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# STATE OF WEST VIRGINIA

## AUDIT REPORT

OF

WEST VIRGINIA STATE BOARD OF INVESTMENTS

DECEMBER 31, 1993



OFFICE OF LEGISLATIVE AUDITOR

CAPITOL BUILDING

CHARLESTON, WEST VIRGINIA 25305

WEST VIRGINIA STATE BOARD OF INVESTMENTS

DECEMBER 31, 1993

WEST VIRGINIA LEGISLATURE  
*Joint Committee on Government and Finance*

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



Phone 558-2154  
Area Code 304

CHARLESTON, WEST VIRGINIA 25305

February 1, 1994

To Members of the West Virginia Legislature:

In compliance with the West Virginia Code, Chapter 12, Article 6, Section 15, one thousand nine hundred thirty-one, as amended, transmitted herewith is the report of the balance sheet of the West Virginia State Board of Investments. This report covers the calendar year 1993.

Respectfully submitted,

*Theodore L. Shanklin*  
Theodore L. Shanklin, CPA, Director  
Legislative Postaudit Division

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## WEST VIRGINIA STATE BOARD OF INVESTMENTS

### INTRODUCTION

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

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

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

The West Virginia Code sections are specific in detailing the types of investments that can be utilized. Chapter 12, Article 6, Section 9 details permissible investments. Chapter 12, Article 6, Section 10, places restrictions on the percentages of each portfolio which may be invested in certain types of securities. Chapter 12, Article 6, Section 9a, specifies amounts that can be transferred to the state's general revenue account. Chapter 12, Article 6, Section 6 deals with the establishment of a special revenue account to handle investigation of claims against third parties for investment losses, for consulting services regarding the restructuring of the office of the State

Treasurer and costs of implementing the changes in the restructuring. The special revenue account is funded by securities lending income and recoveries from third parties. The account is scheduled to expire on June 30, 1995. The Board is authorized to deposit into the special revenue account and to expend a maximum of \$2 million annually from the account. Other Sections of Chapter 12, Article 6 deal with apportionments of interest earnings among state depositories and the standard of care to be exercised by the Board in making investments.

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

The Liquidity Fund consists of the operating funds of the state and certain state agencies. Its purpose is to provide for the investment of all surplus funds and supply the daily cash needs of the state. The State Agency Trust Fund is comprised of funds held in trust by state agencies. The Local Government Fund is available for investment of funds from any local government that desires the opportunity to invest with the State of West Virginia. The Restricted Fund is available for the investment of unexpended bond proceeds, debt service funds and amounts escrowed under the requirements of bond issuances. The Loss Amortization Fund was created to account for those participant claims of the general operating funds of the state which exceeded the underlying assets of the other funds. This excess of participant claims on net assets over underlying assets occurred as a result of the distribution of earnings to participants in various Board investment funds principally in the unrestricted pool, in excess of the true investment income experience of the funds in 1987 and 1988. West Virginia Code Chapter 12, Article 6, Section 5a, prohibits the State of West Virginia, the State Board of Investments or any other state officer to seek, or

attempt to recover any monies that were over apportioned to those participants. As of December 31, 1993, stripped securities whose book value is \$45,900,818.31 with a maturity value of \$183,415,000.00, were being held in the Loss Amortization Account. These stripped securities mature at various times between February 15, 2005 and October 15, 2019. The Participant-Directed-Accounts are comprised of funds from individual state agencies with specific investment needs. The funds held by the participant directed accounts are not co-mingled, but rather each agency has 100% ownership of the underlying investments in a dedicated single account.

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

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

At the date of the writing of this report, there is some indecision regarding the legality of the investment of the Consolidated Pension Fund in equity (stock) securities. Attorney General Darrell McGraw has issued an opinion that the state constitution prohibits the investment of pension funds in the stocks of private associations and corporations. The Board decided to liquidate the equity investments as of August 31, 1993, awaiting further legal action.

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BOARD MEMBERS AND SENIOR STAFF

DECEMBER 31, 1993

Board Members

W. Gaston Caperton III  
Governor  
Charleston . . . . . Chairman

Larrie Bailey  
State Treasurer  
Charleston . . . . . Member

Glen B. Gainer, Jr.  
State Auditor  
Charleston . . . . . Member

John Poffenbarger  
Executive Secretary  
Charleston . . . . . Member

William T. Tracy  
Huntington . . . . . Member

Dwight Keating  
Clarksburg . . . . . Member

Richard K. Riederer  
Weirton . . . . . Member

Senior Staff

H. Craig Slaughter . . . . . Executive Director

D. Jerry Simpson . . . . . Chief Operating Officer

Matthew E. Jones . . . . . Chief Financial Officer

Diana Will . . . . . Chief Investment Officer

Mark E. N. Asaad . . . . . Chief Counsel

WEST VIRGINIA STATE BOARD OF INVESTMENTS  
SUMMARY OF FINDINGS AND RECOMMENDATIONS

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

We recommend that the Board comply with Chapter 12, Article 6, Section 8(c) of the West Virginia Code and allow all agencies to invest their special revenue funds upon request. (See pages 12-13.)

