

# 2004

## Comprehensive Annual Financial Report

Employees Retirement System of Texas  
*A Retirement System of the State of Texas*

Fiscal Year Ended August 31, 2004

*Ann S. Fuelberg*  
Executive Director

Prepared by  
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# COMPREHENSIVE ANNUAL FINANCIAL REPORT

Fiscal Year Ended August 31, 2004

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Fiscal Year Ended August 31, 2004

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Janis Wild retired in August 2004 after working for the Texas Education Agency for 28 years. While she's retired, she's hardly idle. She serves as a Jazzercise manager and is active in her community and church. She periodically goes to the 14-acre ranch she and her husband, Dennis, own. A self-described "city girl," she's surprised by how much she has enjoyed taking care of the livestock, planting oak trees on the land, and learning to build fences and operate a tractor. She and Dennis relax on frequent cruises to distant locales.

*"When I retired, I was able to choose from a variety of annuity payment options and tailor my payments to my needs. I love that my health insurance as a retiree is paid by the State. With our frequent travels, I also feel secure in knowing that HealthSelect provides health coverage anywhere in the world."*

*-Janis Wild*



*Janis Wild, Retiree*

# Introductory 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, 2004

	<u>ERS (A)</u>	<u>LECOS (A)</u>	<u>JRS I</u>	<u>JRS II</u>
Active Members	133,349	38,305	53	484
Terminated Employees Entitled to Benefits	54,658	30	15	79
<b>Total Retirement Accounts</b>	<b>188,007</b>	<b>38,335</b>	<b>68</b>	<b>563</b>
<b>Retirees and Beneficiaries</b>	<b>60,089</b>	<b>4,576</b>	<b>494</b>	<b>72</b>
Service Retirements	3,906	431	10	8
Disability Retirements	8			
<b>Funded Ratios</b>	<b>97.3%</b>	<b>109.3%</b>		<b>117.5%</b>

### 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	529,630,627	17,984,018		3,636,740
Net Appreciation				
in Fair Value of Investments	1,478,546,931	50,385,821		9,771,423

### Time Weighted Rate of Return

	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>
Pension Investment Pool Trust Fund	11.69%	4.22%	2.89%

### Other Transactions Summary

	<u>ERS</u>	<u>LECOS</u>	<u>JRS I (B)</u>	<u>JRS II</u>
	\$	\$	\$	\$
Member Contributions	300,155,783		142,419	2,921,531
State Retirement Contributions	278,844,513			8,204,944
Retirement Benefits	1,184,712,996	27,558,933	22,620,421	2,770,153
Death Benefits:				
Active Members	1,012,352			
Retirees	937,071			
Lump Sum Retiree Death Benefits (C)	6,681,466			
Member Contributions Withdrawn	83,779,001		1,149	302,953
Administrative Expenses	12,447,538	630,216	120,000	272,804
Investment Expenses	13,474,596	463,816		76,117

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 17, 2004

Dear Governor Perry and Members of the Texas Legislature:

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

We are pleased to present the audited Employees Retirement System Comprehensive Annual Financial Report for fiscal year 2004.

ANN S. FUELBERG  
EXECUTIVE DIRECTOR

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 for many higher education employees, excluding retirement.

OWEN WHITWORTH  
CHAIR

We are glad to report that a healthy stock market combined with prudent investment practices earned the ERS trust a vigorous return of 11.7 percent for our investment portfolio in FY 2004, allowing it to close the fiscal year with a market value of \$19.5 billion.

CAROLYN LEWIS GALLAGHER  
VICE-CHAIR

BILL CEVERHA  
DON GREEN

YOLANDA GRIEGO  
MILTON HIXSON

BOARD OF TRUSTEES

Although the strong return was not enough to completely counter the losses the trust experienced in FY 2001-02 with the downturn in the market, it has tempered any further drop in the funded ratio which remained stable at 97.3 percent and kept the ERS fund in the top 25 percent of public retirement funds nationwide. We have used our diversified investment asset allocation policy, risk management process, and consistent funding from the State and our membership to take advantage of the upswing in the market to stabilize the ERS fund. But our most recent actuarial report shows that the State must resume funding the normal cost if it is going to be able to continue to provide State of Texas employees and retirees with secure retirement program.

During the fiscal year ended August 31, 2004, 3,914 employees retired, including 2,287 who took advantage of the retirement incentive program passed by the 78th Legislature. This brings the total number of State retirees to 60,089.

The 2003 reductions in health insurance benefits produced the savings required to help meet the State revenue shortfall that year and close the deficit projected for FY 2004-05 with only a minor additional premium rate increase for FY 2005. Although prospects for substantial improvements appear slim, increasingly careful management of the resources we have available will help the State continue to provide its employees, retirees and their families with comprehensive health coverage that is comparable to benefits available in the private sector.

Customers in the State's Group Benefits Program are able to enroll and change their insurance and TexFlex benefits via the Internet by accessing their personal information in ERS OnLine. More than 97 percent of insurance transactions were made online during our summer enrollment period this year. Eliminating paper saves State employees time and the State money by making the process more efficient.

Annuity payroll functions have been added—allowing annuitants to view their retirement checks, request direct deposit, change tax-withholding amounts, and elect to have membership dues deducted from their monthly annuity.

Pre-retirement functions are the final phase of our multi-year project and by the end of the year, employees will be able to apply for retirement, purchase service and review all of their expected benefit options through ERS OnLine.

We are proud that ERS has earned the reputation of a top-performing retirement system with high standards for financial integrity, benefit management and customer service.

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 and competitive insurance, deferred compensation, and flexible benefits/premium conversion programs for our members and their families.



OWEN WHITWORTH  
Chair, Board of Trustees



ANN S. FUELBERG  
Executive Director





December 17, 2004

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

ANN S. FUELBERG  
EXECUTIVE DIRECTOR

OWEN WHITWORTH  
CHAIR

CAROLYN LEWIS GALLAGHER  
VICE-CHAIR

BILL CEVERHA  
DON GREEN

YOLANDA GRIEGO  
MILTON HIXSON  
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, 2004. 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 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 retirement system 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, 2004. This report consists of five sections:

1. Introductory Section, which contains this Letter of Transmittal, the Executive Director and Chair’s Letter, 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, an independent actuarial audit report, and other actuarial information as of August 31, 2004; 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 Investment 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 11.7% for fiscal year 2004. Over the longer term, the fund returned 8.15% for the 10 years ending August 31, 2004 slightly besting the policy benchmark of 8.09%. This long-term annual return is ahead of the actuarially assumed rate of return of 8.0%.

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

The 78th Legislature led a major initiative to control the rising cost 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, 2004, the System continued implementation of legislatively approved changes to the employee group benefits program that:

- Shifted a greater share of the costs to employees and retirees through increased co-payments and new deductibles,
- Limited the participation through a 90-day waiting period, and
- Increased the eligibility requirements for retiree health insurance coverage.

Other major initiatives for fiscal year 2004 included the following:

- Converted annuitant payroll processing for retirees from mainframe to client/server, and
- Implemented information technology initiative for web-based self-service such that retirees now have online access to their retirement and pension payment related data and can initiate appropriate change transactions.

Fiscal year 2005 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, 2003. 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 15 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, 2003

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.

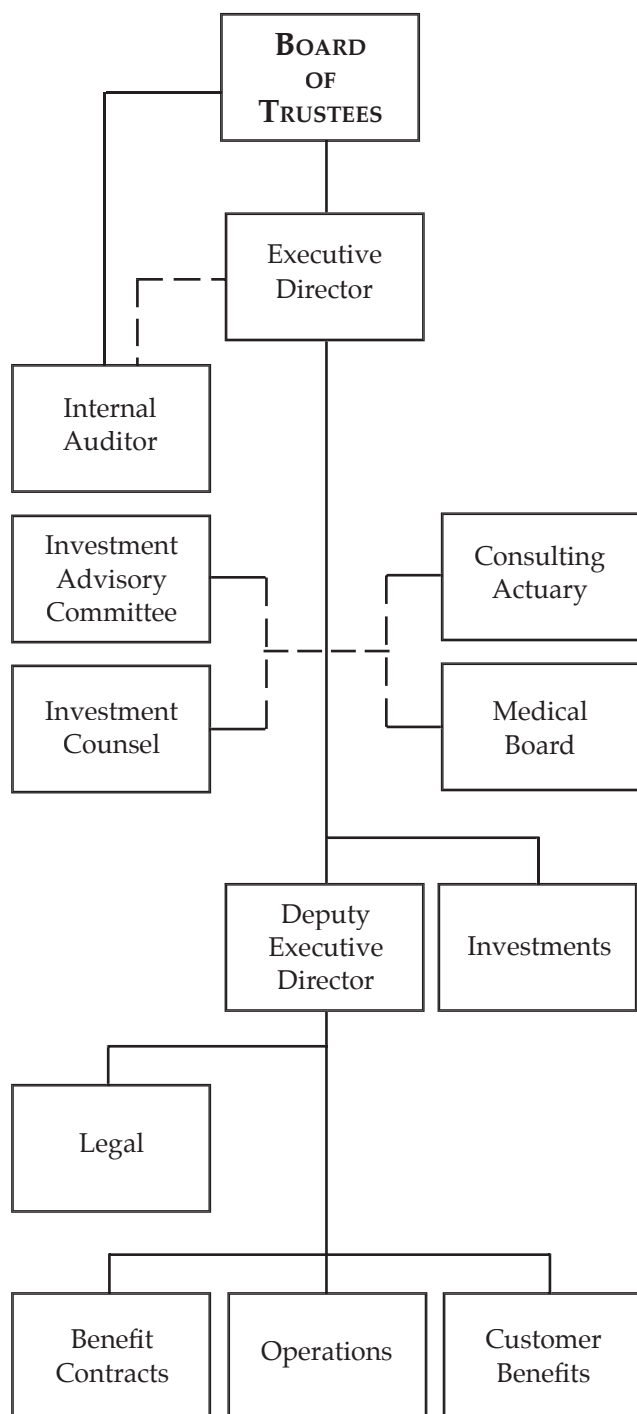


**Nancy L. Zjelke**  
President

**Jeffrey R. Emmer**  
Executive Director

# ORGANIZATIONAL CHART AND DATA

As of August 31, 2004



## BOARD OF TRUSTEES

**Milton Hixson, Chair**  
Owen Whitworth, *Vice-Chair*  
Bill Ceverha  
Carolyn Lewis Gallagher  
Don Green  
Yolanda Griego

## STAFF

**Ann S. Fuelberg, 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. Thomas Tull, CFA, *Chair, Private Investor*  
Bob Alley, CFA, *Vice-Chair, AIM Capital Management*  
I. Craig Hester, CFA, *Hester Capital Management, LLC*  
C. Courtland Huber, Ph.D., *The University of Texas at Austin*  
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  
Templeton Investment Counsel, LLC  
Voyageur Asset Management

### *Master Trust Custodian*

J. P. Morgan Chase & Co.

### *Medical Board*

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

# SUMMARY OF PLAN PROVISIONS

Effective September 1, 2004

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>  <b>Employee Class Only:</b>                      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><b>Elected Class Only:</b></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><b>JRS I Only:</b></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 <b>before</b> September 1, 1985.</li> </ul> <p><b>JRS II Only:</b></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 <b>after</b> August 31, 1985.</li> </ul>
<p><b>Service Retirement Eligibility:</b>  <b>Employee Class Only:</b></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><b>Elected Class Only:</b></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><b>JRS I and JRS II:</b></p> <ul style="list-style-type: none"> <li>● Age 65 with at least 10 years of service credit and 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><b>JRS I Only:</b>                      20 years of service, regardless of whether the member currently holds a judicial office.</p> <p><b>JRS II Only:</b></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 and served at least two 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> Not applicable.</p>	<p>20 years of service credit as a certified peace officer / custodial officer, under the age of 50.</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> <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% percent 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> <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 except for the one-time partial lump sum.</p>

ERS	LECOS	JRS I AND JRS II
<p><b>Vesting Requirement:</b> Five or more years of service credit for Employee Class and eight or more years for Elected Class.</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: Employee Class Only:</b></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 Employee Class service credit, which may include up to five years of purchased military service credit.</li> </ul> <p><b>Elected Class Only:</b></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 Elected Class service (exclusive of military service) or six years of Elected Class 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: Employee Class Only:</b></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><b>Elected Class Only:</b></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 Elected Class service, whichever is greater.</li> </ul> <p><b>Employee Class and Elected Class:</b> Optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.</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>Death Benefits:</b>  <b>Employee Class <u>and</u> Elected Class:</b></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><b>Elected Class Only:</b>            Member with at least eight, but less than 10 years of service and under age of 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 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 details of the provisions.*

In 1997, Reynaldo Alaniz retired from the Disability Determination division of the Texas Rehabilitation Commission (now the Department of Assistive and Rehabilitative Services). He now is an award-winning sculptor and, in 2002, participated in the ERS exhibit “Texas Retirees: An Expression of Talent IV.”

*“I am very grateful that the benefits from the State enabled me to retire at a young age. I am enjoying my second ‘career’ as a sculptor. I received a grant to study and work in Italy, and my work has been on display in New York City. Right now, I’m working on a life-size sculpture for a church in Austin.”*

*-Reynaldo Alaniz*



*Reynaldo Alaniz, Retiree*

# Financial Section

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



## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Employees Retirement System of Texas  
Austin, Texas

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information, of the Employees Retirement System of Texas (the "System") as of and for the year ended August 31, 2004, which collectively comprise the System's basic financial statements as listed in the table of contents. We have also audited the combining statements of fiduciary net assets and changes in fiduciary net assets of the pension plans administered by the System, as identified in Note 1 to the financial statements as of August 31, 2004. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the System, as of August 31, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective net assets of each pension plan administered by the System, as of August 31, 2004, and the respective changes in net assets, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, Budgetary Comparison Schedules-Appropriated Special Revenue Funds, Schedules of Funding Progress, and Schedules of Employer Contributions on pages 19 through 23 and 55 through 57 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the

supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The combining financial statements and supplementary schedules on pages 58 to 69 are presented for purposes of additional analysis and are not a required part of the basic financial statements of the System. The combining financial statements and supplementary schedules are also the responsibility of the management of the System. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

The information in the Introductory Section, Investment Section, Actuarial Section, and the Statistical Section on pages 1 to 13 and 70 to 111 are presented for the purpose of additional analysis and are not a required part of the basic financial statements for the System. Such additional information has not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2004, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

December 16, 2004

Deloitte + Touche LLP

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Management is pleased to provide this overview of the financial activities of the Employees Retirement System of Texas (the System) for the year ended August 31, 2004. Please read it in conjunction with the Basic Financial Statements, which begin after this discussion.

## Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the System's financial statements. The Financial Section 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 four 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 Benefits Fund). Highlights are presented under the heading Financial Analysis on Government-wide Statements below.
- Exhibit VII is a required Statement of Cash Flows for the Group Benefits Fund, which is an Internal Service Fund. That 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 benefits plans retirement funds. Please see the Financial Highlights – Defined Benefit Retirement Plans below 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 five programs:

- Social Security Administration,
- Death Benefits for Public Safety Officers,
- Compensation to Victims of Crime,
- Death Benefits for Retirees, and
- Group Benefits Program.

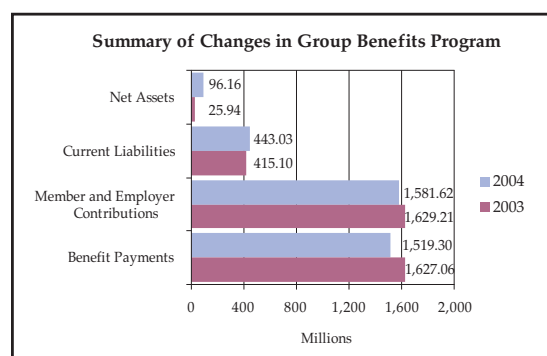
In Exhibits III and IV for the governmental funds, this is the first fiscal year that the System has an appropriation for the Compensation to Victims of Crime Program, but no expenditures were incurred; therefore, the \$2.7 million appropriation was lapsed at the end of the fiscal year.

- Unaudited -

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The Group Benefits Program in Exhibits I and II had significant changes from the prior year. Exhibits V and VI provide additional information on the Group Benefits Program. The changes in the program are summarized in millions as follows:

	August 31		Percent Increase (Decrease)
	2004	2003	
Net Assets	\$ 96.16	\$ 25.94	270.70%
Current Liabilities	443.03	415.10	6.72%
Member and Employer Contributions	1,581.62	1,629.21	(2.92)%
Benefit Payments	1,519.30	1,627.06	(6.62)%



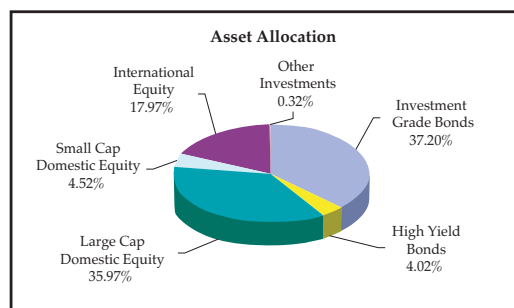
The 270.7% increase in net assets is a result of benefit program design changes. The 6.72% increase in current liabilities is due to increases in claims payable and in obligations for securities lending collateral. The 6.62% decrease in benefit payments reflects the benefit program design changes including higher deductibles and co-payments.

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

### Financial Highlights – Defined Benefit Retirement Plans

- Net assets of the defined benefit plans administered by the System totaled \$19.57 billion as of August 31, 2004, compared with \$18.18 billion as of August 31, 2003. The \$1.39 billion, or 7.6%, increase resulted primarily from an increase in the fair value of investments in the amount of \$1.56 billion.
- The investment portfolio returned 11.7% for the year. A continued economic recovery resulted in strong positive returns for the fund this fiscal year, reflecting robust equity markets during the beginning months of the fiscal year. The fiscal year-end asset allocation stood at:

- 37.20% investment grade bonds,
- 4.02% high yield bonds,
- 35.97% large cap domestic equity,
- 4.52% small cap domestic equity,
- 17.97% international equity, and
- 0.32% other investments.



For additional details, please see the *Report on Investment Activity* in the Investment Section.

- Changes in contributions and benefit payments are summarized in millions as follows:

	August 31		Percent Increase (Decrease)
	2004	2003	
Contributions	\$ 658.00	\$ 697.05	(5.60)%
Benefit Payments	1,329.36	1,133.85	17.24%

The retirement incentives effective for fiscal year 2004 have caused an increase in the annuity benefit payments and a decrease in the contributions.



- Unaudited -

## MANAGEMENT'S DISCUSSION AND ANALYSIS

- The most recent actuarial valuations of the funded defined benefit plans were completed as of August 31, 2004. The funded ratios are as follows:

Plans	Funded Ratios	
	August 31, 2004	August 31, 2003
Employees Retirement System	97.3%	97.6%
Law Enforcement and Custodial Officer Supplemental Retirement Fund	109.3%	111.5%
Judicial Retirement System of Texas Plan Two	117.5%	116.5%

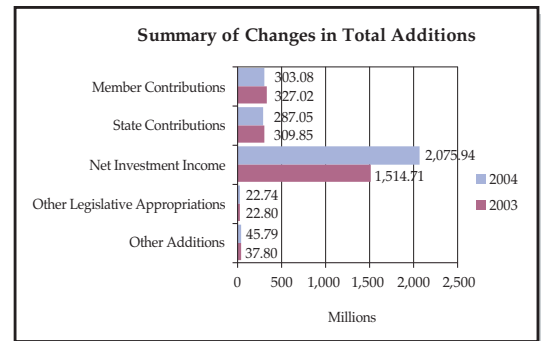
See Exhibits X and XI for more information regarding each of the defined benefit plans.

### Fiduciary Net Assets of Defined Benefit Retirement Plans

#### Additions

Retirement benefits are financed primarily through the collection of member and state retirement contributions, investment income, legislative appropriations, and contributions transferred from the Teacher Retirement System. Additions in Fiduciary Net Assets have been extracted from Exhibit IX, Combined Statement of Changes in Fiduciary Net Assets. The additions in millions were as follows:

	August 31		Percent
	2004	2003	Increase (Decrease)
	\$	\$	%
Member contributions	303.08	327.02	(7.3)
State contributions	287.05	309.85	(7.4)
Net investment income	2,075.94	1,514.71	37.1
Other legislative appropriations	22.74	22.80	(0.3)
Other additions	45.79	37.80	21.1
<b>Total additions</b>	<b>2,734.60</b>	<b>2,212.18</b>	<b>23.6</b>



For the Employees Retirement Fund, member and State 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, member and State retirement contribution rates were 6% and 16.83%, respectively.

Investment revenues are comprised of interest income, dividend income, securities lending income, and net appreciation in fair value of investments.

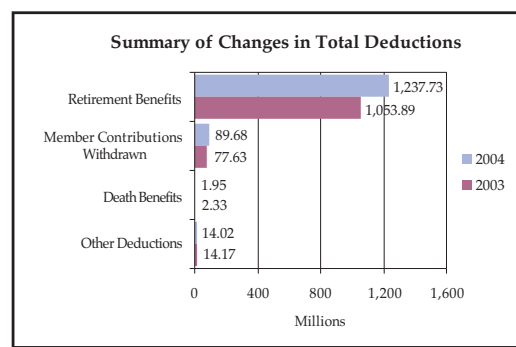
## MANAGEMENT'S DISCUSSION AND ANALYSIS

### 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. Deductions in Net Assets have been extracted from Exhibit XI, Combined Statement of Changes in Fiduciary Net Assets.

The deductions in millions were as follows:

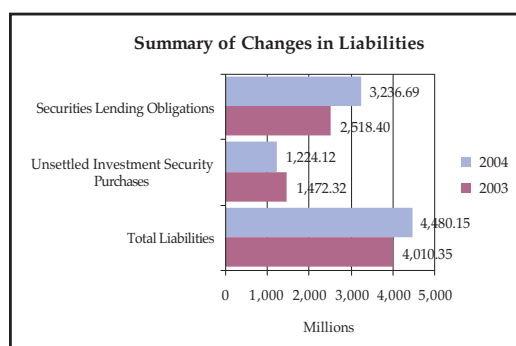
	August 31		Percent Increase (Decrease) %
	2004	2003	
	\$	\$	
Retirement benefits	1,237.73	1,053.89	17.4
Member contributions withdrawn	89.68	77.63	15.5
Death benefits	1.95	2.33	(16.3)
Other deductions	14.02	14.17	(1.1)
<b>Total deductions</b>	<b>1,343.38</b>	<b>1,148.02</b>	<b>17.0</b>



### Liabilities

Changes in liabilities are summarized in millions as follows:

	August 31		Percent Increase (Decrease) %
	2004	2003	
	\$	\$	
Securities Lending Obligations	3,236.69	2,518.40	28.5
Unsettled Investment Security Purchases	1,224.12	1,472.32	(16.9)
<b>Total Liabilities</b>	<b>4,480.15</b>	<b>4,010.35</b>	<b>11.7</b>



Total liabilities increased by 11.7%. The major changes are a 28.5% increase in securities lending obligations and a 16.9% decrease in unsettled investment security purchases. The condensed liabilities have been extracted from Exhibit X, Combined Statement in Fiduciary Net Assets.

