MONTANA

Teachers' Retirement System

A Component Unit of the State of Montana

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FISCAL YEAR ENDED JUNE 30, 2007

Brian Schweitzer, Governor

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FISCAL YEAR ENDED JUNE 30, 2007

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Executive Director

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Deputy Executive Director

Prepared by:
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http://www.trs.mt.gov

Alternative accessible formats of this document will be provided upon request.

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BOARD OF DIRECTORS AND PROFESSIONAL CONSULTANTS

TEACHERS' RETIREMENT SYSTEM

1500 E. SIXTH AVENUE
PO BOX 200139
HELENA, MONTANA 59620-0139   406 444-3134   BRIAN SCHWEITZER, GOVERNOR

STATE OF MONTANA

December 10, 2007

Honorable Brian Schweitzer
Governor of Montana
Room 204, State Capitol
Helena, MT 59620

Dear Governor Schweitzer:

On behalf of the Montana Teachers' Retirement Board, we are pleased to present the Montana Teachers' Retirement System's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007. This report is intended to provide comprehensive information on the financial operations of the Montana Teachers' Retirement System (TRS) for the year.

TRS management is responsible for establishing and maintaining an internal accounting control structure to reasonably assure the safekeeping of assets and the reliability of financial reporting.

The TRS was established by state law in 1937 and has completed its 70th year of operation. The TRS is providing services to over 18,000 active members and managing assets valued in excess of $3.2 billion.

LEGISLATION

The Montana State Legislature during the 2007 session passed House Bill 63 to address the TRS actuarial funding issue. The State's General Fund infused $50 million into the TRS pension fund to help address the unfunded actuarial accrued liability of the system. Also effective July 1, 2007 the employer contribution rate increased 2% from 7.47% to 9.47%. Beginning July 1, 2009 the rate will increase another .38% to a total of 9.85%. The supplemental contribution funded by university employers was also increased from 4.04% to 4.72% of Optional Retirement Plan (ORP) member pay effective July 1, 2007.

WEB ENHANCEMENTS

The TRS implemented significant improvements to its Website enabling employers to report contributions and manage retired employee insurance deductions online greatly reducing the use of paper and increasing efficiency. An electronic payment feature was also introduced to allow employers to make their monthly contribution payments via an electronic funds transfer.

INVESTMENT ACTIVITY

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. The Unified Investment Program is required by law to operate under the "prudent expert principle", defined as: 1) discharging its duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of like character and like aims; 2) diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return; and 3) discharging its duties solely in the interest of and for the benefit of the funds managed.

The TRS investment portfolio posted a total return of 17.94%, resulting in an increase in the fair market value of its investments. The System's total annualized rate of return over the last five and ten years was 10.95% and 7.68% respectively. This rate of return compares with an actuarial assumed rate of 8% through June 30, 2004 and 7.75% effective July 1, 2004. The Board of Investments (BOI) invests the TRS and other pension portfolios for the long-term and its investment strategies are designed to provide sufficient returns over time. However, there is no guarantee of future investment performance. Performance in any given year is dependent not only on the BOI's investment performance but also on the performance of the markets themselves, which are impacted by domestic and global economic conditions, interest rates, and government policies.

TRS Investment Rates of Returns

	FY 2007	3-Year	5-Year	10-Year
Fixed Income	6.88%	5.09%	6.09%	6.94%
Domestic Equities	19.53%	11.05%	10.41%	6.00%
International Equities	31.57%	23.60%	18.18%	8.13%
Private Equities	23.46%	19.21%	17.78%	15.64%
Real Estate	6.55%	7.24%	6.72%	6.66%
Total Portfolio	17.94%	11.64%	10.95%	7.68%

Please refer to the Investment Section of this report for additional detailed information regarding TRS investments.

PLAN FUNDING STATUS

The TRS plan's net Funded Ratio increased from 76.1% at July 1, 2006 to 79.6% at July 1, 2007. The improvements in the TRS funding are primarily due to additional contributions and favorable investment returns. This has also resulted in a significant reduction in the amortization of the Unfunded Actuarial Accrued Liability to 28.6 years. Additional information regarding the financial condition of the TRS plan can be found in the Actuarial Section of this report.

AWARDS

The Government Finance Officers Association (GFOA) of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to TRS for its CAFR for the fiscal year ended June 30, 2006. This was the first year in which TRS had applied for this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to GFOA to determine its eligibility for another certificate.

The Public Pension Coordinating Council (PPCC) also awarded TRS the Public Pension Standards Award for 2007 in recognition of meeting the professional standards for plan design and administration as set forth in the Public Pension Standards. The PPCC is a coalition of National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and National Council on Teacher Retirement

INDEPENDENT AUDIT

The financial statements contained in the TRS CAFR were audited by the State's Legislative Audit Division (LAD) in accordance with generally accepted auditing standards. The Legislative Auditor is appointed by and reports to the State's Legislative Audit Committee. The LAD issued an unqualified opinion on the TRS financial statements for fiscal year 2007.

The Management's Discussion and Analysis and financial statements with accompanying notes and schedules can be found in the Financial Section of this report.

CONCLUSION

On behalf of the Board, I would like to thank the staff, the Board's advisors, and the many people whose commitment, dedication, and proficiency has directly contributed to the continued successful operation of the Montana Teachers' Retirement System. The Teachers' Retirement Board and staff look forward to continuing to serve the educators of Montana.

Sincerely,

David L. Senn
Executive Director

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Montana Teachers' Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

Public Pension Coordinating Council

Public Pension Standards

2007 Award

Presented to

Montana Teachers' Retirement System

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle
Program Administrator

TEACHERS' RETIREMENT SYSTEM
BOARD OF DIRECTORS AND
PROFESSIONAL CONSULTANTS

BOARD OF DIRECTORS

	Term Expires
TIM RYAN CHAIR Public Representative	JUNE 30, 2009
KARI PEIFFER VICE CHAIR Active Member (Classroom Teacher)	JUNE 30, 2012
SCOTT DUBBS Active Member	JUNE 30, 2008
JAMES TURCOTTE Public Representative	JUNE 30, 2010
MONA BILDEN Active Member	JUNE 30, 2011
DARRELL LAYMAN Retired Member	JUNE 30, 2011

PROFESSIONAL CONSULTANTS

MILLIMAN	Actuaries & Consultants Seattle, WA 98101
ICEMILLER	Legal & Business Advisors Indianapolis, IN 46282
ALFRED MUNKSGARD	IT Consultant Thousand Oaks, CA 91362

FINANCIAL SECTION

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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor

Deputy Legislative Auditors:
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Fiduciary Net Assets of the Teachers' Retirement System (system), a component unit of the state of Montana, as of June 30, 2007 and 2006, and the related Statement of Changes in Fiduciary Net Assets for each of the fiscal years then ended. These financial statements are the responsibility of the Teachers' Retirement Board. 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teachers' Retirement System as of June 30, 2007 and 2006, and the changes in fiduciary net assets for each of the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, the Schedule of Funding Progress, and the Schedule of Contributions from the Employer and Other Contributing Entities 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 inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Teachers' Retirement System. The Supporting Schedule of Administrative Expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The Introductory Section, Investment Section, Actuarial Section, and Statistical Section listed in the foregoing table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such additional information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 11, 2007

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Phone (406) 444-3122 · FAX (406) 444-9784 · E-Mail lad@mt.gov

TEACHERS' RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the Montana Teachers' Retirement System's (TRS) Comprehensive Annual Financial Report provides a narrative overview of the TRS's financial activities for the fiscal year ended June 30, 2007 with comparative totals for the fiscal years ended June 30, 2006 and 2005. Please read this in conjunction with the transmittal letter presented in the introductory section and the financial statements with accompanying footnotes, required supplementary information with notes, and supporting schedule included later in this financial section.

Overview of the Financial Statements

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the System's ongoing plan perspective.

The financial section consists of two financial statements with footnotes, two schedules of historical trend information with footnotes, and one supporting schedule. The Statement of Fiduciary Net Assets reflects the resources available to pay benefits to retirees and beneficiaries. The Statement of Changes in Fiduciary Net Assets presents the changes that occurred in those resources for the fiscal year ended.

The Schedule of Funding Progress presents historical trend information about the actuarially funded status for the TRS plan from a long-term, ongoing perspective and the progress made in accumulating sufficient assets to pay benefits when due. The Schedule of Contributions from the Employer and Other Contributing Entities displays historical trend data of the annual required employer contributions and the actual contributions made by employers in relation to the requirement.

The Schedule of Administrative Expenses is a presentation of what comprises the administrative expense item as reported on the Statement of Changes in Fiduciary Net Assets.

Financial Highlights

- The 2007 Legislature infused $50,000,000 into the TRS Pension fund to help address the issue of the System's actuarial soundness.
- The TRS plan net assets increased by $463.5 million in 2007 and $258.7 million in 2006 representing a 16.9% and 10.4% increase respectively.
- Net investment income (fair value of investments plus investment income less investment expense) increased in both 2007 and 2006, $259.7 million and $36.1 million respectively.
- Pension benefits paid to beneficiaries and plan members increased 6.3% and 6.7% for the last two fiscal years respectively.

Condensed Financial Information (in millions)

Fiduciary Net Assets	FY2007	FY2006	FY2005	2007 Percent Inc/(Dec)	2006 Percent Inc/(Dec)
Cash/Short-term Investments	$ 88.4	$ 71.8	$ 31.9	23.1	125.1
Receivables	21.5	21.0	21.2	2.4	(0.9)
Investments (fair value)	3,256.3	2,704.4	2,540.6	20.4	6.4
Capital Assets (net)	0.3	0.7	0.8	(57.1)	(12.5)
Total Assets	3,366.6	2,797.9	2,594.4	20.3	7.8
Liabilities	157.3	52.2	107.2	201.3	(51.3)
Net Assets	**$3,209.3**	**$2,745.8**	**$2,487.1**	**16.9**	**10.4**

Changes in Fiduciary Net Assets	FY2007	FY2006	FY2005	2007 Percent Inc/(Dec)	2006 Percent Inc/(Dec)
Additions:					
Employer Contributions	$ 61.9	$ 58.3	$ 57.2	6.2	1.9
Plan Member Contributions	56.5	53.3	52.9	6.0	0.8
Other Contributions	0.7	0.7	0.7	0.0	0.0
Payment from State of Montana	50.0	100.0	0.0	(50.0)	NA
Net Investment Income	484.5	224.8	188.7	115.5	19.1
Total Additions	653.7	437.0	299.4	49.6	46.0
Deductions:					
Benefit Payments	182.8	172.0	161.2	6.3	6.7
Withdrawals	5.6	4.9	4.3	14.3	14.0
Administrative Expenses	1.4	1.6	1.6	(12.5)	0.0
Loss on Intangible Asset	0.5	0.0	0.0	NA	NA
Total Deductions	190.4	178.4	167.1	6.7	6.8
Net Increase in Net Assets	**$ 463.4**	**$ 258.6**	**$ 132.3**	**79.2**	**95.5**

Financial Analysis

- The increase from year-to-year in cash/short-term investments is due primarily to the change in the number of shares held in the Short Term Investment Pool.
- The increase in investments for 2007 and 2006 reflects the positive change in the fair market value of our investment holdings.
- The continuing decrease in capital assets is due to the depreciation and amortization of the assets and a loss on the write-off of previously capitalized software costs in 2007.
- The significant increase and decrease in liabilities occurs due to the security lending collateral activity conducted by the Montana Board of Investments.
- The significant increase in net investment income was due mostly to a $200.6 million increase in the unrealized net appreciation in the fair value of our investments and a $62.7 million increase in investment earnings in 2007 and a $40.8 million increase in the unrealized net appreciation in the fair value of our investments for 2006. Both are the result of the positive performance of the US and international stock markets.
- The increase in benefit payments from year-to-year reflects an increase in the number of retirees and beneficiaries plus the 1.5% guaranteed annual benefit adjustment.

