

2004

Comprehensive Annual



Financial Report

**for the fiscal year ended June 30,
2004**

**Teachers Retirement
Association**

A Pension Trust Fund of the State of Minnesota

Comprehensive Annual Financial Report

Teachers Retirement Association of Minnesota
A Pension Trust Fund of the State of Minnesota



Retirement Systems of Minnesota

60 Empire Drive

Suite 400

Saint Paul, MN 55103-4000

651.296.2409

800.657.3669

TTY 800.627.3529

www.tra.state.mn.us

Gary Austin

Executive Director

Contents

Introduction

GFOA Certificate of Achievement Award	2
Letter of Transmittal	3
Board of Trustees and Administrative Staff	8
Administrative Organization	9
Mission Statement and Our Values	10

Financial Section

Auditor's Report	12
Management Discussion and Analysis	14
Basic Financial Statements	
Statement of Plan Net Assets	18
Statement of Changes in Plan Net Assets	19
Notes to the Financial Statements (an integral part of the financial statements)	20
Required Supplemental Information	
Required Supplemental Schedule: Employer Contributions	29
Required Supplemental Schedule: Funding Progress	29
Notes to Required Supplemental Schedules	30
Supporting Schedules	
Administrative Expenses	31
Schedule of Changes in Plan Net Assets	32
Schedule of Investment Management Expenses	34
Schedule of Professional Consultant Expenses	34
Schedule of Retainage Payable	35

Investments Section

State Board of Investment Letter	38
Investment Summary	40
Basic Retirement Funds (Active Members)	41
Minnesota Post Retirement Investment Fund (Post Fund)	43
Portfolio Distribution	46
Performance of Asset Pools	46
List of Largest Assets Held	47
Summary of Investments (Active Member Fund only)	48

Actuarial Section

Actuary's Letter	50
Summary of Actuarial Assumptions and Methods	52
Valuation Report Highlights	55
Actuary's Commentary	56
Selected Tables from Actuarial Valuation	57
Solvency Test	67
Schedule of Active Member Valuation Data	68
Schedule of Retirees and Beneficiaries Added To and Removed From Retirement Rolls	68

Statistical Section

Plan Summary	70
Ten-Year Summary of Revenue and Expenditures	74
Summary of Changes in Membership	75
Schedule of Benefit Amounts Paid	78
Schedule of Benefit Recipients by Current Age	79
Schedule of Benefit Recipients by Effective Date of Retirement	79
Schedule of New Retirees and Initial Benefit Paid	80
Distribution of TRA Benefits, Mailing Address of Benefit Recipient	81
Schedule of Benefit Recipients by Type	82
Distribution of Active Members (with Average Annual Salary)	83
Ten-Year Summary of Membership	84
Schedule of Participating Employers	85

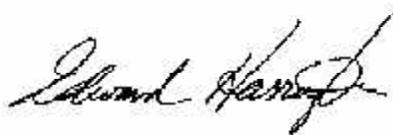
Certificate of Achievement for Excellence in Financial Reporting

Presented to

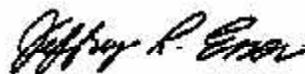
Teachers Retirement Association, Minnesota

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President



Executive Director

Letter of Transmittal



Gary Austin
Executive Director



Teachers Retirement Association

60 Empire Drive • Suite 400 • St. Paul, MN 55103
651.297.2438 • 800.657.3668 • 651.297.5999 FAX • 800.627.3529 TTY

December 31, 2004

Members of the Board of Trustees
Teachers Retirement Association
60 Empire Drive, Suite 400
Saint Paul, MN 55103

Dear Trustee:

We are pleased to present this Comprehensive Annual Financial Report (CAFR) of the Teachers Retirement Association (TRA) for the fiscal year ended June 30, 2004, our 73rd year of service. This report includes the following five sections:

- **Introduction** describes our organizational structure and nature of operations,
- **Financial** contains the general-purpose financial statements, notes to the financial statements, actuarial disclosures and the opinion of our independent auditor,
- **Investments** highlights our asset management and investment performance,
- **Actuarial** contains the certification and results of the actuarial valuation performed by The Segal Group as of July 1, 2004, and
- **Statistical** summarizes TRA plan benefits and illustrates both current and historical data of interest.

Plan Overview

Although you, as members of the Board of Trustees, have a broad scope of authority in the operations and management of TRA, the pension fund is governed by federal laws and state statutes. For financial reporting purposes, TRA is considered a pension trust fund of the State of Minnesota, and TRA financial results are incorporated into the Comprehensive Annual Financial Report of the State of Minnesota.