### Transfers

Retirement membership fees deposited to the Employees Retirement Fund in the amount of \$452 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.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Funding Status and Progress

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, 2004, (compared to the August 31, 2003 actuarial valuation) is summarized in millions as follows:

Plans	Actuarial Net Asset/(Liability)	
	<i>August 31, 2004</i>	<i>August 31, 2003</i>
Employees Retirement System	(\$555.20)	(\$480.56)
Law Enforcement and Custodial Officer Supplemental Retirement	\$57.79	\$68.67
Judicial Retirement System of Texas Plan Two	\$21.63	\$18.31

Under the Employees Retirement System Fund, the normal cost is 12.45% of payroll and the contributions are 12% of payroll. Because the normal cost is greater than the contribution rate, the amortization period is infinite. The actuarial net liability will need to be met over the coming years through improved investment performance, increased contributions, or plan design changes.

There is no amortization period for the Law Enforcement and Custodial Officer Supplemental Retirement Fund and the Judicial Retirement System of Texas Plan Two Fund because they both have actuarial net asset balances.

The Judicial Retirement Plan One is funded on a pay-as-you-go basis; therefore there is no calculation of the actuarial net asset or liability.

### 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 Michael C. Wheeler, Chief Financial Officer at 512-867-7224.

**Exhibit I**  
**STATEMENT OF NET ASSETS**  
**August 31, 2004**  
(With Comparative Totals at August 31, 2003)

<i>ASSETS</i>	<b>Governmental Activities</b>	
	<b>August 31,</b>	
	<b>2004</b>	<b>2003</b>
<i>Current Assets:</i>	\$	\$
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	3,127	57,195
Cash in State Treasury	11,091,922	36,345,298
Total Cash and Cash Equivalents	<u>11,095,049</u>	<u>36,402,493</u>
Securities Lending Collateral	41,603,761	22,804,480
Short-Term Investments	117,815,080	53,940,563
Legislative Appropriations		500
Receivables	81,258,780	85,518,578
Total Current Assets	<u>251,772,670</u>	<u>198,666,614</u>
<i>Non-Current Assets:</i>		
Investments	287,423,594	242,388,762
Total Non-Current Assets	<u>287,423,594</u>	<u>242,388,762</u>
<b>Total Assets</b>	<b><u>539,196,264</u></b>	<b><u>441,055,376</u></b>
<b><i>LIABILITIES</i></b>		
<i>Current Liabilities:</i>		
Payables	399,814,546	390,442,728
Due To External Parties	824,257	767,731
Deferred Revenue	790,923	1,085,701
Obligations Under Securities Lending	41,603,761	22,804,480
Total Current Liabilities	<u>443,033,487</u>	<u>415,100,640</u>
<b>Total Liabilities</b>	<b><u>443,033,487</u></b>	<b><u>415,100,640</u></b>
<b><i>NET ASSETS</i></b>		
<i>Restricted For:</i>		
Employee Benefits - Group Insurance	96,160,216	25,939,226
Unrestricted	2,561	15,510
<b>Total Net Assets (Exh. III)</b>	<b><u>96,162,777</u></b>	<b><u>25,954,736</u></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, 2004**

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

	Program Revenues			Net (Expense) Revenue & Changes in Net Assets Governmental Activities	
	Expenses	Charges for Services	Operating Grants & Contributions	August 31,	
				2004	2003
	\$	\$	\$	\$	\$
<b>Functions/Programs</b>					
<i>Governmental Activities:</i>					
Social Security Administration	30,949			(30,949)	(38,607)
Death Benefits-Peace Officers, Firemen, etc.	4,984,749	4,984,749		-	-
Death Benefits-Retiree \$5,000 Lump Sum	6,681,466	6,681,466		-	(366,290)
Group Benefits Program	<u>1,528,611,347</u>	<u>1,581,773,217</u>	<u>17,059,120</u>	<u>70,220,990</u>	<u>6,606,346</u>
<b>Total Governmental Activities</b>	<u><u>1,540,308,511</u></u>	<u><u>1,593,439,432</u></u>	<u><u>17,059,120</u></u>	<u><u>70,190,041</u></u>	<u><u>6,201,449</u></u>
			<b>General revenues:</b>		
			Transfers	18,000	
			<b>Total General Revenues</b>	<u><b>18,000</b></u>	-
			<b>Change in Net Assets (Exh. IV)</b>	<b>70,208,041</b>	<b>6,201,449</b>
			<b>Net Assets - Beginning</b>	<u><b>25,954,736</b></u>	<u><b>19,753,287</b></u>
			<b>Net Assets - Ending (Exh. I)</b>	<u><u><b>96,162,777</b></u></u>	<u><u><b>25,954,736</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, 2004**

(With Comparative Totals at August 31, 2003)

	<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>Compensation to Victims of Crime (0469) (U/F 3003)</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>\$</b>	<b>August 31, 2004</b>	<b>August 31, 2003</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b><u>ASSETS</u></b>						
<b>Current Assets:</b>						
<i>Cash and Cash Equivalents:</i>						
Cash in State Treasury	5,192	-	-	-	5,192	18,967
Total Cash and Cash Equivalents	5,192	-	-	-	5,192	18,967
Legislative Appropriations	-	-	-	-	-	500
Total Current Assets	5,192	-	-	-	5,192	19,467
<b>Total Assets</b>	<b>5,192</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,192</b>	<b>19,467</b>
<b><u>LIABILITIES &amp; FUND BALANCES</u></b>						
<b>Current Liabilities:</b>						
<i>Payables:</i>						
Accounts Payable	-	-	-	-	-	500
Due To Other Funds (Note 5.D)	2,631	-	-	-	2,631	3,457
Total Current Liabilities	2,631	-	-	-	2,631	3,957
<b>Total Liabilities</b>	<b>2,631</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,631</b>	<b>3,957</b>
<b>Fund Balances:</b>						
<i>Unreserved:</i>						
Undesignated, Reported In:	-	-	-	-	-	-
Special Revenue Funds	2,561	-	-	-	2,561	15,510
<b>Total Fund Balances (Exh. IV)</b>	<b>2,561</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,561</b>	<b>15,510</b>
<b>Total Liabilities &amp; Fund Balances</b>	<b>5,192</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,192</b>	<b>19,467</b>
Total Fund Balances - Governmental Funds (above):					2,561	15,510
<i>Amounts reported for 'Governmental Activities' in the Statement of Net Assets (Exhibit I) are different because:</i>						
An Internal Service Fund is used by the System to account for the assets and liabilities associated with the Group Benefits 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 Statement of Net Assets.						
					96,160,216	25,939,226
<b>Net Assets of Governmental Activities (Exhibit I)</b>					<b>96,162,777</b>	<b>25,954,736</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, 2004**

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

	<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>Compensation to Victims of Crime (0469) (U/F 3003)</b>	<b>Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008)</b>	<b>Special Revenue Funds Totals</b>	
	\$	\$	\$	\$	<b>August 31, 2004</b>	<b>August 31, 2003</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		2,711,951			2,711,951	2,207,760
For Victims of Crime			2,739,951		2,739,951	-
For Death Benefits-Retirees				6,508,651	6,508,651	6,453,923
Total Original Appropriations	-	2,739,951	2,739,951	6,508,651	11,988,553	8,689,683
Additional Appropriations Revenue:						
For Public Employee Survivors		2,244,798			2,244,798	2,441,591
For Death Benefits-Retirees				172,815	172,815	(367,265)
Total Additional Appropriations	-	2,244,798	-	172,815	2,417,613	2,074,326
<b>Total Revenues</b>	<b>-</b>	<b>4,984,749</b>	<b>2,739,951</b>	<b>6,681,466</b>	<b>14,406,166</b>	<b>10,764,009</b>
<b>EXPENDITURES</b>						
<i>Current:</i>						
Death Benefits		4,956,749		6,681,466	11,638,215	11,102,299
<i>Administrative Expenditures:</i>						
Salaries & Wages	24,541				24,541	30,970
Payroll Related Costs	5,609				5,609	6,616
Professional Fees & Services	80				80	28,187
Travel	209				209	201
Materials & Supplies	103				103	128
Communications & Utilities	47				47	46
Repairs & Maintenance		28,000			28,000	-
Printing & Reproduction	1				1	-
Other Expenditures	359				359	459
Total Administrative Expenditures	30,949	28,000	-	-	58,949	66,607
<b>Total Expenditures</b>	<b>30,949</b>	<b>4,984,749</b>	<b>-</b>	<b>6,681,466</b>	<b>11,697,164</b>	<b>11,168,906</b>
<b>Excess (Deficiency) of Revenues over Expenditures Before Other Financing Sources</b>	<b>(30,949)</b>	<b>-</b>	<b>2,739,951</b>	<b>-</b>	<b>2,709,002</b>	<b>(404,897)</b>
<b>OTHER FINANCING SOURCES</b>						
Transfers In-Retirement Membership Fees (Note 5.E)	18,000				18,000	-
<b>Excess (Deficiency) of Revenues over Expenditures and Other Financing Sources</b>	<b>(12,949)</b>	<b>-</b>	<b>2,739,951</b>	<b>-</b>	<b>2,727,002</b>	<b>(404,897)</b>
<b>Fund Balances - Beginning</b>	<b>15,510</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>15,510</b>	<b>420,407</b>
Appropriations Lapsed			(2,739,951)		(2,739,951)	-
<b>Fund Balances - Ending (Exh. III)</b>	<b>2,561</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,561</b>	<b>15,510</b>
Net Change in Fund Balances - Governmental Funds:					(12,949)	(404,897)
<i>Amounts reported for Governmental Activities in the Statement of Activities (Exhibit II) are different because:</i>						
An <i>Internal Service Fund</i> is used by the System to account for the revenues and expenses associated with the Group Benefits 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 <i>Statement of Activities</i> .						
					70,220,990	6,606,346
<b>Change in Net Assets of Governmental Activities (Exhibit II)</b>					<b>70,208,041</b>	<b>6,201,449</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, 2004**

(With Comparative Totals at August 31, 2003)

<u>ASSETS</u>	<u>Internal Service Fund</u>	
	<u>Employees Life, Accident and Health</u>	
	<u>Insurance and Benefits Fund (0973) (U/F 0973)</u>	
	<u>August 31, 2004</u>	<u>August 31, 2003</u>
	\$	\$
<b>Current Assets:</b>		
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	3,127	57,195
Cash in State Treasury	11,086,730	36,326,331
Total Cash and Cash Equivalents	11,089,857	36,383,526
Securities Lending Collateral	41,603,761	22,804,480
<i>Short-Term Investments:</i>		
Short-Term Investment Fund	5,592,620	4,805,152
Money Market Mutual Funds	112,222,460	49,135,411
Total Short-Term Investments	117,815,080	53,940,563
<i>Receivables:</i>		
Interest Receivable	47,000	57,000
Accounts Receivable	80,837,706	85,461,578
Total Receivables	80,884,706	85,518,578
Due From Other Agencies (Note 1.F)	374,074	-
<b>Total Current Assets</b>	<b>251,767,478</b>	<b>198,647,147</b>
<b>Non-Current Assets:</b>		
<i>Investments:</i>		
U.S. Treasury Bonds	41,294,898	40,422,133
Other Government Securities	23,904,386	13,730,924
Mortgage Pass-Thru Securities	53,660,252	35,706,725
Asset Backed Securities	16,086,459	10,035,994
Commercial Mortgage Backed Securities	4,632,814	10,369,411
Corporate Bonds	147,844,785	132,123,575
Total Investments	287,423,594	242,388,762
<b>Total Non-Current Assets</b>	<b>287,423,594</b>	<b>242,388,762</b>
<b>Total Assets</b>	<b>539,191,072</b>	<b>441,035,909</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
<i>Payables:</i>		
Accounts Payable	-	108,925
<i>Claims Payable:</i>		
Incurred, Self-Funded	7,922,852	29,345,003
Incurred, Insured	18,300,694	21,146,300
Incurred But Not Reported, Self-Funded	311,693,000	281,661,000
Incurred But Not Reported, Insured	61,898,000	58,181,000
Total Claims Payable	399,814,546	390,333,303
Total Payables	399,814,546	390,442,228
Due To Other Funds (Note 5.D)	821,626	764,274
Deferred Revenue	790,923	1,085,701
Obligations Under Securities Lending	41,603,761	22,804,480
<b>Total Current Liabilities</b>	<b>443,030,856</b>	<b>415,096,683</b>
<b>Total Liabilities</b>	<b>443,030,856</b>	<b>415,096,683</b>
<b>NET ASSETS</b>		
<i>Restricted For:</i>		
Employee Benefits - Group Insurance Program	96,160,216	25,939,226
<b>Total Net Assets (Exh. VI)</b>	<b>96,160,216</b>	<b>25,939,226</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, 2004**

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

	<b>Internal Service Fund</b>	
	<b>Employees Life, Accident and Health</b>	
	<b>Insurance and Benefits Fund (0973) (U/F 0973)</b>	
	<u>August 31, 2004</u>	<u>August 31, 2003</u>
	\$	\$
<b>OPERATING REVENUES</b>		
<i>Contributions to Insurance Program:</i>		
From the State of Texas:		
For Employees	891,481,949	981,443,208
For Retirees	286,029,756	253,791,305
Total Contributions from the State of Texas	<u>1,177,511,705</u>	<u>1,235,234,513</u>
From Members:		
For Employees	308,021,988	309,510,946
For Retirees	88,467,593	77,997,477
For COBRA	7,617,718	6,468,032
Total Contributions from Members	<u>404,107,299</u>	<u>393,976,455</u>
Total Contributions to Insurance Program	<u>1,581,619,004</u>	<u>1,629,210,968</u>
<i>Other Operating Revenues:</i>		
COBRA 2% Administration Fee	154,213	128,936
Warrants Voided by Statute of Limitations	4,942	2,470
Penalty Assessed to Insurance Carrier	3,680,834	1,148,660
Total Other Operating Revenues	<u>3,839,989</u>	<u>1,280,066</u>
<b>Total Operating Revenues</b>	<b><u>1,585,458,993</u></b>	<b><u>1,630,491,034</u></b>
<b>OPERATING EXPENSES</b>		
<i>Employee Benefit Payments:</i>		
For Employees	1,107,141,024	1,253,809,291
For Retirees	402,270,880	362,684,483
For COBRA	9,883,391	10,563,421
Total Employee Benefit Payments	<u>1,519,295,295</u>	<u>1,627,057,195</u>
<i>Administrative Expenses:</i>		
Salaries & Wages	5,399,195	5,357,672
Payroll Related Costs	1,315,547	1,355,331
Professional Fees & Services	625,825	753,467
Travel	39,472	35,569
Materials & Supplies	339,032	517,291
Communications & Utilities	280,150	334,513
Repairs & Maintenance	513,584	533,836
Rentals & Leases	463,310	566,333
Printing & Reproduction	31,413	82,874
Other Operating Expenses	308,524	389,242
Total Administrative Expenses	<u>9,316,052</u>	<u>9,926,128</u>
<b>Total Operating Expenses</b>	<b><u>1,528,611,347</u></b>	<b><u>1,636,983,323</u></b>
<b>Operating Income (Loss)</b>	<b>56,847,646</b>	<b>(6,492,289)</b>
<b>NON-OPERATING REVENUES (EXPENSES)</b>		
Net Increase in Fair Value of Investments	2,043,385	949,180
Interest Revenue	10,849,240	11,827,470
<i>Securities Lending Activities:</i>		
Loan Premium on Securities Lending	334,082	484,700
Less: Broker Rebates	(196,157)	(348,657)
Agent Fees	<u>(31,280)</u>	<u>(33,988)</u>
Net Securities Lending Activity	106,645	102,055
Settlement Revenue	374,074	219,930
<b>Total Non-Operating Revenues</b>	<b><u>13,373,344</u></b>	<b><u>13,098,635</u></b>
<b>Change in Net Assets</b>	<b>70,220,990</b>	<b>6,606,346</b>
<b>NET ASSETS</b>		
<b>Net Assets - Beginning</b>	<b>25,939,226</b>	<b>19,332,880</b>
<b>Net Assets - Ending (Exh. V)</b>	<b><u>96,160,216</u></b>	<b><u>25,939,226</u></b>

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



**Exhibit VII**

**STATEMENT OF CASH FLOWS - Proprietary Fund**

**For the Year Ended August 31, 2004**

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

	<u>Internal Service Fund</u>	
	<u>Employees Life, Accident and Health</u>	
	<u>Insurance and Benefits Fund (0973) (U/F 0973)</u>	
	<u>August 31,</u>	<u>August 31,</u>
	<u>2004</u>	<u>2003</u>
<i>Cash flows from operating activities:</i>	\$	\$
Cash received from members	404,282,611	394,325,853
Cash received from the State of Texas	1,181,719,331	1,234,997,988
Cash paid to insurance carriers and third party administrators	(1,509,820,781)	(1,596,413,770)
Cash payments to employees for services	(6,106,061)	(7,038,987)
Cash payments for goods and services	(3,154,466)	(3,672,743)
Other cash received	3,685,776	1,371,061
<b>Net cash provided by operating activities</b>	<b><u>70,606,410</u></b>	<b><u>23,569,402</u></b>
<i>Cash flows from investing activities:</i>		
Sales of short-term investment fund	818,200,000	908,300,000
Purchases of short-term investment fund	(914,800,000)	(906,400,000)
Interest on treasury deposits	699,921	891,752
<b>Net cash provided (used) by investing activities</b>	<b><u>(95,900,079)</u></b>	<b><u>2,791,752</u></b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b><u>(25,293,669)</u></b>	<b><u>26,361,154</u></b>
<b>Cash and Cash Equivalents:</b>		
<b>Beginning of Year</b>	<b><u>36,383,526</u></b>	<b><u>10,022,372</u></b>
<b>End of Year (Exh. V)</b>	<b><u>11,089,857</u></b>	<b><u>36,383,526</u></b>
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>		
<b>Operating Income (Loss) (Exh. VI)</b>	<b>56,847,646</b>	<b>(6,492,289)</b>
<b>Adjustments to reconcile operating income (loss) to net cash provided by operating activities:</b>		
Settlement revenue	374,074	219,930
Change in assets and liabilities:		
(Increase) Decrease in Accounts Receivable	4,623,872	(801,175)
Increase in Due From Other Funds	(374,074)	-
Increase in Accounts Payable	9,372,318	30,752,350
Increase (Decrease) in Due To Other Funds	57,352	(785,602)
Increase (Decrease) in Deferred Revenue	(294,778)	676,188
<b>Total Adjustments</b>	<b><u>13,758,764</u></b>	<b><u>30,061,691</u></b>
<b>Net cash provided by operating activities</b>	<b><u>70,606,410</u></b>	<b><u>23,569,402</u></b>
<b>Non-Cash Investing Activities:</b>		
Net appreciation of fair value of non-cash equivalent investments	2,043,385	949,180
Interest revenue of non-cash equivalent investments	10,149,319	10,935,718

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

**Exhibit VIII**

**COMBINED STATEMENT OF FIDUCIARY NET ASSETS**

**For the Year Ended August 31, 2004**

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

	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			2004	2003
<b>ASSETS</b>						
Cash and Cash Equivalents	21,276,930	8,831,679	30,108,609	168,869	30,277,478	46,244,817
Securities Lending Collateral	3,236,686,183		3,236,686,183		3,236,686,183	2,518,401,764
Short-Term Investments	1,118,348,682	90,015,668	1,208,364,350		1,208,364,350	1,194,903,492
Legislative Appropriations	240,947		240,947		240,947	247,026
Investments	19,550,698,910	161,810,108	19,712,509,018		19,712,509,018	18,137,870,810
Receivables	109,190,803	3,538,985	112,729,788	15,990	112,745,778	524,629,803
Due From Other Funds (Note 5.D)	1,150,969	1,827	1,152,796		1,152,796	1,141,285
Due From Other Agencies (Note 1.F)	3,364,305		3,364,305		3,364,305	2,877,596
Prepaid Expenses	31,752	462,324	494,076		494,076	68,040
Capital Assets, Net of Accumulated Depreciation	6,909,348		6,909,348		6,909,348	7,438,651
<b>Total Assets</b>	<b>24,047,898,829</b>	<b>264,660,591</b>	<b>24,312,559,420</b>	<b>184,859</b>	<b>24,312,744,279</b>	<b>22,433,823,284</b>
<b>LIABILITIES</b>						
Payables	1,240,696,542	5,236,448	1,245,932,990	8,555	1,245,941,545	1,493,948,564
Due To Other Funds (Note 5.D)	238,309	90,230	328,539		328,539	373,554
Due To Other Agencies (Note 1.F)	524,267		524,267		524,267	376,116
Deferred Revenue	574,660		574,660		574,660	697,338
Employees Compensable Leave	1,429,412		1,429,412		1,429,412	1,323,070
Obligations Under Securities Lending Funds Held For Others	3,236,686,182		3,236,686,182	176,304	3,236,686,182	2,518,401,763
<b>Total Liabilities</b>	<b>4,480,149,372</b>	<b>5,326,678</b>	<b>4,485,476,050</b>	<b>184,859</b>	<b>4,485,660,909</b>	<b>4,016,724,125</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. IX)</b>	<b>19,567,749,457</b> (Exh. X)	<b>259,333,913</b> (Exh. A-1)	<b>19,827,083,370</b>	<b>-</b> (Exh. A-3)	<b>19,827,083,370</b>	<b>18,417,099,159</b>

