January 10, 2011

Members of the Legislative Audit Committee:

In our audit report dated November 16, 2010, we concluded that the Employees Retirement System’s (System) basic financial statements for fiscal year 2010 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America.

We also issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards. Our procedures did not identify any material weaknesses in internal control over financial reporting or any noncompliance with laws or regulations that materially affected the financial statements. In addition, the major internal controls that we tested for the purpose of forming our opinions on the financial statements were operating effectively. However, our procedures were not intended to provide an opinion on internal control over financial reporting or to provide an opinion on compliance with laws and regulations. Accordingly, we do not express an opinion on the effectiveness of the System’s internal control over financial reporting or on compliance with laws and regulations.

Auditors also determined that the System took appropriate corrective action to implement recommendations and remedy findings from prior year audits that could have had a material effect on the financial statements.

Auditors communicated less significant issues to System management in writing. As required by professional auditing standards, we will also communicate to the System’s Board of Trustees certain matters related to the conduct of a financial statement audit.

Background Information
The Employees Retirement System (System) is authorized to provide retirement and related benefits for employees of the State of Texas, universities, colleges, and certain other entities. The System also administers health care plans for retirees, active employees, and their dependents. The System is responsible for investing funds under its stewardship and for delivering benefits to members as authorized by the Legislature. The System’s pension plans are defined benefit plans, with retirement benefits determined by a pre-established formula.

As of August 31, 2010, the System served 351,052 pension members: 182,103 active members; 87,097 annuitants; and 81,852 individuals no longer employed by the State but still owed benefits.
Pension Plan Financial Highlights

The System asserts that the pension plans’ investments earned 6.65 percent during fiscal year 2010, which was below the 8.00 percent assumed long-term rate of return used for actuarial valuation purposes. As of August 31, 2010, the combined pension plans’ net assets totaled approximately $20.5 billion. The combined pension plans made $2.3 billion in benefit payments in fiscal year 2010.

Summary of Pension and Retiree Health Care Plans Actuarial and Contribution Rate Information

Table 1 summarizes actuarial and contribution rate information regarding the Employees Retirement Fund, the Law Enforcement and Custodial Officer Supplemental Retirement Fund, the Judicial Retirement Plan Two Fund, and the State Retiree Health Plan. The information in Table 1 was obtained from the unaudited actuarial section of the Fiscal Year 2010 Employees Retirement System Annual Financial Report.

### Table 1

<table>
<thead>
<tr>
<th>Plan</th>
<th>Unfunded Actuarial Accrued Liability</th>
<th>Funded Ratio</th>
<th>Funded Ratio Percent Increase/(Decrease) From Fiscal Year 2009</th>
<th>Annual Required Contribution Rate (Actuarially Determined)</th>
<th>Annual Actual Contribution Rate (Statutorily Determined)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees Retirement Fund</td>
<td>$4.8 billion</td>
<td>83.2%</td>
<td>(4.2%)</td>
<td>17.07%</td>
<td>13.45%</td>
</tr>
<tr>
<td>Law Enforcement and Custodial Officer</td>
<td>$163.7 million</td>
<td>83.1%</td>
<td>(3.0%)</td>
<td>2.72%</td>
<td>2.09%</td>
</tr>
<tr>
<td>Supplemental Retirement Fund</td>
<td>$163.7 million</td>
<td>83.1%</td>
<td>(3.0%)</td>
<td>2.72%</td>
<td>2.09%</td>
</tr>
<tr>
<td>Judicial Retirement Plan Two Fund</td>
<td>$17.2 million</td>
<td>93.9%</td>
<td>(3.2%)</td>
<td>20.19%</td>
<td>22.81%</td>
</tr>
<tr>
<td>State Retiree Health Plan</td>
<td>$22.3 billion</td>
<td>0.0%</td>
<td>0.0%</td>
<td>Not Applicable</td>
<td>Not Applicable</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Note</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>The unfunded actuarial accrued liability represents the deficit of a plan’s actuarial assets compared with its actuarial liabilities.</td>
</tr>
<tr>
<td>b</td>
<td>The Judicial Retirement Plan Two Fund is actuarially sound based on a contribution rate of 22.81 percent.</td>
</tr>
<tr>
<td>c</td>
<td>The State Retiree Health Plan has historically been funded on a pay-as-you-go basis (contribution rates are intended to be sufficient to meet the current year’s health care costs), rather than being funded on an actuarially determined basis.</td>
</tr>
</tbody>
</table>

We appreciate the System’s cooperation during this audit. If you have any questions, please contact Lisa Collier, Assistant State Auditor, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

cc: Members of the Employees Retirement System Board of Trustees
   Ms. Cydney C. Donnell, Chair
   Mr. Owen Whitworth, CPA, CIA, Vice-Chair
   Ms. Yolanda Griego
   Mr. I. Craig Hester
   Ms. Cheryl MacBrade
   Mr. Donald Wood
   Ms. Ann Fuelberg, Executive Director, Employees Retirement System

Summary of Objective, Scope, and Methodology

The objective of the audit was to issue an opinion on the Employees Retirement System’s (System) fiscal year 2010 financial statements.

The audit scope covered the System’s basic financial statements for fiscal year 2010.

The audit methodology included performing a review of internal control over financial reporting, an analytical review of material account balances, detailed tests of sample transactions, confirmations of investment holdings and market values, and tests of compliance with laws and regulations.

The audit was conducted in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. The following staff of the State Auditor’s Office performed the audit:

- Hillary Eckford, CIA (Project Manager)
- Cesar Saldivar, CGAP, CICA (Assistant Project Manager)
- John Boyd, CIDA
- Matthew Byrnes, CIDA
- Ben Carter
- Erin J. Cromleigh
- Jonathan Knippa, CISA, CISSP, MCSE, MCITP
- Michael Yokie, CISA
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Lisa R. Collier, CPA (Assistant State Auditor)
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