,574	BANK OF AMERICA CORP	126,640,092
2,165,000	JOHNSON & JOHNSON	120,590,500

LARGEST BOND HOLDINGS

as of June 30, 2004

by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
1,900,000,000	U.S. TREASURY NOTES	1.50%	02/28/2005	Aaa	\$ 1,896,437,500
1,035,000,000	U.S. TREASURY BONDS	5.58%	05/15/2030	Aaa	1,158,876,563
500,000,000	U.S. TREASURY NOTES	3.04%	02/15/2008	Aaa	493,125,000
500,000,000	U.S. TREASURY NOTES	3.22%	04/15/2009	Aaa	485,781,250
400,000,000	U.S. TREASURY NOTES	6.39%	05/15/2006	Aaa	430,625,000
400,000,000	CANADA GOVERNMENT	4.03%	06/01/2006	Aaa	297,484,992
167,000,000	U.S. TREASURY BONDS	6.15%	05/15/2021	Aaa	220,648,750
150,000,000	U.S. TREASURY BONDS	8.95%	08/15/2014	Aaa	209,578,125
155,000,000	U.S. TREASURY BONDS	9.09%	08/15/2013	Aaa	204,600,000
150,000,000	U.S. TREASURY BONDS	6.10%	02/15/2021	Aaa	193,640,625

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, 2004

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	\$ 10,490,826,655	41.41%	\$ 377,149,144	1.49%	\$ 10,867,975,799	42.90%
Corporate Bonds	1,636,825,380	6.46%	241,372,067	0.95%	1,878,197,447	7.41%
Convertible Bonds	0	0.00%	0	0.00%	0	0.00%
Total Bonds	<u>12,127,652,035</u>	<u>47.87%</u>	<u>618,521,211</u>	<u>2.44%</u>	<u>12,746,173,246</u>	<u>50.31%</u>
Preferred Stock	0	0.00%	11,678,396	0.05%	11,678,396	0.05%
Total Fixed Income	<u>12,127,652,035</u>	<u>47.87%</u>	<u>630,199,607</u>	<u>2.49%</u>	<u>12,757,851,642</u>	<u>50.36%</u>
Common Stock						
Capital Goods & Services	158,804,230	0.63%	25,200,599	0.10%	184,004,829	0.73%
Comingled Equity Funds	0	0.00%	1,574,366	0.01%	1,574,366	0.01%
Consumer Durables	123,790,496	0.49%	7,862,762	0.03%	131,653,258	0.52%
Consumer Non-Durables	1,606,076,930	6.34%	223,423,918	0.88%	1,829,500,848	7.22%
Energy	484,501,199	1.91%	80,787,750	0.32%	565,288,949	2.23%
Financial	1,495,858,324	5.90%	1,800,093,941	7.10%	3,295,952,265	13.00%
Materials & Services	1,766,571,885	6.97%	175,380,424	0.69%	1,941,952,309	7.66%
Miscellaneous Common						
Stock	0	0.00%	94,207	0.00%	94,207	0.00%
Real Estate Investment	17,513,480	0.07%	0	0.00%	17,513,480	0.07%
Trust						
Technology	1,329,238,153	5.25%	166,612,964	0.66%	1,495,851,117	5.91%
Transportation	117,081,501	0.46%	51,434,568	0.20%	168,516,069	0.66%
Unit - Compound Instrument	0	0.00%	135,677	0.00%	135,677	0.00%
Utilities	468,273,304	1.85%	164,734,142	0.65%	633,007,446	2.50%
Total Common Stock	<u>7,567,709,502</u>	<u>29.87%</u>	<u>2,697,335,318</u>	<u>10.64%</u>	<u>10,265,044,820</u>	<u>40.51%</u>
Short-term Investments						
Commercial Paper	550,107,968	2.17%	0	0.00%	550,107,968	2.17%
Pooled Funds and Mutual						
Funds	106,167	0.00%	0	0.00%	106,167	0.00%
U.S. Gov't Securities	1,299,409,117	5.13%	0	0.00%	1,299,409,117	5.13%
Total Short term Investments	<u>1,849,623,252</u>	<u>7.30%</u>	<u>0</u>	<u>0.00%</u>	<u>1,849,623,252</u>	<u>7.30%</u>
Real Estate	463,382,896	1.83%	0	0.00%	463,382,896	1.83%
Total Investments	<u>22,008,367,685</u>	<u>86.87%</u>	<u>3,327,534,925</u>	<u>13.13%</u>	<u>25,335,902,610</u>	<u>100.00%</u>
Short Term Investments						
Classified as Cash Equivalents	<u>(1,284,977,478)</u>		<u>0</u>		<u>(1,284,977,478)</u>	
Total Investments as Shown on the						
Statement of Plan Net Assets	<u>\$ 20,723,390,207</u>		<u>\$ 3,327,534,925</u>		<u>\$ 24,050,925,132</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, 2004**

SCHEDULE OF FEES

	Assets Under Management	Fees
Asset Management		
International Investment Manager Fees	\$2.7 Billion	\$ 8,049,975
Real Estate Asset Management	463 Million	2,376,921
Total Asset Management		<u>\$ 10,426,896</u>
Other Investment Services Fees		
Custodian Bank	25 Billion	\$ 867,313
General Investment Consultant	25 Billion	195,000
Real Estate Investment Consultant	463 Million	100,000
Total Investment Services Fees		<u>\$ 1,162,313</u>

SCHEDULES OF COMMISSIONS

Domestic Exchange Traded Shares

Broker	Domestic		
	Shares Traded	Commissions	Commission per Share
A.G. EDWARDS	4,823,200	\$ 231,610	\$ 0.0480
BANC OF AMERICA SECURITIES	7,149,827	320,782	0.0449
BEAR STEARNS FACTSET	6,150,000	265,020	0.0431
BEAR STEARNS SECURITIES CORPORATION	11,693,224	512,817	0.0439
BANK OF NEW YORK BROKERAGE INCORPORATED	7,559,000	113,385	0.0150
CREDIT SUISSE FIRST BOSTON	5,334,800	244,150	0.0458
CIBC	2,478,000	114,710	0.0463
CAPITAL INSTITUTIONAL SVCS., INCORPORATED	20,758,356	1,037,918	0.0500
DEUTSCHE BANK ALEX BROWN	4,320,500	198,773	0.0460
INSTINET CLEARING SERVICES INCORPORATED	14,971,521	286,085	0.0191
JEFFERIES AND COMPANY, INCORPORATED	6,033,397	275,280	0.0456
LEHMAN BROTHERS INCORPORATED	15,355,261	694,614	0.0452
MERRILL LYNCH PIERCE FENNER & SMITH	4,462,500	204,159	0.0457
MORGAN KEEGAN & COMPANY, INCORPORATED	5,345,566	247,788	0.0464
PRUDENTIAL SECURITIES	7,798,600	338,995	0.0435
SALOMAN SMITH BARNEY	12,678,678	571,192	0.0451
SANFORD C BERNSTEIN & COMPANY, LLC	4,187,000	193,940	0.0463
Other Brokers*	25,895,287	1,106,893	0.0427
Totals	<u>166,994,717</u>	<u>\$ 6,958,111</u>	

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

Broker	Domestic		
	Shares Traded	Commissions	Commission per Share
DEUTSCHE BANK ALEX BROWN	15,137,000	\$ 605,288	\$ 0.0400
GOLDMAN SACHS & COMPANY	10,887,000	490,095	0.0450
MERRILL LYNCH PIERCE FENNER & SMITH	22,116,000	1,326,960	0.0600
Totals	<u>48,140,000</u>	<u>\$ 2,422,343</u>	

