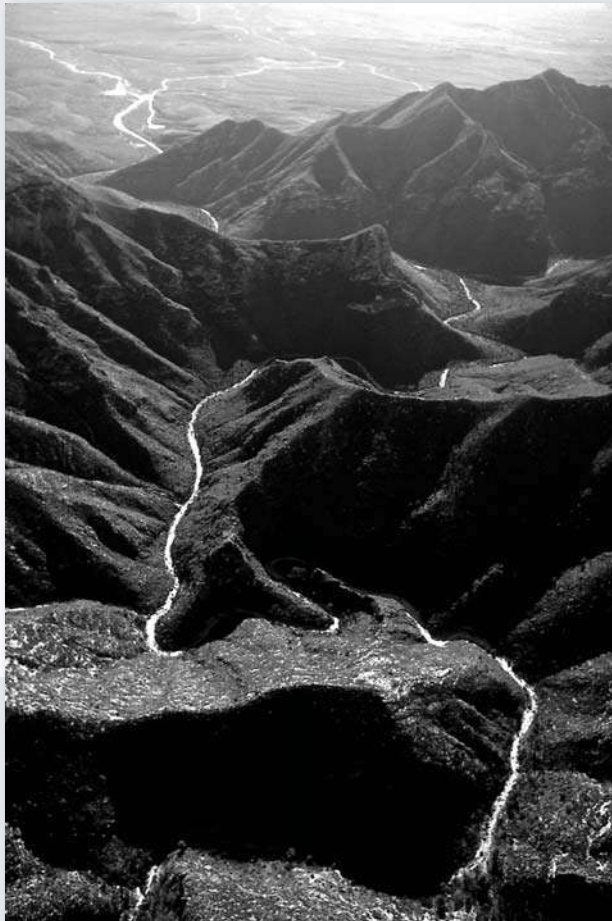


# 2005

**Comprehensive Annual Financial Report**  
**Fiscal Year Ended August 31, 2005**



**Employees Retirement System of Texas**

A Retirement System of the State of Texas

**P.O. Box 13207**  
**Austin, Texas 78711-3207**  
**(512) 867-7711 in Austin**  
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Executive Director

Prepared by  
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**Rosy Moore, CPA, CPFO, CGFM, CEBS**  
Financial Reporting and Investment Accounting Manager

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# 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**



# Highlights of Retirement Programs (Unaudited)

As of August 31, 2005

	ERS (A)	LECOS (A)	JRS I	JRS II
Active Contributing Members	132,417	37,251	28	491
Non-Contributing Members	57,089	8,428	36	90
<b>Total Member Accounts</b>	<b>189,506</b>	<b>45,679</b>	<b>64</b>	<b>581</b>
<b>Retirees and Beneficiaries</b>	<b>63,453</b>	<b>5,072</b>	<b>491</b>	<b>81</b>
Service Retirements	4,609	537	12	9
Disability Retirements	179			
Total Retirements During the Fiscal Year	4,788	537	12	9
<b>Funded Ratios (As of August 31, 2005)</b>	<b>94.8%</b>	<b>103.1%</b>		<b>90.1%</b>
<b>Results of Investments - Pension Trust Funds</b>				
	ERS	LECOS	JRS I (B)	JRS II
	\$	\$	\$	\$
Interest, Dividends & Securities				
Lending Income	629,968,645	21,182,762		4,731,097
Net Appreciation (Depreciation) in Fair Value of Investments	1,718,194,812	57,872,270		12,721,298
<b>Time Weighted Rate of Return</b>				
	1-Year	3-Year	5-Year	
Pension Investment Pool Trust Fund	12.71%	11.19%	3.50%	
<b>Other Transactions Summary</b>				
	ERS	LECOS	JRS I (B)	JRS II
	\$	\$	\$	\$
Member Contributions	305,869,798		61,701	
State Retirement Contributions	276,034,664			
Retirement Benefits	1,200,373,003	29,036,299	22,283,198	3,307,938
Death Benefits:				
Active Members	882,372			9,842
Retirees	1,156,143			
Lump Sum Retiree Death Benefits (C)	7,026,294			
Member Contributions Withdrawn	89,759,681		13,885	106,095
Administrative Expenses	13,219,650	520,982	120,000	401,819
Investment Expenses	17,074,876	610,802		104,450

- 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 the System reports 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 20, 2005

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

ANN S. FUELBERG  
*EXECUTIVE DIRECTOR*

CAROLYN LEWIS GALLAGHER  
*CHAIR*

DON GREEN  
*VICE-CHAIR*

BILL CEVERHA

YOLANDA GRIEGO

I. CRAIG HESTER

OWEN WHITWORTH  
*BOARD OF TRUSTEES*

Dear Governor Perry and Members of the Texas Legislature:

We are pleased to present the audited Comprehensive Annual Financial Report of the Employees Retirement System of Texas (ERS) for fiscal year 2005.

ERS administers the benefits provided by the Legislature to State of Texas officers, employees and retirees including retirement plans, health, dental, disability and life insurance, a flexible benefits tax-saving plan, and two deferred compensation plans. ERS also administers many of these benefits for many higher education employees.

We are pleased to report that a healthy stock market, combined with prudent investment practices, earned the ERS trust fund a strong return of 12.7 percent in fiscal year 2005, and allowed it to close the fiscal year with a market value of \$21.3 billion.

Even though the ERS trust fund has increased in value, it is still battling the losses suffered in fiscal years 2001-2002 when the stock market sank, and it is still trying to keep pace with the benefit enhancements that were approved in the 1990s when earnings exceeded retirement expenses and the state contribution did not meet the normal cost. The 2003 retirement incentive and pay raises recently approved by the Legislature have also had a substantial impact on the fund.

Changes in the demographics of the state employee population have also added to the expenses, but we are proud to report that the 79<sup>th</sup> Texas Legislature raised the state contribution from the minimum of six percent to 6.45 percent to meet our normal cost. Other legislative changes designed to ease pressure on the fund reduced non-occupational disability benefits, restricted additional service credit purchases from five years to three, increased the interest to purchase refunded service from five to ten percent, and eliminated Texas governmental entity service.

We are hopeful the increased state contribution and the other legislative changes will give the trust room to recover so it may continue to provide State of Texas employees with a secure retirement program and high-quality service. When all of the factors are taken into consideration, the funded ratio of the ERS trust currently stands at 94.8 percent.

As of August 31, 2005, there were 132,417 active ERS members. A total of 4,788 employees retired during fiscal year 2005, which brings the total number of state retirees to 63,453 with total retirement payments of \$1.2 billion a year.

We are also pleased to announce that the cost-savings realized from renegotiating our health and pharmacy contracts in fiscal year 2005 saved the health plan more than \$125 million for the three-year term of the contracts and helped ERS keep the plan intact—despite rising costs—without any additional increases in co-pays or changes to co-insurance or the pharmacy plan. The Legislature has also been able to maintain full state funding of employee insurance premiums and support 50 percent of dependent care with only a slight increase in dependent premiums.

We have continued to enhance ERS OnLine so employees in the state's Group Benefits Program can enroll, access or change their insurance and TexFlex benefits via the Internet in the most efficient and cost-effective manner. We have virtually eliminated the inefficiency of paper from the insurance enrollment process. More than 99 percent of insurance transactions were made online during our summer enrollment period in 2005. Annuity payroll functions are also available—allowing retirees and beneficiaries to view retirement checks, request direct deposit, change tax-withholding amounts, and elect to have membership dues deducted from the monthly annuity. Pre-retirement functions will be available soon to active employees allowing them 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, and we are fully committed to maintaining it.

On behalf of the ERS Board of Trustees and the ERS staff, we are grateful for your partnership in providing a secure retirement program as well as a competitive insurance, deferred compensation, and flexible benefits program for our members and their families.



CAROLYN LEWIS GALLAGHER  
Chair, Board of Trustees



ANN S. FUELBERG  
Executive Director



December 20, 2005

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

ANN S. FUELBERG  
*EXECUTIVE DIRECTOR*

CAROLYN LEWIS GALLAGHER  
*CHAIR*

DON GREEN  
*VICE-CHAIR*

BILL CEVERHA

YOLANDA GRIEGO

I. CRAIG HESTER

OWEN WHITWORTH  
*BOARD OF TRUSTEES*

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

Ladies and Gentlemen:

We are pleased to submit the Comprehensive Annual Financial Report of the Employees Retirement System of Texas (the System) for the year ended August 31, 2005, in compliance with TEX. GOV'T CODE ANN Sec. 2101.011 and in accordance with the requirements established by the Texas Comptroller of Public Accounts. 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*. 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.

The System's Finance and Administration staff prepared this report. It has been audited by Deloitte & Touche, LLP. For information regarding the scope of the audit, please see the Independent Auditors' Report in the Financial Section.

The responsibility for the accuracy, completeness, and fair presentation of the information, including all disclosures, rests with the management of the System. 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.

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

**SYSTEM'S STRUCTURE AND SERVICES**

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, 2005.

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 law enforcement officers commissioned by the Department of Public Safety, the Alcoholic Beverage Commission, or the Parks and Wildlife Department recognized as commissioned law enforcement officers by the Commission on Law Enforcement Officer Standards and Education. It also covers certified custodial officers employed by the Department of Criminal Justice, including the Board of Pardons and Paroles.



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 (the Board). Operating administrative expenses, including capital items, are budgeted annually. 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.

## **FINANCIAL CONDITION**

### ***Investment Performance***

The investment portfolio closed the fiscal year with a fair value of \$21.3 billion, and returned 12.7% for the year. The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the third year in a row reflecting the continued rebound in the domestic and international equity markets. Over the longer term, the fund returned 8.08% for the 10 years ended August 31, 2005 slightly better than the policy benchmark of 7.96%.

### ***Funding***

The funding objective of the System's pension plans is to maintain assets sufficient to meet the retirement benefit schedules of its members. I am pleased to report that the pension plans managed by the System are in very good financial condition. During the year ended August 31, 2005, the funded ratio of the Employees Retirement Fund decreased from 97.3% to 94.8% primarily as a result of the actuarial loss experienced from more retirements than expected, which is related to the retirement incentive. We are hopeful that the increase in state contribution to 6.45% and other legislative changes mentioned below will lead to future improvements in the funded ratio. The Judicial Retirement System of Texas Plan Two has a 90.1% funded ratio. This plan is sound with current contribution rates that are sufficient to meet normal costs and fund its accrued actuarial liability within the next 26 years. Additional information regarding the financial condition of the pension plans can be found in the Actuarial Section of this report.

## **MAJOR INITIATIVES**

The Seventy-ninth Legislature enacted legislation that will have a positive effect on the future actuarial status of the Employees Retirement Fund and provide cost savings to the Group Benefits Program. Highlights of the legislative changes are presented below.

### ***Employees Retirement Plan Legislative Changes***

- Increased the State Contribution from 6.0% to 6.45 % of salaries effective September 1, 2005, to meet actuarially determined normal costs as of February 28, 2005,
- Placed limits on non-occupational retirement benefits and death benefits to active/contributing members, and
- Reduced benefits for non-occupational retirees who retire before normal age and length of service.

These and other legislative changes are expected to increase actuarial gains or decrease actuarial losses in future years, thereby improving the actuarial soundness of the fund.

### ***Group Benefits Program Legislative Changes***

- Provided for ERS receipt of funds from the multi-million dollar per year Medicare Part D prescription drug subsidy program,
- Enacted a \$60 incentive for participants to opt out of the group benefits program,
- Provided for a supplemental plan for TriCare military insurance eligible participants who opt out of the group benefits program,
- Provided for a pilot program for nurses to provide on-site health services for state employees,
- Provided for a study on importing prescription drugs from foreign countries, and
- Provided for a study on the impact of implementing Health Savings Accounts (HSAs) and Health Care Reimbursement Accounts (HRAs).

**Information Technology Initiatives**

In fiscal year 2006, the System will continue to enhance web-based, self-service functionality for its members by upgrading hardware and converting additional functions to the client/server environment.

**AWARDS**

**Certificate of Achievement for Excellence in Financial Reporting**

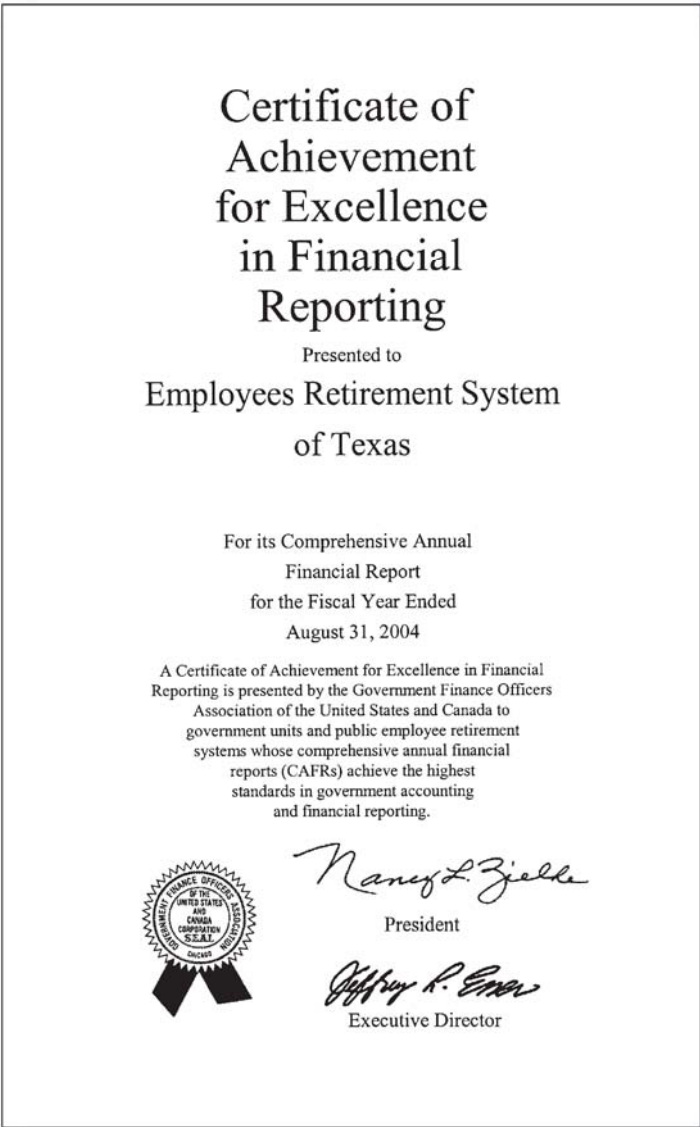
The Government Finance Officers Association (GFOA) of the United States and Canada awarded the Certificate of Achievement for Excellence in Financial Reporting to the System for its Comprehensive Annual Financial Report for the fiscal year ended August 31, 2004. The Certificate of Achievement is a prestigious 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 16 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 was accomplished with the efficient and dedicated service of the Finance and Administration staff and other employees of the System. I would like to express my appreciation for management's support in preparing this report and to all the employees of the System who contributed to its preparation.



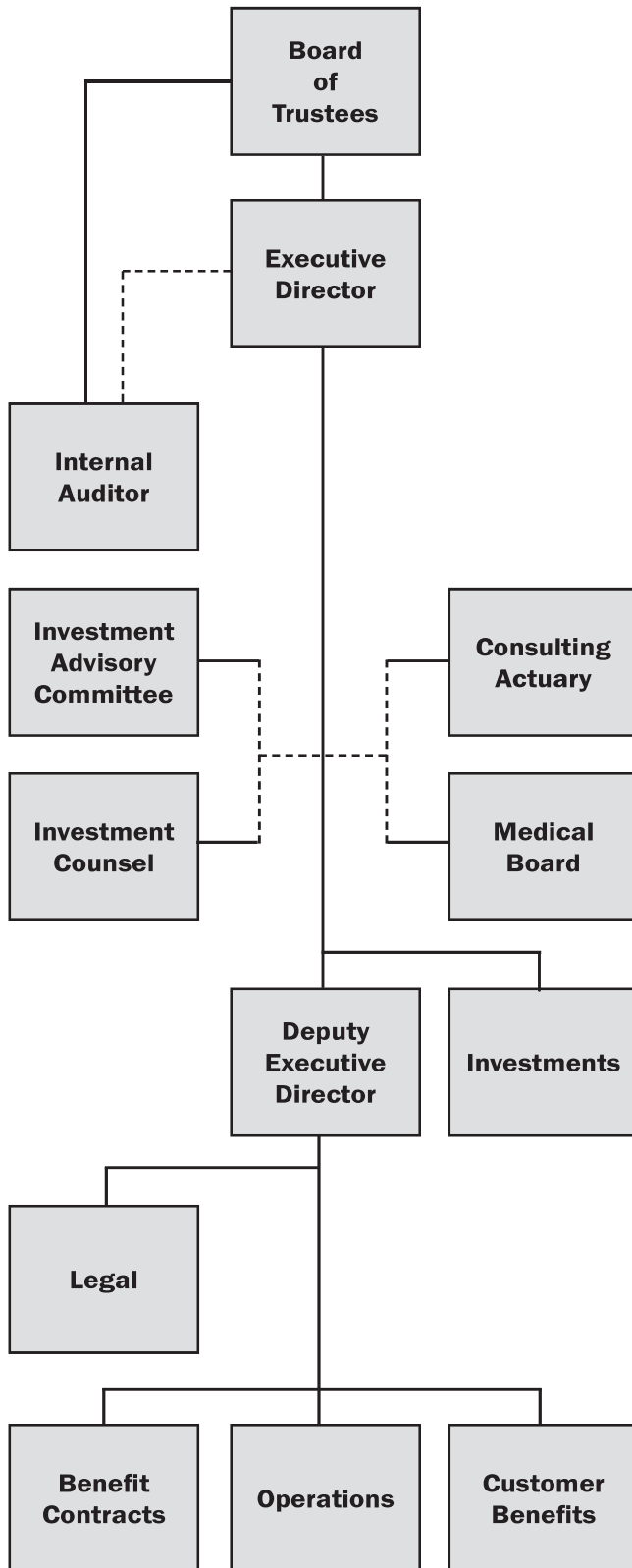
MICHAEL C. WHEELER, CPA  
Chief Financial Officer





# Organizational Chart and Data (Unaudited)

As of August 31, 2005



## BOARD OF TRUSTEES

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

## STAFF

**Ann S. Fuelberg, 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 (Unaudited)

Effective September 1, 2005

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



# Summary of Plan Provisions (Unaudited)

Effective September 1, 2005

ERS	LECOS	JRS I and JRS II
-----	-------	------------------

## Standard Service Retirement Benefits:

### Employee Class Only:

- Monthly annuity is equal to 2.3% of average monthly compensation multiplied by the number of years of service credit.
- Average monthly compensation is the average of the highest 36 months of compensation.
- Minimum standard annuity is \$150 per month.
- Maximum standard annuity is 100% of the average monthly compensation.

### Elected Class Only:

- Monthly annuity is 2.3% of the current State salary of a district judge multiplied by the number of years of service credit.
- Retirement benefits are automatically adjusted as State judicial salaries increase.
- Maximum standard annuity is 100% of the State salary being paid a district judge.

- Monthly annuity is equal to 2.8% of average monthly compensation multiplied by the number of years of service credit.
- Average monthly compensation is the average of the highest 36 months of compensation.
- Minimum standard annuity is \$150 per month.
- Maximum standard annuity is 100% of the average monthly compensation.

- Monthly annuity is equal to 50% of the salary for the position from which the member retired.
- An additional 10% is paid when a member retires within one year of leaving office or within one year of last assignment as a visiting judge.
- The monthly annuity of a member who elects to make contributions after 20 years of service would be based on 50% of the state salary plus 2% for each subsequent year with the total, including the additional 10%, not to exceed 80%.

### JRS II Only:

- The monthly annuity of a member who elects to make contributions after reaching the Rule of 70 with at least 12 years on an appellate court would be based on 50% of the state salary plus 2% for each subsequent year with the total, including the additional 10%, not to exceed 80%.

## Optional Service Retirement Benefits:

### Employee Class and Elected Class:

- Lifetime with 100% to surviving beneficiary;
- Lifetime with 75% to surviving beneficiary;
- Lifetime with 50% to surviving beneficiary;
- Lifetime with five years certain;
- Lifetime with 10 years certain; and
- 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).
- 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.

- Same as ERS.

- Same as ERS except for the one-time partial lump sum.

## Vesting Requirement:

- Five or more years of service credit for Employee Class and eight or more years for Elected Class.

- 20 or more years of service credit as a certified peace officer/custodial officer.

- 12 or more years of service credit.

## Vested Benefits after Termination of Employment:

- Member is entitled to a deferred retirement benefit based on service and compensation prior to termination.
- Member must leave accumulated contributions in the System and must live to normal retirement age.
- Upon or after leaving State employment, member may apply for a refund of

- 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.
- Member must leave accumulated deposits in the System to which the member contributed.

- Member is entitled to a deferred retirement benefit based on service and compensation as a judge prior to termination.
- Member must leave accumulated contributions in the System and must live to normal retirement age.
- Upon or after leaving State judicial



# Summary of Plan Provisions (Unaudited)

Effective September 1, 2005

ERS

LECOS

JRS I and JRS II

## Vested Benefits after Termination of Employment (Continued):

contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.

employment, member may apply for a refund of contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.

## Disability Retirement Eligibility:

### Employee Class Only:

- For occupational disability, no age or length of service requirement.
- 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, and be a contributing member.

- For occupational disability, no age or length of service requirement.
- For non-occupational disability, at least 10 years of service credit, which may include up to five years of purchased military service credit, and be a contributing member.

- No age requirement.
- Seven years of judicial service and currently holding a judicial office.

### Elected Class Only:

- For occupational disability, no age or length of service requirement.
- 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, and be a contributing member.

## Disability Retirement Benefits:

### Employee Class Only:

- For occupational disability, the benefits are the same as those under the standard service retirement, except the standard annuity is equal to not less than 35% of the average of the highest 36 months of compensation regardless of the years of service credit or age.
- For non-occupational disability, the retirement benefits are actuarially reduced from normal retirement eligibility based on age and length of service.
- The optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.

- For occupational disability, the standard annuity is a minimum of 50% of the average of the highest 36 months of compensation regardless of the years of service credit or age.
- The standard annuity is increased to 100% of the average of the highest 36 months of compensation if a member receives Social Security disability benefits as a result of occupational disability.
- For non-occupational disability, the retirement benefits are actuarially reduced from normal retirement eligibility based on age and length of service.
- The optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.

- Same as standard service retirement benefits without reduction for age.

### Elected Class Only:

- 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.
- Optional annuity plans available are the same as those under a service retirement except for the partial lump-sum option.



# Summary of Plan Provisions (Unaudited)

Effective September 1, 2005

ERS	LECOS	JRS I and JRS II
-----	-------	------------------

## Death Benefits:

### Employee Class and Elected Class:

- A contributing 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:
  - Death benefit plan filed by the member, or
  - Lifetime annuity, or
  - 10-year certain annuity.
- 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:
  - Refund of member's contribution with interest.
  - 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.
- 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.
- 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.

### Elected Class Only:

- 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.

- A contributing 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.
- 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.

- Members have the same as those listed in the Employee Class under the ERS Plan.

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.

# 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, 2005, 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, 2005. These financial statements and combining 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.


In our opinion, the 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, 2005, 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, 2005, 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, Schedule of Funding Progress, Schedule of Employer Contributions, and Notes to the Required Supplementary Information 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 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 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 20, 2005, 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.

The signature of Deloitte + Touche LLP is written in a cursive, handwritten style in black ink.

December 20, 2005



# Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2005

We are pleased to provide this overview of the financial activities of the Employees Retirement System of Texas (the System) for the year ended August 31, 2005. 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 the following exhibits in the Basic Financial Statements Section.

- Exhibits I and II are the government-wide statements of governmental net assets and activities. These exhibits exclude the Fiduciary Fund activities and balances.
- 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. This statement reports the transactions for the year on a cash basis. It is similar to Exhibit VI, the Statement of Changes in Net Assets, except that the focus of this statement is on the change to cash balances with accrued income and expense items eliminated.
- Exhibits VIII and IX are the Combined Statement of Fiduciary Net Assets and the Combined Statement of Changes in Fiduciary Net Assets. They report pension and other employee benefit trust fund activities and agency fund balances in total. Please see the *Financial Highlights – Fiduciary Funds* below for a financial analysis of the defined benefit plans, defined contribution plans, the cafeteria plan and the agency funds.
- Exhibits X and XI, the Combining Statement of Fiduciary Net Assets and the Combining Statement of Changes in Fiduciary Net Assets, report activities of the defined benefit plans.

## Financial Analysis on Government-wide Statements

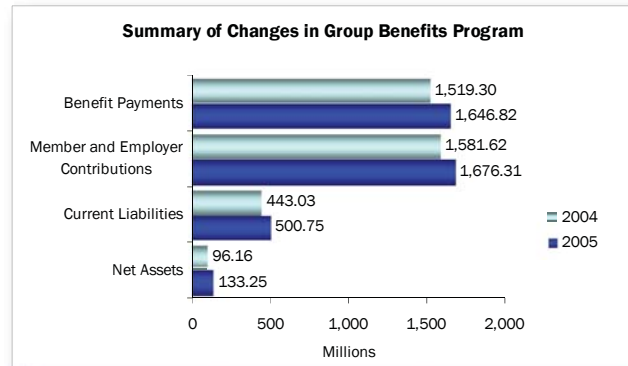
The government-wide activities of the System are comprised of five programs:

- 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 expenditures out of the appropriation for the Compensation to Victims of Crime Program. Beginning this year, the System reports all Special Revenue Funds as nonmajor funds.

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			2004-05 % Incr (Decr) %
	2005	2004	2003	
Net assets	\$ 133.25	\$ 96.16	\$ 25.94	38.57
Current liabilities	500.75	443.03	415.10	13.03
Member and employer contributions	1,676.31	1,581.62	1,629.21	5.99
Benefit payments	1,646.82	1,519.30	1,627.06	8.39



The 38.57% increase in net assets is a result of benefit program design changes, higher state contributions, and appreciation in investment assets. The majority of the 13.03% increase in current liabilities is due to increases in claims payable of \$43.56 million and in obligations for securities lending collateral of \$14.07 million. The 8.39% increase in benefit payments reflects higher medical costs for the program.

## Financial Highlights – Fiduciary Funds

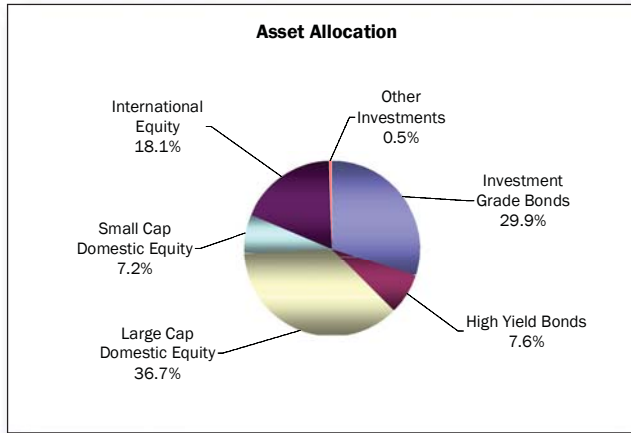
- Net assets of the fiduciary funds administered by the System totaled \$21.59 billion as of August 31, 2005, compared with \$19.83 billion as of August 31, 2004. The \$1.76 billion, or 8.88%, increase resulted primarily from an increase in investment income in the amount of \$337.93 million.
- The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the third year in a row. The 12.71% return for fiscal year 2005 reflects a continued rebound in the domestic and international equity markets. The fiscal year-end asset allocation stood at:



# Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2005

- ◆ 29.9% investment grade bonds,
- ◆ 7.6% high yield bonds,
- ◆ 36.7% large cap domestic equity,
- ◆ 7.2% small cap domestic equity,
- ◆ 18.1% international equity, and
- ◆ 0.5% 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			2004-05 % Incr (Decr)
	2005	2004	2003	
	\$	\$	\$	%
<i>Contributions:</i>				
Retirement	593.25	590.13	636.87	0.53
Other	208.98	206.51	148.60	1.20
<b>Total</b>	<b>802.23</b>	<b>796.64</b>	<b>785.47</b>	<b>0.70</b>
<i>Benefit payments:</i>				
Retirement	1,255.16	1,237.73	1,053.89	1.41
Other	218.46	244.04	183.72	(10.48)
<b>Total</b>	<b>1,473.62</b>	<b>1,481.77</b>	<b>1,237.61</b>	<b>(0.55)</b>

- The most recent actuarial valuations of the funded defined benefit plans were completed as of August 31, 2005. The funded ratios are as follows:

Plans	Funded Ratios August 31,	
	2005	2004
Employees Retirement System	94.8%	97.3%
Law Enforcement and Custodial Officer Supplemental Retirement Fund	103.1%	109.3%
Judicial Retirement System of Texas Plan Two	90.1%	117.5%

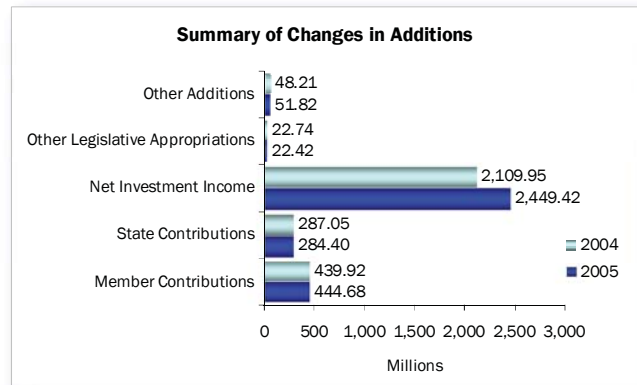
See Exhibits X and XI for more information regarding each of the defined benefit plans and Exhibits VIII and IX for each of the defined contribution and cafeteria plans.

