STATE OF MINNESOTA
Office of the State Auditor

Patricia Anderson
State Auditor

MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

FOR THE YEAR ENDED JUNE 30, 2005

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for over 700 public pension funds; and

Tax Increment Financing, Investment and Finance - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION MINNEAPOLIS, MINNESOTA

For the Year Ended June 30, 2005

Audit Practice Division
Office of the State Auditor
State of Minnesota

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

TABLE OF CONTENTS

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Introductory Section

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

ORGANIZATION

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Financial Section

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Minneapolis Teachers' Retirement Fund Association

We have audited the basic financial statements of the Minneapolis Teachers' Retirement Fund Association as of and for the year ended June 30, 2005, as listed in the table of contents. These basic financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the Minneapolis Teachers' Retirement Fund Association as of June 30, 2005, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis and other required supplementary information referred to in the table of contents are not required parts of the basic financial statements but are required by the Governmental Accounting Standards Board. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

/s/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: November 8, 2005

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2005
(Unaudited)

We are pleased to provide this overview and analysis of the financial activities of the Minneapolis Teachers' Retirement Fund Association (the Association) for the fiscal year ended June 30, 2005. The Association's Board of Trustees are entrusted with the responsibility of providing retirement benefits to its members and their beneficiaries in a fully responsive and effective manner. Since the Management's Discussion and Analysis (MD&A) is designed to focus on current activities, resulting changes, and currently known facts, please read it in conjunction with the financial statements and required supplementary information.

This MD&A is intended to serve as an introduction to the Association's basic financial statements. These statements include the Statement of Plan Net Assets, the Statement of Changes in Plan Net Assets, and the Notes to the Basic Financial Statements for the fiscal year ended June 30, 2005.

The Statement of Plan Net Assets shows the financial position of plan assets and liabilities by investment and accounting categories. The excess of assets over liabilities is reported as "Plan Net Assets Held in Trust for Pension Benefits." Over time, increases or decreases in Plan Net Assets Held in Trust for Pension Benefits may serve as a useful indicator of whether the financial position of the Association is improving or deteriorating.

The Statement of Changes in Plan Net Assets itemizes additions, deductions, and net changes, showing how the Association's assets have decreased or increased during the year ended June 30, 2005. All activities were recorded using the accrual basis of accounting. Transactions are recognized when earned or incurred regardless of the timing of cash flows.

FINANCIAL HIGHLIGHTS

- The Association's total assets exceeded its liabilities by $745.2 million at the close of fiscal year 2005.

- The Association's net assets held in trust for pension benefits decreased by $17.9 million, or 2.3 percent, from the closing balance of net assets in fiscal year 2004.

- Benefit payments for the year totaled $124.2 million, compared to $119.2 million in fiscal year 2004.

- Total contributions for the year totaled $53.4 million, compared to $56.5 million in fiscal year 2004.

FINANCIAL ANALYSIS

The Statement of Net Plan Assets at the close of fiscal year 2005 showed assets exceeding total liabilities by $745.2 million. This amount represents the total plan held in trust for pension benefits. The entire amount is available to cover the Association's obligation to pay benefits to its members and their beneficiaries.

This amount represents a decrease in net assets of $17.9 million, or 2.3 percent, from fiscal year 2004. This decrease was due to the benefit payments exceeding the sum of contributions and net increase in the value of the investment portfolio. Benefit payments (annuity payments and refunds) exceeded contributions (member, employer and supplemental contributions) by $70.8 million.

Additions to Plan Assets

The overall activities of the Association's accounts, shown in the Statement of Changes in Plan Net Assets and reflected in the difference between total additions and total deductions, resulted in a net decrease of $17.9 million for fiscal year 2005. Additions and deductions are the major segments of the Statement of Changes in Plan Net Assets. Additions include employer contributions of $18.4 million, member contributions of $13.8 million, supplemental contributions of $21.2 million, and net gains of the Association's investment portfolios of $53.7 million.

Employer contributions totaled $18.4 million in fiscal year 2005. This was a decrease of $1.4 million, or 7.3 percent. Member contributions totaled $13.8 million. This was a decrease of $1.6 million, or 10.6 percent. Supplemental contributions totaled $21.2 million, which did not change from fiscal year 2004.

Over the long term, the investment portfolio has been a major component in additions to income. In 2005, the investment portfolio showed a net gain of $53.7 million from its investments.

The table below shows a list of revenues by source for fiscal years 2001 through 2005.

(Dollars in Millions)

Year Ended June 30	Net Member Contribution	Employer Contribution	Supplemental Contribution	Net Investment Income/Loss	Total
2001	$ 16.3	$ 22.0	$ 20.9	$ (126.3)	$ (67.1)
2002	17.7	21.7	20.4	(110.9)	(51.1)
2003	16.7	21.1	21.1	5.4	64.2
2004	15.5	19.8	21.2	106.9	163.4
2005	13.8	18.4	21.2	53.7	107.0

Deductions

Deductions from the Association's net assets consist of benefit payments to members and their beneficiaries and administrative expenses. For fiscal year 2005, deductions totaled \$124.9 million. Payments to members and their beneficiaries totaled \$124.2 million and administrative expenses totaled \$0.7 million. The total deductions of \$124.9 million represented an increase of 4.2 percent from the prior year.

Investments

The Association's Board of Trustees recognizes the Association's obligation to provide present and future benefits to the members. To this end, the Board of Trustees has set its investment objective to attain investment returns that are competitive with returns achieved by the broader measures of market performance. This objective is addressed by a strategy of investing in high-quality and diversified assets that emphasize a long-term investment approach.

Summary Information from the Financial Statements

The following two tables summarize data found later in this report. Detailed information can be found in statements with corresponding names under the financial section.

