Section Two

(continued)

Basic Financial Statements

STATE OF TEXAS

Statement of Net Position

August 31, 2012 (Amounts in Thousands)

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
ASSETS				
Current Assets:				
Cash and Cash Equivalents	$ 25,691,472	$ 4,919,379	$ 30,610,851	$ 776,929
Short-Term Investments	618,088	1,228,931	1,847,019	876,624
Securities Lending Collateral	389,323	693,110	1,082,433	
Receivables:				
Taxes (Note 24)	3,094,060		3,094,060	
Federal	2,597,125	683,313	3,280,438	36,420
Other Intergovernmental	891,827	69,646	961,473	2,761
Accounts	773,615	1,797,957	2,571,572	174,963
Interest and Dividends	95,012	138,953	233,965	8,619
Gifts		185,627	185,627	
Investment Trades	9,049	474,347	483,396	
Other	88,123	302,144	390,267	63
From Fiduciary Funds	139,565	4	139,569	
Due From Component Units (Note 12)	89		89	
Inventories	325,690	153,107	478,797	3,855
Prepaid Items	3,697	123,169	126,866	35,327
Loans and Contracts	79,004	290,185	369,189	1,606
Other Current Assets	84	376,199	376,283	1,825
Restricted:				
Cash and Cash Equivalents	10,507	3,072,144	3,082,651	30,908
Short-Term Investments		356,898	356,898	
Loans and Contracts	81,613	83,558	165,171	1,012
Total Current Assets	34,887,943	14,948,671	49,836,614	1,950,912
Noncurrent Assets:				
Internal Balances (Note 12)	29,046	(29,046)		
Loans and Contracts	1,865,615	4,282,189	6,147,804	18,687
Investments	28,921,833	5,640,391	34,562,224	3,233
Receivables:				
Taxes (Note 24)	136,452		136,452	
Federal	30,156		30,156	
Gifts		226,826	226,826	
Other	248,060	450	248,510	1,653
Restricted:				
Cash and Cash Equivalents		17,112	17,112	
Short-Term Investments		1,453	1,453	
Investments		32,346,619	32,346,619	249,753
Receivables		181,601	181,601	
Loans and Contracts	1,327,845	3,106,040	4,433,885	9,339
Other	88,006	4,550	92,556	
Assets Held in Trust		2,900	2,900	
Deferred Charges	34,432	100,472	134,904	
Other Noncurrent Assets	4	195,461	195,465	10,211
Capital Assets: (Note 2)				
Non-Depreciable or Non-Amortizable	66,457,705	5,751,560	72,209,265	5,602
Depreciable or Amortizable, Net	11,991,077	18,591,906	30,582,983	56,252
Total Noncurrent Assets	111,130,231	70,420,484	181,550,715	354,730
Total Assets	146,018,174	85,369,155	231,387,329	2,305,642
DEFERRED OUTFLOWS				
Deferred Outflow of Resources (Note 7)		773,010	773,010	
Total Deferred Outflow of Resources	0	773,010	773,010	0

Concluded on the following page

The accompanying notes to the financial statements are an integral part of this statement.

STATE OF TEXAS

Statement of Net Position (concluded)

August 31, 2012 (Amounts in Thousands)

	Primary Government			
LIABILITIES	**Governmental Activities**	**Business-Type Activities**	**Total**	**Component Units**
Current Liabilities:				
Payables:				
Accounts	$ 5,106,640	$ 1,537,540	$ 6,644,180	$ 329,070
Payroll	634,772	715,368	1,350,140	759
Other Intergovernmental	330,008	18,432	348,440	
Federal	125	31,365	31,490	30,046
Investment Trades	22,864	533,073	555,937	
Interest	371,308	61,148	432,456	3,059
Tax Refunds (Note 24)	725,477		725,477	
Annuities		12,892	12,892	
To Fiduciary Funds	2,847		2,847	
Internal Balances (Note 12)	865,668	(865,668)		
Due To Primary Government (Note 12)				89
Unearned Revenue	4,471,290	2,890,400	7,361,690	249,686
Obligations/Reverse Repurchase Agreement	66,293		66,293	
Obligations/Securities Lending	488,975	693,110	1,182,085	
Short-Term Debt (Note 4)	9,800,000		9,800,000	
Claims and Judgments (Note 5)	50,183	16,708	66,891	
Capital Lease Obligations (Note 5, 8)	5,365	3,514	8,879	54
Employees' Compensable Leave (Note 5)	439,322	364,698	804,020	3,701
Notes and Loans Payable (Note 5)	170,932	673,538	844,470	9,570
General Obligation Bonds Payable (Note 5, 6)	383,782	129,075	512,857	
Revenue Bonds Payable (Note 5, 6)	178,378	2,165,794	2,344,172	25,053
Pollution Remediation Obligation (Note 5)	51,876		51,876	
Liabilities Payable From Restricted Assets (Note 5)		541,137	541,137	
Funds Held for Others		142,843	142,843	267
Hedging Derivative Liability (Note 7)		2,244	2,244	
Other Current Liabilities	203,823	283,567	487,390	254,160
Total Current Liabilities	24,369,928	9,950,778	34,320,706	905,514
Noncurrent Liabilities:				
Claims and Judgments (Note 5)	83,042	44,348	127,390	
Capital Lease Obligations (Note 5, 8)	6,338	18,124	24,462	56
Employees' Compensable Leave (Note 5)	293,574	340,545	634,119	2,184
Notes and Loans Payable (Note 5)	1,209,870	1,401,431	2,611,301	44,512
General Obligation Bonds Payable (Note 5, 6)	10,930,543	3,100,474	14,031,017	
Revenue Bonds Payable (Note 5, 6)	4,098,520	16,867,675	20,966,195	253,866
Pollution Remediation Obligation (Note 5)	195,508		195,508	
Liabilities Payable From Restricted Assets (Note 5)		2,959,350	2,959,350	
Assets Held for Others		851,724	851,724	
Net Pension Obligation (Note 9)	3,058,675		3,058,675	
Net OPEB Obligation (Note 11)		2,867,745	2,867,745	
Hedging Derivative Liability (Note 7)		770,766	770,766	
Other Noncurrent Liabilities		164,470	164,470	246,665
Total Noncurrent Liabilities	19,876,070	29,386,652	49,262,722	547,283
Total Liabilities	44,245,998	39,337,430	83,583,428	1,452,797
NET POSITION				
Invested in Capital Assets, Net of Related Debt	63,458,493	9,712,946	73,171,439	63,230
Restricted for:				
Education	779,724	2,531,612	3,311,336	140,847
Highways	139,441		139,441	
Debt Service	1,389,875	409,734	1,799,609	
Capital Projects	241,924	535,500	777,424	
Veterans Land Board Housing Programs		693,050	693,050	
Unemployment Trust Fund		1,481,132	1,481,132	
Funds Held as Permanent Investments:				
Nonexpendable	12,786,286	15,926,936	28,713,222	
Expendable	16,778,380	5,945,582	22,723,962	
Other	1,632,867	15,565	1,648,432	74,169
Unrestricted	4,565,186	9,552,678	14,117,864	574,599
Total Net Position	$ 101,772,176	$ 46,804,735	$ 148,576,911	$ 852,845

STATE OF TEXAS

Statement of Activities

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

		Program Revenues		
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
PRIMARY GOVERNMENT				
Governmental Activities:				
General Government	$ 3,116,737	$ 1,036,382	$ 1,022,258	$
Education	25,724,127	480,475	7,895,740	
Employee Benefits	423,492	134		
Teacher Retirement State Contributions	2,390,178			
Health and Human Services	44,737,457	1,910,599	29,390,231	
Public Safety and Corrections	5,294,730	342,782	543,227	
Transportation	4,484,662	2,224,635	2,892,143	34,705
Natural Resources and Recreation	1,634,659	699,872	1,047,124	12,873
Regulatory Services	410,724	710,209	5,508	
Interest on General Long-Term Debt	715,148			
Total Governmental Activities	88,931,914	7,405,088	42,796,231	47,578
Business-Type Activities:				
General Government	149,663	50,996	120,156	
Education	22,667,292	11,671,987	9,102,185	259,723
Health and Human Services	5,117,829	2,894,246	2,734,963	
Public Safety and Corrections	91,313	102,593		
Transportation	215,845	85,819		15
Natural Resources and Recreation	346,150	40,084	585,601	12
Lottery	3,027,943	4,191,587	7	
Total Business-Type Activities	31,616,035	19,037,312	12,542,912	259,750
Total Primary Government	$ 120,547,949	$ 26,442,400	$ 55,339,143	$ 307,328
COMPONENT UNITS				
Component Units	$ 2,806,197	$ 2,464,820	$ 314,814	$
Total Component Units	$ 2,806,197	$ 2,464,820	$ 314,814	$ 0

General Revenues
- Taxes:
  - Sales and Use
  - Motor Vehicle and Manufactured Housing
  - Motor Fuels
  - Franchise
  - Oil and Natural Gas Production
  - Insurance Occupation
  - Cigarette and Tobacco
  - Other
- Unrestricted Investment Earnings
- Settlement of Claims
- Gain on Sale of Capital Assets
- Other General Revenues

Capital Contributions

Contributions to Permanent and Term Endowments

Transfers - Internal Activities (Note 12)

Total General Revenues, Contributions and Transfers

Change in Net Position

Net Position, September 1, 2011

Restatements (Note 14)

Net Position, September 1, 2011, as Restated

Net Position, August 31, 2012

The accompanying notes to the financial statements are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Position			
Primary Government			
Governmental Activities	Business-Type Activities	Total	Component Units
$ (1,058,097)	$	$ (1,058,097)	$
(17,347,912)		(17,347,912)	
(423,358)		(423,358)	
(2,390,178)		(2,390,178)	
(13,436,627)		(13,436,627)	
(4,408,721)		(4,408,721)	
666,821		666,821	
125,210		125,210	
304,993		304,993	
(715,148)		(715,148)	
(38,683,017)	0	(38,683,017)	0
	21,489	21,489	
	(1,633,397)	(1,633,397)	
	511,380	511,380	
	11,280	11,280	
	(130,011)	(130,011)	
	279,547	279,547	
	1,163,651	1,163,651	
0	223,939	223,939	0
(38,683,017)	223,939	(38,459,078)	0
			(26,563)
0	0	0	(26,563)
24,349,600		24,349,600	
3,580,663		3,580,663	
3,195,332		3,195,332	
4,574,184		4,574,184	
3,727,498		3,727,498	
1,528,111		1,528,111	
1,428,413		1,428,413	
1,954,752		1,954,752	
645,813	133,680	779,493	(6,611)
620,898	378	621,276	
7,163	543	7,706	735
1,880,352	248,725	2,129,077	1,414
930		930	
	136,800	136,800	
(3,944,781)	3,944,781		
43,548,928	4,464,907	48,013,835	(4,462)
4,865,911	4,688,846	9,554,757	(31,025)
97,252,687	42,134,228	139,386,915	888,310
(346,422)	(18,339)	(364,761)	(4,440)
96,906,265	42,115,889	139,022,154	883,870
$ 101,772,176	$ 46,804,735	$ 148,576,911	$ 852,845

STATE OF TEXAS

Balance Sheet – Governmental Funds

August 31, 2012 (Amounts in Thousands)

	General	State Highway Fund	Permanent School Fund	Nonmajor Funds	Totals
ASSETS					
Cash and Cash Equivalents	$ 17,366,123	$ 3,571,283	$ 1,470,216	$ 3,228,406	$ 25,636,028
Short-Term Investments	69,217		37,709	117,082	224,008
Securities Lending Collateral			370,498		370,498
Receivables:					
Accounts	427,214	146,399	80,004	3,138	656,755
Taxes (Note 24)	2,938,660	218,717		73,135	3,230,512
Federal	2,271,394	333,859		22,028	2,627,281
Investment Trades	2,568		548	5,571	8,687
Other Intergovernmental	831,289	60,538			891,827
Interest and Dividends	3,950	8,189	68,390	12,511	93,040
Other	336,183				336,183
Due From Other Funds (Note 12)	132,857	252,515		73,450	458,822
Due From Component Units (Note 12)	89				89
Interfund Receivable (Note 12)	38,498			457	38,955
Inventories	199,562	125,971		157	325,690
Prepaid Items	1,589	2,097	6	5	3,697
Investments	529,638		27,365,805	737,749	28,633,192
Loans and Contracts	517,612	392,325	3,505	1,031,177	1,944,619
Other Assets				88	88
Restricted:					
Cash and Cash Equivalents	5,782			4,725	10,507
Loans and Contracts	620,394			789,064	1,409,458
Other Assets	5			88,001	88,006
Total Assets	$ 26,292,624	$ 5,111,893	$ 29,396,681	$ 6,186,744	$ 66,987,942
LIABILITIES AND FUND BALANCES					
Liabilities:					
Payables:					
Accounts	$ 3,567,799	$ 883,449	$ 7,988	$ 84,676	$ 4,543,912
Investment Trades	361		18,054	633	19,048
Other Intergovernmental	330,008				330,008
Tax Refunds (Note 24)	725,477				725,477
Payroll	526,384	101,716	2,434	4,238	634,772
Federal	125				125
Interest	18,692				18,692
Due To Other Funds (Note 12)	1,138,033	4,109	451	67,974	1,210,567
Interfund Payable (Note 12)	3,872			2,938	6,810
Deferred Revenues	1,057,804	3,261,582	94,660	364,905	4,778,951
Obligations/Reverse Repurchase Agreements	66,293				66,293
Obligations/Securities Lending			470,169		470,169
Other Liabilities	194,215	8,135		1,473	203,823
Short-Term Debt (Note 4)	9,800,000				9,800,000
Total Liabilities	17,429,063	4,258,991	593,756	526,837	22,808,647
Fund Balances/(Deficits):					
Nonspendable (Note 13)	677,781	128,068	12,041,080	745,373	13,592,302
Restricted (Note 13)	1,763,735	1,033,985	16,761,845	4,101,274	23,660,839
Committed (Note 13)	5,283,325	201,935		811,052	6,296,312
Assigned (Note 13)	44,076			2,208	46,284
Unassigned (Note 13)	1,094,644	(511,086)			583,558
Total Fund Balances	8,863,561	852,902	28,802,925	5,659,907	44,179,295
Total Liabilities and Fund Balances	$ 26,292,624	$ 5,111,893	$ 29,396,681	$ 6,186,744	$ 66,987,942

The accompanying notes to the financial statements are an integral part of this statement.

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position

August 31, 2012 (Amounts in Thousands)

Total Fund Balance – Governmental Funds		$ 44,179,295
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets less accumulated depreciation and amortization are included in the statement of net position. (Note 2)		
Capital Assets – Non-Depreciable or Non-Amortizable	$ 66,457,705	
Capital Assets – Depreciable or Amortizable, Net	11,991,077	
		78,448,782
Some of the state's resources are not currently available and are not reported in the funds.		
Deferred charges for unamortized bond issuance cost	34,432	
Derivative Instruments (Note 7)	25,121	
		59,553
Some of the state's revenues will be collected after year-end but are not available soon enough to pay current year's expenditures and therefore are deferred in the funds.		961,817
Deferred revenues were recorded as an offset to capital assets recognized related to service concession arrangements (SCA). The SCAs are not reported in the governmental funds.		(653,561) *
* The deferred revenues will be reclassified as deferred inflows upon implementation of GASB 60 in fiscal 2013.		
Long-term liabilities applicable to the state's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. These liabilities, however, are included in the statement of net position. (Note 5 and Note 9)		
Claims and Judgments	(133,225)	
Capital Lease Obligations	(11,703)	
Employees' Compensable Leave	(732,896)	
Notes and Loans Payable	(1,380,802)	
General Obligation Bonds Payable	(11,314,325)	
Revenue Bonds Payable	(4,276,898)	
Pollution Remediation Obligation	(247,384)	
Net Pension Obligation	(3,058,675)	
		(21,155,908) **
** current portion = $1,279,838 and noncurrent portion = $19,876,070		
Interest payable applicable to the state's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. These liabilities, however, are included in the statement of net position.		(352,616)
The internal service fund is used by management to charge the costs of employees life, accident and health insurance benefits fund to individual funds. Since governmental activities are the predominant activities of internal service funds, the assets and liabilities of the internal service funds are included in governmental activities in the statement of net position.		284,814
Net Position of Governmental Activities		$ 101,772,176

STATE OF TEXAS

Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	General	State Highway Fund	Permanent School Fund	Nonmajor Funds	Totals
REVENUES					
Taxes	$ 38,326,801	$ 2,366,486	$	$ 3,477,300	$ 44,170,587
Federal	35,307,134	2,853,866		58,353	38,219,353
Licenses, Fees and Permits	2,775,037	1,544,935	1,817	753,942	5,075,731
Interest and Other Investment Income	534,884	37,747	2,513,549	118,381	3,204,561
Land Income	32,042	9,650	390,499	15	432,206
Settlement of Claims	586,765	24,429			611,194
Sales of Goods and Services	1,608,370	17,949	46,762	186,560	1,859,641
Other	3,830,393	1,833	43	55,605	3,887,874
Total Revenues	83,001,426	6,856,895	2,952,670	4,650,156	97,461,147
EXPENDITURES					
Current:					
General Government	2,782,656	17,164		264,740	3,064,560
Education	24,499,872		76,075	1,139,168	25,715,115
Employee Benefits	1,728			11,873	13,601
Teacher Retirement State Contributions	1,640,592				1,640,592
Health and Human Services	44,705,422			3,270	44,708,692
Public Safety and Corrections	4,404,410	629,135		81,029	5,114,574
Transportation	31,477	3,752,230		4,773	3,788,480
Natural Resources and Recreation	1,559,236			59,514	1,618,750
Regulatory Services	342,807	2,560		67,074	412,441
Capital Outlay	205,862	2,669,323	41	653,253	3,528,479
Debt Service:					
Principal	24,633	58,713		496,420	579,766
Interest	43,753			681,686	725,439
Other Financing Fees	456	5,132		2,004	7,592
Total Expenditures	80,242,904	7,134,257	76,116	3,464,804	90,918,081
Excess (Deficiency) of Revenues Over (Under) Expenditures	2,758,522	(277,362)	2,876,554	1,185,352	6,543,066
OTHER FINANCING SOURCES (USES)					
Transfer In (Note 12)	4,891,199	433,409		1,953,305	7,277,913
Transfer Out (Note 12)	(5,779,918)	(453,685)	(1,020,887)	(3,994,482)	(11,248,972)
Bonds and Notes Issued	99,700			238,617	338,317
Bonds Issued for Refunding				37,940	37,940
Premiums on Bonds Issued				14,381	14,381
Payment to Escrow for Refunding				(62,086)	(62,086)
Sale of Capital Assets	18,816	12,318			31,134
Increase in Obligations Under Capital Leases	88	2,779			2,867
Insurance Recoveries	1,467	159			1,626
Total Other Financing Sources (Uses)	(768,648)	(5,020)	(1,020,887)	(1,812,325)	(3,606,880)
Net Change in Fund Balances	1,989,874	(282,382)	1,855,667	(626,973)	2,936,186
Fund Balances, September 1, 2011	7,184,566	751,539	26,947,258	7,183,357	42,066,720
Restatements (Note 14)	(310,879)	383,745		(896,477)	(823,611)
Fund Balances, September 1, 2011, as Restated	6,873,687	1,135,284	26,947,258	6,286,880	41,243,109
Fund Balances, August 31, 2012	$ 8,863,561	$ 852,902	$ 28,802,925	$ 5,659,907	$ 44,179,295

The accompanying notes to the financial statements are an integral part of this statement.

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

Net Change in Fund Balances		$ 2,936,186
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. In the statement of activities, however, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. The amount by which capital outlay exceeds depreciation in the current period is:		
Capital Outlay	$3,528,479	
Depreciation Expense (Note 2)	(969,324)	
Amortization Expense (Note 2)	(36,766)	
		2,522,389
The effect of various miscellaneous transactions involving capital assets (i.e., sales and trade-ins) is to decrease net position.		(23,971)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.		(1,620,511)
The internal service fund is used by management to charge the costs of the employees life, accident and health insurance benefits fund to individual funds. The adjustments for the internal service fund "close" the fund by allocating these amounts to participating governmental activities.		56,830
Bond proceeds provide current financial resources to governmental funds, but increase long-term liabilities in the statement of net position. Repayment of long-term debt consumes current financial resources and is an expenditure in the governmental funds, but reduces long-term liabilities in the statement of net position.		
Bonds and Notes Issued	(376,257)	
Premiums on Bond Proceeds	(14,381)	
Increase in Obligations Under Capital Leases	(2,867)	
Repayment of Bond and Capital Lease Principal	641,852	
		248,347
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		746,600
Transfers of capital assets are not reported in the governmental funds. In addition, resource flows between fiduciary funds and governmental funds are converted to revenues or expenses on the statement of activities.		
Capital Asset Transfers	41	
Increase in Revenues	228	
Increase in Expenses	(26,465)	
Net Change in Transfers	26,237	
		41
Change in Net Position of Governmental Activities		$ 4,865,911

STATE OF TEXAS

Statement of Net Position – Proprietary Funds

August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
ASSETS						
Current Assets:						
Cash and Cash Equivalents	$ 4,572,196	$ 736	$ 137,572	$ 208,875	$ 4,919,379	$ 55,444
Short-Term Investments	336,789			892,142	1,228,931	394,080
Securities Lending Collateral	511,401			181,709	693,110	18,825
Restricted:						
Cash and Cash Equivalents	916,722	1,389,012		766,410	3,072,144	
Short-Term Investments	98,957		176,625	81,316	356,898	
Loans and Contracts	17			83,541	83,558	
Receivables:						
Federal	670,014	7,429		5,870	683,313	
Other Intergovernmental	69,446			200	69,646	
Accounts	1,436,460	302,284	27,613	31,600	1,797,957	116,860
Interest and Dividends	65,804	6,338		66,811	138,953	1,972
Gifts	185,627				185,627	
Investment Trades	348,253			126,094	474,347	362
Other	299,159			2,985	302,144	
Due From Other Funds (Note 12)	848,173	12,712	578	41,267	902,730	21,332
Interfund Receivable (Note 12)	22,390			394	22,784	
Inventories	129,525		13,154	10,428	153,107	
Prepaid Items	119,749	1,604	1,544	272	123,169	
Loans and Contracts	118,111			172,074	290,185	
Other Current Assets	375,933	5		261	376,199	
Total Current Assets	11,124,726	1,720,120	357,086	2,672,249	15,874,181	608,875
Noncurrent Assets:						
Restricted:						
Cash and Cash Equivalents	(17,025)			34,137	17,112	
Short-Term Investments	1,453				1,453	
Investments	28,146,152		897,131	3,303,336	32,346,619	
Receivables	31,782			149,819	181,601	
Loans and Contracts	105,587			3,000,453	3,106,040	
Other				4,550	4,550	
Loans and Contracts	26,876			4,255,313	4,282,189	
Investments	5,640,778			(387)	5,640,391	263,520
Interfund Receivable (Note 12)	734,790			2,710	737,500	
Gifts Receivable	226,826				226,826	
Other Receivables				450	450	
Capital Assets: (Note 2)						
Non-Depreciable or Non-Amortizable	3,470,382			2,281,178	5,751,560	
Depreciable or Amortizable, Net	18,190,233		482	401,191	18,591,906	
Assets Held in Trust	362			2,538	2,900	
Deferred Charges	49,350	4,517		46,605	100,472	
Other Noncurrent Assets	195,120			341	195,461	
Total Noncurrent Assets	56,802,666	4,517	897,613	13,482,234	71,187,030	263,520
Total Assets	67,927,392	1,724,637	1,254,699	16,154,483	87,061,211	872,395
DEFERRED OUTFLOWS						
Deferred Outflow of Resources (Note 7)	336,328			436,682	773,010	
Total Deferred Outflow of Resources	336,328	0	0	436,682	773,010	0
LIABILITIES						
Current Liabilities:						
Payables:						
Accounts	1,414,213	61,146	24,667	37,514	1,537,540	562,728
Payroll	709,927		1,916	3,525	715,368	
Other Intergovernmental	18,432				18,432	
Federal	31,365				31,365	
Investment Trades	387,454			145,619	533,073	3,816
Interest	4,953	11,858		44,337	61,148	
Annuities			12,892		12,892	

Concluded on the following page

STATE OF TEXAS

Statement of Net Position – Proprietary Funds (concluded)

August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
LIABILITIES (concluded)						
Current Liabilities (concluded):						
Due To Other Funds (Note 12)	$ 26,699	$	$ 4,095	$ 3,165	$ 33,959	$ 1,636
Interfund Payable (Note 12)	25,794			89	25,883	
Unearned Revenue	2,763,882	54,173		72,345	2,890,400	595
Obligations/Securities Lending	511,401			181,709	693,110	18,806
Claims and Judgments (Note 5)	16,708				16,708	
Capital Lease Obligations (Note 5, 8)	3,514				3,514	
Employees' Compensable Leave (Note 5)	361,498		1,243	1,957	364,698	
Notes and Loans Payable (Note 5)	673,538				673,538	
General Obligation Bonds Payable (Note 5, 6)	9,080			119,995	129,075	
Revenue Bonds Payable (Note 5, 6)	1,849,393	175,110		141,291	2,165,794	
Liabilities Payable From Restricted Assets (Note 5)			289,166	251,971	541,137	
Funds Held for Others	142,843				142,843	
Hedging Derivative Liability (Note 7)	2,244				2,244	
Other Current Liabilities	281,622		1,053	892	283,567	
Total Current Liabilities	9,234,560	302,287	335,032	1,004,409	10,876,288	587,581
Noncurrent Liabilities:						
Interfund Payable (Note 12)	766,546				766,546	
Claims and Judgments (Note 5)	44,348				44,348	
Capital Lease Obligations (Note 5, 8)	18,124				18,124	
Employees' Compensable Leave (Note 5)	338,201		915	1,429	340,545	
Notes and Loans Payable (Note 5)	318,554			1,082,877	1,401,431	
General Obligation Bonds Payable (Note 5, 6)	20,836			3,079,638	3,100,474	
Revenue Bonds Payable (Note 5, 6)	10,731,887	1,393,012		4,742,776	16,867,675	
Liabilities Payable From Restricted Assets (Note 5)			769,627	2,189,723	2,959,350	
Assets Held for Others	849,186			2,538	851,724	
Net OPEB Obligation (Note 11)	2,867,745				2,867,745	
Hedging Derivative Liability (Note 7)	334,084			436,682	770,766	
Other Noncurrent Liabilities	92,877			71,593	164,470	
Total Noncurrent Liabilities	16,382,388	1,393,012	770,542	11,607,256	30,153,198	0
Total Liabilities	25,616,948	1,695,299	1,105,574	12,611,665	41,029,486	587,581
NET POSITION						
Invested in Capital Assets, Net of Related Debt	9,133,022		482	579,442	9,712,946	
Restricted for:						
Education	2,531,612				2,531,612	
Debt Retirement	100,362	100,141		209,231	409,734	
Capital Projects	535,500				535,500	
Veterans Land Board Housing Programs				693,050	693,050	
Unemployment Trust Funds		1,481,132			1,481,132	
Funds Held as Permanent Investments:						
Nonexpendable	15,926,936				15,926,936	
Expendable	5,945,582				5,945,582	
Other		10,065	5,000	500	15,565	284,814
Unrestricted	8,473,758	(1,562,000)	143,643	2,497,277	9,552,678	
Total Net Position	$ 42,646,772	$ 29,338	$ 149,125	$ 3,979,500	$ 46,804,735	$ 284,814

The accompanying notes to the financial statements are an integral part of this statement.

* Employees life, accident and health insurance benefits fund is the only internal service fund. Combining statements are not presented.

STATE OF TEXAS

Statement of Revenues, Expenses and Changes in Net Position – Proprietary Funds

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
OPERATING REVENUES						
Lottery Collections	$	$	$ 4,191,176	$	$ 4,191,176	$
Tuition Revenue	60,279				60,279	
Tuition Revenue – Pledged	4,952,077				4,952,077	
Discounts and Allowances	(1,155,399)				(1,155,399)	
Hospital Revenue – Pledged	9,050,488				9,050,488	
Discounts and Allowances	(4,912,239)				(4,912,239)	
Professional Fees	4,411,333				4,411,333	
Professional Fees – Pledged	6,335				6,335	
Discounts and Allowances	(2,883,531)				(2,883,531)	
Auxiliary Enterprises	3,856				3,856	
Auxiliary Enterprises – Pledged	1,188,294			102,342	1,290,636	
Discounts and Allowances	(61,518)				(61,518)	
Unemployment Taxes		2,894,245			2,894,245	
Other Sales of Goods and Services	25,751			72,762	98,513	
Other Sales of Goods and Services – Pledged	721,832			104,571	826,403	
Discounts and Allowances	(202)				(202)	
Interest and Investment Income	1,881		5	285,368	287,254	
Interest and Investment Income – Pledged	104			80,268	80,372	
Federal Revenue	2,065,240	2,734,963		31,992	4,832,195	28
State Grant Revenue	27,369				27,369	
Premium Revenue						1,878,972
Other Operating Grant Revenue	747,607				747,607	
Other Operating Grant Revenue – Pledged	699,420				699,420	
Other Revenues	46,535	247,082	982	59,977	354,576	835
Other Revenues – Pledged	142,307				142,307	
Total Operating Revenues	15,137,819	5,876,290	4,192,163	737,280	25,943,552	1,879,835
OPERATING EXPENSES						
Cost of Goods Sold	147,307			74,548	221,855	
Salaries and Wages	10,253,144		17,425	42,291	10,312,860	4,448
Payroll Related Costs	2,263,539		4,402	10,292	2,278,233	1,148
Professional Fees and Services	800,367		4,416	83,701	888,484	1,910
Travel	281,620		278	566	282,464	51
Materials and Supplies	1,906,236		1,726	9,832	1,917,794	404
Communication and Utilities	716,632		604	1,839	719,075	250
Repairs and Maintenance	436,563		423	16,319	453,305	321
Rentals and Leases	241,815		4,452	1,962	248,229	330
Printing and Reproduction	65,550		11,380	224	77,154	12
Depreciation and Amortization	1,626,945		216	22,869	1,650,030	
Unemployment Benefit Payments		5,064,664			5,064,664	
Bad Debt Expense	9,744		435	2,414	12,593	
Interest Expense	2,039			274,067	276,106	
Scholarships	977,905				977,905	
Lottery Fees and Other Costs			313,581		313,581	
Lottery Prize Payments			2,632,624		2,632,624	
Employee/Participant Benefit Payments				160,063	160,063	1,826,996
Claims and Judgments	19,308				19,308	
Net Change in Pension/OPEB Obligations (Note 11)	624,284				624,284	
Other Expenses	1,358,283		35,980	60,927	1,455,190	527
Total Operating Expenses	21,731,281	5,064,664	3,027,942	761,914	30,585,801	1,836,397
Operating Income (Loss)	(6,593,462)	811,626	1,164,221	(24,634)	(4,642,249)	43,438

Concluded on the following page

STATE OF TEXAS

Statement of Revenues, Expenses and Changes in Net Position – Proprietary Funds (concluded)

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
NONOPERATING REVENUES (EXPENSES)						
Federal Revenue	$ 887,300	$	$	$ 307,292	$ 1,194,592	$
Gifts	541,702			879	542,581	
Gifts – Pledged	130,952				130,952	
Land Income	6,525			13	6,538	
Interest and Investment Income	3,427,603	22,552	22,442	158,004	3,630,601	13,166
Interest and Investment Income – Pledged	407,745				407,745	
Loan Premium and Fees on Securities Lending				343	343	36
Investing Activities Expense	(76,255)			(892)	(77,147)	
Interest Expense	(521,419)	(50,119)		(143,949)	(715,487)	
Borrower Rebates and Agent Fees	(2,185)			(257)	(2,442)	(14)
Gain (Loss) on Sale of Capital Assets	(21,035)			(463)	(21,498)	
Settlement of Claims				378	378	204
Claims and Judgments	(686)				(686)	
Other Revenues	20,256				20,256	
Other Revenues – Pledged	85,471				85,471	
Other Expenses	(134,407)	(3,047)		(74,977)	(212,431)	
Total Nonoperating Revenues (Expenses)	4,751,567	(30,614)	22,442	246,371	4,989,766	13,392
Income (Loss) Before Capital Contributions, Endowments and Transfers	(1,841,895)	781,012	1,186,663	221,737	347,517	56,830
CAPITAL CONTRIBUTIONS, ENDOWMENTS AND TRANSFERS						
Capital Contributions – Federal	15,289				15,289	
Capital Contributions – Other	244,391			27	244,418	
Contributions to Permanent and Term Endowments	136,800				136,800	
Transfer In (Note 12)	5,582,453	87,350		68,356	5,738,159	
Transfer Out (Note 12)	(576,426)	(26,102)	(1,155,523)	(35,286)	(1,793,337)	
Total Capital Contributions, Endowments and Transfers	5,402,507	61,248	(1,155,523)	33,097	4,341,329	0
Change in Net Position	3,560,612	842,260	31,140	254,834	4,688,846	56,830
Net Position, September 1, 2011	39,104,136	(812,922)	117,985	3,725,029	42,134,228	227,984
Restatements (Note 14)	(17,976)			(363)	(18,339)	
Net Position, September 1, 2011, as Restated	39,086,160	(812,922)	117,985	3,724,666	42,115,889	227,984
Net Position, August 31, 2012	$42,646,772	$ 29,338	$ 149,125	$3,979,500	$46,804,735	$ 284,814

The accompanying notes to the financial statements are an integral part of this statement.

