



SOUTH DAKOTA RETIREMENT SYSTEM,  
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN,  
AND SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

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INDEPENDENT AUDITORS' REPORTS  
ON AUDITS OF FINANCIAL STATEMENTS  
for the year ended June 30, 2012



**SOUTH DAKOTA RETIREMENT SYSTEM,  
SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN, AND  
SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

**Index**

	<b>Page</b>
<b>South Dakota Retirement System</b>	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Financial Statements:	
Statement of Plan Net Assets	7
Statement of Changes in Plan Net Assets	8
Notes to Financial Statements	9
Required Supplementary Information	25
Supplementary Information	26
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 <i>Government Auditing Standards</i>	28
<b>South Dakota Retirement System Supplemental Retirement Plan</b>	
Independent Auditors' Report	30
Management's Discussion and Analysis	32
Financial Statements:	
Statement of Plan Net Assets and Statement of Changes in Plan Net Assets	35
Notes to Financial Statements	36
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 <i>Government Auditing Standards</i>	40
<b>South Dakota Retirement System Special Pay Plan</b>	
Independent Auditors' Report	42
Management's Discussion and Analysis	44
Financial Statements:	
Statement of Plan Net Assets and Statement of Changes in Plan Net Assets	47
Notes to Financial Statements	48
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 <i>Government Auditing Standards</i>	52



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## **Independent Auditors' Report**

The Board of Trustees  
South Dakota Retirement System:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System (SDRS) as of June 30, 2012, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of SDRS's management. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements present only the financial position and changes in financial position of the State of South Dakota that is attributable to SDRS. They do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2012, and the changes in its financial position and its cash flows, where applicable, for the fiscal year then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System as of June 30, 2012, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

As explained in note 2 to the financial statements, the financial statements include investments valued at \$2,551,821,650 (32.5% of net assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 20, 2012 on our consideration of SDRS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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* and should be considered in assessing the results of our audit.



U.S. generally accepted accounting principles require that management's discussion and analysis on pages 3 through 6, the schedule of funding progress and schedule of employer contributions on page 25 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.

Our audit was conducted for the purpose of forming an opinion on South Dakota Retirement System's financial statements. The supplemental schedules of administrative expenses and investment activity expenses are presented for purposes of additional analysis and are not a required part of the basic 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 basic financial statements. The supplemental schedules of administrative expenses and investment activity expenses have been subjected to the auditing procedures applied in the audit of the basic 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 supplemental schedules of administrative expenses and investment activity expenses are fairly stated in all material respects in relation to the financial statements as a whole.

**KPMG LLP**

Omaha, Nebraska  
November 20, 2012

# **SOUTH DAKOTA RETIREMENT SYSTEM**

## **Management's Discussion and Analysis**

June 30, 2012

This section presents management's discussion and analysis of the South Dakota Retirement System's (SDRS or the System) financial position and performance as of and for the year ended June 30, 2012. This section is intended to supplement the SDRS financial statements and should be read in conjunction with the remainder of the SDRS financial statements.

### **Financial Highlights**

- The plan net assets of SDRS decreased by \$94 million during fiscal year 2012. This decrease was primarily due to the investment performance of 1.91%, which was significantly below the assumed rate of 7.25%.
- SDRS funded ratio decreased to 92.6% in 2012 from 96.4% in 2011.
- SDRS paid \$371.4 million to benefit recipients in fiscal year 2012 compared to \$345.9 million in 2011. SDRS received \$199.4 million in member and employer contributions in fiscal year 2012 compared to \$198.8 million in 2011.

### **Overview of the Financial Statements and Accompanying Information**

The basic financial statements consist of:

#### ***Financial Statements***

The System presents the statement of the plan net assets as of June 30, 2012 and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of the year-end and sources and uses of those funds during the year.

#### ***Notes to Financial Statements***

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules. Information in the notes provides disclosures concerning SDRS's organization, contributions and reserves, investments, the use of derivatives and securities lending, and other information.

#### ***Supplemental Information***

In addition to this discussion and analysis, the supplemental information also consists of two schedules of trend data and related notes concerning the funded status of SDRS and employer contributions.

Other supplementary schedules include detailed information on administrative expenses incurred by SDRS and a breakout of investment manager fees.

#### ***Financial Analysis***

SDRS is a cost-sharing, multiple-employer public employee retirement system. SDRS provides retirement, disability, and survivor benefits for employees of the State of South Dakota and its political subdivisions. The benefits are funded through member and employer contributions and investment income.

SDRS benefits are based on the members' final average compensation, their years of credited service, and a benefit multiplier, and are payable for life with a 60% survivor benefit.

**SOUTH DAKOTA RETIREMENT SYSTEM**

Management's Discussion and Analysis

June 30, 2012

A summary of the plan net assets is shown below:

**Summary of Plan Net Assets**

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets:		
Cash and cash equivalents	\$ 4,334,563	7,108,925
Receivables	24,808,359	31,755,965
Investments, at fair value	7,868,732,360	7,986,138,266
Other assets	22,720	37,941
	<u>7,897,898,002</u>	<u>8,025,041,097</u>
Liabilities:		
Accounts payable and accrued expenses	2,087,340	2,621,179
Securities sold, but not yet purchased	46,263,220	75,896,079
Unsettled investment purchases	6,711,319	8,954,723
Due to brokers – futures transactions	311,882	1,299,620
	<u>55,373,761</u>	<u>88,771,601</u>
Net assets held in trust for pension benefits	\$ <u>7,842,524,241</u>	<u>7,936,269,496</u>

**Funded Ratio**

The funded ratio is an actuarial measure of funding progress and soundness for SDRS based on the actuarial accrued liability measurement of liabilities. The ratio is equal to the actuarial value of assets divided by the actuarial accrued liabilities. A ratio in excess of 100% would indicate that the actuarial accrued liability is fully funded.

The actuarial value of assets is equal to the net actuarial value of assets plus the reserve of funding of long-term benefit goals. The net actuarial value of assets is credited each year with the assumed rate of investment return and debited or credited with the SDRS liability gain or loss for the year. The actuarial value of assets is credited each year with the assumed rate of investment return, debited or credited with the SDRS liability gain or loss for the year and constrained to a range of 80% to 120% of the market value of assets. If the actuarial value of assets is constrained by the 80%/120% corridor, the reserve for funding long-term benefit goals will also be appropriately adjusted.

The actuarial accrued liability is the present value of all benefits currently being paid and expected to be paid in the future, to all members, less the present value of future normal cost contributions.

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Funded ratio	92.6%	96.4%	(3.8)%

## SOUTH DAKOTA RETIREMENT SYSTEM

### Management's Discussion and Analysis

June 30, 2012

#### Change in Plan Net Assets

Additions to the plan net assets include member and employer contributions and net investment income. The fixed member and employer contribution rates are established by law. On an annual basis, an independent actuarial valuation of SDRS is made to determine the adequacy of the fixed contribution rates to pay the normal cost of benefits, expenses, and amortize the unfunded actuarial accrued liability. In addition to the fixed contributions, members and employers may make additional contributions to purchase uncredited prior service. These purchase or acquisition payments are also included as contributions. As the SDRS membership ages, the number and amount of purchases have grown.

Income from investments is the other primary source of revenue for SDRS. The actuarial assumed investment rate is 7.25% at June 30, 2012. The investment returns were 1.91% for 2012 and 25.84% for 2011.

Deductions from plan net assets are primarily benefit payments. During 2012, SDRS paid \$371.4 million to benefit recipients or 7.4% more than 2011. The increase is due to added recipients and the annual 2.1% cost-of-living adjustment. Refunds of accumulated contributions during 2012 increased 0.5%. Administrative costs of SDRS represent less than 0.04% of plan net assets.

A summary of the changes in plan net assets is shown below:

	<u>2012</u>	<u>2011</u>	<u>Percentage change</u>
<b>Additions:</b>			
Employee contributions	\$ 100,484,113	100,179,938	0.3%
Employer contributions	98,866,649	98,624,738	0.2
Investment income	107,541,250	1,616,173,385	(93.3)
Total additions	<u>306,892,012</u>	<u>1,814,978,061</u>	<u>(83.1)</u>
<b>Deductions:</b>			
Benefits	371,417,148	345,942,871	7.4
Refunds of contributions	25,942,146	25,824,829	0.5
Administrative expenses	3,277,973	3,575,854	(8.3)
Total deductions	<u>400,637,267</u>	<u>375,343,554</u>	<u>6.7</u>
Net increase (decrease) in plan net assets	(93,745,255)	1,439,634,507	(106.5)
<b>Net assets held in trust for pension benefits:</b>			
Beginning of year	<u>7,936,269,496</u>	<u>6,496,634,989</u>	<u>22.2</u>
End of year	<u>\$ 7,842,524,241</u>	<u>7,936,269,496</u>	<u>(1.2)%</u>

#### Investments

SDRS investment portfolio management is the statutory responsibility of the South Dakota Investment Council (Investment Council). The South Dakota Investment Office is the primary investment manager, but the Investment Council may utilize the services of external money managers.

