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Financial



**California State Teachers'
Retirement System**
(A Component Unit of the State of California)

**Independent Auditor's Report,
Financial Statements, Required
Supplementary Information, and Other
Supplemental Information**

For the Fiscal Year Ended June 30, 2006



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INDEPENDENT AUDITOR'S REPORT

To the Teachers' Retirement Board of the
California State Teachers' Retirement System
Sacramento, California

We have audited the accompanying statement of fiduciary net assets of the California State Teachers' Retirement System (the System), a component unit of the State of California, as of June 30, 2006, and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the System's 2005 financial statements on which our report dated September 23, 2005, expressed an unqualified opinion.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and 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 fiduciary net assets of the California State Teachers' Retirement System as of June 30, 2006, and the changes in fiduciary net assets for the year then ended in conformity with the accounting principles generally accepted in the United States of America.

As described in Note 1, based on the most recent actuarial valuation as of June 30, 2005, the System's independent actuaries determined that, at June 30, 2005, the value of the Defined Benefit Program's actuarial accrued obligation exceeded the actuarial value of its assets by \$20.3 billion.

In accordance with *Government Auditing Standards*, we have issued our report dated September 22, 2006, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 14 through 17, the Schedule of Funding Progress on page 34 and the Schedule of Contributions from Employers and Other Contributing Entities on pages 35 through 36 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. 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. The introductory section, other supplemental information in the financial section and the investments, actuarial and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplemental information in the financial section 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, investments, actuarial and statistical sections have not been subjected to auditing procedures applied in the audit of the basic financials statements and, accordingly, we express no opinion on them.



Certified Public Accountants

Sacramento, California
September 22, 2006

California State Teachers' Retirement System Management's Discussion and Analysis (Unaudited) As of June 30, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) of the California State Teachers' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2006. We designed the MD&A to focus on the current year's activities, resulting changes, and currently known facts, and we encourage you to read it in conjunction with the System's financial statements and notes to the financial statements.

The System is primarily responsible for administering retirement, disability, survivor and health benefits, as well as administering a supplemental retirement savings plan for California public school teachers and certain other employees of the state's public school system. The System is comprised of a total of four fiduciary funds:

1. Teachers' Retirement Fund (TRF)
2. Voluntary Investment Program (VIP)
3. Teachers' Health Benefits Fund (THBF)
4. Teachers' Replacement Benefits Program Fund (TRBPF)

FINANCIAL HIGHLIGHTS

- Net assets increased by \$14.7 billion or 11% to \$144.3 billion.
- Net investment income totaled \$16.1 billion, an increase of \$1.9 billion or 14%.
- As of June 30, 2005, the System's Defined Benefit Program was estimated to be funded at 86%, compared to an estimated funding level of 85% as of June 30, 2004.
- Total contributions decreased by \$194.5 million or 3% to \$5.5 billion.
- Supplemental Benefit Maintenance Account contributions increased by \$45.7 million or 7% to \$666.6 million.
- Benefit payments increased by \$516.8 million or 8% to \$6.7 billion.
- Refund of members' contributions increased by \$10.8 million or 12% to \$105 million.
- In the THBF, the Medicare Premium Payment Program premiums paid for members totaled \$29.3 million.

OVERVIEW OF FINANCIAL STATEMENTS

This MD&A is an introduction to the System's basic financial statements. The System's financial statements include the following components: (1) fund financial statements, (2) notes to the basic financial statements, (3) required supplementary information, and (4) other supplemental information.

Fund financial statements. The statements of fiduciary net assets presents information on all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, the increase or decrease in net assets serves as a useful indicator of the health of the System's financial position. The statements of changes in fiduciary net assets show how the System's net assets changed during the fiscal year.

California State Teachers' Retirement System Management's Discussion and Analysis (Unaudited) As of June 30, 2006

Notes to the financial statements. The financial statement notes provide additional information that is essential to a full understanding of the data provided in the fund financial statements. Below we describe the information available in the notes to the financial statements.

- Note 1 provides a general description of the System, as well as a concise description of each of the funds administered by the System.
- Note 2 provides a summary of significant accounting policies, including the basis of accounting for the System, management's use of estimates, cash and investment accounting policies, and other significant accounting policies.
- Note 3 describes investments, including disclosures required by the Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, which includes information about the System's investment risk related to credit, (including custodial credit and concentrations of credit risk), interest rate, and foreign currency risks.
- Note 4 generally describes potential contingencies of the System.
- Note 5 provides a summary of significant commitments incurred by the System.
- Note 6 provides a summary of new accounting and financial reporting pronouncements.

Required supplementary information. The required supplementary information consists of two schedules and related notes on the defined benefit pension plans' funding progress and history of contributions from employers and other contributing entities. These schedules provide historical information that assists in understanding the funded status of the System over time.

Other supplemental information. Other supplemental information includes detailed information on administrative expenses, investment expenses, and consultant and professional services expenses.

FINANCIAL ANALYSIS

Teachers' Retirement Fund (TRF). The Teachers' Retirement Fund is an employee benefit trust fund created to administer the State Teachers' Retirement Plan (STRP). The STRP is a defined benefit pension plan which provides for retirement, disability, and survivor benefits. The STRP is comprised of three programs: Defined Benefit (DB) Program, Defined Benefit Supplement (DBS) Program, and the Cash Balance (CB) Benefit Program.

The STRP net assets increased 11% during the fiscal year, from \$129.5 billion in 2005 to \$144.2 billion as of June 30, 2006. Investments, excluding securities lending collateral, increased by \$14.4 billion or 11% to \$145.2 billion as of June 30, 2006. At June 30, 2006, STRP held \$32.3 billion in debt securities, a decrease of \$742.7 million or 2% from fiscal year 2004-05. At June 30, 2006, STRP also held \$91.1 billion in U.S. and international equity securities, an increase of \$10.1 billion or 13% from fiscal year 2004-05. Remaining holdings in short-term, alternative, and real estate investments totaled \$21.9 billion at June 30, 2006, an increase of \$5 billion or 30% from fiscal year 2004-05. Net appreciation on investments totaled \$12.2 billion in fiscal year 2005-2006 compared to \$10.4 billion in fiscal year 2004-05, an increase of \$1.9 billion or 18%. Further, as of June 30, 2006, the benefits in process of payment decreased and the benefits paid increased over \$500 million from the previous year as a result of the timing of the monthly benefits payment at fiscal year end. Receivables and investments settlement balances both decreased over \$3.8 billion dollars from the June 30, 2005

California State Teachers' Retirement System Management's Discussion and Analysis (Unaudited) As of June 30, 2006

amounts. This decrease is due to a change in market conditions that weakened the U.S. dollar, which resulted in a decrease in the hedging of foreign exchange contracts.

NET ASSETS

(Dollars in Thousands)

ASSETS	<u>2006</u>	<u>2005</u>	<u>Percent Change</u>
Investments ¹	\$172,872,149	\$153,433,187	13%
Cash and Cash Equivalents	309,484	175,854	76%
Receivables	3,449,874	7,303,410	(53)%
Other	1,307	2,002	(35)%
TOTAL ASSETS	176,632,814	160,914,453	10%
LIABILITIES			
Benefits in Process of Payment	44,297	551,520	(92)%
Investment Settlement	2,905,945	6,689,052	(57)%
Real Estate Leverage Program Obligation	568,049	879,480	(35)%
Other Liabilities	1,275,954	651,491	96%
Securities Lending Obligation	27,626,193	22,619,277	22%
TOTAL LIABILITIES	32,420,438	31,390,820	3%
TOTAL NET ASSETS	\$144,212,376	\$129,523,633	11%

¹ Includes securities lending collateral.

The System funds STRP benefits from employer, member and State contributions, federal proceeds, and investment earnings. Member contributions overall decreased in fiscal year 2005-06 by \$96 million or 4% from fiscal year 2004-05 because of a sharp increase in members purchasing service credit contributions in fiscal year 2004-05 to avoid an impending Tiered Rate Increase. Employer contributions increased by \$99 million or 5%. The State contributions in fiscal year 2005-06 decreased from fiscal year 2004-05 as a result of a net \$119.5 million repayment of an over requested General Fund contribution from prior fiscal years. The STRP experienced a net investment gain of \$16 billion in fiscal year 2005-06 compared with \$14.1 billion in fiscal year 2004-05.