* Employees life, accident and health insurance benefits fund is the only internal service fund. Combining statements are not presented.

STATE OF TEXAS

Statement of Cash Flows – Proprietary Funds

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
CASH FLOWS FROM OPERATING ACTIVITIES						
Proceeds from Customers	$ 5,956,312	$ 2,893,606	$ 4,180,179	$ 281,425	$ 13,311,522	$ 440,857
Proceeds from Tuition and Fees	3,889,683				3,889,683	
Proceeds from Research Grants and Contracts	3,731,788	2,763,302			6,495,090	
Proceeds from Gifts				35	35	
Proceeds from Loan Programs	307,647			578,078	885,725	
Proceeds from Auxiliaries	1,119,246			675	1,119,921	
Proceeds from Other Operating Revenues	601,800	232,187		91,054	925,041	1,384,928
Payments to Suppliers for Goods and Services	(6,345,783)		(377,969)	(370,823)	(7,094,575)	(3,718)
Payments to Employees	(12,504,895)		(21,830)	(52,129)	(12,578,854)	(6,283)
Payments for Loans Provided	(346,660)			(363,261)	(709,921)	
Payments for Lottery Prizes			(2,595,246)		(2,595,246)	
Payments for Unemployment Benefits		(5,123,336)			(5,123,336)	
Payments for Other Operating Expenses	(854,803)			(8,424)	(863,227)	(1,790,369)
Net Cash Provided (Used) by Operating Activities	(4,445,665)	765,759	1,185,134	156,630	(2,338,142)	25,415
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Proceeds from Debt Issuance	1,995			557,406	559,401	
Proceeds from Gifts	656,400				656,400	
Proceeds from Endowments	131,671				131,671	
Proceeds from Transfers from Other Funds	5,061,431	7,540,574		273,768	12,875,773	
Proceeds from Loan Programs	20,087				20,087	
Proceeds from Grant Receipts	539,949			307,740	847,689	
Proceeds from Interfund Payables	71,415			41,628	113,043	
Proceeds from Other Noncapital Financing Activities	511,244		26,144	222	537,610	
Payments of Principal on Debt Issuance	(36,450)	(314,335)		(299,735)	(650,520)	
Payments of Interest	(37,145)	(80,622)		(278,954)	(396,721)	
Payments of Other Costs on Debt Issuance	(122)	(2)		(2,148)	(2,272)	
Payments for Transfers to Other Funds	(319,072)	(7,461,866)	(1,153,560)	(302,503)	(9,237,001)	
Payments for Grant Disbursements	(560)			(76,163)	(76,723)	
Payments for Interfund Receivables				(61,873)	(61,873)	
Payments for Other Noncapital Uses	(104,946)		(191,601)		(296,547)	
Net Cash Provided (Used) by Noncapital Financing Activities	6,495,897	(316,251)	(1,319,017)	159,388	5,020,017	0
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Proceeds from Sale of Capital Assets	5,711			105	5,816	
Proceeds from Debt Issuance	2,341,991				2,341,991	
Proceeds from State Grants and Contracts	32,602				32,602	
Proceeds from Federal Grants and Contracts	11			968	979	
Proceeds from Gifts	3,868				3,868	
Proceeds from Other Capital and Related Financing Activities	167,478			13	167,491	
Proceeds from Capital Contributions	350,604			3,117	353,721	
Proceeds from Interfund Payables	7,234				7,234	
Payments for Additions to Capital Assets	(2,822,437)		(202)	(2,179)	(2,824,818)	
Payments of Principal on Debt Issuance	(1,618,911)			(26,725)	(1,645,636)	
Payments for Capital Leases	(1,027)			(16)	(1,043)	
Payments of Interest on Debt Issuance	(509,962)			(72,666)	(582,628)	
Payments of Other Costs on Debt Issuance	(158,509)			(32)	(158,541)	
Payments for Interfund Receivables	(3,256)				(3,256)	
Net Cash Used by Capital and Related Financing Activities	(2,204,603)	0	(202)	(97,415)	(2,302,220)	0

Concluded on the following page

STATE OF TEXAS

Statement of Cash Flows – Proprietary Funds (concluded)

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Business-Type Activities – Enterprise Funds					Governmental Activities – Internal Service Fund*
	Colleges and Universities	Unemployment Trust Fund	Lottery Fund	Nonmajor Enterprise Funds	Totals	
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from Sale of Investments	$ 12,783,400	$	$ 191,601	$ 4,381,599	$ 17,356,600	$ 7,200
Proceeds from Interest and Investment Income	1,504,364	21,360	1	263,124	1,788,849	548
Proceeds from Principal Payments on Loans				387,246	387,246	
Payments to Acquire Investments	(13,674,316)		(19,473)	(4,875,004)	(18,568,793)	
Payments for Nonprogram Loans Provided				(815,779)	(815,779)	
Net Cash Provided by Investing Activities	613,448	21,360	172,129	(658,814)	148,123	7,748
Net Increase (Decrease) in Cash and Cash Equivalents	459,077	470,868	38,044	(440,211)	527,778	33,163
Cash and Cash Equivalents, September 1, 2011	5,012,816	918,880	99,528	1,449,632	7,480,856	22,281
Restatements				1	1	
Cash and Cash Equivalents, September 1, 2011, as Restated	5,012,816	918,880	99,528	1,449,633	7,480,857	22,281
Cash and Cash Equivalents, August 31, 2012	$ 5,471,893	$ 1,389,748	$ 137,572	$ 1,009,422	$ 8,008,635	$ 55,444
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES						
Operating Income (Loss)	$ (6,593,462)	$ 811,626	$ 1,164,221	$ (24,634)	$ (4,642,249)	$ 43,438
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:						
Depreciation and Amortization	1,626,945		216	22,869	1,650,030	
Bad Debt Expense	255,184		435	2,414	258,033	
Operating Income (Loss) and Cash Flow Categories Classification Differences	(55,653)			46,256	(9,397)	(115)
Changes in Assets and Liabilities:						
(Increase) Decrease in Receivables	(308,969)	(14,422)	(11,985)	(795)	(336,171)	12,517
(Increase) Decrease in Due From Other Funds	(378)			135	(243)	(20,731)
(Increase) Decrease in Inventories	(8,968)		(4,555)	(865)	(14,388)	
(Increase) Decrease in Notes Receivable	(118)				(118)	
(Increase) Decrease in Loans and Contracts	(4,908)			77,545	72,637	
(Increase) Decrease in Other Assets	(60,609)			(1,248)	(61,857)	
(Increase) Decrease in Prepaid Expenses	(7,053)		(1,544)	145	(8,452)	
Increase (Decrease) in Payables	(75,114)	(34,552)	38,346	5,219	(66,101)	36,627
Increase (Decrease) in Deposits	(5,043)				(5,043)	
Increase (Decrease) in Due To Other Funds	2,454			38	2,492	(46,389)
Increase (Decrease) in Unearned Revenue	139,965	3,107		(1,423)	141,649	68
Increase (Decrease) in Employees' Compensable Leave	21,028			106	21,134	
Increase (Decrease) in Benefits Payable	624,440			27,583	652,023	
Increase (Decrease) in Other Liabilities	4,594			3,285	7,879	
Total Adjustments	2,147,797	(45,867)	20,913	181,264	2,304,107	(18,023)
Net Cash Provided (Used) by Operating Activities	$ (4,445,665)	$ 765,759	$ 1,185,134	$ 156,630	$ (2,338,142)	$ 25,415
NONCASH TRANSACTIONS						
Donation of Capital Assets	$ 76,457	$	$	$	$ 76,457	$
Net Change in Fair Value of Investments	$ 1,703,477	$	$ 22,441	$ 113,659	$ 1,839,577	$ 5,395
Borrowing Under Capital Lease Purchase	$ 2,545	$	$	$	$ 2,545	$
Other	$ 282,399	$	$	$ (415)	$ 281,984	$

The accompanying notes to the financial statements are an integral part of this statement.

* Employees life, accident and health insurance benefits fund – no combining statements presented.

STATE OF TEXAS

Statement of Fiduciary Net Position

August 31, 2012 (Amounts in Thousands)

	Pension and Other Employee Benefit Trust Funds	External Investment Trust Fund*	Private-Purpose Trust Funds	Agency Funds
ASSETS				
Cash and Cash Equivalents	$ 2,080,766	$ 1	$ 486,908	$ 1,070,334
Restricted Cash and Cash Equivalents			14	
Securities Lending Collateral	22,955,321			
Investments:				
U.S. Government	26,535,005	5,242,580	20,179	215,604
Corporate Equity	28,742,583		267,439	177,289
Corporate Obligations	895,507	371,092	2,388	10
Repurchase Agreements		7,929,000		32,313
Foreign Securities	31,413,919			
Externally Managed Investments	35,990,346			
Other	9,349,669		2,154,681	59,870
Receivables:				
Federal	9,970			
Interest and Dividends	331,729	9,092	87	1,236
Accounts	255,021		212	7,979
Other Intergovernmental				2,358
Investment Trades	1,383,919		15,745	
Other	1,446		4,403	
Due From Other Funds (Note 12)	11,737		6	900
Prepaid Items	3,732			
Properties, at Cost, Net of Accumulated Depreciation or Amortization	40,540		843	
Other Assets			91,292	1,742,153
Total Assets	160,001,210	13,551,765	3,044,197	3,310,046
LIABILITIES				
Payables:				
Accounts	$ 299,382	$ 1,706	$ 20,857	$ 205
Investment Trades	668,556	4,500	2,466	
Payroll	3,134			
Other Intergovernmental				791,322
Interest			14	
Annuities	691,237			
Due To Other Funds (Note 12)	122,128		8	27,229
Unearned Revenue	31,442		391	
Employees' Compensable Leave	7,702			
Obligations/Securities Lending	22,933,654			
Funds Held for Others			91,292	2,491,279
Other Liabilities	108,663	567	19	11
Total Liabilities	24,865,898	6,773	115,047	3,310,046
NET POSITION				
Held in Trust for:				
Pension Benefits and Other Purposes	135,135,312			
Individuals, Organizations and Other Governments			2,929,150	
Pool Participants		13,544,992		
Total Net Position	$ 135,135,312	$ 13,544,992	$ 2,929,150	$ 0

The accompanying notes to the financial statements are an integral part of this statement.

* The activities of the Texas local government investment pool (TexPool) and the Texas local government investment pool prime (TexPool Prime) are reported as an external investment trust fund. Combining statements are not presented.

STATE OF TEXAS

Statement of Changes in Fiduciary Net Position

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Pension and Other Employee Benefit Trust Funds	External Investment Trust Fund*	Private-Purpose Trust Funds
ADDITIONS			
Contributions:			
Member Contributions	$ 3,020,250	$	$
State Contributions	2,475,562		
Premium Contributions	363,348		
Federal Contributions	148,970		7,299
Other Contributions	976,194		121,453
Total Contributions	6,984,324	0	128,752
Investment Income:			
From Investing Activities:			
Net Appreciation in Fair Value of Investments	7,140,714		60,621
Interest and Investment Income	2,526,133	26,766	27,611
Total Investing Income	9,666,847	26,766	88,232
Less Investing Activities Expense	211,861	8,206	1,420
Net Income from Investing Activities	9,454,986	18,560	86,812
From Securities Lending Activities:			
Securities Lending Income	170,899		
Less Securities Lending Expense:			
Borrower Rebates	24,372		
Management Fees	35,988		
Net Income from Securities Lending	110,539	0	0
Total Net Investment Income	9,565,525	18,560	86,812
Capital Share and Individual Account Transactions:			
Net Decrease in Participant Investments	0	(439,714)	0
Other Additions:			
Settlement of Claims			4,964
Other Revenue	3,306		305,335
Transfer In (Note 12)	114,821		
Total Other Additions	118,127	0	310,299
Total Additions	16,667,976	(421,154)	525,863
DEDUCTIONS			
Benefits	11,492,269		95,737
Refunds of Contributions	470,698		
Transfer Out (Note 12)	88,396		188
Intergovernmental Payments			58,669
Administrative Expenses	56,255		6,773
Depreciation and Amortization Expense	2,628		39
Settlement of Claims			93,664
Interest Expense	12		4
Other Expenses	3,620		188,550
Total Deductions	12,113,878	0	443,624
INCREASE (DECREASE) IN NET POSITION	4,554,098	(421,154)	82,239
NET POSITION			
Net Position, September 1, 2011	130,580,910	13,966,146	2,846,911
Restatements	304		
Net Position, September 1, 2011, as Restated	130,581,214	13,966,146	2,846,911
Net Position, August 31, 2012	$ 135,135,312	$ 13,544,992	$ 2,929,150

The accompanying notes to the financial statements are an integral part of this statement.

* The activities of the Texas local government investment pool (TexPool) and the Texas local government investment pool prime (TexPool Prime) are reported as an external investment trust fund. Combining statements are not presented.

State of Texas
Notes to Financial Statements

NOTE 1

Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The accompanying financial statements of the state of Texas were prepared in conformance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). 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 opinions and Accounting Research Bulletins issued on or before Nov. 30, 1989, which 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.

GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* was implemented in fiscal 2012. This statement amends the requirements in GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. It sets forth criteria establishing when the effective hedging relationship continues and when to continue applying hedge accounting.

GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple Employer Plans*, which was effective for fiscal 2012, addresses issues related to the use of the alternative measurement method and the frequency of timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans. The state of Texas is not an employer in an agent multiple-employer OPEB plan and therefore this statement does not apply to the state.

FINANCIAL REPORTING ENTITY

For financial reporting purposes, the state of Texas includes all funds, agencies, boards, commissions, authorities, institutions of higher education 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:

- General government
- Education
- Employee benefits
- Teacher retirement state contributions
- Health and human services
- Public safety and corrections
- Transportation
- Natural resources and recreation
- Regulatory services

The reporting entity for the state is in accordance with the criteria established by GASB. Note 19 provides a listing and brief summary of the component units and their relationship to the state of Texas. These financial statements present the balances and activities of 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 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 position 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), and its discretely presented component units. In the statement of net position, both the governmental and business-type activities columns are presented on a consolidated basis by column using an economic resources measurement focus and an accrual basis of accounting, which incorporates noncurrent investments, capital assets, and long-term debt and obligations.

The statement of activities reflects both the gross and net cost per functional category (public safety and corrections, transportation, etc.), which is supported by general government revenues (sales and use taxes, franchise taxes, etc.). In the statement of activities, program revenues are netted against program expenses, including depreciation and amortization, to present the net cost of each program. Program revenues are 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 are charged to the various functions of the state. These charges are paid from applicable funding sources and are reflected as direct expenses.

Program revenues include charges for services; operating grants and contributions; and 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 capital grants reflect capital-specific grants. Multipurpose grants that provide financing for more than one program are reported as program revenue if the amounts restricted to each program are specifically identifiable. Multipurpose grants that do not provide for specific identification of the programs and amounts are reported as general revenues.

Fiduciary funds are presented in the fund financial statements by type (pension and other employee benefit trust, external investment trust, private-purpose trust and agency). The assets of fiduciary funds are held for the benefit of others and cannot be used to address activities or obligations of the government. They are therefore not 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 that 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 not restricted for specific purposes. 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 resources measurement focus and modified accrual basis of accounting. This presentation is deemed most appropriate to demonstrate compliance with legal and covenant requirements, the source and use of financial resources, and how the state's actual results of activities conform to the budget. A reconciliation between the governmental fund financial statements and the governmental activities column of the government-wide financial statements is presented since a different measurement focus and basis of accounting is used. The reconciliation explains the adjustments required to convert the fund-based financial statements.

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 and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. Debt service funds are used to account for and report financial resources that are restricted, committed or assigned to expenditure for principal and interest. Capital projects funds are used to account for and report financial resources that are restricted, committed or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital projects funds exclude those types of capital-related outflows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations or other governments. Permanent funds are used to report resources 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** is the primary operating fund for the state and includes transactions for general government, education, employee benefits, teacher retirement state contributions, 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 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:

- The activity is financed with debt secured solely by a pledge of the net revenues from fees and charges of the activity.
- Laws or regulations require the activity's costs of providing services, including capital costs (such as depreciation, amortization or debt service), be recovered with fees and charges.

- The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs.

Internal service funds are used to report any activity that provides goods or services, on a cost reimbursement basis, to other funds, departments or agencies of the reporting entity or other governments. The employees life, accident and health insurance benefits fund accounts for the services provided to state of Texas agencies and institutions of higher education that participate in the Texas Employees Group Benefits Program.

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
- Texas State Technical College

These institutions of higher education 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 **Unemployment Trust Fund** contains the activity of the state related to the administration of state and federally financed unemployment benefits.

The **Lottery Fund** receives fees from external users that are used to operate the state lottery, finance debt and make investments to meet future installment obligations to prize winners.

Fiduciary Fund Types

Fiduciary funds account for assets held 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.

External 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. These trusts include tobacco settlement money, reserve for insurance company liquidations, relief of catastrophic insurance losses, contributions of prison inmates, educational savings plans and others.

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. Agency funds include those funds established to account for the collection of sales and use tax for distribution to localities, bond escrow funds, deposits of insurance carriers, child support collections and other miscellaneous accounts.

Component Units

All component units of the state of Texas are reported as nonmajor component units. The combining statement of net position – component units and the combining statement of activities – component units are presented for all 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 entity, both current and noncurrent, are reported. 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, generally 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.

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 (i.e., operating grants and contributions and taxes) reported in the governmental funds to be available if the revenues are due at fiscal year-end and collected within 60 days thereafter.

In the governmental fund financial statements, revenues that are earned but not expected to be collected within 60 days are not available to liquidate the liabilities of the current period and are reported as deferred revenue. Deferred revenue also includes unearned revenue when cash or other assets are received prior to being earned.

Under the accrual basis of accounting, as used in the government-wide financial statements, proprietary fund financial statements and fiduciary fund financial statements, unearned revenue is recorded when cash or other assets are collected in advance before the revenue recognition criteria are met. Revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. Amounts paid to acquire capital assets are capitalized as assets rather than reported as expenditures. Proceeds of long-term debt are recorded as liabilities rather than other financing sources. Amounts paid to reduce long-term indebtedness of the state are reported as reductions of the related liabilities rather than expenditures.

Proprietary funds distinguish operating from non-operating 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 capital asset depreciation and amortization. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Although agency funds use the accrual basis of accounting, they do not have a measurement focus because they do not recognize 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 (MD&A) 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. The governmental funds with legally adopted annual budgets are the general fund, the state highway fund and the other nonmajor special revenue funds listed in 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 agency 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 presents the change in cash and cash equivalents during the fiscal year. Cash equivalents are defined as short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near maturity they present insignificant risk of a decrease in value due to changes in interest rates. Investments with an original maturity of three months or less and 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 statements of net 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 date 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.

Receivables and Payables

The major receivables for governmental activities are federal and taxes receivables. The major receivables for business-type activities are federal, patient and tuition receivables. Receivables represent amounts due to the state as of Aug. 31, 2012, from private persons or organizations. Amounts expected to be collected within the next fiscal year are classified as current and amounts expected to be collected beyond the next fiscal year are classified as noncurrent. All receivables are recorded net of allowances for uncollectible accounts.

Taxes receivable represent amounts earned in fiscal 2012 that will be collected sometime in the future. In the government-wide financial statements, a corresponding amount is recorded as revenue. In the governmental fund financial statements, the portion considered available is recorded as revenue; the remainder is recorded as deferred revenue. Taxes receivable are estimated based on collection experience. Tax refunds payable represent amounts owed to taxpayers for overpayments or amended tax returns. See Note 24 for details on taxes receivable and tax refunds payable.

Other receivables in the general fund consist primarily of program receivables for health care assistance and temporary assistance for needy families. Other receivables in the colleges and universities fund consist primarily of public university fund land income and private sponsored programs. 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 or 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 in the general fund, as shown in Note 12, are reported as nonspendable fund balance. Noncurrent interfund receivables in other governmental funds are reported as committed, restricted or assigned fund balance.

Investment trade receivables are reported for sales of investments pending settlement. Investment 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 and prepaid items that appear in both governmental and proprietary fund types. The costs of inventories are expensed when they 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, fiduciary funds and on the 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 table identifying the capitalization threshold and the estimated useful life by asset type. It also provides information on the state's depreciation/amortization policy and other detailed information.

The state adopted the modified approach for reporting its highway system. This approach 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 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 position requires two components – the amount due within one year (current) and the amount due in more than one year (noncurrent).

General long-term liabilities consist of claims and judgments, capital lease obligations, employees' compensable leave 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 position. 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.

In the government-wide financial statements and proprietary fund financial statements, bond premiums, discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line, bonds outstanding or effective interest method. Bonds payable are reported net of the applicable bond accretion, 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, discounts and 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

Annual leave, commonly referred to as vacation leave, and other compensated absences with similar characteristics are accrued as a liability as the benefits are earned by the employee. Benefits are earned when 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. Unused overtime is included in the calculation of current and noncurrent liabilities because each employee may be paid for the overtime or use it as compensatory time.

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. In 2009, the 81st Legislature passed House Bill 2559, which does not allow employees hired on or after Sept. 1, 2009, to apply unused sick or annual leave as service credit to meet retirement eligibility. State employees hired before Sept. 1, 2009, are 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 was not determined. 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 8 provides details for capital lease obligations.

Conduit Debt Obligations

Conduit debt issued by the state in the form of bonds is for the express purpose of providing capital financing for a specific third party that is not part of the state's financial reporting entity. The bonds are secured by the property financed and are payable solely from payments received from the third party on the underlying loans. The state has no obligations for the debt beyond the resources provided by the loan with the third party on whose behalf the bonds were issued. The state has chosen to continue reporting conduit debt obligations as long-term liabilities on the balance sheet for debt issued prior to GASB Interpretation No. 2, *Disclosure of Conduit Debt Obligations, an Amendment of NCGA Statement 1*, as well as subsequent debt obligations that are substantially the same as those already reported. Interpretation 2, which was effective for Texas beginning Sept. 1, 1996, requires only note disclosure for issuance of all other conduit debt. Note 6 provides details on conduit debt obligations.

Deferred Inflows and Deferred Outflows

Changes in fair values of hedging derivative assets and liabilities are reported as deferred inflows and deferred outflows. Note 7 presents additional information about derivative instruments.

Net Position and Fund Balances

The state reports restricted net position when constraints placed on resources are either:

- Externally imposed by creditors (such as debt covenants), grantors, contributors, laws or regulations of other governments
- 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 position is designated as either expendable or nonexpendable. Expendable restricted resources are those that may be expended for either a stated purpose or for a general purpose subject to externally imposed stipulations. Nonexpendable restricted resources are those required to be retained in perpetuity. Restricted resources include the state's permanent endowment funds subject to externally imposed restrictions governing their use.

Invested in capital assets, net of related debt, consists of capital assets – including restricted capital assets – net of accumulated depreciation/amortization 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.

Fund balances for governmental funds are classified as nonspendable, restricted, committed, assigned or unassigned. Nonspendable fund balances include amounts that cannot be spent because they are either not in a spendable form or they are legally or contractually required to be maintained intact. Fund balances are reported as restricted when constraints placed upon the use of resources are either:

- Externally imposed by creditors (such as debt covenants), grantors, contributors, laws or regulations of other governments
- Imposed by law through constitutional provisions or enabling legislation

Committed fund balances are amounts that can only be used for specific purposes pursuant to constraints imposed through legislation passed into law by formal action of the Texas Legislature, the state's highest level of decision-making authority. These committed amounts cannot be used for any other purpose unless the Legislature removes or changes the specified use by taking the same type of action it employed to previously commit those amounts. Fund balances are reported as assigned when the state intends for resources to be used for specific purposes, yet the constraints do not meet the requirements to be reported as restricted or committed. Intent is expressed by either the Texas Legislature or a body (for example, a budget or finance committee) or official to which the governing body has delegated the authority to assign amounts to be used for specific purposes. Unassigned fund balances represent amounts that have not been restricted, committed or assigned to specific purposes. The general fund is the only fund that can report a positive unassigned fund balance. Note 13 presents disaggregated fund balances.

When both restricted and unrestricted resources are available for use, it is the state's policy to use restricted resources first and then unrestricted resources as they are needed. When only unrestricted resources are available for use, it is the state's policy to use committed resources first, then assigned resources, and lastly unassigned resources.

Interfund Activity and Transactions – Government-wide Financial Statements

Interfund activity is eliminated from the government-wide financial statements with the exception of activities between governmental activities and business-type activities. Interfund activity with fiduciary funds is reclassified and reported as external activity.

Interfund payables and receivables are eliminated from the statement of net position except for amounts due between governmental and business-type activities. These amounts are reported as internal balances on the statement of net position. Interfund activities between the primary government and component units with a different fiscal year-end are limited and immaterial.

Interfund transactions with discretely presented component units are reclassified and reported as external activity. Note 12 provides details of interfund activities and transactions.

Risk Financing

The state maintains a combination of commercial insurance and self-insurance programs. The state is self-insured for workers' compensation and unemployment compensation claims. The liabilities are funded on a pay-as-you-go basis. The group insurance programs are provided through a combination of insurance contracts, self-funded health plans 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 incurred but not reported. See Note 17 for additional information.

NOTE 2

Capital Assets

Capital assets, which include land, infrastructure, buildings, equipment and intangible assets, of governmental funds are recorded as expenditures at the time of purchase and capitalized in the governmental activities column of the government-wide statement of net position. Capital assets of other funds and component units are capitalized in the fund in which they are utilized. Capital assets are assets with a cost above a set minimum capitalization threshold that, when acquired, have an estimated useful life of more than one year. The capitalization thresholds and useful lives of the state's various categories of capital assets 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 (Library Books, Leasehold Improvements and Livestock)		
Depreciable	Various	3-22 years
Non-Depreciable	Various	Not applicable
Internally Generated Computer Software	1,000,000	3-10 years
Other Computer Software	100,000	3-10 years
Land Use Rights – Permanent	0	Not applicable
Land Use Rights – Term	100,000	10-60 years
Other Intangible Capital Assets	100,000	3-15 years

The table below presents the composition of the state's capital assets, adjustments, reclassifications, additions and deletions during fiscal 2012. The adjustment column includes assets not previously reported, accounting errors and other changes. The reclassifications column includes amounts for transfers of capital assets between agencies and reclassifies amounts for completed construction projects previously reported as

Capital Asset Activity

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	PRIMARY GOVERNMENT					
	Balance 9/1/11	Adjustments	Reclassifications	Additions	Deletions	Balance 8/31/12
GOVERNMENTAL ACTIVITIES						
Non-Depreciable & Non-Amortizable Assets						
Land and Land Improvements	$ 8,915,039	$ 42,466	$ 438	$ 565,388	$ (3,608)	$ 9,519,723
Infrastructure	49,823,503	(255,078)	579,047	514,936	(674)	50,661,734
Construction in Progress	5,033,330	(268,472)	(1,497,115)	2,910,482		6,178,225
Other Capital Assets	26,399	1,997	13	298	(44)	28,663
Land Use Rights – Permanent	67,573			1,905	(118)	69,360
Total Non-Depreciable & Non-Amortizable Assets	63,865,844	(479,087)	(917,617)	3,993,009	(4,444)	66,457,705
Depreciable Assets						
Buildings and Building Improvements	5,612,312	(3,074)	229,651	8,158	(7,318)	5,839,729
Infrastructure	19,795,776	28,147	642,495	68,954	(19,341)	20,516,031
Facilities and Other Improvements	213,323		3,974	3,689		220,986
Furniture and Equipment	968,017	(2,597)	7,892	77,648	(60,679)	990,281
Vehicles, Boats and Aircraft	1,055,743	(110)	27,605	63,335	(55,871)	1,090,702
Other Capital Assets	146,654			2,890	(8,812)	140,732
Total Depreciable Assets at Historical Cost	27,791,825	22,366	911,617	224,674	(152,021)	28,798,461
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(3,284,942)	3,938		(183,602)	5,454	(3,459,152)
Infrastructure	(11,264,348)	12,946		(627,303)	15,618	(11,863,087)
Facilities and Other Improvements	(143,248)			(7,465)		(150,713)
Furniture and Equipment	(725,144)	1,683	95	(73,318)	57,428	(739,256)
Vehicles, Boats and Aircraft	(637,504)	(68)	36	(70,746)	46,969	(661,313)
Other Capital Assets	(66,316)			(6,890)	7,095	(66,111)
Total Accumulated Depreciation*	(16,121,502)	18,499	131	(969,324)	132,564	(16,939,632)
Depreciable Assets, Net	11,670,323	40,865	911,748	(744,650)	(19,457)	11,858,829
Intangible Capital Assets – Amortizable						
Land Use Rights – Term	21,968			2,189	(670)	23,487
Computer Software	334,952	(821)	5,910	12,696	(12,630)	340,107
Other Intangible Capital Assets – Term	31,967			16,971		48,938
Total Intangible Assets at Historical Cost	388,887	(821)	5,910	31,856	(13,300)	412,532
Less Accumulated Amortization for:						
Land Use Rights – Term	(6,302)			(3,183)	670	(8,815)
Computer Software	(249,474)	809		(30,245)	12,563	(266,347)
Other Intangible Capital Assets – Term	(1,784)			(3,338)		(5,122)
Total Accumulated Amortization*	(257,560)	809	0	(36,766)	13,233	(280,284)
Amortizable Assets, Net	131,327	(12)	5,910	(4,910)	(67)	132,248
Governmental Activities Capital Assets, Net	$ 75,667,494	$ (438,234)	$ 41	$ 3,243,449	$ (23,968)	$ 78,448,782

* Depreciation and amortization expense was charged to governmental activities as follows:

General Government	$ 55,086
Education	9,774
Employee Benefits	3
Health and Human Services	45,392
Public Safety and Corrections	179,174
Transportation	682,349
Natural Resources and Recreation	32,478
Regulatory Services	1,834
Total	$ 1,006,090

Continued on the following page

construction in progress. The additions column includes current year purchases, depreciation and amortization. The deletions column presents assets removed during the current fiscal year.

