CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM PENSION2 PROGRAM (Formerly Known as Voluntary Investment Program)

Independent Auditor's Reports, Financial Statements and Supplemental Information

For the Fiscal Year Ended June 30, 2008

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
PENSION2 PROGRAM
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Table of Contents

MACIAS GINI & O'CONNELL LLP
Certified Public Accountants & Management Consultants

SACRAMENTO
3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

WALNUT CREEK
OAKLAND
LOS ANGELES
NEWPORT BEACH
SAN MARCOS
SAN DIEGO

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

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying statement of fiduciary net assets of the California State Teachers' Retirement System (the System) Pension2 Program (the Program), as of June 30, 2008 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.

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 Standar*ds, 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 Program'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.

As discussed in Note 1, the financial statements present only the Program and do not purport to, and do not, present fairly the fiduciary net assets of the System as of June 30, 2008 and the changes in its fiduciary net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Subsequent to June 30, 2008, the global financial markets have experienced significant volatility. As a result, as of September 30, 2008, the fair value of the Program's investments has declined as described in Note 4.

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 Pension2 Program as of June 30, 2008, and the changes in its fiduciary net assets for the year then ended in conformity with the accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have issued our report dated September 30, 2008, on our consideration of the System's internal control over financial reporting as it relates to the Program and on our tests of its compliance with certain provisions of laws, regulations, contracts and agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Program has not presented Management's Discussion and Analysis which accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplemental information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to 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.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
September 30, 2008

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
PENSION2 PROGRAM
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2008

		403(b) Plan
ASSETS		
Investments:		
Money market mutual funds	$	3,883,707
Guaranteed annuity contract		34,878,271
Mutual funds		133,852,818
Total investments		172,614,796
Receivables:		
Loans		899,843
Total assets		173,514,639
NET ASSETS		
Net assets held in trust for pension benefits	$	173,514,639

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

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
PENSION2 PROGRAM
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	403(b) Plan
ADDITIONS:	
Participant contributions	$ 24,925,249
Investment income:	
Net depreciation (realized and unrealized) in fair value of investments	(19,263,100)
Interest and dividends	6,693,817
Total investment loss	(12,569,283)
Other	16,885
Total additions	12,372,851
DEDUCTIONS:	
Distributions and withdrawals	8,206,383
Administrative expenses	526,045
Total deductions	8,732,428
NET INCREASE IN NET ASSETS	3,640,423
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:	
Beginning of year	169,874,216
End of year	$ 173,514,639

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

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
PENSION2 PROGRAM
NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 1 – OPERATIONS AND PROGRAM DESCRIPTION

Pursuant to Assembly Bill 3064 and 3075, the California State Teachers' Retirement System (CalSTRS) Pension2 (the Program) was established to include two tax-deferred defined contribution plans under the Internal Revenue Code (IRC) Sections 403(b) and 457, respectively. The plans will be presented as two separate funds in the Program's financial statements. The IRC 403(b) plan previously operated under the name of the Voluntary Investment Program. For the year ended June 30, 2008, the IRC 457 plan did not have any activity. CitiStreet L.L.C. acted as the plan administrator for the Voluntary Investment Program from July 2002 through October 2007. In November 2007, the Voluntary Investment Program was renamed to Pension2 and the System engaged TIAA-CREF as the new plan administrator of the Program. TIAA-CREF is responsible for administrative services, including custody and record keeping services. The financial statements present only the Program and do not purport to, and do not, present fairly the fiduciary net assets of the System and the changes in its fiduciary net assets in conformity with accounting principles generally accepted in the United States of America.

As of June 30, 2008, there were approximately, 4,196 plan participants and approximately 597 participating employers (school districts). The Program is open to any school or state employee who is eligible to participate. Contributions to the plan are voluntary and require no minimum limitations; however, the IRC imposes an annual maximum amount that can be contributed to the plan. Employer contributions are precluded.

The IRC 403(b) plan includes the following features:

- Maximum contributions of $15,500 plus catch-up options
- 10% early withdrawal penalty tax may apply under age 59 ½, plus normal income tax
- Funds cannot be distributed until:
  - Age 59 ½ and termination from employment
  - Age 55+ if retiring in same year
  - Plan termination
  - Disability
  - Death
  - Financial hardship
- Required minimum distribution at age 70 ½ or later, termination from service, and also after death. Not required if still employed by employer where funds accumulated.