CHANGES IN NET ASSETS

(Dollars in Thousands)

ADDITIONS	<u>2006</u>	<u>2005</u>	<u>Percent Change</u>
Member/Participant	\$2,230,754	\$2,326,536	(4)%
Employer	2,203,548	2,104,712	5%
State/Federal	1,018,720	1,218,614	(16)%
Investment/Other Income	16,077,792	14,128,986	14%
TOTAL ADDITIONS	21,530,814	19,778,848	9%
DEDUCTIONS			
Benefit Payments	6,649,007	6,133,873	8%
Refund of Contributions	97,453	87,969	11%
Administrative Expenses	95,611	94,662	1%
TOTAL DEDUCTIONS	6,842,071	6,316,504	8%
TOTAL CHANGES IN NET ASSETS	\$14,688,743	\$13,462,344	9%

California State Teachers' Retirement System Management's Discussion and Analysis (Unaudited) As of June 30, 2006

Deductions, which include benefit payments, refund of contributions and administrative expenses, totaled \$6.8 billion for the year. Growth in the number of new retirees increased benefit payments to \$6.6 billion, an increase of \$515.1 million or 8% over the prior year. Refund of contributions in fiscal year 2005-06 increased \$9.5 million or 11% to \$97.5 million. Administrative expenses in fiscal year 2005-06 increased \$949 thousand or 1% to \$95.6 million.

The most recent actuarial valuation for the fiscal year ended June 30, 2005, indicates that the DB Program is underfunded, with 86% of the funds needed to pay the actuarial cost of the benefits accrued as of June 30, 2005. This is an increase from the 85% estimated funding status as of June 30, 2004. The amount by which the DB Program actuarial obligation exceeded actuarial assets was \$20.3 billion as of June 30, 2005. The most recent actuarial valuation indicates that the DB Program's expected future revenue will be insufficient to finance its obligations including amortization of the unfunded status over the next 30 years.

Voluntary Investment Program (VIP). The VIP is a tax-deferred defined contribution plan and meets the requirements of the Internal Revenue Code, Section 403(b). CitiStreet, L.L.C provides Administrative services for VIP. This program's benefits are the accumulation of contributions and investment earnings credited to the member's account at the time of retirement, disability or termination of employment. Through the VIP, members have the opportunity to supplement their pension benefits. The VIP's June 30, 2006 investments increased by \$20.9 million or 19% and net assets increased by \$21.1 million or 19%. Contributions by members in fiscal year 2005-06 increased by \$1.1 million or 6% and investment income in fiscal year 2005-06 increased \$4.1 million or 67% from the previous fiscal year. Deductions from the VIP increased by \$1 million or 10% to \$10.7 million.

Teachers' Health Benefits Fund (THBF). The THBF is an employee benefit trust fund created to administer health benefit programs for members of the California State Teachers' Retirement System. The Medicare Premium Payment Program is the only program within the fund. This program pays Medicare Part A premiums and surcharges and Part B surcharges for members meeting certain eligibility criteria. The System funds this program on an as needed basis from current employer contributions, which increased by \$1.1 million or 4% to \$29.6 million during fiscal year 2005-06. The THBF paid benefits of \$29.3 million in fiscal year 2005-06 compared with \$27.4 million the prior year. The System invests the assets of the THBF in the State of California's Surplus Money Investment Fund and earned \$143 thousand in interest income for the fiscal year ended June 30, 2006.

Teachers' Replacement Benefits Program Fund (TRBPF). The TRBPF is a replacement pension benefit plan established to pay the portion of annual benefits that exceed the annual limitations under Section 415 of the Internal Revenue Code of 1986 (26 U.S.C. Section 415). Current employer contributions fund this benefit program on an as needed basis. The TRBPF received contributions of \$330 thousand to pay benefits during fiscal year 2005-06.

REQUESTS FOR INFORMATION

This Financial Report is designed to provide a general overview of the System's finances. For questions concerning any information in this report or for additional information contact the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, CA 95851-0275.

California State Teachers' Retirement System
Statement of Fiduciary Net Assets
As of June 30, 2006 (with Comparative Totals as of June 30, 2005)
(Dollars in Thousands)

	Teachers' Retirement Fund	Voluntary Investment Program	Teachers' Health Benefits Fund	Teachers' Replacement Benefits Program Fund	Comparative Totals	
					2006	2005
Assets						
Investments, at fair value:						
Short term	\$ 1,506,105	\$ 24,498	\$ 1,604	\$ -	\$ 1,532,207	\$ 1,419,588
Debt securities	32,269,214				32,269,214	33,011,898
Equities:						
Directly held:						
Domestic	59,826,205	-	-	-	59,826,205	55,440,796
International	31,242,535	-	-	-	31,242,535	25,496,315
Mutual funds	-	107,542	-	-	107,542	88,497
Alternative investments	8,609,513	-	-	-	8,609,513	6,921,778
Real estate investments	11,792,384	-	-	-	11,792,384	8,547,848
Securities lending collateral	27,626,193	-	-	-	27,626,193	22,619,277
Total investments	172,872,149	132,040	1,604	-	173,005,793	153,545,997
Cash and cash equivalents	309,484	-	-	-	309,484	175,869
Receivables:						
Investments sold	1,215,865	-	-	-	1,215,865	598,442
Foreign currency contracts	852,284	-	-	-	852,284	5,635,523
Interest and dividends	455,446	98	46	-	455,590	449,323
Member, employer and other	926,279	889	1,293	-	928,461	622,038
Total receivables	3,449,874	987	1,339	-	3,452,200	7,305,326
Other assets	1,307	-	-	-	1,307	2,002
Total assets	176,632,814	133,027	2,943	-	176,768,784	161,029,194
Liabilities						
Investments purchase payable	2,051,505	-	-	-	2,051,505	1,228,253
Foreign currency contracts payable	854,440	-	-	-	854,440	5,460,799
Benefits in process of payment	44,297	-	-	-	44,297	551,534
Real estate leverage program obligation	568,049	-	-	-	568,049	879,480
Other liabilities	1,275,954	67	217	-	1,276,238	651,657
Securities lending obligation	27,626,193	-	-	-	27,626,193	22,619,277
Total liabilities	32,420,438	67	217	-	32,420,722	31,391,000
Net assets held in trust for pension benefits (a schedule of funding progress is presented in Schedule I)						
	\$ 144,212,376	\$ 132,960	\$ 2,726	-	\$ 144,348,062	\$ 129,638,194

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

California State Teachers' Retirement System
Statement of Changes in Fiduciary Net Assets
For the Fiscal Year Ended June 30, 2006
(with Comparative Totals for the Fiscal Year Ended June 30, 2005)
(Dollars in Thousands)

	Teachers' Retirement Fund	Voluntary Investment Program	Teachers' Health Benefits Fund	Teachers' Replacement Benefits Program Fund	Comparative Totals	
					2006	2005
Additions						
Contributions:						
Member contributions	\$ 2,230,754	\$ 21,509	\$ -	\$ -	\$ 2,252,263	\$ 2,346,915
Employer contributions State of California/Federal Government	2,203,548	-	29,602	330	2,233,480	2,133,398
	1,018,720	-	-	-	1,018,720	1,218,614
Total contributions	5,453,022	21,509	29,602	330	5,504,463	5,698,927
Investment Income:						
Net appreciation (realized & unrealized) in fair value of investments	12,212,130	7,901	-	-	12,220,031	10,363,209
Interest, dividends and other	3,911,287	2,344	143	-	3,913,774	3,814,978
Securities lending income	1,087,366	-	-	-	1,087,366	502,398
Less investment expenses:						
Cost of lending securities	(1,020,130)	-	-	-	(1,020,130)	(436,409)
Other investment expenses	(112,929)	-	-	-	(112,929)	(100,232)
Net investment income	16,077,724	10,245	143	-	16,088,112	14,143,944
Other (expense) income	68	-	-	-	68	(8,886)
Total additions	21,530,814	31,754	29,745	330	21,592,643	19,833,985
Deductions						
Retirement, disability, death and survivor benefits	6,433,749	2,286	29,313	330	6,465,678	5,942,866
Purchasing power benefits	215,258	-	-	-	215,258	221,271
Refunds of member contributions	97,453	7,481	-	-	104,934	94,100
Administrative expenses	95,611	935	359	-	96,905	96,008
Total deductions	6,842,071	10,702	29,672	330	6,882,775	6,354,245
Net increase	14,688,743	21,052	73	-	14,709,868	13,479,740
Net assets held in trust for pension benefits						
Beginning of the year	129,523,633	111,908	2,653	-	129,638,194	116,158,454
End of the year	\$144,212,376	\$132,960	\$ 2,726	\$ -	\$144,348,062	\$129,638,194

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

California State Teachers' Retirement System

Notes to the Basic Financial Statements

1. Description of the System and Contribution Information

The California State Teachers' Retirement System (System) is the administrator of cost-sharing multiple-employer pension plans, a tax-deferred defined contribution plan, the Medicare Premium Payment Program and the Replacement Benefits Program as described below. The State Education Code known as the Teachers' Retirement Law (Section 22000 et. seq.), as amended and enacted by the State of California (State) Legislature established these plans and programs and the System as the administrator. The System is a component unit of the State of California. These financial statements include only the accounts of the System. The State of California includes the System's basic financial statements as a fiduciary fund in its financial statements. The System provides pension benefits to California full-time and part-time public school teachers from preschool through grade fourteen and certain other employees of the public school system.