## Fiduciary Net Assets

### 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,			2004-05 % Incr (Decr)
	2005	2004	2003	
	\$	\$	\$	%
Member contributions	444.68	439.92	414.96	1.08
State contributions	284.40	287.05	309.85	(0.92)
Net investment income	2,449.42	2,109.95	1,533.09	16.09
Other legislative appropriations	22.42	22.74	22.80	(1.41)
Other additions	51.82	48.21	38.80	7.49
<b>Total Additions</b>	<b>3,252.74</b>	<b>2,907.87</b>	<b>2,319.50</b>	<b>11.86</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.

Net investment income is comprised of interest income, dividend income, securities lending income and related fees, and net appreciation in fair value of investments, and is net of investment expenses.

### 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



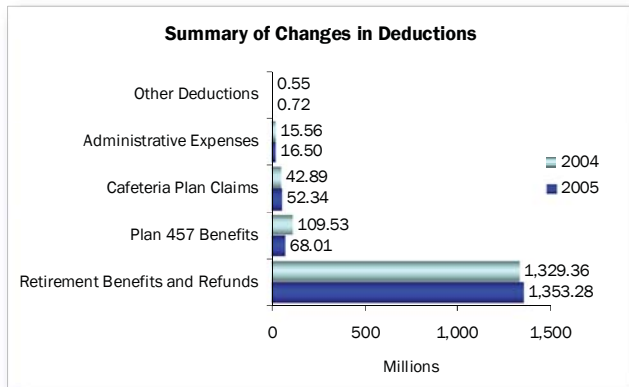
# Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2005

cost of administering the System. Deductions in Net Assets have been extracted from Exhibit IX, Combined Statement of Changes in Fiduciary Net Assets.

The deductions in millions were as follows:

	August 31,			2004-05 % Incr (Decr) %
	2005	2004	2003	
	\$	\$	\$	
Retirement benefits and refunds	1,353.28	1,329.36	1,133.85	1.80
Plan 457 benefits	68.01	109.53	70.22	(37.91)
Cafeteria Plan claims	52.34	42.89	33.54	22.03
Administrative expenses	16.50	15.56	15.45	6.04
Other deductions	0.72	0.55	0.74	30.91
<b>Total Deductions</b>	<b>1,490.85</b>	<b>1,497.89</b>	<b>1,253.80</b>	<b>(0.47)</b>



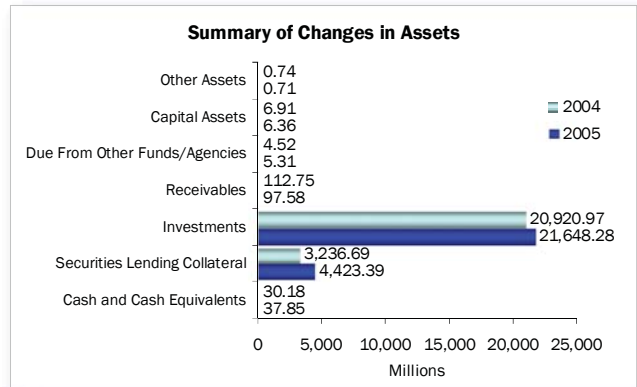
## Assets

Investments, both short-term and long-term, are the primary asset of the System's pension and other employee benefit trust funds. As is shown in the table below, collateral associated with the securities lending program and investments account for 99.44% of all assets of the fiduciary funds.

Condensed asset data has been extracted from Exhibit VIII, Combined Statement of Fiduciary Net Assets.

Changes in assets are summarized in millions as follows:

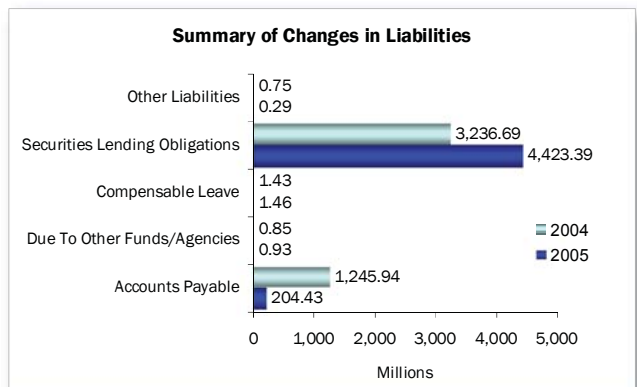
	August 31,			2004-05 % Incr (Decr) %
	2005	2004	2003	
	\$	\$	\$	
Cash and cash equivalents	37.85	30.18	46.24	25.41
Securities lending collateral	4,423.39	3,236.69	2,518.40	36.66
Investments	21,648.28	20,920.97	19,332.77	3.48
Receivables	97.58	112.75	524.63	(13.45)
Due from other funds/agencies	5.31	4.52	4.02	17.48
Capital assets	6.36	6.91	7.44	(7.96)
Other assets	0.71	0.74	0.32	(4.05)
<b>Total Assets</b>	<b>26,219.48</b>	<b>24,312.76</b>	<b>22,433.82</b>	<b>7.84</b>



## Liabilities

Changes in liabilities are summarized in millions as follows:

	August 31,			2004-05 % Incr (Decr) %
	2005	2004	2003	
	\$	\$	\$	
Accounts payable	204.43	1,245.94	1,493.95	(83.59)
Due to other funds/agencies	0.93	0.85	0.75	9.41
Compensable leave	1.46	1.43	1.32	2.10
Securities lending obligations	4,423.39	3,236.69	2,518.40	36.66
Other liabilities	0.29	0.75	2.30	(61.33)
<b>Total Liabilities</b>	<b>4,630.50</b>	<b>4,485.66</b>	<b>4,016.72</b>	<b>3.23</b>



The condensed liabilities have been extracted from Exhibit VIII, Combined Statement of Fiduciary Net Assets.

## 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



# Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2005

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, 2005, (compared to the August 31, 2004 actuarial valuation) is summarized in millions as follows:

<b>Plans</b>	<b>Actuarial Net Asset/(Liability)</b>	
	<b>August 31,</b>	
	<b>2005</b>	<b>2004</b>
Employees Retirement System	(\$1,134.20)	(\$555.20)
Law Enforcement and Custodial Officer Supplemental Retirement Fund	\$20.86	\$57.79
Judicial Retirement System of Texas Plan Two	(\$18.08)	\$21.63

Under the Employees Retirement System Fund, the normal cost is 12.28% 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.

Effective September 1, 2005, the contribution rate was increased to 12.45%.

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, 2005 (With Comparative Totals at August 31, 2004)

<b>ASSETS</b>	<b>Governmental Activities</b>	
	<b>August 31,</b>	
	<b>2005</b>	<b>2004</b>
<i>Current Assets:</i>	\$	\$
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	42,713	3,127
Cash in State Treasury	36,950,413	11,091,922
Total Cash and Cash Equivalents	36,993,126	11,095,049
Securities Lending Collateral	55,676,502	41,603,761
Short-Term Investments	136,661,499	117,815,080
Legislative Appropriations	9,146	-
Receivables	89,635,954	80,884,706
Due From Other Agencies	191,976	374,074
Total Current Assets	319,168,203	251,772,670
<i>Non-Current Assets:</i>		
Investments	314,876,554	287,423,594
Total Non-Current Assets	314,876,554	287,423,594
<b>Total Assets</b>	<b>634,044,757</b>	<b>539,196,264</b>
<b>LIABILITIES</b>		
<i>Current Liabilities:</i>		
Payables	443,378,704	399,814,546
Due To External Parties	850,893	824,257
Deferred Revenue	858,998	790,923
Obligations Under Securities Lending	55,676,502	41,603,761
Total Current Liabilities	500,765,097	443,033,487
<b>Total Liabilities</b>	<b>500,765,097</b>	<b>443,033,487</b>
<b>NET ASSETS</b>		
<i>Restricted For:</i>		
Employee Benefits - Group Benefits Program	133,253,040	96,160,216
Unrestricted	26,620	2,561
<b>Total Net Assets (Exh. II &amp; III)</b>	<b>133,279,660</b>	<b>96,162,777</b>

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



## Exhibit II

### Statement of Activities

Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

Functions/Programs	Program Revenues			Net (Expense) Revenue & Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants & Contributions	Governmental Activities	
				August 31,	
	\$	\$	\$	2005	2004
<b>Governmental Activities:</b>					
Social Security Administration	52,057	72,716		20,659	(12,949)
Death Benefits-Peace Officers, Firemen, etc.	2,660,455	2,660,455		-	-
Compensation to Victims of Crime	1,250,000	1,250,000		-	-
Death Benefits-Retiree \$5,000 Lump Sum	7,026,294	7,029,694		3,400	-
Group Benefits Program	1,657,127,229	1,676,459,908	17,760,145	37,092,824	70,220,990
<b>Total Governmental Activities</b>	<b>1,668,116,035</b>	<b>1,687,472,773</b>	<b>17,760,145</b>		
			<b>Change in Net Assets (Exh. IV)</b>	<b>37,116,883</b>	<b>70,208,041</b>
			<b>Net Assets - Beginning</b>	<b>96,162,777</b>	<b>25,954,736</b>
			<b>Net Assets - Ending (Exh. I)</b>	<b>133,279,660</b>	<b>96,162,777</b>

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





## Exhibit III

### Balance Sheet – Governmental Funds

August 31, 2005 (With Comparative Totals at August 31, 2004)

	Nonmajor Special Revenue Funds Totals	
	August 31, 2005	August 31, 2004
	\$	\$
<b>ASSETS</b>		
<b>Current Assets:</b>		
<i>Cash and Cash Equivalents:</i>		
Cash in State Treasury	12,259	5,192
Total Cash and Cash Equivalents	12,259	5,192
Legislative Appropriations	9,146	-
Accounts Receivable	16,510	-
Total Current Assets	37,915	5,192
<b>Total Assets</b>	<b>37,915</b>	<b>5,192</b>
<b>LIABILITIES &amp; FUND BALANCES</b>		
<b>Current Liabilities:</b>		
<i>Payables:</i>		
Accounts Payable	5,746	-
Due To Other Funds (Note 1.G)	4,533	2,631
Deferred Revenues	1,016	-
Total Current Liabilities	11,295	2,631
<b>Total Liabilities</b>	<b>11,295</b>	<b>2,631</b>
<b>Fund Balances:</b>		
<i>Unreserved:</i>		
Undesignated, Reported In:		
Special Revenue Funds	26,620	2,561
<b>Total Fund Balances (Exh. IV)</b>	<b>26,620</b>	<b>2,561</b>
<b>Total Liabilities &amp; Fund Balances</b>	<b>37,915</b>	<b>5,192</b>
Total Fund Balances - Governmental Funds (above):	26,620	2,561
<i>Amounts reported for 'Governmental Activities' in the Statement of Net Assets (Exhibit I) are different because:</i>		
An <i>Internal Service Fund</i> is used by the System to account for the assets and liabilities associated with the Group 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 in 'Governmental Activities' in the <i>Statement of Net Assets</i> .		
	133,253,040	96,160,216
<b>Net Assets of Governmental Activities (Exhibit I)</b>	<b>133,279,660</b>	<b>96,162,777</b>

USAS Funds (U/F) are: 0929, 3001, 3003 and 3008.

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 Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	Nonmajor Special Revenue Funds	
	Totals	
	August 31, 2005	August 31, 2004
	\$	\$
<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
For Public Employee Survivors	2,711,951	2,711,951
For Victims of Crime	-	2,739,951
For Death Benefits-Retirees	6,556,164	6,508,651
Total Original Appropriations	9,296,115	11,988,553
Additional Appropriations Revenue:		
For Public Employee Survivors	(79,496)	2,244,798
For Death Benefits-Retirees	473,530	172,815
Total Additional Appropriations	394,034	2,417,613
Administration Fees	72,716	-
<b>Total Revenues</b>	<b>9,762,865</b>	<b>14,406,166</b>
<b>EXPENDITURES</b>		
<i>Current:</i>		
Death Benefits	10,908,749	11,638,215
<i>Administrative Expenditures:</i>		
Salaries & Wages	41,129	24,541
Payroll Related Costs	9,536	5,609
Professional Fees & Services	301	80
Travel	254	209
Materials & Supplies	28,192	103
Communications & Utilities	61	47
Repairs & Maintenance	-	28,000
Printing & Reproduction	4	1
Other Expenditures	580	359
Total Administrative Expenditures	80,057	58,949
<b>Total Expenditures</b>	<b>10,988,806</b>	<b>11,697,164</b>
<b>Excess (Deficiency) of Revenues over Expenditures Before</b>		
<b>Other Financing Sources</b>	<b>(1,225,941)</b>	<b>2,709,002</b>
<b>OTHER FINANCING SOURCES</b>		
Transfers In-Retirement Membership Fees (Note 1.G)	-	18,000
Transfers In-From Other State Agencies (Note 1.G)	1,250,000	
<b>Total Other Financing Sources</b>	<b>1,250,000</b>	<b>18,000</b>
<b>Excess of Revenues over Expenditures and Other</b>		
<b>Financing Sources</b>	<b>24,059</b>	<b>2,727,002</b>
<b>Fund Balances - Beginning</b>	<b>2,561</b>	<b>15,510</b>
Appropriations Lapsed	-	(2,739,951)
<b>Fund Balances - Ending (Exh. III)</b>	<b>26,620</b>	<b>2,561</b>
Net Change in Fund Balances - Governmental Funds:	24,059	(12,949)
<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> .		
	37,092,824	70,220,990
<b>Change in Net Assets of Governmental Activities (Exhibit II)</b>	<b>37,116,883</b>	<b>70,208,041</b>

USAS Funds (U/F) are: 0929, 3001, 3003 and 3008.

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, 2005 (With Comparative Totals at August 31, 2004)

ASSETS	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2005	August 31, 2004
	\$	\$
<b>Current Assets:</b>		
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	42,713	3,127
Cash in State Treasury	36,938,154	11,086,730
Total Cash and Cash Equivalents	36,980,867	11,089,857
Securities Lending Collateral	55,676,502	41,603,761
<i>Short-Term Investments:</i>		
Other Investments	136,661,499	117,815,080
Total Short-Term Investments	136,661,499	117,815,080
<i>Receivables:</i>		
Interest Receivable	102,000	47,000
Accounts Receivable	89,517,444	80,837,706
Total Receivables	89,619,444	80,884,706
Due From Other Agencies (Note 1.G)	191,976	374,074
<b>Total Current Assets</b>	<b>319,130,288</b>	<b>251,767,478</b>
<b>Non-Current Assets:</b>		
<i>Investments:</i>		
U.S. Government and Agency Obligations	215,634,404	139,578,809
Corporate Obligations	99,242,150	147,844,785
Total Investments	314,876,554	287,423,594
<b>Total Non-Current Assets</b>	<b>314,876,554</b>	<b>287,423,594</b>
<b>Total Assets</b>	<b>634,006,842</b>	<b>539,191,072</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
<i>Payables:</i>		
<i>Claims Payable:</i>		
Incurred, Self-Funded	22,787,514	7,922,852
Incurred, Insured	22,396,444	18,300,694
Incurred But Not Reported, Self-Funded	337,632,000	311,693,000
Incurred But Not Reported, Insured	60,557,000	61,898,000
Total Claims Payable	443,372,958	399,814,546
Total Payables	443,372,958	399,814,546
Due To Other Funds (Note 1.G)	846,360	821,626
Deferred Revenue	857,982	790,923
Obligations Under Securities Lending	55,676,502	41,603,761
<b>Total Current Liabilities</b>	<b>500,753,802</b>	<b>443,030,856</b>
<b>Total Liabilities</b>	<b>500,753,802</b>	<b>443,030,856</b>
<b>NET ASSETS</b>		
<i>Restricted For:</i>		
Employee Benefits - Group Benefits Program	133,253,040	96,160,216
<b>Total Net Assets (Exh. VI)</b>	<b>133,253,040</b>	<b>96,160,216</b>

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

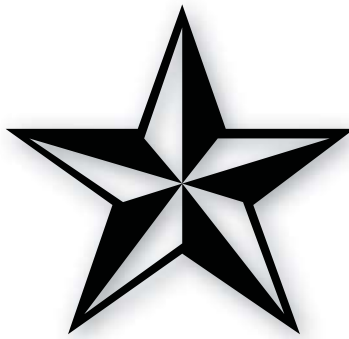


## Exhibit VI

### Statement of Revenues, Expenses and Changes in Net Assets – Proprietary Fund Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2005	August 31, 2004
<b>OPERATING REVENUES</b>	\$	\$
<i>Contributions to Insurance Program:</i>		
From the State of Texas:		
For Employees	949,268,624	891,481,949
For Retirees	306,854,229	286,029,756
Total Contributions from the State of Texas	<u>1,256,122,853</u>	<u>1,177,511,705</u>
From Members:		
For Employees	320,206,008	308,021,988
For Retirees	92,853,754	88,467,593
For COBRA	7,131,851	7,617,718
Total Contributions from Members	<u>420,191,613</u>	<u>404,107,299</u>
Total Contributions to Insurance Program	<u>1,676,314,466</u>	<u>1,581,619,004</u>
<i>Other Operating Revenues:</i>		
COBRA 2% Administration Fee	145,442	154,213
Warrants Voided by Statute of Limitations	3,233	4,942
Penalty Assessed to Insurance Carrier	100,000	3,680,834
Miscellaneous Operating Revenue	204,337	-
Total Other Operating Revenues	<u>453,012</u>	<u>3,839,989</u>
<b>Total Operating Revenues</b>	<b><u>1,676,767,478</u></b>	<b><u>1,585,458,993</u></b>
<b>OPERATING EXPENSES</b>		
<i>Employee Benefit Payments:</i>		
For Employees	1,189,047,542	1,107,187,431
For Retirees	439,171,027	402,224,473
For COBRA	18,596,432	9,883,391
Total Employee Benefit Payments	<u>1,646,815,001</u>	<u>1,519,295,295</u>
<i>Administrative Expenses:</i>		
Salaries & Wages	5,424,874	5,399,195
Payroll Related Costs	1,314,161	1,315,547
Professional Fees & Services	987,784	625,825
Travel	33,396	39,472
Materials & Supplies	577,629	339,032
Communications & Utilities	291,711	280,150
Repairs & Maintenance	827,587	513,584
Rentals & Leases	502,733	463,310
Printing & Reproduction	32,007	31,413
Interest Expense	36	-
Other Operating Expenses	320,310	308,524
Total Administrative Expenses	<u>10,312,228</u>	<u>9,316,052</u>
<b>Total Operating Expenses</b>	<b><u>1,657,127,229</u></b>	<b><u>1,528,611,347</u></b>
<b>Operating Income</b>	<b>19,640,249</b>	<b>56,847,646</b>
<b>NON-OPERATING REVENUES (EXPENSES)</b>		
Net Increase (Decrease) in Fair Value of Investments	(1,750,144)	2,043,385
Interest Revenue	16,405,060	10,849,240
<i>Securities Lending Activities:</i>		
Loan Premium on Securities Lending	1,157,188	334,082
Less: Broker Rebates	(964,916)	(196,157)
Agent Fees	(38,453)	(31,280)
Net Securities Lending Activity	<u>153,819</u>	<u>106,645</u>
Settlement Revenue	2,643,840	374,074
<b>Total Non-Operating Revenues</b>	<b><u>17,452,575</u></b>	<b><u>13,373,344</u></b>
<b>Change in Net Assets</b>	<b>37,092,824</b>	<b>70,220,990</b>
<b>NET ASSETS</b>		
<b>Net Assets - Beginning</b>	<b>96,160,216</b>	<b>25,939,226</b>
<b>Net Assets - Ending (Exh. V)</b>	<b><u>133,253,040</u></b>	<b><u>96,160,216</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

Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2005	August 31, 2004
<b>Cash Flows from Operating Activities:</b>	\$	\$
Cash Received from Members	420,242,326	404,282,611
Cash Received from The State of Texas	1,247,800,730	1,181,719,331
Cash Payments to Insurance Carriers and Third Party Administrators	(1,603,235,882)	(1,509,820,781)
Cash Payments to Employees for Services	(5,136,425)	(6,106,061)
Cash Payments for Goods and Services	(5,166,939)	(3,154,466)
Other Cash Received	2,932,844	3,685,776
<b>Net Cash Provided by Operating Activities</b>	<b>57,436,654</b>	<b>70,606,410</b>
<b>Cash Flows from Investing Activities:</b>		
Net Purchases of Short-Term Investment Fund	(47,950,704)	(106,749,319)
Interest Revenue	16,405,060	10,849,240
<b>Net Cash Used by Investing Activities</b>	<b>(31,545,644)</b>	<b>(95,900,079)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>25,891,010</b>	<b>(25,293,669)</b>
<b>Cash and Cash Equivalents:</b>		
<b>Beginning of Year</b>	<b>11,089,857</b>	<b>36,383,526</b>
<b>End of Year</b>	<b>36,980,867</b>	<b>11,089,857</b>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>		
<b>Operating Income</b>	<b>19,640,249</b>	<b>56,847,646</b>
<b>Adjustments to Reconcile Operating Income to Net Cash Provided by</b>		
<b>Operating Activities:</b>		
Settlement Revenue	2,643,840	374,074
Change in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable	(8,679,738)	4,623,872
(Increase) Decrease in Due From Other Agencies	182,098	(374,074)
Increase in Accounts Payable	43,558,412	9,372,318
Increase in Due To Other Funds	24,734	57,352
Increase (Decrease) in Deferred Revenue	67,059	(294,778)
<b>Total Adjustments</b>	<b>37,796,405</b>	<b>13,758,764</b>
<b>Net Cash Provided by Operating Activities</b>	<b>57,436,654</b>	<b>70,606,410</b>
<b>Non-Cash Investing Activities:</b>		
Net Appreciation (Depreciation) in Fair Value of Non-Cash Equivalent Investments	(1,750,144)	2,043,385

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



## Exhibit VIII

### Combined Statement of Fiduciary Net Assets

August 31, 2005 (With Comparative Totals at August 31, 2004)

	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			2005	2004
<b>ASSETS</b>						
Cash and Cash Equivalents	30,618,859	7,000,781	37,619,640	227,421	37,847,061	30,177,059
Securities Lending Collateral	4,423,390,863		4,423,390,863		4,423,390,863	3,236,686,183
Short-Term Investments	184,179,974	133,925,071	318,105,045		318,105,045	1,208,464,769
Legislative Appropriations	231,168		231,168		231,168	240,947
Investments	21,172,581,037	157,592,090	21,330,173,127		21,330,173,127	19,712,509,018
Receivables	93,507,437	4,074,430	97,581,867	2,082	97,583,949	112,745,778
Due From Other Funds (Note 1.G)	1,239,695		1,239,695		1,239,695	1,152,796
Due From Other Agencies (Note 1.G)	4,064,655	2,736	4,067,391		4,067,391	3,364,305
Prepaid Expenses		479,616	479,616		479,616	494,076
Capital Assets, Net of Accumulated Depreciation	6,361,614		6,361,614		6,361,614	6,909,348
<b>Total Assets</b>	<b>25,916,175,302</b>	<b>303,074,724</b>	<b>26,219,250,026</b>	<b>229,503</b>	<b>26,219,479,529</b>	<b>24,312,744,279</b>
<b>LIABILITIES</b>						
Payables	197,938,709	6,490,019	204,428,728	2,232	204,430,960	1,245,941,545
Due To Other Funds (Note 1.G)	298,652	90,150	388,802		388,802	328,539
Due To Other Agencies (Note 1.G)	543,477		543,477		543,477	524,267
Deferred Revenue	56,620	4,666	61,286		61,286	574,660
Employees Compensable Leave	1,464,396		1,464,396		1,464,396	1,429,412
Obligations Under Securities Lending	4,423,390,863		4,423,390,863		4,423,390,863	3,236,686,182
Funds Held For Others				227,271	227,271	176,304
<b>Total Liabilities</b>	<b>4,623,692,717</b>	<b>6,584,835</b>	<b>4,630,277,552</b>	<b>229,503</b>	<b>4,630,507,055</b>	<b>4,485,660,909</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. IX)</b>	<b>21,292,482,585</b>	<b>296,489,889</b>	<b>21,588,972,474</b>	<b>-</b>	<b>21,588,972,474</b>	<b>19,827,083,370</b>
	(Exh. X)	(Exh. A-1)				

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.

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



## Exhibit IX

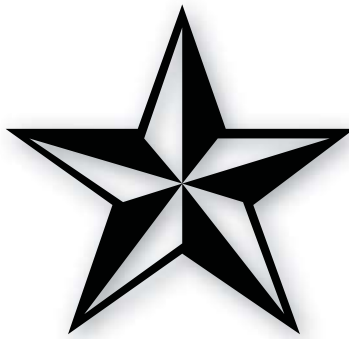
### Combined Statement of Changes in Fiduciary Net Assets

Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	Defined Benefit Plans	Defined Contribution Plans and Cafeteria Plan	Pension and Other Employee Benefit Trust Funds	
			Totals	
			August 31,	
	\$	\$	\$	\$
<b>ADDITIONS</b>				
<b>Contributions:</b>				
Member Contributions	308,855,124	135,828,779	444,683,903	439,921,929
State Contributions	284,399,378		284,399,378	287,049,457
Legislative Appropriations	22,417,083		22,417,083	22,741,570
Service Contributions Transferred from Teacher Retirement System	41,200,491		41,200,491	38,068,440
Settlement Revenue		18,000	18,000	1,326,352
Other Contributions	8,830,130	680,932	9,511,062	7,531,434
<b>Total Contributions</b>	<b>665,702,206</b>	<b>136,527,711</b>	<b>802,229,917</b>	<b>796,639,182</b>
<b>Investment Income:</b>				
From Investing Activities	2,416,726,014	22,541,400	2,439,267,414	2,101,334,957
From Securities Lending Activities	10,154,742		10,154,742	8,611,921
<b>Total Net Investment Income</b>	<b>2,426,880,756</b>	<b>22,541,400</b>	<b>2,449,422,156</b>	<b>2,109,946,878</b>
<b>Other Additions:</b>				
Other Revenue	188,544	242,463	431,007	783,915
Transfers In	223,236	433,815	657,051	501,345
<b>Total Other Additions</b>	<b>411,780</b>	<b>676,278</b>	<b>1,088,058</b>	<b>1,285,260</b>
<b>Total Additions</b>	<b>3,092,994,742</b>	<b>159,745,389</b>	<b>3,252,740,131</b>	<b>2,907,871,320</b>
<b>DEDUCTIONS</b>				
<b>Benefits:</b>				
Retirement Benefits and Refunds	1,347,088,125		1,347,088,125	1,323,761,944
Plan 457 Benefits		68,010,106	68,010,106	109,526,565
Cafeteria Plan Reimbursement Claims		52,336,797	52,336,797	42,886,292
Service Contributions Transferred to Teacher Retirement System	6,188,845		6,188,845	5,600,176
<b>Total Benefits</b>	<b>1,353,276,970</b>	<b>120,346,903</b>	<b>1,473,623,873</b>	<b>1,481,774,977</b>
Administrative Expenses	14,262,451	2,242,510	16,504,961	15,563,478
<b>Other Deductions:</b>				
Other Expenses	1,575		1,575	29,309
Transfers Out	720,618		720,618	519,345
<b>Total Other Deductions</b>	<b>722,193</b>	<b>-</b>	<b>722,193</b>	<b>548,654</b>
<b>Total Deductions</b>	<b>1,368,261,614</b>	<b>122,589,413</b>	<b>1,490,851,027</b>	<b>1,497,887,109</b>
<b>Net Increase</b>	<b>1,724,733,128</b>	<b>37,155,976</b>	<b>1,761,889,104</b>	<b>1,409,984,211</b>
<b>NET ASSETS</b>				
<b>Net Assets Held in Trust For Pension</b>				
<b>Benefits and Other Purposes:</b>				
<b>Beginning of Year</b>	<b>19,567,749,457</b>	<b>259,333,913</b>	<b>19,827,083,370</b>	<b>18,417,099,159</b>
<b>End of Year (Exh. VIII)</b>	<b>21,292,482,585</b>	<b>296,489,889</b>	<b>21,588,972,474</b>	<b>19,827,083,370</b>
	(Exh. XI)	(Exh. A-2)		

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







# Exhibit X

## Combining Statement of Fiduciary Net Assets – Pension and Other Employee Benefit Trust Funds – Defined Benefit Plans August 31, 2005 (With Comparative Totals at August 31, 2004)

ASSETS	Employees	Law Enforcement	Judicial	Judicial	Excess	Totals	
	Retirement Fund (0955)	and Custodial Officer Supplemental Fund (0977)	Retirement System Plan I (0001)	Retirement System Plan II (0993)	Benefit Arrange- ment (5039)	2005	2004
	\$	\$	\$	\$	\$	\$	\$
<b>ASSETS</b>							
<i>Cash and Short-Term Investments:</i>							
<i>Cash and Cash Equivalents:</i>							
Cash on Hand	2,524,405					2,524,405	1,322,454
Cash in Bank	9,700					9,700	9,700
Cash in State Treasury	15,892,516	682,423		436,265		17,011,204	19,844,357
Margin Deposit (Note 5.A)	10,634,340	355,860		83,350		11,073,550	-
Total Cash and Cash Equivalents	29,060,961	1,038,283	-	519,615	-	30,618,859	21,176,511
Securities Lending Collateral	4,247,973,731	142,332,492		33,084,640		4,423,390,863	3,236,686,183
<i>Short-Term Investments:</i>							
Repurchase Agreements	96,043,126	3,213,914		752,766		100,009,806	200,000,000
Other Short-Term Investments	80,831,734	2,704,892		633,542		84,170,168	918,449,101
Total Short-Term Investments	176,874,860	5,918,806	-	1,386,308	-	184,179,974	1,118,449,101
Total Cash and Short-Term Investments	4,453,909,552	149,289,581	-	34,990,563	-	4,638,189,696	4,376,311,795
Legislative Appropriations			231,168			231,168	240,947
<i>Investments:</i>							
U.S. Government and Agency Obligations	4,963,764,570	166,103,617		38,904,968		5,168,773,155	5,454,804,180
Corporate Equity	8,748,433,870	292,750,894		68,568,430		9,109,753,194	7,858,765,289
Corporate Obligations	2,667,315,577	89,257,007		20,905,872		2,777,478,456	2,794,208,377
Foreign Securities	3,953,300,838	132,290,233		30,985,161		4,116,576,232	3,442,921,064
Total Investments	20,332,814,855	680,401,751	-	159,364,431	-	21,172,581,037	19,550,698,910
<i>Receivables:</i>							
Interest and Dividends Receivable	2,913,243	96,832		23,161		3,033,236	1,139,863
Contributions/Accounts Receivable	43,687,506			933,397		44,620,903	45,450,415
Unsettled Sales-Investment Receivables	44,034,907	1,475,432		342,959		45,853,298	62,600,525
Total Receivables	90,635,656	1,572,264	-	1,299,517	-	93,507,437	109,190,803
Due From Other Funds (Note 1.G)	1,239,667			28		1,239,695	1,150,969
Due From Other Agencies (Note 1.G)	4,064,655					4,064,655	3,364,305
Prepaid Lease Expense						-	31,752
<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 \$12,001,652 and \$12,065,745 respectively:</i>							
Building	4,461,599					4,461,599	4,759,811
Furniture and Equipment	1,025,126					1,025,126	1,273,369
Vehicles						-	1,279
Total Capital Assets	6,361,614	-	-	-	-	6,361,614	6,909,348
<b>Total Assets</b>	<b>24,889,025,999</b>	<b>831,263,596</b>	<b>231,168</b>	<b>195,654,539</b>	<b>-</b>	<b>25,916,175,302</b>	<b>24,047,898,829</b>
<b>LIABILITIES</b>							
<i>Payables:</i>							
Benefits/Accounts Payable	18,076,515	214,748	231,168	34,979		18,557,410	16,579,980
Unsettled Purchases-Investment Payables	172,267,627	5,771,994		1,341,678		179,381,299	1,224,116,562
Total Payables	190,344,142	5,986,742	231,168	1,376,657	-	197,938,709	1,240,696,542
Due To Other Funds (Note 1.G)	28	244,721		53,903		298,652	238,309
Due To Other Agencies (Note 1.G)	543,477					543,477	524,267
Deferred Revenue				56,620		56,620	574,660
Employees Compensable Leave	1,464,396					1,464,396	1,429,412
Obligations Under Securities Lending	4,247,973,731	142,332,492		33,084,640		4,423,390,863	3,236,686,182
<b>Total Liabilities</b>	<b>4,440,325,774</b>	<b>148,563,955</b>	<b>231,168</b>	<b>34,571,820</b>	<b>-</b>	<b>4,623,692,717</b>	<b>4,480,149,372</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust for Pension</b>							
<b>Benefits and Other Purposes (Exh. XI)</b>	<b>20,448,700,225</b>	<b>682,699,641</b>	<b>-</b>	<b>161,082,719</b>	<b>-</b>	<b>21,292,482,585</b>	<b>19,567,749,457</b>
						(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 (U/F) are:

Fund 0955: 0955, 1955, 8955; Fund 0977: 0977, 1977; Fund 0001: 2001; Fund 0993: 0993, 1993; Fund 5039: 5039.