International Exchange Traded Shares

Broker	International		
	Shares Traded	Commissions	Commission per Share
CREDIT SUISSE FIRST BOSTON CORPORATION	508,656,403	\$ 184,701	\$ 0.0004
DEUTSCHE BANK ALEX BROWN	325,815,760	161,079	0.0005
GOLDMAN SACHS & COMPANY	68,743,768	773,197	0.0112
JEFFERIES AND COMPANY	1,915,090	143,471	0.0749
JP MORGAN SECURITIES INCORPORATED	161,470,173	125,410	0.0008
MERRILL LYNCH PIERCE FENNER & SMITH	179,978,104	616,257	0.0034
MORGAN STANLEY AND COMPANY	41,651,397	189,751	0.0046
UBS AG	475,468,519	280,798	0.0006
UBS WARBURG LLC	29,688,623	267,850	0.0090
Other Brokers*	377,643,913	1,561,793	0.0041
Totals	<u>2,171,031,750</u>	<u>\$ 4,304,307</u>	

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



Daisies

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 valuation performed as of July 1, 2001, set 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. A valuation was performed as of July 1, 2003, with new employer rates becoming effective July 1, 2004.

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. The next experience study is scheduled to begin June 30, 2004.

ACTUARY'S CERTIFICATION LETTER



October 3, 2004

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, 2003. 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 both July 1, 2001 and July 1, 2003 with the remainder to be recognized in July 1, 2005 actuarial valuation. 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.

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 3, 2004
Page Two

In performing the 2003 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. 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, 2003 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

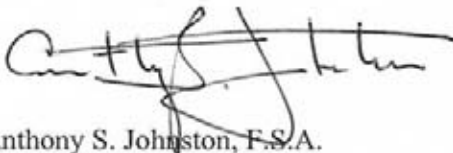
- Summary of Actuarial Assumptions and Methods
- Actuarial Data (current year data)
- Actuarial Balance Sheet
- Short-Term Solvency Test
- Summary of Unfunded Accrued Liabilities and Selected Funding Information
- Analysis of Financial Experience

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, 2001 and 2003 actuarial valuations.

The 2003 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.

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
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%
2003	200,597	6,504,434	32,425	2.93%

SCHEDULE OF RETIRED MEMBER VALUATION DATA

Valuation Year	Number	Annual Allowances In Thousands	Average Annual Allowances	Average Annual Percentage Increase In Average Allowances
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%
2003	83,279	919,582	11,042	3.93%

SCHEDULE OF RETIRED MEMBER ACTIVITY

Expressed in Thousands

2-year period	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		
June 30								
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
2003	11,128	168,529	5,680	44,623	83,279	919,582	15.57%	11,042

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, 2003**

ASSETS	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivision Pension Plan (PSPP)	Total
Present assets creditable to			
Employer accumulation fund	\$ 19,191,061,582	\$ 2,914,374,745	\$ 22,105,436,327
Members' accumulation fund	2,908,190,130	691,154,611	3,599,344,741
Total present assets	<u>22,099,251,712</u>	<u>3,605,529,356</u>	<u>25,704,781,068</u>
Present value of prospective contributions payable to			
Employer accumulation fund			
Normal	3,004,425,125	967,109,743	3,971,534,868
Accrued liability	52,493,209	317,945,618	370,438,827
Total employer accumulation	<u>3,056,918,334</u>	<u>1,285,055,361</u>	<u>4,341,973,695</u>
Members' accumulation fund	<u>1,294,805,852</u>	<u>376,265,035</u>	<u>1,671,070,887</u>
Total prospective contributions	<u>4,351,724,186</u>	<u>1,661,320,396</u>	<u>6,013,044,582</u>
TOTAL ASSETS	<u><u>\$ 26,450,975,898</u></u>	<u><u>\$ 5,266,849,752</u></u>	<u><u>\$ 31,717,825,650</u></u>
LIABILITIES			
Present value of prospective benefits payable on account of			
Present retired members and beneficiaries	9,071,081,541	1,304,957,688	10,376,039,229
Present active members	16,960,751,035	3,851,255,879	20,812,006,914
Former members	419,143,322	110,636,185	529,779,507
TOTAL LIABILITIES	<u><u>\$ 26,450,975,898</u></u>	<u><u>\$ 5,266,849,752</u></u>	<u><u>\$ 31,717,825,650</u></u>

UNAUDITED

SHORT-TERM SOLVENCY TEST

SHORT-TERMSOLVENCYTEST

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 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.

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)
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%
2003 SETHEEPP	\$ 2,908.2	\$ 9,071.1	\$ 10,172.5	\$ 22,099.3	100%	100%	99%
PSPP	691.1	1,304.9	1,927.4	3,605.5	100%	100%	84%
Total	\$ 3,599.3	\$ 10,376.0	\$ 12,099.9	\$ 25,704.8	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>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, 2003 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
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%
2003	26,075.2	25,704.8	99%	370.4 (1)	6,504.4	6%

- 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 Assumptions	Unfunded Liability		State Amortization Period (3)
			SETHEEPP	PSPP	
1993 (1)	8.0%	7.0%	\$ 500,933,773	42,897,901	10/22 (2)
1995	8.0%	7.0%	366,528,134	41,288,942	20
1997 (4)	7.5%	5.5%	111,172,072	61,012,975	18
1999	7.5%	5.5%	93,022,745	200,161,388	16
2001	7.5%	4.75% (5)	81,226,933	340,147,400	14
2003	7.5%	4.75% (5)	52,493,209	317,945,618	12

- 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) Graded scale.

ANALYSIS OF FINANCIAL EXPERIENCE

GAIN AND LOSS ANALYSIS, JULY 1, 2003 VALUATION

	State and Higher Education	Teacher
Normal Cost		
Effective Employer Normal Cost Rate Pursuant to 2001 Valuation	7.30%	3.40%
Investment Results	2.71%	2.65%
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.	(0.41%)	(0.48%)
New Entrants: Includes the effect where normal cost for new entrants since the previous valuation differs from the normal cost of the group.	0.34%	0.72%
Social Security Changes: More rapid increases in the Social Security wage base	(0.01%)	(0.03%)
Cost of Living Escalation: COLA in 2002 was 1.60%; 2003 was 2.40%.	(0.48%)	(0.44%)
Prior Service Purchases : Employee purchases of prior service credits result in liabilities to the plan that are not fully offset by related employee contributions	0.16%	0.09%
Contribution rate change delay	0.17%	(0.04%)
Change in actuarial assumptions (phase-in)	0.40%	-
Other	0.36%	(0.37%)
Effective Employer Normal Cost Rate Pursuant to 2003 Valuation	10.54%	5.50%

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

Unfunded Actuarial Liabilities at June 30, 2003	\$ 52,493,209
Interest Accrual Fiscal Year 2003-2004	3,463,534
Contributions Made toward Unfunded Actuarial Liabilities (Fiscal Year 2003-2004)	(6,312,752)
Unfunded Actuarial Liabilities at June 30, 2004	\$ 49,643,991

*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.