All capital assets are capitalized at cost or estimated historical cost if actual historical cost is not available. Depreciation or amortization is reported on all "exhaustible" assets. "Inexhaustible assets," such as

Capital Asset Activity (continued)

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	PRIMARY GOVERNMENT					
	Balance 9/1/11	Adjustments	Reclassifications	Additions	Deletions	Balance 8/31/12
BUSINESS-TYPE ACTIVITIES						
Non-Depreciable & Non-Amortizable Assets						
Land and Land Improvements	$ 1,524,203	$ (3,488)	$ 12,046	$ 38,933	$ (1,072)	$ 1,570,622
Infrastructure	1,629,344	21		14		1,629,379
Construction in Progress	2,635,344	(192,623)	(2,297,851)	1,985,220	(1,432)	2,128,658
Other Capital Assets	396,815	34	166	10,422	(4,350)	403,087
Land Use Rights – Permanent	19,814					19,814
Other Intangible Capital Assets – Permanent	7,213	(7,213)				
Total Non-Depreciable & Non-Amortizable Assets	6,212,733	(203,269)	(2,285,639)	2,034,589	(6,854)	5,751,560
Depreciable Assets						
Buildings and Building Improvements	22,098,255	89,449	1,980,999	240,302	(50,158)	24,358,847
Infrastructure	1,346,316	92,490	70,568	17,573	(5,495)	1,521,452
Facilities and Other Improvements	1,446,610	5,833	160,995	11,698	(9,210)	1,615,926
Furniture and Equipment	4,139,878	(19,084)	52,520	437,742	(162,815)	4,448,241
Vehicles, Boats and Aircraft	232,108	1,300	719	28,587	(9,306)	253,408
Other Capital Assets	1,440,965	830	(63,734)	69,302	(19,918)	1,427,445
Total Depreciable Assets at Historical Cost	30,704,132	170,818	2,202,067	805,204	(256,902)	33,625,319
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(9,158,821)	885		(921,661)	17,172	(10,062,425)
Infrastructure	(559,463)	(745)		(50,994)		(611,202)
Facilities and Other Improvements	(623,747)	(68)	(43,201)	(63,794)	7,558	(723,252)
Furniture and Equipment	(2,704,179)	(108)	478	(361,119)	126,463	(2,938,465)
Vehicles, Boats and Aircraft	(166,595)	(37)	(32)	(20,091)	8,626	(178,129)
Other Capital Assets	(915,896)	54	43,202	(63,890)	17,275	(919,255)
Total Accumulated Depreciation**	(14,128,701)	(19)	447	(1,481,549)	177,094	(15,432,728)
Depreciable Assets, Net	16,575,431	170,799	2,202,514	(676,345)	(79,808)	18,192,591
Intangible Capital Assets – Amortizable						
Land Use Rights – Term	255					255
Computer Software	1,037,782	(82)	83,084	76,834	(12,358)	1,185,260
Other Intangible Capital Assets – Term	2,359	7,213				9,572
Total Intangible Assets at Historical Cost	1,040,396	7,131	83,084	76,834	(12,358)	1,195,087
Less Accumulated Amortization for:						
Land Use Rights – Term	(38)			(26)		(64)
Computer Software	(638,621)	101		(166,876)	10,912	(794,484)
Other Intangible Capital Assets – Term	(59)	(210)		(955)		(1,224)
Total Accumulated Amortization**	(638,718)	(109)	0	(167,857)	10,912	(795,772)
Amortizable Assets, Net	401,678	7,022	83,084	(91,023)	(1,446)	399,315
Business-Type Activities Capital Assets, Net	$ 23,189,842	$ (25,448)	$ (41)	$ 1,267,221	$ (88,108)	$ 24,343,466

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

Education	$ 1,626,949
Transportation	17,266
Lottery	216
Other Business-Type Activities	4,975
Total	$ 1,649,406

Concluded on the following page

Capital Asset Activity (concluded)

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	PRIMARY GOVERNMENT					
	Balance 9/1/11	Adjustments	Reclassifications	Additions	Deletions	Balance 8/31/12
COMPONENT UNITS						
Non-Depreciable & Non-Amortizable Assets						
Land and Land Improvements	$ 3,705	$	$	$	$	$ 3,705
Construction in Progress	1,213			684		1,897
Total Non-Depreciable & Non-Amortizable Assets	4,918	0	0	684	0	5,602
Depreciable Assets						
Buildings and Building Improvements	42,159			28		42,187
Infrastructure	17			4		21
Facilities and Other Improvements	449					449
Furniture and Equipment	43,104	176		1,358	(477)	44,161
Vehicles, Boats and Aircraft	11,994			918	(1,456)	11,456
Other Capital Assets	60			4		64
Total Depreciable Assets at Historical Cost	97,783	176	0	2,312	(1,933)	98,338
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(12,080)			(910)		(12,990)
Infrastructure	(1)			(1)		(2)
Facilities and Other Improvements	(410)			(17)		(427)
Furniture and Equipment	(24,947)	(195)		(4,140)	301	(28,981)
Vehicles, Boats and Aircraft	(9,536)			(464)	1,285	(8,715)
Other Capital Assets	(6)			(3)		(9)
Total Accumulated Depreciation	(46,980)	(195)	0	(5,535)	1,586	(51,124)
Depreciable Assets, Net	50,803	(19)	0	(3,223)	(347)	47,214
Intangible Capital Assets – Amortizable						
Computer Software	18,802	301		3,289	(160)	22,232
Total Intangible Assets at Historical Cost	18,802	301	0	3,289	(160)	22,232
Less Accumulated Amortization for:						
Computer Software	(10,471)	(100)		(2,783)	160	(13,194)
Total Accumulated Amortization	(10,471)	(100)	0	(2,783)	160	(13,194)
Amortizable Assets, Net	8,331	201	0	506	0	9,038
Component Units Capital Assets, Net	$ 64,052	$ 182	$ 0	$ (2,033)	$ (347)	$ 61,854

works of art and historical treasures, are not depreciated. Professional, academic and research library books and materials are considered "exhaustible" assets and are depreciated. Intangible assets with determinable useful lives are amortized. Donated assets are reported at fair value on the acquisition date. Assets are depreciated or amortized over their estimated useful life using the straight-line method.

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. The required supplementary information other than MD&A section of this report provides further detail on the state's highway infrastructure.

Capitalization of interest incurred during the construction of capital assets is not applicable for governmental activities. For proprietary fund types and fiduciary funds with measurement focus on income determination or capital maintenance, the net amount of interest cost for qualifying assets is capitalized.

The state's capitalization policy regarding works of art and historical treasures is that capitalization is encouraged, but not required, for works of art and historical treasures that meet certain conditions. Works of art and historical treasures not required to be capitalized are those:

- Held for public exhibition, education or research in furtherance of public service, rather than for financial gain
- Protected, kept unencumbered, cared for and preserved
- Subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for the collection

Assets of this nature include the historical archives of the Texas General Land Office. This vast collection includes approximately 35 million records dating back to 1720, including approximately 80 thousand maps, sketches and plat maps.

NOTE 3

Deposits, Investments and Repurchase Agreements

Authority for Investments

All monies in funds established in the Comptroller of Public Accounts Treasury Operations Division (Treasury) by the Texas 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 and its agencies and instrumentalities; 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 2012. The Trust Company safekeeps U.S. Government securities in book-entry form for the major investment funds, 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, component units, public employee retirement systems and institutions of higher education are authorized to invest funds not deposited with the Treasury. As of Aug. 31, 2012, the Teacher Retirement System of Texas (TRS), the permanent school fund (PSF), the Employees Retirement System of Texas (ERS) and the University of Texas System (UT) reported over 85 percent of the total investment fair value. TRS, PSF, ERS and UT make investments following the "prudent investor rule." Authorized investments include equities, fixed income obligations, cash equivalents and other investments.

Collateralization

State law requires 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 U.S. Treasury obligations, most federal 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 2012 no depository holding state funds failed.

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

External Investment Pool

The activities of the Texas local government investment pool (TexPool) and the Texas local government investment pool prime (TexPool Prime) are reported as an external investment trust fund. Separate audited financial statements may be obtained from the Trust Company.

Deposits

As of Aug. 31, 2012, the carrying amount of deposits for governmental and business-type activities, fiduciary funds and discretely presented component units was $1.2 billion, $275.6 million and $220.9 million, respectively. 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 position as part of the "Cash and Cash Equivalents," "Securities Lending Collateral" and "Investments" line items. As of Aug. 31, 2012, the total bank balance for governmental and business-type activities, fiduciary funds and discretely presented component units was $1.1 billion, $273.6 million and $222 million, respectively.

***Custodial Credit Risk*:** Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, deposits or collateral securities in the possession of an outside party will not be recovered. There is no formal deposit policy for managing custodial credit risk. The state's securities lending programs are subject to custodial credit risk. This type of risk is inherent to the securities lending programs. As of Aug. 31, 2012, the bank balances exposed to custodial credit risk were as follows:

Bank Balances Exposed to Custodial Credit Risk

August 31, 2012 (Amounts in Thousands)

	Uninsured and Uncollateralized	Uninsured and Collateralized with Securities Held by the Pledging Financial Institution
GOVERNMENTAL ACTIVITIES		
Permanent School Fund	$ 3,170	$
Other Nonmajor Funds		
Total Governmental Activities	3,170	0
BUSINESS-TYPE ACTIVITIES		
Colleges and Universities	866	93,734
Other Nonmajor Funds	103	
Total Business-Type Activities	969	93,734
Total Governmental and Business-Type Activities	$ 4,139	$ 93,734
FIDUCIARY FUNDS	$ 174,073	$ 0
COMPONENT UNITS	$ 466	$ 0

***Foreign Currency Risk*:** Foreign currency risk for bank balances is the risk that changes in exchange rates will adversely affect the deposit. There is no formal deposit policy for managing foreign currency risk. Foreign currency deposits are intended for settlement of pending international investment trades. The table at the left presents the bank balances exposed to foreign currency risk as of Aug. 31, 2012.

Bank Balances Exposed to Foreign Currency Risk

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities	Fiduciary Funds	Component Units
Australian Dollar	$ 346	$ 1,803	$
Botswana Pula		79	
Brazilian Real	48	2,258	
British Pound	132	11,307	
Canadian Dollar	36	1,849	
Chilean Peso		916	
Colombian Peso		2,206	
Costa Rica Colones			3
Croatian Kuna		19	
Czech Koruna		192	
Danish Krone		1,952	
Egyptian Pound		3,193	
Euro	213	58,385	
Ghanaian Cedi		93	
Hong Kong Dollar		53,135	
Hungarian Forint		128	
Indian Rupee		474	
Indonesian Rupiah		992	
Japanese Yen		10,445	
Jordanian Dinar		62	
Kenyan Shilling		23	
Lithuanian Litas		17	
Malaysian Ringgit	534	454	
Mauritius Rupee		79	
Mexican Peso	11	190	37
Moroccan Dirham		67	
New Israeli Shekel		269	
New Zealand Dollar		97	
Nigerian Naira		72	
Norwegian Kroner		1,814	
Pakistani Rupee		17	
Peruvian Nuevo Sol		41	
Philippine Peso		177	
Polish Zloty		488	
Qatar Riyal	805	10	
Romanian Leu		184	
Russian Ruble		36	
Singapore Dollar		8,148	
South African Rand		976	
South Korean Won		747	
Swedish Krona		717	
Swiss Franc	1,042	1,834	
Taiwan Dollar	584	4,846	
Thai Baht		403	
Turkish Lira		951	
United Arab Emirates Dirham		141	
Total	$ 3,751	$ 172,286	$ 40

Investments

The fair value of 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, on prices from fixed income pricing services or on 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. Fair values can also be determined based on the capital account balance at the closest available reporting period, as communicated by the general partner, and adjusted for subsequent contributions, distributions, management fees and reserves.

Money market investments are reported at amortized cost, which approximates market value. Participating interest-earning investment contracts that have a remaining maturity at the time of purchase of one year or less may also be reported at amortized cost, provided 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 fair value of investments as of Aug. 31, 2012, are presented in the table below.

Investment Fair Value

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities	Fiduciary Funds	Component Units
U.S. Treasury	$ 15,511,171	$ 19,154,883	$ 399,100
U.S. Treasury Strips	335,111	90,588	
U.S. Treasury TIPS	920,859	5,761,401	
U.S. Government Agency	8,329,544	7,176,276	534,491
Corporate Obligations	4,059,750	1,965,267	27,314
Corporate Asset and Mortgage Backed	2,650,805	905,903	263,743
Corporate Equity	17,320,622	28,583,053	
International Obligations	2,447,872	796,690	2,523
International Equity	2,943,696	31,255,750	
International Other Commingled Funds	350,017	3,244,409	
Repurchase Agreements	6,417,492	9,664,190	55,154
Fixed Income and Bond Mutual Fund	4,526,519	436,104	18,584
Other Mutual Funds	212,507	71,527	6
Other Commingled Funds	5,541,827	5,438,046	29,489
Commercial Paper	1,673,210	562,071	14,818
Invested Collateral	997,376	22,955,320	
Securities Lending Collateral Investment Pool	85,056		
Real Estate	3,120,575	443,174	
Derivatives	50,095	86,110	
Externally Managed Investments	20,247,080	36,800,820	
Other Investments	3,922,271	359,565	375,544
Total Investments	$ 101,663,455	$ 175,751,147	$ 1,720,766

ERS, TRS, PSF and UT participate in individual securities lending programs. Cash collateral received by the lending agent on behalf of each entity is invested in a non-commingled pool exclusively for the benefit of the individual entity. Additional information about securities lending activity is disclosed in the "Securities Lending" section of this note. As of Aug. 31, 2012, the investment type balances for the invested securities lending cash collateral were as follows:

Invested Securities Lending Collateral Fair Value

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities	Fiduciary Funds
U.S. Treasury	$ 20,298	$ 356,217
U.S. Government Agency	72,390	
Corporate Obligations	15,525	87,421
Corporate Asset and Mortgage Backed	6,047	
Equity	25,115	867,659
International Obligations	81,569	13,060
International Equity		73,906
Repurchase Agreements	614,746	
Other Commingled Funds		21,557,057
Commercial Paper	110,174	
Other Investments	51,513	
Total Investments	$ 997,377	$ 22,955,320

***Custodial Credit Risk*:** Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the value of its investments or collateral securities in the possession of an outside party will not be recovered. There is no formal investment policy for managing custodial credit risk. Consistent with the securities lending program, underlying securities on loans are subject to custodial credit risk.

As of Aug. 31, 2012, the investments exposed to custodial credit risk were as follows:

Investments Exposed to Custodial Credit Risk

August 31, 2012 (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 Asset and Mortgage Backed	$ 6,047	$
Repurchase Agreements	364,451	
Other Governmental Funds		
Other Commingled Funds		5,805
Total Governmental Activities	370,498	5,805
BUSINESS-TYPE ACTIVITIES		
Colleges and Universities		
U.S. Government Agency	10,149	
Corporate Equity	2,313	8,715
Corporate Asset and Mortgage Backed		2,191
Fixed Income and Bond Mutual Fund	6,437	
International Other Commingled Funds	13,841	
Miscellaneous	9,103	
Other Proprietary Funds		
Other Commingled Funds		306,580
Repurchase Agreements		114,999
Fixed Income and Bond Mutual Fund		27,310
Total Business-Type Activities	41,843	459,795
Total Governmental and Business-Type Activities	$412,341	$465,600
FIDUCIARY FUNDS		
Other Fiduciary Funds		
U.S. Treasury	$ 18,947	$
Total Fiduciary	$ 18,947	$ 0

***Foreign Currency Risk*:** Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investment. TRS, PSF, ERS and UT are exposed to investment foreign currency risk. ERS, TRS and the PSF do not have an investment policy for managing foreign currency risk. UT's investment policy has no limitation on investments in non-U.S. denominated bonds or common stocks.

The investments exposed to foreign currency risk as of Aug. 31, 2012, are presented on the following page.

Investments Exposed to Foreign Currency Risk

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities				Fiduciary Funds			
	International Obligations	International Equity	International Other Commingled Funds	Other Investments	International Obligations	International Equity	International Other Commingled Funds	Other Investments
Argentine Peso	$ 302	$	$ 1,130	$	$	$	$ 3	$
Australian Dollar	180,058	62,620	3,529	263,623	1,037	1,052,349	985	
Botswana Pula						4,596		
Brazilian Real	260,940	224,321	21,213	131,766		1,091,036	898	
British Pound	213,343	236,028	111,587	720,917		4,058,460	4,934	211,656
Canadian Dollar	46,527	70,479	3,353	37,756	1,210	1,608,350	246	
Cayman Island Dollar	70			358,195				
Chilean Peso	995	5,108	1,444	18,728		136,875	2	
Chinese Yuan	88		6,391					
Colombian Peso	8,797		78	12,102		56,313		
Croatian Kuna						5,868		
Czech Koruna		2,614	947	3,048		38,796		
Danish Krone		6,962	392	35,900		170,209	131	
Egyptian Pound		2,004	632	3,657		42,061		
Euro	497,386	155,737	55,234	1,178,193	75,733	4,650,657	5,463	2,696,720
Ghanaian Cedi						2,231		
Hong Kong Dollar	1,445	289,122	6,070	260,187		2,364,774	739	
Hungarian Forint	29,650	2,062	8	2,707		63,646		
Indian Rupee		32,003	9,323	556	1	561,806	417	
Indonesian Rupiah	1,452	29,117	2,225	26,536		453,909	41	
Japanese Yen	166,673	108,794	10,838	595,892		3,203,209	981	
Jordanian Dinar						7,022		
Kenyan Shilling						8,077		
Lithuanian Litas	471							
Malaysian Ringgit	31,464	41,032	680	36,886		289,258	72	
Mauritius Rupee						5,857		
Mexican Peso	104,420	30,855	6,636	48,603		479,094	320	
Moroccan Dirham		801	12	1,161		14,534		
New Israeli Shekel	8,136		359	10,765		57,568	28	
New Zealand Dollar	100,263		(657)	3,919		16,376		
Nigerian Naira						9,019		
Norwegian Kroner		4,152	526	29,494		243,409		
Pakistani Rupee		1,418				19,642		
Panamanian Balboa	97		177					
Peruvian Nuevo Sol	265	10	990	286		5,935	45	
Philippine Peso	1,041	21,422	896	9,752		107,875	26	
Polish Zloty	80,850	12,504	(1)	13,887		131,310		
Qatar Riyal	360					19,379		
Romanian Leu						4,886		
Russian Ruble	181		1,297	45,052		12,402	151	
Singapore Dollar	6,466	34,611	2,216	55,953		251,294	131	
South African Rand	41,009	46,251	5,884	79,555		821,553	306	
South Korean Won	33,265	119,222	27,687	153,409		1,657,481	513	
Swedish Krona		32,902	2,510	94,438	2,957	481,935	414	
Swiss Franc		40,767	5,431	252,286		1,451,648	1,414	
Taiwan Dollar		73,037	6,937	108,349		971,381	370	
Thai Baht	3	40,146	3,198	22,194		358,488		
Turkish Lira		26,261	1,842	18,780		314,238	76	
United Arab Emirates Dirham	50	2,280	355			13,855		
Venuzuelan Bolivar	2,127							
Total	$ 1,818,194	$ 1,754,642	$ 301,369	$ 4,634,532	$ 80,938	$ 27,318,661	$ 18,706	$ 2,908,376

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

TRS' investment policy states that for over-the-counter derivatives, the minimum credit rating, based on a NRSRO, must be at least A- or better at the inception of the contract. The net market value of all over-the-counter derivative positions, less collateral posted, may not exceed $500 million and all over-the-counter derivative positions without collateral may not exceed 5 percent of the total market value of the fund. Repurchase agreements may not exceed 5 percent of the market value of the total investment portfolio. A securities lending agent must be an organization rated A- or better by a NRSRO.

PSF's investment policy requires investments to adhere to specific Standard & Poor's rating guidelines. Fixed income securities must be rated at least BBB- and short-term money market instruments must be rated at least A-1.

ERS' general investment policy requires that non-cash 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 policy has no requirements or limitations for investment ratings.

As of Aug. 31, 2012, the credit quality distribution for securities with credit risk exposure was as follows:

Investments Exposed to Credit Risk

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities								
	U.S. Government Agency	Corporate Obligations	Corporate Asset/Mortgage Backed	International Obligations	Repurchase Agreements	Fixed Income/Bond Mutual Fund	Commercial Paper	Other Investments	Totals
AAA	$ 1,523,038	$ 217,570	$ 1,499,390	$ 583,991	$ 40,105	$	$	$ 390,934	$ 4,255,028
AA	8,281,341	718,961	70,126	245,502	5,896,096			169,136	15,381,162
A	2,099	1,092,529	109,684	421,937	114,999			77,188	1,818,436
BBB		1,161,890	49,808	156,474				16,991	1,385,163
BB		140,280	3,639	45,121				25,362	214,402
B		68,102	5,876	4,334				3,170	81,482
CCC		3,545	37,528	1,552					42,625
CC			2,577						2,577
D			1,814						1,814
AAAf						2,896,731			2,896,731
AAAm						497,353			497,353
Aaf						40,334			40,334
A-1							1,516,861		1,516,861
Not Rated	228,151	559,871	868,480	990,898	695,903	1,414,730	191,560	135,629	5,085,222
Total	$ 10,034,629	$ 3,962,748	$ 2,648,922	$ 2,449,809	$ 6,747,103	$ 4,849,148	$ 1,708,421	$ 818,410	$ 33,219,190

Continued on the following page

Investments Exposed to Credit Risk (concluded)

August 31, 2012 (Amounts in Thousands)

	Fiduciary Funds								
	U.S. Government Agency	Corporate Obligations	Corporate Asset/Mortgage Backed	International Obligations	Repurchase Agreements	Fixed Income/Bond Mutual Fund	Commercial Paper	Other Investments	Totals
AAA	$ 5,125,511	$ 58,073	$ 209,974	$ 236,041	$ 8,365,174	$	$	$ 42,699	$ 14,037,472
AA	5,457,223	222,111	63,121	152,808	630,055			1	6,525,319
A	653	776,347	25,796	204,417				37,286	1,044,499
BBB		631,434	16,334	151,994				25	799,787
BB		89,633	22,995	40,612					153,240
B		94,524	70,838	6,335				4	171,701
CCC		10,323	146,283	114					156,720
CC		3,092	51,629						54,721
D			3,221						3,221
AAAf						50,736			50,736
Aaf						16,927			16,927
A-1							532,497		532,497
Not Rated	31,798	77,341	295,723	61,850		528,757		5,076	1,000,545
Total	$ 10,615,185	$ 1,962,878	$ 905,914	$ 854,171	$ 8,995,229	$ 596,420	$ 532,497	$ 85,091	$ 24,547,385

	Component Units								
	U.S. Government Agency	Corporate Obligations	Corporate Asset/Mortgage Backed	International Obligations	Repurchase Agreements	Fixed Income/Bond Mutual Fund	Commercial Paper	Other Investments	Totals
AAA	$ 915,719	$ 18,722	$ 257,647	$ 2,245	$	$	$	$ 39,626	$ 1,233,959
AA	83,437	3,909	244		42,843				130,433
A		1,751		278					2,029
AAAf						3,296			3,296
AAAm						10,262			10,262
A-1							14,818		14,818
Not Rated	9,931	2,933	5,852		12,311				31,027
Total	$ 1,009,087	$ 27,315	$ 263,743	$ 2,523	$ 55,154	$ 13,558	$ 14,818	$ 39,626	$ 1,425,824

***Concentration of Credit Risk*:** Concentration of credit risk is the risk of loss attributed to the magnitude of the investment in a single issuer. As of Aug. 31, 2012, governmental and business-type activities did not hold more than 5 percent of investments 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. TRS and PSF use the effective weighted duration method to identify and manage interest rate risk. ERS and UT 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 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. It incorporates the effect of embedded options for corporate bonds and changes in prepayments for mortgage backed securities. Modified duration estimates the sensitivity of the fund's investments to changes in interest rates.

The investment policy of PSF mandates the average duration of the fixed income portfolio to be consistent with the Barclay Aggregate Bond Index's duration and the duration of the real return portfolio to be consistent with the Barclay's Capital U.S. Treasury Inflation Protected Securities (TIPS) Index. As of Aug. 31, 2012, the Barclay Aggregate Index duration was 5.02 years and the Barclay's TIPS Index was 5.7 years. 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, reverse repurchase agreements, which is 180 days, and floating rate securities, which is three years. The maximum weighted average maturity of the entire collateral portfolio must be 180 days or less. The maximum weighted average interest rate exposure of the entire collateral portfolio must be 60 days or less. TRS, ERS and UT do not have a formal investment policy for managing interest rate risk.

As of Aug. 31, 2012, PSF's investments by investment type, fair value and the effective weighted duration rate were as follows:

Investments Exposed to Interest Rate Risk

August 31, 2012

PSF Investment Type	Fair Value (in Thousands)	Effective Weighted Duration Rate
Asset Backed Securities	$ 87,599	1.49
Commercial Mortgage Backed Securities	289,547	3.58
Corporate Obligations	1,337,418	6.96
Yankee – Corporate Obligations	39,729	10.78
Non Agency Mortgage Backed Securities	38,109	3.14
Sovereign Government Debt	16,514	8.25
U.S. Government Agency Commercial Mortgage Backed Securities	131,759	10.61
U.S. Government Agency Mortgage Backed Securities	1,420,654	2.06
U.S. Government Agency Obligations	458,313	4.38
U.S. Taxable Municipal Bonds	109,766	10.93
U.S. Treasury Securities	1,296,077	6.73
U.S. Treasury TIPS	913,399	7.97
Total	$ 6,138,884	5.62

The following table provides information about PSF's interest rate risks and maturities associated with its invested securities lending collateral by investment type as of Aug. 31, 2012.

Invested Securities Lending Collateral Exposed to Interest Rate Risk

August 31, 2012 (Amounts in Thousands)

PSF Investment Type	Fair Value	Investment Maturities in Less Than One Year	Investment Maturities Greater Than One Year
Asset Backed Floating Rate Notes	$ 6,047	$	$ 6,047
Repurchase Agreements	364,451	364,451	
Total	$370,498	$364,451	$ 6,047

The following table presents TRS' investments by investment type, fair value and the effective weighted duration rate as of Aug. 31, 2012.

Investments Exposed to Interest Rate Risk

August 31, 2012

TRS Investment Type	Fair Value (In Thousands)	Effective Weighted Duration Rate
U.S. Government Obligations	$ 13,536,791	16.16
U.S. Government STRIPS and TIPS	5,851,985	6.06
U.S. Government Agency Obligations	20,215	4.18
Asset and Mortgage Backed Obligations	525,103	2.67
Corporate Obligations	53,493	9.29
International Government Obligations	80,936	2.14
International Corporate Obligations	11,069	9.78
Total	$ 20,079,592	12.77

As of Aug. 31, 2012, ERS' investments by investment type, fair value and the modified duration rate were as follows:

Investments Exposed to Interest Rate Risk

August 31, 2012

	Fair Value (In Thousands)		Modified Duration Rate	
ERS Investment Type	Fiduciary Funds	Proprietary Fund	Fiduciary Funds	Proprietary Fund
U.S. Treasury Securities	$ 3,840,480	$ 380,052	4.64	2.51
U.S. Government Agency Obligations	1,337,784	49,471	2.79	2.79
Corporate Obligations	1,758,551	58,012	6.42	6.56
Corporate Asset and Mortgage Backed Securities	162,579	6,012	3.04	3.04
International Obligations	723,327	25,951	3.43	3.38
Money Market and Bond Fund	185,206	135,800	0.08	0.08
Municipal Funds	60,285	2,229	13.08	13.08
Total	$ 8,068,212	$ 657,527	4.54	2.46

As of Aug. 31, 2012, UT's investments by investment type, fair value and the modified duration rate were as follows:

Investments Exposed to Interest Rate Risk

August 31, 2012

UT Investment Type	Fair Value (In Thousands)	Modified Duration Rate
INVESTMENTS IN SECURITIES		
U.S. Government Guaranteed:		
U.S. Treasury Bonds and Notes	$ 292,324	7.81
U.S. Treasury Strips	558	1.73
U.S. Treasury Bills	65,054	0.54
U.S.Treasury Inflation Protected	2,703	6.48
U.S. Agency Asset Backed	5,940	4.36
Total U.S. Government Guaranteed	366,579	6.45
U.S. Government Non-Guaranteed:		
U.S. Agency	5,756	3.82
U.S. Agency Asset Backed	237,710	2.99
Total U.S. Government Non-Guaranteed	243,466	3.01
Total U.S. Government	610,045	5.07
Corporate Obligations:		
Domestic	548,204	6.33
Foreign	368,027	5.47
Total Corporate Obligations	916,231	5.99
Foreign Government and Provincial Obligations	1,550,769	6.32
Other Debt Securities	47,556	12.86
Total Debt Securities	3,124,601	6.08
Other Investment Funds – Debt	23,019	6.90
Convertible Stock	1,021	29.03
Fixed Income Money Market Funds	2,452,634	0.04
Total	$ 5,601,275	3.44

Investments with Fair Values Highly Sensitive to Interest Rate Changes

In accordance with the applicable investment policies, TRS, PSF, ERS and UT may invest in asset backed and mortgage backed obligations. Mortgage backed obligations are subject to early principal payment in a period of declining interest rates. The resultant reduction in expected cash flows will affect the fair value of these securities. Asset backed obligations are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligee of the underlying assets in periods of declining interest rates could reduce or eliminate the stream of income that would have been received. As of Aug. 31, 2012, the fair value of investments in asset and mortgage backed obligations highly sensitive to interest rate changes for TRS, PSF, ERS and UT was $3.2 billion.

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 with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. Sale proceeds are invested 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 the 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.

As of Aug. 31, 2012, the Treasury's aggregate amount of reverse repurchase agreement obligations was $66.3 million, including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was $66.4 million. During fiscal 2012, the credit exposure was $60 thousand.

Securities Lending

ERS, TRS, PSF, UT, the Veterans Land Board (VLB) and the Texas Prepaid Higher Education Tuition Board (TPHETB) participate in securities lending programs as authorized by state statute. ERS, TRS, PSF and UT established their own separately managed securities lending programs. VLB participates in collateral investment pools that commingle the cash collateral of several entities. Under these programs, 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, PSF may receive collateral in the form of other assets that it specifically agrees to with its lending agent. ERS, TRS, UT and VLB receive collateral equal to 102 percent of the value of domestic securities lent and 105 percent for international securities. PSF 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. However, the required percentage is 102 percent for foreign securities denominated and payable in U.S. dollars. 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 custodians of the securities are the security lending agents. The securities lending contracts do not allow the governmental entities to pledge or sell collateral securities unless the borrower defaults. The lending agents are required to indemnify ERS, TRS, PSF, UT, VLB and TPHETB if the borrowers fail to return the securities.

TRS, VLB, PSF and TPHETB loans are terminable at will. 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.

Differences between the fair value of the invested cash collateral and the cash collateral liability are recorded as part of the net increase/(decrease) in fair value of investments. There is no credit risk exposure to the lender when the fair value of the security on loan is less than the cash collateral liability. The overall securities lending activity as of Aug. 31, 2012, is summarized below.

Securities Lending Activity Summary

August 31, 2012 (Amounts in Thousands)

Entity	Fair Value of Securities on Loan	Non-Cash Collateral*	Cash Collateral Liability (Obligation/ Securities Lending)	Fair Value of Invested Cash Collateral (Securities Lending Collateral)	Net Increase/ (Decrease) In Fair Value
TRS	$ 22,287,014	$ 1,130,387	$ 21,535,537	$ 21,557,057	$ 21,520
ERS	1,379,139		1,416,923	1,417,088	165
PSF	1,588,075	1,163,039	470,169	370,498	(99,671)
UT*,**	663,607		511,401	511,401	
VLB**	83,855		85,056	85,056	
TPHETB**	94,884	90	96,653	96,653	
Total	$ 26,096,574	$ 2,293,516	$ 24,115,739	$ 24,037,753	$ (77,986)

* Non-cash collateral received for securities lending activities is not recorded as assets because the underlying investments remain under the control of the borrower, except in the event of default.

