
FINANCIAL SECTION



KPMG LLP
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Independent Auditors' Report

Boards of Control
Teachers' Retirement System of Alabama
Employees' Retirement System of Alabama
Judicial Retirement Fund:

We have audited the accompanying combining statement of plan net assets of the Retirement Systems of Alabama (consisting of the Teachers' Retirement System of Alabama, the Employees' Retirement System of Alabama, and the Judicial Retirement Fund), component units of the State of Alabama, as of September 30, 2007, and the related combining statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Retirement Systems of Alabama. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Retirement Systems of Alabama's 2006 financial statements and, in our report dated March 5, 2007, we expressed an unqualified opinion on such financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 Retirement Systems of Alabama'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 financial statements referred to above present fairly, in all material respects, the financial position of the Retirement Systems of Alabama (component units of the State of Alabama) as of September 30, 2007, and its changes in plan net assets for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 14 through 17 and the schedules of funding progress and employer contributions (pages 39 through 41) are not required parts of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 42 through 44 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

March 12, 2008

Management's Discussion and Analysis

The Retirement Systems of Alabama (RSA) is comprised of the Teachers' Retirement System (TRS), Employees' Retirement System (ERS), and Judicial Retirement Fund (JRF). The following discussion provides an overview of the financial position and results of operation for the RSA as of and for the period ended September 30, 2007, respectively. For more detailed information, please refer to the financial statements, including the Notes to the Financial Statements and the Required Supplementary Information.

Financial Statements and Required Supplementary Information

The financial statements (statements) include the Combining Statement of Plan Net Assets and the Combining Statement of Changes in Plan Net Assets. The Notes to the Financial Statements are considered an integral part of the financial statements. The statements are prepared using the economic resources measurement focus and accrual basis of accounting. Revenues are recognized when earned, pursuant to plan requirements, and expenses are recognized when incurred, regardless of when cash is received or expended. Investments are reported at fair value.

Combining Statement of Plan Net Assets – Includes all accounting assets and liabilities of the RSA and provides a snapshot of the financial position of the RSA as of the end of the fiscal year. Assets less liabilities results in the net assets held in trust for pension benefits at fiscal year-end.

Combining Statement of Changes in Plan Net Assets – Reports all additions and deductions of the RSA for the fiscal year. Additions primarily consist of employer contributions, employee contributions, and investment income. Deductions are principally made up of retirement allowance payments. Additions minus deductions provide the change in plan net assets for the fiscal year. The change in plan net assets plus the beginning plan net assets results in the plan net assets at fiscal year-end.

The Notes to the Financial Statements include plan descriptions, a summary of significant accounting policies, a description of legally required reserves and corresponding reserve balances at year-end, credit risk disclosures for cash and investments, concentration of investments disclosures, securities lending disclosures, funded status, and additional actuarial information relevant to the latest actuarial valuations.

The Required Supplementary Information following the Notes to the Financial Statements includes a Schedule of Funding Progress and a Schedule of Employer Contributions. The Schedule of Funding Progress provides trend data on the level of funding for the TRS, ERS, and JRF plans. The Schedule of Employer Contributions provides trend data on the annual required employer contributions and the percentage actually contributed.

Comparative Summary Statements

Summary Comparative Statement of Plan Net Assets As of September 30, 2007 and 2006 (Amounts in Thousands)

	<u>2007</u>	<u>2006</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
<i>Assets</i>				
Cash	\$ 16,428	\$ 15,804	\$ 624	3.95
Receivables	339,147	329,823	9,324	2.83
Investments	32,145,955	28,091,981	4,053,974	14.43
Invested Securities Lending Collateral	4,080,080	2,811,823	1,268,257	45.10
Property and Equipment	<u>94,842</u>	<u>24,500</u>	<u>70,342</u>	287.11
Total Assets	<u>36,676,452</u>	<u>31,273,931</u>	<u>5,402,521</u>	17.27
<i>Liabilities</i>				
Accounts Payable and Other Liabilities	5,471	6,016	(545)	(9.06)
Securities Lending Collateral	<u>4,080,080</u>	<u>2,811,823</u>	<u>1,268,257</u>	45.10
Total Liabilities	<u>4,085,551</u>	<u>2,817,839</u>	<u>1,267,712</u>	44.99
<i>Net Assets</i>	<u>\$ 32,590,901</u>	<u>\$ 28,456,092</u>	<u>\$ 4,134,809</u>	14.53

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)

**Summary Comparative Statement of Changes in Plan Net Assets
For the Fiscal Years Ended September 30, 2007 and 2006**

(Amounts in Thousands)

	<u>2007</u>	<u>2006</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
<i>Additions</i>				
Employee Contributions	\$ 486,422	\$ 464,702	\$ 21,720	4.67
Employer Contributions	827,408	684,861	142,547	20.81
Investment Income	4,943,969	2,306,814	2,637,155	114.32
Transfers Between Systems	<u>5,440</u>	<u>6,376</u>	<u>(936)</u>	<u>(14.68)</u>
Total Additions	<u>6,263,239</u>	<u>3,462,753</u>	<u>2,800,486</u>	<u>80.87</u>
<i>Deductions</i>				
Retirement Allowance Payments	2,034,825	1,777,821	257,004	14.46
Return of Contributions, Unit Withdrawals, and Death Benefits	69,486	68,508	978	1.43
Transfers Between Systems	5,440	6,376	(936)	(14.68)
Administrative Expense	17,901	19,607	(1,706)	(8.70)
Depreciation	<u>778</u>	<u>799</u>	<u>(21)</u>	<u>(2.63)</u>
Total Deductions	<u>2,128,430</u>	<u>1,873,111</u>	<u>255,319</u>	<u>13.63</u>
<i>Increase in Plan Net Assets</i>	4,134,809	1,589,642	2,545,167	160.11
Net Assets - Beginning of Year	<u>28,456,092</u>	<u>26,866,450</u>	<u>1,589,642</u>	<u>5.92</u>
<i>Net Assets - End of Year</i>	<u>\$ 32,590,901</u>	<u>\$ 28,456,092</u>	<u>\$ 4,134,809</u>	<u>14.53</u>

**Comparison of Individual Plan Net Assets
As of September 30, 2007 and 2006**

(Amounts in Thousands)

	<u>2007</u>	<u>2006</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
TRS	\$ 21,918,750	\$ 19,207,803	\$ 2,710,947	14.11
ERS	10,401,218	9,001,867	1,399,351	15.55
JRF	<u>270,933</u>	<u>246,422</u>	<u>24,511</u>	<u>9.95</u>
Totals	<u>\$ 32,590,901</u>	<u>\$ 28,456,092</u>	<u>\$ 4,134,809</u>	<u>14.53</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)