Overview of the Actuarial Funding

The TRS plan experienced an asset gain over the last year. The market assets earned 17.64% net of investment and operating expenses. The actuarial assets earned 10.22% which is 2.47% above the actuarial assumption of 7.75%. Actuarial gains or losses result when the return on the actuarial value of assets differs from the actuarial investment return assumption. The following table compares the annual returns for the past six years.

Fiscal Year	Market Return	Actuarial Return	Actuarial Return over 7.75 % Assumption (8.00% prior to 7/1/04)
7/1/2001 to 6/30/2002	(7.3)%	3.8%	(4.2)%
7/1/2002 to 6/30/2003	6.2%	1.6%	(6.4)%
7/1/2003 to 6/30/2004	13.3%	2.1%	(5.9)%
7/1/2004 to 6/30/2005	8.0%	2.7%	(5.0)%
7/1/2005 to 6/30/2006	8.9%	8.5%	0.7%
7/1/2006 to 6/30/2007	17.6%	10.2%	2.5%

Although the actuarial return on assets has outperformed the assumption in the past two years, the chart above shows that the actuarial return on assets has under performed the assumption more than it has exceeded the assumption in the last six years. These losses led to the need for additional contributions in the 2005 and 2007 legislative Sessions.

The July 1, 2006 actuarial valuation set actuarial assets equal to market value. At their May 2007 meeting, the Retirement Board adopted an actuarial asset method with gains and losses after July 1, 2006 smoothed over a four year period. Due to the superior returns in the year ended June 30, 2007, the System has not yet recognized $203 million in market value gains. This will help to stabilize funding if the Trust's investment return is less than the actuarial assumption for a short period.

The 2007 Legislature in going forward addressed the funding status of the TRS pension fund to help ensure the unfunded actuarial accrued liability (UAAL) can be amortized over a period not exceeding 30 years. Per Governmental Accounting Standards Board (GASB) statement number 25 the maximum acceptable amortization period is 30 years. Effective July 1, 2007 the employer contribution rate increased 2% from 7.47% to 9.47%. Beginning July 1, 2009 the rate will increase another .38% to a total of 9.85%. Also the supplemental contribution to ensure university member benefits are funded by university employers was increased from 4.04% to 4.72% of Optional Retirement Plan (ORP) member pay effective July 1, 2007.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2007 AND 2006

		2007		2006
ASSETS				
Cash/Cash Equivalents-Short Term				
Investment Pool (Note B)	$	88,435,655	$	71,802,925
Receivables:				
Accounts Receivable		15,159,435		15,277,642
Interest Receivable		6,214,473		5,556,602
Due from Primary Government		170,489		208,840
Total Receivables	$	21,544,397	$	21,043,084
Investments, at fair value: (Note B)				
Mortgages	$	31,399,861	$	36,712,095
Investment Pools		3,059,618,387		2,607,713,723
Other Investments		8,236,796		8,056,730
Securities Lending Collateral		157,024,527		51,930,374
Total Investments	$	3,256,279,571	$	2,704,412,922
Assets Used in Plan Operations:				
Land and Buildings	$	193,844	$	193,844
Less: Accumulated Depreciation		(139,880)		(136,118)
Equipment		147,087		147,087
Less: Accumulated Depreciation		(131,200)		(129,561)
Prepaid Expense		9,812		4,452
Intangible Assets, net of amortization		246,113		607,086
Total Other Assets	$	325,776	$	686,790
TOTAL ASSETS	$	3,366,585,399	$	2,797,945,721
LIABILITIES				
Accounts Payable	$	128,299	$	88,974
Due to Primary Government		17,363		29,446
Securities Lending Liability (Note B)		157,024,527		51,930,374
Compensated Absences (Note B)		139,888		125,880
TOTAL LIABILITIES	$	157,310,077	$	52,174,674
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A Schedule of Funding Progress is presented on page 29)	$	3,209,275,322	$	2,745,771,047

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FISCAL YEARS ENDED JUNE 30, 2007 AND 2006

		2007		2006
ADDITIONS				
Contributions:				
Employer	$	61,943,986	$	58,268,941
Plan Member		56,508,585		53,292,921
Other		720,266		693,226
Total Contributions	$	119,172,837	$	112,255,088
Misc Income	$	15,633	$	3,968
Payment from Primary Government (Note C)		50,000,000		100,000,000
Investment Income:				
Net Appreciation/(Depreciation) in Fair Value of Investments	$	354,302,356	$	153,737,011
Investment Earnings		137,540,095		74,818,519
Security Lending Income (Note B)		5,815,626		3,918,769
Investment Income/(Loss)	$	497,658,077	$	232,474,299
Less: Investment Expense		7,616,254		3,859,788
Less: Security Lending Expense (Note B)		5,509,847		3,827,250
Net Investment Income/(Loss)	$	484,531,976	$	224,787,261
Total Additions	$	653,720,446	$	437,046,317
DEDUCTIONS				
Benefit Payments	$	182,826,747	$	171,956,507
Withdrawals		5,594,541		4,876,148
Administrative Expense		1,434,103		1,579,155
Loss on Intangible Asset		501,575		0
Payment to Primary Government		205		0
Total Deductions	$	190,357,171	$	178,411,810
NET INCREASE (DECREASE) IN PLAN NET ASSETS	**$**	463,363,275	$	258,634,507
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS BEGINNING OF YEAR		2,745,771,047		2,487,136,540
Prior Period Adjustment		141,000		0
END OF YEAR	**$**	3,209,275,322	$	2,745,771,047

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE FINANCIAL STATEMENTS
FISCAL YEARS ENDED JUNE 30, 2007 AND 2006

NOTE A. DESCRIPTION OF THE PLAN

The Teachers' Retirement Board is the governing body of a mandatory multiple-employer cost-sharing defined benefit pension plan, which provides retirement services to persons in Montana employed as teachers or professional staff of any public elementary or secondary school, community college or unit of the university system. The system was established by the State of Montana in 1937 to provide retirement, death and disability benefits and is governed by Title 19, chapter 20, of the MCA. TRS as an employer does not participate in the plan and acts only as the administrator of the plan.

At June 30, 2007, the number and type of reporting entities participating in the system were as follows:

Local School Districts	358
Community Colleges	3
University System Units	2
State Agencies	8
Total	371

At June 30, 2007, the system membership consisted of the following:

Retirees and Beneficiaries Currently Receiving Benefits	10,971
Terminated Employees Entitled to But Not Yet Receiving Benefits	10,516
Current Active Members:	
Vested	11,844
Non-vested	6,344
Total Membership	39,675

The pension plan provides retirement benefits and death and disability benefits. Employees with a minimum of 25 years of service or who have reached age 60 with 5 years of service are eligible to receive an annual retirement benefit equal to creditable service years divided by 60 times the average final compensation. Final compensation is the average of the highest three consecutive years of earned compensation. Benefits fully vest after 5 years of creditable service. Vested employees may retire at or after age 50 and receive reduced retirement benefits. A Guaranteed Annual Benefit Adjustment (GABA) of 1.5% is payable each January if the retiree has received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The TRS, a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity, prepares its financial statements using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period when due and investment income is recognized when earned. Expenses including benefit payments and withdrawals are recorded when the corresponding liabilities are incurred.

Compensated Absences

Compensated absences represent 100 percent of accrued vacation and 25 percent of accrued sick leave for TRS personnel at June 30, 2007 and June 30, 2006.

Cash/Cash Equivalents and Investments

Cash and cash equivalents consist of funds deposited in the State Treasurer's pooled cash account and cash invested in the Short-Term Investment Pool. The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. Per the Montana Constitution, Article VIII Section 13(3), investment of TRS assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of an enterprise of a similar character with similar aims.

Information about the primary government's (State of Montana) investments, including credit risk classification, can be obtained from the Department of Administration, Administrative Financial Services Division, at P.O. Box 200102, Helena, MT 59620-0102. Information on investment activity, investment management fees and a listing of specific investments owned by the pooled asset accounts can be obtained from Board of Investments at P.O. Box 200126, Helena, MT 59620-0126.

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. The seven areas of investment include: Short-Term Investment Pool (STIP); Retirement Funds Bond Pool (RFBP); Montana Domestic Equity Pool (MDEP); Montana International Equity Pool (MTIP); Montana Private Equity Pool (MPEP), Montana Real Estate Pool (MTRP), and All Other Funds (AOF). The TRS Investment Portfolio is listed below:

TRS Investment Portfolio
June 30, 2007

Investment	Book Value	Fair Value
STIP	$ 83,102,502	$ 83,102,502
RFBP	774,052,977	766,016,545
MDEP	550,689,795	1,361,988,214
MTIP	311,631,000	629,321,268
MPEP	157,207,970	241,011,163
MTRP	60,321,000	61,281,197
AOF	39,823,176	39,636,659
Total	$ 1,976,828,420	$ 3,182,357,548

Securities Lending - Under the provisions of state statutes, BOI, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the BOI securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the custodial bank must initially receive collateral equal to 102 percent, 105% in MTIP, of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent, 105% in MTIP, of the fair value of the loaned security. BOI retains all rights and risks of ownership during the loan period.

During fiscal years 2007 and 2006, State Street Bank lent, on behalf of the BOI, certain securities held by State Street, as custodian, and received US dollar currency cash, US government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The BOI did not impose any restrictions during fiscal years 2007 and 2006 on the amount of the loans that State Street Bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2007 and 2006. Moreover, there were no losses during fiscal years 2007 and 2006 resulting from a default of the borrowers or State Street Bank.

During fiscal years 2007 and 2006, the BOI and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the BOI's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the BOI could not determine. At year-end, the BOI had no credit risk exposure to borrowers because the collateral pledged by the borrowers exceeded the value of the securities borrowed.

The investment risks for the pooled investments that TRS participates in are described in the following paragraphs.

<u>Credit Risk</u> - Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

The STIP securities and the RFBP and AOF fixed income instruments with the exception of the U.S. government securities have credit risk as measured by major credit rating services. The risk is that the issuer of a STIP, RFBP or AOF security may default in making timely principal and interest payments. The BOI policy requires that STIP securities have ratings provided by Standard and Poors, Moody's or Fitch. For the RFBP and AOF fixed income investments the BOI policy requires the investments at the time of purchase to be rated an investment grade as defined by Moody's or Standard & Poors's rating services. (Please refer to the credit rating chart, Exhibit A, on the following page).

Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

Custodial Credit Risk - 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 the investment or collateral securities that are in the possession of an outside party.