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**

**For the Year Ended August 31, 2004**

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

	<b>Defined Benefit Plans</b>	<b>Defined Contribution Plans and Cafeteria Plan</b>	<b>Pension and Other Employee Benefit Trust Funds</b>	
			<b>Totals</b>	
			<b>August 31,</b>	
			<b>2004</b>	<b>2003</b>
	\$	\$	\$	\$
<hr/> <b>ADDITIONS</b> <hr/>				
<b>Contributions:</b>				
Member Contributions	303,077,314	136,844,615	439,921,929	414,964,088
State Contributions	287,049,457		287,049,457	309,849,466
Legislative Appropriations	22,741,570		22,741,570	22,795,480
Service Contributions Transferred from Teacher Retirement System	38,068,440		38,068,440	28,609,871
Settlement Revenue		1,326,352	1,326,352	85,000
Other Contributions	7,063,119	468,315	7,531,434	9,165,177
<b>Total Contributions</b>	<u>657,999,900</u>	<u>138,639,282</u>	<u>796,639,182</u>	<u>785,469,082</u>
<b>Investment Income:</b>				
From Investing Activities	2,067,329,110	34,005,847	2,101,334,957	1,525,539,215
From Securities Lending Activities	8,611,921		8,611,921	7,554,550
<b>Total Net Investment Income</b>	<u>2,075,941,031</u>	<u>34,005,847</u>	<u>2,109,946,878</u>	<u>1,533,093,765</u>
<b>Other Additions:</b>				
Other Revenue	591,584	192,331	783,915	375,023
Transfers In (Note 5.E)	66,915	434,430	501,345	560,913
<b>Total Other Additions</b>	<u>658,499</u>	<u>626,761</u>	<u>1,285,260</u>	<u>935,936</u>
<b>Total Additions</b>	<u><b>2,734,599,430</b></u>	<u><b>173,271,890</b></u>	<u><b>2,907,871,320</b></u>	<u><b>2,319,498,783</b></u>
<hr/> <b>DEDUCTIONS</b> <hr/>				
<b>Benefits:</b>				
Retirement Benefits and Refunds	1,323,761,944		1,323,761,944	1,129,812,610
Plan 457 Benefits		109,526,565	109,526,565	70,224,903
Cafeteria Plan Reimbursement Claims		42,886,292	42,886,292	33,539,568
Service Contributions Transferred to Teacher Retirement System	5,600,176		5,600,176	4,037,793
<b>Total Benefits</b>	<u>1,329,362,120</u>	<u>152,412,857</u>	<u>1,481,774,977</u>	<u>1,237,614,874</u>
Administrative Expenses	13,470,558	2,092,920	15,563,478	15,446,532
<b>Other Deductions:</b>				
Other Expenses	29,309		29,309	180,021
Transfers Out (Note 5.E)	519,345		519,345	560,913
<b>Total Other Deductions</b>	<u>548,654</u>	<u>-</u>	<u>548,654</u>	<u>740,934</u>
<b>Total Deductions</b>	<u><b>1,343,381,332</b></u>	<u><b>154,505,777</b></u>	<u><b>1,497,887,109</b></u>	<u><b>1,253,802,340</b></u>
<b>Net Increase</b>	<b>1,391,218,098</b>	<b>18,766,113</b>	<b>1,409,984,211</b>	<b>1,065,696,443</b>
<hr/> <b>NET ASSETS</b> <hr/>				
<b>Net Assets Held in Trust For Pension Benefits and Other Purposes:</b>				
<b>Beginning of Year</b>	<b>18,176,531,359</b>	<b>240,567,800</b>	<b>18,417,099,159</b>	<b>17,351,402,716</b>
<b>End of Year (Exh. VIII)</b>	<u><b>19,567,749,457</b></u>	<u><b>259,333,913</b></u>	<u><b>19,827,083,370</b></u>	<u><b>18,417,099,159</b></u>
	(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, 2004**

(With Comparative Totals at August 31, 2003)

	<b>Law</b>					<b>Totals</b>	
	<b>Employees Retirement Fund (0955)</b>	<b>Enforcement and Custodial Officer Supplemental Fund (0977)</b>	<b>Judicial Retirement System Plan I (0001)</b>	<b>Judicial Retirement System Plan II (0993)</b>	<b>Excess Benefit Arrange- ment (5039)</b>	<b>August 31,</b>	
		<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>ASSETS</b>							
<i>Cash and Short-Term Investments:</i>							
<i>Cash and Cash Equivalents:</i>							
Cash on Hand	1,322,454					1,322,454	1,510,588
Cash in Bank	9,700					9,700	14,000
Cash in State Treasury	18,349,214	1,058,309		436,834		19,844,357	24,890,161
Investment in Pool Cash	96,466	3,259		694		100,419	115,217
<b>Total Cash and Cash Equivalents</b>	<b>19,777,834</b>	<b>1,061,568</b>	<b>-</b>	<b>437,528</b>	<b>-</b>	<b>21,276,930</b>	<b>26,529,966</b>
Securities Lending Collateral	3,109,359,854	105,138,017		22,188,312		3,236,686,183	2,518,401,764
<i>Short-Term Investments:</i>							
Short-Term Investment Fund	4,830,627	163,208		34,759		5,028,594	4,710,411
Money Market Mutual Funds	877,364,275	29,642,664		6,313,149		913,320,088	1,121,171,908
Repurchase Agreements	192,126,350	6,491,188		1,382,462		200,000,000	-
<b>Total Short-Term Investments</b>	<b>1,074,321,252</b>	<b>36,297,060</b>	<b>-</b>	<b>7,730,370</b>	<b>-</b>	<b>1,118,348,682</b>	<b>1,125,882,319</b>
<b>Total Cash and Short-Term Investments</b>	<b>4,203,458,940</b>	<b>142,496,645</b>	<b>-</b>	<b>30,356,210</b>	<b>-</b>	<b>4,376,311,795</b>	<b>3,670,814,049</b>
Legislative Appropriations			240,947			240,947	247,026
<i>Investments:</i>							
U.S. Treasury Bonds	1,517,157,433	51,258,741		10,916,835		1,579,333,009	1,297,122,810
Other Government Securities	1,074,310,383	36,296,693		7,730,291		1,118,337,367	822,072,447
Mortgage Pass-Thru Securities	2,190,775,574	74,017,630		15,763,910		2,280,557,114	2,060,176,675
Collateralized Mortgage Obligations	95,247,161	3,218,024		685,359		99,150,544	49,965,299
Asset Backed Securities	150,765,334	5,093,764		1,084,845		156,943,943	162,426,989
Commercial Mortgage Backed Securities	211,802,205	7,155,958		1,524,040		220,482,203	205,234,231
Corporate Bonds	2,684,205,286	90,688,665		19,314,426		2,794,208,377	2,538,982,089
Domestic Equities	7,494,620,499	253,213,543		53,928,175		7,801,762,217	7,501,967,681
Texas Growth Fund	54,758,961	1,850,088		394,023		57,003,072	69,388,993
International Equities	3,307,379,290	111,743,247		23,798,527		3,442,921,064	3,274,935,735
<b>Total Investments</b>	<b>18,781,022,126</b>	<b>634,536,353</b>	<b>-</b>	<b>135,140,431</b>	<b>-</b>	<b>19,550,698,910</b>	<b>17,982,272,949</b>
<i>Receivables:</i>							
Interest and Dividends Receivable	1,091,937	39,841		8,085		1,139,863	2,105,911
Contributions/Accounts Receivable	44,533,649			916,766		45,450,415	48,620,962
Unsettled Sales-Investment Receivables	60,137,915	2,033,467		429,143		62,600,525	471,295,907
<b>Total Receivables</b>	<b>105,763,501</b>	<b>2,073,308</b>	<b>-</b>	<b>1,353,994</b>	<b>-</b>	<b>109,190,803</b>	<b>522,022,780</b>
Due From Other Funds (Note 1.F)	1,150,969					1,150,969	1,141,007
Due From Other Agencies (Note 1.F)	3,364,305					3,364,305	2,877,596
Prepaid Lease Expense	31,752					31,752	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 \$12,065,745 and \$11,537,985 respectively:</i>							
Building	4,759,811					4,759,811	5,058,021
Furniture and Equipment	1,273,369					1,273,369	1,500,626
Vehicles	1,279					1,279	5,115
<b>Total Capital Assets</b>	<b>6,909,348</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,909,348</b>	<b>7,438,651</b>
<b>Total Assets</b>	<b>23,101,700,941</b>	<b>779,106,306</b>	<b>240,947</b>	<b>166,850,635</b>	<b>-</b>	<b>24,047,898,829</b>	<b>22,186,882,098</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, 2004**  
(With Comparative Totals at August 31, 2003)  
**(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 Arrange- ment (5039)	Totals August 31,	
	\$	\$	\$	\$	\$	2004	2003
<b>LIABILITIES</b>							
<i>Payables:</i>							
Benefits/Accounts Payable	16,113,552	196,740	240,947	28,741		16,579,980	16,968,686
Unsettled Purchases-Investment Payables	1,175,961,672	39,763,258		8,391,632		1,224,116,562	1,472,320,083
Total Payables	1,192,075,224	39,959,998	240,947	8,420,373	-	1,240,696,542	1,489,288,769
Due To Other Funds (Note 1.F)		195,898		42,411		238,309	263,683
Due To Other Agencies (Note 1.F)	524,267					524,267	376,116
Deferred Revenue	574,660					574,660	697,338
Employees Compensable Leave	1,429,412					1,429,412	1,323,070
Obligations Under Securities Lending	3,109,359,854	105,138,017		22,188,311		3,236,686,182	2,518,401,763
<b>Total Liabilities</b>	<b>4,303,963,417</b>	<b>145,293,913</b>	<b>240,947</b>	<b>30,651,095</b>	<b>-</b>	<b>4,480,149,372</b>	<b>4,010,350,739</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust for Pension</b>							
Benefits and Other Purposes (Exh. XI)	18,797,737,524	633,812,393	-	136,199,540	-	19,567,749,457	18,176,531,359
						(Exh. VIII)	

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

*USAS Funds are:*

Fund 0955: 0955, 1955  
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, 2004**  
(With Comparative Totals for the Year Ended August 31, 2003)

	Employees Retirement Fund (0955)	Law			Excess Benefit Arrange- ment (5039)	Totals	
		Enforcement and Custodial Officer Supplemental Fund (0977)	Judicial Retirement System Plan I (0001)	Judicial Retirement System Plan II (0993)		August 31,	
						2004	2003
<b>ADDITIONS</b>	\$	\$	\$	\$	\$	\$	\$
<b>Contributions:</b>							
Member Contributions	300,155,783			2,921,531		303,077,314	327,020,124
State Contributions	278,844,513			8,204,944		287,049,457	309,849,466
<i>Legislative Appropriations for:</i>							
Judges Retirement Annuities			22,621,570			22,621,570	22,675,480
Administrative Expenses			120,000			120,000	120,000
Service Contributions Transferred from Teacher Retirement System (Note 1.F)	38,068,440					38,068,440	28,609,871
<i>Other Contributions:</i>							
Membership Fees	463,162					463,162	497,073
Penalty Interest	6,598,740			1,217		6,599,957	8,274,961
Total Other Contributions	7,061,902	-	-	1,217	-	7,063,119	8,772,034
<b>Total Contributions</b>	<b>624,130,638</b>	<b>-</b>	<b>22,741,570</b>	<b>11,127,692</b>	<b>-</b>	<b>657,999,900</b>	<b>697,046,975</b>
<b>Investment Income:</b>							
<i>From Investing Activities:</i>							
Net appreciation (depreciation) in fair value of investments	1,478,546,931	50,385,821		9,771,423		1,538,704,175	978,658,541
Interest and Dividends	521,356,499	17,703,020		3,579,945		542,639,464	543,546,032
Total Investing Activity Income	1,999,903,430	68,088,841	-	13,351,368	-	2,081,343,639	1,522,204,573
Less: Investment Expense	(13,474,596)	(463,816)		(76,117)		(14,014,529)	(15,071,877)
Net Income, Investing Activities	1,986,428,834	67,625,025	-	13,275,251	-	2,067,329,110	1,507,132,696
<i>From Securities Lending Activities:</i>							
Loan Premium on Securities Lending	35,991,399	1,222,129		247,362		37,460,890	41,118,892
Less: Broker Rebates	(25,031,271)	(849,884)		(172,185)		(26,053,340)	(30,812,164)
Agent Fees	(2,686,000)	(91,247)		(18,382)		(2,795,629)	(2,752,178)
Total Securities Lending Expenses	(27,717,271)	(941,131)	-	(190,567)	-	(28,848,969)	(33,564,342)
Net Income, Securities Lending Activities	8,274,128	280,998	-	56,795	-	8,611,921	7,554,550
<b>Net Investment Income</b>	<b>1,994,702,962</b>	<b>67,906,023</b>	<b>-</b>	<b>13,332,046</b>	<b>-</b>	<b>2,075,941,031</b>	<b>1,514,687,246</b>
<b>Other Additions:</b>							
<i>Other Revenue:</i>							
Warrants Voided by Statute of Limitations	196,474	1,876				198,350	137,937
Sale of Surplus Equipment	10,462					10,462	95,302
Rental Income	38,588					38,588	122,056
Miscellaneous Revenue	343,466			718		344,184	1,794
Total Other Revenue	588,990	1,876	-	718	-	591,584	357,089
<i>Transfers In (Note 5.E):</i>							
Excess Benefit Arrangement					66,915	66,915	66,915
Total Transfers In	-	-	-	-	66,915	66,915	66,915
<b>Total Other Additions</b>	<b>588,990</b>	<b>1,876</b>	<b>-</b>	<b>718</b>	<b>66,915</b>	<b>658,499</b>	<b>424,004</b>
<b>Total Additions</b>	<b>2,619,422,590</b>	<b>67,907,899</b>	<b>22,741,570</b>	<b>24,460,456</b>	<b>66,915</b>	<b>2,734,599,430</b>	<b>2,212,158,225</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, 2004**

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

(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 Arrange- ment (5039)	Totals August 31,	
						2004	2003
<b>DEDUCTIONS</b>							
<i>Benefits:</i>							
Retirement Benefits	1,184,712,996	27,558,933	22,620,421	2,770,153	66,915	1,237,729,418	1,053,892,743
<i>Death Benefits:</i>							
Active Members	1,012,352					1,012,352	1,249,356
Retirees	937,071					937,071	1,078,081
Refunds of Retirement Contributions	83,779,001		1,149	302,953		84,083,103	73,592,430
<i>Transfers Out of Contributions:</i>							
Service Contributions Transferred to Teacher Retirement System (Note 1.F)	5,600,176					5,600,176	4,037,793
<b>Total Benefits</b>	<b>1,276,041,596</b>	<b>27,558,933</b>	<b>22,621,570</b>	<b>3,073,106</b>	<b>66,915</b>	<b>1,329,362,120</b>	<b>1,133,850,403</b>
<i>Administrative Expenses:</i>							
Salaries & Wages	5,783,815	374,783		125,568		6,284,166	6,000,086
Payroll Related Costs	1,478,552	99,128	107	31,588		1,609,375	1,597,736
Professional Fees & Services	1,856,307	74,455	18,843	56,641		2,006,246	1,872,192
Travel	35,411	608		516		36,535	43,034
Materials & Supplies	674,747	37,931		10,371		723,049	816,442
Communications & Utilities	304,501	8,345		10,740		323,586	338,301
Repairs & Maintenance	590,991	13,794	101,050	14,928		720,763	608,756
Rentals & Leases	513,933	12,626		14,039		540,598	700,517
Printing & Reproduction	31,782	411		557		32,750	96,174
Depreciation	772,164					772,164	800,098
Other Operating Expenses	405,335	8,135		7,856		421,326	529,879
<b>Total Administrative Expenses</b>	<b>12,447,538</b>	<b>630,216</b>	<b>120,000</b>	<b>272,804</b>	<b>-</b>	<b>13,470,558</b>	<b>13,403,215</b>
<i>Other Deductions:</i>							
<i>Other Expenses:</i>							
Loss on Sale of Capital Assets	29,309					29,309	180,021
Total Other Expenses	29,309	-	-	-	-	29,309	180,021
<i>Transfers Out (Note 5.E):</i>							
Membership Fees	452,430					452,430	493,998
Excess Benefit Arrangement	66,915					66,915	66,915
Total Transfers Out	519,345	-	-	-	-	519,345	560,913
<b>Total Other Deductions</b>	<b>548,654</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>548,654</b>	<b>740,934</b>
<b>Total Deductions</b>	<b>1,289,037,788</b>	<b>28,189,149</b>	<b>22,741,570</b>	<b>3,345,910</b>	<b>66,915</b>	<b>1,343,381,332</b>	<b>1,147,994,552</b>
<b>Net Increase</b>	<b>1,330,384,802</b>	<b>39,718,750</b>	<b>-</b>	<b>21,114,546</b>	<b>-</b>	<b>1,391,218,098</b>	<b>1,064,163,673</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust For Pension Benefits and Other Purposes:</b>							
<b>Beginning of Year</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>End of Year (Exh. X)</b>	<b>18,797,737,524</b>	<b>633,812,393</b>	<b>-</b>	<b>136,199,540</b>	<b>-</b>	<b>19,567,749,457</b>	<b>18,176,531,359</b>

(Exh. IX)

USAS Funds are:

Fund 0955: 0955, 1955

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, 2004

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# NOTES TO THE BASIC FINANCIAL STATEMENTS

## 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 a retirement system 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; and
- 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. These statements present information for each major Governmental Fund, the Internal Service Fund, and the 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 measurement. *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 60 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. Additions are recognized when earned, and deductions are recognized when the liability is incurred, regardless of the timing of related cash flows. Contributions are recognized when due, pursuant to state law. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan. 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. 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.
- Compensation to Victims of Crime – This fund accounts for payments of death benefits to the beneficiaries of victims of crime. It is funded by an appropriation from the Victims of Crime Fund, which was established by Texas Criminal Procedure Code, Article 56.54.
- 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, on a cost-reimbursement basis, to other funds, departments, agencies of the reporting entity, or other governments.

- 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 (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 after August 31, 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) 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 report only the balances of assets and liabilities and do not measure results of operations.

- Unappropriated Receipts (General Revenue Fund) – This fund accounts for member contributions received from the Judicial Retirement System Plan One Fund.
- 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).

- Direct Deposit Correction Account – This fund accounts for monies returned by financial institutions, which had been transmitted for direct deposit but where problems prevented credit from being given to individual depositors. The System transfers the funds back to the original issuing fund.

## **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 also 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. This type of appropriation 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; no budget to actual schedule is presented 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 any transfers between line items, and the Board must approve any amendments 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 budgetary basis, 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 Short-Term Investments**

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

The petty cash and travel advance accounts, and the TexaSaver 401(k) and State Employees Cafeteria Plan accounts (Cash in Bank) are maintained at commercial banks; 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 short-term 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 System 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 TexaSaver 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 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.

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

All investment income is transferred to the Employee Savings, State Accumulation, and Retirement Annuity Reserve accounts based on applicable Texas statutes.

- 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 of the Texas Insurance Code requires that the System estimate funds needed for an average 60-day period, considering projected claims and administrative expenses for a contingency reserve fund for self-funded coverage. The System is further required to include this amount in its legislative appropriations request. Subject to adequate appropriation from the legislature, 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 reserve 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 System 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 System 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 routine transfers of funds between the System and other agencies and institutions within the State of Texas financial reporting entity. This includes the transfer of contributions to or from the Teacher Retirement System of Texas.

At year end, the accrual of transfers from or to the funds of the System are reported as Due To Other Agencies or Due From Other Agencies on the statements of 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. 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, and the administrative expenses of the JRS I are financed by State appropriations.

The most recent actuarial valuation was performed as of August 31, 2004. 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*

System employees are members of the Employees Retirement Plan.

#### *Contributions*

Employees are required to contribute 6% of monthly gross compensation, including base salary, longevity pay, hazardous duty pay, and benefit replacement pay and excluding overtime pay and emoluments other than housing and utilities.

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, 2003 and 2004, 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 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 System Fund.

**Contributions**

Members do not contribute to this fund.

For the bienniums ending August 31, 1995 through August 31, 2005, 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.

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

Effective January 1, 2003, 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. Members who accrue 20 years of service credit in the retirement system cease making contributions, but are considered contributing

members for all other purposes; however, the State contribution continues.

For the fiscal years ended August 31, 2003 and 2004, the State contributed 16.83% of the payroll of members.

**B. Retirement Systems Membership  
(Unaudited)**

The membership of the retirement plans as of August 31, 2004 is summarized in Figure B. The System’s actuary includes members who retired on August 31 and received 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, 2004 and 2003 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 (UNAUDITED)</b>				
	<u>ERS</u>	<u>LECOS</u>	<u>JRS I</u>	<u>JRS II</u>
Retirees and beneficiaries				
currently receiving benefits	60,089	4,576	494	72
Terminated employees				
entitled to benefits	54,658	30	15	79
Current employees	133,349	38,305	53	484
<b>Total</b>	<u><u>248,096</u></u>	<u><u>42,911</u></u>	<u><u>562</u></u>	<u><u>635</u></u>

**3. Pension Plans - Defined Contribution  
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, which is 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

Figure C

**RESERVES (UNAUDITED)**

	ERS	LECOS	JRS II	Totals – August 31,	
				2004	2003
<b>Net Plan Assets Reserved For:</b>	\$	\$	\$	\$	\$
Employee Savings	3,443,207,498	5,275	33,173,821	3,476,386,594	3,539,912,950
State Accumulation	5,192,586,356	400,086,645	73,437,882	5,666,110,883	4,553,184,517
Annuity Reserves	10,161,943,670	233,720,473	29,587,837	10,425,251,980	10,083,433,892
<b>Total Net Plan Assets Reserved</b>	<b>18,797,737,524</b>	<b>633,812,393</b>	<b>136,199,540</b>	<b>19,567,749,457</b>	<b>18,176,531,359</b>
Funded ratios of each plan, from the actuarial valuation:					
As of August 31, 2004	97.3%	109.3%	117.5%		
As of August 31, 2003	97.6%	111.5%	116.5%		

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, 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 participating employees for the diminution in value or loss of all or part of the participating employees' deferred amounts or investment income because of market conditions or the failure, insolvency, or bankruptcy of a qualified vendor.

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 \$255,676,133 as of August 31, 2004.

**Contributions**

As of August 31, 2004, there were 15 System employees participating in the TexaSaver 457 Plan. During the fiscal year ended August 31, 2004, System employees deferred \$97,980, which includes \$29,137 in retirement incentive rollovers.

The State does not contribute to the plan.

**TexaSaver 401(k) Plan**

(In accordance with GASB Statement 25)

**Plan Description**

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

**Contributions**

As of August 31, 2004, there were 81 System employees participating in the TexaSaver 401(k) Plan. During the fiscal year ended August 31, 2004, System employees deferred \$327,015.