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



## Exhibit XI

### Combining Statement of Changes in Fiduciary Net Assets – Pension and Other Employee Benefit Trust Funds - Defined Benefit Plans Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

ADDITIONS	Employees Retirement Fund (0955)	Law	Judicial	Judicial	Excess	Totals	
		Enforcement and Custodial Officer Supplemental Fund (0977)	Retirement System Plan I (0001)	Retirement System Plan II (0993)	Benefit Arrange- ment (5039)	August 31,	
	\$	\$	\$	\$	\$	2005	2004
<b>Contributions:</b>							
Member Contributions	305,869,798			2,985,326		308,855,124	303,077,314
State Contributions	276,034,664			8,364,714		284,399,378	287,049,457
<i>Legislative Appropriations for:</i>							
Judges Retirement Annuities			22,297,083			22,297,083	22,621,570
Administrative Expenses			120,000			120,000	120,000
<i>Service Contributions Transferred from</i>							
Teacher Retirement System (Note 1.G)	41,200,491					41,200,491	38,068,440
<i>Other Contributions:</i>							
Membership Fees	435,760					435,760	463,162
Penalty Interest	8,383,482			10,888		8,394,370	6,599,957
Total Other Contributions	8,819,242	-	-	10,888	-	8,830,130	7,063,119
<b>Total Contributions</b>	<b>631,924,195</b>	<b>-</b>	<b>22,417,083</b>	<b>11,360,928</b>	<b>-</b>	<b>665,702,206</b>	<b>657,999,900</b>
<b>Investment Income:</b>							
<i>From Investing Activities:</i>							
Net appreciation (depreciation)							
in fair value of investments	1,718,194,812	57,872,270		12,721,298		1,788,788,380	1,538,704,175
Interest and Dividends	620,215,533	20,854,846		4,657,383		645,727,762	542,639,464
Total Investing Activity Income	2,338,410,345	78,727,116	-	17,378,681	-	2,434,516,142	2,081,343,639
Less: Investment Expense	(17,074,876)	(610,802)		(104,450)		(17,790,128)	(14,014,529)
Net Income, Investing Activities	2,321,335,469	78,116,314	-	17,274,231	-	2,416,726,014	2,067,329,110
<i>From Securities Lending Activities:</i>							
Loan Premium on Securities Lending	94,521,676	3,178,146		714,104		98,413,926	37,460,890
Less: Broker Rebates	(82,291,548)	(2,766,941)		(621,685)		(85,680,174)	(26,053,340)
Agent Fees	(2,477,016)	(83,289)		(18,705)		(2,579,010)	(2,795,629)
Total Securities Lending Expenses	(84,768,564)	(2,850,230)	-	(640,390)	-	(88,259,184)	(28,848,969)
Net Income, Securities Lending Activities	9,753,112	327,916	-	73,714	-	10,154,742	8,611,921
<b>Net Investment Income</b>	<b>2,331,088,581</b>	<b>78,444,230</b>	<b>-</b>	<b>17,347,945</b>	<b>-</b>	<b>2,426,880,756</b>	<b>2,075,941,031</b>
<b>Other Additions:</b>							
<i>Other Revenue:</i>							
Warrants Voided by Statute of Limitations	103,653	299				103,952	198,350
Sale of Surplus Equipment	47,357					47,357	10,462
Rental Income	31,000					31,000	38,588
Miscellaneous Revenue	6,235					6,235	344,184
Total Other Revenue	188,245	299	-	-	-	188,544	591,584
<i>Transfers In (Note 1.G):</i>							
Excess Benefit Arrangement					223,236	223,236	66,915
Total Transfers In	-	-	-	-	223,236	223,236	66,915
<b>Total Other Additions</b>	<b>188,245</b>	<b>299</b>	<b>-</b>	<b>-</b>	<b>223,236</b>	<b>411,780</b>	<b>658,499</b>
<b>Total Additions</b>	<b>2,963,201,021</b>	<b>78,444,529</b>	<b>22,417,083</b>	<b>28,708,873</b>	<b>223,236</b>	<b>3,092,994,742</b>	<b>2,734,599,430</b>

- to next page



## Exhibit XI

### Combining Statement of Changes in Fiduciary Net Assets – Pension and Other Employee Benefit Trust Funds - Defined Benefit Plans (Concluded) Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

DEDUCTIONS						Totals	
	Employees Retirement Fund (0955)	Law Enforcement and Custodial Officer Supplemental Fund (0977)	Judicial Retirement System Plan I (0001)	Judicial Retirement System Plan II (0993)	Excess Benefit Arrangement (5039)	August 31,	
	\$	\$	\$	\$	\$	2005	2004
<b>Benefits:</b>							
Retirement Benefits	1,200,373,003	29,036,299	22,283,198	3,307,938	159,669	1,255,160,107	1,237,729,418
<i>Death Benefits:</i>							
Active Members	882,372			9,842		892,214	1,012,352
Retirees	1,156,143					1,156,143	937,071
Refunds of Retirement Contributions	89,759,681		13,885	106,095		89,879,661	84,083,103
<i>Transfers Out of Contributions:</i>							
Service Contributions Transferred to Teacher Retirement System (Note 1.G)	6,188,845					6,188,845	5,600,176
<b>Total Benefits</b>	<b>1,298,360,044</b>	<b>29,036,299</b>	<b>22,297,083</b>	<b>3,423,875</b>	<b>159,669</b>	<b>1,353,276,970</b>	<b>1,329,362,120</b>
<b>Administrative Expenses:</b>							
Salaries & Wages	5,759,110	216,042		128,972		6,104,124	6,284,166
Payroll Related Costs	1,533,243	60,416	1,426	33,956		1,629,041	1,609,375
Professional Fees & Services	2,235,432	160,225	49,184	145,264		2,590,105	2,006,246
Travel	29,925	411		381		30,717	36,535
Materials & Supplies	628,731	22,168	69,390	27,979		748,268	723,049
Communications & Utilities	293,274	8,892		11,630		313,796	323,586
Repairs & Maintenance	869,089	23,507		28,954		921,550	720,763
Rentals & Leases	598,796	13,746		15,136		627,678	540,598
Printing & Reproduction	37,596	537		768		38,901	32,750
Depreciation	757,703					757,703	772,164
Interest Expense	900					900	-
Other Operating Expenses	475,851	15,038		8,779		499,668	421,326
<b>Total Administrative Expenses</b>	<b>13,219,650</b>	<b>520,982</b>	<b>120,000</b>	<b>401,819</b>	<b>-</b>	<b>14,262,451</b>	<b>13,470,558</b>
<b>Other Deductions:</b>							
<i>Other Expenses:</i>							
Loss on Sale of Capital Assets	1,575					1,575	29,309
Total Other Expenses	1,575					1,575	29,309
<i>Transfers Out (Note 1.G):</i>							
Membership Fees	433,815					433,815	452,430
Excess Benefit Arrangement	223,236				63,567	286,803	66,915
Total Transfers Out	657,051				63,567	720,618	519,345
<b>Total Other Deductions</b>	<b>658,626</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63,567</b>	<b>722,193</b>	<b>548,654</b>
<b>Total Deductions</b>	<b>1,312,238,320</b>	<b>29,557,281</b>	<b>22,417,083</b>	<b>3,825,694</b>	<b>223,236</b>	<b>1,368,261,614</b>	<b>1,343,381,332</b>
<b>Net Increase</b>	<b>1,650,962,701</b>	<b>48,887,248</b>	<b>-</b>	<b>24,883,179</b>	<b>-</b>	<b>1,724,733,128</b>	<b>1,391,218,098</b>
<b>NET ASSETS</b>							
<b>Net Assets Held in Trust For Pension</b>							
<b>Benefits and Other Purposes:</b>							
<b>Beginning of Year</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>
<b>End of Year (Exh. X)</b>	<b>20,448,700,225</b>	<b>682,699,641</b>	<b>-</b>	<b>161,082,719</b>	<b>-</b>	<b>21,292,482,585</b>	<b>19,567,749,457</b>

(Exh. IX)

USAS Funds (U/F) are:

Fund 0955: 0955, 1955, 8955; Fund 0977: 0977, 1977; Fund 0001: 2001; Fund 0993: 0993, 1993; Fund 5039: 5039.

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



# Notes to the Basic Financial Statements

August 31, 2005

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# Notes to the Basic Financial Statements

August 31, 2005

## 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. New Accounting Pronouncements

Effective September 1, 2004, the System implemented two new statements issued by the GASB.

- In March 2003, the GASB issued Statement No. 40 *Deposit and Investment Risk Disclosures*. GASB 40 amends GASB 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* by expanding the disclosure requirements for credit risk, interest rate risk and foreign currency risk.
- In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*. The adoption of GASB 44 requires some additional information and schedules in the statistical section of the Comprehensive Annual Financial Report (CAFR).

## C. 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 are considered to be *general* revenues/expenses.

Fund financial statements are presented immediately after the government-wide financial statements. These statements present information for nonmajor Governmental Funds in the aggregate, the Internal Service Fund, and the Fiduciary Funds. Fund financial statements have been prepared using the measurement focus appropriate for each type of fund.



# Notes to the Basic Financial Statements

August 31, 2005

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

*Measurement focus* refers to the definition of the resource flows measured. *Basis of accounting* refers to when revenues and expenses are recognized in the accounts and reported in the financial statements.

Special Revenue Funds are accounted for under the modified accrual basis of accounting and current financial resources measurement focus. Under this combination, the financial statements focus on current assets and current liabilities and the changes in net current assets. All revenues reported are recognized based on the criteria of *measurability and availability*. The System considers all revenues reported in the Special Revenue Funds to be *available* if the revenues are due at year-end and collected within 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.

## **E. 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.

Effective in fiscal year 2005, the System reports all of its Special Revenue Funds as nonmajor funds.

- 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 0469,



# Notes to the Basic Financial Statements

August 31, 2005

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**

Internal Service Funds are 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.





# Notes to the Basic Financial Statements

August 31, 2005

## F. 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 and all Special Revenue Funds other than the Social Security Administration 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.

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.

## G. Assets, Liabilities, Fund Balances and Net

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

#### Cash and Temporary Investments

Cash and Cash Equivalents (in accordance with GASB Statement 9), as reported in the *Statement of Cash Flows* for the Internal Service Fund, 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 a local

commercial bank; the TexaSaver 457 Plan accounts are maintained at financial institutions, insurance companies, and mutual fund distributors approved by the System and selected by the plan participants.

#### Valuation

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

#### Investments

##### Valuation

Investments of the Pension Trust Funds and Internal Service Fund are reported at fair value. The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Many factors are considered in arriving at that value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Short-term investments are reported at cost, which approximates fair value.

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

The investments of the Employees Retirement 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



# Notes to the Basic Financial Statements

August 31, 2005

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.

**Figure A  
Capitalization Thresholds and Useful Lives**

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

## Accounts Payable

Accounts Payable under the Internal Service Fund include claims incurred but not reported by the participants prior to fiscal year end and payable in future years as estimated by the System's actuary.

## Employees Compensable Leave

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

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

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

## Net Assets – Held in Trust for Pension Benefits

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

- The Employee Savings Account represents the accumulation of active and inactive member deposits

plus interest.

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



# Notes to the Basic Financial Statements

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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.

## **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.

## **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.

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.

See Note 5.F Interagency Transfers.

## **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, 2005. 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.D, 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.G, Summary of Significant Accounting Policies,



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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, 2004 and 2005, 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.

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



# Notes to the Basic Financial Statements

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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, 2004 and 2005, 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, 2005 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.

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

	ERS	LECOS	JRS I	JRS II
Retirees and beneficiaries currently receiving benefits	65,720	5,070	491	81
Terminated employees entitled to benefits	57,079	12	16	88
Current employees	131,331	37,150	43	491
<b>Total</b>	<b>254,130</b>	<b>42,232</b>	<b>550</b>	<b>660</b>

Note: Estimated based on actuarial valuation as of August 31, 2005.

## C. Reserves (Unaudited)

The balances of legally required reserves in each funded retirement plan as of August 31, 2005 and 2004 are presented in Figure C.

See Note 1.G, 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.

## 3. Pension Plans - Defined Contribution Plan Descriptions and Contributions

### Texa\$aver 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 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 \$293,268,282 as of August 31, 2005.

#### Contributions

As of August 31, 2005, there were 21 System employees

**Figure C**  
**Reserves (Unaudited)**

	ERS	LECOS	JRS II	Totals - August 31,	
				2005	2004
<b>Net Plan Assets Reserved For:</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Employee Savings	3,581,186,131	5,275	37,291,238	3,618,482,644	3,476,386,594
State Accumulation	5,981,451,720	431,219,469	82,119,440	6,494,790,629	5,666,110,883
Annuity Reserves	10,886,033,918	251,474,897	41,672,041	11,179,180,856	10,425,251,980
Administration	28,456			28,456	-
<b>Total Net Plan Assets Reserved</b>	<b>20,448,700,225</b>	<b>682,699,641</b>	<b>161,082,719</b>	<b>21,292,482,585</b>	<b>19,567,749,457</b>
Funded ratios of each plan, from the actuarial valuation:					
As of August 31, 2005	94.8%	103.1%	90.1%		
As of August 31, 2004	97.3%	109.3%	117.5%		



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participating in the Texa\$aver 457 Plan. During the fiscal year ended August 31, 2005, System employees deferred \$82,973, which includes \$10,465 in retirement incentive rollovers. The State does not contribute to the plan.

## Texa\$aver 401(k) Plan

(In accordance with GASB Statement 25)

### Plan Description

The System also offers to all State employees the Texa\$aver 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, 2005, there were 76 System employees participating in the Texa\$aver 401(k) Plan. During the fiscal year ended August 31, 2005, System employees deferred \$366,178. The State does not contribute to the plan.

## 4. Risk Management

(In accordance with GASB Statement 10)

### A. Risk Exposure

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

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

### B. Risk Financing

Claims for health, life, accidental death and dismemberment (AD & D), disability, and dental insurance coverages are recorded in the Employees Life, Accident and Health Insurance and Benefits Fund under the Texas Employees Group Benefits Program (GBP). 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.

**Figure E**  
**Changes in Self-Funded Claims Liabilities**

	Totals - August 31,	
	2005	2004
	\$	\$
Beginning of Fiscal Year Liability	319,615,852	311,006,003
Current-Year Claims and Changes in Estimates	1,371,322,192	1,279,346,907
Claims Payments	(1,330,518,530)	(1,270,737,058)
<b>Balance at Fiscal Year-End</b>	<b>360,419,514</b>	<b>319,615,852</b>

For coverages that are insured (not self-funded), no



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significant reductions in insurance coverage occurred in the past year, and settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years.

For both self-funded and insured coverages, the balance of claims that have been incurred but not reported as of August 31, 2005 is \$398,189,000.

## 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, 31 and 40)

See Note 1.G, Investments-Valuations.

#### Deposits

As of August 31, 2005, the total carrying amount of Cash in Bank and Margin Deposits was \$13,585,800 as presented in Figure F.

**Figure F**  
**Deposits**

Deposits	Carrying Value	Bank Balance
	\$	\$
Cash in Bank:		
Fiduciary Funds:		
Defined Benefit Plans (Exh. X)	9,700	4,511
Defined Contribution Plans and Cafeteria Plan (Exh. A-1)	2,502,550	2,502,550
<b>Total Cash in Bank</b>	<b>2,512,250</b>	<b>2,507,061</b>
Margin Deposit:		
Fiduciary Funds (Exh. X)	11,073,550	11,108,745
<b>Total</b>	<b>13,585,800</b>	<b>13,615,806</b>

#### Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System does not have a deposit policy for custodial credit risk.

As of August 31, 2005, the balances of Cash in Bank and Margin Deposit that were exposed to custodial credit risk are summarized in Figure G.

#### Investments

As of August 31, 2005, the fair value of investments are presented in Figure H.

**Figure G**  
**Custodial Credit Risk - Deposits**

Deposits	Uninsured and Uncollateralized	Uninsured and Collateralized with Securities Held by the Pledging Bank
	\$	\$
Cash in Bank:		
Fiduciary Funds	3,592	
Margin Deposit:		
Fiduciary Funds		11,108,745

**Figure H**  
**Investments**

Investment Type	Fair Value	
	Fiduciary Funds (Exh. VIII)	Proprietary Fund (Exh. V)
<i>Investments:</i>	\$	\$
U.S. Treasury Securities	1,586,844,744	113,810,720
U.S. Treasury TIPS	598,820,731	-
U.S. Government Agency Obligations	2,744,154,637	81,302,792
Corporate Obligations	2,777,478,456	99,242,150
Corporate Asset and Mortgage Backed Securities	238,953,043	20,520,892
Domestic Equity	9,109,753,194	-
International Equity	4,116,576,232	-
Annuities	157,592,090	-
<b>Total</b>	<b>21,330,173,127</b>	<b>314,876,554</b>
<i>Short-Term Investments:</i>		
Investment Pool Cash	100,932	-
Repurchase Agreements	100,009,806	-
Short-Term Investment Funds	3,855,886	136,661,499
Money Market Mutual Funds	214,138,421	-
<b>Total</b>	<b>318,105,045</b>	<b>136,661,499</b>
Securities Lending Collateral	4,423,390,863	55,676,502

#### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy limits holding of securities by counterparties to those involved with securities lending and those used as collateral for futures contracts.

Securities the System received as collateral for the securities lending program were uninsured and unregistered, with the securities held by the counterparty



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or by its trust department or agent, but not in the System's name. As of August 31, 2005, the fair value of these securities are summarized in Figure I.

**Figure I**  
**Custodial Credit Risk - Investments**

Investments	Fair Value
	\$
<i>Fiduciary Funds:</i>	
U.S. Treasury Securities	366,579,179
U.S. Treasury TIPS	98,233,024
U.S. Government Agency Obligations	37,071,808
<b>Total</b>	<b>501,884,011</b>
<i>Proprietary Fund:</i>	
U.S. Treasury Securities	82,434,700
U.S. Government Agency Obligations	17,347,462
<b>Total</b>	<b>99,782,162</b>

## Foreign Currency Risk

Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. The System does not have a policy for managing foreign currency risk.

The System's investment exposure to foreign currency risk as of August 31, 2005 is summarized in Figure J.

**Figure J**  
**Investments Exposed to Foreign Currency Risk**

Foreign Currency	International Equity (US\$)
	\$
<b>Fiduciary Funds:</b>	
Australian Dollar	143,526,718
British Pound	966,358,527
Canadian Dollar	37,356,317
Danish Krone	60,047,544
Euro	1,369,523,364
Hong Kong Dollar	89,034,128
Japanese Yen	729,606,008
Malaysian Ringgit	612
New Zealand Dollar	5,797,488
Norwegian Krone	43,727,751
Singapore Dollar	69,929,449
Swedish Krona	74,801,219
Swiss Franc	253,261,820
<b>Total International Equity Exposed to Foreign Currency Risk</b>	<b>3,842,970,945</b>
ADRs and GDRs Denominated in U.S. Dollars and Classified as International Equity	273,605,287
<b>Total International Equity (Exh. X)</b>	<b>4,116,576,232</b>

## Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policies of the System require that non-cash interest paying securities in the high yield bond portfolios may not exceed 15% of the market value of the portfolio and that investments in money market funds may represent no more than 5% of each individual fund. Credit risk is managed through diversification and by operating within defined parameters versus a benchmark index.

Excluding those securities issued by or explicitly guaranteed by the U.S. Government, which are not considered to have credit risk, the System's credit quality distribution for securities with credit risk exposure as of August 31, 2005 is summarized in Figure K. The securities were rated and categorized according to Standard & Poor's rating standards.

**Figure K**  
**Investment Credit Risk**

Investment Type	Rating	Fair Value
		\$
<b>Fiduciary Funds:</b>		
U.S. Government Agency Obligations	AAA	2,534,252,247
	A-1	81,642,466
Corporate Obligations	AAA	95,255,892
	AA	186,884,257
	A	555,284,644
	BBB	403,042,670
	BB	627,591,972
	B	722,516,453
	CCC	33,149,531
	NR	31,596,929
Corporate Asset and Mortgage Back Securities	AAA	216,839,869
	A	26,732,970
	BBB	24,428,561
	BB	7,485,859
	B	13,008,245
	NR	44,792,182
<b>Total</b>		<b>5,604,504,747</b>
<b>Proprietary Fund:</b>		
U.S. Government Agency Obligations	AAA	80,865,746
Corporate Obligations	AAA	10,014,450
	AA	37,011,410
	A	37,540,859
	BBB	13,809,620
Corporate Asset and Mortgage Back Securities	AAA	15,354,191
	AA	1,846,890
	NR	4,158,269
<b>Total</b>		<b>200,601,435</b>





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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 System had no failed securities either during the fiscal year or at August 31, 2005.

## Concentration Risk

Concentration risk is identified by amount and issuer of investment in any one issuer that represent 5% or more of plan net assets. The System's investment policies stipulate that investments in the securities of any one corporation may not exceed 3% of the market value of the total fund. As of August 31, 2005, the System was not exposed to any concentration risk.

## Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System does not have a policy for interest rate risk management. However, interest rate risk is managed through duration, by operating within defined risk parameters versus a benchmark index.

As of August 31, 2005, the System's exposure to interest rate risk is summarized in Figure L.

**Figure L**  
**Investment Interest Rate Risk**

Investment Type	Modified Duration	
	Fiduciary Fund	Proprietary Fund
U.S. Treasury Securities	5.83	3.07
U.S. Treasury TIPS	6.10	-
U.S. Government Agency Obligations	2.93	3.14
Corporate Obligations	4.70	3.04
Corporate Asset and Mortgage Backed Securities	3.62	1.96
Repurchase Agreement	0.01	-
Money Market Funds	0.20	1.32
<b>Overall</b>	<b>4.32</b>	<b>2.55</b>

## 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. 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 net securities lending income totaling \$10,308,561 for the fiscal year ended August 31, 2005. The collateral information as of August 31, 2005 is summarized in Figure M.

## Repurchase Agreements

During the fiscal year 2005, the System invested in repurchase agreements. As of August 31, 2005, the System had a balance totaling \$100,009,806 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 Collateralized Mortgage Obligations (CMOs), which are based on cash flows from interest



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**Figure M**  
**Securities Lending Collateral Summary**

Investment Type	Underlying Securities Value	Securities Collateral Value	Cash Collateral Value
<i>Fiduciary Funds:</i>	\$	\$	\$
U.S. Treasury Securities	1,497,010,030	373,910,763	1,144,473,035
U.S. Treasury TIPS	407,807,647	100,197,684	312,269,759
U.S. Government Agency Obligations	688,058,320	37,813,244	655,294,860
Corporate Obligations	462,060,279	-	469,367,911
Equity	1,205,497,129	-	1,213,577,747
International Equity	607,228,055	-	628,407,551
<b>Total</b>	<b>4,867,661,460</b>	<b>511,921,691</b>	<b>4,423,390,863</b>
			<b>Exh. X</b>
<i>Proprietary Fund:</i>			
U.S. Treasury Securities	113,811,239	84,083,394	32,045,613
U.S. Government Agency Obligations	23,405,960	17,694,411	6,235,011
Corporate Obligations	17,067,018	-	17,395,878
<b>Total</b>	<b>154,284,217</b>	<b>101,777,805</b>	<b>55,676,502</b>
			<b>Exh. V</b>

payments on underlying mortgages; therefore, they are sensitive to pre-payments by mortgagees that may result from a decline in interest rates. To be eligible for purchase, CMOs will be limited to such securities that exhibit 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 purchases and sells futures contracts as a means of adjusting the portfolio mix and as a lower transaction cost substitute for transactions which would otherwise occur in the underlying portfolios.

A futures contract is a contract to buy or sell units of an index or financial instrument at a specified future date at a price agreed upon when the contract is originated. Upon entering into a futures contract, the System pledges to the broker cash or U.S. government securities equal to the minimum "initial margin" requirement of the futures exchange. The System receives or pays a daily "variation margin," which is an amount of cash equal to the daily fluctuation in value of the contract. The accumulated value of the variation margin is the fair value of the futures contract. As of August 31, 2005, the outstanding

futures contracts are summarized in Figure N.

**Figure N**  
**Summary of Outstanding Futures Contracts**

	No. of Contracts	Notional Amount
		\$
Futures Contracts - Long	1,403	257,267,457
Futures Contracts - Short	4,291	246,486,015
		<b>Fair Value</b>
		\$
Margin Deposit - Cash		18,428,952
Futures Contracts		(7,355,402)
<b>Net Margin Deposit - Cash (Exh. X)</b>		<b>11,073,550</b>
Margin Deposit - Securities (Note A)		41,571,821
<i>Note A: US Treasury TIPS were pledged as margin deposit and reported as U.S. Government and Agency Obligations in the Statement of Net Assets.</i>		

The System could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. The System's investment managers seek to control this risk through counterparty credit requirements and the use of Commodity Futures Trading Commission approved futures and exchange traded options. The System anticipates that the counterparties will be able to satisfy their obligations under the contracts.

### 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, 2005.

### 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 Benefits 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



# Notes to the Basic Financial Statements

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dependents of these retirees are also covered. As of August 31, 2005, there were 72,152 eligible retirees and surviving spouses, plus approximately 32,900 dependents.

