



# ND STATE INVESTMENT BOARD MEETING

Friday, January 24, 2014, 8:30 a.m.  
Peace Garden Room, State Capitol  
600 E Blvd, Bismarck, ND

## AGENDA

### I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

### II. ACCEPTANCE OF MINUTES (November 22, 2013)

### III. INVESTMENTS

- A. Public Pension Peer Performance Summary - Mr. Hunter (enclosed) (5 min)
- B. Investment Manager Rankings (Assets Under Management / Recommendation) - Mr. Hunter (to follow) (5 min)
- C. Global Equity Transition - Mr. Schulz (enclosed) (5 min)
- D. Westridge/WG Trading - Ms. Murtha (5 min)  
Possible Executive Session for Attorney Consultation  
N.D.C.C. §44-04-19.1(5) and N.D.C.C. §44-04-19.2

### IV. GOVERNANCE

- A. Administration - Audit Committee Liaison Report - Mr. Gessner (enclosed) (5 min)
- B. Legislative Update - Audited Financial Statements for fiscal years ended June 30, 2012 and 2013 - Mr. Hunter (5 min)
- C. Organizational Chart Update - Mr. Hunter (enclosed) (5 min)
- D. Interim Compensation Update for Fiscal - Mr. Hunter (5 min)

### V. QUARTERLY MONITORING (enclosed) (5 min)

- A. Budget and Financial Conditions - Ms. Walcker / Ms. Flanagan
- B. Executive Limitations/Staff Relations - Mr. Hunter
- C. Investment Program - Mr. Schulz
- D. Retirement Program - Ms. Kopp
- E. RIO June 30, 2013 Financial Audit Report - Ms. Walcker / Ms. Flanagan (enclosed under Item IV.A.)

### VI. OTHER

Next Meetings:  
SIB meeting - February 28, 2014, 8:30 a.m. - Peace Garden Room  
SIB Audit Committee meeting - February 28, 2014, 1:00 p.m. - Peace Garden Room

### VII. ADJOURNMENT

**NORTH DAKOTA STATE INVESTMENT BOARD  
MINUTES OF THE  
NOVEMBER 22, 2013, BOARD MEETING**

**BOARD MEMBERS PRESENT:** Drew Wrigley, Lt. Governor, Chair  
Mike Sandal, Vice Chair  
Lance Gaebe, Land Commissioner  
Mike Gessner, TFFR Board  
Adam Hamm, Insurance Commissioner (teleconference)  
Rob Lech, TFFR Board  
Howard Sage, PERS Board  
Kelly Schmidt, State Treasurer  
Cindy Ternes, Workforce Safety & Insurance  
Tom Trenbeath, PERS Board

**BOARD MEMBER ABSENT:** Clarence Corneil, TFFR Board

**STAFF PRESENT:** Bonnie Heit, Assistant to the SIB  
Fay Kopp, Interim Executive Director  
Darren Schulz, Interim CIO  
Susan Walcker, Investment Accountant

**OTHERS PRESENT:** Weldee Baetsch, former SIB trustee  
Paul Michaels, Invesco  
Jan Murtha, Attorney General's Office  
Max Swango, Invesco

**CALL TO ORDER:**

Lt. Governor Wrigley called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, November 22, 2013, at the State Capitol, Peace Garden Room, 600 E Boulevard, Bismarck, ND.

A quorum was present for the purpose of conducting business.

**AGENDA:**

IT WAS MOVED BY LT. GOVERNOR WRIGLEY AND SECONDED BY MS. TERNES AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE NOVEMBER 22, 2013, MEETING.

AYES: COMMISSIONER GAEBE, TREASURER SCHMIDT, MR. SANDAL, COMMISSIONER HAMM, MS. TERNES, MR. GESSNER, MR. TRENBEATH, MR. LECH, MR. SAGE, AND LT. GOVERNOR WRIGLEY

NAYS: NONE

MOTION CARRIED

ABSENT: MR. CORNEIL

**MINUTES:**

The minutes were considered from the October 25, 2013, and October 28, 2013, meetings.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. SAGE AND CARRIED ON A VOICE VOTE TO ACCEPT THE OCTOBER 25, 2013, AND OCTOBER 28, 2013, MINUTES AS WRITTEN.

AYES: MR. GESSNER, COMMISSIONER GAEBE, MR. SAGE, MS. TERNES, TREASURER SCHMIDT, MR. LECH, COMMISSIONER HAMM, MR. TRENBEATH, MR. SANDAL, AND LT. GOVERNOR WRIGLEY

**NAYS: NONE**  
**MOTION CARRIED**  
**ABSENT: MR. CORNEIL**

**INVESTMENTS:**

Invesco - Representatives reviewed the investment performance of the Funds currently managed by the firm within the SIB's Global Real Estate allocation in the Pension Trust; Core Commingled, Fund II, Fund III, and Asian LP.

Invesco representatives also reviewed additional investment opportunities for the SIB's consideration; Value Added Fund IV and Asia Real Estate Fund III.

Staff recommended the SIB make the following additional capital commitments with Invesco; \$70 million to the Value Added Fund IV and \$35 million to the Asia Real Estate Fund III.

After discussion,

**IT WAS MOVED BY COMMISSIONER GAEBE AND SECONDED BY MR. SAGE AND CARRIED ON A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND INVEST \$70 MILLION IN THE INVESCO VALUE ADDED FUND IV AND \$35 MILLION TO THE ASIA REAL ESTATE FUND III.**

**AYES: MR. TRENBEATH, COMMISSIONER GAEBE, MR. GESSNER, COMMISSIONER HAMM, MR. SAGE, MR. SANDAL, TREASURER SCHMIDT, MS. TERNES, MR. LECH, AND LT. GOVERNOR WRIGLEY**

**NAYS: NONE**  
**MOTION CARRIED**  
**ABSENT: MR. CORNEIL**

**QUARTERLY MONITORING:**

Callan Investment Measurement for the Pension Trust and Insurance Trust - Mr. Schulz reviewed the Callan performance measurement reports for the Pension Trust and the Insurance Trust for the quarter ending September 30, 2013.

Mr. Schulz informed the SIB an offer has been made and accepted for RIO's Compliance Officer position and a start date of December 9, 2013, has been mutually agreed upon by both parties.

**GOVERNANCE:**

Legislative Update - Mr. Schulz informed the SIB he provided an update on the asset allocation, fund earnings to date, and estimated future fund earnings of the Legacy Fund to the Legacy and Budget Stabilization Fund Advisory Board on November 5, 2013, and the Government Finance Committee on November 7, 2013.

Lt. Governor Wrigley left the meeting and Mr. Sandal presided over the remainder of the meeting.

Interim Compensation - The SIB had issued temporary salary adjustments since June 1, 2012, to the Deputy Chief Investment Officer and Deputy Executive Director/Chief Retirement Officer effective until the SIB had reached a decision on the Executive Director/CIO vacancy for RIO. As a result of the Executive Director/CIO appointment effective December 2, 2013, Mr. Sandal requested

clarification from the SIB on the timeframe of the temporary salary adjustments for the two positions. After discussion,

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. TRENBEATH AND CARRIED ON A ROLL CALL VOTE TO EXTEND THE TEMPORARY SALARY ADJUSTMENTS FOR THE DEPUTY CHIEF INVESTMENT OFFICER AND DEPUTY EXECUTIVE DIRECTOR/CHIEF RETIREMENT OFFICER THROUGH DECEMBER 31, 2013.

AYES: TREASURER SCHMIDT, MR. GESSNER, COMMISSIONER HAMM, MS. TERNES, COMMISSIONER GAEBE, MR. SAGE, MR. LECH, MR. TRENBEATH, AND MR. SANDAL

NAYS: NONE

MOTION CARRIED

ABSENT: LT. GOVERNOR WRIGLEY, MR. CORNEIL

**OTHER:**

The next SIB meeting is scheduled for January 24, 2014, at 8:30 am at the Peace Garden Room, State Capitol, Bismarck, ND.

The next SIB Audit Committee meeting is scheduled for November 22, 2013, at 1:00 pm at the Peace Garden Room, State Capitol, Bismarck, ND.

**ADJOURNMENT:**

With no further business to come before the SIB, Mr. Sandal adjourned the meeting at 11:00 a.m.

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Lt. Governor Wrigley, Chair  
State Investment Board

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Bonnie Heit  
Assistant to the Board

# MEMORANDUM

**TO: SIB Members**

**FROM: Dave Hunter**

**DATE: January 24, 2014**

**SUBJ: RIO Update, Pension Investment Returns and Future Actions**

During my first two months, I have enjoyed meeting with all of our RIO staff in one on one meetings in addition to many SIB Members and Clients including the Executive Director (or Director) of PERS, TFFR, WSI, HRMS, ITD, OMB, Risk Management and the Offices of the Attorney General and State Treasurer in addition to the Lt. Governor and Governor. I have been truly impressed with the outstanding talent and experience of each and every person I have met. I also appreciate the welcome reception I have been kindly granted by everyone and look forward to growing these relationships in the upcoming years.

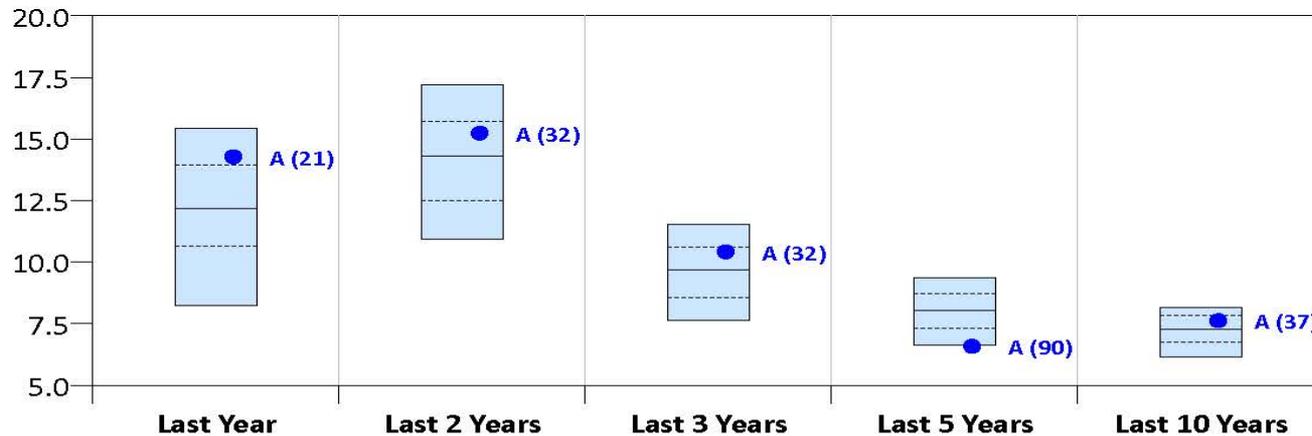
I have focused my initial efforts on staff relations as I realize the success of our organization is heavily dependent on the effectiveness of our RIO team. In the upcoming months, I look forward to meeting with all of our investment managers, consultants and custodian to build upon our current success, while working to further enhance our investment risk management practices and documentation standards, expand upon Board education and refresh our Administrative and Governance manuals and processes. We will look to attain these goals while maintaining the highest level of ethics, integrity and character in all matters.