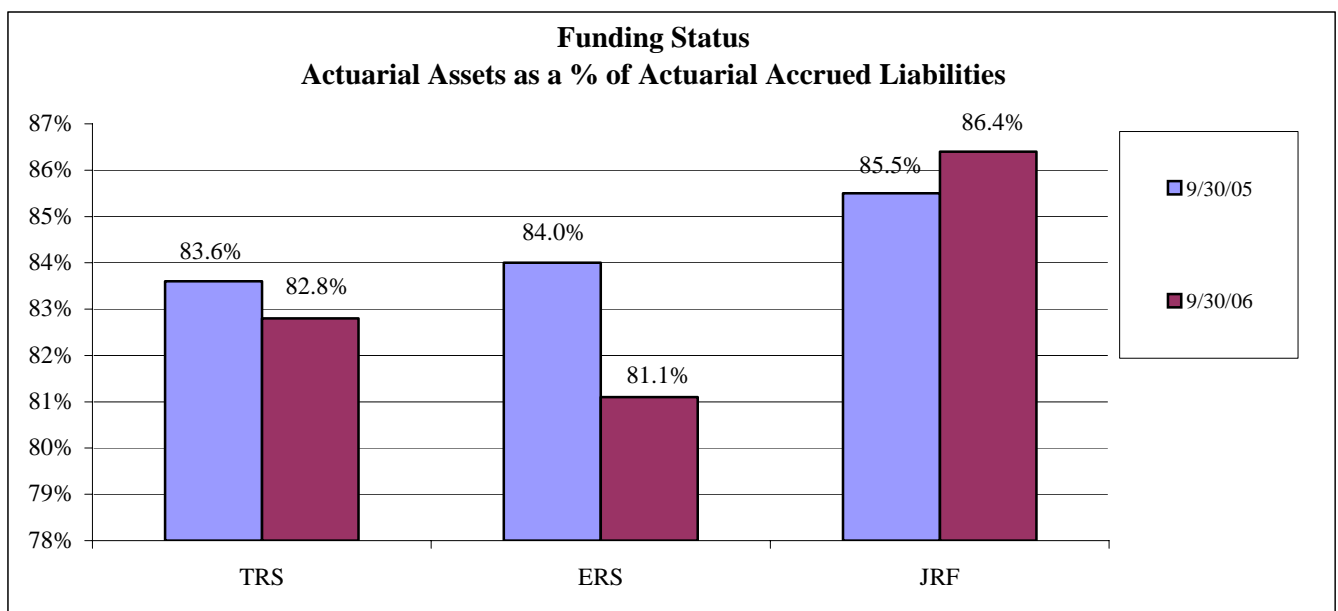
Financial Analysis

- Employer contributions increased primarily as a result of increases in employer cost rates and covered payroll.
- Assets and liabilities related to securities lending increased as a result of increased securities lending activities.
- Investments and investment income increased mainly as a result of the upturn in the equity markets. The RSA returns on equity were in line with the overall market returns. The S&P 500 increased 16.44% in 2007 compared to a return of 10.79% in 2006 and the S&P Midcap 400 increased 18.76% in 2007 compared to 6.56% in 2006.
- Property and equipment increased mainly due to the ongoing construction of a new administrative building.
- Retirement allowance payments increased primarily due to new retirees and an adhoc cost of living adjustments for retirees.

Funding Status

The primary objective of a retirement system is to accumulate sufficient assets to pay benefits to participants when due. The principal sources of assets to fund benefits include investment income and member and employer contributions. A five-year smoothing method is used in actuarially valuing assets to limit fluctuations in the contributions from year to year.

The ratio of actuarial assets to actuarial liabilities provides an excellent indication as to whether sufficient assets are being accumulated to pay benefits when due. The following bar graph provides comparisons of the funded ratio (actuarial assets to actuarial liabilities) as of the last two valuations for each System (September 30, 2006 and September 30, 2005). The funded ratio decreased in the most recent TRS and ERS valuations as a result of the continued amortization of losses in fair value of investments that occurred in fiscal years 2001 and 2002 and changes in assumptions resulting from an experience study. Assumption changes included rates of withdrawal, disability, retirement and mortality. Since a five-year smoothing method is employed to value assets, the funded ratio is likely to continue to decrease over the next few years as the recent losses are incorporated into the smoothing calculations. However, as reflected by the following graph, the TRS, ERS, and JRF continue to operate on an actuarially sound basis and accumulated funds are sufficient to continue to provide benefits as they become due.



RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)

Financial Highlights

- Total assets exceeded total liabilities at September 30, 2007, by \$32.6 billion. Net assets are held in trust to meet future benefit payments.
- The funding level (actuarial value of assets as a percent of actuarial accrued liabilities) as of the latest actuarial valuations was 82.8% for the TRS, 81.1% for the ERS, and 86.4% for the JRF.
- The fair value of investments increased by \$3.9 billion during the fiscal year.
- The investment section contains a detailed schedule of investment returns and related benchmarks.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Combining Statement of Plan Net Assets

September 30, 2007 with comparative figures for 2006

(Amounts in Thousands)

	2007			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
<i>Assets</i>				
Cash (Note 4)	\$ 8,102	\$ 7,190	\$ 1,136	\$ 16,428
Receivables				
Employee Contributions	25,508	14,600	112	40,220
Employer Contributions	47,751	26,083	316	74,150
Dividends and Interest	151,198	72,215	1,364	224,777
Total Receivables	224,457	112,898	1,792	339,147
Investments, at Fair Value (Note 5)				
Domestic Equities	10,350,683	5,002,102	152,778	15,505,563
Domestic Fixed Income	5,282,777	2,497,334	64,232	7,844,343
International	3,735,724	1,650,424	24,752	5,410,900
Real Estate	1,480,737	720,752	2,550	2,204,039
Short-term	776,563	380,667	23,880	1,181,110
Total Investments	21,626,484	10,251,279	268,192	32,145,955
Invested Securities Lending Collateral (Note 5)	2,717,017	1,317,633	45,430	4,080,080
Property and Equipment less				
Accumulated Depreciation (Note 8)	62,798	32,044	-	94,842
Total Assets	24,638,858	11,721,044	316,550	36,676,452
<i>Liabilities</i>				
Accounts Payable and Other Liabilities	3,091	2,193	187	5,471
Securities Lending Collateral (Note 5)	2,717,017	1,317,633	45,430	4,080,080
Total Liabilities	2,720,108	1,319,826	45,617	4,085,551
Net Assets Held in Trust for Pension Benefits (Note 3)	\$ 21,918,750	\$ 10,401,218	\$ 270,933	\$ 32,590,901

See accompanying *Notes to the Financial Statements* .

	2006			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Assets				
Cash	\$ 9,653	\$ 5,074	\$ 1,077	\$ 15,804
Receivables				
Employee Contributions	23,814	14,553	112	38,479
Employer Contributions	38,912	22,281	303	61,496
Dividends and Interest	<u>154,800</u>	<u>73,728</u>	<u>1,320</u>	<u>229,848</u>
Total Receivables	<u>217,526</u>	<u>110,562</u>	<u>1,735</u>	<u>329,823</u>
Investments, at Fair Value				
Domestic Equity	9,157,003	4,345,437	153,064	13,655,504
Domestic Fixed Income	4,990,746	2,314,148	68,108	7,373,002
International	2,967,620	1,307,815	-	4,275,435
Real Estate	1,206,840	583,690	2,494	1,793,024
Short-term	<u>646,143</u>	<u>328,769</u>	<u>20,104</u>	<u>995,016</u>
Total Investments	<u>18,968,352</u>	<u>8,879,859</u>	<u>243,770</u>	<u>28,091,981</u>
Invested Securities Lending Collateral	1,922,021	864,409	25,393	2,811,823
Property and Equipment less				
Accumulated Depreciation	<u>15,875</u>	<u>8,625</u>	<u>-</u>	<u>24,500</u>
Total Assets	<u>21,133,427</u>	<u>9,868,529</u>	<u>271,975</u>	<u>31,273,931</u>
Liabilities				
Accounts Payable and Other Liabilities	3,603	2,253	160	6,016
Securities Lending Collateral	<u>1,922,021</u>	<u>864,409</u>	<u>25,393</u>	<u>2,811,823</u>
Total Liabilities	<u>1,925,624</u>	<u>866,662</u>	<u>25,553</u>	<u>2,817,839</u>
Net Assets Held in Trust for Pension Benefits	<u>\$ 19,207,803</u>	<u>\$ 9,001,867</u>	<u>\$ 246,422</u>	<u>\$ 28,456,092</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Combining Statement of Changes in Plan Net Assets

For the Fiscal Year Ended September 30, 2007 with comparative figures for 2006

(Amounts in Thousands)

