



# Comprehensive Annual Financial Report

**Fiscal Year Ended August 31, 2003**

*Sheila W. Beckett*  
Executive Director

Prepared by  
Finance and Administration

*Michael C. Wheeler, CPA*  
Chief Financial Officer

*Rosy Moore, CPA, CEBS*  
Financial Reporting and Investment Accounting Manager



**Employees Retirement System of Texas**

P.O. Box 13207, Austin, Texas 78711-3207

*A Component Unit of the State of Texas*

# ANNUAL FINANCIAL REPORT

FISCAL YEAR ENDED AUGUST 31, 2003

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# INTRODUCTORY

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## SECTION

*Unaudited*

Highlights of Retirement Programs

Executive Director and Chair's Letter

Letter of Transmittal

Certificate of Achievement

Organizational Chart and Data

Summary of Plan Provisions

- Unaudited -

## HIGHLIGHTS OF RETIREMENT PROGRAMS

As of August 31, 2003

	<u>ERS (A)</u>	<u>LECOS (A)</u>	<u>JRS I</u>	<u>JRS II</u>
Active Members	142,315	40,332	58	476
Inactive Members	51,868	7,264	22	80
<b>Total Retirement Accounts</b>	<b>194,183</b>	<b>47,596</b>	<b>80</b>	<b>556</b>
<b>Retirees and Beneficiaries</b>	<b>57,024</b>	<b>4,166</b>	<b>505</b>	<b>78</b>
Resignation Refunds	16,680			5
Death Refunds	316		1	
Service Retirements	7,581	686	27	24
Disability Retirements	174	1		
Death Benefit Plans	84			
Expiration of Annuity Option or Annuitant's Death	1,037	34	13	

### Results of Investments - Pension Trust Funds

	<u>ERS</u>	<u>LECOS</u>	<u>JRS I (B)</u>	<u>JRS II</u>
	\$	\$	\$	\$
Interest, Dividends & Securities Lending Income	529,629,498	18,200,574		3,270,510
Net Appreciation (Depreciation) in Fair Value of Investments	940,441,971	32,000,171		6,216,399

### Time Weighted Rate of Return

	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>
Pension Investment Pool Trust Fund	9.20%	-1.92%	3.72%

### Other Transactions Summary

	<u>ERS</u>	<u>LECOS</u>	<u>JRS I (B)</u>	<u>JRS II</u>
	\$	\$	\$	\$
Member Contributions	324,000,057		267,840	3,020,067
State Retirement Contributions	301,555,437			8,294,029
Retirement Benefits	1,006,198,844	22,834,139	22,672,574	2,119,474
Death Benefits:				
Active Members	1,249,356			
Retirees	1,078,081			
Lump Sum Retiree Death Benefits (C)	6,452,948			
Member Contributions Withdrawn	73,437,833		2,906	151,691
Administrative Expenses	12,364,102	700,262	120,000	244,708
Investment Expenses	14,453,890	509,083		83,047

ERS - Employees Retirement Fund  
LECOS - Law Enforcement and Custodial Officer Supplemental Retirement Fund  
JRS I - Judicial Retirement System Plan One  
JRS II - Judicial Retirement System Plan Two

Note A: The members of the LECOS are also members of the ERS.

Note B: Member contributions for the Judicial Retirement System Plan One are deposited as unappropriated receipts in the State's General Revenue Fund, which is reported in an Agency Fund. Annuity payments and refunds for the Judicial Retirement System Plan One, which are funded on a pay-as-you-go basis, are appropriated by the Legislature each biennium. This fund has no invested assets; it has no rate of return.

Note C: These expenses are reported in the Lump Sum Retiree Death Benefit Fund.



December 19, 2003

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

SHEILA W. BECKETT  
*EXECUTIVE DIRECTOR*

MILTON HIXSON  
*CHAIR*

OWEN WHITWORTH  
*VICE-CHAIR*

BILL CEVERHA

CAROLYN LEWIS GALLAGHER

DON GREEN

YOLANDA GRIEGO

*BOARD OF TRUSTEES*

Dear Governor Perry and Members of the Texas Legislature:

We are pleased to present the audited Employees Retirement System Comprehensive Annual Financial Report for fiscal year 2003.

Benefits provided by ERS to State of Texas employees and retirees include defined benefit pension plans, health, dental, disability and life insurance, a flexible benefits tax-saving plan, and two deferred compensation plans. ERS also administers these benefits, except for retirement, for many higher education employees.

As a result of prudent investment practices and an upturn in the stock market, we can report a healthy 9.2 percent return for our investment portfolio. It closed the year with a market value of \$18.1 billion.

For the ERS fund, this strong return was not enough to counter the experience of the past two years. Investment losses along with other actuarial demographic changes, lowered the funding ratio to 97.6 percent. This funding ratio, while dipping below 100 percent for the first time in more than a decade, still ranks the ERS fund in the top 20 percent of public retirement funds nationwide. We are fortunate that our diversified investment asset allocation policy, risk management process, and consistent funding from the State and our membership for retirement benefits, enables us to continue to provide State of Texas employees and retirees with a high-quality, stable retirement program and superior service.

Health insurance benefits suffered some painful cuts this year, caused by state budget shortfalls and increased health care costs. Unfortunately, the picture does not look brighter for the near future. However, employees and retirees continue to be fortunate to have all of their premiums paid by the State for employee-only and retiree-only health care coverage, plus the State pays half of the cost for covered dependents.

As of August 31, 2003, we have seen 7,581 state employees retire, a record number, including nearly 5,000 who retired in August under the retirement incentive program passed by the 78th Legislature. This brings the total number of state retirees to 57,024.

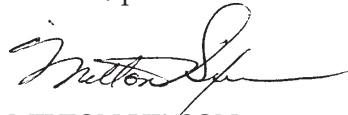
Careful management of the retirement fund assets becomes more crucial as the fund continues its recovery. ERS works hand in hand with fund actuaries to ensure that the System is a proper steward of the retirement funds entrusted to us and is correctly balancing the ability to provide benefit enhancements against the necessity to provide the funding needed to meet all projected liabilities.

This balancing role is even more crucial as it relates to the provision and administration of health insurance. As a result of State budget needs, changes were made to State benefits increasing copayments and co-insurance, implementing new copayments and deductibles, and tightening eligibility requirements for retirees and part-time employees.

The ERS Online project will be fully implemented soon, when retirement program benefits join insurance, deferred compensation and TexFlex in an interactive electronic format. Members currently use the system to update their personal information and make eligible health benefit changes throughout the year. More than 98 percent of insurance transactions were made online during our summer enrollment period this year. When the retirement section is launched, members will be able to apply for retirement and perform other transactions online with access to a number of calculators that can guide them through the process.

We are proud that ERS remains a top-performing retirement system with high standards for financial integrity, benefit management and customer service — thanks to continued Executive and Legislative support and sound management.

On behalf of the ERS Board of Trustees and the ERS staff, we are grateful for your partnership in providing a secure defined benefit pension, excellent insurance, deferred compensation, and flexible benefits/premium conversion programs for our members and their families.



MILTON HIXSON  
Chair, Board of Trustees



SHEILA W. BECKETT  
Executive Director





December 19, 2003

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

SHEILA W. BECKETT  
EXECUTIVE DIRECTOR

MILTON HIXSON  
CHAIR

OWEN WHITWORTH  
VICE-CHAIR

BILL CEVERHA

CAROLYN LEWIS GALLAGHER

DON GREEN

YOLANDA GRIEGO

BOARD OF TRUSTEES

**To: The Board of Trustees and Members of the  
Employees Retirement System of Texas**

Ladies and Gentlemen:

It is my pleasure to submit to you the Comprehensive Annual Financial Report (CAFR) for the Employees Retirement System of Texas (System) for the fiscal year ended August 31, 2003. Its purpose is to provide information as a basis for making management decisions, to determine compliance with legal provisions, and to determine responsible stewardship over the assets contributed by the members and the state.

**REPORT CONTENTS AND STRUCTURE**

This report is in compliance with generally accepted accounting principles as established by the Governmental Accounting Standards Board (GASB), including the new financial reporting model based on GASB Statement 34 *Basic Financial Statements – and Management’s Discussion and Analysis-for State and Local Governments*. For financial reporting purposes, the System is considered a component unit of the State of Texas. The System’s financial activities will be included in the annual financial report for the State of Texas for the fiscal year ended August 31, 2003. This report consists of five sections:

1. Introductory Section, which contains this Letter of Transmittal, the Executive Director and Chair’s Report, Organizational Data including consultants and advisors, and a Summary of Plan Provisions;
2. Financial Section, which contains the auditor’s opinion, the Management’s Discussion and Analysis, the Basic Financial Statements, the Notes to the Basic Financial Statements, Required Supplementary Information, Combining Financial Statements, and Supporting Schedules;
3. Investment Section, which contains the report on investment activity, the investment policy, time-weighted rates of return, target versus actual asset allocations, a list of the 10 largest stock and bond holdings, fees and commissions, investment revenues, and an investment summary;
4. Actuarial Section, which contains the Actuary’s Certification Letter, the results of the annual actuarial valuation, actuarial cost method and assumptions, and other actuarial information as of August 31, 2003; and
5. Statistical Section, which includes other information regarding participants and finances of the System.

The System’s Finance and Administration staff prepared this report. The responsibility for the accuracy, completeness, and fair presentation of the information, including all disclosures, rests with the System.

The scope of the audit performed by the independent certified public accountants, Deloitte & Touche, LLP, did not include:

- The Introductory Section,
- Management's Discussion and Analysis and Required Supplementary Information in the Financial Section,
- The Investments Section,
- The Actuarial Section, or
- The Statistical Section; therefore, there is no audit opinion on them.

### **Reporting Entity and Pension Plans' History**

The Employees Retirement Plan was established in 1947 by the Texas Constitution to provide benefits for officers and employees of the State. The System administers retirement and disability annuities and death and survivor benefits for employees of the State of Texas and their beneficiaries and proportional retirement benefits for members of the Proportionate Retirement Program.

The Law Enforcement and Custodial Officer Supplemental Retirement Plan was established in 1979 to provide service retirement, death and disability benefits. This plan covers custodial officers employed by the Department of Criminal Justice, including the Board of Pardons & Paroles, and law enforcement officers who have been commissioned by the Department of Public Safety, the Alcoholic Beverage Commission, the Parks and Wildlife Department, or the State Board of Pharmacy who are recognized as commissioned law enforcement officers by the Commission on Law Enforcement Officer Standards and Education.

The Judicial Retirement Plan One and Plan Two were established to provide benefits for judges. Plan One was established in 1949 as a pay-as-you-go pension plan rather than a funded pension plan. Plan Two was established as a new plan of actuarially funded retirement benefits for judges becoming members of the Judicial Retirement System after August 31, 1985.

Although the Texas Judicial Retirement Systems are separate legal entities, the Employees Retirement System of Texas and the Texas Judicial Retirement Systems are a single accounting entity because they are governed by the same Board of Trustees and directed by the same management. Accountability for all fiscal and budgetary matters is the responsibility of the Board of Trustees.

### **FINANCIAL INFORMATION**

Please refer to the Management's Discussion and Analysis in the Financial Section for condensed financial information and activities of the current and prior fiscal years.

#### **Accounting and Budget Systems**

We believe that the System's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets and the reliability of financial records.

Operating administrative expenses, including capital items, are budgeted annually by the Board of Trustees. The Board must approve any subsequent increases in the budget. Budgetary control is maintained by the encumbrance of purchase amounts at the time of release of purchase orders to vendors.

The Notes to the Basic Financial Statements contain additional detailed information on the constitutional and statutory provisions under which the System operates. The Notes also include a summary of significant accounting policies, a discussion of the System's reporting entity, and other significant financial data not evident in the Financial Statements.

### **Investment of the Retirement Funds**

Investment decisions adhere to the whole portfolio approach as provided in the Texas Trust Code and the exclusive benefit requirements of the Texas Constitution. Consistent with those requirements, the Board of Trustees establishes investment policies, objectives, and strategies for the purpose of obtaining the optimum return on the Fund's portfolios in keeping with the assumption of prudent risk.

A staff of professional personnel invests state contributions, member contributions, and investment income. To assist the staff with investment recommendations and decisions, the Trustees have employed nationally recognized investment consultants and advisors and have appointed an Investment Advisory Committee composed of prominent members of the financial and business community of Texas. Also, the System retains an independent performance measurement service to evaluate and analyze the investment results of the System. Schedule 5 of the Supporting Schedules in the Financial Section reflects fees paid to investment consultants and advisors.

A summary of the total portfolio of the pooled pension trust funds and asset allocations at year-end are presented in the Investments Section. The investment one-year time-weighted rate of return was 9.2% for fiscal year 2003 after two prior fiscal years with negative returns. Over the longer term, the fund returned 7.18% for the 10 years ending August 31, 2003, slightly besting the policy benchmark of 7.13%.

### **MAJOR CURRENT AND FUTURE INITIATIVES**

The Seventy-eighth Legislature led a major initiative to control the rising costs of health insurance for the State of Texas. This initiative resulted in significant changes to the employee group benefits program administered by the System. During the year ended August 31, 2003, the System implemented changes to the employee group benefits program that were approved by the Legislature as well as the System's Board of Trustees including:

- Increased co-payments, co-insurance and implemented new co-payments and deductibles,
- Limited the participation through a 90-day waiting period, and
- Changed the eligibility requirements for retiree and part-time employee health insurance coverage.

Other major initiatives for fiscal year 2003 included the following:

- Implemented the retirement incentive authorized by the Legislature retiring nearly 5,000 members in August, 2003,
- Implemented the federal Health Insurance Portability and Accountability Act (HIPAA) privacy provisions,
- Established a Texa\$aver investment operational plan and comprehensively reviewed the core products resulting in changes to the fund choice, and
- Obtained a \$4.3 million settlement of claims against two vendors who had breached their agreements with the System.

Fiscal year 2004 initiatives emphasize improved information technology. The System will continue the transition of pension administration from mainframe to client/server infrastructure.

### Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association (GFOA) of the United States and Canada awarded the Certificate of Achievement for Excellence in Financial Reporting to the System for its Comprehensive Annual Financial Report for the fiscal year ended August 31, 2002. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports. To be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid only for one year. The Employees Retirement System of Texas has received a Certificate of Achievement for each of the last fourteen years. We believe our current report continues to meet the Certificate of Achievement program requirements and are submitting it to the GFOA for consideration again this year.

### Acknowledgments

The preparation of this report on a timely basis could not have been accomplished without the efficient and dedicated service of the Finance and Administration staff and other employees of the System. I would like to express my appreciation to all the employees of the System who contributed to its preparation.



MICHAEL C. WHEELER, CPA  
Chief Financial Officer

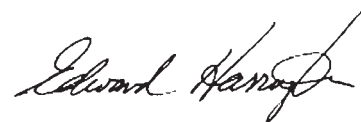
## Certificate of Achievement for Excellence in Financial Reporting

Presented to

### Employees Retirement System of Texas

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
August 31, 2002

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



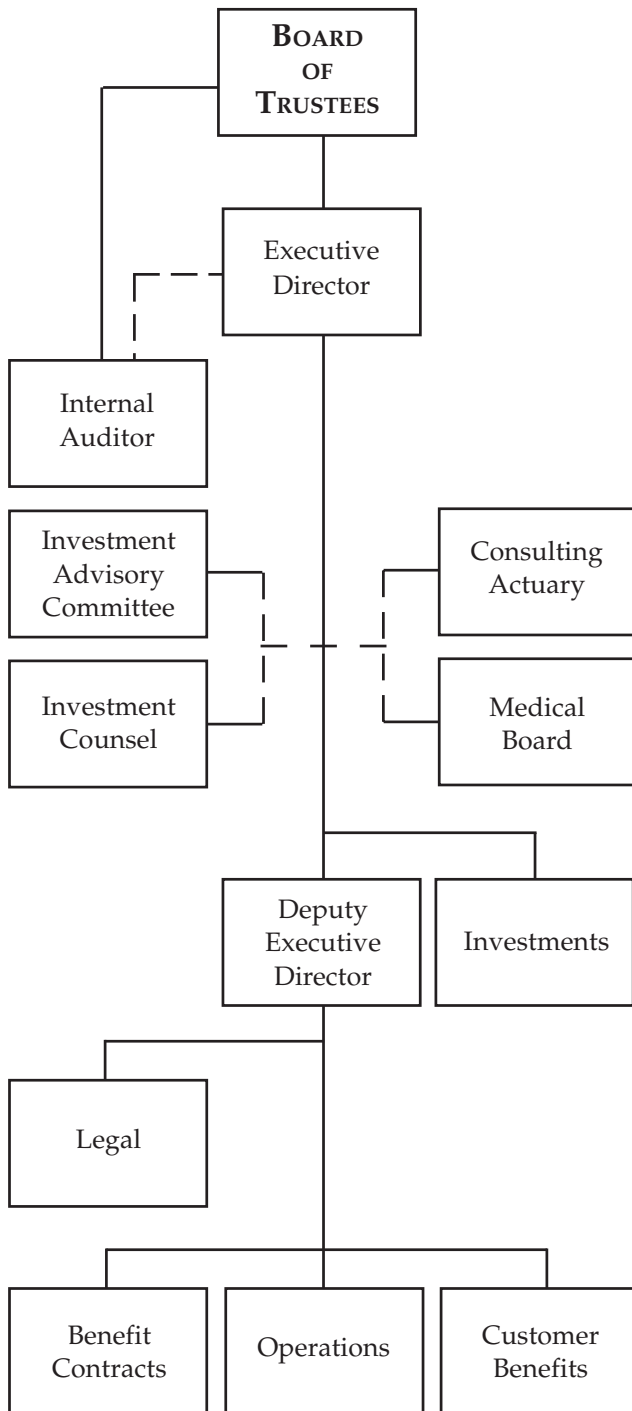
President



Executive Director

# ORGANIZATIONAL CHART AND DATA

As of August 31, 2003



## BOARD OF TRUSTEES

**Milton Hixson, Chair**  
Bill Barton, *Vice-Chair*  
Pamela A. Carley  
Carolyn Lewis Gallagher  
Don Green  
Owen Whitworth

## STAFF

**Sheila W. Beckett, Executive Director**  
William S. Nail, *Deputy Executive Director*

Joe H. Golson, *Director of Benefit Contracts*  
Paula A. Jones, *General Counsel*  
Kathy-Ann Reissman, *Director of Investments*  
Marci Sundbeck, *Director of Internal Audit*  
Catherine E. Terrell, *Director of Customer Benefits*  
Ann Waterman, *Director of Operations*

## CONSULTANTS AND ADVISORS

### Consulting Actuaries

Leslie P. Finertie, FSA, MCA, MAAA, *Towers Perrin*  
Philip S. Dial, FSA, *Rudd and Wisdom, Inc.*

### Investment Advisory Committee

C. Courtland Huber, Ph.D., *Chair, The University of Texas at Austin*  
C. Thomas Tull, CFA, *Vice-Chair, Private Investor*  
Bob Alley, CFA, *AIM Capital Management*  
I. Craig Hester, CFA, *Hester Capital Management, L.L.C.*  
J. Luther King, Jr., CFA, *Luther King Capital Management*  
Laura T. Starks, Ph.D., *The University of Texas at Austin*  
Vernon D. Torgerson, Jr., CFA, *Frost National Bank of San Antonio*

### Investment Consultant

Callan Associates, Inc.

### Investment Advisory Managers

Alliance Bernstein  
AIG Global Investment Group  
Batterymarch Financial Management Inc.  
BNY Asset Management  
DuPont Capital Management  
Earnest Partners  
Fountain Capital Management  
Montag & Caldwell, Inc.  
Putnam Investments  
Templeton Investment Counsel, LLC

### Master Trust Custodian

J. P. Morgan Chase & Co.

### Medical Board

Albert A. LaLonde, M.D.  
Thomas I. Lowry, M.D.  
Grover L. Byrum, M.D.

# SUMMARY OF PLAN PROVISIONS

Effective September 1, 2003

The Employees Retirement System of Texas was created by the Texas Legislature in 1947 and is administered in accordance with the Texas Constitution. The System provides a retirement and disability pension system for State employees, law enforcement and custodial officers, elected state officials and two classes of judges. The System administers the trust funds, with a fiduciary obligation to the members and retirees of the System who are its beneficiaries.

The retirement programs complement the Social Security and Medicare programs by providing a retirement annuity with service, disability and survivorship benefits. The Employees Retirement System of Texas Plan (ERS), the Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS), the Judicial Retirement System of Texas Plan One (JRS I) and Judicial Retirement System of Texas Plan Two (JRS II) are single employer defined benefit pension plans.

Following is the summary of plan provisions:

ERS	LECOS	JRS I AND JRS II
<p><b>Membership:</b>  <i>Employee Class Only:</i>                      Employees and appointed officers of every department, commission, board, agency, or institution of the State except those who are included in the coverage of Teacher Retirement System of Texas, JRS I, and JRS II.</p> <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> <li>● Persons who hold State offices that are normally filled by statewide election and that are not included in the coverage of JRS I and JRS II.</li> <li>● Members of the Legislature.</li> <li>● District and criminal district attorneys.</li> </ul>	<ul style="list-style-type: none"> <li>● Law enforcement officers commissioned by the Department of Public Safety, the Alcoholic Beverage Commission, the Parks and Wildlife Department, or the State Board of Pharmacy recognized as commissioned law enforcement officers by the Commission on Law Enforcement Officer Standards and Education.</li> <li>● Custodial officers employed by the Department of Criminal Justice, including the Board of Pardons and Paroles, and certified by that department according to statutory requirements as having a normal job assignment that requires frequent or infrequent planned contact with inmates of that institution.</li> </ul>	<p><i>JRS I Only:</i></p> <ul style="list-style-type: none"> <li>● Judges, justices and commissioners of the Supreme Court, the Court of Criminal Appeals, the Court of Appeals, District Courts, and certain commissions to a court who commenced service <i>before</i> September 1, 1985.</li> </ul> <p><i>JRS II Only:</i></p> <ul style="list-style-type: none"> <li>● Judges, justices and commissioners of the Supreme Court, the Court of Criminal Appeals, the Court of Appeals, District Courts, and certain commissions to a court who commenced service <i>after</i> August 31, 1985.</li> </ul>
<p><b>Service Retirement Eligibility:</b>  <i>Employee Class Only:</i></p> <ul style="list-style-type: none"> <li>● Age 60 with at least five years of service credit, or</li> <li>● The sum of age and years of service credit equals or exceeds the number 80 with at least five years of service credit, or</li> <li>● Age 55 with at least 10 years of service credit as a certified peace officer or custodial officer.</li> </ul> <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> <li>● Age 60 with eight years of service credit, or</li> <li>● Age 50 with 12 years of service credit.</li> </ul>	<p>20 years of service credit as a certified peace officer/custodial officer and the member's age is the earlier of either the age of 50 or the age at which the sum of age and years of service credit equals or exceeds the number 80.</p>	<p><i>JRS I and JRS II:</i></p> <ul style="list-style-type: none"> <li>● Age 65 with at least 10 years of service credit <i>and</i> currently holding a judicial office, or</li> <li>● Age 65 with at least 12 years of service credit, regardless of whether the member currently holds a judicial office.</li> </ul> <p><i>JRS I Only:</i>                      20 years of service, regardless of whether the member currently holds a judicial office.</p> <p><i>JRS II Only:</i></p> <ul style="list-style-type: none"> <li>● Age 55 with at least 20 years of service, regardless of whether the member currently holds a judicial office; or</li> <li>● The sum of age and years of service credit equals or exceeds the number 70 <i>and</i> served at least 2 full terms on an appellate court, regardless of whether the member currently holds a judicial office.</li> </ul>

ERS	LECOS	JRS I AND JRS II
<p><b>Early Service Retirement Eligibility with Reduced Benefits:</b></p> <p>Not applicable.</p>	<p>20 years of service credit as a certified peace officer/custodial officer, regardless of age.</p>	<ul style="list-style-type: none"> <li>● Age 60 with 10 years of service credit and currently holding judicial office, or</li> <li>● Age 60 with 12 years of service credit, regardless of whether the member currently holds a judicial office.</li> </ul>
<p><b>Standard Service Retirement Benefits:</b></p> <p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> <li>● Monthly annuity is equal to 2.3% of average monthly compensation multiplied by the number of years of service credit.</li> <li>● Average monthly compensation is the average of the highest 36 months of compensation.</li> <li>● Minimum standard annuity is \$150 per month.</li> <li>● Maximum standard annuity is 100% of the average monthly compensation.</li> </ul> <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> <li>● Monthly annuity is 2.3% of the current State salary of a district judge multiplied by the number of years of service credit.</li> <li>● Retirement benefits are automatically adjusted as State judicial salaries increase.</li> <li>● Maximum standard annuity is 100% of the State salary being paid a district judge.</li> </ul>	<ul style="list-style-type: none"> <li>● Monthly annuity is equal to 2.8% of average monthly compensation multiplied by the number of years of service credit.</li> <li>● Average monthly compensation is the average of the highest 36 months of compensation.</li> <li>● Minimum standard annuity is \$150 per month.</li> <li>● Maximum standard annuity is 100% of the average monthly compensation.</li> </ul>	<ul style="list-style-type: none"> <li>● Monthly annuity is equal to 50% of the salary for the position from which the member retired.</li> <li>● An additional 10% is paid when a member retires within one year of leaving the bench.</li> </ul>
<p><b>Optional Service Retirement Benefits:</b></p> <p><i>Employee Class and Elected Class:</i></p> <ul style="list-style-type: none"> <li>● Lifetime with 100% to surviving beneficiary;</li> <li>● Lifetime with 75% to surviving beneficiary,</li> <li>● Lifetime with 50% to surviving beneficiary;</li> <li>● Lifetime with five years certain;</li> <li>● Lifetime with 10 years certain; and</li> <li>● One-time partial lump sum of up to three years of standard annuity at retirement (annuity is reduced for life and the reduced annuity is used to calculate the six beneficiary options listed above).</li> <li>● If beneficiary predeceases member, the annuity paid to the retired member who selected one of the lifetime survivor benefits is increased to the standard annuity.</li> </ul>	<p>Same as ERS.</p>	<p>Same as ERS.</p>

ERS	LECOS	JRS I AND JRS II
<p><b>Vesting Requirements:</b> Five or more years of service credit for <i>Employee Class</i> and eight or more years for <i>Elected Class</i>.</p>	<p>20 or more years of service credit as a certified peace officer/custodial officer.</p>	<p>12 or more years of service credit.</p>
<p><b>Vested Benefits after Termination of Employment:</b></p> <ul style="list-style-type: none"> <li>● Member is entitled to a deferred retirement benefit based on service and compensation prior to termination.</li> <li>● Member must leave accumulated contributions in the System and must live to normal retirement age.</li> <li>● Upon or after leaving State employment, member may apply for a refund of contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.</li> </ul>	<ul style="list-style-type: none"> <li>● Member is entitled to a deferred retirement benefit based on certified peace officer/custodial officer service and the highest average monthly compensation prior to termination.</li> <li>● Member must leave accumulated deposits in the System to which the member contributed.</li> </ul>	<ul style="list-style-type: none"> <li>● Member is entitled to a deferred retirement benefit based on service and compensation as a judge prior to termination.</li> <li>● Member must leave accumulated contributions in the System and must live to normal retirement age.</li> <li>● Upon or after leaving State judicial employment, member may apply for a refund of contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.</li> </ul>
<p><b>Disability Retirement Eligibility:</b> <i>Employee Class Only:</i></p> <ul style="list-style-type: none"> <li>● For occupational disability, no age or length of service requirement.</li> <li>● For non-occupational disability, at least 10 years of <i>Employee Class</i> service credit, which may include up to five years of purchased military service credit.</li> </ul> <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> <li>● For occupational disability, no age or length of service requirement.</li> <li>● For non-occupational disability, eight years of <i>Elected Class</i> service (exclusive of military service) or six years of <i>Elected Class</i> service plus two years of military service if purchased before January 1, 1978.</li> </ul>	<ul style="list-style-type: none"> <li>● For occupational disability, no age or length of service requirement.</li> <li>● For non-occupational disability, at least 10 years of service credit, which may include up to five years of purchased military service credit.</li> </ul>	<ul style="list-style-type: none"> <li>● No age requirement.</li> <li>● Seven years of judicial service and currently holding a judicial office.</li> </ul>
<p><b>Disability Retirement Benefits:</b> <i>Employee Class Only:</i></p> <ul style="list-style-type: none"> <li>● For occupational disability, the benefits are the same as those under the standard service retirement, except the average monthly compensation is equal to 35% of the average of the highest 36 months of compensation.</li> <li>● For non-occupational disability, the retirement benefits are the same as those under standard service retirement.</li> </ul> <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> <li>● For both occupational and non-occupational disability, the standard annuity is 18.4% of the State salary of a district judge, or 2.3% of the State salary of a district judge times years of <i>Elected Class</i> service, whichever is greater.</li> </ul> <p align="right"><i>(Continued on page 13)</i></p>	<ul style="list-style-type: none"> <li>● The standard annuity is a minimum of 50% of the highest average monthly compensation regardless of the years of service credit or age.</li> <li>● The standard annuity is increased to 100% of the highest average monthly compensation if a member receives Social Security disability benefits as a result of occupational disability.</li> <li>● The optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.</li> <li>● For non-occupational disability, the retirement benefits are the same as those under standard service retirement.</li> </ul>	<p>Same as standard service retirement benefits without reduction for age.</p>



ERS	LECOS	JRS I AND JRS II
<p><b>Disability Retirement Benefits (Continued):</b></p> <p><i>Employee Class <u>and</u> Elected Class:</i>                      Optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.</p>		
<p><b>Death Benefits:</b></p> <p><i>Employee Class <u>and</u> Elected Class:</i></p> <ul style="list-style-type: none"> <li>● Member with a minimum of 10 years of service credit, or less than 10 years of service credit but eligible to retire and survived by a spouse or minor children; the benefit options are:                             <ul style="list-style-type: none"> <li>◆ Death benefit plan filed by the member, or</li> <li>◆ Lifetime annuity, or</li> <li>◆ 10-year certain annuity.</li> </ul> </li> <li>● Member with less than 10 years of service credit, or eligible to retire but not survived by a spouse or minor children, or selected in lieu of a death benefit plan; the benefit options are:                             <ul style="list-style-type: none"> <li>◆ Refund of member’s contribution with interest.</li> <li>◆ If member is contributing at the date of death, an additional 5% of the member’s accumulated contributions for each full year of service with a maximum of 100% of the member’s accumulated contributions.</li> </ul> </li> <li>● In case of occupational death, an additional benefit is paid to the surviving spouse or minor children. This additional benefit is equal to one year’s salary based on rate at the time of death. This additional benefit is not paid if there is no surviving spouse or minor children.</li> <li>● If a member dies after retirement and selected the standard annuity, the member’s beneficiaries receive a benefit equal to the excess of accumulated contributions at retirement age over the monthly benefit paid before death. In addition, the beneficiaries are entitled to a lump sum death benefit of \$5,000.</li> </ul> <p><i>Elected Class Only:</i>                      Member with at least eight, but less than 10 years of service credit and under age 60, the surviving spouse receives a lifetime annuity equal to 50% of the monthly standard annuity the member would have been entitled to at the time of death or at age 60, whichever is later.</p>	<ul style="list-style-type: none"> <li>● Member with a minimum of 10 years of service credit as a certified peace officer/custodial officer service may file a death benefit plan, which will provide the member’s beneficiary either a lifetime annuity or a 10-year certain annuity.</li> <li>● Member with 20 or more years of certified peace officer/custodial officer service, the death benefits are the same as those under the service retirement.</li> </ul>	<p>Same as those listed in the Employee Class under the ERS Plan.</p>

*For a complete description of the provision of the law that describes the Retirement Plans, see V.T.C.A., Texas Government Code, Title 9. Alternatively, the staff of the Employees Retirement System of Texas can provide more of the details of the provisions.*



# FINANCIAL

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## SECTION

Independent Auditor's Report  
Management's Discussion and Analysis  
Basic Financial Statements  
Required Supplementary Information  
Combining Financial Statements  
Supporting Schedules



# INDEPENDENT AUDITOR'S REPORT

# INDEPENDENT AUDITOR'S REPORT CONTINUED



November 20, 2003

Ladies and Gentlemen:

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis provides an overview of the financial activities of the Employees Retirement System of Texas for the year ended August 31, 2003. Please read it in conjunction with the Basic Financial Statements, which begin after this discussion.

### EMPLOYEES RETIREMENT SYSTEM OF TEXAS

SHEILA W. BECKETT  
EXECUTIVE DIRECTOR

### Using This Comprehensive Annual Financial Report

This report includes eleven exhibits in the Basic Financial Statements section.

Exhibits I and II are government-wide statements of net assets and activities.

Exhibits III and IV are Special Revenue Funds statements for three of the programs presented in the government-wide statements.

Exhibits V and VI are the Statement of Net Assets and the Statement of Changes in Net Assets for the Employees Life, Accident and Health Insurance and Benefits Fund (Group Insurance Fund). Please see Financial Analysis on Government-wide Statements for highlights.

Exhibit VII is a required Statement of Cash Flows for the Group Insurance Fund, which is an Internal Service Fund. This statement reports the transactions for the year on a cash basis. It is similar to Exhibit VI, the Statement of Changes in Net Assets, except that the focus of this statement is on the change to cash balances with accrued income and expense items eliminated.

Exhibits VIII and IX are the Combined Statement of Fiduciary Net Assets and the Combined Statement of Changes in Fiduciary Net assets. They report pension and other employee benefit trust fund activities in total.

Exhibits X and XI, the Combining Statement of Fiduciary Net Assets and the Combining Statement of Changes in Fiduciary Net Assets, report activities of the defined benefit plans retirement funds. Please see the Financial Highlights – Defined Benefit Retirement Plans for a financial analysis of the defined benefit plans.

### Financial Analysis on Government-wide Statements

The government-wide activities of the System are comprised of four programs: Social Security Administration, Death Benefits for Public Safety Officers, Death Benefits for Retirees, and the Group Benefits Program. Death Benefits for Public Safety Officers and the Group Benefits Programs, which are included in Exhibits I and II, had significant changes from the prior year.

The Death Benefits Program for Commissioned Peace Officers, Firemen, etc. Fund reflects a significant decrease from \$7.29 million in benefit payments to \$4.65 million, or a 36.2% decrease. The relatively high benefit payments amount reported in fiscal year 2002 is largely due to the legislation that increased the benefit payments from \$50,000 to \$250,000. This legislation was applied retroactively to the deaths that occurred from September 1, 2000 through August 31, 2001.

