

Financial Statements

June 30, 2013

**South Dakota Retirement System,
South Dakota Retirement System
Supplemental Retirement Plan, and
South Dakota Retirement System
Special Pay Plan**

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

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Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System (SDRS), which comprise the statement of plan net position as of June 30, 2013, and the related statement of changes in plan net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of the plan net position of the South Dakota Retirement System, as of June 30, 2013, and the respective statement of changes in plan net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 2 to the financial statements, the financial statements include investments valued at \$2,704,546,343 (29.8% of net position) 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.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the required supplementary information on pages 4-7 and 26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the SDRS's basic financial statements as a whole.

The additional supplementary information accompanying financial information listed as supplemental schedules in the table of contents are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying financial information listed as supplemental schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 07, 2013, on our consideration of the SDRS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SDRS's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Eide Bailly LLP". The signature is written in a cursive, flowing style.

November 07, 2013
Boise, Idaho

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2013

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, 2013. 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 position of SDRS increased by \$1.2 billion during fiscal year 2013. This increase was primarily due to the investment performance of 19.53%, which was significantly above the assumed rate of 7.25%.
- SDRS funded ratio increased to 100.0% in 2013 from 92.6% in 2012.
- SDRS paid \$397.6 million to benefit recipients in fiscal year 2013 compared to \$371.4 million in 2012. SDRS received \$202.1 million in member and employer contributions in fiscal year 2013 compared to \$199.4 million in 2012.

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 position as of June 30, 2013 and the statement of changes in plan net position 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, 2013

A summary of the plan net position is shown below:

Summary of Plan Net Position

June 30, 2013 and 2012

	2013	2012
Assets:		
Cash and cash equivalents	\$ 6,347,578	\$ 4,334,563
Receivables	51,026,767	24,808,359
Investments, at fair value	9,122,724,043	7,868,732,360
Other assets	26,442	22,720
Due from brokers – futures transactions	1,870,102	-
Total assets	9,181,994,932	7,897,898,002
Liabilities:		
Accounts payable and accrued expenses	2,232,483	2,087,340
Securities sold, but not yet purchased	55,977,321	46,263,220
Unsettled investment purchases	38,078,420	6,711,319
Due to brokers – futures transactions	-	311,882
Total liabilities	96,288,224	55,373,761
Net position restricted for pension benefits	\$ 9,085,706,708	\$ 7,842,524,241

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 resulting actuarial value of assets is constrained to a range of 80% to 120% of the market value of assets, and the reserve for funding of long-term benefit goals is adjusted if these limits apply.

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.

	2013	2012	Change
Funded ratio	100.0%	92.6%	7.4%

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2013

Change in Plan Net Position

Additions to the plan net position 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, 2013. The investment returns were 19.53% for 2013 and 1.91% for 2012.

Deductions from plan net position are primarily benefit payments. During 2013, SDRS paid \$397.6 million to benefit recipients or 7.1% more than 2012. The increase is due to added recipients and the annual 3.1% cost-of-living adjustment. Refunds of accumulated contributions during 2013 decreased 3.0%. Administrative costs of SDRS represent less than .04% of plan net position.

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

	<u>2013</u>	<u>2012</u>	<u>Percentage change</u>
Additions:			
Employee contributions	\$ 101,678,721	\$ 100,484,113	1.2%
Employer contributions	100,376,481	98,866,649	1.5
Investment income	<u>1,467,497,091</u>	<u>107,541,250</u>	<u>59.8</u>
Total additions	<u>1,669,552,293</u>	<u>306,892,012</u>	<u>50.4</u>
Deductions:			
Benefits	397,620,115	371,417,148	7.1
Refunds of contributions	25,160,994	25,942,146	(3.0)
Administrative expenses	<u>3,588,717</u>	<u>3,277,973</u>	<u>9.5</u>
Total deductions	<u>426,369,826</u>	<u>400,637,267</u>	<u>6.4</u>
Net change in plan net position	1,243,182,467	(93,745,255)	69.8
Net position restricted for pension benefits:			
Beginning of year	<u>7,842,524,241</u>	<u>7,936,269,496</u>	<u>(1.2)</u>
End of year	<u><u>\$ 9,085,706,708</u></u>	<u><u>\$ 7,842,524,241</u></u>	<u><u>15.9%</u></u>

Investments

SDRS investment portfolio management is the statutory responsibility of the South Dakota 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

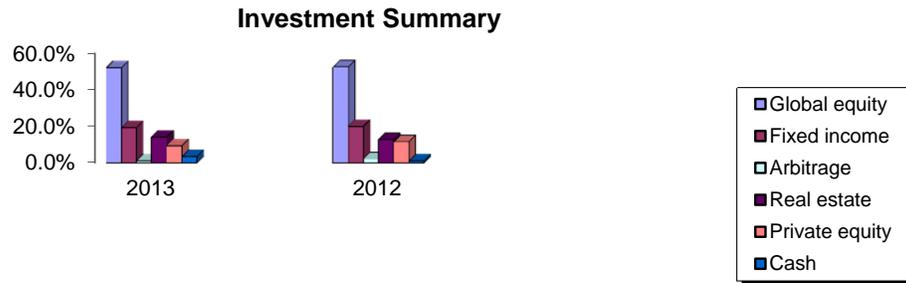
June 30, 2013

Investment performance during 2013 and 2012 was 19.53% and 1.91% , 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.sdrs.sd.gov.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Plan Net Position

