STATE OF MINNESOTA
Office of the State Auditor

Rebecca Otto
State Auditor

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

FOR THE YEAR ENDED JUNE 30, 2012

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

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 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of 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 approximately 730 public pension funds; and

Tax Increment Financing - 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 Employees 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, 2012

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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Financial Section

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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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, 2012, as listed in the table of contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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, 2012, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

/s/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

December 10, 2012

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, 2012
(Unaudited)

The following discussion and analysis provides an overview of the financial performance and actuarial status of the St. Paul Teachers' Retirement Fund Association (hereinafter "SPTRFA," "Plan," "System," or "Fund") for the fiscal year ended June 30, 2012, to assist the reader in understanding the financial statements and to provide an overall review of the financial activities during the past year.

Financial Highlights

+ Net assets of the Plan which measures the amount of funds available to pay current and future pension benefits, decreased by $68.2 million during the fiscal year to a total of $881.9 million. This decrease came on top of strong improvement in net assets in both the prior two fiscal years, 2010 and 2011. The portfolio rose 13% in 2010 and 25% in 2011. Although it was a somewhat disappointing flat return in 2012, the Fund's three-year annualized average stands at 12.4%, well above its 8% target rate of return. Its long-term return remains above the 8% level as well. This near-term stretch of performance has served to maintain the strong financial status of the Fund, even with the decrease in assets over the prior twelve month period.

+ The Plan realized a 0.15% (gross of fees) investment rate of return for the fiscal year. Although the performance this year proved disappointing, the trailing 10-year return for the Fund stands at 7.34%, after one of the most challenging decades for investment performance. The trailing 15-year return for the Fund is at our target return, 8.02%, while long-term (20 years), the Fund has earned 9.12% annually. The Fund has a current long-term investment return objective of 8.0%.

+ The actuarial (smoothed over a rolling five-year period) funded ratio of the Plan compares the actuarial value of assets against the actuarial determined accrued liability. That ratio fell from 70% to 62% as of June 30, 2012, due to a combination of factors. These included the portfolio's flat return for the year, the lowered Fund discount (targeted investment) rate, and changes in the mortality rate, reflecting today's longer life expectancy. The Plan's funded ratio on a market value basis, which does not involve any smoothing factor, stands at 60% from the prior year's 68%.

+ In addition to the Fund's unpredictable investment portfolio performance and the modest supplemental aid from the State of Minnesota, the key, consistent source of funding for the Plan is represented by employer and employee contributions. During FY 2012, this source of contributions, based on fixed percentages of the St. Paul School District's covered payroll, held steady from last year at $239.1 million. It is important to remain sensitive to this total and its direction. Reductions in the number of employees, which may result from various cost savings initiatives, early retirement incentives, and replacing higher salaried senior teachers with more junior professionals, can translate over time into lower contributions from the workforce. This could place a greater burden to generate realized gains from the investment portfolio to make up any difference. Furthermore, retiree payrolls, the bulk of Fund outflows, are increasing steadily. For FY 2012, total benefits paid surpassed $100 million/year for the first time in the Fund's history.

System Overview, Overview of the Financial Statements

System Overview

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

Basic Plan members do not participate in Social Security through their employment with ISD 625. The Coordinated Plan, commenced in 1978, provides retirement benefits for members who simultaneously participate in Social Security.

Under State law, annual payroll contributions to the Fund are a direct operating obligation of the school district and members. While the Association provides an employment-based benefit, the terms are not collectively negotiated, nor are they administered through the District Benefits Division. The Association is not a component unit of St. Paul Public Schools; neither are the Fund's assets or liabilities included currently in the District financial statements. The recently adopted Governmental Accounting Standards Board (GASB) statements require that the Fund's liabilities become part of the employer's financial statements in the future.

Overview of the Financial Statements

The financial section for this report consists of four parts: (1) Independent Auditor's Report; (2) the Management's Discussion and Analysis (this section); (3) the Basic Financial Statements, which include the Statement of the Plan Net Assets, the Statement of Changes in Plan Net Assets and their accompanying notes; and (4) the Required Supplementary Information, which consists of various schedules and accompanying notes.

1. Basic Financial Statements

a) The Statement of Plan Net Assets presents information about assets and liabilities, the difference being the net assets held in trust for pension benefits. The level of net assets reflects the resources available to pay member benefits when due. Over time, increases and decreases in net assets measure whether the financial position of the SPTRFA is improving or deteriorating.

b) The Statement of Changes in Plan Net Assets presents the results of fund operations during the year and the additions or deductions from plan net assets. It provides more detail to support the net change that has occurred to the prior year's net asset value on the Statement of Plan Net Assets.

c) The Notes to the Financial Statements provide additional information essential to gain a full understanding of the SPTRFA's accounting policies, benefit plans, deposits and investments, securities lending, contributions, risk management, funded status/progress, and finally, a narrative description of the actuarial measurement process.

2. Required Supplementary Information

a) Exhibits A-1 and A-2 provide six years of comparative data related to the SPTRFA's funded status and the schedule of contributions which measure and compare the actuarially-determined annual required contributions and the actual amount of contributions made by the employer, employees, and the State of Minnesota.

b) The Notes to Exhibits A-1 and A-2 provide actuarial assumptions and changes to significant plan provisions and actuarial methods/assumptions.

Financial Highlights from the Basic Financial Statements

As shown in the following table, the SPTRFA's total assets for 2012 were $884.6 million and were generally comprised of cash, investments, and securities lending collateral. The lending collateral represents cash on deposit to cover the value of securities loaned to brokerage firms for which they pay a fee to the Fund's custodian. These broker/dealer firms are obligated to return such securities at a future point in time. The Fund and custodian share the lending proceeds on a 70-30 split basis. This strategy, commonly employed by institutions, provides an important source of added income. Due to the Fund's decision to change custodians at fiscal year-end, its securities lending program was being closed down in anticipation of the shift to the new custodian, US Bank. As a result, the portion of the Fund's operating liability of $2.7 million represented by its securities lending program was only $1.1 million. Normally, this would be a much higher number. Last year, the total on loan amount was $6.7 million. Overall, total assets decreased by $73.8 million compared to the prior year, while total operational liabilities declined from $5.6 million to $2.7 million this year. This had the effect of decreasing the net assets available to pay current and future pension benefits to $881.9 million. It represented a decrease of $68.2 million during the fiscal year.