Exhibits V and VI provide information on the Group Benefits Program. The net assets of the Group Insurance Fund were \$25.94 million as of August 31, 2003 compared with \$19.33 million as of August 31, 2002. Member and employer contributions increased by \$139.81 million, or 9.4%, from \$1.49 billion to \$1.63 billion. For the fiscal year 2003, which began September 1, 2002, the rate increase for the group insurance member and employer contributions was 9.7%, and the rates were reduced by 11.4% on May 1, 2003. Benefit payments totaled \$1.63 billion, an increase of \$133.49 million, or 9.4%, over the \$1.49 billion paid in the prior year. The increase reflects the healthcare cost increases. In order to contain the healthcare costs, the State's health maintenance program, HealthSelect Plus, was eliminated effective April 30, 2003, and approximately 110,000 participants of HealthSelect Plus were moved to HealthSelect. Further benefit plan structural changes were implemented May 1 to achieve the necessary plan savings by the end of the fiscal year. This is the first year that the System has made mid-year benefits changes.

Total current liabilities related to the Group Insurance Fund increased by \$34.54 million, or 9.1%, from \$380.56 million to \$415.1 million. The change is due to increases in claims payable and securities lending obligations.

There were no transfers during the entire fiscal year in the Group Insurance Fund.

#### **Financial Highlights – Defined Benefit Retirement Plans**

Net assets of the defined benefit plans administered by the System totaled \$18.18 billion as of August 31, 2003, compared with \$17.11 billion as of August 31, 2002. The \$1.07 billion, or 6.3%, increase resulted primarily from an increase in the fair value of investments in the amount of \$2.85 billion. The increase in the fair value of investments was the result of the rebound in the domestic equity markets in July and August. See the Investments Section for data on the Pooled Pension Trust Funds.

Contributions increased by \$11.91 million, or 1.7%, from \$685.14 million to \$697.05 million, while benefit payments increased by \$109.1 million, or 10.8%, from \$1.02 billion to \$1.13 billion.

The most recent actuarial valuations of the funded defined benefit plans were completed as of August 31, 2003. The funded ratios are listed as follows:

<u>Plans</u>	<u>Funded Ratios</u>	
	<u>2003</u>	<u>2002</u>
Employees Retirement System	97.6%	102.5%
Law Enforcement and Custodial Officer Supplemental Retirement Fund	111.5%	124.7%
Judicial Retirement System of Texas Plan Two	116.5%	110.9%

See Exhibits X and XI for more information regarding each of the defined benefit plans.



**Fiduciary Net Assets of Defined Benefit Retirement Plans**

**Additions**

Retirement benefits are financed primarily through the collection of employer and employee retirement contributions, investment income, legislative appropriations, and contributions transferred from the Teacher Retirement System. The additions, in millions, were as follows:

	August 31,		Percent Increase (Decrease) %
	2003	2002	
	\$	\$	
Employee contributions	327.02	322.35	1.4
Employer contributions	309.85	308.77	0.3
Net investment income	1,514.71	(1,323.92)	214.4
Other legislative appropriations	22.80	21.68	5.2
Other additions	37.80	32.67	15.7
Total additions	2,212.18	(638.45)	446.5

For the Employees Retirement Fund, employee and employer retirement contribution rates were 6% each. For the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOSRF), there are no member contributions; and it has not received funding from the State since August 31, 1993. For the Judicial Retirement Plan Two Fund, employee and employer retirement contribution rates were 6% and 16.83%, respectively.

Investment revenues are comprised of interest, dividend income, securities lending income, and net appreciation in fair value of investments. The investment portfolio returned 9.2% for the year. The investment portfolio's total return was positive for the first time in two fiscal years. The year-end asset allocation stood at 35.1% investment grade bonds, 4% high yield bonds, 37.64% large cap domestic equity, 4.41% small cap domestic equity and 18.42% international equity. Please see the Report on Investment Activity in the Investment Section.

**Deductions**

Benefit payments are the primary expense of a retirement system. Total deductions are comprised of benefit payments, refunds of contributions to members or beneficiaries for reasons of separation from service or death, other death benefit payments, contributions transferred to the Teacher Retirement System, and the cost of administering the System.

The deductions, in millions, were as follows:

	August 31,		Percent Increase (Decrease) %
	2003	2002	
	\$	\$	
Retirement benefits	1,053.89	949.39	11.0
Member contributions withdrawn	77.63	73.31	5.9
Death benefits	2.33	2.09	11.5
Other deductions	14.17	14.39	(1.5)
Total deductions	1,148.02	1,039.18	10.5

The Board of Trustees and Members of the Employees Retirement System of Texas  
November 20, 2003  
Page 3

### *Reserves*

Net assets derived from pension contributions in excess of pension benefit payments are accumulated by the System in order to meet future pension benefit obligations. Soundness in the funding of the System is sought through maintaining suitable reserves in the retirement annuity reserve account and the employee savings and state accumulation reserve accounts.

The latest annual actuarial valuation of the System, as of August 31, 2003 is summarized in millions as follow:

<u>Plans</u>	<u>Actuarial Net Asset/(Liability)</u>	
	<u>2003</u>	<u>2002</u>
Employees Retirement System	(\$480.56)	\$459.55
Law Enforcement and Custodial Officer Supplemental Retirement Fund	\$68.67	\$129.77
Judicial Retirement System of Texas Plan Two	\$18.30	\$11.20

When there is an actuarial net asset balance, there is no amortization period. Any net pension obligation is to be amortized over a period of not more than 31 years from the date of the valuation. The Judicial Retirement Plan One is funded on a pay-as-you-go basis.

### *Liabilities*

Total liabilities decreased by \$588.99 million, or 12.8%, from \$4.6 billion to \$4.01 billion. The major changes are composed of an increase in securities lending obligations from \$2.1 billion to \$2.52 billion, or 20%, and a decrease in unsettled investment security purchases from \$2.48 billion to \$1.47 billion, or 40.7%.

### *Transfers*

Retirement membership fees deposited to the Employees Retirement Fund in the amount of \$494 thousand were transferred to other System funds to cover the costs of administering other benefit programs in accordance with the authority granted to the board of trustees.

### **Contacting the System's Financial Management**

This financial report is designed to provide a general overview of the System's finances. If you have questions about this report or need additional financial information, please contact me at 512-867-7224.

Respectfully submitted,



MICHAEL C. WHEELER, CPA  
Chief Financial Officer

**Exhibit I**  
**STATEMENT OF NET ASSETS**  
**August 31, 2003**  
(With Comparative Totals at August 31, 2002)

<u>ASSETS</u>	<b>Governmental Activities</b>	
	<b>August 31,</b>	
	<b>2003</b>	<b>2002</b>
<i>Current Assets:</i>	\$	\$
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	57,195	13,097
Cash in State Treasury	36,345,298	10,020,730
Total Cash and Cash Equivalents	36,402,493	10,033,827
Securities Lending Collateral	22,804,480	18,907,600
Short-Term Investments	53,940,563	50,034,384
Legislative Appropriations	500	371,050
Receivables	85,518,578	84,735,403
Due From External Parties	-	45,280
Total Current Assets	198,666,614	164,127,544
<i>Non-Current Assets:</i>		
Investments	242,388,762	236,189,988
Total Non-Current Assets	242,388,762	236,189,988
<b>Total Assets</b>	<b>441,055,376</b>	<b>400,317,532</b>
<u>LIABILITIES</u>		
<i>Current Liabilities:</i>		
Payables	390,442,728	359,694,638
Due To External Parties	767,731	1,552,494
Deferred Revenue	1,085,701	409,513
Obligations Under Securities Lending	22,804,480	18,907,600
Total Current Liabilities	415,100,640	380,564,245
<b>Total Liabilities</b>	<b>415,100,640</b>	<b>380,564,245</b>
<u>NET ASSETS</u>		
<i>Restricted For:</i>		
Employee Benefits - Group Insurance	25,939,226	19,332,880
Unrestricted	15,510	420,407
<b>Total Net Assets (Exh. II)</b>	<b>25,954,736</b>	<b>19,753,287</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit II**

**STATEMENT OF ACTIVITIES**

**For the Year Ended August 31, 2003**

(With Comparative Totals for the Year Ended August 31, 2002)

	Program Revenues			Net (Expense) Revenue & Changes in Net Assets Governmental Activities	
	Expenses	Charges for Services	Operating Grants & Contributions	August 31,	
				2003	2002
	\$	\$	\$	\$	\$
<b>Functions/Programs</b>					
<i>Primary Government:</i>					
<i>Governmental Activities:</i>					
Social Security Administration	38,607			(38,607)	(55,280)
Death Benefits-Peace Officers, Firemen, etc.	4,677,351	4,677,351		-	(45,586)
Death Benefits-Retiree \$5,000 Lump Sum	6,452,948	6,086,658		(366,290)	54,552
Group Benefits Program	<u>1,636,983,323</u>	<u>1,629,339,904</u>	<u>14,249,765</u>	<u>6,606,346</u>	<u>1,032,463</u>
<b>Total Governmental Activities</b>	<u><u>1,648,152,229</u></u>	<u><u>1,640,103,913</u></u>	<u><u>14,249,765</u></u>	<b>6,201,449</b>	<b>986,149</b>
			<b>General revenues:</b>		
			Transfers		<u>55,280</u>
			<b>Total General Revenues</b>	-	<u>55,280</u>
			<b>Change in Net Assets (Exh. IV)</b>	<b>6,201,449</b>	<b>1,041,429</b>
			<b>Net Assets - Beginning - As Reported</b>	<u><b>19,753,287</b></u>	<u><b>18,719,068</b></u>
			<i>Restatements:</i>		
			Change in Asset Capitalization Threshold		<u>(7,210)</u>
			<b>Net Assets - Beginning - As Restated</b>	<u><b>19,753,287</b></u>	<u><b>18,711,858</b></u>
			<b>Net Assets - Ending (Exh. I)</b>	<u><u><b>25,954,736</b></u></u>	<u><u><b>19,753,287</b></u></u>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit III**  
**BALANCE SHEET - Governmental Funds**  
**August 31, 2003**  
(With Comparative Totals at August 31, 2002)

	Social Security Administration Fund (0929) (U/F 0929) \$	Death Benefits Program for Commissioned Peace Officers, Firemen, etc. (0001) (U/F 3001) \$	Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008) \$	Special Revenue Funds Totals	
				August 31, 2003 \$	August 31, 2002 \$
<b>ASSETS</b>					
<i>Current Assets:</i>					
<i>Cash and Cash Equivalents:</i>					
Cash in State Treasury	18,967	-	-	18,967	11,455
Total Cash and Cash Equivalents	<u>18,967</u>	<u>-</u>	<u>-</u>	<u>18,967</u>	<u>11,455</u>
Legislative Appropriations Due From Other Funds (Note 5.D)			500	500	371,050
Total Current Assets	<u>18,967</u>	<u>-</u>	<u>500</u>	<u>19,467</u>	<u>427,785</u>
<b>Total Assets</b>	<b><u>18,967</u></b>	<b><u>-</u></b>	<b><u>500</u></b>	<b><u>19,467</u></b>	<b><u>427,785</u></b>
<b>LIABILITIES &amp; FUND BALANCES</b>					
<i>Current Liabilities:</i>					
<i>Payables:</i>					
Accounts Payable			500	500	4,760
Due To Other Funds (Note 5.D)	3,457	-	-	3,457	2,618
Total Current Liabilities	<u>3,457</u>	<u>-</u>	<u>500</u>	<u>3,957</u>	<u>7,378</u>
<b>Total Liabilities</b>	<b><u>3,457</u></b>	<b><u>-</u></b>	<b><u>500</u></b>	<b><u>3,957</u></b>	<b><u>7,378</u></b>
<i>Fund Balances:</i>					
<i>Unreserved:</i>					
Undesignated, Reported In:					
Special Revenue Funds	15,510	-	-	15,510	420,407
<b>Total Fund Balances (Exh. IV)</b>	<b><u>15,510</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>15,510</u></b>	<b><u>420,407</u></b>
<b>Total Liabilities &amp; Fund Balances</b>	<b><u>18,967</u></b>	<b><u>-</u></b>	<b><u>500</u></b>	<b><u>19,467</u></b>	<b><u>427,785</u></b>
Total Fund Balances - Governmental Funds (above):				15,510	420,407
<i>Amounts reported for 'Governmental Activities' in the Statement of Net Assets (Exhibit I) are different because:</i>					
An <i>Internal Service Fund</i> is used by the System to account for the assets and liabilities associated with the Group Insurance Program for State employees and retirees and employees of certain institutions of higher education. The net assets of the Internal Service Fund (Exhibit V) are included with 'Governmental Activities' in the <i>Statement of Net Assets</i> .					
				<u>25,939,226</u>	<u>19,332,880</u>
<b>Net Assets of Governmental Activities (Exhibit I)</b>				<b><u>25,954,736</u></b>	<b><u>19,753,287</u></b>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit IV**

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN  
FUND BALANCES - Governmental Funds**

**For the Year Ended August 31, 2003**

(With Comparative Totals for the Year Ended August 31, 2002)

	<b>Social Security Administration Fund (0929) (U/F 0929)</b>	<b>Death Benefits Program for Commissioned Peace Officers, Firemen, etc. (0001) (U/F 3001)</b>	<b>Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008)</b>	<b>Special Revenue Funds Totals</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>August 31, 2003</b>	<b>August 31, 2002</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>REVENUES</b>					
<i>Legislative Appropriations Out of the State's General Revenue Fund:</i>					
Original Appropriations Revenue:					
For Administrative Expenditures		28,000		28,000	28,000
For Public Employee Survivors		2,207,760		2,207,760	2,368,980
For Death Benefits-Retirees			6,453,923	6,453,923	6,265,945
Total Original Appropriations	-	2,235,760	6,453,923	8,689,683	8,662,925
Additional Appropriations Revenue:					
For Public Employee Survivors		2,441,591		2,441,591	4,879,158
For Death Benefits-Retirees			(367,265)	(367,265)	221,012
Total Additional Appropriations	-	2,441,591	(367,265)	2,074,326	5,100,170
<b>Total Revenues</b>	<b>-</b>	<b>4,677,351</b>	<b>6,086,658</b>	<b>10,764,009</b>	<b>13,763,095</b>
<b>EXPENDITURES</b>					
<i>Current:</i>					
Death Benefits		4,649,351	6,452,948	11,102,299	13,726,129
<i>Administrative Expenditures:</i>					
Salaries & Wages	30,970			30,970	24,438
Payroll Related Costs	6,616			6,616	29,599
Professional Fees & Services	187	28,000		28,187	28,043
Travel	201			201	384
Materials & Supplies	128			128	94
Communications & Utilities	46			46	31
Other Expenditures	459			459	691
Total Administrative Expenditures	38,607	28,000	-	66,607	83,280
<b>Total Expenditures</b>	<b>38,607</b>	<b>4,677,351</b>	<b>6,452,948</b>	<b>11,168,906</b>	<b>13,809,409</b>
<b>Deficiency of Revenues over Expenditures Before Other Financing Sources</b>	<b>(38,607)</b>	<b>-</b>	<b>(366,290)</b>	<b>(404,897)</b>	<b>(46,314)</b>
<b>OTHER FINANCING SOURCES</b>					
Transfers In-Retirement Membership Fees (Note 5.E)				-	55,280
<b>Excess (Deficiency) of Revenues over Expenditures and Other Financing Sources</b>	<b>(38,607)</b>	<b>-</b>	<b>(366,290)</b>	<b>(404,897)</b>	<b>8,966</b>
<b>Fund Balances - Beginning</b>	<b>54,117</b>	<b>-</b>	<b>366,290</b>	<b>420,407</b>	<b>411,441</b>
<b>Fund Balances - Ending (Exh. III)</b>	<b>15,510</b>	<b>-</b>	<b>-</b>	<b>15,510</b>	<b>420,407</b>
Net Change in Fund Balances - Governmental Funds (above):				(404,897)	8,966
<i>Amounts reported for 'Governmental Activities' in the Statement of Activities (Exhibit II) are different because:</i>					
<i>An Internal Service Fund is used by the System to account for the revenues and expenses associated with the Group Insurance Program for State employees and retirees and employees of certain institutions of higher education. The net revenue of the Internal Service Fund (Exhibit VI) is included in 'Governmental Activities' in the Statement of Activities .</i>					
<b>Change in Net Assets of Governmental Activities (Exhibit II)</b>				<b>6,606,346</b>	<b>1,032,463</b>
				<b>6,201,449</b>	<b>1,041,429</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit V**  
**STATEMENT OF NET ASSETS - Proprietary Fund**  
**August 31, 2003**  
(With Comparative Totals at August 31, 2002)

ASSETS	Governmental Activities Internal Service Fund Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2003	August 31, 2002
	\$	\$
<i>Current Assets:</i>		
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	57,195	13,097
Cash in State Treasury	36,326,331	10,009,275
Total Cash and Cash Equivalents	36,383,526	10,022,372
Securities Lending Collateral	22,804,480	18,907,600
<i>Short-Term Investments:</i>		
Short-Term Investment Fund	4,805,152	19,971,908
Money Market Mutual Funds	49,135,411	30,062,476
Total Short-Term Investments	53,940,563	50,034,384
<i>Receivables:</i>		
Interest Receivable	57,000	75,000
Accounts Receivable	85,461,578	84,660,403
Total Receivables	85,518,578	84,735,403
<b>Total Current Assets</b>	<b>198,647,147</b>	<b>163,699,759</b>
<i>Non-Current Assets:</i>		
<i>Investments:</i>		
U.S. Treasury Bonds	40,422,133	-
Other Government Securities	13,730,924	13,882,799
Mortgage Pass-Thru Securities	35,706,725	-
Asset Backed Securities	10,035,994	15,727,846
Commercial Mortgage Backed Securities	10,369,411	14,919,092
Corporate Bonds	132,123,575	191,660,251
Total Investments	242,388,762	236,189,988
<b>Total Non-Current Assets</b>	<b>242,388,762</b>	<b>236,189,988</b>
<b>Total Assets</b>	<b>441,035,909</b>	<b>399,889,747</b>
<b>LIABILITIES</b>		
<i>Current Liabilities:</i>		
<i>Payables:</i>		
Accounts Payable	108,925	-
<i>Claims Payable:</i>		
Incurred, Self-Funded	29,345,003	32,948,563
Incurred, Insured	21,146,300	20,964,315
Incurred But Not Reported, Self-Funded	281,661,000	248,466,000
Incurred But Not Reported, Insured	58,181,000	57,311,000
Total Claims Payable	390,333,303	359,689,878
Total Payables	390,442,228	359,689,878
Due To Other Funds (Note 5.D)	764,274	1,549,876
Deferred Revenue	1,085,701	409,513
Obligations Under Securities Lending	22,804,480	18,907,600
<b>Total Current Liabilities</b>	<b>415,096,683</b>	<b>380,556,867</b>
<b>Total Liabilities</b>	<b>415,096,683</b>	<b>380,556,867</b>
<b>NET ASSETS</b>		
<i>Restricted For:</i>		
Employee Benefits - Group Insurance Program	25,939,226	19,332,880
<b>Total Net Assets (Exh. VI)</b>	<b>25,939,226</b>	<b>19,332,880</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

## Exhibit VI

# STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - Proprietary Fund

For the Year Ended August 31, 2003  
(With Comparative Totals for the Year Ended August 31, 2002)

	Governmental Activities Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
<i>OPERATING REVENUES</i>	August 31, 2003	August 31, 2002
	\$	\$
<i>Contributions to Insurance Program:</i>		
From the State of Texas:		
For Employees	981,443,208	899,406,992
For Retirees	253,791,305	223,000,940
Total Contributions from the State of Texas	1,235,234,513	1,122,407,932
From Members:		
For Employees	309,510,946	290,667,355
For Retirees	77,997,477	68,817,018
For COBRA	6,468,032	7,513,148
Total Contributions from Members	393,976,455	366,997,521
Total Contributions to Insurance Program	1,629,210,968	1,489,405,453
<i>Other Operating Revenues:</i>		
COBRA 2% Administration Fee	128,936	152,097
Warrants Voided by Statute of Limitations	2,470	2,153
Penalty Assessed to Insurance Carrier	1,148,660	494,150
Total Other Operating Revenues	1,280,066	648,400
<b>Total Operating Revenues</b>	<b>1,630,491,034</b>	<b>1,490,053,853</b>
<b><i>OPERATING EXPENSES</i></b>		
Employee Benefit Payments	1,627,057,195	1,493,565,100
<i>Administrative Expenses:</i>		
Salaries & Wages	5,357,672	4,866,445
Payroll Related Costs	1,355,331	1,073,518
Professional Fees & Services	753,467	1,189,302
Travel	35,569	54,889
Materials & Supplies	517,291	659,860
Communications & Utilities	334,513	324,176
Repairs & Maintenance	533,836	510,595
Rentals & Leases	566,333	425,768
Printing & Reproduction	82,874	41,128
Other Operating Expenses	389,242	287,432
Total Administrative Expenses	9,926,128	9,433,113
<b>Total Operating Expenses</b>	<b>1,636,983,323</b>	<b>1,502,998,213</b>
<b>Operating Loss</b>	<b>(6,492,289)</b>	<b>(12,944,360)</b>
<b><i>NON-OPERATING REVENUES (EXPENSES)</i></b>		
Net Increase in Fair Value of Investments	949,180	2,554,725
Interest Revenue	11,827,470	11,378,689
<i>Securities Lending Activities:</i>		
Loan Premium on Securities Lending	484,700	229,439
Less: Broker Rebates	(348,657)	(172,110)
Agent Fees	(33,988)	(13,920)
Net Securities Lending Activity	102,055	43,409
Settlement Revenue	219,930	-
<b>Total Non-Operating Revenues</b>	<b>13,098,635</b>	<b>13,976,823</b>
<b>Change in Net Assets</b>	<b>6,606,346</b>	<b>1,032,463</b>
<b><i>NET ASSETS</i></b>		
<b>Net Assets - Beginning - As Reported</b>	<b>19,332,880</b>	<b>18,307,627</b>
<i>Restatement:</i>		
Change in Asset Capitalization Threshold	-	(7,210)
<b>Net Assets - Beginning - As Restated</b>	<b>19,332,880</b>	<b>18,300,417</b>
<b>Net Assets - Ending (Exh. V)</b>	<b>25,939,226</b>	<b>19,332,880</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.



## Exhibit VII

### STATEMENT OF CASH FLOWS - Proprietary Fund Year Ended August 31, 2003 (With Comparative Totals for the Year Ended August 31, 2002)

	Governmental Activities Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2003	August 31, 2002
	\$	\$
<i>Cash flows from operating activities:</i>		
Cash received from members	394,325,853	374,825,603
Cash received from the State of Texas	1,234,997,988	1,101,598,486
Cash paid to insurance carriers and third party administrators	(1,596,413,770)	(1,442,481,662)
Cash payments to employees for services	(7,038,987)	(5,867,382)
Cash payments for goods and services	(3,672,743)	(3,490,792)
Other cash received	1,371,061	2,153
<b>Net cash provided by operating activities</b>	<b>23,569,402</b>	<b>24,586,406</b>
<i>Cash flows from investing activities:</i>		
Sales of short-term investment fund	908,300,000	742,600,000
Purchases of short-term investment fund	(906,400,000)	(785,200,000)
Interest on treasury deposits	891,752	1,371,685
<b>Net cash provided (used) by investing activities</b>	<b>2,791,752</b>	<b>(41,228,315)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>26,361,154</b>	<b>(16,641,909)</b>
<b>Cash and Cash Equivalents:</b>		
Beginning of Year	10,022,372	26,664,281
End of Year (Exh. V)	36,383,526	10,022,372
<b>Reconciliation of operating loss to net cash provided (used) by operating activities:</b>		
Operating Loss (Exh. VI)	(6,492,289)	(12,944,360)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Settlement Revenue	219,930	-
Change in assets and liabilities:		
Increase in Accounts Receivable	(801,175)	(16,151,403)
Decrease in Due From Other Funds	-	3,896,412
Increase in Accounts Payable	30,752,350	49,224,754
Increase (Decrease) in Due To Other Funds	(785,602)	431,084
Increase in Deferred Revenue	676,188	129,919
<b>Total Adjustments</b>	<b>30,061,691</b>	<b>37,530,766</b>
<b>Net cash provided by operating activities</b>	<b>23,569,402</b>	<b>24,586,406</b>

#### Non-Cash Investing Activities:

The Internal Service Fund recorded \$949,180 and \$2,554,725 in net appreciation in the fair value of its non-cash equivalent investments for the fiscal years ended August 31, 2003 and 2002, respectively.

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit VIII**

**COMBINED STATEMENT OF FIDUCIARY NET ASSETS - Fiduciary Funds**  
**For the Year Ended August 31, 2003**  
(With Comparative Totals for the Year Ended August 31, 2002)

	Pension (and Other Employee Benefit) Trust Funds		Total Pension (and Other Employee Benefit) Trust Funds	Agency Funds	Totals August 31,	
	Defined Benefit Plans	Defined Contribution Plans and Cafeteria Plan			2003	2002
	\$	\$	\$	\$	\$	\$
<b>ASSETS</b>						
Cash and Cash Equivalents	26,529,966	18,110,731	44,640,697	1,604,120	46,244,817	61,041,858
Securities Lending Collateral	2,518,401,764		2,518,401,764		2,518,401,764	2,102,759,968
Short-Term Investments	1,125,882,319	69,021,173	1,194,903,492		1,194,903,492	1,691,633,499
Legislative Appropriations	247,026		247,026		247,026	243,340
Investments	17,982,272,949	155,597,861	18,137,870,810		18,137,870,810	17,008,832,875
Receivables	522,022,780	2,593,648	524,616,428	13,375	524,629,803	1,078,842,789
Due From Other Funds (Note 5.D)	1,141,007		1,141,007	278	1,141,285	1,922,120
Due From Other Agencies (Note 1.F)	2,877,596		2,877,596		2,877,596	2,004,096
Prepaid Lease Expense (Note 5.B)	68,040		68,040		68,040	-
Capital Assets, Net of Accumulated Depreciation	7,438,651		7,438,651		7,438,651	7,674,092
<b>Total Assets</b>	<b>22,186,882,098</b>	<b>245,323,413</b>	<b>22,432,205,511</b>	<b>1,617,773</b>	<b>22,433,823,284</b>	<b>21,954,954,637</b>
<b>LIABILITIES</b>						
Payables	1,489,288,769	4,645,742	1,493,934,511	14,053	1,493,948,564	2,496,936,038
Due To Other Funds (Note 5.D)	263,683	109,871	373,554		373,554	414,906
Due To Other Agencies (Note 1.F)	376,116		376,116		376,116	705,244
Deferred Revenue	697,338		697,338		697,338	756,789
Employees Compensable Leave	1,323,070		1,323,070		1,323,070	1,382,594
Obligations Under Securities Lending Funds Held For Others	2,518,401,763		2,518,401,763		2,518,401,763	2,102,759,968
				1,603,720	1,603,720	596,382
<b>Total Liabilities</b>	<b>4,010,350,739</b>	<b>4,755,613</b>	<b>4,015,106,352</b>	<b>1,617,773</b>	<b>4,016,724,125</b>	<b>4,603,551,921</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. IX)</b>	<b>18,176,531,359</b>	<b>240,567,800</b>	<b>18,417,099,159</b>	<b>-</b>	<b>18,417,099,159</b>	<b>17,351,402,716</b>
	(Exh. X)	(Exh. A-1)		(Exh. A-3)		

(A Schedule of Funding Progress for defined benefit plans is presented in the Required Supplementary Information, immediately following the Notes to the Basic Financial Statements.)

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit IX**  
**COMBINED STATEMENT OF CHANGES IN**  
**FIDUCIARY NET ASSETS - Fiduciary Funds**  
**For the Year Ended August 31, 2003**  
(With Comparative Totals for the Year Ended August 31, 2002)

	Defined Benefit Plans	Defined Contribution Plans and Cafeteria Plan	Pension (and Other Employee Benefit) Trust Funds	
			Totals	
			August 31,	
			2003	2002
	\$	\$	\$	\$
<b>ADDITIONS</b>				
<b>Contributions:</b>				
Member Contributions	327,020,124	87,943,964	414,964,088	367,083,605
State Contributions	309,849,466		309,849,466	308,773,116
Legislative Appropriations	22,795,480		22,795,480	21,683,596
Service Contributions Transferred from				
Teacher Retirement System	28,609,871		28,609,871	24,183,510
Settlement Revenue		85,000	85,000	-
Other Contributions	8,772,034	393,143	9,165,177	8,583,812
<b>Total Contributions</b>	<b>697,046,975</b>	<b>88,422,107</b>	<b>785,469,082</b>	<b>730,307,639</b>
<b>Investment Income:</b>				
From Investing Activities	1,507,158,553	18,406,519	1,525,565,072	(1,379,803,050)
From Securities Lending Activities	7,554,550		7,554,550	7,247,994
<b>Total Net Investment Income</b>	<b>1,514,713,103</b>	<b>18,406,519</b>	<b>1,533,119,622</b>	<b>(1,372,555,056)</b>
<b>Other Additions:</b>				
Other Revenue	357,089	17,934	375,023	274,747
Transfers In (Note 5.E)	66,915	493,998	560,913	726,447
<b>Total Other Additions</b>	<b>424,004</b>	<b>511,932</b>	<b>935,936</b>	<b>1,001,194</b>
<b>Total Additions</b>	<b>2,212,184,082</b>	<b>107,340,558</b>	<b>2,319,524,640</b>	<b>(641,246,223)</b>
<b>DEDUCTIONS</b>				
<b>Benefits:</b>				
Retirement Benefits and Refunds	1,129,812,610		1,129,812,610	1,021,692,761
Plan 457 Benefits		70,224,903	70,224,903	27,295,470
Cafeteria Plan Reimbursement Claims		33,539,568	33,539,568	30,027,446
Service Contributions Transferred to				
Teacher Retirement System	4,037,793		4,037,793	3,091,464
<b>Total Benefits</b>	<b>1,133,850,403</b>	<b>103,764,471</b>	<b>1,237,614,874</b>	<b>1,082,107,141</b>
Administrative Expenses	13,429,072	2,043,317	15,472,389	15,248,340
<b>Other Deductions:</b>				
Other Expenses	180,021		180,021	13,575
Transfers Out (Note 5.E)	560,913		560,913	781,727
<b>Total Other Deductions</b>	<b>740,934</b>	<b>-</b>	<b>740,934</b>	<b>795,302</b>
<b>Total Deductions</b>	<b>1,148,020,409</b>	<b>105,807,788</b>	<b>1,253,828,197</b>	<b>1,098,150,783</b>
<b>Net Increase (Decrease)</b>	<b>1,064,163,673</b>	<b>1,532,770</b>	<b>1,065,696,443</b>	<b>(1,739,397,006)</b>
<b>NET ASSETS</b>				
<b>Net Assets Held in Trust For Pension</b>				
<b>Benefits and Other Purposes:</b>				
<b>Beginning of Year - As Reported</b>	<b>17,112,367,686</b>	<b>239,035,030</b>	<b>17,351,402,716</b>	<b>19,091,553,729</b>
<i>Restatement (Note 5.F):</i>				
Change in Asset Capitalization Threshold				
and Change in Fund Type			-	(754,007)
<b>Beginning of Year - As Restated</b>	<b>17,112,367,686</b>	<b>239,035,030</b>	<b>17,351,402,716</b>	<b>19,090,799,722</b>
<b>End of Year (Exh. VIII)</b>	<b>18,176,531,359</b>	<b>240,567,800</b>	<b>18,417,099,159</b>	<b>17,351,402,716</b>
	(Exh. XI)	(Exh. A-2)		

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

**Exhibit X**

**COMBINING STATEMENT OF FIDUCIARY NET ASSETS -  
Pension (and Other Employee Benefit) Trust Funds - Defined Benefit Plans**

**August 31, 2003**

(With Comparative Totals at August 31, 2002)

	Law					Totals	
	Employees Retirement Fund (0955)	Enforcement and Custodial Officer Supplemental Fund (0977)	Judicial Retirement System Plan I (0001)	Judicial Retirement System Plan II (0993)	Excess Benefit Arrangement (5039)	2003	2002
<b>ASSETS</b>	\$	\$	\$	\$	\$	\$	\$
<i>Cash and Short-Term Investments:</i>							
<i>Cash and Cash Equivalents:</i>							
Cash on Hand	1,510,588					1,510,588	1,548,756
Cash in Bank	14,000					14,000	14,500
Cash in State Treasury	24,114,285	528,819		247,057		24,890,161	28,674,149
Investment in Pool Cash	110,713	3,778		726		115,217	117,043
Total Cash and Cash Equivalents	25,749,586	532,597	-	247,783	-	26,529,966	30,354,448
Securities Lending Collateral	2,419,997,247	82,697,422		15,707,095		2,518,401,764	2,102,759,968
<i>Short-Term Investments:</i>							
Commercial Paper						-	25,105,381
Short-Term Investment Fund	4,526,298	154,471		29,642		4,710,411	2,075,891
Money Market Mutual Funds	1,077,349,396	36,767,166		7,055,346		1,121,171,908	1,555,823,763
Promissory Note						-	50,061,300
Total Short-Term Investments	1,081,875,694	36,921,637	-	7,084,988	-	1,125,882,319	1,633,066,335
Total Cash and Short-Term Investments	3,527,622,527	120,151,656	-	23,039,866	-	3,670,814,049	3,766,180,751
Legislative Appropriations			247,026			247,026	243,340
<i>Investments:</i>							
U.S. Treasury Bonds	1,246,423,011	42,537,180		8,162,619		1,297,122,810	746,367,472
Other Government Securities	789,940,634	26,958,622		5,173,191		822,072,447	1,409,061,892
Mortgage Pass-Thru Securities	1,979,651,882	67,560,370		12,964,423		2,060,176,675	2,285,510,826
Collateralized Mortgage Obligations	48,012,338	1,638,536		314,425		49,965,299	-
Asset Backed Securities	156,078,311	5,326,548		1,022,130		162,426,989	314,774,797
Commercial Mortgage Backed Securities	197,212,374	6,730,347		1,291,510		205,234,231	244,170,647
Corporate Bonds	2,439,742,543	83,262,083		15,977,463		2,538,982,089	2,500,572,525
Domestic Equities	7,208,743,108	246,015,592		47,208,981		7,501,967,681	6,502,309,138
Texas Growth Fund	66,676,831	2,275,506		436,656		69,388,993	58,083,754
International Equities	3,146,930,426	107,396,496		20,608,813		3,274,935,735	2,796,659,259
Total Investments	17,279,411,458	589,701,280	-	113,160,211	-	17,982,272,949	16,857,510,310
<i>Receivables:</i>							
Interest and Dividends Receivable	2,024,444	68,246		13,221		2,105,911	1,812,998
Contributions/Accounts Receivable	47,723,588			897,374		48,620,962	48,983,384
Unsettled Sales-Investment Receivables	452,880,400	15,476,068		2,939,439		471,295,907	1,025,546,899
Total Receivables	502,628,432	15,544,314	-	3,850,034	-	522,022,780	1,076,343,281
Due From Other Funds (Note 5.D)	1,141,007					1,141,007	1,756,181
Due From Other Agencies (Note 1.F)	2,877,596					2,877,596	2,004,096
Prepaid Lease Expense	68,040					68,040	-
<i>Capital Assets:</i>							
<i>Non-Depreciable:</i>							
Land and Land Improvements	874,889					874,889	874,889
<i>Depreciable, Net of Accumulated Depreciation of \$11,537,985 and \$11,053,067, respectively:</i>							
Building	5,058,021					5,058,021	5,356,216
Furniture and Equipment	1,500,626					1,500,626	1,434,035
Vehicles	5,115					5,115	8,952
Total Capital Assets	7,438,651	-	-	-	-	7,438,651	7,674,092
<b>Total Assets</b>	<b>21,321,187,711</b>	<b>725,397,250</b>	<b>247,026</b>	<b>140,050,111</b>	<b>-</b>	<b>22,186,882,098</b>	<b>21,711,712,051</b>

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**Exhibit X**  
**COMBINING STATEMENT OF FIDUCIARY NET ASSETS -**  
**Pension (and Other Employee Benefit) Trust Funds - Defined Benefit Plans**  
**August 31, 2003**  
(With Comparative Totals at August 31, 2002)  
**(Concluded)**

	Employees Retirement Fund (0955)	Law Enforcement and Custodial Officer Supplemental Fund (0977)	Judicial Retirement System Plan I (0001)	Judicial Retirement System Plan II (0993)	Excess Benefit Arrangement (5039)	Totals August 31,	
	\$	\$	\$	\$	\$	2003	2002
<b>LIABILITIES</b>							
<i>Payables:</i>							
Benefits/Accounts Payable	16,654,212	38,118	247,026	29,330		16,968,686	14,910,212
Unsettled Purchases-Investment Payables	1,414,790,364	48,346,962		9,182,757		1,472,320,083	2,478,460,468
Total Payables	1,431,444,576	48,385,080	247,026	9,212,087	-	1,489,288,769	2,493,370,680
Due To Other Funds (Note 5.D)	278	221,105		42,300		263,683	369,530
Due To Other Agencies (Note 1.F)	376,116					376,116	705,244
Deferred Revenue	693,702			3,636		697,338	756,349
Employees Compensable Leave	1,323,070					1,323,070	1,382,594
Obligations Under Securities Lending	2,419,997,247	82,697,422		15,707,094		2,518,401,763	2,102,759,968
<b>Total Liabilities</b>	<b>3,853,834,989</b>	<b>131,303,607</b>	<b>247,026</b>	<b>24,965,117</b>	<b>-</b>	<b>4,010,350,739</b>	<b>4,599,344,365</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust for Pension</b>							
<b>Benefits and Other Purposes (Exh. XI)</b>	<b>17,467,352,722</b>	<b>594,093,643</b>	<b>-</b>	<b>115,084,994</b>	<b>-</b>	<b>18,176,531,359</b>	<b>17,112,367,686</b>
						<b>(Exh. VIII)</b>	

(A Schedule of Funding Progress for the defined benefit plans is presented in the Required Supplementary Information, immediately following the Notes to the Basic Financial Statements.)