	2007			Totals
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	
Additions				
Contributions				
Employee	\$ 302,272	\$ 181,734	\$ 2,416	\$ 486,422
Employer	540,847	277,254	9,307	827,408
Transfers from Teachers' Retirement System	-	2,406	-	2,406
Transfers from Employees' Retirement System	2,814	-	220	3,034
Total Contributions	<u>845,933</u>	<u>461,394</u>	<u>11,943</u>	<u>1,319,270</u>
Investment Income (Note 5)				
<i>From Investing Activities</i>				
Net Increase in Fair Value of Investments	2,589,858	1,249,495	25,988	3,865,341
Interest and Dividends	719,910	347,272	8,500	1,075,682
Total Investment Income from Investing Activities	3,309,768	1,596,767	34,488	4,941,023
Less: Investment Expenses	5,105	3,725	2	8,832
Net Investment Income from Investing Activities	<u>3,304,663</u>	<u>1,593,042</u>	<u>34,486</u>	<u>4,932,191</u>
<i>From Securities Lending Activities</i>				
Securities Lending Income	136,869	58,925	1,945	197,739
Less Securities Lending Expenses:				
Borrower Rebates	126,966	54,648	1,832	183,446
Management Fees	1,770	727	18	2,515
Total Securities Lending Expenses	<u>128,736</u>	<u>55,375</u>	<u>1,850</u>	<u>185,961</u>
Net Income from Securities Lending Activities	<u>8,133</u>	<u>3,550</u>	<u>95</u>	<u>11,778</u>
Total Investment Income	<u>3,312,796</u>	<u>1,596,592</u>	<u>34,581</u>	<u>4,943,969</u>
Total Additions	<u>4,158,729</u>	<u>2,057,986</u>	<u>46,524</u>	<u>6,263,239</u>
Deductions				
Retirement Allowance Payments	1,397,808	615,661	21,356	2,034,825
Return of Contributions and Death Benefits	37,474	31,829	183	69,486
Transfers to Employees' Retirement System	2,406	-	-	2,406
Transfers to Teachers' Retirement System	-	2,814	-	2,814
Transfers to Judicial Retirement Fund	-	220	-	220
Administrative Expenses	9,614	7,813	474	17,901
Depreciation (Note 8)	480	298	-	778
Total Deductions	<u>1,447,782</u>	<u>658,635</u>	<u>22,013</u>	<u>2,128,430</u>
Net Increase	2,710,947	1,399,351	24,511	4,134,809
Net Assets Held in Trust for Pension Benefits:				
Beginning of Year	19,207,803	9,001,867	246,422	28,456,092
End of Year	<u>\$ 21,918,750</u>	<u>\$ 10,401,218</u>	<u>\$ 270,933</u>	<u>\$ 32,590,901</u>

See accompanying *Notes to the Financial Statements* .

	2006			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Additions				
Contributions				
Employee	\$ 278,220	\$ 184,144	\$ 2,338	\$ 464,702
Employer	434,195	241,750	8,916	684,861
Transfers from Teachers' Retirement System	-	2,982	26	3,008
Transfers from Employees' Retirement System	3,235	-	133	3,368
Total Contributions	<u>715,650</u>	<u>428,876</u>	<u>11,413</u>	<u>1,155,939</u>
Investment Income				
<i>From Investing Activities</i>				
Net Increase in Fair Value of Investments	878,743	375,025	11,215	1,264,983
Interest and Dividends	703,189	329,459	9,598	1,042,246
Total Investment Income from Investing Activities	<u>1,581,932</u>	<u>704,484</u>	<u>20,813</u>	<u>2,307,229</u>
Less: Investment Expenses	<u>4,947</u>	<u>3,216</u>	<u>2</u>	<u>8,165</u>
Net Investment Income from Investing Activities	<u>1,576,985</u>	<u>701,268</u>	<u>20,811</u>	<u>2,299,064</u>
<i>From Securities Lending Activities</i>				
Securities Lending Income	84,052	35,407	908	120,367
Less Securities Lending Expenses:				
Borrower Rebates	77,407	32,567	861	110,835
Management Fees	1,271	504	7	1,782
Total Securities Lending Expenses	<u>78,678</u>	<u>33,071</u>	<u>868</u>	<u>112,617</u>
Net Income from Securities Lending Activities	<u>5,374</u>	<u>2,336</u>	<u>40</u>	<u>7,750</u>
Total Investment Income	<u>1,582,359</u>	<u>703,604</u>	<u>20,851</u>	<u>2,306,814</u>
Total Additions	<u>2,298,009</u>	<u>1,132,480</u>	<u>32,264</u>	<u>3,462,753</u>
Deductions				
Retirement Allowance Payments	1,207,251	551,793	18,777	1,777,821
Return of Contributions and Death Benefits	36,683	31,780	45	68,508
Transfers to Employees' Retirement System	2,982	-	-	2,982
Transfers to Teachers' Retirement System	-	3,235	-	3,235
Transfers to Judicial Retirement Fund	26	133	-	159
Administrative Expenses	11,325	7,850	432	19,607
Depreciation	462	337	-	799
Total Deductions	<u>1,258,729</u>	<u>595,128</u>	<u>19,254</u>	<u>1,873,111</u>
Net Increase	1,039,280	537,352	13,010	1,589,642
Net Assets Held in Trust for Pension Benefits:				
Beginning of Year	<u>18,168,523</u>	<u>8,464,515</u>	<u>233,412</u>	<u>26,866,450</u>
End of Year	<u>\$ 19,207,803</u>	<u>\$ 9,001,867</u>	<u>\$ 246,422</u>	<u>\$ 28,456,092</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

1) PLAN DESCRIPTION

The Teachers' Retirement System (TRS), Employees' Retirement System (ERS), and Judicial Retirement Fund (JRF) operate under common management and are collectively referred to as the Retirement Systems of Alabama (RSA or Systems). In addition to executive management, the TRS, ERS, and JRF share investment management, accounting, and information system services, the costs of which are allocated to the funds on an equitable basis.

The TRS, a cost-sharing multiple-employer public employee retirement plan, was established as of September 15, 1939, under the provisions of Act 419 of the Legislature of 1939 for the purpose of providing retirement allowances and other specified benefits for qualified persons employed by State-supported educational institutions. The responsibility for the general administration and operation of the TRS is vested in its Board of Control.

The ERS, an agent multiple-employer public employee retirement plan, was established as of October 1, 1945, under the provisions of Act 515 of the Legislature of 1945. The purpose of the ERS is to provide retirement allowances and other specified benefits for State employees, State police, and on an

elective basis, to all cities, counties, towns, and quasi-public organizations. The responsibility for the general administration and operation of the ERS is vested in its Board of Control.

The JRF, a cost-sharing multiple-employer public employee retirement plan, was established as of September 18, 1973, under the provisions of Act Number 1163 of the Legislature of 1973 for the purpose of providing retirement allowances and other specified benefits for any Justice of the Supreme Court of Alabama, Judge of the Court of Civil Appeals, Judge of the Court of Criminal Appeals, Judge of the Circuit Court, or office holder of any newly created judicial office receiving compensation from the State Treasury. Act Number 1205 of the Legislature of 1975 supplemented the provisions of Act Number 1163 and enlarged the scope and coverage of the JRF to include District and Probate Judges. The responsibility for the general administration and operation of the JRF is vested in the Board of Control of the ERS.

At September 30, 2007, the number of participating units in each system was as follows:

	<u>TRS</u>	<u>ERS</u>
Cities	-	277
Counties	-	64
Other Public Entities	-	502
Universities	13	-
Post-Secondary Institutions	31	-
City and County Bds of Education	131	-
State Agencies & Other	<u>31</u>	<u>-</u>
Totals	<u>206</u>	<u>843</u>

At the date of the latest actuarial valuation as presented in the Notes to the Required Supplementary Information, membership consisted of:

	<u>TRS</u>	<u>ERS</u>	<u>JRF</u>
Retirees and beneficiaries currently receiving benefits:			
General	61,393	17,002	273
State Police	-	735	-
Employees of Local Employers	-	14,856	-
Deferred Retirement Option Plan (DROP)	5,375	1,905	-
Terminated employees entitled to benefits but not yet receiving benefits:			
General	16,913	3,496	51
State Police	-	9	-
Employees of Local Employers	-	6,911	-
Active employees:			
General	138,613	32,283	332
State Police	-	706	-
Employees of Local Employers	-	51,493	-
Totals	<u>222,294</u>	<u>129,396</u>	<u>656</u>

State law establishes retirement benefits as well as death and disability benefits and any ad hoc increase in postretirement benefits for the TRS, ERS, and JRF. Benefits for TRS and ERS members vest after 10 years of credited service. Teachers and state employees who retire after age 60 (52 for state police) with 10 years or more of credited service or with 25 years of service (regardless of age) are entitled to an annual retirement benefit, payable monthly for life. Local employees who retire after age 60 with 10 years or more of credited service or with 25 or 30 years of service (regardless of age), depending on the particular entity's election, are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or a formula method, with the member receiving payment under the method that yields the highest monthly benefit. Under the formula method, members of the TRS and ERS (except State Police) are allowed 2.0125% of their average final compensation (highest 3 of the last 10 years) for each year of service. State Police are allowed 2.875% for each year of state police service in computing the formula method.

