# ND STATE INVESTMENT BOARD
# AUDIT COMMITTEE MEETING

**Friday, November 22, 2013 - 1:00 p.m.**
**Peace Garden Room - State Capitol, Bismarck, ND**

## AGENDA

1. Call to Order and Approval of Agenda - Chair (committee action)

2. Approval of September 27, 2013 Minutes - Chair (committee action)

3. Presentation of June 30, 2013 financial audit report of RIO - Jason Ostroski, CliftonLarsonAllen LLP (committee action)

4. 2013-14 Audit Activities Progress Report - Dottie Thorsen (committee action)

5. RIO Staff Vacancies Update (discussion only)
   - Chief Investment Officer/Exec. Director - Mike Sandal
   - Other staff vacancies - Fay Kopp

6. Audit Supervisor Position - Fay Kopp (committee action)

7. Other
   Next SIB Audit Committee meeting - February 28, 2014

8. Adjournment

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Any individual requiring an auxiliary aid or service should contact the Retirement and Investment Office at (701) 328-9885 at least three (3) days prior to the scheduled meeting.

**STATE INVESTMENT BOARD**
**AUDIT COMMITTEE MEETING**
**MINUTES OF THE**
**SEPTEMBER 27, 2013 MEETING**

**COMMITTEE MEMBERS PRESENT:** Rebecca Dorwart, Chair
Mike Gessner, TFFR Board/Liaison to the SIB
Mike Sandal, PERS Board
Cindy Ternes, Workforce Safety & Insurance

**COMMITTEE MEMBERS ABSENT:** Lonny Mertz, Vice Chair

**STAFF PRESENT:** Bonnie Heit, Assistant to the Audit Committee
Fay Kopp, Interim Executive Director
Dottie Thorsen, Internal Auditor

**CALL TO ORDER:**

Ms. Dorwart called the State Investment Board (SIB) Audit Committee meeting to order at 2:00 p.m., on Friday, September 27, 2013, at Workforce Safety & Insurance, 1600 E Capitol Ave., Bismarck, ND.

A quorum was present for the purpose of conducting business.

**AGENDA:**

The Audit Committee considered the September 27, 2013, agenda.

**IT WAS MOVED BY MR. SANDAL AND SECONDED BY MS. TERNES AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE SEPTEMBER 27, 2013, MEETING.**

**AYES: MR. SANDAL, MS. TERNES, MR. GESSNER, AND MS. DORWART**
**NAYS: NONE**
**MOTION CARRIED**
**ABSENT: MR. MERTZ**

**MINUTES:**

The Audit Committee considered the minutes from the May 17, 2013, meeting.

**IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE MAY 17, 2013, MINUTES AS WRITTEN.**

**AYES: MR. GESSNER, MR. SANDAL, MS. TERNES, AND MS. DORWART**
**NAYS: NONE**
**MOTION CARRIED**
**ABSENT: MR. MERTZ**

**ELECTION OF OFFICERS:**

**IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. GESSNER TO CONTINUE WITH THE CURRENT SLATE OF OFFICERS FOR THE AUDIT COMMITTEE FOR THE 2013-14 FISCAL YEAR; MS. DORWART, CHAIR, MR. MERTZ, VICE CHAIR, AND MR. GESSNER, LIAISON TO THE SIB.**

**AYES: MS. TERNES, MR. SANDAL, MR. GESSNER, AND MS. DORWART**
**NAYS: NONE**
**MOTION CARRIED**
**ABSENT: MR. MERTZ**

**AUDIT ACTIVITIES REPORT:**

Ms. Kopp and Ms. Thorsen reviewed internal audit activities for the July 1, 2012 – June 30, 2013 period.

The Executive Limitations Audit was completed on the Interim Chief Investment Officer for the period of July 1, 2012 – December 31, 2012. There were no exceptions noted.

Forty-five school district audits were completed. The objective was to complete forty-three audits. Of the 45 audits completed, six districts were not in compliance, one district was generally in compliance, and 38 districts were in compliance with state law and state administrative code. Follow-up reviews were also completed on four school districts that were not in compliance from the previous year.

The Internal Audit Division is three and one half years into the third cycle; 108 audits have been completed with 64 remaining. The long-range goal is to audit each school district over a five year period.

Internal audit staff have also started developing a Policy and Procedure Manual for the school district audits.

The Benefit Payments Audit was completed; deaths, long outstanding checks, purchase of service, and refunds were reviewed to determine that established policy and procedures were being followed by the Retirement Services Division. There were no exceptions noted.

The TFFR File Maintenance Audit was completed and changes made to TFFR member account data by RIO employees was tested. One exception was noted.

Ms. Thorsen also covered budgeted hours to actual hours for the Internal Audit Division.

The Audit Committee was very pleased with the progress of the Internal Audit Division and thanked staff for their efforts in accomplishing the goals of the work plan for the period of July 1, 2012 – June 30, 2013.

**IT WAS MOVED BY MS. TERNES AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE INTERNAL AUDIT ACTIVITIES REPORT FOR JULY 1, 2012 – JUNE 30, 2013.**

**AYES: MR. GESSNER, MR. SANDAL, MS. TERNES, AND MS. DORWART**
**NAYS: NONE**
**MOTION CARRIED**
**ABSENT: MR. MERTZ**

**AUDIT COMMITTEE REPORT TO SIB:**

The Audit Committee report to the SIB for the period of July 1, 2012 – June 30, 2013 was reviewed by the Audit Committee.

**IT WAS MOVED BY MS. TERNES AND SECONDED BY MR. SANDAL AND CARRIED ON A VOICE VOTE TO ACCEPT THE AUDIT COMMITTEE'S ANNUAL REPORT TO THE SIB.**

**AYES: MR. SANDAL, MS. TERNES, MR. GESSNER, AND MS. DORWART**
**NAYS: NONE**
**MOTION CARRIED**
**ABSENT: MR. MERTZ**

**AUDIT PROGRESS REPORT:**

Ms. Kopp reviewed the work plan for the period of July 1, 2013 – June 30, 2014, and discussed with the Audit Committee prioritization of projects and whether or not the work plan would need to be amended given the vacancy within the Internal Audit Division.

After discussion, the Audit Committee concurred the existing work plan that was established and accepted at their May 17, 2013, meeting, for the period of July 1, 2013 - June 30, 2014 should not be formally amended. However, it is recognized that the audit supervisor vacancy will have an impact on the plan and it is likely the 2013-14 annual work plan goals will not be met. Since there will be less time available to spend on regular audit coverage, adjustments will be made as the Audit Committee and staff feels is appropriate.

**ED/CIO SEARCH:**

Mr. Sandal updated the Audit Committee on the ED/CIO search for RIO. The SIB, at their September 27, 2013, meeting took action to offer the position to Mr. Deric Righter and directed Korn/Ferry to proceed with recruitment efforts of Mr. Righter.

**INTERNAL AUDIT SUPERVISOR POSITION:**

The Audit Committee and staff discussed the vacancy of the Supervisor of Internal Audit Division of RIO, the current governance structure of the SIB, TFFR, and RIO programs, and the overall audit function within RIO. After discussion, the Audit Committee and staff determined it would be best to delay any action on filling the Supervisor of Internal Audit Division position until the ED/CIO of RIO is in place to allow this individual the opportunity to give their perspective and to also be involved in the process. If the ED/CIO position is not filled in the near future, Ms. Kopp will work with the Audit Committee to replace the audit supervisor position.

**AUDIT COMMITTEE CHARTER:**

Mr. Mertz and staff have been working on updating the Audit Committee's charter. After discussion, the Audit Committee and staff determined it would be better to delay any action on the charter until the audit function of RIO is reviewed and discussed with all entities involved.

**OTHER:**

Ms. Kopp notified the Audit Committee October 15, 2013, will be Ms. Connie Flanagan’s last day serving as RIO’s Fiscal & Investment Officer. Ms. Kopp reviewed the interim office action plan.

The next Audit Committee meeting is scheduled for November 22, 2013, at 1:00 p.m. at the State Capitol, Peace Garden Room.

**ADJOURNMENT:**

With no further business to come before the Audit Committee, Ms. Dorwart adjourned the meeting at 3:35 p.m.

Respectfully Submitted:

________________________________

Ms. Rebecca Dorwart, Chair
SIB Audit Committee

________________________________

Bonnie Heit
Assistant to the Audit Committee

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November 22, 2013

## Audit Results Presentation to:

# North Dakota Retirement and Investment Office – Audit Committee

CliftonLarsonAllen

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# Agenda

- Introductions
- Overview of Critical Audit Areas
- 2013 Audit Results
- Financial Highlights
- Required Communications
- New GASB Pronouncements Regarding Pension Plans

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# Critical Audit Areas

- Investments
- Contributions
- Benefit payments
- Actuarial data

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# Critical Audit Areas - Investments

- Investments
  - Understanding of internal controls
    - ◊ Walkthroughs
      - Reconciliation procedures
      - Initial due diligence and on-going monitoring
      - Compliance monitoring
    - ◊ Review custodial bank's SSAE 16 report
  - Substantive procedures
    - ◊ Confirmation of custodial and non-custodial investments
    - ◊ Price testing of equity and fixed income securities
    - ◊ Review of audited financial statements and roll-fowards of non-custodial (alternative) investments

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# Critical Audit Areas - Contributions

- Understanding of internal controls
  - Review of internal audit procedures and reports
  - Walkthroughs of contribution and purchase of service processes
  - Test of controls over the contributions process
- Substantive procedures
  - Reconciliation of contributions from G/L to CPAS
  - Confirmation of contributions with employers
  - Analytical procedures

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# Critical Audit Areas – Benefit Payments

- Understanding of internal controls
  - Review of internal audit procedures and reports
  - Walkthroughs of benefit payment processes including separate walkthroughs for disability, survivor, regular retirement and refund processes
  - Test of controls over the benefit payment processes
- Substantive Procedures
  - Reconciliation of benefit payments from G/L to CPAS
  - Analytical procedures

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# Critical Audit Areas – Actuarial Data

- AU section 500.08 - use of a management specialist
  - Evaluate the competence, capabilities and objectivity of the specialist
    - ◊ Confirm actuaries independence and accreditation
    - ◊ Prior experience with the actuaries
  - Obtain an understanding of the work of the specialist
    - ◊ Review the nature, scope and objectives of the work of the specialist
  - Evaluate the appropriateness of the work of the specialist
    - ◊ Census data testing
    - ◊ Review of the actuary report and compare key assumptions to pension and actuarial industry standards

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# 2013 Audit Results

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- Independent Auditors’ Report - Unmodified “clean” opinion that the financial statements are presented fairly, in all material respects, in conformity with U.S. Generally Accepted Accounting Principles (GAAP).
  - Formatting change due to implementation of Audit Clarity Standards
  - Minor changes due to implementation of GASB 63
- Limited procedures were performed, and no opinion rendered, on management’s discussion and analysis, required supplemental information, supplemental schedules, and the Introductory, Investment, Actuarial, and Statistical sections.
- Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*
  - No material weaknesses were identified.
  - No significant deficiencies were identified.
- Letter to the Board providing required communications with those charged with governance

# Financial Highlights

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## Net Position – Fiduciary Funds
## (In Millions)

| | 2013 | 2012 | Total % Change |
|---|---|---|---|
| **Assets** | | | |
| Investments | $ 7,422 | $ 6,010 | 23.5% |
| Receivables | 44 | 35 | 25.4% |
| Cash & Other | 16 | 15 | 11.6% |
| **Total Assets** | 7,482 | 6,060 | 23.5% |
| **Liabilities** | | | |
| Accounts Payable | 7 | 6 | 18.5% |
| **Total Liabilities** | 7 | 6 | 18.5% |
| **Total Net Position** | $ 7,475 | $ 6,054 | 23.5% |

# Financial Highlights, cont'd.

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**Changes in Net Position – Fiduciary Funds**
**(In Millions)**

| | 2013 | 2012 | Total % Change |
|---|---|---|---|
| **Additions:** | | | |
| Contributions | $ 116 | $ 89 | 30.4% |
| Investment Income | 638 | 79 | 707.9% |
| **Total Additions** | 754 | 168 | 349.3% |
| **Deductions** | 151 | 140 | 8.1% |
| **Net change from unit transactions** | 818 | 436 | 87.7% |
| **Total change in net position** | $ 1,421 | $ 464 | 206.3% |

# Required Governing Body Communications

- Auditor’s responsibility under U.S. Generally Accepted Auditing Standards
- Significant accounting policies
- Management judgments and accounting estimates
  – Valuation of alternative investments
  – Actuarial assumptions and methods used
- Financial statement disclosures

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# Other Communications

- Management was very cooperative and professional during the audit process
- No disagreements with management
- Management did not consult with other accountants on the application of GAAP or GAAS
- No major issues were discussed with management prior to retention
- Management Representations

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# Recently Issued GASB Statements Regarding Public Pension Plans

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# GASB Pension Standards

| Standard # | Title | Effective Date |
|---|---|---|
| GASB 67 | Financial Reporting for Pension Plans | Fiscal Years beginning after June 15, 2013 |
| GASB 68 | Accounting and Financial Reporting for Pensions | Fiscal years beginning after June 15, 2014 |

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## Summary of Plan Provisions

- **Recognition, measurement and presentation of financial statement amounts generally similar to current guidance**
- **Note disclosures and required supplementary information:**
  - Similar to nature of disclosures for employers with the addition of information on investment policies and actual rates of return on plan assets
  - Certain information only required for single-employer and cost-sharing plans
  - No actuarial-related disclosures for agent multiple-employer plans
- **Requirements regarding the measurement of net pension liability (asset) are similar to the requirements for employers:**
  - Net pension liability (asset) not recognized by pension plans

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# Summary of Plan Provisions *(continued)*

- **Substantial changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes:**
  - Entry Age Normal is the only allowable actuarial cost method
  - Projected benefit payments should include effects of ad-hoc COLAs considered substantially automatic
  - A single blended rate should be used to discount projected future benefit payments, based on:
    - The long-term expected rate of return on plan investments (net of investment expenses) that are expected to be used to finance the payment of pension benefits to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested, using a strategy to achieve that return; and
    - A yield or index rate for 20-year, tax-exempt general obligation (municipal) bonds with average rating of AA or higher, to the extent that the conditions above are not met
  - The actuarial methods and assumptions allowable under current standards may continue to be used to determine funding amounts
- **Note disclosures and required supplementary information related to pensions are expanded**

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# New and Emerging GASB Issues

- What actions need to be taken?
  - GASB 67 and 68 signal the start of this discussion, but this is a conversation that will take time.
  - The first thing state and local governments need to find out is how sustainable are their pension plans.
  - Then they need to clearly communicate the situation to the public and to their board members.
  - Finally, they need to talk about the long-term structural changes needed to shore up the pension plan, if it is currently unsustainable.
  - From an accounting perspective, the books will actually appear different, so it is also important to understand where the technical changes will occur.

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October 24, 2013

State Investment Board
Teachers' Fund for Retirement
North Dakota Retirement and Investment Office
1930 Burnt Boat Drive
Bismarck, ND 58507-7100

We have audited the financial statements of the North Dakota Retirement and Investment Office (RIO) as of and for the year ended June 30, 2013, and have issued our report thereon dated October 24, 2013. We have previously communicated to you information about our responsibilities under auditing standards generally accepted in the United States of America, as well as certain information related to the planned scope and timing of our audit. Professional standards also require that we communicate to you the following information related to our audit.

**Significant audit findings**

***Qualitative aspects of accounting practices***

_Accounting policies_

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by RIO are described in Note 1 to the financial statements.

For the year ended June 30, 2013, the financial statements include the impact of adoption of Governmental Accounting Standards Board Statement (GASBS) numbers 62 and 63.

GASBS 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, supersedes GASBS 20. GASBS 20 gave governments the choice to elect to follow only the authoritative literature of the Governmental Accounting Standards Board (GASB) or to follow Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements that did not conflict with GASB pronouncements. Upon adoption of GASBS 62, all governmental accounting guidance is codified into the GASB literature.

GASBS 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, provides guidance on reporting deferred outflows and inflows of resources. It also renames the residual of all other amounts presented in the statement of financial position from "net assets" to "net position." The financial statements include the statement of net position, which reports all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Adoption of future GASB standards will include reporting of some items previously reported as assets and liabilities as deferred outflows and inflows of resources.

We noted no transactions entered into by RIO during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

*Accounting estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. There were significant estimates in the valuation of alternative investments and the calculation of the actuarial information included in the footnotes and required supplementary information.

The valuation of alternative investments, including private equity and real asset investments, are a management estimate which is primarily based upon net asset values reported by the investment managers and comprise 14% of the total investment portfolio. The values for these investments are reported based upon the most recent financial data available and are adjusted for cash flows through June 30, 2013. Our audit procedures validated this approach through the use of confirmations sent directly to a sample of investment managers and the review of the most recent audited financial statements for these funds. Furthermore, we reviewed management's estimate and found it to be reasonable.

The actuarially calculated information was based on the assumptions and methods adopted by the Board, including an expected investment rate of return of 8.0% per annum compounded annually. The valuation takes into account all of the promised benefits to which members are entitled as of July 1, 2011 as required by the Retirement Code. The valuation is the basis for the contribution rate for TFFR's 2012/2013 fiscal year. Our audit procedures included reviewing the actuarial valuation and related assumptions used therein and we believe the estimate to be reasonable.

*Financial statement disclosures*

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures

The financial statement disclosures are neutral, consistent, and clear.

***Difficulties encountered in performing the audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

***Uncorrected misstatements***

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

***Corrected misstatements***

Management did not identify and we did not notify them of any financial statement misstatements detected as a result of audit procedures.

***Disagreements with management***

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. No such disagreements arose during our audit.

***Management representations***

We have requested certain representations from management that are included in the attached management representation letter dated October 24, 2013.

***Management consultations with other independent accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the entity's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Significant issues discussed with management prior to engagement***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to engagement as RIO's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our engagement.

**Other information in documents containing audited financial statements**

With respect to the required supplementary information (RSI) accompanying the financial statements, we made certain inquiries of management about the methods of preparing the RSI, including whether the RSI has been measured and presented in accordance with prescribed guidelines, whether the methods of measurement and preparation have been changed from the prior period and the reasons for any such changes, and whether there were any significant assumptions or interpretations underlying the measurement or presentation of the RSI. We compared the RSI for consistency with management's responses to the foregoing inquiries, the basic financial statements, and other knowledge obtained during the audit of the basic financial statements. Because these limited procedures do not provide sufficient evidence, we did not express an opinion or provide any assurance on the RSI.

With respect to the schedules of administrative expenses, consultant expenses, investment expenses, and appropriations – budget basis – fiduciary funds (collectively, the supplementary information) accompanying the financial statements, on which we were engaged to report in relation to the financial statements as a whole, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period or the reasons for such changes, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves. We have issued our report thereon dated October 24, 2013.

Other information is being included in documents containing the audited financial statements and the auditors' report thereon. Our responsibility for such other information does not extend beyond the financial information identified in our auditors' report. We have no responsibility for determining whether such other information is properly stated and do not have an obligation to perform any procedures to corroborate other information contained in such documents. As required by professional standards, we read the introductory, investment, actuarial and statistical sections of the comprehensive annual financial report (the other information) in order to identify material inconsistencies between the audited financial statements and the other information. We did not identify any material inconsistencies between the other information and the audited financial statements.

Our auditors' opinion, the audited financial statements, and the notes to financial statements should only be used in their entirety. Inclusion of the audited financial statements in a document you prepare, such as an annual report, should be done only with our prior approval and review of the document.

* * *

This communication is intended solely for the information and use of the State Investment Board, the Board of the Teachers' Fund for Retirement and management of RIO and is not intended to be, and should not be, used by anyone other than these specified parties.

CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

Baltimore, Maryland
October 24, 2013

# ND Retirement and Investment Office

*Teachers' Fund for Retirement*
*State Investment Board*

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This representation letter is provided in connection with your audit of the financial statements of North Dakota Retirement and Investment Office (RIO), which comprise the financial position of the entity as of June 30, 2013, and the changes in financial position for the year then ended, and the related notes to the financial statements, for the purpose of expressing opinions on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of October 24, 2013, the following representations made to you during your audit of the financial statements as of and for the year ended June 30, 2013, and the following representations as they apply to the financial statements as of and for the year ended June 30, 2012.

**Financial Statements**

- We have fulfilled our responsibilities, as set out in the terms of the Contract between the State of North Dakota and CliftonLarsonAllen LLP dated May 8, 2012, for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. The financial statements include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.

- We acknowledge and have fulfilled our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- All significant plan amendments, adopted during the period or subsequent to the date of the financial statements, and their effects on benefits and financial status have been disclosed in the financial statements.

- The values of non-readily marketable investments represent good faith estimates of fair value. The methods and significant assumptions used result in a measure of fair value appropriate for financial measurement and disclosure purposes.

- Significant estimates have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. Significant estimates are estimates at the financial statement date that could change materially within the next year.

- No events, including instances of noncompliance, have occurred subsequent to the financial statement date and through the date of this letter that would require adjustment to, or disclosure in, the financial statements.

- We have not identified or been notified of any uncorrected financial statement misstatements.

- The effects of all known actual or possible litigation, claims, and assessments have been accounted for and disclosed in accordance with U.S. GAAP.

- Guarantees, whether written or oral, under which the entity is contingently liable, if any, have been properly recorded or disclosed in accordance with U.S. GAAP.

- We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

- With respect to actuarial assumptions and valuations:

    - Management agrees with the actuarial methods and assumptions used by the actuary for funding purposes and for determining the actuarial accrued liability and has no knowledge or belief that would make such methods or assumptions inappropriate in the circumstances. We did not give any, nor cause any, instructions to be given to RIO's actuary with respect to values or amounts derived, and we are not aware of any matters that have impacted the independence or objectivity of RIO's actuary.

    - There were no omissions from the participant data provided to the actuary for the purpose of determining the actuarial accrued liability and other actuarially determined amounts in the financial statements.

    - There have been no changes in the actuarial methods or assumptions used in calculating the amounts recorded or disclosed in the financial statements except as noted. There have been no changes in plan provisions between the actuarial valuation date and the date of this letter.

- We believe the plan and trust established under the plan is qualified under the appropriate section of The North Dakota Century Code, and we intend to continue them as a qualified plan and trust.

**Information Provided**

- We have provided you with:

    - Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters.

    - Additional information that you have requested from us for the purpose of the audit.

    - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

    - Complete minutes of the meetings of the governing board and related committees, or summaries of actions of recent meetings for which minutes have not yet been prepared.

    - All actuarial reports prepared for the plan during the year.

- All material transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
    - Management;
    - Employees who have significant roles in internal control; or
    - Others when the fraud could have a material effect on the financial statements.
- We have no knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
- We have no knowledge of any instances of noncompliance or suspected noncompliance with laws and regulations and provisions of contracts, or abuse whose effects should be considered when preparing financial statements.
- We have disclosed to you all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements.
- There are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed in accordance with U.S. GAAP.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- We are responsible for compliance with the laws, regulations, and provisions of contracts applicable to RIO, and we have identified and disclosed to you all laws, regulations, and provisions of contracts that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
- There are no violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts, or any debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.
- The entity has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- We have followed all applicable laws and regulations in adopting, approving, and amending budgets.
- Investments, derivative instruments, and land and other real estate held by RIO are properly valued.
- Expenses have been appropriately classified the statement of changes in net position, and allocations have been made on a reasonable basis.
- Revenues are appropriately classified in the statement of changes in net position.

- Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
- Deposits and investment securities and derivative instruments are properly classified as to risk and are properly valued and disclosed.
- Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated.
- We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
- We acknowledge our responsibility for presenting the schedules (the supplementary information) in accordance with U.S. GAAP, and we believe the supplementary information, including its form and content, is fairly presented in accordance with U.S. GAAP. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information. If the supplementary information is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the supplementary information no later than the date we issue the supplementary information and the auditors' report thereon.

Fay Kopp

Fay Kopp, Interim Executive Director/Chief Retirement Officer

Darren Schulz

Darren Schulz, Interim Chief Investment Officer

# NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE
Bismarck, ND

## FINANCIAL STATEMENTS
June 30, 2013 and 2012

**PAGE**

CliftonLarsonAllen LLP
www.cliftonlarsonallen.com

# Independent Auditors' Report

Governor Jack Dalrymple
The Legislative Assembly
Fay Kopp, Interim Executive Director
State Investment Board
Teacher's Fund for Retirement Board
North Dakota Retirement and Investment Office

## Report on the Financial Statements

We have audited the accompanying financial statements of the North Dakota Retirement and Investment Office (RIO), a department of the State of North Dakota, which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of changes in net position for the years then ended, and the related notes to the financial statements, which collectively comprise RIO's basic financial statements, and the combining and individual fund financial statements as of and for the years ended June 30, 2013 and 2012, as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express opinions 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of RIO as of June 30, 2013 and 2012, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the combining and individual fund financial statements referred to above present fairly, in all material respects, the financial position of each of the individual funds of RIO as of June 30, 2013 and 2012, and the results of the changes in financial position of such funds for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in Note 1, the financial statements of RIO are intended to present the financial position and the changes in financial position of only that portion of the State of North Dakota that is attributable to the transactions of RIO. They do not purport to, and do not, present fairly the financial position of State of North Dakota as of June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedules of funding progress and employer contributions and related notes, as listed on the table of contents, be presented to supplement the basic financial statements. Such information, although not a 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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.

*Other Information*

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise RIO's basic financial statements and the combining and individual fund financial statements. The schedules of administrative expenses, consultant expenses, investment expenses, and appropriations – budget basis – fiduciary funds, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

These schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Audit Standards*, we have also issued our report dated October 24, 2013, on our consideration of RIO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits

CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

Baltimore, Maryland
October 24, 2013

**Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

Governor Jack Dalrymple
The Legislative Assembly
Fay Kopp, Interim Executive Director
State Investment Board
Teacher's Fund for Retirement Board
North Dakota Retirement and Investment Office

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the North Dakota Retirement and Investment Office (RIO), a department of the State of North Dakota, which collectively comprise RIO's basic financial statements, and the combining and individual fund financial statements, as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated October 24, 2013.

**Internal Control over Financial Reporting**

Management of RIO is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered RIO'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 RIO's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of RIO's internal control over financial reporting.

A *deficiency in internal* control 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether RIO's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of RIO's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering RIO's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

Baltimore, Maryland
October 24, 2013

We did not identify any findings that are required to be reported in accordance with *Government Auditing Standards*.

Our discussion and analysis of the ND Retirement and Investment Office's (RIO) financial performance provides an overview of RIO's financial activities for the fiscal year ended June 30, 2013. Please read it in conjunction with the basic financial statements, which follow this discussion.

RIO administers two fiduciary funds, a pension trust fund for the ND Teachers' Fund for Retirement (TFFR) and an investment trust fund for the ND State Investment Board (SIB) consisting of 21 investment clients in two investment pools and one individual investment account

**Financial Highlights**

Total net position increased in the fiduciary funds by $1.42 billion or 23.5% from the prior year. Over 50% of that increase is due to the growth of the Legacy Fund. The Legacy Fund was created by a constitutional amendment in 2010. The amendment provides that 30% of oil and gas gross production and oil extraction taxes on oil produced after June 30, 2011, be transferred to the Legacy Fund. Transfers into the Legacy Fund totaled $791.1 million during the fiscal year.

Additions in the fiduciary funds for the year increased $585.9 million from the previous year. Net investment income increased by $558.9 million and total contributions increased $27.0 million.

Deductions in the fiduciary funds increased over the prior year by $11.3 million or 8.1%. This increase represented a rise in the total number of retirees drawing retirement benefits from the pension fund as well as an increase in the retirement salaries of new retirees.

The TFFR funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2013, the funded ratio was approximately 58.8%.

**Overview of the Financial Statements**

This report consists of four parts – management's discussion and analysis (this section), the basic financial statements, required supplementary information, and an optional section that presents combining statements for the investment trust funds. The basic financial statements include fund financial statements that focus on individual parts of RIO's activities (fiduciary funds).

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements. In addition to these required elements, we have included a section with combining statements that provide details about our investment trust funds, each of which are added together and presented in single columns in the basic financial statements.

**Fund Financial Statements**

The fund financial statements provide detailed information about RIO's activities. Funds are accounting devices that RIO uses to keep track of specific sources of funding and spending for particular purposes.

RIO uses fiduciary funds as RIO is the trustee, or fiduciary, for TFFR (a pension plan) and SIB (investment trust funds). RIO is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of RIO's fiduciary activities are reported in a statement of net position and a statement of changes in net position.

## Financial Analysis

RIO's fiduciary fund total assets as of June 30, 2013, were $7.5 billion and were comprised mainly of investments. Total assets increased by $1.4 billion or 23.5% from the prior year primarily due to the growth of the Legacy Fund.

Total liabilities as of June 30, 2013, were $7 million and were comprised mostly of investment expenses payable. Total liabilities increased by $1.1 million or 18.5% from the prior year due mainly to an increase in investment expenses payable at June 30, 2013.

RIO's fiduciary fund total net position was $7.5 billion at the close of fiscal year 2013.

**North Dakota Retirement and Investment Office**
**Net Position – Fiduciary Funds**
**(In Millions)**

| | 2013 | 2012 | Total % Change |
|---|---|---|---|
| **Assets** | | | |
| Investments | $ 7,422 | $ 6,010 | 23.5% |
| Receivables | 44 | 35 | 25.4% |
| Cash & Other | 16 | 15 | 11.6% |
| **Total Assets** | 7,482 | 6,060 | 23.5% |
| **Liabilities** | | | |
| Accounts Payable | 7 | 6 | 18.5% |
| **Total Liabilities** | 7 | 6 | 18.5% |
| **Total Net Position** | $ 7,475 | $ 6,054 | 23.5% |

| | 2012 | 2011 | Total % Change |
|---|---|---|---|
| **Assets** | | | |
| Investments | $ 6,010 | $ 5,553 | 8.2% |
| Receivables | 35 | 31 | 13.5% |
| Cash & Other | 15 | 13 | 11.7% |
| **Total Assets** | 6,060 | 5,597 | 8.3% |
| **Liabilities** | | | |
| Accounts Payable | 6 | 7 | -2.6% |
| **Total Liabilities** | 6 | 7 | -2.6% |
| **Total Net Position** | $ 6,054 | $ 5,590 | 8.3% |

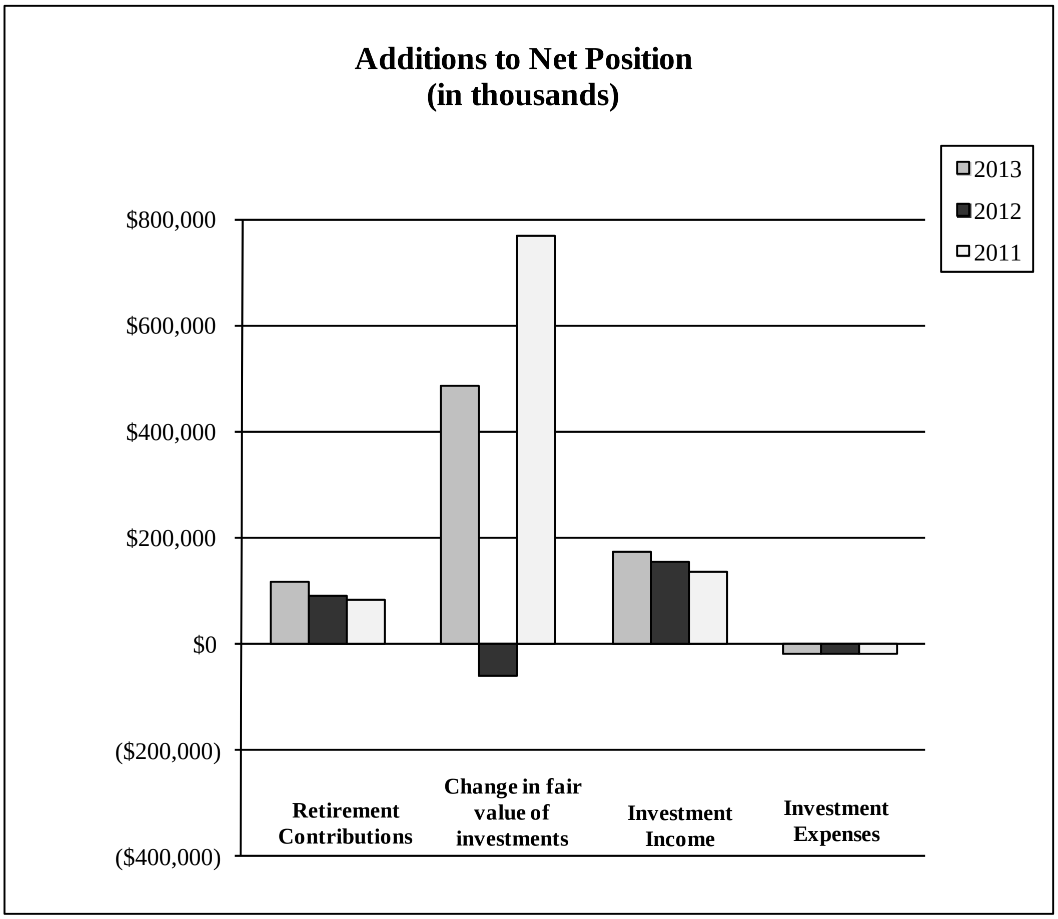
**North Dakota Retirement and Investment Office**
**Changes in Net Position – Fiduciary Funds**
**(In Millions)**

| | 2013 | 2012 | Total % Change |
|---|---|---|---|
| **Additions:** | | | |
| Contributions | $ 116 | $ 89 | 30.4% |
| Investment Income | 638 | 79 | 707.9% |
| **Total Additions** | 754 | 168 | 349.3% |
| **Deductions** | 151 | 140 | 8.1% |
| **Net change from unit transactions** | 818 | 436 | 87.7% |
| **Total change in net position** | $ 1,421 | $ 464 | 206.3% |

| | 2012 | 2011 | Total % Change |
|---|---|---|---|
| **Additions:** | | | |
| Contributions | $ 89 | $ 85 | 4.6% |
| Investment Income | 79 | 884 | 91.1% |
| **Total Additions** | 168 | 969 | 82.7% |
| **Deductions** | 140 | 133 | 5.5% |
| **Net change from unit transactions** | 436 | (63) | 790.9% |
| **Total change in net position** | $ 464 | $ 773 | 40.0% |

**Statement of Changes in Net Position – Additions**

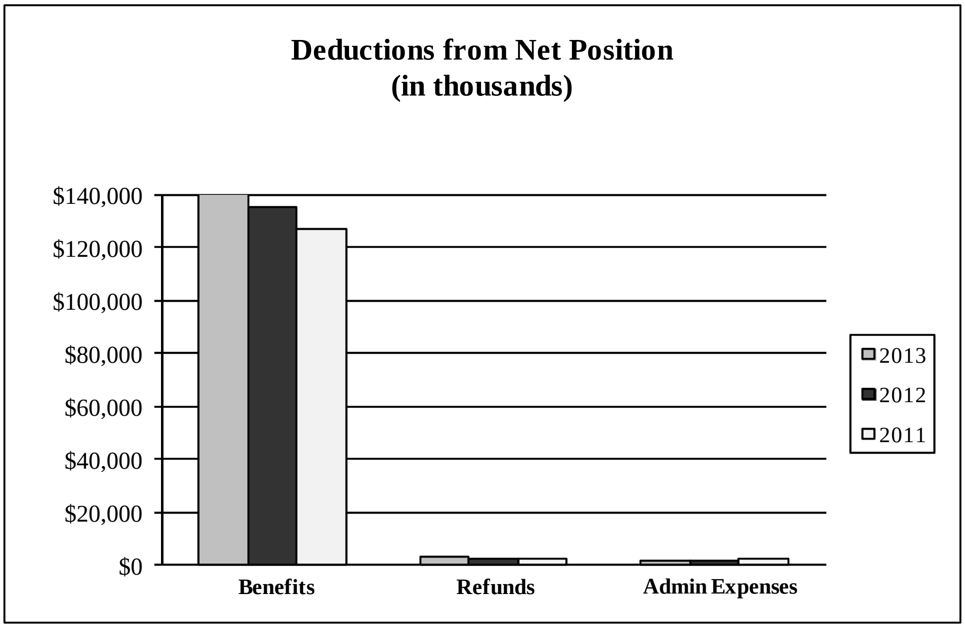
Contributions and net investment income are the two components of the fiduciary fund additions. Contributions collected by the pension trust fund increased by $27.0 million or 30.4% over the previous fiscal year. The increase is due to an increase in the statutorily required contribution rates for members and employers that took effect July 1, 2012. Member contribution rates increased from 7.75% to 9.75% and employer contribution rates increased from 8.75% to 10.75%. Net investment income (net of investment expenses) increased by $558.9 million or 708% from last year. This was the result of stronger financial markets during the fiscal year.



**Statement of Changes in Net Position – Deductions**

Benefits paid to TFFR plan participants, including partial lump-sum distributions, increased by $10.7 million or 7.9% during the fiscal year ended June 30, 2013. This was due to an increase in the total number of retirees in the plan as well as an increased retirement salary on which the benefits are based upon. Refunds increased slightly in fiscal year 2013 by $574,201 or 23.2%.

Administrative expenses increased by $56,023 or 2.6%.




**Conclusion**

Following a challenging market environment the prior fiscal year, financial markets performed well in fiscal year 2013. Aggressive efforts by central banks in developed markets to stimulate economic growth fostered a favorable backdrop for investing, in general. For the year, most developed stock markets advanced to levels exceeding that achieved during the last market cycle. On an absolute basis, all asset and sub-asset classes overseen by the State Investment Board generated positive returns. Relative to underlying benchmarks, most asset classes performed in-line or outperformed.

Despite a barrage of policy initiatives, including near-zero interest rates and interference in financial markets by central banks and policy makers, the leading economies remain generally fragile, underscoring the structural (rather than cyclical) nature of the challenges faced in the post-credit crisis era. Of little doubt, however, are the distorting effects of policy settings designed explicitly to shield financial asset prices from normal market forces and the threat that it may lead to a heightening of the very risks which gave the financial system its dependency on central bank support in the first place.

In this environment, financial markets are, we anticipate, likely to remain unstable. To meet this challenge, the State Investment Board will continue to research strategies and consider investment options to address funding issues in the challenging years ahead.

To address TFFR's funding shortfall, the ND State Legislature took action in 2011 and approved legislation to increase member and employer contributions and modify certain benefits. The first phase of the funding improvement plan went into effect on July 1, 2012 with 2% member and 2% employer contribution increases. This funding recovery plan, along with solid investment performance in the future, is expected to improve TFFR's funding level over the long term. Although TFFR's funding level has been declining, and is 58.8% as of 7/1/13, funding levels are projected to begin rising after past investment losses are phased in to actuarial calculations and as 2012 and 2014 contribution increases begin to flow into the system. Increased contribution rates will be in effect until TFFR reaches 100% funding on an actuarial basis. Protecting the long term solvency of the pension plan is the TFFR Board's fiduciary responsibility. The Board will continue to proactively address TFFR funding issues so the plan will be financially strong and sustainable for past, present, and future ND educators.

**Contacting RIO Financial Management**

This financial report is designed to provide our Boards, our membership, our clients and the general public with a general overview of RIO's finances and to demonstrate RIO's accountability for the money we receive. If you have any questions about this report or need additional information, contact the North Dakota Retirement and Investment Office, PO Box 7100, Bismarck, ND 58507-7100.

# North Dakota Retirement and Investment Office

## Statement of Net Position – Fiduciary Funds

## June 30, 2013 and 2012

| | Pension Trust | | Investment Trust | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Assets: | | | | |
| Investments, at fair value | | | | |
| Equities | $ - | $ - | $ 43,854,432 | $ 36,131,488 |
| Equity pool | 951,272,867 | 812,749,740 | 1,543,210,098 | 1,312,774,041 |
| Fixed income | - | - | 1,611,285,649 | 806,874,577 |
| Fixed income pool | 392,807,091 | 370,045,662 | 1,692,041,813 | 1,582,382,143 |
| Real assets pool | 340,442,941 | 315,768,906 | 516,202,669 | 469,548,278 |
| Private equity pool | 94,185,760 | 104,823,271 | 111,364,820 | 108,766,790 |
| Cash pool | 24,369,601 | 21,082,755 | 100,765,983 | 69,354,213 |
| Total investments | 1,803,078,260 | 1,624,470,334 | 5,618,725,464 | 4,385,831,530 |
| Invested securities lending collateral | - | - | - | - |
| Receivables: | | | | |
| Investment income | 7,657,195 | 6,832,046 | 20,787,440 | 17,254,744 |
| Contributions | 15,648,020 | 11,076,423 | - | - |
| Miscellaneous | 5,172 | 5,472 | 12,752 | 9,506 |
| Total receivables | 23,310,387 | 17,913,941 | 20,800,192 | 17,264,250 |
| Due from other state agency | 616 | 1,461 | - | - |
| Cash and cash equivalents | 16,044,045 | 14,370,170 | 159,403 | 152,772 |
| Equipment & Software (net of depr) | - | 762 | - | - |
| Total assets | 1,842,433,308 | 1,656,756,668 | 5,639,685,059 | 4,403,248,552 |
| Liabilities: | | | | |
| Accounts payable | 69,417 | 62,950 | 50,916 | 26,714 |
| Investment expenses payable | 2,113,717 | 1,922,962 | 4,549,821 | 3,649,932 |
| Securities lending collateral | - | - | - | - |
| Accrued expenses | 658,494 | 607,086 | 60,040 | 50,425 |
| Miscellaneous payable | - | - | 17,382 | 13,537 |
| Due to other state agencies | 7,720 | 14,011 | 1,235 | 3,309 |
| Total liabilities | 2,849,348 | 2,607,009 | 4,679,394 | 3,743,917 |
| Net position: | | | | |
| Held in trust for pension benefits | 1,839,583,960 | 1,654,149,659 | - | - |
| Held in trust for external investment pool participants: | | | | |
| Pension pool | - | - | 2,276,983,263 | 2,022,512,983 |
| Insurance pool | - | - | 3,284,399,099 | 2,314,911,441 |
| Held in trust for individual investment account | - | - | 73,623,303 | 62,080,211 |
| Total net position | $ 1,839,583,960 | $ 1,654,149,659 | $ 5,635,005,665 | $ 4,399,504,635 |
| Each participant unit is valued at $1.00 | | | | |
| Participant units outstanding | | | 5,635,005,665 | 4,399,504,635 |

The accompanying notes are an integral part of the financial statements.

# North Dakota Retirement and Investment Office
## Statement of Changes in Net Position – Fiduciary Funds
## Years Ended June 30, 2013 and 2012

| | Pension Trust | | Investment Trust | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Additions: | | | | |
| Contributions: | | | | |
| Employer contributions | $ 59,352,860 | $ 46,126,193 | $ - | $ - |
| Member contributions | 53,824,557 | 40,254,562 | - | - |
| Purchased service credit | 2,641,019 | 2,417,995 | - | - |
| Interest and penalties | 30,912 | 9,854 | - | - |
| Total contributions | 115,849,348 | 88,808,604 | - | - |
| Investment income: | | | | |
| Net change in fair value of investments | 185,196,374 | (55,818,260) | 299,338,412 | (2,301,149) |
| Interest, dividends and other income | 41,018,935 | 39,954,588 | 132,358,789 | 115,514,522 |
| | 226,215,309 | (15,863,672) | 431,697,201 | 113,213,373 |
| Less investment expenses | 6,010,000 | 5,661,973 | 14,116,162 | 12,779,965 |
| Net investment income | 220,205,309 | (21,525,645) | 417,581,039 | 100,433,408 |
| Securities lending activity: | | | | |
| Securities lending income | - | 8,737 | - | 17,400 |
| Less securities lending expenses | - | (5,384) | - | (3,668) |
| Net securities lending income | - | 14,121 | - | 21,068 |
| Total additions | 336,054,657 | 67,297,080 | 417,581,039 | 100,454,476 |
| Deductions: | | | | |
| Benefits paid to participants | 145,079,333 | 134,718,464 | - | - |
| Partial lump-sum distributions | 863,990 | 532,104 | - | - |
| Refunds | 3,053,395 | 2,479,194 | - | - |
| Administrative charges | 1,623,638 | 1,596,976 | 558,744 | 529,383 |
| Total deductions | 150,620,356 | 139,326,738 | 558,744 | 529,383 |
| Net change in net position resulting from operations | 185,434,301 | (72,029,658) | 417,022,295 | 99,925,093 |
| Unit transactions at net position value of $1.00 per unit: | | | | |
| Purchase of units | - | - | 1,053,337,604 | 716,465,386 |
| Redemption of units | - | - | (234,858,869) | (280,508,738) |
| Net change in position and units resulting from unit transactions | - | - | 818,478,735 | 435,956,648 |
| Total change in net position | 185,434,301 | (72,029,658) | 1,235,501,030 | 535,881,741 |
| Net position: | | | | |
| Beginning of year | 1,654,149,659 | $ 1,726,179,317 | $ 4,399,504,635 | $ 3,863,622,894 |
| End of Year | $ 1,839,583,960 | $ 1,654,149,659 | $ 5,635,005,665 | $ 4,399,504,635 |

The accompanying notes are an integral part of the financial statements.

## Note 1 - Summary of Significant Accounting Policies

### Reporting Entity

The North Dakota Retirement and Investment Office (RIO) is charged with providing and coordinating the administrative activities of the Teachers' Fund for Retirement (TFFR) and the North Dakota State Investment Board (SIB).

RIO is an agency of the State of North Dakota operating through the legislative authority of North Dakota Century Code (NDCC) Chapter 54-52.5 and is considered part of the State of North Dakota financial reporting entity and included in the State of North Dakota's Comprehensive Annual Financial Report.

For financial reporting purposes, RIO has included all funds, and has considered all potential component units for which RIO is financially accountable, and other organizations for which the nature and significance of their relationship with RIO are such that exclusion would cause RIO's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. This criteria includes appointing a voting majority of an organization's governing body and (1) the ability of RIO to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on RIO.

Based upon these criteria, there are no component units to be included within RIO as a reporting entity and RIO is part of the State of North Dakota as a reporting entity.

### Fund Financial Statement

All activities of RIO are pension and investment trust funds and are shown in the fiduciary fund financial statements.

### Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of RIO are reported using the economic resources measurement focus and the accrual basis of accounting.

