State of Texas
Index for Notes to Financial Statements

Note 1

Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The accompanying basic financial statements of the state of Texas have been prepared in conformity with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The state implemented the following GASB Statement and GASB Technical Bulletin in fiscal 2007.

Administrators of the Employees Retirement System and Teacher Retirement System plans for Other Post-Employment Benefits (OPEB) implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The employer reporting requirements for OPEB are detailed in GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB 45 is effective for the state beginning in fiscal 2008. OPEB includes post employment healthcare and other benefits such as life insurance when provided separately from a pension plan.

GASB Technical Bulletin 2006-1, *Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*, was implemented in two parts. The portion implemented in 2006 established guidelines to record Medicare Part D reimbursements received from the federal government in relation to prescription drug benefits. The portion of the bulletin implemented in 2007, simultaneously with GASB 43, pertains specifically to Medicare Part D measurement, recognition and the required supplementary information requirements as they pertain to OPEB.

Financial reporting for the state is based on all GASB pronouncements, as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions and Accounting Research Bulletins issued on or before Nov. 30, 1989, that do not conflict with or contradict GASB pronouncements. FASB pronouncements issued after Nov. 30, 1989, are not followed in the preparation of the accompanying financial statements.

FINANCIAL REPORTING ENTITY

For financial reporting purposes, the state of Texas has included all funds, agencies, boards, commissions, authorities, colleges and universities and other organizations that comprise its legal entity. The reporting entity also includes legally separate organizations for which the state is financially accountable and any other organizations that would cause the financial statements to be misleading or incomplete if they were excluded. All activities considered part of the state are included. These activities provide a range of services in the areas of education, health and human services, public safety and corrections, transportation, natural resources and recreation, regulation, general government, employee benefits and teacher retirement benefits.

The reporting entity for the state is in accordance with the criteria established by GASB. A listing and brief summary of the component units and their relationship to the state of Texas is discussed in Note 19. These financial statements present the state of Texas (the primary government) and its component units.

The state's public school districts and junior and community colleges are excluded from the reporting entity. The state is not financially accountable for these entities. They are legally separate entities that are fiscally independent of the state. This independence warrants their exclusion from the financial statements.

FINANCIAL REPORTING STRUCTURE

The basic financial statements include both government-wide financial statements and fund financial statements. The reporting model based on GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, focuses on the state as a whole in the government-wide financial statements and major individual funds in the fund financial statements.

Government-wide Financial Statements

The government-wide financial statements (statement of net assets and statement of activities) display information about the state as a whole and the change in aggregate financial position resulting from the activities of the fiscal period, except for its fiduciary activities. These statements include separate columns for the governmental and business-type activities of the state (including its blended component units) as well as its discretely presented component units. In the statement of net assets, both the governmental and business-type activities columns are presented on a consolidated basis by column and are reflected on a full accrual, economic resource basis, which incorporates noncurrent investments, capital assets as well as long-term debt and obligations.

The statement of activities reflects both the gross and net cost per functional category (public safety, transportation, etc.), which is otherwise supported by general government revenues (sales, use, franchise taxes, etc.). In the statement of activities, program revenues are netted against program expenses, which include depreciation, to present the net cost of each program. Program revenues must be directly associated with the function or with a business-type activity. Internally dedicated resources are reported as general revenues rather than program revenues. Certain general government administrative overhead expenses have been charged to the various functions of the state. These charges are paid from applicable funding sources and are reflected as direct expenses. The amount of direct interest expense included in direct expenses in the statement of activities is $45.4 million.

Program revenues include (a) charges for services, (b) operating grants and contributions and (c) capital grants and contributions. Charges for services include special assessments and payments made by parties outside of the state's citizenry if that money is restricted to a particular program. Operating grants include operating-specific and discretionary (either operating or capital) grants while the capital grants column reflects capital-specific grants.

The state's fiduciary funds are presented in the fund financial statements by type (pension, investment trust, private-purpose and agency). The assets of the fiduciary funds are held for the benefit of others and cannot be used to address activities or obligations of the government. They are not, therefore, incorporated into the government-wide financial statements.

Fund Financial Statements

The fund financial statements are presented after the government-wide financial statements. They display information about major funds individually and in the aggregate for governmental and proprietary funds. In governmental and fiduciary funds, assets and liabilities are presented in order of relative liquidity. In proprietary funds, assets and liabilities are presented in a classified format which distinguishes between all current and noncurrent assets and liabilities. Current assets in the classified format are those considered available for appropriation and expenditure. Examples of expendable financial resources include cash, various receivables and short-term investments. All other assets are considered noncurrent. Current liabilities are obligations to be paid within the next fiscal year. Examples include payables and the current portion of long-term liabilities.

The major governmental funds in the fund financial statements are presented on a current financial resource and modified accrual basis of accounting. This presentation is deemed most appropriate to demonstrate (a) compliance with legal and covenant requirements, (b) the source and use of financial resources and (c) how the state's actual experience conforms to the budget. Since the governmental fund financial statements are presented using a different measurement focus and basis of accounting than the government-wide financial statements, governmental activities column, a reconciliation is presented. This explains the adjustments required to restate the fund-based financial statements for the government-wide financial statements' governmental activities column.

The state uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. State transactions are recorded in the fund types described below.

Governmental Fund Types

Governmental funds focus on the sources and uses of funds. Included in the governmental fund financial statements are general, special revenue, debt service, capital projects and permanent funds. The general fund is the principal operating fund used to account for most of the state's general activities. It accounts for all financial resources except those accounted for in other funds. Special revenue funds account for specific revenue proceeds which are legally restricted for specific purposes. Debt service funds account for the accumulation of resources for and the payment of general long-term debt principal and interest. Capital projects funds account for financial resources used for the acquisition, repair, renovation or construction of major capital facilities other than those financed by proprietary or similar trust funds. Permanent funds are used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the state's programs.

The state's major governmental funds are listed below.

The **General Fund** includes transactions for general government, education, employee benefits, teacher retirement benefits, health and human services, public safety and corrections, transportation, natural resources and recreation and regulatory services.

The **State Highway Fund** receives funds allocated by law for public road construction, maintenance, monitoring and law enforcement of the state's highway system.

The **Permanent School Fund** is an investment fund consisting of land and proceeds from the sale of land that establishes a perpetual provision for the support of the public schools of Texas. All dividends and other income are allocated to the credit of the available school fund.

Proprietary Fund Types

Proprietary funds focus on determining operating income, changes in net assets, financial position and cash flows. Generally accepted accounting principles similar to those used by private sector businesses are applied in accounting for these funds. Included in proprietary fund financial statements are enterprise funds and an internal service fund.

Enterprise funds are used to report any activity for which a fee is charged to external users for goods or services. Activities must be reported as enterprise funds if any one of the following criteria is met.

1. The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity;
2. Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges; or
3. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs.

Internal service funds account for the financing of goods or services provided by one agency to other agencies on a cost reimbursement basis. The **Employees Life, Accident and Health Insurance Benefits Fund**, presented on the proprietary fund financial statements, is used to account for the services provided by the Group Insurance Program to other agencies of the reporting entity.

The state's major enterprise funds are listed below.

The **Colleges and Universities** include University of Texas System, Texas A&M University System, Texas Tech University System, University of Houston System, Texas State University System, University of North Texas System, Texas Woman's University, Stephen F. Austin State University, Texas Southern University, Midwestern State University and Texas State Technical College. They are represented as a single column in the proprietary fund financial statements and individually in the schedules of colleges and universities in the other supplementary information section of this report.

The **Texas Water Development Board** funds include water development funds, agricultural water conservation funds and water pollution control revolving funds which issue bonds to provide assistance to political subdivisions.

The **Texas Department of Transportation Turnpike Authority** receives proceeds from the sale of bonds that are used to finance a portion of the costs of planning, designing, engineering, developing and constructing the initial phase (referred to as the "FY2002 Project") of the Central Texas Turnpike System.

Fiduciary Fund Types

Fiduciary funds account for assets held by the state in either a trustee capacity or as an agent for individuals, private organizations, other governmental units and/or other funds. When assets are held under the terms of a formal trust agreement, either a pension trust fund or a private-purpose trust fund is used.

Pension and other employee benefit trust funds report resources held in trust for the members and beneficiaries of defined benefit pension plans. Additional information about pension trust funds can be found in Note 9.

Investment trust funds report the external portions of investment pools reported by the sponsoring government.

Private-purpose trust funds report all other trust arrangements whose principal and interest benefit individuals, private organizations or other governments.

Agency funds report assets the state holds on behalf of others in a purely custodial capacity. Agency funds involve only the receipt and remittance of fiduciary resources to individuals, private organizations or other governments.

Component Units

All of the component units for the state of Texas are reported as nonmajor component units. The combining statement of net assets - component units and the combining statement of activities - component units are presented for all of the discrete component units.

Additional information about blended and discretely presented component units can be found in Note 19. More detailed information of the individual component units is available from the component units' separately issued financial statements.

BASIS OF ACCOUNTING, MEASUREMENT FOCUS AND FINANCIAL STATEMENT PRESENTATION

Government-wide financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Under the economic resources measurement focus, all economic resources and obligations of the reporting government, both current and noncurrent, are reported in the government-wide financial statements. Under the accrual basis of accounting, revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Revenues, expenses, gains, losses, assets and liabilities resulting from non-exchange transactions are recognized in accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Governmental funds use the flow of current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and current liabilities are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

All governmental funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year end. The state of Texas considers all major revenue reported in the governmental funds to be available if the revenues are due at year end and collected within 60 days thereafter.

Tax, grant, interest, tuition and sales of goods and services that are associated with the current fiscal period are considered to be susceptible to accrual and therefore, have been recognized as revenues of the current fiscal period. Grants are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All other revenue items are considered to be measurable and available only when cash is received by the state.

Expenditures and other uses of financial resources are recognized when the related liability is incurred. Although agency funds use the accrual basis of accounting, they do not have a measurement focus because they do not recognize revenues and expenditures.

Amounts paid to acquire capital assets are capitalized as assets in the government-wide financial statements rather than reported as expenditures. Proceeds of long-term debt are recorded as liabilities in the government-wide financial statements rather than as other financing sources. Amounts paid to reduce long-term indebtedness of the state are reported as reductions of the related liabilities rather than as expenditures. Proprietary fund types, pension trust funds, investment trust funds and private-purpose trust funds are reported on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred.

Proprietary funds distinguish operating from nonoperating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the proprietary funds principal ongoing operations. Operating expenses for enterprise and internal service funds include the cost of sales and services, administrative expenses and depreciation on capital assets. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Budgetary Information

The budgetary comparison schedule and the notes to the budgetary comparison schedule are in the required supplementary information other than Management Discussion and Analysis section. The budgetary comparison schedule presents the original budget, the final budget and the actual activity of the major governmental funds. Reconciliations for the general fund and the state highway fund budgetary basis to the GAAP basis are presented as required supplementary information with explanations of the reconciling items. Budgetary information for nonmajor governmental funds is presented as other supplementary information.

Cash and Cash Equivalents

For reporting purposes, this account includes cash on hand, cash in transit, cash in local banks, cash in the Federal and State Treasuries and cash equivalents. Cash in local banks is primarily held by special revenue funds, employee benefit trust funds, enterprise funds and component units. Cash balances of most state funds are pooled and invested by the Treasury Operations Division of the Comptroller's office. Interest earned is deposited in the general revenue fund and specified funds designated by law.

The statement of cash flows for proprietary funds shows the change in cash and cash equivalents during the fiscal year. Cash equivalents are defined as short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash and (b) so near maturity they present insignificant risk of changes in value due to changes in interest rates. Investments with an original maturity of three months or less and that are used for cash management rather than investing activities are considered cash equivalents. Restricted securities held as collateral for securities lending are not included as cash equivalents on the statement of cash flows.

Investments

Investments are reported at fair value in the balance sheet or other statement of financial position. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale or through consultation with industry advisors. Certain money market investments may be reported at amortized cost provided the investment has a remaining maturity of one year or less at time of purchase. All investment income, including changes in the fair value of investments, is recognized as revenue in the operating statement or statement of activities. The distribution to the available school fund is based on the total return based formula methodology discussed in Note 22. The amount of transfers allocated to the available school fund is $843.1 million. The objective, significant terms and risks of derivative investments at Aug. 31, 2007, can be found in Note 3.

Receivables and Payables

The major receivables for governmental activities and business-type activities are taxes and investment trade, respectively. See Note 24 for details on taxes receivable. All receivables are shown net of uncollectible amounts. Other receivables consist primarily of food stamp and nutrition assistance program receivables in the general fund and receivables from private sponsored programs in the colleges and universities fund. Activities between funds that represent lending/borrowing arrangements outstanding at the end of the fiscal year are interfund loans. All other outstanding balances between funds are reported as "due from/due to other funds." Any residual balances between governmental and business-type activities are reported in the government-wide financial statements as "internal balances."

Noncurrent interfund receivables between funds, as shown in Note 12, are reported as a fund balance reserve account in applicable governmental funds to indicate they are not available for appropriation and are not expendable financial resources.

Trade receivables are reported for sales of investments pending settlement. Trade payables are purchases of investments pending settlement.

Inventories and Prepaid Items

Inventories include both merchandise inventories on hand for sale and consumable inventories. Inventories are valued at cost generally utilizing the last-in, first-out method.

The consumption method of accounting is used to account for inventories that appear in both governmental and proprietary fund types. The cost of these items is expensed when the items are consumed. Prepaid items reflect payments for costs applicable to future accounting periods and are recorded in both government-wide financial statements and fund financial statements.

Restricted Assets

Restricted assets include monies or other resources restricted by legal or contractual requirements. These assets include certain proceeds of enterprise fund general obligation and revenue bonds, as well as certain revenues, set aside for statutory or contractual requirements. Assets held in reserve for guaranteed student loan defaults are also included.

Capital Assets

Capital assets are reported in proprietary funds, trust funds and government-wide financial statements. The capitalization threshold and the estimated useful life of the assets vary depending upon the asset type. Note 2 includes a chart identifying the capitalization threshold and the estimated useful life by asset type. It also provides information on the state's depreciation policy and other detailed information.

GASB 34 allows an alternative (modified) approach which reflects a reasonable value of the asset and cost required to maintain the service potential at established minimum standards in lieu of depreciation. The state has elected to use this option for its highway infrastructure. The state has developed and implemented an asset management system that establishes minimum standards and makes a yearly determination whether the minimum standards are being met. Disclosures of the minimum standards and the current status of the state's system of highways are included in the required supplementary information other than MD&A section of this report.

Long-Term Liabilities

Reporting long-term liabilities in the statement of net assets requires two components (a) the amount due in one year (current) and (b) the amount due in more than one year (noncurrent).

General long-term liabilities consist of the noncurrent portion of capital lease obligations, compensable leave, claims and judgments and other noncurrent liabilities. General long-term liabilities are not reported as liabilities in governmental funds but are reported in the governmental activities column in the government-wide statement of net assets. The state reports rebatable arbitrage in claims and judgments. General long-term debt is not limited to liabilities arising from debt issuances but may also include noncurrent liabilities on lease-purchase agreements and other commitments that are not current liabilities properly recorded in governmental funds.

In the government-wide financial statements and proprietary fund financial statements, bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line or the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Deferred issuance costs are reported as deferred charges and amortized over the term of the debt.

In the governmental fund financial statements, bond premiums and discounts, as well as bond issuance costs, are recognized during the current period. The face amount of the debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Employees' Compensable Leave Balances

GASB Statement No. 16, *Accounting for Compensated Absences*, establishes standards of accounting and reporting for compensated absences (vacation, unpaid overtime and sick leave) by state and local governmental entities. GASB 34 requires governments to report and disclose the portion of compensated absences that is due within one year of the statement date.

Annual leave, commonly referred to as vacation leave, and other compensated absences with similar characteristics is accrued as a liability as the benefits are earned by the employee if both the employee's right to receive compensation is attributable to services already rendered and it is probable the employer will compensate the employee for the benefits through paid time off or some other means, such as cash payments at termination or retirement. Employees accrue vacation time at a rate of eight to 21 hours per month depending on years of employment. The maximum number of hours that can be carried forward to the next fiscal year ranges from 180 hours to 532 hours based on years of service.

Overtime, under the federal Fair Labor Standards Act and state laws, can be accumulated in lieu of immediate payment as compensatory leave (at one-and-one-half hours for each overtime hour worked) for nonexempt, nonemergency employees to a maximum of 240 hours. All overtime exceeding 240 hours must be paid with the next regular payroll. At termination or death, all overtime balances must be paid in full. For emergency personnel (firefighters, law enforcement, prison officers, etc.), overtime can be accumulated to a maximum of 480 hours. Unpaid overtime must be included in the calculation of current and noncurrent liabilities for each employee since it may be used like compensatory time or be paid.

Compensatory leave is allowed for exempt employees not eligible for overtime pay. This leave is accumulated on an hour-for-hour basis and must be taken within one year from date earned or it lapses. There is no death or termination benefit for compensatory leave and it is nontransferable. Compensatory leave is reported as a current liability.

Sick leave is accrued at a rate of eight hours per month with no limit on the amount that can be carried forward to the next fiscal year. Accumulated sick leave is not paid at employee termination, although an employee's estate may be paid for one-half of the accumulated sick leave to a maximum of 336 hours. A member who retires based on service or a disability is entitled to service credit in the retirement system for unused sick leave on the last day of employment. The maximum amount of the state's contingent obligation for sick leave has not been determined. However, the probability of a material impact on state operations in any given fiscal year is considered remote.

Capital Lease Obligations

Capital lease contracts payable, which are not funded by current resources, represent the liability for future lease payments under capital lease contracts. Note 7 provides details for capital lease obligations.

Encumbrances

Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting is utilized in the governmental funds. Encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year or years.

Net Assets

Invested in capital assets, net of related debt consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of bonds, mortgages, notes or other debt attributable to the acquisition, construction or improvement of such assets. Significant unspent related debt proceeds are not included in the calculation of invested in capital assets, net of related debt. The unspent portion of the debt is included in restricted for capital projects.

The state reports net assets as restricted when constraints placed on net assets are (a) externally imposed by creditors, grantors, contributors or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation. Enabling legislation authorizes the government to assess, levy, charge or otherwise mandate payment of resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Restricted net assets are designated as either expendable or nonexpendable. Expendable restricted net assets are those funds that may be expended for either a stated purpose or for a general purpose subject to externally imposed stipulations. Nonexpendable restricted net assets are those funds that are required to be retained in perpetuity. Restricted net assets include the state's permanent endowment funds subject to externally imposed restrictions governing their use.

Unrestricted net assets consist of net assets that do not meet the definition of invested in capital assets, net of related debt or restricted net assets.

When both restricted and unrestricted net assets are available for use, it is the state's policy to use restricted resources first and then unrestricted resources as they are needed.

Fund balance reserve and designated fund balances for governmental funds are classified to reserved, unreserved/designated or unreserved/undesignated. Reserved fund balances are (a) funds legally segregated for a specific use or (b) assets which, by their nature, are not available for expenditure. Unreserved fund balances reflect the balances available for appropriation for the general purposes. Designations reflect senior management's self-imposed limitations on the use of available current financial resources. Note 13 presents disaggregated fund balances.

Interfund Activity and Transactions - Government-wide Financial Statements

GASB 34 established a classification system with terms and definitions for interfund activity and modified requirements for reporting transfers.

Interfund Activity

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements with the exception of activities between governmental activities and business-type activities. Interfund activity with fiduciary funds has been reclassified and reported as external activity.

Interfund payables and receivables have been eliminated from the statement of net assets except for amounts due between governmental and business-type activities. These amounts are reported as internal balances on the statement of net assets. Interfund activities between the primary government and component units with a different year end are limited and immaterial. Note 12 provides details of interfund activities and transactions.

Interfund Transactions

Interfund transactions with discretely presented component units have been reclassified and reported as external activity.

Risk Financing

The state maintains a combination of commercial insurance and a self-insurance program. The state is self-insured for workers' compensation and unemployment compensation claims and funds the liabilities on a pay-as-you-go basis. The state's group insurance program is provided through a combination of insurance contracts, a self-funded health plan and health maintenance organization contracts.

Liabilities are reported when it is 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. For additional information, see Note 17.

Note 2
Capital Assets

Assets are capitalized at cost or, if not purchased, at appraised fair value as of the date of acquisition. Based on the requirements of GASB Statement No. 34, *Basic Financial Statements - and Management Discussion and Analysis - for State and Local Governments*, depreciation is reported on all "exhaustible" assets. "Inexhaustible assets," such as works of art and historical treasures are not depreciated. Professional, academic and research library books and materials are considered "exhaustible" assets and are depreciated. All capital assets acquired by proprietary funds or trust funds are reported at cost or estimated historical cost if actual historical cost is not available. Donated assets are reported at fair value on the acquisition date. Assets are depreciated over the estimated useful life of the asset using the straight-line method. The capitalization threshold and useful lives are as follows.

Capitalization of Assets

Type	Capitalization Threshold	Estimated Useful Life
Land and Land Improvements	$ 0	Not applicable
Infrastructure, Non-Depreciable	0	Not applicable
Construction in Progress	0	Not applicable
Buildings and Building Improvements	100,000	5-30 years
Infrastructure, Depreciable	500,000	10-50 years
Facilities and Other Improvements	100,000	10-60 years
Furniture and Equipment	5,000	3-15 years
Vehicles, Boats and Aircraft	5,000	5-40 years
Other Capital Assets (Libraries, Leasehold Improvements and Livestock)	Various	0-22 years

Historical cost records for some land and mineral interests are incomplete or not available. Accordingly, historical costs have been estimated. The effect on the financial statements of any error resulting from assumptions and estimates is not considered material.

Most land improvements (infrastructure), including curbs, sidewalks, fences, bridges and lighting systems, are capitalized. The state's highway infrastructure, expected to be maintained in perpetuity, is reported using the modified approach allowed by GASB 34.

Capitalization of interest incurred during the construction of capital assets is not applicable for governmental activities in accordance with GASB Statement No. 37, *Basic Financial Statements - and Management Discussion and Analysis - for State and Local Governments: Omnibus*. For proprietary fund types and trust funds with measurement focus on income determination or capital maintenance, the net amount of interest cost for qualifying assets is capitalized.

The schedule on the following pages presents the composition of the state's capital assets, adjustments, reclassifications, additions and deletions during fiscal 2007. The adjustment column includes assets that were not previously reported, accounting errors and other changes. The reclassifications column shows completed construction projects and transfers of capital assets between agencies. The additions column includes current year purchases and depreciation. The deletions column shows assets removed during the current year.

