SOUTH DAKOTA INVESTMENT COUNCIL

AUDIT REPORT

Fiscal Year Ended June 30, 2016

State of South Dakota
Department of Legislative Audit
427 South Chapelle
℅ 500 East Capitol
Pierre, SD 57501-5070

SOUTH DAKOTA INVESTMENT COUNCIL
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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

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*

Executive Board
Legislative Research Council

and

Investment Council
State of South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Cash Flow portfolio, an internal investment pool of the State of South Dakota, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Cash Flow portfolio's basic financial statements and have issued our report thereon dated October 4, 2016.

Internal Control Over Financial Reporting

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

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

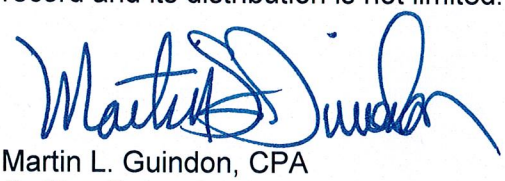
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Martin L. Guindon, CPA
Auditor General

October 4, 2016

STATE OF SOUTH DAKOTA
DEPARTMENT OF LEGISLATIVE AUDIT

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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

Executive Board
Legislative Research Council

and

Investment Council
State of South Dakota

Report on the Financial Statements
We have audited the accompanying financial statements of the Cash Flow portfolio, an internal investment pool of the State of South Dakota, as of and for the fiscal year ended June 30, 2016, and related notes to the financial statements, as listed in the table of contents.

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

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

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

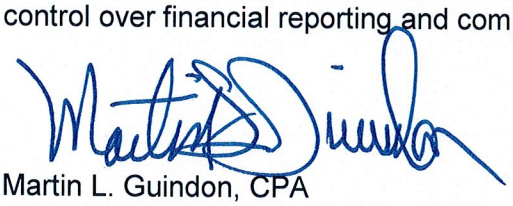
significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the portfolio listed above as of June 30, 2016, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter
The financial statements present only the above referenced investment portfolio managed by the South Dakota Investment Council and do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2016, the changes in its financial position, or, where applicable, its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards
In accordance with *Government Auditing Standards*, we have also issued our report dated October 4, 2016, on our consideration of the South Dakota Investment Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, 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* in considering South Dakota Investment Council's internal control over financial reporting and compliance.



Martin L. Guindon, CPA
Auditor General

October 4, 2016

South Dakota Investment Council
Cash Flow Portfolio
Statement of Net Position
As of June 30, 2016

Assets		
Cash & cash equivalents	$	30,644,168
Receivables		
Investment income receivable		4,070,842
Unsettled investment sales		261,513
Total receivables		4,332,355
Investments, at fair value		
Short term investment fund		197,263,502
Fixed income		1,045,980,693
Total investments		1,243,244,195
Total assets		1,278,220,718
Liabilities		
Unsettled investment purchases		21,663,522
Earnings distribution - declared		18,018,069
Total liabilities		39,681,591
Net Position	$	1,238,539,127

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

South Dakota Investment Council
Cash Flow Portfolio
Statement of Changes in Net Position
For the fiscal year ended June 30, 2016

Additions:		
Investment income (loss):		
From investing activities:		
Net appreciation in fair value of investments	$	11,315,489
Interest		17,020,660
Investment income		28,336,149
Less investment activity expense		(494,002)
Net investment activity income		27,842,147
Total investment income		27,842,147
Total additions		27,842,147
Deductions:		
Withdrawals (net)		59,134,497
Statutorily Required Distributions		18,018,069
Total deductions		77,152,566
Net increase (decrease) in net position		(49,310,419)
Net position - Beginning of year		1,287,849,546
Net position - End of year	$	1,238,539,127

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

SOUTH DAKOTA INVESTMENT COUNCIL
CASH FLOW PORTFOLIO
NOTES TO THE FINANCIAL STATEMENTS

1. Reporting Entity:

The South Dakota Investment Council (SDIC) is a principal, functional sub-unit of state government. The SDIC is responsible for the investment of the state's monies in the state treasury. The SDIC provides investment management services on a prefunded cost recovery basis as authorized by South Dakota Codified Law (SDCL) 4-5-30.

The statements represent the financial activity of the Cash Flow portfolio. The Cash Flow portfolio represents the state's aggregate idle fund monies for all state funds, except certain funds for which separate portfolios have been established.

2. Summary of Significant Accounting Policies:

a. Basis of Presentation:

The accompanying financial statements of the investment activity of the SDIC on behalf of the Cash Flow portfolio are prepared in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

b. Basis of Accounting:

The statements for the portfolio are reported on the full accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred. Security transactions and the related gains and losses are recorded on a trade date basis using the average cost method. Interest income is accrued as earned.

c. Cash and Cash Equivalents:

Cash includes demand deposits. Cash equivalents include non-negotiable certificates of deposit, which are reported at cost.

d. Valuation of Securities:

Investments are reported at fair value, in accordance with GASB Statement No. 72. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 sets forth the framework for measuring value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. The three levels of the fair value hierarchy under GASB 72 are described as follows:

Level 1 – Valuation inputs are quoted prices in active markets for an identical asset or liability as of the measurement date.

Level 2 – Valuation inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Valuation inputs are based on significant unobservable inputs for an asset or liability.

As a practical expedient, GASB 72 allows the net asset value (NAV) or its equivalent to be used when a readily determinable fair value is not available. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner and are excluded from the fair value hierarchy.

Additional required disclosures can be found in Note 4: Fair Value Measurement.

e. Use of Estimates:

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect the reported amounts of net position as of June 30, 2016. Actual results could differ from those estimates.

f. New GAAP Implementation:

In fiscal year 2016, SDIC implemented Government Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application.* GASB 72 addresses accounting and financial reporting issues related to fair value measurements and guidance for financial reporting purposes. There was no material impact on valuation inputs used to measure fair value as a result of the implementation of GASB 72. A classification change has been made as a result of the implementation. In prior years, investments in short term investment funds had been included with cash and cash equivalents on the Statement of Net Position, but are now reclassified as investments. Certificates of deposit had been reported as investments, but are now reclassified as cash equivalents since they are non-negotiable, valued at cost (not fair value), and are not subject to the disclosure requirements of GASB 72.

