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STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT

OF

INDIANA STATE TEACHERS' RETIREMENT FUND

July 1, 2005 to June 30, 2006

FILED
12/28/2006

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AGENCY OFFICIALS

Office	Official	Term
Executive Director	Cristy Wheeler	11-01-05 to 06-30-07
Interim Executive Director	Robert D. Newland (Interim)	07-01-05 to 10-31-05
President of the Board	Don Bennett	08-05-05 to 08-31-07
	Vacant	07-01-05 to 08-04-05

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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE INDIANA STATE TEACHERS' RETIREMENT FUND

We have audited the accompanying basic financial statements of the Indiana State Teachers' Retirement Fund as of and for the year ended June 30, 2006. These basic financial statements are the responsibility of the Indiana State Teachers' Retirement Funds' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the fiduciary funds of the Indiana State Teachers' Retirement Fund as of June 30, 2006, and the changes in the plan net assets of the fiduciary fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, Schedule of Funding Progress, Schedule of Employer Contributions, and the Notes to Required Supplemental Schedules are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

September 14, 2006

MANAGEMENT'S DISCUSSION & ANALYSIS

This section presents management's discussion and analysis of the Indiana State Teachers' Retirement Fund (TRF) financial statements for the year ended June 30, 2006.
The MD&A is presented as a narrative overview and analysis. The MD&A should also be read in conjunction with the financial statements, the notes to the financial statements, and the supplementary information.

FINANCIAL HIGHLIGHTS

- The net assets of TRF were $7.8 billion as of June 30, 2006.

- The net assets of TRF increased by $611 million, or 8.51% from the prior year. The increase was primarily due to positive total returns on Fund investments, resulting in higher investment values.

- The TRF rate of return on investments for the year was positive 8.30% on a market value basis, compared to last year's positive 8.64%, as stocks provided returns that were somewhat higher than historically expected returns and bonds provided a flat return.

- As of June 30, 2005, the date of the most recent actuarial valuation, the Pre-96 plan (Closed Plan) is actuarially funded at 40.7%, which is less than the 42.6% funded level as of June 30, 2004. The 96 plan (New Plan) is actuarially funded at 63.1%, which is more than the 63.0% funded level as of June 30, 2004. The closed plan includes all members who were hired before July 1, 1995 and have been continuously employed by the same board of education as they were on that date. The new plan includes all other members.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to TRF's financial statements. The financial section of the TRF Annual Financial Report is comprised of three components: 1) TRF's financial statements, 2) notes to the financial statements, 3) required supplementary information. The information available in each of these sections is briefly summarized as follows:

1) Financial Statements

The statement of plan assets presents information on TRF's assets and liabilities and the resulting net assets held in trust for pension benefits. This statement reflects TRF's investments, at fair value, along with cash and short-term investments, receivables and other assets and liabilities. This statement indicates the net assets available to pay future pension benefits and gives a snapshot at a particular point in time.

The statement of changes in plan net assets presents information showing how TRF's net assets held in trust for pension benefits changed during the years ended June 30, 2006. It reflects contributions by members and employers along with deductions for retirement benefits, refunds, and administrative expenses. Investment income and losses during the period are also presented showing income from investing and securities lending activities.

2) Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in TRF's financial statements.

3) Required Supplementary Information

The required supplementary information consists of a Schedule of Funding Progress and a Schedule of Employer Contributions and related notes concerning the funding status of TRF.

FINANCIAL ANALYSIS

Total assets of TRF were $10.4 billion as of June 30, 2006 compared with $9.5 billion as of June 30, 2005. The increase in total assets was primarily due to an increase in the market value of investments and interest and dividends received from the Fund's investments during the fiscal year ended June 30, 2006.

Total liabilities of TRF were $2.6 billion as of June 30, 2006 compared with $2.3 billion as of June 30, 2005. The increase in total liabilities was due to a increase in investments purchased at year end that did not settle until the next fiscal year and a increase in Securities Lending Collateral...

A summary of TRF's Net Assets is presented below:

NET ASSETS
($ in thousands)

	June 30, 2006	June 30, 2005	% Change
Assets			
Cash and Cash Equivalents	$ 1,037,220	$ 981,878	5.64%
Securities Lending Collateral	1,317,608	1,117,488	17.91%
Receivables	797,245	702,949	13.41%
Investments	7,256,555	6,680,003	8.63%
Other Assets	31	55	-43.64%
Total Assets	10,408,659	9,482,373	9.77%
Liabilities			
Securities Lending Collateral	1,317,608	1,117,488	17.91%
Other Current Liabilities	1,299,504	1,185,047	9.66%
Long-Term Liabilities	123	122	0.82%
Total Liabilities	2,617,235	2,302,657	13.66%
Total Net Assets	$ 7,791,424	$ 7,179,716	8.52%

As the above table shows, plan net assets were $7.8 billion as of June 30, 2006 a increase of $611 million, or 8.51%, compared to the prior year, driven by the increase in market value of investments during the year.

