Virginia Retirement System

COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED JUNE 30, 2006

AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

Virginia Retirement System
Fiscal Year 2006
Financial and Statistical Highlights – All Pension Trust Funds

(DOLLARS IN THOUSANDS)

	2006	2005	% Change
For the Year			
Contributions	$ 1,566,679	$ 1,468,261	6.7%
Investment Income (Net of investment expenses)	$ 5,213,323	$ 4,601,463	13.3%
Retirement Benefits	$ 2,101,785	$ 1,945,471	8.0%
Refunds	$ 91,230	$ 84,731	7.7%
Administrative Expenses (Net of misc. income)	$ 20,166	$ 18,706	7.8%
Increase in Net Assets Held in Trust for Pension Benefits	$ 4,566,821	$ 4,020,816	13.6%
Retirement Benefits as a percentage of contributions	134.2%	132.5%	
Retirement Benefits as a percentage of contributions and investment income	31.0%	32.1%	
At Fiscal Year End			
Net Assets Held in Trust for Pension Benefits - VRS	$ 46,020,734	$ 41,640,481	10.5%
Net Assets Held in Trust for Pension Benefits - SPORS	$ 580,371	$ 529,844	9.5%
Net Assets Held in Trust for Pension Benefits - VaLORS	$ 699,923	$ 593,370	18.0%
Net Assets Held in Trust for Pension Benefits - JRS	$ 325,685	$ 296,197	10.0%
Investment Performance			
One-Year Return on Investments	12.4%	12.0%	
Three-Year Return on Investments	14.0%	10.6%	
Five-Year Return on Investments	7.1%	3.0%	
Participating Employers			
Counties/Cities/Towns	248	245	
Special Authorities	181	180	
School Boards	145	145	
State Agencies	230	228	
Total Employers	804	798	0.8%
Membership/Retirees			
Active Members	332,916	325,025	2.4%
Retired Members	124,639	119,360	4.4%

OUR MISSION: TO SERVE AS STEWARDS OF THE FUNDS IN OUR CARE AND TO PROVIDE SUPERIOR CUSTOMER SERVICE

Virginia Retirement System

COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2006

AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

THIS REPORT WAS PREPARED BY THE FINANCIAL, ADMINISTRATIVE AND INVESTMENT STAFF OF THE VIRGINIA RETIREMENT SYSTEM

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, 2005

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.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

Table of Contents

PPCC

Public Pension Coordinating Council

Public Pension Standards

2005 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.

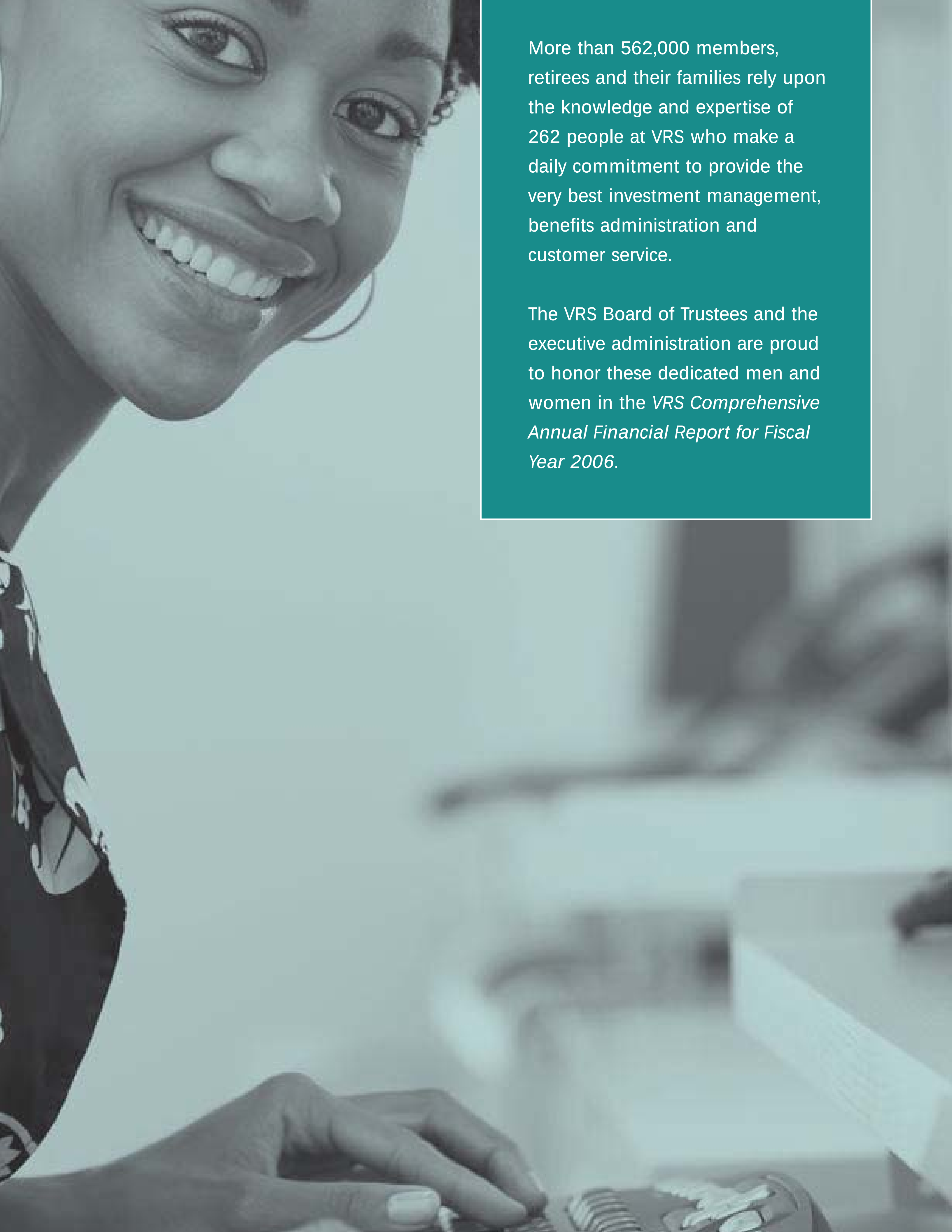
Presented by the Public Pension Coordinating Council, a confederation of

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

Alan H Winkle

Alan H. Winkle
Program Administrator

How we serve Virginia's public employees...



More than 562,000 members, retirees and their families rely upon the knowledge and expertise of 262 people at VRS who make a daily commitment to provide the very best investment management, benefits administration and customer service.

The VRS Board of Trustees and the executive administration are proud to honor these dedicated men and women in the *VRS Comprehensive Annual Financial Report for Fiscal Year 2006*.

Chairman's Letter

Virginia Retirement System

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
Toll Free:1-888-VARETIR (827-3847); TDD: (804) 344-3190

November 1, 2006

The Honorable Timothy M. Kaine,
Governor of Virginia
Members of the General Assembly:

I am pleased to inform you that the Virginia Retirement System (VRS) fund returned 12.4% for fiscal year 2006, ending with assets totaling $48.7 billion. VRS is now the 25th largest public or private pension system in the United States and the 48th largest internationally.

According to Wilshire Associates, the median return among U.S. public pension plans in FY 2006 was 9.44%. Wilshire ranked VRS' one-year investment return of 12.4% in the top 13th percentile; its three-year return of 14.0% in the upper 8th percentile; and its five-year return of 7.1% in the upper 28th percentile of all public plans.

The fund's private equity and real estate investments produced outstanding returns in FY 2006 at 28.6% and 23.4%, respectively. The system also saw a 15.3% return in public equity (U.S. and international stocks); a 5.3% return in credit strategies; and a –0.6% return in fixed income. The Board salutes the work of the VRS investment staff for its outstanding achievement on behalf of VRS members, retirees and beneficiaries.

Notwithstanding the VRS fund's recent performance, the Board of Trustees is less optimistic about future investment returns. To that end, the Board lowered the actuarial return expectation from 8.0% to 7.5%. On a more positive note, however, the Board also lowered the long-term inflation expectation from 3.0% to 2.5%. In addition, the Board certified new contribution rates for state employees, teachers and other public employees for FY 2007 to support future retirement obligations. Thanks to you, former Governor Warner and the members of the 2006 General Assembly, rates for state employees increased to 5.74% of payroll (from 3.91%) and for teachers to 9.20% (from 6.62%), effective July 1, 2006.

These rate increases will help offset the impact of the 2001-2003 soft market on VRS' Trust Fund reserves and protect benefits for Virginia's future public employees. On behalf of the Board of Trustees, I congratulate you on your foresight and prudence in strengthening the fund's financial condition on behalf of VRS members and retirees.

VRS also achieved several outstanding administrative milestones during FY 2006. The agency launched *my*VRS in May, providing active and deferred members secure online access to their retirement records. Members can verify their VRS records with service, compensation, and member contributions updated monthly. They can create retirement estimates using actual data and simulate retirement income options with a new automated benefit estimator. They also can check the status of an application for retirement, purchase of prior service or refund.

"Our mission to provide financial security for members and retirees depends on knowledgeable and prudent investment management, cost-effective administration, a commitment to customer service, and responsible Board governance."

In another milestone for customer service, the Customer Contact Center significantly reduced its abandoned rate on inbound telephone calls. For the last two years, the rate has averaged 22% to 23% of inbound calls going unanswered. The abandoned call rate for FY 2006 averaged 7.3%.

Finally, VRS runs efficiently. CEM Benchmarking, Inc., a research and assessment service for national and international public pension systems, reported that VRS' total adjusted cost of administration in 2005 was $37 per active member and annuitant, down from $40 in 2004. This compares to a peer group average of $77 for public pension systems participating in the study. The Board of Trustees appreciates the administrative staff for a job well done.

Our mission to provide financial security for members and retirees depends on knowledgeable and prudent investment management, cost-effective administration, a commitment to customer service, and responsible Board governance. I am delighted to report that VRS posted exceptional achievements in all these areas in FY 2006.

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.

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.

VRS Organization

BOARD OF TRUSTEES

ADMINISTRATION

Robert P. Schultze
Director

INVESTMENTS

Charles W. Grant, CFA
Chief Investment Officer

INTERNAL AUDIT

Franklin O. Berry
Internal Audit Director

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, Investure

Deborah Allen-Hewitt
President, Rutledge Research

Donald W. Lindsey
Chief Investment Officer, The George Washington University

Stuart A. Sachs
President (Retired), Sovran Capital Management

Dr. Katrina F. Sherrerd
Senior Vice President, Educational Products, Association for Investment Management and Research

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:
Robert P. Schultze, LaShaunda B. King, Kenneth C. Robertson, Jr., Jeanne L. Chenault, Craig M. Burns, Donna M. Blatecky, Barry C. Faison, L. Farley Beaton and Franklin O. Berry.

Robert P. Schultze
Director

Franklin O. Berry
Internal Audit Director

L. Farley Beaton
Chief Technology Officer

Donna M. Blatecky
Deputy Director, Customer Relationships Division

Craig M. Burns
Director of Policy, Planning and Compliance

Jeanne L. Chenault
Director of Public Relations

Barry C. Faison
Chief Financial Officer

LaShaunda B. King
Executive Assistant

Kenneth C. Robertson, Jr.
Director of Human Resources

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
Daniel L. Homan, EA, MAAA
Senior Consultant
Wachovia Retirement Services
(formerly Palmer & Cay)

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
Michelle Jackson
UnumProvident Corporation

Letter of Transmittal

Virginia
Retirement
System

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

P.O. Box 2500, 1200 East Main Street
Richmond, Virginia 23218-2500
Toll Free: 1-888-VARETIR (827-3847); TDD: (804) 344-3190

November 6, 2006

To the Members of the Board of Trustees:

We are pleased to submit the Comprehensive Annual Financial Report (CAFR) of the Virginia Retirement System (the "System") for the fiscal year ended June 30, 2006.

VRS administers benefits and services for more than 562,000 members, retirees and beneficiaries covered under the following systems:

- Virginia Retirement System (VRS) for teachers, state employees, employees of participating political subdivisions and local law enforcement officers and full-time firefighters
- State Police Officers' Retirement System (SPORS)
- Virginia Law Officers' Retirement System (VaLORS)
- Judicial Retirement System (JRS)

Benefits include the traditional defined benefit plan; 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. More than 800 state agencies, school boards, political subdivisions and special authorities participate in VRS on behalf of their employees.

VRS' Comprehensive Annual Report for FY 2006 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 2, Special Session 1, of the 2006 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 2006 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 and notes; required supplementary 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, Wachovia Retirement Services (formerly Palmer & Cay); 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.

Accounting System and Internal Control

The financial statements included in the CAFR for FY 2006 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, 2006 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 in the Financial Section immediately following the report of the independent auditor.

The System's management 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. The System also conducts 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.

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	State Police Officers' Retirement System (SPORS) created.
1960	Group Life Insurance Program established.
1970	Cost-of-Living Adjustment (COLA) established. Judicial Retirement System (JRS) created.

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, 2006 adequately safeguard the System's assets and provide reasonable assurance regarding the proper recording of financial transactions.

Funding

The System's most recent actuarial valuation was prepared as of June 30, 2005. As expected, the report indicated a decline in the funded ratios of most of the plans. This resulted from a continuation of the negative impact of the investment losses from FY 2001 and FY 2002 in the Actuarial Value of Assets. Further information on this valuation is included in the Financial Section and the Actuarial Section of this CAFR.

As a result of the June 30, 2005 actuarial valuation, the Board of Trustees certified new employer retirement contribution rates for most employers, and the Governor and General Assembly increased the retirement contribution funding for teachers and the state employee groups. The FY 2007 CAFR and the actuarial valuation as of June 30, 2007 will reflect the impact of these new rates.

Investments

The VRS investment objective is to maximize the investment return while managing risk within an acceptable range. Due to the long-term nature of the plan's liabilities, the horizon for investment decisions is generally defined as 10 years or longer. Risk is assessed in an asset-liability framework. The primary risk measures are volatility in the plan's assets, funded status and contribution rates.

At June 30, 2006, the total value of the VRS investment portfolio was $49.2 billion. This is an increase from the investment balance of $44.8 billion at June 30, 2005. The increased growth in the portfolio resulted from an investment return of 12.4% for FY 2006, partially offset by the excess of benefit payments over contributions for the year. The System's net assets at June 30, 2006 totaled $48.7 billion.

Legislative Initiatives

The Virginia General Assembly enacted several bills during the 2006 session that affect Virginia public employees and retirees:

HEALTH INSURANCE CREDIT

- *House Bill 59* removed the monthly health insurance credit cap of $120 for retired state employees.

LOCAL LAW ENFORCEMENT OFFICERS (LEOS)

- *House Bill 37* added local emergency medical technicians to those local employees for whom localities may provide retirement benefits equivalent to those provided to state police officers.

VRS Milestones

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. Virginia Law Officers' Retirement System (VaLORS) created.

2002 Long-term care benefit added to VSDP.

TEACHING IN CRITICAL SHORTAGE AREAS

- *Senate Bill 99* allows retirees other than retired teachers to teach in critical shortage areas while continuing to receive a retirement allowance provided the retiree becomes licensed by the Virginia Board of Education to serve as a teacher or an administrator in a local public school system.

Year in Review

- The VRS membership grew from 542,831 in fiscal year 2005 to 562,459 in FY 2006, an increase of 3.6%:
    - Active VRS members grew from 325,025 to 332,916, an increase of 2.4%.
    - Retirees and beneficiaries grew from 119,360 to 124,639, an increase of 4.4%.
    - Inactive and deferred members grew from 98,446 to 104,904, an increase of 6.6%.
- VRS processed nearly 13,100 applications for service retirement, disability retirement and purchase of prior service during the fiscal year.
- In FY 2006, the VRS retiree payroll was $2,101,800,000, compared to $1,945,500,000 in FY 2005.
- Each month, VRS staff updated member records by processing more than 1,000 payroll reports submitted by employers.
- The Customer Contact Center handled more than 161,000 calls during FY 2006.
- The Member Counseling Team provided assistance to more than 2,300 members who visited VRS and responded to more than 4,500 e-mails during the fiscal year. Staff also conducted 39 retirement education sessions and 39 group counseling sessions at community colleges around the state attended by nearly 6,400 members, and held another 68 retirement sessions, special presentations and benefit fairs for approximately 4,600 members at their workplaces.
- The Employer Education and Training staff provided 28 sessions for more than 350 benefit administrators and payroll officers during FY 2006. VRS' Employer Representatives made nearly 70 site visits and held 19 forums in locations around the state attended by more than 300 representatives of VRS-participating employers.
- At June 30, approximately 45,600 members held active accounts through the Commonwealth of Virginia Deferred Compensation Program. Of these participants, more than 41,000 received a cash match from their employers through the Virginia Cash Match Program.
- During FY 2006, the VRS Web site (*www.varetire.org*) received 782,582 visits, an increase from 706,756 in FY 2005 and 615,637 in FY 2004. The member pages were the most frequently visited area of the site during the fiscal year, followed by the employer

Customer contact center representatives focused on decreasing the abandoned call rate during the fiscal year – and achieved dramatic results. Over the previous two years, the rate of calls going unanswered averaged 22% to 23%. In FY 2006, the abandoned call rate averaged only 7.3%.

and retiree pages. The most frequently downloaded forms were the Designation of Beneficiary, the Application for Service Retirement and the Request for Refund. The top publications were the VRS Member Handbook, the Pre-Retirement Planning Guide and the Applying for Service Retirement Booklet.

