A Report
to the
Montana
Legislature

Financial Audit

Teachers' Retirement System

For the Two Fiscal Years Ended June 30, 2009

November 2009

Legislative Audit
Division

08-09B

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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

November 2009

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report on the Teachers' Retirement System (system), a component unit of the state of Montana, for the fiscal year ended June 30, 2009. This report contains one recommendation related to the actuarial soundness of the system.

We issued an unqualified opinion on the system's financial statements for the two fiscal years ended June 30, 2009. Our opinion on the system's financial statements is also contained in the Teachers' Retirement System Comprehensive Annual Financial (CAFR) Report. The CAFR contains additional background, statistical, investment and actuarial information not included in this audit report, which may be of interest to legislators or the public. Copies of the CAFR can be obtained from the Teachers' Retirement System or accessed on its website. The CAFR for fiscal year 2008-09 is expected to be available in late December 2009.

The system's response to our audit is on page B-1. We thank the Executive Director and his staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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Appointed and Administrative Officials

			Term Expires
Teachers' Retirement Board	Kari Peiffer, Chair	Kalispell	7/1/12
	Darrell Laymen, Vice Chair	Glendive	7/1/11
	Scott Dubbs	Lewistown	7/1/13
	Jeff Greenfield	Shepherd	7/1/11
	Robert Pancich	Great Falls	7/1/14
	James Turcotte	Helena	7/1/10

Administrative Officials

David L. Senn, Executive Director

Tammy Rau, Deputy Executive Director

Dan Gaughan, Accounting/Fiscal Manager

For additional information concerning the Teachers' Retirement System, contact:

David L. Senn, Executive Director
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P.O. Box 200139
Helena, MT 59620-0139
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Report Summary

Teachers' Retirement System

This report documents the results of our financial audit of the Teachers' Retirement System for the fiscal year ended June 30, 2009. This report contains a recommendation related to the actuarial soundness of the system.

System personnel prepare the financial statements from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustment. We issued an unqualified opinion on the financial statements presented in this report, which means the reader can rely on the financial information presented.

The listing below serves as a means of summarizing the recommendations contained in the report, the system's response thereto, and a reference to the supporting comments.

Recommendation #1 4

We recommend the Teachers' Retirement System take necessary measures to ensure the system is funded on an actuarially sound basis as required by the State of Montana Constitution and board policy.

System Response: Conditionally Concur B-1

Chapter I – Introduction

Introduction

We performed a financial audit of the Teachers' Retirement System (system) for the fiscal year ended June 30, 2009. The objectives of our audit were to:

- Determine the system's compliance with direct and material laws and regulations.
- Obtain an understanding of the system's control processes, and if appropriate, make recommendations for improvement in the internal and management controls of the system.
- Determine if the financial statements prepared by system personnel fairly present the fiduciary net assets of the system as of June 30, 2009, and the changes in fiduciary net assets for the fiscal year then ended, in conformity with generally accepted accounting principles.

The financial statements are prepared by system personnel from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustment. Adjustments are made to correct errors in the accounting records and to accurately present financial activity to the readers of the statements in accordance with generally accepted accounting principles (GAAP). As such, a reader should not expect these financial statements to agree in all instances to the state's primary accounting records.

This report contains a recommendation regarding the unfunded actuarial liability. Other areas of concern deemed not to have a significant effect on the successful operations of the system are not specifically included in the report, but have been discussed with management. In accordance with §5-13-307, MCA, we analyzed the cost of implementing the recommendation contained in this report and determined it was significant; this is discussed in the report section beginning on page 3.

Background

The system is a component unit of the state of Montana. A component unit is a legally separate organization for which the state of Montana is financially accountable. The system, established by state law in 1937, had more than 18,400 active members not yet receiving benefits at July 1, 2009. Approximately 12,000 retirees or their beneficiaries were receiving retirement, disability, or survivor benefits as of July 1, 2009.

A six-member board, appointed by the Governor for five-year terms, governs the system. In addition to providing oversight to system personnel, the board's responsibilities include:

- Establishing rules and regulations necessary for the proper administration and operation of the retirement system.

- Determining the eligibility of a person who is applying for membership in the system.
- Designating an actuary to provide consultation on the technical actuarial aspects of the retirement system.

The Executive Director and system personnel are responsible for the daily administration of the system. At June 30, 2009, 17 full-time equivalent (FTE) positions were authorized for the system.

All full-time members of the public teaching profession, except for eligible employees of the Montana University System hired after July 1, 1993, are required by law to be members in the retirement system. All contributions are exempt from income tax to the employees until benefits are drawn against those contributions. The system implemented a Guaranteed Annual Benefit Adjustment (GABA) effective in January 2000. Retirees are eligible for GABA once they have received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made. GABA provides eligible retirees with a guaranteed 1.5 percent increase in retirement benefits on an annual basis.

Prior Audit Recommendations

Our office performed the prior financial-compliance audit of the Teachers' Retirement System for the two fiscal years ended June 30, 2008. The system concurred with the two recommendations contained in the report. The system partially implemented one and did not implement one of the recommendations.