3. Deposits, Investments and Securities Lending:

The State Investment Officer is responsible for the investment of state public funds. State public funds in the Cash Flow portfolio are invested using the pooled deposit and investment concept which preserves the integrity of the fund cash balances of each state fund while simultaneously allowing the deposit and investment of aggregate idle fund monies. The Cash Flow portfolio may be invested in the following classes of securities and investments and not otherwise:

(1) Direct and indirect obligations of the United States government;

(2) Agencies and instrumentalities of the United States government;

(3) Direct obligations of the State of South Dakota and any of its political subdivisions;

(4) Obligations consisting of notes, bonds, debentures, and certificates which are direct obligations of a solvent corporation or trust existing under the laws of the United States or any state thereof, if such investments are rated in the four highest classifications established by at least two standard rating services at the time of purchase;

(5) Savings accounts, share accounts, certificates of deposit of banks, savings and loan associations, building and loan associations and bankers' acceptances;

(6) In addition to the investments authorized by subdivisions (1) to (5) of this section, inclusive, the investment council may also allocate a sum certain of state public funds for investment in the accounts and certificates of South Dakota banks and associations. This sum shall initially be offered to South Dakota banks and associations, and if not initially fully subscribed, the investment officer shall immediately reoffer the unsubscribed sum to other qualified public depositories. "Qualified public depository" is a state bank and loan association or federally chartered credit union located in this state which receives or holds public deposits and segregates eligible collateral for public deposits.

Deposits:

Custodial Credit Risk. The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Cash Flow portfolio's certificates of deposit and other deposits in state financial institutions in excess of depository insurance must be 100% collateralized. Collateral is valued at the lower of cost or market as reported in the quarterly call reports prepared by the qualified public depositories pursuant to SDCL 4-6A-7. Collateral is required to be segregated by each depository as approved by the South Dakota Public Deposit Protection Commission. Collateral may not be held in any safety deposit vault owned or controlled either directly or indirectly by the pledging financial institution, but must be deposited for safekeeping in a financial institution that is a member of the Federal Reserve. As of June 30, 2016, pledged collateral for all depositories equaled at least 100 percent of the total public deposits in excess of depository insurance. As a result, none of the Cash Flow portfolio's certificates of deposit was exposed to custodial credit risk.

Investments:

Securities Lending. State statutes and the SDIC policies permit the use of investments for securities lending transactions. These transactions involve the lending of corporate debt to broker-dealers for collateral in the form of securities, with the simultaneous agreement to return the collateral for the same securities in the future. The SDIC's securities custodian is an agent in lending securities and shall accept only U.S. Government securities or its agencies as collateral for any loan or loaned securities. The collateral required must equal 102% of fair value plus accrued interest for corporate debt securities. The earnings generated from the collateral investments results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

The Cash Flow portfolio did not have any securities on loan as of June 30, 2016 so the portfolio did not have any credit risk exposure to borrowers.

The contract with the lending agent requires the agent to indemnify the SDIC if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent. All securities loans can be terminated on demand by either the SDIC or the borrower. The SDIC does not have the ability to pledge or sell collateral securities unless the borrower defaults. Regarding restrictions on loans, the securities lending agreement does limit the total value of securities that can be out on loan on any given day.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The SDIC's securities lending policies are detailed in the preceding Securities Lending section. As of June 30, 2016, the Cash Flow portfolio does not have custodial credit risk with regard to securities lending.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SDIC policy limits or establishes ranges for the durations of the fixed income portfolios. Modified duration estimates the sensitivity of a bond's price to interest rate changes. The Cash Flow short term portfolio policy limits average portfolio duration to 2.88 years, and no holding's maturity can exceed 5.25 years. The Cash Flow intermediate term portfolio is benchmarked to the duration of the Citigroup Broad Investment Grade (BIG) Index. The fair value (in USD) and weighted modified duration (in years) of the Cash Flow portfolio as of June 30, 2016 is listed in the following table:

Investment Type	Fair Value	Weighted Modified Duration
U.S. Treasuries	$ 21,870,238	6.23
U.S. Treasury STRIPS	15,023,891	8.77
U.S. Agencies	213,330,890	1.94
Investment Grade Corporates	761,712,488	2.20
Agency Mortgage-Backed Securities	34,043,186	3.54
TOTAL	$ 1,045,980,693	
Portfolio modified duration		2.37

The Cash Flow portfolio invests in mortgage-backed securities. These securities are sensitive to prepayments by mortgagees, which is likely in declining interest rate environments, which can reduce the value of these securities.

Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. SDIC policy establishes a percentage range and a normal allocation to various credit risk categories. The Cash Flow short term portfolio can invest 4% of the portfolio into each corporate security rated Aaa or Aa, 2% in A-rated, 1% in Baa1 or Baa2, and 0.5% in individual holdings of corporate securities rated Baa3. The SDIC sets the investment policy annually for the Cash Flow intermediate term portfolio. This policy establishes the benchmark percentage invested in each asset category and the minimum and maximum range of each asset category. As of June 30, 2016, the portfolio held the following investments, excluding those issued by or explicitly guaranteed by the U.S. Government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service (at fair value):

Moody's rating:	
Aaa	$ 436,743,174
Aa	93,390,645
A	519,604,507
Baa	122,568,555
Total	$ 1,172,306,881

Concentration of Credit Risk. Concentration of credit risk is the risk of loss that may be attributed to the magnitude of a government's investment in a single issuer. The Cash Flow portfolio has a policy in place limiting its investments in individual holdings. Information regarding the policy is located in the Credit Risk section. Additionally, there are no single issuer exposures (excluding those issued by or explicitly guaranteed by the U.S. Government, or involving mutual funds or investment pools) within the portfolio that comprises 5% of the overall portfolio as of June 30, 2016.