This measurement focus includes all assets and liabilities associated with the operations of the fiduciary funds on the statements of net position. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

### Fiduciary Fund

A pension trust fund and investment trust funds have been established to account for the assets held by RIO in a trustee capacity for TFFR and as an agent for other governmental units or funds which have placed certain investment assets under the management of SIB. The SIB manages two external investment pools and one individual investment account. The two external investment pools consist of a pension pool and insurance pool. SIB manages the investments of the North Dakota Public Employees Retirement System, Job Service of North Dakota, Bismarck City Employees and Police, City of Fargo Employees, City of Grand Forks Employees and Grand Forks Parks Employees pension plans in the pension pool. The investments of Workforce Safety and Insurance, State Fire & Tornado, State Bonding, Petroleum Tank Release Compensation Fund, Insurance Regulatory Trust, North Dakota Association of Counties Fund, Risk Management, Risk Management Workers

Comp, PERS Group Insurance, City of Bismarck Deferred Sick Leave, City of Fargo FargoDome Permanent Fund, Cultural Endowment Fund, Legacy Fund and Budget Stabilization Fund are managed in the insurance pool. PERS Retiree Health investments are managed by SIB in an individual investment account.

RIO has no statutory authority over, nor responsibility for, these investment trust funds other than the investment responsibility provided for by statute or through contracts with the individual agencies. Those pool participants that are required to participate according to statute are: Public Employees Retirement System, Workforce Safety and Insurance, State Fire and Tornado, State Bonding, Petroleum Tank Release Compensation Fund, Insurance Regulatory Trust, Risk Management, Risk Management Workers Comp, Cultural Endowment Fund, Legacy Fund and Budget Stabilization Fund.

RIO follows the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard setting body for establishing accounting principles generally accepted in the United States of America for governmental entities.

Pension and Investment Trust Funds are accounted for using the accrual basis of accounting. Member contributions are recognized in the period in which they are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the NDCC.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RIO utilizes various investment instruments. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the statements of net position.

**Budgetary Process**

RIO operates through a biennial appropriation, which represents appropriations recommended by the Governor and presented to the General Assembly (the Assembly) at the beginning of each legislative session. The Assembly enacts RIO's budget through passage of a specific appropriation bill. The State of North Dakota's budget is prepared principally on a modified accrual basis. The Governor has line item veto power over all legislation, subject to legislative override.

Once passed and signed, the appropriation bill becomes RIO's financial plan for the next two years. Changes to the appropriation are limited to Emergency Commission authorization, initiative, or referendum action. The Emergency Commission can authorize receipt of federal or other moneys not appropriated by the Assembly if the Assembly did not indicate intent to reject the money. The Emergency Commission may authorize pass-through federal funds from one state agency to another. The Emergency Commission may authorize the transfer of expenditure authority between appropriated line items, however RIO has specific authority as a special fund to transfer between the contingency line item and other line items. Unexpended appropriations lapse at the end of each biennium, except certain capital expenditures covered under the NDCC section 54-44.1-11.

RIO does not use encumbrance accounting. The legal level of budgetary control is at the agency, appropriation and expenditure line item level. RIO does not formally budget revenues and it does not budget by fund. The statement of revenues, expenditures and changes in fund balances - budget and actual is not prepared because revenues are not budgeted.

**Capital Assets and Depreciation**

Capital asset expenditures greater than $5,000 are capitalized at cost in accordance with Section 54-27-21 of the NDCC. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows:

| | Years |
|---|---|
| Office equipment | 5 |
| Furniture and fixtures | 5 |

**Investments**

NDCC Section 21-10-07 states that the SIB shall apply the prudent investor rule when investing funds under its supervision. The prudent investor rule means that in making investments, the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation, but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

The pension fund belonging to TFFR and investment trust funds attributable to the City of Bismarck Employee Pension Plan, the City of Bismarck Police Pension Plan, City of Fargo Employee Pension Plan, Job Service of North Dakota, City of Grand Forks Employee Pension Plan, Grand Forks Parks Pension Plan and the Public Employees Retirement System (PERS) must be invested exclusively for the benefit of their members. All investments are made in accordance with the respective fund's long-term investment objectives and performance goals.

**Pooled Investments**

Most agencies whose investments are under the supervision of the SIB participate in pooled investments. The agencies transfer money into the investment pools and receive an appropriate percentage ownership of the pooled portfolio based upon fair value. All activities of the investment pools are allocated to the agencies based upon their respective ownership percentages. Each participant unit is valued at $1.00 per unit.

**Investment Valuation and Income Recognition**

Investments are reported at fair value. Quoted market prices, when available, have been used to value investments. The fair values for securities that have no quoted market price represent estimated fair value. International securities are valued based upon quoted foreign market prices and translated into U.S. dollars at the exchange rate in effect at June 30. In general, corporate debt securities have been valued at quoted market prices or, if not available, values are based on yields currently available on comparable securities of issuers with similar credit ratings. Mortgages have been valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, including timberland, is based on appraisals plus fiscal year-to-date capital transactions. Publicly traded alternative investments are valued based on quoted market prices. When not readily available, alternative investment securities are valued using current estimates of fair value from the investment manager. Such valuations consider variables such as financial performance of the issuer, comparison of comparable companies' earnings multiples, cash flow analysis, recent sales prices of investments, withdrawal restrictions, and other pertinent information. Because of the inherent uncertainty of the valuation for these other alternative investments, the estimated fair value may differ from the values that would have been used had a ready market existed.

The net increase (decrease) in fair value of investments consists of the realized gains or losses and the unrealized increase or decrease in fair value of investments during the year. Realized gains and losses on sales of investments are computed based on the difference between the sales price and the original cost of the investment sold. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current fiscal year were included as a change in the fair value of investments reported in the prior year(s) and the current year.

Unrealized increase or decrease is computed based on changes in the fair value of investments between years. Security transactions are accounted for on a trade date basis. Interest income is recognized when earned. Dividend income is recorded on the ex-dividend date.

**Accumulated Leave**

Annual leave for permanent employees of the state of North Dakota is a part of their compensation as set forth in Section 54-06-14 of the NDCC. Employees earn leave based on tenure of employment. Sick leave is also part of permanent employees' compensation as set forth in Section 54-52-04 of the NDCC. Accrued leave amounted to $147,115 and $136,458 at June 30, 2013 and 2012, respectively. The current portions of accrued leave amounted to $71,864 and $69,848 at June 30, 2013 and 2012, respectively, and are included in accrued expenses of the Fiduciary Funds in the statements of net position.

Changes in accrued leave for the years ended June 30, 2013 and 2012 consisted of the following:

| | |
|---|---|
| Balance, July 1, 2011 | $129,737 |
| Additions | 82,071 |
| Deductions | (75,350) |
| Balance, June 30, 2012 | 136,458 |
| Additions | 94,877 |
| Deductions | (84,220) |
| Balance, June 30, 2013 | $147,115 |

## Note 2 - Cash and Cash Equivalents

### Custodial Credit Risk

State law generally requires that all state funds be deposited in the Bank of North Dakota. NDCC 21-04-01 provides that public funds belonging to or in the custody of the state shall be deposited in the Bank of North Dakota. Also, NDCC 6-09-07 states, "[a]ll state funds … must be deposited in the Bank of North Dakota" or must be deposited in accordance with constitutional and statutory provisions.

### Pension Trust Fund

Deposits held by the Pension Trust Fund at June 30, 2013 and 2012 were deposited in the Bank of North Dakota. At June 30, 2013 and 2012, the carrying amount of TFFR's deposits was $16,044,045 and $14,370,170, respectively, and the bank balance was $16,055,352 and $14,380,332 respectively. The difference results from checks outstanding or deposits not yet processed by the bank. These deposits are exposed to custodial credit risk as uninsured and uncollateralized. However, these deposits at the Bank of North Dakota are guaranteed by the State of North Dakota through NDCC Section 6-09-10.

### Investment Trust Funds

Certificates of deposit and an insurance trust cash pool are recorded as investments and have a cost and carrying value of $188,293,365 and $146,245,136 at June 30, 2013 and 2012, respectively. In addition these funds carry cash and cash equivalents totaling $159,403 and $152,772 at June 30, 2013 and 2012, respectively. These deposits are exposed to custodial credit risk as uninsured and uncollateralized. However, these deposits held at the Bank of North Dakota are guaranteed by the State of North Dakota through NDCC Section 6-09-10.

## Note 3 - Investments

The investment policy of the SIB is governed by NDCC 21-10. The SIB shall apply the prudent investor rule in investing for funds under its supervision. The "prudent investor rule" means that in making investments, the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The retirement funds belonging to the teachers' fund for retirement and the public employees' retirement system must be invested exclusively for the benefit of their members and in accordance with the respective funds' investment goals and objectives.

### Securities Lending

The State Investment Board (SIB) did not have a securities lending program in place during the fiscal years ended June 30, 2013 and 2012. Income and expenses from securities lending activity appearing on the financial statements represent final activity from June, 2011, not recorded until July, 2011.

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates of debt securities will adversely affect the fair value of an investment. The price of a debt security typically moves in the opposite direction of the change in interest rates. The SIB does not have a formal investment policy that limits investment maturities as a means of managing its exposure to potential fair value losses arising from future changes in interest rates.

At June 30, 2013 and 2012, the following tables show the investments by investment type and maturity (expressed in thousands).

| 2013 | Total Fair Value | Less than 1 Year | 1-6 Years | 6-10 Years | More than 10 Years |
|---|---|---|---|---|---|
| Asset Backed Securities | $ 199,406 | $ 301 | $ 99,376 | $ 24,782 | $ 74,947 |
| Bank Loans | 2,928 | - | 2,447 | 481 | - |
| Collateralized Bonds | 325 | - | - | 325 | - |
| Commercial Mortgage-Backed | 72,266 | - | 205 | 1,011 | 71,050 |
| Commercial Paper | 325,951 | 325,951 | - | - | - |
| Corporate Bonds | 895,610 | 70,183 | 536,976 | 140,078 | 148,373 |
| Corporate Convertible Bonds | 23,851 | 237 | 11,481 | 3,071 | 9,062 |
| Government Agencies | 136,027 | 37,219 | 76,811 | 10,765 | 11,232 |
| Government Bonds | 439,887 | 99,659 | 261,554 | 30,147 | 48,527 |
| Gov't Mortgage Backed and CMB | 521,193 | - | 3,742 | 15,179 | 502,272 |
| Guaranteed Fixed Income | - | - | - | - | - |
| Index Linked Government Bonds | 12,289 | 1,442 | 6,894 | - | 3,953 |
| Municipal/Provincial Bonds | 17,273 | - | 7,244 | 867 | 9,162 |
| Non-Government Backed CMOs | 25,052 | - | 3,054 | 729 | 21,269 |
| Other Fixed Income | 9,901 | 482 | 9,419 | - | - |
| Short Term Bills and Notes | 31,442 | 31,442 | - | - | - |
| Funds/Pooled Investments | 924,518 | 5,430 | 554,075 | 120,030 | 244,983 |
| Total Debt Securities | $ 3,637,919 | $ 572,346 | $ 1,573,278 | $ 347,465 | $ 1,144,830 |

| 2012 | Total Fair Value | Less than 1 Year | 1-6 Years | 6-10 Years | More than 10 Years | Maturity not Determined |
|---|---|---|---|---|---|---|
| Asset Backed Securities | $ 102,356 | $ - | $ 48,669 | $ 12,196 | $ 41,491 | $ - |
| Bank Loans | 8,174 | - | 6,647 | 1,527 | - | - |
| Collateralized Bonds | 467 | - | - | 467 | - | - |
| Commercial Mortgage-Backed | 51,641 | 210 | 216 | - | 51,215 | - |
| Commercial Paper | 148,695 | 148,695 | - | - | - | - |
| Corporate Bonds | 654,246 | 37,542 | 300,508 | 149,223 | 166,928 | 45 |
| Corporate Convertible Bonds | 28,737 | 8,096 | 8,126 | 5,265 | 7,250 | - |
| Government Agencies | 122,362 | 6,385 | 85,036 | 16,639 | 14,302 | - |
| Government Bonds | 328,043 | 17,257 | 170,222 | 64,109 | 76,455 | - |
| Gov't Mortgage Backed and CMB | 457,941 | - | 3,530 | 27,893 | 426,518 | - |
| Guaranteed Fixed Income | 4,058 | 4,058 | - | - | - | - |
| Index Linked Government Bonds | 2,664 | - | - | - | 2,664 | - |
| Municipal/Provincial Bonds | 22,267 | 879 | 9,407 | 687 | 11,294 | - |
| Non-Government Backed CMOs | 29,353 | - | 6,277 | 5,441 | 17,635 | - |
| Other Fixed Income | 5,089 | 251 | 4,838 | - | - | - |
| Short Term Bills and Notes | 11,909 | 11,909 | - | - | - | - |
| Funds/Pooled Investments | 645,416 | 67,902 | 285,942 | 121,849 | 169,723 | - |
| Total Debt Securities | $ 2,623,418 | $ 303,184 | $ 929,418 | $ 405,296 | $ 985,475 | $ 45 |

In the table above, the fair values of inflation indexed bonds are reflected in the columns based on their stated maturity dates. The principal balances of these bonds are adjusted every six months based on the inflation index for that period.

Some investments are more sensitive to interest rate changes than others. Variable and floating rate collateralized mortgage obligations (CMOs), asset-backed securities (ABS), interest-only and principal-only securities are examples of investments whose fair values may be highly sensitive to interest rate changes.

Interest-only (IO) and principal-only (PO) strips are transactions which involve the separation of the interest and principal components of a security. They are highly sensitive to prepayments by mortgagors, which may result from a decline in interest rates. The SIB held IOs valued at $4.2 million and $4.8 million, and POs valued at $3.4 million and $3.2 million at June 30, 2013 and 2012 respectively. The SIB has no policy regarding IO or PO strips.

**Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The State Investment Board maintains a highly diversified portfolio of debt securities encompassing a wide range of credit ratings. Although the SIB has no overall policy regarding credit risk, each debt securities manager is given a specific set of guidelines to invest within based on the mandate for which it was hired. The guidelines specify in which range of credit the manager may invest. These ranges include investment grade and high yield categories. The following tables present the SIB’s ratings as of June 30, 2013 and 2012 (expressed in thousands).

| 2013 | Total Fair Value | Credit Rating* A-1 | A-2 | AAA | AA | A | BBB | BB | B | CCC | CC | C | D | NR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Asset Backed Securities | $ 199,406 | $ - | $ - | $ 115,713 | $ 41,692 | $ 24,401 | $ 10,545 | $ 3,274 | $ 2,011 | $ 1,623 | $ 145 | $ - | $ 2 | $ - |
| Bank Loans | 2,928 | - | - | - | - | - | 291 | 2,066 | 571 | - | - | - | - | - |
| Collateralized Bonds | 325 | - | - | 325 | - | - | - | - | - | - | - | - | - | - |
| Commercial Mortgage Backed | 70,815 | - | - | 39,405 | 12,598 | 14,157 | 3,507 | 1,148 | - | - | - | - | - | - |
| Commercial Paper | 325,951 | 14,692 | 311,259 | - | - | - | - | - | - | - | - | - | - | - |
| Corporate Bonds | 895,610 | - | - | 3,853 | 43,139 | 225,872 | 462,032 | 102,342 | 37,470 | 18,932 | 1,529 | - | 441 | - |
| Corporate Convertible Bonds | 23,851 | - | - | - | - | 2,170 | 1,522 | 11,692 | 6,876 | 1,591 | - | - | - | - |
| Gov't Agencies | 136,027 | - | - | 8,534 | 118,474 | 5,256 | 3,763 | - | - | - | - | - | - | - |
| Gov't Bonds | 86,364 | - | - | 500 | 12,507 | 27,039 | 34,309 | 9,386 | 164 | - | - | - | - | 2,459 |
| Gov't Issued Commercial & Gov't Mortgage Backed | 398,611 | - | - | 705 | 397,906 | - | - | - | - | - | - | - | - | - |
| Guaranteed Fixed Income | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Index Linked Corporate Bonds | 1,300 | - | - | - | - | - | 1,300 | - | - | - | - | - | - | - |
| Municipal/Provincial Bonds | 17,273 | - | - | 4,868 | 4,166 | 5,375 | 2,346 | 518 | - | - | - | - | - | - |
| Non-Gov't Backed CMOs | 23,956 | - | - | 1,804 | 5,922 | 6,108 | 5,328 | 234 | 63 | 3,529 | 623 | 276 | 69 | - |
| Other Fixed Income | 9,901 | - | - | 9,901 | - | - | - | - | - | - | - | - | - | - |
| Short Term Bills & Notes | 15,626 | - | - | - | 15,626 | - | - | - | - | - | - | - | - | - |
| Funds/Pooled Investments | 924,518 | - | - | 216,755 | 399,773 | 32,218 | 61,911 | - | 17,519 | - | - | 196,342 | - | - |
| Total Credit Risk of Debt Securities | 3,132,462 | $ 14,692 | $ 311,259 | $ 402,363 | $ 1,051,803 | $ 342,596 | $ 586,854 | $ 130,660 | $ 64,674 | $ 25,675 | $ 2,297 | $ 196,618 | $ 512 | $ 2,459 |
| US Gov't & Agencies ** | 505,457 | | | | | | | | | | | | | |
| Total Debt Securities | $ 3,637,919 | | | | | | | | | | | | | |

| 2012 | Total Fair Value | Credit Rating* A-1 | A-2 | AAA | AA | A | BBB | BB | B | CCC | CC | C | D | NR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Asset Backed Securities | $ 102,356 | $ - | $ - | $ 66,546 | $ 21,144 | $ 5,400 | $ 3,975 | $ 959 | $ 816 | $ 3,382 | $ 129 | $ - | $ 5 | $ - |
| Bank Loans | 8,174 | - | - | - | - | - | 1,690 | 4,634 | 1,850 | - | - | - | - | - |
| Collateralized Bonds | 467 | - | - | 467 | - | - | - | - | - | - | - | - | - | - |
| Commercial Mortgage Backed | 51,641 | - | - | 33,073 | 4,007 | 11,746 | 2,752 | 63 | - | - | - | - | - | - |
| Commercial Paper | 148,695 | 6,499 | 142,196 | - | - | - | - | - | - | - | - | - | - | - |
| Corporate Bonds | 654,246 | - | - | 1,129 | 31,044 | 154,661 | 329,180 | 74,848 | 38,781 | 19,594 | 1,264 | 295 | 2,851 | 599 |
| Corporate Convertible Bonds | 28,737 | - | - | - | - | 9,407 | - | 5,359 | 10,241 | 3,730 | - | - | - | - |
| Gov't Agencies | 115,457 | - | - | 4,643 | 98,647 | 8,076 | 4,091 | - | - | - | - | - | - | - |
| Gov't Bonds | 65,005 | - | - | 7,479 | 5,142 | 31,203 | 15,591 | 5,590 | - | - | - | - | - | - |
| Gov't Issued Commercial & Gov't Mortgage Backed | 360,427 | - | - | - | 360,427 | - | - | - | - | - | - | - | - | - |
| Guaranteed Fixed Income | 4,058 | - | - | - | 4,058 | - | - | - | - | - | - | - | - | - |
| Index Linked Corporate Bonds | 1,117 | - | - | - | - | - | 1,117 | - | - | - | - | - | - | - |
| Municipal/Provincial Bonds | 22,267 | - | - | 5,080 | 7,726 | 6,961 | 896 | 725 | - | - | - | - | - | 879 |
| Non-Gov't Backed CMOs | 29,353 | - | - | 18,110 | 1,437 | 1,586 | 1,931 | 554 | 1,084 | 3,750 | 854 | - | 47 | - |
| Other Fixed Income | 5,089 | - | - | 5,089 | - | - | - | - | - | - | - | - | - | - |
| Funds/Pooled Investments | 645,416 | - | - | 88,548 | 331,989 | 54,842 | 2,609 | 13,303 | 150,277 | - | - | - | - | 3,848 |
| Total Credit Risk of Debt Securities | 2,242,505 | $ 6,499 | $ 142,196 | $ 230,164 | $ 865,621 | $ 283,882 | $ 363,832 | $ 106,035 | $ 203,049 | $ 30,456 | $ 2,247 | $ 295 | $ 2,903 | $ 5,326 |
| US Gov't & Agencies ** | 380,913 | | | | | | | | | | | | | |
| Total Debt Securities | $ 2,623,418 | | | | | | | | | | | | | |

* Ratings are determined in the following order:

1. S&P rating
2. Moody's rating
3. Fitch rating
4. Manager-determined rating (internal rating)
5. If no ratings available using steps 1-4, then shown as not rated.

** US government agency securities explicitly guaranteed by the US government are categorized here. Credit ratings of US government agency securities that are only implicitly guaranteed by the US government are categorized accordingly in the main body of this table. Implicitly guaranteed agency securities included in the *Gov't Mortgage Backed, Gov't Agencies,* and *Short Term Bills and Notes* categories are issued by FNMA, FDIC, FHLB, FHLMC, Federal Financing Corp., SBA, Farmer Mac and Federal Farm Credit.

**Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. Although the SIB does not have a formal investment policy governing foreign currency risk, the SIB does manage its exposure to fair value loss by requiring their international securities investment managers to maintain diversified portfolios to limit foreign currency and security risk. The SIB's exposure to foreign currency risk is presented in the following tables as of June 30, 2013 and 2012 (expressed in thousands).

2013

| Currency | Short-Term | Debt | Equity | Total |
|---|---|---|---|---|
| Australian dollar | $ (7,940) | $ 10,481 | $ 13,350 | $ 15,891 |
| Brazilian real | 1,898 | 4,833 | 6,905 | 13,636 |
| British pound sterling | 13,886 | 5,191 | 71,637 | 90,714 |
| Canadian dollar | 132 | 830 | 17,011 | 17,973 |
| Chilean peso | 3,297 | (2) | - | 3,295 |
| Chinese yuan renminbi | 137 | (2) | - | 135 |
| Columbian peso | 100 | 14 | - | 114 |
| Czech koruna | (1) | 2 | 1,922 | 1,923 |
| Israeli shekel | 42 | - | 1,590 | 1,632 |
| Danish krone | - | - | 1,328 | 1,328 |
| Euro | (15,889) | 22,493 | 127,923 | 134,527 |
| Hong Kong dollar | 128 | - | 18,215 | 18,343 |
| Hungarian forint | (16) | 4,004 | 1,034 | 5,022 |
| Iceland krona | 31 | - | - | 31 |
| Indian rupee | 4,605 | 8 | - | 4,613 |
| Indonesian Rupiah | - | - | 56 | 56 |
| Japanese yen | 14,150 | 72 | 64,525 | 78,747 |
| Malaysian Ringgit | 94 | 4,209 | 2,173 | 6,476 |
| Mexican peso | 317 | 19,102 | - | 19,419 |
| New Zealand dollar | (2,692) | 3,040 | - | 348 |
| Norwegian krone | 449 | 9 | 3,193 | 3,651 |
| Peruvian nuevo sol | (61) | - | - | (61) |
| Philippine peso | - | 2,219 | - | 2,219 |
| Polish zloty | 65 | 4,204 | 1,239 | 5,508 |
| Russian ruble | 15 | (9) | - | 6 |
| Singapore dollar | 450 | (1) | 4,233 | 4,682 |
| South African rand | 91 | 3,100 | 4,024 | 7,215 |
| South Korean won | (4,224) | 4,435 | 8,344 | 8,555 |
| Swedish krona | 1,067 | - | 7,447 | 8,514 |
| Swiss franc | - | - | 29,353 | 29,353 |
| Thai baht | 56 | 1 | 1,172 | 1,229 |
| Turkish lira | (394) | 3,220 | 997 | 3,823 |
| International commingled funds (various currencies) | - | 91,153 | 327,274 | 418,427 |
| Total international investment securities | $ 9,793 | $ 182,606 | $ 714,945 | $ 907,344 |

2012

| Currency | Short-Term | Debt | Equity | Total |
|---|---|---|---|---|
| Australian dollar | $ (11,683) | $ 11,796 | $ 13,446 | $ 13,559 |
| Brazilian real | 217 | 5,362 | 77 | 5,656 |
| British pound sterling | 6,868 | 7,480 | 64,386 | 78,734 |
| Canadian dollar | 338 | 1,249 | 4,004 | 5,591 |
| Chilean peso | 3,152 | - | - | 3,152 |
| Czech koruna | 136 | 1 | - | 137 |
| Israeli shekel | 21 | - | 1,234 | 1,255 |
| Danish krone | 37 | - | 1,600 | 1,637 |
| Euro | (7,385) | 3,435 | 98,386 | 94,436 |
| Hong Kong dollar | 36 | - | 7,471 | 7,507 |
| Hungarian forint | 197 | 3,966 | - | 4,163 |
| Iceland krona | 30 | - | - | 30 |
| Indian rupee | - | - | - | - |
| Indonesian Rupiah | - | - | - | - |
| Japanese yen | (3,317) | - | 50,209 | 46,892 |
| Malaysian Ringgit | - | 4,222 | - | 4,222 |
| Mexican peso | 200 | 12,493 | - | 12,693 |
| New Zealand dollar | (2,382) | 3,330 | - | 948 |
| Norwegian krone | 514 | 6 | 4,425 | 4,945 |
| Philippine peso | - | 2,251 | - | 2,251 |
| Polish zloty | 301 | 5,756 | - | 6,057 |
| Singapore dollar | 405 | 1 | 3,160 | 3,566 |
| South African rand | 56 | 3,967 | - | 4,023 |
| South Korean won | - | 4,428 | 572 | 5,000 |
| Swedish krona | 394 | 1 | 7,034 | 7,429 |
| Swiss franc | - | - | 19,809 | 19,809 |
| Thai baht | - | - | - | - |
| Turkish lira | (307) | 4,774 | - | 4,467 |
| International commingled funds (various currencies) | - | 94,744 | 280,732 | 375,476 |
| Total international investment securities | $ (12,172) | $ 169,262 | $ 556,545 | $713,635 |

## Derivative Securities

Derivatives are financial arrangements between two parties whose payments are based on, or "derived" from, the performance of some agreed upon benchmark. The investment policies of the SIB's clients allow the use of derivative securities to hedge or replicate underlying exposures but not for speculation. All derivatives are considered investment derivative instruments. The fair value of all derivative securities is reported in the statements of net position. At June 30, 2013 and 2012, the SIB had four types of derivative securities: futures, options, swaps and currency forwards.