Plan Net Assets
(Dollars in Thousands)

	June 30	
	2005	2004
Assets		
Cash	$ 49,104	$ 62,328
Receivables	21,895	15,139
Investments at fair value	696,830	713,695
Securities lending collateral	43,869	55,823
Capital assets, less depreciation	19	32
Total Assets	$ 811,717	$ 847,017
Liabilities		
Payables	$ 1,177	$ 933
All other liabilities	65,325	82,995
Total Liabilities	$ 66,502	$ 83,928
Net Assets in Trust of Benefits	$ 745,215	$ 763,089

Changes in Plan Net Assets
(Dollars in Thousands)

	Year Ended June 30	
	2005	2004
Additions		
Contributions		
Employer, employee, and other sources	$ 53,368	$ 56,465
Investment activity	56,073	109,194
Investment management expenses	(2,518)	(2,407)
Net securities lending income	123	125
Total Additions	$ 107,046	$ 163,377
Deductions		
Benefits, withdrawals, and refunds	$ 124,199	$ 119,156
Administrative expenses	721	731
Total Deductions	$ 124,920	$ 119,887
Net Increase (Decrease)	$ (17,874)	$ 43,490
Net Assets in Trust for Benefits - Beginning of Year	763,089	719,599
Net Assets in Trust for Benefits - End of Year	$ 745,215	$ 763,089

BASIC FINANCIAL STATEMENTS

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

EXHIBIT 1

STATEMENT OF PLAN NET ASSETS
JUNE 30, 2005

Assets		
Cash and cash equivalents	**$**	**49,103,777**
Receivables		
Employer and employee contributions	$	1,310,086
Direct contribution aid		
State of Minnesota		2,249,017
Special School District No. 1		1,125,000
City of Minneapolis		1,074,092
Sales of securities		14,662,980
Dividends and interest		1,474,238
Total receivables	**$**	**21,895,413**
Investments, at fair value		
Government and corporate bonds	$	158,280,744
Common and preferred stock		229,814,179
Commingled investment funds		
Equity index fund		135,371,091
International equity fund		53,894,467
Bond index fund		111,535,756
Other investments		6,054,764
Options contracts		1,879,040
Total investments, at fair value	**$**	**696,830,041**
Invested securities lending collateral	**$**	**43,868,602**
Furniture and fixtures (at cost, less accumulated depreciation of $278,011)	**$**	**18,937**
Total Assets	**$**	**811,716,770**
Liabilities		
Accounts payable	$	1,176,651
Security purchases payable		20,616,593
Deferred premiums on options contracts		840,066
Securities lending collateral		43,868,602
Total Liabilities	**$**	**66,501,912**
Net Assets Held in Trust for Pension Benefits (a Schedule of Funding Progress is presented on page 24)	**$**	**745,214,858**

The notes to the financial statements are an integral part of this statement.

MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

EXHIBIT 2

STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2005

Additions		
Contributions		
Employer	$	18,356,191
Members		13,820,754
Other sources		
State of Minnesota		16,764,411
Special School District No. 1		2,250,000
City of Minneapolis		2,176,742
Total contributions	**$**	**53,368,098**
Investment income (loss)		
From investing activity		
Net appreciation (depreciation) in fair value of investments	$	42,632,806
Interest and dividends		13,440,310
Total investing activity income (loss)	**$**	**56,073,116**
Less: investing activity expense		(2,518,116)
Net income (loss) from investing activity	**$**	**53,555,000**
From securities lending activity		
Securities lending income	**$**	**949,505**
Less: securities lending expense		
Borrower rebates	$	(760,510)
Management fees		(66,134)
Total securities lending expense	**$**	**(826,644)**
Net income (loss) from securities lending activity	**$**	**122,861**
Net investment income (loss)	**$**	**53,677,861**
Total Additions	**$**	**107,045,959**
Deductions		
Benefits to participants		
Retirement, beneficiary, and disability annuities	$	123,031,355
Death benefits		66,190
Withdrawals and refunds		1,101,736
Total benefits, withdrawals, and refunds	**$**	**124,199,281**
Administrative expenses		721,096
Total Deductions	**$**	**124,920,377**
Net Increase (Decrease)	**$**	**(17,874,418)**
Net Assets Held in Trust for Pension Benefits		
Beginning of Year		**763,089,276**
End of Year	**$**	**745,214,858**

The notes to the financial statements are an integral part of this statement.

NOTES TO THE BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

1. Summary of Significant Accounting Policies

Reporting Entity

The Minneapolis Teachers' Retirement Fund (the Fund) is a single-employer defined benefit pension fund administered by the Minneapolis Teachers' Retirement Fund Association (the Association). The Association was originally incorporated under 1909 Minn. Laws ch. 343 and is now governed by Minn. Stat. chs. 354A and 317A and applicable sections of Minn. Stat. chs. 356 and 356A. The Fund's membership consists of eligible employees of Minneapolis Special School District No. 1, employees formerly employed by Special School District No. 1, and the employees of the Association. The Association is governed by a seven-member Board of Trustees.

The Association is tax exempt as an organization under Section 501(c)(11) of the Internal Revenue Code and is subject to federal income tax only on net unrelated business income. The Association had no unrelated business income during the year ended June 30, 2005.

Basis of Presentation

The accompanying financial statements are presented in accordance with Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*, as amended.

Basis of Accounting

The basis of accounting is the method by which additions and deductions to plan net assets are recognized in the accounts and reported in the financial statements. The Association uses the accrual basis of accounting. Under the accrual basis of accounting, additions are recognized when they are earned, and deductions are recognized when the liability is incurred.

1. Summary of Significant Accounting Policies (Continued)

Contributions

Member employee contributions are recognized when withheld or when paid directly by the member employee. Required contributions from the employer are based upon a specific formula applied to teacher compensation used to fund all teachers' retirement plans in the State of Minnesota and are recognized as covered payroll is paid. Supplemental contributions from the State of Minnesota, the City of Minneapolis, and Special School District No. 1 are recognized by the Association when the related tax from levies becomes due to the City of Minneapolis and Special School District No. 1. (The State of Minnesota is required to match some of these tax levies.)

Investment Income

Interest income is recorded when earned on an accrual basis. Dividend income is recorded on the ex-dividend date.

Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on an exchange are valued at the last reported sales price at current exchange rates. Market values of investments in venture capital funds are determined by reference to financial information of the funds adjusted for subsequent distributions from the funds. Investments that do not have an established market are reported at estimated fair value.

Net appreciation (depreciation) in the fair value of investments includes net unrealized and realized gains and losses. Purchases and sales of securities are recorded on a trade-date basis.