VRS Accomplishments

- The Customer Contact Center worked to dramatically reduce the abandoned call rate, which is the number of calls going unanswered. Over the last two years, the rate has averaged 22% to 23% of calls. The abandoned call rate for FY 2006 averaged 7.3%. One of the Customer Contact Center's initiatives was the establishment of the "Xtras," a team of retirees and other part-time employees who work on a temporary, hourly basis during periods of peak demand.

- VRS implemented the first phase of a new telephone system that enhances the effectiveness and efficiency of the Customer Contact Center as well as all agency staff. The system uses Voice over Internet Protocol (VoIP), a technology that makes phone calls through a broadband Internet connection rather than a regular (analog) phone line. This technology allows staff to access their voicemail, e-mail and faxes from a touchtone phone or desktop PC, among several other new features.

_my_VRS, a secure online system for active and deferred members, was launched in FY 2006.

- VRS launched *my*VRS in May, providing active and deferred members secure online access to their retirement records. Members can verify their VRS records, create retirement estimates using their actual data and simulate various retirement options. They also can check the status of an application for retirement, purchase of prior service or refund. Future phases of *my*VRS will include a version for employers and a version for retirees.

- CEM Benchmarking, Inc., a research and assessment service for national and international public pension systems, reported that VRS' total adjusted cost of administration in 2005 was $37 per active member and annuitant, down from $40 in 2004. This compares to a peer group average of $77 for public pension systems participating in the study.

- In June, VRS received the approval of the Board of Trustees to proceed with a six-year modernization program to update systems, business processes and customer services through state-of-the-art technology. The objectives of modernization are to provide customers near "24/7" access to VRS services, including new self-service capabilities; enhance the timeliness, accuracy and consistency of customer service; implement comprehensive knowledge and learning desktop tools; improve business process efficiency; and update outmoded technology systems. The ultimate vision of the program is "to create a workplace where skilled and confident staff routinely deliver superior customer service in a collaborative work environment that encourages and supports continuous improvement."

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, 2005. This was the 24th 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 2006* 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) awarded VRS a 2005 Leadership Award for excellence and innovation in government defined contribution plans. The award recognized VRS for its efforts to develop reports and benchmarking tools to monitor the goals of the Commonwealth of Virginia Deferred Compensation Plan.

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 business 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 Timothy M. Kaine and the members of the Virginia General Assembly for their continued commitment to the financial security of the members and retirees of the Virginia Retirement System.

Respectfully submitted,

Robert P. Schultze
Director

Barry C. Faison
Chief Financial Officer

…provide financial security

The people who work for VRS understand that when it comes to the financial security of members, retirees and their beneficiaries, it is not enough to do the job. The job has to be done well.

Every year, the VRS staff exceeds the agency's stringent quality standard of achieving accurate, timely benefits processing at least 95% of the time. In FY 2006, that achievement encompassed:

- Paying approximately $2.1 billion in monthly annuities to retirees and beneficiaries.

- Processing nearly 13,100 applications for service retirement, disability retirement and purchase of prior service.

- Ensuring the payment of 17,000 claims for life and optional life insurance benefits.

- Processing an average of 1,000 employer payroll reports every month.

- Ensuring VRS systems were accessible to staff virtually 100% of the time.

Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

October 20, 2006

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
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 the Virginia Retirement System as of and for the years ended June 30, 2006 and 2005, as listed in the Table of Contents. These financial statements are the responsibility of the Virginia Retirement 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 Virginia Retirement System. They do not purport to, and do not, present fairly the Commonwealth of Virginia's overall financial position as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows, where applicable, for the year 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, 2006 and 2005, and the changes in plan net assets for the years 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, actuarial methods and significant assumptions and additional financial information included in the report on pages 23 through 29 and pages 55 through 60 are not a required part of the basic financial statements, but are supplementary information required by 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 20, 2006 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 considered in assessing the results of our audit.

AUDITOR OF PUBLIC ACCOUNTS

Management's Discussion and Analysis

The Financial 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, 2006. We encourage readers to consider the information presented here in conjunction with the information provided in the Letter of Transmittal.

The System administers the following four defined benefit retirement plans, which are defined as pension trust funds:

- Virginia Retirement System (VRS) for state employees, teachers and public school board employees, employees of participating political subdivisions and other qualifying employees;
- State Police Officers' Retirement System (SPORS) for state police officers;
- Virginia Law Officers' Retirement System (VaLORS) for state law enforcement and correctional officers other than state police officers;
- 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, which are defined as other employee benefit trust funds. Both 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 $4,566.9 million, or 10.6%, during the fiscal year ended June 30, 2006. 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, 2006 was 12.4% compared with a return of 12.0% for the fiscal year ended June 30, 2005. The increase is primarily due to an increase in the performance of public and private equity investments.
- The VRS, SPORS, VaLORS and JRS plans were actuarially funded at 81.3%, 76.4%, 58.7% and 71.5% based on the actuarial valuation as of June 30, 2005. For the VRS, SPORS and JRS plans, this was a decline from their funded ratios of 90.3%, 77.8% and 78.0% based on the actuarial valuation as of June 30, 2004. For the VaLORS plan, there was a slight improvement from the June 30, 2004 funded ratio of 54.9%. Changes in a number of actuarial assumptions had an impact on the funded ratios. These included reducing the investment return assumption from 8.0% to 7.5% and reducing the inflation assumption from 3.0% to 2.5%. In addition, 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, 2006 and 2005 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 include:
   - Statement of Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds. 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 Trust Funds. 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 the following two schedules with related notes:
   - 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. The following supplementary schedules provide additional details not included in the basic financial statements:
   - Schedule of Administrative Expenses
   - Schedule of Professional and Consulting Services
   - Schedule of Investment Expenses

Plan Net Assets

(EXPRESSED IN MILLIONS)

	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Assets					
Cash, Receivables and Capital Assets	$ 2,443.5	$ (249.3)	$ 2,692.8	$ 184.9	$ 2,507.9
Investments	49,186.8	4,337.3	44,849.5	4,582.7	40,266.8
Security Lending Collateral	4,019.0	(166.7)	4,185.7	1,050.9	3,134.8
Total Assets	**$ 55,649.3**	**$ 3,921.3**	**$ 51,728.0**	**$ 5,818.5**	**$ 45,909.5**
Liabilities					
Accounts Payable	$ 389.5	$ 145.4	$ 244.1	$ 2.4	$ 241.7
Investment Purchases Payable	2,492.8	(682.5)	3,175.3	684.1	2,491.2
Obligations Under Security Lending	4,019.0	(166.7)	4,185.7	1,050.9	3,134.8
Total Liabilities	**$ 6,901.3**	**$ (703.8)**	**$ 7,605.1**	**$ 1,737.4**	**$ 5,867.7**
Total Net Assets	**$ 48,748.0**	**$ 4,625.1**	**$ 44,122.9**	**$ 4,081.1**	**$ 40,041.8**

Change in Plan Net Assets

(EXPRESSED IN MILLIONS)

	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Additions					
Member Contributions	$ 39.8	$ (25.1)	$ 64.9	$ (22.8)	$ 87.7
Member Contributions Paid by Employer	661.0	39.5	621.5	36.4	585.1
Employer Contributions	1,010.8	92.5	918.3	292.3	626.0
Net Investment Income	5,340.6	621.1	4,719.5	(1,381.8)	6,101.3
Total Additions	**$ 7,052.2**	**$ 728.0**	**$ 6,324.2**	**$ (1,075.9)**	**$ 7,400.1**
Deductions					
Retirement Benefits	$ 2,101.8	$ 156.3	$ 1,945.5	$ 184.5	$ 1,761.0
Refunds of Member Contributions	91.2	6.5	84.7	(0.3)	85.0
Insurance Premiums and Claims	111.5	14.4	97.1	(8.9)	106.0
Retiree Health Insurance Reimbursements	72.5	3.5	69.0	4.1	64.9
Long-Term Disability Benefits	27.3	1.5	25.8	2.0	23.8
Administrative and Other Expenses	22.8	1.8	21.0	0.3	20.7
Total Deductions	**$ 2,427.1**	**$ 184.0**	**$ 2,243.1**	**$ 181.7**	**$ 2,061.4**
Net Increase (Decrease) in Net Assets	**$ 4,625.1**	**$ 544.0**	**$ 4,081.1**	**$ (1,257.6)**	**$ 5,338.7**

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, 2006, 2005 and 2004 is presented in Figure 1.

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 active members and their 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, 2006

FIGURE 1.

Active Membership Distribution at June 30

	2006	2005	2004
State Employees (VRS)	79,728	78,158	76,911
Teachers (VRS)	142,467	139,209	135,130
Political Subdivision Employees (VRS)	98,690	95,658	93,436
State Police Officers (SPORS)	1,790	1,807	1,751
Virginia Law Officers (VaLORS)	9,826	9,779	9,573
Judges (JRS)	415	414	402
Total	**332,916**	**325,025**	**317,203**

amounted to $6,780.4 million. This was an increase of $710.5 million when compared with FY 2005 and also an increase from the decline of $1,053.0 million that was recorded in FY 2005. This information is presented in Figure 2.

Total member contributions, including those paid by employers, increased $14.5 million, while employer contributions increased $84.0 million for a total increase in contributions of $98.5 million from the previous fiscal year. Investment income also provided an increase to plan net assets in FY 2006. Member contributions paid by members decreased by $25.0 million. This was caused mostly by a continuing decline in activity among members purchasing previously refunded and other qualified service. Employer contributions increased primarily due to payroll growth, an increase in the employer contribution rate for teachers from 6.03% to 6.62% and the addition of special coverage by some local governments. This is discussed further in Note 13 of the Notes to Financial Statements. During FY 2005, the System experienced growth in total member contributions of $13.6 million and an increase in employer contributions of $269.5 million. As in FY 2006, the member contributions were affected by the number of members purchasing service. The growth in the employer contributions is related to an increase on July 1, 2004 in the employer contribution rates for most employers, based on the June 30, 2003 actuarial valuation.

INVESTMENTS

There was net investment income for FY 2006 of $5,213.7 million, which represented an increase of $612.0 million from FY 2005 (Figure 2). This compares to a net investment income decrease of $1,336.1 million in FY 2005. Total pension trust fund investments increased to $48,026.4 million at fair value at June 30, 2006. This was an increase of $4,283.2 million over the fair value of $43,743.2 million at June 30, 2005. The total pension trust fund investments also increased in FY 2005 by $4,518.7 million from their fair value of $39,224.5 million at June 30, 2004.

The total return on pension trust fund investments for the fiscal year ended June 30, 2006 was 12.4%. The annualized return was 14.0% over the past three years and 7.1% 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 2006 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.

FIGURE 2.

Contributions and Investment Earnings for the Years Ended June 30

(EXPRESSED IN MILLIONS)

	2006	**Increase (Decrease)**	2005	Increase (Decrease)	2004
Member Contributions	$ 39.8	$ (25.0)	$ 64.8	$ (22.8)	$ 87.6
Member Contributions Paid by Employer	661.0	39.5	621.5	36.4	585.1
Employer Contributions	865.9	84.0	781.9	269.5	512.4
Net Investment Income *	5,213.7	612.0	4,601.7	(1,336.1)	5,937.8
Total	**$ 6,780.4**	**$ 710.5**	**$ 6,069.9**	**$ (1,053.0)**	**$ 7,122.9**

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

FIGURE 3.

Primary Expenses for the Years Ended June 30

(EXPRESSED IN MILLIONS)

	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Benefits	$ 2,101.8	$ 156.3	$ 1,945.5	$ 184.5	$ 1,761.0
Refunds	91.2	6.5	84.7	(0.3)	85.0
Administration and Other Expenses	20.6	1.7	18.9	0.3	18.6
Total	**$ 2,213.6**	**$ 164.5**	**$ 2,049.1**	**$ 184.5**	**$ 1,864.6**

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 2006 totaled $2,213.6 million, an increase of $164.5 million, or 8.0%, over the 2005 period. The details are presented in Figure 3.

The increase in benefit payments to $2,101.8 million in FY 2006 was due to continued growth in the number of retirees and beneficiaries receiving benefits combined with a cost-of-living adjustment (COLA) of 2.7% on July 1, 2005. The number of retirees and beneficiaries receiving benefit payments was approximately 124,639 at June 30, 2006, an increase of 4.4% from the 119,360 retirees and beneficiaries at June 30, 2005. The increase in benefit payments for FY 2006 was $156.3 million compared to $184.5 million for FY 2005.

Refunds of contributions to members who terminated employment during FY 2006 amounted to $91.2 million (14,139 refunds), compared with $84.7 million refunded (13,588 refunds) during FY 2005 and $85.0 million refunded (15,328 refunds) during FY 2004. The change during FY 2006 reflects both an increase in the number of refunds and a higher average refund amount compared to FY 2005.

Administration and other expenses for FY 2006 were $20.6 million, compared with $18.9 million for FY 2005 and $18.6 million for FY 2004. Administration expenses increased $1.7 million for FY 2006. This compares to an increase in administration expenses in FY 2005 of $0.3 million. The increase is related to benefit costs, as well as other administrative costs. Further details are provided in the Schedule of Administrative Expenses.

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 2006, there was a net increase of $4,566.9 million in the retirement reserves held by the plans. This compares to an increase of $4,020.8 million in the retirement reserves in FY 2005. As noted above, the increase for FY 2006 was primarily related to the investment performance for the year, which was slightly better than it was in FY 2005. During the fiscal year, the amount of interest credited to member accounts was $285.3 million. The amount of member balances transferred to employer reserves upon members' retirements was $382.2 million. The member and employer balances in retirement reserves at June 30, 2006 are presented in Figure 4.

FIGURE 4.
Reserve Balances at June 30

(EXPRESSED IN MILLIONS)

	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Member Reserves	$ 7,918.0	519.2	$ 7,398.8	$ 490.4	$ 6,908.4
Employer Reserves	39,708.7	4,047.7	35,661.0	3,530.4	32,130.6
Total	**$ 47,626.7**	**$ 4,566.9**	**$ 43,059.8**	**$ 4,020.8**	**$ 39,039.0**

ACTUARIAL VALUATIONS AND FUNDING PROGRESS

The System's actuarial firm 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, 2005 by the VRS consulting actuary, Wachovia Retirement Services (formerly, Palmer & Cay), indicated that the ratio of assets accumulated by the plans to their total actuarial accrued liabilities for benefits was 81.3% for VRS, 76.4% for SPORS, 58.7% for VaLORS and 71.5% for JRS. The valuations reflect full pre-funding 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 of this CAFR.

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 covered under 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 348,419 employees and 117,409 retirees were covered by the group life insurance program at June 30, 2006.

During FY 2006, the System remitted $111.5 million to the insurance company for claims and administrative costs. This is an increase from the $97.0 million remitted for FY 2005. The difference between the amounts collected and paid by the System for the group life insurance program is covered by the reserve established to pre-fund death benefits for retirees. This reserve had net assets held in trust for benefits of $751.4 million at June 30, 2006 and had an investment income, including net securities lending income, of $92.2 million during the fiscal year. For FY 2005, this reserve had an investment income of $91.5 million and ended the year with a reserve balance of $771.8 million, down from the $778.5 million at June 30, 2004. For FY 2006, the growth is the result of investment income. For all three years, 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 61,508 employees participating in the program at June 30, 2006. This compares to approximately 56,267 employees participating in the program at June 30, 2005.

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 2006, the System collected $86.9 million in retiree health insurance credit contributions from participating employers and provided reimbursements of $72.5 million to 72,387 eligible retirees. 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 approximately 69,114 eligible retirees. The growth in contributions reflects a continuation of general payroll increases. 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 $178.1 million at June 30, 2006 and had an investment income, including net securities lending income, of $17.0 million during the fiscal year. The reserve balances at June 30, 2005 and June 30, 2004 were $147.0 million and $120.9 million, respectively.