Plan Net Assets (at Market)
(in Thousands of Dollars)

	June 30	
	2012	2011
Assets		
Cash	$ 10,862	$ 11,558
Receivables	5,134	3,438
Investments at fair value	867,494	936,647
Securities lending collateral	1,114	6,749
Capital assets, less depreciation	26	20
Total Assets	$ 884,630	$ 958,412
Liabilities		
Accounts payable	$ 1,017	$ 1,116
Securities purchases payable	573	426
Securities lending collateral	1,114	6,749
Total Liabilities	$ 2,704	$ 8,291
Net Assets Held in Trust for Pension Benefits	$ 881,926	$ 950,121

The following table, Changes in Plan Net Assets, lists additions and deductions, as required in governmental accounting.

The main source of Fund outflows were benefit payments as well as refunds to those members who opted to leave the System and take their contributions. Benefit payments reached $102.7 million and exceeded contributions by nearly $63.5 million. This negative cash flow is typical of defined benefit plans as mature as SPTRFA's which are designed to permit accumulated investment returns to offset annual shortfalls. With growing numbers of benefit recipients, the level of negative cash flow is expected to grow, although changes to contribution rates that went into effect July 2011 are expected to somewhat neutralize the impact of the higher annual benefit payroll. Benefit payments increased $4.5 million from $98.2 million for FY 2011 to $102.7 million this past year. Benefit payments for FY 2010 had been $96.3 million. Administrative costs edged incrementally to 7/10ths of one percent, but remain extremely low.

Changes in Plan Net Assets (at Market)
(in Thousands of Dollars)

	Year Ended June 30	
	2012	2011
Additions		
Employer and employee contributions	$ 35,568	$ 34,759
State of Minnesota amortization aids	3,658	4,077
Investment activity, less management fees	(4,025)	194,860
Net securities lending income	51	70
Other Income	15	-
Total Additions	$ 35,267	$ 233,766
Deductions		
Benefits, withdrawals, and refunds	$ 102,726	$ 98,230
Administrative expenses	736	722
Total Deductions	$ 103,462	$ 98,952
Net Increase (Decrease)	$ (68,195)	$ 134,814
Net Assets in Trust for Benefits - Beginning of the Year	950,121	815,307
Net Assets in Trust for Benefits - End of the Year	$ 881,926	$ 950,121

Investment Performance

The Defined Benefit Plan administered by the SPTRFA accumulates assets in advance of benefit obligations, covering those obligations primarily through contributions and prudent investment growth. The level of supportable benefits and the long-term financial health of the Fund depend on the efficient and prudent investment of contributions from members, our employer, and taxpayers through the annual State supplement.

For every dollar paid in benefits, about 70% will derive not from contributions directly but from compounded investment earnings. There are cyclical economic, market-driven, and tactical risks associated with investing plan assets in the capital markets. The State Legislature this past year revised downward our actuarial assumed investment rate of return to 8.0%. This represents the long-term, absolute annualized target investment return. Over shorter periods (3, 5, and 10 years), this target may or may not be achieved, as has been the case in the most recent stretch of unprecedented market turmoil. However, the important factor is that over the longer-term range of time, 20, 30, even 50 years, time periods in which the pension system operates for its beneficiaries, this 8.0% return level has been consistently achieved. The Plan return for 20 years, for example, is 9.12%.

During the past fiscal year, the Fund's return was basically unchanged, 0.15%. The year was marked by four distinct performance quarters which sharply demonstrated investors' mood from embracing "risk" to avoiding it. Risk is defined by volatility and investors' appetite to look positively upon global economic conditions ('risk on'), especially Europe's debt crisis, in which case equities performed strongly, or with caution ('risk-off'), where investors spurned stocks in favor of U.S. Treasury issues or other traditional safe havens, such as precious metals. The Fund experienced two 'risk-on' quarters surrounded by two 'risk-off' quarters, battling to a draw over the twelve months. With few realized investment gains, the portfolio was called upon to finance monthly benefit payouts resulting in the overall reduction in total assets and a concomitant increase in its level of liabilities. Furthermore, with the Legislative decision to reduce the investment rate of return from 8.5% annually to 8.0% (at least for the next five-year period, at which point investment conditions will be re-evaluated), a position confirmed by the Board, the Plan's funded ratio, which had experienced a modest improvement the prior year, fell from 70% to 62%. That 62% funded ratio is virtually comparable for both the actuarial value of assets (under the Fund's five-year smoothing of assets methodology) and the current market value of assets approach.

Performance against the current 8.0% statutory target provides an important check on whether asset growth has avoided falling behind the pace of liability accumulations. However, we also want to assess whether SPTRFA assets are being deployed efficiently so as to maximize potential gain within risk constraints and considering prevailing market conditions. To do so, we compare our returns relative to other public pension funds and also consider our performance compared to a representative composite benchmark return. This latter performance indicates how the portfolio would have performed if the portfolio consisted solely of passively run, index-matching accounts. This is an indicator of how much "value-added" comes from our active managers and whether higher fees, associated with active managers, are justified.

Comparison of Annualized Returns %

	1-Year	3-Year	5-Year
Actual performance (net of fees)	-0.17	12.05	1.24
Indexed benchmark	0.86	11.91	1.17
Actuarial target	8.0	8.5	8.5
Actual versus indexed benchmark	-1.03	0.14	0.07
Actual versus actuarial target	-8.17	3.55	-7.26

Absolute Basis of Assessment

The 2012 total Fund return (net of fees) was negative 0.17%. That is 8.17% less than the stated annual target return required to meet projected "normal costs" (i.e., the measurement of impact on the System represented by one year's future liability). Normal cost is comparable to your regular weekly personal expenses, such as utilities, monthly mortgage payment, food, etc. This does not take into account the cost related to eventually paying off the System's actuarial unfunded liability, a result of past years of underfunded employer and state contributions. This actuarial longer-term liability would compare to one's home mortgage balance. The Fund's long-term liabilities are separate from the funds needed to meet a Plan's annual pension liability, or "normal cost," which are being adequately financed by member and employer contributions.