The RIO investment team will continue to focus on generating above benchmark returns over the long term, while striving to reduce management fees and other operating expenses. As such, it is my pleasure to report that our Pension investment returns were in the **first quartile** of all public pension plans for the 12 months ended September 30, 2013, in addition to being in the top third during the last three years. For the 10-year period ended September 30, 2013, our Pension investment returns were in the **37<sup>th</sup> percentile** of the Callan Associates Public Fund Sponsor Database, which is more than respectable when considering the challenges faced during the Great Recessionary period. In order to build upon this success, the RIO investment team is rank ordering our investment managers in terms of assets and fees in order to prioritize our efforts. We will then embark on a relationship review with our major service providers to ensure we are adhering to risk and return expectations while seeking further fee reductions. During the past two months, I am also pleased to report that RIO was successful in completing the Global Equity transition which will generate an estimated **\$750,000** in annual fee savings while identifying another opportunity to realize approximately **\$300,000** in future annual fee reductions.

I am honored and humbled to be the new Executive Director / CIO of RIO and thank everyone who has allowed me to assume this important role. Going forward, I invite each Board Member to reach out to me at anytime to expand our relationship.

The Pension Funds generated **1<sup>st</sup> Quartile** returns for 1-year ended 9/30/13 and **2<sup>nd</sup> Quartile** returns for the 10-years ended 9/30/13.

**Returns  
for Periods Ended September 30, 2013  
Group: CAI Public Fund Sponsor Database**



|                              |              |              |              |             |             |
|------------------------------|--------------|--------------|--------------|-------------|-------------|
| 10th Percentile              | 15.43        | 17.22        | 11.54        | 9.37        | 8.14        |
| 25th Percentile              | 13.93        | 15.72        | 10.61        | 8.74        | 7.84        |
| Median                       | 12.19        | 14.32        | 9.70         | 8.03        | 7.28        |
| 75th Percentile              | 10.67        | 12.48        | 8.55         | 7.31        | 6.75        |
| 90th Percentile              | 8.26         | 10.93        | 7.64         | 6.62        | 6.16        |
| Member Count                 | 243          | 237          | 226          | 211         | 176         |
| <b>ND Pen-Total Fund</b> ● A | <b>14.28</b> | <b>15.23</b> | <b>10.42</b> | <b>6.58</b> | <b>7.63</b> |

**1<sup>st</sup> Quartile**

Top Third

**Top Third**

Bottom 10%

**2<sup>nd</sup> Quartile**

# **State Investment Board Addendum**

## **Fee Study & Legislative Audit & Fiscal Review Committee Meeting**

January 24, 2014

Dave Hunter, Executive Director / CIO  
Darren Schulz, Deputy Chief Investment Officer  
ND Retirement & Investment Office (RIO)  
State Investment Board (SIB)

# SIB Addendum for January 24, 2014

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- ▶ Review Investment Manager, Consultant & Custodian Relations
  - Prioritize our efforts by size of relationship and fees paid.
  - Develop a short-term and medium term strategy.
  - Leverage internal expertise before seeking external assistance in order to reduce costs and maximize returns (as some external parties are paid based on fee savings).
  
- ▶ Legislative Audit & Fiscal Review Committee Meeting Update
  - CliftonLarsonAllen LP provided an update for the fiscal years ended June 30, 2012 and June 30, 2013.
  - Other discussions and follow-up requests.

# Investment Manager Assets Under Management (“AUM”) and Fees

## - Relationship Reviews Prioritized by AUM and Annual Fees Paid in 2013

| Unaudited Data Subject to Change      | Avg Market Value     | Investment Manager     | Investment          | Net               |              |
|---------------------------------------|----------------------|------------------------|---------------------|-------------------|--------------|
|                                       |                      | Fees Paid in FY 2013   | Manager Fees %      | Manager Fees      |              |
| 1                                     | J.P. MORGAN          | \$1,015,200,890        | \$5,811,082         | 0.57%             | 0.57%        |
| 2                                     | BABSON               | \$575,839,079          | \$758,881           | 0.13%             | 0.13%        |
| 3                                     | LA CAPITAL           | \$515,772,684          | \$1,086,380         | 0.21%             | 0.21%        |
| 4                                     | WESTERN              | \$502,277,941          | \$894,348           | 0.18%             | 0.18%        |
| 5                                     | CLIFTON              | \$490,225,426          | \$863,595           | 0.18% *           | 0.04%        |
| 6                                     | LSV                  | \$487,792,473          | \$2,481,730         | 0.51% *           | 0.30%        |
| 7                                     | PIMCO                | \$400,802,720          | \$13,177,910        | 3.29% *           | 0.64%        |
| 8                                     | WELLS                | \$280,345,750          | \$613,148           | 0.22%             | 0.22%        |
| 9                                     | TIR                  | \$260,597,741          | \$1,279,439         | 0.49%             | 0.49%        |
| 10                                    | INVESCO              | \$245,216,424          | \$2,229,471         | 0.91% *           | 0.62%        |
| 11                                    | BANK OF ND           | \$190,480,934          | \$80,718            | 0.04%             | 0.04%        |
| 12                                    | EPOCH                | \$187,755,328          | \$1,412,498         | 0.75%             | 0.75%        |
| 13                                    | LOOMIS SAYLES        | \$176,536,925          | \$882,685           | 0.50%             | 0.50%        |
| 14                                    | UBS                  | \$127,174,470          | \$577,148           | 0.45%             | 0.45%        |
| 15                                    | CALLAN               | \$119,901,922          | \$834,282           | 0.70%             | 0.70%        |
| 16                                    | DECLARATION          | \$114,357,118          | \$618,842           | 0.54%             | 0.54%        |
| 17                                    | NORTHERN TRUST NTGI  | \$109,202,332          | \$307,640           | 0.28% *           | 0.03%        |
| 18                                    | CAPITAL GUARDIAN     | \$108,447,374          | \$547,646           | 0.50%             | 0.50%        |
| 19                                    | BRANDYWINE           | \$103,743,039          | \$427,726           | 0.41%             | 0.41%        |
| 20                                    | DFA                  | \$101,905,746          | \$687,260           | 0.67%             | 0.67%        |
| 21                                    | STATE STREET         | \$89,660,762           | \$251,892           | 0.28%             | 0.28%        |
| 22                                    | PRUDENTIAL           | \$69,466,857           | \$204,186           | 0.29%             | 0.29%        |
| 23                                    | WELLINGTON           | \$65,752,285           | \$561,118           | 0.85%             | 0.85%        |
| 24                                    | SEI                  | \$58,844,793           | \$294,454           | 0.50%             | 0.50%        |
| 25                                    | CALAMOS              | \$53,732,841           | \$386,180           | 0.72%             | 0.72%        |
| 26                                    | ADAMS STREET/BRINSON | \$51,767,770           | \$982,338           | 1.90%             | 1.90%        |
| 27                                    | NORTHERN TRUST STIF  | \$41,947,286           | \$60,935            | 0.15%             | 0.15%        |
| 28                                    | CREDIT SUISSE        | \$40,658,091           | \$665,651           | 1.64% *           | 1.11%        |
| 29                                    | CORSAIR              | \$32,490,963           | \$736,920           | 2.27%             | 2.27%        |
| 30                                    | EIG                  | \$32,042,116           | \$365,606           | 1.14%             | 1.14%        |
| 31                                    | RESEARCH AFFILIATES  | \$31,076,018           | \$138,437           | 0.45%             | 0.45%        |
| 32                                    | CAPITAL INTL         | \$28,714,648           | \$768,528           | 2.68%             | 2.68%        |
| 33                                    | MATLIN PATTERSON     | \$27,338,691           | -\$427,782          | n.m.              | n.m.         |
| 34                                    | QUANTUM              | \$18,902,357           | \$896,941           | 4.75%             | 4.75%        |
| 35                                    | PANAGORA             | \$16,618,079           | \$116,010           | 0.70%             | 0.70%        |
| 36                                    | INVEST AMERICA       | \$15,313,985           | \$536,928           | 3.51%             | 3.51%        |
| 37                                    | GOLDMAN SACHS        | \$14,859,358           | \$754,745           | 5.08% *           | 2.13%        |
| 38                                    | VANGUARD             | \$10,727,178           | \$45,054            | 0.42%             | 0.42%        |
| 39                                    | CORAL PARTNERS       | \$3,759,373            | \$129,958           | 3.46%             | 3.46%        |
| 40                                    | HEARTHSTONE          | \$1,458                | \$566               | n.m.              | n.m.         |
| <b>Pension &amp; Insurance Trusts</b> |                      | <b>\$6,817,251,224</b> | <b>\$43,041,094</b> | <b>0.63%</b>      | <b>0.43%</b> |
|                                       |                      | <b>Annual Fees**</b>   | <b>Gross Fee</b>    | <b>Net Fee***</b> |              |

Note: During the last 1-, 2- and 3-year periods ended 9/30/13, the North Dakota Pension Fund Trust generated investment returns which were in the top third of the Callan Associates Public Fund Sponsor Database (see page 4 for further detail).

