
Comprehensive Annual Financial Report

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



Retirement Systems of Minnesota

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Gary Austin

Executive Director

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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, 2004

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.



Nancy L. Ziehl

President

Jeffrey R. Emer

Executive Director

Letter of Transmittal



Gary Austin
Executive Director



Teachers Retirement Association

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December 31, 2005

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, 2005, our 74th year of service. This report includes the following five sections:

- Introduction describes our organizational structure and nature of operations,
- Financial contains the basic 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, 2005, and
- Statistical summarizes TRA plan benefits and illustrates both current and historical data of interest.

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 TRA 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 and additional financial reporting detail for the fiscal year.

TRA Profile

Although the TRA Board of Trustees have a broad scope of authority in the operations and management of TRA, the pension fund is also 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, 2005, TRA had 565 reporting employer units, 74,552 active members and a total of 38,957 retirees, survivors, beneficiaries and disabilitants who were receiving monthly benefits. 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.

We purchase actuarial services from the firm Buck Consultants of San Francisco, California. However, the annual actuarial valuation of the pension fund is prepared by The Segal Company, the actuary jointly retained by the seven largest Minnesota 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. 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.

TRA's Economic Condition

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 are members of the IAC and represent their members in its role to advise the SBI on investment-related matters.

Investment Results

Capital markets were robust during fiscal year 2005. The U.S. stock market increased 8.1 percent, as measured by the Russell 3000 index. Despite uncertainty over the presidential election and rising oil prices, the U.S. economy was buoyed by strong Gross Domestic Product, productivity growth, and healthy corporate balance sheets.

International stock markets displayed continued strength for the second year in a row. 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 16.5 percent for the fiscal year.

The U.S. bond market, as measured by the Lehman Brothers Aggregate Bond Index, returned 6.8 percent during the fiscal year. Concerns about inflation and the pace of the economic recovery spurred the Federal Reserve to increase short term interest rates nine times during the year. Corporate bonds outpaced U.S. Treasury and mortgage securities for the twelve month period.

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 11.0 percent during fiscal year 2005. Over the latest ten year period, the fund has experienced an annualized return of 9.3 percent.

- The Minnesota Post Retirement Investment Fund (Post Fund) for retired members increased 10.5 percent for fiscal year 2005. Overall the Post Fund provided a ten year annualized return of 8.8 percent.
- The lifetime post-retirement benefit increase will be 2.50 percent for eligible retirees on January 1, 2006. 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 2.59 percent. For the fourth straight year, no investment-based component will be paid. As of June 30, 2005, the liabilities of the Post Fund exceed its assets, leaving a deficit of an estimated \$4.3 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 recovered.

Economic Conditions and Outlook

Minnesota's economy grew during the 2005 fiscal year, but by most measures it did not perform as well as the U.S. averages. The state's unemployment rate was the bright spot, falling from 4.6 percent to 3.7 percent between June 2004 and June 2005. The U.S. average also fell over that same 12-month span, but only by 0.6 percentage points. Minnesota's unemployment rate is now 1.3 percentage points below the U.S. average rate of 5.0 percent. Historically, Minnesota's unemployment rate has been between 1.0 and 1.5 percentage points less than the U.S. average. Payroll employment grew by 33,800 jobs between June 2004 and June 2005, the largest fiscal year increase since the 2000 fiscal year. In June 2005, total payroll employment in Minnesota exceeded its pre-recession highs. The national economy exceeded its pre-recession employment high in January 2005. Payroll employment in Minnesota increased by 1.3 percent in the twelve months between June 2004 and June 2005, while nationally payroll employment increased by 1.6 percent.

Personal income growth in Minnesota also lagged the U.S. averages. Personal income grew 6 percent between the second quarter of 2004 and the second quarter of 2005. The U.S. average growth rate was 6.4 percent. In

calendar 2004, per capita personal income in Minnesota was \$36,173, which was 9.5 percent above the U.S. average. Minnesota ranked ninth among all states in personal income per capita.

In fiscal 2006, the economy is expected to slow nationally and in Minnesota. Employment and income are expected to continue to grow, but the rate of growth is projected to be slightly slower than that observed in fiscal year 2005, and well below the growth rates of the late 1990s.

In Minnesota, personal income is expected to increase by 4.2 percent, 1.8 percent less than in fiscal year 2005. Higher interest rates, continued high energy prices, and lost production due to Hurricanes Katrina, Rita, and Wilma will slow U.S. economic growth through at least early 2006. Payroll employment in Minnesota is projected to grow at a 1 percent annual rate during fiscal year 2006. U.S. payroll employment is projected to grow at a 1.6 percent annual rate. Private construction spending in storm damaged areas along the Gulf Coast, federal disaster assistance for rebuilding and restoring damaged infrastructure, and a return to normal production levels by energy producers along the Gulf Coast will provide a boost to the national economy, but have relatively little impact in Minnesota.