Teachers' Retirement Fund (TRF)

The TRF is used to account for the State Teachers' Retirement Plan (STRP) which is comprised of three programs: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program (DBS Program) and the Cash Balance Benefit Program (CB Benefit Program). STRP holds these assets for the exclusive purpose of providing benefits to members and beneficiaries of the DB Program, the DBS Program and the CB Benefit Program. Also, the System uses these assets to defray reasonable expenses of administering the STRP and the System.

STRP Defined Benefit Program (DB Program)

The DB Program is a defined benefit pension program. At June 30, 2006, there were over 1,350 contributing employers (school districts, community college districts, county offices of education and regional occupational programs). The State is a non-employer contributor to the STRP. Membership is mandatory for all employees meeting certain statutory requirements, and optional for all other employees performing creditable service. At June 30, 2005, membership consisted of:

Active Members	
Vested	283,990
Nonvested	166,292
Inactive members	124,394
Retirees and benefit recipients	201,241
Total members, retirees and beneficiaries	<u>775,917</u>

Information as of June 30, 2006 will not be available prior to December 2006.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

The DB Program provides defined retirement benefits based on members' final compensation, age, and years of credited service. In addition, the retirement program provides benefits to members upon disability, and to survivors/beneficiaries upon the death of eligible members. Benefit provisions include:

- After five years of credited service, members become 100% vested in retirement benefits earned to date. Members are eligible for normal retirement at age 60. The normal retirement benefit is equal to 2% of final compensation for each year of credited service. Early retirement options are available at age 55 or as early as age 50 with 30 years of credited service. The age factor for retirements after age 60 increases with each quarter year of age to 2.4% at age 63 or older. Members who have 30 years or more of credited service shall receive an additional 0.2% of final compensation. In no event shall the total benefit factor exceed 2.4%.
- The System calculates retirement benefits based on a one-year final compensation for members who retire on or after January 1, 2001, with 25 or more years of credited service, or for classroom teachers with less than 25 years of credited service if the employer elects to pay the additional benefit cost. One-year final compensation means a member's highest average annual compensation earnable calculated by taking the creditable compensation that a member could earn in a school year while employed, if he or she were employed on a full-time basis, and if that person worked full time in that position during any period of 12 consecutive months. For all other members, final compensation is defined as the highest average annual compensation earned during any three consecutive years of credited service.
- Members who retire on or after January 1, 2001, and accumulate at least 30 years of credited service by January 1, 2011, will receive a longevity bonus.
- After five years of credited service, a member (prior to age 60 if under Coverage A, no age limit if under Coverage B, as defined in Education Code Sections 24001 and 24101, respectively) is eligible for disability benefits of up to 50% of final compensation plus 10% of final compensation for each eligible child, up to a maximum addition of 40%. The member must have a disability that will exceed a period of twelve or more months to qualify for a benefit.
- A family benefit is available if an active member died and had at least one year of credited service.
- Members' accumulated contributions are refundable with interest upon separation from the System. The board determines the credited interest rate each fiscal year. For the year ended June 30, 2006, the rate of interest credited to members' accounts is 2.75%.

Purchasing power protection is provided to members of the DB Program through the Purchasing Power Protection Program. Annual distributions (in quarterly payments) to retired and disabled members and beneficiaries restore purchasing power to a minimum of 80% of the initial monthly allowance. The annual contribution needed to meet the obligation of the purchasing power protection program on an actuarial basis has not been determined. Funding for the Purchasing Power Protection Program is from School Lands Revenue and the Supplemental Benefit Maintenance Account (SBMA). Public Resources Code Section 6217.5 appropriates School Lands Revenue. The State is required to contribute 2.5% of prior fiscal year teacher payroll to fund the SBMA. In addition, the proceeds from the sale of the Elk Hills Naval Petroleum Reserve are appropriated in annual installments by the federal government to be deposited to the SBMA.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

In fiscal year 2005-06, the State statutory SBMA contribution is \$582.2 million. In fiscal year ended June 30, 2004, special legislation reduced the State's contribution by \$500 million to \$58.9 million. The System has taken legal action to compel State to contribute the remaining \$500 million.

Required Contributions

Required member and employer contribution rates are set by the Teachers' Retirement Law. Required contribution rates are expressed as a level percentage of payroll using the entry age normal actuarial cost method. The System also uses the level percentage of payroll method to calculate the amortization of any unfunded liability.

A summary of statutory contribution rates and other sources of contributions to the DB Program is as follows:

- Members - 6% of applicable member earnings through December 31, 2010, increasing to 8% thereafter.
- Employers - 8.25% of applicable member earnings.
- State of California - Beginning July 1, 1999, under Education Code Section 22955, the General Fund transferred annually to the DB Program an amount equal to 3.102% of total creditable earnings of the immediately preceding calendar year to fund certain benefit enhancements effective January 1, 1999. The enactment of Chapter 1021, Statutes of 2000 (AB 2700) provided for a reduction in such funding from the General Fund to a factor of 2.5385% beginning July 1, 2000. The funding was further reduced to 1.9750% beginning July 1, 2001, and effective through June 30, 2003. Beginning July 1, 2003, the rate increased to 2.017% of the member's creditable earnings from the fiscal year ending in the prior calendar year.

Beginning October 1, 1998, a statutory contribution rate of 0.524%, adjustable annually in 0.25% increments up to a maximum of 1.505%, of the creditable earnings of the immediately preceding calendar year was established under Education Code Section 22955. This contribution is reduced to zero if there is no unfunded actuarial obligation and no normal cost deficit for benefit plans in place as of July 1, 1990. Based on the most recent actuarial valuation, as of June 30, 2005, there is no normal cost deficit or unfunded obligation for benefits in place as of July 1, 1990. As a result, the General Fund is not required to contribute quarterly payments starting October 1, 2006.

In the most recent actuarial valuation as of June 30, 2005, the System's actuaries determined that, at June 30, 2005, the value of the DB Program's actuarial accrued obligation exceeded the program's actuarial value of assets by \$20.3 billion. Based on this valuation, the current statutory contributions are equivalent to 17.567% of covered payroll and are sufficient to fund normal cost (16.829% of covered payroll) but not expected to be sufficient to amortize the unfunded actuarial obligation. While certain risks related to the global financial markets may affect the fair value of the System's investment portfolio, the System's management is continually evaluating the impact of market fluctuations on the assets of the DB Program. However, future estimates of the actuarial unfunded obligation may change due to market performance, legislative actions and other experience that may differ from the actuarial assumptions.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

STRP Defined Benefit Supplement Program (DBS Program)

The DBS Program, established pursuant to Chapter 74, Statutes of 2000 (AB 1509), is a defined benefit pension plan that operates within the STRP. All persons who were active members of the DB Program on or after January 1, 2001, are also members of the DBS Program.

Beginning January 1, 2001, and continuing through December 31, 2010, 2% of applicable member earnings for service less than or equal to one year of creditable service per fiscal year are credited to the members' nominal DBS Program accounts. In addition, beginning July 1, 2002, for service in excess of one year of service credit within one fiscal year, the member contributions of 8% and employer contributions of 8% are credited to the members' nominal DBS program account. Also, contributions for the compensation as a result of retirement incentives or limited term enhancements are credited to the members account. Interest is credited to the nominal DBS Program accounts at the minimum guaranteed annual rate established by the Teacher's Retirement Board (Board) prior to each plan year, which was 5.00% for the fiscal year ended June 30, 2006. The Board may credit additional earnings to members' nominal accounts if actual investment earnings exceed the expected rate of return.