*U/F's are:*

Fund 0955: 0955, 1955, 8955

Fund 0977: 0977, 1977

Fund 0001: 2001

Fund 0993: 0993, 1993

Fund 5039: 5039

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

## Exhibit XI

### COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - Pension (and Other Employee Benefit) Trust Funds - Defined Benefit Plans For the Year Ended August 31, 2003 (With Comparative Totals for the Year Ended August 31, 2002)

ADDITIONS	Law					Totals	
	Employees	Enforcement	Judicial	Judicial	Excess	August 31,	
	Retirement Fund (0955)	and Custodial Officer Supplemental Fund (0977)	Retirement System Plan I (0001)	Retirement System Plan II (0993)	Benefit Arrangement (5039)	2003	2002
	\$	\$	\$	\$	\$	\$	\$
<b>Contributions:</b>							
Member Contributions	324,000,057			3,020,067		327,020,124	322,350,528
State Contributions	301,555,437			8,294,029		309,849,466	308,773,116
<i>Legislative Appropriations for:</i>							
Judges Retirement Annuities			22,675,480			22,675,480	21,563,598
Administrative Expenses			120,000			120,000	119,998
<i>Service Contributions Transferred from</i>							
Teacher Retirement System (Note 1.F)	28,609,871					28,609,871	24,183,510
<i>Other Contributions:</i>							
Membership Fees	497,073					497,073	522,338
Penalty Interest	8,256,933			18,028		8,274,961	7,631,606
Total Other Contributions	8,754,006	-	-	18,028	-	8,772,034	8,153,944
<b>Total Contributions</b>	<b>662,919,371</b>	<b>-</b>	<b>22,795,480</b>	<b>11,332,124</b>	<b>-</b>	<b>697,046,975</b>	<b>685,144,694</b>
<b>Investment Income:</b>							
<i>From Investing Activities:</i>							
Net appreciation (depreciation)							
in fair value of investments	940,441,971	32,000,171		6,216,399		978,658,541	(1,869,518,933)
Interest and Dividends	522,369,455	17,951,077		3,225,500		543,546,032	550,475,922
Total Investing Activity Income	1,462,811,426	49,951,248	-	9,441,899	-	1,522,204,573	(1,319,043,011)
Less: Investment Expense	(14,453,890)	(509,083)		(83,047)		(15,046,020)	(12,121,915)
Net Income, Investing Activities	1,448,357,536	49,442,165	-	9,358,852	-	1,507,158,553	(1,331,164,926)
<i>From Securities Lending Activities:</i>							
Loan Premium on Securities Lending	39,516,612	1,359,406		242,874		41,118,892	45,179,424
Less: Broker Rebates	(29,611,688)	(1,019,028)		(181,448)		(30,812,164)	(35,391,887)
Agent Fees	(2,644,881)	(90,881)		(16,416)		(2,752,178)	(2,539,543)
Total Securities Lending Expenses	(32,256,569)	(1,109,909)		(197,864)		(33,564,342)	(37,931,430)
Net Income, Securities Lending Activities	7,260,043	249,497	-	45,010	-	7,554,550	7,247,994
<b>Net Investment Income</b>	<b>1,455,617,579</b>	<b>49,691,662</b>	<b>-</b>	<b>9,403,862</b>	<b>-</b>	<b>1,514,713,103</b>	<b>(1,323,916,932)</b>
<b>Other Additions:</b>							
<i>Other Revenue:</i>							
Warrants Voided by Statute of Limitations	135,595	2,342				137,937	110,076
Sale of Surplus Equipment	95,302					95,302	593
Rental Income	122,056					122,056	122,056
Miscellaneous Revenue	1,794					1,794	31,103
Total Other Revenue	354,747	2,342	-	-	-	357,089	263,828
<i>Transfers In (Note 5.E):</i>							
Excess Benefit Arrangement					66,915	66,915	62,801
Total Transfers In	-	-	-	-	66,915	66,915	62,801
<b>Total Other Additions</b>	<b>354,747</b>	<b>2,342</b>	<b>-</b>	<b>-</b>	<b>66,915</b>	<b>424,004</b>	<b>326,629</b>
<b>Total Additions</b>	<b>2,118,891,697</b>	<b>49,694,004</b>	<b>22,795,480</b>	<b>20,735,986</b>	<b>66,915</b>	<b>2,212,184,082</b>	<b>(638,445,609)</b>

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**Exhibit XI**

**COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS -  
Pension (and Other Employee Benefit) Trust Funds - Defined Benefit Plans**

**For the Year Ended August 31, 2003**

(With Comparative Totals for the Year Ended August 31, 2002)

(Concluded)

<i>DEDUCTIONS</i>	Employees Retirement Fund (0955)	Law	Judicial	Judicial	Excess Benefit Arrangement (5039)	Totals	
		Enforcement and Custodial Officer Supplemental Fund (0977)	Retirement System Plan I (0001)	Retirement System Plan II (0993)		August 31,	
	\$	\$	\$	\$	\$	2003	2002
						\$	\$
<b>Benefits:</b>							
Retirement Benefits	1,006,199,641	22,834,139	22,672,574	2,119,474	66,915	1,053,892,743	949,390,252
<i>Death Benefits:</i>							
Active Members	1,249,356					1,249,356	981,534
Retirees	1,078,081					1,078,081	1,104,525
Refunds of Retirement Contributions	73,437,833		2,906	151,691		73,592,430	70,218,256
<i>Transfers Out of Contributions:</i>							
Service Contributions Transferred to Teacher Retirement System (Note 1.F)	4,037,793					4,037,793	3,091,464
<b>Total Benefits</b>	<b>1,086,002,704</b>	<b>22,834,139</b>	<b>22,675,480</b>	<b>2,271,165</b>	<b>66,915</b>	<b>1,133,850,403</b>	<b>1,024,786,031</b>
<b>Administrative Expenses:</b>							
Salaries & Wages	5,505,032	380,280		114,774		6,000,086	6,482,462
Payroll Related Costs	1,466,924	101,313		29,499		1,597,736	1,682,884
Professional Fees & Services	1,612,335	99,869	120,000	39,988		1,872,192	1,151,694
Travel	42,148	502		384		43,034	35,227
Materials & Supplies	743,870	59,847		12,725		816,442	1,226,012
Communications & Utilities	343,340	8,769		9,952		362,061	377,913
Repairs & Maintenance	583,551	12,323		12,882		608,756	758,608
Rentals & Leases	673,114	14,041		15,459		702,614	496,811
Printing & Reproduction	94,217	1,499		458		96,174	152,276
Depreciation	800,098					800,098	744,345
Other Operating Expenses	499,473	21,819		8,587		529,879	495,247
<b>Total Administrative Expenses</b>	<b>12,364,102</b>	<b>700,262</b>	<b>120,000</b>	<b>244,708</b>	<b>-</b>	<b>13,429,072</b>	<b>13,603,479</b>
<b>Other Deductions:</b>							
<b>Other Expenses:</b>							
Loss on Sale of Capital Assets	180,021					180,021	11,769
Total Other Expenses	180,021	-	-	-	-	180,021	11,769
<b>Transfers Out (Note 5.E):</b>							
Membership Fees	493,998					493,998	718,926
Excess Benefit Arrangement	66,915					66,915	62,801
Total Transfers Out	560,913	-	-	-	-	560,913	781,727
<b>Total Other Deductions</b>	<b>740,934</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>740,934</b>	<b>793,496</b>
<b>Total Deductions</b>	<b>1,099,107,740</b>	<b>23,534,401</b>	<b>22,795,480</b>	<b>2,515,873</b>	<b>66,915</b>	<b>1,148,020,409</b>	<b>1,039,183,006</b>
<b>Net Increase (Decrease)</b>	<b>1,019,783,957</b>	<b>26,159,603</b>	<b>-</b>	<b>18,220,113</b>	<b>-</b>	<b>1,064,163,673</b>	<b>(1,677,628,615)</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust For Pension</b>							
<b>Benefits and Other Purposes:</b>							
Beginning of Year - As Reported	16,447,568,765	567,934,040	-	96,864,881	-	17,112,367,686	18,790,750,308
<i>Restatement (Note 5.F):</i>							
Change in Asset Capitalization Threshold and Change in Fund Type						-	(754,007)
Beginning of Year - As Restated	16,447,568,765	567,934,040	-	96,864,881	-	17,112,367,686	18,789,996,301
End of Year (Exh. X)	17,467,352,722	594,093,643	-	115,084,994	-	18,176,531,359	17,112,367,686
						(Exh. IX)	

U/F's are:

Fund 0955: 0955, 1955, 8955

Fund 0977: 0977, 1977

Fund 0001: 2001

Fund 0993: 0993, 1993

Fund 5039: 5039

The accompanying Notes to the Basic Financial Statements are an integral part of this exhibit.

# NOTES TO THE BASIC FINANCIAL STATEMENTS

AUGUST 31, 2003

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# NOTES TO THE BASIC FINANCIAL STATEMENTS

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## 1. Summary Of Significant Accounting Policies

The financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) as established by the Governmental Accounting Standards Board (GASB).

### A. The Reporting Entity

#### (In accordance with GASB Statement 14)

The Texas Constitution under Article XVI, Section 67 authorized the Texas Legislature to establish by law an Employees Retirement System of Texas (the System) to provide benefits for officers and employees of the State. The System was established in 1947 and operates primarily under V.T.C.A., Texas Government Code, Title 8, Subtitle B.

The System has the powers, privileges and immunities of a corporation. The System is governed by a Board of Trustees, which is made up of six members responsible for the general administration and operations of the System. The six-member board is composed of three elected members and three members who are appointed by the Governor, the Speaker of the Texas House of Representatives, and the Chief Justice of the Supreme Court of Texas. The Board appoints a person other than a member of the Board to serve at the Board's will as Executive Director to manage a staff of approximately 300 people to provide benefits to State employees and retirees, higher education employees and beneficiaries of these groups. Although the Employees Retirement System is a separate legal entity and by statute must prepare a separate annual financial report, it is also considered a blended component unit of the State of Texas financial reporting entity and is included in the State's annual financial report.

### B. Basic Financial Statements

#### (In accordance with GASB Statement 34)

The Basic Financial Statements consist of:

- ◆ Government-wide Financial Statements
- ◆ Fund Financial Statements and Combining Financial Statements of the Defined Benefit Plans
- ◆ Notes to the Basic Financial Statements

Government-wide financial statements report all assets, liabilities and net assets of the System's Governmental Funds and Internal Service Fund. Governmental activities are generally financed through intergovernmental revenues and other non-exchange revenues. Fiduciary activities are *excluded* from the government-wide financial statements.

The government-wide *Statement of Net Assets* and *Statement of Activities* use the economic resources measurement focus and the accrual basis of accounting.

The government-wide *Statement of Activities* presents the System's governmental activities by function and distinguishes between *program* revenues and *general* revenues. *Program* revenues are further broken down into charges for services, and operating grants and contributions.

*Program revenues* of the governmental activities are: appropriations from the State's General Revenue Fund for law enforcement and peace officer death benefits and lump sum retiree death benefits, insurance premiums received by the internal service fund from employees, retirees and the State of Texas and all investment income deposited or credited to the internal service fund.

*Program expenses* of the governmental activities are: death benefit expenses of the appropriated special revenue funds, claims expenses and premium payments of the internal service fund, and all administrative expenses.

All other revenues and expenses (i.e. transfers) are considered to be *general* revenues/expenses.

Fund financial statements are presented immediately after the government-wide financial statements. They present information for each major governmental fund and the internal service fund. Fund financial statements are also presented for the System's fiduciary funds.

Fund financial statements have been prepared using the measurement focus appropriate for each type of fund.

### C. Measurement Focus – Basis of Accounting (In accordance with GASB Statement 34)

*Measurement focus* refers to the definition of the resource flows measured.

*Basis of accounting* refers to when revenues and expenses are recognized in the accounts and reported in the financial statements.

Special Revenue Funds are accounted for under the modified accrual basis of accounting and current financial resources measurement focus. Under this combination, the financial statements focus on current assets and current liabilities and the changes in net current assets. All revenues reported are recognized based on the criteria of *measurability* and *availability*. The System considers all revenues reported in the Special Revenue Funds to be *available* if the revenues are due at year-end and collected within sixty days thereafter. Amounts are defined as *measurable* if they can be estimated or otherwise determined. Expenditures are recognized when the related liability is incurred.

Pension (and Other Employee Benefit Trust) Funds and Internal Service Funds are maintained on the full accrual basis of accounting and the economic resources measurement focus. All economic resources, including financial and capital assets and related liabilities, both current and long-term, and the changes therein are reported in the fund's financial statements. Revenues, including contributions, are recognized when earned and expenses are recognized when the underlying transaction or event occurs, regardless of the timing of related cash flows. Benefit expenses are recognized when the benefit liability is incurred, and refunds of members' deposits are recognized when processed. Capital assets are depreciated. The System applies all GASB pronouncements as well as the Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements.

Agency funds are used to report resources held by the System in a purely custodial capacity. Assets and offsetting liabilities are accounted for using the full accrual basis. Agency funds have no revenues, expenditures, expenses, or fund balance and typically involve only the receipt and remittance of resources to individuals, the State or other governments.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses/ expenditures during the reporting period. Actual results could differ from those estimates.

## **D. Basis of Presentation**

(In accordance with GASB Statement 34)

### **Fund Structure**

The fund financial statements are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts. These accounts are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with applicable statutory guidelines or restrictions.

The System's funds fall under three fund categories: Governmental Funds, Proprietary Funds, and Fiduciary Funds. The following is a brief description of each fund category and fund type used by the System.

### **Governmental Fund Category**

Governmental Fund reporting focuses primarily on the sources, uses, and balances of current financial resources and whether current-year revenues were sufficient to pay for current-year services.

### **Special Revenue Funds**

Special Revenue Funds are used to account for the proceeds from specific revenue sources that are legally restricted to expenditures for specific purposes. The System displays general revenue funds/accounts of the State of Texas as special revenue funds, except for the Judicial Retirement System Plan One Fund, which is a pay-as-you-go pension plan reported as a Pension (and Other Employee Benefit) Trust Fund.

- ◆ Social Security Administration Fund – This fund accounts for the expenditures of administration of the Social Security Program.
- ◆ Death Benefits Program for Commissioned Peace Officers, Firemen, etc. Fund (General Revenue Fund) – This fund accounts for payments of death benefits and administrative fees, which are funded by an appropriation from the State's General Revenue Fund. Established by V.T.C.A., Texas Government Code, Title 6, Chapter 615.
- ◆ Lump Sum Retiree Death Benefit Fund (General Revenue Fund) – This fund accounts for the payments of the \$5,000 lump sum benefit, which is an additional benefit provided by the System to the beneficiaries of retirees who die while still receiving a retirement annuity.

### ***Proprietary Fund Category***

Proprietary Fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

#### **Internal Service Fund**

The Internal Service Fund is used to report any activity that provides goods or services to other funds, departments, or agencies of the reporting entity, or to other governments, on a cost-reimbursement basis.

- ◆ Employees Life, Accident and Health Insurance and Benefits Fund – This fund accounts for the services provided to State of Texas agencies and higher education institutions that participate in the Texas Employees Group Benefits Program. Established by Chapter 1551, Texas Insurance Code.

### ***Fiduciary Fund Category***

#### **Pension (and Other Employee Benefit) Trust Funds**

Pension (and Other Employee Benefit) Trust Funds (hereafter referred to as 'Pension Trust Funds') report the resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, and other employee benefit plans.

- ◆ Employees Retirement System Fund (ERS) – This fund is established by V.T.C.A., Texas Government Code, Title 8, Subtitle B and is used to account for the accumulation of resources for pension benefit payments to qualified state employees or beneficiaries.
- ◆ Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS) – This fund is established by V.T.C.A., Texas Government Code, Title 8, Subtitle B and is used to account for the payments of benefits as provided by the Commissioned Law Enforcement and Custodial Officer Supplemental Retirement Benefit Act.
- ◆ Judicial Retirement System Plan One Fund (JRS I) (General Revenue Fund) – This fund is established by V.T.C.A., Texas Government Code, Title 8, Subtitle D and is used to account for appropriations received from the State's General Revenue Fund for annuity and refund payments to eligible judicial employees who commenced service prior to September 1, 1985.

- ◆ Judicial Retirement System Plan Two Fund (JRS II) – This fund is established by V.T.C.A., Texas Government Code, Title 8, Subtitle E and is used to account for the accumulation of resources for pension benefit payments to eligible Judicial employees who commenced service on or after September 1, 1985.
- ◆ Excess Benefit Arrangement (EBA) – This fund is established by V.T.C.A., Texas Government Code, Title 8, Subtitle B and is used to account for the payments of annuities otherwise payable from the Employees Retirement Fund that exceed the limitations on benefits imposed by Internal Revenue Code (IRC) Section 415(b).
- ◆ TexaSaver 401(k) Administrative Trust Fund – This fund is established by V.T.C.A., Article 6252-3g and is used to account for the costs of administering the IRC Section 401(k) defined contribution plan.
- ◆ TexaSaver 457 Trust Fund – This fund is established by V.T.C.A., Article 6252-3g and is used to account for tax-deferred portions of salaries of State employees in accordance with the provisions of IRC Section 457, and the costs of administering the program.
- ◆ State Employees Cafeteria Plan Trust Fund (Flexible Benefits Fund) – This fund is established by Chapter 1551, Texas Insurance Code and is used to account for before-tax salary reduction contributions from state employees and higher education institutions, reimbursements for health care and dependent care, and the costs of administering the program.

#### **Agency Funds**

Agency Funds are used to account for assets held by a governmental unit in a purely custodial capacity for individuals, other governmental entities, or private organizations. Agency Funds do not measure results of operations (assets = liabilities).

- ◆ Unappropriated Receipts (General Revenue Fund) - This fund accounts for member contributions received from Judicial Retirement System Plan One members.
- ◆ Employees Savings Bond Fund - This fund accounts for payroll deductions and the purchases of U.S. Savings Bonds.
- ◆ TexaSaver 401(k) Trust Fund - This fund accounts for tax-deferred portions of salaries of State employees in accordance with the provisions of IRC Section 401(k).

- ◆ **TexaSaver 401(k) Hold Transmittal Fund** - This fund accounts for tax-deferred portions of salaries of State employees in accordance with the provisions of IRC Section 401(k).

**E. Basis of Budgeting**  
(In accordance with GASB Statement 34)

**Budgets**

*Appropriated Budgets*

The Texas Legislature appropriates monies out of the State’s General Revenue Fund for administrative expenses/expenditures of the Judicial Retirement System Plan One Fund, and the Death Benefits Program for Commissioned Peace Officers, Firemen, etc. Fund.

The Texas Legislature appropriates monies out of the State’s General Revenue Fund for benefit payments of the Judicial Retirement System Plan One Fund, the Death Benefits Program for Commissioned Peace Officers, Firemen, etc. Fund and the Lump Sum Retiree Death Benefit Fund on an ‘estimated to be’ basis, which means that the System has the authority to increase the appropriations as needed during the time period that the appropriation is allowed to remain open. For benefit payments, expenditures in excess of appropriations received are not a violation of budgetary authority.

There is *no* legally adopted appropriated budget for the Social Security Administration Fund; there is no budget to actual schedule in the Required Supplementary Information for this fund. The cost of administering the Social Security Program is covered with membership fee transfers from the Employees Retirement Fund.

The System is required to lapse all unencumbered appropriations by November 1 of each year.

*Non-appropriated Budget*

The Texas Legislature does not appropriate monies to the System for administrative expenses. A non-appropriated budget for administrative expenses, including capital outlay, is prepared annually and approved by the System’s Board of Trustees at the line-item level. The System’s management must approve transfers between line items. The Board must approve any amendment to the approved budget.

Administrative expenses are budgeted in and paid entirely from the Employees Retirement Fund. Expenses are allocated periodically to the other funds based on percentages determined by the studies of time and resources used to administer each fund within each division. Expenses are limited by a statutory provision

that no expenses can be made for more than the State of Texas pays for similar services.

Non-appropriated budgets are not lapsed at year end.

*Basis of Budgeting*

Appropriated budgets are prepared on the basis of budgeting, which differs from the GAAP basis. Schedules of Budgeted to Actual Expenditures for the Death Benefits Program for Peace Officers, Firemen, etc. Fund and the Lump Sum Retiree Death Benefit Fund are presented as Required Supplementary Information immediately after the Notes to the Basic Financial Statements. A reconciliation from the basis of budgeting to the GAAP basis is provided on the face of the schedule.

*Variations*

Negative variations, if any, for administrative expenditures of the appropriated Special Revenue Funds are the result of expenditures applicable to the prior year, but expensed and paid in the current year.

**F. Assets, Liabilities, Fund Balances and Net Assets**  
(In accordance with GASB Statement 34)

**Cash and Temporary Investments**

Cash and Cash Equivalents (in accordance with GASB Statement 9) as reported in the *Statement of Cash Flows* for the Internal Service Fund is composed of Cash on Hand and Cash in State Treasury.

The petty cash and travel advance accounts and the TexaSaver 401(k) account (Cash in Bank) are maintained at a local commercial bank; the TexaSaver 457 Plan accounts are maintained at financial institutions, insurance companies, and mutual fund distributors approved by the System and selected by the plan participants.

*Valuation*

Cash on Hand, Cash in Bank, Cash in State Treasury, Investment in Pool Cash, and Short-Term Investment Fund are reported at book value. Other temporary investments are reported at fair value.

**Investments**

*Valuation*

Investments of the Pension Trust Funds and Internal Service Fund are reported at fair value. The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Many factors are considered in arriving at that value. In general, however, corporate

bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Short-term investments are reported at cost, which approximates fair value.

For investments where no readily ascertainable market value exists, management, in consultation with their investment advisors and the Master Trust Custodian, has determined fair values for the individual investments.

The investments of the Employees Retirement Fund, the Law Enforcement and Custodial Officer Supplemental Retirement Fund, and the Judicial Retirement System Plan Two Fund are pooled in the Pension Investment Pool Trust Fund.

The investments in the Texa\$aver 457 Trust Fund are reported at estimated fair value.

### *Permissible Investments*

Eligible securities are as follows:

- ◆ Domestic equities, screened to eliminate against any known bankruptcy proceedings, lawsuits or breach of corporate ethics that might jeopardize the company's economic future or existence;
- ◆ Equities of companies domiciled in countries outside of the United States; and
- ◆ U.S. dollar denominated fixed income and short-term securities including both publicly-traded and those issued pursuant to the Securities and Exchange Commission's Rule 144A.

### **Capital Assets**

Pension Trust Funds are accounted for on a cost of service measurement focus. This means that all capital assets associated with the funds' activities are included in their statements of net assets. Purchases of capital assets by these funds are reported at cost or, if donated, at fair market value on the acquisition date.

Depreciation of all exhaustible capital assets is charged as an expense against the funds' operations. Accumulated depreciation is reported on the statements of net assets.

Depreciation has been provided over the estimated useful lives, using the straight-line method. The capitalization thresholds and estimated useful lives is as shown in Figure A.

### **Accounts Payable**

Accounts Payable under the Internal Service Fund include claims incurred but not reported by the participants prior to

fiscal year end and payable in future years as estimated by the System's actuary.

### **Employees Compensable Leave**

Under the provisions of Article 6252-8b, (V.A.C.S.), a State employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal, or separation from State employment, provided the employee has had continuous employment with the State for six months.

In fiduciary fund types, salary costs related to employees' rights to be compensated for vacation time are accrued as expenses of the period in which the services were rendered. Accumulated compensable leave liabilities are reported in the *Statement of Fiduciary Net Assets* for the Employees Retirement Fund.

No liability is recorded for non-vesting accumulating rights to receive sick leave benefits.

### **Net Assets - Held in Trust for Pension Benefits**

The net assets of the retirement trust funds consist of up to five reserve accounts, depending on the particular fund.

- ◆ The Employee Savings Account represents the accumulation of active and inactive member deposits plus interest.
- ◆ The State Accumulation Account represents reserves available to fund the future active member retirement, death, and survivor benefits.
- ◆ The Retirement Annuity Reserve Account represents reserves to pay retirement, death, and survivor benefits and post-retirement benefit increases for current retirees.
- ◆ The Interest Account represents the interest, dividends, securities lending income, and net appreciation or depreciation received and accrued on the invested assets of the fund. All investment income is transferred to the Employee Savings, State Accumulation and Retirement Annuity Reserve accounts based on applicable Texas statutes.

Figure A

### **CAPITALIZATION THRESHOLDS AND USEFUL LIVES**

<b>Asset Category</b>	<b>Capitalization Threshold</b>	<b>Estimated Useful Life (in Years)</b>
Land	\$0	n/a
Building and Improvements	\$100,000	40
Furniture and Equipment	\$5,000	3-10
Motor Vehicles	\$5,000	7

- ◆ The *Administration Account* represents reserves to pay all administration and maintenance expenses of the retirement trust funds.

See Note 2.C for the balances of each funded plans' legally required reserves.

### **Restricted Net Assets - Proprietary Fund (In accordance with GASB Statement 34)**

Chapter 1551, Texas Insurance Code, requires that the System estimate funds needed to place in a contingency reserve fund for adverse fluctuations for self-funded plans. The estimate is based on an average 60-day period, considering projected claims and administrative expenses. The estimated amount must be placed in the contingency reserve fund along with interest on, earnings of, and proceeds from the sale of investments of assets in the contingency reserve fund. This estimated amount is reported as 'Restricted Net Assets' in both the government-wide and the proprietary fund *Statement of Net Assets*.

### **Interfund Activity and Balances (In accordance with GASB Statement 34)**

Activities between the System and agencies of the State of Texas, and activities between the System's funds have been analyzed and classified in accordance with the following criteria.

#### ***Interfund Services Provided and Used***

This activity represents transactions that would be treated as revenues, expenditures or expenses if they involved organizations external to State government. They are accounted for as revenues by the recipient fund and as expenditures or expenses by the disbursing fund.

Contributions for retirement and insurance from other funds within the State of Texas reporting entity are reported as Interfund Services Provided and Used.

The accrual of interfund services provided and used is classified as Accounts Receivable and Accounts Payable on the government-wide and the fund financial statements.

#### ***Interfund Reimbursements***

This activity represents expenditures or expenses applicable to a particular fund but paid from another fund. The transactions are reported as expenditures or expenses in the reimbursing fund and a reduction of corresponding amounts in the reimbursed fund.

Administrative expenses paid by the Employees Retirement Fund and subsequently reimbursed by the System's other funds are reported as Interfund Reimbursements in the financial statements.

The accrual of interfund reimbursements is reported on the government-wide *Statement of Net Assets* as Due From External Parties or Due To External Parties and on the fund financial statements as Due From Other Funds or Due To Other Funds.

See Note 5.D, Interfund Receivables and Payables, for a summary of accruals of interfund reimbursements.

#### ***Interfund Transfers***

This activity represents routine transfers of resources. Interfund transfers are reported in the Other Financing Sources (Uses) section for Governmental Funds and as Other Additions or Other Deductions in the Pension Trust Fund financial statements.

The accrual of interfund transfers is reported on the government-wide *Statement of Net Assets* as Due From External Parties or Due To External Parties and on the fund financial statements as Due From Other Funds or Due To Other Funds.

Retirement Membership Fees received by the Employees Retirement Fund and transferred to other funds of the System are reported as Interfund Transfers.

See Note 5.E, Interfund Transfers, for a summary of interfund transfers.

### **Interagency Activity and Balances (In accordance with GASB Statement 34)**

This activity represents transfers of contributions to or from the Teacher Retirement System of Texas.

At year end, the accrual of transfers of service contributions to or from the Teacher Retirement System of Texas is reported as Due To Other Agencies or Due From Other Agencies on the *Statement of Fiduciary Net Assets*.

### **Reclassifications**

Certain items from the prior year's financial statements have been reclassified for comparative purposes. Such reclassifications had no effect on previously reported net assets.

## **2. Pension Plans - Defined Benefit (In accordance with GASB Statement 25)**

The Employees Retirement System of Texas Plan (ERS), the Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS), the Judicial Retirement System of Texas Plan One (JRS I) and Judicial

Retirement System of Texas Plan Two (JRS II) are single employer defined benefit pension plans.

Each plan provides service retirement, death and disability benefits. Benefit and contribution provisions of each plan are authorized by State law and may be amended by the Texas Legislature.

Member contribution rates of the ERS, JRS I and JRS II and State contribution rates of the ERS and LECOS are set by State law. The law prohibits any amendment to the plans that would cause the period required to amortize any unfunded actuarial accrued liability to equal or exceed 31 years. The LECOS does not receive member contributions.

The State is required to make appropriations from the General Revenue Fund sufficient to pay benefits of the JRS I on a pay-as-you-go basis.

State contribution rates of the JRS II are actuarially determined each even-numbered year for the next biennium.

Administrative expenses of the ERS, LECOS and JRS II are financed through investment earnings. Administrative expenses of the JRS I are financed by State appropriations.

The most recent actuarial valuation was performed as of August 31, 2003. The actuarial funding method used to perform the valuations is the entry age actuarial cost method. Using this method, the plan's normal cost is determined as a percentage of payroll. The excess of the total contributions over the normal cost is used to amortize the plan's unfunded actuarial accrued liability, if any exists. The number of years needed to amortize the plan's unfunded actuarial accrued liability is determined using a level percentage of payroll method. An actuarial valuation for the JRS I is performed solely to satisfy the requirements of GASB Statement No. 25 Required Supplementary Information calculations, which is presented immediately after the Notes to the Basic Financial Statements.

See Note 1.C., Summary of Significant Accounting Policies, Basis of Accounting, for the System's policies regarding recognition of contributions, benefits paid and refunds paid.

See Note 1.F., Summary of Significant Accounting Policies, Assets, Liabilities, Fund Balances and Net Assets, for the System's policies regarding investment valuation.

## **A. Plan Descriptions and Contributions**

### **Employees Retirement Plan**

#### *Plan Description*

There are two classes of membership within this retirement plan: (1) the elected class and (2) the employee class.

Membership in the elected class is limited to persons who hold State offices that are normally filled by statewide election (including legislators) and excludes officials covered by the Judicial Retirement System of Texas Plans One and Two.

Membership in the employee class includes all employees and appointed officers of the State and excludes independent contractors and their employees and employees covered by the Teacher Retirement System of Texas.

System employees are members of the Employees Retirement Plan.

#### *Contributions*

Employees are required to contribute 6% of their compensation to the System.

Legislators are required to contribute 8% and other elected class members are required to contribute 6% of their compensation to the System.

For the fiscal years ended August 31, 2002 and 2003, the State contributed 6% of the payroll of members for both the elected class and the employee class.

### **Law Enforcement and Custodial Officer Supplemental Retirement Plan**

#### *Plan Description*

The plan covers custodial officers employed by the Department of Criminal Justice, including the Board of Pardons and Paroles, and certified by that department according to statutory requirements as having a normal job assignment that requires frequent or infrequent regularly planned contact with inmates of that institution. The plan also covers law enforcement officers who have been commissioned by the Department of Public Safety, the Alcoholic Beverage Commission, the Parks and Wildlife Department, or, effective September 1, 1995, the State Board of Pharmacy who are recognized as commissioned law enforcement officers by the Commission on Law Enforcement Officer Standards and Education.

The monthly benefit amount payable from this fund is equal to the excess of the total benefit over the regular benefit payable to the member from the Employees Retirement Fund.

**Contributions**

Members do not contribute to this fund. For the bienniums ending August 31, 1995 through August 31, 2003, the State has not and will not be required to contribute to this fund.

