



30th

annual report

TEACHERS' RETIREMENT SYSTEM

STATE OF KENTUCKY

1969 - 1970

DECEMBER 1970



COMMONWEALTH OF KENTUCKY
TEACHERS' RETIREMENT SYSTEM

TED L. CROSTHWAIT
EXECUTIVE SECRETARY

309 LEWIS STREET
FRANKFORT

PAT N. MILLER
ASSISTANT SECRETARY

December 21, 1970

Honorable Louie B. Nunn, Governor
Commonwealth of Kentucky
Capitol Building
Frankfort, Kentucky 40601

Dear Governor Nunn:

Submitted herewith is the Thirtieth Annual Report of the Teachers' Retirement System of the State of Kentucky, as provided for in KRS 161.320.

The Teachers' Retirement System ended the fiscal year with new highs in terms of return on investments, average benefits to members, and capital worth of the investments. On June 30, 1970, the average monthly benefit to retired teachers was \$212 as compared to an average of \$183 per month a year earlier. The investment income for 1969-70 averaged 5.59% on an annual basis, and the net worth of the System's assets totaled approximately \$272 million. These represent gains of 27/100% in average yield and about \$32.8 million in total assets of the System.

On the other side of the ledger is the fact that accrued obligations for present and future annuitants are increasing at an annual rate somewhat in excess of our gains in assets. Part of this increase in unfunded obligation results from substantial improvements in benefits to members and part from failure of the State to make regular contributions toward the "Prior Service" obligation of the System.

The latest Actuarial Valuation indicates that the obligation for current benefits will be funded in approximately fifty-four years, but that the "prior service" obligation will never be funded if the rate of contributions of the past seven years is not increased substantially. Pertinent excerpts from the latest Actuarial Valuation are included in this Report.

Kentucky teachers have an excellent program of retirement; a program which on any rating scale would place our System among the best in the nation. Certainly, your administration and the members of the 1968 and 1970 General Assemblies have made significant contributions toward the improvement of our benefit structure. Adequate financing of these improvements must, of course, depend upon future appropriations for both current matching and prior service obligations.

The Board of Trustees is dedicated to providing the maximum benefit program possible within the limits of financial ability as indicated by our periodic actuarial valuations.

TEACHERS' RETIREMENT SYSTEM

The assistance of the Executive and Legislative branches of State Government in meeting this commitment is deeply appreciated.

Respectfully yours,

Edna Lindle, Chairman
Board of Trustees

Ted L. Crosthwait
Executive Secretary
Teachers' Retirement System
of the State of Kentucky

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TEACHERS' RETIREMENT SYSTEM
STATE OF KENTUCKY

BOARD OF TRUSTEES

Elected by members:

Mrs. Edna Lindle, Chairman Henderson
Mrs. James Sheehan, Vice Chairman Danville
W. D. Bruce, Jr. Louisville
Harold Miller Fort Thomas

Ex-Officio:

Thelma Stovall, State Treasurer Frankfort
John Breckinridge, Attorney General Frankfort
Wendell P. Butler, Superintendent of Public Instruction Frankfort

STAFF

Ted L. Crosthwait, Executive Secretary
Pat Miller, Assistant Secretary
William R. Holt, Supervisor of Finance & Accounting
Huggins & Company, Actuary
Moody's Alliance Capital Corporation, Investment Counselors

Louise Bates	Wilma Gaines	Isabelle Royalty
Hazel Buffin	Mary J. Games	Glenna Stewart
Joan Burke	Rosa Harlow	Martha Sudduth
Polly Casey	Albert Hudson	Elizabeth Tharpe
Betty Cohorn	Alean McDonald	Doris Ward
Anna Mae Connelly	Jean Pulliam	Dorothy Wood
Nancy G. Cosby		Frances Wright

PART I. FINANCIAL

The Balance Sheet reveals that the assets of the System on June 30, 1970, were \$272,181,171.28, approximately fourteen percent larger than for the same date in 1969. If this rate of percentage increase continues, the assets of the System will exceed \$310,000,000 by June 30, 1971. This increase in the assets is a result of the larger amount of member and state contributions which comes from salary increases and additional members, plus greater return on the investments of the System.

Sometimes there is a tendency on the part of public officials and members of the System to feel that the increasing amount of the assets of the Teachers' Retirement System would permit larger or extended benefits, lower contributions, or a reduction of state appropriations. It must be realized, however, that these are trust funds and held in large measure in reserve to assure retirement and related benefits for teachers who may be expected to retire in the future or who will at least receive their contributions in the form of refunds. Unless adequate reserves are established and maintained now, future liabilities will exceed future assets with the resulting inability to pay benefits.