### Futures

Futures represent commitments to purchase (asset) or sell (liability) securities at a future date and at a specific price. Futures contracts are traded on organized exchanges (exchange traded) thereby minimizing the SIB's counterparty risk. The net change in the futures contracts' value is settled daily in cash with the exchanges. Net gains or losses resulting from the daily settlements are included in net change in fair value of investments in the statements of changes in net position and totaled $90.1 million for fiscal year 2013 and $(35.0) million for fiscal year 2012. At June 30, 2013 and 2012, the SIB investment portfolio had the notional futures balances shown below (expressed in thousands).

| Futures | Notional Value | |
|---|---|---|
| | June 30, 2013 | June 30, 2012 |
| Cash & Cash Equivalent Derivative Futures | | |
| Long | $ 180,058 | $ 188,297 |
| Short | (165,105) | (117,655) |
| Equity Derivative Futures | | |
| Long | 478,996 | 411,726 |
| Short | - | - |
| Fixed Income Derivative Futures | | |
| Long | 3,124 | 4,710 |
| Short | (64,623) | (31,035) |
| Total Futures | $ 432,450 | $ 456,043 |

### Options

Options represent or give buyers the right, but not the obligation, to buy (call) or sell (put) an asset at a preset price over a specified period. Options are traded on organized exchanges (exchange traded) thereby minimizing the SIB's counterparty credit risk. The option's price is usually a small percentage of the underlying asset's value. As a seller of a financial option, the SIB, through its investment manager, receives a premium at the beginning of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. As a buyer of a financial option, the SIB, through its investment manager, pays a premium at the beginning of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option. Gains and losses on options are determined based on fair values and recorded with the net change in fair value of investments in the statements of changes in net position and totaled $43,000 for fiscal year 2013 and $0.4 million for fiscal year 2012. At June 30, 2013 and 2012, the SIB investment portfolio had the following option balances (expressed in thousands).

| Options | Fair Value June 30, 2013 | Fair Value June 30, 2012 |
|---|---|---|
| Cash & Cash Equivalent Options | | |
| Call | $ - | $ - |
| Put | - | 1 |
| Equity Options | | |
| Call | - | - |
| Put | - | - |
| Fixed Income Options | | |
| Call | - | - |
| Put | - | 5 |
| Total Options | $ - | $ 6 |

**Swaps**

A swap is a derivative in which counterparties exchange certain benefits of one party's financial instrument for those of the other party's financial instrument. Specifically, the two counterparties agree to exchange one stream of cash flows for another stream. The SIB, through its investment managers, has entered into various swap agreements in an attempt to manage its exposure to interest rate and credit risk.

Interest rate risk represents the exposure to fair value losses arising from future changes in prevailing market interest rates. In the most common type of interest rate swap arrangement, one party agrees to pay fixed interest payments on designated dates to a counterparty, who in turn agrees to make return interest payments that float with some reference rate.

Credit risk represents the exposure to fair value losses arising from a credit event such as default, failure to pay, restructuring or bankruptcy. In a credit default swap (CDS) contract, the protection buyer of the CDS makes a series of payments to the protection seller and, in exchange, receives a payoff if the credit instrument experiences a credit event. CDS contracts are also used to establish exposure to a desired credit instrument.

Gains and losses on swaps are determined based on fair values and are recorded with the net change in fair value of investments in the statements of changes in net position and totaled $(933) thousand for fiscal year 2013 and $921 thousand for fiscal year 2012. The maximum loss that would be recognized at June 30, 2013 and 2012, if all counterparties failed to perform as contracted is $4.25 million and $1.75 million respectively. Swap fair values are determined by a third party pricing source. At June 30, 2013 and 2012, the SIB's investment portfolio had the swap fair value balances as shown below (expressed in thousands).

## Credit Default Swaps

| Counterparty/Moody's Rating | Notional Amount | Expiration Date | Fair Value June 30, 2013 | Fair Value June 30, 2012 |
|---|---|---|---|---|
| JP Morgan Chase Bank N.A./Aa3 (3 contracts) | $ 11,000 | 10/12/2052 | $ - | $ 396 |
| JP Morgan Chase Bank N.A./Aa3 | 400 | 3/20/2017 | - | 12 |
| JP Morgan Chase Bank N.A./Aa3 (3 contracts) | 12,700 | 6/20/2017 | - | 73 |
| Deutsche Bank AG New York/Aa3 | 45 | 3/20/2014 | - | (5) |
| Deutsche Bank AG New York/Aa3 | 120 | 9/20/2013 | - | - |
| Morgan Stanley Cap Services NY/Baa1 (3 contracts) | 300 | 3/20/2013 | - | 2 |
| Citibank N.A. NY/A3 | 2,000 | 6/20/2017 | - | 68 |
| Bank of America N.A./A3 | 1,560 | 12/20/2017 | 6 | - |
| Credit Suisse International London/A1 | 240 | 12/20/2016 | (15) | - |
| Deutsche Bank AG New York/A2 (3 contracts) | 2,160 | 12/20/2016 | (135) | - |
| Deutsche Bank AG New York/A2 | 120 | 9/20/2013 | - | - |
| Deutsche Bank AG New York/A2 | 1,560 | 6/20/2017 | 1 | - |
| Deutsche Bank AG New York/A2 (2 contracts) | (3,250) | 12/20/2017 | 34 | - |
| Deutsche Bank London/A2 | 1,560 | 6/20/2017 | 1 | - |
| Deutsche Bank London/A2 | 1,560 | 12/20/2017 | 6 | - |
| JP Morgan Chase U.S. NYC/Aa3 | 400 | 3/20/2017 | - | - |
| JP Morgan Chase N.A./Aa3 (4 contracts) | 12,700 | 6/20/2017 | (140) | - |
| JP Morgan Chase N.A./Aa3 (2 contracts) | 4,400 | 12/20/2017 | (46) | - |
| JP Morgan Chase N.A./Aa3 (3 contracts) | 30 | 10/12/2052 | 1 | - |
| Total Credit Default Swaps | $ 49,605 | | $ (287) | $ 546 |

## Interest Rate Swaps

| Counterparty | Notional Amount | Rate Range | Counterparty Rate | Expiration Date Range | Counterparty Rating (Moody's) | Fair Value June 30, 2013 | Fair Value June 30, 2012 |
|---|---|---|---|---|---|---|---|
| Bank of Nova Scotia (4 contracts) | $ (493) | 0.751% to 1.355% | Various overnight bank rates depending on currency | 08/2013 - 10/2019 | Aa2 | $ 34 | |
| Barclays Bank PLC London (2 contracts) | (53) | 2.065% to 4.423% | | 12/2027 - 12/2032 | A2 | 2 | |
| Barclays Bank PLC New York (13 contracts) | 6,047 | 0.359% to 5.750% | | 08/2012 - 02/2022 | A2 | | 8 |
| Barclays Bank PLC New York (6 contracts) | 4,240 | 0.00% to 5.48% | | 07/2013 - 12/2037 | A2 | (108) | |
| Barclays Capital Securities London (7 contracts) | 3,124 | 1.10% to 6.60% | | 02/2013 - 02/2022 | A2 | | 20 |
| Barclays Capital Securities London (9 contracts) | 1,800 | 0.00% to 7.42% | | 09/2013 - 05/2023 | A2 | (19) | - |
| Citibank N.A. New York (11 contracts) | 5,426 | 0.62% to 7.70% | | 11/2012 - 06/2022 | A3 | | 151 |
| Citibank N.A. New York (14 contracts) | (2,094) | 0.349% to 4.50% | | 12/2014 - 04/2023 | A3 | 57 | |
| Citibank London (3 contracts) | 1,364 | 0.695% to 4.42% | | 01/2016 - 06/2017 | A3 | (58) | |
| Credit Suisse First Boston Corporation (5 contracts) | 1,783 | 0.689% to 7.25% | | 06/2018 - 05/2023 | A1 | (6) | |
| Deutsche Bank London (2 contracts) | 670 | 1.96% to 3.12% | | 10/2013 - 01/2014 | A2 | - | |
| Deutsche Bank Singapore (1 contract) | 316 | 0.345% | | 7/21/2012 | A2 | | (0) |
| Goldman Sachs Bank USA (2 contracts) | 233 | 0.52% to 1.438% | | 4/19/2020 | A2 | 3 | |
| HSBC Bank USA New York (1 contract) | 190 | 3.810% | | 1/3/2028 | A1 | | 75 |
| HSBC Bank USA New York (6 contracts) | 2,277 | 0.38% to 3.81% | | 07/2013 - 01/2028 | A1 | 54 | |
| JP Morgan Chase Bank N.A. (4 contracts) | (4,109) | 0.913% to 6.380% | | 07/2012 - 01/2028 | Aa3 | | (8) |
| JP Morgan Chase Bank N.A. (5 contracts) | 206 | 0.654% to 4.74% | | 07/2013 - 08/2016 | Aa3 | (23) | |
| Morgan Stanley Capital Services NY (1 contract) | 290 | 6.370% | | 5/25/2022 | Baa1 | | 11 |
| Morgan Stanley Capital Services NY (1 contract) | 299 | 6.370% | | 5/25/2022 | Baa1 | (4) | |
| Morgan Stanley Capital Group Inc. NY (1 contract) | 1,090 | 1.355% | | 2/15/2020 | Baa1 | (48) | |
| Morgan Stanley & Co. Inc. NY (5 contracts) | (2,435) | 1.155% to 6.06% | | 10/2013 - 05/2022 | Baa1 | 27 | |
| Total Interest Rate Swaps | $ 20,171 | | | | | $ (89) | $ 257 |

**Currency Forwards**

Currency forwards represent forward exchange contracts that are entered into in order to manage the exposure to changes in currency exchange rates on the currency denominated portfolio holdings. A forward exchange contract is a commitment to purchase or sell a currency at a future date at a negotiated forward rate. The gain or loss arising from the difference between the original contracts and the closing of such contracts is included in the net change in fair value of investments in the statements of changes in net position and totaled $0.2 million for fiscal year 2013 and $0.9 million for fiscal year 2012. At June 30, 2013 and 2012, the SIB's investment portfolio included the currency forwards balances shown below (expressed in thousands).

| | | | | Fair Value | |
|---|---|---|---|---|---|
| Currency | Cost | Purchases | Sales | 6/30/2013 | 6/30/2012 |
| Australian dollar | $ (10,009) | $ 1,996 | $ (12,005) | $ (8,874) | $ (9,486) |
| Brazilian real | 2,087 | 2,087 | - | 1,899 | 217 |
| British pound sterling | 8,263 | 9,121 | (858) | 8,074 | 7,108 |
| Canadian dollar | 108 | 1,259 | (1,151) | 98 | 300 |
| Chilean peso | 3,369 | 3,501 | (132) | 3,296 | 3,152 |
| Chinese yuan renminbi | 132 | 522 | (390) | 138 | - |
| Colombian peso | 102 | 102 | - | 101 | - |
| Czech koruna | 1 | 606 | (605) | (2) | 132 |
| Euro | (23,251) | 638 | (23,889) | (23,087) | (3,451) |
| Hungarian forint | (35) | 836 | (871) | (35) | 197 |
| Indian rupee | 4,741 | 4,803 | (62) | 4,605 | - |
| Japanese yen | (353) | 604 | (957) | (345) | (1,859) |
| South Korean won | (4,365) | 68 | (4,433) | (4,225) | - |
| Malaysian ringgit | 68 | 68 | - | 68 | - |
| Mexican peso | 323 | 1,465 | (1,142) | 317 | 199 |
| New Zealand dollar | (2,720) | 1,260 | (3,980) | (2,694) | (2,382) |
| Norwegian krone | 402 | 2,269 | (1,867) | 373 | 263 |
| Peruvian nuevo sol | (61) | 56 | (117) | (61) | - |
| Polish zloty | 81 | 864 | (783) | 66 | 300 |
| Russian ruble | 32 | 2,180 | (2,148) | 15 | - |
| Singapore dollar | 394 | 2,063 | (1,669) | 378 | 367 |
| South African rand | - | - | - | - | 55 |
| Swedish krona | 409 | 1,779 | (1,370) | 388 | 205 |
| Turkish lira | (425) | 420 | (845) | (395) | 3,919 |
| United States dollar | 20,705 | 59,271 | (38,566) | 20,705 | 843 |
| Total forwards subject to currency risk | | | | $ 803 | $ 79 |

**Derivative Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the value of an interest rate-based derivative investment. The SIB does not have a formal investment policy regarding such derivative investments. At June 30, 2013 and 2012, the tables below show the SIB's derivative investments subject to interest rate risk (expressed in thousands).

**2013**

| | Total Notional Value | 3 months or less | 3 to 6 months | 6 to 12 months | 1-5 years | Greater than 5 years |
|---|---|---|---|---|---|---|
| Futures-interest rate contracts | $ (218,918) | $ (38,025) | $ (98,722) | $ (89,857) | $ 7,686 | $ - |

| | Total Fair Value | 3 months or less | 3 to 6 months | 6 to 12 months | 1-5 years | Greater than 5 years |
|---|---|---|---|---|---|---|
| Options on interest rate futures | $ - | $ - | $ - | $ - | $ - | $ - |
| Swaps - interest rate contracts | (90) | 22 | 10 | (31) | (142) | 51 |
| Total | $ (90) | $ 22 | $ 10 | $ (31) | $ (142) | $ 51 |

**2012**

| | Total Notional Value | 3 months or less | 3 to 6 months | 6 to 12 months | 1-5 years | Greater than 5 years |
|---|---|---|---|---|---|---|
| Futures-interest rate contracts | $ (151,319) | $ (98,853) | $ (2,736) | $ (42,526) | $ (7,204) | $ - |

| | Total Fair Value | 3 months or less | 3 to 6 months | 6 to 12 months | 1-5 years | Greater than 5 years |
|---|---|---|---|---|---|---|
| Options on interest rate futures | $ 6 | $ - | $ 6 | $ - | $ - | $ - |
| Swaps - interest rate contracts | 257 | 6 | 4 | 16 | 30 | 201 |
| Total | $ 263 | $ 6 | $ 10 | $ 16 | $ 30 | $ 201 |

## Alternative Investments

The AICPA defines Alternative Investments for the purpose of performing audits. The definition includes investments for which a readily determinable fair value does not exist (that is, investments not listed on national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or Nasdaq). These types of investments can be held within any of the asset classes used by the SIB based on underlying portfolio holdings and analysis of risk and return relationships. These investments can be structured in different ways, including limited partnerships, limited liability companies, common trusts and mutual funds. Some are closed-ended with a specific life and capital commitment while others are open-ended with opportunity for ad hoc contributions or withdrawals and termination upon proper notice.

**Commingled/Mutual Funds —** These types of funds are generally open-ended funds and may be utilized in equity or fixed income asset classes. They are funds made up of underlying securities that have readily available fair values (publicly traded stocks or bonds). The SIB owns units of these funds rather than the individual securities. Contributions or withdrawals from these funds can be made as needed.

**Private Equity —** Private Equity investments are typically private interests in corporations across different areas of the capital structure and in different stages of the corporations' development via limited partnership vehicles. Private Equity investments are illiquid and long term in nature (10-12 years), typically held until maturity. Private Equity portfolios generally have a "J-Curve Effect" whereby there are low to negative returns in the initial years due to the payment of investment management fees and initial funding of investments made by the General Partner during a period when investments are typically carried at cost and returns have not been realized. To diversify the program, Private Equity investments are made across business cycles, vintage years, and different strategies. The SIB has a dedicated asset class for private equity investments.

**Venture Capital —** these include investments in companies in a range of stages of development from start-up/seed stage, early stage, and later/expansion stage. Investments are typically made in years one through six and returns typically occur in years four through ten.

**Buyouts —** these include investments in funds that seek out and purchase underperforming or undervalued companies in order to improve them and sell them or take them public many years later. These funds are also often involved in management buyouts, which are buyouts conducted by the management of the company being purchased, and they often play key roles in leveraged buyouts, which are buyouts that are funded with borrowed money.

**Distressed Debt —** these include investments in the debt instruments of companies which may be publicly traded or privately held that are financially distressed and are either in bankruptcy or likely candidates for bankruptcy. Typical holdings are senior and subordinated debt instruments, mortgages and bank loans. The SIB is including these types of investments in its private equity asset class.

**Mezzanine Debt** — This strategy is a hybrid of debt and equity financing. It is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to senior debt. The SIB utilizes this strategy, through a limited partnership structure, in its below investment grade fixed income allocation.

**Equity Long/Short —** This strategy is a combination of long and short positions, primarily in publicly traded equities. The SIB utilizes this strategy within its US equity allocations.

**Real Estate and Real "Tangible" Assets —** These investments are intended to provide allocations to tangible assets that are expected to be inflation protected and provide performance above the inflation rate as indicated by the CPI. Investments are generally structured as limited partnerships or limited liability companies. Investments in Real Estate and Real Assets include:

**Real Estate** — includes investments in private vehicles through limited partnerships or commingled vehicles that have an ownership interest in direct real estate properties. The investment strategies may include "value added" strategies, which derive their return from both income and appreciation, "opportunistic", which derive their return primarily through appreciation, and "alternative" which invest in less traditional types of property. Both domestic and international real estate funds are utilized. The SIB has a dedicated asset class for these types of investments.

**Timberland** — includes investments in limited liability companies that have an ownership interest in properties where the value of the property is derived mainly from income-producing timber but also from the "higher and better use" value of the underlying land. The SIB has a dedicated asset class for these types of investments.

**Infrastructure** — includes investments in limited partnerships that have an ownership interest in transportation assets such as toll roads, tunnels and bridges; and regulated assets such as electricity transmission, gas and oil distribution and wastewater collection. Other possible investments would include communication assets and social infrastructure. The SIB has a dedicated asset class for these types of investments.

**Securities Lending**

There was no securities lending program in place for the fiscal years ended June 30, 2013 and 2012.

## Note 4 - Capital Assets

| | June 30, 2011 | Additions | Retirements | June 30, 2012 | Additions | Retirements | June 30, 2013 |
|---|---|---|---|---|---|---|---|
| Office equipment | $19,321 | $ - | $ - | $19,321 | $ - | $ - | $19,321 |
| Less accumulated depreciation on office equipment | (16,271) | (2,288) | - | (18,559) | (762) | - | (19,321) |
| Software | 1,213,500 | - | - | 1,213,500 | - | - | 1,213,500 |
| Less accumulated depreciation on software | (1,213,500) | - | - | (1,213,500) | - | - | (1,213,500) |
| | $3,050 | | | $762 | | | $0 |

## Note 5 - State Agency Transactions

**Due From/To Other State Agencies**

Amounts due from/to other state agencies are as follows as of June 30, 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| Due To | | |
| Information Technology Department | $ 7,010 | $ 6,234 |
| Office of Attorney General | 1,035 | 1,336 |
| Office of Management and Budget | 910 | 9,750 |
| Total due to other state agencies | $ 8,955 | $ 17,320 |
| Due From | | |
| Public Employees Retirement System | $ 616 | $ 1,461 |
| Total due from other state agencies | $ 616 | $ 1,461 |

These balances are a result of a time lag between the dates that services are provided, the payments are made, and the transactions are entered into the accounting system.

## Note 6 - Operating Leases

RIO leases office space under an operating lease effective July 1, 2011 through June 30, 2013. RIO also incurs rent expense at other locations on a temporary basis to sponsor retirement education for TFFR members. Rent expense totaled $77,948 and $77,983 for fiscal 2013 and 2012. Minimum payments under the lease for fiscal 2014 are $78,467.

## Note 7 - Changes in Noncurrent Liabilities

Changes in noncurrent liabilities for the years ended June 30, 2013 and 2012 are summarized as follows:

| | Beginning Balance 7/1/2012 | Additions | Reductions | Ending Balance 6/30/2013 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| Accrued Leave | $136,458 | $94,877 | ($84,220) | $147,115 | $71,864 |

| | Beginning Balance 7/1/2011 | Additions | Reductions | Ending Balance 6/30/2012 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| Accrued Leave | $129,737 | $82,071 | ($75,350) | $136,458 | $69,848 |

Pension and Investment Trust Funds liquidate the accrued annual leave.

## Note 8 - North Dakota Teachers' Fund for Retirement

### General

The following brief description of TFFR is provided for general information purposes only. Participants should refer to NDCC Chapter 15-39.1 for more complete information.

TFFR is a cost-sharing multiple-employer defined benefit pension plan covering all North Dakota public teachers and certain other teachers who meet various membership requirements. TFFR provides for pension, death and disability benefits. The cost to administer the TFFR plan is financed by investment income and contributions.

### Membership

As of June 30, 2013 and 2012, the number of participating employer units was 220 and 222, respectively, consisting of the following:

| | 2013 | 2012 |
|---|---|---|
| Public School Districts | 179 | 180 |
| County Superintendents | 7 | 8 |
| Special Education Units | 19 | 19 |
| Vocational Education Units | 5 | 5 |
| Other | 10 | 10 |
| Total | 220 | 222 |

TFFR's membership consisted of the following:

| | 2013 | 2012 |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits | 7,489 | 7,151 |
| Terminated employees - vested | 1,500 | 1,483 |
| Terminated employees - nonvested | 563 | 468 |
| Total | 9,552 | 9,102 |
| Current employees | | |
| Vested | 7,465 | 7,570 |
| Nonvested | 2,673 | 2,444 |
| Total | 10,138 | 10,014 |

**Investments**

Current investment guidelines set by TFFR's board specify the percentage of assets to be invested in various types of investments (global equities, global fixed income, global real assets, and cash). The Board has set 8% as the plan's actuarially assumed rate of return. Long-term performance goals are set and evaluated by the boards of SIB and TFFR for each type of investment.