**Judicial Retirement System of Texas Plan One**

**Plan Description**

The plan covers judges, justices and commissioners of the supreme court, the court of criminal appeals, the court of appeals, district courts, and certain commissions to a court who first became members before September 1, 1985. Members of the Judicial Retirement System of Texas Plan Two are excluded from this plan.

As a result of new judicial officers participating in the Judicial Retirement Plan Two, the Plan One membership continues to decrease while the annuity payroll increases as members retire.

**Contributions**

Members are required to contribute 6% of their compensation to the State's General Revenue Fund.

Effective January 1, 2002, members who accrue 20 years of service credit in the Judicial Retirement System Plan One cease making contributions, but are considered contributing members for all other purposes.

**Judicial Retirement System of Texas Plan Two**

**Plan Description**

The plan covers judges, justices and commissioners of the supreme court, the court of criminal appeals, the court of appeals, district courts and certain commissions to a court who first become members after August 31, 1985. Members of the Judicial Retirement System of Texas Plan One are excluded from this plan.

**Contributions**

Members are required to contribute 6% of their compensation to the System. A member who accrues 20 years of service credit in the retirement system ceases making contributions, but is considered a contributing member for all other purposes; however, the State contribution continues.

For the fiscal years ended August 31, 2002 and 2003, the State contributed 16.83% of the payroll of members.

**B. Retirement Systems Membership**

The membership of the retirement plans as of August 31, 2003 is summarized in Figure B. The System's actuary includes members who retire on August 31 who receive their first annuity in September, as retirees in the actuarial valuation.

**C. Reserves (Unaudited)**

The balances of legally required reserves in each funded retirement plan as of August 31, 2003 and 2002 are presented in Figure C.

See Note 1.F, Net Assets Held In Trust for Pension Benefits, for a description of each reserve account.

**D. Historical Trend Information**

Historical trend information is designed to provide information about the ERS, LECOS, JRS I and JRS II's progress made in accumulating sufficient assets to pay benefits when due. This information is presented in the Required Supplementary Information immediately after the Notes to the Basic Financial Statements.

*Figure B*

<b>RETIREMENT SYSTEMS MEMBERSHIP</b>				
	<u>ERS</u>	<u>LECOS</u>	<u>JRS I</u>	<u>JRS II</u>
Retirees and beneficiaries currently receiving benefits	58,975	4,173	505	59
Terminated employees entitled to benefits	51,871	19	17	79
Current employees	142,163	40,335	40	477
<b>Total</b>	<u>253,009</u>	<u>44,527</u>	<u>562</u>	<u>615</u>

**3. Pension Plans - Defined Contribution**

**A. Plan Descriptions and Contributions**

**TexaSaver 457 Plan**

(In accordance with GASB Statements 25 and 32)

**Plan Description**

The State of Texas offers to all State employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan permits employees to defer a portion of their salary until future years. The deferred compensation funds are not available to employees until distribution due to termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts,



Figure C

**RESERVES (UNAUDITED)**

<i>Net Plan Assets Reserved For:</i>				<b>Totals – August 31,</b>	
	<b>ERS</b>	<b>LECOS</b>	<b>JRS II</b>	<b>2003</b>	<b>2002</b>
	\$	\$	\$	\$	\$
Employee Savings	3,510,221,815	5,275	29,685,860	3,539,912,950	3,361,108,974
State Accumulation	4,116,401,460	375,819,263	60,963,794	4,553,184,517	5,126,850,111
Annuity Reserves	9,840,729,447	218,269,105	24,435,340	10,083,433,892	8,623,896,982
Administration	-	-	-	-	511,619
<b>Total Net Plan Assets Reserved</b>	<b>17,467,352,722</b>	<b>594,093,643</b>	<b>115,084,994</b>	<b>18,176,531,359</b>	<b>17,112,367,686</b>
Funded ratios of each plan, from the actuarial valuation:					
As of August 31, 2003	0.976	1.115	1.165		
As of August 31, 2002	1.025	1.247	1.109		

property or rights are held in trust by the Board of Trustees for the exclusive benefit of participants and their beneficiaries and may not be used for or diverted to any other expense, except to defray the reasonable expenses of administering the plan.

The Board of Trustees is not liable to a participating employee for the diminution in value or loss of all or part of the participating employee's deferred amounts or investment income because of market conditions or the failure, insolvency, or bankruptcy of a qualified vendor.

Beginning September 1, 2001, the deferred compensation plan balances are recorded in a Pension Trust Fund at fair value. The estimated fair value of the aggregate deferred compensation plan assets was \$238,588,037 as of August 31, 2003.

**Contributions**

As of August 31, 2003, there were 15 System employees participating in the TexaSaver 457 Plan. During the fiscal year ended August 31, 2003, System employees deferred \$32,274.

The State does not contribute to the plan.

**TexaSaver 401(k) Plan**

(In accordance with GASB Statement 25)

**Plan Description**

The System also administers another plan for the State, TexaSaver 401(k), created in accordance with Internal Revenue Code Section 401(k). This plan is also offered to all State employees. The assets of this plan do not belong to the State. The State has no liability related to this plan.

**Contributions**

The State does not contribute to the plan.

**4. Risk Management**

(In accordance with GASB Statement 10)

**A. Risk Exposure**

The System is exposed to the following types of claims for risk of loss:

- ◆ Health insurance
- ◆ Life insurance
- ◆ Accidental death and dismemberment (AD & D) insurance
- ◆ Disability insurance
- ◆ Dental insurance
- ◆ Property and casualty
- ◆ Unemployment
- ◆ Workers' compensation

**B. Risk Financing**

Claims for health, life, accidental death and dismemberment (AD & D), disability, and dental insurance coverages are recorded in the Employees Life, Accident and Health Insurance and Benefits Fund under the Texas Employees Group Benefits Program (GBP), formerly known as the Texas Employees Uniform Group Insurance Program (UGIP). These coverages are provided through a combination of insurance contracts, a self-funded health plan, a self-funded dental indemnity plan, health maintenance organization (HMO) contracts, and dental health maintenance organization (DHMO) contracts.

The System purchases commercial insurance to cover the risk of loss related to general liability; theft of, damage to, and destruction of assets; and natural disasters. Claims for unemployment and workers' compensation are funded by the System on a pay-as-you-go basis. Claims for property and casualty,

Figure D

**SUMMARY OF RISK FINANCING**

Type of Coverage	Plan Name	Self-Funded	Risk Retained with	Plan Status
Health	◆ HealthSelect	Yes	System	Active
	◆ HealthSelect Plus	Yes	System	Terminated on April 30, 2003
	◆ HMOs	No	Insurance Carrier	Active
	◆ Prescription Drug	Yes	System	Active
Life	N/A	No	Insurance Carrier	Active
Accidental Death and Dismemberment	N/A	No	Insurance Carrier	Active
Disability	N/A	Yes	System	Active
Dental	◆ DHMOs	No	Insurance Carrier	Active
	◆ Dental Indemnity Plan	Yes	System	Active
Property and Casualty	N/A	No	Insurance Carrier	Active
Unemployment	N/A	Yes	System	Active
Workers' Compensation	N/A	Yes	System	Active

unemployment, and workers' compensation are recorded in the Employees Retirement Fund. These claims are allocated periodically to other funds based on percentages determined by a study of each fund's usage.

The risk financing for coverages is summarized in Figure D.

**C. Liabilities**

For self-funded coverages, the System's liabilities are reported when it is both probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Based on the estimates provided by the System's actuary (Rudd and Wisdom, Inc.), liabilities are reevaluated to consider current settlements, frequency of claims, past experience and economic factors. Changes in the balances of the self-funded claims liabilities for the current and prior fiscal years are presented in Figure E.

For coverages that are not self-funded, no significant reductions in insurance coverage occurred in the past year and settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years.

For both self-funded and not self-funded coverages, the balance of claims that have been incurred but not reported as of August 31, 2003 is \$339,842,000.

Figure E

**CHANGES IN SELF-FUNDED CLAIMS LIABILITIES**

	Totals – August 31,	
	2003	2002
Beginning of Fiscal Year Liability	\$ 281,414,563	\$ 222,508,868
Current-Year Claims and Changes in Estimates	1,367,649,008	1,258,042,728
Claims Payments	(1,338,057,568)	(1,199,137,033)
Balance at Fiscal Year-End	<u>311,006,003</u>	<u>281,414,563</u>

**5. Detail Disclosures on Funds**

**A. Assets**

**Deposits, Investments, Securities Lending, Repurchase Agreements, Derivatives and Forward Contracts**

(In accordance with GASB Statements 3, 25, 28 and 31)

See Note 1.F, Investments-Valuations.

**Deposits**

The System's deposits have been categorized to give an indication of the level of credit risk assumed by the System at year end.

Figure F

**DEPOSITS**

Categorized Deposits	Insured/ Collateralized Deposits (Category 1)	Uncollateralized Deposits (Category 3)	Total Carrying Value
	\$	\$	\$
<i>Cash on Hand:</i>			
Proprietary Fund (Exh. V)	57,195		57,195
<i>Fiduciary Funds:</i>			
Pension (and Other Employee Benefit) Trust Funds (Exh. X)	1,510,588		1,510,588
<b>Total Cash on Hand</b>	<b>1,567,783</b>	-	<b>1,567,783</b>
<i>Cash in Bank:</i>			
<i>Fiduciary Funds:</i>			
Pension (and Other Employee Benefit) Trust Funds (Exh. X)	14,000		14,000
Pension (and Other Employee Benefit) Trust Funds (Exh. A-1)	12,804,454	666,722	13,471,176
Agency Funds (Exh. A-3)	1,391,668		1,391,668
<b>Total Cash in Bank</b>	<b>14,210,122</b>	<b>666,722</b>	<b>14,876,844</b>
<i>Cash in State Treasury:</i>			
Governmental Funds (Exh. III)	18,967		18,967
Proprietary Fund (Exh. V)	36,326,331		36,326,331
<i>Fiduciary Funds:</i>			
Pension (and Other Employee Benefit) Trust Funds (Exh. X)	24,890,161		24,890,161
Pension (and Other Employee Benefit) Trust Funds (Exh. A-1)	4,639,555		4,639,555
Agency Funds (Exh. A-3)	212,452		212,452
<b>Total Cash in State Treasury</b>	<b>66,087,466</b>	-	<b>66,087,466</b>
Investment in Pool Cash (Exh. X)	115,217		115,217
<b>Total Categorized Deposits</b>	<b>81,980,588</b>	<b>666,722</b>	<b>82,647,310</b>

**Category 1** includes deposits that are insured or collateralized with securities held by the System or its agent in the System's name.

**Category 2** includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the System's name.

**Category 3** includes deposits that are uncollateralized, or for which the securities are held by the pledging financial institution, or by its trust department or agent, but not in the System's name.

Cash in Bank includes \$14,000 petty cash and travel advance funds, \$1,391,668 TexaSaver 401(k) Trust Fund, and \$230,352 Cafeteria Plan Trust Fund. These funds are maintained at Bank One of Austin. The \$13,240,824 balance of Cash in Bank is composed of the deposits in the TexaSaver 457 Plan. These deposits are maintained among various financial institutions and credit unions.

The System's Cash in Bank at year-end was fully insured by the Federal Depository Insurance Corporation or the National Credit Union Association, *except* \$666,722 of the deposits from the 457 Deferred Compensation Plan. This portion of the Cash in Bank was not insured because the participants' deposit balance exceeded the \$100,000 maximum coverage as stipulated by the National Credit Union Association. Fully insured Cash in Bank is presented under Category 1 in Figure F; whereas uninsured Cash in Bank is listed under Category 3 in Figure F.

Cash in State Treasury and Investment in Pool Cash were fully collateralized through the Comptroller of Public Accounts' Treasury Operations Section and, therefore, listed under Category 1 in Figure F.

The bank balances of deposits at August 31, 2003 are presented in Figure F.

## *Investments*

The System's investments have been categorized to give an indication of the level of credit risk assumed by the System at year end.

**Category 1** includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name.

**Category 2** includes uninsured and unregistered investments for which the securities are held by the counter-party's trust department or agent in the System's name.

**Category 3** includes uninsured and unregistered investments for which the securities are held by the counter-party, or by its trust department or agent but not in the System's name.

The System earns failed interest on monies held at the custodial agent bank overnight when a security purchase transaction fails to be completed due to the broker not delivering the purchased security on settlement date. When this occurs, the System's money is invested overnight in a Common Trust Fund at the custodial agent bank. The Common Trust Fund investment instrument is a Trust asset and would be shown as an uncategorized investment in the summary of investment credit risk. The System had no failed securities either during the fiscal year or at August 31, 2003.

The carrying values of investments for all funds administered by the System at August 31, 2003 are presented in Figure G.

## *Securities Lending*

The System participates in a securities lending program, administered by the custodial agent bank, whereby certain securities are transferred to an approved independent broker/dealer (borrower) with a simultaneous agreement to return the collateral for the same securities in the future. Securities lending transactions are governed by the Texas Trust Code and the Texas State Constitution. Securities lent include fixed income securities and domestic and international equities. The System's custodian lends the securities for collateral in the form of cash or U.S. Government or Agency securities of 100% plus any accrued interest on the loaned securities. Securities lent at year end for cash collateral are presented as uncategorized and securities lent for securities collateral are presented as categorized in either Category I or Category III in the preceding schedule of custodial credit risk. At year end, the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers

exceed the amounts the borrowers owe the System. The contract with the System's custodial agent bank requires it to fully indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are on loan. The System has not experienced any losses due to credit or market risk on securities lending activities since implementation of the program in July 1991.

The System is permitted to loan securities under 1) open loans which are generally overnight loans and 2) term loans with specified expected termination dates that require prior written approval of the System. Cash collateral is invested in traditional money market instruments. The policy is to match the maturities of investments made with the cash collateral to the maturities of the loan agreements. The System cannot pledge or sell collateral securities received unless the borrower defaults and, therefore, the System does not establish an asset and a corresponding liability in the balance sheet for the collateral value of securities received. There were no significant violations of legal or contractual provisions, and no borrower or lending agent default losses.

The System received cash collateral in the amount of \$2,496,815,432 in exchange for securities with a fair value of \$2,541,206,244, which were on loan to brokers/dealers at August 31, 2003. Fair value of securities on loan for securities collateral at August 31, 2003, is \$597,963,342. Net securities lending income totaled \$7,656,605 for the fiscal year ended August 31, 2003. Securities on loan are maintained in the System's financial records in their respective categories.

## *Repurchase Agreements*

During the fiscal year 2003, the System held no investments in repurchase agreements.

## *Derivative Investing*

Derivatives are generally defined as contracts or securities whose value depends on, or derives from, the value of an underlying asset, reference rate, or index. The System invests in derivative securities, not derivative contracts. The System invests in Collateralized Mortgage Obligations (CMOs), which are based on cash flows from interest payments on underlying mortgages; therefore, they are sensitive to pre-payments by mortgagees that may result from a decline in interest rates. To be eligible for purchase, CMOs will be limited to such securities that exhibit

Figure G

## INVESTMENTS

Categorized Investments	Insured/Registered Securities (Category 1)	Uninsured/Unregistered Securities <sup>1</sup> (Category 3)	Total Carrying Value
	\$	\$	\$
Government Investments	695,134,985	586,598,509	1,281,733,494
Mortgage Backed Securities	1,073,383,463		1,073,383,463
Corporate Obligations	2,227,230,386		2,227,230,386
Corporate Stock	6,744,807,716		6,744,807,716
Foreign Equity	2,847,617,311	11,364,833	2,858,982,144
<b>Total Categorized Investments</b>	<b>13,588,173,861</b>	<b>597,963,342</b>	<b>14,186,137,203</b>
<b>Uncategorized Investments</b>	<b>Trade Payables</b>	<b>Securities on Loan with Cash Collateral<sup>2</sup></b>	
	\$	\$	
Government Investments		891,614,820	891,614,820
Mortgage Backed Securities	1,460,531,861		1,460,531,861
Corporate Obligations	236,524	443,638,754	443,875,278
Corporate Stock	11,551,698	745,608,267	757,159,965
Foreign Equity		415,953,591	415,953,591
<i>Short-Term Mutual Funds:</i>			
Chase Bank Liquidity Fund for Pension and Profit Sharing Funds			4,710,411
JP Morgan Prime Money Market II Institutional Fund			4,805,152
Money Market Mutual Funds			1,170,307,319
Texas Growth Fund			69,388,993
<i>Deferred Compensation:</i>			
Money Market Funds			18,569,204
Mutual Funds			69,021,173
Annuities			137,028,657
Total Trade Payables & Securities on Loan with Cash Collateral	1,472,320,083	2,496,815,432	<b>5,442,966,424</b>
<b>Total Uncategorized Investments</b>			<b>5,442,966,424</b>
<b>Total Investments</b>			<b>19,629,103,627</b>
<b>Investments Consist of:</b>			\$
<i>Fiduciary Funds (Exh. VIII):</i>			
Short-Term Investments			1,194,903,492
Investments			18,137,870,810
<i>Proprietary Funds (Exh. V):</i>			
Short-Term Investments			53,940,563
Investments			242,388,762
<b>Total Investments</b>			<b>19,629,103,627</b>

Included above are \$471,295,907 in investment trade receivables.

<sup>1</sup> Category 3 consists entirely of investment securities held by broker dealers under securities loans for securities collateral.

<sup>2</sup> Fair value of securities lending cash collateral invested in traditional money market instruments:

Fiduciary Funds	\$ 2,518,401,764
Proprietary Funds	22,804,480
Total	<b>2,541,206,244</b>

Figure H

**STATE CONTRIBUTION RATES - RETIREE  
HEALTH AND BASIC LIFE PREMIUM –  
FISCAL YEAR 2003**

	May 1, 2003	Sep. 1, 2002
	\$	\$
Retiree Only	274.00	308.84
Retiree & Spouse	430.27	485.14
Retiree & Children	378.63	426.89
Retiree & Family	534.90	603.19

no more than 200% cash flow variability as compared to the underlying securities' collateral, and must be rated no lower than A-, A3 or their equivalent by any of the following: Moody's, Standard & Poor's, Duff & Phelps, and Fitch/IBCA Investor Services. The System's assets are broadly diversified in order to minimize the market risk of large losses in individual investments. The System limits its exposure to credit risk, market risk, and legal risk by considering yield, quality, marketability, and long-term investment objectives for the portfolio.

**Forward Contracts**

The System enters into forward contracts to minimize the short-term impact of foreign exchange rate fluctuations on the asset and liability positions of international equities. The System had no outstanding forward contract on August 31, 2003.

**B. Liabilities**

**Other Postemployment Benefits**

**(In accordance with GASB Statement 12)**

In addition to the pension benefits described in Note 2 and Note 3, the System administers a program, which provides postemployment health care, life and dental insurance benefits through the Employees Life, Accident and Health Insurance and Benefits Fund in accordance with Chapter 1551, Texas Insurance Code. Eligible participants include retirees who retired with at least 10 years of service to State agencies and certain higher education institutions. These retirees must meet certain age requirements. Surviving spouses and dependents of these retirees are also covered. As of August 31, 2003, there were 63,616 eligible retirees and surviving spouses, plus approximately 28,700 dependents.

Figure H summarizes the maximum monthly State contribution toward an eligible retiree's health and basic life premium. The retiree pays any premium over

Figure I

**CONTRIBUTIONS BY SOURCE AND  
CLAIMS EXPENSES-RETIREEES**

	August 31,	
	2003	2002
	\$	\$
State Contributions	253,791,305	223,000,940
Retiree Contributions	77,997,477	68,817,018
Total Contributions	331,788,782	291,817,958
Claim Expenses	362,684,483	325,677,004

Figure J

**NON-CANCELABLE OPERATING LEASES**

Fiscal Year	Future Minimum Lease Rental Payments
	\$
2004	870,047
2005	753,110
2006	242,141
2007	1,117
<b>Total Future Minimum Lease Rental Payments</b>	<b>1,866,415</b>

and above the State contribution. The State does not contribute toward dental or optional life insurance. Surviving spouses and their dependents do not receive the State contribution.

Figure I summarizes premium contributions by source and claims expenses on a pay-as-you-go basis for the current and prior fiscal years. The System's actuaries have estimated certain health, life, accidental death and dismemberment, and indemnity administrative fees; therefore, the prior year claims expenses have been re-stated to reflect the current estimates. See also Note 4, Risk Management.

**Operating Leases**

**(In accordance with GASB Statement 38)**

Included in rental expenses/expenditures are assets leased on a long-term basis that have been classified as operating leases. A schedule of future minimum lease rental payments on non-cancelable operating leases as of August 31, 2003 is presented in Figure J.

Figure K

### NET ASSETS - FIDUCIARY FUNDS

Fund Type - Pension (and Other Employee Benefit) Trust Funds	Totals - August 31	
	2003	2002
<i>Defined Benefit Plans:</i>	\$	\$
Employee Savings	3,539,912,950	3,361,108,974
State Accumulation	4,553,184,517	5,126,850,111
Retirement Annuity Reserves	10,083,433,892	8,623,896,982
Administration	-	511,619
Total Defined Benefit Plans	18,176,531,359	17,112,367,686
<i>Defined Contribution Plans and Cafeteria Plan:</i>		
Plan 457 Participants	237,507,004	235,039,475
Administration - Defined Contribution Plans	1,081,670	1,289,922
Administration - Cafeteria Plan	1,979,126	2,705,633
Total Defined Contribution Plans and Cafeteria Plan	240,567,800	239,035,030
<b>Total Fiduciary Net Assets Held In Trust for Pension Benefits and Other Purposes</b>	<b>18,417,099,159</b>	<b>17,351,402,716</b>
	(Exh. VIII)	

Figure L

### INTERFUND RECEIVABLES AND PAYABLES

	Due From Other Funds	Due To Other Funds
<i>Governmental Activities:</i>	\$	\$
<i>Major Governmental Funds:</i>		
Social Security Administration (Agency 327, Fund 955)		3,457
<i>Proprietary Fund:</i>		
Employees Life, Accident and Health Insurance and Benefits Fund (Agency 327, Fund 955)		764,274
<b>Total Governmental Activities</b>	<b>-</b>	<b>767,731</b>
<i>Fiduciary Funds:</i>		
Pension (and Other Employee Benefit) Trust Funds	1,141,285	373,554
<b>Total - Interfund Receivables and Payables</b>	<b>1,141,285</b>	<b>1,141,285</b>

#### C. Fund Equity

##### Fiduciary Net Assets Held in Trust for Pension Benefits and Other Purposes

A summary of pension plan and other employee benefit fiduciary net assets at August 31, 2003 and 2002 is presented in Figure K.

#### D. Interfund Receivables and Payables

##### (In accordance with GASB Statement 38)

At year-end, accruals related to interfund transfers and interfund reimbursements between the System's funds, are reported as Due From External Parties or Due To External Parties in the government-wide *Statement of Net Assets* and as Due From Other Funds

or Due To Other Funds in the fund financial statements. (See Note 1.F)

Figure L presents individual interfund receivable and interfund payable balances at August 31, 2003.

#### E. Interfund Transfers

##### (In accordance with GASB Statement 38)

Activity between the System's funds related to the transfers of membership fees from the Employees Retirement Fund to other funds of the System, are reported as Due From External Parties or Due To External Parties in the government-wide *Statement of Net Assets* and as Due From Other Funds or Due To Other Funds in the fund financial statements. (See Note 1.F)

Figure M

## INTERFUND TRANSFERS

	Transfers In	Transfers Out
<i>Fiduciary Funds:</i>	\$	\$
Pension (and Other Employee Benefit) Trust Funds	560,913	560,913
<b>Total - Interfund Transfers</b>	<b>560,913</b>	<b>560,913</b>

Figure N

## RESTATEMENTS

	Internal Service Fund	Expendable Trust Funds	Pension Trust Funds	Pension (and Other Employee Benefit) Trust Funds	General Fixed Assets Account Group
	\$	\$	\$	\$	\$
<b>Fund Equity/Net Plan Assets/ Investment in General Fixed Assets, August 31, 2001, As Reported</b>	<b>18,307,627</b>	<b>300,791,757</b>	<b>18,790,761,972</b>	<b>-</b>	<b>3,624</b>
Change in Fund Type		(300,791,757)	(18,790,761,972)	19,091,553,729	
<i>Restatements:</i>					
General Fixed Assets				3,624	(3,624)
Change in Capitalization Threshold	(7,210)			(757,631)	
Net Restatements	(7,210)	-	-	(754,007)	(3,624)
<b>Fund Equity/Fiduciary Net Assets, September 1, 2001, As Restated</b>	<b>18,300,417</b>	<b>-</b>	<b>-</b>	<b>19,090,799,722</b>	<b>-</b>
	(Exh. VI)			(Exh. IX)	

Figure M presents interfund transfers for the year ended August 31, 2003.

## F. Restatements

On September 1, 2001 (fiscal year 2002), the System implemented GASB Statements 34, 37 and 38, which required that funds previously reported as Expendable Trust Funds now be reported as Pension (and Other Employee Benefit) Trust Funds. In addition, the System increased the minimum amount at which it capitalizes purchases of assets from \$1,000 to \$5,000.

The change in accounting practice and change in fund type resulted in restatements to the September 1, 2001 beginning Net Plan Assets/Fund Equity balances as shown in Figure N.

## 6. Contingent Liability

### A. Litigation

The System is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the System's attorneys, the resolution of these matters will not have a material adverse effect on the financial condition of the System.

### B. Sick Leave

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is taken only in the event of illness. In the event of an employee's death, a payment is made to the employee's estate for one-half of the employee's accumulated leave or 336 hours, whichever is less. Such payments are recognized as expenses/expenditures when paid.

Service credit is given upon retirement at the rate of one month of service for each 160 hours of an employee's accumulated sick leave balance. Effective August 28, 1995, unused accumulated sick leave may also be used to meet service requirements to qualify for retirement at a rate of one month of service for each 160 hours of accrued unused sick leave.

The additional contingent liability for future compensation of sick leave, based on accumulated sick leave balances as of August 31 was not considered material.



- Unaudited -

**REQUIRED SUPPLEMENTARY INFORMATION**  
**Budgetary Comparison Schedule -**  
**Appropriated Special Revenue Funds (Basis of Budgeting) (Note A)**  
**Year Ended August 31, 2003**

	Death Benefits Program for Commissioned Peace Officers, Firemen, etc. (0001) (U/F 3001)				Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008)			
	Budget		Actual	Variance with Final Budget Positive (Negative)	Budget		Actual	Variance with Final Budget Positive (Negative)
	Original	Final			Original	Final		
<b>Budgetary Fund Balances-Beginning</b>	\$ 50,886	\$ 5,300	\$ -	\$ (5,300)	\$ 311,738	\$ 366,290	\$ 366,290	\$ -
Appropriations Lapsed	-	-	-	-	-	-	-	-
Decrease in Previous Years' Appropriations	(50,886)	(5,300)	-	5,300	(311,738)	-	-	-
<b>Adjusted Budgetary Fund Balances - Beginning</b>	-	-	-	-	-	366,290	366,290	-
<b>Revenues</b>								
Legislative Appropriations Out of the State's General Revenue Fund:								
For Administrative Expenditures	28,000	28,000	28,000	-	-	-	-	-
For Death Benefits-Peace Officers, Firemen, Etc.	2,207,760	4,649,351	4,649,351	-	6,453,923	6,086,658	6,086,658	-
<b>Total Appropriations Revenue</b>	<b>2,235,760</b>	<b>4,677,351</b>	<b>4,677,351</b>	<b>-</b>	<b>6,453,923</b>	<b>6,086,658</b>	<b>6,086,658</b>	<b>-</b>
<b>Expenditures</b>								
Current:								
Administrative Expenditures	28,000	28,000	28,000	-	-	-	-	-
Death Benefits	2,207,760	4,649,351	4,649,351	-	6,453,923	6,452,949	6,452,949	-
<b>Total Expenditures</b>	<b>2,235,760</b>	<b>4,677,351</b>	<b>4,677,351</b>	<b>-</b>	<b>6,453,923</b>	<b>6,452,949</b>	<b>6,452,949</b>	<b>-</b>
<b>Deficiency of Revenues Over Expenditures</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(366,290)</b>	<b>(366,290)</b>	<b>-</b>
<b>Budgetary Fund Balances - Ending</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Note A: The Budget and Actual columns are presented on the budgetary basis which differs from the GAAP basis as follows:

Reconciliation of Basis of Budgeting to GAAP:

Entity Differences:

Total Actual Budgetary Fund Balances-Ending, as above	\$ -
Plus: Fund Balance of the Unappropriated Special Revenue Fund-Social Security Administration Fund (Exh. IV)	15,510

**Total Fund Balances-Special Revenue Funds-GAAP Basis (Exh. IV)** **\$ 15,510**

- Unaudited -

**REQUIRED SUPPLEMENTARY INFORMATION**  
**Schedules of Funding Progress**  
**Pension Trust Funds**

<b>Fiscal Year</b>	<b>(a) Actuarial Value Of Assets (000's)</b>	<b>(b) Actuarial Accrued Liability (AAL) (000's)</b>	<b>(c) (Overfunded) Unfunded AAL (UAAL) (b) - (a) (000's)</b>	<b>(d) Funded Ratio (a) / (b)</b>	<b>(e) Covered Payroll (000's)</b>	<b>(f) UAAL As A Percentage Of Covered Payroll (b-a) / e</b>
<b>Employees Retirement System (ERS)</b>						
1998	\$ 14,175,628	\$ 13,161,749	\$ (1,013,879)	107.7 %	\$ 4,497,668	(22.5) %
1999	15,769,708	14,656,131	(1,113,577)	107.6	4,719,116	(23.6)
2000	17,416,036	16,176,616	(1,239,420)	107.7	4,680,182	(26.5)
2001	18,394,458	17,527,696	(866,762)	104.9	4,946,244	(17.5)
2002	18,909,072	18,449,521	(459,551)	102.5	4,979,532	(9.2)
2003	19,478,555	19,959,112	480,557	97.6	4,800,612	10.0
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>						
1998	\$ 527,484	\$ 384,136	\$ (143,348)	137.3 %	\$ 1,134,322	(12.6) %
1999	573,154	497,794	(75,360)	115.1	1,325,675	(5.7)
2000	619,218	547,767	(71,451)	113.0	1,265,797	(5.6)
2001	647,757	492,127	(155,630)	131.6	1,291,750	(12.0)
2002	655,979	526,205	(129,774)	124.7	1,298,593	(10.0)
2003	666,588	597,914	(68,674)	111.5	1,277,894	(5.4)
<b>Judicial Retirement System Plan One (JRS I)</b>						
1998	\$ 0	\$ 355,051	\$ 355,051	0.0 %	\$ 16,111	2,203.8 %
1999	0	358,201	358,201	0.0	12,623	2,837.7
2000	0	354,562	354,562	0.0	12,254	2,893.5
2001	0	341,316	341,316	0.0	9,334	3,656.6
2002	0	336,960	336,960	0.0	8,240	4,089.3
2003	0	262,766	262,766	0.0	3,710	7,082.6
<b>Judicial Retirement System Plan Two (JRS II)</b>						
1998	\$ 56,336	\$ 59,505	\$ 3,169	94.7 %	\$ 36,890	8.6 %
1999	70,834	69,663	(1,171)	101.7	39,630	(3.0)
2000	86,962	81,417	(5,545)	106.8	41,419	(13.4)
2001	101,327	92,490	(8,836)	109.6	44,490	(19.9)
2002	114,433	103,229	(11,204)	110.9	45,965	(24.4)
2003	129,426	111,116	(18,310)	116.5	47,479	(38.6)

**Notes to the Required Supplementary Information**

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

	<b>ERS</b>	<b>LECOS</b>	<b>JRS I</b>	<b>JRS II</b>
Valuation date	August 31, 2003	August 31, 2003	August 31, 2003	August 31, 2003
Actuarial Cost Method	Entry Age	Entry Age	Entry Age	Entry Age
Amortization Method	Level Percent Open	Level Percent Open	Level Dollar Open	Level Percent Open
Remaining Amortization Period	40.0	6.6	40.0	40.0
Asset Valuation Method	5-Year Smoothed Market Value	5-Year Smoothed Market Value	N/A	5-Year Smoothed Market Value
Actuarial Assumptions:				
Investment Rate of Return	8.0%	8.0%	8.0%	8.0%
Projected Salary Increases	5.25%-17.5%	5.5%-17.5%	4.0%	4.0%
Includes Inflation At	4.0%	4.0%	4.0%	4.0%
Cost-of-living Adjustments	Employee - 0.0% Elected - 6.0%	0.0%	4.0%	0.0%

- Unaudited -

**REQUIRED SUPPLEMENTARY INFORMATION  
Schedules of Employer Contributions  
Pension Trust Funds**

<u>Fiscal Year</u>	<u>Annual Required Contribution (ARC)</u>	<u>Percentage Contributed</u>	<u>Annual Required Contribution (ARC)</u>	<u>Percentage Contributed</u>
	<u>Employees Retirement System (ERS)</u>		<u>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</u>	
1998	\$ 295,138,210	89.7 %	\$ 0	100.0 %
1999	209,683,942	126.4	0	100.0
2000	240,477,301	116.1	0	100.0
2001	238,289,602	118.3	0	100.0
2002	288,814,605	104.2	0	100.0
2003	311,800,224	96.7	0	100.0
2004	324,185,322	N/A	0	N/A
	<u>Judicial Retirement System Plan One (JRS I)</u>		<u>Judicial Retirement System Plan Two (JRS II)</u>	
1998	\$ 32,288,077	59.8 %	\$ 5,908,255	101.7 %
1999	34,168,974	60.1	6,622,045	102.9
2000	32,607,288	64.5	6,537,210	109.1
2001	32,163,339	68.1	6,821,463	106.4
2002	30,393,898	76.8	7,357,163	106.1
2003	29,631,522	76.5	7,777,293	106.6
2004	21,862,625	N/A	5,687,956	N/A

**Exhibit A-1**

**COMBINING STATEMENT OF FIDUCIARY NET ASSETS -  
Pension (and Other Employee Benefit) Trust Funds  
Defined Contribution Plans and Cafeteria Plan**

**August 31, 2003**

(With Comparative Totals at August 31, 2002)

