

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

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Independent Auditors' Report

Board of Trustees
Teachers' Retirement System of Oklahoma
Oklahoma City, Oklahoma

Report on the Financial Statements

We have audited the accompanying statement of plan net position of the Teachers' Retirement System of Oklahoma (the System), a part of the financial reporting entity of the state of Oklahoma, as of June 30, 2013, and the related statement of changes in plan net position for the year then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teachers' Retirement System of Oklahoma as of June 30, 2013, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note M, the System's actuary has determined that the System's unfunded actuarial accrued liability is approximately \$8,112,000,000. The funding of the actuarial accrued liabilities is predicated on a funding schedule mandated by Oklahoma Statutes. Under the present funding schedule, the UAAL will be fully amortized in 17 years.

Report on Summarized Comparative Information

We have previously audited the System's fiscal year 2012 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 11, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matters*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedules of funding progress and employer contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The information included in pages 31 through 33 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated November 8, 2013, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Cole & Reed P.C.

Oklahoma City, Oklahoma
November 8, 2013

Teachers' Retirement System of Oklahoma

Management's Discussion and Analysis

Management is pleased to present this discussion and analysis of the financial activities of the Oklahoma Teachers Retirement System ("OTRS" or the "System") for the years ended June 30, 2013 and 2012. The System is responsible for administering retirement benefits for a 401(a) defined benefit plan for all educational employees of the state of Oklahoma as well as a voluntary defined contribution plan, 403(b). The System was established on July 1, 1943, for the purpose of providing these retirement benefits and other specific benefits for qualified persons employed by public educational institutions. The main purpose of the System is to provide a primary source of lifetime retirement benefits relative to years of service at the time of retirement. It is the objective of the System to provide these benefits in a prudent, responsible, and cost-effective manner. Plan net assets are used to pay current and future benefits to retired clients.

This discussion and analysis is intended to serve as an introduction to the System's basic financial statements. OTRS's basic financial statements are comprised of three components: 1) *statement of plan net position*, 2) *statement of changes in plan net position*, and 3) *notes to the financial statements*. This report also contains *required supplementary information* in addition to the basic financial statements themselves.

The *statement of plan net position* presents information on all of the System's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference between these reported as *net position held in trust for pension benefits and annuity benefits of electing members*. Over time, increases or decreases in plan net position may serve as a useful indicator of whether the financial position of the System is improving or deteriorating. Information relating to the System's ability to meet the cost of future benefit payments is not shown on the *statement of plan net position* but is located in both the *notes to the financial statements* and the *required supplementary information*.

The *statement of changes in plan net position* presents information showing how the System's net position changed during the most recent fiscal year. Changes in net position are recognized using the accrual basis of accounting, in which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measurable.

The *notes to the financial statements* are critical to the reader's understanding of the financial status of the System. These notes include a description of the System, details on the cash and investments of the System, as well as contribution and benefit information.

The *required supplementary information* presents a Schedule of Funding Progress that provides historical trend information about the actuarially determined funded status of the System. The Schedule of Employers' Contributions provides historical trend information about the annual required contributions ("ARC") of the System and the contributions made to the System in relation to the ARC. Other supplementary information includes the Schedule of Administrative Expenses, the Schedule of Investment Expenses, and the Schedule of Professionals/Consultants Fees. These schedules provide additional analysis of the information provided in the financial statements.

Teachers' Retirement System of Oklahoma
Management's Discussion and Analysis (Continued)

CONDENSED FINANCIAL INFORMATION

Plan net position as of June 30:

	2013	2012	2013 % Change
ASSETS			
Cash	\$ 14,903,504	\$ 24,936,734	-40.2%
Receivables	286,998,149	276,870,038	3.7%
Long and short-term investments, at fair value	12,133,453,542	10,414,998,956	16.5%
Capital assets, net	2,180,235	1,543,239	41.3%
TOTAL INVESTMENTS AND OTHER ASSETS	12,437,535,430	10,718,348,967	16.0%
Securities lending institutional daily assets fund	2,363,777,689	1,764,088,842	34.0%
TOTAL ASSETS	14,801,313,119	12,482,437,809	18.6%
LIABILITIES			
Investment settlements and other liabilities	397,929,117	313,564,107	26.9%
Payable under securities lending agreement	2,363,777,689	1,764,088,842	34.0%
TOTAL LIABILITIES	2,761,706,806	2,077,652,949	32.9%
NET POSITION			
Net position held in trust for pension benefits	\$ 12,039,606,313	\$ 10,404,784,860	15.7%

Changes in plan net position for the year ended June 30:

	2013	2012	2013 % Change
ADDITIONS:			
Member contributions	\$ 290,044,395	\$ 291,385,506	-0.5%
Employer contributions	373,789,020	376,635,234	-0.8%
Matching contributions	26,995,423	23,188,952	16.4%
Dedicated tax revenue	300,509,886	281,806,711	6.6%
Member tax shelter contributions	2,910,706	3,448,031	-15.6%
Net investment income gain (loss)	1,783,073,902	134,376,020	1226.9%
Security lending net income	9,531,387	9,279,228	2.7%
TOTAL ADDITIONS	2,786,854,719	1,120,119,682	148.8%
DEDUCTIONS:			
Benefit payments	1,095,144,055	1,036,132,586	5.7%
Refund of member contributions and tax sheltered annuity	52,732,344	54,737,731	-3.7%
Administrative expenses	4,156,867	4,273,189	-2.7%
TOTAL DEDUCTIONS	1,152,033,266	1,095,143,506	5.2%
NET INCREASE	1,634,821,453	24,976,176	6445.5%
NET POSITION, BEGINNING OF YEAR	10,404,784,860	10,379,808,684	0.2%
NET POSITION, END OF YEAR	\$ 12,039,606,313	\$ 10,404,784,860	15.7%

Teachers' Retirement System of Oklahoma

Management's Discussion and Analysis (Continued)

FINANCIAL HIGHLIGHTS AND ANALYSIS

The increase in net position primarily is due to investment gains as a result of significant market improvement in fiscal year 2013. The total investment returns for fiscal year 2013 were positive 17.8%. Domestic and international equity, which compose 60.3% of the investment portfolio asset allocation, had the greatest increases at 25.5%.

	2013	2012	2009	2004
Plan net position	12,039,606,313	10,404,784,860	7,452,192,711	6,951,777,868
Yearly % change	15.7%	0.2%	-16.7%	18.6%

As a result of the market decline in 2009, the total investment return for the five year period of 7.7% is below the actuarial assumed rate of investment return. The 2009 loss was due to weaknesses in the United States and global markets. The assumed actuarial rate of return is currently 8.0%.