The partially implemented recommendation relates to the documentation and monitoring of internal controls. In our prior audit, we recommended the system document procedures to monitor and test internal controls in accordance with state policy. In response, the Teachers' Retirement System staff drafted an internal controls testing and monitoring policy that was approved at the May 2009 board meeting. Due to the timing of the approval, there was not time to actually perform the testing and monitoring needed. We make no additional recommendation at this time.

The recommendation not implemented addresses the need for the system to take necessary measures to ensure the system is funded on an actuarially sound basis as required by the Montana Constitution. We determined that this recommendation has not been implemented. The system's actuarial soundness is discussed in this report beginning on page 3.

Chapter II – Findings and Recommendations

System Not Actuarially Sound

The results of the July 1, 2009 actuarial valuation show the Teachers' Retirement System is not actuarially sound.

Article VIII, Section 15, of the Constitution of the State of Montana, requires public retirement systems to be funded on an actuarially sound basis. To be actuarially sound, Government Accounting Standards Board Statement No. 25, paragraph 36, provides that the maximum amortization period for an unfunded actuarial accrued liability (UAAL) is 30 years.

The most recent actuarial valuation, performed as of July 1, 2009, indicates the system is not actuarially sound and the system does not amortize. Below is a chart of the actuarial soundness of the system for the last seven valuations.

Table 1
History of Plan Soundness

Valuation Date	Actuarially Sound	Amortization Period
July 1, 2002	Yes	23.4
July 1, 2004*	No	71.3
July 1, 2005	No	Does not amortize
July 1, 2006**	No	Does not amortize
July 1, 2007***	Yes	28.6
July 1, 2008	No	31.3
July 1, 2009	No	Does not amortize

*Prior to 2004, valuations were performed every two years.

**Legislature provided supplemental cash contribution of $100 million

***Legislature provided supplemental cash contribution of $50 million

Source: Compiled by the Legislative Audit Division.

The funding policy of the system's board (Board) provides, "Whenever the amortization period of the unfunded liabilities for two consecutive evaluations are projected to exceed 30 years based on the market value of assets, or the funded ratio is less than 85 percent, and the Board cannot reasonably anticipate that the amortization period would decline or the funded ratio improve without an increase in funding sources, it is

the obligation of the Board to recommend to the legislature that funding be increased and/or liabilities be reduced." The funding ratio refers to the portion of the UAAL that can be satisfied with the current level of investments. The required contributions are noted below.

Contributions as a Percent of Pay

	Members	Participating Employers	State General Fund Contribution	Total
Prior to July 1, 2007	7.15%	7.47%	0.11%	14.73%
July 1, 2007 to June 30, 2009	7.15%	7.47%	2.11%	16.73%
July 1, 2009 and beyond	7.15%	7.47%	2.49%	17.11%

The actuarial valuation disclosed that the amortization period at July 1, 2009, is infinite and the funded ratio is currently 66.18 percent. Additionally, the actuarial valuation noted the system's market value investments had a return of -20.80 percent for the year ended June 30, 2009. This is 28.55 percent less than the actuarial assumed rate, which was 7.75 percent. This represents an asset loss of $843.7 million less than was expected due to lower investment returns.

The valuation also notes that, based on market assets, a contribution increase of 7.54 percent of pay (from 17.11 percent to 24.65 percent) for the fiscal year ended 2012 would be needed to maintain an amortization of the unfunded actuarial accrued liability over a 30 year period.

Recommendation #1

We recommend the Teachers' Retirement System take necessary measures to ensure the system is funded on an actuarially sound basis as required by the State of Montana Constitution and board policy.

Independent Auditor's Report

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Fiduciary Net Assets of the Teachers' Retirement System, a component unit of the state of Montana, as of June 30, 2009 and June 30, 2008, and the related Statement of Changes in Fiduciary Net Assets for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Teachers' Retirement Board. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teachers' Retirement System as of June 30, 2009, and 2008, and its changes in fiduciary net assets for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, the Schedule of Funding Progress, and the Schedule of Contributions from the Employer and Other Contributing Entities are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Teachers' Retirement System. The Supporting Schedule of Administrative Expenses and Schedule of Payments to Consultants are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures

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applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

At July 1, 2009, the Teachers' Retirement System was not actuarially sound. The amortization period for the Unfunded Actuarially Accrued Liability is infinite. The maximum allowable amortization period is 30 years.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 4, 2009

Teachers' Retirement System
Management's Discussion and Analysis, Financial Statements, Required Supplementary Information, and Supplemental Information

TEACHERS' RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis provides an overview of the financial activity of the Montana Teachers' Retirement System's (TRS) for the fiscal year ended June 30, 2009, with comparative totals for the fiscal years ended June 30, 2008 and 2007. Please read this in conjunction with the financial statements, accompanying footnotes, required supplementary information with notes, and supporting schedules.

Overview of the Financial Statements

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the System's ongoing plan perspective.

The financial section consists of two financial statements with footnotes, two schedules of historical trend information with footnotes, and two supporting schedules. The Statement of Fiduciary Net Assets reflects the resources available to pay benefits to retirees and beneficiaries. The Statement of Changes in Fiduciary Net Assets presents the changes that occurred in those resources for the fiscal year ended.