As of June 30, 2007 and June 30, 2006, all STIP, RFBP, MDEP, MTIP and AOF securities were registered in the nominee name for the Montana BOI and held in the possession of the BOI's custodial bank, State Street Bank. All other investments are registered in the name of the Montana BOI.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement No. 40, the BOI selected the effective duration method to disclose interest rate risk.

According to GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool. The RFBP and AOF investment policies do not formally address interest rate risk.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment.

Certain MTRP investments represent limited partnership investments in various foreign countries denominated in U.S. dollars. Per GASB Statement No. 40, no foreign currency risk disclosure is required for these limited partnership investments. Currency exposures within the MTIP portfolio may be hedged, partially or fully, at the discretion of the manager to preserve the U.S dollar value of investments made. Currency speculation, such as over-hedging, reverse hedging or other trading activity not specifically aimed at preserving the U.S. dollar value of investments, is not authorized.

The MTIP has significant investments in multiple foreign countries. Future economic and political developments in these countries could adversely affect the liquidity or value, or both, of the securities held by the funds in which MTIP is invested.

The TRS investments subject to credit and interest rate risk at June 30, 2007 and June 30, 2006 are categorized below:

Exhibit A

Investment		Fair Value 6/30/07	Fair Value 6/30/06	Rating 6/30/07	Rating 6/30/06	Duration 6/30/07	Duration 6/30/06
STIP	$	83,102,502	68,736,963	A1+	A1+	NA	NA
RFBP		766,016,545	717,609,842	AA	AA-	5.27	5.05

*NA (not applicable)

The securities in the RFBP have a maturity ranging from 8/15/2007 to 6/12/2050.

At June 30, 2007 the TRS share of the MTIP portfolio is approximately 39%. The investment security type MTIP as prepared by BOI is subject to foreign currency risk at June 30, 2007 as categorized below converted to value in U.S. dollars:

Currency	Carrying Value	Fair Value	%
AUSTRALIAN DOLLAR	38,279,708	50,915,926	3.16%
AUSTRIAN SCHILLING	10,412,698	13,930,219	0.86%
BELGIUM FRANC	7,408,223	8,488,887	0.53%
BRAZILIAN REAL	1,764,304	1,981,024	0.12%
CANADIAN DOLLAR	29,320,055	35,890,007	2.23%
DANISH KRONE	9,316,434	13,037,001	0.81%
FINNISH MARKKA	11,822,681	14,315,298	0.89%
FRENCH FRANC	85,086,140	100,730,411	6.25%
GERMAN MARK	67,373,715	84,083,860	5.22%
GREEK DRACHMA	6,420,397	7,999,225	0.50%
HONG KONG DOLLAR	25,240,441	34,255,197	2.12%
HUNGARIAN FORINT	1,375,386	2,003,487	0.12%
INDONESIAN RUPIAH	741,043	982,562	0.06%
IRISH PUNT	1,987,111	1,975,479	0.12%
ISRAELI SHEKEL	1,817,817	1,871,608	0.12%
ITALIAN LIRA	31,499,283	37,031,582	2.30%
JAPANESE YEN	165,809,915	186,819,142	11.59%
SOUTH KOREAN WON	21,988,142	29,199,894	1.81%
MALAYSIAN RINGGIT	3,921,885	4,493,461	0.28%
MEXICAN PESO)	6,373,053	6,854,022	0.43%
NETHERLANDS ANTILLES GUILDER	39,963,600	45,873,044	2.85%
NEW ZEALAND DOLLAR	371,062	438,522	0.03%
NORWEGIAN KRONE	6,565,909	10,320,168	0.64%
PHILIPPINES PESO	639,398	1,226,819	0.08%
POLISH ZLOTY	567,298	768,410	0.05%
PORTUGUESE ESCUDO	2,213,129	2,884,776	0.18%
SINGAPORE DOLLAR	11,107,459	14,983,915	0.93%
SOUTH AFRICAN RAND	1,596,750	1,850,274	0.11%
SPAINISH PESETA	18,128,964	20,443,255	1.27%
SWEDISH KRONA	21,940,872	23,603,481	1.46%
SWISS FRANC	54,609,564	61,902,461	3.84%
NEW TAIWAN DOLLAR	5,567,126	7,360,087	0.46%
THAI BAHT	4,546,002	5,404,292	0.34%
TURKISH LIRA	2,506,283	3,568,453	0.22%
U K BRITISH POUND	125,242,587	141,522,336	8.78%
U S DOLLAR (ADR)	35,061,310	42,010,883	2.61%
U S DOLLAR (Commingled Accounts)	368,158,834	529,923,232	32.87%
EQUITY TOTAL	**1,226,744,578**	**1,550,942,700**	**96.21%**
STATE STREET EAFE ISPIFF	41,753,738	50,883,047	3.16%
STATE STREET STIF	10,245,619	10,245,619	0.64%
MTIP GRAND TOTAL	**1,278,743,935**	**1,612,071,366**	**100.00%**

1. STIP as per Montana Code Annotated (MCA) sections 17-6-201, 202 and 204, requires investments by state agencies of available funds. The STIP unit value is fixed at $1 for both participant buys and sells. The STIP portfolio may include asset-backed securities, commercial paper, corporate and U.S. government direct-backed U.S. government indirect-backed securities, repurchase agreements, and variable-rate (floating-rate) instruments to provide diversification and a competitive total rate of return.

According to the Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The BOI has adopted a policy to treat STIP as a 2a7-like pool.

2. The RFBP portfolio includes securities classified as corporate, foreign government bonds, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. Unit values are calculated weekly and at month end based on portfolio pricing. Unit value at June 30, 2007 and June 30, 2006 was $100.47 per unit and $99.81 per unit respectively.

3. The MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts equity derivatives and commingled funds. Unit value at June 30, 2007 and June 30, 2006 was $163.87 per unit and $138.01 per unit respectively.

4. The MTIP portfolios for fiscal years 2007 and 2006 includes equity portfolios invested in securities of foreign-based corporations listed on legal and recognized foreign exchanges as well as domestic exchanges. Security types may include ordinary common shares, preferred shares, convertible securities, American Depositary Receipts (ADR's), Global Depositary Receipts (GDR's), commingled funds and other global securities, as appropriate. Unit values are calculated weekly and once a month at the close of the last business day of the month, based upon the fair value of the MTIP equity holdings, other assets and liabilities. Unit value at June 30, 2007 and June 30, 2006 was $197.07 per unit and $151.74 per unit respectively.

5. The MPEP portfolio includes venture capital, leveraged buyout, mezzanine, distressed debt, special situation and secondary investments. Private equity investments are long-term, by design, and very illiquid. Due to the complexity and specialization of private equity investment, the BOI contracts with external private equity managers to invest in venture capital, leveraged buyout and other private equity investments. Unit value at June 30, 2007 and June 30, 2006 was $166.58 and $135.55 per unit respectively. The unit value is calculated at month end.

6. The MTRP was approved by the BOI on April 26, 2006, to permit the state's retirement systems to participate in a diversified real estate portfolio. Effective June 1, 2006, the nine retirement funds sold $30,035,000 of their STIP shares to fund the new Montana Real Estate Pool. The MTRP will invest with external real estate managers in both open-end and closed-end pooled funds. Each pension fund participant was issued units in the new pool at an initial unit value of $100. Unit values are calculated on the close of the last business day of the month, and based on the portfolio fair value. The unit value at June 30, 2007 and 2006 was $101.89 and $100.00 respectively.

7. The AOF investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle" and applicable investment restrictions of the participants. The AOF portfolio includes securities classified as corporate, U.S. government direct-backed, U.S. government indirect-backed, equity index, real estate, mortgages and loans.

Real Estate Investments

<u>100 North Park Building</u> - In January 1996, the BOI, on behalf of the Public Employees' and Teachers' Retirement funds, purchased the 100 North Park Avenue Building in Helena, Montana as a real estate investment. Acquired for a cost of $4,864,326, the building carries a fair value of $6,500,874 as of June 30, 2007. During fiscal year 2007, building improvements for build-outs, heating/cooling, and leasing fees totaling $352,187 were added to the cost of the building. Building improvements and leasing fees totaling $64,607 were included in the cost of the building in fiscal year 2006. The three-story building provides office space for seven tenants.

<u>2401 Colonial Drive Building</u> - In August 1997, the BOI authorized the construction of an office building, as a real estate investment owned equally by the Public Employees' and Teachers' Retirement funds. Construction costs, including interest capitalization, totaled $6,481,741 as of June 30, 2000. For fiscal year 2007, $99 was capitalized for a composite plan of building and heating/cooling improvements. In fiscal year 2006, heating/cooling system improvements and leasing fees of $93,257 were added to the building cost. The three-story building, providing office space for three tenants, was occupied in November 1999. As of June 30, 2007, the building carries a cost and fair value of $7,183,950 and $7,676,349, respectively.

<u>2273 Boot Hill Court Building</u> - In August 1999, the BOI authorized the purchase of a new office building in Bozeman, Montana. The Public Employees' and Teachers' Retirement funds purchased the building, in March 2004, as a real estate investment with equal ownership, for $2,051,032. In fiscal year 2007 and 2006, there were no improvements made to this building. The building, located on state school trust land, is occupied by four state agencies. As of June 30, 2007, the building carries a fair value of $2,082,014.

NOTE C. CONTRIBUTIONS

The TRS funding policy provides for monthly employee and employer contributions at rates specified by state law. Plan members are currently required to contribute 7.15% of their earned compensation and employers contribute 7.47% of earned compensation. The State's General Fund contributes an additional 0.11% of earned compensation. Each employer in the Montana university system shall contribute to the TRS a supplemental employer contribution currently at a rate of 4.04% of the total compensation of employees participating in the Optional Retirement Program (ORP). An actuary determines the actuarial implications of the funding requirement in annual actuarial valuations. The actuarial method used to determine the implications of the statutory funding level is the entry age actuarial cost method, with both normal cost and amortization of the accrued liability determined as a level percentage of payroll. The actuarial valuation prepared as of July 1, 2007, the most recent valuation date, indicates the statutory rate is sufficient to fund the normal cost and to amortize the unfunded accrued liability under the entry age actuarial cost method over 30 years. The unfunded actuarial accrued liability is included in the Schedule of Funding Progress.

The Montana State Legislature during the 2007 session infused $50 million from the State's General Fund into the TRS pension fund to help address the unfunded actuarial accrued liability of the system.

NOTE D. FUNDED STATUS and FUNDING PROGRESS

Effective June 30, 2007, the TRS implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 50 – Pension Disclosures. Our most recent actuarial valuation may be accessed on our website at:
www.trs.mt.gov/Board/ActuarialValuations/ActuarialValuations

The funded status of the TRS plan as of July 1, 2007, the most recent actuarial valuation date, is as follows (dollar amounts in millions):

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a) /c)
$3,006.2	$3,928.5	$768.9	79.6%	$664.1	115.8%

The TRS net Funded Ratio increased from 76.1% at July 1, 2006 to 79.6% at July 1, 2007. The improvements in the TRS funding are primarily due to additional contributions and favorable investment returns.