Total Plan Net Assets

FY	2006	$48.7 billion
	2005	$44.1 billion
	2004	$40.0 billion
% Change 2004-2006		21.8%

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 2006, the System collected $58.0 million in VSDP contributions from participating employers and provided long-term disability benefits of $27.3 million to eligible employees. This is an increase over the $54.5 million in contributions collected and $25.8 million in benefits paid in FY 2005. Contribution increases reflect growth in covered payrolls. 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 $191.9 million at June 30, 2006 and had an investment income, including net securities lending income, of $17.6 million during the fiscal year. The reserve balances at June 30, 2005 and June 30, 2004 were $144.2 million and $103.3 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, 2006 AND 2005
(EXPRESSED IN THOUSANDS)

	Pension Trust Funds				
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total Pension Trust Funds
Assets					
Cash (Note 5)	$ 224,572	$ 2,807	$ 3,385	$ 1,575	$ 232,339
Receivables:					
Contributions	110,711	–	266	–	110,977
Interest and dividends	133,599	1,682	2,029	944	138,254
Receivable for security transactions	1,738,197	21,889	26,395	12,281	1,798,762
Other receivables	77,673	959	1,156	538	80,326
Total receivables	**2,060,180**	**24,530**	**29,846**	**13,763**	**2,128,319**
Due from other funds	2,432	2,650	2,518	2,195	9,795
Investments (Note 5)					
Bonds and mortgage securities	9,861,580	124,191	149,750	69,672	10,205,193
Stocks	15,452,627	194,601	234,651	109,173	15,991,052
Fixed income commingled funds	2,044,494	25,747	31,046	14,445	2,115,732
Index and pooled funds	13,682,893	172,314	207,777	96,671	14,159,655
Real estate	1,438,825	18,120	21,849	10,165	1,488,959
Private equity	2,555,644	32,184	38,808	18,056	2,644,692
Short-term investments	1,373,274	17,294	20,853	9,702	1,421,123
Total investments	**46,409,337**	**584,451**	**704,734**	**327,884**	**48,026,406**
Collateral on loaned securities	3,792,069	47,755	57,583	26,791	3,924,198
Property, plant, furniture and equipment (Note 6)	6,780	–	–	–	6,780
Total assets	**52,495,370**	**662,193**	**798,066**	**372,208**	**54,327,837**
Liabilities					
Retirement benefits payable	171,653	2,735	2,442	2,155	178,985
Refunds payable	5,684	–	283	–	5,967
Accounts payable and accrued expenses	134,961	1,690	2,038	948	139,637
Compensated absences payable	1,410	–	–	–	1,410
Insurance premiums and claims payable	–	–	–	–	–
Payable for security transactions	2,352,005	29,620	35,716	16,617	2,433,958
Other payables	3,653	22	27	12	3,714
Obligations under security lending program	3,792,069	47,755	57,583	26,791	3,924,198
Due to other funds	13,201	–	54	–	13,255
Total liabilities	**6,474,636**	**81,822**	**98,143**	**46,523**	**6,701,124**
Net assets held in trust for benefits (Note 4) (See Required Supplemental Schedule of Funding Progress.)	**$46,020,734**	**$ 580,371**	**$ 699,923**	**$ 325,685**	**$ 47,626,713**

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

Other Employee Benefit Trust Funds				Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	**2006**	2005
$ 3,788	$ 849	$ 937	$ 5,574	$ 237,913	$ 64,065
7	3,808	417	4,232	115,209	128,990
2,271	509	561	3,341	141,595	149,536
29,536	6,620	7,305	43,461	1,842,223	2,320,188
1,294	306	2,160	3,760	84,086	8,563
33,108	**11,243**	**10,443**	**54,794**	**2,183,113**	**2,607,277**
–	5,837	–	5,837	15,632	15,465
167,570	37,558	41,446	246,574	10,451,767	9,582,639
262,574	58,852	64,944	386,370	16,377,422	15,980,181
34,740	7,787	8,592	51,119	2,166,851	1,590,868
232,501	52,112	57,506	342,119	14,501,774	12,709,002
24,449	5,480	6,047	35,976	1,524,935	1,228,253
43,426	9,733	10,741	63,900	2,708,592	2,225,579
23,335	5,230	5,772	34,337	1,455,460	1,533,003
788,595	**176,752**	**195,048**	**1,160,395**	**49,186,801**	**44,849,525**
64,436	14,442	15,937	94,815	4,019,013	4,185,747
–	–	–	–	6,780	5,958
889,927	**209,123**	**222,365**	**1,321,415**	**55,649,252**	**51,728,037**
–	–	–	–	178,985	163,760
2	70	63	135	6,102	6,664
2,282	6,720	3,989	12,991	152,628	24,747
–	–	–	–	1,410	1,243
30,943	–	–	30,943	30,943	30,878
39,965	8,958	9,885	58,808	2,492,766	3,175,280
31	7	7	45	3,759	1,354
64,436	14,442	15,937	94,815	4,019,013	4,185,747
907	858	612	2,377	15,632	15,465
138,566	**31,055**	**30,493**	**200,114**	**6,901,238**	**7,605,138**
$ 751,361	**$ 178,068**	**$ 191,872**	**$ 1,121,301**	**$ 48,748,014**	**$ 44,122,899**

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, 2006 AND 2005
(EXPRESSED IN THOUSANDS)

	Pension Trust Funds				
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total Pension Trust Funds
Additions					
Contributions:					
Members	$ 38,825	$ 304	$ 534	$ 108	$ 39,771
Member-paid by employers	638,242	4,627	15,492	2,653	661,014
Employers	781,769	15,257	52,662	16,206	865,894
Total contributions	**1,458,836**	**20,188**	**68,688**	**18,967**	**1,566,679**
Investment income					
Net appreciation/(depreciation) in fair value of investments	4,246,983	53,459	60,560	29,787	4,390,789
Interest, dividends and other investment income	1,003,466	12,632	14,310	7,039	1,037,447
Total investment income before investment expenses	5,250,449	66,091	74,870	36,826	5,428,236
Investment expenses	(224,464)	(2,825)	(3,201)	(1,574)	(232,064)
Net investment income	**5,025,985**	**63,266**	**71,669**	**35,252**	**5,196,172**
Security lending income:					
Gross income	169,918	2,139	2,423	1,192	175,672
Less borrower rebates and agent fees	(153,328)	(1,930)	(2,187)	(1,076)	(158,521)
Net security lending income	**16,590**	**209**	**236**	**116**	**17,151**
Miscellaneous revenue	185	–	–	–	185
Transfers in	–	–	255	–	255
Total additions	**6,501,596**	**83,663**	**140,848**	**54,335**	**6,780,442**
Deductions					
Retirement benefits	2,015,557	32,309	29,202	24,717	2,101,785
Refunds of member contributions	85,804	596	4,830	–	91,230
Insurance premiums and claims	–	–	–	–	–
Retiree health insurance reimbursements	–	–	–	–	–
Long-term disability benefits	–	–	–	–	–
Administrative expenses	19,724	231	263	130	20,348
Other expenses	3	–	–	–	3
Transfers out	255	–	–	–	255
Total operating expenses	**2,121,343**	**33,136**	**34,295**	**24,847**	**2,213,621**
Net increase (decrease)	4,380,253	50,527	106,553	29,488	4,566,821
Net assets held in trust for benefits - beginning of year	41,640,481	529,844	593,370	296,197	43,059,892
Net assets held in trust for benefits - end of year	**$ 46,020,734**	**$ 580,371**	**$ 699,923**	**$ 325,685**	**$ 47,626,713**

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

Other Employee Benefit Trust Funds				Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	**2006**	2005
$ 32	$ –	$ –	$ 32	$ 39,803	$ 64,872
–	–	–	–	661,014	621,529
20	86,913	57,991	144,924	1,010,818	918,329
52	**86,913**	**57,991**	**144,956**	**1,711,635**	**1,604,730**
77,641	14,333	14,791	106,765	4,497,554	4,035,278
18,346	3,386	3,495	25,227	1,062,674	844,865
95,987	17,719	18,286	131,992	5,560,228	4,880,143
(4,104)	(757)	(782)	(5,643)	(237,707)	(174,320)
91,883	**16,962**	**17,504**	**126,349**	**5,322,521**	**4,705,823**
3,107	573	592	4,272	179,944	84,055
(2,803)	(517)	(534)	(3,854)	(162,375)	(71,348)
304	**56**	**58**	**418**	**17,569**	**12,707**
–	–	–	–	185	743
–	–	–	–	255	230
92,239	**103,931**	**75,553**	**271,723**	**7,052,165**	**6,324,233**
–	–	–	–	2,101,785	1,945,471
–	–	–	–	91,230	84,731
111,490	–	–	111,490	111,490	97,041
–	72,482	–	72,482	72,482	68,966
–	–	27,339	27,339	27,339	25,840
716	337	576	1,629	21,977	20,368
489	–	–	489	492	444
–	–	–	–	255	230
112,695	**72,819**	**27,915**	**213,429**	**2,427,050**	**2,243,091**
(20,456)	31,112	47,638	58,294	4,625,115	4,081,142
771,817	146,956	144,234	1,063,007	44,122,899	40,041,757
$ 751,361	**$ 178,068**	**$ 191,872**	**$ 1,121,301**	**$48,748,014**	**$44,122,899**

Notes to Financial Statements

JUNE 30, 2006 AND 2005

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

Virginia Retirement System (VRS)
State Police Officers' Retirement System (SPORS)
Virginia Law Officers' Retirement System (VaLORS)
Judicial Retirement System (JRS)

Other Employee Benefit Plans

Group Life Insurance Fund
Retiree Health Insurance Credit Fund
Disability Insurance Trust Fund (also known as the Virginia Sickness and Disability Program [VSDP])

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 Board of Trustees is responsible for the general administration and operation of the defined benefit pension plans, other employee benefit plans and other funds. 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. Because optional life insurance is an insured product and the premium collection is handled by the carrier, the Board of Trustees provides only oversight for the program with little administrative responsibility.

The Board of Trustees has oversight responsibility, but little administrative involvement and no investment responsibility, for 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 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, 2006 and 2005 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 Board of Trustees approves expenses related to the administration and trust fund management activities of the System. These expenses are 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 principles (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.

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, 2006 and 2005

	2006	2005
Cities and Towns	155	153
Counties	93	92
School Boards*	145	145
Special Authorities	181	180
State Agencies	230	228
Total Employers	**804**	**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, 2006 and 2005

	2006				2006	2005
	VRS	SPORS	VaLORS	JRS	Total	Total
Retirees and beneficiaries receiving benefits	121,901	958	1,380	400	124,639	119,360
Terminated employees entitled to benefits but not yet receiving them	30,466	69	310	9	30,854	29,455
Total	**152,367**	**1,027**	**1,690**	**409**	**155,493**	**148,815**
Active plan participants:						
Vested	208,725	1,401	6,210	348	216,684	211,613
Nonvested	112,160	389	3,616	67	116,232	113,412
Total	**320,885**	**1,790**	**9,826**	**415**	**332,916**	**325,025**

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 the average of the member's 36 consecutive months of highest creditable compensation. Benefits are actuarially reduced for members who retire prior to becoming eligible for full retirement benefits. Members of SPORS and VaLORS as well as 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.

As required by Title 51.1 of the *Code of Virginia* (1950), as amended, employees contribute 5% of their annual compensation to the defined benefit plans. Employers may assume the 5% member contribution. 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 compensation 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 348,419 employees and 117,409 retirees were covered under the program at June 30, 2006.

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 pre-fund death benefits to members after retirement.

An Optional Group Life Insurance Fund was established on November 1, 1995 for employees 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 equal to one, two, three or four times the employee's annual compensation 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 61,508 employees were covered under this program at June 30, 2006.

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).

Employees who elect optional life insurance coverage are responsible for the premiums, which their employers deduct from their pay 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, 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 72,387 retired employees were covered under this program at June 30, 2006.

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 to provide 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 salaried permanent state employees who work at least 20 hours a week and 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 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 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 125 work days of short-term disability, eligible employees receive long-term disability benefits equal to 60% of their 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 70,026 employees were covered under the program at June 30, 2006.

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 2006 and FY 2005 were based on their valuation as of June 30, 2003. In addition, a separate contribution requirement was computed for the teacher cost-sharing pool by the actuary for each year using the same valuation date noted above.

Contributions for the Years Ending June 30, 2006 and 2005

(EXPRESSED IN THOUSANDS)

	2006				2006	2005
	VRS	SPORS	VaLORS	JRS	**Total**	Total
Employer contributions	$ 781,769	$ 15,257	$ 52,662	$ 16,206	$ 865,894	$ 781,876
Employee contributions paid by employer	638,242	4,627	15,492	2,653	661,014	621,529
Employee contributions	38,825	304	534	108	39,771	64,856
Total Contributions	**$ 1,458,836**	**$ 20,188**	**$ 68,688**	**$ 18,967**	**$ 1,566,679**	**$ 1,468,261**

Contributions totaling $1,566,679,000 and $1,468,261,000 for the fiscal years ended June 30, 2006 and 2005, 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 $865,894,000 for FY 2006. Included in total employer contributions were $339,000 from school boards for payments toward early retirement program costs and $4,416,000 from state agencies for payments toward Workforce Transition Act (WTA) costs. Included in the employee contributions of $39,771,000 were $35,895,000 paid for the purchase of previously refunded service and other qualifying service.

Employer contributions to the VRS cost-sharing pool for teachers represented 6.62% of covered payrolls. This is an increase from the 6.03% contribution rate for FY 2005. Additionally, the employer contributions to VRS by the state for state employees were 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. These rates were unchanged from FY 2005. 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, 2006 and 2005 are presented in the table shown on this 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, 2006 and 2005

(EXPRESSED IN THOUSANDS)

	2006	2005
Virginia Retirement System		
Member Reserve	$ 7,658,117	$ 7,154,648
Employer Reserve	38,362,617	34.485,833
Total VRS	**46,020,734**	**$ 41,640,481**
State Police Officers' Retirement System		
Member Reserve	67,037	63,535
Employer Reserve	513,334	466,309
Total SPORS	**580,371**	**529,844**
Virginia Law Officers' Retirement System		
Member Reserve	161,512	151,407
Employer Reserve	538,411	441,963
Total VaLORS	**699,923**	**593,370**
Judicial Retirement System		
Member Reserve	31,379	29,281
Employer Reserve	294,306	266,916
Total JRS	**325,685**	**296,197**
Group Life Insurance		
Advance Premium Deposit Reserve	**751,361**	**771,817**
Retiree Health Insurance Credit Reserve	**178,068**	**146,956**
Virginia Sickness and Disability Program		
Disability Insurance Trust Fund	**191,872**	**144,234**
Total Pension and Other Employee Benefit Reserve	**$ 48,748,014**	**$ 44,122,899**

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.

Deposits at June 30, 2006 and 2005

(EXPRESSED IN THOUSANDS)

	2006 Carrying Amount	2005 Carrying Amount
Treasurer of Virginia	$ 234,497	$ 64,065
Master Custodian	3,416	–
Total Deposits	**$ 237,913**	**$ 64,065**

A. DEPOSITS

Deposits of the System that are maintained by the Treasurer of Virginia at June 30, 2006 and 2005 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.

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 also must 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, 2006 and 2005, the equity interests of each fund were as follows:

Equity Interests at June 30, 2006 and 2005

Fund	**2006**	2005
Virginia Retirement System	94.35%	94.33%
State Police Officers' Retirement System	1.19%	1.20%
Virginia Law Officers' Retirement System	1.43%	1.34%
Judicial Retirement System	0.67%	0.67%
Group Life Insurance Fund	1.60%	1.82%
Retiree Health Insurance Credit Fund	0.36%	0.32%
Disability Insurance Trust Fund	0.40%	0.32%
Total	**100.00%**	**100.00%**

Effective Duration of Debt Securities by Investment Type as of June 30, 2006

(EXPRESSED IN THOUSANDS)

Investment Type	Market Value June 30, 2006	Weighted Avg. Effective Duration (years)
U.S. Government	$ 2,280,097	5.01
Agencies	3,276,019	3.34
Municipal securities	13,847	3.98
Asset-backed securities	1,271,551	0.30
Collateralized mortgage obligations	406,432	2.07
Commercial mortgages	333,895	4.01
Corporate bonds and other bonds	2,712,311	3.32
Fixed-Income commingled funds	2,166,851	4.85
Treasurer of Virginia - LGIP Investment Pool	73,407	0.08
TBC Pooled Employee Trust Fund	1,321,106	0.08
Total	**$ 13,855,516**	**3.22**

2. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The risk is managed within the portfolio using the effective duration or option-adjusted methodology (see table above.) 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.

Credit Quality and Exposure Levels of Nongovernment Guaranteed Securities as of June 30, 2006

(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
U.S. Government Agencies	$3,261,407	$ –	$ –	$ 111,928	$ –	$ 3,678	$ –	$ –	$ –
AAAm	–	–	–	–	–	–	–	73,407	–
Aaa	424	8,977	1,227,587	256,679	247,639	188,554	–	–	–
Aa1	–	2,165	–	–	–	80,561	518,401	–	–
Aa2	14,188	–	–	–	4,348	72,701	–	–	–
Aa3	–	–	782	–	–	103,455	–	–	1,321,106
A1	–	–	–	–	615	92,517	1,108,761	–	–
A2	–	–	–	–	–	99,648	–	–	–
A3	–	–	938	–	277	104,365	–	–	–
Baa1	–	–	–	–	–	162,232	–	–	–
Baa2	–	1,132	13,880	–	–	214,042	–	–	–
Baa3	–	–	4,397	–	–	215,222	–	–	–
Ba1	–	–	4,120	–	–	116,483	–	–	–
Ba2	–	–	–	–	–	209,244	–	–	–
Ba3	–	–	–	–	–	171,856	366	–	–
B1	–	–	1,905	–	–	127,315	7,202	–	–
B2	–	–	–	–	–	203,876	26,106	–	–
B3	–	–	–	–	–	138,256	35,812	–	–
Ba	–	–	–	–	–	–	91,962	–	–
Baa	–	–	–	–	–	–	199,513	–	–
Caa1	–	–	677	–	–	74,210	5,006	–	–
Caa2	–	–	–	–	–	8,224	–	–	–
Caa3	–	–	–	–	–	1,389	–	–	–
Ca	–	–	–	–	–	265	–	–	–
C	–	–	1,595	–	–	580	–	–	–
P-1	–	–	–	–	–	–	56,676	–	–
VMIG1	–	–	–	–	–	802	–	–	–
VMIG2	–	–	–	–	–	4,870	–	–	–
VMIG3	–	–	–	–	–	9,555	–	–	–
Not Rated	–	1,573	15,670	37,825	81,016	308,411	117,046	–	–
Total	**$3,276,019**	**$ 13,847**	**$1,271,551**	**$ 406,432**	**$ 333,895**	**$2,712,311**	**$2,166,851**	**$ 73,407**	**$1,321,106**

3. CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the System. As of June 30, 2006, the System's fixed income assets that are not government guaranteed represented 84% of the fixed income assets.