Total Returns	1 year	3 year	5 year	10 year
2013	17.8%	14.0%	7.7%	8.8%
2012	1.8%	13.6%	2.7%	7.6%
2011	23.5%	6.5%	5.9%	6.9%
2010	16.6%	-3.1%	3.4%	4.4%
2009	6.0%	-2.6%	2.3%	3.9%
2004	20.6%	6.4%	5.5%	(1)

(1) Historical returns were not available for this time period.

Benefit payments increased 5.7% in 2013 compared to 2012. The increase is a result of a 3.5% increase in the number of benefit recipients and a 1.6% increase in the average monthly benefit. Benefit payments in 2013 to retired members exceed contributions from contributing members and employers by \$133 million, or a ratio of 1.13 to 1. A ratio of less than one is desirable because it signifies that the System is receiving more contributions than it pays out in benefits. The table on the following page reflects the ongoing employer and member contributions.

Teachers' Retirement System of Oklahoma

Management's Discussion and Analysis (Continued)

FINANCIAL HIGHLIGHTS AND ANALYSIS (Continued)

	2013	2012	2009	2004
Member contributions	\$ 290,044,395	\$ 291,385,506	\$ 288,238,426	\$ 233,121,332
Employer contributions	373,789,020	376,635,234	338,974,512	219,126,867
Matching contributions	26,995,423	23,188,952	22,652,221	13,042,355
Dedicated tax revenue	300,509,886	281,806,711	257,019,830	143,100,533
Total contributions	991,338,724	973,016,403	906,884,989	608,391,087
Benefit payments	1,095,144,055	1,036,132,586	876,273,193	647,277,986
Refund of contributions	28,894,193	32,076,398	32,130,596	33,663,295
Total payments	\$ 1,124,038,248	\$ 1,068,208,984	\$ 908,403,789	\$ 680,941,281
Ratio benefit payments/ contributions	1.13	1.10	1.00	1.12

The number of benefit recipients increased 3.5% over the past year from 52,716 to 54,581. Since 2004, the number of benefit recipients increased by 14,988, or 37.9%. The number of members retiring has remained relatively stable for the last five years.

	2013	2012	2009	2004
Benefit recipients	54,581	52,716	46,745	39,593
Yearly % change	3.5%	3.7%	3.3%	4.0%
Net increase	1,865	1,887	1,507	1,534

The following table reflects the average monthly benefit for service retirements. Over the ten year period from 2004, the average benefit increased by \$287, or 22.0%. Retirement benefit payments increased 69.2%, or \$447.9 million, over this ten year period. The increase in the average monthly benefits in FY 2009 are due to cost-of-living adjustments ("COLAs") being granted by the state legislature to retirees. In FY 2013 and 2012, a COLA was not granted; however, the average benefit increases are due to an increase in the average benefit received by the newer retirees.

	2013	2012	2009	2004
Average benefit	\$ 1,591	\$ 1,555	\$ 1,483	\$ 1,304
Yearly % change	2.3%	1.1%	1.9%	0.0%

Teachers' Retirement System of Oklahoma

Management's Discussion and Analysis (Continued)

FINANCIAL HIGHLIGHTS AND ANALYSIS (Continued)

The ratio of active members to retired members of the System is 1.64 to 1 in 2013, compared to 2.06 to 1 in 2004. Over the past ten years, the number of members contributing into the System increased 9.4%. During the same period, the number of retired members increased by 37.9%.

	2013	2012	2009	2004
Members contributing	89,333	87,778	89,388	81,683
Yearly % change	1.8%	-0.3%	0.8%	-1.7%
Benefit recipients	54,581	52,716	46,745	39,593
Yearly % change	3.5%	3.7%	3.3%	4.0%
Ratio contributing/retired	1.64	1.67	1.91	2.06

The measure of the progress in accumulating sufficient assets to meet the long-term benefit obligations is the funded status or the funded ratio of the System. The funded ratio is the actuarial value of assets expressed as a percentage of the actuarial accrued liability. The funding policy is the method to provide benefits, specified in the System, through the amounts and timing of contributions from the employers and the contributing clients. The excess of the actuarial accrued liability over the actuarial value of assets is the unfunded actuarial accrued liability ("UAAL"). The actuarial value of assets differs from the year-end fair value of the System's plan net assets by smoothing the effects of market fluctuations. In the calculation of the actuarial value of assets, 20% of the difference between the actual and assumed investment returns is included in the actuarial value of assets. During extended periods of market declines, the market value of the System's plan net assets usually will be less than the actuarial value of assets.

The UAAL as of June 30, 2012 was \$8.398 billion, and decreased to \$8.112 billion in 2013. As a result, the System's funded ratio - actuarial value of assets divided by the actuarial accrued liability - increased from 54.8% as of June 30, 2012 to 57.2% as of June 30, 2013. The increase in funded position is primarily due to a liability gain resulting from member payroll increasing less than expected and continued positive investment returns. Based on the current contribution and benefit provisions, assuming no actuarial gains or losses in the future, and assuming that market value asset returns are 8%, the UAAL is expected to trend steadily down to zero over the next 17 years.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the System's finances for all those with an interest in the System. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Executive Director of the Teachers' Retirement System of Oklahoma, P.O. Box 53524, Oklahoma City, Oklahoma 73152 or (405) 521-2387.

STATEMENTS OF PLAN NET POSITION

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

As of June 30, 2013 (with Comparative Totals as of June 30, 2012)

	401(a) Plan	403(b) Plan	Totals June 30	
	2013	2012		
ASSETS				
Cash	\$ 14,903,504	\$ -	\$ 14,903,504	\$ 24,936,734
Short-term investments	796,745,800	-	796,745,800	275,456,138
Accrued interest and dividends receivable	39,448,046	-	39,448,046	43,659,356
Member contributions receivable	17,143,101	-	17,143,101	23,754,560
Employer contributions receivable	26,082,418	-	26,082,418	33,991,038
Receivable from the State of Oklahoma	28,855,587	-	28,855,587	29,333,333
Due from brokers for securities sold	175,468,997	-	175,468,997	146,131,751
Security lending institutional daily assets fund	2,363,777,689	-	2,363,777,689	1,764,088,842
Long-term investments:				
Mutual funds	-	204,133,915	204,133,915	210,049,295
U.S. government securities	1,056,986,977	-	1,056,986,977	1,086,437,639
U.S. corporate bonds	1,657,819,302	-	1,657,819,302	1,714,515,243
International corporate bonds and government securities	117,154,794	-	117,154,794	76,226,837
Equity securities	7,357,893,901	-	7,357,893,901	6,296,233,773
Alternative investments	412,641,707	-	412,641,707	283,762,403
Real estate	530,077,146	-	530,077,146	472,317,628
Total long-term investments	11,132,573,827	204,133,915	11,336,707,742	10,139,542,818
Capital assets, net	2,180,235	-	2,180,235	1,543,239
TOTAL ASSETS	\$ 14,597,179,204	\$ 204,133,915	\$ 14,801,313,119	\$ 12,482,437,809
LIABILITIES				
Benefits in process of payment	\$ 71,624,164	\$ -	\$ 71,624,164	\$ 3,906,006
Due to brokers for securities purchased	317,047,427	-	317,047,427	300,652,220
Payable under security lending agreement	2,363,777,689	-	2,363,777,689	1,764,088,842
Other liabilities	9,257,526	-	9,257,526	9,005,881
TOTAL LIABILITIES	\$ 2,761,706,806	\$ -	\$ 2,761,706,806	\$ 2,077,652,949
NET POSITION				
Net position held in trust for pension benefits and annuity benefits of electing members	\$ 11,835,472,398	\$ 204,133,915	\$ 12,039,606,313	\$ 10,404,784,860

