

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Financial Statements

For the Years Ended June 30, 2000 and 1999

(With Independent Auditors' Report Thereon)



**STATE OF OHIO**  
**OFFICE OF THE AUDITOR**  

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We have reviewed the Independent Auditor's Report of the State Teachers Retirement System of Ohio, Franklin County, prepared by KPMG LLP, for the audit period July 1, 1999 through June 30, 2000. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The State Teachers Retirement System of Ohio is responsible for compliance with these laws and regulations.

**JIM PETRO**  
Auditor of State

January 3, 2001

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

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## Independent Auditors' Report

To the Retirement Board  
The State Teachers Retirement System of Ohio:

We have audited the accompanying combining statements of plan net assets of the State Teachers Retirement System of Ohio (the System) as of June 30, 2000 and 1999, and the related combining statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the System as of June 30, 2000 and 1999, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2000, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

The schedules of funding progress and employer contributions on pages 18 and 19, respectively, are not a required part of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. We have applied to the schedules of funding progress and employer contributions certain limited procedures prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of schedules.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information included on pages 21 and 22 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the System's management. Such additional information has been subjected to the auditing procedures applied in our audits of the basic financial statements for the years ended June 30, 2000 and 1999, and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

**KPMG LLP**

November 22, 2000

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Combining Statements of Plan Net Assets

(In thousands)

Assets	June 30, 2000			June 30, 1999		
	Pensions	Post-employment health care	Totals	Pensions	Post-employment health care	Totals
Cash and short-term investments	\$ 714,385	45,415	759,800	1,814,049	101,656	1,915,705
Receivables:						
Accrued interest and dividends	176,530	11,222	187,752	165,155	9,255	174,410
Employer contributions	179,557	11,415	190,972	168,736	9,456	178,192
Retirement incentive	29,876	—	29,876	38,867	—	38,867
Member contributions	148,830	—	148,830	135,426	—	135,426
Securities sold	243,360	15,471	258,831	169,899	9,521	179,420
Miscellaneous receivables	3,481	—	3,481	3,446	—	3,446
Total receivables	781,634	38,108	819,742	681,529	28,232	709,761
Investments, at fair value:						
Fixed income	11,984,781	761,904	12,746,685	12,144,588	680,564	12,825,152
Common and preferred stock	25,111,718	1,596,417	26,708,135	21,710,886	1,216,645	22,927,531
International	10,069,930	640,171	10,710,101	9,590,600	537,442	10,128,042
Real estate	5,503,754	349,888	5,853,642	4,484,015	251,277	4,735,292
Alternative investments	702,843	44,682	747,525	269,161	15,084	284,245
Total investments	53,373,026	3,393,062	56,766,088	48,199,250	2,701,012	50,900,262
Collateral on loaned securities	3,289,356	209,113	3,498,469	3,520,529	197,285	3,717,814
Fixed assets, at cost, net of accumulated depreciation of \$38,610 and \$32,510, respectively	118,287	—	118,287	79,364	—	79,364
Total assets	\$ 58,276,688	3,685,698	61,962,386	54,294,721	3,028,185	57,322,906
<b>Liabilities</b>						
Securities purchased	264,538	16,817	281,355	178,306	9,992	188,298
Accrued expenses and other liabilities	20,535	1,305	21,840	17,696	992	18,688
Pension benefits payable	101,896	—	101,896	—	—	—
Medical benefits payable	—	39,357	39,357	—	36,550	36,550
Obligations under securities lending program	3,289,356	209,113	3,498,469	3,520,529	197,285	3,717,814
Total liabilities	\$ 3,676,325	266,592	3,942,917	3,716,531	244,819	3,961,350
Net assets held in trust for pension and postemployment healthcare benefits: (A schedule of funding progress is presented on required supplemental schedule 1)	\$ 54,600,363	3,419,106	58,019,469	50,578,190	2,783,366	53,361,556

See accompanying notes to financial statements.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Combining Statements of Changes in Plan Net Assets

(in thousands)