Capital Asset Activity

For the Fiscal Year Ended August 31, 2007 (Amounts in Thousands)

	PRIMARY GOVERNMENT					
	Balance 9/1/06	Adjustments	Reclassifications	Additions	Deletions	Balance 8/31/07
GOVERNMENTAL ACTIVITIES						
Nondepreciable Assets						
Land and Land Improvements	$ 6,799,132	$ (45)	$ 1,065	$ 500,774	$ (22,682)	$ 7,278,244
Infrastructure	38,817,170	(18,693)	2,559,578			41,358,055
Construction in Progress	4,020,789	(18,126)	(3,065,798)	3,686,923		4,623,788
Other Capital Assets	181,140			58		181,198
Total Nondepreciable Assets	49,818,231	(36,864)	(505,155)	4,187,755	(22,682)	53,441,285
Depreciable Assets						
Buildings and Building Improvements	5,111,831	(252)	67,176	9,710	(5,919)	5,182,546
Infrastructure	15,693,196	18,693	422,251	1,399	(27,037)	16,108,502
Facilities and Other Improvements	193,040		7,176	574	(834)	199,956
Furniture and Equipment	1,077,114	(11,634)	2,336	82,413	(60,350)	1,089,879
Vehicles, Boats and Aircraft	913,130	63	(123)	85,655	(57,868)	940,857
Other Capital Assets	89,222	(14)	6,343	3,216	(1,717)	97,050
Total Depreciable Assets at Historical Cost	23,077,533	6,856	505,159	182,967	(153,725)	23,618,790
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(2,482,452)	250	1	(161,550)	4,115	(2,639,636)
Infrastructure	(8,583,093)	(669)		(509,658)	24,504	(9,068,916)
Facilities and Other Improvements	(109,489)	57		(7,171)	764	(115,839)
Furniture and Equipment	(813,524)	938	2	(77,279)	55,106	(834,757)
Vehicles, Boats and Aircraft	(546,433)	(113)	195	(55,383)	49,975	(551,759)
Other Capital Assets	(42,761)		(1)	(4,794)	1,114	(46,442)
Total Accumulated Depreciation*	(12,577,752)	463	197	(815,835)	135,578	(13,257,349)
Depreciable Assets, Net	10,499,781	7,319	505,356	(632,868)	(18,147)	10,361,441
Governmental Activities Capital Assets, Net	$ 60,318,012	$ (29,545)	$ 201	$ 3,554,887	$ (40,829)	$ 63,802,726

* Depreciation expense was charged to Governmental Activities as follows:

General Government	$ 47,894
Education	5,206
Employee Benefits	1
Health and Human Services	38,252
Public Safety and Corrections	145,796
Transportation	552,531
Natural Resources and Recreation	23,437
Regulatory Services	2,718
Total Governmental Activities Depreciation Expense	$ 815,835

Concluded on the following page

Capital Asset Activity (concluded)

For the Fiscal Year Ended August 31, 2007 (Amounts in Thousands)

	Balance 9/1/06	Adjustments	Reclassifications	Additions	Deletions	Balance 8/31/07
BUSINESS-TYPE ACTIVITIES						
Nondepreciable Assets						
Land and Land Improvements	$ 1,145,692	$ 1,598	$ 2,892	$ 126,549	$ (2,276)	$ 1,274,455
Construction in Progress	3,419,532	(31,464)	(2,842,860)	1,653,128	(157,279)	2,041,057
Infrastructure			1,073,997	159,844		1,233,841
Other Capital Assets	315,725	(22)	21	11,445	(428)	326,741
Total Nondepreciable Assets	4,880,949	(29,888)	(1,765,950)	1,950,966	(159,983)	4,876,094
Depreciable Assets						
Buildings and Building Improvements	13,834,209	15,724	1,146,120	162,792	(29,146)	15,129,699
Infrastructure	664,369	(655)	400,865	1,273	(4,208)	1,061,644
Facilities and Other Improvements	960,305	(15,839)	131,725	8,725	(532)	1,084,384
Furniture and Equipment	3,316,430	(6,093)	73,464	362,560	(167,390)	3,578,971
Vehicles, Boats and Aircraft	184,197	(236)	439	13,415	(9,499)	188,316
Other Capital Assets	1,125,874	(1,201)	13,168	82,295	(5,419)	1,214,717
Total Depreciable Assets at Historical Cost	20,085,384	(8,300)	1,765,781	631,060	(216,194)	22,257,731
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(6,089,136)	(8,166)		(504,556)	17,315	(6,584,543)
Infrastructure	(367,762)	(92)		(27,519)	8	(395,365)
Facilities and Other Improvements	(438,429)	4,108		(37,120)	291	(471,150)
Furniture and Equipment	(2,143,034)	3,161	44	(333,274)	145,139	(2,327,964)
Vehicles, Boats and Aircraft	(133,433)	319	(77)	(13,786)	8,690	(138,287)
Other Capital Assets	(680,598)	374	1	(58,864)	5,232	(733,855)
Total Accumulated Depreciation**	(9,852,392)	(296)	(32)	(975,119)	176,675	(10,651,164)
Depreciable Assets, Net	10,232,992	(8,596)	1,765,749	(344,059)	(39,519)	11,606,567
Business-Type Activities Capital Assets, Net	$ 15,113,941	$ (38,484)	$ (201)	$ 1,606,907	$ (199,502)	$ 16,482,661
COMPONENT UNITS						
Nondepreciable Assets						
Land and Land Improvements	$ 3,600	$	$	$	$ (131)	$ 3,469
Construction in Progress	94		(959)	1,516		651
Total Nondepreciable Assets	3,694	0	(959)	1,516	(131)	4,120
Depreciable Assets						
Buildings and Building Improvements	35,693			4,099		39,792
Facilities and Other Improvements	370					370
Furniture and Equipment	28,674		959	2,577	(205)	32,005
Vehicles, Boats and Aircraft	21,349			6,148	(4,339)	23,158
Other Capital Assets	3					3
Total Depreciable Assets at Historical Cost	86,089	0	959	12,824	(4,544)	95,328
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(7,713)			(847)		(8,560)
Facilities and Other Improvements	(279)				25	(254)
Furniture and Equipment	(14,884)	(4,289)		(3,461)	466	(22,168)
Vehicles, Boats and Aircraft	(16,121)			(3,399)	3,646	(15,874)
Other Capital Assets	(4,289)	4,289				
Total Accumulated Depreciation	(43,286)	0	0	(7,707)	4,137	(46,856)
Depreciable Assets, Net	42,803	0	959	5,117	(407)	48,472
Component Units Capital Assets, Net	$ 46,497	$ 0	$ 0	$ 6,633	$ (538)	$ 52,592

** Depreciation expense was charged to business-type activities as follows:

Colleges and Universities	$ 963,213
Veterans Land Board Loan Program Funds	3,221
Other Business-Type Activities	8,685
Total Business-Type Activities Depreciation Expense	$ 975,119

Note 3
Deposits, Investments and Repurchase Agreements

LEGAL AND CONTRACTUAL PROVISIONS

Authority for Investments

All monies in funds established in the Treasury Operations Division - Comptroller's office (Treasury) by the state Constitution or by an act of the Legislature are pooled for investment purposes. State statutes authorize the Treasury to invest state funds in fully collateralized time deposits, direct security repurchase agreements, reverse repurchase agreements, obligations of the United States, obligations of various federal credit organizations, bankers' acceptances, commercial paper and contracts written by the Comptroller which are commonly known as covered call options.

The Treasury obtains direct access to the services of the Federal Reserve System through the Texas Treasury Safekeeping Trust Company (Trust Company). The Federal Reserve Bank requires that the Trust Company maintain a positive cash balance in the account during and at the end of the day. The Trust Company met those requirements throughout fiscal 2007. The Trust Company safekeeps U.S. Government securities in book-entry form for the major investment funds of the state, safekeeps collateral pledged to secure deposits of the Treasury in financial institutions and acts as trustee for other public bodies to hold and manage funds on their behalf.

Certain state agencies, as well as colleges and universities, are authorized to invest funds not deposited with the Treasury. Three of the four largest investing agencies; the Teacher Retirement System (TRS), the Texas Education Agency (TEA) and the Employees Retirement System (ERS) make investments following the "prudent person rule." The University of Texas System (UT) and TRS comply with the "prudent investor rule" when making investments. Authorized investments include equities, fixed income obligations, cash equivalents and alternative investments.

Collateralization

State law requires that all Treasury funds deposited in financial institutions above the amounts insured by the Federal Deposit Insurance Corporation be fully collateralized by pledging, to the Treasury, securities valued at market excluding accrued interest. Generally, the list of eligible securities includes all United States Treasury obligations, most agency obligations and securities issued by state agencies and political subdivisions within the state. All securities pledged to the Treasury must be held by a third-party bank doing business in the state through a main office or one or more branches, any Federal Reserve Bank, the Trust Company, any Federal Home Loan Bank or in the vault of the Treasury. During fiscal 2007 no depository holding state funds failed.

State agencies and institutions of higher education, with deposits of public funds which are not managed by the Treasury, are required to secure deposits through collateral pledged by depository banks and savings and loans. Eligible collateral securities are prescribed by state law, however, retirement systems are exempt by statute from this requirement.

External Investment Pool

The state reports the Texas Government Investment Pool (TexPool) trust fund, as an external investment trust fund. A separate report for TexPool can be obtained from the Trust Company.

Deposits

As of Aug. 31, 2007, the carrying amount of deposits for governmental and business-type activities was $967.2 million, for fiduciary funds was $268.6 million and for discretely presented component units was $35 million. These amounts consist of all cash in local banks and a portion of short-term investments. These amounts are included on the combined statement of net assets as part of the "Cash and Cash Equivalents," "Securities Lending Collateral," and "Investments" accounts. As of Aug. 31, 2007, the total bank balance for governmental and business-type activities was $1 billion, for fiduciary funds was $267.5 million and for discretely presented component units was $35.1 million.

Custodial Credit Risk: Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the state will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The state does not have a deposit policy for custodial credit risk. The state's securities lending program is subject to custodial credit risk. This type of risk is inherent to the securities lending programs. Bank balances were exposed to custodial credit risk as follows.

Bank Balances Exposed to Custodial Credit Risk

August 31, 2007 (Amounts in Thousands)

	Uninsured and Uncollateralized	Uninsured and Collateralized with Securities Held by the Pledging Financial Institution
GOVERNMENTAL ACTIVITIES		
Permanent School Fund	$ 4,382	$
Other Nonmajor Funds	503	
Total Governmental Activities	4,885	0
BUSINESS-TYPE ACTIVITIES		
Colleges and Universities	1,973	27,400
Total Business-Type Activities	1,973	27,400
Total Governmental and Business-Type Activities	$ 6,858	$27,400
FIDUCIARY	$185,565	$50,803
COMPONENT UNITS	$ 1,420	$ 0

Foreign Currency Risk: Foreign currency risk for bank balances is the risk that changes in exchange rates will adversely affect the deposit. The state does not have a formal deposit policy related to foreign currency. Foreign currency deposits are intended for settlement of pending international investment trades. The exposure to foreign currency risk for bank balances at Aug. 31, 2007, is as follows.

Bank Balances Exposed to Foreign Currency Risk

August 31, 2007 (Amounts in Thousands)

	Governmental and Business-Type Activities	Pension and Other Employee Benefit Trust Funds
Australian Dollar	$ 206	$ 3,546
Brazilian Real		374
Canadian Dollar	139	698
Chilean Peso	1,441	
Euro	22	47,111
Hong Kong Dollar	36	193
Indian Rupee		68
Indonesian Rupiah		1,523
Japanese Yen	13	11,124
Malaysian Ringgit	14	1,120
New Taiwan Dollar	732	96,072
New Turkish Lira		(475) *
Norwegian Krone	47	360
Philippine Peso		100
Pound Sterling	1,448	19,249
Qatar Riyal	379	
Singapore Dollar	247	1,414
South African Rand	501	416
South Korean Won		129
Swedish Krona		149
Swiss Franc	53	164
Thai Baht		2,210
Total	$ 5,278	$185,545

* Balance was repatriated to the U.S. Dollar cash account held at the custodian bank.

Investments

The fair value of the state's investments is determined from published market prices, quotations from major investment brokers or independent pricing services. In general, the fair value of fixed income securities is based on yields currently available on comparable securities of issuers with similar credit ratings or are valued based on prices from fixed income pricing services or external broker quotes. The changes in the fair value of investments are reported as revenue in the operating statements.

Where no readily ascertainable market value exists (including private equity), fair values can be determined in consultation with investment advisors and Master Trust Custodians or based on the capital account balance at the closest available reporting period, as communicated by the general partner, adjusted for subsequent contributions, distributions, management fees and reserves.

Investments in money market investments are reported at amortized cost which approximates market value. Participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less may also be reported at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors.

The state's investments at Aug. 31, 2007, are as follows.

Investment Fair Value

August 31, 2007 (Amounts in Thousands)

	Governmental and Business-Type Activities	Fiduciary	Component Units
U.S. Treasury	$ 2,108,792	$ 8,361,530	$ 196,392
U.S. Treasury Strips	78,980	31,712	
U.S. Treasury TIPS	1,004,089	608,607	
U.S. Government Agency	18,858,138	15,649,700	707,585
Corporate Obligations	2,173,458	9,983,609	
Corporate Asset and Mortgage Back	1,334,629	17,509,787	
Corporate Equity	17,296,454	65,157,246	
International Obligations	595,934	2,737,358	22
International Equity	6,804,148	21,113,808	
International Other Commingled Funds	956,564	414,803	
Repurchase Agreements	3,375,128	15,765,642	98,125
Fixed Income and Bond Mutual Fund	5,557,939	453,640	11,812
Other Commingled Funds	7,568,084	1,926,978	4,113
Commercial Paper	3,706,612	2,738,573	87,377
Securities Lending Collateral Investment Pool	7,437,518	6,118,447	
Real Estate	3,088,606		
Alternative Investments	8,499,656	8,853,398	
Other Investments	3,351,248	10,326,462	120,493
Total Investments	$ 93,795,977	$187,751,300	$ 1,225,919

Custodial Credit Risk: Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the state will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The state does not have an investment policy for custodial credit risk. Consistent with the state's securities lending program, underlying securities on loans are subject to custodial credit risk.

At Aug. 31, 2007, the state's investments were exposed to custodial credit risk as follows.

Investments Exposed to Custodial Credit Risk

August 31, 2007 (Amounts in Thousands)

	Fair Value that is Uninsured and Unregistered with Securities Held by the Counterparty	Fair Value that is Uninsured and Unregistered with Securities Held by the Counterparty's Trust Department or Agent But Not in the State's Name
GOVERNMENTAL ACTIVITIES		
Permanent School Fund		
Corporate Obligations	$	$ 450,258
Corporate Asset and Mortgage Back		765,495
Repurchase Agreements		1,037,956
Commercial Paper		1,526,011
Other Investments		1,342,211
Other Nonmajor Governmental Funds		
Corporate Equity		11,117
Total Governmental Activities	0	5,133,048
BUSINESS-TYPE ACTIVITIES		
Colleges and Universities		
U.S. Treasury		3,500
U.S. Government Agency	1,982	
Other Nonmajor Enterprise Funds		
U.S. Treasury		31,845
U.S. Government Agency		7,937
Total Business-Type Activities	1,982	43,282
Total Governmental and Business-Type Activities	$ 1,982	$5,176,330
FIDUCIARY		
Pension and Other Employee Benefit Trust Funds		
U.S. Treasury		122,665
U.S. Treasury TIPS		25,025
U.S. Government Agency		6,547
Corporate Obligations		3,108
Total Fiduciary	$ 0	$ 157,345
COMPONENT UNITS		
U.S. Treasury	9,224	
Repurchase Agreements	74,672	
Total Component Units	$ 83,896	$ 0

Foreign Currency Risk: Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investment. TRS, TEA, ERS and UT have exposure to investment foreign currency risk. TRS does not have a formal policy related to its investments in non-U.S. dollar equity securities. TRS' investment policy states that not more than 10 percent of the market value of the fixed income portfolio or 4 percent of the total fund, whichever is greater, may be invested in non-U.S. dollar fixed income securities. UT does not have a formal policy related to its investments in non-U.S. dollar equity securities. UT's investment policy limits investments in non-U.S. denominated bonds to 50 percent of its total fixed income exposure. TEA and ERS do not have an investment policy for managing foreign currency risk.

The state's exposure to foreign currency risk at Aug. 31, 2007, is as follows.

Investments Exposed to Foreign Currency Risk

August 31, 2007 (Amounts in Thousands)

	Governmental and Business-Type Activities				Fiduciary		
	International Obligations	International Equity	Alternative Investments	International Other Commingled Funds	International Obligations	International Equity	Alternative Investments
Argentine Peso	$	$ 86	$	$	$	$	$
Australian Dollar	32,548	297,062		391		945,528	
Bermudan Dollar		29					
Brazilian Real		101,323				260,118	
Bulgarian Lev		319					
Canadian Dollar	37,613	433,393		3,769		1,105,065	
Cayman Islands Dollar		29					
Chilean Peso		1,599				35,452	
Chinese Yuan		3,319					
Colombian Peso		12					
Czech Koruna		8,409				15,382	
Danish Krone	8,633	45,181		174		179,107	
Egyptian Pound		3,647					
Euro	240,354	1,661,048	12,219	284,345	220,847	5,914,763	728,368
Hong Kong Dollar		258,343		32		802,807	
Hungarian Forint		10,202		4		31,104	
Indian Rupee		1,038				157,382	
Indonesian Rupiah		15,027				42,888	
Japanese Yen	24,251	1,265,107		14,392	199,505	3,439,774	
Jordanian Dinar		5					
Malaysian Ringgit	9,611	22,930				88,582	
Mexican Peso		51,581		29		79,780	
Moroccan Dirham		15					
New Israel Shekel		9,061				10,923	
New Taiwan Dollar		87,441		992		302,396	
New Turkish Lira		14,911				46,419	
New Zealand Dollar	6,108	8,596		610		5,162	
Norwegian Krone	6,204	67,496		556		197,157	
Pakistani Rupee		9					
Peruvian Nuevo Sol		30					
Philippine Peso		6,398				6,202	
Polish Zloty	20,758	17,243		269		32,368	
Pound Sterling	47,968	1,094,222		20,144		3,601,090	17,812
Romanian Leu		702					
Russian Ruble		15,738					
Singapore Dollar	14,275	54,819		299		203,964	
South African Rand	9,288	67,574		494		207,694	
South Korean Won		149,661				425,664	
Swedish Krona	9,374	121,303		511		366,528	
Swiss Franc		304,838		799		1,002,808	
Thai Baht		13,639				65,538	
Total	$466,985	$6,213,385	$12,219	$327,810	$420,352	$19,571,645	$746,180

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO).

TRS' investment policy states that, except for investments in board-approved high yield bond funds and certain commercial mortgage-backed security (CMBS) and asset-backed security (ABS) instruments, each security must be rated at least speculative grade (the lowest notch of the single B category) by at least one NRSRO. Except for certain CMBS and ABS instruments, unrated fixed income securities may only be purchased if those securities have investment grade characteristics and would otherwise meet the rating quality requirements defined in the investment policy if rated. No NRSRO rating is required for fixed income investments issued, insured, guaranteed by, supported by or based on the credit of the U.S. Government or any U.S. Government agency, department or government sponsored enterprise. Except for board-approved high yield fund investments, the following quality rating exposure limits apply to the fixed income portfolio: 100 percent portfolio limit for investment grade, 10 percent portfolio limit for speculative grade and 1 percent portfolio limit for nonrated and/or equity classes of CMBS and ABS instruments.

TEA's investment policy requires investments in fixed income securities be rated at least BBB and short-term money market instruments must be rated at least A-1 by Standard & Poor's.

ERS' general investment policies require that noncash interest paying securities in the high yield bond portfolios not exceed 15 percent of the market value of the portfolio and that investments in money market funds represent no more than 5 percent of each individual fund.

UT's investment policies limit investments in U.S. domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, BBB- or better by Standard & Poor's. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

At Aug. 31, 2007, the state's credit quality distribution for securities with credit risk exposure was as follows.

Investments Exposed to Credit Risk

August 31, 2007 (Amounts in Thousands)

	AAA	AA	A	BBB	BB	B	CCC	C	D	NR
GOVERNMENTAL ACTIVITIES										
U.S. Government Agency	$ 7,798,639	$ 17,677	$	$	$	$	$	$	$	$5,446,671
Corporate Obligations	507,418	1,348,839	543,203	305,651	24,672	31,704	19,848			40,535
Corporate Asset and Mortgage Back	1,584,951									14,591
International Obligations			20,192	346	2,801	478				
Repurchase Agreements	1,810,921	33,551								1,037,956
Alternative Investments										
Other Investments		91,499								25,386
Total Governmental Activities	$11,701,929	$1,491,566	$ 563,395	$ 305,997	$ 27,473	$ 32,182	$ 19,848	$ 0	$ 0	$6,565,139
BUSINESS-TYPE ACTIVITIES										
U.S. Government Agency	$ 4,805,741	$ 200	$	$	$	$	$	$	$	$ 214,155
Corporate Obligations	81,919	265,263	307,491	200,325	99,933	56,007	2,949	4		48,090
Corporate Asset and Mortgage Back	373,784	15,952	7,271	834	1,762					10,111
International Obligations	335,495	29,291	88,620	59,099	8,354	1,550				47,962
Repurchase Agreements	1,090,251	117,289								577,582
Alternative Investments	35,326									85,087
Other Investments	152,104	121,860	266,038	1,387	13,714	18,834				590,760
Total Business-Type Activities	$ 6,874,620	$ 549,855	$ 669,420	$ 261,645	$ 123,763	$ 76,391	$ 2,949	$ 4	$ 0	$1,573,747
GOVERNMENTAL AND BUSINESS-TYPE ACTIVITIES										
U.S. Government Agency	$12,604,380	$ 17,877	$	$	$	$	$	$	$	$5,660,826
Corporate Obligations	589,337	1,614,102	850,694	505,976	124,605	87,711	22,797	4		88,625
Corporate Asset and Mortgage Back	1,958,735	15,952	7,271	834	1,762					24,702
International Obligations	335,495	29,291	108,812	59,445	11,155	2,028				47,962
Repurchase Agreements	2,901,172	150,840								1,615,538
Alternative Investments	35,326									85,087
Other Investments	152,104	213,359	266,038	1,387	13,714	18,834				616,146
Total Governmental and Business-Type Activities	$18,576,549	$2,041,421	$ 1,232,815	$ 567,642	$ 151,236	$ 108,573	$ 22,797	$ 4	$ 0	$8,138,886
FIDUCIARY										
U.S. Government Agency	$16,949,164	$ 3	$ 114,971	$	$	$	$	$	$	$ 321,336
Corporate Obligations	1,179,536	2,684,752	2,054,469	1,753,701	945,977	1,196,728	244,120		3,674	140,785
Corporate Asset and Mortgage Back	10,266,980	148,736	3,948,011	45,087	15,653	8,357	8,345			586,883
International Obligations	516,406	383,993	808,754	682,489	69,761	36,988	1,118			237,848
Repurchase Agreements	14,020,863	3,840	931,431							
Alternative Investments										
Other Investments	97,897	2,167,535	7,028,982							48,341
Total Fiduciary	$43,030,846	$5,388,859	$14,886,618	$2,481,277	$1,031,391	$1,242,073	$253,583	$ 0	$3,674	$1,335,193
COMPONENT UNITS										
U.S. Government Agency	$ 540,411	$	$	$	$	$	$	$	$	$ 18,395
Corporate Obligations										
Corporate Asset and Mortgage Back										
International Obligations			22							
Repurchase Agreements	6,777	37								16,173
Alternative Investments										
Other Investments										
Total Component Units	$ 547,188	$ 37	$ 22	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 34,568

Concluded on the following page

Investments Exposed to Credit Risk (concluded)

August 31, 2007 (Amounts in Thousands)

	AAAf	Aaf	NR
GOVERNMENTAL ACTIVITIES			
Fixed Income and Bond Mutual Fund	$1,175,021	$ 0	$ 146,091
BUSINESS-TYPE ACTIVITIES			
Fixed Income and Bond Mutual Fund	$3,803,716	$ 78,117	$ 387,020
GOVERNMENTAL AND BUSINESS-TYPE ACTIVITIES			
Fixed Income and Bond Mutual Fund	$4,978,737	$ 78,117	$ 533,111
FIDUCIARY			
Fixed Income and Bond Mutual Fund	$ 134,496	$ 0	$ 297,286
COMPONENT UNITS			
Fixed Income and Bond Mutual Fund	$ 11,812	$ 0	$ 0

	A-1	A-2	NR
GOVERNMENTAL AND BUSINESS-TYPE ACTIVITIES			
Commercial Paper	$5,083,943	$ 4,133	$ 320,747
FIDUCIARY			
Commercial Paper	$2,717,901	$ 0	$ 0
COMPONENT UNITS			
Commercial Paper	$ 87,378	$ 0	$ 0

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of the state's investment in a single issuer. At Aug. 31, 2007, more than 5 percent of investments held by governmental activities were in securities issued by the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. These holdings were the result of the governmental activities' participation in the Treasury's internal investment pool. The Treasury places no limit on the amount it may invest in any one issuer.

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. TEA and TRS use the effective weighted duration method to identify and manage interest rate risk. UT and ERS use the modified duration method.

Duration is a measure of the price sensitivity of a debt investment to changes arising from movements in interest rates. Duration is the weighted average maturity of an instrument's cash flows, where the present value of the cash flows serves as the weights. The duration of an instrument can be calculated by first multiplying the time until receipt of cash flow by the ratio of the present value of that cash flow to the instrument's total present value. The sum of these weighted time periods is the duration of the instrument. Effective duration extends this analysis to incorporate an option adjusted measure of an instrument's sensitivity to changes in interest rates. Modified duration estimates the sensitivity of the fund's investments to changes in interest rates.

The investment policy of TEA mandates the average duration of the fixed income portfolio be consistent with the Lehman Bros. Aggregate Index's duration. The Lehman Bros. Aggregate Index duration as of Aug. 31, 2007, was 4.8 percent. The maximum maturity for invested securities lending collateral is 397 days except for bank time deposits which is 60 days, bankers' acceptances which is 45 days and reverse repurchase agreements which is 180 days. The maximum weighted average maturity of the entire collateral portfolio must be 180 days. The maximum weighted average interest rate exposure of the entire collateral portfolio must be 60 days. Under TRS' investment policy, its portfolio will generally be structured to have an effective duration range of plus or minus two years of the Lehman U.S. Aggregate Bond Index. UT and ERS do not have a formal investment policy with respect to overall modified duration.

TEA's investments by investment type, fair value and the effective weighted duration rate as of Aug. 31, 2007, are as follows.

Investments Exposed to Interest Rate Risk

August 31, 2007

TEA Investment Type	Fair Value (in Thousands)	Effective Weighted Duration Rate
U.S. Government and U.S. Government Agency Obligations	$2,257,810	5.00
U.S. Government Mortgage Backed Obligations	947,120	3.82
U.S. Government Agency Mortgage Obligations	912,761	4.61
Asset Backed Obligations	42,530	3.40
Commercial Mortgage Backed Securities	312,599	5.93
Corporate Backed Commercial Mortgage Obligations	469,915	3.63
Corporate Obligations	1,031,721	5.58
U.S. Treasury Inflation Index Obligation	57,970	1.58
U.S. Private Placements - Corporate	63,851	0.49
U.S. Private Placements - Government	24,802	7.38
Total Fixed Income	$6,121,079	4.72

The following provides information about TEA's interest rate risks and maturities associated with its invested securities lending collateral by investment type.

Invested Securities Lending Collateral Exposed to Interest Rate Risk

August 31, 2007 (Amounts in Thousands)

TEA Investment Type	Fair Value	Investment Maturities in Less Than One Year
Certificates of Deposit	$ 91,499	$ 91,499
Commercial Paper	1,526,011	1,526,011
Asset Backed Floating Rate Notes	765,495	765,495
Bank Floating Rate Notes	1,250,712	1,250,712
Corporate Floating Rate Notes	364,258	364,258
Corporate Interest Bearing Notes	86,000	86,000
Repurchase Agreements	1,037,956	1,037,956
Total	$ 5,121,931	$ 5,121,931

TRS' investments by investment type, fair value and the effective weighted duration rate as of Aug. 31, 2007, are as follows. The effective weighted duration rate is an option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. It is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve +/-100 basis points. It incorporates the effect of embedded options for corporate bonds and changes in prepayments for mortgage backed securities (including pass-throughs, CMOs and ARMs). The effective weighted duration calculation excludes the High Yield Limited Partnerships, which are pooled instruments and not debt securities.

Investments Exposed to Interest Rate Risk

August 31, 2007

TRS Investment Type	Fair Value (in Thousands)	Effective Weighted Duration Rate
U.S. Government Obligations	$ 7,420,015	7.06
U.S. Government Agency Obligations	10,186,011	4.51
Asset and Mortgage Backed Obligations	6,002,713	2.92
Corporate Obligations	4,524,970	5.45
International Obligations	2,307,584	5.24
Total Interest Rate Risk Debt Securities	$ 30,441,293	5.01

ERS' investments by investment type, fair value and the modified duration rate as of Aug. 31, 2007, are as follows.