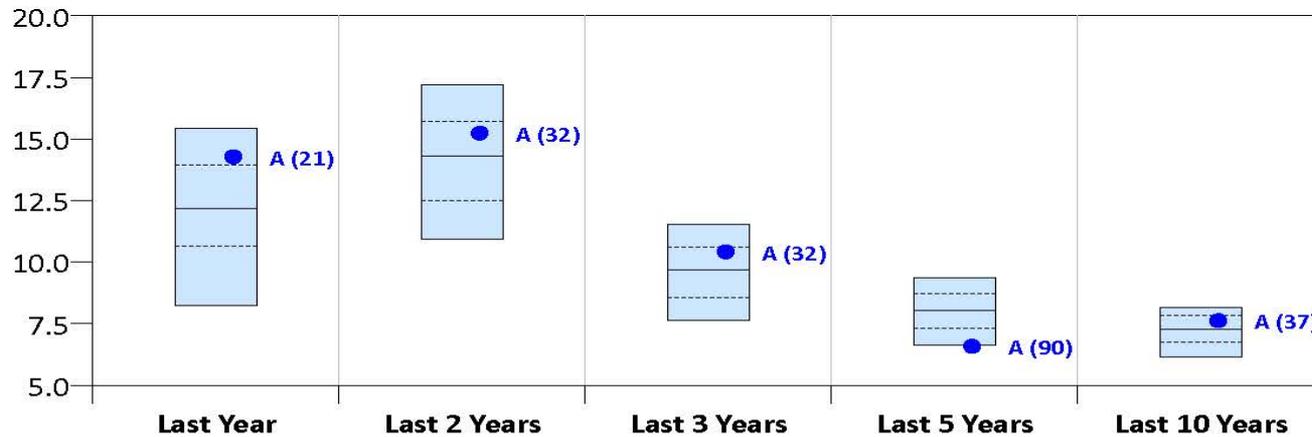
\* - Performance Fees were \$14 million in aggregate for FY 13. n.m. = not meaningful

\*\* - Annual Fees excludes \$1.6 million in Custodian, Investment Consultant and Service Fees for the Pension and Insurance Trusts.

\*\*\* - Net Investment Management Fees excludes the impact of Performance Fees.

The Pension Funds generated **1<sup>st</sup> Quartile** returns for 1-year ended 9/30/13 and **2<sup>nd</sup> Quartile** returns for the 10-years ended 9/30/13.

**Returns  
for Periods Ended September 30, 2013  
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**1<sup>st</sup> Quartile**

Top Third

**Top Third**

Bottom 10%

**2<sup>nd</sup> Quartile**

Pension “Risk” has declined as measured by “Standard Deviation”.

**Standard Deviation  
for Periods Ended September 30, 2013  
Group: CAI Public Fund Sponsor Database**



Risk, as measured by standard deviation, has declined during the last five years as the Pension Funds’ standard deviation declined by over 75% to 3.55 for the “Last Year” from 14.69 for the “Last 5 Years”. The Pension Funds’ peer risk rating also improved noting that it went from the 19<sup>th</sup> highest percentile (“Last 5- and 10-Years”) to the 94<sup>th</sup> highest percentile in the “Last Year”. A lower standard deviation is preferred over a higher standard deviation when comparing risk profiles.

## Recent & Upcoming Fee Review Activity

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- ▶ The Global Equity mandate was reviewed in late-2013 and restructured in December to generate \$750,000 in annual cost savings in future years.
- ▶ In December, PIMCO agreed to reduce fees in our investment strategy from 0.90% to 0.60% by setting up a separate account structure in 2014.
- ▶ During the 1<sup>st</sup> half of 2014, the RIO Investment Team will meet with all our major investment managers to conduct a relationship review and confirm the reasonableness of investment management fees in addition to adherence to our overall investment guidelines and risk and return expectations (while pursuing fee reductions wherever possible).
- ▶ During the 2<sup>nd</sup> half of 2014, the RIO Investment Team will make a recommendation to the SIB about engaging an independent third party to complete an in-depth fee study

# State Investment Board Assets Under Management

| <u>Fund Name</u>                          | <u>Market Values<br/>as of 11/30/13</u> |
|---|---|
| <b>Pension Trust Fund</b>                 |   |
| Public Employees Retirement System (PERS) | 2,174,798,671                           |
| Teachers' Fund for Retirement (TFFR)      | 1,944,568,116                           |
| Job Service of North Dakota Pension       | 94,857,788                              |
| City of Bismarck Employees Pension        | 73,974,387                              |
| City of Grand Forks Employees Pension     | 53,067,974                              |
| City of Fargo Employees Pension           | 36,938,921                              |
| City of Bismarck Police Pension           | 32,481,531                              |
| Grand Forks Park District                 | 5,576,050                               |
| <b>Subtotal Pension Trust Fund</b>        | <b>4,416,263,438</b>                    |
| <b>Insurance Trust Fund</b>               |   |
| Workforce Safety & Insurance              | 1,625,359,963                           |
| Legacy Fund                               | 1,616,640,670                           |
| Budget Stabilization Fund                 | 587,002,205                             |
| PERS Group Insurance Account              | 39,625,943                              |
| City of Fargo FargoDome Permanent Fund    | 38,320,722                              |
| State Fire and Tornado Fund               | 28,434,501                              |
| Petroleum Tank Release Compensation Fund  | 6,905,200                               |
| State Risk Management Fund                | 6,555,052                               |
| State Risk Management Workers Comp Fund   | 5,612,437                               |
| State Bonding Fund                        | 3,174,443                               |
| ND Association of Counties (NDACo) Fund   | 2,878,634                               |
| Insurance Regulatory Trust Fund           | 1,101,314                               |
| Bismarck Deferred Sick Leave Account      | 803,611                                 |
| Cultural Endowment Fund                   | 355,364                                 |
| <b>Subtotal Insurance Trust Fund</b>      | <b>3,962,770,059</b>                    |
| PERS Retiree Insurance Credit Fund        | 81,913,484                              |
| <b>Total Assets Under SIB Management</b>  | <b>8,460,946,981</b>                    |

# Legislative Audit & Fiscal Review Committee Meeting

- ▶ The key points from the January 21, 2014 meeting were:
  - ▶ CliftonLarsonAllen noted that RIO received an “unqualified” or “unmodified” audit opinion related to the financial statements for the years ended June 30, 2012 and 2013.
  - ▶ This “**clean**” opinion was further supported by no material weaknesses of internal accounting controls or systems and there were no management recommendations.

▶ Other Topics included:

- ▶ TFFR Funded Ratio Trends; and
- ▶ Investment Management Fees.

|      | a             | b                | c            |
|------|---------------|------------------|--------------|
|      | Actuarial     | Actuarial        | a / b        |
|      | Value of      | Accrued          | Funded       |
|      | <u>Assets</u> | <u>Liability</u> | <u>Ratio</u> |
| 2008 | \$ 1,909.5    | \$ 2,330.6       | 81.9%        |
| 2009 | \$ 1,900.3    | \$ 2,445.9       | 77.7%        |
| 2010 | \$ 1,842.0    | \$ 2,637.2       | 69.8%        |
| 2011 | \$ 1,822.6    | \$ 2,749.8       | 66.3%        |
| 2012 | \$ 1,748.1    | \$ 2,871.9       | 60.9%        |
| 2013 | \$ 1,762.3    | \$ 2,997.1       | 58.8%        |

## Contact Information

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▶ **Phone:**

Dave 701-328-9889 or Darren 701-328-9885  
1-800-952-2970 (outside Bismarck/Mandan)

▶ **Mailing Address**

ND Retirement and Investment Office  
1930 Burnt Boat Drive, P.O. Box 7100  
Bismarck, ND 58507-7100

▶ **E-mail Address:**

[rio@nd.gov](mailto:rio@nd.gov), [djhunter@nd.gov](mailto:djhunter@nd.gov) or [djschulz@nd.gov](mailto:djschulz@nd.gov)

▶ **Website Address:**

[www.nd.gov/rio](http://www.nd.gov/rio)

## **Pension Trust Global Equity Transition Update**

### **Background**

At the October 25, 2013 State Investment Board meeting, the Board approved a Staff recommendation to reduce the number of non-U.S. manager mandates as part of the first phase of restructuring the pension global equity asset class. The rationale behind the recommendation was to reduce the number of specialist mandates across equity segments so as to lower management fees, reduce tracking error and complexity, and realize investment and administrative efficiencies.

The State Investment Board approved the transition of the following mandates to pure passive mandates: SSgA International Alpha, PanAgora Diversified Risk Emerging Markets Equity Plus and UBS Emerging Market Equity. Additionally, the Clifton MSCI EAFE synthetic mandate would be transitioned to a MSCI World ex-US mandate to reduce tracking error. Redemptions from the two emerging market mandates would be transitioned to an existing MSCI Emerging Markets index fund managed by Northern Trust, while the developed international mandates would be transitioned to a new MSCI World ex-US index mandate also managed by Northern Trust. Lastly, Staff recommended the termination of Calamos Global Opportunities as a global equity manager and the transition of the legacy assets to the existing Epoch Global Choice mandate.

### **Update**

The global equity transition was initiated and completed during the month of December. Cost savings from the reduction in investment manager fees through the new manager structure is estimated to be approximately \$750,000 per annum going forward.

## **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

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.

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

**CliftonLarsonAllen LLP**

Baltimore, Maryland

October 24, 2013



# ND Retirement and Investment Office

*Teachers' Fund for Retirement  
State Investment Board*

1930 Burnt Boat Drive  
P.O. Box 7100  
Bismarck, ND 58507-7100  
Telephone 701-328-9885  
Toll Free 800-952-2970  
Fax 701-328-9897  
[www.nd.gov/rio](http://www.nd.gov/rio)

CliftonLarsonAllen LLP  
9515 Deereco Road, Suite 500  
Timonium, Maryland 21093

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.

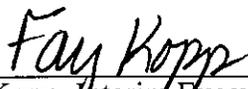
- No events, including instances of noncompliance, have occurred subsequent to the financial statement date and through the date of this letter that would require adjustment to, or disclosure in, the financial statements.
- We have not identified or been notified of any uncorrected financial statement 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, Interim Executive Director/Chief Retirement Officer



Darren Schulz, Interim Chief Investment Officer

**NORTH DAKOTA RETIREMENT  
AND INVESTMENT OFFICE  
Bismarck, ND**

**FINANCIAL STATEMENTS**  
June 30, 2013 and 2012

North Dakota Retirement and Investment Office

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June 30, 2013 and 2012

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## 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.

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.

A handwritten signature in cursive script that reads "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*.