** UT, VLB and TPHETB did not experience any net change in fair value because the cash collateral pools they participated in were maintained at amortized cost as of Aug. 31, 2012.

Investment Derivative Instruments

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. These securities or contracts serve as components of the investment strategies of certain state agencies, public employee retirement systems and institutions of higher education. Those investment strategies are utilized to manage and reduce the risk of the overall investment portfolio. Investment derivative levels and types are monitored to ensure that portfolio derivatives are consistent with the intended purpose and at the appropriate level.

All investment derivative instruments are reported at fair value on the statement of net position and the statement of fiduciary net position. The changes in the fair value of investment derivative instruments are reported as investment revenue in the operating statements. As of Aug. 31, 2012, TRS, PSF, UT, Texas A&M University System (A&M), VLB and the Texas Department of Transportation (TxDOT) held investment derivatives (forwards, futures, options and swaps).

Forward foreign currency exchange contracts are used for the purchase or sale of a specific foreign currency at a fixed quantity and price on a future date as a hedge against either specific transactions or portfolio positions. The contracts are in the currency native to the security transactions for settlement date and are marked-to-market daily with the change in market value recorded as an unrealized gain or loss. Realized gain or loss is recorded at the closing of the contract. Risks associated with such contracts include the potential inability of the counterparties to meet the terms of their contracts and unanticipated movements in currency exchange rates.

Futures contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price and date. Futures contracts are used to facilitate various trading strategies, primarily as a tool to hedge against the increase or decrease of market exposure to various asset classes. Upon entering into a futures contract, an initial margin deposit is pledged to the broker equal to a percentage of the contract amount. Contracts are marked-to-market, settled in cash with the broker and recorded as an unrealized gain or loss daily. The daily gain or loss difference is referred to as the daily variation margin. Realized gain or loss is recorded at the closing of the contract. Holders of futures contracts look to the exchange for performance under the contract and not to the entity holding the offsetting futures. Accordingly, the amount of risk posed by the nonperformance of counterparties to futures contracts is minimal. Risks due to movements in the value of the futures contracts and the inability to close out futures contracts due to a non-liquid secondary market remain.

Options are used to alter market (systematic) exposure without trading the underlying cash market securities and to hedge and control risks so the actual risk/return profile is more closely aligned with the target risk/return profile. Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. With written options, market risk arises from an unfavorable change in the price of the derivative instrument, security or currency underlying the written option.

Swaps represent contracts that obligate two counterparties to exchange a series of cash flows at specified intervals. The ultimate gain or loss depends upon the price or rate at which the underlying financial instrument of the swap is valued at the settlement date. Swaps are used to manage risk and enhance returns. As of Aug. 31, 2012, swap investments were interest rate, credit default, commodity, equity and total return swaps.

UT, VLB and TxDOT invested in pay-variable, receive-variable and pay-fixed, receive-variable interest rate swap agreements that are reported as investment derivatives because they are ineffective hedges.

***Foreign Currency Risk*:** TRS, UT and A&M have exposure to investment foreign currency risk in forwards, futures, options and swaps derivative investments. As of Aug. 31, 2012, derivative investments exposed to foreign currency risk were as follows:

Derivative Investments Exposed to Foreign Currency Risk

August 31, 2012 (Amounts in Thousands)

	Governmental and Business-Type Activities				Fiduciary Funds
	Swaps	Options	Futures	Forwards	Swaps
Australian Dollar	$ 104	$ (4,180)	$ (139)	$ (4,594)	$
Brazilian Real			(2,504)	(2,559)	
British Pound	(476)			663	186
Canadian Dollar			(21)	157	43
Chilean Peso				857	
Chinese Yuan				(1,507)	
Columbian Peso				78	
Danish Krone				31	
Euro	1		20	(3,225)	4,985
Hong Kong Dollar					29
Indian Rupee				3,658	
Japanese Yen	(2,457)		35	(3,568)	(55)
Malaysian Ringgit				52	
Mexican Peso	1,554			(768)	
New Zealand Dollar				(598)	
Norwegian Kroner				8	
Polish Zloty				(194)	
Singapore Dollar				6	
South African Rand				(27)	
South Korean Won		(16,960)		1,149	(63)
Swedish Krona				214	468
Swiss Franc				(1,093)	
Taiwan Dollar				(872)	
Thai Baht				16	
Turkish Lira				(594)	
Total	$ (1,274)	$ (21,140)	$ (2,609)	$ (12,710)	$ 5,593

***Credit Risk*:** TRS and UT instituted policies to mitigate counterparty credit risk for investment derivatives by having master netting agreements and collateral posting arrangements. TRS and UT negotiated thresholds or limits for each counterparty above which collateral must be posted.

TRS' investment policy limits the net market value of all over-the-counter derivative positions, less collateral posted, to an amount not exceeding $500 million for any individual counterparty.

UT requires collateral to be posted on a daily basis by the counterparty to cover exposure to a counterparty above the limits set in place by the master netting agreement. Collateral posted by counterparties is held by UT in one of its accounts at their custodian bank.

TxDOT's basis swap agreements contain provisions for collateral posting by counterparties in the event of a credit rating downgrade. Acceptable forms of collateral include cash in the form of U.S. dollars, negotiable debt obligations issued by the U.S. Treasury Department and agency securities. Agency securities include negotiable debt obligations fully guaranteed as to both principal and interest by the Federal National Mortgage Association, the Government National Mortgage Association or the Federal Home Loan Mortgage Corporation.

The aggregate fair value of investment derivative instruments in asset positions as of Aug. 31, 2012, was $193.2 million. The investment derivative instruments were executed with counterparties that had a credit rating of no less than A using the Standard & Poor's rating scale. This represents the maximum amount of loss that would have been recognized as of Aug. 31, 2012, if all counterparties failed to perform as contracted. This maximum exposure is reduced by $43.1 million of collateral held and by $81.8 million in liabilities included in netting arrangements with those counterparties, resulting in a $68.3 million net exposure of investment derivative instruments to credit risk.

***Interest Rate Risk*:** TRS, UT, VLB and TxDOT are exposed to interest rate risk on swap transactions. Investments in pay-variable, receive-variable interest rate swaps ranged from payment of 100 to 131.25 percent of Securities Industry and Financial Markets Association

(SIFMA) and receipt of 67 to 103 percent of one month to 10-year London Interbank Offered Rate (LIBOR). Investments in pay-variable, receive-fixed interest rate swaps paid a fixed rate of 0.25 percent and received the 6-month LIBOR at the foreign currency rate. Investments in pay-fixed, receive-variable interest rate swaps ranged from receipt of various foreign currency rates and payment of 0.3 to 6.96 percent. As of Aug. 31, 2012, the investment maturities for the state's swap contracts exposed to interest rate risk were as follows:

Derivative Investments Exposed to Interest Rate Risk

August 31, 2012 (Amounts in Thousands)

		Investment Maturities (in years)				
Investment Type	**Fair Value**	**Less Than 1**	**1-5**	**6-10**	**11-15**	**More than 15**
Interest Rate Swaps	$54,482	$21,534	$(401)	$276	$792	$32,281

Investment Funds

Investment funds include hedge fund pools, private investment pools, public market funds and other alternative investments managed by external investment managers. Risks associated with these investments include investment manager risk, liquidity risk, market risk and leverage risk. Investment manager risk is substantially dependent upon key investment managers; therefore, the loss of those individuals may adversely impact the return on investment. Also, some investment funds are not subject to regulatory controls. Liquidity may be limited due to imposed lock-up periods, with penalties to redeem units or restricting redemption of shares until a certain period of time has elapsed. Investment funds may employ sophisticated investment strategies using leverage, which could result in the loss of invested capital. As of Aug, 31, 2012, the fair value of various investment funds was $57 billion.

NOTE 4

Short-Term Debt

On Aug. 23, 2011 (with an issue date of Sept. 1, 2011), $9.8 billion of the state of Texas Tax and Revenue Anticipation Notes, Series 2011, were sold to coordinate the cash flow of the state for fiscal 2012. Issuance of these notes enhanced the state's ability to make timely payment of expenditures payable from the general revenue fund. The Series 2011 notes were repaid during fiscal 2012, bore interest at 2.5 percent and were priced to yield 0.273 percent.

On Aug. 21, 2012, the Comptroller's office sold approximately $9.8 billion of the state of Texas Tax and Revenue Anticipation Notes, Series 2012, with an issue date of Aug. 30, 2012, and a maturity date of Aug. 30, 2013. The notes bear interest at 2.5 percent and were priced to yield 0.225 percent. They are not subject to redemption prior to maturity. On Aug. 21, 2012, good faith funds in the amount of $98 million were received. The balance of the $9.8 billion was received on Aug. 30, 2012.

The state also sold $500 million in commercial paper for the purpose of coordinating the cash flow of the state for fiscal 2012. Issuance of the commercial paper also enhanced the state's ability to make timely payments of expenditures payable from the general revenue fund.

Short-term debt activity for the fiscal year ended Aug. 31, 2012, is presented below.

Short-Term Debt

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Balance 9/1/11	Issued	Redeemed	Balance 8/31/12
Tax and Revenue Anticipation Notes	$	$ 19,600,000	$ 9,800,000	$ 9,800,000
Commercial Paper		500,000	500,000	
	$ 0	$ 20,100,000	$ 10,300,000	$ 9,800,000

NOTE 5

Long-Term Liabilities

Long-term liabilities activity for the fiscal year ended Aug. 31, 2012, is presented in the table below.

Long-Term Liabilities Activity

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Balance 9/1/11	Restatement	Additions	Reductions	Balance 8/31/12	Amounts Due Within One Year	Amounts Due Thereafter
GOVERNMENTAL ACTIVITIES							
Claims and Judgments	$ 147,973	$	$ 48,079	$ 62,827	$ 133,225	$ 50,183	$ 83,042
Capital Lease Obligations	14,177		2,867	5,341	11,703	5,365	6,338
Employees' Compensable Leave	718,842		773,481	759,427	732,896	439,322	293,574
Notes and Loans Payable	1,149,953		302,515 *	71,666	1,380,802	170,932	1,209,870
General Obligation Bonds Payable	11,519,544		188,956 *	394,175	11,314,325	383,782	10,930,543
Revenue Bonds Payable	5,455,607	(1,004,165)	(3,894) *	170,650	4,276,898	178,378	4,098,520
Pollution Remediation Obligation	263,806		53,111	69,533	247,384	51,876	195,508
Governmental Activities Long-Term Liabilities	$ 19,269,902	$ (1,004,165)	$ 1,365,115	$ 1,533,619	$ 18,097,233	$ 1,279,838	$ 16,817,395
BUSINESS-TYPE ACTIVITIES							
Claims and Judgments	$ 60,230	$	$ 20,569	$ 19,743	$ 61,056	$ 16,708	$ 44,348
Capital Lease Obligations	20,484		3,946	2,792	21,638	3,514	18,124
Employees' Compensable Leave	684,427		224,523	203,707	705,243	364,698	340,545
Notes and Loans Payable	2,005,719		980,772 *	911,522	2,074,969	673,538	1,401,431
General Obligation Bonds Payable	2,955,651		414,460 *	140,562	3,229,549	129,075	3,100,474
Revenue Bonds Payable	18,766,862		1,607,012 *	1,340,405	19,033,469	2,165,794	16,867,675
Pollution Remediation Obligation	20			20			
Liabilities Payable From Restricted Assets	3,561,533		270,552	331,598	3,500,487	541,137	2,959,350
Business-Type Activities Long-Term Liabilities	$ 28,054,926	$ 0	$ 3,521,834	$ 2,950,349	$ 28,626,411	$ 3,894,464	$ 24,731,947
COMPONENT UNITS							
Capital Lease Obligations	$ 143	$	$	$ 33	$ 110	$ 54	$ 56
Employees' Compensable Leave	5,685		2,650	2,450	5,885	3,701	2,184
Notes and Loans Payable	73,206		2,003 *	21,127	54,082	9,570	44,512
Revenue Bonds Payable	336,509		31,459 *	89,049	278,919	25,053	253,866
Liabilities Payable From Restricted Assets	50,080			50,080			
Component Units Long-Term Liabilities	$ 465,623	$ 0	$ 36,112	$ 162,739	$ 338,996	$ 38,378	$ 300,618

* Includes current year amortization of accretion, premiums and discounts.

Notes and Loans Payable Debt Service Requirements Governmental Activities

(Amounts in Thousands)

Year	Principal	Interest	Total
2013	$ 170,932	$ 12,469	$ 183,401
2014	173,315	11,495	184,810
2015	197,875	10,527	208,402
2016	205,217	11,336	216,553
2017	202,173	10,324	212,497
2018 - 2022	784,492	38,184	822,676
2023 - 2027	143,901	19,930	163,831
2028 - 2032	43,945	5,891	49,836
Total Requirements	1,921,850	120,156	2,042,006
Unamortized Accretion	(541,048)		(541,048)
Total Requirements	$ 1,380,802	$ 120,156	$ 1,500,958

Notes and Loans Payable Debt Service Requirements Business-Type Activities

(Amounts in Thousands)

Year	Principal	Interest	Total
2013	$ 673,538	$ 42,326	$ 715,864
2014	14,110	42,925	57,035
2015	13,134	43,997	57,131
2016	29,327	50,413	79,740
2017	12,700	51,512	64,212
2018 - 2022	96,268	292,112	388,380
2023 - 2027	119,961	349,157	469,118
2028 - 2032	228,726	326,966	555,692
2033 - 2037	328,776	262,278	591,054
2038 - 2042	740,233	137,526	877,759
Total Requirements	2,256,773	1,599,212	3,855,985
Unamortized Accretion	(181,804)		(181,804)
Total Requirements	$ 2,074,969	$ 1,599,212	$ 3,674,181

Notes and Loans Payable Debt Service Requirements Component Units

(Amounts in Thousands)

Year	Principal	Interest	Total
2013	$ 9,570	$ 286	$ 9,856
2014	3,043	355	3,398
2015	2,927	309	3,236
2016	4,531	418	4,949
2017	6,058	371	6,429
2018 - 2022	26,693	974	27,667
2023 - 2027	1,260	120	1,380
Total Requirements	$ 54,082	$ 2,833	$ 56,915

Notes and loans payable consist 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. The Texas Department of Transportation (TxDOT) entered into pass-through toll agreements with local entities as a means of financing state highway capital improvements and maintenance. In fiscal 2012, TxDOT recognized $125.4 million as a long-term liability for pass-through toll payables related to highway projects constructed under pass-through financing agreements. See Note 15 for additional details. Debt service requirements for notes and loans payable in the long-term liabilities are presented in the tables to the left.

General obligation bonds and revenue bonds are described in detail in Note 6. Certain revenue bonds related to pass-through activities amounting to $1 billion recorded in prior years were determined to meet the definition of conduit debt, which should not be recorded on the balance sheet and instead be disclosed in the notes. A restatement was recorded to remove the amount from the financial statements.

Claims and judgments are payments on behalf of the state, its agencies and employees for various legal proceedings, self-insurance and workers' compensation 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 $50 thousand or numerous separate claims from the same individual or entity that in total exceed $50 thousand must be approved by the Legislature before being paid. Claims are paid from one or more of approximately 50 governmental funds. Workers' compensation claims are usually paid from the same funding source(s) from which the employee's salary or wage compensation was 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.

Note 8 provides details on capital lease obligations.

Long-term liabilities 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.

Pollution Remediation Obligations

Pollution remediation obligations are recognized in the financial statements for existing pollution sites after the occurrence of one or more of the following events:

- The pollution creates an imminent endangerment to public health or the environment.
- The state is in violation of a pollution prevention-related permit or license.
- The state is named as a potentially responsible party by a regulator.
- The state is named in a lawsuit that compels it to participate in remediation.
- The state has commenced, or legally obligated itself to commence, cleanup activities.

Under applicable accounting standards, estimated expected recoveries from insurance policies and other responsible parties that are not yet realizable in the financial statements reduce the measurement of the pollution remediation obligation liability. A realized or realizable recovery involves the acknowledgment or recognition by the third party of its responsibility. Realized or realizable recoveries are recognized as assets. Recoveries from the federal government are considered nonexchange transactions and do not reduce the liability measurement, but are recognized separately as revenues when realizable. As of Aug. 31, 2012, the amount expected to offset state remediation costs could not reasonably be estimated.

Federal Regulatory Cleanup Requirements**:** Pollution remediation obligations are associated with projects initiated under federal regulatory requirements. Applicable federal laws and regulations include the Comprehensive Environmental Response, Compensation and Liability Act (also known as Superfund), the National Emissions Standards for Hazardous Air Pollutants and U.S. Environmental Protection Agency Class V Wells regulations.

The Superfund obligation estimates are based on budgeted projects to cover necessary activities for the upcoming fiscal year, along with estimated costs for future years and phases, plus direct salaries and benefits. Other obligations are calculated based on contractor estimates or historical costs as applicable.

Federal reimbursements are expected to offset a portion of these expected costs. The potential for changes due to price increases or reductions, technology or applicable laws or regulations was incorporated into these estimates.

State Regulatory Cleanup Requirements**:** Other pollution remediation obligations are associated with cleanups required under state of Texas law. The Texas Commission on Environmental Quality operates as a regulatory agency to ensure cleanups are conducted within applicable state laws and regulations contained in the Texas Administrative Code, Title 30; Texas Water Code; Texas Health and Safety Code; Texas Occupations Code; and Texas Natural Resources Code.

Other Pollution Remediation Activity**:** A remediation activities estimate for land owned by Texas Tech University in Carson County, Texas, remains pending as of Aug. 31, 2012.

NOTE 6

Bonded Indebtedness

DESCRIPTION OF BOND ISSUES

The state of Texas had 473 bond issues outstanding as of Aug. 31, 2012. During fiscal 2012 the state paid $467.7 million from the general revenue fund for debt service.

Information on Bond Issuances

August 31, 2012

Description of Issue	Bond Issues Outstanding Number	Bond Issues Outstanding Amount (in Thousands)	Range of Interest Rates Lowest	Range of Interest Rates Highest	Maturities First Year	Maturities Last Year	First Call Date
GOVERNMENTAL ACTIVITIES							
General Obligation Bonds	71	$ 13,564,472	0.25	6.07	1998	2045	07/01/03
Revenue Bonds	21	5,174,213	2.50	7.25	1991	2030	02/01/01
Governmental Activities Total	92	18,738,685					
BUSINESS-TYPE ACTIVITIES							
General Obligation Bonds	89	4,299,860	1.37	8.06	1995	2047	02/24/94
Revenue Bonds	276	24,809,839	0.30	15.00	1988	2047	05/04/95
Business-Type Activities Total	365	29,109,699					
COMPONENT UNITS							
Revenue Bonds	16	397,417	5.30	7.10	1986	2042	10/08/86
Total	473	$ 48,245,801					

Changes in Bonds Payable

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Bonds Outstanding 9/1/11	Restatement	Bonds Issued*	Bonds Matured or Retired	Bonds Refunded	Bonds Outstanding 8/31/12	Due Within One Year
GOVERNMENTAL ACTIVITIES							
General Obligation Bonds	$ 11,519,544	$	$ 188,956	$ 332,110	$ 62,065	$ 11,314,325	$ 383,782
Revenue Bonds	5,455,607	(1,004,165)	(3,894)	170,650		4,276,898	178,378
Governmental Activities Total	16,975,151	(1,004,165)	185,062	502,760	62,065	15,591,223	562,160
BUSINESS-TYPE ACTIVITIES							
General Obligation Bonds	2,955,651		414,460	116,017	24,545	3,229,549	129,075
Revenue Bonds	18,766,862		1,607,012	637,628	702,777	19,033,469	2,165,794
Business-Type Activities Total	21,722,513	0	2,021,472	753,645	727,322	22,263,018	2,294,869
COMPONENT UNITS							
Revenue Bonds	336,509		31,459	29,849	59,200	278,919	25,053
Total	$ 39,034,173	$ (1,004,165)	$ 2,237,993	$ 1,286,254	$ 848,587	$ 38,133,160	$ 2,882,082

* Includes current year amortization of accretion, premiums and discounts.

Debt Service Requirements

(Amounts in Thousands)

GOVERNMENTAL ACTIVITIES	General Obligation Bonds			Revenue Bonds		
Year	Principal	Interest	Total	Principal	Interest	Total
2013	$ 358,015	$ 503,449	$ 861,464	$ 172,015	$ 203,458	$ 375,473
2014	365,925	490,906	856,831	174,925	195,900	370,825
2015	394,755	477,311	872,066	162,130	188,155	350,285
2016	378,325	460,638	838,963	165,075	180,432	345,507
2017	339,855	444,667	784,522	167,305	172,609	339,914
2018 - 2022	1,736,260	1,989,122	3,725,382	883,005	737,704	1,620,709
2023 - 2027	1,914,750	1,565,792	3,480,542	1,450,740	470,823	1,921,563
2028 - 2032	2,046,490	1,088,346	3,134,836	1,013,145	106,121	1,119,266
2033 - 2037	2,217,085	603,321	2,820,406			
2038 - 2042	1,167,695	93,376	1,261,071			
2043 - 2047	45,000	260	45,260			
	10,964,155 *	7,717,188	18,681,343	4,188,340 *	2,255,202	6,443,542
Accretion	(15,098)		(15,098)	(1,952)		(1,952)
Premium	365,793		365,793	90,510		90,510
Discount	(525)		(525)			
Total	$ 11,314,325	$ 7,717,188	$ 19,031,513	$ 4,276,898	$ 2,255,202	$ 6,532,100

BUSINESS-TYPE ACTIVITIES	General Obligation Bonds			Revenue Bonds		
Year	Principal	Interest	Total	Principal	Interest	Total
2013	$ 126,937	$ 63,676	$ 190,613	$ 2,102,493	$ 757,972	$ 2,860,465
2014	142,835	61,203	204,038	716,670	728,091	1,444,761
2015	149,744	58,331	208,075	786,032	695,016	1,481,048
2016	148,882	55,479	204,361	829,022	658,228	1,487,250
2017	162,710	52,770	215,480	853,552	619,644	1,473,196
2018 - 2022	783,560	215,788	999,348	3,983,875	2,523,652	6,507,527
2023 - 2027	690,320	130,640	820,960	3,165,088	1,762,799	4,927,887
2028 - 2032	575,575	69,943	645,518	2,607,851	1,167,882	3,775,733
2033 - 2037	304,120	34,156	338,276	2,370,348	712,020	3,082,368
2038 - 2042	101,700	7,415	109,115	1,985,124	295,984	2,281,108
2043 - 2047	7,484	1,053	8,537	222,697	26,435	249,132
	3,193,867 *	750,454	3,944,321	19,622,752 *	9,947,723	29,570,475
Accretion	(593)		(593)	(1,202,156)		(1,202,156)
Premium	36,275		36,275	686,881		686,881
Discount				(16,150)		(16,150)
Loss on Refunding				(57,858)		(57,858)
Total	$ 3,229,549	$ 750,454	$ 3,980,003	$ 19,033,469	$ 9,947,723	$ 28,981,192

COMPONENT UNITS	Revenue Bonds		
Year	Principal	Interest	Total
2013	$ 24,176	$ 8,324	$ 32,500
2014	3,909	10,867	14,776
2015	4,134	10,690	14,824
2016	4,202	10,498	14,700
2017	4,297	10,300	14,597
2018 - 2022	26,335	47,944	74,279
2023 - 2027	55,505	40,007	95,512
2028 - 2032	49,737	29,190	78,927
2033 - 2037	69,588	15,198	84,786
2038 - 2042	27,974	2,269	30,243
	269,857 *	185,287	455,144
Premium	9,062		9,062
Total	$ 278,919	$ 185,287	$ 464,206

* Includes accretion adjustment on deep discount bonds, premium, discount and/or loss on refunding.

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, the Constitutional Appropriation Bonds and the Texas Transportation Commission highway improvement 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, sporting goods sales tax revenue and investment earnings are applied to debt service on the bonds.

The **Texas Public Finance Authority** issues general obligation bonds to finance the acquisition, construction or renovation of buildings for the use of state agencies and institutions of higher education and to fund cancer research. The Texas Public Finance 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 conservation and 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 **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.

The **Texas Department of Transportation**, through the Texas mobility fund, issues general obligation bonds to pay or reimburse the state highway fund for the payment of part of the costs of constructing, reconstructing, acquiring and expanding state highways. In addition, the bond proceeds provide funds for participation by the state in the payment of part of the costs of constructing and providing certain publicly owned toll roads and other public transportation projects. Sources of pledged revenue for the Texas mobility fund include the United We Stand license plate fees, investment income, motor vehicle inspection fees, driver record information fees, driver license fees and certificate of title fees. Debt service for highway improvement bonds is provided by the state's general revenue.

Constitutional Appropriation Bonds are issued in support of the construction programs of institutions of higher education not benefiting from the permanent university fund, which is dedicated to the University of Texas System and Texas A&M University System. Debt service payments on bonds issued are limited to the $131.3 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, promote domestic business development, provide loans to finance the commercialization of new and improved products and processes, and provide loans to defense-related communities for economic development projects. Debt service payments are funded from revenues of the Economic Development and Tourism Office, 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, 2012, the amounts of general obligation bonds, other than Constitutional Appropriation Bonds, authorized but unissued, are presented in the table below.

General Obligation Bonds Authorized But Unissued

(Amounts in Thousands)

SELF-SUPPORTING	
Texas Agricultural Finance Authority Bonds	$ 46,000
Farm and Ranch Loan Bonds	475,000
Veterans Land and Housing Bonds	1,873,372
Water Development Bonds	6,499,820
College Student Loan Bonds	1,310,390
Texas Military Value Revolving Loan Fund	200,405
Total	10,404,987
NOT SELF-SUPPORTING	
Agricultural Water Conservation Bonds	164,840
Texas Public Finance Authority Bonds	3,084,517
Transportation Commission Transportation Bonds	4,000,709
Water Development Bonds -	
Economically Distressed Areas Program	186,036
Water Infrastructure Fund Program	152,134
Total	7,588,236
Total General Obligation Bonds	$ 17,993,223

Revenue Bonds – General Comments

Each series of revenue bonds is backed by the pledged revenue sources and restricted funds specified in the bond resolution. The purpose and primary pledged revenue sources of each type of revenue bond are summarized below.

Self-Supporting

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

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

The **Texas Water Development Board** issues bonds for the Texas water resources fund and the state water pollution control revolving fund. The proceeds are used to provide financial assistance to political subdivisions for water quality enhancement purposes. Principal and interest repayments from political subdivision loans are pledged for debt service requirements of the bonds.

University of Texas System and Texas A&M University System issue **Permanent University Fund** bonds to build, equip or buy buildings or other permanent improvements. The Texas Constitution limits each system's permanent university fund debt to an amount not to exceed 20 percent and 10 percent, respectively, of the cost value of permanent university fund assets, excluding real estate. Revenue from investments of the permanent university fund is pledged to secure the payment of principal and interest. The cost value of permanent university fund assets as of Aug. 31, 2012, excluding real estate, was $11.8 billion. A comparison between the legal debt limits and the actual bonds outstanding at that date is presented below.

Permanent University Fund Bonds

(Amounts in Thousands)

	Legal Debt Limits	Actual Bonds Payable	Authorized But Unissued
University of Texas System	$ 2,356,349	$ 1,431,030	$ 925,319
Texas A&M University System	1,178,174	730,295	447,879
Total	$ 3,534,523	$ 2,161,325	$ 1,373,198

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 pledged revenue of the respective institutions and are not an obligation of the state of Texas.

The Office of the Governor is the oversight agency for the **Texas Small Business Industrial Development Corporation**, a discretely presented component unit of the state. The Texas Small Business Industrial Development Corporation bond program provides financing to state and local governments and to businesses and nonprofit corporations for the purchase of land, facilities and equipment for economic development. The bonds are not an obligation of the state and are payable from the repayment of loans and investment earnings on the bond proceeds.

The **Texas Water Resources Finance Authority**, a discretely presented component unit of the state, issues bonds to purchase the majority of existing political subdivision bonds including those held by the Texas Water Development Board. Principal and interest from political subdivision bonds are pledged for debt service requirements of the bonds.

The **Texas Department of Transportation (TxDOT)** issues revenue bonds to finance state highway improvement projects. Pledged revenues include all revenues deposited to the credit of the state highway fund, including dedicated registration fees, dedicated taxes, dedicated federal revenues, amounts collected or received pursuant to other state highway fund revenue laws and any interest or earnings from the investment of these funds.

The **Texas Department of Transportation Turnpike Authority**, a division within TxDOT, 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.

The **Texas Workforce Commission** issued revenue bonds to fund the workers' compensation insurance fund. The bond obligations are secured by a special obligation assessment imposed on Texas employers.

Non Self-Supporting

The following revenue bonds are supported by pledged lease or rental revenue derived from contracts with other state agencies, which in turn comes from legislative appropriations.

The **Adjutant General's Department** assumed the Texas Military Facilities Commission's responsibilities on Sept. 1, 2007. The Texas Military Facilities Commission's title to facilities, rental and other income pledged to the bonds was transferred to the Texas Public Finance Authority. Title will pass to the Adjutant General's Department upon final discharge of all bond obligations. Bonds are issued for the construction, expansion and renovation of armories. The bonds are payable from certain pledged revenues, primarily rentals from the Adjutant General's Department. As of Aug. 31, 2012, the bond obligations were still outstanding.

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

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

Pledged Future Revenues

Pledged revenues are those specific revenues that are formally committed to directly secure revenue bonds. The table below provides information on pledged revenue and pledged future revenue for the state's revenue bonds.

Build America Bonds

The American Recovery and Reinvestment Act (ARRA) of 2009 was implemented in February 2009. As part of this federal legislation, a new bond program called Build America Bonds (BABs) was created. Authority to issue BABs expired on Dec. 31, 2010.

The Texas Department of Transportation, the University of Texas System, the Texas Public Finance Authority and the University of Houston System had $3.5 billion, $1.7 billion, $181.8 million and $80 million of Direct Payment BABs outstanding, respectively, as of Aug. 31, 2012.

Variable Rate Bonds

Nine state agencies had a total of 108 variable rate bond issues with outstanding balances as of Aug. 31, 2012. Most of the issues' interest rates reset every seven days. The remaining issues' interest rates reset daily or monthly. The potential volatility for related debt service increases with these interest rate reset provisions.

Pledged Future Revenue

(Amounts in Thousands)

	General Obligation Bonds	Revenue Bonds		
	Governmental Activities	Governmental Activities	Business-Type Activities	Component Units
Pledged Revenue Required for Future Principal and Interest on Existing Bonds	$ 11,393,870	$ 6,443,542	$ 29,570,476	$ 455,145
Current Year Pledged Revenue	395,566	6,619,706	13,595,958	42,905
Current Year Principal and Interest Paid	337,922	381,344	1,464,461	40,529
Term of Commitment Year Ending August 31,	2039	2030	2047	2042
Percentage of Revenue Pledged	98%	100%	100%	100%

Demand Bonds

The Office of the Governor, the Veterans Land Board, the Texas Department of Housing and Community Affairs, the Texas Department of Transportation, the University of Houston System and the University of Texas System had outstanding demand bonds as of Aug. 31, 2012.

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 a 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, 2012, there were no purchased bonds held by liquidity providers under the terms of the various agreements. Details are presented in the tables below and on the following page.