The IRC 457 plan includes the following features:

- Maximum contributions of $15,500 plus catch-up options
- No early withdrawal penalty tax, except for funds rolled over from another qualified plan
- Funds cannot be distributed until:
  - Age 70 ½ if still working
  - Termination from employment at any age
  - Disability
  - Death
  - Unforeseeable emergency
- Required minimum distribution applies at age 70 ½ or later, termination from service, and after death

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting - The financial statements are prepared using the accrual basis of accounting. Participant contributions are recognized when earned and benefit payments are recognized when they become due.

Estimates - The preparation of 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 reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

Investment income - Dividends are recorded on the ex-dividend date. Gain or loss on a sale of securities is based on the average cost of the securities held at the date of sale.

Investments - All investments are reported at fair value, except for TIAA Traditional Annuity investment which is reported at cost plus accumulated interest. The fair values of investments are generally based on published market prices and quotations from major investment firms. Purchases and sales of investments are recorded on the trade date. Upon the sale of investments, the difference between the sales proceeds and the cost is reflected in the statement of changes in fiduciary net assets and included with net appreciation (depreciation) (realized and unrealized) in fair value of investments.

NOTE 3 – INVESTMENTS

At June 30, 2008, the Program consists of investments in the following funds:

CREF Money Market Account's objective is to seek high current income consistent with maintaining liquidity and preserving capital. The Account consists of investments in short-term debt and government securities. The balance at June 30, 2008 totals $3,883,707.

TIAA Traditional Annuity is a guaranteed annuity subject to TIAA's claims paying ability; TIAA Traditional Annuity guarantees the principal and a minimum interest rate of 3%. The annuity also offers the opportunity for additional amounts in excess of the guaranteed rate. The balance at June 30, 2008 totals $34,878,271.

Artisan International Fund invests in international equity markets, across capitalizations and regions, with a focus on well-managed growth companies. The fund is typically benchmarked against the MSCI EAFE Index. The balance at June 30, 2008 totals $12,497,017.

DFA Emerging Markets Portfolio invests at least 65% of assets in securities issued by companies of governments in emerging markets; it invests primarily in equities issued by larger companies within an emerging market. The balance at June 30, 2008 totals $956,419.

DFA Global Equity Portfolio invests primarily all of its assets in both domestic and international equity funds. The balance at June 30, 2008 totals $718,568.

NOTE 3 – INVESTMENTS (Continued)

Dodge & Cox International Stock Fund invests in a diversified portfolio of equity securities issued by non-US companies from at least three different foreign countries. The fund focuses on countries whose economic and political systems appear more stable and are believed to provide some protection to foreign shareholders. The balance at June 30, 2008 totals $2,127,883.

Dodge & Cox Stock Fund invests primarily in a broadly diversified portfolio of common stocks that appear to be temporarily undervalued by the stock market, but have a favorable outlook for long-term growth. The balance at June 30, 2008 totals $17,834,729.

T. Rowe Price Growth Stock Fund seeks long-term growth of capital and income secondary. The fund invests at least 80% of assets in common stocks of a diversified group of growth companies. It targets investments in companies that have the ability to pay increasing dividends. The balance at June 30, 2008 totals $3,996,106.

Vanguard Institutional Index Fund invests in a substantial portion of the nation's largest stocks. The balance at June 30, 2008 totals $45,001,870.

Vanguard Small Cap Index Fund is a passively managed fund that tracks the performance of the MSCI US Small Cap 1750 index. The fund attempts to replicate the target index by investing all, or substantially all, of its' assets in the stocks that make up the index, holding each stock in the approximate same proportion as its weighting in the index. The balance at June 30, 2008 totals $5,016,250.

Vanguard Total Stock Market Index Fund Institutional Shares is a passively managed fund that tracks the performance of the MSCI US Broad Market index, which consists of all the US common stocks traded on the NYSE, AMEX, and OTC markets. The fund invests all of its assets in the 1,300 largest stocks in the target index. The balance at June 30, 2008 totals $15,984,052.

Vanguard Inflation-Protected Securities Fund invests at least 80% of its assets in inflation-indexed bonds issued by the US Government. The Fund invests in bonds of any maturity, but maintains a dollar-weighted average maturity of seven to twenty years. The balance at June 30, 2008 totals $3,108,531.