In the actuarial valuation, of the DBS Program's assets and liabilities as of June 30, 2005, the System's independent actuaries determined that the actuarial value of assets of the DBS Program exceeded the actuarial obligation by \$267 million. While certain risks related to the global financial markets may affect the fair value of the System's investment portfolio, the System's management is continually evaluating the impact of market fluctuations on the assets of the DBS Program. However, future estimates of the actuarial obligation may change due to market performance, legislative actions and other experience that may differ from the actuarial assumptions.

STRP Cash Balance Benefit Program (CB Benefit Program)

The CB Benefit Program, established under Chapter 592, Statutes of 1995 and subsequently merged into the STRP by Chapter 1048, Statutes of 1998 (SB 2085), is a defined benefit pension plan. The CB Benefit Program is designed for employees of California's public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Interest is credited to the nominal CB Benefit Program accounts at the minimum guaranteed annual rate established by the Board prior to each plan year, which was 5.00% for the year ended June 30, 2006. The Board may credit additional earnings to members' nominal accounts if actual investment earnings exceed the expected rate of return.

Participation in the CB Benefit Program is optional to school districts, community college districts, county offices of education, and regional occupational programs. A school district, community college district, county office of education, or regional occupational program may elect to offer the CB Benefit Program. Under such election, the program will automatically cover each eligible employee, unless the employee elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire or the election period determined by the employer.

A summary of statutory contribution rates for the CB Benefit Program is as follows:

Participants	-	4% of applicable participant earnings
Employers	-	4% of applicable participant earnings

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

Employers may enter into a collective bargaining agreement to pay different rates if certain minimum conditions are met. At June 30, 2006, there were 30 contributing school districts and 24,679 contributing participants.

In their most recent actuarial valuation as of June 30, 2005, the System's independent actuaries determined that the actuarial value of assets of the CB Benefit Program exceeded the actuarial obligation by \$2 million. While certain risks related to the global financial markets may affect the fair value of the System's investment portfolio, the System's management is continually evaluating the impact of market fluctuations on the assets of the CB Benefit Program. However, future estimates of the actuarial obligation may change due to market performance, legislative actions and other experience that may differ from the actuarial assumptions.

Voluntary Investment Program (VIP)

The VIP (formerly STRS 403(b) Program) was established pursuant to Chapter 291, Statutes of 1994. Under the requirements of Internal Revenue Code (IRC) Section 403(b), the VIP is a tax-deferred defined contribution plan and is open to any employee from the state's school districts, community college districts, county offices of education and regional occupational programs. Contributions to the program are voluntary and are not subject to a minimum limitation; however, the IRC establishes a maximum amount that can be contributed annually. At June 30, 2006, there were 3,629 plan participants and 404 participating employers (school districts).

CitiStreet, L.L.C. provides administrative services to the VIP, including custody and record keeping services. The VIP's investments are comprised of the Share Accounted Mutual Funds, Mutual Fund Window Account and Citi Institutional Liquid Reserves Fund. The Share Accounted Manager invests in various mutual funds. The Mutual Fund Window Account allows plan participants to select and invest in various domestic and international stock and mutual funds. The Citi Institutional Liquid Reserves Fund invests in various money market instruments.

Teachers' Health Benefits Fund (THBF)

The THBF was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435) to provide the Medicare Premium Payment Program to retired members of the DB Program. Funds from the THBF are used to pay Medicare Part A premiums for DB Program members who are retired or will retire prior to July 1, 2007, and who meet certain other eligibility criteria.

The THBF is funded as needed, from that portion of the monthly DB Program statutory employer contribution that exceeds the amount needed to finance the liabilities of the DB Program based on the June 30, 2000 actuarial valuation of the DB Program. Management believes the current source of THBF funding will be adequate to provide for the statutory THBF benefits. At June 30, 2006, there were 6,087 retirees participating in the THBF Medicare Premium Payment Program.

Teachers' Replacement Benefits Program Fund (TRBPF)

IRC Section 415(b) imposes a dollar limit on the annual retirement benefits an individual may receive from a qualified defined benefit pension plan. The TRBPF was established pursuant to Chapter 465, Statutes of 1999 (AB 819) and initially funded during the year ended June 30, 2001, to provide benefits to the members of the System whose retirement benefit exceeds IRC limits.

The TRBPF is funded as needed. Monthly employer contributions are received by the TRBPF and paid to members in amounts "equivalent to" the benefits not paid as a result of IRC Section 415(b), subject to withholding for any applicable income or employment taxes. During fiscal year 2005-06, there were 24 retirees participating in the TRBPF.

California State Teachers' Retirement System Notes to the Basic Financial Statements (continued)

2. Summary of Significant Accounting Policies

Basis of Accounting

The System maintains its accounting records using the accrual basis of accounting. It recognizes member contributions in the period in which the contributions are due. Further, the System recognizes employer and State contributions when due and the employer or State has made a formal commitment to provide the contributions. Also, it recognizes benefits when due and payable in accordance with the System's retirement and benefits programs.

Use of Estimates in the Preparation of Financial Statements

The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain financial statement amounts and disclosures. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit and highly liquid financial instruments with original maturities of 90 days or less. Significant cash equivalents held by the System include repurchase agreements and foreign currency.

Investments

The majority of the securities held in the investment portfolio at June 30, 2006, are in the custody of or controlled by State Street Bank, the System's master custodian. State statutes and Board policies allow investments consisting of government, corporate and international bonds, domestic and international equities, mutual funds, limited partnership holdings, real estate, mortgages, and other investments.

Investments are reported at fair value. The fair values of investments are generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, management, based on market yields, computes fair value and average maturity dates of comparable quoted securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by the System's contract real estate advisors or independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Alternative investments represent interests in private equity partnerships in which the System enters under a limited partnership agreement. For alternative investments and other investments where no readily ascertainable market value exists, management, in consultation with investment advisors, has determined the fair values for the individual investments.

The System presents, in the statement of changes in fiduciary net assets, the net appreciation in the fair value of its investments, which consists of the realized gains and losses and the unrealized appreciation and depreciation on those investments. Purchases and sales are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

There are certain market risks, credit risks, foreign currency exchange risks, and event risks which may subject the System to economic changes occurring in certain industries, sectors, or geographies. See Note 3 for disclosures related to these risks.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

Investment Risk Management

The STRP enters into forward foreign currency exchange contracts for hedging purposes to minimize the short-term impact of foreign currency fluctuations on the asset positions of its foreign investments. The STRP also enters into futures contracts to minimize exposure to unfavorable fluctuations in the domestic equity markets. The futures contracts are financial instruments that derive their value from underlying indices. These hedging contracts are reported at fair value based on published market prices and quotations from major investment firms. The STRP could be exposed to risk if the counter-parties to the contracts are unable to meet the terms of their contracts. The STRP seeks to minimize risk from counter-parties by establishing minimum credit quality standards and maximum credit limits.

Administrative Expenses

The cost of administering the STRP is financed through the contributions and investment earnings. The VIP and the THBF reimburse the STRP for administrative services provided on their behalf.

Income Taxes

The STRP, THBF, and TRBPF are organized as tax-exempt retirement or benefit plans under the IRC. The VIP is organized as a tax-deferred supplemental program under the IRC. The System's management believes that it has operated these funds and programs within the constraints imposed by federal tax law.

Investment Expenses

Expenses directly associated with investment management have been included as other investment expenses. Indirect expenses have not been allocated.

Securities Lending Transactions

The System reports securities lent, the cash collateral held as assets, and the related liabilities resulting from securities lending transactions on the statement of fiduciary net assets. The System also reports the income earned and costs of lending securities as investment expenses on the statement of changes in fiduciary net assets.

3. Deposits and Investments

Deposits in the Pooled Money Investment Account (PMIA), administered by the State, represent various investments with average days to maturity of approximately 152 days, and are reported at amortized cost which approximates fair value. The State Treasury pools these monies with the monies of other State agencies for investing.

The investment in the Short-term Investment Fund, administered by State Street Bank, represents various investments with average days to maturity of approximately 27 days, and is reported at amortized cost which approximates fair value.

The repurchase agreement transactions as of June 30, 2006, have underlying collateral with fair values of approximately 102% of the cost of the repurchase agreement. The agreed-upon yields were 4.25% with maturity dates through July 3, 2006.