The Association participates in a securities lending program. In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, investments lent under the program are reported as assets on the statement of plan net assets, and collateral received on those investments is reported as an asset and a liability.

1. Summary of Significant Accounting Policies (Continued)

Accounting for Derivatives

The Minneapolis Teachers' Retirement Fund Association invests in various derivative instruments, including futures contracts and options, with the investment objective of exceeding the total return of the S&P 500 index by using arbitrage strategies. In addition, the Association invests in forward currency exchange contracts.

Futures Contracts

Upon entering into a futures contract, each party is required to deposit with the broker an amount, referred to as an initial margin, equal to a percentage of the purchase price indicated by the futures contract. In lieu of a cash initial margin, the Association holds certain investments in its account for the broker as collateral. Subsequent deposits, referred to as variation margins, are received or paid each day by each party as unrealized gains and losses. When a contract is closed, each party records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

Futures contracts involve, to varying degrees, credit and market risks. The Association enters into contracts only on exchanges or boards of trade where the exchange or board of trade acts as the counterparty to the transaction. Losses in value may arise from changes in the value of the underlying instruments or if there is an illiquid secondary market for the contracts.

Options

The Association's investment in options gives it the right, but not obligation, to buy (call) or sell (put) such options at a fixed price (exercise or strike price) during a specified period. The Association pays a nonrefundable fee (the premium) to the seller (the writer). Option contracts are valued daily. Unrealized gains or losses are recorded based upon the last sales price on the principal exchange on which the option is traded. A realized gain or loss is recognized upon expiration or closing of the contract. When an option is exercised, the proceeds on sales for a written call option, the purchase cost of the security for a written put option, or the cost of the security for a purchased put or call option, is adjusted by the amount of the premium received or paid.

1. Summary of Significant Accounting Policies

Accounting for Derivatives

Options (Continued)

The risk in buying an option is that the premium is paid whether or not the option is exercised. The risk in writing a call option is the lost opportunity for profit if the market price of the security increases and the option is exercised. The risk in writing a put option is that a loss may be incurred if the market price of the security decreases and the option is exercised. Risks may also arise from an illiquid secondary market or from the inability of counterparties to meet the terms of the contract.

Forward Currency Exchange Contracts

A forward currency exchange contract is an agreement between two parties to pay or receive specific amounts of a currency at a future date in exchange for another currency at an agreed-upon exchange rate. Forward currency exchange contracts are valued at an estimate of the exchange rate on the settlement date. These amounts fluctuate daily, and the fluctuation is captured in the market value as an unrealized gain/loss. On the settlement date, the difference between the contract exchange rate and the actual exchange rate on that day is recorded as a realized gain/loss. Risks may arise from an illiquid secondary market or from the inability of counterparties to meet the terms of the contract.

Benefits and Refunds

Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Furniture and Equipment

Furniture and equipment is carried at cost less accumulated depreciation. Depreciation has been provided using the straight-line method over estimated useful lives of five years.

2. Description of Plans

General

The Minneapolis Teachers' Retirement Fund Association was created to provide retirement and other specified benefits for its members. The Association maintains two defined benefit pension plans covering teachers in the Minneapolis public school system.

Effective July 1, 1978, the Association established a plan, coordinated with Social Security, in accordance with Minnesota statutes (the Coordinated Plan). Teachers who become members of the Association subsequent to June 30, 1978, automatically become members of the Coordinated Plan. Members' contributions and benefits under the Coordinated Plan have been adjusted to reflect contributions to and benefits from Social Security. Teachers who were members of the Association prior to July 1, 1978, are generally covered under the Basic Plan, which provides all retirement benefits for its members.

Membership

At June 30, 2005, the Association's membership consisted of:

Retirees and beneficiaries currently receiving benefits	3,839
Terminated employees entitled to but not yet receiving benefits	1,377
Terminated, non-vested	3,604
Current active plan members (including members on leave)	4,756
Total Membership	13,576

Pension Benefits

Members who satisfy required length of service and minimum age requirements are entitled to annual pension benefits equal to a certain percentage of final average salary (as defined in each plan) multiplied by the number of years of accredited service.

Disability Benefits

Active members who become totally and permanently disabled and satisfy required length of service requirements are entitled to receive annual disability benefits as calculated under each plan.

2. Description of Plans (Continued)

Other Benefits

Limited service pensions, deferred pensions, survivor benefits, and family benefits are available to qualifying members and their survivors.

3. Deposits and Investments

A. Deposits

Authority

Minn. Stat. § 356A.06 authorizes the Association to deposit its cash in financial institutions designated by the Board of Trustees.

Custodial Credit Risk

The custodial credit risk for deposits is the risk that in the event of a bank failure, the Association's deposits may not be recovered. The Association's policy for custodial credit risk is to maintain compliance with Minnesota statutes that require all the Association's deposits be protected by insurance, surety bond, or pledged collateral. The Association's deposits at June 30, 2005, are completely protected and, therefore, there is no custodial credit risk for deposits.

B. Investments

Authority

The Association's investments are authorized by state law and its own Articles of Incorporation. Permissible investments include, but are not limited to: government and corporate bonds, foreign and domestic common stock, real property, venture capital investments, and notes.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Association will not be able to recover the value of the investment or the collateral securities that are in the possession of an outside party.

3. Deposits and Investments

B. Investments

Custodial Credit Risk (Continued)

According to Association policy, all securities purchased by the Association are held by a third-party safekeeping agent appointed as custodian who is also the lending agent/counterparty. The securities lending agreement in place between the Association and its custodian is also consistent with this policy.

The Association has no custodial credit risk for investments at June 30, 2005.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price.

The Association manages its exposure to fair value of loss arising from changing interest rates by having fixed income investments managed by external money managers. The Association employs three managers who invest in fixed income investments. The investment guidelines for each manager require that the manager be responsible for determining the maturities for all fixed income securities within their portfolio.

For BlackRock Financial Management, Inc., the duration of the overall portfolio must be managed to have a targeted duration within a band of +/- 20 percent around the duration of the Lehman Brothers Aggregate Bond Index. Mellon Capital Bond Index Fund is a fund that approximates the Lehman Brothers Aggregate Bond Index and, therefore, has a duration similar to that of the index. For CliftonGroup, LLC, the duration of the overall portfolio must be a maximum of one year. All managers were in compliance with the duration guidelines for the year ended June 30, 2005.