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, long-term care, 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). 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, and they are paid out of the Employees Retirement System Fund. These claim expenses are allocated periodically to other funds based on percentages determined by a study of each fund's usage.

The risk financing for different coverages is summarized in Figure D.

*Figure D*

**SUMMARY OF RISK FINANCING**

Type of Coverage	Plan Name	Self-Funded	Risk Retained with
Health	● HealthSelect	Yes	System
	● HMOs	No	Insurance Carrier
	● Prescription Drug	Yes	System
Life	N/A	No	Insurance Carrier
Accidental Death and Dismemberment	N/A	No	Insurance Carrier
Disability	N/A	Yes	System
Dental	● DHMOs	No	Insurance Carrier
	● Dental Indemnity Plan	Yes	System
Property and Casualty	N/A	No	Insurance Carrier
Unemployment	N/A	Yes	System
Workers' Compensation	N/A	Yes	System

**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 insured (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.

*Figure E*

**CHANGES IN SELF-FUNDED CLAIMS LIABILITIES**

	Totals – August 31,	
	2004	2003
Beginning of Fiscal Year Liability	\$ 311,006,003	\$ 281,414,563
Current-Year Claims and Changes in Estimates	1,279,346,907	1,367,649,008
Claims Payments	(1,270,737,058)	(1,338,057,568)
Balance at Fiscal Year-End	<u>319,615,852</u>	<u>311,006,003</u>

For both self-funded and insured coverages, the balance of claims that have been incurred but not reported as of August 31, 2004 is \$373,591,000.

**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.

**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.

The System's Cash in Bank as of August 31, 2004 is summarized in Figure F.

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 \$28,269 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 or

the Federal Depository Insurance Corporation. Fully insured Cash in Bank is presented under Category 1 in Figure G. Cash in Bank collateralized with securities held by pledging financial institutions is shown under Category 2 in Figure G. Uncollateralized Cash in Bank is listed under Category 3 in Figure G.

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 G.

*Figure F*

**SUMMARY OF CASH IN BANK**

<u>Deposits Held at</u>		<u>Amount</u>
		\$
Petty Cash and Travel Advance Funds (Exh. X)	Bank One of Austin	9,700
Cafeteria Plan Trust Fund (Exh. A-1)	Bank One of Austin	948,516
Texasaver 401 (k) Trust Fund (Exh. A-3)	Bank One of Austin and State Street Bank & Trust Co.	4,591
Texasaver 457 Trust Fund (Exh. A-1)	Various financial institutions and credit unions	3,850,357
<b>Total</b>		<b>4,813,164</b>

*Figure G*

**DEPOSITS**

<u>Categorized Deposits</u>	<u>Insured/ Collateralized Deposits (Category 1)</u>	<u>Collateralized Deposits with Pledged Securities (Category 2)</u>	<u>Uncollateralized Deposits (Category 3)</u>	<u>Total Carrying Value</u>
	\$	\$	\$	\$
<i>Cash on Hand:</i>				
Proprietary Fund (Exh. V)	3,127			3,127
Fiduciary Funds (Exh. X)	1,322,454			1,322,454
<b>Total Cash on Hand</b>	<b>1,325,581</b>	<b>-</b>	<b>-</b>	<b>1,325,581</b>
<i>Cash in Bank:</i>				
Fiduciary Funds:				
Defined Benefit Plans (Exh. X)	9,700			9,700
Defined Contribution Plans and Cafeteria Plan (Exh. A-1)	4,584,721	185,883	28,269	4,798,873
Agency Funds (Exh. A-3)	4,591			4,591
<b>Total Cash in Bank</b>	<b>4,599,012</b>	<b>185,883</b>	<b>28,269</b>	<b>4,813,164</b>
<i>Cash in State Treasury:</i>				
Governmental Funds (Exh. III)	5,192			5,192
Proprietary Fund (Exh. V)	11,086,730			11,086,730
Fiduciary Funds:				
Defined Benefit Plans (Exh. X)	19,844,357			19,844,357
Defined Contribution Plans and Cafeteria Plan (Exh. A-1)	4,032,806			4,032,806
Agency Funds (Exh. A-3)	164,278			164,278
<b>Total Cash in State Treasury</b>	<b>35,133,363</b>	<b>-</b>	<b>-</b>	<b>35,133,363</b>
Investment in Pool Cash (Exh. X)	100,419			100,419
<b>Total Categorized Deposits</b>	<b>41,158,375</b>	<b>185,883</b>	<b>28,269</b>	<b>41,372,527</b>

The bank balances of deposits at August 31, 2004 are presented in Figure G.

### ***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, 2004.

The carrying values of investments for all funds administered by the System at August 31, 2004 are presented in Figure H.

### ***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 investments. Securities on loan with securities collateral are presented as categorized investments in either Category 1 or Category 3 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 indemnify the System fully 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 the implementation of this 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 \$3,278,289,944 in exchange for securities with a fair value of \$3,221,633,311, which were on loan to brokers/dealers at August 31, 2004. Fair value of securities on loan for securities collateral at August 31, 2004, is \$488,433,689. Net securities lending income totaled \$8,718,566 for the fiscal year ended August 31, 2004. Securities on loan are maintained in the System's financial records in their respective categories.

### ***Repurchase Agreements***

During the fiscal year 2004, the System invested in repurchase agreements. As of August 31, 2004, the System had \$200,000,000 balance in these assets.

### ***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,

Figure H

<b>INVESTMENTS</b>			
<b>Categorized Investments</b>	<b>Insured/Registered Securities (Category 1)</b>	<b>Uninsured/Unregistered Securities<sup>1</sup> (Category 3)</b>	<b>Total Carrying Value</b>
	\$	\$	\$
Repurchase Agreements	200,000,000		200,000,000
Government Investments	377,180,772	488,433,689	865,614,461
Mortgage Backed Securities	1,664,396,343		1,664,396,343
Corporate Obligations	2,589,750,778		2,589,750,778
Corporate Stock	7,020,284,099		7,020,284,099
Foreign Equity	3,188,766,139		3,188,766,139
<b>Total Categorized Investments</b>	<b>15,040,378,131</b>	<b>488,433,689</b>	<b>15,528,811,820</b>
		<b>Securities on Loan with Cash Collateral<sup>2</sup></b>	
<b>Uncategorized Investments</b>	<b>Trade Payables</b>	<b>Securities on Loan with Cash Collateral<sup>2</sup></b>	
	\$	\$	
Government Investments	49,857,500	1,847,397,699	1,897,255,199
Mortgage Backed Securities	1,167,116,986		1,167,116,986
Corporate Obligations	267,875	352,034,510	352,302,385
Corporate Stock	6,874,201	774,603,916	781,478,117
Foreign Equity		254,154,925	254,154,925
<i>Short-Term Mutual Funds:</i>			
Chase Bank Liquidity Fund for Pension and Profit Sharing Funds			5,028,594
JP Morgan Prime Money Market II Institutional Fund			5,592,620
Money Market Mutual Funds			1,025,542,548
Texas Growth Fund			57,003,072
<i>Deferred Compensation:</i>			
Mutual Funds			90,015,668
Annuities			161,810,108
Total Trade Payables & Securities on Loan with Cash Collateral	<b>1,224,116,562</b>	<b>3,228,191,050</b>	
<b>Total Uncategorized Investments</b>			<b>5,797,300,222</b>
<b>Total Investments</b>			<b>21,326,112,042</b>
<b>Investments Consist of:</b>			\$
<i>Fiduciary Funds (Exh. VIII):</i>			
Short-Term Investments			1,208,364,350
Investments			19,712,509,018
<i>Proprietary Funds (Exh. V):</i>			
Short-Term Investments			117,815,080
Investments			287,423,594
<b>Total Investments</b>			<b>21,326,112,042</b>
Included above are \$62,600,525 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	\$ 3,236,686,183		
Proprietary Funds	41,603,761		
Total	<b>3,278,289,944</b>		

CMOs will be limited to such securities that exhibit 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, 2004.

**B. Liabilities**

**Other Postemployment Benefits**

(in accordance with GASB Statement 12)

In addition to the pension benefits described in Notes 2 and 3, the System provides postemployment health care, life and dental insurance benefits through the Group Benefit Program in accordance with Chapter 1551, Texas Insurance Code. The activities of this program are recorded in the Employees Life, Accident and Health Insurance and Benefits Fund.

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, 2004, there were 70,406 eligible retirees and surviving spouses, plus approximately 32,900 dependents.

Figure I summarizes the maximum monthly State contribution toward eligible retirees' health and basic life premium. Retirees pay any premium over and above the State contribution. The State does not contribute toward dental or optional life insurance. Surviving spouses and their dependents do not receive any State contribution.

Figure J 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 restated 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, 2004 is presented in Figure K.

*Figure I*

**STATE CONTRIBUTION RATES - RETIREE HEALTH AND BASIC LIFE PREMIUM – FISCAL YEAR 2004**

	September 1, 2003
	\$
Retiree Only	300.27
Retiree & Spouse	471.65
Retiree & Children	415.02
Retiree & Family	586.39

*Figure J*

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

	August 31,	
	2004	2003
	\$	\$
State Contributions	286,029,756	253,791,305
Retiree Contributions	88,467,593	77,997,477
Total Contributions	374,497,349	331,788,782
Claims Expenses	402,270,880	362,684,483

*Figure K*

**NON-CANCELABLE OPERATING LEASES**

Fiscal Year	Future Minimum Lease Rental Payments
	\$
2005	901,567
2006	537,102
2007	223,387
2008	19,009
<b>Total Future Minimum Lease Rental Payments</b>	<b>1,681,065</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, 2004 and 2003 is presented in Figure L.

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 presents individual interfund receivable and interfund payable balances at August 31, 2004.

### 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

*Figure L*

### NET ASSETS - FIDUCIARY FUNDS

Fund Type - Pension and Other Employee Benefit Trust Funds	Totals - August 31	
	2004	2003
<i>Defined Benefit Plans:</i>	\$	\$
Employee Savings	3,476,386,594	3,539,912,950
State Accumulation	5,666,110,883	4,553,184,517
Retirement Annuity Reserves	10,425,251,980	10,083,433,892
Total Defined Benefit Plans	19,567,749,457	18,176,531,359
<i>Defined Contribution Plans and Cafeteria Plan:</i>		
Plan 457 Participants	255,418,432	237,507,004
Administration - Defined Contribution Plans	1,854,808	1,081,670
Administration - State Employees Cafeteria Plan	2,060,673	1,979,126
Total Defined Contribution Plans and Cafeteria Plan	259,333,913	240,567,800
<b>Total Fiduciary Net Assets Held In Trust for Pension Benefits and Other Purposes</b>	<b>19,827,083,370</b>	<b>18,417,099,159</b>
	(Exh. VIII)	

*Figure M*

### 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		2,631
<i>Proprietary Fund:</i>		
Employees Life, Accident and Health Insurance and Benefits Fund		
Agency 327, Fund 955		819,799
Agency 327, Fund 943		1,827
<b>Total Proprietary Fund</b>	<b>-</b>	<b>821,626</b>
<b>Total Governmental Activities</b>		<b>824,257</b>
<i>Fiduciary Funds:</i>		
Pension and Other Employee Benefit Trust Funds	1,152,796	328,539
<b>Total Interfund Receivables and Payables</b>	<b>1,152,796</b>	<b>1,152,796</b>

**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) This category also includes transfers from the Employees Retirement Fund to the Excess Benefit Arrangement Fund for retirement benefit payments.

Figure N presents interfund transfers for the year ended August 31, 2004.

**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.

Figure N

**INTERFUND TRANSFERS**

	<u>Transfers In</u>	<u>Transfers Out</u>
<i>Governmental Activities:</i>	\$	\$
<i>Major Governmental Funds:</i>		
Social Security Administration		
Agency 327, Fund 955	18,000	
<b>Total Governmental Activities</b>	<b>18,000</b>	
<i>Fiduciary Funds:</i>		
Pension and Other Employee Benefit Trust Funds	501,345	519,345
<b>Total Interfund Receivables and Payables</b>	<b>519,345</b>	<b>519,345</b>

- Unaudited -

**REQUIRED SUPPLEMENTARY INFORMATION**  
**Budgetary Comparison Schedule -**  
**Appropriated Special Revenue Funds (Note A)**  
**For the Year Ended August 31, 2004**

	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>	-	-	-	-	-	-	-	-
Appropriations Lapsed	-	-	-	-	-	-	-	-
Decrease in Previous Years' Appropriations	-	-	-	-	-	-	-	-
<b>Adjusted Budgetary Fund Balances - Beginning</b>	-	-	-	-	-	-	-	-
<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.	2,711,951	4,956,749	4,956,749	-	6,508,651	6,681,466	6,681,466	-
<b>Total Appropriations Revenue</b>	<b>2,739,951</b>	<b>4,984,749</b>	<b>4,984,749</b>	<b>-</b>	<b>6,508,651</b>	<b>6,681,466</b>	<b>6,681,466</b>	<b>-</b>
<b>Expenditures</b>								
Current:								
Administrative Expenditures	28,000	28,000	28,000	-				
Death Benefits	2,711,951	4,956,749	4,956,749	-	6,508,651	6,681,466	6,681,466	-
<b>Total Expenditures</b>	<b>2,739,951</b>	<b>4,984,749</b>	<b>4,984,749</b>	<b>-</b>	<b>6,508,651</b>	<b>6,681,466</b>	<b>6,681,466</b>	<b>-</b>
<b>Deficiency of Revenues Over Expenditures</b>	-	-	-	-	-	-	-	-
<b>Budgetary Fund Balances - Ending</b>	-	-	-	-	-	-	-	-

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

Reconciliation of Budgetary Basis 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)		2,561
<b>Total Fund Balances-Special Revenue Funds-GAAP Basis (Exh. IV)</b>	<b>\$</b>	<b>2,561</b>

- 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</b>						
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)	104.9	4,979,532	(17.5)
2003	19,478,555	19,959,112	480,557	97.6	4,800,612	10.0
2004	20,036,647	20,591,848	555,201	97.3	4,616,761	12.0
<b>Law Enforcement and Custodial Officer Supplemental Retirement</b>						
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)	131.6	1,298,593	(12.0)
2003	666,588	597,914	(68,674)	111.5	1,277,894	(5.4)
2004	679,243	621,457	(57,786)	109.3	1,230,581	(4.7)
<b>Judicial Retirement System Plan One</b>						
1999	\$ 0	\$ 358,201	\$ 358,201	0.0 %	\$ 12,623	2,837.7 %
2000	0	354,562	354,562	0.0	12,254	2,893.4
2001	0	341,316	341,316	0.0	9,334	3,656.8
2002	0	336,960	336,960	0.0	8,240	3,656.6
2003	0	262,766	262,766	0.0	3,710	7,082.6
2004	0	263,068	263,068	0.0	4,921	5,345.8
<b>Judicial Retirement System Plan Two</b>						
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	(5,545)	109.6	44,490	(12.5)
2002	114,433	103,229	(8,836)	109.6	45,965	(19.9)
2003	129,426	111,116	(18,310)	116.5	47,479	(38.6)
2004	145,538	123,913	(21,625)	117.5	48,504	(44.6)

**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, 2004	August 31, 2004	August 31, 2004	August 31, 2004
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	3.7	40.0	40.0
Asset Valuation Method	5-Year Smoothed Fair Value	5-Year Smoothed Fair Value	N/A	5-Year Smoothed Fair Value
Actuarial Assumptions:				
Investment Rate of Return	8.0%	8.0%	8.0%	8.0%
Projected Salary Increases	5.8%-10.8%	6.0%-14.0%	4.0%	4.0%
Includes Inflation at	4.0%	4.0%	4.0%	4.0%
Cost-of-living Adjustments	None-Employee 4.0%-Elected	None	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</u>		<u>Law Enforcement and Custodial Officer Supplemental Retirement</u>	
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	312,285,035	89.3	0	100.0
	<u>Judicial Retirement System Plan One</u>		<u>Judicial Retirement System Plan Two</u>	
2000	\$ 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	103.5	5,789,655	141.7

**Exhibit A-1**

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

**August 31, 2004**

(With Comparative Totals at August 31, 2003)

	<b>TexaSaver 401(k) Trust Fund (0946) (U/F 0946)</b>	<b>TexaSaver 457 Trust Fund (0945) (U/F 0945)</b>	<b>Totals Defined Contribution Plans</b>	<b>State Employees Cafeteria Plan Trust Fund (0943) (U/F 0943)</b>	<b>Totals August 31,</b>	
	\$	\$	\$	\$	2004 (Exh. VIII)	2003
	\$	\$	\$	\$	\$	\$
<b><u>ASSETS</u></b>						
<i>Cash and Short-Term Investments:</i>						
<i>Cash and Cash Equivalents:</i>						
Cash in Bank		3,850,357	3,850,357	948,516	4,798,873	13,471,176
Cash in State Treasury	995,881	917,729	1,913,610	2,119,196	4,032,806	4,639,555
Total Cash and Cash Equivalents	995,881	4,768,086	5,763,967	3,067,712	8,831,679	18,110,731
<i>Short-Term Investments:</i>						
Mutual Funds		90,015,668	90,015,668		90,015,668	69,021,173
Total Short-Term Investments	-	90,015,668	90,015,668	-	90,015,668	69,021,173
Total Cash and Short-Term Investments	995,881	94,783,754	95,779,635	3,067,712	98,847,347	87,131,904
<i>Investments:</i>						
Miscellaneous Investments		161,810,108	161,810,108		161,810,108	155,597,861
Total Investments	-	161,810,108	161,810,108	-	161,810,108	155,597,861
<i>Receivables:</i>						
Interest and Dividends Receivable	1,087	1,200	2,287	4,400	6,687	11,160
Contributions/Accounts Receivable			-	3,532,298	3,532,298	2,582,488
Total Receivables	1,087	1,200	2,287	3,536,698	3,538,985	2,593,648
Due From Other Funds (Note 1.F)			-	1,827	1,827	-
Prepaid Claims Expense			-	462,324	462,324	-
<b>Total Assets</b>	<b>996,968</b>	<b>256,595,062</b>	<b>257,592,030</b>	<b>7,068,561</b>	<b>264,660,591</b>	<b>245,323,413</b>
<b><u>LIABILITIES</u></b>						
<i>Payables:</i>						
Benefits/Accounts Payable		257,701	257,701	4,978,747	5,236,448	4,645,742
Total Payables	-	257,701	257,701	4,978,747	5,236,448	4,645,742
Due To Other Funds (Note 1.F)	29,568	31,521	61,089	29,141	90,230	109,871
<b>Total Liabilities</b>	<b>29,568</b>	<b>289,222</b>	<b>318,790</b>	<b>5,007,888</b>	<b>5,326,678</b>	<b>4,755,613</b>
<b><u>NET ASSETS</u></b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. A-2)</b>	<b>967,400</b>	<b>256,305,840</b>	<b>257,273,240</b>	<b>2,060,673</b>	<b>259,333,913</b>	<b>240,567,800</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**

**For the Year Ended August 31, 2004**  
(With Comparative Totals at August 31, 2003)

	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,	
	\$	\$	\$	\$	2004 (Exh. IX)	2003
<b>ADDITIONS</b>						
<i>Contributions:</i>						
<i>Member Contributions:</i>						
Plan 457 Deferrals		37,047,181	37,047,181		37,047,181	27,132,462
Plan 457 Rollovers In and Transfers In		56,425,620	56,425,620		56,425,620	27,240,834
Total Plan 457 Contributions	-	93,472,801	93,472,801	-	93,472,801	54,373,296
Cafeteria Plan				43,091,155	43,091,155	33,388,986
Debit Card Fees				280,659	280,659	181,682
Total Cafeteria Plan Contributions	-	-	-	43,371,814	43,371,814	33,570,668
Total Member Contributions	-	93,472,801	93,472,801	43,371,814	136,844,615	87,943,964
Settlement Revenue	1,153,382	172,970	1,326,352		1,326,352	85,000
<i>Other Contributions:</i>						
Cafeteria Plan Forfeitures				468,315	468,315	393,143
Total Contributions	1,153,382	93,645,771	94,799,153	43,840,129	138,639,282	88,422,107
<i>Investment Income:</i>						
<i>From Investing Activities:</i>						
Net Appreciation		16,431,957	16,431,957		16,431,957	11,095,862
Interest & Dividends	4,166	17,544,476	17,548,642	25,248	17,573,890	7,310,657
Total Investing Activity Income	4,166	33,976,433	33,980,599	25,248	34,005,847	18,406,519
<i>Other Additions:</i>						
<i>Other Revenue:</i>						
Financial Processing Error Penalty	5,250	750	6,000		6,000	-
Miscellaneous Revenue	169,798	3,368	173,166	13,165	186,331	17,934
Total Other Revenue	175,048	4,118	179,166	13,165	192,331	17,934
<i>Transfers In (Note 5.E):</i>						
Membership Fees		8,813	8,813	425,617	434,430	493,998
Total Other Additions	175,048	12,931	187,979	438,782	626,761	511,932
<b>Total Additions</b>	<b>1,332,596</b>	<b>127,635,135</b>	<b>128,967,731</b>	<b>44,304,159</b>	<b>173,271,890</b>	<b>107,340,558</b>
<b>DEDUCTIONS</b>						
<i>Benefits:</i>						
Plan 457 Distributions (Include Withholding Taxes)		41,851,036	41,851,036		41,851,036	27,604,277
Plan 457 Fees		604,008	604,008		604,008	396,252
Plan 457 Rollovers Out and Transfers Out		67,071,521	67,071,521		67,071,521	42,224,374
Total Plan 457 Benefits	-	109,526,565	109,526,565	-	109,526,565	70,224,903
Cafeteria Plan Reimbursement Claims				42,886,292	42,886,292	33,539,568
Total Benefits	-	109,526,565	109,526,565	42,886,292	152,412,857	103,764,471
<i>Administrative Expenses:</i>						
Salaries & Wages	257,224	261,464	518,688	228,432	747,120	822,264
Payroll Related Costs	60,511	64,958	125,469	56,391	181,860	196,257
Professional Fees & Services	10,062	9,954	20,016	953	20,969	16,087
Travel	1,801	1,100	2,901	1,126	4,027	3,653
Materials & Supplies	7,006	17,580	24,586	14,648	39,234	74,384
Communications & Utilities	3,315	5,821	9,136	8,284	17,420	29,688
Repairs & Maintenance	11,305	12,512	23,817	13,720	37,537	38,256
Rentals & Leases	7,862	10,138	18,000	12,104	30,104	45,995
Printing & Reproduction	33	209	242	1,221	1,463	3,682
Interest Expense			-	5,513	5,513	-
<i>Other Operating Expenses:</i>						
Other Expenses	6,714	7,031	13,745	14,524	28,269	62,277
Third Party Administrator Fees			-	698,745	698,745	569,092
Debit Card Fees				280,659	280,659	181,682
Total Other Operating Expenses	6,714	7,031	13,745	993,928	1,007,673	813,051
Total Administrative Expenses	365,833	390,767	756,600	1,336,320	2,092,920	2,043,317
<b>Total Deductions</b>	<b>365,833</b>	<b>109,917,332</b>	<b>110,283,165</b>	<b>44,222,612</b>	<b>154,505,777</b>	<b>105,807,788</b>
<b>Net Increase</b>	<b>966,763</b>	<b>17,717,803</b>	<b>18,684,566</b>	<b>81,547</b>	<b>18,766,113</b>	<b>1,532,770</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes:</b>						
Beginning of Year	637	238,588,037	238,588,674	1,979,126	240,567,800	239,035,030
End of Year (Exh. A-1)	967,400	256,305,840	257,273,240	2,060,673	259,333,913	240,567,800

