

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Financial Statements and Supplemental Schedules

June 30, 2001 and 2000

(With Independent Auditors' Report Thereon)





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

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To the Retirement Board  
State Teachers Retirement System of Ohio  
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We have reviewed the Independent Auditor's Report of the State Teachers Retirement System of Ohio, prepared by KPMG LLP, for the audit period July 1, 2000 through June 30, 2001. 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

February 4, 2002

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# 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, 2001 and 2000, 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, 2001 and 2000, 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 October 26, 2001, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The schedules of funding progress and employer contributions on pages 19 and 20, respectively, are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of schedules. However, we did not audit the information and express no opinion on it.



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 22 and 23 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, 2001 and 2000, and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

**KPMG LLP**

October 26, 2001

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Combining Statements of Plan Net Assets

June 30, 2001 and 2000

(In thousands)

Assets	2001			2000		
	Pensions	Post-employment health care	Totals	Pensions	Post-employment health care	Totals
Cash and short-term investments	\$ 591,481	39,208	630,689	714,385	45,415	759,800
Receivables:						
Accrued interest and dividends	163,769	10,856	174,625	176,530	11,222	187,752
Employer contributions	189,137	12,537	201,674	179,557	11,415	190,972
Retirement incentive	14,507	—	14,507	29,876	—	29,876
Member contributions	161,166	—	161,166	148,830	—	148,830
Securities sold	77,866	5,162	83,028	243,360	15,471	258,831
Miscellaneous receivables	1,191	—	1,191	3,481	—	3,481
Total receivables	607,636	28,555	636,191	781,634	38,108	819,742
Investments, at fair value:						
Fixed income	10,861,681	720,002	11,581,683	11,984,781	761,904	12,746,685
Common and preferred stock	22,671,485	1,502,852	24,174,337	25,111,718	1,596,417	26,708,135
International	8,598,248	569,963	9,168,211	10,069,930	640,171	10,710,101
Real estate	5,941,282	393,837	6,335,119	5,503,754	349,888	5,853,642
Alternative investments	865,857	57,396	923,253	702,843	44,682	747,525
Total investments	48,938,553	3,244,050	52,182,603	53,373,026	3,393,062	56,766,088
Invested securities lending collateral	3,391,009	224,784	3,615,793	3,289,356	209,113	3,498,469
Fixed assets, at cost, net of accumulated depreciation of \$46,713 and \$38,610, respectively	149,524	—	149,524	118,287	—	118,287
Total assets	\$ 53,678,203	3,536,597	57,214,800	58,276,688	3,685,698	61,962,386
<b>Liabilities</b>						
Securities purchased	190,923	12,656	203,579	264,538	16,817	281,355
Accrued expenses and other liabilities	14,461	958	15,419	20,535	1,305	21,840
Pension benefits payable	—	—	—	101,896	—	101,896
Medical benefits payable	—	42,035	42,035	—	39,357	39,357
Obligations under securities lending program	3,394,384	225,008	3,619,392	3,289,356	209,113	3,498,469
Total liabilities	\$ 3,599,768	280,657	3,880,425	3,676,325	266,592	3,942,917
Net assets held in trust for pension and post-employment healthcare benefits: (A schedule of funding progress is presented in required supplemental schedule 1)	\$ 50,078,435	3,255,940	53,334,375	54,600,363	3,419,106	58,019,469

See accompanying notes to financial statements.



**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Combining Statements of Changes in Plan Net Assets

Years ended June 30, 2001 and 2000

(In thousands)