The System's policy for credit risk is based on the concept of a risk budget rather than specific limitations related to the rating of an individual security. The System's risk budget is allocated among the different investment strategies. The table on the previous page summarizes the System's fixed income portfolio exposure levels and credit qualities.

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 that 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, 2006 and 2005 consisted of the following:

(EXPRESSED IN THOUSANDS)

	2006	2005
U.S. Government and agency mortgage securities	$ 194,798	$ 122,754
Corporate and other bonds	–	6,158
Common and preferred stocks	48,409	49,182
Held by broker-dealers under securities lending program:		
U.S. Government and agency mortgage securities	202,390	229,118
Corporate and other bonds	–	889
Common and preferred stocks	60,609	54,286
Total	**$ 506,206**	**$462,387**

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, 2006

(EXPRESSED IN THOUSANDS)

Currency	Cash & Cash Equivalents	Equity	Corporate Bonds	Private Equity	Real Estate	Total
Euro Currency Unit	$ 3,855	$ 2,732,539	$ 10,693	$ 385,647	$ –	$ 3,132,734
British Pound Sterling	10,608	1,868,194	–	76,250	661	1,955,713
Japanese Yen	24,788	1,569,603	–	–	(5,930)	1,588,461
Australian Dollar	108	1,149,845	6,186	–	–	1,156,139
Canadian Dollar	1,637	814,125	396	–	–	816,158
Norwegian Krone	323	462,048	–	–	–	462,371
Swiss Franc	1,163	347,391	–	–	–	348,554
Hong Kong Dollar	1,628	311,125	–	–	439	313,192
South Korean Won	1,087	287,449	–	–	–	288,536
New Taiwan Dollar	6,455	208,772	–	–	–	215,227
Brazil Real	707	201,574	–	–	–	202,281
Indian Rupee	5,347	90,894	–	–	–	96,241
South African Comm Rand	429	95,253	–	–	–	95,682
New Turkish Lira	38	94,953	–	–	–	94,991
Singapore Dollar	570	94,395	–	–	–	94,965
Malaysian Ringgit	344	55,001	–	–	–	55,345
Danish Krone	2	38,612	–	–	–	38,614
Mexican New Peso	1,139	35,015	–	–	–	36,154
Egyptian Pound	104	28,475	–	–	–	28,579
Russian Ruble (New)	1	21,003	–	–	–	21,004
Philippines Peso	92	17,548	–	–	–	17,640
Polish Zloty	83	17,021	–	–	–	17,104
Thailand Baht	15	15,590	–	–	–	15,605
Indonesian Rupian	–	15,158	–	–	–	15,158
Israeli Sheckel	1,298	12,763	–	–	–	14,061
Turkish Lira	7,189	–	–	–	–	7,189
Nigeria Naira	–	7,182	–	–	–	7,182
Slovenia Tolar	–	5,964	–	–	–	5,964
Pakistan Rupee	–	3,607	–	–	–	3,607
Colombian Peso	–	666	–	–	–	666
Peruvian Nuevo Sol	–	213	–	–	–	213
Iceland Kronur	–	187	–	–	–	187
Jordan Dinar	–	136	–	–	–	136
Morocco Dirham	–	127	–	–	–	127
Venezuela Bolivar	–	27	–	–	–	27
Argentina Peso	–	(23,310)	–	–	–	(23,310)
Chinese Yuan Renminbi	–	(27,274)	–	–	–	(27,274)
Hungarian Forint	194	(27,760)	–	–	–	(27,566)
Czech Koruna	56	(31,981)	–	–	–	(31,925)
Chilean Peso	–	(40,876)	–	–	–	(40,876)
Swedish Krona	321	(187,104)	–	22,890	–	(163,893)
New Zealand Dollar	94	(246,177)	–	–	–	(246,083)
Total	**$ 69,675**	**$ 10,017,973**	**$ 17,275**	**$ 484,787**	**$ (4,830)**	**$ 10,584,880**

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 an irrevocable letter-of-credit issued by a major bank, 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 88 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, 2006 and 2005 was $4,335,714,000 and $4,401,317,000, respectively. The June 30, 2006 and 2005 balances were composed of U.S. Government and agency securities of $2,366,847,000 and $2,440,464,000, respectively; corporate and other bonds of $225,695,000 and $296,354,000, respectively; and common and preferred stocks of $1,743,172,000 and $1,664,499,000, respectively.

The value of collateral (cash and non-cash) at June 30, 2006 and 2005 was $4,421,712,000 and $4,573,872,000, 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, 2006 and 2005, respectively, include (1) receivables for deposits with brokers for securities sold short of $1,142,069,000 and $1,248,041,000; and (2) payables for securities sold short and not covered with market values of $1,152,007,000 and $1,353,204,000, 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 generally are 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 also may 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 $237,369,000 at June 30, 2006 and $961,708,000 at June 30, 2005.

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, 2006, the System had purchased S&P, Russell Index, Treasury bonds and notes and global indices futures and options with a notional value of $5,462,482,000, and sold Treasury bonds and notes and global indices futures and options with a notional value of $638,208,000. At June 30, 2005, the notional values of the balances purchased and sold were $3,997,496,000 and $1,149,667,000, respectively. At June 30, 2006, the System had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of $158,222,000 as the margin requirement for futures contracts. At June 30, 2005, the market value of the pledged securities was $177,992,000.

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, 2006, the System had sold foreign currency contracts with a notional value of $7,157,688,000 and had purchased foreign currency contracts with a notional value of $7,160,565,000. At June 30, 2005, the notional values of the foreign currency contract sold and purchased were $7,237,509,000 and $7,222,991,000, 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. 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 2006, the System entered into interest rate and total return swaps with a total notional value of $1,226,074,000. For FY 2005, the total notional value was $684,638,000. 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, 2005	Increases	Decreases	**Balance June 30, 2006**
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	4,143	1,192	–	5,335
Total depreciable capital assets	**8,775**	**1,192**	**–**	**9,967**
Less accumulated depreciation:				
Building	811	115	–	926
Furniture and equipment	3,374	255	–	3,629
Total accumulated depreciation	**4,185**	**370**	**–**	**4,555**
Total depreciable capital assets – Net	**4,590**	**822**	**–**	**5,412**
Total capital assets – Net	**$ 5,958**	**$ 822**	**$ –**	**$ 6,780**

Depreciation expense amounted to $370,000 and $313,000 in 2006 and 2005, 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, 2006 was $1,566,000. The System has, as of June 30, 2006, the accompanying total future minimum rental payments due under the above leases:

(EXPRESSED IN THOUSANDS)

Year	**Amount**
2007	$ 1,176
2008	1,161
2009	784
2010	703
2011	720
2012-2017	4,428
Total future minimum rental payments	**$ 8,972**

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, 2006.

9. Other Employee Benefit Programs

A. LIFE INSURANCE BENEFITS

The Commonwealth of Virginia participates in the System-administered group life insurance program, which provides post-employment life insurance benefits, in accordance with state statutes, to eligible retired and terminated employees. There were approximately 100,557 state employees and 46,197 retirees in the program during FY 2006. Information regarding eligibility requirements and benefit provisions as well as contribution requirements can be found in Note 2B.

Post-employment life insurance benefits are pre-funded 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 post-employment death benefits actuarially determined through an actuarial valuation performed as of June 30, 2005 were $1,672.4 million. The actuarial value of the program's assets available for benefits on that date was $746.3 million, leaving a present value of future contributions of $926.1 million.

The System's contribution requirements for its employees for the fiscal years ended June 30, 2006 and 2005 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 30,856 state retirees were receiving health insurance credits at June 30, 2006. Note 2C contains information regarding eligibility requirements, benefit provisions and contribution requirements.

For the fiscal year ended June 30, 2006, 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, 2006 and 2005 were $143,000 and $129,000, 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, 2006, approximately 70,026 participants were enrolled in the program.

For the fiscal year ended June 30, 2006, 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, 2006 and 2005 were $228,000 and $203,000, 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, 2006. 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 2006 and the three preceding fiscal years.

12. Commitments

The System extends investment commitments in the normal course of business. At June 30, 2006 and 2005, these commitments amounted to $4,842,000,000 and $3,491,000,000, 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 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 and FY 2006, 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 6.03% (the "normal cost") in FY 2005 and 6.62% (the "normal cost" plus a portion of the shortfall) in FY 2006. The rate for state employees in the VRS plan was increased from 3.89% to 3.91% and was used in FY 2005 and FY 2006. For FY 2005 and FY 2006, the 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)			
2005 **	$ 40,372	$ 49,628	$ 9,256	81.3%	$ 12,212	75.8%
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%
			STATE POLICE OFFICERS' RETIREMENT SYSTEM (SPORS)			
2005 **	$ 514	$ 673	$ 159	76.4%	$ 91	174.8%
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%
			VIRGINIA LAW OFFICERS' RETIREMENT SYSTEM (VaLORS)			
2005 **	$ 575	$ 980	$ 405	58.7%	$ 307	132.0%
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)			
2005 **	$ 288	$ 402	$ 114	71.5%	$ 52	220.7%
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%

** Change in benefit formula, 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 MILLIONS)

Year Ended June 30	Annual Required Contribution	Percentage Contributed	Statutory Required Contribution	Percentage Contributed
		VIRGINIA RETIREMENT SYSTEM (VRS)		
2006 *	$ 864,245	89.51%	$ 773,553	100.00%
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)		
2006 *	$ 23,132	65.96%	$ 15,258	100.00%
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)		
2006 *	$ 77,414	67.96%	$ 52,611	100.00%
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)		
2006 *	$ 23,871	67.89%	$ 16,206	100.00%
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, 2005 and 2006 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 pre-funding of the automatic cost-of-living increases (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 increases (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, 2005
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	21 Years
Political Subdivision Employees	21 Years
Teachers	21 Years
State Police/VA Law Officers /Judges	21 Years
Asset Valuation Method	5-year smoothed market
Actuarial Assumptions	
Investment Rate of Return *	7.50%
Projected Salary Increases *	
State Employees	3.75% to 5.60%
Teachers	3.75% to 6.20%
Political Subdivisions (non-LEO Employees)	3.75% to 5.73%
Political Subdivisions (LEO Employees)	3.50% to 4.71%
State Police/VA Law Officers	3.50% to 4.75%
Judges	3.50%
Cost-of-Living Adjustments	2.50%

** Includes inflation at 2.50%.*

Schedule of Administrative Expenses for the Years Ended June 30, 2006 and 2005

(EXPRESSED IN THOUSANDS)

	2006	2005
Personal Services		
Salaries and wages	$ 15,704	$ 13,597
Per diem services	291	323
Retirement contributions	1,302	1,173
Social Security	1,036	947
Group life and medical insurance	1,936	1,599
Compensated absences	280	241
Total personal services	**20,549**	**17,880**
Professional Services		
Data processing	3,944	3,857
Actuarial and consulting	1,008	816
Legal	727	786
Medical	154	150
Management services	340	294
Personnel development services	79	3
Total professional services	**6,252**	**5,906**
Communication Services		
Media	25	32
Printing	734	904
Postal and delivery	520	387
Telecommunications	489	456
Total communication services	**1,768**	**1,779**
Rentals		
Business equipment	775	632
Office space	791	507
Total rentals	**1,566**	**1,139**
Other Services and Charges		
Skilled and clerical services	158	315
Depreciation	370	313
Dues and memberships	91	64
Building expense	269	1,027
Equipment	1,111	232
Insurance	32	32
Repairs and maintenance	8	7
Supplies and materials	176	147
Travel and transportation	600	731
Miscellaneous	85	55
Total other services and charges	**2,900**	**2,923**
Total administrative expenses (GAAP basis)	**33,035**	**29,627**
Adjustments necessary to convert administrative expenses on the GAAP basis to the budgetary basis at year end (net)	250	(316)
Administrative Expenses (Budgetary basis)	**$ 33,285**	**$ 29,311**
Administrative Expenses Appropriated	**$ 35,466**	**$ 33,504**
Distribution of Administrative Expenses		
Total administrative expenses (GAAP Basis)	$ 33,035	$ 29,627
Less In-house Investment Management	(11,058)	(9,259)
Net Administrative Expenses	**$ 21,977**	**$ 20,368**

Schedule of Professional and Consulting Services for the Year Ended June 30, 2006

(EXPRESSED IN THOUSANDS)

Actuarial, Legal and Oversight Services			
Attorney General of Virginia	Legal Services	$ 152	
Joint Legislative Audit Review Commission	Oversight Responsibilities	158	
Troutman Sanders, LLP	Legal Services	82	
Wachovia Retirement Services (formerly, Palmer & Cay)	Actuarial Services and Benefits Consulting	456	
Williams Mullin	Legal Services	81	
Subtotal Actuarial, Legal, and Oversight Services			**$ 929**
Consulting Services			
Advantage 2000	Social Security Advocacy and Disability Tracking	$ 65	
Baskervill	Space Requirements Study	7	
Bon Secours Memorial Regional Medical Center	Disability Medical Reviews	84	
CorVel Corporation	Physician Referral for Disability Cases	70	
Cost Effectiveness Measurement, Inc.	Cost Driver Benchmarking Analysis	49	
David Elsberg	Fact Finding Hearing Officer for Disability Cases	9	
Ennis Knupp & Associates, Inc.	Investment Compensation Study	20	
Georgeson Shareholder Communications	Address Verification Services	33	
R. Louis Harrison	Fact Finding Hearing Officer for Disability Cases	9	
Katzen & Frye, PC	Fact Finding Hearing Officer for Disability Cases	20	
McCaul, Martin, Evans & Cook, PC	Fact Finding Hearing Officer for Disability Cases	6	
McLagan Partners, Inc.	Investment Compensation Study	65	
Medical Board	Medical Examiners	61	
Property & Portfolio Research, Inc.	Investment Consulting Services	151	
Prince Goldsmith	CIO Search Consulting Services	91	
Social Security Disability Consultants	Social Security Advocacy and Disability Tracking	286	
Strategic Economic Decisions, Inc.	Economic Advisory Services	20	
Townsend Group	Investment Consulting Services	90	
Unisys	Security Consulting Services	75	
L. R. Wechsler, Ltd.	Modernization Consultant	137	
Subtotal Consulting Services			**$ 1,348**
Total			**$ 2,277**

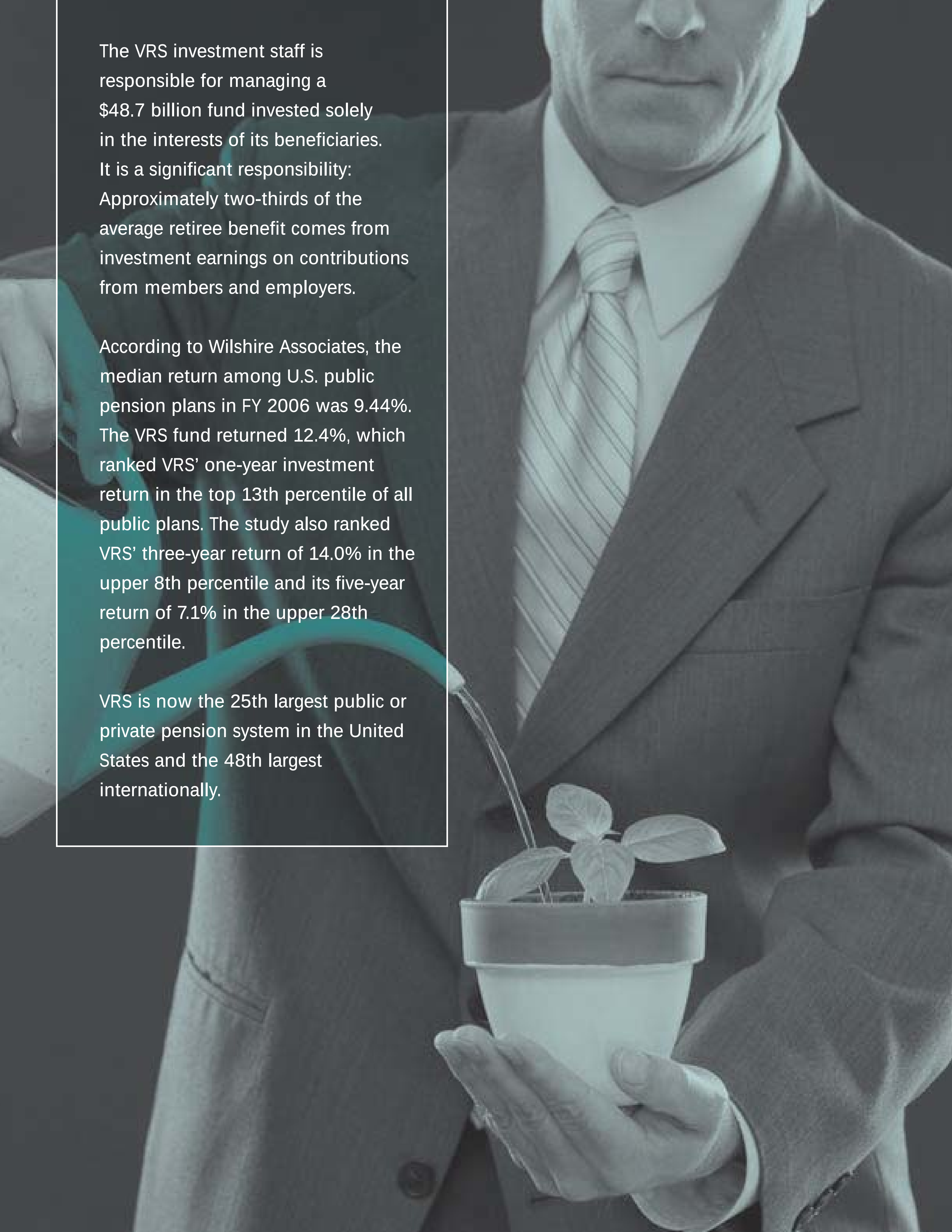
Schedule of Investment Expenses for the Year Ended June 30, 2006

(EXPRESSED IN THOUSANDS)

Management Fees		
Domestic managers	$ 19,143	
Non-U.S. equity managers	26,011	
Global equity managers	15,043	
Fixed income managers	6,158	
Credit strategies managers	10,471	
Real estate managers	16,969	
Alternative investment managers	59,122	
Hedge fund managers	32,638	**$ 185,555**
Performance Fees		**36,511**
Total Management and Performance Fees		**$ 222,066**
Miscellaneous Fees and Expenses		
Custodial fees	$ 3,300	
Legal fees	251	
Other fees and expenses	1,032	**$ 4,583**
In-House Investment Management		**11,058**
Total Investment Expenses		**$ 237,707**

VRS is an efficient organization. According to a 2006 study by CEM Benchmarking, Inc., a research and assessment service for national and international public pension systems, VRS' total adjusted cost of administration was $37 per active member and annuitant. The peer group average was $77 for public pension systems participating in the study.