The flat negative 0.15% return from the portfolio in FY 2012 placed it in the bottom half of comparable plans, which is not a common occurrence for the Paul Teachers' Retirement Fund, which is often in the top quarter. The Board is weighing several revisions to the portfolio in light of this development and to make the portfolio more "all weather" in its composition, while lowering overall portfolio risk. This will take considerable time to implement, realistically one to two years, but the long-term impact on Fund performance should prove advantageous going forward. During the prior year, the gap that existed between the actuarial and market value of portfolio assets had been reduced quite dramatically, as a result of the strong investment performance. This gap is a moving target and quite volatile based on annual performance and thus should not be used as any meaningful indicator of financial soundness of the system. However, it is helpful to monitor for longer-term trends and as a means of assessing Plan liabilities.

Compared to our peers, the Fund's investments underperformed. However, the spread of fiscal year performance was unusually narrow, notwithstanding these highly volatile market conditions. In fact, the median Fund performed at slightly over 1% during FY 2012, while we were 0.15%. However, looked at by asset class, the Association's portfolio comparative performance placed it in the following rankings: domestic equity, 79th percentile; international equity, 25th percentile; fixed income, 42nd percentile; real estate, 67th percentile and global, 50th percentile. Domestic equity represents, by far, the Fund's largest commitment and thus had the effect of dragging down the overall relative performance. Also, in an uncommon development, the Fund's policy target (passive management) outperformed its active managers in all but the non-U.S. category. Almost without exception, the Fund's active managers have annually added value. This wasn't the case in the past fiscal year. Had they done so, the return would have been 0.86% for the year.

Actuarial Valuation Summary

While the short-term returns are a helpful snapshot of current conditions, the actuarial valuation analysis is key to understanding the more important, longer-term health of the Plan. During the past fiscal year, improvements in this category were also achieved. The table below helps to assess whether assets and current financing strategies appear to be sufficient to satisfy the long-term liabilities associated with current and future plan benefits. This actuarial valuation, modeling the future through deterministic and probabilistic projection methods, can supplement accounting-based measures of plan funding.

Below are summary comparative statistics from the July 1, 2012, valuation:

Summary of Actuarial Valuation Results

	Plan Year Beginning July 1	
	2011	2012
Covered payroll	$ 239,501,000	$ 239,053,000
Statutory contributions (ch. 354A)	16.10%	16.47%
Required (ch. 356)	18.37%	22.87%
Sufficiency/(Deficiency)	**- 2.27**%	**- 6.40**%*
Market value of assets	950,121,000	883,516,000
Actuarial value of assets	972,718,000	911,930,000
Actuarial accrued liability	1,389,900,000	1,471,200,000
Unfunded liability	**439,800,000**	**589,300,000**
Funding ratio	**69.99%**	**61.98%**

*By employing a revised wage inflation factor based on the most recent experience study, the deficiency lowers to 5.05 %. This will be reflected in subsequent reports.

The Association as a Whole

The performance gains realized in the prior two years, FY 2010 and FY 2011, had served to reduce the contribution deficiency quite dramatically, by nearly 50%. This past year, the combination of a flat investment return coupled with the decision to reduce the future target rate of investment return, based on recent history and projected market returns from 8.5% to 8.0%, had the effect of, once again, raising that required annual contribution amount, which is stated at a percentage of payroll, climbed from 2.27% last year to 6.40% as of June 30, 2012.

The Board has taken several steps at narrowing this deficiency, including the past year's Legislative-approved increase in contribution rates for the employer and employees. It will continue to diligently examine other steps that could be taken to narrow this gap. Understanding that the sooner this is addressed, the lower the amount needed in additional funding or operational savings, or both. The new GASB provisions that require calculation, including the use of a lowered discount rate for accounting for this deficiency, together with notice of this long-term liability as a component of the employer's fiscal balance sheet going forward, could help to ensure that corrective action is taken sooner rather than later.

Another important component that has not been adjusted to help resolve any remaining deficiency is the State of Minnesota's contribution. A report issued a few years back by the Legislative Auditor recommended that funding to the SPTRFA be increased as soon as possible. The SPTRFA Board is expected to ask the Minnesota Legislature during the 2013 session to provide increased supplemental contributions to help make up for those periods of past funding shortfalls.

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, 2012

Assets		
Cash	**$**	**10,861,976**
Receivables		
Employer contributions	$	2,511,064
Service purchases		83,939
Pensions		15,294
Real estate income		58,749
Commission recapture		1,405
Interest		559
Dividends		194,475
Escrow funds		609,276
Sales of securities		1,656,807
Miscellaneous		2,753
Total receivables	**$**	**5,134,321**
Investments, at fair value		
Corporate stocks	$	146,879,694
Real estate securities		19,675,970
Limited partnerships		
Private equity		10,841,167
Real estate		71,929,072
Commingled investment funds		
Pooled international equity trust		40,382,517
Government/credit bond index fund		80,630,690
U.S. debt index fund		79,226,305
Extended equity index fund		134,118,588
Russell 1000 growth fund		44,606,749
International emerging markets growth fund		30,617,518
Mutual fund		39,197,531
International corporate stock fund		82,381,134
Global equity		36,589,624
Global franchise		41,333,929
Money market funds		9,083,768
Total investments, at fair value	**$**	**867,494,256**
Invested securities lending collateral	**$**	**1,114,008**
Furniture and fixtures (at cost, less accumulated depreciation of $91,240)	**$**	**26,143**
Total Assets	**$**	**884,630,704**

The notes to the financial statements are an integral part of this statement.

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

EXHIBIT 1
(Continued)

STATEMENT OF PLAN NET ASSETS
JUNE 30, 2012

Liabilities		
Accounts payable	$	1,017,149
Security purchases payable		573,133
Securities lending collateral		1,114,008
Total Liabilities	**$**	**2,704,290**
Net Assets Held in Trust for Pension Benefits	**$**	**881,926,414**

The notes to the financial statements are an integral part of this statement.