The following table presents TRF's investment allocation compared to TRF's target investment allocation and the prior year allocation.

	June 30,2006	June 30, 2006	June 30,2005
	Actual	Target	Actual
Fixed Income	23.2%	25.0%	21.5%
Large Cap Equity	31.0%	29.0%	42.8%
Mid Cap Equity	4.8%	5.0%	4.8%
Small Cap Equity	9.8%	8.0%	9.6%
International Equity	20.3%	18.0%	19.6%
Hedge Funds	4.7%	5.0%	0.0%
Private Equity	2.8%	5.0%	1.7%
Real Estate	3.4%	5.0%	0.0%
Total	100%	100%	100%

The remaining Private Equity target allocation of 2.2% will be drawn from the Large Cap Equity investments as suitable investment in this asset class are selected.

A summary of the changes in net assets during the years ended June 30, 2006 and 2005 is presented below:

CHANGES IN NET ASSETS
($ in thousands)

	FY Ended June 30, 2006	FY Ended June 30, 2005	% Change
Additions			
Member Contributions	$ 130,496	$ 117,897	10.7%
Employer Contributions	671,340	454,779	47.6%
Contributions to Pension Stabilization Fund:			
From State Lottery	30,000	30,000	0.0%
Net Investments (Loss) Income	572,290	560,890	2.0%
Transfers from Public Employees' Fund	5,092	3,973	28.2%
Other	1,014	864	17.4%
Total Additions	1,410,232	1,168,403	20.7%
Deductions			
Benefits	780,706	723,643	7.9%
Refunds	9,562	9,237	3.5%
Transfers to Public Employees' Fund	1,484	2,982	(50.2%)
Capital Projects	653	594	9.9%
Administrative Expenses	6,099	6,431	(5.2%)
Claims on Outdated Benefit Checks	20	91	(78.0%)
Total Deductions	798,524	742,978	7.5%
Increase (Decrease) in Net Assets	$ 611,708	$ 425,425	43.8%

ADDITIONS

Additions needed to fund benefits are accumulated through contributions from members and employers and returns on invested funds. Member contributions for the year ended June 30, 2006 totaled $130.5 million. This represents an increase of $12.6 million or 10.7% compared to the prior year. Employer contributions were $671.3 million, an increase of $216.6 million or 47.6%. The increase was due to larger appropriations made by the State of Indiana and new employees that the employers were making contributions on. In FY 2005 the State of Indiana under appropriated the funding of the pension payout by $168.6 million. This shortage was covered by the Pension Stablization Fund.

TRF recognized net investment income of $572.3 million for the year ended June 30, 2006 compared to net investment income of $560.9 million in the prior year. The higher investment income was primarily due to the fact that TRF had more investments to earn on. TRF's domestic large cap equity investments returned a gain of 8.70% for the fiscal year. This compares to a gain of 8.63% for the S&P 500 index during the year. Domestic Mid Cap equities had a gain of 11.68% as compared to a gain of 12.97% for the S & P 400 Mid Cap index during the fiscal year. Domestic Small Cap equities had a gain of 10.55%, as compared to a gain of 14.58% for the Russell 2000 index during the fiscal year. International equities had a gain of 28.16%, as compared to a gain of 26.56% for the EAFE index during the fiscal year. Investment gains on equities were supplemented by TRF's fixed income portfolio, which achieved a total return of 1.0% for the year ended June 30, 2006. This compares to a loss of -.81% for the Lehman's Brothers Aggregate Index. The total rate of return on TRF's investments was a positive 8.30% compared to a positive 8.64% in the prior year.

DEDUCTIONS

The deductions from TRF's net assets held in trust for pension benefits include primarily retirement, disability, and survivor benefits, refunds of contributions to former members, and administrative expenses. For the year ended June 30, 2006, benefits amounted to $780.7 million, an increase of $57.1 million or 7.9% from the prior year. The increase in benefits was due to an increase both in the number of retirees and the average benefit paid. Refunds to former members were $9.6 million, which represents a increase of 3.5% over the prior year.

Administrative expenses were $6.1 million, an decrease of $.3 million compared to the prior year. This decrease is due largely to a slight reduction in our staff and job vacancies at the Fund. Capital projects expenses were $653 thousand in the fiscal year ending June 30, 2006 compared to $594 thousand in the fiscal year ending June 30, 2005.

HISTORICAL TRENDS

A pension fund is well funded when it has enough money in reserve to meet all expected future obligations to participants. The funded ratios of the defined benefit pension plans administered by TRF as of the latest actual valuations were as follows:

	July 1, 2005	July 1, 2004
Pre –96 Plan (Closed Plan)	40.7%	42.6%
96 Plan (New Plan)	63.1%	63.0%

An analysis of the funding progress, employer contributions, and a discussion of actuarial assumptions and methods is set forth in the required supplementary information section of the financial statements.