	2001			2000		
	Pensions	Post-employment health care	Totals	Pensions	Post-employment health care	Totals
Additions:						
Contributions:						
Member	\$ 785,009	—	785,009	755,146	—	755,146
Employer	779,274	363,166	1,142,440	470,473	615,652	1,086,125
Retirement incentive	25,390	—	25,390	42,189	—	42,189
State of Ohio appropriations	—	—	—	1,514	—	1,514
Benefit recipient health care premiums	—	68,582	68,582	—	60,375	60,375
Other retirement systems	9,416	—	9,416	6,476	—	6,476
Additional death benefits (net)	194	—	194	11	—	11
Total contributions	1,599,283	431,748	2,031,031	1,275,809	676,027	1,951,836
Investment (loss) income:						
From investing activities						
Net (depreciation) appreciation in fair value of investments	(4,993,942)	(318,843)	(5,312,785)	3,770,584	222,348	3,992,932
Interest	754,350	48,162	802,512	716,174	42,232	758,406
Dividends	395,654	25,261	420,915	384,106	22,650	406,756
Real estate income	379,727	24,244	403,971	333,561	19,670	353,231
	(3,464,211)	(221,176)	(3,685,387)	5,204,425	306,900	5,511,325
Less investment expenses	(21,662)	(1,383)	(23,045)	(18,934)	(1,117)	(20,051)
Net (loss) income from investing activities	(3,485,873)	(222,559)	(3,708,432)	5,185,491	305,783	5,491,274
From securities lending activities						
Securities lending income	208,346	13,302	221,648	185,052	10,912	195,964
Securities lending expenses	(194,894)	(12,443)	(207,337)	(172,905)	(10,196)	(183,101)
Net income from securities lending activities	13,452	859	14,311	12,147	716	12,863
Net investment (loss) income	(3,472,421)	(221,700)	(3,694,121)	5,197,638	306,499	5,504,137
Total (deductions) additions	(1,873,138)	210,048	(1,663,090)	6,473,447	982,526	7,455,973
Deductions:						
Benefits:						
Service retirement	2,203,280	—	2,203,280	2,019,521	—	2,019,521
Disability retirement	160,775	—	160,775	152,365	—	152,365
Survivor benefits	65,591	—	65,591	62,346	—	62,346
Supplemental benefit	50,386	—	50,386	48,493	—	48,493
Health care	—	369,354	369,354	—	343,512	343,512
Other retirement systems	6,473	—	6,473	8,247	—	8,247
Total benefit payments	2,486,505	369,354	2,855,859	2,290,972	343,512	2,634,484
Refunds to members who have withdrawn	93,868	—	93,868	105,759	—	105,759
Administrative expenses	68,417	3,860	72,277	54,543	3,274	57,817
Total deductions	2,648,790	373,214	3,022,004	2,451,274	346,786	2,798,060
Net (decrease) increase	(4,521,928)	(163,166)	(4,685,094)	4,022,173	635,740	4,657,913
Net assets held in trust for pension and post-employment health care benefits						
Beginning of year	54,600,363	3,419,106	58,019,469	50,578,190	2,783,366	53,361,556
End of year	\$ 50,078,435	3,255,940	53,334,375	54,600,363	3,419,106	58,019,469

See accompanying notes to financial statements.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

June 30, 2001 and 2000

### (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 teacher 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-dividend 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

June 30, 2001 and 2000

**(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 alternative investment 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 2000 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, 2001 and 2000, the number of participating employers were:

	<u>2001</u>	<u>2000</u>
City school districts	194	194
Local school districts	369	369
County education service centers	61	61
Exempted village school districts	49	49
Joint vocational schools	49	49
Universities and colleges	37	37
County boards of mental retardation and developmental disabilities	80	82
Community schools	72	51
State of Ohio	1	1
Other	7	7
	<u>919</u>	<u>900</u>
Total	<u>919</u>	<u>900</u>

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Financial Statements

June 30, 2001 and 2000

At July 1, 2001 and 2000, member and retiree totals were:

	<u>2001</u>	<u>2000</u>
Current active members	177,013	174,072
Inactive members eligible for refunds only	105,617	102,935
Terminated members entitled to receive a benefit in the future	17,827	17,428
Retirees and beneficiaries currently receiving a benefit	102,132	99,011
Reemployed retirees	<u>14,380</u>	<u>13,081</u>
Total plan membership	<u>416,969</u>	<u>406,527</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 2.2% for the first 30 years of credited service. Each year over 30 years is incrementally increased by .1% starting at 2.5% for the 31<sup>st</sup> year of contribution service up to a maximum allowance of 100% of final average salary. 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 incrementally increased by .1% starting at 2.6% for the 32<sup>nd</sup> year. Members retiring before age 65 with less than 30 years of service credit receive a percentage reduction in benefit amounts.

Effective July 1999, legislation enacted in July 2000 provided an adjustment for retirees whose benefits had not kept pace with the rate of inflation. A pension benefit payable for the year ended June 30, 2000 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.

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.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

June 30, 2001 and 2000

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 for at least 12 months) 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 access to comprehensive health care benefits to retirees and their dependents.

Coverage includes hospitalization, physicians' fees, prescription drugs and reimbursement of monthly Medicare Part B 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, 2001 and 2000, 4.5% and 8.0%, respectively, of covered payroll were allocated by the Retirement Board to the Health Care Reserve Fund.