The Schedule of Funding Progress presents historical trend information about the actuarially funded status for the TRS plan from a long-term, ongoing perspective and the progress made in accumulating sufficient assets to pay benefits when due. The Schedule of Contributions from the Employer and Other Contributing Entities displays historical trend data of the annual required employer contributions and the actual contributions made by employers in relation to the requirement.

The Schedule of Administrative Expenses is a presentation of what comprises the administrative expense item as reported on the Statement of Changes in Fiduciary Net Assets. The Schedule of Payments to Consultants represents our fees paid to outside professionals.

Financial Highlights

- Beginning July 1, 2009, the employer contribution rate increases from 9.47% to 9.85%.
- The TRS plan net assets decreased by another $691.8 million for 2009 following a decrease of $215.9 million in 2008, representing a 23.1% and 6.7% decrease respectively.
- Net investment income (fair value of investments plus investment income less investment expense) decreased in 2009 by $299.9 million and in 2008 by $131.6 million representative of the continued negative volatility of the stock market.
- Pension benefits paid to beneficiaries and plan members increased 7.0% and 7.3% for the last two fiscal years respectively.

Condensed Financial Information (in millions)

Fiduciary Net Assets	FY2009	FY2008	FY2007	2009 Percent Inc/(Dec)	2008 Percent Inc/(Dec)
Cash/Short-term Investments	$ 25.5	$ 31.8	$ 88.4	(19.8)	(64.0)
Receivables	22.6	29.5	21.5	(23.4)	37.2
Investments (fair value)	2,463.9	3,113.1	3,256.3	(20.9)	(4.4)
Capital Assets (net)	0.3	0.3	0.3	0	0
Total Assets	2,512.2	3,174.7	3,366.6	(20.9)	(5.7)
Liabilities	210.6	181.3	157.3	16.2	15.3
Net Assets	**$2,301.6**	**$2,993.4**	**$3,209.3**	**(23.1)**	**(6.7)**
Changes in Fiduciary Net Assets					
Additions:					
Employer Contributions	$ 66.9	$ 67.9	$ 61.9	(1.5)	9.7
Plan Member Contributions	57.3	59.6	56.5	(3.9)	5.5
Other Contributions	14.1	13.5	0.7	4.4	1,828.6
Payment from State of Montana	0	0	50.0	0	(100.0)
Net Investment Income	(613.0)	(153.3)	484.5	(299.9)	(131.6)
Total Additions	(474.8)	(12.3)	653.7	(3,760.2)	(101.9)
Deductions:					
Benefit Payments	209.9	196.1	182.8	7.0	7.3
Withdrawals	5.2	5.7	5.6	(8.8)	1.8
Administrative Expenses	1.9	1.8	1.4	5.6	28.6
Loss on Intangible Asset	0	0	0.5	0	(100.0)
Total Deductions	217.0	203.6	190.4	6.6	6.9
Net Inc/(Dec) in Net Assets	**$ (691.8)**	**(215.9)**	**$ 463.4**	**(220.4)**	**(146.6)**

Financial Analysis

- The decrease from year-to-year in cash/short-term investments is due mostly to the change in the number of shares held, a per share value of $1, in the Short Term Investment Pool.
- The decrease in receivables for 2009 represents a $2.4 million less in investment interest receivable and $4.5 million less in contributions due at fiscal year end. The significant increase in receivables for 2008 reflects the supplemental payment due at fiscal year end from the general fund in relation to the 2% increase in the employer contribution rate for school districts that was effective July 1, 2007.
- The decrease in investments for 2009 and 2008 respectively is due primarily to the decline in the fair market value of our investment holdings.
- The significant fluctuation in liabilities is due to the security lending collateral activity conducted by the Montana Board of Investments.
- The significant decrease in net investment income in 2009 primarily reflects the continued decline in the fair value of investments of $435.5 million. The decrease in 2008 was due to a $590.7 million drop in the fair value of investments and $40.8 million less in investment earnings.
- The increase in benefit payments from year-to-year reflects an increase in the number of retirees and beneficiaries plus the 1.5% guaranteed annual benefit adjustment.

Overview of the Actuarial Funding

The TRS plan experienced an asset loss over the last year. The market assets had a negative return of 20.8% net of investment and operating expenses. The actuarial assets earned a negative 10.3% which is 18.0% below the actuarial assumption of 7.75%. Actuarial gains or losses result when the return on the actuarial value of assets differs from the actuarial investment return assumption. The following table compares the annual returns for the past six years.

Fiscal Year	Market Return	Actuarial Return	Actuarial Return over 7.75 % Assumption (8.00% prior to 7/1/04)
7/1/2003 to 6/30/2004	13.3%	2.1%	(5.9)%
7/1/2004 to 6/30/2005	8.0%	2.7%	(5.0)%
7/1/2005 to 6/30/2006	8.9%	8.5%	0.7%
7/1/2006 to 6/30/2007	17.6%	10.2%	2.5%
7/1/2007 to 6/30/2008	(4.9)%	7.2%	(0.6)%
7/1/2008 to 6/30/2009	(20.8)%	(10.3)%	(18.0)%

The chart above shows the actuarial return on assets has underperformed the assumption more than it has exceeded the assumption in the last six years. The 2007 Legislature increased funding contributions as noted below.