See accompanying notes to financial statements.

STATEMENTS OF CHANGES IN PLAN NET POSITION

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

For the Year Ended June 30, 2013 (with Comparative Totals for the Year Ended June 30, 2012)

	401(a) Plan	403(b) Plan	Totals Year Ended June 30	
			2013	2012
Additions:				
Members	\$ 290,044,395	\$ -	\$ 290,044,395	\$ 291,385,506
Members tax shelter	-	2,910,706	2,910,706	3,448,031
Employer statutory requirement from local school districts	373,789,020	-	373,789,020	376,635,234
Matching funds	26,995,423	-	26,995,423	23,188,952
Dedicated tax	300,509,886	-	300,509,886	281,806,711
Total contributions	991,338,724	2,910,706	994,249,430	976,464,434
Investment income:				
Interest & dividends	320,417,159	10,913,177	331,330,336	319,565,705
Net appreciation in fair value of investments	1,483,934,082	4,098,888	1,488,032,970	(150,407,697)
Investment expenses	(36,289,404)	-	(36,289,404)	(34,781,988)
Gain from investing activities	1,768,061,837	15,012,065	1,783,073,902	134,376,020
Income from securities lending activities:				
Securities lending income	11,213,396	-	11,213,396	10,916,738
Securities lending expenses:				
Management fees:	(1,682,009)	-	(1,682,009)	(1,637,510)
Net income from securities lending activities	9,531,387	-	9,531,387	9,279,228
Net investment gain	1,777,593,224	15,012,065	1,792,605,289	143,655,248
Total additions	2,768,931,948	17,922,771	2,786,854,719	1,120,119,682
Deductions:				
Retirement, death, survivor, and health benefits	1,095,144,055	-	1,095,144,055	1,036,132,586
Refund of member contributions and annuity payments	28,894,193	23,838,151	52,732,344	54,737,731
Administrative expenses	4,156,867	-	4,156,867	4,273,189
Total deductions	1,128,195,115	23,838,151	1,152,033,266	1,095,143,506
NET INCREASE (DECREASE)	1,640,736,833	(5,915,380)	1,634,821,453	24,976,176
NET POSITION, BEGINNING OF YEAR	10,194,735,565	210,049,295	10,404,784,860	10,379,808,684
NET POSITION, END OF YEAR	<u>\$ 11,835,472,398</u>	<u>\$ 204,133,915</u>	<u>\$ 12,039,606,313</u>	<u>\$ 10,404,784,860</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE A--DESCRIPTION OF THE SYSTEM

The following brief description of the Teachers' Retirement System of Oklahoma (the "System") is provided for general information purposes only. Participants should refer to Title 70 of the Oklahoma Statutes, 1991, Sections 17-101 through 121, as amended.

The System was established as of July 1, 1943, for the purpose of providing retirement allowances and other specified benefits for qualified persons employed by state-supported educational institutions. The System is a part of the state of Oklahoma financial reporting entity, which is combined with other similar funds to comprise the fiduciary-pension trust funds of the state of Oklahoma (the "State"). The supervisory authority for the management and operation of the System is a 13-member board of trustees, which acts as a fiduciary for investment of the funds and the application of plan interpretations. The System administers a cost-sharing multiple-employer pension plan which is a defined benefit pension plan ("DB Plan"), as well as a tax-deferred defined contribution plan ("DC Plan").

DB Plan: Oklahoma teachers and other certified employees of common schools, faculty and administrators in public colleges and universities, and administrative personnel of state educational boards and agencies who are employed at least half-time, must join the System's DB Plan. Membership is optional for all other regular employees of public educational institutions who work at least 20 hours per week. The DB Plan's membership consisted of the following as of June 30:

	2013
Retirees and beneficiaries currently receiving benefits	54,581
Inactive vested clients	9,120
Active clients	89,333
	<u>153,034</u>

There are 609 contributing employers in the System. There were 8,926 non-vested inactive members at June 30, 2013 who are entitled to a refund of their accumulated contributions.

DC Plan: Members are also offered a tax-deferred defined contribution plan qualified under the Internal Revenue Code ("IRC") Section 403(b). The DC Plan is also referred to by the System as the Tax-Sheltered Annuity Plan. Membership in the DC Plan is voluntary and investments primarily consist of mutual funds and are participant directed. ING is responsible for administrative services, including custody and record keeping services.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE A--DESCRIPTION OF THE SYSTEM--Continued

DC Plan--Continued: The DC Plan had approximately 3,986 participants as of June 30, 2013. Contributions are voluntary and require a minimum of \$200 per year. The maximum deferral amount is the lesser of 100% of the participant's compensation or the maximum amount allowed by the IRC, currently \$17,500.

NOTE B--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting: The System has prepared its financial statements in accordance with accounting principles generally accepted in the United States of America and using the economic resources measurement focus. The financial statements are prepared using the accrual basis of accounting, under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period they are earned and become measurable, and investment purchases and sales are recorded as of their trade dates. Member and employer contributions are established by Oklahoma Statutes as a percentage of salaries and are recognized when due, pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the Oklahoma Statutes. Administrative expenses are funded through investment earnings.

Budgetary Control: The System prepares and submits an annual budget of operating expenses on the cash basis for monitoring and reporting to the Office of Management and Enterprise Services. The System's budget process follows the budget cycle for State operations as outlined by the Office of Management and Enterprise Services.

The Executive Director may approve changes within the budget, but a change to the total budget must be handled according to the provision of Title 62 O.S. Sec. 41.12 of the Oklahoma Statutes.