BALANCE SHEET
 Teachers' Retirement System
 June 30, 1970

ASSETS

Cash, All Funds	\$ 4,727,097.66	
Special Reserve Account, Aetna Life Insurance Company	<u>368,679.17</u>	
		\$ 5,095,776.83
Investments	\$267,514,029.31	
Unamortized Premium on Investments	2,248,694.48	
Accrued Interest Purchased	<u>83,858.12</u>	
Sub-total: Investments plus deferred charges	269,846,581.91	
Deduct Unamortized Discount on Investments	<u>2,761,187.46</u>	
		<u>267,085,394.45</u>
TOTAL ASSETS		<u>\$272,181,171.28</u>

FUND BALANCES

Teachers' Savings Fund	\$122,717,840.67	
State Accumulation Fund	121,059,800.67	
Guarantee Fund	15,530,006.26	
Voluntary Contributions, Active Members	1,221,859.12	
Expense Fund	21,586.62	
Allowance Reserve Fund	3,824,060.48	
Hospital & Medical Insurance Fund	3,841,210.71	
Survivor & Death Benefit Fund	<u>3,964,806.75</u>	
TOTAL FUND BALANCES		<u>\$272,181,171.28</u>

STATEMENT OF RECEIPTS AND DISBURSEMENTS
 Teachers' Retirement System
 for the period July 1, 1969-June 30, 1970

CASH BALANCE, ALL FUNDS JULY 1, 1969 \$ 3,378,874.03

Receipts:

Teachers' Savings	\$ 19,774,253.40	
Reinstatements	138,744.37	
Voluntary Unmatched Contributions	<u>271,835.39</u>	
Total from Members		\$20,184,833.16

State Contributions:

"Permanent" to match Teachers' Savings	\$ 16,913,000.00	
Administrative Expenses	<u>274,910.00</u>	

17,187,910.00

Interest Collected, Bonds Redeemed or Sold; Adjustments

29,639,600.59

Aetna Special Reserve Account Recovery

104,891.45

Employer Matching of Teacher Contributions

1,099,535.72

Total Receipts

68,216,770.92

TOTAL CASH AVAILABLE

\$71,595,644.95

Disbursements:

Administrative Expenses Current Year	\$ 253,323.38	
Liquidation of Prior Year Encumbrances	<u>3,358.58</u>	\$ 256,681.96

Refunds for Withdrawal from Membership		2,892,906.03
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Premiums for Comprehensive Medical Plan		657,644.81
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Benefits for Service & Disability Retirement	\$ 13,514,163.06	
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Survivor Payments	221,773.28	
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Death Benefits	<u>285,887.53</u>	14,021,823.87
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Purchase of Investments

48,670,811.45

66,499,868.12

CASH BALANCE, ALL FUNDS-June 30, 1970

\$ 5,095,776.83

ANALYSIS OF RECEIPTS
Teachers' Retirement System
Fiscal Years 1940-41 through 1969-70

<u>Date</u>	<u>Teachers' Savings</u>	<u>Reinstatements</u>	<u>State Contribution for Current Obligations</u>	<u>Federal Matching Contributions</u>	<u>State Prior Service Contribution</u>	<u>Interest and Profit</u>	<u>Total Receipts</u>
7/1/40 - 6/30/44	\$ 2,063,716.64	\$ 675.28	\$ 2,152,853.79	\$	\$ 147,146.21	\$ 161,182.57	\$ 4,525,574.49
7/1/44 - 6/30/48	3,184,177.52	8,138.74	3,170,405.44		363,594.56	680,795.86	7,407,112.12
7/1/48 - 6/30/52	4,951,457.55	9,880.10	5,289,182.83		3,374,273.81	1,676,157.12	15,300,951.41
7/1/52 - 6/30/56	7,293,671.35	21,120.78	6,756,355.79		936,448.21	2,983,220.77	17,990,816.90
1956-57	3,409,800.55	6,946.98	3,485,749.24		611,125.76	1,082,779.34	8,596,401.87
1957-58	3,533,508.21	4,583.72	3,648,776.57		612,278.43	1,557,061.91	9,356,208.84
1958-59	3,877,031.28	7,026.22	3,987,893.67		479,306.33	1,638,554.23	9,989,811.73
1959-60	4,198,829.94	10,015.71	4,362,574.23		281,225.77	2,045,440.74	10,898,086.39
1960-61	5,826,133.35	391,207.80	5,951,960.89		1,173,039.11	2,537,175.78	15,879,516.93
1961-62	6,344,302.54	120,331.07	6,480,881.04		1,119,118.96	2,902,788.98	16,967,422.59
1962-63	6,795,670.37	110,996.21	6,960,461.18		950,175.82	3,866,534.20	18,683,837.78
1963-64	7,160,866.67	134,357.38	7,295,523.28		696,608.72	4,401,450.78	19,688,806.83
1964-65	7,886,032.37	129,066.14	7,999,217.37		400,782.63	5,391,261.59	<u>21,806,360.10</u>
1965-66	11,948,546.60	77,594.19	11,000,000.00	147,969.24	--	5,217,998.29	28,392,108.32
1966-67	14,318,742.10	152,312.44	12,858,630.00	942,771.10	--	6,786,657.62	35,059,113.26
1967-68	16,381,912.34	100,611.48	14,397,000.00	951,273.29	--	8,116,302.09	39,947,099.20
1968-69	18,395,874.24	147,753.52	18,741,796.94	1,301,561.26	424,963.06	10,279,269.43	49,291,218.45
1969-70	<u>20,046,088.79</u>	<u>138,744.37</u>	<u>17,187,910.00</u>	<u>1,099,535.72</u>	<u>--</u>	<u>12,229,003.20</u>	<u>50,701,282.08</u>
	<u>\$147,616,362.41</u>	<u>\$1,571,362.13</u>	<u>\$141,727,172.26</u>	<u>\$4,443,110.61</u>	<u>\$11,570,087.38</u>	<u>\$73,553,634.50</u>	<u>\$380,481,729.29</u>