California State Teachers' Retirement System Notes to the Basic Financial Statements (continued)

In fiscal year 2002-03, the System initiated an investment program to leverage its real estate investments by borrowing against select real estate holdings (Leverage Program). Under the Leverage Program, two debt strategies were executed: a commercial mortgage-backed security (CMBS) for \$750 million and a revolving line of credit for \$275.0 million, net (collectively, the Leverage Program Obligation). The System used the proceeds from the Leverage Program Obligation to purchase various investments. During the 2005-06 fiscal year, the revolving line of credit matured and the debt was paid in full. At June 30, 2006, the CMBS obligation to the fair value of the underlying collateral of real estate properties was 30.3%. Approximately \$333.4 million and \$234.6 million are due November 2007 and November 2009, respectively. Interest on the Leverage Program Obligation is based on various factors and is payable monthly. As of June 30, 2006, the annual interest rates ranged from 4.39% to 5.77%.

State statutes and board policies permit the System to make short-term, collateralized loans of its securities to broker-dealers and other entities in order to earn incremental income. STRP has contracted with third party securities lending agents and its custodian to lend domestic and international equity and debt securities. The majority of security loans can be terminated on demand by either STRP or the borrower. Collateral in the form of cash or other securities is required for 102% and 105% of the fair value of domestic and international securities loaned, respectively. Since the majority of these loans are terminable at will, their duration does not generally match the duration of the investments made with the cash collateral. At June 30, 2006, the weighted duration difference between the investments and these loans was 22 days. As of June 30, 2006, the System has no credit risk exposure to borrowers because the amounts the STRP owes the borrowers exceed the amounts the borrowers owe the STRP. STRP is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify STRP if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrower fails to pay STRP for income distributions by the securities' issuers while the securities are on loan.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to a debt instrument will not fulfill its obligations. This is measured by the assignment of ratings by nationally recognized statistical rating organizations.

The System's Investment Guidelines require that the lowest long-term credit rating of securities eligible for purchase by the internally managed fixed income assets be Baa3 by Moody's Investor Services or BBB- by Standard and Poor's Corporation (i.e., investment grade by at least one major rating agency). Furthermore, the total position of the outstanding debt of any one issuer shall be limited to ten-percent (10%) of the market value of the portfolio. The Investment Guidelines also include an allocation to high yield assets which are managed externally and allow for the purchase of bonds rated below investment grade. Limitations regarding the amount of debt of any one issuer a manager may hold is negotiated on a manager by manager basis.

California State Teachers' Retirement System Notes to the Basic Financial Statements (continued)

Below is a table which depicts the fixed income and short-term assets as well as the securities lending collateral by credit rating as of June 30, 2006:

Fixed Income & Short Term (Dollars in Thousands)

Ratings	Securitized Obligations	Credit Obligations	International Government	Money Market Securities	PMIA	U.S. Government	Total
AAA	\$ 14,119,897	\$ 706,420	\$ 19,755	\$ -	\$ -	\$ -	\$ 14,846,072
A-1	-	-	-	466,999	-	-	466,999
AA	54,473	1,033,781	192,306	-	-	-	1,280,560
A	84,895	3,001,617	127,773	-	-	-	3,214,285
BBB	20,634	1,645,778	64,784	-	-	-	1,731,196
BB	30,242	1,513,201	116,395	-	-	-	1,659,838
B	12,013	828,578	-	-	-	-	840,591
CCC	518	124,670	-	-	-	-	125,188
NR	47,065	-	-	82,481	282,357	-	411,903
NA	-	-	-	-	-	9,198,687	9,198,687
Total	\$ 14,369,737	\$ 8,854,045	\$ 521,013	\$ 549,480	\$ 282,357	\$ 9,198,687	\$ 33,775,319

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. NR represents those securities that are not rated and NA represents those securities that are not applicable to the rating disclosure requirements.

Securities Lending Collateral (Dollars in Thousands)

Ratings	Money Market Securities	Repurchase Agreements	Short Term Investment Fund	Coroprate Floating Rate Notes	Agency Callable Obligations	Asset Backed	Total
AAA	\$ 184	\$ -	\$ -	\$ 954,128	\$ 851,366	\$ 6,408,757	\$ 8,214,435
A-1	5,147,319	2,575,000	-	-	-	1,110,221	8,832,540
AA	822,486	-	377,214	2,666,327	-	-	3,866,027
A	425,159	-	-	5,825,152	49,987	16,017	6,316,315
BB	-	-	-	12,000	-	-	12,000
NR	16,490	317,724	-	-	-	5,063	339,277
Total	\$ 6,411,638	\$ 2,892,724	\$ 377,214	\$ 9,457,607	\$ 901,353	\$ 7,540,058	\$ 27,580,594

The above amount excludes cash and accruals in the total of a positive \$45,599 (in thousands) which is included in the Securities Lending Collateral line item in the Statement of Fiduciary Net Assets.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The Investment Guidelines allow the internally managed long-term investment grade portfolios the discretion to deviate within +/- .50 years from the effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the effective duration within the high yield portfolios is negotiated with each of the high yield managers and detailed within the Investment Guidelines.

Investments may contain terms that increase the sensitivity of their fair values to increasing and decreasing interest rates. Although CalSTRS has investments in securitized obligations which have an inherent prepayment risk, this is mitigated through the diversification of asset classes, security selection, and credit quality.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

Below is a table which depicts the duration of the portfolio vs. the benchmark in years on June 30, 2006:

Long Term Fixed Income Investments

Duration

(Dollars in Thousands)

Investment Type (by portfolio)	Portfolio Net Asset Value	Effective Duration	Benchmark Duration	Difference
US Government and Agency Obligations	\$ 8,414,312	4.51	4.50	0.01
Credit Obligations				
Corporate	7,950,240	5.61	5.73	-0.12
High Yield	1,451,592	3.89	4.54	-0.65
Securitized Obligations				
Asset Backed Securities	835,240	2.69	2.65	0.04
Commercial Mortgage Backed Securities	1,707,614	4.59	4.55	0.04
Mortgage Backed Securities	11,405,515	4.61	4.48	0.13
Total Market Value with Weighted Avg. Duration	\$ 31,764,513	4.75	4.73	0.02

The above table represents the net asset value of the long term fixed income portfolios, which include cash and accruals that are not included in the Investments line item of the Statement of Fiduciary Net Assets.

The Investment Objective for the Short-Term Fixed Income Portfolio is to seek the preservation of capital and liquidity.

The Investment Guidelines state that 50% of the portfolio shall reflect an expected maturity, 1st call date or 1st reset date to be within a 0-30 day range and/or in US Government and Agency Obligations.

Below is a table depicting the segmented time distribution for the short term fixed income assets based upon the expected maturity, 1st call date and/or 1st reset date, as of June 30, 2006:

Short Term Fixed Income Investments

Segmented Time Distribution

(Dollars in Thousands)

Investment Type	0-30 days	31-90 days	91- 120 days	121- 180 days	181- 365 days	365+ days	Total
Money Market Securities	\$ 340,782	\$ 209,117	\$ -	\$ -	\$ -	\$ -	\$ 549,899
PMIA	282,358	-	-	-	-	-	282,358
Credit Obligations							
Corporate Bonds	-	-	-	-	-	14,984	14,984
Corporate Floating Rate Notes	48,609	113,079	7,001	-	-	-	168,689
US Government and Agency Obligations							
Bullets (noncallables)	35,000	-	-	29,937	25,000	-	89,937
Discount Notes	309,536	218,167	-	-	-	-	527,703
Callable	63,000	55,997	39,000	5,000	-	-	162,997
US Treasury	-	-	-	-	112,084	-	112,084
Asset Backed Securities	12,810	15,600	-	-	-	-	28,410
Totals	\$ 1,092,095	\$ 611,960	\$ 46,001	\$ 34,937	\$ 137,084	\$ 14,984	\$ 1,937,061
Weightings	56.38%	31.59%	2.38%	1.80%	7.08%	0.77%	100.00%

The table above represents the investment types of the short term fixed income portfolios. In addition to short-term securities, the short term fixed income portfolios also contain debt securities as classified in the Investments section of the Statement of Fiduciary Net Assets.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

Securities Lending Cash Collateral assets are diversified among different asset classes with the maximum remaining effective maturity of any instrument being five years. The fund must remain liquid to meet collateral returns.