	Year ended June 30, 2000			Year ended June 30, 1999		
	Pensions	Post-employment health care	Totals	Pensions	Post-employment health care	Totals
Additions:						
Contributions:						
Member	\$ 755,146	—	755,146	716,551	—	716,551
Employer	470,473	615,652	1,086,125	450,479	587,062	1,037,541
Retirement incentive	42,189	—	42,189	39,338	—	39,338
State of Ohio appropriations	1,514	—	1,514	1,780	—	1,780
Benefit recipient health care premiums	—	60,375	60,375	—	47,819	47,819
Other retirement systems	6,476	—	6,476	7,738	—	7,738
Additional death benefits (net)	11	—	11	158	—	158
Total contributions	1,275,809	676,027	1,951,836	1,216,044	634,881	1,850,925
Investment income:						
From investing activities						
Net appreciation in fair value of investments	3,770,584	222,348	3,992,932	4,366,770	223,729	4,590,499
Interest	716,174	42,232	758,406	630,194	32,288	662,482
Dividends	384,106	22,650	406,756	427,540	21,905	449,445
Real estate income	333,561	19,670	353,231	293,213	15,022	308,235
	5,204,425	306,900	5,511,325	5,717,717	292,944	6,010,661
Less investment expenses	(18,934)	(1,117)	(20,051)	(15,719)	(805)	(16,524)
Net income from investing activities	5,185,491	305,783	5,491,274	5,701,998	292,139	5,994,137
From securities lending activities						
Securities lending income	185,052	10,912	195,964	156,612	8,024	164,636
Securities lending expenses	(172,905)	(10,196)	(183,101)	(147,613)	(7,563)	(155,176)
Net income from securities lending activities	12,147	716	12,863	8,999	461	9,460
Net investment income	5,197,638	306,499	5,504,137	5,710,997	292,600	6,003,597
Total additions	6,473,447	982,526	7,455,973	6,927,041	927,481	7,854,522
Deductions:						
Benefits:						
Service retirement	2,019,521	—	2,019,521	1,764,172	—	1,764,172
Disability retirement	152,365	—	152,365	139,296	—	139,296
Survivor benefits	62,346	—	62,346	52,863	—	52,863
Supplemental benefit	48,493	—	48,493	46,448	—	46,448
Health care	—	343,512	343,512	—	297,748	297,748
Other retirement systems	8,247	—	8,247	6,922	—	6,922
Total benefit payments	2,290,972	343,512	2,634,484	2,009,701	297,748	2,307,449
Refunds to members who have withdrawn	105,759	—	105,759	91,037	—	91,037
Administrative expenses	54,543	3,274	57,817	46,596	2,371	48,967
Total deductions	2,451,274	346,786	2,798,060	2,147,334	300,119	2,447,453
Net increase	4,022,173	635,740	4,657,913	4,779,707	627,362	5,407,069
Net assets held in trust for pension and postemployment health care benefits						
Beginning of year	50,578,190	2,783,366	53,361,556	45,798,483	2,156,004	47,954,487
End of year	\$ 54,600,363	3,419,106	58,019,469	50,578,190	2,783,366	53,361,556

See accompanying notes to financial statements.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

### (1) Summary of Significant Accounting Policies

The financial statements of the State Teachers Retirement System of Ohio (STRS Ohio) presented herein have been prepared on the accrual basis of accounting following the accounting policies set forth below.

#### (a) Organization

STRS Ohio is a cost-sharing, multiple-employer plan that was created by Chapter 3307 of the Ohio Revised Code (Revised Code) and is administered by a board comprised of five active members, one retired teacher and three voting ex officio members.

The accompanying financial statements comply with the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. This statement requires that financial statements of the reporting entity include all of the organizations, activities, functions and component units for which the reporting entity is financially accountable. Financial accountability is defined as the appointment of a voting majority of the component unit's board and either (1) the reporting entity's ability to impose its will over the component unit, or (2) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the reporting entity. STRS Ohio does not have financial accountability over any entities.

#### (b) Investment Accounting

Purchases and sales of investments are recorded as of their trade date. Dividend income is recognized on the ex-date. Interest and rental income is recognized as the income is earned.

STRS Ohio has no individual investment that exceeds 5% of net assets available for benefits.

#### (c) Contributions and Benefits

Employer and member contributions are recorded in the period the related member salaries are earned. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

#### (d) Fixed Assets

Fixed assets are recorded at historical cost. Depreciation is provided on a straight-line basis over estimated useful lives of five to 10 years for equipment and 40 years for building and building improvements.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

**(e) Method Used to Value Investments**

Investments are reported at fair value. Short-term investments are reported at amortized cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at the then current exchange rates. Fixed income investments are valued based on their coupon rate relative to the coupon rate for similar securities. The fair value of real estate investments is based on independent appraisals and internal valuations. The fair value of alternative investments is determined by the partnership based on the valuation methodology outlined in the partnership agreement.

**(f) Federal Income Tax Status**

STRS Ohio qualifies under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes.

**(g) Reclassifications**

Certain 1999 balances have been reclassified to conform to the current year presentation.

**(2) Description of the STRS Ohio Plan**

**(a) Plan Membership**

STRS Ohio is a statewide retirement plan for certified teachers and other faculty members employed in the public schools of Ohio (the state) or any school, college, university, institution or other agency controlled, managed and supported, in whole or part, by the state or any political subdivision thereof.

At June 30, 2000 and 1999, the number of participating employers were:

	<u>2000</u>	<u>1999</u>
City school districts	192	192
Local school districts	371	371
County education service centers	60	63
Exempted village school districts	49	49
Joint vocational schools	49	49
Universities and colleges	37	37
County boards of mental retardation and developmental disabilities	82	82
Community schools	51	16
State of Ohio	1	1
	<u>1</u>	<u>1</u>
Total	<u>892</u>	<u>860</u>

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

At July 1, 2000 and 1999, the member and retirant data was:

	<u>2000</u>	<u>1999</u>
Current active members	174,072	170,854
Inactive members eligible for refunds only	102,935	101,707
Terminated members entitled to receive a benefit in the future	17,428	17,408
Retirants and beneficiaries currently receiving a benefit	99,011	95,796
Reemployed retirees	<u>13,081</u>	<u>12,590</u>
 Total plan membership	 <u>406,527</u>	 <u>398,355</u>

**(b) Plan Benefits**

Plan benefits are established under Chapter 3307 of the Revised Code. Any member may retire who has (i) five years of service credit and attained age 60, (ii) 25 years of service credit and attained age 55, or (iii) 30 years of service credit regardless of age.