Investments Exposed to Interest Rate Risk

August 31, 2007

	Fair Value (Amounts in Thousands)		Modified Duration	
ERS Investment Type	Fiduciary Fund	Proprietary Fund	Fiduciary Fund	Proprietary Fund
U.S. Treasury Securities	$ 718,648	$ 86,706	8.23	6.79
U.S. Treasury TIPS	608,607		11.60	
U.S. Government Agency Obligations	1,004,985	22,860	4.55	2.37
Corporate Obligations	2,755,417	87,980	5.37	2.49
Corporate Asset and Mortgage Backed Securities	3,131,422	112,837	4.58	4.75
Derivatives	599,338	430,861	5.71	
Overall Interest Rate Risk Debt Securities	$ 8,818,417	$ 741,244	4.86	1.78

UT's investments by investment type, fair value and the modified duration rate as of Aug. 31, 2007, are as follows.

Investments Exposed to Interest Rate Risk

August 31, 2007

UT Investment Type	Fair Value (In Thousands)	Modified Duration
INVESTMENTS IN SECURITIES:		
U.S. Government Guaranteed:		
U.S. Treasury Bonds and Notes	$ 296,312	7.20
U.S. Treasury Strips	11,295	4.05
U.S. Treasury Bills	22,685	0.04
U.S. Treasury Inflation Protected	946,118	8.73
U.S. Agency Asset Backed	18,643	6.82
Total U.S. Government Guaranteed	1,295,053	8.16
U.S. Government Non-Guaranteed:		
U.S. Agency	70,908	1.38
U.S. Agency Asset Backed	1,355,526	5.03
Total U.S. Government Non-Guaranteed	1,426,434	4.85
Total U.S. Government	2,721,487	6.43
Corporate Obligations:		
Domestic	553,277	3.86
Commercial Paper	176,199	0.13
Foreign	107,567	6.88
Total Corporate Obligations	837,043	3.46
Foreign Government and Provincial Obligations	234,352	5.45
Other Debt Securities	10,390	10.16
Total Debt Securities	244,742	5.65
Other Investment Funds – Debt	459,777	3.73
Fixed Income Money Market Funds	3,240,095	0.11
Repurchase Agreements	8,500	
Certificates of Deposit	25,603	0.94
Total Investments in Securities	$7,537,247	3.16
DEPOSIT WITH BROKERS FOR DERIVATIVE CONTRACTS:		
U.S. Government Guaranteed:		
U.S. Treasury Bills	$ 136,878	0.14
U.S. Treasury Inflation Protected		
Total U.S. Government Guaranteed	136,878	0.14
Cash	6,372	
Total Deposit with Brokers for Derivative Contracts	$ 143,250	0.13

Reverse Repurchase Agreements

Investments in reverse repurchase agreements by the Treasury and the Trust Company are permitted by statute. A reverse repurchase agreement consists of a sale of securities by the state with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. Sale proceeds are invested by the state in securities or repurchase agreements that mature at or almost at the same time as the reverse repurchase agreement. Proceeds from the matured securities are used to liquidate the agreement resulting in a matched position. With a matched position there is minimal market risk because the seller-borrower will hold the securities to maturity and liquidate them at face value. In the event of default on a reverse repurchase agreement, the Treasury would potentially suffer a loss. The loss occurs if the cash received does not exceed the fair value of the securities underlying reverse repurchase agreements. The amount of the loss would equal the difference between the fair value plus accrued interest of the underlying securities and the agreement price plus accrued interest. To minimize the risk of default, all securities backing reverse repurchase agreements are held by the Federal Reserve Bank in the state's name.

The Treasury's aggregate amount of reverse repurchase agreement obligations at Aug. 31, 2007, was $106 million including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was $106.2 million. The credit exposure at fiscal year end was $134 thousand.

Securities Lending

TRS, TEA, ERS, UT, the Trust Company, the Texas A&M University System (A&M), the General Land Office/ Veterans Land Board (GLO/VLB) and the Texas Prepaid Higher Education Tuition Board (TPHETB) participate in a securities lending program as authorized by state statute. Under this program, the governmental entities transfer securities to an independent broker or dealer in exchange for collateral in the form of cash, governmental securities or bank letters of credit. In addition, TEA may receive collateral in the form of other assets which it specifically agrees to with its lending agent and A&M may receive collateral in the form of fixed income securities and repurchase agreements. TRS, UT and GLO/VLB receive collateral equal to 102 percent of the value of domestic securities lent and 105 percent for international securities. TEA receives collateral in an amount of 102 percent of the fair value plus accrued income for domestic corporate securities and 105 percent of the fair value plus accrued income for foreign securities; except in the case of foreign securities denominated and payable in U.S. Dollars, the required percentage is 102 percent. ERS receives collateral of 100 percent of the value of securities lent plus accrued interest. A&M receives collateral of 100 percent of the value of the securities lent. The Trust Company receives collateral of 102 percent of the value of U.S. securities lent plus any accrued interest and 105 percent of the value of non-U.S. government securities plus any accrued interest. TPHETB receives collateral of 102 percent of the value of domestic securities lent plus accrued interest and 105 percent plus accrued interest for foreign securities. There is a simultaneous agreement to return the collateral for the same securities in the future.

The state's securities custodians are the security lending agents. The securities lending contracts do not allow the state to pledge or sell collateral securities unless the borrower defaults. For TRS, TEA, ERS, UT, GLO/VLB and TPHETB, the lending agents are required to indemnify the state if the borrowers fail to return the securities. For the Trust Company and A&M, the lending agent is not liable with respect to any losses except to the extent that such losses result from the lending agent's negligence, failure to live up to its contractual responsibilities or willful misconduct.

At year end there was no credit risk exposure to the state, because the amounts the state owed the borrowers exceeded the amounts the borrowers owed the state. For ERS, the relationship between the maturities of investments made with cash collateral generally matched the maturities of the loan agreements. For A&M, cash collateral received from the borrower is invested in a money market mutual fund with next day liquidity and repurchase agreements. TRS, the Trust Company, GLO/VLB and TPHETB loans are terminable at will. UT manages its investments to maintain an average maturity and overnight liquidity and TEA maturities are defined by the lending agreement. 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.

The state's aggregate amount of securities out on loan to broker-dealers at Aug. 31, 2007, was $40.3 billion, of which TRS had $26.3 billion, TEA had $5.3 billion, ERS had $6.2 billion, UT had $1.7 billion, the Trust Company had $124.4 million, A&M had $283.8 million, GLO/VLB had $38 million and TPHETB had $324.4 million.

Derivatives

Derivatives are financial instruments (securities or contracts) whose value is linked to or "derived" from changes in interest rates, currency rates and stock and commodity prices. Certain state agencies and colleges and universities were parties to various derivative financial instruments including derivative contracts, options and investments in commingled funds which are authorized to use derivatives and swaps.

At Aug. 31, 2007, the following derivatives were held and reported at fair value on the statement of net assets and the statement of fiduciary net assets.

Type	Held By
Forward Contracts	TRS, A&M and UT
Futures Contracts	ERS, TEA and UT
Written Options	TRS and UT
Index Funds, Hedge Funds and Commingled Funds	UT
Swaps	UT

Forward contracts are bought or sold when an international trade has been made. The contract is in the currency native to the security transactions for settlement date. Risks associated with such contracts include movement in the value of the foreign currency related to the U.S. dollar and the ability of the counterparty to perform.

Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes.

Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities and to hedge and control risks so that the actual risk/return profile is more closely aligned with the target risk/return profile. If a call option expires, the state realizes a gain to the extent of the premium received. If a call option is exercised, the difference between the proceeds of the sale plus the amount of the premium and the fair value of the security are realized as a gain or loss. If a call option is repurchased, the difference between the premium income received and the amount paid to close the option contract is realized as a gain or loss. If a put option is exercised, the premium reduces the cost basis of the securities purchased.

Index funds, hedge funds and commingled funds alter market exposure without trading the underlying cash market securities.

Swaps are entered into primarily to hedge and control interest rate risks.

Note 4
Short-Term Debt

On Aug. 22, 2006 (with an issue date of Aug. 31, 2006), $4.6 billion in the State of Texas Tax and Revenue Anticipation Notes, Series 2006, were sold to coordinate the cash flow of the state for the fiscal year ended Aug. 31, 2007. Issuance of these notes enhanced the state's ability to make timely payment of expenditures payable from the general revenue fund. The Series 2006 were repaid during fiscal 2007 and bore interest at 4.5 percent and were priced to yield 3.598 percent.

On Aug. 22, 2007, the Comptroller's office sold approximately $4.9 billion of the State of Texas Tax and Revenue Anticipation Notes, Series 2007, with an issue date of Sept. 4, 2007, and a maturity date of Aug. 28, 2008. The notes bear interest at 4.5 percent and were priced to yield 3.728 percent. They are not subject to redemption prior to maturity. On Aug. 21, 2007, good faith funds in the amount of $49 million were received. Short-term debt activity for the year ended Aug. 31, 2007, is as follows.

Short-Term Debt

For the Fiscal Year Ended August 31, 2007 (Amounts in Thousands)

	Beginning Balance 09/01/06	Issued	Redeemed	Ending Balance 08/31/07
Tax and Revenue Anticipation Notes	$4,600,000	$ 0	$4,600,000	$ 0
Commercial Paper	88,850	170,000	100,850	158,000
	$4,688,850	$ 170,000	$4,700,850	$ 158,000

During fiscal 2007 the Texas Department of Transportation issued commercial paper under its short-term borrowing program. The commercial paper proceeds are being used to cover temporary funding short falls for capital expenditures.

Note 5

Long-Term Liabilities

The long-term liabilities activity for fiscal 2007 is shown in the table below.

Long-Term Liabilities Activity

For the Fiscal Year Ended August 31, 2007 (Amounts in Thousands)

	Beginning Balance 09/01/06	Additions	Reductions	Ending Balance 08/31/07	Amounts Due Within One Year	Amounts Due Thereafter
GOVERNMENTAL ACTIVITIES						
Claims and Judgments	$ 207,154	$ 46,281	$ 46,467	$ 206,968	$ 70,379	$ 136,589
Capital Lease Obligations	14,549		3,989	10,560	1,425	9,135
Employees' Compensable Leave	666,527	691,196	635,193	722,530	425,016	297,514
Notes and Loans Payable	330,799	151,500	266,599	215,700	21,702	193,998
General Obligation Bonds Payable	4,478,891	2,602,277	324,275	6,756,893	300,083	6,456,810
Revenue Bonds Payable	1,152,483	982,333	104,077	2,030,739	111,655	1,919,084
Governmental Activities Long-Term Liabilities	$ 6,850,403	$ 4,473,587	$ 1,380,600	$ 9,943,390	$ 930,260	$ 9,013,130
BUSINESS-TYPE ACTIVITIES						
Claims and Judgments	$ 206,822	$ 586,841	$ 629,823	$ 163,840	$ 94,801	$ 69,039
Capital Lease Obligations	12,089	3,621	2,131	13,579	2,554	11,025
Employees' Compensable Leave	547,509	148,209	115,535	580,183	283,023	297,160
Notes and Loans Payable	1,741,254	1,078,620	790,552	2,029,322	1,666,201	363,121
General Obligation Bonds Payable	2,738,685	233,251	196,469	2,775,467	110,226	2,665,241
Revenue Bonds Payable	12,378,384	2,429,312	2,503,338	12,304,358	582,702	11,721,656
Liabilities Payable From Restricted Assets	3,751,199	387,843	470,478	3,668,564	516,563	3,152,001
Business-Type Activities Long-Term Liabilities	$21,375,942	$ 4,867,697	$ 4,708,326	$21,535,313	$ 3,256,070	$18,279,243
COMPONENT UNITS						
Capital Lease Obligations	$ 317	$ 24	$ 191	$ 150	$ 120	$ 30
Employees' Compensable Leave	4,574	2,580	2,402	4,752	3,202	1,550
Notes and Loans Payable	184,681	122,000	138,663	168,018	42,193	125,825
Revenue Bonds Payable	262,148	165,534	51,360	376,322	6,914	369,408
Liabilities Payable From Restricted Assets	217,139	38,593	26,641	229,091		229,091
Component Units Long-Term Liabilities	$ 668,859	$ 328,731	$ 219,257	$ 778,333	$ 52,429	$ 725,904

Notes and loans payable consists of amounts used to purchase capital equipment. Other uses include the acquisition, construction and renovation of other capital assets, including the interim financing of higher education projects, software/database acquisition and development; refinancing of existing debt and the funding of agency specific missions such as economic development projects and pest eradication programs. Debt service requirements for notes and loans payable in the long-term liabilities are shown to the right and at the top of the following page.

General Obligation Bonds and Revenue Bonds are described in detail in Note 6.

Notes and Loans Payable Debt Service Requirements Governmental Activities

(Amounts in Thousands)

Year	Principal	Interest	Total
2008	$ 21,702	$ 10,588	$ 32,290
2009	20,629	9,450	30,079
2010	18,026	8,419	26,445
2011	14,546	7,517	22,063
2012	11,991	6,801	18,792
2013 - 2017	59,644	24,961	84,605
2018 - 2022	45,119	10,946	56,065
2023 - 2027	23,293	2,219	25,512
2028 - 2032	750	3	753
Total Requirements	$ 215,700	$ 80,904	$ 296,604

Notes and Loans Payable
Debt Service Requirements
Business-Type Activities
(Amounts in Thousands)

Year	Principal	Interest	Total
2008	$1,666,201	$ 54,519	$1,720,720
2009	50,436	8,132	58,568
2010	8,083	30,561	38,644
2011	8,606	14,651	23,257
2012	8,662	14,244	22,906
2013 - 2017	56,383	64,510	120,893
2018 - 2022	43,253	52,055	95,308
2023 - 2027	54,967	41,559	96,526
2028 - 2032	17,511	31,773	49,284
2033 - 2037	35,288	25,246	60,534
2038 - 2042	68,424	11,587	80,011
Total Requirements	2,017,814	348,837	2,366,651
Premium	11,508		11,508
Total Requirements	$2,029,322	$ 348,837	$2,378,159

Notes and Loans Payable
Debt Service Requirements
Component Units
(Amounts in Thousands)

Year	Principal	Interest	Total
2008	$ 42,193	$ 5,871	$ 48,064
2009	19,344	5,095	24,439
2010	12,449	4,248	16,697
2011	27,162	3,706	30,868
2012	11,759	2,958	14,717
2013 - 2017	54,301	5,672	59,973
2018 - 2022	167	233	400
2023 - 2027	230	171	401
2028 - 2032	319	97	416
2033 - 2037	94	3	97
Total Requirements	$ 168,018	$ 28,054	$ 196,072

Claims and judgments are payments on behalf of the state, its agencies and employees for various legal proceedings and claims. Tort claims are covered under the Texas Tort Claims Act. Numerous miscellaneous claims are covered under the Miscellaneous Claims Act for legal liabilities against the state for which no appropriation otherwise exists. Individual claims above $25,000 or numerous separate claims from the same individual or entity that in total exceed $25,000 must be approved by the Legislature before being paid.

Employees' compensable leave is the state's liability for all unused vacation and unpaid overtime accrued by employees, payable as severance pay under specified conditions. This obligation is paid only at the time of termination, usually from the same funding source(s) from which the employee's salary or wage compensation was paid.

Capital lease obligations are described in detail in Note 7.

Long-term liabilities that are associated with the acquisition of restricted assets or long-term liabilities that will be liquidated with restricted assets are classified as liabilities payable from restricted assets.

Note 6
Bonded Indebtedness

DESCRIPTION OF BOND ISSUES

The State of Texas has 460 bond issues outstanding as of Aug. 31, 2007. During fiscal 2007 the state paid $403.1 million from the general revenue fund for debt service.

General Obligation Bonds – General Comments

The Texas Constitution authorizes the state to issue several types of general obligation bonds. Each issue of general obligation bonds is designed to be self-supporting from a primary revenue source related to the program being financed, except for the general obligation bonds of the Texas Public Finance Authority, the Water Development Board and the Constitutional Appropriation Bonds.

The purpose and primary pledged revenue sources of each type of general obligation bond are summarized below.

The **Texas Higher Education Coordinating Board** issues bonds for educational loans to eligible Texas college students. Payments received on the loan contracts are applied to debt service on the bonds.

The **Texas Parks and Wildlife Department** issues bonds to finance the acquisition and development of state park sites. Park entrance fees and investment earnings are applied to debt service on the bonds.

The **Texas Public Finance Authority** (Authority) issues general obligation bonds to finance the acquisition, construction or renovation of buildings for the use of state agencies and institutions. The Authority is also authorized to issue general obligation bonds to assist local government economic development projects to enhance the value of military facilities. The bonds are payable from state appropriations.

The **Texas Water Development Board** issues bonds to provide financial assistance to political subdivisions for water development, water quality enhancement projects and flood control projects. Debt service payments are funded by principal and interest received on loans to political subdivisions, repayments of purchased water storage contracts and earnings on temporary investments.

The **General Land Office and Veterans Land Board** issues bonds to provide funds to loan to eligible Texas veterans for the purchase of land, housing or home improvements. Principal and interest payments on loans, plus investment earnings, are the primary source of repayment for bonds.

Constitutional Appropriation Bonds are issued in support of the construction programs of colleges and universities not benefiting from the Permanent University Fund, which is dedicated to the University of Texas and Texas A&M University systems. Debt service payments on bonds issued are limited to the $87.5 million in General Revenue Funds available for debt service each year.

The **Economic Development and Tourism Office**, a division within the Office of the Governor, issues general obligation bonds to provide financial assistance to export businesses, to promote domestic business development, to provide loans to finance the commercialization of new and improved products and processes and to provide loans to defense-related communities for economic development projects. Debt service payments are funded primarily from the repayment of loans and the disposition of debt instruments.

General Obligation Bonds – Authorized But Unissued

The Texas Constitution limits the amount of bonds that can be issued in any of the general obligation categories. As of Aug. 31, 2007, the amounts of general obligation bonds, other than Constitutional Appropriation Bonds, that were authorized but unissued are listed in the table below.

General Obligation Bonds Authorized But Unissued

(Amounts in Thousands)

SELF-SUPPORTING	
Texas Agricultural Finance Authority Bonds	$ 25,000
Farm and Ranch Loan Bonds	475,000
Veterans Land and Housing Bonds	180,592
Water Development Bonds	2,066,427
College Student Loan Bonds	177,195
Texas Military Preparedness Commission	200,405
	3,124,619
NOT SELF-SUPPORTING	
Agricultural Water Conservation Bonds	164,840
Texas Public Finance Authority Bonds	525,950
Water Development Bonds - Economically Distressed Areas Program	12,013
	702,803
Total General Obligation Bonds	$3,827,422

Bonds Issued and Issues Outstanding

(Amounts in Thousands)

	Bond Issues Outstanding 8/31/07	Bonds Issued
GOVERNMENTAL ACTIVITIES		
General Obligation Bonds	54	$ 8,136,890
Revenue Bonds	27	3,014,068
Governmental Activities Bond Total	81	11,150,958
BUSINESS-TYPE ACTIVITIES		
General Obligation Bonds	86	3,576,774
Revenue Bonds	270	15,677,874
Business-Type Activities Bond Total	356	19,254,648
COMPONENT UNITS		
Revenue Bonds	23	445,778
Total Bonds	460	$30,851,384

Changes in Bonds Payable

For the Fiscal Year Ended August 31, 2007 (Amounts in Thousands)

	Bonds Outstanding 9/1/06	Bonds Issued	Bonds Matured or Retired	Bonds Refunded	Bonds Outstanding 8/31/07	Due Within One Year
GOVERNMENTAL ACTIVITIES						
General Obligation Bonds	$ 4,478,891	$ 2,602,277	$ 262,190	$ 62,085	$ 6,756,893	$ 300,083
Revenue Bonds	1,152,483	982,333	104,077	0	2,030,739	111,655
Governmental Activities Bond Total	5,631,374	3,584,610	366,267	62,085	8,787,632	411,738
BUSINESS-TYPE ACTIVITIES						
General Obligation Bonds	2,738,685	233,251	100,489	95,980	2,775,467	110,226
Revenue Bonds	12,378,384	2,429,312	683,149	1,820,189	12,304,358	582,702
Business-Type Activities Bond Total	15,117,069	2,662,563	783,638	1,916,169	15,079,825	692,928
COMPONENT UNITS						
Revenue Bonds	262,148	165,534	51,360	0	376,322	6,914
Total Bonds	$21,010,591	$ 6,412,707	$ 1,201,265	$ 1,978,254	$24,243,779	$ 1,111,580

Revenue Bonds – General Comments

Each series of revenue bonds is backed by the pledged revenue sources and restricted funds specified in the bond resolution. Each series is designed to be self-supporting except for the following, which are supported by pledged lease or rental revenue derived from contracts with other state agencies, which in turn comes from legislative appropriations.

- Texas Military Facilities Commission Bonds;
- Texas Public Finance Authority Bonds;
- Texas Department of Criminal Justice Bonds and
- Texas Parks and Wildlife Department Bonds.

The purpose and primary pledged revenue sources of each type of revenue bond are summarized below.

The **Texas Military Facilities Commission** issues bonds for the construction, expansion and renovation of armories. The bonds are payable from certain pledged revenues, primarily rentals from the Adjutant General's Department.

The **Texas Workforce Commission** was authorized to issue, in an amount not to exceed $2 billion for any separate bond issue, revenue bonds to (a) repay advances from the federal unemployment insurance program, (b) pay unemployment benefits by depositing the proceeds in the unemployment compensation fund, (c) pay costs of issuance and (d) pay capitalized interest on bonds. The bonds are payable from revenues collected through an Unemployment Insurance Obligation Tax Assessment.

The **Texas Public Finance Authority** issues bonds to finance the acquisition of real property and the construction, equipping or renovation of buildings for the use of state agencies and institutions of higher education. The bonds are payable from specified pledged revenues, primarily occupant-agency rentals collected.

The **Texas Public Finance Authority** issued bonds to establish the Texas Workers' Compensation Insurance Fund that would operate as an insurance carrier. Due to changes in organizational structure, the fund is now a related organization and their name has changed to the Texas Mutual Insurance Company. Debt service is paid from securities on deposit in the escrow fund. The escrow fund was established to provide for the full and complete discharge of the fund's obligation to continue collecting a maintenance tax surcharge on gross premiums of insurers providing workers compensation insurance in the state.

The **Texas Parks and Wildlife Department** issues bonds for infrastructure repairs and construction. The bonds are payable from rent payments made by the Department to the Texas Public Finance Authority which are funded from state appropriations.

The **General Land Office and Veterans Land Board** issues bonds to assist in the construction of skilled nursing care facilities for veterans and to make home mortgage loans to veterans. The bonds are limited and special revenue obligations of the Board payable solely from the income, revenues, receipts and collateral pledged under the related trust indentures.

Debt Service Requirements

(Amounts in Thousands)

GOVERNMENTAL ACTIVITIES

Year	General Obligation Bonds Principal	General Obligation Bonds Interest	General Obligation Bonds Total	Revenue Bonds Principal	Revenue Bonds Interest	Revenue Bonds Total
2008	$ 300,083	$ 313,458	$ 613,541	$ 111,655	$ 93,387	$ 205,042
2009	366,286	305,451	671,737	115,320	88,782	204,102
2010	303,525	287,263	590,788	120,280	83,828	204,108
2011	313,030	271,287	584,317	110,975	78,995	189,970
2012	275,770	257,405	533,175	117,470	74,276	191,746
2013 - 2017	1,101,250	1,118,632	2,219,882	534,625	297,946	832,571
2018 - 2022	741,015	924,548	1,665,563	491,755	178,522	670,277
2023 - 2027	829,155	737,917	1,567,072	451,380	52,688	504,068
2028 - 2032	1,070,440	518,111	1,588,551			0
2033 - 2037	1,390,785	225,804	1,616,589			0
2038 - 2042	75,000	14,346	89,346			0
2043 - 2047	45,000	7,587	52,587			0
	6,811,339 *	4,981,809	11,793,148	2,053,460 *	948,424	3,001,884
Accretion	(54,446)		(54,446)	(22,721)		(22,721)
Total	$ 6,756,893	$ 4,981,809	$ 11,738,702	$ 2,030,739	$ 948,424	$ 2,979,163

BUSINESS-TYPE ACTIVITIES

Year	General Obligation Bonds Principal	General Obligation Bonds Interest	General Obligation Bonds Total	Revenue Bonds Principal	Revenue Bonds Interest	Revenue Bonds Total
2008	$ 110,226	$ 137,320	$ 247,546	$ 565,407	$ 574,852	$ 1,140,259
2009	117,915	132,768	250,683	489,866	542,995	1,032,861
2010	151,538	126,792	278,330	549,832	518,549	1,068,381
2011	142,479	119,725	262,204	387,209	495,894	883,103
2012	113,027	113,654	226,681	401,059	477,200	878,259
2013 - 2017	614,593	482,927	1,097,520	2,334,632	2,063,679	4,398,311
2018 - 2022	586,385	326,263	912,648	2,295,052	1,504,126	3,799,178
2023 - 2027	406,250	192,963	599,213	1,830,314	1,052,012	2,882,326
2028 - 2032	382,580	88,581	471,161	1,701,983	735,882	2,437,865
2033 - 2037	139,355	17,600	156,955	1,669,370	440,202	2,109,572
2038 - 2042	17,090	2,652	19,742	1,161,247	206,032	1,367,279
2043 - 2047	945	45	990	118,498	13,293	131,791
	2,782,383 *	1,741,290	4,523,673	13,504,469 *	8,624,716	22,129,185
Accretion	(6,916)		(6,916)	(1,392,983)		(1,392,983)
Premium				249,706		249,706
Discount				(19,773)		(19,773)
Loss on Refunding				(37,061)		(37,061)
Total	$ 2,775,467	$ 1,741,290	$ 4,516,757	$ 12,304,358	$ 8,624,716	$ 20,929,074

COMPONENT UNITS

Year	Revenue Bonds Principal	Revenue Bonds Interest	Revenue Bonds Total
2008	$ 6,914	$ 12,672	$ 19,586
2009	8,610	18,126	26,736
2010	8,568	17,594	26,162
2011	3,574	17,069	20,643
2012	3,805	16,876	20,681
2013 - 2017	22,615	81,006	103,621
2018 - 2022	30,108	73,978	104,086
2023 - 2027	140,077	59,704	199,781
2028 - 2032	56,414	31,069	87,483
2033 - 2037	69,710	13,405	83,115
2038 - 2042	12,873	819	13,692
	363,268 *	342,318	705,586
Premium	13,054		13,054
Total	$ 376,322	$ 342,318	$ 718,640

* Increase/Decrease is due to accretion adjustment on deep discount bonds, premium, discount and/or loss on refunding.