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

EXHIBIT 2

STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2012

Additions		
Contributions		
Employer	$	21,451,545
Members		14,117,481
Other sources		
State of Minnesota		3,657,839
Total contributions	**$**	**39,226,865**
Investment income (loss)		
From investing activity		
Net appreciation (depreciation) in fair value of investments	$	(7,161,707)
Interest		4,523
Dividends		2,907,344
Other		4,372,937
Total investing activity income (loss)	**$**	**123,097**
Investing activity expense		
External	$	(3,928,521)
Internal		(219,810)
Total investing activity expense	**$**	**(4,148,331)**
Net income (loss) from investing activity	**$**	**(4,025,234)**
From securities lending activity		
Securities lending income	**$**	**(18,131)**
Securities lending expense		
Borrower rebates	$	106,303
Management fees		(37,517)
Total securities lending expense	**$**	**68,786**
Net income from securities lending activity	**$**	**50,655**
Net investment income (loss)	**$**	**(3,974,579)**
Other income	**$**	**15,076**
Total Additions	**$**	**35,267,362**

The notes to the financial statements are an integral part of this statement.

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, 2012

Deductions		
Benefits to participants		
Retirement	$	91,968,941
Disability		702,083
Survivor		9,092,643
Dependent children		23,992
Withdrawals and refunds		937,832
Total benefits, withdrawals, and refunds	**$**	**102,725,491**
Administrative expenses		
Staff compensation	$	450,651
Professional services		143,207
Office lease and maintenance		46,739
Communication-related expenses		30,212
Other expense		65,637
Total administrative expenses	**$**	**736,446**
Total Deductions	**$**	**103,461,937**
Net Increase (Decrease)	**$**	**(68,194,575)**
Net Assets Held in Trust for Pension Benefits		
Beginning of Year		**950,120,989**
End of Year	**$**	**881,926,414**

The notes to the financial statements are an integral part of this statement.

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 were prepared and are presented to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board (GASB).

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.

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*, investment collateral under the program is listed as both 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.

Investment Income

Interest income is recognized when earned on an accrual basis. Dividend income is recorded on the date that the funds are received and a receivable for the dividend is recorded at the time of the dividend announcement.

1. Summary of Significant Accounting Policies (Continued)

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 upon receipt pursuant to schedules established in 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 with a purchased value over $500 are carried at cost, less accumulated depreciation. Depreciation occurs using the straight-line method over estimated useful asset life 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.

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 Schools system (SPPS).

Effective July 1, 1978, the Association established a plan, coordinated with Social Security, in accordance with Minnesota statutes (the Coordinated Plan). Teachers who became members of the Association subsequent to June 30, 1978, automatically became 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

2. Description of Plans

General (Continued)

who were members of the Association prior to July 1, 1978, are generally covered under the Basic Plan, which provides a higher benefit payment to its members to account for the fact that they are not eligible for Social Security for their service with SPPS.

Membership

At June 30, 2012, the Association's membership consisted of:

Retirees and beneficiaries currently receiving benefits	3,292
Terminated employees entitled to but not yet receiving benefits	1,833
Terminated, non-vested	1,427
Current active plan members (including members on leave)	3,880
Total Membership	10,432

Pension Benefits

Members who satisfy required length-of-service and minimum age requirements are entitled to monthly pension benefits equal to a certain percentage of final average salary (as defined in each plan) based on 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 monthly disability benefits as calculated under each plan.

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

The Association is authorized by Minn. Stat. § 356A.06 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. Beginning December 31, 2010 through December 31, 2012, deposits held in noninterest-bearing transactions accounts were fully insured regardless of the amount in the account at all FDIC insured institutions.

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, non-U.S. and domestic common stock, real property, venture capital investments, derivatives, options, 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 under-collateralized 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.

3. Deposits and Investments

B. Investments

Custodial Credit Risk (Continued)

The Association has no custodial credit risk for investments at June 30, 2012, 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 "passive" or indexed investment manager accounts, as listed below.

Mandate	Account	Market Value
Indexed	BlackRock - Government/Credit Bond Index Fund	$ 80,630,690
Indexed	BlackRock - U. S. Debt Index Fund	79,226,305

The Association has a 20 percent target allocation to fixed income assets approved by its investment policy. At June 30, 2012, the actual allocation was 18 percent of total Fund invested assets due to the relative performance of the asset classes.

The indexed fixed income accounts have the explicit objective of matching, as closely as possible, the overall weighted composition and duration of their respective unmanaged indices. 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, 2012.

Account	Average Duration in Years	Average Duration of Benchmark
BlackRock - U.S. Debt Index Fund	4.40	4.41
BlackRock - Government/Credit Bond Index Fund	5.67	5.69
BNY/Mellon - Cash Collateral	0.20	None

3. Deposits and Investments

B. Investments (Continued)

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. 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.

The following table provides the range of security types and (where applicable) for the Association's fixed income holdings.

	Market Value	Quality Ratings Standard and Poor's/Moody's	Percent (%) of Total Investments
Debt Investment Type			
BlackRock - Government/Credit Bond Index Fund	$ 80,630,690	Unrated	9.29
BlackRock - U.S. Debt Bond Index Fund	79,226,305	Unrated	9.13
Money Market Funds	9,083,768	Unrated	1.05
Total	$ 168,940,763		

Concentration of Risk

Concentration of risk relates to the adequacy of policy and practice in limiting the risk of loss due to insufficient diversification of holdings measured from several different aspects, such as asset class, region, sector, industry, or company size.

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. As specified in Minn. Stat. § 356A.06, subd. 7, equity investment holdings may not exceed 5.0 percent of any one corporation's outstanding shares. Association policy also limits exposure to any one company's securities at 1.5 percent of the total fund. The largest aggregate total holding is well under this requirement at 0.26 percent. Further, no more than 15.0 percent of the Fund assets may be invested in any one sector, and the maximum allocation to any single active investment manager is 15.0 percent of the total Fund. The Fund held 4.6 percent and 4.8 percent, respectively.

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.

The U.S. share of global economic output continues to diminish, therefore, it becomes increasingly difficult for any institutional investing entity to justify a fiduciary posture on investments that does not include a significant non-U.S. component.

Because the liabilities of any public pension plan are due and payable in U.S. dollars, all foreign holdings must ultimately be converted into U.S. dollars. Owning securities and currencies of other countries, therefore, adds another level of risk, which occurs due to movement in the rate of exchange between the U.S. dollar and the relevant local currency.

