

# STATE OF MINNESOTA

## Office of the State Auditor



**Patricia Anderson**  
**State Auditor**

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**ST. PAUL TEACHERS' RETIREMENT  
FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

**FOR THE YEAR ENDED JUNE 30, 2005**

## **Description of the Office of the State Auditor**

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

**Audit Practice** - conducts financial and legal compliance audits for local governments;

**Government Information** - collects and analyzes financial information for cities, towns, counties, and special districts;

**Legal/Special Investigations** - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

**Pension** - monitors investment, financial, and actuarial reporting for over 700 public pension funds; and

**Tax Increment Financing, Investment and Finance** - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**ST. PAUL TEACHERS' RETIREMENT  
FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

**For the Year Ended June 30, 2005**



**Audit Practice Division  
Office of the State Auditor  
State of Minnesota**

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

**BOARD OF TRUSTEES  
JUNE 30, 2005**

Feryle W. Borgeson	President
John R. Kunz	Vice President
Eugene R. Waschbusch	Secretary-Treasurer
Carol Adams	Trustee
Matthew Bogenschultz	Trustee
Michael McCollor	Trustee
Erma E. McGuire	Trustee
James Paddock	Trustee
Chong Thao	Trustee
Al Oertwig	Trustee, ex-officio

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**STATE OF MINNESOTA**  
**OFFICE OF THE STATE AUDITOR**

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PATRICIA ANDERSON  
STATE AUDITOR

**INDEPENDENT AUDITOR'S REPORT**

Board of Trustees  
St. Paul Teachers' Retirement Fund Association

We have audited the basic financial statements of the St. Paul Teachers' Retirement Fund Association as of and for the year ended June 30, 2005, as listed in the table of contents. These basic financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the St. Paul Teachers' Retirement Fund Association as of June 30, 2005, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis and other required supplementary information referred to in the table of contents are not required parts of the basic financial statements but are required by the Governmental Accounting Standards Board. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*/s/Pat Anderson*

PATRICIA ANDERSON  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

End of Fieldwork: December 30, 2005

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2005  
(Unaudited)

This section summarizes key information drawn from more detailed sections elsewhere in this report. It includes a brief overview of the financial performance and actuarial status of the St. Paul Teachers' Retirement Fund Association (hereinafter "SPTRFA," "Association," or "Fund") for the fiscal year ended June 30, 2005.

The following principle schedules are referenced throughout:

- (1) Fund basic financial statements
  - (a) Statement of Plan Net Assets
  - (b) Statement of Changes in Plan Net Assets
- (2) Notes to the financial statements
- (3) Required supplementary schedules of contributions and funding progress

**ORGANIZATIONAL STRUCTURE**

The SPTRFA is a non-profit organization formed in 1909, incorporated under Minn. Stat. ch. 317A. At the direction and oversight of a ten-member Board of Trustees, Association staff manage two tax-qualified, defined benefit pension programs covering licensed personnel for a single employer, Independent School District (ISD) No. 625, central administrative body for public schools within the City of Saint Paul.

*Basic Plan* members do not participate in Social Security through their employment with ISD No. 625. The *Coordinated Plan*, commenced in 1978, provides retirement benefits for members who do participate in Social Security.

Under state law, payroll contributions to the Fund are a direct operating obligation of the school district and members. However, the Association is not a component unit of St. Paul Public Schools; neither are the Fund's assets or liabilities included in District financial statements.

## INVESTMENT PERFORMANCE

Contributions provide the initial capital base of any retirement plan, as a lake or pond is often the origin point for a river. However, most of the water that ultimately flows out to sea comes not from the headwaters; rather, its source is the many tributaries on the long and winding voyage toward the sea.

Retirement funds operate in similar fashion. For every dollar ultimately paid out in benefits, about 30 cents will come from employee and employer contributions. Typically, about 70 cents will come from investment earnings on those contributions over time. Clearly, the adequacy of benefits and the long-term health of the Fund rely heavily on the efficient and prudent investment of contributions from members, employers, and taxpayers. In this regard, the Association has performed very well in recent years.

Our statutory, actuarial assumed return is 8.5 percent per year; an *absolute standard* of investment performance. Over any five-year window, annualized returns below this absolute target will cause unfunded liabilities to increase. Excess returns add to the actuarial balance sheet and reduce the unfunded liabilities of the plan, *ceteris paribus*. It is also important to measure how assets are performing in comparison to other public pension funds and to how the assets might have performed if passively invested in index-matching portfolios. To assess *relative* investment performance, we compare returns to those of similar pension funds and the composite benchmark return that would have occurred if the assets had been indexed to matching asset class targets selected by the trustees.

### Comparison of Annualized Returns (%)

	1-Year	3-Year	5-Year
Actual performance (net of fees)	11.8	11.1	4.9
Benchmark	10.2	11.1	3.7
Actuarial target	8.5	8.5	8.5
Actual versus benchmark	+ 1.6	-	+ 1.2
Actual versus actuarial target	+ 3.3	+ 2.6	- 3.6

The 2005 total Fund return (net of fees) rose to 11.8 percent, or about 1.6 percent more than the absolute actuarial target needed to offset “normal cost,” or the annual rate of liability accumulation. This is very positive news, especially on the heels of a 19.7 percent return in 2004. It would be good to see a few more years of such excess returns, as the three years preceding these witnessed the worst period of consecutive returns to the broad equity markets since the Great Depression. Despite the gains of recent years, the drag of those down market years is manifested in the five-year return relative to the actuarial target of 8.5 percent, and our current funding ratio reflects continued drag from the more adverse markets of 2001, 2002, and 2003.

When *relative returns* are considered, our performance was equally positive. Data from Callan Associates, our general investment consultant, indicate that on a net-of-fees basis, the Association beat its composite benchmark by 1.6 percent over the fiscal year. In the world of

institutional investing, that is a *wide* margin of relative gain. On a five-year basis, the Fund outperformed the composite by 1.1 percent; again, a significant positive spread. Among all plans included in the Callan Public Funds Universe, our overall performance in 2004-05 ranked in the top three percent, which attests to superior strategic placement of assets by the trustees and strong performance from active managers under contract.

This is a good time to remind ourselves of the standard mutual fund prospectus disclaimer: “Past performance is no guarantee of future returns.”

Recent absolute gains may be hard to repeat over the next few years. Most experts forecast domestic equity markets returns to hover in the mid-single digit range for the rest of this decade. The Fund has 47 percent of its assets in U.S. equities. If the forecasters are proven correct, total Fund returns below the absolute 8.5 percent target are nearly assured.

Our asset allocation was another contributor to excess performance, with a large allocation to international equities (25 percent) and an overweight to small cap and value-style equity markets. The value style tilt of the portfolio will be corrected through rebalancing transactions. The assets invested in international equities reflect a long-term allocation that the Trustees and their consultant consider a sound, long-term allocation. In certain shorter-term market environments, that strategy may not add to performance as well as it has in recent years.