Investments: The System is authorized to invest in eligible investments as approved by the board of trustees as set forth in the System's investment policy.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE B--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Investments--Continued: System investments are reported at fair value. The short-term investment fund is comprised of an investment in units of commingled trust funds of the System's custodial agent, which is reported at cost, which approximates fair value. Debt and equity securities are reported at fair value, as determined by the System's custodial agent, using pricing services or prices quoted by independent brokers based on the latest reported sales prices at current exchange rates for securities traded on national or international exchanges. The Security Lending Institutional Daily Assets Fund represents investment in JP Morgan's Institutional Daily Assets Fund and is carried at amortized cost, which approximates fair value.

The System also invests as a limited partner in alternative investments. These investments employ specific strategies such as leverage buyouts, venture capital, growth capital, distressed investments, and mezzanine capital. The strategies of all such funds are long term and illiquid in nature. As a result, investors are subject to redemption restrictions which generally limit distributions and restrict the ability of limited partners to exit a partnership investment prior to its dissolution. Alternative investment partnerships are valued using their respective net asset value (NAV), and are audited annually. The most significant input into the NAV of such an entity is the fair value of its investment holdings. These holdings are valued by the general partners on a quarterly or semi-annual basis, in conjunction with management and investment advisors and consultation with valuation specialists. The management assumptions are based upon the nature of the investment and the underlying business. The valuation techniques vary based upon investment type and involve a certain degree of expert judgment.

The System's real estate investments are primarily through limited partnerships. Properties owned by the partnership are subject to independent third-party appraisals performed in accordance with the Uniform Standards of Professional Appraisal Practice once every year. The System's real estate investments are long term and illiquid in nature. As a result, investors are subject to redemption restrictions which generally limit distributions and restrict the ability of limited partners to exit a partnership investment prior to its dissolution. Limited partner interests are valued by the System using the NAV of the partnership. The most significant input into the NAV of such an entity is the value of its investment holdings. These holdings are valued by the general partners on a continuous basis, audited annually and may be periodically appraised by an independent third party. The valuation assumptions are based upon both market and property specific inputs which are not observable and involve a certain degree of expert judgment.

Net investment income includes net appreciation (depreciation) in the fair value of investments, interest income, dividend income, investment income from foreign currency translation gains and losses, securities lending income and expenses, and investment expenses, which includes investment management and custodial fees and all other significant investment related costs.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE B--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Investments--Continued: International investment managers use forward foreign exchange contracts to enhance returns or to control volatility. Currency risks arise due to foreign exchange rate fluctuations. Forward foreign exchange contracts are negotiated between two counter-parties. The System could incur a loss if its counter-parties failed to perform pursuant to the terms of their contractual obligations. The gains and losses on these contracts are included in the income in the period in which the exchange rates change. See Note C for additional information regarding investment derivatives as of June 30, 2013.

The System's investment policy provides for investment diversification of stocks, bonds, fixed income securities, real estate, alternative investments, and other investment securities along with investment in commingled or mutual funds. Investment securities and investment securities underlying commingled or mutual fund investments are exposed to various risks, such as interest rate, market, and credit risks. Due to the risks associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities may occur in the near term and those changes could materially affect the amounts reported in the statements of plan net position.

Capital Assets: Capital assets are stated at cost when acquired, net of accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from five to ten years.

Risks and Uncertainties: Contributions to the System and the actuarial information included in the required supplementary information are reported based on certain assumptions pertaining to interest rates, inflation rates, employee compensation, and demographics. Due to the changing nature of these assumptions, it is at least reasonably possible that changes in these assumptions may occur in the near term and, due to the uncertainties inherent in setting assumptions, that the effect of such changes could be material to the financial statements.

Income Taxes: The System is exempt from federal and state income taxes and has received a favorable determination from the Internal Revenue Service (the "IRS") under Internal Revenue Code (the "IRC") Section 401(a). The System's 403(b) Plan is also tax exempt and has received a private letter ruling from the IRS.

Compensated Absences: It is the State's policy to permit employees to accumulate earned but unused vacation and sick leave. Employees earn annual vacation leave based upon their start date and years of service. All accrued vacation leave is payable upon termination, resignation, retirement, or death. Sick leave does not vest to the employee and therefore is not recorded as a liability. Amounts due to the employees for compensated absences were approximately \$272,000 at June 30, 2013.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE B--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Plan Termination: In the event the System terminates, the board of trustees will distribute the net assets of the System to provide the following benefits in the order indicated:

Accumulated contributions will be allocated to each respective member, former member, retired member, joint annuitant, or beneficiary then receiving payments.

The balance of such assets, if any, will be allocated to each member then having an interest in the System based upon the excess of their retirement income under the System less the retirement income, which is equal to the actuarial equivalent of the amount allocated to them in accordance with the preceding paragraph in the following order:

- Those retired members, joint annuitants, or beneficiaries receiving payments,
- Those members eligible to retire,
- Those members eligible for early retirement,
- Former members electing to receive a vested benefit, and
- All other members.

Use of Estimates: The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States of America requires the System's management to make significant estimates and assumptions that affect the reported amounts of net position held in trust for pension benefits at the date of the financial statements and the actuarial information included in the required supplementary information as of the benefit information date, the changes in System net position during the reporting period, and, when applicable, disclosures of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Comparative Totals: The financial statements include certain prior year summarized comparative information in total but not at the level of detail required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2012, from which the summarized information was derived.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS

Custodial Credit Risk: Custodial credit risk is the risk that in the event of the failure of a counterparty, the System will not be able to recover the value of its bank deposits or investments. Bank deposits are exposed to custodial credit risk if they are uninsured and uncollateralized. In relation to its bank deposits, the System is not considered to be exposed to custodial credit risk. Although the System does not have a formal bank deposit policy for custodial credit risk, the State Treasurer holds all of the System's bank deposits. As required by Oklahoma Statutes, all bank deposits held by the State Treasurer are insured by Federal Deposit Insurance Corporation, collateralized by securities held by the cognizant Federal Reserve Bank, or invested in U.S. government obligations.

At June 30, 2013, the carrying amount of the System's bank deposits was approximately \$14,903,000. The bank balance of the System's bank deposits at June 30, 2013 was approximately \$20,241,000.

Investment securities are exposed to custodial credit risk if they are uninsured, are not registered in the name of the System, and are held by a counterparty or the counterparty's trust department but not in the name of the System. While the System's investment policy does not specifically address custodial credit risk it does limit the amount of cash equivalents and short-term investments to no more than 5% of each manager's portfolio. At June 30, 2013, the System had uninsured and uncollateralized cash and cash equivalents of approximately \$796,746,000 and respectively, with its custodial agent. The System's custodial agent for the years ended June 30, 2013 was JP Morgan.

