

VIRGINIA RETIREMENT SYSTEM



Comprehensive Annual Financial Report

FOR THE YEAR ENDED JUNE 30, 2005



AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

Virginia Retirement System
Fiscal Year 2005
Financial and Statistical Highlights – All Pension Trust Funds

(Dollars in Thousands)

	2005	2004	% Change
For the Year			
Contributions	\$ 1,468,261	\$ 1,185,155	23.9%
Investment Income (Net of investment expenses)	\$ 4,601,463	\$ 5,937,777	-22.5%
Retirement Benefits	\$ 1,945,471	\$ 1,760,992	10.5%
Refunds	\$ 84,731	\$ 84,966	-0.3%
Administrative Expenses (Net of misc. income)	\$ 18,706	\$ 18,645	0.3%
Increase in Net Assets Held in Trust for Pension Benefits	\$ 4,020,816	\$ 5,258,329	-23.5%
Retirement Benefits as a percentage of contributions	132.5%	148.6%	
Retirement Benefits as a percentage of contributions and investment income	32.1%	24.7%	
At Fiscal Year End			
Net Assets Held in Trust for Pension Benefits - VRS	\$ 41,640,481	\$ 37,784,408	10.2%
Net Assets Held in Trust for Pension Benefits - SPORS	\$ 529,844	\$ 485,743	9.1%
Net Assets Held in Trust for Pension Benefits - VaLORS	\$ 593,370	\$ 497,771	19.2%
Net Assets Held in Trust for Pension Benefits - JRS	\$ 296,197	\$ 271,154	9.2%
Investment Performance			
One-Year Return on Investments	12.00%	17.90%	
Three-Year Return on Investments	10.60%	3.80%	
Five-Year Return on Investments	3.00%	3.70%	
Participating Employers			
Counties/Cities/Towns	245	243	
Special Authorities	180	176	
School Boards	145	145	
State Agencies	228	234	
Total Employers	<u>798</u>	<u>798</u>	0.0%
Membership/Retirees			
Active Members	325,025	317,203	2.5%
Retired Members	119,360	113,717	5.0%

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Virginia Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Nancy L. Ziehl

President

Jeffrey R. Emer

Executive Director

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Public Pension Coordinating Council
**Public Pension Standards
2004 Award**

Presented to

Virginia Retirement System

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script, reading 'Alan H. Winkle'.

Alan H. Winkle
Program Administrator

INTRODUCTORY SECTION



VRS: SERVING THE PEOPLE WHO SERVE VIRGINIANS

Every day, Virginians rely upon the high quality services provided by public employees working in our communities all across the state.

Building safe bridges, teaching the next generation of Virginians and keeping neighborhoods secure play a vital role in the quality of Virginians' lives, and those who choose public service as a career derive satisfaction from that honorable purpose.

In return, the Virginia Retirement System can help public employees achieve a financially secure retirement.

We at VRS are proud to dedicate our *Comprehensive Annual Financial Report for Fiscal Year 2005* to the experienced, knowledgeable and devoted men and women who serve Virginians.



CHAIRMAN'S LETTER



Paul W. Timmreck, Chairman
Robert P. Schultze, Director
Charles W. Grant, CFA, Chief Investment Officer

P.O. Box 2500, 1200 East Main Street
Richmond, Virginia 23218-2500
Telephone: (804) 649-8059; TDD: (804) 344-3190

November 15, 2005

The Honorable Mark R. Warner
Governor of Virginia
Members of the General Assembly

I am pleased to announce that the Virginia Retirement System (VRS) fund returned 12 percent for fiscal year 2005, ending with assets totaling \$44 billion. VRS is now the 27th largest public or private pension system in the United States and the 48th largest internationally.

Each of the fund's asset classes earned a positive return for the fiscal year. Real estate led the way posting a 24.4 percent return, closely followed by private equity at 21.5 percent. The public equity portfolio experienced a 12.3 percent return, and the hedge fund portfolio had a 9.0 percent return. Credit strategies returned 7.6 percent, and fixed income returned 7.2 percent.

In FY 2005, Cost Effectiveness Measurement, Inc., which provides research and assessment of national and international public pension systems, reported VRS' total adjusted cost of administration to be \$40 per active member and annuitant. This compares to a peer median of \$68. We believe VRS delivers services more efficiently than most public retirement systems.

We were very fortunate to welcome new leadership to VRS and the Board of Trustees, with the selection of Robert P. Schultze as VRS Director and Charles W. Grant as Chief Investment Officer, as well as the appointment of Dr. J. Alfred Broadus, Jr. and Palmer P. Garson to the Board. The Commonwealth can be confident that public employees and retirees of Virginia are being well served by these experienced, knowledgeable and innovative leaders.

Among the activities of the fiscal year was the Board's reevaluation of agency governance in conjunction with recommendations by the Joint Legislative Audit and Review Commission (JLARC). To protect against the potential for conflicts of interest and imprudent behavior, the Board approved a bylaw revision that any member of the Board or the Investment Advisory Committee (IAC) is ineligible for employment at VRS until five years after termination from either the Board or the IAC. In addition, the Board enacted new policy that determines severance pay for VRS employees in accordance with the Commonwealth's Workforce Transition Act, as provided for all state employees.

Our mission to provide financial security for our members and retirees depends on positive and prudent investment management, cost-effective administration, innovations in customer service and, above all, the Board's commitment to its fiduciary duties. The investment and administrative achievements of FY 2005, combined with the Board's actions to strengthen agency governance, will sustain our ability to fulfill that mission.

On behalf of the Board of Trustees and the VRS staff, I would like to express our gratitude to you for your continued support and leadership.

A handwritten signature in cursive script that reads 'Paul W. Timmreck'.

Paul W. Timmreck
Chairman
Virginia Retirement System

VRS BOARD OF TRUSTEES

COMPOSITION OF THE BOARD

Nine members serve on the VRS Board of Trustees. Their appointment is shared between the executive and legislative branches of state government.

The Governor appoints five members, including the chairman. The Joint Rules Committee of the Virginia General Assembly appoints four members. The General Assembly confirms all appointments.

Of the nine Board members, four must be investment experts; one must be experienced in employee benefit plans; one must be a local government employee; one must be an employee of a Virginia public institution of higher education; one must be a state employee; and one must be a public school teacher. The public employee members may be either active or retired.



Paul W. Timmreck, Chair
Virginia Commonwealth University



John M. Albertine
Albertine Enterprises



J. Alfred Broaddus, Jr., Ph.D.
Federal Reserve Bank of Richmond (Retired)



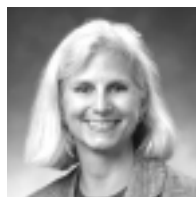
Edwin T. Burton III, Ph.D.
University of Virginia



J. Douglas Conway, Jr.
Henrico County Division of Fire



Judith Ewell, Ph.D.
College of William and Mary (Retired)



Palmer P. Garson
Jefferson Capital Partners



Vernard W. Henley
Consolidated Bank (Retired)



Raymond B. Wallace, Jr.
Henrico County Public Schools (Retired)

VRS ORGANIZATION



VRS INVESTMENT ADVISORY COMMITTEE



Left to right: Alice W. Handy, Dr. Katrina F. Sherrerd, Joe Grills, Deborah Allen-Hewitt, Erwin H. Will, Jr., Stuart A. Sachs and Christopher J. Brightman. *Not pictured:* Donald W. Lindsey and Rod Smyth.

Joe Grills, Chair

Former Chief Investment Officer, IBM Retirement Funds

Christopher J. Brightman

Chief Executive Officer, University of Virginia Investment Management Company

Alice W. Handy

President, Investiture

Deborah Allen-Hewitt

President, Rutledge Research

Donald W. Lindsey

Chief Investment Officer, The George Washington University

Dr. Katrina F. Sherrerd

Senior Vice President, Educational Products, Association for Investment Management and Research

Stuart A. Sachs

President (Retired), Sovran Capital Management

Rod Smyth

Chief Investment Strategist, Wachovia Securities LLC

Erwin H. Will, Jr.

Chief Investment Officer (Retired), VRS; President (Retired), Capitoline Investment Services

VRS ADMINISTRATIVE EXECUTIVE TEAM



Left to right: Donna M. Shumate, Donna M. Blatecky, Robert P. Schultze, Barry C. Faison, Jeanne L. Chenault and Franklin O. Berry. *Not pictured:* LaShaunda B. King and Marion W. Price.

Robert P. Schultze

Director

Franklin O. Berry

Internal Audit Director

Donna M. Blatecky

Deputy Director, Customer Relationships Division

Jeanne L. Chenault

Director of Public Relations

Barry C. Faison

Chief Financial Officer

LaShaunda B. King

Executive Assistant

Marion W. Price

Acting Chief Technology and Security Officer

Donna M. Shumate

Chief Human Resources Officer

VRS INVESTMENT EXECUTIVE TEAM



Left to right: Steven C. Henderson, Steven P. Peterson, Stephen R. McClelland, Brian J. Wade, John T. Grier, Kenneth C. Howell, Charles W. Grant, Field H. Griffith and Larry D. Kicher.

Charles W. Grant, CFA
Chief Investment Officer

John T. Grier, CFA
Director of Internal Equity

Field H. Griffith, CFA
Director of Real Estate Investment

Steven C. Henderson, CFA
Director of Fixed Income

Kenneth C. Howell, CFA
Director of Global Equity

Larry D. Kicher, CFA
Chief Operations Officer

Stephen R. McClelland, CFA
Director of Credit Strategies

Steven P. Peterson, Ph.D.
Director of Research

Brian J. Wade
Director of Private Equity

PROFESSIONAL CONSULTANTS

Actuary

W. Michael Carter
Gabriel, Roeder, Smith & Company

Auditor

Walter J. Kucharski
Auditor of Public Accounts
Commonwealth of Virginia

Life Insurance Carrier

Joseph K. W. Chang
Minnesota Life Insurance Company

Master Custodian

Mellon Trust

Legal Counsel

Stephanie L. Hamlett
Brian J. Goodman
Office of the Attorney General
Commonwealth of Virginia
Virginia Sickness & Disability Program
Melissa D. Lamm
UnumProvident Corporation

LETTER OF TRANSMITTAL



Robert P. Schultze, *Director*
Barry C. Faison, *Chief Financial Officer*

P.O. Box 2500, 1200 East Main Street
 Richmond, Virginia 23218-2500
 Telephone: (804) 649-8059; TDD: (804) 344-3190

November 22, 2005

To the Members of the Board of Trustees:

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the Virginia Retirement System (the "System") for the fiscal year ended June 30, 2005.

The System administers benefits and services for more than 542,000 members, retirees and beneficiaries covered under VRS, the State Police Officers' Retirement System (SPORS), the Virginia Law Officers' Retirement System (VaLORS) and the Judicial Retirement System (JRS). Benefits include the traditional defined benefit plans; defined contribution plans; the Basic Group Life Insurance Program and the Optional Group Life Insurance Program for members and retirees; the retiree Health Insurance Credit Program; and the Virginia Sickness and Disability Program (VSDP) for state employees, which includes employer-paid long-term care coverage. Nearly 800 state agencies, school boards, political subdivisions and special authorities participate in VRS on behalf of their employees.

VRS' Comprehensive Annual Report for FY 2005 has been prepared in accordance with Section 51.1-1003 of the *Code of Virginia* (1950), as amended, and Section 4-9.00 of Chapter 951 of the 2005 Virginia Acts of Assembly, which requires every retirement system to publish an annual report. The report has been mailed to the Governor and the members of his Cabinet, the members of the Virginia General Assembly, VRS' participating employers and other interested parties. It also is available on the VRS Web site at www.varetire.org.

The FY 2005 report consists of the following sections:

- **Introductory Section:** Letter from the Chairman of the VRS Board of Trustees; Letter of Transmittal; identification of the organization.
- **Financial Section:** Opinion of the Auditor of Public Accounts; Management's Discussion and Analysis; the financial statements; required supplementary data; additional financial information.
- **Investment Section:** Letter from the Chief Investment Officer; review of investment activity and performance for the fiscal year.
- **Actuarial Section:** Certification letter of the independent consulting actuary, Gabriel, Roeder, Smith & Company; summary of the results of the most recent actuarial valuations; plan summary.
- **Statistical Section:** Significant data pertaining to the System; list of participating employers; information on other programs.

VRS MILESTONES

1908	Retired Teachers Fund created.
1942	VRS created for teachers and state employees.
1944	Political subdivisions have the option to join VRS.
1950	SPORS created.
1960	Group life insurance established.
1970	COLA established. JRS created.
1989	Health insurance credit for state retirees established.
1992	Health insurance credit for retired teachers and political subdivision retirees established.
1995	Optional group life insurance program established.
1999	Virginia Sickness and Disability Program (VSDP) for state employees established. VaLORS created.
2002	Long-term care benefit added to VSDP.

Accounting System and Internal Control

The financial statements included in the CAFR for FY 2005 are the responsibility of the System's management and have been prepared in accordance with generally accepted accounting principles (GAAP) for governmental accounting and reporting under the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

The accrual basis of accounting is used in the preparation of the financial statements. Revenues are taken into account when they are earned and become measurable; expenses are recorded when the liabilities are incurred. Investments are reported at fair value as determined by the System's master custodian. Capital assets are recorded at cost and depreciated over their estimated useful life. Contributions to the System are based on the principle of level cost funding and are developed using the entry age normal cost method with current service financed on a current basis and prior service amortized within a period of 30 years or less. In management's opinion, the financial statements fairly present the plan net assets of the System at June 30, 2005 and the changes in its plan net assets for the period then ended.

GASB Statement Number 34 requires the System to include additional information in the CAFR. This additional information is provided in Management's Discussion and Analysis (MD&A) and includes a narrative introduction and an overview and analysis of the System's financial activities for the current fiscal year and the two preceding years. The Letter of Transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditor in the Financial Section.

The System's management also is responsible for maintaining a system of adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with GAAP. The internal control system includes the organization plan; the appropriate segregation of duties and responsibilities and sound practices in the performance of duties; and personnel with capabilities commensurate with their responsibilities.

There is an internal audit program that reports to the Audit Committee of the Board of Trustees, and the budget for the System's administrative expenses is approved by the Board and appropriated by the General Assembly of Virginia. In addition, the retirement funds held by the System are constitutionally established as independent trust funds dedicated to the exclusive benefit of its members, retirees and beneficiaries. In management's opinion, the internal controls in effect during the fiscal year ended June 30, 2005 adequately safeguard the System's assets and provide reasonable assurance regarding the proper recording of financial transactions.

Legislative Initiatives

The Virginia General Assembly enacted several bills during the 2005 session that affect benefits for Virginia public employees and retirees:

Group Life Insurance

- *House Bill 1651* changed the maximum limits for optional life insurance and the timeframe for review of the maximum limits by the VRS Board of Trustees.

Health Insurance Credit

- *House Bill 1925* requires constitutional officers to have at least 15 years of service as a constitutional officer in order to qualify for the health insurance credit. This legislation codified budget language from the 2004 General Assembly session.
 - *House Bill 1926* clarified that members of the Optional Retirement Plan who are covered under a long-term disability program are entitled to the maximum health insurance credit.
-

- *House Bill 2765* included retired general registrars and their retired employees with at least 15 years of creditable service as eligible to receive a health insurance credit.

Mandatory Retirement Payments

- *Senate Bill 785* conformed state statutes to federal regulations regarding mandatory payments of retirement benefits at age 70 years and six months for members no longer working in a VRS-covered position.

Optional Retirement Plan

- *House Bill 1927* clarified that the service retirement benefit will cease upon the reemployment of the member in a position covered under any VRS Optional Retirement Plan.

Year in Review FY 2005

VRS Members

- Of the more than 325,000 active public employees covered under VRS, 34 percent are under age 40 and 66 percent are age 40 and older. Between now and 2010, approximately 40,000 current VRS members, or 12.3 percent of the total membership, will be eligible to retire with an unreduced benefit.
- Active VRS-covered members increased from 317,203 to 325,025, a 2.5 percent increase over FY 2004.
- Retirees increased from 113,717 to 119,360, a 5.0 percent increase over FY 2004.
- In FY 2005, the VRS retiree payroll was \$1,945,500,000, compared to \$1,761,000,000 in FY 2004.

VRS Service

During FY 2005, VRS employees continued to provide superior customer service and administrative efficiency on behalf of members, retirees and employers:

- The Customer Contact Center received 181,888 calls in FY 2005.
- The agency processed 8,317 applications for service retirement, 6.1 percent more than in FY 2004.
- Approximately 4,900 members attended Group Counseling Sessions and Retirement Education Seminars in FY 2005.
- The total number of retirees receiving the health insurance credit rose from 66,039 to 70,076, a 6.1 percent increase over FY 2004.
- Participation in the Commonwealth of Virginia Deferred Compensation Plan increased from 38,296 to 42,002, a 9.7 percent increase over FY 2004.
- Seven new employers elected VRS coverage and four new employers elected special coverage for local law enforcement officers and firefighters in FY 2005. Three local employers added firefighters to their covered employees.

VRS Accomplishments

Customer Contact Center

During FY 2005, VRS personnel developed benchmarks of service and usage in the Customer Contact Center as the first step in addressing the abandon call rate, which is one of the top agency priorities for FY 2006. In support of this priority, the agency increased the Customer Contact Center staff and implemented a new online skills assessment tool for Customer Contact Center positions.

The development of a new Customer Information Management System (CIMS) also got under way during the fiscal year. CIMS is a Web-based customer service solution for the Customer Contact Center that will improve the efficiency of the agents by consolidating access to member and retiree information on one screen.

Employer Support

The Customer Contact Center created a new Employer Support Team in response to employer requests for knowledgeable individuals dedicated to providing information pertinent to their needs.

The addition of this team has not only enhanced service to employers but also allowed other agents to focus on the needs of members and retirees.

VRS also offered training for payroll officers in political subdivisions and school boards as well as training for new benefits administrators during FY 2005. Enhancements to employer training information on the VRS Web site, including a more efficient Web-based registration method and posting course materials for preview by training participants, supported this effort.

Online Service Enhancements

In FY 2005, VRS established the foundation to enhance customer self-service for members. The first phase will be launched for FY 2006. Projects included developing benchmarks from other public pension systems regarding their online service capabilities and experiences; researching and acquiring technologies and software to support the demand for and security of online services; and establishing functional level security with regard to employer contacts to ensure that their access to secure member data is appropriate to the type of position they hold and their need for data.

Communications

VRS published new handbooks for members of the State Police Officers' Retirement System (SPORS) and the Virginia Law Officers' Retirement System (VaLORS) as well as a new handbook for participants in the Optional Retirement Plans for Political Appointees and School Superintendents in FY 2005.

Members, retirees and employers also continued to rely on the VRS Web site for important updates, news and benefit plan information as well as a convenient source for publications and forms. There were more than 700,000 total visits to the Web site in FY 2005 compared to approximately 620,000 in FY 2004. The average number of visits per day was 1,936. In addition, QuickAccess, the secure area of the Web site which employers can use to assist their employees, received more than 181,000 visits.

Partnerships

Thanks to the collaboration of other organizations, VRS was able to undertake several key customer service projects during the fiscal year.

VRS and Minnesota Life, the third-party administrator for the group life insurance program, collaborated to transfer optional life premium billing and reconciliation activities to Minnesota Life. This means that instead of communicating members' optional life coverage information through VRS, employers can communicate it directly to Minnesota Life, thus increasing the accuracy and efficiency of program administration.

A multidisciplinary team of staff from VRS and the Virginia Department of the Treasury implemented a new "lost member" capability on the VRS and Treasury Web sites. This innovation enhances VRS' efforts to find deferred members who still have funds or service credit with VRS but whom VRS cannot locate because they have not updated their addresses.

A partnership between the Virginia Sickness and Disability Program (VSDP), the Department of Human Resource Management, the Office of Workers' Compensation and UnumProvident, the third-party administrator for VSDP, led to a new return-to-work initiative for VSDP-participating members with work-related and non-work related disabilities. This initiative encourages employers to develop return-to-work and rehabilitation plans for their employees. As a part of the partnership, the Governor signed an executive order emphasizing the Commonwealth's priority to return state employees to productive employment from work-related and non-work related disabilities.

Technology Support

VRS made a number of enhancements during the fiscal year to automate and enhance database administration and management for the investment division. These enhancements have led to more accurate and better access to investment information and data.

During FY 2005, the agency also met its 99 percent system availability standard. Technology accomplishments included implementing a new Anti-Spam System and moving the servers supporting the VRS Web site from the Virginia Information Technologies Agency to VRS' investment and administrative buildings. This move has resulted in decreased costs and more efficient server maintenance, as well as reduced the vulnerability of the Web site in the event of a disaster.

Fiduciary Responsibility

The VRS Board of Trustees (the "Board") has full power to invest and reinvest the trust funds of the System. To fulfill its responsibility, the Board has adopted various investment policies and guidelines. The Board's investment objective for the VRS portfolio is to maximize long-term investment returns while targeting an acceptable level of risk. Primary risk measures are volatility in the plan's assets, funded status and contribution rates. As set forth in Section 11 of Article X of the Constitution of Virginia, the funds of the retirement system shall be deemed separate and independent trust funds; shall be segregated from all other funds of the Commonwealth; and shall be invested and administered solely in the interests of the members and beneficiaries thereof. The Board retains a professional investment staff, as well as outside managers, to advise and assist in the implementation of these policies and objectives.

The assets of the System are invested in a prudent manner that is intended to provide for the anticipated growth of VRS' pension liability. Section 51.1-124.30(C) of the *Code of Virginia* states that "... the Board shall invest the assets of the Retirement System with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims." Accordingly, the Board must sufficiently diversify the portfolio to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Virginia Retirement System for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2004. This was the 23rd consecutive year that VRS achieved this prestigious recognition. To be awarded the certificate, a government unit must publish an easily readable and efficiently organized comprehensive annual report. This report must satisfy both generally accepted accounting principles and applicable legal requirements. The certificate is valid for a period of one year only. The VRS Comprehensive Annual Financial Report for FY 2005 continues to conform to the Certificate of Achievement Program requirements, and it will be submitted to GFOA to determine its eligibility for another certificate.

Achievement Award from the Public Pension Coordinating Council

VRS received the Achievement Award from the Public Pension Coordinating Council (PPCC) in recognition of the agency's excellence in meeting the Public Pension Standards. Developed by PPCC, these standards are the benchmark for measuring excellence in defined benefit plan administration. The purpose of the award is to promote high professional standards for public employee retirement systems and publicly commend systems that adhere to these standards. The PPCC is a coalition of the National Association of State Retirement Administrators (NASRA), the National Council on Teacher Retirement (NCTR) and the National Conference on Public Employee Retirement Systems (NCPERS).

Leadership Award from the National Association of Government Defined Contribution Administrators

The National Association of Government Defined Contribution Administrators (NAGDCA) recognized VRS for its Regional Enrollment and Education Meetings (REEMs) program. REEMs provides eligible members around the state with opportunities to learn more about and enroll in the Commonwealth of Virginia Deferred Compensation Plan. The program includes information about account management and the importance of asset allocation.

Acknowledgements

The mission of the Virginia Retirement System calls upon us to provide the best service possible and to be responsible stewards of the funds in our care on behalf of VRS members, retirees and beneficiaries. This report provides complete and reliable information that supports management's decisions in carrying out that mission.

Responsible stewardship, however, is more than sound management. It also encompasses the outstanding commitment of VRS staff to excellence and the support of VRS' affiliated employers and partners as well as the guidance and dedication of the Board of Trustees. We would like to express our sincere thanks and appreciation to each of these exceptional individuals and representatives.

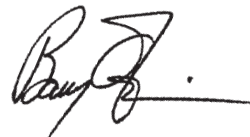
Finally, we wish to thank Governor Mark R. Warner and the members of the Virginia General Assembly for their continued commitment to the financial security of the employees and retirees of the Virginia Retirement System.

Respectfully submitted,



Robert P. Schultze

Director



Barry C. Faison

Chief Financial Officer

FINANCIAL SECTION



Approximately 78,000 state employees provide services in areas as diverse as health and veterinary services, finance, corrections, emergency management, higher education, community development and transportation.

VRS, however, is not just for state employees. Teachers are the largest group with approximately 139,000 active members. VRS' earliest forerunner is the Retired Teachers Fund established in 1908. It was not until 1942 that VRS was created for state employees as well as teachers.

ABOVE: Virginia Department of Transportation employees, families and friends gathered in September 2004 in memory of 124 VDOT workers who have died on the job since the 1930s. The distinctive granite monument, located in the second scenic overlook on Interstate-64 east of Afton Mountain, was made possible by donations from VDOT employees and retirees as well as businesses, organizations and individuals around the state. (Photo courtesy of VDOT.)

The first part of the paper discusses the importance of understanding the cultural context of the research. It highlights the need for researchers to be sensitive to the values and beliefs of the communities they are studying. This is particularly important in the field of education, where cultural differences can significantly impact learning outcomes.

The second part of the paper focuses on the methodology used in the study. It describes the process of selecting participants, collecting data, and analyzing the results. The authors emphasize the importance of using a mixed-methods approach to gain a comprehensive understanding of the research topic.

The third part of the paper presents the findings of the study. It discusses the results of the quantitative data analysis and the insights gained from the qualitative interviews. The authors conclude that there are significant differences in learning outcomes between the two groups, and these differences can be attributed to cultural factors.

The final part of the paper discusses the implications of the findings for future research and practice. It suggests that educators should be aware of the cultural context of their students and tailor their teaching strategies accordingly. The authors also recommend further research to explore the underlying reasons for the observed differences.



Commonwealth of Virginia

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Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

October 28, 2005

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
And Review Commission

Board of Trustees
Virginia Retirement System

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of Virginia Retirement System as of and for the years ended June 30, 2005 and 2004, as listed in the Table of Contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the basic financial statements of the Virginia Retirement System are intended to present the financial position and the changes in financial position of only that portion of the aggregate remaining fund information of the Commonwealth of Virginia that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the Commonwealth of Virginia's overall financial position as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Virginia Retirement System as of June 30, 2005 and 2004, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis, funding progress, employer contributions, and actuarial methods and significant assumptions on pages 20 through 25 and 48 through 50 are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated October 28, 2005 on our consideration of the Virginia Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

AUDITOR OF PUBLIC ACCOUNTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents Management's Discussion and Analysis of the financial statements of the Virginia Retirement System (the "System") and the significant events and conditions that affected the operations and performance of the System for the year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with the information provided in the Letter of Transmittal.

The System is responsible for administering four defined benefit retirement plans, which are defined as pension trust funds: the Virginia Retirement System (VRS) for state employees, teachers and public school board employees, employees of participating political subdivisions and other qualifying employees; the State Police Officers' Retirement System (SPORS) for state police officers; the Virginia Law Officers' Retirement System (VaLORS) for state law enforcement and correctional officers other than state police officers; and the Judicial Retirement System (JRS) for judges of state courts of record, state district courts and other qualifying employees. The System also administers a Group Life Insurance Fund, a Retiree Health Insurance Credit Fund and a Disability Insurance Trust Fund. These plans are defined as other employee benefit trust funds. The pension and other employee benefit trust funds are classified as fiduciary funds.

Financial Highlights

- The combined total net assets held in trust for benefits of the pension trust funds increased by \$4,020.8 million, or 10.3%, during the fiscal year ended June 30, 2005. The increase was due to continued strong investment returns; however, these were partially offset by the increased expense for benefit payments as a percentage of contributions.
- The System's rate of return on investments during the fiscal year ended June 30, 2005 was 12.0% compared with a return of 17.9% for the fiscal year ended June 30, 2004. The decrease is primarily due to a decline in the returns on public equity investments.
- The VRS, SPORS, VaLORS and JRS plans were actuarially funded at 90.3%, 77.8%, 54.9% and 78.0% based on the actuarial valuation as of June 30, 2004. For the VRS, SPORS and JRS plans, this was a decline from their funded ratios of 96.4%, 82.6% and 81.0% based on the actuarial valuation as of June 30, 2003. For the VaLORS plan, there was a slight improvement from the June 30, 2003 funded ratio of 53.6%. All of the funded ratios continue to reflect the impact of the significant investment losses recorded in FY 2001 and FY 2002 on the Actuarial Value of Assets because of the "five-year smoothing" asset valuation method used by the VRS actuary.

Overview of the Financial Statements and Accompanying Information

1. **Fund Financial Statements.** The System presents the Statement of Plan Net Assets as of June 30, 2005 and 2004 and the Statement of Changes in Plan Net Assets for the years then ended. The statements were prepared on the accrual basis of accounting and are used to account for resources administered by VRS for the benefit of the plan members and beneficiaries. These statements are as follows:
 - Statement of Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Plans. This statement reflects the balance of the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal year.
 - Statement of Changes in Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Plans. This statement reflects the changes in the resources available to pay benefits to members, including retirees and beneficiaries, during the fiscal year.
2. **Notes to Financial Statements.** The Notes to Financial Statements are an integral part of the financial statements and contain additional detailed information and schedules to provide a better understanding of the financial statements.

3. **Required Supplementary Information.** The required supplementary information consists of two schedules and related notes. The required supplementary schedules are as follows:

- Required Supplemental Schedule of Funding Progress
- Required Supplemental Schedule of Employer Contributions
- Notes to Required Supplemental Schedules – Actuarial Methods and Significant Assumptions

4. **Other Supplementary Schedules.** Other schedules included in this section provide more detailed information not provided in the basic financial statements. The other supplementary schedules are as follows:

- Schedule of Administrative Expenses
- Schedule of Investment Expenses
- Schedule of Professional and Consulting Services

Plan Net Assets

(Expressed in Millions)

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Assets					
Cash, Receivables and Capital Assets	\$ 2,692.8	\$ 184.9	\$ 2,507.9	\$ 374.6	\$ 2,133.3
Investments	44,849.5	4,582.7	40,266.8	4,700.0	35,566.8
Security Lending Collateral	4,185.7	1,050.9	3,134.8	691.4	2,443.4
Total Assets	\$ 51,728.0	\$ 5,818.5	\$ 45,909.5	\$ 5,766.0	\$ 40,143.5
Liabilities					
Accounts Payable	\$ 244.1	\$ 2.4	\$ 241.7	\$ 17.7	\$ 224.0
Investment Purchases Payable	3,175.3	684.1	2,491.2	(281.8)	2,773.0
Obligations Under Security Lending	4,185.7	1,050.9	3,134.8	691.4	2,443.4
Total Liabilities	\$ 7,605.1	\$ 1,737.4	\$ 5,867.7	\$ 427.3	\$ 5,440.4
Total Net Assets	\$ 44,122.9	\$ 4,081.1	\$ 40,041.8	\$ 5,338.7	\$ 34,703.1

Change in Plan Net Assets

(Expressed in Millions)

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Additions					
Member Contributions	\$ 64.9	\$ (22.8)	\$ 87.7	\$ (41.5)	\$ 129.2
Member Contributions Paid by Employer	621.5	36.4	585.1	65.1	520.0
Employer Contributions	918.3	292.3	626.0	124.4	501.6
Net Investment Income	4,719.3	(1,382.0)	6,101.3	5,106.8	994.5
Total Additions	\$ 6,324.0	\$ (1,076.1)	\$ 7,400.1	\$ 5,254.8	\$ 2,145.3
Deductions					
Retirement Benefits	\$ 1,945.5	\$ 184.5	\$ 1,761.0	\$ 163.3	\$ 1,597.7
Refunds of Member Contributions	84.7	(0.3)	85.0	12.8	72.2
Insurance Premiums and Claims	97.1	(8.9)	106.0	1.7	104.3
Retiree Health Insurance Reimbursements	69.0	4.1	64.9	3.9	61.0
Long-Term Disability Benefits	25.8	2.0	23.8	7.0	16.8
Administrative and Other Expenses	20.8	0.1	20.7	2.0	18.7
Total Deductions	\$ 2,242.9	\$ 181.5	\$ 2,061.4	\$ 190.7	\$ 1,870.7
Net Increase (Decrease) in Net Assets	\$ 4,081.1	\$ (1,257.6)	\$ 5,338.7	\$ 5,064.1	\$ 274.6

Analysis of Financial Activities – Pension Plans

The System's funding objective is to meet its long-term benefit obligations through investment income and contributions. Accordingly, the collection of contributions and the income from investments provide the reserves needed to finance the benefits provided under the plans.

Membership

As discussed earlier, the System administers retirement plans for a variety of employee groups. The distribution of the active membership as of June 30, 2005, 2004 and 2003 is presented in Figure 1.

Figure 1.

Active Membership Distribution at June 30

	2005	2004	2003
State Employees (VRS)	78,158	76,911	76,161
Teachers (VRS)	139,209	135,130	132,656
Political Subdivision Employees (VRS)	95,658	93,436	91,340
State Police Officers (SPORS)	1,807	1,751	1,709
Virginia Law Officers (VaLORS)	9,779	9,573	9,538
Judges (JRS)	414	402	407
Total	325,025	317,203	311,811

Contributions and Investment Earnings

Pension trust fund revenue is used to finance the retirement benefits provided by the retirement plans. The primary sources of revenue for the retirement plans include contributions from both active members and employers as well as investment income generated from the investment of plan assets. Total contributions and investment earnings for the fiscal year ended June 30, 2005 amounted to \$6,069.7 million. This was a decrease of \$1,053.2 million when compared with FY 2004 and a decline from the increase of \$5,111.4 million that was recorded in FY 2003. This information is presented in Figure 2.