The maximum annual retirement allowance, payable for life, is the greater of the “formula benefit” or the “money-purchase benefit” calculation. Under the “formula benefit”, the retirement allowance is based on years of credited service and final average salary, which is the average of the member’s three highest salary years. The annual allowance is determined by multiplying final average salary by 2.1% for the first 30 years of credited service. Each year over 30 years is incremented by .1% starting at 2.5% for the 31<sup>st</sup> year of Ohio service up to a maximum allowance of 100% of final average salary. Members retiring before age 65 with less than 30 years of service credit receive a percentage reduction in benefit amounts.

Effective July 1999, enacted legislation provided an adjustment for retirees whose benefits have not kept pace with the rate of inflation. This legislation changed the formula for calculating the formula benefit. The formula benefit increased to 2.2% per year for all years of credited service up to 30 years. Each year over 30 years is incremented by .1%, starting at 2.5% for the 31<sup>st</sup> year of Ohio service. Upon reaching 35 years of Ohio service, the first 31 years of Ohio contributing service is multiplied by 2.5%, and each year over 31 years is incremented by .1% starting at 2.6% for the 32<sup>nd</sup> year.

Although enacted in July 2000, the benefit increases were retroactive to July 1999. A pension benefit payable has been reported in the statement of plan net assets to properly accrue for the retroactive application of the legislation.

Under the “money-purchase benefit” calculation, a member’s lifetime contributions plus interest at specified rates are matched by an equal amount from contributed employer funds. This total is then divided by an actuarially determined annuity factor to compute the maximum annual retirement allowance.

Since the plan is tax-qualified, benefits are subject to limits established by Section 415 of the Internal Revenue Code.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

After retirement, benefits are increased annually by the greater of the amount of the change in the Consumer Price Index (CPI) or the cumulative CPI increase since retirement, less previous cost-of-living increases, up to a maximum of 3% of the original base amount.

A retiree of STRS Ohio or another Ohio public retirement system is eligible for reemployment as a teacher following the elapse of two months from the date of retirement. Contributions are made by the reemployed member and employer during the reemployment. Upon termination of reemployment or age 65, whichever comes later, the retiree is eligible for a money-purchase benefit or a lump-sum payment in addition to the original retirement allowance.

**(c) *Death, Survivor and Disability Benefits***

A member with five or more years of credited service who becomes disabled (illness or injury preventing individual's ability to teach) is entitled to a disability benefit. Additionally, monthly benefits are paid to eligible survivors of members who die prior to retirement. A death benefit of \$1,000 is payable to the beneficiary of each deceased retired member. Additional death benefit coverage up to \$2,000 can be purchased. Various other benefits are available to members' beneficiaries.

**(d) *Health Care Benefits After Retirement***

The plan provides comprehensive health care benefits to retirees and their dependents.

Coverage includes hospitalization, physicians' fees, prescription drugs and reimbursement of monthly Medicare premiums. Pursuant to the Revised Code, the State Teachers Retirement Board, (the Retirement Board) has discretionary authority over how much, if any, of the associated health care costs will be absorbed by the plan. Most benefit recipients pay a portion of the health care cost in the form of a monthly premium.

Under Ohio law, medical costs paid from the funds of the plan are included in the employer contribution rate, currently 14% of compensation. For the fiscal years ended June 30, 2000 and 1999, 8.0% of covered payroll was allocated to the Health Care Reserve Fund. Beginning July 1, 2000, 4.5% of covered payroll will be allocated to the Health Care Reserve Fund.

**(e) *Supplemental Benefits***

In December of each year, if the Retirement Board determines that sufficient funds are available, a lump-sum supplemental benefit payment is made to eligible retirees. The payment is based on the retiree's years of service and date of retirement. The amount of the payment may vary and is not guaranteed from year to year.

**(f) *Refunds***

Upon termination of employment, a member may withdraw accumulated contributions made to STRS Ohio. Withdrawal cancels the individual's rights and benefits in STRS Ohio. Refunds of member contributions may include interest and 50% matching payments.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

### **(g) *Alternative Retirement Plan***

Eligible faculty of Ohio's public colleges and universities may choose to enroll in either STRS Ohio or an alternative retirement plan (ARP) offered by their employer.

Full time faculty with less than five years of service credit have a one-time option to select an ARP instead of STRS Ohio. Employees hired after the ARP is established have 90 days from their hire date to select a retirement plan.