Credit Risk: Fixed-income securities are subject to credit risk. Credit quality rating is one method of assessing the ability of the issuer to meet its obligation. The System's investment policy requires that at the time of purchase all corporate bonds or debentures be at the highest rating of the four rating services recognized by the Comptroller of the Currency of the United States of America.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS--Continued

Credit Risk--Continued:

Investment Type	S&P Ratings (Unless Noted)	Fair Value	Fair Value as a Percent of Total Fixed Income Fair Value
<i>(Amounts in Thousands)</i>			
U.S. corporate bonds	AAA	\$ 84,314	3.0%
	AA+	18,815	0.7%
	AA	15,878	0.6%
	AA-	10,345	0.4%
	A+	24,684	0.9%
	A	57,228	2.0%
	A-	111,594	3.9%
	BBB+	73,482	2.6%
	BBB	188,480	6.7%
	BBB-	237,603	8.4%
	BB+	139,286	4.9%
	BB	116,021	4.1%
	BB-	109,372	3.9%
	B+	94,828	3.3%
	B	105,482	3.7%
	B-	97,182	3.4%
	CCC+	46,160	1.6%
	CCC	18,206	0.6%
	CCC-	6,107	0.2%
	CC	1,555	0.1%
	D	4,198	0.1%
	NR	96,999	3.4%
Total U.S. corporate bonds		\$ 1,657,819	58.5%
International corporate bonds	AA-	\$ 2,938	0.1%
	A-	1,759	0.1%
	BBB+	1,568	0.1%
	BBB	1,905	0.1%
	BBB-	1,629	0.1%
	BB	1,312	0.0%
	B+	2,560	0.1%
	B	1,719	0.1%
	B-	803	0.0%
	CCC+	2,425	0.1%
Total international corporate bonds		\$ 18,618	0.8%

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS--Continued

Credit Risk--Continued:

Investment Type	S&P Ratings (Unless Noted)	Fair Value	Fair Value as a Percent of Total Fixed Income Fair Value
		(Amounts in Thousands)	
International government securities	AAA	\$ 3,498	0.1%
	AA	2,496	0.1%
	AA-	1,264	0.0%
	A-	25,740	0.9%
	BBB+	2,837	0.1%
	BBB	4,939	0.2%
	BBB-	29,159	1.0%
	BB+	3,875	0.1%
	BB	2,582	0.1%
	BB-	396	0.0%
	B+	433	0.0%
	B	816	0.0%
	B-	780	0.0%
	NR	19,721	0.7%
Total international government securities		\$ 98,536	3.3%
Municipal bonds	AAA	\$ 750	0.0%
	AA+	584	0.0%
	AA	832	0.0%
	AA-	1,934	0.1%
	A	2,143	0.1%
	A-	1,297	0.1%
	BBB+	1,043	0.1%
Total municipal bonds		\$ 8,583	0.4%
U.S. government securities	AA+	\$ 1,046,043	36.9%
	A+	2,362	0.1%
Total U.S. government securities		\$ 1,048,405	37.0%
		\$ 2,831,961	100.0%

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS--Continued

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. While all investments are subject to market changes, securities invested in index funds are more sensitive to market risk. Although the System's investment policy does not specifically address the duration of fixed-income securities, the System's management does monitor interest rate risk by monitoring the performance of each investment manager. As of June 30, 2013, the System had the following investments with maturities:

Investment Type	Investment Maturities at Fair Value (in Years)				
	<i>(Amounts in Thousands)</i>				
	Less than One	One to Five	Five to Ten	More than Ten	Total Fair Value
U.S. corporate securities					
Asset-backed securities	\$ 33,732	\$ 44,736	\$ 16,076	\$ 5,780	\$ 100,324
CMO/REMIC/CMBS	68,230	-	1,007	46,254	115,491
Corporate bonds	43,783	397,942	780,248	220,031	1,442,004
	145,745	442,678	797,331	272,065	1,657,819
International corporate bonds	3,716	5,566	5,999	3,337	18,618
International government securities	28,411	11,618	24,540	33,967	98,536
Municipal bonds	-	-	-	8,583	8,583
U.S. government securities	82,736	284,588	120,001	561,080	1,048,405
	<u>\$ 260,608</u>	<u>\$ 744,450</u>	<u>\$ 947,871</u>	<u>\$ 879,032</u>	<u>\$ 2,831,961</u>

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS--Continued

Foreign Currency Risk: Foreign currency risk is the potential risk for loss due to changes in exchange rates. The System's investment policy provides that international investment managers invest no more than 30% of their portfolio's total assets in one or more issuers in a single country, provided that in the U.K. such limit shall be 35%. Investment in cash and cash equivalents, foreign equities, and fixed-income securities as of June 30, 2013 is shown in the following table by monetary unit to indicate possible foreign currency risk.

<i>(Amounts in Thousands)</i>						
Currency	Equities	Corporate Bonds	Government Bonds	Foreign Exchange Contracts	Cash and Cash Equivalents	Grand Total
Australian Dollar	\$ 13,640	\$ 1,759	\$ -	\$ (1,727)	\$ 1,346	\$ 15,018
Brazilian Real	11,474	1,129	-	(941)	-	11,662
Canadian Dollar	25,987	1,114	-	(831)	1,838	28,108
Chilean Peso	484	-	-	-	-	484
Colombia Peso	1,436	-	-	-	-	1,436
Danish Krone	16,436	-	-	-	-	16,436
Euro	308,746	10,453	36,225	904	7,422	363,750
Hong Kong Dollar	84,235	-	-	13	2,524	86,772
Indonesian Rupiah	2,696	-	-	-	-	2,696
India Rupee	-	-	-	(471)	-	(471)
Japanese Yen	236,100	-	-	3,893	3,224	243,217
Malaysian Ringgit	3,193	-	-	-	434	3,627
Mexican Peso	8,675	2,932	29,238	(258)	-	40,587
New Taiwan Dollar	10,059	-	-	(32)	-	10,027
New Turkish Lira	5,723	-	-	-	-	5,723
New Zealand Dollar	2,138	-	-	-	-	2,138
Norwegian Krone	6,838	-	-	4	-	6,842
Phillipine Peso	4,602	-	700	-	-	5,302
Polish Zloty	1,580	-	-	-	-	1,580
Pound Sterling	241,179	567	-	(294)	3,838	245,290
Russian Ruble	-	-	-	(233)	-	(233)
Singapore Dollar	15,836	-	-	(195)	384	16,025
South African Rand	11,068	-	-	(246)	539	11,361
South Korean Won	23,361	-	-	(276)	1,591	24,676
Swedish Krona	15,462	-	-	(147)	1,174	16,489
Swiss Franc	97,550	667	-	704	-	98,921
Thai Baht	4,521	-	-	-	-	4,521
	<u>1,153,019</u>	<u>18,621</u>	<u>66,163</u>	<u>(133)</u>	<u>24,314</u>	<u>1,261,984</u>
Not subject to foreign currency risk	6,204,876	-	32,372	-	758,358	6,995,606
Total	<u>\$ 7,357,895</u>	<u>\$ 18,621</u>	<u>\$ 98,535</u>	<u>\$ (133)</u>	<u>\$ 782,672</u>	<u>\$ 8,257,590</u>