# SOUTH DAKOTA RETIREMENT SYSTEM

## Management's Discussion and Analysis

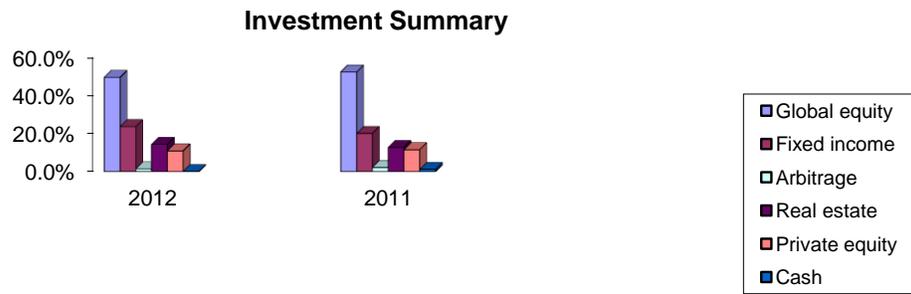
June 30, 2012

Investment performance during 2012 and 2011 was 1.91% and 25.84%, respectively.

The Investment Council is governed by the prudent-man standard, as defined in South Dakota Codified Law 4-5-27:

4-5-27. Prudent-man standard required in investments. Any investments under the provisions of §4-5-12 to 4-5-39, inclusive, shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Though monthly benefit payments exceed monthly contributions, the SDRS is not subject to sudden, substantial, and unexpected withdrawals. As a result, it is not necessary to maintain a high percentage of assets in short-term investments unless that is deemed to be the best investment strategy. This allows the SDRS trust fund to be fully invested in a diversified portfolio of securities.



### Plan Status

While the markets have not always made it possible to achieve the long-term assumptions, the System's funding remains solid. The reserve for long-term benefit goals has provided a process for both improving benefits and protecting the System in down markets.

### Requests for Information

Requests for information about SDRS may be directed to the South Dakota Retirement System at P.O. Box 1098, Pierre, SD 57501. You may also contact SDRS online at [www.state.sd.us/sdrs/](http://www.state.sd.us/sdrs/).

**SOUTH DAKOTA RETIREMENT SYSTEM**

Statement of Plan Net Assets

June 30, 2012

Assets:

Cash and cash equivalents \$ 4,334,563

Receivables:

Employer 2,099,767

Employee 2,818,196

Benefits 196,430

Unsettled investment sales 2,159,387

Accrued interest and dividends 17,534,579

Total receivables 24,808,359

Investments, at fair value:

Fixed income 1,936,330,724

Equities 3,942,768,242

Real estate 1,131,601,832

Private equity 858,031,562

Total investments, at fair value 7,868,732,360

Other assets 22,720

Total assets 7,897,898,002

Liabilities:

Accounts payable and accrued expenses 2,087,340

Securities sold, but not yet purchased, at fair value 46,263,220

Unsettled investment purchases 6,711,319

Due to brokers – futures transactions 311,882

Total liabilities 55,373,761

Net assets held in trust for pension benefits (see schedule of  
funding progress) \$ 7,842,524,241

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM**

Statement of Changes in Plan Net Assets

Year ended June 30, 2012

Additions:

Contributions:

Employee	\$ 100,484,113
Employer	98,866,649
	<hr/>
Total contributions	199,350,762

Investment income:

From investing activities:

Net depreciation in fair value of investments	(68,698,652)
Interest	87,228,463
Dividends	116,219,557
Real estate	7,217,203
Securities lending, net	716,958
	<hr/>

Investment income 142,683,529

Less investment activity expenses (35,142,279)

Net investment income 

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107,541,250

Total additions 

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306,892,012

Deductions:

Benefits	371,417,148
Refunds of contributions	25,942,146
Administrative expenses	3,277,973
	<hr/>

Total deductions 400,637,267

Net decrease in plan net assets (93,745,255)

Net assets held in trust for pension benefits (see schedule of funding progress):

Beginning of year 

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7,936,269,496

End of year \$ 

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7,842,524,241

See accompanying notes to financial statements.

# SOUTH DAKOTA RETIREMENT SYSTEM

## Notes to Financial Statements

June 30, 2012

### (1) General Description of the System

The South Dakota Retirement System (SDRS or the System) is a cost-sharing, multiple-employer public employee retirement system (PERS) established to provide retirement benefits for employees of the State of South Dakota (the State) and its political subdivisions. Members of SDRS include full-time employees of public schools, the State, the Board of Regents, city and county governments, and other public entities. Public schools, cities, and counties may choose not to include certain full-time employees in the System.

SDRS is considered a part of the State financial reporting entity and is included in the State's financial report as a pension trust fund. Authority for establishing, administering, and amending plan provisions is found in South Dakota Codified Law (SDCL) 3-12.

The South Dakota Retirement System Board of Trustees (the Board) is the governing authority of SDRS. The Board consists of 14 elected representatives from participating groups, two appointees of the governor, and an ex-office nonvoting representative of the South Dakota Investment Council. The elected representatives of the Board are two teacher members; two State employee members; a participating municipality member; a participating county member; a participating classified employee member; a current contributing Class B member other than a justice, judge, or magistrate judge; a county commissioner of a participating county; a school district board member and an elected municipal official of a participating municipality; a retiree; and a faculty or administrative member employed by the Board of Regents. The two Governor's appointees consist of one head of a principal department established pursuant to SDCL 1-32-2, or one head of a bureau under the office of executive management and one individual from the private or public sector.

SDRS is a hybrid defined benefit plan designed with several defined contribution plan type provisions. The system includes two classes of members: Class A—general members and Class B—public safety and judicial members. Members and their employers make matching contributions, which are defined in State statute. SDRS may expend up to 3% of the annual contributions for administrative expenses subject to approval by the executive and legislative branches of the State.

SDRS provides retirement, disability, and survivor benefits. The right to receive retirement benefits vests after three years of contributory service. Class A members and Class B judicial members who retire after age 65 with three years of service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A members where the sum of age and credited service is equal to or greater than 85 or after age 55 for Class B judicial members where the sum of age and credited service is equal to or greater than 80. Class B public safety members can retire with an unreduced annual retirement benefit after age 55 with three years of contributory service. An unreduced annual retirement benefit is also available after age 45 for Class B public safety members where the sum of age and credited service is equal to or greater than 75. All retirement benefits that do not meet the above criteria may be payable at a reduced level.

The annual increase in the amount of the SDRS benefits payable on each July 1st is indexed to CPI and based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more – 3.1% COLA

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

- If the SDRS market value funded ratio is 80.0% to 99.9%, index with the CPI
  - \* 90.0% to 99.9% funded – 2.1% minimum and 2.8% maximum COLA
  - \* 80.0% to 90.0% funded – 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% – 2.1% COLA

All benefits except those depending on the Member’s Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

SDRS is a qualified defined benefit retirement plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. SDRS last received a favorable determination letter dated July 3, 2012, in which the Internal Revenue Service stated that the System, as then designated, was in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in SDRS’ financial statements.

SDRS is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. SDRS participates in the various programs administered by the State. These risk management programs are funded through assessments charged to participating entities. The risk management programs include (1) coverage for risks associated with automobile liability and general tort liability (including public officials’ errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State’s Public Entity Pool for Liability Fund, (2) coverage of employee medical claims through the State’s health insurance program, (3) coverage for unemployment benefits through the State’s Unemployment Insurance Fund, and (4) coverage for workers’ compensation benefits through the State’s Workers’ Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

As of June 30, 2012, the number of participating governmental employers is as follows:

School districts	168
State of South Dakota	1
Board of Regents	1
Municipalities	153
Counties	64
Board and Commissions	86
Total employers	473

# SOUTH DAKOTA RETIREMENT SYSTEM

## Notes to Financial Statements

June 30, 2012

At June 30, 2012, SDRS membership consists of the following:

Retirees and beneficiaries currently receiving benefits:	
Class A (general employees)	21,110
Class B (public safety and judicial employees)	<u>1,298</u>
Total retirees and beneficiaries	<u>22,408</u>
Terminated members entitled to benefits, but not yet receiving them:	
Class A (general employees)	14,151
Class B (public safety and judicial employees)	<u>602</u>
Total terminated members	<u>14,753</u>
Current active members:	
Vested:	
Class A (general employees)	28,984
Class B (public safety and judicial employees)	2,094
Nonvested:	
Class A (general employees)	6,518
Class B (public safety and judicial employees)	<u>611</u>
Total current active members	<u>38,207</u>
Grand total	<u><u>75,368</u></u>

## (2) Summary of Significant Accounting Policies

### (a) Basis of Accounting and Presentation

The accompanying financial statements are prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles applicable to governmental accounting for a pension trust fund. Employee and employer contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Pension benefit payments are due the first day of the month following the retirement of a member, and the first of each month thereafter. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

### (b) Method Used to Value Investments

Investments are reported at fair value. The fair value of investments in securities is determined based on last reported prices for those securities traded on national and international stock exchanges. In general, fixed income securities not traded on a national or international exchange are valued based

# SOUTH DAKOTA RETIREMENT SYSTEM

## Notes to Financial Statements

June 30, 2012

on comparable securities of issuers with similar yield and risk. The value of foreign securities in foreign currency amounts is expressed in U.S. dollars at the closing daily rate of exchange. Purchases and sales are recorded as of the trade date.