Miscellaneous Bond Information

(Amounts in Thousands)

Description of Issue	Bonds Issued to Date	Range of Interest Rates		Maturities First Year	Maturities Last Year	First Call Date
GOVERNMENTAL ACTIVITIES						
General Obligation Bonds	$ 8,479,495	2.00	8.00	1992	2045	07/01/04
Revenue Bonds	3,066,428	2.50	9.00	1991	2026	02/01/01
Governmental Activities Bond Total	11,545,923					
BUSINESS-TYPE ACTIVITIES						
General Obligation Bonds	3,679,649	1.37	8.06	1995	2043	02/24/94
Revenue Bonds	18,212,012	1.20	15.00	1988	2047	02/01/88
Business-Type Activities Bond Total	21,891,661					
COMPONENT UNITS						
Revenue Bonds	485,341	3.50	7.10	1986	2040	10/08/86
Grand Total	$33,922,925					

The **Texas Department of Housing and Community Affairs** (Department) issues bonds to assist in financing the purchase of homes by, or the construction of rental housing for, families with low to moderate incomes. Loan payments provide the revenues for debt service payments. The Department has also issued taxable bonds for investment in collateralized mortgage obligations of federal agencies, to finance mortgage loans and carry out financial assistance programs.

The **Texas Water Development Board** issues bonds for the water pollution control revolving fund commonly referred to as the state revolving fund. The proceeds are used to provide financial assistance to political subdivisions for water quality enhancement purposes. Political subdivision bonds are pledged for debt service requirements of the bonds.

Permanent University Fund (Fund) Bonds are issued by the University of Texas and Texas A&M University systems to build, equip or buy buildings or other permanent improvements. The Texas Constitution limits each system's Fund debt to an amount not to exceed 20 percent and 10 percent, respectively, of the cost value of Fund assets, excluding real estate. Revenue from investments of the Fund is pledged to secure the payment of interest and principal. The cost value of Fund assets at Aug. 31, 2007, excluding real estate, was $10.3 billion. A comparison between the legal debt limits and the actual bonds outstanding at that date is shown below.

Permanent University Fund Bonds

(Amounts in Thousands)

	Legal Debt Limits	Actual Bonds Payable	Authorized But Unissued
University of Texas System	$2,055,595	$ 962,625	$1,092,970
Texas A&M University System	1,027,798	404,594	623,204
Total	$3,083,393	$1,367,219	$1,716,174

Miscellaneous College and University Revenue Bonds are issued to provide funds to acquire, construct, improve, enlarge and equip property, buildings, structures or facilities. The revenue bonds issued by each institution's governing board are secured by the income of the respective institutions and are an obligation of the state of Texas.

The **Texas Small Business Industrial Development Corporation** (TSBIDC), a nonprofit corporation, came under the management of the Office of the Governor effective Sept. 1, 2003, based on Senate Bill 275. The Office is now the oversight agency for the TSBIDC. TSBIDC's financial status is reported as a discretely presented component unit of the Office. The TSBIDC bond program is composed of revenue demand bonds secured by an amended irrevocable letter of credit (LOC) issued by Bank of America, N.A. (Bank of America) for $101.7

million. This instrument replaces the previous LOC issued by Kredietbank Bank. As of Aug. 31, 2007, no principal drawings have been made on the LOC. The Office does not have a take out agreement as part of this LOC or as a separate agreement. Bondholders may tender the bonds for repurchase every seven days. Any bonds so tendered will be purchased by proceeds of the remarketing of the bonds or, if not successfully marketed, from amounts drawn under the LOC.

The **Texas Water Resources Finance Authority**, a public authority created within the Texas Water Development Board, issued bonds to purchase from the Board the majority of existing political subdivision bonds held. The political subdivision bonds are pledged for debt service requirements of the bonds.

The **Texas Department of Transportation Turnpike Authority** issued bonds to pay a portion of the costs of planning, designing, engineering, developing and constructing the initial phase of the Central Texas Turnpike System located in the greater city of Austin metropolitan area in Travis and Williamson counties. The bond obligations are payable from and secured solely by a first lien on and pledge of the Trust Estate.

Demand Bonds

The Office of the Governor, the General Land Office, the Department of Transportation and the University of Texas System had outstanding demand bonds at Aug. 31, 2007. Details are presented in the tables below and on the following page.

A bond holder may tender any of these bonds for repurchase prior to maturity, usually every seven days. Any bonds so tendered will be purchased either by the proceeds of the remarketing of such bonds or, if not successfully remarketed, from amounts drawn under the letter of credit, liquidity agreement or standby purchase agreement of the respective agency until such time as the remarketing is finalized. As of Aug. 31, 2007, there have been no draws on the letters of credit or other agreements.

Early Extinguishment of Debt

Entities that had early debt extinguishments in fiscal 2007 are as follows.

The source of funds used for the extinguishments included loan repayments and other available funds.

Early Extinguished Debt Issues

(Amounts in Thousands)

GOVERNMENTAL ACTIVITIES	
General Obligation Bonds	
Texas Public Finance Authority	$ 15,265
Governmental Activities Total	15,265
BUSINESS-TYPE ACTIVITIES	
General Obligation Bonds	
General Land Office	$ 15,370
Revenue Bonds	
Texas Department of Housing and Community Affairs	138,907
Texas Water Development Board	12,952
University of Texas System	13,595
Business-Type Activities Total	180,824
Grand Total	$ 196,089

Demand Bond – Standby Purchase Agreements

Counterparties	Secured Bond Issue Agreements	Annual Liquidity Fee	Agreement Termination Date
Comptroller of Public Accounts	3	0.0400%	08/31/09
DEPFA Bank plc	1	0.0800%	04/08/12
DEPFA Bank plc	9	0.0750%	02/22/10
DEPFA Bank plc	5	0.0750%	05/10/09
Landesbank Hessen-Thuringen Girozentrale	4	0.1000%	12/31/15
Dexia Credit Local	9	0.0650%	11/15/11
State Street Bank and Trust Company	2	0.1000%	02/23/08
State Street Bank and Trust Company	1	0.1000%	08/08/08
State Street Bank and Trust Company	1	0.0500%	12/13/13
California Public Employees Retirement System	1	0.0500%	12/13/13
Banco Bilbao Vizcaya Argentaria, S.A.	1	0.0875%	11/07/16
Total	37		

Demand Bonds

(Amounts in Thousands)

	Number of Demand Bond Issues 8/31/07	Standby Purchase Agreement	Letter of Credit	Other	Bonds Redeemed	Principal Balance Outstanding 8/31/07
GOVERNMENTAL ACTIVITIES						
General Obligation Bonds						
Office of the Governor	2	0	0	2 B	None	$ 45,000
Texas Department of Transportation	2	2 A	0	0	None	244,075
	4	2	0	2	None	289,075
Revenue Bonds						
Texas Department of Transportation	1	1 A	0	0	None	100,000
	1	1	0	0	None	100,000
Governmental Activities Total	5	3	0	2	None	$ 389,075
BUSINESS-TYPE ACTIVITIES						
General Obligation Bonds						
General Land Office	27	27 A	0	0	None	$1,061,965
General Land Office/Veterans Land Board	6	6 A	0	0	None	167,150
	33	33	0	0	None	1,229,115
Revenue Bonds						
University of Texas System	1	0	0	1 B	None	23,765
	1	0	0	1	None	23,765
Business-Type Activities Bond Total	34	33	0	1	None	$1,252,880
COMPONENT UNITS						
Revenue Bonds						
Office of the Governor	1	0	1 C	0	None	$ 99,335
Component Units Total	1	0	1	0	None	$ 99,335

A - See Demand Bonds - Standby Purchase Agreements table.
B - In the event redeemed bonds are not remarketed, internal funds of the agency are available for redemption.
C - In the event that redeemed bonds are not remarketed, a letter of credit with Bank of America will be used until remarketed.

Refunding

During fiscal 2007 six entities refunded bonds to lower interest rates or to restructure debt service requirements for cash management purposes.

Refunding Issues

(Amounts in Thousands)

	Types of Refunding	Par Value of Refunding Issue	Par Value Refunded	Cash Flow Difference Increase	Economic Gain
GOVERNMENTAL ACTIVITIES					
General Obligation Bonds					
Texas Higher Education Coordination Board	Current Refunding	$ 26,820	$ 26,820	$ 663	$ 666
Texas Water Development Board	Current Refunding	19,680	20,000	2,382	1,275
Governmental Activities Total		46,500	46,820	3,045	1,941
BUSINESS-TYPE ACTIVITIES					
General Obligation Bonds					
General Land Office and Veterans Land Board	Current Refunding	80,610	80,610	6,831	2,874
Revenue Bonds					
Texas Water Development Board	Current Refunding	520,860	768,065	150,525	30,635
Texas Department of Housing and Community Affairs	Advance Refunding	36,600	44,880	19,913	10,032
Midwestern State University	Advance Refunding	5,695	5,525	207	176
University of Texas System	Advance Refunding	806,020	829,005	63,501	37,635
		1,369,175	1,647,475	234,146	78,478
Business-Type Activities Total		1,449,785	1,728,085	240,977	81,352
Grand Total		$1,496,285	$1,774,905	$ 244,022	$ 83,293

Defeased Bonds Outstanding

Texas has defeased various bond issues by placing funds in irrevocable trusts in the Texas Treasury Safekeeping Trust Company and external financial institutions to provide for all future debt service payments on the old bonds. Funds placed in the Texas Treasury Safekeeping Trust Company to defease $224.5 million in bonds are included in the state's financial statements in an agency fund. The trust account assets and the liability for all other defeased bonds are not included in the state's financial statements. As of Aug. 31, 2007, the following amounts of defeased bonds, at par, remained outstanding.

Defeased Bonds Outstanding

(Amounts in Thousands)

GOVERNMENTAL ACTIVITES	
General Obligation Bonds	
Texas Water Development Board	$ 69,690
Texas National Research Laboratory Commission	44,075
Texas Public Finance Authority	27,027
Texas Parks and Wildlife Department	8,250
Revenue Bonds	
Texas Public Finance Authority	202,210
Texas Parks and Wildlife Department	31,245
	382,497
BUSINESS-TYPE ACTIVITIES	
General Obligation Bonds	
General Land Office and Veterans Land Board	64,700
Texas Water Development Board	24,955
Revenue Bonds	
University of Texas System	1,482,379
Texas A&M University System	187,426
Texas Tech University System	168,455
Texas State University System	79,983
Department of Housing and Community Affairs	61,225
University of Houston System	44,430
University of North Texas System	25,255
Texas Water Development Board	17,425
Midwestern State University	5,525
Stephen F. Austin State University	3,021
Texas Southern University	245
	2,165,024
Total	$2,547,521

Conduit Debt

The Texas State Affordable Housing Corporation (Corporation) is authorized to issue statewide 501 (c) (3) tax-exempt multifamily mortgage revenue bonds under the Texas Government Code §2306.555. The 501 (c) (3) tax-exempt multifamily mortgage revenue bond program provides long-term variable or fixed rate financing to nonprofit borrower/developers of new or existing multifamily rental properties in order to generate and/or preserve affordable rental housing. The Corporation may finance single developments or pools of properties located throughout the state of Texas. Borrowers must agree to set aside a prescribed percentage of a property's units for rent to persons and families of low income. The Corporation finances properties under the program primarily through the sale of tax-exempt multifamily housing revenue bonds.

The bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Neither the Corporation, the state nor any political subdivision thereof is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying statements.

As of Aug. 31, 2007, there were 22 series of multifamily housing revenue bonds outstanding with an aggregate $375 million principal amount payable.

Pay-Fixed
Receive-Variable Interest Rate Swaps

(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Fixed-Rate Paid	Variable-Rate Received	Knock-out Barrier
GENERAL LAND OFFICE – VETERANS LAND BOARD					
Vet Hsg Ref Bds Ser '95	$ 61,275	11/29/1995	5.5200%	Actual Bond Rate	N/A
Vet Land Ref Bds Ser '99A	30,470	06/01/1999	5.1120%	68% of 6M LIBOR**	N/A
Vet Land Tax Ref Bds Ser '99B	20,245	12/01/1999	5.1250%	100% of 6M LIBOR	1M LIBOR >= 6.50%
Vet Land Tax Ref Bds Ser 2000	39,960	12/01/2000	6.1060%	100% of 6M LIBOR	1M LIBOR >= 7.00%
Vet Hsg Fund II Bds Ser 2001A-2	20,000	03/22/2001	4.3000%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2001C-2	25,000	12/18/2001	4.3650%	68% of 1M LIBOR	N/A
Vet Land Bds Ser 2002	18,610	02/21/2002	4.1400%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2002A-2	28,760	07/10/2002	3.8725%	68% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2002	27,685	12/01/2002	4.9350%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund I Tax Ref Bds Ser 2002B	19,780	12/01/2002	4.9100%	100% of 6M LIBOR	6M LIBOR > 7.00%
Vet Hsg Fund II Bds Ser 2003A	43,010	03/04/2003	3.3040%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2003B	44,215	10/22/2003	3.4030%	64.5% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2003	26,465	12/01/2003	5.1230%	100% of 1M LIBOR	1M LIBOR >= 7.00%
Vet Hsg Fund I Tax Ref Bds Ser 2003	47,865	12/01/2003	5.1900%	100% of 6M LIBOR	6M LIBOR > 7.00%
Vet Hsg Fund II Bds Ser 2004A	44,820	04/07/2004	3.3130%	68% of 1M LIBOR	N/A
Vet Hsg Fund I Tax Ref Bds Ser 2004	16,535	06/01/2004	5.4500%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Bds Ser 2004B	47,315	09/15/2004	3.6800%	68% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2004	23,710	12/01/2004	5.4550%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2004C,D,E	38,385	12/01/2004	5.3480%	100% of 1M LIBOR	1M LIBOR >= 7.00%
Vet Hsg Fund II Bds Ser 2005A	47,030	02/24/2005	3.2790%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2005B	47,695	08/09/2005	3.0870%	68% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2005	22,210	12/01/2005	6.5170%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund I/II Tax Ref Bds Ser 2005C/D	24,400	12/01/2005	5.1450%	100% of 1M LIBOR	1M LIBOR >= 7.00%; 6M LIBOR > 4.00% and SIFMA***/LIBOR Ratio > 74%
Vet Hsg Fund I Tax Ref Bds Ser 2005C	18,970	12/01/2005	4.9290%	100% of 1M LIBOR	1M LIBOR >= 7.00%; 6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%
Vet Hsg Fund I Tax Ref Bds Ser 2005C	4,980	12/01/2005	4.3300%	100% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2006A	48,705	06/01/2006	3.5170%	68% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2006A	30,380	06/01/2006	6.5400%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2006C	21,865	06/01/2006	5.7900%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2006B	38,570	06/01/2006	5.8300%	100% of 1M LIBOR	1M LIBOR >= 7.00%
Vet Land Tax Ref Bds Ser 2006B	23,520	06/01/2006	4.6100%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Bds Ser 2006D	49,630	09/20/2006	3.6890%	68% of 1M LIBOR	N/A
Vet Land Tax Ref Bds Ser 2006C	40,325	12/01/2006	6.5130%	100% of 1M LIBOR	1M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2006E	39,560	12/01/2006	5.4610%	100% of 1M LIBOR	1M LIBOR >= 7.00%; 6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%
Vet Hsg Fund II Tax Ref Bds Ser 2007	54,160	12/01/2007	4.6580%	100% of 1M LIBOR	1M LIBOR >= 7.00%; SIFMA/5Y ISDA CMS >71%
Vet Hsg Fund II Bds Ser 2007A	50,000	02/22/2007	3.6450%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Bds Ser 2007B	50,000	06/26/2007	3.7120%	68% of 1M LIBOR	N/A
Vet Hsg Fund II Tax Ref Bds Ser 2009	16,950	12/01/2009	6.2200%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2009A	65,845	12/01/2009	5.4525%	100% of 6M LIBOR	6M LIBOR >= 7.00%
Vet Hsg Fund II Tax Ref Bds Ser 2010A	66,720	06/01/2010	5.4010%	100% of 1M LIBOR	1M LIBOR >= 7.00%; 6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%
Vet Land Tax Ref Bds Ser 2010	16,480	12/01/2010	5.2090%	100% of 1M LIBOR	1M LIBOR >= 7.00%; 6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%
Vet Homes Rev Ref Bds, Ser 2012	21,795	08/01/2012	3.7600%	68% of 1M LIBOR	1M LIBOR >= 7.00%
Subtotal General Land Office – Veterans Land Board	1,423,895				

Continued on the following page

Pay-Fixed
Receive-Variable Interest Rate Swaps (continued)

(Amounts in Thousands)

Associated Bond Issue	Knock-out Type	Knock-out Period	Up-Front Knock-out Premium Received	Fair Value	Swap Termination Date	Counterparty Credit Ratings *
GENERAL LAND OFFICE – VETERANS LAND BOARD						
Vet Hsg Ref Bds Ser '95	N/A	N/A	N/A	$ (6,589)	12/01/2016	AAA/Aaa
Vet Land Ref Bds Ser '99A	N/A	N/A	N/A	(2,748)	12/01/2018	AAA/Aaa
Vet Land Tax Ref Bds Ser '99B	Optional	Permanent	740	(159)	12/01/2009	AAA/Aaa
Vet Land Tax Ref Bds Ser 2000	Optional	Permanent	2,700	(3,597)	12/01/2020	AAA/Aaa
Vet Hsg Fund II Bds Ser 2001A-2	N/A	N/A	N/A	(1,458)	12/01/2029	AA-/Aa1
Vet Hsg Fund II Bds Ser 2001C-2	N/A	N/A	N/A	(2,429)	12/01/2033	AAA/Aaa
Vet Land Bds Ser 2002	N/A	N/A	N/A	(1,069)	12/01/2032	AA-/Aa3
Vet Hsg Fund II Bds Ser 2002A-2	N/A	N/A	N/A	(825)	06/01/2033	AAA/Aaa
Vet Land Tax Ref Bds Ser 2002	Mandatory	Periodic	2,785	(453)	12/01/2021	AA-/Aa3
Vet Hsg Fund I Tax Ref Bds Ser 2002B	Mandatory	Periodic	2,165	(335)	06/01/2023	AAA/Aaa
Vet Hsg Fund II Bds Ser 2003A	N/A	N/A	N/A	775	06/01/2034	AA-/Aa3
Vet Hsg Fund II Bds Ser 2003B	N/A	N/A	N/A	43	06/01/2034	AAA/Aaa
Vet Land Tax Ref Bds Ser 2003	Mandatory	Periodic	1,896	(824)	12/01/2023	AA-/Aa3
Vet Hsg Fund I Tax Ref Bds Ser 2003	Mandatory	Periodic	4,470	(1,583)	06/01/2021	AAA/Aaa
Vet Hsg Fund II Bds Ser 2004A	N/A	N/A	N/A	787	12/01/2034	AAA/Aaa
Vet Hsg Fund I Tax Ref Bds Ser 2004	Mandatory	Periodic	1,442	(1,024)	12/01/2024	AAA/Aaa
Vet Hsg Fund II Bds Ser 2004B	N/A	N/A	N/A	(553)	12/01/2034	AAA/Aaa
Vet Land Tax Ref Bds Ser 2004	Mandatory	Periodic	2,075	(1,438)	12/01/2024	AA-/Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2004C,D,E	Mandatory	Periodic	2,594	(1,716)	06/01/2020	AA-/Aa3
Vet Hsg Fund II Bds Ser 2005A	N/A	N/A	N/A	1,005	06/01/2035	AAA/Aaa
Vet Hsg Fund II Bds Ser 2005B	N/A	N/A	N/A	1,769	06/01/2036	AAA/Aaa
Vet Land Tax Ref Bds Ser 2005	Mandatory	Periodic	1,542	(3,064)	12/01/2026	AAA/Aaa
Vet Hsg Fund I/II Tax Ref Bds Ser 2005C/D	Mandatory	Periodic	1,367	(1,661)	06/01/2026	AA-/Aa3
			566			
Vet Hsg Fund I Tax Ref Bds Ser 2005C	Mandatory	Periodic	484	(673)	12/01/2023	AA-/Aa3
			267			
Vet Hsg Fund I Tax Ref Bds Ser 2005C	N/A	N/A	N/A	50	12/01/2009	AA-/Aa3
Vet Hsg Fund II Bds Ser 2006A	N/A	N/A	N/A	350	12/01/2036	AAA/Aaa
Vet Land Tax Ref Bds Ser 2006A	Mandatory	Periodic	1,931	(4,234)	12/01/2027	AAA/Aaa
Vet Hsg Fund II Tax Ref Bds Ser 2006C	Mandatory	Periodic	1,493	(1,803)	12/01/2027	AAA/Aaa
Vet Hsg Fund II Tax Ref Bds Ser 2006B	Mandatory	Periodic	1,992	(3,984)	12/01/2026	AA-/Aa3
Vet Land Tax Ref Bds Ser 2006B	Mandatory	Periodic	886	72	12/01/2026	AAA/Aaa
Vet Hsg Fund II Bds Ser 2006D	N/A	N/A	N/A	(405)	12/01/2036	AA+/Aa2
Vet Land Tax Ref Bds Ser 2006C	Mandatory	Periodic	2,725	(5,635)	12/01/2027	AA-/Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2006E	Mandatory	Periodic	2,652	(4,057)	12/01/2026	AA-/Aa3
			1,018			
Vet Hsg Fund II Tax Ref Bds Ser 2007	Mandatory	Periodic	935	(1,831)	06/01/2029	AA-/Aa3
			1,020			
Vet Hsg Fund II Bds Ser 2007A	N/A	N/A	N/A	(453)	06/01/2037	AAA/Aaa
Vet Hsg Fund II Bds Ser 2007B	N/A	N/A	N/A	(742)	06/01/2038	AAA/Aaa
Vet Hsg Fund II Tax Ref Bds Ser 2009	Mandatory	Periodic	612	(1,167)	12/01/2021	AAA/Aaa
Vet Hsg Fund II Tax Ref Bds Ser 2009A	Mandatory	Periodic	2,740	(3,675)	06/01/2031	AAA/Aaa
Vet Hsg Fund II Tax Ref Bds Ser 2010A	Mandatory	Periodic	2,355	(6,183)	12/01/2031	AA-/Aa3
			1,427			
Vet Land Tax Ref Bds Ser 2010	Mandatory	Periodic	466	(1,181)	12/01/2030	AA-/Aa3
			208			
Vet Homes Rev Ref Bds, Ser 2012	Mandatory	Periodic	579	(959)	08/01/2035	AAA/Aaa
Subtotal General Land Office – Veterans Land Board			48,132	(63,656)		

Continued on the following page

Pay-Fixed
Receive-Variable Interest Rate Swaps (continued)
(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Fixed-Rate Paid	Variable-Rate Received	Knock-out Barrier
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS					
2004B Single Family	53,000	09/01/2004	3.8430%	63% of LIBOR + .30%	N/A
2004D Single Family	35,000	01/01/2005	3.6125%	Lesser of (the greater of 65% of LIBOR and 56% of LIBOR + .45%) and LIBOR	N/A
2005A Single Family	98,145	08/01/2005	3.9900%	Lesser of (the greater of 65% of LIBOR and 56% of LIBOR + .45%) and LIBOR	N/A
2006H Single Family	36,000	11/15/2006	3.8570%	63% of LIBOR + .30%	N/A
2007A Single Family	143,005	06/05/2007	4.0130%	Lesser of (the greater of 65% of LIBOR and 56% of LIBOR + .45%) and LIBOR	N/A
Subtotal Tx. Dept. of Housing and Comm Affairs	365,150				
UNIVERSITY OF TEXAS SYSTEM					
Rev Fin Sys Ref Bds Ser 2001A	23,445	08/15/2001	4.6330%	67% of 1M LIBOR	N/A
Rev Fin Sys Ref Bds Ser 2008	310,000	02/15/2008	3.8400%		
Subtotal University of Texas System	333,445				
Total	$2,122,490				

* Standard and Poor's, Moody's Investor Service and Fitch Ratings, LTD.
** London Interbank Offered Rate (LIBOR).
*** Securities Industry and Financial Markets Association Index (SIMFA) rate.

Concluded on the following page

DERIVATIVES

During fiscal 2007 the Veterans Land Board (VLB), the Texas Department of Housing and Community Affairs (the Department), the Texas Department of Transportation and the University of Texas System (UT) have reported derivatives.