Figure O 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 O**  
**State Contribution Rates -**  
**Retiree Health and Basic Life Premium -**  
**Fiscal Year 2005**

	September 1, 2004
	\$
Retiree Only	315.56
Retiree & Spouse	495.73
Retiree & Children	436.19
Retiree & Family	616.36

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

**Figure P**  
**Contributions by Source and Claims Expenses -**  
**Retirees**

	August 31,	
	2005	2004
	\$	\$
State Contributions	306,854,229	286,029,756
Retiree Contributions	92,853,754	88,467,593
<b>Total Contributions</b>	<b>399,707,983</b>	<b>374,497,349</b>
<b>Claims Expenses</b>	<b>439,171,027</b>	<b>402,224,473</b> (Note A)

Note A: Claims Expenses totaling \$46,407 in 2004 have been reclassified.

## 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. Current year expenses for these leased

assets totaled \$734,961. A schedule of future minimum lease rental payments on non-cancelable operating leases as of August 31, 2005 is presented in Figure Q.

**Figure Q**  
**Non-Cancelable Operating Leases**

Fiscal Year	Future Minimum Lease Rental Payments
	\$
2006	499,569
2007	223,982
2008	19,009
<b>Total Future Minimum Lease Rental Payments</b>	<b>742,560</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, 2005 and 2004 is presented in Figure R.

**Figure R**  
**Net Assets - Fiduciary Funds**

Fund Type	Totals - August 31	
	2005	2004
	\$	\$
Defined Benefit Plans (Note A)	21,292,482,585	19,567,749,457
<i>Defined Contribution Plans and Cafeteria Plan:</i>		
Plan 457 Participants	292,946,379	255,418,432
Administration - Defined Contribution Plans	1,517,834	1,854,808
Administration - State Employees Cafeteria Plan	2,025,676	2,060,673
<b>Total Defined Contribution Plans and Cafeteria Plan</b>	<b>296,489,889</b>	<b>259,333,913</b>
<b>Total Fiduciary Net Assets Held In Trust for Pension Benefits and Other Purposes</b>	<b>21,588,972,474</b>	<b>19,827,083,370</b>
	(Exh. VIII)	
Note A: See Note 3.C, Reserves, for details of the statutorily required reserve balances of the Defined Benefit Plans.		

## D. Interfund Receivables and Payables (In accordance with GASB Statement 38)

At year-end, accruals related to interfund transfers and interfund reimbursements between the System's funds, are reported as Due From External Parties or Due To External Parties in the government-wide *Statement of Net Assets* and as Due From Other Funds or Due To Other Funds in the fund financial statements. (See Note 1.G)



# Notes to the Basic Financial Statements

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Figure S presents individual interfund receivable and interfund payable balances at August 31, 2005.

**Figure S**  
**Interfund Receivables and Payables**

	Due From Other Funds	Due To Other Funds
<b>Governmental Activities:</b>	\$	\$
Nonmajor Governmental Funds		4,533
<i>Proprietary Fund:</i>		
Employees Life, Accident and Health Insurance and Benefits Fund		
Agency 327, Fund 955		846,360
<b>Total Governmental Activities</b>	-	<b>850,893</b>
<b>Fiduciary Funds:</b>		
Pension and Other Employee Benefit Trust Funds	1,239,695	388,802
<b>Total - Interfund Receivables and Payables</b>	<b>1,239,695</b>	<b>1,239,695</b>

## E. Interfund Transfers

(In accordance with GASB Statement 38)

Interfund Transfers include transfers of membership fees from the Employees Retirement Fund to other funds of the System and transfers between the Employees Retirement Fund and the Excess Benefit Arrangement Fund for retirement benefit payments. (See Note 1.G).

Interfund Transfers between Governmental Activities and fiduciary funds are reclassified to revenues and expenses in the government-wide *Statement of Activities*.

Figure T presents interfund transfers for the year ended August 31, 2005.

**Figure T**  
**Interfund Transfers**

	Transfers In	Transfers Out
<i>Fiduciary Funds:</i>	\$	\$
Pension and Other Employee Benefit Trust Funds	657,051	657,051
<b>Total - Interfund Transfers</b>	<b>657,051</b>	<b>657,051</b>

## F. Interagency Transfers

Interagency Transfers include transfers between the System's funds and other funds of the State of Texas reporting entity that are for payment of benefits from the Compensation to Victims of Crime fund that are funded by the Office of the Attorney General. (See Note 1.G). Also included in this category is the amount transferred to the Teacher Retirement System for service established in the

Employees Retirement Fund and payable from the Excess Benefit Arrangement Fund.

Interagency Transfers between Governmental Activities and other funds of the State are reclassified to revenues and expenses in the government-wide *Statement of Activities*.

Figure U presents interagency transfers for the year ended August 31, 2005.

**Figure U**  
**Interagency Transfers**

	Transfers In	Transfers Out
<b>Governmental Activities:</b>	\$	\$
Nonmajor Governmental Funds	1,250,000	
<b>Total Governmental Activities</b>	<b>1,250,000</b>	-
<b>Fiduciary Funds:</b>		
Pension and Other Employee Benefit Trust Funds		63,567
<b>Total - Interagency Transfers</b>	<b>1,250,000</b>	<b>63,567</b>

## 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.



# Required Supplementary Information (Unaudited)

## Schedule of Funding Progress – Pension Trust Funds

Fiscal Year	(a) Actuarial Value of Assets (000's)	(b) Actuarial Accrued Liability (AAL) (000's)	(c) (Overfunded) Unfunded AAL (UAAL) (b) - (a) (000's)	(d) Funded Ratio (a) / (b)	(e) Covered Payroll (000's)	(f) UAAL As A Percentage Of Covered Payroll ((b-a) / e)
<b>Employees Retirement System (ERS)</b>						
2000	\$ 17,416,036	\$ 16,176,616	\$ (1,239,420)	107.7 %	\$ 4,680,182	(26.5)
2001	18,394,458	17,527,696	(866,762)	104.9	4,946,244	(17.5)
2002	18,909,072	18,449,521	(459,551)	102.5	4,979,532	(9.2)
2003	19,478,555	19,959,112	480,557	97.6	4,800,612	10.0
2004	20,036,647	20,591,848	555,201	97.3	4,616,761	12.0
2005	20,835,469	21,969,670	1,134,201	94.8	4,842,525	23.4
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>						
2000	\$ 619,218	\$ 547,767	\$ (71,451)	113.0 %	\$ 1,265,797	(5.6)
2001	647,757	492,127	(155,630)	131.6	1,291,750	(12.0)
2002	655,979	526,205	(129,774)	124.7	1,298,593	(10.0)
2003	666,588	597,914	(68,674)	111.5	1,277,894	(5.4)
2004	679,243	621,457	(57,786)	109.3	1,230,581	(4.7)
2005	698,814	677,953	(20,861)	103.1	1,283,815	(1.6)
<b>Judicial Retirement System Plan One (JRS I)</b>						
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	4,089.3
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
2005	0	327,145	327,145	0.0	5,284	6,191.2
<b>Judicial Retirement System Plan Two (JRS II)</b>						
2000	\$ 86,962	\$ 81,417	\$ (5,545)	106.8 %	\$ 41,419	(13.4)
2001	101,327	92,490	(8,837)	109.6	44,490	(19.9)
2002	114,433	103,229	(11,204)	110.9	45,965	(24.4)
2003	129,426	111,116	(18,310)	116.5	47,479	(38.6)
2004	145,538	123,913	(21,625)	117.5	48,504	(44.6)
2005	164,231	182,311	18,080	90.1	60,775	29.7

## Schedule of Employer Contributions – Pension Trust Funds

Fiscal Year	Annual Required Contribution (ARC)	Percentage Contributed	Annual Required Contribution (ARC)	Percentage Contributed
<b>Employees Retirement System (ERS)</b>			<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>	
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
2005	321,859,685	85.8	0	100.0
2006	360,138,599 (Note A)	N/A	0	N/A
<b>Judicial Retirement System Plan One (JRS I)</b>			<b>Judicial Retirement System Plan Two (JRS II)</b>	
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
2005	22,121,567	100.8	5,722,632	146.2
2006	27,298,940	N/A	10,228,484 (Note A)	N/A

Note A: Calculations based on estimated fiscal year 2006 covered payroll. At the end of fiscal year 2006 the ARC will be recalculated based on actual 2006 covered payroll.



## Required Supplementary Information (Unaudited)

### Notes to the Required Supplementary Information

The information presented in these 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, 2005	August 31, 2005	August 31, 2005	August 31, 2005
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	1.0 (Note A)	40.0	26.0 (Note A)
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 Including Inflation at	0.0%-10.8%	6.0%-14.0%	4.0%	4.0%
Cost-of-living Adjustments	None-Employee 4.0%-Elected	None	4.0%	0.0%

Note A: The amortization period was calculated based on estimated fiscal year 2006 covered payroll. At the end of fiscal year 2006 the ARC and the amortization period will be recalculated based on actual 2006 covered payroll.



# Exhibit A-1

## Combining Statement of Fiduciary Net Assets - Pension and Other Employee Benefit Trust Funds - Defined Contribution Plans and Cafeteria Plan August 31, 2005 (With Comparative Totals at August 31, 2004)

	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,	
	\$	\$	\$	\$	2005 (Exh. VIII) \$	2004 \$
<b>ASSETS</b>						
<i>Cash and Short-Term Investments:</i>						
<i>Cash and Cash Equivalents:</i>						
Cash in Bank		1,751,121	1,751,121	751,429	2,502,550	4,798,873
Cash in State Treasury	930,726	650,957	1,581,683	2,916,548	4,498,231	4,032,806
Total Cash and Cash Equivalents	930,726	2,402,078	3,332,804	3,667,977	7,000,781	8,831,679
<i>Short-Term Investments:</i>						
Corporate Equity		133,925,071	133,925,071		133,925,071	90,015,668
Total Short-Term Investments	-	133,925,071	133,925,071	-	133,925,071	90,015,668
Total Cash and Short-Term Investments	930,726	136,327,149	137,257,875	3,667,977	140,925,852	98,847,347
<i>Investments:</i>						
Other Investments		157,592,090	157,592,090		157,592,090	161,810,108
Total Investments	-	157,592,090	157,592,090	-	157,592,090	161,810,108
<i>Receivables:</i>						
Interest and Dividends Receivable	2,371	1,900	4,271	10,700	14,971	6,687
Contributions/Accounts Receivable		6,816	6,816	4,052,643	4,059,459	3,532,298
Total Receivables	2,371	8,716	11,087	4,063,343	4,074,430	3,538,985
Due From Other Funds (Note 1.G)			-		-	1,827
Due From Other Agencies (Note 1.G)			-	2,736	2,736	-
Prepaid Claims Expense			-	479,616	479,616	462,324
<b>Total Assets</b>	<b>933,097</b>	<b>293,927,955</b>	<b>294,861,052</b>	<b>8,213,672</b>	<b>303,074,724</b>	<b>264,660,591</b>
<b>LIABILITIES</b>						
<i>Payables:</i>						
Benefits/Accounts Payable		331,359	331,359	6,158,660	6,490,019	5,236,448
Total Payables	-	331,359	331,359	6,158,660	6,490,019	5,236,448
Due To Other Funds (Note 1.G)	23,762	39,428	63,190	26,960	90,150	90,230
Deferred Revenue		2,290	2,290	2,376	4,666	-
<b>Total Liabilities</b>	<b>23,762</b>	<b>373,077</b>	<b>396,839</b>	<b>6,187,996</b>	<b>6,584,835</b>	<b>5,326,678</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. A-2)</b>	<b>909,335</b>	<b>293,554,878</b>	<b>294,464,213</b>	<b>2,025,676</b>	<b>296,489,889</b>	<b>259,333,913</b>



## Exhibit A-2

### Combining Statement of Changes in Fiduciary Net Assets - Pension and Other Employee Benefit Trust Funds - Defined Contribution Plans and Cafeteria Plan Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	TexaSaver	TexaSaver	Totals	State	Totals	
	401(k)	457	Defined	Employees	August 31,	
	Trust Fund	Trust Fund	Contribution	Cafeteria	2005 (Exh. IX)	2004
	(0946)	(0945)	Plans	Plan Trust		
	(U/F 0946)	(U/F 0945)		Fund (0943)		
	\$	\$	\$	\$	\$	\$
<b>ADDITIONS</b>						
<i>Contributions:</i>						
<i>Member Contributions:</i>						
Plan 457 Deferrals		43,817,151	43,817,151		43,817,151	37,047,181
Plan 457 Rollovers In and Transfers In		39,267,583	39,267,583		39,267,583	56,425,620
Total Plan 457 Contributions	-	83,084,734	83,084,734	-	83,084,734	93,472,801
Cafeteria Plan				52,379,689	52,379,689	43,091,155
Debit Card Fees				364,356	364,356	280,659
Total Cafeteria Plan Contributions	-	-	-	52,744,045	52,744,045	43,371,814
Total Member Contributions	-	83,084,734	83,084,734	52,744,045	135,828,779	136,844,615
Settlement Revenue	13,000	5,000	18,000		18,000	1,326,352
<i>Other Contributions:</i>						
Cafeteria Plan Forfeitures				680,932	680,932	468,315
Total Contributions	13,000	83,089,734	83,102,734	53,424,977	136,527,711	138,639,282
<i>Investment Income:</i>						
<i>From Investing Activities:</i>						
Net Appreciation		15,954,435	15,954,435		15,954,435	16,431,957
Interest & Dividends	28,830	6,518,477	6,547,307	39,658	6,586,965	17,573,890
Total Investing Activity Income	28,830	22,472,912	22,501,742	39,658	22,541,400	34,005,847
<i>Other Additions:</i>						
<i>Other Revenue:</i>						
Financial Processing Error Penalty						6,000
Miscellaneous Revenue	15,733	2,576	18,309	74,721	93,030	186,331
Administration Fees	37,660	111,773	149,433		149,433	-
Total Other Revenue	53,393	114,349	167,742	74,721	242,463	192,331
<i>Transfers In (Note 1.G):</i>						
Membership Fees	100,000		100,000	333,815	433,815	434,430
Total Other Additions	153,393	114,349	267,742	408,536	676,278	626,761
<b>Total Additions</b>	<b>195,223</b>	<b>105,676,995</b>	<b>105,872,218</b>	<b>53,873,171</b>	<b>159,745,389</b>	<b>173,271,890</b>
<b>DEDUCTIONS</b>						
<i>Benefits:</i>						
Plan 457 Distributions (Includes Withholding Taxes)		24,394,436	24,394,436		24,394,436	41,851,036
Plan 457 Fees		425,088	425,088		425,088	604,008
Plan 457 Rollovers Out and Transfers Out		43,190,582	43,190,582		43,190,582	67,071,521
Total Plan 457 Benefits	-	68,010,106	68,010,106	-	68,010,106	109,526,565
Cafeteria Plan Reimbursement Claims				52,336,797	52,336,797	42,886,292
Total Benefits	-	68,010,106	68,010,106	52,336,797	120,346,903	152,412,857
<i>Administrative Expenses:</i>						
Salaries & Wages	175,421	290,854	466,275	184,597	650,872	747,120
Payroll Related Costs	40,416	68,525	108,941	46,016	154,957	181,860
Professional Fees & Services	6,290	4,212	10,502	4,564	15,066	20,969
Travel	1,091	1,220	2,311	747	3,058	4,027
Materials & Supplies	2,502	11,301	13,803	19,110	32,913	39,234
Communications & Utilities	3,146	6,056	9,202	8,683	17,885	17,420
Repairs & Maintenance	12,418	17,931	30,349	23,441	53,790	37,537
Rentals & Leases	8,637	10,864	19,501	12,943	32,444	30,104
Printing & Reproduction	21	271	292	1,273	1,565	1,463
Interest Expense				37,297	37,297	5,513
<i>Other Operating Expenses:</i>						
Other Expenses	3,346	6,617	9,963	12,207	22,170	28,269
Third Party Administrator Fees				856,137	856,137	698,745
Debit Card Fees				364,356	364,356	280,659
Total Other Operating Expenses	3,346	6,617	9,963	1,232,700	1,242,663	1,007,673
Total Administrative Expenses	253,288	417,851	671,139	1,571,371	2,242,510	2,092,920
<b>Total Deductions</b>	<b>253,288</b>	<b>68,427,957</b>	<b>68,681,245</b>	<b>53,908,168</b>	<b>122,589,413</b>	<b>154,505,777</b>
<b>Net Increase (Decrease)</b>	<b>(58,065)</b>	<b>37,249,038</b>	<b>37,190,973</b>	<b>(34,997)</b>	<b>37,155,976</b>	<b>18,766,113</b>
<b>NET ASSETS</b>						
<b>Net Assets Held in Trust for Pension Benefits</b>						
<b>and Other Purposes:</b>						
Beginning of Year	967,400	256,305,840	257,273,240	2,060,673	259,333,913	240,567,800
End of Year (Exh. A-1)	909,335	293,554,878	294,464,213	2,025,676	296,489,889	259,333,913





# Schedule 1

## Revenues, Expenses and Changes in Statutory Account Balances (Non-GAAP Presentation) - Employees Retirement Fund Year Ended August 31, 2005

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2005
	\$	\$	\$	\$	\$	\$
<b>OPERATING REVENUES</b>						
Contributions to Retirement System:						
Member Contributions	305,869,798					305,869,798
State Contributions		276,034,664				276,034,664
Service Contributions from Teacher Retirement System		41,200,491				41,200,491
Membership Fees					435,760	435,760
Penalty Interest		8,383,482				8,383,482
Investment Income:						
Net Appreciation in Fair Value of Investments				1,718,194,812		1,718,194,812
Interest and Dividends				629,968,645		629,968,645
Rental Income					31,000	31,000
Warrants Voided by Statute of Limitations		103,653				103,653
Sale of Surplus Equipment					47,357	47,357
Miscellaneous					6,235	6,235
<b>Total Operating Revenues</b>	<b>305,869,798</b>	<b>325,722,290</b>	<b>-</b>	<b>2,348,163,457</b>	<b>520,352</b>	<b>2,980,275,897</b>
<b>OPERATING EXPENSES</b>						
Retirement System Benefits Paid:						
Retirement Benefits			1,200,373,003			1,200,373,003
Death Benefits:						
Active Members		882,372				882,372
Retirees		184,190	971,953			1,156,143
Member Contributions Withdrawn	89,759,681					89,759,681
Service Contributions to Teacher Retirement System		6,188,845				6,188,845
Administrative Expenses					29,536,823	29,536,823
Depreciation Expense					757,703	757,703
<b>Total Operating Expenses</b>	<b>89,759,681</b>	<b>7,255,407</b>	<b>1,201,344,956</b>	<b>-</b>	<b>30,294,526</b>	<b>1,328,654,570</b>
<b>Income (Loss) Before Non-Operating Expenses and Operating Transfers</b>	<b>216,110,117</b>	<b>318,466,883</b>	<b>(1,201,344,956)</b>	<b>2,348,163,457</b>	<b>(29,774,174)</b>	<b>1,651,621,327</b>
<b>NON-OPERATING REVENUES (EXPENSES)</b>						
Loss on Disposal of Fixed Assets					(1,575)	(1,575)
<b>Income (Loss) Before Operating Transfers</b>	<b>216,110,117</b>	<b>318,466,883</b>	<b>(1,201,344,956)</b>	<b>2,348,163,457</b>	<b>(29,775,749)</b>	<b>1,651,619,752</b>
<b>OPERATING TRANSFERS IN (OUT)</b>						
Distribution of Interest	168,562,240	1,336,355,530	803,830,996	(2,308,748,766)		-
Interest Paid on Withdrawals	8,953,435			(8,953,435)		-
Establishment of Benefit Reserves	(254,539,901)	(867,106,702)	1,121,646,603			-
Member Savings Reinstated	39,045	(39,045)				-
Distribution of Interest for Administrative Expenses				(30,461,256)	30,461,256	-
Benefits Waived		42,395	(42,395)			-
Member Accounts - Escheated	(1,146,303)	1,146,303				-
Membership Fees Transferred Out					(433,815)	(433,815)
Excess Benefit Arrangement Transfers					(223,236)	(223,236)
<b>Net Operating Transfers</b>	<b>(78,131,484)</b>	<b>470,398,481</b>	<b>1,925,435,204</b>	<b>(2,348,163,457)</b>	<b>29,804,205</b>	<b>(657,051)</b>
<b>Net Income</b>	<b>137,978,633</b>	<b>788,865,364</b>	<b>724,090,248</b>	<b>-</b>	<b>28,456</b>	<b>1,650,962,701</b>
<b>Account Balances - Beginning</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>
<b>Account Balances - Ending</b>	<b>3,581,186,131</b>	<b>5,981,451,720</b>	<b>10,886,033,918</b>	<b>-</b>	<b>28,456</b>	<b>20,448,700,225</b>



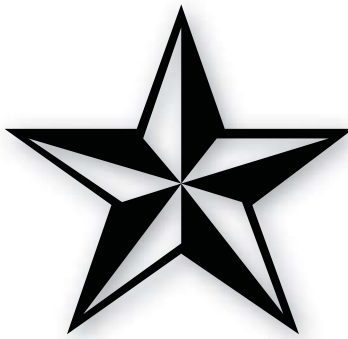
## Schedule 2

### Revenues, Expenses and Changes in Statutory Account Balances

(Non-GAAP Presentation) - Law Enforcement and Custodial Officer Supplemental Retirement Fund

Year Ended August 31, 2005

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2005
	\$	\$	\$	\$	\$	\$
<b>OPERATING REVENUES</b>						
Investment Income:						
Net Appreciation in Fair Value of						
Investments				57,872,270		57,872,270
Interest and Dividends				21,182,762		21,182,762
Warrants Voided by Statute of Limitations		299				299
<b>Total Operating Revenues</b>	-	<b>299</b>	-	<b>79,055,032</b>	-	<b>79,055,331</b>
<b>OPERATING EXPENSES</b>						
Retirement System Benefits Paid:						
Retirement Benefits			29,036,299			29,036,299
Administrative Expenses					1,131,784	1,131,784
<b>Total Operating Expenses</b>	-	-	<b>29,036,299</b>	-	<b>1,131,784</b>	<b>30,168,083</b>
<b>Income (Loss) Before Operating Transfers</b>	-	<b>299</b>	<b>(29,036,299)</b>	<b>79,055,032</b>	<b>(1,131,784)</b>	<b>48,887,248</b>
<b>OPERATING TRANSFERS IN (OUT)</b>						
Distribution of Interest		59,230,649	18,692,599	(77,923,248)		-
Establishment of Benefit Reserves		(28,098,124)	28,098,124			-
Distribution of Interest for						
Administrative Expenses				(1,131,784)	1,131,784	-
<b>Net Operating Transfers</b>	-	<b>31,132,525</b>	<b>46,790,723</b>	<b>(79,055,032)</b>	<b>1,131,784</b>	-
<b>Net Income</b>	-	<b>31,132,824</b>	<b>17,754,424</b>	-	-	<b>48,887,248</b>
<b>Account Balances - Beginning</b>	<b>5,275</b>	<b>400,086,645</b>	<b>233,720,473</b>	-	-	<b>633,812,393</b>
<b>Account Balances - Ending</b>	<b>5,275</b>	<b>431,219,469</b>	<b>251,474,897</b>	-	-	<b>682,699,641</b>





## Schedule 3

### Revenues, Expenses and Changes in Statutory Account Balances (Non-GAAP Presentation) - Judicial Retirement System Plan Two Fund Year Ended August 31, 2005

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2005
	\$	\$	\$	\$	\$	\$
<b>OPERATING REVENUES</b>						
Contributions to Retirement System:						
Member Contributions	2,985,326					2,985,326
State Contributions		8,364,714				8,364,714
Penalty Interest		10,888				10,888
Investment Income:						
Net Appreciation in Fair Value of Investments				12,721,298		12,721,298
Interest and Dividends				4,731,097		4,731,097
<b>Total Operating Revenues</b>	<b>2,985,326</b>	<b>8,375,602</b>	<b>-</b>	<b>17,452,395</b>	<b>-</b>	<b>28,813,323</b>
<b>OPERATING EXPENSES</b>						
Retirement System Benefits Paid:						
Retirement Benefits			3,307,938			3,307,938
Death Benefits:						
Active Members		9,842				9,842
Member Contributions Withdrawn	106,095					106,095
Administrative Expenses					506,269	506,269
<b>Total Operating Expenses</b>	<b>106,095</b>	<b>9,842</b>	<b>3,307,938</b>	<b>-</b>	<b>506,269</b>	<b>3,930,144</b>
<b>Income (Loss) Before Operating Transfers</b>	<b>2,879,231</b>	<b>8,365,760</b>	<b>(3,307,938)</b>	<b>17,452,395</b>	<b>(506,269)</b>	<b>24,883,179</b>
<b>OPERATING TRANSFERS IN (OUT)</b>						
Distribution of Interest	1,879,379	12,709,021	2,347,327	(16,935,727)		-
Interest Paid on Withdrawals	10,399			(10,399)		-
Establishment of Benefit Reserves	(651,592)	(12,393,223)	13,044,815			-
Distribution of Interest for Administrative Expenses				(506,269)	506,269	-
<b>Net Operating Transfers</b>	<b>1,238,186</b>	<b>315,798</b>	<b>15,392,142</b>	<b>(17,452,395)</b>	<b>506,269</b>	<b>-</b>
<b>Net Income</b>	<b>4,117,417</b>	<b>8,681,558</b>	<b>12,084,204</b>	<b>-</b>	<b>-</b>	<b>24,883,179</b>
<b>Account Balances - Beginning</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>
<b>Account Balances - Ending</b>	<b>37,291,238</b>	<b>82,119,440</b>	<b>41,672,041</b>	<b>-</b>	<b>-</b>	<b>161,082,719</b>



# Schedule 4

## Combining Schedule of Administrative and Investment Expenses/Expenditures Statutory Administrative Funds and Accounts

Year Ended August 31, 2005

	Administrative Expenses- Non-Investment	Administrative Expenses- Investment
	\$	\$
<b><u>PERSONNEL SERVICES</u></b>		
Salaries and Wages	12,184,082	2,251,471
Payroll Related Costs:		
Retirement Contributions	705,215	116,650
Retirement Membership Fees	793	84
Employees Insurance Contributions	1,119,303	133,168
Retirees Insurance Contributions	379,560	
Social Security Contributions	883,933	141,404
Unemployment Compensation	12,625	
Total Payroll Related Costs	<u>3,101,429</u>	<u>391,306</u>
<b>Total Personnel Services</b>	<b><u>15,285,511</u></b>	<b><u>2,642,777</u></b>
<b><u>PROFESSIONAL FEES AND SERVICES</u></b>		
Actuarial Services	1,349,939	
Audit Services	315,300	
Investment Consulting Fees		133,968
Investment Advisor Fees		13,175,143
Medical Board Member Fees	104,600	
Architectural Services	47,137	
Legal Services	6,073	
Computer Programming Services	1,501,933	
Other Professional Services	268,274	
<b>Total Professional Fees and Services</b>	<b><u>3,593,256</u></b>	<b><u>13,309,111</u></b>
<b><u>OTHER SERVICES AND CHARGES</u></b>		
Travel	66,109	85,634
Materials and Supplies:		
Postage	588,408	
General Office and Other Supplies	179,883	45
Subscriptions	28,220	6,592
Furniture and Equipment	493,484	8,227
Computer Software	96,804	
Total Materials and Supplies	<u>1,386,799</u>	<u>14,864</u>
Communications and Utilities:		
Electricity, Gas and Water	293,787	
Telephone and Telegraph	249,223	
Electronic Communications Services	62,418	1,130,949
Total Communications and Utilities	<u>605,428</u>	<u>1,130,949</u>
Repairs and Maintenance:		
Land and Building	544,033	
Furniture and Equipment	23,648	
Computer Software and Equipment	1,235,246	98,660
Total Repairs and Maintenance	<u>1,802,927</u>	<u>98,660</u>
Rentals and Leases:		
Computer Software and Equipment	917,073	
Office Equipment	230,184	
Space	15,597	
Total Rentals and Leases	<u>1,162,854</u>	-
Printing and Reproduction Services	72,477	
Depreciation	757,703	
Bad Debt Expense		365
Interest Expense	38,233	

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## Schedule 4

### Combining Schedule of Administrative and Investment Expenses/Expenditures Statutory Administrative Funds and Accounts (Concluded)

Year Ended August 31, 2005

	Administrative Expenses- Non-Investment	Administrative Expenses- Investment
	\$	\$
<b><i>OTHER SERVICES AND CHARGES (continued)</i></b>		
Other Operating Expenses/Expenditures:		
Membership Fees	16,217	31,793
Employee Training	82,052	16,844
Insurance - Building and Vehicle	28,908	
Fees and Other Charges	14,240	4,710
Investment Banking		517,306
Tenure Awards	1,229	
Witness Fees	1,200	
Temporary Employment Agencies	188,600	5,535
Cleaning Services	82,711	
Advertising Services	21,893	
Freight/Delivery Services	8,036	
Purchased Contracted Services	390,343	80
Prompt Payment Interest	190	
Claims & Judgments	1,337	
Third Party Administrator Fee - Cafeteria Plan	856,137	
Debit Card Fees - Cafeteria Plan	364,356	
Total Other Operating Expenses/Expenditures	<u>2,057,449</u>	<u>576,268</u>
<b>Total Other Services and Charges</b>	<b>7,949,979</b>	<b>1,906,740</b>
<b>Total Expenses/Expenditures</b>	<b>26,828,746</b>	<b>17,858,628</b>
<b>Method of Finance:</b>		
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	13,219,650	17,074,876
Law Enforcement and Custodial Officer Supplemental Ret. Trust Fund (0977)	520,982	610,802
Judicial Retirement System Plan One Fund (0001)	120,000	
Judicial Retirement System Plan Two Trust Fund (0993)	401,819	104,450
TexaSaver 401(k) Trust Fund (0946)	253,288	
TexaSaver 457 Trust Fund (0945)	417,851	
State Employees Cafeteria Plan Trust Fund (0943)	1,571,371	
<b>Total Fiduciary Funds</b>	<b>16,504,961</b>	<b>17,790,128</b>
Employees Life, Accident, Health Insurance and Benefits Trust Account (0973)	10,243,728	68,500
<b>Total Proprietary Fund</b>	<b>10,243,728</b>	<b>68,500</b>
Social Security Administration Trust Account (0929)	52,057	
Death Benefits for Certain Law Enforce. Officers, Fire Fighters and Others (0001)	28,000	
<b>Total Governmental Funds</b>	<b>80,057</b>	<b>-</b>
<b>Total Method of Finance</b>	<b>26,828,746</b>	<b>17,858,628</b>