INDIANA STATE TEACHERS' RETIREMENT FUND
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2006

Assets	
Cash and Cash Equivalents	$ 1,027,346,126
Securities Lending Collateral	1,317,607,781
Receivables:	
Employer Contributions	22,997,354
Due From PERF	825,869
Member Contributions	35,838,987
Other	500,000
Securities Sold	705,948,710
Investments Interest	31,134,389
Total Receivables	797,245,309
Investments:	
Debt securities	3,361,817,347
Equity securities	3,591,564,913
Other	313,047,045.00
Total Investments	7,266,429,305
Furniture and Equipment (Original Cost of $280,175 Net of $249,563 Accumulated Depreciation)	30,612
Total Assets	10,408,659,133
Liabilities	
Accrued Salaries Payable (See Note I)	97,375
Accrued Liability for Compensated Absences - Current	153,164
Accounts Payable	4,960,385
Securities Lending Collateral	1,317,607,781
Payables for Securities Purchased	1,294,293,153
Total Current Liabilities	2,617,111,858
Accrued Liability for Compensated Absences - Long-Term	123,444
Total Liabilities	2,617,235,302
Net Assets Held in Trust for Pension Benefits (See Schedule of Funding Progress, page 23)	$ 7,791,423,831

The accompanying notes are an integral part of the financial statements.

INDIANA STATE TEACHERS' RETIREMENT FUND
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Year Ended June 30, 2006

Additions:	
Contributions:	
Member Contributions	$ 130,496,002
Employer Contributions	671,340,085
Employer Contributions - Pension Stabilization	30,000,000
Total Contributions	831,836,087
Investment Income:	
Net Appreciation (Depreciation) in Fair Value	357,187,368
Interest Income	165,264,619
Dividend Income	64,373,704
Securities Lending Income	58,937,319
Less Investment Expense:	
Securities Lending Fees	(54,864,087)
Investment Fees	(18,609,224)
Net Investment Income	572,289,699
Other Additions:	
Transfers From Other Retirement Funds	5,091,848
Total Additions	1,409,217,634
Deductions:	
Annuity and Disability Benefits	779,693,539
Voluntary and Death Withdrawals	9,562,221
Claims on Outdated Benefit Checks	20,218
Administrative Expenses	6,725,760
Depreciation Expenses	24,211
Transfers to Other Retirement Funds	1,483,728
Total Deductions	797,509,677
Change in Net Assets Held in Trust for Pension Benefits	611,707,957
Net Assets Beginning of Year	7,179,715,874
Net Assets End of Year	$ 7,791,423,831

The accompanying notes are an integral part of the financial statements.

Note I. Summary of Significant Accounting Policies

A. Reporting Entity - The financial statements presented in this report represent only those funds that the Indiana State Teachers' Retirement Fund (TRF) has responsibility for and are not intended to present the financial position or results of operations of the State of Indiana or all of the retirement and benefit plans administered by the State. Effective July 1, 2001, TRF became an independent corporate and politic (Public Law 119-2000). TRF is not a department or agency of the State but is an independent body corporate and politic exercising essential government functions. The members of the Board of Trustees of the Indiana State Teachers' Retirement Fund are appointed by the Governor of the State of Indiana and a financial benefit/burden relationship exists between the TRF and the State of Indiana. For these reasons, TRF is considered a component unit of the State of Indiana for financial statement reporting purposes.

B. Basis of Presentation - The financial statements of the Indiana State Teachers' Retirement Fund have been prepared using fund accounting in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standards setting body for established governmental accounting and financial reporting principles. GASB Statement 25 has been implemented for the defined benefit pension plans.

C. Fund Accounting - Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain governmental functions or activities. The Indiana State Teachers' Retirement Fund is a pension trust fund. For a description of this fund, see Note 2.

D. Basis of Accounting - The records of this Fund are maintained on a cash basis. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

E. Budgets - A budget for the administrative expenses is prepared and approved by the Board of Trustees.

F. Deposits and Investments - The Treasurer of State acts as the official custodian of the cash and securities, except for securities held by banks or trust companies under custodial agreements with the Board of Trustees. The Board of Trustees may contract with investment counsel, trust companies, or banks to assist the Board in its investment program. The Board is required to diversify investments in accordance with prudent investment standards. The Board has issued investment guidelines for its investment program which authorized investments of: U.S. Treasury and Agency obligations, U.S. Government securities, common stock, international equity, corporate bonds, notes and debentures, repurchase agreements secured by U.S. Treasury obligations, mortgage securities, commercial paper, and banker's acceptances. See Note 4 for more details.

   During the year ended June 30, 2005, the Fund adopted Governmental Accounting Standards Board Statement No. 40, Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3) ("GASB 40"). The adoption of GASB 40 required the Fund to include a presentation of Deposit and Investment Risk Disclosures. The adoption of GASB 40 did not have an impact on the Fund's financial statements.

G. Method Used to Value Investments - GASB 25 requires that investments of defined benefit plans be reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value.