An 18-member Board of Trustees has the responsibility to manage and oversee the operation of the consolidated system. The Board consists of nine ex-officio members from the executive, legislative, and judicial branches of state government 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, three representatives of local governments and one retired teacher representative. 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 2004**

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	\$ 3,544		\$ 4,725		\$ 5,906		\$ 7,088		\$ 8,269	
	Social Security	8,760		8,760		8,760		8,760		8,760	
	Total	\$ 12,304	82.0%	\$ 13,485	89.9%	\$ 14,666	97.8%	\$ 15,848	105.7%	\$ 17,029	113.5%
\$20,000	TCRS	\$ 4,725		\$ 6,300		\$ 7,875		\$ 9,450		\$ 11,025	
	Social Security	10,344		10,344		10,344		10,344		10,344	
	Total	\$ 15,069	75.3%	\$ 16,644	83.2%	\$ 18,219	91.1%	\$ 19,794	99.0%	\$ 21,369	106.8%
\$25,000	TCRS	\$ 5,906		\$ 7,875		\$ 9,844		\$ 11,813		\$ 13,781	
	Social Security	11,916		11,916		11,916		11,916		11,916	
	Total	\$ 17,822	71.3%	\$ 19,791	79.2%	\$ 21,760	87.0%	\$ 23,729	94.9%	\$ 25,697	102.8%
\$30,000	TCRS	\$ 7,088		\$ 9,450		\$ 11,813		\$ 14,175		\$ 16,538	
	Social Security	13,488		13,488		13,488		13,488		13,488	
	Total	\$ 20,576	68.6%	\$ 22,938	76.5%	\$ 25,301	84.3%	\$ 27,663	92.2%	\$ 30,026	100.1%
\$35,000	TCRS	\$ 8,269		\$ 11,025		\$ 13,781		\$ 16,538		\$ 19,294	
	Social Security	15,060		15,060		15,060		15,060		15,060	
	Total	\$ 23,329	66.7%	\$ 26,085	74.5%	\$ 28,841	82.4%	\$ 31,598	90.3%	\$ 34,354	98.2%
\$40,000	TCRS	\$ 9,450		\$ 12,600		\$ 15,750		\$ 18,900		\$ 22,050	
	Social Security	16,632		16,632		16,632		16,632		16,632	
	Total	\$ 26,082	65.2%	\$ 29,232	73.1%	\$ 32,382	81.0%	\$ 35,532	88.8%	\$ 38,682	96.7%
\$45,000	TCRS	\$ 10,749		\$ 14,333		\$ 17,916		\$ 21,499		\$ 25,082	
	Social Security	17,820		17,820		17,820		17,820		17,820	
	Total	\$ 28,569	63.5%	\$ 32,153	71.5%	\$ 35,736	79.4%	\$ 39,319	87.4%	\$ 42,902	95.3%
\$50,000	TCRS	\$ 12,128		\$ 16,170		\$ 20,213		\$ 24,255		\$ 28,298	
	Social Security	18,456		18,456		18,456		18,456		18,456	
	Total	\$ 30,584	61.2%	\$ 34,626	69.3%	\$ 38,669	77.3%	\$ 42,711	85.4%	\$ 46,754	93.5%
\$55,000	TCRS	\$ 13,506		\$ 18,008		\$ 22,509		\$ 27,011		\$ 31,513	
	Social Security	19,068		19,068		19,068		19,068		19,068	
	Total	\$ 32,574	59.2%	\$ 37,076	67.4%	\$ 41,577	75.6%	\$ 46,079	83.8%	\$ 50,581	92.0%
\$60,000	TCRS	\$ 14,884		\$ 19,845		\$ 24,806		\$ 29,768		\$ 34,729	
	Social Security	19,596		19,596		19,596		19,596		19,596	
	Total	\$ 34,480	57.5%	\$ 39,441	65.7%	\$ 44,402	74.0%	\$ 49,364	82.3%	\$ 54,325	90.5%

* 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 2004. 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 2004;
- (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.
- (4) Please note that 2002 was the last year in which an employee who attained age 65 would be entitled to an unreduced social security benefit. The above chart represents a reduced social security benefit for someone beginning social security benefits at age 65 during 2004.

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>
---	---

A vintage wooden wagon with large spoked wheels is parked in a field of tall grass and white daisies. The wagon is weathered and appears to be abandoned. In the background, there are trees with yellowing leaves, suggesting autumn, and a wooden fence. The scene is bathed in warm, golden light.

STATISTICAL SECTION

Abandoned In Place

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	14,975	17,295	5,125	28,426	65,821
5 - 9	7,733	14,370	2,903	18,505	43,511
10 - 14	5,218	9,604	2,333	10,146	27,301
15 - 19	5,937	7,472	2,089	7,108	22,606
20 - 24	4,276	5,787	1,742	3,819	15,624
25 - 29	3,677	6,884	1,547	2,676	14,784
30 - 34	1,956	4,197	915	1,028	8,096
35 - 39	637	1,095	300	296	2,328
40 - 44	176	164	65	62	467
Over 44	61	42	22	23	148
Total	44,646	66,910	17,041	72,089	200,686

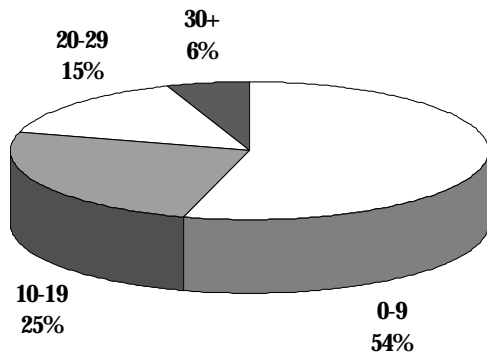
SCHEDULE OF ACTIVE MEMBERS

by Enrollment Date

Date of Membership	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1940s	3	9	4	1	17
1950s	62	49	13	7	131
1960s	884	1,871	298	132	3,185
1970s	5,824	11,649	2,757	3,553	23,783
1980s	11,554	13,591	4,367	11,600	41,112
1990s	13,505	24,434	5,310	30,834	74,083
2000s	12,814	15,307	4,292	25,962	58,375
Total	44,646	66,910	17,041	72,089	200,686

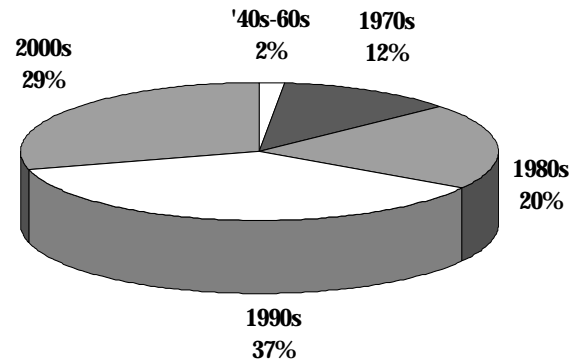
PERCENTAGE OF ACTIVE MEMBERS

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	206	4	19	187	416
20-29	5,445	10,389	1,469	7,389	24,692
30-39	8,598	16,035	2,923	16,667	44,223
40-49	13,312	17,529	5,174	22,216	58,231
50-54	7,417	11,912	2,889	10,154	32,372
55-59	5,899	8,140	2,507	8,234	24,780
60-64	2,529	2,398	1,399	4,575	10,901
65-69	868	398	486	1,741	3,493
Over 69	372	105	175	926	1,578
Total	44,646	66,910	17,041	72,089	200,686