Alternative investments consist of investments in a variety of markets and industries through partnerships, corporate entities, coinvestments, and other investment vehicles. For alternative investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, values these investments in good faith based upon the investment's current financial statements or other information provided by the underlying investment advisor. For all of these alternative investments, SDRS has determined that net asset value reported by the underlying fund approximates the fair value of the investment. These fair value estimates are, by their nature, subjective and based on judgment. These alternative investments were valued at \$2,551,821,650 (32.5% of net assets) at June 30, 2012. The estimated fair value of these investments may differ significantly from values that would have been used had a ready market existed.

Foreign exchange rate gains and losses are included with the net appreciation in fair value in investments. Futures contracts are market-to-market based on quoted futures prices with changes in fair value reflected in the current period.

Interest is accrued in the period in which it is earned and dividend income is recorded on the ex-dividend date.

(c) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and changes therein. Actual results could differ from those estimates.

(3) **Contributions and Reserves**

(a) *Contributions*

Covered employees are required by statute to contribute a percentage of their salary to SDRS as follows:

Class B public safety members	8.0% of salary
Class B judicial members	9.0% of salary
Class A members	6.0% of salary

All participating employers are required to contribute an amount equal to the members' contributions. Members may make an additional contribution of 1.5% of compensation for optional spouse coverage.

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

SDRS is funded by fixed member and employer contributions at a rate established by law. On an annual basis, an independent actuarial valuation of SDRS is made to determine the adequacy of the fixed contractually required contributions to pay the normal cost, expenses, and amortize the frozen unfunded actuarial accrued liability (UAAL). The June 30, 2012 actuarial valuation of the plan determined that the contractually required employer contributions equal the requirements for the annual required contribution of the employers under Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*; and the contractually required employer contributions are sufficient to pay the employer normal cost, expenses, and amortize the frozen UAAL over a period of less than 30 years (29 years as of June 30, 2012). The maximum contributions limits are not considered in the projection of pension benefit liabilities. Annual required contributions of the employer equal to the contractually required contributions have been listed below pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

	<u>Employer</u>	<u>Percentage contributed</u>
Year ending June 30:		
2012	\$ 98,866,649	100%
2011	98,624,737	100
2010	96,914,192	100
2009	94,244,915	91
2008	89,766,090	100

Contributions during fiscal year 2012 totaling \$199,350,762 (\$100,484,113–employee and \$98,866,649–employer) were made in accordance with statutory rates. These contributions represent 100% of current year covered payroll for all participating units. The employee contributions exceed the employer contributions because of optional spouse coverage contributions and employee service purchase payments.

SDRS allows participating entities to pay their deferred contributions for funding of accrued benefits over periods of up to 20 years and members to pay for the purchase of certain prior service over periods of up to 10 years. Interest is charged at rates of 5% to 8%.

Future payments will be received as follows:

	<u>Employees</u>
Year ending June 30:	
2013	\$ 332,860
2014	241,726
2015	48,929
2016	45,618
2017	45,778
Later	<u>43,323</u>
Deferred contributions receivable at June 30, 2012	\$ <u><u>758,234</u></u>

# SOUTH DAKOTA RETIREMENT SYSTEM

## Notes to Financial Statements

June 30, 2012

### (b) *Reserves*

The reserve for funding of long-term benefit goals is designed to fund benefit improvements and provide the plan with protection against adverse experience. The reserve for funding of long-term benefit goals is equal to the cumulative amounts credited or debited annually based on the immediate recognition of actuarial investment losses, the five-year recognition of actuarial investment gains, and the five-year recognition of SDRS liability gains or losses, less reductions described below. If benefit improvements are enacted into law and funded from the reserve for funding of long-term benefit goals, the reserve for funding of long-term benefit goals is reduced by the present value of all benefits for those improvements. The reserve for funding of long-term benefit goals may also be reduced to offset unfavorable experience, if required, to meet the funding objectives of SDRS as established by the Board of Trustees. As of June 30, 2012, there is a negative balance of \$982 million in the reserve for funding of long-term benefit goals, which will require favorable experience to eliminate the negative balance prior to providing funds for future benefit improvements or protection against unfavorable experience.

### (4) **Funded Status and Funding Progress**

As of June 30, 2012, the most recent actuarial valuation date, the plan was 92.6% funded. The actuarial accrued liability for benefits was \$8.5 billion, and the actuarial value of assets was \$7.8 billion, resulting in an UAAL of \$625.0 million. The covered payroll (annual payroll of active employees covered by the plan) was \$1.5 billion, and the ratio of the UAAL to the covered payroll was 41.6%.

The schedule of funding progress, presented as required supplementary information following the notes to financial statements on page 25, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

In the June 30, 2012 actuarial valuation, the entry age frozen UAAL method was used. The actuarial assumptions included (a) 7.25% investment rate of return and (b) projected salary increases ranging from 3.75% to 5.83%. Both (a) and (b) include the inflation component of 3.25%. The actuarial value of assets was determined by the following method: assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year, and constrained to a range of 80% to 120% of market. The UAAL is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2012 was 29 years.

### (5) **Cash and Investments**

#### *Cash and Deposits*

Cash and cash equivalents are held by the State Treasurer and were invested in the State's pooled investment fund. Investments in the State's pooled investment fund consist primarily of commercial paper rated A1 or P2 or better, short-term U.S. Treasury obligations, bank certificates of deposit, and money market funds.

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are held in the possession of an outside party. SDRS has no formal deposit policy specific to custodial credit risk. At June 30, 2012, SDRS has bank balances in various foreign currencies. These deposits are not

## **SOUTH DAKOTA RETIREMENT SYSTEM**

### Notes to Financial Statements

June 30, 2012

collateralized or covered by depository insurance. As a result, \$60,268,023 was exposed to custodial credit risk, which is recorded in investments in the statement of plan net assets.

#### ***Investments***

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). Below is a detail of the investment balances and amounts managed by the respective fund managers:

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

	<u>Cost</u>	<u>Fair value</u>
State of South Dakota Investment Council	\$ 4,749,832,676	5,015,284,884
Sanders All Asset Value	16,024,660	16,264,063
Sanders Capital	26,200,048	26,693,955
Blackstone Real Estate Partners	823,219,098	983,480,525
Cargill North American Real Estate Partners	102,040,675	71,147,039
CINVIN	81,030,875	104,999,723
Pinebridge	8,835,743	7,529,650
CVI Global Value Fund	144,589,495	134,997,441
CVI Specialized Ventures Fund	7,035,145	4,248,526
PIMCO Distressed Mtg Fund II	153,318,685	144,812,806
TCW Specialized Mtg Credits	258,632,877	263,118,883
Oaktree Loan Fund 2x	21,749,149	21,408,974
Blackstone Distressed Securities	—	606,453
Blackstone Credit Liquidity	13,071,953	14,511,723
Silver Lake Partners LP	114,232,064	127,403,812
KKR Associates	51,873,170	45,958,696
Cypress Merchant Banking Partners LP	9,152,113	5,103,873
Capital International	34,797,064	36,274,245
Apollo Real Estate Advisors LP	34,617,493	20,337,036
Bridgewater Pure Alpha Fund II	36,510,303	69,077,195
Dimensional Fund Advisors, Inc.	8,918,381	41,261,975
Blackstone Private Equity	235,449,949	226,799,689
Doughty Hanson & Co. Private Equity IV	72,934,799	108,691,283
Brandes Global Mid-Cap	40,478,037	34,988,300
Doughty Hanson & Co. European Real Estate	40,114,758	17,144,553
CVC	57,926,200	73,629,823
Carlyle	40,171,685	54,233,639
Riverstone	22,646,433	31,910,880
GE Asset Management	59,920,000	66,550,680
Elevation Partners	16,736,425	30,922,890
Crossroads Investment Advisors LP	6,114,455	4,098,346
Lonestar Real Estate	34,636,474	39,492,679
GE Active Commodities	25,000,000	25,273,090
DLJ Merchant Banking Partners LP	585,912	475,031
Total investments	<u>7,348,396,794</u>	<u>7,868,732,360</u>
Securities sold, but not yet purchased	<u>(42,726,979)</u>	<u>(46,263,220)</u>
Total	<u>\$ 7,305,669,815</u>	<u>7,822,469,140</u>