H. Other Investments - Other investments includes investment in shares of limited liability partnerships, real estate securities, options and swaps. Also included is property owned for investments purposes.

I. Equipment - Equipment with a cost of $20,000 or more is capitalized at the original cost. Depreciation is computed on the straight-line method over the estimated five-year life of all assets.

J. Contributions Receivable - The contributions receivable was determined by using actual contributions received in July for days paid in the quarter ended June 30, 2006.

K. Inventories - Inventories of consumable supplies are not recognized on the balance sheet as they are considered immaterial. Purchases of consumable supplies are recognized as expenditures at the time of purchase.

L. Reserves and Designations

The following are the legally required reserves and other designations of fund equity:

1. Member Reserve: The member's reserve represents member contributions made by or on the behalf of the employees plus any interest distributions, less amounts refunded or transferred to the Benefits in Force reserve for retirement disability, or other benefit. For Indiana State Teachers' Retirement Fund this reserve is the employees' annuity savings account.

2. Benefits in Force: This reserve represents the actuarial present value of future benefits for all members who are presently retired or disabled. The accumulated contributions of the members are transferred to the reserve upon retirement or disability. The remainder of the actuarial pension cost is transferred from the employer reserve to fund the benefits. This reserve contains $1,537,061,366 for the Pension Stabilization Fund. The Pension Stabilization Fund was established by IC 5-10.4-2-5. See Note 3 for further detail on the Pension Stabilization Fund. This reserve has an unfunded actuarial accrued liability.

3. Employer Reserves: This reserve consists of the accumulated employer contributions plus earnings distributions less transfers made to the Benefits in Force reserve of the actuarial pension cost. This reserve has an unfunded actuarial accrued liability.

4. Undistributed Investment Income Reserve: This reserve was credited with all investment earnings. Interest transfers have been made annually to the other reserves as allowed or required by statutes. The transfers are at rates established by the Board of Trustees.

5. Unreserved Fund Balance: This reserve represents the unfunded actuarial accrued liability for retired and non-retired participants, determined by the fund's actuary, as of the date of the last valuation.

   The following are the balances of the reserves and designations of fund equity:

Member Reserve	Employer Reserve	Benefits in Force	Undistributed Income	Unreserved Fund Balance
$ 3,231,260,527	$ 1,682,325,941	$ 2,605,819,308	$ 232,580,781	$ (9,199,593,968)

M. Payables and Liabilities - Payables and liabilities are not maintained throughout the year on the accounting records. They are calculated or estimated for financial statement reporting purposes and are posted to the general ledger at year end.

N. Compensated Absences – TRF's full-time employees are permitted to accumulate earned but unused vacation and sick pay benefits. Vacation leave accumulates at the rate of one day per month and sick leave at the rate of one day every two months plus an extra day every four months. Bonus vacation days are awarded upon completion of five, ten and twenty years of employment with the State of Indiana. Personal leave days are earned at the rate of one day every four months; any personal leave accumulated in excess of three days automatically becomes part of the sick leave balance. Upon separation from service, employees in good standing will be paid for a maximum of thirty unused vacation leave days.

   No liability is reported for unpaid accumulated sick leave. Vacation and personal leave and the salary-related payments that are expected to be liquidated are reported as Compensated Absences Liability.

Note II. Fund Description

The Indiana State Teachers' Retirement Fund is the administrator of a multiple-employer retirement fund established to provide pension benefits for persons who are engaged in teaching or in the supervision of teaching in the public schools of the state or persons who are employed by the fund. At June 30, 2006, the number of participating school unit employers was:

Public School Units	351
Higher Education Units	4
State of Indiana Agencies	30
Associations	2
Total	387

Membership in the Fund is required for all legally qualified and regularly employed teachers who serve in the public schools of Indiana, including the faculty at Vincennes University, and employees of Fund. Additionally, faculty members at Ball State University, Indiana State University, and University of Southern Indiana have the option of selecting membership in the Fund or the alternate University Plan. As of July 1, 2005, Indiana State Teachers' Retirement Fund membership consisted of:

Retirees and Beneficiaries	
Currently Receiving Benefits	38,512
Active Plan Members	73,923
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	5,243
Total	117,678
Covered Payroll (in thousands)	$ 3,734,329

The Indiana State Teachers' Retirement Fund provides retirement benefits, as well as death and disability benefits. Eligibility to retire occurs at age 50 with 15 or more years of service or at age 65 with 10 years of service. Annual retirement benefits, disability benefits, and death benefits are computed as follows:

Regular Retirement (No Reduction Factor For Age)

Eligibility - Age 65 with 10 years service or age 60 with at least 15 years of service or age 55 with age plus years of service equaling at least 85.

Mandatory Retirement Age - none.

Annual Amount - State pension equal to total years of service times 1.1% of final average salary; plus an annuity purchased by the member's accumulated contributions unless the member elects to withdraw the accumulated contributions in a lump sum.

Type of Final Average Salary - Average of highest 5 years.