**Realized Gains and Losses**

Realized gains and losses on sales of investments are components of net appreciation in fair value of investments and are computed as described in Note 1. For the years ended June 30, 2013 and 2012, TFFR had net realized gains of $73,604,646 and $10,017,507 respectively.

**Investment Expenses**

Investment expenses consist of fees charged by RIO for investment managers and investment-related service fees from The Northern Trust Company, the Bank of North Dakota, and certain other investment advisors. All TFFR expenses are paid out of TFFR assets.

**Member and Employer Contributions**

Member and employer contributions paid to TFFR are set by NDCC Section 15-39.1-09. Every eligible teacher in the State of North Dakota is required to be a member of TFFR and is assessed at a rate of 9.75% of salary as defined by NDCC Section 15-39.1-04. Every governmental body employing a teacher must also pay into TFFR a sum equal to 10.75% of the teacher's salary. Member contributions will increase to 11.75% on 7/1/2014. Employer contributions will increase to 12.75% on 7/1/2014. Member and employer contributions will be reduced to 7.75% each when the fund reaches 100% funded ratio on an actuarial basis.

A vested member who terminates covered employment may elect a refund of contributions paid plus 6% interest or defer payment until eligible for pension benefits. A nonvested member who terminates covered employment must claim a refund of contributions paid before age 70½. Refunded members forfeit all service credits under TFFR. These service credits may be repurchased upon return to covered employment under certain circumstances, as defined by the NDCC.

**Pension Benefits**

For purposes of determining pension benefits, members are classified within one of two "tiers." Tier 1 members are those with service credit on file as of July 1, 2008, and Tier 2 members are those newly employed and returning refunded members on or after July 1, 2008. (Note: Legislation approved in 2011 will modify pension eligibility requirements for certain non-grandfathered Tier 1 members and Tier 2 members effective 7/1/2013.)

**Tier 1**

A Tier 1 member is entitled to receive unreduced benefits when three or more years of credited service as a teacher in North Dakota have accumulated, the member is no longer employed as a teacher and the member has reached age 65, or the sum of age and years of service credit equals or exceeds 85. TFFR permits early retirement from ages 55 to 64, with benefits actuarially reduced by 6% per year for every year the member's retirement age is less than 65 years or the date as of which age plus service equal 85. In either case, benefits may not exceed the maximum benefits specified in Section 415 of the Internal Revenue Code.

Pension benefits paid by TFFR are determined by NDCC Section 15-39.1-10. Monthly benefits under TFFR are equal to the three highest annual salaries earned divided by 36 months and multiplied by 2.00% times the number of service credits earned. Retirees may elect payment of benefits in the form of a single life annuity, 100% or 50% joint and survivor annuity, ten or twenty-year term certain annuity, partial lump-sum option or level income with Social Security benefits. Members may also qualify for benefits calculated under other formulas.

**Tier 2**

A Tier 2 member is entitled to receive unreduced benefits when five or more years of credited service as a teacher in North Dakota have accumulated, the member is no longer employed as a teacher and the member has reached age 65, or the sum of age and years of service credit equals or exceeds 90. TFFR permits early retirement from ages 55 to 64, with benefits actuarially reduced by 6% per year for every year the member's retirement age is less than 65 years or the date as of which age plus service equal 90. In either case, benefits may not exceed the maximum benefits specified in Section 415 of the Internal Revenue Code.

Pension benefits paid by TFFR are determined by NDCC Section 15-39.1-10. Monthly benefits under TFFR are equal to the five highest annual salaries earned divided by 60 months and multiplied by 2.00% times the number of service credits earned. Retirees may elect payment of benefits in the form of a single life annuity, 100% or 50% joint and survivor annuity, ten or twenty-year term certain annuity, partial lump-sum option or level income with Social Security benefits. Members may also qualify for benefits calculated under other formulas.

**Death and Disability Benefits**

Death benefits may be paid to a member's designated beneficiary. If a member's death occurs before retirement, the benefit options available are determined by the member's vesting status prior to death. If a member's death occurs after retirement, the death benefit received by the beneficiary (if any) is based on the retirement plan the member selected at retirement.

An active member is eligible to receive disability benefits when: (a) a total disability lasting 12 months or more does not allow the continuation of teaching, (b) the member has accumulated one year of credited service in North Dakota, and (c) the Board of Trustees of TFFR has determined eligibility based upon medical evidence. The amount of the disability benefit is computed by the retirement formula in NDCC Section 15-39.1-10 without consideration of age and assuming the member has a minimum of 20 years of credited service. There is no actuarial reduction for reason of disability retirement. (Note: Legislation approved in 2011 will modify disability eligibility requirements and benefit calculations effective 7/1/2013.)

**Funded Status and Funding Progress**

The funded status of the Defined Benefit Plan as of the most recent actuarial valuation date is as follows (in millions):

| Actuarial Valuation Date | Actuarial Value of Plan Assets | Actuarial Accrued Liability (AAL) | Unfunded Actuarial Accrued Liability (UAAL) | Funded Ratio | Annual Covered Payroll | UAAL as a Percentage of Annual Covered Payroll |
|---|---|---|---|---|---|---|
| 2013 | $ 1,762.3 | $ 2,997.1 | $ 1,234.8 | 58.8% | $ 526.7 | 234.4% |

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear funding trend information as obtained from TFFR's independent actuary's annual valuation report.

Expressing the actuarial value of assets as a percentage of the actuarial accrued liabilities provides an indication whether the plan is becoming financially stronger or weaker. Generally, the greater the percentage the stronger the retirement plan. Trends in unfunded actuarial accrued liabilities and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liabilities as a percentage of annual covered payroll aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage the stronger the retirement plan.

The accompanying schedule of employer contributions, presented as required supplementary information following the notes to the financial statements, presents trend information about the amounts contributed to the plan by employers in comparison to the Annual Required Contribution (ARC). The ARC is actuarially determined in accordance with the parameters of GASB Statement 50. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years.

Additional information as of the latest actuarial valuation follows:

| | | |
|---|---|---|
| Valuation date | July 1, 2013 | July 1, 2012 |
| Actuarial cost method | Entry Age Normal | Entry Age Normal |
| Amortization method | Level percent of payroll, assuming payroll increases of 3.25% per annum | Level percent of payroll, assuming payroll increases of 3.25% per annum |
| Amortization period | 30-year closed period, effective July 1, 2013 | 30-year open period |
| Asset valuation method | Market value of assets less unrecognized returns in each of last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five-year period. The actuarial value is further adjusted, if necessary, to be within 20% of the market value. | Market value of assets less unrecognized returns in each of last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five-year period. |
| Actuarial assumptions: | | |
| Investment rate of return | 8.00% | 8.00% |
| Projected salary increases | 4.50% to 14.75% | 4.50% to 14.75% |
| Inflation | 3.00% | 3.00% |
| Cost of living adjustments | None | None |

**TFFR Plan Changes Affecting Audit Period**

1. Effective with the July 1, 2013 actuarial valuation, the Trustees adopted an Actuarial Funding Policy, which includes the following:

   - Actuarial Cost Method: The Entry Age Normal method shall be applied to the projected benefits in determining the Normal Cost and the Actuarial Accrued Liability. The Normal Cost shall be determined as a level percentage of pay on an individual basis for each active member based on the benefit provisions applicable to that member.
   - Asset Smoothing Method: The investment gains or losses of each valuation period, as a result of comparing the actual market return to the expected market return, shall be recognized in level amounts over 5 years in calculating the Actuarial Value of Assets. Deferred investment gains or losses cannot exceed a corridor of 20% of the Market Value of Assets (i.e., the Actuarial Value of Assets cannot be more than 120%, nor less than 80%, of the Market Value of Assets as of any valuation date).

- Amortization Policy: The Unfunded Actuarial Accrued Liability shall be amortized over a "closed" 30-year period that began July 1, 2013.

2. Prior to adoption of the Actuarial Funding Policy, the Actuarial Cost Method used for valuation purposes was "ultimate" entry age normal with normal cost determined for each member based on the ultimate schedule of benefits (e.g., the normal cost for a Tier 1 Grandfathered member was based on the benefits applicable to Tier 2 members). The change in Entry Age Normal valuation approach resulted in a decrease in accrued liability of $11,150,759.

3. The employer statutory contribution rate for the fiscal year beginning July 1, 2013 under the North Dakota Century Code is equal to 10.75% of payroll for employers. Compared to the annual required contribution of 10.26% of payroll, the contribution sufficiency is 0.49% of payroll as of July 1, 2013.

4. The 2011 legislative changes included increases to the statutory contribution rates: 2% each for employer and member effective July 1, 2012 and an additional 2% each for employer and member effective July 1, 2014. Employer and member contributions will be reset to 7.75% each once the Fund reaches a 100% funded ratio, measured using the actuarial value of assets. The 10.26% annual required contribution stated above reflects the actuarial present value of the increased statutory contributions scheduled to occur July 1, 2014.

5. The funding ratio based on the actuarial value of assets over the actuarial accrued liability as of July 1, 2013, is 58.8%, compared to 60.9% as of July 1, 2012. This ratio is a measure of funding status, its history is a measure of funding progress, and is the ratio required to be reported under GASB 25. The total 8% increase in the statutory contribution rates is expected to improve the funding ratio of the plan over time.

6. For the year ended June 30, 2013, Segal has determined that the asset return on a market value basis was 13.4%. After gradual recognition of investment gains and losses under the actuarial smoothing method, the actuarial rate of return was 2.7%. This represents an experience loss when compared to the assumed rate of 8%. As of June 30, 2013, the actuarial value of assets ($1.762 billion) represented 95.8% of the market value ($1.840 billion).

7. The portion of deferred investment gains and losses recognized during the calculation of the July 1, 2013, actuarial value of assets contributed to a loss of $91,132,324. In addition, the demographic and liability experience resulted in a $4,300,712 loss.

8. As mentioned above, the current method used to determine the actuarial value of assets yields an amount that is 95.8% of the market value of assets as of June 30, 2013. 95.8% falls within the 20% corridor, so no further adjustment to the actuarial value of assets is necessary. Guidelines in Actuarial Standard of Practice No. 44 (Selection and Use of Asset Valuation Methods for Pension Valuations) recommend that asset values fall within a reasonable range around the corresponding market value. The actuarial asset method complies with these guidelines.

9. The actuarial valuation report as of July 1, 2013, is based on financial data as of the date. Changes in the value of assets subsequent to that date are not reflected. Declines in asset values will increase the cost of the plan, while increases in asset values (in excess of expected) will decrease the cost of the plan.

10. The Fund's cash flow (contributions minus benefit payments, refunds, and expenses) as a percentage of the market value of assets is -1.9% as of June 30, 2013, compared to -3.1% as of June 30, 2012. The scheduled increases in the employer and member contribution rates will continue to improve the cash flow percentage, assuming all other experience emerges as expected.

## Note 9 - Public Employees Retirement System (PERS)

Permanent employees of RIO participate in PERS, which is also an agency of the State of North Dakota financial reporting entity and is included in the State of North Dakota's Comprehensive Annual Financial Report. PERS is a cost-sharing multiple-employer defined benefit public employee retirement system that provides retirement, disability and death benefits to eligible employees and beneficiaries. PERS is administered in accordance with NDCC Chapter 54-52. PERS issues a publicly available financial report that may be obtained by writing to North Dakota Public Employees Retirement System, 400 East Broadway, Suite 505, Bismarck, North Dakota 58501 or by calling 1-800-803-7377.

The financial statements of PERS are prepared using the accrual basis of accounting. Contributions are recognized in the period in which they are due. Benefits and refunds are recognized when due and payable in accordance with the terms of PERS.

RIO is required to contribute to PERS at an actuarially determined rate for permanent employees. The current contribution rate (as of January 1, 2013) is 10.12% of annual covered payroll as established by the NDCC. Prior to that date the contribution rate was 9.12% (as of January 1, 2012) and 8.12% prior to January 1, 2012. RIO's contributions to PERS for the years ended June 30, 2013, 2012, and 2011, were $108,353, $102,664 and $84,091, equal to the required contributions for each year plus a 1.14% contribution for retiree health benefits.

## Note 10 - Related Parties

As stated in Note 1, RIO is an agency of the State of North Dakota; as such, other agencies of the state are related parties.

## Note 11 - Commitments

The State Investment Board has at June 30, 2013, committed to fund certain alternative investment partnerships in the amount of $900.0 million. Funding of $694.1 million has been provided leaving an unfunded commitment of approximately $205.9 million.

## Note 12 - Litigation

*WG Trading*

In February, 2009, the State Investment Board (SIB) was notified of legal action being taken against one of its investment advisors. The principals of WG Trading Company, the broker/dealer for the Westridge Capital Management portfolios, were charged with securities fraud for allegedly diverting investor funds for their personal use. The SIB was an investor along with numerous other public and private pension funds. Investors had been offered two options: invest directly in WG Trading Company (WGTC) by purchasing a limited partnership interest in it; or lend money to WG Trading Inc. (WGTI). WGTC was subject to SEC regulation, capital requirements, reporting and oversight, whereas WGTI was an unregulated and unaudited entity. SIB chose to invest directly in the regulated, audited WGTC.

At the time the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) charges were filed, the court appointed a receiver to take control of any recoverable assets. The receiver recommended the court distribute the recovered assets as follows: pool the assets of WGTC and WGTI, and distribute those assets *pro rata* to all investors. The receiver's method did not take into consideration the terms in which each investor entered into the investment (i.e. limited partnership interest versus note holder agreement), even though the majority of the WGTC assets were intact and the fraud predominantly occurred with WGTI. The SIB joined with other WGTC investors and objected to a *pro rata* distribution to all investors. The receiver and the WGTI investors opposed. The court agreed with the receiver and in April, 2011, the recovered assets were distributed to all investors in a *pro rata* distribution based on net investment balances. The SIB received a total distribution of $63.9 million, which represented approximately 85% of its remaining cost basis with WGTC.

The SIB did not agree with the method used to distribute the assets, and along with the other WGTC limited partners appealed the District Court's ruling. It was the SIB's position that the District Court incorrectly determined the amount of the distribution; and that the audited limited partners were entitled to a greater share of the recovered assets than the unaudited note holders. In April, 2013, the District Court's original ruling was upheld by the United States Court of Appeals for the Second Circuit and the SIB received an additional $3.1 million *pro rata* distribution, bringing the total distributions received to $67.1 million. It should be noted that the receiver continues to pursue certain "clawback" actions and to dispose of various real and personal property held by the receiver in order to recover additional funds that may eventually be distributed to the investors, including the SIB. While future additional distributions are possible, the amount of any additional distributions to the SIB will likely be small as compared to the prior distributions. Total distributions to date have resulted in a net realized loss attributable to the fraud of $8.2 million which was allocated to the participating pooled funds as follows (expressed in thousands):

| | Initial Recovery April 2011 (in thousands) | Subsequent Recovery April 2013 (in thousands) | Cost Basis (in thousands) | Net Realized loss (in thousands) |
|---|---|---|---|---|
| Teachers' Fund for Retirement | $ 23,001 | $ 1,129 | $ 27,080 | $ (2,950) |
| Public Employees Retirement System | 26,012 | 1,277 | 30,626 | (3,337) |
| Bismarck City Employee Pension Plan | 503 | 25 | 592 | (64) |
| Bismarck City Police Pension Plan | 268 | 13 | 316 | (35) |
| Job Service of ND | 1,408 | 69 | 1,657 | (180) |
| City of Fargo Employee Pension Plan | 445 | 22 | 524 | (57) |
| Workforce Safety & Insurance | 10,616 | 521 | 12,499 | (1,362) |
| State Fire & Tornado | 512 | 25 | 603 | (66) |
| State Bonding | 51 | 2 | 60 | (7) |
| Risk Mgmt | 88 | 4 | 104 | (12) |
| Risk Mgmt Work Comp | 63 | 3 | 74 | (8) |
| Insurance Regulatory Trust Fund | 16 | 1 | 18 | (1) |
| Petroleum Tank Release Comp Fund | 155 | 8 | 182 | (19) |
| ND Ass'n of Counties Fund | 54 | 3 | 64 | (7) |
| City of Bismarck Deferred Sick Leave | 13 | 1 | 15 | (1) |
| City of Fargo FargoDome Permanent Fund | 718 | 35 | 846 | (93) |
| Cultural Endowment Fund | 8 | - | 10 | (2) |
| Totals | $ 63,931 | $ 3,138 | $ 75,270 | $ (8,201) |

*Tribune*

The SIB has been listed as a defendant in a putative defense class action originally filed in the United States Bankruptcy Court for the District of Delaware, styled The Official Committee of Unsecured Creditors of Tribune Company v. Fitzsimmons, et al., Bankr. Case No. 10-54010 (the "Adversary Proceeding"), and subsequently transferred to a multi-district litigation proceeding in the United States District Court for the Southern District of New York, Case Nos. 12-cv-02652, and 11-md-02296. In addition to the Adversary Proceeding, other Tribune creditors have filed numerous state court actions (the "State Court Actions") to assert fraudulent transfer claims against certain recipients of the offering described below. The SIB was not named in any of these actions, which have since been consolidated and transferred to the MDL Proceeding (the State Court Actions together with the Adversary Proceeding, the "Tribune LBO Litigation").

The Adversary Proceeding arises out of a leveraged buyout by which the Tribune Company converted to a privately held company in 2007 pursuant to which beneficial owners of Tribune stock were paid $34 a share. The Official Committee of Unsecured Creditors (the "Committee") contends that there was misconduct in connection with that offering, including fraud. No such allegations have been made against the SIB. Nevertheless, the Committee seeks to recover the payments made pursuant to the offering to beneficial owners, allegedly including the SIB (among thousands of other putative shareholder defendants) in connection with the leveraged buyout. The SIB's records indicate that it received, in the aggregate, $1,003,000.00 in Tribune leveraged buyout payments, comprised of two separate payments.

The Committee purportedly served the SIB with a copy of the summons and complaint in the Adversary Proceeding on or about February 13, 2012. On July 26, 2013, the Court granted the Litigation Trustee leave to file a Fifth Amended Complaint. A response to the Litigation Trustee's Fifth Amended Complaint will not yet be required, and the Court has stayed all discovery pending its disposition of a Motion to Dismiss in the State Court Actions. The Court held a hearing on the Motion on May 23, 2013, and took the matter under advisement. In large part, however, the Adversary Proceeding has been stayed from its inception, and continues to be stayed. No substantive motions or answers have been filed by the SIB or any other defendant in response to the complaint. Under the circumstances, we are not able to assess the likelihood of a loss to the State or predict the probability of a favorable or unfavorable outcome or the amount of potential loss, in the event of an unfavorable outcome.

# SUPPLEMENTARY INFORMATION

## Schedule of Funding Progress
## North Dakota Teachers' Fund for Retirement
## (Dollars in Millions)

| Actuarial Valuation Date July 1 | Actuarial Value of Plan Assets | Actuarial Accrued Liability (AAL) | Unfunded Actuarial Accrued Liability (UAAL) (Funded Excess) | Funded Ratio | Annual Covered Payroll | UAAL (Funded Excess) as a Percentage of Annual Covered Payroll |
|---|---|---|---|---|---|---|
| 2008 | $1,909.5 | $2,330.6 | $ 421.1 | 81.9% | $417.7 | 100.8% |
| 2009 | 1,900.3 | 2,445.9 | 545.6 | 77.7 | 440.0 | 124.0 |
| 2010 | 1,842.0 | 2,637.2 | 795.2 | 69.8 | 465.0 | 171.0 |
| 2011 | 1,822.6 | 2,749.8 | 927.2 | 66.3 | 488.8 | 189.7 |
| 2012 | 1,748.1 | 2,871.9 | 1,123.8 | 60.9 | 505.3 | 222.4 |
| 2013 | 1,762.3 | 2,997.1 | 1,234.8 | 58.8 | 526.7 | 234.4 |

## Schedule of Employer Contributions
## North Dakota Teachers' Fund for Retirement

| | GASB 25 Annual Required Contribution (ARC) | | Actual Employer Contributions | | Percentage of GASB ARC Contributed |
|---|---|---|---|---|---|
| Fiscal Year | % of Payroll[1] | Amount[2] | % of Payroll | Amount | |
| 2008 | 10.15% | $44,114,585 | 7.75% | $33,683,550 | 76.4% |
| 2009 | 9.24% | 41,986,174 | 8.25% | 37,487,655 | 89.3% |
| 2010 | 10.78% | 52,053,217 | 8.25% | 39,836,646 | 76.5% |
| 2011 | 12.79% | 65,112,696 | 8.75% | 44,545,433 | 68.4% |
| 2012 | 13.16% | 69,373,794 | 8.75% | 46,126,193 | 66.5% |
| 2013 | 9.49%[3] | 52,396,153 | 10.75% | 59,352,860 | 113.3% |

1. The GASB ARC for each fiscal year is based on the actuarial valuation as of the beginning of the year. Therefore, the FY 2013 ARC is based on the July 1, 2012 valuation. The ARC is defined as the contribution rate required to pay the employer normal cost and to amortize the unfunded actuarial accrued liability over a 30-year period as a level percentage of payroll, but not less than the statutory contribution rate. For FY 2005 and prior years, the unfunded actuarial accrued liability is amortized over a 20-year period as a level dollar amount.

2. The dollar amount of the ARC is based on actual payroll for the year. The FY 2013 ARC shown above differs from the estimated dollar amount shown in the July 1, 2012 actuarial valuation report because of differences between estimated and actual FY 2013 payroll.

3. The FY 2013 ARC reflects the actuarial present value of the increased statutory contributions scheduled to occur July 1, 2014 and has been restated in this valuation report.