## SOUTH DAKOTA RETIREMENT SYSTEM

### Notes to Financial Statements

June 30, 2012

(a) ***Interest Rate Risk***

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The SDRS's investment grade fixed income portfolio's duration must fall between 70% and 130% of the duration of the Citigroup Broad Investment Grade (BIG) Index. The SDRS's internally managed high-yield fixed income portfolio's duration must fall between 70% and 130% of the Citigroup High-Yield Cash Pay Capped Index durations. Modified duration estimates the sensitivity of a bond's price to interest rate changes. The durations of the various investment types are listed in the following table:

Investment type:		
U.S. Treasuries	\$ 125,058,449	7.07
U.S. Treasury strips	48,008,599	11.01
U.S. Treasury Bills	2,499,538	0.21
U.S. agencies	56,105,755	3.84
U.S agencies discount notes	2,059,640	—
Investment grade corporates	396,427,357	4.28
High-yield corporates	137,625,490	3.57
Mortgage-backed securities	328,966,889	3.10
Nonagency mortgage-backed securities	143,317,500	0.09
Mutual funds	121,621,346	—
FDIC Temporary Liquidity Guarantee Program	5,011,499	0.03
Total	<u>\$ 1,366,702,062</u>	3.55

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

**(b) Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SDRS. SDIC sets the investment policy annually for the SDRS. This policy establishes the average percentage invested in each asset category and the fund allocation range that each asset category can vary during the fiscal year. As of June 30, 2012, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service.

	<u>Fair value</u>
Moody's rating:	
Aaa	\$ 463,836,184
Aa	43,197,904
A	113,200,718
Baa	199,994,189
Ba	38,818,676
B	73,123,965
Caa	79,032,862
Ca	39,427,235
C	2,198,351
P-1	79,057,033
Not rated	<u>2,059,640</u>
Total	<u>\$ 1,133,946,757</u>

**(c) Concentration of Credit Risk**

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of SDRS' investment in a single issuer. SDRS does not have guidelines to limit its investments in any particular investment. SDRS does not have investments in any one issuer that represent 5% or more of the total fair value of investments as of June 30, 2012 (excluding those issued by or explicitly guaranteed by the U.S. government).

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

**(d) Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SDRS's exposure to foreign currency risk derives from its positions in foreign currency and foreign-currency-denominated equity and fixed income investments. SDRS does not hedge foreign currency back to U.S. dollars (to match the unhedged benchmark), but does allow hedging under certain circumstances, when deemed appropriate. The portfolio's exposure to foreign currency risk at June 30, 2012 is as follows (in U.S. dollar fair value):

	<u>Equities</u>	<u>Fixed income</u>	<u>Cash</u>	<u>Total</u>
Currency:				
Australian dollar	\$ 9,577,381	—	48,056	9,625,437
Brazilian real	1,134,560	—	12,795	1,147,355
British pound	225,523,224	—	2,128,094	227,651,318
Canadian dollar	49,980,831	—	498,251	50,479,082
Danish kroner	6,086,917	—	—	6,086,917
Euro	247,060,184	—	2,204,852	249,265,036
Hong Kong dollar	2,649,166	—	36,510	2,685,676
Hungarian forint	412,304	—	—	412,304
Japanese yen	180,087,099	—	2,066,752	182,153,851
Korean won	14,336,467	—	1,494	14,337,961
Norwegian krone	6,118,830	—	95,117	6,213,947
Singapore dollar	275,957	—	—	275,957
Swedish krona	131,839	—	35,956	167,795
Swiss franc	182,937,229	—	3,359,812	186,297,041
Turkish lira	620,221	—	—	620,221
	<u>926,932,209</u>	<u>—</u>	<u>10,487,689</u>	<u>937,419,898</u>
Total fair value	\$ <u>926,932,209</u>	<u>—</u>	<u>10,487,689</u>	<u>937,419,898</u>

Investments with limited partnerships and certain global equity investments with outside managers, which are not included in the table above, may expose SDRS's portfolio to additional foreign currency risk. The total fair value of investments in real estate and private equity limited partnerships as of June 30, 2012 was \$1,989,633,394. The total fair value of global equity, arbitrage equity, and distressed and high-yield fixed income investments managed by outside managers was \$194,767,999, \$85,341,258, and \$583,704,806, respectively.

**(e) Return on Investments**

During fiscal year 2012, SDRS's investments (including investments bought and sold, as well as held during the year) depreciated in value by \$68,698,652.

## SOUTH DAKOTA RETIREMENT SYSTEM

### Notes to Financial Statements

June 30, 2012

The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior years and current year.

#### Change in Fair Value of Investments

Appreciation (depreciation) in fair value of investments:	
Equities	\$ (272,223,984)
Fixed income	(31,565,039)
Real estate	37,837,435
Private equity	(81,395,284)
Commodities	(3,979,213)
	<u>(351,326,085)</u>
Total decrease in fair value	
	<u>(351,326,085)</u>
Realized gain on investments:	
Equities	141,188,663
Fixed income	48,767,676
Real estate	3,407,086
Private equity	66,450,308
	<u>259,813,733</u>
Total net realized gains	
	<u>259,813,733</u>
Net gain on futures contracts	<u>22,813,700</u>
Net depreciation in investments	<u><u>\$ (68,698,652)</u></u>

**(f) *Securities Lending***

State statutes and the SDRS policies permit the use of investments for securities lending transactions. These transactions involve the lending of corporate debt, foreign equity securities, and domestic equity securities to broker-dealers for collateral in the form of securities, with the simultaneous agreement to return the collateral for the same securities in the future. The SDRS's securities custodian is an agent in lending securities and shall accept only U.S. government securities or its agencies as collateral for any loan or loaned securities. The collateral required must equal 102% of fair value plus accrued interest for corporate debt securities, 102% of fair value for U.S. equity securities, and 105% of fair value for foreign securities except in the case of loans of foreign securities, which are denominated and payable in U.S. dollars, in which event the collateral required is 102% of fair value. The earnings generated from the collateral investments result in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

At year-end, the SDRS has no credit risk exposure to borrowers because the amounts the SDRS owes the borrowers exceed the amounts the borrowers owe the SDRS. The contract with the lending agent requires the agent to indemnify the SDRS if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

All securities loans can be terminated on demand by either the SDRS or the borrower. The SDRS does not have the ability to pledge or sell collateral securities unless the borrower defaults, therefore,

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

no asset and corresponding liability for the collateral value of securities received has been established on the statement of plan net assets. Regarding restrictions on loans, the securities lending agreement does limit the total value of securities that can be out on loan on any given day.

**(g) Custodial Credit Risk**

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party SDRS securities lending policies are detailed above. As of June 30, 2012, the SDRS does not have custodial credit risk with regard to the security lending collateral due to the collateral not being reported as an asset on the financials.

**(6) Derivatives**

Derivatives are generally defined as contracts whose values depend on, or derive from, the value of an underlying asset, reference rate, or index. SDRS is exposed to various derivative products through the investment management of the SDIC and its outside managers. All of the SDRS’s derivatives are classified as investment derivatives.