Early Retirement (Age Reduction Factor Used)

Eligibility - Age 50 with 15 or more years service.

Annual Amount - State pension is computed as regular retirement benefit but reduced one-tenth of 1% for each month age at retirement is between 60 and 65 and five-twelfths of 1% for each month under age 60.

Deferred Retirement (Vested Benefit)

Eligibility - 10 years of service. Benefit commences at age 65, or at age 50 if member has 15 or more years of service.

Annual Amount - Computed as a regular retirement benefit with state pension based on service and final average salary at termination.

Regular Disability

Eligibility - 5 years of service.

Annual Amount - $125 per month plus $5 for each year of service credit over 5 years.

Disability Retirement (No Reduction Factor For Age)

Eligibility - 5 years of service and also qualify for Social Security Disability at time of termination.

Annual Amount - Computed as a regular retirement benefit with state pension based on service and final average salary at termination.

Duty Death Before Retirement

Eligibility – 15 years of service. Spouse to whom member had been married for 2 or more years is automatically eligible, or a dependent may be designated as beneficiary.

Annual Amount - Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Benefit Increases After Retirement: No automatic increases after retirement are provided. Unscheduled increases have been made from time to time.

Each member shall, as a condition of employment, contribute to the Fund 3% of his/her compensation. Effective July 1, 1986, each employing unit may elect to "pick up" the employee contribution. No part of the member contributions to the Fund picked up by the employer is includable in the gross income of the member. The "pick up" amount does count in the salaries used to determine the final average at retirement. Any member who leaves covered employment has the option to withdraw accumulated contributions and interest. In the event of a death of a member who has served less than 15 years or does not meet the surviving spouse requirements, their designated beneficiary or estate is entitled to a lump sum settlement of their contributions plus interest.

Indiana pension statutes stipulate that each member of the Fund shall have the opportunity to direct their annuity savings account into one of five current investment programs:

1. The Guaranteed Fund - Interest is credited at a rate annually determined by the Board of Trustees. Principal and interest are "guaranteed." Market risk is assumed by the Fund.

2. The Bond Fund - Contains high quality fixed-income instruments which provide interest/capital gain income. Market risk is assumed by the member.

3. S & P 500 Index Fund - Closely tracts the return on the S & P 500 Index by employing an indexing strategy that invest in the stocks of the S & P 500 Index companies. Market risk is assumed by the member.

4. Small Cap Equity Fund - Consist of stocks with a market capitalization of less than $1.5 billion. Market risk is assumed by the member.

5. International Equity Fund - Consists of securities of developed non-U.S. countries. Market risk is assumed by the member.

The Guaranteed Fund, Bond Fund, S & P 500 Index Fund, Small Cap Fund and International Fund are valued at market value. When a member retires, dies or suspends membership and withdraws from the fund, the amount credited to the member shall be valued at the market value of the member's investment plus accrued interest on investment less accrued investment expenses.

Members may only make a selection or re-allocation once per quarter. The changes will be in effect the first month of the quarter following the request for change. Members may request allocations to one or all of the approved funds, as long as those allocations are made in 10% increments of the total balance in the member's account at the time of allocation. The total must equal 100%.

Note III. Employer Contributions Required and Employer Contributions Made

The Indiana State Teachers' Retirement Fund is funded on a "pay as you go" basis for employees hired prior to July 1, 1995. State appropriations are made for the amount of estimated pension benefit payout for each fiscal year. If the actual pension benefit payout for the fiscal year exceeds amount appropriated, the difference is paid from the Pension Stabilization Fund. For employees hired on or after July 1, 1995, the individual employer will make annual contributions. These contributions are actuarially determined.

Based on the actuarial valuation at June 30, 2005, employer actuarially required contributions were $742,882,002 of normal cost, with no amortization of the unfunded actuarial accrued liability and zero provision for expenses. Contributions made by employers for the year ended June 30, 2006, were $701,340,085, which was 18.0% of covered payroll.

Note IV. Deposit and Investment Risk Disclosures

The Fund's Investment policy states the following:

"The Fund was established to provide retirement, disability, death, and termination benefits to present and former members of the Fund and their beneficiaries who meet the statutory requirements for such benefits. The Fund must be operated for the exclusive benefit of members and their beneficiaries, pursuant to Indiana law and the Internal Revenue Code. The Fund is required by Indiana law to meet all rules applicable to a qualified plan under Section 401 of the Internal Revenue Code, in order to provide the ensuing tax advantages to its members. In addition, the Fund is a trust, exempt from taxation under Section 501 of the Internal Revenue Code. The Fund is also governed by Indiana statutes and administrative rules. See IC 5-10.2 and IC 21-6.1."

"Whereas, the general assembly also believes that a prudent diversification of investments by public retirement funds is an essential element of a stringent investment standard for such funds and is critical for the future; and . . ."