ANALYSIS OF ACCOUNTS REFUNDED 1969-70
Teachers' Retirement System of the State of Kentucky

<u>REASONS FOR WITHDRAWAL</u>	<u>MALES</u>	<u>FEMALES</u>	<u>TOTAL</u>
Other Teaching Employment:			
State of Ohio	51	124	175
State of Florida	26	52	78
State of Indiana	28	73	101
Other States	186	310	496
Outside Limits of U. S. A.	4	9	13
Kentucky College or school not covered by Teachers' Retirement System	39	45	84
Non-Teaching Employment:			
Entered Business or Industry	198	61	259
Church-Related Profession	26	8	34
Medical Profession	3	3	6
Legal Profession	13	0	13
Military Service	43	4	47
Further Training & Education	106	115	221
Local, State, or Federal Government	98	56	154
Homemaking, Family Duties, Children	0	757	757
Husband Transferred Within Kentucky	0	1	1
Husband Transferred Out of Kentucky	0	232	232
Moved Residence to Another State	25	123	148
Emergency Teacher, Lack of Training, Not Re-employed	36	121	157
Salary too Low	65	15	80
Needed the Money	8	14	22
Disliked Teaching	15	16	31
Personal Reasons	106	141	247
Illness of Member	8	40	48
Death of Member	20	33	53
Absent from Profession 4 - 6 Years	1	2	3
Lost Service Credit, Absent 7 or More Years	<u>7</u>	<u>33</u>	<u>40</u>
TOTALS	<u>1,112</u>	<u>2,388</u>	<u>3,500</u>

PART II. INVESTMENTS

Again the Teachers' Retirement System ended the year with record returns on invested reserves. Our yield again is in the upper ten percent of similar systems throughout the nation. These results are secured within a framework of high quality investments.

Action by the 1968 General Assembly increased the permissible investment in common stocks to twenty-five percent of assets. At the close of the 1969-70 fiscal year the share of assets invested in common and preferred stocks had been increased to about eighteen percent of the total, as compared to about fourteen percent on June 30, 1969.

During this fiscal year the Trustees have continued an active program of portfolio improvements through exchanges of securities whenever favorable "swaps" are presented. Continued increases of yields on investments have resulted both from higher interest rates on current offerings and on improvements of returns due to exchanges of securities. Details of the various exchanges are too voluminous to include here, but information on each transaction is available to auditors and other interested persons.

ANALYSIS OF INVESTMENTS HELD AT JUNE 30, 1970
to show annual yield rate
Teachers' Retirement System of the State of Kentucky

	Percentage of Total	Par Value	Interest Income/Year	Annual Yield
Obligations Secured by U. S. Treasury	1.84%	\$ 4,915,830.38	\$ 273,803.33	5.570%
Federal Agencies	2.02%	5,394,000.00	223,160.66	4.137%
FHA & VA Mortgages	17.04%	45,581,518.17	2,466,386.79	5.411%
Other Guaranteed Mortgages	3.46%	9,255,545.15	526,207.89	5.685%
Corporate Bonds	56.61%	151,448,136.01	8,628,177.72	5.697%
∞ School & Municipal Bonds	.38%	1,006,000.00	60,006.64	5.965%
Kentucky Industrial Development Finance Authority	.54%	1,450,000.00	72,250.00	4.983%
Sub-Total	81.89%	\$ 219,051,029.71	\$ 12,249,993.03	
<u>NET YIELD RATE:</u>				
$\$12,249,993.03 \div \$219,051,029.71 = 5.592\%$				
<u>Not Included Above:</u>				
1,038,925 Shares Common Stocks	17.29%	46,263,162.03		
6,196 Shares Preferred Stocks	.15%	415,659.61		
Guaranteed Mortgages in Construction Status	.67%	1,784,177.96		
TOTAL INVESTMENTS	100.00%	\$ 267,514,029.31		

SUMMARY OF INVESTMENT PROFIT YIELDS

<u>Year</u>	<u>Invested Assets</u>	<u>Net Yield</u>
1959	\$ 57,572,000	3.39
1960	64,655,000	3.53
1961	78,017,000	3.81
1962	90,712,000	4.03
1963	102,938,000	4.17
1964	118,466,000	4.27
1965	132,805,000	4.43
1966	152,609,000	4.58
1967	174,612,000	4.69
1968	200,836,000	5.06
1969	235,898,000	5.32
1970	267,514,029	5.59

PART III. ACTUARIAL VALUATION

The latest Actuarial Valuation (July 1, 1968) was received too late for inclusion in the 1969 Annual Report. Complete copies of the Valuation were distributed to concerned persons and groups as a supplement to the 1969 Annual Report. However, certain excerpts from the Actuarial Report are included herewith, because of their importance in understanding the Retirement program and in planning future improvements in benefits.

Special attention is directed to the Summary and Recommendations which conclude the Actuary's Report.

Valuation as of July 1, 1968

Before making a valuation of any retirement system, it is necessary, in addition to making assumptions as to future experience as to rates of decrement among active members and pensioners, family composition, and salary scales, to recognize an assumed rate of investment yield on the assets over future years. As of July 1, 1966, this assumed rate was 4% per annum, compounded annually.

