

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, 2006

	ERS (A)	LECOS (A)	JRS I	JRS II
Active Members	132,411	37,103	43	498
Terminated Employees Entitled to Benefits	61,567	33	12	95
Total Retirement Accounts	193,978	37,136	55	593
Retirees and Beneficiaries	67,596	5,318	486	89
Service Retirements	2,929	306	7	10
Disability Retirements	80			
Total Retirements During the Fiscal Year	3,009	306	7	10
Funded Ratios (As of August 31, 2006)	95.2%	101.7%		93.7%
Results of Investments - Pension Trust Funds				
	ERS	LECOS	JRS I (B)	JRS II
	\$	\$	\$	\$
Interest, Dividends & Securities				
Lending Income	688,296,366	22,874,456		5,629,251
Net Appreciation in Fair Value of Investments	1,069,644,848	35,478,030		8,905,402
Time Weighted Rate of Return				
	1-Year	3-Year	5-Year	
Pension Investment Pool Trust Fund	8.83%	11.06%	6.79%	
Other Transactions Summary				
	ERS	LECOS	JRS I (B)	JRS II
	\$	\$	\$	\$
Member Contributions	292,022,735		213,501	3,550,847
Service Purchases	50,129,384		566,394	127,724
State Retirement Contributions	316,197,838			10,052,152
Retirement Benefits	1,244,181,983	30,184,076	27,664,199	4,223,003
Death Benefits:				
Active Members	1,316,713			24,363
Retirees	915,567			
Lump Sum Retiree Death Benefits (C)	6,931,297			
Member Contributions Withdrawn	75,614,028			64,806
Administrative Expenses	13,263,934	378,051	120,000	302,835
Investment Expenses	20,353,515	696,281		150,567

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.

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

December 20, 2006



**EMPLOYEES
RETIREMENT
SYSTEM OF TEXAS**

ANN S. FUELBERG
EXECUTIVE DIRECTOR

DON GREEN
CHAIR

OWEN WHITWORTH
VICE-CHAIR

BILL CEVERHA

CAROLYN LEWIS GALLAGHER

YOLANDA GRIEGO

I. CRAIG HESTER

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 2006.

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 prudent investment practices and a stable stock market earned the ERS trust fund a return of 8.83 percent in fiscal year 2006, allowing it to close the fiscal year with a market value of \$22.3 billion.

Although the ERS trust fund has increased in value, it is still working through losses suffered in fiscal years 2001-2002 when the stock market sank, and trying to keep pace with the benefit enhancements that were approved in the 1990s when earnings exceeded retirement expenses.

The 2003 retirement incentive and pay raises have also had an impact on the fund, but they have been tempered slightly by salary and demographic changes in 2006 that fell short of earlier assumptions.

The state resumed funding the normal cost contribution in the last regular legislative session for the first time in 10 years, which has also eased pressure on the trust.

When all factors are taken into consideration, the funded ratio of the ERS trust is currently 95.2 percent.

Funding gaps occur during the life of all retirement systems. While investment return rates are the easiest way to close them, investment earnings are the largest source of money to pay retirement benefits at ERS and they should not be expected to close the funding gap alone.

In order to remain actuarially sound, it is critical for ERS to continue to receive the normal cost and the Annual Required Contribution (ARC).

We are currently in the process of reviewing and upgrading our investment program to take advantage of every efficiency the industry can offer and we are hopeful that the restoration of retirement funds through the maintenance of normal cost and the ARC will allow the trust to continue to provide State of Texas officers and employees with a secure retirement program and high-quality service.

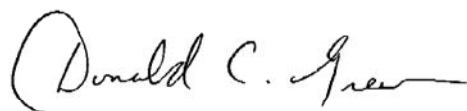
As of August 31, 2006, there were 132,411 active ERS members. A total of 3,009 employees retired during fiscal year 2006, which brings the total number of state retirees and beneficiaries to 67,596 and total retirement payments of \$1.3 billion a year.

We are proud to report that we have been successful at holding health care costs in the Group Benefits Plan below national trends and we will continue to work with our plan administrators to explore new cost containment strategies. We have requested funds for the next biennium that will allow the state to maintain the health insurance plan as it is currently structured without revisions that would place additional burdens on employees or retirees.

In 2006, ERS enhanced telephone access with automated 24-hour service to allow members to check account balances, service credit totals, projected retirement eligibility, and estimated annuity amounts. The same information will be available soon for members through ERS OnLine, along with the ability to model retirement situations and gather estimates on the cost to purchase service.

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.



DON GREEN
Chair, Board of Trustees



ANN S. FUELBERG
Executive Director



December 20, 2006

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

Ladies and Gentlemen:

**EMPLOYEES
RETIREMENT
SYSTEM OF TEXAS**

ANN S. FUELBERG
EXECUTIVE DIRECTOR

DON GREEN
CHAIR

OWEN WHITWORTH
VICE-CHAIR

BILL CEVERHA

CAROLYN LEWIS GALLAGHER

YOLANDA GRIEGO

I. CRAIG HESTER

BOARD OF TRUSTEES

I am pleased to submit the Comprehensive Annual Financial Report of the Employees Retirement System of Texas (the System) for the year ended August 31, 2006, 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 staff prepared this report. It has been audited by Deloitte & Touche, LLP. For information regarding the scope of the audit, please see 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, 2006.

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 covers certified custodial officers employed by the Department of Criminal Justice, including the Board of Pardons and Paroles.

The Judicial Retirement Plan I and Plan II were established to provide benefits for judges. Plan I was established in 1949 as a pay-as-you-go pension plan rather than a funded pension plan. Plan II 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 (the Board) and directed by the same management.

Accountability for all fiscal and budgetary matters is the responsibility of 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 \$22.3 billion, and returned 8.8% for the year. The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the fourth year in a row reflecting the continued rebound in the domestic and international equity markets. Over the longer term, the fund returned 7.99% for the 10 years ended August 31, 2006 slightly better than the policy benchmark of 7.89%.

Funding

A pension system instills confidence and trust when it has assets sufficient to meet the retirement benefit schedules of its members. For the Employees Retirement System Fund, the August 31, 2006 actuarial valuation shows that the ratio of the actuarial value of assets to the actuarial accrued liability was 95.2%, which is in the upper echelon of public pension systems. The System is taking the initiative to enhance investment systems and to work with the Legislature to increase state contributions in an on-going effort to improve the funding status of the various benefit systems under management.

MAJOR INITIATIVES

In fiscal year 2006, the Board and staff began fully restructuring the Systems' Investments Division, including: a complete top-to-bottom operational review; a global custodian bank search to enhance services at an overall lower cost; innovative new investment software technology to improve reporting practices; and the successful transition to four new investment advisors.

The System also implemented legislation passed by the 79th Legislature to continue to provide for a financially secure retirement system. Interest rates were increased for re-established service; non-occupational disability and death benefits were restricted to contributing members; the amount of Additional Service Credit that may be purchased by members was reduced to three years; and a provision allowing service credit with certain governmental employers was repealed.

The Group Benefits Program (GBP) for active and retired employee insurance benefited from an audit of the GBP actuary to determine that the actuarial projections are appropriate for planning and budgeting purposes.

The System also implemented legislation that was designed to help manage growing costs in the health insurance program, which included: the acquisition of a federal subsidy to support the cost of pharmaceuticals for retirees who are eligible for Medicare Part D, while maintaining their state benefit; a nurse practitioner pilot program to determine cost-savings that may be associated with the availability of work-site health care; and a Health Savings Account (HSA) study to explore the costs and benefits that may be associated with creating an HSA program for the State.

In fiscal year 2007, 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

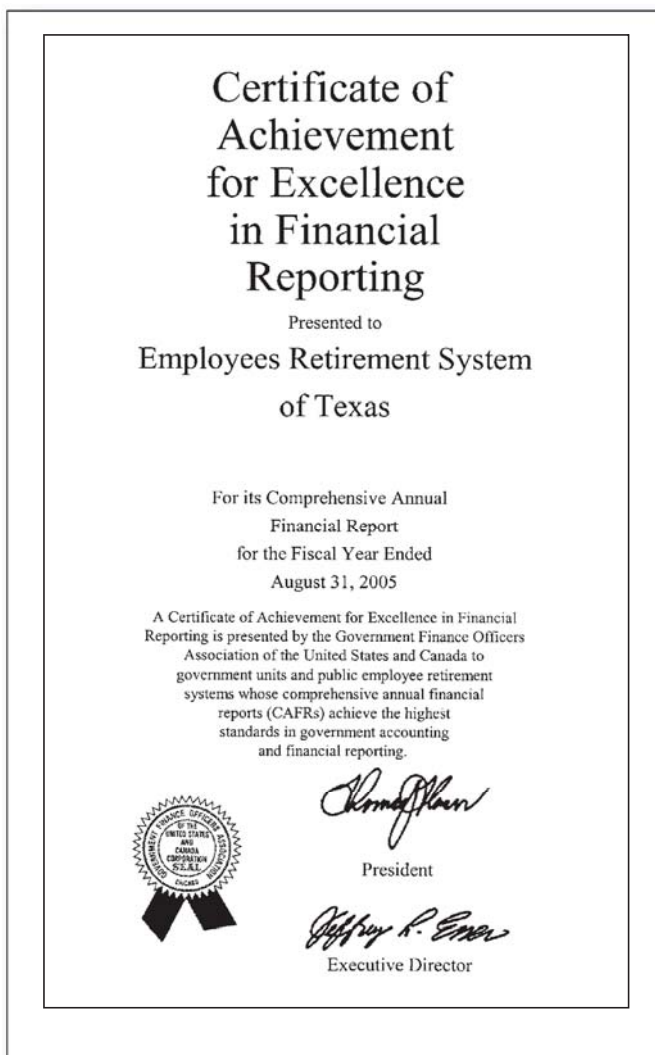
The Government Finance Officers Association (GFOA) of the United States and Canada awarded the Certificate of Achievement for Excellence in Financial Reporting to the System for its Comprehensive Annual Financial Report for the fiscal year ended August 31, 2005. The Certificate of Achievement is a prestigious 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 for only one year. The System has received a Certificate of Achievement for each of the last 17 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 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.

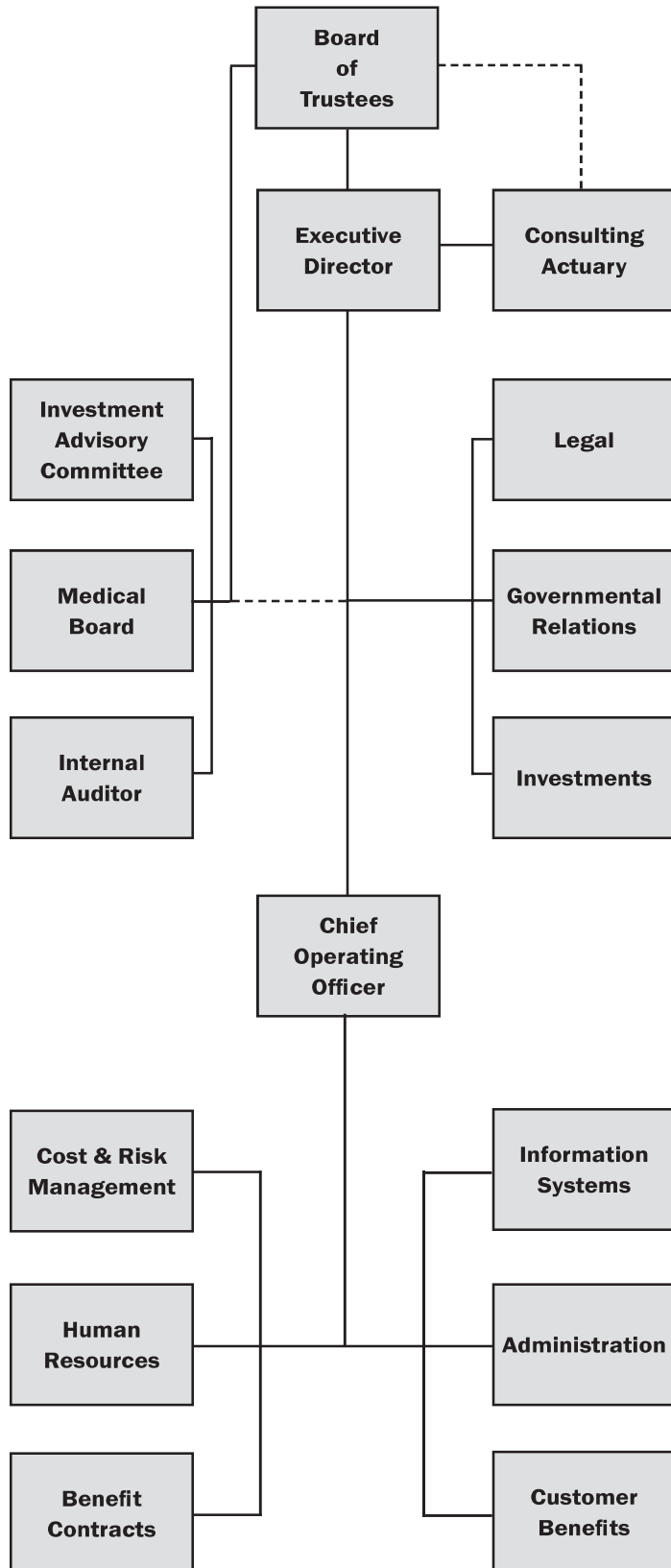


MICHAEL C. WHEELER, CPA
Chief Financial Officer



Organizational Chart and Data (Unaudited)

As of August 31, 2006



BOARD OF TRUSTEES

Carolyn Lewis Gallagher, Chair

Don Green, Vice Chair
 Bill Ceverha
 Yolanda Griego
 I. Craig Hester
 Owen Whitworth

STAFF

Ann S. Fuelberg, Executive Director

Joe H. Golson, Director of Cost & Risk Management
 Paula A. Jones, General Counsel
 Robert Kukla, Director of Benefit Contracts
 Kurt Lehmann, Chief Technology Officer
 William S. Nail, Director of Governmental Relations
 Kathy-Ann Reissman, Chief Investment Officer
 Marci Sundbeck, Director of Internal Audit
 Catherine E. Terrell, Director of Customer Benefits
 Ann Waterman, Director of Administration
 Larry Zeplin, Chief Operating Officer

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Consulting Actuaries

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 Kim N. Nicholl, FSA, EA, MAAA, Buck Consultants, an ACS Company

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 Milton Hixson, CFP, Financial Management Professionals
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 EARNEST Partners
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 Voyageur Asset Management

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AIG Global Investment Group, Inc.
 Fountain Capital Management, L.L.C.

International Equity

Fisher Investment Institutional Group
 Franklin Templeton Institutional
 JP Morgan Asset Management

Global Custodian

J. P. Morgan Chase & Co.

Medical Board

Grover L. Bynum, M.D.
 Marvin R. Cressman, M.D.
 Thomas I. Lowry, M.D.

Summary of Plan Provisions (Unaudited)

Effective since 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
Membership:		
<p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> • Employees and appointed officers of every department, commission, board, agency, or institution of the State except those who are included in the coverage of Teacher Retirement System of Texas, JRS I, and JRS II. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> • 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. • Members of the Legislature. • District and criminal district attorneys. 	<ul style="list-style-type: none"> • 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. • 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. 	<p><i>JRS I Only:</i></p> <ul style="list-style-type: none"> • 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 before September 1, 1985. <p><i>JRS II Only:</i></p> <ul style="list-style-type: none"> • 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 after August 31, 1985.
Service Retirement Eligibility:		
<p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> • Age 60 with at least five years of service credit, or • The sum of age and years of service credit equals or exceeds the number 80 with at least five years of service credit, or • Age 55 with at least 10 years of service credit as a certified peace officer or custodial officer. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> • Age 60 with eight years of service credit, or • Age 50 with 12 years of service credit. 	<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • Age 65 with at least 10 years of service credit and currently holding a judicial office, or • Age 65 with at least 12 years of service credit, regardless of whether the member currently holds a judicial office, or • 20 years of service at any age, regardless of whether the member currently holds a judicial office, or • 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.
Early Service Retirement Eligibility with Reduced Benefits:		
<p>Not applicable.</p>	<ul style="list-style-type: none"> • 20 years of service credit as a certified peace officer/custodial officer, under the age of 50. 	<ul style="list-style-type: none"> • Age 60 with 10 years of service credit and currently holding judicial office, or • Age 60 with 12 years of service credit, regardless of whether the member currently holds a judicial office.

Summary of Plan Provisions (Unaudited)

Effective since September 1, 2005

ERS	LECOS	JRS I and JRS II
Standard Service Retirement Benefits:		
<p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> • 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. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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%. <p><i>JRS II Only:</i></p> <ul style="list-style-type: none"> • 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:		
<p><i>Employee Class and Elected Class:</i></p> <ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • Same as ERS. 	<ul style="list-style-type: none"> • Same as ERS except for the one-time partial lump sum.
Vesting Requirement:		
<ul style="list-style-type: none"> • Five or more years of service credit for Employee Class and eight or more years for Elected Class. 	<ul style="list-style-type: none"> • 20 or more years of service credit as a certified peace officer/custodial officer. 	<ul style="list-style-type: none"> • 12 or more years of service credit.
Vested Benefits after Termination of Employment:		
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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 since September 1, 2005

ERS	LECOS	JRS I and JRS II
Vested Benefits after Termination of Employment (Continued):		
<p>contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.</p>		<p>employment, member may apply for a refund of contributions plus accrued interest. A refund cancels membership and terminates the member's rights to benefits.</p>
Disability Retirement Eligibility:		
<p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> • 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. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • No age requirement. • Seven years of judicial service and currently holding a judicial office.
Disability Retirement Benefits:		
<p><i>Employee Class Only:</i></p> <ul style="list-style-type: none"> • 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. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • Same as standard service retirement benefits without reduction for age.

Summary of Plan Provisions (Unaudited)

Effective since September 1, 2005

ERS	LECOS	JRS I and JRS II
Death Benefits:		
<p><i>Employee Class and Elected Class:</i></p> <ul style="list-style-type: none">• 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:<ul style="list-style-type: none">- 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:<ul style="list-style-type: none">- 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. <p><i>Elected Class Only:</i></p> <ul style="list-style-type: none">• 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.	<ul style="list-style-type: none">• 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.	<ul style="list-style-type: none">• 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.

2006

Comprehensive Annual Financial Report

Employees Retirement System of Texas

A Retirement System of the State of Texas

Fiscal Year Ended August 31, 2006

Ann S. Fuelberg
Executive Director

Prepared by Finance

Michael C. Wheeler, CPA
Chief Financial Officer

Rosy Moore, CPA, CPFO, CGFM, CEBS
Financial Reporting Manager

P.O. Box 13207
Austin, Texas 78711-3207
(512) 867-7711 in Austin
(877) 275-4377 toll-free

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Financial Section



Independent Auditors' Report
Management's Discussion and Analysis
Basic Financial Statements
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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, 2006, 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 and other Employee Benefit Trusts Funds – Defined Benefit Plans administered by the System, as identified in Note 1 to the financial statements as of August 31, 2006. 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, 2006, 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 combining 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, 2006, 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.

As discussed in Note 8, the beginning balance of Net Assets Held in Trust for Pension Benefits for the TexaSaver 457 Trust Fund has been restated.

The Management's Discussion and Analysis, Budgetary Comparison Schedule – Appropriated Special Revenue Funds, 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 schedules and supplementary schedules included in other supplementary information are presented for purposes of additional analysis and are not a required part of the basic financial statements of the System. The combining financial schedules 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 is the responsibility of the management of the System and 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, 2006, 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, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Debitte i Touche LLP

December 20, 2006

Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2006

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, 2006. 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.

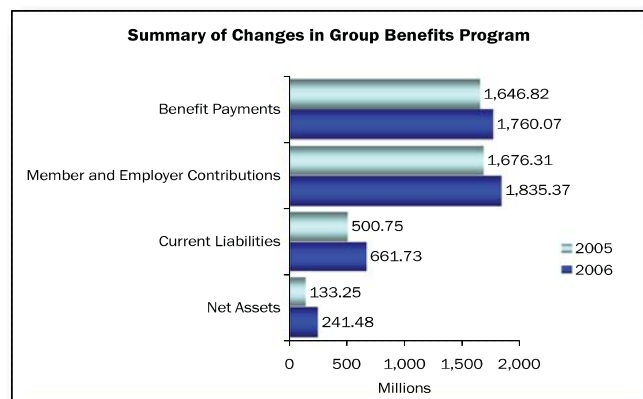
Financial Analysis on Government-wide Statements

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.

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			2005-06 % Incr (Decr) %
	2006	2005	2004	
Net assets	\$ 241.48	\$ 133.25	\$ 96.16	81.22
Current liabilities	661.73	500.75	443.03	32.15
Member and employer contributions	1,835.37	1,676.31	1,581.62	9.49
Benefit payments	1,760.07	1,646.82	1,519.30	6.88



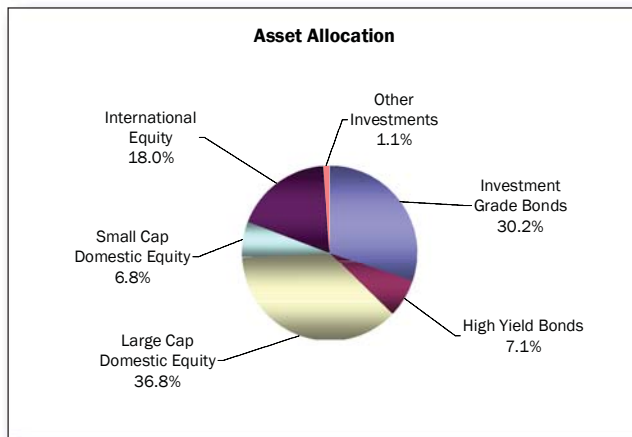
The majority of the 32.15% increase in current liabilities is due to increases in claims payable of \$32.89 million and in obligations for securities lending collateral of \$128.07 million. Most of the 9.49% increase in member and employer contributions results from an 8.85% increase in contribution rates of the Group Benefits Program.

Financial Highlights – Fiduciary Funds

- Net assets of the fiduciary funds administered by the System totaled \$22.76 billion as of August 31, 2006, compared with \$21.57 billion as of August 31, 2005. The \$1.19 billion, or 5.5%, increase resulted primarily from appreciation in investment assets and an increase in the state contribution raised from 6% to 6.45% effective September 1, 2005.
- The investment portfolio returned 8.83% for the year. The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the fourth year in a row. The fiscal year-end asset allocation stood at:
 - 30.2% investment grade bonds,
 - 7.1% high yield bonds,
 - 36.8% large cap domestic equity,
 - 6.8% small cap domestic equity,
 - 18.0% international equity, and
 - 1.1% other investments.

Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2006



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

- Changes in contributions and benefit payments in the Defined Benefit Plans are summarized in millions as follows:

	August 31			2005-06 % Incr (Decr)
	2006	2005	2004	
	\$	\$	\$	%

Contributions:

Retirement	733.23	656.87	650.94	11.62
Other	12.89	8.83	7.06	45.98
Total (Exh. XI)	746.12	665.70	658.00	12.08

Benefit payments:

Retirement	1,306.49	1,255.16	1,237.73	4.09
Other	84.84	98.12	91.63	(13.53)
Total (Exh. XI)	1,391.33	1,353.28	1,329.36	2.81

- The most recent actuarial valuations of the funded defined benefit plans were completed as of August 31, 2006. The funded ratios are as follows:

Plans	Funded Ratios August 31,	
	2006	2005
Employees Retirement System	95.2%	94.8%
Law Enforcement and Custodial Officer Supplemental Retirement Fund	101.7%	103.1%
Judicial Retirement System of Texas Plan II	93.7%	90.1%

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

Fiduciary Net Assets

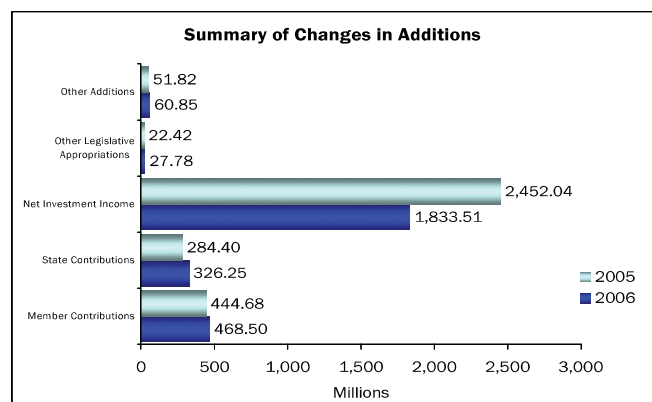
The amount of changes in fiduciary net assets (in millions) were as follows:

	August 31,			2005-06 % Incr (Decr)
	2006	2005 (Restated)	2004	
Changes in Fiduciary Net Assets (Exhibit IX)	\$ 1,187.54	\$ 1,764.89	\$ 1,409.98	(32.71)

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,			2005-06 % Incr (Decr)
	2006	2005 (Restated)	2004	
Member contributions	468.50	444.68	439.92	5.36
State contributions	326.25	284.40	287.05	14.72
Net investment income	1,833.51	2,452.04	2,109.95	(25.23)
Other legislative appropriations	27.78	22.42	22.74	23.91
Other additions	60.85	51.82	48.21	17.43
Total Additions (Exh. IX)	2,716.89	3,255.36	2,907.87	(16.54)



For the Employees Retirement Fund, member and state retirement contribution rates were 6% and 6.45%, respectively. For the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS), there are no member contributions; and it has not received funding from the state since August 31, 1993. For the Judicial Retirement Plan II 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.

Management's Discussion and Analysis (Unaudited)

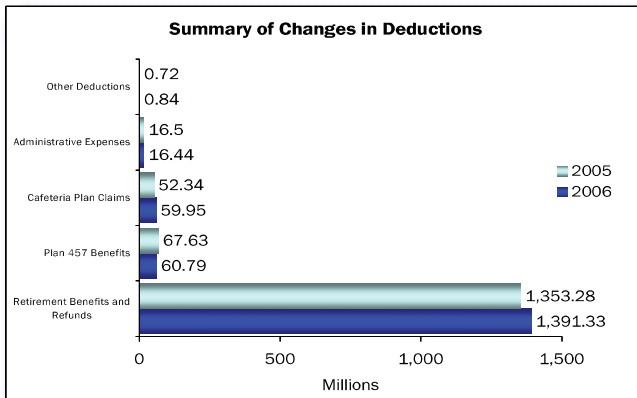
Year Ended August 31, 2006

Deductions

Benefit payments are the primary expense of a retirement system. Total deductions are comprised of benefit payments, refunds of contributions to members or beneficiaries for reasons of separation from service or death, other death benefit payments, contributions transferred to the Teacher Retirement System, and the cost of administering the System. Deductions in Net Assets have been extracted from Exhibit IX, Combined Statement of Changes in Fiduciary Net Assets.

The deductions in millions were as follows:

	August 31,			2005-06 % Incr (Decr)
	2006	2005 (Restated)	2004	
	\$	\$	\$	%
Retirement benefits and refunds	1,391.33	1,353.28	1,329.36	2.81
Plan 457 benefits	60.79	67.63	109.53	(10.11)
Cafeteria Plan claims	59.95	52.34	42.89	14.54
Administrative expenses	16.44	16.50	15.56	(0.36)
Other deductions	0.84	0.72	0.55	16.67
Total Deductions (Exh. IX)	1,529.35	1,490.47	1,497.89	2.61

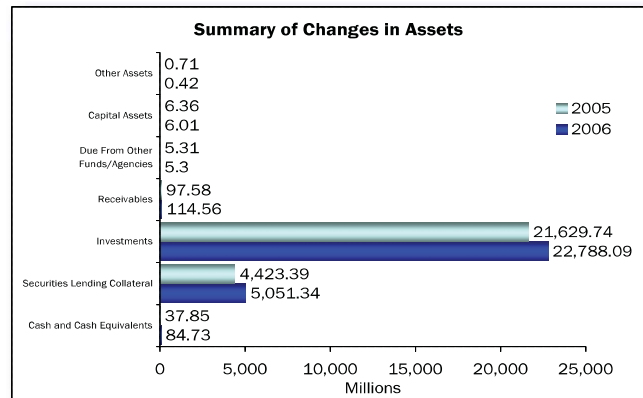


Assets

Investments, both short-term and long-term, are the primary asset of the System's pension and other employee benefit trust funds as shown in the following table.

Changes in assets are summarized in millions as follows:

	August 31,			2005-06 % Incr (Decr)
	2006	2005 (Restated)	2004	
	\$	\$	\$	%
Cash and cash equivalents	84.73	37.85	30.18	123.86
Securities lending collateral	5,051.34	4,423.39	3,236.69	14.20
Investments	22,788.09	21,629.74	20,920.97	5.36
Receivables	114.56	97.58	112.75	17.40
Due from other funds/agencies	5.30	5.31	4.52	(0.19)
Capital assets	6.01	6.36	6.91	(5.50)
Other assets	0.42	0.71	0.74	(40.85)
Total Assets (Exh. VIII)	28,050.45	26,200.94	24,312.76	7.06



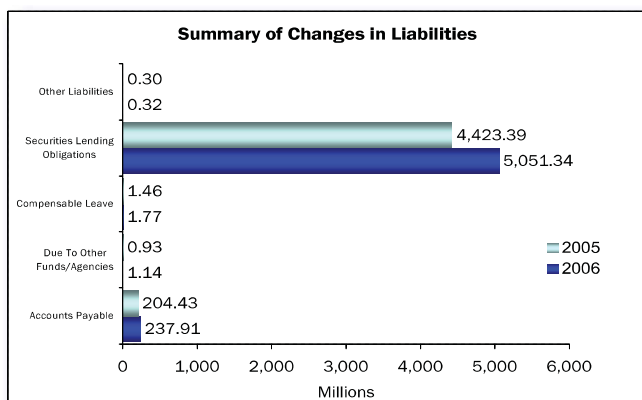
Liabilities

The condensed liabilities have been extracted from Exhibit VIII, Combined Statement of Fiduciary Net Assets. Changes in liabilities are summarized in millions as follows:

	August 31,			2005-06 % Incr (Decr)
	2006	2005	2004	
	\$	\$	\$	%
Accounts payable	237.91	204.43	1,245.94	16.38
Due to other funds/agencies	1.14	0.93	0.85	22.58
Compensable leave	1.77	1.46	1.43	21.23
Securities lending obligations	5,051.34	4,423.39	3,236.69	14.20
Other liabilities	0.32	0.30	0.75	6.67
Total Liabilities (Exh. VIII)	5,292.48	4,630.51	4,485.66	14.30

Management's Discussion and Analysis (Unaudited)

Year Ended August 31, 2006



Funding Status and Progress

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

The latest annual actuarial valuation of the System, as of August 31, 2006, (compared to the August 31, 2005 actuarial valuation) is summarized in millions as follows:

Plans	Unfunded Accrued Liability August 31,	
	2006	2005
Employees Retirement System	\$1,104.48	\$1,134.20
Law Enforcement and Custodial Officer Supplemental Retirement Fund	(\$11.87)	(\$20.86)
Judicial Retirement System of Texas Plan II	\$12.44	\$18.08

For the Employees Retirement System Fund, the August 31, 2006 actuarial valuation shows that there is an unfunded accrued liability of \$1,104.5 million. The funded ratio, the ratio of the actuarial value of assets to the actuarial accrued liability, is 95.2% as of August 31, 2006. The valuation shows that the total normal cost is 11.98% of payroll and total contributions are 12.45% of payroll. While the total contribution rate exceeds the normal cost by 0.47% of payroll, this contribution is not sufficient to ever amortize the unfunded 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 is 13.20% of payroll. The actuarial net liability will need to be met over the coming years through improved investment performance, increased contributions, or plan design changes.

The actuarial valuation for the Law Enforcement and Custodial Officer Supplemental Retirement Fund shows that the normal cost is 1.55% of payroll. The funded ratio, the ratio of the actuarial value of assets to the accrued liability, is 101.7% as of August 31, 2006. The actuarial value of assets in excess of the accrued liability covers only a portion of the normal cost. Therefore, the amortization period is less than one year.

For the Judicial Retirement System of Texas Plan II, the August 31, 2006 actuarial valuation shows that the total normal cost is 20.59% of payroll and unfunded accrued liability is \$12.4 million. The funded ratio, the ratio of the actuarial value of assets to the actuarial accrued liability is 93.7% as of August 31, 2006. Assuming state contributions of 16.83% of payroll and member contributions of 6% of pay, the amortization period is 11.4 years. The financing of the Judicial Retirement System Plan II is adequate and the plan is actuarially sound.

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

Restatement of Net Assets of Texa\$aver 457 Trust Fund

The System's management determined that allocated insurance contracts (annuitized accounts) of \$21.5 million should not have been included in the *Miscellaneous Assets* in the Texa\$aver 457 Trust Fund; therefore, the *Net Assets Held in Trust for Pension Benefits* were restated in fiscal year 2005. Please see Note 8 in the Notes to the Basic Financial Statements for additional information.

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, 2006 (With Comparative Totals at August 31, 2005)

ASSETS	Governmental Activities	
	August 31,	
	2006	2005
<i>Current Assets:</i>	\$	\$
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	37,833	42,713
Cash in State Treasury	22,171,267	36,950,413
Certificates of Deposit	5,005,124	-
Total Cash and Cash Equivalents	27,214,224	36,993,126
Securities Lending Collateral	183,741,694	55,676,502
Short-Term Investments	151,794,110	136,661,499
Legislative Appropriations	16,877	9,146
Receivables	106,646,117	89,635,954
Due From Other Agencies	18,937	191,976
Total Current Assets	469,431,959	319,168,203
<i>Non-Current Assets:</i>		
Investments	433,854,016	314,876,554
Total Non-Current Assets	433,854,016	314,876,554
Total Assets	903,285,975	634,044,757
LIABILITIES		
<i>Current Liabilities:</i>		
Payables	476,276,143	443,378,704
Due To External Parties	5,017	850,893
Due To Other Funds	882,066	
Deferred Revenue	853,918	858,998
Obligations Under Securities Lending	183,741,694	55,676,502
Total Current Liabilities	661,758,838	500,765,097
Total Liabilities	661,758,838	500,765,097
NET ASSETS		
<i>Restricted For:</i>		
Employee Benefits - Group Benefits Program	241,477,738	133,253,040
Unrestricted	49,399	26,620
Total Net Assets (Exh. II & III)	241,527,137	133,279,660

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

Exhibit II

Statement of Activities

Year Ended August 31, 2006 (With Comparative Totals for August 31, 2005)

Functions/Programs	Program Revenues			Net (Expense) Revenue & Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants & Contributions	Governmental Activities	
				August 31,	
\$	\$	\$	2006	2005	
Governmental Activities:					
Social Security Administration	58,170	78,184		20,014	20,659
Death Benefits-Peace Officers, Firemen, etc.	4,361,358	4,361,358		-	-
Compensation to Victims of Crime	750,000	750,000		-	-
Death Benefits-Retiree \$5,000 Lump Sum	6,907,711	6,910,476		2,765	3,400
Group Benefits Program	1,770,379,328	1,835,512,158	43,091,868	108,224,698	37,092,824
Total Governmental Activities	<u>1,782,456,567</u>	<u>1,847,612,176</u>	<u>43,091,868</u>		
		Change in Net Assets (Exh. IV)	108,247,477	37,116,883	
		Net Assets - Beginning	133,279,660	96,162,777	
		Net Assets - Ending (Exh. I)	<u>241,527,137</u>	<u>133,279,660</u>	

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

Exhibit III

Balance Sheet – Governmental Funds

August 31, 2006 (With Comparative Totals at 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)	Special Revenue Funds Totals	
	\$	\$	\$	\$	August 31, 2006	August 31, 2005
ASSETS						
Current Assets:						
<i>Cash and Cash Equivalents:</i>						
Cash in State Treasury	35,312				35,312	12,259
Total Cash and Cash Equivalents	35,312	-	-	-	35,312	12,259
Legislative Appropriations				16,877	16,877	9,146
Accounts Receivable	21,050				21,050	16,510
Total Current Assets	56,362	-	-	16,877	73,239	37,915
Total Assets	56,362	-	-	16,877	73,239	37,915
LIABILITIES & FUND BALANCES						
Current Liabilities:						
<i>Payables:</i>						
Accounts Payable				10,712	10,712	5,746
Due To Other Funds (Note 1.G)	5,017				5,017	4,533
Deferred Revenues	8,111				8,111	1,016
Total Current Liabilities	13,128	-	-	10,712	23,840	11,295
Total Liabilities	13,128	-	-	10,712	23,840	11,295
Fund Balances:						
<i>Unreserved:</i>						
<i>Undesignated, Reported In:</i>						
Special Revenue Funds	43,234	-	-	6,165	49,399	26,620
Total Fund Balances (Exh. IV)	43,234	-	-	6,165	49,399	26,620
Total Liabilities & Fund Balances	56,362	-	-	16,877	73,239	37,915
Total Fund Balances - Governmental Funds (above):					49,399	26,620
<i>Amounts reported for 'Governmental Activities' in the Statement of Net Assets (Exhibit I)</i>						
<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> .						
					241,477,738	133,253,040
Net Assets of Governmental Activities (Exhibit I)					241,527,137	133,279,660

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, 2006 (With Comparative Totals for 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) \$	Special Revenue Funds Totals	
					August 31, 2006 \$	August 31, 2005 \$
REVENUES						
<i>Legislative Appropriations Out of the State's General Revenue Fund:</i>						
Original Appropriations Revenue:						
For Administrative Expenditures		28,000			28,000	28,000
For Public Employee Survivors		2,909,925			2,909,925	2,711,951
For Victims of Crime			2,541,976		2,541,976	1,250,000
For Death Benefits-Retirees				6,931,297	6,931,297	6,556,164
Total Original Appropriations	-	2,937,925	2,541,976	6,931,297	12,411,198	10,546,115
Additional Appropriations Revenue:						
For Public Employee Survivors		1,423,433			1,423,433	(79,496)
For Death Benefits-Retirees				(20,821)	(20,821)	473,530
Total Additional Appropriations	-	1,423,433	-	(20,821)	1,402,612	394,034
Administration Fees	78,184				78,184	72,716
Total Revenues	78,184	4,361,358	2,541,976	6,910,476	13,891,994	11,012,865
EXPENDITURES						
<i>Current:</i>						
Death Benefits		4,333,358	750,000	6,907,711	11,991,069	10,908,749
<i>Administrative Expenditures:</i>						
Salaries & Wages	45,170				45,170	41,129
Payroll Related Costs	10,507	411			10,918	9,536
Professional Fees & Services	218				218	301
Travel	385				385	254
Materials & Supplies	530	27,589			28,119	28,192
Communications & Utilities	49				49	61
Rentals & Leases	2				2	-
Printing & Reproduction	9				9	4
Other Expenditures	1,300				1,300	580
Total Administrative Expenditures	58,170	28,000	-	-	86,170	80,057
Total Expenditures	58,170	4,361,358	750,000	6,907,711	12,077,239	10,988,806
Excess of Revenues over Expenditures	20,014	-	1,791,976	2,765	1,814,755	24,059
Fund Balances - Beginning	23,220	-	-	3,400	26,620	2,561
Appropriations Lapsed			(1,791,976)		(1,791,976)	-
Fund Balances - Ending (Exh. III)	43,234	-	-	6,165	49,399	26,620
Net Change in Fund Balances - Governmental Funds:					22,779	24,059
<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> .						
Change in Net Assets of Governmental Activities (Exhibit II)					108,224,698	37,092,824
					108,247,477	37,116,883

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, 2006 (With Comparative Totals at August 31, 2005)

ASSETS	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2006	August 31, 2005
	\$	\$
Current Assets:		
<i>Cash and Cash Equivalents:</i>		
Cash on Hand	37,833	42,713
Cash in State Treasury	22,135,955	36,938,154
Certificates of Deposit	5,005,124	-
Total Cash and Cash Equivalents	27,178,912	36,980,867
Securities Lending Collateral	183,741,694	55,676,502
<i>Short-Term Investments:</i>		
Corporate Obligations	139,199,472	
Other Investments	12,594,638	136,661,499
Total Short-Term Investments	151,794,110	136,661,499
<i>Receivables:</i>		
Interest Receivable	156,000	102,000
Accounts Receivable	106,469,067	89,517,444
Total Receivables	106,625,067	89,619,444
Due From Other Agencies (Note 1.G)	18,937	191,976
Total Current Assets	469,358,720	319,130,288
Non-Current Assets:		
<i>Investments:</i>		
U.S. Government and Agency Obligations	296,780,904	215,634,404
Corporate Obligations	137,073,112	99,242,150
Total Investments	433,854,016	314,876,554
Total Non-Current Assets	433,854,016	314,876,554
Total Assets	903,212,736	634,006,842
LIABILITIES		
Current Liabilities:		
<i>Payables:</i>		
<i>Claims Payable:</i>		
Incurred, Self-Funded	33,048,332	22,787,514
Incurred, Insured	22,047,099	22,396,444
Incurred But Not Reported, Self-Funded	363,044,000	337,632,000
Incurred But Not Reported, Insured	58,126,000	60,557,000
Total Claims Payable	476,265,431	443,372,958
Total Payables	476,265,431	443,372,958
Due To Other Funds (Note 1.G)	882,066	846,360
Deferred Revenue	845,807	857,982
Obligations Under Securities Lending	183,741,694	55,676,502
Total Current Liabilities	661,734,998	500,753,802
Total Liabilities	661,734,998	500,753,802
NET ASSETS		
<i>Restricted For:</i>		
Employee Benefits - Group Benefits Program	241,477,738	133,253,040
Total Net Assets (Exh. VI)	241,477,738	133,253,040

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, 2006 (With Comparative Totals for August 31, 2005)

	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2006	August 31, 2005
OPERATING REVENUES	\$	\$
<i>Contributions to Insurance Program:</i>		
<i>From the State of Texas:</i>		
For Employees	1,040,866,625	949,268,624
For Retirees	343,821,335	306,854,229
Total Contributions from the State of Texas	1,384,687,960	1,256,122,853
<i>From Members:</i>		
For Employees	341,163,753	320,206,008
For Retirees	102,165,373	92,853,754
For COBRA	7,348,475	7,131,851
Total Contributions from Members	450,677,601	420,191,613
Total Contributions to Insurance Program	1,835,365,561	1,676,314,466
Federal Revenues-Medicare Part D	19,359,506	
<i>Other Operating Revenues:</i>		
COBRA 2% Administration Fee	146,597	145,442
Warrants Voided by Statute of Limitations	13,162	3,233
Penalty Assessed to Insurance Carrier	140,000	100,000
Miscellaneous Operating Revenue	228,597	204,337
Total Other Operating Revenues	528,356	453,012
Total Operating Revenues	1,855,253,423	1,676,767,478
OPERATING EXPENSES		
<i>Employee Benefit Payments:</i>		
For Employees	1,265,966,252	1,189,047,542
For Retirees	478,228,775	439,171,027
For COBRA	15,877,630	18,596,432
Total Employee Benefit Payments	1,760,072,657	1,646,815,001
<i>Administrative Expenses:</i>		
Salaries & Wages	5,767,762	5,424,874
Payroll Related Costs	1,444,459	1,314,161
Professional Fees & Services	960,341	987,784
Travel	43,730	33,396
Materials & Supplies	628,055	577,629
Communications & Utilities	298,372	291,711
Repairs & Maintenance	343,443	827,587
Rentals & Leases	367,231	502,733
Printing & Reproduction	25,126	32,007
Interest Expense	-	36
Other Operating Expenses	428,152	320,310
Total Administrative Expenses	10,306,671	10,312,228
Total Operating Expenses	1,770,379,328	1,657,127,229
Operating Income	84,874,095	19,640,249
NON-OPERATING REVENUES (EXPENSES)		
Net Decrease in Fair Value of Investments	(4,833,910)	(1,750,144)
Interest Revenue	27,399,067	16,405,060
<i>Securities Lending Activities:</i>		
Loan Premium on Securities Lending	7,943,326	1,157,188
Less: Broker Rebates	(7,383,104)	(964,916)
Agent Fees	(102,244)	(38,453)
Net Securities Lending Activity	457,978	153,819
Settlement Revenue	327,468	2,643,840
Total Non-Operating Revenues	23,350,603	17,452,575
Change in Net Assets	108,224,698	37,092,824
NET ASSETS		
Net Assets - Beginning	133,253,040	96,160,216
Net Assets - Ending (Exh. V)	241,477,738	133,253,040

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, 2006 (With Comparative Totals for August 31, 2005)

	Internal Service Fund	
	Employees Life, Accident and Health Insurance and Benefits Fund (0973) (U/F 0973)	
	August 31, 2006	August 31, 2005
Cash Flows from Operating Activities:	\$	\$
Cash Received from Members	449,853,387	420,242,326
Cash Received from The State of Texas	1,380,729,902	1,247,800,730
Cash Payments to Insurance Carriers and Third Party Administrators	(1,727,092,834)	(1,603,235,882)
Cash Received from Federal Government - Medicare Part D	7,738,904	-
Cash Payments to Employees for Services	(5,528,584)	(5,136,425)
Cash Payments for Goods and Services	(4,742,380)	(5,166,939)
Other Cash Received	380,872	2,932,844
Net Cash Provided by Operating Activities	101,339,267	57,436,654
Cash Flows from Investing Activities:		
Net Purchases of Short-Term Investment Fund	(113,394,876)	(47,950,704)
Interest Revenue	2,253,654	16,405,060
Net Cash Used by Investing Activities	(111,141,222)	(31,545,644)
Net Increase (Decrease) in Cash and Cash Equivalents	(9,801,955)	25,891,010
Cash and Cash Equivalents:		
Beginning of Year	36,980,867	11,089,857
End of Year	27,178,912	36,980,867
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	84,874,095	19,640,249
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Operating Activities:		
Settlement Revenue	327,468	2,643,840
Change in Assets and Liabilities:		
Increase in Accounts Receivable	(16,951,623)	(8,679,738)
Decrease in Due From Other Agencies	173,039	182,098
Increase in Accounts Payable	32,892,473	43,558,412
Increase in Due To Other Funds	35,990	24,734
Increase (Decrease) in Deferred Revenue	(12,175)	67,059
Total Adjustments	16,465,172	37,796,405
Net Cash Provided by Operating Activities	101,339,267	57,436,654
Non-Cash Investing Activities:		
Net Depreciation in Fair Value of Non-Cash Equivalent Investments	(4,833,910)	(1,750,144)