4. Fair Value Measurement:

Investments are reported at fair value as of June 30, 2016, to the extent available. GASB Statement No. 72 – *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are other than quoted prices included within Level 1 that are observable; Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the hierarchy below.

The following table summarizes the Cash Flow portfolio investments within the fair value hierarchy as of June 30, 2016:

	Total	Level 1	Level 2	Level 3
Investments by fair value level				
Debt securities				
U.S. Treasuries	$ 21,870,238	$ 0	$ 21,870,238	$ 0
U.S. Treasury STRIPS	15,023,891	0	15,023,891	0
U.S. Agencies	213,330,890	0	213,330,890	0
Investment Grade Corporates	761,712,488	0	761,712,488	0
Agency Mortgage-Backed Securities	34,043,186	0	34,043,186	0
Total debt securities	1,045,980,693	0	1,045,980,693	0
Total investments by fair value level	1,045,980,693	$ 0	$ 1,045,980,693	$ 0
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	197,263,502			
Total Investments measured at the NAV	197,263,502			
Total Investments measured at the fair value	$ 1,243,244,195			

The Cash Flow portfolio did not hold any Level 1 or Level 3 investments as of June 30, 2016.

Debt securities classified in Level 2 of the fair value hierarchy are valued using observable inputs other than quoted prices for identical securities. The prices are determined by the use of matrix pricing techniques

maintained by the various pricing vendors for these securities. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

The Cash Flow portfolio holds shares or interest in investments where the fair value of the investments are measured on a recurring basis using net asset value per share (or its equivalent) of the investment as a practical expedient. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager.

The following table summarizes the fair value, unfunded commitments, and redemption rules of those investments as of June 30, 2016:

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Short Term Investment Funds [a]	$ 197,263,502		Daily	0 days
Investments measured at the net asset value (NAV)	$ 197,263,502			

a. Short Term Investment Funds. This type includes investments in two open-end mutual funds that invest exclusively in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies and instrumentalities. The fair values of the investments in this type have been determined using the NAV per share of the investments.

5. Rate of Return:

The percentage rate of return for fiscal year 2016 for the Cash Flow portfolio was 1.4%. The percentage was derived by dividing the total investment income by the average daily investment balances.

6. Derivatives:

Derivatives are generally defined as contracts whose values depend on, or derive from, the value of an underlying asset, reference rate, or index. During fiscal year 2016, no derivative instruments were utilized by the Cash Flow portfolio.

7. Proration of Investment Income and Fees:

The cash income received from pooled investments in the Cash Flow portfolio is prorated to state funds which have been certified as participating funds by the Legislative Appropriations Committee. The cash income is prorated to each individual participating fund using the ratio of its average daily cash balance to the total average daily cash balance of all funds. The income is distributed to the participating funds in the next fiscal year.

Per SDCL 4-5-30, the South Dakota Retirement System, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios' share of the SDIC fiscal year budgeted expenditures are transferred to the SDIC Operating Expense Fund. The Cash Flow and School and Public Lands portfolios' share of the SDIC fiscal year budgeted expenditures is deducted from the Cash Flow portfolio income and transferred to the SDIC Operating Expense Fund.

8. Commitments:

On June 30, 2016, the Cash Flow portfolio did not have any uncalled capital commitments.

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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

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*

Executive Board
Legislative Research Council

and

Investment Council
State of South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios, internal investment pools of the State of South Dakota, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios basic financial statements and have issued our report thereon dated October 4, 2016.

Internal Control Over Financial Reporting

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

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

combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

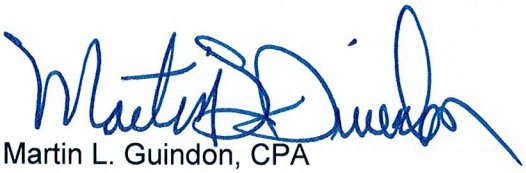
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Martin L. Guindon, CPA
Auditor General

October 4, 2016

STATE OF SOUTH DAKOTA
DEPARTMENT OF LEGISLATIVE AUDIT

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AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

Executive Board
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Report on the Financial Statements
We have audited the accompanying financial statements of the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust and Health Care Trust portfolios, internal investment pools of the State of South Dakota, as of and for the fiscal year ended June 30, 2016, and related notes to the financial statements, as listed in the table of contents.

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

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

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

significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

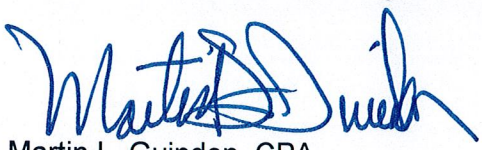
Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the portfolios listed above as of June 30, 2016, and the changes in their financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter
As explained in the following table and in Note 2 to the financial statements, the financial statements include investments whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners:

Portfolio	Amount	Percent of Financial Position
School and Public Lands	$ 30,855,403	12%
Dakota Cement Trust	$ 39,213,466	13%
Education Enhancement Trust	$ 61,191,800	12%
Health Care Trust	$ 16,940,732	13%

The financial statements present only the above referenced investment portfolios managed by the South Dakota Investment Council and do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2016, the changes in its financial position, or, where applicable, its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards
In accordance with *Government Auditing Standards*, we have also issued our report dated October 4, 2016, on our consideration of the South Dakota Investment Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, 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* in considering South Dakota Investment Council's internal control over financial reporting and compliance.