WEST VIRGINIA STATE BOARD OF INVESTMENTS

GENERAL REMARKS

We have completed an audit of the investment activity of the West Virginia State Board of Investments as required by West Virginia Code Chapter 12, Article 6, Section 15. Our audit covers the year ended December 31, 1993. However, due to the legal deadline of the report, February 1, 1994, we were unable to examine some transactions of the investment activity as set forth in our Independent Auditors' Opinion.

The Consolidated Pension Fund was composed of eight accounts during calendar year 1993 as listed below:

<u>Fund</u>	<u>State Street Account</u>	<u>Old Fund Number Jan.-Sept. '93</u>	<u>New West Virginia FIMS Number</u>
Judges' Retirement System	V301	7615-06	8580
Public Safety Retirement System	V302	7620-07	8581
Workers' Compensation Fund	V303	7625-08	8582
Workers' Compensation Fund II	V304	7625-16	8583
Pneumoconiosis Fund	V305	7630-09	8584
Public Employees' Retirement System	V306	7635-10	8585
Teachers' Retirement System	V307	7640-11	8586
Duff and Phelps Equity Account	V308	7600-52	8594

The Duff and Phelps Equity Account is a new account opened May 1, 1993. The purpose of the account is to hold stock investments from up to twenty percent of the pension portfolio. The account was active from May 1, 1993 to August 31, 1993. All stock investments were liquidated by August 31, 1993, following an Attorney General's opinion on July 13, 1993 that the state constitution prohibits the investment of public pension funds in the stock of private corporations or associations. The State Board of Investments has retained a law firm to determine whether to ask the Supreme Court if it can legally purchase stock investments with the pension monies.

The Consolidated Fund was composed of 30 "pools" during 1993 which are identified below. Pool 100 contains investments from agencies which are

unrestricted by type, i.e., not restricted by instrument. Pool 101 contains investments made from monies held in trust for State agencies. Pool 102 contains investments made from funds held in trust for local governmental units. Pool 140 contains investments from agencies which may only be government instruments. The remaining 26 pools contain specific investments for individual agencies due to constitutional or bonding restrictions prohibiting commingling with Pools 100 and 140.

1. Liquidity Fund - (Pool No. 100) - State Street Bank No. 324

This Pool consists of the operating funds of State agencies. This pool was restructured in February 1993 by transferring all Economic Authority Loans and mortgages to a State Loan Pool.

2. State Agency Trust Fund - (Pool No. 101) - State Street Bank No. V331

Money held in trust by State agencies including such money as Performance Bonds and State Hospital Patient Funds. The Fund is to be run as a money type fund with a weighted average maturity of no more than 59 days. The account was created November 1, 1989.

3. Local Government Fund - (Pool No. 102) - State Street Bank No. V332

This pool contains only money deposited by local governments. The Fund is to be run as a money market type fund with a weighted average maturity of no more than 59 days. The account was created November 1, 1989.

4. Construction Trust Fund - Huntington Toll Bridge - (Pool No. 120)  
State Street Bank No. V321

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

5. The School Fund - (Pool No. 130) - State Street Bank No. 322

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

6. Restricted Fund - (Pool No. 140) - State Street Bank No. V330

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

7. State Loan Pool - State Street Bank No. V329  
A new pool established February 1993. All mortgage and Economic Development Authority loans were transferred from the Unrestricted Pool to this pool.
8. Loss Amortization - (Pool No. 141) - State Street Bank No. V333  
This pool contains zero coupon bonds bought to amortize the losses in Pool 100 and 140. At the maturity date of the bonds, the funds will be transferred to Pools 100 and 140.
9. Municipal Bond Restricted Fund - State Street Bank No. V340  
This fund was opened July 1, 1992 for the Municipal Bond Commission to address their accounting requirements. Securities and cash were transferred out of the Restricted Fund - State Street Bank No. V330.
10. Municipal Bond Commission - County Revenue - (Pool No. 152) - State Street Bank No. V341  
This Municipal Bond Commission Account is for the investment of county revenues. No purchases or sales of investments may occur without the authorization of the Municipal Bond Commission.
11. Municipal Bond Commission - General Obligation - (Pool No. 156) - State Street Bank No. V342  
This Municipal Bond Commission Account is for the defeasance of general obligations of municipalities, only U.S. Treasury Securities may be purchased.
12. Municipal Bond Commission - WVU Project 11 Escrow - (Pool No. 160) State Street Bank No. V336  
This Escrow Account is for West Virginia University's Project 11. No purchases or sales of investments may occur without the authorization of the Municipal Bond Commission.
13. Municipal Bond Commission - County Schools - (Pool No. 162) - State Street Bank No. V337  
This Pool is for the investment of funds held by county schools systems. No purchases or sales of investments may occur in Pool No. 162 without Municipal Bond Commission authorization.
14. Municipal Bond Commission - Public Service Districts - (Pool No. 164) State Street Bank No. V338  
This Pool is for the investment of Public Service District Funds. No purchases or sales of investments may occur in Pool No. 164 without Municipal Bond Commission authorization.
15. Municipal Bond Commission - (Pool No. 166) - State Street Bank No. V339  
No purchases or sales of investments may occur in Pool No. 166 without Municipal Bond Commission authorization.