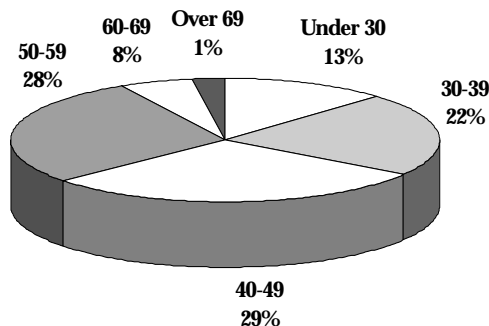
SCHEDULE OF ACTIVE MEMBERS

by Age at Enrollment

Age at Enrollment	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than 20	1,677	119	316	1,105	3,217
20 - 24	9,459	23,731	2,859	8,860	44,909
25 - 29	9,306	16,147	3,321	10,808	39,582
30 - 34	6,778	8,828	2,949	11,787	30,342
35 - 39	5,696	7,153	2,668	12,166	27,683
40 - 44	4,483	5,340	2,071	10,367	22,261
45 - 49	3,342	3,239	1,425	7,279	15,285
50 - 54	2,196	1,626	863	4,951	9,636
55 - 59	1,281	592	407	2,899	5,179
60 - 64	324	105	109	1,199	1,737
65 - 69	84	25	42	484	635
Over 69	20	5	11	184	220
Total	44,646	66,910	17,041	72,089	200,686

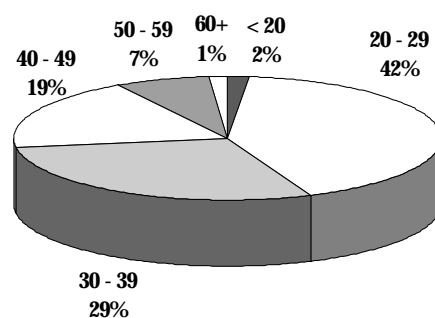
PERCENTAGE OF ACTIVE MEMBERS

by Current Age



PERCENTAGE OF ACTIVE MEMBERS

by Age at Enrollment



SCHEDULES OF ACTIVE MEMBERS

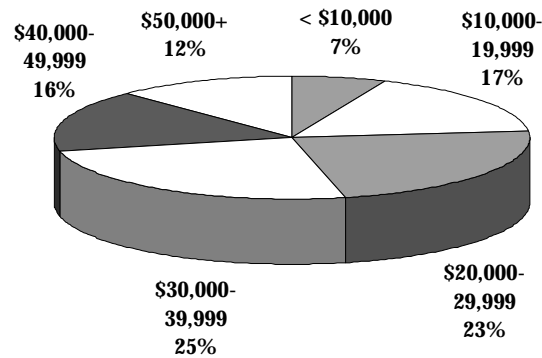
SCHEDULE OF ACTIVE MEMBERS

by Salary

Annual Salary	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than \$10,000	2,519	286	815	9,141	12,761
\$10,000-19,999	6,825	984	3,048	23,148	34,005
\$20,000-29,999	15,610	4,685	5,792	20,075	46,162
\$30,000-39,999	10,064	25,996	2,890	11,584	50,534
\$40,000-49,999	5,113	21,343	1,637	4,617	32,710
\$50,000+	4,515	13,616	2,859	3,524	24,514
Total	44,646	66,910	17,041	72,089	200,686

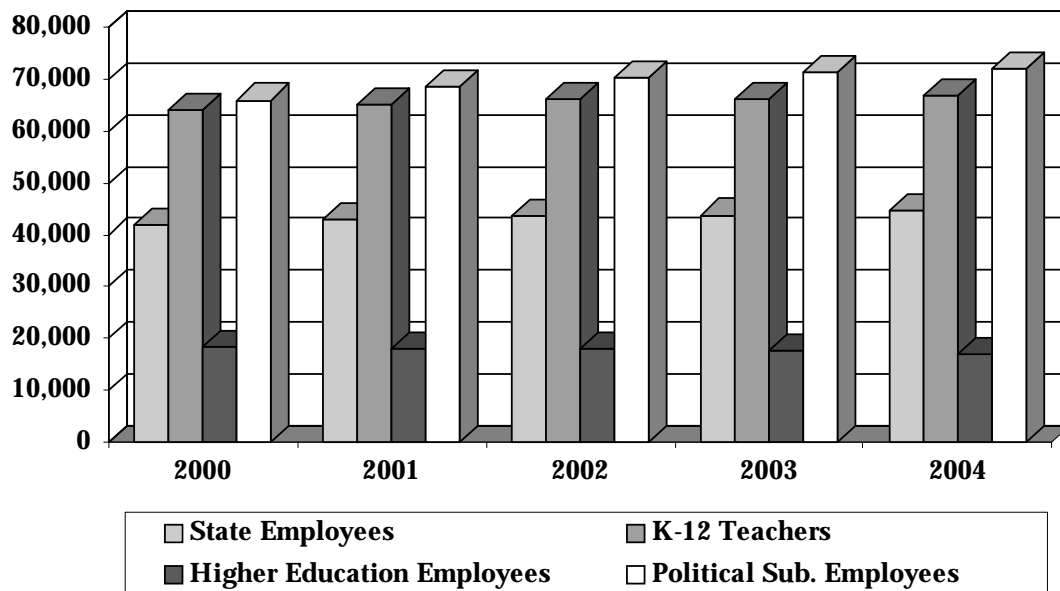
PERCENTAGE OF ACTIVE MEMBERS

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	11,106	18,868	5,787	15,735	51,496
Option I	1,625	1,428	1,273	1,779	6,105
Option II	803	726	515	613	2,657
Option III	2,026	2,222	1,037	1,816	7,101
Option IV	1,556	2,089	860	1,010	5,515
S.S. Leveling	1,336	2,923	339	1,046	5,644
Subtotal	18,452	28,256	9,811	21,999	78,518
Survivors	2,615	1,719	1,235	2,118	7,687
Total	21,067	29,975	11,046	24,117	86,205

- * 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

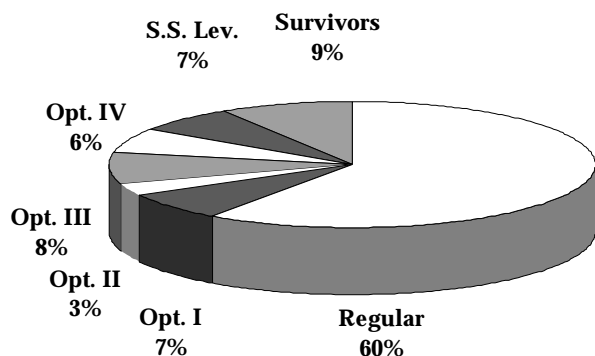
SCHEDULE OF RETIRED MEMBERS

by Type of Retirement

Type of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Retirees:					
Service	14,672	23,599	7,779	17,074	63,124
Early	2,427	3,797	1,493	3,276	10,993
Disability	1,353	860	539	1,649	4,401
Total Retirees	18,452	28,256	9,811	21,999	78,518
Survivors	2,615	1,719	1,235	2,118	7,687
Total	21,067	29,975	11,046	24,117	86,205