As of June 30, 2004, TRA had 538 reporting employer units, 72,008 active members and a total of 37,649 retirees, survivors, beneficiaries and disabilitants who were receiving monthly benefits.

Financial Information

TRA follows the provisions of statements promulgated by the Governmental Accounting Standards Board (GASB) including GASB Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans. TRA's Comprehensive Annual Financial Report also complies with Minnesota Statutes, Section 356.20. Transactions are reported on the accrual basis of accounting. Contributions from employers and members are recognized as revenue when earned. Expenses are recorded when corresponding liabilities are incurred, regardless of when payment is made.

A system of internal controls is in place to help monitor and safeguard assets, ensure transactions are carried out in accordance with Minnesota statutes, and promote efficient operations. The Minnesota Office of the Legislative Auditor annually conducts a financial and legal compliance audit of the Association. Management believes that the accompanying statements, schedules, and tables are fairly presented. We are solely responsible for the content of this report, including its financial statements, which should be helpful in understanding information about the pension fund and comparing our operating results with those of other teacher retirement systems.

Readers are encouraged to refer to the Management Discussion and Analysis on pages 14-17 for an overview of additions to and deductions from the TRA Fund for the fiscal year.

Actuarial Funding

The actuary jointly retained by the seven largest public pension plans in Minnesota is The Segal Company of Englewood, Colorado. The actuary determines the actuarial liabilities and reserves of the pension fund under the Entry Age Normal Cost Method. The actuarial value of assets is market-value based and uses a five-year smoothing mechanism to reduce volatility. The TRA total net assets on an actuarial basis increased to \$17.5 billion from the previous year's total of \$17.4 billion. The total required reserves necessary to fund current and future retirees of the fund also increased from \$16.9 billion to \$17.5 billion. The comparison of net assets to required reserves shows that

the funding ratio for fiscal year 2004 was 100.01 percent, a moderate decrease from the comparable 103.13 percent for fiscal year 2003. Recognition of deferred investment losses from the 2001-2003 period was responsible for most of the decrease. This funding ratio results in the eighth consecutive year in which the TRA fund is considered fully funded from an actuarial standpoint. The TRA funding sufficiency, as measured by a percentage of covered payroll, declined during the year from 1.63 percent to 1.54 percent.

Investment Strategies

All TRA assets are invested under the authority and direction of the State Board of Investment (SBI). TRA invested assets have two main components: the Active Fund (assets of TRA active and inactive members) and the assets for TRA retirees and benefits recipients invested into the Minnesota Post Retirement Investment Fund (MPRIF). The MPRIF (Post Fund) consists of the assets of not only TRA benefit recipients, but also the benefit recipients of the other two major statewide public pension associations: the Minnesota State Retirement System and the Public Employees Retirement Association. The SBI has developed strategic asset allocation and other investment policies to represent the long-term funding needs of our members and benefit recipients. The SBI, along with its Investment Advisory Council (IAC), continually reviews its policies to ensure sufficient assets are available to finance promised benefits. The executive directors of the three statewide retirement systems sit on the IAC and represent their members in its role to advise the SBI on investment-related matters.

Investment Environment

After three years of lackluster performance, the U.S. and international stock markets provided strong returns during fiscal year 2004. The U.S. stock market increased 20.5 percent, as measured by the Russell 3000. The market improvement was a result of the U.S. economic recovery, strong consumer confidence and improving unemployment data. This strong performance was somewhat muted by concerns about terrorism, the war in Iraq, the presidential election, record high oil prices, and a 25 basis point increase in the federal funds rate.

International stock markets were very strong during the year. The Morgan Stanley Capital International (MSCI) All Country World Index excluding the United States (ACWI Ex U.S.), which represents the developed and emerging international markets outside the U.S., returned 32.1 percent for the fiscal year.

The U.S. bond market, as measured by the Lehman Brothers Aggregate Bond Index, returned 0.3 percent for the fiscal year. The economic recovery and higher commodity pricing raised fears of inflation, which resulted in higher inflation rates. Mortgage securities and corporate bonds outpaced U.S. Treasury securities to allow the overall market to end in positive territory.