16. Municipal Bond Commission - Huntington Bridge 65 Revenue - (Pool No. 400)  
State Street Bank No. V335

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

17. Municipal Bond Commission - Combined Revenue Account - (Pool No. 401)  
State Street Bank No. V343

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

18. Municipal Bond Commission - Hancock County Schools 83G/0 - (Pool No. 402)  
State Street Bank No. V344

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

19. Municipal Bond Commission - Fairmont 85 Sewer Revenue - (Pool No. 403)  
State Street Bank No. V345

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

20. Municipal Bond Commission - Fairmont 85 Water Revenue Esc - (Pool No. 404)  
State Street Bank No. V334

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

21. Municipal Bond Commission - Escrow Agent For Board of Regents  
(Pool No. 406) - State Street Bank No. V346

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

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

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

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

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

24. Bank Services Fund - (Pool No. 8002) - State Street Bank No. V327

The interest earned in this account is used to pay all banking charges.

25. Lottery Defeasance - (Pool No. 8013) - State Street Bank No. V323

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

26. Department of Transportation Special Highway Fund - (Pool No. 9312)  
State Street Bank No. V348

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

27. Department of Transportation Zero Coupon - (Pool No. 9313) - State  
Street Bank No. V349

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

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

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

29. DOH - Parkway Authority - (Pool No. 9314) - State Street Bank No. V351

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

30. School Building Authority - (Pool No. 9800) - State Street Bank No. V326

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

## Management of the Funds

The activities of the pension funds were administered by the following advisors during calendar year 1993:

Judges' Retirement System:  
Kemper Asset Management Company

Public Safety Retirement System:  
Kemper Asset Management Company

Workers' Compensation Fund:  
Investment Advisors, Inc.

Workers' Compensation Fund II:  
Duff and Phelps Investment Management Company

Pnuemoconiosis Fund:  
Duff and Phelps Investment Management Company

Public Employees' Retirement System:  
Investment Advisors, Inc.

Teachers' Retirement System:  
Duff and Phelps Investment Management Company

Also, the activities of the account "pools" in the Consolidated Fund were administered by the following advisors during calendar year 1993:

Liquidity Fund - (Pool No. 100) - State Street Bank No. V324:  
Charleston National Bank  
United National Bank

State Agency Trust Fund - (Pool No. 101) - State Street Bank No. V331:  
Commerce Bank

Local Government Fund - (Pool No. 102) - State Street Bank No. V332:  
T. Rowe Price Associates, Inc.

Restricted Fund - (Pool No. 140) - State Street Bank No. V330:  
Brinson Partners, Inc.

Bank Services Fund - (Pool No. 8002) - State Street Bank No. V327:  
Charleston National Bank

During calendar year 1993, all other account "pools" in the Consolidated Fund commonly referred to as "single account pools" were administered by the staff of the State Board of Investments. However, the activities of these accounts were directed by the management of the individual agencies.

## INVESTMENT POLICY

### Investment of Special Revenue Funds

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

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

On or about November 1, 1989, the State Treasurer's Office, which acted at that time in the capacity of staff agency for the State Board of Investments, began allowing only specific agencies to invest special revenue funds. Only agencies having specific Code authority allowing the agency to invest special revenue collections were allowed to remain in the Liquidity Fund - Pool No. 100. Any agency lacking specific legislative authorization to invest monies was required to transfer invested funds back into the special revenue account on the books of the State Treasury commonly referred to as the "cash account".

Since the practice of the State of West Virginia is to fully invest all available cash balances, the effect of this policy change was to allow interest earnings on these special revenue funds to accrue to the General Revenue Fund of West Virginia. Since special revenue accounts generally contain user fees collected for specific programs, the Board's policy effectively diverts funding away from legislatively mandated programs. While it is not possible to determine the amount of interest earnings on special revenue monies which accrued to the General Revenue Fund as a result of this policy, the following schedule for calendar years 1989-1993 shows the amount of interest apportioned to the General Revenue Fund as a part of the Liquidity Fund - Pool No. 100, the total amount of the interest apportioned in the Liquidity Fund - Pool No. 100 and the proportional share of interest credited to the General Revenue Fund as a part of the total interest apportioned:

<u>Calendar Year</u>	(a) <u>Apportioned Interest General Revenue</u>	(b) <u>Total Apportioned Interest</u>	<u>Percentage (a÷b)</u>
1989	\$ 6,769,390.16	\$ 9,378,320.33	72.18%
1990	13,523,917.89	16,743,780.93	80.77%
1991	10,591,076.15	12,948,822.34	81.79%
1992	7,555,888.83	11,616,418.16	65.04%
1993	4,992,581.96	11,710,968.67	42.63%
	<u>\$43,432,854.99</u>	<u>\$62,398,310.43</u>	

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

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

#### EVALUATION OF THE CONSOLIDATED PENSION FUND

We obtained copies of the rating service's evaluation of the Consolidated Pension Funds' performance for the quarters ended December 31, 1992, March 31, 1993, June 30, 1993 and September 30, 1993. The evaluation for quarter ended December 31, 1992 was prepared by SEI Funds Evaluation, Inc. The evaluations for the quarters ended March 31, 1993, June 30, 1993 and September 30, 1993 were prepared by Hewitt Associates. The rating service's evaluation for the quarter ended December 31, 1993 was not yet available at the conclusion of our current fieldwork (January 26, 1994). We reviewed the rating service's reports and noted

fieldwork (January 26, 1994). We reviewed the rating service's reports and noted the following observations:

<u>Fund</u>	<u>09/30/93</u>	<u>06/30/93</u>	<u>03/31/93</u>	<u>12/31/92</u>
Judges' Retirement	2.42%	2.23%	4.34%	(0.30%)
Public Safety Retirement	2.32%	2.32%	4.22%	0.10%
Workers' Compensation	4.07%	3.84%	5.37%	0.50%
Workers' Compensation II	2.53%	2.85%	4.26%	(0.20%)
Pneumoconiosis Retirement	2.41%	2.87%	4.13%	0.30%
Public Employees' Retirement	4.00%	3.77%	5.26%	0.50%
Teachers' Retirement	2.30%	2.26%	4.23%	(0.10%)

The asset allocation reported by Hewitt Associates for the quarters ended December 31, 1992, March 31, 1993, June 30, 1993 and September 30, 1993 are as follows:

<u>Fund</u>	<u>Quarter Ended</u>			
	<u>09/30/93</u>	<u>06/30/93</u>	<u>03/31/93</u>	<u>12/31/92</u>
Judges' Retirement:				
Bonds	95.4%	83.4%	89.3%	88.8%
Cash Equivalents and Cash	4.6%	16.0%	10.7%	11.2%
Private Placements	0.0%	0.6%	0.0%	0.0%
Public Safety:				
Bonds	93.7%	91.2%	91.2%	89.2%
Cash Equivalents and Cash	6.3%	8.8%	8.8%	10.8%
Workers' Compensation I:				
Bonds	90.3%	92.3%	91.9%	90.10%
Cash Equivalents and Cash	3.1%	0.2%	0.5%	2.3%
Private Placements	6.6%	7.5%	7.6%	7.6%
Workers' Compensation II:				
Bonds	96.8%	94.4%	92.2%	92.8%
Cash Equivalents and Cash	3.2%	5.6%	7.8%	7.2%
Pneumoconiosis:				
Bonds	93.20%	86.10%	84.80%	91.8%
Cash Equivalents and Cash	6.8%	13.9%	9.5%	8.2%
Private Placements	0.0%	0.0%	5.7%	0.0%
Public Employees:				
Bonds	96.6%	97.9%	96.90%	97.00%
Cash Equivalents and Cash	3.0%	1.5%	1.5%	1.5%
Private Placements	0.4%	0.6%	1.6%	1.5%

<u>Fund</u>	<u>09/30/93</u>	<u>Quarter Ended</u>		<u>12/31/92</u>
		<u>06/30/93</u>	<u>03/31/93</u>	
Teachers':				
Bonds	93.3%	85.2%	91.8%	90.7%
Cash Equivalents and Cash	6.4%	14.5%	8.0%	9.1%
Private Placements	0.3%	0.3%	0.2%	0.2%

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

<u>Fund</u>	<u>Performance Ranking for Quarter Ended</u>			
	<u>09/30/93</u>	<u>06/30/93</u>	<u>03/31/93</u>	<u>12/31/92</u>
Judges'	32	56	61	76
Public Safety	28	59	56	59
Workers' Compensation	91	88	82	38
Workers' Compensation II	37	74	58	72
Pnuemoconiosis	32	75	53	50
Public Employees'	90	87	81	34
Teachers'	27	57	57	66

#### Pension Investment Activity

As reflected in the following schedule entitled "INVESTMENT ACTIVITIES", the trust funds experienced net gains on sale of investments during 1993 as follows: Judges' \$37,190; Public Safety \$270,586; Workers' Compensation \$15,798,050; Workers' Compensation II \$4,393,917; Pnuemoconiosis \$106,994; and, Public Employees' \$41,039,393; and Teachers' \$15,939,552. The total net gain on sale of investments for all funds in 1993 was \$77,585,682.00.