For employees who elect an ARP, employers are required to remit to STRS Ohio 5.76% and 6% employer contributions on compensation paid for the years ended June 30, 2000 and June 30, 1999, respectively. The employer contribution rate is based on independent actuarial studies. As of June 30, 2000 and 1999, the ARP participant payroll totaled \$149,376,000 and \$105,938,000, respectively, and there were 3,337 and 2,390 participants, respectively.

### **(3) Contribution Requirements and Reserves**

Employer and member contribution rates are established by the Retirement Board and limited by Chapter 3307 of the Revised Code to 14% and 10%, respectively, of covered payroll. The employer and member contribution rates for the years ended June 30, 2000 and 1999, were 14% and 9.3%, respectively. Eight percent of the 14% employer rate was allocated for postemployment health care for the fiscal year ended June 30, 2000 and June 30, 1999. Beginning July 1, 2000, 4.5% of covered payroll is being allocated to the Health Care Reserve Fund.

Various funds are established under the Revised Code to account for contributions, reserves, income and administrative expenses.

- The Teachers' Savings Fund (TSF) is used to accumulate member contributions in trust.
- The Employers' Trust Fund (ETF) is used to accumulate employer contributions in trust. The ETF includes assets allocated to the Health Care Reserve Fund from which payments for comprehensive health care benefits are made.
- The Annuity and Pension Reserve Fund (APRF) is the fund from which all annuities and pension payments to retired members are made. Reserves are transferred to this fund from the TSF and ETF funds at the time of retirement.
- The Survivors' Benefit Fund is the fund from which all survivor benefit payments are made for which reserves have been transferred from the Teachers' Savings Fund and the Employers' Trust Fund.
- The Guarantee Fund is used to accumulate income derived from gifts, bequests and investments for the year.
- The Expense Fund is the fund from which all expenses for the administration and management of STRS Ohio are paid each year.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

After interest is allocated to the various funds, the Guarantee Fund and the Expense Fund are closed into the Employers' Trust Fund at year-end.

At June 30, 2000 and 1999, plan net assets were included in the various funds as follows (in thousands):

	<b>June 30,</b>	
	<b>2000</b>	<b>1999</b>
Teachers' Savings Fund	\$ 7,174,675	6,867,910
Employers' Trust Fund	23,532,839	21,341,020
Annuity and Pension Reserve Fund	26,648,931	24,558,652
Survivors' Benefit Fund	<u>663,024</u>	<u>593,974</u>
	<u>\$ 58,019,469</u>	<u>53,361,556</u>

#### (4) Commitments and Contingencies

STRS Ohio has made commitments to fund various real estate investments totaling approximately \$770,982,226 as of June 30, 2000, and \$537,428,000 as of June 30, 1999. The commitments for the year ended June 30, 2000 have expected funding dates from July 2000 to August 2003.

STRS Ohio has made commitments to fund various alternative investments totaling approximately \$1,071,792,000 and \$808,734,000 as of June 30, 2000 and 1999, respectively. The average expected funding dates range from July 2000 to June 2006.

In October 2000, the board passed a resolution that provides a lump-sum supplemental benefit payment to be paid to eligible retirees in December 2000. Estimated payments to be made are \$51 million.

STRS Ohio is a party in various lawsuits. While the final outcome cannot be determined at this time, management is of the opinion that the liability, if any, for these legal actions will not have a material adverse effect on the net assets available for benefits.

#### (5) Cash and Investments

##### (a) GASB Statement No. 3

Statement No. 3 of the Governmental Accounting Standards Board requires governmental entities to categorize investments as an indication of the level of risk at fiscal year end. Category 1 includes investments that are insured or registered or for which the securities are held by STRS Ohio or its agent in the name of STRS Ohio. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of STRS Ohio. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty in STRS Ohio name or held by the counterparty's trust department or agent but not in STRS Ohio name.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

All investments subject to categorization at June 30, 2000 and 1999, meet the criteria of Category 1. Investments are held in the name of STRS Ohio or its nominee by the treasurer of the state of Ohio as custodian. Real estate investments and securities on loan are investments that, by their nature, are not required to be categorized.

At June 30, 2000 and 1999, the carrying amount of STRS Ohio cash deposits were \$(1,816,000) and \$2,522,000 and the bank cash balances were \$10,757,000 and \$9,948,000, respectively. Of the bank balances, \$100,000 was insured by the Federal Deposit Insurance Corporation. The remaining bank balance was covered by collateral held in the name of STRS Ohio's pledging financial institution, as required by state statute (Category 3).