Figure 2.

Contributions and Investment Earnings for the Years Ended June 30

(Expressed in Millions)

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Member Contributions	\$ 64.8	\$ (22.8)	\$ 87.6	\$ (41.5)	\$ 129.1
Member Contributions Paid by Employer	621.5	36.4	585.1	65.1	520.0
Employer Contributions	781.9	269.5	512.4	119.7	392.7
Investment Income*	4,601.5	(1,336.3)	5,937.8	4,968.1	969.7
Total	\$ 6,069.7	\$ (1,053.2)	\$ 7,122.9	\$ 5,111.4	\$ 2,011.5

* Net of investment expenses, including net securities lending income and miscellaneous income.

Total member contributions, including those paid by employers, increased \$13.6 million, while employers' contributions increased \$269.5 million for a total increase in contributions of \$283.1 million from the previous fiscal year. Investment income also provided an increase to plan net assets in FY 2005. Member contributions decreased by \$22.8 million. This was caused mostly by a decline in activity among members purchasing previously refunded and other qualified service. Employer contributions increased due to an increase on July 1, 2004 in the employer contribution rates for most employers, based on the June 30, 2003 actuarial valuation. This is discussed further in Note 13 of the Notes to Financial Statements. During FY 2004, the System experienced growth in total member contributions of \$23.6 million and an increase in employer contributions of \$119.7 million. As in FY 2005, the member contributions were affected by the number of members purchasing service. The growth in the employer contributions is related to the reinstatement of contributions for state employees on July 1, 2004.

Investments

There was net investment income for FY 2005 of \$4,601.5 million, which represented a decrease of \$1,336.3 million from FY 2004 (Figure 2). This compares to a net investment income increase of \$4,968.1 million in FY 2004. Total pension trust fund investments increased to \$43,743.2 million at fair value at June 30, 2005. This was an increase of \$4,518.7 million over the fair value of \$39,224.5 million at June 30, 2004. The total pension trust fund assets also increased in FY 2004 by \$4,639.9 million from their fair value of \$34,584.6 million at June 30, 2003.

The total return on pension trust fund investments for the fiscal year ended June 30, 2005 was 12.0%. The annualized return was 10.6% over the past three years and 3.0% over the past five years. An explanation of investment policies and strategies and the portfolio's composition is included in the Investment Section of this CAFR. A review of investment activity and results for FY 2005 also is provided in that section.

The System's investment portfolio consists of funds contributed by both employers and employees of Virginia's state agencies, teachers, state police, other law enforcement officers and participating local governments. These contributions are held in a commingled pool and invested to provide for the payment of current and future benefits to participants when they retire. Each plan owns an equity position in the pool and receives a proportionate share of the total investment income or loss from the pool.

Expenses—Deductions from Plan Net Assets

The primary expenses of the pension trust funds include annuity benefits for retirees and beneficiaries; refunds of contributions to former members; and expenses associated with the administration of the retirement plans. Expenses for FY 2005 totaled \$2,048.9 million, an increase of \$184.3 million, or 9.9%, over the 2004 period. The details are presented in Figure 3.

Figure 3.

Primary Expenses for the Years Ended June 30

(Expressed in Millions)

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Benefits	\$ 1,945.5	\$ 184.5	\$ 1,761.0	\$ 163.3	\$ 1,597.7
Refunds	84.7	(0.3)	85.0	12.8	72.2
Administration and Other	18.7	0.1	18.6	1.9	16.7
Total	\$ 2,048.9	\$ 184.3	\$ 1,864.6	\$ 178.0	\$ 1,686.6

The increase in benefit payments to \$1,945.5 million in FY 2005 was due to continued growth in the number of retirees and beneficiaries receiving benefits combined with a cost-of-living adjustment (COLA) of 2.3% on July 1, 2004. The number of retirees and beneficiaries receiving benefit payments was approximately 119,360 at June 30, 2005, an increase of 5.0% from the 113,717 retirees and beneficiaries at June 30, 2004. The increase in benefit payments for FY 2005 was \$184.5 million compared to \$163.3 million for FY 2004.

Refunds of contributions to members who terminated employment during FY 2005 amounted to \$84.7 million (13,588 refunds), compared with \$85.0 million refunded (15,328 refunds) during FY 2004 and \$72.2 million refunded (13,148 refunds) during FY 2003. The change during FY 2005 reflects both a decline in the number of refunds and a higher average refund amount compared to FY 2004.

Administration and other expenses for FY 2005 were \$18.7 million, compared with \$18.6 million for FY 2004 and \$16.7 million for FY 2003. Administration expenses increased \$0.1 million for FY 2005. This compares to an increase in administration expenses in FY 2004 of \$1.9 million related to benefit costs, especially the resumption of the employer share of retirement, as well as other administrative costs.

Retirement Reserves

Funds are accumulated by the pension plans to meet current and future obligations to retirees and beneficiaries and are derived from the excess of revenues over expenses. The higher the level of funding, the larger the accumulation of assets and the greater the investment income potential.

Since revenues exceeded expenses for FY 2005, there was a net increase of \$4,020.8 million in the retirement reserves held by the plans. This compares to an increase of \$5,258.3 million in the retirement reserves in FY 2004. As noted above, the increase for FY 2005 was primarily related to the investment performance for the year, although it was not as significant as it was in FY 2004. During the fiscal year, the amount of interest credited to member accounts was \$265.6 million. The amount of member balances transferred to employer reserves upon members' retirements was \$382.5 million. The member and employer balances in retirement reserves at June 30, 2005 are presented in Figure 4.

Figure 4.

Reserve Balances at June 30

(Expressed in Millions)

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Member Reserves	\$ 7,398.8	\$ 490.4	\$ 6,908.4	\$ 505.1	\$ 6,403.3
Employer Reserves	35,661.0	3,530.4	32,130.6	4,753.2	27,377.4
Total	\$ 43,059.8	\$ 4,020.8	\$ 39,039.0	\$ 5,258.3	\$ 33,780.7

Actuarial Valuations and Funding Progress

The System's actuarial firm, Gabriel, Roeder, Smith & Company, performs actuarial valuations of VRS, SPORS, VaLORS and JRS at least every two years to determine funding requirements. The funding policy provides for periodic employer contributions at actuarially determined rates that will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the costs of all basic benefits when due.

The latest valuations of the four pension plans performed as of June 30, 2004 indicated that the ratio of assets accumulated by the plans to their total actuarial accrued liabilities for benefits was 90.3% for VRS, 77.8% for SPORS, 54.9% for VaLORS and 78.0% for JRS. The valuations reflect full prefunding of the statutory cost-of-living adjustment (COLA) for retirees. Funding progress for the pension plans is presented in the Required Supplemental Schedule of Funding Progress. Additional information on the plans' funding progress is presented in the Actuarial Section.

Analysis of Financial Activities—Other Employee Plans

Group and Optional Life Insurance Programs

The group life insurance program, enacted by the Virginia General Assembly on July 1, 1960, provides life insurance and accidental death and dismemberment coverage to the majority of members participating in the pension plans administered by the System as well as other qualifying employees. Group life insurance premiums are paid by covered employees and/or employers to fund the program. Approximately 340,251 employees and 112,346 retirees were covered by the group life insurance program at June 30, 2005.

During FY 2005, the System remitted \$97.0 million to the insurance company for claims and administrative costs. This is a decrease from the \$106.0 million remitted for FY 2004. The difference between the amounts collected and paid by the System for the group life insurance program is covered by the reserve established to prefund death benefits for retirees. This reserve had net assets held in trust for benefits of \$771.8 million at June 30, 2005 and had an investment income, including net

securities lending income, of \$91.5 million during the fiscal year. For FY 2004, this reserve had an investment income of \$133.7 million and ended the year with a reserve balance of \$778.5 million, up from the \$751.7 million at June 30, 2003. For FY 2005, the growth is the result of investment income. As was the case in FY 2004, there was a lack of contributions as a result of the continuing premium holiday declared by the General Assembly beginning in April 2002.

The optional life insurance program, enacted by the General Assembly on November 1, 1995, provides life insurance and accidental death and dismemberment coverage to employees covered under the group life insurance program as a supplement to that program. Employees also may cover their spouses and children under this program. Optional life insurance premiums are paid by the covered employees. There were approximately 56,267 employees participating in the program at June 30, 2005. This compares to approximately 51,613 employees participating in the program at June 30, 2004.

Retiree Health Insurance Credit Program

The retiree health insurance credit program was established by the General Assembly on January 1, 1990 to provide credits against health insurance premiums for eligible state retirees. Coverage under the program was extended to retired teachers and employees of participating political subdivisions on July 1, 1993. During FY 2005, the System collected \$82.0 million in retiree health insurance credit contributions from participating employers and provided reimbursements of \$69.0 million to 69,114 eligible retirees. During FY 2004, the System collected \$78.4 million in retiree health insurance credit contributions from participating employers and provided reimbursements of \$64.9 million to approximately 65,163 eligible retirees. The growth in contributions reflects general payroll increases and a contribution rate increase that went into effect July 1, 2004. The growth in retiree health insurance credits reflects the increase in the number of eligible retirees. The Retiree Health Insurance Credit Fund reserve had net assets held in trust for benefits of \$147.0 million at June 30, 2005 and had an investment income, including net securities lending income, of \$13.5 million during the fiscal year. The reserve balances at June 30, 2004 and June 30, 2003 were \$120.9 million and \$92.2 million, respectively.

Virginia Sickness and Disability Program

The Disability Insurance Trust Fund, also known as the Virginia Sickness and Disability Program (VSDP), was established by the General Assembly on January 1, 1999 and provides sick leave, family and personal leave and short-term and long-term disability benefits to eligible state employees. The System is responsible for the administration of the program and the payment of long-term disability benefits. Sick leave and short-term disability benefits are paid to eligible employees by their employers. During FY 2005, the System collected \$54.5 million in VSDP contributions from participating employers and provided long-term disability benefits of \$25.8 million to eligible employees. This is an increase over the \$35.2 million in contributions collected and \$23.8 million in benefits paid in FY 2004. Contribution increases reflect growth in covered payrolls and a contribution rate increase that went into effect July 1, 2004. The increase in benefits reflects growth in the number of employees receiving long-term disability benefits, the amount of these benefits and the operating costs of the program. The Disability Insurance Trust Fund reserve had net assets held in trust for benefits of \$144.2 million at June 30, 2005 and had an investment income, including net securities lending income, of \$12.7 million during the fiscal year. The reserve balances at June 30, 2004 and June 30, 2003 were \$103.3 million and \$78.4 million, respectively.

Request for Information

This financial report is designed to provide a general overview of the Virginia Retirement System's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Financial Officer of the Virginia Retirement System, P.O. Box 2500, Richmond, VA 23218-2500.

Virginia Retirement System Statement of Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds

As of June 30, 2005 and 2004

	Pension Trust Funds				Total Pension Trust Funds
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	
Assets					
Cash (Note 5)	\$ 60,703	\$ 710	\$ 793	\$ 396	\$ 62,602
Receivables:					
Contributions	116,879	819	2,853	762	121,313
Interest and dividends	141,059	1,790	1,999	1,000	145,848
Receivable for security transactions	2,188,656	27,772	31,016	15,509	2,262,953
Other receivables	6,595	60	67	34	6,756
Total receivables	2,453,189	30,441	35,935	17,305	2,536,870
Due from other funds	2,960	2,715	2,292	1,921	9,888
Investments (Note 5)					
Bonds and mortgage securities	9,039,399	114,700	128,098	64,056	9,346,253
Stocks	15,074,263	191,275	213,619	106,821	15,585,978
Fixed income commingled funds	1,500,682	19,042	21,266	10,634	1,551,624
Index and pooled funds	10,411,019	132,104	147,535	73,776	10,764,434
Real estate	1,158,623	14,702	16,419	8,210	1,197,954
Private equity	2,099,411	26,639	29,751	14,877	2,170,678
Hedge Funds	1,577,509	20,017	22,355	11,179	1,631,060
Short-term investments	1,446,097	18,349	20,493	10,247	1,495,186
Total investments	42,307,003	536,828	599,536	299,800	43,743,167
Collateral on loaned securities	3,948,457	50,101	55,954	27,980	4,082,492
Property, plant, furniture and equipment (Note 6)	5,958	–	–	–	5,958
Total assets	48,778,270	620,795	694,510	347,402	50,440,977
Liabilities					
Retirement benefits payable	157,028	2,644	2,194	1,894	163,760
Refunds payable	6,248	9	333	–	6,590
Accounts payable and accrued expenses	15,723	181	203	101	16,208
Compensated absences payable	1,243	–	–	–	1,243
Insurance premiums and claims payable	–	–	–	–	–
Payable for security transactions	2,995,273	38,007	42,446	21,225	3,096,951
Other payables	1,312	9	10	5	1,336
Obligations under security lending program	3,948,457	50,101	55,954	27,980	4,082,492
Due to other funds	12,505	–	–	–	12,505
Total liabilities	7,137,789	90,951	101,140	51,205	7,381,085
Net assets held in trust for benefits (Note 4) (See Required Supplemental Schedule of Funding Progress.)	\$41,640,481	\$ 529,844	\$ 593,370	\$ 296,197	\$43,059,892

The accompanying Notes to Financial Statements are an integral part of this statement.

(Expressed in Thousands)

Other Employee Benefit Trust Funds				Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	2005	2004
\$ 1,078	\$ 193	\$ 192	\$ 1,463	\$ 64,065	\$ 6,682
9	5,221	2,447	7,677	128,990	103,720
2,719	485	484	3,688	149,536	84,987
42,189	7,539	7,507	57,235	2,320,188	2,278,768
93	34	1,680	1,807	8,563	7,791
45,010	13,279	12,118	70,407	2,607,277	2,475,266
—	5,577	—	5,577	15,465	19,801
174,245	31,135	31,006	236,386	9,582,639	7,166,400
290,575	51,922	51,706	394,203	15,980,181	14,224,149
28,928	5,169	5,147	39,244	1,590,868	1,225,707
200,685	35,860	35,711	272,256	11,036,690	11,728,611
22,334	3,991	3,974	30,299	1,228,253	1,092,179
40,469	7,231	7,201	54,901	2,225,579	1,996,233
30,407	5,434	5,411	41,252	1,672,312	1,195,556
27,876	4,981	4,960	37,817	1,533,003	1,638,002
815,519	145,723	145,116	1,106,358	44,849,525	40,266,837
76,112	13,600	13,543	103,255	4,185,747	3,134,769
—	—	—	—	5,958	6,089
937,719	178,372	170,969	1,287,060	51,728,037	45,909,444
—	—	—	—	163,760	151,378
26	47	1	74	6,664	6,197
276	5,849	2,414	8,539	24,747	24,106
—	—	—	—	1,243	1,161
30,878	—	—	30,878	30,878	37,959
57,738	10,317	10,274	78,329	3,175,280	2,491,239
13	3	2	18	1,354	1,077
76,112	13,600	13,543	103,255	4,185,747	3,134,769
859	1,600	501	2,960	15,465	19,801
165,902	31,416	26,735	224,053	7,605,138	5,867,687
\$ 771,817	\$ 146,956	\$ 144,234	\$ 1,063,007	\$ 44,122,899	\$40,041,757

Virginia Retirement System Statement of Changes in Plan Net Assets - Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds

For the Years Ended June 30, 2005 and 2004

	Pension Trust Funds				Total Pension Trust Funds
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	
Additions					
Contributions:					
Members	\$ 63,503	\$ 494	\$ 700	\$ 159	\$ 64,856
Member-paid by employers	599,769	4,392	14,869	2,499	621,529
Employers	701,620	14,477	50,510	15,269	781,876
Total contributions	1,364,892	19,363	66,079	17,927	1,468,261
Investment income					
Net appreciation/(depreciation) in fair value of investments	3,808,483	48,303	50,906	26,835	3,934,527
Interest, dividends and other investment income	797,382	10,113	10,658	5,618	823,771
Total investment income before investment expenses	4,605,865	58,416	61,564	32,453	4,758,298
Investment expenses	(164,522)	(2,087)	(2,199)	(1,159)	(169,967)
Net investment income	4,441,343	56,329	59,365	31,294	4,588,331
Security lending income:					
Gross income	79,331	1,006	1,060	559	81,956
Less borrower rebates and agent fees	(67,339)	(854)	(900)	(474)	(69,567)
Net security lending income	11,992	152	160	85	12,389
Miscellaneous revenue	743	-	-	-	743
Total additions	5,818,970	75,844	125,604	49,306	6,069,724
Deductions					
Retirement benefits	1,865,776	30,487	25,100	24,108	1,945,471
Refunds of member contributions	78,709	1,053	4,927	42	84,731
Insurance premiums and claims	-	-	-	-	-
Retiree health insurance reimbursements	-	-	-	-	-
Long-term disability benefits	-	-	-	-	-
Administrative expenses	18,182	203	208	113	18,706
Other expenses	-	-	-	-	-
Total operating expenses	1,962,667	31,743	30,235	24,263	2,048,908
Transfers (Note 13)	(230)	-	230	-	-
Net increase (decrease)	3,856,073	44,101	95,599	25,043	4,020,816
Net assets held in trust for benefits - beginning of year	37,784,408	485,743	497,771	271,154	39,039,076
Net assets held in trust for benefits - end of year	\$41,640,481	\$ 529,844	\$ 593,370	\$ 296,197	\$43,059,892

The accompanying Notes to Financial Statements are an integral part of this statement.

(Expressed in Thousands)

Other Employee Benefit Trust Funds				Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	2005	2004
\$ 16	\$ —	\$ —	\$ 16	\$ 64,872	\$ 87,648
—	—	—	—	621,529	585,131
(47)	81,995	54,505	136,453	918,329	626,026
<u>(31)</u>	<u>81,995</u>	<u>54,505</u>	<u>136,469</u>	<u>1,604,730</u>	<u>1,298,805</u>
78,291	11,580	10,880	100,751	4,035,278	5,627,437
<u>16,392</u>	<u>2,424</u>	<u>2,278</u>	<u>21,094</u>	<u>844,865</u>	<u>588,401</u>
94,683	14,004	13,158	121,845	4,880,143	6,215,838
<u>(3,383)</u>	<u>(500)</u>	<u>(470)</u>	<u>(4,353)</u>	<u>(174,320)</u>	<u>(126,297)</u>
<u>91,300</u>	<u>13,504</u>	<u>12,688</u>	<u>117,492</u>	<u>4,705,823</u>	<u>6,089,541</u>
1,631	241	227	2,099	84,055	37,769
<u>(1,384)</u>	<u>(205)</u>	<u>(192)</u>	<u>(1,781)</u>	<u>(71,348)</u>	<u>(26,946)</u>
<u>247</u>	<u>36</u>	<u>35</u>	<u>318</u>	<u>12,707</u>	<u>10,823</u>
—	—	—	—	743	908
<u>91,516</u>	<u>95,535</u>	<u>67,228</u>	<u>254,279</u>	<u>6,324,003</u>	<u>7,400,077</u>
—	—	—	—	1,945,471	1,760,992
—	—	—	—	84,731	84,966
97,041	—	—	97,041	97,041	106,031
—	68,966	—	68,966	68,966	64,920
—	—	25,840	25,840	25,840	23,835
678	508	476	1,662	20,368	20,303
<u>444</u>	<u>—</u>	<u>—</u>	<u>444</u>	<u>444</u>	<u>372</u>
<u>98,163</u>	<u>69,474</u>	<u>26,316</u>	<u>193,953</u>	<u>2,242,861</u>	<u>2,061,419</u>
—	—	—	—	—	—
(6,647)	26,061	40,912	60,326	4,081,142	5,338,658
<u>778,464</u>	<u>120,895</u>	<u>103,322</u>	<u>1,002,681</u>	<u>40,041,757</u>	<u>34,703,099</u>
<u>\$ 771,817</u>	<u>\$ 146,956</u>	<u>\$ 144,234</u>	<u>\$ 1,063,007</u>	<u>\$44,122,899</u>	<u>\$40,041,757</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2005 and 2004

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

The Virginia Retirement System (the “System”) is an independent agency of the Commonwealth of Virginia that administers defined benefit pension plans, other employee benefit plans and other funds established by the Commonwealth. The System is included in the basic financial statements of the Commonwealth of Virginia. As required by generally accepted accounting principles (GAAP), these financial statements include all of the funds for which financial transactions are recorded in the System’s accounting system and for which its Board of Trustees exercises administrative responsibility.

Defined Benefit Pension Plans	Other Employee Benefit Plans
Virginia Retirement System (VRS)	Group Life Insurance Fund
State Police Officers’ Retirement System (SPORS)	Retiree Health Insurance Credit Fund
Virginia Law Officers’ Retirement System (VaLORS)	Disability Insurance Trust Fund (<i>also known as the</i>
Judicial Retirement System (JRS)	<i>Virginia Sickness and Disability Program [VSDP]</i>)

Effective January 1, 1997, the Constitution of Virginia was amended to strengthen the independence of the Virginia Retirement System and to protect its funds by requiring that they be separate and independent trust funds segregated from all other funds of the Commonwealth and administered solely in the interest of the members and beneficiaries thereof.

B. Administration

The responsibility for general administration and operation of the defined benefit pension plans, other employee benefit plans and other funds is vested in the Board of Trustees. The board consists of five members appointed by the Governor and four members appointed by the Joint Rules Committee, all subject to confirmation by the General Assembly of Virginia. The Board of Trustees appoints a director to serve as the chief administrative officer of the System and a chief investment officer to direct, manage and administer the investment of the System’s funds. Full power to invest and reinvest the assets of the defined benefit pension plans, other employee benefit plans and other funds is vested in the board. The Board of Trustees has appointed Mellon Trust as the custodian of designated assets of the System.

The Virginia Retirement System, the State Police Officers’ Retirement System, the Virginia Law Officers’ Retirement System and the Judicial Retirement System are administered in accordance with Title 51.1, Chapters 1, 2, 2.1, 3 and 4 of the *Code of Virginia* (1950), as amended. The Group Life Insurance Fund, the Retiree Health Insurance Credit Fund and the Disability Insurance Trust Fund are administered in accordance with Title 51.1, Chapter 5; Title 51.1, Chapter 14; and Title 51.1, Chapter 11, respectively, of the *Code of Virginia* (1950), as amended.

The Optional Life Insurance Fund is administered in accordance with Section 51.1-512 and 51.1-512.1 of the *Code of Virginia* (1950), as amended. During FY 2005, VRS transferred the premium collection function to the carrier. Because optional life insurance is an insured product and the premium collection is now handled by the carrier, the Board of Trustees provides only oversight for the program with little administrative responsibility.

Other programs of the Commonwealth of Virginia for which the Board of Trustees has oversight responsibility but has little administrative involvement and does not perform the investment function include the following: the Commonwealth’s Deferred Compensation Plan (IRC Section 457) and its Cash Match Plan for state employees and employees of participating political subdivisions; defined contribution plans for political appointees, employees of public institutions of higher education and certain employees of public school divisions and teaching hospitals; the Commonwealth Health Research Fund, which provides financial support for research efforts that may maximize

human health benefits for citizens of the Commonwealth; and the Volunteer Firefighters' and Rescue Squad Workers' Service Award Fund, which provides service awards to eligible volunteer firefighters and rescue squad workers. Because the Board of Trustees has a limited administrative role for these programs (it neither owns the assets nor has custody of them), and their financial transactions are not recorded in the System's accounting system, these programs are not included in the System's financial statements.

C. Basis of Accounting

The accounts of the defined benefit pension plans and the other employee benefit plans are accounted for and presented using the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recognized when liabilities are incurred, regardless of the timing of related cash flows. Employee and employer contributions are recognized as revenues when due, pursuant to formal commitments, as well as statutory or contractual requirements; and investment income is recognized as earned by the plans. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans.

D. Investments

1. Investment Valuation

Investments are reported at fair value as determined by the System's master custodian, Mellon Trust, from its Global Pricing System. This system assigns a price source, based on asset type and the vendor pricing products to which the master custodian subscribes, for every security held immediately following its acquisition. Prices supplied by these sources are monitored daily by the master custodian.

When a pricing source is unable to provide a price, quotes are sought from major investment brokers and market-making dealers; or internal calculations are applied if feasible. As a last resort, the master custodian will contact investment managers for a price. Commingled funds, partnerships, and real estate assets are priced by the master custodian from statements received from the funds, partnerships or investment managers.

The pricing sources used by the master custodian provide daily prices for equity securities; corporate, government and mortgage-backed fixed income securities; private placement securities; futures and options on futures; open-ended funds; and foreign exchange rates. Depending on the vendor, collateralized mortgage obligations (CMOs); adjustable rate mortgages (ARMs); and asset-backed securities are priced either daily, weekly or twice a month and at month end. Municipal fixed income securities and options on U.S. Treasury/GNMA securities are priced at month end.

2. Investment Transactions and Income

Security transactions and related gains and losses are recorded on a trade date basis. The cost of investments sold is the average cost of the aggregate holding of the specific investment sold. Dividend income is recorded on the ex-dividend date, and interest income is accrued as earned. Futures contracts are valued daily, with the resulting adjustments recorded as realized gains or losses arising from the daily settlement of variation margin. Gains and losses related to forward contracts and options are recognized at the time the contracts are settled. Investments in limited partnerships are accounted for on the equity method of accounting, and their earnings or losses for the period are included in investment income using the equity method.

E. Property, Plant, Furniture and Equipment

Capital assets are recorded at cost at the time of acquisition and are reported net of accumulated depreciation. The System capitalizes all property, plant and equipment that have a cost or value greater than \$5,000. Depreciation is computed on the straight-line basis over the estimated useful life of the property, ranging from five to 40 years.

F. Accumulated Vacation, Sick Leave and Disability Credits

Employees of the System participate in the Commonwealth's accumulated vacation program and in either its sick leave program or the Virginia Sickness and Disability Program (VSDP), which is administered by the System. Unused vacation may be accumulated and is paid at the time of permanent separation from service up to the maximum calendar year limit. Unused sick leave may be accumulated. If the member is vested, unused sick leave is paid at the rate of 25% of the amount accumulated not to exceed \$5,000 at the time of permanent separation from service. Unused VSDP disability credits converted from unused sick leave are paid in the same manner as unused sick leave at the time of permanent separation. The accrued liability for unused vacation, sick leave or disability credits reflected in the accompanying statements at June 30, 2005 and 2004 was computed using salary rates in effect at those times and represents vacation and sick leave earned up to the allowable ceilings as well as unused, converted disability credits.

G. Administrative Expenses and Budget

The administrative expenses related to the System's administration and trust fund management activities are approved by the Board of Trustees and included in a budget prepared in compliance with the Commonwealth's biennial budgetary system (cash basis). Appropriations are controlled at the program level and lapse at the end of the fiscal year. Administrative expenses are funded exclusively from investment income. Expenses for goods and services received but not paid for prior to the System's fiscal year end are accrued for financial reporting purposes in accordance with generally accepted accounting principals (GAAP). A reconciliation of the difference between the GAAP basis and budgeted basis is presented in the Schedule of Administrative Expenses.

H. Investment Income Allocation

Income earned on investments is distributed monthly to the Virginia Retirement System, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, the Judicial Retirement System, the Group Life Insurance Fund, the Retiree Health Insurance Credit Fund and the Disability Insurance Trust Fund. Distribution of investment income is based on the respective equity of each trust fund in the common investment pool.

The retirement plans distribute their cumulative investment income, net of administrative expenses, in the following manner:

1. Investment income is distributed to each of the individual member accounts based on a rate of 4% applied to each member's cumulative balance as of the close of the preceding fiscal year.
 2. The remaining portion is allocated quarterly to the participating employer accounts based on the ratio of their member account and employer account balances to the total of all such balances.
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2. Plan Description

A. Retirement Plans

The Virginia Retirement System was established on March 1, 1952, as the administrator of the Virginia Retirement System (VRS), a qualified governmental retirement plan that provides defined benefit coverage for state employees, public school board employees, employees of participating political subdivisions and other qualifying employees. VRS is a mixed agent and cost-sharing, multiple-employer retirement plan. The plan's accumulated assets may legally be used to pay all plan benefits provided to any of the plan members or beneficiaries.

The System also administers single-employer retirement plans for state police officers, who are covered under a separate State Police Officers' Retirement System (SPORS) established on July 1, 1950; state law enforcement and correctional officers other than state police officers, who are covered under the Virginia Law Officers' Retirement System (VaLORS) established on October 1, 1999; and judges of a court of record or a district court of the state and other qualifying employees, who are covered under the Judicial Retirement System (JRS) established on July 1, 1970.

Distribution of VRS Employers at June 30, 2005 and 2004

	2005	2004
Cities and Towns	153	151
Counties	92	92
School Boards*	145	145
Special Authorities	180	176
State Agencies	228	234
Total employers	798	798

* Of the 145 school boards, 132 also provide coverage for nonprofessional employees and are treated as political subdivisions by the System.

Membership Figures at June 30, 2005 and 2004

	2005					2004
	VRS	SPORS	VaLORS	JRS	TOTAL	TOTAL
Retirees and beneficiaries receiving benefits	116,838	923	1,204	395	119,360	113,717
Terminated employees entitled to benefits but not yet receiving them	29,111	60	276	8	29,455	27,872
Total	145,949	983	1,480	403	148,815	141,589
Active plan participants:						
Vested	203,514	1,397	6,361	341	211,613	204,433
Nonvested	109,511	410	3,418	73	113,412	112,770
Total	313,025	1,807	9,779	414	325,025	317,203

All full-time, salaried permanent employees of VRS-participating employers are automatically covered under VRS, SPORS, VaLORS or JRS, with these exceptions: (1) certain full-time faculty and administrative staff of public colleges and universities; and (2) eligible classified employees of the two state teaching hospitals. These employees have the option to elect not to participate in the systems. Benefit provisions and all other requirements are established by Title 51.1 of the *Code of Virginia* (1950), as amended.

Benefits vest for all plans after five years of service. Employees are eligible for an unreduced retirement benefit at age 65 if they have five years of service (age 60 for participating law enforcement officers and firefighters) or at age 50 with at least 30 years of service if elected by the employer (age 50 with at least 25 years of service for participating law enforcement officers and firefighters). Employees may retire with a reduced benefit at age 50 if they have at least 10 years of credited service or at age 55 (age 50 for participating law enforcement officers and firefighters) if they have at least five years of credited service.

Annual retirement benefits are payable monthly for life in an amount equal to 1.7 % of eligible members' average final compensation (AFC) for each year of credited service. AFC is defined as the highest consecutive 36 months of credible compensation. Benefits are actuarially reduced for members who retire prior to becoming eligible for full retirement benefits. Members of SPORS and VaLORS and participating law enforcement officers and firefighters may receive a monthly benefit supplement if they retire prior to age 65. Members of VaLORS hired before July 1, 2001 were allowed to make a one-time election to increase the multiplier from 1.7% to 2.0% instead of receiving the supplement. Members of VaLORS hired after June 30, 2001 have their benefit computed using the 2.0% multiplier and are not eligible for the supplement. Members of JRS receive weighted years of creditable service for each year of actual service under JRS. VRS, SPORS, VaLORS and JRS also provide death and disability benefits. Cost-of-living increases, based on changes in the Consumer Price Index and limited to 5% per year, are granted in the second year of retirement and in every year thereafter.

Employees are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual salary to the retirement plans. This 5% member contribution may be assumed by the employer. If an employee leaves covered employment, the accumulated contributions plus earned interest may be refunded to the employee. Each participating employer is required by state statute to contribute the remaining amounts necessary to fund the retirement plans using the entry age normal actuarial cost method adopted by the Board of Trustees. State statute may be amended only by the General Assembly of Virginia.

B. Group and Optional Life Insurance Programs

The Group Life Insurance Fund was established on July 1, 1960 for state employees, teachers and employees of political subdivisions participating in VRS; state police officers; other state law enforcement and correctional officers; judges; and other qualifying employees. The program provides life insurance for natural death coverage equal to an employee's annual salary rounded to the next highest \$1,000, and then doubled. Accidental death coverage is double the natural death coverage. The program also provides coverage for accidental dismemberment and accidental blindness as well as an accelerated death benefit for terminal conditions. Approximately 340,251 employees and 112,346 retirees were covered under the program at June 30, 2005.

Employees who retire or terminate from service after age 50 with at least 10 years of service or at age 55 with at least five years of service (age 50 for state police officers; other state law enforcement and correctional officers; and participating law enforcement officers and firefighters of political subdivisions), or who retire because of disability, are entitled to post-employment life insurance benefits. At retirement or termination, accidental death benefits cease and natural death coverage reduces at a rate equal to 25% on January 1 of the first full year following retirement or termination and each year thereafter, until it reaches 25% of its original value. These group life insurance benefit provisions and requirements are established by Title 51.1 of the *Code of Virginia* (1950), as amended.

Participating employers and their covered employees are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute to the cost of group life insurance benefits. Retirees are not required to contribute, and employers may assume the employees' contributions.

Contribution requirements are determined on the aggregate actuarial cost method adopted by the Board of Trustees. Since 1960, when the group life insurance program was first established, a portion of the premium contributions collected during employees' active careers has been placed in an Advance Premium Deposit Reserve, which was established to prefund death benefits to members after retirement.