***Futures Contracts***

A futures contract is a contract to buy or sell units of an index or financial instrument at a specified future date at a price agreed upon when the contract is originated. The SDIC purchases and sells futures contracts as a means of adjusting the SDRS portfolio mix at a lower transaction cost than the transactions, which would otherwise occur in the underlying portfolios. During fiscal year ended June 30, 2012, S&P 500 futures and 10-year U.S. Treasury note futures were utilized. Upon entering into such a contract, the SDRS pledges to the broker cash or U.S. government securities equal to the minimum initial margin requirement of the futures exchange. Additionally, SDRS receives or pays a daily variation margin, which is an amount of cash equal to the daily fluctuation in value of the contract. The pending variation margin at June 30, 2012 of \$(311,812) is presented in the statement of plan net assets as “Due to brokers – futures transactions.” The change in fair value of the futures contracts is presented in the statement of changes in plan net assets as “Net appreciation in fair value of investments.” The net change in fair value from futures contracts for fiscal year ended June 30, 2012 was \$22,813,700. Futures contract positions at June 30, 2012 were as follows:

Description	Expiration date	Open position	Number of contracts	Notional contract size	Fair value
U.S. Treasury note	September 2012	Long	610	100,000 par value 6% U.S. Treasury note	\$ 276,498

***Foreign Currency Forward Contracts***

The SDIC enters into foreign exchange forward contracts for SDRS to manage foreign currency exposure, as permitted by portfolio policies. The fair values of the contracts are presented in the statement of net assets as investments – equities. The change in fair value of the forward contracts is presented in the

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

statement of changes in net assets as “Net appreciation in fair value of investments.” The net change in fair value from foreign currency forward contracts for fiscal year ended June 30, 2012 was \$(3,284,795). At June 30, 2012, the foreign currency forward contracts outstanding were as follows:

<u>Description</u>	<u>Notional amount</u>	<u>Currency</u>	<u>Maturity date</u>	<u>Fair value (U.S. dollars)</u>
Forward sale	(801,363)	British Pound	7/13/2012	12,479
Forward sale	(2,122,956)	Swiss Franc	7/27/2012	94,319
Forward sale	(19,770,519)	Swiss Franc	8/03/2012	961,201
Forward sale	(115,000,000)	Japanese Yen	8/08/2012	(3,107)
Forward sale	(282,573)	Euro	8/10/2012	9,695
Forward sale	(114,780,000)	Japanese Yen	8/14/2012	1,511
Forward sale	(1,587,150)	Euro	9/04/2012	(38,552)
Forward sale	(630,435)	British Pound	9/07/2012	(12,897)
Forward sale	(828,930)	British Pound	9/13/2012	(7,721)
Forward sale	(118,000,000)	Japanese Yen	9/14/2012	11,427
Forward sale	(20,777,375)	Euro	9/24/2012	(41,347)
Forward purchase	828,930	British Pound	9/13/2012	7,212
Forward purchase	129,400,000	Chinese Yuan	7/24/2014	219,919
Forward purchase	128,050,000	Chinese Yuan	7/28/2014	8,969
Forward purchase	150,250,000	Chinese Yuan	3/30/2015	(1,522,080)
Forward purchase	117,237,600	Chinese Yuan	9/10/2015	319,434
Forward purchase	158,375,000	Chinese Yuan	11/30/2016	(252,476)
				<u>(232,014)</u>

**(a) Credit Risk**

SDRS is exposed to credit risk on derivative instruments that are in asset positions. The SDIC attempts to minimize credit risk by entering into derivatives contracts with major financial institutions. At June 30, 2012, the net fair value of foreign currency forward contracts was \$(232,014). This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. The credit ratings of the counterparties are as follows:

	<u>Number of counterparties</u>	<u>Fair value</u>
Moody’s credit rating:		
Aaa	1	\$ 984,389
Aa3	1	(1,216,403)

**(b) Foreign Currency Risk**

SDRS is exposed to foreign currency risk on its foreign currency forward contracts because they are denominated in foreign currencies. The net fair value of the foreign currency forward contracts in U.S. dollars is \$(232,014).

**SOUTH DAKOTA RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2012

**(7) Compensated Absences**

Annual leave is earned by all SDRS employees. Upon termination, SDRS employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2012, a liability existed for accumulated annual leave calculated at the employees' June 30, 2012 pay rate in the amount of \$126,721. Employees who have been continuously employed by SDRS and the State for at least seven years prior to the date of their retirement, voluntary resignation, or death will receive payment for one-fourth of their accumulated sick leave balance with such payment not to exceed the sum of 12 weeks of the employee's annual compensation. For employees who have not been employed for seven continuous years, an accrued liability is calculated assuming the likelihood that they will meet the seven-year threshold in the future. At June 30, 2012, a liability existed for accumulated and accrued sick leave calculated at the employees' June 30, 2012 pay rate in the amount of \$143,717.

	<b>2012</b>	<b>2011</b>	<b>Percentage change</b>
Total compensated absences	\$ 270,438	257,426	5.05%

The total leave liability for the current year is on the statement of net assets available for benefits in accounts payable and accrued expenses.

**(8) Operating Leases**

As of June 30, 2012, SDRS was a party to an agreement to lease office space on a month-to-month basis. In September 2012, SDRS entered into a new agreement for the same office space that has a 10-year term.

**(9) Supplemental Retirement Plan**

SDRS offers a deferred compensation plan known as the Supplemental Retirement Plan (SRP), created in accordance with Internal Revenue Code Section 457. SRP is available to all public employees and permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseen emergency.

All amounts of compensation deferred under the SRP, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are at all times held in trust for the exclusive benefit of the participants until made available to a participant or the participant's beneficiary.

Of the \$177,701,777 net assets available for plan benefits at June 30, 2012, \$110,348,272 was held in trust for employees of the State, while the remaining \$67,353,505 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$811,532 is included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2012.

## **SOUTH DAKOTA RETIREMENT SYSTEM**

### Notes to Financial Statements

June 30, 2012

#### **(10) Special Pay Plan**

The Special Pay Plan (SPP) was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the SDRS Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the plan. The SPP mandates that qualifying employees (over age 55 and \$600 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

Of the \$27,762,040 net assets available for plan benefits at June 30, 2012, \$15,665,432 was held in trust for employees of the State, while the remaining \$12,096,608 represents the assets held in trust for employees of other jurisdictions.

#### **(11) Plan Termination**

SDRS is administered in accordance with South Dakota statutes. The statutes provide for full vesting in accrued benefits upon termination of the plan (SDCL 3-12-72.2).

#### **(12) Commitments**

At June 30, 2012, SDRS had uncalled capital commitments to private equity limited partnerships totaling approximately \$295,824,263 and to real estate limited partnerships totaling approximately \$321,928,867. The commitments may be called at the discretion of the general partner or may never be called.

#### **(13) Litigation**

Deutsche Bank and Wilmington Trust Company have filed a number of actions around the country against selling shareholders, and those actions are all now consolidated in a Multi District Panel proceeding in the Southern District of New York (In re: Tribune Company Fraudulent Conveyance Litigation, Case No. 11-MD-2296). A separate adversary proceeding which was pending in Delaware has been consolidated into this action as well (The Official Committee of Unsecured Creditors of Tribune Company, on behalf of Tribune Company v. Dennis J. Fitzsimmons, et al., Case No. 1:12-cv-02652). SDRS is a defendant as a result of selling Tribune Stock in connection with a leveraged buyout of the Tribune Company in 2007. Through this lawsuit the creditors of Tribune Company are attempting to clawback funds received in connection with the sale of the stock, which, in the case of SDRS, is approximately four million dollars. SDRS contends that it has persuasive arguments favoring dismissal and its counsel is vigorously defending their case.

**SOUTH DAKOTA RETIREMENT SYSTEM**

Required Supplementary Information

June 30, 2012

<b>Schedule of Funding Progress</b>						
(Dollar amounts in millions)						
<b>Actuarial valuation date</b>	<b>(a) Actuarial value of assets</b>	<b>(b) Actuarial accrued liability – entry age (AAL)</b>	<b>Unfunded actuarial accrued liability (UAAL) (b-a)</b>	<b>Funded ratio (a/b)</b>	<b>(c) Covered payroll</b>	<b>UAAL as a percentage of covered payroll ((b-a)/c)</b>
6/30/2007	\$ 6,526.5	6,718.8	192.3	97.1%	\$ 1,297.3	14.8%
6/30/2008	6,784.3	6,976.8	192.5	97.2	1,363.9	14.1
6/30/2009	6,778.5	7,387.4	608.9	91.8	1,450.7	42.0
6/30/2010	7,119.9	7,393.3	273.4	96.3	1,491.1	18.3
6/30/2011	7,433.8	7,712.6	278.8	96.4	1,490.5	18.7
6/30/2012	7,828.0	8,453.0	625.0	92.6	1,503.0	41.6

<b>Schedule of Employer Contributions</b>		
Last Six Years		
	<b>Annual required contributions</b>	<b>Percentage contributed</b>
Year ended June 30:		
2007	\$ 85,361,762	100%
2008	89,766,090	100
2009	94,244,915	91
2010	96,914,192	100
2011	98,624,737	100
2012	98,866,649	100
The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows:		
Valuation date	June 30, 2012	Actuarial assumptions:
Actuarial cost method	Entry age with frozen unfunded actuarial accrued liability	Investment rate of return * 7.25% through June 30, 2017 7.5% thereafter
Amortization method	Level percentage-closed	Projected salary increase * based on service, with average of 4.8% 3.75% to 5.83%
Remaining amortization period	29 years	Cost of living adjustments 2.70%
Asset valuation method	Assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year, and constrained to a range of 80% to 120% of market	* Includes inflation at 3.25%
See accompanying independent auditors' report.		