Regarding future *relative* performance, our stated goal is to consistently exceed the median public fund total return. That goal is both reasonable and attainable. Any presumption, however, that we can indefinitely sustain top-decile relative performance could only be child to a reckless and unbridled form of hubris.

The reader might well ask at this point, “So, what’s the bottom line?” Well, it so happens that our financial statements actually provide a “bottom line,” and what follows is a discussion of the summary statistics drawn from those schedules.

## **SUMMARY INFORMATION FROM THE FUND FINANCIAL STATEMENTS**

The next two tables summarize data found later in this report. Detailed information can be found in schedules with corresponding names under the Financial Section of this annual report.

**Plan Net Assets**  
**(In Thousands of Dollars)**

	June 30	
	2005	2004
<b>Assets</b>		
Cash	\$ 3,179	\$ 8,929
Receivables	8,313	4,394
Investments at fair value	933,728	860,404
Securities lending collateral	101,596	79,012
Capital assets, less depreciation	33	36
<b>Total Assets</b>	<b>\$ 1,046,849</b>	<b>\$ 952,775</b>
<b>Liabilities</b>		
Accounts payable	\$ 737	\$ 772
Securities purchases payable	9,849	1,053
Variation margins payable	-	35
Securities lending collateral	101,596	79,012
<b>Total Liabilities</b>	<b>\$ 112,182</b>	<b>\$ 80,872</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$ 934,667</b>	<b>\$ 871,903</b>

**Changes in Plan Net Assets**  
**(In Thousands of Dollars)**

	Year Ended June 30	
	2005	2004
<b>Additions</b>		
Employer and employee contributions	\$ 34,021	\$ 34,686
State of Minnesota amortization aids	3,398	3,393
Investment activity, less management fees	99,268	145,367
Net securities lending income	156	213
<b>Total Additions</b>	<b>\$ 136,843</b>	<b>\$ 183,659</b>
<b>Deductions</b>		
Benefits, withdrawals, and refunds	\$ 73,520	\$ 68,880
Administrative expenses	559	516
<b>Total Deductions</b>	<b>\$ 74,079</b>	<b>\$ 69,396</b>
<b>Net Increase (Decrease)</b>	<b>\$ 62,764</b>	<b>\$ 114,263</b>
<b>Net Assets in Trust for Benefits - Beginning of the Year</b>	<b>871,903</b>	<b>757,640</b>
<b>Net Assets in Trust for Benefits - End of the Year</b>	<b>\$ 934,667</b>	<b>\$ 871,903</b>

Two important observations can be drawn from the Statement of Changes in Plan Net Assets:

- (1) Investment had a very positive effect on the Fund's bottom line, generating approximately \$99 million in additional assets; and
- (2) the SPTRFA manages a mature defined benefit program, for which annual benefit expenditures typically exceed payroll contributions by a significant amount.

These two facts underscore the importance of a sound investment management program. Annual benefit expenditures are about double the level of annual contributions. This is not unusual for a fund such as that administered by the SPTRFA. However, this relationship exposes a certain structural erosion to the asset base. Any year in which the targeted absolute return of 8.5 percent is missed amplifies the effect of this structural budgetary imbalance. The long-term required rate of return then, all else remaining the same, must *exceed* the assumed return by some percentage factor. While we do not know with any precision what that "excess return" is, it most certainly grows by some marginal increment any time the Fund falls short of the actuarial target return.

Administrative costs, as can be seen above, are a small part of program expenditures. The Board of Trustees nevertheless must be diligent to monitor and control those costs, since any dollar spent to administer the program affects the total assets available to pay benefits. In a recent report by the Office of the State Auditor<sup>1</sup>, the Association's operating expenditures ranked very low compared to other public plans in the state when measured on a per-member basis. Investment expenses, as a percent of assets, were above average, due in part to a relatively larger allocation to active asset management.

### **Notes to the Basic Financial Statements**

The notes provide supplementary information essential to fully understand the data provided in the basic financial statements. Below is a brief description of the notes, listed in numerical order:

- (1) Describes accounting policies applied in the development of the basic financial statements.
- (2) Provides a description of the plans administered by the SPTRFA, including coverage, classes of membership, and benefits.
- (3) Describes the laws and policies governing the deposit and investment of Association assets and also describes other common risks, including concentrations of credit risk, interest rate risk, and foreign currency risk.
- (4) Explains the securities lending program which the SPTRFA participates in through its custodian, the Bank of New York. By state law, securities on loan must be at least 100 percent collateralized at all times.

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<sup>1</sup> "State of Minnesota, Office of the State Auditor, Large Public Pension Plan Investment Report, For the Year Ended December 31, 2004."

- (5) Describes how funds are accumulated through contributions.
- (6) Describes the risk management policies of the Association with respect to losses related to torts, loss of assets, injuries to employees, and natural disasters.

**Actuarial Valuation Summary**

The financial statements can tell the reader whether, on a certain date, a plan is solvent, or how certain critical financial variables are moving over narrow time frames. They do not, however, tell the reader whether current financing mechanisms are adequate to satisfy future liabilities associated with promised plan benefits over longer periods of time. Hence, an actuarial valuation is needed to supplement accounting-based measures of funded status, and an entire section of this report is dedicated to actuarial measures of the Fund’s long-term fiscal health.

The July 1, 2005, valuation is a forecast and, as such, indicates the funded status of the defined benefit plans administered by the Association, provided that key assumptions driving the forecast results are valid. An experience study is conducted every four or five years in order to test whether important assumptions are consistent with real data over time. If the demographic and economic assumptions governing the valuation process are, in fact, relatively accurate, then policymakers may focus on those factors that may be directly influenced; namely, contribution rates and investment performance.

In 2002, the Fund adopted a number of changes to demographic, mortality, and salary progression assumptions to facilitate more accurate estimation of plan liabilities over time. No other changes have been solicited or adopted since. There were no changes to assumptions governing the valuation methodology or key valuation economic assumptions in the most recent year. Below are summary comparative statistics from the July 1, 2005, valuation:

**Summary of 2005 Actuarial Valuation  
Plan Year Beginning July 1, 2005**

	2004	2005	Change
Covered payroll	\$ 221,685,475	\$ 223,762,071	+ 0.94%
Statutory contributions (Ch. 354A)	16.62%	16.49%	- 0.13%
Required (Ch. 356)	21.59%	23.78%	+ 2.19%
<b>Sufficiency/(Deficiency)</b>	<b>- 4.97%</b>	<b>- 7.29%</b>	<b>- 2.32%</b>
Market value of assets	\$ 871,902,589	\$ 934,667,364	+ 7.20%
Actuarial value of assets	\$ 898,859,732	\$ 905,292,514	+ 0.72%
Actuarial accrued liability	\$ 1,251,460,084	\$ 1,299,831,584	+ 3.87%
<b>Unfunded liability</b>	<b>\$ 352,600,352</b>	<b>\$ 394,539,070</b>	<b>+ 11.89%</b>
<b>Funded ratio</b>	<b>71.82%</b>	<b>69.65%</b>	<b>- 2.17%</b>

The 2005 actuarial valuation reflects a slight deterioration in overall funded status compared to the previous year, despite significant excess investment gains of 3.3 percent (net of fees) in the most recent fiscal year. A decline in the funded ratio seems counterintuitive. It occurs because the actuary is required to “smooth out” the effect of investment gains and losses over a five-year

window, with each year allowed an additional 20 percent in the weighting formula. Hence, while investment gains for the most recent years have been very strong, less weight is given to those gains, while the relative weight for *negative* years (2001-03) *increased* relative to the previous year valuation. In time, the bad years will drop out of the current asset equation, and the funded ratio should reflect gains driven by more recent and more positive years.