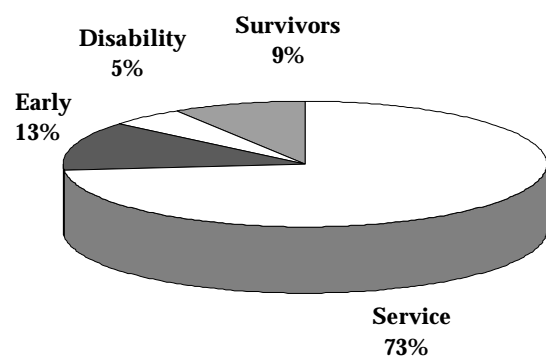
PERCENTAGE OF RETIRED MEMBERS

by Type of Benefit Plan



PERCENTAGE OF RETIRED MEMBERS

by Type of Retirement



SCHEDULES OF RETIRED MEMBERS

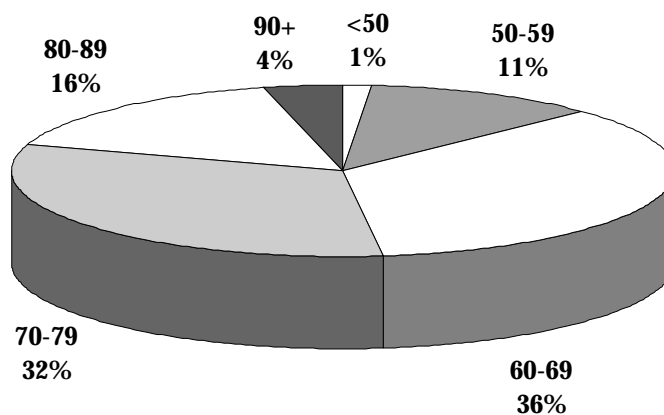
SCHEDULE OF RETIRED MEMBERS

by Current Age

Current Age	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 40	105	72	38	68	283
40-44	117	51	39	85	292
45-49	234	119	94	207	654
50-54	666	733	230	532	2,161
55-59	1,902	3,503	751	1,587	7,743
60-64	3,234	5,094	1,610	3,497	13,435
65-69	4,026	5,186	2,283	5,249	16,744
70-74	3,758	4,708	2,145	4,758	15,369
75-79	3,082	3,878	1,759	3,567	12,286
80-84	2,208	2,668	1,258	2,552	8,686
85-89	1,179	2,103	605	1,383	5,270
90-94	462	1,318	189	528	2,497
95-99	82	475	43	94	694
Over 99	12	67	2	10	91
Total	21,067	29,975	11,046	24,117	86,205

PERCENTAGE OF TOTAL RETIRED MEMBERS

by Current Age



SCHEDULES OF RETIRED MEMBERS

SCHEDULE OF RETIRED MEMBERS

by Date of Retirement

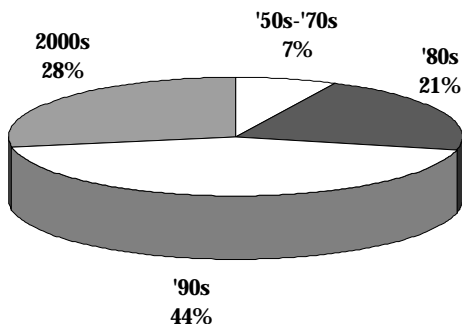
Date of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1950s	2	19	0	3	24
1960s	30	171	7	7	215
1970s	1,253	3,066	464	1,274	6,057
1980s	4,392	6,808	2,292	4,898	18,390
1990s	9,676	11,728	5,338	10,752	37,494
2000s	5,714	8,183	2,945	7,183	24,025
Total	21,067	29,975	11,046	24,117	86,205

SCHEDULE OF RETIRED MEMBERS

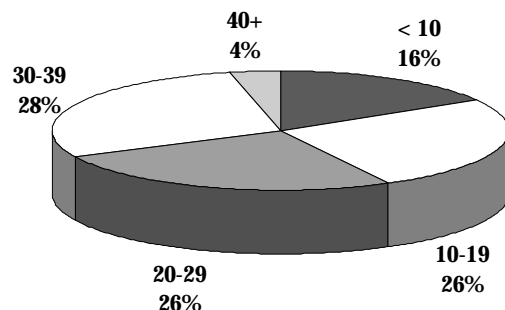
by Service Credit at Retirement

Years of Service	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 10	4,410	2,283	2,070	5,322	14,085
10-14	3,018	1,797	1,682	4,962	11,459
15-19	2,734	2,226	1,580	4,291	10,831
20-24	2,779	3,273	1,466	3,666	11,184
25-29	2,330	4,508	1,299	2,663	10,800
30-34	3,790	10,063	1,832	2,341	18,026
35-39	1,317	3,921	741	631	6,610
40-44	556	1,622	281	200	2,659
Over 44	133	282	95	41	551
Total	21,067	29,975	11,046	24,117	86,205

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	422	Kentucky	366
Alaska	15	Louisiana	65
Arizona	96	Maine	14
Arkansas	257	Maryland	57
California	134	Massachusetts	11
Colorado	59	Michigan	69
Connecticut	7	Minnesota	19
Delaware	8	Mississippi	764
Dist. of Columbia	7	Missouri	99
Florida	973	Montana	5
Georgia	714	Nebraska	4
Hawaii	11	Nevada	34
Idaho	17	New Hampshire	13
Illinois	85	New Jersey	13
Indiana	84	New Mexico	27
Iowa	10	New York	41
Kansas	27	North Carolina	347

North Dakota	3
Ohio	110
Oklahoma	43
Oregon	25
Pennsylvania	50
Rhode Island	2
South Carolina	151
South Dakota	6
Tennessee	80,164
Texas	287
Utah	10
Vermont	7
Virginia	357
Washington	45
West Virginia	18
Wisconsin	23
Wyoming	2
Total U.S.	86,177

INTERNATIONAL COUNTRIES

Australia	2
Canada	5
England	2
France	1
Germany	2
Greece	2
Ireland	1
Israel	1
Japan	1
Kenya	1
Kuwait	1
Mexico	2
Total Foreign Countries	21
Overseas Military Bases	7
Total U.S.	86,177
Total	86,205

TENNESSEE

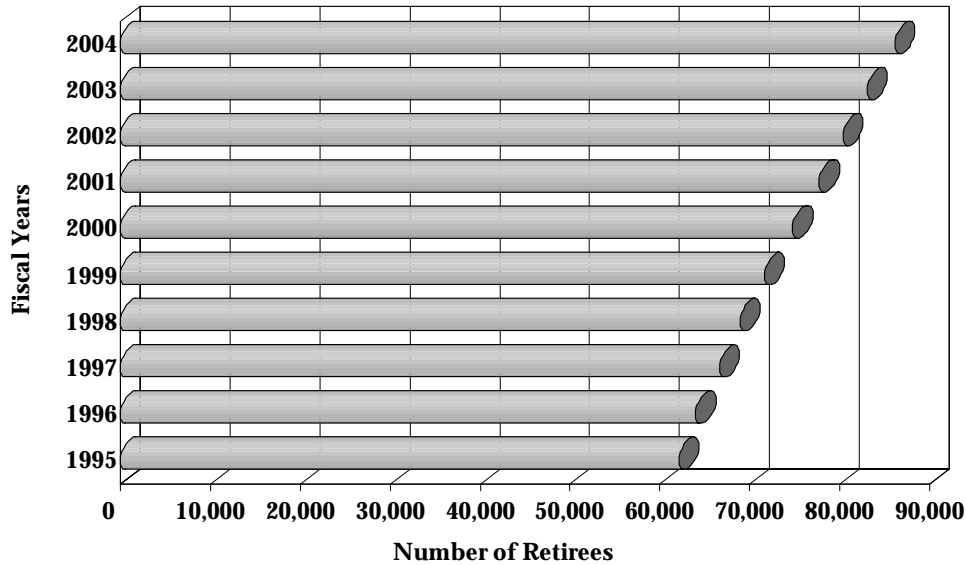
Anderson	1,240	Fentress	258
Bedford	511	Franklin	597
Benton	259	Gibson	878
Bledsoe	314	Giles	409
Blount	2,020	Grainger	227
Bradley	1,042	Greene	1,456
Campbell	625	Grundy	244
Cannon	231	Hamblen	912
Carroll	490	Hamilton	3,955
Carter	1,180	Hancock	63
Cheatham	487	Hardeman	718
Chester	320	Hardin	435
Claiborne	508	Hawkins	719
Clay	116	Haywood	445
Cocke	451	Henderson	249
Coffee	683	Henry	625
Crockett	243	Hickman	408
Cumberland	662	Houston	72
Davidson	6,781	Humphreys	306
Decatur	176	Jackson	168
Dekalb	240	Jefferson	653
Dickson	538	Johnson	253
Dyer	400	Knox	5,376
Fayette	623	Lake	191