## Schedule 5

### Professional and Consulting Fees

Year Ended August 31, 2005

<b><u>NATURE OF SERVICE</u></b>	<b><u>Totals</u></b>
	<b>\$</b>
Medical Board	104,600
Investment Consulting	133,968
Investment Advisors	13,175,143
Actuarial Services - Retirement	713,259
Actuarial Services - Insurance	636,680
Computer Programming Services	1,501,933
Audit Fees - Financial	82,300
Audit Fees - Insurance Carrier	154,000
Audit Fees - Other	79,000
Educational Services	42,779
Architectural Services	47,137
Legal Services	6,073
Employee Compensation Review	37,313
Engineering Consulting	32,108
Fiduciary Counsel	21,996
Security Consulting	21,108
Group Benefits Plan Review	78,121
Employee Assistance Program	3,499
Other Professional Services	31,350
<b>Total Professional and Consulting Fees</b>	<b><u>16,902,367</u></b>
<b>Method of Finance:</b>	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	15,027,141
Law Enforcement and Custodial Officer Supplemental Ret. Trust Fund (0977)	610,197
Judicial Retirement System Plan One Fund (0001)	49,184
Judicial Retirement System Plan Two Trust Fund (0993)	212,694
Texa\$aver 401(k) Trust Fund (0946)	6,290
Texa\$aver 457 Trust Fund (0945)	4,212
State Employees Cafeteria Plan Trust Fund (0943)	4,564
<b>Total Fiduciary Funds</b>	<b><u>15,914,282</u></b>
Employees Life, Accident, Health Insurance and Benefits Trust Account (0973)	987,784
<b>Total Proprietary Fund</b>	<b><u>987,784</u></b>
Social Security Administration Fund (0929)	301
<b>Total Governmental Funds</b>	<b><u>301</u></b>
<b>Total Method of Finance</b>	<b><u>16,902,367</u></b>



## Schedule 6

### Combining Balance Sheet – Nonmajor Governmental Funds

August 31, 2005

	Social Security Administration Fund (0929) (U/F 0929)	Death Benefits Program for Commissioned Peace Officers, Firemen, etc. (0001) (U/F 3001)	Compensation to Victims of Crime (0469) (U/F 3003)	Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008)	Nonmajor Special Revenue Funds Totals August 31, 2005
	\$	\$	\$	\$	\$
<b>ASSETS</b>					
<b>Current Assets:</b>					
<i>Cash and Cash Equivalents:</i>					
Cash in State Treasury	12,259				12,259
Total Cash and Cash Equivalents	12,259	-	-	-	12,259
Legislative Appropriations				9,146	9,146
Accounts Receivable	16,510				16,510
Total Current Assets	28,769	-	-	9,146	37,915
<b>Total Assets</b>	<b>28,769</b>	<b>-</b>	<b>-</b>	<b>9,146</b>	<b>37,915</b>
<b>LIABILITIES &amp; FUND BALANCES</b>					
<b>Current Liabilities:</b>					
<i>Payables:</i>					
Accounts Payable				5,746	5,746
Due To Other Funds	4,533				4,533
Deferred Revenues	1,016				1,016
Total Current Liabilities	5,549	-	-	5,746	11,295
<b>Total Liabilities</b>	<b>5,549</b>	<b>-</b>	<b>-</b>	<b>5,746</b>	<b>11,295</b>
<b>Fund Balances:</b>					
<i>Unreserved:</i>					
Undesignated, Reported In:					
Special Revenue Funds	23,220	-	-	3,400	26,620
<b>Total Fund Balances</b>	<b>23,220</b>	<b>-</b>	<b>-</b>	<b>3,400</b>	<b>26,620</b>
<b>Total Liabilities &amp; Fund Balances</b>	<b>28,769</b>	<b>-</b>	<b>-</b>	<b>9,146</b>	<b>37,915</b>





# Schedule 7

## Combining Schedule of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds

Year Ended August 31, 2005

	Social Security Administration Fund (0929) (U/F 0929) \$	Death Benefits Program for Commissioned Peace Officers, Firemen, etc. (0001) (U/F 3001) \$	Compensation to Victims of Crime (0469) (U/F 3003) \$	Lump Sum Retiree Death Benefit Fund (0001) (U/F 3008) \$	Nonmajor Special Revenue Funds Totals August 31, 2005 \$
<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
For Public Employee Survivors		2,711,951			2,711,951
For Death Benefits-Retirees				6,556,164	6,556,164
Total Original Appropriations	-	2,739,951	-	6,556,164	9,296,115
Additional Appropriations Revenue:					
For Public Employee Survivors		(79,496)			(79,496)
For Death Benefits-Retirees				473,530	473,530
Total Additional Appropriations	-	(79,496)	-	473,530	394,034
Administration Fees	72,716				72,716
<b>Total Revenues</b>	<b>72,716</b>	<b>2,660,455</b>	<b>-</b>	<b>7,029,694</b>	<b>9,762,865</b>
<b>EXPENDITURES</b>					
<i>Current:</i>					
Death Benefits		2,632,455	1,250,000	7,026,294	10,908,749
<i>Administrative Expenditures:</i>					
Salaries & Wages	41,129				41,129
Payroll Related Costs	9,188	348			9,536
Professional Fees & Services	301				301
Travel	254				254
Materials & Supplies	540	27,652			28,192
Communications & Utilities	61				61
Printing & Reproduction	4				4
Other Expenditures	580				580
Total Administrative Expenditures	52,057	28,000	-	-	80,057
<b>Total Expenditures</b>	<b>52,057</b>	<b>2,660,455</b>	<b>1,250,000</b>	<b>7,026,294</b>	<b>10,988,806</b>
<b>Excess (Deficiency) of Revenues over Expenditures Before Other Financing Sources</b>					
	<b>20,659</b>	<b>-</b>	<b>(1,250,000)</b>	<b>3,400</b>	<b>(1,225,941)</b>
<b>OTHER FINANCING SOURCES</b>					
Transfers In-From Other State Agencies			1,250,000		1,250,000
<b>Total Other Financing Sources</b>	<b>-</b>	<b>-</b>	<b>1,250,000</b>	<b>-</b>	<b>1,250,000</b>
<b>Excess of Revenues over Expenditures and Other Financing Sources</b>					
	<b>20,659</b>	<b>-</b>	<b>-</b>	<b>3,400</b>	<b>24,059</b>
<b>Fund Balances - Beginning</b>	<b>2,561</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,561</b>
<b>Fund Balances - Ending</b>	<b>23,220</b>	<b>-</b>	<b>-</b>	<b>3,400</b>	<b>26,620</b>



## Schedule 8

### Combining Schedule of Fiduciary Net Assets – Agency Funds

August 31, 2005

	Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)	Employee Savings Bond Fund (0901) (U/F 0901)	TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942/8942)	Totals August 31, 2005
<b>ASSETS</b>	\$	\$	\$	\$
<b>Current Assets:</b>				
<i>Cash and Cash Equivalents:</i>				
Cash in State Treasury		150	227,271	227,421
Total Cash and Cash Equivalents	-	150	227,271	227,421
Accounts Receivable	2,082			2,082
<b>Total Current Assets</b>	<b>2,082</b>	<b>150</b>	<b>227,271</b>	<b>229,503</b>
<b>Total Assets</b>	<b>2,082</b>	<b>150</b>	<b>227,271</b>	<b>229,503</b>
<b>LIABILITIES</b>				
<b>Current Liabilities:</b>				
Accounts Payable	2,082	150		2,232
Funds Held For Others			227,271	227,271
<b>Total Current Liabilities</b>	<b>2,082</b>	<b>150</b>	<b>227,271</b>	<b>229,503</b>
<b>Total Liabilities</b>	<b>2,082</b>	<b>150</b>	<b>227,271</b>	<b>229,503</b>
<b>Net Assets</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>



# Schedule 9

## Combining Schedule of Changes in Assets and Liabilities – Agency Funds

Year Ended August 31, 2005

	Beginning Balances	Additions	Deductions	Ending Balances
	\$	\$	\$	\$
<b>Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)</b>				
<b>ASSETS</b>				
Cash in State Treasury	-	61,701	61,701	-
Accounts Receivable	8,305	79,758	85,981	2,082
<b>Total Assets</b>	<b>8,305</b>	<b>141,459</b>	<b>147,682</b>	<b>2,082</b>
<b>LIABILITIES</b>				
Accounts Payable	8,305	79,876	86,099	2,082
<b>Total Liabilities</b>	<b>8,305</b>	<b>79,876</b>	<b>86,099</b>	<b>2,082</b>
<b>Employee Savings Bond Fund (0901) (U/F 0901)</b>				
<b>ASSETS</b>				
Cash in State Treasury	250	1,700	1,800	150
<b>Total Assets</b>	<b>250</b>	<b>1,700</b>	<b>1,800</b>	<b>150</b>
<b>LIABILITIES</b>				
Accounts Payable	250	1,700	1,800	150
Vouchers Payable	-	1,800	1,800	-
<b>Total Liabilities</b>	<b>250</b>	<b>3,500</b>	<b>3,600</b>	<b>150</b>
<b>TexaSaver 401(k) Trust Fund (0946) (U/F 1946)</b>				
<b>ASSETS</b>				
Cash in Bank	4,591	114,418,954	114,423,545	-
<b>Total Assets</b>	<b>4,591</b>	<b>114,418,954</b>	<b>114,423,545</b>	<b>-</b>
<b>LIABILITIES</b>				
Funds Held For Others	4,591	114,418,954	114,423,545	-
<b>Total Liabilities</b>	<b>4,591</b>	<b>114,418,954</b>	<b>114,423,545</b>	<b>-</b>
<b>TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942 &amp; 8942)</b>				
<b>ASSETS</b>				
Cash in State Treasury	163,562	63,709		227,271
Accounts Receivable	7,685		7,685	-
<b>Total Assets</b>	<b>171,247</b>	<b>63,709</b>	<b>7,685</b>	<b>227,271</b>
<b>LIABILITIES</b>				
Funds Held For Others	171,247	56,024		227,271
<b>Total Liabilities</b>	<b>171,247</b>	<b>56,024</b>	<b>-</b>	<b>227,271</b>
<b>Direct Deposit Correction Account (0980) (U/F 0980)</b>				
<b>ASSETS</b>				
Cash in State Treasury	466	286,365	286,831	-
<b>Total Assets</b>	<b>466</b>	<b>286,365</b>	<b>286,831</b>	<b>-</b>
<b>LIABILITIES</b>				
Funds Held For Others	466	286,831	287,297	-
<b>Total Liabilities</b>	<b>466</b>	<b>286,831</b>	<b>287,297</b>	<b>-</b>
<b>Totals - All Agency Funds</b>				
<b>ASSETS</b>				
Cash in Bank	4,591	114,418,954	114,423,545	-
Cash in State Treasury	164,278	413,475	350,332	227,421
Accounts Receivable	15,990	79,758	93,666	2,082
<b>Total Assets</b>	<b>184,859</b>	<b>114,912,187</b>	<b>114,867,543</b>	<b>229,503</b>
<b>LIABILITIES</b>				
Accounts Payable	8,555	81,576	87,899	2,232
Vouchers Payable	-	1,800	1,800	-
Funds Held For Others	176,304	114,761,809	114,710,842	227,271
<b>Total Liabilities</b>	<b>184,859</b>	<b>114,845,185</b>	<b>114,800,541</b>	<b>229,503</b>



# Notes to the Basic Financial Statements

August 31, 2005

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# Notes to the Basic Financial Statements

August 31, 2005

## 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. New Accounting Pronouncements

Effective September 1, 2004, the System implemented two new statements issued by the GASB.

- In March 2003, the GASB issued Statement No. 40 *Deposit and Investment Risk Disclosures*. GASB 40 amends GASB 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* by expanding the disclosure requirements for credit risk, interest rate risk and foreign currency risk.
- In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*. The adoption of GASB 44 requires some additional information and schedules in the statistical section of the Comprehensive Annual Financial Report (CAFR).

## C. 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 are considered to be *general* revenues/expenses.

Fund financial statements are presented immediately after the government-wide financial statements. These statements present information for nonmajor Governmental Funds in the aggregate, the Internal Service Fund, and the Fiduciary Funds. Fund financial statements have been prepared using the measurement focus appropriate for each type of fund.



# Notes to the Basic Financial Statements

August 31, 2005

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

*Measurement focus* refers to the definition of the resource flows measured. *Basis of accounting* refers to when revenues and expenses are recognized in the accounts and reported in the financial statements.

Special Revenue Funds are accounted for under the modified accrual basis of accounting and current financial resources measurement focus. Under this combination, the financial statements focus on current assets and current liabilities and the changes in net current assets. All revenues reported are recognized based on the criteria of *measurability and availability*. The System considers all revenues reported in the Special Revenue Funds to be *available* if the revenues are due at year-end and collected within 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.

## **E. 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.

Effective in fiscal year 2005, the System reports all of its Special Revenue Funds as nonmajor funds.

- 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 0469,



# Notes to the Basic Financial Statements

August 31, 2005

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**

Internal Service Funds are 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.



# Notes to the Basic Financial Statements

August 31, 2005

## F. 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 and all Special Revenue Funds other than the Social Security Administration 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.

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.

## G. Assets, Liabilities, Fund Balances and Net

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

#### Cash and Temporary Investments

Cash and Cash Equivalents (in accordance with GASB Statement 9), as reported in the *Statement of Cash Flows* for the Internal Service Fund, 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 a local

commercial bank; the TexaSaver 457 Plan accounts are maintained at financial institutions, insurance companies, and mutual fund distributors approved by the System and selected by the plan participants.

#### Valuation

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

#### Investments

##### Valuation

Investments of the Pension Trust Funds and Internal Service Fund are reported at fair value. The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Many factors are considered in arriving at that value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Short-term investments are reported at cost, which approximates fair value.

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

The investments of the Employees Retirement 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





# Notes to the Basic Financial Statements

August 31, 2005

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.

**Figure A  
Capitalization Thresholds and Useful Lives**

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

## Accounts Payable

Accounts Payable under the Internal Service Fund include claims incurred but not reported by the participants prior to fiscal year end and payable in future years as estimated by the System's actuary.

## Employees Compensable Leave

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

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

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

## Net Assets – Held in Trust for Pension Benefits

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

- The Employee Savings Account represents the accumulation of active and inactive member deposits

plus interest.

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



# Notes to the Basic Financial Statements

August 31, 2005

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.

## **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.

## **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.

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.

See Note 5.F Interagency Transfers.

## **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, 2005. 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.D, 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.G, Summary of Significant Accounting Policies,



# Notes to the Basic Financial Statements

August 31, 2005

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, 2004 and 2005, 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.

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



# Notes to the Basic Financial Statements

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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, 2004 and 2005, 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, 2005 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.

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

	ERS	LECOS	JRS I	JRS II
Retirees and beneficiaries currently receiving benefits	65,720	5,070	491	81
Terminated employees entitled to benefits	57,079	12	16	88
Current employees	131,331	37,150	43	491
<b>Total</b>	<b>254,130</b>	<b>42,232</b>	<b>550</b>	<b>660</b>

Note: Estimated based on actuarial valuation as of August 31, 2005.

## C. Reserves (Unaudited)

The balances of legally required reserves in each funded retirement plan as of August 31, 2005 and 2004 are presented in Figure C.

See Note 1.G, 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.

## 3. Pension Plans - Defined Contribution Plan Descriptions and Contributions

### Texa\$aver 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 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 \$293,268,282 as of August 31, 2005.

#### Contributions

As of August 31, 2005, there were 21 System employees

**Figure C**  
**Reserves (Unaudited)**

	ERS	LECOS	JRS II	Totals - August 31,	
				2005	2004
<b>Net Plan Assets Reserved For:</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Employee Savings	3,581,186,131	5,275	37,291,238	3,618,482,644	3,476,386,594
State Accumulation	5,981,451,720	431,219,469	82,119,440	6,494,790,629	5,666,110,883
Annuity Reserves	10,886,033,918	251,474,897	41,672,041	11,179,180,856	10,425,251,980
Administration	28,456			28,456	-
<b>Total Net Plan Assets Reserved</b>	<b>20,448,700,225</b>	<b>682,699,641</b>	<b>161,082,719</b>	<b>21,292,482,585</b>	<b>19,567,749,457</b>
Funded ratios of each plan, from the actuarial valuation:					
As of August 31, 2005	94.8%	103.1%	90.1%		
As of August 31, 2004	97.3%	109.3%	117.5%		



# Notes to the Basic Financial Statements

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participating in the Texa\$aver 457 Plan. During the fiscal year ended August 31, 2005, System employees deferred \$82,973, which includes \$10,465 in retirement incentive rollovers. The State does not contribute to the plan.

## Texa\$aver 401(k) Plan

(In accordance with GASB Statement 25)

### Plan Description

The System also offers to all State employees the Texa\$aver 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, 2005, there were 76 System employees participating in the Texa\$aver 401(k) Plan. During the fiscal year ended August 31, 2005, System employees deferred \$366,178. The State does not contribute to the plan.

## 4. Risk Management

(In accordance with GASB Statement 10)

### A. Risk Exposure

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

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

### B. Risk Financing

Claims for health, life, accidental death and dismemberment (AD & D), disability, and dental insurance coverages are recorded in the Employees Life, Accident and Health Insurance and Benefits Fund under the Texas Employees Group Benefits Program (GBP). 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.

**Figure E**  
**Changes in Self-Funded Claims Liabilities**

	Totals - August 31,	
	2005	2004
	\$	\$
Beginning of Fiscal Year Liability	319,615,852	311,006,003
Current-Year Claims and Changes in Estimates	1,371,322,192	1,279,346,907
Claims Payments	(1,330,518,530)	(1,270,737,058)
<b>Balance at Fiscal Year-End</b>	<b>360,419,514</b>	<b>319,615,852</b>

For coverages that are insured (not self-funded), no



# Notes to the Basic Financial Statements

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significant reductions in insurance coverage occurred in the past year, and settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years.

For both self-funded and insured coverages, the balance of claims that have been incurred but not reported as of August 31, 2005 is \$398,189,000.

## 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, 31 and 40)

See Note 1.G, Investments-Valuations.

#### Deposits

As of August 31, 2005, the total carrying amount of Cash in Bank and Margin Deposits was \$13,585,800 as presented in Figure F.

**Figure F  
Deposits**

Deposits	Carrying Value	Bank Balance
	\$	\$
Cash in Bank:		
Fiduciary Funds:		
Defined Benefit Plans (Exh. X)	9,700	4,511
Defined Contribution Plans and Cafeteria Plan (Exh. A-1)	2,502,550	2,502,550
<b>Total Cash in Bank</b>	<b>2,512,250</b>	<b>2,507,061</b>
Margin Deposit:		
Fiduciary Funds (Exh. X)	11,073,550	11,108,745
<b>Total</b>	<b>13,585,800</b>	<b>13,615,806</b>

#### Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System does not have a deposit policy for custodial credit risk.

As of August 31, 2005, the balances of Cash in Bank and Margin Deposit that were exposed to custodial credit risk are summarized in Figure G.

#### Investments

As of August 31, 2005, the fair value of investments are presented in Figure H.

**Figure G  
Custodial Credit Risk - Deposits**

Deposits	Uninsured and Uncollateralized	Uninsured and Collateralized with Securities Held by the Pledging Bank
	\$	\$
Cash in Bank:		
Fiduciary Funds	3,592	
Margin Deposit:		
Fiduciary Funds		11,108,745

**Figure H  
Investments**

Investment Type	Fair Value	
	Fiduciary Funds (Exh. VIII)	Proprietary Fund (Exh. V)
<i>Investments:</i>	\$	\$
U.S. Treasury Securities	1,586,844,744	113,810,720
U.S. Treasury TIPS	598,820,731	-
U.S. Government Agency Obligations	2,744,154,637	81,302,792
Corporate Obligations	2,777,478,456	99,242,150
Corporate Asset and Mortgage Backed Securities	238,953,043	20,520,892
Domestic Equity	9,109,753,194	-
International Equity	4,116,576,232	-
Annuities	157,592,090	-
<b>Total</b>	<b>21,330,173,127</b>	<b>314,876,554</b>
<i>Short-Term Investments:</i>		
Investment Pool Cash	100,932	-
Repurchase Agreements	100,009,806	-
Short-Term Investment Funds	3,855,886	136,661,499
Money Market Mutual Funds	214,138,421	-
<b>Total</b>	<b>318,105,045</b>	<b>136,661,499</b>
Securities Lending Collateral	4,423,390,863	55,676,502

#### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy limits holding of securities by counterparties to those involved with securities lending and those used as collateral for futures contracts.

Securities the System received as collateral for the securities lending program were uninsured and unregistered, with the securities held by the counterparty



# Notes to the Basic Financial Statements

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or by its trust department or agent, but not in the System's name. As of August 31, 2005, the fair value of these securities are summarized in Figure I.

**Figure I**  
**Custodial Credit Risk - Investments**

Investments	Fair Value
	\$
<i>Fiduciary Funds:</i>	
U.S. Treasury Securities	366,579,179
U.S. Treasury TIPS	98,233,024
U.S. Government Agency Obligations	37,071,808
<b>Total</b>	<b>501,884,011</b>
<i>Proprietary Fund:</i>	
U.S. Treasury Securities	82,434,700
U.S. Government Agency Obligations	17,347,462
<b>Total</b>	<b>99,782,162</b>

## Foreign Currency Risk

Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. The System does not have a policy for managing foreign currency risk.

The System's investment exposure to foreign currency risk as of August 31, 2005 is summarized in Figure J.

**Figure J**  
**Investments Exposed to Foreign Currency Risk**

Foreign Currency	International Equity (US\$)
	\$
<b>Fiduciary Funds:</b>	
Australian Dollar	143,526,718
British Pound	966,358,527
Canadian Dollar	37,356,317
Danish Krone	60,047,544
Euro	1,369,523,364
Hong Kong Dollar	89,034,128
Japanese Yen	729,606,008
Malaysian Ringgit	612
New Zealand Dollar	5,797,488
Norwegian Krone	43,727,751
Singapore Dollar	69,929,449
Swedish Krona	74,801,219
Swiss Franc	253,261,820
<b>Total International Equity Exposed to Foreign Currency Risk</b>	<b>3,842,970,945</b>
ADRs and GDRs Denominated in U.S. Dollars and Classified as International Equity	273,605,287
<b>Total International Equity (Exh. X)</b>	<b>4,116,576,232</b>

## Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policies of the System require that non-cash interest paying securities in the high yield bond portfolios may not exceed 15% of the market value of the portfolio and that investments in money market funds may represent no more than 5% of each individual fund. Credit risk is managed through diversification and by operating within defined parameters versus a benchmark index.

Excluding those securities *issued by or explicitly guaranteed* by the U.S. Government, which are not considered to have credit risk, the System's credit quality distribution for securities with credit risk exposure as of August 31, 2005 is summarized in Figure K. The securities were rated and categorized according to Standard & Poor's rating standards.

**Figure K**  
**Investment Credit Risk**

Investment Type	Rating	Fair Value
		\$
<b>Fiduciary Funds:</b>		
U.S. Government Agency Obligations	AAA	2,534,252,247
	A-1	81,642,466
Corporate Obligations	AAA	95,255,892
	AA	186,884,257
	A	555,284,644
	BBB	403,042,670
	BB	627,591,972
	B	722,516,453
	CCC	33,149,531
	NR	31,596,929
Corporate Asset and Mortgage Back Securities	AAA	216,839,869
	A	26,732,970
	BBB	24,428,561
	BB	7,485,859
	B	13,008,245
	NR	44,792,182
<b>Total</b>		<b>5,604,504,747</b>
<b>Proprietary Fund:</b>		
U.S. Government Agency Obligations	AAA	80,865,746
Corporate Obligations	AAA	10,014,450
	AA	37,011,410
	A	37,540,859
	BBB	13,809,620
Corporate Asset and Mortgage Back Securities	AAA	15,354,191
	AA	1,846,890
	NR	4,158,269
<b>Total</b>		<b>200,601,435</b>



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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 System had no failed securities either during the fiscal year or at August 31, 2005.

## Concentration Risk

Concentration risk is identified by amount and issuer of investment in any one issuer that represent 5% or more of plan net assets. The System's investment policies stipulate that investments in the securities of any one corporation may not exceed 3% of the market value of the total fund. As of August 31, 2005, the System was not exposed to any concentration risk.

## Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System does not have a policy for interest rate risk management. However, interest rate risk is managed through duration, by operating within defined risk parameters versus a benchmark index.

As of August 31, 2005, the System's exposure to interest rate risk is summarized in Figure L.

**Figure L**  
**Investment Interest Rate Risk**

Investment Type	Modified Duration	
	Fiduciary Fund	Proprietary Fund
U.S. Treasury Securities	5.83	3.07
U.S. Treasury TIPS	6.10	-
U.S. Government Agency Obligations	2.93	3.14
Corporate Obligations	4.70	3.04
Corporate Asset and Mortgage Backed Securities	3.62	1.96
Repurchase Agreement	0.01	-
Money Market Funds	0.20	1.32
<b>Overall</b>	<b>4.32</b>	<b>2.55</b>

## 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. 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 net securities lending income totaling \$10,308,561 for the fiscal year ended August 31, 2005. The collateral information as of August 31, 2005 is summarized in Figure M.

## Repurchase Agreements

During the fiscal year 2005, the System invested in repurchase agreements. As of August 31, 2005, the System had a balance totaling \$100,009,806 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 Collateralized Mortgage Obligations (CMOs), which are based on cash flows from interest





# Notes to the Basic Financial Statements

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**Figure M**  
**Securities Lending Collateral Summary**

Investment Type	Underlying Securities Value	Securities Collateral Value	Cash Collateral Value
<i>Fiduciary Funds:</i>	\$	\$	\$
U.S. Treasury Securities	1,497,010,030	373,910,763	1,144,473,035
U.S. Treasury TIPS	407,807,647	100,197,684	312,269,759
U.S. Government Agency Obligations	688,058,320	37,813,244	655,294,860
Corporate Obligations	462,060,279	-	469,367,911
Equity	1,205,497,129	-	1,213,577,747
International Equity	607,228,055	-	628,407,551
<b>Total</b>	<b>4,867,661,460</b>	<b>511,921,691</b>	<b>4,423,390,863</b>
			<b>Exh. X</b>
<i>Proprietary Fund:</i>			
U.S. Treasury Securities	113,811,239	84,083,394	32,045,613
U.S. Government Agency Obligations	23,405,960	17,694,411	6,235,011
Corporate Obligations	17,067,018	-	17,395,878
<b>Total</b>	<b>154,284,217</b>	<b>101,777,805</b>	<b>55,676,502</b>
			<b>Exh. V</b>

payments on underlying mortgages; therefore, they are sensitive to pre-payments by mortgagees that may result from a decline in interest rates. To be eligible for purchase, CMOs will be limited to such securities that exhibit 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 purchases and sells futures contracts as a means of adjusting the portfolio mix and as a lower transaction cost substitute for transactions which would otherwise occur in the underlying portfolios.

A futures contract is a contract to buy or sell units of an index or financial instrument at a specified future date at a price agreed upon when the contract is originated. Upon entering into a futures contract, the System pledges to the broker cash or U.S. government securities equal to the minimum "initial margin" requirement of the futures exchange. The System receives or pays a daily "variation margin," which is an amount of cash equal to the daily fluctuation in value of the contract. The accumulated value of the variation margin is the fair value of the futures contract. As of August 31, 2005, the outstanding

futures contracts are summarized in Figure N.

**Figure N**  
**Summary of Outstanding Futures Contracts**

	No. of Contracts	Notional Amount
		\$
Futures Contracts - Long	1,403	257,267,457
Futures Contracts - Short	4,291	246,486,015
		<b>Fair Value</b>
		\$
Margin Deposit - Cash		18,428,952
Futures Contracts		(7,355,402)
<b>Net Margin Deposit - Cash (Exh. X)</b>		<b>11,073,550</b>
Margin Deposit - Securities (Note A)		41,571,821
<i>Note A: US Treasury TIPS were pledged as margin deposit and reported as U.S. Government and Agency Obligations in the Statement of Net Assets.</i>		

The System could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. The System's investment managers seek to control this risk through counterparty credit requirements and the use of Commodity Futures Trading Commission approved futures and exchange traded options. The System anticipates that the counterparties will be able to satisfy their obligations under the contracts.

### 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, 2005.

### 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 Benefits 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



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dependents of these retirees are also covered. As of August 31, 2005, there were 72,152 eligible retirees and surviving spouses, plus approximately 32,900 dependents.