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE C--CASH AND INVESTMENTS--Continued

Derivative Instruments: The System's investment derivatives include forward currency contracts. These investments are not speculative in nature and do not increase investment risk beyond allowable limits specified in the System's investment policy. The changes in fair values of the System's investment derivatives are included in net appreciation in fair value of investments in the accompanying statement of plan net position. The fair values of the System's investment derivatives are included in due from brokers for securities sold and due to brokers for securities purchased in the accompanying statement of plan net position. The fair value balances and notional amounts of derivative instruments outstanding at June 30, 2013, classified by type, and the changes in fair value of such derivative instruments for the year then ended as reported in the 2013 financial statements are as follows:

Investment Derivatives	Change in Fair Value	Fair Value	Notional
Forward - foreign currency purchases	\$ (2,373)	\$ (2,329)	\$ 522,948
Forward - foreign currency sales	907	2,196	167,726

A foreign currency forward contract is an agreement that obligates the parties to exchange given quantities of currencies at a pre-specified exchange rate on a certain future date. The fair values of the forward contracts are estimated based on the present value of their estimated future cash flows.

The foreign currency forward contracts subject the System to foreign currency risk because the investments are denominated in international currencies. The risks are described in foreign currency risk schedule where the fair value of the foreign currency contracts in U.S. dollars is presented.

NOTE D--COMMITMENTS

Commitments: At June 30, 2013, the System has total capital commitments related to alternative investments of \$1,172,500,000. Of this amount, \$743,067,126 remained unfunded.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE E--SECURITIES LENDING ACTIVITY

The System's investment policy and State statutes provide for its participation in a securities lending program. The program is administered by the System's master custodian and there are no restrictions on the amount of loans that can be made. Certain securities of the System are loaned to participating brokers, who must provide collateral in the form of cash, U. S. Treasury or government agency securities, or letters of credit issued by approved banks. Under the terms of the agreement, collateralization of the fair value of the loaned securities must be provided in the amount of 102% when the security to be loaned and the collateral are in the same currency and 105% when the loan and collateral currencies are dissimilar.

The fair value of securities on loan at June 30, 2013 was approximately \$2,436,423,000. The underlying collateral for these securities had a fair value of approximately \$2,497,087,000 at June 30, 2013. Collateral of securities and letters of credit represented approximately \$133,309,000 of total collateral at June 30, 2013. Because the System cannot pledge or sell collateral securities and letters of credit received unless the borrower defaults, the collateral and related liability are not presented in the accompanying statements of plan net position. The following table describes the types of securities lent and collateral as of June 30, 2013.

Type of securities on loan	<i>(Amounts in Thousands)</i>	
	Market Value of Securities on Loan	Collateral Value
Government loans compared to non-cash collateral	\$ 129,886	\$ 131,885
Equity loans compared to cash collateral	2,305,135	2,363,778
Corporate loans compared to non-cash collateral	1,404	1,424
	<u>\$ 2,436,425</u>	<u>\$ 2,497,087</u>

At June 30, 2013, the System had no credit risk exposure since the amounts the System owed to borrowers exceeded the amounts borrowers owed the System. The contract with the System's lending agent requires it to indemnify the System if the borrowers fail to return the lent securities. In the event of a collateral shortfall due to a loss in value of investments made with cash collateral, such loss would be the responsibility of the System.

All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in a separate account for the System in accordance with investment guidelines approved by the System. At June 30, 2013, the weighted average maturity of the cash collateral investments was 73 days. The cash collateral investments are structured and maintained by the lending agent's investment desk utilizing an asset and liability methodology designed to manage to an appropriate extent any mismatch between the investment maturities and the System's loans.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE F--CAPITAL ASSETS

Capital assets consist of the following at June 30, 2013:

	<i>(Amounts in Thousands)</i>
Furniture and fixtures	\$ 3,286
Accumulated depreciation	<u>(1,106)</u>
Capital assets, net	<u>\$ 2,180</u>

The System has commitments to lease building space as well as leases on certain equipment. The future minimum commitment for operating leases as of June 30, 2013 was approximately \$221,000. The System's leases are one-year renewable contracts. Rental expense for all operating leases amounted to approximately \$213,000 for the year ended June 30, 2013.

NOTE G--RESERVE AND DESIGNATED FUNDS

The amount included in the Teachers' Deposit Fund, the Expense Fund, and the Capital Assets Fund is not available to pay regular retirement benefits. A brief description of the major funds is as follows:

- The Teachers' Deposit Fund represents funds in the DC Plan. During FY 2010, the System hired ING as the service provider for the DC Plan. This process was undertaken to steadfastly provide a supplemental retirement program that will enhance the System's clients' retirement future. ING provides a comprehensive educational strategy and an array of investment options, clients have 24 hours a day access to their accounts on line, and dedicated customer service representatives are available each weekday from 7:00 A.M. to 7:00 P.M.
- The Expense Fund represents funds accumulated to pay for the expense of administering and maintaining the System budgeted for the next fiscal year plus any accrued administrative costs as of the current fiscal year-end.
- The Capital Assets Fund represents the net book value of furniture and fixtures for the System.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE G--RESERVE AND DESIGNATED FUNDS--Continued

The Funds had the following approximate balances at June 30:

	<i>(Amounts in Thousands)</i>	
	2013	
Teacher's deposit fund (DC Plan)	\$	204,134
Expense fund		57,358
Capital assets fund		2,180
	\$	<u>263,672</u>

NOTE H--CONTRIBUTIONS

All contribution rates are defined or amended by the Oklahoma Legislature. All active members contribute to the System; however, the employer may elect to make all or part of the contribution for its employees. There are special provisions for members of higher education who joined the System before July 1, 1995. The annual employer contributions reported for the years ended June 30, 2013 were \$373,789,020. Employers satisfied 100% of their contribution requirements for 2013.

All members must contribute 7% of regular annual compensation, not to exceed the member's maximum compensation level, which for the year ended June 30, 2013 was the full amount of regular annual compensation.