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, 2006 (With Comparative Totals at August 31, 2005, as Restated)

	Pension and Other Employee Benefit Trust Funds		Total Pension and Other Employee Benefit Trust Funds	Agency Funds	Totals August 31, (Note 8)	
	Defined Benefit Plans	Defined Contribution Plans and Cafeteria Plan			2006	2005 (Restated)
	\$	\$	\$	\$	\$	\$
ASSETS						
Cash and Cash Equivalents	78,042,277	6,410,498	84,452,775	278,672	84,731,447	37,847,061
Securities Lending Collateral	5,051,335,054		5,051,335,054		5,051,335,054	4,423,390,863
Short-Term Investments	352,492,800	169,978,284	522,471,084		522,471,084	318,105,045
Legislative Appropriations	321,566		321,566		321,566	231,168
Investments	22,124,858,002	140,760,681	22,265,618,683		22,265,618,683	21,311,630,154
Receivables	110,054,672	4,488,414	114,543,086	18,804	114,561,890	97,583,949
Due From Other Funds (Note 1.G)	1,363,374		1,363,374		1,363,374	1,239,695
Due From Other Agencies (Note 1.G)	3,927,278	4,460	3,931,738		3,931,738	4,067,391
Prepaid Expenses		101,490	101,490		101,490	479,616
Capital Assets, Net of						
Accumulated Depreciation	6,011,484		6,011,484		6,011,484	6,361,614
Total Assets	27,728,406,507	321,743,827	28,050,150,334	297,476	28,050,447,810	26,200,936,556
LIABILITIES						
Payables	231,710,157	6,176,553	237,886,710	18,954	237,905,664	204,430,960
Due To Other Funds (Note 1.G)	392,843	83,448	476,291		476,291	388,802
Due To Other Agencies (Note 1.G)	663,277		663,277		663,277	543,477
Deferred Revenue	39,018	7,940	46,958		46,958	61,286
Employees Compensable Leave	1,773,580		1,773,580		1,773,580	1,464,396
Obligations Under Securities Lending	5,051,335,054		5,051,335,054		5,051,335,054	4,423,390,863
Funds Held For Others				278,522	278,522	227,271
Total Liabilities	5,285,913,929	6,267,941	5,292,181,870	297,476	5,292,479,346	4,630,507,055
NET ASSETS						
Net Assets Held in Trust for Pension Benefits and Other Purposes (Exh. IX)	22,442,492,578	315,475,886	22,757,968,464	-	22,757,968,464	21,570,429,501
	(Exh. X)					

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, 2006 (With Comparative Totals for August 31, 2005, as Restated)

ADDITIONS	Defined Benefit Plans \$	Defined Contribution Plans and Cafeteria Plan \$	Pension and Other Employee Benefit Trust Funds	
			Totals	
			August 31, (Note 8)	
			2006	2005 (Restated)
	\$	\$	\$	\$
Contributions:				
Member Contributions	333,480,620	135,019,241	468,499,861	444,683,903
State Contributions	326,249,990		326,249,990	284,399,378
Legislative Appropriations	27,784,199		27,784,199	22,417,083
Service Contributions Transferred from Teacher Retirement System	45,716,307		45,716,307	41,200,491
Settlement Revenue		145,179	145,179	18,000
Other Contributions	12,890,163	662,130	13,552,293	9,511,062
Total Contributions	746,121,279	135,826,550	881,947,829	802,229,917
Investment Income:				
From Investing Activities	1,797,569,809	23,878,842	1,821,448,651	2,441,887,803
From Securities Lending Activities	12,058,181		12,058,181	10,154,742
Total Investment Income	1,809,627,990	23,878,842	1,833,506,832	2,452,042,545
Other Additions:				
Other Revenue	202,310	399,296	601,606	431,005
Transfers In	297,169	536,536	833,705	657,051
Total Other Additions	499,479	935,832	1,435,311	1,088,056
Total Additions	2,556,248,748	160,641,224	2,716,889,972	3,255,360,518
DEDUCTIONS				
Benefits:				
Retirement Benefits and Refunds	1,384,424,548		1,384,424,548	1,347,088,125
Plan 457 Benefits		60,788,587	60,788,587	67,633,610
Cafeteria Plan Reimbursement Claims		59,950,562	59,950,562	52,336,797
Service Contributions Transferred to Teacher Retirement System	6,908,439		6,908,439	6,188,845
Total Benefits	1,391,332,987	120,739,149	1,512,072,136	1,473,247,377
Administrative Expenses	14,064,820	2,373,105	16,437,925	16,504,961
Other Deductions:				
Other Expenses	7,899		7,899	1,575
Transfers Out	833,049		833,049	720,618
Total Other Deductions	840,948	-	840,948	722,193
Total Deductions	1,406,238,755	123,112,254	1,529,351,009	1,490,474,531
Net Increase	1,150,009,993	37,528,970	1,187,538,963	1,764,885,987
NET ASSETS				
Net Assets Held in Trust For Pension Benefits and Other Purposes:				
Beginning of Year	21,292,482,585	296,489,889	21,588,972,474	19,827,083,370
Restatement (Note 8)	-	(18,542,973)	(18,542,973)	(21,539,856)
Beginning of Year, as Restated	21,292,482,585	277,946,916	21,570,429,501	19,805,543,514
End of Year (Exh. VIII)	22,442,492,578	315,475,886	22,757,968,464	21,570,429,501
	(Exh. XI)			

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, 2006 (With Comparative Totals at August 31, 2005)

ASSETS	Employees	Law Enforcement	Judicial	Judicial	Excess	Totals	
	Retirement	and Custodial	Retirement	Retirement	Benefit	August 31,	
Fund (0955)	Supplemental	System	System	Arrangement	2006	2005	
	Fund (0977)	Plan I	Plan II	(5039)			
		(0001)	(0993)				
ASSETS							
<i>Cash and Short-Term Investments:</i>							
<i>Cash and Cash Equivalents:</i>							
Cash on Hand	3,927,998					3,927,998	2,524,405
Cash in Bank	9,700					9,700	9,700
Cash in State Treasury	25,135,769	573,397		398,060		26,107,226	17,011,204
Margin Deposit (Note 5.A)	46,082,067	1,522,473		392,813		47,997,353	11,073,550
Total Cash and Cash Equivalents	75,155,534	2,095,870	-	790,873	-	78,042,277	30,618,859
Securities Lending Collateral	4,849,890,471	160,388,530		41,056,053		5,051,335,054	4,423,390,863
<i>Short-Term Investments:</i>							
Corporate Obligations	187,480,274	6,194,030		1,598,121		195,272,425	-
Repurchase Agreements	144,035,642	4,758,693		1,227,790		150,022,125	100,009,806
Other Short-Term Investments	6,911,011	228,328		58,911		7,198,250	84,170,168
Total Short-Term Investments	338,426,927	11,181,051	-	2,884,822	-	352,492,800	184,179,974
Total Cash and Short-Term Investments	5,263,472,932	173,665,451	-	44,731,748	-	5,481,870,131	4,638,189,696
Legislative Appropriations			321,566			321,566	231,168
<i>Investments:</i>							
U.S. Government and Agency Obligations	5,077,075,391	167,737,951		43,278,050		5,288,091,392	5,168,773,155
Corporate Equity	9,339,103,342	308,548,117		79,608,470		9,727,259,929	9,109,753,194
Corporate Obligations	2,746,953,079	90,754,666		23,415,602		2,861,123,347	2,777,478,456
Foreign Securities	4,078,855,843	134,758,471		34,769,020		4,248,383,334	4,116,576,232
Total Investments	21,241,987,655	701,799,205	-	181,071,142	-	22,124,858,002	21,172,581,037
<i>Receivables:</i>							
Interest and Dividends Receivable	4,284,863	140,265		36,742		4,461,870	3,033,236
Contributions/Accounts Receivable	48,564,962			1,188,719		49,753,681	44,620,903
Unsettled Sales-Investment Receivables	53,612,286	1,772,988		453,847		55,839,121	45,853,298
Total Receivables	106,462,111	1,913,253	-	1,679,308	-	110,054,672	93,507,437
Due From Other Funds (Note 1.G)	1,363,374					1,363,374	1,239,695
Due From Other Agencies (Note 1.G)	3,927,278					3,927,278	4,064,655
<i>Capital Assets:</i>							
<i>Non-Depreciable:</i>							
Land and Land Improvements	874,889					874,889	874,889
<i>Depreciable, Net of Accumulated Depreciation</i>							
<i>of \$12,668,117 and \$12,001,652 respectively:</i>							
Building	4,455,004					4,455,004	4,461,599
Furniture and Equipment	681,591					681,591	1,025,126
Total Capital Assets	6,011,484	-	-	-	-	6,011,484	6,361,614
Total Assets	26,623,224,834	877,377,909	321,566	227,482,198	-	27,728,406,507	25,916,175,302
LIABILITIES							
<i>Payables:</i>							
Benefits/Accounts Payable	21,656,645	237,911	321,566	48,673		22,264,795	18,557,410
Unsettled Purchases-Investment Payables	201,092,791	6,650,249		1,702,322		209,445,362	179,381,299
Total Payables	222,749,436	6,888,160	321,566	1,750,995	-	231,710,157	197,938,709
Due To Other Funds (Note 1.G)		307,361		85,482		392,843	298,652
Due To Other Agencies (Note 1.G)	663,277					663,277	543,477
Deferred Revenue	35,715			3,303		39,018	56,620
Employees Compensable Leave	1,773,580					1,773,580	1,464,396
Obligations Under Securities Lending	4,849,890,471	160,388,530		41,056,053		5,051,335,054	4,423,390,863
Total Liabilities	5,075,112,479	167,584,051	321,566	42,895,833	-	5,285,913,929	4,623,692,717
NET ASSETS							
Net Assets Held in Trust for Pension							
Benefits and Other Purposes (Exh. XI)	21,548,112,355	709,793,858	-	184,586,365	-	22,442,492,578	21,292,482,585
						(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, 8977; Fund 0001: 2001; Fund 0993: 0993, 1993, 8993; 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, 2006 (With Comparative Totals for August 31, 2005)

ADDITIONS	Employees	Law	Judicial	Judicial	Excess	Totals	
	Retirement Fund (0955)	Enforcement and Custodial Officer Supplemental Fund (0977)	Retirement System Plan I (0001)	Retirement System Plan II (0993)	Benefit Arrange- ment (5039)	2006	2005
	\$	\$	\$	\$	\$	\$	\$
Contributions:							
Member Contributions	329,802,863			3,677,757		333,480,620	308,855,124
State Contributions	316,197,838			10,052,152		326,249,990	284,399,378
<i>Legislative Appropriations for:</i>							
Judges Retirement Annuities			27,664,199			27,664,199	22,297,083
Administrative Expenses			120,000			120,000	120,000
<i>Service Contributions Transferred from</i>							
Teacher Retirement System (Note 1.G)	45,716,307					45,716,307	41,200,491
<i>Other Contributions:</i>							
Membership Fees	540,092					540,092	435,760
Penalty Interest	12,349,257			814		12,350,071	8,394,370
Total Other Contributions	12,889,349	-	-	814	-	12,890,163	8,830,130
Total Contributions	704,606,357	-	27,784,199	13,730,723	-	746,121,279	665,702,206
Investment Income:							
<i>From Investing Activities:</i>							
<i>Net appreciation</i>							
in fair value of investments	1,069,644,848	35,478,030		8,905,402		1,114,028,280	1,788,788,380
Interest and Dividends	676,717,730	22,489,664		5,534,498		704,741,892	645,727,762
Total Investing Activity Income	1,746,362,578	57,967,694	-	14,439,900	-	1,818,770,172	2,434,516,142
Less: Investment Expense	(20,353,515)	(696,281)		(150,567)		(21,200,363)	(17,790,128)
Net Income, Investing Activities	1,726,009,063	57,271,413	-	14,289,333	-	1,797,569,809	2,416,726,014
<i>From Securities Lending Activities:</i>							
Loan Premium on Securities Lending	211,866,857	7,041,405		1,733,310		220,641,572	98,413,926
Less: Broker Rebates	(197,781,839)	(6,573,278)		(1,618,115)		(205,973,232)	(85,680,174)
Agent Fees	(2,506,382)	(83,335)		(20,442)		(2,610,159)	(2,579,010)
Total Securities Lending Expenses	(200,288,221)	(6,656,613)	-	(1,638,557)	-	(208,583,391)	(88,259,184)
Net Income, Securities Lending Activities	11,578,636	384,792	-	94,753	-	12,058,181	10,154,742
Net Investment Income	1,737,587,699	57,656,205	-	14,384,086	-	1,809,627,990	2,426,880,756
Other Additions:							
<i>Other Revenue:</i>							
Warrants Voided by Statute of Limitations	108,523	139		3,844		112,506	103,952
Sale of Surplus Equipment	2,790					2,790	47,357
Rental Income	83,687					83,687	31,000
Miscellaneous Revenue	3,327					3,327	6,235
Total Other Revenue	198,327	139	-	3,844	-	202,310	188,544
<i>Interfund Transfers In (Note 1.G):</i>							
Excess Benefit Arrangement					235,154	235,154	223,236
<i>Interagency Transfers In (Note 5.F):</i>							
Excess Benefit Arrangement					62,015	62,015	-
Total Transfers In	-	-	-	-	297,169	297,169	223,236
Total Other Additions	198,327	139	-	3,844	297,169	499,479	411,780
Total Additions	2,442,392,383	57,656,344	27,784,199	28,118,653	297,169	2,556,248,748	3,092,994,742

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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, 2006 (With Comparative Totals for August 31, 2005)

DEDUCTIONS	Employees	Law	Judicial	Judicial	Excess	Totals	
	Retirement	Enforcement	Retirement	Retirement	Benefit	August 31,	
	Fund (0955)	and Custodial	System	System	Arrangement	2006	2005
	\$	Officer	Plan I	Plan II	(5039)	\$	\$
		Supplemental	(0001)	(0993)			
		Fund (0977)					
Benefits:							
Retirement Benefits	1,244,181,983	30,184,076	27,664,199	4,223,003	235,810	1,306,489,071	1,255,160,107
<i>Death Benefits:</i>							
Active Members	1,316,713			24,363		1,341,076	892,214
Retirees	915,567					915,567	1,156,143
Refunds of Retirement Contributions	75,614,028		-	64,806		75,678,834	89,879,661
<i>Transfers Out of Contributions:</i>							
Service Contributions Transferred to Teacher Retirement System (Note 1.G)	6,908,439					6,908,439	6,188,845
Total Benefits	1,328,936,730	30,184,076	27,664,199	4,312,172	235,810	1,391,332,987	1,353,276,970
Administrative Expenses:							
Salaries & Wages	6,500,617	191,075		134,548		6,826,240	6,104,124
Payroll Related Costs	1,708,839	58,038	1,685	37,667		1,806,229	1,629,041
Professional Fees & Services	2,024,466	75,982	16,897	75,254		2,192,599	2,590,105
Travel	37,694	746		693		39,133	30,717
Materials & Supplies	451,141	8,228	101,418	7,430		568,217	748,268
Communications & Utilities	302,910	8,748		11,183		322,841	313,796
Repairs & Maintenance	484,543	10,637		12,504		507,684	921,550
Rentals & Leases	481,510	13,677		11,434		506,621	627,678
Printing & Reproduction	24,799	759		1,087		26,645	38,901
Depreciation	727,275					727,275	757,703
Interest Expense						-	900
Other Operating Expenses	520,140	10,161	-	11,035		541,336	499,668
Total Administrative Expenses	13,263,934	378,051	120,000	302,835	-	14,064,820	14,262,451
Other Deductions:							
<i>Other Expenses:</i>							
Loss on Sale of Capital Assets	7,899					7,899	1,575
Total Other Expenses	7,899	-	-	-	-	7,899	1,575
<i>Interfund Transfers Out (Note 5.E):</i>							
Membership Fees	536,536					536,536	433,815
Excess Benefit Arrangement	235,154					235,154	223,236
<i>Interagency Transfers Out (Note 5.F):</i>							
Excess Benefit Arrangement					61,359	61,359	63,567
Total Transfers Out	771,690	-	-	-	61,359	833,049	720,618
Total Other Deductions	779,589	-	-	-	61,359	840,948	722,193
Total Deductions	1,342,980,253	30,562,127	27,784,199	4,615,007	297,169	1,406,238,755	1,368,261,614
Net Increase	1,099,412,130	27,094,217	-	23,503,646	-	1,150,009,993	1,724,733,128
NET ASSETS							
Net Assets Held in Trust For Pension							
Benefits and Other Purposes:							
Beginning of Year	20,448,700,225	682,699,641	-	161,082,719	-	21,292,482,585	19,567,749,457
End of Year (Exh. X)	21,548,112,355	709,793,858	-	184,586,365	-	22,442,492,578	21,292,482,585
						(Exh. IX)	

USAS Funds (U/F) are :
Fund 0955: 0955, 1955, 8955; Fund 0977: 0977, 1977, 8977; Fund 0001: 2001; Fund 0993: 0933, 1993, 8993; 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, 2006

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Notes to the Basic Financial Statements

August 31, 2006

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).

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.

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

September 1, 2004, the System early implemented GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*. The implementation required some additional information and schedules in the statistical section of the Comprehensive Annual Financial Report (CAFR).

The System implemented GASB Statement 47, Accounting for Termination Benefits in the fiscal year

ended August 31, 2006. The implementation required disclosure of the type of termination benefits provided, the number of employees affected, and the period of time over which the benefits are expected to be provided.

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.

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

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.

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, lump sum retiree death benefits, and benefits for victims of crime, insurance premiums received by the Internal Service Fund from employees, retirees and the State of

Notes to the Basic Financial Statements

August 31, 2006

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 of the governmental activities are considered to be *general revenues/expenses*.

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. Benefit payments to participants are recorded upon distribution.

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.

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.

- 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, which was established by Texas Criminal Procedure Code, Article 56.54.

Notes to the Basic Financial Statements

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- 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

The fiduciary funds are not part of the government-wide financial statements.

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 (TexFlex) – 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.
- Employee 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, 2006

- Departmental Suspense Fund - This fund provides a temporary depository for money held awaiting final disposition.

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.

Basis of Budgeting

Appropriated budgets are prepared on the budgetary basis, which differs from the GAAP basis. Schedules of Budgeted to Actual Expenditures for the Death Benefits Program for Commissioned Peace Officers, Firemen, etc. Fund, the Lump Sum Retiree Death Benefit Fund, and the Compensation to Victims of Crime Fund are presented as Required Supplementary Information immediately

after the Notes to the Basic Financial Statements. A reconciliation from the basis of budgeting to the GAAP basis is provided on the face of the schedule.

Variations

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

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, Cash in State Treasury and Certificates of Deposit.

The petty cash and travel advance accounts, and the Texa\$aver 401(k) and State Employees Cafeteria Plan accounts (Cash in Bank) are maintained at a local commercial bank; the Texa\$aver 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

Notes to the Basic Financial Statements

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Supplemental Retirement Fund, and the Judicial Retirement System Plan Two Fund are pooled in the Pension Investment Pool Trust Fund.

Permissible Investments

Eligible securities are as follows:

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

Capital Assets

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

Depreciation has been provided over the estimated useful lives, using the straight-line method. The capitalization thresholds and estimated useful lives are 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

Notes to the Basic Financial Statements

August 31, 2006

amount is reported as 'Restricted Net Assets' in both the government-wide and the proprietary fund *Statement of Net Assets*.

Interfund Activity and Balances

(In accordance with GASB Statement 34)

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

Interfund Services Provided and Used

This activity represents transactions that would be treated as revenues, expenditures or expenses if they involved organizations external to State government. They are accounted for as revenues by the recipient fund and as expenditures or expenses by the disbursing fund. Contributions for retirement and insurance from other funds within the State of Texas reporting entity are reported as Interfund Services Provided and Used. The accrual of Interfund Services Provided and Used is classified as Accounts Receivable and Accounts Payable on the government-wide and the fund financial statements.

Interfund Reimbursements

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

Administrative expenses paid by the Employees Retirement System Fund and subsequently reimbursed by the System's other funds are reported as Interfund Reimbursements in the financial statements. The accrual of Interfund Reimbursements is reported on the government-wide *Statement of Net Assets* as Due From External Parties or Due To External Parties and on the fund financial statements as Due From Other Funds or Due To Other Funds.

See Note 5.D Interfund Receivables and Payables.

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.

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, 2006. 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

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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, 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 year ended August 31, 2006, the State

contributed 6.45% 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 fiscal years ending August 31, 1995 through August 31, 2006, the state has not been 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

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

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

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Members who accrue 20 years of service credit in the System cease making contributions, but are considered contributing members for all other purposes.

Effective September 1, 2005, a judicial officer who is a member of the System may elect to make contributions for each subsequent year of service credit that the member accrues, up to 10 years, by filing an application with the System. An eligible member may establish service credit for service in excess of 20 years performed before September 1, 2005.

Judicial Retirement System of Texas Plan Two Plan Description

The plan covers judges, justices and commissioners of the Supreme Court, the Court of Criminal Appeals, the Court of Appeals, District Courts and certain commissions to a court who first become members after August 31, 1985. Members of the Judicial Retirement System of Texas Plan One are excluded from this plan.

Contributions

Members are required to contribute 6% of their compensation to the System. Members who accrue 20 years of service credit in the System cease making contributions, but are considered contributing members for all other purposes; however, the state contribution continues.

Effective September 1, 2005, a judicial officer who is a member of the System may elect to make contributions for each subsequent year of service credit that the member accrues, up to 10 years, by filing an application with the System. An eligible member may establish service credit for service in excess of 20 years performed before September 1, 2005.

For the fiscal year ended August 31, 2006, the state contributed 16.83% of the payroll of members.

B. Retirement Systems Membership

The membership of the retirement plans as of August 31, 2006 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

	ERS	LECOS	JRS I	JRS II
Retirees and beneficiaries currently receiving benefits	67,596	5,318	486	89
Terminated employees entitled to benefits	61,567	33	12	95
Current employees	132,411	37,103	43	498
Total	261,574	42,454	541	682

Note: Based on actuarial valuation as of August 31, 2006.

C. Reserves

The balances of legally required reserves in each funded retirement plan as of August 31, 2006 and 2005 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

Figure C
Reserves

	ERS	LECOS	JRS II	Totals – August 31,	
				2006	2005
Net Plan Assets Reserved For:	\$	\$	\$	\$	\$
Employee Savings	3,823,418,359	5,275	41,929,809	3,865,353,443	3,618,482,644
State Accumulation	6,683,228,105	450,640,740	96,327,029	7,230,195,874	6,494,790,629
Annuity Reserves	11,041,465,891	259,147,843	46,328,996	11,346,942,730	11,179,180,856
Administration			531	531	28,456
Total Net Plan Assets Reserved	21,548,112,355	709,793,858	184,586,365	22,442,492,578	21,292,482,585
				(Exhibit X)	(Exhibit X)
Funded ratios of each plan, from the actuarial valuation:					
As of August 31, 2006	95.2%	101.7%	93.7%		
As of August 31, 2005	94.8%	103.1%	90.1%		

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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 \$311,984,417 as of August 31, 2006.