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| | Pension Pool Participants | | | | | | | Insurance Pool Participants | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Public Employees Retirement System | Bismarck City Employee Pension Plan | Bismarck City Police Pension Plan | Job Service of North Dakota | City of Fargo Employee Pension Plan | City of Grand Forks Employee Pension Plan | City of Grand Forks Park District | Workforce Safety & Insurance | State Fire & Tornado | State Bonding | Petroleum Tank Release Comp. Fund |
| Assets: | | | | | | | | | | | |
| Investments | | | | | | | | | | | |
| Equities | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Equity pool | 1,051,393,689 | 29,432,743 | 14,093,881 | 36,368,800 | 18,847,898 | 27,730,342 | 3,059,307 | 329,124,548 | 9,440,169 | - | - |
| Fixed income | - | - | - | - | - | - | - | - | - | - | - |
| Fixed income pool | 441,491,591 | 23,397,268 | 8,696,450 | 53,427,026 | 8,217,984 | 12,062,393 | 1,278,331 | 1,096,297,039 | 14,640,443 | 1,683,588 | 3,323,991 |
| Real assets pool | 375,048,624 | 13,198,095 | 5,559,176 | - | 4,979,280 | 7,531,092 | 479,034 | 109,390,403 | - | - | - |
| Private equity pool | 102,930,687 | 2,434,322 | 1,481,843 | - | 1,681,860 | 2,585,280 | 250,828 | - | - | - | - |
| Cash pool | 26,448,952 | 305,985 | 207,675 | 601,042 | 425,132 | 223,873 | 42,581 | 14,537,107 | 2,446,147 | 1,433,736 | 3,463,508 |
| Total investments | 1,997,313,543 | 68,768,413 | 30,039,025 | 90,396,868 | 34,152,154 | 50,132,980 | 5,110,081 | 1,549,349,097 | 26,526,759 | 3,117,324 | 6,787,499 |
| Invested sec lending collateral | - | - | - | - | - | - | - | - | - | - | - |
| Investment income receivable | 3,585,793 | 54,434 | 33,794 | 45,896 | (18,483) | 15,081 | (770) | 8,370,189 | 106,658 | 23,894 | 51,984 |
| Operating Cash | 56,297 | - | - | - | - | - | - | 53,954 | 775 | 916 | 1,078 |
| Miscellaneous receivable | 5,107 | - | - | - | - | - | - | 4,057 | 70 | 8 | 18 |
| Total assets | 2,000,960,740 | 68,822,847 | 30,072,819 | 90,442,764 | 34,133,671 | 50,148,061 | 5,109,311 | 1,557,777,297 | 26,634,262 | 3,142,142 | 6,840,579 |
| Liabilities: | | | | | | | | | | | |
| Investment expenses payable | 2,346,133 | 81,902 | 37,038 | 78,952 | 39,384 | 57,491 | 4,486 | 1,015,148 | 19,127 | 843 | 1,674 |
| Securities lending collateral | - | - | - | - | - | - | - | - | - | - | - |
| Accounts payable | 22,629 | - | - | - | - | - | - | 15,669 | 316 | 37 | 85 |
| Accrued expenses | 27,231 | - | - | - | - | - | - | 21,341 | 394 | 45 | 121 |
| Miscellaneous payable | - | 2,691 | 1,180 | 3,954 | 1,369 | 1,765 | 250 | - | - | - | - |
| Due to other state agencies | 495 | - | - | - | - | - | - | 393 | 7 | - | 2 |
| Total liabilities | 2,396,488 | 84,593 | 38,218 | 82,906 | 40,753 | 59,256 | 4,736 | 1,052,551 | 19,844 | 925 | 1,882 |
| Net position held in trust for external investment pool participants | $ 1,998,564,252 | $ 68,738,254 | $ 30,034,601 | $ 90,359,858 | $ 34,092,918 | $ 50,088,805 | $ 5,104,575 | $ 1,556,724,746 | $ 26,614,418 | $ 3,141,217 | $ 6,838,697 |
| Each participant unit is valued at $1.00 | | | | | | | | | | | |
| Participant units outstanding | 1,998,564,252 | 68,738,254 | 30,034,601 | 90,359,858 | 34,092,918 | 50,088,805 | 5,104,575 | 1,556,724,746 | 26,614,418 | 3,141,217 | 6,838,697 |

# North Dakota Retirement and Investment Office
## Combining Statement of Net Position – Investment Trust Funds – Fiduciary Funds
## June 30, 2013 (with Comparative Totals for 2012)

| | Insurance Pool Participants | | | | | | | | | Individual Investment Acct. | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Insurance Regulatory Trust Fund | Cultural Endowment Fund | Risk Mgmt | Risk Mgmt Work Comp | ND Ass'n. of Counties Fund | PERS Group Insurance | Budget Stabilization Fund | Legacy Fund | City of Bismarck Deferred Sick Leave | City of Fargo FargoDome Fund | PERS Retiree Health Credit Fund | Totals 2013 | Totals 2012 |
| $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ 43,854,432 | $ 43,854,432 | $ 36,131,488 |
| 312,902 | 178,141 | 1,874,447 | 1,958,548 | 815,897 | - | - | - | 305,919 | 18,272,867 | - | 1,543,210,098 | 1,312,774,041 |
| - | - | - | - | - | - | 392,878,101 | 1,188,657,699 | - | - | 29,749,849 | 1,611,285,649 | 806,874,577 |
| 351,942 | 118,892 | 3,954,801 | 3,126,548 | 1,541,597 | - | - | - | 658,600 | 17,773,329 | - | 1,692,041,813 | 1,582,382,143 |
| - | 16,965 | - | - | - | - | - | - | - | - | - | 516,202,669 | 469,548,278 |
| - | - | - | - | - | - | - | - | - | - | - | 111,364,820 | 108,766,790 |
| 370,477 | 9,936 | 315,768 | 161,256 | 360,305 | 42,792,860 | 6,132,284 | 71,022 | 51,836 | 364,501 | - | 100,765,983 | 69,354,213 |
| 1,035,321 | 323,934 | 6,145,016 | 5,246,352 | 2,717,799 | 42,792,860 | 399,010,385 | 1,188,728,721 | 1,016,355 | 36,410,697 | 73,604,281 | 5,618,725,464 | 4,385,831,530 |
| - | - | - | - | - | - | - | - | - | - | - | - | - |
| 8,326 | (20) | 42,282 | 1,096 | (355) | 18 | 2,342,796 | 6,050,472 | 479 | 894 | 72,982 | 20,787,440 | 17,254,744 |
| 890 | 166 | 1,072 | 1,071 | - | - | 12,878 | 30,306 | - | - | - | 159,403 | 152,772 |
| 3 | 1 | 15 | 11 | - | - | 1,038 | 2,424 | - | - | - | 12,752 | 9,506 |
| 1,044,540 | 324,081 | 6,188,385 | 5,248,530 | 2,717,444 | 42,792,878 | 401,367,097 | 1,194,811,923 | 1,016,834 | 36,411,591 | 73,677,263 | 5,639,685,059 | 4,403,248,552 |
| 577 | 275 | 4,160 | 3,821 | 1,762 | 1 | 202,045 | 568,043 | 711 | 34,952 | 51,296 | 4,549,821 | 3,649,932 |
| - | - | - | - | - | - | - | - | - | - | - | - | - |
| 12 | 4 | 64 | 48 | - | - | 3,614 | 8,438 | - | - | - | 50,916 | 26,714 |
| 16 | 4 | 72 | 57 | - | - | 3,940 | 6,819 | - | - | - | 60,040 | 50,425 |
| - | - | - | - | 250 | 1,565 | - | - | 250 | 1,444 | 2,664 | 17,382 | 13,537 |
| - | - | 1 | 1 | - | - | 101 | 235 | - | - | - | 1,235 | 3,309 |
| 605 | 283 | 4,297 | 3,927 | 2,012 | 1,566 | 209,700 | 583,535 | 961 | 36,396 | 53,960 | 4,679,394 | 3,743,917 |
| $ 1,043,935 | $ 323,798 | $ 6,184,088 | $ 5,244,603 | $ 2,715,432 | $ 42,791,312 | $ 401,157,397 | $ 1,194,228,388 | $ 1,015,873 | $ 36,375,195 | $ 73,623,303 | $ 5,635,005,665 | $ 4,399,504,635 |
| 1,043,935 | 323,798 | 6,184,088 | 5,244,603 | 2,715,432 | 42,791,312 | 401,157,397 | 1,194,228,388 | 1,015,873 | 36,375,195 | 73,623,303 | 5,635,005,665 | 4,399,504,635 |

| | Pension Pool Participants | | | | | | | Insurance Pool Participants | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Public Employees Retirement System | Bismarck City Employee Pension Plan | Bismarck City Police Pension Plan | Job Service of North Dakota | City of Fargo Employee Pension Plan | City of Grand Forks Employee Pension Plan | City of Grand Forks Park District | Workforce Safety & Insurance | State Fire & Tornado | State Bonding | Petroleum Tank Release Comp. Fund |
| Additions: | | | | | | | | | | | |
| Investment income: | | | | | | | | | | | |
| Net change in fair value of investments | $ 200,819,548 | $ 6,237,415 | $ 2,898,709 | $ 7,978,316 | $ 3,464,908 | $ 4,988,932 | $ 561,321 | $ 75,120,636 | $ 1,873,759 | $ 16,248 | $ 35,781 |
| Interest, dividends and other income | 44,790,884 | 1,613,666 | 680,528 | 2,248,708 | 763,619 | 1,104,377 | 97,383 | 48,176,241 | 803,166 | 73,189 | 148,726 |
| | 245,610,432 | 7,851,081 | 3,579,237 | 10,227,024 | 4,228,527 | 6,093,309 | 658,704 | 123,296,877 | 2,676,925 | 89,437 | 184,507 |
| Less investment expenses | 6,656,785 | 228,569 | 102,691 | 242,783 | 112,375 | 162,026 | 14,622 | 4,698,342 | 62,939 | 3,575 | 7,178 |
| Net investment income | 238,953,647 | 7,622,512 | 3,476,546 | 9,984,241 | 4,116,152 | 5,931,283 | 644,082 | 118,598,535 | 2,613,986 | 85,862 | 177,329 |
| Securities lending activity: | | | | | | | | | | | |
| Securities lending income | - | - | - | - | - | - | - | - | - | - | - |
| Less Securities lending expenses | - | - | - | - | - | - | - | - | - | - | - |
| Net securities lending income | - | - | - | - | - | - | - | - | - | - | - |
| Total Additions | 238,953,647 | 7,622,512 | 3,476,546 | 9,984,241 | 4,116,152 | 5,931,283 | 644,082 | 118,598,535 | 2,613,986 | 85,862 | 177,329 |
| Deductions: | | | | | | | | | | | |
| Administrative Expenses | 254,826 | - | - | - | - | - | - | 172,933 | 3,068 | 990 | 1,030 |
| Net change in net position resulting from operations | 238,698,821 | 7,622,512 | 3,476,546 | 9,984,241 | 4,116,152 | 5,931,283 | 644,082 | 118,425,602 | 2,610,918 | 84,872 | 176,299 |
| Unit transactions at net position value of $1 per unit: | | | | | | | | | | | |
| Purchase of units | - | - | - | - | 740,000 | 4,148,698 | 236,892 | 26,500,000 | - | - | - |
| Redemption of units | (12,389,125) | - | - | (4,305,267) | (286,000) | (3,881,321) | (267,234) | (22,000,000) | (500,000) | - | (100,000) |
| Net change in net position and units resulting from unit transactions | (12,389,125) | - | - | (4,305,267) | 454,000 | 267,377 | (30,342) | 4,500,000 | (500,000) | - | (100,000) |
| Total change in net position | 226,309,696 | 7,622,512 | 3,476,546 | 5,678,974 | 4,570,152 | 6,198,660 | 613,740 | 122,925,602 | 2,110,918 | 84,872 | 76,299 |
| Net position: | | | | | | | | | | | |
| Beginning of year | 1,772,254,556 | 61,115,742 | 26,558,055 | 84,680,884 | 29,522,766 | 43,890,145 | 4,490,835 | 1,433,799,144 | 24,503,500 | 3,056,345 | 6,762,398 |
| End of year | $ 1,998,564,252 | $ 68,738,254 | $ 30,034,601 | $ 90,359,858 | $ 34,092,918 | $ 50,088,805 | $ 5,104,575 | $ 1,556,724,746 | $ 26,614,418 | $ 3,141,217 | $ 6,838,697 |
| | 1,998,564,252 | 68,738,254 | 30,034,601 | 90,359,858 | 34,092,918 | 50,088,805 | 5,104,575 | 1,556,724,746 | 26,614,418 | 3,141,217 | 6,838,697 |

# Combining Statement of Changes in Net Position – Investment Trust Funds – Fiduciary Funds

## Year Ended June 30, 2013 (with Comparative Totals for 2012)

| Insurance Pool Participants | | | | | | | | | | Individual Investment Acct. | Totals | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Insurance Regulatory Trust Fund | Cultural Endowment Fund | Risk Mgmt | Risk Mgmt Work Comp | ND Ass'n of Counties Fund | PERS Group Insurance | Budget Stabilization Fund | Legacy Fund | City of Bismarck Deferred Sick Leave | City of Fargo FargoDome Fund | PERS Retiree Health Credit Fund | 2013 | 2012 |
| $ 61,472 | $ 35,577 | $ 352,442 | $ 349,656 | $ 107,664 | $ - | $ (3,112,671) | $ (12,331,605) | $ 60,827 | $ 3,435,467 | $ 6,384,010 | $ 299,338,412 | $ (2,301,149) |
| 22,735 | 9,320 | 181,504 | 144,640 | 63,052 | 129,167 | 10,804,040 | 17,696,018 | 32,997 | 997,950 | 1,776,879 | 132,358,789 | 115,514,522 |
| 84,207 | 44,897 | 533,946 | 494,296 | 170,716 | 129,167 | 7,691,369 | 5,364,413 | 93,824 | 4,433,417 | 8,160,889 | 431,697,201 | 113,213,373 |
| 1,886 | 925 | 12,368 | 10,097 | 6,171 | 3,819 | 407,183 | 1,070,706 | 3,439 | 109,886 | 197,797 | 14,116,162 | 12,779,965 |
| 82,321 | 43,972 | 521,578 | 484,199 | 164,545 | 125,348 | 7,284,186 | 4,293,707 | 90,385 | 4,323,531 | 7,963,092 | 417,581,039 | 100,433,408 |
| - | - | - | - | - | - | - | - | - | - | - | - | 17,400 |
| - | - | - | - | - | - | - | - | - | - | - | - | (3,668) |
| - | - | - | - | - | - | - | - | - | - | - | - | 21,068 |
| 82,321 | 43,972 | 521,578 | 484,199 | 164,545 | 125,348 | 7,284,186 | 4,293,707 | 90,385 | 4,323,531 | 7,963,092 | 417,581,039 | 100,454,476 |
| 997 | 449 | 985 | 987 | - | - | 44,798 | 77,681 | - | - | - | 558,744 | 529,383 |
| 81,324 | 43,523 | 520,593 | 483,212 | 164,545 | 125,348 | 7,239,388 | 4,216,026 | 90,385 | 4,323,531 | 7,963,092 | 417,022,295 | 99,925,093 |
| - | - | 500,000 | 1,000,000 | 900,000 | 224,605,535 | - | 791,126,479 | - | - | 3,580,000 | 1,053,337,604 | 716,465,386 |
| - | (4,000) | - | (1,250,000) | - | (188,839,125) | (1,036,797) | - | - | - | - | (234,858,869) | (280,508,738) |
| - | (4,000) | 500,000 | (250,000) | 900,000 | 35,766,410 | (1,036,797) | 791,126,479 | - | - | 3,580,000 | 818,478,735 | 435,956,648 |
| 81,324 | 39,523 | 1,020,593 | 233,212 | 1,064,545 | 35,891,758 | 6,202,591 | 795,342,505 | 90,385 | 4,323,531 | 11,543,092 | 1,235,501,030 | 535,881,741 |
| 962,611 | 284,275 | 5,163,495 | 5,011,391 | 1,650,887 | 6,899,554 | 394,954,806 | 398,885,883 | 925,488 | 32,051,664 | 62,080,211 | 4,399,504,635 | 3,863,622,894 |
| $ 1,043,935 | $ 323,798 | $ 6,184,088 | $ 5,244,603 | $ 2,715,432 | $ 42,791,312 | $ 401,157,397 | $ 1,194,228,388 | $ 1,015,873 | $ 36,375,195 | $ 73,623,303 | $ 5,635,005,665 | $ 4,399,504,635 |
| 1,043,935 | 323,798 | 6,184,088 | 5,244,603 | 2,715,432 | 42,791,312 | 401,157,397 | 1,194,228,388 | 1,015,873 | 36,375,195 | 73,623,303 | 5,635,005,665 | 4,399,504,635 |

| | Pension Trust | | Investment Trust | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Salaries and wages: | | | | |
| Salaries and wages | $661,555 | $624,735 | $370,585 | $445,615 |
| Fringe benefits | 250,440 | 227,391 | 116,457 | 124,842 |
| Total salaries and wages | 911,995 | 852,126 | 487,042 | 570,457 |
| Operating expenses: | | | | |
| Information services | 66,750 | 74,036 | 12,415 | 11,899 |
| Intergovernmental services | 5,558 | 6,210 | 2,616 | 2,790 |
| Professional services | 166,169 | 161,937 | 51,949 | 45,650 |
| Rent of building space | 52,299 | 54,665 | 25,649 | 23,318 |
| Mailing services and postage | 49,934 | 39,147 | 25,483 | 23,926 |
| Travel and lodging | 21,359 | 21,665 | 12,056 | 25,454 |
| Printing | 21,859 | 10,498 | 6,550 | 5,345 |
| Supplies | 3,446 | 1,658 | 1,674 | 847 |
| Professional development | 10,344 | 9,819 | 5,939 | 1,882 |
| Outside services | 8,033 | 8,421 | 51,005 | 2,679 |
| Small office equipment expense | 2,040 | 700 | 2,483 | 2,527 |
| Miscellaneous fees | 2,642 | 3,771 | 30,341 | 2,908 |
| Resource and reference materials | 427 | 443 | 1,270 | 2,149 |
| IT contractual services | 125,506 | 154,436 | 15,018 | 1,326 |
| Repairs - office equipment | 510 | 9 | 215 | 340 |
| Insurance | 709 | 754 | 334 | 279 |
| Total operating expenses | 537,585 | 548,170 | 244,997 | 153,319 |
| Pension trust portion of investment program expenses | 173,295 | 194,393 | (173,295) | (194,393) |
| Depreciation | 763 | 2,288 | - | - |
| Total administrative expenses | 1,623,638 | 1,596,976 | 558,744 | 529,383 |
| Less - nonappropriated items: | | | | |
| Professional fees | 166,169 | 161,937 | 51,949 | 45,650 |
| Other operating fees paid under continuing appropriation | 20,607 | 19,305 | 47,831 | 40,136 |
| Depreciation | 763 | 2,288 | - | - |
| Accrual adjustments to employee benefits | 10,118 | 5,557 | 539 | 1,164 |
| Total nonappropriated items | 197,657 | 189,087 | 100,319 | 86,951 |
| Total appropriated expenditures | $ 1,425,981 | $ 1,407,890 | $ 458,425 | $ 442,432 |

| | Pension Trust | | Investment Trust | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Actuary fees: | | | | |
| Segal Company | $ 94,848 | $ 93,777 | $ - | $ - |
| Auditing fees: | | | | |
| CliftonLarsonAllen LLC | 45,385 | 44,755 | 26,290 | 24,220 |
| Eide Bailly, P.C. | - | (5,461) | - | (2,789) |
| Total Auditing Fees | 45,385 | 39,294 | 26,290 | 21,431 |
| Disability consulting fees: | | | | |
| Dr. G.M. Lunn | 775 | 300 | - | - |
| Legal fees: | | | | |
| Calhoun Law Group P.C. | - | 5,748 | - | - |
| K&L Gates LLP | 9,073 | 6,742 | 10,692 | 8,508 |
| Jenner & Block | 2,337 | 978 | 3,644 | 1,903 |
| ND Attorney General | 13,751 | 15,098 | 11,323 | 13,808 |
| Total legal fees: | 25,161 | 28,566 | 25,659 | 24,219 |
| Total consultant expenses | $ 166,169 | $ 161,937 | $ 51,949 | $ 45,650 |

# North Dakota Retirement and Investment Office

## Pension and Investment Trust Funds – Schedule of Investment Expenses

### Years Ended June 30, 2013 and 2012

| | Pension Trust | | Investment Trust | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Investment managers' fees: | | | | |
| Global equity managers | $ 1,403,825 | $ 628,427 | 1,761,085 | 793,618 |
| Domestic large cap equity managers | 661,279 | 1,162,581 | 1,201,040 | 1,814,098 |
| Domestic small cap equity managers | 656,041 | 674,689 | 1,111,392 | 1,105,160 |
| International equity managers | 911,366 | 1,027,046 | 1,630,296 | 1,586,055 |
| Emerging markets equity managers | 378,684 | 428,517 | 559,955 | 590,141 |
| Domestic fixed income managers | 2,787,286 | 712,767 | 10,394,210 | 3,985,356 |
| Below investment grade fixed income managers | 1,604,541 | 990,581 | 2,108,519 | 1,264,007 |
| Inflation protected assets managers | - | - | 1,782,509 | 2,324,656 |
| International fixed income managers | 317,489 | 293,376 | 395,909 | 370,977 |
| Real estate managers | 1,863,035 | 1,628,104 | 3,090,481 | 2,784,378 |
| Infrastructure managers | 939,370 | 886,429 | 1,148,077 | 1,266,196 |
| Timber managers | 349,639 | 451,879 | 422,177 | 584,518 |
| Private equity managers | 1,850,618 | 2,798,325 | 2,148,730 | 2,920,720 |
| Short term fixed income managers | - | - | 1,235,929 | 564,284 |
| Cash & equivalents managers | 26,873 | 23,326 | 34,063 | 49,510 |
| Balanced account managers | - | - | 294,454 | 249,704 |
| Total investment managers' fees | 13,750,046 | 11,706,050 | 29,318,826 | 22,253,378 |
| Custodian fees | 257,367 | 247,562 | 717,989 | 552,859 |
| Investment consultant fees | 198,775 | 96,205 | 412,898 | 232,947 |
| SIB Service Fees | - | - | 47,331 | 45,891 |
| Total investment expenses | $ 14,206,188 | $ 12,049,817 | $ 30,497,044 | $ 23,085,076 |
| Securities lending fees | $ - | $ (5,384) | $ - | $ (3,668) |

Reconciliation of investment expenses to financial statements

| | 2013 | 2012 | 2013 | 2012 |
|---|---|---|---|---|
| Investment expenses as reflected in the financial statements | $ 6,010,000 | $ 5,661,973 | $ 14,116,162 | $ 12,779,965 |
| Plus investment management fees included in investment income | | | | |
| Domestic large cap equity managers | 61,579 | 136,427 | 103,667 | 197,944 |
| Domestic small cap equity managers | 365,861 | 437,092 | 468,421 | 547,055 |
| International equity managers | 177,806 | 179,602 | 318,745 | 281,352 |
| Emerging markets equity managers | 94,991 | 101,321 | 140,772 | 137,180 |
| Domestic fixed income managers | 2,595,308 | 403,043 | 8,593,171 | 2,073,076 |
| Below investment grade fixed income managers | 1,227,212 | 664,742 | 1,603,162 | 857,137 |
| Inflation protected assets managers | - | - | 729,506 | 1,228,180 |
| Real estate managers | 1,076,639 | 871,583 | 1,257,309 | 832,223 |
| Infrastructure managers | 466,573 | 446,542 | 571,119 | 622,240 |
| Timber managers | 349,639 | 451,879 | 422,177 | 584,518 |
| Private equity managers | 1,780,580 | 2,695,613 | 2,068,299 | 2,814,550 |
| Short term fixed income managers | - | - | - | 18,401 |
| Cash equivalents managers | - | - | - | - |
| Balanced account managers | - | - | 104,534 | 111,255 |
| Investment expenses per schedule | $ 14,206,188 | $ 12,049,817 | $ 30,497,044 | $ 23,085,076 |

## North Dakota Retirement and Investment Office

### Schedule of Appropriations – Budget Basis – Fiduciary Funds

### July 1, 2011 to June 30, 2013 Biennium

| | Approved 2011-2013 Appropriation | 2011-2013 Appropriation Adjustment | Adjusted 2011-2013 Appropriation | Fiscal 2012 Expenses | Fiscal 2013 Expenses | Unexpended Appropriations |
|---|---|---|---|---|---|---|
| All Fund Types: | | | | | | |
| Salaries and wages | $ 3,203,114 | $ - | $ 3,203,114 | $ 1,415,862 | $ 1,388,380 | $ 398,872 |
| | | - | | | | |
| Operating expenses | 947,840 | - | 947,840 | 434,460 | 447,938 | 65,442 |
| | | - | | | | |
| Contingency | 82,000 | - | 82,000 | - | 48,088 | 33,912 |
| Total | $ 4,232,954 | $ - | $ 4,232,954 | $ 1,850,322 | $ 1,884,406 | $ 498,226 |

***NOTE:*** *Only those expenses for which there are appropriations are included in this statement.*

Reconciliation of Administrative Expenses
to Appropriated Expenditures

| | 2013 | 2012 |
|---|---|---|
| Administrative expenses as reflected in the financial statements | $ 2,182,382 | $ 2,126,359 |
| Less: | | |
| Professional fees* | (218,118) | (207,587) |
| Other operating fees paid under continuing appropriations* | (68,438) | (59,441) |
| Depreciation expense | (763) | (2,288) |
| Changes in annual leave and FICA payments | (10,657) | (6,721) |
| Total appropriated expenses | $1,884,406 | $1,850,322 |

* North Dakota Century Code 21-10-06.2 and 15-39.1-05.2 provide authorization for the continuing appropriation.