As of June 30, 2012, the Investment Policy of the Association dedicated a significant portion of the total Fund to the non-U.S. and global equity components. These positions are held in commingled investment funds. The Fund's interest is limited in all cases to a unit valuation expressed in U.S. dollars. The actual allocation of non-U.S. and global equity investments subject to the indirect foreign currency risk was $190.7 million, or 22 percent, of total invested assets. This allocation to non-U.S. markets is detailed in the following chart.

3. Deposits and Investments

B. Investments

Foreign Currency Risk (Continued)

Assets Held in Non-U.S. Securities by Currency as of June 30, 2012

Country	Currency	Equity	Cash and Cash Equivalents	Total
Australia	Australian Dollar	$ 3,967,607	$ 122,470	$ 4,090,077
Brazil	Brazilian Real	3,365,656	(275,558)	3,090,098
Canada	Canadian Dollar	2,495,893	398,028	2,893,921
Chile	Chilean Peso	122,470	-	122,470
China	Chinese Renminbi	9,287,182	-	9,287,182
Czech Republic	Czech Koruna	91,853	-	91,853
European Union	Euro	40,929,391	61,235	40,990,626
Hong Kong	Hong Kong Dollar	5,545,757	-	5,545,757
Hungary	Hungarian Forint	61,235	(61,235)	-
India	Indian Rupee	3,041,564	-	3,041,564
Indonesia	Indonesian Rupiah	981,964	-	981,964
Israel	Israeli New Shekel	1,102,588	(122,470)	980,118
Japan	Japanese Yen	26,897,507	61,235	26,958,742
Malaysia	Malaysian Ringgit	979,761	-	979,761
Mexico	Mexican Peso	1,590,614	(122,470)	1,468,144
Morocco	Moroccan Dirham	30,617	-	30,617
Pakistan	Pakistani Rupee	30,617	-	30,617
Peru	Peruvian Nuevo Sol	61,235	-	61,235
Philippines	Philippine Peso	275,558	-	275,558
Poland	Polish Zloty	398,028	(214,323)	183,705
Russian Federation	Russian Rouble	2,388,166	-	2,388,166
Saudi Arabia	Saudi Riyal	367,410	-	367,410
Singapore	Singapore Dollar	1,439,027	-	1,439,027
South Africa	South African Rand	1,100,717	(183,705)	917,012
South Korea	South Korean Won	4,842,681	-	4,842,681
Sultanate of Oman	Omani Rial	122,470	-	122,470
Sweden	Swedish Krona	2,629,551	-	2,629,551
Switzerland	Swiss Franc	17,945,873	122,470	18,068,343
Taiwan	Taiwanese New Dollar	4,118,406	-	4,118,406
Thailand	Thai Baht	367,410	-	367,410
Turkey	Turkish New Lira	214,323	(61,235)	153,088
United Arab Emirates	UAE Dirham	122,470	-	122,470
United Kingdom	British Pound	54,722,770	(673,585)	54,049,185
Totals		$ 191,638,371	$ (949,143)	$ 190,689,228

Negative amounts in Cash and Cash Equivalents represent forward contracts on foreign currencies that have not settled. Total amount will not reconcile with the combined total for the investment manager reports. U.S. dollars of $2,663,724 are included in those reports; however, they are not included in this table because they are not relevant for foreign currency disclosure purposes.

3. Deposits and Investments

B. Investments (Continued)

Derivatives

As of June 30, 2012, the Association had futures contracts involving government obligations and commingled investment funds. Maturity dates ranged from September 19 to September 28, 2012. As of June 30, 2012, the Fund's cash overlay account associated with the futures contracts had $4,593,349 of money market funds and $917,472 of security purchase receivables reported on the Statement of Plan Net Assets. The futures contracts on this date netted to the fair value of $235,580, which is not reported as an asset or liability because, upon maturity of the contract, an exchange does not take place, but instead the gain or loss is settled in cash.

The following are risks associated generally with futures contracts, which are mitigated by the practice of the money manager settling the futures contracts each business day.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. 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.

Interest Rate Risk

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

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.

Market Risk

Market risk is the possibility that a change in market prices or currency rates will cause the value of a financial instrument to decrease or become more costly to settle.

4. Securities Lending

The Association participates in a securities lending program. On June 30, 2012, 0.642 percent of its securities available for lending were actually loaned out.

The Association is permitted to enter into securities lending transactions by Minn. Stat. § 356A.06, subd. 7. 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. On June 30, 2012, the collateral held for the loaned securities was 98.4 percent. The securities on loan are valued daily at the close of the market and the collateral pool is adjusted the following business day to reflect any changes. Due to a surge in market activity on June 29, 2012, of nearly 300 Dow points, the value of the investments on loan increased sharply. The following business day, July 2, 2012, the Fund's custodian, responsible for the Securities Lending Program, secured additional collateral to restore the value to 102 percent of the value of the securities on loan.

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

The Association's contract with BNY/Mellon 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 29, 2012, the fair value of cash collateral received was $1,114,008, which is included in the Statement of Plan Net Assets both as an asset and offsetting liability. The cash collateral, with an average weighted maturity of two days, was invested entirely in repurchase agreements. The Association had no non-cash collateral. The Association has no credit risk exposure to borrowers because the amounts the Association owes borrowers exceeds amounts borrowers owe the Association. All securities loans may be terminated on demand by either the Association or the borrower.

4. Securities Lending (Continued)

The Association's collateral pool held a security, which during the past fiscal year had become downgraded. Related to the planned fiscal year-end change in trust companies, the Association sold the downgraded security, realizing a small loss as a result. It represented the Fund's only loss related to this important contributor to performance. The experience did serve to dramatize, however, that some risk does exist in lending programs and taking precaution to best manage that risk by regularly monitoring the quality of the trust company's collateral pool is important.

5. Contributions

Funding

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

Rates for employee and employer contributions expressed as a percentage of annual covered payroll are set by Minn. Stat. § 354A.12. In 2008, Minn. Stat. § 356.215, subd. 11, was amended, and the established date for full funding is now June 30 of the 25th year from the valuation date. 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, 2012, the difference between the statutory and actuarially required contributions is a deficiency of 6.40 percent of payroll. As part of the annual actuarial valuation, the actuary is required by Minn. Stat. § 356.215, subd. 11, to determine the funded ratio and the sufficiency or deficiency in annual contributions when comparing liabilities to the market value of the assets of the Fund as of the close of the most recent fiscal year. As of July 1, 2012, there was a contribution deficiency of 7.16 percent between the statutory and required contributions based on the market value of assets.