Martin L. Guindon, CPA
Auditor General

October 4, 2016

South Dakota Investment Council
Trust Portfolios
Statement of Net Position
As of June 30, 2016

	School and Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Assets				
Cash & Cash Equivalents	$ 62,799	$ 53,016	$ 489,103	$ 22,831
Receivables				
Investment income receivable	527,451	597,864	1,292,159	261,416
Unsettled investment sales	136,397	167,163	139,474	74,865
Total receivables	663,848	765,027	1,431,633	336,281
Investments, at fair value				
Short term investment fund	48,492,774	51,809,019	108,037,080	27,238,519
Fixed income	75,345,468	90,747,164	145,761,433	39,989,552
Equities	103,959,775	113,036,643	192,859,081	49,100,340
Alternative investments	30,855,403	39,213,466	61,191,800	16,940,732
Total investments	258,653,420	294,806,292	507,849,394	133,269,143
Other assets	1,244,553	-	-	-
Total assets	260,624,620	295,624,335	509,770,130	133,628,255
Liabilities				
Unsettled investment purchases	856,658	1,052,580	1,823,923	466,813
Earnings distribution - declared	-	-	18,242,854	4,970,123
Total liabilities	856,658	1,052,580	20,066,777	5,436,936
Net Position	$ 259,767,962	$ 294,571,755	$ 489,703,353	$ 128,191,319

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

South Dakota Investment Council
Trust Portfolios
Statement of Changes in Net Position
For the fiscal year ended June 30, 2016

	School and Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Additions:				
Contributions	$ 8,584,742	$ -	$ 11,067,987	$ -
Investment income (loss):				
From investing activities:				
Net depreciation in fair value of investments	(6,087,187)	(5,832,222)	(11,412,165)	(2,534,905)
Interest	2,410,493	2,881,602	5,346,644	1,263,130
Dividends	2,630,578	2,890,597	4,882,166	1,292,301
Real estate income	1,108,286	1,274,238	2,096,918	577,223
Investment income	62,170	1,214,215	913,563	597,749
Less investment activity expense	(420,645)	(655,371)	(1,257,555)	(315,260)
Net investment activity income (loss)	(358,475)	558,844	(343,992)	282,489
From security lending activities:				
Security lending income	71,429	71,315	120,606	32,692
Security lending expenses	(17,057)	(16,774)	(28,403)	(7,706)
Net security lending activity income	54,372	54,541	92,203	24,986
Total investment income (loss)	(304,103)	613,385	(251,789)	307,475
Total additions	8,280,639	613,385	10,816,198	307,475
Deductions:				
Statutorily Required Distributions	12,522,565	11,436,003	18,242,854	4,970,123
Total deductions	12,522,565	11,436,003	18,242,854	4,970,123
Net increase (decrease) in net position	(4,241,926)	(10,822,618)	(7,426,656)	(4,662,648)
Net position - Beginning of year	264,009,888	305,394,373	497,130,009	132,853,967
Net position - End of year	$ 259,767,962	$ 294,571,755	$ 489,703,353	$ 128,191,319

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

SOUTH DAKOTA INVESTMENT COUNCIL
TRUST PORTFOLIOS
NOTES TO THE FINANCIAL STATEMENTS

1. Reporting Entity:

The South Dakota Investment Council (SDIC) is a principal, functional sub-unit of state government. The SDIC is responsible for the investment of the state's monies in the state treasury. The SDIC provides investment management services on a prefunded cost recovery basis as authorized by South Dakota Codified Law (SDCL) 4-5-30.

The statements represent the financial activity of the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios. The statements report investments by each portfolio. The School and Public Lands portfolio represents assets held in permanent school funds. The Dakota Cement Trust portfolio represents proceeds from the sale of the South Dakota Cement Plant. The Education Enhancement Trust portfolio represents assets held in trust from the master settlement agreement between the State of South Dakota and major United States tobacco product manufacturers and other funds. The Health Care Trust portfolio represents assets held in trust from federal reimbursement for Medicaid and Medicare costs associated with publicly owned and operated nursing facilities.

2. Summary of Significant Accounting Policies:

a. Basis of Presentation:

The accompanying financial statements of the investment activity of the SDIC on behalf of the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios are prepared in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

b. Basis of Accounting:

The statements for the portfolios are reported on the full accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred. Security transactions and the related gains and losses are recorded on a trade date basis using the average cost method. Purchases and sales of foreign investments and the related income are translated at the rate of exchange on the respective transaction dates. Realized and unrealized gains and losses resulting from foreign currency changes are included in the Statement of Changes in Net Position. Dividend income is recorded on the ex-dividend date and interest income is accrued as earned.

c. Cash and Cash Equivalents:

Cash includes demand deposits and foreign currency cash balances. Foreign currency cash balances are translated into United States Dollars (USD) using the year-end spot foreign currency exchange rates.

d. Valuation of Securities:

Investments are reported at fair value, in accordance with GASB Statement No. 72. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 sets forth the framework for measuring value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. The three levels of the fair value hierarchy under GASB 72 are described as follows:

Level 1 – Valuation inputs are quoted prices in active markets for an identical asset or liability as of the measurement date.

Level 2 – Valuation inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Valuation inputs are based on significant unobservable inputs for an asset or liability.

As a practical expedient, GASB 72 allows the net asset value (NAV) or its equivalent to be used when a readily determinable fair value is not available. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner and are excluded from the fair value hierarchy.

Additional required disclosures can be found in Note 4: Fair Value Measurement.

Alternative investments, which consist of investments in a variety of markets and industries through limited partnerships, are valued as Level 3 on the fair value hierarchy or at NAV. These fair value estimates are subjective and based on judgment. The alternative investments fair values as a percentage of net position as of June 30, 2016 for School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios were 12%, 13%, 12%, and 13%, respectively.

Investments denominated in foreign currencies are translated into USD using the year-end spot foreign currency exchange rates. Foreign exchange rate gains and losses are included with the net appreciation in fair value of investments.

e. Use of Estimates:

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect the reported amounts of net position as of June 30, 2016. Actual results could differ from those estimates.

f. New GAAP Implementation:

In fiscal year 2016, SDIC implemented Government Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application.* GASB 72 addresses accounting and financial reporting issues related to fair value measurements and guidance for financial reporting purposes. There was no material impact on valuation inputs used to measure fair value as a result of the implementation of GASB 72. A classification change has been made as a result of the implementation. In prior years, investments in short term investment funds had been included with cash and cash equivalents on the Statement of Net Position but are now reclassified as investments.