Contributions

As of August 31, 2006, there were 33 System employees participating in the Texa\$aver 457 Plan. During the fiscal year ended August 31, 2006, System employees deferred \$150,792. 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, 2006, there were 84 System employees participating in the Texa\$aver 401(k) Plan. During the fiscal year ended August 31, 2006, System employees deferred \$333,827. 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.

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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,	
	2006	2005
	\$	\$
Beginning of Fiscal Year Liability	360,419,514	319,615,852
Current-Year Claims and Changes in Estimates	1,793,203,964	1,371,322,192
Claims Payments	(1,757,531,146)	(1,330,518,530)
Balance at Fiscal Year-End	396,092,332	360,419,514

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

For both self-funded and insured coverages, the balance of claims that have been incurred but not reported as of August 31, 2006 is \$421,170,000.

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, 2006, the total carrying amount of Cash in Bank and Margin Deposits was \$49,483,656 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	7,212
Defined Contribution Plans and Cafeteria Plan	1,472,632	1,472,632
Agency Funds	3,971	3,971
Total Cash in Bank	1,486,303	1,483,815
Margin Deposit:		
Fiduciary Funds (Exh. X)	47,997,353	47,045,152
Total	49,483,656	48,528,967

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 cover 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, 2006, the balances of Cash in Bank and Margin Deposit that were exposed to custodial credit risk are summarized in Figure G.

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**Figure G
Custodial Credit Risk - Deposits**

Deposits	Uninsured and	Uninsured and
	Uncollateralized	Collateralized with Securities Held by the Pledging Bank
	\$	\$
Margin Deposit:		
Fiduciary Funds	-	47,045,152

Investments

As of August 31, 2006, the fair value of investments are presented in Figure H.

**Figure H
Investments**

Investment Type	Fair Value	
	Fiduciary Funds (Exh. VIII)	Proprietary Fund (Exh. V)
	\$	\$
<i>Investments:</i>		
U.S. Treasury Securities	1,503,847,883	212,929,559
U.S. Treasury TIPS	586,883,038	-
U.S. Government Agency Obligations	2,823,105,743	70,514,979
Corporate Obligations	2,861,123,347	137,073,112
Corporate Asset and Mortgage Backed Securities	374,254,729	13,336,366
Domestic Equity	9,727,259,928	-
International Equity	4,248,383,334	-
Annuities	140,760,681	-
Total	22,265,618,683	433,854,016
<i>Short-Term Investments:</i>		
Investment Pool Cash	254,647	-
Repurchase Agreements	150,022,125	-
Short-Term Investment Funds	6,943,603	12,594,638
Commercial Paper	195,272,425	139,199,472
Money Market Mutual Funds	169,978,284	-
Total	522,471,084	151,794,110
<i>Cash Equivalents:</i>		
Certificates of Deposit	-	5,005,124
Securities Lending Collateral	5,051,335,054	183,741,694

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 or by its trust department or agent, but not in the System's name. As of August 31, 2006, the fair value of these securities are summarized in Figure I.

**Figure I
Custodial Credit Risk - Deposits**

Investments	Fair Value
	\$
<i>Fiduciary Funds:</i>	
U.S. Treasury Securities	449,260,796
U.S. Government Agency Obligations	2,593,669
Total	451,854,465
<i>Proprietary Fund:</i>	
U.S. Treasury Securities	55,042,798
U.S. Government Agency Obligations	4,069,076
Total	59,111,874

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, 2006 is summarized in Figure J.

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Figure J
Investments Exposed to Foreign Currency Risk

Foreign Currency	International Equity (US\$)
Fiduciary Funds:	\$
Australian Dollar	142,260,701
British Pound	852,790,787
Canadian Dollar	44,682,212
Danish Krone	46,422,153
Euro	1,451,970,717
Hong Kong Dollar	118,378,934
Japanese Yen	852,386,480
Malaysian Ringgit	481
Mexican Peso	2,397,624
New Zealand Dollar	2,298,068
Norwegian Krone	59,929,912
Singapore Dollar	33,036,039
South African Rand	1,264,035
Swedish Krona	80,267,893
Swiss Franc	318,347,584
Total International Equity Exposed to Foreign Currency Risk	4,006,433,620
ADRs and GDRs Denominated in U.S. Dollars and Classified as International Equity	241,949,714
Total International Equity (Exh. X)	4,248,383,334

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, 2006 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
Fiduciary Funds:		
U.S. Government Agency Obligations	AAA	\$ 2,566,197,644
	AA	19,692,410
	A-1	27,762,336
	NR	25,394,425
Corporate Obligations	AAA	154,566,404
	AA	270,003,937
	A	448,329,860
	BBB	385,243,276
	BB	565,113,892
	B	752,306,312
	CCC	48,946,688
	D	3,487,875
	NR	64,919,202
Corporate Asset and Mortgage Back Securities	AAA	327,388,748
	A	15,054,122
	BBB	41,299,414
	BB	11,334,376
	B	9,096,959
	NR	68,213,833
Total		5,804,351,713
Proprietary Fund:		
U.S. Government Agency Obligations	AAA	63,213,365
	A-1	6,922,657
Corporate Obligations	AAA	6,903,320
	AA	66,324,736
	A	48,340,074
	A-1	139,502,853
	BBB	12,355,968
Corporate Asset and Mortgage Back Securities	AAA	8,195,018
	A	5,793,226
	BBB	882,646
Miscellaneous - Certificates of Deposit	A-1	5,000,000
Total		363,433,863

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, 2006.

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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, 2006, 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, 2006, 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	5.53	1.28
U.S. Treasury TIPS	15.06	-
U.S. Government Agency Obligations	4.41	4.23
Corporate Obligations	4.95	0.97
Corporate Asset and Mortgage Backed Securities	4.41	1.61
Repurchase Agreement	0.01	-
Money Market Funds	0.25	0.25
Overall	5.14	1.46

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 \$12,516,159 for the fiscal year ended August 31, 2006. The collateral information as of August 31, 2006 is summarized in Figure M.

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	\$ 1,459,067,889	\$ 458,246,011	\$ 1,025,726,545
U.S. Treasury TIPS	546,162,065	-	554,060,134
U.S. Government Agency Obligations	1,450,676,925	2,645,543	1,478,383,727
Corporate Obligations	423,839,459	-	428,975,498
Equity	1,036,501,748	-	1,055,542,411
International Equity	484,681,214	-	508,646,739
Total	5,400,929,300	460,891,554	5,051,335,054
Exh. X			
<i>Proprietary Fund:</i>			
U.S. Treasury Securities	211,561,129	56,143,654	159,197,694
U.S. Government Agency Obligations	20,512,404	4,150,457	16,734,500
Corporate Obligations	7,649,020	-	7,809,500
Total	239,722,553	60,294,111	183,741,694
Exh. V			

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Repurchase Agreements

During the fiscal year 2006, the System invested in repurchase agreements. As of August 31, 2006, the System had a balance totaling \$150,022,125 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 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, 2006, the outstanding futures contracts are summarized in Figure N.

The System could be exposed to risk if the counterparties

Figure N
Summary of Outstanding Futures Contracts

	No. of Contracts	Notional Amount
		\$
Futures Contracts - Long	2,017	234,182,145
Futures Contracts - Short	3,635	304,881,737
		Fair Value
		\$
Margin Deposit - Cash		61,856,010
Futures Contracts		(13,858,657)
Net Margin Deposit - Cash (Exh. X)		47,997,353
Margin Deposit - Securities (Note A)		40,554,648
<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>		

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, 2006.

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

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recorded in the Employees Life, Accident and Health Insurance and Benefits Fund.

Eligible participants include retirees who retired with at least 10 years of service to State agencies and certain higher education institutions. These retirees must meet certain age requirements. Surviving spouses and dependents of these retirees are also covered. As of August 31, 2006, there were 73,703 eligible retirees and surviving spouses, plus approximately 32,800 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 2006

	September 1, 2005
	\$
Retiree Only	343.48
Retiree & Spouse	539.70
Retiree & Children	474.86
Retiree & Family	671.08

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,	
	2006	2005
	\$	\$
State Contributions	343,821,335	306,854,229
Retiree Contributions	102,165,373	92,853,754
Total Contributions	445,986,708	399,707,983
Claims Expenses	478,228,775	439,171,027

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 \$900,105. A schedule of future minimum lease rental payments on non-cancelable operating leases as of August 31, 2006 is presented in Figure Q.

Figure Q
Non-Cancelable Operating Leases

Fiscal Year	Future Minimum Lease Rental Payments
	\$
2007	488,543
2008	206,422
2009	187,413
2010	187,413
Total Future Minimum Lease Rental Payments	1,069,791

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, 2006 and 2005 is presented in Figure R.

Figure R
Net Assets - Fiduciary Funds

Fund Type	Totals - August 31	
	2006	2005
	\$	\$
Defined Benefit Plans (Note A)	22,442,492,578	21,292,482,585
<i>Defined Contribution Plans and Cafeteria Plan:</i>		
Plan 457 Participants, as Restated	311,879,329	274,403,406
Administration - Defined Contribution Plans	2,005,587	1,517,834
Administration - State Employees Cafeteria Plan	1,590,970	2,025,676
Total Defined Contribution Plans and Cafeteria Plan	315,475,886	277,946,916
Total Fiduciary Net Assets Held In Trust for Pension Benefits and Other Purposes	22,757,968,464	21,570,429,501
	(Exh. VIII)	
<i>Note A: See Note 3.C, Reserves, for details of the statutorily required reserve balances of the Defined Benefit Plans.</i>		

Notes to the Basic Financial Statements

August 31, 2006

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) Figure S presents individual interfund receivable and interfund payable balances at August 31, 2006.

Figure S
Interfund Receivables and Payables

	Due From Other Funds	Due To Other Funds
Governmental Activities:	\$	\$
Governmental Funds		5,017
<i>Proprietary Fund:</i>		
Employees Life, Accident and Health Insurance and Benefits Fund		
Agency 327, Fund 973		882,066
Total Governmental Activities	-	887,083
Fiduciary Funds:		
Pension and Other Employee Benefit Trust Funds	1,363,374	476,291
Total - Interfund Receivables and Payables	1,363,374	1,363,374

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, 2006.

Figure T
Interfund Transfers

	Transfers In	Transfers Out
<i>Fiduciary Funds:</i>	\$	\$
Pension and Other Employee Benefit Trust Funds	771,690	771,690
Total - Interfund Transfers	771,690	771,690

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*.

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 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.

7. Termination Benefits

(in accordance with GASB Statement 47)

Termination benefits in the form of healthcare continuation under the Consolidated Omnibus Budget Reconciliation Act (COBRA) are provided for both voluntary and involuntary terminations under the Group Benefits Program.

Notes to the Basic Financial Statements

August 31, 2006

The System maintains the COBRA membership in the Group Benefits Program as part of a group without designating the entity where the members worked prior to being eligible for COBRA benefits. The Group Benefits Program has 2,485 COBRA participants.

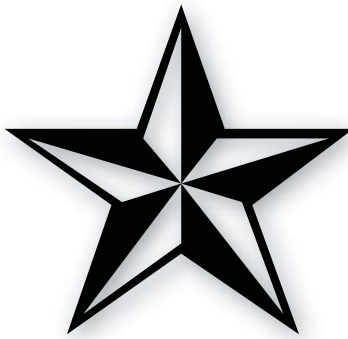
The COBRA members are eligible to remain in the Group Benefits Program for 18 months, 29 months if disabled, and their dependents are eligible to remain in the program for 36 months. The premium rates are set annually, and are based on the experience of the group.

8. Restatement of Net Assets of Texa\$aver 457 Trust Fund

Subsequent to the issuance of the Comprehensive Annual Financial Report for the fiscal year ended August 31, 2005, the System's management determined that allocated insurance contracts, also called annuitized accounts, reported as Miscellaneous Investments in the Texa\$aver 457 Trust Fund should not have been included in the assets of the System in accordance with GASB 25. Therefore, the beginning balance of Net Assets Held in Trust for Pension Benefits as of September 1, 2004 was reduced by \$21,539,856, and the activity related to these allocated contracts during the fiscal year ended August 31, 2005 has been restated as shown in Figure U.

Figure U

Financial Statement Line Item	2005 (As Previously Reported)	2005 (As Restated)
	\$	\$
Combined Statement of Fiduciary Net Assets (Exhibit VIII)		
Investments	21,330,173,127	21,311,630,154
Total Assets	26,219,479,529	26,200,936,556
Net Assets Held in Trust for Pension Benefits and Other Purposes (Exhibit IX)	<u>21,588,972,474</u>	<u>21,570,429,501</u>
Combined Statement of Changes in Fiduciary Net Assets (Exhibit IX)		
ADDITIONS		
Investment Income:		
From Investing Activities	2,439,267,414	2,441,887,803
Total Investment Income	2,449,422,156	2,452,042,545
Total Additions	3,252,740,131	3,255,360,518
DEDUCTIONS		
Benefits:		
Plan 457 Benefits	68,010,106	67,633,610
Total Benefits	1,473,623,873	1,473,247,377
Total Deductions	1,490,851,027	1,490,474,531
Net Increase	1,761,889,104	1,764,885,987
NET ASSETS		
Net Assets Held in Trust for Pension Benefits and Other Purposes:		
Beginning of Year	19,827,083,370	19,827,083,370
Restatement		(21,539,856)
Beginning of Year, as Restated	<u>19,805,543,514</u>	<u>19,805,543,514</u>
End of Year	<u>21,588,972,474</u>	<u>21,570,429,501</u>



Required Supplementary Information (Unaudited)

Schedule of Budgetary Comparison - Appropriated Special Revenue Funds (Basis of Budgeting) (Note A)

Year Ended August 31, 2006

	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)			
	Budget		Actual	Variance with Final Budget Positive (Negative)	Budget		Actual	Variance with Final Budget Positive (Negative)	Budget		Actual	Variance with Final Budget Positive (Negative)
	Original	Final			Original	Final			Original	Final		
Budgetary Fund Balances - Beginning	\$ -	\$ -	\$ -	-	\$ -	\$ -	\$ -	-	\$ -	\$ 3,400	\$ 3,400	-
Revenues												
Legislative Appropriations Out of the State's General Revenue Fund:												
For Administrative Expenditures	28,000	28,000	28,000	-								
For Death Benefits	2,909,925	4,333,358	4,333,358	-	2,541,976	750,000	750,000	-	6,931,297	6,910,476	6,910,476	-
Total Appropriations Revenue	2,937,925	4,361,358	4,361,358	-	2,541,976	750,000	750,000	-	6,931,297	6,910,476	6,910,476	-
Expenditures												
Current:												
Administrative Expenditures	28,000	28,000	28,000	-								
Death Benefits	2,909,925	4,333,358	4,333,358	-	2,541,976	750,000	750,000	-	6,931,297	6,907,711	6,907,711	-
Total Expenditures	2,937,925	4,361,358	4,361,358	-	2,541,976	750,000	750,000	-	6,931,297	6,907,711	6,907,711	-
Budgetary Fund Balances - Ending	-	-	-	-	-	-	-	-	-	6,165	6,165	-

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

Reconciliation of Basis of Budgeting to GAAP:	
Entity Differences:	
Total Actual Budgetary Fund Balances-Ending, as above	\$ 6,165
Plus: Fund Balance of the Unappropriated Special Revenue Fund-Social Security Administration Fund (Exh. IV)	43,234
Total Fund Balances-Special Revenue Funds-GAAP Basis (Exh. IV)	\$ 49,399

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)
Employees Retirement System (ERS)						
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
2006	21,780,437	22,884,917	1,104,480	95.2	5,051,330	21.9
Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)						
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)
2006	720,307	708,437	(11,870)	101.7	1,279,463	(0.9)
Judicial Retirement System Plan One (JRS I)						
2001	\$ 0	\$ 341,316	\$ 341,316	0.0%	\$ 9,334	3,656.6%
2002	0	336,960	336,960	0.0	8,240	4,089.3
2003	0	262,766	262,766	0.0	3,710	7,081.9
2004	0	263,068	263,068	0.0	4,921	5,345.4
2005	0	327,145	327,145	0.0	5,284	6,191.5
2006	0	325,977	325,977	0.0	5,138	6,344.8
Judicial Retirement System Plan Two (JRS II)						
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
2006	186,400	198,840	12,440	93.7	62,306	20.0

Schedule of Employer Contributions – Pension Trust Funds

Fiscal Year	Annual Required Contribution (ARC)	Percentage Contributed	Annual Required Contribution (ARC)	Percentage Contributed
Employees Retirement System (ERS)			Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)	
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	362,753,541	87.2	0	100.0
2007	364,800,444 (Note A)	N/A	7,495,672 (Note A)	N/A
Judicial Retirement System Plan One (JRS I)			Judicial Retirement System Plan Two (JRS II)	
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	101.3	10,075,506	99.8
2007	28,966,194 (Note A)	N/A	10,486,034 (Note A)	N/A

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:

	ERS	LECOS	JRS I	JRS II
Valuation Date	August 31, 2006	August 31, 2006	August 31, 2006	August 31, 2006
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	30.0	0.6 (Note A)	30.0	11.4 (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	0.0%-14.0%	6.0%-14.0%	4.0%	4.0%
Including Inflation at	4.0%	4.0%	4.0%	4.0%
Cost-of-living Adjustments	None-Employee 4.0%-Elected	None	4.0%	0.0%

Note A: Calculations based on estimated fiscal year 2007 covered payroll. At the end of fiscal year 2007 the ARC will be recalculated based on actual 2007 covered payroll.

Other Supplementary Information - Schedule A-1

Combining Schedule of Fiduciary Net Assets -

Pension and Other Employee Benefit Trust Funds - Defined Contribution Plans and Cafeteria Plan

August 31, 2006 (With Comparative Totals at August 31, 2005, as Restated)

	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, (Note 8)	
	\$	\$	\$	\$	\$	\$
ASSETS						
<i>Cash and Short-Term Investments:</i>						
<i>Cash and Cash Equivalents:</i>						
Cash in Bank		1,245,452	1,245,452	227,180	1,472,632	2,502,550
Cash in State Treasury	1,046,564	969,938	2,016,502	2,921,364	4,937,866	4,498,231
Total Cash and Cash Equivalents	1,046,564	2,215,390	3,261,954	3,148,544	6,410,498	7,000,781
<i>Short-Term Investments:</i>						
Mutual Funds		169,978,284	169,978,284		169,978,284	133,925,071
Total Short-Term Investments	-	169,978,284	169,978,284	-	169,978,284	133,925,071
Total Cash and Short-Term Investments	1,046,564	172,193,674	173,240,238	3,148,544	176,388,782	140,925,852
<i>Investments:</i>						
Miscellaneous Investments		140,760,681	140,760,681		140,760,681	139,049,116
Total Investments	-	140,760,681	140,760,681	-	140,760,681	139,049,116
<i>Receivables:</i>						
Interest and Dividends Receivable	4,300	3,000	7,300	17,100	24,400	14,971
Contributions/Accounts Receivable		4,205	4,205	4,459,809	4,464,014	4,059,459
Total Receivables	4,300	7,205	11,505	4,476,909	4,488,414	4,074,430
Due From Other Agencies (Note 1.G)			-	4,460	4,460	2,736
Prepaid Claims Expense			-	101,490	101,490	479,616
Total Assets	1,050,864	312,961,560	314,012,424	7,731,403	321,743,827	284,531,750
LIABILITIES						
<i>Payables:</i>						
Benefits/Accounts Payable		62,633	62,633	6,113,920	6,176,553	6,490,019
Total Payables	-	62,633	62,633	6,113,920	6,176,553	6,490,019
Due To Other Funds (Note 1.G)	22,843	34,092	56,935	26,513	83,448	90,150
Deferred Revenue		7,940	7,940	-	7,940	4,665
Total Liabilities	22,843	104,665	127,508	6,140,433	6,267,941	6,584,834
NET ASSETS						
Net Assets Held in Trust for Pension						
Benefits and Other Purposes (Sch. A-2)	1,028,021	312,856,895	313,884,916	1,590,970	315,475,886	277,946,916

Other Supplementary Information - Schedule A-2

Combining Schedule of Changes in Fiduciary Net Assets -

Pension and Other Employee Benefit Trust Funds - Defined Contribution Plans and Cafeteria Plan

Year Ended August 31, 2006 (With Comparative Totals for August 31, 2005, as Restated)