	TexaSaver 401(k) Trust Fund (0946) <u>(U/F 0946)</u>	TexaSaver 457 Trust Fund (0945) <u>(U/F 0945)</u>	<u>Totals</u> Defined Contribution Plans	State Employees Cafeteria Plan Trust Fund (0943) <u>(U/F 0943)</u>	<u>Totals</u> August 31,	
	\$	\$	\$	\$	2003 (Exh. VIII)	2002
	\$	\$	\$	\$	\$	\$
<b>ASSETS</b>						
<i>Cash and Short-Term Investments:</i>						
<i>Cash and Cash Equivalents:</i>						
Cash in Bank		13,240,824	13,240,824	230,352	13,471,176	25,154,137
Cash in State Treasury	31,946	1,115,157	1,147,103	3,492,452	4,639,555	4,936,141
Total Cash and Cash Equivalents	31,946	14,355,981	14,387,927	3,722,804	18,110,731	30,090,278
<i>Short-Term Investments:</i>						
Mutual Funds		69,021,173	69,021,173		69,021,173	58,567,164
Total Short-Term Investments	-	69,021,173	69,021,173	-	69,021,173	58,567,164
Total Cash and Short-Term Investments	31,946	83,377,154	83,409,100	3,722,804	87,131,904	88,657,442
<i>Investments:</i>						
Miscellaneous Investments		155,597,861	155,597,861		155,597,861	151,322,565
Total Investments	-	155,597,861	155,597,861	-	155,597,861	151,322,565
<i>Receivables:</i>						
Interest and Dividends Receivable	60	1,400	1,460	9,700	11,160	12,480
Contributions/Accounts Receivable			-	2,582,488	2,582,488	2,462,738
Total Receivables	60	1,400	1,460	2,592,188	2,593,648	2,475,218
Due From Other Funds (Note 5.D)			-		-	165,939
<b>Total Assets</b>	<b>32,006</b>	<b>238,976,415</b>	<b>239,008,421</b>	<b>6,314,992</b>	<b>245,323,413</b>	<b>242,621,164</b>
<b>LIABILITIES</b>						
<i>Payables:</i>						
Benefits/Accounts Payable		348,701	348,701	4,297,041	4,645,742	3,540,318
Total Payables	-	348,701	348,701	4,297,041	4,645,742	3,540,318
Due To Other Funds (Note 5.D)	31,369	39,677	71,046	38,825	109,871	45,376
Deferred Revenue			-		-	440
<b>Total Liabilities</b>	<b>31,369</b>	<b>388,378</b>	<b>419,747</b>	<b>4,335,866</b>	<b>4,755,613</b>	<b>3,586,134</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. A-2)</b>	<b>637</b>	<b>238,588,037</b>	<b>238,588,674</b>	<b>1,979,126</b>	<b>240,567,800</b>	<b>239,035,030</b>

## Exhibit A-2

# COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - Pension (and Other Employee Benefit) Trust Funds Defined Contribution Plans and Cafeteria Plan

Year Ended August 31, 2003

(With Comparative Totals at August 31, 2002)

	TexaSaver 401(k) Trust Fund (0946) (U/F 0946)	TexaSaver 457 Trust Fund (0945) (U/F 0945)	Totals Defined Contribution Plans	State Employees Cafeteria Plan Trust Fund (0943) (U/F 0943)	Totals August 31,	
	\$	\$	\$	\$	2003 (Exh. IX)	2002
<b>ADDITIONS</b>						
<i>Contributions:</i>						
<i>Member Contributions:</i>						
Plan 457 Deferrals		27,132,462	27,132,462		27,132,462	10,648,819
Plan 457 Rollovers In and Transfers In		27,240,834	27,240,834		27,240,834	30,472,497
Total Plan 457 Contributions	-	54,373,296	54,373,296	-	54,373,296	41,121,316
Cafeteria Plan Contributions			-	33,570,668	33,570,668	30,071,684
Total Member Contributions	-	54,373,296	54,373,296	33,570,668	87,943,964	71,193,000
Settlement-Former 401(k) Administrator	85,000		85,000		85,000	-
<i>Other Contributions:</i>						
Cafeteria Plan Forfeitures			-	393,143	393,143	429,868
Total Contributions	85,000	54,373,296	54,458,296	33,963,811	88,422,107	71,622,868
<i>Investment Income:</i>						
<i>From Investing Activities:</i>						
Net Appreciation (Depreciation)		11,095,862	11,095,862		11,095,862	(38,763,953)
Interest & Dividends	783	7,244,855	7,245,638	65,019	7,310,657	(9,872,236)
Total Investing Activity Income	783	18,340,717	18,341,500	65,019	18,406,519	(48,636,189)
Less: Investment Expense			-		-	(1,935)
Net Investment Income	783	18,340,717	18,341,500	65,019	18,406,519	(48,638,124)
<i>Other Additions:</i>						
<i>Other Revenue:</i>						
Miscellaneous Revenue			-	17,934	17,934	10,919
<i>Transfers In (Note 5.E):</i>						
Membership Fees	260,000	233,998	493,998		493,998	663,646
Total Other Additions	260,000	233,998	493,998	17,934	511,932	674,565
<b>Total Additions</b>	<b>345,783</b>	<b>72,948,011</b>	<b>73,293,794</b>	<b>34,046,764</b>	<b>107,340,558</b>	<b>23,659,309</b>
<b>DEDUCTIONS</b>						
<i>Benefits:</i>						
Plan 457 Distributions (Includes Withholding Taxes)		27,604,277	27,604,277		27,604,277	26,901,867
Plan 457 Fees		396,252	396,252		396,252	393,603
Plan 457 Rollovers Out and Transfers Out		42,224,374	42,224,374		42,224,374	26,459,923
Total Plan 457 Benefits	-	70,224,903	70,224,903	-	70,224,903	53,755,393
Reimbursement Account Claims			-	33,539,568	33,539,568	30,027,446
Total Benefits	-	70,224,903	70,224,903	33,539,568	103,764,471	83,782,839
<i>Administrative Expenses:</i>						
Salaries & Wages	250,919	285,490	536,409	285,855	822,264	624,422
Payroll Related Costs	58,013	69,139	127,152	69,105	196,257	137,811
Professional Fees & Services	4,713	2,312	7,025	9,062	16,087	165,887
Travel	1,595	1,025	2,620	1,033	3,653	8,430
Materials & Supplies	10,178	32,153	42,331	32,053	74,384	31,309
Communications & Utilities	4,394	11,299	15,693	13,995	29,688	28,315
Repairs & Maintenance	10,397	13,372	23,769	14,487	38,256	37,714
Rentals & Leases	9,030	17,024	26,054	19,941	45,995	33,032
Printing & Reproduction	180	182	362	3,320	3,682	5,255
<i>Other Operating Expenses:</i>						
Other Expenses	7,391	20,808	28,199	34,078	62,277	62,049
Third Party Administrator Fees			-	750,774	750,774	510,637
Total Administrative Expenses	356,810	452,804	809,614	1,233,703	2,043,317	1,644,861
<b>Total Deductions</b>	<b>356,810</b>	<b>70,677,707</b>	<b>71,034,517</b>	<b>34,773,271</b>	<b>105,807,788</b>	<b>85,427,700</b>
<b>Net Increase (Decrease)</b>	<b>(11,027)</b>	<b>2,270,304</b>	<b>2,259,277</b>	<b>(726,507)</b>	<b>1,532,770</b>	<b>(61,768,391)</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes:</b>						
<b>Beginning of Year</b>	<b>11,664</b>	<b>236,317,733</b>	<b>236,329,397</b>	<b>2,705,633</b>	<b>239,035,030</b>	<b>300,803,421</b>
<b>End of Year (Exh. A-1)</b>	<b>637</b>	<b>238,588,037</b>	<b>238,588,674</b>	<b>1,979,126</b>	<b>240,567,800</b>	<b>239,035,030</b>

**Exhibit A-3**

**COMBINING STATEMENT OF FIDUCIARY NET ASSETS - Agency Funds**  
**Year Ended August 31, 2003**  
 (With Comparative Totals at August 31, 2002)

	Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)	Employee Savings Bond Fund (0901) (U/F 0901)	TexaSaver 401(k) Fund (0946) (U/F 1946)	TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942/8942)	Totals August 31,	
	\$	\$	\$	\$	2003 (Exh. VIII)	2002
<b>ASSETS</b>						
<i>Current Assets:</i>						
<i>Cash and Cash Equivalents:</i>						
Cash in Bank			1,391,668		1,391,668	406,855
Cash in State Treasury		400		212,052	212,452	190,277
Total Cash and Cash Equivalents	-	400	1,391,668	212,052	1,604,120	597,132
Accounts Receivable	13,375				13,375	24,290
Due From Other Funds (Note 5.D)	278				278	-
<b>Total Current Assets</b>	<b>13,653</b>	<b>400</b>	<b>1,391,668</b>	<b>212,052</b>	<b>1,617,773</b>	<b>621,422</b>
<b>Total Assets</b>	<b>13,653</b>	<b>400</b>	<b>1,391,668</b>	<b>212,052</b>	<b>1,617,773</b>	<b>621,422</b>
<b>LIABILITIES</b>						
<i>Current Liabilities:</i>						
Accounts Payable	13,653	400			14,053	25,040
Funds Held For Others			1,391,668	212,052	1,603,720	596,382
<b>Total Current Liabilities</b>	<b>13,653</b>	<b>400</b>	<b>1,391,668</b>	<b>212,052</b>	<b>1,617,773</b>	<b>621,422</b>
<b>Total Liabilities</b>	<b>13,653</b>	<b>400</b>	<b>1,391,668</b>	<b>212,052</b>	<b>1,617,773</b>	<b>621,422</b>
<b>Net Assets</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

**Exhibit A-4**

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES - Agency Funds  
Year Ended August 31, 2003**

	Balances, Beginning	Additions	Deductions	Balances, Ending
	\$	\$	\$	\$(Exh. A-3)
<b>Unappropriated Receipts General Revenue Fund (0001) (UIF 1001)</b>				
<b>ASSETS</b>				
Cash in State Treasury	-	267,840	267,840	-
Accounts Receivable	24,290	213,323	224,238	13,375
Due From Other Funds	-	278	-	278
<b>Total Assets</b>	<b>24,290</b>	<b>481,441</b>	<b>492,078</b>	<b>13,653</b>
<b>LIABILITIES</b>				
Accounts Payable	24,290	343,331	353,968	13,653
<b>Total Liabilities</b>	<b>24,290</b>	<b>343,331</b>	<b>353,968</b>	<b>13,653</b>
<b>Employee Savings Bond Fund (0901) (UIF 0901)</b>				
<b>ASSETS</b>				
Cash in State Treasury	750	6,100	6,450	400
<b>Total Assets</b>	<b>750</b>	<b>6,100</b>	<b>6,450</b>	<b>400</b>
<b>LIABILITIES</b>				
Accounts Payable	750	6,100	6,450	400
Vouchers Payable	-	6,450	6,450	-
<b>Total Liabilities</b>	<b>750</b>	<b>12,550</b>	<b>12,900</b>	<b>400</b>
<b>TexaSaver 401(k) Trust Fund (0946) (UIF 1946)</b>				
<b>ASSETS</b>				
Cash in Bank	406,855	120,548,347	119,563,534	1,391,668
<b>Total Assets</b>	<b>406,855</b>	<b>120,548,347</b>	<b>119,563,534</b>	<b>1,391,668</b>
<b>LIABILITIES</b>				
Funds Held For Others	406,855	120,548,347	119,563,534	1,391,668
<b>Total Liabilities</b>	<b>406,855</b>	<b>120,548,347</b>	<b>119,563,534</b>	<b>1,391,668</b>
<b>TexaSaver 401(k) Hold Transmittal (0942) (UIF 0942 &amp; 8942)</b>				
<b>ASSETS</b>				
Cash in State Treasury	189,527	22,525	-	212,052
<b>Total Assets</b>	<b>189,527</b>	<b>22,525</b>	<b>-</b>	<b>212,052</b>
<b>LIABILITIES</b>				
Funds Held For Others	189,527	22,525	-	212,052
<b>Total Liabilities</b>	<b>189,527</b>	<b>22,525</b>	<b>-</b>	<b>212,052</b>
<b>Totals - All Agency Funds</b>				
<b>ASSETS</b>				
Cash in Bank	406,855	120,548,347	119,563,534	1,391,668
Cash in State Treasury	190,277	296,465	274,290	212,452
Accounts Receivable	24,290	213,323	224,238	13,375
Due From Other Funds	-	278	-	278
<b>Total Assets</b>	<b>621,422</b>	<b>121,058,413</b>	<b>120,062,062</b>	<b>1,617,773</b>
<b>LIABILITIES</b>				
Accounts Payable	25,040	349,431	360,418	14,053
Vouchers Payable	-	6,450	6,450	-
Funds Held For Others	596,382	120,570,872	119,563,534	1,603,720
<b>Total Liabilities</b>	<b>621,422</b>	<b>120,926,753</b>	<b>119,930,402</b>	<b>1,617,773</b>

**Schedule 1**  
**REVENUES, EXPENSES AND CHANGES IN ACCOUNT BALANCES -**  
**EMPLOYEES RETIREMENT FUND**  
**CHANGES IN STATUTORY RESERVES (NON-GAAP PRESENTATION)**  
**Year Ended August 31, 2003**

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2003
	\$	\$	\$	\$	\$	\$
<b><i>Operating Revenues</i></b>						
Contributions to Retirement System:						
Member Contributions	324,000,057					324,000,057
State Contributions		301,555,437				301,555,437
Service Contributions from Teacher Retirement System		28,609,871				28,609,871
Membership Fees					497,073	497,073
Penalty Interest		8,256,933				8,256,933
Investment Income:						
Net Appreciation in Fair Value of Investments				940,441,971		940,441,971
Interest and Dividends				529,629,498		529,629,498
Rental Income					122,056	122,056
Warrants Voided by Statute of Limitations		135,595				135,595
Sale of Surplus Equipment					95,302	95,302
Miscellaneous					1,794	1,794
<b>Total Operating Revenues</b>	<b>324,000,057</b>	<b>338,557,836</b>	<b>-</b>	<b>1,470,071,469</b>	<b>716,225</b>	<b>2,133,345,587</b>
<b><i>Operating Expenses</i></b>						
Retirement System Benefits Paid:						
Retirement Benefits			1,006,198,844			1,006,198,844
Death Benefits:						
Active Members		1,249,356				1,249,356
Retirees		260,885	817,196			1,078,081
Member Contributions Withdrawn	73,437,833					73,437,833
Service Contributions to Teacher Retirement System		4,037,793				4,037,793
Re-Issue Warrants Voided		797				797
Administrative Expenses					26,017,894	26,017,894
Depreciation Expense					800,098	800,098
<b>Total Operating Expenses</b>	<b>73,437,833</b>	<b>5,548,831</b>	<b>1,007,016,040</b>	<b>-</b>	<b>26,817,992</b>	<b>1,112,820,696</b>
<b>Income (Loss) Before Non-Operating Expenses and Operating Transfers</b>	<b>250,562,224</b>	<b>333,009,005</b>	<b>(1,007,016,040)</b>	<b>1,470,071,469</b>	<b>(26,101,767)</b>	<b>1,020,524,891</b>
<b><i>Non-Operating Revenues (Expenses)</i></b>						
Loss on Disposal of Fixed Assets					(180,021)	(180,021)
<b>Income (Loss) Before Operating Transfers</b>	<b>250,562,224</b>	<b>333,009,005</b>	<b>(1,007,016,040)</b>	<b>1,470,071,469</b>	<b>(26,281,788)</b>	<b>1,020,344,870</b>
<b><i>Operating Transfers In (Out)</i></b>						
Distribution of Interest	141,606,272	620,907,937	673,062,270	(1,435,576,479)		-
Interest Paid on Withdrawals	8,162,959			(8,162,959)		-
Establishment of Benefit Reserves	(224,460,881)	(1,523,215,771)	1,747,676,652			-
Member Savings Reinstated	199,488	(199,488)				-
Distribution of Interest for Administrative Expenses				(26,332,031)	26,332,031	-
Benefits Waived		85,580	(85,580)			-
Member Accounts - Escheated	581,200	(581,200)				-
Membership Fees Transferred Out					(493,998)	(493,998)
Excess Benefit Arrangement Transfers					(66,915)	(66,915)
<b>Net Operating Transfers</b>	<b>(73,910,962)</b>	<b>(903,002,942)</b>	<b>2,420,653,342</b>	<b>(1,470,071,469)</b>	<b>25,771,118</b>	<b>(560,913)</b>
<b>Net Income (Loss)</b>	<b>176,651,262</b>	<b>(569,993,937)</b>	<b>1,413,637,302</b>	<b>-</b>	<b>(510,670)</b>	<b>1,019,783,957</b>
<b>Fund Balances - Beginning</b>	<b>3,333,570,553</b>	<b>4,686,395,397</b>	<b>8,427,092,145</b>	<b>-</b>	<b>510,670</b>	<b>16,447,568,765</b>
<b>Fund Balances - Ending</b>	<b>3,510,221,815</b>	<b>4,116,401,460</b>	<b>9,840,729,447</b>	<b>-</b>	<b>-</b>	<b>17,467,352,722</b>



**Schedule 2**  
**REVENUES, EXPENSES AND CHANGES IN ACCOUNT BALANCES -**  
**LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND**  
**CHANGES IN STATUTORY RESERVES (NON-GAAP PRESENTATION)**  
Year Ended August 31, 2003

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2003
	\$	\$	\$	\$	\$	\$
<i><b>Operating Revenues</b></i>						
Investment Income:						
Net Appreciation in Fair Value of Investments				32,000,171		32,000,171
Interest and Dividends				18,200,574		18,200,574
Warrants Voided-Statute of Limitations		2,342				2,342
<b>Total Operating Revenues</b>	-	2,342	-	50,200,745	-	50,203,087
<i><b>Operating Expenses</b></i>						
Retirement System Benefits Paid:						
Retirement Benefits			22,834,139			22,834,139
Administrative Expenses					1,209,345	1,209,345
<b>Total Operating Expenses</b>	-	-	22,834,139	-	1,209,345	24,043,484
<b>Income (Loss) Before Operating Transfers</b>	-	2,342	(22,834,139)	50,200,745	(1,209,345)	26,159,603
<i><b>Operating Transfers In (Out)</b></i>						
Distribution of Interest		33,925,432	15,066,555	(48,991,987)		-
Establishment of Benefit Reserves		(43,266,117)	43,266,117			-
Distribution of Interest for Administrative Expenses				(1,208,758)	1,208,758	-
<b>Net Operating Transfers</b>	-	(9,340,685)	58,332,672	(50,200,745)	1,208,758	-
<b>Net Income (Loss)</b>	-	(9,338,343)	35,498,533	-	(587)	26,159,603
<b>Fund Balances - Beginning</b>	5,275	385,157,606	182,770,572	-	587	567,934,040
<b>Fund Balances - Ending</b>	5,275	375,819,263	218,269,105	-	-	594,093,643

**Schedule 3**  
**REVENUES, EXPENSES AND CHANGES IN ACCOUNT BALANCES -**  
**JUDICIAL RETIREMENT SYSTEM PLAN TWO FUND**  
**CHANGES IN STATUTORY RESERVES (NON-GAAP PRESENTATION)**  
**Year Ended August 31, 2003**

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2003
	\$	\$	\$	\$	\$	\$
<b><u>Operating Revenues</u></b>						
Contributions to Retirement System:						
Member Contributions	3,020,067					3,020,067
State Contributions		8,294,029				8,294,029
Penalty Interest		18,028				18,028
Investment Income:						
Net Appreciation in Fair Value of Investments				6,216,399		6,216,399
Interest and Dividends				3,270,510		3,270,510
<b>Total Operating Revenues</b>	<b>3,020,067</b>	<b>8,312,057</b>	<b>-</b>	<b>9,486,909</b>	<b>-</b>	<b>20,819,033</b>
<b><u>Operating Expenses</u></b>						
Retirement System Benefits Paid:						
Retirement Benefits			2,119,474			2,119,474
Member Contributions Withdrawn	151,691					151,691
Administrative Expenses					327,755	327,755
<b>Total Operating Expenses</b>	<b>151,691</b>	<b>-</b>	<b>2,119,474</b>	<b>-</b>	<b>327,755</b>	<b>2,598,920</b>
<b>Income (Loss) Before Operating Transfers</b>	<b>2,868,376</b>	<b>8,312,057</b>	<b>(2,119,474)</b>	<b>9,486,909</b>	<b>(327,755)</b>	<b>18,220,113</b>
<b><u>Operating Transfers In (Out)</u></b>						
Distribution of Interest	1,001,054	6,901,742	1,223,483	(9,126,279)		-
Interest Paid on Withdrawals	33,237			(33,237)		-
Establishment of Benefit Reserves	(1,749,953)	(9,547,113)	11,297,066			-
Distribution of Interest for Administrative Expenses				(327,393)	327,393	-
<b>Net Operating Transfers</b>	<b>(715,662)</b>	<b>(2,645,371)</b>	<b>12,520,549</b>	<b>(9,486,909)</b>	<b>327,393</b>	<b>-</b>
<b>Net Income (Loss)</b>	<b>2,152,714</b>	<b>5,666,686</b>	<b>10,401,075</b>	<b>-</b>	<b>(362)</b>	<b>18,220,113</b>
<b>Fund Balances - Beginning</b>	<b>27,533,146</b>	<b>55,297,108</b>	<b>14,034,265</b>	<b>-</b>	<b>362</b>	<b>96,864,881</b>
<b>Fund Balances - Ending</b>	<b>29,685,860</b>	<b>60,963,794</b>	<b>24,435,340</b>	<b>-</b>	<b>-</b>	<b>115,084,994</b>

**Schedule 4**

**ADMINISTRATIVE EXPENSES/EXPENDITURES (Excluding Investment Expenses)-  
Statutory Administrative Funds and Accounts  
Year Ended August 31, 2003**

	<u>Totals</u>
	\$
<b><u>PERSONNEL SERVICES</u></b>	
Salaries and Wages	12,176,346
Payroll Related Costs:	
Retirement Contributions	747,726
Retirement Membership Fees	833
Employees Insurance Contributions	1,197,276
Retirees Insurance Contributions	273,827
Social Security Contributions	895,390
Unemployment Compensation	34,822
Total Payroll Related Costs	<u>3,149,874</u>
<b>Total Personnel Services</b>	<b><u>15,326,220</u></b>
<b><u>PROFESSIONAL FEES AND SERVICES</u></b>	
Actuarial Services	752,592
Audit Services	225,100
Medical Board Member Fees	81,500
Architectural Services	54,334
Legal Services	690
Computer Programming Services	1,300,576
Data Processing Services	126,230
Other Professional Services	128,911
<b>Total Professional Fees and Services</b>	<b><u>2,669,933</u></b>
<b><u>OTHER SERVICES AND CHARGES</u></b>	
Travel	82,006
Materials & Supplies:	
Postage	808,727
General Office and Other Supplies	209,960
Subscriptions	29,253
Furniture and Equipment	219,440
Computer Software	140,728
Total Materials & Supplies	<u>1,408,108</u>
Communications & Utilities:	
Electricity, Gas and Water	269,261
Telephone and Telegraph	401,462
Electronic Communications Services	37,044
Total Communications & Utilities	<u>707,767</u>
Repairs & Maintenance:	
Land and Building	114,587
Furniture and Equipment	11,196
Computer Software and Equipment	1,055,065
Total Repairs & Maintenance	<u>1,180,848</u>
Rentals & Leases:	
Computer Software and Equipment	995,314
Office Equipment	290,304
Space	29,324
Total Rentals & Leases	<u>1,314,942</u>
Printing & Reproduction Services	182,730
Depreciation	800,098

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## Schedule 4

### ADMINISTRATIVE EXPENSES/EXPENDITURES (Excluding Investment Expenses)- Statutory Administrative Funds and Accounts Year Ended August 31, 2003 (Concluded)

	<b>Totals</b>
	\$
<b><u>OTHER SERVICES AND CHARGES (continued)</u></b>	
Other Operating Expenses/Expenditures:	
Membership Fees	23,890
Employee Training	106,153
Insurance - Building	22,722
Employee Bonds - Notary	100
Fees and Other Charges	32,048
Tenure Awards	877
Witness Fees	300
Temporary Employment Agencies	188,304
Cleaning Services	83,308
Advertising Services	26,040
Freight/Delivery Services	7,531
Purchased Contracted Services	472,587
Credit Card Purchases Less Than \$5,000	14
Prompt Payment Interest	158
Claims & Judgments	12,306
Third Party Administrator Fee - State Employees Cafeteria Plan	750,774
Total Other Operating Expenses/Expenditures	1,727,112
<b>Total Other Services and Charges</b>	<b>7,403,611</b>
<b>Total Expenses/Expenditures-Non-Investment Administrative</b>	<b>25,399,764</b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	12,364,102
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)	700,262
Judicial Retirement System Plan One Fund (0001)	120,000
Judicial Retirement System Plan Two Trust Fund (0993)	244,708
Texasaver 401(k) Trust Fund (0946)	356,810
Texasaver 457 Trust Fund (0945)	452,804
State Employees Cafeteria Plan Trust Fund (0943)	1,233,703
<b>Total Fiduciary Funds</b>	<b>15,472,389</b>
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)	9,860,768
<b>Total Proprietary Fund</b>	<b>9,860,768</b>
Social Security Administration Trust Account (0929)	38,607
Death Benefits for Certain Law Enforce. Officers, Fire Fighters and Others (0001)	28,000
<b>Total Governmental Funds</b>	<b>66,607</b>
<b>Total Method of Finance</b>	<b>25,399,764</b>

**Schedule 5**  
**PROFESSIONAL AND CONSULTING FEES**  
**Year Ended August 31, 2003**

Name	Service Rendered	Totals
<b>Professional/Consulting Fees:</b>		<b>\$</b>
Albert A. LaLonde, M.D.	Medical Board Member	28,500
Grover L. Bynum, M.D.	Medical Board Member	28,500
Thomas I. Lowry, M.D.	Medical Board Member	24,500
Bob Alley, CFA	Investment Consulting	2,525
C. Courtland Huber, Ph.D.	Investment Consulting	4,463
C. Thomas Tull, CFA	Investment Consulting	4,449
Callan Associates, Inc.	Investment Consulting	131,238
I. Craig Hester, CFA	Investment Consulting	2,400
J. Luther King, Jr., CFA	Investment Consulting	1,600
Laura T. Starks, Ph.D.	Investment Consulting	2,407
Vernon D. Torgerson, Jr., CFA	Investment Consulting	2,719
AIG Global Investors Group	Investment Advisors	517,500
Alliance Capital Management LP	Investment Advisors	1,186,641
American General Investment Management	Investment Advisors	172,500
BNY Asset Management	Investment Advisors	250,000
Batterymarch Financial Management, Inc.	Investment Advisors	757,585
Dresdner RCM Global Investors, L.L.C.	Investment Advisors	266,096
DuPont Capital Management	Investment Advisors	900,000
Earnest Partners	Investment Advisors	1,005,495
Fountain Capital Management	Investment Advisors	745,000
Montag & Caldwell, Inc.	Investment Advisors	750,242
Putnam Advisory Company	Investment Advisors	2,458,333
Templeton Investment Counsel	Investment Advisors	1,645,833
Rudd and Wisdom, Inc.	Actuarial Services	364,863
Towers Perrin	Actuarial Services	387,729
Allied Consultants, Inc.	Computer Programs Svcs	681,340
Authoria, Inc.	Computer Programs Svcs	53,254
Data Communications Corp.	Computer Programs Svcs	147,860
DDM, Inc.	Computer Programs Svcs	4,680
eVerge Group of Texas Ltd.	Computer Programs Svcs	154,988
IBM Corporation	Computer Programs Svcs	10,182
Mastech Emplifi	Computer Programs Svcs	9,000
Oxford Global Resources	Computer Programs Svcs	130,638
RFD & Associates, Inc.	Computer Programs Svcs	27,650
Shi Government Solutions	Computer Programs Svcs	69,366
Thomson Financial Software Solutions	Computer Programs Svcs	10,324
Workspace, Inc.	Computer Programs Svcs	1,294
CDCI	Data Processing Services	126,230
Deloitte & Touche, LLP	Financial Audit Fees	71,100
Sagebrush Solutions, Inc.	Insurance Carrier Audit Fees	154,000
Financial Concepts and Applications	Educational Services	1,000
Linda Haines Associates	Educational Services	8,700
Microassist, Inc.	Educational Services	13,370
MicroMain Corporation	Educational Services	2,795
Mike Scott and Associates	Educational Services	14,700
Shi Government Solutions	Educational Services	9,801
Team Performance	Educational Services	2,355
Boon-Chapman Benefit Administrators, Inc.	Other Services	44,000
Cost Effectiveness Management, Inc.	Other Services	25,000
Sandra L. Cochrun	Other Services	300
Tommie Pepper, R.N., C.O.H.N.	Other Services	200
Video Call Company	Other Services	3,000
Workers Assistance Program, Inc.	Other Services	3,690
Waugh Engineering, Inc.	Architectural Services	54,334
Barton Law Office	Legal Services	690
<b>Total Professional/Consulting Fees</b>		<b><u>13,476,959</u></b>
<b>Method of Finance:</b>		
State Employees Retirement System (S.E.R.S.) Trust Account (0955)		12,012,203
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)		454,149
Judicial Retirement System Plan Two Trust Fund (0993)		92,866
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)		753,467
State Employees Cafeteria Plan Trust Fund (0943)		9,062
Texasaver 457 Trust Fund (0945)		2,312
Texasaver 401 (k) Trust Fund (0946)		4,713
Social Security Administration Fund (0929)		187
Death Benefits for Certain Law Enforce. Officers, Fire Fighters and Others (0001)		28,000
Judicial Retirement System Plan One Fund (0001)		120,000
<b>Total Method of Finance</b>		<b><u>13,476,959</u></b>

**Schedule 6**  
**INVESTMENT EXPENSES**  
Year Ended August 31, 2003

	<b>Totals</b>
	<b>\$</b>
<b><u>PERSONNEL SERVICES</u></b>	
Salaries and Wages	2,217,674
Payroll Related Costs:	
Retirement Contributions	119,556
Retirement Membership Fees	96
Employees Insurance Contributions	145,088
Social Security Contributions	137,931
Total Payroll Related Costs	402,671
<b>Total Personnel Services</b>	<b>2,620,345</b>
<b><u>PROFESSIONAL FEES AND SERVICES</u></b>	
Investment Consulting Fees	151,801
Investment Advisory Fees	10,655,225
<b>Total Professional Fees and Services</b>	<b>10,807,026</b>
<b><u>OTHER SERVICES AND CHARGES</u></b>	
Travel	27,434
Materials & Supplies:	
General Office and Other Supplies	208
Subscriptions	4,333
Furniture and Equipment	7,543
Total Materials & Supplies	12,084
Communications & Utilities:	
Electronic Communications Services	1,169,361
Other Operating Expenses:	
Membership Fees	26,336
Employee Training	3,358
Fees and Other Charges	2,739
Investment Banking	408,314
Temporary Employment Agencies	34,383
Total Other Operating Expenses	475,130
<b>Total Other Services and Charges</b>	<b>1,684,009</b>
<b>Total Investment Expenses</b>	<b>15,111,380</b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	14,453,890
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)	509,083
Judicial Retirement System Plan Two Trust Fund (0993)	83,047
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)	65,360
<b>Total Method of Finance</b>	<b>15,111,380</b>

# INVESTMENT

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## SECTION

*Unaudited*

Report on Investment Activity

Outline of Investment Policies

Time-Weighted Rates of Return and Asset Allocations

List of Largest Assets Held

Schedule of Fees and Commissions

Investment Revenues

Investment Summary at Fair Value –  
Pooled Pension Trust Funds

# REPORT ON INVESTMENT ACTIVITY – FISCAL YEAR 2003

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## OVERVIEW

The Employees Retirement System of Texas (System) investment portfolio closed the fiscal year with a fair value of \$18.1 billion, and returned 9.2% for the year. The fiscal year-end asset allocation stood at 35.10% investment grade bonds, 4.00% high yield bonds, 37.64% large cap domestic equity, 4.41% small cap domestic equity and 18.42% international equity. Not reflected in the asset allocation mix is the \$100 million commitment to the Texas Growth Fund. The Texas Growth Fund is a private equity fund that pursues a focused, niche investment strategy targeting Texas as a region.

Major accomplishments for the investment program this fiscal year included the Board's selection of three advisors to the active international equity mandate, which included exposure to the emerging markets, completion of the new trade order management system implementation, and development of a quantitative screening process in the internal domestic equity portfolios. Staff also continued to update its software tools to improve the overall efficiency of the investment program.

The investment portfolio's total return was positive for the first time in two fiscal years, reflecting the rebound in the domestic equity markets in July and August. Over the longer term, the fund returned 7.18% for the 10 years ending August 31, 2003 slightly besting the policy benchmark of 7.13%. This long-term annual return is within an acceptable range of the actuarially assumed rate of return of 8.0%. Of the five asset classes in which the System invests, only international equity was unable to outperform its benchmark over the 10-year period.

## MARKET PERFORMANCE

### Domestic Equity Market

For the fiscal year ended August 31, 2003, the S&P 500 Index returned 12%, while the S&P 600 Small Cap Index returned 23%. These gains were a welcome reversal after two consecutive down years and a bear market that reduced the S&P 500 Index by 50%. Although the S&P 500 is still 35% below its peak value, the S&P 600 Small Cap Index has performed much

better and is trading only 6% below its peak value. Operating earnings for the S&P 500 is expected to increase 14% in calendar 2003 to \$53 per share. This is just \$3 below the peak earnings in the year 2000 and provides some evidence that the market is not significantly over-extended at this time. The key factors impacting the domestic equity markets over the last year have been the stimulative impact of tax cuts, budget deficits and record low interest rates, offset by excess capacity in many industries, high private sector debt levels and the political uncertainty surrounding the Iraq war. The best performing sectors in the S&P 500 were technology and consumer discretionary. The worst performing sectors were consumer staples and utilities.

### International Equity Market

International equity markets rose modestly in local currency terms in fiscal 2003 with the Morgan Stanley Capital International EAFE Free Index returning 2.36% for the period. The Pacific ex-Japan area gained most in local terms with Hong Kong up 16.86% and Australia up 4.74%. Pan-Europe lagged, with stock prices remaining nearly flat in local currency.

For U.S. dollar-based investors, a weakening dollar against most major currencies boosted total returns from EAFE to 9.11% for the fiscal year. In particular, the U.S. dollar fell 11.5% against the Euro as the Euro re-rated against world currencies on better economic forecasts from Europe.

On a sector basis, consumer cyclical and industrial cyclical stocks performed best, while consumer staple and utility stocks were weakest.

### Fixed Income Market

Interest rates exhibited two distinct patterns of movement for the year. During the first eight months, interest rates moved in a relatively narrow 60 basis point range. The only noteworthy event during this time period was the conflict in Iraq. In the second part of the year, the fixed income markets began to focus on the views of the Federal Reserve and on the fundamentals of the economy. As the Federal Reserve began to express concern over deflation and committed



– Unaudited –

to use all means necessary to fight such an environment, the fixed income markets reacted strongly driving yields to new cycle lows. This was followed by fresh evidence of rebounding economic growth. The fixed income markets quickly reversed course and rates moved dramatically higher in an exceptionally short period of time, setting new cycle high rates two months after setting cycle lows. The end result of the Fed's attention to avoiding deflation and stronger economic

growth was a steeper and higher yielding curve at the end of the fiscal year. The Lehman Brothers Aggregate Bond Index returned 4.36% for the fiscal year with the best performing sector corporate bonds, which returned 9.33%. The rapid reversal of interest rate movements in June, July and August hurt the performance of the U.S. Treasury, Agency and Mortgage sectors.