**Exhibit A-3**

**COMBINING STATEMENT OF FIDUCIARY NET ASSETS - Agency Funds**

**August 31, 2004**

(With Comparative Totals at August 31, 2003)

	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)	Direct Deposit Correction Account (0980) (U/F 0980)	Totals August 31,	
	\$	\$	\$	\$	\$	2004 (Exh. VIII)	2003
<u>ASSETS</u>	\$	\$	\$	\$	\$	\$	\$
<i>Current Assets:</i>							
<i>Cash and Cash Equivalents:</i>							
Cash in Bank			4,591			4,591	1,391,668
Cash in State Treasury		250		163,562	466	164,278	212,452
Total Cash and Cash Equivalents	-	250	4,591	163,562	466	168,869	1,604,120
Accounts Receivable	8,305			7,685		15,990	13,375
Due From Other Funds (Note 1.F)						-	278
<b>Total Current Assets</b>	<b>8,305</b>	<b>250</b>	<b>4,591</b>	<b>171,247</b>	<b>466</b>	<b>184,859</b>	<b>1,617,773</b>
<b>Total Assets</b>	<b>8,305</b>	<b>250</b>	<b>4,591</b>	<b>171,247</b>	<b>466</b>	<b>184,859</b>	<b>1,617,773</b>
 <u>LIABILITIES</u>							
<i>Current Liabilities:</i>							
Accounts Payable	8,305	250				8,555	14,053
Funds Held For Others			4,591	171,247	466	176,304	1,603,720
<b>Total Current Liabilities</b>	<b>8,305</b>	<b>250</b>	<b>4,591</b>	<b>171,247</b>	<b>466</b>	<b>184,859</b>	<b>1,617,773</b>
<b>Total Liabilities</b>	<b>8,305</b>	<b>250</b>	<b>4,591</b>	<b>171,247</b>	<b>466</b>	<b>184,859</b>	<b>1,617,773</b>
<b>Net Assets</b>	<b>-</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**

**For the Year Ended August 31, 2004**

	Balances, Beginning	Additions	Deductions	Balances, Ending
	\$	\$	\$	\$ (Exh. A-3)
<i>Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)</i>				
<b>ASSETS</b>				
Cash in State Treasury	-	142,419	142,419	-
Accounts Receivable	13,375	121,115	126,185	8,305
Due From Other Funds	278		278	-
<b>Total Assets</b>	<b>13,653</b>	<b>263,534</b>	<b>268,882</b>	<b>8,305</b>
<b>LIABILITIES</b>				
Accounts Payable	13,653	176,014	181,362	8,305
<b>Total Liabilities</b>	<b>13,653</b>	<b>176,014</b>	<b>181,362</b>	<b>8,305</b>
<i>Employee Savings Bond Fund (0901) (U/F 0901)</i>				
<b>ASSETS</b>				
Cash in State Treasury	400	1,800	1,950	250
<b>Total Assets</b>	<b>400</b>	<b>1,800</b>	<b>1,950</b>	<b>250</b>
<b>LIABILITIES</b>				
Accounts Payable	400	1,800	1,950	250
Vouchers Payable	-	1,950	1,950	-
<b>Total Liabilities</b>	<b>400</b>	<b>3,750</b>	<b>3,900</b>	<b>250</b>
<i>TexaSaver 401(k) Trust Fund (0946) (U/F 1946)</i>				
<b>ASSETS</b>				
Cash in Bank	1,391,668	107,269,715	108,656,792	4,591
<b>Total Assets</b>	<b>1,391,668</b>	<b>107,269,715</b>	<b>108,656,792</b>	<b>4,591</b>
<b>LIABILITIES</b>				
Funds Held For Others	1,391,668	107,268,393	108,655,470	4,591
<b>Total Liabilities</b>	<b>1,391,668</b>	<b>107,268,393</b>	<b>108,655,470</b>	<b>4,591</b>
<i>TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942 &amp; 8942)</i>				
<b>ASSETS</b>				
Cash in State Treasury	212,052	16,810	65,300	163,562
Accounts Receivable	-	7,685		7,685
<b>Total Assets</b>	<b>212,052</b>	<b>24,495</b>	<b>65,300</b>	<b>171,247</b>
<b>LIABILITIES</b>				
Funds Held For Others	212,052	16,810	57,615	171,247
<b>Total Liabilities</b>	<b>212,052</b>	<b>16,810</b>	<b>57,615</b>	<b>171,247</b>
<i>Direct Deposit Correction Account (0980) (U/F 0980)</i>				
<b>ASSETS</b>				
Cash in State Treasury	-	1,223,536	1,223,070	466
<b>Total Assets</b>	<b>-</b>	<b>1,223,536</b>	<b>1,223,070</b>	<b>466</b>
<b>LIABILITIES</b>				
Funds Held For Others	-	1,223,536	1,223,070	466
<b>Total Liabilities</b>	<b>-</b>	<b>1,223,536</b>	<b>1,223,070</b>	<b>466</b>
<b>Totals - All Agency Funds</b>				
<b>ASSETS</b>				
Cash in Bank	1,391,668	107,269,715	108,656,792	4,591
Cash in State Treasury	212,452	1,384,565	1,432,739	164,278
Accounts Receivable	13,375	128,800	126,185	15,990
Due From Other Funds	278	-	278	-
<b>Total Assets</b>	<b>1,617,773</b>	<b>108,783,080</b>	<b>110,215,994</b>	<b>184,859</b>
<b>LIABILITIES</b>				
Accounts Payable	14,053	177,814	183,312	8,555
Vouchers Payable	-	1,950	1,950	-
Funds Held For Others	1,603,720	108,508,739	109,936,155	176,304
<b>Total Liabilities</b>	<b>1,617,773</b>	<b>108,688,503</b>	<b>110,121,417</b>	<b>184,859</b>

## Schedule 1

# REVENUES, EXPENSES AND CHANGES IN STATUTORY ACCOUNT BALANCES (NON-GAAP PRESENTATION) - EMPLOYEES RETIREMENT FUND

For the Year Ended August 31, 2004

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2004
	\$	\$	\$	\$	\$	\$
<b><i>Operating Revenues</i></b>						
Contributions to Retirement System:						
Member Contributions	300,155,783					300,155,783
State Contributions		278,844,513				278,844,513
Service Contributions from Teacher Retirement System		38,068,440				38,068,440
Membership Fees					463,162	463,162
Penalty Interest		6,598,740				6,598,740
Investment Income:						
Net Appreciation in Fair Value of Investments				1,478,546,931		1,478,546,931
Interest and Dividends				529,630,627		529,630,627
Rental Income					38,588	38,588
Warrants Voided by Statute of Limitations		196,474				196,474
Sale of Surplus Equipment					10,462	10,462
Miscellaneous					343,466	343,466
<b>Total Operating Revenues</b>	<b>300,155,783</b>	<b>323,708,167</b>	<b>-</b>	<b>2,008,177,558</b>	<b>855,678</b>	<b>2,632,897,186</b>
<b><i>Operating Expenses</i></b>						
Retirement System Benefits Paid:						
Retirement Benefits			1,184,711,052			1,184,711,052
Death Benefits:						
Active Members		1,012,352				1,012,352
Retirees		167,832	769,239			937,071
Member Contributions Withdrawn	83,779,001					83,779,001
Service Contributions to Teacher Retirement System		5,600,176				5,600,176
Re-Issue Warrants Voided		1,944				1,944
Administrative Expenses					25,149,970	25,149,970
Depreciation Expense					772,164	772,164
<b>Total Operating Expenses</b>	<b>83,779,001</b>	<b>6,782,304</b>	<b>1,185,480,291</b>	<b>-</b>	<b>25,922,134</b>	<b>1,301,963,730</b>
<b>Income (Loss) Before Non-Operating Expenses and Operating Transfers</b>	<b>216,376,782</b>	<b>316,925,863</b>	<b>(1,185,480,291)</b>	<b>2,008,177,558</b>	<b>(25,066,456)</b>	<b>1,330,933,456</b>
<b><i>Non-Operating Expenses</i></b>						
Loss on Disposal of Fixed Assets					(29,309)	(29,309)
<b>Income (Loss) Before Operating Transfers</b>	<b>216,376,782</b>	<b>316,925,863</b>	<b>(1,185,480,291)</b>	<b>2,008,177,558</b>	<b>(25,095,765)</b>	<b>1,330,904,147</b>
<b><i>Operating Transfers In (Out)</i></b>						
Distribution of Interest	152,345,680	961,030,720	849,957,706	(1,963,334,106)		-
Interest Paid on Withdrawals	19,228,342			(19,228,342)		-
Establishment of Benefit Reserves	(453,570,552)	(203,248,281)	656,818,833			-
Member Savings Reinstated	41,202	(41,202)				-
Distribution of Interest for Administrative Expenses				(25,615,110)	25,615,110	-
Benefits Waived		82,025	(82,025)			-
Member Accounts - Escheated	(1,435,771)	1,435,771				-
Membership Fees Transferred Out					(452,430)	(452,430)
Excess Benefit Arrangement Transfers					(66,915)	(66,915)
<b>Net Operating Transfers</b>	<b>(283,391,099)</b>	<b>759,259,033</b>	<b>1,506,694,514</b>	<b>(2,008,177,558)</b>	<b>25,095,765</b>	<b>(519,345)</b>
<b>Net Income (Loss)</b>	<b>(67,014,317)</b>	<b>1,076,184,896</b>	<b>321,214,223</b>	<b>-</b>	<b>-</b>	<b>1,330,384,802</b>
<b>Account Balances - Beginning</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>
<b>Account Balances - Ending</b>	<b>3,443,207,498</b>	<b>5,192,586,356</b>	<b>10,161,943,670</b>	<b>-</b>	<b>-</b>	<b>18,797,737,524</b>

**Schedule 2**  
**REVENUES, EXPENSES AND CHANGES IN STATUTORY ACCOUNT BALANCES**  
**(NON-GAAP PRESENTATION) -**  
**LAW ENFORCEMENT AND CUSTODIAL OFFICER SUPPLEMENTAL RETIREMENT FUND**  
For the Year Ended August 31, 2004

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2004
	\$	\$	\$	\$	\$	\$
<b><i>Operating Revenues</i></b>						
Investment Income:						
Net Appreciation in Fair Value of Investments				50,385,821		50,385,821
Interest and Dividends				17,984,018		17,984,018
Warrants Voided by Statute of Limitations		1,876				1,876
<b>Total Operating Revenues</b>	<b>-</b>	<b>1,876</b>	<b>-</b>	<b>68,369,839</b>	<b>-</b>	<b>68,371,715</b>
<b><i>Operating Expenses</i></b>						
Retirement System Benefits Paid:						
Retirement Benefits			27,558,933			27,558,933
Administrative Expenses					1,094,032	1,094,032
<b>Total Operating Expenses</b>	<b>-</b>	<b>-</b>	<b>27,558,933</b>	<b>-</b>	<b>1,094,032</b>	<b>28,652,965</b>
<b>Income (Loss) Before Operating Transfers</b>	<b>-</b>	<b>1,876</b>	<b>(27,558,933)</b>	<b>68,369,839</b>	<b>(1,094,032)</b>	<b>39,718,750</b>
<b><i>Operating Transfers In (Out)</i></b>						
Distribution of Interest		48,568,715	18,707,092	(67,275,807)		-
Establishment of Benefit Reserves		(24,303,209)	24,303,209			-
Distribution of Interest for Administrative Expenses				(1,094,032)	1,094,032	-
<b>Net Operating Transfers</b>	<b>-</b>	<b>24,265,506</b>	<b>43,010,301</b>	<b>(68,369,839)</b>	<b>1,094,032</b>	<b>-</b>
<b>Net Income</b>	<b>-</b>	<b>24,267,382</b>	<b>15,451,368</b>	<b>-</b>	<b>-</b>	<b>39,718,750</b>
<b>Account Balances - Beginning</b>	<b>5,275</b>	<b>375,819,263</b>	<b>218,269,105</b>	<b>-</b>	<b>-</b>	<b>594,093,643</b>
<b>Account Balances - Ending</b>	<b>5,275</b>	<b>400,086,645</b>	<b>233,720,473</b>	<b>-</b>	<b>-</b>	<b>633,812,393</b>

**Schedule 3**

**REVENUES, EXPENSES AND CHANGES IN STATUTORY ACCOUNT BALANCES  
(NON-GAAP PRESENTATION) - JUDICIAL RETIREMENT SYSTEM PLAN TWO FUND**

For the Year Ended August 31, 2004

	<b>Employees Savings Account</b>	<b>State Accumulation Account</b>	<b>Retirement Annuity Reserve Account</b>	<b>Interest Account</b>	<b>Expense Account</b>	<b>Totals August 31, 2004</b>
	\$	\$	\$	\$	\$	\$
<b><i>Operating Revenues</i></b>						
Contributions to Retirement System:						
Member Contributions	2,921,531					2,921,531
State Contributions		8,204,944				8,204,944
Penalty Interest		1,217				1,217
Investment Income:						
Net Appreciation in Fair Value of Investments				9,771,423		9,771,423
Interest and Dividends				3,636,740		3,636,740
Miscellaneous Revenue					718	718
<b>Total Operating Revenues</b>	<b>2,921,531</b>	<b>8,206,161</b>	<b>-</b>	<b>13,408,163</b>	<b>718</b>	<b>24,536,573</b>
<b><i>Operating Expenses</i></b>						
Retirement System Benefits Paid:						
Retirement Benefits			2,770,153			2,770,153
Member Contributions Withdrawn	302,953					302,953
Administrative Expenses					348,921	348,921
<b>Total Operating Expenses</b>	<b>302,953</b>	<b>-</b>	<b>2,770,153</b>	<b>-</b>	<b>348,921</b>	<b>3,422,027</b>
<b>Income (Loss) Before Operating Transfers</b>	<b>2,618,578</b>	<b>8,206,161</b>	<b>(2,770,153)</b>	<b>13,408,163</b>	<b>(348,203)</b>	<b>21,114,546</b>
<b><i>Operating Transfers In (Out)</i></b>						
Distribution of Interest	1,391,648	9,705,876	1,944,667	(13,042,191)		-
Interest Paid on Withdrawals	17,769			(17,769)		-
Establishment of Benefit Reserves	(540,034)	(5,437,949)	5,977,983			-
Distribution of Interest for Administrative Expenses				(348,203)	348,203	-
<b>Net Operating Transfers</b>	<b>869,383</b>	<b>4,267,927</b>	<b>7,922,650</b>	<b>(13,408,163)</b>	<b>348,203</b>	<b>-</b>
<b>Net Income</b>	<b>3,487,961</b>	<b>12,474,088</b>	<b>5,152,497</b>	<b>-</b>	<b>-</b>	<b>21,114,546</b>
<b>Account Balances - Beginning</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>
<b>Account Balances - Ending</b>	<b>33,173,821</b>	<b>73,437,882</b>	<b>29,587,837</b>	<b>-</b>	<b>-</b>	<b>136,199,540</b>



**Schedule 4**

**ADMINISTRATIVE EXPENSES/EXPENDITURES (Excluding Investment Expenses)-**

**Statutory Administrative Funds and Accounts**

For the Year Ended August 31, 2004

	<u>Totals</u>
	\$
<b><u>PERSONNEL SERVICES</u></b>	
Salaries and Wages	12,419,723
Payroll Related Costs:	
Retirement Contributions	718,600
Retirement Membership Fees	798
Employees Insurance Contributions	1,109,599
Retirees Insurance Contributions	340,853
Social Security Contributions	896,598
Unemployment Compensation	39,893
Total Payroll Related Costs	<u>3,106,341</u>
<b>Total Personnel Services</b>	<b><u>15,526,064</u></b>
<b><u>PROFESSIONAL FEES AND SERVICES</u></b>	
Actuarial Services	741,485
Audit Services	235,560
Medical Board Member Fees	82,500
Architectural Services	14,372
Legal Services	55,558
Computer Programming Services	1,445,231
Other Professional Services	78,414
<b>Total Professional Fees and Services</b>	<b><u>2,653,120</u></b>
<b><u>OTHER SERVICES AND CHARGES</u></b>	
Travel	79,200
Materials & Supplies:	
Postage	464,089
General Office and Other Supplies	173,108
Subscriptions	24,535
Furniture and Equipment	302,393
Computer Software	137,145
Total Materials & Supplies	<u>1,101,270</u>
Communications & Utilities:	
Electricity, Gas and Water	277,131
Telephone and Telegraph	268,487
Electronic Communications Services	60,172
Total Communications & Utilities	<u>605,790</u>
Repairs & Maintenance:	
Land and Building	132,509
Furniture and Equipment	19,205
Computer Software and Equipment	1,148,170
Total Repairs & Maintenance	<u>1,299,884</u>
Rentals & Leases:	
Computer Software and Equipment	808,351
Office Equipment	204,220
Space	21,441
Total Rentals & Leases	<u>1,034,012</u>
Printing & Reproduction Services	65,627
Depreciation	772,164
Interest Expense	5,513

- to next page

**Schedule 4**

**ADMINISTRATIVE EXPENSES/EXPENDITURES (Excluding Investment Expenses)-  
Statutory Administrative Funds and Accounts**

For the Year Ended August 31, 2004

(Concluded)

	<u>Totals</u>
	\$
<b><i>OTHER SERVICES AND CHARGES (continued)</i></b>	
Other Operating Expenses/Expenditures:	
Membership Fees	22,628
Employee Training	139,697
Insurance - Building	23,912
Employee Bonds - Notary	4,763
Fees and Other Charges	16,889
Tenure Awards	1,112
Witness Fees	1,170
Temporary Employment Agencies	176,081
Cleaning Services	73,908
Advertising Services	30,267
Freight/Delivery Services	4,164
Purchased Contracted Services	257,139
Prompt Payment Interest	2
Claims & Judgments	1,360
Third Party Administrator Fee - Cafeteria Plan	698,745
Debit Card Fees - Cafeteria Plan	280,659
Total Other Operating Expenses/Expenditures	<u>1,732,496</u>
<b>Total Other Services and Charges</b>	<b><u>6,695,956</u></b>
<b>Total Expenses/Expenditures</b>	<b><u><u>24,875,140</u></u></b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	12,447,538
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)	630,216
Judicial Retirement System Plan One Fund (0001)	120,000
Judicial Retirement System Plan Two Trust Fund (0993)	272,804
TexaSaver 401(k) Trust Fund (0946)	365,833
TexaSaver 457 Trust Fund (0945)	390,767
State Employees Cafeteria Plan Trust Fund (0943)	1,336,320
<b>Total Fiduciary Funds</b>	<b><u>15,563,478</u></b>
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)	9,252,713
<b>Total Proprietary Fund</b>	<b><u>9,252,713</u></b>
Social Security Administration Fund (0929)	30,949
Death Benefits for Certain Law Enforce. Officers, Fire Fighters and Others (0001)	28,000
<b>Total Governmental Funds</b>	<b><u>58,949</u></b>
<b>Total Method of Finance</b>	<b><u><u>24,875,140</u></u></b>

**Schedule 5**  
**PROFESSIONAL AND CONSULTING FEES**  
For the Year Ended August 31, 2004

<b>Nature of Service:</b>	<b>Totals</b>
	<b>\$</b>
Medical Board	82,500
Investment Consulting	161,377
Investment Advisors	9,531,085
Actuarial Services - Retirement	349,867
Actuarial Services - Insurance	391,618
Computer Programming Services	1,455,555
Audit Fees - Financial	73,560
Audit Fees - Insurance Carrier	154,000
Audit Fees - Other	8,000
Educational Services	24,755
Architectural Services	14,372
Legal Services	55,558
Executive Search Consulting	14,850
Engineering Consulting	2,000
Fiduciary Counsel	26,656
Software Services	4,850
Employee Assistance Program	3,562
Other Professional Services	1,741
	<b>12,355,906</b>
<b>Total Professional and Consulting Fees</b>	<b>12,355,906</b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	11,205,721
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)	381,934
Judicial Retirement System Plan One Fund (0001)	18,843
Judicial Retirement System Plan Two Trust Fund (0993)	102,534
Texasaver 401(k) Trust Fund (0946)	10,062
Texasaver 457 Trust Fund (0945)	9,954
State Employees Cafeteria Plan Trust Fund (0943)	953
<b>Total Fiduciary Funds</b>	<b>11,730,001</b>
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)	625,825
<b>Total Proprietary Fund</b>	<b>625,825</b>
Social Security Administration Fund (0929)	80
<b>Total Governmental Funds</b>	<b>80</b>
	<b>12,355,906</b>
<b>Total Method of Finance</b>	<b>12,355,906</b>



**Schedule 6**

**INVESTMENT EXPENSES**

**For the Year Ended August 31, 2004**

	<u>Totals</u>
	\$
<b><u>PERSONNEL SERVICES</u></b>	
Salaries and Wages	2,252,753
Payroll Related Costs:	
Retirement Contributions	121,490
Retirement Membership Fees	84
Employees Insurance Contributions	132,603
Social Security Contributions	142,535
Total Payroll Related Costs	<u>396,712</u>
<b>Total Personnel Services</b>	<b><u>2,649,465</u></b>
<b><u>PROFESSIONAL FEES AND SERVICES</u></b>	
Investment Consulting Fees	161,377
Investment Advisor Fees	9,531,085
Computer Programming Services	10,324
<b>Total Professional Fees and Services</b>	<b><u>9,702,786</u></b>
<b><u>OTHER SERVICES AND CHARGES</u></b>	
Travel	68,678
Materials & Supplies:	
General Office and Other Supplies	169
Subscriptions	5,961
Furniture and Equipment	3,872
Total Materials & Supplies	<u>10,002</u>
Communications & Utilities:	
Telephone and Telegraph	39,141
Electronic Communications Services	1,021,994
Total Communications & Utilities	<u>1,061,135</u>
Repairs & Maintenance:	
Computer Software and Hardware	203,446
Other Operating Expenses:	
Membership Fees	29,356
Employee Training	18,126
Fees and Other Charges	2,465
Investment Banking	326,620
Temporary Employment Agencies	5,789
Total Other Operating Expenses	<u>382,356</u>
<b>Total Other Services and Charges</b>	<b><u>1,725,617</u></b>
<b>Total Investment Expenses</b>	<b><u>14,077,868</u></b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	13,474,596
Law Enforcement and Custodial Officer Supplement Ret. Trust Fund (0977)	463,816
Judicial Retirement System Plan Two Trust Fund (0993)	76,117
Employees Life, Accident, Health Insurance And Benefits Trust Account (0973)	63,339
<b>Total Method of Finance</b>	<b><u>14,077,868</u></b>

Paula Hunt-Wilson, who is employed by the Public Utility Commission of Texas, has worked for the State for 2 1/2 years. She enjoys writing fiction, reading and spending time with her young children, Hannah and Connor.