**SOUTH DAKOTA RETIREMENT SYSTEM**

Supplementary Information

June 30, 2012

<b>Schedule of Administrative Expenses</b>	
Year ended June 30, 2012	
Personal services:	
Salary and per diem	\$ 1,528,867
Employee benefits	396,946
Total personal services	<u>1,925,813</u>
Operating expenses:	
Travel	50,045
Contractual services:	
Finance	32,542
Valuations	72,327
Consulting	136,615
Studies	81,340
Special studies	27,790
Legal	7,950
Communications	5,474
Medical	25,704
Operations	665,505
Total contractual services	<u>1,055,247</u>
Supplies and materials	214,363
Capital assets	32,505
Total operating expenses	<u>1,352,160</u>
Total administrative expenses	<u>\$ 3,277,973</u>

See accompanying independent auditors' report.

## SOUTH DAKOTA RETIREMENT SYSTEM

Supplementary Information

June 30, 2012

### Schedule of Investment Activity Expenses

Year ended June 30, 2012

Investment managers:

State of South Dakota Investment Council	\$ 5,313,251
Pinebridge	601,727
Apollo Real Estate Advisors LP	349,175
Blackstone Distressed Securities and credit liquidity	91,935
Blackstone Private Equity	1,120,687
Blackstone Real Estate Partners	3,673,777
Brandes Investment Partners	366,799
Capital International	1,691,685
Cargill North American Real Estate Partners	1,359,716
Carlyle	466,239
CINVIN	2,084,773
CVC	885,275
CVI	2,530,422
Cypress Merchant Banking Partners LP	21,656
Dimensional Fund Advisors, Inc.	190,391
Doughty Hanson & Co. European Real Estate	1,220,699
Doughty Hanson & Co. Private Equity IV	2,504,836
Elevation Partners	242,717
GE Asset Management China	1,258,736
GE Asset Management Commodities	278,771
KKR Associates	262,384
Crossroads Investment Advisors LP	170,061
Lonestar Real Estate	2,244,040
Oaktree Loan Fund 2x	168,462
PIMCO Distressed Mtg Fund II	2,731,047
Sanders All Asset Value	197,795
Sanders Capital	188,548
Riverstone	565,827
Silver Lake Partners LP	1,126,407
TCW Specialized Mtg Credits	1,234,441
Total investment activity expenses	\$ <u>35,142,279</u>

See accompanying independent auditors' report.

**SOUTH DAKOTA RETIREMENT SYSTEM**

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*

June 30, 2012



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**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  
South Dakota Retirement System:

We have audited the financial statements of South Dakota Retirement System (SDRS) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 20, 2012. 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.

**Internal Control over Financial Reporting**

Management of SDRS is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered SDRS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SDRS's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether SDRS's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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*.



This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and others within the entity, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

Omaha, Nebraska  
November 20, 2012

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Financial Statements

June 30, 2012

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
Suite 1501  
222 South 15th Street  
Omaha, NE 68102-1610

Suite 1600  
233 South 13th Street  
Lincoln, NE 68508-2041

## **Independent Auditors' Report**

The Board of Trustees  
South Dakota Retirement System  
Supplemental Retirement Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of June 30, 2012, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Supplemental Retirement Plan as of June 30, 2012, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 20, 2012, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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* and should be considered in assessing the results of our audit.

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 32 through 34 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.

KPMG LLP

Omaha, Nebraska  
November 20, 2012

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2012

This section presents management's discussion and analysis of the South Dakota Retirement System Supplemental Retirement Plan's (SRP or the Plan) financial position and performance for the year ended June 30, 2012. This section is intended to supplement the SRP financial statements.

**Financial Highlights**

- The net assets available for plan benefits of the SRP increased by \$11.9 million during fiscal year 2012. This increase was primarily attributable to investment gains during the year and contributions outweighing distributions to participants.
- The SRP paid \$6.3 million to benefit recipients in fiscal year 2012 compared to \$6.6 million in 2011. The SRP received \$15.5 million in contributions in fiscal year 2012 compared to \$14.6 million in 2011.

**Overview of the Financial Statements and Accompanying Information**

The basic financial statements consist of:

*Financial Statements*

The Plan presents the statement of plan net assets as of June 30, 2012, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

*Notes to Financial Statements*

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

**Financial Analysis**

The SRP was established in accordance with Internal Revenue Code Section 457 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SRP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2012

A summary of the net assets held in trust for plan benefits is shown below:

	<u>2012</u>	<u>2011</u>
Assets:		
Investments, at fair value	\$ 177,094,500	165,190,726
Cash	172,592	152,258
Other assets	125,150	—
Accrued interest	5,629	6,314
Contributions receivable	342,286	495,290
Total assets	<u>177,740,157</u>	<u>165,844,588</u>
Liabilities:		
Accounts payable	<u>38,380</u>	<u>36,974</u>
Net assets held in trust for plan benefits	<u>\$ 177,701,777</u>	<u>165,807,614</u>

**Change in Plan Net Assets**

Additions to the net assets include contributions and net investment income. Deductions from net assets are primarily benefit payments. During 2012, SRP paid \$6.3 million to benefit recipients, or 4.14% less than 2011.

A summary of the changes in plan net assets is shown below:

	<u>2012</u>	<u>2011</u>	<u>Percentage change</u>
Additions:			
Contributions – employee	\$ 15,549,771	14,616,270	6.39%
Investment income	2,999,248	25,791,502	(88.37)
Other income	125,150	—	100.00%
	<u>18,674,169</u>	<u>40,407,772</u>	<u>(53.79)</u>
Deductions:			
Distributions to participants	6,344,047	6,617,907	(4.14)
Administrative expenses	435,959	408,230	6.79
Total deductions	<u>6,780,006</u>	<u>7,026,137</u>	<u>(3.50)</u>
Net increase in plan net assets	11,894,163	33,381,635	(64.37)
Net assets held in trust for pension benefits:			
Beginning of year	<u>165,807,614</u>	<u>132,425,979</u>	<u>25.21</u>
End of year	<u>\$ 177,701,777</u>	<u>165,807,614</u>	<u>7.17%</u>

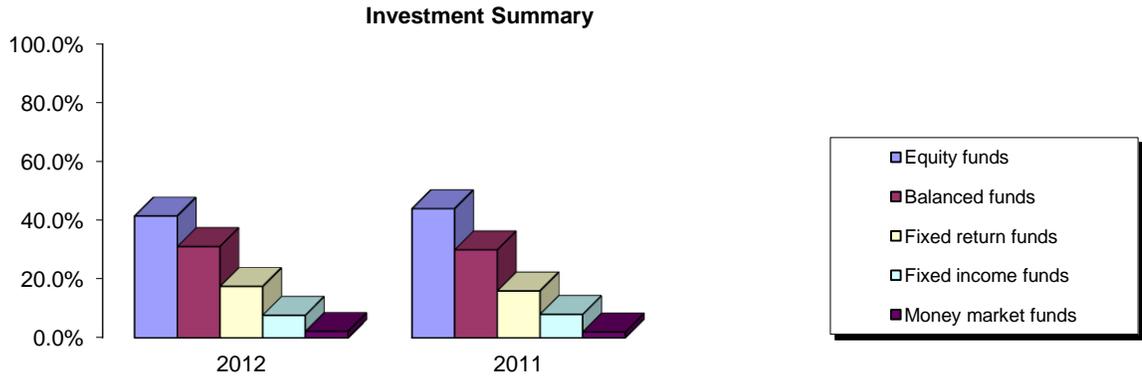
**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2012

**Investments**

The selection of SRP investment portfolio alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SRP fund types.



**Requests for Information**

Requests for information about the SRP may be directed to the Supplemental Retirement Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SRP at (605) 224-2230, 1-800-959-4457, or online at [www.srp457.com](http://www.srp457.com). You may link to the SRP Web site from the SDRS Web site at [www.state.sd.us/sdrs/](http://www.state.sd.us/sdrs/).