Distortions introduced by the valuation methodology and the compression of the amortization target period to 15 years are factors that must be taken into consideration. They do not, however, completely overcome the serious deterioration in measured contribution adequacy in the last two valuations. Continuing to expect investment performance to offset the effects of a slowly growing payroll base and an erosion in the adequacy of the contribution stream does not seem wise. It will be necessary to supplement the plan by a significant amount in order to prevent further deterioration in the funded ratio due to insufficient contributions.

\* \* \* \* \*

Collectively, the schedules, accompanying notes, and discussions in this report provide comprehensive information as of June 30, 2005, regarding the benefit plans administered by the Association, the asset and liability structure of the Fund, the financial and actuarial status of the SPTRFA, and key policies and procedures of the Association.

Information compiled for this report is intended to conform with generally accepted accounting principles and Governmental Accounting Standards Board Statements 25, 28, 34, and 40. At all times, the objective has been to provide an accurate and balanced picture of the financial and actuarial condition of the retirement program established and administered on behalf of educators in St. Paul. Questions about the information in this report should be directed to:

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St. Paul Teachers' Retirement Fund Association  
1619 Dayton Avenue, Room 309  
St. Paul, Minnesota 55104-6206

Phone: (651) 642-2550  
Facsimile: (651) 642-2553  
Website: <http://www.sptrfa.org>  
Email: [info@sptrfa.org](mailto:info@sptrfa.org)

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## **BASIC FINANCIAL STATEMENTS**

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

**EXHIBIT 1**

**STATEMENT OF PLAN NET ASSETS  
JUNE 30, 2005**

<u>Assets</u>	
<b>Cash</b>	<b>\$ 3,179,437</b>
<b>Receivables</b>	
Employer and employee contributions	\$ 1,891,723
Interest	765,084
Dividends	209,530
Sales of securities	5,436,117
Other	10,886
<b>Total receivables</b>	<b>\$ 8,313,340</b>
<b>Investments, at fair value</b>	
U.S. government securities	\$ 26,531,474
TBAs	18,665,733
Corporate bonds	42,369,736
Corporate stocks	204,503,038
Commingled investment funds	
Pooled international equity trust	93,298,019
Government/credit bond index fund	82,135,856
Equity index fund	129,770,147
Extended equity index fund	49,325,110
Russell 2000 equity index fund	11,478,539
International emerging markets growth fund	41,219,677
Mutual fund	44,029,907
International corporate stock fund	96,767,387
Money market funds	13,171,966
Limited partnership	2,642,675
Real estate securities	77,819,036
<b>Total investments, at fair value</b>	<b>\$ 933,728,300</b>
<b>Invested securities lending collateral</b>	<b>\$ 101,595,603</b>
<b>Furniture and fixtures (at cost, less accumulated depreciation of \$97,887)</b>	<b>\$ 32,679</b>
<b>Total Assets</b>	<b>\$ 1,046,849,359</b>
<u>Liabilities</u>	
Accounts payable	\$ 737,364
Security purchases payable	9,849,028
Securities lending collateral	101,595,603
<b>Total Liabilities</b>	<b>\$ 112,181,995</b>
<b>Net Assets Held in Trust for Pension Benefits (A Schedule of Funding Progress is Presented on Page 28.)</b>	<b>\$ 934,667,364</b>

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

***EXHIBIT 2***

**STATEMENT OF CHANGES IN PLAN NET ASSETS  
FOR THE YEAR ENDED JUNE 30, 2005**

<b>Additions</b>	
<b>Contributions</b>	
Employer	\$ 20,435,230
Members	13,586,719
Other sources	
State of Minnesota	3,397,761
<b>Total contributions</b>	<b>\$ 37,419,710</b>
<b>Investment income (loss)</b>	
<b>From investing activity</b>	
Net appreciation (depreciation) in fair value of investments	\$ 91,055,139
Interest	4,836,461
Dividends	3,523,864
Other	3,275,157
<b>Total investing activity income (loss)</b>	<b>\$ 102,690,621</b>
Less: investing activity expense	(3,422,410)
<b>Net income (loss) from investing activity</b>	<b>\$ 99,268,211</b>
<b>From securities lending activity</b>	
Securities lending income	<b>\$ 2,198,847</b>
Less: securities lending expense	
Borrower rebates	\$ (1,976,965)
Management fees	(65,961)
<b>Total securities lending expense</b>	<b>\$ (2,042,926)</b>
<b>Net income from securities lending activity</b>	<b>\$ 155,921</b>
<b>Net investment income (loss)</b>	<b>\$ 99,424,132</b>
<b>Total Additions</b>	<b>\$ 136,843,842</b>

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

***EXHIBIT 2  
(Continued)***

**STATEMENT OF CHANGES IN PLAN NET ASSETS  
FOR THE YEAR ENDED JUNE 30, 2005**

<b>Deductions</b>	
Benefits to participants	
Retirement	\$ 65,125,102
Disability	1,020,828
Survivor	6,243,438
Dependent children	58,833
Withdrawals and refunds	<u>1,072,293</u>
<b>Total benefits, withdrawals, and refunds</b>	<b>\$ 73,520,494</b>
Administrative expenses	<u>558,573</u>
<b>Total Deductions</b>	<b>\$ 74,079,067</b>
<b>Net Increase (Decrease)</b>	<b>\$ 62,764,775</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	
Beginning of Year	<u>871,902,589</u>
End of Year	<u><u>\$ 934,667,364</u></u>

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

NOTES TO THE BASIC FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

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1. Summary of Significant Accounting Policies

Reporting Entity

The St. Paul Teachers' Retirement Fund (Fund) is a single-employer defined benefit pension fund administered by the St. Paul Teachers' Retirement Fund Association (Association), pursuant to the Association's bylaws and Minn. Stat. chs. 354A and 356. The Fund's membership consists of eligible employees of Independent School District No. 625, St. Paul, employees formerly employed by Independent School District No. 625, charter schools, and the employees of the Association. The Association is governed by a ten-member Board of Trustees.

Basis of Presentation

The accompanying financial statements are presented in accordance with Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and with Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*, as amended.

Basis of Accounting

The basis of accounting is the method by which additions and deductions to plan net assets are recognized in the accounts and reported in the financial statements. The Association uses the accrual basis of accounting. Under the accrual basis of accounting, additions are recognized when they are earned, and deductions are recognized when the liability is incurred.

Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on an exchange are valued at the last reported sales price at current exchange rates. Market values of investments in limited partnerships are determined by reference to published financial information of the partnership. Investments that do not have an established market are reported at estimated fair value.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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1. Summary of Significant Accounting Policies

Investments (Continued)

Net appreciation (depreciation) in fair value of investments includes net unrealized and realized gains and losses. Purchases and sales of securities are recorded on a trade-date basis.

The Association participates in a securities lending program. In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, investments lent under the program are reported as assets on the balance sheet, and collateral received on those investments is reported as an asset and a liability.

Derivative Investments

The Association may invest in futures contracts using a static asset allocation investment strategy.

Upon entering into a futures contract, each party is required to deposit with the broker an amount, referred to as the initial margin, equal to a percentage of the purchase price indicated by the futures contract. In lieu of a cash initial margin, certain investments are held for the broker as collateral. Subsequent deposits, referred to as variation margins, are received or paid each day by each party equal to the daily fluctuations in the fair value of the contract. These amounts are recorded by each party as unrealized gains or losses. When a contract is closed, each party records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

Futures contracts involve, to varying degrees, credit and market risks. The Association may enter into contracts only on exchanges or boards of trade where the exchange or board of trade acts as the counterparty to the transactions. Thus, credit risk on such transactions is limited to the failure of the exchange or board of trade. Losses in value may arise from changes in the value of the underlying instruments or if there is an illiquid secondary market for the contracts.

The Association invests in TBA, or "to-be-announced," mortgage-backed securities. TBA mortgage-backed securities transactions are a basic mechanism for trading federal agency mortgage pass-through securities on a delayed delivery and settlement basis. They do not represent a separate type or class of mortgage-backed securities. A TBA transaction is a purchase or sale of mortgage pass-through securities with settlement agreed upon for some future date. The purchase of pass-throughs on a TBA basis creates a long position in the underlying security on the trade date with associated market risk in the position. The securities

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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1. Summary of Significant Accounting Policies

Derivative Investments (Continued)

to be delivered are described in general detail at the time of trade but are not specifically identified until shortly prior to settlement. TBA transactions may involve newly-issued or existing agency mortgage pass-throughs.

Investment Income

Interest income is recognized when earned on an accrual basis. Dividend income is recorded on the ex-dividend date.

Contributions

Member employee contributions are recognized when withheld or when paid directly by the member employee. Employer contributions are recognized as a percentage of covered payroll as earned. Direct state-aid and state amortization aid are recognized pursuant to state statute.

Benefits and Refunds

Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Furniture and Fixtures

Furniture and fixtures are carried at cost, less accumulated depreciation. Depreciation has been provided using the straight-line method over estimated useful lives of five years.

2. Description of Plans

The following brief description of the plans is provided for general information purposes only. Participants should refer to the plan agreements for more complete information.

The plans are not subject to the provisions of the Employee Retirement Income Security Act of 1974.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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2. Description of Plans (Continued)

General

The Association was created to provide retirement and other specified benefits for its members. The Association maintains two defined benefit pension plans covering teachers in the St. Paul public school system.

Effective July 1, 1978, the Association established a plan, coordinated with Social Security, in accordance with Minnesota statutes (the Coordinated Plan). Teachers who become members of the Association subsequent to June 30, 1978, automatically become members of the Coordinated Plan. Members' contributions and benefits under the Coordinated Plan have been adjusted to reflect contributions to and benefits from Social Security. Teachers who were members of the Association prior to July 1, 1978, are generally covered under the Basic Plan, which provides all retirement benefits for its members.

Membership

At June 30, 2005, the Association's membership consisted of:

Retirees and beneficiaries currently receiving benefits	2,505
Terminated employees entitled to but not yet receiving benefits	1,368
Terminated, non-vested	1,687
Current active plan members (including members on leave)	<u>4,349</u>
Total Membership	<u>9,909</u>

Pension Benefits

Members who satisfy required length-of-service and minimum age requirements are entitled to annual pension benefits equal to a certain percentage of final average salary (as defined in each plan) multiplied by the number of years of accredited service.

Disability Benefits

Active members who become totally and permanently disabled and satisfy required length-of-service requirements are entitled to receive annual disability benefits as calculated under each plan.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
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2. Description of Plans (Continued)

Other Benefits

Limited service pensions, deferred pensions, survivor benefits, and family benefits are available to qualifying members and their survivors.

3. Deposits and Investments

A. Deposits

Authority

Minn. Stat. § 356A.06 authorizes the Association to deposit its cash in financial institutions designated by the Board of Trustees.

Custodial Credit Risk

The custodial credit risk for deposits of the Association describes the potential for partial or total loss of cash or near-cash holdings in the event of a depository failure. Minnesota statutes require that assets held in depository accounts be insured by the Federal Deposit Insurance Corporation (FDIC), or exclusively pledged collateral of 110 percent of the uninsured amount on deposit. Balances in the Associations' checking account at US Bank can vary dramatically over short periods of time, as this account holds short-term deposits and transfers necessary to meet not only general operating expenses, but large monthly benefit payments totaling \$6.7 million or more per month. Association deposits at US Bank are fully collateralized by pledged U.S. Treasury or federal agency notes on deposit with the Federal Reserve Bank.

Deposits with the Bank of New York consist primarily of net earnings on loaned securities. Rarely would this account exceed \$100,000, the FDIC limit, as balances are regularly drawn down below \$25,000 in order to pay bank, investment consultant, and certain other investment manager fees. Balances are swept daily and included in the Bank of New York Short-Term Collective Trust, where they are invested in a commingled pool, consisting of U.S. Treasury, other governmental, and high-grade short-term corporate bonds. The Association's deposits at June 30, 2005, are completely protected and, therefore, there is no custodial credit risk for deposits.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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3. Deposits and Investments (Continued)

B. Investments

Authority

The Association's investments are authorized by state law and its own investment policy. Permissible investments include, but are not limited to: government and corporate bonds, foreign and domestic common stock, real property, venture capital investments, and notes.

Custodial Credit Risk

Custodial credit risk for investments is generally defined as an assessment of the potential that loaned securities of the Association may be insufficiently collateralized, or that a counterparty to any loan of Association securities might be either undercollateralized or fail to deliver loaned securities in time to satisfy current security trading needs.

According to Association policy, all securities purchased by the Association are held by a third-party safekeeping agent appointed as a custodian who is also the lending agent/counterparty. The securities lending agreement in place between the Association and its custodian is also consistent with this policy.

The Association has no custodial credit risk for investments at June 30, 2005, other than that related to the invested securities lending collateral, as described in Note 4.

Interest Rate Risk

Interest rate risk for investments consists of assessing the potential for adverse effects on the market value of debt securities held as a result of interest rate changes.

The Association participates in fixed income markets through both "active" and "passive" or indexed investment manager accounts, as listed below.