**Special Comments Requested by the Legislative Audit
and Fiscal Review Committee
Year Ended June 30, 2013**

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by auditors performing audits of state agencies. These items and our responses are as follows:

**Audit Report Communications**

**1.** What type of opinion was issued on the financial statements?

Unmodified

**2.** Was there compliance with statutes, laws, rules, regulations under which the agency was created and is functioning?

Yes

**3.** Was internal control adequate and functioning effectively?

Yes

**4.** Were there any indications of lack of efficiency in financial operations and management of the agency?

No

**5.** Has action been taken on findings and recommendations included in prior year reports?

There were no prior year findings or recommendations.

**6.** Was a management letter issued? If so, provide a summary below, including any recommendations and the management response.

Yes, a separate management letter has been issued and is attached. There were no recommendations included in the management letter.

**Audit Committee Communications**

1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.

   For the year ended June 30, 2013, the financial statements include the impact of adoption of Governmental Accounting Standards Board Statement (GASBS) numbers 62 and 63.

   GASBS 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, supersedes GASBS 20. GASBS 20 gave governments the choice to elect to follow only the authoritative literature of the Governmental Accounting Standards Board (GASB) or to follow Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements that did not conflict with GASB pronouncements. Upon adoption of GASBS 62, all governmental accounting guidance is codified into the GASB literature.

   GASBS 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, provides guidance on reporting deferred outflows and inflows of resources. It also renames the residual of all other amounts presented in the statement of financial position from “net assets” to “net position.” The financial statements include the statement of net position, which reports all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Adoption of future GASB standards will include reporting of some items previously reported as assets and liabilities as deferred outflows and inflows of resources.

2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor’s conclusions regarding the reasonableness of those estimates.

   The valuation of alternative investments, including private equity and real asset investments, are a management estimate which is primarily based upon net asset values reported by the investment managers and comprise 14% of the total investment portfolio. The values for these investments are reported based upon the most recent financial data available and are adjusted for cash flows through June 30, 2013. Our audit procedures validated this approach through the use of confirmations sent directly to a sample of investment managers and the review of the most recent audited financial statements for these funds. Furthermore, we reviewed management’s estimate and found it to be reasonable.

   The actuarial valuation was based on the actuarial assumptions and methods adopted by the Board, including an actuarial expected investment rate of return of 8.0% per annum compounded annually. The valuation takes into account all of the promised benefits to which members are entitled as of July 1, 2013 as required by the North Dakota Century Code. The valuation provides certain information required by GASB to be disclosed in the financial statements. Additionally, the valuation is used to determine the adequacy of the current employer contribution rate. Our audit procedures included reviewing the actuarial valuation and related assumptions used therein and we believe the estimate to be reasonable.

**3.** Identify any significant audit adjustments.

None

**4.** Identify any disagreements with management, whether or not resolved to the auditor's satisfaction, relating to financial accounting, reporting, or auditing matters that could be significant to the financial statements.

None

**5.** Identify any significant difficulties encountered in performing the audit.

None

**6.** Identify any major issues discussed with management prior to retention.

None

**7.** Identify any management consultations with other accounts about auditing and accounting matters.

None

**8.** Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission or whether any exceptions identified in the six audit report questions addressed above are directly related to the operations of an information technology system.

Based on the audit procedures performed, the Retirement and Investment Office's critical information technology system is the CPAS system. There were no exceptions identified that were directly related to this application.

This report is intended solely for the information and use of the audit committee, management, the Legislative Audit and Fiscal Review Committee, and other state officials, and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Baltimore, Maryland
October 24, 2013

# MEMORANDUM

**TO:** **SIB Audit Committee**

**FROM:** **Fay Kopp, Interim Executive Director - Chief Retirement Officer**

**DATE:** **November 15, 2013**

**SUBJ:** **2013-14 Audit Progress Report**

Attached is the Audit Activities Progress Report for the 1st quarter ending September 30, 2013 which Dottie Thorsen will review at the meeting.

As the Audit Committee discussed at the September meeting, we anticipate the 2013-14 annual work plan goals will not be met due to the Audit Supervisor's retirement in July 2013. The Audit Committee decided to not formally revise the audit work plan for the year, but recognizes the impact the audit supervisor vacancy will have on the plan.

At this point, Dottie is on track to complete the audits which were initially assigned to her for the year (24 school district compliance audits, 4 not in compliance reviews, 4 file maintenance audits, and one benefits payment review).

Enclosures

# RETIREMENT AND INVESTMENT OFFICE
# INTERNAL AUDIT SERVICES UNIT

## AUDIT ACTIVITIES REPORT FOR THE FIRST QUARTER
## JULY 1, 2013 - SEPTEMBER 30, 2013

The audit objective of the Internal Audit Services Unit (Audit Unit) is twofold: first, to provide comprehensive, practical audit coverage of the Retirement and Investment Office (RIO) programs; second, to assist RIO management and the State Investment Board (SIB) by conducting special reviews or audits.

Our audit coverage is based on the Fiscal Year July 1, 2013 through June 30, 2014 Work Plan. The Work Plan is consistent with the Audit Unit charter and goals, and the goals of RIO. To the extent possible, our audits are being carried out in accordance with the International Standards for the Professional Practice of Internal Auditing. Audit effort is being directed to the needs of RIO and the concerns of management and the SIB Audit Committee.

### REGULAR AUDIT COVERAGE

#### Retirement Program

- **School District Reporting**

We examine school district reporting to the Teachers' Fund for Retirement (TFFR) to determine whether retirement salaries and contributions reported for members of TFFR are in compliance with the definition of salary as it appears in NDCC 15-39.1-04(9). Other reporting procedures reviewed during the audit process are calculation of service hours and eligibility for TFFR membership. A written report is issued after each audit examination is completed.

The 2013/14 Work Plan includes a goal of 52 school district compliance audits and 7 not in compliance reviews. However, due to the Audit Supervisor's retirement on July 12, 2013, the goal is not expected to be met. Current plans are to complete 24 school district audits and 4 not in compliance reviews. As of September 30, 2013, 6 audits were completed, 5 audits were in progress, and information for 7 districts was on file. The attached report details the current status of these audits. (Note: As of November 15, 2013, 8 audits have been completed, 3 audits are in progress, and 1 not in compliance review is in progress.)

This is an area that requires special emphasis due to the level of risk identified through previous audit results. Long-range plans include auditing each district over a five year period.

- **TFFR File Maintenance**

We periodically test changes made to TFFR member account data by RIO employees. Journals are generated daily and monthly indicating any file maintenance changes made.

No exceptions were noted for the first quarter ending September 30, 2013.

**SUMMARY**

The 2013/14 Work Plan adjustments are being made to reflect the Audit Supervisor's retirement and currently vacant position. However, audit effort will continue to be directed to activities that are of greatest concern to the SIB Audit Committee, RIO management, and the external auditors.

**North Dakota Retirment and Investment Office**
**SCHOOL DISTRICT AUDIT PROGRESS AND STATUS REPORT**
**For the fiscal Year July 1, 2013-June 30, 2014**

**Progress as of 11/15/2013**

| | Auditor | School District | 100% or on-site | Info Request | Info Received | Audit Started | Report Date | Status | Members | days b/w info request and received | days b/w info received and report | days b/w info received & start date | days b/w start and report | | hours to complete |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | DT | Sheyenne Valley Sp Ed | | 3/15/2013 | 4/16/2013 | 6/10/2013 | 7/18/2013 | Done | 27 | 32 | 93 | 55 | 38 | In Compliance | 27 |
| 2 | DT | Jamestown | | 3/15/2013 | 4/4/2013 | 4/12/2013 | 7/19/2013 | Done | 225 | 20 | 106 | 8 | 98 | In Compliance | 35 |
| 3 | DT | Surrey | | 4/16/2013 | 4/25/2013 | 6/17/2013 | 8/5/2013 | Done | 38 | 9 | 102 | 53 | 49 | In Compliance | 39 |
| 4 | DT | TGU School District | | 4/16/2013 | 5/10/2013 | 6/21/2013 | 8/22/2013 | Done | 43 | 24 | 104 | 42 | 62 | In Compliance | 47 |
| 5 | DT | Wishek | | 4/16/2013 | 5/21/2013 | 8/1/2013 | 9/23/2013 | Done | 22 | 35 | 125 | 72 | 53 | In Compliance | 50 |
| 6 | DT | Wyndmere | | 4/16/2013 | 5/16/2013 | 7/26/2013 | 9/30/2013 | Done | 29 | 30 | 137 | 71 | 66 | In Compliance | 30 |
| 7 | DT | Westhope | | 4/16/2013 | 5/16/2013 | 7/10/2013 | 10/14/2013 | Done | 21 | 30 | 151 | 55 | 96 | In Compliance | 36 |
| 8 | DT | Hebron | | 6/18/2013 | 7/5/2013 | 10/1/2013 | 11/14/2013 | Done | 28 | 17 | 132 | 88 | 44 | In Compliance | 49 |
| 8 | DT | Turtle Lake - Mercer | | 4/16/2013 | 5/15/2013 | 7/5/2013 | | In progress | 53 | 29 | | 51 | | | |
| 9 | DT | Nedrose | | 6/18/2013 | 7/2/2013 | 9/27/2013 | | In progress | 19 | 14 | | 87 | | | |
| 10 | DT | GST Educational | | 6/18/2013 | 7/18/2013 | 10/9/2013 | | In progress | 30 | 30 | | 83 | | | |
| 11 | DT | Grand Forks | | 6/18/2013 | 7/22/2013 | | | | | 34 | | | | | |
| 12 | DT | Maddock | | 6/18/2013 | 7/22/2013 | | | | | 34 | | | | | |
| 13 | DT | Manvel Elementary | | 6/18/2013 | 7/19/2013 | | | | | 31 | | | | | |
| 14 | DT | Medina | | 6/18/2013 | 7/26/2013 | | | | | 29 | | | | | |
| 15 | DT | Midkota | | 6/18/2013 | 7/19/2013 | | | | | 31 | | | | | |
| 16 | DT | Midway | | 6/18/2013 | 7/19/2013 | | | | | 31 | | | | | |
| 17 | DT | Minto | | 6/18/2013 | 7/22/2013 | | | | | 34 | | | | | |
| 18 | DT | Devils Lake | | | | | | | | | | | | | |
| 19 | open | Elgin-New Leipzig | | | | | | | | | | | | | |
| 20 | open | Fargo | | | | | | | | | | | | | |
| 21 | open | Flasher | | | | | | | | | | | | | |
| 22 | DT | New Public School | | | | | | | | | | | | | |
| 23 | open | Parshall | | | | | | | | | | | | | |
| 24 | open | Pingree-Buchanan | | | | | | | | | | | | | |
| 25 | DT | St. John | | | | | | | | | | | | | |
| 26 | open | West Fargo | | | | | | | | | | | | | |
| 27 | open | West River Student Serv | | | | | | | | | | | | | |
| 28 | open | White Shield | | | | | | | | | | | | | |
| 29 | DT | Wolford | | | | | | | | | | | | | |
| 30 | open | Zeeland | | | | | | | | | | | | | |
| 31 | open | Oliver-Mercer Spec Ed | | | | | | | | | | | | | |
| 32 | open | Emerado | | | | | | | | | | | | | |
| 33 | DT | Fort Totten | | | | | | | | | | | | | |
| 34 | open | Hazelton-Moffit School | | | | | | | | | | | | | |
| 35 | open | Kensal | | | | | | | | | | | | | |
| 36 | open | Lake Region Spec Ed | | | | | | | | | | | | | |
| 37 | open | Nesson | | | | | | | | | | | | | |
| 38 | open | South Heart School | | | | | | | | | | | | | |
| 39 | DT | Kulm | | | | | | | | | | | | | |
| 40 | open | Lewis & Clark School | | | | | | | | | | | | | |
| 41 | open | Maple Valley | | | | | | | | | | | | | |
| 42 | DT | Mohall/Lansford/Sherwood | | | | | | | | | | | | | |
| 43 | open | Montpelier | | | | | | | | | | | | | |

| | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 44 | DT | Warwick | | | | | | | | | | | | | |
| 45 | DT | Billings Co. Sch. District | | | | | | | | | | | | | |
| 46 | DT | East Central Excp. Child | | | | | | | | | | | | | |
| 47 | DT | Edmore | | | | | | | | | | | | | |
| 48 | DT | Glen Ullin | | | | | | | | | | | | | |
| 49 | open | James River Multidistrict | | | | | | | | | | | | | |
| 50 | open | Dickinson | | | | | | | | | | | | | |
| 51 | DT | Mayville-Portland C-G | | | | | | | | | | | | | |
| | | | | | | | Average | | 49 | 27 | 119 | 60 | 63 | | 39 |

| Assigned | | Total Audit Days | Average Audit Days | Audits Completed | Total Hours | Average hrs | Average days |
|---|---|---|---|---|---|---|---|
| 24 | DT | #REF! | #REF! | 8 | #REF! | #REF! | #REF! |

Note: Audit Supervisor Position vacant as of 7/15/2013

**NOT IN COMPLIANCE FOLLOW-UP REVIEWS**

| | Auditor | School District | 100% or on-site audit | Info Request | Info Received | Review Started | Report Date | Status | Members | days b/w info request and received | days b/w info received and report | days b/w info received & start date | days b/w start and report | | hours to complete |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | DT | Williston | | | | | | | 217 | | | | | | |
| 2 | Hold | McClusky | | | | | | | 18 | | | | | | |
| 3 | Hold | Ft. Yates | | | | | | | 35 | | | | | | |
| 4 | DT | Kindred | | | | | | | 54 | | | | | | |
| 5 | Hold | Minnewaukan | | | | | | | 36 | | | | | | |
| 6 | DT | Powers Lake | | 10/10/2013 | | | | In progress | 18 | | | | | | |
| 7 | DT | Dunseith | | | | | | | 54 | | | | | | |
| | | | | | | | | | 62 | | | | | | |

Assigned

4 DT

## REPORT ON COMPLIANCE AUDIT
## FOR REPORTING AND PAYMENTS
## TO THE TEACHERS' FUND FOR RETIREMENT
## WYNDMERE SCHOOL DISTRICT
## SEPTEMBER 30, 2013

### PURPOSE

The Teachers' Fund for Retirement (TFFR) Board of Trustees, through the Retirement and Investment Office (RIO), is responsible for ensuring that required reports and payments for TFFR members are made by public school districts and other member employers. This responsibility is contained in Chapter 15-39.1, NDCC, and most specifically, section 15-39.1-23, NDCC.

An Audit Program (AP) has been established within RIO to carry out this responsibility. This AP is in conjunction with and in addition to the audit performed by RIO's external auditors. Independent reports are filed with the Interim Director-Retirement Officer of RIO upon completion, and the Audit Committee of the State Investment Board (SIB) quarterly.

### SCOPE

This audit is designed to test the accuracy of retirement salaries reported by the employer to determine compliance with the definition of salary as it appears in NDCC 15-39.1-04(9). The employer's master contracts, employer payment plan, salary schedules, extra-curricular payment schedules, along with the individual teacher contracts, are used in the examination.

A representative sample of TFFR accounts was selected from members of the District for the 2010/11 through 2011/12 school years. For each school year under audit, member accounts were selected from the final Employer's Report of Member and Employer Contributions. Member contributions, employer contributions, and salaries reported for the selected members were examined. See Primary Test.

The Primary Test calculates the member and employer contributions due to TFFR based on the information provided by the employer. The results are then compared to the amounts actually reported by the employer for the years being audited. See Primary Test.

The Primary Test did not disclose any reporting procedure used by the District that would affect a large portion of the population for fiscal years 2010/11 through 2011/12. Therefore, the Primary Test was not expanded to include 100 percent of the members.

However, it is the policy of the TFFR Board that the time limitation applied to reporting errors shall be from the onset of the error or 36 months prior to the beginning of the current school year.

### FINDING

In our opinion, for the time period covered in the audit, the retirement salaries reported by the Wyndmere School District for fiscal years 2010/11 through 2011/12 were in compliance with the definition of salary as it appears in NDCC 15-39.1-04 (9). The following finding was noted.

The District did not issue written agreements for summer salary.

### RECOMMENDATION AND CORRECTIVE ACTION

TFFR recommends that District personnel review the *TFFR Employer Guide* for assistance in reporting salary to TFFR. The website address is www.nd.gov/rio//TFFR/Publications.

The District reported summer salary to TFFR without a written agreement. The District stated that they do not issue contracts or written agreements for summer salary. A written agreement can be a contract, school board minutes or other official document evidencing a contractual relationship between a teacher and participating employer. As a best practice, TFFR recommends that the District should issue some form of written agreement to the district as well as out-of-district teachers for all summer salary. If written agreements are not issued to teachers from outside the District or teachers without a continuing contract, the summer salary would not be reportable to TFFR.

Please provide a written response on the District's intent to correct the above error in future reporting to TFFR. **The written response needs to be returned to the Retirement and Investment Office by October 31, 2013.**

The findings and recommendations in this compliance audit are based on state statutes and rules in effect during the audit period. Legislative and rule changes may occur after the audit period. Therefore, any future modifications to negotiated agreements, salary schedules, or special payments should be discussed with TFFR in advance to confirm whether amounts should be reported as eligible TFFR salary and subject to member and employer contributions. Written authorization and documentation describing the payment details will be requested in order to make eligible salary determinations.

In addition to the compliance audit, all accounts are reviewed as members notify the TFFR of their intent to retire.

Dottie C. Thorsen

Dottie C. Thorsen
Internal Auditor

bh
Enclosures

**REPORT ON COMPLIANCE AUDIT**
**FOR REPORTING AND PAYMENTS**
**TO THE TEACHERS' FUND FOR RETIREMENT**
**WESTHOPE SCHOOL DISTRICT**
**OCTOBER 14, 2013**

## PURPOSE

The Teachers' Fund for Retirement (TFFR) Board of Trustees, through the Retirement and Investment Office (RIO), is responsible for ensuring that required reports and payments for TFFR members are made by public school districts and other member employers. This responsibility is contained in Chapter 15-39.1, NDCC, and most specifically, section 15-39.1-23, NDCC.

An Audit Program (AP) has been established within RIO to carry out this responsibility. This AP is in conjunction with and in addition to the audit performed by RIO's external auditors. Independent reports are filed with the Interim Director-Retirement Officer of RIO upon completion, and the Audit Committee of the State Investment Board (SIB) quarterly.

## SCOPE

This audit is designed to test the accuracy of retirement salaries reported by the employer to determine compliance with the definition of salary as it appears in NDCC 15-39.1-04(9). The employer's master contracts, employer payment plan, salary schedules, extra-curricular payment schedules, along with the individual teacher contracts, are used in the examination.

A representative sample of TFFR accounts was selected from members of the District for the 2010/11 through 2011/12 school years. For each school year under audit, member accounts were selected from the final Employer's Report of Member and Employer Contributions. Member contributions, employer contributions, and salaries reported for the selected members were examined. See Primary Test.

The Primary Test calculates the member and employer contributions due to TFFR based on the information provided by the employer. The results are then compared to the amounts actually reported by the employer for the years being audited. See Primary Test.

The Primary Test did not disclose any reporting procedure used by the District that would affect a large portion of the population for fiscal years 2010/11 through 2011/12. Therefore, the Primary Test was not expanded to include 100 percent of the members.

However, it is the policy of the TFFR Board that the time limitation applied to reporting errors shall be from the onset of the error or 36 months prior to the beginning of the current school year.

## FINDINGS

In our opinion, for the time period covered in the audit, the retirement salaries reported by the Westhope School District for the fiscal years 2010/11 through 2011/12 were in compliance with the definition of salary as it appears in NDCC 15-39.1-04 (9). The following findings were noted.

1. The District reported ineligible library aide salary for one member.
2. The District reported service hours incorrectly for two part-time retired teachers.

## RECOMMENDATIONS AND CORRECTIVE ACTION

TFFR recommends that District personnel review the *TFFR Employer Guide* for assistance in reporting salary to TFFR. The website address is www.nd.gov/rio//TFFR/Publications.

Finding 1:
The District reported ineligible library aide salary to TFFR for one teacher in 2011/12. RIO will make a correction to the member's account and notify the member about the adjustment. The error caused an overpayment of contributions.

Finding 2:
The District reported service hours incorrectly to TFFR for two retired members who had returned to teach. The error did not cause the retired teachers to exceed the maximum service hours' limit. RIO will adjust the members' accounts and notify them about the correction (See Schedule 5 for the members).

A check will be sent to the Business Manager for the contributions overpaid of $1,480.08 noted in Finding 1. Please provide a written response on the District's intent to correct the above errors in future reporting to TFFR. **The written response needs to be returned to the Retirement and Investment Office by November 18, 2013.**

The findings and recommendations in this compliance audit are based on state statutes and rules in effect during the audit period. Legislative and rule changes may occur after the audit period. Therefore, any future modifications to negotiated agreements, salary schedules, or special payments should be discussed with TFFR in advance to confirm whether amounts should be reported as eligible TFFR salary and subject to member and employer contributions. Written authorization and documentation describing the payment details will be requested in order to make eligible salary determinations.

In addition to the compliance audit, all accounts are reviewed as members notify the TFFR of their intent to retire.

Dottie C. Thorsen

Dottie C. Thorsen
Internal Auditor

bh
Enclosures

**REPORT ON COMPLIANCE AUDIT**
**FOR REPORTING AND PAYMENTS**
**TO THE TEACHERS' FUND FOR RETIREMENT**
**HEBRON SCHOOL DISTRICT**
**NOVEMBER 14, 2013**

## PURPOSE

The Teachers' Fund for Retirement (TFFR) Board of Trustees, through the Retirement and Investment Office (RIO), is responsible for ensuring that required reports and payments for TFFR members are made by public school districts and other member employers. This responsibility is contained in Chapter 15-39.1, NDCC, and most specifically, section 15-39.1-23, NDCC.

An Audit Program (AP) has been established within RIO to carry out this responsibility. This AP is in conjunction with and in addition to the audit performed by RIO's external auditors. Independent reports are filed with the Interim Director-Retirement Officer of RIO upon completion, and the Audit Committee of the State Investment Board (SIB) quarterly.

## SCOPE

This audit is designed to test the accuracy of retirement salaries reported by the employer to determine compliance with the definition of salary as it appears in NDCC 15-39.1-04(9). The employer's master contracts, employer payment plan, salary schedules, extra-curricular payment schedules, along with the individual teacher contracts, are used in the examination.

A representative sample of TFFR accounts was selected from members of the District for the 2010/11 through 2011/12 school years. For each school year under audit, member accounts were selected from the final Employer's Report of Member and Employer Contributions. Member contributions, employer contributions, and salaries reported for the selected members were examined.

The Primary Test calculates the member and employer contributions due to TFFR based on the information provided by the employer. The results are then compared to the amounts actually reported by the employer for the years being audited. See Primary Test.