June 30, 2013

Assets	
Cash and cash equivalents	\$ 6,347,578
Receivables	
Employer	2,223,068
Employee	2,594,082
Benefits	61,924
Unsettled investment sales	27,806,373
Accrued interest and dividends	18,341,320
	<hr/>
Total receivables	51,026,767
	<hr/>
Investments, at fair value	
Fixed income	1,958,995,995
Equities	5,020,038,052
Real estate	1,284,334,590
Private equity	859,355,406
	<hr/>
Total investments, at fair value	9,122,724,043
	<hr/>
Due from brokers - futures transactions	1,870,102
	<hr/>
Property, at cost (net of accumulated depreciation of \$10,643)	5,258
	<hr/>
Other assets	21,184
	<hr/>
Total assets	9,181,994,932
	<hr/>
Liabilities	
Accounts payable and accrued expenses	2,232,483
Securities sold, but not yet purchased, at fair value	55,977,321
Unsettled investment purchases	38,078,420
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Total liabilities	96,288,224
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Net position restricted for pension benefits	\$ 9,085,706,708
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See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Changes in Plan Net Position

Year Ended June 30, 2013

Additions	
Contributions	
Employee	\$ 101,678,721
Employer	<u>100,376,481</u>
Total contributions	<u>202,055,202</u>
Investment Income:	
From investing activities:	
Net appreciation in fair value of investments	1,278,299,836
Interest	74,193,432
Dividends	126,514,828
Real estate	<u>23,274,159</u>
Investment activity income	1,502,282,255
Less investment activity expenses	<u>(35,665,820)</u>
Net investment activity income	<u>1,466,616,435</u>
From security lending activities	
Security lending income	1,258,076
Security lending expenses	<u>(377,420)</u>
	<u>880,656</u>
Total additions	<u>1,669,552,293</u>
Deductions	
Benefits	397,620,115
Refunds of contributions	25,160,994
Administrative expenses	<u>3,588,717</u>
Total deductions	<u>426,369,826</u>
Net change in plan net position	1,243,182,467
Net position restricted for pension benefits:	
Beginning of year	<u>7,842,524,241</u>
End of year	<u>\$ 9,085,706,708</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

(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-officio 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, a justice, judge, or magistrate judge, 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, 2013

- 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. SDRS believes that the system currently is designed and being operated in compliance with the applicable requirements of the Internal Revenue Code, and therefore, SDRS continues to be tax-exempt as of June 30, 2013. 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, 2013, the number of participating governmental employers is as follows:

School districts	166
State of South Dakota	1
Board of Regents	1
Municipalities	154
Counties	64
Board and Commissions	88
	<hr/>
Total employers	474
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SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

At June 30, 2013, SDRS membership consists of the following:

Retirees and beneficiaries currently receiving benefits:	
Class A (general employees)	21,946
Class B (public safety and judicial employees)	<u>1,381</u>
Total retirees and beneficiaries	<u>23,327</u>
Terminated members entitled to benefits but not yet receiving them:	
Class A (general employees)	14,525
Class B (public safety and judicial employees)	<u>657</u>
Total terminated members	<u>15,182</u>
Current active members:	
Vested:	
Class A (general employees)	28,649
Class B (public safety and judicial employees)	2,091
Nonvested:	
Class A (general employees)	7,189
Class B (public safety and judicial employees)	<u>665</u>
Total current active members	<u>38,594</u>
Grand total	<u><u>77,103</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, 2013

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, co-investments, 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 \$2,704,546,343 (29.8% of net position) at June 30, 2013. 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 marked 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 A members	6.0% of salary
Class B public safety members	8.0% of salary
Class B judicial members	9.0% 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 (closed to new enrollees after July 1, 2010).

SDRS is funded by fixed member and employer contributions at a rate established by South Dakota law. On an annual basis, an independent actuarial valuation of SDRS is performed to determine the adequacy of the fixed contributions to pay the normal costs and expenses if the System is fully

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

funded or pay the normal costs, expenses and amortize the unfunded actuarial accrued liability (UAAL) if the System is not fully funded. The June 30, 2013 actuarial valuation of the plan determined that the System is fully funded and that the statutorily required employer contributions meet the requirements for the annual required contributions 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 statutorily required employer contributions are sufficient to pay the employer normal cost and expenses. Annual required contributions of the employers equal to the statutorily required contributions have been listed below pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

	Employer	Percentage contributed
Year ending June 30:		
2013	100,376,481	100%
2012	98,866,649	100
2011	98,624,737	100
2010	96,914,192	100
2009	94,244,915	91

Contributions during fiscal year 2013 totaling \$202,055,202 (\$101,678,721 employee and \$100,376,481 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:

	Employees
Year ending June 30:	
2014	\$ 231,192
2015	56,410
2016	43,734
2017	30,976
2018	7,605
Later	6,144
Deferred contributions receivable at June 30, 2013	\$ 376,061

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

(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 or to meet the funding objectives of SDRS as established by the Board of Trustees. As of June 30, 2013, the balance in the reserve for funding of long-term benefit goals is (\$1,106 million). The reserve will increase by net gains of \$1,303 million that will be recognized in the reserve for funding of long-term benefit goals over the next four years.

(4) Funded Status and Funding Progress

As of June 30, 2013, the most recent actuarial valuation date, the plan was 100.0% funded. The actuarial accrued liability for benefits was \$8.8 billion and the actuarial value of assets was \$8.8 billion, resulting in an UAAL of \$0. The covered payroll (annual payroll of active employees covered by the plan) was \$1.6 billion and the ratio of UAAL to the covered payroll was 0.0%.