An Optional Group Life Insurance Fund was established on November 1, 1995 for all employees currently covered under the basic group life program as a supplement to that plan. Employees also may purchase optional life insurance on their spouses and children. The optional program provides natural death coverage for the employee equal to one, two, three or four times annual salary rounded to the next highest \$1,000, up to a maximum of \$600,000. Spouse coverage is available up to one-half of the employee's optional insurance amount. Minor children who are at least 15 days old can be insured for \$10,000, \$20,000 or \$30,000, depending on the option chosen by the employee. An additional accidental death and dismemberment benefit is payable for death or bodily injuries. Approximately 56,267 employees were covered under this program at June 30, 2005.

Optional group life insurance coverage ends for employees when they retire or terminate their employment, or when their basic coverage ends. Employees who retire for disability may continue their optional coverage until age 65 provided they continue to pay the required insurance premiums. Spouse coverage terminates should a couple divorce or when the employee leaves employment. Children's coverage ends with the termination of the employee's coverage or when the child marries or turns 21 years of age (25 years of age for full-time college students).

Premiums for optional life insurance coverage are the responsibility of the covered employees and are deducted from their salaries by their employers as required by Title 51.1 of the *Code of Virginia* (1950), as amended. Premium requirements are based on the age of the covered employee and are determined by the Board of Trustees. Because optional life insurance is an insured product, VRS transferred the responsibility for the collection of premiums for this program directly to the carrier during FY 2005. Under the new arrangement, the carrier bills each employer directly, and the employer makes the contribution payments to the carrier. Any differences and adjustments are settled between the employer and the carrier.

C. Retiree Health Insurance Credit Program

The Retiree Health Insurance Credit Fund was established on January 1, 1990 and provides benefits for retired state employees, state police officers, other state law enforcement and correctional officers and judges who have at least 15 years of creditable service under the retirement plans. The program provides a maximum credit reimbursement of \$120 against the monthly health insurance premiums of eligible retirees.

A similar program was established on July 1, 1993 to provide benefits for retired teachers and employees of participating political subdivisions with at least 15 years of creditable service under the retirement plans. Retired teachers may receive a monthly credit ranging from \$75 to \$105, and local government retirees may receive a maximum credit of \$45.

Benefit provisions and eligibility requirements are established by Title 51.1, Chapter 14 of the *Code of Virginia* (1950), as amended. The amount required to fund all credits is financed on a current disbursement basis by the employers based on contribution rates determined by the System's actuary. Approximately 69,114 retired employees were covered under this program at June 30, 2005.

D. Virginia Sickness and Disability Program

The Disability Insurance Trust Fund, also known as the Virginia Sickness and Disability Program (VSDP), was established on January 1, 1999 and provides benefits for all full-time, classified state employees hired on or after January 1, 1999. Classified state employees include state police officers and other state law enforcement and correctional officers. Part-time, classified state employees who work at least 20 hours a week on a salaried basis and who accrue leave also are covered. Eligible state employees and state police officers of the Commonwealth employed prior to January 1, 1999 had the option during an open enrollment period to elect to participate in the VSDP or remain under the Commonwealth's existing sick leave program and retain their eligibility for disability retirement benefits under VRS and SPORS. Eligible employees enrolled in VSDP are not eligible for disability retirement benefits under the VRS, SPORS or VaLORS.

Teaching, administrative and research faculty of Virginia public institutions of higher education hired or appointed on or after January 1, 1999 who elected VRS as their retirement plan must make an irrevocable election to participate in the VSDP or in the institution's disability program. If there is no institution program, the faculty member is covered under the VSDP.

By providing sick leave, family and personal leave, and short-term and long-term disability benefits, the VSDP gives its members income protection from the first day of employment. After a seven-calendar day waiting period following the first incident of disability, eligible full-time and part-time classified employees receive short-term disability benefits from 60% to 100% of compensation, for a maximum of 125 work days, based on months of state service. After a 180-calendar day waiting period (125 work days of short-term disability), eligible employees receive long-term disability benefits equal to 60% of compensation until they return to work until age 65 (age 60 for state police officers and other state law enforcement and correctional officers) or until death. Approximately 67,567 employees were covered under the program at June 30, 2005.

State agencies are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute to the cost of providing long-term disability benefits and administering the program. Initial contribution requirements to fund the program were determined by the System's actuary using an estimate of the amount of liability for disability benefits that would transfer from VRS, SPORS and VaLORS to VSDP for the anticipated participants in VSDP.

3. Contributions – Retirement Plans

The funding policy of the retirement plans provides for periodic employer contributions at actuarially determined rates, which will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the cost of all basic benefits when due. Contribution rates are developed using the entry age normal cost method for both normal cost and amortization of the unfunded actuarial accrued liability. Gains and losses are reflected in the unfunded actuarial accrued liability that is being amortized as a level percentage of payroll within 30 years or less.

The amount of contributions to be provided by employers for state employees, each participating political subdivision, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System and the Judicial Retirement System was actuarially computed by Gabriel, Roeder, Smith & Company. The contribution rates for FY 2005 were based on their valuation as of June 30, 2003 and the contribution rates for FY 2004 were based on their valuation as of June 30, 2001. In addition, a separate contribution requirement was computed for the teacher cost-sharing pool by the actuary for each year using the same valuation dates noted above.

Contributions totaling \$1,468,261,000 and \$1,185,155,000 for the fiscal years ended June 30, 2005 and 2004, respectively, were made by employers and employees in accordance with statutory requirements. These contributions covered employers' normal costs and amortization of unfunded actuarial accrued liabilities.

Total employer contributions were \$781,876,000 for FY 2005. Included in total employer contributions were \$1,152,000 from school boards for payments toward the early retirement program costs and \$5,617,000 from state agencies for payments toward Workforce Transition Act (WTA) costs. Included in the employee contributions of \$64,856,000 were \$62,008,000 paid for the purchase of previously refunded service and other qualifying service.

Contributions for the Years Ending June 30, 2005 and 2004

(Expressed in Thousands)

	2005					2004
	VRS	SPORS	VaLORS	JRS	TOTAL	TOTAL
Employer contributions	\$ 701,620	\$ 14,477	\$ 50,510	\$ 15,269	\$ 781,876	\$ 512,388
Employee contributions paid by employer	599,769	4,392	14,869	2,499	621,529	585,131
Employee contributions	63,503	494	700	159	64,856	87,636
Total contributions	\$ 1,364,892	\$ 19,363	\$ 66,079	\$ 17,927	\$1,468,261	\$ 1,185,155

Employer contributions to the VRS cost-sharing pool for teachers represented 6.03% of covered payrolls. Additionally, the employer contributions to VRS by the state for state employees was 3.91% of covered payroll. Each political subdivision's contributions ranged from zero (0.00%) to 22.00% of covered payrolls. Employer contributions to SPORS by the state represented 16.49%; employer contributions to VaLORS by the state represented 16.99%; and employer contributions to JRS by the state represented 30.55% of covered payrolls. Employee contributions represented 5.00% of covered payrolls. Employer and employee contributions are required by Title 51.1 of the *Code of Virginia* (1950), as amended.

In addition to determining contribution requirements, the actuarial computations present an estimate of the discounted present value of the prospective accrued liability contributions that will have to be paid by employers in the future so that such contributions, together with the assets on hand, the normal contributions to be made in the future by employers and employees, and the income earned by investing the funds, will be sufficient to provide all benefits to be paid to present members in the future as well as to annuitants and their designated beneficiaries. Historical trend information regarding the System's progress in accumulating sufficient assets to pay benefits when due is presented in the Required Supplemental Schedule of Funding Progress.

4. Reserve Accounts

The reserve account balances available for benefits at June 30, 2005 and 2004 are presented in the table shown on the next page. These funds are required by Titles 51.1 and 2.1 of the *Code of Virginia* (1950), as amended, to provide for the payment of current and future benefits.

Member and employer reserves are funded by member and employer contributions and investment income. Each member has an account that accumulates member contributions plus annual interest. Each employer has an account that accumulates employer contributions; transfers of investment income reduced by the administrative expenses incurred in operating the retirement plans; and transfers of member contributions and interest upon a member's retirement. Employer accounts are charged with benefit payments.

The Advance Premium Deposit Reserve accumulates a portion of insurance premium contributions collected during an employee's active career and investment earnings thereon, and is charged for death benefits paid and expenses incurred in operating the group life insurance program.

The Retiree Health Insurance Credit Reserve is funded by employer contributions and investment income. It is charged for credit reimbursements applied to the monthly health insurance premiums of eligible retired employees and for expenses incurred in operating the Retiree Health Insurance Credit Fund program.

The Disability Insurance Trust Fund is funded by employer contributions and investment income. It is charged for long-term disability benefits and for expenses incurred in operating the Virginia Sickness and Disability Program.

Reserve Balances Available for Benefits at June 30, 2005 and 2004

(Expressed in Thousands)

	2005	2004
Virginia Retirement System		
Member Reserve	\$ 7,154,648	\$ 6,675,417
Employer Reserve	34,485,833	31,108,991
Total VRS	41,640,481	37,784,408
State Police Officers' Retirement System		
Member Reserve	63,535	62,070
Employer Reserve	466,309	423,673
Total SPORS	529,844	485,743
Virginia Law Officers' Retirement System		
Member Reserve	151,407	143,047
Employer Reserve	441,963	354,724
Total VaLORS	593,370	497,771
Judicial Retirement System		
Member Reserve	29,281	27,900
Employer Reserve	266,916	243,254
Total JRS	296,197	271,154
Group Life Insurance		
Advance Premium Deposit Reserve	771,817	778,464
Retiree Health Insurance Credit Reserve	146,956	120,895
Virginia Sickness and Disability Program		
Disability Insurance Trust Fund	144,234	103,322
Total Pension and Other Employee Benefit Reserve	\$ 44,122,899	\$ 40,041,757

5. Deposits and Investments

The Governmental Accounting Standards Board (GASB) issued Statement No. 40, Deposit and Investment Risk Disclosures, an amendment to GASB 3, which modified previous disclosure requirements related to investment risk. This statement became effective beginning for the fiscal year ended June 30, 2005. Required investment risk disclosures address credit risk, including custodial credit risk and concentrations of credit risk, interest rate risk and foreign currency risk. The statement also requires disclosures of custodial credit risk and foreign currency risk for depository accounts.

A. Deposits

Deposits of the System that are maintained by the Treasurer of Virginia at June 30, 2005 and 2004 were entirely insured under the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the *Code of Virginia* (1950), as amended, which provides for an assessable multiple financial institution collateral pool. Deposits with the System's master custodian, Mellon Trust, were entirely insured by federal depository insurance coverage.

Deposits at June 30, 2005 and 2004

(Expressed in Thousands)

	2005 Carrying Amount	2004 Carrying Amount
Treasurer of Virginia	\$ 64,065	\$ 6,453
Master Custodian	—	229
Total Deposits	\$ 64,065	\$ 6,682

B. Investments

1. Authorized Investments

The Board of Trustees of the System has full power to invest and reinvest the trust funds in accordance with Section 51.1-124.30 of the *Code of Virginia* (1950), as amended. This section requires the board to discharge its duties solely in the interest of the beneficiaries and to invest the assets with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The board must also diversify such instruments so as to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so.

Investment value and earnings of the investment pool are proportionally allocated among the System's trust funds on the basis of each fund's equity interest in the common investment pool. An Investment Summary is included in the Investment Section of this report. As of June 30, 2005 and 2004, the equity interests of each fund were as follows:

Equity Interests at June 30, 2005 and 2004

Fund	2005	2004
Virginia Retirement System	94.33%	94.27%
State Police Officers' Retirement System	1.20%	1.21%
Virginia Law Officers' Retirement System	1.34%	1.24%
Judicial Retirement System	0.67%	0.68%
Group Life Insurance Fund	1.82%	2.04%
Retiree Health Insurance Credit Fund	0.32%	0.30%
Disability Insurance Trust Fund	0.32%	0.26%
Total	100.00%	100.00%

2. Interest Rate Risk

Interest rate risk is the risk adversely affecting the fair value of an investment as a result of changes in interest rates. The risk is managed within the portfolio using the effective duration or option-adjusted methodology. It is widely used in the management of fixed income portfolios in that it quantifies, to a much greater degree, the risk of interest rate changes. The methodology takes into account optionality on bonds and scales the risk of price changes on bonds depending upon the degree of change in rates and the slope of the yield curve. All of the System's fixed income portfolios are managed in accordance with investment guidelines, most of which are specific as to the degree of interest rate risk that can be taken. It is believed that the reporting of segmented time distribution found in the following table quantifies to the fullest extent possible the interest rate risk of the System's fixed income assets.

Segmented Time Distribution of Debt Securities by Investment Type as of June 30, 2005

(Expressed in Thousands)

Investment Type	0-3 Months	4-12 Months	1-5 Years	6-10 Years	Greater Than 10 Years	Total
U.S. Government	\$ 116,177	\$ 4,472	\$ 1,081,053	\$ 365,497	\$ 1,086,198	\$ 2,653,397
Agencies	12,652	7,375	467,200	311,498	2,075,316	2,874,041
Municipal securities	5,020	—	7,512	1,731	4,081	18,344
Asset-backed securities	—	—	366,641	298,315	183,077	848,033
Collateralized mortgage obligations	—	—	—	—	207,484	207,484
Commercial mortgages	—	—	3,248	13,417	224,197	240,862
Corporate bonds and other bonds	104,933	128,318	630,564	952,078	718,525	2,534,418
Fixed-Income commingled funds	237,910	—	698,769	395,963	258,226	1,590,868
Treasurer of Virginia -						
LGIP Investment Pool	200,158	—	—	—	—	200,158
TBC Pooled Employee Trust Fund	1,274,734	—	—	—	—	1,274,734
Total	\$1,951,584	\$ 140,165	\$ 3,254,987	\$ 2,338,499	\$ 4,757,104	\$12,442,399

3. Credit Risk

Credit risk is the risk that obligations to the System will not be fulfilled by an issuer or other counterparty to an investment. As of June 30, 2005, the System's fixed income assets that are not government guaranteed represented 79% of the fixed income assets. The following table summarizes the System's fixed income portfolio exposure levels and credit qualities.

Credit Quality and Exposure Levels of Nongovernment Guaranteed Securities as of June 30, 2005

(Expressed in Thousands)

Credit Rating Level	Agencies	Municipal Securities	Asset-Backed Securities	Collateralized Mortgage Obligations	Commercial Mortgages	Corporate and Other Bonds	Fixed-Income Commingled Funds	Treasurer of Virginia LGIP Investment Pool	TBC Pooled Employee Trust Fund
AAA	\$2,845,356	\$ 12,690	\$ 812,822	\$ 184,965	\$ 185,737	\$ 277,909	\$ 319,531	\$ —	\$ —
AAA+Am	—	—	—	—	—	—	—	200,158	—
AA+	—	—	—	—	4,528	21,844	7,255	—	—
AA	—	1,776	—	—	—	24,791	28,935	—	1,274,734
AA-	8,721	—	—	—	—	77,346	87,776	—	—
A-1+	2,059	—	—	—	—	—	—	—	—
A+	—	—	1,052	—	—	120,527	174,659	—	—
A	—	—	3,786	—	—	128,432	177,852	—	—
A-	—	—	—	—	—	94,001	122,085	—	—
BBB+	—	—	1,407	—	—	177,073	126,448	—	—
BBB	—	1,628	10,832	—	—	229,503	372,332	—	—
BBB-	—	—	6,641	—	—	174,332	71,421	—	—
BB+	—	—	280	—	—	188,115	114	—	—
BB	—	—	527	707	—	113,882	—	—	—
BB-	—	—	—	—	—	157,176	—	—	—
B+	—	—	227	—	—	145,976	417	—	—
B	—	—	—	659	—	193,003	—	—	—
B-	—	—	3,304	—	—	169,604	—	—	—
CCC+	—	—	—	—	—	40,221	—	—	—
CCC	—	—	—	—	—	17,301	—	—	—
CCC-	—	—	2,224	—	—	6,806	—	—	—
C	—	—	—	—	—	753	—	—	—
Not Rated	17,905	2,250	4,931	21,153	50,597	175,823	102,043	—	—
Total	\$2,874,041	\$ 18,344	\$ 848,033	\$ 207,484	\$ 240,862	\$2,534,418	\$1,590,868	\$ 200,158	\$1,274,734

Credit risk for derivative instruments held by the System results from counterparty risk assumed by the System. This is essentially the risk that the borrower will be unable to meet its obligation. Information regarding the System's credit risk related to derivatives is found in the Derivative Financial Instruments note. Policies related to credit risk pertaining to the System's securities lending program are found in the Securities Lending note.

Concentration of Credit Risk

Concentration of credit risk is related to the risk of loss that may be attributed to the magnitude of a government's investment in a single issue. The System's investment guidelines for each specific portfolio limits investments in any corporate entity to no more than 5% of the market value of the account for both the internally and externally managed portfolios. There is no concentration of investments in any one organization that represents 5% or more of plan net assets available for benefits.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The System's market value of securities that were uninsured and held by a counterparty at June 30, 2005 and 2004 consisted of the following (in thousands):

	2005	2004
U.S. Government and agency mortgage securities	\$ 122,754	\$ 85,929
Corporate and other bonds	6,158	6,241
Common and preferred stocks	49,182	—
Held by broker-dealers under securities lending program:		
U.S. Government and agency mortgage securities	229,118	82,598
Corporate and other bonds	889	—
Common and preferred stocks	54,286	38,843
Total	<u>\$ 462,387</u>	<u>\$ 213,611</u>

4. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The System's currency risk exposures, or exchange rate risk, primarily exists in the international and global equity investment holdings. From time to time, the System's external managers may hedge their portfolios' foreign currency exposures with currency forward contracts. This will depend upon their views about a specific foreign currency relative to the U.S. dollar. The System's exposure to foreign currency risk is highlighted in the following table:

Currency Exposures by Asset Class as of June 30, 2005

(Expressed in Thousands)

Currency	Cash & Cash Equivalents	Common & Preferred Stocks	Equity Index & Pooled Funds	Corporate Bonds	Total
Euro Currency Unit	\$ 17,908	\$1,153,194	\$1,358,687	\$ 59,889	\$2,589,678
British Pound Sterling	126,370	604,399	1,011,566	—	1,742,335
Japanese Yen	12,328	732,032	884,572	12,219	1,641,151
Swiss Franc	3,127	173,889	238,480	—	415,496
Canadian Dollar	7,274	144,387	168,333	3,698	323,692
Australian Dollar	(1,257)	313,968	1,037	6,575	320,323
Hong Kong Dollar	(3,095)	156,035	112,900	—	265,840
South Korean Won	—	242,959	—	—	242,959
New Taiwan Dollar	5,183	215,152	6,090	—	226,425
Swedish Krona	4,193	73,949	85,191	—	163,333
Norwegian Krone	2,882	101,883	42,997	—	147,762
South African Comm Rand	4,088	86,972	5,938	—	96,998
Singapore Dollar	4,845	38,081	44,496	—	87,422
Indian Rupee	1,091	53,393	12,513	—	66,997
New Turkish Lira	271	62,021	—	—	62,292
Mexican New Peso	265	30,106	30,498	—	60,869
Malaysian Ringgit	711	41,381	4,883	—	46,975
Brazil Real	890	9,305	35,138	—	45,333
Danish Krone	2	10,269	34,678	—	44,949
Polish Zloty	39	25,277	4,930	—	30,246
Egyptian Pound	116	16,362	13,754	—	30,232
Thailand Baht	171	23,248	5,636	—	29,055
Indonesian Rupian	—	19,607	7,206	—	26,813
Russian Ruble (New)	—	1,257	15,237	—	16,494
Hungarian Forint	293	14,944	1,241	—	16,478
Philippines Peso	146	11,358	4,702	—	16,206
Israeli Shekel	858	11,321	1,192	—	13,371
New Zealand Dollar	2	2,400	9,810	—	12,212
Argentina Peso	—	—	7,714	—	7,714
Turkish Lira	7,189	(295)	295	—	7,189
Colombian Peso	525	3,291	220	—	4,036
Chilean Peso	—	—	1,474	—	1,474
Czech Koruna	35	1,428	10	—	1,473
Chinese Yuan Renminbi	—	1	950	—	951
Pakistan Rupee	—	455	—	—	455
German Mark	—	—	54	—	54
Peruvian Nuevo Sol	—	15	—	—	15
Slovak Koruna	—	—	(202)	—	(202)
Total	\$ 196,450	\$4,374,044	\$4,152,220	\$ 82,381	\$ 8,805,095

5. Securities Lending

Under authorization of the Board, the System lends its fixed income and equity securities to various broker-dealers on a temporary basis. This program is administered through an agreement with the System's custodial agent bank. All security loan agreements are collateralized by cash, securities, or irrevocable letter of credit issued by major banks, and have a market value equal to at least 102% of the market value for domestic securities and 105% for

international securities. Securities received as collateral cannot be pledged or sold by the System unless the borrower defaults. Contracts require the lending agents to indemnify the System if the borrowers fail to return the securities lent and related distributions, and if the collateral is inadequate to replace the securities lent. All securities loans can be terminated on demand by either the System or the borrowers. The majority of loans are open loans, meaning the rebate is set daily. This results in a maturity of one or two days on average, although securities are often on loan for longer periods. The maturity of loans generally does not match the maturity of collateral investments, which averages 62 days. At year end, the System has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. The market value of securities on loan at June 30, 2005 and 2004 was \$4,401,317,000 and \$3,319,263,000, respectively. The June 30, 2005 and 2004 balances were composed of U.S. Government and agency securities of \$2,440,464,000 and \$2,170,252,000, respectively; corporate and other bonds of \$296,354,000 and \$138,902,000, respectively; and common and preferred stocks of \$1,664,499,000 and \$1,010,109,000, respectively.

The value of collateral (cash and non-cash) at June 30, 2005 and 2004 was \$4,573,872,000 and \$3,364,650,000, respectively.

Securities on loan are included with investments on the statement of net assets. The invested cash collateral is included in the statement of net assets as an asset and corresponding liability.

6. Accounts Receivable/Accounts Payable for Security Transactions

In addition to unsettled purchases and sales, accounts receivable and accounts payable for security transactions at June 30, 2005 and 2004, respectively, include (1) receivables for deposits with brokers for securities sold short of \$1,248,041,000 and \$820,698,000; and (2) payables for securities sold short and not covered with market values of \$1,353,204,000 and \$796,912,000, respectively.

7. Derivative Financial Instruments

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates or financial indexes. They include futures, forwards, options and swap contracts. Some traditional securities, such as structured notes, can have derivative-like characteristics. In this case, the return may be linked to one or more indexes and asset-backed securities such as collateralized mortgage obligations (CMOs), which are sensitive to changes in interest rates and prepayments. Futures, forwards, options and swaps are generally not recorded on the financial statements, whereas structured notes and asset-backed investments generally are recorded.

The System is a party, both directly and indirectly, to various derivative financial investments that may or may not appear on the financial statements and that are used in the normal course of business to enhance returns on investments and manage risk exposure to changes in value resulting from fluctuations in market conditions. These investments may involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the financial statements. Credit risk is the possibility that loss may occur from the failure of a counterparty to perform according to the terms of the contract. Market risk arises from adverse changes in market prices, interest rates and foreign exchange rates that may result in a decrease in the market value of a financial investment or an increase in its funding cost, or both.

In addition to risk exposure from directly held derivative financial instruments, the System may have indirect exposure to risk through its ownership interests in commingled investment funds that use, hold or write derivative financial instruments. Indirect exposure may also arise from stock lending programs in which the commingled funds participate. Such programs usually reinvest a portion of their cash collateral holdings in derivative instruments. The System's pro rata share of the contractual or notional amounts of outstanding derivative transactions in commingled investment funds and their related security lending programs approximated \$961,708,000 at June 30, 2005 and \$412,888,000 at June 30, 2004.

8. Forward, Futures and Option Contracts

Forward contracts are contracts to purchase or sell; futures contracts are contracts to deliver or receive financial instruments, foreign currencies or commodities at a specified future date and at a specified price or yield. Futures contracts are traded on organized exchanges (exchange-traded) and require initial margin (collateral) in the form of cash or marketable securities. The net change in the futures contract value is settled daily, in cash, with the exchanges. Holders of futures contracts look to the exchange for performance under the contract and not to the entity holding the offsetting futures position. Accordingly, the amount at risk posed by nonperformance of counterparties to futures contracts is minimal. In contrast, forward contracts traded over the counter are generally negotiated between two counterparties. They are subject to credit risks resulting from nonperformance of one of the counterparties and to market risks resulting from adverse fluctuations in market prices, interest rates and foreign exchange rates.

Options may be either exchange-traded or negotiated directly between two counterparties over the counter. Options grant the holder the right, but not the obligation, to purchase or sell a financial instrument at a specified price and within a specified period of time from the “writer” of the option. As a purchaser of options, the System typically pays a premium at the outset. This premium is reflected as an asset on the financial statements. The System then retains the right but not the obligation to exercise the option and purchase the underlying financial instrument. Should the option not be exercised, it expires worthless and the premium is recorded as a loss. A writer of options assumes the obligation to deliver or receive the underlying financial instrument on exercise of the option. Certain option contracts may involve cash settlements based on specified indexes such as stock indexes. As a writer of options, the System receives a premium at the outset. This premium is reflected as a liability on the financial statements and bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

Forward, futures and options contracts provide the System with the opportunity to build passive benchmark positions; manage portfolio duration in relation to various benchmarks; adjust portfolio yield curve exposure; and gain market exposure to various indexes in a more efficient way and at lower transaction costs. Credit risks depend on whether the contracts are exchange-traded or exercised over-the-counter. Market risks arise from adverse changes in market prices, interest rates and foreign exchange rates. At June 30, 2005, the System had purchased S&P, Russell Index, Treasury bonds and notes and global indices futures and options with a notional value of \$3,997,496,000, and sold Treasury bonds and notes and global indices futures and options with a notional value of \$1,149,667,000. At June 30, 2004, the notional values of the balances purchased and sold were \$3,684,005,000 and \$570,095,000, respectively. At June 30, 2005, the System had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of \$177,992,000 as the margin requirement for futures contracts. At June 30, 2004, the market value of the pledged securities was \$92,170,000.

9. Foreign Exchange Contracts

Foreign exchange contracts include forward, futures and options contracts. They involve either the exchange of specific amounts of two currencies or the delivery of a fixed amount of a currency at a future date and specified exchange rate. Forward and futures contracts settle three or more business days from the contract date. Forward contracts are negotiated over-the-counter between two counterparties, while futures contracts are exchange-traded. Foreign currency options, which are either negotiated between two counterparties or are exchanged-traded, grant the buyer the right, but not the obligation, to purchase or sell at a specified price, a stated amount of an underlying currency at a future date. At June 30, 2005, the System had sold foreign currency contracts with a notional value of \$7,237,509,000 and had purchased foreign currency contracts with a notional value of \$7,222,991,000. At June 30, 2004, the notional values of the foreign currency contract sold and purchased were \$1,190,129,000 and \$1,127,966,000, respectively.

Foreign exchange contracts are used by the System to effect settlements and to protect the base currency (\$US) value of portfolio assets denominated in foreign currencies against fluctuations in the exchange rates of those currencies. The credit risk of currency contracts that are exchange-traded lies with the clearinghouse of the

exchange where the contracts are traded. The credit risk of currency contracts traded over-the-counter lies with the counterparty, and exposure is usually equal to the unrealized profit on in-the-money contracts. The market risk in foreign currency contracts is related to adverse movements in currency exchange rates.

10. Asset-Backed Securities

Among the instruments with derivative-like characteristics in which the System invests and that appear on the financial statements are various asset-backed securities such as collateralized mortgage obligations (CMOs), asset backed securities (ABSs), principal-only strips (POs) and interest-only strips (IOs). These instruments are used primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets. CMO securities are bonds collateralized by mortgage-backed securities and issued in several tranches that represent a reallocation of the underlying mortgage-backed securities cash flows. Both PO and IO securities are created by splitting the asset-backed securities into principal-only and interest-only portions. At June 30, 2005, the System held CMO securities with a market value of \$442,404,000; IO and PO securities with a market value of \$2,188,000; and ABSs with a market value of \$531,264,000. At June 30, 2004, the market value for CMO securities held was \$217,916,000, and the market value for IO and PO securities held was \$2,777,000.

The credit risks on the various asset-backed securities in which the System invests are usually very low. Many of the securities held by the System are issued by quasi-U.S. governmental agencies. Others are issued by organizations with AAA or AA credit ratings. The market risk of these securities depends on changes in interest rates and the level of the underlying prepayments (i.e., when the underlying principal and interest are repaid by the mortgagors).

11. Swap Agreements

Swaps are negotiated contracts between two counterparties for the exchange of payments at certain intervals over a predetermined timeframe. The payments are based on a notional principal amount and calculated using either fixed or floating interest rates or total returns from certain instruments or indices. During FY 2005, the System entered into interest rate and total return swaps with a total notional value of \$684,638,000. For FY 2004, the total notional value was \$126,500,000. Swaps are used to manage risk and enhance returns. To reduce the risk of counterparty nonperformance, the System generally requires collateral on any material gains from these transactions.

6. Property, Plant, Furniture and Equipment

(Expressed in Thousands)

	Balance June 30, 2004	Increases	Decreases	Balance June 30, 2005
Nondepreciable capital assets: Land	\$ 1,368	\$ –	\$ –	\$ 1,368
Total nondepreciable capital assets	1,368	–	–	1,368
Depreciable capital assets:				
Building	4,632	–	–	4,632
Furniture and equipment	3,961	182	–	4,143
Total depreciable capital assets	8,593	182	–	8,775
Less accumulated depreciation:				
Building	695	116	–	811
Furniture and equipment	3,177	197	–	3,374
Total accumulated depreciation	3,872	313	–	4,185
Total depreciable capital assets – Net	4,721	(131)	–	4,590
Total capital assets – Net	\$ 6,089	\$ (131)	\$ –	\$ 5,958

Depreciation expense amounted to \$313,000 and \$359,000 in 2005 and 2004, respectively.

7. Operating Leases

The System has commitments under various operating leases for equipment and office space for some staff. In general, the leases are for a three-year term. In most cases, the System expects that in the normal course of business, these leases will be replaced by similar leases. Total rental expense for the year ended June 30, 2005 was \$1,659,000. The System has, as of June 30, 2005, the accompanying total future minimum rental payments due under the above leases (in thousands).

Year	Amount
2006	\$ 935
2007	780
2008	335
Total future minimum rental payments	\$ 2,050

8. Defined Benefit Pension Plan

A. Contributions to Pension Plan

All full-time, salaried permanent employees of the System are employees of the Commonwealth and are included in the Commonwealth's participation in the Virginia Retirement System (VRS), a defined benefit pension plan administered by the System. The Commonwealth, not the System, has overall responsibility for contributions to this plan and other employee benefit plans.

B. Other Information

Note 2A provides information regarding types of employees covered, benefit provisions, employee eligibility requirements (including eligibility requirements for vesting) and the authority under which benefit provisions and employer/employee obligations to contribute are established. Additional information on funding policy and contributions required and made can be found in Note 3. Information on the actuarial method and assumptions can be found in the "Notes to Required Supplemental Schedules."

Historical trend information showing the Commonwealth of Virginia's progress in accumulating sufficient assets to pay benefits when due is presented in the Commonwealth's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005.

9. Other Employee Benefit Programs

A. Life Insurance Benefits

The Commonwealth of Virginia participates in the System-administered group life insurance program, which provides postemployment life insurance benefits, in accordance with state statutes, to eligible retired and terminated employees. There were approximately 98,354 state employees and 44,333 retirees in the program during FY 2005. Information regarding eligibility requirements and benefit provisions as well as contribution requirements can be found in Note 2B.

Postemployment life insurance benefits are prefunded based on biennial actuarial computations using the aggregate cost actuarial method. The significant actuarial assumptions used were the same as those used to prepare actuarial valuations of the System-administered pension plans at June 30, 2003. The modified market value of plan assets was used for valuation purposes.

Separate measurements of assets and actuarial-accrued liabilities are not made for individual employers participating in the program. The accrued liabilities for postemployment death benefits actuarially determined through an actuarial valuation performed as of June 30, 2004 were \$1,802.0 million. The actuarial value of the program's assets available for benefits on that date was \$834.3 million, leaving a present value of future contributions of \$967.7 million.

The System's contribution requirements for its employees for the fiscal years ended June 30, 2005 and 2004 were zero for each year. In April 2002, the General Assembly suspended contributions for the group life insurance program through June 30, 2004. This was subsequently extended by the General Assembly through June 30, 2006.

B. Retiree Health Insurance Credits

The Commonwealth of Virginia provides health insurance credit reimbursements, in accordance with state statutes, against the monthly health insurance premiums of its retirees who have at least 15 years of service. The monthly credit amounts to

\$4 per year of service, not to exceed a maximum credit of \$120. All state agencies are required to contribute to the program at an actuarially determined percentage of their payroll. Contributions are financed on a current disbursement basis. Approximately 30,076 state retirees were receiving health insurance credits at June 30, 2005. Note 2C contains information regarding eligibility requirements, benefit provisions and contribution requirements.