Figure O 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 O**  
**State Contribution Rates -**  
**Retiree Health and Basic Life Premium -**  
**Fiscal Year 2005**

	September 1, 2004
	\$
Retiree Only	315.56
Retiree & Spouse	495.73
Retiree & Children	436.19
Retiree & Family	616.36

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

**Figure P**  
**Contributions by Source and Claims Expenses -**  
**Retirees**

	August 31,	
	2005	2004
	\$	\$
State Contributions	306,854,229	286,029,756
Retiree Contributions	92,853,754	88,467,593
<b>Total Contributions</b>	<b>399,707,983</b>	<b>374,497,349</b>
<b>Claims Expenses</b>	<b>439,171,027</b>	<b>402,224,473</b> (Note A)

Note A: Claims Expenses totaling \$46,407 in 2004 have been reclassified.

## 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. Current year expenses for these leased

assets totaled \$734,961. A schedule of future minimum lease rental payments on non-cancelable operating leases as of August 31, 2005 is presented in Figure Q.

**Figure Q**  
**Non-Cancelable Operating Leases**

Fiscal Year	Future Minimum Lease Rental Payments
	\$
2006	499,569
2007	223,982
2008	19,009
<b>Total Future Minimum Lease Rental Payments</b>	<b>742,560</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, 2005 and 2004 is presented in Figure R.

**Figure R**  
**Net Assets - Fiduciary Funds**

Fund Type	Totals - August 31	
	2005	2004
	\$	\$
Defined Benefit Plans (Note A)	21,292,482,585	19,567,749,457
<i>Defined Contribution Plans and Cafeteria Plan:</i>		
Plan 457 Participants	292,946,379	255,418,432
Administration - Defined Contribution Plans	1,517,834	1,854,808
Administration - State Employees Cafeteria Plan	2,025,676	2,060,673
<b>Total Defined Contribution Plans and Cafeteria Plan</b>	<b>296,489,889</b>	<b>259,333,913</b>
<b>Total Fiduciary Net Assets Held In Trust for Pension Benefits and Other Purposes</b>	<b>21,588,972,474</b>	<b>19,827,083,370</b>
	(Exh. VIII)	
Note A: See Note 3.C, Reserves, for details of the statutorily required reserve balances of the Defined Benefit Plans.		

## D. Interfund Receivables and Payables (In accordance with GASB Statement 38)

At year-end, accruals related to interfund transfers and interfund reimbursements between the System's funds, are reported as Due From External Parties or Due To External Parties in the government-wide *Statement of Net Assets* and as Due From Other Funds or Due To Other Funds in the fund financial statements. (See Note 1.G)



# Notes to the Basic Financial Statements

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Figure S presents individual interfund receivable and interfund payable balances at August 31, 2005.

**Figure S**  
**Interfund Receivables and Payables**

	Due From Other Funds	Due To Other Funds
<b>Governmental Activities:</b>	\$	\$
Nonmajor Governmental Funds		4,533
<i>Proprietary Fund:</i>		
Employees Life, Accident and Health Insurance and Benefits Fund		
Agency 327, Fund 955		846,360
<b>Total Governmental Activities</b>	-	<b>850,893</b>
<b>Fiduciary Funds:</b>		
Pension and Other Employee Benefit Trust Funds	1,239,695	388,802
<b>Total - Interfund Receivables and Payables</b>	<b>1,239,695</b>	<b>1,239,695</b>

## E. Interfund Transfers

(In accordance with GASB Statement 38)

Interfund Transfers include transfers of membership fees from the Employees Retirement Fund to other funds of the System and transfers between the Employees Retirement Fund and the Excess Benefit Arrangement Fund for retirement benefit payments. (See Note 1.G).

Interfund Transfers between Governmental Activities and fiduciary funds are reclassified to revenues and expenses in the government-wide *Statement of Activities*.

Figure T presents interfund transfers for the year ended August 31, 2005.

**Figure T**  
**Interfund Transfers**

	Transfers In	Transfers Out
<i>Fiduciary Funds:</i>	\$	\$
Pension and Other Employee Benefit Trust Funds	657,051	657,051
<b>Total - Interfund Transfers</b>	<b>657,051</b>	<b>657,051</b>

## F. Interagency Transfers

Interagency Transfers include transfers between the System's funds and other funds of the State of Texas reporting entity that are for payment of benefits from the Compensation to Victims of Crime fund that are funded by the Office of the Attorney General. (See Note 1.G). Also included in this category is the amount transferred to the Teacher Retirement System for service established in the

Employees Retirement Fund and payable from the Excess Benefit Arrangement Fund.

Interagency Transfers between Governmental Activities and other funds of the State are reclassified to revenues and expenses in the government-wide *Statement of Activities*.

Figure U presents interagency transfers for the year ended August 31, 2005.

**Figure U**  
**Interagency Transfers**

	Transfers In	Transfers Out
<b>Governmental Activities:</b>	\$	\$
Nonmajor Governmental Funds	1,250,000	
<b>Total Governmental Activities</b>	<b>1,250,000</b>	-
<b>Fiduciary Funds:</b>		
Pension and Other Employee Benefit Trust Funds		63,567
<b>Total - Interagency Transfers</b>	<b>1,250,000</b>	<b>63,567</b>

## 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.

# 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**



# Report on Investment Activity (Unaudited)

Fiscal Year 2005

## Overview

The Employees Retirement System of Texas (System) investment portfolio closed the fiscal year with a fair value of \$21.3 billion, and returned 12.7% for the year. The fiscal year-end asset allocation stood at 29.9% investment grade bonds, 7.6% high yield bonds, 36.7% large cap domestic equity, 7.2% small cap domestic equity and 18.1% 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 transition to the new asset allocation approved by the Board toward the end of fiscal year 2004. This was implemented through the use of an innovative strategy to effect asset allocation rebalancing with futures. Because of the ability to get immediate total exposure to the increased small cap allocation, the System was able to capture fully the fall rally in those securities. Additionally, the System established a Real Estate Investment Trust (REIT) portfolio, improved fixed income performance attribution analysis, developed international analyst coverage based on industry sector rather than region, fine-tuned strategy to use more tracking error in the internal small-cap portfolio and increased collection and validation of first-hand knowledge about its investments. And, as always, the System continued to invest in the infrastructure and software tools needed to improve and maintain the overall efficiency of the investment program.

The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the third year in a row reflecting the continued rebound in the domestic and international equity markets. Over the longer term, the fund returned 8.08% for the 10 years ended August 31, 2005 slightly besting the policy benchmark of 7.96%.

## Market Performance *Domestic Equity Market*

For the fiscal year ended August 31, 2005, the S&P 500 Index returned 12.6%, while the S&P 600 Small Cap Index returned 26.5%. These gains were a continuation of the positive returns experienced during the prior two fiscal years. Nevertheless, after three years of positive returns, the S&P 500 would still need to rise by 25% to achieve its peak value reached in March of 2000. On the other hand, the S&P 600 Small Cap Index continues to reach new highs, with a return of 41% over the last two years. Operating earnings for the S&P 500 are expected to increase 9% in calendar 2005; this is a significant deceleration from the 24% gain in 2004, but still good enough to keep the market moving higher. Increasing

energy prices and a bull market in energy stocks has been the dominating theme this year. For the year ended August 31, 2005, the S&P 500 Energy sector returned 52% and the S&P 600 Energy Sector returned 73%, far exceeding the returns from the other economic sectors. Other sectors that performed well included large and small cap utilities and small cap health care. The telecommunications and financial sectors were the worst performing sectors in both the large and small cap indexes.

## *Fixed Income Market*

Long term interest rates traded within a fairly narrow band during the year, with the 10-year Treasury showing a net change of only 0.10%. Most of the volatility was contained to only a couple of months. The most significant changes in interest rates were in short term (3 years and less) maturities. The continued Fed tightening cycle pushed 2-year Treasury yields higher by 1.4 percentage points and 3-month yields higher by 1.93 percentage points. The result of the changes between short-term and long-term interest rates left the Treasury yield curve "flatter" by over 1.53 percentage points.

The U.S. economy continued to grow at potential during the year. Despite a continued surge in gasoline prices, consumer confidence and consumption remained strong, pushing the housing market to new all time highs and raising concerns over a potential bubble. Retail sales continued to provide growth for the economy and auto sales showed improvement due to financing incentives and "employee pricing" programs. A negative result of these programs has been the continued deterioration of both Ford and GM's financial position, which resulted in both being downgraded to "junk" status.

Employment growth continued at a moderate pace, slowing slightly in the second half of the year. Despite the growth, concern continues around the "quality" of the jobs – with estimates of greater than 40% of all job growth due to housing construction.

The Federal Reserve raised short-term interest rates by 1.25 percentage points during the year, citing concern over asset prices and risks toward higher inflation. Inflation statistics show a rise in producer prices but a fall in consumer prices, with concerns over potential impacts of higher gasoline prices.

Hurricane Katrina occurred late in the year with economic implication still uncertain.

The Lehman Brothers Aggregate Bond Index returned 4.15% for the Fiscal Year. The best performing sector for the third year in a row, was the Corporate sector which returned 4.87%. Other sectors were mixed in a rather calm year in fixed income.



# Report on Investment Activity (Unaudited)

Fiscal Year 2005

## International Stock Market

International equity markets continued to recover in fiscal year 2005 from their early calendar year 2003 lows. The Morgan Stanley Capital International Europe, Australia and Far East (EAFE) Free index returned 24.1% in US dollar terms for the period. The Pacific ex-Japan region returned 33.1%, Japan gained 12.4%, the Europe region gained 28.5% and the United Kingdom returned 22.4%, all adjusted to US dollars.

Currencies were little changed on the year but traded in fairly wide bands during the period. The Euro began and ended the fiscal year near the 1.22 USD/EUR level, touching a high of 1.36 USD per EUR in late December 2004. The British pound started and ended the period at 1.80 USD/GBP, with a high of 1.95 USD per GBP. The Japanese Yen started and ended the year near the 110 JPY/USD, touching near-parity at 102 JPY/USD in early January 2005.

## Key Portfolio Statistics

	2005	2004
Contributions to Pool	\$423,500,000	\$451,800,000
Withdrawals from Pool	(\$1,138,523,000)	(\$1,141,440,000)
Interest & Dividends	\$645,727,762	\$542,639,464
Securities Lending Income	\$10,154,742	\$8,611,921
Net Appreciation in Fair Value	\$1,788,788,380	\$1,538,704,175

### 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.



# Outline of Investment Policies (Unaudited)

Fiscal Year 2005

## 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;
- The cost of including them in the program; and
- Futures and options to facilitate risk management and to provide efficiency in investment implementation through lower transaction costs and lower turnover or to provide higher correlation to the benchmark index returns.

Eligible securities are as follows:

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

## Proxies and Bond Indenture Changes

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

*Basis of Presentation:*

Texas Statute and ERS Investment Policy



# Time-Weighted Rates of Return and Asset Allocations (Unaudited)

## Pension Investment Pool Trust Fund (Note A)

August 31, 2005

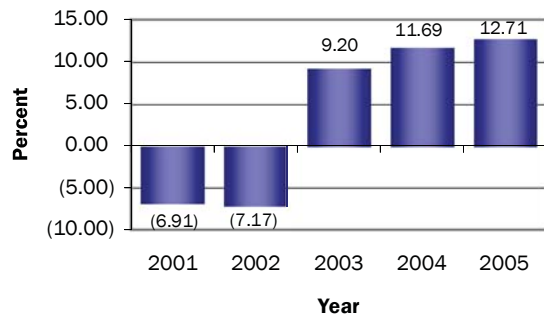
### Time-Weighted Rates of Return

	Fixed Income Securities		Domestic Equities		International Equities		Cash Equivalent		ERS	
	ERS	Index	ERS	Index	ERS	Index	ERS	Index	Overall	CPI
1 Year	%	%	%	%	%	%	%	%	%	%
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
2005	5.21	4.15	14.68	12.56	24.39	23.58	2.54	2.44	<b>12.71</b>	3.59
3 Year										
(2003-2005)	6.49	4.88	12.60	12.03	16.97	18.25	1.68	1.63	<b>11.19</b>	2.80
5 Year										
(2001-2005)	7.47	6.98	0.15	(2.71)	(0.43)	1.27	2.61	2.53	<b>3.50</b>	2.58

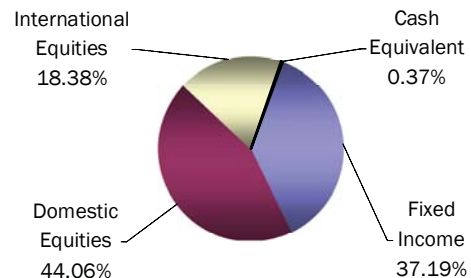
### Average Asset Allocations

	1-Year		3-Year		5-Year	
	Target	Actual	Target	Actual	Target	Actual
	%	%	%	%	%	%
Fixed Income	38.00	37.19	40.00	39.49	40.40	41.21
Domestic Equities	44.00	44.06	42.00	42.22	41.60	40.79
International Equities	18.00	18.38	18.00	18.12	18.00	17.88
Cash Equivalent	0.00	0.37	0.00	0.17	0.00	0.12
Total	100.00	100.00	100.00	100.00	100.00	100.00

Overall One Year Time-Weighted Return



One Year Average Actual Asset Allocations



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.





# List of Largest Assets Held (Unaudited)

August 31, 2005

## Ten Largest Stock Holdings (Note A)

No. of Shares	Description	Fair Value
		\$
7,436,100	General Electric Co.	249,927,328
3,606,144	ExxonMobil Corporation	217,053,815
7,597,400	Microsoft Corporation	208,786,552
2,254,600	Johnson & Johnson	143,663,110
3,209,101	Citigroup, Inc.	140,462,351
44,732,980	Vodafone Group PLC	122,090,463
4,203,500	Pfizer, Inc.	107,903,845
3,056,496	Royal Dutch Shell PLC - B Share	104,418,962
4,042,100	Intel Corporation	104,286,176
2,375,500	Bank of America Corporation	103,405,513

## Ten Largest Fixed Income Security Holdings (Note A)

Par Value	Description	Fair Value
		\$
175,000,000	Treasury Inflation Index N/B 3.875% due on 04/15/2029, Rating AAA	291,002,745
207,000,000	U.S. Treasury Note 3.625% due on 06/30/2007, Rating AAA	207,433,831
165,000,000	U.S. Treasury Note 3.5% due on 05/31/2007, Rating AAA	165,545,068
122,000,000	U.S. Treasury Note 6.25% due on 05/15/2030, Rating AAA	160,329,012
114,000,000	U.S. Treasury Note 7.5% due on 11/15/2016, Rating AAA	150,697,133
145,000,000	U.S. Treasury Note 3.125% due on 01/31/2007, Rating AAA	144,000,572
136,125,867	JP Morgan Prime Money Market Capital Shares, Rating NR	136,661,499
100,000,000	Treasury Inflation Index N/B 4.25% due on 01/15/2010, Rating AAA	130,332,969
125,000,000	Federal Home Loan Bank 4.25% due on 11/02/2010, Rating AAA	126,705,729
100,224,505	Fannie Mae 5.5% due on 03/01/2020, Rating AAA	102,909,853

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.



# Schedule of Fees and Commissions (Unaudited)

Year Ended August 31, 2005

## Investment Advisory Fees

	Assets Under		
	Management	Fees	Basis Point
Fixed Income Advisors	\$1,517,309,257	\$ 2,785,001	0.1835%
Domestic Equity Advisors	3,291,474,316	4,846,543	0.1472%
International Equity Advisors	2,732,993,578	5,543,599	0.2028%
<b>Total</b>	<b><u>7,541,777,151</u></b>	<b><u>13,175,143</u></b>	<b>0.1747%</b>

## Other Investment Service Fees

Custodian Fees	\$ 300,000
Security Lending Agent Fees	2,579,010
Investment Consultant Fees	133,968
<b>Total</b>	<b><u>3,012,978</u></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 2005.

## Domestic Equity Commissions

Brokerage Firm	No. of Shares	Commis-	Commission
	Traded	sions	Per Share
Bank of America	10,765,675	\$ 232,639	0.022
Bear Stearns	15,228,260	401,095	0.026
Bloomberg Tradebook -ESI Securities	19,091,578	418,269	0.022
BOE Securities, Inc.	943,175	40,587	0.043
CIBC World Markets - Oppenheimer	235,600	10,904	0.046
Citigroup Global Markets, Inc.	4,300,510	97,146	0.023
Davis Mendel & Regenstein, Inc.	139,150	5,566	0.040
Deutsche Bank Securities	3,627,477	78,277	0.022
First Boston	5,706,954	126,323	0.022
Fox-Pitt Kelton, Inc.	201,000	10,050	0.050
Goldman Sachs	9,670,964	253,190	0.026
Green Street Advisors	783,750	31,431	0.040
GRW Capital Corp.	684,250	25,620	0.037
ITG	105,700	2,114	0.020
J.P. Morgan	8,452,191	209,394	0.025
Jefferies & Co.	6,850,270	201,356	0.029
Keefe, Bruyette & Woods	539,889	26,994	0.050
Leerink Swann & Co.	1,387,445	62,452	0.045
Legg Mason Wood Walker, Inc.	5,900,018	171,722	0.029
Lehman Brothers	10,478,612	304,088	0.029
M. Ramsey King	315,000	15,750	0.050
Merrill Lynch	2,209,000	56,604	0.026
Morgan Stanley Dean Witter	12,805,107	259,698	0.020
Prudential Securities	3,009,077	108,992	0.036
Raymond James & Associates	1,837,189	62,295	0.034
Robert Van Securities, Inc.	315,000	15,750	0.050
Robert W. Baird & Co.	2,073,300	75,713	0.037
Sandler O'Neil & Partners, L.P.	87,000	4,350	0.050
Sanford Bernstein	8,140,789	194,518	0.024
Schwab Soundview Capital Markets	445,800	13,374	0.030
Score Securities, Inc.	76,700	3,068	0.040
Southwest Securities	30,164	1,382	0.046
UBS Securities	6,899,357	162,003	0.023
Washington Analysis, LLC	550,025	26,001	0.047
Weeden & Co	1,263,124	37,894	0.030
Williams Capital Group	684,500	27,023	0.039
<b>Total</b>	<b><u>145,833,600</u></b>	<b><u>3,773,632</u></b>	<b>0.026</b>

## International Equity Commissions

Brokerage Firm	No. of Shares	Commission per		
	Traded	Principal	Commissions	Principal %
Bloomberg Tradebook	143,800	\$ 2,520,974	\$ 2,876	0.114
Citigroup Global Markets, Inc.	7,679,584	89,916,024	140,926	0.157
Collins Stewart, Inc.	6,992,149	56,804,243	90,146	0.159
Credit Lyonnais Securities (USA), Inc.	8,722,821	118,735,269	290,160	0.244
Credit Suisse First Boston Corp.	40,944,100	492,494,718	513,409	0.104
Deutsche Bank Securities	6,915,170	56,997,796	74,606	0.131
Dresdnerkleinwort Benson NA, LLC	29,673,662	519,124,535	367,869	0.071
G Trade	1,907,500	50,923,389	50,922	0.100
G-Trade-Netherlands	258,000	3,592,913	3,593	0.100
Goldman Sachs	1,311,600	6,760,600	16,894	0.250
J.P. Morgan	17,747,990	133,681,359	229,695	0.172
JB Were & Son	2,449,000	26,009,966	76,586	0.294
Keefe, Bruyette & Woods	2,508,400	24,753,528	37,131	0.150
Lehman Brothers	21,558,750	148,063,733	148,065	0.100
Merrill Lynch	37,079,330	512,042,898	654,457	0.128
Mitsubishi Securities - Japan	4,746,900	48,361,759	48,362	0.100
Mizuho Securities	1,661,498	112,333,748	168,502	0.150
Morgan Stanley Dean Witter	6,200	108,979	124	0.114
Nomura Securities	43,404,068	167,112,178	170,232	0.102
<b>Total</b>	<b><u>235,710,522</u></b>	<b><u>2,570,338,609</u></b>	<b><u>3,084,555</u></b>	<b>0.120</b>

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



## Investment Revenues (Unaudited)

Year Ended August 31, 2005 (With Comparative Totals for August 31, 2004)

	Pooled Pension Trust Funds (Note A)	
	August 31,	
	2005	2004
	\$	\$
<b>Interest On:</b>		
Deposits in State Treasury	1,073,778	931,954
Margin Deposit	401,958	
Commercial Paper	2,335,166	
Short-Term Investment Fund	1,031,656	334,751
Repurchase Agreements	4,060,560	357,167
Money Market Mutual Funds	11,922,762	11,843,554
U.S. Treasury Bonds	62,301,769	44,861,455
Other Government Securities	32,661,874	27,263,853
Mortgage Pass-Thru Securities	66,009,005	66,121,195
Collateralized Mortgage Obligations	3,713,595	3,159,498
Asset Backed Securities	4,264,077	6,657,335
Commercial Mortgage Backed Securities	9,716,266	11,934,563
Corporate Bonds	182,526,349	158,628,572
<b>Total Interest</b>	<b>382,018,815</b>	<b>332,093,897</b>
<b>Dividends On:</b>		
Domestic Equities	154,223,845	122,513,177
Texas Growth Fund	4,657,020	6,090,682
International Equities	104,828,082	81,941,708
<b>Total Dividends</b>	<b>263,708,947</b>	<b>210,545,567</b>
<b>Net Securities Lending Income</b>	<b>10,154,742</b>	<b>8,611,921</b>
<b>Net Appreciation (Depreciation) In Fair Value of:</b>		
Repurchase Agreements	9,806	
Futures	25,393,178	
Short-Term Investment Fund	(3,554,159)	(15,725)
Money Market Mutual Funds	(882,740)	173,494
U.S. Treasury Bonds	45,466,925	74,636,223
Other Government Securities	(7,521,750)	16,515,429
Mortgage Pass-Thru Securities	(5,127,356)	50,087,715
Collateralized Mortgage Obligations	(1,746,631)	(7,923)
Asset Backed Securities	(2,263,317)	(1,107,718)
Commercial Mortgage Backed Securities	(3,846,129)	3,657,516
Corporate Bonds	(5,247,614)	88,587,698
Domestic Equities	1,008,341,749	711,973,135
International Equities	739,766,418	594,204,331
<b>Total Appreciation</b>	<b>1,788,788,380</b>	<b>1,538,704,175</b>
<b>Total Investment Revenue</b>	<b>2,444,670,884</b>	<b>2,089,955,560</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.



# Investment Summary at Fair Value (Unaudited)

August 31, 2005

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	2,098,975,622	70,238,513	16,451,340	2,185,665,475	10.22876%
Other Government Securities	893,212,163	29,889,768	7,000,813	930,102,744	4.35282%
Mortgage Pass-Thru Securities	1,742,101,315	58,296,345	13,654,233	1,814,051,893	8.48964%
Asset Backed Securities	54,795,898	1,833,648	429,479	57,059,025	0.26703%
Commercial Mortgage Backed Securities	174,679,572	5,845,343	1,369,103	181,894,018	0.85125%
Corporate Bonds	2,667,315,577	89,257,007	20,905,872	2,777,478,456	12.99841%
<b>Total Long-Term Fixed Securities</b>	<b>7,631,080,147</b>	<b>255,360,624</b>	<b>59,810,840</b>	<b>7,946,251,611</b>	<b>37.18791%</b>
<b>Equities:</b>					
Domestic Equities	8,692,776,593	290,888,421	68,132,200	9,051,797,214	42.36179%
Texas Growth Fund	55,657,277	1,862,473	436,230	57,955,980	0.27123%
International Equities	3,953,300,838	132,290,233	30,985,161	4,116,576,232	19.26529%
<b>Total Equities</b>	<b>12,701,734,708</b>	<b>425,041,127</b>	<b>99,553,591</b>	<b>13,226,329,426</b>	<b>61.89831%</b>
<b>Cash Equivalents:</b>					
Margin Deposit	17,698,006	592,233	138,713	18,428,952	0.08625%
Changes in Futures Contracts	(7,063,666)	(236,373)	(55,363)	(7,355,402)	(0.03442%)
Net Margin Deposit	10,634,340	355,860	83,350	11,073,550	0.05183%
Cash in State Treasury-Investment Pool	96,929	3,244	759	100,932	0.00047%
Short Term Investment Fund	3,702,950	123,913	29,023	3,855,886	0.01805%
Money Market Mutual Funds	77,031,855	2,577,735	603,760	80,213,350	0.37539%
Repurchase Agreements	96,043,126	3,213,914	752,766	100,009,806	0.46804%
<b>Total Cash Equivalents</b>	<b>187,509,200</b>	<b>6,274,666</b>	<b>1,469,658</b>	<b>195,253,524</b>	<b>0.91378%</b>
<b>Total Before Securities Lending Collateral (Notes B &amp; C)</b>	<b>20,520,324,055</b>	<b>686,676,417</b>	<b>160,834,089</b>	<b>21,367,834,561</b>	<b>100.0000%</b>
Securities Lending Collateral	4,247,973,731	142,332,492	33,084,640	4,423,390,863	
<b>Total Pension Investment Pool Trust Fund (0888)</b>	<b>24,768,297,786</b>	<b>829,008,909</b>	<b>193,918,729</b>	<b>25,791,225,424</b>	
<b>Cash Equivalents:</b>					
Cash in State Treasury-Pension Funds	15,892,516	682,423	436,265		
<b>Total Investments</b>	<b>24,784,190,302</b>	<b>829,691,332</b>	<b>194,354,994</b>		
<b>Percent Ownership in Investment Pool</b>	<b>96.0338%</b>	<b>3.2143%</b>	<b>0.7519%</b>	<b>100.0000%</b>	

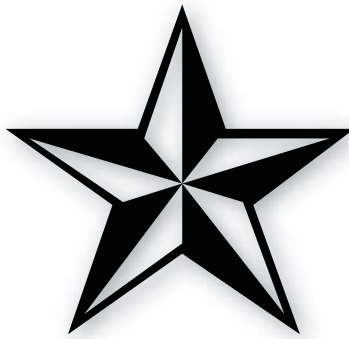
Note A: The Pension Investment Pool Trust Fund (Fund 0888) includes the Employees Retirement Fund (Fund 0955), the Law Enforcement and Custodial Officer Supplemental Retirement Fund (Fund 0977), and the Judicial Retirement System Plan Two Fund (Fund 0993).

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	20,520,324,055	686,676,417	160,834,089	21,367,834,561
Unsettled Sales-Investment Receivables	44,034,907	1,475,432	342,959	45,853,298
Adjustment from Accrued Interest on TBAs	(69,990)	(2,345)	(545)	(72,880)
Adjusted Unsettled Sales-Investment Receivables	43,964,917	1,473,087	342,414	45,780,418
Unsettled Purchases-Investment Payables	(172,267,627)	(5,771,994)	(1,341,678)	(179,381,299)
Adjustment from Accrued Interest on TBAs	340,181	11,398	2,649	354,228
Adjusted Unsettled Purchases-Investment Payables	(171,927,446)	(5,760,596)	(1,339,029)	(179,027,071)
Coupons, Dividends & Corporate Action Proceeds in Transit	12,678,327	424,258	99,370	13,201,955
Tax Reclaim Receivables	2,814,512	94,303	21,920	2,930,735
<b>Total Fair Value of Investments, Adjusted to Comply with the CFA Institute Standards</b>	<b>20,407,854,365</b>	<b>682,907,469</b>	<b>159,958,764</b>	<b>21,250,720,598</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.



# Actuarial Section *(Unaudited)*



**Actuary's Certification Letter**

**Actuarial Balance Sheets**

**Summary of Actuarial Methods and Assumptions**

**Effect of Changes in Plan Provisions and Actuarial  
Assumptions**

**Active Member Valuation Data**

**Retirees and Beneficiaries Added to and Removed  
from the Annuity Payrolls**

**Solvency Test**

**Analysis of Financial Experience**

December 14, 2005

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, 2005 for the Employees Retirement System and the Judicial Retirement System of Texas Plan Two. Towers Perrin prepared the Actuarial Balance Sheets and the supporting schedules in the Actuarial Section. Towers Perrin prepared the Schedules of Funding Progress and the Schedules of Employer Contributions of the Required Supplementary Information and the Notes to the Required Supplementary Information presented in the Financial Section of this report. Towers Perrin also prepared the Retired Members by Type of Benefit schedule in the Statistical Section.

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 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. The Board adopted modifications to these assumptions on December 14, 2005 to reflect 2005 legislation. 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 6.45% 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, 2005. Since the prior valuation was prepared, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in plan provisions as a result of SB 1176 and other legislation. There have been changes in the assumed rates of salary increases to reflect changes in the salary structure resulting from 2005 legislation.

The August 31, 2005 actuarial valuation shows that there is an unfunded actuarial accrued liability (net liability balance) of \$1,134.2 million. The ratio of the actuarial value of assets to the actuarial accrued liability is 0.948 as of August 31, 2005. The valuation shows that the total normal cost is 12.280% of payroll. Total contributions are 12.45% of payroll. Because the total contribution rate is less than the sum of the normal cost and interest on the unfunded actuarial accrued liability, 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 13.587% of payroll. In addition, as of August 31, 2005, the market value of assets was \$387 million less than the actuarial value. Unless the market value earns 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, 2007. Thereafter, the State contribution will be established by legislation. 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, 2005. Since the prior valuation was performed, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in plan provisions as a result of SB 1176 and other legislation, but these plan changes had no material impact on the actuarial valuation results. There have been changes in the assumed rates of salary increases to reflect changes in the salary structure resulting from 2005 legislation.