Experience during recent years indicates that an investment yield rate assumption of 4% is less than will probably be experienced over the long run. For example, as of June 30, 1968, the yield rate on mean fixed dollars assets was 5.065%. Furthermore, it is reasonable to anticipate that a return of at least this order of magnitude would continue to be received for a number of years because of several factors present in the economy which tend to induce high interest rates. As for equity holdings, it should be recognized that there is a potential for appreciation in the value of common stock which, together with dividends, should produce an overall yield that would average at least as high as the return on fixed dollar assets. Accordingly, it was decided that the assumed yield rate used for the valuation as of July 1, 1968, should be raised from 4% to 4 1/2%. The results of the valuation using this 4 1/2% rate, in conjunction with the actuarial tables shown in our December 18, 1967 report, are summarized in the actuarial balance sheet on the following page.

It will be noted that the assets in the balance sheet are broken down into the two main categories of (1) the present assets and (2) prospective assets represented by prospective member and State contributions. The various fund balances included in the total present assets of \$204,808,599 are shown in the balance sheet and the actual distribution of these present assets according to type is shown in a footnote. The value of all present assets is based on the value shown on the books of the System.

In the prospective asset category, the present values of members' and State's contributions were each computed at a rate of 6.75% of salaries. While the actual rate for each is 7% of salaries, 1/4% of this rate is paid to the Hospital and Medical Insurance Fund. Since this Fund is considered to be self-supporting, both the assets and liabilities for benefits from the Fund were eliminated from our valuation, except to the extent of reserves already on hand in the Fund. Therefore, the prospective assets reflect a present value of only a 6.75% rate for each of the members' and State's contributions, while the only liability shown for hospital and medical benefits are for the reserves currently in the Fund. Both of these present values relate only to contributions by and on behalf of present members.

On the liability side of the balance sheet, there are two main divisions of the liability; the first relates to the present annuitants and the second to the present active and inactive members. It will be noted that the total liability on account of benefits payable in the future to annuitants is \$128,204,802; the liability on account of benefits payable in the future to active and inactive members accounts to \$712,558,911; and, finally, there are special reserve items of \$2,654,122 representing the balances in the account for Voluntary Contributions and in the Hospital and Medical Insurance Fund and the Expense Fund.

Summary and Recommendations

This valuation of the Retirement System as of July 1, 1968 has been made using the actuarial tables developed in the actuarial investigation for the period July 1, 1959 to June 30, 1966 as submitted in our report dated December 18, 1967. In conjunction with these actuarial tables, we have used an interest assumption of 4 1/2% per annum, which represents an increase from the 4% assumption used for our valuation as of July 1, 1966.

This valuation reveals that the Retirement System is actuarially sound assuming that the total payroll continues to expand substantially in the future as the result of increases in the number of members. While it is true that the deficiency of \$250,007,532 in addition to the unfunded prior service liability of \$47,055,402 is very high in relation to the present assets and the prospective contributions, the period required to fund the deficiency is not unduly lengthy - ranging from approximately 54 years, assuming that the total payroll increases at a rate of 4% annually in the future, to approximately 37 years, assuming increases at the rate of 6% annually in the future. These periods represent reductions from the corresponding respective periods of 82 years and 49 years which were quoted in our valuation report as of July 1, 1966. Much of this reduction results from the change in interest assumption and the large number of new members covered by the System.

One unfavorable aspect of the combined deficiency of \$297,062,934 is that it is higher than the corresponding amount of \$261,200,518 as of July 1, 1966. It might have been expected that the deficiency would have been reduced because of (1) the introduction of new members for whom the total 14% rate of contribution by the member and the State is more than sufficient to fund benefits and (2) the change in interest assumption. However, these points were more than counter balanced by the additional

liabilities resulting from (1) benefit liberalizations since July 1, 1966 and (2) rates of salary increase substantially in excess of those assumed in calculating liabilities. Since retirement benefits are primarily based on average of the five highest salaries, salary increases for individuals at rates higher than assumed can lead to substantial increases in the deficiency.

Another unfavorable factor is the fact that the State did not make any payment toward the prior service liability for the fiscal years of the System ending June 30, 1966, 1967 and 1968. This situation results in increases in this liability which will have to be paid over future years.

It is our conclusion that the Retirement System is actuarially sound and that the deficiency can be met in the future. However, because of the experience relating to rates of increase in individual salaries, we recommend that no further benefit liberalizations be made at this time. Furthermore, the State should resume direct appropriations as soon as possible in order to reduce the unfunded liability for prior service.

PART IV. LEGISLATIVE AUDIT

A comprehensive audit report of the Teachers' Retirement System for the 1968-69 fiscal year has been prepared under direction of the Legislative Audit Committee. This report covers many phases of the financial and administrative functions of the System and includes many constructive suggestions related to these matters.