The JRF benefits vest from five to eighteen years. Except for justices or judges who were either disabled, elected prior to July 30, 1979, or have at least 25 years of credited service, no justice or judge is eligible to receive judicial service retirement pay prior to attaining sixty years of age. Service retirement benefits for justices and judges are dependent upon the particular office held in the judicial branch of government. A retirement benefit is payable upon the request of any member who has: (1) 25 years of credited service (regardless of age), (2) completed 12 years of credited service and has attained age 65, (3) completed 15 years of credited service and whose age plus service equals or exceeds 77, (4) completed at least 18 years of credited service or three full terms as a judge or justice and has attained age 65, (5) completed 10 years of credited service and has attained age 70 or (6) been elected prior to July 30, 1979 and has 18 years of service (regardless of age). A member eligible to retire who has not requested his or her retirement benefit to commence at the end of the term in which the member's seventieth birthday occurs is entitled only to the refund of his or her contributions (except for members with at least 25 years of credited service).

(Dollar Amounts in Thousands)

The service retirement benefit for circuit, appellate, and probate judges is 75% of the member's salary at the time of separation from service. The service retirement benefit for a district judge is 75% of the position's salary immediately prior to retirement.

Covered members of the TRS and ERS (except state police and certified law enforcement, correctional officers and firemen) are required by statute to contribute 5% of earnable compensation to the TRS and ERS. State police members of the ERS contribute 10% of earnable compensation. JRF members and certified law enforcement, correctional officers, and firemen members of the TRS and ERS are required to contribute 6% of earnable compensation.

2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The TRS, ERS, and JRF financial statements are prepared using the accrual basis of accounting. Contributions are recognized as revenues when earned, pursuant to plan requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans. Expenses are recognized when the corresponding liability is incurred, regardless of when the payment is made. The accompanying financial statements are prepared in accordance with requirements of the Governmental Accounting Standards Board (GASB). Under these requirements, the TRS, ERS, and JRF are considered component units of the State of Alabama and are included in the State's Comprehensive Annual Financial Report.

B. Investments

The Boards of Control of the Systems have the responsibility and authority to invest and reinvest available funds, through the Secretary-Treasurer and Investment Committee, in bonds, mortgage-backed securities, common and preferred stock, and other investment vehicles with the care, skill, prudence, and diligence under the circumstances then

prevailing that a prudent person acting in a like capacity and familiar with such matters would use. All plan assets are carried at fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. Short-term investments are reported at cost, which approximates fair value. Mortgage-backed securities are reported based on future principal and interest payments discounted at the prevailing interest rate for similar instruments. The fair value of real estate investments is based on independent appraisals. Generally, private placements are valued based on the selling price of similar investments sold in the open market. In those instances where there are no similar investments sold in the open market, an appraisal is performed to determine the fair value of the private placements.

C. Comparative Combining Statements

The basic financial statements include the prior year Combining Statement of Plan Net Assets and Combining Statement of Changes in Plan Net Assets (Statements) for comparative purposes only. Prior-year Note Disclosures are not included. Therefore, the prior year basic financial statement presentation does not meet the minimum level of detail required for a presentation in conformity with generally accepted accounting principles. Accordingly, the prior year Statements should be read in conjunction with the RSA's prior year financial report from which the prior year Statements were derived.

D. Interfund Transfers

Interfund transfers result from transfers of members between retirement systems.

E. New Accounting Pronouncements

During the current fiscal year, GASB 50, *Pension Disclosures (an amendment of GASB Statements No. 25 and No. 27)* was implemented.

3) LEGALLY REQUIRED RESERVES

A. Annuity Savings

Member contributions are credited to the Annuity Savings account. Interest at 4% per annum is credited to the annuity savings account of each member on the basis of the average of the beginning and end of year balances (as of June 30 for the TRS and September 30 for the ERS and JRF).

When a member withdraws from service prior to becoming vested, the member's accumulated contributions and a portion of accumulated interest credited to the Annuity Savings account are returned to the member. The portion of accumulated interest that, by law, is not payable to the member is transferred to the Expense fund.

When a TRS or ERS member dies prior to becoming eligible for retirement, the member's accumulated contributions and accumulated interest credited to the Annuity Savings account are returned to the member's designated beneficiary. If the pre-retirement death benefit defined below is not payable, an additional death benefit equal to the member's accumulated contributions, up to five thousand dollars, is paid from the Pension Accumulation account to the member's beneficiary.

When a member retires or when a survivor allowance becomes payable, the amount of the member's accumulated contributions and accumulated interest is transferred from the Annuity Savings account to the Pension Accumulation account.

B. Pension Accumulation

The Pension Accumulation account is credited with contributions made by the employer and net investment income. The lump sum death benefit is paid from this account when a TRS or ERS member dies prior to becoming eligible for the pre-retirement death benefit or retirement. Periodic interest representing member's earnings is transferred from the Pension Accumulation account to the Annuity Savings account. When a TRS, ERS, or JRF member

retires or when a survivor allowance becomes payable, the member's accumulated contributions and accumulated interest is credited to the pension accumulation account, and all monthly benefit payments are paid from this account.

C. Pre-retirement Death Benefit

The Pre-retirement Death Benefit (PRDB) account (established October 1, 1983, under the provisions of Act 616 of the Legislature of 1983) is credited with contributions made by TRS and ERS employers and investment income on such funds. The pre-retirement death benefit (in the form of group term life insurance) is paid in addition to the return of member contributions upon the death of an active TRS or ERS member who has completed at least one year of active membership in the system and whose date of death was within 180 days of such member's last date of actual service. However, a surviving spouse beneficiary of a deceased member who was eligible for service retirement may elect a survivor allowance in lieu of this benefit. The pre-retirement death benefit is equal to the annual earnable compensation of the member as reported to the System for the preceding year ending June 30 for the TRS and September 30 for the ERS. There is no PRDB available for JRF members.

D. Term Life Insurance

The Alabama Teacher's Group Term Life Insurance Plan (established October 1, 1987) is credited with a portion of the employer contributions. All active contributing members of the TRS are covered by this plan. Contingent on availability of funds, upon death, a benefit is paid to the designated beneficiary of an insured member of the TRS. Beneficiaries of full-time employees receive fifteen thousand dollars while beneficiaries of part-time employees receive a pro-rated amount of fifteen thousand dollars.

E. Expense

The Expense fund is used to pay the administrative expenses of the RSA. A portion of the employer contributions and the interest not payable upon member withdrawal provide the funding of the

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

Expense fund. The majority of expenses are directly identifiable as expenses of the TRS, ERS, or JRF. As discussed in Note 1, certain administrative salaries and other expenses are shared on an equitable basis between the TRS and ERS.

F. Deferred Retirement Option Plan (DROP)

The DROP was established for election to participate on or after June 1, 2002, under the provisions of Act 23 of the Legislature of 2002. Eligible members may elect to retire, and, in lieu of immediate withdrawal from service, continue employment for a period of

three to five years. The retirement allowance, employee contributions, and interest earned are accumulated in an account for the benefit of the member. At the end of participation, the account balance is paid to the member. DROP participation is an option available to eligible members that have at least twenty-five years of service (exclusive of sick leave), are at least fifty-five years of age, and are eligible for retirement. See the actuarial section for additional information.

G. Reserves

The reserves of the RSA are funded to the full extent required by statute. The reserve balances as of September 30, 2007, are as follows:

	<u>TRS</u>	<u>ERS</u>	<u>JRF</u>
Annuity Savings	\$ 3,038,296	\$ 1,830,813	\$ 30,286
Pension Accumulation	18,247,298	8,329,813	239,699
Preretirement Death Benefit	18,735	18,880	-
Term Life Insurance	10,949	-	-
Deferred Retirement Option Plan	534,395	184,067	-
Expense	6,279	5,601	948

4) CASH

Cash consists of deposits held by the State Treasurer in the respective retirement system's name. Deposits are entirely insured by Federal depository insurance or protected under the Security for Alabama Funds Enhancement (SAFE) Program. The *Code of Alabama 1975* requires all State organizations to participate in the SAFE Program. The SAFE Program is a multiple financial institution collateral pool. The SAFE Program requires all public funds to be deposited in a financial institution designated by the State Treasurer as a qualified public depository. Each qualified public depository is required to pledge collateral in accordance with the rules established by the SAFE Board of Directors. In the event that a qualified public depository defaults or becomes insolvent and the pledged collateral is insufficient to satisfy the claims of public depositors, the *Code of*

Alabama 1975, Section 41-14A-9(3) authorizes the State Treasurer to make assessments against the other qualified public depositories in the pool so that there will be no loss of public funds. Virtually all cash on hand at September 30 was restricted for administrative expenses.