ADDITIONS	TexaSaver	TexaSaver	Totals	State	Totals	
	401(k)	457		Employees	August 31,	
	Trust Fund	Trust Fund	Defined	Cafeteria	(Note 8)	
	(0946)	(0945)	Contribution	Plan Trust	2006 (Exh. IX)	2005 (Restated)
	(U/F 0946)	(U/F 0945)	Plans	Fund (0943)		
	\$	\$	\$	\$	\$	\$
Contributions:						
<i>Member Contributions:</i>						
Plan 457 Deferrals		43,832,042	43,832,042		43,832,042	43,817,151
Plan 457 Rollovers In and Transfers In		30,769,685	30,769,685		30,769,685	39,267,583
Total Plan 457 Contributions	-	74,601,727	74,601,727	-	74,601,727	83,084,734
<i>Cafeteria Plan</i>						
Debit Card Fees				60,030,516	60,030,516	52,379,689
Total Cafeteria Plan Contributions	-	-	-	386,998	386,998	364,356
Total Member Contributions	-	74,601,727	74,601,727	60,417,514	60,417,514	52,744,045
Settlement Revenue	132,763	12,416	145,179	60,417,514	135,019,241	135,828,779
<i>Other Contributions:</i>						
Cafeteria Plan Forfeitures					145,179	18,000
Total Contributions	132,763	74,614,143	74,746,906	61,079,644	135,826,550	136,527,711
Investment Income:						
<i>From Investing Activities:</i>						
Net Appreciation		17,555,333	17,555,333		17,555,333	19,131,982
Interest & Dividends	52,589	6,196,710	6,249,299	74,730	6,324,029	6,029,807
Total Investing Activity Income	52,589	23,752,043	23,804,632	74,730	23,879,362	25,161,789
Less: Investment Expense	(260)	(260)	(520)		(520)	-
Net Investment Income	52,329	23,751,783	23,804,112	74,730	23,878,842	25,161,789
Other Additions:						
<i>Other Revenue:</i>						
Miscellaneous Revenue	-	-	-	55,913	55,913	93,029
Administration Fees	183,811	159,572	343,383		343,383	149,432
Total Other Revenue	183,811	159,572	343,383	55,913	399,296	242,461
<i>Transfers In (Note 1.G):</i>						
Membership Fees	25,000	511,536	536,536	-	536,536	433,815
Total Other Additions	208,811	671,108	879,919	55,913	935,832	676,276
Total Additions	393,903	99,037,034	99,430,937	61,210,287	160,641,224	162,365,776
DEDUCTIONS						
<i>Benefits:</i>						
Plan 457 Distributions (Includes Withholding Taxes)		28,291,425	28,291,425		28,291,425	25,727,194
Plan 457 Fees		629,935	629,935		629,935	425,088
Plan 457 Rollovers Out and Transfers Out		31,867,227	31,867,227		31,867,227	41,481,328
Total Plan 457 Benefits	-	60,788,587	60,788,587	-	60,788,587	67,633,610
Cafeteria Plan Reimbursement Claims				59,950,562	59,950,562	52,336,797
Total Benefits	-	60,788,587	60,788,587	59,950,562	120,739,149	119,970,407
<i>Administrative Expenses:</i>						
Salaries & Wages	194,774	283,204	477,978	203,934	681,912	650,872
Payroll Related Costs	45,854	71,586	117,440	51,419	168,859	154,957
Professional Fees & Services	7,375	6,930	14,305	3,804	18,109	15,066
Travel	1,365	1,612	2,977	1,002	3,979	3,058
Materials & Supplies	2,536	4,685	7,221	5,747	12,968	32,913
Communications & Utilities	3,264	6,573	9,837	9,361	19,198	17,885
Repairs & Maintenance	6,427	8,868	15,295	11,090	26,385	53,790
Rentals & Leases	6,367	8,228	14,595	9,694	24,289	32,444
Printing & Reproduction	42	484	526	1,070	1,596	1,565
Interest Expense				78,626	78,626	37,297
<i>Other Operating Expenses:</i>						
Other Expenses	7,213	11,287	18,500	17,317	35,817	22,170
Third Party Administrator Fees				914,369	914,369	856,137
Debit Card Fees				386,998	386,998	364,356
Total Other Operating Expenses	7,213	11,287	18,500	1,318,684	1,337,184	1,242,663
Total Administrative Expenses	275,217	403,457	678,674	1,694,431	2,373,105	2,242,510
Total Deductions	275,217	61,192,044	61,467,261	61,644,993	123,112,254	122,212,917
Net Increase (Decrease)	118,686	37,844,990	37,963,676	(434,706)	37,528,970	40,152,859
NET ASSETS						
Net Assets Held in Trust for Pension Benefits and Other Purposes:						
Beginning of Year, as Reported	909,335	293,554,878	294,464,213	2,025,676	296,489,889	259,333,913
Restatement (Note 8)		(18,542,973)	(18,542,973)		(18,542,973)	(21,539,856)
Beginning of Year, as Restated	909,335	275,011,905	275,921,240	2,025,676	277,946,916	237,794,057
End of Year (Sch. A-1)	1,028,021	312,856,895	313,884,916	1,590,970	315,475,886	277,946,916

Other Supplementary Information - Schedule B-1

Combining Schedule of Net Assets - Agency Funds

Year Ended August 31, 2006

	Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)	Departmental Suspense Fund (0900) (U/F 0900 & 9015)	Direct Deposit Correction Account (0980) (U/F 0980)	Employee Savings Bond Fund (0901) (U/F 0901)	TexaSaver 401(k) Fund (0946) (U/F 1946)	TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942/8942)	Totals August 31, 2006
ASSETS	\$			\$	\$	\$	\$
Current Assets:							
<i>Cash and Cash Equivalents:</i>							
Cash in State Treasury				150		274,551	274,701
Cash in Bank	-	-	-	-	3,971	-	3,971
Total Cash and Cash Equivalents	-	-	-	150	3,971	274,551	278,672
Accounts Receivable	18,804						18,804
Total Current Assets	18,804	-	-	150	3,971	274,551	297,476
Total Assets	18,804	-	-	150	3,971	274,551	297,476
LIABILITIES							
Current Liabilities:							
Accounts Payable	18,804	-	-	150			18,954
Funds Held For Others		-	-		3,971	274,551	278,522
Total Current Liabilities	18,804	-	-	150	3,971	274,551	297,476
Total Liabilities	18,804	-	-	150	3,971	274,551	297,476

Other Supplementary Information - Schedule B-2

Combining Schedule of Changes in Assets and Liabilities - Agency Funds

For the Year Ended August 31, 2006

	Beginning Balances	Additions	Deductions	Ending Balances
	\$	\$	\$	\$
Unappropriated Receipts General Revenue Fund (0001) (U/F 1001)				
ASSETS				
Cash in State Treasury	-	769,980	769,980	-
Accounts Receivable	2,082	213,609	196,887	18,804
Total Assets	2,082	983,589	966,867	18,804
LIABILITIES				
Accounts Payable	2,082	823,446	806,724	18,804
Due To Other Funds	-	1,145	1,145	-
Total Liabilities	2,082	824,591	807,869	18,804
Departmental Suspense Fund (0900) (U/F 0900 & 9015)				
ASSETS				
Cash in State Treasury	-	2,263	2,263	-
Total Assets	-	2,263	2,263	-
LIABILITIES				
Funds Held For Others	-	2,263	2,263	-
Total Liabilities	-	2,263	2,263	-
Employee Savings Bond Fund (0901) (U/F 0901)				
ASSETS				
Cash in State Treasury	150	600	600	150
Total Assets	150	600	600	150
LIABILITIES				
Accounts Payable	150	600	600	150
Vouchers Payable	-	600	600	-
Total Liabilities	150	1,200	1,200	150
TexaSaver 401(k) Trust Fund (0946) (U/F 1946)				
ASSETS				
Cash in Bank	-	122,077,938	122,073,967	3,971
Total Assets	-	122,077,938	122,073,967	3,971
LIABILITIES				
Funds Held For Others	-	122,077,938	122,073,967	3,971
Total Liabilities	-	122,077,938	122,073,967	3,971
TexaSaver 401(k) Hold Transmittal (0942) (U/F 0942 & 8942)				
ASSETS				
Cash in State Treasury	227,271	47,280	-	274,551
Total Assets	227,271	47,280	-	274,551
LIABILITIES				
Funds Held For Others	227,271	47,280	-	274,551
Total Liabilities	227,271	47,280	-	274,551
Direct Deposit Correction Account (0980) (U/F 0980)				
ASSETS				
Cash in State Treasury	-	343,367	343,367	-
Total Assets	-	343,367	343,367	-
LIABILITIES				
Funds Held For Others	-	343,367	343,367	-
Total Liabilities	-	343,367	343,367	-
Totals - All Agency Funds				
ASSETS				
Cash in Bank	-	122,077,938	122,073,967	3,971
Cash in State Treasury	227,421	1,163,490	1,116,210	274,701
Accounts Receivable	2,082	213,609	196,887	18,804
Total Assets	229,503	123,455,037	123,387,064	297,476
LIABILITIES				
Accounts Payable	2,232	824,046	807,324	18,954
Vouchers Payable	-	600	600	-
Due To Other Funds	-	1,145	1,145	-
Funds Held For Others	227,271	122,470,848	122,419,597	278,522
Total Liabilities	229,503	123,296,639	123,228,666	297,476

Other Supplementary Information - Schedule 1

Revenues, Expenses and Changes in Statutory Account Balances

(Non-GAAP Presentation) - Employees Retirement Fund

Year Ended August 31, 2006

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2006
	\$	\$	\$	\$	\$	\$
OPERATING REVENUES						
Contributions to Retirement System:						
Member Contributions	329,802,863					329,802,863
State Contributions		316,197,838				316,197,838
Service Contributions from Teacher Retirement System		45,716,307				45,716,307
Membership Fees					540,092	540,092
Penalty Interest		12,349,257				12,349,257
Investment Income:						
Net Appreciation in Fair Value of Investments				1,069,644,848		1,069,644,848
Interest and Dividends				688,296,366		688,296,366
Rental Income					83,687	83,687
Warrants Voided by Statute of Limitations		108,523				108,523
Sale of Surplus Equipment					2,790	2,790
Miscellaneous					3,327	3,327
Total Operating Revenues	329,802,863	374,371,925	-	1,757,941,214	629,896	2,462,745,898
OPERATING EXPENSES						
Retirement System Benefits Paid:						
Retirement Benefits			1,244,181,983			1,244,181,983
Death Benefits:						
Active Members		1,316,713				1,316,713
Retirees		128,985	786,582			915,567
Member Contributions Withdrawn	75,614,028					75,614,028
Service Contributions to Teacher Retirement System		6,908,439				6,908,439
Administrative Expenses					32,890,174	32,890,174
Depreciation Expense					727,275	727,275
Total Operating Expenses	75,614,028	8,354,137	1,244,968,565	-	33,617,449	1,362,554,179
Income (Loss) Before Non-Operating Expenses and Operating Transfers	254,188,835	366,017,788	(1,244,968,565)	1,757,941,214	(32,987,553)	1,100,191,719
NON-OPERATING REVENUES (EXPENSES)						
Loss on Disposal of Fixed Assets					(7,899)	(7,899)
Income (Loss) Before Operating Transfers	254,188,835	366,017,788	(1,244,968,565)	1,757,941,214	(32,995,452)	1,100,183,820
OPERATING TRANSFERS IN (OUT)						
Distribution of Interest	172,062,474	693,121,108	851,075,222	(1,716,258,804)		-
Interest Paid on Withdrawals	7,943,724			(7,943,724)		-
Establishment of Benefit Reserves	(190,354,943)	(359,008,084)	549,363,027			-
Member Savings Reinstated	62,941	(62,941)				-
Distribution of Interest for Administrative Expenses				(33,738,686)	33,738,686	-
Benefits Waived		37,711	(37,711)			-
Member Accounts - Escheated	(1,670,803)	1,670,803				-
Membership Fees Transferred Out					(536,536)	(536,536)
Excess Benefit Arrangement Transfers					(235,154)	(235,154)
Net Operating Transfers	(11,956,607)	335,758,597	1,400,400,538	(1,757,941,214)	32,966,996	(771,690)
Net Income	242,232,228	701,776,385	155,431,973	-	(28,456)	1,099,412,130
Account Balances - Beginning	3,581,186,131	5,981,451,720	10,886,033,918	-	28,456	20,448,700,225
Account Balances - Ending	3,823,418,359	6,683,228,105	11,041,465,891	-	-	21,548,112,355

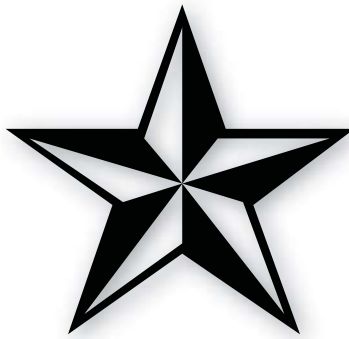
Other Supplementary Information - Schedule 2

Revenues, Expenses and Changes in Statutory Account Balances

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

Year Ended August 31, 2006

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2006
	\$	\$	\$	\$	\$	\$
OPERATING REVENUES						
Investment Income:						
Net Appreciation in Fair Value of						
Investments				35,478,030		35,478,030
Interest and Dividends				22,874,456		22,874,456
Warrants Voided by Statute of Limitations		139				139
Total Operating Revenues	-	139	-	58,352,486	-	58,352,625
OPERATING EXPENSES						
Retirement System Benefits Paid:						
Retirement Benefits			30,184,076			30,184,076
Administrative Expenses					1,074,332	1,074,332
Total Operating Expenses	-	-	30,184,076	-	1,074,332	31,258,408
Income (Loss) Before Operating Transfers	-	139	(30,184,076)	58,352,486	(1,074,332)	27,094,217
OPERATING TRANSFERS IN (OUT)						
Distribution of Interest		37,798,441	19,479,713	(57,278,154)		-
Establishment of Benefit Reserves		(18,377,309)	18,377,309			-
Distribution of Interest for						
Administrative Expenses				(1,074,332)	1,074,332	-
Net Operating Transfers	-	19,421,132	37,857,022	(58,352,486)	1,074,332	-
Net Income	-	19,421,271	7,672,946	-	-	27,094,217
Account Balances - Beginning	5,275	431,219,469	251,474,897	-	-	682,699,641
Account Balances - Ending	5,275	450,640,740	259,147,843	-	-	709,793,858



Other Supplementary Information - Schedule 3

Revenues, Expenses and Changes in Statutory Account Balances

(Non-GAAP Presentation) - Judicial Retirement System Plan Two Fund

Year Ended August 31, 2006

	Employees Savings Account	State Accumulation Account	Retirement Annuity Reserve Account	Interest Account	Expense Account	Totals August 31, 2006
	\$	\$	\$	\$	\$	\$
OPERATING REVENUES						
Contributions to Retirement System:						
Member Contributions	3,677,757					3,677,757
State Contributions		10,052,152				10,052,152
Penalty Interest		814				814
Investment Income:						
Net Appreciation in Fair Value of						
Investments				8,905,402		8,905,402
Interest and Dividends				5,629,251		5,629,251
Warrants Voided by Statute of Limitations		3,844				3,844
Miscellaneous						-
Total Operating Revenues	3,677,757	10,056,810	-	14,534,653	-	28,269,220
OPERATING EXPENSES						
Retirement System Benefits Paid:						
Retirement Benefits			4,223,003			4,223,003
Death Benefits:						
Active Members		24,363				24,363
Member Contributions Withdrawn	64,806					64,806
Administrative Expenses					453,402	453,402
Total Operating Expenses	64,806	24,363	4,223,003	-	453,402	4,765,574
Income (Loss) Before Operating Transfers	3,612,951	10,032,447	(4,223,003)	14,534,653	(453,402)	23,503,646
OPERATING TRANSFERS IN (OUT)						
Distribution of Interest	1,829,135	8,985,497	3,237,815	(14,052,447)		-
Interest Paid on Withdrawals	28,273			(28,273)		-
Establishment of Benefit Reserves	(831,788)	(4,810,355)	5,642,143			-
Distribution of Interest for Administrative Expenses				(453,933)	453,933	-
Net Operating Transfers	1,025,620	4,175,142	8,879,958	(14,534,653)	453,933	-
Net Income	4,638,571	14,207,589	4,656,955	-	531	23,503,646
Account Balances - Beginning	37,291,238	82,119,440	41,672,041	-	-	161,082,719
Account Balances - Ending	41,929,809	96,327,029	46,328,996	-	531	184,586,365

Other Supplementary Information - Schedule 4

Administrative and Investment Expenses/Expenditures

Statutory Administrative Funds and Accounts

Year Ended August 31, 2006

	Administrative Expenses- Non-Investment	Administrative Expenses- Investment
	\$	\$
<u>PERSONNEL SERVICES</u>		
Salaries and Wages	13,286,008	2,458,880
Payroll Related Costs:		
Retirement Contributions	796,096	141,741
Retirement Membership Fees	764	84
Employees Insurance Contributions	1,214,721	147,072
Retirees Insurance Contributions	450,762	
Social Security Contributions	945,144	154,792
Unemployment Compensation	16,312	
Total Payroll Related Costs	<u>3,423,799</u>	<u>443,689</u>
Total Personnel Services	<u>16,709,807</u>	<u>2,902,569</u>
<u>PROFESSIONAL FEES AND SERVICES</u>		
Actuarial Services	945,709	
Audit Services	272,510	
Investment Consulting Fees		395,706
Investment Advisor Fees		15,830,634
Medical Board Member Fees	64,700	
Architectural Services	104,941	
Legal Services	23,850	1,735
Computer Programming Services	1,559,010	57,437
Other Professional Services	200,373	
Total Professional Fees and Services	<u>3,171,093</u>	<u>16,285,512</u>
<u>OTHER SERVICES AND CHARGES</u>		
Travel	84,893	154,967
Materials and Supplies:		
Postage	559,059	
General Office and Other Supplies	164,304	158
Subscriptions	19,741	5,192
Furniture and Equipment	260,776	4,454
Computer Software	233,330	
Total Materials and Supplies	<u>1,237,210</u>	<u>9,804</u>
Communications and Utilities:		
Electricity, Gas and Water	313,119	
Telephone and Telegraph	254,112	31,642
Electronic Communications Services	58,773	1,246,765
Total Communications and Utilities	<u>626,004</u>	<u>1,278,407</u>
Repairs and Maintenance:		
Land and Building	231,357	
Furniture and Equipment	22,218	
Computer Software and Equipment	623,937	113,592
Total Repairs and Maintenance	<u>877,512</u>	<u>113,592</u>
Rentals and Leases:		
Computer Software and Equipment	719,958	24,001
Office Equipment	156,117	29
Space	22,064	245
Total Rentals and Leases	<u>898,139</u>	<u>24,275</u>
Printing and Reproduction Services	53,376	
Depreciation	727,275	
Interest Expense	78,626	

- to next page

Other Supplementary Information - Schedule 4

Administrative and Investment Expenses/Expenditures

Statutory Administrative Funds and Accounts (Concluded)

Year Ended August 31, 2006

	Administrative Expenses- Non-Investment	Administrative Expenses- Investment
	\$	\$
OTHER SERVICES AND CHARGES (continued)		
Other Operating Expenses/Expenditures:		
Membership Fees	27,590	39,995
Employee Training	109,556	12,883
Insurance - Building and Vehicle	27,716	
Fees and Other Charges	22,537	2,159
Investment Banking		397,193
Tenure Awards	4,834	
Witness Fees	1,351	
Temporary Employment Agencies	345,939	8,786
Cleaning Services	83,262	
Advertising Services	14,473	
Freight/Delivery Services	3,226	
Purchased Contracted Services	361,855	33,229
Prompt Payment Interest	16	
Claims & Judgments	621	
Third Party Administrator Fee - Cafeteria Plan	914,369	
Debit Card Fees - Cafeteria Plan	386,998	
Total Other Operating Expenses/Expenditures	<u>2,304,343</u>	<u>494,245</u>
Total Other Services and Charges	6,887,378	2,075,290
Total Expenses/Expenditures	26,768,278	21,263,371
Method of Finance:		
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	13,263,934	20,353,515
Law Enforcement and Custodial Officer Supplemental Ret. Trust Fund (0977)	378,051	696,281
Judicial Retirement System Plan One Fund (0001)	120,000	
Judicial Retirement System Plan Two Trust Fund (0993)	302,835	150,567
Texasaver 401(k) Trust Fund (0946)	275,217	260
Texasaver 457 Trust Fund (0945)	403,457	260
State Employees Cafeteria Plan Trust Fund (0943)	1,694,431	
Total Fiduciary Funds	16,437,925	21,200,883
Employees Life, Accident, Health Insurance and Benefits Trust Account (0973)	10,244,183	62,488
Total Proprietary Fund	10,244,183	62,488
Social Security Administration Trust Account (0929)	58,170	
Death Benefits for Certain Law Enforce. Officers, Fire Fighters and Others (0001)	28,000	
Total Governmental Funds	86,170	-
Total Method of Finance	26,768,278	21,263,371

Other Supplementary Information - Schedule 5

Professional and Consulting Fees

Year Ended August 31, 2006

<u>NATURE OF SERVICE</u>	<u>Totals</u>
	\$
Medical Board	64,700
Investment Consulting	395,706
Investment Advisors	15,830,634
Actuarial Services - Retirement	365,174
Actuarial Services - Insurance	580,535
Computer Programming Services	1,616,447
Audit Fees - Financial	84,710
Audit Fees - Insurance Carrier	158,500
Audit Fees - Other	29,300
Educational Services	51,083
Architectural Services	104,941
Legal Services	25,585
Employee Compensation Review	19,764
Fiduciary Counsel	26,000
Strategic Planning Services	27,286
Defined Benefit Plan Review	30,000
Employee Assistance Program	3,597
Other Professional Services	42,643
Total Professional and Consulting Fees	<u>19,456,605</u>
Method of Finance:	
State Employees Retirement System (S.E.R.S.) Trust Account (0955)	17,669,443
Law Enforcement and Custodial Officer Supplemental Ret. Trust Fund (0977)	603,730
Judicial Retirement System Plan One Fund (0001)	16,897
Judicial Retirement System Plan Two Trust Fund (0993)	187,348
TexaSaver 401(k) Trust Fund (0946)	7,635
TexaSaver 457 Trust Fund (0945)	7,190
State Employees Cafeteria Plan Trust Fund (0943)	3,804
Total Fiduciary Funds	<u>18,496,047</u>
Employees Life, Accident, Health Insurance and Benefits Trust Account (0973)	960,340
Total Proprietary Fund	<u>960,340</u>
Social Security Administration Fund (0929)	218
Total Governmental Funds	<u>218</u>
Total Method of Finance	<u>19,456,605</u>

Other Supplementary Information - Schedule 6

Expenditures of Federal Awards

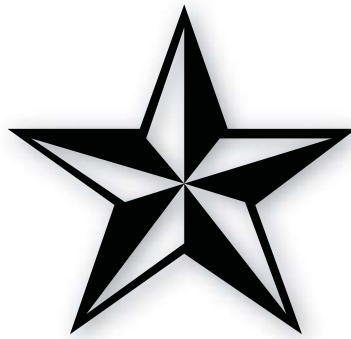
August 31, 2006

Federal Grantor/ Pass-through Grantor/Program Title	CFDA Number	Identifying Number	From		To	
			Direct Program Amount	Total Pass Through From and Direct Program Amount	Expenditures Amount	Total Pass Through To and Expenditures Amount
U.S. Department of Health & Human Services			\$	\$	\$	\$
Direct Programs:						
Reimbursement of State						
Costs for Provision of Medicare Part D Drugs	93.794		19,359,506	19,359,506	19,359,506	19,359,506
Totals - U.S. Department of Health and Human Services			19,359,506	19,359,506	19,359,506	19,359,506
Total Expenditures of Federal Awards			19,359,506	19,359,506	19,359,506	19,359,506

Reconciliation:

Below is the reconciliation of the total federal expenditures as reported on the Schedule of Expenditures of Federal Awards to the total of federal revenues as reported in the basic financial statements. Generally, federal funds are not earned until expended; therefore, federal revenues equal federal expenditures for the reporting period.

Total Federal Revenue - Proprietary Fund (Exhibit VI)	\$ 19,359,506
Total Expenditures per Federal Schedule	19,359,506
Difference	-



Investment Section

(unaudited)



Report on Investment Activity
Outline of Investment Policies
**Time-Weighted Rates of Return
and Asset Allocations**
Fees and Commissions
List of Largest Assets Held
Investment Summary at Fair Value

Report on Investment Activity (Unaudited)

Fiscal Year 2006

OVERVIEW

The Employees Retirement System of Texas (System) investment portfolio closed the fiscal year with a fair value of \$22.3 billion, and returned 8.8% for the year. The fiscal year-end asset allocation stood at 30.2% investment grade bonds, 7.1% high yield bonds, 36.8% large cap domestic equity, 6.8% small cap domestic equity and 18.0% 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 an investment operations review by the system's investment consultant as well as a custodian bank search that resulted in the enhancement of our existing custodial relationship at a lower overall cost. Additionally, the System hired and successfully transitioned to four new investment advisors better diversifying our small capitalization, domestic equity and international equity asset classes. 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 including a new investment accounting software package providing daily net asset values.

The investment portfolio's total return outperformed the actuarially assumed rate of return of 8.0% for the fourth year in a row reflecting the continued rebound in the domestic and international equity markets. Over the longer term, the fund returned 7.99% for the 10 years ending August 31, 2006 slightly besting the policy benchmark of 7.89%.