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to financial statements on page 26, presents 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, 2013 actuarial valuation, the entry age frozen UAAL method was used. The actuarial assumptions included (a) investment rate of return of 7.25% for four years and 7.50% thereafter and (b) projected salary increases ranging from 3.75% to 5.83%. Both (a) and (b) include an inflation component of 3.25%. The actuarial value of assets was determined by the increasing or decreasing prior year assets with net actual cash flow (increasing by contributions and decreasing by benefit payments and expenses) and crediting it with the assumed rate of investment return. The actuarial value of assets is also debited/credited with liability gains/losses for the year and constrained to a range of 80% to 120% of market value of assets. In addition, for the June 30, 2013 valuation, \$634 million was transferred from the cushion to the actuarial value of assets to eliminate the UAAL in accordance with the Board of Trustees funding policy objectives. As a result, the UAAL is \$0 as of June 30, 2013.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

(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 short-term U.S. Treasury and Agency obligations, short-term US Corporate securities, 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, 2013, SDRS has bank balances in various foreign currencies. These deposits are not collateralized or covered by depository insurance. As a result, \$11,463,635 was exposed to custodial credit risk, which are recorded in investments in the statement of plan net position.

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.).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

Below is a detail of the investment balances and amounts managed by the respective fund managers:

	Cost	Fair value
State of South Dakota Investment Council	\$ 5,147,977,583	\$ 6,120,819,618
Sanders Capital	27,811,527	33,619,962
Blackstone Real Estate Partners	859,629,666	1,138,390,846
Rockport RE IV	15,509,890	19,183,471
Starwood RE IX	10,446,662	12,329,122
Cargill North American Real Estate Partners	45,403,232	29,543,771
CINVIN	88,046,337	98,477,588
Pinebridge	7,104,045	4,806,821
CVI Global Value Fund	85,430,213	95,414,971
CVI Specialized Ventures Fund	5,739,053	4,219,638
TCW Opp MBS Strategy	400,270,767	447,837,677
PIMCO Distressed Mtg Fund II	145,993	116,245
Blackstone Credit Liquidity	2,431,587	1,360,337
Sanders All Asset Value	17,206,955	19,693,158
Silver Lake Partners LP	113,015,546	125,952,530
KKR Associates	42,507,636	42,500,790
Cypress Merchant Banking Partners LP	5,815,153	4,711,980
Capital International	31,394,546	31,651,050
Apollo Real Estate Advisors LP	27,975,441	17,144,353
Bridgewater Pure Alpha Fund II	36,510,303	72,183,617
Dimensional Fund Advisors, Inc.	8,918,381	44,964,081
Blackstone Private Equity	216,325,450	264,217,264
Doughty Hanson & Co. Private Equity IV	66,295,329	86,422,923
Brandes Global Mid-Cap	42,787,090	47,228,870
Doughty Hanson & Co. European Real Estate	34,466,858	19,609,719
CVC	57,465,992	68,283,859
Carlyle	40,666,530	58,353,533
Riverstone	46,174,492	57,289,887
GE Asset Management	92,730,000	91,575,887
Elevation Partners	12,113,359	13,122,570
Crossroads Investment Advisors LP	5,175,182	3,213,149
Lonestar Real Estate	44,195,123	48,133,308
DLJ Merchant Banking Partners LP	388,412	351,448
	7,638,074,333	9,122,724,043
Total investments	7,638,074,333	9,122,724,043
Securities sold, but not yet purchased	(46,243,682)	(55,977,321)
	\$ 7,591,830,651	\$ 9,066,746,722
Total	\$ 7,591,830,651	\$ 9,066,746,722

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

(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 85% and 115% 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:

	Fair value	Duration (in years)
Investment type:		
U.S. Treasuries	\$ 128,778,875	6.46
U.S. Treasury strips	43,759,723	9.99
U.S. Treasury Bills	21,998,033	0.22
U.S. agencies	57,189,922	4.57
US Treasury Inflation Protected Securities	1,788,964	1.54
Investment grade corporates	362,652,463	4.12
High-yield corporates	173,142,638	3.61
Agency Mortgage-backed securities	319,135,372	4.97
Non-agency Mortgage-backed securities	432,959,133	0.58
Total	\$1,541,405,123	3.56

The SDRS fixed income portfolios invest in mortgage-backed securities. These securities are sensitive to prepayments by mortgagees, which is likely in declining interest rate environments, thereby reducing the value of these securities. The SDIC invests in mortgage-backed securities to diversify the portfolio and increase the return while minimizing the extent of risk.

(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, 2013, 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.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

	<u>Fair value</u>
Moody's rating:	
Aaa	\$ 455,191,398
Aa	65,109,899
A	109,951,973
Baa	185,672,773
Ba	63,826,051
B	112,753,649
Caa	177,326,685
Ca	134,336,808
Not rated	<u>111,006,279</u>
Total	<u>\$ 1,415,175,515</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, 2013 (excluding those issued by or explicitly guaranteed by the U.S. government).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

(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, 2013 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	\$ 10,120,137	\$ -	\$ 238,414	\$ 10,358,551
Brazilian Real	1,868,540	-	-	1,868,540
British Pound	268,094,206	-	4,921,610	273,015,816
Canadian Dollar	65,137,338	-	348,679	65,486,017
Danish Krone	8,309,828	-	29,487	8,339,315
Euro	312,773,012	-	2,951,241	315,724,253
Hong Kong Dollar	2,936,526	-	48,988	2,985,514
Hungarian Forint	862,698	-	70,679	933,377
Japanese Yen	181,140,594	-	1,777,749	182,918,343
Korean Won	30,820,966	-	1,749	30,822,715
Norwegian Krone	1,463,303	-	1,061,893	2,525,196
Singapore Dollar	675,895	-	4,258	680,153
Swedish Krona	478,789	-	-	478,789
Swiss Franc	247,808,331	-	8,887	247,817,218
Total fair value	<u>\$ 1,132,490,163</u>	<u>\$ -</u>	<u>\$ 11,463,634</u>	<u>\$ 1,143,953,797</u>

Investments with limited partnerships and certain global equity investments with external 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, 2013 was \$2,143,689,981. The total fair value of global equity, hedge fund, and distressed and high-yield fixed income investments managed by external managers was \$217,388,801, \$91,876,775, and \$101,111,191 respectively.