With reference to the recommendations made by the Audit Committee Report, the following comments seem pertinent to the matters discussed:

1. Prior Service Obligation - This item is mentioned in both the letter of transmittal and the Actuary's Report. No further comments seem necessary.
2. Permanent Contributions by the State - Apparent differences in the amount of the deficiency in the State's contribution for matching of member contributions arise from differences of opinion in regard to items which the State is obligated to match. It is important that these differences of opinion be resolved before budget requests are made for the next biennium. The suggestion for an "open end" appropriation is an excellent solution for a recurring problem.
3. Non-confirmation of Members' Accounts - It is true that individual member accounts are not being posted on a current basis due to problems arising from delays in completing the transition to a more sophisticated computer system. Member accounts, however, are not in jeopardy and are posted manually as the situation requires. Hopefully, the computer problems will be solved in the very near future.
4. Accounting for Pension Costs - This suggestion will require careful study to determine its effects on the System's method of funding pension costs.
5. Violations of Personnel Regulations - Steps had already been taken to bring the System into full compliance with Personnel policy prior to publication of this Report.
6. Benefit Liberalizations - The Retirement Board is in complete agreement with this recommendation.

7. Actuarial Evaluation Report - This is a very desirable objective, and will be done if data can be collected in time for an accurate valuation in the short time available.
8. Reconciliation of Fund Balances - These balances are now being reconciled as recommended. However, due to differences in bookkeeping procedures, adjustments will continue to be necessary.
9. Investments - Recommendation "A" is being carried out as rapidly as fiscally expedient. The securities mentioned in "B" were sold at cost several months ago. Recommendations "C" and "D" have been given favorable consideration by the Board of Trustees and full compliance with these suggestions are being incorporated in the System's administrative procedures.

A copy of the Audit Committee recommendations and excerpts from the financial summaries of this report are included herein. The entire Audit Report is too voluminous to include, but copies will be given rather wide distribution among State Officials and other interested groups. Copies also will be available for inspection in the Offices of the Teachers' Retirement System.



COMMONWEALTH OF KENTUCKY

Legislative Audit Committee

of the

Legislative Research Commission

CAPITOL BUILDING, FRANKFORT, KENTUCKY 40601

REPRESENTATIVE RALPH MITCHELL
CHAIRMAN

SENATOR PAT M. MCCUISTON
VICE CHAIRMAN

REPRESENTATIVE JOHN E. WHITE
SECRETARY

SENATOR WILLIAM A. LOGAN

SENATOR DONALD L. JOHNSON

REPRESENTATIVE LLOYD CLAPP

DONALD D. HARKINS
LEGISLATIVE AUDITOR

November 4, 1970

Legislative Audit Committee
General Assembly
The Capitol
Frankfort, Kentucky

We have examined the balance sheet of the Teachers' Retirement System of the Commonwealth of Kentucky for the fiscal year ended June 30, 1969, and the related statement of receipts and disbursements. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such tests of accounting procedures as we considered necessary under the circumstances, except that we were unable to perform a confirmation of balances of individual members' accounts for reasons stated in the attached report.

In our opinion, the accompanying Balance Sheet and related statements of cash receipts and disbursements present fairly the financial position of the Teachers' Retirement System of the Commonwealth of Kentucky at June 30, 1969 and the cash transactions for the year then ended, in conformity with generally accepted governmental accounting principles, applied on a basis consistent with that of the preceding year, except that the method of handling gains and losses on exchanges of investments was changed on May 17, 1968, as stated in the Audit Report of the Auditor of Public Accounts for FYE 6/30/68.

The examination was conducted by Charles Watson, Robert Purdom, and Clyde Adkins.

Respectfully submitted,

A handwritten signature in cursive script, reading "Donald D. Harkins".

Donald D. Harkins
Legislative Auditor

DDH/pr

TEACHERS' RETIREMENT SYSTEM

BALANCE SHEET

JUNE 30, 1969

EXHIBIT A

ASSETS

Cash on Deposit with State Treasurer (1)	\$ 3,111,727.73	
Special Reserve Account Aetna Life Insurance (1)	<u>263,787.72</u>	\$ 3,375,515.45
Investments (3&8)	235,777,468.49	
Unamortized Premiums on Investments (4)	2,383,214.50	
Unamortized Discounts on Investments (4)	<u>(2,312,762.65)</u>	235,847,920.34
Accrued Interest Purchased		<u>50,293.61</u>
TOTAL ASSETS		<u>\$239,273,729.40</u>

FUND BALANCES

State Accumulation Fund	\$108,123,099.54
Teachers' Savings Fund	108,088,150.55
Allowance Reserve Fund	3,199,830.08
Voluntary Contribution Fund	986,166.81
Guarantee Fund	12,858,441.86
Hospital & Medical Ins. Fund	2,954,428.62
Survivor & Death Benefit Fund	<u>3,063,611.94</u>
TOTAL FUND BALANCES	<u>\$239,273,729.40</u>

Accompanying "Notes to Financial Statements" are an integral part of this report.