Lauderdale	537
Lawrence	584
Lewis	214
Lincoln	464
Loudon	580
McMinn	667
McNairy	408
Macon	173
Madison	1,805
Marion	343
Marshall	382
Maury	668
Meigs	121
Monroe	505
Montgomery	1,691
Moore	81
Morgan	478
Obion	612
Overton	348
Perry	199
Pickett	95
Polk	172
Putnam	1,462
Rhea	372

Roane	1,054
Robertson	741
Rutherford	2,215
Scott	372
Sequatchie	211
Sevier	733
Shelby	9,151
Smith	289
Stewart	138
Sullivan	2,549
Sumner	1,614
Tipton	536
Trousdale	142
Unicoi	317
Union	226
VanBuren	155
Warren	593
Washington	2,114
Wayne	241
Weakley	852
White	463
Williamson	1,454
Wilson	1,286
Total Tennessee	80,164

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

NUMBER OF RETIREES ON PAYROLL
Fiscal Years 1995-2004



PRIOR SERVICE ESTABLISHED
for the Year Ended June 30, 2004

Type of Service	Members	Years of Service	Payments
State:			
Backpayment	101	116	\$ 130,012
Military	119	241	20,151
Redeposit	105	464	1,179,814
Total	325	821	\$ 1,329,977
Teachers:			
Backpayment	89	174	\$ 553,535
Military	39	85	0
Redeposit	157	732	1,910,311
Total	285	991	\$ 2,463,846
Higher Education:			
Backpayment	166	225	\$ 280,781
Military	34	77	24,702
Redeposit	24	103	217,164
Total	224	405	\$ 522,647
Political Subdivisions:			
Backpayment	527	1,222	\$ 832,429
Military	123	236	9,197
Redeposit	51	232	352,424
Total	701	1,690	\$ 1,194,050
Totals by Category:			
Backpayment	883	1,737	\$ 1,796,757
Military	315	639	54,050
Redeposit	337	1,531	3,659,713
Total	1,535	3,907	\$ 5,510,520

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, 2004

Type of Service	Members	Years of Service	Payments
State:			
Backpayment	6	21	\$ 15,792
Military	0	0	0
Redeposit	101	566	327,137
Total	107	587	\$ 342,929
Teachers:			
Backpayment	27	78	\$ 58,868
Military	0	0	0
Redeposit	198	1,026	691,889
Total	225	1,104	\$ 750,757
Higher Education:			
Backpayment	20	95	\$ 38,386
Military	0	0	0
Redeposit	12	65	26,227
Total	32	160	\$ 64,613
Political Subdivisions:			
Backpayment	51	287	\$ 109,173
Military	0	0	0
Redeposit	73	432	188,885
Total	124	719	\$ 298,058
Totals by Category:			
Backpayment	104	481	\$ 222,219
Military	0	0	0
Redeposit	384	2,089	1,234,138
Total	488	2,570	\$ 1,456,357

REFUND ACTIVITY AND POLITICAL SUBDIVISION PARTICIPATION

REFUND ACTIVITY

For the Year Ended June 30	Number of Refunds Processed	Amount Refunded
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
2004	4,688	29,925,762

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
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
2004	163	88	179	430

HISTORICAL EMPLOYER CONTRIBUTION RATES

HISTORICAL EMPLOYER CONTRIBUTION RATES

Expressed as a Percentage of Salary

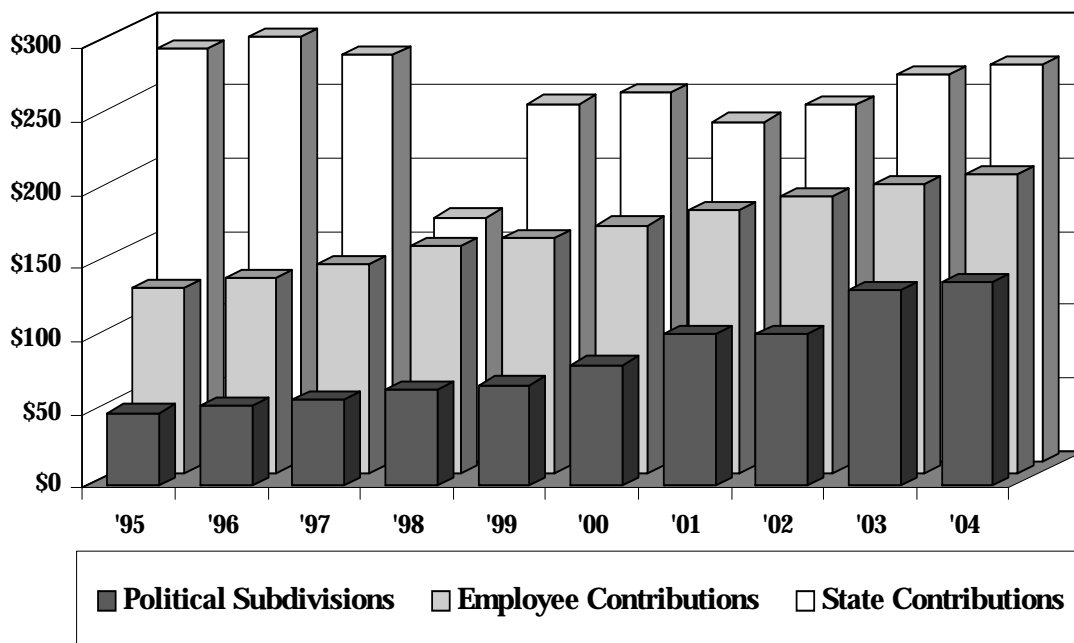
Year Ended June 30	State Employees	Teachers	Higher Education Employees Faculty	General
1995	6.33%	8.51%	6.33%	6.33%
1996	6.33	8.51	6.33	6.33
1997	7.36	6.50	7.36	7.36
1998	3.65	3.89	3.65	3.65
1999	5.43	5.47	5.43	5.43
2000	5.43	5.47	5.43	5.43
2001	6.19	3.72	6.19	6.19
2002	6.19	3.72	6.19	6.19
2003	7.30	3.40	7.30	7.30
2004 (1)	7.29	3.39	7.29	7.29

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

- (1) As part of a statewide request for budget reductions, TCRS reduced the administrative component of the employer contribution rate by .01%.