# North Dakota Retirement and Investment Office

Management's Discussion and Analysis

June 30, 2013 and 2012

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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)**

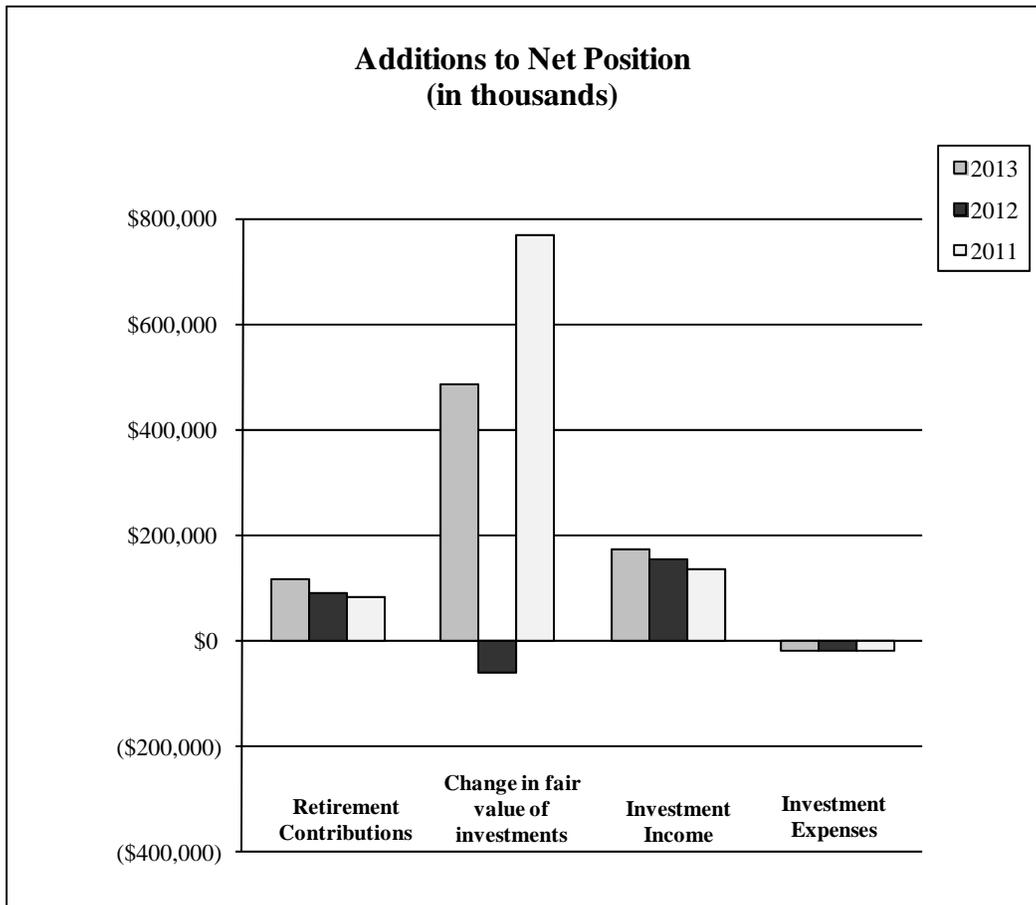
|                           | <b>2013</b>     | <b>2012</b>     | <b>Total %<br/>Change</b> |
|---------------------------|-----------------|-----------------|---------------------------|
| <b>Assets</b>             |                 |                 |                           |
| Investments               | \$ 7,422        | \$ 6,010        | 23.5%                     |
| Receivables               | 44              | 35              | 25.4%                     |
| Cash & Other              | 16              | 15              | 11.6%                     |
| <b>Total Assets</b>       | <b>7,482</b>    | <b>6,060</b>    | <b>23.5%</b>              |
| <b>Liabilities</b>        |                 |                 |                           |
| Accounts Payable          | 7               | 6               | 18.5%                     |
| <b>Total Liabilities</b>  | <b>7</b>        | <b>6</b>        | <b>18.5%</b>              |
| <b>Total Net Position</b> | <b>\$ 7,475</b> | <b>\$ 6,054</b> | <b>23.5%</b>              |
| <br>                      |                 |                 |                           |
|                           | <b>2012</b>     | <b>2011</b>     | <b>Total %<br/>Change</b> |
| <b>Assets</b>             |                 |                 |                           |
| Investments               | \$ 6,010        | \$ 5,553        | 8.2%                      |
| Receivables               | 35              | 31              | 13.5%                     |
| Cash & Other              | 15              | 13              | 11.7%                     |
| <b>Total Assets</b>       | <b>6,060</b>    | <b>5,597</b>    | <b>8.3%</b>               |
| <b>Liabilities</b>        |                 |                 |                           |
| Accounts Payable          | 6               | 7               | -2.6%                     |
| <b>Total Liabilities</b>  | <b>6</b>        | <b>7</b>        | <b>-2.6%</b>              |
| <b>Total Net Position</b> | <b>\$ 6,054</b> | <b>\$ 5,590</b> | <b>8.3%</b>               |

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

|  | <b>2013</b>  | <b>2012</b> | <b>Total %<br/>Change</b> |
|--|--------------|-------------|---------------------------|
| <b>Additions:</b>                            |              |             |                           |
| Contributions                                | \$ 116       | \$ 89       | 30.4%                     |
| Investment Income                            | 638          | 79          | 707.9%                    |
| <b>Total Additions</b>                       | 754          | 168         | 349.3%                    |
| <br><b>Deductions</b>                        | <br>151      | <br>140     | <br>8.1%                  |
| <br><b>Net change from unit transactions</b> | <br>818      | <br>436     | <br>87.7%                 |
| <br><b>Total change in net position</b>      | <br>\$ 1,421 | <br>\$ 464  | <br>206.3%                |
|  |              |             |                           |
|  | <b>2012</b>  | <b>2011</b> | <b>Total %<br/>Change</b> |
| <b>Additions:</b>                            |              |             |                           |
| Contributions                                | \$ 89        | \$ 85       | 4.6%                      |
| Investment Income                            | 79           | 884         | 91.1%                     |
| <b>Total Additions</b>                       | 168          | 969         | 82.7%                     |
| <br><b>Deductions</b>                        | <br>140      | <br>133     | <br>5.5%                  |
| <br><b>Net change from unit transactions</b> | <br>436      | <br>(63)    | <br>790.9%                |
| <br><b>Total change in net position</b>      | <br>\$ 464   | <br>\$ 773  | <br>40.0%                 |

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

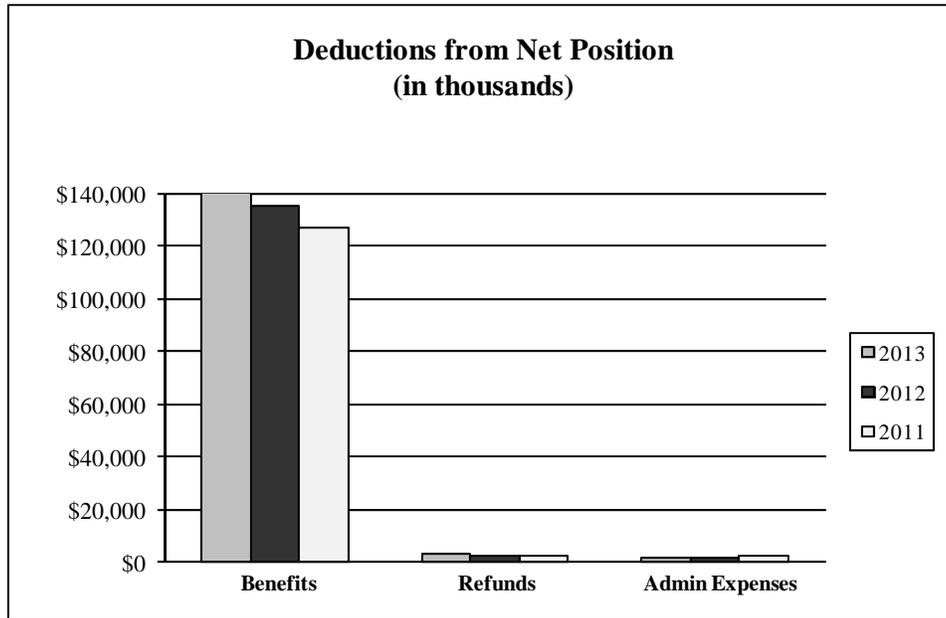
Contributions and net investment income are the two components of the fiduciary fund additions. Contributions collected by the pension trust fund increased by \$27.0 million or 30.4% over the previous fiscal year. The increase is due to an increase in the statutorily required contribution rates for members 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  | <u>1,803,078,260</u>           | <u>1,624,470,334</u>           | <u>5,618,725,464</u>           | <u>4,385,831,530</u>           |
| 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  | <u>23,310,387</u>              | <u>17,913,941</u>              | <u>20,800,192</u>              | <u>17,264,250</u>              |
| 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   | <u><u>1,842,433,308</u></u>    | <u><u>1,656,756,668</u></u>    | <u><u>5,639,685,059</u></u>    | <u><u>4,403,248,552</u></u>    |
| 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  | <u>2,849,348</u>               | <u>2,607,009</u>               | <u>4,679,394</u>               | <u>3,743,917</u>               |
| 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                                       | <u><u>\$ 1,839,583,960</u></u> | <u><u>\$ 1,654,149,659</u></u> | <u><u>\$ 5,635,005,665</u></u> | <u><u>\$ 4,399,504,635</u></u> |
| 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                    |
| <b>Additions:</b>  |                         |                         |                         |                         |
| <b>Contributions:</b>  |                         |                         |                         |                         |
| 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  | <u>115,849,348</u>      | <u>88,808,604</u>       | <u>-</u>                | <u>-</u>                |
| <b>Investment income:</b>  |                         |                         |                         |                         |
| 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             |
|  | <u>226,215,309</u>      | <u>(15,863,672)</u>     | <u>431,697,201</u>      | <u>113,213,373</u>      |
| Less investment expenses   | 6,010,000               | 5,661,973               | 14,116,162              | 12,779,965              |
| Net investment income  | <u>220,205,309</u>      | <u>(21,525,645)</u>     | <u>417,581,039</u>      | <u>100,433,408</u>      |
| <b>Securities lending activity:</b>                                |                         |                         |                         |                         |
| Securities lending income  | -                       | 8,737                   | -                       | 17,400                  |
| Less securities lending expenses                                   | -                       | (5,384)                 | -                       | (3,668)                 |
| Net securities lending income                                      | <u>-</u>                | <u>14,121</u>           | <u>-</u>                | <u>21,068</u>           |
| Total additions  | <u>336,054,657</u>      | <u>67,297,080</u>       | <u>417,581,039</u>      | <u>100,454,476</u>      |
| <b>Deductions:</b>   |                         |                         |                         |                         |
| 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   | <u>150,620,356</u>      | <u>139,326,738</u>      | <u>558,744</u>          | <u>529,383</u>          |
| Net change in net position resulting from operations               | <u>185,434,301</u>      | <u>(72,029,658)</u>     | <u>417,022,295</u>      | <u>99,925,093</u>       |
| <b>Unit transactions at net position value of \$1.00 per unit:</b> |                         |                         |                         |                         |
| 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  | <u>-</u>                | <u>-</u>                | <u>818,478,735</u>      | <u>435,956,648</u>      |
| Total change in net position                                       | 185,434,301             | (72,029,658)            | 1,235,501,030           | 535,881,741             |
| <b>Net position:</b>   |                         |                         |                         |                         |
| Beginning of year  | <u>1,654,149,659</u>    | <u>\$ 1,726,179,317</u> | <u>\$ 4,399,504,635</u> | <u>\$ 3,863,622,894</u> |
| End of Year  | <u>\$ 1,839,583,960</u> | <u>\$ 1,654,149,659</u> | <u>\$ 5,635,005,665</u> | <u>\$ 4,399,504,635</u> |