Contributions as a Percent of Pay

	Members	Employer Rate	State Contribution	Total
Prior to July 1, 2007	7.15%	7.47%	0.11%	14.73%
July 1, 2007 - June 30, 2009	7.15%	9.47%	0.11%	16.73%
July 1, 2009 and after	7.15%	9.85%	0.11%	17.11%

The State's General Fund picked up the increase in the employer rate of 2% effective July 1, 2007 and 2.38% effective July 1, 2009 in lieu of the contributions being paid by the school district and community college employers.

The July 1, 2008 actuarial valuation calculated a 31.3 year amortization period for the Unfunded Actuarial Accrued Liability. If there were no assumption changes, or experience gains and losses, the amortization period would have been expected to decrease by 1.0 a year to 30.3 at July 1, 2009. The experience gains and losses (primarily asset losses) from the year ending June 30, 2009, increased the amortization period. The resulting amortization period at July 1, 2009, is infinite. The net funded ratio is currently 66.18%.

Section 19-20-201, MCA, requires the actuarial report to show how market performance is affecting the actuarial funding of the Retirement System. The July 1, 2009 market value of assets is $460.4 million less than the actuarial value of assets due to a negative 20.8% market return in the year ended June 30, 2009. If the market value of assets was used, the amortization period would be infinite, and the net Funded Ratio would be 55.15%. Based on market assets, a contribution increase of 7.54% of pay (17.11% to 24.65%) for the fiscal year ending June 30, 2012, is projected to maintain an amortization of the unfunded actuarial accrued liability over a 30 year period.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2009 AND 2008

	2009	2008
ASSETS		
Cash/Cash Equivalents-Short Term		
Investment Pool (Note B)	$ 25,485,799	$ 31,811,457
Receivables:		
Accounts Receivable	14,319,630	18,946,006
Interest Receivable	4,840,668	7,292,299
Due from Primary Government	3,405,139	3,241,381
Total Receivables	$ 22,565,437	$ 29,479,686
Investments, at fair value (Note B):		
Mortgages	$ 20,491,720	$ 27,120,606
Investment Pools	2,222,769,923	2,893,544,962
Other Investments	10,511,607	11,426,652
Securities Lending Collateral (Note B)	210,084,770	180,987,059
Total Investments	$ 2,463,858,020	$ 3,113,079,279
Assets Used in Plan Operations:		
Land and Buildings	$ 193,844	$ 193,844
Less: Accumulated Depreciation	(147,409)	(143,645)
Equipment	63,662	63,662
Less: Accumulated Depreciation	(53,076)	(48,999)
Prepaid Expense	0	647
Intangible Assets, net of amortization	215,843	252,351
Total Other Assets	$ 272,864	$ 317,860
TOTAL ASSETS	$ 2,512,182,120	$ 3,174,688,282
LIABILITIES		
Accounts Payable	$ 186,799	$ 88,004
Due to Primary Government	16,891	14,434
Accountability for Advances	3,841	0
Securities Lending Liability (Note B)	210,084,770	180,987,059
Compensated Absences (Note B)	174,174	158,675
OPEB Implicit Rate Subsidy	96,974	47,478
TOTAL LIABILITIES	$ 210,563,449	$ 181,295,650
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 2,301,618,671	$ 2,993,392,632

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FISCAL YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
ADDITIONS		
Contributions:		
Employer	$ 66,850,644	$ 67,921,950
Plan Member	57,256,365	59,552,619
Other	14,147,324	13,492,375
Total Contributions	$ 138,254,333	$ 140,966,944
Misc Income	$ 15,421	$ 15,654
Investment Income:		
Net Appreciation/(Depreciation) in Fair Value of Investments	$ (671,926,498)	$ (236,359,446)
Investment Earnings	70,040,815	96,731,693
Security Lending Income (Note B)	4,318,004	9,544,163
Investment Income/(Loss)	$ (597,567,679)	$ (130,083,590)
Less: Investment Expense	13,562,768	15,425,847
Less: Security Lending Expense (Note B)	1,897,208	7,802,791
Net Investment Income/(Loss)	$ (613,027,655)	$ (153,312,228)
Total Additions	$ (474,757,901)	$ (12,329,630)
DEDUCTIONS		
Benefit Payments	$ 209,942,663	$ 196,060,216
Withdrawals	5,170,028	5,694,601
Administrative Expense	1,853,873	1,750,765
OPEB Expenses	49,496	47,478
Total Deductions	$ 217,016,060	$ 203,553,060
NET INCREASE (DECREASE) IN PLAN NET ASSETS	$ (691,773,961)	$ (215,882,690)
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS BEGINNING OF YEAR	2,993,392,632	3,209,275,322
END OF YEAR	$ 2,301,618,671	$ 2,993,392,632

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE FINANCIAL STATEMENTS
FISCAL YEARS ENDED JUNE 30, 2009 AND 2008

NOTE A. DESCRIPTION OF THE PLAN

The Teachers' Retirement Board is the governing body of a mandatory multiple-employer cost-sharing defined benefit pension plan, which provides retirement services to persons in Montana employed as teachers or professional staff of any public elementary or secondary school, community college, or unit of the university system. The system was established by the State of Montana in 1937 to provide retirement, death, and disability benefits and is governed by Title 19, chapter 20, of the MCA. TRS as an employer does not participate in the plan and acts only as the administrator of the plan.