The Primary Test did not disclose any reporting procedure used by the District that would affect a large portion of the population for fiscal years 2010/11 through 2011/12. Therefore, the Primary Test was not expanded to include 100 percent of the members.

However, it is the policy of the TFFR Board that the time limitation applied to reporting errors shall be from the onset of the error or 36 months prior to the beginning of the current school year.

## FINDINGS

In our opinion, for the time period covered in the audit, the retirement salaries reported by the Hebron School District for the fiscal years 2010/11 through 2011/12 were in compliance with the definition of salary as it appears in NDCC 15-39.1-04 (9). The following findings were noted:

1. The District reported an ineligible amount of a health insurance policy converted to salary as retirement salary for one member.

2. The District reported one part-time member's salary to TFFR without a written agreement.

**RECOMMENDATIONS AND CORRECTIVE ACTION**

TFFR recommends that District personnel review the *TFFR Employer Guide* for assistance in determining when salary is reportable. The website address is www.nd.gov/rio//TFFR/Publications.

Finding 1:
A portion of a health insurance policy was converted to salary for one member during fiscal year 2011/12. The District reported the ineligible $1,200.00 conversion to salary to TFFR as retirement salary. RIO will make the adjustments to the member's account and return the overpaid member/employer contributions to the District for fiscal years 2011/12, 2012/13, and 2013/14. It is the responsibility of the District to return the overpaid contributions to the member (See Primary Test and Worksheet for Salary Adjustments).

Finding 2:
The District reported after-school salary for a part-time member without a written agreement. The District noted the approval of the after-school program in the Board Minutes. However, the member's name, rate of pay, and term of employment was not noted in the Board Minutes. A written agreement can be a contract, school board minutes, or other official document evidencing a contractual relationship between a teachers and participating employer. No adjustment will be made to the account for the audit period. However, to continue reporting the salary in future years, the District will need to issue some form of written agreement that contains the member's name, amount paid, and term of employment.

The amount of member/employer contributions overpaid for Finding 1 is $690.00 (See Schedule 2). The check for the overpaid contributions will be sent to the Business Manager. Please provide a written response on the District's intent to correct the above findings in future reporting to TFFR. **The written response is due December 17, 2013.**

The findings and recommendations in this compliance audit are based on state statutes and rules in effect during the audit period. Legislative and rule changes may occur after the audit period. Therefore, any future modifications to negotiated agreements, salary schedules, or special payments should be discussed with TFFR in advance to confirm whether amounts should be reported as eligible TFFR salary and subject to member and employer contributions. Written authorization and documentation describing the payment details will be requested in order to make eligible salary determinations.

In addition to the compliance audit, all accounts are reviewed as members notify the TFFR of their intent to retire.

Dottie C. Thorsen

Dottie C. Thorsen
Internal Auditor

Enclosures

Final report

MEMORANDUM

FROM: Dottie C. Thorsen, Internal Auditor

TO: Fay Kopp, Interim Executive Director
Shelly Schumacher, Retirement Program Manager

DATE: November 12, 2013

SUBJECT: TFFR File Maintenance Audit
First Quarter (2013/14)
(July, August, and September)

**Conclusion: No exceptions noted**

These are the audit procedures for the quarterly audit.

1) I ran and reviewed the table reports for all RIO staff members.

2) I reviewed all of the transactions on the Data Processing Coordinator's table report.

3) The Retirement Program Manager notified me that there were some unusual transactions found on her and the Membership Specialist's table reports. An error occurred in the programming of interest to re-employed retired teacher's accounts. No interest should have been calculated on member/employer contributions. They deleted the interest calculated in subsequent months. I tested ten of these and found that the interest had successfully been deleted.

4) I compared the information on six member action forms with the information posted on CPAS.

**NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE AUDIT DIVISION**
**BUDGETED HOURS FOR THE FISCAL YEAR JULY 1, 2013 TO JUNE 30, 2014**

**Progress as of September 30, 2013**

| | | **2013-14** BUDGET HOURS | YTD HOURS 7/1/2013 - 6/30/2014 | 1st quart. hours 7/1/2013 - 9/30/2013 | 2nd quart. hours 10/1/2013 - 12/31/2013 | 3rd quart hours 1/1/14 3/31/14 | 4th quart. hours 4/1/14 - 6/30/2014 |
|---|---|---|---|---|---|---|---|
| **1. Audit** | | | | | | | |
| School District Audits | | 2,680 | 248 | 248 | | | |
| Follow-up on "not-in-compliance" previous audits | | 276 | 0 | 0 | | | |
| TFFR File Maintenance | | 48 | 14 | 14 | | | |
| Benefit Payments-deaths, purchase of service, and refunds review | | 32 | 24 | 24 | | | |
| Executive Limitations | | 20 | 0 | 0 | | | |
| Policy & Procedure Manual | | 0 | 0 | 0 | | | |
| Special Projects(Including Policy & Procedure Manual) | | 80 | 0 | 0 | | | |
| **Total Audit Hours** | 76% | 3,136 | 285 | 285 | | | |
| **2. Administrative (meetings & prep, CEU's, etc.)** | 9% | 384 | 207 | 207 | | | |
| **3. Annual/Sick Leave, Holidays** | 15% | 640 | 116 | 116 | | | |
| **Total Budget Hours (2 FTE's)** | 100% | 4,160 | 608 | 608 | | | |

Note: Audit Supervisor position vacant as of 7/15/2013

# MEMORANDUM

**TO:** SIB Audit Committee
**FROM:** Fay Kopp, Interim Executive Director – Chief Retirement Officer
**DATE:** November 15, 2013
**SUBJ:** RIO Staff Vacancies Update

Here is a status report on the vacant positions at RIO.

1) **Chief Investment Officer/Executive Director** (John Geissinger 05-12)
   SIB hired David Hunter who will begin on December 2, 2013.

2) **Compliance Officer** (Leslie Moszer 06-13)
   After two rounds of posting/advertising for the position in August and September, Fay and Darren interviewed top finalists for the position (ranked by HRMS) on 11/2/13. The position has been offered to a well qualified candidate, Cody Schmidt, who has verbally accepted the job.

3) **Audit Supervisor** (Les Mason retirement 07-13)
   Position to be discussed by Audit Committee at November 2013 meeting.

4) **Investment Analyst** (newly approved position 07-13)
   Pending organizational review of investment division duties and positions with new CIO/ED in December 2013.

5) **Fiscal and Investment Officer** (Connie Flanagan 10-13)
   Pending organizational review of investment and fiscal division duties and positions with new CIO/ED in December 2013.

6) **IT Supervisor** (Gary Vetter retirement 03-14)
   Gary recently announced his upcoming retirement, so we plan to review position and selection of new IT Supervisor with new CIO/ED in December 2013.

As mentioned earlier, RIO will need to re-examine all areas of the agency's organizational structure, with particular emphasis on investment, accounting, and audit functions, to determine how to best structure the various job duties and responsibilities. Until then, our dedicated RIO staff will strive to handle agency responsibilities in a timely manner, however, we are prioritizing critical agency functions. Some projects, activities, and initiatives may need to take lower priority and will likely be delayed. Unfortunately, we anticipate service levels will be affected as our small, but capable, staff adjusts to minimal staffing levels and expanded roles within the agency.

# MEMORANDUM

**TO:** SIB Audit Committee
**FROM:** Fay Kopp, Interim Executive Director – Chief Retirement Officer
**DATE:** November 15, 2013
**SUBJ:** Audit Supervisor Position Vacancy

Under the current Audit Committee Charter (Responsibilities – Internal Audit, #5):

> ***"The Audit Committee will participate with RIO's Executive Director in the appointment of the Audit Supervisor, and evaluation of the performance of the Audit Supervisor. The Committee will also approve any changes in staffing, including the addition, termination, or replacement of auditors, and the approval of salary increases and/or promotions other than those authorized by the Legislature."***

Attached is a copy of the current Audit Supervisor (Auditor III) job description and RIO organizational chart which was also sent to you in September. As noted earlier, some of the job duties reflected on the job description are outdated, and are no longer being done or are being done on a very limited basis. Current primary job duties include supervising the audit program and staff, auditing board compliance with Executive Limitation governance policy, and conducting compliance audits of school district reporting. I have also included a copy of RIO's hiring policy. Please note that this policy also needs some minor updates dealing with veteran's preference, etc.

After consideration of the overall audit function within the agency, as well as the various vacant RIO positions, I would recommend that we move forward with filling the Audit Supervisor vacancy in substantially the same form as it exists today. With that said, I believe that once a new Audit Supervisor is hired, it would be appropriate for that individual to work with RIO executive management and the Audit Committee to review the current audit function within the agency, audit reporting structure, and audit programs and procedures in order to identify how to best structure RIO's audit function for the future. In addition, by filling the Audit Supervisor position in a similar form, the individual could be hired, trained in school district compliance audits, and start to understand the current organizational structure of RIO/SIB/TFFR before suggesting audit program changes (if any) to the Audit Committee. This would also allow the new ED/CIO to be part of those discussions over the course of the next 6 – 12 months.

If the Committee agrees with this course of action, I would recommend that the Audit Committee select a member(s) to work with me and the new CIO/ED in the recruitment and selection process. I plan to update the job description, but keep it as an Auditor III, at this time. I would like to get the job vacancy posted in December, with the possibility of interviews in January.

On a related note, at the September meeting, the Committee also discussed hiring an intern or temporary employee to assist Dottie in more routine aspects of the audit programs, primarily with school district compliance audits. While I believe it is appropriate for RIO to consider hiring an intern, unfortunately I have not had the time to pursue this effort. Additionally, now that the ED/CIO position has been filled, I believe our agency's highest priorities need to be with filling the permanent vacant positions.

Please plan to discuss the vacant audit supervisor position, and overall audit function within the RIO agency.

Enclosures

## AUDITOR III
## CLASS 0243, GRADE L

**WORK TITLE:** Supervisor of Internal Audit

Job Duties

1. Supervise internal audit program.
    a. Plan, direct, and organize audits.
    b. Develop and update audit programs.
    c. Determine and apply audit tests.
    d. Prepare computer generated audit reports and present findings to the Executive Director, Deputy Executive Director, and Audit Committee.
    e. Analyze and evaluate effectiveness of the audit procedures.
    f. Supervise and evaluate the work activities of internal audit staff.
    g. Assist with recruiting, hiring, and training of internal audit staff.

2. Responsible for the internal audit of the investment program.
    a. Complete appropriate audit tests.
    b. Identify problems.
    c. Prepare computer-generated report on findings with recommendations and file with Executive Director, Deputy Executive Director, and Audit Committee.

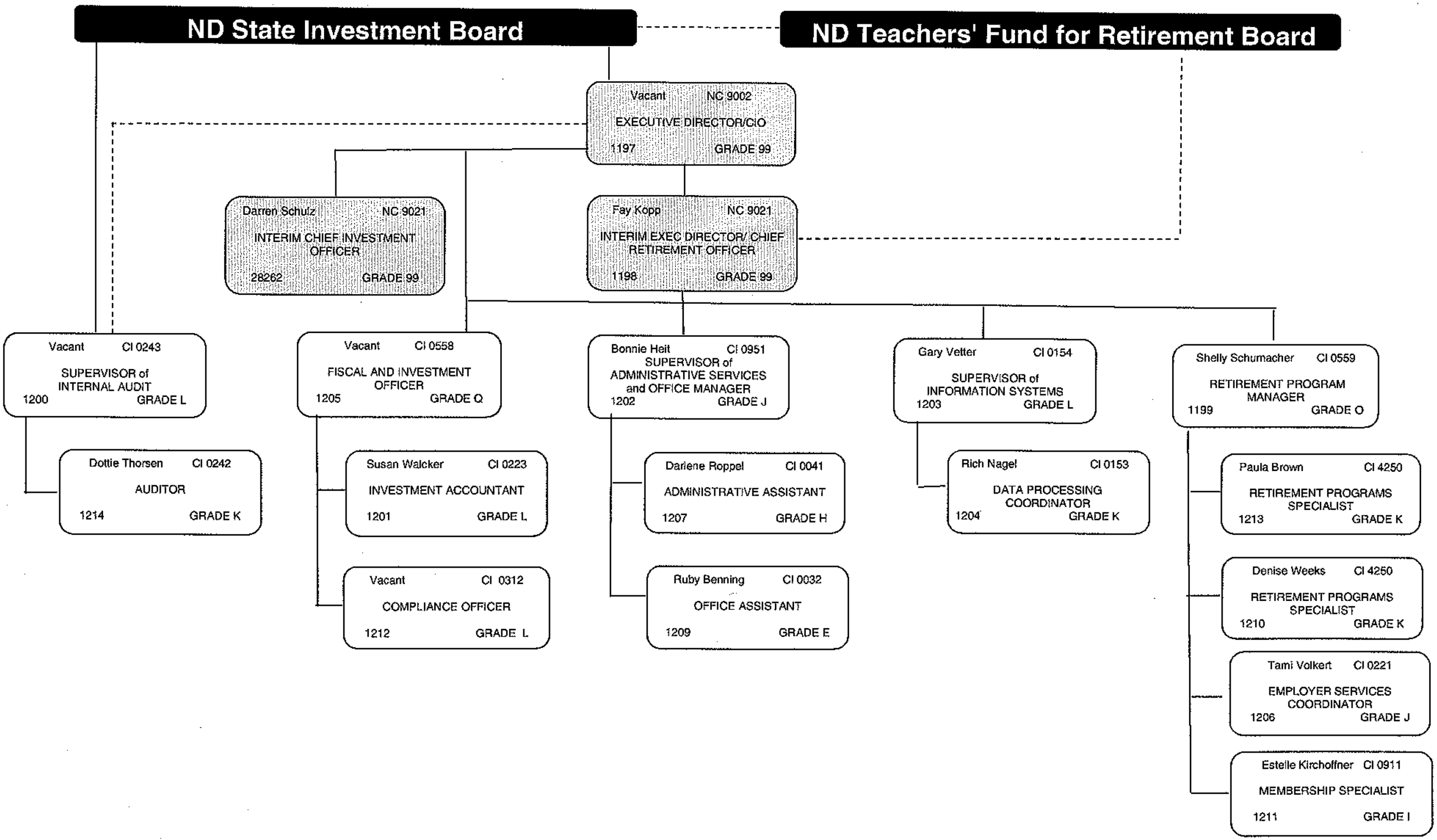
3. Responsible for auditing board compliance with governance policies
    a. Complete appropriate audit tests.
    b. Identify problems.
    c. Prepare computer-generated report on findings with recommendations and file with Executive Director, Deputy Executive Director, and Audit Committee.

4. Assist in the coordination of external audit activities.

5. Conduct audits of school district reporting.

# ND Retirement and Investment Office (RIO)

October 16, 2013




Note: NDRIO has total of 18 FTE positions.
Staff is allocated between SIB & TFFR programs
based on approximate time spent on each program.

**POLICY TYPE: ADMINISTRATIVE**

**POLICY TITLE:** *HIRING STAFF*

The staff hiring and selection process used by RIO complies with HRMS guidelines. Supervisors are primarily responsible for the selection process, with final hiring approval by the Executive Director.

Position Analysis

1. Review the current job description and update if necessary. If job duties/responsibilities have changed significantly, revise the Position Information Questionnaire (PIQ).
2. If needed, determine the essential job functions and complete a job analysis form.
3. Any classified, non-temporary position that 1) has been vacant six months or longer, or 2) is new or was created through reorganization or realignment of duties, or 3) has duties which changed substantially is required to go before the Hiring Council.
4. Announce the job opening internally.

Job Announcement

1. Develop the job announcement for the open position utilizing information in the class specifications, job description and PIQ and submit to HRMS>
2. Include language in the job announcement that a criminal history record check, including fingerprinting, will be conducted on the successful candidate prior to hiring per N.D.C.C. 12-60-24.
3. HRMS will list the job announcement on their web page and also send it to Job Service. (Mandatory)
4. HRMS will also advertise in a combination ad in the state's four major daily newspapers.
5. In order to reach a specific pool of candidates, advertising may also be requested in additional newspapers and/or trade publications. HRMS can assist in this area.

Application Screening and Rating Form

1. Prior to receiving applications, predetermine the number of candidates to be interviewed, usually the top five candidates. This will comprise the certificate of eligibles to be determined by HRMS.
2. Develop an application screening and rating form based on the job announcement, job description, and PIQ. The form factors in five points for qualified veterans and ten points for qualified disabled veterans using a 100 point rating score. This form is used by HRMS to establish the certificate of eligibles.
3. RIO will only accept applications on the state Application for Employment Form (SFN 10950).
4. Upon receipt, complete applications are filed until the application deadline date has passed. Applications received after the deadline will not be considered. Eligible applications and the Screening and Rating Form are sent to HRMS. Once reviewed, HRMS will return the applications with a registry of applicants (a list of all applicants in rank order) and a certificate of eligible's to interview.

Interviews

1. Interview questions and a scoring mechanism must be developed before the interviews take place. All interview questions must be job related. In addition, job-related testing may also be administered to measure a specific skill required for the job.

2. A panel of at least three members will conduct the interviews using the predetermined questions and scoring system.

3. Reference checks shall be conducted on the top candidate from the interview. Copies of the top candidates' previous job performance evaluations may be used in place of or in addition to a reference check.

4. If a disabled veteran is among the candidates, the job must be offered to this individual unless justifiable cause is noted. The justifiable cause must be documented in writing and must relate to the disabled veteran's suitability for the job. The fact that other candidates are better or more qualified should not be considered justifiable cause.

5. If the certificate of eligible's does not include a disable veteran the person with the highest examination score, whether a veteran or non-veteran, is first entitled to the position and in the absence of justifiable cause, must be offered the position. If the highest examination score is a veteran and the veteran is not selected, there must be a justifiable cause documented in writing for not employing the veteran.

Candidate Selection & Follow-up

1. After reference checks, the panel will make a selection decision and offer the position to the candidate by phone. Once a verbal acceptance is given, a criminal history record check will be conducted.

2. Criminal history record check will be conducted on RIO employees first employed after July 31, 2005 who has unescorted physical access to the office or any security-sensitive area of the office as designated by the Executive Director per N.D.C.C 12-60-24.

3. The Executive Director will send a written offer noting salary and start date after a satisfactory criminal history record check is received.

4. After the offer of employment has been accepted, all other applicants are notified, by letter, that the position has been filled. All veterans must be notified by certified mail.

5. Applications, rating sheets, and interview scoring results are filed and kept for three years then purged.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE:** *STANDING COMMITTEES*

The board's standing committee is that which is set forth in this policy as follows:

1. Audit Committee

    A. The audit committee shall operate under the terms of a charter approved by the board.

INTRODUCTION

An Audit Committee has been established as a standing committee of the State Investment Board (SIB). The Audit Committee will assist the SIB in carrying out its oversight responsibilities as they relate to the Retirement and Investment Office (RIO) internal and external audit programs, including financial and other reporting practices, internal controls, and compliance with laws, regulations, and ethics.

The primary objective of the internal audit function is to assist the SIB and management in the effective discharge of their responsibilities. To this end, internal auditing will furnish them with analyses, appraisals, recommendations, and pertinent information concerning the activities reviewed.

Functions and units within RIO will be reviewed at appropriate intervals to determine whether they are effectively carrying out their responsibilities of planning, organizing, directing, and controlling in accordance with SIB and management instructions, applicable laws, policies, and procedures, and in a manner consistent with both the RIO objectives and high standards of administrative practice.

POLICY OF THE STATE INVESTMENT BOARD

The audit staff shall have full, free, and unrestricted access to all RIO activities, records, property, and personnel relative to the subject under review. The audit function will be conducted in a manner consistent with acceptable professional standards and coordinated with others to best achieve the audit objectives and the RIO objectives.

The Internal Audit Services Unit is responsible for developing and directing a broad, comprehensive program of internal auditing within RIO. The Internal Audit Services Unit will report administratively to management and functionally to the Audit Committee of the SIB.

The RIO unit supervisors are responsible for seeing that corrective action on reported weaknesses is either planned or taken within 30 days from the receipt of a report disclosing those weaknesses if known or applicable. The unit supervisors are also responsible for seeing that a written report of action planned or completed is sent to the executive director. If a plan for action is reported, a second report shall be made promptly upon completion of the plan.

**Policy Implemented:** June 23, 1995.

# MEMORANDUM

**TO:** SIB Audit Committee
**FROM:** Fay Kopp, Interim Executive Director – Chief Retirement Officer
**DATE:** November 22, 2013
**SUBJ:** SIB Audit Committee Authority

Here is some background information relating to SIB Audit Committee authority. Please note the SIB governance policy and Audit Committee Charter were provided to you at the September Audit Committee meeting, along with a memo relating to potential audit charter changes and approval process.

**SIB Governance Policy (attached)**

SIB Governance Policy B-6, Standing Committees, established the Audit Committee as a standing committee of the SIB on June 23, 1995. Pertinent provisions of the policy state:

- The Audit Committee shall operate under the terms of a charter approved by the Board.

- The Audit Committee will assist the SIB in carrying out its oversight responsibilities as they relate to RIO internal and external audit programs, including financial and other reporting practices, internal controls, and compliance with laws, regulations, and ethics.

- The Internal Audit Services Unit will report administratively to Management and functionally to the Audit Committee of the SIB.

*Note:* There have been no changes made to this policy since it was adopted in 1995.

**SIB Audit Committee Charter (attached)**

The SIB Audit Committee Charter was originally approved by the SIB in 1994. The Charter identifies numerous responsibilities for the Audit Committee relating to the Internal Audit, External Audit, RIO Management, and Administration.

Pertinent Audit Committee **Internal Audit** responsibilities include:

- Approve and periodically review the Internal Audit Charter, and submit to the SIB for approval.

- Review, and approve the annual audit work plan.

- Participate with RIO's Executive Director in the appointment of the Internal Audit Supervisor, and evaluation of the performance of the Internal Audit Supervisor. Approve any changes in staffing; including the addition, termination, or replacement of internal auditors, and the approval of salary increases and/or promotions other than those authorized by the legislature.

Pertinent Audit Committee **Administrative** responsibilities include:

- RIO's Executive Director will supervise the administrative activities of the internal and external audit programs such as travel, securing contracts, paying fees, maintaining official reports, and other appropriate activities.

- The Supervisor of Internal Audit Services will be the staff member to report directly to the Audit Committee.

*Note:* The Audit Committee Charter was originally adopted by the SIB in 1994, and was modified by the Audit Committee in 1996, 1997, 2001, 2007, and 2009. In our review of SIB minutes, the Audit Charter modifications made by the Audit Committee do not appear to have been formally submitted to the SIB for approval since 1996, although certain Audit Committee annual activity reports to the SIB notified the SIB that audit charter changes were made.

In my September 20, 2013 memo to the Audit Committee relating to potential Audit Charter changes (attached), I outlined what I believed was the appropriate process for approval of Audit Charter changes, considering the current SIB governance policy and audit charter provisions. I view audit charter changes made by the Audit Committee to be recommendations to the SIB, since the SIB has final approval.

**Audit Supervisor Vacancy**

Under the provisions of the current SIB governance policy, "Standing Committees," and Audit Charter, I believe that the Audit Supervisor position must report administratively to RIO Management and functionally to the SIB Audit Committee. I further believe the Audit Committee must participate with RIO's Executive Director in the hiring of the Audit Supervisor.

While the Audit Committee and/or RIO Management can recommend changes to the SIB governance policy and Audit Charter, only the SIB can approve changes that would modify the reporting structure and general responsibilities of the Audit Supervisor and Audit Committee.

Attachments: SIB Governance Policy B-6, Standing Committees
SIB Audit Committee Charter
Memo to SIB Audit Committee, September 20, 2013