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

## North Dakota Retirement and Investment Office

Notes to Combined Financial Statements

June 30, 2013 and 2012

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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

# North Dakota Retirement and Investment Office

Notes to Combined Financial Statements

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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:

|                        | <u>Years</u> |
|------------------------|--------------|
| 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

# North Dakota Retirement and Investment Office

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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             | <u>(75,350)</u>         |
| Balance, June 30, 2012 | 136,458                 |
| Additions              | 94,877                  |
| Deductions             | <u>(84,220)</u>         |
| Balance, June 30, 2013 | <u><u>\$147,115</u></u> |

## **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.

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## 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<br>Value | Less than<br>1 Year | 1-6 Years           | 6-10 Years        | More than<br>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               |
| <b>Total Debt Securities</b>  | <b>\$ 3,637,919</b> | <b>\$ 572,346</b>   | <b>\$ 1,573,278</b> | <b>\$ 347,465</b> | <b>\$ 1,144,830</b>   |

North Dakota Retirement and Investment Office  
Notes to Combined Financial Statements  
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| 2012                          | Total Fair<br>Value | Less than<br>1 Year | 1-6 Years         | 6-10 Years        | More than<br>10 Years | Maturity not<br>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               | -                          |
| <b>Total Debt Securities</b>  | <b>\$ 2,623,418</b> | <b>\$ 303,184</b>   | <b>\$ 929,418</b> | <b>\$ 405,296</b> | <b>\$ 985,475</b>     | <b>\$ 45</b>               |

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).

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| 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                           | <u>\$ 3,637,919</u> |                |            |            |              |            |            |            |           |           |          |            |        |          |

| 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                           | <u>\$ 2,623,418</u> |                |            |            |            |            |            |            |            |           |          |        |          |          |

- \* 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).

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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<br>funds (various currencies) | -          | 91,153     | 327,274    | 418,427    |
| Total international investment<br>securities           | \$ 9,793   | \$ 182,606 | \$ 714,945 | \$ 907,344 |

# North Dakota Retirement and Investment Office

Notes to Combined Financial Statements

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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<br>funds (various currencies) | -                  | 94,744            | 280,732           | 375,476           |
| Total international investment<br>securities           | <u>\$ (12,172)</u> | <u>\$ 169,262</u> | <u>\$ 556,545</u> | <u>\$ 713,635</u> |

## 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).

| <u>Futures</u>                            | Notional Value       |                      |
|---|----------------------|----------------------|
|   | <u>June 30, 2013</u> | <u>June 30, 2012</u> |
| 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)             |
|   | <u>\$ 432,450</u>    | <u>\$ 456,043</u>    |

### 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).

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

### 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).

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**Credit Default Swaps**

| Counterparty/Moody's Rating                       | Notional<br>Amount | Expiration Date | Fair Value      |               |
|---|--------------------|-----------------|-----------------|---------------|
|   |                    |                 | June 30, 2013   | 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               | -             |
| <b>Total Credit Default Swaps</b>                 | <b>\$ 49,605</b>   |                 | <b>\$ (287)</b> | <b>\$ 546</b> |

**Interest Rate Swaps**

| Counterparty   | Notional<br>Amount | Rate Range       | Counterparty Rate | Expiration Date<br>Range | Counterparty<br>Rating<br>(Moody's) | Fair Value     |               |
|--|--------------------|------------------|-------------------|--------------------------|-------------------------------------|----------------|---------------|
|  |                    |                  |                   |                          |                                     | June 30, 2013  | June 30, 2012 |
| Bank of Nova Scotia (4 contracts)                    | \$ (493)           | 0.751% to 1.355% | Various overnight | 08/2013 - 10/2019        | Aa2                                 | \$ 34          |               |
| Barclays Bank PLC London (2 contracts)               | (53)               | 2.065% to 4.423% | bank rates        | 12/2027 - 12/2032        | A2                                  | 2              |               |
| Barclays Bank PLC New York (13 contracts)            | 6,047              | 0.359% to 5.750% | depending on      | 08/2012 - 02/2022        | A2                                  |                | 8             |
| Barclays Bank PLC New York (6 contracts)             | 4,240              | 0.00% to 5.48%   | currency          | 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             |               |
| <b>Total Interest Rate Swaps</b>                     | <b>\$ 20,171</b>   |                  |                   |                          |                                     | <b>\$ (89)</b> | <b>\$ 257</b> |

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### 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).

| Currency                                | Cost        | Purchases | Sales       | Fair Value |            |
|---|-------------|-----------|-------------|------------|------------|
|   |             |           |             | 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).

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| 2013                             | Total<br>Notional<br>Value | 3 months or<br>less | 3 to 6<br>months | 6 to 12<br>months | 1-5 years | Greater than<br>5 years |
|----------------------------------|----------------------------|---------------------|------------------|-------------------|-----------|-------------------------|
| Futures-interest rate contracts  | \$ (218,918)               | \$ (38,025)         | \$ (98,722)      | \$ (89,857)       | \$ 7,686  | \$ -                    |
|                                  | Total Fair<br>Value        | 3 months or<br>less | 3 to 6<br>months | 6 to 12<br>months | 1-5 years | Greater than<br>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<br>Notional<br>Value | 3 months or<br>less | 3 to 6<br>months | 6 to 12<br>months | 1-5 years  | Greater than<br>5 years |
|----------------------------------|----------------------------|---------------------|------------------|-------------------|------------|-------------------------|
| Futures-interest rate contracts  | \$ (151,319)               | \$ (98,853)         | \$ (2,736)       | \$ (42,526)       | \$ (7,204) | \$ -                    |
|                                  | Total Fair<br>Value        | 3 months or<br>less | 3 to 6<br>months | 6 to 12<br>months | 1-5 years  | Greater than<br>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.

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**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**

|   | <u>June 30, 2011</u> | <u>Additions</u> | <u>Retirements</u> | <u>June 30, 2012</u> | <u>Additions</u> | <u>Retirements</u> | <u>June 30, 2013</u> |
|---|----------------------|------------------|--------------------|----------------------|------------------|--------------------|----------------------|
| 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)          |
|   | <u>\$3,050</u>       |                  |                    | <u>\$762</u>         |                  |                    | <u>\$0</u>           |

**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:

|                                     | <u>2013</u>     | <u>2012</u>      |
|-------------------------------------|-----------------|------------------|
| 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   | <u>\$ 8,955</u> | <u>\$ 17,320</u> |
| Due From                            |                 |                  |
| Public Employees Retirement System  | \$ 616          | \$ 1,461         |
| Total due from other state agencies | <u>\$ 616</u>   | <u>\$ 1,461</u>  |

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<br>Balance<br><u>7/1/2012</u> | <u>A d d i t i o n s</u> | <u>R e d u c t i o n s</u> | Ending<br>Balance<br><u>6/30/20 13</u> | Amounts<br>Due Within<br><u>One Year</u> |
|---------------|---|--------------------------|----------------------------|--|--|
| Accrued Leave | <u>\$ 136,458</u>                       | <u>\$94,877</u>          | <u>(\$84,220)</u>          | <u>\$147,115</u>                       | <u>\$71,864</u>                          |
|               | Beginning<br>Balance<br><u>7/1/2011</u> | <u>A d d i t i o n s</u> | <u>R e d u c t i o n s</u> | Ending<br>Balance<br><u>6/30/20 12</u> | Amounts<br>Due Within<br><u>One Year</u> |
| Accrued Leave | <u>\$ 129,737</u>                       | <u>\$82,071</u>          | <u>(\$75,350)</u>          | <u>\$136,458</u>                       | <u>\$69,848</u>                          |

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:

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|                            | 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.

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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<br>Valuation Date | Actuarial<br>Value of Plan<br>Assets | Actuarial<br>Accrued<br>Liability<br>(AAL) | Unfunded<br>Actuarial<br>Accrued<br>Liability<br>(UAAL) | Funded<br>Ratio | Annual<br>Covered<br>Payroll | UAAL as a<br>Percentage of<br>Annual<br>Covered<br>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).