(e) Return on Investments

During fiscal year 2013, SDRS's investments (including investments bought and sold, as well as held during the year) appreciated in value by \$1,278,299,836.

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.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

Change in Fair Value of Investments

Appreciation in fair value of investments:	
Equities	\$ 758,352,700
Fixed income	28,978,913
Real estate	149,734,376
Private equity	21,322,708
Commodities	(273,090)
Change in accrued income	471,140
Total increase in fair value	<u>958,586,747</u>
Realized gain (loss) on investments:	
Equities	151,296,168
Fixed income	71,670,839
Real estate	13,702,791
Private equity	83,439,851
Commodities	665,596
Total net realized gains	<u>320,775,245</u>
Futures - change in unrealized gain (loss)	1,913,939
Futures - Realized gain (loss)	<u>(2,966,477)</u>
Net loss on futures	<u>(1,052,538)</u>
Net appreciation in investments	<u>\$ 1,278,309,454</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.

The fair value of securities on loan as of June 30, 2013 was \$43,777,748 and the collateral held on the same date was \$46,309,192. 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, no asset and corresponding liability for the collateral value of securities received has been

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

established on the statement of plan net position. 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 in the preceding Securities Lending section. As of June 30, 2013, the SDRS does not have custodial credit risk with regard to the security lending collateral.

(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 external 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 South Dakota Investment Council 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, 2013, 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, 2013 of \$1,870,102 is presented in the statement of plan net position as "Due from brokers – futures transactions." The change in fair value of the futures contracts is presented in the statement of changes in plan net position as "Net appreciation in fair value of investments." The net change in fair value from futures contracts for fiscal year ended June 30, 2013 was \$1,052,538.

Futures contract positions at June 30, 2013 were as follows:

<u>Description</u>	<u>Expiration date</u>	<u>Open position</u>	<u>Number of contracts</u>	<u>Notional Contract size</u>	<u>Fair value</u>
U.S. Treasury note	September 2013	Long	1,525	100,000 par value 6%, 10 year U.S. Treasury note	\$ 193,007,813
S&P 500 Index	September 2013	Short	(1,090)		\$ (435,809,250)

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

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

Position as Investments, at fair value – Equities. The change in fair value of the forward contracts is presented in the Statement of Changes in Net Position 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, 2013 was \$3,197,930. At June 30, 2013, 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 (US dollars)</u>
Forward sale	(1,943,536)	CHF	7/25/2013	\$ 12,753
Forward sale	(19,770,519)	CHF	8/2/2013	316,745
Forward sale	(20,777,375)	EUR	9/20/2013	355,975
Forward sale	(115,000,000)	JPY	8/8/2013	1,721
Forward purchase	129,400,000	CNY	7/24/2014	548,163
Forward purchase	128,050,000	CNY	7/28/2014	330,883
Forward purchase	117,237,600	CNY	9/10/2015	359,684
Forward purchase	150,250,000	CNY	3/30/2015	(1,337,837)
Forward purchase	158,375,000	CNY	11/30/2016	(473,115)

(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, 2013, the net fair value of foreign currency forward contracts was \$1,925,924. 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:		
A1	1	\$ (1,913,172)
Aa3	1	(12,753)

(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 \$114,972.

(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, 2013, a liability existed for accumulated annual leave calculated at the employees’ June 30, 2013 pay rate in the amount of \$135,413. 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

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

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, 2013, a liability existed for accumulated and accrued sick leave calculated at the employees’ June 30, 2013 pay rate in the amount of \$160,110.

	2013	2012	Percentage change
Total compensated absences	\$ 295,523	\$ 270,438	9.28%

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

(8) Operating Leases

The SDRS has entered into an agreement to lease office space effective September 2012 and has a term of ten years. A schedule of minimum office rental payments as of June 30, 2013, is as follows for the fiscal year ending June 30:

2014	\$	104,471
2015		104,471
2016		104,471
2017		104,471
2018		104,471
2019		104,471
2020		104,471
2021		104,471
2022		104,471
Total remaining minimum payments	\$	940,239

(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 \$209,543,260 net position restricted for plan benefits at June 30, 2013, \$129,643,753 was held in trust for employees of the State, while the remaining \$79,899,507 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$801,756 is

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2013

included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2013.

(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 \$31,668,746 net position restricted for plan benefits at June 30, 2013, \$18,067,484 was held in trust for employees of the State, while the remaining \$13,601,262 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, 2013, SDRS had uncalled capital commitments to private equity limited partnerships totaling approximately \$620,736,309 and to real estate limited partnerships totaling approximately \$300,455,932. 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 claw-back 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 working on this. The pending legal action does not represent an immediate negative contingency.