3. Deposits, Investments and Securities Lending:

The State Investment Officer is responsible for the investment of state public funds. The portfolios are governed by the prudent man rule; that is, the SDIC should use the same degree of care as a prudent man. The SDIC dictates the limits on the percentages the portfolios invest in various asset classes.

Deposits:

Custodial Credit Risk. The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The SDIC has a formal deposit policy specific to custodial credit risk for the global equity portfolios of School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust. The policy states that the USD equivalent of any non-USD currency cannot exceed 2.0% of the portfolio fair value on a trade date + 7 day basis. As of June 30, 2016, the portfolios had bank balances in various foreign currencies. These deposits are not collateralized or covered by depository insurance. As a result, the following amounts were exposed to custodial credit risk:

	School & Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Foreign Currency Cash Balances	$ 63,337	$ 53,685	$ 88,598	$ 23,135

Investments:

Securities Lending. State statutes and the SDIC policies permit the use of investments for securities lending transactions. These transactions involve the lending of corporate debt, foreign equity securities, and domestic equity securities to broker-dealers for collateral in the form of securities, with the simultaneous agreement to return the collateral for the same securities in the future. The SDIC's securities custodian is an agent in lending securities and shall accept only U.S. Government securities or its agencies as collateral for any loan or loaned securities. The collateral required must equal 102% of fair value plus accrued interest for corporate debt securities, 102% of fair value for U.S. equity securities and 105% of fair value for foreign securities except in the case of loans of foreign securities which are denominated and payable in USD, in which event the collateral required is 102% of fair value. The earnings generated from the collateral investments results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

The fair value of securities on loan as of June 30, 2016 and the collateral held on the same date is listed in the following table:

	School & Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Fair Value of Securities on Loan	$ 3,511,566	$ 2,495,371	$ 2,767,758	$ 1,093,521
Collateral Held	$ 3,591,459	$ 2,556,393	$ 2,835,441	$ 1,120,261
Collateral % Held	102.28%	102.45%	102.45%	102.45%

The portfolios have no credit risk exposure to borrowers because the amounts the portfolios owe the borrowers exceed the amounts the borrowers owe the portfolios. The contract with the lending agent requires the agent to indemnify the portfolios if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

All securities loans can be terminated on demand by either the SDIC or the borrower. The SDIC does not have the ability to pledge or sell collateral securities unless the borrower defaults, therefore no asset and corresponding liability for the collateral value of securities received has been established on the Statement of Net Position. Regarding restrictions on loans, the securities lending agreement does limit the total value of securities that can be out on loan on any given day.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The SDIC's securities lending policies are detailed in the preceding Securities Lending section. As of June 30, 2016, the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios do not have custodial credit risk with regard to securities lending.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SDIC policy limits or establishes ranges for the durations of the fixed income portfolios. Modified duration estimates the sensitivity of a bond's price to interest rate changes. The investment grade fixed income portfolios of School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust are benchmarked to the duration of the Citigroup Broad Investment Grade (BIG) Index. The fair value (in USD) and weighted modified duration (in years) of the portfolios as of June 30, 2016 are listed in the following table:

Investment Type	School & Public Lands Portfolio Fair Value	Wgtd. Mod. Dur.	Dakota Cement Trust Portfolio Fair Value	Wgtd. Mod. Dur.	Education Enhancement Trust Portfolio Fair Value	Wgtd. Mod. Dur.	Health Care Trust Portfolio Fair Value	Wgtd. Mod. Dur.
U.S. Treasuries	$ 3,905,929	5.81	$ 4,802,438	5.81	$ 3,973,673	5.81	$ 2,130,297	5.81
U.S. Treasury Bills	464,701	0.25	269,816	0.26	669,614	0.22	79,970	0.16
U.S. Treasury STRIPS	7,672,963	8.76	9,432,629	8.76	7,794,387	8.76	4,182,468	8.76
U.S. Agencies	2,498,584	4.11	3,072,514	4.11	2,656,452	3.94	1,296,547	4.32
U.S. Agency Discount Notes	94,900	0.29	114,879	0.29	184,806	0.29	54,942	0.29
U.S. Government-Backed Loans	1,247,186	11.06						
Investment Grade Corporates	19,091,850	4.77	23,531,148	4.76	19,326,907	4.76	10,268,109	4.75
High Yield Corporates	431,470	6.66	532,147	6.66	439,689	6.66	236,281	6.66
High Yield Bond Mutual Fund	11,583,036	4.50	13,231,280	4.50	21,541,180	4.50	5,754,903	4.50
Agency Mortgage-Backed Securities	17,386,153	3.74	21,380,924	3.74	18,004,368	3.73	9,511,951	3.74
Non-Agency Mortgage-Backed Securities	12,215,882	0.54	14,559,389	0.55	23,089,878	0.54	6,474,084	0.54
Municipal Bonds					48,050,479	4.23		
TOTAL	$ 76,592,654		$ 90,747,164		$ 145,761,433		$ 39,989,552	
Portfolio modified duration		4.33		4.25		3.96		4.25

The School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios invest in mortgage-backed securities. These securities are sensitive to prepayments by mortgagees, which is likely in declining interest rate environments, which can reduce the value of these securities.

Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. SDIC policy establishes a percentage range and a normal allocation to various credit risk categories. The SDIC sets the investment policy annually for the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios. This policy establishes the benchmark percentage invested in each asset category and the minimum and maximum range of each asset category. As of June 30, 2016, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. Government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service (at fair value):

Moody's rating:	School & Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Aaa	$ 62,083,068	$ 71,155,642	$ 128,233,453	$ 35,901,563
Aa	3,906,625	4,743,809	27,734,667	2,161,989
A	6,665,023	8,056,122	20,271,459	3,464,385
Baa	9,054,497	11,113,248	9,824,500	4,956,423
Ba	1,797,686	2,161,667	3,047,952	915,816
B	827,875	1,009,377	1,616,761	443,346
Caa	3,492,972	4,178,847	6,497,729	1,804,450
Ca	2,841,387	3,409,731	5,397,143	1,579,373
P-1	94,900	114,879	184,806	54,942
Unrated	13,896,352	15,970,346	33,595,269	6,948,759
Total	$ 104,660,385	$ 121,913,668	$ 236,403,739	$ 58,231,046

Concentration of Credit Risk. Concentration of credit risk is the risk of loss that may be attributed to the magnitude of a government's investment in a single issuer. The SDIC does not have a formal policy in place to limit investments in any particular issuer for the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios. Additionally, there are no single issuer exposures (excluding those issued by or explicitly guaranteed by the U.S. Government, or involving mutual funds or investment pools) within the portfolios that comprise 5% of the overall portfolios as of June 30, 2016.

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios' exposure to foreign currency risk derives

from their positions in foreign currency and foreign currency-denominated equity investments. To match the unhedged benchmark, the SDIC's normal policy is not to hedge foreign currency back to USD. SDIC's policy does allow hedging under certain circumstances when deemed appropriate by the State Investment Officer and portfolio manager. The portfolios' exposure to foreign currency risk as of June 30, 2016 was as follows (in USD fair values):

	School & Public Lands Portfolio			Dakota Cement Trust Portfolio		
Currency	Equities	Cash	Totals	Equities	Cash	Totals
British Pound	$ 4,709,281	$ 0	$ 4,709,281	$ 6,067,366	$ 0	$ 6,067,366
Canadian Dollar	1,702,349	5,180	1,707,529	1,750,859	5,472	1,756,331
Euro	4,594,613	17,706	4,612,319	5,620,528	19,296	5,639,824
Japanese Yen	2,280,947	40,450	2,321,397	1,502,337	28,916	1,531,253
South Korean Won	1,051,761	0	1,051,761	1,131,312	0	1,131,312
Swiss Franc	5,556,818	1	5,556,819	6,107,650	1	6,107,651
Total	$ 19,895,769	$ 63,337	$ 19,959,106	$ 22,180,052	$ 53,685	$ 22,233,737

	Education Enhancement Trust Portfolio			Health Care Trust Portfolio		
Currency	Equities	Cash	Totals	Equities	Cash	Totals
British Pound	$ 10,627,962	$ 0	$ 10,627,962	$ 2,708,363	$ 0	$ 2,708,363
Canadian Dollar	2,902,028	9,120	2,911,148	831,323	2,550	833,873
Euro	9,504,010	32,896	9,536,906	2,456,885	8,725	2,465,610
Japanese Yen	2,404,752	46,578	2,451,330	603,883	11,859	615,742
South Korean Won	1,904,226	0	1,904,226	518,098	0	518,098
Swiss Franc	9,945,615	4	9,945,619	2,553,557	1	2,553,558
Total	$ 37,288,593	$ 88,598	$ 37,377,191	$ 9,672,109	$ 23,135	$ 9,695,244

Investments with external managers, which are not included in the table above, may expose the portfolios to additional foreign currency risk. The fair values (in USD) of externally-managed real estate, private equity, and other fund investments as of June 30, 2016 were as follows:

	School & Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Real Estate Funds	$ 23,333,672	$ 29,196,916	$ 45,958,813	$ 12,680,348
Private Equity Funds	7,155,908	9,419,787	14,370,543	4,041,708
Other Funds	365,823	596,763	862,444	218,676
Total	$ 30,855,403	$ 39,213,466	$ 61,191,800	$ 16,940,732

4. Fair Value Measurement:

Investments are reported at fair value as of June 30, 2016, to the extent available. GASB Statement No. 72 – *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are other than quoted prices included within Level 1 that are observable; Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the hierarchy below.

The following tables summarize the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolio investments within the fair value hierarchy as of June 30, 2016:

School & Public Lands Portfolio

	Total	Level 1	Level 2	Level 3
Investments by fair value level				
Debt securities				
U.S. Treasuries	$ 3,905,929	$ 0	$ 3,905,929	$ 0
U.S. Treasury Bills	464,701	0	464,701	0
U.S. Treasury STRIPS	7,672,963	0	7,672,963	0
U.S. Agencies	2,498,584	0	2,498,584	0
U.S. Agency Discount Notes	94,900	0	94,900	0
Investment Grade Corporates	19,091,850	0	19,091,850	0
High Yield Corporates	431,470	0	431,470	0
Agency Mortgage-Backed Securities	17,386,153	0	17,386,153	0
Non-Agency Mortgage-Backed Securities	12,215,882	0	12,215,882	0
Total debt securities	63,762,432	0	63,762,432	0
Equity securities				
Domestic Stock	76,421,822	76,421,822	0	0
Depository Receipts	4,163,216	4,163,216	0	0
ETF - Exchange Traded Funds	3,478,968	3,478,968	0	0
International Stock	19,895,769	19,895,769	0	0
Total equity securities	103,959,775	103,959,775	0	0
Alternative Investments				
Other Funds	0	0	0	0
Total alternative investments	0	0	0	0
Total investments by fair value level	167,722,207	$ 103,959,775	$ 63,762,432	$ 0
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	48,492,774			
High Yield Bond Mutual Funds	11,583,036			
Alternative investments				
Real Estate Funds	23,333,672			
Private Equity Funds	7,155,908			
Other Funds	365,823			
Total alternative investments	30,855,403			
Total Investments measured at the NAV	90,931,213			
Total Investments measured at the fair value	$ 258,653,420			