…maximize and protect the VRS fund



The VRS investment staff is responsible for managing a $48.7 billion fund invested solely in the interests of its beneficiaries. It is a significant responsibility: Approximately two-thirds of the average retiree benefit comes from investment earnings on contributions from members and employers.

According to Wilshire Associates, the median return among U.S. public pension plans in FY 2006 was 9.44%. The VRS fund returned 12.4%, which ranked VRS' one-year investment return in the top 13th percentile of all public plans. The study also ranked VRS' three-year return of 14.0% in the upper 8th percentile and its five-year return of 7.1% in the upper 28th percentile.

VRS is now the 25th largest public or private pension system in the United States and the 48th largest internationally.

Chief Investment Officer's Letter

Virginia Retirement System

Charles W. Grant, CFA, Chief Investment Officer

P.O. Box 2500, 1200 East Main Street
Richmond, Virginia 23218-2500
Toll Free: 1-888-VARETIR (827-3847); TDD: (804) 344-3190

November 1, 2006

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

The VRS investment fund returned 12.4% for the fiscal year ending June 30, 2006 using a time-weighted return methodology. This return was well above our actuarially assumed long-term return of 7.5% and significantly exceeded the performance benchmark established by the Board of Trustees.

Economic growth and corporate earnings remained healthy and produced an attractive market environment for equity investing, both public and private. The fund's public equity investments (domestic and international combined) returned 15.3%, while the fund's private equity portfolio returned 28.6%. The environment also was favorable for real estate investments, which continued to benefit from low long-term interest rates and increased demand for the asset class. The VRS real estate program delivered a total return of 23.4%.

The environment was more challenging for fixed income and credit-related investments, as inflation pressures mounted and the Federal Reserve continued to raise short-term interest rates. The VRS fixed income program lost 0.6%, while credit strategies gained 5.3%. Overall, the fund's diversified portfolio produced a high return while maintaining risk at an acceptable level.

Significant progress was made over the last year on a number of projects that will improve our investment process. Following a multi-year research effort, we implemented a total fund risk management system that tracks and projects absolute and relative risks for individual asset classes and the total fund.

In another significant development, we changed our approach toward hedge fund investing and now view these funds as active investment strategies that can be appropriately used within any of our investment programs, subject to a total policy limit set by the Board (currently 5%). This more flexible approach should provide for both better returns and stronger risk management in this portion of our portfolio.

We expect the economy will slow over the next year as the Federal Reserve continues to execute monetary policy designed to maintain price stability. The markets will likely experience some weakness and volatility as this occurs, but over the long-term, price stability will be a key positive factor for continued economic growth and healthy investment returns. Our expectation is that the fund will produce returns in the range of 7% to 8% over the next 5 to 10 years.

VRS is fortunate to have a talented and hard-working investment staff, and I want to thank them for their commitment to achieve outstanding investment results. I also want to thank the Board of Trustees and the Investment Advisory Committee for their guidance and support.

Respectfully submitted,

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 and asset allocation policy for the management of fund assets.

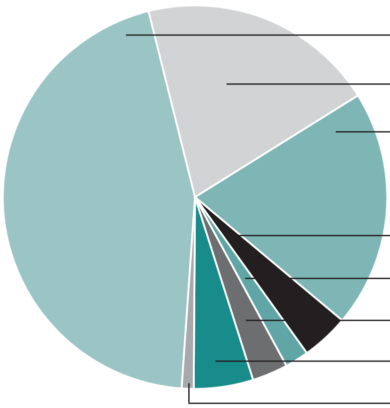
Benefit payments are projected to occur over a long period of time. This allows VRS to adopt a long-term investment horizon and asset allocation policy for the management of fund assets. Asset allocation policy is critical because it defines the basic risk and return characteristics of the VRS investment portfolio. Asset allocation targets are established using an asset-liability analysis designed to assist the Board in determining an acceptable volatility target for the fund and an optimal asset allocation policy mix. This asset-liability analysis considers both sides of the VRS balance sheet in order to estimate the potential impact of various asset class mixes on key measures of total plan risk including the resulting estimated impact on funded status and contribution rates.

The Chief Investment Officer has been delegated authority by the Board to allocate the system's investments within the approved asset allocation policy and within the Board approved active risk budget. The total fund active risk budget describes the degree of tolerance for yearly variation in the fund's performance relative to the Intermediate Term Benchmark. The primary risk measure used for this purpose is Total Fund Tracking Error, calculated as the standard deviation of the difference between the fund's return and the return of the Intermediate Term Benchmark. From this measure, probability estimates can be derived to help the Board estimate the risk of underperforming the benchmark by certain margins.

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. Managers employ both active and passive investment strategies. The Board has established various performance benchmarks 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, 2006 is shown on the next page:

Asset Allocation Mix



Investment Performance Summary

ANNUALIZED DATA FOR PERIOD ENDING JUNE 30, 2006

	1 Year	3 Years	5 Years
1. Total Fund Time-Weighted Returns			
VRS	12.4%	14.0%	7.1%
Total Fund Intermediate Benchmark	11.8%	13.5%	6.7%
2. Total Public Equity			
VRS	15.3%	17.1%	6.5%
Custom Benchmark	15.4%	16.7%	6.2%
3. Total Fixed Income			
VRS	-0.6%	2.5%	5.2%
Custom Benchmark	-0.8%	2.0%	5.0%
4. Total Credit Strategies			
VRS	5.3%	n/a	n/a
Custom Benchmark	5.7%	n/a	n/a
5. Total Real Estate			
VRS	23.4%	20.2%	15.6%
Custom Benchmark	21.2%	18.7%	13.6%
6. Total Private Equity			
VRS	28.6%	25.9%	10.1%
Custom Benchmark	16.8%	21.7%	7.9%

Investment return calculations were prepared using a time-weighted return methodology.

Portfolio Highlights

Public Equity

The market value of the total Public Equity Program as of June 30, 2006 was $31.8 billion, representing approximately 65% of the total fund. Roughly 69% was invested in Domestic Equity and 31% in International Equity. Seventeen percent of the Total Public Equity portfolio was invested in passive strategies, and 23% 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 underperformed the Custom Benchmark during the fiscal year by -0.17%. During the year, the Russell 3000 was up 9.6%, and the BMI Global Ex US was up 29.2%. Value stocks significantly outperformed, especially in the larger capitalization companies both internationally and domestically, as did the emerging markets.

The Total Public Equity Program includes equity-related hedge fund strategies. As of June 30, 2006, the total value of the assets included in these strategies was $1.96 billion.

The Total Public Equity Program also utilizes risk-controlled active currency strategies that attempt to capitalize on currency market inefficiencies by taking long and short currency positions based on their fundamental attractiveness. Staff believes active currency management represents an attractive opportunity because of the numerous observed market inefficiencies, low transaction costs, high liquidity and modest fees. The notional value of these strategies totaled $4.9 billion as of June 30, 2006.

Total Public Equity Program

Benchmark Category	VRS Return *	Benchmark Return *	VRS Weight	Benchmark Weight
Russell 1000	8.9%	9.1%	37.5%	38.5%
Russell 2000	13.7%	14.6%	4.9%	3.8%
Russell 3000	9.2%	9.6%	11.5%	11.5%
Russell Special Small Cap	14.0%	13.9%	1.7%	1.8%
S&P 500	8.1%	8.6%	7.1%	7.0%
S&P/Citigroup PMI World	20.0%	17.6%	13.7%	13.8%
S&P/Citigroup PMI Emerging	28.7%	35.9%	5.0%	2.8%
S&P/Citigroup EMI World Ex US	37.0%	31.4%	5.7%	4.7%
S&P/Citigroup PMI World Ex US	26.3%	27.8%	12.9%	16.1%
Total Program	**15.3%**	**15.4%**	**100.0%**	**100.0%**

**One-Year Total Return June 30, 2006* *Weights as of June 30, 2006*

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

Custom Benchmark Sectors and Regions

Sectors*	VRS	Strategic BM	Regions*	VRS	Strategic BM
Consumer Discretionary	10.9%	11.4%	North America	69.2%	71.2%
Consumer Staples	7.2%	7.8%	Europe/Australia/Far East	17.6%	16.2%
Energy	9.8%	9.8%	Asia/Pacific	12.2%	11.4%
Financials	24.3%	23.2%	Latin & South America	1.0%	1.2%
Health Care	10.1%	10.3%			
Industrials	11.6%	11.4%			
Information Technology	12.9%	12.5%			
Materials	5.6%	5.1%			
Telecommunication Services	4.2%	4.3%			
Utilities	3.4%	4.2%			

** 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, two companies fell from the list. Intel Corporation and Cisco Systems, Inc. were dropped, and JP Morgan Chase & Co. and Chevron Corp. were added.

Public Equity: Top 10 Holdings

Company	Market Value	Shares
Exxon Mobil Corporation	$ 465,240,845	7,583,388
General Electric Company	458,090,883	13,898,388
Citigroup Inc.	407,063,362	8,438,295
Bank of America Corporation	318,847,517	6,628,847
Microsoft Corporation	317,452,879	13,624,587
Johnson & Johnson	257,055,779	4,289,983
JP Morgan Chase & Co.	250,708,907	5,969,260
Pfizer Inc.	235,471,956	10,032,891
Altria Group Inc.	221,815,803	3,020,779
Chevron Corp.	211,515,037	3,408,235

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 $9.7 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 in a less active, more "risk-controlled" style. Internally managed accounts made up approximately 75% of the risk-controlled portion of the portfolio. The objective of the entire 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 –0.65% for the fiscal year. This was below our long-term expected return for bonds but well ahead of the program benchmark of –0.84%.

Fixed Income: Top 10 Holdings By Market Value

AS OF JUNE 30, 2006

Par	Security Description	Market Value
272,500,000	FNMA 5.00% 30-year MBS	$ 254,686.685
135,620,000	FNMA 6.00% 30-Year MBS	133,472,512
136,400,000	FNMA 5.50% 30-Year MBS	130,984,920
96,100,000	U.S. Treasury Notes 4.875% due 5/31/2008	95,562,802
84,369,416	U.S. Treasury CPI Notes 2.375% due 4/15/2011	84,020,127
82,500,000	GNMA 6.00% 30-Year MBS	81,807,000
83,970,000	U.S. Treasury Notes 3.50% due 12/15/2009	79,733,715
75,000,000	GE Dealer Floorplan 1 mo Libor due 6/30/2006	75,000,000
60,840,176	FHLMC pool A36526 5.00% 30-year MBS	56,874,888
43,695,000	U.S. Treasury Notes 8.125% due 8/15/2019	55,333,601

The yield curve flattened further over the last fiscal year as the Federal Reserve, in an effort to keep economic growth moderate and inflation benign, continued to push short-term rates higher. Two-year rates increased by 151 basis points to 5.15% and ten-year rates increased by 122 basis points to 5.14%. The increase in treasury yields put some pressure on the spreads in the various high-grade sectors of the bond market. Spreads were generally higher, but they remain at historically low levels. Looking forward, we believe that the Federal Reserve has neared the end of the tightening cycle, and they have succeeded in creating an environment in which economic growth will remain moderately strong and core inflation will remain in the 2% to 2.5% area.

Fixed Income Portfolio

AS OF JUNE 30, 2006

Sector Allocation

Sector	% Portfolio
Treasury	20.0%
Agency	7.0%
Corporate	25.0%
Mortgage	36.0%
Asset Backed	2.0%
CMBS	4.0%
Foreign	0.0%
Other	6.0%
Total	**100%**

Credit Quality Breakdown

Rating	% Portfolio
Government	20.3%
AAA	56.2%
AA	2.0%
A	15.1%
BBB	5.0%
BB	1.0%
B	0.3%
Below B	0.0%
NR	0.1%
Total	**100%**

Short-Term Investments

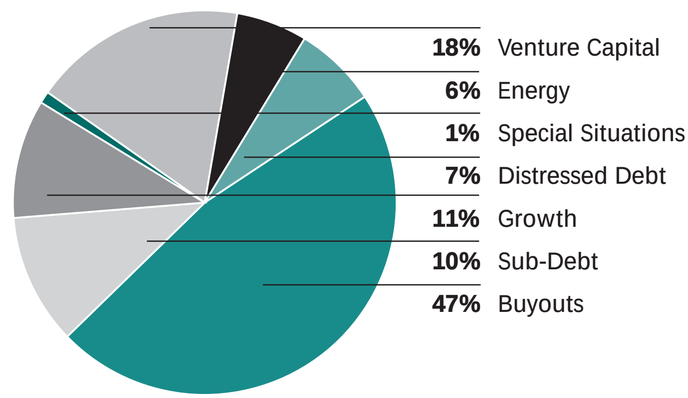
As a general rule, VRS desires to remain fully invested at all times and seeks to minimize its holdings of cash investments. Temporary cash balances are invested in short-term money market instruments with the goal of maintaining high credit quality and liquidity. The return on such investments approximates the return on 90-day U.S. Treasury bills, which was 3.98% 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 3000 Index on a dollar-weighted basis 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 return for FY 2006 was 28.6%. This marks the third consecutive year the private equity program has generated a return exceeding 20%. The substantial returns over the last three years have been 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 23.8% (as of March 31, 2006). By comparison, a dollar-weighted return for the Russell 3000 Index over the same time frame was 17.4%.

As of June 30, 2006, the carrying value of the program was approximately $2.7 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, energy and special situations. The breakdown of the Private Equity Program by sub-class was as follows:

Private Equity Program*



** As of March 31, 2006.*

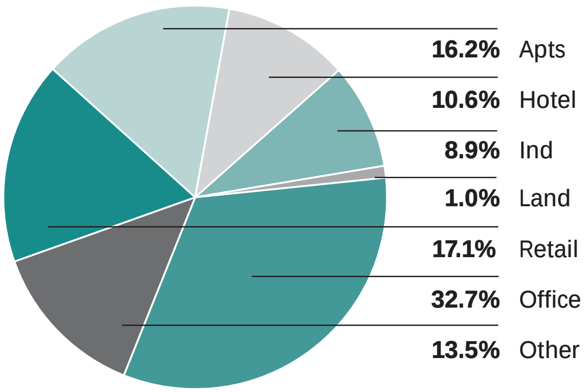
Real Estate

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 (see charts, next page). Real estate produced a 23.4% return for the fiscal year, 20.2% over the past three years and 15.6% over the past five years, outperforming its benchmark by 220 basis points for the fiscal year, 150 basis points for three years and 200 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 4.2% to 4.7% due to income and 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 39.1% as of June 30, 2006.