The employers are required to contribute a fixed percentage of annual compensation on behalf of active clients. The employer contribution rate was 9.5% beginning on January 1, 2011 for all remitting entities other than comprehensive and four year regional universities. The employer contribution rate was 8.55% starting on January 1, 2011 for comprehensive and four year universities. The rates for fiscal years 2013 are applied on the full amount of the Client's regular annual compensation up to certain limits prescribed by the Internal Revenue Code.

NOTE I--BENEFITS

The System provides defined retirement benefits based on members' final compensation, age, and term of service. In addition, the retirement program provides for benefits upon disability and to survivors upon the death of eligible members. Title 70 O. S. Sec. 17-105 defines all retirement benefits. The authority to establish and amend benefit provisions rests with the State Legislature.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE I--BENEFITS--Continued

Benefit provisions include:

- Members become 100% vested in retirement benefits earned to date after five years of credited Oklahoma service. Members, who joined the System on June 30, 1992 or prior are eligible to retire at maximum benefits when age and years of creditable service total 80. Members joining the System after June 30, 1992 are eligible for maximum benefits when their age and years of creditable service total 90. Members whose age and service do not equal the eligible limit may receive reduced benefits as early as age 55, and at age 62 receive unreduced benefits based on their years of service. The maximum retirement benefit is equal to 2% of final compensation for each year of credited service.
- Final compensation for members who joined the System prior to July 1, 1992 is defined as the average salary for the three highest years of compensation. Final compensation for members joining the System after June 30, 1992 is defined as the average of the highest five consecutive years of annual compensation in which contributions have been made. The final average compensation is limited for service credit accumulated prior to July 1, 1995 to \$40,000 or \$25,000, depending on the member's election. Monthly benefits are 1/12 of this amount. Service credits accumulated after June 30, 1995 are calculated based on each member's final average compensation, except for certain employees of the two comprehensive universities.
- Upon the death of a member who has not yet retired, the designated beneficiary shall receive the member's total contributions plus 100% of interest earned through the end of the fiscal year, with interest rates varying based on time of service. A surviving spouse of a qualified member may elect to receive, in lieu of the aforementioned benefits, the retirement benefit the member was entitled to at the time of death as provided under the Joint Survivor Benefit Option.
- Upon the death of a retired member, the System will pay \$5,000 to the designated beneficiary, in addition to the benefits provided for the retirement option selected by the member.
- A member is eligible for disability benefits after ten years of credited Oklahoma service. The disability benefit is equal to 2% of final average compensation for the applicable years of credited service.
- Upon separation from the System, members' contributions are refundable with interest based on certain restrictions provided in the plan, or by the IRC.
- Members may elect to make additional contributions to a tax-sheltered annuity program up to the exclusion allowance provided under the IRC under Code Section 403(b).

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE I--BENEFITS--Continued

At the election of each eligible member initiating receipt of retirement benefits, the System remits between \$100 and \$105 per month per eligible retiree to the Oklahoma State and Education Employees Group Insurance Board ("OSEEGIB"), depending on the members' years of service during 2013. Such amounts were approximately \$29,748,000 in 2013 and are included in retirement and other benefits expense. The System performs no administrative functions related to the benefits provided by OSEEGIB and the payments have a minimal and declining impact on the operation of the System.

NOTE J--DEDICATED TAX

The System receives 5.0% of the State's sales, use, and corporate and individual income taxes collected as dedicated tax. The System receives 1% of the cigarette taxes collected by the State and receives 5% of net lottery proceeds collected by the State. The System received approximately \$300,510,000 from the State in 2013. Amounts due from the State were approximately \$28,856,000 at June 30, 2013.

NOTE K--PENSION PLAN FOR EMPLOYEES OF THE SYSTEM

The System also makes employer contributions for its employees who are also members of the System. The System's contributions are under the same terms as other participating employers, as discussed in Note H. In addition to the employer contributions, the System also pays the employees' contributions as a fringe benefit. Benefits paid to members that worked for the System are the same as those described in Note I. The total employee contributions paid by the System for its employees were approximately \$168,000, \$161,000, and \$188,000 for the years ended June 30, 2013, 2012, and 2011, respectively. Total employer contributions paid by the System were approximately \$227,000, \$219,000, and \$256,000 for the years ended June 30, 2013, 2012, and 2011 respectively. The employer contributions for FY 2013, 2012, and 2011 were 113.1%, 115.9%, and 77.6%, respectively, of the actuarial determined annual required contribution amounts and 100% of the contribution rate amounts determined by the legislature.

NOTE L--PLAN AMENDMENTS

The 2013 legislative session resulted in no bills with an actuarial impact on the system.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE M--DB PLAN FUNDING STATUS AND ACTUARIAL INFORMATION

The System's actuary conducts an annual valuation to determine the adequacy of the current employer contribution rates, to describe the current financial condition of the System, and to analyze changes in the System's condition. This valuation shows the funded position of the System increased from the funding level at June 30, 2012. Based on current statutes for determining the state, federal, and employer contribution rates, the funded period which is the number of years that would be required to amortize the unfunded actuarial accrued liability (the "UAAL") is 17 years. The actuarial accrued liability increased by \$385.2 million, and the actuarial value of assets increased \$670.6 million. As a result, the System's unfunded actuarial accrued liability decreased \$285.5 million to \$8,112.1 million at June 30, 2013. The funded ratio - actuarial value of assets divided by actuarial accrued liability - increased from 54.8% to 57.2%.

The decrease in the UAAL is primarily due to a liability gain resulting from member payroll increasing less than expected and continued investment returns greater than the 8% annual investment return assumption. Based on the current contribution and benefit provisions, assuming no actuarial gains or losses in the future, and assuming the market value of assets returns 8%, the UAAL is expected to trend steadily down to zero over the next 17 years.

The funded status of the System as of June 30, 2013, the most recent actuarial date, is as follows:

Actuarial value of assets (a)	\$	10,861.1	
Actuarial accrued liability (AAL) (b)	\$	18,973.2	
Total unfunded actuarial accrued liability (UAAL) (b-a)	\$	8,112.1	
Funded ratio (a/b)			57.2%
Covered payroll	\$	3,933.1	
UAAL as a percentage of covered payroll			206.3%

The Schedule of Funding Progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time. The figures above (the UAAL, the funded ratio, and the funded period) are based on actuarial calculations that make use of the actuarial value of assets, not the fair value. Asset gains and losses (earnings greater or less than the 8% investment return assumption) are recognized 20% per year for five years in the actuarial value of assets; the current actuarial value (\$10,861.1 million) is \$948.8 million smaller than the market value of net assets (\$11,809.9 million).