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## KEY PORTFOLIO STATISTICS

	<u>2003</u>	<u>2002</u>
◆ Contributions to Pool	\$594,800,000	\$609,800,000
◆ Withdrawals from Pool	(\$1,053,400,000)	(\$975,236,000)
◆ Interest & Dividends	\$543,546,032	\$550,475,923
◆ Securities Lending Income	\$7,554,550	\$7,247,994
◆ Net Appreciation/(Depreciation) in Fair Value	978,658,541	(\$1,869,518,933)

*Prepared by:*

Chief Investment Officer and Finance & Administration staff of the System.

*Basis of Presentation:*

Master Custodian Records in accordance with the Association for Investment Management and Research (AIMR) Standard, and the System's Financial Records.

# OUTLINE OF INVESTMENT POLICIES

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## Background

The Board of Trustees' investment policies are governed by the Texas Trust Code and the Texas State Constitution. As fiduciaries of the System's funds, the Board of Trustees practices the following duties of care:

- ◆ Manage the assets for the exclusive benefit of the members of the retirement plans;
- ◆ Establish prudent investment policies defining investment objectives and strategies;
- ◆ Seek to maximize return while maintaining the safety of principal;
- ◆ Diversify the assets to reduce risk of loss;
- ◆ Monitor and document investment performance; and
- ◆ Efficiently manage the costs associated with implementation of its investment program.

Investments shall be made exercising the judgment and care, under the circumstances prevailing at the time of investment, that persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in speculation, but when making a permanent disposition of their funds, considering the probable income from the disposition and the probable safety of their capital.

A staff of trained professional personnel in accordance with Trustee policies and Constitutional and Statutory regulations invests State contributions, member contributions, and investment income. To assist the staff with investment recommendations and decisions, the Trustees have employed nationally recognized investment managers and have appointed an Investment Advisory Committee composed of prominent members of the financial and business community of Texas. Also, the System retains an independent consultant to evaluate and analyze the investment results of the System.

## Diversification

- ◆ Investments in the securities of any one corporation may not exceed 3% of the market value of the total fund.
- ◆ Investments in the stock of any one corporation may not exceed 1.5% of the market value of the total fund.
- ◆ Investments in the stock of any one corporation may not exceed 5% of the voting stock of that corporation.

- ◆ Investments in the Texas Growth Fund may not exceed 1% of the market value of the total fund.
- ◆ Investments in non-cash interest paying securities in the high yield bond portfolios may not exceed 15% of the market value of the portfolio.
- ◆ Investments in money market funds may represent no more than 5% of each individual fund.

## Permissible Investments

The Board of Trustees will consider investment instruments appropriate for the System and deemed to be prudent based on:

- ◆ Their consistency with investment policy and portfolio objectives;
- ◆ Their application to the portfolio's diversification;
- ◆ Staff and/or advisor competency in evaluating and trading the securities;
- ◆ Consideration of their liquidity within the portfolio; and
- ◆ The cost of including them in the program.

Eligible securities are as follows:

- ◆ Domestic equities, screened to eliminate against any known bankruptcy proceedings, lawsuits or breach of corporate ethics that might jeopardize the company's economic future or existence;
- ◆ Equities of companies domiciled in countries outside of the United States; and
- ◆ U.S. dollar denominated fixed income and short term securities including both publicly-traded and those issued pursuant to the Securities and Exchange Commission's Rule 144A.

## Proxies and Bond Indenture Changes

All proxies and proposals for bond indenture changes involving companies whose securities are owned by the Fund shall be voted in such a way as to give the most benefit to the participants of the Fund and be consistent with the stated goals and objectives of the Fund.

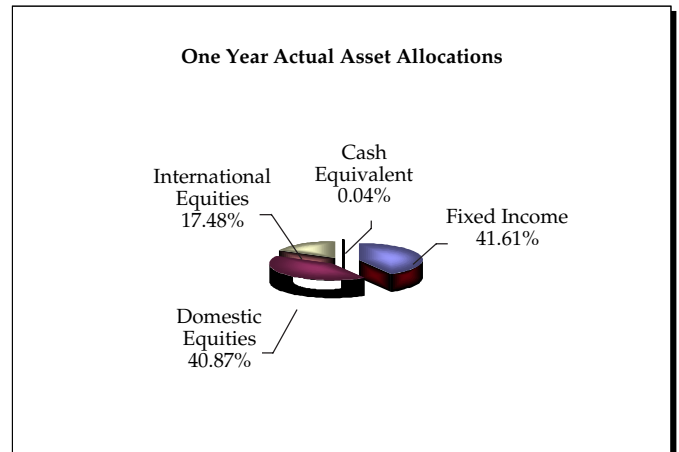
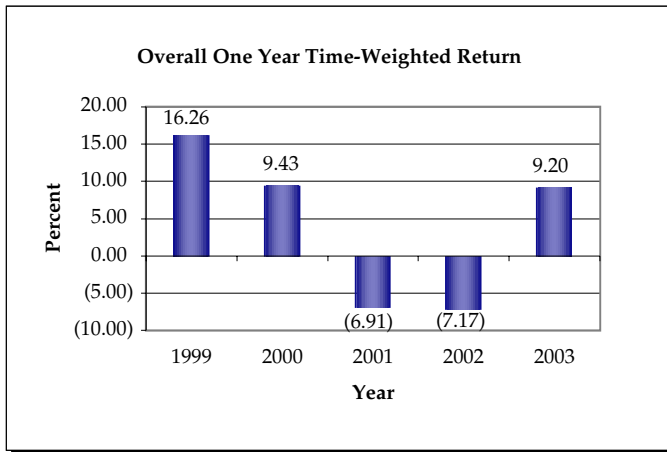
*Basis of Presentation:* Texas Statute and ERS Investment Policy

- Unaudited -

**TIME-WEIGHTED RATES OF RETURN AND ASSET ALLOCATIONS**  
**Pension Investment Pool Trust Fund (Note A)**  
As of August 31, 2003

	Time-Weighted Rates of Return									
	Fixed Income Securities		Domestic Equities		International Equities		Cash Equivalent		ERS	
	ERS	Index	ERS	Index	ERS	Index	ERS	Index	Overall	CPI
1 Year	%	%	%	%	%	%	%	%	%	%
1999	1.12	0.80	39.43	39.90	23.44	25.57	5.92	4.71	<b>16.26</b>	2.33
2000	7.49	7.55	12.81	16.32	10.01	9.53	6.38	5.04	<b>9.43</b>	3.47
2001	11.80	12.36	(16.61)	(24.39)	(24.25)	(24.28)	5.75	5.55	<b>(6.91)</b>	2.76
2002	6.17	8.11	(15.37)	(17.99)	(19.28)	(14.95)	2.29	2.27	<b>(7.17)</b>	1.58
2003	6.50	4.36	11.90	12.07	5.96	9.11	1.42	1.38	<b>9.20</b>	1.88
3 Year (2001-2003)	8.13	8.23	(7.57)	(11.43)	(13.47)	(11.10)	2.91	3.05	<b>(1.92)</b>	2.13
5 Year (1999-2003)	6.56	6.56	4.43	2.48	(2.53)	(0.68)	4.09	3.86	<b>3.72</b>	2.41

	Asset Allocations					
	1-Year		3-Year		5-Year	
	Target	Actual	Target	Actual	Target	Actual
Fixed Income	41.00	41.61	41.00	42.34	42.51	44.17
Domestic Equities	41.00	40.87	41.00	40.45	40.42	40.22
International Equities	18.00	17.48	18.00	17.17	17.07	15.52
Cash Equivalent	0.00	0.04	0.00	0.04	0.00	0.09
Total	100.00	100.00	100.00	100.00	100.00	100.00



Note A: The Time-Weighted Rate of Return measures the performance of the total investment portfolio, considering income and market impact, including realized and unrealized gains, and eliminates the effect of timing of cash flows due to contributions and withdrawals which are not controllable by investment managers. The 5-year return is used to smooth market swings and to maintain consistency with the long-term nature of the fund. The Time-Weighted Rate of Return is calculated as follows:

$$\frac{\text{Ending Market Value} - \text{Beginning Market Value} - \text{Purchases} + \text{Income Received} + \text{Sales} - \text{Contributions} + \text{Withdrawals}}{\text{Beginning Market Value} + 1/2(\text{Purchases} - \text{Sales} + \text{Contributions} - \text{Withdrawals})}$$

The indices used for comparison are as follows:

Fixed Income Securities Portfolio:	Lehman Aggregate Index
Domestic Equities Portfolio:	S & P 500 Index
International Equities Portfolio:	EAFE Free Index (i.e., Europe, Australia and Far East Index excluding securities unavailable to foreign investors)
Cash Equivalents Portfolio:	90-Day U.S. Treasury Bill

Basis of Presentation: Master Custodian Records in accordance with the Association for Investment Management and Research (AIMR) Standard.

– Unaudited –

**LIST OF LARGEST ASSETS HELD (NOTE A)**  
As of August 31, 2003

**Ten Largest Stock Holdings**

<b># of Shares</b>	<b>Description</b>	<b>Fair Value</b>
		\$
6,943,200	Pfizer, Inc.	208,782,024
7,692,548	Microsoft Corporation	204,006,373
3,987,101	Citigroup, Inc.	172,840,828
5,408,200	General Electric Co.	159,920,474
2,480,500	Wal Mart Stores, Inc.	146,771,185
3,866,344	Exxon Mobil Corporation	146,727,755
2,177,055	American International Group, Inc.	129,687,166
2,542,700	Johnson & Johnson	126,677,314
1,257,500	Procter & Gamble Co.	109,767,175
3,287,600	Intel Corporation	109,504,530

**Ten Largest Fixed Income Security Holdings**

<b>Par Value</b>	<b>Description</b>	<b>Fair Value</b>
\$		\$
669,286,474	Merrill Lynch Premier Institutional Fund, Rating NR	670,256,704
500,000,000	Financial Square Prime Obligations Fund, Rating NR	500,050,615
200,000,000	Treasury Inflation Index N/B 3.875% due on 04/15/2029, Rating AAA	271,999,889
138,000,000	U.S. Treasury Note 5.75% due on 08/15/2010, Rating AAA	152,964,375
150,000,000	FNCI 5% September TBA due on 09/25/2016, Rating NR	150,515,700
140,000,000	Federal Home Loan Bank 4.875% due on 05/15/2007, Rating AAA	149,709,583
135,000,000	Freddie Mac 2.75% due on 08/15/2006, Rating AAA	134,869,688
100,000,000	Treasury Inflation Index N/B 4.25% due on 01/15/2010, Rating AAA	125,606,029
115,000,000	U.S. Treasury Note 3% due on 11/15/2007, Rating AAA	115,437,500
100,000,000	Federal Home Loan Bank 3.875% due on 08/22/2008, Rating AAA	99,909,375

Note A: The investment portfolio listing is available for review at the System's office or the listing will be mailed upon request.

Basis of Presentation:  
System's Subsidiary Records in accordance with the Association for Investment Management and Research (AIMR) Standard.

- Unaudited -

## SCHEDULE OF FEES AND COMMISSIONS

### For the Fiscal Year Ended August 31, 2003

INVESTMENT ADVISORY FEES				DOMESTIC EQUITY COMMISSIONS			
	Assets Under Advisory Management	Fees	Basis Point	Brokerage Firm	No. of Shares Traded	Commissions	Commission Per Share
Fixed Income Advisors	\$ 724,171,563	\$ 1,435,000	0.1982%	A.G. Edwards	100,000	\$ 5,000	0.050
Domestic Equity Advisors	2,729,658,635	3,949,963	0.1447%	Bank Of America	8,821,931	287,656	0.033
International Equity Advisors	2,019,623,478	5,270,262	0.2610%	Bear Stearns	9,978,723	316,978	0.032
<b>Total</b>	<b>5,473,453,676</b>	<b>10,655,225</b>	<b>0.1947%</b>	Blaylock & Partners, LP	861,500	43,075	0.050
				Bloomberg Tradebook - ESI Securities	7,572,511	151,452	0.020
				BOE Securities, Inc.	598,500	29,925	0.050
				Capital Institutional Services, Inc.	661,700	33,085	0.050
				CIBC World Markets - Oppenheimer	862,700	43,135	0.050
				Citigroup Global Markets, Inc.	1,923,425	55,463	0.029
				Deutsche Bank Securities	7,699,145	160,639	0.021
				First Boston	11,383,511	292,043	0.026
				Fox-Pitt Kelton, Inc.	879,900	43,995	0.050
				Goldman Sachs	10,597,811	372,574	0.035
				GRW Capital Corp.	326,300	16,315	0.050
				ITG	11,933,035	235,162	0.020
				J.P. Morgan	3,128,977	125,248	0.040
				Jefferies & Co.	2,119,742	95,618	0.045
				Keefe, Bruyette & Woods	333,700	21,035	0.063
				Lehman Brothers	7,549,555	174,407	0.023
				M. Ramsey King	200,000	10,000	0.050
				Merrill Lynch	3,918,445	116,027	0.030
				Morgan Stanley Dean Witter	2,447,843	110,858	0.045
				Off The Record Research	1,426,400	70,320	0.049
				Prudential Securities	4,531,670	204,904	0.045
				Raymond James & Associates	1,787,000	87,350	0.049
				Robert W. Baird & Co.	1,152,400	57,620	0.050
				Sanford Bernstein	3,048,537	152,427	0.050
				Score Securities, Inc.	459,900	22,995	0.050
				SG Cowen Securities Corp.	1,277,700	63,885	0.050
				Southwest Securities	875,900	43,795	0.050
				UBS Securities	7,343,351	149,866	0.020
				Weeden & Co.	5,089,463	116,595	0.023
				Williams Capital Group	1,149,100	57,455	0.050
				<b>Total</b>	<b>122,040,375</b>	<b>3,766,902</b>	<b>0.031</b>
OTHER INVESTMENT SERVICE FEES							
Custodian Fees			\$ 300,000				
Security Lending Agent Fees			2,752,178				
Investment Consultant Fees			151,801				
<b>Total</b>			<b>3,203,979</b>				
DIRECTED COMMISSIONS							
<p>Consistent with the System's Investment Policy as adopted by the Board of Trustees, and in order to maximize the System's resources including commission dollars generated through trade activity, directed commissions are sometimes used to fund a portion of budgeted investment program expenses. Trade activity in excess of the level required to support research products used by the System investment staff is directed toward the payment of budgeted items.</p>							

#### INTERNATIONAL EQUITY COMMISSIONS

Brokerage Firm	No. of Shares Traded	Principal	Commissions	Commission per Principal %
Banque Paribas	10,846,400	\$ 100,629,832	\$ 268,835	0.267
Bear Stearns	2,245,776	11,501,359	25,100	0.218
Citigroup Global Markets, Inc.	146,645,088	1,292,085,207	509,710	0.039
Credit Lyonnais Securities (USA), Inc.	2,313,900	23,798,402	72,325	0.304
Credit Suisse First Boston Corp.	16,568,683	170,662,146	339,890	0.199
Deutsche Bank Securities	3,376,164	75,336,966	105,252	0.140
Dresdnerkleinwort Benson Na LLC	29,059,433	207,566,143	173,745	0.084
First Boston	100,050	3,277,345	4,918	0.150
Goldman Sachs	92,765,493	1,623,796,039	711,168	0.044
HSBC, Inc.	10,662,600	82,479,225	155,295	0.188
J.P. Morgan	6,328,800	42,700,702	82,907	0.194
JB Were & Son	3,708,413	18,874,918	66,063	0.350
Jefferies & Co.	2,360,000	8,381,658	30,681	0.366
Lehman Brothers	125,223,023	1,020,815,838	679,363	0.067
Merrill Lynch	23,962,203	211,052,274	316,578	0.150
Mitsubishi Securities- Japan	962,700	5,471,099	10,942	0.200
Morgan Stanley Dean Witter	190,500	2,229,824	0	0.000
Nomura Securities	10,167,885	52,361,997	150,745	0.288
<b>Total</b>	<b>487,487,111</b>	<b>4,953,020,974</b>	<b>3,703,517</b>	<b>0.075</b>

Basis of Presentation: Master Custodian and System's Subsidiary Records in accordance with the Association for Investment Management and Research (AIMR) Standard.

- Unaudited -

## INVESTMENT REVENUES

Year Ended August 31, 2003

(With Comparative Totals for the Year Ended August 31, 2002)

	Pooled Pension Trust Funds (Note A)	
	August 31,	
	2003	2002
<b>Interest On:</b>	\$	\$
Deposits in State Treasury	1,406,258	2,096,648
Commercial Paper	261,094	5,770,484
Short-Term Investment Fund	1,176,505	2,893,746
Money Market Mutual Funds	19,466,728	30,635,613
Promissory Note	312,780	1,826,951
Certificate of Deposits		556,660
U.S. Treasury Bonds	46,734,169	27,843,512
Other Government Securities	34,660,055	51,191,654
Mortgage Pass-Thru Securities	62,011,660	42,416,366
Collateralized Mortgage Obligations	121,975	4,141,352
Asset Backed Securities	10,607,210	20,925,679
Commercial Mortgage Backed Securities	10,305,580	24,301,028
Corporate Bonds	159,568,323	183,423,775
<b>Total Interest</b>	<b>346,632,337</b>	<b>398,023,468</b>
<b>Dividends On:</b>		
Domestic Equities	118,791,899	102,436,187
Texas Growth Fund	196,264	243,090
International Equities	77,925,532	49,773,177
<b>Total Dividends</b>	<b>196,913,695</b>	<b>152,452,454</b>
<b>Net Securities Lending Income</b>	<b>7,554,550</b>	<b>7,247,994</b>
<b>Net Appreciation (Depreciation) In Fair Value of:</b>		
Commercial Paper	(105,381)	(1,716,506)
Short-Term Investment Fund	(32,892)	55,361
Money Market Mutual Funds	(1,651,855)	2,599,765
Promissory Note	(1,136)	61,300
Certificates of Deposit		(253,210)
U.S. Treasury Bonds	(7,672,999)	84,818,074
Other Government Securities	7,970,628	112,443,353
Mortgage Pass-Thru Securities	(11,773,409)	93,948,426
Collateralized Mortgage Obligations	(800,387)	437,246
Asset Backed Securities	(2,473,103)	8,777,206
Commercial Mortgage Backed Securities	(6,102,871)	9,047,770
Corporate Bonds	115,084,327	(228,553,208)
Domestic Equities	740,475,554	(1,244,555,273)
International Equities	145,742,065	(706,629,237)
<b>Total Appreciation (Depreciation)</b>	<b>978,658,541</b>	<b>(1,869,518,933)</b>
<b>Total Investment Revenue</b>	<b>1,529,759,123</b>	<b>(1,311,795,017)</b>

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- Unaudited -

**INVESTMENT REVENUES**  
**Year Ended August 31, 2003**  
(With Comparative Totals for the Year Ended August 31, 2002)  
(Concluded)

	<u>State Employees Cafeteria Plan Trust Fund (0943)</u>		<u>Employees Life, Accident and Health Insurance and Benefits Fund (0973)</u>		<u>TexaSaver 457 Trust Fund (0945)</u>	
	August 31,		August 31,		August 31,	
	2003	2002	2003	2002	2003	2002
<b>Interest On:</b>	\$	\$	\$	\$	\$	\$
Deposits in Local Banks					1,011,200	1,551,424
Deposits in State Treasury	65,019	120,492	873,753	1,339,685	21,818	38,874
Short-Term Investment Fund			126,597	800,121		
Money Market Mutual Funds			1,093,766	2,764,419		
U.S. Treasury Bond			774,375	243,750		
Other Government Securities			715,000	504,722		
Mortgage Pass-Thru Securities			477,615	485,678		
Collateralized Mortgage Obligations				75,000		
Asset Backed Securities			245,096	350,948		
Commercial Mortgage Backed Securities			418,360	202,433		
Corporate Bonds			7,102,908	4,611,933		
Annuities					5,044,391	(5,661,923)
<b>Total Interest</b>	<u>65,019</u>	<u>120,492</u>	<u>11,827,470</u>	<u>11,378,689</u>	<u>6,077,409</u>	<u>(4,071,625)</u>
<b>Dividends On:</b>						
Equity Securities					1,167,446	(5,923,191)
<b>Total Dividends</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,167,446</u>	<u>(5,923,191)</u>
<b>Net Securities Lending Income</b>			<b>102,055</b>	<b>43,409</b>		
<b>Net Appreciation (Depreciation) In Fair Value of:</b>						
Short-Term Investment Fund			2,862			
Money Market Fund			72,935			
U.S. Treasury Bond			(1,308,947)	235,818		
Other Government Securities			(151,875)	1,147,659		
Mortgage Pass-Thru Securities			(1,129,704)	106,486		
Collateralized Mortgage Obligations				51,421		
Asset Backed Securities			(11,822)	(9,011)		
Commercial Mortgage Backed Securities			28,607	224,684		
Corporate Bonds			3,447,124	797,668		
Annuities					3,545,642	(9,755,233)
Equity Securities					7,550,220	(29,008,720)
<b>Total Appreciation (Depreciation)</b>	<u>-</u>	<u>-</u>	<u>949,180</u>	<u>2,554,725</u>	<u>11,095,862</u>	<u>(38,763,953)</u>
<b>Total Investment Revenue</b>	<u>65,019</u>	<u>120,492</u>	<u>12,878,705</u>	<u>13,976,823</u>	<u>18,340,717</u>	<u>(48,758,769)</u>

Note A: The Pooled Pension Trust Funds category includes the Employees Retirement Fund, the Law Enforcement and Custodial Officer Supplemental Retirement Fund, and the Judicial Retirement Plan Two Fund. The Pension Investment Pool Trust Fund was established effective February 1, 1994.

Basis of Presentation: System's Financial Records.

– Unaudited –

**INVESTMENT SUMMARY AT FAIR VALUE  
POOLED PENSION TRUST FUNDS  
Year Ended August 31, 2003**

Type of Investment	Pooled Funds (Note A)			Investment Pool	
	Fund 0955	Fund 0977	Fund 0993	Fair Value	% Total
	\$	\$	\$	\$	
<b>Long-Term Fixed Securities:</b>					
U.S. Treasury Bonds	1,246,423,011	42,537,180	8,162,619	1,297,122,810	6.788280%
Other Government Securities	789,940,634	26,958,622	5,173,191	822,072,447	4.302181%
Mortgage Pass-Thru Securities	1,979,651,882	67,560,370	12,964,423	2,060,176,675	10.781597%
Collateralized Mortgage Obligations	48,012,338	1,638,536	314,425	49,965,299	0.261485%
Asset Backed Securities	156,078,311	5,326,548	1,022,130	162,426,989	0.850035%
Commercial Mortgage Backed Securities	197,212,374	6,730,347	1,291,510	205,234,231	1.074060%
Corporate Bonds	2,439,742,543	83,262,083	15,977,463	2,538,982,089	13.287346%
<b>Total Long-Term Fixed Securities</b>	<b>6,857,061,093</b>	<b>234,013,686</b>	<b>44,905,761</b>	<b>7,135,980,540</b>	<b>37.344984%</b>
<b>Equities:</b>					
Domestic Equities	7,208,743,108	246,015,592	47,208,981	7,501,967,681	39.260318%
Texas Growth Fund	66,676,831	2,275,506	436,656	69,388,993	0.363136%
International Equities	3,146,930,426	107,396,496	20,608,813	3,274,935,735	17.138839%
<b>Total Equities</b>	<b>10,422,350,365</b>	<b>355,687,594</b>	<b>68,254,450</b>	<b>10,846,292,409</b>	<b>56.762293%</b>
<b>Cash Equivalents:</b>					
Cash in State Treasury-Investment Pool	110,713	3,778	726	115,217	0.000603%
Short Term Investment Fund	4,526,298	154,471	29,642	4,710,411	0.024651%
Money Market Mutual Funds	1,077,349,396	36,767,166	7,055,346	1,121,171,908	5.867469%
<b>Total Cash Equivalents</b>	<b>1,081,986,407</b>	<b>36,925,415</b>	<b>7,085,714</b>	<b>1,125,997,536</b>	<b>5.892723%</b>
<b>Total Before Securities Lending Collateral (Notes B &amp; C)</b>	<b>18,361,397,865</b>	<b>626,626,695</b>	<b>120,245,925</b>	<b>19,108,270,485</b>	<b>100.000000%</b>
Securities Lending Collateral	2,419,997,247	82,697,422	15,707,095	2,518,401,764	
<b>Total Pension Investment Pool Trust Fund (0888)</b>	<b>20,781,395,112</b>	<b>709,324,117</b>	<b>135,953,020</b>	<b>21,626,672,249</b>	
<b>Cash Equivalents:</b>					
Cash in State Treasury-Pension Funds	24,114,285	528,819	247,057		
<b>Total Investments</b>	<b>20,805,509,397</b>	<b>709,852,936</b>	<b>136,200,077</b>		
<b>Percent Ownership in Investment Pool</b>	<b>96.09%</b>	<b>3.28%</b>	<b>0.63%</b>	<b>100.00%</b>	

Note A: The Pension Investment Pool Trust Fund (Fund 0888) includes the Employees Retirement Fund (Fund 0955), the Law Enforcement and Custodial Officer Supplemental Retirement Fund (Fund 0977), and the Judicial Retirement System Plan Two Fund (Fund 0993).

Note B: Fair value of investments adjusted to comply with the Association for Investment Management and Research (AIMR) Standard:

	Fair Value			
	Fund 0955	Fund 0977	Fund 0993	Total
Total Fair Value of Investments Before				
Securities Lending Collateral, as above	\$ 18,361,397,865	\$ 626,626,695	\$ 120,245,925	\$ 19,108,270,485
Unsettled Sales-Investment Receivables	452,880,400	15,476,068	2,939,439	471,295,907
Adjustment from Accrued Interest on TBAs	(1,044,460)	(35,692)	(6,779)	(1,086,931)
Adjusted Unsettled Sales-Investment Receivables	451,835,940	15,440,376	2,932,660	470,208,976
Unsettled Purchases-Investment Payables	(1,414,790,364)	(48,346,962)	(9,182,757)	(1,472,320,083)
Adjustment from Accrued Interest on TBAs	3,516,537	120,169	22,824	3,659,530
Adjusted Unsettled Purchases-Investment Payables	(1,411,273,827)	(48,226,793)	(9,159,933)	(1,468,660,553)
Tax Reclaim Receivables	1,935,795	66,151	12,564	2,014,510
<b>Total Fair Value of Investments, Adjusted to Comply with the AIMR Standard</b>	<b>17,403,895,773</b>	<b>593,906,429</b>	<b>114,031,216</b>	<b>18,111,833,418</b>

Note C: The investment portfolio listing is available for review at the System's office or the listing will be mailed upon request.

Basis of Presentation: System's Financial Records.



# ACTUARIAL

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## SECTION

*Unaudited*

Actuary's Certification Letter

Actuarial Balance Sheets

Actuarial Cost Method and Assumptions

Summary of Actuarial Methods and Assumptions

Summary of Effects of Changes in Plan Provisions  
and Actuarial Assumptions

Active Member Valuation Data

Retirees and Beneficiaries Added To and Removed  
From the Annuity Payrolls

Solvency Test

Analysis of Financial Experience



## *Towers Perrin*

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December 10, 2003

Board of Trustees  
Employees Retirement System of Texas

### ACTUARIAL CERTIFICATION FOR FUNDED PROGRAMS

Towers Perrin performed actuarial valuations of the Employees Retirement Fund (ERF) of the Employees Retirement System of Texas (ERS) including a separate valuation of the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOSRF) of the ERS, and the Judicial Retirement System of Texas Plan Two (JRSII). No actuarial valuation was performed for the Judicial Retirement System of Texas Plan One because it is not advance funded.

This letter with attachments represents Towers Perrin's certification of the funding status as required for the financial report for the fiscal year ended August 31, 2003 for the Employees Retirement System and the Judicial Retirement System of Texas Plan Two. Towers Perrin prepared the Actuarial Balance Sheets and the Actuarial Cost Method and Assumptions schedule that follow this letter. Towers Perrin reviewed the other supporting schedules in the Actuarial Section which were prepared by the staff of the Employees Retirement System. Towers Perrin provided the information shown in the trend data schedules presented in the Financial Section of this report. The staff of the Employees Retirement System prepared these schedules.

We relied upon the member data and assets provided by the staff of the ERS. The active member valuation data and retiree and beneficiary data exhibits following this certification provide a summary of the data. This data was compared to information provided in the prior actuarial valuation for reasonableness. Otherwise, the data provided was assumed to be correct.

The actuarial assumptions used for these valuations are discussed in the following "Actuarial Cost Method and Assumptions" exhibit and are also outlined in the "Summary of Actuarial Methods and Assumptions." These assumptions are based on an experience study which reviewed data from 1997 to 2002. The ERS Board of Trustees adopted the assumptions on December 10, 2003. In our opinion, these assumptions generate reasonable valuation results, and the assumptions individually and in the aggregate relate reasonably to the past and anticipated experience of the ERF, the LECOSRF and the JRSII. The actuarial assumptions and methods used for funding purposes meet the parameters set for the disclosures presented in the Financial Section by Government Accounting Standards Board (GASB) Statement No. 25, except that the net asset balance is not amortized for funding purposes.

For each Fund, the following "Actuarial Balance Sheet" and "Summary of Actuarial Valuation Results" exhibits indicate the level of funding for the Fund. Both August 31, 2003 and August 31, 2002 results are shown. The August 31, 2003 results are shown both before and after the changes in actuarial assumptions and plan provisions discussed below. The effect of these changes can be determined by examining the difference in results between these two columns.

## **EMPLOYEES RETIREMENT FUND**

The funding objective of the plan is to fund the sum of the normal cost and the amount necessary to amortize any unfunded actuarial accrued liability over a period which does not exceed 30 years by one or more years. Contribution rates are established which, over time, will remain level as a percent of payroll.

The contribution levels of the ERF are set by legislation. Most members contribute 6% of pay and the State contributes 6% of payroll. The actuarial valuation was completed using the entry age actuarial cost method which generates a normal cost expected to remain level as a percent of payroll. To the extent that an unfunded actuarial accrued liability exists, it is amortized as a level percent of projected payroll.

The actuarial valuation is completed annually with the most recent conducted as of August 31, 2003. Since the prior valuation was prepared, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in plan provisions, but these changes had no material impact on actuarial valuation results. There have been changes in the actuarial assumptions as a result of an experience study which reviewed data from 1997 to 2002. The most significant changes were updates to assumed rates of service retirement, termination, salary increases, accumulated leave, active and disability mortality, disability retirement, expenses and option elections.

The August 31, 2003 actuarial valuation shows that there is an unfunded actuarial accrued liability (net liability balance) of \$480.6 million. The ratio of the actuarial value of assets to the actuarial accrued liability is 0.976 as of August 31, 2003. The valuation shows that the normal cost is 12.258% of payroll. Total contributions are 12% of payroll. Because the normal cost is greater than the total contribution rate, no contributions are available to amortize the unfunded actuarial accrued liability. As a result, the amortization period is currently infinite and the funding objective is not currently being realized. In addition, as of August 31, 2003, the market value of assets was \$2.0 billion less than the actuarial value. Unless the market value earns significantly more than 8% over the next few years (on the average), unrecognized investment losses will gradually be reflected in the actuarial value of assets and the funded ratio will likely continue to fall.

Because the amortization period exceeds 31 years, Texas Government Code Section 811.006 would preclude any benefit improvements that would decrease the funded position of the plan until the valuation indicates that the contribution would fund the normal cost and amortize any unfunded actuarial accrued liability over less than 31 years.

## **LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND**

The funding objective of the plan is to fund the sum of the normal cost and the amount necessary to amortize any unfunded actuarial accrued liability over a period which does not exceed 30 years by one or more years. Contribution rates are established which, over time, will remain level as a percent of payroll. If there is a net asset balance (excess of actuarial value of assets over actuarial

*Towers Perrin* 

accrued liability), then the total contribution may be established at a level less than the normal cost for a temporary period if this would not produce an unfunded actuarial accrued liability.

The contribution levels of the LECOSRF are set by legislation. No State contributions will be made through August 31, 2005. Thereafter, the valuation assumed that the State contribution would be established by legislation. For the actuarial valuation, State contributions after August 31, 2005 were assumed to be equal to the normal cost. The actuarial valuation was completed using the entry age actuarial cost method which generates a normal cost expected to remain level as a percent of payroll. To the extent that an unfunded actuarial accrued liability exists, it is amortized as a level percent of projected payroll.

The actuarial valuation is completed annually with the most recent conducted as of August 31, 2003. Since the prior valuation was performed, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in plan provisions, but these changes had no material impact on the actuarial valuation results. There have been changes in the actuarial assumptions as a result of an experience study which reviewed data from 1997 to 2002. The most significant changes were updates to assumed rates of service retirement, termination, salary increases, accumulated leave, active and disability mortality, disability retirement, expenses and option elections.

The valuation shows that the normal cost is 1.607% of payroll. The ratio of the actuarial value of assets to the actuarial accrued liability is 1.115 as of August 31, 2003. Total contributions of 1.607% of payroll were assumed after August 31, 2005 to finance the liabilities of the LECOSRF. As of August 31, 2003, the Fund had a net asset balance. Therefore, there is no amortization period. Based on the actuarial valuation conducted as of August 31, 2003, we are of the opinion that the financing of the Law Enforcement and Custodial Officer Supplemental Retirement Fund is adequate and the Fund is actuarially sound. However, as of August 31, 2003, the market value of assets was \$72 million less than the actuarial value. Because of this shortfall, the funded ratio is expected to fall below 100% unless the market value earns significantly more than 8% over the next few years.

## **JUDICIAL RETIREMENT SYSTEM OF TEXAS PLAN TWO**

The funding objective of the plan is to fund the sum of the normal cost and the amount necessary to amortize any unfunded actuarial accrued liability over a period which does not exceed 30 years by one or more years. Contribution rates are established which, over time, will remain level as a percent of payroll.

The contribution levels of the JRSII are set by legislation. Members contribute 6% of pay during the first 20 years of service and the State contribution rate was 16.83% of payroll as of the August 31, 2003 valuation. The actuarial valuation was completed using the entry age actuarial cost method which generates a normal cost expected to remain level as a percent of payroll. To the extent that an unfunded actuarial accrued liability exists, it is amortized as a level percent of projected payroll.