Demand Bonds

August 31, 2012

	Number of				
	Demand Bond Issues	Standby Purchase Agreements	Letters of Credit	Other	Principal Balance Outstanding (In Thousands)
GOVERNMENTAL ACTIVITIES					
General Obligation Bonds					
Office of the Governor	2		2 (c)		$ 45,000
Texas Department of Transportation	2	3 (a)			229,130
Total	4	3	2	0	274,130
Revenue Bonds					
Texas Department of Transportation	1	1 (a)			100,000
Total	1	1	0	0	100,000
Governmental Activities Total	5	4	2	0	$ 374,130
BUSINESS-TYPE ACTIVITIES					
General Obligation Bonds					
Veterans Land Board	45	45 (a)			$ 1,771,425
Total	45	45	0	0	1,771,425
Revenue Bonds					
University of Texas System	4			4 (b)	1,344,315
Texas Department of Housing and Community Affairs	7	7 (a)			294,440
University of Houston System	1			1 (b)	8,390
Total	12	7	0	5	1,647,145
Business-Type Activities Total	57	52	0	5	$ 3,418,570
COMPONENT UNITS					
Revenue Bonds					
Office of the Governor	1		1 (d)		$ 20,000
Component Units Total	1	0	1	0	$ 20,000

(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 redeemed bonds are not remarketed, a standby letter of credit with National Australia Bank will be used until remarketed.
(d) – In the event redeemed bonds are not remarketed, a letter of credit with Comerica will be used until remarketed.

Demand Bond – Standby Purchase Agreements

August 31, 2012

Counterparties	Number of Secured Bond Issue Agreements	Annual Liquidity Fee	Agreement Termination Date
Banco Bilbao Vizcaya Argentaria, S.A.	1	0.0875%	11/07/16
Bank of Tokyo-Mitsubishi UFJ	2	0.5600%	08/22/14
Bank of Tokyo-Mitsubishi UFJ	3	0.5250%	07/31/15
California Public Employees Retirement System	1	0.0500%	12/13/13
Comptroller of Public Accounts*	10	0.1200%	08/31/13
J.P. Morgan Chase Bank	1	0.6500%	03/07/14
J.P. Morgan Chase Bank	9	0.5600%	07/03/14
J.P. Morgan Chase Bank	3	0.5600%	09/19/14
Landesbank Hessen-Thuringen Girozentrale	5	0.5500%	06/30/13
Landesbank Hessen-Thuringen Girozentrale	4	0.5500%	12/31/15
Royal Bank of Canada	1	0.3000%	03/01/15
State Street Bank and Trust Company	1	0.0500%	12/13/13
State Street Bank and Trust Company	4	0.2950%	11/17/14
State Street Bank and Trust Company	4	0.2950%	04/03/15
State Street Bank and Trust Company	1	0.3750%	05/22/15
Sumitomo Mitsui Banking Corp	1	0.6000%	05/20/13
Sumitomo Mitsui Banking Corp	1	0.6000%	11/01/13
Sumitomo Mitsui Banking Corp	2	0.5000%	08/12/15
Wells Fargo Bank, NA	1	0.4900%	08/25/14
Wells Fargo Bank, NA	1	0.4900%	12/14/14
Total	56		

* Comptroller of Public Accounts Treasury Operations Division

Takeout agreements are used by the Texas Department of Transportation to provide an alternative debt instrument to replace any repurchased bonds that were not remarketed within the prescribed time constraints. The table below provides the estimated impact of such an event.

Demand Bonds – Takeout Agreement Provisions

August 31, 2012

	Estimated Debt Service (In Thousands)	Rate	Basis
GOVERNMENTAL ACTIVITIES			
General Obligation Bonds			
Texas Department of Transportation			
Texas Mobility Fund Bonds			
Series 2005B	$ 90,998 (a)	10.00%	2% + the greater of: Bank Prime rate + 1.5%, Daily Fed Fds Rate + 2% or 8%
Series 2006B	158,500 (b)	4.25%	1% + the greater of: 0.5% + Daily Fed Fds Rate or Bank prime rate
Revenue Bonds			
Texas Department of Transportation			
State Highway Fund Revenue Bonds			
Series 2006B	108,750 (c)	5.25%	2% + the greater of: 0.5% + Daily Fed Fds Rate or Bank prime rate
Total	$ 358,248		

(a) – Replacement debt is subject to semi-annual payments over three years starting the first day of the third month of that period.
(b) – Replacement debt is subject to semi-annual payments over three years starting the first day of the second month of that period.
(c) – Replacement debt is subject to semi-annual payments over three years starting the first day of the sixth month of that period.

Early Extinguishment of Debt

The following table presents early debt extinguishments in fiscal 2012. The source of funds used for the extinguishments included loan repayments and other available funds.

Early Extinguished Debt Issues

(Amounts in Thousands)

BUSINESS-TYPE ACTIVITIES	
General Obligation Bonds	
Texas Water Development Board	$ 23,015
Veterans Land Board	1,530
Revenue Bonds	
Texas Workforce Commission	168,095
Texas Department of Housing and Community Affairs	99,247
Texas Water Development Board	31,975
Veterans Land Board	21,795
University of Texas System	3,400
University of Houston System	880
Business-Type Activities Total	$349,937
COMPONENT UNITS	
Revenue Bonds	
Office of the Governor	$ 40,000
Component Units Total	$ 40,000

Refunding

The table below summarizes bonds refunded during fiscal 2012 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 (Decrease)	Economic Gain
GOVERNMENTAL ACTIVITIES					
General Obligation Bonds					
Texas Water Development Board	Current Refunding	$ 37,940	$ 51,565	$21,899	$10,611
Governmental Activities Total		37,940	51,565	21,899	10,611
BUSINESS-TYPE ACTIVITIES					
Revenue Bonds					
University of Houston System	Current Refunding	75,640	87,450	12,683	11,418
Texas A&M University System	Advance Refunding	70,680	79,715	13,640	10,974
Texas A&M University System	Current Refunding	1,015	1,015	51	50
University of Texas System	Advance Refunding	47,465	53,990	12,030	9,545
Texas Tech University System	Advance Refunding	49,395	52,460	9,265	8,009
Texas Tech University System	Current Refunding	31,645	31,925	11,142	7,826
University of North Texas System	Advance Refunding	27,785	29,880	(5,443)	3,796
Texas State University System	Advance Refunding	10,970	12,535	(1,974)	1,558
Texas State University System	Current Refunding	2,530	3,200	(1,050)	619
Texas State Technical College	Advance Refunding	5,990	6,355	412	344
Texas Woman's University	Advance Refunding	6,339	4,065	1,047	906
Texas Woman's University	Current Refunding	11,576	14,795	1,912	1,655
Business-Type Activities Total		341,030	377,385	53,715	56,700
Total		$378,970	$428,950	$75,614	$67,311

* Other funds totaling approximately $24 million were used to refund/defease additional bonds.

Defeased Bonds

Texas defeased various bond issues by placing funds in irrevocable trusts in the Texas Treasury Safekeeping Trust Company (Trust Company) and external financial institutions to provide for all future debt service payments on the old bonds. Funds placed in the Trust Company to defease $209.3 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. The Texas Water Development Board defeased $10.5 million of governmental activity general obligation bonds this year. As of Aug. 31, 2012, the following amounts of defeased bonds, at par, remain outstanding for all bond issuers.

Defeased Bonds Outstanding

(Amounts in Thousands)

GOVERNMENTAL ACTIVITIES	
General Obligation Bonds	
Texas Public Finance Authority	$ 200,660
Texas Water Development Board	10,500
Revenue Bonds	
Texas Public Finance Authority	29,395
Texas National Research Laboratory Commission	8,625
Governmental Activities Total	249,180
BUSINESS-TYPE ACTIVITIES	
General Obligation Bonds	
Texas Water Development Board	37,995
Veterans Land Board	25,500
Revenue Bonds	
University of Texas System	1,496,163
Texas Water Development Board	173,845
Texas A&M University System	121,560
Texas Tech University System	52,460
University of North Texas System	29,880
Texas State University System	29,175
Texas Woman's University	4,065
Stephen F. Austin State University	1,016
Business-Type Activities Total	1,971,659
Total	$ 2,220,839

Conduit Debt

The Texas State Affordable Housing Corporation (TSAHC), a discrete component unit of the state, is authorized to issue statewide 501(c)(3) tax-exempt multifamily mortgage revenue bonds under Texas Government Code, Section 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. TSAHC 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. TSAHC 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. TSAHC, the state and any political subdivision thereof are not 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, 2012, there were 14 series of multifamily housing revenue bonds outstanding with an aggregate $183 million principal amount payable. No bonds were issued in fiscal 2012.

The Private Activity Bond Surface Transportation Corporation, a blended component unit of the state, issued two series of bonds in the aggregate amount of $1 billion that remains outstanding as of Aug. 31, 2012. The proceeds were loaned to LBJ Infrastructure Group LLC and NTE Mobility Partners LLC to finance the development and expansion of public transportation projects. Debt service is funded from loan and interest repayments from the borrowers. These bonds, previously recorded as a long-term liability, were determined to be conduit debt. The financial statements were restated in the current year and the conduit debt is only disclosed in these notes.

Conduit bond debt for the Texas Department of Housing and Community Affairs (multifamily housing bonds) and the Texas Small Business Industrial Development Corporation, a discrete component unit of the state, predates the implementation of note disclosure requirements and is reported in the financial statements.

INTEREST RATE SWAPS

Effective interest rate swap agreements are considered hedging derivatives. The aggregate debt service requirements and associated net swap payments are detailed in this note. See Note 7 for additional information on derivatives.

Estimated Debt Service of Swap Payments

Using rates as of Aug. 31, 2012, the debt service requirements of the state's variable-rate and fixed-rate bonds and associated net swap payments were estimated and are presented in the following tables.

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

(Amounts in Thousands)

	Variable-Rate Bonds		Interest Rate	
Year	Principal	Interest	Swaps, Net	Total
2013	$ 106,045	$ 5,708	$ 118,990	$ 230,743
2014	110,300	5,517	114,942	230,759
2015	123,395	5,321	110,838	239,554
2016	131,675	5,093	106,048	242,816
2017	132,090	4,852	100,948	237,890
2018 - 2022	642,845	20,669	430,958	1,094,472
2023 - 2027	701,880	14,588	305,026	1,021,494
2028 - 2032	647,630	8,597	179,936	836,163
2033 - 2037	543,360	3,745	79,139	626,244
2038 - 2042	166,055	369	5,897	172,321
2043 - 2047	195		1	196
Total	$ 3,305,470	$ 74,459	$ 1,552,723	$ 4,932,652

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

(Amounts in Thousands)

	Variable-Rate Bonds		Interest Rate	
Year	Principal	Interest	Swaps, Net *	Total
2013	$ 890	$ 76	$ (756)	$ 210
2014	950	74	(755)	269
2015	1,010	72	(754)	328
2016	1,070	70	(754)	386
2017	1,135	67	(754)	448
2018 - 2022	6,830	292	(3,771)	3,351
2023 - 2027	9,250	201	(3,767)	5,684
2028 - 2032	10,995	80	(2,944)	8,131
2033 - 2037	1,370	2	(1,483)	(111)
2038 - 2042			(120)	(120)
Total	$ 33,500	$ 934	$ (15,858)	$ 18,576

* Includes swap payments for swaps that overlay pay-fixed, receive-variable swaps on the same bonds. Principal and interest on these bonds are reported only in the pay-fixed, receive-variable swap table.

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			
Year	Principal	Interest	Interest Rate Swaps, Net	Total
2013	$ 4,185	$ 65,995	$ (5,880)	$ 64,300
2014	5,115	65,828	(5,667)	65,276
2015	6,045	65,623	(5,666)	66,002
2016	6,955	65,379	(5,666)	66,668
2017	8,895	65,101	(5,666)	68,330
2018 - 2022	181,040	311,238	(28,316)	463,962
2023 - 2027	310,960	245,303	(22,902)	533,361
2028 - 2032	485,245	151,159	(85)	636,319
2033 - 2037	340,145	32,472	(22)	372,595
Total	$ 1,348,585	$ 1,068,098	$ (79,870)	$ 2,336,813

The tables were prepared assuming current interest rates and swap index relationships remain the same for their terms. As rates and index relationships vary in the future, so will the resulting actual interest payments and net swap payments.

NOTE 7

Derivative Instruments

Derivatives are financial instruments whose values are derived, in whole or part, from the value of any one or more underlying assets or index of asset values. Derivatives include swap contracts, futures contracts, options, options on futures contracts, and forward contracts.

Hedging derivatives are entered into to reduce the overall cost of borrowing long-term capital and protect against the risk of rising interest rates. The hedging derivatives primarily consist of interest rate swap agreements entered into in connection with long-term bonds. The derivative contracts enable the state to issue bonds at a cost less than what the state would have paid to issue conventional fixed rate debt.

Investment derivatives are entered into with the intention of managing transaction risk, reducing interest cost, or reducing currency exchange risk in purchasing, selling or holding investments. Ineffective hedges are also reported as investment derivatives.

Summary of Derivative Activity

The fair value of effective hedging derivatives is recorded as derivative instrument assets (positive fair value) and derivative instrument liabilities (negative fair value). The cumulative change in fair value of effective hedging derivatives is reported as deferred inflows and deferred outflows. The state's cumulative derivative activity as of Aug. 31, 2012, is summarized on the following page. The notional amounts are presented in U.S. dollar equivalents, with the exception of commodity forwards, which are presented in million British thermal units (MMBTU).

Summary of Derivative Activity

(Amounts in Thousands)

	Change in Fair Value	Fair Value	Notional Amount	
GOVERNMENTAL ACTIVITIES				
Investment Derivatives				
Basis Swaps	$ (1,131)	$ 25,121	$ 400,000	
Futures	7,352		34,872	
BUSINESS-TYPE ACTIVITIES				
Cash Flow Hedges				
Pay-Fixed Receive-Variable Interest Rate Swaps	$ (202,010)	$ (770,766)	$ 3,345,785	
Commodity Forwards	(2,244)	(2,244)	960	*
Investment Derivatives				
Pay-Fixed Receive-Variable Interest Rate Swaps	$ 539	$ 996	$ 135,040	
Pay-Variable Receive-Fixed Interest Rate Swaps	32	32	28,225	
Basis Swaps	374	7,729	954,975	
Credit Default Swaps	(681)	152	137,273	
Equity Swaps	1,554	1,554	596,856	
Currency Swaps	(50)	(50)	5,054	
Commodity Swaps	(214)	(214)	12,161	
Forwards	(12,710)	(12,710)	2,451,993	
Futures	(2,543)		1,336,261	
Options	(89,216)	42,476	24,390,722	
FIDUCIARY ACTIVITIES				
Investment Derivatives				
Pay-Fixed Receive-Variable Interest Rate Swaps	$ (3,415)	$ (699)	$ 60,532	
Pay-Variable Receive-Fixed Interest Rate Swaps	2,561	777	41,192	
Total Return Swaps	(197,909)	21,316	1,131,863	
Credit Default Swaps	247			
Forwards	(42,750)	23,326	6,124,786	
Futures	(635,424)		9,038,282	
Warrants	6,427	32,821	10,445	
Options	4,910	4,830	38,134	

* The unit of measurement for the notional amount of the commodity forwards is expressed in million British thermal units (MMBTU). The notional amount of the commodity forwards is 960 thousand MMBTUs.

Derivative Instruments by Entity and Type

Entity/Type of Derivative Instruments

Veterans Land Board (VLB)
Hedging and investment derivatives

Texas Department of Housing and Community Affairs (TDHCA)
Hedging derivatives

University of Texas System (UT)
Hedging and investment derivatives

Texas A&M University System (A&M)
Hedging and investment derivatives

Texas Department of Transportation (TxDOT)
Investment derivatives

Permanent School Fund (PSF)*
Investment derivatives

Employees Retirement System of Texas (ERS)
Investment derivatives

Teacher Retirement System of Texas (TRS)
Investment derivatives

* The permanent school fund is jointly managed by the Texas Education Agency and the Texas General Land Office, but issues a separately audited stand-alone annual financial report.

Fair Value

Derivative instruments are recorded at fair value. The fair values of the interest rate swaps were determined using a combination of methods as outlined below.

VLB and UT used the zero-coupon method in determining the fair values of their effective interest rate swaps. Several of VLB's effective interest rate swaps contain a provision for the state to be "knocked out" of the swaps by the respective counterparties upon the breach of certain predetermined barriers. In each of these cases, VLB was paid an up-front option premium by the respective counterparties. With regard to the swap associated with Vet Land Tax Ref Bds Ser '2000, the knock-out is permanent once the option is taken at the discretion of the counterparty. In the remainder of the swaps with knock-out provisions, the knock-out is mandatory and is periodic in nature, with the knock-out period corresponding only to the period during which the respective barrier is breached. The knock-out provisions are an integral part of the associated swaps, and the fair values of the swaps include the effects of the knock-outs.

TDHCA based the fair value of its swaps on market conditions as of Aug. 31, 2012. Fair values were directly obtained by the counterparties to the transactions and separately verified by an independent third party. Valuations are based on mid-market levels and may not reflect the amount a counterparty would have required in the event of an early termination of the swap transaction on that date. For swaps with no pre-defined notional amortization schedule, a valuation was performed based on an assumed notional amortization.

Futures contracts are marked-to-market daily and valued at closing market prices on the valuation date. A daily variation margin (the gain or loss) between the daily value of the contracts and the value on the previous day is recorded and settled in cash with the broker the following morning. Options and swaps are valued using broker quotes, proprietary pricing agents or appropriate pricing models with primarily externally verifiable model inputs.

The fair value of forward currency contracts is estimated by adding the forward points to the corresponding spot rate. These rates are then applied to the outstanding currency exchange to derive a change in valuation.

HEDGING DERIVATIVES

The state entered into interest rate swap agreements with various counterparties, all of which are highly rated financial institutions, to manage various risks associated with the state's debt programs. Each of the state's interest rate swaps is a contractual agreement entered into between the state and a counterparty under which each party agrees to exchange periodic fixed or variable payments, based upon a stated notional amount, over the stated life of the agreement. The net differential paid or received is recognized over the life of the agreement as an adjustment to interest expense. Interest rate swaps determined to be hedging derivatives are designated as cash flow hedges. The state also entered into commodity forward contracts to hedge against the future purchase of natural gas. The specific objectives for each category of effective hedges are summarized below.

***Pay-fixed Interest Rate Swaps*:** The combination of these swaps and variable rate bonds creates synthetic fixed-rate debt. The use of synthetic fixed-rate debt has historically lowered the state's borrowing costs, as compared to the borrowing costs associated with the issuance of traditional fixed-rate bonds.

***Commodity Forward*:** The state enters into commodity forward contracts to meet the objective of hedging the risk that changes in the market price of natural gas will adversely affect the cash flows of the expected purchase of natural gas. As of Aug. 31, 2012, the outstanding commodity forward contracts include contracts with future expiration dates extending from September 2012 through August 2013. Contracts will be cash-settled on the expiration date based on the New York Mercantile Exchange (NYMEX) market price.

Significant Terms and Credit Ratings

The significant terms and credit ratings of the state's hedging derivatives as of Aug. 31, 2012, are shown in the following tables. The variable rates are quoted in terms of a percentage of the London Interbank Offered Rate (LIBOR) or Securities Industry and Financial Markets Association (SIFMA) municipal swap index rates as noted. Standard & Poor's and Moody's Investor service credit ratings are disclosed for each swap and forward contract. The notional amount for the commodity forward is expressed as MMBTUs.

Hedging Interest Rate Swaps: Significant Terms and Credit Ratings

(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Maturity Date	Term
VETERANS LAND BOARD – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS				
Vet Hsg Ref Bds Ser '95	$ 37,540	11/29/1995	12/01/2016	Pay 5.52%; receive Actual Bond Rate
Vet Land Ref Bds Ser '99A	20,945	06/01/1999	12/01/2018	Pay 5.112%; receive 68% of 6M LIBOR
Vet Land Tax Ref Bds Ser '2000	36,835	12/01/2000	12/01/2020	Pay 6.106%; receive 100% of 6M LIBOR
Vet Hsg Fund II Bds Ser 2001A-2	20,000	03/22/2001	12/01/2029	Pay 4.259%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2001C-2	25,000	12/18/2001	12/01/2033	Pay 4.365%; receive 68% of 1M LIBOR
Vet Land Bds Ser 2002	16,480	02/21/2002	12/01/2032	Pay 4.14%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2002A-2	23,650	07/10/2002	06/01/2033	Pay 3.8725%; receive 68% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2002	27,685	12/01/2002	12/01/2021	Pay 4.935%; receive 100% of 6M LIBOR
Vet Hsg Fund I Tax Ref Bds Ser 2002B	19,780	12/01/2002	06/01/2023	Pay 4.91%; receive 100% of 6M LIBOR
Vet Hsg Fund II Bds Ser 2003A	32,330	03/04/2003	06/01/2034	Pay 3.304%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2003B	33,605	10/22/2003	06/01/2034	Pay 3.403%; receive 64.5% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2003	21,165	12/01/2003	12/01/2023	Pay 5.123%; receive 100% of 1M LIBOR
Vet Hsg Fund I Tax Ref Bds Ser 2003	47,865	12/01/2003	06/01/2021	Pay 5.19%; receive 100% of 6M LIBOR
Vet Hsg Fund I Tax Ref Bds Ser 2004	16,535	06/01/2004	12/01/2024	Pay 5.45%; receive 100% of 6M LIBOR
Vet Hsg Fund II Bds Ser 2004B	36,475	09/15/2004	12/01/2034	Pay 3.68%; receive 68% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2004	21,095	12/01/2004	12/01/2024	Pay 5.455%; receive 100% of 6M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2004C,D	32,305	12/01/2004	06/01/2020	Pay 5.348%; receive 100% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2005A	36,060	02/24/2005	06/01/2035	Pay 3.279%; receive 68% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2005	19,585	12/01/2005	12/01/2026	Pay 6.517%; receive 100% of 6M LIBOR
Vet Hsg Fund I/II Tax Ref Bds Ser 2005C,D	23,290	12/01/2005	06/01/2026	Pay 5.145%; receive 100% of 1M LIBOR
Vet Hsg Fund I Tax Ref Bds Ser 2005C	14,525	12/01/2005	12/01/2023	Pay 4.929%; receive 100% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2006A	37,715	06/01/2006	12/01/2036	Pay 3.517%; receive 68% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2006A	26,335	06/01/2006	12/01/2027	Pay 6.54%; receive 100% of 6M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2006B	38,570	06/01/2006	12/01/2026	Pay 5.83%; receive 100% of 1M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2006C	19,030	06/01/2006	12/01/2027	Pay 5.79%; receive 100% of 6M LIBOR
Vet Land Tax Ref Bds Ser 2006B	20,745	06/01/2006	12/01/2026	Pay 4.61%; receive 100% of 6M LIBOR
Vet Hsg Fund II Bds Ser 2006D	39,730	09/20/2006	12/01/2036	Pay 3.689%; receive 68% of 1M LIBOR
Vet Land Tax Ref Bds Ser 2006C	34,305	12/01/2006	12/01/2027	Pay 6.513%; receive 100% of 1M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2006E	39,560	12/01/2006	12/01/2026	Pay 5.461%; receive 100% of 1M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2007C	33,760	12/01/2007	06/01/2029	Pay 4.658%; receive 100% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2007A	39,810	02/22/2007	06/01/2037	Pay 3.645%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2007B	42,005	06/26/2007	06/01/2038	Pay 3.712%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2008A	42,095	03/26/2008	12/01/2038	Pay 3.189%; receive 68% of 1M LIBOR
Vet Hsg Fund II Bds Ser 2008B	43,400	09/11/2008	12/01/2038	Pay 3.225%; receive 68% of 1M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2009C	15,395	12/01/2009	12/01/2021	Pay 6.22%; receive 100% of 6M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2009C	63,850	12/01/2009	06/01/2031	Pay 5.4525%; receive 100% of 6M LIBOR
Vet Hsg Fund II Tax Ref Bds Ser 2010B	63,990	06/01/2010	12/01/2031	Pay 5.401%; receive 100% of 1M LIBOR
Vet Bds Ser 2010C	73,095	08/20/2010	12/01/2040	Pay 2.3095%; receive 68% of 1M LIBOR
Vet Tax Ref Bds Ser 2010D	16,020	12/01/2010	12/01/2030	Pay 5.209%; receive 100% of 1M LIBOR
Vet Tax Ref Bds Ser 2010E	47,540	12/01/2010	06/01/2032	Pay 2.79%; receive 100% of 1M LIBOR
Vet Bds Ser 2011A	73,215	03/09/2011	06/01/2041	Pay 2.675%; receive 68% of 1M LIBOR
Vet Bds Ser 2011B	74,140	08/25/2011	12/01/2041	Pay 2.367%; receive 68% of 1M LIBOR
Vet Bds Ser 2011C	74,995	12/15/2011	06/01/2042	Pay 1.917%; receive 68% of 3M LIBOR
Vet Bds Ser 2012A	74,995	05/23/2012	12/01/2042	Pay 1.692%; receive 68% of 3M LIBOR
Vet Bds Ser 2012B	100,000	11/01/2012	12/01/2042	Pay 1.447%; receive 68% of 3M LIBOR
Vet Tax Ref Bds, Ser 1994A-2	21,795	08/01/2012	12/01/2033	Pay 3.76%; receive 68% of 1M LIBOR

Continued on the following page

Hedging Interest Rate Swaps:
Significant Terms and Credit Ratings (continued)

(Amounts in Thousands)

Associated Bond Issue	Knock-Out Barrier	Up Front Premium Received	Counterparty Credit Ratings
VETERANS LAND BOARD – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS			
Vet Hsg Ref Bds Ser '95	N/A	$	A- / Baa1
Vet Land Ref Bds Ser '99A	N/A		A- / Baa1
Vet Land Tax Ref Bds Ser '2000	1M LIBOR >= 7.00%	2,700	AAA / Aa2
Vet Hsg Fund II Bds Ser 2001A-2	N/A		A- / Baa2
Vet Hsg Fund II Bds Ser 2001C-2	N/A		AAA / Aa2
Vet Land Bds Ser 2002	N/A		A / A2
Vet Hsg Fund II Bds Ser 2002A-2	N/A		A+ / Aa3
Vet Land Tax Ref Bds Ser 2002	6M LIBOR >= 7.00%	2,785	A / A2
Vet Hsg Fund I Tax Ref Bds Ser 2002B	6M LIBOR > 7.00%	2,165	AAA / Aa2
Vet Hsg Fund II Bds Ser 2003A	N/A		A+ / Aa3
Vet Hsg Fund II Bds Ser 2003B	N/A		AAA / Aa2
Vet Land Tax Ref Bds Ser 2003	1M LIBOR >= 7.00%	1,896	A+ / Aa3
Vet Hsg Fund I Tax Ref Bds Ser 2003	6M LIBOR > 7.00%	4,470	AAA / Aa2
Vet Hsg Fund I Tax Ref Bds Ser 2004	6M LIBOR >= 7.00%	1,442	A+ / Aa3
Vet Hsg Fund II Bds Ser 2004B	N/A		A+ / Aa3
Vet Land Tax Ref Bds Ser 2004	6M LIBOR >= 7.00%	2,075	A / A2
Vet Hsg Fund II Tax Ref Bds Ser 2004C,D	1M LIBOR >= 7.00%	2,594	A+ / Aa3
Vet Hsg Fund II Bds Ser 2005A	N/A		AAA / Aa2
Vet Land Tax Ref Bds Ser 2005	6M LIBOR >= 7.00%	1,542	A+ / Aa3
Vet Hsg Fund I/II Tax Ref Bds Ser 2005C,D	1M LIBOR >= 7.00%;	1,367	A+ / Aa3
	6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%	567	
Vet Hsg Fund I Tax Ref Bds Ser 2005C	1M LIBOR >= 7.00%;	484	A+ / Aa3
	6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%	267	
Vet Hsg Fund II Bds Ser 2006A	N/A		A+ / As3
Vet Land Tax Ref Bds Ser 2006A	6M LIBOR >= 7.00%	1,931	A+ / Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2006B	1M LIBOR >= 7.00%	1,992	A+ / Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2006C	6M LIBOR >= 7.00%	1,493	A+ / Aa3
Vet Land Tax Ref Bds Ser 2006B	6M LIBOR >= 7.00%	886	AAA / Aa2
Vet Hsg Fund II Bds Ser 2006D	N/A		A / A2
Vet Land Tax Ref Bds Ser 2006C	1M LIBOR >= 7.00%	2,725	A+ / Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2006E	1M LIBOR >= 7.00%;	2,652	A+ / Aa3
	6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%	1,018	
Vet Hsg Fund II Tax Ref Bds Ser 2007C	1M LIBOR >= 7.00%;	935	A+ / Aa3
	SIFMA/5Y ISDA CMS > 71%	1,020	
Vet Hsg Fund II Bds Ser 2007A	N/A		AAA / Aa2
Vet Hsg Fund II Bds Ser 2007B	N/A		A+ / Aa3
Vet Hsg Fund II Bds Ser 2008A	N/A		A+ / As3
Vet Hsg Fund II Bds Ser 2008B	N/A		AAA / Aa2
Vet Hsg Fund II Tax Ref Bds Ser 2009C	6M LIBOR >= 7.00%	612	A+ / Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2009C	6M LIBOR >= 7.00%	2,740	A+ / Aa3
Vet Hsg Fund II Tax Ref Bds Ser 2010B	1M LIBOR >= 7.00%;	2,355	A+ / Aa3
	6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%	1,427	
Vet Bds Ser 2010C	N/A		A / A2
Vet Tax Ref Bds Ser 2010D	1M LIBOR >= 7.00%;	466	A+ / Aa3
	6M LIBOR > 4.00% and SIFMA/LIBOR Ratio > 74%	208	
Vet Tax Ref Bds Ser 2010E	N/A		AAA / Aa2
Vet Bds Ser 2011A	N/A		A+ / A2
Vet Bds Ser 2011B	N/A		A+ / A2
Vet Bds Ser 2011C	N/A		AAA / Aa2
Vet Bds Ser 2012A	N/A		AAA / Aa2
Vet Bds Ser 2012B	N/A		AAA / Aa2
Vet Tax Ref Bds, Ser 1994A-2	1M LIBOR >= 7.00%	579	A+ / As3

Continued on the following page

Hedging Interest Rate Swaps: Significant Terms and Credit Ratings (continued)

(Amounts in Thousands)

Associated Bond Issue	Notional Amount	Effective Date	Maturity Date	Term
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS				
2004B Single Family	$ 53,000	09/01/2004	09/01/2034	Pay 3.84%; receive 63% of LIBOR + .30%
2004D Single Family	35,000	01/01/2005	03/01/2035	Pay 3.64%; receive Lesser of (the greater of (a) 65% of LIBOR and (b) 56% of LIBOR + .45%) and LIBOR
2005A Single Family	67,475	08/01/2005	09/01/2036	Pay 4.01%; receive Lesser of (the greater of (a) 65% of LIBOR and (b) 56% of LIBOR + .45%) and LIBOR
2006H Single Family	36,000	11/15/2006	09/01/2025	Pay 3.86%; receive 63% of LIBOR +.30%
2007A Single Family	94,820	06/05/2007	09/01/2038	Pay 4.01%; receive Lesser of (the greater of (a) 65% of LIBOR and (b) 56% of LIBOR + .45%) and LIBOR
UNIVERSITY OF TEXAS SYSTEM – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS*				
RFS Bonds 2007B	166,850	12/20/2007	08/01/2034	Pay 3.805%; receive SIFMA
RFS Bonds 2007B	166,850	12/20/2007	08/01/2034	Pay 3.805%; receive SIFMA
PUF Bonds 2008A	195,690	11/03/2008	07/01/2038	Pay 3.696%; receive SIFMA
PUF Bonds 2008A	195,690	11/03/2008	07/01/2038	Pay 3.6575%; receive SIFMA
RFS Bonds 2008B	141,725	03/18/2008	08/01/2036	Pay 3.9%; receive SIFMA
RFS Bonds 2008B	141,725	03/18/2008	08/01/2036	Pay 3.9%; receive SIFMA
RFS Bonds 2008B	332,120	03/18/2008	08/01/2039	Pay 3.614%; receive SIFMA

* PUF stands for permanent university fund and RFS stands for revenue financing system.