Dakota Cement Trust Portfolio

	Total	Level 1	Level 2	Level 3
Investments by fair value level				
Debt securities				
U.S. Treasuries	$ 4,802,438	$ 0	$ 4,802,438	$ 0
U.S. Treasury Bills	269,816	0	269,816	0
U.S. Treasury STRIPS	9,432,629	0	9,432,629	0
U.S. Agencies	3,072,514	0	3,072,514	0
U.S. Agency Discount Notes	114,879	0	114,879	0
Investment Grade Corporates	23,351,148	0	23,351,148	0
High Yield Corporates	532,147	0	532,147	0
Agency Mortgage-Backed Securities	21,380,924	0	21,380,924	0
Non-Agency Mortgage-Backed Securities	14,559,389	0	14,559,389	0
Total debt securities	77,515,884	0	77,515,884	0
Equity securities				
Domestic Stock	84,416,539	84,416,539	0	0
Depository Receipts	4,074,710	4,074,710	0	0
ETF - Exchange Traded Funds	2,365,342	2,365,342	0	0
International Stock	22,180,052	22,180,052	0	0
Total equity securities	113,036,643	113,036,643	0	0
Alternative Investments				
Other Funds	0	0	0	0
Total alternative investments	0	0	0	0
Total investments by fair value level	190,552,527	$ 113,036,643	$ 77,515,884	$ 0
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	51,809,019			
High Yield Bond Mutual Funds	13,231,280			
Alternative investments				
Real Estate Funds	29,196,917			
Private Equity Funds	9,419,786			
Other Funds	596,763			
Total alternative investments	39,213,466			
Total Investments measured at the NAV	104,253,765			
Total Investments measured at the fair value	$ 294,806,292			

Education Enhancement Trust Portfolio

	Total	Level 1	Level 2	Level 3
Investments by fair value level				
Debt securities				
U.S. Treasuries	$ 3,973,673	$ 0	$ 3,973,673	$ 0
U.S. Treasury Bills	699,614	0	699,614	0
U.S. Treasury STRIPS	7,794,387	0	7,794,387	0
U.S. Agencies	2,656,452	0	2,656,452	0
U.S. Agency Discount Notes	184,806	0	184,806	0
Investment Grade Corporates	19,326,907	0	19,326,907	0
High Yield Corporates	439,689	0	439,689	0
Agency Mortgage-Backed Securities	18,004,368	0	18,004,368	0
Non-Agency Mortgage-Backed Securities	23,089,878	0	23,089,878	0
Municipal Bonds	48,050,479	0	48,050,479	0
Total debt securities	124,220,253	0	124,220,253	0
Equity securities				
Domestic Stock	144,005,597	144,005,597	0	0
Depository Receipts	7,561,354	7,561,354	0	0
ETF - Exchange Traded Funds	4,003,537	4,003,537	0	0
International Stock	37,288,593	37,288,593	0	0
Total equity securities	192,859,081	192,859,081	0	0
Alternative Investments				
Other Funds	0	0	0	0
Total alternative investments	0	0	0	0
Total investments by fair value level	317,079,334	$ 192,859,081	$ 124,220,253	$ 0
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	108,037,080			
High Yield Bond Mutual Funds	21,541,180			
Alternative investments				
Real Estate Funds	45,958,813			
Private Equity Funds	14,370,543			
Other Funds	862,444			
Total alternative investments	61,191,800			
Total Investments measured at the NAV	190,770,060			
Total Investments measured at the fair value	$ 507,849,394			

Health Care Trust Portfolio

	Total	Level 1	Level 2	Level 3
Investments by fair value level				
Debt securities				
U.S. Treasuries	$ 2,130,297	$ 0	$ 2,130,297	$ 0
U.S. Treasury Bills	79,970	0	79,970	0
U.S. Treasury STRIPS	4,182,468	0	4,182,468	0
U.S. Agencies	1,296,547	0	1,296,547	0
U.S. Agency Discount Notes	54,942	0	54,942	0
Investment Grade Corporates	10,268,109	0	10,268,109	0
High Yield Corporates	236,281	0	236,281	0
Agency Mortgage-Backed Securities	9,511,951	0	9,511,951	0
Non-Agency Mortgage-Backed Securities	6,474,084	0	6,474,084	0
Total debt securities	34,234,649	0	34,234,649	0
Equity securities				
Domestic Stock	36,558,649	36,558,649	0	0
Depository Receipts	1,810,216	1,810,216	0	0
ETF - Exchange Traded Funds	1,059,366	1,059,366	0	0
International Stock	9,672,109	9,672,109	0	0
Total equity securities	49,100,340	49,100,340	0	0
Alternative Investments				
Other Funds	0	0	0	0
Total alternative investments	0	0	0	0
Total investments by fair value level	83,334,989	$ 49,100,340	$ 34,234,649	$ 0
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	27,238,519			
High Yield Bond Mutual Funds	5,754,903			
Alternative investments				
Real Estate Funds	12,680,348			
Private Equity Funds	4,041,708			
Other Funds	218,676			
Total alternative investments	16,940,732			
Total Investments measured at the NAV	49,934,154			
Total Investments measured at the fair value	$ 133,269,143			

Equity securities classified in Level 1 of the fair value hierarchy are valued using quoted prices in active markets for identical securities as of the measurement date as issued by pricing vendors.

Debt securities classified in Level 2 of the fair value hierarchy are valued using observable inputs other than quoted prices for identical securities. The prices are determined by the use of matrix pricing techniques maintained by the various pricing vendors for these securities. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

The Other Fund classified in Level 3 of the fair value hierarchy is valued at zero. It is an investment in an alternative investment fund that invested in distressed and defaulted debt securities and equities of financially troubled companies. All positions in the fund have been liquidated and only cash remains. The fund holds contingent liabilities that offset cash. Due to the highly questionable outcome of the contingent liabilities it has been determined that a value of zero best reflects the fair value considering the information available as of June 30, 2016.