Pay-Fixed, Receive-Variable Interest Rate Swaps (Veterans Land Board)

Objective of the Swaps: The Veterans Land Board is currently a party to 41 pay-fixed, receive-variable interest rate swaps that are associated with 45 variable-rate bond issues. The combination of swaps and variable-rate bonds creates synthetic fixed-rate debt. The use of synthetic fixed-rate debt has historically lowered the VLB's borrowing costs, as compared to the borrowing costs associated with the issuance of traditional fixed-rate bonds. Several of the swaps contain embedded barrier options that provide for the VLB to be "knocked out" of the swaps by the respective counterparties upon the breach of a certain predetermined barrier. In each of these cases, the VLB was paid an up-front option premium by the respective counterparties. With regard to the swaps associated with the Vet Land Tax Ref

Pay-Fixed
Receive-Variable Interest Rate Swaps (concluded)

(Amounts in Thousands)

Associated Bond Issue	Knock-out Type	Knock-out Period	Up-Front Knock-out Premium Received	Fair Value	Swap Termination Date	Counterparty Credit Ratings *
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS						
2004B Single Family	N/A	N/A	N/A	(379)	09/01/2034	AA/A3/AA+
2004D Single Family	N/A	N/A	N/A	(96)	03/01/2035	NR/Aa3/AA-
2005A Single Family	N/A	N/A	N/A	(1,580)	09/01/2036	AAA/NR/NR
2006H Single Family	N/A	N/A	N/A	(554)	09/01/2025	AA/A3/AA+
2007A Single Family	N/A	N/A	N/A	(3,224)	09/01/2038	AAA/NR/NR
Subtotal Tx. Dept. of Housing and Comm Affairs			0	(5,833)		
UNIVERSITY OF TEXAS SYSTEM						
Rev Fin Sys Ref Bds Ser 2001A	N/A	N/A	N/A	(970)	08/15/2013	AA/Aaa
Rev Fin Sys Ref Bds Ser 2008	N/A	N/A	N/A	6,760	08/15/2036	50% AA/Aaa 50% A+/Aa3
Subtotal University of Texas System			0	5,790		
Total			$48,132	$(63,699)		

Bds Ser '99B and the Vet Land Tax Ref Bds Ser 2000, the knock-outs are permanent and are optional at the discretion of the counterparty. In the remainder of the swaps with embedded barrier options, the knock-out is mandatory and is periodic in nature, with the knock-out period corresponding only to the period during which the barrier was breached.

Terms, Fair Values and Credit Ratings: The terms, fair values and counterparty credit ratings related to the outstanding variable-to-fixed swaps as of Aug. 31, 2007, are shown in the tables on the previous pages. The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds.

Pay-Variable, Receive-Fixed Interest Rate Swaps (Veterans Land Board)

Objective of the Swaps: The VLB is currently a party to one pay-variable, receive-fixed interest rate swap that is associated with a taxable variable-rate bond issue. The swap was overlaid on an existing pay-fixed, receive-variable swap and effectively results in unhedged variable-rate bonds with an expected borrowing cost significantly below market over the life of the swap.

Terms, Fair Values and Credit Ratings: The terms, fair values and counterparty credit ratings related to the outstanding fixed-to-variable basis swaps as of Aug. 31, 2007, are shown in the table below. The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds.

Pay-Variable Receive-Fixed Interest Rate Swaps

(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Variable-Rate Paid	Fixed-Rate Received	Knock-out Barrier
GENERAL LAND OFFICE – VETERANS LAND BOARD					
Vet Land Tax Ref Bds Ser 2006B	$23,520	06/01/2006	100% of 6M LIBOR	4.6100%	6M LIBOR >= 8.00%
Total	$23,520				

Associated Bond Issue	Knock-out Type	Knock-out Period	Up-Front Knock-out Premium Received	Fair Value	Swap Termination Date	Counterparty Credit Ratings
GENERAL LAND OFFICE – VETERANS LAND BOARD						
Vet Land Tax Ref Bds Ser 2006B	Mandatory	Periodic	674	$(563)	12/01/2026	AAA/Aaa
Total			$674	$(563)		

Pay-Variable, Receive-Variable Interest Rate Swaps (Veterans Land Board)

Objective of the Swaps: The VLB is currently a party to six pay-variable, receive-variable interest rate swaps that are associated with three taxable variable-rate bond issues, four taxable fixed-rate bond issues and 14 synthetic taxable fixed-rate bond issues. Four of these swaps are London Interbank Offered Rate (LIBOR) - to - Securities Industry Financial Markets Association rate (SIFMA) basis swaps and effectively convert the variable rate on the associated variable-rate bond issues from a LIBOR (taxable) based rate to a SIFMA (tax-exempt) based rate. The two remaining swaps are a LIBOR Constant Maturity Swap (CMS) basis swap and a SIFMA CMS basis swap, respectively. Both are expected to increase the cash flow on the associated taxable fixed and synthetic fixed-rate bonds due to projected changes in the relationship between short and long-term interest rates. The swaps are expected to generate an effective lower borrowing cost to the VLB over the life of the swaps.

Terms, Fair Values and Credit Ratings: The terms, fair values and counterparty credit ratings related to the outstanding variable-to-variable basis swaps as of Aug. 31, 2007, are shown in the table below. The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds.

Fair Value Methodology and Risk Exposure of Swap Transactions (Veterans Land Board)

Fair Value: The fair values of the swaps were estimated using the zero-coupon method. Using observable market information for Treasury bonds and LIBOR spreads, a smoothed LIBOR swap yield curve is constructed. From this swap yield curve, the path of future expected floating LIBOR interest rates is determined for a specific swap

Pay-Variable Receive-Variable Interest Rate Swaps

(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Variable-Rate Paid	Variable-Rate Received	Fair Value	Swap Termination Date	Counter-party Credit Ratings *
GENERAL LAND OFFICE – VETERANS LAND BOARD							
Vet Hsg Fund II Tax Bds Ser '97B-2	$ 25,000	09/27/2002	132.60% of SIFMA	100% of 3M LIBOR	$ 316	12/01/2010	AA-/Aa3
Vet Hsg Fund II Tax Bds Ser '99A-2	90,000	08/05/2002	134.40% of SIFMA	100% of 1M LIBOR	975	09/01/2011	AAA/Aaa
Vet Hsg Fund II Tax Bds Ser '99A-2	60,000	08/05/2002	134.40% of SIFMA	100% of 1M LIBOR	644	09/01/2011	AAA/Aaa
Vet Land Tax Bds Ser 2000A/2002A	37,240	08/05/2002	131.25% of SIFMA	100% of 1M LIBOR	322	12/01/2032	AA-/Aa3
Various Vet Land & Hsg Fd I/II Tax Bds	217,860	05/10/2006	3M LIBOR	10Y ISDA CMS - 42.5 bp	1,436	06/01/2014	AAA/Aaa
Various Vet Land & Hsg Fd I/II Tax Bds	249,465	09/01/2007	100% of SIFMA	10Y SIMFA CMS - 54 bp	(959)	12/01/2027	AAA/Aaa
Subtotal General Land Office – Veterans Land Board	679,565				2,734		
TEXAS DEPARTMENT OF TRANSPORTATION							
Mobility Fund GO Bds Ser 2006A	400,000	09/01/2007	100% of SIFMA	69.42% 10Y USD-ISDA	1,663	09/01/2027	50% AA/Aaa/AA- 25% AAA/Aa3/AA- 25% AA-/Aa3/AA-
Subtotal Texas Department of Transportation	400,000				1,663		
Total	$1,079,565				$4,397		

* Standard and Poor's, Moody's Investor Service and Fitch Ratings, LTD.

transaction. The path of the floating payments is then averaged together to produce a single fixed swap rate for the same time horizon as the swap being valued. The difference between this calculated fixed swap rate and the actual fixed swap rate on the transaction is then multiplied by the applicable outstanding notional amount at each future payment date to generate a series of payments. These payments are then discounted back to the valuation date using hypothetical zero-coupon bond rates derived from the LIBOR swap yield curve. The sum of these discounted payments produces the fair value of the swap.

For swaps with embedded options, an additional calculation similar to that described above is conducted to determine the value of the options. Using the approach described above, a swap rate is derived for each potential exercise date of each option. Market-derived data for interest rate volatility is then used to determine a probabilistic range of potential swap rates. For each potential swap rate, a value is determined for the option. These values are then weighted by their probabilities and discounted back to the valuation date using hypothetical zero-coupon bond rates as described above. The sum of the present value of the values for each exercise date produces the fair value of the option.

Credit Risk: The VLB mitigates the credit risk associated with its swaps by entering into transactions with highly-rated counterparties. As shown in the tables on the previous page, the credit ratings of the VLB's counterparties range from AAA to AA- by Standard & Poor's (S&P) and Aaa to Aa3 by Moody's Investors Service (Moody's).

The VLB also mitigates its concentration of credit risk by diversifying its swap portfolio across several different counterparties. The VLB's 52 currently outstanding swaps are spread among nine different counterparties with no more than 30 percent of the total notional amount of swaps outstanding being associated with any single counterparty.

The VLB's swap agreements also contain collateralization provisions that require counterparties to post collateral in the full amount of the fair value of the swap if the counterparty's credit rating is at or below A+ by S&P or A1 by Moody's. Only U.S. Government obligations are acceptable forms of collateral. Posted collateral may be held either by the VLB itself or by a third party custodian that is rated at least BBB+ by S&P or Baa1 by Moody's.

Basis Risk: The VLB is exposed to basis risk to the extent that the interest payments on its variable-rate bonds do not match the variable-rate payments received on the associated swaps. The VLB mitigates this risk by (a) matching the notional amount and amortization schedule of each swap to the principal amount and amortization schedule of each associated variable-rate bond issue and (b) selecting an index for the variable-rate leg of each swap that is reasonably expected to closely match the interest rate resets on the associated variable-rate bonds over the life of each bond issue.

Termination Risk: The VLB or the counterparties may terminate any of the swaps if the other party fails to perform under the terms of the respective swap agreements. The VLB also has the right to terminate any of the swaps at any time without cause. In addition, the swaps associated with the Vet Land Tax Ref Bds Ser '99B and the Vet Land Tax Ref Bds Ser 2000 provide the counterparty with the option to terminate the swap under certain conditions. If any of the swaps are terminated, the associated variable-rate bonds would no longer have a synthetic fixed rate and the VLB would be subject to interest rate risk to the extent that the variable-rate bonds were not hedged with another swap or with variable-rate assets on the VLB's balance sheet. If, at

Interest Rate Swaps Subject to Rollover

Associated Bond Issue	Maturity Date of Bonds	Option Exercise Date	Swap Termination Date
GENERAL LAND OFFICE			
Vet Land Tax Ref Bds Ser '99B	12/01/09	04/29/02	12/01/09
Vet Land Tax Ref Bds Ser 2000	12/01/20	04/29/02	12/01/20
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS			
2004 Single Family Series B	09/01/34	03/01/14	09/01/34
2004 Single Family Series D	03/01/35	09/01/14	03/01/35
2005 Single Family Series A	09/01/36	Anytime with 10 day notice	09/01/36
2006 Single Family Series H	09/01/37	03/01/16	09/01/25
2007 Single Family Series A	09/01/38	Anytime with 10 day notice	09/01/38
TEXAS DEPARTMENT OF TRANSPORTATION			
Mobility Fund GO Bds Ser 2006A	04/01/35	N/A	09/01/27

the time of termination for a reason other than the exercise of a termination option held by a counterparty, a swap has a negative fair value, the VLB would owe the respective counterparty a termination payment equal to the swap's fair value.

Rollover Risk: The swaps associated with the Vet Land Tax Ref Bds Ser '99B and the Vet Land Tax Ref Bds Ser 2000 provide the counterparty with the option to terminate the swap under certain conditions at any time. If either of these swaps is terminated through the counterparty's exercise of its option, the associated variable-rate bonds would no longer have a synthetic fixed rate and the VLB would be subject to interest rate risk to the extent that the variable-rate bonds were not hedged with another swap or with variable-rate assets on the VLB's balance sheet.

Bonds that are exposed to such rollover risk are shown in the table on the previous page.

Swap Payments and Associated Debt: Using rates as of Aug. 31, 2007, the estimated debt service requirements of the VLB's variable-rate bonds and associated net swap payments, assuming current interest rates and swap index relationships remain the same for their terms, are shown in the tables below: "Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments" and "Pay-Variable, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments." As rates and index relationships vary in the future, so will the resulting actual interest payments and net swap payments.

Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments

(Amounts in Thousands)

Year	Variable-Rate Bonds Principal	Variable-Rate Bonds Interest	Interest Rate Swaps, Net	Total
2008	$ 44,565	$ 68,642	$ 1,655	$ 114,862
2009	52,475	67,966	1,812	122,253
2010	56,695	65,588	1,758	124,041
2011	48,170	63,205	1,665	113,040
2012	48,425	61,126	1,539	111,090
2013 - 2017	324,250	267,483	5,616	597,349
2018 - 2022	367,725	181,135	3,387	552,247
2023 - 2027	296,610	101,283	2,827	400,720
2028 - 2032	195,155	47,655	1,377	244,187
2033 - 2037	135,760	13,028	693	149,481
2038 - 2042	8,205	231	25	8,461
Total	$1,578,035	$937,342	$22,354	$2,537,731

Pay-Variable, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments

(Amounts in Thousands)

Year	Variable-Rate Bonds Principal	Variable-Rate Bonds Interest	Interest Rate Swaps, Net	Total
2008	$ 660	$ 11,867	$ 400	$ 12,927
2009	700	11,830	404	12,934
2010	745	11,790	408	12,943
2011	790	11,748	453	12,991
2012	845	11,704	797	13,346
2013 - 2017	5,055	57,748	1,617	64,420
2018 - 2022	9,230	56,107	(675)	64,662
2023 - 2027	23,250	51,655	(461)	74,444
2028 - 2032	169,595	23,702	(176)	193,121
2033 - 2037	1,370	37	(4)	1,403
Total	$212,240	$248,188	$2,763	$463,191

Pay-Variable, Receive-Variable Interest Rate Swaps (Texas Department of Transportation)

Objective of the Swaps: The Texas Department of Transportation's Texas Transportation Commission (Commission) is currently a party to three pay-variable, receive-variable Constant Maturity Swaps (CMS) associated with the Commission's State of Texas General Obligation Mobility Fund Series 2006A fixed rate bonds. These swaps exchange SIFMA rates for LIBOR rates. The swaps are expected to generate an effective lower borrowing cost to the Commission over the life of the swaps through the assumption of yield curve risk (the difference between short-term and long-term rates) and tax risk (the spread between tax-exempt rates and taxable rates).

Terms, Fair Values and Credit Ratings: The terms, fair values and counterparty credit ratings related to the outstanding variable-to-variable basis swaps as of Aug. 31, 2007, are shown in the table below. The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds.

Pay-Variable, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Fixed-Rate Debt Outstanding and Net Swap Payments

(Amounts in Thousands)

	Fixed-Rate Bonds		Interest Rate	
Year	Principal	Interest	Swaps, Net	Total
2008	$	$ 49,795	$ (4,682)	$ 45,113
2009	375	49,795	(5,108)	45,062
2010	1,325	49,795	(5,108)	46,012
2011	2,275	49,726	(5,108)	46,893
2012	3,215	49,635	(5,108)	47,742
2013 - 2017	31,195	245,489	(25,540)	251,144
2018 - 2022	102,985	232,640	(25,540)	310,085
2023 - 2027	223,925	195,722	(25,540)	394,107
2028 - 2032	381,200	127,826	(426)	508,600
2033 - 2037	293,585	26,330		319,915
Total	$1,040,080	$1,076,753	$(102,160)	$2,014,673

Risk Exposure of Swap Transactions (Texas Department of Transportation)

Credit Risk: The Commission mitigates the credit risk associated with its swaps by entering into transactions with highly-rated counterparties. As shown in the table on page 93, the credit ratings of the Commission's counterparties range from AAA to AA- by S&P and Aaa to Aa3 by Moody's.

The Commission also mitigates its concentration of credit risk by diversifying its swap portfolio across several different counterparties. The Commission's three currently outstanding swaps are spread among three different counterparties, with no more than 50 percent of the total notional amount of swaps outstanding being associated with any single counterparty.

The Commission's swap agreements also contain collateralization provisions that require counterparties to post collateral in the full amount of the fair value of the swap if the counterparty's credit rating is downgraded. Only cash in the form of U.S. Dollars or U.S. Government obligations are acceptable forms of collateral. Posted collateral may be held either by the Commission or its designated third party custodian.

Basis Risk: The Commission is exposed to basis risk to the extent that the interest payments on its variable-rate bonds do not match the variable-rate payments received on the associated swaps. The Commission mitigates this risk by (a) matching the notional amount and amortization schedule of each swap to the principal amount and amortization schedule of each associated variable-rate bond issue, (b) selecting an index for the variable-rate leg of each swap that is reasonably expected to closely match the interest rate resets on the associated variable-rate bonds over the life of each bond issue and (c) limiting the portion of the total portfolio that can be exposed to this risk at a given time.

Termination Risk: The Commission or the counterparties may terminate any of the swaps if the other party fails to perform under the terms of the respective swap agreements. The Commission also has the right to terminate any of the swaps at any time without cause. The Commission mitigates termination risk by maintaining a strong financial standing and by maintaining sufficient reserves to cover all or part of a termination payment that might materialize.

Rollover Risk: The swaps terminate on Sept. 1, 2027. Final maturity of the associated debt is April 1, 2035. The Commission accepted the rollover risk for the period beyond Sept. 1, 2027, because extending the term of the swap agreements to match the final maturity of the associated debt provided only marginal projected benefit.

Swap Payments and Associated Debt: Using rates as of Aug. 31, 2007, the estimated debt service requirements of the Commission's fixed-rate bonds and associated net swap payments, assuming current interest rates and swap index relationships remain the same for their terms, are included in the table above: "Pay-Variable, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Fixed-Rate Debt Outstanding and Net Swap Payments." As rates and index relationships vary in the future, so will the resulting actual interest payments and net swap payments.

Market-Access Risk: Market-access risk is the risk that an entity will not be able to enter credit markets or that credit will become more costly. This swap does not present market-access risk because the transaction does not require access to the credit market.

Pay-Fixed, Receive-Variable Interest Rate Swaps (Texas Department of Housing and Community Affairs)

Objective of the Swaps: The Department is a party to five pay-fixed, receive-variable interest rate swap agreements with three rated counterparties, UBS AG, Goldman Sachs Capital Markets, L.P. (Goldman) and Bear Stearns Financial Products, Inc. The objective of the swaps is to reduce interest rate risk of certain variable rate demand bonds. Under the terms of the agreements, the Department makes periodic fixed interest rate payments in exchange for receiving variable rate payments comparable to the rates payable on the variable rate demand bonds. The swap notional amounts amortize in accordance with the scheduled and/or anticipated reductions in the related variable rate demand bond liability. The Department is potentially exposed to loss in the event of nonperformance by the counterparties under the swap agreements. Termination of the swap agreements may result in the Department making or receiving termination payments. Each swap agreement includes optional early termination provisions granting the Department the right, but not an obligation, to terminate the interest rate swaps at par without a termination payment after an effective date.

Terms, Fair Values and Credit Ratings: The terms, fair values and counterparty credit ratings related to the outstanding variable-to-fixed swaps as of Aug. 31, 2007, are shown in the table titled “Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments.” The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds.

Credit Risk: As of Aug. 31, 2007, the Department is not exposed to credit risk on any of its outstanding swaps. The Department has entered into these transactions with highly-rated counterparties to mitigate credit risk. The swap portfolio is spread among three counterparties. Collateral agreements and insurance policy requirements contained in the swap agreements further mitigate credit risk.

Basis Risk: The Department’s variable-rate bond coupon payments are equivalent to the SIFMA rate. Payments received on these swaps are a function of LIBOR. As these rates converge, basis risk exposure increases.

Rollover Risk: The Department is exposed to rollover risk on swap agreements which mature or may be terminated prior to the maturity of the associated debt. Bonds that are exposed to rollover risk are shown in table “Interest Rate Swaps Subject to Rollover.”

Swap Payments and Associated Debt: Using rates as of Aug. 31, 2007, the estimated debt service requirements of the Department’s variable-rate bonds and associated net swap payments, assuming current interest rates and swap index relationships remain the same for their terms, are shown in the table “Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments.” As rates and index relationships vary in the future, so will the resulting actual interest payments and net swap payments.

Pay-Fixed, Receive-Variable Interest Rate Swaps (University of Texas System)

Objective of the interest rate swap: In June 1999, UT executed forward-starting, floating-to-fixed rate interest rate swap agreements with J.P. Morgan Chase Bank (Morgan) and Goldman. The swap agreements were used to create a synthetic fixed-rate refunding of $80.5 million of the Board of Regents of The University of Texas System Revenue Financing System Bonds, Series 1991A and 1991B (“Refunded Bonds”), on their optional redemption date of Aug. 15, 2001 to achieve debt service savings. On May 17, 2001, the University of Texas System Board of Regents (Regents) issued its Revenue Financing System Refunding Bonds, Series 2001A, in the form of variable rate demand bonds. The swap agreements effectively change the Regents’ interest rate on the Series 2001A Bonds, subject to some basis risk discussed below, to a fixed rate of 4.633 percent. The difference between the swap rate and the rates on the Refunded Bonds called Aug. 15, 2001, resulted in estimated present value debt service savings of approximately $5.6 million.

In March 2007, UT executed forward-starting, floating-to-fixed rate interest rate swap agreements (2007 Swap Agreements) with Morgan and Morgan Stanley Capital Services, Inc. (MSCS). The 2007 swap agreements are being used to hedge interest rate risk on revenue financing system bonds expected to be issued in February 2008.

Terms, Fair Values and Credit Ratings: On Feb. 6, 2007, the Goldman Swap Agreement was ended and the Morgan Swap Agreement was increased to 100 percent of the notional amount. The terms, fair values and counterparty credit ratings related to the outstanding variable-to-fixed swaps as of Aug. 31, 2007, are shown in the table titled "Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments." The notional amounts and amortization schedules of the swaps match those of the associated variable-rate bonds. The fair value was estimated using market-standard practice, which includes a calculation of future net settlement payments required by the swap, utilizing market expectations implied by the current yield curve for interest rate swap transactions.

Pursuant to the terms of the 2007 swap agreements, the Regents have agreed to pay interest on a notional amount of $310 million at a fixed rate of 3.84 percent per annum, commencing on Feb. 15, 2008. In consideration for these payments, Morgan and MSCS agreed to pay the Regents a variable rate based on SIFMA Municipal Swap Index. The Morgan Swap Agreement and the MSCS Swap Agreement were each for 50 percent of the notional amount. The 2007 Swap Agreements are scheduled to terminate on Aug. 15, 2036. Fair value of the 2007 swap agreements at Aug. 31, 2007 was estimated at a positive $6.8 million using market-standard practice, which includes a calculation of future net settlement payments required by the swap, utilizing market expectations implied by the yield curve for interest rate swap transactions.

Basis and Termination Risk: The Morgan Swap Agreement exposes the Regents to basis risk as the variable rate received under the swap agreement does not perfectly match the variable rate paid on the Series 2001A Bonds. The swap agreement may be terminated if the counterparty does not maintain a credit rating of at least Aa3 by Moody's or AA- by S&P. The swap agreement may also be terminated by Morgan if the Regents do not maintain a credit rating of at least Aa3 by Moody's or AA- by S&P.

The 2007 swap agreements expose the Regents to termination risk. Each 2007 swap agreement may be terminated if the respective counterparty does not maintain a credit rating of at least Baa2 by Moody's or BBB by S&P. The swap agreement may also be terminated by Morgan or MSCS if the Regents do not maintain a credit rating of at least Baa2 by Moody's or BBB by S&P.

Swap Payments and Associated Debt: Using rates as of Aug. 31, 2007, the estimated debt service requirements of UT's variable-rate bonds and associated net swap payments, assuming current interest rates and swap index relationships remain the same for their terms, are shown on the table "Pay-Fixed, Receive-Variable Interest Rate Swaps: Estimated Debt Service Requirements of Variable-Rate Debt Outstanding and Net Swap Payments." As rates and index relationships vary in the future, so will the resulting actual interest payments and net swap payments. As of Aug. 31, 2007, there was $23.8 million of the Series 2001A Bonds outstanding and the notional amount of the swap agreements was $23.4 million.

Pay-Variable, Receive-Variable Interest Rate Swaps (University of Texas System)

Objective of the Swaps: In May 2006, UT executed basis swap agreements with Merrill Lynch Capital Services (Merrill Lynch) and Bank of America. The swap agreements are associated with the Board of Regents of The University of Texas System Revenue Financing System Bonds, Series 2006B to lower the net cost of borrowing.

Terms, Fair Values and Credit Ratings: On Feb. 27, 2007, UT terminated both basis swaps and received an aggregate termination payment of $5.25 million from Merrill Lynch and Bank of America.

Note 7
Capital Leases

The state has entered into long-term capital leases to buy certain assets. The capital assets are recorded at the present value of the future minimum lease payments at the inception of the lease plus any cash paid or trade-in value received.

For governmental and business-type activities, the assets and liabilities are recorded in the government-wide financial statements.

The table below is a summary of the future minimum lease payments for capital leases.

Future Capital Lease Payments

August 31, 2007 (Amounts in Thousands)

	Primary Government						Discretely Presented Component Units		
	Governmental Activities			Business-Type Activities					
Year	Principal	Interest	Total Future Minimum Lease Payments	Principal	Interest	Total Future Minimum Lease Payments	Principal	Interest	Total Future Minimum Lease Payments
2008	$ 1,425	$ 681	$ 2,106	$ 2,554	$ 534	$ 3,088	$ 120	$ 5	$ 125
2009	1,373	584	1,957	2,008	442	2,450	29	1	30
2010	1,458	489	1,947	1,620	361	1,981	1		1
2011	1,548	390	1,938	1,347	287	1,634			
2012	1,652	285	1,937	733	229	962			
2013 - 2017	3,104	184	3,288	2,991	714	3,705			
2018 - 2022				1,579	301	1,880			
2023 - 2027				684	77	761			
2028 - 2032				63	1	64			
Total	$ 10,560	$ 2,613	$ 13,173	$ 13,579	$ 2,946	$ 16,525	$ 150	$ 6	$ 156

The following table is an analysis of the property acquired under capital leases by asset category at Aug. 31, 2007.

Assets Under Capital Leases

(Amounts in Thousands)

	Primary Government				Discretely Presented Component Units*	
	Governmental Activities		Business - Type Activities			
Type	Assets under Capital Lease	Accumulated Depreciation	Assets under Capital Lease	Accumulated Depreciation	Assets under Capital Lease	Accumulated Depreciation
Land	$	$	$ 456	$	$	$
Buildings	18,084	10,193	12,059	1,493		
Furniture and Equipment	4,390	3,048	8,162	2,521		
Vehicles, Boats, etc.	91	36	375	156		
Total	$ 22,565	$ 13,277	$ 21,052	$ 4,170	$ 0	$ 0

* There is no balance because the original cost of each asset reported under capital leases was below the capital asset threshold.