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Valuation date	July 1, 2007
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	28.6 years
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	4.50%
Guaranteed annual benefit adjustment	1.50%
Inflation rate	3.50%

The method of measuring the System's actuarial assets has changed since the prior valuation. Asset gains and losses are smoothed over a four-year period as of July 1, 2007, beginning with gains and losses over the year ending on June 30, 2007. As of July 1, 2006, the System's assets were measured on a market value basis, with immediate recognition of all gains and losses. The change to a four-year smoothing method was done to balance the need for responsiveness in the actuarial value of assets comparable with other pension plans. The amortization period of the Unfunded Actuarial Accrued Liability is 28.6 years using the four-year smoothing method and 18.3 years using market value.

NOTE E. SUBSEQUENT EVENT

The 2007 Legislature in going forward addressed the funding status of the TRS pension fund to help ensure the unfunded actuarial accrued liability (UAAL) can be amortized over a period not exceeding 30 years. Per Governmental Accounting Standards Board (GASB) statement number 25 the maximum acceptable amortization period is 30 years. Effective July 1, 2007 the employer contribution rate increased 2% from 7.47% to 9.47%. Beginning July 1, 2009 the rate will increase another .38% to a total of 9.85%. Also the supplemental contribution to ensure university member benefits are funded by university employers was increased from 4.04% to 4.72% of Optional Retirement Plan (ORP) member pay effective July 1, 2007.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress
(All dollar amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)[1]	Present Value of Future University Supplemental Contributions	Unfunded Actuarial Accrued Liabilities (UAAL)[2]	Funded Ratio[3]	Covered Payroll[4]	UAAL as a Percentage of Covered Payroll
July 1, 1998[5]	$ 1,809.0	$ 2,123.3	$ 90.6	$ 223.7	89.0%	$ 529.8	42.2%
July 1, 1998[6]	1,809.0	2,342.7	90.6	443.1	80.3	529.8	83.6
July 1, 2000[7]	2,247.5	2,648.3	96.4	304.4	88.1	537.5	56.6
July 1, 2000[8]	2,247.5	2,652.0	96.4	308.1	87.9	537.5	57.3
July 1, 2002	2,484.8	2,980.1	111.8	383.5	86.6	563.2	68.1
July 1, 2004	2,485.7	3,359.2	115.7	757.8	76.6	600.7	126.2
July 1, 2005	2,497.5	3,527.0	126.2	903.3	73.4	612.6	147.5
July 1, 2006	2,745.8	3,733.6	124.7	863.1	76.1	636.0	135.7
July 1, 2007	3,006.2	3,928.5	153.4	768.9	79.6	664.1	115.8

(1) Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.
(2) Actuarial accrued liabilities less actuarial value of assets and present value of future university supplemental contributions.
(3) Funded Ratio is the ratio of the actuarial value of assets over the actuarial accrued liabilities less the present value of future university supplemental contributions.
(4) Covered Payroll includes compensation paid to all active employees on which contributions are calculated.
(5) Results of July 1, 1998 Actuarial Valuation.
(6) July 1, 1998 results adjusted for 1.5% GABA and $500 minimum benefit for legislation which passed in Spring 1999 and the new salary scale adopted in November 1998.
(7) Results of July 1, 2000 Actuarial Valuation.
(8) July 1, 2000 results adjusted for $600 minimum benefit for legislation which passed in Spring 2001.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Contributions from the Employer and Other Contributing Entities
(All dollar amounts in thousands)

Fiscal Year Ending	Covered Employee Payroll[1]	Actual Employer Contributions[2]	Actual Employer Contribution %[2]	Annual Required Contribution (ARC) %[3]	Percentage of ARC Contributed[4]
June 30, 1998	$ 529,795	$44,476	7.47%	7.47%	100%
June 30, 1999	543,071	44,987	7.47	7.47	100
June 30, 2000	537,507	48,376	7.58	7.58	100
June 30, 2001	567,861	51,524	7.58	7.58	100
June 30, 2002	563,163	51,519	7.58	7.58	100
June 30, 2003	597,131	53,277	7.58	7.58	100
June 30, 2004	600,728	55,774	7.58	7.58	100
June 30, 2005	612,622	57,150	7.58	7.58	100
June 30, 2006	635,997	158,962	7.58	10.45	223
June 30, 2007	664,140	112,664	7.58	11.64	130

(1) *Computed as the dollar amount of the actual employer contribution made as a percentage of payroll (less ORP and term pay contributions) divided by the contribution rate expressed as a percentage of payroll.*

(2) *The actual and required employer contributions are expressed as a percentage of payroll. Contributions for termination pay of $6,221,313 and supplemental university contributions of $6,103,160 are included in the $112,664,252 actual employer dollar contribution, but are not made as a set percentage of payroll, and do not help to satisfy the ARC. Therefore, they are not included in the 7.58% employer contribution shown in this exhibit, or the calculation of the percentage of ARC contributed. The $50 million one time contribution made by the State in FYE 2007 and the $100 million one-time contribution made by the State in FYE 2006 are included in the employer dollar contribution, and the calculation of the percentage of ARC contributed, but are not included in the 7.58% employer contribution shown in this exhibit.*

(3) *The State makes employer contributions as a percentage of actual payroll. Thus, as long as the percentage equals the percentage required by the most recent actuarial valuation, the dollar amount of the Annual Required Contributions (ARC) is equal to the actual dollar amount of the required employer contributions. The 2007 ARC was determined in the July 1, 2005 valuation as the amount needed starting July 1, 2006 to maintain a 30 year amortization period.*

(4) *This is the Actual Employer Contribution expressed as a percentage of the product of the ARC percent and the Covered Employee Payroll.*

Actuarial Cost Method

The actuarial valuation was prepared using the entry age actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the valuation is allocated as a level percentage of the individual's projected compensation between entry age and assumed exit. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The normal cost was first calculated for each individual member. The normal cost rate is defined to equal the total of the individual normal costs, divided by the total pay rate.

The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets and (b) the actuarial present value of future normal costs is called the unfunded actuarial accrued liability. The unfunded actuarial accrued liability is amortized as a level percentage of the projected salaries of present and future members of the System.

The ultimate cost of any pension program over time equals the benefits paid and expenses incurred while administering the program. The source of revenue used to pay for this cost is equal to the contribution from employers and employees to fund the program, plus investment return earned on contributions made through pre-funding the benefit payments.

Valuation of Assets - Actuarial Basis

Assets are valued based on their market value, with a four-year smoothing of all market value gains and losses. The expected return is determined for each year based on the beginning of year market value and actual cash flows during the year. Any difference between the expected market value return and the actual market value return is recognized evenly over a period of four years. The gains and losses are measured starting with the year ended June 30, 2007 (adopted 7/1/2007). The method of measuring the System's actuarial assets has changed since the prior valuation. Asset gains and losses are smoothed over a four-year period as of July 1, 2007, beginning with gains and losses over the year ending on June 30, 2007. As of July 1, 2006, the System's assets were measured on a market value basis, with immediate recognition of all gains and losses. Prior to 2006, asset gains and losses were smoothed over a five-year period.

Inflation Rate

The assumed inflation rate is 3.50% per annum, compounded annually (adopted 7/1/2004).

Investment Earnings

The annual rate of investment earnings of the assets of the System is assumed to be 7.75% per year, compounded annually. (Adopted effective July 1, 2004)

Guaranteed Annual Benefit Adjustment Increases

On January 1 of each year, the retirement allowance payable must be increased by 1.5% if the retiree's most recent retirement effective date is at least 36 months prior to January 1 of the year in which the adjustment is to be made.

Future Salaries
The rates of annual salary increases assumed for the purpose of the valuation include an assumed 4.5% annual rate of increase in the general wage level of the membership plus a variable merit and longevity rate from 0% to 4.51%. The merit and longevity increases for the Montana University System (MUS) members did not show a pattern of increasing or decreasing with service at the time of our most recent study. Therefore, the MUS members have a flat 1% merit and longevity assumption. The general wage increase assumption was adopted July 1, 2004 and the merit and longevity scales were adopted July 1, 2002.

MUS members are assumed to have a 0.63% higher average final compensation to account for the larger than average annual compensation increases observed in the years immediately preceding retirement.

Amortization Method
The unfunded actuarial accrued liability created by this method, including gains and losses, is amortized as a level percentage of the System's projected payroll.

Amortization Period
The amortization period of the unfunded actuarial liability over an open period is 28.6 years as of July 1, 2007.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
SUPPORTING SCHEDULE
FISCAL YEARS ENDED JUNE 30, 2007 AND 2006

ADMINISTRATIVE EXPENSES

Expenses for the administration of the plan, excluding compensated absences, depreciation and amortization, are budgeted and approved by the TRS Board. The administrative costs of the TRS are financed through realized investment income. The expenses, less amortization of intangible assets, may not exceed 1.5% of retirement benefits paid. Administrative expenses for the fiscal years ended June 30, 2007 and 2006 are outlined below:

	2007	2006
Budgeted Expenses:		
Personnel Services:		
Salaries	$ 675,800	$ 628,364
Other Compensation	2,750	2,450
Employee Benefits	205,418	186,284
Total Personal Services	$ 883,968	$ 817,098
Operating Expenses:		
Contracted Services:		
Personnel Management	$ 1,045	$ 6,146
Actuarial Services	55,685	133,216
Legal Services	7,091	3,076
Medical Evaluations	390	205
Audit Services	14,773	17,771
Information Technology Services	13,520	117,058
Other Contracted Services	139,709	150,158
Supplies & Material	25,350	32,806
Communications	33,289	39,466
Travel	21,817	12,375
Rent	48,046	44,915
Repair & Maintenance	42,235	56,207
Other Expenses	48,926	49,734
	$ 451,876	$ 663,133
Non-Budgeted Expenses:		
Compensated Absences	$ 14,008	$ 8,811
Depreciation	5,403	5,403
Amortization of Intangible Assets	78,848	84,710
Total Non-Budgeted	$ 98,259	$ 98,924
Total Administrative Expense	**$ 1,434,103**	**$ 1,579,155**

INVESTMENT SECTION

REPORT ON INVESTMENT ACTIVITIES

INVESTMENT POLICY

INVESTMENT RESULTS

INVESTMENT ASSET ALLOCATION AND SUMMARY

LIST OF TEN LARGEST HOLDINGS IN PORTFOLIO

MONTANA
BOARD OF INVESTMENTS

Department of Commerce

Street Address:
2401 Colonial Drive, 3rd Floor
Helena, MT 59601

Mailing Address:
P.O. Box 200126
Helena, MT 59620-0126

Phone: 406/444-0001
Facsimile: 406/449-6579
Rateline: 406/444-3557
Website: www.investmentmt.com

September 19, 2007

Teachers' Retirement System Board Members
1500 East 6th Avenue
Helena, MT 59601

RE: TRS Annual Report Investment Letter
For the Fiscal Year ended June 30, 2007

Members of the Board,

The Teachers' Retirement System investment portfolio posted a total return of 17.94% for the fiscal year ended June 30, 2007. This was a very strong nominal return which far exceeded normal expectations and was well above the actuarial return assumption of 7.75%. The high return for this fiscal year helped pull up longer term returns that were depressed from the equity bear market of 2000-2002. The past five year fiscal period annualized return is now 10.95% and the ten year return, 7.68%. The high return for the year was primarily due to the equity exposure in the portfolio, both public and private. Stock market gains were dramatic, while bond returns were moderate for the fiscal year. The portfolio was well-positioned to benefit from the gain in public equities, with U.S. and international stocks representing the majority of holdings at 62-64% throughout the fiscal year. The domestic stock portfolio return was 19.7% while international stocks enjoyed the strongest returns at 31.6%. Private equity, which grew from 5.7% to 7.6% of the portfolio over the year, also helped bolster the overall portfolio return given its 23.5% return. Fixed income assets, which declined from 28% to 25% of the portfolio during the year, enjoyed modest coupon-like returns at 6.9%.