The valuation shows that the normal cost is 1.628% of payroll. The ratio of the actuarial value of assets to the actuarial accrued liability is 1.031 as of August 31, 2005. As of August 31, 2005, the Fund had a net asset balance. Therefore, there is no amortization period. Based on the actuarial valuation conducted as of August 31, 2005, 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 for the current year. In future years, in order to remain actuarially sound, the total contribution rate will need to be at least the normal cost rate plus an amount to amortize any net liability balance over no more than 31 years.

As of August 31, 2005, the market value of assets was \$16.1 million less than the actuarial value. Unless the market value earns 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 and the State contribution rate was 16.83% of payroll as of the August 31, 2005 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, 2005. Since the prior valuation was performed, there have not been any changes in the actuarial cost method or actuarial procedures. There were changes in plan provisions as a result of HB 617, HB 831, HB 1079, HB 1114, SB 1176 and HB 11 (2nd Called Session). There were changes in actuarial assumptions to update the assumed retirement rates and add an assumption for the election to continue member contributions.

The valuation shows that the total normal cost is 20.98% of payroll and the unfunded actuarial accrued liability (net liability balance) is \$18.1 million. The ratio of the actuarial value of assets to the actuarial accrued liability is 0.901 as of August 31, 2005. State contributions of 16.83% of payroll and member contributions of 6% of pay were assumed available to finance the liabilities of the JRSII. The amortization period is 26.0 years. 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, 2005, the market value of assets was \$3.1 million less than the actuarial value. Unless the market value earns 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:cm

Attachments



## Actuarial Balance Sheet – Employees Retirement Fund (Unaudited)

August 31, 2005 (With Comparative Totals at August 31, 2004)

ACTUARIAL BALANCE SHEET	August 31, 2005		August 31, 2004
	After Changes	Before Changes	
<b>ACTUARIAL ASSETS:</b>			
Actuarial Value of Tangible Assets	\$20,835,468,872	\$20,835,468,872	\$20,036,646,562
Actuarial Present Value of Future Normal Costs			
Member	\$2,334,898,058	\$2,331,726,584	\$2,248,977,273
Employer	<u>2,346,572,548</u>	<u>2,369,034,209</u>	<u>2,323,943,183</u>
Total	<u>\$4,681,470,606</u>	<u>\$4,700,760,793</u>	<u>\$4,572,920,456</u>
Total	\$25,516,939,478	\$25,536,229,665	\$24,609,567,018
<b>ACTUARIAL LIABILITY:</b>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$13,524,085,713	\$13,504,301,524	\$12,764,777,842
– nonoccupational disability	250,418,138	362,062,273	350,167,811
– occupational disability	13,042,939	13,020,381	12,596,149
– death before retirement	269,866,483	269,425,358	256,136,279
– termination	<u>952,288,916</u>	<u>951,031,650</u>	<u>946,750,221</u>
– total	\$15,009,702,189	\$15,099,841,186	\$14,330,428,302
Inactive Members	755,404,679	755,404,679	672,396,482
Annuitants	<u>10,886,033,918</u>	<u>10,886,033,918</u>	<u>10,161,943,670</u>
Total	\$26,651,140,786	\$26,741,279,783	\$25,164,768,454
<b>Net Asset/(Liability) Balance:</b>	<b>(\$1,134,201,308)</b>	<b>(\$1,205,050,118)</b>	<b>(\$555,201,436)</b>
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate	12.450%	12.000%	12.000%
Normal Cost			
– dollars	\$594,641,604	\$597,746,129	\$574,778,721
– percent of payroll	12.280%	12.346%	12.450%
Contribution Available to Amortize Net Asset/(Liability) Balance	0.170%	(0.346%)	(0.450%)
Actuarial Accrued Liability	\$21,969,670,180	\$22,040,518,990	\$20,591,847,998
Amortization Period in Years	Infinite	Infinite	Infinite
Funded Ratio	0.948	0.945	0.973
Valuation Payroll	\$4,842,525,200	\$4,841,526,389	\$4,616,760,675
Active Members	131,331	131,331	133,349





## Actuarial Balance Sheet – Law Enforcement and Custodial Officers Supplemental Retirement Fund (Unaudited)

August 31, 2005 (With Comparative Totals at August 31, 2004)

ACTUARIAL BALANCE SHEET	August 31, 2005		August 31, 2004
	After Changes	Before Changes	
<u>Actuarial Assets:</u>			
Actuarial Value of Tangible Assets	\$698,814,428	\$698,814,428	\$679,242,950
Actuarial Present Value of Future Normal Costs	<u>173,311,939</u>	<u>171,863,065</u>	<u>166,222,261</u>
Total	\$872,126,367	\$870,677,493	\$845,465,211
<u>Actuarial Liability:</u>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$587,915,367	\$586,979,729	\$542,792,620
– death benefit plan	7,188,184	7,176,459	6,613,007
– occupational disability	<u>4,252,676</u>	<u>4,241,878</u>	<u>4,056,847</u>
– total	\$599,356,227	\$598,398,066	\$553,462,474
Inactive Vested Members	433,702	433,702	496,650
Annuitants	<u>251,474,897</u>	<u>251,474,897</u>	<u>233,720,473</u>
Total	\$851,264,826	\$850,306,665	\$787,679,597
<u>Net Asset/(Liability) Balance:</u>	\$20,861,541	\$20,370,828	\$57,785,614
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate (current biennium)	0.000%	0.000%	0.000%
Normal Cost			
– dollars	\$20,894,392	\$20,776,559	\$19,943,898
– percent of payroll	1.628%	1.619%	1.621%
Contribution Available to Amortize Net Asset/(Liability)			
Balance (current biennium)	(1.628%)	(1.619%)	(1.621%)
Actuarial Accrued Liability	\$677,952,887	\$678,443,600	\$621,457,336
Amortization Period in Years	0.0	0.0	0.0
Funded Ratio	1.031	1.030	1.093
Valuation Payroll	\$1,283,815,360	\$1,283,322,236	\$1,230,580,964
Active Members	37,150	37,150	38,305





# Actuarial Balance Sheet – Judicial Retirement system of Texas Plan Two Fund (Unaudited)

August 31, 2005 (With Comparative Totals at August 31, 2004)

ACTUARIAL BALANCE SHEET	August 31, 2005		August 31, 2004
	After Changes	Before Changes	
<b>Actuarial Assets:</b>			
Actuarial Value of Tangible Assets	\$164,230,979	\$164,230,979	\$145,538,335
Actuarial Present Value of Future Normal Costs			
Member	\$27,289,187	\$23,605,906	\$19,787,941
Employer	59,719,400	59,966,675	47,483,696
Total	<u>\$87,008,587</u>	<u>\$83,572,581</u>	<u>\$67,271,637</u>
	\$251,239,566	\$247,803,560	\$212,809,972
<b>Actuarial Liability:</b>			
Actuarial Present Value of Benefits:			
Active Members			
– service retirement	\$195,744,708	\$182,913,365	\$138,887,035
– disability	6,318,431	6,339,654	5,278,656
– death before retirement	6,509,467	6,519,328	5,144,394
– termination	11,451,784	11,724,741	7,587,183
– total	\$220,024,390	\$207,497,088	\$156,897,268
Inactive Members			
Annuitants	7,623,317	7,623,317	4,699,140
	<u>41,672,041</u>	<u>33,325,866</u>	<u>29,587,837</u>
Total	\$269,319,748	\$248,446,271	\$191,184,245
<b>Net Asset/(Liability) Balance:</b>	<b>(\$18,080,182)</b>	<b>(\$642,711)</b>	<b>\$21,625,727</b>
<b>SUMMARY OF ACTUARIAL VALUATION RESULTS</b>			
Total Contribution Rate	22.83%	22.83%	22.83%
Normal Cost			
– dollars	\$12,751,871	\$12,182,310	\$9,494,691
– percent of payroll	20.98%	20.04%	19.58%
Contribution Available to Amortize Net Asset/(Liability) Balance	1.85%	2.79%	3.25%
Actuarial Accrued Liability	\$182,311,161	\$164,873,690	\$123,912,608
Amortization Period in Years	26.0	0.4	0.0
Funded Ratio	0.901	0.996	1.175
Valuation Payroll	\$60,775,307	\$60,775,307	\$48,504,058
Active Members	491	491	484





## Summary of Actuarial Methods and Assumptions (Unaudited)

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 study 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:

	Employee Class & Supplemental Benefits for CPO/CO's	Elected Class	Judicial Class
<b>Investment Rate of Return:</b> (Same for all classes)	8% per year, compounded annually.		
<b>Administrative Expenses:</b> (As a percentage of payroll per year, compounded annually)	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> (Same for all classes)	4% per year, compounded annually.		
<b>Cost-of-Living Increase:</b>	N/A	4% per year, compounded annually	N/A



## Summary of Actuarial Methods and Assumptions (Unaudited)

**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	2-4	5-9	10+
20	6.80%	5.25%	4.75%	4.65%				10.0%	5.0%	2.2%	2.1%	2.0%
30	6.00	5.25	4.45	3.85	3.65%	3.20%		10.0	5.0	2.2	2.1	2.0
40	5.50	4.55	4.05	3.45	3.05	2.70	2.60%	10.0	5.0	2.2	2.1	2.0
50	4.90	4.55	3.85	3.25	2.75	2.30	2.20	10.0	5.0	2.2	2.1	2.0
60	2.90	2.95	2.65	2.45	2.35	1.90	1.80	10.0	5.0	2.2	2.1	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 (Unaudited)

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

Age	<u>Employee Class (Non-CPO/CO) (Note D)</u>				<u>Employee Class (CPO/CO)</u>			
	<u>Occupational</u>		<u>Non-occupational</u>		<u>Occupational</u>		<u>Non-occupational</u>	
	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

**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

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

Age	<u>Employee Class (Non-CPO/CO) (Note I)</u>			<u>Employee Class (CPO/CO)</u>		
	<u>Occupational</u>	<u>Non-occupational</u>		<u>Occupational – Females &amp; Males</u>		<u>Non-occupational</u>
	Females & Males	Females	Males	Total Disability	Non-Total	Females & Males
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.



**Table 8  
Demographic Assumption –  
Option Selection Percentage and Beneficiary Characteristics  
under Disability Retirement**

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

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	<b>Years of Service – Members in the Employee Class (Non-CPO/CO)</b>								<b>Years of Service – Members in the Employee Class (CPO/CO)</b>						<b>Elected Class (Note L)</b>		<b>Judicial Class (Note L)</b>	
	<b>Female</b>				<b>Male</b>				<b>Female</b>		<b>Male</b>				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+				
<b>50</b>	0%	0%	0%	25%	0%	0%	0%	10%	0%	30%	26%	45%	50%	60%	<b>50-59</b>	10%	<b>50-69</b>	20%
<b>55</b>	0	0	30	30	0	0	15	10	12	24	13	22	30	30	<b>60-64</b>	15	<b>70-74</b>	25
<b>60</b>	30	30	30	30	20	25	30	20	24	24	26	45	50	60	<b>65-74</b>	20	<b>75+</b>	100
<b>65</b>	30	30	50	50	25	30	40	40	35	35	45	40	50	50	<b>75+</b>	100		
<b>70+</b>	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. Judicial members are assumed to retire when they have accrued a standard retirement annuity of 80% of salary.

**Table 10  
Demographic Assumption –  
Option Selection Percentage and Beneficiary Characteristics  
under Service Retirement**

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

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





## Effect of Changes in Plan Provisions and Actuarial Assumptions (Unaudited)

Following is a summary of key results of the August 31, 2005 actuarial valuation under both the old and new plan provisions and actuarial assumptions.

Key Result	As of August 31, 2005 (dollar amounts expressed in millions)					
	ERS		LECOS		JRS II	
	After Changes	Before Changes	After Changes	Before Changes	After Changes	Before Changes
Normal Cost:						
Dollars	\$594.6	\$597.7	\$20.9	\$20.8	\$12.8	\$12.2
% of Payroll	12.280%	12.346%	1.628%	1.619%	20.98%	20.04%
Actuarial Accrued Liability	\$21,969.7	\$22,040.5	\$678.0	\$678.4	\$182.3	\$164.9
Unfunded/(Overfunded) Actuarial Accrued Liability	\$1,134.2	\$1,205.1	(\$20.9)	(\$20.4)	\$18.1	\$0.6
Funded Ratio	94.8%	94.5%	103.1%	103.0%	90.1%	99.6%
Amortization Period in Years	Infinite	Infinite	0.0	0.0	26.0	0.4



## Active Member Valuation Data (Unaudited)

Valuation Year August 31,	Number (Note A)	Actual Annual Payroll		Average Pay (Note B)	% Change in Average Pay
		\$	\$		
<b>Employees Retirement Fund:</b>					
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
2005	131,331	4,569,274,344		34,345	0.5
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund:</b>					
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
2005	37,150	1,283,815,360		31,848	0.1
<b>Judicial Retirement Plan Two Fund:</b>					
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
2005	491	49,121,306		99,734	(0.5)

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

Note B: The average rate of salary is based on the salary for the month of August.



## Retirees and Beneficiaries Added to and Removed from the Annuity Payrolls (Unaudited)

Period Ended Sept. 30,	Added to Rolls		Removed from Rolls		Other Beneficiaries		Rolls End of Year		% Increase Annual Benefits	Average Annual Benefit
	No.	Annual Benefits	No.	Annual Benefits	No.	Annual Benefits	No.	Annual Benefits		
		\$	\$	\$	\$	\$	\$	%	\$	
<b>Employees Retirement Fund:</b>										
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 (Note A)	4,048	65,652,607	1,515	26,105,172	337	6,186,781	61,845	1,090,042,062	4.4	17,625
2005	5,006	89,911,159	1,922	27,794,348	791	9,863,136	65,720	1,162,022,009	6.6	17,681
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund:</b>										
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
2005	548	3,572,920	122	803,561	68	68,769	5,070	28,676,247	11.0	5,656
<b>Judicial Retirement Plan Two Fund:</b>										
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 (Note A)	12	553,529	1	22,724	2	7,200	72	3,014,309	21.7	41,865
2005	10	1,340,441	1	56,932	-	(1,047)	81	4,296,771	42.5	53,047

Note A: The annual benefit amounts include increases provided by 2005 legislation that are effective after September 30, 2005.



## Solvency Test (Unaudited)

### 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)	(2)	(3)		(1)	(2)	(3)
	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)		%	%	%
	\$	\$	\$	\$	%	%	%
<b>Employees Retirement Fund:</b>							
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
2005	3,482,090,916	10,886,033,918	7,601,545,346	20,835,468,872	100	100	85.1
<b>Law Enforcement And Custodial Officer Supplemental Retirement Fund:</b>							
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
2005	-	251,474,897	426,477,990	698,814,428	-	100	104.9
<b>Judicial Retirement Plan Two Fund:</b>							
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
2005	35,303,352	41,672,041	105,335,768	164,230,979	100	100	82.8



## Analysis of Financial Experience (Unaudited)

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:

### **Age and Service Retirement:**

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

### **Disability Retirement:**

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

### **Death-in-Service Benefit:**

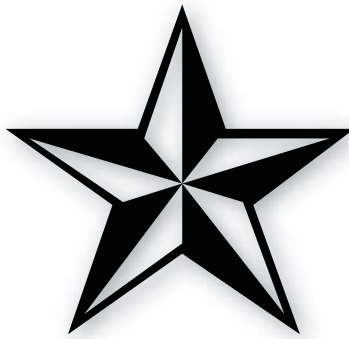
If survivor claims are less (more) than assumed, there is a gain (loss).

### **Withdrawal from Employment:**

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>	<b>Gain/(Loss) For Year (in Millions)</b>					
	<b>ERS</b>		<b>LECOS</b>		<b>JRS II</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Combined gain/(loss) from age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment</b>	(324.3)	(166.2)	(4.0)	0.5	(2.7)	(1.1)
<u>Pay Increases</u> If there are smaller pay increases than assumed, there is a gain. If greater increases occur, a loss.	(251.6)	400.9	(17.3)	15.5	(22.7)	3.6
<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.	(44.4)	(38.4)	4.6	5.5	1.7	1.5
<u>Contribution Income</u> If contributions are received in excess of normal cost, there is a gain. If less, a loss.	(21.4)	(12.4)	(20.7)	(21.4)	1.8	1.7
<u>Investment Income</u> If there is greater investment income than assumed, there is a gain. If less income, a loss.	(98.6)	(309.8)	(3.3)	(10.7)	(0.9)	(2.4)
<u>Death After Retirement</u> If retirees live longer than assumed, there is a loss. If not as long, a gain.	120.9	76.2	3.3	(0.3)	0.5	-
<u>Other</u> Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, valuation methods, etc.	(30.4)	(24.9)	-	-	-	-
<b>Gain/(Loss) During Year from Financial Experience</b>	<b>(649.8)</b>	<b>(74.6)</b>	<b>(37.4)</b>	<b>(10.9)</b>	<b>(22.3)</b>	<b>3.3</b>
<u>Non-Recurring Items</u> Adjustments for plan amendments, changes in actuarial assumptions, increase in Service Retirement Formula, etc.	70.8	-	0.5	-	(17.4)	-
<b>Composite Gain/(Loss) During Year</b>	<b>(579.0)</b>	<b>(74.6)</b>	<b>(36.9)</b>	<b>(10.9)</b>	<b>(39.7)</b>	<b>3.3</b>



# Statistical Section *(Unaudited)*



**Changes in Net Assets – Proprietary Fund**

**Changes in Net Assets – Defined Benefit Plans**

**Changes in Net Assets – Defined Contribution Plans and  
Cafeteria Plan**

**Net Assets – Governmental Activities**

**Changes in Net Assets – Governmental Activities**

**Fund Balances – Governmental Funds**

**Changes in Fund Balances – Governmental Funds**

**Benefit and Refund Payments**

**Retired Members by Type of Benefit**

**Average Benefit Payments**

**Statistical Information – Defined Benefit Plans**

**Contribution Rates**

**Statistical Information – Other Programs**



## Changes in Net Assets – Proprietary Fund (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Operating Revenues</b>	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<i>Insurance Contributions:</i>										
State	691,761	686,768	704,182	720,598	803,196	870,735	1,122,408	1,235,235	1,177,512	1,256,123
Member	243,074	244,863	254,203	269,847	293,970	327,981	366,998	393,976	404,107	420,192
Other	190	138	145	142	151	151	648	1,280	3,840	453
<b>Total Operating Revenues</b>	<b>935,025</b>	<b>931,769</b>	<b>958,530</b>	<b>990,587</b>	<b>1,097,317</b>	<b>1,198,867</b>	<b>1,490,054</b>	<b>1,630,491</b>	<b>1,585,459</b>	<b>1,676,768</b>
<b>Operating Expenses</b>										
<i>Benefit Payments:</i>										
Employee	914,805	937,489	993,026	1,070,713	1,168,466	1,308,239	1,493,565	1,627,057	1,107,187	1,189,048
Retiree (Note A)									402,224	439,171
COBRA (Note A)									9,883	18,596
Administrative and Other Expenses	6,378	6,396	6,888	7,880	8,733	9,782	9,433	9,926	9,316	10,312
<b>Total Operating Expenses</b>	<b>921,183</b>	<b>943,885</b>	<b>999,914</b>	<b>1,078,593</b>	<b>1,177,199</b>	<b>1,318,021</b>	<b>1,502,998</b>	<b>1,636,983</b>	<b>1,528,610</b>	<b>1,657,127</b>
<b>Operating Income (Loss)</b>	<b>13,842</b>	<b>(12,116)</b>	<b>(41,384)</b>	<b>(88,006)</b>	<b>(79,882)</b>	<b>(119,154)</b>	<b>(12,944)</b>	<b>(6,492)</b>	<b>56,849</b>	<b>19,641</b>
<b>Non-Operating Revenues (Expenses)</b>										
Net Appreciation (Depreciation) in Fair Value of Investments (B)			(916)	(1,186)	(293)	(1,284)	2,555	949	2,043	(1,750)
Interest Income	23,074	23,993	28,352	24,356	25,190	22,657	11,422	11,930	10,956	16,559
Other	(3)		(8)	(23)	(14)	(4)		220	374	2,644
<b>Change in Net Assets</b>	<b>36,913</b>	<b>11,877</b>	<b>(13,956)</b>	<b>(64,859)</b>	<b>(54,999)</b>	<b>(97,785)</b>	<b>1,033</b>	<b>6,607</b>	<b>70,222</b>	<b>37,094</b>

Note A: Prior to fiscal year 2004 the System recorded benefit payments at a summarized level. Therefore, this level of detail is not available for all years presented.

Note B: Due to the implementation of GASBS 31 in fiscal year 1998, the System began recording the net appreciation(depreciation) in fair value of investments.



# Changes in Net Assets – Defined Benefit Plans (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Employees Retirement Fund (ERS)</b>										
<b>Additions</b>										
Member Contributions	250,793	255,191	267,977	270,260	283,841	286,982	319,565	324,000	300,156	305,870
Employer Contributions	247,904	251,310	264,776	265,031	279,192	281,906	300,969	301,555	278,845	276,035
Investment Income (Net of Expenses)	1,081,935	2,551,653	1,339,836	2,479,568	1,729,163	(1,410,270)	(1,272,412)	1,455,591	1,994,703	2,331,089
Other Additions	18,324	17,870	15,381	18,735	22,944	26,913	32,601	37,719	45,719	50,208
<b>Total Additions</b>	<b>1,598,956</b>	<b>3,076,024</b>	<b>1,887,970</b>	<b>3,033,594</b>	<b>2,315,140</b>	<b>(814,469)</b>	<b>(619,277)</b>	<b>2,118,865</b>	<b>2,619,423</b>	<b>2,963,202</b>
<b>Deductions</b>										
Retirement Benefits	452,234	511,660	552,415	599,827	681,524	827,940	908,511	1,010,238	1,190,313	1,206,562
Death Benefits	7,538	7,057	1,856	1,716	2,487	1,836	2,086	2,327	1,949	2,039
Refunds	85,936	89,943	99,562	104,939	96,261	91,800	70,031	73,438	83,779	89,760
Administrative and Other Expenses	10,889	11,977	13,315	12,499	12,273	12,621	13,295	13,078	12,996	13,878
<b>Total Deductions</b>	<b>556,597</b>	<b>620,637</b>	<b>667,148</b>	<b>718,981</b>	<b>792,545</b>	<b>934,197</b>	<b>993,923</b>	<b>1,099,081</b>	<b>1,289,037</b>	<b>1,312,239</b>
<b>Change in Net Assets</b>	<b>1,042,359</b>	<b>2,455,387</b>	<b>1,220,822</b>	<b>2,314,613</b>	<b>1,522,595</b>	<b>(1,748,666)</b>	<b>(1,613,200)</b>	<b>1,019,784</b>	<b>1,330,386</b>	<b>1,650,963</b>

<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)</b>										
<b>Additions</b>										
Member Contributions							5			
Investment Income (Net of Expenses)	41,996	96,565	50,024	90,550	61,763	(49,664)	(44,338)	49,692	67,906	78,444
Other Additions	18	18		1	1	2		2	2	
<b>Total Additions</b>	<b>42,014</b>	<b>96,583</b>	<b>50,024</b>	<b>90,551</b>	<b>61,764</b>	<b>(49,662)</b>	<b>(44,333)</b>	<b>49,694</b>	<b>67,908</b>	<b>78,444</b>
<b>Deductions</b>										
Retirement Benefits	10,310	14,503	15,507	16,593	18,789	16,815	20,762	22,834	27,559	29,036
Administrative and Other Expenses	447	469	558	576	624	625	685	700	630	521
<b>Total Deductions</b>	<b>10,757</b>	<b>14,972</b>	<b>16,065</b>	<b>17,169</b>	<b>19,413</b>	<b>17,440</b>	<b>21,447</b>	<b>23,534</b>	<b>28,189</b>	<b>29,557</b>
<b>Change in Net Assets</b>	<b>31,257</b>	<b>81,611</b>	<b>33,959</b>	<b>73,382</b>	<b>42,351</b>	<b>(67,102)</b>	<b>(65,780)</b>	<b>26,160</b>	<b>39,719</b>	<b>48,887</b>

<b>Judicial Retirement System of Texas Plan One (JRS I)</b>										
<b>Additions</b>										
Member Contributions	1,057	931	955	890	702	679	439	268	142	62
Appropriations	15,938	16,249	19,177	20,545	21,024	21,918	21,564	22,675	22,622	22,297
Other Additions	146	123	120	135	101	148	120	120	120	120
<b>Total Additions</b>	<b>17,141</b>	<b>17,303</b>	<b>20,252</b>	<b>21,570</b>	<b>21,827</b>	<b>22,745</b>	<b>22,123</b>	<b>23,063</b>	<b>22,884</b>	<b>22,479</b>
<b>Deductions</b>										
Retirement Benefits	15,938	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283
Refunds	27	3						3	1	14
Administrative and Other Expenses	119	120	120	135	88	152	120	120	120	120
<b>Total Deductions</b>	<b>16,084</b>	<b>16,372</b>	<b>19,297</b>	<b>20,680</b>	<b>21,124</b>	<b>21,853</b>	<b>21,898</b>	<b>22,796</b>	<b>22,741</b>	<b>22,417</b>
<b>Change in Net Assets</b>	<b>1,057</b>	<b>931</b>	<b>955</b>	<b>890</b>	<b>703</b>	<b>892</b>	<b>225</b>	<b>267</b>	<b>143</b>	<b>62</b>

<b>Judicial Retirement System of Texas Plan Two (JRS II)</b>										
<b>Additions</b>										
Member Contributions	1,702	1,858	2,144	2,369	2,496	2,638	2,780	3,020	2,922	2,985
Employer Contributions	4,720	5,125	6,008	6,815	7,130	7,258	7,804	8,294	8,205	8,365
Investment Income (Net of Expenses)	2,615	7,674	4,489	9,537	7,637	(6,916)	(7,168)	9,404	13,332	17,348
Other Additions	4	5	6	13	4	5		18	2	11
<b>Total Additions</b>	<b>9,041</b>	<b>14,662</b>	<b>12,647</b>	<b>18,734</b>	<b>17,267</b>	<b>2,985</b>	<b>3,416</b>	<b>20,736</b>	<b>24,461</b>	<b>28,709</b>
<b>Deductions</b>										
Retirement Benefits	213	403	488	722	898	1,211	1,365	2,119	2,770	3,308
Death Benefits	3			13		3				10
Refunds	25	73	22	267	94	116	187	152	303	106
Administrative and Other Expenses	94	134	144	283	249	268	299	245	273	402
<b>Total Deductions</b>	<b>335</b>	<b>610</b>	<b>654</b>	<b>1,285</b>	<b>1,241</b>	<b>1,598</b>	<b>1,851</b>	<b>2,516</b>	<b>3,346</b>	<b>3,826</b>
<b>Change in Net Assets</b>	<b>8,706</b>	<b>14,052</b>	<b>11,993</b>	<b>17,449</b>	<b>16,026</b>	<b>1,387</b>	<b>1,565</b>	<b>18,220</b>	<b>21,115</b>	<b>24,883</b>

<b>Excess Benefit Arrangement</b>										
<b>Additions</b>										
Other Additions							63	67	67	223
<b>Total Additions</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63</b>	<b>67</b>	<b>67</b>	<b>223</b>
<b>Deductions</b>										
Retirement Benefits							63	67	67	223
<b>Total Deductions</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63</b>	<b>67</b>	<b>67</b>	<b>223</b>
<b>Change in Net Assets</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>