3. Deposits and Investments

B. Investments

Interest Rate Risk (Continued)

The following table shows the Association's durations by investment type.

Investment Type	Fair Value	Option Adjusted Duration (in Years)
Asset-Backed Securities	$ 18,176,439	0.67
CMBS	11,791,514	2.39
CMO Corporate	11,617,627	0.96
CMO Government Agencies	22,644,784	1.18
Corporates and Other Credits	29,941,091	3.11
Government	25,150,291	3.33
Other	46,588,616	0.08
Other Fixed Income	141,436	-
Revenue Bonds	1,000,000	4.20
TIPS	909,617	5.81
Treasury	912,637	0.21
U.S. Government Mortgages	36,441,570	1.33
U.S. Preferred Stock	3,294,485	0.32
U.S. Private Placements	3,959,977	2.58
U.S. Taxable Municipal Bonds	754,469	2.27
Non-U.S.	1,435,656	2.82
Total	$ 214,760,209	

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Minnesota statutes provide for the types of fixed income investments that a pension plan can make. In addition, the Association establishes other restrictions that are set forth in the investment guidelines for the management of the Association's fixed income assets.

CliftonGroup, LLC must invest in securities with a minimum rating of A or equivalent by at least one of the major rating services. BlackRock Financial Management, Inc., may hold up to 20 percent in a combination of non-dollar securities that have a minimum of investment grade quality and high yield and emerging markets. In addition, CliftonGroup, LLC and BlackRock Financial Management, Inc., can hold no

3. Deposits and Investments

B. Investments

Credit Risk (Continued)

more than five percent from any one issuer, but obligations of the U. S. government or its agencies are not subject to the five percent rule, which acts to limit concentration of credit risk from any one issuer.

The following table shows the Association's investments by type and credit quality rating at June 30, 2005.

Debt Investment Type	Fair Value	Quality Ratings AAA	AA	A	BBB	Below Grade	Unrated**
Asset Backed	$ 18,176,439	$ 17,126,941	$ -	$ 1,002,120	$ -	$ 16,762	$ 30,616
Bond Index Fund*	111,535,756	-	-	-	-	-	111,535,756
CMBS	11,791,513	7,710,755	-	-	-	-	4,080,758
CMO corporate	11,617,627	11,273,613	-	-	-	-	344,014
CMO government agencies	20,314,150	19,969,846	-	-	-	-	344,304
Corporate and other credits	31,718,807	1,852,671	3,416,143	12,036,077	3,632,530	1,508,662	9,272,724
Government	9,853,876	9,853,876	-	-	-	-	-
Other	460,401	-	-	460,401	-	-	-
Other fixed income	141,436	-	-	-	-	-	141,436
Revenue bonds	1,000,000	1,000,000	-	-	-	-	-
Short-term investment fund	45,819,950	-	-	-	-	-	45,819,950
U.S. fixed income	10,394,464	-	907,124	4,935,236	-	-	4,552,104
U.S. government mortgages	34,313,670	34,313,670	-	-	-	-	-
U.S. preferred stock	3,294,485	-	-	1,889,202	-	-	1,405,283
U.S. private placements	4,959,975	1,187,709	345,015	825,533	273,173	444,615	1,883,930
U.S. taxable municipal bonds	754,469	650,000	104,469	-	-	-	-
Non-U.S.	1,435,655	-	-	161,298	-	-	1,274,357
Totals	$317,582,673	$104,939,081	$ 4,772,751	$21,309,867	$ 3,905,703	$ 1,970,039	$180,685,232

*These funds were not rated by a nationally recognized rating agency.
** Standard and Poors was used as the primary rating agency. Many of the unrated debt securities held by the Association would be rated if another rating agency was used.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates of foreign currencies relative to the U. S. dollar adversely affect the fair value of an investment or a deposit. The Association limits this risk in several ways.

3. Deposits and Investments

B. Investments

Foreign Currency Risk (Continued)

Minnesota statutes limit certain investments to a total portfolio limit of no more than 35 percent of the market value of the portfolio. Both international equities and international bonds are in this category. Other items include venture capital, real estate, and partnerships.

In the area of fixed income securities, BlackRock Financial Management, Inc., is subject to a limit of no more than 20 percent of assets managed invested in foreign bonds, and the foreign bond must be credit quality.

The Association's foreign equity exposure is through the Mellon Capital International Index Fund and Templeton. The Mellon Capital International Index Fund is a broadly diversified index of European, Australian, and the Far Eastern companies. Templeton has considerable authority to select among investments across the world.

Risk of loss arises from changes in currency exchange rates. The Association's exposure to foreign currency risk at June 30, 2005, is presented in the following table.

Currency	Total	Convertible Securities	Equity	Futures Contracts	Fixed Income Securities	Cash
Australian Dollar	$ 1,745,440	$ -	$ 1,716,205	$ -	$ -	$ 29,235
British Pound Sterling	12,240,819	-	12,239,499	-	-	1,320
Canadian Dollar	503,056	-	502,884	-	-	172
Danish Krone	1,503,775	-	1,503,164	-	-	611
Euro Currency Unit	15,625,444	-	15,256,055	291,338	-	78,051
Hong Kong Dollar	2,493,175	-	2,493,175	-	-	-
Japanese Yen	6,691,349	2,437	5,917,346	-	695,391	76,175
Mexican New Peso	487,015	-	-	110,290	375,437	1,288
New Zealand Dollar	1,016,971	-	467,967	-	384,901	164,103
Norwegian Krone	1,178,616	-	1,178,616	-	-	-
Singapore Dollar	550,881	-	550,880	-	-	1
Swedish Krona	1,823,759	-	1,823,759	-	-	-
Swiss Franc	2,793,358	-	2,699,143	-	-	94,215
Totals	$ 48,653,658	$ 2,437	$ 46,348,693	$ 401,628	$ 1,455,729	$ 445,171

3. Deposits and Investments

   B. Investments (Continued)

   Concentration of Credit Risk

   The Association's investment policy limits investments in any one issuer to not more than five percent unless the manager has received prior approval, or the increase is a result of market price increase. U. S. Treasuries and agencies are exempted. The Association's investments as of June 30, 2005, were below these limits.