Concluded on the following page

Hedging Forward Contracts: Significant Terms and Credit Ratings

	Number of Contracts	Notional Amount	Effective Dates Range*	Termination Dates Range*	Terms: Pay (Average)	Terms: Receive	Counterparty Credit Ratings
2013 Forward Contracts (A&M)	24 Contracts	960,000/ MMBTUs	02/06/2009 - 02/12/2009	09/01/2012 - 08/01/2013	$7.44/ MMBTU	NYMEX market price	AA

* A&M invested in several separate commodity forward contracts. This disclosure summarizes the contracts by establishing ranges and averages of detailed individual contract information.

Hedging Interest Rate Swaps: Significant Terms and Credit Ratings (concluded)

(Amounts in Thousands)

Associated Bond Issue	Knock-Out Barrier	Up Front Premium Received	Counterparty Credit Ratings
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS			
2004B Single Family	N/A	$	A / A2
2004D Single Family	N/A		A / A2
2005A Single Family	N/A		A+ / Aa3
2006H Single Family	N/A		A / A2
2007A Single Family	N/A		A+ / Aa3
UNIVERSITY OF TEXAS SYSTEM – PAY-FIXED, RECEIVE-VARIABLE INTEREST RATE SWAPS			
RFS Bonds 2007B	N/A		A+ / Aa3
RFS Bonds 2007B	N/A		A / A2
PUF Bonds 2008A	N/A		A- / Baa1
PUF Bonds 2008A	N/A		AA- / Aa3
RFS Bonds 2008B	N/A		A+ / Aa3
RFS Bonds 2008B	N/A		A- / Baa1
RFS Bonds 2008B	N/A		A+ / Aa3

Risks

***Credit Risk*:** The state is exposed to credit risk if the counterparty to an interest rate swap fails to meet the terms and obligations of its contracts. The state mitigates the credit risk associated with its swaps by entering into transactions with a diversified group of highly-rated counterparties. The interest rate swap agreements also contain varying collateral agreements and insurance policies with the counterparties. Posted collateral may be held either by the state itself or by a quality third party custodian. Swap contracts with a negative fair value do not expose the state to credit risk. As of Aug. 31, 2012, the state was not exposed to credit risk because the swap recorded in the positive position was offset by other swaps with negative fair values.

***Interest Rate Risk*:** On the pay-fixed, receive-variable interest rate swaps, as LIBOR or the SIFMA municipal swap index decrease, the state's net payment on the swap increases. For the related hedged variable rate debt, as LIBOR or the SIFMA municipal swap index decrease the state's interest payments on the bonds decrease. The value of interest rate swap agreements with a longer weighted average maturity tend to be more sensitive to changing interest rates, and therefore, more volatile than those with shorter maturities.

***Basis Risk*:** The state 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 state mitigates this risk by 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 by 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. Additionally, tax-exempt interest rates can change without a corresponding change in taxable interest rates due to factors affecting the tax-exempt market that do not have a similar effect on the taxable market.

The state is exposed to basis risk on its commodity forward contracts because the expected commodity purchase will be priced based on a pricing point of Waha Natural Gas Hub, while the hedging forward contract is expected to settle on the NYMEX pricing point. As of Aug. 31, 2012, the Waha price was $2.65 per MMBTU and the NYMEX price was $2.74 per MMBTU.

***Termination Risk*:** Termination risk is the risk that the swap may be terminated prior to its scheduled maturity date as a result of certain specified events. The swap associated with the Vet Land Tax Ref Bds Ser '2000 provides the counterparty with the option to terminate the swap under certain conditions.

The state or the counterparties may terminate any of the swaps if the other party fails to perform under the terms of the respective swap agreements. If any of the swaps are terminated, the associated variable-rate bonds would no longer have a synthetic fixed-rate and the state 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. Unless there is a termination option exercised by the counterparty, the state would owe the counterparty a termination payment equal to the swap's negative fair value.

Several swap agreements include optional early termination provisions granting the state the right, but not an obligation, to terminate the interest rate swaps at par without a termination payment after an effective date or after the breach of certain counterparty credit ratings.

***Rollover Risk*:** Rollover risk is the risk caused by a mismatch between the amortization of a derivative contract and the underlying hedged bonds. The maturity dates of the state's effective interest rate swaps were designed to extend to the maturity dates of the underlying bonds. However, in the case of the swap associated with the Vet Land Tax Ref Bds Ser '2000, the state will be subject to rollover risk if the counterparty exercises the option to terminate the swap contract.

***Market-access Risk*:** Each swap associated with underlying variable-rate debt subject to tender at the option of the bondholder is subject to market-access risk. In the event the state is unable to remarket its variable-rate bonds, the state may choose to refund the variable-rate bonds with fixed-rate bonds and optionally terminate the related interest rate swap agreements. If an early termination event occurs, the state could be required to pay or to receive a substantial termination payment.

Swap Payments and Associated Debt

Aggregate debt service requirements of the state's variable-rate debt and net receipts/payments on associated hedging derivative instruments are disclosed in Note 6.

Contingent Features

Some of the state's derivative instruments include provisions that require the posting of collateral in the event that the contracting agency's credit rating falls below a specified level as issued by Moody's Investor Service and Standard & Poor's. If the contracting agency fails to post eligible collateral, the derivative instrument may be terminated by the counterparty. Note 15 discloses detail about derivatives with contingent features.

INVESTMENT DERIVATIVES

Investment derivatives expose the state to certain investment related risks. Note 3 discloses detail about the state's investment derivatives.

NOTE 8

Leases

The state leases office buildings, computer and office equipment and other assets under a variety of agreements. Although lease terms vary, most leases are subject to biennial appropriations from the Legislature to continue the lease obligations.

Operating Leases

Operating lease payments are recorded as expenditures or expenses during the life of the lease. Rental expenditures or expenses related to operating leases for fiscal 2012 were $297 million for the primary government and $2.7 million for discrete component units. The following table presents minimum future rental obligations on noncancelable operating leases as of Aug. 31, 2012.

Noncancelable Operating Lease Obligations

August 31, 2012 (Amounts in Thousands)

	Minimum Future Lease Payments	
Year	Primary Government	Component Units
2013	$ 256,941	$ 1,592
2014	206,613	1,088
2015	165,617	883
2016	128,739	735
2017	99,720	571
2018 – 2022	190,098	1,422
2023 – 2027	12,964	
2028 – 2032	6,288	
2033 – 2037	2,454	
2038 – 2042	1,155	
Total	$ 1,070,589	$ 6,291

Additionally, the permanent school fund (PSF), the University of Texas System (UT), the Texas A&M University System (A&M) and the Texas Tech University System (Tech) have leased buildings, equipment and land to outside parties under various operating leases. The following table presents estimated future lease rentals on noncancelable operating leases as of Aug. 31, 2012.

Noncancelable Operating Lease Rentals

August 31, 2012 (Amounts in Thousands)

	Minimum Future Lease Rentals	
Year	Primary Government	Component Units
2013	$ 24,867	$ 23,600
2014	19,479	
2015	16,468	
2016	13,928	
2017	12,562	
2018 and beyond	85,313	
Total	$ 172,617	$ 23,600

The historical cost of PSF's leased assets is $341 million. Depreciation is not recorded because the assets are held for investment purposes in a permanent fund. Real estate investments are re-appraised periodically and the carrying amounts are adjusted when permanent impairments occur. In fiscal 2012, PSF reported contingent rental revenues in the amount of $227 thousand.

The historical cost of UT's leased buildings and leased land is $84 million and $3.3 million, respectively. As of Aug. 31, 2012, the carrying value of UT's leased assets was $59.5 million and the related accumulated depreciation was $27.8 million. UT did not report any contingent rental revenues.

The historical cost of A&M's leased buildings and leased land is $86 million and $1.1 million, respectively. As of Aug. 31, 2012, the carrying value of A&M's leased assets was $54.9 million and the related accumulated depreciation was $32.2 million. In fiscal 2012, A&M reported contingent rental revenues of $686 thousand.

The historical cost of Tech's leased building space is $17.9 million. As of Aug. 31, 2012, the carrying value of Tech's leased building space was $7.8 million and the related accumulated depreciation was $10.1 million. The historical cost, accumulated depreciation and carrying value of the leased building space represents 7.5 percent of the full carrying value of the leased buildings. Tech did not report any contingent rental revenues.

Capital Leases

Leases that are purchases in substance are reported as capital lease obligations. 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, 2012 (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
2013	$ 5,365	$ 1,237	$ 6,602	$ 3,514	$ 896	$ 4,410	$ 54	$ 7	$ 61
2014	4,002	804	4,806	2,982	737	3,719	56	6	62
2015	1,717	385	2,102	2,803	597	3,400			
2016	619	66	685	2,099	469	2,568			
2017				1,493	386	1,879			
2018 - 2022				4,993	1,224	6,217			
2023 - 2027				2,837	455	3,292			
2028 - 2032				917	33	950			
Total	$ 11,703	$ 2,492	$ 14,195	$ 21,638	$ 4,797	$ 26,435	$ 110	$ 13	$ 123

The following table presents an analysis of the property recorded under capital leases by asset category as of Aug. 31, 2012.

Assets Under Capital Leases

August 31, 2012 (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	$	$	$ 894	$	$	$
Buildings	18,084	14,098	20,234	4,088		
Furniture and Equipment	6,724	1,398	14,157	2,880	238	107
Vehicles, Boats, Aircraft			223	22		
Computer Software	9,215	1,044	657	99		
Total	$ 34,023	$ 16,540	$ 36,165	$ 7,089	$ 238	$ 107

NOTE 9

Retirement Plans

The state of Texas contributes to six defined benefit pension plans and one defined contribution plan that provide financial benefits to retired employees, as well as to their spouses and beneficiaries, of the state of Texas, school districts and other entities. The defined benefit pension plans are administered by the Employees Retirement System of Texas (ERS) and the Teacher Retirement System of Texas (TRS), which are component units, and the Fire Fighters' Pension Commissioner (FPC), which is part of the primary government. The state is a participating employer in these plans with the exception of the FPC defined benefit pension plan. The state is not an employer in the FPC plan, but makes on-behalf contributions to the FPC plan.

The state makes employer contributions to the defined contribution plan, Optional Retirement Program (ORP), which benefits certain employees of institutions of higher education. This plan is administered by the employers of institutions of higher education.

The state's contributions to these plans are authorized by statute and may be amended by the Legislature. The state reports the pensions' financial activities in the other employee benefit trust funds column of the fiduciary funds financial statements. The investments of the pension funds are included in Note 3.

The Texas Guaranteed Student Loan Corporation's (TGSLC) defined contribution pension plan is disclosed because the TGSLC is a discrete component unit of the state, but the state is not considered an employer of the plan and does not contribute to the plan.

Audited financial statements for each defined benefit pension plan may be obtained from:

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 Commissioner
P.O. Box 12577
Austin, Texas 78711-2577

Additional information for each defined contribution plan may be obtained from:

Statewide Coordinator, Optional Retirement Program
Texas Higher Education Coordinating Board
P.O. Box 12788
Austin, Texas 78711-2788

Texas Guaranteed Student Loan Corporation
P.O. Box 83100
Round Rock, Texas 78683-3100

DESCRIPTION OF PLANS AND FUNDING POLICY

Employees Retirement System of Texas

The Board of Trustees of ERS is the administrator of four pension plans that provide a standard monthly benefit in a life annuity at retirement and death and disability benefits for members. The Employees Retirement System of Texas Plan (ERS Plan) is considered a cost-sharing, multiple-employer defined benefit plan with a special funding situation. In addition to the state of Texas, employers of the ERS Plan include various component units of the state. The Employees Retirement System and the Texas Treasury Safekeeping Trust Company, which are blended component units, and the Teacher's Retirement System and the State Bar of Texas, which are discrete component units, are also employers of the ERS Plan. The Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS) and the Judicial Retirement System of Texas (JRS) Plan One (JRS1) and Plan Two (JRS2) are considered single-employer defined benefit pension plans.

Contribution requirements are not actuarially determined, but are set by legislation, except for the JRS2, under which the state contribution rate is actuarially determined every even-numbered year for the next biennium. The contribution rates are based on a percentage of the monthly gross compensation for each member. Each plan's monthly contribution requirements are disclosed in the table below.

Required Contribution Rates

	Employer			Members		
Plan	Employee Class	Elected Class – Legislators	Elected Class – Other	Employee Class	Elected Class – Legislators	Elected Class – Other
ERS	6.0%	6.0%	6.0%	6.5%	8.0%	6.0%
LECOS*	0.0%	N/A	N/A	0.5%	N/A	N/A
JRS1	N/A**	N/A	N/A	6.0%	N/A	N/A
JRS2	6.0%	N/A	N/A	6.0%	N/A	N/A
TRS	6.0%	N/A	N/A	6.4%	N/A	N/A

* Amount contributed is supplemental to amount contributed for the employee class of the ERS Plan.

** JRS1 is funded on a pay-as-you-go basis. Therefore, there is not a required employer contribution rate.

The ERS audited financial statements reflect the results of the actuarial valuations of the four plans it administers. The statements do not note any subsequent legislative action that would negatively affect the certification of actuarial soundness of the plans.

The ERS Plan, established by the Texas Government Code, Chapters 811-815, covers elected class members and employee class members. 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 service credit and may retire at age 50 with 12 years of service credit or at age 60 with eight years of service credit. The monthly standard annuity equals the statutory percentage of 2.3 percent of the current state salary of a district judge multiplied by the number of years of service credit. Retirement benefits are automatically adjusted as state judicial salaries change. The maximum standard annuity is 100 percent of the 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. Other employee class members include certified peace officers and custodial officers.

In 2009, the 81st Legislature created new plan provisions for members of the employee class hired after Sept. 1, 2009, with the exception of certified peace officers and custodial officers. This resulted in different requirements for benefit eligibility, vesting and early service retirement eligibility with reduced benefits, dependent upon the employee hire date.

For members of the employee class hired on or before Aug. 31, 2009, the following provisions apply:

- Employees vest after five years of service credit.
- Employees may retire at age 60 with five years of service credit or at any age when the sum of age and service credit (including months) total 80.
- The average monthly compensation is the average of the highest 36 months of compensation.
- The monthly standard annuity equals the statutory percentage of 2.3 percent of the average monthly compensation multiplied by the number of years of service credit.
- The minimum monthly standard annuity is $150; the maximum standard annuity is 100 percent of the average monthly compensation.

For members of the employee class hired on or after Sept. 1, 2009, the following provisions apply:

- Employees vest after 10 years of service credit.
- Employees may retire at age 65 with 10 years of service credit or at any age when the sum of age and service credit (including months) equals or exceeds 80.
- The standard retirement annuity is reduced by five percent for each year the member retires before the member reaches age 60, with a maximum possible reduction of 25 percent.
- The average monthly compensation is the average of the highest 48 months of compensation.
- The monthly standard annuity equals the statutory percentage of 2.3 percent of the average monthly compensation multiplied by the number of years of service credit.

Certified peace officers and custodial officers may retire at age 55 with 10 years of service as a certified peace officer or custodial officer. The average monthly compensation is the average of the highest 36 months of compensation. The monthly standard annuity equals the statutory percentage of 2.3 percent of the average monthly compensation multiplied by the number of years of service credit.

A Partial Lump Sum Payment Option is available to members of the employee class, the elected class and certified peace officers 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.

LECOS, established under Texas Government Code, Section 814.107, provides a supplemental retirement benefit to the ERS employee class member with service rendered while a law enforcement officer (commissioned peace officer) or a custodial officer. Upon meeting the qualification requirements under LECOS, members are eligible for LECOS benefits in addition to those received under the ERS Plan.

In 2009, the 81st Legislature created new plan provisions for LECOS members hired after Sept. 1, 2009. This resulted in different requirements for benefit eligibility, vesting and early service retirement eligibility with reduced benefits, dependent upon the employee hire date.

For members hired on or before Aug. 31, 2009, the following provisions apply:

- Employees with 20 years of service may retire at age 50 or at any age when the sum of age and service credit equals or exceeds 80.
- A member under the age of 50 may receive reduced benefits upon completing 20 years of service.
- The average monthly compensation is the average of the highest 36 months of compensation.
- The monthly standard annuity equals the statutory percentage of 2.3 percent from the ERS Plan plus an additional 0.5 percent from the LECOS Plan of the average monthly compensation multiplied by the number of years of service credit.
- The minimum monthly standard annuity is $150; the maximum standard annuity is 100 percent of the average monthly compensation.

For members hired on or after Sept. 1, 2009, the following provisions apply:

- Employees may retire after 20 years of service at age 55 or at any age when the sum of age and service credit equals or exceeds 80.
- A member under the age of 55 may receive reduced benefits upon completing 20 years of service.
- The average monthly compensation is the average of the highest 48 months of compensation.
- The monthly standard annuity equals the statutory percentage of 2.3 percent from the ERS Plan plus an additional 0.5 percent from the LECOS Plan of the average monthly compensation multiplied by the number of years of service credit.

- The minimum monthly standard annuity is $150; the maximum standard annuity is 100 percent of the average monthly compensation.

Annual actuarial valuations of the fund are performed to monitor the adequacy of the financing arrangement. In 2011, the 82nd Legislature did not appropriate any state funding for the LECOS plan for fiscal 2012.

JRS1 is established by Texas Government Code, Chapter 831, and JRS2 is established by Texas Government Code, Chapter 836. 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 JRS1 and all others participate in JRS2.

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 JRS1 and JRS2 may retire at any age 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 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.

Member contributions for JRS1 are made to the general revenue fund, and the state is obligated to make appropriations from the general revenue fund in an amount sufficient to pay benefits on a pay-as-you-go basis. The contribution requirements are not actuarially determined since the plan is not funded in advance.

State statutes prohibit benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize the ERS, LECOS or JRS2 plans' unfunded actuarial liabilities would be increased to a period that exceeds 30 years by one or more years. The statutes also apply if the amortization period already exceeds 30 years by one or more years. According to the actuarial valuations as of Aug. 31, 2012, contributions are insufficient to amortize the current unfunded accrued liabilities of the ERS, LECOS and JRS2 plans over any period of time. Therefore, the 30 year funding objective is not being realized for any of the plans. In 2011, the 82nd Legislature reduced the employer contribution rate for fiscal 2012 for ERS, LECOS and JRS2, and reduced the member contribution rate for the elected class-other.

Teacher Retirement System of Texas

The Board of Trustees of TRS is the administrator of one pension plan (TRS Plan). The TRS Plan, established under Texas Government Code, Chapters 822-824, is considered a cost-sharing multiple-employer defined benefit plan with a special funding situation. The state is required by statute to make contributions to the TRS Plan. For fiscal 2012 the state made the majority of contributions to the TRS Plan. A special funding situation is created, which results in the state reporting the TRS Plan as if it was the sole employer. The employers of the TRS Plan include the state of Texas, TRS and 1,300 public schools, service centers, charter schools and community colleges. Employees of TRS and state of Texas colleges, universities and medical schools are members of the TRS Plan, provided they are employed for one-half or more of the standard work load and are not exempted from membership under Texas Government Code, Section 822.002. The commissioner of the Texas Education Agency may also elect to participate in the TRS Plan in lieu of participation in the ERS Plan in the same manner and under the same conditions as other members of the TRS Plan.

Retirement Systems' Membership

	ERS	LECOS	JRS1	JRS2	TRS
Retirees and Beneficiaries Currently Receiving Benefits	87,799	8,477	433	215	331,747
Terminated Employees Entitled to Benefits But Not Yet Receiving Them	90,190	7,129	4	143	80,856
Current Employees: Vested and Non-Vested	132,669	37,404	17	541	922,799
Total Members	310,658	53,010	454	899	1,335,402

The TRS Plan provides retirement, disability annuities and death and survivor benefits. The benefit and contribution provision of the TRS Plan are authorized by state law and may be amended by the Legislature.

A member is vested after five years of service credit and is eligible to retire at a future date and receive a lifetime monthly annuity.

For members who established membership before Sept. 1, 2007, the following provisions apply:

- Members may retire at age 65 with five years of service credit or when the sum of the member's age and years of service credit equals at least 80 years and membership is maintained until retirement.
- 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 credit.
- For members who established membership on or before Aug. 31, 2005, known as "grandfathered" members, the three highest annual salaries are used to calculate the annuity benefit.
- At normal retirement age, the minimum monthly standard annuity is the greater of $150 or the formula standard annuity. Total payments will not be less than accumulated contributions at retirement.
- Members qualify for early retirement with reduced benefits at age 55 with five years of service credit or any age below 50 with 30 years of service credit, provided the sum of the member's age and years of credited service is less than 80 and membership is maintained until retirement.

For members who established membership after Sept. 1, 2007, the following provisions apply:

- Members may retire at age 65 with five years of service credit, or at age 60 if the sum of the member's age and years of service credit equals at least 80 years.
- Grandfathered members who re-enter TRS on or after Sept. 1, 2007, may retire at age 65 with at least five years of service credit, or if the sum of the member's age and years of service credit equals at least 80 and the member is at least age 55 with at least 20 years of service credit.
- 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 credit.
- For grandfathered members, the three highest annual salaries are used to calculate the annuity benefit.
- At normal retirement age, the minimum monthly standard annuity is the greater of $150 or the formula standard annuity. Total payments will not be less than accumulated contributions at retirement.

- Members qualify for early retirement with reduced benefits if the member meets one of the following criteria:
  - The member is age 55 with five years of service credit.
  - The member is less than age 60 and the sum of the member's age and years of credited service equals at least 80.
  - The member is less than age 60 and the member has 30 years of credited service.
- Grandfathered members who re-enter TRS on or after Sept. 1, 2007, qualify for early retirement with reduced benefits if the member meets one of the following criteria:
  - The member is age 55 with at least five years of credited service.
  - The member is less than age 55 and the sum of the member's age and years of credited service equals at least 80.
  - The member is less than age 50 and has 30 years of credited service.

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-year and 10-year guaranteed period annuities.

TRS also offers two other annuity payment options:

- **The Deferred Retirement Option Plan (DROP)** DROP allowed members to freeze their standard annuity and, instead of retiring, have a portion of the frozen standard annuity deposited into a DROP account, for up to five years, while continuing to work for a TRS-affiliated employer. 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

Actuarial Methods and Assumptions

	ERS	LECOS	JRS1	JRS2	TRS
Actuarial Valuation Date	Aug. 31, 2012	Aug. 31, 2012	Aug. 31, 2012	Aug. 31, 2012	Aug. 31, 2012
Actuarial Cost Method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent Open	Level Percent Open	Level Dollar Open	Level Percent Open	Level Percent Open
Remaining Amortization Period	30 years	30 years	30 years*	30 years	30 years
Asset Valuation Method	20% of market plus 80% of expected actuarial value	20% of market plus 80% of expected actuarial value	Market	20% of market plus 80% of expected actuarial value	5-year Smoothed Market
Actuarial Assumptions:					
Investment Rate of Return	8.0%	8.0%	8.0%	8.0%	8.0%
Payroll Growth	3.5%	3.5%	N/A	3.5%	N/A
Projected Salary Increases	0.0%-13.5%	0.0%-13.5%	3.5%	3.5%	4.25%-7.25%
Includes Inflation at	3.5%	3.5%	3.5%	3.5%	3.0%
Cost-of-Living Adjustments	None-Employee 3.5%-Elected	None	3.5%	None	None

* JRS1 is funded on a pay-as-you-go basis; therefore, there is no advance funding.

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.

Contribution requirements are not actuarially determined but are legally established each biennium. The TRS Plan's monthly contribution requirements are disclosed on the "Required Contribution Rates" table. 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 but not greater than 10 percent of the aggregate annual compensation of all members of the TRS Plan during that fiscal year. As required by state statute, the state rate is paid by the employer for compensation paid to new members during the first 90 days of employment, on amounts paid to employees above the statutory minimum amount, and on compensation paid from private or federal funds. Total employer contributions to the TRS Plan are a combination of state, public schools, federal and private funding.

State statute prohibits benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize the TRS Plan's unfunded actuarial liabilities would be increased to a period that would exceed 30 years by one or more years, or, if the amortization period already exceeds 30 years by one or more years, the period would be increased by such action. According to the actuarial valuation as of Aug. 31, 2012, contributions are insufficient to amortize the current unfunded accrued liabilities of the TRS Plan over any period of time. Therefore, the 30 year funding objective is not being realized. In 2011, the 82nd Legislature reduced the employer contribution rate for fiscal 2012.

Optional Retirement Program

The state's contributions to the Optional Retirement Program (ORP) are authorized by Texas Government Code, Chapter 830. Full-time faculty, librarians and certain professionals and administrators employed in public higher education are eligible to elect ORP in lieu of the TRS Plan before the 91st day after becoming eligible. It is a one-time irrevocable choice between two distinct plans. ORP is administered by the benefits offices at each employer. The Texas Higher Education Coordinating Board develops policies, practices and procedures to provide greater uniformity in the administration of ORP.

ORP is a defined contribution pension plan in which each participant selects from a variety of investments offered by several insurance and investment companies through annuity contracts or mutual fund investments. These types of investments are authorized by Internal Revenue Code, Section 403(b). With the purchase of these individual contracts, the state has effectively transferred the obligation for the payment of benefits to the companies. Participants vest in ORP after one year of participation.

The contributory percentages of participant salaries provided by each participant and the state were 6.65 percent and 6 percent, respectively, for fiscal 2012. Institutions and agencies authorized under state law to provide ORP to their employees may supplement the state contribution at a rate of up to 2.5 percent of payroll.

Individual accounts are maintained at the insurance and investment companies selected by each ORP participant. Separate financial statements for ORP are not prepared because the state retains no liability for plan performance and has very limited administrative involvement.

The employers of ORP are institutions of higher education, one educational state agency and several two-year college institutions that are not part of the state reporting entity. State entity participation in ORP for fiscal 2012 resulted in participant contributions of $226.7 million and employer contributions of $270.2 million.

As of Aug. 31, 2012, ORP had 37,943 participants. The total participant contributions were $258.6 million and total employer contributions were $304 million. Additional information for ORP is included in the fiscal 2012 *ORP Participation Report Summary* published annually by the Texas Higher Education Coordinating Board.

Fire Fighters' Pension Commissioner

FPC is the administrator of the Texas Emergency Services Retirement System (TESRS), a cost-sharing multiple-employer defined benefit pension plan established to provide pension benefits for emergency services personnel who serve without significant monetary remuneration. As of Aug. 31, 2012, there were 214 member fire departments participating in TESRS. The state is not an employer of the TESRS plan.

The statutory authority for TESRS is found in Texas Government Code, Chapters 861-865. 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 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. Per Texas Government Code, Section 865.015, the state is required to appropriate a limited amount to make the fund actuarially sound. The appropriations may not exceed the amount of one-third of the total of all contributions by governing bodies in one year. Legislative appropriations to assist with TESRS's administrative expenses for the past three fiscal years are:

- Fiscal 2012: $572.3 thousand
- Fiscal 2011: $628 thousand
- Fiscal 2010: $502.9 thousand

The member fire department contributions to the fund were $3.6 million for fiscal 2012. Contributions made were equal to the yearly statutorily required contributions.

Annual Pension Cost and Net Pension Obligation

The state's annual pension cost and net pension obligation or asset for fiscal 2012 is presented below.

Annual Pension Cost and Net Pension Obligation/Asset

(Amounts in Thousands)

	ERS	LECOS	JRS1	JRS2	TRS
Annual Required Contribution (ARC)	$ 704,853	$ 35,057	$ 21,424	$ 10,716	$ 2,780,976
Interest on Net Pension Obligation (NPO)	59,452	3,053	5,713	(400)	84,119
Adjustment to ARC	(44,627)	(2,292)	(6,104)	300	(63,128)
Annual Pension Cost	719,678	35,818	21,033	10,616	2,801,967
Employer Contributions Made	(346,656)	3	(26,464)	(4,151)	(2,052,381)
Increase (Decrease) in NPO	373,022	35,821	(5,431)	6,465	749,586
Net Pension Obligation/(Asset), September 1, 2011	743,151	38,169	71,408	(4,997)	1,051,481
Net Pension Obligation/(Asset), August 31, 2012*	$ 1,116,173	$ 73,990	$ 65,977	$ 1,468	$ 1,801,067

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

Three–Year Trend Information

(Amounts in Thousands)

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation/(Asset)
ERS			
08/31/12	$ 719,678	48.2%	$ 1,116,173
08/31/11	715,931	57.8%	743,151
08/31/10	634,439	63.0%	440,823
LECOS			
08/31/12	$ 35,818	0.0% *	$ 73,990
08/31/11	36,953	65.6%	38,169
08/31/10	34,141	81.4%	25,444
JRS1			
08/31/12	$ 21,033	125.8%	$ 65,977
08/31/11	22,651	119.1%	71,408
08/31/10	23,014	118.6%	75,745
JRS2			
08/31/12	$ 10,616	39.1%	$ 1,468
08/31/11	11,512	103.7%	(4,997)
08/31/10	12,066	95.4%	(4,576)
TRS			
08/31/12	$ 2,801,967	73.2%	$ 1,801,067
08/31/11	2,740,560	85.1%	1,051,481
08/31/10	2,667,179	86.1%	637,713

* In 2011, the 82nd Legislature did not appropriate any state funding for the LECOS plan for the fiscal year ending Aug. 31, 2012.

Trend Information

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

The table at left presents the three-year trend information regarding annual pension cost and the net pension obligations of the plans.

Funded Status

Information on the state's pension plans funded status for each plan as of Aug. 31, 2012, is presented in the table below.

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, provides multi-year trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Funded Status

(Amounts in Thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
ERS						
08/31/12	$ 24,272,514	$ 29,377,069	$ 5,104,555	82.6%	$ 5,676,509	89.9%
LECOS						
08/31/12	$ 832,451	$ 1,015,668	$ 183,217	82.0%	$ 1,498,979	12.2%
JRS1						
08/31/12	$ 0	$ 232,922	$ 232,922	0.0%	$ 2,200	10,587.4%
JRS2						
08/31/12	$ 300,433	$ 315,199	$ 14,766	95.3%	$ 68,778	21.5%
TRS						
08/31/12	$ 118,326,042	$ 144,427,226	$ 26,101,184	81.9%	$ 35,444,569	73.6%

Included in the audited financial reports for ERS and TRS are:

- 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
- 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

Texas Guaranteed Student Loan Corporation

The Texas Guaranteed Student Loan Corporation (TGSLC), a discrete component unit of the state, maintains its own defined contribution retirement plan, the TGSLC Money Purchase Pension Plan and Trust (the Plan). The Plan covers substantially all employees of the TGSLC. As of June 30, 2012, there were 700 participants in the Plan. Employees do not contribute to the Plan; TGSLC's contributions to the Plan are generally based on 9 percent of gross annual salaries, net of forfeitures. Total payroll and covered payroll was approximately $38.8 million and $37.6 million, respectively, in the Plan year ended June 30, 2012. Total TGSLC contributions were approximately $3.2 million for the fiscal year ended Sept. 30, 2012. Plan amendments are subject to the Plan's Board of Trustees' approval and the TGSLC Board of Directors' ratification.

NOTE 10

Deferred Compensation

The state of Texas offers two deferred compensation plans to all state employees. One was established in accordance with Internal Revenue Code, Section 457. The second was 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.