The market environment during the year was a steady upward bull market for equities with few interruptions while bond markets were more volatile, initially rallying during the first half of the year and then declining during the second half as rates backed up. The economy was sluggish during the first three quarters of the fiscal year with growth ranging in the 0.6% to 2.1% range, but then finished with a strong 4.0% quarter. Inflation was well-behaved during the period, especially considering we are well into an economic upturn. Oil prices weakened during the first half of the year and then rose over the second half of the year. Core CPI (excluding food and energy prices) never reached 3% and has trended down in recent months to only 2.2% as of June. The Federal Reserve stood pat with the Fed funds rate stable during the entire year at 5.25%. Non-U.S. economic growth accelerated during the year and the exchange value of the dollar continued to weaken, both supporting the strong performance of international equities. Also supportive of equity prices were corporate profits, the backbone of equity valuations, which continued to remain strong.

International equities, especially emerging market stocks, experienced the strongest returns for the fiscal year after a weak period of performance in the middle of 2006. Developed country markets enjoyed a return of 27.5% during the year and emerging markets had a phenomenal return of 45.5%. These returns were interrupted by only short bouts of market concern that prompted minor sell-offs during the spring. While U.S. stocks posted comparatively lower returns, they were still very high compared to long-term norms with the

S&P 500 index up 20.6%. Small cap stocks lost their relative advantage during the year, posting a return of 16.4%. This moderate under-performance follows seven years of out-performance by small cap stocks. Credit market conditions remained largely benign during the year, with low spreads or risk premiums available on corporate bonds and loans. These conditions fostered a frothy market for corporate buyouts which are often funded by adding leverage during the transaction. Readily available cheap financing led to high leverage in many of these transactions. The "buyout bid" also helped drive stock prices to record highs.

As we entered the new 2008 fiscal year the market environment began a dramatic change. Concerns regarding the residential housing market in the U.S. that emerged in the prior year had grown steadily and finally erupted into a crisis in July. Worries that sub-prime mortgages had spread via the securities markets to many unexpected holders prompted a global liquidity scare that has caused a credit crunch for many sectors of the credit markets. Corporate credit access has been denied to many lower quality firms until pricing and covenants adjust to the new conditions and a huge backlog of LBO-related financings clear the market. The sudden reversal of market attitude towards risk, although sparked by sub-prime mortgage problems, has spread to the corporate lending markets and promoted concerns of an economic recession. Stock markets around the globe have fallen in reaction to this sudden change in risk-taking. The "buyout bid" has largely evaporated as the cost and terms of financing have tightened. Yet the emerging markets have behaved atypically and held up better than developed country stocks since the mid-July peak in prices. As of this writing the broad U.S. stock market has only declined 3% from its peak in mid-July, after significant recovery from a low in mid-August that marked a decline of 9.6%. This kind of market volatility has not been seen since the inception of the bull market in the spring of 2003.

The broad implications on the global economy of these new equity and credit market conditions remain unknown at this stage. Central banks around the world are assessing the impact and have taken steps to ease the lack of market liquidity. The Fed took a major step in addressing economic risks by cutting the Fed funds rate by a larger-than-expected 50 basis points at its September meeting. Still, how successful they will be in propping up confidence and economic growth will take several months to play out. There is a consensus that economic growth, particularly in the U.S., will slow versus prior expectations. The biggest concern is over the impact of the deteriorating housing market on general consumer confidence and spending, and in turn, business confidence and employment conditions. The most recent forecasts of real GDP growth expect a slowing to the low-2% level by the end of 2007, and then a slight pickup in 2008, thus avoiding a recession. Ultimately, the key to the next fiscal year's investment returns will depend on whether the present economic growth cycle can survive, albeit at a slower pace, and extend into an even longer cycle of growth similar to the pattern of the 1990's.

Significant portfolio changes have been made over the past year. Some of the most important involved changes to our international equity pool which increased the degree of active management and broadened our exposure to the emerging markets. Also, the domestic equity pool was revamped with a broader diversification by manager and investment styles. Significant progress has been made in the addition of real estate, a new asset class introduced a year ago, and additional investments have increased our allocation to private equity. During the new fiscal year we expect to consider new asset classes for the portfolio as we seek further benefits of diversifying the sources of return. The Board will consider implementing changes only after a thorough understanding of the risks and benefits of taking such actions with an appropriate long term timeframe in mind.

Respectfully,

Clifford A. Sheets, CFA
Chief Investment Officer
Montana Board of Investments

Investment Policy

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. The Unified Investment Program is required by law to operate under the "prudent expert principle", defined as: 1) discharging its duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of like character and like aims; 2) diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return; and 3) discharging its duties solely in the interest of and for the benefit of the funds managed.

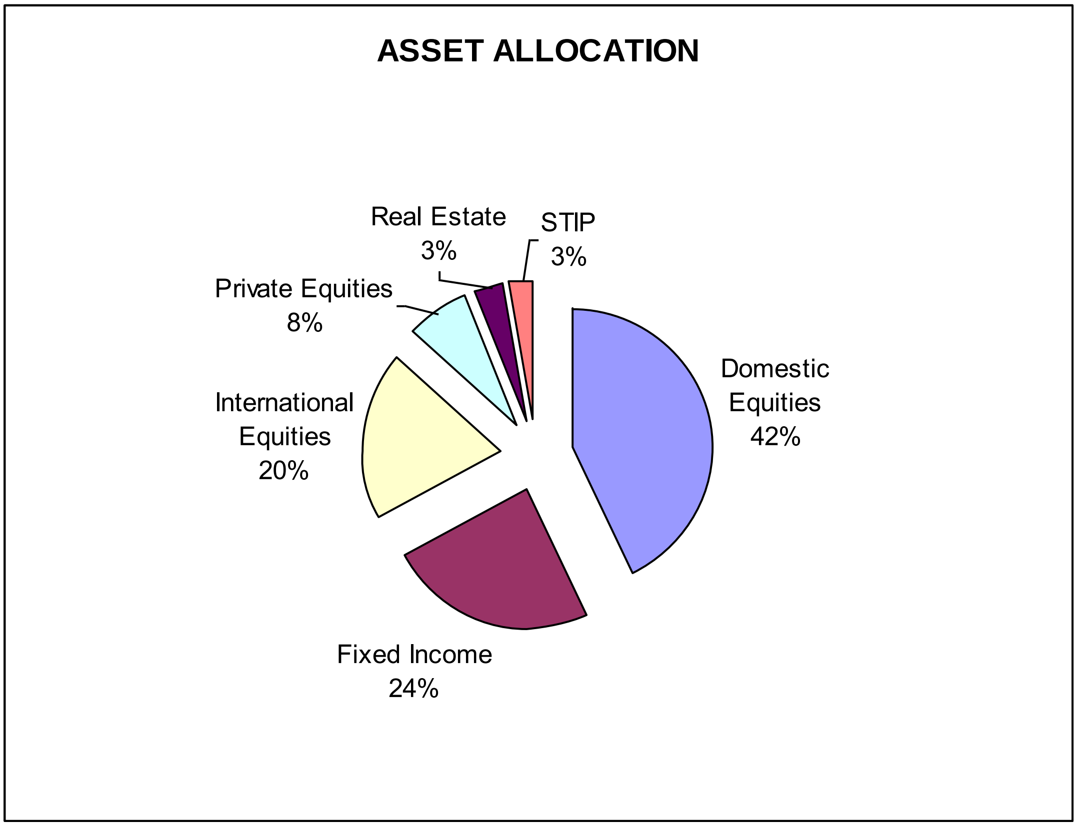
Investment Results

TRS Rates of Returns

	FY 2007	3-Year	5-Year	10-Year
Fixed Income	6.88%	5.09%	6.09%	6.94%
Domestic Equities	19.53%	11.05%	10.41%	6.00%
International Equities	31.57%	23.60%	18.18%	8.13%
Private Equities	23.46%	19.21%	17.78%	15.64%
Real Estate	6.55%	7.24%	6.72%	6.66%
Total Portfolio	17.94%	11.64%	10.95%	7.68%

Asset Allocation

Investment Type		Market Value
Domestic Equities	$	1,361,988,214
Fixed Income		766,016,545
International Equities		629,321,268
Private Equities		241,011,163
Real Estate		100,917,856
STIP		83,102,502
Total	$	3,182,357,548



Ten Largest Bond Holdings at fair value:

1.	Federal Home Loan Mortgage Corp	$	13,752,765
2.	Freddie Mac		13,297,844
3.	DOT Headquarters II Lease Mortgage		11,736,504
4.	FNMA Pool 256600		11,152,968
5.	Federal Home Loan Pool G11812		10,903,266
6.	ARIA CDO		10,564,125
7.	Federal Home Loan Pool G02070		10,097,293
8.	Cypresstree Synthetic CDO		10,031,775
9.	Federal Home Loan Pool G11994		9,817,589
10.	Bishopsgate CDO LTD		9,571,575

Ten Largest Equity Securities Holdings at fair value:

1.	BGI S&P 500 Passive Equity Index Fund	$	504,136,721
2.	Western Asset Large Cap Enhanced Index		90,406,274
3.	Goldman Sachs Large Cap Enhanced Index		57,971,007
4.	Dimensional Fund Small Cap Enhanced Index		30,363,151
5.	Exxon Mobil Corp		20,253,597
6.	General Electric Co		20,035,652
7.	SPDR Trust		12,414,988
8.	CitiGroup Inc		11,949,052
9.	Microsoft Corp		11,721,849
10.	Johnson + Johnson		10,144,359

A complete list of the portfolio holdings is available upon request from the Montana Board of Investments.

ACTUARIAL SECTION

ACTUARY'S CERTIFICATION LETTER

EXHIBITS

1. SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS
2. SCHEDULE OF ACTIVE MEMBER VALUATION DATA
3. SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS
4. SOLVENCY TEST
5. ANALYSIS OF FINANCIAL EXPERIENCE
6. PROVISIONS OF GOVERNING LAW

A MILLIMAN GLOBAL FIRM

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October 10, 2007

Teachers' Retirement Board
State of Montana
1500 Sixth Avenue
Helena, MT 59620-0139

Members of the Board:

We have completed the annual valuation of the Teachers' Retirement System of the State of Montana as of July 1, 2007. The purpose of this valuation is to determine the financial status of the Retirement System. To achieve this purpose, an actuarial valuation is made at the beginning of each fiscal year as required by MCA 19-20-201.

The purpose of this letter is to provide the Actuarial Section, the Schedule of Funding Progress, and the Schedule of Contributions from the Employers and Other Contributing Entities for the System's Comprehensive Annual Financial Report. Milliman, Inc. has performed actuarial valuations for the Teachers' Retirement System since July 1, 1992. Biennial valuations occurred between 1992 and 2004. Beginning on July 1, 2004, annual valuations have been performed. The most recent actuarial valuation of the Teachers' Retirement System was performed as of July 1, 2007. The next scheduled valuation of the Teachers' Retirement System will be as of July 1, 2008.