For the fiscal year ended June 30, 2005, state agencies were required to contribute to the program at the statutory rate of 1.04% of covered payroll. The System's contribution requirements for its employees for the fiscal years ended June 30, 2005 and 2004 were \$129,000 and \$102,000, respectively.

C. Virginia Sickness and Disability Program

By providing sick leave, family and personal leave, and short-term and long-term disability benefits, the VSDP gives its members income protection from the first day of employment. At June 30, 2005 approximately 67,567 participants were enrolled in the program.

For the fiscal year ended June 30, 2005, state agencies were required to contribute to the program at the statutory rate of 1.65% of payroll for state employees, state police officers and state law enforcement and correctional officers other than state police officers. The System's contribution requirements for its employees for the fiscal years ended June 30, 2005 and 2004 were \$203,000 and \$124,000, respectively.

10. Litigation

The System, its Board of Trustees, officers and employees are defendants in claims and lawsuits that are either pending, in progress or have been settled since June 30, 2005. It is not reasonably possible at the present time to estimate the ultimate outcome of the System's liability, if any, with respect to the various proceedings. However, on the basis of advice received from the Attorney General and outside counsel who have reviewed the status of these claims and lawsuits, it is the opinion of management that such liability, if any, would not have a material adverse effect on the System's financial condition.

11. Risk Management

In order to cover its exposure to various risks of loss, the System, as an independent agency of the Commonwealth of Virginia, participates in the Commonwealth's self-insurance programs for state employee health care and risk management. The latter program includes property, general (tort) liability, medical malpractice and automobile plans. The System's employees are covered by the Commonwealth's Worker's Compensation program administered by the Department of Human Resource Management. In addition, the System is self-insured for fiduciary liability and director's and officer's liability under a program administered by the Commonwealth's Division of Risk Management. There were no claims in excess of coverage and no reductions in coverage during FY 2005 and the three preceding fiscal years.

12. Commitments

The System extends investment commitments in the normal course of business. At June 30, 2005 and 2004, these commitments amounted to \$3,491,000,000 and \$1,829,000,000, respectively.

13. Statutory Contribution Adjustment

During its 2004 Session, the General Assembly made a number of adjustments to reduce funded employer contributions for the defined benefit retirement plans to levels generally below those recommended by the VRS actuary and approved by the Board of Trustees. These changes affected FY 2005 and will affect FY 2006. These changes modified the contributions received for all state employee groups (state employees in the VRS plan as well as those in SPORS, VaLORS and JRS) and teachers. These changes did not impact the rates contributed by political subdivisions. For FY 2005 and FY 2006, the rates computed by the actuary were 3.89%, 8.10%, 12.11%, 13.22% and 30.61% for state employees, teachers, SPORS, VaLORS and JRS, respectively. The VRS Board of Trustees approved the rates recommended by the actuary for state employees and teachers. The Board certified a rate of 25.00% for SPORS and VaLORS and a rate of 45.00% for JRS. These rates reflect efforts by the Board to raise the funding ratios of these plans to a 90% funded level.

For FY 2005, the General Assembly revised the VRS actuary's data by extending the funding period for these groups from 23 years to 30 years. As a result, the rate for teachers was reduced from 8.10% to 7.82%, and the General Assembly funded the "normal cost" of 6.03%. The rate for state employees in the VRS plan was increased from 3.89% to 3.91%. FY 2005 rates for SPORS, VaLORS and JRS were 16.49%, 16.99% and 30.55%, respectively, or the rates recommended by the actuary based on the 30-year funding period.

Required Supplemental Schedule of Funding Progress

(Dollars in Millions)

Biennial Actuarial Valuation Date June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a)/(c)
Virginia Retirement System (VRS)						
2004	\$ 39,691	\$ 43,958	\$ 4,267	90.3%	\$ 11,510	37.1%
2003	39,243	40,698	1,455	96.4%	\$ 10,885	13.4%
2002	38,957	38,265	(692)	101.8%	10,669	(6.5%)
2001	37,968	35,384	(2,584)	107.3%	10,145	(25.5%)
2000 **	34,392	32,643	(1,749)	105.4%	9,529	(18.4%)
1999	29,804	31,419	1,615	94.9%	9,138	17.7%
1998 *	25,481	29,027	3,546	87.8%	8,638	41.1%
1996 **	19,032	23,842	4,810	79.8%	7,769	61.9%
1994	14,891	20,405	5,514	73.0%	7,274	75.8%
State Police Officers' Retirement System (SPORS)						
2004	\$ 510	\$ 656	\$ 146	77.8%	\$ 82	178.0%
2003	509	616	107	82.6%	79	135.4%
2002	508	595	87	85.4%	81	107.4%
2001	495	557	62	88.9%	83	74.7%
2000 **	441	513	72	86.0%	81	88.9%
1999	377	463	86	81.4%	77	111.7%
1998 *	322	425	103	75.8%	65	158.5%
1996 **	243	371	128	65.5%	60	213.3%
1994	201	277	76	72.6%	58	131.0%
Virginia Law Officers' Retirement System (VaLORS)						
2004	\$ 509	\$ 927	\$ 418	54.9%	\$ 298	140.3%
2003	458	854	396	53.6%	292	135.6%
2002	418	806	388	51.9%	306	126.8%
2001	393	628	235	62.6%	320	73.4%
2000 ***	307	680	373	45.1%	315	118.4%
Judicial Retirement System (JRS)						
2004	\$ 285	\$ 366	\$ 81	78.0%	\$ 48	168.8%
2003	282	348	66	81.0%	48	137.5%
2002	281	352	71	79.8%	48	147.9%
2001	277	342	65	81.0%	47	138.3%
2000 **	245	330	85	74.2%	45	188.9%
1999	210	302	92	69.5%	42	219.0%
1998 *	180	274	94	65.7%	39	241.0%
1996 **	138	243	105	56.8%	36	291.7%
1994	115	199	84	57.8%	33	254.5%

* Change in benefit formula and unreduced early retirement age, and in the actuarial amortization method.

** Revised economic and demographic assumptions due to experience study.

*** The first actuarial valuation for the Virginia Law Officers' Retirement System, established on October 1, 1999, was performed as of June 30, 2000.

Required Supplemental Schedule of Employer Contributions

(Dollars in Thousands)

Year Ended June 30	Annual Required Contribution	Percentage Contributed	Statutory Required Contribution	Percentage Contributed
Virginia Retirement System (VRS)				
2005 *	\$ 810,944	85.26%	\$ 691,415	100.00%
2004 *	469,200	91.66%	430,064	100.00%
2003 *	450,766	67.61%	304,784	100.00%
2002 *	459,613	79.68%	366,239	100.00%
2001 *	630,458	99.99%	630,370	100.00%
2000 *	785,376	93.24%	732,273	100.00%
1999 *	738,051	85.64%	632,084	100.00%
1998 *	757,164	71.06%	538,016	100.00%
1997 **	720,436	61.91%	446,005	100.00%
State Police Officers' Retirement System (SPORS)				
2005 *	\$ 21,946	65.96%	\$ 14,475	100.00%
2004 *	20,187	51.16%	10,328	100.00%
2003 *	19,866	44.20%	8,781	100.00%
2002 *	20,190	50.00%	10,095	100.00%
2001 *	20,420	100.00%	20,420	100.00%
2000 *	17,684	85.07%	15,044	100.00%
1999 *	16,088	69.87%	11,241	100.00%
1998 *	11,764	71.70%	8,435	100.00%
1997 **	11,099	64.69%	7,180	100.00%
Virginia Law Officers' Retirement System (VaLORS)				
2005 *	\$ 74,301	67.96%	\$ 50,495	100.00%
2004 *	72,752	55.80%	40,596	100.00%
2003 *	72,699	48.00%	34,895	100.00%
2002 *	77,417	32.30%	25,006	100.00%
2001 *	51,072	100.00%	51,072	100.00%
2000 ***	16,216	84.81%	13,753	100.00%
Judicial Retirement System (JRS)				
2005 *	\$ 22,490	67.89%	\$ 15,269	100.00%
2004 *	21,341	71.18%	15,190	100.00%
2003 *	21,110	64.44%	13,604	100.00%
2002 *	21,282	50.00%	10,641	100.00%
2001 *	20,822	100.00%	20,822	100.00%
2000 *	15,075	99.07%	14,935	100.00%
1999 *	14,118	91.64%	12,938	100.00%
1998 *	12,873	86.74%	11,166	100.00%
1997 **	12,378	83.43%	10,327	100.00%

* Contributions made by employers during the fiscal years ended June 30, 1998, 1999, 2000, 2001, 2002, 2003, 2004 and 2005 were not in all cases in accordance with the actuarially determined Annual Required Contribution (ARC), but they did meet the statutory requirements. Beginning with FY 1998, all employers were provided an option to elect an annual contribution that met the parameters of the ARC, which includes full prefunding of the automatic cost-of-living adjustments (COLAs) for retirees, or an annual contribution that would phase in the parameters over a five-year period ending with FY 2003.

** Contributions made by employers during the fiscal year ended June 30, 1997 were in accordance with statutory requirements that differ from the actuarially determined Annual Required Contributions (ARC), primarily because statutory required contributions funded cost-of-living adjustments (COLAs) for retirees on a current disbursement basis. Contribution information that meets the ARC parameters of GASB Statement No. 25 is unavailable for fiscal years prior to FY 1997.

*** The VaLORS program went into effect on October 1, 1999.

Notes to Required Supplemental Schedules - Actuarial Methods and Significant Assumptions

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	June 30, 2004
Actuarial Cost Method	Entry Age Normal
Amortization Method	
State Employees	Level percent, closed
Political Subdivision Employees	Level percent, open
Teachers	Level percent, closed
State Police/VA Law Officers /Judges	Level percent, closed
Payroll Growth Rate	3.00%
Remaining Amortization Period	
State Employees	22 Years
Political Subdivision Employees	0 to 30 Years
Teachers	22 Years
State Police/VA Law Officers /Judges	22 Years
Asset Valuation Method	5-year smoothed market
Actuarial Assumptions	
Investment Rate of Return *	8.00%
Projected Salary Increases *	
State/Political Subdivision Employees	4.25% to 6.30%
Teachers	4.00% to 7.00%
State Police/VA Law Officers	4.50% to 5.75%
Judges	5.00%
Cost-of-Living Adjustments	3.00%

* Includes inflation at 3.00%.

Schedule of Administrative Expenses for the Years Ended June 30, 2005 and 2004

(Expressed in Thousands)

	Totals	
	2005	2004
Personal Services		
Salaries and wages	\$ 13,597	\$ 12,440
Per diem services	323	309
Workforce Transition Act service costs	0	66
Retirement contributions	1,173	1,068
Social Security	947	876
Group life and medical insurance	1,599	1,296
Compensated absences	241	131
Total personal services	17,880	16,186
Professional Services		
Data processing	3,857	4,853
Actuarial and consulting	816	596
Legal	786	1,081
Medical	150	196
Management services	294	263
Public information services	0	32
Personnel development services	3	13
Total professional services	5,906	7,034
Communication Services		
Media	32	15
Printing	904	755
Postal and delivery	387	394
Telecommunications	456	343
Total communication services	1,779	1,507
Rentals		
Business equipment	632	667
Office space	1,027	634
Total rentals	1,659	1,301
Other Services and Charges		
Skilled and clerical services	315	216
Depreciation	313	359
Dues and memberships	64	115
Building expense	507	472
Equipment	232	156
Insurance	32	27
Repairs and maintenance	7	29
Supplies and materials	147	159
Travel and transportation	731	623
Miscellaneous	55	110
Total other services and charges	2,403	2,266
Total administrative expenses (GAAP basis)	29,627	28,294
Adjustments necessary to convert administrative expenses on the GAAP basis to the budgetary basis at year end (net)	(316)	(279)
Administrative Expenses (Budgetary basis)	\$ 29,311	\$ 28,015
Administrative Expenses Appropriated	\$ 33,504	\$ 30,930
Distribution of Administrative Expenses		
Total administrative expenses (GAAP Basis)	\$ 29,627	\$ 28,294
Less in-house investment management	(9,259)	(7,991)
Net Administrative Expenses	\$ 20,368	\$ 20,303

Schedule of Investment Expenses for the Year Ended June 30, 2005

(Expressed in Thousands)

Management Fees		
Domestic managers	\$ 7,841	
Non-U.S. equity managers	22,644	
Global equity managers	14,527	
Fixed income managers	4,591	
Credit strategies managers	4,931	
Real estate managers	9,159	
Alternative investment managers	54,590	
Hedge fund managers	<u>21,643</u>	\$ 139,926
Performance Fees		20,149
Total Management and Performance Fees		\$ 160,075
Miscellaneous Fees and Expenses		
Custodial fees	\$ 3,713	
Legal fees	264	
Other fees and expenses	<u>1,009</u>	\$ 4,986
In-House Investment Management		9,259
Total Investment Expenses		\$ 174,320

Schedule of Professional and Consulting Services for the Year Ended June 30, 2005

(Expressed in Thousands)

Actuarial, Legal and Oversight Services		
Attorney General of Virginia	Legal Services	\$ 205
Gabriel, Roeder, Smith & Company	Actuarial Services	152
Joint Legislative Audit Review Commission	Oversight Responsibilities	98
Kaufman & Canoles	Legal Services	36
Palmer & Cay Consulting Group	Actuarial Services and Benefits Consulting	187
Troutman Sanders Mays & Valentine, LLP	Legal Services	<u>70</u>
Subtotal Actuarial, Legal, and Oversight Services		\$ 748
Consulting Services		
Baskervill	Space Requirements Study	\$ 32
Bon Secours Memorial Regional Medical Center	Disability Medical Reviews	86
Samuel R. Brown, PC	Fact Finding Hearing Officer for Disability Cases	5
Clear Management Human Resource Consultants	Organizational Consulting Services	19
Competitive Edge	Communications Consulting Services	78
CorVel Corporation	Physician Referral for Disability Cases	64
Cost Effectiveness Measurement Inc.	Cost Driver Benchmarking	48
EFL Associates	Director Search Consulting Services	34
Indigitech	Information Systems Consulting Services	19
Katzen & Frye, PC	Fact Finding Hearing Officer for Disability Cases	21
McCaul, Martin, Evans & Cook, PC	Fact Finding Hearing Officer for Disability Cases	3
Medical Board	Medical Examiners	61
Mellon Consultants, LLC	Investment Consulting Services	49
Pension Consulting Alliance Inc.	Real Estate Services	27
Prince Goldsmith	CIO Search Consulting Services	102
Reed Smith, LLP	Professional Services	7
Steven P. Peterson, Independent Contractor	Systems Analysis for Public Equity Investments	111
Social Security Disability Consultants	Social Security Advocacy and Disability Tracking	440
Smartfish	Information Systems Consulting Services	25
Strategic Economic Decisions, Inc.	Economic Advisory Services	<u>30</u>
Subtotal Consulting Services		\$ 1,261
Total		\$ 2,009

INVESTMENT SECTION



More than 1,800 state police and 9,700 other Virginia law enforcement officers are covered under the State Police Officers' Retirement System (SPORS) and the Virginia Law Officers' Retirement System (VaLORS).

State police officers not only patrol Virginia's interstates but also search for missing children, wanted criminals and those who commit insurance fraud. They maintain extensive criminal and fingerprint records and visit classrooms to teach kids how to be safe. Other Virginia law officers protect college campuses and the Capitol grounds and serve as game wardens, marine resource officers and other correctional officers.

Localities are protected, too, by the sheriffs, sheriff's deputies, full-time firefighters and other local law enforcement personnel who receive special coverage under VRS.

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CHIEF INVESTMENT OFFICER'S LETTER



Charles W. Grant, CFA Chief Investment Officer

P.O. Box 2500, 1200 East Main Street
Richmond, Virginia 23218-2500
Telephone: (804) 649-8059; TDD: (804) 344-3190

November 15, 2005

To the Members of the Board of Trustees and
Participants of the Virginia Retirement System:

Market conditions were favorable over the last year with a continuation of moderate growth and relatively low inflation. Despite a gradual increase in short-term interest rates engineered by the Federal Reserve, longer-term interest rates remained low, resulting in a good environment for the economy and for investors.

The VRS investment fund returned 12.0% in fiscal 2005, with attractive returns generated by each asset class. Real estate and private equity investments had particularly strong performance, posting returns of 24.4% and 21.5%, respectively. The total fund significantly outperformed the performance benchmarks as established by the Board of Trustees.

Several significant initiatives were undertaken over the last year and are expected to contribute to improved risk-adjusted returns at VRS:

- The real estate program's investment objectives were broadened to allow investments in a more diverse group of strategies and risk levels.
- A credit strategies program was launched to invest across a wide spectrum of public and private credit related instruments with a goal of earning an equity-like return but with lower risk.
- Within the public equity program, an absolute return currency strategy was implemented with an expectation to enhance returns through relative value analysis within the currency market.
- Additional funds were shifted to internal management to take advantage of cost savings and attractive low risk investment strategies.

The biggest challenge facing the fund in the years ahead will be maintaining above-average returns, especially when compared to the last 10 years. Economic growth is likely to be moderate; and while inflation may accelerate in the short run, it is likely to stay low over the intermediate and longer term. This environment is likely to produce nominal investment returns in the 7% to 8% range over the next five to 10 years and real returns in the 5% range.

We appreciate the support of the Board and the Investment Advisory Committee as we continue to manage risk and seek out attractive investment returns for the Virginia Retirement System.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'C. Grant'.

Charles W. Grant, CFA
Chief Investment Officer

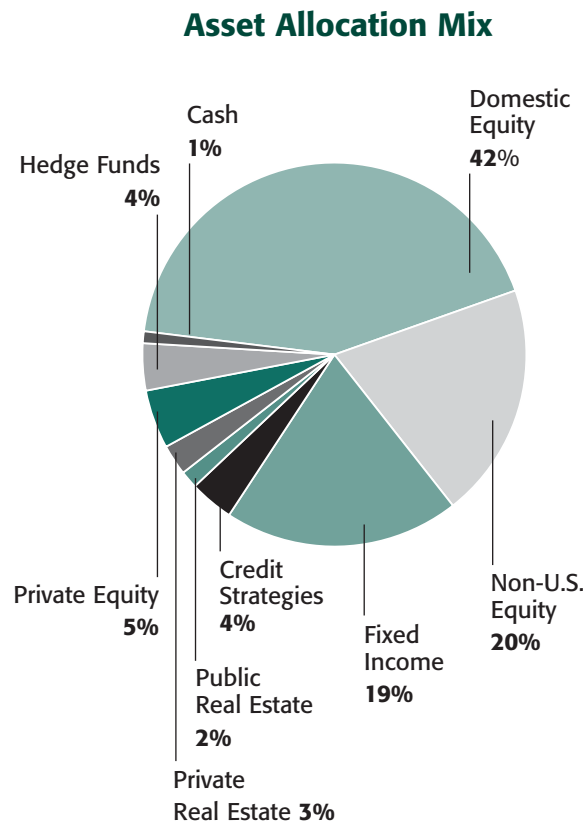
INVESTMENT ACCOUNT

The VRS Board of Trustees has fiduciary responsibility to invest the fund solely in the interest of the beneficiaries of the System. As established by the *Code of Virginia*, “the Board shall invest the assets of the Retirement System with the care, skill, prudence, and due diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.”

Benefit payments are projected to occur over a long period of time. This allows VRS to adopt a long-term investment horizon in the management of fund assets. The Board conducts an asset-allocation and asset-liability analysis on a regular basis in order to understand the nature of the fund’s liabilities and determine the appropriate level of risk to take in the management of the investment portfolio. This analysis helps the Board establish an asset allocation policy mix and develop a long-term return expectation for the fund, which is currently 7.5%. This expected return is used for actuarial valuation purposes.

The investment staff manages the VRS portfolio on a day-to-day basis according to policies and guidelines established by the Board. The staff manages assets on a direct basis and through outside investment managers. Various performance benchmarks have been established by the Board to serve as tools for measuring progress toward the achievement of intermediate and longer-term investment goals.

The asset allocation mix of the VRS fund as of June 30, 2005 is shown in the chart below:



Investment Performance Summary

Annualized Data for Period Ending June 30, 2005

	1 Year	3 Years	5 Years
1. Total Fund Time Weighted Returns			
VRS	12.0%	10.6%	3.0%
Total Fund Intermediate Benchmark	10.3%	9.9%	2.6%
2. Total Public Equity			
VRS	12.3%	11.5%	0.1%
Custom Benchmark	11.0%	11.2%	- 0.3%
3. Total Fixed Income			
VRS	7.2%	6.1%	7.6%
Custom Benchmark	6.8%	5.7%	7.4%
4. Total Credit Strategies			
VRS	7.6%	n/a	n/a
Custom Benchmark	8.6%	n/a	n/a
5. Total Real Estate			
VRS	24.4%	14.8%	13.7%
Custom Benchmark	21.2%	13.1%	12.5%
6. Total Hedge Funds			
VRS	9.0%	n/a	n/a
Custom Benchmark	6.5%	n/a	n/a
7. Total Private Equity			
VRS	21.5%	11.5%	1.3%
Custom Benchmark	9.6%	6.3%	0.1%

Investment return calculations were prepared using a time-weighted rate of return based on the CFA Institute's performance presentation standards.

INVESTMENT SUMMARY

In accordance with Section 51.1-124.31 of the *Code of Virginia* (1950), as amended, the Board of Trustees has pooled substantially all assets of the Virginia Retirement System, the State Police Officers' Retirement System, the Judicial Retirement System, the Group Life Insurance Fund and the Retiree Health Insurance Credit Fund into a common investment pool. The common investment pool of the pension trust funds and other trust funds held the following composition of investments at June 30, 2005 and 2004 (in thousands):

	2005 Fair Value	Percent of Total Value	2004 Fair Value	Percent of Total Value
Bonds and Mortgage Securities				
U. S. Government and Agencies	\$ 2,947,558	6.57%	\$ 2,284,001	5.67%
Mortgage securities	3,287,705	7.33%	3,307,543	8.21%
Corporate and other bonds	3,347,376	7.46%	1,574,856	3.91%
Total Bonds and Mortgage Securities	9,582,639	21.36%	7,166,400	17.79%
Common and Preferred Stocks	15,980,181	35.64%	14,224,149	35.33%
Index and Pooled Funds				
Equity Index and Pooled Funds	11,036,690	24.61%	11,728,611	29.13%
Fixed Income Commingled Funds	1,590,868	3.55%	1,225,707	3.04%
Total Index and Commingled Funds	12,627,558	28.16%	12,954,318	32.17%
Real Estate				
Commingled funds	588,607	1.31%	466,521	1.16%
Properties	—	0.00%	5,500	0.01%
Real estate loans	459	0.00%	459	0.00%
Focused	639,187	1.42%	619,699	1.54%
Total Real Estate	1,228,253	2.73%	1,092,179	2.71%
Private Equity	2,225,579	4.96%	1,996,233	4.96%
Hedge Funds	1,672,312	3.73%	1,195,556	2.97%
Short-term Investments				
Treasurer of Virginia - LGIP Investment Pool	200,158	0.45%	262,700	0.65%
TBC Pooled employee trust fund	1,274,734	2.84%	1,336,210	3.32%
Foreign currencies	58,111	0.13%	39,092	0.10%
Total Short-term Investments	1,533,003	3.42%	1,638,002	4.07%
Total Investments	\$ 44,849,525	100.00%	\$ 40,266,837	100.00%

PORTFOLIO HIGHLIGHTS

Public Equity

The Total Public Equity Program totaled \$27.6 billion at year end, approaching 63% of the total fund. Approximately 69% was invested in Domestic Equity and 31% in International Equity. Thirty-five percent of the Total Public Equity portfolio was invested in passive strategies, and 27% was managed internally. The objective of the portfolio is to exceed the return of the Custom Benchmark over three-year periods net of all costs. At year end, the Custom Benchmark was comprised of 69% Russell 3000 and 31% of the S&P/Citigroup BMI Global Ex US.

The Total Public Equity Program outperformed the Custom Benchmark during the fiscal year by 1.26%. During the year, the Russell 3000 was up 8.1%, and the BMI Global Ex US was up 18.0%. Value stocks significantly outperformed, especially in the mid and smaller capitalization companies both internationally and domestically.

Total Public Equity Program

Benchmark Category	VRS Return*	Benchmark Return*	VRS Weight	Benchmark Weight
Russell 1000	8.1%	7.9%	41.0%	42.7%
Russell 2000	10.3%	9.4%	5.8%	4.1%
Russell 3000	8.2%	8.1%	5.6%	5.6%
Russell Special Small Cap	15.4%	13.6%	1.1%	1.9%
S&P 500	10.5%	6.3%	8.1%	7.3%
S&P/Citigroup PMI World	14.9%	10.8%	14.2%	14.2%
S&P/Citigroup PMI Emerging	32.2%	33.3%	4.0%	2.4%
S&P/Citigroup EMI World Ex US	25.4%	20.3%	5.6%	4.7%
S&P/Citigroup PMI World Ex US	14.4%	15.6%	14.6%	17.1%
Total Program	12.3%	11.0%	100.0%	100.0%

*One-Year Total Return June 30, 2005

Weights as of June 30, 2005

The VRS portfolio remained fairly close to the Custom Benchmark Sectors and Region weights.

Custom Benchmark Sectors and Regions

Sectors**	Strategic VRS BM		Regions**	Strategic VRS BM	
Consumer Discretionary	11.5%	12.4%	North America	72.0%	70.7%
Consumer Staples	9.4%	8.1%	Europe/Australia/Far East	17.7%	18.5%
Energy	9.5%	8.6%	Asia Pacific	9.6%	10.1%
Financials	22.9%	23.3%	Latin & South America	0.7%	0.7%
Health Care	11.4%	11.4%			
Industrials	10.0%	10.4%			
Information Technology	13.1%	12.9%			
Materials	3.7%	4.8%			
Telecommunication Services	5.1%	4.1%			
Utilities	3.4%	4.0%			

**Barra Sectors, Regions & Weights

The top 10 holdings in the total Public Equity program comprised 10% of the program at year end. In comparison to last year, one company fell from the list. American International Group was replaced with Altria Group.

Public Equity: Top 10 Holdings

Company	Market Value	Shares
General Electric Company	\$ 425,845,177	12,289,904
Exxon Mobil Corporation	418,652,646	7,284,716
Citigroup Inc.	339,416,164	7,341,903
Microsoft Corporation	273,251,301	11,000,455
Bank of America Corporation	258,103,695	5,658,928
Pfizer Inc.	242,291,715	8,785,051
Johnson & Johnson	224,849,204	3,459,219
Altria Group Inc.	205,277,346	3,174,719
Intel Corporation	203,851,574	7,822,393
Cisco Systems Inc.	163,413,663	8,551,212

Currency Program

At the end of March 2005, VRS introduced an active currency program. At year end, the notional exposure of this program was \$3.6 billion with a total return year-to-date of 28 basis points.

Fixed Income

VRS invests a portion of its portfolio in fixed income investments in order to reduce total fund volatility, produce income and provide for some protection in the event of a deflationary environment. At year end, approximately \$8.7 billion was invested in fixed-income assets, representing 20% of the VRS portfolio. Of this amount, approximately 50% was invested actively using outside investment managers, and 50% was invested passively. Internally managed accounts made up approximately 75% of the passive portion of the portfolio. The objective of the program is to control risk and exceed the return of the VRS Custom Lehman Brothers Index, net of all costs.

The fixed income program return was 7.2% for the fiscal year. This was above our long-term expected return for bonds and well ahead of the program benchmark of 6.8%.

The yield curve flattened dramatically over the last fiscal year as the Federal Reserve methodically pushed short-term rates higher in an effort to keep economic growth moderate and inflation benign. Two-year rates rose 96 basis points to 3.63% and ten-year rates fell 67 basis points to 3.91%. As a result of the relatively low level of long-term treasury yields, investors increasingly focused on high-grade spread sectors such as corporate, agency and mortgage securities. By the end of the fiscal year, spreads in these sectors were at very low levels. Looking forward, we believe that the Federal Reserve has created an environment in which treasury yields will be fairly stable, economic growth will remain moderately strong and core inflation will remain in the 2% to 2.5% area.

Fixed Income: Top 10 Holdings By Market Value

As of June 30, 2005

Par	Security Description	Market Value
205,000,000	FHLMC 5.00% 30-year MBS	\$205,135,101
121,860,000	U.S. Treasury Notes 3.50% due 12/15/2009	120,710,859
103,595,000	U.S. Treasury Notes 3.375% due 2/28/2007	103,144,364
82,196,000	GNMA 6.00% 30-year MBS	84,768,735
60,396,000	U.S. Treasury Bonds 6.25% due 8/15/2023	75,286,633
68,125,000	U.S. Treasury Notes 3.75% due 3/31/2007	68,228,550
62,680,000	U.S. Treasury Notes 4.00% due 2/15/2015	62,911,291
41,945,000	U.S. Treasury Bonds 8.125% due 8/15/2019	59,448,647
57,200,000	FNMA 6.00% 30-year MBS	58,576,349
50,000,000	FHLMC 5.50% 30-year MBS	50,727,634
47,800,000	GNMA 6.50% 30-year MBS	49,922,320

Fixed Income Portfolio

As of June 30, 2005

Sector Allocation Sector	% Portfolio
Treasury	25.2%
Agency	8.1%
Corporate	26.8%
Mortgage	30.9%
Asset Backed	2.0%
CMBS	3.2%
Foreign	1.1%
Other	2.7%
TOTAL	<u>100.0%</u>
Credit Quality Breakdown Rating	% Portfolio
Government	65.2%
AAA	7.6%
AA	2.5%
A	16.3%
BBB	6.5%
BB	0.9%
B	0.0%
Below B	0.1%
NR	0.9%
TOTAL	<u>100.0%</u>

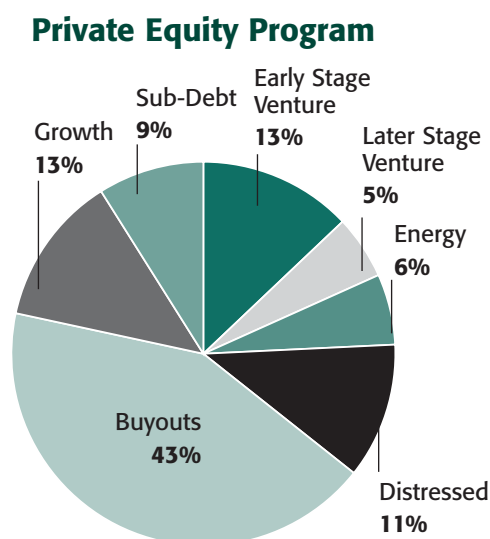
Short-Term Investments

As a general rule, VRS desires to remain fully invested at all times and seeks to minimize its holdings of cash investments. Temporary cash balances are invested in short-term money market instruments with the goal of maintaining high credit quality and liquidity. The return on such investments approximates the return on 90-day U.S. Treasury bills, which was 2.15% over last year.

Private Equity

VRS invests in Private Equity in order to achieve returns greater than those available in the public equity markets. Specifically, the program seeks to outperform the Russell dollar-weighted 3000 Index by 2.5% per year. Program returns are calculated on both a time-weighted basis and a dollar-weighted or internal rate-of-return basis. On a time-weighted basis, the program returns for fiscal years 2005 and 2004 were 21.5% and 27.8%, respectively. The returns during the last two fiscal years are due primarily to a strong exit environment for buyout funds and improving fundamentals for venture capital funds. Time-weighted returns are calculated for purposes of including the private equity return in the overall fund's total time-weighted return. A more appropriate measurement of returns for the private equity asset class is a dollar-weighted or internal rate of return (IRR) calculation. Based on this methodology, the program's since-inception (1989) IRR was an annualized 23.7% (as of March 31, 2005). By comparison, a dollar-weighted return for the Russell 3000 Index over the same time frame was 17.4%.

As of June 30, 2005, the appraised value of the program was approximately \$2.2 billion. The vast majority of the program is invested in limited partnerships. Sectors in which the program invests include leveraged buyouts, venture capital, growth, sub-debt, distressed debt and energy. The breakdown of the Private Equity program by sub-class was as follows:



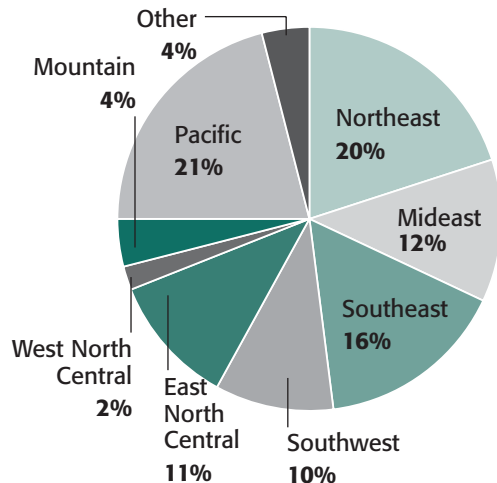
Real Estate

A portion of the portfolio is invested in real estate to help diversify the total fund by providing exposure to an asset class that has a low correlation with the public markets. Real estate produced a 24.4% return for the fiscal year, 14.8% over the past three years and 13.7% over five years, outperforming its benchmark by 320 basis points for the fiscal year, 170 basis points for three years and 120 basis points over the five-year period.