5. Contributions (Continued)

Employer and Employee Contributions

For the fiscal year ended June 30, 2012, the contribution rates required by statute were as follows:

	Percentage of Members' Salaries	
	Basic Plan	Coordinated Plan
Employee contribution	8.25%	5.75%
Employer contribution	11.89	8.59

All contribution rates will increase a total of 1.00 percent, by 0.25 percent increments over four years. The first scheduled increase occurred on July 1, 2011, with the second scheduled on July 1, 2012.

Other Contributions

The state is required by Minn. Stat. § 354A.12, subd. 3a, to annually provide the Association with direct aid until neither the Association nor the Minnesota Teachers Retirement Association has an unfunded actuarial accrued liability or until the current assets of the Fund equal or exceed the actuarial accrued liability of the Fund, as measured by the Fund's actuary, or until 2037, whichever occurs first. The direct state-aid contribution was $2,827,000 for fiscal year 2012.

The state is required by Minn. Stat. § 423A.02, subd. 3, to annually provide certain aid to the Association. The state amortization aid contribution was $830,839 for fiscal year 2012. The School District must make an additional annual contribution to the Association in order for the Association to continue receiving this state amortization aid. The School District contributed $800,000 for fiscal year 2012. These contributions must be paid until the current assets of the Fund equal or exceed the actuarial accrued liability of the Fund, as measured by the Fund's actuary, or until 2037, whichever occurs first.

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 the prior year. The amount of settlements did not exceed insurance coverage for each of the past three fiscal years.

7. Funded Status and Funding Progress

The funded status in thousands of dollars as of July 1, 2012, the most recent actuarial date, is as follows:

Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (%) (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (%) ((b-a)/c)
$ 911,930	$ 1,471,216	$ 559,286	61.98	$ 239,053	233.96

The net funded ratio decreased 8.01 percentage points. The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents similar information but uses a multi-year format to show trend information. These trends indicate whether the actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liability for benefits. The trend information was obtained from the Association's independent actuary's annual valuation report.

Additional information as of the latest valuation follows:

- Most Recent Actuarial Valuation Date: July 1, 2012
- Actuarial Cost Method: Entry Age Normal
- Amortization Method: Level percent of pay, open, assuming four-percent payroll growth
- Amortization Period: 25-year open period
- Remaining Amortization Period at July 1, 2012: 25 years
- Asset Valuation Method: 5-Year Smoothed Market

  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).

7. <u>Funded Status and Funding Progress</u> (Continued)

- Actuarial Assumptions:

  - Investment rate of return (select and ultimate rates): 8.00 percent during the 5-year period July 1, 2012, to June 30, 2017; 8.50 percent thereafter.

  - Underlying inflation rate: 3.00 percent

  - Cost-of-living adjustments: 1.00 percent. Beginning with the cost-of-living adjustment payable January 1, 2012, the cost-of-living adjustment is 1.00 percent until an 80 percent Accrued Liability Funding Ratio, based on the Actuarial Value of Assets, is achieved; 2.00 percent once an 80 percent funding is achieved but funding is less than 90 percent. Once 90 percent funding is achieved, cost-of-living adjustment determined by the Consumer Price Index - Urban Wage Earners and Clerical Workers All Items Index with a maximum of 5.00 percent and a minimum of 0.00 percent.

  - Projected salary increases: Based on a ten-year select and ultimate rate table with rates ranging from 5.00 percent to 9.90 percent, age and service based.

  - Mortality: Non-disabled participants (both pre-retirement and post-retirement) mortality assumptions are based on the RP-2000 Combined Mortality Table projected with Scale AA to 2020 with rates set back 1 year for males and 3 years for females. Disabled mortality assumptions are based on the RP-2000 Disabled Life Mortality Table for males and females.

8. <u>Narrative Description of Actuarial Measurement Process</u>

The actuarial measurement process takes many assumptions, such as estimates, probabilities, and techniques, into account. Our Actuary, Gabriel Roeder Smith & Company, developed its actuarial assumptions in accordance with the Standards for Actuarial Work established by the Minnesota Legislative Commission on Pensions and Retirement.

Actuarial assumptions are used to project future demographic and economic expectations for purposes of valuing the liabilities of the plan. The assumptions should reflect current patterns. However, their primary orientation is the long-term outlook for each factor affecting the valuation. Thus, while actual experience will fluctuate over the short run, actuarial assumptions are chosen in an attempt to model the future long-term experience.

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REQUIRED SUPPLEMENTARY INFORMATION

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

EXHIBIT A-1

SCHEDULE OF FUNDING PROGRESS
(IN THOUSANDS OF DOLLARS)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (%) (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (%) ((b-a)/c)
2007	$ 1,015,722	$ 1,391,298	$ 375,576	73.01	$ 229,172	163.88
2008	1,075,951	1,432,040	356,089	75.13	235,993	150.89
2009	1,049,954	1,454,314	404,360	72.20	243,166	166.29
2010	1,001,444	1,471,630	470,186	68.05	239,996	195.91
2011	972,718	1,389,875	417,157	69.99	239,738	174.01
2012	911,930	1,471,216	559,286	61.98	239,053	233.96

(Unaudited)

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

EXHIBIT A-2

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

Fiscal Year	Annual Required Contributions (a)	Employer Contributions (b)	Employer Percentage Contributed (%) (b/a)	State Contributions (c)	State Percentage Contributed (%) (c/a)
2007	$ 43,924	$ 20,466	46.59	$ 3,651	8.31
2008	41,580	20,775	49.96	3,509	8.44
2009	29,007	21,501	74.12	3,343	11.52
2010	30,328	21,018	69.30	4,108	13.55
2011	33,819	21,013	62.13	4,077	12.06
2012	29,797	21,452	72.00	3,658	12.28

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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NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
EXHIBITS A-1 AND A-2
AS OF AND FOR THE YEAR ENDED JUNE 30, 2012
(Unaudited)

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, 2012.