At June 30, 2009, the number and type of reporting entities participating in the system were as follows:

Local School Districts	349
Community Colleges	3
University System Units	2
State Agencies	8
Total	362

At July 1, 2009, the date of the most recent actuarial valuation system membership consisted of the following:

Retirees and Beneficiaries Currently Receiving Benefits	12,036
Terminated Employees:	
Vested	1,640
Non-vested	9,868
Current Active Members:	
Vested	11,876
Non-vested	6,580
Total Membership	42,000

The pension plan provides retirement, death, and disability benefits. Employees with a minimum of 25 years of service or who have reached age 60 with 5 years of service are eligible to receive an annual retirement benefit equal to creditable service years divided by 60 times the average final compensation. Final compensation is the average of the highest three consecutive years of earned compensation. Benefits fully vest after 5 years of creditable service. Vested employees may retire at or after age 50 and receive reduced retirement benefits. A Guaranteed Annual Benefit Adjustment (GABA) of 1.5% is payable each January if the retiree has received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The TRS, a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity, prepares its financial statements using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period when due pursuant to statutory requirements and investment income is recognized when earned. Benefit and withdrawal payments are recorded in the period in which the liabilities are due and payable.

Compensated Absences

Compensated absences represent 100 percent of accrued vacation and 25 percent of accrued sick leave for TRS personnel at June 30, 2009 and June 30, 2008.

Cash/Cash Equivalents and Investments

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. Per the Montana Constitution, Article VIII Section 13(3), investment of TRS assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of an enterprise of a similar character with similar aims. Investments administered by the BOI for the TRS are subject to their investment risk policies. Information on investment policies, investment activity, investment management fees and a listing of specific investments owned by the pooled asset accounts can be obtained from Board of Investments at P.O. Box 200126, Helena, MT 59620-0126.

Information about the primary government's (State of Montana) investments, including credit risk classification, can be obtained from the Department of Administration, State Accounting Division, at P.O. Box 200102, Helena, MT 59620-0102.

Cash and cash equivalents consist of funds deposited in the State Treasurer's pooled cash account and cash invested in the Short-Term Investment Pool (STIP). Pool investments other than STIP are reported at the fair value of each unit times the number of units owned. STIP is recorded at $1 per unit for each unit held. The fair value of publicly traded stocks and bonds is determined by reference to market prices supplied by State Street Bank (the custodial bank). Because a public market does not exist for private equity and real estate investments, the fair value of these investments is the value reported in the most recent external managers' valuation reports.

The TRS investments include: STIP; Retirement Funds Bond Pool (RFBP); Montana Domestic Equity Pool (MDEP); Montana International Equity Pool (MTIP); Montana Private Equity Pool (MPEP), Montana Real Estate Pool (MTRP), mortgages and real estate.

The TRS Investment Portfolio is listed below:

TRS Cash Equivalent and Investment Portfolio
June 30, 2009

Investment	Book Value	Fair Value
STIP	$ 25,893,766	$ 25,893,766
RFBP	683,779,834	662,541,761
MDEP	529,924,277	814,890,157
MTIP	328,858,701	376,245,403
MPEP	233,113,970	258,450,838
MTRP	149,634,000	110,641,764
Mortgages	20,824,266	20,491,720
Real Estate	8,232,917	8,357,337
Total	$ 1,980,261,731	$ 2,277,512,746

Securities Lending - Under the provisions of state statutes, BOI authorized the custodial bank to lend the BOI securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The custodial bank is required to maintain collateral equal to 102 percent of the fair value of domestic securities and 105 percent of the fair value of international securities while the securities are on loan. The BOI and the custodial bank split the earnings on security lending activities. The securities lending collateral, securities lending collateral liability, securities lending income, and securities lending expense consist of allocations to TRS on a pro rata basis of its ownership share of each pool with securities lending activity. At June 30, 2009, and 2008, the BOI had no credit risk exposure to borrowers because the collateral pledged by the borrowers exceeded the value of the securities borrowed. The private equity and real estate Pools do not participate in securities lending.

Mortgages and Real Estate – The mortgages consist of a portfolio of Montana residential mortgages and the real estate holdings represent an equity interest in four real estate properties.

The investment risks for the pooled investments that TRS participates in are described in the following paragraphs.

Credit Risk – Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

Custodial Credit Risk - Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the BOI may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's investment in a single issuer.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement No. 40, the BOI selected the effective duration method to disclose interest rate risk.

All securities in pools are held in the name of the Montana BOI, or were registered in the nominee name for the Montana BOI and held in the possession of the BOI's custodial bank. MDEP, MTIP, MPEP, and MTRP do not invest in debt securities, so interest rate risk, credit risk, and concentration of credit risk do not apply to these holdings. MTIP, MPEP, and MTRP include assets subject to foreign currency risk. At June 30, 2009, approximately 33% of the combined portfolios are held in foreign currencies.