<u>Mandate</u>	<u>Management Firm</u>	<u>Market Value</u>
Active	Voyageur Asset Management	\$ 93,657,672
Indexed	Barclays Global Investors	\$ 82,135,856

The Association has, relative to peers, a small allocation to fixed income assets as part of its investment policy. At June 30, 2005, the targeted allocation was 19 percent of total Fund assets. The actual share of total Fund assets was 18.8 percent.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
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3. Deposits and Investments

B. Investments

Interest Rate Risk (Continued)

The active fixed portfolio has a shorter overall weighted duration than the Lehman Aggregate Index benchmark. All else being equal, this would be expected to reduce the account's risk to adverse effects from rising interest rates.

The index account manager, Barclays Global Investors (BGI), has as part of its mandate, the explicit objective of matching, as closely as possible, the overall weighted direction of the Lehman Government/Credit Bond Index. Here, the fixed income strategy is indifferent to changes in the near-term changes in rates of interest.

The following table shows weighted overall durations of each investment account and the associated benchmark as of June 30, 2005:

<u>Account</u>	<u>Average Duration in Years</u>	<u>Average Duration of Benchmark</u>
Voyageur Asset Management	4.79	4.91
Barclays Global Investors	5.20	5.21

Liquidity needs of the Association are not a factor in the structure of the fixed income, or any other asset class in which the Fund participates. The allocation of assets and the structure of investment accounts are optimized relative to long-term investment objectives and capital asset pricing models. The Association attempts to match asset allocations to policy targets and draws down accounts to meet short-term liquidity needs by targeting accounts that are, relative to targets, overfunded. This, in effect, rules out considerations about changes to interest rates, security duration, or portfolio term structures.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Minn. Stat. § 356A.06, subd. 7, limits fixed income holdings to investment grade securities. Government-issued debt securities, while broadly defined in law, must be backed by the full faith and credit of the issuing domestic government or agency, with principal and interest payable in U.S. dollars.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

3. Deposits and Investments

B. Investments

Credit Risk (Continued)

Corporate fixed securities are limited to those either issued by companies domiciled in the United States or the Dominion of Canada. In all cases, securities must be rated among the top four categories of a nationally recognized rating agency.

The following table provides the range of security types and credit ratings (where applicable) to the holdings of the Association's one active fixed income portfolio manager.

Actively Managed Fixed Income Securities Type, Rating, Relative Shares June 30, 2005				
Fixed Income Security Type	Rating (Standard and Poors)	Amount	Amount/ Subtotal	Percent (%)
Asset Backed Securities	A- AAA	\$ 461,881 12,262,509		
Subtotal			\$ 12,724,390	16
Collateralized Mortgage Obligations	AAA Federal/Unrated	\$ 4,187,615 8,083,647		
Subtotal			12,271,262	15
Corporate Bonds	AA+ AA A+ A- A BBB+ BBB BBB-	\$ 522,495 536,602 1,963,071 3,147,641 2,566,141 4,164,107 3,833,812 1,412,059		
Subtotal			18,145,928	22
U.S. Government Bonds	AAA	\$ 11,789,883		
U.S. Government Agencies	AAA	330,563		
Government National Mortgage Association	Federal/Unrated	564,130		
Federal Home Loan Mortgage Corporation	Federal/Unrated	2,894,453		
Federal National Mortgage Association	Federal/Unrated	17,278,115		
Subtotal			32,857,145	41
Miscellaneous Other Fixed Income	AAA		800,000	1
Preferred Stock	BBB+		429,510	1
Private Placements	AAA BBB+	\$ 753,603 332,287		
Subtotal			1,085,889	1
State and Local Obligations	AA+ AAA AA	\$ 134,621 1,992,556 415,905		
Subtotal			2,543,082	3
Total			\$ 80,857,206	100

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

3. Deposits and Investments

B. Investments (Continued)

Concentration of Credit Risk

Concentration of credit risk relates to the adequacy of policy and practice in limiting the risk of loss due to insufficient diversification of holdings and could be measured on the basis of holdings from several aspects, such as asset class, region, sector, industry, or company size. The Investment Policy of the Association incorporates the Modern Portfolio Theory approach to capital market pricing, which holds that risk is inevitable for the institutional investor, but it can be reasonably estimated from historical return dispersion patterns and “budgeted” in allocating assets in a manner most likely to earn a targeted long-term rate of return on the overall portfolio.

A good investment policy defines what types of risks will be assumed, how they will be managed, and that each incremental addition to portfolio risk should carry a corresponding and proportional opportunity for gain. The Association’s policy is that the standard deviation of quarterly returns should not exceed 120 percent of the same measure for the asset category benchmark. Minn. Stat. § 356A.06, subd. 7, specifies that equity investment holdings may not exceed 5 percent of the outstanding shares of any one corporation. Association policy also limits exposure to any one company’s securities at 1.5 percent of the total portfolio. Further, no more than 15 percent of the Fund assets may be invested in any one sector, and the maximum allocation to any single active investment manager is 12.5 percent of the total Fund.

The following tables indicate these risk control policies were reflected in portfolio holdings as of June 30, 2005.

Top Ten Holdings - Percent of Assets as of June 30, 2005

<u>Investment Manager - Account</u>	<u>Security or Asset</u>	<u>Market Value</u>	<u>Percent of Total Fund (%)</u>
1. Voyageur - Fixed Income	U.S. Treasury Bonds	\$ 3,921,823	0.4%
2. Barrow Hanley - Large Cap Value	WellPoint, Inc.	2,952,736	0.3
3. Voyageur - Fixed Income	U.S. Treasury Bonds	2,880,825	0.3
4. Voyageur - Fixed Income	Fed. Nat. Mtg. Assn.	2,837,249	0.3
5. Barrow Hanley - Large Cap Value	ConocoPhillips	2,657,533	0.3
6. Barrow Hanley - Large Cap Value	Occidental Petroleum	2,484,839	0.3
7. Voyageur - Fixed Income	U.S. Treasury Bonds	2,301,432	0.2
8. Barrow Hanley - Large Cap Value	Nokia Corp. ADR	2,033,408	0.2
9. Barrow Hanley - Large Cap Value	BP plc ADR	2,021,112	0.2
10. Barrow Hanley - Large Cap Value	Allstate Corporation	2,007,600	0.2
Total for Group		<u>\$ 26,098,557</u>	<u>2.7%</u>

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
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3. Deposits and Investments

B. Investments

Concentration of Credit Risk (Continued)

Assets by Investment Account as of June 30, 2005

Investment Manager - Account	Total Assets Under Management (Market Value)	Percent of Total (%)
Bank of New York - Cash Flow	\$ 42,895	-
Alliance Capital - Large Cap Growth	30,345,505	3.3
Barrow Hanley - Large Cap Value	65,084,459	7.0
Fifth Third Advisors - Large Cap	33,031,380	3.6
Wellington - Sm/Mid Cap Growth	40,907,484	4.4
Boston Company - Small Value	36,972,610	4.0
Voyageur - Fixed Income	93,657,672	10.1
Barclays - Govt/Credit Bond Index Fd	82,135,856	8.8
Barclays - Russell 2000 Equity Index	11,478,539	1.2
Barclays - Equity Index Fund	129,770,147	14.0
Barclays - Extended Equity Market Fd	49,325,110	5.3
Dimensional Fund Advisors	44,029,907	4.7
Morgan Stanley - Intl. Equity	93,298,019	10.1
Capital Intl. - Emerging Mkts Gr	41,219,677	4.4
RWI Group	2,642,675	0.2
Turin Networks	1,634,260	0.2
UBS Realty Investors	63,584,244	6.9
Advantus	14,362,177	1.5
JP Morgan - International	96,767,387	10.4
Total Assets by Investment Account	<u>\$ 930,290,003</u>	<u>100.0</u>

The total assets under management at market value are classified as follows on Exhibit 1.