DOMESTIC EQUITY MARKET

For the fiscal year ended August 31, 2006, the S&P 500 Index returned 8.9%, while the S&P 600 Small Cap Index returned 7.2%. These gains were a continuation of the positive returns experienced during the prior three fiscal years. The modest under-performance of the small cap benchmark, after five years of relative out-performance, is likely the reflection of a slowing economy. After four years of very robust earnings growth, operating earnings for the S&P 500 are forecasted to slow to 7% in 2007 and this projection has a downward bias. Small cap earnings are forecasted to grow over 10% in 2007, but these earnings are more volatile and the forecast also has a downward bias. It may be possible for the market to advance during the next year, especially if earnings hold up better than expected, but the advance is likely to be modest in light of the economic headwinds. The energy and materials sectors continued to post strong relative

performance over the year, a continuation of last year, but this year they were joined by financial stocks and consumer staples. The worst performing sectors were consumer discretionary and technology, with health care not far behind. These stocks have recently started to outperform, perhaps recovering somewhat from over-sold conditions while energy and material stocks have started to lag the market.

INTERNATIONAL EQUITY MARKET

International equity markets continued to march higher in FY 2006 capping four consecutive years of strong returns. The Morgan Stanley Capital International EAFE Free index returned 24.9% in US dollar terms for the period. However, following four years of healthy returns the international markets are still more than 15% below the all-time high. The Pacific ex-Japan region returned 22.8%, Japan gained 27.1%, the Europe region gained 26.8% and the United Kingdom returned 21.4% in fiscal 2006, all adjusted to US dollars.

Major currencies were generally stronger versus the dollar with the exception of the Japanese Yen. The Euro began the fiscal year near the 1.24 USD/EUR level, touched a low of 1.17 USD/EUR and ended near 1.28EUR/USD, for a gain of 3.8% for the year. The British Pound followed a similar trend and ended the year with a 5.6% gain. The Japanese Yen was decidedly weak as it began the year at 110 JPY/USD, went to 121 JPY/USD and ended the year near 117, or down 5.8%.

FIXED INCOME MARKET

Long term rates traded off significantly over the last 12 months. Ten year interest rates traded above 5% for the first time since June 2002. Additionally, we saw an inversion in the spread between the 10 and 2 year interest rate curve. This was the first time the curve had inverted since November 2000. The Federal Open Market Committee raised the Fed Funds overnight rate 7 times from 3.50% to 5.25% before finally pausing after 17 straight 25 basis point rate hikes.

For the past 12 months the primary focus for the bond market and the Fed has been inflation and energy prices. Post Katrina, consumer confidence waned with rising energy costs. Despite this, housing and employment remained strong. First quarter GDP rebounded to 5.6% from a low 1.8%. The Fed continued to hike short term rates as data indicated a strong economy with inflationary risk. Federal Reserve Chairman Alan Greenspan retired and Ben Bernanke was appointed to the position in February 2006. The reintroduction of the 30 year U.S. Treasury bond also occurred around this time, causing

Report on Investment Activity (Unaudited)

Fiscal Year 2006

the first inversion of the curve for the year. As the year progressed, we started to see some weakness in the economic data, particularly in housing. Housing data, including declining sales and growing inventories continued as well as a 14 year low reading in the National Association of Homebuilders Index. Inflation data became tame as energy prices finally started to come down. It was at this juncture the Fed paused. At the June 29th meeting, the FOMC left short term rates unchanged at 5.25%.

Index Performance

The Lehman Brothers Aggregate Index returned 1.71% for the Fiscal year. The best performing sectors were in the securitized products areas including ABS and MBS.

Total Return 12 Months Ending August 31, 2006

Lehman Aggregate	1.94
Treasuries	0.79
Government Related	1.94
Corporates	0.53
Securitized	2.80

Key Portfolio Statistics

	2006	2005
Contributions to Pool	\$505,300,000	\$423,500,000
Withdrawals from Pool	(\$1,195,626,000)	(\$1,138,523,000)
Interest & Dividends	\$704,741,892	\$645,727,762
Securities Lending Income	\$12,058,181	\$10,154,742
Net Appreciation in Fair Value	\$1,114,028,280	\$1,788,788,380

Prepared by:
Chief Investment Officer and Finance 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 2006

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)

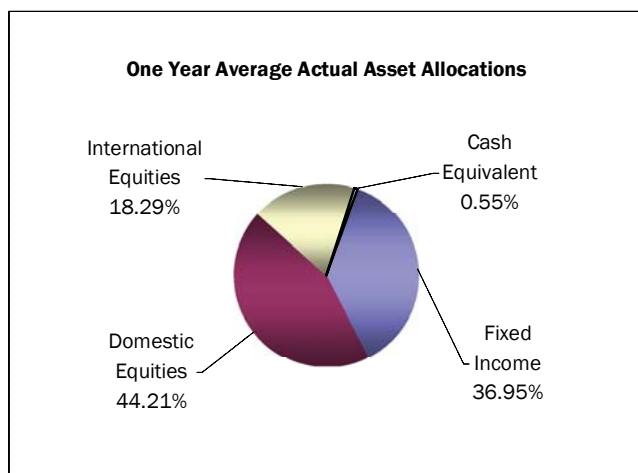
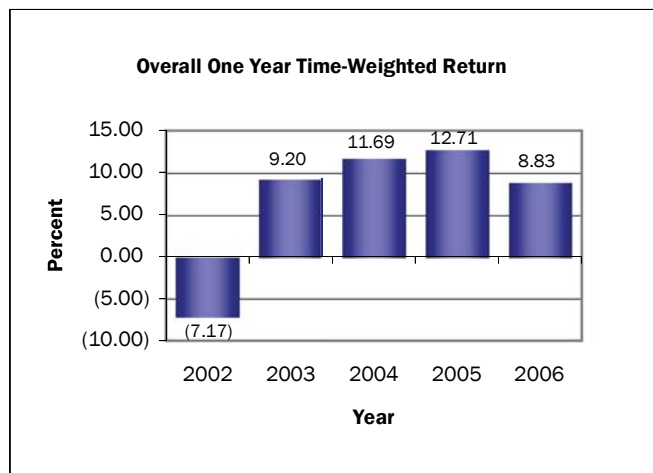
August 31, 2006

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	%	%	%	%	%	%	%	%	%	%
2002	6.17	8.11	(15.37)	(17.99)	(19.28)	(14.95)	2.29	2.27	(7.17)	1.58
2003	6.50	4.36	11.90	12.07	5.96	9.11	1.42	1.38	9.20	1.88
2004	7.78	6.13	11.25	11.45	21.41	22.64	1.13	1.08	11.69	2.44
2005	5.21	4.15	14.68	12.56	24.39	23.58	2.54	2.44	12.71	3.59
2006	2.52	1.71	8.29	8.88	22.39	24.28	4.66	4.34	8.83	3.92
3 Year										
(2004-2006)	5.15	3.98	11.38	10.95	22.72	23.50	2.76	2.61	11.06	3.40
5 Year										
(2002-2006)	5.62	4.87	5.52	4.65	9.59	11.81	2.40	2.29	6.79	2.83

Average Asset Allocations

	1-Year		3-Year		5-Year	
	Target	Actual	Target	Actual	Target	Actual
	%	%	%	%	%	%
Fixed Income	38.00	36.95	39.00	38.02	39.80	39.52
Domestic Equities	44.00	44.21	43.00	43.29	42.20	42.28
International Equities	18.00	18.29	18.00	18.35	18.00	17.97
Cash Equivalent	0.00	0.55	0.00	0.34	0.00	0.23
Total	100.00	100.00	100.00	100.00	100.00	100.00



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

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

The indices used for comparison are as follows:

Fixed Income Securities Portfolio:	Lehman Aggregate Index
Domestic Equities Portfolio:	S & P 500 Index
International Equities Portfolio:	EAFE Free Index (i.e., Europe, Australia and Far East Index excluding securities unavailable to foreign investors)
Cash Equivalents Portfolio:	91-Day U.S. Treasury Bill

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

Fees and Commissions (Unaudited)

Year Ended August 31, 2006

Investment Advisory Fees				Domestic Equity Commissions			
	Assets Under		Basis Points	Brokerage Firm	No. of Shares Traded	Commissions	Commission Per Share
	Advisory						
	Management	Fees					
Fixed Income Advisors	\$ 1,504,088,832	\$ 2,785,000	0.1852%	Bank of America	8,560,632	\$ 250,816	0.029
Domestic Equity Advisors	3,416,566,747	5,979,479	0.1750%	Bear Stearns	4,356,289	81,171	0.019
International Equity Advisors	2,834,869,463	7,066,155	0.2493%	Bloomberg Tradebook - ESI Securities	20,943,435	419,983	0.020
Total	7,755,525,042	15,830,634	0.2041%	BOE Securities, Inc.	1,249,690	49,988	0.040
				CIBC World Markets - Oppenheimer	631,670	18,950	0.030
				Citigroup Global Markets, Inc.	6,244,263	129,316	0.021
				Davis, Mendel & Regenstein, Inc.	1,346,900	53,876	0.040
				Deutsche Bank Securities	1,844,525	43,010	0.023
				Empirical Research Partners, LLC	191,000	7,640	0.040
				First Boston	7,906,660	164,348	0.021
				Goldman Sachs	7,311,324	204,367	0.028
				Green Street Advisors	1,931,075	86,668	0.045
				GRW Capital Corporation	81,740	3,270	0.040
				Harris Nesbitt Corporation	227,473	11,374	0.050
				ITG	1,463,040	29,263	0.020
				J.P. Morgan	7,487,546	209,019	0.028
				Jefferies & Co.	6,428,810	174,895	0.027
				Leerink Swann & Co.	520,600	26,030	0.050
				Legg Mason Wood Walker, Inc.	537,594	15,628	0.029
				Lehman Brothers	9,288,300	214,278	0.023
				M. Ramsey King Securities, Inc.	11,693	468	0.040
				Merrill Lynch	13,398,937	217,846	0.016
				Morgan Stanley Dean Witter	6,883,639	149,162	0.022
				Nicolas Stifel & Company, Inc.	758,368	22,752	0.030
				Prudential Securities	4,300,946	120,794	0.028
				Raymond James & Associates	4,027,042	123,253	0.031
				Robert W. Baird & Co.	1,904,750	57,143	0.030
				Sanford Bernstein	6,261,756	170,870	0.027
				Score Securities, Inc.	105,000	4,200	0.040
				Thomas Weisel Partners, LLC	2,759,428	55,276	0.020
				UBS Securities	5,956,895	119,494	0.020
				Washington Analysis, LLC	1,655,240	66,210	0.040
				Weeden & Co.	721,062	21,631	0.030
				Total	137,297,322	3,322,989	0.024

Other Investment Service Fees	
Custodian Fees	\$ 150,000
Security Lending Agent Fees	2,610,160
Investment Consultant Fees	395,706
Total	3,155,866

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 2006.	

International Equity Commissions

Brokerage Firm	No. of Shares Traded	Commission per		
		Principal	Principal %	
Bernstein	4,538,973	\$ 58,565,165	\$ 102,289	0.175
Bloomberg Tradebook	16,000	1,424,414	320	0.022
Citigroup Global Markets, Inc.	43,000,508	473,798,661	547,814	0.116
Collins Stewart, Inc.	8,881,300	71,986,611	129,519	0.180
Credit Lyonnais Securities (USA), Inc.	4,918,195	127,419,514	225,159	0.177
Credit Suisse First Boston Corp.	72,405,731	1,035,970,648	408,360	0.039
Deutsche Bank Securities	504,260	6,871,479	8,126	0.118
Dresdnerkleinwort Benson NA, LLC	40,207,509	918,165,025	430,246	0.047
Exane, Inc.	1,760,100	100,622,431	154,652	0.154
G-Trade	2,292,500	58,392,429	58,393	0.100
G-Trade-Canada	34,000	1,031,483	1,031	0.100
Goldman Sachs	3,504,138	28,696,919	54,522	0.190
J.P. Morgan	16,374,532	105,378,529	176,044	0.167
J.P. Morgan-U.S.	770,710	11,413,446	16,310	0.143
J.P. Morgan-Canada	32,000	2,135,792	1,440	0.067
Keefe, Bruyette & Woods	6,483,766	100,402,606	188,275	0.188
Lehman Brothers	24,642,398	471,192,178	508,727	0.108
M. Ramsey King Securities, Inc.	107,840	3,398,157	4,314	0.127
Macquarie Securities	8,225,259	71,995,752	122,637	0.170
Merrill Lynch	67,371,146	927,724,865	435,464	0.047
Mitsubishi Securities - Japan	1,251,510	21,482,371	21,751	0.101
Mizuho Securities	14,007,216	184,791,358	292,062	0.158
Nomura Securities	12,918,160	79,859,985	150,992	0.189
State Street	151,162,790	2,111,087,472	550,161	0.026
UBS Securities	972,200	9,789,672	19,579	0.200
Total	486,382,741	6,983,596,962	4,608,187	0.066

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

List of Largest Assets Held (Unaudited)

August 31, 2006

Ten Largest Stock Holdings

# of Shares	Description	Fair Value
7,747,900	General Electric Company	\$ 263,893,474
3,578,144	Exxon Mobil Corporation	243,281,211
2,787,000	Procter & Gamble Company	172,515,300
6,177,400	Microsoft Corporation	159,253,372
3,162,101	Citigroup, Inc.	156,049,684
6,778,900	Cisco Systems, Inc.	149,068,011
2,877,704	Bank of America Corporation	148,115,425
2,043,000	Pepsico, Inc.	133,367,040
4,751,600	Pfizer, Inc.	132,094,480
1,407,900	Altria Group, Inc.	117,601,887

Ten Largest Fixed Income Security Holdings

Par Value	Description	Fair Value
\$ 175,000,000	Treasury Inflation Index Bond 3.87% due on 4/15/2029, Rating AAA	\$ 283,882,534
213,000,000	U.S. Treasury Bond 4.25% due on 10/15/2010, Rating AAA	212,918,572
150,000,000	U.S. Treasury Bond 7.5% due on 11/15/2016, Rating AAA	185,781,401
150,000,000	Merrill Lynch Repo 5.31% due 9/5/2006, Rating NR	150,022,125
145,000,000	U.S. Treasury Bond 4.875% due on 8/15/2009, Rating AAA	145,983,541
100,000,000	Treasury Inflation Index Bond 4.25% due on 1/15/2010, Rating AAA	128,833,092
114,000,000	U.S. Treasury Note 3.625% due on 6/30/2007, Rating AAA	114,495,321
85,000,000	U.S. Treasury Bond 7.25% due on 5/15/2016, Rating AAA	103,011,856
95,000,000	U.S. Treasury Bond 5.25% due on 2/15/2029, Rating AAA	99,282,721
75,000,000	U.S. Treasury Bond 7.125% due on 2/15/2023, Rating AAA	93,364,008

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.

Investment Summary at Fair Value (Unaudited)

August 31, 2006

Type of Investment	Pooled Funds (Note A)			Investment Pool	
	Fund 0955	Fund 0977	Fund 0993	Fair Value	% Total
	\$	\$	\$	\$	
Long-Term Fixed Securities:					
U.S. Treasury Bonds	2,007,302,392	66,317,863	17,110,665	2,090,730,920	9.28168%
Other Government Securities	767,531,187	25,357,927	6,542,596	799,431,710	3.54903%
Mortgage Pass-Thru Securities	1,942,921,343	64,190,822	16,561,868	2,023,674,033	8.98399%
Collateralized Mortgage Obligations	23,182,956	765,926	197,616	24,146,498	0.10720%
Asset Backed Securities	46,345,969	1,531,192	395,062	48,272,223	0.21430%
Commercial Mortgage Backed Securities	289,791,544	9,574,221	2,470,243	301,836,008	1.33998%
Corporate Bonds	2,746,953,079	90,754,666	23,415,602	2,861,123,347	12.70179%
Total Long-Term Fixed Securities	7,824,028,470	258,492,617	66,693,652	8,149,214,739	36.17797%
Equities:					
Domestic Equities	9,305,366,884	307,433,522	79,320,893	9,692,121,299	43.02762%
Texas Growth Fund	33,736,458	1,114,595	287,577	35,138,630	0.15600%
International Equities	4,078,855,843	134,758,471	34,769,020	4,248,383,334	18.86046%
Total Equities	13,417,959,185	443,306,588	114,377,490	13,975,643,263	62.04408%
Cash Equivalents:					
Margin Deposit	59,387,708	1,962,069	506,233	61,856,010	0.27461%
Changes in Futures Contracts	(13,305,641)	(439,596)	(113,420)	(13,858,657)	(0.06153%)
Net Margin Deposit	46,082,067	1,522,473	392,813	47,997,353	0.21308%
Cash in State Treasury-Investment Pool	244,485	8,077	2,085	254,647	0.00113%
Commercial Paper	187,480,274	6,194,030	1,598,121	195,272,425	0.86690%
Short Term Investment Fund	6,666,526	220,251	56,826	6,943,603	0.03083%
Repurchase Agreements	144,035,642	4,758,693	1,227,790	150,022,125	0.66601%
Total Cash Equivalents	384,508,994	12,703,524	3,277,635	400,490,153	1.77795%
Total Before Securities Lending Collateral (Notes B & C)	21,626,496,649	714,502,729	184,348,777	22,525,348,155	100.00000%
Securities Lending Collateral	4,849,890,471	160,388,530	41,056,053	5,051,335,054	
Total Pension Investment Pool Trust Fund (0888)	26,476,387,120	874,891,259	225,404,830	27,576,683,209	
Cash Equivalents:					
Cash in State Treasury-Pension Funds	25,135,769	573,397	398,060		
Total Investments	26,501,522,889	875,464,656	225,802,890		
Percent Ownership in Investment Pool	96.01%	3.17%	0.82%	100.00%	

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	21,626,496,649	714,502,729	184,348,777	22,525,348,155
Unsettled Sales-Investment Receivables	53,612,286	1,772,988	453,847	55,839,121
Unsettled Purchases-Investment Payables	(201,092,791)	(6,650,249)	(1,702,322)	(209,445,362)
Adjustment from Accrued Interest on TBAs	321,000	10,616	2,717	334,333
Adjusted Unsettled Purchases-Investment Payables	(200,771,791)	(6,639,633)	(1,699,605)	(209,111,029)
Coupons, Dividends & Corporate Action Proceeds in Transit	604,964	19,987	5,157	630,108
Tax Reclaim Receivables	4,162,382	137,652	35,236	4,335,270
Total Fair Value of Investments, Adjusted to Comply with the CFA Institute Standards	21,484,104,490	709,793,723	183,143,412	22,377,041,625

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**

Active Member Valuation Data

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

Solvency Test

Analysis of Financial Experience



December 6, 2006

Board of Trustees
Employees Retirement System of Texas

ACTUARIAL CERTIFICATION FOR FUNDED PROGRAMS

Buck Consultants (Buck) 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 Buck's certification of the funding status as required for the financial report for the fiscal year ended August 31, 2006 for the Employees Retirement System and the Judicial Retirement System of Texas Plan Two. Buck prepared the Actuarial Balance Sheets and the supporting schedules in the Actuarial Section. Buck 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. Buck also prepared the Retired Members by Type of Benefit schedule in the Statistical Section.

Buck 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. While we did not verify the data at their source, we did perform tests for internal consistency and reasonableness.

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 that 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 current contribution rates may not amortize the unfunded accrued liabilities.

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 accrued liability over a period that 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 accrued liability exists, it is amortized as a level percent of projected payroll.

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312.846.3000 • 312.846.3999 (fax)

The actuarial valuation is completed annually with the most recent valuation conducted as of August 31, 2006. There have not been any changes in the actuarial cost method, actuarial procedures, assumptions or plan provisions from the prior valuation.

The August 31, 2006 actuarial valuation shows that there is an unfunded accrued liability of \$1,104.5 million. The funded ratio, the ratio of the actuarial value of assets to the accrued liability, is 95.2% as of August 31, 2006. The valuation shows that the total normal cost is 11.98% of payroll. Total contributions are 12.45% of payroll. While the total contribution rate exceeds the normal cost by 0.47% of payroll, this contribution is not sufficient to ever amortize the unfunded accrued liability. Therefore, 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 13.20% of payroll. In addition, as of August 31, 2006, the market value of assets was \$232 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 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 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 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 accrued liability over a period that 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 an excess of actuarial value of assets over 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 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 accrued liability exists, it is amortized as a level percent of projected payroll.

The actuarial valuation is completed annually with the most recent valuation conducted as of August 31, 2006. There have not been any changes in the actuarial cost method, actuarial procedures, assumptions or plan provisions from the prior valuation.

The valuation shows that the normal cost is 1.55% of payroll. The funded ratio, the ratio of the actuarial value of assets to the accrued liability, is 101.7% as of August 31, 2006. As of August 31, 2006, the actuarial value of assets in excess of the accrued liability covers only a portion of the normal cost. Therefore, the amortization period is less than one year. In future years, in order to become actuarially sound, the total contribution rate will need to be at least equal to the normal cost rate plus an amount to amortize any unfunded accrued liability over no more than 31 years.

As of August 31, 2006, the market value of assets was \$10.5 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 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 accrued liability over a period that 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.

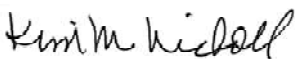
The contribution levels of the JRSII are set by legislation. Members contribute 6% of pay and the State contribution rate was 16.83% of payroll as of the August 31, 2006 valuation. The actuarial valuation was completed using the entry age actuarial cost method, which generates a normal cost expected to remain level as a percent of payroll. To the extent that an unfunded accrued liability exists, it is amortized as a level percent of projected payroll.

The actuarial valuation is completed annually with the most recent valuation conducted as of August 31, 2006. There have not been any changes in the actuarial cost method, actuarial procedures, assumptions or plan provisions from the prior valuation.

The valuation shows that the total normal cost is 20.59% of payroll and the unfunded accrued liability is \$12.4 million. The funded ratio, the ratio of the actuarial value of assets to the accrued liability, is 93.7% as of August 31, 2006. 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 11.4 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, 2006, the market value of assets was \$1.8 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.

Qualified actuaries completed the valuations in accordance with accepted actuarial procedures as prescribed by the Actuarial Standards Board. The qualified actuaries are members of the American Academy of Actuaries and are experienced in performing actuarial valuations of public employee retirement systems. To the best of our knowledge, this report is complete and accurate and has been prepared in accordance with generally accepted actuarial principles and practice.