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE M--DB PLAN FUNDING STATUS AND ACTUARIAL INFORMATION--Continued

Significant actuarial assumptions employed by the actuary for funding purposes as of June 30, 2013 are as follows:

Funding Method: Costs are developed using the entry age normal cost method (based on a level percentage of covered payrolls). Under the method used for the System, the accrued liability and the present value of future normal costs are determined by summing the individual entry age results for each participant. The normal cost is then determined in aggregate by spreading the present value of future normal costs as a level percentage of expected future covered payrolls. Entry age is defined as the first day service is credited under the System.

Experience gains and losses (i.e., decreases or increases in accrued liabilities attributable to deviations in experience from the actuarial assumption) adjust the unfunded actuarial accrued liability.

Asset Valuation Method: The actuarial value of assets is equal to the market value, adjusted for a five-year phase in of actual investment return in excess of expected investment return. The actual return is calculated net of investment and administrative expenses, and the expected investment return is equal to the assumed investment return rate multiplied by the prior year's market value of assets, adjusted for contributions, benefits paid, and refunds.

Amortization: The unfunded actuarial accrued liability is amortized on a percent of pay method over a 30-year open period.

Investment Return: 8% per annum, compounded annually, (includes inflation of 3%).

Salary Increases: 4% to 12% per year (includes inflation of 3% and a productivity increase of 1%).

NOTE N--NEW PRONOUNCEMENTS

New Accounting Pronouncements Adopted in Fiscal Year 2013

The System adopted Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), during 2013. GASB 62 is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The adoption of GASB 62 did not have a significant impact on the System's financial statements.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE N--NEW PRONOUNCEMENTS--Continued

New Accounting Pronouncements Adopted in Fiscal Year 2013--Continued

The System adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63), during 2013. GASB 63 provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. Adoption of GASB 63 resulted in changes to the System's financial statement presentation, but such changes were not significant.

New Accounting Pronouncements Issued, Not Yet Adopted

In April 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). GASB 65 provides further guidance on determining which balances currently reported as assets and liabilities should instead be reported as deferred outflows or deferred inflows of resources. GASB 65 is effective for periods beginning after December 15, 2012, and will be applied on a retroactive basis.

In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans* (GASB 67). GASB 67 replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. GASB 67 builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. GASB 67 enhances note disclosures and required supplementary information (RSI) for both defined benefit and defined contribution pension plans. GASB 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules. The requirements of GASB 67 are effective for fiscal years beginning after June 15, 2013.

NOTES TO FINANCIAL STATEMENTS--Continued

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

June 30, 2013

NOTE N--NEW PRONOUNCEMENTS--Continued

New Accounting Pronouncements Issued, Not Yet Adopted--Continued

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68). GASB 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 50 as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time and to more comprehensively and comparably measure the annual costs of pension benefits. GASB 68 also enhances accountability and transparency through revised and new note disclosures and RSI. The requirements of GASB 68 are effective for fiscal years beginning after June 15, 2014.

In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations* (GASB 69). GASB 69 establishes guidance for 1) determining whether a specific government combination is a government merger, a government acquisition, or a transfer of operations; 2) using carrying values to measure the assets, deferred outflows of resources, liabilities, and deferred inflows of resources combined in a government merger or transfer of operations; 3) measuring acquired assets, deferred outflows of resources, liabilities, and deferred inflows of resources based upon their acquisition values in a government acquisition; and 4) reporting the disposal of government operations that have been transferred or sold. The requirements of GASB 69 are effective for fiscal years beginning after December 15, 2013.

In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees* (GASB 70). GASB 70 requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. GASB 70 also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units and specifies information required to be disclosed by governments that extend and/or receive nonexchange financial guarantees. The requirements of GASB 70 are effective for fiscal years beginning after June 15, 2013.

The System is currently evaluating the effects the above GASB Pronouncements will have on its financial statements.

SCHEDULE OF FUNDING PROGRESS AND SCHEDULE OF
EMPLOYERS' CONTRIBUTIONS (UNAUDITED)

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

(Dollar Amounts in Millions)

Actuarial Valuation Date	Actuarial Value of Assets (AVA) (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b) - (a)	Funded Ratio (a / b)	Annual Covered Payroll	UAAL as % of Covered Payroll ((b-a) / c)
June 30, 2007	\$ 8,421.9	\$ 16,024.4	\$ 7,602.5	52.6%	\$ 3,598.9	211.2%
June 30, 2008	9,256.8	18,346.9	9,090.1	50.5%	3,751.4	242.3%
June 30, 2009	9,439.0	18,950.9	9,512.0	49.8%	3,807.9	249.8%
June 30, 2010	9,566.7	19,980.6	10,414.0	47.9%	3,854.8	270.2%
June 30, 2011	9,960.6	17,560.8	7,600.2	56.7%	3,773.3	201.4%
June 30, 2012	10,190.5	18,588.0	8,397.6	54.8%	3,924.8	214.0%
June 30, 2013	10,861.1	18,973.2	8,112.1	57.2%	3,933.1	206.3%

SCHEDULE OF EMPLOYERS' CONTRIBUTIONS (UNAUDITED)

Fiscal Year Ended June 30,	Annual Required Contribution	Percentage Contributed
2007	\$ 575,745,142	93.1%
2008	590,495,652	101.1%
2009	714,367,558	86.6%
2010	742,286,289	83.6%
2011	822,419,996	77.6%
2012	588,287,377	115.9%
2013	619,805,640	113.1%

The employer contribution rates are established by the Oklahoma Legislature. The annual required contribution is performed to determine the adequacy of such contribution rates.

Unaudited - see accompanying independent auditor's report.

SCHEDULE OF INVESTMENT EXPENSES

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

For the Year Ended June 30, 2013

Investment managers	\$	35,587,404
Investment consultants		<u>702,000</u>
Total investment expenses	\$	<u><u>36,289,404</u></u>

See accompanying independent auditors' report.

SCHEDULE OF ADMINISTRATIVE EXPENSES

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

For the Year Ended June 30, 2013

Salaries and benefits	\$	2,728,652
General and miscellaneous		680,822
Professional/consultant fees		607,303
Travel and related expenses		94,878
Depreciation expense		<u>45,212</u>
Total administrative expenses	\$	<u><u>4,156,867</u></u>

See accompanying independent auditors' report.

SCHEDULE OF PROFESSIONAL/CONSULTANT FEES

TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

For the Year Ended June 30, 2013

Actuarial	\$	114,580
Medical		8,400
Legal		80,391
Audit		97,131
Data processing		79,245
Miscellaneous		<u>227,556</u>
Total professional/ consultant fees	\$	<u><u>607,303</u></u>

See accompanying independent auditors' report.

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

The Board of Trustees
Oklahoma Teachers' Retirement System

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Oklahoma Teachers' Retirement System (the System), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated November 8, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Cole & Reed P.C.

Oklahoma City, Oklahoma
November 8, 2013