The University of Texas System (UT) offers its own deferred compensation plan, created in accordance with Internal Revenue Code, Section 457(b). All UT employees are eligible to participate in UT's plan and do not participate in the plan offered by the state of Texas. All investments, amounts, property and rights held under the deferred compensation trust fund are held for the exclusive benefit of participants and beneficiaries at the fair market value of the plan account for each participant. UT has no liability under the plan.

NOTE 11

Postemployment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the state of Texas contributes to four plans that provide health care and life insurance benefits for retired employees, their spouses and beneficiaries. These other postemployment benefits (OPEB) are authorized by statute and contributions are established by the General Appropriations Act. The Texas Constitution does not allow the Legislature to impose financial obligations for a period longer than two years.

The state of Texas is a participating employer in three different OPEB plans and is an on-behalf contributor to one plan. The financial statement recognition and note disclosure requirements in GASB Statement

No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, were applied separately for each plan. The following note disclosures are organized by OPEB plan administrator.

University of Texas and Texas A&M University Systems

The state of Texas contributes to two single-employer defined benefit retiree health care and life insurance benefit plans: the UT System Employee Group Insurance Program (UT Plan) and A&M System Group Insurance Program (A&M Plan). The UT Plan is administered by the University of Texas System and the A&M Plan is administered by the Texas A&M University System.

The University of Texas System (UT) and the Texas A&M University System (A&M) each issue a publically available financial report that includes financial statements and required supplementary information. Those reports may be obtained by writing to the systems at the following addresses:

University of Texas System
601 Colorado Street
Austin, Texas 78701-2982

Texas A&M University System
200 Technology Way
College Station, Texas 77845

Plan Descriptions

Each plan provides separate postemployment health care and life insurance coverage to university system retirees, surviving spouses and beneficiaries. UT and A&M are part of the state of Texas primary government. Employees of these systems are considered to be state employees. Benefit provisions for the UT and A&M plans are established and amended by the administering systems as allowed under Texas Insurance Code, Chapter 1601. Retiree eligibility for insurance continuation after employment is determined by the Legislature and is subject to change.

Funding Policy

The university system and member contribution rates are determined annually by each system based on the recommendations of the employee benefits office and consulting actuaries. The plan rates are based on the plan costs expected to be incurred, the funds appropriated for the plans and the funding policy established by the Legislature in connection with benefits provided through the plan. Amounts contributed by the state are currently based on pay-as-you-go financing requirements determined during each legislative session. State contribution requirements are established and may be amended by the Legislature. The three-year history of employer contributions and annual OPEB costs is presented in the table below.

Three-Year Trend Information

(Amounts in Thousands)

Fiscal Year Ending	Employer Contribution	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
UT Plan				
8/31/12	$ 142,737	$ 639,952	22.3%	$ 2,263,867
8/31/11	124,280	595,169	20.9%	1,766,652
8/31/10	117,023	571,761	20.5%	1,295,763
A&M Plan				
8/31/12	$ 63,131	$ 190,200	33.2%	$ 603,878
8/31/11	40,489	174,919	23.1%	476,809
8/31/10	40,174	162,680	24.7%	342,379

For the fiscal year ended Aug. 31, 2012, the state made monthly contributions for health care and life insurance to the UT and A&M plans. Contribution rates for the state and retirees are presented on the following page. 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.

Required Contribution Rates – Retiree Health Care and Life Insurance Premium

For the Fiscal Year Ended August 31, 2012

	UT Plan		A&M Plan	
Level of Coverage	**Employer**	**Plan Member**	**Employer**	**Plan Member***
Retiree Only	$462	$	$367	$ 99
Retiree/Spouse	705	199	552	284
Retiree/Children	617	208	482	215
Retiree/Family	861	392	644	377

* Plan member contribution for health insurance only. There is no plan member contribution for basic life

Annual OPEB Cost and Net OPEB Obligation

The state's annual OPEB cost for the UT and A&M plans is calculated based on the employer annual required contributions (ARC). The ARC is an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period no greater than 30 years. The following table shows the components of the annual OPEB cost for the UT and A&M plans for fiscal 2012.

Annual OPEB Cost and Net OPEB Obligation

(Amounts in Thousands)

	UT Plan	A&M Plan
Annual Required Contribution, ARC	$ 607,827	$180,940
Interest on Net OPEB Obligation	123,666	34,807
Adjustment to ARC	(91,541)	(25,547)
Annual OPEB Cost	639,952	190,200
Employer Contributions Made	(142,737)	(63,131)
Increase in Net OPEB Obligation	497,215	127,069
Net OPEB Obligation, September 1, 2011	1,766,652	476,809
Net OPEB Obligation, August 31, 2012	$2,263,867	$603,878

Funded Status and Funding Progress

The funded status of the UT and A&M plans as of Aug. 31, 2012, is disclosed below.

Funded Status

(Amounts in Thousands)

	UT Plan	A&M Plan
Actuarial Valuation Date	Dec. 31, 2010	Sept. 1, 2010
Actuarial Accrued Liability (AAL)	$ 5,956,798	$ 1,854,690
Actuarial Value of Plan Assets	0	0
Unfunded Actuarial Accrued Liability (UAAL)	$ 5,956,798	$ 1,854,690
Funded Ratio (actuarial value of plan assets/AAL)	0.0%	0.0%
Covered Payroll (active plan members)	$ 5,309,413	$ 1,313,538
UAAL as a Percentage of Covered Payroll	112.2%	141.2%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress is presented as required supplementary information following the notes to the financial statements. The schedule presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Since there are no plan assets for UT and A&M plans, the actuarial accrued liability for these two plans continues to increase.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used in the UT and A&M plan valuations include techniques designed to reduce short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculations. See the table below for additional detail on the actuarial methods and assumptions used in the UT plan and A&M plan valuations.

Summary of Actuarial Methods and Assumptions

	UT Plan	A&M Plan
Actuarial Valuation Date	Dec. 31, 2010	Sept. 1, 2010
Actuarial Cost Method	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent Open	Level Percent Open
Amortization Period	30 years	30 years
Asset Valuation Method	Market	Market
Actuarial Assumptions:		
Projected Salary Increases	4.75% to 7.75%	3.5%
Investment Rate of Return	7%	7.3%
Includes Inflation at	3.5%	3%
Health Care Trend Rates	8% initial 5.5% ultimate	10% initial 5% ultimate

Employees Retirement System of Texas

The Employees Retirement System of Texas (ERS) administers a program that provides postemployment health care, life and dental insurance benefits to retirees through the Texas Employees Group Benefits Program as authorized by Texas Insurance Code, Chapter 1551. The State Retiree Health Plan (SRHP) is a cost-sharing multiple-employer defined benefit plan with 61 participating employers.

In a cost-sharing multiple-employer plan without a special funding situation, employers recognize their annual contractually required contributions to the plan in the fund financial statements. Because SRHP is funded by multiple employers, the GASB 45 special funding situation does not apply.

For cost-sharing multiple-employer defined benefit plans like SRHP, the amount of OPEB liability or asset is equal to the difference between contributions required and contributions made. Contractually required contributions to a cost-sharing multiple-employer OPEB plan are not required to be based on the plan ARC.

Each employer has limited note disclosure requirements under the cost-sharing multiple-employer provisions of GASB 45. No disclosure of actuarial information as it relates to the entire plan is required on individual employer reports. Instead, the OPEB plan discloses all required actuarial calculations in the notes to its financial statements and required supplementary information. ERS issues a publically available financial report that includes financial statements and required supplementary information for SRHP. That report may be obtained by writing to ERS at:

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

Plan Description

Retirees of state agencies, institutions of higher education (not part of UT and A&M) and other non-state entities selected by the Legislature are eligible to receive OPEB through SRHP. Retirees must meet certain age and service requirements and have at least 10 years of service at retirement to participate in the plan. Surviving spouses and dependents of retirees are also covered by the plan. Benefit and contribution provisions of SRHP are authorized by state law and may be amended by the Legislature.

The financial statements of 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.

Funding Policy

The Legislature sets and has the power to amend annual state contributions to SRHP. Currently, the state pays 100 percent of eligible retiree health insurance premiums and 50 percent of dependents' premiums. The retiree contributes any premium over and above state contributions. The table below summarizes the maximum monthly state and retiree contributions toward the health and basic life premiums of eligible retirees.

Required Contribution Rates – Retiree Health Care and Life Insurance Premium

For the Fiscal Year Ended August 31, 2012

	ERS SRHP	
Level of Coverage	Employer	Plan Member
Retiree Only	$438	$
Retiree/Spouse	689	262
Retiree/Children	606	176
Retiree/Family	857	438

Contractually required contributions to the plan are currently based on the annual pay-as-you-go expenses of SRHP. In fiscal 2012 the state contributed $425 million to SRHP, which equaled the required contribution as established by the Legislature. In fiscal 2011 and fiscal 2010, the state contributed $394.2 million and $432.4 million, respectively. These contributions also equaled the contribution required by the Legislature.

Teacher Retirement System of Texas

The Teacher Retirement System of Texas (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 1,248 participating employers, provides a free basic level of coverage for eligible retirees and optional coverage for eligible retirees and their dependents.

The state of Texas is not an employer in the TRS-Care OPEB plan and is not legally required to continue contributing benefits. A special funding situation is not created because costs are shared between the state and the many participating non-state school district employers. The fiscal 2012 contributions to the TRS-Care OPEB plan are displayed below.

Schedule of Contributions from the Employers and Other Contributing Entities

For the Fiscal Year Ended August 31, 2012
(Amounts in Thousands)

	TRS-Care
From Reporting Entities	$ 154,608
On Behalf From State	272,029
On Behalf From Federal Government	68,634
	$ 495,271

TRS issues a publically available financial report that includes financial statements and required supplementary information for TRS-Care. That report may be obtained by writing to TRS at:

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

Plan Description

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. Eligibility provisions of the TRS-Care plan are established in Texas Insurance Code, Chapter 1575.

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.

Funding Policy

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.

TRS-Care retiree health care and life insurance benefits are 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.

Medicare Part D

In fiscal 2012 the administrators of each OPEB plan received payments from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. On-behalf payments are recorded as revenues and expenses of each plan. The OPEB administrators reported the following amounts of Medicare Part D payments from the federal government in fiscal 2012.

Medicare Part D Receipts

For the Fiscal Year Ended August 31, 2012
(Amounts in Thousands)

UT Plan	$ 9,757
A&M Plan	3,834
ERS SRHP	39,612
TRS-Care	71,576
	$ 124,779

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 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 with a requirement for repayment. These loans are reported as interfund receivables/payables and are classified as either current or noncurrent.

Interfund services are sales and purchases of goods and services 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 is eliminated. Additional eliminations are made and transfers in and out are netted and presented in the government-wide statement of activities as "transfers-internal activities."

Certain reclassifications and eliminations are made between the fund financial statements and the government-wide financial statements. Resource flows between the primary government and its discretely presented component units are 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 fiduciary funds are reported as transfers on the fund financial statements and are 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. 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. These reimbursements are reported in the appropriate expenditure/expense category in the fund responsible for the payment.

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 Appropriations 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 interfund receivables/payables include loans for energy efficiency programs of approximately $38.3 million. There is also a $757.2 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 $2.7 billion transfer from the property tax relief fund and a $1.1 billion transfer from the lottery fund to the foundation school fund for educational programs. There is also a $1 billion transfer from the permanent school fund to the available school fund. The detail of interfund activity and transactions by fund type and category as of Aug. 31, 2012, is presented in the following tables.

Interfund Receivables/Payables

(Amounts in Thousands)

	Current		Noncurrent		Total	
Fund Type	Interfund Receivables	Interfund Payables	Interfund Receivables	Interfund Payables	Interfund Receivables	Interfund Payables
Governmental Funds						
General Fund	$ 3,869	$ 999	$ 34,629	$ 2,873	$ 38,498	$ 3,872
Nonmajor Governmental Funds	457	228		2,710	457	2,938
	4,326	1,227	34,629	5,583	38,955	6,810
Proprietary Funds						
Colleges and Universities	22,390	25,794	734,790	766,546	757,180	792,340
Nonmajor Enterprise Funds	394	89	2,710		3,104	89
	22,784	25,883	737,500	766,546	760,284	792,429
Total	$ 27,110	$ 27,110	$772,129	$772,129	$799,239	$799,239

Due From/Due To

(Amounts in Thousands)

Fund Type	Due From Other Funds	Due From Primary Government	Due From Component Unit	Due To Other Funds	Due To Primary Government	Due To Component Unit
Governmental Funds						
General Fund	$ 132,857	$	$ 89	$ 1,138,033	$	$
State Highway Fund	252,515			4,109		
Permanent School Fund				451		
Nonmajor Governmental Funds	73,450			67,974		
	458,822	0	89	1,210,567	0	0
Proprietary Funds						
Colleges and Universities	848,173			26,699		
Unemployment Trust Fund	12,712					
Lottery Fund	578			4,095		
Nonmajor Enterprise Funds	41,267			3,165		
Internal Service Fund	21,332			1,636		
	924,062	0	0	35,595	0	0
Fiduciary Funds						
Pension and Other Employee Benefit Trust Funds	11,737			122,128		
Private-Purpose Trust Funds	6			8		
Agency Funds	900			27,229		
	12,643	0	0	149,365	0	0
Discretely Presented Component Units	0	0	0	0	89	0
Total	$ 1,395,527	$ 0	$ 89	$ 1,395,527	$ 89	$ 0

Internal Balances per the Government-wide Financial Statements

(Amounts in Thousands)

	Governmental Activities	Business-Type Activities	Total
NONCURRENT ASSETS			
Internal Balances–Receivables	$ 29,046	$ (29,046)	$ 0
CURRENT LIABILITIES			
Internal Balances–Payables	$ 865,668	$ (865,668)	$ 0

Transfers – Internal Activities per the Government-wide Financial Statements

(Amounts in Thousands)

Fund Category	Other Funds
Governmental Activities	$ (3,944,781)
Business-Type Activities	$ 3,944,781

Transfers In/Out

(Amounts in Thousands)

Fund Type	Transfers In Other Funds	Transfers Out Other Funds
Governmental Funds		
General Fund	$ 4,891,199	$ 5,779,918
State Highway Fund	433,409	453,685
Permanent School Fund		1,020,887
Nonmajor Governmental Funds	1,953,305	3,994,482
	7,277,913	11,248,972
Proprietary Funds		
Colleges and Universities	5,582,453	576,426
Unemployment Trust Fund	87,350	26,102
Lottery Fund		1,155,523
Nonmajor Enterprise Funds	68,356	35,286
	5,738,159	1,793,337
Fiduciary Funds		
Pension and Other Employee Benefit Trust Funds	114,821	88,396
Private-Purpose Trust Funds		188
	114,821	88,584
Total	$ 13,130,893	$ 13,130,893

NOTE 13

Classification of Fund Balances/ Net Position

The table below presents a summary of the Aug. 31, 2012, governmental fund balances by fund type and specific purpose.

The classifications of nonspendable, restricted, committed, assigned and unassigned are the fund balance classifications according to GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. With the exception of nonspendable fund balances, fund balances are presented based on each fund's specific purpose as required by GASB 54. For the general fund, special revenue funds, capital projects funds and nonmajor permanent funds, the specific purpose of the fund balance is determined by the governmental function for which the funds are restricted, committed, assigned or unassigned. The governmental function is assigned to an agency and all fund balances reported by the agency reflect that function.

If a fund reported by an agency is exclusively for another governmental function and the amount is significant, the balance is reclassified to the appropriate governmental function.

Governmental Fund Balances – Nonspendable, Restricted, Committed, Assigned and Unassigned

(Amounts in Thousands)

MAJOR FUNDS	
General Fund	
Nonspendable:	
Inventory	$ 199,562
Prepaid Items	1,589
Long-term Receivables	476,630
	$ 677,781
Restricted for:	
General Government	$ 783,162
Education	342,918
Health and Human Services	351,224
Public Safety and Corrections	45,632
Natural Resources and Recreation	240,799
	$ 1,763,735
Committed to:	
General Government	$ 1,851,551
Education	965,245
Health and Human Services	809,789
Public Safety and Corrections	87,862
Transportation	330
Natural Resources and Recreation	1,302,802
Regulatory Services	265,746
	$ 5,283,325
Assigned to:	
General Government	$ 36,865
Health and Human Services	6,205
Natural Resources	841
Regulatory Services	165
	$ 44,076

MAJOR FUNDS (concluded)	
Unassigned:	
General Government	$ 914,770
Education	180,155
Employee Benefits	105
Health and Human Services	(321,263)
Public Safety and Corrections	135,050
Transportation	79,747
Natural Resources and Recreation	95,914
Regulatory Services	10,166
	$ 1,094,644
State Highway Fund	
Nonspendable:	
Inventory	$ 125,971
Prepaid Items	2,097
	$ 128,068
Restricted for:	
General Government	$ 4,115
Public Safety and Corrections	7,087
Transportation	1,022,783
	$ 1,033,985
Committed to:	
Transportation	$ 201,935
	$ 201,935
Unassigned:	
Transportation	$ (511,086)
	$ (511,086)
Permanent School Fund	
Nonspendable:	
Permanent Fund Principal	$ 12,041,074
Prepaid Items	6
	$ 12,041,080
Restricted for:	
Public School Support	16,761,845
	$ 16,761,845

Concluded on the following page

Capital projects fund balances are often reported by two agencies with different governmental functions. In these instances, the fund balance is reported in the function for the project. The function is determined by the specific purpose reflected for each column in the combining balance sheet – non-major capital projects funds.

The specific purpose for debt service funds is considered debt service.

Restrictions of net position are listed on the face of the government-wide and proprietary statements of net position. Per GASB 54, balances reported as restricted in the fund financial statements plus the nonspendable permanent fund corpus balances are reported as restricted in the statement of net position. All other fund financial balances are reported as unrestricted in the statement of net position.

Of the $14.1 billion reported as unrestricted net position, $6.1 billion is for the economic stabilization fund. The economic stabilization fund was authorized by the Texas Constitution, Article III, Section 49g. In November of each year a transfer is made equal to 75 percent of the excess of the prior fiscal year collections for natural gas and crude oil production taxes over 1987 collections. The Legislature may appropriate, by a three-fifths vote of the members present in each house, amounts in the ESF for spending that does not exceed the amount of any unanticipated deficit or revenue decline during a biennium. The Legislature may also appropriate any amount from the ESF for any purpose only if approved by at least two-thirds of the members present in each house.

Governmental Fund Balances – Nonspendable, Restricted, Committed, Assigned and Unassigned (concluded)

(Amounts in Thousands)

NONMAJOR FUNDS	
Special Revenue Funds	
Nonspendable:	
Inventory	$ 154
Prepaid Items	5
	$ 159
Restricted for:	
General Government	$ 48,532
Education	1,297,183
Health and Human Services	1,028
Public Safety and Corrections	2,148
Natural Resources and Recreation	1,120,234
	$ 2,469,125
Committed to:	
General Government	$ 41,632
Employee Benefits	17
Public Safety and Corrections	7,830
Natural Resources and Recreation	209
Regulatory Services	753,688
	$ 803,376
Assigned to:	
General Government	$ 1,049
Education	988
Transportation	171
	$ 2,208
Debt Service Funds	
Restricted for:	
Debt Service	$ 1,389,875
	$ 1,389,875

NONMAJOR FUNDS (concluded)	
Capital Projects Funds	
Nonspendable:	
Inventory	$ 3
	$ 3
Restricted for:	
General Government	$ 85,507
Education	139
Health and Human Services	10,029
Public Safety and Corrections	32,141
Transportation	100,922
Natural Resources and Recreation	13,184
	$ 241,922
Permanent Funds	
Nonspendable:	
Permanent Fund Principal	$ 745,211
	$ 745,211
Restricted for:	
Natural Resources and Recreation	$ 352
	$ 352
Committed to:	
Education	$ 7,676
	$ 7,676
ALL GOVERNMENTAL FUNDS	
Nonspendable	$ 13,592,302
Restricted	23,660,839
Committed	6,296,312
Assigned	46,284
Unassigned	583,558
Total Fund Balances – Governmental Funds	$ 44,179,295

NOTE 14

Restatement of Beginning Balances

During fiscal 2012, certain accounting changes and adjustments were made that required the restatement of fund balances or net position. The beginning balances and all related restatements for the components of the state's financial reporting entity are included below and discussed on the following page.

Restatements to Fund Balances/Net Position

(Amounts in Thousands)

	September 1, 2011, As Previously Reported	Restatements	September 1, 2011, As Restated
GOVERNMENTAL FUNDS AND GOVERNMENTAL ACTIVITIES			
Major Funds:			
General Fund	$ 7,184,566	$ (310,879)	$ 6,873,687
State Highway Fund	751,539	383,745	1,135,284
Permanent School Fund	26,947,258		26,947,258
Total Major Funds	34,883,363	72,866	34,956,229
Nonmajor Funds:			
Special Revenue Funds	4,002,160	(878,415)	3,123,745
Debt Service Funds	1,554,996	(2,252)	1,552,744
Capital Project Funds	868,892	(54)	868,838
Permanent Funds	757,309	(15,756)	741,553
Total Nonmajor Funds	7,183,357	(896,477)	6,286,880
Total Governmental Funds	42,066,720	(823,611)	41,243,109
Governmental Activities Adjustments:			
Capital Assets	75,667,494	(438,234)	75,229,260
Long-Term Liabilities	(21,493,574)	915,423	(20,578,151)
Deferred Revenue	784,063		784,063
Internal Service Fund	227,984		227,984
Total Governmental Activities Adjustments	55,185,967	477,189	55,663,156
Total Governmental Activities	97,252,687	(346,422)	96,906,265
BUSINESS-TYPE ACTIVITIES			
Major Funds:			
Colleges and Universities	39,104,136	(17,976)	39,086,160
Unemployment Trust Fund	(812,922)		(812,922)
Lottery Fund	117,985		117,985
Total Major Funds	38,409,199	(17,976)	38,391,223
Nonmajor Enterprise Funds	3,725,029	(363)	3,724,666
Total Business-Type Activities	42,134,228	(18,339)	42,115,889
Total Primary Government	139,386,915	(364,761)	139,022,154
FIDUCIARY FUNDS			
Pension and Other Employee Benefit Trust Funds	130,580,910	304	130,581,214
External Investment Trust Funds	13,966,146		13,966,146
Private-Purpose Trust Funds	2,846,911		2,846,911
Total Fiduciary Funds	147,393,967	304	147,394,271
Discretely Presented Component Units	888,310	(4,440)	883,870
Total Reporting Entity	$ 287,669,192	$ (368,897)	$ 287,300,295

Restatements by Activity

(Amounts in Thousands)

Restatements	Governmental Activities	Business-Type Activities	Fiduciary Activities	Component Units	Total
A. Capital Asset Adjustments	$ (438,234)	$ (25,448)	$	$ 182	$ (463,500)
B. State Highway Fund Nontraditional Agreements	99,494				99,494
C. Conduit Debt	100,225				100,225
D. Federal CDBG Disaster Grant	(57,022)				(57,022)
E. Miscellaneous Adjustments	(50,885)	7,109	304	(4,622)	(48,094)
Total Restatements	$ (346,422)	$ (18,339)	$ 304	$ (4,440)	$ (368,897)

Restatements are grouped into the following five categories:

A. These restatements are for adjustments to capital assets and accumulated depreciation or amortization. The restatements include an amount of $628.3 million to correct an overstatement of toll projects related to nontraditional agreements of the state highway fund. These toll projects are under the ownership of a local toll project entity under state law and should not be reported as state's assets.

B. This restatement is to correct accounting errors other than those in capital assets pertinent to nontraditional agreements of the state highway projects.

C. This restatement is to correct prior year bond issuances of a blended component unit of the state that were reported on the state's financial statements. These bonds were determined to be conduit debt in fiscal 2012 and only require a note disclosure. The restatement includes $1 billion for revenue bonds payable and $910 million for the associated loans receivable.

D. This restatement is to correct the prior year accrued expenditures related to the disaster grant portion of the federal Community Development Block Grant (CDBG).

E. These are miscellaneous restatements necessary to correct accounting errors in the prior period or recognize changes in the application of accounting principles and methodologies, including restatements for funds reclassified to a different fund type, to improve consistency within the financial reporting entity.

NOTE 15

Commitments and Contingencies

COMMITMENTS

Outstanding Loan Commitments

The state makes loan commitments to political subdivisions for financing purposes. These loan commitments are provided from remaining current bond proceeds, future bond proceeds and federal drawdowns. The Texas Water Development Board had loan commitments totaling $577.2 million as of Aug. 31, 2012. The Texas Department of Transportation (TxDOT) has an equity loan agreement of $6 billion with North Texas Tollway Authority with a maximum amount of $6 billion to be used for State Highway (SH) 161 Project in Dallas.

Investment Funds

As of Aug. 31, 2012, state agencies, public employee retirement systems and institutions of higher education had entered into capital commitments with investment managers for future funding of investment funds. Investment funds include hedge fund pools, private investment pools, public market funds and other alternative investments managed by external investment managers. As of Aug. 31, 2012, the remaining commitment was $26.9 billion.

Construction and Other Commitments

As of Aug. 31, 2012, TxDOT had contractual commitments of approximately $6.1 billion for construction and comprehensive developments. These are not recognized liabilities because the terms of the contracts or agreements were not met and benefits were not received as of the end of the fiscal year.

Additionally, TxDOT is party to several pass-through toll agreements with local entities. Under these agreements, the local entities will finance, design and construct certain roadway projects and may maintain them for a specified period of time. Upon completion of the projects, TxDOT will make payments (i.e., pass-through toll payments) to the entities based on traffic utilization of the roadways and other payment requirements governed by the agreements. Motorists traveling these roadways will not be required to pay a toll. Estimated payments under the agreements are included as notes payable as each project is completed. Liabilities for uncompleted agreements are not recognized. As of Aug. 31, 2012, the amount of unrealized payables for uncompleted pass-through toll agreements was $541 million. In addition, TxDOT has equity grant commitments of $553.6 million to various local toll project entities.

CONTINGENCIES

Protested Tax Payments

As of Aug. 31, 2012, pending litigation filed by taxpayers seeking refunds of state taxes totaled $203.8 million. The protested taxes include sales, franchise, insurance and other taxes. Although the outcome of these cases cannot presently be determined, adverse ruling in some of them could result in significant additional refunds.

Unpaid Claims and Lawsuits

A variety of cases that may affect the state were filed as of Aug. 31, 2012. These claims total $85.9 million and include a number of lawsuits and claims that may be significant to individual state agencies. While the outcome of these cases cannot be determined, adverse rulings could result in additional liabilities. Additionally, TxDOT filed 800 cases exercising eminent domain for $256 million.

Federal Assistance

The state receives federal financial assistance 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 but is considered immaterial to its overall financial condition.

The Texas Office of the Attorney General and the Texas Health and Human Services Commission's Office of Inspector General investigate allegations of overpayments to Medicaid providers. Until investigations are completed, the total amount of overpayments to providers is potentially subject to recovery (amounts associated with the "open case list") and may represent a corresponding potential liability for the federal share of these payments – about 60 to 65 percent of that total.

An actual liability is realized only after a completed investigation substantiates an overpayment and the provider is notified of the results and given an opportunity to submit rebuttal or claims for offsets. The percent of total dollars on the open case list that are ultimately confirmed as overpayments cannot be reliably predicted. The state estimates the amounts that may become payable to the federal government will be immaterial to its overall financial condition.

Guaranteed Debt

In 1983, the voters of the state approved a constitutional amendment that provides for the guarantee by the permanent school fund of up to a defined capacity of $75.4 billion in school district bonds as of Aug. 31, 2012. Approval by the state of Texas attorney general is required for each bond issuance. In the event of a default by a school district, the permanent school fund will transfer to the paying agent/registrar an amount necessary to pay the maturing or matured principal and/or interest to bondholders. As of Aug. 31, 2012, $53.6 billion in debt was guaranteed by the permanent school fund for outstanding bond issues in 800 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 $53.6 billion represents the principal amount and does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities), nor does it include interest on current interest bonds or variable rate notes. The amount also excludes bonds that were refunded and released from the bond guarantee program. From the inception of the program through Aug. 31, 2012, none of the school districts with guaranteed debt have defaulted on the guaranteed debt.

TxDOT is proceeding with the development of the SH 99 (Grand Parkway) project. TxDOT expects to pay expenditures in connection with the project prior to the issuance of obligations to finance the portion of the project for which TxDOT has jurisdiction. The Grand Parkway Transportation Corporation, a blended component unit of the state, expects to incur debt, with the aggregate maximum amount of project expenditures of $600 million being incurred prior to such issuance. The debt would be one or more separate series of various types of obligations for the purpose of paying the costs of the project prior to issuance of such obligations. TxDOT is authorized to be reimbursed for such payments for the project when the obligations are issued to finance the project.

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 investments 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 institutions of higher education 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.

Derivatives with Contingent Features

All of the Department of Housing and Community Affair's (TDHCA) derivative instruments include provisions that require posting collateral in the event its credit rating falls below a specified level as issued by Moody's Investor Service and Standard & Poor's. If TDHCA fails to post eligible collateral, the derivative instrument may be terminated by the counterparty. As of Aug. 31, 2012, the aggregate fair value of all derivative instruments with collateral provisions was $46.9 million. If the posting requirements had been triggered, TDHCA would have been required to post eligible collateral equal to the aggregate fair value of the derivative instruments. TDHCA posted no collateral as of Aug. 31, 2012.

The Teacher Retirement System of Texas (TRS) is party to derivative instruments with provisions that require TRS to post collateral in the event that the fair value surpasses a specified contractual threshold. As of Aug, 31, 2012, the aggregate fair value of all derivative instruments with these provisions was $82.4 million. If the collateral posting thresholds did not exist, TRS would be required to post the aggregate amount of $3.4 million in collateral to its counterparties. TRS posted no collateral as of Aug. 31, 2012.

NOTE 16

Subsequent Events

Primary Government

Bonds and Commercial Paper Issued/Refunded

State agencies and institutions of higher education issued $1.6 billion in new bonds and commercial paper and $820.5 million in refunding bonds since Aug. 31, 2012. This routine activity finances state facilities, housing assistance programs, educational loans and refunds outstanding debt.

Other Subsequent Events

The Texas Workforce Commission transferred $92.7 million of taxes to the unemployment trust fund in September 2012 in accordance with Texas Labor Code, Section 204.123. The taxes were originally deposited to the employment and training investment holding fund, an account within the general revenue fund. Texas Labor Code, Section 204.061, defines a statutory floor for the unemployment trust fund as 1 percent of total taxable wages for the four quarters ended June 30, 2012. The transfer was required because the unemployment trust fund balance was below that floor.

The Facility Concession Agreement (FCA) for the State Highway (SH) 130 Segments 5 and 6 facility provides for the developer to pay an additional concession payment to the Texas Department of Transportation (TxDOT) if a maximum posted speed of 80 mph or 85 mph is authorized within 180 days after the service commencement date for the facility and TxDOT elects to waive increased revenue sharing that otherwise would be required. On Aug. 30, 2012, the Texas Transportation Commission authorized and directed the implementation of the maximum speed limit of 85 mph. In addition, the Commission authorized and directed TxDOT to notify the developer of TxDOT's election to waive increased revenue sharing and instead receive the additional concession payment amount of $100 million. On Sept. 17, 2012, the TxDOT executive director provided the developer with sufficient documentation and the additional concession payment was received on Nov. 9, 2012.

The Regional Transportation Council of the North Central Texas Council of Governments allocated a portion of the SH 121 concession funding to pay off the state infrastructure bank (SIB) loan balance related to segments I through IV of the President George Bush Turnpike Authority. During the October 2012 meeting, the Texas Transportation Commission concurred with the allocation. The transfer of funds totaling approximately $145 million from the SH 121 account to the SIB, representing the full repayment of the loan, occurred on Feb. 15, 2013.