Required Supplementary Information
June 30, 2013

South Dakota Retirement System

SOUTH DAKOTA RETIREMENT SYSTEM

Required Supplementary Information

June 30, 2013

Schedule of Funding Progress

Actuarial valuation date	(a)	(b)	Unfunded actuarial liability (UAAL) (b-a)	Funded ratio (a/b)	(c)	UAAL as a percentage of covered payroll ((b-a)/c)
	Actuarial value of assets	Actuarial accrued liability – entry age (AAL)			Covered payroll	
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
6/30/2013	8,803.7	8,803.7	—	100.0	1,519.7	—

Schedule of Employer Contributions
Last Six Years

Year ended June 30:	Annual required contributions	Percentage contributed
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
2013	100,376,481	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, 2013	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 *	
Remaining amortization period	0 years	based on service, with average of 4.8%	3.75% to 5.83%
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	Cost of living adjustments * Includes inflation at 3.25%	2.70%

Other Supplementary Information
June 30, 2013

South Dakota Retirement System

SOUTH DAKOTA RETIREMENT SYSTEM

Other Supplementary Information

June 30, 2013

Schedule of Administrative Expenses

Year Ended June 30, 2013

Personal services:	
Salary and per diem	\$ 1,528,499
Employee benefits	<u>455,428</u>
Total personal services	<u>1,983,927</u>
Operating expenses:	
Travel	<u>59,485</u>
Contractual services:	
Audit	117,320
Finance	13,108
Valuations	77,730
Consulting	224,888
Studies	19,367
Special studies	82,673
Legal	11,610
Communications	4,290
Medical	15,040
Operations	<u>644,116</u>
Total contractual services	<u>1,210,142</u>
Supplies and materials	320,541
Capital assets	<u>14,622</u>
Total operating expenses	<u>1,604,790</u>
Total administrative expenses	<u><u>\$ 3,588,717</u></u>

SOUTH DAKOTA RETIREMENT SYSTEM

Other Supplementary Information

June 30, 2013

Schedule of Investment Activity Expenses

Year Ended June 30, 2013

Investment managers	
State of South Dakota Investment Council	\$ 5,713,364
Pinebridge	179,652
Apollo Real Estate Advisors LP	357,347
Blackstone Distressed Securities and credit liquidity	(21,577)
Blackstone Private Equity	418,641
Blackstone Real Estate Partners	6,271,824
Brandes Investment Partners	388,187
Capital International	1,277,005
Cargill North American Real Estate Partners	739,869
Carlyle	604,908
CINVIN	2,731,550
Crossroads Investment Advisors LP	161,185
CVC	765,250
CVI	1,818,082
Cypress Merchant Banking Partners LP	62,096
Dimensional Fund Advisors, Inc.	204,949
Doughty Hanson & Co. European Real Estate	725,267
Doughty Hanson & Co. Private Equity IV	898,904
Elevation Partners	185,367
GE Asset Management China	1,130,174
GE Asset Management Commodities	259,941
KKR Associates	160,687
Lonestar Real Estate	1,681,012
Oaktree Loan Fund 2x	59,031
PIMCO Distressed Mtg Fund II	919,479
Riverstone	1,510,027
Rockpoint RE IV	2,113,018
Sanders All Asset Value	225,766
Sanders Capital	204,192
Starwood RE IX	1,052,645
Silver Lake Partners LP	1,370,643
TCW	1,497,335
	<hr/>
Total investment activity expenses	<u>\$ 35,665,820</u>



Independent Auditor's 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*

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System (SDRS), as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated November 07, 2013.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

A handwritten signature in black ink that reads "Eide Sully LLP". The signature is written in a cursive, flowing style.

Boise, Idaho
November 07, 2013

Financial Statements
June 30, 2013

**South Dakota Retirement System
Supplemental Retirement Plan**



Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System Supplemental Retirement Plan (the Plan), which comprise the statement of plan net position as of June 30, 2013, and the related statement of changes in plan net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of plan net position of the South Dakota Retirement System Supplemental Retirement Plan, as of June 30, 2013, and the respective statement of changes in plan net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 33-35 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 07, 2013, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Plan's internal control over financial reporting and compliance.



November 07, 2013
Boise, Idaho

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2013

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, 2013. This section is intended to supplement the SRP financial statements.

Financial Highlights

- The net position available for plan benefits of the SRP increased by \$31.8 million during fiscal year 2013. This increase was primarily attributable to investment gains during the year and contributions outweighing distributions to participants.
- The SRP paid \$7.7 million to benefit recipients in fiscal year 2013 compared to \$6.3 million in 2012. The SRP received \$17.1 million in contributions in fiscal year 2013 compared to \$15.5 million in 2012.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of plan net position as of June 30, 2013, and the statement of changes in plan net position 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, 2013

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

Summary of Plan Net Position

June 30, 2013 and 2012

	2013	2012
Assets:		
Investments, at fair value	\$ 208,857,131	\$ 177,094,500
Cash	184,365	172,592
Revenue sharing	164,596	125,150
Accrued interest	4,021	5,629
Contributions receivable	357,000	342,286
Total assets	209,567,113	177,740,157
Liabilities:		
Accounts payable	23,853	38,380
Net position held in trust for plan benefits	\$ 209,543,260	\$ 177,701,777

Change in Plan Net Position

Additions to the net position include contributions and net investment income. Deductions from net position are primarily benefit payments. During 2013, SRP paid \$7.7 million to benefit recipients, or 22.16% more than 2012.