*Towers Perrin*

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The actuarial valuation is completed annually with the most recent conducted as of August 31, 2003. Since the prior valuation was performed, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in the plan provisions as a result of H.B. 820 and other legislation. There have been changes in the actuarial assumptions as a result of an experience study which reviewed data from 1997 to 2002. The most significant changes were updates to assumed rates of salary increases, termination, payroll growth, active and disability mortality, disability retirement, expenses and option elections.

The valuation shows that the normal cost is 19.58% of payroll. The ratio of the actuarial value of assets to the actuarial accrued liability is 1.165 as of August 31, 2003. State contributions of 16.83% of payroll and member contributions of 6% of pay during the first 20 years of service were assumed available to finance the liabilities of the JRSII. As of August 31, 2003, the Fund had a net asset balance. Therefore, there is no amortization period. We are of the opinion that the financing of the Judicial Retirement System of Texas Plan Two is adequate and the System is actuarially sound. However, as of August 31, 2003, the market value of assets was \$14.3 million less than the actuarial value. Unless the market value earns significantly more than 8% over the next few years (on the average), unrecognized investment losses will gradually be reflected in the actuarial value of assets and the funded ratio may fall below 100%.

Sincerely,



Leslie P. Finertie  
Fellow of the Society of Actuaries  
Member of the American Academy of Actuaries  
Enrolled Actuary



Steven R. Rusher  
Fellow of the Society of Actuaries  
Member of the American Academy of Actuaries  
Enrolled Actuary

LPF/SRR:mp

Attachments

## EMPLOYEES RETIREMENT FUND

	<u>August 31, 2003</u>		<u>August 31, 2002</u>
	<u>After Changes</u>	<u>Before Changes</u>	
<b>ACTUARIAL BALANCE SHEET</b>			
<u>Actuarial Assets:</u>			
Actuarial Value of Tangible Assets	\$19,478,554,993	\$19,478,554,993	\$18,909,071,718
Actuarial Present Value of Future Normal Costs			
Member	\$2,359,025,573	\$2,652,355,913	\$2,727,787,343
Employer	<u>2,362,170,940</u>	<u>2,993,183,647</u>	<u>3,050,120,881</u>
Total	<u>\$4,721,196,513</u>	<u>\$5,645,539,560</u>	<u>\$5,777,908,224</u>
Total	\$24,199,751,506	\$25,124,094,553	\$24,686,979,942
<u>Actuarial Liability:</u>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$12,661,844,659	\$13,101,214,154	\$13,645,722,030
– nonoccupational disability	356,941,540	435,093,961	441,518,607
– occupational disability	12,912,674	23,626,267	24,143,153
– death before retirement	255,381,615	350,074,666	362,016,926
– termination	<u>991,930,447</u>	<u>772,944,849</u>	<u>780,659,371</u>
– total	\$14,279,010,935	\$14,682,953,897	\$15,254,060,087
Inactive Members	621,155,984	627,399,683	546,276,690
Supplemental Payments and COLAs	0	0	0
Annuitants	<u>9,780,141,140</u>	<u>9,840,729,447</u>	<u>8,427,092,145</u>
Total	\$24,680,308,059	\$25,151,083,027	\$24,227,428,922
<u>Net Asset/(Liability) Balance:</u>	(\$480,556,553)	(\$26,988,474)	\$459,551,020
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate	12.000%	12.000%	12.000%
Normal Cost			
– dollars	\$588,499,147	\$612,206,176	\$632,869,285
– percent of payroll	12.258%	12.771%	12.709%
Contribution Available to Amortize Net Asset/(Liability) Balance	(0.258%)	(0.771%)	(0.709%)
Actuarial Accrued Liability	\$19,959,111,546	\$19,505,543,467	\$18,449,520,698
Amortization Period in Years	Infinite	Infinite	0.0
Funded Ratio	0.976	0.999	1.025
Valuation Payroll	\$4,800,611,900	\$4,793,856,202	\$4,979,531,987
Contributing Members	142,163	142,163	148,957

**LAW ENFORCEMENT AND CUSTODIAL OFFICERS SUPPLEMENTAL RETIREMENT FUND**

	<u>August 31, 2003</u>		<u>August 31, 2002</u>
	<u>After Changes</u>	<u>Before Changes</u>	
<b>ACTUARIAL BALANCE SHEET</b>			
<u>Actuarial Assets:</u>			
Actuarial Value of Tangible Assets	\$666,588,289	\$666,588,289	\$655,978,723
Actuarial Present Value of Future Normal Costs	<u>171,401,218</u>	<u>233,417,017</u>	<u>235,482,803</u>
Total	\$837,989,507	\$900,005,306	\$891,461,526
<u>Actuarial Liability:</u>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$539,159,560	\$553,170,677	\$556,032,471
– death benefit plan	6,533,875	12,103,901	12,254,925
– occupational disability	<u>4,154,665</u>	<u>9,658,158</u>	<u>9,738,113</u>
– total	\$549,848,100	\$574,932,736	\$578,025,509
Inactive Vested Members	1,160,853	1,160,853	891,475
Supplemental payments and COLAs	0	0	0
Annuitants	<u>218,306,453</u>	<u>218,269,105</u>	<u>182,770,572</u>
Total	\$769,315,406	\$794,362,694	\$761,687,556
<u>Net Asset/(Liability) Balance:</u>	\$68,674,101	\$105,642,612	\$129,773,970
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate			
– current biennium	0.000%	0.000%	0.000%
– thereafter	1.607%	1.762%	1.753%
Normal Cost			
– dollars	\$20,530,863	\$22,483,378	\$22,761,576
– percent of payroll	1.607%	1.762%	1.753%
Contribution Available to Amortize Net Asset/(Liability) Balance			
– current biennium	(1.607%)	(1.762%)	(1.753%)
– thereafter	0.000%	0.000%	0.000%
Actuarial Accrued Liability	\$597,914,188	\$560,945,677	\$526,204,753
Amortization Period in Years	0.0	0.0	0.0
Funded Ratio	1.115	1.188	1.247
Valuation Payroll	\$1,277,894,221	\$1,275,676,869	\$1,298,593,196
Contributing Members	40,335	40,335	40,926



**JUDICIAL RETIREMENT SYSTEM OF TEXAS PLAN TWO**

	<u>August 31, 2003</u>		<u>August 31, 2002</u>
	<u>After Changes</u>	<u>Before Changes</u>	
<b>ACTUARIAL BALANCE SHEET</b>			
<u>Actuarial Assets:</u>			
Actuarial Value of Tangible Assets	\$129,425,907	\$129,425,907	\$114,433,092
Actuarial Present Value of Future Normal Costs			
Member	\$20,093,735	\$23,104,507	\$22,698,385
Employer	<u>47,561,984</u>	<u>74,191,750</u>	<u>71,007,653</u>
Total	<u>\$67,655,719</u>	<u>\$97,296,257</u>	<u>\$93,706,038</u>
	\$197,081,626	\$226,722,164	\$208,139,130
<u>Actuarial Liability:</u>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$131,989,630	\$165,268,379	\$159,098,776
– disability	5,329,958	6,545,861	6,761,252
– death before retirement	4,923,132	7,039,646	6,998,529
– termination	<u>7,696,800</u>	<u>6,329,419</u>	<u>6,509,622</u>
– total	\$149,939,520	\$185,183,305	\$179,368,179
Inactive Members	4,418,012	4,418,012	3,532,278
Annuitants	<u>24,413,787</u>	<u>24,435,340</u>	<u>14,034,265</u>
Total	\$178,771,319	\$214,036,657	\$196,934,722
<u>Net Asset/(Liability) Balance:</u>	\$18,310,307	\$12,685,507	\$11,204,408
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate	22.83%	22.83%	22.83%
Normal Cost			
– dollars	\$9,298,605	\$10,987,957	\$10,518,646
– percent of payroll	19.58%	23.14%	22.88%
Contribution Available to Amortize Net Asset/(Liability) Balance	3.25%	(0.31%)	(0.05%)
Actuarial Accrued Liability	\$111,115,600	\$116,740,400	\$103,228,684
Amortization Period in Years	0.0	0.0	0.0
Funded Ratio	1.165	1.109	1.109
Valuation Payroll	\$47,478,768	\$47,478,768	\$45,964,856
Contributing Members	477	477	464

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## ACTUARIAL COST METHOD AND ASSUMPTIONS

### EMPLOYEES RETIREMENT FUND

The actuarial cost method used was the entry age actuarial cost method. The calculation of the years required to amortize the unfunded actuarial accrued liability assumes that the unfunded actuarial accrued liability is amortized as a level percent of payroll which is the total contribution rate minus the normal cost contribution rate. The total contribution rate is set by statute, so the variable from year to year is the amortization period. The payroll is assumed to increase 4.0% annually. Actuarial gains and losses are recognized as they occur each year, and they increase or decrease the net asset balance.

The method used to value plan assets for actuarial valuation purposes is based on the market-related value of plan assets, with five-year smoothing of unexpected returns. The market-related value is equal to the fair value of investments plus the carrying value (net of depreciation) of other assets and liabilities as of the valuation date. The actuarial value of assets is determined as the expected value of plan assets as of the valuation date plus 20% of the difference between the market-related value and the expected value. The expected value equals the actuarial value of plan assets as of the prior valuation date, plus contributions, less benefit payments and administrative expenses, all accumulated at the assumed rate of interest to the current valuation date.

Included in the actuarial assumptions are an assumed rate of investment return of 8.0% per year and assumed rates of salary increase. The salary increase assumption is for individual members and includes expected inflationary increases of 4.0% per year plus merit, promotion and longevity increases. This assumption differs from the payroll increase assumption of 4.0% per year, which is for the aggregate payroll of all contributing members and which consists of 4.0% for inflationary salary increases but nothing additional for the aggregate effect of merit, promotion and longevity increases.

### LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND

The actuarial cost method used was the entry age actuarial cost method. The calculation of the years required to amortize the unfunded actuarial accrued liability assumes that the unfunded actuarial accrued liability is amortized as a level percent of payroll which is the total contribution rate minus the normal cost contribution rate. The total contribution rate is set by statute, so the variable from year to year is the amortization period. The payroll is assumed to increase 4.0% annually. Actuarial gains and losses are recognized as they occur each year, and they increase or decrease the net asset balance.

The method used to value plan assets for actuarial valuation purposes is based on the market-related value of plan assets, with five-year smoothing of unexpected returns. The market-related value is equal to the fair value of investments plus the carrying value (net of depreciation) of other assets and liabilities as of the valuation date. The actuarial value of assets is determined as the expected value of plan assets as of the valuation date plus 20% of the difference between the market-related value and the expected value. The expected value

## ACTUARIAL COST METHOD AND ASSUMPTIONS

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equals the actuarial value of plan assets as of the prior valuation date, plus contributions, less benefit payments and administrative expenses, all accumulated at the assumed rate of interest to the current valuation date.

The actuarial assumptions include an assumed rate of investment return of 8.0%. The other actuarial assumptions are the same as those used for the law enforcement and custodial officers in the actuarial valuation of the ERF. They include assumed rates of salary increase of 4.0% for inflation plus adjustments for merit, promotion and longevity.

### JUDICIAL RETIREMENT SYSTEM OF TEXAS PLAN TWO

The actuarial cost method used was the entry age actuarial cost method. The calculation of the years required to amortize the unfunded actuarial accrued liability assumes that the unfunded actuarial accrued liability is amortized as a level percent of payroll which is the total contribution rate minus the normal cost contribution rate. The total contribution rate is set by statute, so the variable from year to year is the amortization period when contribution rates are constant. The payroll is assumed to increase 4.0% annually. Actuarial gains and losses are recognized as they occur each year, and they decrease or increase the unfunded actuarial accrued liability.

The method used to value plan assets for actuarial valuation purposes is based on the market-related value of plan assets, with five-year smoothing of unexpected returns. The market-related value is equal to the fair value of investments plus the carrying value (net of depreciation) of other assets and liabilities as of the valuation date. The actuarial value of assets is determined as the expected value of plan assets as of the valuation date plus 20% of the difference between the market-related value and the expected value. The expected value equals the actuarial value of plan assets as of the prior valuation date, plus contributions, less benefit payments and administrative expenses, all accumulated at the assumed rate of interest to the current valuation date.

Included in the actuarial assumptions are an assumed rate of investment return of 8.0% per year and assumed across-the-board salary increases of 4.0%. The payroll growth assumption is 4.0% per year.

# SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS

Adopted by the Board of Trustees of the System in December 2003, except as otherwise noted, after consulting with the actuarial firm of Towers Perrin. The actuarial experience investigation covered fiscal years 1997-2002.

## I. Actuarial Cost Method

The Entry Age Actuarial Cost Method is used for the Employees Retirement Fund, the Law Enforcement and Custodial Officer Supplemental Retirement Fund, and the Judicial Retirement Plan Two Fund. The System's unfunded actuarial accrued liability is recomputed in connection with each actuarial valuation. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the unfunded actuarial accrued liability. Following are the dates of adoption of the Entry Age Actuarial Cost Method for each fund.

- A. Employees Retirement Fund. Adopted 1958.
- B. Law Enforcement and Custodial Officer Supplemental Retirement Fund. Adopted December 1982.
- C. Judicial Retirement Plan Two Fund. Adopted October 1987.

## II. Actuarial Valuation of Assets

Five year smoothing of the following values:

- A. Cash Equivalents - fair value. Adopted 1996.
- B. Bonds - fair value. Adopted 1996.
- C. Stocks - fair value. Adopted 1996.
- D. Fixed Assets - depreciated value.

## III. Actuarial Assumptions

The members of the System are segregated into four classes - employee class, elected class, supplemental benefits for commissioned peace officers and custodial officers (CPO/CO's), and judicial class. The employee class is further classified into Non-CPO/CO's and CPO/CO's with regular benefits.

### A. Employee Class Assumptions

#### Economic

An annual rate of 4.00% is the assumption for the long-term future for the inflation component of the investment rate of return, salary increase, and payroll increase assumptions.

- (1) Rate of Return on Investment of Present and Future Assets: 8.00% per year, compounded annually.
- (2) Administrative Expenses: 0.25% of payroll per year.
- (3) Salary Increase: The salary increase assumption includes an inflationary increase of 4.0% plus increases in merit, promotion, and longevity; which vary by entry age and service. Rates of salary increase for sample ages are shown at the end of the summary of assumptions.
- (4) Payroll Growth: 

Inflation	<u>4.00</u>
Total	<u><u>4.00</u></u>

#### Demographic

- (1) Termination Rates: Termination rates are rates of termination of members from active contribution status for reasons other than death or disability before retirement. Tables are shown at the end of the summary of assumptions for sample years of service credit.
- (2) Annual Rates of Withdrawal of Contributions: Rates of withdrawal of employee contributions by vested terminated members for sample ages are shown at the end of the summary of assumptions.
- (3) Active Member Mortality Rates: Rates of mortality while in active employment for sample ages are shown at the end of the summary of assumptions.

- (4) Disability Retirement Rates: Rates of disability while in active employment for sample ages are shown at the end of the summary of assumptions.

◆ *Option Selection Percentage (Note A):*

	<u>Standard</u>	<u>Option 1</u>	<u>Option 4</u>
	%	%	%
Male	50	40	10
Female	75	15	10

◆ *Age and Sex Difference Between Member and Nominee:*

Male	Member is three years older than female nominee
Female	Member is same age as male nominee

*Note A: Descriptions of Options 1 and 4 are presented in the Summary of Plan Provisions.*

- (5) Service Retirement Rates: Rates of service retirement for sample ages are shown at the end of the summary of assumptions.
- (6) Retiree Mortality Rates: The mortality table adopted for service retirement retirees and nominees is the 1994 Group Annuity Mortality Table (GAM). This table is shown at end of the summary of assumptions.
- (7) Disability Mortality Rates: The assumption for female disability retirees is 95% of Pension Benefit Guaranty Corporation (PBGC) Disabled Mortality grading to 100% from 85 to 90. For male disability retirees, the assumption is 70% of PBGC Disabled Mortality grading to 100% from age 60 to 90. Rates of mortality of disability retirees for sample ages are shown at end of the summary of assumptions.
- (8) Death Benefit Plan: The assumptions for valuing the death benefit plan for active, terminated vested and disabled members are the following:

◆ *Option Selection Percentage (Note A):*

	<u>Option 1</u>	<u>Option 4</u>
	%	%
Male	75	25
Female	60	40

◆ *Age and Sex Difference Between Member and Nominee:*

Male	Member is three years older than female nominee
Female	Member is same age as male nominee

*Note A: Descriptions of Options 1 and 4 are presented in the Summary of Plan Provisions.*

**B. Elected Class or Elected State Officials (ESO's) Assumptions that are different from the Employee Class**

**Economic**

- (1) Salary Increase: ◆ The across-the-board salary increase rate is 4% with no increase for reasons of merit, promotion, and longevity for members of the elected class who are not legislators.
- ◆ No salary increase for ESO's who are legislators.
- (2) Cost of Living Increase: The cost of living increase used to project the pay of a district judge and the benefit increases after retirement is 4.00%.

**Demographic**

- (1) Termination Rates: ESO's are vested with eight years of service credit. A flat rate of 5% is used for all entry age groups and years of service credit. The same flat rate is used for males and females. Adopted December 2003.
- (2) Active Member Mortality Rates. It is assumed that there are no occupational deaths among the elected class while in active employment. Adopted December 2003.
- (3) Disability Retirement Rates. It is assumed that there are no occupational disabilities among the elected class while in active employment. Adopted September 1990.
- (4) Service Retirement Rates. Rates of service retirement for sample ages are shown at the end of the summary of assumptions.

**C. Commissioned Peace Officer and Custodial Officers (CPO/CO) Assumptions under the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS) that are different from the Employee Class**  
*Economic*

Administrative Expenses: 0.1% of payroll per year.

**D. Judicial Class Assumptions that are different from the Employee Class**  
*Economic*

Administrative Expenses: 0.5% of payroll per year  
(For Judicial Retirement System Plan Two only).

*Demographic*

- (1) Termination Rates: A flat rate of 3% is used for all entry age groups and years of service credit. The same flat rate is used for males and females. Adopted December 2003.
- (2) Active Member Mortality Rates: It is assumed that there are no occupational deaths among the judicial class while in active employment. Adopted December 2003.
- (3) Disability Retirement Rates: It is assumed that there are no occupational disabilities among the judicial class while in active employment. Adopted December 2003.
- (4) Service Retirement Rates: Rates of service retirement for sample ages are shown at the end of the summary of assumptions.

# DEMOGRAPHIC ASSUMPTION TABLES

## RATES OF MERIT, PROMOTION AND LONGEVITY SALARY INCREASES

### EMPLOYEE CLASS - Non-CPO/CO (Note A)

*Male and Female – Years of Service*

Age	0	1	2-4	5-9	10-14	15-19	20+
20	6.8%	5.2%	4.7%	4.6%			
30	6.0	5.2	4.4	3.98	3.6%	3.2%	
40	5.5	4.5	4.0	3.4	3.0	2.7	2.6%
50	4.9	4.5	3.8	3.2	2.7	2.3	2.2
60	2.9	2.9	2.6	2.4	2.3	1.9	1.8

### EMPLOYEE CLASS - CPO/CO (Note A)

*Male and Female – Years of Service*

Age	0	1	2+
20	10.0%	4.5%	2.0%
30	10.0	4.5	2.0
40	10.0	4.5	2.0
50	10.0	4.5	2.0
60	10.0	4.5	2.0

Note A: Where no rates are shown, it is assumed there will be no salary increases.

## ANNUAL RATES OF TERMINATION FROM ACTIVE EMPLOYMENT BEFORE AGE AND SERVICE RETIREMENT

### EMPLOYEE CLASS - Non-CPO/CO

*Male and Female – Years of Service*

Age	0	1	2	3	4	5-6	7-9	10-14	15-19	20-24	25+
20	49.0%	31.0%	27.0%	25.0%	19.0%	19.0%	11.0%	6.0%	3.0%	2.0%	0.0%
30	25.0	22.0	18.0	17.0	14.0	14.0	9.0	6.0	3.0	2.0	0.0
40	22.0	18.0	15.0	13.0	10.0	10.0	8.0	5.0	3.0	2.0	0.0
50	22.0	14.0	12.0	10.0	9.0	7.0	6.0	4.0	3.0	2.0	0.0
60	23.0	18.0	16.0	13.0	12.0	10.0	0.0	0.0	0.0	0.0	0.0

### EMPLOYEE CLASS - CPO/CO (Notes B)

*Male and Female – Years of Service*

Age	0	1	2	3	4	5	6	7	8-9	10-14	15-19	20+
20	29.0%	25.0%	18.0%	18.0%	17.0%	17.0%	16.0%	11.0%	11.0%	0.0%	0.0%	0.0%
30	24.0	19.0	15.0	15.0	11.0	10.0	10.0	10.0	9.0	9.0	0.0	0.0
40	23.0	14.0	10.0	10.0	10.0	10.0	9.0	7.0	7.0	6.0	2.0	0.0
50	19.0	10.0	8.0	8.0	6.0	5.0	5.0	5.0	5.0	5.0	2.0	0.0
60	25.0	22.0	10.0	10.0	6.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0

### ELECTED CLASS

Age	Rate
All ages	5%

### JUDICIAL PLAN I CLASS

Age	Rate
All ages	3%

### JUDICIAL PLAN II CLASS

Age	Rate
All ages	3%

Note A: Where no rates are shown, it is assumed that there will be no terminations.

Note B: It is assumed that no CPO/CO's will terminate after completing 20 years of service. CPO/CO's are eligible to retire with 20 years of service regardless of age.

– Unaudited –

## ANNUAL RATES OF WITHDRAWAL OF EMPLOYEE CONTRIBUTIONS BY VESTED TERMINATED MEMBERS

EMPLOYEE CLASS – Non-CPO/CO					EMPLOYEE CLASS – CPO/CO			
Age	Years of Service				5-10	Years of Service		
	5-10	10-15	15-20	20+		10-15	15-20	20+
20-24	100%	100%	0%	0%	100%	0%	0%	0%
25-34	85	80	60	0	90	85	80	0
35-44	75	65	60	50	85	75	65	0
45-54	65	55	50	35	75	65	55	0
55+	55	45	40	25	65	0	0	0

## MORTALITY RATES - ACTIVE MEMBERS (Note A)

EMPLOYEE CLASS - Non CPO/CO (Note B)					EMPLOYEE CLASS - CPO/CO				
Age	Occupational		Nonoccupational		Age	Occupational		Nonoccupational	
	Females	Males	Females	Males		Females	Males	Females	Males
20	0.001%	0.002%	0.026%	0.036%	20	0.001%	0.003%	0.034%	0.044%
30	0.001	0.002	0.032	0.059	30	0.001	0.003	0.042	0.071
40	0.001	0.002	0.064	0.079	40	0.001	0.003	0.085	0.097
50	0.001	0.002	0.129	0.195	50	0.001	0.003	0.171	0.237
60	0.001	0.002	0.400	0.608	60	0.001	0.003	0.533	0.739
65	0.001	0.002	0.777	1.109	65	0.001	0.003	1.036	1.349

Note A: It is assumed that there are no occupational deaths of Elected State Officials (ESO), or Judicial Members.

Note B: Non-occupational rates are also applied to the Elected Class (ESO) and the Judicial Class.

## MORTALITY RATES - SERVICE RETIREES AND BENEFICIARIES AND DISABILITY RETIREES

SERVICE RETIREES AND BENEFICIARIES (Note A)			DISABILITY RETIREES (Note B)		
Age	Females	Males	Age	Females	Males
20	0.0284%	0.0507%	20	2.5%	3.38%
30	0.0351	0.0801	30	2.25	2.53
40	0.0709	0.1072	40	1.99	1.97
50	0.1428	0.2579	50	2.44	2.68
60	0.4439	0.7976	60	3.14	4.22
70	1.3730	2.3730	70	3.90	5.91
80	3.9396	6.2027	80	7.09	10.15
90	11.6265	15.2931	90	16.82	25.25

Note A: Based on 1994 Group Annuity Mortality Table.

Note B: For female disability retirees, the assumption is 95% of Pension Benefit Guaranty Corporation (PBGC) Disabled Mortality grading to 100% from age 85 to 90. For male disability retirees, the assumption is 70% of PRGC Disabled Mortality grading to 100% from age 60 to 90.



## DISABILITY RETIREMENT RATES (Notes A & B)

EMPLOYEE CLASS - Non-CPO/CO (Note C)				EMPLOYEE CLASS - CPO/CO			
Occupational		Nonoccupational		Occupational-Females & Males		Nonoccupational	
Age	Females & Males	Females	Males	Age	Total Disability	Non-Total	Females & Males
20	0.003%	0.000%	0.000%	20	0.0002%	0.0008%	0.000%
30	0.003	0.028	0.057	30	0.0006	0.0024	0.016
40	0.004	0.186	0.144	40	0.0018	0.0072	0.101
50	0.008	0.430	0.308	50	0.0040	0.0161	0.284
60	0.015	0.000	0.000	60	0.0054	0.0216	0.000
65	0.0128	0.000	0.000	65	0.0052	0.0208	0.000

Note A: There are no rates of non-occupational disability at age 20 because of the eligibility requirements for a non-occupational disability benefit. The requirement of 10 years of service excludes the youngest members. Members over age 60 are assumed to select a service retirement in lieu of a non-occupational disability retirement.

Note B: It is assumed that there are no occupational disabilities among the Elected Class (ESO) or the Judicial Class.

Note C: Non-occupational rates are also applied to the Elected Class (ESO) and the Judicial Class.

## SERVICE RETIREMENT RATES (Note A)

### EMPLOYEE CLASS - Non-CPO/CO

Females – Based on Service							Males – Based on Service					
Age	0-9	10-14	15-19	20-24	25-29	30+	Age	0-14	15-19	20-24	25-29	30+
50	0.0%	0.0%	0.0%	0.0%	0.0%	25.0%	50	0.0%	0.0%	0.0%	0.0%	10.0%
55	0.0	0.0	0.0	0.0	30.0	30.0	55	0.0	0.0	0.0	15.0	10.0
60	10.0	20.0	30.0	30.0	30.0	30.0	60	15.0	20.0	25.0	30.0	20.0
65	15.0	20.0	30.0	30.0	50.0	50.0	65	15.0	25.0	30.0	40.0	40.0
70	100.0	100.0	100.0	100.0	100.0	100.0	70	100.0	100.0	100.0	100.0	100.0

### EMPLOYEE CLASS - CPO/CO

Females – Based on Service				Males – Based on Service										
Age	0-9	0-19	20+	Age	0-9	10-14	15-19	20-23	24	25-26	27	28	29-34	35+
50	0.0%	0.0%	30.0%	50	0.0%	0.0%	26.0%	29.0%	30.0%	45.0%	47.0%	50.0%	50.0%	60.0%
55	0.0	12.0	24.0	55	0.0	12.0	13.0	30.0	30.0	22.0	24.0	25.0	30.0	30.0
60	24.0	24.0	24.0	60	21.0	24.0	26.0	43.0	45.0	45.0	47.0	50.0	50.0	60.0
65	35.0	35.0	35.0	65	37.0	41.0	45.0	50.0	50.0	40.0	40.0	43.0	50.0	50.0
70+	100.0	100.0	100.0	70+	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

#### ELECTED CLASS (Note B)

Age	Rate
50-59	10.0%
60-64	15.0
65-74	20.0
75+	100.0

#### JUDICIAL PLAN I CLASS (Note B)

Age	Rate
50-69	20.0%
70-74	25.0
75+	100.0

#### JUDICIAL PLAN II CLASS (Note B)

Age	Rate
50-69	20.0%
70-74	25.0
75+	100.0

Note A: Where no rates are shown, it is assumed that there will be no service retirements.

Note B: The rates are the same for all years of service.

– Unaudited –

## SUMMARY OF EFFECTS OF CHANGES IN PLAN PROVISIONS AND ACTUARIAL ASSUMPTIONS

Following is a summary of key results of the August 31, 2003 actuarial valuation under both the old and new plan provisions and actuarial assumptions.

Key Result	As of August 31, 2003			
	ERS	LECOS	JRS II	Total
<b>Normal Cost</b>				
Old Provisions	\$612,206,176	\$22,483,378	\$10,987,957	\$645,677,511
New Provisions	\$588,499,147	\$20,530,863	\$9,298,605	\$618,328,615
<b>Actuarial Accrued Liability</b>				
Old Provisions	\$19,505,543,467	\$560,945,677	\$116,740,400	\$20,183,229,544
New Provisions	\$19,959,111,546	\$597,914,188	\$111,115,600	\$20,668,141,334
<b>Unfunded/(Overfunded)</b>				
<b>Actuarial Accrued Liability</b>				
Old Provisions	\$26,988,474	(\$105,642,612)	(\$12,685,507)	(\$91,339,645)
New Provisions	\$480,556,553	(\$68,674,101)	(\$18,310,307)	\$393,572,145
<b>Funded Ratio</b>				
Old Provisions	99.9	118.8	110.9	N/A
New Provisions	97.6	111.5	116.5	N/A
<b>Amortization Period in Years</b>				
Old Provisions	N/A	N/A	N/A	N/A
New Provisions	N/A	N/A	N/A	N/A

# ACTIVE MEMBER VALUATION DATA

## EMPLOYEES RETIREMENT FUND

*Active Contributing Members as of August 31*

Valuation Year	Number (Note A)	Actual Annual Payroll	Average Pay (Note B)	% Increase In Average Pay
		\$	\$	%
1998	154,660	4,369,644,381	28,156	1.7
1999	152,994	4,391,902,009	30,498	8.3
2000	150,656	4,621,831,129	30,721	0.7
2001	149,045	4,670,513,572	31,415	2.3
2002	148,957	4,978,703,758	33,053	5.2
2003	142,163	4,986,410,107	33,335	0.9

## LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND (CPO/CO)

*Active CPO/CO Members as of August 31*

Valuation Year	Number (Note A)	Actual Annual Payroll	Average Pay (Note B)	% Increase In Average Pay
		\$	\$	%
1998	39,677	1,134,322,064	27,918	(0.2)
1999	41,910	1,325,675,214	31,390	12.4
2000	41,833	1,265,797,207	30,031	(4.3)
2001	40,231	1,291,750,375	30,546	1.7
2002	40,926	1,298,593,196	31,494	3.1
2003	40,335	1,277,894,221	31,382	(0.4)

## JUDICIAL CLASS - JUDICIAL RETIREMENT PLAN TWO FUND

*Active Judicial Members as of August 31*

Valuation Year	Number (Note A)	Actual Annual Payroll	Average Pay (Note B)	% Increase In Average Pay
		\$	\$	%
1998	362	35,631,317	98,300	0.7
1999	392	39,085,650	101,099	2.8
2000	410	41,500,873	101,022	(0.1)
2001	441	43,894,184	100,885	(0.1)
2002	464	45,600,138	99,062	(1.8)
2003	477	47,364,759	99,536	0.5

Note A: Number of active contributing members as of August 31, excluding those who retired August 31 because they were included as retirees in the actuarial valuation.

Note B: The average rate of salary is based on the salary for the month of August adjusted for any known across-the-board increases effective in the following year.

# RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM THE ANNUITY PAYROLLS

## EMPLOYEES RETIREMENT FUND

Period Ended September 30	Added to Rolls		Removed from Rolls		Other Beneficiaries		Rolls End of Year		% Increase	Average
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowance	Annual Allowances	Annual Allowance
	\$		\$		\$		\$		%	\$
1998	3,554	54,833,341	975	9,171,773	236	3,247,495	40,727	532,452,405	10.1	13,074
1999	3,067	45,604,675	1,087	10,596,965	321	1,579,429	43,028	569,039,544	6.9	13,225
2000	3,697	56,762,630	1,084	10,485,267	202	73,735,584	45,843	689,052,491	21.4	15,031
2001	3,459	54,201,425	1,198	15,004,405	252	2,811,191	48,356	731,060,702	6.1	15,118
2002	4,372	77,907,778	1,233	15,046,639	243	120,431,064	51,738	914,352,905	25.1	17,673
2003	8,172	146,646,113	1,252	18,818,474	317	2,127,302	58,975	1,044,307,846	14.2	17,708

## LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND

Period Ended September 30	Added to Rolls		Removed from Rolls		Other Beneficiaries		Rolls End of Year		% Increase	Average
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowance	Annual Allowances	Annual Allowance
	\$		\$		\$		\$		%	\$
1998	170	1,185,517	27	106,927	28	(91,246)	2,461	15,322,085	6.9	6,226
1999	143	905,096	35	135,904	24	(111,636)	2,593	15,979,641	4.3	6,163
2000	240	1,611,347	33	149,423	26	1,789,456	2,826	19,231,021	20.3	6,805
2001	288	1,722,478	63	404,553	21	(1,030,035)	3,072	19,518,911	1.5	6,354
2002	492	3,199,996	91	507,637	29	(2,318,473)	3,502	19,892,797	1.9	5,680
2003	701	4,527,310	56	458,863	26	(142,646)	4,173	23,818,598	19.7	5,708

## JUDICIAL RETIREMENT PLAN TWO FUND

Period Ended September 30	Added to Rolls		Removed from Rolls		Other Beneficiaries		Rolls End of Year		% Increase	Average
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowance	Annual Allowances	Annual Allowance
	\$		\$		\$		\$		%	\$
1998	2	64,038	-	-	-	(18,710)	14	518,394	9.6	37,028
1999	8	395,818	-	-	-	-	22	914,212	76.4	41,555
2000	5	206,017	-	-	-	-	27	1,120,229	22.5	41,490
2001	6	236,641	2	74,921	-	-	31	1,281,949	14.4	41,353
2002	3	141,951	-	-	-	-	34	1,423,900	11.1	41,879
2003	25	1,052,404	-	-	-	-	59	2,476,304	73.9	41,971

# SOLVENCY TEST

## Funding Objective

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due - the ultimate test of financial soundness.

In a system that has been following the level contribution rate of payroll financing principle, the liabilities for active member contributions on deposit (liability 1); and the liabilities for future benefits to present retirees (liability 2) will be fully covered by present assets except in rare circumstances. In addition, the liabilities for service already rendered by active members (liability 3) will be partially covered by the remainder of present assets. Generally, if the system has been using level contribution rate financing, the funded portion of liability 3 will increase over time.