4. Securities Lending

   The Association participates in a securities lending program. On June 30, 2005, 11.1 percent, of its U. S. government securities, corporate bonds, and corporate stocks were loaned out.

   Minn. Stat. § 356A.06, subd. 7, permits the Association to enter into securities lending transactions. These are loans of securities to broker-dealers and other entities for collateral with simultaneous agreement to return the collateral for the same securities in the future. Loans may be made only to pre-approved borrowers. The Association's securities custodian is the agent in lending the Association's domestic securities for collateral of 102 percent and international securities for cash collateral of 105 percent of the market value of loaned securities. Loaned investments are marked to market daily. If the collateral provided by the borrower falls below 100 percent of the market value of the loaned investments, the borrower is required to provide additional collateral to bring the collateral to 102 percent of the current market value. Collateral may be provided in securities or cash.

   All of the collateral at June 30, 2005, was provided in cash. The Association has no credit risk exposure to borrowers because the amounts the Association owes borrowers exceed amounts borrowers owe the Association. The contract with the trust company requires the trust company to indemnify the Association if borrowers fail to return the securities (and, if the collateral is inadequate, to replace the securities lent) or fail to pay the system for income distributions by the securities' issuers while the securities are on loan.

   All securities loans may be terminated on demand by either the Association or the borrower. The average term of loans is 127 days. Cash collateral is invested in a short-term investment pool with a weighted average maturity of 31 days on June 30, 2005.

5. Contributions and Reserves

Funding

Benefit and contribution provisions are established by state law and may be amended only by the State of Minnesota Legislature.

Minn. Stat. § 354A.12 sets the rate for employee and employer contributions that are expressed as a percentage of annual covered payroll. The requirement to reach full funding by the year 2020 is set in Minn. Stat. § 356.215, subd. 11. As part of the annual actuarial valuation, the actuary determines the sufficiency or deficiency of the statutory contribution rates toward meeting the required full funding deadline. The actuary compares the actual contribution rate to a "required" contribution rate. The required contribution rate consists of: (a) normal costs based on entry age normal cost methods, (b) a supplemental contribution for amortizing any unfunded actuarial accrued liability by the required date for full funding, and (c) an allowance for administrative expenses. At June 30, 2005, the difference between the statutory and actuarially required contributions is a deficiency of 23.3 percent of payroll.

Employer and Employee Contributions

For the fiscal year ended June 30, 2005, the contribution rates required by statute are as follows:

	Percentage of Members' Salaries	
	Basic Plan	Coordinated Plan
Employee contribution	8.50%	5.50%
Employer contribution	12.14	8.14

Other Contributions

Minn. Stat. § 354A.12, subd. 3b, authorizes Special School District No. 1 and the City of Minneapolis to each levy for the benefit of the Association. Actual contributions to the Association from the levy will be dependent upon the actual amount of the levy. The State of Minnesota was authorized to match, up to $1,250,000 per year each, the total contributions of the School District and the City. This direct contribution aid will be allowed to continue until the Association reaches the same funded status as the Minnesota Teachers' Retirement Association (TRA). Direct contribution aid as of June 30 follows:

State of Minnesota	$ 2,459,301
Special School District No. 1	1,250,000
City of Minneapolis	1,209,301

5. Contributions and Reserves

Other Contributions (Continued)

Minn. Stat. § 423A.02, subd. 3, requires the state to annually provide certain aid to the Association until it is fully funded provided that the School District and the City make additional annual contributions. The state amortization aid contribution was $1,005,110 for fiscal year 2005. In fiscal year 2005, the School District and the City made additional contributions of $1,000,000 and $967,441, respectively.

Minn. Stat. § 354A.12 requires the state to provide the Association with additional funding. This aid was $13,300,000 in fiscal year 2005 and will continue to be paid annually until the Association reaches the same funded status as the TRA.

Statutes also require active and retired members of the Association to provide contributions for the relative difference between the administrative expenses incurred by the Association and the TRA. No additional contributions were required in fiscal year 2005.

Reserves

The Association's Articles of Incorporation and state statute identify the following accounts:

Retirement Deposit Fund

Article 11 of the Association's Articles of Incorporation states that all monies deposited by or on behalf of members, with interest credited thereon as applicable, shall be held in the retirement deposit account for the benefit of the individual member for the purpose of providing an annuity or other benefit. Minn. Stat. § 354A.37 requires that, in lieu of other benefits, a withdrawing member's contributions, and interest as applicable, be refunded.

Annuity Reserve Fund

Minn. Stat. § 354A.28 and Article 12 of the Association's Articles of Incorporation establish an annuity reserve fund to provide an investment vehicle for the reserves for various retirement annuities and benefits payable by the fund. The assets of this fund are to consist of the money representing the actuarially determined required reserves for various retirement annuities and benefits payable by the Association. The Association shall determine the reserves to be allocated to the annuity reserve fund as the amount of the present value of each recipient's prospective benefit payments multiplied by the Association's preceding year's funding ratio.

5. Contributions and Reserves

Reserves (Continued)

Balance and Funded Status

Total net assets held in trust for pension benefits consists of the following:

- At June 30, 2005, $26,887,494 of the total net assets held in trust for pension benefits is considered reserved as it represents the amount of state amortization aid which, pursuant to Minn. Stat. § 423A.02, subd. 3, must be separately accounted for and may not be used in determining benefit increases. This reserve is considered to be fully funded.

- The retirement deposit fund balance of $196,445,769 at June 30, 2005, is the accumulated employee and employer contributions from current active members based on actual payroll records. It includes interest on the Basic members' contributions, but not the interest on the Coordinated members' contributions. This reserve is not fully funded.

- The annuity reserve fund balance of $521,881,595 at June 30, 2005, represents the Association's net assets held in trust for pension benefits less the amounts considered reserved for state amortization aid and the retirement deposit fund. This reserve is not fully funded.