Also, the trust funds achieved interest earnings from investments sold during 1993 as follows: Judges' \$218,450; Public Safety \$2,024,322; Workers' Compensation \$28,434,099; Workers' Compensation II \$3,779,325; Pnuemoconiosis

\$188,167; Public Employees' \$108,643,082; and Teachers' \$35,568,736. The total interest earnings from investments sold for all funds in 1993 was \$178,856,181.00.

The total earnings generated by the sale of investments is the sum of the net gain (loss) on sale of investments and interest earnings. The trust funds had total earnings from investments sold during 1993 as follows: Judges' \$255,640; Public Safety \$2,294,908; Workers' Compensation \$44,232,149; Workers' Compensation II \$8,173,243; Pnuemoconiosis \$295,162; Public Employees' \$149,682,475; and, Teachers' \$51,508,288. The total earnings generated by the sale of investments for all funds in 1993 was \$256,441,865.00.

There were 115 investments sold during 1993 compared to 70 investments sold during 1992. The following is a comparative schedule of the number of investments sold during these years:

<u>Fund</u>	<u>1993</u>	<u>1992</u>	<u>Increase (Decrease)</u>
Judges'	2	10	(8)
Public Safety	5	11	(6)
Workers' Compensation	19	29	(10)
Workers' Compensation II	9	1	8
Pneumoconiosis	12	2	10
Public Employees'	54	17	37
Teachers'	14	0	14
	<u>115</u>	<u>70</u>	<u>45</u>

Overall, the sales activity increased by 64.29% from 1992 sales.

There were 105 purchases in 1993 compared to 124 purchases in 1992. The total par value of 1993 purchases was \$1,991,069,888.72 while the total purchase price of 1993 purchases was \$1,909,437,224.40 resulting in a discount of \$81,632,664.02. The following is a comparative schedule of the number of investments purchased during these years:

<u>Fund</u>	<u>1993</u>	<u>1992</u>	<u>(Decrease)</u>
Judges'	10	11	(1)
Public Safety	11	11	0
Workers' Compensation	16	48	(32)
Workers' Compensation II	13	5	8
Pneumoconiosis	12	5	7
Public Employees'	22	39	(17)
Teachers'	<u>21</u>	<u>5</u>	<u>16</u>
	<u>105</u>	<u>124</u>	<u>(19)</u>

Overall, the purchase activity decreased by 15% from 1992 levels.

We noted the following changes in the amount of repurchase agreements on hand at December 31, 1993:

<u>Fund</u>	<u>1993</u>	<u>1992</u>	<u>(Over) Under 1992</u>
Judges'	\$ 847,301	\$ 1,784,118	(\$ 936,817)
Public Safety	2,615,333	6,298,240	(3,682,907)
Workers' Compensation	30,024,664	16,252,607	13,772,057
Workers' Compensation II	4,553,190	18,516,593	(13,963,403)
Pneumoconiosis	3,512,501	15,124,437	(11,611,936)
Public Employees'	38,857,170	28,139,891	10,717,279
Teachers'	<u>19,061,297</u>	<u>25,542,744</u>	<u>(6,481,447)</u>
	<u>\$99,471,456</u>	<u>\$111,658,630</u>	<u>(\$12,187,174)</u>

The amount of repurchase agreements decreased by \$12,187,174 at December 31, 1993 over the amount invested on December 31, 1992.

INVESTMENT ACTIVITIES

The following schedule is a comparative analysis of the activities of the State long-term trust funds for calendar years 1993 and 1992:

	<u>Judges'</u>	<u>Public Safety</u>
<b>Sales 1993:</b>		
Number	2	5
Average Years Held	3.22	3.96
Average Years to Maturity from Sale Date	3.58	3.42
Average Approximate Yield to Maturity	8.97%	8.65%
Par Value	\$ 625,000	\$ 5,745,000
Book Value	\$ 622,811	\$ 5,731,147
Sale Proceeds	\$ 660,001	\$ 6,001,734
Net Gain (Loss)	\$ 37,190	\$ 270,586
Interest Earnings	\$ 218,450	\$ 2,024,322
Total Earned	\$ 255,640	\$ 2,294,908
<b>Sales 1992:</b>		
Number	10	11
Average Years Held	1.16	1.25
Average Years to Maturity from Sale Date	14.04	12.76
Average Approximate Yield to Maturity	9.450%	9.184%
Par Value	\$2,750,000	\$11,550,000
Book Value	\$2,494,782	\$ 9,669,053
Sale Proceeds	\$2,671,170	\$10,201,820
Net Gain (Loss)	\$ 176,388	\$ 532,767
Interest Earnings	\$ 340,163	\$ 1,119,250
Total Earned	\$ 516,551	\$ 1,652,017
<b>Purchases 1993:</b>		
Number	10	11
Average Years to Maturity	20.07	18.47
Approximate Yield at Maturity	6.78%	6.60%
Total:		
Par Value	\$4,462,212	\$13,365,981
Purchase Price	\$4,613,205	\$13,910,303
<b>Purchases 1992:</b>		
Number	11	11
Average Years to Maturity	14.63	14.75
Approximate Yield at Maturity	7.704%	7.703%
Total:		
Par Value	\$3,350,000	\$ 9,850,000
Purchase Price	\$3,347,000	\$ 9,843,606