The funding objective of the System is to establish contribution rates that will tend to remain level as a percentage of payroll. The contribution rates have been:

Applicable Period	Participating Employers	State General Fund	Members	Total Rate
Prior to 07/01/2007	7.47%	0.11%	7.15%	14.73%
07/01/2007 to 06/30/2009	7.47	2.11	7.15	16.73
07/01/2009 and after	7.47	2.49	7.15	17.11

Our July 1, 2007 actuarial valuation shows that the current rates are sufficient to pay the System's normal cost and to amortize the System's unfunded actuarial accrued liability over 28.6 years, based on the current funding methods and long term actuarial assumptions. The normal cost of 10.40% of pay for the year beginning on July 1, 2007 is funded by employer and employee contributions. The remaining contributions (6.33%) funds the amortization of the unfunded actuarial accrued liability. The System's Unfunded Actuarial Accrued Liability funded by TRS contributions as of July 1, 2007 is $768.9 million based on actuarial assets.

A funding measurement that may be considered is the funding ratio of the Actuarial Accrued Liability to Assets. This ratio is shown in the Schedule of Funding Progress. As the actuarial experience varies from year to year, the funding ratio will reflect actuarial gains and losses. The Actuarial Accrued Liability represents the portion of the total plan benefits and expenses which is not provided for by future Normal Cost contributions.

The actuarial assumptions used in our 2007 actuarial valuation are summarized in Exhibit 1 and have not changed since the July 1, 2006 actuarial valuation. These assumptions were recommended by the actuary and adopted by the Board.

The assumptions represent our best estimate of future conditions affecting the System, and we believe they are reasonably related to the past experience of the System. Nevertheless, the emerging costs of the System will vary from those presented in our report to the extent that actual experience differs from that projected by the actuarial assumptions. Gains or losses in future experience may result in changes in future contribution rates. The current actuarial asset method smoothes asset gains and losses over four years. Therefore, the 2007 valuation only recognizes a portion of the recent asset gains.

In preparing our actuarial valuation reports, we relied, without audit, on the financial statements prepared by the staff of the System. We also relied upon the employee and beneficiary data provided to us by the staff. We compared the data for the July 1, 2007 actuarial valuation with corresponding information from the prior valuation and tested for missing or incomplete items, such as birth dates and hire dates. Based on these tests, we believe the data to be sufficient and reliable for the purposes of our calculations. It should be noted that if any data or other information is inaccurate or incomplete, our calculations might need to be revised.

The assumptions and methods used for funding purposes meet the parameters set for the disclosures presented in the financial section by Governmental Accounting Standards Board (GASB) Statement No. 25, Financial Reporting for Defined Benefit Pension Plans. The GASB guidelines specify a 30-year maximum for the amortization of the unfunded actuarial accrued liability. Since the corresponding amortization period is greater than 30 years as of July 1, 2005, the Fiscal Year 2007 employer contribution rate must include an amount sufficient to amortize the unfunded actuarial accrued liability over 30 years. Thus, the Fiscal Year 2007 Annual Required Contribution Rate (ARC) is 11.64% under the GASB requirements.

Funding and Benefits Policy

The Teachers' Retirement System has adopted a Funding and Benefits Policy to provide general guidelines to help ensure decisions are made based on sound, consistent, and thoroughly examined criteria. The Funding and Benefits Policy includes guidance on the following topics:

1) Additional Funding

   a) The Funding and Benefits Policy states: "Whenever the amortization period of the unfunded liabilities for two consecutive valuations are projected to exceed 30 years based on the market value of assets, or the funded ratio is less than 85%, and the

Board cannot reasonably anticipate that the amortization period would decline or the funded ratio improve without an increase in funding sources, it is the obligation of the Board to recommend to the legislature that funding be increased and/or liabilities be reduced."

b) Analysis: Although the funded ratio at July 1, 2007 is below 85% on an Actuarial Value of Assets basis, the net funded ratio has improved from 76.1% to 79.6% over the last year and the System's amortization period of 28.6 years is less than 30. In addition, the July 1, 2007 Market Value of Assets includes $203 million of unrecognized gains that were not included in the Actuarial Value of Assets. Therefore, assuming experience follows the actuarial assumptions, the Board can reasonably anticipate that the amortization period will decline and the funded ratio will improve without an increase in funding sources.

2) Ultimate Goal

a) The Funding and Benefits Policy states: "It is the ultimate goal of the TRB to eliminate the current Unfunded Actuarial Accrued Liability and to establish a Stabilization Reserve equal to at least 10% of the Actuarial Accrued Liability. Once the system has achieved this goal, any surplus funds that become available may be applied toward the cost of benefit enhancements and/or contribution reductions, provided, sufficient reserves are retained to reasonably allow for adverse experience and the contribution rates remain at least 1 percent above the normal cost."

b) Analysis: The funding of the TRS is moving in this direction, but it is still projected to be a long way off. This is represented by an amortization period of the Unfunded Actuarial Accrued Liability of 28.6 years using actuarial assets and 18.3 years using market assets. Discipline will be required by all parties concerned to reach this goal.

3) Benefit Enhancements

a) The Funding and Benefits Policy states: "Proposed benefit enhancements must include additional funding sufficient to cover any increase in the normal cost and to amortize any increase in unfunded liabilities over a period not to exceed 25 years. In addition, as of the most recent actuarial valuation, the funded ratio must be 85% or greater before the Board will support legislation to enhance benefits."

b) Analysis: Since the net funded ratio at July 1, 2007 of 79.6% is below 85% the Board's Funding and Benefits policy does not currently support enhanced benefits, even if funding of increased unfunded liabilities over 25 years is included.

Changes in Plan Provisions Since Prior Actuarial Valuation

There have been no changes in plan provisions since the prior actuarial valuation.

Changes in Actuarial Assumptions Since Prior Actuarial Valuation

There have been no changes in Actuarial assumptions since the prior actuarial valuation.

Milliman's work product was prepared exclusively for the System for a specific and limited purpose. It is a complex, technical analysis that assumes a high level of knowledge concerning the System's operations, and uses the System's data, which Milliman has not audited. It is not for the use or benefit of any third party for any purpose. Any third party recipient of Milliman's work product who desires professional guidance should not rely upon Milliman's work product, but should engage qualified professionals for advice appropriate to its own specific needs. Any distribution of this report must be in its entirety including this cover letter, unless prior written consent from Milliman is obtained.

The Exhibits provide further information. Milliman is completely responsible for these exhibits. Specifically, they are:

Exhibit 1	Summary of Actuarial Assumptions and Methods
Exhibit 2	Schedule of Active Member Valuation Data
Exhibit 3	Schedule of Retirees and Beneficiaries Added to and Removed from Rolls
Exhibit 4	Solvency Test
Exhibit 5	Analysis of Financial Experience
Exhibit 6	Provisions of Governing Law

The Schedule of Funding Progress and the Schedule of Contributions from the Employers and Other Contributing Entities shown in the Financial Section of this report were also prepared by Milliman.

I, Mark C. Olleman, am a member of the American Academy of Actuaries and a Fellow of the Society of Actuaries, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Sincerely,

Mark C Olleman

Mark C. Olleman, FSA, EA, MAAA
Consulting Actuary

MCO/nlo

cc: Mr. Craig Glyde

Enclosures

TEACHERS' RETIREMENT SYSTEM OF MONTANA

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

1. **Investment Return**

   The annual rate of investment earnings based on the actuarial value of the assets of the System are assumed to be 7.75% per year, compounded annually and net of investment and operating expenses (adopted 7/1/2004).

2. **Valuation of Assets**

   Assets are valued based on their market value, with a four-year smoothing of all market value gains and losses. The expected return is determined for each year based on the beginning of year market value and actual cash flows during the year. Any difference between the expected market value return and the actual market value return is recognized evenly over a period of four years. The gains and losses are measured starting with the year ended June 30, 2007 (adopted 7/1/2007).

3. **Selection of Assumptions**

   The actuarial assumptions and methods used to value the System's liabilities and measure the System's funding progress are recommended by a Member of the American Academy of Actuaries (MAAA) and approved by the retirement board.

4. **Mortality**

   The mortality rates used in this valuation are:

Contributing Members, Retired Members and Beneficiaries: Basis – RP-2000 Combined Healthy Mortality projected by Scale AA to 2008 for respective sexes, as adjusted:

	Group	*Adjustment*	*Adopted*
Contributing Members, Retired Members and Beneficiaries:	Males	-3 years	7/1/2006
	Females	-2 years	7/1/2006
Disabled Members:	Males	-3 years	7/1/2006
	Females	+3 years	7/1/2006

5. **Retirement**

Service Retirement

Annual probabilities among persons eligible for service retirement are illustrated in the following table:

	General Members			University Members		
Age	Eligible for Reduced Benefits	First Year Eligible for Full Benefits	Thereafter	Eligible for Reduced Benefits	First Year Eligible for Full Benefits	Thereafter
45		18.0%	9.5%		5.0%	4.9%
46		18.0	9.5		5.0	4.9
47		12.5	9.5		5.0	4.9
48		12.5	9.5		5.0	4.9
49	*	12.5	9.5	*	5.0	4.9
50	4.0%	12.5	9.5	1.9%	8.0	4.9
51	4.0	16.0	9.5	2.2	8.0	4.9
52	4.5	16.0	9.5	2.5	8.0	6.0
53	4.5	16.0	9.5	2.8	8.0	6.0
54	5.0	16.0	9.5	3.1	12.0	6.0
55	5.5	22.0	14.0	3.4	15.0	6.0
56	6.0	22.0	14.0	3.7	15.0	6.0
57	6.5	22.0	14.0	4.0	15.0	7.0
58	6.5	22.0	15.0	4.3	15.0	7.0
59	7.0	22.0	18.0	4.7	15.0	9.0
60	*	22.0	22.0	*	19.0	10.0
61		22.0	22.0		19.0	14.0
62		27.0	27.0		24.0	24.0
63		22.0	22.0		14.0	14.0
64		25.0	25.0		20.0	20.0
65		35.0	35.0		33.0	33.0
66		30.0	30.0		23.0	23.0
67		24.0	24.0		23.0	23.0
68		22.0	22.0		23.0	23.0
69		22.0	22.0		23.0	23.0
70		**	**		**	**

* *All benefits are unreduced after attaining age 60. Reduced benefits are not available before age 50.*

** *Immediate retirement is assumed at age 70 or over.*

(Adopted 7/1/2002)

Disability Retirement

Annual probabilities are illustrated below:

Age	General Members	University Members
25	.010%	.003%
30	.010	.006
35	.020	.012
40	.040	.021
45	.080	.036
50	.130	.055
55	.180	.083
60	.260	.126

(General Member rates adopted 7/1/2002; University Member rates adopted 7/1/1996)

6. **Other Terminations of Employment**

The annual rates of termination are illustrated below:

Years of Service	General Members	University Members
1	30.0%	33.0%
2	16.0	17.0
3	11.0	13.0
4	9.0	11.0
5	8.0	9.0
6	7.7	8.3
7	7.3	7.7
8	7.0	7.0
9	6.6	6.6
10	6.2	6.2
11	5.8	5.8
12	5.4	5.4
13	5.0	5.0
14	4.6	4.6
15	4.2	4.2
16	3.8	3.8
17	3.4	3.4
18 and up	3.0	3.0

(Adopted 7/1/2002)

7. Future Salaries

The total annual rates of salary increase include an assumed 4.5% per annum ultimate rate of increase in the wage growth plus increases due to promotions and longevity. The 4.5% general wage increase assumption is based on an assumption that the Consumer Price Index will increase at a rate of 3.5% per year and there will be Real Wage Growth of 1.0% per year (adopted 7/1/2004).