**(b) *Investment Authority***

The investment authority of the Retirement Board is governed by Section 3307.15 of the Revised Code that also requires the Retirement Board to publish its investment policies annually and make copies available to interested parties. This section requires that investments be made with care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. It further provides that the Retirement Board may invest in bonds, notes, certificates of indebtedness, mortgage notes, real estate, stocks and debentures with certain restrictions as to the nature and quality of the investment and composition of the investment portfolio.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

Investments held at fair value by STRS Ohio at June 30, 2000 and 1999, are summarized as follows (in thousands):

	<b>June 30,</b>	
	<b>2000</b>	<b>1999</b>
Short-term:		
Commercial paper	\$ 735,186	1,894,283
Government notes	10,000	10,000
Short-term investment funds	14,614	8,900
Total short-term	759,800	1,913,183
Fixed income:		
Guaranteed mortgages	4,078,061	3,785,429
U.S. government/agencies:		
Not on securities loan	1,798,761	1,984,159
On securities loan	2,260,891	2,611,819
Corporate bonds:		
Not on securities loan	4,331,807	4,197,701
On securities loan	59,646	61,644
Canadian bonds	116,559	183,826
Supernationals	100,667	-
Municipal bonds	293	574
Total fixed income	12,746,685	12,825,152
Common and preferred stock:		
Not on securities loan	26,054,617	22,571,107
On securities loan	653,518	356,424
Total common and preferred stock	26,708,135	22,927,531
International (see Note 6):		
Not on securities loan	10,256,266	9,517,499
On securities loan	453,835	610,543
Total international	10,710,101	10,128,042
Real estate (see Note 7):		
East Region	1,118,422	977,006
Midwest Region	1,006,963	725,095
South Region	931,457	775,566
West Region	1,407,536	1,252,380
REITs	492,718	429,565
Other	896,546	575,680
Total real estate	5,853,642	4,735,292
Alternative investments	747,525	284,245
Collateral on loaned securities	3,498,469	3,717,814
Total investments and collateral on loaned securities	\$ 61,024,357	56,531,259

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

### (c) *Fair Valuation*

Stocks traded on a national securities exchange are valued at the closing price on the last business day of the fiscal year; stocks traded over the counter are valued at the closing price, as reflected by NASDAQ, on the last business day of the fiscal year; international investments are valued by the subcustodian using relevant closing market prices and exchange rates; U.S. government and governmental agency securities, bonds, certain guaranteed mortgages, and short-term corporate and government notes are valued based on information from an independent service organization for institutional investors; guaranteed mortgages are valued based on their coupon rate relative to the coupon rate for similar mortgages on the last business day of the fiscal year; short-term cash equivalent investments are stated at amortized cost which approximates market value; real estate is valued based on appraisals performed by independent appraisers or, for properties not appraised, at the present value of the projected future net income stream. All real estate investments have independent appraisals at the minimum of every 3 years. The fair value of alternative investments is determined by the partnership based on the valuation methodology outlined in the partnership agreement.

### (d) *Securities Lending*

STRS Ohio participates in a domestic and international securities lending program whereby securities are loaned to investment brokers/dealers (borrower). Securities loaned are collateralized by the borrower at 102% of the domestic loaned securities' market value and 105% of the international loaned securities' market value.

STRS Ohio lends domestic equities, international equities, U.S. Treasuries, agencies and corporate bonds. The collateral received is cash, U.S. Treasuries or related agency securities. STRS Ohio cannot sell or pledge collateral received. If a borrower defaults, then the collateral can be liquidated.

A custodial agent bank administers the program and STRS Ohio receives a fee from the borrower for the use of loaned securities. Cash collateral from securities lending is invested in repurchase agreements, commercial paper, and U.S. corporate obligations. The credit quality of the invested cash collateral is the same as the credit quality on STRS direct holdings. There are slight mismatches of less than 30 days between the duration of the cash invested and the length of time the securities are on loan. STRS Ohio has minimized its exposure to credit risk due to borrower default by having the custodial agent bank determine daily that the required collateral meets the specified collateral requirements. There are no restrictions on the amount of securities that can be loaned. The fair value of the loaned securities was \$3,427,890,000 and \$3,640,430,000 as of June 30, 2000 and 1999, respectively. The fair value of the associated collateral received as of June 30, 2000 and 1999 was \$3,498,469,000 and \$3,717,814,000, respectively.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

### (6) International Investments

#### (a) *Externally Managed*

STRS Ohio has investments in international equity securities through the use of external money managers. It is the intent of STRS Ohio and the money managers to be fully invested, however, cash and short-term fixed income investments are held temporarily. The portfolios are managed in accordance with various mandates based on Morgan Stanley Capital International's (MSCI) indexes. Investments are held in both developed and emerging international markets.

#### (b) *Internally Managed:*

##### *Country Funds*

STRS Ohio actively invests in developed and emerging markets through traded country funds. Each country fund consists of individual equity securities pooled together in an attempt to match or exceed the local country's index.

##### *Europe, Australia and Far East (EAFE) Index Fund*

To increase diversification in international developed markets, STRS Ohio invests in an EAFE Index Fund. The EAFE Index Fund purchases foreign equities, futures and other traded investments to replicate the makeup of the EAFE benchmark.

##### *Emerging Markets Free (EMF) Index Fund*

STRS Ohio invests in an EMF Index Fund to increase diversification in emerging market countries. The fund invests in foreign equities, swaps and other traded investments to imitate the EMF Index.