6. Summary of Significant Contingencies and Other Items

Financial Condition

The benefit payments the Association makes have historically exceeded all contributions received. While the statutory contributions to the Association have been made, the statutory contributions are less than the actuarially determined required contributions needed to fund benefits. These conditions have continued for decades resulting in increases to the unfunded actuarial accrued liability and a funded ratio that this year has fallen to 45 percent. Under current operations and plan benefits, it appears the financial condition of the Association will continue to deteriorate, and the Association's ability to provide future benefits will be severely compromised.

7. Risk Management

The Association is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; and natural disasters. To cover its liabilities, the Association purchases commercial insurance. There were no significant reductions in insurance coverage from coverage in the prior year. The amount of settlements did not exceed insurance coverage for each of the past three fiscal years.

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REQUIRED SUPPLEMENTARY INFORMATION

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MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

Schedule 1

SCHEDULE OF FUNDING PROGRESS
(IN THOUSANDS OF DOLLARS)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b) (%)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c) (%)
2000	$ 1,027,633	$ 1,544,358	$ 516,725	66.54	$ 242,072	213.46
2001	1,061,983	1,610,364	548,381	65.95	254,100	215.81
2002	1,027,883	1,659,512	631,629	61.94	248,304	254.38
2003	956,913	1,671,982	715,069	56.85	247,418	289.01
2004	877,764	1,729,551	851,787	50.75	232,386	366.54
2005	783,354	1,755,913	972,559	44.61	216,052	450.15

(Unaudited)

MINNEAPOLIS TEACHERS' RETIREMENT FUND ASSOCIATION
MINNEAPOLIS, MINNESOTA

Schedule 2

SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYER
AND OTHER CONTRIBUTING ENTITIES
(IN THOUSANDS OF DOLLARS)

Fiscal Year	Annual Required Contributions	Employer Contributions	Employer Percentage Contributed (%)	State Contributions	State Percentage Contributed (%)	City Contributions	City Percentage Contributed (%)
2000	$ 41,638	$ 23,663	56.83	$ 17,183	41.27	$ 1,710	4.11
2001	47,839	23,904	42.90	17,166	30.81	1,835	3.29
2002	45,478	23,770	52.27	16,409	36.08	1,927	4.24
2003	55,202	23,279	42.17	16,792	30.42	2,115	3.83
2004	58,809	22,052	37.50	16,771	28.52	2,180	3.71
2005	68,517	20,606	30.07	16,764	24.47	2,177	3.18

Note:

The annual required contributions are actuarially determined. The employer and state are required by statute to make contributions, all of which have been made.

(Unaudited)

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NOTES TO SCHEDULE 1 AND SCHEDULE 2
AS OF AND FOR THE YEARS ENDED JUNE 30, 2005
(Unaudited)

Actuarial Methods and Assumptions

The actuarial accrued liability is determined as part of an annual actuarial valuation on July 1. Significant methods are as follows:

- The most recent actuarial valuation date is July 1, 2005.
- Actuarial cost is determined using the Entry Age Normal Actuarial Cost Method.
- The amortization method assumes a level percentage of payroll each year is used to pay the unfunded actuarial accrued liability.
- The amortization period is closed.
- The remaining amortization period at July 1, 2005, is 15 years.
- Actuarial value of assets is determined using market value, adjusted for amortization obligations receivable at the end of each fiscal year, less a percentage of the unrecognized asset return determined at the close of each of the four preceding fiscal years. Unrecognized asset return is the difference between actual net return on market value of assets and the asset return expected during that fiscal year (based on the assumed interest rate employed in the July 1 actuarial valuation of the fiscal year).

<u>Actuarial Methods and Assumptions</u> (Continued)

Significant actuarial assumptions are as follows:

- Investment rate of return is 8.5 percent. However, the annual two percent increase in benefits is accounted for by using a 6.5 percent post-retirement interest rate.

- Payroll increase is five percent. Salary increase varies by age and ranges from five to 6.5 percent.

- Post-retirement benefit increase is two percent.

- Mortality assumptions:

- Pre-Retirement

Male:	1983 Group Annuity Mortality Table male rates set back 12 years
Female:	1983 Group Annuity Mortality Table female rates set back ten years

- Post-Retirement

Male:	1983 Group Annuity Mortality Table male rates set back four years
Female:	1983 Group Annuity Mortality Table female rates set back one year

- Post-Disability

Male:	1977 Railroad Retirement Board Mortality for Disabled Lives
Female:	1977 Railroad Retirement Board Mortality for Disabled Lives

<u>Significant Plan Provision and Actuarial Methods and Assumption Changes</u>

<u>2000</u>

- Asset valuation method changed to employ a more effective asset-smoothing technique which is market-value based and which eliminates artificial bias related to manager style (effective July 1, 2000).

<u>2001</u>

- The annual lump sum benefits payable to pre-1974 retirees will be paid as monthly installments (effective January 1, 2002).

Significant Plan Provision and Actuarial Methods and Assumption Changes (Continued)

2002

Assumption	Prior	Revised
Salary increases	Merit table that ranges from 7.5% at age 20 down to 5.0% at age 70.	Ten-year select and ultimate table. During the select period, 0.4% x (10 - T) where T is completed years of service is added to the ultimate rate. Ultimate table ranges from 6.5% at ages 20 to 45 down to 5.0% at age 60 and over.
Male Pre-Retirement Mortality	1983 GAM (Male - 6)	1983 GAM (Male - 12)
Female Pre-Retirement Mortality	1983 GAM (Female - 4)	1983 GAM (Female - 10)
Male Post-Retirement Mortality	1983 GAM (Male - 4)	1983 GAM (Male - 4)
Female Post-Retirement Mortality	1983 GAM (Female - 2)	1983 GAM (Female - 1)
Retirement Age	Graded rates. Different sets of rates apply to Basic and Coordinated Plan members.	Graded rates. Different sets of rates apply to Basic and Coordinated Plan members. Revised rates are generally higher before age 60 and lower thereafter.
Separation Decrement	Graded rates.	Select and ultimate table. Ultimate rates are generally higher than prior rates.
Disability Decrement	Graded rates.	Graded rates. Revised rates are higher than prior rates.
Form of Annuity Selected - Male	80% married 15% elect 50% J&S option 20% elect 75% J&S option 40% elect 100% J&S option	80% married 15% elect 50% J&S option 20% elect 75% J&S option 40% elect 100% J&S option
Form of Annuity Selected - Female	60% married 15% elect 50% J&S option 5% elect 75% J&S option 10% elect 100% J&S option	60% married 15% elect 50% J&S option 5% elect 75% J&S option 15% elect 100% J&S option
Combined Service Annuity Load Factor	None assumed.	4.0% load on liabilities for active members and 30% load on liabilities for former members.