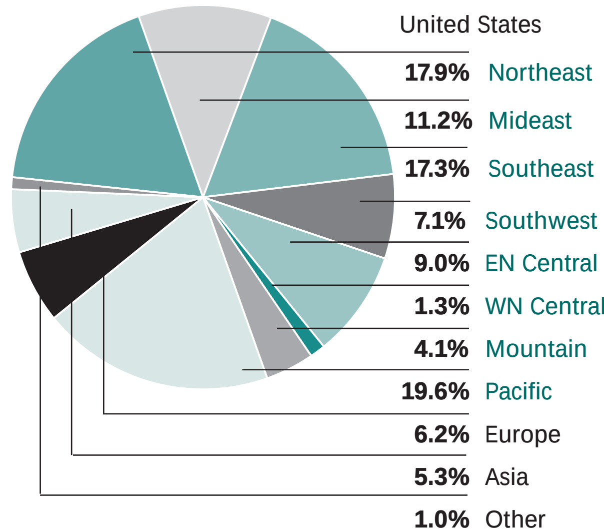
Real Estate by Property Type

JUNE 30, 2006



Real Estate by Geographic Region

JUNE 30, 2006



Credit Strategies

The Credit Strategies Program was initially funded in July 2004. This program seeks to deliver an investment profile that provides return and diversification benefits to the total fund. The program has grown 24% over the course of the last fiscal year to $2.05 billion, or 4.2% of the total fund. The program is made up of externally managed portfolios that are invested in high yield credit and convertible securities. Within high yield credit, funds are allocated across the public corporate credit, private corporate credit and structured credit areas.

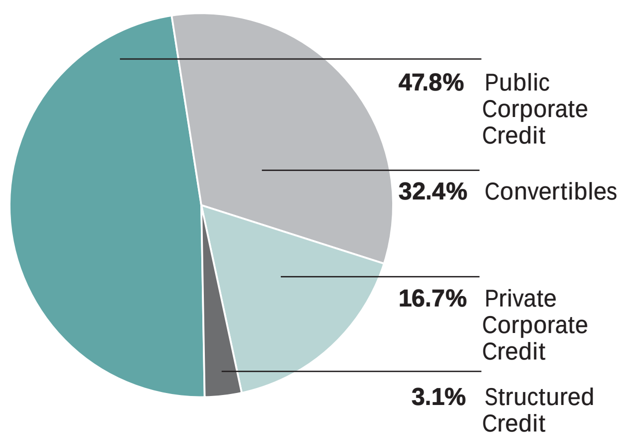
The program's return net of fees for the fiscal year was 5.3%, while the VRS Credit Strategies benchmark returned 5.7% over the same period.

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.

Credit Strategies

JUNE 30, 2006



VRS Money Managers

The diversified investment structure as of June 30, 2006 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
AllianceBernstein	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	U.S. Large & Active Currency
Capital Guardian Trust Company	Global
Freeman Associates Investment Management	U.S. Large
Grantham, Mayo and Van Otterloo & Company	Non-U.S. Small
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
Select Equity Group	U.S. Small
Shamrock Capital Advisors	U.S. Small
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

Internal	Style Description
Afton	U.S. Small
Madison	U.S. Large
MSCI Emerging Swap	Emerging Markets
Potomac Core	U.S. Large
Russell 2000 Synthetic	U.S. Small
York Value	U.S. Large

Hedge Funds – Top 10 Managers	Style Description
Ironbound Partners Overseas, Ltd.	Equity Long/Short
New Mountain	Equity Long/Short
Blue Ridge, LP	Equity Long/Short
Glenhill Capital	Equity Long/Short
Magnetar Capital Asset Fund, Ltd	Multi-Strategy
TPG-Axon Partners (Overshore), Ltd	Equity Long/Short
Oz Overseas Fund, Ltd	Multi-Strategy
Clovis Capital Partners	Equity Long/Short
Seneca Capital International, Ltd	Multi-Strategy
King Street Capital, Ltd	Multi-Strategy

Fixed Income Managers

External	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 Risk Controlled

Private Equity – Top 10 Managers

	Style Description
Welsh, Carson, Anderson and Stowe	Buyout and Sub-Debt
Madison Dearborn	Buyout
Summit Partners	Growth and Sub-Debt
First Reserve	Energy
Charterhouse	International Buyout
Hellman and Friedman	Buyout
TA Associates	Growth and Sub-Debt
Nordic Capital	International Buyout
Joseph, Littlejohn, and Levy	Turnaround
New Enterprise Associates	Venture

Credit Strategy Managers

	Style Description
Babson Capital	Mezzanine Credit
BlackRock Kelso Capital	Bank Loans and Mezzanine Credit
Hyperion Brookfield Asset Management	Structured Credit
Oaktree Capital Management	Mezzanine Credit and Convertibles
Post Advisory Group	Public High Yield Credit
Prudential	Public High Yield and Mezzanine Credit
Stone Harbor Investment Partners	Public High Yield Credit
Seix Advisors	Public High Yield Credit
W. R. Huff	Public High Yield Credit
Zazove Associates	Convertibles

Real Estate Managers

Public Real Estate Securities	Style Description
ING Clarion Real Estate Securities	REIT Portfolio
Internal - Monroe	REIT Portfolio
Urdang Securities Management, Inc.	REIT Portfolio
Wellington Management Company, LLP	REIT Portfolio

Private Real Estate	Style Description
AvalonBay Communities, Inc.	Enhanced Core
CIM Group	Enhanced Core
Liquid Realty Partners	Enhanced Core
ProLogis	Enhanced Core
Prudential Real Estate Investors	Enhanced Core
Security Capital European Realty	Enhanced Core
TA Associates Realty	Enhanced Core
AMB Investment Management, Inc.	Opportunistic
Blackstone Real Estate Partners	Opportunistic
Colonnade Properties	Opportunistic
Hines	Opportunistic
JER Partners	Opportunistic
Koll Bren Schreiber	Opportunistic
Lazard Frères Real Estate Investors	Opportunistic
Oaktree Capital Management	Opportunistic

Public Equity Commissions

JULY 1, 2005 THROUGH JUNE 30, 2006

Broker	Commission	Broker	Commission
Banc of America Securities, LLC	$ 2,876,401	Credit Lyonnais Securities	$ 602,982
Lehman Brothers, Inc.	2,401,095	Societe Generale Americas Securities	449,511
Jeffries & Co., Inc.	2,301,787	J. P. Morgan Securities, Inc.	392,900
Investment Technology Groups	1,797,444	Pershing, LLC	272,329
Goldman, Sachs & Co.	1,582,117	Neuberger and Berman	212,727
Morgan Stanley & Co., Inc.	1,426,971	National Financial Services Corp.	177,243
Merrill Lynch Pierce Fenner & Smith, Inc.	1,326,315	Kleinwort Benson Securities	175,064
Citigroup GBL Markets, Inc.	1,400,781	Weeden & Co.	167,283
Credit Suisse	1,086,582	Carnegie Fondcommission	157,237
Bear Stearns & Co., Inc.	1,017,323	MacQuarie Securities, Ltd.	142,066
Union Bank Switzerland Securities	964,041	ABN Amro Securities, LLC	131,266
Instinet Corp.	962,581	Liquidnet, Inc.	119,917
Deutsche Bank Securities, Inc.	799,931	Sanford C. Bernstein & Co.	112,055
Nomura Securities International, Inc.	726,740	Other Brokers	2,539,484
		Total FY 2006	**$26,322,173**

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, the Retiree Health Insurance Credit Fund and the Disability Insurance Trust 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, 2006 and 2005 (in thousands):

	2006 Fair Value	**Percent of Total Value**	2005 Fair Value	Percent of Total Value
Bonds and Mortgage Securities				
U. S. Government and Agencies	$ 2,939,665	5.97%	$ 2,947,558	6.57%
Mortgage securities	3,651,298	7.42%	3,287,705	7.33%
Corporate and other bonds	3,860,804	7.85%	3,347,376	7.46%
Total Bonds and Mortgage Securities	**10,451,767**	**21.24%**	**9,582,639**	**21.36%**
Common and Preferred Stocks	**16,377,422**	**33.30%**	**15,980,181**	**35.64%**
Index and Pooled Funds				
Equity Index and Pooled Funds	14,501,774	29.48%	12,709,002	28.34%
Fixed Income Commingled Funds	2,166,851	4.41%	1,590,868	3.55%
Total Index and Pooled funds	**16,668,625**	**33.89%**	**14,299,870**	**31.89%**
Real Estate				
Private Real Estate	**1,524,935**	**3.10%**	**1,228,253**	**2.73%**
Private Equity	**2,708,592**	**5.51%**	**2,225,579**	**4.96%**
Short-Term Investments				
Treasurer of Virginia - LGIP Investment Pool	73,407	0.15%	200,158	0.45%
TBC Pooled employee trust fund	1,321,106	2.69%	1,274,734	2.84%
Foreign Currencies	60,947	0.12%	58,111	0.13%
Total Short-Term Investments	**1,455,460**	**2.96%**	**1,533,003**	**3.42%**
Total Investments	**$ 49,186,801**	**100.00%**	**$ 44,849,525**	**100.00%**

. . .serve our customers

Providing superior customer service, education and information depends on skilled customer representatives, counselors, trainers and communicators who have extensive knowledge of VRS. During FY 2006, these staff:

- Handled more than 154,600 calls and e-mails.
- Counseled more than 2,300 customers who visited VRS.
- Conducted retirement education sessions, special presentations and benefit fairs at locations around the state attended by more than 11,000 members.
- Held employer training sessions, site visits and forums that reached more than 650 representatives of VRS' participating employers.
- Maintained a comprehensive communication program, including handbooks for VRS, SPORS, VaLORS, LEOS/FIRE and retired members; the VRS Employer Manual; and a Web site that received more than 782,000 visits in FY 2006.

Actuary Letter

December 16, 2005

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

PALMER & CAY
Established 1868

June 30, 2005 Actuarial Valuation Report

Dear Members of the Board:

We are pleased to present the annual actuarial valuation results for the following retirement plans of the Virginia Retirement System (VRS):

- VRS (state employees, teachers, employees of participating political subdivisions)
- State Police Officers' Retirement System (SPORS)
- Virginia Law Officers' Retirement System (VaLORS)
- Judicial Retirement System (JRS)

We certify the information contained in this report is accurate and fairly presents the actuarial status of the retirement plans as of June 30, 2005. The valuation reflects the benefits in effect on the valuation date, and was prepared on the basis of the data submitted by the VRS.

Participant Data and Assets

The individual data for members of the system as of the valuation date was reported to the actuary by the VRS. While we did not verify the individual records, we did perform tests for internal consistency and reasonableness in relation to the data submitted for the prior year's valuation.

The balance of current assets in the trust fund taken into account for the valuation was based on statements prepared for us by the VRS staff. We did not perform any type of audit on the plan assets.

Actuarial Assumptions and Methods

Actuarial assumptions are adopted by the Board of Trustees, upon review of recommendations made by the actuary. An experience study was conducted for the five-year period ending June 30, 2004 in May of 2005. This study resulted in the Board adopting several changes in assumptions, at the recommendation of the actuary, in order to better anticipate emerging liabilities of the plan.

The actuarial cost method utilized is the entry age normal cost method. This method is an acceptable method for determining the annual required contribution in accordance with GASB statements 25 and 27. For the purpose of determining contribution rates, the excess (shortfall) between expected and actual investment income is recognized over a five-year period, with the restriction that the actuarial asset value cannot be less than 80% or more than 120% of market value.

Legislative Changes

There were no legislative changes during the fiscal year ending June 30, 2005, which had a financial impact on the retirement plans.

Actuarial Certification

To the best of our knowledge, this report is complete and accurate. All costs and liabilities have been determined in conformity with generally accepted actuarial principles and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion, we believe the assumptions used are individually reasonable and represent the best estimate of anticipated experience under the VRS. The undersigned are available to answer questions regarding this report.

Respectfully submitted,

Palmer & Cay, a Wachovia Company

Daniel L. Homan

Daniel L. Homan, EA, MAAA
Senior Consultant

Kathleen M. Potter

Kathleen M. Potter, FSA
Senior Consultant

Solvency Test

(EXPRESSED IN THOUSANDS)

Valuation Date (June 30)	Aggregate Accrued Liabilities for: (1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members*	Valuation Assets	Portion of Accrued Liabilities Covered by Assets: (1)	(2)	(3)
VIRGINIA RETIREMENT SYSTEM (VRS)							
2005	$ 6,555,402	$ 21,140,882	$ 21,932,204	$ 40,372,648	100.00%	100.00%	57.80%
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)							
2005	$ 62,917	$ 337,017	$ 273,239	$ 514,330	100.00%	100.00%	41.87%
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)**							
2005	$ 148,890	$ 330,502	$ 500,705	$ 575,327	100.00%	100.00%	19.16%
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)							
2005	$ 32,143	$ 229,942	$ 140,216	$ 287,825	100.00%	100.00%	18.36%
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%

** Employer-financed portion.*

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

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.

Actuarial Assumptions and Methods	1994/1996	1998/1999	2000/2001	2002/2003/2004	2005
Valuation interest rate	8.0%	8.0%	8.0%	8.0%	7.5%
Salary scale inflation factor	4.0%	4.0%	3.0%	3.0%	2.5%
Change in decremental assumptions	Yes	No	Yes	No	Yes
Value of ancillary benefits included	Yes	Yes	Yes	Yes	Yes
Value of post-retirement adjustments to date included	Yes	Yes	Yes	Yes	Yes
Assets valued at	Modified Market	Modified Market	Modified Market	Modified Market	Modified Market

Schedule of Active Member Valuation Data

	Active Members				
Valuation Date (June 30)	Number	Annual Payrolls (000s)	Average Annual Pay	Annualized % Increase in Average Pay	Number of Employers
		VIRGINIA RETIREMENT SYSTEM (VRS)			
2005	312,981	$ 12,212,145	$ 39,019	3.5%	571
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)			
2005	1,811	$ 90,865	$ 50,174	7.3%	1
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)*			
2005	9,819	$ 306,574	$ 31,222	2.0%	1
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)			
2005	414	$ 51,874	$ 125,300	5.1%	1
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)					
2005	9,151/4,250	116,671	$ 1,814,791	8.3%	$ 15,555
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)					
2005	70/9	923	$ 29,186	10.7%	$ 31,620
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)***					
2005	248/12	1,206	$ 27,286	33.6%	$ 22,625
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)					
2005	25/17	395	$ 23,736	8.9%	$ 60,092
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 2005, total Annual Allowances increased because of added retirees and the COLA of 2.3% provided to existing retirees effective July 1, 2004. The increases totaled $197,344,000. For the same period, total Annual Allowances decreased because of reductions for retiree deaths and retirees who became inactive. The decreases totaled $47,093,000. During FY 2004, total Annual Allowances were increased by $172,420,000 for individuals added to the annuity payroll as well as for the COLA of 1.6% effective July 1, 2003. Total Annual Allowances decreased by $25,781,000 for individuals removed from the annuity payroll.

Analysis of Actuarial Gains and Losses for the Year Ended June 30, 2005

(IN THOUSANDS)

	VRS	SPORS	VaLORS	JRS	**Total**
A. Calculation of Expected Unfunded Actuarial Accrued Liability (UAAL)					
1. UAAL as of June 30, 2004	$ 4,266,788	$ 145,740	$ 418,571	$ 80,397	$ 4,911,496
2. Normal Cost for previous year	1,220,855	10,665	40,302	13,400	1,285,222
3. Actual contributions during the year	(1,364,892)	(19,363)	(66,079)	(17,927)	(1,468,261)
4. Interest at previous year's rate of 8.00%					
a. On UAAL	341,343	11,659	33,486	6,432	392,920
b. On Normal Cost	48,834	427	1,612	536	51,409
c. On contributions	(54,595)	(775)	(2,643)	(717)	(58,730)
d. Total	**335,582**	**11,311**	**32,455**	**6,251**	**385,599**
5. Expected UAAL as of June 30, 2005 (A1 + A2 + A3 + A4)	4,458,333	148,353	425,249	82,121	5,114,056
6. Actual UAAL as of June 30, 2005	9,254,402	158,843	404,770	114,476	9,932,491
7. Total Gain/(Loss) (A5 – A6)	**(4,796,069)**	**(10,490)**	**20,479**	**(32,355)**	**(4,818,435)**
B. Calculation of Asset Gain/(Loss)					
1. Actual Value of Assets (AVA) as of June 30, 2004	39,672,957	510,604	508,561	285,178	40,977,300
2. Contributions during the year	1,364,892	19,363	66,079	17,927	1,468,261
3. Benefit payments during the year	(1,944,485)	(31,540)	(30,027)	(24,150)	(2,030,202)
4. Interest at previous year's rate of 8.00%					
a. On AVA at beginning of year	3,173,837	40,848	40,685	22,814	3,278,184
b. On contributions	54,595	775	2,643	717	58,730
c. On benefit payments	(77,779)	(1,262)	(1,201)	(966)	(81,208)
d. Total	**3,150,653**	**40,361**	**42,127**	**22,565**	**3,255,706**
5. Expected AVA as of June 30, 2005 (B1 + B2 + B3 + B4)	42,244,017	538,788	586,740	301,520	43,671,065
6. Actual AVA as of June 30, 2005	40,370,244	514,330	575,327	287,825	41,747,726
7. Total Gain/(Loss) on assets (B6 – B5)	**(1,873,773)**	**(24,458)**	**(11,413)**	**(13,695)**	**(1,923,339)**
C. Calculation of Liability Gain/(Loss)					
1. Gain/(Loss) due to changes in actuarial assumptions	291,625	–	–	–	291,625
2. Gain/(Loss) due to plan amendments	–	–	–	–	–
3. Liability Experience Gain/(Loss) (A7-B7-C1-C2)	**$ (3,213,921)**	**$ 13,968**	**$ 31,892**	**$ (18,660)**	**$ (3,186,721)**

Summary of Actuarial Assumptions and Methods

The VRS Board of Trustees adopted the following actuarial assumptions and methods on May 19, 2005 on the recommendation of its actuary. Assumptions were changed effective for the June 30, 2005 valuation based upon an analysis of plan experience for the five-year period of July 1, 1999 through June 30, 2004.