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- 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,

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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<br>Recovery<br>April 2011<br><u>(in thousands)</u> | Subsequent<br>Recovery<br>April 2013<br><u>(in thousands)</u> | Cost Basis<br><u>(in thousands)</u> | Net Realized<br>loss<br><u>(in thousands)</u> |
|--|--|---|-------------------------------------|---|
| 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                                 | <u>\$ 63,931</u>   | <u>\$ 3,138</u>   | <u>\$ 75,270</u>                    | <u>\$ (8,201)</u>                             |

*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<br>Valuation Date<br>July 1 | Actuarial<br>Value of Plan<br>Assets | Actuarial<br>Accrued<br>Liability<br>(AAL) | Unfunded<br>Actuarial<br>Accrued<br>Liability<br>(UAAL) (Funded<br>Excess) | Funded<br>Ratio | Annual<br>Covered<br>Payroll | UAAL<br>(Funded Excess)<br>as a Percentage of<br>Annual Covered<br>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**

| Fiscal Year | GASB 25 Annual Required<br>Contribution (ARC) |                     | Actual Employer Contributions |              | Percentage of<br>GASB ARC<br>Contributed |
|-------------|---|---------------------|-------------------------------|--------------|--|
|             | % of Payroll <sup>1</sup>                     | Amount <sup>2</sup> | % 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% <sup>3</sup>                            | 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 |
| <b>Assets:</b>  |                                    |                                     |                                   |                             |                                     |   |                                   |                              |                      |                     |                                   |
| 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                         |
| <b>Total investments</b>  | <b>1,997,313,543</b>               | <b>68,768,413</b>                   | <b>30,039,025</b>                 | <b>90,396,868</b>           | <b>34,152,154</b>                   | <b>50,132,980</b>                         | <b>5,110,081</b>                  | <b>1,549,349,097</b>         | <b>26,526,759</b>    | <b>3,117,324</b>    | <b>6,787,499</b>                  |
| 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                                |
| <b>Total assets</b>   | <b>2,000,960,740</b>               | <b>68,822,847</b>                   | <b>30,072,819</b>                 | <b>90,442,764</b>           | <b>34,133,671</b>                   | <b>50,148,061</b>                         | <b>5,109,311</b>                  | <b>1,557,777,297</b>         | <b>26,634,262</b>    | <b>3,142,142</b>    | <b>6,840,579</b>                  |
| <b>Liabilities:</b>   |                                    |                                     |                                   |                             |                                     |   |                                   |                              |                      |                     |                                   |
| Investment expenses payable   | 2,346,133                          | 81,902                              | 37,038                            | 78,952                      | 39,384                              | 57,491                                    | 4,486                             | 10,151,148                   | 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                                 |
| <b>Total liabilities</b>  | <b>2,396,488</b>                   | <b>84,593</b>                       | <b>38,218</b>                     | <b>82,906</b>               | <b>40,753</b>                       | <b>59,256</b>                             | <b>4,736</b>                      | <b>1,052,551</b>             | <b>19,844</b>        | <b>925</b>          | <b>1,882</b>                      |
| <b>Net position held in trust for external investment pool participants</b> | <b>\$ 1,998,564,252</b>            | <b>\$ 68,738,254</b>                | <b>\$ 30,034,601</b>              | <b>\$ 90,359,858</b>        | <b>\$ 34,092,918</b>                | <b>\$ 50,088,805</b>                      | <b>\$ 5,104,575</b>               | <b>\$ 1,556,724,746</b>      | <b>\$ 26,614,418</b> | <b>\$ 3,141,217</b> | <b>\$ 6,838,697</b>               |
| Each participant unit is valued at \$100                                    |                                    |                                     |                                   |                             |                                     |   |                                   |                              |                      |                     |                                   |
| 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                        | 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               |
| <u>\$ 1,043,935</u>             | <u>\$ 323,798</u>       | <u>\$ 6,184,088</u> | <u>\$ 5,244,603</u> | <u>\$ 2,715,432</u>        | <u>\$ 42,791,312</u> | <u>\$ 401,157,397</u>     | <u>\$ 1,194,228,388</u> | <u>\$ 1,015,873</u>                  | <u>\$ 36,375,195</u>         | <u>\$ 73,623,303</u>            | <u>\$ 5,635,005,665</u>     | <u>\$ 4,399,504,635</u> |
| 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               |                                   |                              |                      |               | Petroleum Tank Release Comp. Fund |
|---|------------------------------------|-------------------------------------|-----------------------------------|-----------------------------|-------------------------------------|---|-----------------------------------|------------------------------|----------------------|---------------|-----------------------------------|
|   | 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 |                                   |
| 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                         |

**North Dakota Retirement and Investment Office**  
**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<br>Investment<br>Acct. | Totals                  |  |
|--|-------------------------------|---------------------|---------------------------|------------------------------------|----------------------------|---------------------------------|-------------------------|---|---------------------------------------|--|-----------------------------------|-------------------------|--|
| Insurance<br>Regulatory<br>Trust<br>Fund | Cultural<br>Endowment<br>Fund | Risk<br>Mgmt        | Risk<br>Mgmt<br>Work Comp | ND<br>Ass'n of<br>Counties<br>Fund | PERS<br>Group<br>Insurance | Budget<br>Stabilization<br>Fund | Legacy<br>Fund          | City of<br>Bismarck<br>Deferred<br>Sick Leave | City of<br>Fargo<br>FargoDome<br>Fund | PERS<br>Retiree<br>Health<br>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           |  |
| <u>\$ 1,043,935</u>                      | <u>\$ 323,798</u>             | <u>\$ 6,184,088</u> | <u>\$ 5,244,603</u>       | <u>\$ 2,715,432</u>                | <u>\$ 42,791,312</u>       | <u>\$ 401,157,397</u>           | <u>\$ 1,194,228,388</u> | <u>\$ 1,015,873</u>                           | <u>\$ 36,375,195</u>                  | <u>\$ 73,623,303</u>                     | <u>\$ 5,635,005,665</u>           | <u>\$ 4,399,504,635</u> |  |
| 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           |  |

**North Dakota Retirement and Investment Office**  
Pension and Investment Trust Funds – Schedule of Administrative Expenses  
Years Ended June 30, 2013 and 2012

|  | 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                                 | <u>911,995</u>      | <u>852,126</u>      | <u>487,042</u>    | <u>570,457</u>    |
| 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                                 | <u>537,585</u>      | <u>548,170</u>      | <u>244,997</u>    | <u>153,319</u>    |
| Pension trust portion of investment program expenses     | 173,295             | 194,393             | (173,295)         | (194,393)         |
| Depreciation   | 763                 | 2,288               | -                 | -                 |
| Total administrative expenses                            | <u>1,623,638</u>    | <u>1,596,976</u>    | <u>558,744</u>    | <u>529,383</u>    |
| 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                              | <u>197,657</u>      | <u>189,087</u>      | <u>100,319</u>    | <u>86,951</u>     |
| Total appropriated expenditures                          | <u>\$ 1,425,981</u> | <u>\$ 1,407,890</u> | <u>\$ 458,425</u> | <u>\$ 442,432</u> |

North Dakota Retirement and Investment Office  
Pension and Investment Trust Funds – Schedule of Consultant Expenses  
Years Ended June 30, 2013 and 2012

---

|                             | 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         | <u>45,385</u>            | <u>39,294</u>            | <u>26,290</u>           | <u>21,431</u>           |
| 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:           | <u>25,161</u>            | <u>28,566</u>            | <u>25,659</u>           | <u>24,219</u>           |
| Total consultant expenses   | <u><u>\$ 166,169</u></u> | <u><u>\$ 161,937</u></u> | <u><u>\$ 51,949</u></u> | <u><u>\$ 45,650</u></u> |

**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                               | <u>13,750,046</u>    | <u>11,706,050</u>    | <u>29,318,826</u>    | <u>22,253,378</u>    |
| 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                                     | <u>\$ 14,206,188</u> | <u>\$ 12,049,817</u> | <u>\$ 30,497,044</u> | <u>\$ 23,085,076</u> |
| Securities lending fees                                       | <u>\$ -</u>          | <u>\$ (5,384)</u>    | <u>\$ -</u>          | <u>\$ (3,668)</u>    |
| 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                              | <u>\$ 14,206,188</u> | <u>\$ 12,049,817</u> | <u>\$ 30,497,044</u> | <u>\$ 23,085,076</u> |

North Dakota Retirement and Investment Office  
Schedule of Appropriations – Budget Basis – Fiduciary Funds  
July 1, 2011 to June 30, 2013 Biennium

|                    | Approved<br>2011-2013<br>Appropriation | 2011-2013<br>Appropriation<br>Adjustment | Adjusted 2011-<br>2013<br>Appropriation | Fiscal 2012<br>Expenses | Fiscal 2013<br>Expenses | Unexpended<br>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              | <u>\$ 4,232,954</u>                    | <u>\$ -</u>                              | <u>\$ 4,232,954</u>                     | <u>\$ 1,850,322</u>     | <u>\$ 1,884,406</u>     | <u>\$ 498,226</u>            |

*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                        | <u>(10,657)</u>    | <u>(6,721)</u>     |
| Total appropriated expenses                                      | <u>\$1,884,406</u> | <u>\$1,850,322</u> |

\* 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

## **NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE**

### **Staffing Update**

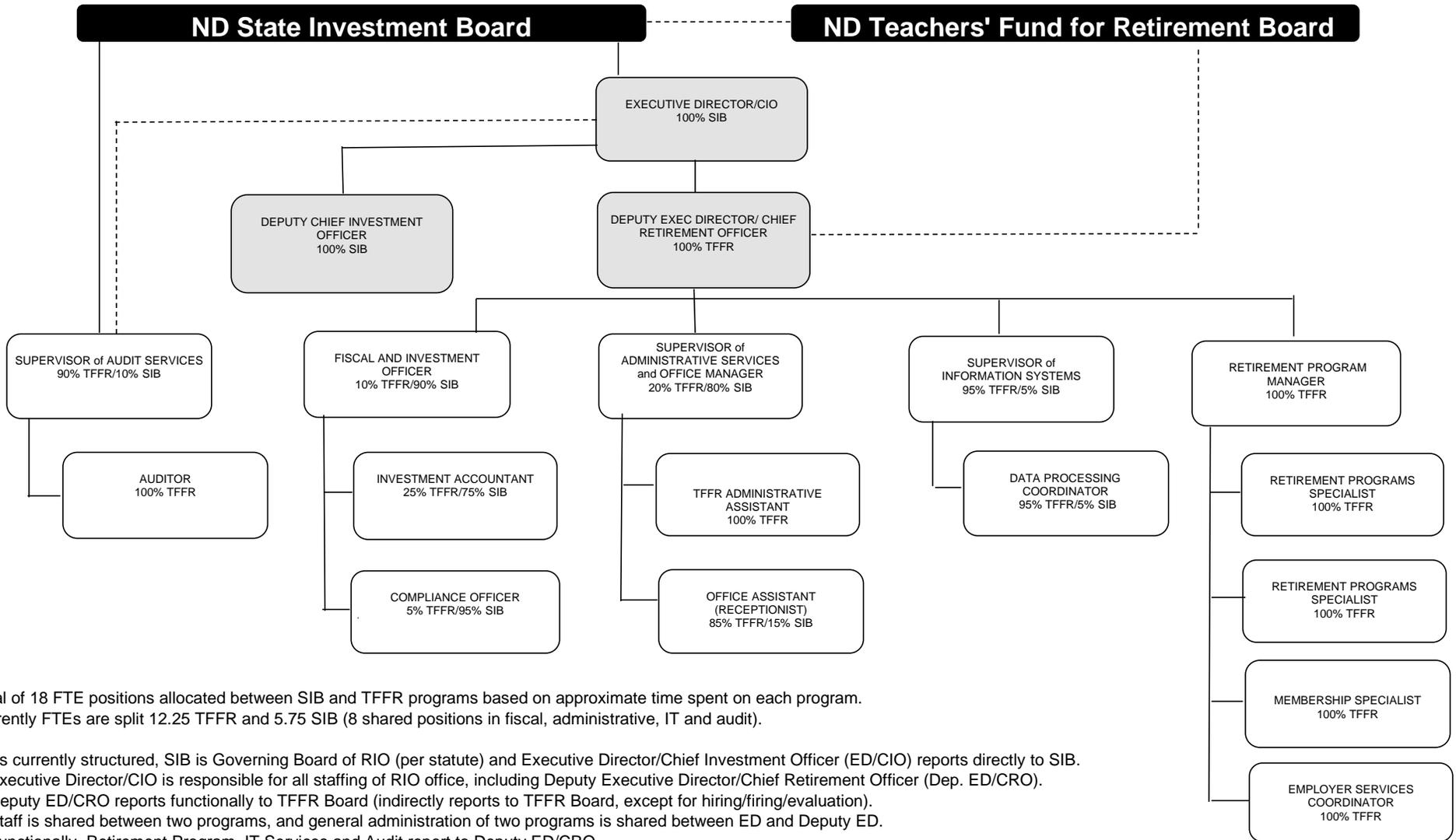
During the past two months, the RIO team has been successful in filling three vacant positions, promoting from within to eliminate a future vacancy in Information Technology and posting for the Audit Supervisor position. We are also in the process of revising our organizational chart to more accurately reflect observed reporting lines from a functional perspective.