Over the course of the year, the percentage of the total fund represented by the real estate portfolio increased from 3.7% to 4.2% due primarily to appreciation. At fiscal year end, the composition of the portfolio was composed of approximately 37% public real estate (mostly REITs) and 63% in private assets. Debt as a percentage of total real estate assets remained at a conservative level of 33.2%.

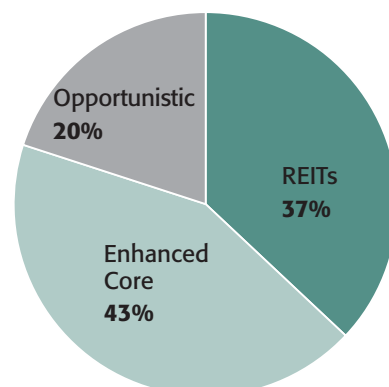
By Geographic Region

June 30, 2005



By Risk Return Category

June 30, 2005

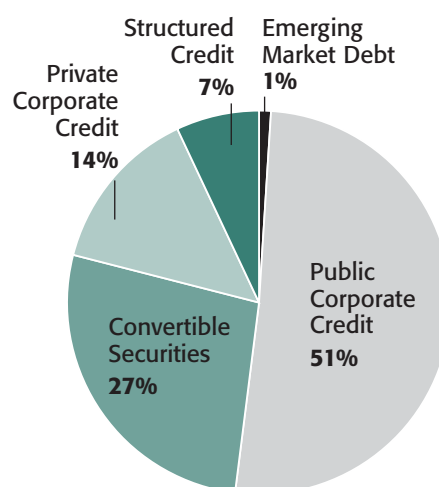


Credit Strategies

The Credit Strategies program was initially funded in July 2004. The program has grown over the course of the year to \$1.65 billion, or 3.8% of the plan. The program is made up of externally managed portfolios that are invested in high-yield credit and convertible securities. Within the high-yield credit area, funds are allocated across the public corporate credit, private corporate credit, structured credit and emerging market areas.

The credit strategies program return was 7.6% for the fiscal year. This was below the program benchmark return of 8.6%, but ahead of the long-term expected return for the program.

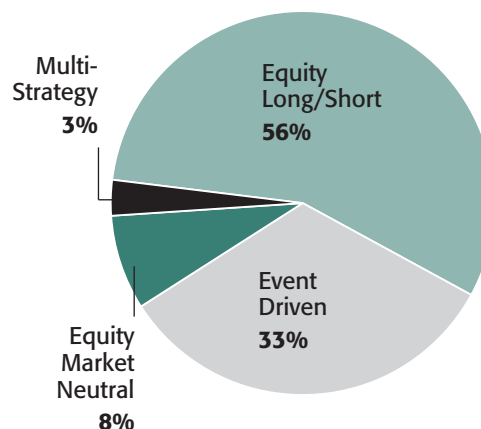
Credit Strategies



Hedge Funds

VRS invests in hedge funds to match the domestic equity market returns while taking substantially less risk and to provide a return stream that exhibits low correlation to the rest of the plan. Specifically, the program seeks to outperform its customized benchmark. Since its inception on July 1, 2003, the Hedge Fund Program has generated an annualized net return of 9.3% versus the benchmark return of 7.3%. Over the past fiscal year, the Hedge Fund Program generated an annualized return net of fees of 9.0% versus the benchmark return of 6.5%. As of June 30, 2005, the program was approximately \$1.7 billion. Approximately 75% of the investments have been made with the assistance of outside advisors while the remaining 25% has been invested internally by staff.

Hedge Funds



More Information

A complete list of the investment portfolio is available on request. Address requests to the Chief Investment Officer of the Virginia Retirement System, P.O. Box 2500, Richmond, VA 23218-2500.

VRS MONEY MANAGERS

The diversified investment structure as of June 30, 2005 is reflected in the following tables, which list VRS managers by investment program and style.

Public Equity Money Managers

External	Style Description
Acadian Asset Management	Non U.S. Small & Emerging Markets
Alliance Bernstein	Global
Aronson + Johnson + Ortiz	U.S. Small & U.S. Large
Arrowstreet Capital	Global
Ashmore Investment Management	Emerging Markets
BlackRock	Non U.S. Small
Barclays Global Investors	Active Currency
Capital Guardian Trust Company	Global
Franklin Portfolio Associates	U.S. Small
Freeman Associates Investment Management	U.S. Large
Fuller & Thaler Asset Management	U.S. Large
Goldman Sachs Asset Management	U.S. Small & Global
Grantham, Mayo and Van Otterloo & Company	Non U.S. Small
Hermes Focus Asset Management	Non U.S. Large
Ironbound Capital Management	Global
J.P. Morgan Investment Management	U.S. Large
Lee Overlay Partners	Active Currency
LSV Asset Management	Non U.S. Small
Relational Investors	U.S. Large
Russell Investment Group	U.S. Large
State Street Global Advisors	U.S. Large & Non U.S. Large
Symphony Asset Management	U.S. Large
T. Rowe Price	Emerging Markets
The Boston Company	Emerging Markets
TimesSquare Capital Management	U.S. Small
Wellington Management	Non U.S. Large, Global & Active Currency
Internal	Style Description
Afton	U.S. Small
Madison	U.S. Large
Potomac Core	U.S. Large
Russell 2000 Synthetic	U.S. Small
York Value	U.S. Large

Fixed Income Managers

	Style Description
Agincourt	Core/External Active
BlackRock	Core/External Active
Prudential	Core/External Active
Wellington	Core/External Active
Western Asset Management	Core/External Active
State Street Global Advisors	External Passive
VRS Internal	Internal Passive

VRS Credit Strategies Managers

Style Description	
BlackRock Kelso Capital	Bank Loans and Mezzanine Credit
Hyperion GMAC Capital	Structured Credit
Oaktree Capital Management	Mezzanine Credit
Post Advisory Group	Public High Yield Credit
Prudential	Public High Yield and Mezzanine Credit
Salomon Brothers Asset Management	Public High Yield and Emerging Markets
Seix Advisors	Public High Yield Credit
W.R. Huff	Public High Yield Credit
Oaktree Capital Management	Convertibles
Zazove Associates	Convertibles

Private Equity - Top 10 Managers

Style Description	
Welsh Carson, Anderson & Stowe	Buyout and Sub-Debt
Summit Partners	Growth and Sub-Debt
Hellman & Friedman	Buyout
Credit Suisse First Boston	Fund of Funds
Joseph, Littlejohn & Levy	Turnaround
Charterhouse	International Buyout
First Reserve	Buyout
Madison Dearborn	Buyout
Apax Partners	International Buyout
TA Associates	Growth and Sub-Debt

Hedge Fund Managers

Style Description	
Ivy Asset Management	Multiple Strategy
Rock Creek Group	Multiple Strategy
Anchorage	Event Driven
TPG Axon	Equity Long/Short
Blue Ridge	Equity Long/Short
Drawbridge	Event Driven
Frontpoint Healthcare	Equity Long/Short
Och Ziff	Multiple Strategy
Pennant Windward	Equity Long/Short
SAB	Equity Long/Short

Real Estate Managers

Public Real Estate Securities	Style Description
ING-Clarion	REIT Portfolio
Urdang	REIT Portfolio
Internal-Monticello II	REIT Portfolio
Private Real Estate	Style Description
AMB	Opportunistic
Blackstone Real Estate Partners	Opportunistic
Colonnade Capital	Opportunistic
Hines	Opportunistic
JER Partners	Opportunistic
Koll Bren Schreiber	Opportunistic
Lazard Frères	Opportunistic
Oaktree Capital Management	Opportunistic
Prudential	Enhanced Core
Security Capital	Enhanced Core
TA Associates	Enhanced Core
Avalon Bay	Enhanced Core

Public Equity Commissions

July 1, 2004 through June 30, 2005

Broker name	Commission
Banc of America Securities, LLC	\$ 2,475,577
Lehman Brothers, Inc.	2,184,227
Goldman, Sachs & Co.	1,752,917
Citigroup GBL Mkts/Salomon	1,739,551
Merrill Lynch Pierce Fenner & Smith, Inc.	1,624,367
Deutsche Bank Securities	1,169,544
Investment Tech Group, Inc.	1,038,286
Union Bank Switzerland Securities	924,887
Morgan Stanley & Co.	917,323
Credit Lyonnais	809,161
Credit Suisse	795,768
Bear Stearns & Co., Inc.	732,274
Pershing Securities Ltd.	607,035
Instinet Corp.	462,826
Jeffries & Co., Inc.	372,000
Neuberger and Berman	313,394
Weeden & Co.	162,109
ABN AMRO Bank N.V.	148,845
Kleinwort Benson Securities, Ltd.	143,437
SG Securities (London), Ltd.	140,843
J.P. Morgan Securities, Ltd.	139,069
SBC Warburg Dillon Read	132,302
Nomura Securities	131,276
Sanford C. Bernstein & Co.	120,248
HSBC Securities	114,592
National Financial Service	112,391
Cantor Fitzgerald & Co., Inc.	105,545
Other Brokers	2,575,062
Total FY 2005	\$ 21,944,856

ACTUARIAL SECTION



On January 1, 2006, the first wave of baby-boomers will turn 60. With the aging of the American population, public pension systems will continue to see a steady increase in the number of retirees over the remainder of this decade and into the next.

Between 1996 and 2005, VRS retirees increased almost 47 percent, from 81,400 to 119,400. Between now and 2010, approximately 40,000 current VRS members, or 12.3 percent of the total membership, will be eligible to retire with a full benefit.

Retired teachers are the largest segment of the VRS retiree population. In fact, of the 65 retirees who are age 100 or older, 50 are retired teachers.

**GABRIEL, ROEDER, SMITH & COMPANY****Consultants & Actuaries**

5605 N. MacArthur Blvd. • Suite 870 • Irving, Texas 75038-2631 • 469-524-0000 • fax 469-524-0003

December 29, 2004

Board of Trustees
Virginia Retirement System
P.O. Box 2500
Richmond, VA 23218-2500

Subject: Actuarial Valuation as of June 30, 2004

Dear Members of the Board:

We certify that the information contained in this report is accurate and fairly presents the actuarial position of the Virginia Retirement System (VRS) as of June 30, 2004, with respect to the Virginia Retirement System (State Employee and Teacher members), the State Police Officers' Retirement System, the Judicial Retirement System and the Virginia Law Officers' Retirement System. Separate reports will be issued later for each of the local employer units that participate in VRS.

Rates shown in this report exclude the cost of the health care credit and the group life insurance program. The employer contribution rates calculated in this report are hypothetical rates that will never actually go into effect. The actual contribution rates are set by the odd-numbered year valuations for the two-year period beginning one year after the valuation date.

The hypothetical contribution rates in this report were determined as if they would be effective beginning in fiscal year 2006-2007. While they will never actually go into effect, they give an indication of the current actuarial status of the System and the direction that the next applicable set of rates will follow.

Our firm, as actuary of the System, supplied the data presented in the schedule of funding progress in the Financial Section of this Comprehensive Annual Financial Report (CAFR) as well as the supporting schedules in the Actuarial Section of the CAFR.

All calculations have been made in conformity with generally accepted actuarial principles and practices and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion, the results presented also comply with the Virginia statutes and, where applicable, the Internal Revenue Code, ERISA and the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries and all are experienced in performing valuations for large public retirement systems.

Actuarial Valuation

The primary purposes of the valuation report are (i) to determine the hypothetical employer contribution rate; (ii) to describe the current financial condition of VRS; and (iii) to analyze changes in VRS' condition. In addition, the report provides information required by VRS in connection with Governmental Accounting Standards Board Statement No. 25 (GASB No. 25), and it provides various summaries of the data.

Financing Objectives

The member contribution rates are established by statute. The employer contribution rates are intended to be calculated by the actuarial valuation. In consideration of the COLA implementation and the funded condition of the State Police, Virginia Law Officers, and State Judges Systems, the Board of Trustees has set the employer rate for these Systems to 25%, 25%, and 45% of annual payroll, respectively. The Board mandated these rates to be effective until these Systems have funded ratios (the ratio of the actuarial value of assets to the actuarial accrued liability) of 90% or greater. None of these funds has achieved a 90% funded ratio as of the valuation date.

We have calculated the contribution rate for the State Employees and Teachers independently and on a “pooled” basis. The “pooled” rates are calculated by combining the liabilities and assets of the employee groups. The resulting “pooled” rate is tested to comply with GASB No. 27 requirements. Please note that if the “pooled” rate is contributed, then the contribution to the Teachers’ plan will be less than the Annual Required Contribution (ARC).

The contribution rates determined by this valuation are hypothetical rates that will never actually be contributed. The contribution rates for the two-year period July 1, 2004 to June 30, 2006 were determined by the 2003 valuation (these rates were later modified by the General Assembly). The 2005 valuation will determine the contribution rates to be effective July 1, 2006. These hypothetical rates in this valuation are intended to be sufficient to pay the normal cost and to amortize the unfunded actuarial accrued liability (UAAL) in level percentage of payroll payments over a period of 22 years from the current valuation date, June 30, 2004. We consider this amortization period to be reasonable. Please note that we have recognized in the calculation of the contribution rates the delay (one year for odd-numbered valuations and two years for even-numbered valuations) between the valuation date and the date the new rates become effective.

The contribution rates currently being contributed to the Systems are not the rates that were established by the Board. Instead the General Assembly legislated that lower rates be contributed for fiscal years 2004, 2005, and 2006 than the rates specified by the Board.

Progress Toward Realization of Financing Objectives

The funded ratio decreased for the State Employees, Teachers, Judicial, and State Police plans since the last actuarial valuation. The decrease in the funded ratio is primarily due to asset losses on the actuarial value of assets. The Virginia Law Officers plan saw its funded ratio improve slightly. This plan also suffered losses on the actuarial value of assets, but also had large actuarial gains on the liability side that more than offset the asset losses from a funded ratio point of view.

The calculated employer contribution rates increased for all of the groups. The calculated rates reflect the full prefunding of the automatic COLA benefits in compliance with the requirements of Governmental Accounting Standards Board Statement No. 25.

Benefit Provisions

The actuarial valuation reflects the benefit provisions set forth in the Virginia statutes. There were several technical changes to the statutes along with a couple of minor benefit provision changes. None of the changes was material from an actuarial viewpoint. There are no ancillary benefits (such as cost-of-living increases to retirees) funded by a source independent of VRS.

Assumptions and Methods

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan’s actuary. No assumptions used in this valuation have been changed from those used for the 2003 valuation. Principle assumptions used for the June 30, 2004 valuation can be found in Table 20.

Data

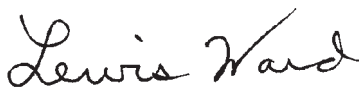
Member data for retired, active and inactive participants was supplied as of June 30, 2004 by the staff of VRS. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior valuation’s data. The VRS staff also supplied required asset information.

Sincerely,

Gabriel, Roeder, Smith & Company



W. Michael Carter, FSA
Senior Consultant



Lewis Ward
Consultant



Joe Newton, ASA
Consultant

Solvency Test

(Expressed in Thousands)

Valuation Date (June 30)	Aggregate Accrued Liabilities for				Portion of Accrued Liabilities Covered by Assets		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members*	Valuation Assets	(1)	(2)	(3)
Virginia Retirement System (VRS)							
2004	\$ 6,139,908	\$ 18,971,864	\$ 18,846,578	\$ 39,691,562	100.00%	100.00%	77.36%
2003	5,703,557	17,223,070	17,770,944	39,242,624	100.00%	100.00%	91.81%
2002	5,285,338	15,878,494	17,101,328	38,957,256	100.00%	100.00%	104.05%
2001	4,847,656	14,411,943	16,119,211	37,967,820	100.00%	100.00%	116.06%
2000	4,639,007	12,652,663	15,350,685	34,392,303	100.00%	100.00%	111.40%
1999	4,240,017	11,820,608	15,358,116	29,803,990	100.00%	100.00%	89.49%
1998	3,937,941	10,732,243	14,359,783	25,480,634	100.00%	100.00%	75.28%
1996	3,202,232	9,213,095	11,426,575	19,031,780	100.00%	100.00%	57.90%
1994	2,842,030	7,257,368	10,305,790	14,890,663	100.00%	100.00%	46.49%
State Police Officers' Retirement System (SPORS)							
2004	\$ 61,529	\$ 310,306	\$ 284,509	\$ 510,604	100.00%	100.00%	48.77%
2003	59,097	277,282	279,243	508,576	100.00%	100.00%	61.67%
2002	57,152	253,687	283,797	507,889	100.00%	100.00%	69.43%
2001	54,507	215,658	286,463	494,952	100.00%	100.00%	78.47%
2000	50,044	199,822	262,761	440,903	100.00%	100.00%	72.70%
1999	45,516	200,288	217,252	376,780	100.00%	100.00%	60.29%
1998	42,154	190,196	192,348	321,696	100.00%	100.00%	46.45%
1996	37,715	139,258	193,888	243,066	100.00%	100.00%	34.10%
1994	37,211	80,867	158,520	201,149	100.00%	100.00%	52.40%
Virginia Law Officers' Retirement System (VaLORS)**							
2004	\$ 143,836	\$ 246,872	\$ 536,424	\$ 508,561	100.00%	100.00%	21.97%
2003	135,144	195,554	523,138	457,615	100.00%	100.00%	24.26%
2002	127,975	110,426	567,716	418,518	100.00%	100.00%	31.73%
2001	111,143	5,639	510,857	392,815	100.00%	100.00%	54.03%
2000	108,538	27,356	543,943	307,301	100.00%	100.00%	31.51%
Judicial Retirement System (JRS)							
2004	\$ 30,176	\$ 211,228	\$ 124,171	\$ 285,178	100.00%	100.00%	35.25%
2003	28,766	198,005	121,265	282,326	100.00%	100.00%	45.81%
2002	28,089	186,886	137,029	281,056	100.00%	100.00%	48.22%
2001	23,595	176,142	142,095	276,542	100.00%	100.00%	54.05%
2000	24,079	191,146	115,127	244,721	100.00%	100.00%	25.62%
1999	20,978	171,136	110,328	209,992	100.00%	100.00%	16.20%
1998	19,239	152,557	102,629	179,693	100.00%	100.00%	7.69%
1996	16,885	140,964	84,918	137,886	100.00%	85.80%	0.00%
1994	15,593	102,889	80,080	115,306	100.00%	96.91%	0.00%

Aggregate Accrued Liabilities are determined under the entry age normal cost method (system-funded method used to determine employer contribution requirements).

The progress of a retirement system in accumulating assets to pay benefits when due can be measured by examining the extent to which assets accumulated for benefits cover 1) active member contributions to the system; 2) liabilities for future benefits to retirants and beneficiaries; and 3) liabilities for the employer-financed portion of service already rendered by active members. In a system receiving actuarially determined employer contributions, the liabilities for member contributions and future benefits to retirants and beneficiaries will generally be fully covered by accumulated assets. In addition, the liabilities for service already rendered will be partially covered by the remainder of accumulated assets and will increase over time.

* Employer-financed portion.

** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

Actuarial Assumptions and Methods	1994/1996	1998/1999	2000/2001	2002/2003/2004
Valuation interest rate	8%	8%	8%	8%
Salary scale inflation factor	4%	4%	3%	3%
Change in decremental assumptions	Yes	No	Yes	No
Value of ancillary benefits included	Yes	Yes	Yes	Yes
Value of post-retirement adjustments to date included	Yes	Yes	Yes	Yes
Assets valued at market	Modified Market	Modified Market	Modified Market	Modified Market

Schedule of Active Member Valuation Data

Valuation Date (June 30)	Active Members				Number of Employers
	Number	Annual Payrolls (000s)	Average Annual Pay	Annualized % Increase in Average Pay	
Virginia Retirement System (VRS)					
2004	305,388	\$ 11,509,902	\$ 37,689	4.1%	565
2003	300,612	10,884,629	36,208	1.1%	559
2002	297,921	10,668,980	35,811	2.9%	551
2001	291,621	10,145,212	34,789	3.9%	551
2000	284,486	9,528,666	33,494	4.7%	545
1999	285,596	9,138,060	31,996	2.7%	532
1998	277,223	8,638,414	31,161	6.2%	519
1996	264,656	7,769,043	29,355	5.9%	513
1994	262,512	7,274,210	27,710	5.4%	504
State Police Officers' Retirement System (SPORS)					
2004	1,755	\$ 82,100	\$ 46,781	2.2%	1
2003	1,727	79,020	45,756	(1.3%)	1
2002	1,740	80,680	46,368	(1.5%)	1
2001	1,771	83,339	47,058	2.7%	1
2000	1,768	80,977	45,801	5.3%	1
1999	1,761	76,628	43,514	11.9%	1
1998	1,682	65,427	38,898	4.7%	1
1996	1,604	59,599	37,156	3.2%	1
1994	1,607	57,838	35,991	6.5%	1
Virginia Law Officers' Retirement System (VaLORS)*					
2004	9,746	\$ 298,313	\$ 30,609	1.0%	1
2003	9,626	291,801	30,314	(0.6%)	1
2002	10,036	306,024	30,493	(0.7%)	1
2001	10,434	320,254	30,693	2.7%	1
2000	10,542	315,158	29,895	0.0%	1
Judicial Retirement System (JRS)					
2004	405	\$ 48,271	\$ 119,188	2.2%	1
2003	408	47,568	116,588	0.0%	1
2002	408	47,568	116,588	0.0%	1
2001	404	47,125	116,646	2.5%	1
2000	399	45,394	113,769	6.7%	1
1999	390	41,590	106,641	3.8%	1
1998	383	39,332	102,695	8.5%	1
1996	378	35,783	94,664	4.7%	1
1994	362	32,716	90,376	4.4%	1

* The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

Schedule of Retirants and Beneficiaries

Valuation Date (June 30)	Retired Members and Beneficiaries				
	Retirees and Beneficiaries Added/Removed*	Total Retirees and Beneficiaries	Annual Allowances (000)s	Annualized % Increase in Annual Allowances	Average Annual Allowances
Virginia Retirement System (VRS)					
2004	7,913/2,561	111,770	\$ 1,676,175	9.0%	\$ 14,997
2003	7,920/3,554	106,418	1,537,902	11.8%	14,452
2002	7,451/3,496	102,052	1,375,777	6.7%	13,481
2001	7,962/3,337	98,097	1,289,657	12.1%	13,147
2000	7,932/3,685	93,472	1,150,213	8.6%	12,305
1999		89,225	1,059,602	16.4%**	11,786
1998		88,500	896,409	3.4%	10,129
1996		80,499	838,147	8.9%	10,412
1994		72,422	711,518	7.9%	9,825
State Police Officers' Retirement System (SPORS)					
2004	56/4	862	\$ 26,361	11.1%	\$ 30,581
2003	63/25	810	23,737	18.2%	29,305
2002	72/12	772	20,077	7.1%	26,006
2001	26/11	712	18,748	8.0%	26,331
2000	38/8	697	17,362	9.9%	24,910
1999		667	15,793	23.2%**	23,678
1998		668	12,844	15.1%	19,227
1996		572	9,865	14.5%	17,247
1994		470	7,649	11.9%	16,275
Virginia Law Officers' Retirement System (VaLORS)***					
2004	207/2	970	\$ 20,423	27.8%	\$ 21,055
2003	248/10	765	15,982	72.7%	20,892
2002	251/18	527	9,252	324.2%	17,556
2001	197/13	294	2,181	198.8%	7,418
2000	124/14	110	730	0.0%	6,636
Judicial Retirement System (JRS)					
2004	33/21	387	\$ 21,789	6.4%	\$ 56,302
2003	35/26	375	20,488	8.3%	54,635
2002	14/17	366	18,918	1.2%	51,689
2001	21/16	369	18,699	7.6%	50,675
2000	21/9	364	17,373	4.3%	47,728
1999		352	16,659	11.1%**	47,327
1998		347	14,787	4.1%	42,615
1996		330	13,666	12.4%	41,412
1994		305	10,944	5.9%	35,882

* Number of retirees and beneficiaries added and removed is unavailable prior to FY 2000.

** Increase in annual allowances due to 2% ad hoc increase in retiree benefit allowances effective January 1, 1999 and an increase in the benefit formula multiplier.

*** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

During FY 2004, total Annual Allowances were decreased by \$25,781,000 for individuals removed from the annuity payroll and increased by \$172,420,000 for individuals added to the annuity payroll as well as for the COLA of 1.3% effective July 1, 2003.

Analysis of Actuarial Gains and Losses for the Year Ended June 30, 2004

(in thousands)

	VRS	SPORS	VaLORS	JRS	Total
A. Calculation of Expected Unfunded Actuarial Accrued Liability (UAAL)					
1. UAAL as of June 30, 2003	\$ 1,454,947	\$ 107,046	\$ 396,221	\$ 65,710	\$ 2,023,924
2. Normal Cost for previous year	1,143,296	10,265	39,422	12,934	1,205,917
3. Actual contributions during the year	(1,095,873)	(15,232)	(56,293)	(17,758)	(1,185,156)
4. Interest at previous year's rate of 8.00%					
a. On UAAL	116,396	8,564	31,698	5,257	161,915
b. On Normal Cost	45,733	411	1,577	517	48,238
c. On contributions	(43,835)	(609)	(2,252)	(710)	(47,406)
d. Total	118,294	8,366	31,023	5,064	162,747
5. Expected UAAL as of June 30, 2004 (A1 + A2 + A3 + A4)	1,620,664	110,445	410,373	65,950	2,207,432
6. Actual UAAL as of June 30, 2004	4,266,788	145,740	418,572	80,397	4,911,497
7. Total Gain/(Loss) (A5 - A6)	(2,646,124)	(35,295)	(8,199)	(14,447)	(2,704,065)
B. Calculation of Asset Gain/(Loss)					
1. Actuarial Value of Assets (AVA) as of June 30, 2003	39,242,624	508,576	457,615	282,326	40,491,141
2. Contributions during the year	1,095,873	15,232	56,293	17,758	1,185,156
3. Benefit payments during the year	(1,772,405)	(27,067)	(23,783)	(22,706)	(1,845,961)
4. Interest at previous year's rate of 8.00%					
a. On AVA at beginning of year	3,139,410	40,686	36,609	22,586	3,239,291
b. On contributions	43,835	609	2,252	710	47,406
c. On benefit payments	(70,897)	(1,083)	(951)	(908)	(73,839)
d. Total	3,112,348	40,212	37,910	22,388	3,212,858
5. Expected AVA as of June 30, 2004 (B1 + B2 + B3 + B4)	41,678,440	536,953	528,035	299,766	43,043,194
6. Actual AVA as of June 30, 2004	39,691,562	510,604	508,561	285,178	40,995,905
7. Total Gain/(Loss) on assets (B6 - B5)	(1,986,878)	(26,349)	(19,474)	(14,588)	(2,047,289)
C. Calculation of Liability Gain/(Loss)					
1. Gain/(Loss) due to changes in actuarial assumptions	—	—	—	—	—
2. Gain/(Loss) due to plan amendments	—	—	—	—	—
3. Liability Experience Gain/(Loss) (A7-B7-C1-C2)	\$ (659,246)	\$ (8,946)	\$ 11,275	\$ 141	\$ (656,776)

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

The following actuarial assumptions and methods were adopted by the VRS Board of Trustees on November 15, 2000 on the recommendation of its actuary. Assumptions were changed effective for the June 30, 2000 valuation based upon an analysis of plan experience for the four years then ending.

Investment Return Rate	8.00% per annum, compounded annually, composed of an assumed 3.00% inflation rate and a 5.00% real rate of return. Benefits are assumed to increase by 3.00% annually due to the COLA.
Mortality Rates	Virginia Retirement System, State Police Officers' Retirement System, Virginia Law Officers' Retirement System and Judicial Retirement System.
<i>Pre-Retirement</i>	1994 Group Annuity Mortality Table for males and females.
<i>Post-Retirement</i>	1994 Group Annuity Mortality Table for males and females set back two years for male teachers, one year for female teachers and three years for state police officers and other law enforcement and correctional officers.
<i>Post-Disablement</i>	70% of PBGC Disabled Mortality Table 5a for males; 90% of PBGC Disabled Mortality Table 6a for females.

Retirement Rates

State Employees and Employees of Political Subdivisions

Sample rates of retirement are shown below for members eligible to retire.

Retirement Per 100 Members

Age	Reduced Retirement		Unreduced Retirement	
	Male	Female	Male	Female
50	1.00	1.25	10.00	5.00
55	2.25	3.00	10.00	5.00
59	6.00	4.25	6.50	7.50
60	4.00	7.50	11.50	10.00
61	12.50	12.50	20.00	20.00
62	20.00	20.00	30.00	25.00
64	20.00	20.00	29.00	20.00
65	—	—	42.00	45.00
67	—	—	28.00	15.00
70	—	—	100.00	100.00

Retirement Rates, continued

Teachers

Sample rates of retirement are shown below for members eligible to retire.

Retirement Per 100 Members

Age	Reduced Retirement		Unreduced Retirement	
	Male	Female	Male	Female
50	1.00	1.50	7.50	6.50
55	2.00	2.00	22.50	19.50
59	5.00	5.00	22.50	19.50
60	6.00	6.00	30.00	19.50
61	8.00	8.00	30.00	26.00
62	20.00	20.00	52.50	45.50
64	20.00	20.00	30.00	32.50
65	—	—	90.00	58.50
67	—	—	30.00	39.00
70	—	—	100.00	100.00

State Police Officers' and Virginia Law Officers' Retirement Systems

Retirement Per 100 Members

Age	Reduced Retirement	Unreduced Retirement
50	3.00	18.00
55	6.00	27.00
56	6.00	36.00
60	—	100.00

Judicial Retirement System

Sample rates of retirement are shown below for members eligible to retire with an unreduced retirement benefit.

Age	Rate
At first age eligible for an unreduced retirement benefit	50.0%
At subsequent ages	5.0%
At age 70	100.0%

Disability Rates

As shown below for selected ages.

State Employees and Employees of Political Subdivisions

14% of disability cases are assumed to be service-related.

Disability Per 100 Members

Age	Male	Female
20	0.030	0.009
30	0.120	0.036
40	0.270	0.081
50	1.020	0.306
60	3.000	0.900

Teachers

5% of disability cases are assumed to be service-related.

Disability Per 100 Members

Age	Male	Female
20	—	—
30	0.026	0.016
40	0.052	0.093
50	0.299	0.326
60	0.845	0.884

State Police Officers' and Virginia Law Officers' Retirement Systems

60% of disability cases are assumed to be service-related.

Disability Per 100 Members

Age	
20	—
30	0.019
40	0.400
50	1.350
60	—

Judicial Retirement System

Disability Per 100 Members

Age	Male	Female
20	—	—
30	0.007	0.007
40	0.142	0.090
50	0.480	0.397
60	—	—

Termination Rates

Withdrawal rates are based on age and service. Sample rates for selected ages and years of service are shown below for causes other than death, disability, or retirement.

State Employees and Employees of Political Subdivisions

Probability of Decrement Due to Withdrawal

Age	Years of Service–Males					Years of Service–Females				
	1	3	6	9	10+	1	3	6	9	10+
25	0.1637	0.1170	0.0704	0.0433	0.0386	0.1847	0.1404	0.1110	0.0602	0.0533
35	0.1296	0.0925	0.0684	0.0433	0.0294	0.1366	0.1069	0.0802	0.0534	0.0393
45	0.0994	0.0663	0.0558	0.0354	0.0171	0.1052	0.0762	0.0574	0.0392	0.0218
55	0.0848	0.0518	0.0347	0.0226	0.0107	0.0924	0.0587	0.0381	0.0223	0.0110

Teachers

Probability of Decrement Due to Withdrawal

Age	Years of Service–Males					Years of Service–Females				
	1	3	6	9	10+	1	3	6	9	10+
25	0.1302	0.1028	0.0565	0.0384	0.0643	0.1130	0.1053	0.0762	0.0891	0.0919
35	0.1174	0.0824	0.0567	0.0381	0.0280	0.1133	0.0932	0.0669	0.0494	0.0325
45	0.1030	0.0652	0.0480	0.0312	0.0117	0.0929	0.0634	0.0449	0.0292	0.0130
55	0.1051	0.0605	0.0322	0.0187	0.0074	0.0929	0.0532	0.0308	0.0197	0.0067

State Police Officers' and Virginia Law Officers' Retirement Systems

Probability of Decrement Due to Withdrawal

Age	Years of Service–Males					Years of Service–Females				
	1	3	6	9	10+	1	3	6	9	10+
25	0.0569	0.0535	0.0485	0.0199	0.0240	0.0888	0.0698	0.0682	0.0362	0.0292
35	0.0624	0.0515	0.0343	0.0215	0.0165	0.0958	0.0664	0.0447	0.0399	0.0405
45	0.0681	0.0481	0.0292	0.0195	0.0094	0.0781	0.0656	0.0513	0.0426	0.0394
55	0.0766	0.0479	0.0278	0.0149	0.0065	0.0382	0.0682	0.1859	0.0447	0.0274

Judicial Retirement System

There are no assumed rates of withdrawal prior to service retirement for causes other than death, disability, or retirement.

Salary Increase Rates

The sample salary increase rates are shown below.

State Employees and Employees of Political Subdivisions

Inflation rate of 3.00% plus productivity component of 1.25% plus step-rate/promotional component as shown.