According to GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a7-like pool. RFBP has an effective duration of 4.08 and 4.63 for the pool at June 30, 2009, and 2008, respectively.

NOTE C. CONTRIBUTIONS

The TRS funding policy provides for monthly employee and employer contributions at rates specified by state law. Plan members are currently required to contribute 7.15% of their earned compensation and the employer contribution rate for fiscal year 2009 was 9.47% of earned compensation. The State's General Fund contributed 2% of earned compensation by school district and community college members and an additional .11% of total earned compensation. Each employer in the Montana university system shall contribute to the TRS a supplemental employer contribution currently at a rate of 4.72% of the total compensation of employees participating in the Optional Retirement Program (ORP). An actuary determines the actuarial implications of the funding requirement in annual actuarial valuations. The actuarial method used to determine the implications of the statutory funding level is the entry age actuarial cost method, with both normal cost and amortization of the accrued liability determined as a level percentage of payroll.

NOTE D. FUNDED STATUS and FUNDING PROGRESS

Our most recent actuarial valuation may be accessed on our website at:
www.trs.mt.gov/Board/ActuarialValuations/ActuarialValuations

The funded status of the TRS plan as of July 1, 2009, the most recent actuarial valuation date is as follows (dollar amounts in millions):

Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
$2,762.2	$4,331.0	$1,411.6	66.2%	$683.2	206.6%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about

whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Valuation date	July 1, 2009
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	Infinite
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	4.50%
Guaranteed annual benefit adjustment	1.50%
Inflation rate	3.50%

The actuarial valuation prepared as of July 1, 2009, the most recent valuation date, indicates the statutory rate is insufficient to fund the normal cost and to amortize the unfunded accrued liability under the entry age actuarial cost method over 30 years.

On a market value basis the TRS earned $401.5 million less than anticipated by the 7.75% assumption for the year ended June 30, 2008 and $843.7 million less than anticipated by the 7.75% assumption for the year ended June 30, 2009. The net result as of July 1, 2009 is that the market value of assets is $460.4 million less than the actuarial value of assets. This $460.4 million in unrecognized asset losses, if not offset by future gains, will cause the contributions needed to amortize the UAAL in future valuations to increase even further. Therefore, to remain financially sound in the future, TRS will need either (1) future gains such as asset returns greater than the 7.75% assumption, (2) an increase in contribution rates, (3) a reduction in liabilities, or some combination thereof.

NOTE E. OTHER POSTEMPLOYMENT BENEFITS

For the fiscal year ending June 30, 2008, the TRS implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 45 – Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions (OPEB). This statement requires disclosure of employer participation in defined benefit OPEB plans. The resulting TRS liability and expense for fiscal year 2009 and 2008 have been reported in our financial statements.

Plan Description

TRS employees and dependents are eligible to receive health care through the State Group Benefits Plan administered by the Montana Department of Administration (MDOA). In accordance with Section 2-18-704, MCA, the State provides optional post-employment medical, vision and dental health care benefits for retirees and their dependents and beneficiaries that elect to continue coverage and pay administratively established premiums. Plan coverage is on a calendar year basis. For GASB 45 reporting, the State Group Benefits Plan is considered an agent multiple-employer plan and TRS is considered to be a separate employer participating in the plan. Information about the State of Montana OPEB can be obtained from the Department of Administration, State Accounting Division, at P.O. Box 200102, Helena, MT 59620-0102.

Funding Policy

The contribution requirements of plan members are established and may be amended by the MDOA. The monthly premium for plan members ranges from $182 to $896 for 2009 depending on the medical plan selected, family coverage, and Medicare eligibility. The plan is financed on a pay-as-you-go basis.

GASB 45 requires the plan's employers to report each year the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The 2009 ARC is calculated for all the plan's employers and then allocated to each participating employer. The TRS 2009 ARC is $47,478 and is based on the plan's current ARC rate of 7.99% percent of total annual covered payroll for all employers. The 2009 ARC is equal to an annual amount required each year to fully fund the liability over 30 years. The amount of the estimated OPEB actuarial accrued liability at transition was determined in accordance with the GASB Statement 45, and the liability for TRS is estimated at $548,418. (The actuarial accrued liability is the present value of future retiree benefits and expenses.)

Annual OPEB Cost

For fiscal year 2009, the TRS allocated annual OPEB cost (expense) of $47,478 was equal to the ARC. The TRS annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2009 are as follows:

Fiscal Year Ended	Percentage of Annual OPEB Cost	Net Annual OPEB Cost Contributed	OPEB Obligation
6/30/09	0%	$49,496	$96,974

Funded Status and Funding Progress

The funded status of the TRS allocation of the plan as of January 1, 2007, the most recent valuation date was as follows:

Actuarial accrued liability (AAL)	$548,418
Actuarial value of plan assets	$ 0
Unfunded actuarial accrued liability (UAAL)	$548,418
Funded ratio (actuarial value of plan assets/AAL)	0
TRS Covered payroll (active plan members)	$634,670
UAAL as a percentage of covered payroll	86.41%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared

with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting progress are based on the substantive plan (the plan as understood by the employer and the plan members), and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Actuarial Methods and Assumptions