The RIO Executive Team understands the importance of proper staffing levels as the success of the Agency is critically dependent on the interaction and effectiveness of our outstanding staff.

- David Hunter joined RIO as Executive Director/CIO on December 2, 2013.
- Cody Schmidt joined RIO as Compliance Officer on December 9, 2013.
- Connie Flanagan will be rejoining RIO as Fiscal and Investment Officer on January 21, 2014.
- Gary Vetter announced his retirement on November 4, 2013 as RIO's Information Technology Supervisor. Mr. Vetter's last day will be March 31, 2014.
- Rich Nagel will be promoted to RIO's Information Technology Supervisor effective April 1, 2014.
- RIO's Audit Supervisor position was posted on December 31, 2013 and closes on January 24, 2014.
- The Investment Analyst position will be posted once an organizational review of investment and fiscal division duties are reviewed.



**ND Retirement and Investment Office (RIO)  
Agency Organizational Chart (December 2013)**



Total of 18 FTE positions allocated between SIB and TFFR programs based on approximate time spent on each program. Currently FTEs are split 12.25 TFFR and 5.75 SIB (8 shared positions in fiscal, administrative, IT and audit).

1. As currently structured, SIB is Governing Board of RIO (per statute) and Executive Director/Chief Investment Officer (ED/CIO) reports directly to SIB.
2. Executive Director/CIO is responsible for all staffing of RIO office, including Deputy Executive Director/Chief Retirement Officer (Dep. ED/CRO).
3. Deputy ED/CRO reports functionally to TFFR Board (indirectly reports to TFFR Board, except for hiring/firing/evaluation).
4. Staff is shared between two programs, and general administration of two programs is shared between ED and Deputy ED.
5. Functionally, Retirement Program, IT Services and Audit report to Deputy ED/CRO.

**BUDGETING / FINANCIAL CONDITION**

**AS OF DECEMBER 31, 2013**

|                        | 2013-2015<br>BUDGET    | ADJUSTED<br>APPROPRIATION | BIENNIUM TO<br>DATE ACTUAL | EXPENDITURES        |                       |                            |
|------------------------|------------------------|---------------------------|----------------------------|---------------------|-----------------------|----------------------------|
|                        |                        |                           |                            | BUDGET<br>AVAILABLE | % BUDGET<br>AVAILABLE | % OF BIENNIUM<br>REMAINING |
| SALARIES AND BENEFITS  | \$ 3,772,504.00        | \$ 3,772,504.00           | \$ 688,889.49              | \$ 3,083,614.51     | 81.74%                | 75.00%                     |
| ACCRUED LEAVE PAYMENTS | 71,541.00              | 71,541.00                 | 20,701.94                  | 50,839.06           | 71.06%                | 75.00%                     |
| OPERATING EXPENDITURES | 973,324.00             | 973,324.00                | 173,267.65                 | 800,056.35          | 82.20%                | 75.00%                     |
| CONTINGENCY            | 82,000.00              | 82,000.00                 | 60,600.33                  | 21,399.67           | 26.10%                | 75.00%                     |
| <b>TOTAL</b>           | <b>\$ 4,899,369.00</b> | <b>\$ 4,899,369.00</b>    | <b>\$ 943,459.41</b>       | <b>3,955,909.59</b> | <b>80.74%</b>         | <b>75.00%</b>              |

## EXPENDITURE REPORT

QUARTER ENDED DECEMBER 31, 2013

|  | INVESTMENT      | RETIREMENT       | QUARTERLY<br>TOTALS | FISCAL YEAR<br>TO - DATE | BIENNIUM<br>TO - DATE |
|--|-----------------|------------------|---------------------|--------------------------|-----------------------|
| <u>CONTINUING APPROPRIATIONS</u>                 |                 |                  |                     |                          |                       |
| INVESTMENT EXPENDITURES<br>(SEE ATTACHED DETAIL) | \$ 3,873,788.35 | \$ 0.00          | \$ 3,873,788.35     | \$ 10,664,771.96         | \$ 10,664,771.96      |
| MEMBER CLAIMS                                    |                 |                  |                     |                          |                       |
| 1. ANNUITY PAYMENTS                              | 0.00            | 39,555,017.55    | 39,555,017.55       | 78,784,317.48            | 78,784,317.48         |
| 2. REFUND PAYMENTS                               | 0.00            | 1,099,094.39     | 1,099,094.39        | 2,653,338.83             | 2,653,338.83          |
| TOTAL MEMBER CLAIMS                              | 0.00            | 40,654,111.94    | 40,654,111.94       | 81,437,656.31            | 81,437,656.31         |
| OTHER CONTINUING APPROPRIATIONS                  | 69,195.60       | 61,708.75        | 130,904.35          | 138,327.61               | 138,327.61            |
| TOTAL CONTINUING APPROPRIATIONS                  | 3,942,983.95    | 40,715,820.69    | 44,658,804.64       | 92,240,755.88            | 92,240,755.88         |
| <u>BUDGETED EXPENDITURES</u>                     |                 |                  |                     |                          |                       |
| 1. SALARIES & BENEFITS                           |                 |                  |                     |                          |                       |
| SALARIES   | 90,733.26       | 162,293.19       | 253,026.45          | 506,470.97               | 506,470.97            |
| OVERTIME/TEMPORARY                               | 2,300.00        | 0.00             | 2,300.00            | 2,300.00                 | 2,300.00              |
| TERMINATION SALARY & BENEFITS                    | 0.00            | 0.00             | 0.00                | 0.00                     | 0.00                  |
| FRINGE BENEFITS                                  | 27,531.38       | 62,267.16        | 89,798.54           | 180,118.52               | 180,118.52            |
| TOTAL SALARY & BENEFITS                          | 120,564.64      | 224,560.35       | 345,124.99          | 688,889.49               | 688,889.49            |
| 2. ACCRUED LEAVE PAYMENTS                        | 10,588.76       | 1,176.53         | 11,765.29           | 20,701.94                | 20,701.94             |
| 3. OPERATING EXPENDITURES                        |                 |                  |                     |                          |                       |
| DATA PROCESSING                                  | 2,332.06        | 17,562.16        | 19,894.22           | 32,056.35                | 32,056.35             |
| TELECOMMUNICATIONS - ISD                         | 966.99          | 1,996.44         | 2,963.43            | 4,937.33                 | 4,937.33              |
| TRAVEL   | 1,523.24        | 9,301.58         | 10,824.82           | 16,352.67                | 16,352.67             |
| IT - SOFTWARE/SUPPLIES                           | 0.00            | 19.00            | 19.00               | 2,244.00                 | 2,244.00              |
| POSTAGE SERVICES                                 | 826.82          | 2,877.46         | 3,704.28            | 18,738.54                | 18,738.54             |
| IT - CONTRACTUAL SERVICES                        | 50.50           | 1,537.30         | 1,587.80            | 30,812.77                | 30,812.77             |
| BUILDING/LAND RENT & LEASES                      | 6,588.33        | 13,143.96        | 19,732.29           | 39,764.58                | 39,764.58             |
| DUES & PROF. DEVELOPMENT                         | 358.00          | 3,877.00         | 4,235.00            | 9,019.00                 | 9,019.00              |
| OPERATING FEES & SERVICES                        | 742.22          | 345.81           | 1,088.03            | 3,175.31                 | 3,175.31              |
| REPAIR SERVICE                                   | 0.00            | 0.00             | 0.00                | 69.25                    | 69.25                 |
| PROFESSIONAL SERVICES                            | 865.56          | 2,923.49         | 3,789.05            | 5,439.05                 | 5,439.05              |
| INSURANCE  | 0.00            | 0.00             | 0.00                | 126.12                   | 126.12                |
| OFFICE SUPPLIES                                  | 51.69           | 337.05           | 388.74              | 534.97                   | 534.97                |
| PRINTING   | 105.41          | 3,729.33         | 3,834.74            | 7,292.40                 | 7,292.40              |
| PROFESSIONAL SUPPLIES & MATERIALS                | 0.00            | 255.00           | 255.00              | 255.00                   | 255.00                |
| MISCELLANEOUS SUPPLIES                           | 27.13           | 87.18            | 114.31              | 172.55                   | 172.55                |
| IT EQUIPMENT UNDER \$5000                        | 0.00            | 1,664.96         | 1,664.96            | 1,664.96                 | 1,664.96              |
| OTHER EQUIPMENT UNDER \$5000                     | 0.00            | 612.80           | 612.80              | 612.80                   | 612.80                |
| TOTAL OPERATING EXPENDITURES                     | 14,437.95       | 60,270.52        | 74,708.47           | 173,267.65               | 173,267.65            |
| 3. CONTINGENCY                                   | 32,868.00       | 0.00             | 32,868.00           | 60,600.33                | 60,600.33             |
| TOTAL BUDGETED EXPENDITURES                      | 178,459.35      | 286,007.40       | 464,466.75          | 943,459.41               | 943,459.41            |
| TOTAL EXPENDITURES                               | \$ 4,052,247.70 | \$ 40,940,119.34 | \$ 45,123,271.39    | \$ 93,184,215.29         | \$ 93,184,215.29      |