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

	2013	2012	Change
Additions:			
Contributions-employee	\$ 17,181,701	\$ 15,549,771	10.49%
Investment income	22,763,597	2,999,248	658.98%
Other income	39,446	125,150	-68.48%
Total additions	39,984,744	18,674,169	114.12%
Deductions:			
Distributions to participants	7,749,678	6,344,047	22.16%
Administrative expenses	393,583	435,959	-9.72%
Total deductions	8,143,261	6,780,006	20.11%
Net change in net position	31,841,483	11,894,163	167.71%
Net position held in trust for plan benefits:			
Beginning of year	177,701,777	165,807,614	7.17%
End of year	\$ 209,543,260	\$ 177,701,777	

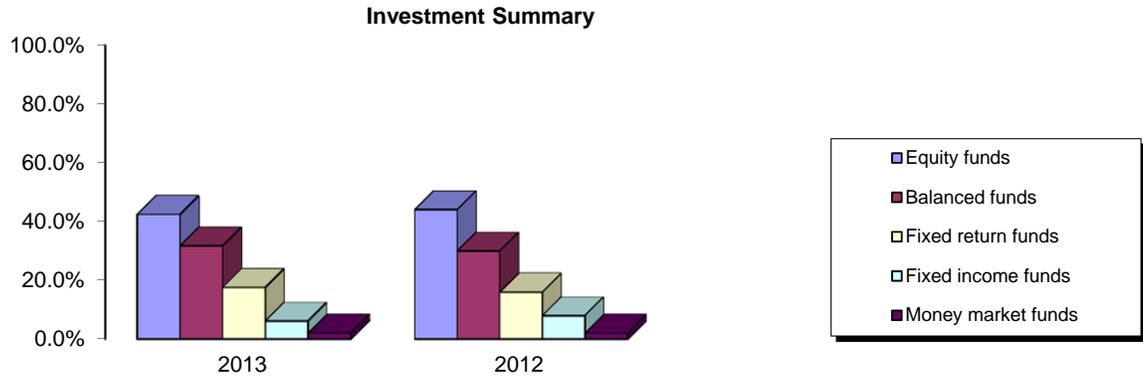
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2013

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. You may link to the SRP Web site from the SDRS Web site at www.state.sd.us/sdrs/.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Statement of Plan Net Position

June 30, 2013

Assets:

Investments, at fair value:

Equity funds	\$ 88,678,185
Balanced funds	66,333,832
Fixed return funds	36,656,941
Fixed income funds	12,870,480
Money market funds	<u>4,317,693</u>

Total investments, at fair value 208,857,131

Cash 184,365

Revenue sharing 164,596

Accrued interest 4,021

Contributions receivable 357,000

Total assets 209,567,113

Liabilities:

Accounts payable 23,853

Net position held in trust for plan benefits \$ 209,543,260

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Statement of Changes in Plan Net Position

Year Ended June 30, 2013

	<u>2013</u>
Additions:	
Contributions-employee	\$ 17,181,701
Investment income	22,763,597
Other income	<u>39,446</u>
Total additions	<u>39,984,744</u>
Deductions:	
Distributions to participants	7,749,678
Administrative expenses	<u>393,583</u>
Total deductions	<u>8,143,261</u>
Net increase in plan net position	31,841,483
Net position held in trust for plan benefits	
Beginning of year	<u>177,701,777</u>
End of year	<u>\$ 209,543,260</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2013

(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 consists of 12,480 participants and 294 employers. 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 \$17,500 for calendar year 2013 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.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2013

(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 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 position.

(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 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, 2013, 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 United States 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, 2013

Changes in plan net position for the year ended June 30, 2013 by investment alternatives available to participants were as follows:

	<u>Beginning balance</u>	<u>Contributions</u>	<u>Investment income</u>	<u>Additions/ Deductions</u>	<u>Ending balance</u>	<u>Market value as a percentage of plan assets</u>
Money market:						
Vanguard Prime Reserve	\$ 3,881,785	\$ 425,300	\$ 929	\$ 9,679	\$ 4,317,693	2.1%
Balanced:						
Vanguard Target Ret Inc Fund	6,234,785	116,282	278,407	(1,178,439)	5,451,035	2.6
Vanguard Target Ret 2010	6,567,964	210,207	461,011	(580,575)	6,658,607	3.2
Vanguard Target Ret 2015	12,084,896	1,298,308	1,177,452	(170,103)	14,390,553	6.9
Vanguard Target Ret 2020	12,090,521	1,889,205	1,427,815	(475,759)	14,931,782	7.1
Vanguard Target Ret 2025	7,067,484	1,172,125	961,045	(54,757)	9,145,897	4.4
Vanguard Target Ret 2030	5,152,783	835,338	777,562	(311,835)	6,453,848	3.1
Vanguard Target Ret 2035	2,269,389	624,806	404,524	15,929	3,314,648	1.6
Vanguard Target Ret 2040	1,336,725	535,249	253,323	(55,869)	2,069,428	1.0
Vanguard Target Ret 2045	1,068,638	478,070	207,001	(12,779)	1,740,930	0.8
Vanguard Target Ret 2050	1,278,945	537,966	242,807	(33,930)	2,025,788	1.0
Vanguard Target Ret 2055	12,268	87,771	8,157	32,111	140,307	0.1
Vanguard Target Ret 2055	—	500	(438)	10,949	11,011	—
	<u>55,164,398</u>	<u>7,785,827</u>	<u>6,198,666</u>	<u>(2,815,057)</u>	<u>66,333,834</u>	<u>31.8</u>
Fixed return:						
Prudential	31,082,883	3,492,613	1,012,975	1,068,470	36,656,941	17.5
Fixed income:						
Vanguard Bond Market	13,613,503	748,091	(99,013)	(1,392,101)	12,870,480	6.2
Equity:						
Mutual shares	12,135,017	499,753	2,502,149	(1,279,092)	13,857,827	6.61
Windsor II Adm	18,226,011	766,816	4,116,017	(1,143,667)	21,965,177	10.48
Vanguard Inst Index	18,832,158	936,957	3,938,777	(287,762)	23,420,130	11.18
Vanguard Tot Intl Stock Ind	6,727,355	491,935	919,945	(540,261)	7,598,974	3.63
Alliance Bern with App St	361,835	29,415	33,408	(424,658)	—	—
Dodge & Cox Int Stock Fund	1,297,223	208,677	291,256	(176,488)	1,620,668	0.77
Dodge & Cox Global Stock Fund	—	19,787	50,831	431,488	502,106	0.24
Legg Mason Opp Fund	509,172	42,530	82,104	(633,806)	—	—
Legg Mason Value Trust	580,659	28,469	51,178	(660,306)	—	—
Growth fund of America	3,723,252	486,535	882,725	(111,133)	4,981,379	2.38
Capital World Grth & Inc	2,206,940	283,979	431,317	(212,629)	2,709,607	1.29
Vanguard Small Cap Index	—	72,631	7,124	182,135	261,890	0.12
Vanguard Ext Mkt Idx Fund	7,012,349	499,419	1,829,761	(475,793)	8,865,736	4.23
Vanguard Ext Mkt Idx Fund	—	62,877	7,243	462,567	532,687	0.25
Vanguard Strategic Equity	1,739,960	283,680	502,184	(163,823)	2,362,001	1.13
	<u>73,351,931</u>	<u>4,713,460</u>	<u>15,646,019</u>	<u>(5,033,228)</u>	<u>88,678,182</u>	<u>42.3</u>
Total investments	177,094,500	17,165,291	22,759,576	(8,162,237)	208,857,130	99.7
Other plan net assets	607,277	16,412	43,468	18,973	686,130	0.3
Total plan net assets	<u>\$ 177,701,777</u>	<u>\$ 17,181,703</u>	<u>\$ 22,803,044</u>	<u>\$ (8,143,264)</u>	<u>\$ 209,543,260</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, 2013

(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.



**Independent Auditor's 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***

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System (SDRS), as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated November 07, 2013.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDRS's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The

results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

A handwritten signature in black ink that reads "Eide Sully LLP". The signature is written in a cursive, flowing style.

Boise, Idaho
November 07, 2013

Financial Statements
June 30, 2013

**South Dakota Retirement System
Special Pay Plan**



Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System Special Pay Plan (SPP or the Plan), which comprise the statement of plan net position as of June 30, 2013, and the related statement of changes in plan net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of plan net position of the South Dakota Retirement System Special Pay Plan, as of June 30, 2013, and the respective statement of changes in plan net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 46-48 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 07, 2013, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Plan's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Eric Sully LLP". The signature is written in a cursive, flowing style.

November 07, 2013
Boise, Idaho

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2013

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, 2013. This section is intended to supplement the SPP financial statements and notes.

Financial Highlights

- The net position available for plan benefits of the SPP increased by \$3.9 million during fiscal year 2013. This increase was primarily attributable to additional participant contributions and investment gains.
- The SPP paid \$4.5 million to benefit recipients in fiscal year 2013 compared to \$4.3 million in 2012. The SPP received \$7.2 million in contributions in fiscal year 2013 compared to \$7.8 million in 2012.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of plan net position as of June 30, 2013, and the statement of changes in plan net position 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, 2013

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

Summary of Plan Net Position

June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Assets:		
Investments, at fair value	\$ 31,353,528	\$ 27,268,995
Cash	82,733	147,836
Revenue sharing	4,859	4,622
Accrued interest	199	287
Contributions receivable	<u>238,732</u>	<u>349,660</u>
Total assets	31,680,051	27,771,400
Liabilities:		
Accounts payable	<u>11,305</u>	<u>9,360</u>
Net position held in trust for plan benefits	<u><u>\$ 31,668,746</u></u>	<u><u>\$ 27,762,040</u></u>

Changes in Plan Net Position

Additions to the net position mainly were due to contributions during the year. Deductions from net position are primarily benefit payments and administrative expenses. During 2013, SPP paid \$4.5 million to benefit recipients, or 5.8% more than 2012.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

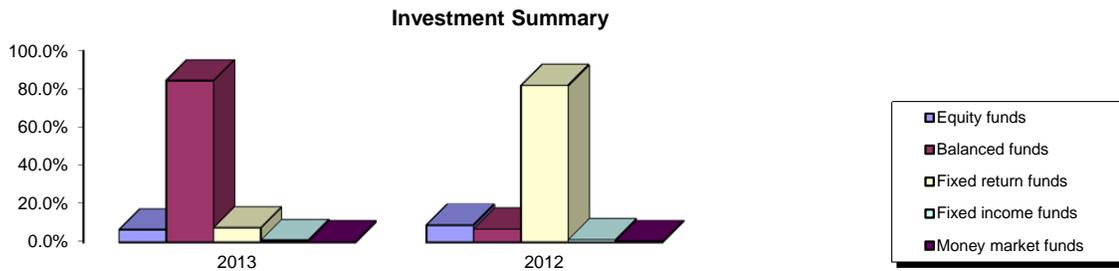
June 30, 2013

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

	2013	2012	Percentage Change
Additions:			
Contributions-employee	\$ 7,232,301	\$ 7,835,504	-7.70%
Investment income	1,225,501	616,002	98.94%
Other income	29,442	35,582	-17.26%
Total additions	8,487,244	8,487,088	0.00%
Deductions:			
Distributions to participants	4,504,932	4,257,261	5.82%
Administrative expenses	75,606	44,509	69.87%
Total deductions	4,580,538	4,301,770	6.48%
Net change in plan net position	3,906,706	4,185,318	-6.66%
Net position held in trust for plan benefits:			
Beginning of year	27,762,040	23,576,722	17.75%
End of year	<u>\$ 31,668,746</u>	<u>\$ 27,762,040</u>	14.07%