*“I like that providers are very familiar with the HealthSelect plan. With two children, it is very important to me that I can use the TexFlex program to help budget my out-of-pocket medical and day care expenses and pay for them income tax free. It’s good to know that my annual TexFlex Health Care Reimbursement Account funds are available at the start of the plan year, if I need them.”*

*-Paula Hunt-Wilson*



*Paula Hunt-Wilson,  
Public Utility Commission of Texas Employee*

# Investment 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 2004

## OVERVIEW

The Employees Retirement System of Texas (System) investment portfolio closed the fiscal year with a fair value of \$19.5 billion, and returned 11.7% for the year. The fiscal year-end asset allocation stood at 37.20% investment grade bonds, 4.02% high yield bonds, 35.97% large cap domestic equity, 4.52% small cap domestic equity and 17.97% 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 one international equity advisor and one domestic equity advisor, fuller integration of corporate credit reviews into the fixed income portfolio management process, and the continued update of investment program software tools to improve overall efficiency. In addition, an Asset Allocation and Liability Study was completed resulting in the Board's choosing a new asset allocation for the fund shown below:

Asset Class	Old	New
Domestic Large Capitalization Stocks	37%	37%
Domestic Small Capitalization Stocks	4%	7%
International Stocks	18%	18%
Investment Grade Bonds	37%	30%
High Yield Bonds	4%	8%

Staff also continued to update its software tools to improve the overall efficiency of the investment program.

A continued economic recovery resulted in strong positive returns for the fund this fiscal year, reflecting robust equity markets during the beginning months of the fiscal year. Over the longer term, the fund returned 8.15% for the 10 years ending August 31, 2004 slightly besting the policy benchmark of 8.09%. This long-term annual return is ahead 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, 2004, the S&P 500 Index returned 11.4%, while the S&P 600 Small Cap Index returned 14.9%. These gains were a continuation of the positive returns experienced during the prior fiscal year. Nevertheless, after two years of positive returns, the S&P 500 is still 28% below its peak value reached in March of 2000. The S&P 600 Small Cap Index reached new highs this year and is currently trading only 3.5% below its all time high. Operating earnings for the S&P 500 are expected to increase 20% in calendar 2004 to \$65.57 per share. Although this will be a new high, earnings growth is expected to slow significantly over the next two years and this appears to be restraining further gains in the index. The key factors impacting the domestic equity markets over the last year have been rising energy prices and a slow down in consumer spending as personal income growth has been moderate coupled with a lack of stimulative impacts from tax cuts and home refinancing. Fortunately, interest rates have remained low supporting housing values and keeping debt servicing affordable. There is still little need for additional capacity in most industries, suggesting corporate spending and employment growth will also remain modest in the year ahead. The best performing sectors in the S&P 500 were energy and utilities. The worst performing sectors were technology and consumer discretionary.

### Fixed Income Market

Interest rates generally trended lower during FY 2004. The yield on the 10-year U.S. Treasury Note declined by 0.48% points during the year, but moved within a range of nearly 1.20% points. Short-term interest rates, three years and less, actually increased during the year, while longer term interest rates declined.

The U.S. economy began the fiscal year by exhibiting remarkably strong growth. This growth actually moderated during the year. Unfortunately, this strong economic growth stimulated only modest increases in jobs. The slow growth in jobs continued to worry the fixed income markets, driving interest rates lower during the first half of the fiscal year.

In the March through May period the U.S. economy began to add jobs at a more robust pace, commodities prices were increasing, and the posture of the Federal Reserve was beginning to change. Up to this point, the Federal Reserve had expressed its concern about slow job growth and the risk of falling prices. With improvement in the labor markets and increases in commodity prices, the Federal Reserve began preparing the markets for the eventuality that the Federal Funds rate would be increased. This resulted in the dramatic increase in rates during the March through May period.

Increases in gasoline prices, higher interest rates, and some stalling in the job growth combined to slow economic growth from the rapid pace of the summer and fall of 2003. This in turn pushed interest rates lower for longer maturities in the June through August period.

The Lehman Brothers Aggregate Bond Index returned 6.82% for the fiscal year. The best performing sector for the second year in a row was the Corporate sector, which returned 8.16%. The combined impact of improved

corporate profitability and cash flow and lower interest rates resulted in significant performance by corporate bonds. Additionally, the longer maturity CMBS sector was the next best performer during the period.

### International Stock Market

International equity market returns were strong on a local currency basis in fiscal year 2004. The Morgan Stanley Capital International EAFE Free index returned 11.26% for the period. Pacific ex-Japan returned 16.85%, with Hong Kong leading the way gaining 23.41% while Japan gained 13.29%. Pan Europe lagged with local returns of 10.20% held back by Germany with a return of 8.86% while the United Kingdom returned 10.70%.

For U.S. dollar-based investors a weakening dollar against most major currencies pushed returns even higher. The local currency return of 11.26% was boosted to 22.64% in U.S. dollars. The dollar fell 15.2% against the British Pound and 11.62% against the Euro as these currencies rallied strongly in the first four months of the fiscal year.

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## KEY PORTFOLIO STATISTICS

	<b>2004</b>	<b>2003</b>
● Contributions to Pool	\$451,800,000	\$594,800,000
● Withdrawals from Pool	(\$1,141,440,000)	(\$1,053,400,000)
● Interest & Dividends	\$542,639,392	\$543,546,032
● Securities Lending Income	\$8,611,921	\$7,554,550
● Net Appreciation in Fair Value	\$1,538,704,175	\$978,658,541

*Prepared by:*

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

*Basis of Presentation:*

Master Custodian and System's Financial Records in accordance with the CFA Institute Standards. CFA Institute is the global, non-profit professional association that administers the Chartered Financial Analyst curriculum and examination program worldwide and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute was known as AIMR (Association for Investment Management and Research) from 1990 to early 2004.

# OUTLINE OF INVESTMENT POLICIES

## 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 subject to the same quality standards indicated above; 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 -

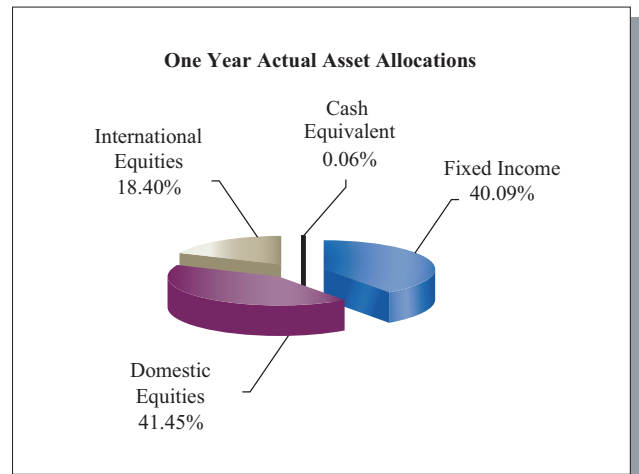
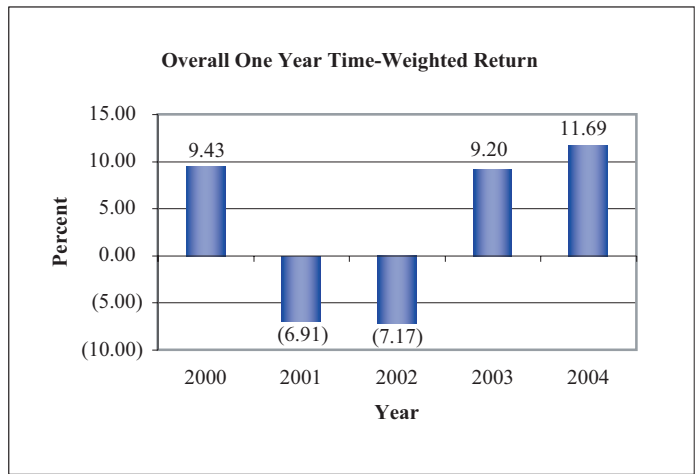
## TIME-WEIGHTED RATES OF RETURN AND ASSET ALLOCATIONS Pension Investment Pool Trust Fund (Note A)

August 31, 2004

	Time-Weighted Rates of Return									
	Fixed Income Securities		Domestic Equities		International Equities		Cash Equivalent		ERS	CPI
	ERS	Index	ERS	Index	ERS	Index	ERS	Index	Overall	
<i>1 Year</i>	%	%	%	%	%	%	%	%	%	%
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
2004	7.78	6.13	11.25	11.45	21.41	22.64	1.13	1.08	<b>11.69</b>	2.44
<i>3 Year</i> (2002-2004)	6.81	6.19	1.75	0.80	1.27	4.41	1.61	1.57	<b>4.22</b>	2.13
<i>5 Year</i> (2000-2004)	7.93	7.67	(0.18)	(2.07)	(2.85)	(1.15)	3.23	3.13	<b>2.89</b>	2.50

### Asset Allocations

	1-Year		3-Year		5-Year	
	Target	Actual	Target	Actual	Target	Actual
	%	%	%	%	%	%
Fixed Income	41.00	40.09	41.00	41.42	41.00	42.06
Domestic Equities	41.00	41.45	41.00	40.84	41.00	40.76
International Equities	18.00	18.40	18.00	17.69	18.00	17.11
Cash Equivalent	0.00	0.06	0.00	0.05	0.00	0.07
<b>Total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>



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:	91-Day U.S. Treasury Bill

Basis of Presentation: Master Custodian Records in accordance with the CFA Institute Standards.

- Unaudited -

## LIST OF LARGEST ASSETS HELD (NOTE A)

As of August 31, 2004

### Ten Largest Stock Holdings

# of Shares	Description	Fair Value
		\$
7,216,300	Microsoft Corporation	197,582,294
5,757,900	Pfizer, Inc.	189,097,936
5,598,600	General Electric Co.	183,578,094
3,594,144	ExxonMobil Corporation	166,634,051
3,130,701	Citigroup, Inc.	145,828,053
2,090,500	Johnson & Johnson	122,053,843
2,693,576	Bank of America Corporation	121,157,048
1,696,405	American International Group, Inc.	120,851,892
52,544,075	Vodafone Group PLC	119,336,718
2,245,500	Wal Mart Stores, Inc.	118,562,400

### Ten Largest Fixed Income Security Holdings

Par Value	Description	Fair Value
\$		\$
924,286,474	Merrill Lynch Premier Institutional Fund, Rating NR	925,431,561
200,000,000	Treasury Inflation Index N/B 3.875% due on 04/15/2029, Rating AAA	308,557,003
195,000,000	U.S. Treasury Note 7.5% due on 11/15/2016, Rating AAA	254,592,170
248,000,000	FNCI 4.5% September TBA due on 05/25/2019, Rating NR	247,766,880
200,000,000	Merrill Lynch Repurchase Agreement 1.50% due on 09/01/2004, Rating NR	200,000,000
185,000,000	FNCI 5% September TBA due on 09/25/2016, Rating NR	188,411,400
140,000,000	Federal Home Loan Bank 4% due on 05/15/2008, Rating AAA	144,748,956
140,000,000	FGLMC 5.5% September TBA due on 06/15/2034, Rating NR	142,188,200
130,000,000	FNCI 6% September TBA due on 04/25/2029, Rating NR	134,631,900
100,000,000	Treasury Inflation Index N/B 4.25% due on 01/15/2010, Rating AAA	131,638,138

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 CFA Institute Standards.



- Unaudited -

## SCHEDULE OF FEES AND COMMISSIONS

For the Year Ended August 31, 2004

INVESTMENT ADVISORY FEES				DOMESTIC EQUITY COMMISSIONS			
	Assets Under			Brokerage Firm	No. of Shares Traded	Commissions	Commission Per Share
	Management	Fees	Basis Point				
Fixed Income Advisors	\$ 783,849,340	\$ 1,415,402	0.1806%	A.G. Edwards	246,600	\$ 12,330	0.050
Domestic Equity Advisors	2,957,631,835	4,086,920	0.1382%	Bank Of America	9,584,186	244,968	0.026
International Equity Advisors	2,306,504,216	4,028,763	0.1747%	Bear Stearns	13,948,416	399,403	0.029
<b>Total</b>	<b>6,047,985,391</b>	<b>9,531,085</b>	<b>0.1576%</b>	Blaylock & Partners, LP	528,500	26,425	0.050
				Bloomberg Tradebook -ESI Securities	10,317,858	206,322	0.020
				BOE Securities, Inc.	519,100	25,955	0.050
				CIBC World Markets - Oppenheimer	1,045,083	51,291	0.049
				Citigroup Global Markets, Inc.	3,352,413	101,120	0.030
				Davis Mendel & Regenstein, Inc.	300,000	15,000	0.050
				Deutsche Bank Securities	8,377,865	169,920	0.020
				First Boston	15,482,996	385,667	0.025
				Fox-Pitt Kelton, Inc.	855,600	42,295	0.049
				Goldman Sachs	7,824,067	364,016	0.047
				GRW Capital Corp.	250,000	12,500	0.050
				ITG	11,507,493	230,142	0.020
				J.P. Morgan	6,333,239	147,153	0.023
				Jefferies & Co.	1,912,091	93,721	0.049
				Keefe, Bruyette & Woods	1,149,431	57,472	0.050
				Legg Mason Wood Walker, Inc.	1,759,191	59,185	0.034
				Lehman Brothers	7,781,506	256,614	0.033
				M. Ramsey King	200,000	10,000	0.050
				Merrill Lynch	38,261,700	317,262	0.008
				Morgan Stanley Dean Witter	4,075,395	192,973	0.047
				Off The Record Research	1,049,900	52,495	0.050
				Prudential Securities	2,098,560	104,928	0.050
				Raymond James & Associates	1,419,000	70,950	0.050
				Robert Van Securities, Inc.	534,600	26,730	0.050
				Robert W. Baird & Co.	1,594,630	79,732	0.050
				Sanford Bernstein	3,324,722	127,376	0.038
				Schwab Soundview Capital Markets	231,100	6,933	0.030
				Score Securities, Inc.	400,000	20,000	0.050
				SG Cowen Securities Corp.	847,500	42,375	0.050
				Southwest Securities	554,700	27,735	0.050
				UBS Securities	8,194,243	190,317	0.023
				Washington Analysis, LLC	376,100	18,805	0.050
				Weeden & Co	3,560,744	76,334	0.021
				Williams Capital Group	787,800	38,486	0.049
				<b>Total</b>	<b>170,586,329</b>	<b>4,304,930</b>	<b>0.025</b>

OTHER INVESTMENT SERVICE FEES			
Custodian Fees		\$ 300,000	
Security Lending Agent Fees		2,795,629	
Investment Consultant Fees		161,377	
<b>Total</b>		<b>3,257,006</b>	

DIRECTED COMMISSIONS			
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. Directed commissions were not used during fiscal year 2004.			

INTERNATIONAL EQUITY COMMISSIONS				
Brokerage Firm	No. of Shares		Commission per	
	Traded	Principal	Commissions	Principal %
Bear Stearns	24,050	\$ 6,200,041	\$ 0	0.000
Citigroup Global Markets, Inc.	26,542,225	220,421,260	335,429	0.152
Collins Stewart, Inc.	25,818,453	143,658,803	222,019	0.155
Credit Lyonnais Securities (USA), Inc.	6,891,410	19,546,612	52,430	0.268
Credit Suisse First Boston Corp.	18,044,715	286,409,327	496,000	0.173
Dresdnerkleinwort Benson NA, LLC	48,076,077	722,157,450	529,542	0.073
Exane BNP Paribas	11,042,168	114,929,536	271,078	0.236
Goldman Sachs	41,021,040	430,985,125	298,806	0.069
J.P. Morgan	1,559,200	23,013,227	47,881	0.208
JB Were & Son	2,216,305	12,397,211	43,389	0.350
Jefferies & Co.	3,712,223	14,451,801	36,129	0.250
Lehman Brothers	86,461,415	1,486,739,809	487,690	0.033
Merrill Lynch	35,728,126	387,729,816	539,025	0.139
Mitsubishi Securities- Japan	1,078,000	24,375,849	48,754	0.200
Mizuho Securities	4,475,200	88,413,083	176,832	0.200
Nomura Securities	8,895,086	39,205,703	104,504	0.267
<b>Total</b>	<b>321,585,693</b>	<b>4,020,634,653</b>	<b>3,689,508</b>	<b>0.092</b>

Basis of Presentation: Master Custodian and System's Subsidiary Records in accordance with the CFA Institute Standards.

- Unaudited -

## INVESTMENT REVENUES

**For the Year Ended August 31, 2004**

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

	<b>Pooled Pension Trust Funds (Note A)</b>	
	<b>Year Ended August 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Interest On:</b>	\$	\$
Deposits in State Treasury	931,954	1,406,258
Commercial Paper		261,094
Short-Term Investment Fund	334,751	1,176,505
Repurchase Agreements	357,167	
Money Market Mutual Funds	11,843,554	19,466,728
Promissory Note		312,780
U.S. Treasury Bonds	44,861,455	46,734,169
Other Government Securities	27,263,853	34,660,055
Mortgage Pass-Thru Securities	66,121,195	62,011,660
Collateralized Mortgage Obligations	3,159,498	121,975
Asset Backed Securities	6,657,335	10,607,210
Commercial Mortgage Backed Securities	11,934,563	10,305,580
Corporate Bonds	158,628,572	159,568,323
<b>Total Interest</b>	<b>332,093,897</b>	<b>346,632,337</b>
<b>Dividends On:</b>		
Domestic Equities	122,513,177	118,791,899
Texas Growth Fund	6,090,682	196,264
International Equities	81,941,708	77,925,532
<b>Total Dividends</b>	<b>210,545,567</b>	<b>196,913,695</b>
<b>Net Securities Lending Income</b>	<b>8,611,921</b>	<b>7,554,550</b>
<b>Net Appreciation (Depreciation) In Fair Value of:</b>		
Commercial Paper		(105,381)
Short-Term Investment Fund	(15,725)	(32,892)
Money Market Mutual Funds	173,494	(1,651,855)
Promissory Note		(1,136)
U.S. Treasury Bonds	74,636,223	(7,672,999)
Other Government Securities	16,515,429	7,970,628
Mortgage Pass-Thru Securities	50,087,715	(11,773,409)
Collateralized Mortgage Obligations	(7,923)	(800,387)
Asset Backed Securities	(1,107,718)	(2,473,103)
Commercial Mortgage Backed Securities	3,657,516	(6,102,871)
Corporate Bonds	88,587,698	115,084,327
Domestic Equities	711,973,135	740,475,554
International Equities	594,204,331	145,742,065
<b>Total Appreciation</b>	<b>1,538,704,175</b>	<b>978,658,541</b>
<b>Total Investment Revenue</b>	<b>2,089,955,560</b>	<b>1,529,759,123</b>

*Note A: The Pooled Pension Trust Funds category includes the Pension Investment Pool Trust Fund, the Employees Retirement Fund, the Law Enforcement 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

August 31, 2004

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	1,517,157,433	51,258,741	10,916,835	1,579,333,009	7.641017%
Other Government Securities	1,074,310,383	36,296,693	7,730,291	1,118,337,367	5.410660%
Mortgage Pass-Thru Securities	2,190,775,574	74,017,630	15,763,910	2,280,557,114	11.033629%
Collateralized Mortgage Obligations	95,247,161	3,218,024	685,359	99,150,544	0.479703%
Asset Backed Securities	150,765,334	5,093,764	1,084,845	156,943,943	0.759315%
Commercial Mortgage Backed Securities	211,802,205	7,155,958	1,524,040	220,482,203	1.066721%
Corporate Bonds	2,684,205,286	90,688,665	19,314,426	2,794,208,377	13.518740%
<b>Total Long-Term Fixed Securities</b>	<b>7,924,263,376</b>	<b>267,729,475</b>	<b>57,019,706</b>	<b>8,249,012,557</b>	<b>39.909785%</b>
<b>Equities:</b>					
Domestic Equities	7,494,620,499	253,213,543	53,928,175	7,801,762,217	37.745930%
Texas Growth Fund	54,758,961	1,850,088	394,023	57,003,072	0.275788%
International Equities	3,307,379,290	111,743,247	23,798,527	3,442,921,064	16.657296%
<b>Total Equities</b>	<b>10,856,758,750</b>	<b>366,806,878</b>	<b>78,120,725</b>	<b>11,301,686,353</b>	<b>54.679014%</b>
<b>Cash Equivalents:</b>					
Cash in State Treasury-Investment Pool	96,466	3,259	694	100,419	0.000486%
Short Term Investment Fund	4,830,627	163,208	34,759	5,028,594	0.024329%
Money Market Mutual Funds	877,364,275	29,642,664	6,313,149	913,320,088	4.418760%
Repurchase Agreements	192,126,350	6,491,188	1,382,462	200,000,000	0.967626%
<b>Total Cash Equivalents</b>	<b>1,074,417,718</b>	<b>36,300,319</b>	<b>7,731,064</b>	<b>1,118,449,101</b>	<b>5.411201%</b>
<b>Total Before Securities Lending Collateral (Notes B &amp; C)</b>	<b>19,855,439,844</b>	<b>670,836,672</b>	<b>142,871,495</b>	<b>20,669,148,011</b>	<b>100.000000%</b>
Securities Lending Collateral	3,109,359,854	105,138,017	22,188,312	3,236,686,183	
<b>Total Pension Investment Pool Trust Fund (0888)</b>	<b>22,964,799,698</b>	<b>775,974,689</b>	<b>165,059,807</b>	<b>23,905,834,194</b>	
<b>Cash Equivalents:</b>					
Cash in State Treasury-Pension Funds	18,349,214	1,058,309	436,834		
<b>Total Investments</b>	<b>22,983,148,912</b>	<b>777,032,998</b>	<b>165,496,641</b>		
<b>Percent Ownership in Investment Pool</b>	<b>96.06%</b>	<b>3.25%</b>	<b>0.69%</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 CFA Institute Standards:

	Fair Value			
	Fund 0955	Fund 0977	Fund 0993	Total
Total Fair Value of Investments Before				
Securities Lending Collateral, as above	19,855,439,844	670,836,672	142,871,495	20,669,148,011
Unsettled Sales-Investment Receivables	60,137,915	2,033,467	429,143	62,600,525
Unsettled Purchases-Investment Payables	(1,175,961,672)	(39,763,258)	(8,391,632)	(1,224,116,562)
Adjustment from Accrued Interest on TBAs	2,740,994	92,682	19,560	2,853,236
Adjusted Unsettled Purchases-Investment Payables	(1,173,220,678)	(39,670,576)	(8,372,072)	(1,221,263,326)
Coupon, Dividends, Corporate Actions Proceeds in Transit	7,272,612	245,713	52,331	7,570,656
Tax Reclaim Receivables	1,057,173	35,747	7,544	1,100,464
<b>Total Fair Value of Investments, Adjusted to Comply with the CFA Institute Standards</b>	<b>18,750,686,866</b>	<b>633,481,023</b>	<b>134,988,441</b>	<b>19,519,156,330</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 in accordance with the CFA Institute Standards.