Vanguard Short-Term Bond Index Fund Signal Shares tracks the performance of a market-weighted bond index with a short-term dollar weighted average maturity. The fund invests by sampling the index, with at least 80% of the funds assets in bonds held in the index. The weighted average maturity is not expected to exceed three years. The balance at June 30, 2008 totals $12,411,369.

TIAA Real Estate Account's objective is to seek favorable long-term returns through rental income and appreciation of real estate investments owned by the Account. The Account invests at least 75% of its assets directly in real estate or real estate related investments. The balance at June 30, 2008 totals $1,144,402.

TIAA-CREF Self Directed Brokerage Account allows a participant to open an individual brokerage account at TIAA-CREF. This account allows the plan participant to personally trade among several other mutual funds outside of the plan's pre-selected investment options. The balance at June 30, 2008 totals $13,055,622.

NOTE 3 – INVESTMENTS (Continued)

Investments are subject to certain types of risks; including credit risk, custodial credit risk, concentration of credit risk, interest rate risk and foreign currency risk. The following describes those risks:

Credit Risk - Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Presented below is the average quality rating at June 30, 2008:

Investment Type	Fair Value	Rating
CREF Money Market Account	$ 3,883,707	NR
Vanguard Inflation Protected Securities Fund	3,108,531	NR
TIAA Traditional Annuity	34,878,271	NR
Vanguard Short-Term Bond Index Fund	12,411,369	AA

NR represents securities that are not rated. The Vanguard Short-Term Bond Index Fund was rated by Moody's.

Custodial Credit Risk - custodial credit risk is the risk that in the event a financial institution or counterparty fails, the Program would not be able to recover the value of its investments. As of June 30, 2008, one hundred percent (100%) of the Program's investments are held by custodian bank in the name of the participants.

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, 2008, the Program has no single issuer that exceeds 5% of total investments, as the Program's investments are comprised of mutual funds.

Interest Rate Risk - interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

Below is the weighted average maturity at June 30, 2008:

Investment Type	Fair Value	Weighted Average Maturity
CREF Money Market Account	$ 3,883,707	55 days
Vanguard Inflation Protected Securities Fund	3,108,531	9.5 years
Vanguard Short-Term Bond Index Fund	12,411,369	2.8 years

The TIAA Traditional Annuity's primary objective is the guarantee of principal and a specified interest rate. A guaranteed annuity backed by TIAA's claims-paying ability, TIAA Traditional guarantees the principal and a 3% minimum annual interest rate.

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. As of June 30, 2008 the Program is not exposed to foreign currency risk.

NOTE 4 - SUBSEQUENT EVENTS

Subsequent to the June 30, 2008 fiscal year end, the financial markets experienced a significant decline in value. As a result, the investments within the Program have decreased in value by approximately $8 million to $164.6 million as of September 30, 2008. As the global financial markets experience historic volatility due to the financial crisis, the investments within the Program will change in value. In light of the extreme volatility in the markets, any decisions based upon these financial statements must take into consideration current information along with fiscal year end information.

SUPPLEMENTAL INFORMATION

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
PENSION2 PROGRAM
SUPPLEMENTAL SCHEDULE OF ADMINISTRATIVE EXPENSES
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	403(b) Plan
CitiStreet administrative fee	351,436
TIAA-CREF administrative fee	119,410
CalSTRS administrative/sponsor fees	55,199
Total	$ 526,045

OTHER REPORT

MACIAS GINI & O'CONNELL LLP
Certified Public Accountants & Management Consultants

SACRAMENTO
3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

WALNUT CREEK
OAKLAND
LOS ANGELES
NEWPORT BEACH
SAN MARCOS
SAN DIEGO

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

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the California State Teachers' Retirement System (the System) Pension2 (the Program), as of and for the year ended June 30, 2008 and have issued our report thereon dated September 30, 2008. Our report contained explanatory paragraph describing the volatility of the global financial markets subsequent to June 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as it relates to the Program as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the System's internal control.

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

Compliance and Other Matters

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

This report is intended solely for the information and use of management, the Audits and Risk Management Committee and the Teachers' Retirement Board, and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
September 30, 2008