- Actuarial cost is determined using the Entry Age Normal Actuarial Cost Method.

- The amortization method assumes a level percentage of payroll each year, open, and assuming four-percent payroll growth to pay the unfunded actuarial accrued liability.

- The amortization period is a 25-year open period.

- The remaining amortization period at July 1, 2012, is 25 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 8.00 percent for the 5-year period July 1, 2012, to June 30, 2017, and 8.50 percent thereafter.

  - Underlying inflation rate is 3.00 percent.

  - Projected salary increases are based on a ten-year select and ultimate rate table with rates ranging from 5.00 to 9.90 percent, age and service-based.

Actuarial Methods and Assumptions (Continued)

- Post-retirement cost-of-living adjustments are 1.00 percent at January 1, 2012 (actual). Beginning with the cost-of-living adjustment payable January 1, 2012, the cost-of-living adjustment is 1.00 percent until an 80 percent Accrued Liability Funding Ratio, based on the Actuarial Value of Assets, is achieved; 2.00 percent once an 80 percent funding is achieved but funding is less than 90 percent. Once 90 percent funding is achieved, cost-of-living adjustment determined by the Consumer Price Index - Urban Wage Earners and Clerical Workers All Items Index with a maximum of 5.00 percent and a minimum of 0.00 percent.

- Healthy mortality assumptions are based on the RP-2000 Combined Mortality Table projected with Scale AA to 2020 with rates set back 1 year for males and 3 years for females.

- Disabled mortality assumptions are based on the RP-2000 Disabled Life Mortality Table for males and females.

Significant Plan Provision and Actuarial Methods and Assumption Changes

2007

- Post-retirement benefits were changed in the 2007 Legislative Session. The old increase formula provided a guaranteed 2.00 percent increase each year for any member in pay status for one full year as of June 30 in the calendar year prior to the next January 1 increase. In addition, if the fund net investment return on a five-year annualized basis exceeded 8.50 percent, the difference was added to the 2.00 percent guaranteed increase.

- Under a two-year pilot program, commencing with increases for calendar 2008, the SPTRFA will instead pay a retirement benefit cost-of-living adjustment (COLA) similar to that of the U.S. Social Security Administration up to an initial maximum of 2.50 percent. The maximum increases to 5.00 percent if the investment returns of the fund exceed 8.50 percent on both a one- and five-year basis. The full COLA amount will be equal to current year average third quarter CPI-w over the same figure for the prior year. Members with less than one full year in pay status will receive a pro-rated COLA based on full calendar quarters.

- The administrative expense assessment process under Minn. Stat. § 354A.12, subd. 3d, was repealed.

Significant Plan Provision and Actuarial Methods and Assumption Changes (Continued)

2008

- The period of amortization of the unfunded actuarial accrued liability was revised in the 2008 Legislative Session. Previously, the unfunded actuarial accrued liability was required to be amortized by a fixed amortization target date (June 30, 2021). The amortization of the unfunded actuarial accrued liability is now a fixed amortization target period of 25 years.

2009

- Under a two-year pilot program, commencing with increases for calendar 2010, the SPTRFA will pay a retirement benefit COLA similar to that of the U.S. Social Security Administration up to a maximum of 5.00 percent. The full COLA amount will be equal to current year average third quarter CPI-w over the same figure for the prior year. Members with less than one full year in pay status will receive a pro-rated COLA based on full calendar quarters.

2010

- A one-year COLA suspension, for January 1, 2011, was passed in the 2010 Legislative Session.

- Statutory employer and employee contributions will increase by one-quarter of one percent increments over four years, with the first increase scheduled on July 1, 2011.

2011

- Effective July 1, 2011, for the next COLA payable January 1, 2012, the 2011 Omnibus Pension Bill modified statutes to provide a transitional change to the COLA. If the Accrued Liability Funding Ratio, based on the Actuarial Value of Assets, as determined by the most recent actuarial valuation is:

  - less than 80 percent, the COLA: 1.00 percent;

  - at least 80 percent, but less than 90 percent: 2.00 percent;

Significant Plan Provision and Actuarial Methods and Assumption Changes

2011 (Continued)

- if at least 90 percent, then the subdivisions for the 1.00 percent and 2.00 percent provisions above will expire, and COLAs will be paid as follows:

  Increases will be equal to the Consumer Price Index - Urban Wage Earners and Clerical Workers All Items Index as reported by the Bureau of Labor Statistics within the United States Department of Labor each year as part of the determination of annual COLA to recipients of federal old age, survivors, and disability insurance. The final amount may not be a negative number and may not exceed 5.00 percent.

- Interest credited to member contribution accounts was reduced from 6.00 percent to 4.00 percent.

- Augmentation of deferred retirement benefits was changed prospectively, starting July 1, 2012, to a rate of 2.00 percent.

2012

- The legislated investment return rate of 8.50 percent (pre-retirement and post-retirement) changed to select and ultimate rates of 8.00 percent for the period July 1, 2012, through June 30, 2017, and 8.50 percent thereafter.

- The underlying inflation rate assumption is 3.00 percent. Previously, the rate was unstated.

- The payroll growth and wage inflation rate was reduced from 5.00 percent to 4.00 percent.

- Mortality assumptions were updated:

  Previously, pre-retirement mortality assumptions were based on the 1983 Group Annuity Mortality Table with rates set back seven years for males and five years for females; post-retirement mortality assumptions were based on the 1983 Group Annuity Mortality Table with rates set back four years for males and one year for females. Post-disability mortality assumptions were based on the 1977 Railroad Retirement Board Mortality Table for Disabled Lives.

Significant Plan Provision and Actuarial Methods and Assumption Changes

2012 (Continued)

Currently, pre-retirement and post-retirement mortality assumptions for non-disabled participants are based on the RP-2000 Combined Mortality Table projected with Scale AA to 2020 with rates set back 1 year for males and 3 years for females. Disabled mortality assumptions are based on the RP-2000 Disabled Life Mortality Table for males and females.

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Management and
Compliance Section

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

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2012

I. INTERNAL CONTROL OVER FINANCIAL REPORTING

<u>ITEM ARISING THIS YEAR</u>

12-1 <u>Benefit Payments</u>

Criteria: Standard internal control procedures should include a review process of the benefit payment calculations to ensure accurate and proper benefit payments.