Investment Return Rate

7.50% per annum, compounded annually, composed of an assumed 2.50% inflation rate and a 5.00% real rate of return. Benefits are assumed to increase by 2.50% annually due to the COLA.

Mortality Rates

Virginia Retirement System, State Police Officers' Retirement System, Virginia Law Officers' Retirement System and Judicial Retirement System.

Pre-Retirement

1994 Group Annuity Mortality Table for males and females with a one-year set back in age for males and females in all employer groups.

Post-Retirement

1994 Group Annuity Mortality Table for males and females with a one-year set back in age for male and female state employees, a three-year set back in age for male and female teachers, and a one-year set back in age for male and female judges. 1994 Group Annuity Mortality Table for males with a four-year set back in age for state police officers and other law enforcement and correctional officers.

Post-Disablement

70% of PBGC Disabled Mortality Table 5a for males; 90% of PBGC Disabled Mortality Table 6a for females.

VRS customers have access to services and information such as in-person counseling, telephone and e-mail communication, publications and the VRS Web site. Customers also benefit from a comprehensive outreach program that includes site visits, retirement education, employer training, benefit fairs, special presentations and employer forums at locations around the state.

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

	Reduced Retirement		Unreduced Retirement	
Age	Male	Female	Male	Female
50	3.0	3.0	10.0	10.0
55	5.0	5.0	10.0	10.0
59	5.0	5.0	10.0	10.0
60	5.0	7.5	15.0	15.0
61	10.0	10.0	20.0	20.0
62	15.0	15.0	30.0	30.0
64	15.0	20.0	25.0	20.0
65	—	—	35.0	45.0
67	—	—	30.0	30.0
70	—	—	100.0	100.0

Teachers

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

RETIREMENT PER 100 MEMBERS

	Reduced Retirement		Unreduced Retirement	
Age	Male	Female	Male	Female
50	2.0	2.0	20.0	20.0
55	5.0	5.0	22.5	25.0
59	7.0	8.0	22.5	30.0
60	10.0	10.0	25.0	30.0
61	10.0	10.0	25.0	25.0
62	20.0	20.0	40.0	40.0
64	15.0	15.0	30.0	30.0
65	—	—	40.0	40.0
67	—	—	30.0	30.0
70	—	—	100.0	100.0

State Police Officers' and Virginia Law Officers' Retirement Systems

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

RETIREMENT PER 100 MEMBERS

Age	Reduced Retirement	Unreduced Retirement
50	10.0	20.0
55	10.0	20.0
59	12.0	35.0
60	—	100.0

Judicial Retirement System

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

Age	Rate
At first age eligible for an unreduced retirement benefit	50.0%
At subsequent ages	15.0%
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	0.014
30	0.140	0.054
40	0.270	0.122
50	0.510	0.459
60	—	—

Teachers

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

DISABILITY PER 100 MEMBERS

Age	Male	Female
20	—	—
30	0.013	0.008
40	0.026	0.046
50	0.149	0.163
60	0.422	0.442

State Police Officers' and Virginia Law Officers' Retirement Systems

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

DISABILITY PER 100 MEMBERS

Age	Rate
20	—
30	0.028
40	0.210
50	0.675
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

PORTABILITY OF DECREMENT DUE TO WITHDRAWAL

	Years of Service – Males					Years of Service – Females				
Age	1	3	6	9	10+	1	3	6	9	10+
25	0.1883	0.1346	0.0810	0.0498	0.0483	0.2309	0.1755	0.1388	0.0753	0.0586
35	0.1490	0.1064	0.0787	0.0498	0.0368	0.1708	0.1336	0.1002	0.0668	0.0432
45	0.1143	0.0762	0.0642	0.0407	0.0214	0.1315	0.0953	0.0718	0.0490	0.0240
55	0.0975	0.0596	0.0399	0.0260	0.0134	0.1155	0.0734	0.0476	0.0279	0.0121

Teachers

PORTABILITY OF DECREMENT DUE TO WITHDRAWAL

	Years of Service – Males					Years of Service – Females				
Age	1	3	6	9	10+	1	3	6	9	10+
25	0.1758	0.1234	0.0565	0.0384	0.0804	0.1413	0.1316	0.0953	0.1114	0.1241
35	0.1585	0.0989	0.0567	0.0381	0.0350	0.1416	0.1165	0.0836	0.0618	0.0439
45	0.1391	0.0782	0.0480	0.0312	0.0146	0.1161	0.0793	0.0561	0.0365	0.0176
55	0.1419	0.0726	0.0322	0.0187	0.0093	0.1161	0.0665	0.0385	0.0246	0.0090

State Police Officers' and Virginia Law Officers' Retirement Systems

PORTABILITY OF DECREMENT DUE TO WITHDRAWAL

	Years of Service – Males					Years of Service – Females				
Age	1	3	6	9	10+	1	3	6	9	10+
25	0.0854	0.0803	0.0728	0.0299	0.0360	0.1332	0.1047	0.1023	0.0543	0.0438
35	0.0936	0.0773	0.0515	0.0323	0.0248	0.1437	0.0996	0.0671	0.0599	0.0608
45	0.1022	0.0722	0.0438	0.0293	0.0141	0.1172	0.0984	0.0770	0.0639	0.0591
55	0.1149	0.0719	0.0417	0.0224	0.0098	0.0573	0.1023	0.1289	0.0671	0.0411

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 2.50% plus productivity component of 1.25% plus step-rate/promotional component as shown. It is assumed state employees covered under the Virginia Sickness and Disability Program (VSDP) receive a 3.75% annual increase in pay and this adjusted pay is used to determine deferred retirement benefits payable from the System.

Years of Service	Annual Step-Rate/Promotional Rates of Increase	Total Annual Rate of Increase
1	1.85%	5.60%
3	1.25%	5.00%
6	0.95%	4.70%
9	0.50%	4.25%
11	0.15%	3.90%
15	0.15%	3.90%
19	0.15%	3.90%
20 or more	—	3.75%

Teachers

Inflation rate of 2.50% 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	2.45%	6.20%
3	2.35%	6.10%
6	1.95%	5.70%
9	1.85%	5.60%
11	1.35%	5.10%
15	1.15%	4.90%
19	0.95%	4.70%
20 or more	—	3.75%

State Police Officers' and Virginia Law Officers' Retirement Systems

Inflation rate of 2.50% plus productivity component of 1.00% plus step-rate/promotional component as shown. It is assumed state police and Virginia law officers receive a 3.50% annual increase in pay while disabled and this adjusted pay is used to determine deferred retirement benefits payable from the System.

Years of Service	Annual Step-Rate/Promotional Rates of Increase	Total Annual Rate of Increase
1	1.25%	4.75%
3	1.25%	4.75%
6	0.90%	4.40%
9	0.90%	4.40%
11	0.50%	4.00%
15	0.50%	4.00%
19	0.50%	4.00%
20 or more	—	3.50%

Judicial Retirement System

Salary increase rates are 3.50%.

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 21 years (closed amortization, computed as a level percent of payroll). Political subdivision employees 21 years (open amortization, computed as level percent of payroll).

Cost-of-Living Increase

2.50% 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 (2.50% 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 credible 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 36 consecutive months of highest 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.

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 the 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 disability retirement 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.

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 the 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 (on an actuarially equivalent basis) 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 3.0% of the Consumer Price Index increase plus half of each percentage increase from 3.0% to 7.0%. COLAs are capped at 5.0%.

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.

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.

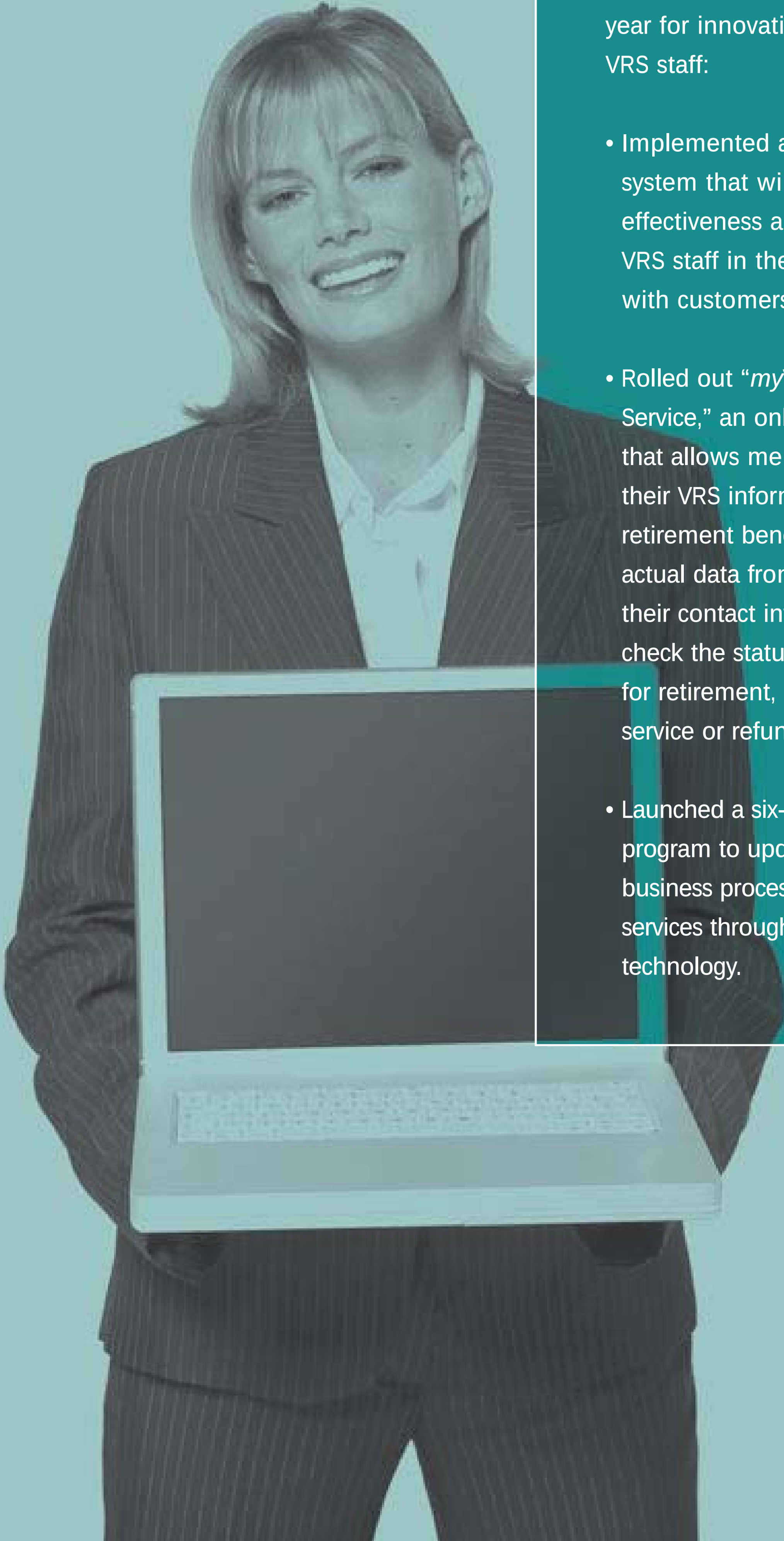
2004 Valuation

No material changes were made in the plan provisions.

2005 Valuation

1. No material changes were made in the plan provisions.
2. On May 19, 2005, the VRS Board of Trustees adopted the recommended economic and demographic assumptions proposed by the actuary as a result of the June 2004 actuarial experience study.

…plan for tomorrow



FY 2006 was a very productive year for innovation at VRS. The VRS staff:

- Implemented a new telephone system that will enhance the effectiveness and efficiency of VRS staff in their interactions with customers.
- Rolled out "*my*VRS: At Your Service," an online secure system that allows members to access their VRS information; create retirement benefit estimates using actual data from their files; update their contact information; and check the status of an application for retirement, purchase of prior service or refund.
- Launched a six-year modernization program to update systems, business processes and customer services through state-of-the-art technology.

Pension Trust Funds

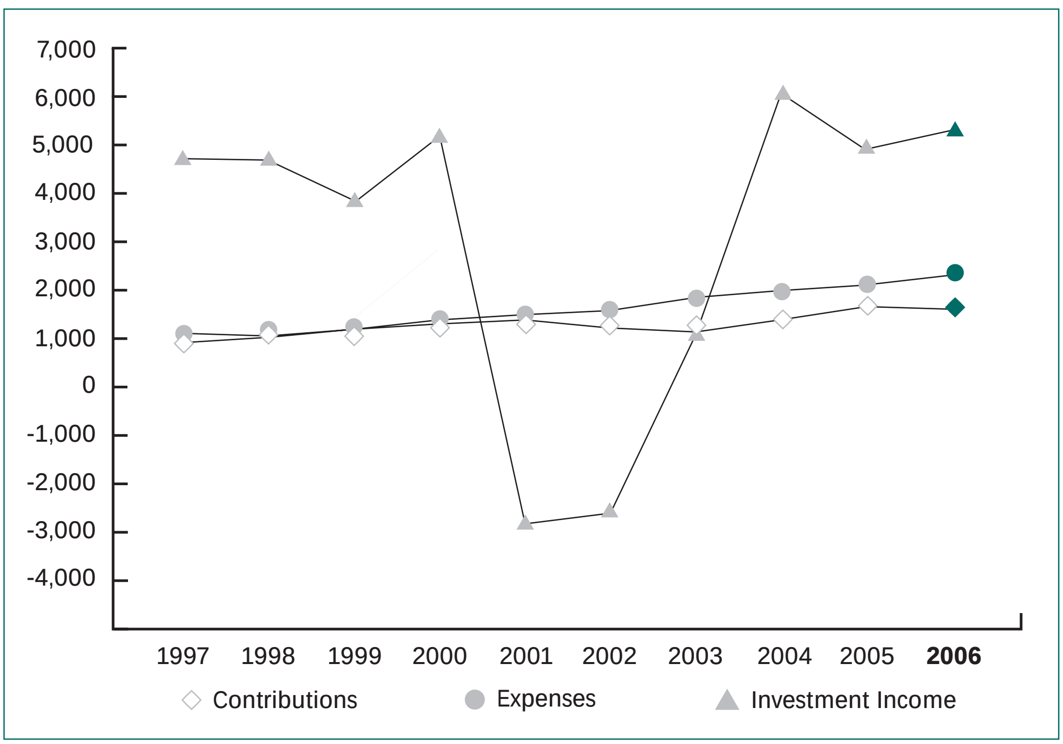
Analysis of Changes and Growth in Plan Net Assets

FOR THE YEARS ENDED JUNE 30 (EXPRESSED IN MILLIONS)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Net Assets Available Beginning of Year	**$ 21,460**	**$ 26,057**	**$ 30,784**	**$34,634**	**$ 39,786**	**$36,693**	**$ 33,456**	**$ 33,781**	**$39,039**	**$43,060**
Employee and Employer Contributions	913	1,131	1,141	1,291	1,270	1,044	1,042	1,185	1,468	1,567
Benefit and Administration Expenses	(1,017)	(1,090)	(1,176)	(1,282)	(1,394)	(1,529)	(1,687)	(1,865)	(2,049)	(2,214)
Net Funding	(104)	41	(35)	9	(124)	(485)	(645)	(680)	(581)	(647)
Investment Income										
Interest, Dividends and Other Investment Income	504	534	551	705	785	624	569	461	667	823
Net Appreciation (Depreciation) in Fair Value	4,197	4,152	3,334	4,438	(3,754)	(3,376)	401	5,477	3,935	4,391
Net Investment Income	4,701	4,686	3,885	5,143	(2,969)	(2,752)	970	5,938	4,602	5,214
Net Assets Available End of Year	**$ 26,057**	**$ 30,784**	**$ 34,634**	**$ 39,786**	**$ 36,693**	**$ 33,456**	**$ 33,781**	**$39,039**	**$43,060**	**$ 47,627**

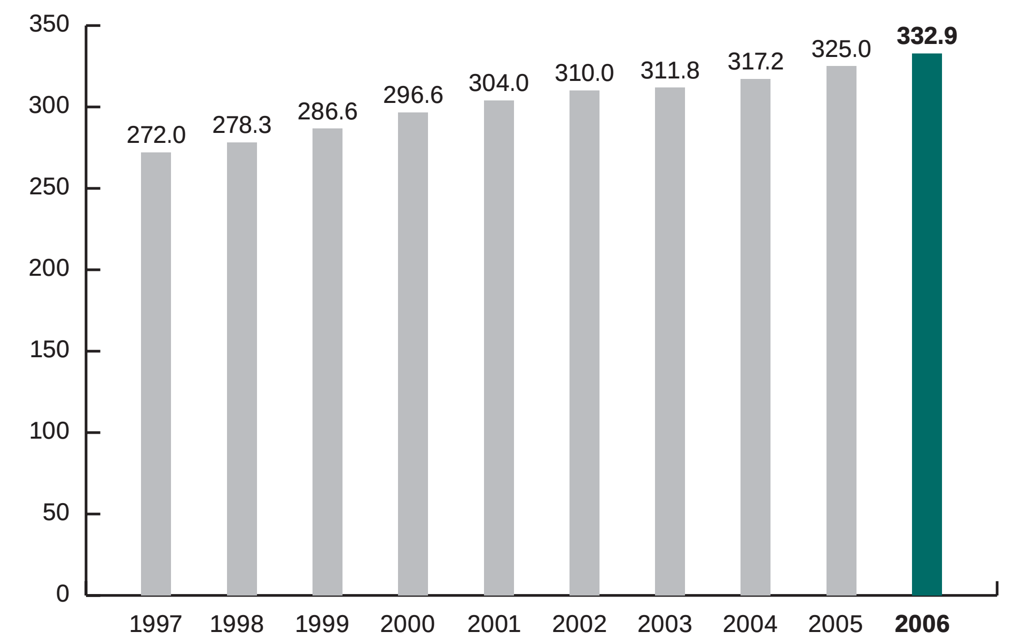
Pension Trust Funds Additions Versus Deductions