Investment Results

Within this investment environment, the retirement assets under the SBI's control produced the following results:

- The Basic Retirement Funds (including the TRA Active Fund) for active members increased 16.6 percent during fiscal year 2004. Over the latest ten year period, the fund has experienced an annualized return of 9.8 percent.
- The Minnesota Post Retirement Investment Fund (Post Fund) for retired members increased 16.3 percent for fiscal year 2004. Overall the Post Fund provided a ten year annualized return of 9.4 percent.
- The lifetime post-retirement benefit increase will be 2.50 percent for eligible retirees on January 1, 2005. The increase represents the maximum inflation component payable in the Post Fund's annual adjustment formula. The federal Consumer Price Index for inflation (CPI-W) for fiscal year 2004 was 3.17 percent. For the third straight year, no investment-based component will be paid. As of June 30, 2004, the liabilities of the Post Fund exceed its assets, leaving a deficit of about \$4.1 billion. The deficit of the Post Fund must be fully recovered before any future investment-based adjustment is given. Benefit recipients should expect inflation-only annual benefit adjustments, capped at 2.5 percent, until the deficit is reversed.

Economic Conditions and Outlook

The performance of Minnesota's economy mirrored that of U.S. national economy during fiscal year 2004. While the state's unemployment rate continued to be well below the national average, the state's performance on other economic measures was mixed. During fiscal year 2004, unemployment in Minnesota averaged 4.8 percent, which is a full percentage point below the U.S. average of 5.8 percent. However, payroll employment grew by 1.1 percent in Minnesota, slightly slower than the 1.2 percent growth observed in national payroll employment. Minnesota's manufacturing sector showed some renewed strength with the state's manufacturing firms adding 7,400 jobs during fiscal 2004. Nationally, 121,000 manufacturing jobs were lost during the same time period. At the end of fiscal 2004, Minnesota manufacturing employment was 10.6 percent below that observed at the start of the 2001 recession. Nationally, manufacturing employment was 15.4 percent below pre-recession levels.

Income growth in Minnesota also tracked the U.S. average, growing at an annual rate of 4.5 percent in fiscal 2004, less than 0.1 percentage point below the national average. In calendar 2003, Minnesota's personal income grew by 3.3 percent and personal income per capita by 2.6 percent. Those growth rates were slightly greater than the U.S. average. Personal income per capita was \$34,309 in calendar 2003, more than 8 percent above the national average. Minnesota now ranks eighth among states in per capital personal income.

Growth rates for the Minnesota economy during fiscal year 2005 are expected to be below those recorded last year as higher interest rates and energy price increases reduce U.S. real Gross Domestic Product (GDP) growth to a more sustainable rate of 3.6 percent in fiscal 2005. Real GDP is now reported to have grown at an annual rate of 4.5 percent during the 2004 fiscal year. Growth at that rate is generally not believed sustainable for the long term. Minnesota payroll employment is projected to grow by 19,000 (0.7 percent) and total wage and salary disbursements by 4.5 percent. The state forecast calls for personal income growth of 4.6 percent in the 2005 fiscal year. Minnesota's manufacturing sector is projected to add about 6,000 jobs during fiscal 2005 even though manufacturing jobs are expected to continue to decline nationally.

Professional Services

We purchase actuarial services from the firm Mellon Human Resources and Investor Solutions of San Francisco, California. The annual actuarial valuation of the pension fund is prepared by The Segal Company, the actuary jointly retained by the seven largest public pension plans to prepare actuarial reports for all the statewide retirement plans for legislative review.

The Office of the Attorney General provides legal counsel to our Board of Trustees and the Minnesota Office of the Legislative Auditor conducts an annual financial audit of the pension fund and prepares a report (see pages 12-13). All financial transactions, including the disbursements from the pension fund, are processed through the centralized controls of the Minnesota Accounting and Procurement System, under the supervision of the state departments of Finance and Administration.

Financial Communication

An Annual Statement of Account for fiscal year 2004 was mailed to each active member in October 2004. This statement provides current and cumulative information related to salaries, contributions and service credit. Projected and deferred retirement benefit estimates are also provided for eligible members. In November 2004, inactive TRA members (those no longer employed as teachers) received their Annual Statement of Account balance with contribution and service data.

A plan summary with financial and actuarial data for the year ended June 30, 2004, will be distributed to each active and retired member as part of a 2004-2005 edition of the *TRIB*, our quarterly newsletter. The TRA web site contains the entire text of this Comprehensive Annual Financial Report for members to download. Printed copies are available upon request.