"Whereas, the general assembly finds that numerous actuarial studies of retirement funds in Indiana and other states have demonstrated that, due to the long term nature of the investment made by public retirement funds, diversification of such investments in a responsible manner reduces risk, increases income, and improves security for such funds, while a lack of diversification results in reduced income and increased risk to the retirement funds, while creating a substantial additional burden for the taxpayers who ultimately bear the burden of providing the assets for such funds in the absence of sufficient investment income; and . . . "

"Whereas, the general assembly desires to pass a diversification rule patterned after the stringent federal law applicable to private plans, which will provide that the trustees of each fund must diversify the investments of their fund so as to minimize the risk of large losses."

"Thus, the primary governing statutory provision is that the Board must 'invest its assets with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims.' The Board is also required to diversify such investments in accordance with prudent investment standards. IC 21-6.1-3-9."

It is the responsibility of the Board of Trustees to determine the allocation of assets among distinct capital markets in accordance with allowable legal limits.

At its April 27, 2004, meeting, the Board changed the strategic asset allocation to:

Domestic Equities	42%
International Equities	18%
Private Equity	5%
Real Estate	5%
Absolute Return	5%
Fixed Income	25%
	100%

At its October 26, 2004, meeting, the Board also adjusted the domestic equity manager structure to the following: 20% large cap passive; 30% large cap enhanced; 10% large cap value; 10% large cap growth; 10% midcap core; 5% midcap value; 5% midcap growth; 5% small cap value; 5% small cap growth.

At its November 30, 2004, meeting, the Board adjusted the international equity manager structure to the following: 40% enhanced index and 60% to active management.

Interest Rate Risk

The Fund uses the Lehman Brothers Aggregate Index (LBA) as the benchmark for performance measurement of their fixed income managers. TRF's investment policy states that each fixed income manager must manage their portfolio so that the duration is no less than 80% and no more than 120% of the duration of the index.

As of June 30, 2006, the Fund had the following debt investments and maturities. (Amounts are in thousands.)

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1-5	6-10	More than 10
Short Term Investment Funds	$ 670,798	$ 670,798	$ -	$ -	$ -
Commercial Paper	128,560	128,560	-	-	-
Asset Backed Securities	150,042	1,740	105,715	7,768	34,819
Commercial Mortgage-Backed Securities	170,275	-	-	-	170,275
Corporate Bonds	848,307	108,340	446,540	136,510	156,917
U.S. Agencies	388,040	206,830	76,275	56,125	48,810
U.S. Treasuries	421,808	95,989	54,021	83,661	188,137
Government Mortgage-Backed Securities	1,413,939	-	10,862	126,592	1,276,485
Government Issued Commercial Mortgage-Backed Securities	3,004	-	3,004	-	-
Index Linked Governmentt Bonds	8,744	637	-	3,239	4,868
Municipal/Provincial Bonds	7,801	-	-	7,075	726
Collaterized Mortgage Obligations	118,573	-	-	8,660	109,913
Totals	$ 4,329,891	$ 1,212,894	$ 696,417	$ 429,630	$ 1,990,950

Custodial Credit Risk

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the Fund.

There was no custodial credit risk for investments including investments related to securities-lending collateral. Per Indiana Code 5-10.3-5-4(a) and Indiana Code 5-10.3-5-5, all fund investments are held by banks under custodial agreements, all custodians are domiciled in the United States and approved by the department of financial institutions to act in a fiduciary capacity and manage custodial accounts in Indiana.

Deposit Risks

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or collateralized with securities held by the pledging financial institution. Deposits held in the demand deposit account are carried at cost and are insured up to $100,000 each. Deposits in the demand accounts held in excess of $100,000 are not collateralized. Deposits with the Treasurer of State are entirely insured. Cash Deposits held with the custodian are carried at cost and are not insured or collateralized.

Cash Deposits (in thousands)	Totals	National City Bank
Demand Deposit Account – Bank Balance	$ 1,203	$ 1,203
Held with Treasurer of State	3,770	-
Cash Held with Custodian	26,324	-

Credit Risk

The credit risk of investments is the risk that the issuer will default and not meet their obligation. This credit risk is measured by the credit quality ratings issued by national rating agencies such as Moody's and Standard and Poor's.

The Fund's investment policy limits each fixed income manager's purchase of below Baa grade securities to 10% of the total market value of the manager's portfolio.

The following table (in thousands of dollars) provides information on the credit ratings associated with the Fund's investments in debt securities. Ratings were obtained from Moody's. On securities that Moody's did not provide a rating then a rating was obtained from Standard and Poor's.

Rating	Fair Value	Percentage of Portfolio
Aaa	$ 2,694,941	62.03%
Aa1	117,838	2.70%
A1	380,612	8.76%
Baa1	238,777	5.50%
Ba1	102,367	2.36%
B1	45,718	1.05%
Caa1	8,714	0.2%
Unrated	755,926	17.40%
Totals	$ 4,344,893	100.00%

Of the total fair value, 77% or $3,362 million are debt securities. The balance is classified as cash equivalents. Approximately 47% of the total fair value reported is AAA rated U.S. Treasury, U.S. Agency, or U.S. Agency Mortgage Backed Securities ($2,058 million). The remaining balance of $2,287 million consists of corporate debt, commingled funds, and asset- and mortgage-backed securities of various credit quality ratings.