TEACHERS' RETIREMENT SYSTEM
 COMBINED STATEMENT OF CHANGES IN FUND BALANCE EXHIBIT B
 FOR THE YEAR ENDED JUNE 30, 1969

FUND BALANCES - JULY 1, 1968 \$204,808,335.01

ADDITIONS

MEMBERS' CONTRIBUTIONS:

Teachers' Contributions	\$18,080,829.17	
Reinstatements	147,753.52	
Voluntary Unmatched Contributions	<u>315,045.07</u>	\$18,543,627.76

STATE CONTRIBUTIONS: (6)

To Match Teachers Contributions	\$18,475,036.94	
To Fund Prior Service Liability	424,963.06	
To Administrative Expense Fund	<u>266,760.00</u>	19,166,760.00

EMPLOYER MATCHING OF TEACHERS' CONTRIBUTIONS (7)

1,301,561.26

INVESTMENT INCOME:

Dividends & Interest	\$10,240,322.12	
Net Gain on Sale of Investments (4)	<u>50,070.55</u>	10,290,392.71

Correction of Prior Periods and Miscellaneous

772.97 49,303,114.70

TOTAL FUNDS AVAILABLE

\$254,111,449.71

DEDUCTIONS

Benefits for Service & Disability Retirement	11,263,199.29	
Survivor Payments	269,962.30	
Death Benefits	<u>224,000.00</u>	11,757,161.59
Refunds on Withdrawal from Membership	2,373,008.53	
Administrative Expenditures	228,132.69	
Irregular Payments (5)	7,902.09	
Premiums for Medical Ins. (Net of Experience Adjustment)	<u>471,515.41</u>	

TOTAL DEDUCTIONS

\$14,837,720.31

FUND BALANCES - JUNE 30, 1969

\$239,273,729.40

Accompanying "Notes to Financial Statements" are an integral part of this report.

TEACHERS' RETIREMENT SYSTEM
RECONCILIATION OF ACCOUNTS EXHIBIT C
AS OF JUNE 30, 1969

CASH BALANCE

Department of Finance Balance - Cash June 30, 1969		\$1,103,903.44
Add: Deposits in Transit	\$2,004,909.94	
Expense Fund Balance in Transit	38,627.31	
Transfer from Western Kentucky Univ.	412.04	
Special Reserve Acct. - Aetna Life Ins. Co.	263,787.72	
Less: Semi-annual Int. on \$1,450,000.00 Industrial Development Finance Authority Notes in Transit June 30, 1969	(36,125.00)	<u>2,271,612.01</u>
Teachers' Retirement System Cash - June 30, 1969		<u>\$3,375,515.45</u>

Investment Fund Balances

	<u>Investments</u>	<u>Unamortized Premium</u>	<u>Unamortized Discount</u>	<u>Accrued Interest Purchased</u>
Dept. of Finance Balance 6/30/69	\$235,777,468.49	\$2,383,214.50	\$(2,312,762.65)	\$ 50,293.61
Teachers' Retirement System Balance 6/30/69	235,777,468.49	2,383,214.50	(2,312,762.65)	50,293.61

Accompanying "Notes to Financial Statements" are an integral part of this report.

TEACHERS' RETIREMENT SYSTEM
 RECONCILIATION OF FUND BALANCES EXHIBIT D
 BETWEEN DEPARTMENT OF FINANCE AND TEACHERS' RETIREMENT
 AS OF JUNE 30, 1969

	State Accumulation Fund	Teachers' Savings Fund	Allowance Reserve Fund	Voluntary Contribution Fund	Guarantee Fund	Hospital & Medical Ins. Fund	Survivor & Death Benefit Fund
BALANCE - JUNE 30, 1969 per Dept. of Finance	\$106,548,345.17	\$104,561,231.34	\$ 1,124,991.67	\$ 951,444.41	\$18,411,403.54	\$2,533,467.13	\$2,871,234.13
Deposits in Transit June 30, 1969	114,777.04	1,714,400.40	-0-	39,768.36	-0-	67,982.07	67,982.07
Semi-annual interest on \$1,450,000.00							
Industrial Development Finance Authority Notes in Transit 6/30/69	-0-	-0-	-0-	-0-	(36,125.00)	-0-	-0-
Transfers from Western Kentucky University	382.60	-0-	-0-	-0-	-0-	14.72	14.72
Inter Fund Transactions to be completed	1,428,271.91	1,822,880.45	2,067,795.01	28,237.14	(5,526,067.45)	54,624.48	124,258.46
Transfer from General Fund - Administration	-0-	-0-	7,043.40	-0-	31,583.91	-0-	-0-
Inter Fund Adjustments - Per Audit (1)	31,322.82	(10,361.64)	-0-	(33,283.10)	(22,353.14)	34,552.50	122.56
Special Reserve Acct., Aetna Life Ins. Co.	-0-	-0-	-0-	-0-	-0-	263,787.72	-0-
BALANCE - JUNE 30, 1969 PER AUDIT OF TEACHERS' RETIREMENT SYSTEM	\$108,123,099.54	\$108,088,150.55	\$ 3,199,830.08	\$ 986,166.81	\$12,858,441.86	\$2,954,428.62	\$3,063,611.94

(1) Note: These adjustments were made necessary because of the incorrect posting on the part of the Teachers' Retirement System, of funds received during the 1968-69 fiscal year.

Accompanying "Notes to Financial Statements" are an integral part of this report.

Reconciliation of Fund Balances

The individual fund balances as reported by the Department of Finance were not reconciled to the balances as shown on the System's books. Consequently, the "fund adjustments - per audit" depicted on Exhibit D were made necessary to correct erroneous postings during the period examined. The amounts reflected as fund balances by the Department of Finance represent the amount of funds available to the System for current use. Periodic reconciliation of such reports to the System's records would facilitate the prompt detection and correction of errors. A monthly reconciliation would be preferable, but a quarterly reconciliation would be acceptable. The reconciliation should be maintained by the System pending post-audit examination.