Years of Service	Annual Step Rate/Promotional Rates of Increase	Total Annual Rate of Increase
1	1.85%	6.10%
3	1.25%	5.50%
6	0.95%	5.20%
9	0.50%	4.75%
11–19	0.15%	4.40%
20 or more	0.00%	4.25%

Teachers

Inflation rate of 3.00% plus productivity component of 1.00% plus step-rate/promotional component as shown.

Years of Service	Annual Step Rate/Promotional Rates of Increase	Total Annual Rate of Increase
1	2.10%	6.10%
3	2.00%	6.00%
6	1.60%	5.60%
9	1.50%	5.50%
11–19	1.00%	5.00%
20 or more	0.00%	4.00%

State Police Officers' and Virginia Law Officers' Retirement Systems

Inflation rate of 3.00% plus productivity component of 1.50% plus step-rate/promotional component as shown.

Years of Service	Annual Step Rate/Promotional Rates of Increase	Total Annual Rate of Increase
1	1.25%	5.75%
3	1.25%	5.75%
6	0.90%	5.40%
9	0.90%	5.40%
11–19	0.50%	5.00%
20 or more	0.00%	4.50%

Judicial Retirement System

Salary increase rates are 5.00%.

It is assumed state employees covered under the Virginia Sickness and Disability Program (VSDP) receive a 4.25% annual increase in pay and state police and Virginia law officers receive a 4.50% annual increase in pay while disabled. This adjusted pay is used to determine deferred retirement benefits.

Percent Electing a Deferred Termination Benefit

(Excludes Judicial Retirement System)

Terminating members are assumed to elect a return of contribution or a deferred annuity, whichever is the most valuable benefit at the time of termination. Termination benefits are assumed to commence at the first age at which unreduced benefits are available.

Provision for Expense

The assumed investment return represents the anticipated net rate of return after payment of all administrative expenses.

Asset Valuation Method

The actuarial value of assets is equal to the market value of assets less a five-year phase in of the excess (shortfall) between expected investment return and actual income (both based on market value), with the resulting value not being less than 80% or more than 120% of the market value of assets.

Actuarial Cost Method

The funding period required to amortize the unfunded actuarial accrued liability (UAAL) is determined using the Entry Age Normal actuarial cost method. This method assigns the plan's total actuarial present value of future benefits to various periods. The actuarial accrued liability is assigned to years prior to the valuation, and the normal cost is assigned to the year following the valuation. The remaining costs are assigned to future years.

The normal cost rate is determined based on a group of new entrants. The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability (UAAL) is the excess of the actuarial accrued liability over the actuarial value of assets.

Payroll Growth Rate

3.00% based on a zero population growth assumption.

Funding Period

State employees, teachers, state police officers, Virginia law officers and judges 23 years (closed amortization, computed as a level percent of payroll). Calculation is pooled for state employees and teachers. Political subdivision employees 0 to 30 years (open amortization, computed as level percent of payroll).

Cost-of-Living Increase

3.00% per year compounded annually for the basic benefit. The temporary supplement for state police officers and Virginia law officers is assumed to increase at the inflation rate (3.00% per year, compounded annually).

SUMMARY OF BENEFIT PLAN PROVISIONS

Retirement Plans

- Virginia Retirement System (VRS), effective March 1, 1952
- State Police Officers' Retirement System (SPORS), effective July 1, 1950
- Judicial Retirement System (JRS), effective July 1, 1970
- Virginia Law Officers' Retirement System; (VaLORS), effective October 1, 1999

Plan Year

Twelve-month period ending June 30.

Administration

Plans are administered by the Board of Trustees of the Virginia Retirement System.

Type of Plans

- VRS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered an agent multiple-employer Public Employee/Retirement System (PERS) for participating Virginia cities, counties, towns and political subdivisions, with separate cost-sharing pools for state employees and teachers.
- SPORS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.
- JRS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.
- VaLORS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.

Eligibility

All full-time, salaried permanent employees of the Commonwealth of Virginia and all full-time, salaried permanent employees of local Virginia school boards or any participating Virginia county, city, town or political subdivision are eligible to become members of VRS. All state police officers of the Commonwealth of Virginia are eligible to become members of SPORS. All full-time judges of the Commonwealth of Virginia are eligible to become members of JRS. All full-time, salaried permanent Virginia law enforcement officers and correctional officers other than state police officers are eligible to become members of VaLORS.

Employee Contributions

All active members contribute 5.00% of their creditable compensation per year. The employer may pick-up the member's assessment under the provisions of Internal Revenue Code Section 414(h).

Creditable Compensation

Annual salary minus any overtime pay, payments of a temporary nature or payments for extra duties.

Service

Employees, state police officers and Virginia law officers receive credit of one month of service for each month a contribution is made on their behalf to VRS, SPORS and VaLORS. Judges receive credit of one month of service multiplied by a weighting factor of 3.5 (2.5 for judges entering JRS on or after January 1, 1995) for each month a contribution is made to JRS on their behalf. A member also may purchase credit for certain periods, such as time spent in the military, by paying a purchase rate (5% of the larger of current creditable compensation or final average compensation times the number of years to be purchased or actuarial cost). Special rules and limits govern the purchase of prior service.

Average Final Compensation

The average of the member's highest consecutive 36 months of creditable compensation.

Normal Retirement

Eligibility

Members of VRS and JRS may retire under Normal Retirement on or after age 65 with five years of service credit. A member of SPORS and VaLORS may retire under Normal Retirement on or after age 60 with five years of service credit.

Annual Benefit

For members of VRS and SPORS, 1.7% of average final compensation (AFC) times years of service. Members of VaLORS hired before July 1, 2001 were allowed to make a one-time election to have their benefit based on 2.0% of average annual compensation (AFC) instead of receiving a supplement. For members of JRS, 1.7% of average final compensation (AFC), times years of service, not to exceed 78% of AFC.

Supplement

Members of SPORS with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receive an additional allowance payable annually from the date of retirement to their Social Security normal retirement age. This supplement is adjusted biennially based upon increases in Social Security benefits during the interim period. Electing members of VaLORS hired before July 1, 2001 with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receive an additional allowance payable annually from the date of retirement to age 65.

Payment Form

Benefits are paid as a monthly life annuity, with a guarantee that if the payments made do not exceed the member's contributions plus interest, determined as of the date of retirement, the balance will be paid in a lump-sum to the member's beneficiary.

Early Retirement

Eligibility

A member of VRS may retire early after reaching age 50 with credit for 10 years of service, or age 55 with credit for five years of service. Members of SPORS and VaLORS may retire early after reaching age 50 with credit for five years of service. A member of JRS may retire early after reaching age 55 with credit for five years of service.

Annual Benefit

Calculated the same as the normal retirement benefit using actual service at retirement and multiplied by a reduction factor. No reduction applies if the VRS member has credit for 30 years of service at retirement and is at least age 50 (25 years of service and at least age 50 for members of SPORS and VaLORS, and 30 years of service and at least age 60 for members of JRS). For members of VRS and JRS at least age 55 (at least age 50 for members of SPORS and VaLORS), the reduction is 0.5% per month for the first 60 months and 0.4% per month for the next 60 months. This reduction is applied for each month the retirement age precedes 65 or, if more favorable, for each month the service at retirement is less than 30 (age 60 with service less than 25 for members of SPORS and VaLORS). For VRS members younger than age 55 at retirement, the reduction factor determined as though the member were 55 is further reduced by multiplying it by a second factor, to reflect a 0.6% reduction for each month retirement precedes age 55.

Supplement

Eligibility

Members of SPORS with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receive an additional allowance payable annually from the date of retirement to their Social Security normal retirement age. This supplement is adjusted biennially based upon increases in Social Security benefits during the interim period. Electing members of VaLORS hired before July 1, 2001 with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receive an additional allowance payable annually from the date of retirement to age 65.

Payment Form

Same as for Normal Retirement above.

Disability Retirement

Eligibility

VRS teacher and political subdivision members and JRS members are eligible from the first day of employment. VRS state employees, SPORS and VaLORS members hired prior to January 1, 1999 and who declined coverage under the Virginia Sickness & Disability Program (VSDP) are eligible from the first day of employment.

Annual Benefit

Members with less than five years of service credit receive the minimum guaranteed benefit. Members with more than five years of service credit receive the greater of (1) the minimum guaranteed benefit, which is 50% of AFC (66 ²/₃% if work-related disability) if member does not qualify for primary Social Security and 33 ¹/₃% of AFC (50% if work-related disability) if member qualifies for primary Social Security or (2) 1.7% of AFC times service credit. The work-related benefit is reduced by Worker's Compensation (if any).

Service Credit

If a disability occurs before age 60, service is the lesser of (1) twice actual service or (2) rendered service plus the number of years remaining between the member's age at disability retirement and age 60.

Payment Form

The disability benefit commences immediately upon the member's retirement. Benefits cease upon recovery or reemployment. Disability benefits are payable as a monthly life annuity. If, at the member's death, payments made have not exceeded the sum of the member's contributions plus interest as of the date of retirement, the balance is paid in a lump sum to the member's beneficiary. The 50% and 100% Survivor Options also are permitted for disability retirement. (A refund of the member's contribution account is paid for work-related disability.)

Virginia Sickness and Disability Program (VSDP)

In lieu of the above benefits, VRS state employees and VaLORS and SPORS members who elected this benefit (which is automatic for any new employee since January 1, 1999) are covered by the Virginia Sickness and Disability Program. These members will receive a deferred service retirement benefit payable at age 65 (age 60 for SPORS and VaLORS). The deferred benefit will be computed like a normal retirement benefit. For this calculation, a member's creditable service will include the period of disability, and the AFC will be adjusted to reflect increases in the cost of living between the date of disability and age 65. If the member dies while disabled, a death benefit will be determined as though the employee were an active member.

Deferred Retirement Benefit

Eligibility

A member with at least five years of service who does not withdraw his or her contributions from the fund is eligible for a deferred retirement benefit.

Annual Benefit

The annual benefit is the same as the normal retirement benefit, but both AFC and service are determined at the time the member leaves active employment. Reduced benefits may commence at or after age 55 with at least five years of service, or at age 50 with 10 years of service (age 50 with at least five years of service for members of SPORS and VaLORS).

Payment Form

The form of payment is the same as for Normal Retirement above.

Death Benefit

The beneficiary of a member who dies after leaving active service but before retiring is entitled to receive a lump-sum distribution of the deceased member's contribution account.

Withdrawal (Refund) Benefit

Eligibility

All members leaving covered employment are eligible. Vested members (those with five or more years of service) may withdraw their contributions plus interest instead of receiving the deferred retirement benefits otherwise due.

Benefit

A member who takes a refund receives a lump-sum payment of his or her member contributions, plus the interest credited on these contributions. Interest is credited at 4%, compounded annually on contributions in the account for at least one year.

Death Benefit

Eligibility

Death must have occurred while a member is an active or an inactive, non-retired member.

Benefit

Upon the death of a non-vested active or inactive member, a refund of the member's contributions and interest is paid to the beneficiary. Upon the death of a vested active member, if the named beneficiary is the spouse, minor child or parent of the member, the beneficiary is eligible to receive a monthly benefit under the 100% Survivor Option. If death occurs before age 55 (age 50 for members of SPORS and VaLORS), the member is assumed to be age 55 (age 50 for members of SPORS and VaLORS) for benefit calculation purposes. A beneficiary may elect to receive a refund of the member's contributions plus interest in lieu of the monthly benefit.

Work-Related Death

If the member's death is work-related, the surviving spouse, minor child or parent is eligible to receive 50% of AFC if the survivor does not qualify for Social Security survivor benefits, or 33 ¹/₃% of AFC if the survivor qualifies for Social Security survivor benefits. This benefit is reduced by Worker's Compensation. The named beneficiary receives a refund of the member's contributions and interest. Benefits paid to a spouse cease upon remarriage.

Optional Forms of Payment

Optional forms of payment are available on an actuarially equivalent basis, as follows:

100% Survivor Option

This option is payable for the member's life. Upon member's death, 100% of the benefit continues to the contingent annuitant.

Variable Survivor Option

For the member, the benefit is more than the 100% survivor option. Upon the member's death, a designated percentage of the benefit continues to the contingent annuitant.

Leveling Option

Allows an advance on future benefits. The member receives the higher payments in the early years of retirement and smaller payments at a future date the member specifies.

Partial Lump Sum Option

This option allows the member with earned service beyond the normal retirement date to elect a lump sum payment equal to the sum of 12, 24 or 36 payments of the standard monthly life annuity. The member's monthly benefit will be actuarially reduced to reflect the lump sum payment. The member may then elect to receive the reduced monthly annuity under any of the other optional forms of payment.

Cost-of-Living Adjustments

Members qualify for cost-of-living adjustments (COLAs) on July 1 of the second calendar year after retirement. Automatic COLAs are calculated as the first 3% of the Consumer Price Index increase plus half of each percentage increase from 3% to 7%. COLAs are capped at 5%.

SUMMARY OF PLAN CHANGES

1996 Valuation

1. Any member with at least 25 years of service may purchase up to three years of prior service credit for (a) active duty military service in the armed forces of the United States; (b) certified creditable service in the retirement system of another state; or (c) both at the rate of 5% of current compensation or average final compensation if greater, times years of service purchased.
2. VRS may enter into an agreement with any political subdivision of the Commonwealth of Virginia which has a defined benefit plan that is not supplemental to VRS to permit portability of service credit on a cost-neutral basis.
3. Early retirement is allowed at age 50 with 10 years of service. The early retirement benefit is determined as if the member is age 55 (but using actual service and AFC), reduced by 6/10% for each month the member is younger than age 55. This benefit can be no smaller than the value of the member's contributions and interest paid in monthly installments over the member's lifetime.
4. The service multiplier for judges entering the Judicial Retirement System after January 1, 1995 is 2.5%.
5. Effective July 1, 1998, a health insurance credit of \$1.50 per month per year of service (up to 30 years) is automatically provided to covered teachers who retire with at least 15 years of service. At local option, an additional credit of \$1 per month per year of service (up to 30 years) can be provided.

1998 Valuation

1. Effective January 1, 1999, the retirement benefit became 1.7% of AFC times years of service. The 3% benefit adjustment was eliminated for future retirees. A 2% ad hoc benefit increase was provided for all retirees and beneficiaries receiving benefits as of December 31, 1998.
2. On January 1, 1999, the Virginia Sickness and Disability Program (VSDP) became effective. New members since that date are automatically covered by this program and thus will only receive a deferred retirement benefit from VRS. Members joining before 1999 were allowed to make a one-time irrevocable election to join this program. (Applies to state employees and state police officers.)
3. Effective July 1, 1999, state employees, teachers and employees of participating political subdivisions that had not elected out of this benefit may retire with an unreduced benefit if they are at least age 50 and have earned at least 30 years of service.

1999 Valuation

1. 100% Joint and Survivor Option is payable in the case of a death of a member who dies while in active service.
2. 100% Joint and Survivor Option is payable for disability retirement.

2000 Valuation

1. The Virginia Law Officers' Retirement System went into effect on October 1, 1999.
 2. On November 15, 2000, the VRS Board of Trustees adopted the recommended economic and demographic assumptions proposed by the actuary as a result of the June 2000 actuarial experience study.
 3. The Board of Trustees adopted the use of a "pooled" contribution rate for state employees and teachers.
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2001 Valuation

1. Members of SPORS had their temporary supplement starting at retirement extended from age 65 to their Social Security retirement age.
2. Members of VaLORS had their benefit multiplier changed from 1.7% to 2.0% of pay with no temporary supplement for all new hires and rehires after July 1, 2001 as well as for current participants who had made an election to change formulas.
3. The Partial Lump Sum Option was added as an optional form of payment. This option provides the retiring member with a lump sum payment equal to the sum of either 12, 24 or 36 payments of the standard monthly life annuity. The member's monthly annuity is actuarially reduced to reflect the lump sum payment.

2002 Valuation

No material changes were made in the plan provisions.

2003 Valuation

No actuarially material changes were made in the plan provisions. Listed below are two minor changes of note:

1. School superintendents with five years of service can purchase an additional 10 years of out-of-state service. The superintendent must not be eligible for an out-of-state benefit.
2. The leveling option was restored as an optional form of payment. Benefits may be leveled to age 62 or older, and the benefits cannot reduce more than 50%. Any COLAs are calculated on the basic benefit amount.

2004 Valuation

No material changes were made in the plan provisions.

STATISTICAL SECTION



The impact of services provided by more than 95,000 covered employees of Virginia's cities, counties, towns and other political subdivisions can be found in our own backyards.

These employees ensure we have clean water, clean streets and scenic bike trails.

They administer recycling programs, run immunization clinics for infants and children and assist small-business owners. They support neighborhood watch programs. They are our local and regional librarians.

Local government employees live and work all across Virginia, from South Hill to Manassas, from Eastern Shore to Abingdon, from Winchester to Roanoke to Richmond. They are our relatives, our neighbors and our friends.

PENSION TRUST FUNDS

Analysis of Changes and Growth in Plan Net Assets

For the Years Ended June 30

(Expressed in Millions)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Net Assets Available Beginning of Year	\$ 18,215	\$ 21,460	\$ 26,057	\$ 30,784	\$ 34,634	\$ 39,786	\$ 36,693	\$ 33,456	\$ 33,781	\$ 39,039
Employee and Employer Contributions	879	913	1,131	1,141	1,291	1,270	1,044	1,042	1,185	1,468
Benefit and Administration Expenses	(934)	(1,017)	(1,090)	(1,176)	(1,282)	(1,394)	(1,529)	(1,687)	(1,865)	(2,049)
Net Funding	(55)	(104)	41	(35)	9	(124)	(485)	(645)	(680)	(581)
Investment Income										
Interest, Dividends and Other Investment Income	413	504	534	551	705	785	624	569	461	667
Net Appreciation (Depreciation) in Fair Value	2,887	4,197	4,152	3,334	4,438	(3,754)	(3,376)	401	5,477	3,935
Net Investment Income	3,300	4,701	4,686	3,885	5,143	(2,969)	(2,752)	970	5,938	4,602
Net Assets Available End of Year	\$ 21,460	\$ 26,057	\$ 30,784	\$ 34,634	\$ 39,786	\$ 36,693	\$ 33,456	\$ 33,781	\$ 39,039	\$ 43,060

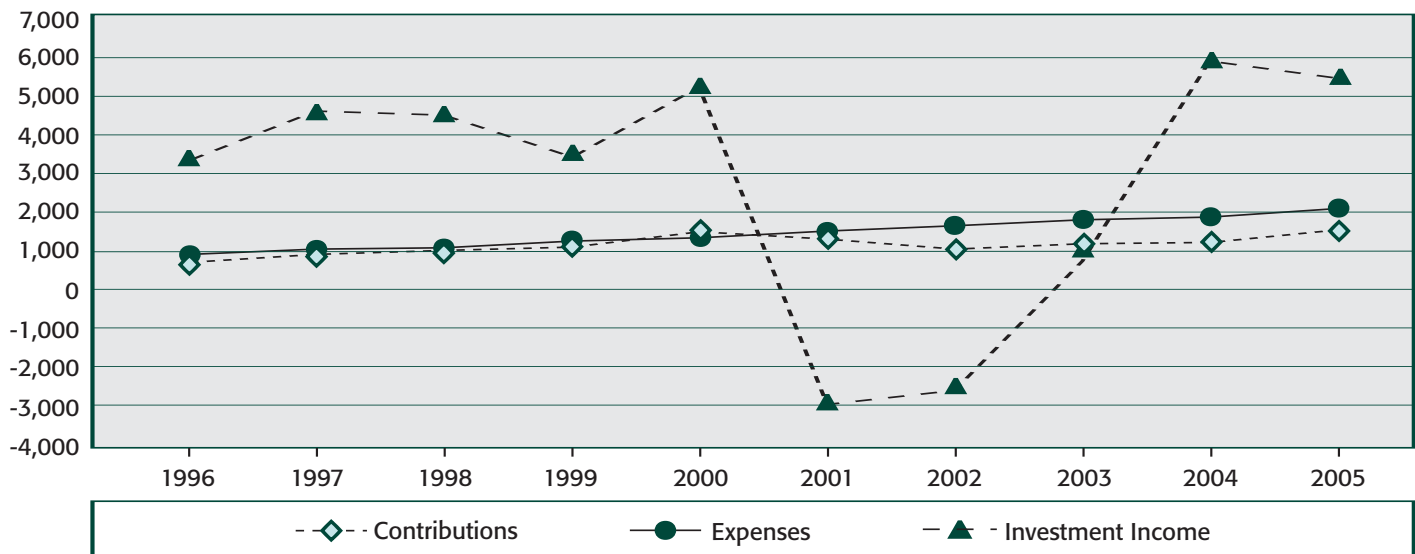
FY 1996 Net Appreciation was restated to reflect adjustments from conversion to GASB 25 presentation.

FY 1996 Investment Income categories were restated to reflect recategorization of Index Fund, Real Estate and Private Equity income as Net Appreciation (Depreciation) in Fair Value.

Pension Trust Funds Additions Versus Deductions

Fiscal Years 1996-2005

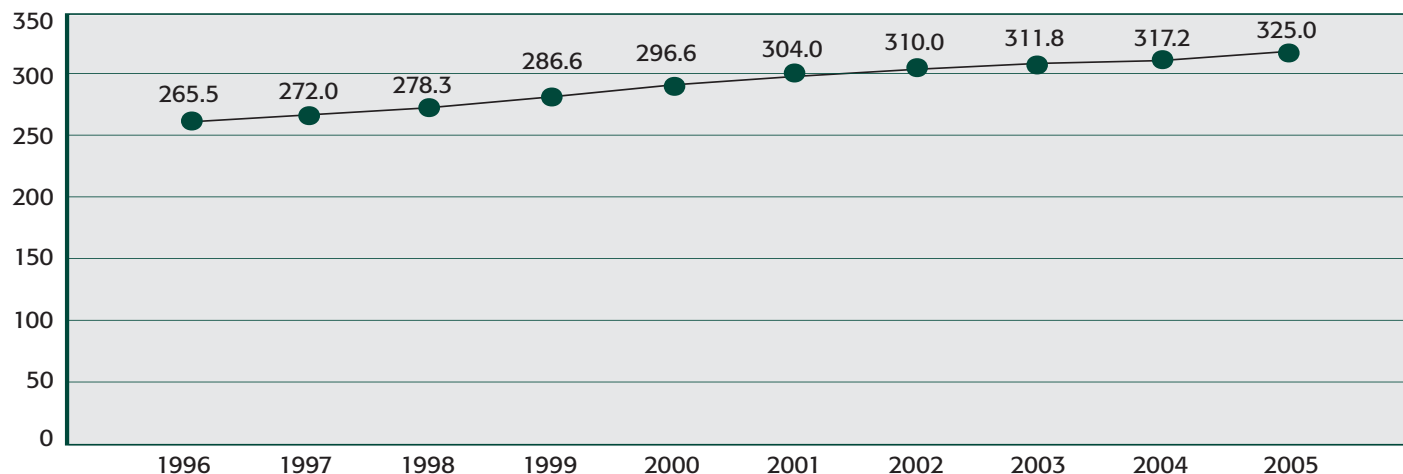
(Millions of Dollars)



Number of Active Members

Fiscal Years 1996-2005

(Expressed in Thousands)



Schedule of Retirement Contributions by System

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Virginia Retirement System				State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total
	State	Teacher	Political Subdivisions	Sub-Total				
2005	\$ 295,736	\$ 671,152	\$ 398,004	\$ 1,364,892	\$ 19,363	\$ 66,079	\$ 17,927	\$ 1,468,261
2004	292,895	515,750	287,228	1,095,873	15,232	56,292	17,758	1,185,155
2003****	199,217	492,562	270,280	962,059	13,305	50,433	16,038	1,041,835
2002****	234,992	455,488	283,756	974,236	14,974	42,148	13,100	1,044,458
2001	299,079	591,620	264,229	1,154,928	24,632	67,040	23,149	1,269,749
2000	314,044	631,344	284,641	1,230,029	19,170	25,192 ***	17,131	1,291,522
1999	296,748	556,712	257,140	1,110,600	15,298	—	15,034	1,140,932
1998**	265,364	603,579 *	237,736	1,106,679	11,767	—	13,107	1,131,553
1997	242,380	439,490	203,427	885,297	16,035 *	—	11,957	913,289
1996	240,393	442,600 *	176,545	859,538	8,330	—	11,087	878,955

* Increased as a result of the Workforce Transition Act of 1995 for state agencies and school board contributions for the 1991 early retirement program.

** In fiscal year 1998, employer contributions increased to begin prefunding cost-of-living adjustments (COLAs) for retirees.

*** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

**** The Virginia General Assembly suspended employer contributions for all state employees effective January 2002. Employer contributions for SPORS, VaLORS and JRS were resumed in July 2002 and for state in July 2003.

Pension Trust Funds Additions by Source

Fiscal Years 1996-2005

(Expressed in Thousands)

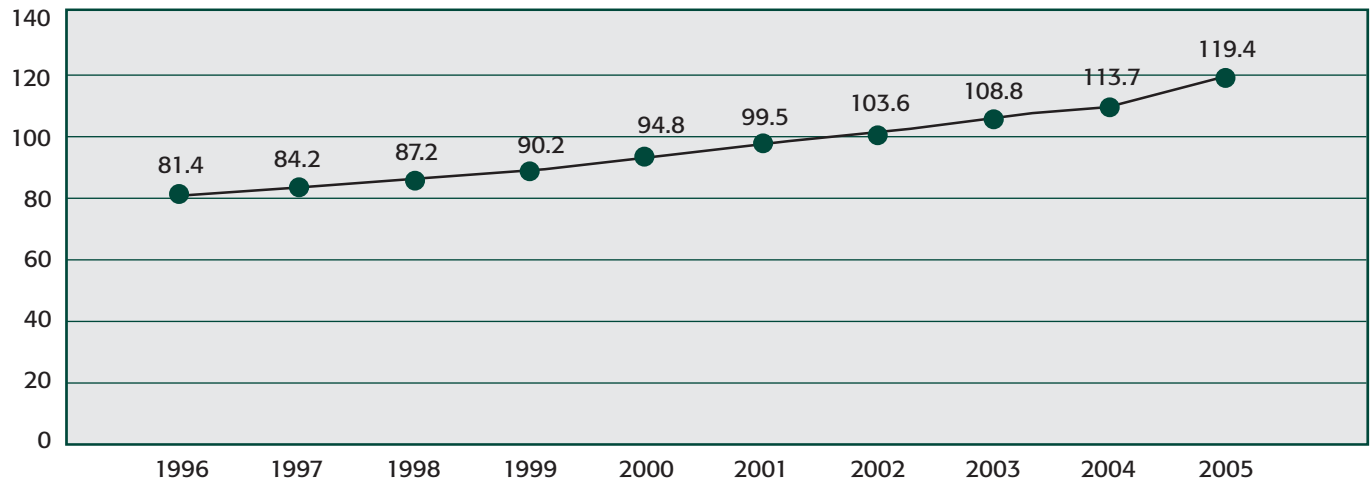
Year Ended June 30	Member Contributions	Employer Contributions		Investment Income (Loss)	Other	Total
		For Members	Employer Share			
Virginia Retirement System (VRS)						
2005	\$ 63,503	\$ 599,769	\$ 701,620	\$ 4,453,335	\$ 743	\$ 5,818,970
2004	85,769	564,020	446,084	5,751,277	908	6,848,058
2003	127,578	499,077	335,404	935,415	2,682	1,900,156
2002	115,979	482,516	375,741	(2,667,982)	286	(1,693,460)
2001	65,810	453,133	635,985	(2,907,769)	381	(1,752,460)
2000	68,208	426,088	735,733	5,042,490	269	6,272,788
1999	55,710	406,543	648,347	3,809,905	703	4,921,208
1998 **	57,032	379,953	669,694	4,594,358	116	5,701,153
1997	58,003	356,759	470,535	4,608,323	—	5,493,620
1996	51,595	340,645	467,298	3,235,211	—	4,094,749
State Police Officers' Retirement System (SPORS)						
2005	\$ 494	\$ 4,392	\$ 14,477	\$ 56,481	\$ —	\$ 75,844
2004	790	4,037	10,405	73,977	—	89,209
2003	556	3,972	8,777	11,929	—	25,234
2002	755	4,039	10,180	(34,596)	—	(19,622)
2001	125	4,087	20,420	(37,192)	—	(12,560)
2000	192	3,922	15,056	63,638	—	82,808
1999	179	3,548	11,571	47,974	—	63,272
1998	121	3,152	8,494	58,661	2	70,430
1997 *	136	2,923	12,976	58,840	—	74,875
1996	270	2,984	5,076	41,865	—	50,195
Virginia Law Officers' Retirement System (VaLORS)						
2005	\$ 700	\$ 14,869	\$ 50,510	\$ 59,525	\$ —	\$ 125,604
2004	880	14,703	40,709	70,668	—	126,960
2003	927	14,559	34,947	13,069	—	63,502
2002	1,007	15,630	25,511	(31,330)	—	10,818
2001	77	15,858	51,105	(4,057)	—	62,983
2000***	33	11,405	13,754	690	—	25,882
Judicial Retirement System (JRS)						
2005	\$ 159	\$ 2,499	\$ 15,269	\$ 31,379	\$ —	\$ 49,306
2004	197	2,371	15,190	40,947	—	58,705
2003	88	2,346	13,604	6,543	—	22,581
2002	73	2,365	10,662	(19,248)	—	(6,148)
2001	4	2,315	20,830	(20,637)	—	2,512
2000	16	2,180	14,935	35,297	—	52,428
1999	6	2,049	12,979	26,569	—	41,603
1998	49	1,892	11,166	32,637	—	45,744
1997	25	1,780	10,152	32,952	—	44,909
1996	10	1,745	9,332	23,492	—	34,579

* In fiscal year 1997, employer contributions increased by \$5.9 million for SPORS as a result of the Workforce Transition Act of 1995.

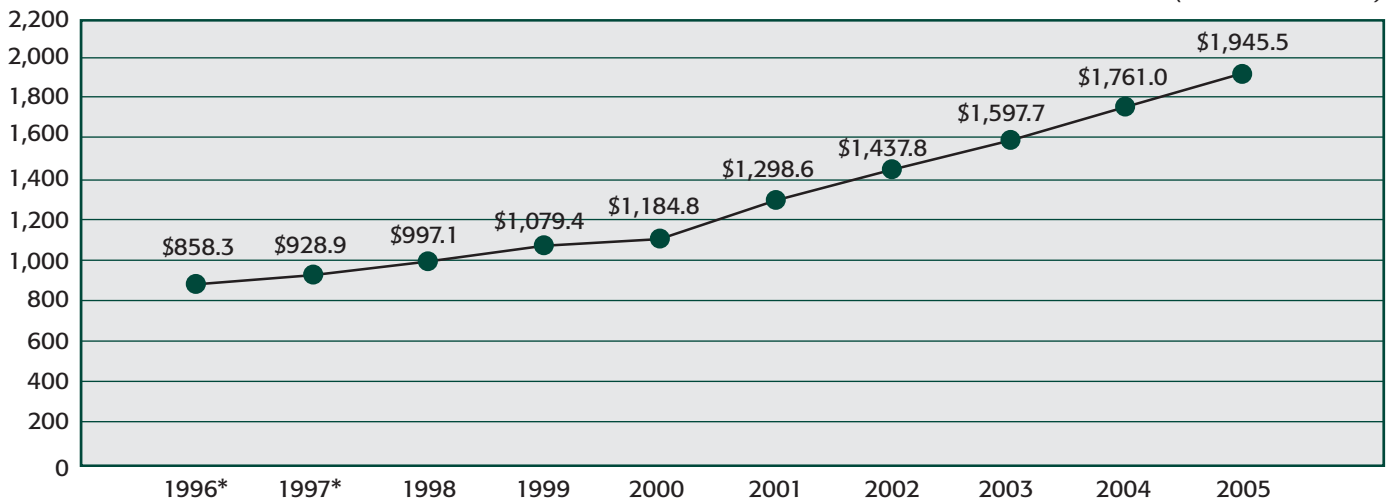
** In fiscal year 1998, employer contributions increased to begin prefunding cost-of-living adjustments (COLAs) for retirees.

*** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

Number of Retired Members

*Fiscal Years 1996-2005**(Expressed in Thousands)*

Retirement Benefits Paid

*Fiscal Years 1996-2005**(Millions of Dollars)*

* Increased by the Workforce Transition Act of 1995 for state agencies.