Concentration of Credit Risk

At June 30, 2006, TRF did not have investments in any one issuer, other than securities issued or guaranteed by the U.S. Government that represented more than 5% of net investments.

Foreign Currency Risk

As of June 30, 2006, 13.19% of the Fund's investments were in foreign currencies. In addition to the Fund's international equity managers, fixed income managers are allowed to invest up to 10% of their portfolio in international bonds. The table below breaks down the Fund's exposure to each foreign currency:

Currency	Equity Securities	Contracts, Currencies and Commingled Money Funds	Total Fair Value	Percent of Total Fund Fair Value
Euro Currency Unit	$ 340,969,015	$ 24,379,566	$ 365,348,581	4.72%
Japanese Yen	221,256,365	1,814,843	223,071,208	2.88%
British Pound Sterling	174,931,086	3,116,069	178,047,155	2.30%
Canadian Dollar	45,433,308	1,960,726	47,394,034	0.61%
Swiss Franc	45,979,260	127,950	46,107,210	0.60%
Hong Kong Dollar	32,315,625	54,932	32,370,557	0.42%
Australian Dollar	30,507,867		30,507,867	0.39%
Norwegian Krone	14,897,923	741,064	15,638,987	0.20%
South Korean Won		14,178,721	14,178,721	0.18%
Swedish Krona	11,895,026	80	11,895,106	0.15%
Other	27,084,613	137,589	27,222,202	0.74%
Totals	$ 945,270,088	$ 46,511,540	$ 991,781,628	13.19%

Securities Lending

State statutes and the Board of Trustees permit the Fund to lend securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Fund's custodial bank manages the securities lending program and receives securities or cash as collateral. The Fund's custodial bank maintains a list of broker-dealers that have passed their credit analysis and are eligible to borrow securities. In addition the Fund can have any borrower removed from this list by requesting the custodian not lend to this borrower. The collateral securities cannot be pledged or sold by the Fund unless the borrower defaults, but cash collateral may be invested by the Fund. Collateral securities and cash are initially pledged at 102% of the market value of domestic securities lent and 105% on international securities lent. Collateral is adjusted to the market on a daily basis. No more than 40% of TRF's total assets may be lent at any one time. At year-end, TRF has no credit risk exposure to borrowers because the amount TRF owes the borrowers exceed the amounts the borrowers owe TRF.

Approximately 25% of the securities loans can be terminated on demand either by the Fund or by the borrower, although generally the average term of these loans is one day. Total cash collateral of $1,317 million is invested in a pooled fund.

As of June 30, 2006, the Fund had the following securities on loan:

Security Type	Market Value of Loaned Securities Collateralized by Cash	Market Value of Loaned Securities Collateralized Noncash	Total Securities Loaned
Global Equities	$ 166,936,415	$ 719,847	$ 167,656,262
U.S. Agencies	135,925,385	21,200,113	157,125,498
U.S. Corporate Fixed	137,385,775	18,183,128	155,568,903
U.S. Equities	381,574,460	17,383,235	398,957,695
U.S. Government Fixed	472,386,763	5,420,632	477,807,395
Totals	$ 1,294,208,798	$ 62,906,955	$ 1,357,115,753

Derivative Financial Instruments

TRF invested in derivative financial investments as authorized by Board policy. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or market index. TRF's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, TRF's derivative investments included cash and cash equivalent futures, equity derivatives-options, fixed income derivatives – options, rights/warrants, swaps, foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), and futures.

Cash and cash equivalent futures are used to manage exposure at the front end of the yield curve. These include swaps with duration of one year or less, and Eurodollar, Euribor and other futures based on short-term interest rates. At June 30, 2006, TRF's investments in these instruments totaled a negative $2.0 million.

Equity derivatives – options are used to gain exposure to an index or market sector. These may offer an opportunity to outperform due to active management of the liquid portfolio backing the exposure. Exposure is backed by underlying fixed-income portfolio. At June 30, 2006, the carrying value of TRF's equity derivatives – options totaled a negative $.3 million.

Stock Rights/Warrants give the holder the right to buy a stock at a certain price until a certain date. At June 30, 2006, the carrying value of TRF's stock rights and warrants totaled $.6 million.

Swaps are used to adjust interest rate and yield curve exposures and substitute for physical securities. Long swap positions ("received fixed") increase exposure to long-term interest rates; short positions ("pay fixed") decrease exposure. At June 30, 2006, the carrying value of TRF's swaps was $2.5 million.

TRF's fixed income managers invest in CMOs to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2006, the carrying value of the TRF's CMO holdings totaled $118.6 million.