Receivables	
Interest	\$ 765,084
Dividends	209,530
Sales of securities	5,436,117
Investments	933,728,300
Less: securities purchases payable	<u>(9,849,028)</u>
Total Assets Under Management, Market Value	<u>\$ 930,290,003</u>

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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3. Deposits and Investments

B. Investments (Continued)

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates of foreign currencies relative to the U.S. dollar adversely affect the fair value of an investment or a deposit.

As the U.S. share of global economic output continues to diminish, and the returns to broad U.S. equity markets continue to deliver among the lowest of those for major developed and developing markets globally, it becomes increasingly difficult for any institutional investing entity to justify a fiduciary posture on investments that does not include a significant international component.

However, because the liabilities of any public pension plan are due and payable in U.S. dollars, it is an inescapable fact that ultimately, all foreign holdings must be converted into U.S. dollar liquidity at some point. Owning securities and currencies of other countries, therefore, adds another level and type of risk, which occurs with each movement in the rate of exchange between the U.S. dollar and the relevant currency of trade.

As of June 30, 2005, the Investment Policy of the Association included a dedication of 25 percent of the total Fund as the international equity component of the total portfolio. International positions are held in pooled or commingled investment funds, which render the exposure to foreign currencies to a derivative risk, as the Fund's interest is limited in all cases to a unit valuation expressed in U.S. dollars. The actual allocation was \$231 million, or 24.8 percent of total invested assets. This allocation resulted in derivative exposures to international markets as detailed in the following chart.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

3. Deposits and Investments

B. Investments

Foreign Currency Risk (Continued)

Assets Held in Non-U.S. Securities/by Currency  
June 30, 2005

Currency	Debt	Equity	Total
Argentine Peso	\$ 164,879	\$ 412,197	\$ 577,076
Australian Dollar	-	1,754,846	1,754,846
Brazilian Real	82,439	6,105,058	6,187,497
British Pound Sterling	-	52,135,231	52,135,231
Canadian Dollar	-	805,577	805,577
Chilean Peso	-	329,757	329,757
Chinese Yuan	-	1,525,128	1,525,128
Columbian Peso	41,220	206,098	247,318
Croatian Kuna	-	41,220	41,220
Czech Koruna	-	123,659	123,659
Egyptian Pound	-	453,416	453,416
European Union Euro	-	62,945,931	62,945,931
Hong Kong Dollar	-	3,895,823	3,895,823
Hungarian Forint	-	247,318	247,318
Indian Rupee	-	4,245,627	4,245,627
Indonesian Rupiah	-	1,112,931	1,112,931
Israeli Shekel	-	1,236,590	1,236,590
Japanese Yen	-	36,369,114	36,369,114
Korean Won	-	9,935,165	9,935,165
Malaysian Ringitt	-	2,060,984	2,060,984
Mexican Peso	-	3,519,017	3,519,017
New Zealand Dollar	-	737,054	737,054
Peruvian Nuero Sol	-	82,439	82,439
Philippine Peso	41,220	206,098	247,318
Polish Zloty	-	164,879	164,879
Russian Rouble	41,220	761,307	802,527
Singapore Dollar	-	554,359	554,359
South African Rand	-	2,844,158	2,844,158
Swedish Krona	-	2,501,662	2,501,662
Swiss Franc	-	19,271,010	19,271,010
Taiwan Dollar	-	5,878,655	5,878,655
Thai Baht	-	453,416	453,416
Turkish Lira	41,220	865,613	906,833
Venezuelan Bolivar	-	82,439	82,439
Vietnam Dong	-	41,220	41,220
Total Securities	\$ 412,198	\$ 223,904,996	\$ 224,317,194

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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4. Securities Lending

The Association participates in a securities lending program. On June 30, 2005, 11 percent of its U.S. government securities, corporate bonds, and corporate stocks were loaned out.

Minn. Stat. § 356A.06, subd. 7, permits the Association to enter into securities lending transactions. These are loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Loans may be made only to pre-approved borrowers. Qualifications of borrowers and the fiscal status of such entities are monitored on a continuing basis. The Association's securities custodian is the agent in lending the Association's securities for collateral of at least 102 percent of the market value of loaned securities. Loaned investments are marked to market daily. If the collateral provided by the borrower falls below 100 percent of the market value of the loaned investment, the borrower is required to provide additional collateral to bring the collateral to 102 percent of the current market value. Collateral may be provided in securities or cash.

In the event of failure by the borrowing party to deliver the securities at all, the Association should be at least 100 percent collateralized in order to recover the market value equivalent of securities not returned.

The Association's contract with the Bank of New York also specifies that the custodian will indemnify the Association for any "fails," or loss of securities by failure of borrowers to return securities.

As of June 30, 2005, the fair value of cash collateral received was \$101,595,603, which is included in the Statement of Plan Net Assets both as an asset and offsetting liability. Of the cash collateral, \$62,961,084 was invested in corporate obligations; \$20,599,338 was invested in certificates of deposit; and \$18,035,181 was invested in repurchase agreements, which have an average weighted maturity of 27 days. The Association has no credit risk exposure to borrowers because the amounts the Association owes borrowers exceed amounts borrowers owe the Association. The contract with the trust company requires the trust company to indemnify the Association if borrowers fail to return the loaned securities, requiring delivery of collateral up to the market value of the loaned securities to the Association. All securities loans may be terminated on demand by either the Association or the borrower.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

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5. Contributions

Funding

Benefit and contribution provisions are established by state law and may be amended only by the State of Minnesota Legislature.

Minn. Stat. § 354A.12 sets the rate for employee and employer contributions expressed as a percentage of annual covered payroll. The requirement to reach full funding by the year 2021 is set in Minn. Stat. § 356.215, subd. 11. As part of the annual actuarial valuation, the actuary determines the sufficiency or deficiency of the statutory contribution rates toward meeting the required full funding deadline. The actuary compares the actual contribution rate to a "required" contribution rate. The required contribution rate consists of: (a) normal costs based on entry age normal cost methods, (b) a supplemental contribution for amortizing any unfunded actuarial accrued liability by the required date for full funding, and (c) an allowance for administrative expenses. At June 30, 2005, the difference between the statutory and actuarially required contributions is a deficiency of 7.29 percent of payroll.