## Changes in Net Assets – Defined Contribution Plans and Cafeteria Plan (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>TexaSaver 401(k) Plan</b>										
<b>Additions</b>										
Investment Income (Net of Expenses)	4	4	3	3	4	9	2	1	4	29
Other Additions	104	6	100	200	150	203	234	345	1,328	166
<b>Total Additions</b>	<b>108</b>	<b>10</b>	<b>103</b>	<b>203</b>	<b>154</b>	<b>212</b>	<b>236</b>	<b>346</b>	<b>1,332</b>	<b>195</b>
<b>Deductions</b>										
Administrative and Other Expenses	54	52	76	225	184	220	236	357	366	253
<b>Total Deductions</b>	<b>54</b>	<b>52</b>	<b>76</b>	<b>225</b>	<b>184</b>	<b>220</b>	<b>236</b>	<b>357</b>	<b>366</b>	<b>253</b>
<b>Change in Net Assets</b>	<b>54</b>	<b>(42)</b>	<b>27</b>	<b>(22)</b>	<b>(30)</b>	<b>(8)</b>	<b>-</b>	<b>(11)</b>	<b>966</b>	<b>(58)</b>
<b>TexaSaver 457 Plan</b>										
<b>Additions</b>										
Deferrals	12,210	12,386	12,039	9,280	11,806	8,505	10,649	27,132	37,047	43,817
Rollovers and Transfers	7,291	14,375	17,430	48,832	19,637		30,472	27,241	56,426	39,268
Investment Income (Net of Expenses)	19,263	33,294	25,893	43,448	16,579	(4,842)	(48,761)	18,341	33,976	22,473
Other Additions	418	519	332	300	329	200	430	234	186	119
<b>Total Additions</b>	<b>39,182</b>	<b>60,574</b>	<b>55,694</b>	<b>101,860</b>	<b>48,351</b>	<b>3,863</b>	<b>(7,210)</b>	<b>72,948</b>	<b>127,635</b>	<b>105,677</b>
<b>Deductions</b>										
Distributions and Fees	20,844	21,092	21,884	28,376	25,795	35,692	26,902	27,604	41,851	24,820
Rollovers and Transfers	7,292	14,375	17,430	45,976	21,541		26,460	42,224	67,071	43,191
Administrative and Other Expenses	363	399	401	546	667	1,022	832	849	995	418
<b>Total Deductions</b>	<b>28,499</b>	<b>35,866</b>	<b>39,715</b>	<b>74,898</b>	<b>48,003</b>	<b>36,714</b>	<b>54,194</b>	<b>70,677</b>	<b>109,917</b>	<b>68,429</b>
<b>Change in Net Assets</b>	<b>10,683</b>	<b>24,708</b>	<b>15,979</b>	<b>26,962</b>	<b>348</b>	<b>(32,851)</b>	<b>(61,404)</b>	<b>2,271</b>	<b>17,718</b>	<b>37,248</b>
<b>State Employees Cafeteria Plan (TexFlex)</b>										
<b>Additions</b>										
Contributions	17,006	17,822	18,923	19,388	22,786	27,502	30,502	33,964	43,840	53,425
Investment Income (Net of Expenses)	227	253	282	290	340	238	120	65	25	40
Other Additions	17	9	29	2	2	45	11	18	439	409
<b>Total Additions</b>	<b>17,250</b>	<b>18,084</b>	<b>19,234</b>	<b>19,680</b>	<b>23,128</b>	<b>27,785</b>	<b>30,633</b>	<b>34,047</b>	<b>44,304</b>	<b>53,874</b>
<b>Deductions</b>										
Reimbursement Account Claims	16,346	17,118	18,207	18,553	22,648	27,104	30,027	33,539	42,886	52,337
Administrative and Other Expenses	577	581	596	869	739	1,358	970	1,234	1,336	1,571
<b>Total Deductions</b>	<b>16,923</b>	<b>17,699</b>	<b>18,803</b>	<b>19,422</b>	<b>23,387</b>	<b>28,462</b>	<b>30,997</b>	<b>34,773</b>	<b>44,222</b>	<b>53,908</b>
<b>Change in Net Assets</b>	<b>327</b>	<b>385</b>	<b>431</b>	<b>258</b>	<b>(259)</b>	<b>(677)</b>	<b>(364)</b>	<b>(726)</b>	<b>82</b>	<b>(34)</b>



## Net Assets – Governmental Activities (Unaudited)

Last Four Fiscal Years (in 000's)  
(Accrual Basis of Accounting)

	Fiscal Year (Note A)			
	2002	2003	2004	2005
<b>Governmental Activities:</b>	\$	\$	\$	\$
Restricted	19,333	25,939	96,160	133,253
Unrestricted	420	16	3	27
<b>Total Governmental Activities</b>	<b>19,753</b>	<b>25,955</b>	<b>96,163</b>	<b>133,280</b>



## Changes in Net Assets – Governmental Activities (Unaudited)

Last Four Fiscal Years (in 000's)  
(Accrual Basis of Accounting)

	Fiscal Year (Note A)			
	2002	2003	2004	2005
<b>Expenses</b>	\$	\$	\$	\$
<i>Governmental Activities:</i>				
Social Security Administration	55	39	31	52
<i>Death Benefits:</i>				
Peace Officers, Firemen, etc.	7,322	4,677	4,985	2,660
Compensation to Victims of Crime				1,250
Retiree \$5,000 Lump Sum	6,432	6,453	6,681	7,026
<i>Group Benefits Program:</i>				
Claims Expenses	1,493,565	1,627,057	1,519,295	1,646,815
Administration	9,433	9,926	9,316	10,312
<b>Total Governmental Activities Expenses</b>	<b>1,516,807</b>	<b>1,648,152</b>	<b>1,540,308</b>	<b>1,668,115</b>

### Program Revenues

<i>Governmental Activities:</i>				
<i>Charges for Services:</i>				
Administration Fees				73
<i>Appropriations:</i>				
Administration	28	28	28	28
<i>Death Benefits:</i>				
Peace Officers, Firemen, etc.	7,248	4,649	4,957	2,632
Compensation to Victims of Crime				1,250
Retiree \$5,000 Lump Sum	6,487	6,087	6,681	7,030
<i>Insurance Contributions:</i>				
State	1,122,408	1,235,235	1,177,512	1,256,123
Member	366,998	393,976	404,107	420,192
Other	152	129	154	145
<i>Operating Grants and Contributions:</i>				
Membership Fee Revenue	55		18	
Investment Income	13,977	12,879	12,999	14,809
Other	496	1,371	4,060	2,951
<b>Total Governmental Activities Program Revenues</b>	<b>1,517,849</b>	<b>1,654,354</b>	<b>1,610,516</b>	<b>1,705,233</b>

### Net Revenue

<b>Governmental Activities</b>	<b>1,042</b>	<b>6,202</b>	<b>70,208</b>	<b>37,118</b>
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Note A: Information is available since the implementation of GASB Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments in 2002.



## Fund Balances – Governmental Funds (Unaudited)

Last Ten Fiscal Years (in 000's)  
(Modified Accrual Basis of Accounting)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Governmental Funds:</b>	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Unreserved, reported in:										
Special Revenue Funds	77	37	97	49	80	411	420	16	3	27
<b>Total Governmental Funds</b>	<b>77</b>	<b>37</b>	<b>97</b>	<b>49</b>	<b>80</b>	<b>411</b>	<b>420</b>	<b>16</b>	<b>3</b>	<b>27</b>



## Changes in Fund Balances – Governmental Funds (Unaudited)

Last Ten Fiscal Years (in 000's)  
(Modified Accrual Basis of Accounting)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Revenues</b>	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Appropriations for (Note A):										
Administration	28	28	28	28	28	28	28	28	28	28
Death Benefits:										
Public Employee Survivors	554	845	667	734	930	1,410	7,248	4,649	4,957	2,632
Retiree \$5,000 Lump Sum			5,376	5,946	6,102	6,418	6,487	6,087	6,681	7,030
Judicial Salaries	71									
Administration Fees										73
<b>Total Revenues</b>	<b>653</b>	<b>873</b>	<b>6,071</b>	<b>6,708</b>	<b>7,060</b>	<b>7,856</b>	<b>13,763</b>	<b>10,764</b>	<b>11,666</b>	<b>9,763</b>
<b>Expenditures</b>										
Death Benefits:										
Public Employee Survivors	554	845	667	739	936	1,359	7,294	4,649	4,957	2,632
Victims of Crime										1,250
Retiree \$5,000 Lump Sum			5,376	5,946	6,077	6,132	6,432	6,453	6,681	7,026
Judicial Salaries	698									
Administrative Expenditures	66	68	68	72	71	84	83	67	59	80
<b>Total Expenditures</b>	<b>1,318</b>	<b>913</b>	<b>6,111</b>	<b>6,757</b>	<b>7,084</b>	<b>7,575</b>	<b>13,809</b>	<b>11,169</b>	<b>11,697</b>	<b>10,988</b>
<b>Excess of Revenues Over (Under)</b>										
<b>Expenditures</b>	<b>(665)</b>	<b>(40)</b>	<b>(40)</b>	<b>(49)</b>	<b>(24)</b>	<b>281</b>	<b>(46)</b>	<b>(405)</b>	<b>(31)</b>	<b>(1,225)</b>
<b>Other Financing Sources (Uses)</b>										
Membership Fees			100		54	50	55		18	
Victims of Crime Fund										1,250
<b>Net Change in Fund Balances</b>	<b>(665)</b>	<b>(40)</b>	<b>60</b>	<b>(49)</b>	<b>30</b>	<b>331</b>	<b>9</b>	<b>(405)</b>	<b>(13)</b>	<b>25</b>

Note A: Includes lapsed appropriations.



## Benefit and Refund Payments (Unaudited)

Last Ten Fiscal Years (in 000's)

Type of Benefit	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Employees Retirement Fund:</b>										
Retirement Benefits:										
Service:										
Retirees	434,749	491,106	530,214	576,262	656,150	797,887	876,335	978,090	1,058,681	1,095,209
Survivors	not avail.	not avail.	not avail.	not avail.	not avail.	not avail.	not avail.	not avail.	3,532	20,286
Disability	15,827	18,739	20,001	21,198	22,599	26,786	28,375	28,005	30,815	31,419
Partial Lump Sum Option									91,731	53,030
Proportional	1,658	1,815	2,200	2,367	2,775	3,267	3,801	4,143	5,554	6,618
Total Retirement Benefits	452,234	511,660	552,415	599,827	681,524	827,940	908,511	1,010,238	1,190,313	1,206,562
Death Benefits:										
Active Members:										
Occupational	56	70	18	117	63	84	72		128	41
Non-Occupational	1,126	1,119	1,202	708	1,364	899	909	1,249	884	842
Retiree	6,356	5,868	636	891	1,060	853	1,105	1,078	937	1,156
Total Death Benefits	7,538	7,057	1,856	1,716	2,487	1,836	2,086	2,327	1,949	2,039
Refunds:										
Resignation	83,764	87,523	97,139	103,204	93,915	89,621	67,838	70,542	82,075	87,513
Death	2,172	2,420	2,423	1,735	2,346	2,179	2,193	2,896	1,704	2,247
Total Refunds	85,936	89,943	99,562	104,939	96,261	91,800	70,031	73,438	83,779	89,760

Type of Benefit	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund:</b>										
Retirement Benefits:										
Service	9,558	13,567	14,500	15,537	17,681	15,635	19,583	21,477	23,492	25,836
Disability	752	936	1,007	1,056	1,108	1,180	1,179	1,357	1,275	1,318
Partial Lump Sum Option									2,792	1,882
Total Retirement Benefits	10,310	14,503	15,507	16,593	18,789	16,815	20,762	22,834	27,559	29,036

Type of Benefit	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Judicial Retirement System of Texas Plan One:</b>										
Retirement Benefits:										
Service	15,938	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283
Total Retirement Benefits	15,938	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283
Refunds:										
Resignation	27	3							1	13
Death								3		1
Total Refunds	27	3	-	-	-	-	-	3	1	14

Type of Benefit	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Judicial Retirement System of Texas Plan Two:</b>										
Retirement Benefits:										
Service	162	340	397	501	603	744	868	1,453	1,983	2,609
Disability	16	34	56	104	92	208	208	208	184	192
Proportional	35	29	35	117	203	259	289	458	603	507
Total Retirement Benefits	213	403	488	722	898	1,211	1,365	2,119	2,770	3,308
Death Benefits:										
Active Members:										
Non-Occupational	3			13		3				10
Total Death Benefits	3			13		3				10
Refunds:										
Resignation		73	22	224	5	55	195	152	235	67
Death	25			43	89	61	(8)		68	39
Total Refunds	25	73	22	267	94	116	187	152	303	106

Type of Benefit	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Excess Benefit Arrangement:</b>										
Retirement Benefits:										
Service							63	67	67	223
Total Retirement Benefits	-	-	-	-	-	-	63	67	67	223



# Retired Members by Type of Benefit (Unaudited)

August 31, 2005

## Employees Retirement Fund (Note A)

Average Amount of Monthly Benefit (Note C)	Number of Retirees	Type of Retirement		Option Selected (Note B)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
\$ 0-300	4,160	4,039	121	2,434	859	284	63	376	144
301-600	9,721	8,880	841	7,032	1,437	517	92	319	324
601-900	9,854	8,922	932	7,215	1,292	627	108	260	352
901-1,200	8,222	7,744	478	5,849	1,068	716	94	176	319
1,201-1,500	7,026	6,782	244	4,706	932	769	94	139	386
1,501-2,000	8,959	8,800	159	5,541	1,162	1,246	138	186	686
2,001-2,500	7,138	7,096	42	4,161	874	1,234	69	162	638
2,501-3,000	5,011	4,999	12	2,594	647	1,008	55	128	579
3,001-4,000	4,134	4,129	5	2,172	540	774	46	76	526
4,001-10,999	1,495	1,491	4	782	214	237	17	28	217
<b>Total</b>	<b>65,720</b>	<b>62,882</b>	<b>2,838</b>	<b>42,486</b>	<b>9,025</b>	<b>7,412</b>	<b>776</b>	<b>1,850</b>	<b>4,171</b>

## Law Enforcement And Custodial Officer Supplemental Retirement Fund (Note A)

Average Amount of Monthly Benefit	Number of Retirees	Type of Retirement		Option Selected (Note B)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
\$ 0-200	345	344	1	184	86	38	7	5	25
201-400	1,980	1,927	53	1,116	377	266	38	39	144
401-600	1,710	1,681	29	734	266	409	11	29	261
601-800	640	639	1	267	104	144	8	5	112
801-1,000	173	172	1	88	28	37	5	2	13
1,001-1,200	79	78	1	41	23	6	3	1	5
1,201-1,400	51	41	10	34	7	6	1	0	3
1,401-1,600	36	23	13	26	5	2	0	1	2
1,601-1,800	19	11	8	13	2	0	1	0	3
1,801-9,999	37	26	11	25	7	2	0	0	3
<b>Total</b>	<b>5,070</b>	<b>4,942</b>	<b>128</b>	<b>2,528</b>	<b>905</b>	<b>910</b>	<b>74</b>	<b>82</b>	<b>571</b>

## Judicial Retirement Plan Two Fund (Note A)

Average Amount of Monthly Benefit (Note C)	Number of Retirees	Type of Retirement		Option Selected (Note B)					
		Service	Disability	Life	Option 1	Option 2	Option 3	Option 4	Option 5
\$ 0-2,000	8	8	0	5	2	0	1	0	0
2,001-2,500	3	3	0	0	0	0	2	1	0
2,501-3,000	1	1	0	1	0	0	0	0	0
3,001-3,500	1	1	0	1	0	0	0	0	0
3,501-4,000	7	7	0	2	4	0	0	1	0
4,001-4,500	18	18	0	4	13	0	0	0	1
4,501-5,000	14	14	0	4	6	3	0	1	0
5,001-5,500	15	14	1	5	6	1	0	0	3
5,501-6,000	5	5	0	3	1	0	0	1	0
6,001-6,500	5	4	1	4	0	1	0	0	0
6,501-7,000	3	3	0	3	0	0	0	0	0
7,001-7,500	1	1	0	1	0	0	0	0	0
<b>Total</b>	<b>81</b>	<b>79</b>	<b>2</b>	<b>33</b>	<b>32</b>	<b>5</b>	<b>3</b>	<b>4</b>	<b>4</b>

Note A: These calculations are based on actuarial estimates.

Note B: 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 C: The monthly benefit amounts include increases provided by 2005 legislation that are effective after August 31, 2005.



## Average Benefit Payments (Unaudited)

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, 1995 to August 31, 2005</b>						
<b>- Period 9/30/95 to 8/31/96:</b>						
Average Monthly Benefit	\$ 356.89	\$ 684.67	\$ 945.22	\$ 1,292.75	\$ 1,859.27	\$ 2,585.13
Average Final Average Salary	\$ 2,172.22	\$ 2,372.71	\$ 2,265.09	\$ 2,373.19	\$ 2,799.40	\$ 3,262.21
Number of Retired Members	127	386	234	234	370	413
<b>- Period 9/30/96 to 8/31/97:</b>						
Average Monthly Benefit	\$ 378.97	\$ 590.85	\$ 933.06	\$ 1,195.45	\$ 1,794.90	\$ 2,341.35
Average Final Average Salary	\$ 2,316.28	\$ 2,150.10	\$ 2,364.57	\$ 2,288.23	\$ 2,831.47	\$ 3,075.11
Number of Retired Members	110	300	159	188	234	225
<b>- Period 9/30/97 to 8/31/98:</b>						
Average Monthly Benefit	\$ 379.63	\$ 624.65	\$ 932.88	\$ 1,348.21	\$ 2,024.98	\$ 2,550.79
Average Final Average Salary	\$ 2,302.42	\$ 2,226.61	\$ 2,303.80	\$ 2,451.95	\$ 3,030.36	\$ 3,350.66
Number of Retired Members	161	510	319	601	959	685
<b>- Period 9/30/98 to 8/31/99:</b>						
Average Monthly Benefit	\$ 393.43	\$ 661.12	\$ 990.56	\$ 1,364.33	\$ 1,979.82	\$ 2,522.20
Average Final Average Salary	\$ 2,347.88	\$ 2,399.09	\$ 2,459.13	\$ 2,568.62	\$ 3,048.61	\$ 3,325.61
Number of Retired Members	156	515	319	437	718	574
<b>- Period 9/30/99 to 8/31/00:</b>						
Average Monthly Benefit	\$ 334.30	\$ 637.29	\$ 924.71	\$ 1,317.65	\$ 1,942.26	\$ 2,404.53
Average Final Average Salary	\$ 2,207.62	\$ 2,541.75	\$ 2,468.23	\$ 2,779.21	\$ 3,247.34	\$ 3,439.58
Number of Retired Members	191	607	398	504	918	747
<b>- Period 9/30/00 to 8/31/01:</b>						
Average Monthly Benefit	\$ 379.80	\$ 619.43	\$ 941.20	\$ 1,333.48	\$ 1,927.79	\$ 2,479.18
Average Final Average Salary	\$ 2,704.07	\$ 2,548.18	\$ 2,706.21	\$ 2,869.50	\$ 3,349.04	\$ 3,637.24
Number of Retired Members	145	581	387	459	831	665
<b>- Period 9/30/01 to 8/31/02:</b>						
Average Monthly Benefit	\$ 370.35	\$ 636.58	\$ 978.86	\$ 1,396.80	\$ 2,050.67	\$ 2,689.17
Average Final Average Salary	\$ 2,588.34	\$ 2,633.68	\$ 2,834.02	\$ 3,037.54	\$ 3,544.02	\$ 3,943.99
Number of Retired Members	177	684	415	601	1036	1021
<b>- Period 9/30/02 to 8/31/03:</b>						
Average Monthly Benefit	\$ 373.18	\$ 687.49	\$ 1,025.94	\$ 1,440.62	\$ 2,052.42	\$ 2,750.33
Average Final Average Salary	\$ 2,542.35	\$ 2,775.54	\$ 2,888.55	\$ 3,198.93	\$ 3,558.83	\$ 3,995.88
Number of Retired Members	357	1477	911	1086	1762	1816
<b>- Period 9/30/03 to 8/31/04:</b>						
Average Monthly Benefit	\$ 403.29	\$ 646.52	\$ 1,118.33	\$ 1,559.41	\$ 2,222.87	\$ 2,714.35
Average Final Average Salary	\$ 2,785.86	\$ 2,815.99	\$ 3,084.32	\$ 3,331.79	\$ 3,794.45	\$ 3,995.63
Number of Retired Members	200	516	316	727	920	462
<b>- Period 9/30/04 to 8/31/05:</b>						
Average Monthly Benefit	\$ 387.14	\$ 716.07	\$ 1,232.23	\$ 1,620.98	\$ 2,324.41	\$ 2,892.16
Average Final Average Salary	\$ 2,623.48	\$ 2,848.58	\$ 3,219.87	\$ 3,386.78	\$ 3,907.85	\$ 4,165.92
Number of Retired Members	163	568	369	733	957	494
<b>Five Year Average -</b>						
<b>Period 9/30/00 to 8/31/05:</b>						
Average Monthly Benefit	\$ 381.58	\$ 666.77	\$ 1,048.04	\$ 1,480.29	\$ 2,109.04	\$ 2,707.86
Average Final Average Salary	\$ 2,632.10	\$ 2,731.95	\$ 2,926.47	\$ 3,195.07	\$ 3,624.42	\$ 3,949.31
Average Number of Retired Members	208	765	480	721	1101	892
<b>Ten Year Average -</b>						
<b>Period 9/30/95 to 8/31/05:</b>						
Average Monthly Benefit	\$ 375.47	\$ 657.31	\$ 1,009.76	\$ 1,424.73	\$ 2,052.47	\$ 2,627.05
Average Final Average Salary	\$ 2,480.09	\$ 2,592.33	\$ 2,724.17	\$ 2,962.97	\$ 3,415.33	\$ 3,719.90
Average Number of Retired Members	179	614	383	557	871	710

Note A: This schedule includes service retirements of the employee class as of September 26, 2005. It does not include disability retirements or the elected state official class.



## Statistical Information – Defined Benefit Plans (Unaudited)

(All items expressed as numbers unless otherwise indicated)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Employees Retirement Fund</b>										
Active Contributing Members	158,232	159,454	155,317	154,183	152,167	149,956	150,313	142,315	133,349	132,417
Non-Contributing Members	23,890	27,589	31,346	36,502	41,276	46,089	48,903	51,868	54,658	57,089
Retirees and Beneficiaries	35,085	34,857	39,247	43,860	47,310	47,392	50,514	57,024	60,089	63,453
Service Retirements	2,486	1,624	2,654	3,244	3,688	3,229	4,050	7,581	3,906	4,609
Disability Retirements	215	186	142	209	196	213	156	174	181	179
Resignation Refunds	19,317	19,456	19,916	19,503	21,109	21,869	16,817	16,680	13,947	14,239
Death Refunds	256	261	240	247	261	301	335	316	237	294
<b>Law Enforcement and Custodial Officer Supplemental Retirement Fund (Notes A &amp; B)</b>										
Active Contributing Members	38,852	39,622	39,716	39,979	42,040	40,431	41,221	40,332	38,391	37,251
Non-Contributing Members	not avail.	3,879	2,425	3,132	4,372	5,619	6,519	7,264	7,856	8,428
Retirees and Beneficiaries	2,034	2,185	2,356	2,526	2,774	3,093	3,523	4,166	4,576	5,072
Service Retirements	201	127	143	153	249	296	508	686	431	537
Disability Retirements	6	4		1	3	4	3	1	3	
<b>Judicial Retirement System of Texas Plan One</b>										
Active Contributing Members	194	165	162	133	123	95	91	58	53	28
Non-Contributing Members	27	60	25	29	27	24	24	22	15	36
Retirees and Beneficiaries	425	443	436	461	465	485	493	505	494	491
Service Retirements	16	27	5	27	9	26	13	27	10	12
Disability Retirements			1							
Resignation Refunds	3	1			1				1	1
Death Refunds							1			1
<b>Judicial Retirement System of Texas Plan Two</b>										
Active Contributing Members	329	359	362	395	412	442	464	476	484	491
Non-Contributing Members	38	52	40	50	51	77	63	80	79	90
Retirees and Beneficiaries	6	12	14	22	27	29	34	78	72	81
Service Retirements	2	5	6	1	3	3	3	24	8	9
Disability Retirements			2		2					
Resignation Refunds		7	2	3	1	3	7	5	8	8
Death Refunds	2									1

Note A: Refunds are not applicable to the LECOS because there is no member contribution.

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

Source: The System's Member Records supplemented with actuarial estimates.



## Contribution Rates (Unaudited)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Defined Benefit Plans (Note A)</b>	%	%	%	%	%	%	%	%	%	%
<b>Employees Retirement Fund</b>										
<i>Employee Class:</i>										
Employee	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
State	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
<i>Elected Class:</i>										
Legislators	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Other Elected Class	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
State	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
<b>Judicial Retirement System Plan One Fund</b>										
Employee	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
<b>Judicial Retirement System Plan Two Fund</b>										
Employee	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
State	16.54	16.54	16.83	16.83	16.83	16.83	16.83	16.83	16.83	16.83

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Group Benefits Program</b>	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<i>Employee Only:</i>										
State Contribution Monthly Rate	186.31	186.31	190.73	190.73	215.58	249.71	276.02	308.84	300.27	315.56
HealthSelect Monthly Premium	186.31	186.31	190.73	199.78	215.58	249.71	276.02	308.84	300.27	315.56
ERS Supplement (Note B)				9.05						
<i>Employee &amp; Children:</i>										
State Contribution Monthly Rate	257.16	257.16	263.29	263.29	297.70	344.97	381.43	426.89	415.02	436.19
HealthSelect Monthly Premium	328.01	328.01	335.84	351.86	379.82	440.23	486.84	544.93	529.76	556.82
ERS Supplement (Note B)				12.53						
<i>Employee &amp; Spouse:</i>										
State Contribution Monthly Rate	292.13	292.13	299.09	299.09	338.23	391.98	433.45	485.14	471.65	495.73
HealthSelect Monthly Premium	397.94	397.94	407.45	426.91	460.88	534.25	590.88	661.44	643.02	675.89
ERS Supplement (Note B)				14.26						
<i>Employee &amp; Family:</i>										
State Contribution Monthly Rate	362.98	362.98	371.65	371.65	420.35	487.24	538.86	603.19	586.39	616.36
HealthSelect Monthly Premium	539.64	539.64	552.56	578.99	625.12	724.77	801.70	897.53	872.51	917.15
ERS Supplement (Note B)				17.74						
Total State Contribution (in millions)	691.8	686.8	704.2	720.6	803.2	870.7	1,122.4	1,235.2	1,177.5	1,256.1

Note A: There are no State or employee contributions for the Law Enforcement and Custodial Officer Supplemental Retirement Fund.

Note B: In fiscal year 1999, the System provided a supplement to make up the difference between the State contribution rate and the HealthSelect premium.





## Statistical Information – Other Programs (Unaudited)

(All items expressed as numbers unless otherwise indicated)

	Fiscal Year									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>457 Defined Contribution Plan (Note A)</b>										
<b>TexaSaver 457 Plan (Note B):</b>										
Total Participants	n/a	n/a	n/a	n/a	n/a	4,531	5,793	7,525	9,937	12,425
Participants Currently Deferring	n/a	n/a	n/a	n/a	n/a	3,419	3,971	4,862	5,908	7,632
Current Market Value of Plan Assets (in millions)	n/a	n/a	n/a	n/a	n/a	\$ 56.4	\$ 69.7	\$ 103.7	\$ 159.6	\$ 219.8
<b>Original 457 Plan (Notes B &amp; C):</b>										
Total Participants	10,960	11,000	10,500	11,000	10,838	8,374	7,422	6,015	5,104	3,693
Participants Currently Deferring	5,500	5,370	5,200	5,200	4,423	267	261	207	138	127
Current Market Value of Plan Assets (in millions)	\$ 258.0	\$ 285.0	\$ 301.0	\$ 328.7	\$ 329.1	\$ 244.8	\$ 183.0	\$ 133.8	\$ 95.8	\$ 73.5
<b>TexaSaver 401(k) Defined Contribution Plan (Note A)</b>										
Total Participants	39,700	43,830	47,600	51,100	57,306	54,177	57,155	56,848	56,504	54,349
Participants Currently Deferring	30,400	31,960	34,700	36,400	39,533	38,407	35,856	32,714	30,075	28,574
Current Market Value of Plan Assets (in millions)	\$ 257.0	\$ 343.0	\$ 402.7	\$ 545.4	\$ 675.8	\$ 602.6	\$ 604.7	\$ 703.4	\$ 779.3	\$ 886.0
Deferrals (in millions)	not avail.	not avail.	not avail.	\$ 80.6	\$ 90.3	\$ 94.9	\$ 95.0	\$ 89.1	\$ 86.9	\$ 83.6
<b>Cafeteria Plan (Note A)</b>										
Reimbursement Accounts:										
Health Care	8,500	8,582	9,500	9,800	12,314	15,924	17,419	19,128	23,868	29,728
Dependent Care	2,600	2,646	2,500	2,400	2,425	2,480	2,336	2,297	2,416	2,522
Total Redirected (in millions)	\$ 16.3	\$ 17.1	\$ 18.2	\$ 18.7	\$ 22.5	\$ 27.1	\$ 30.1	\$ 33.6	\$ 43.1	\$ 52.4
Premium Conversion:										
Participants	147,000	146,109	142,493	146,407	209,031	208,511	208,651	209,929	199,215	206,173
Premiums Redirected (in millions)	\$ 161.7	\$ 179.6	\$ 192.5	\$ 203.4	\$ 237.8	\$ 263.8	\$ 291.0	\$ 312.1	\$ 321.4	\$ 337.8
Tax Savings (in millions):										
Employees	\$ 40.0	\$ 40.7	\$ 43.6	\$ 46.1	\$ 53.9	\$ 59.7	\$ 65.9	\$ 70.7	\$ 72.8	\$ 76.5
State of Texas	\$ 13.6	\$ 13.7	\$ 14.7	\$ 15.6	\$ 18.2	\$ 20.2	\$ 22.3	\$ 23.9	\$ 24.6	\$ 25.8
<b>Group Benefits Program (Note A)</b>										
Membership:										
Active	211,580	211,255	209,657	209,558	210,675	210,924	209,859	211,695	192,859	198,627
Retired	45,178	46,423	49,390	52,015	54,974	57,953	56,714	59,603	66,348	68,109
Dependents	241,000	246,000	250,000	253,000	255,000	252,000	253,000	248,749	235,834	236,691
COBRA	2,617	2,733	2,640	2,707	2,545	2,124	2,060	1,744	1,736	1,558
	<u>500,375</u>	<u>506,411</u>	<u>511,687</u>	<u>517,280</u>	<u>523,194</u>	<u>523,001</u>	<u>521,633</u>	<u>521,791</u>	<u>496,777</u>	<u>504,985</u>
<b>Death Benefit Programs</b>										
Lump Sum Payments	5	10	7	9	13	29	36	20	19	11
Monthly Payments to Guardians	125	117	106	97	101	104	107	113	109	127
Victims of Violent Crime	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	5

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

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

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