Sincerely,



Kim M. Nicholl, F.S.A.
Principal, Consulting Actuary



S. Lynn Hill
Director, Retirement Consulting



Richard A. Mackesey, F.S.A.
Principal, Consulting Actuary

Actuarial Balance Sheet – Employees Retirement Fund (Unaudited)

August 31, 2006 (With Comparative Totals at August 31, 2005)

ACTUARIAL BALANCE SHEET

	August 31, 2006	August 31, 2005
Assets:		
Actuarial Value Assets	\$ 21,780,437,358	\$ 20,835,468,872
Present Value of Future Normal Cost		
Member	2,444,069,139	2,334,898,058
Employer	2,334,086,028	2,346,572,548
Total	<u>4,778,155,167</u>	<u>4,681,470,606</u>
Total	\$ 26,558,592,525	\$ 25,516,939,478
Liabilities:		
Present Value of Benefits		
Active Members		
- service retirement	\$ 14,286,044,025	\$ 13,524,085,713
- disability	290,019,625	263,461,077
- death before retirement	290,000,366	269,866,483
- termination	981,798,689	952,288,916
- total	<u>15,847,862,705</u>	<u>15,009,702,189</u>
Inactive Members	799,418,473	755,404,679
Annuitants	<u>11,015,791,411</u>	<u>10,886,033,918</u>
Total	\$ 27,663,072,589	\$ 26,651,140,786
Unfunded Accrued Liability (UAL)	\$ 1,104,480,064	\$ 1,134,201,308

SUMMARY OF ACTUARIAL VALUATION RESULTS

Total Contribution Rate	12.45%	12.45%
Normal Cost		
- dollars	\$ 605,149,374	\$ 594,641,604
- percent of payroll	11.98%	12.28%
Contribution Available to Amortize UAL	0.47%	0.17%
Accrued Liability	\$ 22,884,917,422	\$ 21,969,670,180
Amortization Period in Years	Infinite	Infinite
Funded Ratio	95.2%	94.8%
Valuation Payroll	\$ 5,051,330,334	\$ 4,842,525,200
Active Members	132,411	131,331

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

August 31, 2006 (With Comparative Totals at August 31, 2005)

ACTUARIAL BALANCE SHEET

	August 31, 2006	August 31, 2005
Assets:		
Actuarial Value Assets	\$ 720,306,864	\$ 698,814,428
Present Value of Future Normal Cost	161,579,702	173,311,939
Total	\$ 881,886,566	\$ 872,126,367
Liabilities:		
Present Value of Benefits		
Active Members		
- service retirement	\$ 591,382,599	\$ 587,915,367
- occupational disability	12,417,965	4,252,676
- death benefit plan	8,031,567	7,188,184
- total	611,832,131	599,356,227
Vested Inactive Members	1,264,370	433,702
Annuitants	256,919,744	251,474,897
Total	\$ 870,016,245	\$ 851,264,826
Unfunded Accrued Liability (UAL)	\$ (11,870,321)	\$ (20,861,541)

SUMMARY OF ACTUARIAL VALUATION RESULTS

Total Contribution Rate (current biennium)	0.00%	0.00%
Normal Cost		
- dollars	\$ 19,831,672	\$ 20,894,392
- percent of payroll	1.55%	1.63%
Contribution Available to Amortize UAL	-1.55%	-1.63%
Accrued Liability	\$ 708,436,543	\$ 677,952,887
Amortization Period in Years	0.6	1.0
Funded Ratio	101.7%	103.1%
Valuation Payroll	\$ 1,279,462,692	\$ 1,283,815,360
Active Members	37,103	37,150

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

August 31, 2006 (With Comparative Totals at August 31, 2005)

ACTUARIAL BALANCE SHEET

	August 31, 2006	August 31, 2005
Assets:		
Actuarial Value Assets	\$ 186,400,313	\$ 164,230,979
Present Value of Future Normal Cost		
Member	24,029,031	27,289,187
Employer	61,319,439	59,719,400
Total	85,348,470	87,008,587
Total	\$ 271,748,783	\$ 251,239,566
Liabilities:		
Present Value of Benefits		
Active Members		
- service retirement	\$ 205,071,518	\$ 195,744,708
- disability	6,329,524	6,318,431
- death before retirement	6,865,772	6,509,467
- termination	10,972,214	11,451,784
- total	229,239,028	220,024,390
Inactive Members	9,010,740	7,623,317
Annuitants	45,939,202	41,672,041
Total	\$ 284,188,970	\$ 269,319,748
Unfunded Accrued Liability (UAL)	\$ 12,440,187	\$ 18,080,182

SUMMARY OF ACTUARIAL VALUATION RESULTS

Total Contribution Rate	22.78%	22.81%
Normal Cost		
- dollars	\$ 12,828,725	\$ 12,751,871
- percent of payroll	20.59%	20.98%
Contribution Available to Amortize UAL	2.19%	1.83%
Accrued Liability	\$ 198,840,500	\$ 182,311,161
Amortization Period in Years	11.4	26.0
Funded Ratio	93.7%	90.1%
Valuation Payroll	\$ 62,305,610	\$ 60,775,307
Active Members	498	491

Summary of Actuarial Methods and Assumptions (Unaudited)

In December 2003, the Board of Trustees of the System adopted the actuarial methods and assumptions for the Employees Retirement System (ERS), the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS), and the Judicial Retirement Plan II Fund (JRS II) with assistance from the System's actuary and based on the actuarial experience study that covered the fiscal years from 1997 to 2002. The Board adopted modifications to these assumptions on December 14, 2005 to reflect 2005 legislation.

The System relies on the services of qualified actuaries to perform periodic valuations of the assets and liabilities of the pension funds. In May 2006, the System selected Buck Consultants as its new pension actuaries after a due diligence process of issuing a Request for Proposal (RFP) and the evaluation of the RFP responses.

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
Investment Rate of Return: (Same for all classes)	8% per year, compounded annually.		
Administrative Expenses: (As a percentage of payroll per year, compounded annually)	ERS Fund: 0.25% LECOS Fund: 0.10%	0.25%	0.50%
Salary Increase:	<ul style="list-style-type: none"> • Include 4% annual increase for inflation plus increases for merit, promotion and longevity. • See Table 1 below for rates of salary increase for sample ages. 	<ul style="list-style-type: none"> • 4% annually with no increase for merit, promotion, and longevity. • No salary increase for legislators. 	<ul style="list-style-type: none"> • 4% annually with no increase for merit, promotion, and longevity.
Payroll Growth: (Same for all classes)	4% per year, compounded annually.		
Cost-of-Living Increase:	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	3.45	2.70	2.60%	10.0	5.0	2.2	2.1	2.0
50	4.90	4.55	3.85	3.25	3.25	2.30	2.20	10.0	5.0	2.2	2.1	2.0
60	2.90	2.95	2.65	2.45	2.45	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	Employee Class (Non-CPO/CO) (Note D)				Employee Class (CPO/CO)			
	Occupational		Non-occupational		Occupational		Non-occupational	
	Females	Males	Females	Males	Females	Males	Females	Males
20	0.001%	0.002%	0.026%	0.036%	0.001%	0.003%	0.034%	0.044%
30	0.001	0.002	0.032	0.059	0.001	0.003	0.042	0.071
40	0.001	0.002	0.064	0.079	0.001	0.003	0.085	0.097
50	0.001	0.002	0.129	0.195	0.001	0.003	0.171	0.237
60	0.001	0.002	0.400	0.608	0.001	0.003	0.533	0.739
65	0.001	0.002	0.777	1.109	0.001	0.003	1.036	1.349

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

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

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

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

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	Employee Class (Non-CPO/CO) (Note I)			Employee Class (CPO/CO)		
	Occupational	Non-occupational		Occupational – Females & Males		Non-occupational
	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.

Summary of Actuarial Methods and Assumptions (Unaudited)

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

	Option Selection Percentage (Note J)			Beneficiary Characteristics
	Standard	Option 1	Option 4	
Male	50%	40%	10%	Member is three years older than female beneficiary.
Female	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	Years of Service – Members in the Employee Class (Non-CPO/CO)								Years of Service – Members in the Employee Class (CPO/CO)						Elected Class (Note L)		Judicial Class (Note L)	
	Female				Male				Female		Male				Age	Rate	Age	Rate
	15-19	20-24	25-29	30+	15-19	20-24	25-29	30+	10-19	20+	15-19	25-26	29-34	35+				
50	0%	0%	0%	25%	0%	0%	0%	10%	0%	30%	26%	45%	50%	60%	50-59	10%	50-69	20%
55	0	0	30	30	0	0	15	10	12	24	13	22	30	30	60-64	15	70-74	25
60	30	30	30	30	20	25	30	20	24	24	26	45	50	60	65-74	20	75+	100
65	30	30	50	50	25	30	40	40	35	35	45	40	50	50	75+	100		
70+	100	100	100	100	100	100	100	100	100	100	100	100	100	100				

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

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

	Option Selection Percentage (Note M)		Beneficiary Characteristics
	Option 1	Option 4	
Male	75%	25%	Member is three years older than female beneficiary.
Female	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.

Active Member Valuation Data (Unaudited)

Valuation Year August 31,	Number (Note A)	Actual Annual	Average Pay	% Change
		Payroll	(Note B)	in Average Pay
		\$	\$	%
Employees Retirement Fund:				
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
2006	132,411	4,866,494,021	36,886	7.4
Law Enforcement and Custodial Officer Supplemental Retirement Fund:				
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
2006	37,103	1,282,310,905	34,136	7.2
Judicial Retirement Plan Two Fund:				
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)
2006	498	59,180,787	125,112	25.4

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		
		\$	\$	\$	\$	\$	\$	\$	%	\$
Employees Retirement Fund										
2001	3,459	54,201,425	1,198	15,004,405	252	2,811,191	48,356	731,060,702	6.1	15,118
2002	4,372	77,907,778	1,233	15,046,639	243	120,431,064	51,738	914,352,905	25.1	17,673
2003	8,172	146,646,113	1,252	18,818,474	317	2,127,302	58,975	1,044,307,846	14.2	17,708
2004	4,048	65,652,607	1,515	26,105,172	337	6,186,781	61,845	1,090,042,062	4.4	17,625
2005 (Note A)	5,006	89,911,159	1,922	27,794,348	791	9,863,136	65,720	1,162,022,009	6.6	17,681
2006	3,009	46,362,777	1,464	22,247,287	331	7,937,499	67,596	1,194,074,998	2.8	17,665
Law Enforcement and Custodial Officer Supplemental Retirement Fund:										
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
2006	306	1,972,500	94	774,771	36	(269,668)	5,318	29,604,308	3.2	5,567
Judicial Retirement Plan Two Fund:										
2001	6	236,641	2	74,921	-	-	31	1,281,949	14.4	41,353
2002	3	141,951	-	-	-	-	34	1,423,900	11.1	41,879
2003	25	1,052,404	-	-	-	-	59	2,476,304	73.9	41,971
2004	12	553,529	1	22,724	2	7,200	72	3,014,309	21.7	41,865
2005 (Note A)	10	1,340,441	1	56,932	-	(1,047)	81	4,296,771	42.5	53,048
2006	10	539,286	2	139,500	-	16,616	89	4,713,173	9.7	52,957

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)		%	%	%
	\$	\$	\$	\$	%	%	%
Employees Retirement Fund:							
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
2006	3,823,418,359	11,015,791,411	8,045,707,652	21,780,437,358	100	100	86.3
Law Enforcement And Custodial Officer Supplemental Retirement Fund:							
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
2006	-	256,919,744	451,516,799	720,306,864	-	100	102.6
Judicial Retirement Plan Two Fund:							
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
2006	41,929,809	45,939,202	110,971,489	186,400,313	100	100	88.8

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 or unfavorable, such differences are called actuarial gains and 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 younger (older) ages or with final average pay that is higher (lower) than assumed, there is a loss (gain).

Disability Retirement:

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

Death-in-Service Benefit:

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

Withdrawal from Employment:

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

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

Type of Activity	Increase/(Decrease) in Unfunded Accrued Liability for Year (in Millions)					
	ERS		LECOS		JRS II	
	2006	2005	2006	2005	2006	2005
<u>Contribution Income and Interest on Unfunded Actuarial Accrued Liability</u> If contributions are received in excess of normal cost, there is a decrease. If less, an increase.	80.9	65.8	19.2	16.1	0.3	(3.5)
<u>Components of (Gain)/Loss</u>						
<u>Investment Income</u> If there is greater investment income than assumed, there is a gain. If less income, a loss.	58.1	98.6	2.6	3.3	0.5	0.9
<u>Active Member Demographics</u> Combined (gain)/loss from age and service retirements, disability retirements, death-in-service benefits, and withdrawal from employment	(90.2)	324.3	(10.1)	4.0	(0.9)	2.7
<u>Pay Increases</u> If there are smaller pay increases than assumed, there is a gain. If greater increases occur, a loss.	(12.7)	251.6	(2.5)	17.3	(5.7)	22.7
<u>Death After Retirement</u> If retirees live longer than assumed, there is a loss. If not as long, a gain.	(68.3)	(120.9)	(0.5)	(3.3)	-	(0.5)
<u>Other</u> Miscellaneous (gains)/losses resulting from data adjustments, timing of financial transactions, valuation methods, etc.	2.5	30.4	0.3	-	0.2	-
Increase/(Decrease) in Unfunded Accrued Liability During Year from Financial Experience	(29.7)	649.8	9.0	37.4	(5.6)	22.3
<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
Composite Increase/(Decrease) During Year	(29.7)	579.0	9.0	36.9	(5.6)	39.7

Statistical Section

(unaudited)



Governmental Activities:

Net Assets

Changes in Net Assets

Governmental Funds:

Fund Balances

Changes in Fund Balances

Changes in Net Assets:

Proprietary Fund

Defined Benefit Plans

Defined Contribution Plans and Cafeteria Plan

Benefit and Refund Payments—Defined Benefit Plans

Average Benefit Payments—Employee Class

Retired Members by Type of Benefit

Contribution Rates

Statistical Information:

Defined Benefit Plans

Other Programs

Net Assets – Governmental Activities (Unaudited)

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

	Fiscal Year (Note A)				
	2002	2003	2004	2005	2006
Governmental Activities:	\$	\$	\$	\$	\$
Restricted	19,333	25,939	96,160	133,253	241,478
Unrestricted	420	16	3	27	49
Total Governmental Activities	19,753	25,955	96,163	133,280	241,527

Changes in Net Assets – Governmental Activities (Unaudited)

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

	Fiscal Year (Note A)				
	2002	2003	2004	2005	2006
Expenses					
<i>Governmental Activities:</i>					
<i>Social Security Administration</i>	55	39	31	52	58
<i>Death Benefits:</i>					
Peace Officers, Firemen, etc.	7,322	4,677	4,985	2,660	4,361
Compensation to Victims of Crime				1,250	750
Retiree \$5,000 Lump Sum	6,432	6,453	6,681	7,026	6,908
<i>Group Benefits Program:</i>					
Claims Expenses	1,493,565	1,627,057	1,519,295	1,646,815	1,760,073
Administration	9,433	9,926	9,316	10,312	10,307
Total Governmental Activities Expenses	1,516,807	1,648,152	1,540,308	1,668,115	1,782,457
Program Revenues					
<i>Governmental Activities:</i>					
<i>Charges for Services:</i>					
Administration Fees				73	78
<i>Appropriations:</i>					
Administration	28	28	28	28	28
<i>Death Benefits:</i>					
Peace Officers, Firemen, etc.	7,248	4,649	4,957	2,632	4,333
Compensation to Victims of Crime				1,250	750
Retiree \$5,000 Lump Sum	6,487	6,087	6,681	7,030	6,910
<i>Insurance Contributions:</i>					
State	1,122,408	1,235,235	1,177,512	1,256,123	1,384,688
Member	366,998	393,976	404,107	420,192	450,678
Other	152	129	154	145	147
Federal Revenue-Medicare Part D					19,360
<i>Operating Grants and Contributions:</i>					
Membership Fee Revenue	55		18		
Investment Income	13,977	12,879	12,999	14,809	23,023
Other	496	1,371	4,060	2,951	709
Total Governmental Activities Program Revenues	1,517,849	1,654,354	1,610,516	1,705,233	1,890,704
Net Revenue					
Governmental Activities	1,042	6,202	70,208	37,118	108,247

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.

Source: Comprehensive Annual Financial Reports

Fund Balances – Governmental Funds (Unaudited)

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

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Governmental Funds:	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Unreserved, reported in:										
Special Revenue Funds	37	97	49	80	411	420	16	3	27	49
Total Governmental Funds	37	97	49	80	411	420	16	3	27	49

Changes in Fund Balances – Governmental Funds (Unaudited)

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

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Revenues	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Appropriations for (Note A):										
Administration	28	28	28	28	28	28	28	28	28	28
Death Benefits:										
Public Employee Survivors	845	667	734	930	1,410	7,248	4,649	4,957	2,632	4,333
Victims of Crime										750
Retiree \$5,000 Lump Sum		5,376	5,946	6,102	6,418	6,487	6,087	6,681	7,030	6,910
Administration Fees									73	78
Total Revenues	873	6,071	6,708	7,060	7,856	13,763	10,764	11,666	9,763	12,099
Expenditures										
Death Benefits:										
Public Employee Survivors	845	667	739	936	1,359	7,294	4,649	4,957	2,632	4,333
Victims of Crime									1,250	750
Retiree \$5,000 Lump Sum		5,376	5,946	6,077	6,132	6,432	6,453	6,681	7,026	6,908
Administrative Expenditures	68	68	72	71	84	83	67	59	80	86
Total Expenditures	913	6,111	6,757	7,084	7,575	13,809	11,169	11,697	10,988	12,077
Excess of Revenues Over (Under)										
Expenditures	(40)	(40)	(49)	(24)	281	(46)	(405)	(31)	(1,225)	22
Other Financing Sources (Uses)										
Membership Fees		100		54	50	55		18		
Victims of Crime Fund									1,250	
Net Change in Fund Balances	(40)	60	(49)	30	331	9	(405)	(13)	25	22

Note A: Includes lapsed appropriations.

Source: Comprehensive Annual Financial Reports

Changes in Net Assets – Proprietary Fund (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Operating Revenues	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<i>Insurance Contributions:</i>										
State	686,768	704,182	720,598	803,196	870,735	1,122,408	1,235,235	1,177,512	1,256,123	1,384,688
Member	244,863	254,203	269,847	293,970	327,981	366,998	393,976	404,107	420,192	450,678
Federal Revenues-Medicare Part D										19,360
Other	138	145	142	151	151	648	1,280	3,840	453	528
Total Operating Revenues	931,769	958,530	990,587	1,097,317	1,198,867	1,490,054	1,630,491	1,585,459	1,676,768	1,855,254
Operating Expenses										
<i>Benefit Payments:</i>										
Employee	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	1,265,966
Retiree (Note A)								402,224	439,171	478,229
COBRA (Note A)								9,883	18,596	15,878
Administrative and Other Expenses	6,396	6,888	7,880	8,733	9,782	9,433	9,926	9,316	10,312	10,307
Total Operating Expenses	943,885	999,914	1,078,593	1,177,199	1,318,021	1,502,998	1,636,983	1,528,610	1,657,127	1,770,380
Operating Income (Loss)	(12,116)	(41,384)	(88,006)	(79,882)	(119,154)	(12,944)	(6,492)	56,849	19,641	84,874
Non-Operating Revenues (Expenses)										
Net Appreciation (Depreciation)										
in Fair Value of Investments (Note B)		(916)	(1,186)	(293)	(1,284)	2,555	949	2,043	(1,750)	(4,834)
Interest Income	23,993	28,352	24,356	25,190	22,657	11,422	11,930	10,956	16,559	27,857
Other		(8)	(23)	(14)	(4)		220	374	2,644	327
Change in Net Assets	11,877	(13,956)	(64,859)	(54,999)	(97,785)	1,033	6,607	70,222	37,094	108,224

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.

Source: Comprehensive Annual Financial Reports

Changes in Net Assets – Defined Benefit Plans (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Employees Retirement Fund (ERS)										
Additions										
Member Contributions	255,191	267,977	270,260	283,841	286,982	319,565	324,000	300,156	305,870	292,023
Employer Contributions	251,310	264,776	265,031	279,192	281,906	300,969	301,555	278,845	276,035	316,198
Investment Income (Net of Expenses)	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	1,737,588
Other Additions	17,870	15,381	18,735	22,944	26,913	32,601	37,719	45,719	50,208	58,804
Total Additions	3,076,024	1,887,970	3,033,594	2,315,140	(814,469)	(619,277)	2,118,865	2,619,423	2,963,202	2,404,613
Deductions										
Retirement Benefits	511,660	552,415	599,827	681,524	827,940	908,511	1,010,238	1,190,313	1,206,562	1,251,090
Death Benefits	7,057	1,856	1,716	2,487	1,836	2,086	2,327	1,949	2,039	2,232
Refunds	89,943	99,562	104,939	96,261	91,800	70,031	73,438	83,779	89,760	75,614
Administrative and Other Expenses	11,977	13,315	12,499	12,273	12,621	13,295	13,078	12,996	13,878	14,044
Total Deductions	620,637	667,148	718,981	792,545	934,197	993,923	1,099,081	1,289,037	1,312,239	1,342,980
Change in Net Assets	2,455,387	1,220,822	2,314,613	1,522,595	(1,748,666)	(1,613,200)	1,019,784	1,330,386	1,650,963	1,061,633
Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)										
Additions										
Member Contributions						5				
Investment Income (Net of Expenses)	96,565	50,024	90,550	61,763	(49,664)	(44,338)	49,692	67,906	78,444	57,656
Other Additions	18		1	1	2		2	2		-
Total Additions	96,583	50,024	90,551	61,764	(49,662)	(44,333)	49,694	67,908	78,444	57,656
Deductions										
Retirement Benefits	14,503	15,507	16,593	18,789	16,815	20,762	22,834	27,559	29,036	30,184
Administrative and Other Expenses	469	558	576	624	625	685	700	630	521	378
Total Deductions	14,972	16,065	17,169	19,413	17,440	21,447	23,534	28,189	29,557	30,562
Change in Net Assets	81,611	33,959	73,382	42,351	(67,102)	(65,780)	26,160	39,719	48,887	27,094
Judicial Retirement System of Texas Plan One (JRS I)										
Additions										
Member Contributions	931	955	890	702	679	439	268	142	62	214
Appropriations	16,249	19,177	20,545	21,024	21,918	21,564	22,675	22,622	22,297	27,784
Other Additions	123	120	135	101	148	120	120	120	120	-
Total Additions	17,303	20,252	21,570	21,827	22,745	22,123	23,063	22,884	22,479	27,998
Deductions										
Retirement Benefits	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283	27,664
Refunds	3						3	1	14	-
Administrative and Other Expenses	120	120	135	88	152	120	120	120	120	120
Total Deductions	16,372	19,297	20,680	21,124	21,853	21,898	22,796	22,741	22,417	27,784
Change in Net Assets	931	955	890	703	892	225	267	143	62	214
Judicial Retirement System of Texas Plan Two (JRS II)										
Additions										
Member Contributions	1,858	2,144	2,369	2,496	2,638	2,780	3,020	2,922	2,985	3,551
Employer Contributions	5,125	6,008	6,815	7,130	7,258	7,804	8,294	8,205	8,365	10,052
Investment Income (Net of Expenses)	7,674	4,489	9,537	7,637	(6,916)	(7,168)	9,404	13,332	17,348	14,384
Other Additions	5	6	13	4	5		18	2	11	5
Total Additions	14,662	12,647	18,734	17,267	2,985	3,416	20,736	24,461	28,709	27,992
Deductions										
Retirement Benefits	403	488	722	898	1,211	1,365	2,119	2,770	3,308	4,223
Death Benefits			13		3				10	24
Refunds	73	22	267	94	116	187	152	303	106	65
Administrative and Other Expenses	134	144	283	249	268	299	245	273	402	303
Total Deductions	610	654	1,285	1,241	1,598	1,851	2,516	3,346	3,826	4,615
Change in Net Assets	14,052	11,993	17,449	16,026	1,387	1,565	18,220	21,115	24,883	23,377
Excess Benefit Arrangement										
Additions										
Other Additions						63	67	67	223	297
Total Additions	-	-	-	-	-	63	67	67	223	297
Deductions										
Retirement Benefits						63	67	67	223	236
Administrative and Other Expenses										61
Total Deductions	-	-	-	-	-	63	67	67	223	297
Change in Net Assets	-	-	-	-	-	-	-	-	-	-