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 Position

June 30, 2013

Assets:

Investments, at fair value:

Equity funds	\$ 2,083,287
Balanced funds	26,445,564
Fixed return funds	2,387,778
Fixed income funds	329,921
Money market funds	<u>106,978</u>

Total investments, at fair value 31,353,528

Cash 82,733

Revenue sharing 4,859

Accrued interest 199

Contributions receivable 238,732

Total assets 31,680,051

Liabilities:

Accounts payable 11,305

Net position held in trust for plan benefits \$ 31,668,746

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Statement of Changes in Plan Net Position

Year Ended June 30, 2013

Additions:

Contributions-employee	\$ 7,232,301
Investment income	1,225,501
Revenue sharing	237
Other income	<u>29,205</u>

Total additions 8,487,244

Deductions:

Distributions to participants	4,504,932
Administrative expenses	<u>75,606</u>

Total deductions 4,580,538

Net change in net position 3,906,706

Net position held in trust for plan benefits:

Beginning of year 27,762,040

End of year \$ 31,668,746

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2013

(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 consists of 2,051 participants and 115 employers. 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 \$51,000 for calendar year 2013.

(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, 2013

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 position.

(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 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, 2013, 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 United States 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, 2013

Changes in plan net position for the year ended June 30, 2013 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income (loss)	Additions/ Deductions	Ending balance	Market value as a percentage of plan assets
Money market:						
Vanguard prime reserve	\$ 146,571	\$ -	\$ 31	\$ (39,624)	\$ 106,978	0.3%
Balanced:						
Vanguard Target Ret Inc	211,145	-	9,493	35,538	256,176	0.8
Vanguard Target Ret 2010	630,484	-	46,502	26,478	703,464	2.2
Vanguard Target Ret 2015	886,685	-	86,989	9,681	983,355	3.1
Vanguard Target Ret 2020	7,692	-	2,740	83,731	94,163	0.3
Vanguard Target Ret 2025	-	-	2,943	36,841	39,784	0.1
Vanguard Target Ret 2030	3,624	-	580	1,401	5,605	-
Vanguard Target Ret 2035	18,997	-	1,135	(20,132)	-	-
Vanguard Target Ret 2050	635	-	107	(2)	740	-
Vanguard Target Ret 2055	912	-	90	(1,002)	-	-
	<u>1,760,174</u>	<u>-</u>	<u>150,579</u>	<u>172,534</u>	<u>2,083,287</u>	<u>6.5</u>
Fixed return:						
Prudential	23,300,706	7,302,126	689,980	(4,847,248)	26,445,564	83.5
Fixed income:						
Vanguard Bond Market	328,988	-	(2,820)	3,753	329,921	1.0
Equity:						
Dodge & Cox Int Stock	70,703	-	15,866	(3,405)	83,164	0.3
Dodge & Cox Global Stock	-	-	649	7,820	8,469	-
Capital World Grth & Inc	98,950	-	19,758	45,365	164,073	0.5
Vanguard Ext Mkt Ind	249,292	-	67,006	19,008	335,306	1.1
Legg Mason Opp Trust	6,493	-	1,121	(7,614)	-	-
Legg Mason Cap Mgt	668	-	569	(1,237)	-	-
Growth Fund of America	218,221	52,819	51,511	5,841	328,392	1.0
Alliance Bern with App St	4,166	-	365	(4,531)	-	-
Mutual shares	297,282	52,819	61,700	(23,570)	388,231	1.2
Windsor II Adm	248,394	-	58,934	36,794	344,122	1.1
Vanguard Small cap Indx	-	-	1,808	34,976	36,784	0.1
Vanguard Inst Index	281,980	-	59,888	24,398	366,266	1.2
Vanguard Total Int'l Stock ind	183,068	-	24,541	504	208,113	0.7
Vanguard Wisly Inc Adml	-	-	435	13,629	14,064	-
Vanguard Strategic Eq	73,339	-	23,381	14,074	110,794	0.3
	<u>1,732,556</u>	<u>105,638</u>	<u>387,532</u>	<u>162,052</u>	<u>2,387,778</u>	<u>7.5</u>
Total investments	27,268,995	7,407,764	1,225,302	(4,548,533)	31,353,528	99.0
Other plan net assets	493,045	(175,463)	436	(2,800)	315,218	1.0
Total plan net position	<u>\$ 27,762,040</u>	<u>\$ 7,232,301</u>	<u>\$ 1,225,738</u>	<u>\$ (4,551,333)</u>	<u>\$ 31,668,746</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, 2013

(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.

Other Supplementary Information
June 30, 2013

South Dakota Retirement System Special Pay Plan

Independent Auditor's 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*

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System (SDRS), as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated November 07, 2013.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDRS's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the

determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

A handwritten signature in black ink that reads "Erik Sully LLP". The signature is written in a cursive, flowing style.

Boise, Idaho
November 07, 2013