Treasury inflation protected securities (TIPS) are used by TRF's fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). As of June 30, 2006, the carrying value of the System's TIPS holdings totaled $8.7 million.

TRF's investment managers use financial futures to replicate an underlying security or index they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, TRF's investment managers use futures contracts to adjust the portfolios risk exposure. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. At June 30, 2006, the total offset was $652 million. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio.

Note V. Deferred Compensation Plan

The State offers its employees a deferred compensation plan (the plan) created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees and employees of certain quasi-agencies and political subdivisions within the State, 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 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 are (until paid or made available to the employee or other beneficiary) held for the exclusive benefit of participants of the plan and their beneficiaries as required by section 457(g) of the Internal Revenue Code. In addition, the State has an Indiana Incentive Match Plan which provides $15 per pay period for each employee who contributes to the 457 Plan.

The state has established a deferred compensation committee that holds the fiduciary responsibility for the plan. The committee holds the deferred amounts in an expendable trust.

Note VI. Contingent Liabilities

The Indiana State Teachers' Retirement Fund is defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, the resolution of these matters will not have a material or adverse effect on the financial condition of the Fund. Tort claims are paid from the General Fund of the State of Indiana through the Attorney General's Office and are not paid by the Fund.

Note VII. Risk Management

The Fund is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters.

The policy of the Fund is not to purchase commercial insurance for the risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters.

Note VIII. Employee Fund Membership

Employees of the Indiana State Teachers' Retirement Fund are eligible for membership in the Fund. Effective July 1, 2001, Indiana Code 21-6.1-4-1(a)-10 states that members of the fund include persons who are employed by the fund.

Note IX. Reserve Transfers with the Public Employees Retirement Fund (PERF)

Transfers of a member's reserves are made between TRF and PERF when a member has service at the time of retirement that is covered by both funds. Service covered by PERF and the related Annuity Savings Account balance will be used by TRF at the time of retirement in calculating the member's retirement benefit from TRF if the member was last employed in a TRF covered position. If the member was last employed in a PERF covered position, PERF will use the member's TRF service and Annuity Savings Account balance. At the time the retirement is calculated TRF sets up a receivable from PERF for both the Annuity Savings Account balance and the calculated reserve for the service credit brought in from PERF. This receivable is included as a line item in the "Receivables" section of TRF's Statement of Fiduciary Net Assets. On the reverse side, TRF recognizes a payable in the Liabilities section of the Statement of Fiduciary Net Assets for TRF amounts used in calculating a PERF retiree's benefit.

INDIANA STATE TEACHERS' RETIREMENT FUND
REQUIRED SUPPLEMENTAL SCHEDULES
JUNE 30, 2006

SCHEDULE OF FUNDING PROGRESS
(Dollar Amounts in Millions)

Actuarial Valuation Date June 30	Actuarial Value of Assets (a)	Actuarial Liability (AAL) -Entry-Age- (b)	Unfunded AAL (UAAL) (b)-(a)	Funded Ratio (a) / (b)	Covered Payroll (c)	UAAL as a % of Covered Payroll (b)-(a) / (c)
2000	$ 5,578,046,785	$ 13,115,065,443	$ 7,537,018,658	42.5%	$ 3,192,604,492	236.1%
2001	5,810,759,564	13,523,825,973	7,713,066,409	43.0	3,318,877,027	232.4%
2002*	6,176,574,529	14,664,661,236	8,488,086,707	42.1	3,609,470,436	235.2%
2003*	6,554,364,927	14,747,339,056	8,192,974,129	44.4	3,585,134,913	228.5%
2004*	6,804,394,627	15,197,925,988	8,393,531,361	44.8	3,651,653,125	229.9%
2005*	7,065,299,476	16,264,893,444	9,199,593,968	43.4	3,734,329,113	246.4%

* Revised benefits and/or actuarial assumptions and/or methods

SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS AND OTHER CONTRIBUTING ENTITIES

Fiscal Year Ending	Valuation Date June 30	Annual Required Contribution	Percentage Contributed
2001	1999	$ 547,532,673	126%
2002	2000	537,789,669	106%
2003	2001	572,226,197	106%
2004	2002	638,541,074	69%
2005	2003	619,186,005	78%
2006	2004	672,555,533	104%

NOTES TO REQUIRED SUPPLEMENTAL SCHEDULES

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	June 30, 2005
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Pay Closed
Amortization Period	29 Years
Asset Valuation Method	4-year smoothed market value with corridor
Actuarial Assumptions:	
Investment Rate of Return	7.50%
Projected Salary Increase*	4.50% - 15.50%
*Includeds Wage Inflation at	4.50%
Cost of Living Adjustmnents	0.5% compounded annually on pension portion

INDIANA STATE TEACHERS' RETIREMENT FUND
EXIT CONFERENCE

The contents of this report were discussed on December 5, 2006, with Cristy Wheeler, Executive Director; and Thomas Abbett, Controller. Our report disclosed no material items that warrant comment at this time.