	General Members			University* Members		
Years of Service	Individual Promotion & Longevity	General Wage Increase	Total Salary Increase	Individual Promotion & Longevity	General Wage Increase	Total Salary Increase
1	4.51%	4.50%	9.01%	1.00%	4.50%	5.50%
2	4.09	4.50	8.59	1.00	4.50	5.50
3	3.46	4.50	7.96	1.00	4.50	5.50
4	2.94	4.50	7.44	1.00	4.50	5.50
5	2.52	4.50	7.02	1.00	4.50	5.50
6	2.21	4.50	6.71	1.00	4.50	5.50
7	1.89	4.50	6.39	1.00	4.50	5.50
8	1.68	4.50	6.18	1.00	4.50	5.50
9	1.47	4.50	5.97	1.00	4.50	5.50
10	1.31	4.50	5.81	1.00	4.50	5.50
11	1.16	4.50	5.66	1.00	4.50	5.50
12	1.00	4.50	5.50	1.00	4.50	5.50
13	0.84	4.50	5.34	1.00	4.50	5.50
14	0.68	4.50	5.18	1.00	4.50	5.50
15	0.58	4.50	5.08	1.00	4.50	5.50
16	0.47	4.50	4.97	1.00	4.50	5.50
17	0.37	4.50	4.87	1.00	4.50	5.50
18	0.26	4.50	4.76	1.00	4.50	5.50
19	0.21	4.50	4.71	1.00	4.50	5.50
20	0.16	4.50	4.66	1.00	4.50	5.50
21	0.11	4.50	4.61	1.00	4.50	5.50
22 & Up	0.00	4.50	4.50	1.00	4.50	5.50

* *Montana University System (MUS) members are assumed to have a 0.63% higher average final compensation to account for the larger than average annual compensation increases observed in the years immediately preceding retirement.*

(General Member promotion and longevity rates adopted 7/1/2002; University Member promotion and longevity rates adopted 7/1/2002.)

8. **Growth in Membership**

No growth in the membership of the System is assumed. The combined effects of replacements of members and general increases in salaries are assumed to produce an average 4.5% annual expansion in the payroll of covered members (adopted 7/1/2004).

9. **Actuarial Cost Method**

The entry age actuarial cost method has been used since before Milliman became the retained actuary in 1992. We have no record of a different cost method ever being used.

The unfunded actuarial accrued liability created by this method, including gains and losses, is amortized as a level percentage of the System's projected payroll. The amortization payment is set so the total contribution rate will be unchanged, provided that rate allows the unfunded actuarial accrued liability to be completely funded over an acceptable period.

10. **Postretirement Increases**

On January 1 of each year, the retirement allowance payable is increased by 1.50% if the retiree's most recent retirement date is at least 36 months prior to that date.

11. **Effective Dates**

All assumptions and procedures were initially adopted for the actuarial valuation as of July 1, 2007, except as noted.

12. **Date of Last Study**

The last study of the System's active member experience reflected in this report was performed in 2002. It analyzed the experience for the six-year period from 1995-2001. The next study of the System's active member and economic experience is scheduled for the year 2008 and will cover the six years of experience from 2001 through 2007.

A study of the System's retired and disabled mortality experience was performed in 2006. It analyzed the experience for the six-year period from 1999-2005. It will be updated in 2010.

A study of the System's economic experience was performed in 2004. The next study of the System's economic experience is scheduled for 2010.

13. **Interest on Member Contributions**

Interest on member contributions is assumed to accrue at an annual rate of 5.0% compounded annually (adopted 7/1/2004).

14. **Price Inflation**

3.50% per annum, compounded annually (adopted 7/1/2004).

15. **Recent Changes**

The following details recent changes in:

The Nature of the Plan

There have been no changes in the nature of the plan since the prior valuation.

Actuarial Assumptions

There have been no changes in actuarial assumptions since the prior valuation.

Actuarial Method

The method of measuring the System's actuarial assets has changed since the prior valuation. Asset gains and losses are smoothed over a four-year period as of July 1, 2007, beginning with gains and losses over the year ending on June 30, 2007. As of July 1, 2006, the System's assets were measured on a market value basis, with immediate recognition of all gains and losses.

Retained Actuary

There has been no change in the retained actuary or actuarial firm employed to perform actuarial valuations since the prior valuation.

TEACHERS' RETIREMENT SYSTEM OF MONTANA

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Full-Time Members

Valuation Date	Number	Annual Payroll	Average Annual Pay	Annualized % of Increase in Average Pay
July 1, 2000	13,289	$ 477,160,000	$ 35,906	5.9%
July 1, 2002	12,796	486,204,000	37,997	5.8
July 1, 2004	12,601	510,808,000	40,537	6.7
July 1, 2005	12,523	523,909,000	41,836	3.2
July 1, 2006	12,715	549,268,000	43,198	3.3
July 1, 2007	12,634	568,351,000	44,986	4.1

Part-Time Members*

Valuation Date	Number	Annual Payroll	Average Annual Pay	Annualized % of Increase in Average Pay
July 1, 2000	4,245	$ 42,000,000	$ 9,894	N/A
July 1, 2002	4,650	52,700,000	11,333	14.5%
July 1, 2004	5,013	60,300,000	12,029	6.1
July 1, 2005	5,019	62,000,000	12,353	2.7
July 1, 2006	4,840	57,700,000	11,921	-3.5
July 1, 2007	4,994	61,100,000	12,235	2.6

** Excludes part-time active members with annual compensation less than $1,000.*

TEACHERS' RETIREMENT SYSTEM OF MONTANA

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS*

	Added to Rolls		Removed from Rolls		Rolls end of year			
Year Ended	**No.**	**Annual Allowances**	**No.**	**Annual Allowances**	**No.**	**Annual Allowances**	**% Increase in Annual Allowances**	**Average Annual Allowances**
June 30, 2000	N/A	$ N/A	N/A	$ N/A	9,021	$ 117,227,000	18.4%	$ 12,995
June 30, 2002	N/A	N/A	N/A	N/A	9,768	139,131,000	18.7	14,244
June 30, 2004	1,232	N/A	625	N/A	10,375	159,776,000	14.8	15,400
June 30, 2005	613	N/A	324	N/A	10,664	170,129,000	6.5	15,954
June 30, 2006	617	12,898,000	262	1,913,000	11,019	181,114,000	6.5	16,436
June 30, 2007	668	16,737,000	331	2,614,000	11,356	195,237,000	7.8	17,192

** Information provided where available.*

TEACHERS' RETIREMENT SYSTEM OF MONTANA

SOLVENCY TEST

(All dollar amounts in millions)

		Actuarial Accrued Liabilities for			Portion of Actuarial Accrued Liabilities Covered by Assets		
		(A)	(B)	(C)			
Actuarial Valuation Date	Actuarial Value of Assets	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)	(A)	(B)	(C)
July 1, 1998[1]	$ 1,809.0	$ 603.6	$ 980.0	$ 539.7	100.0%	100.0%	41.8%
July 1, 1998[2]	1,809.0	603.6	1,111.3	627.8	100.0	100.0	15.0
July 1, 2000[3]	2,247.5	647.2	1,346.7	654.4	100.0	100.0	38.8
July 1, 2000[4]	2,247.5	647.2	1,346.7	658.1	100.0	100.0	38.5
July 1, 2002	2,484.8	722.6	1,598.4	659.1	100.0	100.0	24.9
July 1, 2004	2,485.7	750.6	1,865.3	743.3	100.0	93.0	0.0
July 1, 2005	2,497.5	771.5	1,979.2	776.3	100.0	87.2	0.0
July 1, 2006	2,745.8	791.3	2,033.8	908.5	100.0	96.1	0.0
July 1, 2007	3,006.2	804.5	2,171.1	952.9	100.0	100.0	3.2

(1) Results of July 1, 1998 Actuarial Valuation.

(2) July 1, 1998 results adjusted for 1.5% GABA and $500 minimum benefit for legislation which passed in Spring 1999 and the new salary scale adopted in November 1998.

(3) Results of July 1, 2000 Actuarial Valuation.

(4) July 1, 2000 results adjusted for $600 minimum benefit for legislation which passed in Spring 2001.

TEACHERS' RETIREMENT SYSTEM OF MONTANA

ANALYSIS OF FINANCIAL EXPERIENCE

An analysis of financial experience is performed in conjunction with all regularly scheduled valuations.

The results of our analysis of the financial experience of the System in the two most recent regular actuarial valuations are presented in Exhibit 7. Each gain or loss shown represents our estimate of how much the given type of experience caused the Unfunded Actuarial Accrued Liability or Funding Reserve to change in the period since the previous actuarial valuation.

Gains and losses shown due to demographic sources are approximate. Demographic experience is analyzed in greater detail in our periodic assumption studies.

Non-recurring gains and losses result from changes in the actuarial assumptions and benefit improvements.

TEACHERS' RETIREMENT SYSTEM OF MONTANA

ANALYSIS OF FINANCIAL EXPERIENCE

(All dollar amounts in millions)

	UAAL (Gain)/Loss	
	2006 - 2007	2005 - 2006
Investment Income. Investment income was (greater) less than expected. Based on actuarial value of assets.	($ 67.7)	($ 17.9)
Pay Increases. Pay increases were (less) greater than expected.	2.5	(1.3)
Age & Service Retirements. Members retired at (older) younger ages or with (less) greater final average pay than expected.	(0.9)	(4.1)
Disability Retirements. Disability claims were (less) greater than expected.	0.2	0.3
Death-in-Service Benefits. Survivor claims were (less) greater than expected.	(1.0)	(0.2)
Withdrawal From Employment. (More) less reserves were released by withdrawals than expected.	7.2	6.5
Death After Retirement. Retirees (died younger) lived longer than expected.	0.5	(6.2)
Other. Miscellaneous (gains) and losses resulting from data adjustments.	(1.6)	17.6
Total (Gain) or Loss During Period From Financial Experience.	$ (60.8)	$ (5.3)
Non-Recurring Items.		
Changes in actuarial assumptions caused a (gain) loss.	0.0	24.0
Changes in benefits caused a (gain) loss.	0.0	0.0
Composite (Gain) Loss During Period.	$ (60.8)	$ 18.7

* *Effects related to losses are shown in parentheses. Numerical results are expressed as a decrease (increase) in the UAAL.*

TEACHERS' RETIREMENT SYSTEM OF MONTANA

PROVISIONS OF GOVERNING LAW

Effective Date	September 1, 1937.
Vesting Period	5 years. No benefits are payable unless the member has a vested right, except the return of employee contributions with interest.
Final Compensation	Average of highest 3 consecutive years of earned compensation.
Normal Form of Benefits	Life only annuity. All benefits cease upon death; however, in no event will the member receive less than the amount of employee contributions with interest.
Normal Retirement Benefits	
Eligibility:	25 years of service or age 60 and 5 years of service.
Benefit:	The retirement benefit is equal to 1/60 of final compensation for each year of service.
Early Retirement Benefits	
Eligibility:	5 years of service and age 50.
Benefit:	The retirement benefit is calculated in the same manner as described for normal retirement, but the benefit is reduced 1/2 of 1% for each of the first 60 months early and 3/10 of 1% for each of the next 60 months early.
Death Benefit	
Eligibility:	5 years of service.
Benefit:	The death benefit is equal to 1/60 of final compensation for each year of service accrued at date of death, with an actuarial adjustment based on the relation of the member's age at death to the beneficiary's age. A monthly benefit of $200 is paid to each child until age 18. In addition, a lump-sum benefit of $500 is paid upon the death of an active or retired member.