<u>Workers'</u> <u>Compensation</u>	<u>Workers'</u> <u>Compensation II</u>	<u>Pneumoconiosis</u>	<u>Public</u> <u>Employees'</u>	<u>Teachers'</u>
19	9	12	54	14
1.45	2.69	4.37	1.22	5.05
16.37	6.17	7.81	12.99	10.26
6.36%	7.14%	6.89%	6.64%	6.38%
\$245,012,403	\$ 44,422,872	\$33,655,178	\$ 898,915,830	\$145,451,250
\$236,983,069	\$ 39,036,590	\$29,507,009	\$ 874,228,847	\$128,047,449
\$252,781,119	\$ 43,430,497	\$32,707,962	\$ 915,268,240	\$143,987,001
\$ 15,798,050	\$ 4,393,917	\$ 106,994	\$ 41,039,393	\$ 15,939,552
\$ 28,434,099	\$ 3,779,325	\$ 188,167	\$ 108,643,082	\$ 35,568,736
\$ 44,232,149	\$ 8,173,243	\$ 295,162	\$ 149,682,475	\$ 51,508,288
29	1	2	17	0
3.32	1.16	1.82	2.65	0.00
10.13	2.01	2.00	8.54	0.00
7.287%	7.550%	7.460%	7.727%	0.000%
\$369,802,200	\$ 5,000,000	\$ 6,000,000	\$ 669,353,707	\$ -0-
\$353,040,973	\$ 4,993,371	\$ 5,993,579	\$ 661,121,606	\$ -0-
\$378,035,647	\$ 5,153,200	\$ 6,198,810	\$ 707,313,836	\$ -0-
\$ 24,994,674	\$ 159,829	\$ 205,231	\$ 46,192,230	\$ -0-
\$ 75,026,308	\$ 434,589	\$ 922,301	\$ 101,530,060	\$ -0-
\$100,020,982	\$ 594,418	\$ 1,127,532	\$ 147,722,290	\$ -0-
16	13	12	22	21
17.79	13.45	15.19	17.15	17.19
6.72%	6.56%	6.60%	6.43%	6.57%
\$400,276,350	\$ 96,879,240	\$88,241,332	\$1,177,297,985	\$210,546,785
\$374,063,569	\$100,872,056	\$91,244,820	\$1,103,718,028	\$221,015,240
48	5	5	39	5
13.29	8.04	17.49	9.91	9.39
7.146%	7.326%	7.366%	6.816%	7.270%
\$492,304,164	\$ 27,047,837	\$ 31,390,400	\$1,145,507,556	\$ 32,003,483
\$418,274,209	\$ 27,523,358	\$ 32,292,120	\$ 984,063,985	\$ 33,016,918

INDEPENDENT AUDITORS' OPINION

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

We have audited the accompanying balance sheet of the West Virginia State Board of Investments as of December 31, 1993. The financial statement is the responsibility of the management of the West Virginia State Board of Investments. Our responsibility is to express an opinion on the financial statement based on our audit.

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

Due to the report date set forth in Chapter 12, Article 6, Section 15 of the West Virginia Code, we were unable to perform several auditing procedures. An examination of security lending income was not performed in either the Consolidated Fund or Consolidated Pension Fund. An examination of investment purchases and sales was not performed in either the Consolidated Fund or Consolidated Pension Fund for the period October 1, 1993 through December 31, 1993. An examination of the purchase of corporate stock in the Consolidated Pension Fund was not performed.

In our opinion, except for the effects of the matters discussed in paragraph three above, if any, as might have been determined if these additional auditing procedures had been performed, the balance sheet referred to in the first paragraph above presents fairly, in all material respects, the financial position of the West Virginia State Board of Investments as of December 31, 1993, in conformity with generally accepted accounting principles.