NOTES TO FINANCIAL STATEMENTS

1. Cash on deposit with State Treasurer is the amount available at September 30, 1969 after the ninety day closeout period for liquidating June 30, 1969 encumbrances of \$3,358.58 in the Administrative Expense Fund.
2. The System has a contract with Aetna Life Insurance Company of Hartford, Connecticut which provides medical expense coverage to members of the System. Premiums are payable in advance and an "experience-surplus" credit is computed after the policy year. At June 30, 1969 these credits plus interest had accumulated in the amount of \$263,787.72.
3. Bonds and notes are carried on the books at adjusted cost (see note 4). Stocks are carried at cost. Mortgages are carried at current amortized value. Market value of all investments at June 30, 1969 as computed by Moody's Investors Service, Inc. was \$207,592,047.
4. During the year the System sold some of their investments in debt obligations and invested the proceeds in other, more attractive debt obligations. The System treats these transactions as exchanges recording the new securities at the lesser of their maturity value or cost plus unrecognized loss on old security whichever is less and treating a portion of discount or premium as an adjustment of the gain or loss on the sale of the old security. This practice causes gains and losses (by reducing subsequent year premium and discount amortization and current year gains and losses) on these exchanges to be spread over the life of the security. Other gains and losses are recognized in the year in which they occur.
5. In this report we have treated "Irregular Payments" from the Teachers' Savings Fund as a reduction in the Fund Balance in order to be consistent with prior audit reports. These payments are recorded on the System's books as a receivable and represent amounts reported as withheld from teachers' salaries but not submitted by the school district. The total amount of this receivable at June 30, 1969 was \$34,948.99.
6. Contributions made by the state to match teachers' contributions were the exact amount set up in the Executive Budget for the year under review. This represented an overmatch of \$1,695,769 to be applied against the cumulative deficit in state permanent contributions matching members' contributions. (KRS 161.550)
7. Employer matching of teachers' contributions is from employers of teachers whose salaries are from sources other than public school system funds.
8. As of May 1, 1970 the System had a claim against the Kentucky Company for 2,000 shares of Dow Chemical purchased at 70 3/8 and not received. The Kentucky Company is in receivership and a civil suit against them by the Securities and Exchange Commission is in U.S. District Court to compel the receiver to distribute the assets. In addition the System also has a claim against the Kentucky Company of \$2200 for dividends not received.



COMMONWEALTH OF KENTUCKY

Legislative Audit Committee

of the

Legislative Research Commission

CAPITOL BUILDING, FRANKFORT, KENTUCKY 40601

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CHAIRMAN

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DONALD D. HARKINS

LEGISLATIVE AUDITOR

November 19, 1970

Honorable Edna Lindle, Chairman
Board of Trustees
Teachers' Retirement System
309 Lewis Street
Frankfort, Kentucky

Dear Mrs. Lindle:

The Legislative Audit Committee has reviewed the report of the Legislative Auditor on the examination of the Teachers' Retirement System, for the fiscal year ended June 30, 1969. As a result of such examination, the following recommendations relating to the Teachers' Retirement System were adopted by the Committee:

1. Prior Service Obligation

It appears that the requirement of KRS 161.550 is not being discharged, and that the State must either markedly increase its activity in this contribution area, or change the statutory requirement. While the State's obligation to fund prior service credit benefits, separate and apart from present members' contributions, has remained constant since the establishment of the System, the funding formula has changed. Since the existing funding formula is not being achieved, it appears timely to suggest that the funding of the State's obligation for prior service credit be objectively reconsidered.

We recommend that the Legislative Research Commission direct its appropriate Interim Committee, or a special subcommittee formed from more than one Interim Committee to study future State funding of such obligation. The Committee should consult with the Board of Trustees, staff and actuary of the Teachers' Retirement System, and with the Department of Finance and should recommend legislation to the 1972 General Assembly to more adequately fund the obligation. We specifically

commend to the attention of such Committee the suggestions as to current funding of current benefits, and form of appropriations set forth in the report of the Legislative Auditor.

2. Permanent Contributions by the State

A. The Accumulated Deficit

The 1970 General Assembly by Part Four of 1970 Ky Acts c.15 authorized general fund surplus in excess of official estimates and in excess of any deficiency in the Minimum School Foundation Program to be transferred to the Teachers' Retirement System as a "current contribution for prior years' obligations" in an amount not exceeding \$2,030,440. The designated maximum sum was responsive to data in the 1970-72 Executive Budget and explanatory comments of the Executive Secretary of the Teachers' Retirement System before the joint Appropriations and Revenue Committees of the Senate and House of Representatives relating to the failure of the State's appropriations to match members' contributions. It appears that such data and comments overstated the extent of the accumulated deficiency for the years cited. If any surplus in the General Fund at the close of fiscal 1971 is eligible for transfer to the Teachers' Retirement System, we recommend that the Commissioner of Finance limit the actual allotment and transfers for "prior years obligations" to the amount of the actual deficiency, which would be an amount of money equal to the amount contributed by members under KRS 161.540, less the amount contributed by other employers under KRS 161.555, and less all amounts appropriated by the State under KRS 161.550 for purposes other than prior service credit, including amounts appropriated by the State for administration costs, for each fiscal year 1964 through 1970. If the surplus funds conditionally appropriated by 1970 Ky Acts c.15, Part Four (7) for prior years obligations exceed the amount of the actual deficiency as computed above, we recommend that the Commissioner of Finance act under KRS 45.160 to allot the balance of such funds to the Teachers' Retirement System for the purpose of discharging the State's prior service obligations.