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Statement of Plan Net Assets

June 30, 2012

Assets:

Investments, at fair value:

Equity funds	\$ 73,351,931
Balanced funds	55,164,398
Fixed return funds	31,082,883
Fixed income funds	13,613,503
Money market funds	3,881,785

Total investments, at fair value	177,094,500
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Cash	172,592
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Other assets	125,150
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Accrued interest	5,629
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Contributions receivable	342,286
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Total assets	177,740,157
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Liabilities:

Accounts payable	38,380
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Net assets held in trust for plan benefits	\$ 177,701,777
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Statement of Changes in Plan Net Assets

Year ended June 30, 2012

Additions:

Contributions – employee	\$ 15,549,771
--------------------------	---------------

Investment income	2,999,248
-------------------	-----------

Other income	125,150
--------------	---------

Total additions	18,674,169
-----------------	------------

Deductions:

Distributions to participants	6,344,047
-------------------------------	-----------

Administrative expenses	435,959
-------------------------	---------

Total deductions	6,780,006
------------------	-----------

Net increase in plan net assets	11,894,163
---------------------------------	------------

Net assets held in trust for plan benefits:

Beginning of year	165,807,614
-------------------	-------------

End of year	\$ 177,701,777
-------------	----------------

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2012

**(1) Plan Description**

The following description of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

**(a) General**

The Plan was established in July 1987 in accordance with Internal Revenue Code Section 457 under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The State of South Dakota is a participating unit and every political subdivision thereof may become a participating unit in the Plan. The Plan permits employees of participating units to defer a portion of their salary until future years. The deferred compensation is not available to the participants until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary, shall be held in trust for the exclusive benefit of the participant.

**(b) Contributions**

Participants of the Plan may contribute an amount of not less than \$25 per month and not in excess of \$17,000 for calendar year 2012 or 100% of includable compensation. A participant may make a one-time election to defer an additional amount of twice the otherwise applicable limit during any of the three calendar years immediately preceding a participant's elected normal retirement age. If age 50 or over, participants may also defer additional contributions of \$5,500.

**(c) Participant's Account**

Each participant's account is credited with the participant's contributions, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

**(d) Distribution to Participants**

Distributions of benefits to participants can be made upon termination, retirement, death, or unforeseeable emergency. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or installments, as defined in the plan agreement.

**(e) Vesting**

Participants are vested immediately in their contributions plus actual earnings thereon.

**(f) Risks and Uncertainties**

The Plan invests in various investment securities. These securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2012

securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of plan net assets.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

**(b) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

**(3) Investments**

Investments are carried at fair value based upon quoted market prices at June 30, 2012, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury Bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of U.S. and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2012

Changes in plan net assets for the year ended June 30, 2012 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income	Deductions	Ending balance	Market value as a percentage of plan assets
Money market:						
Vanguard Prime Reserve	\$ 4,432,728	518,714	1,288	(1,070,945)	3,881,785	2.2%
Balanced:						
Vanguard Target Ret Inc Fund	2,636,681	106,623	192,862	3,298,619	6,234,785	3.5
Vanguard Target Ret 2005	3,186,683	42,427	132,465	(3,361,575)	—	—
Vanguard Target Ret 2010	6,329,582	301,307	245,099	(308,024)	6,567,964	3.7
Vanguard Target Ret 2015	11,239,364	1,018,400	332,068	(504,936)	12,084,896	6.8
Vanguard Target Ret 2020	10,617,446	1,487,270	222,570	(236,765)	12,090,521	6.8
Vanguard Target Ret 2025	5,658,814	1,204,689	102,465	101,516	7,067,484	4.0
Vanguard Target Ret 2030	4,353,566	863,297	30,919	(94,999)	5,152,783	2.9
Vanguard Target Ret 2035	1,652,411	655,801	4,778	(43,601)	2,269,389	1.3
Vanguard Target Ret 2040	1,072,968	368,577	(736)	(104,084)	1,336,725	0.8
Vanguard Target Ret 2045	732,030	325,647	4,757	6,204	1,068,638	0.6
Vanguard Target Ret 2050	892,381	412,171	4,634	(30,241)	1,278,945	0.7
Vanguard Target Ret 2055	—	5,068	(56)	7,256	12,268	—
	<u>48,371,926</u>	<u>6,791,277</u>	<u>1,271,825</u>	<u>(1,270,630)</u>	<u>55,164,398</u>	<u>31.1</u>
Fixed return:						
Prudential	26,626,958	2,917,447	864,023	674,455	31,082,883	17.5
Fixed income:						
Vanguard Bond Market	11,891,323	820,038	920,790	(18,648)	13,613,503	7.7
Equity:						
Mutual shares	12,347,344	544,689	(68,991)	(688,025)	12,135,017	6.8
Windsor II Adm	17,624,774	842,851	825,852	(1,067,466)	18,226,011	10.3
Vanguard Inst Index	18,182,724	865,957	981,596	(1,198,119)	18,832,158	10.6
Vanguard Tot Intl Stock Ind	7,898,526	637,623	(1,140,584)	(668,210)	6,727,355	3.8
Alliance Bern with App St	375,307	36,616	(26,190)	(23,898)	361,835	0.2
Dodge & Cox Int Stock Fund	1,580,593	176,868	(247,128)	(213,110)	1,297,223	0.7
Legg Mason Opp Fund	595,926	78,396	(80,415)	(84,735)	509,172	0.3
Legg Mason Value Trust	600,223	62,930	5,740	(88,234)	580,659	0.3
Growth fund of America	3,630,752	378,989	5,325	(291,814)	3,723,252	2.1
Capital World Grth & Inc	2,218,030	256,771	(121,774)	(146,087)	2,206,940	1.2
Vanguard Ext Mkt Idx Fund	7,333,714	456,311	(174,270)	(603,406)	7,012,349	3.9
Vanguard Strategic Equity	1,479,878	303,278	(23,468)	(19,728)	1,739,960	1.0
	<u>73,867,791</u>	<u>4,641,279</u>	<u>(64,307)</u>	<u>(5,092,832)</u>	<u>73,351,931</u>	<u>41.2</u>
Total investments	165,190,726	15,688,755	2,993,619	(6,778,600)	177,094,500	99.7
Other plan net assets	616,888	(138,984)	130,779	(1,406)	607,277	0.3
Total plan net assets	<u>\$ 165,807,614</u>	<u>15,549,771</u>	<u>3,124,398</u>	<u>(6,780,006)</u>	<u>177,701,777</u>	<u>100.0%</u>

**(4) Plan Administration**

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2012

**(5) Federal Income Tax Status**

The Plan is an eligible nonqualified deferred compensation plan under Section 457(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated September 15, 1988. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

**(6) Transfers to Related Plan**

During the year, no assets were transferred from the Plan into the South Dakota Retirement System Special Pay Plan (SPP), a related plan. Transfers between SRP and SPP are allowed under state statutes.

**(7) Plan Termination**

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SUPPLEMENTAL RETIREMENT PLAN**

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*

June 30, 2012



**KPMG LLP**  
Suite 1501  
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**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  
South Dakota Retirement System  
Supplemental Retirement Plan:

We have audited the financial statements of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 20, 2012. 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.

**Internal Control over Financial Reporting**

Management of the Plan is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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*.



This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and others within the entity, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

Omaha, Nebraska  
November 20, 2012

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Financial Statements

June 30, 2012

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
Suite 1501  
222 South 15th Street  
Omaha, NE 68102-1610

Suite 1600  
233 South 13th Street  
Lincoln, NE 68508-2041

## **Independent Auditors' Report**

The Board of Trustees  
South Dakota Retirement System  
Special Pay Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Special Pay Plan (the Plan) as of June 30, 2012, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Special Pay Plan as of June 30, 2012, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 20, 2012, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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* and should be considered in assessing the results of our audit.

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 44 through 46 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.

KPMG LLP

Omaha, Nebraska  
November 20, 2012

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2012

This section presents management's discussion and analysis of the South Dakota Retirement System Special Pay Plan's (SPP or the Plan) financial position and performance for the year ended June 30, 2012. This section is intended to supplement the SPP financial statements and notes.

**Financial Highlights**

- The net assets available for plan benefits of the SPP increased by \$4.2 million during fiscal year 2012. This increase was primarily attributable to additional participant contributions and investment gains.
- The SPP paid \$4.3 million to benefit recipients in fiscal year 2012 compared to \$3.8 million in 2011. The SPP received \$7.8 million in contributions in fiscal year 2012 compared to \$6.7 million in 2011.

**Overview of the Financial Statements and Accompanying Information**

The basic financial statements consist of:

***Financial Statements***

The Plan presents the statement of plan net assets as of June 30, 2012, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

***Notes to Financial Statements***

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

**Financial Analysis**

The SPP was established in accordance with Internal Revenue Code Section 401 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SPP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2012

A summary of the net assets held in trust for plan benefits is shown below:

**Summary of Plan Net Assets**

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets:		
Investments, at fair value	\$ 27,268,995	23,183,573
Cash	147,836	97,041
Other assets	4,622	—
Accrued interest	287	428
Contributions receivable	349,660	307,963
Total assets	<u>27,771,400</u>	<u>23,589,005</u>
Liabilities:		
Accounts payable	9,360	12,283
Net assets held in trust for plan benefits	<u>\$ 27,762,040</u>	<u>23,576,722</u>

**Changes in Plan Net Assets**

Additions to the net assets mainly were due to contributions during the year. Deductions from net assets are primarily benefit payments and administrative expenses. During 2012, SPP paid \$4.3 million to benefit recipients, or 12.8% more than 2011.