Respectfully submitted,

  
Thedford L. Shanklin, CPA, Director  
Legislative Postaudit Division

January 26, 1994

Auditors: Ellen C. Quillen, CPA, Supervisor  
Michael E. Sizemore, CPA, Supervisor  
Timothy Butler, CPA  
Paul Deuley  
Kristi Ernest  
Etheibert Scott, Jr.  
Donna Simmers

WEST VIRGINIA STATE BOARD OF INVESTMENTS

BALANCE SHEET

DECEMBER 31, 1993

	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUND</u>	<u>COMBINED TOTALS (MEMORANDUM ONLY)</u>
Assets:			
Cash	\$ -0-	\$ -0-	\$ -0-
Investments at Book Value			
Notes 3 and 4 (Par Value \$1,221,879,246.28 Consolidated Fund, \$3,508,803,334.45 Consolidated Pension Fund)	1,059,312,506.05	3,155,722,289.57	4,215,034,795.62
Other assets Note 4	2,259,708.16	-0-	2,259,708.16
Interest Receivable	<u>4,176,346.98</u>	<u>40,702,352.75</u>	<u>44,878,699.73</u>
Total Assets	<u>\$1,065,748,561.19</u>	<u>\$3,196,424,642.32</u>	<u>\$4,262,173,203.51</u>
Liabilities and Fund Balances:			
Due Investors			
Note 6	\$1,203,122,288.09	\$3,196,179,942.48	\$4,399,302,230.57
Due West Virginia State General Fund	<u>140,454.79</u>	<u>244,699.84</u>	<u>385,154.63</u>
Total Liabilities	1,203,262,742.88	3,196,424,642.32	4,399,687,385.20
Fund Balance (Deficit) Note 5	<u>(137,514,181.69)</u>	<u>-0-</u>	<u>(137,514,181.69)</u>
Total Liabilities and Fund Balances	<u>\$1,065,748,561.19</u>	<u>\$3,196,424,642.32</u>	<u>\$4,262,173,203.51</u>

See Notes to Financial Statement

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

NOTES TO FINANCIAL STATEMENT

DECEMBER 31, 1993

1. DESCRIPTION OF THE ENTITY

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

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

Consolidated Fund

Unrestricted Pool - This investment pool consists of the operating funds of the State and certain State agencies. Its purpose is to provide for the investment of all surplus funds and supply the daily cash needs of the State.

State Agency Trust Pool - This pool is comprised of funds held in trust by State agencies.

Local Government Pool - The local government pool is available for investment of funds from any local government who desires the opportunity to invest with the State.

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

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

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

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

### Consolidated Pension Fund

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

## 2. SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of Accounting - The Board is the investment vehicle of the State of West Virginia and its component units, all of which are governmental entities. As a result, as permitted within governmental accounting standards, the Board carries its investments at cost, adjusted for amortization of premium and accretion of discount, except for the Restricted Fund for which investments are recorded at fair market value. Commissions on purchases of securities by the Board are generally an unidentified component of the security price quoted by the seller and are included in the investment cost or carrying value.
- b. Investment Transactions - Investment transactions are accounted for on a trade date basis.
- c. Investment Gains and Losses - Gains and losses on sales of investment securities are recognized at the time of sale by the specific identification method.
- d. Interest Income - Interest income is recognized as earned on the accrual method.
- e. Allowance for Possible Loan Losses - The allowance for possible loan losses is available to absorb future loan charge-offs. The allowance is increased by provisions charged to operations and reduced by losses or charge-offs, net of recoveries. The amount charged to operations is based on several factors including: analytical reviews of loan loss experience in relationship to outstanding loans; a continuing review of problem loans and overall portfolio quality, including analysis of the quality of the underlying collateral; and management's judgment on the impact of current and expected economic conditions on the portfolio.
- f. Expenses - All the expenses of the Funds, except for fees paid for banking services and a service fee, are paid by the Board of Investments from appropriations granted by the State Legislature. Fees for banking services are paid by the Board through the use of the investment earnings

of the Bank Compensation Pool, one of the Participant Directed Accounts of the Consolidated Fund. The pools are assessed a management service fee by the Board. The service fee ranges from a flat fee to 1¼% of the monthly earnings of the pool. This service fee is remitted to the general fund of the State on a monthly basis.

### 3. INVESTMENTS

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

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

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

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

Investments at December 31, 1993, by security type and level of risk category, are as follows:

<u>Security Type</u>	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUND</u>	<u>TOTAL</u>	<u>CATEGORY 1</u>	<u>CATEGORY 2</u>
U.S. government and government agency obligations	\$ 319,670,742.48	\$2,721,254,448.06	\$3,040,925,190.54	\$3,040,925,190.54	\$ -0-
State & local government securities	27,710,900.00	-0-	27,710,900.00	27,710,900.00	-0-
Corporate bonds and notes	-0-	247,869,702.30	247,869,702.30	247,869,702.30	-0-
Repurchase agreements	580,417,657.24	99,471,459.74	679,889,116.98	9,363,361.02	670,525,755.96
Collateralized mortgage obligations	-0-	36,288,017.44	36,288,017.44	36,288,017.44	-0-
Loans - net of allowance for possible loan losses	123,928,917.53	50,838,662.03	174,767,579.56	174,767,579.56	-0-
Other	7,584,288.80	-0-	7,584,288.80	7,584,288.80	-0-
	<u>\$1,059,312,506.05</u>	<u>\$3,155,722,289.57</u>	<u>\$4,215,034,795.62</u>	<u>\$3,544,509,039.66</u>	<u>\$670,525,755.96</u>