As of January 1, 2007, the TRS actuarially accrued liability (AAL) for benefits was $548,418, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $548,418, and the ratio of the UAAL to the covered payroll was 86.41%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the January 1, 2007, actuarial valuation, the projected unit credit funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 3.00% payroll growth rate. The projected annual healthcare cost trend rate is 7.00% for medical and 13.30% for prescription drugs, initially. Prescription drugs are reduced by decrements to a rate of 5.00% after eight years. Medical costs increase to 8.00% for the next three years. Then, these costs are reduced by decrements to a rate of 5.00% after five additional years.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

TRS PLAN
SCHEDULE OF FUNDING PROGRESS
(All dollar amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)[1]	Present Value of Future Universtiy Supplemental Contributions	Unfunded Actuarial Accrued Liabilities (UAAL)[2]	Funded Ratio[3]	Covered Payroll[4]	UAAL as a Percentage of Covered Payroll
July 1, 2004	2,485.7	3,359.2	115.7	757.8	76.6%	600.7	126.2%
July 1, 2005	2,497.5	3,527.0	126.2	903.3	73.4%	612.6	147.5%
July 1, 2006	2,745.8	3,733.6	124.7	863.1	76.1%	636.0	135.7%
July 1, 2007	3,006.2	3,928.5	153.4	768.9	79.6%	664.1	115.8%
July 1, 2008	3,159.1	4,110.8	157.1	794.6	79.9%	689.5	115.2%
July 1, 2009	2,762.2	4,331.0	157.2	1,411.6	66.2%	683.2	206.6%

(1) Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.
(2) Actuarial accrued liabilities less actuarial value of assets and present value of future university supplemental contributions.
(3) Funded Ratio is the ratio of the actuarial value of assets over the actuarial accrued liabilities less the present value of future university supplemental contributions.
(4) Covered Payroll includes compensation paid to all active employees on which contributions are calculated.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

TRS PLAN
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS AND OTHER CONTRIBUTING ENTITIES

(All dollar amounts in thousands)

Fiscal Year Ended	Annual Required Contribution	Percentage Contributed
June 30, 2004	$ 55,774	100%
June 30, 2005	57,150	100%
June 30, 2006	158,962	223%
June 30, 2007	112,656	130%
June 30, 2008	81,423	100%
June 30, 2009	80,998	100%

A $50 million one-time contribution made by the State in FYE 2007 and a $100 million one-time contribution made by the State in FYE 2006 are included in the calculation of the percentage of ARC contributed.

Since the System is a Cost Sharing Multiple Employer Plan, there is no Net Pension Obligation (NPO).

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION

Actuarial Cost Method

The actuarial valuation was prepared using the entry age actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the valuation is allocated as a level percentage of the individual's projected compensation between entry age and assumed exit. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The normal cost was first calculated for each individual member. The normal cost rate is defined to equal the total of the individual normal costs, divided by the total pay rate.

The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets and (b) the actuarial present value of future normal costs is called the unfunded actuarial accrued liability. The unfunded actuarial accrued liability is amortized as a level percentage of the projected salaries of present and future members of the System.

The ultimate cost of any pension program over time equals the benefits paid and expenses incurred while administering the program. The source of revenue used to pay for this cost is equal to the contribution from employers and employees to fund the program, plus investment return earned on contributions made through pre-funding the benefit payments.

Valuation of Assets - Actuarial Basis

Assets are valued based on their market value, with a four-year smoothing of all market value gains and losses. The expected return is determined for each year based on the beginning of year market value and actual cash flows during the year. Any difference between the expected market value return and the actual market value return is recognized evenly over a period of four years. The gains and losses are measured starting with the year ended June 30, 2007 (adopted 7/1/2007). Asset gains and losses are smoothed over a four-year period as of July 1, 2007, beginning with gains and losses over the year ending on June 30, 2007. As of July 1, 2006, the System's assets were measured on a market value basis, with immediate recognition of all gains and losses. Prior to 2006, asset gains and losses were smoothed over a five-year period.

Inflation Rate

The assumed inflation rate is 3.50% per annum, compounded annually (adopted 7/1/2004).

Investment Earnings

The annual rate of investment earnings of the assets of the System is assumed to be 7.75% per year, compounded annually. (Adopted July 1, 2004)

Guaranteed Annual Benefit Adjustment Increases

On January 1 of each year, the retirement allowance payable must be increased by 1.5% if the retiree's most recent retirement effective date is at least 36 months prior to January 1 of the year in which the adjustment is to be made.

Future Salaries
The rates of annual salary increases assumed for the purpose of the valuation include an assumed 4.5% annual rate of increase in the general wage level of the membership plus a variable merit and longevity rate from 0% to 4.51%. The merit and longevity increases for the Montana University System (MUS) members did not show a pattern of increasing or decreasing with service at the time of our most recent study. Therefore, the MUS members have a flat 1% merit and longevity assumption. The general wage increase assumption was adopted July 1, 2004 and the merit and longevity scales were adopted July 1, 2002.