5) INVESTMENTS

A. Investment Risks

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, and foreign currency risk. The following describes those risks:

Interest Rate Risk – The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value

of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. However, the System's intent is to hold all fixed maturity investments until maturity, and as such, fixed maturity investments are classified in the following tables as if they were held to maturity.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The RSA's custodial credit risk policy requires the custodial agent to hold or direct its agents or subcustodians to hold, for the account of the RSA all securities and other non-cash property other than securities in the Federal Reserve book-entry system, in a clearing agency which acts as a securities depository, or in another book-entry system. The RSA's safekeeping agent holds all investments of the RSA in the RSA's name with the exception of domestic and emerging markets equity-linked notes. The RSA has domestic equity-linked notes included in domestic equities that were purchased by the counterparty and are held by the counterparty. Investment returns on the domestic equity-linked notes are indexed to the S&P 500. At September 30, investments in domestic equity-linked notes were \$584,749 and \$263,653 for the TRS and ERS, respectively. Also, the RSA has emerging market equity-linked notes included in international investments that were purchased by the counterparty and are held by the counterparty. Investment returns on the emerging market equity-linked notes are indexed to the returns of various emerging market indices. At September 30, investments in emerging market equity-linked notes were \$189,346, \$92,586, and \$3,124 in the TRS, ERS, and JRF, respectively.

Credit Quality – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. Domestic fixed-maturity

investments may consist of rated or non-rated securities. International fixed-maturity investments may consist of securities with a rating of at least A by one of the principal rating agencies at the time of purchase or acquisition, except that up to 2% of the fair value of each System's total portfolio may be invested in obligations of sovereign countries with a rating of BBB or BAA at the time of purchase. The Systems may hedge against the possible adverse effects of currency fluctuations on each System's portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A-2 and/or P-2, repurchase agreements, short-term U.S. securities, and other money market investments.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by the Systems, the issuing company must be incorporated in a country whose debt securities are eligible for purchase as discussed above, and the fair value of the aggregate outstanding equity of the issuing company must be at least \$100 million.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments. The policy limits are as follows:

- Domestic Fixed Income – Limited to 50% of the fair value of the aggregate portfolio for each System.
- International Fixed Income – Limited to 10% of the fair value of each System's total portfolio.
- Domestic Equity – Limited to 65% of the fair value of each System's aggregate portfolio.
- International Equity – The aggregate fair value of international equities is limited to 25% of the aggregate fair value of each System's total portfolio. Also, each System may not purchase or hold more than 5% of any class of the outstanding stock of a company.
- Real Estate – The suggested limit is 15% of the book value of each System's portfolio.
- Alternative Investments (mezzanine financing, LBO's, venture capital, limited partnerships,

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

futures, commodities and derivative investments)
 – Limited to 10% of the book value of each
 System's aggregate portfolio.

- Short-term Investments – Limited to 20% of the fair value of each System's aggregate portfolio.

The following tables provide information as of September 30, 2007, concerning the fair value of investments, interest rate risk, and foreign currency risk:

Type of Investment	INVESTMENTS				Total Fair Value	Cost
	TRS					
	Maturity in Years at Fair value					
Less Than 1	1-5	6-10	More Than 10			
<i>Fixed Maturity</i>						
Domestic						
Commercial Paper	\$ 655,206	\$ -	\$ -	\$ -	\$ 655,206	\$ 655,206
U.S. Government Guaranteed	16,395	157,214	282,494	-	456,103	450,486
U.S. Agency	-	364,645	352,704	31,953	749,302	748,130
Corporate Bonds	33,510	447,576	469,387	273,904	1,224,377	1,215,551
Private Placements	11,960	152,253	2,559,095	91,321	2,814,629	2,859,584
GNMAs	7	1,362	1,091	32,638	35,098	32,519
CMOs	-	-	2,857	16,805	19,662	19,667
Money Market Funds	104,963	-	-	-	104,963	104,963
Total Domestic Fixed Maturity	<u>\$ 822,041</u>	<u>\$ 1,123,050</u>	<u>\$ 3,667,628</u>	<u>\$ 446,621</u>	<u>6,059,340</u>	<u>6,086,106</u>
<i>Equities</i>						
Domestic						
					9,994,777	6,745,803
Private						
					355,906	356,211
International						
United Kingdom - Pound Sterling					800,836	516,705
Japan - Yen					728,674	561,325
France - Euro					362,304	205,369
Germany - Euro					305,277	162,029
Switzerland - Franc					234,716	127,693
Netherlands - Euro					131,452	76,973
Italy - Euro					135,501	91,949
Spain - Euro					144,127	73,898
Australia - U.S. Dollar					235,640	105,023
Singapore - U.S. Dollar					36,076	22,357
Belgium - Euro					38,806	24,933
Finland - Euro					68,682	34,655
Hong Kong - U.S. Dollar					74,313	42,540
Sweden - Krona					91,100	44,260
Denmark - Krone					32,022	15,272
Ireland - Euro					24,948	18,887
Norway - Krone					40,362	18,649
Greece - Euro					25,547	13,388
Emerging Markets					189,346	166,000
Other					35,995	25,961
Total International Equities					3,735,724	2,347,866
Total Equities					14,086,407	9,449,880
Real Estate					1,480,737	913,312
Total Investments					\$ 21,626,484	\$ 16,449,298

INVESTMENTS						
ERS						
Type of Investment	Maturity in Years at Fair Value				Total Fair Value	Cost
	Less Than 1	1-5	6-10	More Than 10		
<i>Fixed Maturity</i>						
<i>Domestic</i>						
Commercial Paper	\$ 316,421	\$ -	\$ -	\$ -	\$ 316,421	\$ 316,421
U.S. Government Guaranteed	8,828	72,002	128,320	-	209,150	206,548
U.S. Agency	-	152,934	173,388	14,991	341,313	340,298
Corporate Bonds	15,769	202,682	213,492	127,237	559,180	555,034
Private Placements	6,440	60,857	1,268,275	40,576	1,376,148	1,398,939
GNMAs	13	511	1,140	11,466	13,130	12,161
CMOs	-	-	1,183	6,058	7,241	7,289
Money Market Funds	55,418	-	-	-	55,418	55,418
Total Domestic Fixed Maturity	<u>\$ 402,889</u>	<u>\$ 488,986</u>	<u>\$ 1,785,798</u>	<u>\$ 200,328</u>	<u>2,878,001</u>	<u>2,892,108</u>
<i>Equities</i>						
<i>Domestic</i>						
Private					<u>4,647,740</u>	<u>3,153,139</u>
International					<u>354,362</u>	<u>354,811</u>
United Kingdom - Pound Sterling					351,599	225,374
Japan - Yen					319,569	246,699
France - Euro					159,272	89,848
Germany - Euro					133,962	70,741
Switzerland - Franc					102,988	55,093
Netherlands - Euro					57,714	32,885
Italy - Euro					59,252	39,954
Spain - Euro					64,785	33,059
Australia - U.S. Dollar					103,461	45,962
Singapore - U.S. Dollar					15,771	9,721
Belgium - Euro					17,009	10,911
Finland - Euro					30,162	15,396
Hong Kong - U.S. Dollar					32,500	18,584
Sweden - Krona					40,004	19,554
Denmark - Krone					14,048	6,672
Norway - Krone					17,582	8,187
Emerging Markets					92,586	81,250
Other					38,160	25,519
Total International Equities					<u>1,650,424</u>	<u>1,035,409</u>
Total Equities					<u>6,652,526</u>	<u>4,543,359</u>
Real Estate					<u>720,752</u>	<u>453,542</u>
Total Investments					<u>\$ 10,251,279</u>	<u>\$ 7,889,009</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