Component Units

On Nov. 5, 2012, Texas Small Business Industrial Development Corporation, a discrete component unit of the state, notified bondholders of its intent to redeem $7.8 million of its Floating Rate Demand Revenue Bonds on Dec. 5, 2012.

On Nov. 19, 2012, the Texas State Affordable Housing Corporation, a discrete component unit of the state, redeemed the remaining $21.4 million in market rate bonds to close out the 2009 New Issue Bond Program.

Bonds and Commercial Paper Issued/Refunded

(Amounts in Thousands)

	Description	Amount	Issuance Date	Purpose
Department of Aging and Disability Services	General Obligation Commercial Paper Notes, Series 2008	$ 8,000	09/12/12	Finance capital repairs and renovations for the State Supported Living Centers.
Department of Housing and Community Affairs	Residential Mortgage Revenue Bonds, Series 2009 C-4	78,070	09/13/12	Provide funds for the purchase of mortgage-backed securities guaranteed as timely payments of principal and interest by Government National Mortgage Association ("Ginnie Mae").
Midwestern State University	Revenue Financing System Bonds, Series 2012A	4,710	10/09/12	Refund Revenue Bonds, Series 2002 to reduce debt service payments.
	Revenue Financing System Bonds, Series 2012B	5,415	10/09/12	Refund Revenue and Refunding Bonds, Series 2003 to reduce debt service payments.
Texas Department of Transportation	Revenue Refunding Bonds, Series 2012A	585,330	11/27/12	Refund Series 2002A for savings.
	Revenue Refunding Bonds, Series 2012B	225,000	11/27/12	Refund Series 2009 for savings.
	General Obligation Bonds, Series 2012A	818,635	12/18/12	Fund various highway improvement projects.
	General Obligation Bonds, Series 2012B	99,570	12/18/12	Fund various highway improvement projects.
Texas Public Finance Authority	General Obligation Commercial Paper Notes, CPRIT Series A	9,600	09/06/12	To fund indirect administration, grant review and award operations and the Texas Cancer Registry Operations of the Cancer Prevention Research Institute of Texas (CPRIT).
	General Obligation Commercial Paper Notes, Series 2008	6,000	10/04/12	To fund projects for the Texas Department of State Health Services and the Texas Historical Commission.
Texas Southern University	Revenue Bonds, Series A 2012-10	55,000	09/27/12	To construct new student housing.
Texas State Affordable Housing Corporation*	Multifamily Housing Mortgage Revenue Bonds, Series 2012	71,100	09/20/12	To acquire and rehabilitate six properties.
Texas State University System	Revenue Financing System Bonds, Series 2013	100,049	01/13/13	To fund various construction and renovation projects.
Water Development Board	General Obligation Bonds, Series 2012F	29,385	09/05/12	Provide financial assistance for Economically Distressed Areas Program (EDAP) projects.
	General Obligation Bonds, Series 2012G	156,065	10/02/12	Provide financial assistance from the Texas Water Development Fund II (Dfund) for water assistance projects.
	General Obligation Bonds, Series 2013A	42,470	02/12/13	Provide financial assistance from the Water Infrastructure Fund (WIF) for water assistance projects.
University of Texas System	Permanent University Fund Taxable Commercial Paper Notes, Series B	75,000	10/02/12	To finance a variety of capital projects and equipment purchases at various institutions.
	Revenue Financing System Commercial Paper Notes, Series A	50,316	11/05/12	To finance a variety of capital projects and equipment purchases at various institutions.
Veterans Land Board	General Obligation State of Texas Veterans Bonds, Series 2012B	100,000	11/01/12	To augment the Veterans' Housing Assistance Fund II.
	Total Bond and Commercial Paper Issued/Refunded	$ 2,519,715		

* Discretely presented component unit

NOTE 17

Risk Management

The state of Texas is exposed to various risks of loss related to property, general and employer liability, net income, and personnel. The state of Texas and its employees are covered by numerous immunities and defenses that limit some of these risks of loss, particularly in liability actions brought against the state or its employees. Remaining exposures are managed by self-insurance arrangements, contractual risk transfers, the purchase of commercial insurance or a combination of these risk financing techniques.

Estimates of liabilities for incurred but not reported 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. Claims liabilities include specific, incremental claims adjustment expenditures/expenses. In addition, estimated recoveries on unsettled claims, such as salvage and subrogation, are evaluated in terms of their estimated realizable value and deducted from the liability for unpaid claims. Unallocated claim adjustment expenditures/expenses are not included in the liability for claims and judgments.

There were no significant reductions in insurance coverage in the past year. Also, in the past three years, settlements have not exceeded insurance coverage.

Property and Liability

The Texas Labor Code, Chapter 412, identifies the executive director of the State Office of Risk Management (SORM) as the state risk manager. SORM operates as a full-service risk and insurance manager for the state and oversees all surety bond and property and liability insurance purchases by state agencies.

SORM administers the statewide workers' compensation program. The state does not carry commercial insurance for workers' compensation, but instead, uses the general revenue fund to account for its risk financing activities. Certain agencies are exempt from the SORM program or elect to purchase additional insurance coverage outside of the program. The University of Texas System (UT), Texas A&M University System (A&M) and Texas Department of Transportation (TxDOT) administer separate self-insured workers' compensation programs.

Where applicable, certain agencies purchased fire and extended insurance coverage for buildings financed through the issuance of bonds. Other risks are addressed through a combination of interim financing and commercial coverage for fire and all other perils, as well as coverage for medical malpractice, torts, named windstorms, floods and other potential liabilities.

Health, Life and Dental

Insurance coverage is provided to active state employees and their dependents by one of three health plan administrators. All state employees not covered by insurance plans provided by UT and A&M are included in the Texas Employees Group Benefits Program (GBP) administered by the Employees Retirement System of Texas (ERS). Public school employees and their dependents are covered by the Texas Active School Employees Uniform Group Benefits Program (TRS-ActiveCare) administered by the Teacher Retirement System of Texas (TRS). Risk of loss is retained with self-insured plans or transferred to the insurance carrier with health maintenance organization (HMO) plans.

Texas Employee Group Benefits Program

Claims for health, life, accidental death and dismemberment (AD&D), disability and dental insurance coverages are established under the GBP. These coverages are provided through a combination of insurance contracts, a self-funded health plan, a self-funded dental indemnity plan, HMO contracts and dental health maintenance organizations (DHMO) contracts.

University of Texas System and Texas A&M University System

UT and A&M provide health insurance, dental insurance, vision insurance, life insurance, AD&D, long-term disability, short-term disability, long-term care and flexible-spending account coverages to all benefits-eligible employees. These insurance benefits are provided through both self-funded and fully insured arrangements.

Teacher Retirement System

TRS-ActiveCare is a health benefits program that offers options ranging from catastrophic coverage with reduced premiums to a comprehensive plan with near first-dollar coverage at higher premiums. TRS-ActiveCare covers members currently employed by public educational employers that participate in the plan.

TRS-ActiveCare offers a choice of four preferred provider organization plans statewide as well as HMO plans in certain service areas. The risk associated with TRS-ActiveCare is retained by the plan's participants, and no risk is transferred to the plan's administrators, employers or the state.

Changes in Claims Liability Balances

The following table presents the changes in claims liability reported in various balance sheet/statement of net position liability accounts during fiscal years ended Aug. 31, 2011, and Aug. 31, 2012. Claims and judgment amounts presented in Note 5 are also included in the table.

Changes in Claims Liability Balances

(Amounts in Thousands)

	Beginning Balance	Increases	Decreases	Ending Balance
2012	$ 760,167	$ 2,726,971	$ 2,699,682	$ 787,456
2011	$ 786,122	$ 2,736,829	$ 2,762,784	$ 760,167

Of the fiscal 2012 claims liability ending balance, $194 million relates to long-term claims liabilities, which are reported in Note 5. The remaining $593 million relates to the state's health, life and dental insurance programs, which are reported as accounts payable.

NOTE 18

Contested Taxes

The state may assess a claim against one or multiple taxpayers for a tax liability. 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. As of Aug. 31, 2012, there was an estimated $1.3 billion of assessments filed that are currently in the redetermination hearings process. 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.

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 entity's 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. Most component units, however, 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 informational purposes of interested parties. The component units are reported for the year ended Aug. 31, 2012, unless indicated otherwise.

Blended Component Units

The state is financially accountable for two material blended component units. These component units are reported as if they are part of the primary government because they provide substantially all of their services directly to the state. The component units' financial data is blended in the appropriate funds within the financial statements. There are no other material blended component units of the state.

Employees Retirement System of Texas (ERS) is a legally separate entity established by the Legislature to administer benefits for officers and employees of the state. ERS is governed by a six-member board of trustees. The governor, with the advice and consent of the Senate, appoints three of the six members of the board of trustees. The state of Texas has the ability to impose its will upon ERS through its budget approval powers. Separate financial statements may be obtained by contacting ERS at P.O. Box 13207, Austin, Texas 78711.

Texas Treasury Safekeeping Trust Company (Trust Company) is a legally separate entity established by the Legislature. The Comptroller of Public Accounts is the single shareholder of the Trust Company and is charged with managing the Trust Company. The Trust Company is authorized to manage, disburse, transfer, safekeep and invest funds and securities provided by statute or belonging to state and local entities and gives the Comptroller direct access to services provided by the Federal Reserve System. Separate financial statements may be obtained by contacting the Trust Company at 208 E. 10th St., 4th Floor, Austin, Texas 78701.

Discretely Presented Component Units

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

Texas Guaranteed Student Loan Corporation (TGSLC) is a public nonprofit corporation that guarantees loans made to eligible students under the federal guaranteed student loan program. All nine members of TGSLC's board are appointed by the governor with the advice and consent of the Senate. The state of Texas imposes its will on TGSLC through its application of the Texas Sunset Act. TGSLC's liabilities are not debts of the state. TGSLC received a one-time appropriation of $1.5 million to fund initial startup operations. TGSLC is reported for the year ended Sept. 30, 2012. Separate financial statements may be obtained by contacting TGSLC at P.O. Box 83100, Round Rock, Texas 78683-3100.

Teacher Retirement System of Texas (TRS) is a legally separate entity established by the Legislature to administer retirement and disability annuities to employees and beneficiaries of public school systems and institutions of higher education. TRS is governed by a nine-member board of trustees, three of whom are direct appointments of the governor. The remaining trustees are appointed by the governor from lists prepared by various constituent groups. TRS is subject to the budget approval powers of the Texas Legislature, and therefore is fiscally dependent on the state of Texas. Separate financial statements may be obtained by contacting TRS at 1000 Red River St., Austin, Texas 78701.

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 annual budget for the State Bar of Texas must be reviewed and approved by the Supreme Court, thus making the State Bar of Texas fiscally dependent on the state of Texas. The State Bar is reported for the year ended May 31, 2012. Separate financial statements may be obtained by contacting the State Bar at 1414 Colorado St., Austin, Texas 78701.

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, professional educators, firefighters and police officers who are first-time home buyers and are not afforded housing finance options through conventional lending channels. TSAHC operates under the name Texas Star Mortgage to provide single and multifamily loans to low-income Texans. Prior to any bonds being issued by TSAHC, the issuance must be reviewed by the Bond Review Board, which is composed of the governor, lieutenant governor, speaker of the House of Representatives and Comptroller of Public Accounts. Separate financial statements may be obtained by contacting TSAHC at P.O. Box 12637, Austin, Texas 78711-2637.

OneStar National Service Commission Inc. and **OneStar Foundation** (OneStar) are legally separate nonprofit corporations that administer the AmeriCorps*Texas program. They serve as the state's liaison to and oversee Texas' participation in OneStar programs for the Corporation for National and Community Service (a federal agency), as well as prepare a comprehensive three-year national service plan for the state. The governor appoints all members of OneStar's boards. The governor can also remove any board member at will. The OneStar Foundation Inc. performs all administrative duties of the OneStar National Service Commission Inc., as well as provides technical assistance, education, information and other support to the volunteer community. OneStar is reported for the year ended Dec. 31, 2011. The financial statements of OneStar can be obtained by contacting OneStar at 9011 Mountain Ridge Drive, Suite 100, Austin, Texas 78759.

Texas Low-Level Radioactive Waste Disposal Compact Commission (Commission) is a legally separate organization established to promote the health, safety and welfare of the citizens and environment of the states participating in the Texas Low-Level Radioactive Waste Disposal Compact (Compact), known as party states. There are currently three party states, Texas, Maine and Vermont, with Texas serving as the host party state. The mission of the Commission is to:

- Limit the number of radioactive waste disposal facilities
- Effectively, efficiently and economically manage low-level radioactive waste
- Encourage the reduction of the generation thereof

Since Texas serves as the host party state for the Compact, it is entitled to six voting members, whereas the other party states are only entitled to one voting member. The governor appoints the six members of the Commission serving on behalf of Texas. As host state, Texas has the authority to establish the disposal fees assessed at the facility for disposal of low-level radioactive waste generated in the party states. The Texas Legislature, with the approval of the governor, also has the authority to revise the portion of the Compact pertaining to the volume of waste the host state will dispose of without the consent of the nonhost party states. The financial statements of the Commission may be obtained by contacting the Commission at 333 Guadalupe St. #3-240, Austin, Texas 78701.

Texas Windstorm Insurance Association (Association) is a legally separate organization established to provide an adequate market for windstorm and hail insurance in the seacoast territory of Texas and serves as an insurer of last resort. The commissioner of the Texas Department of Insurance (TDI) appoints the nine-member board of directors, and the board is responsible and accountable to the commissioner. The state of Texas has the ability to impose its will on the Association through TDI commissioner approval of rates and maximum liability limits for windstorm and hail insurance policies issued by the Association. The Association is reported for the year ended Dec. 31, 2011. Separate financial statements may be obtained by contacting the Association at 5700 South Mopac, Building E, Suite 530, Austin, Texas 78749.

Surplus Lines Stamping Office of Texas (Stamping Office) is a legally separate nonprofit corporation created by the Legislature to assist 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, 2011. Separate financial statements may be obtained by contacting the Stamping Office at P.O. Box 160170, Austin, Texas 78716-0170.

Texas Health Reinsurance System is a legally separate entity that 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 are presented on statutory accounting principles established by TDI, and are reported for the year ended Dec. 31, 2011. Financial statements may be obtained at 100 Great Meadow Rd., Suite 704, Wethersfield, Connecticut 06109.

Texas Health Insurance Risk Pool (THIRP) is a legally separate entity that provides access to quality health care at a minimum cost to the public for those unable to obtain traditional health care coverage. TDI approves all rates and rate schedules before they are used. The nine-member board of directors is appointed by TDI's commissioner. THIRP is reported for the year ended Dec. 31, 2011. Financial statements may be obtained at 1701 Director's Blvd., Suite 120, Austin, Texas 78744.

Texas Boll Weevil Eradication Foundation Inc. (Foundation) is a legally separate entity that establishes and implements a boll weevil eradication program for Texas. It is fiscally dependent on the Texas Department of Agriculture (TDA) and governed by 21 board members. TDA's commissioner appoints five of the board members. TDA approves the Foundation's budget, assessment fees and debt. The Foundation is reported for the year ended Dec. 31, 2011. Separate financial statements may be obtained by contacting TDA at P.O. Box 12847, Austin, Texas 78711-2847.

Texas Agricultural Finance Authority (TAFA) is a legally separate entity that provides financial assistance for the expansion, development and diversification of agricultural businesses. TAFA primarily benefits the citizens of Texas. If there are insufficient funds to pay TAFA's bond obligations, the primary government is obligated to transfer money from the state treasury to TAFA in an amount sufficient to pay those obligations. 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 TAFA with the assistance of the board. Separate financial statements may be obtained by contacting TDA at P.O. Box 12847, Austin, Texas 78711-2847.

Texas Water Resources Finance Authority (Authority) is a legally separate entity 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. The members of the TWDB are appointed by the governor. TWDB, through a sales and servicing agreement, wholly manages the Authority's operations. Prior to any bonds being issued by the Authority, the issuance must be reviewed by the Bond Review Board, which is composed of the governor, lieutenant governor, speaker of the House of Representatives and the Comptroller of Public Accounts. Financial statements may be obtained by contacting TWDB at P.O. Box 13231, Austin, Texas 78711-3231.

Texas On-Site Wastewater Treatment Research Council (Council) was abolished effective Sept. 1, 2011. Its purpose was to award competitive grants and contracts to support applied research, demonstration projects and information transfer regarding on-site wastewater treatment. Upon its abolishment, the Council's activities and functions were absorbed by the Texas Commission on Environmental Quality.

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 the 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 Economic Development Corporation (TED Corp), a nonprofit corporation, was created to assist, promote, develop and advance economic development in the state of Texas. The Office of the Governor is the oversight agency for TED Corp, and has the ability to remove board members at will. The board of directors is appointed by the governor. TED Corp'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 Small Business Industrial Development Corporation (TSBIDC) was chartered to promote economic development in the state of Texas. The Office of the Governor is the oversight agency for TSBIDC. The board of directors is appointed by the governor, and all programs and expenditures of TSBIDC must be approved on behalf of the state by the Texas Economic Development Bank. 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 Disaster Relief Fund (TDRF), a nonprofit corporation, was established to help the Office of the Governor provide disaster relief. 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. Based on TDRF's relationship with the Office of the Governor, omitting TDRF would result in misleading financial statements. TDRF's financial statements may be obtained by contacting the Office of the Governor at P.O. Box 12428, Austin, Texas 78711.

Texas Health Services Authority (THSA) is a legally separate entity created to assist the Office of the Governor with the improvement of the Texas health care system. THSA promotes and coordinates the electronic exchange of health information throughout the state to ensure information is available to health care providers and to improve patient safety and quality of care. The board of directors consists of 11 members and is appointed by the governor, with the advice and consent of the Senate. The state of Texas has the ability to impose its will upon THSA through the ability of the governor to order the dissolution of THSA at any time the governor declares the purposes of THSA are fulfilled or that THSA is inoperative or abandoned. THSA is reported for the year ended Sept. 30, 2011. THSA's financial statements may be obtained by contacting THSA at 221 E. 9th St., Suite 201, Austin, Texas 78701.

Beacon State Fund is a legally separate organization established to assist the Governor's Commission for Women (Commission) to promote issues affecting the women of Texas. Members of the board of trustees are appointed by the Office of the Governor or someone designated by the Office of the Governor. The Office of the Governor has fiscal oversight over the Beacon State Fund to ensure funds are expended properly and the public purpose is being accomplished. The Beacon State Fund increases public awareness through the distribution of information, media events and community outreach programs. The Beacon State Fund is reported for the year ended Dec. 31, 2011. Financial statements may be obtained by contacting the Commission at P.O. Box 12428, Austin, Texas 78711.

State Agency Council is a legally separate organization established to assist the Governor's Commission for Women (Commission) by honoring women who have made significant contributions to Texas through their work in state government. The board of directors is appointed by the director of the Commission. The director of the Commission is required to sign all contracts and has check signing privileges. Expenses exceeding $500 require the Commission director's signature. Financial statements for the State Agency Council may be obtained by contacting the Commission at P.O. Box 12428, Austin, Texas 78711.

Film Texas Fund is a legally separate nonprofit organization created to support, encourage and promote the development of the film, television and multimedia industry in Texas. The Film Texas Fund is closely related to the Office of the Governor Texas Film Commission (Commission). However, the Commission is not financially accountable for the Film Texas Fund and the Film Texas Fund supports its own mission in promoting the film industry in Texas. Due to the Film Texas Fund's close relationship with the Commission, omitting the Film Texas Fund would result in misleading financial statements. The Film Texas Fund is reported for the year ended Dec. 31, 2011. Financial statements for the Film Texas Fund may be obtained by contacting the Office of the Governor at P.O. Box 13246, Austin, Texas 78711.

Casa Verde Research Center, Sociedad Anonimo (Casa Verde) is a legally separate organization established in Costa Rica to provide research opportunities for students and faculty of Texas A&M University. Casa Verde also provides services to outside organizations, such as study abroad programs to corporations and research and education opportunities for Costa Rican universities. The board of Casa Verde is appointed by executive management of Texas A&M University. The executive management can also remove board members at will and modify the budget of Casa Verde. Casa Verde is reported for the year ended Sept. 30, 2011. Separate financial statements may be obtained by contacting Texas A&M University, External Reporting, at 750 Agronomy Rd., Suite 3101 GSC, 6000 TAMU, College Station, Texas 77843-6000.

Representacion de TAMU en la Republica Mexicana, A.C. (Mexico Center) is a legally separate organization established in Mexico City, Mexico, to serve as a central point of contact for the support and promotion of Texas A&M University's international education, research and outreach activities. In addition, the

Mexico Center provides services outside of Texas A&M University, such as to Mexican government entities. The executive management of Texas A&M University appoints the voting majority of the board of the Mexico Center. It can also remove board members at will and approve and modify the Mexico Center's budget. The Mexico Center is reported for the year ended Dec. 31, 2011. Separate financial statements may be obtained by contacting Texas A&M University, External Reporting, at 750 Agronomy Rd., Suite 3101 GSC, 6000 TAMU, College Station, Texas 77843-6000.

National Biosecurity Foundation (Foundation) is a legally separate nonprofit corporation established to develop national, regional and local biosecurity countermeasures against unconventional weapons, including biological, chemical and radioactive weapons, and communicable diseases applicable to both military and civilian populations. The board consists of initially three directors, originally appointed by the deputy general counsel of the Texas A&M University System (A&M). Additional directors may be elected by a majority of the existing directors of the Foundation. A&M can modify or approve the budget of the Foundation, as well as veto, overrule or modify the decisions of the Foundation's board. The Foundation was dissolved at the end of fiscal 2012. Separate financial statements may be obtained by contacting Texas A&M University System, Office of Budgets and Accounting, 301 Tarrow, Suite 350, College Station, Texas 77840-7896.

Texas 4-H Inc. is a legally separate nonprofit organization established to prepare the youth of Texas to meet the challenges of childhood, adolescence and adulthood through a coordinated, long-term, progressive series of educational experiences that enhance life skills and develop social, emotional, physical and cognitive competencies. Texas 4-H Inc. serves as the central organization for the subordinate organizations and affiliate organizations that comprise the 4-H program in Texas. Texas A&M AgriLife Extension Service is responsible for the Texas 4-H programs. Although the state of Texas is not financially accountable for Texas 4-H Inc., Texas 4-H Inc. is closely related to the Texas A&M System. Failure to include the financial information of Texas 4-H Inc. would result in misleading financial statements. Separate financial statements may be obtained by contacting Texas A&M University System, Office of Budgets and Accounting, 301 Tarrow, Suite 350, College Station, Texas 77840-7896.

Related Organizations

Related organizations are legally separate, fiscally independent entities for which the state appoints a voting majority of the board, but 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 due to the impairment or insolvency of the member insurer that issued the policies or contracts. TDI's commissioner appoints the Association's nine-member board of directors.

Texas Title Insurance Guaranty Association was created for the purpose of providing funds for the protection of holders of "covered claims," as defined in 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) 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. The governor, with the advice and consent of the Senate, appoints five of the nine members of Texas Mutual's board of directors.

Midwestern State University Charitable Trust (Trust) is a nonprofit organization with the sole purpose of educational and other activities of Midwestern State University. It is governed by a board of trustees of no less than three members. This board appoints individuals to fill vacancies on the board as they occur with the approval of the Midwestern State University board of regents, which is appointed by the governor. The Trust's board of trustees serves under the direction of the board of regents, which has the power by majority vote to appoint or remove any or all of the trustees.

Charter School Finance Corporation is a nonprofit organization with the sole purpose of issuing revenue bonds for authorized open-enrollment charter schools for the acquisition, construction, repair or renovation of education facilities at those schools. The Texas Public Finance Authority appoints the board of directors in consultation with the commissioner of the Texas Education Agency.

Texas State University System Foundation Inc. (Foundation) is a nonprofit corporation with the purpose of providing financial support for the universities and colleges within the Texas State University System. The Foundation provides funds for student scholarships and faculty awards and assists the chancellor in performing his/her duties. The board of directors is comprised of all members of the Texas State University System board of regents, which is appointed by the governor.

Texas Farm and Ranch Lands Conservation Council was established to advise and assist the commissioner of the General Land Office with the administration of the Texas Farm and Ranch Lands Conservation Program and to select applicants to receive grants under the program. The governor appoints the members of the council.

Operation Game Thief Committee was established to administer the operation game thief program. The program facilitates the apprehension and prosecution of persons who violate Texas laws intended to protect the state's natural or cultural resources and the public safety of persons using those natural or cultural resources. The program also pays rewards and death benefits authorized by Texas statute. The Texas Parks and Wildlife Department's executive director appoints the members of the committee.

Parks and Wildlife Foundation (Foundation) is a legally separate nonprofit organization established to manage and conserve the natural and cultural resources of Texas. The Foundation provides private support to the Texas Parks and Wildlife Department (Department), but the Department is not financially accountable to the Foundation, nor is the Foundation fiscally dependent on the Department. The Foundation is governed by a group of trustees, the majority of whom are appointed by the chairman of the Department.

River Authorities are political subdivisions 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 for irrigation, power and all other useful purposes of storm waters, flood waters and the waters of rivers and streams; the reclamation and irrigation of arid, semiarid and other lands needing irrigation; the reclamation of drainage of overflowed lands and other lands needing drainage; the conservation and development of forests, water and hydro-electric power; the navigation of inland and coastal waters; and the preservation and conservation of all such natural resources of the state. The state of Texas appoints the voting majority for the following 16 river/water authorities:

- Angelina and 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
- San Jacinto River Authority
- Sulphur River Basin Authority
- Trinity River Authority
- Upper Colorado River Authority
- Upper Guadalupe River Authority
- Upper Neches Municipal Water Authority

NOTE 20

Deficit Fund Balances/Net Position

Proprietary Funds

The **Texas Prepaid Tuition Plans**, a nonmajor enterprise fund, reported a deficit of $620.8 million. The deficit is due to the difference between the present value of actual and projected contract benefit payments and of actual and projected contributions from account holders and investment earnings on those contributions to the Texas Guaranteed Tuition Plan (Plan). The Plan was closed to new enrollment in 2003 when tuition was deregulated. Over the life of the Plan, actual tuition and required fees for Texas public four-year colleges and universities grew at a higher percentage rate than the Plan's investment return.

Discretely Presented Component Units

The Texas Low-Level Radioactive Waste Disposal Compact Commission, a discrete component unit, reported a deficit of $116.4 thousand. The deficit is due to the fund having no assets or program revenues to offset the operating expenditures.

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 settling 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 court-ordered annual payment amounts are subject to adjustments based on the tobacco companies' domestic cigarette sales, the general consumer inflation rate, the profitability of the tobacco companies and any other court-ordered factors. A revenue accrual of $312.5 million is based on the payments received in December 2012. Tobacco settlement revenues were $474.7 million in fiscal 2011 and $484 million in fiscal 2012. Cumulative actual tobacco settlement revenues as of fiscal 2012 were $7.6 billion.

NOTE 22

Donor-Restricted Endowments

The state of Texas has donor-restricted endowments with net appreciation of $2.1 billion on investments available for authorization for expenditure by the governing board. Details for the amounts of the net appreciation on investments and how they are reported can be found in the "Donor-Restricted Endowments" table. 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 are 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 required to be retained in perpetuity.

Donor-Restricted Endowments

(Amounts in Thousands)

Donor-Restricted Endowments	Amount of Net Appreciation	Reported in Net Position
True Endowments	$ 2,034,786	Expendable
Term Endowments	35,340	Expendable
	$ 2,070,126	

The majority of the state's endowments are the results of donations made to institutions of higher education. The Uniform Prudent Management of Institutional Funds Act, Texas Property Code, Chapter 163, provides general guidelines on how endowments should be maintained. An institution may appropriate for expenditures or accumulate as much as the institution determines prudent for the uses, benefits, purposes and duration of the endowment. Each institution sets the amounts and/or percentage of net appreciation on endowment investments that are authorized for expenditure in its spending plan.

NOTE 23

Extraordinary and Special Items

The state did not report extraordinary items in the current fiscal year. Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence.

The state did not report special items in the current fiscal year. Special items are significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.

NOTE 24

Taxes Receivable and Tax Refunds Payable

Taxes receivable and tax refunds payable, as reported in the general fund on the balance sheet – governmental funds, are detailed by tax type in the following tables.

Taxes Receivable by Tax Type

August 31, 2012 (Amounts in Thousands)

Tax Type	Taxes Receivable
Sales and Use Tax	$ 1,550,483
Motor Vehicle and Manufactured Housing	133,374
Motor Fuels	7,256
Oil and Natural Gas Production	633,027
Franchise	233,843
Insurance Occupation	200,287
Cigarette and Tobacco	19,736
Other	160,654
Total Taxes Receivable*	$ 2,938,660
Liquidity Characteristics:	
Current Taxes Receivable	$ 2,802,208
Noncurrent Taxes Receivable	136,452
Total Taxes Receivable	$ 2,938,660

* Total Taxes Receivable General Fund	$ 2,938,660
Motor Fuel Taxes Receivable in Other Govermental Funds:	
State Highway Fund	218,717
Nonmajor Governmental Funds	73,135
Total Taxes Receivable – Balance Sheet – Governmental Funds	$ 3,230,512

Tax Refunds Payable by Tax Type

August 31, 2012 (Amounts in Thousands)

Tax Type	Tax Refunds Payable
Franchise	$ 453,256
Oil and Natural Gas Production	272,221
Total Tax Refunds Payable	$ 725,477

Texas franchise tax receivables represent balances due at Aug. 31, 2012, for business activity that occurred in calendar year 2011. The franchise tax payments were due May 15, 2012; however, taxpayers were allowed to extend the filing date to November 2012.

Franchise taxes are considered earned when the underlying business activity occurs. There are no required estimated payments under this tax. Tax payments are due annually each May 15. The tax earned during the first eight months of calendar year 2012 is not due until May 2013. As a result, the taxes receivable and related revenue that are earned in this eight month period are not measurable and are not accrued at fiscal year-end.

NOTE 25

Termination Benefits

Health Care Related Termination Benefits

Health care continuation under the Consolidated Omnibus Budget Reconciliation Act (COBRA) is provided for both voluntary and involuntary terminations. COBRA members are allowed to remain in their eligible insurance program for 18 months, or 29 months if disabled. Covered dependents are eligible to remain in the program for 36 months. COBRA plan administrators for the state include the Employees Retirement System of Texas, the University of Texas System and the Texas A&M University System.

As part of the American Recovery and Reinvestment Act (ARRA), employees involuntarily terminated between Sept. 1, 2008, and May 31, 2010, are eligible for a 65 percent subsidy of COBRA premiums for up to a 15 month period. The administrators of the COBRA premium assistance program recover the subsidy as a credit on their quarterly employment tax return.

For self-insured and fully-insured plans, the insurance carrier performs the billing and collections process for COBRA participants. If the plan is self-insured, the insurance carrier then forwards the premium to the plan administrators, net of a 2 percent administrative fee, which is intended to cover costs related to the billing and collection functions. The plan administrators are responsible for any claims or administrative costs associated with COBRA participants that exceed these payments. For fiscal 2012, the cost to the state was approximately $31.8 million for 4,647 COBRA participants.

For the fully-insured health maintenance organization health insurance plans, the insurance carrier retains all premiums and is liable for all claims and expenses. Premium and expense information is not available for these plans.

Non-Health Care Related Termination Benefits

There were no material non-health care related voluntary or involuntary termination benefits accepted in fiscal 2012.

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 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 required these homes' revenues, expenses, gains and losses, assets and liabilities to be separately accounted for and independently audited. Pursuant to the board exercising an option redemption provision, the entire $21.8 million principal amount outstanding of the Veteran's Homes revenue bonds were redeemed on Aug. 1, 2012, resulting in a zero balance at fiscal year-end. Therefore, the condensed financial statements are not required or presented.