Major Initiatives

The number of new retirements has remained fairly steady over the past couple of years due to a slowly recovering economy and uncertainties about post-retiree health care. However, we believe the effect is temporary and expect the number of new retirees to increase dramatically over the next decade. During fiscal year 2005, TRA substantially completed work on the business reengineering project called FROST (Functional Redesign of Strategic Technologies). The project's main goal is to meet the customer service needs of the "baby boom" generation rapidly approaching retirement. Together with our consulting partner, BearingPoint, we designed and developed an integrated package of computer applications to improve the processing and servicing of member pension benefits. The first two phases of FROST were a redesign of employer reporting of member data and a concerted effort to audit and purify our existing member data. In November 2004, TRA implemented

Phase 3 of the FROST Project, which concentrated on core administrative processes such as retirement estimates, benefit applications, and all aspects of the benefit payments process. The final phase of the project was completed during late 2005 and included the implementation of new systems to enhance the various customer service improvements such as member annual statements and the newly redesigned TRA interactive web site.

Legislation

The 2005 Minnesota Legislature passed an Omnibus Pension Bill during the final days of the special session in July 2005. Most of the items in the bill affecting TRA members were of a “housekeeping” administrative nature and did not materially affect plan provisions for TRA members.

The 2005 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 2006 Legislature in efforts to improve the funding status of these local teacher pension plans.

Awards and 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, 2004. This was the seventh 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.

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, 2005

President



Curtis D. Hutchens
Elected Member
St. Cloud, MN

Vice President



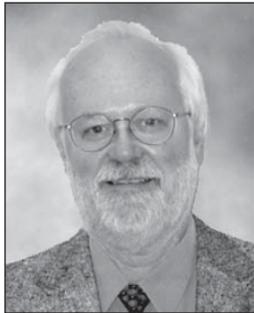
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Elected Member
Hopkins, MN



Carol Ackerson
Retiree Representative
New Ulm, 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



Peggy Ingison
Commissioner
of Finance

Administrative Staff



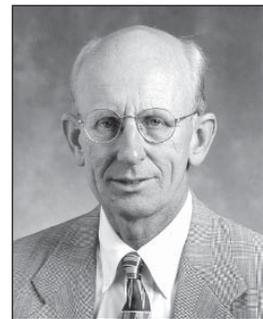
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Executive Director



John Wicklund
Assistant Director
of
Administration



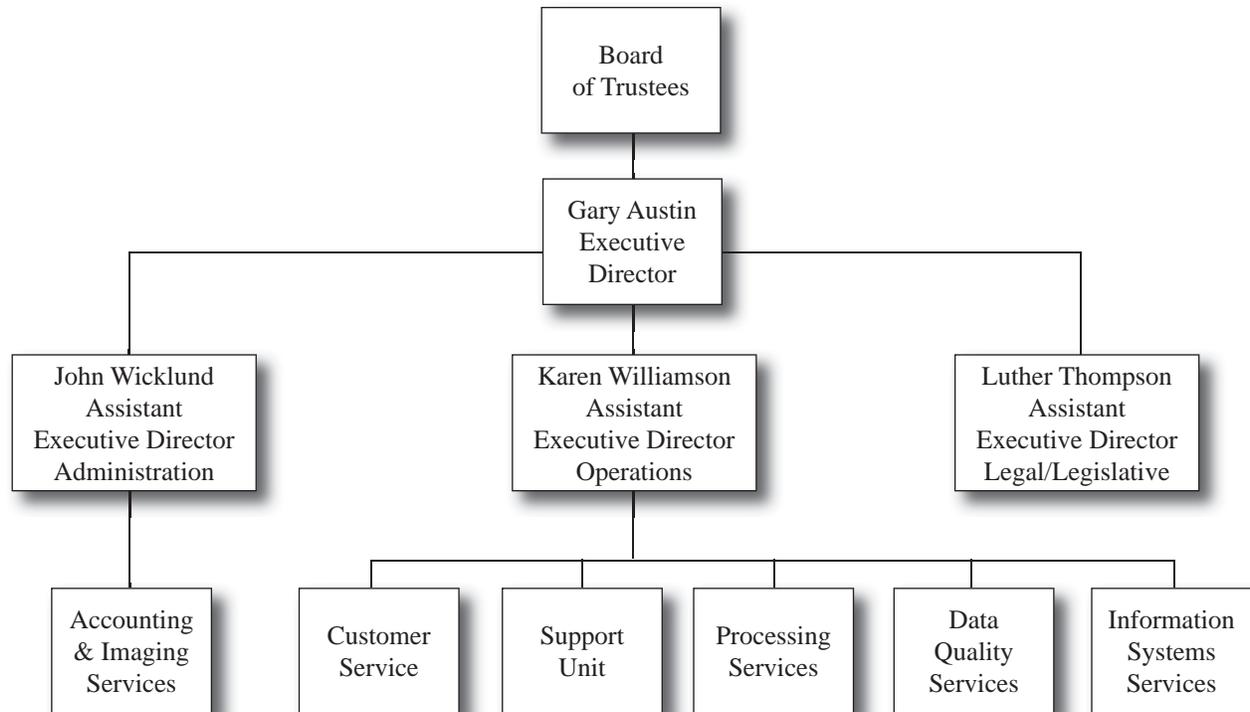
Karen Williamson
Assistant Director
of
Operations



Luther Thompson
Assistant Director
Legal and
Legislative Services

Administrative Organization

As of December 2005



Consulting Services

Actuary

Buck Consulting
San Francisco, California

The Segal Company
Englewood, Colorado

Auditor

Office of the Legislative Auditor
Saint Paul, Minnesota

Investment

Minnesota State Board of Investment
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.

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