Type of Investment	INVESTMENTS				Total Fair Value	Cost
	JRF					
	Maturity in Years at Fair Value					
Less Than 1	1-5	6-10	More Than 10			
<i>Fixed Maturity</i>						
Domestic						
Commercial Paper	\$ 18,996	\$ -	\$ -	\$ -	\$ 18,996	\$ 18,996
U.S. Government Guaranteed	-	4,389	6,516	-	10,905	10,737
U.S. Agency	-	6,250	9,813	2,387	18,450	18,434
Corporate Bonds	1,088	6,162	12,528	6,077	25,855	26,131
Private Placements	-	2,423	6,277	-	8,700	9,361
GNMAs	-	2	42	3	47	41
CMOs	-	-	107	168	275	272
Money Market Funds	4,884	-	-	-	4,884	4,884
Total Domestic Fixed Maturity	\$ 24,968	\$ 19,226	\$ 35,283	\$ 8,635	88,112	88,856
<i>Equities</i>						
Domestic						
					152,778	78,592
International						
United Kingdom - Pound Sterling					4,869	4,233
Japan - Yen					4,495	4,287
France - Euro					2,172	1,809
Germany - Euro					1,860	1,312
Switzerland - Franc					1,422	1,253
Netherlands - Euro					798	627
Italy - Euro					824	728
Spain - Euro					896	712
Australia - U.S. Dollar					1,446	983
Singapore - U.S. Dollar					224	157
Belgium - Euro					237	227
Finland - Euro					417	253
Hong Kong - U.S. Dollar					428	301
Sweden - Krona					553	416
Denmark - Krone					201	142
Ireland - Euro					152	155
Norway - Krone					248	157
Greece - Euro					159	117
Austria - Euro					129	108
Emerging Markets					3,124	2,750
Other					98	76
Total International Equities					24,752	20,803
Total Equities					177,530	99,395
Real Estate					2,550	892
Total Investments					\$ 268,192	\$ 189,143

The following tables provide information as of September 30, 2007, concerning credit risk:

**RATINGS OF FIXED MATURITIES
TRS**

Moody's Ratings§ (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
US Govt Guaranteed Securities	\$ 491,201	\$ 483,006	8.107
Aaa	825,426	824,209	13.621
AAA (SP)	214	197	0.004
Aa1	22,529	22,209	0.372
Aa2	48,083	48,264	0.794
Aa3	117,481	115,289	1.939
P-1	100,370	100,370	1.656
P-2	655,206	655,206	10.813
A1	139,796	140,530	2.307
A2	89,478	91,096	1.477
A3	124,981	123,773	2.063
Baa1	190,191	161,284	3.139
BBB+ (SP)	26,672	21,898	0.440
Baa2	233,946	228,730	3.861
Baa3	156,632	156,268	2.585
Ba1	66,976	64,421	1.105
Ba2	51,356	50,389	0.848
Ba3	5,182	4,798	0.086
B1	13,769	13,376	0.227
B3	547	528	0.009
‡ Not Rated	2,699,304	2,780,265	44.547
Totals	<u>\$ 6,059,340</u>	<u>\$ 6,086,106</u>	<u>100.000</u>

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

‡ Primarily consists of private placements.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

**RATINGS OF FIXED MATURITIES
ERS**

Moody's Ratings§ (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
US Govt Guaranteed Securities	\$ 222,280	\$ 218,743	7.723
Aaa	374,255	373,244	13.003
Aa1	10,180	10,036	0.354
Aa2	21,890	21,971	0.761
Aa3	50,392	49,688	1.751
A1	63,619	63,961	2.211
A2	41,204	41,953	1.432
P-1	59,319	59,319	2.061
P-2	311,176	311,176	10.812
A3	61,294	59,940	2.130
Baa1	91,106	75,543	3.166
BBB+ (SP)	11,750	9,647	0.408
Baa2	100,631	98,786	3.497
Baa3	71,771	71,519	2.494
Ba1	33,605	32,281	1.168
Ba2	25,069	24,626	0.871
Ba3	2,073	1,919	0.072
B1	6,332	6,198	0.220
B2	225	217	0.008
Caa	96	94	0.003
‡ Not Rated	1,319,734	1,361,247	45.855
Totals	<u>\$ 2,878,001</u>	<u>\$ 2,892,108</u>	<u>100.000</u>

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

‡ Primarily consists of private placements.

RATINGS OF FIXED MATURITIES

JRF

Moody's Ratings[§] (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
US Govt Guaranteed Securities	\$ 10,952	\$ 10,777	12.430
Aaa	20,461	20,469	23.221
Aa1	531	524	0.603
Aa2	1,045	1,049	1.186
Aa3	2,305	2,291	2.616
A1	3,191	3,207	3.622
A2	2,131	2,162	2.419
P-1	4,884	4,884	5.543
P-2	18,996	18,996	21.558
A3	2,611	2,690	2.963
Baa1	3,702	3,731	4.201
Baa2	3,211	3,288	3.644
Baa3	3,512	3,518	3.986
Ba1	2,532	2,312	2.874
Caa	1,458	1,438	1.655
‡ Not Rated	6,590	7,520	7.479
Totals	<u>\$ 88,112</u>	<u>\$ 88,856</u>	<u>100.000</u>

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

‡ Primarily consists of private placements.

B. Concentration of Investments

As of September 30, 2007, the TRS and ERS owned debt and equity securities of Raycom Media Corporation which represented approximately 7.7% and 9.2%, respectively, of the TRS and ERS investments. As of September 30, 2007, the ERS owned debt and equity securities in Community News, which represented 5% of ERS investments.

C. Securities Lending Program

The TRS, ERS, and JRF are authorized by the Boards of Control to participate in a securities lending program. The Systems' custodian, State Street Bank and Trust Company, administers the program. Certain securities from the TRS, ERS, and JRF are loaned to borrowers approved by the Systems. Approved borrowers of securities provide acceptable

collateral in the form of cash, securities issued or guaranteed by the United States government or its agencies or instrumentalities, sovereign debt, Canadian Provincial debt, convertible bonds, irrevocable bank letters of credit by a person other than the borrower or an affiliate of the borrower if State Street determines to be appropriate, and such other collateral as the parties may agree to in writing from time to time. All security loans are open loans and can be terminated on demand by the TRS, ERS, JRF, or borrower. The initial collateral received shall have (i) in the case of loaned securities denominated in United States Dollars or whose primary trading market is located in the United States, sovereign debt issued by foreign governments (other than Canada) or corporate bonds that are not denominated in United States Dollars (other than those issued in Canada), a value of 102% of the fair value of the

(Dollar Amounts in Thousands)

loaned securities, or (ii) in the case of loaned securities which are not denominated in United States Dollars or whose primary trading market is not located in the United States (and are not referenced in (i)), a value of 105% of the fair value of the loaned securities, or (iii) in the case of loaned securities comprised of UK gilts, a value of 102.5% of the fair value of the loaned securities, or (iv) in all other cases, such value, not less than 102% of the fair value of the loaned securities, as may be applicable in the jurisdiction in which such loaned securities are customarily traded. Pursuant to the terms of the applicable securities loan agreement, State Street shall, in accordance with State Street's reasonable and customary practices, mark loaned securities and collateral to their fair value each business day based upon the fair value of the collateral and the loaned securities at the close of the business employing the most recently available pricing information and receive and deliver collateral in order to maintain the value of the collateral at no less than 100% of the fair value of the loaned securities.

The TRS, ERS, and JRF cannot pledge or sell collateral securities received unless the borrower defaults. Cash collateral is invested in the State Street Quality D Short-term Investments Fund (QDF).

The following describes the QDF's fund guidelines. The QDF's average effective duration is restricted to 120 days or less. The maximum option-adjusted duration of any variable rate security investment of the QDF shall be five years or less. All fixed rate instruments must have an option-adjusted duration not to exceed 30 months. At the time of purchase, all securities with maturities of 13 months or less must qualify as first tier securities and all securities with maturities in excess of 13 months will be rated A or

better by at least two nationally recognized statistical rating organizations (NRSROs), or, if not rated, be of comparable quality. The QDF may invest in other State Street managed investment vehicles provided they conform to QDF guidelines.

As of September 30, 2007, the average term of the loans was 4, 4, and 5 days, respectively for the TRS, ERS, and JRF. Cash collateral investments in the QDF are matured as needed to fulfill loan obligations. There is no direct matching of the maturities of the loans with the investments made with cash collateral.