##### *EAFE Equity Swaps*

Four international equity swap agreements were contracted during fiscal 2000 with maturity dates in fiscal 2001. In exchange for a negotiated LIBOR (London Interbank Offered Rate), STRS Ohio will receive dividends on a quarterly basis. At maturity, STRS Ohio will receive or pay the difference in the change in the various market indices included in the swap agreement. Fixed income securities with an initial notional amount of \$1,450,090,000 have been set aside at the Bank of New York as security.

##### *EMF Equity Swaps*

Six international equity swap agreements were contracted during fiscal 1999 and matured by September 1999. No new EMF Equity Swaps were contracted beyond September 1999. These are similar to the EAFE equity swaps, except that at maturity, STRS Ohio received or paid the difference in the EMF index.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

The fair values of international investments held at June 30, 2000 and 1999 are (in thousands):

	<b>June 30,</b>	
	<b>2000</b>	<b>1999</b>
Externally managed:		
International stocks	\$ 6,880,342	6,821,456
International fixed income	137,587	80,659
International currency and liquidity reserves	242,263	217,870
Forward contracts	(24,890)	24,109
Total externally managed	7,235,302	7,144,094
Internally managed:		
Country Funds	515,172	345,542
EAFE Index Fund	2,583,604	1,554,555
EMF Index Fund	342,276	873,118
EAFE Equity Swaps	33,747	145,626
EMF Equity Swaps	-	65,107
Total internally managed	3,474,799	2,983,948
Total international	\$ 10,710,101	10,128,042

#### (7) Real Estate Investments

##### (a) General

STRS Ohio properties are geographically distributed throughout the United States. Real estate investments include retail single-tenant stores and malls, single and multitenant office properties and warehouses, apartments, REITs and other.

##### (b) REITs

Real estate investment trusts (REITs) are real estate company stocks with a high dividend-income component. REITs divide the ownership of the real estate company and its properties among all the shareholders. REITs are required to distribute 95% of the company's taxable income to their shareholders. Distributions are taxable to shareholders rather than the real estate company. STRS Ohio is exempt from federal and state income taxes.

##### (c) Other

Other real estate investments include farmland, timberland and opportunity funds, that are externally managed, and private REITs. Farmland investments generate income primarily as a result of harvest proceeds. Income is generated from the sale of timber on timberland investments. Opportunity funds generate income as a result of operations and property sales, which are distributed to the investors. Finally, private REITs are privately traded real estate

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

company stocks with a dividend-income component, similar to the public REIT investments discussed above.

#### (8) Derivatives

##### (a) *Equity Swap Agreements*

As discussed in Note 6, STRS Ohio has entered into international equity swap agreements. No funds are required as collateral by either party; however, STRS Ohio has purchased fixed-income securities equivalent to the initial exposure, which are located in a subcustodial account at the Bank of New York. The initial notional amount of the fixed income securities is \$1,450,090,000. The market risk of the swap is the same as if STRS Ohio owned the underlying stocks that comprise the indexes. The net interest revenues and expenses resulting from these agreements have been recorded in the financial statements. See Note 6 for the related equity swap market values as of June 30, 2000 and 1999. Equity swaps were also used in the EMF Index Fund during 2000 and 1999. Of the total EMF holdings, \$12.6 million and \$7 million were invested in swap agreements at June 30, 2000 and 1999, respectively.

##### (b) *Forward Contracts*

Forward contracts in various currencies were used to transact and hedge direct foreign equity investments that STRS Ohio maintains through the use of outside managers. Additionally, forward contracts were used to hedge currency exposure as a result of the EAFE Equity Swap agreements. STRS Ohio is obligated to deliver the foreign currency at a certain dollar price sometime in the future. To fulfill this obligation at maturity, STRS Ohio must obtain the currency in the open market. Before the contract matures, STRS Ohio can enter into an offsetting forward contract that nets out the original contract. These events expose STRS Ohio to currency market risk, which can fluctuate. The external money managers hedged \$1.95 and \$1.56 billion of currency exposure in various currencies with varying maturities as of June 30, 2000 and 1999, respectively. At June 30, 2000, STRS Ohio hedged \$0, \$1,388 and \$57 million of currency exposure on the EAFE Equity Swaps, EAFE Index Fund and the Country Funds, respectively. At June 30, 1999, STRS Ohio hedged \$16, \$752 and \$43 million of currency exposure on the EAFE Equity Swaps, EAFE Index Fund and the Country Funds, respectively.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

### (c) *Futures*

STRS Ohio had investments in S&P 500 index futures during the year. Index futures are designed to offer lower-cost and more efficient alternatives to buying a basket of individual stocks that comprise the index. The market and credit risk of the futures were the same as if STRS Ohio had owned the underlying stocks that comprise the index. From July 1999 to June 2000, S&P Futures ranged from \$3.6 million to \$459 million. From August 1998 to September 1998, S&P Futures ranged from \$49.7 million to \$228 million. Additionally, futures were used in the EAFE Index Fund. Of the total EAFE Index Fund holdings, \$34.7 and \$3.7 million was invested in futures at June 30, 2000 and 1999, respectively. External money managers also used futures. Approximately, \$49.9 and \$180.3 million of external money managers' holdings were invested in futures at June 30, 2000 and 1999, respectively.