Pension Trust Funds Deductions by Type

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Retirement Benefits	Refunds	Administrative Expenses	Other	Total
Virginia Retirement System (VRS)					
2005	\$ 1,865,776	\$ 78,709	\$ 18,182	\$ —	\$ 1,962,667
2004	1,692,166	80,237	18,119	—	1,790,522
2003	1,537,762	67,473	16,201	—	1,621,436
2002	1,389,815	69,235	15,039	2,449	1,476,538
2001	1,261,348	79,439	14,100	—	1,354,887
2000	1,150,694	83,412	12,613	—	1,246,719
1999	1,047,362	84,797	11,359	—	1,143,518
1998	966,876	81,168	10,980	123	1,059,147
1997	900,241*	76,884	10,395	—	987,520
1996	833,927*	65,157	10,189	3	909,276
State Police Officers' Retirement System (SPORS)					
2005	\$ 30,487	\$ 1,053	\$ 203	\$ —	\$ 31,743
2004	26,336	731	213	—	27,280
2003	23,594	863	205	—	24,662
2002	20,607	559	185	—	21,351
2001	17,980	289	170	—	18,439
2000	16,946	314	137	—	17,397
1999	16,020	420	141	—	16,581
1998	15,324	474	139	—	15,937
1997	14,634	465	131	—	15,230
1996	11,039*	420	134	—	11,593
Virginia Law Officers' Retirement System (VaLORS)					
2005	\$ 25,100	\$ 4,927	\$ 208	\$ —	\$ 30,235
2004	19,784	3,998	196	—	23,978
2003	15,020	3,763	151	—	18,934
2002	8,485	3,657	57	—	12,199
2001	1,511	862	17	—	2,390
2000**	330	149	2	—	481
Judicial Retirement System (JRS)					
2005	\$ 24,108	\$ 42	\$ 113	\$ —	\$ 24,263
2004	22,706	—	117	—	22,823
2003	21,359	51	113	—	21,523
2002	18,884	—	104	—	18,988
2001	17,788	32	94	—	17,914
2000	16,872	24	105	—	17,001
1999	16,050	6	79	—	16,135
1998	14,856	—	78	—	14,934
1997	13,986	—	74	—	14,060
1996	13,380	—	74	—	13,454

* Retirement benefits increased as a result of the Workforce Transition Act of 1995 for state agencies.

** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

Schedule of Retirement Benefits by System

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Virginia Retirement System				State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total
	State	Teacher	Political Subdivisions	Sub-Total				
2005	\$ 589,113	\$ 959,268	\$ 317,395	\$ 1,865,776	\$ 30,487	\$ 25,100	\$ 24,108	\$ 1,945,471
2004	552,282	855,113	284,771	1,692,166	26,336	19,784	22,706	1,760,992
2003	503,249	782,652	251,861	1,537,762	23,594	15,020	21,359	1,597,735
2002	454,123	710,538	225,154	1,389,815	20,607	8,485	18,884	1,437,791
2001	421,033	639,760	200,555	1,261,348	17,980	1,511	17,788	1,298,627
2000	394,601	575,876	180,217	1,150,694	16,946	330**	16,872	1,184,842
1999	372,503	514,124	160,735	1,047,362	16,020	—	16,050	1,079,432
1998	354,862	467,367	144,647	966,876	15,324	—	14,856	997,056
1997	339,687*	429,892	130,662	900,241	14,634*	—	13,986	928,861
1996	317,398*	400,111	116,418	833,927	11,039*	—	13,380	858,346

* Increased as a result of the Workforce Transition Act of 1995 for state agencies.

** The Virginia Law Officers' Retirement System went into effect on October 1, 1999.

Schedule of Retirement Benefits by Type

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Service Benefits	Disability Benefits	Survivor Benefits	Total
2005	\$ 1,708,147	\$ 222,632	\$ 14,692	\$ 1,945,471
2004	1,537,173	210,385	13,434	1,760,992
2003	1,386,236	199,391	12,108	1,597,735
2002	1,242,235	184,582	10,974	1,437,791
2001	1,121,588	167,931	9,108	1,298,627
2000	1,021,185	155,450	8,207	1,184,842
1999	928,862	143,181	7,389	1,079,432
1998	861,377	128,637	7,042	997,056
1997	805,391*	117,133	6,337	928,861
1996	745,864*	106,449	6,033	858,346

• Increased as a result of the Workforce Transition Act of 1995 for state agencies.

Schedule of Refunds by Type

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Separation	Death	Total
2005	\$ 76,296	\$ 8,435	\$ 84,731
2004	73,715	11,251	84,966
2003	64,203	7,947	72,150
2002	65,893	7,558	73,451
2001	73,659	6,963	80,622
2000	77,027	6,872	83,899
1999	78,530	6,693	85,223
1998	74,731	6,911	81,642
1997	72,077	5,272	77,349
1996	61,126	4,451	65,577

Schedule of Retired Members by Type of Benefit and Option Selected

As of June 30, 2005

			Type of Retirement								
Amount of Retirement Benefit	Number of Retirants	Service	Early Retirement Window	50/30 Service Retirement	1991 Fac. Early Retirement		Regular Disability	Survivor Payment-Death in Service	Line-of-Duty Disability	Survivor Payment-Death in Line-of-Duty	50/10 Provision
					Window	Window					
\$ 1 - 200	15,703	13,608	5	—	1		960	537	66	4	522
201 - 400	18,318	14,456	153	—	—		2,360	403	134	19	793
401 - 600	15,005	11,072	380	5	1		2,632	219	233	28	435
601 - 800	11,937	8,457	504	23	1		2,157	137	364	19	275
801 - 1,000	9,698	6,669	645	79	3		1,589	83	370	8	252
1,001 - 1,200	7,910	5,306	670	209	4		1,185	70	262	6	198
1,201 - 1,400	6,507	4,330	625	259	15		863	36	210	4	165
1,401 - 1,600	5,774	3,840	580	324	21		635	40	176	4	154
1,601 - 1,800	5,432	3,579	458	601	36		455	23	144	2	134
1,801 - 2,000	5,622	3,691	337	909	37		403	24	134	—	87
Over 2,001	17,454	12,433	674	2,761	170		819	70	332	2	193
Totals	119,360	87,441	5,031	5,170	289		14,058	1,642	2,425	96	3,208

Min. Guar. Amount of Retirement Benefit	Option Selected																
	A	B	C	D	E	F	H	K	L	M	N	R	V	X	Y	Z	
\$ 1 - 200	12,785	93	543	216	1,153	2	84	5	—	2	697	10	99	2	10	2	
201 - 400	14,343	37	615	415	1,035	7	843	35	2	23	690	4	229	14	19	7	
401 - 600	10,932	38	516	489	962	15	1,193	73	—	32	479	2	216	22	28	8	
601 - 800	8,328	27	419	518	899	13	932	66	—	57	376	4	229	21	39	9	
801 - 1,000	6,546	10	363	557	867	22	608	43	1	20	318	3	238	16	71	15	
1,001 - 1,200	5,165	2	341	513	770	14	392	29	1	20	225	4	266	30	107	31	
1,201 - 1,400	4,289	3	278	447	526	22	240	21	1	11	174	9	263	35	139	49	
1,401 - 1,600	3,827	1	278	405	383	34	150	6	—	9	154	3	270	38	174	42	
1,601 - 1,800	3,721	—	207	373	259	35	76	5	—	1	131	5	251	39	264	65	
1,801 - 2,000	3,915	—	164	357	178	36	62	5	—	3	139	7	248	41	385	82	
Over 2,001	10,762	1	553	1,074	300	196	75	12	—	2	598	106	1,410	341	1,625	399	
Totals	84,613	212	4,277	5,364	7,332	396	4,655	300	5	180	3,981	157	3,719	599	2,861	709	

A = Basic Benefit
B = Increased Basic Benefit
C = 100% Survivor Benefit
D = 50% Survivor Benefit
E = Social Security Leveling Benefit
F = Special Survivor Option

H = Minimum Guaranteed Disability Basic Benefit
K = Minimum Guaranteed Disability -50% Survivor
L = 100% Survivor - Disability
M = Special Survivor Option - Disability
N = Leveling Benefit
R = Leveling Benefit - Rollover

V = Survivor Option
X = Advance Pension Option
Y = PLOP Basic
Z = PLOP with Survivor

Retirement breakdown: During FY 2005, 88% of all retirements were service retirements, and 12% were certified as disability retirements by the Medical Board.

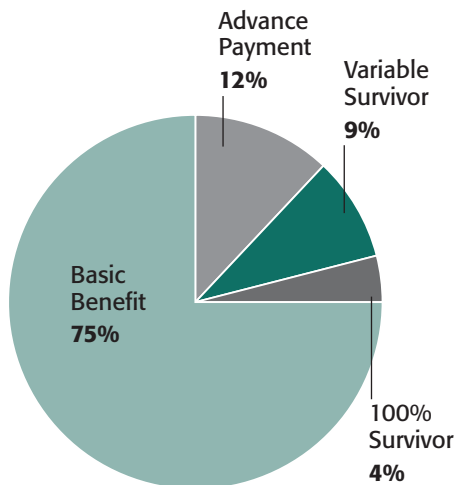
Schedule of Average Benefit Payments

Retirement Effective Date July 1, 2001 to June 30, 2005

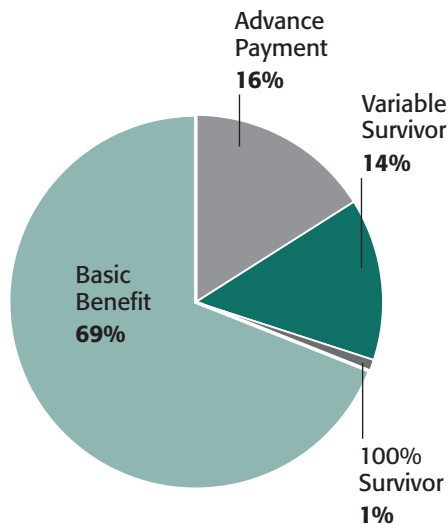
		Years of Credited Service					
		1-10	11-15	16-20	21-25	26-30	Over 30
FY 2005	Average Monthly Benefit	\$ 316.96	\$ 496.99	\$ 745.37	\$ 1,066.32	\$ 1,773.77	\$ 2,352.01
	Number of Active Retirants	768	784	902	921	1,623	3,342
FY 2004	Average Monthly Benefit	\$ 311.29	\$ 492.98	\$ 716.50	\$ 1,057.30	\$ 1,726.91	\$ 2,396.00
	Number of Active Retirants	694	711	867	851	1,582	2,935
FY 2003	Average Monthly Benefit	\$ 326.30	\$ 473.50	\$ 686.13	\$ 1,052.83	\$ 1,739.64	\$ 2,389.74
	Number of Active Retirants	659	794	798	958	1,575	2,904
FY 2002	Average Monthly Benefit	\$ 294.63	\$ 450.29	\$ 671.40	\$ 1,010.69	\$ 1,757.42	\$ 2,316.68
	Number of Active Retirants	627	715	743	988	1,538	2,277
FY 2001	Average Monthly Benefit	\$ 306.46	\$ 452.17	\$ 678.20	\$ 999.05	\$ 1,689.12	\$ 2,302.94
	Number of Active Retirants	623	803	805	1,037	1,504	2,453

Distribution of Retirees by Payment Option Selected

All Retirees at June 30, 2005

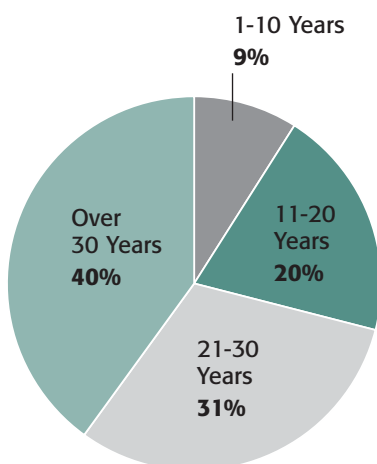


2005 Retirees

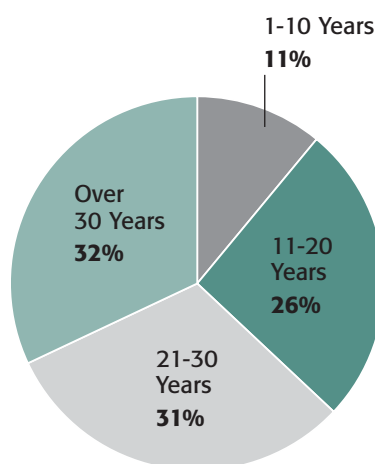


Distribution of Retirees by Years of Service

All Retirees at June 30, 2005



2005 Retirees



RETIREMENT OPTIONS

Basic Benefit

Monthly annuity payments are based on the normal benefit formula. Any accumulated contributions that have not been used between the date of contributions and the date of death are paid in a lump sum to the designated beneficiaries.

Variable Survivor

For the retiree, the benefit is more than the 100% survivor option benefit. At death, a percentage of the monthly benefit is continued to the designated contingent annuitant.

Advance Payment

Leveling/Social Security

As an advance on the benefit, the retiree receives a higher benefit in the early years of retirement. The advance is paid from the retirement date until the age specified by the retiree (between 59½ and 70½, or age 65 under the Social Security option). This benefit reduces at the level age.

Partial Lump Sum

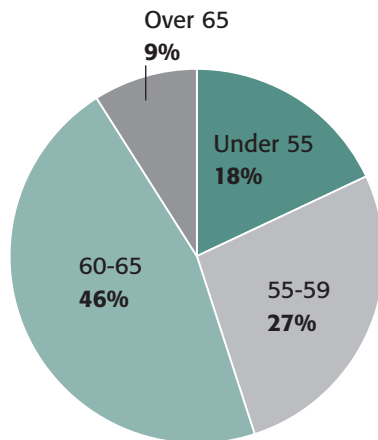
This option allows members with earned service beyond their normal retirement date to elect a lump sum payment equal to the sum of 12, 24 or 36 payments of the standard monthly life annuity. The member's monthly benefit will be actuarially reduced to reflect the lump-sum payment.

100% Survivor

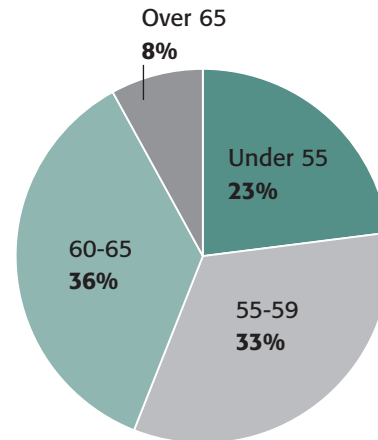
The basic benefit is reduced during the member's lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

Distribution of Retirees by Age at Retirement

All Retirees at June 30, 2005

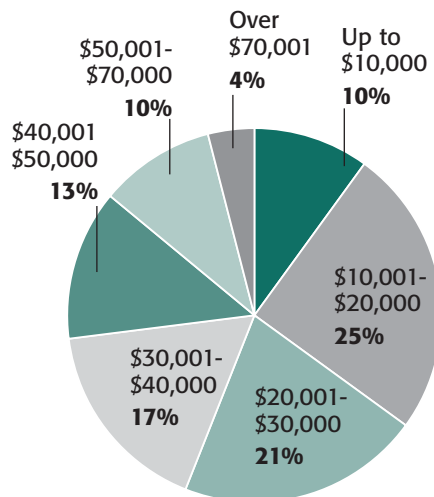


2005 Retirees

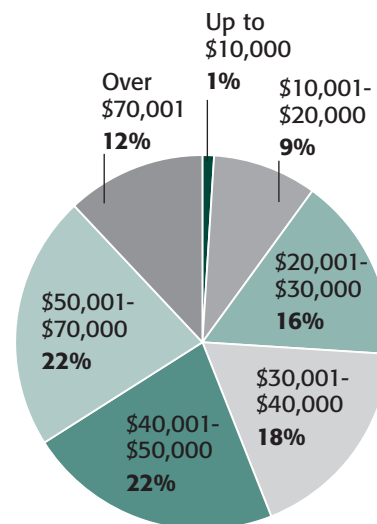


Distribution of Retirees by Average Final Compensation

All Retirees at June 30, 2005



2005 Retirees



OTHER EMPLOYEE BENEFIT TRUST FUNDS

Schedule of Group Insurance Additions by Source

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Contributions				Investment Income (Loss)	Other	Total
	State	Teacher	Political Subdivisions	Sub-Total			
2005*	\$ 1	\$ (33)	\$ 1	\$ (31)	\$ 91,547	\$ —	\$ 91,516
2004*	1	—	19	20	133,715	—	133,735
2003*	5	22	17	44	18,297	—	18,341
2002*	22,919	28,267	17,614	68,800	(72,021)	—	(3,221)
2001	29,703	37,027	21,894	88,624	(77,363)	—	11,261
2000*	1	2	41	44	139,707	277	140,028
1999*	(1)	1	22	22	110,393	—	110,415
1998	8,973	10,958	6,435	26,366	145,280	—	171,646
1997*	12	(39)	33	6	154,091	—	154,097
1996	9,904	12,136	6,924	28,964	116,840	—	145,804

* The group life insurance contribution rates for fiscal years 2005, 2004, 2003, 2000, 1999 and 1997 were zero. Amounts shown are adjustments and contributions for new employers. For fiscal years 2000, 1999 and 1997, the rate change was the result of a statutory premium holiday. There was also a premium holiday beginning in April 2002.

Schedule of Group Insurance Claims by Type

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Active Claims	Retired Claims	Total
2005	\$ 37,139	\$ 59,902	\$ 97,041
2004	42,290	63,741	106,031
2003	44,614	59,661	104,275
2002	39,617	56,008	95,625
2001	36,899	51,280	88,179
2000	34,113	48,912	83,025
1999	23,309	36,772	60,081
1998	26,854	45,919	72,773
1997	27,461	44,644	72,105
1996	25,081	40,095	65,176

Schedule of Retiree Health Insurance Credit Additions and Reimbursements

Fiscal Years 1996-2005

(Expressed in Thousands)

Year Ended June 30	Additions				Health Insurance Reimbursements
	Contributions	Investment Income (Loss)	Other	Total	
2005	\$ 81,995	\$ 13,540	\$ —	\$ 95,535	\$ 68,966
2004	78,383	15,582	—	93,965	64,920
2003	74,123	3,265	—	77,388	61,027
2002	85,209	(5,080)	—	80,129	57,590
2001	73,901	(3,089)	—	70,812	54,628
2000**	17,592	6,323	—	23,915	50,456
1999*	35,260	7,689	1	42,950	30,254
1998	22,123	7,637	14	29,774	17,372
1997	20,357	7,158	—	27,515	16,810
1996	20,180	3,592	—	23,772	13,594

* Data for FY 1999 reflect extension of coverage to all teachers on July 1, 1998 and a premium holiday for state agencies in May and June 1999.

** No contributions were paid for state employees during FY 2000. The maximum health credit for state employees increased to \$120 per month and for teachers to \$75 per month effective July 1, 1999.

Participating Employers as of June 30, 2005

Political Subdivisions (425)

Accomack County	Montgomery County	City of Norton	Town of Gordonsville
Albemarle County	Nelson County	City of Petersburg	Town of Gretna
Alleghany County	New Kent County	City of Poquoson	Town of Grottoes
Amelia County	Northampton County	City of Portsmouth	Town of Grundy
Amherst County	Northumberland County	City of Radford	Town of Halifax
Appomattox County	Nottoway County	City of Richmond	Town of Hamilton
Augusta County	Orange County	City of Roanoke	Town of Herndon
Bath County	Page County	City of Salem	Town of Hillsville
Bedford County	Patrick County	City of Staunton	Town of Hurt
Bland County	Pittsylvania County	City of Suffolk	Town of Independence
Botetourt County	Prince Edward County	City of Virginia Beach	Town of Iron Gate
Brunswick County	Prince George County	City of Waynesboro	Town of Jarratt
Buchanan County	Prince William County	City of Williamsburg	Town of Jonesville
Buckingham County	Pulaski County	City of Winchester	Town of Kenbridge
Campbell County	Rappahannock County	Town of Abingdon	Town of Kilmarnock
Caroline County	Richmond County	Town of Alberta	Town of La Crosse
Carroll County	Roanoke County	Town of Altavista	Town of Lawrenceville
Charles City County	Rockbridge County	Town of Amherst	Town of Leesburg
Charlotte County	Rockingham County	Town of Appomattox	Town of Louisa
Chesterfield County	Russell County	Town of Ashland	Town of Luray
Clarke County	Scott County	Town of Berryville	Town of Madison
Craig County	Shenandoah County	Town of Big Stone Gap	Town of Marion
Culpeper County	Smyth County	Town of Blacksburg	Town of McKenney
Cumberland County	Southampton County	Town of Blackstone	Town of Middleburg
Dickenson County	Spotsylvania County	Town of Bluefield	Town of Middletown
Dinwiddie County	Stafford County	Town of Bowling Green	Town of Montross
Essex County	Surry County	Town of Boyce	Town of Mt. Jackson
Fauquier County	Sussex County	Town of Boydton	Town of Narrows
Floyd County	Tazewell County	Town of Boykins	Town of New Market
Fluvanna County	Warren County	Town of Bridgewater	Town of Onancock
Franklin County	Washington County	Town of Broadway	Town of Onley
Frederick County	Westmoreland County	Town of Brookneal	Town of Orange
Giles County	Wise County	Town of Burkeville	Town of Parksley
Gloucester County	Wythe County	Town of Cape Charles	Town of Pearisburg
Goochland County	York County	Town of Chase City	Town of Pembroke
Grayson County	City of Alexandria	Town of Chatham	Town of Pennington Gap
Greene County	City of Bedford	Town of Chilhowie	Town of Pound
Greensville County	City of Bristol	Town of Chincoteague	Town of Pulaski
Halifax County	City of Buena Vista	Town of Christiansburg	Town of Purcellville
Hanover County	City of Chesapeake	Town of Clarksville	Town of Quantico
Henrico County	City of Colonial Heights	Town of Clifton Forge	Town of Remington
Henry County	City of Covington	Town of Coeburn	Town of Rich Creek
Highland County	City of Danville	Town of Colonial Beach	Town of Rocky Mount
Isle of Wight County	City of Emporia	Town of Courtland	Town of Round Hill
James City County	City of Fairfax	Town of Craigsville	Town of Rural Retreat
King & Queen County	City of Falls Church	Town of Crewe	Town of Saltville
King George County	City of Franklin	Town of Culpeper	Town of Scottsville
King William County	City of Fredericksburg	Town of Dayton	Town of Shenandoah
Lancaster County	City of Galax	Town of Dillwyn	Town of Smithfield
Lee County	City of Hampton	Town of Dublin	Town of South Boston
Loudoun County	City of Harrisonburg	Town of Dumfries	Town of South Hill
Louisa County	City of Hopewell	Town of Edinburg	Town of St. Paul
Lunenburg County	City of Lexington	Town of Elkton	Town of Stanley
Madison County	City of Lynchburg	Town of Exmore	Town of Strasburg
Mathews County	City of Manassas	Town of Floyd	Town of Stuart
Mecklenburg County	City of Manassas Park	Town of Front Royal	Town of Tappahannock
Middlesex County	City of Martinsville	Town of Gate City	Town of Tazewell
	City of Norfolk	Town of Glasgow	Town of Timberville

Town of Urbanna	Chesapeake Bay Bridge & Tunnel District	Hampton Roads Transit	Northern Virginia Juvenile Detention Home
Town of Victoria	Chesapeake Redevelopment & Housing Authority	Handley Library Board	Northwestern Community Services Board
Town of Vienna	Chesterfield County Health Center Commission	Harrisonburg-Rockingham Community Services Board	Opportunity Inc. of Hampton Roads
Town of Vinton	Clinch Valley Soil & Water Conservation District	Harrisonburg-Rockingham Regional Sewer Authority	Pamunkey Regional Jail
Town of Wakefield	Coeburn-Norton-Wise Regional Water Treatment Authority	Henricopolis Soil & Water Conservation District	Peaks of Otter Soil & Water Conservation District
Town of Warrenton	Colonial Services Board	Henry County Public Service Authority	Peninsula Airport Commission
Town of Warsaw	Colonial Soil & Water Conservation District	Highlands Juvenile Detention Center Commission	Pepper's Ferry Regional Wastewater Authority
Town of Waverly	Covington Redevelopment & Housing Authority	Holston River Soil & Water Conservation District	Peter Francisco Soil & Water Conservation District
Town of Weber City	Crater Juvenile Detention Home Commission	Hopewell Redevelopment & Housing Authority	Petersburg Redevelopment & Housing Authority
Town of West Point	Culpeper Soil & Water Conservation District	Industrial Development Authority of Henrico County	Peumansend Creek Regional Jail
Town of Windsor	Cumberland Mountain Community Services Board	Institute for Advanced Learning and Research	Piedmont Planning District Commission
Town of Wise	Cumberland Plateau Regional Housing Authority	James City Service Authority	Piedmont Regional Jail
Town of Woodstock	Daniel Boone Soil & Water Conservation District	John Marshall Soil & Water Conservation District	Piedmont Regional Juvenile Detention Center
Town of Wytheville	Danville-Pittsylvania Community Services Board	Lee County Redevelopment & Housing Authority	Pittsylvania County Service Authority
Accomack-Northampton Planning District Commission	Danville Redevelopment & Housing Authority	Lee County Public Service Authority	Planning District One Behavioral Health Services Board
Albemarle County Service Authority	Dinwiddie County Water Authority	Lenwisco Planning District Commission	Potomac and Rappahannock Transportation Commission
Albermarle-Charlottesville Regional Jail	District 19 Community Services Board	Lonesome Pine Regional Library	Potomac River Fisheries Commission
Alexandria Redevelopment & Housing Authority	Eastern Shore Community Services Board	Loudoun County Sanitation Authority	Prince William County Service Authority
Alexandria Sanitation Authority	Eastern Shore Public Library	Massanuttan Regional Library	Prince William Soil & Water Conservation District
Alleghany Highlands Community Services Board	Evergreen Soil & Water Conservation District	Meherrin Regional Library	Rappahannock Area Community Services Board
Amherst County Service Authority	Fauquier County Water & Sanitation Authority	Middle Peninsula-Northern Neck Community Services Board	Rappahannock Juvenile Center
Anchor Commission	Ferrum Water & Sewage Authority	Middle Peninsula Regional Security Center	Rappahannock-Rapidan Community Services Board
Appomattox Regional Library	Franklin Redevelopment & Housing Authority	Monacan Soil & Water Conservation District	Rappahannock-Rapidan Regional Planning District Commission
Appomattox River Water Authority	Frederick County Sanitation Authority	Montgomery Regional Solid Waste Authority	Rappahannock Regional Jail
Augusta County Service Authority	Fredericksburg-Stafford Park Authority	Nelson County Service Authority	Region Ten Community Services Board
Bedford County Public Service Authority	Giles County Public Service Authority	New River Resource Authority	Richmond Metropolitan Authority
Bedford Public Library	Goochland-Powhatan Community Services Board	New River Soil & Water Conservation District	Richmond Redevelopment & Housing Authority
Big Walker Soil & Water Conservation District	Great Southwest Regional Group Home Commission	New River Valley Community Services Board	Richmond Regional Planning District Commission
Blacksburg-Christiansburg-VPI Water Authority	Greensville County Water & Sewer Authority	New River Valley Juvenile Detention Home Commission	Rivanna Solid Waste Authority
Blacksburg-VPI Sanitation Authority	Greensville-Emporia Department of Social Services	New River Valley Planning District Commission	Rivanna Water & Sewer Authority
Blue Ridge Juvenile Detention Center	Hampton-Newport News Community Services Board	New River Valley Regional Jail	Riverside Regional Jail
Blue Ridge Regional Jail Authority	Hampton Redevelopment & Housing Authority	Norfolk Airport Authority	Roanoke Higher Education Authority
Bristol Redevelopment & Housing Authority	Hampton Roads Planning District Commission	Norfolk Redevelopment & Housing Authority	Roanoke River Service Authority
Brunswick Industrial Development Authority	Hampton Roads Regional Jail Authority	Northern Neck-Essex County Group Home Commission	Robert E. Lee Soil & Water Conservation District
Campbell County Utilities & Service Authority	Hampton Roads Sanitation District	Northern Neck Planning District Commission	Rockbridge Area Community Services Board
Capital Regional Airport Commission		Northern Neck Regional Jail	Rockbridge Area Social Services Department
Central Rappahannock Regional Library		Northern Shenandoah Valley Regional Commission	Rockbridge County Public Service Authority
Central Virginia Community Services Board		Northern Virginia Health Care Center Commission	Rockbridge Regional Library
Central Virginia Regional Jail			
Central Virginia Waste Management Authority			
Charles Pickney Jones Memorial Library			
Charlottesville-Albemarle Airport Authority			
Charlottesville Redevelopment & Housing Authority			

Russell County
Water & Sewage Authority
Scott County Public Service
Authority
Scott County Redevelopment and
Housing Authority
Scott County
Soil & Water Conservation District
Shenandoah Valley Juvenile
Detention Home Commission
Shenandoah Valley
Regional Airport Commission
South Central Wastewater Authority
Southeastern Virginia
Public Services Authority
Southside Community
Services Board
Southside Planning
District Commission
Southside Regional Jail
Southside Regional Juvenile
Group Home Commission
Southside Regional Library Board
Southwest Virginia Regional Jail
Spotsylvania-Stafford-Fredericksburg
Group Home Commission
Staunton Redevelopment &
Housing Authority
Suffolk Redevelopment &
Housing Authority
Sussex Service Authority
Tazewell Soil & Water
Conservation District
Thomas Jefferson
Planning District Commission
Thomas Jefferson
Soil & Water Conservation District
Tidewater Regional
Group Home Commission
Tidewater Transportation
District Commission
Tri-County/City Soil & Water
Conservation District
Upper Occoquan Sewage Authority
Valley Community Services Board
Virginia Biotechnology
Research Park Authority
Virginia Coalfield Economic
Development Authority
Virginia Highlands
Airport Commission
Virginia Peninsula Regional Jail
Virginia Peninsulas
Public Service Authority
Virginia Resources Authority
Washington County
Service Authority
Waynesboro Redevelopment &
Housing Authority
Western Tidewater
Community Services Board
Western Tidewater Regional Jail
Western Virginia
Water Authority

Wise County
Public Service Authority
Wise County Redevelopment &
Housing Authority
Wythe-Grayson Regional Library
Wytheville Redevelopment &
Housing Authority

**Public School Boards—Professional
Employees**
City/Town Schools (39)
Alexandria City Schools*
Bristol City Schools*
Buena Vista City Schools*
Charlottesville Public Schools*
Chesapeake Public Schools*
Colonial Beach Schools
Colonial Heights City Schools*
Covington City Schools*
Danville City Schools*
Fairfax City Schools
Falls Church Public Schools
Franklin City Schools*
Fredericksburg City Schools*
Galax City Schools*
Hampton City Schools*
Harrisonburg City Schools*
Hopewell City Schools*
Lexington City Schools*
Lynchburg Public Schools*
Manassas City Schools*
Manassas Park City Schools*
Martinsville City Schools*
Newport News Public Schools
Norfolk Public Schools*
Norton City Schools*
Petersburg City Schools*
Poquoson City Schools*
Portsmouth City Schools*
Radford City Schools*
Richmond Public Schools*
Roanoke City Schools
Salem City Schools*
Staunton City Schools*
Suffolk City Schools*
Virginia Beach City Schools*
Waynesboro City Schools*
West Point Schools
Williamsburg-James City
County Schools*
Winchester Public Schools*

County Schools (94)
Accomack County Schools*
Albemarle County Schools*
Alleghany County Schools*
Amelia County Schools*
Amherst County Schools*
Appomattox County Schools*
Arlington County Schools*
Augusta County Schools*
Bath County Schools*

Bedford County Schools*
Bland County Schools*
Botetourt County Schools*
Brunswick County Schools*
Buchanan County Schools*
Buckingham County Schools*
Campbell County Schools*
Caroline County Schools*
Carroll County Schools*
Charles City County Schools*
Charlotte County Schools*
Chesterfield County Schools*
Clarke County Schools*
Craig County Schools*
Culpeper County Schools*
Cumberland County Schools*
Dickenson County Schools*
Dinwiddie County Schools*
Essex County Schools*
Fairfax County Schools
Fauquier County Schools*
Floyd County Schools*
Fluvanna County Schools*
Franklin County Schools*
Frederick County Schools*
Giles County Schools*
Gloucester County Schools*
Goochland County Schools*
Grayson County Schools*
Greene County Schools*
Greensville County Schools*
Halifax County Schools*
Hanover County Schools*
Henrico County Schools*
Henry County Schools*
Highland County Schools*
Isle of Wight County Schools*
King & Queen County Schools*
King George County Schools*
King William County Schools*
Lancaster County Schools*
Lee County Schools*
Loudoun County Schools*
Louisa County Schools*
Lunenburg County Schools*
Madison County Schools*
Mathews County Schools*
Mecklenburg County Schools*
Middlesex County Schools*
Montgomery County Schools*
Nelson County Schools*
New Kent County Schools*
Northampton County Schools*
Northumberland County Schools*
Nottoway County Schools*
Orange County Schools*
Page County Schools*
Patrick County Schools*
Pittsylvania County Schools*
Powhatan County Schools*
Prince Edward County Schools*

Prince George County Schools*
Prince William County Schools*
Pulaski County Schools*
Rappahannock County Schools*
Richmond County Schools*
Roanoke County Schools*
Rockbridge County Schools*
Rockingham County Schools*
Russell County Schools*
Scott County Schools*
Shenandoah County Schools*
Smyth County Schools*
Southampton County Schools*
Spotsylvania County Schools*
Stafford County Schools*
Surry County Schools*
Sussex County Schools*
Tazewell County Schools*
Warren County Schools*
Washington County Schools*
Westmoreland County Schools*
Wise County Schools*
Wythe County Schools*
York County Schools*

Other Schools (12)

Amelia-Nottoway Vocational Center
Appomattox Region
Governor's School*
Charlottesville-Albemarle
Vocational Technical Center
Governor's School for
Global Economics and
Technology
Jackson River Vocational
Technical Center*
Maggie Walker Governor's School
for Government and International
Studies
New Horizons Technical Center*
Northern Neck Regional
Special Education Program
Northern Neck Regional
Vocational Center*
Rowanty Vocational
Technical Center
The Pruden Center for
Industry and Technology*
Valley Vocational Technical Center*

*Non-Professional employees also
covered (132 School Boards)

Agencies of the Commonwealth of
Virginia (234)

PROGRAM WITH OVERSIGHT BY VRS

Deferred Compensation Plan of the Commonwealth of Virginia

The Deferred Compensation Plan is regulated by Chapter Six of Title 51.1 of the *Code of Virginia* and is intended to be an eligible plan within the meaning of Internal Revenue Code 457(b). The purpose of the Plan is to provide participants with a convenient way to save for retirement through deferrals of compensation. The Plan is available, on a voluntary basis, to all salaried and wage employees, including elected and appointed officials providing services to the Commonwealth as well as eligible employees of participating political subdivisions.