B. Form of Appropriations

Future appropriation acts should appropriate the specific amount estimated to be required for matching members' contributions, and should include a provision that any amount in excess of the amount appropriated necessary to fund the State's permanent con-

tribution under KRS 161.550 would be deemed a necessary governmental expense and is appropriated for that purpose in the amount necessary for each fiscal year.

C. Amending the Substantive Law

KRS 161.550 should be amended to define the State's permanent contribution as an amount equal to that contributed by all members under KRS 161.540, less the amounts contributed by school districts or institutions under KRS 161.555.

3. Non-confirmation of Members' Accounts

Members' contributions should be posted to each member's account as soon after the close of each fiscal year as possible, and statements of individual accounts showing the member's contributions and interest should be mailed to each member. The Legislative Auditor reports that with the exception of members who have retired or withdrawn, neither posting to or mailing of individual members' accounts has been accomplished since July 1, 1968. Such delay has been occasioned in part by an issue of data processing. The Committee is aware that the Teachers' Retirement System has been seeking to acquire more sophisticated data processing facilities. It is similarly aware of efforts by the Department of Finance to improve the effectiveness and efficiency of data processing in State government, which improvements necessarily involve time to review and analyze existing facilities and to plan meaningful improvements. The proposals for computer changes have been under consideration, review and discussion between the System and the Department since August of 1968. We would not assess responsibility for delay, or characterize the delay as unnecessary. However, the members' accounts remain unposted and unreported. Continuation of this condition will impair the System's internal control over members' contributions. We recommend that the Department of Finance and Teachers' Retirement System resolve their differences over data processing as quickly as possible, in order that more adequate control over such records may be secured.

4. Accounting for Pension Costs

We recommend that the System's treatment of accounting for pension costs be revised to implement the treatment and satisfy the criteria outlined in Opinion No. 8 of the Accounting Principles Board of the American Institute of Certified Public Accountants. We specifically commend to the attention of the Board of Trustees the provisions of that Opinion respecting disclosure.

5. Violations of Personnel Regulations

The provisions of Administrative Regulation Per. 15 relating to vacation, sick and compensatory leave are mandatory and self-executing as to all employees in State service except those excluded by KRS 18.140(1). Accumulated vacation, sick or compensatory time in excess of the maximum permitted should be purged. Employees who must be absent for illness but who have no accumulated sick time, should be charged with vacation leave and should not be permitted to "borrow" sick leave in anticipation of future service.

6. Benefit Liberalizations

The appropriate Committees of the 1972 General Assembly should consider the effects of 1970 Ky Acts cs. 54 and 168 on the actuarial soundness of the Teachers' Retirement System before approving further benefit liberalizations.

7. Actuarial Evaluation Report

We recommend that the Teachers' Retirement System cause an actuarial evaluation to be made as of July 1, 1971 including the projected effect on the System of Acts adopted in 1970, and provide copies of that report to the Legislative Research Commission for distribution to all members of the 1972 General Assembly. While the Committee acknowledges that certain practical problems exist to challenge the System's ability to secure such a report before the 1972 session of the General Assembly, its importance as a source document to facilitate adequate legislative response to the System's needs should impart a sense of priority to its completion. We note that while some school districts historically have been dilatory in filing payroll reports and contributions lists, the timely production of such documents may be required by administrative regulation under KRS 161.560.

8. Reconciliation of Fund Balances

Individual fund balances as reported by the Department of Finance should be reconciled to the balances shown on the System's books periodically, not less than once every three months. Reconciliation facilitates the prompt detection and correction of error and is important to internal control.

9. Investments

Honorable Edna Lindle
PAGE 5
November 19, 1970

A. Planned Program of Investment Exchanges

Consistent with its program to sell or exchange low yield government bonds with higher yield corporate securities, it is recommended that the Board of Trustees sell all tax-exempt bonds with a yield of less than 6% for reinvestment in securities with a higher yield as promptly and advantageously as market conditions permit.

B. Classification of Investments and Compliance With KRS 161.430

The Committee finds that System ownership of water and sewer revenue bonds of a sixth class city contravenes KRS 161.430. The System should divest itself of the security as promptly as possible.

C. Corporate Debt Securities

It appears that so much of Paragraph II of the Board of Trustee's "Operating Guidelines" of March 10, 1967 that relates to the purchase of privately placed unrated bonds is beyond the authority of KRS 161.430(1)(h), and should be rescinded. We recommend that vouchers for the purchase of corporate debt securities record the rating service used and rating existing at the time of purchase, and that such information in turn become an item on the printout of the data processing runs available to management.

D. Recognition of Gains and Losses

While the System's treatment of gains or losses on the exchanges or swapping of investments to increase yield is an acceptable practice, we recommend that deferred gains and losses thereon be shown as a separate figure in the balance sheet in the interest of full disclosure, accompanied by an explanation of the System's treatment.

The Legislative Auditor will be available to discuss the foregoing recommendations with you or to answer any questions that might arise. The assistance and cooperation of the Teachers' Retirement System during the course of the examination is appreciated.

Very truly yours,

Ralph Mitchell
Chairman