At September 30, 2007, the fair value of the securities on loan was \$2,923,901, \$1,391,978, and \$46,023 for the TRS, ERS, and JRF, respectively. The fair value of the collateral pledged by the borrowers was \$3,018,637, \$1,437,141 and \$47,230 for the TRS, ERS, and JRF, respectively. Since the amounts owed by the TRS, ERS, and JRF exceeded the amounts the borrowers owed to the TRS, ERS, and JRF, there was no credit risk exposure as of September 30, 2007. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Investments purchased with cash collateral are held by the custodial agent, but not in the name of the Systems. Securities pledged as collateral are held by the custodial agent, but not in the name of the Systems. Letters of credit pledged as collateral are issued by the borrower's bank and are irrevocable. The following table provides information as of September 30, 2007, concerning securities lent:

SECURITIES LENDING - INVESTMENTS LENT AND COLLATERAL RECEIVED

(at Fair Value)

<u>Type of Investment Lent</u>	<u>TRS</u>	<u>ERS</u>	<u>JRF</u>	<u>Totals</u>
<i>For Cash Collateral</i>				
Domestic Fixed Maturities	\$ 721,676	\$ 327,661	\$ 19,201	\$ 1,068,538
Domestic Equity	1,037,732	551,520	21,753	1,611,005
International Equity	875,219	398,395	3,350	1,276,964
Total Lent for Cash Collateral	2,634,627	1,277,576	44,304	3,956,507
<i>For Non-cash Collateral</i>				
Domestic Equity	88,658	25,541	907	115,106
International Equity	200,616	88,861	812	290,289
Total Lent for Non-cash Collateral	289,274	114,402	1,719	405,395
Total Securities Lent	\$ 2,923,901	\$ 1,391,978	\$ 46,023	\$ 4,361,902
<u>Type of Collateral Received</u>				
<i>Cash Collateral - Invested in State Street Quality D Fund</i>	\$ 2,717,017	\$ 1,317,633	\$ 45,430	\$ 4,080,080
<i>Non-cash Collateral</i>				
<i>For Lent Domestic Equity Securities</i>				
International Sovereign Debt	5,143	4,067	113	9,323
Letters of Credit	35,075	14,384	637	50,096
U.S. Government & Agency Securities	50,542	7,765	192	58,499
<i>For Lent International Equity Securities</i>				
Letters of Credit	441	2,038	6	2,485
International Sovereign Debt	210,419	90,307	852	301,578
Domestic Fixed Maturities	-	947	-	947
Total Non-cash Collateral	301,620	119,508	1,800	422,928
Total Collateral Received	\$ 3,018,637	\$ 1,437,141	\$ 47,230	\$ 4,503,008

D. Mortgage-backed Securities

As of September 30, 2007, the TRS, ERS, and JRF had investments in mortgage-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obligees tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of the mortgage-backed securities.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

6) FUNDED STATUS AND FUNDING PROGRESS

State law provides that the Boards of Control engage an actuary to prepare an annual valuation of the assets and liabilities of the various reserve funds. Under the provisions of GASB Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*, the actuary determines the “unfunded actuarial liability.” The “unfunded actuarial liability” is the difference between the actuarial value of assets and the actuarial accrued liability.

The funded status of each plan as of the latest actuarial valuation is as follows:

FUNDED STATUS						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded/ (Overfunded) AAL (UAAL)	Percentage Funded (A/B)	Annual Covered Payroll (C)	UAAL as a % of Covered Payroll ((B-A)/C)
	(A)	(B)	(B-A)			((B-A)/C)
TRS						
9/30/2006	\$ 19,821,133	\$ 23,945,100	\$ 4,123,967	82.8	\$ 5,458,443	75.6
ERS						
9/30/2006	9,287,531	11,457,564	2,170,033	81.1	3,070,146	70.7
JRF						
9/30/2006	260,664	301,592	40,928	86.4	39,185	104.4

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation follows:

	ACTUARIAL ASSUMPTIONS		
	TRS	ERS	JRF
Valuation date	September 30, 2006	September 30, 2006	September 30, 2006
Actuarial cost method	Entry Age Normal	Entry Age Normal	Projected unit credit
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market
Amortization method	Level percent open	Level percent open	Level percent open
Remaining amortization period	20 years	Within 20 years - varies by employer	19 years
Actuarial assumptions:			
Investment rate of return ‡	8%	8%	8%
Projected salary increases ‡	5.00%-7.75%	4.61%-7.75%	5%
Cost of living adjustments	None	None	None

‡ Includes inflation at 4.5%.

7) CONTRIBUTIONS REQUIRED AND MADE

The actuary has computed, as of the date of the latest available actuarial valuations, the estimated present value of benefits payable to retired members, beneficiaries, and active members. The actuarial valuations for the TRS and ERS are prepared using the entry age method, while the JRF valuation utilizes the projected unit credit method. The present value of all expected benefits payable from each system to the present group of members and beneficiaries is calculated by adding the present value of the expected benefits payable to the active members to the present value of the expected future payments to retired members and beneficiaries.

As required by statute, the TRS, ERS, and JRF provide for employer contributions at actuarially determined rates (expressed as percentages of annual covered payroll) that accumulate sufficient assets to pay benefits when due. The employer contributions required to support the benefits of each system are determined following a level funding approach and consist of a normal contribution, an accrued liability contribution, and a portion to finance administrative costs. Additionally, a portion of the TRS and ERS employer contributions fund a pre-retirement death benefit. Also, a portion of the TRS employer contributions fund a term-life benefit.

For the TRS and ERS, the normal contribution is determined using the "entry age normal" method. Under this method, a calculation is made to determine the uniform and constant percentage rate of employer contributions which, if applied to the compensation of the average new member during the entire period of the member's anticipated covered service, would be required in addition to the contributions of the member to meet the cost of all benefits payable on the member's behalf.

For the JRF, the normal contribution is determined using the "projected accrued benefit" (unit-credit) method. Under this method, the benefits of each individual included in an actuarial valuation are allocated by a consistent formula to valuation years. The actuarial gains (losses), as they occur, generally

reduce (increase) the unfunded actuarial accrued liability.

The 2007 retirement contributions were made in accordance with actuarially determined contribution requirements.

8) PROPERTY AND EQUIPMENT

Plan assets used in plan operations are reported at historical cost less accumulated depreciation. Depreciation is determined on the straight-line basis using estimated useful lives of 30 years for buildings and 3 to 10 years for furniture and equipment.

Property and equipment was comprised of the following amounts as of September 30, 2007:

	<u>TRS</u>	<u>ERS</u>
Land	\$ 5,776	\$ 3,034
Building and Improvements	60,008	31,063
Furniture and Equipment	<u>2,546</u>	<u>1,450</u>
Total Property and Equipment	68,330	35,547
Less Accum Depreciation	<u>(5,532)</u>	<u>(3,503)</u>
Net Property and Equipment	<u>\$ 62,798</u>	<u>\$ 32,044</u>

9) OTHER POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 1, the TRS, ERS, and JRF (as agencies of the State of Alabama) participate in the State Employees' Health Insurance Plan (SEHIP).

The SEHIP provides postretirement health care benefits, in accordance with State statute, to all TRS, ERS, and JRF employees who retire with a retirement benefit payable from the TRS, ERS, or JRF. The SEHIP establishes the rate each retiree must pay for health insurance coverage with the difference between claims costs and retiree payments funded on a pay as you go basis through the premiums each agency pays for its active employees. During the fiscal year 2007, the estimated portion of health insurance premiums paid and included in administrative expense by the TRS, ERS, and JRF on behalf of retirees was \$303, \$330, and \$17, respectively.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

10) PENSION PLAN FOR RSA EMPLOYEES

A portion of the RSA employees participates in the TRS pension plan, which is a cost sharing plan, and a portion of the RSA employees participates in the ERS pension plan, which is an agent multiple-employer pension plan. As a component unit, RSA employees participating in the ERS pension plan are valued with all other State of Alabama employees, and therefore, report under the requirements of a cost sharing unit.

Contributions were made to each plan in accordance with actuarially determined contribution requirements. A schedule of Employer Contributions is shown below:

	<u>Fiscal Year</u> <u>Ended</u>	<u>Annual</u> <u>Required</u> <u>Contributions</u>	<u>Percentage</u> <u>Contributed</u>
TRS	2007	\$ 739	100
	2006	613	100
	2005	469	100
ERS	2007	558	100
	2006	422	100
	2005	291	100

11) RELATED PARTY TRANSACTIONS

The TRS and ERS jointly own office buildings in Montgomery and lease office space to agencies of the State of Alabama. These agencies are obligated to the TRS and ERS to lease space for varying terms through the year 2019. Rental payments (reported as investment income) from leases with state agencies totaled \$21,462 during the 2007 fiscal year.

(Dollar Amounts in Thousands)

1) CONTRIBUTIONS

Contributions were made in accordance with actuarially determined contribution requirements. The employer cost rate expressed as a percent of payroll is determined annually by reviewing a variety of factors including benefits promised, member contributions, investment earnings, mortality, and withdrawal experience.