Anthony Walker has enjoyed working for the Texas Comptroller of Public Accounts for more than 12 years. He and his wife, Judy, have one daughter, Jazzmyne. Anthony serves as pastor of a local progressive Austin church. He also loves lifting weights and taking walks around Austin's Town Lake.

*"HealthSelect is a wonderful plan. I'm very happy with the benefits. I also like that I can use the TexFlex program to pay my dental expenses."*

*-Anthony Walker*



*Anthony Walker,  
Texas Comptroller of Public Accounts Employee*

# Actuarial Section *(Unaudited)*

Actuary's Certification Letter

Actuarial Balance Sheets

Actuarial Cost Method and Assumptions

Independent Actuarial Audit Report

Summary of Actuarial Methods  
and Assumptions

Active Member Valuation Data

Retirees and Beneficiaries Added to and  
Removed from the Annuity Payrolls

Solvency Test

Analysis of Financial Experience



December 8, 2004

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, 2004 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.

## **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, 2004. Since the prior valuation was prepared, there have not been any changes in the actuarial assumptions, actuarial cost method, actuarial procedures, or plan provisions.

The August 31, 2004 actuarial valuation shows that there is an unfunded actuarial accrued liability (net liability balance) of \$555.2 million. The ratio of the actuarial value of assets to the actuarial accrued liability is 0.973 as of August 31, 2004. The valuation shows that the total normal cost is 12.450% 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. The total contribution to fund the normal cost plus amortize the net liability balance over 31 years as a level percentage of covered payroll is 13.121% of payroll. In addition, as of August 31, 2004, the market value of assets was \$1.2 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. This would preclude the Board of Trustees from authorizing any supplemental payments under Texas Government Code Section 814.603, and it would preclude any increases in annuity benefits unless the total contribution is increased to 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 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, 2004. Since the prior valuation was performed, there have not been any changes in the actuarial assumptions, actuarial cost method, actuarial procedures, or plan provisions.

The valuation shows that the normal cost is 1.621% of payroll. The ratio of the actuarial value of assets to the actuarial accrued liability is 1.093 as of August 31, 2004. Total contributions of 1.621% of payroll were assumed after August 31, 2005 to finance the liabilities of the LECOSRF. As of August 31, 2004, the Fund had a net asset balance. Therefore, there is no amortization period. Based on the actuarial valuation conducted as of August 31, 2004, 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, 2004, the market value of assets was \$45.4 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 will likely continue to fall.

## **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, 2004 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.

The actuarial valuation is completed annually with the most recent conducted as of August 31, 2004. Since the prior valuation was performed, there have not been any changes in the actuarial assumptions, actuarial cost method, actuarial procedures, or plan provisions.

The valuation shows that the total normal cost is 19.58% of payroll. The ratio of the actuarial value of assets to the actuarial accrued liability is 1.175 as of August 31, 2004. 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, 2004, 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, 2004, the market value of assets was \$9.3 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 decrease.

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

	August 31, 2004	August 31, 2003
<b>ACTUARIAL BALANCE SHEET</b>		
<u>Actuarial Assets:</u>		
Actuarial Value of Tangible Assets	\$20,036,646,562	\$19,478,554,993
Actuarial Present Value of Future Normal Costs		
Member	\$2,248,977,273	\$2,359,025,573
Employer	<u>2,323,943,183</u>	<u>2,362,170,940</u>
Total	<u>\$4,572,920,456</u>	<u>\$4,721,196,513</u>
Total	\$24,609,567,018	\$24,199,751,506
<u>Actuarial Liability:</u>		
Actuarial Present Value of Benefits:		
Active Members		
— service retirement	\$12,764,777,842	\$12,661,844,659
— nonoccupational disability	350,167,811	356,941,540
— occupational disability	12,596,149	12,912,674
— death before retirement	256,136,279	255,381,615
— termination	<u>946,750,221</u>	<u>991,930,447</u>
— total	\$14,330,428,302	\$14,279,010,935
Inactive Members		
Annuitants	<u>10,161,943,670</u>	<u>9,780,141,140</u>
Total	\$25,164,768,454	\$24,680,308,059
<u>Net Asset/(Liability) Balance:</u>	(\$555,201,436)	(\$480,556,553)
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>		
Total Contribution Rate	12.000%	12.000%
Normal Cost		
— dollars	\$574,778,721	\$588,499,147
— percent of payroll	12.450%	12.258%
Contribution Available to Amortize Net Asset/(Liability) Balance	(0.450%)	(0.258%)
Actuarial Accrued Liability	\$20,591,847,998	\$19,959,111,546
Amortization Period in Years	Infinite	Infinite
Funded Ratio	0.973	0.976
Valuation Payroll	\$4,616,760,675	\$4,800,611,900
Active Members	133,349	142,163



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

	August 31, 2004	August 31, 2003
<b>ACTUARIAL BALANCE SHEET</b>		
<u>Actuarial Assets:</u>		
Actuarial Value of Tangible Assets	\$679,242,950	\$666,588,289
Actuarial Present Value of Future Normal Costs	<u>166,222,261</u>	<u>171,401,218</u>
Total	\$845,465,211	\$837,989,507
<u>Actuarial Liability:</u>		
Actuarial Present Value of Benefits:		
Active Members		
– service retirement	\$542,792,620	\$539,159,560
– death benefit plan	6,613,007	6,533,875
– occupational disability	<u>4,056,847</u>	<u>4,154,665</u>
– total	\$553,462,474	\$549,848,100
Inactive Vested Members	496,650	1,160,853
Annuitants	<u>233,720,473</u>	<u>218,306,453</u>
Total	\$787,679,597	\$769,315,406
<u>Net Asset/(Liability) Balance:</u>	\$57,785,614	\$68,674,101
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>		
Total Contribution Rate		
– current biennium	0.000%	0.000%
– thereafter	1.621%	1.607%
Normal Cost		
– dollars	\$19,943,898	\$20,530,863
– percent of payroll	1.621%	1.607%
Contribution Available to Amortize Net Asset/(Liability) Balance		
– current biennium	(1.621%)	(1.607%)
– thereafter	0.000%	0.000%
Actuarial Accrued Liability	\$621,457,336	\$597,914,188
Amortization Period in Years	0.0	0.0
Funded Ratio	1.093	1.115
Valuation Payroll	\$1,230,580,964	\$1,277,894,221
Active Members	38,305	40,335



## JUDICIAL RETIREMENT SYSTEM OF TEXAS PLAN TWO

	August 31, 2004	August 31, 2003
<b>ACTUARIAL BALANCE SHEET</b>		
<u>Actuarial Assets:</u>		
Actuarial Value of Tangible Assets	\$145,538,335	\$129,425,907
Actuarial Present Value of Future Normal Costs		
Member	\$19,787,941	\$20,093,735
Employer	<u>47,483,696</u>	<u>47,561,984</u>
Total	<u>\$67,271,637</u>	<u>\$67,655,719</u>
	\$212,809,972	\$197,081,626
<u>Actuarial Liability:</u>		
Actuarial Present Value of Benefits:		
Active Members		
– service retirement	\$138,887,035	\$131,989,630
– disability	5,278,656	5,329,958
– death before retirement	5,144,394	4,923,132
– termination	<u>7,587,183</u>	<u>7,696,800</u>
– total	\$156,897,268	\$149,939,520
Inactive Members		
Annuitants	<u>4,699,140</u>	<u>4,418,012</u>
	<u>29,587,837</u>	<u>24,413,787</u>
Total	\$191,184,245	\$178,771,319
<u>Net Asset/(Liability) Balance:</u>	\$21,625,727	\$18,310,307
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>		
Total Contribution Rate	22.83%	22.83%
Normal Cost		
– dollars	\$9,494,691	\$9,298,605
– percent of payroll	19.58%	19.58%
Contribution Available to Amortize Net Asset/(Liability) Balance	3.25%	3.25%
Actuarial Accrued Liability	\$123,912,608	\$111,115,600
Amortization Period in Years	0.0	0.0
Funded Ratio	1.175	1.165
Valuation Payroll	\$48,504,058	\$47,478,768
Active Members	484	477



## 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



## **ACTUARIAL COST METHOD AND ASSUMPTIONS**

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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.

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.



# INDEPENDENT ACTUARIAL AUDIT REPORT

A retirement system may periodically have an actuarial review or actuarial audit performed by someone other than the system's retained actuary. This is generally done to ascertain that actuarial assumptions were reasonable and that the actuarial valuations have been performed in accordance with generally recognized and accepted actuarial principles and practices.

Towers Perrin is the consulting actuary to the System. An audit was performed by Milliman Consultants and Actuaries for the 2003 Actuarial Valuations of the four retirement plans administered by the System at the request of the System's staff. The following is the Executive Summary of the report from Milliman Consultants and Actuaries prepared in November 2004.

## EXECUTIVE SUMMARY

### ***Purpose and Scope of the Actuarial Audit***

This actuarial audit reviews the August 31, 2003 actuarial valuations performed by the ERS retained actuary, Towers Perrin (Towers). The purpose of the audit is to verify that the results presented in their reports are actuarially sound and reasonable.

As requested, the following tasks were performed in this audit:

- ✓ analysis of the appropriateness of the actuarial assumptions;
- ✓ review of the assumptions and methodology for compliance with the funding standards;
- ✓ verification of demographic data; and
- ✓ confirmation of the valuation results, including a determination of actuarial accrued liability, normal cost, expected employee contributions and effects of any recent legislation.

The following plans are included in this audit. Note that ERS will refer to all systems in total, unless specifically referred to as the "ERS plan".

- Employees Retirement System of Texas (ERS plan)
- Judicial Retirement System of Texas – Plan One (JRS I)
- Judicial Retirement System of Texas – Plan Two (JRS II)
- Law Enforcement and Custodial Officer Supplemental Retirement Fund of the Employees Retirement System of Texas (LECOSRF)

### ***Statement of Key Findings***

Based upon our review of the August 31, 2003 actuarial valuations, we found the actuarial work performed by Towers was reasonable and appropriate. We have recommended a few minor changes in Section 9, but we do not believe that any of these would have a material impact on the valuations, if reflected.

Concerning the overall condition of the system, our one significant comment has to do with the funding of the ERS plan. The current State contribution rate of 6.00% of pay does not fund the ERS plan on an actuarially sound basis. We recommend that to be actuarially sound, the State increase its contribution rate, so that it pays the employer's normal cost plus an amortization of the unfunded actuarial accrued liability (UAAL) over a period of not more than 30 years. Based on the August 31, 2003 valuation results, this would require the State to contribute 6.83% of pay.





Even if the contribution rate is increased, the next valuation will need to recognize at least a portion of the \$2 billion of deferred asset losses. This may result in a State contribution rate greater than 6.83% if the plan is to be funded on an actuarially sound basis. In future years, we would expect an increase in the State contribution rate needed to keep the ERS plan funded on an actuarially sound basis, unless there is significant positive actuarial experience, such as investment returns considerably greater than the actuarial assumption.

Our conclusions concerning the primary issues of this review are as follows:

- ❑ **Review of ERS Benefit Calculations:** As part of the audit process, we reviewed fifteen different benefit calculations that were recently completed by the ERS staff. We found these calculations accurate and consistent with the statutory provisions.
- ❑ **Membership Data:** We performed tests on the raw data and the valuation data. Based on this review, we feel the data used in the valuation is appropriate. We note a few minor issues where we have recommended changes to the valuation data.
- ❑ **Actuarial Value of Assets:** We have reviewed the calculation of the actuarial value of assets used in the August 31, 2003 valuation. We found the methodology to be reasonable and in compliance with actuarial standards of practice. We have recommended one minor change in the disclosure and treatment of expenses.
- ❑ **Actuarial Liabilities:** We independently calculated the costs and liabilities of ERS. We found that the significant benefit provisions of all plans were accounted for in an accurate manner, the actuarial assumptions and methods are being applied correctly, and that our total liabilities matched those calculated by Towers within an acceptable level.
- ❑ **Funding:** We reviewed the application of the funding method and find it is reasonable and that it meets generally accepted actuarial standards. Based on the system's funding methods and assumptions, we believe the actuarial costs are appropriately calculated.

However, the current employer contribution rate for the ERS plan of 6.00% does not cover the calculated employer normal cost of 6.26% (net of member contributions), let alone make an adequate provision to amortize the UAAL of \$481 million. Therefore, the current contribution rate does not fund the ERS plan on an actuarially sound basis.

- ❑ **Actuarial Assumptions:** The audit of actuarial assumptions was beyond the scope of this assignment. We performed a general overview of these assumptions and find them to be reasonable.



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- ❑ **Other Comments:** There were a few other comments that were not addressed in earlier sections of the report that we offer here for completion of our review. None of these comments significantly impacts the overall results of the review.
- ❑ **Recommendations & Considerations:** We are not recommending any changes be reflected in the August 31, 2003 valuation. There are a few minor issues that we are recommending Towers incorporate in future valuations. In Section 9 of the report we have gathered together all of these recommendations and comments for consideration in future valuations. Other than the funding issue for the ERS plan we mentioned earlier, none of these recommendations is material or significant.



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## SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS

After having consulted with Towers Perrin, the System's actuary, the Board of Trustees of the System adopted the actuarial methods and assumptions for the Employees Retirement Fund (ERS), the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS), and the Judicial Retirement Plan Two Fund (JRS II) in December 2003. The actuarial experience investigation covered the fiscal years from 1997 to 2002. The actuarial methods used for the three funds are summarized as follows:

**Actuarial Cost Method:** The Entry Age Actuarial Cost Method was used for actuarial valuation. Actuarial gains and losses resulting from differences between actual and assumed experience are recognized as they occur each year. These gains or losses increase or decrease the unfunded actuarial accrued liability. 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; the variable from year to year is the amortization period.

**Actuarial Valuation of Assets:** The method used to value plan assets for actuarial 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.

For 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. The *economic* assumptions for these classes are summarized as follows:

	<b>Employee Class &amp; Supplemental Benefits for CPO/CO's</b>	<b>Elected Class</b>	<b>Judicial Class</b>
<b>Investment Rate of Return:</b> <i>(Same for all classes)</i>	8% per year, compounded annually.		
<b>Administrative Expenses:</b> <i>(As a percentage of payroll per year, compounded annually)</i>	ERS Fund: 0.25% LECOS Fund: 0.10%	0.25%	0.50%
<b>Salary Increase:</b>	<ul style="list-style-type: none"> <li>● Include 4% annual increase for inflation plus increases for merit, promotion and longevity.</li> <li>● See Table 1 below for rates of salary increase for sample ages.</li> </ul>	<ul style="list-style-type: none"> <li>● 4% annually with no increase for merit, promotion, and longevity.</li> <li>● No salary increase for legislators.</li> </ul>	<ul style="list-style-type: none"> <li>● 4% annually with no increase for merit, promotion, and longevity.</li> </ul>
<b>Payroll Growth:</b> <i>(Same for all classes)</i>	4% per year, compounded annually.		
<b>Cost-of-Living Increase:</b>	N/A	4% per year, compounded annually	N/A

- Unaudited -

## SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS

(Continued)

**Table 1**

**Economic Assumption –  
Rates of Merit, Promotion and Longevity Salary Increases  
For Male and Female Members in the Employee Class (Note A)**

Age	Years of Service – Non-CPO/CO							Years of Service – CPO/CO		
	0	1	2-4	5-9	10-14	15-19	20+	0	1	2+
20	6.8%	5.2%	4.7%	4.6%				10.0%	4.5%	2.0%
30	6.0	5.2	4.4	3.8	3.6%	3.2%		10.0	4.5	2.0
40	5.5	4.5	4.0	3.4	3.0	2.7	2.6%	10.0	4.5	2.0
50	4.9	4.5	3.8	3.2	2.7	2.3	2.2	10.0	4.5	2.0
60	2.9	2.9	2.6	2.4	2.3	1.9	1.8	10.0	4.5	2.0

Note A: No salary increases where no rates are shown.

The demographic assumptions are summarized in Tables 2 to 10.

**Table 2**

**Demographic Assumption –  
Annual Rates of Termination from Active Employment before Age and Service Retirement**

Age	Years of Service – Male and Female Members in the Employee Class (Non-CPO/CO)					Years of Service – Male and Female Members in the Employee Class (CPO/CO) (Note B)					Elected Class	Judicial Class
	0	5	10	20	25+	0	5	10	15	20+		
20	49.0%	19.0%	6.0%	2.0%	0.0%	29.0%	17.0%	0.0%	0.0%	0.0%	5.0% for all ages and gender.	3.0% for all ages and gender.
30	25.0	14.0	6.0	2.0	0.0	24.0	10.0	9.0	0.0	0.0		
40	22.0	10.0	5.0	2.0	0.0	23.0	10.0	6.0	2.0	0.0		
50	22.0	7.0	4.0	2.0	0.0	19.0	5.0	5.0	2.0	0.0		
60	23.0	10.0	0.0	0.0	0.0	25.0	5.0	0.0	0.0	0.0		

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.

**Table 3**

**Demographic Assumption –  
Annual Rates of Withdrawal of Employee Contributions by Vested Terminated Members**

Age	Years of Service – Male and Female Members in the Employee Class (Non-CPO/CO)				Years of Service – Male and Female Members in the Employee Class (CPO/CO)			
	5-10	10-15	15-20	20+	5-10	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

## SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS

(Continued)

**Table 4**  
Demographic Assumption –  
Mortality Rates for Active Members (Note C)

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

Note C: It is assumed that there are no occupational deaths of members in the Elected and Judicial Classes.

Note D: Non-occupational rates are also applied to the Elected and Judicial Classes.

**Table 5**  
Demographic Assumption –  
Mortality Rates for Service Retirees and Beneficiaries  
(Note E)

Age	Females	Males
20	0.0284%	0.0507%
30	0.0351	0.0801
40	0.0709	0.1072
50	0.1428	0.2579
60	0.4439	0.7976
70	1.3730	2.3730
80	3.9396	6.2027
90	11.6265	15.2931

Note E: Based on 1994 Group Annuity Mortality Table.

Note F: 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 PBGC Disabled Mortality grading to 100% from age 60 to 90.

**Table 6**  
Demographic Assumption –  
Mortality Rates for Disability Retirees  
(Note F)

Age	Females	Males
20	2.50%	3.38%
30	2.25	2.53
40	1.99	1.97
50	2.44	2.68
60	3.14	4.42
70	3.90	5.91
80	7.09	10.15
90	16.82	25.25

**Table 7**  
Demographic Assumption –  
Disability Retirement Rates (Notes G & H)

Age	Employee Class (Non-CPO/CO) (Note I)			Employee Class (CPO/CO)		
	Occupational Females & Males	Non-occupational		Occupational – Females & Males		Non-occupational Females & Males
		Females	Males	Total Disability	Non-Total	
20	0.003%	0.000%	0.000%	0.0002%	0.0008%	0.000%
30	0.003	0.028	0.057	0.0006	0.0024	0.016
40	0.004	0.186	0.144	0.0018	0.0072	0.101
50	0.008	0.430	0.308	0.0040	0.0160	0.284
60	0.015	0.000	0.000	0.0054	0.0216	0.000
65	0.018	0.000	0.000	0.0052	0.0208	0.000

Note G: There are no rates of non-occupational disability at age 20 because of the eligibility requirements for a non-occupational disability benefit. In addition, 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 H: It is assumed that there are no occupational disabilities in the Elected and Judicial Classes.

Note I: Non-occupational rates are also applied to the Elected and Judicial Classes.

**SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS**

(Continued)

**Table 8**

**Demographic Assumption –  
Option Selection Percentage and Beneficiary Characteristics under Disability Retirement**

	<u>Option Selection Percentage (Note J)</u>			<u>Beneficiary Characteristics</u>
	<u>Standard</u>	<u>Option 1</u>	<u>Option 4</u>	
<b>Male</b>	50%	40%	10%	Member is three years older than female beneficiary. Member is same age as male beneficiary.
<b>Female</b>	75	15	10	

Note J: Descriptions of Options 1 and 4 are presented in the Summary of Plan Provisions in the Introductory Section.

**Table 9**

**Demographic Assumption –  
Service Retirement Rate (Note K)**

Age	<u>Years of Service – Members in the Employee Class (Non-CPO/CO)</u>								<u>Years of Service – Members in the Employee Class (CPO/CO)</u>						<u>Elected Class (Note L)</u>		<u>Judicial Class (Note L)</u>	
	<u>Female</u>				<u>Male</u>				<u>Female</u>		<u>Male</u>				Age	Rate	Age	Rate
	15-19	20-24	25-29	30+	15-19	20-24	25-29	30+	10-19	20+	15-19	25-26	29-34	35+				
50	0%	0%	0%	25%	0%	0%	0%	10%	0%	30%	26%	45%	50%	60%	50-59	10%	50-69	20%
55	0	0	30	30	0	0	15	10	12	24	13	22	30	30	60-64	15	70-74	25
60	30	30	30	30	20	25	30	20	24	24	26	45	50	60	65-74	20	75+	100
65	30	30	50	50	25	30	40	40	35	35	45	40	50	50	75+	100		
70+	100	100	100	100	100	100	100	100	100	100	100	100	100	100				

Note K: Rates in this table apply to members **after** their first year of service retirement eligibility. Rates that apply to members **in** their first year of eligibility for service retirement are available upon request. No service retirements where no rates are shown.