Pension and postemployment health care assets are commingled for investment purposes. Consequently, amounts reported for individual assets classes are allocated between pension and postemployment health care based upon ending net assets.

**(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

June 30, 2001 and 2000

### **(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.

Employees hired after the ARP is established have 120 days from their hire date to select a retirement plan.

For employees who elect an ARP, employers are required to remit 5.76% employer contributions to STRS Ohio on compensation paid for the years ended June 30, 2001 and June 30, 2000. The employer contribution rate is based on independent actuarial studies. For the year ended June 30, 2001, the ARP participant payroll totaled \$186,332,000 and there were 4,380 participants. For the year ended June 30, 2000, the ARP participant payroll totaled \$149,376,000 and there were 3,337 participants.

### **(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. The employer rate is limited to 14% and the member rate is limited to 10% of covered payroll. The employer and member contribution rates for the years ended June 30, 2001 and 2000 were 14% and 9.3%, respectively. Of the 14% employer rate, 4½% and 8% was allocated for postemployment health care for the fiscal year ended June 30, 2001 and June 30, 2000, respectively.

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.

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.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Financial Statements

June 30, 2001 and 2000

At June 30, 2001 and 2000, plan net assets were included in the various funds as follows (in thousands):

	<b>2001</b>	<b>2000</b>
Teachers' Savings Fund	\$ 7,445,894	7,174,675
Employers' Trust Fund	15,896,463	23,532,839
Annuity and Pension Reserve Fund	29,293,437	26,648,931
Survivors' Benefit Fund	698,581	663,024
	\$ 53,334,375	58,019,469

**(4) Commitments and Contingencies**

STRS Ohio has made commitments to fund various real estate investments totaling approximately \$592,555,000 as of June 30, 2001. The commitments as of June 30, 2001 have expected funding dates from October 2001 to December 2004.

STRS Ohio has made commitments to fund various alternative investments totaling approximately \$1,291,729,000 as of June 30, 2001. The average expected funding dates for the commitments as of June 30, 2001 range from July 2001 to June 2008.

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.

All investments subject to categorization at June 30, 2001 and 2000, 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, alternative investments and securities on loan are investments that, by their nature, are not required to be categorized.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

June 30, 2001 and 2000

At June 30, 2001 and 2000, the carrying amount of STRS Ohio cash deposits were \$2,441,000 and \$(1,816,000) and the bank cash balances were \$10,048,000 and \$10,757,000, 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

June 30, 2001 and 2000

Investments held at fair value by STRS Ohio at June 30, 2001 and 2000, are summarized as follows (in thousands):

	<u>2001</u>	<u>2000</u>
Short-term:		
Commercial paper	\$ 613,248	735,186
Government notes	10,000	10,000
Short-term investment funds	<u>5,000</u>	<u>14,614</u>
Total short-term	628,248	759,800
Fixed income:		
Guaranteed mortgages	3,371,419	4,078,061
U.S. government/agencies:		
Not on securities loan	594,246	1,798,761
On securities loan	1,932,186	2,260,891
Corporate bonds:		
Not on securities loan	4,378,725	4,331,807
On securities loan	126,527	59,646
Canadian bonds	110,632	116,559
Supernationals	127,386	100,667
Municipal bonds	—	293
High yield and emerging market:		
Not on securities loan	827,737	—
On securities loan	<u>112,825</u>	<u>—</u>
Total fixed income	11,581,683	12,746,685
Common and preferred stock:		
Not on securities loan	23,325,508	26,054,617
On securities loan	<u>848,829</u>	<u>653,518</u>
Total common and preferred stock	24,174,337	26,708,135
International (see Note 6):		
Not on securities loan	8,674,099	10,256,266
On securities loan	<u>494,112</u>	<u>453,835</u>
Total international	9,168,211	10,710,101

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Financial Statements

June 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Real estate (see Note 7):		
East Region	1,260,205	1,118,422
Midwest Region	939,894	1,006,963
South Region	927,093	931,457
West Region	1,602,373	1,407,536
REITs	636,360	492,718
Other	<u>969,194</u>	<u>896,546</u>
Total real estate	6,335,119	5,853,642
Alternative investments	923,253	747,525
Invested securities lending collateral	<u>3,615,793</u>	<u>3,498,469</u>
Total investments and invested securities lending collateral	\$ <u>56,426,644</u>	<u>61,024,357</u>

**(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 alternative investment 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' fair value and 105% of the international loaned securities' fair value.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

June 30, 2001 and 2000

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 between the duration of the cash invested and the length of time the securities are on loan. As of June 30, 2001, the average maturity of the invested cash collateral is 459 days. Because much of the cash collateral is invested in floating rate securities, interest rates are reset every 29 days on average as of June 30, 2001. 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 \$3,514,479,000 and \$3,427,890,000 as of June 30, 2001 and 2000, respectively. The fair value of the associated collateral received as of June 30, 2001 and 2000 was \$3,619,392,000 and \$3,498,469,000, respectively.