A summary of the changes in plan net assets is shown below:

	<u>2012</u>	<u>2011</u>	<u>Percentage change</u>
Additions:			
Contributions – employee	\$ 7,835,504	6,701,348	16.92%
Investment income	616,002	1,199,545	(48.65)
Other income	35,582	26,235	35.63
	<u>8,487,088</u>	<u>7,927,128</u>	<u>7.06</u>
Deductions:			
Distributions to participants	4,257,261	3,773,161	12.83
Administrative expenses	44,509	26,235	69.66
Total deductions	<u>4,301,770</u>	<u>3,799,396</u>	<u>13.22</u>
Net increase in plan net assets	4,185,318	4,127,732	1.40
Net assets held in trust for pension benefits:			
Beginning of year	<u>23,576,722</u>	<u>19,448,990</u>	<u>21.22</u>
End of year	<u>\$ 27,762,040</u>	<u>23,576,722</u>	<u>17.75%</u>

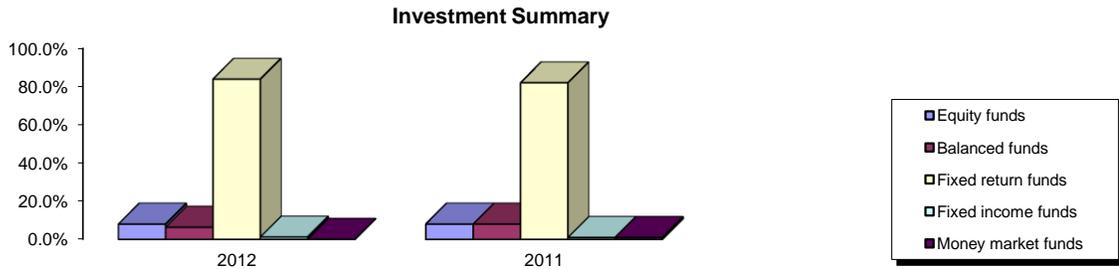
**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2012

**Investments**

The selection of SPP investment portfolios alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SPP fund types.



**Requests for Information**

Requests for information about the SPP may be directed to the Special Pay Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SPP at (605) 224-2230 or 1-800-959-4457.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Statement of Plan Net Assets

June 30, 2012

Assets:

Investments, at fair value:

Equity funds	\$ 1,732,556
Balanced funds	1,760,174
Fixed return funds	23,300,706
Fixed income funds	328,988
Money market funds	<u>146,571</u>

Total investments, at fair value 27,268,995

Cash 147,836

Other assets 4,622

Accrued interest 287

Contributions receivable 349,660

Total assets 27,771,400

Liabilities:

Accounts payable 9,360

Net assets held in trust for plan benefits \$ 27,762,040

Statement of Changes in Plan Net Assets

Year ended June 30, 2012

Additions:

Contributions – employee	\$ 7,835,504
Investment income	616,002
Other income	<u>35,582</u>

Total additions 8,487,088

Deductions:

Distributions to participants	4,257,261
Administrative expenses	<u>44,509</u>

Total deductions 4,301,770

Net increase in plan net assets 4,185,318

Net assets held in trust for plan benefits:

Beginning of year 23,576,722

End of year \$ 27,762,040

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2012

**(1) Plan Description**

The following description of the South Dakota Retirement System Special Pay Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

**(a) General**

The Plan was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the South Dakota Retirement System Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the Plan. The Plan mandates that qualifying employees (over age 55 and \$600 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. Special pay is compensation other than regular salary or wages granted to a member of the South Dakota Retirement System and transferred in a sum to the Plan at termination of the member's employment. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

All amounts of special termination pay deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary for estate, shall be held in trust for the exclusive benefit of the participant.

**(b) Contributions**

Participants in the Plan can contribute the lesser of 100% of their one-time, lump-sum special pay associated with their termination or \$50,000 for calendar year 2012.

**(c) Participant's Account**

Each participant's account is credited with the participant's contribution, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

**(d) Distribution to Participants**

Distributions of benefits to participants can be made immediately after the participant's termination, or upon the participant's retirement, or to a beneficiary or an estate upon the participant's death. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or in the form of installments as defined in the plan agreement.

**(e) Risks and Uncertainties**

The Plan invests in various investment securities. These securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2012

occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of plan net assets.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

**(b) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

**(3) Investments**

Investments are carried at fair value based upon quoted market prices at June 30, 2012, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury Bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of U.S. and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2012

Changes in plan net assets for the year ended June 30, 2012 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income (loss)	Deductions	Ending balance	Market value as a percentage of plan assets
Money market:						
Vanguard prime reserve	\$ 166,239	—	46	(19,714)	146,571	0.5%
Balanced:						
Vanguard Target Ret Inc	166,017	—	9,322	35,806	211,145	0.8
Vanguard Target Ret 2005	43,706	—	1,712	(45,418)	—	—
Vanguard Target Ret 2010	599,480	—	23,953	7,051	630,484	2.3
Vanguard Target Ret 2015	881,717	—	23,027	(18,059)	886,685	3.2
Vanguard Target Ret 2020	44,582	—	(2,075)	(34,815)	7,692	—
Vanguard Target Ret 2030	5,517	—	(1,184)	(33,256)	(28,923)	(0.1)
Vanguard Target Ret 2025	34,440	—	509	(2,402)	32,547	0.1
Vanguard Target Ret 2035	26,020	—	60	(7,083)	18,997	0.1
Vanguard Target Ret 2040	1,344	—	41	(1,385)	—	—
Vanguard Target Ret 2045	11,236	—	160	(11,396)	—	—
Vanguard Target Ret 2050	641	—	(6)	—	635	—
Vanguard Target Ret 2055	—	—	(33)	945	912	—
	<u>1,814,700</u>	<u>—</u>	<u>55,486</u>	<u>(110,012)</u>	<u>1,760,174</u>	<u>6.4</u>
Fixed return:						
Prudential	19,120,762	7,717,310	585,048	(4,122,414)	23,300,706	83.9
Fixed income:						
Vanguard Bond Market	260,004	23,207	20,734	25,043	328,988	1.2
Equity:						
Dodge & Cox Int Stock	136,692	—	(19,137)	(46,852)	70,703	0.3
Capital World Grth & Inc	41,068	—	(835)	58,717	98,950	0.4
Vanguard Ext Mkt Ind	259,776	—	(8,708)	(1,776)	249,292	0.9
Legg Mason Opp Trust	8,913	—	(1,171)	(1,249)	6,493	—
Legg Mason Cap Mgt	1,874	—	110	(1,316)	668	—
Growth Fund of America	239,148	—	(45)	(20,882)	218,221	0.8
Alliance Bern with App St	6,257	—	(390)	(1,701)	4,166	—
Mutual shares	300,038	—	(1,371)	(1,385)	297,282	1.1
Windsor II Adm	265,705	—	8,225	(25,536)	248,394	0.9
Vanguard Inst Index	271,331	—	14,174	(3,525)	281,980	1.0
Vanguard Total Int'l Stock ind	244,910	—	(35,253)	(26,589)	183,068	0.7
Vanguard Strategic Eq	46,156	—	(1,198)	28,381	73,339	0.3
	<u>1,821,868</u>	<u>—</u>	<u>(45,599)</u>	<u>(43,713)</u>	<u>1,732,556</u>	<u>6.4</u>
Total investments	23,183,573	7,740,517	615,715	(4,270,810)	27,268,995	98.2
Other plan net assets	393,149	94,987	4,909	—	493,045	1.8
Total plan net assets	<u>\$ 23,576,722</u>	<u>7,835,504</u>	<u>620,624</u>	<u>(4,270,810)</u>	<u>27,762,040</u>	<u>100.0%</u>

**(4) Plan Administration**

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2012

**(5) Federal Income Tax Status**

The Plan is a qualified plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated October 28, 2004. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

**(6) Transfers from Related Plan**

During the year, no assets were transferred into the Plan from the South Dakota Retirement System Supplemental Retirement Plan (SRP), a related plan. Transfers between SPP and SRP are allowed under state statutes.

**(7) Plan Termination**

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants would continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM  
SPECIAL PAY PLAN**

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*

June 30, 2012



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222 South 15th Street  
Omaha, NE 68102-1610

Suite 1600  
233 South 13th Street  
Lincoln, NE 68508-2041

**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  
South Dakota Retirement System  
Special Pay Plan:

We have audited the financial statements of South Dakota Retirement System Special Pay Plan (the Plan) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 20, 2012. 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.

**Internal Control over Financial Reporting**

Management of the Plan is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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*.



This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and others within the entity, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

Omaha, Nebraska  
November 20, 2012