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

**Table 10**

**Demographic Assumption –  
Option Selection Percentage and Beneficiary Characteristics  
under Service Retirement**

	<u>Option Selection Percentage (Note M)</u>		<u>Beneficiary Characteristics</u>
	<u>Option 1</u>	<u>Option 4</u>	
<b>Male</b>	75%	25%	Member is three years older than female beneficiary. Member is same age as male beneficiary.
<b>Female</b>	60	40	

Note M: Descriptions of Options 1 and 4 are presented in the Summary of Plan Provisions in the Introductory Section.

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## ACTIVE MEMBER VALUATION DATA

Valuation Year August 31,	Number (Note A)	Actual Annual Payroll		Average Pay (Note B)	% Change in Average Pay
		\$	\$		
<b>Employees Retirement Fund:</b>					
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
2004	133,349	4,624,389,682		34,174	2.5
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund:</b>					
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)
2004	38,305	1,230,580,964		31,818	1.4
<b>Judicial Retirement Plan Two Fund:</b>					
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
2004	484	48,327,669		100,215	0.7

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

Period Ended Sept. 30,	Added to Rolls		Removed from Rolls		Other Beneficiaries		Rolls End of Year		% Increase Annual Allowances	Average Annual Allowance
	No.	Annual	No.	Annual	No.	Annual	No.	Annual		
		Allowances		Allowance		Allowances		Allowance		
		\$		\$		\$		\$	%	\$
<b>Employees Retirement Fund:</b>										
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
2004	4,048	65,652,607	1,515	26,105,172	337	6,186,781	61,845	1,090,042,062	4.4	17,625
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund:</b>										
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
2004	454	2,663,312	51	643,791	-	-	4,576	25,838,119	8.5	5,646
<b>Judicial Retirement Plan Two Fund:</b>										
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
2004	12	553,529	1	22,724	2	7,200	72	3,014,309	21.7	41,865

# 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.

## 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.

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. Following is a summary of the solvency test:

Valuation Year	Aggregate Accrued Liabilities For			Valuation Assets	Portion of Accrued Liabilities Covered by Assets			
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed Portion)		(1)	(2)	(3)	
	\$	\$	\$		%	%	%	
<b>Employees Retirement Fund:</b>								
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	3,213,061,085	8,427,092,145	6,809,367,468	18,909,071,718	100	100	106.7	
2003	3,207,842,243	9,780,141,140	6,971,128,163	19,478,554,993	100	100	93.1	
2004	3,368,149,356	10,161,943,670	7,061,754,972	20,036,646,562	100	100	92.1	
<b>Law Enforcement And Custodial Officer Supplemental Retirement Fund:</b>								
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	-	182,770,572	343,434,181	655,978,723	-	100	137.8	
2003	-	218,306,453	379,607,735	666,588,289	-	100	118.1	
2004	-	233,720,473	387,736,863	679,242,950	-	100	114.9	
<b>Judicial Retirement Plan Two Fund:</b>								
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	26,660,363	14,034,265	62,534,056	114,433,092	100	100	117.9	
2003	28,461,427	24,413,787	58,240,386	129,425,907	100	100	131.4	
2004	31,761,192	29,587,837	62,563,579	145,538,335	100	100	134.6	



## 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. The assumed experience should be changed to reflect observed reality when an actuarial investigation reveals that the difference between actual and assumed experience in the various risk areas to be material and persistent.

If the differences between actual and assumed experience is financially favorable (unfavorable), such differences are called actuarial gains (losses). In the actuarial valuation of the System, actuarial gains and losses are recognized immediately, with actuarial gains decreasing the unfunded actuarial accrued liability and actuarial losses increasing the unfunded actuarial accrued liability. A general description of actuarial gains and losses for age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment is summarized as follows:

<i>Age and Service Retirement:</i>	If members retire at older (younger) ages or with final average pay that is lower (higher) than assumed, there is a gain (loss).
<i>Disability Retirement:</i>	If disability claims are less (more) than assumed, there is a gain (loss).
<i>Death-in-Service Benefit:</i>	If survivor claims are less (more) than assumed, there is a gain (loss).
<i>Withdrawal from Employment:</i>	If withdrawals are more (less) than assumed, there is a gain (loss).

The gains and losses in actuarial accrued liabilities resulting from differences between assumed experience and actual experience is summarized as follows:

<u>Type of Activity</u>	Gain/(Loss) For Year (in Millions)					
	ERS		LECOS		JRS II	
	2004	2003	2004	2003	2004	2003
<i>Combined gain/(loss) from age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment</i>	(166.2)	(345.7)	0.5	(3.7)	(1.1)	(1.7)
<u>Pay Increases</u> If there are smaller pay increases than assumed, there is a gain. If greater increases occur, a loss.	400.9	383.8	15.5	12.6	3.6	5.3
<u>Interest on Overfunded/(Unfunded) Actuarial Accrued Liability</u> 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.	(38.4)	36.8	5.5	10.4	1.5	0.9
<u>Contribution Income</u> If contributions are received in excess of normal cost, there is a gain. If less, a loss.	(12.4)	(36.8)	(21.4)	(23.7)	1.7	0.5
<u>Investment Income</u> If there is greater investment income than assumed, there is a gain. If less income, a loss.	(309.8)	(502.8)	(10.7)	(18.1)	(2.4)	(3.6)
<u>Death After Retirement</u> If retirees live longer than assumed, there is a loss. If not as long, a gain.	76.2	7.5	(0.3)	(1.6)	-	0.1
<u>Other</u> Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, valuation methods, etc.	(24.9)	(29.4)	-	-	-	-
<b>Gain/(Loss) During Year from Financial Experience</b>	<b>(74.6)</b>	<b>(486.6)</b>	<b>(10.9)</b>	<b>(24.1)</b>	<b>3.3</b>	<b>1.5</b>
<u>Non-Recurring Items</u> Adjustments for plan amendments, changes in actuarial assumptions, increase in Service Retirement Formula, etc.	-	(453.6)	-	(37.0)	-	5.6
<b>Composite Gain/(Loss) During Year</b>	<b>(74.6)</b>	<b>(940.2)</b>	<b>(10.9)</b>	<b>(61.1)</b>	<b>3.3</b>	<b>7.1</b>

Nadine “Deen” Grantham retired from the Texas State Board of Insurance in 1983 at the age of 70. During her 21 years at the Board, Deen worked her way up from the position of file clerk to insurance examiner. Tireless, she had two outside jobs (at Montgomery Wards and as a Mary Kay consultant) for many years, and she started her own business after she retired.

*“I loved the people I worked with at the State. More than 270 people attended my retirement party; it was wonderful. After I retired, I gave myself a cruise on the Love Boat with six of my friends. I enjoy the benefits I receive as a retiree.”*

*-Nadine Grantham*



*Nadine Grantham, Retiree*

# Statistical 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 – All Other Funds
- Statistical Information –  
Defined Benefit Plans
- Statistical Information – Other Programs
- Retired Members by Type of Benefit
- Average Benefit Payments – Employee Class

- Unaudited -

## REVENUES BY SOURCE

### Pension and Other Employee Benefit Trust Funds

(in 000's)

Fiscal Year	Member Contributions	Transfers In/ Rollovers In	Contributions 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>								
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	1,455,591	37,719	2,118,865
2004	300,156			278,845	6.00	1,994,703	45,719	2,619,423
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>								
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
2004						67,906	2	67,908
<b>Judicial Retirement System of Texas Plan One (JRS I)</b>								
	Note C				Note B			
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
2004				22,622			120	22,742
<b>Judicial Retirement System of Texas Plan Two (JRS II) (Note D)</b>								
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
2004	2,922			8,205	16.83	13,332	2	24,461
<b>Excess Benefit Arrangement</b>								
2002							63	63
2003							67	67
2004							67	67
<b>TexaSaver 401(k) Trust Fund</b>								
1999						3	200	203
2000						4	150	154
2001						9	203	212
2002						2	234	236
2003						1	345	346
2004						4	1,328	1,332
<b>TexaSaver 457 Trust Fund (Notes F &amp; G)</b>								
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
2004	37,047	56,426				33,976	186	127,635
<b>State Employees Cafeteria Plan Trust Fund (Note G)</b>								
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
2004	43,372		468			25	439	44,304

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*

Employees Life, Accident and Health Insurance and Benefits Fund

<u>Fiscal Year</u>	<u>Employer Contributions</u>	<u>Member Contributions</u>	<u>Investment Income</u>	<u>Miscellaneous</u>	<u>Total</u>
	\$	\$	\$	\$	\$
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
2004	1,177,512	404,107	12,999	4,214	1,598,832

*Agency Fund*

TexaSaver 401(k) Trust Fund

<u>Fiscal Year</u>	<u>Benefits Member Contributions</u>
	\$
1999	80,567
2000	90,296
2001	94,881
2002	95,002
2003	89,098
2004	86,943

- 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>										
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	13,078	1,099,081
2004	1,190,313					1,949	83,779	1,276,041	12,996	1,289,037
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>										
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
2004	27,559							27,559	630	28,189
<b>Judicial Retirement System of Texas Plan One (JRS I)</b>										
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
2004	22,620						1	22,621	120	22,741
<b>Judicial Retirement System of Texas Plan Two (JRS II)</b>										
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
2004	2,770						303	3,073	273	3,346
<b>Excess Benefit Arrangement</b>										
2002	63							63		63
2003	67							67		67
2004	67							67		67
<b>TexaSaver 401(k) Trust Fund</b>										
1999									225	225
2000									184	184
2001									220	220
2002									236	236
2003									357	357
2004									366	366
<b>TexaSaver 457 Trust Fund (Notes A &amp; B)</b>										
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
2004				41,851	67,071			108,922	995	109,917
<b>State Employees Cafeteria Plan Trust Fund (Note B)</b>										
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
2004		39,221	3,665					42,886	1,336	44,222

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*

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

<b>Fiscal Year</b>	<b>Claims and Premium Payments</b>	<b>Administrative Expenses</b>	<b>Miscellaneous</b>	<b>Total</b>
	\$	\$	\$	\$
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
2004	1,519,295	9,316		1,528,611

- Unaudited -

**STATISTICAL INFORMATION - Defined Benefit Plans (NOTE A)**

(all items expressed as numbers unless otherwise indicated)

**Employees Retirement System (ERS)**

<b>Fiscal Year</b>	<b>Membership</b>		<b>Retirees/ Beneficiaries</b>	<b>Retirements</b>	
	<b>Active</b>	<b>Inactive</b>		<b>Service</b>	<b>Disability</b>
1999	154,183	36,502	43,860	3,244	209
2000	152,167	41,276	47,310	3,688	196
2001	149,956	46,089	47,392	3,229	213
2002	150,313	48,903	50,514	4,050	156
2003	142,315	51,868	57,024	7,581	174
2004	133,349	54,658	60,089	3,906	8

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

<b>Fiscal Year</b>	<b>Membership</b>		<b>Retirees/ Beneficiaries</b>	<b>Retirements</b>	
	<b>Active</b>	<b>Inactive</b>		<b>Service</b>	<b>Disability</b>
1999	39,979	3,132	2,526	153	1
2000	42,040	4,372	2,774	249	3
2001	40,431	5,619	3,093	296	4
2002	41,221	6,519	3,523	508	3
2003	40,332	7,264	4,166	686	1
2004	38,305	30	4,576	431	

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

<b>Fiscal Year</b>	<b>Membership</b>		<b>Retirees/ Beneficiaries</b>	<b>Retirements</b>	
	<b>Active</b>	<b>Inactive</b>		<b>Service</b>	<b>Disability</b>
1999	133	29	461	27	
2000	123	27	465	9	
2001	95	24	485	26	
2002	91	24	493	13	
2003	58	22	505	27	
2004	53	15	494	10	

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

<b>Fiscal Year</b>	<b>Membership</b>		<b>Retirees/ Beneficiaries</b>	<b>Retirements</b>	
	<b>Active</b>	<b>Inactive</b>		<b>Service</b>	<b>Disability</b>
1999	395	50	22	1	
2000	412	51	27	3	2
2001	442	77	29	3	
2002	464	63	34	3	
2003	476	80	78	24	
2004	484	79	72	8	

*Note A: Beginning Fiscal Year 2004 we have included August 31, 2004 retirees who receive their first benefit payment in September, 2004.*



- 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
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
2004	192,859	66,348	235,834	1,736	496,777

### 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)
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
2004	23,868	2,416	199,215	321.4	72.8	24.6

### 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)
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 (D)	7,422	261	183.0	5,793	3,971	69.7
2003 (D)	6,015	207	133.8	7,525	4,862	103.7
2004 (D)	5,104	138	95.8	9,937	5,908	159.6

### TexaSaver 401(k) Trust Fund

Fiscal Year	Participants (Note A)		
	Total	Currently Deferring	CMV of Assets (Note B) (in millions)
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
2004	56,504	30,075	779.3

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.

Note D: Data for the original 457 Plan is as of June 30th.

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

Fiscal Year	Lump Sum Payments	Monthly Payments To:	
		Guardians	Children
1999	9	97	145
2000	13	101	138
2001	29	104	148
2002	36	107	156
2003	20	113	163
2004	19	109	154

- Unaudited -

## RETIRED MEMBERS BY TYPE OF BENEFIT

August 31, 2004

### 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	3,851	3,738	113	2,284	789	260	52	331	135
301-600	9,323	8,483	840	6,836	1,329	486	80	286	306
601-900	9,373	8,471	902	6,921	1,182	602	86	239	343
901-1,200	7,658	7,211	447	5,493	954	666	81	166	298
1,201-1,500	6,426	6,185	241	4,302	853	716	82	130	343
1,501-2,000	8,456	8,297	159	5,203	1,100	1,213	120	172	648
2,001-2,500	6,678	6,633	45	3,850	802	1,213	58	150	605
2,501-3,000	4,759	4,748	11	2,429	609	985	48	118	570
3,001-4,000	3,909	3,904	5	2,024	498	758	41	70	518
4,001-10,999	1,412	1,408	4	726	201	229	14	25	217
<b>Total</b>	<b>61,845</b>	<b>59,078</b>	<b>2,767</b>	<b>40,068</b>	<b>8,317</b>	<b>7,128</b>	<b>662</b>	<b>1,687</b>	<b>3,983</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	296	295	1	167	74	30	4	2	19
201-400	1,734	1,674	60	964	338	236	32	37	127
401-600	1,632	1,602	30	687	245	406	11	28	255
601-800	588	587	1	233	90	142	8	5	110
801-1,000	153	152	1	72	26	33	5	2	15
1,001-1,200	53	52	1	24	18	3	3	1	4
1,201-1,400	42	31	11	26	7	4	2	0	3
1,401-1,600	36	22	14	27	5	2	0	1	1
1,601-1,800	13	5	8	11	1	0	1	0	0
1,801-9,999	29	18	11	22	4	2	0	0	1
<b>Total</b>	<b>4,576</b>	<b>4,438</b>	<b>138</b>	<b>2,233</b>	<b>808</b>	<b>858</b>	<b>66</b>	<b>76</b>	<b>535</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	4	4	0	4	0	0	0	0	0
1,201-1,400	2	2	0	0	2	0	0	0	0
1,401-1,600	1	1	0	1	0	0	0	0	0
1,801-2,000 B	2	2	0	0	0	0	1	1	0
2,001-2,200	2	2	0	1	0	0	1	0	0
2,601-2,800 B	1	1	0	1	0	0	0	0	0
2,801-3,000	2	2	0	0	2	0	0	0	0
3,001-3,200	3	3	0	1	1	0	0	1	0
3,201-3,400	13	13	0	2	10	0	0	0	1
3,401-3,600	4	4	0	1	3	0	0	0	0
3,601-3,800	2	2	0	0	2	0	0	0	0
3,801-4,000	9	9	0	2	3	2	0	2	0
4,001-4,200	14	13	1	3	7	2	0	0	2
4,201-4,400	3	2	1	2	0	0	0	0	1
4,401-4,600	4	4	0	3	1	0	0	0	0
4,601-4,800	1	1	0	1	0	0	0	0	0
5,001-5,400 B	5	4	1	5	0	0	0	0	0
<b>Total</b>	<b>72</b>	<b>69</b>	<b>3</b>	<b>27</b>	<b>31</b>	<b>4</b>	<b>2</b>	<b>4</b>	<b>4</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 nominee.

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

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

Option 4 - a reduced annuity to the member or the nominee 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 nominee.

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, 1994 to May 31, 2004</b>						
<b>- Period 9/30/94 to 8/31/95:</b>						
Average Monthly Benefit	\$ 383.11	\$ 649.86	\$ 1,017.59	\$ 1,361.42	\$ 1,919.50	\$ 2,571.73
Average Final Average Salary	\$ 2,080.32	\$ 2,097.09	\$ 2,260.07	\$ 2,445.23	\$ 2,772.73	\$ 3,116.86
Number of Active Retirees	179	555	388	425	588	828
<b>- Period 9/30/95 to 8/31/96:</b>						
Average Monthly Benefit	\$ 356.70	\$ 705.40	\$ 955.62	\$ 1,310.52	\$ 1,929.59	\$ 2,619.66
Average Final Average Salary	\$ 2,162.91	\$ 2,409.17	\$ 2,271.65	\$ 2,395.72	\$ 2,828.24	\$ 3,278.78
Number of Active Retirees	135	388	237	239	363	413
<b>- Period 9/30/96 to 8/31/97:</b>						
Average Monthly Benefit	\$ 376.25	\$ 594.17	\$ 962.39	\$ 1,240.34	\$ 1,827.27	\$ 2,337.14
Average Final Average Salary	\$ 2,292.33	\$ 2,138.35	\$ 2,371.06	\$ 2,276.05	\$ 2,811.51	\$ 3,061.31
Number of Active Retirees	115	305	154	175	235	223
<b>- Period 9/30/97 to 8/31/98:</b>						
Average Monthly Benefit	\$ 376.01	\$ 627.91	\$ 950.57	\$ 1,351.85	\$ 2,041.96	\$ 2,573.63
Average Final Average Salary	\$ 2,281.84	\$ 2,237.05	\$ 2,314.38	\$ 2,443.77	\$ 3,034.84	\$ 3,348.37
Number of Active Retirees	166	519	317	605	958	673
<b>- Period 9/30/98 to 8/31/99:</b>						
Average Monthly Benefit	\$ 395.73	\$ 660.73	\$ 994.28	\$ 1,367.73	\$ 1,993.63	\$ 2,529.28
Average Final Average Salary	\$ 2,361.46	\$ 2,389.83	\$ 2,453.87	\$ 2,565.45	\$ 3,044.92	\$ 3,318.64
Number of Active Retirees	162	530	324	438	704	566
<b>- Period 9/30/99 to 8/31/00:</b>						
Average Monthly Benefit	\$ 334.29	\$ 641.64	\$ 934.52	\$ 1,332.74	\$ 1,940.95	\$ 2,415.11
Average Final Average Salary	\$ 2,214.08	\$ 2,542.17	\$ 2,484.48	\$ 2,761.84	\$ 3,240.00	\$ 3,440.15
Number of Active Retirees	196	613	401	491	919	750
<b>- Period 9/30/00 to 8/31/01:</b>						
Average Monthly Benefit	\$ 383.42	\$ 618.36	\$ 948.00	\$ 1,335.46	\$ 1,932.66	\$ 2,490.12
Average Final Average Salary	\$ 2,701.15	\$ 2,536.25	\$ 2,682.90	\$ 2,865.97	\$ 3,344.27	\$ 3,644.27
Number of Active Retirees	147	587	386	455	832	671
<b>- Period 9/30/01 to 8/31/02:</b>						
Average Monthly Benefit	\$ 371.62	\$ 639.40	\$ 983.95	\$ 1,395.46	\$ 2,055.46	\$ 2,693.89
Average Final Average Salary	\$ 2,587.63	\$ 2,636.12	\$ 2,831.35	\$ 3,024.14	\$ 3,539.87	\$ 3,936.13
Number of Active Retirees	183	690	416	599	1036	1006
<b>- Period 9/30/02 to 8/31/03:</b>						
Average Monthly Benefit	\$ 373.70	\$ 689.18	\$ 1,025.03	\$ 1,445.92	\$ 2,060.05	\$ 2,756.13
Average Final Average Salary	\$ 2,536.44	\$ 2,768.82	\$ 2,881.66	\$ 3,193.45	\$ 3,547.63	\$ 3,992.20
Number of Active Retirees	364	1485	919	1079	1739	1796
<b>- Period 9/30/03 to 5/31/04:</b>						
Average Monthly Benefit	\$ 395.55	\$ 650.97	\$ 1,096.71	\$ 1,534.72	\$ 2,202.05	\$ 2,545.22
Average Final Average Salary	\$ 2,750.66	\$ 2,832.21	\$ 3,034.15	\$ 3,300.22	\$ 3,765.90	\$ 3,794.68
Number of Active Retirees	160	381	232	507	654	284
<b>Five Year Average -</b>						
<b>Period 9/30/99 to 5/31/04:</b>						
Average Monthly Benefit	\$ 370.67	\$ 657.33	\$ 996.78	\$ 1,416.85	\$ 2,035.47	\$ 2,632.59
Average Final Average Salary	\$ 2,540.89	\$ 2,677.54	\$ 2,787.55	\$ 3,063.07	\$ 3,486.39	\$ 3,823.57
Average Number of Active Retirees	210	751	471	626	1036	901
<b>Ten Year Average -</b>						
<b>Period 9/30/94 to 5/31/04:</b>						
Average Monthly Benefit	\$ 373.95	\$ 654.32	\$ 990.84	\$ 1,388.78	\$ 2,013.20	\$ 2,602.11
Average Final Average Salary	\$ 2,411.32	\$ 2,516.99	\$ 2,615.54	\$ 2,833.18	\$ 3,292.01	\$ 3,603.64
Average Number of Active Retirees	181	605	377	501	803	721

Note A: This schedule includes service retirements of the employee class through May 31, 2004. It does not include disability retirements or the elected state official class.