The difference between the obligations under securities lending and the invested securities lending collateral is caused by the default of a Pacific Gas & Electric commercial paper investment. Pacific Gas & Electric is in bankruptcy and the fair value of the commercial paper investment as of June 30, 2001 has been recorded in the financial statements.

#### **(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.

**THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO**

Notes to Financial Statements

June 30, 2001 and 2000

**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 2001 with maturity dates in fiscal 2002. 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 \$1.5 billion have been set aside at the Bank of New York as security.

The fair values of international investments held at June 30, 2001 and 2000 are (in thousands):

	<u>2001</u>	<u>2000</u>
Externally managed:		
International stocks	5,179,648	6,880,342
International fixed income	95,390	137,587
International currency and liquidity reserves	222,157	242,263
Forward contracts	7,102	(24,890)
Total externally managed	<u>5,504,297</u>	<u>7,235,302</u>
Internally managed:		
Country Funds	533,363	515,172
EAFE Index Fund	2,983,118	2,583,604
EMF Index Fund	253,394	342,276
EAFE Equity Swaps	(105,961)	33,747
Total internally managed	<u>3,663,914</u>	<u>3,474,799</u>
Total international	<u>\$ 9,168,211</u>	<u>10,710,101</u>

**(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.

## THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

### Notes to Financial Statements

June 30, 2001 and 2000

**(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 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 \$1.5 billion. 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 fair values as of June 30, 2001 and 2000. Equity swaps were also used in the EMF Index Fund during 2000. Of the total EMF holdings, \$12.6 million were invested in swap agreements at June 30, 2000.

**(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. STRS is also subject to the risk that the counterparty will fail to fulfill the contract. The external money managers hedged \$1.37 and \$1.95 billion of currency exposure in various currencies with varying maturities as of June 30, 2001 and 2000, respectively. At June 30, 2001, STRS Ohio hedged \$1,441 and \$32 million of currency exposure on the EAFE Index Fund and the County Funds, respectively. At June 30, 2000, STRS Ohio hedged \$1,388 and \$57 million of currency exposure on the EAFE Index Fund and the Country Funds, respectively.

# THE STATE TEACHERS RETIREMENT SYSTEM OF OHIO

## Notes to Financial Statements

June 30, 2001 and 2000

**(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 notional amounts ranged from \$3.6 million to \$459 million. From July 2000 to June 2001, S&P Futures notional amounts ranged from \$7.1 to \$896.6 million. Additionally, futures were used in the EAFE Index Fund. Of the total EAFE Index Fund holdings, \$15.1 and \$34.7 million was invested in futures at June 30, 2001 and 2000, respectively. External money managers also used futures. Approximately, \$52.7 and \$49.9 million of external money managers' holdings were invested in futures at June 30, 2001 and 2000, 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. There were no open option contracts as of June 30, 2001 or 2000.

**(9) State Appropriations**

From time to time, the legislature of the State of Ohio has increased benefit payments to retirees. In certain instances, concurrent with the passage of such legislation, a provision for reimbursement of these benefits through future state appropriations has been made. In January 2001, the state legislature acted to discontinue reimbursement for these benefit increases in the future.

STRS Ohio received approximately \$1,514,000 from the state for increased benefits paid for the year ended June 30, 2000.

**(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 2.2% 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 credited 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

June 30, 2001 and 2000

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; 9.25% is the portion used to fund pension obligations, with the remainder used to fund the health care program for retirees. PERS made a one-time employer contribution rate rollback for calendar year 2000. The employer rate was 10.84% for calendar year 2000. The required employer contributions for the current year and the two preceding years are as follows:

<u>Year ended June 30</u>	<u>Annual required contributions</u>	<u>Percentage contributed</u>
2001	\$ 3,968,000	100%
2000	\$ 4,151,000	100%
1999	\$ 3,472,000	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 issues 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 2000 employer contribution rate for local government employees was 10.84% of covered payroll; 4.30% was the portion that was used to fund health care for the year.