Statement of Changes in Plan Assets

Years Ended June 30, 2005 and 2004

	2005	2004
Plan Assets on July 1	\$ 631,422,212	\$ 513,766,036
Contributions	91,408,590	81,146,682
Distributions	(33,076,187)	(30,962,780)
Plan Transfers ¹	578,402	492,087
Third Party Administration Fees ²	(1,786,993)	(1,615,771)
Period Earnings	50,685,317	69,344,804
Net Decrease/Increase in the Present Value of Annuitants' Future Benefits	346,666	(748,846)
Plan Assets on June 30	\$ 739,578,007	\$ 631,422,212

¹ Represents plan transfers from other eligible Section 457(b) plans into the Commonwealth's Plan.

² The current third party administrator, Great-West/Benefits Corporation, is compensated based on an annual recordkeeping and communication fee of 30 basis points (0.30%) capped at account balances of \$150,000 on total non-annuitized assets.

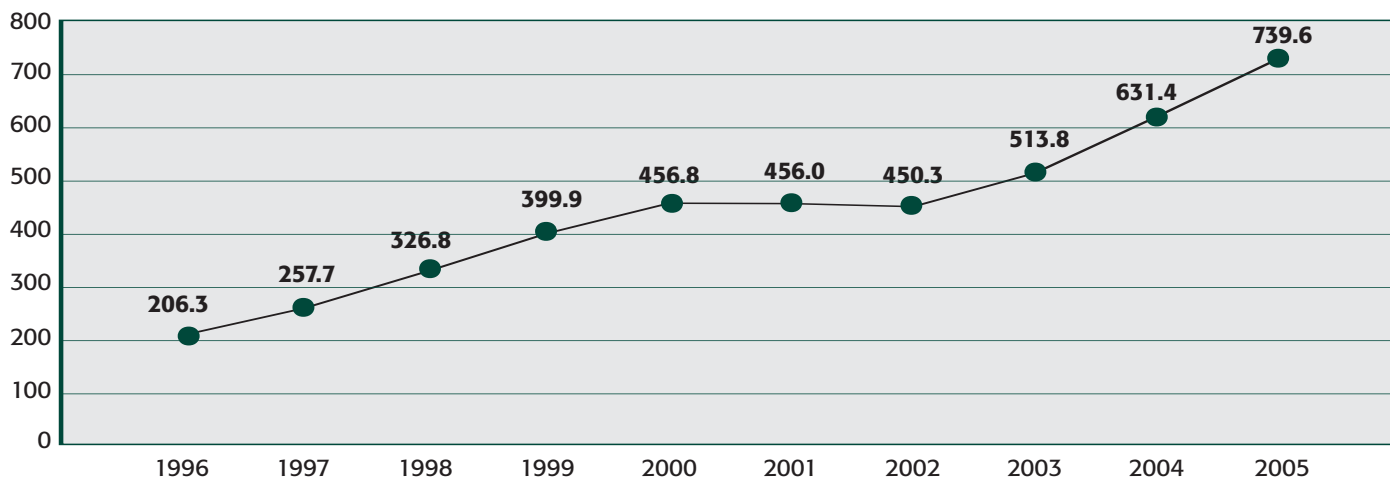
Deferred Compensation Plan - Operational Overview

A total of 5,175 employees enrolled in the Commonwealth's 457 Deferred Compensation Plan during the 2004-2005 fiscal year. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became effective January 1, 2002, allowing increased tax-deferred savings and to have increased portability of benefits. Contributions to the Plan during FY 2005 increased to \$91,408,590 from \$81,146,682 in FY 2004.

EGTRRA also made the 457 Plan attractive for employees of colleges and universities by removing the coordination between 457 Plans and 403(b) tax-deferred accounts. From the effective date of EGTRRA to June 30, 2005, the number of college and university employee Plan accounts increased from 287 in FY 2001 (the baseline year) to 2,659 in FY 2005.

The 2001 legislation also allowed 457 Plan participants to use monies in their accounts to purchase permissible service credit in the defined benefit plan. During the fiscal year ended June 30, 2005, 417 Plan participants used the trustee-to-trustee provision to buy VRS service credit with \$2,018,421 transferring from the 457 Plan to the defined benefit plan.

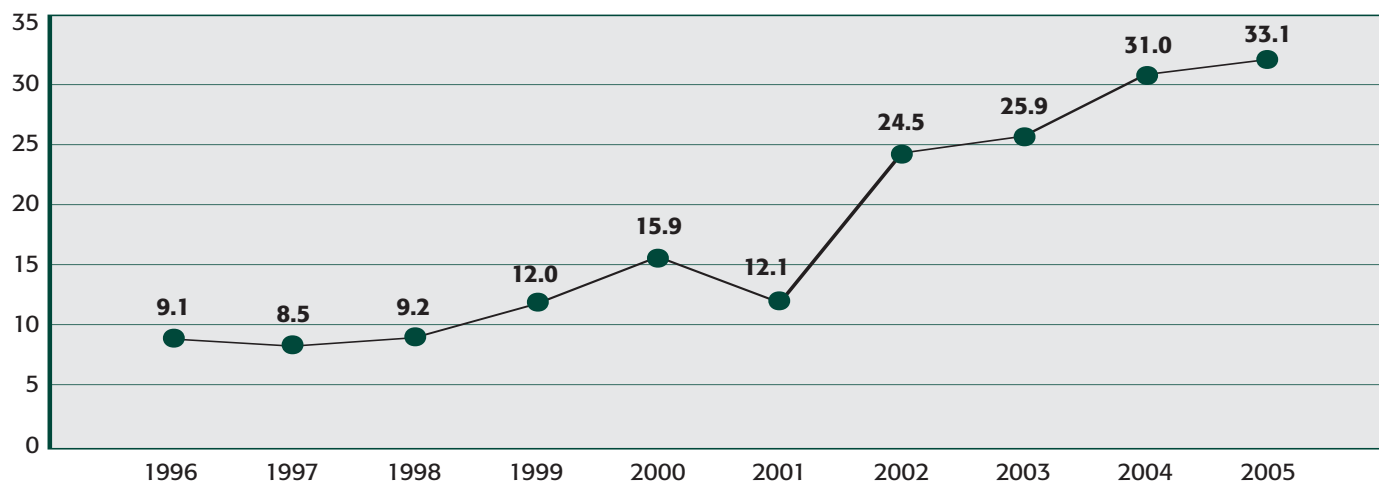
Deferred Compensation Program Assets

(Millions of Dollars)

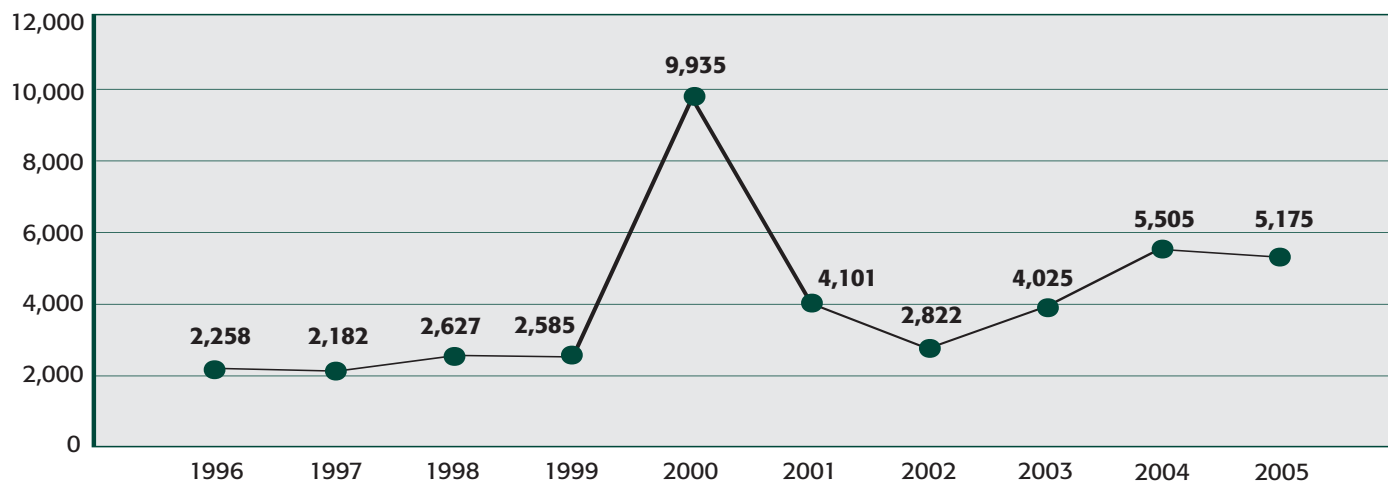
Contributions to the Deferred Compensation Plan

(Millions of Dollars)

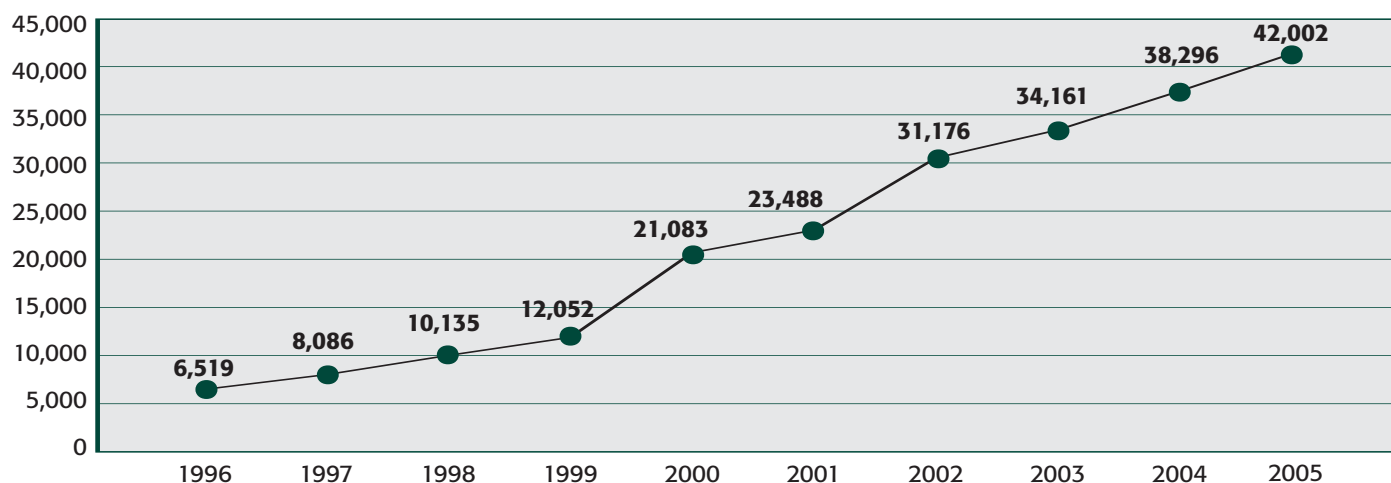
Distributions from the Deferred Compensation Plan

(Millions of Dollars)

New Enrollments in the Deferred Compensation Plan



Active and Inactive Deferred Compensation Plan Participants



Total Participant Accounts in Each Fund Option

Fund Name	Total Participant Accounts	Fund Name	Total Participant Accounts
Income & Growth Fund	4,389	International Equity Index Fund	6,389
Balanced Growth Fund	9,667	Money Market Fund	2,595
Long-Term Growth Fund	6,049	Active Inflation-Protected Bond Fund	1,557
Bond Index Fund	5,373	Active Bond Fund	4,165
S&P 500 Index Fund	22,934	Active High Yield Bond Fund	1,037
Russell 1000 Value Index Fund	5,024	Active Small/Mid Cap Equity Fund	6,204
Russell 1000 Growth Index Fund	2,977	Active Global Equity Fund	459
Russell 3000 Index Fund	330	Stable Value Fund	16,672
Real Estate Investment Trust Fund	4,446	Harris Direct Money Market	62
Small/Mid Cap Equity Index Fund	6,311	Harris Direct Self-Directed	58

Plan Assets

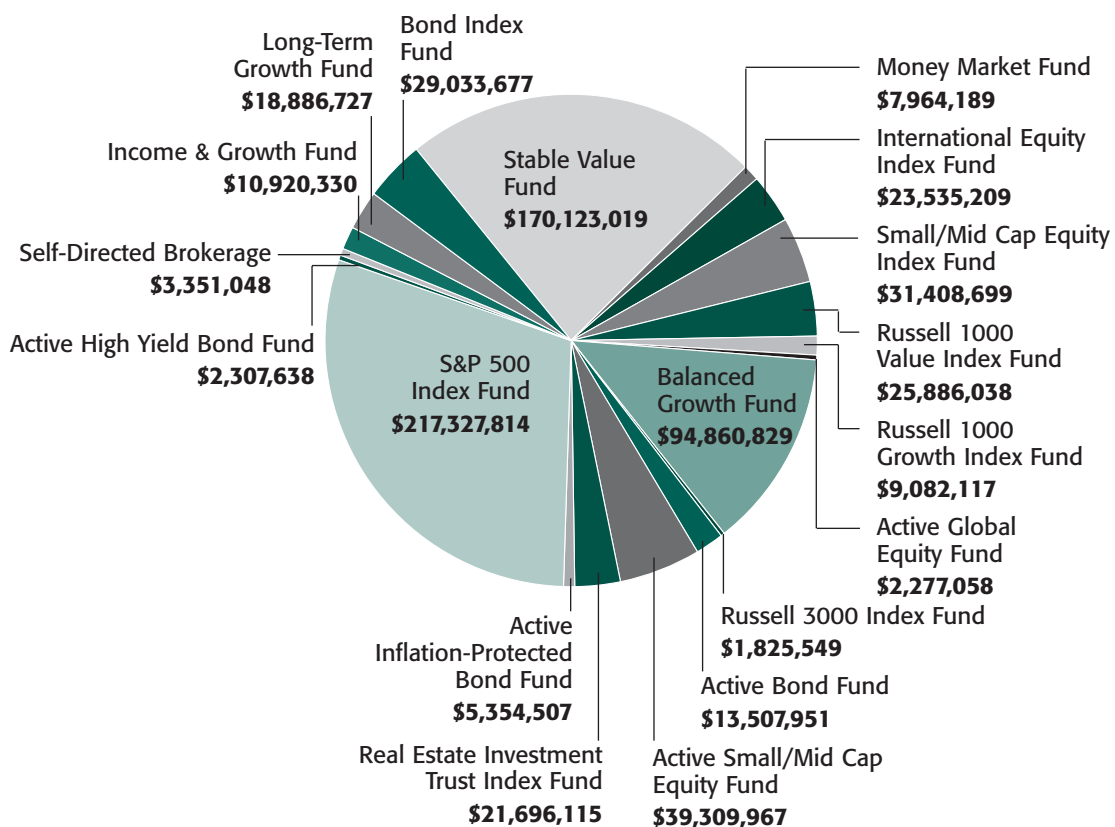
Plan Assets are divided into two categories: Annuity Plan Assets and Accumulation Plan Assets. Annuity Plan Assets represent the present value of future benefits for those participants who chose an annuity as a distribution payment. Accumulation Plan Assets represent funds invested among the 18 core investment options and two self-directed brokerage options.

Annuity Plan Assets

The Hartford Life Insurance Company	
Annuity Plan Assets at June 30, 2005	\$ 8,581,222
Metropolitan Life Annuity	
Plan Assets at June 30, 2005	2,338,305
Total at June 30, 2005	\$ 10,919,527

Accumulation Plan Assets

Total at June 30, 2005 - \$728,658,481



Description of Funds

Tier I: Passively Managed Asset Allocation Funds																																																			
Income & Growth Fund: Seeks to provide income and a modest level of capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term total returns that are slightly higher than inflation with the possibility of occasional short-term losses. U.S. Bonds - 75% U.S. Stocks - 22% Foreign Stocks - 3% Balanced Growth Fund: Seeks to provide income and a modest level of capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term total returns that are higher than inflation with the possibility of short-term losses. U.S. Bonds - 50% U.S. Stocks - 43% Foreign Stocks - 7% Long-Term Growth Fund: Seeks to provide capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term total returns that are higher than inflation with the possibility of significant short-term losses. U.S. Stocks - 64% U.S. Bonds - 25% Foreign Stocks - 11%	Russell 1000 Value Index Fund: Seeks to track the performance of the Russell 1000 Value Index Fund. This Index is comprised of stocks in the Russell 1000 that have lower price-to-book ratios and lower forecasted growth values. <table> <tr> <td>Financials - 36%</td><td>Industrials - 7%</td></tr> <tr> <td>Energy - 13%</td><td>Telecommunication Services - 6%</td></tr> <tr> <td>Consumer Discretionary - 10%</td><td>Consumer Staples - 5%</td></tr> <tr> <td>Health Care - 8%</td><td>Materials - 4%</td></tr> <tr> <td>Utilities - 7%</td><td>Information Technology - 4%</td></tr> </table> Russell 1000 Growth Index Fund: Seeks to track the performance of the Russell 1000 Growth Index. This Index is comprised of stocks in the Russell 1000 that have higher price-to-book ratios and higher forecasted growth values. <table> <tr> <td>Information Technology - 26%</td><td>Financials - 6%</td></tr> <tr> <td>Health Care - 20%</td><td>Energy - 2%</td></tr> <tr> <td>Consumer Discretionary - 17%</td><td>Materials - 2%</td></tr> <tr> <td>Industrials - 15%</td><td>Telecommunication Services - 1%</td></tr> <tr> <td>Consumer Staples - 10%</td><td>Utilities - 1%</td></tr> </table> Russell 3000 Index Fund: Seeks to track the performance of the Russell 3000 Index. This Index is comprised of the 3,000 largest stocks in the U.S. Market. <table> <tr> <td>Financials - 21%</td><td>Energy - 8%</td></tr> <tr> <td>Information Technology - 15%</td><td>Consumer Staples - 7%</td></tr> <tr> <td>Consumer Discretionary - 14%</td><td>Utilities - 4%</td></tr> <tr> <td>Health Care - 14%</td><td>Materials - 3%</td></tr> <tr> <td>Industrials - 11%</td><td>Telecommunication Services - 3%</td></tr> </table> Real Estate Investment Trust Index Fund: Seeks to track the performance of the Dow Jones Wilshire REIT Index. The Index is a market capitalization weighted index of publicly traded REITs whose charter is the equity ownership and operation of commercial real estate. <table> <tr> <td>Office - 21%</td><td>Industrial - 8%</td></tr> <tr> <td>Apartments - 18%</td><td>Hotels - 6%</td></tr> <tr> <td>Retail/Malls - 16%</td><td>Self-Storage - 5%</td></tr> <tr> <td>Retail/Strip Centers - 13%</td><td>Industrial Mixed - 4%</td></tr> <tr> <td>Diversified - 8%</td><td>Manufactured Homes - 1%</td></tr> </table> Small/Mid Capitalization Equity Index Fund: Seeks to track the performance of the Russell Small Capitalization Completeness Index. This Index is a measure of the small to mid-capitalization sector of the U.S. stock market. <table> <tr> <td>Financials - 24%</td><td>Energy - 6%</td></tr> <tr> <td>Consumer Discretionary - 18%</td><td>Materials - 4%</td></tr> <tr> <td>Information Technology - 16%</td><td>Utilities - 4%</td></tr> <tr> <td>Health Care - 12%</td><td>Consumer Staples - 3%</td></tr> <tr> <td>Industrials - 12%</td><td>Telecommunication Services - 1%</td></tr> </table>	Financials - 36%	Industrials - 7%	Energy - 13%	Telecommunication Services - 6%	Consumer Discretionary - 10%	Consumer Staples - 5%	Health Care - 8%	Materials - 4%	Utilities - 7%	Information Technology - 4%	Information Technology - 26%	Financials - 6%	Health Care - 20%	Energy - 2%	Consumer Discretionary - 17%	Materials - 2%	Industrials - 15%	Telecommunication Services - 1%	Consumer Staples - 10%	Utilities - 1%	Financials - 21%	Energy - 8%	Information Technology - 15%	Consumer Staples - 7%	Consumer Discretionary - 14%	Utilities - 4%	Health Care - 14%	Materials - 3%	Industrials - 11%	Telecommunication Services - 3%	Office - 21%	Industrial - 8%	Apartments - 18%	Hotels - 6%	Retail/Malls - 16%	Self-Storage - 5%	Retail/Strip Centers - 13%	Industrial Mixed - 4%	Diversified - 8%	Manufactured Homes - 1%	Financials - 24%	Energy - 6%	Consumer Discretionary - 18%	Materials - 4%	Information Technology - 16%	Utilities - 4%	Health Care - 12%	Consumer Staples - 3%	Industrials - 12%	Telecommunication Services - 1%
Financials - 36%	Industrials - 7%																																																		
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Consumer Discretionary - 10%	Consumer Staples - 5%																																																		
Health Care - 8%	Materials - 4%																																																		
Utilities - 7%	Information Technology - 4%																																																		
Information Technology - 26%	Financials - 6%																																																		
Health Care - 20%	Energy - 2%																																																		
Consumer Discretionary - 17%	Materials - 2%																																																		
Industrials - 15%	Telecommunication Services - 1%																																																		
Consumer Staples - 10%	Utilities - 1%																																																		
Financials - 21%	Energy - 8%																																																		
Information Technology - 15%	Consumer Staples - 7%																																																		
Consumer Discretionary - 14%	Utilities - 4%																																																		
Health Care - 14%	Materials - 3%																																																		
Industrials - 11%	Telecommunication Services - 3%																																																		
Office - 21%	Industrial - 8%																																																		
Apartments - 18%	Hotels - 6%																																																		
Retail/Malls - 16%	Self-Storage - 5%																																																		
Retail/Strip Centers - 13%	Industrial Mixed - 4%																																																		
Diversified - 8%	Manufactured Homes - 1%																																																		
Financials - 24%	Energy - 6%																																																		
Consumer Discretionary - 18%	Materials - 4%																																																		
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Tier II: Passively Managed Funds																																																			
Bond Index Fund: Seeks to track the total return performance of the Lehman Brothers Aggregate Bond Index. This Index is a combination of government, corporate, mortgage-backed and asset-backed securities. <table> <tr> <td>Mortgage-Backed Securities - 34%</td><td>Agency - 11%</td></tr> <tr> <td>Treasury - 26%</td><td>CMBS - 3%</td></tr> <tr> <td>Corporate - 24%</td><td>Asset-Backed - 2%</td></tr> </table> S&P 500 Index Fund: Seeks to track the performance of the Standard & Poor's 500 Index. This Index is comprised of 500 widely held U.S. stocks chosen by Standard & Poor's. <table> <tr> <td>Financials - 20%</td><td>Consumer Staples - 9%</td></tr> <tr> <td>Information Technology - 15%</td><td>Energy - 8%</td></tr> <tr> <td>Consumer Discretionary - 13%</td><td>Utilities - 4%</td></tr> <tr> <td>Health Care - 13%</td><td>Materials - 3%</td></tr> <tr> <td>Industrials - 12%</td><td>Telecommunication Services - 3%</td></tr> </table>	Mortgage-Backed Securities - 34%	Agency - 11%	Treasury - 26%	CMBS - 3%	Corporate - 24%	Asset-Backed - 2%	Financials - 20%	Consumer Staples - 9%	Information Technology - 15%	Energy - 8%	Consumer Discretionary - 13%	Utilities - 4%	Health Care - 13%	Materials - 3%	Industrials - 12%	Telecommunication Services - 3%																																			
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Description of Funds, continued

International Equity Index Fund: Seeks to track the performance of the Morgan Stanley Capital International Europe, Australasia, Far East Index (MSCI EAFE). This Index is comprised of approximately 1,000 stocks in 21 countries in Europe and the Pacific Basin. Financials - 27% Consumer Discretionary - 12% Industrials - 10% Energy - 9% Health Care - 9% Consumer Staples - 8% Materials - 7% Telecommunication Services - 7% Information Technology - 6% Utilities - 5%	Active Small/Mid Capitalization Equity Fund: Seeks to provide long-term returns that exceed the performance of the Russell Small Capitalization Completeness Index. This Index is a measure of the small to mid-capitalization sector of the U.S. Stock Market. Financials - 23% Consumer Discretionary - 18% Information Technology - 15% Health Care - 14% Industrials - 10% Energy - 7% Consumer Staples - 4% Utilities - 4% Materials - 3% Telecommunication Services - 2%
Tier III: Actively Managed Funds	
Money Market Fund: Seeks to provide short, medium and long-term returns that provide for a high level of current income while preserving capital. CDs, ECDs, TDs, BAs - 48% Floating Rate Corporate Notes - 16% Repurchase Agreements - 16% Commercial Paper - 14% Floating Rate Agencies - 3% Other - 2% Bank Notes/Corporates/MTNs - 1% Active Inflation-Protected Bond Fund: Seeks to provide inflation protection and income consistent with investment in inflation-indexed securities and to provide long-term returns that exceed the performance of the Lehman Brothers U.S. Treasury Inflation Notes Index. This Index is a measure of the inflation-indexed sector of the U.S. Bond Market. Treasury - 100% Active Bond Fund: Seeks to provide long-term returns that exceed the performance of the Lehman Brothers Aggregate Bond Index. This Index is a combination of government, corporate, mortgage-backed and asset-backed securities. Mortgage-Backed Securities - 39% Cash & Equivalents - 29% U.S. Treasury/Agency - 19% Foreign - 5% Emerging Markets - 4% Corporate - 3% Other - 1%	Active Global Equity Fund: Seeks to provide long-term growth of capital with current income and long-term returns that exceed the performance of the MSCI World Index. This Index is a measure of the global development market. Financials - 20% Other - 12% Consumer Discretionary - 11% Telecommunication Services - 10% Consumer Staples - 9% Materials - 8% Energy - 7% Health Care - 7% Information Technology - 6% Industrials - 5% Utilities - 5% Stable Value Fund: Seeks to provide a safety of principal and a stable credited rate of interest while generating competitive returns over time compared to other conservative investments, such as money market funds or short-term yields available in the fixed-income (bond) market. Wells Fargo Stable Return Fund - 28% AIG Financial Products Security Backed Contract - 24% JP Morgan Chase Bank Security Backed Contract - 24% Union Bank of Switzerland AG Security Backed Contract - 24%
Active High Yield Bond Fund: Seeks to provide a high level of current income and long-term returns that exceed the performance of a custom benchmark consisting of 95% Lehman Brothers High-Yield ex-CCC Index and 5% Lehman Brothers 1-3 Year Treasury Index. Communication - 19% Consumer Cyclical - 17% Basic Industries - 13% Consumer Non-Cyclical - 11% Utilities - 11% Capital Goods - 7% Energy - 7% Treasury/Agency - 5% Information Technology - 4% Finance - 2% Industrial/Other - 2% Transportation - 2%	
Tier IV: Self-Directed Brokerage Option	
The Self-Directed Brokerage (SDB) option from Harrisdirect allows investors to elect from thousands of mutual funds in addition to the core investment options in Tier I, Tier II and Tier III. The SDB option is for knowledgeable investors who acknowledge and understand the risks associated with the mutual fund investments contained within the option. (Participants cannot invest in individual securities such as stocks, bonds or options.) In addition to the annual recordkeeping and communication services fee, there is a plan fee of \$15 per quarter, as well as transaction fees charged by the brokerage provider and investment management fees charged by the investment managers.	

Investment Option Performance Summary

Below are totals for the period ending June 30, 2005

(Returns greater than one year are annualized)

Investment Options	1 Year	3 Years	5 Years	Expense Ratio
Tier I: Passively Managed Asset Allocation Funds ¹				
Income & Growth Fund Benchmark (75% Lehman Bros. Aggregate Bond Index, 22% Russell 3000, 3% MSCI EAFE)	7.36% 7.39%	6.93% 6.99%	5.46% 5.48%	0.08%
Balanced Growth Fund Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE)	7.94% 7.95%	7.97% 8.09%	3.34% 3.40%	0.09%
Long-Term Growth Fund Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE)	8.46% 8.46%	8.85% 9.06%	1.07% 1.18%	0.10%
Tier II: Passively Managed Funds ^{1,2}				
Bond Index Fund Lehman Bros. Aggregate Bond Index	6.77% 6.80%	5.79% 5.76%	7.43% 7.40%	0.05%
S&P 500 Index Fund S&P 500 Index	6.36% 6.32%	8.30% 8.28%	-2.36% -2.38%	0.02%
Russell 1000 Value Index Fund Russell 1000 Value Index	14.01% 14.05%	10.98% 10.99%	6.51% 6.56%	0.09%
Russell 1000 Growth Index Fund Russell 1000 Growth Index	1.57% 1.70%	7.10% 7.26%	-10.41% -10.35%	0.10%
Russell 3000 Index Fund Russell 3000 Index	8.03% 8.06%	9.30% 9.46%	1.37% 1.36%	0.12%
Real Estate Investment Trust Index Fund Dow Jones Wilshire REIT Index	33.39% 34.22%	20.29% 20.98%	n/a 20.87%	0.25%
Small/Mid Cap Equity Index Fund ³ Russell Small Cap Completeness Index	13.67% 13.62%	14.51% 14.67%	1.19% 1.13%	0.10%
International Equity Index Fund ^{4,5} MSCI EAFE Index	13.73% 13.66%	10.85% 12.06%	-1.53% 0.55%	0.14%

Investment Option Performance Summary, continued

Investment Options	1 Year	3 Years	5 Years	Expense Ratio
Tier III: Actively Managed Funds				
Money Market Fund 91-Day Treasury Bill Average	2.13% 2.32%	1.54% 1.56%	2.66% 2.49%	0.13%
Active Inflation Protected Bond Fund Lehman Bros. US Treas. Inflation Notes Index	9.07% 9.33%	9.21% 9.43%	9.77% 9.99%	0.17%
Active Bond Fund Lehman Bros. Aggregate Bond Index	7.70% 6.80%	6.57% 5.76%	8.22% 7.40%	0.43%
Active High Yield Bond Fund ⁷ Benchmark (95% Lehman Bros. High Yield ex-CCC, 5% Leman Bros. 1-3 Year Treasury Index)	8.52% 10.27%	9.56% 12.39%	5.79% 6.95%	0.12%
Active Small/Mid Cap Equity Fund ^{1, 3} Russell Small Cap Completeness Index	10.66% 13.62%	14.38% 14.67%	1.56% 1.13%	0.57%
Active Global Equity Fund ⁴ MCSI World Index	16.51% 10.05%	16.30% 10.04%	7.94% 2.08%	0.54%
Stable Value Fund ⁶	5.22%	5.15%	5.50%	0.20%

¹ The VRS Defined Contribution Plans purchase units in various State Street Global Advisors (SSgA) Series A or Series T collective trust funds in order to provide plan participants with the ability to purchase and redeem units on a daily basis. SSgA Series A or Series T Funds invest in other SSgA collective trust funds referred to as Base Funds.

² Inception dates shown reflect the inception dates of the Base Funds. Performance returns for the Series A Funds have been linked to those Base Funds' returns. The actual performance for the Base Funds has been restated to reflect the Plans' investment management fees. Inception dates for the Series A Funds commenced as follows:

SSgA Bond Index Series A	10/97	SSgA REIT Index Series A	5/01
SSgA S&P Index Series A	3/96	SSgA Russell Small Cap Completeness Index Series A	9/97
SSgA Russell 1000 Value Index Series A	3/99	SSgA EAFE Index Series A	1/97
SSgA Russell 1000 Growth Index Series A	8/99	SSgA Russell 3000 Index Series A	6/97

³ Equity Securities of companies with relatively small market capitalization may be more volatile than securities of larger, more established companies.

⁴ Foreign investments involve special risks, including currency fluctuations and political developments.

⁵ The inception date shown reflects the inception date of the Base Fund. Performance returns for the Series T Fund have been linked to the returns of the Series A and Base Funds. The actual performance for the Base Fund has been restated to reflect the Plans' investment management fees. The inception date of VRS' participation in the Series T Fund was April 21, 2003.

⁶ Performance returns have been linked to the previous investment manager. Returns prior to May 5, 2003 represent performance by MetLife.

⁷ The estimated yield range is provided to help participants make choices concerning their investment options. **There is no guarantee that the Fund will earn the projected estimated yield.**





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