## Evaluation of Funding Objective

A short-term solvency test is one way of evaluating a system's progress under its funding program. In a short-term solvency test, the plan's present assets are compared with:

1. Active member contributions on deposit;
2. The liabilities for future benefits to present retirees; and
3. The liabilities for service already rendered by active members.,

### EMPLOYEES RETIREMENT FUND

Valuation Year	Aggregate Accrued Liabilities For			Valuation Assets	Portion of Accrued Liabilities Covered by Assets		
	(1)	(2)	(3)		(1)	(2)	(3)
	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)		%	%	%
1998	\$ 2,664,626,445	\$ 4,993,987,223	\$ 5,503,134,833	\$ 14,175,628,294	100	100	118.4
1999	2,826,576,291	5,917,857,824	5,911,696,451	15,769,708,372	100	100	118.8
2000	2,963,566,069	6,383,052,357	6,829,997,182	17,416,035,565	100	100	118.1
2001	3,165,823,900	7,760,766,776	6,601,104,966	18,394,458,066	100	100	113.1
2002	3,333,570,553	8,427,092,145	6,688,858,000	18,909,071,718	100	100	106.9
2003	3,510,221,815	9,840,729,447	6,608,160,284	19,478,554,993	100	100	92.7

### LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND (CPO/CO)

Valuation Year	Aggregate Accrued Liabilities For			Valuation Assets	Portion of Accrued Liabilities Covered by Assets		
	(1)	(2)	(3)		(1)	(2)	(3)
	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)		%	%	%
1998	-	145,364,165	238,772,171	527,483,777	-	100	160.0
1999	-	167,491,215	330,303,238	573,154,258	-	100	122.8
2000	-	178,628,475	369,138,708	619,217,633	-	100	119.4
2001	-	155,471,174	336,655,962	647,756,655	-	100	146.2
2002	5,275	182,770,572	343,428,906	655,978,723	100	100	137.8
2003	5,275	218,269,105	379,639,808	666,588,289	100	100	118.1

(Note A)

(Note A)

Note A: Prior to 2002, no accrued liabilities for active member contributions were reported because there were no CPO/CO member contributions.

(to next page)

# SOLVENCY TEST

(concluded)

## JUDICIAL RETIREMENT PLAN TWO FUND

*Aggregate Accrued Liabilities For*

Valuation Year	(1)	(2)	(3)	Valuation Assets	Portion of Accrued Liabilities Covered by Assets		
	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)		(1)	(2)	(3)
	\$	\$	\$	\$	%	%	%
1998	14,587,265	5,011,215	39,906,604	56,335,777	100	100	92.1
1999	17,242,726	9,030,396	43,389,613	70,833,942	100	100	102.7
2000	20,362,949	11,100,926	49,953,397	86,962,078	100	100	111.1
2001	23,555,252	12,812,755	56,122,344	101,326,545	100	100	115.7
2002	27,533,146	14,034,265	61,661,273	114,433,092	100	100	118.2
2003	29,685,860	24,435,340	56,994,400	129,425,907	100	100	132.1

## ANALYSIS OF FINANCIAL EXPERIENCE

Actual financial experience will not coincide exactly with assumed financial experience because the future cannot be predicted with 100 percent precision.

An actuarial investigation reveals the difference between actual and assumed experience in the various risk areas. Once a difference has been observed to be sizable and persistent, the assumed experience should usually be changed to reflect observed reality.

Differences between actual and assumed experiences result in changes in liabilities which are called actuarial gains, if the experience was financially favorable, and actuarial losses, if the experience was financially unfavorable. In the actuarial valuation of the Employees Retirement System, such gains and losses are recognized immediately, with actuarial gains decreasing the unfunded actuarial accrued liability and actuarial losses increasing the unfunded actuarial accrued liability.

One of the more easily understood types of actuarial investigations is the Gain/Loss Analysis of changes in accrued liabilities. While considerable data processing work and actuarial work is needed to perform a Gain/Loss Analysis, the significant results can be presented in a concise format. Such gain/loss knowledge is most helpful in understanding the financial condition of a retirement system, and in adopting sound financial assumptions for the retirement system.

The schedule that follows presents the gains and losses in unfunded actuarial accrued liabilities resulting from differences between assumed experience and actual experience. The combined gain or loss from age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment includes the following:

***Age & Service Retirement:***

If members retire at older ages or with lower final average pay than assumed, there is a gain. If at younger ages or higher average pay, a loss.

***Disability Retirement:***

If disability claims are less than assumed, there is a gain. If there are more claims, a loss.

***Death-in-Service Benefits:***

If survivor claims are less than assumed, there is a gain. If there are more claims, there is a loss.

***Withdrawal From Employment:***

If more liabilities are released by withdrawals than assumed, there is a gain. If fewer individuals, a loss.

– Unaudited –

# ANALYSIS OF FINANCIAL EXPERIENCE

(concluded)

## GAINS & LOSSES IN ACTUARIAL ACCRUED LIABILITIES RESULTING FROM DIFFERENCES BETWEEN ASSUMED EXPERIENCE & ACTUAL EXPERIENCE

Type of Activity	Gain/(Loss) For Year (in Millions)					
	ERS		LECOS		JRS II	
	2003	2002	2003	2002	2003	2002
<i>Combined gain/(loss) from age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment</i>	\$ (345.7)	\$ (193.4)	\$ (3.7)	\$ (3.7)	\$ (1.7)	\$ 0.7
<b>Pay Increases</b> If there are smaller pay increases than assumed, there is a gain. If greater increases occur, a loss.	383.8	409.2	12.6	13.7	5.3	5.1
<b>Interest on Overfunded/(Unfunded) Actuarial Accrued Liability</b> A gain/(loss) is recognized each year for the actual interest accumulated and credited to the overfunded/(unfunded) actuarial accrued liability at the beginning of the year.	36.8	69.3	10.4	12.5	0.9	0.7
<b>Contribution Income</b> If contributions are received in excess of normal cost, there is a gain. If less, a loss.	(36.8)	(34.5)	(23.7)	(23.6)	0.5	0.4
<b>Investment Income</b> If there is greater investment income than assumed, there is a gain. If less income, a loss.	(502.8)	(615.4)	(18.1)	(22.0)	(3.6)	(4.4)
<b>Death After Retirement</b> If retirees live longer than assumed, there is a loss. If not as long, a gain.	7.5	(15.3)	(1.6)	(2.7)	0.1	(0.1)
<b>Other</b> Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, valuation methods, etc.	(29.4)	(27.1)	-	-	-	-
<b>Gain/(Loss) During Year from Financial Experience</b>	<b>(486.6)</b>	<b>(407.2)</b>	<b>(24.1)</b>	<b>(25.8)</b>	<b>1.5</b>	<b>2.4</b>
<b>Non-Recurring Items</b> Adjustments for plan amendments, changes in actuarial assumptions, increase in Service Retirement Formula, etc.	<b>(453.6)</b>	<b>-</b>	<b>(37.0)</b>	<b>-</b>	<b>5.6</b>	<b>-</b>
<b>Composite Gain/(Loss) During Year</b>	<b>(940.2)</b>	<b>(407.2)</b>	<b>(61.1)</b>	<b>(25.8)</b>	<b>7.1</b>	<b>2.4</b>





# STATISTICAL

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## SECTION

*Unaudited*

- Revenues by Source –
  - Pension (and Other Employee Benefit) Trust Funds
- Receipts and/or Revenues by Source –
  - All Other Funds
- Expenses by Type –
  - Pension (and Other Employee Benefit) Trust Funds
- Expenses/Expenditures and/or Disbursements by Type –
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- Statistical Information – Defined Benefit Plans
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- Retired Members by Type of Benefit
- Average Benefit Payments – Employee Class
- Summary of Cash Receipts and Disbursements –
  - Pension (and Other Employee Benefit) Trust Funds

- Unaudited -

## REVENUES BY SOURCE

### Pension (and Other Employee Benefit) Trust Funds

(in 000's)

Fiscal Year	Member Contributions	Transfers In/ Rollovers In	Contri- butions Forfeited	Employer Contributions		Investment Income (Note E)	Other Revenue	Total Revenues
				Dollars	% of Annual Covered Payroll			
	\$		\$	\$	%	\$	\$	\$
<b>Employees Retirement System (ERS) - (Notes A &amp; D)</b>								
1998	267,977			264,776	6.00	1,339,836	15,381	1,887,970
1999	270,260			265,031	6.00	2,479,568	18,735	3,033,594
2000	283,841			279,192	6.00	1,729,163	22,944	2,315,140
2001	286,982			281,906	6.00	(1,410,270)	26,913	(814,469)
2002	319,565			300,969	6.00	(1,272,412)	32,601	(619,277)
2003	324,000			301,555	6.00	1,455,618	37,719	2,118,892
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>								
1998						50,024		50,024
1999						90,550	1	90,551
2000						61,763	1	61,764
2001						(49,664)	2	(49,662)
2002	5					(44,338)		(44,333)
2003						49,692	2	49,694
<b>Judicial Retirement System of Texas Plan One (JRS I)</b>								
					(Note B)			
1998				19,177			120	19,297
1999				20,542			135	20,677
2000				21,024			101	21,125
2001				21,918			148	22,066
2002				21,564			120	21,684
2003				22,675			120	22,795
<b>Judicial Retirement System of Texas Plan Two (JRS II) (Note D)</b>								
1998	2,144			6,008	16.83	4,489	6	12,647
1999	2,369			6,815	16.83	9,537	13	18,734
2000	2,496			7,130	16.83	7,637	4	17,267
2001	2,638			7,258	16.83	(6,916)	5	2,985
2002	2,780			7,804	16.83	(7,168)		3,416
2003	3,020			8,294	16.83	9,404	18	20,736
<b>Excess Benefit Arrangement</b>								
2002							63	63
2003							67	67
<b>TexaSaver 401(k) Trust Fund</b>								
1998						3	100	103
1999						3	200	203
2000						4	150	154
2001						9	203	212
2002						2	234	236
2003						1	345	346
<b>TexaSaver 457 Trust Fund (Notes F &amp; G)</b>								
1998	12,039	17,430				25,893	332	55,694
1999	9,280	48,832				43,448	300	101,860
2000	11,806	19,637				16,579	329	48,351
2001	8,505					(4,842)	200	3,863
2002	10,649	30,472				(48,761)	430	(7,210)
2003	27,132	27,241				18,341	234	72,948
<b>State Employees Cafeteria Plan Trust Fund (Note G)</b>								
1998	18,641		282			282	29	19,234
1999	19,165		223			290	2	19,680
2000	22,479		307			340	2	23,128
2001	27,097		405			238	45	27,785
2002	30,072		430			120	11	30,633
2003	33,571		393			65	18	34,047

Note A: Other Revenue also includes Non-Operating Revenues and Other Additions, if any.

Note B: The JRS I receives appropriations from the State's General Revenue Fund to cover on a pay-as-you-go basis annuity payments and refunds of member contributions; therefore, the amounts reported as state contributions are not based on payroll.

Note C: Member Contributions for JRS I are composed of Judges' Contributions and Service Purchases received in the form of unappropriated receipts and deposited in the State's General Revenue Fund and are reported in an Agency Fund.

Note D: The State contribution rate is set by State law for the ERS and JRS Plan II.

Note E: Investment Income consists of Interest, Dividends and Net Appreciation (Depreciation) in Fair Value of Investments. It also includes the Investment Expenses of the System.

Note F: On September 1, 1998, the TexaSaver 457 Trust Fund was reclassified from Agency Fund and Pension Trust Fund to Expendable Trust Fund pursuant to GASB Statement No. 32.

Note G: On September 1, 2001, the State Employees Cafeteria Plan Trust Fund and TexaSaver 457 Trust Fund were reclassified from Expendable Trust Funds to Pension (and Other Employee Benefit) Trust Funds pursuant to GASB Statement No. 34.

- Unaudited -

**RECEIPTS AND/OR REVENUES BY SOURCE**  
**All Other Funds**  
(in 000's)

*Internal Service Fund*

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**Employees Life, Accident and Health Insurance and Benefits Fund**

<b>Fiscal Year</b>	<b>Employer Contributions</b>	<b>Member Contributions</b>	<b>Investment Income</b>	<b>Miscellaneous</b>	<b>Total</b>
	\$	\$	\$	\$	\$
1998	704,182	254,203	27,435	1,339	987,159
1999	720,598	269,847	23,169	142	1,013,756
2000	803,196	293,970	24,897	151	1,122,214
2001	870,735	327,981	21,373	151	1,220,240
2002	1,122,408	366,998	13,977	648	1,504,031
2003	1,235,235	393,976	12,879	1,500	1,643,590

*Agency Fund*

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**TexaSaver 401(k) Trust Fund** (Note A)

<b>Fiscal Year</b>	<b>Benefits Member Contributions</b>
	\$
1999	80,567
2000	90,296
2001	94,881
2002	95,002
2003	89,098

Note A: Only five years of data are available.

– Unaudited –

**EXPENSES BY TYPE**  
**Pension (and Other Employee Benefit) Trust Funds**  
(in 000's)

<u>Fiscal Year</u>	<u>Retirement Benefits of Retirees and Survivors</u>	<u>Claims Reimbursements</u>	<u>Estimated Claims</u>	<u>Distributions</u>	<u>Transfers Outs/Roll-overs Out</u>	<u>Death Benefits</u>	<u>Member Contributions Withdrawn</u>	<u>Total Benefit Expenses</u>	<u>Administrative &amp; Miscellaneous Expenses</u>	<u>Total Expenses</u>
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Employees Retirement System (ERS)</b>										
1998	552,415					1,856	99,562	653,833	13,315	667,148
1999	599,827					1,716	104,939	706,482	12,499	718,981
2000	681,524					2,487	96,261	780,272	12,273	792,545
2001	827,940					1,836	91,800	921,576	12,621	934,197
2002	908,511					2,086	70,031	980,628	13,295	993,923
2003	1,010,238					2,327	73,438	1,086,003	13,105	1,099,108
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>										
1998	15,507							15,507	558	16,065
1999	16,593							16,593	576	17,169
2000	18,789							18,789	624	19,413
2001	16,815							16,815	625	17,440
2002	20,762							20,762	685	21,447
2003	22,834							22,834	700	23,534
<b>Judicial Retirement System of Texas Plan One (JRS I)</b>										
1998	19,177							19,177	120	19,297
1999	20,542							20,542	135	20,677
2000	21,036							21,036	88	21,124
2001	21,701							21,701	152	21,853
2002	21,778							21,778	120	21,898
2003	22,673						3	22,676	120	22,796
<b>Judicial Retirement System of Texas Plan Two (JRS II)</b>										
1998	488						22	510	144	654
1999	722					13	267	1,002	283	1,285
2000	898						94	992	249	1,241
2001	1,211					3	116	1,330	268	1,598
2002	1,365						187	1,552	299	1,851
2003	2,119						152	2,271	245	2,516
<b>Excess Benefit Arrangement</b>										
2002	63							63		63
2003	67							67		67
<b>TexaSaver 401(k) Trust Fund</b>										
1998									76	76
1999									225	225
2000									184	184
2001									220	220
2002									236	236
2003									357	357
<b>TexaSaver 457 Trust Fund (Notes A &amp; B)</b>										
1998				21,884	17,430			39,314	401	39,715
1999				28,376	45,976			74,352	546	74,898
2000				25,795	21,541			47,336	667	48,003
2001				35,692				35,692	1,022	36,714
2002				26,902	26,460			53,362	832	54,194
2003				27,604	42,224			69,828	849	70,677
<b>State Employees Cafeteria Plan Trust Fund (Note B)</b>										
1998		16,956	1,251					18,207	596	18,803
1999		17,022	1,531					18,553	869	19,422
2000		19,716	2,932					22,648	739	23,387
2001		24,504	2,600					27,104	1,358	28,462
2002		26,612	3,415					30,027	970	30,997
2003		29,670	3,869					33,539	1,234	34,773

Note A: On September 1, 1998, the TexaSaver 457 Trust Fund was reclassified from Agency Fund and Pension Trust Fund to Expendable Trust Fund pursuant to GASB Statement No. 32.

Note B: On September 1, 2001, the State Employees Cafeteria Plan Trust Fund and TexaSaver 457 Trust Fund were reclassified from Expendable Trust Funds to Pension (and Other Employee Benefit) Trust Funds pursuant to GASB Statement No. 34.

- Unaudited -

EXPENSES/EXPENDITURES AND/OR DISBURSEMENTS BY TYPE  
All Other Funds  
(in 000's)

*Internal Service Fund*

**Employees Life, Accident and Health Insurance and Benefits Fund**

<u>Fiscal Year</u>	<u>Claims and Premium Payments</u>	<u>Administrative Expenses</u>	<u>Miscellaneous</u>	<u>Total</u>
	\$	\$	\$	\$
1998	993,026	6,888	8	999,922
1999	1,070,714	7,890	14	1,078,618
2000	1,168,466	8,744	3	1,177,213
2001	1,308,239	9,785	1	1,318,025
2002	1,493,565	9,433		1,502,998
2003	1,627,057	9,926		1,636,983

- Unaudited -

## STATISTICAL INFORMATION - Defined Benefit Plans

(all items expressed as numbers unless otherwise indicated)

### Employees Retirement System (ERS)

Fiscal Year	Membership		Retirees/ Beneficiaries	Refunds		Retirements		Death Benefit Plans	Expiration of Annuity
	Active	Inactive		Resignation	Death	Service	Disability		
1998	155,317	31,346	39,247	19,916	240	2,654	142	68	900
1999	154,183	36,502	43,860	19,503	247	3,244	209	92	914
2000	152,167	41,276	47,310	21,109	261	3,688	196	60	948
2001	149,956	46,089	47,392	21,869	301	3,229	213	41	975
2002	150,313	48,903	50,514	16,817	335	4,050	156	69	1,017
2003	142,315	51,868	57,024	16,680	316	7,581	174	84	1,037

### Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)

Fiscal Year	Membership		Retirees/ Beneficiaries	Refunds (Note A)		Retirements		Death Benefit Plans	Expiration of Annuity
	Active	Inactive		Resignation	Death	Service	Disability		
1998	39,716	2,425	2,356			143		3	26
1999	39,979	3,132	2,526			153	1	1	23
2000	42,040	4,372	2,774			249	3	1	30
2001	40,431	5,619	3,093			296	4		21
2002	41,221	6,519	3,523			508	3		41
2003	40,332	7,264	4,166			686	1		34

### Judicial Retirement System of Texas Plan One (JRS I)

Fiscal Year	Membership		Retirees/ Beneficiaries	Refunds		Retirements		Death Benefit Plans	Expiration of Annuity
	Active	Inactive		Resignation	Death	Service	Disability		
1998	162	25	436			5	1	1	10
1999	133	29	461			27		1	5
2000	123	27	465	1		9			7
2001	95	24	485			26			11
2002	91	24	493			13			6
2003	58	22	505		1	27			13

### Judicial Retirement System of Texas Plan Two (JRS II)

Fiscal Year	Membership		Retirees/ Beneficiaries	Refunds		Retirements		Death Benefit Plans	Expiration of Annuity
	Active	Inactive		Resignation	Death	Service	Disability		
1998	362	40	14	2		6	2		
1999	395	50	22	3		1		1	
2000	412	51	27	1		3	2		
2001	442	77	29	3		3			2
2002	464	63	34	7		3			1
2003	476	80	78	5		24			

Note A: Refunds are not applicable to the Law Enforcement and Custodial Officer Supplemental Retirement Fund because there is no member contribution.

- Unaudited -

**STATISTICAL INFORMATION - Other Programs**  
(all items expressed as numbers unless otherwise indicated)

**Employees Life, Accident and Health Insurance and Benefits Fund**

Fiscal Year	Enrollment (Note A)				
	Active	Retired	Dependents	COBRA	Total
1998	209,657	49,390	250,000	2,640	511,687
1999	209,558	52,015	253,000	2,707	517,280
2000	210,675	54,974	255,000	2,545	523,194
2001	210,924	57,953	252,000	2,124	523,001
2002	209,859	56,714	253,000	2,060	521,633
2003	211,695	59,603	248,749	1,744	521,791

**State Employees Cafeteria Plan Trust Fund**

Fiscal Year	Enrollment (Note A)			Total Redirected Dollars (in millions)	Total Tax Savings	
	Health Care	Dependent Care	Premium Conversion		Employees (in millions)	State (in millions)
	1998	9,500	2,500	142,493	192.5	43.6
1999	9,800	2,400	146,407	203.4	46.1	15.6
2000	12,314	2,425	209,031	237.8	53.9	18.2
2001	15,924	2,480	208,511	263.8	59.7	20.2
2002	17,419	2,336	208,651	291.0	65.9	22.3
2003	19,128	2,297	209,929	312.1	70.7	23.9

**TexaSaver 457 Trust Fund**

Fiscal Year	Original 457 Plan Participants (Note A)			TexaSaver 457 Plan Participants		
	Total	Currently Deferring	CMV of Assets (Note B) (in millions)	Total	Currently Deferring	CMV of Assets (Note B) (in millions)
1998	10,500	5,200	301.0			
1999	11,000	5,200	328.7			
2000	10,838	4,423	329.1			
2001 (C & D)	8,374	267	244.8	4,531	3,419	56.4
2002	7,422	261	183.0	5,793	3,971	69.7
2003	6,015	207	133.8	7,525	4,862	103.7

**TexaSaver 401(k) Trust Fund**

Fiscal Year	Participants (Note A)		
	Total	Currently Deferring	CMV of Assets (Note B) (in millions)
1998	47,600	34,700	402.7
1999	51,100	36,400	545.4
2000	57,306	39,533	675.8
2001	54,177	38,407	602.6
2002	57,155	35,856	604.7
2003	56,848	32,714	703.4

Note A: Rounded participant or enrollment figures indicate approximate numbers.

Note B: CMV = Current Market Value

Note C: In fiscal year 2001, a new TexaSaver 457 Plan was established with different investment options. The original 457 Plan only has life insurance investment products.

**Death Benefits Program for Commissioned Peace Officers, Firemen, etc.**

Fiscal Year	Lump Sum Payments	Monthly Payments To:	
		Guardians	Children
1998	7	106	(not available)
1999	9	97	145
2000	13	101	138
2001	29	104	148
2002	36	107	156
2003	20	113	163

Note D: The fiscal year 2001 data of the original 457 Plan are as of June 30, 2001.

- Unaudited -

## RETIRED MEMBERS BY TYPE OF BENEFIT August 31, 2003

### Employees Retirement Fund

Average Amount of Monthly Benefit \$	Number of Retirees	Type of Retirement		Option Selected (Note A)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
0-300	3,394	3,282	112	2,027	688	235	48	275	121
301-600	8,977	8,074	903	6,612	1,246	465	78	283	293
601-900	9,081	8,138	943	6,724	1,121	581	89	233	333
901-1,200	7,274	6,805	469	5,225	872	638	82	158	299
1,201-1,500	6,070	5,812	258	4,030	801	701	68	126	344
1,501-2,000	8,104	7,938	166	4,935	1,050	1,191	111	174	643
2,001-2,500	6,376	6,321	55	3,600	781	1,189	64	148	594
2,501-3,000	4,590	4,575	15	2,288	602	969	53	113	565
3,001-4,000	3,754	3,748	6	1,917	487	744	37	67	502
4,001-10,999	1,355	1,351	4	679	193	229	10	26	218
<b>Total</b>	<b>58,975</b>	<b>56,044</b>	<b>2,931</b>	<b>38,037</b>	<b>7,841</b>	<b>6,942</b>	<b>640</b>	<b>1,603</b>	<b>3,912</b>

### Law Enforcement And Custodial Officer Supplemental Retirement Fund

Average Amount of Monthly Benefit \$	Number of Retirees	Type of Retirement		Option Selected (Note A)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
0-200	267	266	1	148	67	29	3	1	19
201-400	1,510	1,445	65	825	294	214	26	32	119
401-600	1,569	1,537	32	658	225	397	10	29	250
601-800	538	538		204	82	136	6	6	104
801-1,000	127	127		53	25	29	3	2	15
1,001-1,200	43	42	1	17	16	2	2	1	5
1,201-1,400	37	26	11	22	8	3	1		3
1,401-1,600	34	19	15	25	5	2		1	1
1,601-1,800	17	9	8	11	3		2	1	
1,801-9,999	31	20	11	23	3	3			2
<b>Total</b>	<b>4,173</b>	<b>4,029</b>	<b>144</b>	<b>1,986</b>	<b>728</b>	<b>815</b>	<b>53</b>	<b>73</b>	<b>518</b>

### Judicial Retirement Plan Two Fund

Average Amount of Monthly Benefit \$	Number of Retirees	Type of Retirement		Option Selected (Note A)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
0-1,200	1	1		1					
1,201-1,400	1	1			1				
1,401-1,600	1	1		1					
1,801-2,000 (B)	3	3		1			1	1	
2,001-2,200	3	3		1			1	1	
2,601-2,800 (B)	1	1		1					
2,801-3,000	2	2			2				
3,001-3,200	2	2		1	1				
3,201-3,400	12	12		2	9				1
3,401-3,600	3	3		1	2				
3,601-3,800	2	2			2				
3,801-4,000	7	7			3	2		2	
4,001-4,200	12	11	1	3	6	2			1
4,201-4,400	2	2		2					
4,401-4,600	3	3		2	1				
4,601-4,800	1	1		1					
5,001-5,400 (B)	3	2	1	3					
<b>Total</b>	<b>59</b>	<b>57</b>	<b>2</b>	<b>20</b>	<b>27</b>	<b>4</b>	<b>2</b>	<b>4</b>	<b>2</b>

Note A: Life - standard annuity

Option 1 - a reduced annuity for the lifetime of the member, then pays the same amount throughout the life of the beneficiary.

Option 2 - a reduced annuity for the lifetime of the member, then pays one-half of that amount throughout the life of the beneficiary.

Option 3 - a reduced annuity to the member or the beneficiary for a guaranteed period of 5 years, and for the lifetime of the member.

Option 4 - a reduced annuity to the member or the beneficiary for a guaranteed period of 10 years, and for the lifetime of the member.

Option 5 - a reduced annuity for the lifetime of the member, then pays three-fourths of that amount throughout the life of the beneficiary.

Note B: No annuitants were receiving an annuity between \$1,601 and \$1,800, between \$2,201 and \$2,600, or between \$4,801 and \$5,000.



- Unaudited -

## AVERAGE BENEFIT PAYMENTS - EMPLOYEE CLASS (Note A)

Retirement Effective Dates	Years of Credited Service					
	5-10	10-15	15-20	20-25	25-30	30+
<b>September 30, 1993 to August 31, 2003</b>						
<b>- Period 9/30/93 to 8/31/94:</b>						
Average Monthly Benefit	\$ 383.19	\$ 632.27	\$ 971.24	\$ 1,375.60	\$ 1,857.84	\$ 2,652.81
Average Final Average Salary	\$ 2,088.96	\$ 2,047.87	\$ 2,124.15	\$ 2,353.19	\$ 2,623.13	\$ 3,033.02
Number of Active Retirees	203	605	554	674	985	2053
<b>- Period 9/30/94 to 8/31/95:</b>						
Average Monthly Benefit	\$ 383.73	\$ 649.71	\$ 1,021.73	\$ 1,362.85	\$ 1,917.28	\$ 2,571.16
Average Final Average Salary	\$ 2,081.07	\$ 2,094.23	\$ 2,264.96	\$ 2,443.82	\$ 2,770.55	\$ 3,115.07
Number of Active Retirees	180	560	390	430	590	830
<b>- Period 9/30/95 to 8/31/96:</b>						
Average Monthly Benefit	\$ 356.70	\$ 699.37	\$ 950.22	\$ 1,302.20	\$ 1,927.99	\$ 2,616.61
Average Final Average Salary	\$ 2,162.91	\$ 2,387.90	\$ 2,258.64	\$ 2,376.32	\$ 2,826.11	\$ 3,276.39
Number of Active Retirees	135	395	240	244	364	415
<b>- Period 9/30/96 to 8/31/97:</b>						
Average Monthly Benefit	\$ 376.25	\$ 595.26	\$ 967.30	\$ 1,236.70	\$ 1,820.48	\$ 2,345.46
Average Final Average Salary	\$ 2,292.33	\$ 2,138.27	\$ 2,368.12	\$ 2,271.38	\$ 2,808.86	\$ 3,061.31
Number of Active Retirees	115	307	156	178	238	223
<b>- Period 9/30/97 to 8/31/98:</b>						
Average Monthly Benefit	\$ 376.81	\$ 626.52	\$ 953.84	\$ 1,353.34	\$ 2,040.10	\$ 2,570.85
Average Final Average Salary	\$ 2,277.25	\$ 2,231.85	\$ 2,313.20	\$ 2,445.99	\$ 3,034.40	\$ 3,344.29
Number of Active Retirees	168	525	319	609	962	677
<b>- Period 9/30/98 to 8/31/99:</b>						
Average Monthly Benefit	\$ 397.30	\$ 660.06	\$ 994.97	\$ 1,365.57	\$ 1,991.93	\$ 2,533.78
Average Final Average Salary	\$ 2,363.47	\$ 2,384.30	\$ 2,456.12	\$ 2,560.27	\$ 3,045.21	\$ 3,317.01
Number of Active Retirees	164	535	327	442	707	567
<b>- Period 9/30/99 to 8/31/00:</b>						
Average Monthly Benefit	\$ 334.29	\$ 641.66	\$ 933.09	\$ 1,333.72	\$ 1,937.84	\$ 2,414.35
Average Final Average Salary	\$ 2,214.08	\$ 2,544.48	\$ 2,481.35	\$ 2,760.46	\$ 3,236.32	\$ 3,438.57
Number of Active Retirees	196	616	406	496	920	754
<b>- Period 9/30/00 to 8/31/01:</b>						
Average Monthly Benefit	\$ 381.48	\$ 618.03	\$ 945.81	\$ 1,333.91	\$ 1,932.54	\$ 2,486.17
Average Final Average Salary	\$ 2,684.78	\$ 2,536.02	\$ 2,677.08	\$ 2,863.95	\$ 3,341.71	\$ 3,641.46
Number of Active Retirees	150	592	391	457	835	673
<b>- Period 9/30/01 to 8/31/02:</b>						
Average Monthly Benefit	\$ 370.52	\$ 638.66	\$ 982.23	\$ 1,397.43	\$ 2,053.54	\$ 2,696.77
Average Final Average Salary	\$ 2,577.75	\$ 2,631.27	\$ 2,828.70	\$ 3,027.36	\$ 3,535.24	\$ 3,936.13
Number of Active Retirees	184	694	416	598	1036	1006
<b>- Period 9/30/02 to 8/31/03:</b>						
Average Monthly Benefit	\$ 374.68	\$ 689.58	\$ 1,024.49	\$ 1,450.03	\$ 2,064.82	\$ 2,754.12
Average Final Average Salary	\$ 2,533.94	\$ 2,768.66	\$ 2,874.82	\$ 3,204.20	\$ 3,558.16	\$ 3,991.32
Number of Active Retirees	352	1476	900	1069	1736	1787
<b>Five Year Average -</b>						
<b>Period 9/30/98 to 8/31/03:</b>						
Average Monthly Benefit	\$ 370.90	\$ 658.15	\$ 985.51	\$ 1,391.39	\$ 2,009.32	\$ 2,624.78
Average Final Average Salary	\$ 2,476.62	\$ 2,621.25	\$ 2,713.69	\$ 2,954.05	\$ 3,393.23	\$ 3,763.60
Average Number of Active Retirees	209	783	488	612	1047	957
<b>Ten Year Average -</b>						
<b>Period 9/30/93 to 8/31/03:</b>						
Average Monthly Benefit	\$ 373.33	\$ 651.80	\$ 981.81	\$ 1,373.04	\$ 1,979.65	\$ 2,614.86
Average Final Average Salary	\$ 2,342.92	\$ 2,448.86	\$ 2,520.35	\$ 2,723.87	\$ 3,176.27	\$ 3,465.23
Average Number of Active Retirees	185	631	410	520	837	899

Note A: This schedule includes service retirements of the employee class as of September 30, 2003. It does not include disability retirements or the elected state official class.

- Unaudited -

**SUMMARY OF CASH RECEIPTS AND DISBURSEMENTS -  
Pension (and Other Employee Benefit) Trust Funds  
Year Ended August 31, 2003**

	Employees Retirement Fund (0955)	Law Enforcement and Custodial Officer Supplemental Retirement Fund (0977)	Judicial Retirement System Plan One (0001)	Judicial Retirement System Plan Two (0993)	TexaSaver 401 (k) Trust Fund (0946)	TexaSaver 457 Trust Fund (0945)	Excess Benefit Arrangement Fund (5039)	State Employees Cafeteria Trust Plan Fund (0943)	Totals
	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Cash in State Treasury/ Legislative Appropriations - Beginning of Year</b>	27,511,469	556,866	243,340	605,814	7,232	1,086,666	-	3,842,243	33,853,630
<b>Receipts:</b>									
Member Contributions	360,304,072			3,040,814				33,421,550	396,766,436
State Contributions	302,072,859			8,268,748					310,341,607
Legislative Appropriations			27,364,127						27,364,127
Interest on Treasury Deposits	1,248,419	32,328		10,961	803	22,818		65,319	1,380,648
Other Receipts	230,134	2,342			100,052	150,887			483,415
<b>Total Cash Receipts</b>	<b>663,855,484</b>	<b>34,670</b>	<b>27,364,127</b>	<b>11,320,523</b>	<b>100,855</b>	<b>173,705</b>	<b>-</b>	<b>33,486,869</b>	<b>736,336,233</b>
<b>Disbursements:</b>									
Benefit Payments	1,017,177,522	22,851,587	27,237,534	2,164,409			66,915	32,649,812	1,102,147,779
Member Contributions Withdrawn	69,664,581		2,906	97,577					69,765,064
Administrative Expenses	22,877,378	1,111,130	120,001	317,294	336,141	379,212		1,186,848	26,328,004
Capital Assets	772,274								772,274
<b>Total Cash Disbursements</b>	<b>1,110,491,755</b>	<b>23,962,717</b>	<b>27,360,441</b>	<b>2,579,280</b>	<b>336,141</b>	<b>379,212</b>	<b>66,915</b>	<b>33,836,660</b>	<b>1,199,013,121</b>
<b>Operating Transfers In (Out):</b>									
From Investment Pool	1,022,000,000	27,100,000		4,300,000					1,053,400,000
To Investment Pool	(578,200,000)	(3,200,000)		(13,400,000)					(594,800,000)
Excess Benefit Arrangement Transfers-Membership Fees	(66,915) (493,998)				260,000	233,998	66,915		-
<b>Net Operating Transfers</b>	<b>443,239,087</b>	<b>23,900,000</b>	<b>-</b>	<b>(9,100,000)</b>	<b>260,000</b>	<b>233,998</b>	<b>66,915</b>	<b>-</b>	<b>458,600,000</b>
<b>Net Cash Activity</b>	<b>(3,397,184)</b>	<b>(28,047)</b>	<b>3,686</b>	<b>(358,757)</b>	<b>24,714</b>	<b>28,491</b>	<b>-</b>	<b>(349,791)</b>	<b>(4,076,888)</b>
<b>Cash in State Treasury/ Legislative Appropriations - End of Year</b>	<b>24,114,285</b>	<b>528,819</b>	<b>247,026</b>	<b>247,057</b>	<b>31,946</b>	<b>1,115,157</b>	<b>-</b>	<b>3,492,452</b>	<b>29,776,742</b>