RETIREMENT CONTRIBUTIONS

Fiscal Years 1995-2004



HISTORICAL FAIR VALUE

HISTORICAL FAIR VALUE

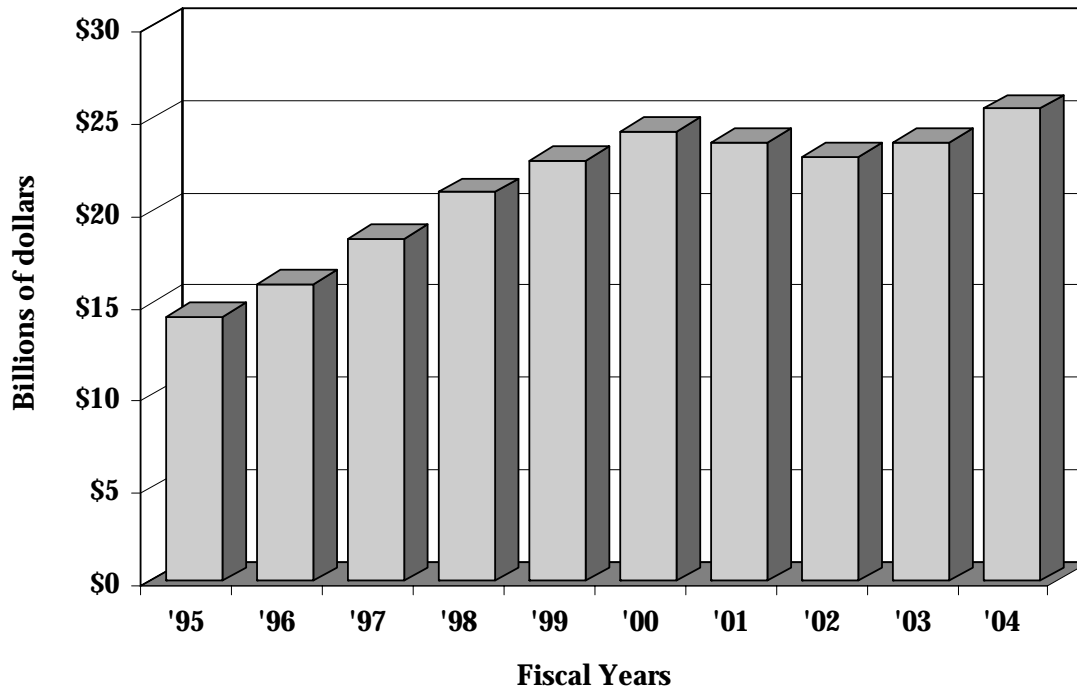
Fiscal Years 1995-2004

Expressed in Thousands

As of June 30	Fair Value	As of June 30	Fair Value
1995	\$ 14,293,461	2000	\$ 24,337,679
1996	16,072,177	2001	23,737,926
1997	18,519,341	2002	22,982,880
1998	21,057,487	2003	23,778,484
1999	22,797,512	2004	25,586,516

HISTORICAL FAIR VALUE

Fiscal Years 1995-2004



**ANALYSIS OF MEMBER AND EMPLOYER RESERVES
FOR THE YEAR ENDED JUNE 30, 2004**

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, 2003 Member Reserve Fund	\$ 2,909,347,419	\$ 691,169,623	\$ 3,600,517,042
Member contributions	154,333,060	50,650,584	204,983,644
Employer provided contributions	24,041,113	11,670,635	35,711,748
Interest	137,796,386	33,000,750	170,797,136
Refunded account balances	(15,305,206)	(14,620,556)	(29,925,762)
Transfers to employer fund of retiring members'	<u>(151,037,872)</u>	<u>(24,965,902)</u>	<u>(176,003,774)</u>
June 30, 2004 Member Reserve Fund	<u>\$ 3,059,174,900</u>	<u>\$ 746,905,134</u>	<u>\$ 3,806,080,034</u>

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, 2003 Employer Reserve Fund	\$ 17,533,906,925	\$ 2,644,060,391	\$ 20,177,967,316
Employer Contributions	271,298,488	139,807,651	411,106,139
Investment Income	1,870,972,985	310,880,643	2,181,853,628
Transfers from Retiring Members' Account	151,037,872	24,965,902	176,003,774
Employer Provided Contributions	(24,041,113)	(11,670,635)	(35,711,748)
Interest Credited to Members' Account	(137,796,386)	(33,000,750)	(170,797,136)
Lump-Sum Death Benefits	(3,148,644)	(1,328,945)	(4,477,589)
Retirement and Survivors Annuities	(823,790,118)	(126,183,607)	(949,973,725)
Administrative Expenses	<u>(2,934,964)</u>	<u>(2,599,477)</u>	<u>(5,534,441)</u>
June 30, 2004 Employer Reserve Fund	<u>\$ 18,835,505,045</u>	<u>\$ 2,944,931,173</u>	<u>\$ 21,780,436,218</u>

AVERAGE BENEFIT PAYMENTS SCHEDULE

AVERAGE BENEFIT PAYMENTS SCHEDULE

Fiscal Year of Retirement

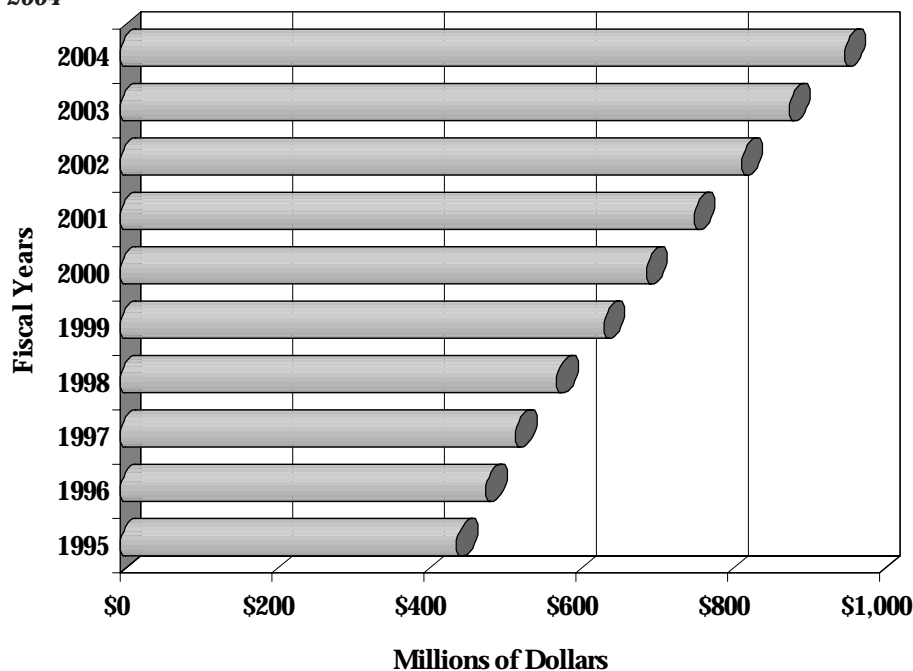
Years of Service Credit

	10 - 14	15 - 19	20 - 24	25 - 29	30 or more
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
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
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
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
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
2004 Average Monthly Benefit	\$ 406	\$ 721	\$ 1,080	\$ 1,458	\$ 2,167
Number of Retirees	387	344	358	390	1,754
Average Final Salary	\$ 30,591	\$ 31,239	\$ 35,619	\$ 39,432	\$ 46,718

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 1995-2004



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
SETHEPP								
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
6/30/2004	617,659	20,341	40,022	145,767	3,149	826,938	15,305	842,243
PSPP								
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
6/30/2004	98,680	3,250	6,394	17,860	1,329	127,513	14,621	142,134

**SCHEDULES OF EXPENSES BY TYPE AND REVENUE BY SOURCE
FOR THE YEAR ENDED JUNE 30, 2004**

SCHEDULES OF EXPENSES BY TYPE

Expressed in Thousands

Year Ending	Benefit Payments	Administrative Expenses	Refunds	Total
SETHEEPP				
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
6/30/2004	826,938	2,935	15,305	845,178
PSPP				
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
6/30/2004	127,513	2,599	14,621	144,733

SCHEDULES OF REVENUE BY SOURCE

Expressed in Thousands

Year Ending	Member Contributions	Employer Contributions		Investment Income (Loss)	Total
		Dollars	% of Annual Covered Payroll		
SETHEEPP					
6/30/1999	\$ 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
6/30/2004	154,334	271,298	5.47%	1,870,972	2,296,604
PSPP					
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
6/30/2004	50,650	139,808	7.60%	310,881	501,339

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, 2004, 430 political subdivisions were participating in TCRS.