Significant Plan Provision and Actuarial Methods and Assumption Changes

2002 (Continued)

- Charter schools are no longer covered by the Association. Active charter school teachers retain their rights to benefits earned in this Association through June 30, 2002, as if they were former members with a termination of employment on June 30, 2002. Effective July 1, 2002, these 174 charter school members were transferred to the Minnesota Teachers' Retirement Association.

- The Supplemental Administrative Expense Assessment, otherwise payable under law, will not be assessed if the administrative expenses of the Association do not exceed the July 1, 2001, administrative expense amount adjusted for inflation.

- A change in the amount of state-aid has occurred with the Association. Since the Duluth Teachers' Retirement Fund accrued liability funding ratio exceeded the Minnesota Teachers' Retirement Fund accrued liability funding ratio as of July 1, 2001, the state-aid normally provided to Duluth shall be re-allocated to the other first class city teachers' funds. This results in an increase in the amount of state-aid for this fund.

Management and
Compliance Section

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SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2005

MINNESOTA LEGAL COMPLIANCE

ITEMS ARISING THIS YEAR

05-1 Holdings in Authorized Investments

The Association holds investments in index funds operated as mutual funds or bank-sponsored collective funds. Formerly these investments were characterized as "units in commingled trusts" authorized under Minn. Stat. §§ 356A.06, subd. 7(b), and 11A.24, subd. 1, "Securities generally." However, further review indicates these bank-sponsored collective and mutual funds are authorized under the "Other investment" sections of Minn. Stat. §§ 356A.06, subd. 7(g)(iii), and 11A.24, subd. 6(3). All investments authorized under "Other investments" must not exceed 35 percent of the Association's investment portfolio. When index funds are added to the Association's investments held as authorized under Minn. Stat. §§ 356A.06, subd. 7(g), and 11A.24, subd. 6, the Association exceeds the 35 percent limitation for investments held under this clause.

There has been increased usage of index funds by several of the larger pension funds and associations, and support for index funds as an appropriate type of pension investment vehicle is considerable. The Office of the State Auditor is supportive of proposals to revise Minn. Stat. §§ 356A.06, subd. 7(g), and 11A.24, subd. 6, to permit investments in these index funds without restriction provided the index funds invested only in securities that are authorized by Minn. Stat. §§ 356A.06, subd. 7, and 11A.24 (excluding the "Other investments" sections of these statutes).

In the meantime, we recommend the Association's Board of Trustees be aware that its investments categorized under Minn. Stat. §§ 356A.06, subd. 7(g), and 11A.24, subd. 6, exceed the 35 percent limitation for investments held under these clauses, and the Association, along with other similarly situated pension funds and associations, seek a remedy through the Minnesota Legislature in order to achieve compliance with Minnesota statutes governing authorized investments.

Client's Response:

Even before 1975, when the legislature abolished the City of Minneapolis' power to levy for teacher retirement, this Association had been regularly petitioning the legislature for relief from the funding deficiency created by persistent annual contribution deficiencies, as reported by the Association's actuary. As the problem worsened after 1975, the Association continued to petition, even resorting to litigation to bring attention to the developing crisis. That legal action did not resolve the funding question. The Court stopped short of deciding who should be held ultimately responsible for paying promised benefits, deciding only that there was no obligation for the state to keep the fund actuarially sound at any particular point in time. Minneapolis Teachers Retirement Fund Association v. State, 490 N.W.2d 124 (Minn. Ct. App. 1992). (Rev. denied.) The funding problem, as long predicted, is now a grave crisis, pushing the Association past the tipping point, even though the Association has for many years sought a legislative remedy.

The Association's decision to index was made at the recommendation of the Association's Investment Advisory Committee. It was a direct and intentional consequence of having to draw down sizable blocks of invested assets in order to meet monthly obligations for annuities and benefits. In this environment it is difficult and expensive to maintain a balanced allocation among actively managed asset classes. When all asset classes under management are subject to a destabilizing rate of liquidations, it is simply more cost effective to index. Moreover, indexing prudently links the Association's investment performance to a bellwether performance benchmark.

The Association disagrees with the Auditor's reclassification of the Association's investment in the Mellon Bank index funds as "Other Investments" under Section 356A.06, subd. 7(g), rather than "Securities Generally" under 356A.06, subd. 7(b), as formerly classified. The 35 percent limit under subd. 7(g) applies to investments in "regional and mutual funds through bank sponsored collective funds…" (Emphasis added). "Regional and mutual funds" does not describe the securities in the Mellon Bank S & P 500 Index Fund and other Mellon Bank index funds held by the Association. The Mellon Bank index fund investments are accurately described as "units in commingled trusts that own the securities" within the broad categories authorized under "securities generally" in subd. 7(b), which are not subject to the 35 percent limit. The Auditor's reclassification of these investments under subd. 7(g) places inappropriate emphasis on the words "bank sponsored collective" while ignoring the words "regional and mutual funds." This reclassification has created a hardship for the Association that may require it to reposition certain indexed assets with no real concomitant benefit for the expense of so doing.

The Association understands the Auditor would join in supporting a change in the statute to obviate the hairsplitting that underlies the Auditor's reclassification of the Association's investment in Mellon Bank index funds. More generally, the Association is in agreement that, unless funding relief is immediately forthcoming to stem the draw down of assets and enable the Association to meet annuity and benefit obligations as they come due, the statutory guidelines in Sections 356A.06, subd. 7, and 11A.24, subd. 6, should be revised to clarify the authority to invest in index funds regardless of how such funds are structured.