Below is a table depicting the segmented time distribution based upon the expected maturity, 1st call date and/or 1st reset date, as of June 30, 2006:

Securities Lending Collateral Segmented Time Distribution (Dollars in Thousands)

Investment Type	2-6 days	7-29 days	30-59 days	60-89 days	90+ days	Total
Money Market Securities	\$ 1,991,680	\$ 1,394,650	\$ 700,191	\$ 181,349	\$ 2,143,768	\$ 6,411,638
Repurchase Agreements	2,892,724	-	-	-	-	2,892,724
Short Term						
Investment Fund	377,214	-	-	-	-	377,214
Corporate Floating						
Rate Notes	3,020,390	1,925,603	1,562,843	2,622,848	325,923	9,457,607
Agency Callable Obligations	49,987	263,473	154,994	186,943	245,956	901,353
Asset Backed Securities	246,779	4,754,718	510,528	1,520,360	507,673	7,540,058
Totals	\$ 8,578,774	\$ 8,338,444	\$ 2,928,556	\$ 4,511,500	\$ 3,223,320	\$ 27,580,594
Weightings	31.10%	30.23%	10.62%	16.36%	11.69%	100.00%

Note: The above amount excludes cash and accruals in the total of \$45,599 (in thousands) which is included from the Securities Lending Collateral line item in the Statement of Fiduciary Net Assets.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. As of June 30, 2006, the System has no single issuer that exceeds 5% of total investments. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded. The System's Investment Policy states that no more than 3% of the total fund shall be invested or exposed to any one security or corporation, with the exception of United States Treasury or Agency Obligations.

Custodial Credit Risk

Custodial credit risk is the risk that in the event a financial institution or counterparty fails, the System would not be able to recover the value of its deposits, investments, or collateral securities. As of June 30, 2006, all of the System's investments are held in the System's name and are not exposed to custodial credit risk. There are no general policies relating to the custodial credit risk.

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The System's foreign currencies and investments at June 30, 2006, as shown in the table below, were distributed among the following:

Foreign Currency Risk

(Dollars in Thousands)

(In U.S. Dollar Equivalents)

Currency Name	Cash	Equity	Pending Foreign Currency Exchanges	Total Exposure
Argentine Peso	\$ 14	\$ -	\$ -	\$ 14
Australian Dollar	2,318	1,206,670	(4,389)	1,204,599
Brazilian Real	3,991	277,171	386	281,548
Canadian Dollar	24,267	1,322,443	(21,709)	1,325,001
Chilean Peso	625	2,145	-	2,770
Czech Koruna	197	12,248	-	12,445
Danish Krone	88	124,955	2,299	127,342
Egyptian Pound	-	11,825	-	11,825
Euro Dollar	39,357	9,935,795	179,281	10,154,433
Hong Kong Dollar	1,095	842,414	189	843,698
Hungarian Forint	215	61,775	-	61,990
Indian Rupee	-	15,593	-	15,593
Indonesian Rupiah	1,127	50,092	62	51,281
Israeli Shekel	16	46,497	(905)	45,608
Japanese Yen	41,364	6,077,019	50,082	6,168,465
Malaysian Ringgit	53	73,325	(81)	73,297
Mexican Peso	1,734	166,191	(2,380)	165,545
Moroccan Dirham	630	13,067	-	13,697
New Taiwan Dollar	4,144	419,434	-	423,578
New Turkish Lira	2,417	116,748	310	119,475
New Zealand Dollar	267	27,348	-	27,615
Norwegian Krone	762	260,760	(1,080)	260,442
Philippine Peso	3,062	2,157	-	5,219
Polish Zloty	124	30,364	(116)	30,372
Pound Sterling	17,979	5,709,839	(62,696)	5,665,122
Singapore Dollar	618	211,614	71	212,303
South African Rand	1,007	371,990	1,667	374,664
South Korean Won	966	680,169	-	681,135
Swedish Krona	2,164	526,103	66	528,333
Swiss Franc	1,391	1,841,856	26,074	1,869,321
Thailand Baht	64	92,857	-	92,921
Total	\$ 152,056	\$ 30,530,464	\$ 167,131	\$ 30,849,651

California State Teachers' Retirement System

Notes to the Basic Financial Statements (continued)

The table on the previous page represents securities purchased in a foreign currency. The equity figures are comprised of numerous portfolios within the international equity, alternative, and real estate investment line items on the statement of fiduciary net assets.

Foreign currency is comprised of international investment proceeds and income to be repatriated into U.S. dollars and funds available to purchase international securities. Foreign currency is not held as a form of investment. Foreign currency is held temporarily in foreign accounts until it is able to be repatriated or expended.

The System believes that its Currency Management Program should emphasize the protection of the value of its non-dollar public and private (i.e. international debt and equity, alternative investments and real estate) equity assets against a strengthening U.S. dollar. The active non-dollar equity managers are permitted to hedge their assets, and do so in the process of implementing their investment strategies. The System's fixed income staff develops and implements the System's currency hedging strategy for the passively managed equity portion. The System's fixed income staff may reduce the risk by hedging up to 50% of the total market value of the passively managed segment of the non-dollar equity portfolio. In addition, no more than 100% of each individual currency may be hedged.

4. Contingencies

The System is involved in litigation relating to various matters. In the opinion of management, after consultation with legal counsel, the outcome of these matters is not expected to have a material adverse effect on the System's financial position.

5. Commitments

In connection with the purchase of various partnership interests under the alternative investment portfolio and the real estate portfolio, the STRP has remaining unfunded commitments of approximately \$9.3 billion and \$9.3 billion, respectively, at June 30, 2006.

The STRP has entered into agreements through its Credit Enhancement Program to guarantee payment of principal and interest on certain debt securities in the event of default. At June 30, 2006, the STRP had commitments of approximately \$2 billion expiring through July 2013. The STRP is paid a fee over the term of such agreements and earned approximately \$4.5 million for the year ended June 30, 2006.

6. New Accounting Pronouncements

GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, provides uniform financial reporting standards for plans that provide postemployment benefits such as healthcare benefits. The statement will require the System to obtain actuarial valuations, and report in its financial statements the funded status and funding progress of the Teachers' Health Benefits Fund. GASB Statement No. 43 will be implemented in the financial statements for fiscal year 2006-07.



Required Supplementary Information—Unaudited

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Funding Progress
(Dollars in Millions)

Schedule I

The information presented in Supplementary Schedules I and II was determined as part of the actuarial valuations at June 30, 2005 except where noted. For the years ended June 30, 2001, and June 30, 2002, the DBS Program was funded by member contributions only.

Actuarial Valuation Date as of June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Funded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
Defined Benefit Program						
2006	(1)	(1)	(1)	(1)	(1)	(1)
2005	\$ 121,882	\$ 142,193	\$ 20,311	86 %	\$ 23,257	87 %
2004 ⁽⁴⁾	114,094	134,677	20,583	85 %	22,591	91 %
2003 ⁽⁴⁾	108,667	128,104	19,437	85 %	22,649	86 %
2002	(2)	(2)	(2)	(2)	(2)	(2)
2001	107,654	109,881	2,227	98 %	20,585	11 %
Cash Balance Benefit Program						
2006	(1)	(1)	(1)	(1)	(1)	(1)
2005	\$ 54	\$ 52	\$ (2)	104 %	\$ 107	(2) %
2004	42	42	0	100 %	96	0 %
2003	30	34	4	88 %	81	5 %
2002	22	25	3	88 %	90	3 %
2001	16	17	1	94 %	98	1 %
Defined Benefit Supplement Program ⁽³⁾						
2006	(1)	(1)	(1)	(1)	(1) (5)	(1)
2005	\$ 3,023	\$ 2,756	\$ (267)	110 %	\$ 23,263	(1.15)%
2004	2,204	2,035	(169)	108 %	23,763	(0.71)%
2003	1,311	1,358	47	97 %	23,865	0.20 %
2002	660	711	51	93 %	21,732	0.20 %
2001	207	213	6	97 %	20,585	0.03 %

- (1) Actuarial valuations as of June 30, 2006, are expected to be available by summer of 2007.
- (2) Except for the year ended June 30, 2004 actuarial valuations were not prepared in even numbered years. No estimation using actuarial methodology is made in years between valuations.
- (3) Effective January 1, 2001, the Defined Benefit Supplement Program (DBS Program) was established as part of the STRP. The 2001 information presented for the DBS Program, was subject to an actuarial study only, which is less in scope than a full actuarial valuation.
- (4) Actuarial accrued liability and covered payroll figures for 2003 and 2004 were revised on an estimated basis in 2006 to reflect data corrections.
- (5) Starting with the June 30, 2005 valuation, covered payroll excludes limited term incentive pay and extra service credit pay in order to present the payroll base most relevant to the funding of any unfunded actuarial accrued liabilities of the DBS Program. Covered payrolls for 2003 and 2004 include these additional pay items

Note: The benefits under the Purchasing Power Protection Program are not guaranteed by law; only the contributions for this are guaranteed. An actuarial valuation has not been completed for the Purchasing Power Protection Program. Contribution and funding under this program are not made on an actuarial basis and items required under this schedule have not been determined. Therefore a schedule of funding progress for the Purchasing Power Protection Program is not presented.