The employer cost rates for the fiscal year 2007-2008 are 11.75% for the TRS, 10.26% for the ERS - State Employees, 30.42% for the ERS - State Police and 23.23% for the JRF. Local agency rates differ for each agency.

2) ANALYSIS OF FUNDING PROGRESS

Analysis of the dollar amounts of the actuarial value of assets, the actuarial accrued liability, and the unfunded actuarial accrued liability in isolation may be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability (assets to liabilities percentage) provides one indication of the respective retirement system's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the respective system is becoming financially stronger or weaker. Generally, the strength of a retirement system is considered to increase as the assets to liabilities percentage increases. Trends in the actuarial accrued liability and the annual covered payroll are affected by inflation. Expressing the unfunded accrued liability as a percentage of annual covered payroll (liabilities to payroll percentage) approximately adjusts for the effects of inflation and aids analysis of the respective retirement system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the strength of a retirement system is considered to increase as the liabilities to payroll percentage decreases.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Required Supplementary Information (Continued)

For the Fiscal Year Ended September 30, 2007

(Dollar Amounts in Thousands)

The following schedules provide information concerning funding progress, employer contributions, and actuarial assumptions:

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) (B)	Unfunded/ (Overfunded) AAL (UAAL) (B-A)	Percentage Funded (A/B)	Annual Covered Payroll (C)	UAAL as a % of Covered Payroll ((B-A)/C)
TRS						
9/30/2006	\$19,821,133	\$ 23,945,100	\$ 4,123,967	82.8	\$5,458,443	75.6
9/30/2005	19,248,207	23,027,338	3,779,131	83.6	5,326,408	71.0
9/30/2004	18,704,009	20,886,190	2,182,181	89.6	4,846,677	45.0
6/30/2003	18,110,470	19,357,735	1,247,265	93.6	4,632,611	26.9
6/30/2002	17,904,881	18,374,174	469,293	97.4	4,379,183	10.7
6/30/2001	17,475,298	17,238,616	(236,682)	101.4	4,305,080	(5.5)
ERS						
9/30/2006	9,287,531	11,457,564	2,170,033	81.1	3,070,146	70.7
9/30/2005	8,935,358	10,634,976	1,699,618	84.0	2,982,122	57.0
9/30/2004	8,563,945	9,546,478	982,533	89.7	2,702,393	36.4
9/30/2003	8,312,500	9,124,279	811,779	91.1	2,677,025	30.3
9/30/2002	8,100,846	8,493,469	392,623	95.4	2,547,775	15.4
9/30/2001	8,028,471	8,010,123	(18,348)	100.2	2,408,543	(0.8)
JRF						
9/30/2006	260,664	301,592	40,928	86.4	39,185	104.4
9/30/2005	256,091	299,664	43,573	85.5	40,144	108.5
9/30/2004	251,844	293,055	41,211	85.9	39,419	104.5
9/30/2003	247,011	285,123	38,112	86.6	39,742	95.9
9/30/2002	245,425	289,858	44,433	84.7	39,763	111.7
9/30/2001	245,705	289,044	43,339	85.0	38,694	112.0

SCHEDULE OF EMPLOYER CONTRIBUTIONS

<u>Fiscal Year</u> <u>Ended</u>	<u>Annual Required</u> <u>Contribution</u>	<u>Percentage</u> <u>Contributed</u>
TRS		
9/30/2007	\$ 540,847	100
9/30/2006	434,195	100
9/30/2005	347,862	100
9/30/2004	312,474	100
9/30/2003	235,786	100
9/30/2002	265,670	100
ERS		
9/30/2007	277,254	100
9/30/2006	241,750	100
9/30/2005	195,846	100
9/30/2004	170,713	100
9/30/2003	154,218	100
9/30/2002	123,887	100
JRF		
9/30/2007	9,307	100
9/30/2006	8,916	100
9/30/2005	8,943	100
9/30/2004	8,994	100
9/30/2003	8,637	100
9/30/2002	8,222	100

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Administrative Expenses

For the Fiscal Year Ended September 30, 2007

(Amounts in Thousands)

	<u>Teachers' Retirement System</u>	<u>Employees' Retirement System</u>	<u>Judicial Retirement Fund</u>	<u>Totals</u>
Personal Services:				
Salaries	\$ 4,941	\$ 4,656	\$ 371	\$ 9,968
Employee Fringe Benefits	1,350	1,365	62	2,777
Total Personal Services	<u>6,291</u>	<u>6,021</u>	<u>433</u>	<u>12,745</u>
Professional Services:				
Actuarial	123	218	22	363
Accounting and Auditing	57	47	16	120
Information Technology	58	47	-	105
Education & Training	13	15	-	28
Information & Research	4	2	-	6
Mailing Services	192	122	-	314
Legal Services	1	4	-	5
Personnel Services	41	-	-	41
Other Professional Services and Fees	61	4	-	65
Total Professional Services	<u>550</u>	<u>459</u>	<u>38</u>	<u>1,047</u>
Communications and Travel:				
Telecommunications	22	68	-	90
Internet Access	90	12	-	102
Postage	1,062	610	-	1,672
Travel	88	83	-	171
Total Communications and Travel	<u>1,262</u>	<u>773</u>	<u>-</u>	<u>2,035</u>
Rentals:				
Office Space	495	212	-	707
Equipment Leasing	16	177	-	193
Total Rentals	<u>511</u>	<u>389</u>	<u>-</u>	<u>900</u>
Miscellaneous:				
Supplies	929	125	3	1,057
Maintenance	71	46	-	117
Total Miscellaneous	<u>1,000</u>	<u>171</u>	<u>3</u>	<u>1,174</u>
Total Administrative Expenses	<u>\$ 9,614</u>	<u>\$ 7,813</u>	<u>\$ 474</u>	<u>\$ 17,901</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Investment Expenses

For the Fiscal Year Ended September 30, 2007

(Amounts in Thousands)

	<u>Teachers' Retirement System</u>	<u>Employees' Retirement System</u>	<u>Judicial Retirement Fund</u>	<u>Totals</u>
<i>Investment Activity</i>				
Investment Management Fees:				
Salaries and Benefits	\$ 4,304	\$ 3,165	\$ -	\$ 7,469
Dues and Subscriptions	357	356	-	713
Travel	24	2	-	26
Professional Services:				
Investment Advisor	60	15	-	75
Investment Custodian	128	79	2	209
Real Estate Appraisal	232	108	-	340
Total Investment Activity Expenses	<u>5,105</u>	<u>3,725</u>	<u>2</u>	<u>8,832</u>
<i>Securities Lending Activity</i>				
Securities Lending Borrower Rebates	126,966	54,648	1,832	183,446
Securities Lending Management Fees	1,770	727	18	2,515
Total Securities Lending Activity Expenses	128,736	55,375	1,850	185,961
Total Investment Expenses	<u>\$ 133,841</u>	<u>\$ 59,100</u>	<u>\$ 1,852</u>	<u>\$ 194,793</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Professional/Consultant Fees
For the Fiscal Year Ended September 30, 2007

(Amounts in Thousands)

<u>Professional/Consultant</u>	<u>Nature of Service</u>	<u>Teachers' Retirement System</u>	<u>Employees' Retirement System</u>	<u>Judicial Retirement Fund</u>	<u>Totals</u>
Cavanaugh MacDonald	Actuary	\$ 123	\$ 218	\$ 22	\$ 363
KPMG	Auditor	57	47	16	120
Covenant Technology Solutions	Information Technology	32	32	-	64
Action in Mailing Inc.	Mail	84	84	-	168
VR Election Services	Mail	97	27	-	124
State Personnel Department	Personnel	41	-	-	41
Fine & Geddie	Consultant	75	-	-	75
Alabama Dept of Finance	Information Technology	19	13	-	32
Various	Other	22	38	-	60
Total Professional/Consultant Fees-Admin Services		550	459	38	1,047
Regions Bank	Investment Advisor	60	15	-	75
State Street Bank & Trust Co.	Investment Custodial	128	79	2	209
Houlihan, Lokey, Zukin Fin. Advisors	Real Estate Appraisor	232	108	-	340
Total Professional/Consultant Fees-Investment Services		420	202	2	624
Total Professional/Consultant Fees		\$ 970	\$ 661	\$ 40	\$ 1,671