MUS members are assumed to have a 0.63% higher average final compensation to account for the larger than average annual compensation increases observed in the years immediately preceding retirement.

Amortization Method
The unfunded actuarial accrued liability created by this method, including gains and losses, is amortized as a level percentage of the System's projected payroll.

Amortization Period
The amortization period of the unfunded actuarial liability over an open period will not amortize as of July 1, 2009.

REQUIRED SUPPLEMENTARY INFORMATION
OTHER POSTEMPLOYMENT BENEFITS PLAN INFORMATION

Other Postemployment Benefits Plan Information (1)
Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability(AAL) Entry Age (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
1/1/2007	-	$548,418	$548,418	0.00%	$634,670	86.41%

(1) TRS and the State of Montana implemented GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, for the fiscal year ended June 30, 2008. Information for prior years is not available.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
SUPPORTING SCHEDULES
FISCAL YEARS ENDED JUNE 30, 2009 AND 2008

SCHEDULE OF ADMINISTRATIVE EXPENSES

Expenses for the administration of the plan, excluding compensated absences, depreciation and amortization, are budgeted and approved by the TRS Board. The administrative costs of the TRS are financed through realized investment income. The expenses, less amortization of intangible assets, may not exceed 1.5% of retirement benefits paid. Administrative expenses for the fiscal years ended June 30, 2009 and 2008 are outlined below:

	2009	2008
Budgeted Expenses:		
Personnel Services:		
Salaries	$ 777,851	$ 720,003
Other Compensation	3,900	2,750
Employee Benefits	239,816	223,647
Total Budgeted Personal Srvs	$ 1,021,567	$ 946,400
Operating Expenses:		
Contracted Services	$ 423,789	$ 426,746
Supplies & Material	47,488	22,909
Communications	44,231	37,285
Travel	23,556	21,642
Rent	61,139	58,433
Repair & Maintenance	35,390	49,892
Other Expenses	77,505	72,106
Total Budgeted Operating Exp	$ 713,098	$ 689,013
Non-Budgeted Expenses:		
Compensated Absences	$ 15,499	$ 18,787
Depreciation	7,841	20,273
Amortization of Intangible Assets	95,868	76,292
Total Non-Budgeted Expenses	$ 119,208	$ 115,352
Total Administrative Expenses	**$ 1,853,873**	**$ 1,750,765**

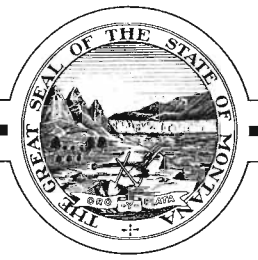
SCHEDULE OF PAYMENTS TO CONSULTANTS (included in contracted services above)

	2009	2008
Actuarial Services	$ 104,511	$ 141,616
Personnel Services	4,290	1,095
Legal Services	28,357	24,161
Medical Evaluations	1,450	815
Information Technology Services	80,760	51,360
Total Consultant Payments	**$ 219,368**	**$ 219,047**

Teachers' Retirement System

System's Response

TEACHERS' RETIREMENT SYSTEM



BRIAN SCHWEITZER, GOVERNOR

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November 12, 2009

Tori Hunthausen, CPA
Legislative Auditor
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to reply to the audit report for the Teachers' Retirement System. Once again, we are pleased with the unqualified opinion on the financial statements for the two fiscal years ending June 30, 2009.

The report includes one recommendation that the Teachers' Retirement System take necessary measures to ensure the system is funded on an actuarially sound basis, as required by the Montana Constitution and Board Policy. The Board conditionally concurs with the recommendation as it is beyond the Board's authority to increase contributions, reduce benefits, change the investment allocation, or to implement any other measures that may be necessary to "ensure" actuarial funding. The Board's function is limited to making recommendations to the Governor and the Legislature, and supporting legislation that will ensure the system is actuarially funded.

This recommendation is almost identical to the recommendation made by the Legislative Auditor's office in 2008. However, while the Board worked with the Governor and the Legislature during the 2009 session to address the underfunded status of the system, the markets continued to decline, further exacerbating the problem. In response, the Board wrote the Governor and the leadership in both the House and the Senate proposing contributions be increased. Although we did not end the Session with the system actuarially funded, we were successful in passage of House Bill 34, which requires employers to pay the full employer contribution rate on wages paid to retired teachers and administrators hired back on a part-time basis. However, the effective date of the proposal was amended in the House, State Administration Committee, to postpone collection of the additional funding until July 1, 2013.

In addition to the passage of HB 34, the Board endorsed HB 659, which directs the State Administration and Veterans' Affairs (SAVA) interim committee to examine and recommend funding and benefit changes to the state's public employees' retirement systems. With respect to the Teachers' Retirement System, HB 659 directs the SAVA committee to compare and contrast options for a redesign of the system and develop legislation to implement that redesign. While a redesign of the TRS for new hires will not produce meaningful savings for many years, it can correct many of the underfunded problems inherent in the current system design.

The Teachers' Retirement Board will continue to work with the Governor, the SAVA committee and the legislature to redesign the TRS for new hires, and take every reasonable step necessary to ensure the system is funded on an actuarially sound basis.

Sincerely,

David L. Senn
Executive Director

DS/cw