### (d) *Options*

STRS Ohio writes option contracts on existing stock positions to enhance the return on the stock portfolio. In exchange for a premium, STRS Ohio gives the option buyer the right to buy or sell the underlying stock. Options are also purchased to "cover" existing written open option positions.

### (9) **State Appropriations**

From time to time, the legislature of the state has increased benefit payments to retirees. In certain instances, concurrent with the passage of such legislation, a provision for payment of these benefits through future state appropriations has been made.

STRS Ohio received approximately \$1,514,000 and \$1,780,000 from the state for increased benefits paid for the years ended June 30, 2000 and 1999, respectively. Funding for these increased benefits is on a pay-as-you-go basis by the state.

### (10) **Pension Plan**

Substantially all STRS Ohio employees are required to participate in a contributory retirement plan administered by the Public Employees Retirement System of Ohio (PERS). PERS is a cost-sharing multiple-employer public employee retirement system.

Eligible employees are entitled to a retirement benefit, payable monthly for life, equal to 2.1% of their final average salary for each year of credited service up to 30 years and 2.5% for each year of service over 30 years. Final average salary is the employee's average salary over the highest three years of earnings. Benefits fully vest on reaching five years of service. Vested employees may retire at any age with 30 years of credited service, at age 55 with a minimum of 25 years of accredited service, and at age 60 with a minimum of five years of service. Employees retiring with less than 30 years of service and under age 65 receive reduced retirement benefits. Benefits are established by state statute.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

For the Years Ended June 30, 2000 and 1999

Employees covered by PERS are required by Ohio statute to contribute 8.5% of their salary to the plan. STRS Ohio is required by the same statute to contribute 13.55% of covered payroll; 9.35% is the portion used to fund pension obligations, with the remainder used to fund the health care program for retirees. The required employer contributions for the current year and the two proceeding years are as follows:

<u>Year ended June 30</u>	<u>Annual required contributions</u>	<u>Percentage contributed</u>
2000	\$4,151,000	100%
1999	\$3,472,000	100%
1998	\$3,090,000	100%

Historical trend information showing the progress of PERS in accumulating sufficient assets to pay benefits when due is presented in the PERS *Comprehensive Annual Financial Report*. PERS issued a publicly available financial report for the plans. The report may be obtained by writing to PERS, 277 E. Town St., Columbus, Ohio 43215-4642.

PERS also provides postretirement health care coverage to age and service retirees with 10 or more years of qualifying Ohio service credit and to primary survivor recipients of such retirees. Health care coverage for disability recipients is available. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to PERS is set aside for the funding of post retirement health care. The Revised Code provides statutory authority for employer contributions. The 1999 employer contribution rate for local government employees was 13.55% of covered payroll; 4.20% was the portion that was used to fund health care for the year.

PERS expenditures for OPEB during 1999 were \$523,599,000. The number of benefit recipients eligible for OPEB at Dec. 31, 1999 was 118,062.

#### **(11) Required Supplemental Schedules and Additional Information**

The schedule of funding progress, the schedule of employer contributions, and the related notes are required supplemental schedules. These schedules are designated as schedules 1 and 2 and are designed to provide information about STRS Ohio's progress in accumulating sufficient assets to pay benefits when due. The schedule of administrative expenses and the schedule of investment expenses are included as additional information. These schedules are designated as schedules 3 and 4.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Required Schedule of Funding Progress

(Dollar Amounts in Thousands)

<b>Valuation Year</b>	<b>Actuarial Accrued Liabilities (AAL)*</b>	<b>Valuation assets</b>	<b>Unfunded Actuarial Accrued Liability (UAAL)*</b>	<b>Ratio of assets to AAL</b>	<b>Covered payroll**</b>	<b>UAAL as % of active member payroll</b>
2000	\$ 55,774,052	\$ 51,293,815	\$ 4,480,237	92.0%	\$ 7,845,021	57%
1999	51,979,974	46,341,436	5,638,538	89.2%	7,444,243	76%
1998	48,972,084	41,709,903	7,262,181	85.2%	7,112,124	102%
1997	44,704,237	36,883,739	7,820,498	82.5%	6,805,797	115%
1996	41,128,062	32,930,801	8,197,261	80.1%	6,553,642	125%
1995	<u>38,483,947</u>	<u>29,913,449</u>	<u>8,570,498</u>	<u>77.7%</u>	<u>6,327,049</u>	<u>135%</u>

\*The amounts reported in this schedule do not include assets or liabilities for postemployment health care benefits.

\*\*Covered payroll includes salaries for alternative retirement plan participants. For 2000 and 1999, alternative retirement plan participant payroll totaled \$149,376 and 105,938 respectively.

See accompanying notes to Schedules 1 and 2.