Participation as of June 30, 2004:

Cities	163
Counties	88
Utility Districts	44
Special School Districts	19
Joint Ventures	23
Housing Authorities	10
911 Emergency Communication Districts	33
Miscellaneous Authorities	50
Total	<u>430</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 430
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

<p>911 EMERGENCY COMMUNICATION DISTRICTS</p> <p>Campbell County Carroll County Carter County Cheatham Co. Claiborne County Fayette County Fentress Co. Gibson County Greene County Hamilton County Hamblen County Hardeman Co. Hawkins County Johnson Co. Lauderdale Co. Lawrence County Madison County Monroe County McNairy Co. Montgomery Co. Overton County Roane County Robertson Co. Rutherford Co. Sevier County Shelby County Sullivan County Tipton County Warren County Washington Co. Weakley County White County Wilson County</p> <p>CITIES</p> <p>Adams Alamo Alcoa Ashland City Athens* Atoka Atwood Baileyton Belle Meade Bells Benton Big Sandy Bluff City Bolivar Brentwood Bristol Brownsville Byrdstown Camden Carthage Caryville Centerville Charleston Charlotte</p>	<p>Church Hill Clarksville Cleveland Clifton Clinton Collegedale Collierville Collinwood Cookeville Coopertown Cornersville Cowan Crossville Dandridge Dayton Decaturville Dickson Dover Dunlap Dyer East Ridge Elizabethhton Elkton Erin Erwin Estill Springs Etowah Fairview Fayetteville Forest Hills Friendship Friendsville Gainesboro Gatlinburg Gleason Goodlettsville Gordonsville Greenbrier Greeneville Greenfield Harriman Hartsville Henderson Hendersonville Hohenwald Humboldt Huntland Jacksboro Jackson Jamestown Jefferson City Johnson City Jonesborough Kenton Kingsport Kingston Springs Lafayette Lafollette Lake City Lakewood Lawrenceburg Lebanon</p>	<p>Lenoir City* Linden Livingston Lobelville Lookout Mountain Loretto Loudon Luttrell Madisonville Martin Maryville Maury City Maynardville McEwen McMinnville Middleton Milan Millersville Millington Morrison Morristown Moscow Mountain City Mt. Carmel Mt. Juliet Munford Murfreesboro* New Johnsonville New Tazewell Newport Nolensville Norris Oak Ridge Oakland Obion Oliver Springs Paris Parsons Pikeville Pittman Center Pleasant View Portland Puryear Red Bank Ripley Rockwood Rogersville* Rutledge Savannah Selmer Sevierville Signal Mountain Soddy Daisy Somerville South Carthage Sparta Spencer Spring Hill Spring City Springfield Sweetwater Tazewell</p>	<p>Tellico Plains Townsend Trenton Tusculum Unicoi Union City Vonore Waynesboro Waverly Westmoreland White House White Pine Whiteville Whitwell Woodbury</p> <p>COUNTIES</p> <p>Anderson Bedford Benton Bledsoe Blount Bradley Campbell Cannon Carroll Carter Cheatham Chester Claiborne Clay Cocke Coffee Crockett Cumberland Decatur DeKalb Dickson Fayette Fentress Franklin Gibson Giles Grainger Greene Grundy Hamblen Hamilton Hardeman Hardin Hawkins Haywood Henderson Henry Hickman Humphreys Jackson Jefferson Johnson Lake Lauderdale Lawrence</p>	<p>Lewis* Lincoln Loudon Macon Madison Marion Marshall Maury McMinn McNairy Monroe Montgomery Moore* Morgan Obion Overton Perry Pickett Polk Putnam Rhea Roane Robertson Rutherford Scott Sequatchie Sevier Shelby* Smith Sullivan Sumner Tipton Trousdale Unicoi Union Van Buren Warren Washington Wayne Weakley White Williamson Wilson</p> <p>HOUSING AUTHORITIES</p> <p>Bristol Clinton Cookeville Hartsville Hohenwald Lawrenceburg Memphis Morristown Rockwood Sweetwater</p> <p>* All departments not covered by TCRS.</p> <p style="text-align: right;">(continued)</p>
--	---	---	--	--

**POLITICAL SUBDIVISION PARTICIPANTS
(CONTINUED)**

JOINT VENTURES

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

MISCELLANEOUS AGENCIES

Beech River Watershed
 Blount County Fire Protection Dist.
 Blount County Library
 Bristol/Kingsport/Sullivan Co. Industrial Commission Dist.
 Cookeville Reg. Medical Center Auth.
 County Officials Assoc. of Tenn.
 Delta Human Resource Agency
 Douglas Cherokee Economic Auth.
 East Tenn. Community Svc. Agency
 First Tenn. Dev. District
 First Tenn. Human Resource Agency
 Four Lake Reg. Industrial Dev. Auth.
 Greater Nashville Regional Council
 Hamilton Co. Comm. Svc. Agency
 Hardin County General Hospital
 Knox Co. Community Services Agency
 Mid-Cumberland Comm. Svc. Agency
 Newport/Locke Co. Economic Dev. Dist.
 Northeast Community Svc. Agency
 Northwest Tenn. Comm. Svc. Agency
 Sequatchie Valley Plan. & Dev. Dist.
 Shelby Co. Community Svc. Agency
 South Central Tenn. Community Services Agency
 South Central Tenn. Dev. Dist.
 Southeast Tenn. Comm. Svc. Agency
 Southeast Tenn. Dev. District

Southeast Tenn. Human Res. Agency
 Southwest Tenn. Comm. Svc. Agency
 Southwest Tenn. Dev. District
 Southwest Tenn. Human Res. Agency
 Tenn. Assoc. of Assessing Officers
 Tenn. Assoc. of County Mayors
 Tenn. Athletic Coaches Assoc.
 Tenn. Co. Commissioners Assoc.
 Tenn. Co. Highway Officials Assoc.
 Tenn. County Services Assoc.
 Tenn. Education Assoc.
 Tenn. Historical Society
 Tenn. Municipal Bond Fund
 Tenn. Municipal League
 Tenn. Mun. League Risk Mgt. Pool
 Tenn. Org. of School Superintendents
 Tenn. School Board Assoc.
 Tenn. Secondary Sch. Athletic Assoc.
 Tenn. Sheriffs Assoc.
 Tenn. State Employees Assoc.
 Tenn. Veterans Home Board
 Upper Cumberland Community Services Agency
 Upper East Tenn. Human Dev. Agency
 Workforce Solutions

SPECIAL SCHOOL DISTRICTS


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

UTILITY DISTRICTS

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

** All departments not covered by TCRS.*

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 2004,
 Authorization No. 309209, 550 copies.
 This public document was printed at a cost of \$7.12 each.