Employer and Employee Contributions

For the fiscal year ended June 30, 2005, the contribution rates required by statute were as follows:

	<u>Percentage of Members' Salaries</u>	
	<u>Basic Plan</u>	<u>Coordinated Plan</u>
Employee contribution	8.00%	5.50%
Employer contribution	11.64%	8.34%

Other Contributions

Minn. Stat. § 354A.12 requires the state to annually provide the Association with direct aid until it reaches the same funded status as the Minnesota Teachers' Retirement Association (TRA). The direct state-aid contribution was \$2,967,000 for fiscal year 2005.

Minn. Stat. § 423A.02, subd. 3, requires the state to annually provide certain aid to the Association until it is fully funded. The state amortization aid contribution was \$430,761 for fiscal year 2005. Beginning in fiscal year 1998, the School District must make an additional annual contribution to the Association in order for the Association to continue receiving state amortization aid. The School District contributed \$800,000 for fiscal year 2005.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

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5. Contributions

Other Contributions (Continued)

Statutes also require active and retired members of the Association to provide contributions for the relative difference (per member) between the administrative expenses incurred by the Association and the state TRA. No additional contributions were required in fiscal year 2005.

Reserve

At June 30, 2005, \$11,909,300 of the net assets is considered reserved as it represents the amount of state amortization aid which, pursuant to legislation, must be separately accounted for and may not be used in determining post-retirement benefit increases. This is considered to be fully funded.

6. Risk Management

The Association is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; and natural disasters. To cover its liabilities, the Association purchases commercial insurance. There were no significant reductions in insurance coverage from coverage in the prior year. The amount of settlements did not exceed insurance coverage for each of the past three fiscal years.

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**REQUIRED SUPPLEMENTARY INFORMATION**

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

*Schedule 1*

**SCHEDULE OF FUNDING PROGRESS  
(IN THOUSANDS OF DOLLARS)**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Plan Assets (a)</b>	<b>Actuarial Liability (AAL) - Entry Age (b)</b>	<b>Unfunded AAL (UAAL) (b-a)</b>	<b>Funded Ratio (%) (a/b)</b>	<b>Annual Covered Payroll (c)</b>	<b>UAAL as a Percentage of Covered Payroll (%) ((b-a)/c)</b>
2000	\$ 801,823	\$ 998,253	\$ 196,430	80.32	\$ 187,950	104.51
2001	869,045	1,060,931	191,886	81.91	202,915	94.56
2002	899,572	1,141,300	241,728	78.82	201,456	119.99
2003	898,760	1,189,361	290,601	75.57	205,655	141.31
2004	898,860	1,251,460	352,600	71.82	221,685	159.05
2005	905,293	1,299,832	394,539	69.65	223,762	176.32

(Unaudited)

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

*Schedule 2*

**SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES  
(IN THOUSANDS OF DOLLARS)**

<b>Fiscal Year</b>	<b>Annual Required Contributions</b>	<b>Employer Contributions</b>	<b>Employer Percentage Contributed (%)</b>	<b>State Contributions</b>	<b>State Percentage Contributed (%)</b>
2000	\$ 20,814	\$ 19,049	91.52	\$ 3,573	17.17
2001	20,444	19,996	97.81	3,573	17.48
2002	17,382	20,958	120.58	3,258	18.74
2003	23,948	19,986	83.46	3,384	14.13
2004	30,828	20,378	66.10	3,393	11.01
2005	34,724	20,435	58.85	3,398	9.79

**Note:**

The annual required contributions are actuarially determined. The employer and state are required by statute to make contributions, all of which have been made.

(Unaudited)

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION**  
**ST. PAUL, MINNESOTA**

NOTES TO SCHEDULE 1 AND SCHEDULE 2  
AS OF AND FOR THE YEAR ENDED JUNE 30, 2005  
(Unaudited)

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Actuarial Methods and Assumptions

The actuarial accrued liability is determined as part of an annual actuarial valuation on July 1. Significant methods and assumptions are as follows:

- The most recent actuarial valuation date is July 1, 2005.
- Actuarial cost is determined using the Entry Age Normal Actuarial Cost Method.
- The amortization method assumes a level percentage of payroll each year is used to pay the unfunded actuarial accrued liability.
- The amortization period is determined each year by the legislatively-appointed actuary.
- The remaining amortization period at July 1, 2005, is 16 years.
- The actuarial value of assets is determined using market value, adjusted for amortization obligations receivable at the end of each fiscal year, less a percentage of the unrecognized asset return determined at the close of each of the four preceding fiscal years. Unrecognized asset return is the difference between actual net return on market value of assets and the asset return expected during that fiscal year (based on the assumed interest rate employed in the July 1 actuarial valuation of the fiscal year).
- Actuarial Assumptions:
  - Investment rate of return is 8.5 percent.
  - Inflation and projected salary increases are based on a ten-year select and ultimate rate table with rates ranging from 5.0 to 6.9 percent.
  - Two percent annual post-retirement adjustment.
  - Pre-retirement mortality assumptions are based on the 1983 Group Annuity Mortality Table with rates set back seven years for males and five years for females.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

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Actuarial Methods and Assumptions (Continued)

- Post-retirement mortality assumptions are based on the 1983 Group Annuity Mortality Table with rates set back three years for males and one year for females.
- Post-disability mortality assumptions are based on the 1977 Railroad Retirement Board Mortality Table for Disabled Annuitants.

Significant Plan Provision and Actuarial Methods and Assumption Changes

2000

- Asset valuation method changed to employ a more effective asset-smoothing technique which is market-value based and which eliminates artificial bias related to manager style (effective July 1, 2000).

2001

- The annual lump sum benefits payable to pre-1974 retirees will be paid as monthly installments (effective January 1, 2002).

2002

The following actuarial assumptions changed:

<u>Assumptions</u>	<u>Prior</u>	<u>Revised</u>
Salary increases	Merit table that ranges from 7.25% at age 20 down to 5.25% at age 70	Ten-year select and ultimate table. During the select period, 0.3% x (10-T) where T is completed years of service is added to the ultimate rate. Ultimate table ranges from 6.9% at age 20 down to 5.0% at age 60 and over.
Male Pre-Retirement Mortality	1983 GAM (Male - 5)	1983 GAM (Male - 7)
Female Pre-Retirement Mortality	1983 GAM (Female - 3)	1983 GAM (Female - 5)
Separation Decrement	Graded rates	Select and ultimate table. Ultimate rates are generally lower than prior rates.

**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

Significant Plan Provision and Actuarial Methods and Assumption Changes

2002 (Continued)

Assumptions	Prior	Revised
Disability Decrement	Graded rates	Graded rates. Revised rates are lower than prior rates.
Form of Annuity Selected - Male	85% married 15% elect 50% J&S option 50% elect 100% J&S option	85% married 10% elect 50% J&S option 45% elect 100% J&S option
Form of Annuity Selected - Female	60% married 10% elect 50% J&S option 10% elect 100% J&S option	60% married 10% elect 50% J&S option 10% elect 100% J&S option
Combined Service Annuity Load Factor	None assumed	7.0% load on liabilities for active members and 30% load on liabilities for former members.