05-2 Annuity Reserve Fund Allocation

Minn. Stat. § 354A.28 and Article 12 of the Association's Articles of Incorporation establish an annuity reserve fund to provide an investment vehicle for the reserves for various retirement annuities and benefits payable by the fund. The assets of this fund are to consist of the money representing the actuarially determined required reserves for various retirement annuities and benefits payable by the Association. The Association shall determine the reserves to be allocated to the annuity reserve fund as the amount of the present value of each recipient's prospective benefit payments multiplied by the Association's preceding year's funding ratio.

This process of determining the reserves to be allocated to the annuity reserve fund has not been calculated as described in statute and Article 12. The annuity reserve fund balance represents the Association's net assets held in trust for pension benefits less the amounts considered reserved for state amortization aid and the retirement deposit fund. The annuity reserve fund is not fully funded.

We recommend the Association determine the reserves to be allocated to the annuity reserve fund as described in current statute and Article 12 or seek legislative change to both.

Client's Response:

The Association does not agree with the recommendation insofar as it suggests that the manner of presentation of the Annuity Reserve Fund is out of compliance. The manner of presentation has been consistent since 1997, and was arrived at with full consultation and approval of the State Auditor.

As indicated in Note 1 to the Financial Statements, the Association's financial statements are presented in accordance with Governmental Accounting Standards Board (GASB) Statements 25 and 34, as amended. Use of these statements represented an accounting *change effective for the annual report for 1997. Before 1997 the financial statements presented a consolidated balance sheet of plan assets and liabilities at cost rather than a statement of net plan assets at fair value. Thus, the liabilities section of the pre-1997 annual consolidated balance sheets listed a fund balance for both the Retirement Deposit Fund and the Annuity Reserve Fund, with additional explanation in the Notes.*

These funds have become outdated as accounting tools. The Annuity Reserve Fund in particular is of little utility for purposes of assessing the condition of the retirement fund, that function having long been fulfilled by actuarial evaluations and reporting under state statute. In each year since the accounting changes in 1997, however, the notes to the financial statements have nonetheless continued to state a fund balance for both the Retirement Deposit Fund and the Annuity Reserve Fund, with the indication that neither is fully funded. The manner of presentation was adopted with full consultation and approval of the Auditor for each of the last eight years.

The Association is willing to consider new ideas regarding the manner of presentation of the Retirement Deposit Fund and the Annuity Reserve Fund in its annual reports.

OTHER ITEM FOR CONSIDERATION

Financial Condition

The Association's financial statements are prepared based on the assumption that the Association has the ability to continue as a going concern for a reasonable period of time. From an accounting principles standpoint, a reasonable period of time is considered to be at least one year beyond the financial statement date. However, as a result of the Association's current and deteriorating financial condition, it is questionable just how far into the future the Association will continue to be a going concern.

The actuarially determined required contribution rate consists of amounts needed to cover (a) normal costs, (b) administrative costs, and (c) amortization of unfunded actuarial accrued liabilities. These financial requirements have exceeded actual statutory contributions made to the Association for decades. This difference between the statutory and actuarially required contributions is a deficiency at June 30, 2005, of 23.30 percent of payroll.

Between 2000 and 2005, actual contributions fell slightly from $58.7 million to $53.4 million. During this same period, total deductions for benefits and administrative expenses increased from $87.5 million to $124.9 million. Factoring in investment earnings/losses for the same five years, net assets available for pension benefits at

June 30, 2005, is $745.2 million - a decrease of $354.3 million or 32 percent. Clearly, under continued conditions such as this, a failure to make benefit payments as they become due is inevitable.

According to the Association's actuarial valuation and review for June 30, 2005, the unfunded actuarial accrued liability is $972.6 million. This amount has increased 88 percent since June 30, 2000, when the unfunded actuarial accrued liability was $516.7 million. During this same period, the funded ratio has fallen from 66.54 percent to 44.61 percent.

The ability of the Association to meet long-term obligations is also questioned in the actuary's report for June 30, 2005, which states: "We are expressing continued serious concerns about the financial health of this plan. Absent a significant financial solution, we are concerned about the liability of this plan to make its benefit promises."

The current law does not provide a safety net for this pension fund. If steps are not taken immediately, Minn. Stat. § 354A.09 states:

> "In the event that the assets of the special retirement fund of a teachers retirement fund association are not sufficient to pay annuities and other retirement benefits in full as they come due in any particular year, the amount of special retirement fund assets available for payment shall be prorated among those annuitants and beneficiaries entitled to receive annuities and other retirement benefits."

Further, as the court noted in *Minneapolis Teachers Retirement Fund Association v. State*, 490 N.W.2d 124, 128, 129 (Minn. Ct. App. 1992), *rev. denied*, there is no promise by the legislature to make the Minneapolis Teachers' Retirement Fund Association actuarially sound.

The Association is in a position where it will be unable to make benefit payments at some point in the foreseeable future. Regardless of the history behind the Association's funding status and benefit levels, the current financial condition of this fund puts the Association in a position where it must concede to changes. The Association's primary fiduciary responsibility is to immediately develop a viable plan to improve its current financial condition. Consistent with this, we recommend the Association initiate and actively pursue all courses of legislative action. This should include consolidation with the Teachers' Retirement Association of Minnesota as a permanent solution. It should also include alternatives for restructuring or capping benefit amounts and formulas. While these alternatives may be small scale or temporary when compared to consolidation, they must be considered as an option since consolidation is not guaranteed.

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REPORT ON MINNESOTA LEGAL COMPLIANCE

Board of Trustees
Minneapolis Teachers' Retirement Fund Association

We have audited the basic financial statements of the Minneapolis Teachers' Retirement Fund Association as of and for the year ended June 30, 2005, and have issued our report thereon dated November 8, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories, except that we did not test for compliance in contracting and bidding, public indebtedness, and claims and disbursements, because these areas do not apply to the Minneapolis Teachers' Retirement Fund Association.

The results of our tests indicate that, for the items tested, the Minneapolis Teachers' Retirement Fund Association complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 05-1 and 05-2.

This report is intended solely for the information and use of the Board of Trustees and management and is not intended to be, and should not be, used by anyone other than those specified parties.

We would like to express our appreciation to the Board of Trustees of the Association and the staff for their cooperation and assistance during the audit.

/s/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: November 8, 2005