NOTE 8
Operating Leases

Included in rental expenditures or expenses are assets leased on a long-term basis that have been classified as operating leases. The following is a schedule of minimum future rentals on noncancelable operating leases as of Aug. 31, 2007.

Noncancelable Operating Leases
August 31, 2007 (Amounts in Thousands)

	Minimum Future Lease Payments	
Year	Primary Government	Component Units
2008	$196,063	$ 1,540
2009	167,060	1,070
2010	141,681	877
2011	112,673	629
2012	87,085	322
2013 – 2017	138,113	911
2018 – 2022	6,757	
2023 – 2027	1,512	
2028 – 2032	1,370	
2033 – 2037	733	
Total	$853,047	$ 5,349

NOTE 9
Retirement Systems

The state of Texas has three public employee retirement systems (PERS) that administer seven defined benefit plans. All defined benefit plans are included in the state's financial statements as pension trust funds. Amounts and types of securities held by the retirement systems are included in Note 3. The three agencies that administer the plans; the Employees Retirement System of Texas (ERS), the Teacher Retirement System of Texas (TRS) and the Fire Fighters' Pension Commission (FPC); issue separate financial reports. These reports are audited as individual entities with a separate opinion issued for each and may be obtained from the following:

Employees Retirement System of Texas
P.O. Box 13207
Austin, Texas 78711-3207

Teacher Retirement System of Texas
1000 Red River Street
Austin, Texas 78701-2698

Fire Fighters' Pension Commission
920 Colorado Street, 11th Floor
Austin, Texas 78701-2332

The state has also established a defined contribution plan as authorized by Tex. Gov. Code, Chapter 830, an optional retirement program for agencies and institutions of higher education. All employees employed in a position that is eligible for the TRS pension plan are automatically enrolled in that plan on their first day of employment. Full-time faculty, librarians and certain professionals and administrators employed in public higher education are eligible to elect the Optional Retirement Program (ORP) in lieu of the TRS pension plan. The selection made is a one-time irrevocable choice. ORP is an individualized defined contribution plan in which each participant selects from a variety of investments offered by several companies through annuity contracts or mutual fund investments. With the purchase of these individual contracts, the state has effectively transferred the obligation for the payment of benefits to the company. In the event of the insurance or annuity company's insolvency, the state does not guarantee benefits. The contributory percentages of participant salaries provided by each participant and the state were 6.65 percent for the participant and 6 percent for the state. In addition, the Texas Higher Education Coordinating Board and institutions of higher education contributed 2.5 percent from operating funds for this retirement program. For the year ended Aug. 31, 2007, the state's expense/contribution was $107.2 million.

GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*, is not applicable for the state of Texas since the health care plans are not administered by the pension trust funds.

DESCRIPTION OF PLANS AND FUNDING POLICY

Employees Retirement System of Texas

The Board of Trustees of ERS is the administrator of four pension plans. Each of these plans is considered to be a single-employer defined benefit pension plan.

- The Employees Retirement System of Texas Plan (ERS Plan);
- The Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS); and
- The Judicial Retirement System of Texas Plan One and Plan Two (JRS).

Each plan provides a standard monthly benefit in a life annuity at retirement as well as death and disability benefits for members. A Partial Lump Sum Payment Option is available to members of the employee class, the elected class and law enforcement and custodial officers. A one-time partial lump sum of up to three years of standard annuity at retirement can be taken and the annuity is reduced for life. The benefit and contribution provisions are authorized by state law and may be amended by the Legislature. Contribution requirements are not actuarially determined, but are set by legislation, except for the JRS Plan Two under which state contribution rates are actuarially determined every even-numbered year for the next biennium.

The ERS audited report contains the actuarial valuations as of Aug. 31, 2007, along with an actuarial letter dated Nov. 27, 2007. No subsequent legislative action that would negatively affect their certification of actuarial soundness of the funds was noted.

The ERS Plan, established by the Tex. Gov. Code, Title 8, Subtitle B, Chapters 811-815 covers elected class members, employee class members, commissioned peace officers and custodial officers. The funding policy requires monthly contributions by both the state and employees (see "Funding Information, Actuarial Methods and Assumptions" table). The monthly benefit is determined by the years and months of service multiplied by a statutorily determined percentage and may vary by class.

- The elected class members are vested after eight years of credited service and may retire at age 50 with 12 years of service or at age 60 with eight years of service. The statutory percentage is equal to 2.3 percent of the current state salary of a district judge.
- The employee class includes all employees and appointed officers of the state and excludes independent contractors and their employees and employees covered by TRS and JRS. Employee class retirement benefits vest after five years of credited service and employees may retire at age 60 with five years of service or at any age when the combination of age and service (including months) total 80. The monthly standard annuity equals the statutory percentage of 2.3 percent times the average of the highest 36 months of compensation. The minimum monthly standard annuity is $150; the maximum standard annuity is 100 percent of the average monthly compensation.
- Commissioned peace officers and custodial officers may retire at age 55 with 10 years of service.

LECOS, established under Tex. Gov. Code, Chapter 814.107, covers statutorily certified custodial officers employed by the Department of Criminal Justice, including the Board of Pardons and Paroles, who have contact with inmates of that institution. The fund also covers other commissioned state agency law enforcement officers who are recognized by the Commission on Law Enforcement Officer Standards and Education.

Benefits vest after 20 years of credited service. Covered employees may retire at age 50, if vested, or the age at which the sum of the member's age and amount of service credit in the employee class equals 80. A member may receive reduced benefits upon completing 20 years of service, regardless of age. The monthly benefit at retirement is payable in a life only form of annuity. The monthly annuity is equal to 2.8 percent of average monthly compensation multiplied by years of service. Average monthly compensation is the average of the highest 36 months of salary out of the member's established service. The minimum monthly standard annuity is $150; the maximum standard annuity is 100 percent of the average monthly compensation.

There are no member contributions for the LECOS fund and it has not received funding from the state since Aug. 31, 1993. Annual actuarial valuations of the fund are performed to monitor the adequacy of the financing arrangement. During the last legislative session, state funding was appropriated for this fund for the biennium ending Aug. 31, 2009 based on 1.59 percent of covered payroll for LECOS members.

JRS 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. Members prior to Sept. 1, 1985, participate in Plan One and all others participate in Plan Two. Participants in both plans may retire at age 65 with 10 years of service with at least the last year being continuous and currently holding judicial office, or at age 65 with 12 years of service. Members of Plan One and Plan Two may retire at any age with 20 years of service. Prior to Sept. 1, 2005, members of Plan Two were restricted to retirement at age 55 with 20 years of service. Participants in both plans are eligible for reduced early service retirement benefits once they attain age 60 and complete 10 years of service if the member currently holds judicial office with at least the last year being continuous or at age 60 with 12 years of service.

The monthly benefit at retirement is payable in a life only form of annuity. The monthly benefit for members of both plans is equal to 50 percent of the salary for the position from which the member retired and is increased by 10 percent of final compensation if in office within one year of benefit commencement.

Tex. Gov. Code, Title 8, Subtitle D, Chapter 835 requires employees to contribute 6 percent of their compensation and the state to make appropriations from the general revenue fund sufficient to administer JRS Plan One. The contribution requirements are not actuarially determined since the plan is not funded in advance. There are actuarial valuations and an actuarial cost method only for fulfilling GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, requirements.

The funding policy of JRS Plan Two is established by Tex. Gov. Code, Title 8, Subtitle E, Chapter 840. The state's contribution to the plan is determined each even-numbered year for the next biennium and is based upon an actuarial valuation. Significant actuarial assumptions are the same as those used to compute the net pension benefit.

Teacher Retirement System of Texas

TRS administers retirement, proportional retirement, disability annuities and death and survivor benefits to employees and beneficiaries of employees of the public school system of Texas (the Plan). TRS is a multiple-employer PERS. It is a cost-sharing PERS with one exception: risks and costs are generally not shared by the employer (unless the employer is a senior college, medical school or a state agency in which case the employer is considered the state of Texas) but are the liability of the state of Texas. The Plan is reported under the sole-employer provisions of GASB 27, since the state of Texas is legally responsible for a significant portion of the annual required contributions. The benefit and contribution provisions of the Plan are authorized by state law and may be amended by the Legislature.

All employees of public, state-supported educational institutions in Texas who are employed for one-half or more of the standard work load and who are not exempted from membership under Tex. Gov. Code, Title 8, Subtitle C, Chapter 822 are covered by the Plan.

A member is vested after five years of creditable service and is eligible to retire at a future date and receive a lifetime monthly annuity. The normal service retirement is at age 65 with five years of credited service or when the sum of the member's age and years of credited service equals at least 80 years. The service age requirement for early retirement is age 55 with five years of credited service or any age below 50 with 30 years of credited service. The standard life annuity benefit formula is 2.3 percent of the average of the five highest annual salaries multiplied by the years of service. For members who are "grandfathered," the three highest annual salaries are used. At normal retirement age, the minimum monthly standard annuity is the greater of $150 or the formula standard annuity. Total payments shall in no case be less than accumulated contributions at retirement.

Law changes from the 2007 legislative session modified the state contribution rate for the TRS plan. Effective Sept. 1, 2007, the state contribution rate was increased from 6.0 percent to 6.58 percent of pay. The new law also requires the state contribution rate to be at least equal to the member contribution rate.

At Aug. 31, 2007, the number of participating employing districts was as follows.

Employing Districts	
Public Schools, Service Centers and Charter Schools	1,243
Colleges, Universities and Medical Schools	102
Educational State Agencies	2
Total	1,347

Contribution requirements are not actuarially determined, but are legally established each biennium pursuant to the following state funding policy.

The Texas Constitution requires the Legislature to establish a member contribution rate of not less than 6 percent of the member's annual compensation and a state contribution rate of not less than 6 percent and not more than 10 percent of the aggregate annual compensation of all members of TRS during that fiscal year. A state statute prohibits benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize TRS' unfunded actuarial liabilities would be increased to a period that exceeds 31 years or, if the amortization period already exceeds 31 years, the period would be increased by such action.

TRS offers to all service and eligible disability retirees several annuity payment options that reduce the standard annuity by application of age-related actuarial reduction factors in order to continue payment to a beneficiary after the retiree's death. The available options include 100, 75 and 50 percent joint and survivor annuities and five and 10 year guaranteed period annuities.

TRS also offers two other annuity payment options:

- The Deferred Retirement Option Plan (DROP)
  DROP allows members to freeze their standard annuity and, instead of retiring, to have a portion of the frozen standard annuity deposited into a DROP account while continuing to work for a TRS-affiliated employer. Members may elect to participate in the DROP program for up to five years. The plan was closed for new participants effective Dec. 31, 2005.
- A Partial Lump-Sum Cash Option (PLSO)
  PLSO reduces the standard monthly annuity and provides a cash lump sum distribution. Members may participate in the PLSO if they are eligible for service retirement and meet the Rule of 90 (age and years of service credit equal at least 90), are not participating in the DROP plan and are not retiring with disability benefits.

Annual Pension Cost and Net Pension Obligation

The state's annual pension cost and net pension obligation for plans subject to sole-employer provisions of GASB 27 for fiscal 2007 are presented below.

Fire Fighters' Pension Commission

FPC is the administrator of two pension plans.

- The Texas Emergency Services Retirement System (TESRS) Fund and
- The Texas Local Fire Fighters Retirement Act (TLFFRA).

TESRS is a cost-sharing multiple-employer pension plan established and administered by the state of Texas to provide pension benefits for emergency services personnel who serve without pay. At Aug. 31, 2007, there were 180 member fire departments participating in the pension system.

The statutory authority for TESRS is found in Tex. Gov. Code, Title 8, Chapter 865.014. The governing bodies of participating departments are required to contribute at least the minimum prescribed amount per month for each active member. No contributions are required by individual members

Annual Pension Cost and Net Pension Obligation

(Amounts in Thousands)

	ERS	LECOS	JRS1	JRS2	TRS*	FPC**
Annual Required Contribution, ARC	$ 370,496	$ 6,956	$ 28,966	$ 10,925	$1,721,224	$ 2,753
Interest on Net Pension Obligation, NPO	(3,093)		6,861	(601)	6,148	N/A
Adjustment to ARC	2,196		(7,330)	824	(4,918)	N/A
Annual Pension Cost	369,599	6,956	28,497	11,148	1,722,454	2,753
Employer Contributions Made	329,524	0	29,029	10,909	1,471,131	2,753
Increase (Decrease) in NPO	40,075	6,956	(532)	239	251,323	N/A
Net Pension Obligation/(Asset), September 1, 2006	(38,666)	0	85,757	(7,509)	76,859	N/A
Net Pension Obligation/(Asset), August 31, 2007***	$ 1,409	$ 6,956	$ 85,225	$ (7,270)	$ 328,182	N/A

* The sole-employer provisions of GASB Statement No. 27 applies to TRS.

** An NPO calculation is not applicable for the FPC since contributions are received from member fire departments. The state's contribution, if any, would be insignificant. The ARC and Employer Contributions Made are from the 2006 actuarial valuation.

*** See "Funding Information, Actuarial Methods and Assumptions" table for actuarial assumptions used in determining cost and obligation.

Retirement Systems' Membership

	ERS*	LECOS*	JRS1*	JRS2*	TRS**	FPC***
Retirees and Beneficiaries Currently Receiving Benefits	70,455	5,805	488	116	265,307	1,866
Terminated Employees Entitled to Benefits But Not Yet Receiving Them	67,803	27	15	115	52,416	1,947
Current Employees: Vested and Non-Vested	132,497	36,413	24	515	895,777	4,410
Total Members	270,755	42,245	527	746	1,213,500	8,223

* Totals are from actuarial valuations as of Aug. 31, 2007.

** Totals are from the audited agency annual financial report.

*** This total does not include the 588 retirees and beneficiaries from the TLFFRA (Texas Local Firefighters Retirement Act) plan as of Aug. 31, 2007.

Funding Information, Actuarial Methods and Assumptions

(Amounts in Thousands)

	ERS	LECOS	JRS1	JRS2	TRS	FPC*
Contribution Rates						
Employees	6.0%	0.0%	6.0%	6.0%	6.4%	N/A
Legislators	8.0%	N/A	N/A	N/A	N/A	N/A
Employer**	6.5%	0.0%	N/A	16.8%	6.0%	N/A
Annual Pension Cost	$369,599	$6,956	$28,497	$11,148	$1,722,454	$2,753
Employer Contributions Made***	$329,524	$0	$29,029	$10,909	$1,471,131	$2,753
Actuarial Valuation Date	August 31, 2007	August 31, 2007	August 31, 2007	August 31, 2007	August 31, 2007	August 31, 2006
Actuarial Cost Method	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age Normal	Entry Age
Amortization Method	Level Percent Open	Level Percent Open	Level Dollar Open	Level Percent Open	Level Percent Open	Level Dollar Open
Remaining Amortization Period of Unfunded Liability	30 years	30 years	30 years	4.3 years****	27.4 years	30 years
Asset Valuation Method	5-year Smoothed Fair Value	5-year Smoothed Fair Value	N/A	5-year Smoothed Fair Value	5-year Smoothed Market	5-year Smoothed Market
Actuarial Assumptions:						
Investment Rate of Return	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Projected Salary Increases	0.0%-14.0%	6.0%-14.0%	4.0%	4.0%	4.25%-26.4%	N/A
Includes Inflation at	4.0%	4.0%	4.0%	4.0%	3.0%	3.8%
Cost-of-Living Adjustments	None-Employee 4.0%-Elected	None	4.0%	None	None	None

* Contributions and benefits are not based on the salaries of members.

** The plan for JRS1 is closed to new participants and the state contributions are based upon benefits paid to participants during the year. Contribution requirements for JRS2 are actuarially determined each even-numbered year. TRS and ERS contribution requirements are based on actuarial evaluations as established by state statute.

*** The 79th Legislature addressed funding problems for FPC with an appropriation for additional funding in the 2006-07 biennium.

**** The amortization period was calculated based on estimated fiscal 2008 covered payroll. At the end of fiscal 2008 the ARC and the amortization period will be recalculated based on actual 2008 covered payroll.

of participating departments. Additional contributions may be made by a governing body to pay for granting credit for service before the department began participating in TESRS. The state may also be required to make a limited amount of annual contributions to make the fund actuarially sound. The contributions may not exceed the amount of one-third of the total of all contributions by governing bodies in one year. The state is not an employer of the TESRS plan therefore, the sole-employer reporting provisions of GASB 27 for net pension obligation calculations are not applicable.

Eligible members include volunteer emergency service personnel who are members in good standing with a qualifying fire-fighting unit. Effective Jan. 1, 2007, the TESRS board amended the vesting and reduced the compounded amount paid for each year of service over 15 years. The TESRS board protected currently vested members by "grandfathering" vested accrued benefits as of Dec. 31, 2006.

Through Dec. 31, 2006, a current member became vested upon completing at least five years of qualified service. These members were vested, beginning with the fifth year of service at 5 percent per year of service for the first 10 years and 10 percent for each of the next five years of service.

Effective Jan. 1, 2007, a member must have at least ten years of qualified service to become vested. Those members are vested at 50 percent and accrue an additional 10 percent for each of the next five years of service.

Vested members are eligible to receive a pension for life starting at age 55 that is equal to six times the average contribution rate paid by the governing entity over the member's period of qualified service. For years of service in excess of 15 years, this monthly benefit is increased at the rate of 7 percent compounded annually for "grandfathered" members, or 6.2 percent for members vested under the amended Jan. 1, 2007, TESRS board rules.

Actuarial valuations are performed biennially. Death and disability benefits are dependent on whether or not the member was engaged in the performance of duties at the time of death or disability. Death benefits include a lump-sum amount and continuing monthly payments to a member's spouse and dependents.

The member fire department contributions to the fund for the years ending Aug. 31, 2007, 2006 and 2005, were $2.5 million, $2.1 million and $1.5 million, respectively, equal to the yearly statutorily required contributions.

TLFFRA, established by statute, is a pay-as-you-go agent multiple-employer plan. Because actuarial valuations are not obtained, the TLFFRA is not presented on the Schedule of Funding Progress. It is not cost beneficial to obtain

Schedule of Funding Progress

(Amounts in Thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Assets over AAL (Unfunded AAL) (a) - (b)	Funded Ratio (a)/(b)	Covered Payroll (c)	Excess/UAAL as a Percentage of Covered Payroll ((a-b)/c)
Employees Retirement System (ERS)						
08/31/07	$ 22,938,947	$ 23,987,165	$ (1,048,218)	95.6%	$ 5,253,723	(20.0)%
08/31/06	21,780,437	22,884,917	(1,104,480)	95.2%	5,051,330	(21.9)%
08/31/05	20,835,469	21,969,670	(1,134,201)	94.8%	4,842,525	(23.4)%
Law Enforcement and Custodial Officer Supplemental Retirement (LECOS)						
08/31/07	$ 747,765	$ 762,666	$ (14,901)	98.0%	$ 1,360,819	(1.1)%
08/31/06	720,307	708,437	11,870	101.7%	1,279,463	0.9%
08/31/05	698,814	677,953	20,861	103.1%	1,283,815	1.6%
Judicial Retirement System Plan One (JRS1)						
08/31/07	$ 0	$ 312,852	$ (312,852)	0.0%	$ 2,777	(11,265.8)%
08/31/06	0	325,977	(325,977)	0.0%	5,138	(6,344.4)%
08/31/05	0	327,145	(327,145)	0.0%	5,284	(6,191.2)%
Judicial Retirement System Plan Two (JRS2)						
08/31/07	$ 211,933	$ 220,884	$ (8,951)	95.9%	$ 64,654	(13.8)%
08/31/06	186,400	198,840	(12,440)	93.7%	62,306	(20.0)%
08/31/05	164,231	182,311	(18,080)	90.1%	60,775	(29.7)%
Teacher Retirement System of Texas (TRS)						
08/31/07	$ 103,419,088	$ 115,963,722	$ (12,544,634)	89.2%	$ 31,114,096	(40.3)%
08/31/06	94,217,922	107,911,459	(13,693,537)	87.3%	28,397,283	(48.2)%
08/31/05	89,298,813	102,494,536	(13,195,723)	87.1%	25,956,807	(50.8)%

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Assets over AAL (Unfunded AAL) (a) - (b)	Funded Ratio (a)/(b)	Total Members Covered (not rounded)	Excess/UAAL Per Member Covered (not rounded)
Texas Emergency Services Retirement System (TESRS)						
08/31/06*	$ 42,268	$ 58,083	$ (15,815)	72.8%	8,061	1,962
08/31/04	38,141	51,567	(13,426)	74.0%	7,994	1,680
08/31/02*	32,797	45,976	(13,179)	71.3%	7,669	1,718

* Actuarial assumptions and methodology were changed for the Aug. 31, 2002 and the Aug. 31, 2006 valuation.

valuations and the TLFFRA assets are less than 1 percent of the TESRS and TLFFRA plans combined.

Upon election, a department under TLFFRA can merge with the TESRS plan. At Aug. 31, 2007, there were 114 plans merged into the TESRS plan. Benefit determinations for these plans are determined by each local governing board. Members under both plans are eligible for retirement service at age 55 with five years of service credited in the retirement system. Monthly benefits payable for service retirement is six times the average contribution rate per member. Authority for contributions is established by statute. Members vested under the TLFFRA plan will be paid by the Commission with funds received from the local governing bodies on a pay-as-you-go basis. The liabilities of the TLFFRA pension plan are always equal to the assets and, therefore, there is no fund balance.

Contributions are not actuarially determined and the state has no legal obligation for benefit payments. As of Aug. 31, 2007, membership consisted of 588 retirees and beneficiaries.

Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due.

Included in the audited financial reports for the Employees Retirement System of Texas, the Teacher Retirement System of Texas and the Fire Fighters' Pension Commission are:

(1) Schedules of funding progress that include historical trend information about the actuarially determined funded status of the plan from a long-term on-going plan perspective and the progress made in accumulating sufficient assets to pay benefits when due.

(2) Schedules of employer contributions that include historical trend information about the Annual Required Contributions (ARC) of the employer and the contributions made by the employers in relation to the ARC.

The table on the previous page presents the funding progress for the three most recent actuarial valuations of each plan. The table below presents the three-year trend information regarding annual pension cost and net pension obligation of the plans. The TLFFRA plan which is not funded in advance is not included in the funding progress or the three-year trend information tables.

Three–Year Trend Information

(Amounts in Thousands)

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
Employees Retirement System (ERS)			
08/31/07	$ 369,599	89.2%	$ 1,409
08/31/06	360,224	87.8%	(38,666)
08/31/05	318,045	86.8%	(82,692)
Law Enforcement and Custodial Officer Supplemental Retirement (LECOS)			
08/31/07	$ 6,956	0.0%	$ 6,956
08/31/06	0	0.0%	0
08/31/05	0	0.0%	0
Judicial Retirement System Plan One (JRS1)			
08/31/07	$ 28,497	101.9%	$ 85,225
08/31/06	27,239	101.6%	85,757
08/31/05	22,061	101.1%	86,182
Judicial Retirement System Plan Two (JRS2)			
08/31/07	$ 11,148	97.9%	$ (7,270)
08/31/06	9,938	101.1%	(7,509)
08/31/05	5,582	149.9%	(7,395)
Teacher Retirement System of Texas (TRS)			
08/31/07	$ 1,722,454	85.4%	$ 328,182
08/31/06	1,593,347	83.6%	76,859
08/31/05	1,525,025	82.5%	(184,387)
Texas Emergency Services Retirement System (TESRS)*			
08/31/06 **	$ 2,753	100.0%	N/A
08/31/04	2,897	65.0%	N/A
08/31/02 **	1,768	100.0%	N/A

* TESRS is not subject to NPO calculation since the state's contributions are insignificant.

** Actuarial assumptions and methodology were changed for the Aug. 31, 2002 valuation and the Aug. 31, 2006 valuation.

Note 10
Deferred Compensation

The state of Texas offers to all state employees two deferred compensation plans. One is established in accordance with Internal Revenue Code Section 457. The second is established in accordance with Internal Revenue Code Section 401(k). All costs of administering and funding these programs are the responsibility of plan participants. The assets of the two plans remain the property of the contributing employees and are not presented in the accompanying financial statements. The state makes no contributions to either plan, the assets do not belong to the state and the state has no liability related to the plans.

Note 11
Postemployment Health Care and Life Insurance Benefits

In addition to providing pension benefits, four state entities administer programs which provide health care and life insurance benefits for retired employees, their spouses and beneficiaries. These Other Post-Employment Benefits (OPEB) are authorized by statute and contributions are determined by the General Appropriations Act.

The Employees Retirement System (ERS) administers a program that provides benefits to retirees of state agencies (including Teacher Retirement System employees), state universities (not part of the University of Texas and Texas A&M University systems) and other non-state entities as established by the Legislature. Eligible participants include retirees who retired with at least 10 years of service to eligible entities. The State Retiree Health Plan (SRHP), a cost-sharing multiple-employer defined benefit plan with 58 participating employers, provides for a continuance in health care and life insurance coverage at retirement. Currently, the state pays 100 percent of eligible retiree health insurance premiums and 50 percent of dependents premiums. Benefit and contribution provisions of the SRHP are authorized by state law and may be amended by the Legislature.

The financial statements of the SRHP are reported using the accrual basis of accounting. 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.

Investments of the SRHP are reported at fair value. The fair value is based on published market prices and quotations from major investment brokers at current exchange rates, as available, plus accrued interest and dividends. For investments where no readily ascertainable market value exists, management, in consultation with their investment advisors and the Master Trust Custodian, determines the fair values for the individual investments.