See accompanying independent auditors' report.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

## Required Schedule of Employer Contributions

(Dollar Amounts in Thousands)

Year Ended June 30		Annual required contributions*	Percentage contributed
2000	\$	470,343	100%
1999		446,655	100%
1998		746,773	100%
1997		816,696	100%
1996		786,437	100%
1995		759,246	100%

\*The amounts reported in this schedule do not include contributions for postemployment health care benefits.

See accompanying notes to Schedules 1 and 2.

See accompanying independent auditors' report.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Schedules 1 and 2

*The information presented in required supplemental schedules 1 and 2 was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuations follows:*

<b>Valuation date</b>	<b>July 1, 2000</b>	<b>July 1, 1999</b>
Actuarial cost method	Entry Age	Entry Age
Amortization method	Level percent closed	Level percent closed
Remaining amortization period	23.1 years	16.3 years
Asset valuation method	4-year smoothed market with 91%/109% corridor	4-year smoothed market with 91%/109% corridor
Actuarial assumptions:		
Investment rate of return	7.75%	7.50%
Projected salary increases	9.25% at age 20 to 3.25% at age 65	9.25% at age 20 to 3.25% at age 65
Inflation assumption	3.50%	3.50%
Cost-of-living adjustments	3% simple	3% simple

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Schedule of Administrative Expenses

For the Years Ended June 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
Personnel:		
Salaries and wages	\$ 20,601,552	17,755,080
Retirement contributions	2,853,638	2,341,857
Benefits	<u>2,689,260</u>	<u>2,328,760</u>
Total personnel	26,144,450	22,425,697
Professional and technical services:		
Computer support services	9,005,571	6,622,961
Health care services	1,645,420	1,513,573
Actuary	283,480	496,078
Auditing	69,733	69,271
Legal	<u>232,803</u>	<u>238,562</u>
Total professional and technical services	11,237,007	8,940,445
Communications:		
Postage and courier services	1,939,015	1,969,168
Printing and supplies	2,625,742	2,717,732
Telephone	<u>697,262</u>	<u>589,019</u>
Total communications	5,262,019	5,275,919
Other expenses:		
Equipment repairs and maintenance	1,826,506	1,243,077
Building utilities and maintenance	1,023,487	1,035,342
Transportation and travel	704,510	583,049
Recruitment fees	307,977	246,509
Equipment rental	3,322,708	2,212,939
Depreciation	6,282,680	5,384,814
Insurance	300,205	376,188
Memberships and subscriptions	132,078	102,332
Retirement study commission	286,943	211,476
Miscellaneous	882,075	781,036
Loss on sale of assets	<u>103,955</u>	<u>148,531</u>
Total other expenses	<u>15,173,124</u>	<u>12,325,293</u>
Total administrative expenses	<u>\$ 57,816,600</u>	<u>48,967,354</u>

See accompanying independent auditors' report.

Note: Above amounts do not include investment administrative expenses, which are deducted from investment income.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Schedule of Investment Expenses

For the Years Ended June 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
Personnel:		
Salaries and wages	\$ 10,726,151	9,287,086
Retirement contributions	1,297,401	1,130,604
Benefits	797,897	706,616
	<u>12,821,449</u>	<u>11,124,306</u>
Total personnel		
Professional and technical services:		
Legal	36,373	31,177
Investment research	507,168	259,698
Real estate and international advisor	491,933	493,079
Investment advisors	478,114	391,388
Banking fees	4,102,679	2,845,644
	<u>5,616,267</u>	<u>4,020,986</u>
Total professional and technical services		
Other expenses:		
Printing and supplies	5,955	36,075
Equipment repairs and maintenance	1,606	2,717
Building utilities and maintenance	641,836	506,693
Travel	649,895	581,598
Equipment rental	150,004	104,286
Memberships and subscriptions	95,893	84,604
Miscellaneous	68,148	62,701
	<u>1,613,337</u>	<u>1,378,674</u>
Total other expenses		
Total investment expenses	<u>\$ 20,051,053</u>	<u>16,523,966</u>

See accompanying independent auditors' report.



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**Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards***

To the Retirement Board  
The State Teachers Retirement System of Ohio:

We have audited the financial statements of the State Teachers Retirement System of Ohio (STRS Ohio) as of and for the year ended June 30, 2000, and have issued our report thereon dated November 22, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audits, we considered STRS Ohio's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Ohio Auditor of State, and the management and members of the Retirement Board of the State Teacher's Retirement System of Ohio and is not intended to be and should not be used by anyone other than those specified parties.

**KPMG LLP**

November 22, 2000



STATE OF OHIO  
OFFICE OF THE AUDITOR  

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JIM PETRO, AUDITOR OF STATE

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**STATE TEACHERS RETIREMENT SYSTEM**

**FRANKLIN COUNTY**

**CLERK'S CERTIFICATION**

**This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.**

*Susan Babbitt*

**CLERK OF THE BUREAU**

**CERTIFIED  
JANUARY 30, 2001**