Disability Benefit

Eligibility:	5 years of service.
Benefit:	The disability benefit is equal to 1/60 of final compensation for each year of service accrued at date of disability. The minimum benefit is 1/4 of the final compensation.

Withdrawal Benefits	With less than 5 years of service, the accumulated employee contributions with interest are returned. With more than 5 years, the member may elect a refund of contributions with interest or leave the contributions and interest in the System and retain a vested right to retirement benefits.
Contributions	Member: 7.15% of compensation. Employer: 9.58% of compensation, 9.96% starting July 1, 2009. MCA 19-20-604 specifies that the employer contribution rate will be reduced by 0.11% when the amortization period of the System's UAAL is 10 years or less according to the System's latest actuarial valuation.
Interest on Member Contributions	Interest on member contributions is currently being credited at a rate of 5.0% per annum.
Cost-of-Living Adjustments	On January 1 of each year, the retirement allowance payable must be increased by 1.5% if the retiree's most recent retirement effective date is at least 36 months prior to January 1 of the year in which the adjustment is to be made.

STATISTICAL SECTION

SCHEDULE OF CHANGES IN NET ASSETS

SCHEDULE OF AVERAGE BENEFIT PAYMENTS

SCHEDULE OF MEMBERSHIP

SCHEDULE OF PRINCIPAL PARTICIPATING EMPLOYERS

LOCATION OF BENEFIT RECIPIENTS

Teachers' Retirement System
A Component Unit of the State of Montana

Schedule of Changes in Net Assets
(In thousands)

		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Additions:											
Member Contributions	$	41,938	42,642	45,599	48,278	47,872	50,221	51,383	52,900	53,293	56,509
Employer Contributions		44,476	44,987	47,848	50,990	51,519	53,277	55,774	57,150	58,269	61,944
Other Contributions		200	103	674	611	762	754	770	656	100,693	50,720
Misc Income		18	20	22	6		4			4	16
Net Investment Income		287,136	240,321	175,235	(119,050)	(159,585)	126,246	281,793	188,734	224,787	484,532
Total Additions	$	373,768	328,073	269,378	(19,165)	(59,432)	230,502	389,720	299,440	437,046	653,721
Deductions:											
Benefit Payments	$	94,205	100,028	109,231	118,842	130,006	140,229	150,271	161,247	171,957	182,827
Withdrawals		4,826	5,126	5,271	5,370	6,472	6,468	5,843	4,340	4,876	5,595
Administrative Expenses		881	1,361	1,294	1,716	1,607	1,861	1,507	1,561	1,579	1,434
Other								890			502
Total Deductions	$	99,912	106,515	115,796	125,928	138,085	148,558	158,511	167,148	178,412	190,358
Change in Net Assets	$	273,856	221,558	153,582	(145,093)	(197,517)	81,944	231,209	132,292	258,634	463,363

Teachers' Retirement System
A Component Unit of the State of Montana

Schedule of Average Benefit Payments
Ten Years Ended June 30, 2007

Fiscal Year of Retirement			Years of Credited Service					
			5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30+
1998	Average Monthly Benefit	$	190	319	566	1,080	1,390	1,978
	Average Final Average Salary	$	1,987	2,184	2,552	3,365	3,637	4,088
	Number of Retirees		28	27	32	27	144	120
1999	Average Monthly Benefit	$	291	453	658	978	1,430	2,018
	Average Final Average Salary	$	2,522	2,621	2,825	3,069	3,600	4,097
	Number of Retirees		34	33	40	44	159	153
2000	Average Monthly Benefit	$	227	410	737	1,217	1,490	2,155
	Average Final Average Salary	$	2,009	2,553	3,088	3,716	3,686	4,327
	Number of Retirees		24	27	40	47	144	173
2001	Average Monthly Benefit	$	185	472	872	1,196	1,660	2,155
	Average Final Average Salary	$	1,846	2,649	3,488	3,576	4,035	4,260
	Number of Retirees		30	44	33	62	170	217
2002	Average Monthly Benefit	$	261	441	744	1,214	1,689	2,219
	Average Final Average Salary	$	2,073	2,530	3,237	3,504	4,068	4,363
	Number of Retirees		28	37	43	66	173	222
2003	Average Monthly Benefit	$	310	432	797	1,347	1,725	2,193
	Average Final Average Salary	$	2,216	2,502	3,084	3,891	4,066	4,238
	Number of Retirees		24	40	51	85	149	193
2004	Average Monthly Benefit	$	263	474	954	1,383	1,838	2,489
	Average Final Average Salary	$	2,231	2,589	3,814	3,904	4,290	4,757
	Number of Retirees		35	37	34	62	127	198
2005	Average Monthly Benefit	$	263	639	879	1,327	1,776	2,605
	Average Final Average Salary	$	2,283	3,404	3,433	3,737	4,184	4,876
	Number of Retirees		38	31	39	57	141	205
2006	Average Monthly Benefit	$	307	515	845	1,410	1,883	2,626
	Average Final Average Salary	$	2,577	2,801	3,297	4,089	4,416	4,896
	Number of Retirees		43	53	43	47	140	208
2007	Average Monthly Benefit	$	296	585	821	1,393	2,009	2,714
	Average Final Average Salary	$	2,598	3,283	3,318	3,982	4,727	5,041
	Number of Retirees		42	42	46	74	135	193

Teachers' Retirement System
A Component Unit of the State of Montana

Schedule of Membership

Active and Inactive Members

Period Ended	Active Members	Inactive Vested Members	Inactive Non-vested	Total
June 30, 1998	18,205	1,179	8,061	27,445
June 30, 1999	18,287	1,209	8,612	28,108
June 30, 2000	18,423	1,245	9,212	28,880
June 30, 2001	18,530	1,359	10,034	29,923
June 30, 2002	17,262	1,611	8,834	27,707
June 30, 2003	18,285	1,519	7,736	27,540
June 30, 2004	18,257	1,607	7,723	27,587
June 30, 2005	18,247	1,640	8,431	28,318
June 30, 2006	18,108	1,681	8,470	28,259
June 30, 2007	18,188	1,660	8,856	28,704

Retired Members and Benefit Recipients

Period Ended	Retirement	Survivors	Disability	Total
June 30, 1998	7,400	412	276	8,088
June 30, 1999	7,661	415	282	8,358
June 30, 2000	7,927	422	291	8,640
June 30, 2001	8,288	434	294	9,016
June 30, 2002	8,615	432	295	9,342
June 30, 2003	8,957	431	294	9,682
June 30, 2004	9,246	427	294	9,970
June 30, 2005	9,578	427	294	10,299
June 30, 2006	9,909	429	299	10,637
June 30, 2007	10,242	424	305	10,971

Teachers' Retirement System
A Component Unit of the State of Montana

Schedule of Principal Participating Employers

Employer	Covered Employees	Percentage of Total Covered Employees
Billings Public Schools	1,576	8.4%
Great Falls Public Schools	1,106	5.9%
Missoula Co Public Schools	979	5.2%
Helena Public Schools	852	4.5%
Bozeman Public Schools	588	3.1%
Kalispell Public Schools	476	2.5%
Butte Public Schools	396	2.1%
Browning Public Schools	289	1.5%
Columbia Falls Public Schools	282	1.5%
Belgrade Public Schools	273	1.5%
University of Montana	268	1.4%
Hardin Public Schools	261	1.4%
Hamilton Public Schools	225	1.2%
Havre Public Schools	220	1.2%

Teachers' Retirement System
A Component Unit of the State of Montana

Location of Benefit Recipients as of June 30, 2007

Alabama	6	Michigan	18	Texas	75
Alaska	36	Minnesota	78	Utah	52
Arizona	247	Mississippi	4	Vermont	5
Arkansas	11	Missouri	25	Virginia	21
California	138	Montana	8,566	Washington	393
Colorado	100	Nebraska	22	West Virginia	5
Connecticut	7	Nevada	104	Wisconsin	26
Florida	50	New Hampshire	3	Wyoming	98
Georgia	12	New Jersey	3	District of Columbia	1
Hawaii	12	New Mexico	30	APO	2
Idaho	133	New York	16	Australia	4
Illinois	13	North Carolina	30	Canada	15
Indiana	6	North Dakota	86	Egypt	1
Iowa	14	Ohio	8	England	1
Kansas	18	Oklahoma	19	Germany	1
Kentucky	6	Oregon	156	New Zealand	2
Louisiana	6	Pennsylvania	10	Scotland	1
Maine	4	South Carolina	6	Thailand	1
Maryland	7	South Dakota	50		
Massachusetts	6	Tennessee	12	TOTAL*	10,782

*189 recipients receive two benefits

INVESTMENT ACTIVITY

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. The Unified Investment Program is required by law, 17-6-201 MCA, to operate under the "prudent expert principle", defined as: 1) discharging its duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of like character and like aims; 2) diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return; and 3) discharging its duties solely in the interest of and for the benefit of the funds managed.

The TRS investment portfolio posted a total return of 17.94%, resulting in an increase in the fair market value of its investments. The System's total annualized rate of return over the last five and ten years was 10.95% and 7.68% respectively. This rate of return compares with an actuarial assumed rate of 8% through June 30, 2004 and 7.75% effective July 1, 2004. The Board of Investments (BOI) invests the TRS and other pension portfolios for the long-term and its investment strategies are designed to provide sufficient returns over time. However, there is no guarantee of future investment performance. Performance in any given year is dependent not only on the BOI's investment performance but also on the performance of the markets themselves, which are impacted by domestic and global economic conditions, interest rates, and government policies.

TRS Investment Rates of Returns

	FY 2007	3-Year	5-Year	10-Year
Fixed Income	6.88%	5.09%	6.09%	6.94%
Domestic Equities	19.53%	11.05%	10.41%	6.00%
International Equities	31.57%	23.60%	18.18%	8.13%
Private Equities	23.46%	19.21%	17.78%	15.64%
Real Estate	6.55%	7.24%	6.72%	6.66%
Total Portfolio	17.94%	11.64%	10.95%	7.68%

Please refer to the Investment Section of this report for additional detailed information regarding TRS investments.

PLAN FUNDING STATUS

The TRS plan's net Funded Ratio increased from 76.1% at July 1, 2006 to 79.6% at July 1, 2007. The improvements in the TRS funding are primarily due to additional contributions and favorable investment returns. This has also resulted in a significant reduction in the amortization of the Unfunded Actuarial Accrued Liability to 28.6 years. Additional information regarding the financial condition of the TRS plan can be found in the Actuarial Section of this report.