Customer Services

Although the number of new retirements has remained fairly steady over the past couple of years due to a weak economy and uncertainties about post-retiree health care, we believe the effect is temporary and expect the number of new retirees to increase dramatically over the next decade. During fiscal year 2004, TRA continued work on the business reengineering project called FROST (Functional Redesign of Strategic Technologies). The project's main goal is to be ready to meet the customer service needs of our "baby boom" generation rapidly approaching retirement. Together with our consulting partner, BearingPoint, we are designing and developing an integrated package of computer applications to improve the processing and servicing of member pension benefits. Our first emphasis was a redesign of employer reporting of member data and a concerted effort to audit and purify our existing member data. We implemented the new employer member payroll reporting functionality in the summer of 2002. In November 2004, TRA implemented Phase 3 of the FROST Project, which concentrated on administrative processes such as retirement estimates, benefit applications, and all aspects of the benefit payments process. The final phase of the project, scheduled for completion in 2005, will include the implementation of new systems to enhance the various customer service improvements to the telephone service center and TRA interactive web site.

While the future holds exciting promise of new and enhanced features, we continue to provide quality counseling and benefit payment services to our members. Retirement counseling services take place in both our main Saint Paul office and at 15 temporary locations throughout the state. In partnership with the Minnesota State Retirement System, we established a new satellite office in Detroit Lakes in October 2004. Along with the two existing satellite offices in Saint Cloud and Mankato, TRA has ongoing pre-retirement counseling available within 100 miles of the homes of the vast majority of TRA's membership. These satellite locations are staffed on a permanent basis by a TRA pre-retirement benefit counselor who provides both individual and group counseling sessions to our members.

The TRA Customer Service Information Center received over 55,000 calls last year, and an estimated 95 percent of them were addressed without a callback or transfer. The TRIB is mailed to all active and retired members. Our web site offers the ability to self-calculate future retirement benefits, and is also updated regularly with the latest news of TRA events and other benefit provision changes. The implementation of enhanced internet functionality during fiscal year 2005 promises many opportunities to inform and educate our members on the value of their TRA benefit program.

Legislation and Other Initiatives

The 2004 Minnesota Legislature passed an Omnibus Pension Bill during the final days of session this past May. Most of the items in the bill affecting TRA members were of a “housekeeping” administrative nature; unfortunately, the bill did not contain authority to extend the purchase of prior service provision that was first established by the 1999 Legislature. During the five years of the program, over 1,000 members purchased service credit related to military service, sabbatical leaves, parental leaves and out-of-state teaching time.

The 2004 Legislature continued to evaluate the ongoing funding concerns of the Minneapolis and St. Paul Teacher Retirement Fund Associations and possible consolidation of these plans with TRA. We expect to continue our participation with the 2005 Legislature in efforts to improve the funding status of these local teacher pension plans.

National Recognition

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Teachers Retirement Association for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003. This was the sixth consecutive year that the Association has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of only one year. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

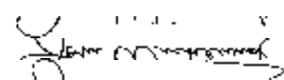
The preparation of this report is possible only through the combined efforts of our employees, employer units, and professional consultants. It is intended to provide a complete and reliable portrayal of the financial status of the pension fund. A copy is mailed to each public school administrator in the state and posted on the TRA web site.

We would like to thank you, our Board of Trustees, who act as advisors. In addition, we would like to thank our employees, consultants and the many people who diligently work to ensure the successful operation and financial soundness of our pension fund.

Respectfully submitted,



Gary Austin
Executive Director



John Wicklund
Assistant Executive Director
Administration

Board of Trustees

As of December 1, 2004

President



Curtis D. Hutchens
Elected Member
St. Cloud, MN

Vice President



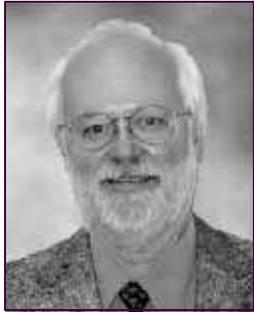
Martha Lee (Marti) Zins
Elected Member
Hopkins, MN