Source: Comprehensive Annual Financial Reports

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

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	(Restated) 2005	2006
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
TexaSaver 401(k) Plan										
Additions										
Investment Income (Net of Expenses)	4	3	3	4	9	2	1	4	29	52
Other Additions	6	100	200	150	203	234	345	1,328	166	342
Total Additions	10	103	203	184	212	236	346	1,332	195	394
Deductions										
Administrative and Other Expenses	52	76	225	184	220	236	357	366	253	275
Total Deductions	52	76	225	184	220	236	357	366	253	275
Change in Net Assets	(42)	27	(22)	(30)	(8)	-	(11)	966	(58)	119
TexaSaver 457 Plan										
Additions										
Deferrals	12,386	12,039	9,280	11,806	8,505	10,649	27,132	37,047	43,817	43,832
Rollovers and Transfers	14,375	17,430	48,832	19,637		30,472	27,241	56,426	39,268	30,770
Investment Income (Net of Expenses)	33,294	25,893	43,448	16,579	(4,842)	(48,761)	18,341	33,976	25,093	23,752
Other Additions	519	332	300	329	200	430	234	186	119	684
Total Additions	60,574	55,694	101,860	48,351	3,863	(7,210)	72,948	127,635	108,297	99,038
Deductions										
Distributions and Fees	21,092	21,884	28,376	25,795	35,692	26,902	27,604	41,851	26,152	28,921
Rollovers and Transfers	14,375	17,430	45,976	21,541		26,460	42,224	67,071	41,481	31,867
Administrative and Other Expenses	399	401	546	667	1,022	832	849	995	418	403
Total Deductions	35,866	39,715	74,898	48,003	36,714	54,194	70,677	109,917	68,051	61,191
Change in Net Assets	24,708	15,979	26,962	348	(32,851)	(61,404)	2,271	17,718	40,246	37,847
State Employees Cafeteria Plan (TexFlex)										
Additions										
Contributions	17,822	18,923	19,388	22,786	27,502	30,502	33,964	43,840	53,425	61,080
Investment Income (Net of Expenses)	253	282	290	340	238	120	65	25	40	75
Other Additions	9	29	2	2	45	11	18	439	409	56
Total Additions	18,084	19,234	19,680	23,128	27,785	30,633	34,047	44,304	53,874	61,211
Deductions										
Reimbursement Account Claims	17,118	18,207	18,553	22,648	27,104	30,027	33,539	42,886	52,337	59,951
Administrative and Other Expenses	581	596	869	739	1,358	970	1,234	1,336	1,571	1,694
Total Deductions	17,699	18,803	19,422	23,387	28,462	30,997	34,773	44,222	53,908	61,645
Change in Net Assets	385	431	258	(259)	(677)	(364)	(726)	82	(34)	(434)

Source: Comprehensive Annual Financial Reports

Benefit and Refund Payments - Defined Benefit Plans (Unaudited)

Last Ten Fiscal Years (in 000's)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Employees Retirement Fund:										
<i>Type of Benefit</i>										
Retirement Benefits:										
Service:										
Retirees	491,106	530,214	576,262	656,150	797,887	876,335	978,090	1,058,681	1,095,209	1,153,347
Survivors	not avail.	not avail.	not avail.	not avail.	not avail.	not avail.	not avail.	3,532	20,286	20,379
Disability	18,739	20,001	21,198	22,599	26,786	28,375	28,005	30,815	31,419	31,690
Partial Lump Sum Option								91,731	53,030	37,679
Proportional	1,815	2,200	2,367	2,775	3,267	3,801	4,143	5,554	6,618	7,994
Total Retirement Benefits	511,660	552,415	599,827	681,524	827,940	908,511	1,010,238	1,190,313	1,206,562	1,251,089
Death Benefits:										
Active Members:										
Occupational	70	18	117	63	84	72		128	41	297
Non-Occupational	1,119	1,202	708	1,364	899	909	1,249	884	842	1,019
Retiree	5,868	636	891	1,060	853	1,105	1,078	937	1,156	916
Total Death Benefits	7,057	1,856	1,716	2,487	1,836	2,086	2,327	1,949	2,039	2,232
Refunds:										
Resignation	87,523	97,139	103,204	93,915	89,621	67,838	70,542	82,075	87,513	73,176
Death	2,420	2,423	1,735	2,346	2,179	2,193	2,896	1,704	2,247	2,438
Total Refunds	89,943	99,562	104,939	96,261	91,800	70,031	73,438	83,779	89,760	75,614

Law Enforcement and Custodial Officer Supplemental Retirement Fund:

<i>Type of Benefit</i>										
Retirement Benefits:										
Service	13,567	14,500	15,537	17,681	15,635	19,583	21,477	23,492	25,836	27,694
Disability	936	1,007	1,056	1,108	1,180	1,179	1,357	1,275	1,318	1,250
Partial Lump Sum Option								2,792	1,882	1,240
Total Retirement Benefits	14,503	15,507	16,593	18,789	16,815	20,762	22,834	27,559	29,036	30,184

Judicial Retirement System of Texas Plan One:

<i>Type of Benefit</i>										
Retirement Benefits:										
Service	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283	27,664
Total Retirement Benefits	16,249	19,177	20,545	21,036	21,701	21,778	22,673	22,620	22,283	27,664
Refunds:										
Resignation	3							1	13	
Death							3		1	
Total Refunds	3	-	-	-	-	-	3	1	14	-

Judicial Retirement System of Texas Plan Two:

<i>Type of Benefit</i>										
Retirement Benefits:										
Service	340	397	501	603	744	868	1,453	1,983	2,609	3,107
Disability	34	56	104	92	208	208	208	184	192	291
Proportional	29	35	117	203	259	289	458	603	507	825
Total Retirement Benefits	403	488	722	898	1,211	1,365	2,119	2,770	3,308	4,223
Death Benefits:										
Active Members:										
Non-Occupational			13		3				10	24
Total Death Benefits	-	-	13	-	3	-	-	-	10	24
Refunds:										
Resignation	73	22	224	5	55	195	152	235	67	4
Death			43	89	61	(8)		68	39	61
Total Refunds	73	22	267	94	116	187	152	303	106	65

Excess Benefit Arrangement:

<i>Type of Benefit</i>										
Retirement Benefits:										
Service						63	67	67	223	236
Total Retirement Benefits	-	-	-	-	-	63	67	67	223	236

Source: Comprehensive Annual Financial Reports

Average Benefit Payments - Employee Class (Unaudited)

Last Ten Fiscal Years

Retirement Effective Dates <small>(Note A)</small>	Years of Credited Service					
	5-10	10-15	15-20	20-25	25-30	30+
September 30, 1996 to August 31, 2006						
- Period 9/30/96 to 8/31/97:						
Average Monthly Benefit	\$ 383.97	\$ 592.19	\$ 933.44	\$1,205.71	\$1,799.00	\$2,330.17
Average Final Average Salary	\$2,353.23	\$2,152.91	\$2,367.61	\$2,296.79	\$2,833.27	\$3,070.69
Number of Retired Members	104	291	154	185	229	225
- Period 9/30/97 to 8/31/98:						
Average Monthly Benefit	\$ 381.55	\$ 625.21	\$ 932.02	\$1,352.47	\$2,019.26	\$2,544.62
Average Final Average Salary	\$2,311.19	\$2,259.68	\$2,310.17	\$2,458.80	\$3,026.22	\$3,355.54
Number of Retired Members	158	497	320	597	954	684
- Period 9/30/98 to 8/31/99:						
Average Monthly Benefit	\$ 395.14	\$ 659.98	\$ 992.26	\$1,365.79	\$1,987.87	\$2,517.18
Average Final Average Salary	\$2,352.18	\$2,399.32	\$2,463.82	\$2,575.73	\$3,057.47	\$3,321.98
Number of Retired Members	154	509	317	434	712	570
- Period 9/30/99 to 8/31/00:						
Average Monthly Benefit	\$ 339.66	\$ 639.61	\$ 931.49	\$1,316.33	\$1,938.09	\$2,393.72
Average Final Average Salary	\$2,247.51	\$2,551.91	\$2,479.36	\$2,776.78	\$3,244.25	\$3,434.27
Number of Retired Members	186	599	393	497	912	745
- Period 9/30/00 to 8/31/01:						
Average Monthly Benefit	\$ 389.17	\$ 622.05	\$ 931.38	\$1,337.86	\$1,930.25	\$2,467.94
Average Final Average Salary	\$2,765.28	\$2,563.68	\$2,711.96	\$2,877.50	\$3,353.31	\$3,630.21
Number of Retired Members	143	575	387	460	829	659
- Period 9/30/01 to 8/31/02:						
Average Monthly Benefit	\$ 370.90	\$ 636.25	\$ 979.93	\$1,388.79	\$2,048.93	\$2,688.98
Average Final Average Salary	\$2,591.34	\$2,633.38	\$2,834.40	\$3,029.82	\$3,544.72	\$3,945.18
Number of Retired Members	176	673	414	599	1,028	1,011
- Period 9/30/02 to 8/31/03:						
Average Monthly Benefit	\$ 375.27	\$ 687.28	\$1,029.16	\$1,442.34	\$2,055.65	\$2,748.66
Average Final Average Salary	\$2,553.10	\$2,775.28	\$2,895.11	\$3,199.26	\$3,562.14	\$3,996.49
Number of Retired Members	354	1,462	897	1,091	1,755	1,811
- Period 9/30/03 to 8/31/04:						
Average Monthly Benefit	\$ 406.21	\$ 643.08	\$1,121.03	\$1,557.74	\$2,222.07	\$2,693.12
Average Final Average Salary	\$2,805.71	\$2,800.89	\$3,093.50	\$3,325.73	\$3,794.49	\$3,983.92
Number of Retired Members	198	521	318	724	921	461
- Period 9/30/04 to 8/31/05:						
Average Monthly Benefit	\$ 385.69	\$ 715.06	\$1,216.71	\$1,627.02	\$2,330.95	\$2,902.87
Average Final Average Salary	\$2,587.18	\$2,841.04	\$3,260.82	\$3,377.34	\$3,909.51	\$4,121.47
Number of Retired Members	156	580	380	684	864	446
- Period 9/30/05 to 8/31/06:						
Average Monthly Benefit	\$ 407.98	\$ 723.17	\$1,245.98	\$1,655.42	\$2,152.30	\$3,042.20
Average Final Average Salary	\$2,685.09	\$2,836.89	\$3,305.84	\$3,505.32	\$3,659.51	\$4,301.29
Number of Retired Members	161	446	316	392	392	268
Five Year Average -						
Period 9/30/01 to 8/31/06:						
Average Monthly Benefit	\$ 386.99	\$ 680.42	\$1,093.08	\$1,517.22	\$2,140.75	\$2,764.05
Average Final Average Salary	\$2,632.83	\$2,770.79	\$3,027.03	\$3,265.69	\$3,669.88	\$4,016.44
Average Number of Retired Members	209	736	465	698	992	799
Ten Year Average -						
Period 9/30/96 to 8/31/06:						
Average Monthly Benefit	\$ 382.29	\$ 660.67	\$1,032.98	\$1,445.87	\$2,063.70	\$2,639.13
Average Final Average Salary	\$2,534.59	\$2,628.89	\$2,809.72	\$3,021.66	\$3,449.74	\$3,762.24
Average Number of Retired Members	179	615	390	566	860	688

Note A: This schedule includes service retirements of the employee class as of October 9, 2006. It does not include disability retirements or the elected state official class.

Source: The System's Member Records.

Retired Members by Type of Benefit (Unaudited)

August 31, 2006

Employees 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
\$ 0-300	4,475	4,335	140	2,684	899	288	59	404	141
301-600	9,989	9,151	838	7,267	1,481	502	91	324	324
601-900	10,179	9,239	940	7,456	1,352	632	121	264	354
901-1,200	8,471	7,993	478	6,048	1,098	712	102	188	323
1,201-1,500	7,187	6,945	242	4,842	957	752	107	144	385
1,501-2,000	9,140	8,983	157	5,683	1,213	1,232	143	189	680
2,001-2,500	7,235	7,196	39	4,267	879	1,226	74	168	621
2,501-3,000	5,090	5,079	11	2,658	674	1,004	57	124	573
3,001-4,000	4,218	4,213	5	2,232	558	781	47	79	521
4,001-10,999	1,612	1,609	3	844	252	246	19	31	220
Total	67,596	64,743	2,853	43,981	9,363	7,375	820	1,915	4,142

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	382	381	1	245	81	30	3	3	20
201-400	2,149	2,096	53	1,237	408	269	43	44	148
401-600	1,726	1,700	26	761	263	401	13	31	257
601-800	656	655	1	282	106	143	9	5	111
801-1,000	189	188	1	101	28	39	5	2	14
1,001-1,200	80	79	1	44	22	5	3	1	5
1,201-1,400	46	36	10	29	7	6	1	0	3
1,401-1,600	34	22	12	24	4	3	0	1	2
1,601-1,800	21	13	8	17	0	0	0	0	4
1,801-9,999	35	24	11	23	6	3	0	0	3
Total	5,318	5,194	124	2,763	925	899	77	87	567

Judicial Retirement Plan Two 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
\$ 0-2,000	9	9	0	5	2	1	1	0	0
2,001-2,500	3	3	0	2	0	0	0	1	0
2,501-3,000	1	1	0	0	0	0	1	0	0
3,001-3,500	0	0	0	0	0	0	0	0	0
3,501-4,000	8	8	0	4	3	0	0	1	0
4,001-4,500	19	19	0	4	14	0	0	0	1
4,501-5,000	19	19	0	6	9	3	0	1	0
5,001-5,500	16	16	0	4	7	1	0	0	4
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
Total	89	88	1	36	36	6	2	4	5

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.

Source: System's actuarial firm

Contribution Rates (Unaudited)

Last Ten Fiscal Years

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Defined Benefit Plans (Note A)	%	%	%	%	%	%	%	%	%	%
Employees Retirement Fund										
<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	6.45
<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	6.45
Judicial Retirement System Plan One Fund										
Employee	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Judicial Retirement System Plan Two Fund										
Employee	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
State	16.54	16.83	16.83	16.83	16.83	16.83	16.83	16.83	16.83	16.83

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Group Benefits Program	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<i>Employee Only:</i>										
State Contribution Monthly Rate	186.31	190.73	190.73	215.58	249.71	276.02	308.84	300.27	315.56	343.48
HealthSelect Monthly Premium	186.31	190.73	199.78	215.58	249.71	276.02	308.84	300.27	315.56	343.48
ERS Supplement (Note B)			9.05							
<i>Employee & Children:</i>										
State Contribution Monthly Rate	257.16	263.29	263.29	297.70	344.97	381.43	426.89	415.02	436.19	474.86
HealthSelect Monthly Premium	328.01	335.84	351.86	379.82	440.23	486.84	544.93	529.76	556.82	606.24
ERS Supplement (Note B)			12.53							
<i>Employee & Spouse:</i>										
State Contribution Monthly Rate	292.13	299.09	299.09	338.23	391.98	433.45	485.14	471.65	495.73	539.70
HealthSelect Monthly Premium	397.94	407.45	426.91	460.88	534.25	590.88	661.44	643.02	675.89	735.92
ERS Supplement (Note B)			14.26							
<i>Employee & Family:</i>										
State Contribution Monthly Rate	362.98	371.65	371.65	420.35	487.24	538.86	603.19	586.39	616.36	671.08
HealthSelect Monthly Premium	539.64	552.56	578.99	625.12	724.77	801.70	897.53	872.51	917.15	998.68
ERS Supplement (Note B)			17.74							
Total State Contribution (in millions)	686.8	704.2	720.6	803.2	870.7	1,122.4	1,235.2	1,177.5	1,256.1	1,384.7

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.

Source: System's records

Statistical Information – Defined Benefit Plans (Unaudited)

(All items expressed as numbers unless otherwise indicated)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employees Retirement Fund										
Active Contributing Members	159,454	155,317	154,183	152,167	149,956	150,313	142,315	133,349	132,417	132,411
Non-Contributing Members	27,589	31,346	36,502	41,276	46,089	48,903	51,868	54,658	57,089	61,567
Retirees and Beneficiaries	34,857	39,247	43,860	47,310	47,392	50,514	57,024	60,089	63,453	67,596
Service Retirements	1,624	2,654	3,244	3,688	3,229	4,050	7,581	3,906	4,609	2,929
Disability Retirements	186	142	209	196	213	156	174	181	179	80
Resignation Refunds	19,456	19,916	19,503	21,109	21,869	16,817	16,680	13,947	14,239	11,199
Death Refunds	261	240	247	261	301	335	316	237	294	317

(Note C)

Law Enforcement and Custodial Officer Supplemental Retirement Fund (Notes A & B)

Active Contributing Members	39,622	39,716	39,979	42,040	40,431	41,221	40,332	38,391	37,251	37,103
Non-Contributing Members	3,879	2,425	3,132	4,372	5,619	6,519	7,264	7,856	8,428	33
Retirees and Beneficiaries	2,185	2,356	2,526	2,774	3,093	3,523	4,166	4,576	5,072	5,318
Service Retirements	127	143	153	249	296	508	686	431	537	306
Disability Retirements	4		1	3	4	3	1	3		

Judicial Retirement System of Texas Plan One

Active Contributing Members	165	162	133	123	95	91	58	53	28	43
Non-Contributing Members	60	25	29	27	24	24	22	15	36	12
Retirees and Beneficiaries	443	436	461	465	485	493	505	494	491	486
Service Retirements	27	5	27	9	26	13	27	10	12	7
Disability Retirements		1								
Resignation Refunds	1			1				1	1	
Death Refunds							1		1	

Judicial Retirement System of Texas Plan Two

Active Contributing Members	359	362	395	412	442	464	476	484	491	498
Non-Contributing Members	52	40	50	51	77	63	80	79	90	95
Retirees and Beneficiaries	12	14	22	27	29	34	78	72	81	89
Service Retirements	5	6	1	3	3	3	24	8	9	10
Disability Retirements		2		2						
Resignation Refunds	7	2	3	1	3	7	5	8	8	2
Death Refunds									1	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.

Note C: The source of the retirement systems membership is the System's actuary. The System's actuary includes members who retired on August 31 and received their first annuity in September as retirees in the actuarial valuation.

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

Statistical Information – Other Programs (Unaudited)

(All items expressed as numbers unless otherwise indicated)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
457 Defined Contribution Plan (Note A)										
TexaSaver 457 Plan (Note B):										
Total Participants	n/a	n/a	n/a	n/a	4,531	5,793	7,525	9,937	12,425	14,960
Participants Currently Deferring	n/a	n/a	n/a	n/a	3,419	3,971	4,862	5,908	7,632	8,350
Current Market Value of Plan Assets (in millions)	n/a	n/a	n/a	n/a	\$ 56.4	\$ 69.7	\$ 103.7	\$ 159.6	\$ 219.8	\$ 265.3
Original 457 Plan (Notes B, C & D):										
Total Participants	11,000	10,500	11,000	10,838	8,374	7,422	6,015	5,104	3,693	3,169
Participants Currently Deferring	5,370	5,200	5,200	4,423	267	261	207	138	127	121
Current Market Value of Plan Assets (in millions)	\$ 285.0	\$ 301.0	\$ 328.7	\$ 329.1	\$ 244.8	\$ 183.0	\$ 133.8	\$ 95.8	\$ 55.0	\$ 49.6
TexaSaver 401(k) Defined Contribution Plan (Note A)										
Total Participants	43,830	47,600	51,100	57,306	54,177	57,155	56,848	56,504	54,349	54,710
Participants Currently Deferring	31,960	34,700	36,400	39,533	38,407	35,856	32,714	30,075	28,574	28,314
Current Market Value of Plan Assets (in millions)	\$ 343.0	\$ 402.7	\$ 545.4	\$ 675.8	\$ 602.6	\$ 604.7	\$ 703.4	\$ 779.3	\$ 886.0	\$ 990.4
Deferrals (in millions)	not avail.	not avail.	\$ 80.6	\$ 90.3	\$ 94.9	\$ 95.0	\$ 89.1	\$ 86.9	\$ 83.6	\$ 89.2
Cafeteria Plan (Note A)										
Reimbursement Accounts:										
Health Care	8,582	9,500	9,800	12,314	15,924	17,419	19,128	23,868	29,728	33,047
Dependent Care	2,646	2,500	2,400	2,425	2,480	2,336	2,297	2,416	2,522	2,665
Total Redirected (in millions)	\$ 17.1	\$ 18.2	\$ 18.7	\$ 22.5	\$ 27.1	\$ 30.1	\$ 33.6	\$ 43.1	\$ 52.4	\$ 60.0
Premium Conversion:										
Participants	146,109	142,493	146,407	209,031	208,511	208,651	209,929	199,215	206,173	209,214
Premiums Redirected (in millions)	\$ 179.6	\$ 192.5	\$ 203.4	\$ 237.8	\$ 263.8	\$ 291.0	\$ 312.1	\$ 321.4	\$ 337.8	\$ 363.3
Tax Savings (in millions):										
Employees	\$ 40.7	\$ 43.6	\$ 46.1	\$ 53.9	\$ 59.7	\$ 65.9	\$ 70.7	\$ 72.8	\$ 76.5	\$ 82.3
State of Texas	\$ 13.7	\$ 14.7	\$ 15.6	\$ 18.2	\$ 20.2	\$ 22.3	\$ 23.9	\$ 24.6	\$ 25.8	\$ 27.8
Group Benefits Program (Note A)										
Membership:										
Active	211,255	209,657	209,558	210,675	210,924	209,859	211,695	192,859	198,627	200,775
Retired	46,423	49,390	52,015	54,974	57,953	56,714	59,603	66,348	68,109	69,748
Dependents	246,000	250,000	253,000	255,000	252,000	253,000	248,749	235,834	236,691	232,846
COBRA (Note E)	2,733	2,640	2,707	2,545	2,124	2,060	1,744	1,736	1,558	2,485
	506,411	511,687	517,280	523,194	523,001	521,633	521,791	496,777	504,985	505,854
Death Benefit Programs										
Lump Sum Payments	10	7	9	13	29	36	20	19	11	16
Monthly Payments to Guardians	117	106	97	101	104	107	113	109	127	133
Victims of Violent Crime	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	5	3

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.

Note D: In fiscal year 2005, the Original 457 Plan assets were restated by the amount of the allocated insurance contracts of \$18,542,973.

Note E: Starting in fiscal year 2006, the COBRA membership includes the beneficiaries of the COBRA group plan.

Source: The System's member records supplemented with actuarial estimates.