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

COMPARISON OF BOOK AND MARKET  
 WEST VIRGINIA STATE BOARD OF INVESTMENTS  
 DECEMBER 31, 1993

DESCRIPTION	CONSOLIDATED FUND		CONSOLIDATED PENSION FUND	
	BOOK	MARKET	BOOK	MARKET
U.S. government and government agency obligations \$	319,670,742.48	\$344,550,377.60	\$2,271,254,448.06	\$2,894,612,491.92
State & local government securities	27,710,900.00	N/A	-0-	-0-
Corporate bonds and notes	-0-	-0-	247,869,702.30	254,130,977.40
Repurchase agreements	580,417,657.24	580,417,657.24	99,471,459.74	99,471,459.74
Collateralized mortgage obligations	-0-	-0-	36,288,017.44	39,391,290.00
Loans - net of allowance for possible loan losses	123,928,917.53	N/A	50,838,662.03	N/A
Other	7,584,288.80	N/A	-0-	-0-
	<u>\$1,059,312,506.05</u>	<u>\$924,968,034.84</u>	<u>\$3,155,722,289.57</u>	<u>\$3,287,606,219.06</u>

N/A - Market Values - Investments held by the Funds at December 31, 1993 include loans consisting primarily of economic development and mortgage loans. These loans have no ready market values and, therefore, no market value is reported. State and local government securities (SLGS) are direct obligations of the U.S. government, issued to State and local government entities to provide those governments with required cash flows at yields which do not exceed IRS arbitrage limits. As the SLGS are issued to retire debt investments, market values is not a meaningful measure.

4. LOANS AND ALLOWANCE FOR POSSIBLE LOAN LOSSES

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

In 1991, the Board implemented a policy to review its loan portfolio for purposes of the establishment of an allowance for possible loan losses. This allowance in the aggregate amounted to \$3,798,000.00 at December 31, 1993.

The composition of loans and the allowance for possible loan losses at December 31, 1993 are as follows:

	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUND</u>
Loans:		
West Virginia Economic Development Authority	\$111,678,792.16	\$22,153,474.28
Other	<u>15,250,125.37</u>	<u>29,483,187.75</u>
	126,928,917.53	51,636,662.03
Less allowance for possible loan losses	<u>3,000,000.00</u>	<u>798,000.00</u>
	<u>\$123,928,917.53</u>	<u>\$50,838,662.03</u>

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

5. SCHEDULE FOR STATUS OF INVESTMENT DIFFERENCE  
 WEST VIRGINIA STATE BOARD OF INVESTMENTS  
 DECEMBER 31, 1993

The following schedule updates as of December 31, 1993, the carrying cost and market value of the securities purchases to fund the investment difference.

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

Securities Held to Offset the Difference:

<u>Description</u>	<u>Maturity</u>	<u>Carrying Cost</u>	<u>Market Value</u>	<u>Face Value</u>
Zero Coupon Bonds	02/15/2005	\$ 9,118,757.55	\$11,033,660.00	\$ 22,000,000.00
Zero Coupon Bonds	08/15/2005	10,853,881.99	14,987,570.00	31,000,000.00
Zero Coupon Bonds	02/15/2010	4,670,868.97	6,844,600.00	20,000,000.00
Zero Coupon Bonds	11/15/2011	18,219,991.49	24,024,957.00	80,300,000.00
Zero Coupon Bonds	10/15/2019	<u>3,037,318.31</u>	<u>5,021,977.40</u>	<u>30,115,000.00</u>
Total Zero Coupon Bonds		<u>\$45,900,818.31</u>	<u>\$61,912,764.40</u>	<u>\$183,415,000.00</u>

Current difference (Fund Balance less Carrying Cost)	<u>\$137,514,181.69</u>
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6. COMPONENTS OF DUE INVESTORS

The following components make up the amounts due the investors in each of the Fund at December 31, 1993:

	<u>CONSOLIDATED FUND</u>	<u>CONSOLIDATED PENSION FUNDS</u>
Investors' Balances	\$1,201,378,229.62	\$3,177,029,410.76
Undistributed Earnings	<u>1,744,058.47</u>	<u>19,150,531.72</u>
	<u>\$1,203,122,288.09</u>	<u>\$3,196,179,942.48</u>

STATE OF WEST VIRGINIA

OFFICE OF LEGISLATIVE AUDITOR, TO WIT:

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

Given under my hand this 1<sup>st</sup> day of February,  
1994.

*Thedford L. Shanklin*

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

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