Vernell R. Jackels
Retiree Representative
Winona, MN



Sandy Schaefer
Elected Member
Fairfax, MN



Richard Gendreau
Elected Member
Bemidji, MN



Bob Lowe
Minnesota School Boards
Association
Representative



Barry Sullivan
Representing
Alice Seagren
Commissioner of
Education



Lee Mehrkens
Representing
Peggy Ingison
Commissioner
of Finance

Administrative Staff



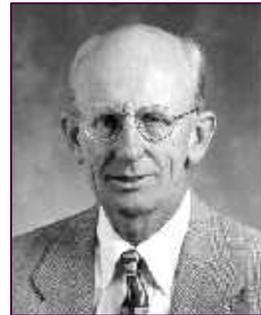
Gary Austin
Executive Director



John Wicklund
Assistant Director
of
Administration



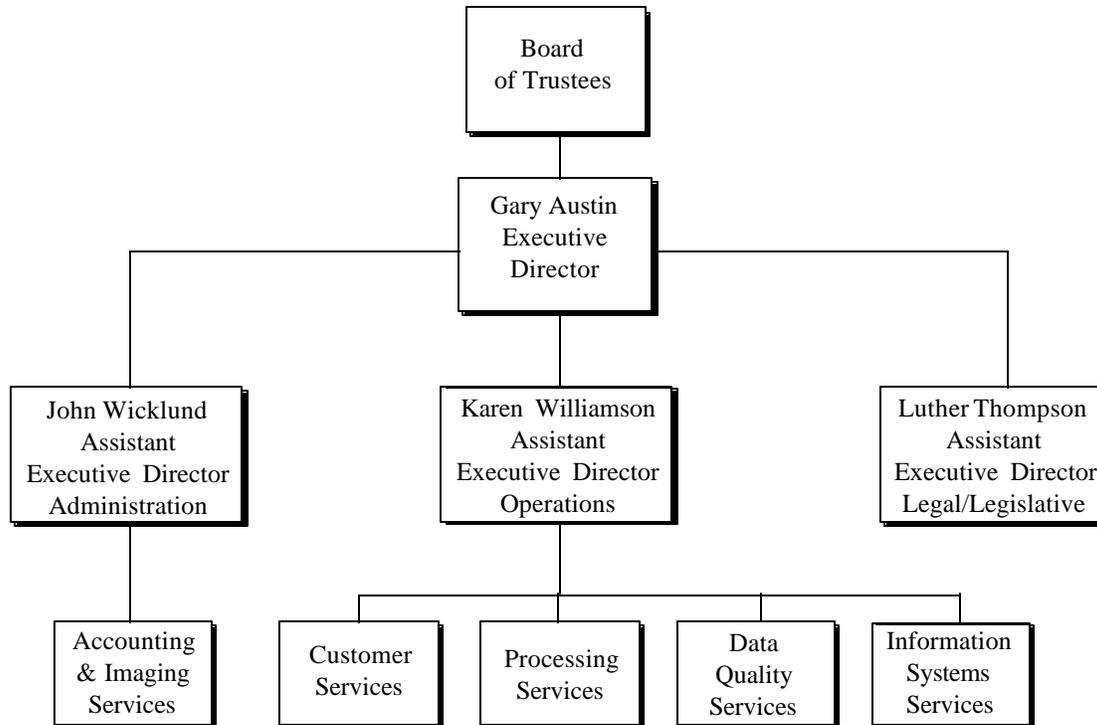
Karen Williamson
Assistant Director
of
Operations



Luther Thompson
Assistant Director
Legal and
Legislative Services

Administrative Organization

As of December 2004



Consulting Services

Actuary

Mellon Human Resources and Investor Solutions
San Francisco, California

The Segal Company
Englewood, Colorado

Auditor

Office of the Legislative Auditor
Saint Paul, Minnesota

Legal Counsel

Office of the Attorney General
Saint Paul, Minnesota

Medical Advisor

Minnesota Department of Health
Minneapolis, Minnesota

Mission Statement

TRA provides retirement, disability and death benefits to Minnesota college faculty, administrators, public school teachers, retirees, their families and beneficiaries.

Our mission is to enhance the quality of life for Minnesota teachers and their beneficiaries and to assist them in planning for an independent and financially secure retirement.

To this end we are committed to offering quality customer services by providing retirement counseling, maintaining member data, administering funds, communicating accurate information and delivering benefits.

Our Values

- | | |
|----------------------------|---|
| Accuracy | Ensure that all information received, maintained and provided is clear and accurate. |
| Quality | Make high-quality services accessible to our customers. |
| Timeliness | Provide timely receipt and dissemination of information. |
| Efficiency | Make efficient use of technological and human resources in a team environment. |
| Employee Excellence | Provide ongoing employee development that encourages cooperation and mutual respect, focuses on common goals and recognizes superior performance. |