The University of Texas System and the Texas A&M University System provide separate post-employment health care and life insurance coverage to their retirees, surviving spouses and beneficiaries under two single-employer defined benefit plans. Many of the employees under these university systems may become eligible for health and life insurance benefits as retired employees if they meet certain age and service requirements. The state contribution provisions under these plans are currently the same as under the SRHP.

For the year ended Aug. 31, 2007, the state made monthly contributions for health care and life insurance. Contribution rates are shown below. Costs are estimated by an actuary for claims expected to be paid during the year. The retiree contributes any premium over and above state contributions.

State Contribution Rates – Retiree Health and Basic Life Premium

For the Fiscal Year Ended August 31, 2007

Level of Coverage	ERS	Texas A&M University	University of Texas*
Retiree Only	$ 361	$ 361	$ 348
Retiree/Spouse	$ 567	$ 512	$ 531
Retiree/Children	$ 498	$ 455	$ 465
Retiree/Family	$ 705	$ 587	$ 649

* The amounts shown for the University of Texas represent self-funded insurance. The monthly contribution per full-time retirees participating in the fully insured programs (HMO's) ranged from $339 to $746 depending upon the region and the level of coverage selected.

The Teacher Retirement System (TRS) administers a program that provides benefits to public school district retirees with at least 10 years of service. The Texas Public School Retired Employees Group Insurance Program (TRS-Care), a cost-sharing multiple-employer defined benefit plan with 1,242 participating employers, provides a free basic level of coverage for eligible retirees and optional coverage for eligible retirees and their dependents. Basic coverage includes participation in a major medical group health insurance plan with deductibles based upon enrollment in Part A or Part B of Medicare. Funding for free basic coverage is provided based on public school district payroll. The state and active school employee contribution rates are 1 percent and 0.65 percent of school district payroll, respectively, with school districts also contributing 0.55 percent of payroll. The state is not an employer in TRS-Care.

The financial statements for TRS-Care are reported using the accrual basis of accounting. Contributions are recognized in the period in which amounts are due, pursuant to state law. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan.

Investments of TRS-Care are reported at fair value. The fair value of investments is based on published market prices and quotations at current exchange rates. For investments where no readily ascertainable market value exists, management has determined fair values for the individual investments based on the capital account balance at the closest available reporting period, adjusted for subsequent contributions, distributions, management fees and reserves.

The cost of state retirees' health care and life insurance benefits and TRS-Care is financed on a pay-as-you-go-basis. The expenditures are recognized when reimbursements are made for claims paid by non-state entities or when premiums are paid.

Expenditures recognized in fiscal 2007 for retiree health and life insurance benefits paid for by the state are shown as follows.

Post Employment Health Care and Life Insurance

For the Fiscal Year Ended August 31, 2007

Benefits Provided Through	Number of Retirees*	Cost (In Thousands)**
Employees Retirement System	75,958	$ 422,715
University of Texas System	15,905	44,548
Texas A&M University System	6,365	29,664
Teacher Retirement System (Public School District Employees)	153,865	238,191
Total	252,093	$ 735,118

* Total number of retirees, including non-state retirees. Dependents are counted as one with the participant retiree.

** Costs paid for by the state, excludes costs paid by non-state employers.

In fiscal 2007 the ERS and TRS OPEB plans received payments from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, requires that these on-behalf payments be recorded as revenues and expenses of each plan. The total fiscal 2007 federal contributions for Medicare Part D were $28.6 million for ERS and $52.3 million for TRS.

Administrators of the ERS and TRS OPEB plans implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, in fiscal 2007. Implementation required actuarial valuations of the ERS and TRS OPEB plans. Implementation of that statement does not require the state to change its current funding of OPEB, which is on a pay-as-you-go basis. The Legislature determines the level of state funding for the ERS and TRS OPEB plans and has no continuing legal obligation to provide benefits beyond each fiscal year. Actuarial information related to these plans is included in the ERS and TRS financial reports. These reports are individually audited with a separate opinion issued for each and may be obtained from the following:

Employees Retirement System of Texas
P.O. Box 13207
Austin, Texas 78711-3207

Teacher Retirement System of Texas
1000 Red River Street
Austin, Texas 78701-2698

Note 12
Interfund Activity and Transactions

Interfund activity refers to financial interactions between funds and/or blended component units and is restricted to internal events. Interfund transactions under GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, refer to financial interactions with legally separate entities, i.e., discrete component units and other governments, and are restricted to external events.

Reciprocal Interfund Activity

Interfund loans are reciprocal interfund activity between funds and blended component units with a requirement for repayment. These loans are reported as interfund receivables/payables, classified as either current or noncurrent.

Interfund services are sales and purchases of goods and services between funds for a price approximating their external exchange value. This activity is reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as receivables and payables.

Nonreciprocal Interfund Activity

Interfund transfers are nonreciprocal interfund activity. This activity refers to flows of assets without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing sources or uses. In proprietary funds, transfers are reported after nonoperating revenues and expenses. The majority of transfers are legally authorized by statute or bond covenant to move amounts from one fund to another. Amounts not transferred at fiscal year end are accrued as "due from/due to." Activity occurring within the same fund has been eliminated. Additional eliminations have been made and transfers in and out have been netted and presented in the government-wide statement of activities as "transfers-internal activities."

According to GASB 34, certain reclassifications and eliminations have been made between the fund financial statements and the government-wide financial statements. Resource flows between the primary government and its discretely presented component units have been reported as revenues and expenses, as if they were external transactions on the fund financial statements and the government-wide financial statements. Transfers between the governmental or business-type activities and the fiduciary funds have been reported as transfers on the fund financial statements and were reclassified to revenues and expenses, as if they were external transactions on the government-wide financial statements.

Due from/due to amounts between the primary government and the discretely presented component units are reported separately from due from/due to amounts between funds in the fund financial statements and the government-wide financial statements, according to GASB 34. Due from/due to amounts between governmental or business-type activities and fiduciary funds are reported as due from/due to amounts between funds in the fund financial statements and are reclassified to receivables from fiduciary funds/payables to fiduciary funds, as if they were external transactions on the government-wide financial statements.

Interfund reimbursements are repayments from funds responsible for payment of expenditures or expenses to the funds that actually made the payment. Reimbursements are not displayed in the financial statements.

For the state of Texas, routine transfers are those transfers from unrestricted revenue collected in the general revenue fund to finance various programs accounted for in other funds in accordance with the General Appropriation Act, which is the primary budget document for the state of Texas. Other transfers are legally authorized by statute to move resources from one fund to another. The noncurrent interfund receivables/payables include loans for energy efficiency programs of approximately $17.6 million. There is also a $382.6 million receivable for Texas A&M System from the University of Texas System from permanent university funds. The earnings will be used for bond payments. Significant transfers include a $1 billion transfer from lottery earnings to the foundation school fund for educational programs, an $843 million transfer from the permanent school fund to the available school fund and a $2.2 billion transfer to the highway fund and $1.5 billion transfer to the Teacher Retirement System trust account, both from the general revenue fund. The detail of interfund activity and transactions by fund type and category as of Aug. 31, 2007, is shown on the following pages.

Interfund Receivables/Payables per the Fund Statements

(Amounts in Thousands)

Fund Type	Current		Noncurrent		Total	
	Interfund Receivables	Interfund Payables	Interfund Receivables	Interfund Payables	Interfund Receivables	Interfund Payables
INTERFUND RECEIVABLES/PAYABLES WITHIN THE PRIMARY GOVERNMENT						
Governmental Funds						
General Fund	$ 199	$ 60	$ 17,646	$	$ 17,845	$ 60
State Highway Fund						
Nonmajor Governmental Funds	60	30		1,888	60	1,918
	259	90	17,646	1,888	17,905	1,978
Proprietary Funds						
Colleges and Universities	23,340	23,340	382,630	398,388	405,970	421,728
Nonmajor Enterprise Funds		169				169
	23,340	23,509	382,630	398,388	405,970	421,897
Fiduciary Funds						
Agency Funds						
	0	0	0	0	0	0
Total Interfund Receivables/Payables Within the Primary Government	$ 23,599	$ 23,599	$ 400,276	$ 400,276	$ 423,875	$ 423,875

Due From/Due To per the Fund Statements

(Amounts in Thousands)

Fund Type	Due From			Due To		
	Other Funds	Primary Government	Component Unit	Other Funds	Primary Government	Component Unit
DUE FROM/DUE TO WITHIN THE PRIMARY GOVERNMENT						
Governmental Funds						
General Fund	$ 198,021	$	$ 431	$ 777,894	$	$ 348
State Highway Fund	329,192			8,430		
Permanent School Fund	10,253			310		
Nonmajor Governmental Funds	70,922			286,391		
	608,388	0	431	1,073,025	0	348
Proprietary Funds						
Colleges and Universities	431,164		9	10,040		
Texas Water Development Board Funds				2,297		
Texas Department of Transportation Turnpike Authority	3,524					
Nonmajor Enterprise Funds	63,557			17,984		
Internal Service Fund	1,750			73,252		
	499,995	0	9	103,573	0	0
Fiduciary Funds						
Pension and Other Employee Benefit Trust Funds	123,913			55,474		
Agency Funds	255			479		
	124,168	0	0	55,953	0	0
Total Due From/Due To Within the Primary Government	$ 1,232,551	$ 0	$ 440	$ 1,232,551	$ 0	$ 348
DUE FROM/DUE TO OUTSIDE THE PRIMARY GOVERNMENT						
Discretely Presented Component Units	$	$ 348	$	$	$ 440	$
Total Due From/Due To Outside the Primary Government	$ 0	$ 348	$ 0	$ 0	$ 440	$ 0
TOTAL DUE FROM/DUE TO			$ 1,233,339			$ 1,233,339

Internal Balances per the Government-wide Financial Statements

(Amounts in Thousands)

	Governmental Activities	Business-Type Activities	Total
NONCURRENT ASSETS			
Internal Balances–Receivables	$ 15,758	$ (15,758)	$ 0
CURRENT LIABILITIES			
Internal Balances–Payables	$ 467,755	$ (467,755)	$ 0

Transfers In/Out per the Fund Statements

(Amounts in Thousands)

Fund Type	Transfers In Other Funds	Transfers Out Other Funds
Governmental Funds		
General Fund	$ 1,425,527	$ 9,969,934
State Highway Fund	4,081,160	151,772
Permanent School Fund		843,137
Nonmajor Governmental Funds	2,258,493	1,922,551
	7,765,180	12,887,394
Proprietary Funds		
Colleges and Universities	4,607,617	216,209
Texas Water Development Board Funds	3,637	7,626
Texas Department of Transportation Turnpike Authority	114,885	
Nonmajor Enterprise Funds	10,968	1,129,161
	4,737,107	1,352,996
Fiduciary Funds		
Pension and Other Employee Benefit Trust Funds*	1,823,277	84,114
Private-Purpose Trust Funds		1,060
	1,823,277	85,174
Total Transfers In/Out	$ 14,325,564	$ 14,325,564

* State contributions to the Teacher Retirement System (TRS) pension and other postemployment benefits plans are included in Transfers In. For fiscal 2007, the total state contributions were $1,735,915 (in thousands) for the TRS plans.

Transfers In/Out per the Government-wide Financial Statements

(Amounts in Thousands)

Fund Category	Other Funds
Governmental Activities	$ (3,383,910)
Business-Type Activities	$ 3,383,910

Note 13
Fund Balances/Net Assets

A summary of the nature and purposes of governmental fund balances is shown in the table below by fund type at Aug. 31, 2007. The government-wide, proprietary and fiduciary restrictions are listed on the face of their statement of net assets.

The government-wide statement of net assets reports $55.2 billion of restricted net assets for the primary government, of which $45.5 billion is restricted by enabling legislation.

Governmental Fund Balances – Reserved, Unreserved/Designated, Unreserved/Undesignated

(Amounts in Thousands)

MAJOR FUNDS	
General Fund – Reserved:	
Encumbrances	$ 1,210,050
Inventories	161,140
Imprest Accounts	3,513
Loans and Contracts	144,355
Interfund Receivables (Noncurrent)	17,646
Tax Receivables (Noncurrent)	462,764
Health and Human Services	136,394
Natural Resources and Recreation	2,482
	$ 2,138,344
General Fund – Unreserved	
Undesignated:	$ 8,697,977
State Highway Fund – Reserved:	
Encumbrances	$ 184,241
Inventories	92,241
Imprest Accounts	553
Loans and Contracts	233,807
	$ 510,842
State Highway Fund – Unreserved/Designated:	
Transportation	$ (498,644)
Permanent School Fund – Reserved:	
Encumbrances	$ 1,445
Loans and Contracts	1,672
Public School Support	26,770,768
	$26,773,885
NONMAJOR FUNDS	
Special Revenue Funds – Reserved:	
Encumbrances	$ 36,734
Inventories	464
Imprest Accounts	10
Loans and Contracts	859,408
	$ 896,616
Special Revenue Funds – Unreserved/Designated:	
General Government	$ 795,049
Regulatory Services	411,511
Health and Human Services	13,202
Natural Resources and Recreation	127,226
Education	334,364
Transportation	779,333
Public Safety and Corrections	9,141
Employee Benefits	90
Teacher Retirement Benefits	382
Total Unreserved/Designated	$ 2,470,298
Undesignated:	(124,338)
	$ 2,345,960

Debt Service Funds – Reserved:	
Debt Service	$ 145,165
Capital Projects Funds – Reserved:	
Encumbrances	$ 76,442
Inventories	85
Capital Projects	33,366
	$ 109,893
Capital Projects Funds – Unreserved:	
Designated:	
Public Safety and Corrections	$ 860
Total Unreserved/Designated	860
Undesignated:	
General Government	90
Health and Human Services	1,707
Public Safety and Corrections	(15,552)
Natural Resources and Recreation	1,417
Total Unreserved/Undesignated	(12,338)
	$ (11,478)
Permanent Funds – Reserved:	
Education	$ 617,427
	$ 617,427
Permanent Funds – Unreserved:	
Designated:	
Permanent Health Fund	$ 616,539
Total Unreserved/Designated	616,539
Undesignated:	
General Government	15,189
Education	9
Natural Resources and Recreation	297
Total Unreserved/Undesignated	15,495
	$ 632,034
ALL GOVERNMENTAL FUNDS	
Reserved	$31,192,172
Unreserved/Designated	2,589,053
Unreserved/Undesignated	8,576,796
Total Fund Balances – Governmental Funds	$42,358,021

NOTE 14

Adjustments to Fund Balances/ Net Assets

During fiscal 2007 certain accounting changes and adjustments were made which required the restatement of fund balances or net assets as shown and discussed below.

Restatements to Fund Balances/Net Assets

(Amounts in Thousands)

	September 1, 2006, As Previously Reported	Restatements	September 1, 2006, As Restated
GOVERNMENTAL FUNDS AND GOVERNMENT-WIDE ACTIVITIES			
Major Funds:			
General Fund	$ 7,320,890	$ 11,732	$ 7,332,622
State Highway Fund	255,662		255,662
Permanent School Fund	23,912,384	(1,327)	23,911,057
Total Major Funds	31,488,936	10,405	31,499,341
Nonmajor Funds:			
Special Revenue Funds	1,970,604	(23)	1,970,581
Debt Service Funds	150,442		150,442
Capital Project Funds	84,918	(959)	83,959
Permanent Funds	1,116,834		1,116,834
Total Nonmajor Funds	3,322,798	(982)	3,321,816
Total Governmental Funds	34,811,734	9,423	34,821,157
Governmental Activities:			
Capital Assets Net of Accumulated Depreciation	60,318,012	(29,545)	60,288,467
Long-Term Liabilities	(7,090,537)	(16,185)	(7,106,722)
Other Adjustments	1,881,472	1,352	1,882,824
Internal Service Fund	241,478		241,478
Total Governmental Activities	55,350,425	(44,378)	55,306,047
Total Governmental Funds and Government-wide Activities	90,162,159	(34,955)	90,127,204
PROPRIETARY FUNDS AND BUSINESS-TYPE ACTIVITIES			
Major Funds:			
Colleges and Universities	32,433,980	(6,055)	32,427,925
Texas Water Development Board Funds	1,823,529		1,823,529
Texas Department of Transportation Turnpike Authority	761,719		761,719
Nonmajor Enterprise Funds	2,720,044	5	2,720,049
Total Enterprise Funds and Business-Type Activities	37,739,272	(6,050)	37,733,222
Fiduciary Funds			
Pension and Other Employee Benefit Trust Funds	123,504,102	(311,875)	123,192,227
External Investment Trust Funds	12,608,093		12,608,093
Private-Purpose Trust Funds	2,897,606		2,897,606
Total Fiduciary Funds	139,009,801	(311,875)	138,697,926
Total Primary Government	266,911,232	(352,880)	266,558,352
Discretely Presented Component Units	401,601		401,601
Total Reporting Entity	$267,312,833	$ (352,880)	$266,959,953

Restatements by Activity

(Amounts in Thousands)

Restatements	Governmental Activities	Business-Type Activities	Fiduciary Activities	Total Restatements
A.	$ (5,410)	$ 32,149		$ 26,739
B.	(29,545)	(38,199)		(67,744)
C.			(311,875)	(311,875)
Total Restatements	$ (34,955)	$ (6,050)	$ (311,875)	$ (352,880)

A. These are miscellaneous restatements and other changes necessary to correct accounting errors in the prior period that resulted in the over or understatement of revenues and/or expenditures.

B. This restatement is for adjusting capital assets and accumulated depreciation.

C. This restatement recognizes a change in Tex$aver 457 trust fund reporting was appropriate. Previously, investment assets of participants and related activities had been reported as assets of the Employees Retirement System of Texas in the agencies financial statements. Since the System does not have significant administrative involvement, it is no longer reporting assets and activities of the individuals pursuant to GASB Statement 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. The agency is a government sponsor of the Internal Revenue Code Section 457 deferred compensation plan for state employees. Such plans are not reported in the sponsoring employer's financial statements because sponsors typically remit employee contributions directly to a third-party administrator who holds the asset in trust. Therefore, the beginning balance of Net Assets Held in Trust for Pension Benefits as of Sept. 1, 2006, was totally restated by $311.9 million and consequently there is no activity reported relating to this Texa$aver 457 trust fund during the fiscal year ended Aug. 31, 2007.

Note 15
Contingent Liabilities

The state has been named as a defendant in routine legal proceedings, which normally occur in governmental operations. The recurring pattern of such litigation is not likely to have a materially adverse effect on the state's revenues or expenditures. Potential claims have been classified into the following categories to facilitate disclosure.

Protested Tax Payments

As of Aug. 31, 2007, the state held protested tax payments of $118.5 million, the majority of which were held by the Comptroller. The taxes included state sales and use tax, franchise tax, insurance premium and maintenance taxes, surtaxes and various other fees under protest. In addition, plaintiffs have filed lawsuits seeking refunds for franchise, sales, insurance, motor vehicle sales and use and oil and gas production taxes totaling $698 million. Although the outcome of these cases cannot presently be determined, adverse rulings in some of them could result in significant additional refunds.

Unpaid Claims and Lawsuits

A variety of cases with claims totaling $266.4 million have been filed which may affect the state. While the outcome of these cases cannot be determined, adverse rulings could result in additional liabilities. Included are a number of lawsuits and claims that may be significant to individual state agencies. The Texas Department of Transportation faces a potential liability of $91.9 million from litigation and contractual claims. The Department of Family and Protective Services is potentially impacted from civil rights, discrimination and tort claims of $139.9 million.

Outstanding Loan Commitments

The state makes loan commitments to political subdivisions for financing purposes to be provided from remaining current bond proceeds, future bond proceeds and federal drawdowns.

The Texas Water Development Board has loan commitments totaling $1.2 billion as of Aug. 31, 2007.

Federal Assistance

The state receives federal financial assistance which is subject to review or audit by federal grantor agencies. Entitlement to this assistance is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance as a result of the audits may become a liability of the state. The state estimates that the ultimate disallowance pertaining to these grants, if any, will be immaterial to its overall financial condition.

Arbitrage

Rebatable arbitrage is defined by Internal Revenue Code Section 148 as earnings on investments purchased with the gross proceeds of a bond issue in excess of the amount that would have been earned if the investment were invested at a yield equal to the yield on the bond issue. The rebatable arbitrage must be paid to the federal government. State agencies and universities responsible for investments from bond proceeds carefully monitor their investments to restrict earnings to a yield less than the bond issue and, therefore, limit any state arbitrage liability. The state estimates that rebatable arbitrage liability, if any, will be immaterial to its overall financial condition.

Guaranteed Debt

At Aug. 31, 2007, $44.9 billion in debt had been guaranteed by the permanent school fund for 2,518 outstanding bond issues in 767 school districts in the state. Under state statute, payments by the permanent school fund on such guarantees are recoverable from the state of Texas. The $44.9 billion represents principal amount and does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities). The amount also excludes bonds that have been refunded and released from the Bond Guarantee Program.

Partnerships

The University of Texas System (UT) has invested in certain limited partnerships. The partnership agreements commit UT to possible future capital contributions amounting to $2 billion as of Aug. 31, 2007. The Teacher Retirement System has $9.5 billion in remaining commitments for private equity domestic and international partnerships.

Note 16
Subsequent Events

Primary Government

State agencies and universities have issued $2.3 billion in new bonds and commercial paper and $218 million in refunding bonds since Aug. 31, 2007. This routine activity finances state facilities, housing assistance programs, educational loans and refunds outstanding debt.

Texas Public Finance Authority (TPFA) issued $22.1 million of General Obligation Commercial Paper Notes, Series 2002A on Sept. 10, 2007. TPFA issued $10 million of Revenue Commercial Paper Notes, Series 2003 on Sept. 13, 2007. Building Revenue Refunding Bonds for Texas Department of Criminal Justice (TDCJ) Projects, Series 2007 in the amount of $45.4 million were sold on Sept. 25, 2007, to refund and legally defease the Series 1998A (TDCJ) bonds in order to lower the overall debt service requirements. The agency issued $15 million of General Obligation Commercial Paper Notes, Series 2002B on Oct. 22, 2007, and $4.7 million of General Obligation Commercial Paper Notes, Series 2002A, on Nov. 14, 2007. The purpose of the general obligation debt was to support various projects for the Colonias Roadway Program, the Texas Facilities Commission, the Texas Department of State Health Services and the Texas Youth Commission. Revenue financing using commercial paper was issued for projects for the Texas Department of Aging and Disability Services, Angelo State University and Texas Tech University.

The Texas Department of Housing and Community Affairs issued $172.1 million in single-family revenue bonds for the primary purpose of providing funds for the purchase of mortgage-backed, pass-through certificates.

In September 2007, the Texas Workforce Commission and its advisors determined that sufficient balances existed in the obligation assessment fund to enable redemption of some of the variable rate bonds (Series D). On Sept. 7, 2007, the Texas Workforce Commission transferred to the TPFA $65.3 million and on Oct. 4, 2007, the Commission transferred an additional $3.7 million. These funds will reduce the amount of debt of the Series D principal outstanding to $79 million. This transaction will reduce the amount of debt remaining, if any, in the last year of the bond debt service and also reduce interest paid by lowering the principal outstanding by selectively redeeming variable rate bonds with the highest interest rates.

The Texas Water Development Board (TWDB) issued $118.5 million in general obligation debt in September 2007 for the purpose of refunding $121.5 million in Water Development Bonds, Series 1997-A, 1997-B and 1997-D. These represent self-supporting general obligation bonds related to business-type activities and to provide loans to political subdivisions for the construction of water treatment systems. On Oct. 20, 2007, TWDB issued $25 million of Series 2007-D general obligation bonds for the purpose of providing loans for self-supporting business-type activities. On Jan. 8, 2008, the agency issued $203 million of Series 2008-A self-supporting revenue bonds as part of the $350 million in authorized bonds for the "New Money for Trinity River Authority Clean Water State Revolving Fund."

On Nov. 14, 2007, the General Land Office board issued its $54.2 million Series 2007C Taxable Refunding Bonds to refund the State of Texas Veterans' Housing Assistance Program, Fund II Series 1997A and 1997B Bonds.

On Oct. 31, 2007, the Texas Department of Transportation issued $1.2 billion in State Highway Fund First Tier Revenue Bonds Series 2007 for the purpose of (i) financing state highway improvement projects that are eligible for funding with revenues dedicated under Article VIII, Section 7-a of the Texas Constitution; and (ii) to pay the costs of issuing bonds.

On Nov. 6, 2007, the University of Texas System (UT) Board of Regents issued $150 million of Permanent University Fund Flexible Rate Notes, Series A. On Dec. 20, 2007, $345.5 million of Revenue Financing System Bonds were issued for construction and refund of RFS Commercial Paper Notes, Series A.

Effective Dec. 17, 2007, the UT Health Science Center at San Antonio (UTHSCSA) assumed responsibility for the operation of the Cancer Therapy and Research Center (CTRC), a 501(c)(3) nonprofit corporation. In the merger of the two entities, UTHSCSA acquired possession of the real and personal property of CTRC, paying off the long-term real estate indebtedness of CTRC at a cost of $13.8 million. Net property and equipment acquired in the combination was valued at $55.3 million as of Sept. 30, 2007.

Effective Sept. 1, 2007, the governance, control, management and property of Angelo State University was transferred from the Board of Regents of the Texas State University System to the Board of Regents of the Texas Tech University System, which will increase net assets by $215 million for the Texas Tech University System. Existing debt issued by the Texas State University System and attributable to Angelo State University as of Sept. 1, 2007, remains a liability of the Texas State University System. The transfer is governed by House Bill 3564 and Senate Bill 1749.

The 80th Legislature appropriated more than $217 million to the Texas Department of Criminal Justice (TDCJ) for the expansion of treatment and diversion programs in fiscal years 2008-09. These initiatives included funding for additional substance abuse treatment for probationers and incarcerated offenders, additional funding for mental health services for offenders, additional probation and parole intermediate sanction facility beds, probation residential treatment beds and parole halfway house beds. Also, two Texas Youth Commission facilities in Marlin and San Saba were transferred to TDCJ by state legislative action, thereby increasing TDCJs correctional capacity. By the end of the 2008-09 biennium, these targeted appropriations will add approximately 5,700 beds to the adult Texas criminal justice system.