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Contributions from Employers
And Other Contributing Entities
(Dollars in Millions)

Schedule II

Year Ended June 30	Annual Required Contributions (a) ⁽³⁾⁽⁶⁾	Contributed By Employers ⁽¹⁾ (b)	Contributed By the State/Federal ⁽²⁾⁽⁴⁾ (c)	Total Contributed (b) + (c)	Percentage Contributed (b + c)/a
Defined Benefit Program⁽³⁾⁽⁶⁾					
2006	\$ 3,821	\$ 2,092	\$ 348	\$ 2,440	64%
2005	3,709	2,002	595	2,597	70%
2004	3,410	1,916	451	2,367	69%
2003	2,545	1,890	431	2,321	91%
2002	2,498	1,851	385	2,236	90%
2001	1,794	1,749	455	2,204	123%
Cash Balance Benefit Program⁽³⁾					
2006	\$ 4.99	\$ 5.10	0	\$ 5.10	102%
2005	4.48	4.49	0	4.49	100%
2004	4.05	3.85	0	3.85	95%
2003	3.58	3.58	0	3.58	100%
2002	3.58	3.58	0	3.58	100%
2001	3.04	3.04	0	3.04	100%
Defined Benefit Supplement Program⁽³⁾					
2006	\$ 90	\$ 104	0	\$ 104	116%
2005	86	96	0	96	111%
2004	128	125	0	125	98%
2003	72	72	0	72	100%
Purchasing Power Protection Program⁽⁴⁾⁽⁵⁾					
2006	\$ 673	\$ 3	\$ 670	\$ 673	100%
2005	626	2	624	626	100%
2004	601	3	98	101	17%

(1) For the DB Program, amounts include employer contributions under Education Code Sections 22135, 22714 (less amounts deposited in the SBMA), 22718, 22950 and 22951.

(2) The DB and Purchasing Power Protection Programs include State contributions under Education Code Section 22954 and 22955.

(3) For the determination of the Annual Required Contribution, an amortization period of 30 years is used for the Unfunded Actuarial Accrued Liability.

(4) The amount included in the "Contributed by State" column includes federal proceeds from the sale of the Elk Hills Petroleum Reserve. Certain reclassifications of our previous presentations of the Purchasing Power Protection Program for fiscal year 2003-04 were made to be consistent with later years' presentations.

(5) An ARC has not been determined for the Purchasing Power Protection Program. The amount given is the contractual amount for all entities.

(6) The ARC's for 2005 and 2004 were revised on an estimated basis to reflect data corrections.

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Contributions from Employers
And Other Contributing Entities
(Dollars in Millions)

Schedule II (Continued)

Additional information as of the June 30, 2005 actuarial valuations are as follows:

	DB Program		
Actuarial Cost Method	Entry age normal		
Amortization Method	Level percent of payroll		
Amortization Period	Open		
Remaining Amortization Period	Not amortizable based on current statutory contribution rates		
Asset Valuation Method	Expected value with 1/3 of the adjustment to market value		
Actuarial Assumptions:			
Investment rate of return	8.00%		
Interest on accounts	6.00%		
Projected salary increases	4.25%		
Consumer price inflation	3.25%		
Post-retirement benefit increases	2.00% simple		
	CB Benefit Program	DBS Program	
Actuarial Cost Method	Traditional unit credit	Traditional unit credit	
Amortization Method	Not applicable	Not applicable	
Amortization Period	Not applicable	Not applicable	
Remaining Amortization Period	Not applicable	Not applicable	
Asset Valuation Method	Fair market value of net assets	Fair market value of net assets	
Actuarial Assumptions:			
Investment rate of return	8.00%	8.00%	
Interest on accounts	8.00%	8.00%	
Projected salary increases	4.25%	4.25%	
Consumer price inflation	3.25%	3.25%	
Post-retirement benefit increases	Not applicable	Not applicable	



Other Supplemental Information

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Administrative Expenses
(Dollars in Thousands)

Schedule III

Personnel services:

Salaries and wages	\$ 37,795
Staff benefits	12,850
Accrued vacation	466
Accrued worker's compensation expense	(223)
Accrued personal leave expense	<u>(34)</u>
Total personnel services	<u>50,854</u>

Operating expenses and equipment:

General expense	1,917
Depreciation expense	505
Printing	1,520
Communications	813
Postage	1,158
Insurance	(30)
Travel	529
Training	537
Facilities operations	5,716
Consultants and professional services	20,583
Consolidated data center:	
Consultants and professional services	6,861
Data Processing:	
Consultants and professional services	485
Software and other	1,170
Indirect State central services	2,423
Equipment	513
Other	<u>57</u>
Total operating expenses and equipment	<u>44,757</u>
Total	<u>\$ 95,611</u>

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Investment Expenses from Continuous Appropriation
(Dollars in Thousands)

Schedule IV

External Equity Managers:**Domestic:**

Ariel Capital Management	\$	970
Barclays Global Investors		2,533
Brown Capital Management, Inc.		459
Chicago Equity Partners		2,033
Delaware Investment Advisors		284
Delphi Management, Inc.		1,769
Denver Investment Advisor, Inc.		887
DSI International Management, Inc.		375
First Quadrant		4,625
FIS Funds Management, Inc.		1,520
Frank Russell Trust Co.		1,591
Mellon Capital Management		1,073
NCM Capital Management Group, Inc.		613
Northern Trust Funds Mgmt.		1,408
Sasco Capital, Inc.		6,346
Sterling Capital Management, LLC		143
State Street Global Advisors		1,081
TCW Asset Management		615
UBS Global Asset Management		1,794
Total Domestic		<u>30,119</u>

International:

Bank of Ireland		3,373
Barclays Global Investors		943
Battery March		1,895
Blackrock International, Ltd.		1,447
Capital Guardian Trust		5,108
Fidelity Management Trust Co.		2,892
Fiduciary Trust International		2,609
Goldman Sachs		1,975
Lazard Freres Asset Management		3,201
Mondrian Investment Partners		2,734
Morgan Stanley		2,346
Nicholas Applegate		2,210
Oechsle International Advisors		4,344
Schroder Capital Management Investment, Ltd.		1,971
State Street Global Advisors		2,073
UBS Global Asset Management		2,721
Total International		<u>41,842</u>
Total External Equity Managers		<u>71,961</u>

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Investment Expenses from Continuous Appropriation
(Dollars in Thousands) **Schedule IV (Continued)**

External Fixed Income Managers

Capital Guardian Trust Company	\$ 369
Hartford Investment Management Company	826
MW Post Advisory Group, LLC	1,789
Seix Investment Advisors	1,464
Shenkman Capital Management	1,784
Total Fixed Income Managers	6,232

Real Estate Managers/Advisors:

CB Richard Ellis	8,550
Clarion Partners	1,610
Heitman Capital MGMT, LLC	1,711
Low Enterprise	644
Principal Global Investors	2,723
Blackrock Realty Advisors	3,814
Thomas Properties	1,050
Total Real Estate Managers/Advisors	20,102

Advisors and Consultants:

Altius Associates	581
Altura Capital	62
Angeles Investment Advisors	50
Bard Consulting	420
Bonuccelli & Associates, Inc	48
Callan Associates	82
Cambridge Associates, LLC	2,645
Courtland Partners, Ltd.	249
Ennis Knupp & Associates	215
Houlihan Loke Howard & Zukin	460
KPMG, LLP	290
McKinsey & Company, Inc. Uni	259
McLagan Partners, Inc.	56
The McMahan Group	33
Pension Consulting Alliance	1,215
Valuation Research Corp.	138
Warren, McVeigh & Griffin, Inc.	72
Westwood Consulting Group	171
Total Advisors and Consultants	7,046

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Investment Expenses from Continuous Appropriation
(Dollars in Thousands) **Schedule IV (Continued)**

Attorneys, Master Custodian and Insurers:

Cox, Castle & Nicholson	\$	84
Groom Law Group		97
Robert Driver Ins Brokerage		811
Sheppard Mullin Richter & Hampton, LLP		68
State Street Bank & Trust Co.		5,390
Total Attorneys, Master Custodian and Insurers		<u>6,450</u>