PERS expenditures for OPEB during 2000 were \$559,606,000.

**(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)

<u>Valuation Year</u>	<u>Actuarial accrued liabilities (AAL)*</u>	<u>Valuation assets</u>	<u>Unfunded actuarial accrued liability (UAAL)*</u>	<u>Ratio of assets to AAL</u>	<u>Covered payroll**</u>	<u>UAAL as % of covered payroll</u>
2001	\$ 59,425,300	\$ 54,194,672	\$ 5,230,628	91.2%	\$ 8,256,683	63%
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%

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

\*\* Covered payroll includes salaries for alternative retirement plan participants. For 2001 and 2000, alternative retirement plan participant payroll totaled \$186,332 and \$149,376 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)

<b>Year ended June 30</b>		<b>Annual required contributions*</b>	<b>Percentage contributed</b>
2001	\$	777,416	100%
2000		470,343	100%
1999		446,655	100%
1998		746,773	100%
1997		816,696	100%
1996		786,437	100%

\* The amounts reported in this schedule do not include contributions for post-employment 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 valuation follows:*

<b>Valuation date</b>	<b>July 1, 2001</b>	<b>July 1, 2000</b>
Actuarial cost method	Entry Age	Entry Age
Amortization method	Level percent closed	Level percent closed
Remaining amortization period	27.5 years	23.1 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%	7.75%
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

Years Ended June 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Personnel:		
Salaries and wages	\$ 25,957,912	20,601,552
Retirement contributions	2,753,803	2,853,638
Benefits	<u>3,862,264</u>	<u>2,689,260</u>
Total personnel	32,573,979	26,144,450
Professional and technical services:		
Computer support services	10,212,356	9,005,571
Health care services	1,548,734	1,645,420
Actuary	239,083	283,480
Auditing	71,329	69,733
Legal	358,059	232,803
Temporary employment services	<u>143,627</u>	<u>168,592</u>
Total professional and technical services	12,573,188	11,405,599
Communications:		
Postage and courier services	1,936,578	1,939,015
Printing and supplies	3,799,746	2,625,742
Telephone	<u>869,822</u>	<u>697,262</u>
Total communications	6,606,146	5,262,019
Other expenses:		
Equipment repairs and maintenance	2,718,681	1,826,506
Building utilities and maintenance	1,351,114	1,023,487
Transportation and travel	627,349	704,510
Recruitment fees	238,320	307,977
Equipment rental	4,510,381	3,322,708
Depreciation	8,924,630	6,282,680
Member and staff education	408,420	172,696
Insurance	354,910	300,205
Memberships and subscriptions	190,328	132,078
Retirement study commission	318,430	286,943
Miscellaneous	<u>881,525</u>	<u>644,742</u>
Total other expenses	20,524,088	15,004,532
Total administrative expenses	<u>\$ 72,277,401</u>	<u>57,816,600</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

Years Ended June 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Personnel:		
Salaries and wages	\$ 13,031,461	10,726,151
Retirement contributions	1,214,519	1,297,401
Benefits	<u>1,254,054</u>	<u>797,897</u>
Total personnel	15,500,034	12,821,449
Professional and technical services:		
Legal	94,066	36,373
Investment research	851,936	507,168
Real estate and international advisor	579,753	491,933
Investment advisors	420,000	478,114
Banking fees	<u>3,791,643</u>	<u>4,102,679</u>
Total professional and technical services	5,737,398	5,616,267
Other expenses:		
Printing and supplies	23,925	5,955
Equipment repairs and maintenance	460	1,606
Building utilities and maintenance	729,831	641,836
Travel	714,646	649,895
Equipment rental	167,869	150,004
Memberships and subscriptions	108,228	95,893
Miscellaneous	<u>62,319</u>	<u>68,148</u>
Total other expenses	<u>1,807,278</u>	<u>1,613,337</u>
Total investment expenses	<u>\$ 23,044,710</u>	<u>20,051,053</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 years ended June 30, 2001 and 2000, and have issued our report thereon dated October 26, 2001. 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.

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 these specified parties.

**KPMG LLP**

October 26, 2001





STATE OF OHIO  
OFFICE OF THE AUDITOR  

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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  
FEBRUARY 21, 2002**