The following plan provisions changed:

- Effective July 1, 2002, 359 charter school teachers are no longer covered by this Fund. Active charter school teachers retain their rights to benefits earned in this Fund through June 30, 2002, as if they were former members with a termination of employment on June 30, 2002. They may not, however, draw a refund of contributions as long as they remain employed by the same school they were employed with on June 30, 2002. Effective July 1, 2002, these 359 charter school members were transferred to the Minnesota Teachers' Retirement Association.
- An administrative expense assessment otherwise payable under law will not be assessed if the administrative expenses of the Fund do not exceed the July 1, 2001, administrative expense amount adjusted for inflation.
- While not a formal change in provisions, a change in the expected amount of state-aid has occurred with the Fund. Since the Duluth Teachers' Retirement Fund accrued liability funding ratio exceeded the Minnesota Teachers' Retirement Fund accrued liability funding ratio as of July 1, 2001, the state-aid normally provided to Duluth shall be re-allocated to the other first class city teachers' funds. This results in a marginal increase in the amount of state-aid for this Fund.

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**ST. PAUL TEACHERS' RETIREMENT FUND ASSOCIATION  
ST. PAUL, MINNESOTA**

**Schedule 3**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
FOR THE YEAR ENDED JUNE 30, 2005**

**MINNESOTA LEGAL COMPLIANCE**

**PREVIOUSLY REPORTED ITEM NOT RESOLVED**

04-1 **Compliance with Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989**

The Saint Paul Teachers' Retirement Fund Association (Association) did not have documentation demonstrating that it had a perfected security interest in pledged collateral in compliance with FIRREA, 12. U.S.C. § 1823(e). A 1992 U.S. Court of Appeals decision stated that, if a municipality fails to perfect a security interest under federal law, its right to such collateral in the event of default is not enforceable. To obtain an enforceable security interest in the collateral, FIRREA requires the pledging institution's security agreement or pledge of collateral to meet certain requirements.

We recommend that when the Association receives the written collateral assignment, it also reviews the assignment to determine that:

- the assignment is approved by the depository's board of directors or loan committee, and
- the assignment of collateral is continuously, from the time of its execution, an official record of the depository.

We also recommend the Association require its depository institution to comply with FIRREA and to provide proof of compliance in the form of a copy of the depository's board of directors or loan committee resolution. The agreement or pledge should include a list of particular securities pledged at the time of the resolution.

**Client's Response:**

*The Association concurs with the Auditor's Finding and acknowledges that the perfection of our collateral interest with our depository institution was not fully documented and, therefore, is not yet able to be demonstrated.*

*We did provide the Auditor with monthly reports of pledged collateral provided by US Bank, our local depository, and monthly reports from the Federal Reserve Bank in Cincinnati, Ohio, which identify each month the securities they report as held for the SPTRFA as “Pledgee.” The Auditor has concluded that these reports are not sufficient to meet the FIRREA collateral perfection criteria.*

*The SPTRFA will move as soon as possible to request a copy of the bank’s board of directors’ assignment of our collateral in order to satisfy this requirement.*

ITEM ARISING THIS YEAR

05-1 Holdings in Authorized Investments

The Association holds investments in index funds operated as mutual funds or bank-sponsored collective funds. Formerly these investments were characterized as “units in commingled trusts” authorized under Minn. Stat. § 356A.06, subd. 7(b), “Securities generally.” However, further review indicates these bank-sponsored collective and mutual funds are authorized under the “Other investment” section of Minn. Stat. § 356A.06, subd. 7(h)(iii). The total of investments authorized under “Other investments” must not exceed 35 percent of the Association’s investment portfolio. When index funds are added to the Association’s investments held as authorized under Minn. Stat. § 356A.06, subd. 7(h), the Association exceeds the 35 percent limitation for investments held under this clause.

There has been increased usage of index funds by several of the larger pension funds and associations, and support for index funds as an appropriate type of pension investment vehicle is considerable. The Office of the State Auditor is supportive of proposals to revise Minn. Stat. § 356A.06, subd. 7(h), to permit investments in these index funds without restriction provided the index funds invest only in securities authorized by Minn. Stat. § 356A.06, subd. 7, (excluding the “Other investments” section of this statute).

In the meantime, we recommend the Association’s Board of Trustees be aware that its investments categorized under Minn. Stat. § 356A.06, subd. 7(h), exceed the 35 percent limitation for investments held under this clause, and the Association, along with other similarly situated pension funds and associations, seek a remedy through the Minnesota Legislature in order to achieve compliance with Minnesota statutes governing authorized investments.

Client's Response:

*As interpreted by the Office of the State Auditor, it does indeed appear the St. Paul Teachers' Retirement Fund Association has more than 35 percent in assets allocated to bank-sponsored collective and mutual funds under the "other assets" category as separately identified in Minn. Stat. § 356A.06, subd. 7(h)(iii).*

*The interpretation rendered is not, in our view, a settled matter. As the Auditor has noted, Minn. Stat. § 356A.06, subd. 7(b) does authorize investments in commingled trusts that, in general, hold securities traded in regulated markets, and government or corporate debt issues rated among the top four quality categories.*

*Language has been introduced in the 2006 Legislative Session that would more clearly distinguish between those commingled assets that are considered less liquid and perhaps more volatile in market value, from those trading in broader and more regulated markets. A definition based on the nature of the underlying securities, rather than the structure and form of the organization sponsoring the commingled investment vehicle, would help resolve this matter.*

*The SPTRFA endorses legislation that will address the question raised by the Auditor's interpretation, while recognizing commingled funds as a legitimate approach to dampening portfolio volatility, reducing transaction costs, custody and investment manager fees.*

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# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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PATRICIA ANDERSON  
STATE AUDITOR

## REPORT ON MINNESOTA LEGAL COMPLIANCE

Board of Trustees  
St. Paul Teachers' Retirement Fund Association

We have audited the basic financial statements of the St. Paul Teachers' Retirement Fund Association as of and for the year ended June 30, 2005, and have issued our report thereon dated December 30, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories, except that we did not test for compliance in contracting and bidding, public indebtedness, and claims and disbursements because these areas do not apply to the St. Paul Teachers' Retirement Fund Association.

The results of our tests indicate that, for the items tested, the St. Paul Teachers' Retirement Fund Association complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 04-1 and 05-1.

This report is intended solely for the information and use of the Board of Trustees and management and is not intended to be, and should not be, used by anyone other than those specified parties.

We would like to express our appreciation to the Board of Trustees of the Association and the staff for their cooperation and assistance during the audit.

*/s/Pat Anderson*

PATRICIA ANDERSON  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

End of Fieldwork: December 30, 2005