Other Expenses:

Bayard Advertising		43
Bloomberg, LP		84
Council of Institutional Investors		30
CSUS Foundation		169
Intex Solutions		144
Miscellaneous		170
State Controller's Office		11
Department of Technology Services		18
Travel		469
Total Other Expenses		<u>1,138</u>
Total	\$	<u>112,929</u>

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
(Dollars in Thousands)

Schedule V

Individual or Firm	Commission/ Fee	Nature of Services
Consulting and professional services:		
Active Strategy	\$ 15	Consulting Services
Alameda County Office of Education	88	Regional Counseling Services
American Management Systems	227	Consulting Services
Aspen Computer Solutions	20	Consulting Services
The Ballard Group	361	Consulting Services
Business Advantage	438	Consulting Services
Cal Gov Technology	39	Consulting Services
California State University Foundation	779	Consulting Services
Capital Network Solutions	31	Consulting Services
The Centre for Organizations	32	Consulting Services
Cheiron	48	Consulting Services
CitiStreet Advisors, LLC	101	Consulting Services
Coastline Technology	119	Consulting Services
Comsys Services, LLC	68	Consulting Services
Consultants to Management	32	Consulting Services
Contra Costa County Office of Education	128	Regional Counseling Services
Convansys Corporation	12	Consulting Services
Dee Hanford Consulting	41	Consulting Services
Department of Finance	200	Consulting Services
Department of General Services	91	Legal Services
Department of Justice	473	Consulting Services
Department of Personnel Administration	17	Consulting Services
Eclipse Solutions, Inc.	190	Consulting Services
Elk Grove Unified School District	59	Regional Counseling Services
Employee Relations, Inc.	13	Consulting Services
Employment Development Department	41	Consulting Services
Estrada Consulting, Inc.	141	Consulting Services
Filenet Corporation	168	Consulting Services
Folsom Cordova Unified School District	153	Regional Counseling Services
Forward Solutions	575	Consulting Services
Fresno County Office of Education	120	Regional Counseling Services
G. R. Helm, Inc.	76	Consulting Services
Graphic Focus	36	Consulting Services
H. L. Yoh, Company, LLC	118	Consulting Services

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
(Dollars in Thousands) **Schedule V (Continued)**

Individual or Firm	Commission/ Fee	Nature of Services
Consulting and professional services (continued):		
Hareline Graphics	\$ 42	Consulting Services
The Highland Consulting	157	Consulting Services
Hogan and Hartson, LLP	176	Legal Services
Infiniti Consulting Group	46	Consulting Services
Inforce, Inc.	809	Consulting Services
Information Technology	37	Consulting Services
Infre	50	Consulting Services
Intergalactic Placements	89	Consulting Services
International Network	664	Consulting Services
Jackson Lewis, LLP	14	Consulting Services
Jaykumar Maistry	1,292	Consulting Services
Jeve Consulting, Inc.	89	Consulting Services
Kearnford Application Systems	170	Consulting Services
Kenda Systems, Inc.	80	Consulting Services
Kern County Superintendent of Schools	157	Regional Counseling Services
KPMG, LLP	25	Consulting Services
Leading Resources, Inc.	35	Consulting Services
Liebman & Associates	33	Consulting Services
Linda Rogers & Associates	211	Consulting Services
Los Angeles Community Colleges	39	Regional Counseling Services
Los Angeles County Supt. of Schools	574	Regional Counseling Services
Macias, Gini and Company, LLP	147	Audit Services
Madsen Rayner Consulting, LLC	185	Consulting Services
Mara Consulting, Inc.	379	Consulting Services
Milliman USA	258	Consulting Services
Monterey County Office of Education	55	Regional Counseling Services
Montridge Consulting	285	Consulting Services
MSX International	13	Consulting Services
MTI Technology Corporation	24	Consulting Services
Nanran, Inc.	1,328	Consulting Services
Network Design Associates	94	Consulting Services
Olsen, Hagel & Fishburn, LLP	80	Legal Services
Orange County Department of Education	343	Regional Counseling Services
Personal Enterprises, Inc.	114	Consulting Services

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
(Dollars in Thousands) **Schedule V (Continued)**

Individual or Firm	Commission/ Fee	Nature of Services
Consulting and professional services (continued):		
Placer County Office of Education	\$ 66	Regional Counseling Services
Pleasanton Unified School District	102	Regional Counseling Services
Princeton Solutions Group	353	Consulting Services
Public Sector Consultants, Inc.	55	Consulting Services
Q Data Consulting	180	Consulting Services
Quest Media & Supplies	256	Consulting Services
Rapidigm	176	Consulting Services
Rene Ewing and Associates	114	Consulting Services
RS Computer Associates, LLC	195	Consulting Services
Russbo, Inc.	162	Consulting Services
San Bernardino County Office of Education	356	Regional Counseling Services
San Diego County Office of Education	361	Regional Counseling Services
San Francisco County Office of Education	41	Regional Counseling Services
San Joaquin County Office of Education	96	Regional Counseling Services
San Jose Unified School District	181	Regional Counseling Services
San Juan Unified School District	75	Regional Counseling Services
San Mateo-Foster City School District	97	Regional Counseling Services
Santa Barbara County Office of Education	84	Regional Counseling Services
Santa Cruz County Office of Education	87	Regional Counseling Services
Shasta County Office of Education	112	Regional Counseling Services
Shiva Systems	21	Consulting Services
Sierra Metrics, Inc.	621	Consulting Services
Software AG, Inc.	526	Consulting Services
Solano County Office of Education	55	Regional Counseling Services
Sonoma County Supt. of Schools	108	Regional Counseling Services
Stanislaus County Office of Education	53	Regional Counseling Services
State Controller's Office	992	Consulting Services
State Personnel Board	17	Consulting Services
Synergy Consulting, Inc.	35	Consulting Services
Systems West Computer	34	Consulting Services
Thomas V. Ennis Consulting	161	Consulting Services
Thomas/Ferrous	180	Consulting Services
Tulare County Superintendent of Schools	55	Regional Counseling Services

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
(Dollars in Thousands) **Schedule V (Continued)**

Individual or Firm	Commission/ Fee	Nature of Services
Consulting and professional services (continued):		
Ventura County Supt. of Schools	\$ 62	Regional Counseling Services
Venturi Technology Partners	26	Consulting Services
Visionary Integration	300	Consulting Services
Visual Communications	19	Consulting Services
Weintraub Genshlea Chediak Law	15	Legal Services
Worldgroup Consulting, Inc.	379	Consulting Services
Wozniak Consultancy	111	Consulting Services
Wright On-Line Systems	228	Consulting Services
YOH Services, LLC	116	Consulting Services
Yuba County Office of Education	51	Regional Counseling Services
Other	125	Various Services under \$10
	20,583	
Data Processing:		
Bridge Micro	53	Data Processing
Compucom Systems, Inc.	32	Data Processing
IBM	20	Data Processing
Image Access West	16	Data Processing
Kearnford Application Systems	13	Data Processing
Lason, Inc.	7	Data Processing
Linda Rogers & Associates	13	Data Processing
Logical Design, Inc.	35	Data Processing
MTI Technology Corporation	10	Data Processing
Quest Media & Supplies	95	Data Processing
Soft Net Solutions	79	Data Processing
Software House International	41	Data Processing
Thomas/Ferrous	11	Data Processing
Other	60	Various Services under \$10
	485	
Consolidated Data Center:		
Department of Technology Services	6,306	Data Processing
Stephen P. Teale Data Center	545	Data Processing
Health & Welfare Data Center	10	Data Processing
	6,861	
Total consultant and professional services expenses	\$ 27,929	

California State Teachers' Retirement System
Voluntary Investment Program
Schedule of Administrative Expenses
(Dollars in Thousands)

Schedule VI

CitiStreet administrative fee	\$ 773
STRS administrative/sponsor fees	142
Loan fees	2
Mutual fund fees	16
Redemption fees	2
Total	<u>\$ 935</u>

California State Teachers' Retirement System
Teachers' Health Benefits Fund
Schedule of Administrative Expenses
(Dollars in Thousands)

Schedule VII

Personnel services:

Salaries & Wages	\$	37
Staff benefits		17
Accrued Vacation		(1)
Total personnel services		<u>53</u>

Operating expenses and equipment:

General expense		135
Communications		3
Facilities Operations		23
Consultants and professional services		112
Indirect State central services		33
Total operating expenses and equipment		<u>306</u>
Total	\$	<u>359</u>