The School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios hold shares or interests in investments where the fair value of the investments are measured on a recurring basis using net asset value per share (or its equivalent) of the investment as a practical expedient. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner.

The following tables summarize the fair value, unfunded commitments, and redemption rules of those investments as of June 30, 2016:

School & Public Lands Portfolio

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Short Term Investment Funds [a]	$ 48,492,774		Daily	0 days
High Yield Bond Mutual Funds [b]	11,583,036		Daily	1 day
Alternative investments				
Real Estate Funds [c]	23,333,672	$ 15,533,131		
Private Equity Funds [d]	7,155,908	10,350,705		
Other Funds [e]	365,823			
Total alternative investments	30,855,403			
Investments measured at the net asset value (NAV)	$ 90,931,213			

Dakota Cement Trust Portfolio

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Short Term Investment Funds [a]	$ 51,809,019		Daily	0 days
High Yield Bond Mutual Funds [b]	13,231,280		Daily	1 day
Alternative investments				
Real Estate Funds [c]	29,196,917	$ 16,960,479		
Private Equity Funds [d]	9,419,786	12,464,742		
Other Funds [e]	596,763			
Total alternative investments	39,213,466			
Investments measured at the net asset value (NAV)	$ 104,253,765			

Education Enhancement Trust Portfolio

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Short Term Investment Funds [a]	$ 108,037,080		Daily	0 days
High Yield Bond Mutual Funds [b]	21,541,180		Daily	1 day
Alternative investments				
Real Estate Funds [c]	45,958,813	$ 28,523,575		
Private Equity Funds [d]	14,370,543	20,039,948		
Other Funds [e]	862,444			
Total alternative investments	61,191,800			
Investments measured at the net asset value (NAV)	$ 190,770,060			

Health Care Trust Portfolio

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Short Term Investment Funds [a]	$ 27,238,519		Daily	0 days
High Yield Bond Mutual Funds [b]	5,754,903		Daily	1 day
Alternative investments				
Real Estate Funds [c]	12,680,348	$ 7,711,266		
Private Equity Funds [d]	4,041,708	5,543,024		
Other Funds [e]	218,676			
Total alternative investments	16,940,732			
Investments measured at the net asset value (NAV)	$ 49,934,154			

a. Short Term Investment Funds. This type includes investments in one open-end mutual fund that invests exclusively in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies and instrumentalities. The fair value of the investment in this type has been determined using the NAV per share of the investment.

b. High Yield Bond Mutual Funds. This type includes an investment in one open-end mutual fund that invests mainly in a diversified group of high-yielding, higher risk corporate bonds with medium- and lower-range credit-quality ratings. The fair value of the investment in this type has been determined using the NAV per share of the investment.

c. Real Estate Funds. This type includes eleven real estate funds that invest primarily in commercial real estate. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. These investments can never be redeemed from the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 20 years. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

d. Private Equity Funds. This type includes eight private equity funds that invest primarily in leveraged buyouts. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. These investments can never be redeemed from the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 20 years. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

e. Other Funds. This type includes one other alternative investment that is a hybrid private equity hedge fund that invests primarily in a broad range of debt, debt-related, and real estate-related investments. The fair values of the investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. This investment can never be redeemed from the fund. Distributions from the fund will be received as the underlying investments of the fund are liquidated. It is expected that the underlying assets of the fund will be liquidated over the next 5 years. Because it is not

probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

5. Rate of Return:

The percentage rates of return for fiscal year 2016 for the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios were (0.0%), 0.2%, (0.1%), and 0.2%, respectively. The percentages were derived using the net-of-fee time-weighted rate of return calculation and the geometric linking of those returns.

6. Derivatives:

Derivatives are generally defined as contracts whose values depend on, or derive from, the value of an underlying asset, reference rate, or index. The School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios may be exposed to various derivative products through the investment management of the SDIC and its external managers. During fiscal year 2016, no derivative instruments were utilized by SDIC in the internally-managed portfolios.

7. Statutorily Required Distributions:

The cash income received from investments in the School and Public Lands portfolio is received and deposited into the trust fund. Annual distributions of the receipted income are distributed to the permanent school and other educational and charitable funds administered by the Commissioner of School and Public Lands.

The cash income from investments in the Dakota Cement Trust portfolio is received and deposited into the trust fund. By June 30th, annual distributions of four percent of the lesser of the average fair value of the sixteen most recent calendar quarter ends as of the prior December 31st or the fair value as of the prior December 31st are made from the Dakota Cement Trust to the State General Fund.

The cash income from investments in the Education Enhancement Trust and Health Care Trust portfolios is received and deposited into the respective trust funds. At the beginning of each fiscal year, amounts equal to four percent of the average fair value at the end of the sixteen most recent calendar quarter ends as of the prior December 31st are transferred from the Education Enhancement Trust and the Health Care Trust portfolios to the State General Fund. The transfer amount cannot invade the principal of either trust.

8. Commitments:

As of June 30, 2016, the School and Public Lands, Dakota Cement Trust, Education Enhancement Trust, and Health Care Trust portfolios had uncalled capital commitments to private equity and real estate limited partnerships funds. The commitments may be called at the discretion of the general partner or may never be called. As capital is called, it is funded from capital and earnings returned by the limited partnerships or from other assets. In addition to the uncalled commitments reported in Note 4, the following amounts include uncalled commitments for funds established as of June 30, 2016 that have not yet provided an NAV (or its equivalent) of the portfolio's ownership interest or called capital. Approximate uncalled capital commitments as of June 30, 2016 were as follows:

	School & Public Lands Portfolio	Dakota Cement Trust Portfolio	Education Enhancement Trust Portfolio	Health Care Trust Portfolio
Real Estate Funds	$ 26,262,682	$ 28,569,935	$ 48,296,213	$ 12,540,150
Private Equity Funds	13,239,173	15,519,853	25,261,410	6,876,164
Total	$ 39,501,855	$ 44,089,788	$ 73,557,623	$ 19,416,314