Condition: During our testing of 25 beneficiary files for the current year's audit, we identified 3 instances where benefit payments were incorrectly calculated:

- In one instance, the Association used an incorrect yearly salary for one of the highest five years of paid service used to calculate the retiree's average salary. The error amounted to a $1.08 underpayment per month to the beneficiary.

- In two instances, the Association used incorrect factors while calculating the months for augmentation. The factors used for augmentation are set by state statute. While the augmentation factors used in the Association's benefit calculations were those specified in state statute, proposed legislation putting those precise augmentation factors in effect early did not pass and became effective by default some time later. Having used incorrect factors resulted in a $0.11 overpayment per month for one retiree and a $4.52 underpayment per month for another retiree.

Context: Benefit calculations are complex using a formula unique to each retiree based on plan specifics such as average salary, years of service, age, and benefit option selection. Even a small error in one of the many components involved in the calculation can result in an incorrect benefit payment.

Effect: The Association did not pay proper amounts to some retirees nor follow Minnesota statutes. This could result in financial and legal consequences.

Cause: The one instance where an incorrect yearly salary was used in the calculation of the average salary was the result of a transposition error. The other two instances noted resulted from a belief that Minn. Stat. § 354A.37, subd. 2(b), was going to be amended to move forward changes in the augmentation rates to become effective July 1, 2011, but this legislation was not passed. Instead, such rates integral to the benefit payment calculation formulas did not become effective until after year-end July 1, 2012, and the augmentation factors were never changed back to the precise factors to be in effect at the time.

Recommendation: We recommend the Association follow its policies and procedures for reviewing and verifying benefit payments are calculated using correct data. This will help to better ensure that benefit payments are correctly calculated so that beneficiaries are not over or under paid. We also recommend that the Association implement policies and procedures to make note of, and to monitor, the files of retirees whose benefit calculations are based on estimated data, and to adjust those calculations as necessary when actual data becomes known.

<u>Client's Response</u>:

The SPTRFA agrees with the auditor's findings. In mid-2011 and 2012, the SPTRFA Board took proactive steps to minimize the risk of future errors in the calculation and administration of member benefits. This included the hiring of supplemental member benefits staff and the approval for a professionally-developed pension administration system (to be developed and implemented during FY 2012-2013).

(a) *Hiring additional staff to supplement the member benefits team: Due to staff turnover in 2010 and 2011, the team had dwindled from three to two staff. At the same time, the staff was also responsible for many other critical duties within the office. The Board approved the hiring of Janet Williams and Rachel Pastick, who joined the SPTRFA on June 1, 2011, and July 1, 2012, respectively. With the advancement of training and experience in fiscal year 2012 - 2013, we expect to see a much improved review and finalization of the files.*

(b) *Approving the professional development of a pension administration system, providing both payment administration on behalf of all participants and calculation support for the Coordinated Plan: The pension administration system will ensure that the benefit payments calculated for Coordinated Plan participants are accurate and consistent according to SPTRFA provisions (bylaw, statutory, policy, and administrative). To responsibly limit costs of the project, Basic Plan calculations will not be a part of the system. This is due to both the complexity of introducing the very different benefit rules of the Basic Plan and the few (26) Basic Plan participants yet to require calculations.*

II. MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

12-2 Investments

Criteria: The Association is required to follow all applicable sections of Minn. Stat. § 356A.06 regarding its investments. This includes identification of the statutory authority under which an investment falls and monitoring compliance with the additional statutory requirements.

Condition: The Association monitors compliance with statutory requirements for investments only at fiscal year-end. Also, the compliance monitoring performed may not have been appropriately applied for one investment because the statutory authority under which the investment fell was unclear.

Context: The investment authority granted to the Association under Minn. Stat. § 356A.06 is complex.

Effect: The Association may not be in compliance with Minnesota statutes currently in effect.

Cause: There was some uncertainty regarding which specific statute granted the Association the authority to purchase one of its investments. Additionally, the Association does not monitor throughout the year its percentage of ownership of the "Other Investments" category established under Minn. Stat. § 356A.06, subd 7.

Recommendation: We recommend the Association develop policies, procedures, and a strategy clearly identifying the statutory authority for investments purchased, particularly those investments falling under the "Other Investments" category. We also recommend the Association monitor periodically throughout the fiscal year the additional requirements imposed on the Association by this section of the statute. This will better ensure that the Association is in compliance with all statutory requirements applicable to its investments.

Client's Response:

The issue raised in the audit dealing with legal compliance addresses a section of Minn. Stat. § 356A.06, specifically subd. 7. That is a provision that has undergone significant change in the past session, in part related to past concerns about interpretation. The point raised in this audit is well taken, and establishing a process to best insure sufficient and timely compliance with the new statute is currently before the Board for expected favorable action.

Going forward, the Board will periodically review, at least semiannually, compliance with the provision to not hold more than 20 percent of an investment within one of three asset classes: venture capital/private equity partnerships, real estate partnerships, and resources partnerships. It is understood from the record that the legislation is directed at identifying <u>asset classes</u> within this 20 percent limitation rather than investment vehicles, such as commingled funds, separate accounts, etc. As a result, going forward, the Fund will insure that no portfolio holding in any one of these three asset classes will exceed more than 20 percent ownership and report such to the State as part of its annual audit information and in compliance with this provision.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND MINNESOTA LEGAL COMPLIANCE

Board of Trustees
St. Paul Teachers' Retirement Fund Association

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements of the St. Paul Teachers' Retirement Fund Association as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the Association's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Association's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency described in the accompanying Schedule of Findings and Recommendations as item 12-1. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Minnesota Legal Compliance

We have audited the basic financial statements of the St. Paul Teachers' Retirement Fund Association as of and for the year ended June 30, 2012. 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 Political Subdivisions*, 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 Political Subdivisions* covers three categories of compliance applicable to the St. Paul Teachers' Retirement Fund Association to be tested: the deposits section of deposits and investments, conflicts of interest, and the investments section of relief associations. Our study included all of the listed categories.

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 item 12-2.

The St. Paul Teachers' Retirement Fund Association's written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the Association's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Trustees, management, and others within the St. Paul Teachers' Retirement Fund Association and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 10, 2012