Component Unit

On Oct. 30, 2007, the Texas State Affordable Housing Corporation (the Corporation) issued $23.5 million in single-family mortgage revenue bonds (Series 2007D). On Sept. 24, 2007, the Corporation closed a transaction involving the acquisition and rehabilitation of thirteen existing multi-family rental properties located in nine Texas cities. The transaction was financed with the issuance of $34.9 million in private activity bonds and a $500,000 loan from the Corporation. One hundred percent of the units in the apartment complex will be set aside for residents at or below 50 percent of the area median income. On Sept. 19, 2007, the Corporation issued $23.5 million Series 2007B revenue bonds, and a refunding transaction was completed for $100 million on Oct. 1, 2007. The funds are to be used primarily to provide single family home loans to professional educators, fire fighters, law enforcement or security officers and nursing faculty. Funds are available for the single family Homes for Texas Heroes Home Loan Program and to finance affordable multifamily rental housing.

Note 17
Risk Management

It is the policy of the state and its agencies to periodically assess the proper combination of commercial insurance and self-insurance to cover the risk of losses to which it may be exposed. The state is not involved in any risk pools with other governmental entities.

Liabilities are reported when it is 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.

For workers' compensation and unemployment compensation claims, the state is generally self-insured and funds such liabilities on a pay-as-you-go basis. The state assumes substantially all risks associated with tort claims and liability claims against the state or its agencies due to conditions of property, vehicles, aircraft or watercraft.

The Texas Employees Group Benefits Program (GBP) provides health, life, accidental death and dismemberment (AD&D), disability and dental insurance coverage to state and higher education employees, retirees and their dependents. Coverage is 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. Effective Sept. 1, 1992, the Employees Retirement System of Texas (ERS) implemented a self-funded managed care health plan — HealthSelect of Texas. The managed care arrangement includes provider fee negotiations and utilization management. HealthSelect is administered by Blue Cross and Blue Shield of Texas, Inc.

The administrative contract involves no transfer of risk to the administrator. The state's group insurance fund retains all risk under HealthSelect. The GBP also includes HMOs to provide health care services in lieu of coverage under HealthSelect. There is a full transfer of risk to the HMOs. The state retains no risk beyond the payment of premiums. The life, AD&D and disability insurance coverages are administered by Group Life and Health (the carrier), a division of Fort Dearborn Life Insurance Company. The carrier, not the fund, is liable in the event claims exceed the claims portion of premium. The AD&D insurance is fully insured. ERS approved two dental plans for fiscal 2007, a dental health maintenance organization (DHMO) administered by Aetna Dental, Inc. and a dental indemnity plan administered by the Government Employees Hospital Association (GEHA). The DHMO is fully insured with all risk transferred to Aetna Dental, Inc. Beginning Sept. 1, 1997, the dental indemnity plan became self-funded by ERS with all risk retained by the Group Insurance Fund.

The 77th Legislature enacted the Texas School Employees Uniform Group Health Coverage Act, establishing a new statewide health coverage program for public school employees and their dependents. The Teacher Retirement System administers this program. Enrollment commenced in September 2002. The new plan took effect Sept. 1, 2002, and includes employees of most small to mid-size districts, charter schools, education service centers and certain other employers.

A number of state universities have self-insurance plans providing various coverages in the areas of workers' compensation, unemployment compensation, employee health and medical malpractice on a funded or pay-as-you-go basis. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Estimates of liabilities for incurred (both reported and unreported), but unpaid claims are actuarially determined based on estimates of the ultimate cost of settling claims, using past experience adjusted for current trends and any other factors that would modify past experience. There have been no significant reductions in insurance coverage in the past year and losses did not exceed funding arrangements during the past three years.

The following table presents the changes in claims liability reported in various balance sheet/statement of net assets liability accounts for the general fund government-wide governmental activities, enterprise funds, internal service fund and colleges and universities during fiscal years ending Aug. 31, 2006, and Aug. 31, 2007. Claims and judgment amounts presented in Note 5 (Long-Term Liabilities) are also included in the table.

Changes in Claims Liability Balances

(Amounts in Thousands)

	Beginning Balance	Increases	Decreases	Ending* Balance
2007	$810,226	$1,716,867	$1,809,210	$717,883
2006	$791,206	$2,400,267	$2,381,247	$810,226

* The ending balance includes both short-term and long-term claims. Long-term claims are reported as claims and judgments (current and noncurrent liabilities) which are included in Note 5 (long-term liabilities). Short-term claims payable, the majority of which relate to claims filed for the state's Group Benefits Program, are included as accounts payable in the statement of net assets and not included in Note 5.

Note 18
Contested Taxes

Taxpayers may petition for a formal hearing before an independent administrative law judge if they wish to challenge a tax liability assessed by the state. If the request for a determination hearing is received within a specified time, the taxpayer does not have to pay the tax until a final decision is reached. Collectability of these assessments is dependent upon the decisions of administrative law judges. These assessments are not recognized as tax revenue until the administrative hearing is final. Therefore, these amounts are not included in the receivables reported in the financial statements. As of Aug. 31, 2007, the redetermination hearings process had an estimated amount of $530 million.

Note 19
Component Units and Related Organizations

Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. Component units can also be other organizations for which the nature and significance of their relationship with a primary government is such that exclusion would cause the reporting entities financial statements to be misleading or incomplete. In addition, component units can be organizations that raise and hold economic resources for the direct benefit of a government unit. Because of the closeness of their relationships with the primary government, some component units are blended as though they are part of the primary government. However, most component units are discretely presented. None of the component units for the state of Texas meet the criteria for major component unit presentation and those presented are for information purposes of interested parties. The component units are reported for the year ended Aug. 31, 2007, unless indicated otherwise. There are no material blended component units of the state.

Discretely Presented Component Units

The state is financially accountable for the following legally separate entities (component units); however, the units do not provide services entirely or almost entirely to the state. The component unit's financial data is discretely presented in the component units column of the state's financial statements.

State Bar of Texas is a public corporation and an administrative agency of the judicial branch of government. The purpose of the State Bar is to ensure that public responsibilities of the legal profession are effectively discharged. The state of Texas has the ability to impose its will upon the State Bar through its budget approval powers. The State Bar is reported for the year ended May 31, 2007. Separate financial statements may be obtained by contacting the State Bar of Texas at P.O. Box 12487, Austin, Texas 78711.

Texas Agricultural Finance Authority (Authority) is a legally separate entity within the Texas Department of Agriculture (TDA) and is financially accountable to the state.

The governor, with the advice and consent of the Senate, appoints seven of the nine members of the board of directors. The commissioner of TDA administers the Authority with the assistance of the board. The Authority was created to provide financial assistance for the expansion, development and diversification of agricultural businesses. The Authority primarily benefits the citizens of Texas. Separate financial statements may be obtained by contacting the TDA at P.O. Box 12847, Austin, Texas 78711-2847.

Texas On-Site Wastewater Treatment Research Council (Council) awards competitive grants and contracts to support applied research, demonstration projects and information transfer regarding on-site wastewater treatment. The Council is not an advisory council and does not regulate the on-site wastewater industry in the state of Texas. The Council is a component unit due to its fiscal dependency on the Texas Commission on Environmental Quality (TCEQ). The Council's fiscal operations (revenues, budget, expenditures and administration) are maintained by TCEQ. In order to emphasize that the Council is a legally separate entity, its financial information is presented in a separate column in the TCEQs combined financial statements.

Texas Appraiser Licensing and Certification Board (TALCB) was statutorily created as an independent subdivision of the Texas Real Estate Commission (TREC) and is a legally separate entity from the primary government. The governor appoints the members of the board. TREC provides administrative support to TALCB, but has no authority to approve or modify its budget or to set its fees. Although TALCB is not fiscally dependent on TREC, to exclude it would result in presentation of incomplete financial statements. TALCB serves the real estate community in Texas. Financial statements can be obtained by contacting TREC at P.O. Box 12188, Austin, Texas 78711-2188.

Texas Prepaid Higher Education Tuition Scholarship Foundation, Inc. (Foundation) is a legally separate entity created to provide prepaid tuition scholarships to students meeting economic or academic requirements. The Foundation is a direct-support organization of the prepaid tuition program and is authorized by Section 54-633 of the Texas Education Code. The Foundation is governed by a board composed of the Comptroller of Public Accounts, a member appointed by the governor with the advice and consent of the Senate and three members appointed jointly by the Comptroller and the member who is appointed by the governor. Separate financial statements may be obtained by contacting the Texas Comptroller of Public Accounts, Texas Guaranteed Tuition Plan at 111 E. 17th Street, Austin, Texas 78774.

Texas Guaranteed Student Loan Corporation (Corporation) is a public nonprofit corporation that guarantees loans made to eligible students under the federal guaranteed student loan program. The state of Texas is financially accountable for the Corporation through board appointment and imposition of will. All members of the Corporation's board are appointed by the governor with the advice and consent of the Senate. The Corporation's liabilities are not debts of the state. The Corporation received a one-time appropriation of $1.5 million to fund initial startup operations. The Corporation is reported for the year ended Sept. 30, 2007. Separate financial statements may be obtained by contacting the Texas Guaranteed Student Loan Corporation at P.O. Box 201725, Austin, Texas 78720-1725.

Texas Boll Weevil Eradication Foundation, Inc. (Foundation) was created by Senate Bill 30, 73rd Legislature, 1993 (now codified at Texas Agriculture Code, Chapter 74, Subchapter D). The Foundation establishes and implements a boll weevil eradication program for Texas. It is a legally separate entity, fiscally dependent on the TDA and governed by sixteen board members. TDA's commissioner appoints eight of the board members. TDA approves the Foundation's budget, assessment fees and debt. The Foundation is reported for the year ended Dec. 31, 2006. Separate financial statements may be obtained by contacting the TDA at P.O. Box 12847, Austin, Texas 78711-2847.

Texas Water Resources Finance Authority (Authority) was created by the Legislature as a governmental entity and body politic and corporate for the purpose of increasing the availability of financing for water-related projects. A board of directors, composed of the six members of the Texas Water Development Board (TWDB), governs the Authority. TWDB, through a sales and servicing agreement, wholly manages the Authority's operations. Financial statements may be obtained by contacting the TWDB at P.O. Box 13231, Austin, Texas 78711-3231.

Texas Small Business Industrial Development Corporation (TSBIDC) was chartered in 1983 under the Development Corporation Act of 1979 to promote economic development in the state of Texas. The Office of the Governor is the oversight agency for the TSBIDC and is its reporting entity. The board of directors is appointed by the governor. TSBIDC's services primarily benefit the Texas citizenry. Separate financial statements may be obtained by contacting the Office of the Governor at P.O. Box 12428, Austin, Texas 78711.

Texas Economic Development Corporation (TED Corp), a nonprofit corporation, was created in 1991 under the provisions of the Texas NonProfit Corporation Act to assist, promote, develop and advance economic development in the state of Texas. The Office of the Governor is the oversight agency for the TED Corp and is its reporting entity. The board of directors is appointed by the governor. The entity's services primarily benefit the Texas citizenry. Separate financial statements may be obtained by contacting the Office of the Governor at P.O. Box 12428, Austin, Texas 78711.

Texas Disaster Relief Fund (TDRF), a nonprofit corporation, was established to help the Office of the Governor provide disaster relief. The chief of staff, director of homeland security and the chief financial officer of the Office of the Governor serve as initial directors and will change only when these positions change. The services provided by TDRF assist the Office of the Governor in responding to the needs of the citizens before, during and after a disaster in Texas. TDRF's financial statements for the fiscal year ended Dec. 31, 2006, may be obtained by contacting the Office of the Governor at P.O. Box 12428, Austin, Texas 78711.

Surplus Lines Stamping Office of Texas (Stamping Office) is a nonprofit corporation created by the Legislature to assist the Texas Department of Insurance (TDI) in the regulation of surplus lines insurance. TDI's commissioner appoints the board. The Stamping Office performs its functions under a plan of operation approved by order of TDI. The Stamping Office assesses each surplus lines insurance agent a stamping fee for the administrative funding of the Stamping Office. The state of Texas has the ability to impose its will upon the Stamping Office through the approval of the assessment rate that funds its operations. The Stamping Office is reported for the year ended Dec, 31, 2006. Separate financial statements may be obtained at P.O. Box 160170, Austin, Texas 78716-0170.

Texas Health Reinsurance System reinsures risks covered under the health benefit plans of small employers' insurance carriers. TDI's commissioner appoints, supervises and controls the nine-member board. The state of Texas has the ability to impose its will through TDI commissioner approval of base reinsurance premium rates and the assessment rates against reinsured health benefit plan issuers. Financial statements may be obtained at 100 Great Meadow Rd., Suite 704, Wethersfield, Connecticut 06109.

Texas Health Insurance Risk Pool provides access to quality health care at a minimum cost to the public for those unable to obtain traditional health care coverage. The TDI approves all rates and rate schedules before they are used. The board of directors, composed of nine members, is appointed by TDI's commissioner. Financial statements may be obtained at 1701 Director's Blvd., Suite 120, Austin, Texas 78744.

Texas State Affordable Housing Corporation (TSAHC) was incorporated under the Texas NonProfit Corporation Act and is legally separate from the state. Its purpose is to serve the housing needs of low-income Texans who are not afforded housing finance options through conventional lending channels, professional educators, firefighters and police officers who are first-time home buyers. TSAHC operates under the name Texas Star Mortgage to provide single and multifamily loans to low-income Texans. Although a separate entity from the state, there is a statutory link between the state and TSAHC as it issues bonds. Because of this link, TSAHC is included in the state's CAFR as a discretely presented component unit. Separate financial statements may be obtained by contacting TSAHC at P.O. Box 12637, Austin, Texas 78711-2637.

Related Organizations

Related organizations are legally separate, fiscally independent entities for which the state appoints a voting majority of the board, however, the state is not financially accountable for the entity.

Life, Accident, Health and Hospital Service Insurance Guaranty Association (Association) was created for the protection of persons against failure in the performance of contractual obligations under life, accident and health insurance policies and annuity contracts, because of the impairment or insolvency of the member insurer that issued the policies or contracts. TDI's commissioner appoints a board of directors of the Association consisting of nine members.

Texas Title Insurance Guaranty Association was created for the purpose of providing funds for the protection of holders of "covered claims," as defined in Article 9.48 of the Texas Insurance Code. This applies to all title insurance written by title insurance companies authorized to do business in Texas. The nine-member board of directors is appointed by TDI's commissioner.

Texas Mutual Insurance Company (Texas Mutual) was created by House Bill 3458. It was previously known as the Texas Workers' Compensation Insurance Fund and reported as a discretely presented component unit. Texas Mutual operates as a domestic mutual insurance company providing workers' compensation insurance in the state of Texas and also serves as the insurer of last resort. It is legally separate and fiscally independent of the state, but the state appoints a voting majority of the Texas Mutual's board.

Texas Institute for Genomic Medicine (TIGM) is a nonprofit institute founded in 2005 under a $50 million award from the Texas Enterprise Fund to pioneer the development of life changing medical breakthroughs, accelerate the pace of medical discoveries and foster the development of the biotechnology industry in Texas. The voting majority of the TIGM Board is appointed by the A&M System Board of Regents upon recommendations from member CEOs.

Midwestern State University Charitable Trust is a nonprofit organization with the sole purpose of educational and other activities of Midwestern State University. It is governed by a five-member board of trustees. This board appoints individuals to fill vacancies on the Board as they occur.

River Authorities are political subdivisions that are created by Texas statute. The Texas Constitution, Article XVI, Section 59, authorizes the Legislature to create districts that conserve and develop natural resources of the state. The conservation and development of the state's natural resources includes the control, storing, preservation and distribution of its storm and flood waters, the waters of its rivers and streams, for irrigation, power and all other useful purposes, the reclamation and irrigation of its arid, semiarid and other lands needing irrigation, the reclamation of drainage of its overflowed lands and other lands needing drainage, the conservation and development of its forests, water and hydro-electric power, the navigation of its inland and coastal waters and the preservation and conservation of all such natural resources of the state. The state of Texas has voting majority for the following 14 river/water authorities:

- Angelina-Neches River Authority
- Brazos River Authority
- Central Colorado River Authority
- Guadalupe Blanco River Authority
- Lavaca Navidad River Authority
- Lower Colorado River Authority
- Lower Neches Valley River Authority
- Nueces River Authority
- Red River Authority
- Sabine River Authority
- Trinity River Authority
- Upper Colorado River Authority
- Upper Guadalupe River Authority
- Upper Neches Municipal Water Authority

Note 20
Deficit Fund Balances/Net Assets

A. Primary Government

Proprietary Funds

The Texas Prepaid Higher Education Tuition Board, a nonmajor enterprise fund, reported a deficit of $164.6 million. This deficit was caused by tuition increases at Texas public senior colleges for the academic years 2002-05. A prolonged stock market downturn in 2000-02 also contributed to this deficit.

B. Discretely Presented Component Units

The Texas Boll Weevil Eradication Foundation, Inc., a component unit of the Texas Department of Agriculture, reported a deficit unrestricted net assets of $33.7 million.

This is a result of incurring debt during the early years of the eradication program which resulted in a decrease in unrestricted net assets on the statement of activities and an unrestricted deficit on the statement of net assets. Although this "loss" was incurred during the initial operations of the program, management expects an increase in net assets in later years to offset this loss.

Note 21
Tobacco Settlement

The state of Texas settled a lawsuit against certain tobacco manufacturers in 1998. The settlement included monetary and injunctive relief. The tobacco manufacturers agreed to remit annual payments to the state. Estimates made at the time of the agreement projected that these payments could total $15.1 billion over the first 25 years of the agreement. The actual amounts of the annual payments are subject to adjustments for domestic tobacco sales, inflation and any other court-ordered factors; however, the tobacco companies have no obligation to make settlement payments until cigarettes are shipped (sales). Since annual payments are based on cigarette sales from the preceding calendar year, a revenue accrual of $331.9 million has been calculated on estimated sales from Jan. 1 to the end of the fiscal year. Tobacco settlement revenues were $550.9 million in fiscal 2006 and $503 million in fiscal 2007. Cumulative actual tobacco settlement revenues as of fiscal 2007 were $5.2 billion.

Note 22
Donor-Restricted Endowments

The state of Texas has donor-restricted endowments with net appreciation of $26.7 billion on investments that are available for authorization for expenditure by the governing board. Details for the amounts of the net appreciation on investments and how they are reported in net assets can be found in the donor-restricted endowments schedule below. True endowments require the principal to be maintained inviolate and in perpetuity. Term endowments allow the principal to be expended after the passage of a stated period of time and all conditions of the endowment have been met.

Expendable funds are those funds that may be expended for either a stated purpose or for a general purpose as per the endowment gift terms. Nonexpendable funds are those that are required to be retained in perpetuity. The policies of each individual state agency govern the authorizing and spending of net appreciation on endowment investments.

Each endowment fund evaluated the allocation of their restricted net assets as either expendable or nonexpendable. The permanent school fund (PSF) and permanent university fund (PUF) account for the majority of the donor-restricted endowment funds reported by the state. The PSF and PUF each consider historical oil and gas contributions from endowment lands as nonexpendable net assets. The PUF also considers the reported value of the land as nonexpendable net assets. The PSF does not include the value of its land in calculating nonexpendable net assets as the land is considered investment property and not part of the original corpus of the endowment. The remaining restricted net assets of each endowment are classified as expendable.

The Uniform Management of Institutional Funds Act, as adopted by the Legislature, gives general guidelines on how endowments should be maintained for higher education institutions. Each institution sets the amounts and/or percentages that are authorized for expenditure in its spending plan; however, the PSF and PUF are governed by provisions of the Texas Constitution. Distributions made by the PSF and PUF endowments to the available school fund (ASF) and available university fund (AUF), respectively, are made using a total return methodology. The ASF distribution should not exceed the lesser of 6 percent or the total return on all investment assets over the current year and proceeding nine years. The AUF distribution should not exceed 7 percent of the average net fair value of investment assets.

Donor-Restricted Endowments
(Amounts in Thousands)

Donor-Restricted Endowments	Amount of Net Appreciation	Reported in Net Assets
True Endowments	$ 26,721,759	Expendable
Term Endowments	1	Expendable
	$ 26,721,760	

Note 23
Extraordinary and Special Items

The state did not report extraordinary items in the current fiscal year. Extraordinary items, as defined in GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, are transactions or other events that are both unusual in nature and infrequent in occurrence.

The state reported a special item equal to $318.8 million in the current fiscal year. Special items are significant items, subject to management control, that meet one, but not both of the criteria used for identifying extraordinary items. At Oct. 1, 2006, the unemployment compensation trust fund exceeded the statutorily mandated ceiling of 2 percent of taxable wages. This required the refunding of surplus tax credits to eligible employers based on tax returns filed during the 2007 calendar year. Tax refunds of $318.8 million applied to 304,508 employers who had paid taxes into the unemployment compensation trust fund.

Note 24
Taxes Receivable

Taxes receivable represent amounts due to the state at Aug. 31, 2007, for revenues earned in the current fiscal year that will be collected in the future. Amounts expected to be collected in the next fiscal year are classified as "current" and amounts expected to be collected beyond the next fiscal year are classified as "noncurrent." The receivables have been recorded net of allowances for uncollectible accounts. Revenue is recorded on the governmental fund financial statements using the modified accrual basis of accounting for amounts due to the state of Texas at Aug. 31, 2007, that are considered "available" (e.g. received by the state within approximately 60 days after that date). Revenue earned but not "available" at Aug. 31, 2007, is recorded as deferred revenue. Prepaid taxes are also recorded as deferred revenue.

On the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting, which includes revenue earned at fiscal year end regardless of its availability. Deferred revenue includes only the prepaid taxes that have not been earned by fiscal year end. Taxes receivable are the same for both modified and full accrual bases.

Taxes receivable, as reported in the general fund on the balance sheet – governmental funds, are detailed by tax type as follows.

Taxes Receivable by Tax Type

August 31, 2007 (Amounts in Thousands)

Tax Type	Net Taxes Receivable
Sales and Use Tax	$ 1,402,570
Motor Vehicle and Manufactured Housing	88,045
Motor Fuels	236,531
Franchise	487,591
Oil and Natural Gas Production	407,746
Insurance Occupation	121,349
Cigarette and Tobacco	389
Other	212,905
Total Net Taxes Receivable	$ 2,957,126
Liquidity Characteristics:	
Current Taxes Receivable	$ 2,494,362
Noncurrent Taxes Receivable	462,764
Total Net Taxes Receivable	$ 2,957,126

COBRA Benefits

(Amounts in Thousands)

Fiscal 2007 Summary Benefits Provided Through:	Number of Participants	Premium Revenue	2 Percent Administrative Fee Revenue	Claims Paid	Cost to State
Employees Retirement System	2	$ 7,536	$ 150	$18,232	$10,546
University of Texas System	2	4,307	84	9,652	5,261
Texas A&M University System*	1	851	17	1,325	457
Teacher Retirement System**	N/A	N/A	N/A	N/A	N/A
Total	5	$12,694	$ 251	$29,209	$16,264

* The participants and costs for Texas A&M University System are for the self-insured program. The system also has 128 participants in HMO groups. The cost for the HMO is unknown. The 2 percent administrative fee is not retained by the system but is passed to the carrier.

** The Teacher Retirement System Active Care Plan is administered by the system for public school district employees. The state is not the employer nor does it contribute to the plan.

Note 25
Termination Benefits

Health care continuation under the Consolidated Omnibus Budget Reconciliation Act (COBRA) is provided for both voluntary and involuntary terminations. The COBRA members are eligible to remain in the Group Benefits Program for 18 months or 29 months if disabled. Covered dependents are eligible to remain in the program for 36 months. COBRA benefits for the state in fiscal 2007 are shown above.

Note 26
Segment Information

Primary Government

Segments are separately identifiable activities reported as or within enterprise funds for which revenue bonds or other revenue-backed debt instruments are outstanding and for which related expenses, gains, losses, assets and liabilities can be identified. To qualify as a segment, an activity must also be subject to an external requirement to separately account for this revenue stream. The activities reported in the following financial information meet these requirements.

The State of Texas David A. Gloier State Veterans Home Program was created to provide long-term skilled nursing care for veterans, spouses of veterans and gold star parents of veterans of the state of Texas. The construction of the first four homes was funded by the issuance of revenue bonds, which require these homes' revenues, expenses, gains and losses, assets and liabilities to be separately accounted for and independently audited. The following tables present the financial statements of the homes related to the revenue bonds.

Condensed Statement of Net Assets

(Amounts in Thousands)

	Veterans Homes Revenue Bonds
ASSETS	
Current Restricted Assets:	
Cash and Cash Equivalents	$ 12,122
Other Current Assets	4,491
Capital Assets, Net of Depreciation	30,849
Total Assets	47,462
LIABILITIES	
Current Liabilities	4,137
Noncurrent Liabilities	23,345
Total Liabilities	27,482
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	7,174
Restricted Net Assets	12,806
Total Net Assets	$ 19,980

Condensed Statement of Revenues, Expenses and Changes in Net Assets

(Amounts in Thousands)

	Veterans Homes Revenue Bonds
OPERATING REVENUES (EXPENSES)	
Sale of Goods and Services	$ 35,346
Other Operating Revenues	6
Operating Expenses	(32,365)
Net Operating Income	2,987
NONOPERATING REVENUES (EXPENSES)	
Other Nonoperating Revenues	704
Interest Expense	(1,497)
Change in Net Assets	2,194
Net Assets, September 1, 2006	17,786
Net Assets, August 31, 2007	$ 19,980

Condensed Statement of Cash Flows

(Amounts in Thousands)

	Veterans Homes Revenue Bonds
NET CASH PROVIDED (USED) BY:	
Operating Activities	$ 4,025
Financing Activities	(1,828)
Investing Activities	(39)
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,158
Cash and Cash Equivalents, September 1, 2006	9,964
Cash and Cash Equivalents, August 31, 2007	$ 12,122