**INVESTMENT EXPENDITURE DETAIL**

**FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2013**

**FOR QUARTER ENDED 6/30/13**

**PENSION DEVELOPED INTERNATIONAL EQUITY POOL**

|              |           |
|--------------|-----------|
| State Street | 12,426.66 |
|--------------|-----------|

**PENSION GLOBAL EQUITY POOL**

|         |           |
|---------|-----------|
| Calamos | 96,674.00 |
|---------|-----------|

**PENSION INVESTMENT GRADE FIXED INCOME POOL**

|              |        |
|--------------|--------|
| State Street | 992.26 |
|--------------|--------|

**PENSION REAL ESTATE**

|                                 |            |
|---------------------------------|------------|
| JP Morgan (Special & Strategic) | 311,795.16 |
|---------------------------------|------------|

**INSURANCE FIXED INCOME POOL**

|              |          |
|--------------|----------|
| State Street | 2,308.97 |
|--------------|----------|

|  |                   |
|--|-------------------|
| <b>TOTAL FOR QUARTER ENDED 6/30/13</b> | <b>424,197.05</b> |
|--|-------------------|

**FOR QUARTER ENDED 9/30/13**

**PENSION DEVELOPED INTERNATIONAL EQUITY POOL**

|                                    |            |            |
|------------------------------------|------------|------------|
| Capital Guardian                   | 84,885.89  |            |
| Clifton - EAFE Index               | 45,029.00  |            |
| Wellington                         | 162,659.64 |            |
| TOTAL PENSION INTERNATIONAL EQUITY | <hr/>      | 292,574.53 |

**PENSION GLOBAL EQUITY POOL**

|                            |            |            |
|----------------------------|------------|------------|
| Calamos                    | 103,284.00 |            |
| Epoch                      | 405,396.75 |            |
| LSV                        | 112,033.00 |            |
| Pension Global Equity Pool | <hr/>      | 620,713.75 |

**PENSION BELOW INVESTMENT GRADE FIXED**

|               |            |
|---------------|------------|
| Loomis Sayles | 241,169.90 |
|---------------|------------|

**PENSION INVESTMENT GRADE FIXED INCOME POOL**

|               |           |
|---------------|-----------|
| Western Asset | 48,265.12 |
|---------------|-----------|

**PENSION INFRASTRUCTURE POOL**

|           |            |
|-----------|------------|
| JP Morgan | 313,073.27 |
|-----------|------------|

**PENSION LARGE CAP EQUITY POOL**

|            |            |
|------------|------------|
| LA Capital | 214,967.84 |
|------------|------------|

**PENSION REAL ESTATE**

|         |            |
|---------|------------|
| Invesco | 140,503.45 |
|---------|------------|

**PENSION INTERNATIONAL FIXED INCOME**

|  |            |            |
|--|------------|------------|
| Brandywine                               | 105,395.56 |            |
| UBS                                      | 68,761.03  |            |
| TOTAL PENSION INTERNATIONAL FIXED INCOME | <hr/>      | 174,156.59 |

**INVESTMENT EXPENDITURE DETAIL****FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2013****PENSION EMERGING MARKETS**

|                                |           |            |
|--------------------------------|-----------|------------|
| JP Morgan                      | 46,096.09 |            |
| PanAgora                       | 28,168.94 |            |
| UBS                            | 48,369.15 |            |
| TOTAL PENSION EMERGING MARKETS |           | 122,634.18 |

**PENSION PRIVATE EQUITY**

|                       |  |           |
|-----------------------|--|-----------|
| Adams Street Partners |  | 27,301.00 |
|-----------------------|--|-----------|

**PENSION CASH**

|                |  |           |
|----------------|--|-----------|
| Northern Trust |  | 16,791.46 |
|----------------|--|-----------|

**INSURANCE FIXED INCOME POOL**

|                              |            |            |
|------------------------------|------------|------------|
| Declaration                  |            |            |
| Prudential                   | 50,560.85  |            |
| Wells                        | 155,590.71 |            |
| Western Asset                | 94,104.90  |            |
| TOTAL INSURANCE FIXED INCOME |            | 300,256.46 |

**INSURANCE LARGE CAP EQUITY POOL**

|                           |           |           |
|---------------------------|-----------|-----------|
| LA Capital                | 50,785.77 |           |
| LSV                       | 47,899.00 |           |
| TOTAL INSURANCE LARGE CAP |           | 98,684.77 |

**INSURANCE SMALL CAP EQUITY POOL**

|                     |  |           |
|---------------------|--|-----------|
| Research Affiliates |  | 40,035.70 |
|---------------------|--|-----------|

**INSURANCE INT'L EQUITY**

|                              |           |            |
|------------------------------|-----------|------------|
| Capital Guardian             | 75,419.57 |            |
| LSV                          | 74,423.00 |            |
| TOTAL INSURANCE INT'L EQUITY |           | 149,842.57 |

**INSURANCE INFLATION PROTECTED**

|                                     |            |            |
|-------------------------------------|------------|------------|
| JP Morgan                           | 214,210.59 |            |
| Western Asset                       | 87,560.28  |            |
| TOTAL INSURANCE INFLATION PROTECTED |            | 301,770.87 |

**INSURANCE REAL ESTATE**

|                             |            |            |
|-----------------------------|------------|------------|
| Invesco                     | 43,403.02  |            |
| JP Morgan                   | 213,328.00 |            |
| TOTAL INSURANCE REAL ESTATE |            | 256,731.02 |

**PERS RETIREE HEALTH INSURANCE CREDIT FUND**

|     |  |           |
|-----|--|-----------|
| SEI |  | 52,406.82 |
|-----|--|-----------|

**CONSULTANT**

|              |  |           |
|--------------|--|-----------|
| Adams Street |  | 37,712.00 |
|--------------|--|-----------|

**TOTAL FOR QUARTER ENDED 9/30/13** **3,449,591.30**

**TOTAL FEES PAID DURING QUARTER ENDED 9/30/2013** **3,873,788.35**

# NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

## QUARTERLY MONITORING REPORT

Quarter Ended December 31, 2013

### STAFF RELATIONS

The Executive Limitation "Staff Relations" deals with the treatment of staff at RIO. The executive director "shall not cause or allow any condition or any communication which is unfair, undignified, or disrespectful." This Executive Limitation lists six specific limitations that range from personnel policies to exit interviews. All the limitations are intended to protect staff from unfair, undignified, or disrespectful treatment by management.

**During the past quarter, there were no exceptions to this Executive Limitation.**

David Hunter joined RIO as Executive Director/CIO on December 2, 2013.

Cody Schmidt joined RIO as Compliance Officer on December 9, 2013.

Connie Flanagan will be rejoining RIO as Fiscal and Investment Officer on January 21, 2014.

Gary Vetter announced his retirement on November 4, 2013 as RIO's Information Technology Supervisor. Mr. Vetter's last day will be March 31, 2014.

Rich Nagel will be promoted to RIO's Information Technology Supervisor effective April 1, 2014.

RIO's Audit Supervisor position was posted on December 31, 2013 and closes on January 24, 2014.

**Quarterly Report on Ends  
Q2:FY14**

Investment Program

Continuing due diligence conducted on following:

|                |                |               |
|----------------|----------------|---------------|
| Hamilton Lane  | DB Fitzpatrick | MSCI Barra    |
| Clifton Group  | Vontobel       | Prudential    |
| Blackrock      | DFA            | PIMCO         |
| Northern Trust | UBS            | Adams Street  |
| Sands Capital  | TRowe Price    | Credit Suisse |
| LSV            | State Street   |               |

At the October SIB meeting, the State Investment Board approved the transition of the Declaration Management & Research separate account mortgage mandate within the insurance trust to the Total Return Bond Fund. Staff commenced the execution of the transition in November.

At the October SIB meeting, the State Investment Board approved a plan to reduce the number of non-U.S. manager mandates as part of the first phase of restructuring the global equity asset class within the pension trust. The transition was initiated and completed in the month of December.

At the November SIB meeting, the State Investment Board approved a \$70 commitment to Invesco Value Added Fund IV and a \$35 million commitment to Invesco Asia Real Estate Fund III. A legal contract review is in progress.

Staff finalized the new consulting services agreement with Callan Associates in October.

Staff continued to progress with the implementation of the new strategic asset allocation for the Legacy Fund, which is expected to be completed in January 2015.

Staff attended meetings with the following entities: TFFR Board, NDPERS Investment Subcommittee, Legacy and Budget Stabilization Advisory Board, Legislative Employee Benefits Programs Committee, Legislative Government Finance Committee, North Dakota Board of Medical Examiners, and the North Dakota Association of Counties.

Staff continues to conduct preliminary due diligence on possible managers/products for future consideration.

Staff continues to monitor each client's asset allocation monthly and makes rebalancing decisions based on rebalancing policy and cash flow requirements.

## **Quarterly Monitoring Report on TFFR Ends Quarter ended December 31, 2013**

### **Retirement Program**

This report highlights exceptions to normal operating conditions.

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- NDRTA, NDUnited, and NDCEL honored TFFR's 100-year anniversary at their fall 2013 conventions. A centennial slide show depicting TFFR's history (1913-2013) was presented. The TFFR Board also recognized the event at their October board meeting.
- TFFR's actuary presented 2013 annual actuarial valuation report and funding projections to TFFR Board and the Legislative Employee Benefits Programs Committee. Actuary provided board and legislative committee education on GASB pension reporting changes.
- Staff from TFFR, PERS, and State Auditor's Office met to begin formulating a collaborative plan to implement the new GASB pension reporting standards.
- TFFR received 2013 Public Pension Standards Award for Funding and Administration. This award is designed to recognize and commend public employee retirement systems that meet professional standards for pension plan funding and administration.
- TFFR staff presented first group benefits counseling session for Fargo Public Schools. Over 50 Fargo area teachers attended the session.