FISCAL YEARS 1997-2006 (MILLIONS OF DOLLARS)



Number of Active Members

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)



Schedule of Retirement Contributions by System

FISCAL YEARS 1997-2006 (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	Sub-Total				
2006	$ 303,183	$ 731,929	$ 423,724	$1,458,836	$ 20,188	$ 68,688	$ 18,967	$1,566,679
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

* *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 employees in July 2003.*

Pension Trust Funds Additions by Source

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Member Contributions	Employer Contributions For Members	Employer Contributions Employer Share	Investment Income (Loss)	Other	**Total**
VIRGINIA RETIREMENT SYSTEM (VRS)						
2006	$ 38,825	$ 638,242	$ 781,769	$ 5,042,575	$ 185	$ 6,501,596
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
STATE POLICE OFFICERS' RETIREMENT SYSTEM (SPORS)						
2006	$ 304	$ 4,627	$ 15,257	$ 63,475	$ –	$ 83,663
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
VIRGINIA LAW OFFICERS' RETIREMENT SYSTEM (VaLORS)						
2006	$ 534	$ 15,492	$ 52,662	$ 71,905	$ 255	$ 140,848
2005	700	14,869	50,510	59,525	230	125,834
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)						
2006	$ 108	$ 2,653	$ 16,206	$ 35,368	$ –	$ 54,335
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

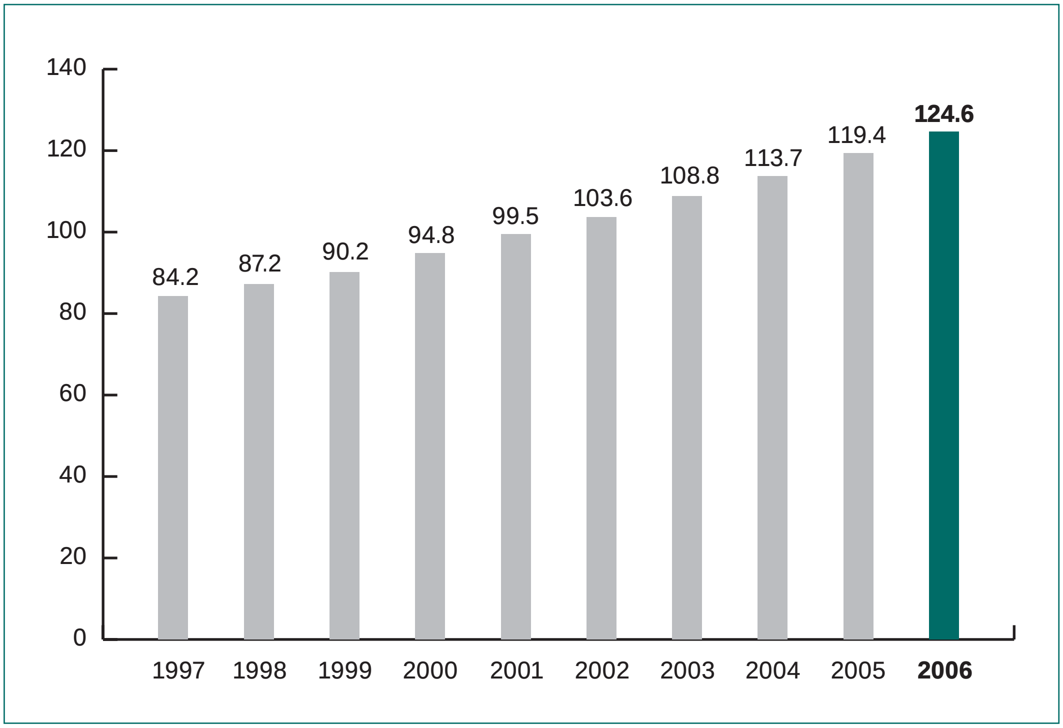
* *In fiscal year 1997, employer contributions increased by $5.9 million for SPORS as a result of the Workforce Transition Act of 1995.*

** *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.*

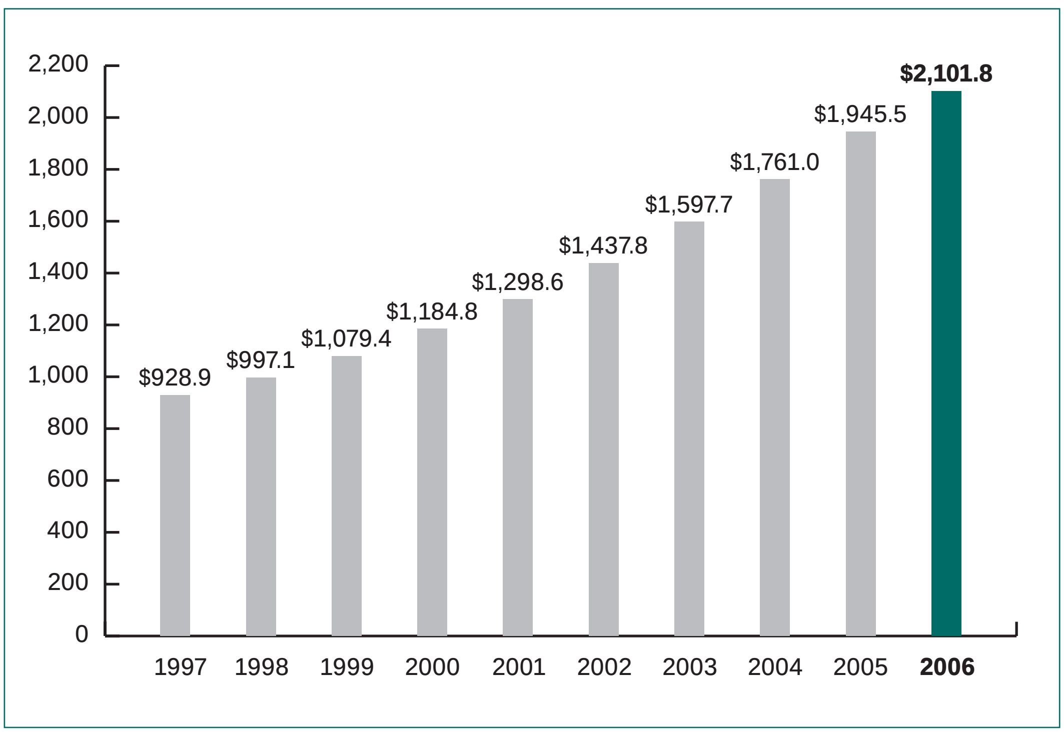
Number of Retired Members

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)



Retirement Benefits Paid

FISCAL YEARS 1997-2006 (MILLIONS OF DOLLARS)



Pension Trust Funds Deductions by Type

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Retirement Benefits	Refunds	Administrative Expenses	Other	**Total**
VIRGINIA RETIREMENT SYSTEM (VRS)					
2006	$ 2,015,557	$ 85,804	$ 19,724	$ 258	$ 2,121,343
2005	1,865,776	78,709	18,182	230	1,962,897
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
STATE POLICE OFFICERS' RETIREMENT SYSTEM (SPORS)					
2006	$ 32,309	$ 596	$ 231	$ –	$ 33,136
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
VIRGINIA LAW OFFICERS' RETIREMENT SYSTEM (VaLORS)					
2006	$ 29,202	$ 4,830	$ 263	$ –	$ 34,295
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)					
2006	$ 24,717	$ –	$ 130	$ –	$ 24,847
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

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

Schedule of Retirement Benefits by System

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Virginia Retirement System State	Virginia Retirement System Teacher	Virginia Retirement System Political Subdivisions	Virginia Retirement System Sub-Total	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	**Total**
2006	$ 623,571	$ 1,037,509	$ 354,477	$ 2,015,557	$ 32,309	$ 29,202	$ 24,717	$ 2,101,785
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

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

Schedule of Retirement Benefits by Type

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Service Benefits	Disability Benefits	Survivor Benefits	**Total**
2006	$1,849,239	$ 236,266	$ 16,280	$ 2,101,785
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

Schedule of Refunds by Type

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Separation	Death	**Total**
2006	$ 79,744	$ 11,486	$ 91,230
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

Schedule of Retired Members by Type of Benefit and Option Selected

AS OF JUNE 30, 2006

Amount of Retirement Benefit	Number of Retirants	Type of Retirement: Service	Early Retirement Window	50/30 Service Retirement	1991 Fac. Early Retirement Window	Regular Disability	Survivor Payment–Death in Service	Line-of-Duty Disability	Survivor Payment–Death in Line-of-Duty	50/10 Provision
$ 1 - 200	15,550	13,476	6	–	1	904	539	68	4	552
201 - 400	18,522	14,544	173	–	–	2,376	417	131	15	866
401 - 600	15,267	11,255	412	7	1	2,621	232	240	26	473
601 - 800	12,310	8,723	523	23	2	2,184	158	371	21	305
801 - 1,000	10,161	6,989	676	88	4	1,640	95	387	9	273
1,001 - 1,200	8,337	5,641	663	227	4	1,231	75	274	10	212
1,201 - 1,400	6,868	4,611	601	286	16	912	43	216	7	176
1,401 - 1,600	6,164	4,153	551	378	22	661	41	188	5	165
1,601 - 1,800	5,723	3,842	408	642	35	479	26	147	2	142
1,801 - 2,000	6,032	4,006	301	1,000	36	432	27	141	–	89
Over 2,001	19,705	14,167	608	3,182	165	923	81	371	2	206
Totals	**124,639**	**91,407**	**4,922**	**5,833**	**286**	**14,363**	**1,734**	**2,534**	**101**	**3,459**

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	12,654	82	542	201	1,097	2	82	5	–	3	712	8	133	8	16	5
201 - 400	14,510	34	599	387	1,014	7	868	35	2	29	691	3	286	20	29	8
401 - 600	11,141	36	498	460	962	15	1,190	69	–	42	505	1	262	35	42	9
601 - 800	8,615	24	426	491	911	11	956	60	–	62	377	4	279	27	57	10
801 - 1,000	6,879	10	356	527	890	20	620	43	1	25	334	2	302	33	103	16
1,001 - 1,200	5,467	2	339	488	760	12	409	29	1	25	232	4	331	40	156	42
1,201 - 1,400	4,550	3	276	431	501	22	248	20	1	17	167	6	326	51	191	58
1,401 - 1,600	4,089	1	273	393	357	33	158	6	–	8	157	3	336	55	233	62
1,601 - 1,800	3,910	–	208	362	211	35	83	5	–	4	120	2	308	49	343	83
1,801 - 2,000	4,163	–	166	350	143	34	64	5	–	3	123	5	306	56	510	104
Over 2,001	11,961	1	546	1,050	238	194	75	11	–	3	527	78	1,769	468	2,281	503
Totals	**87,939**	**193**	**4,229**	**5,140**	**7,084**	**385**	**4,753**	**288**	**5**	**221**	**3,945**	**116**	**4,638**	**842**	**3,961**	**900**

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 2006, 89% of all retirements were service retirements, and 11% were certified as disability retirements by the Medical Board.*

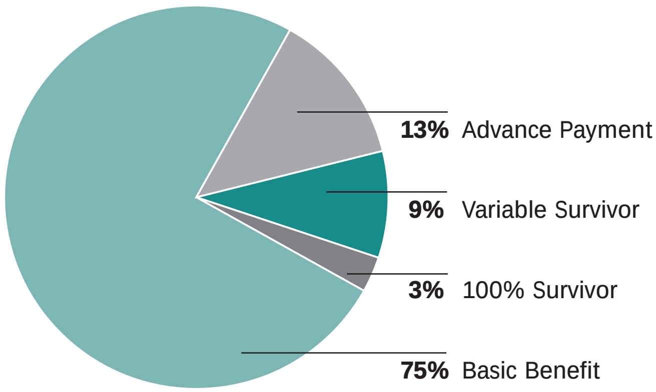
Schedule of Average Benefit Payments

RETIREMENT EFFECTIVE DATE JULY 1, 2002 TO JUNE 30, 2006

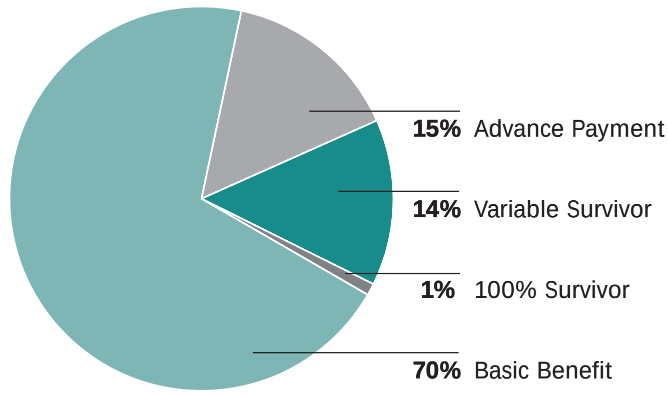
		Years of Credited Service: 1–10	11–15	16–20	21–25	26–30	Over 30
FY 2006	Average Monthly Benefit	$ 306.43	$ 496.82	$ 775.31	$ 1,131.49	$ 1,811.18	$ 2,438.66
	Number of Active Retirants	890	809	960	937	1,569	2,886
FY 2005	Average Monthly Benefit	$ 316.96	$ 496.99	$ 745.37	$ 1,066.32	$ 1,773.77	$ 2,352.01
	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

Distribution of Retirees by Payment Option Selected

ALL RETIREES AT JUNE 30, 2006



2006 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 retirement 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 leveling age.

PARTIAL LUMP SUM

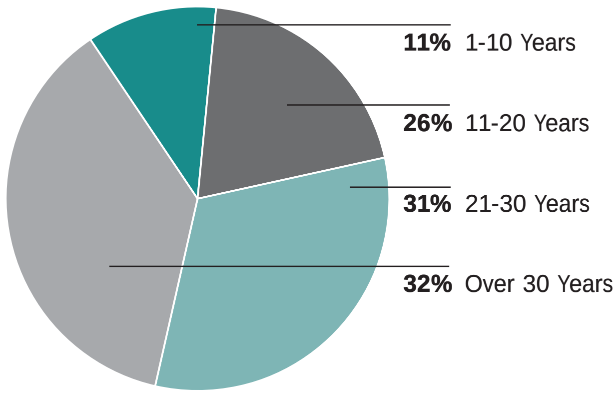
This option allows members with earned service beyond their normal retirement date to elect a lump sum payment equal to the sum of 12, 24 or 36 payments of the standard monthly life annuity. The member's monthly benefit will be actuarially reduced to reflect the lump-sum payment.

100% Survivor

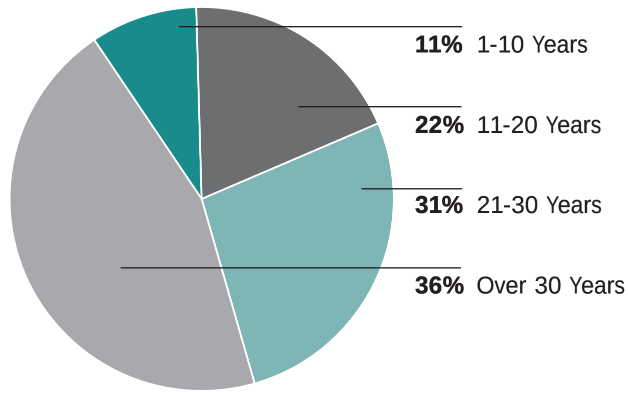
The basic benefit is reduced during the member's lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

Distribution of Retirees by Years of Service

ALL RETIREES AT JUNE 30, 2006

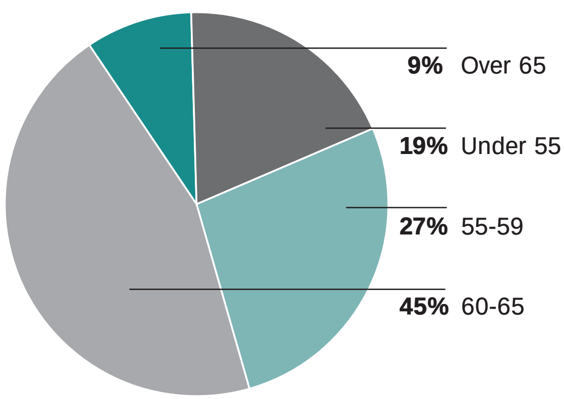


2006 RETIREES

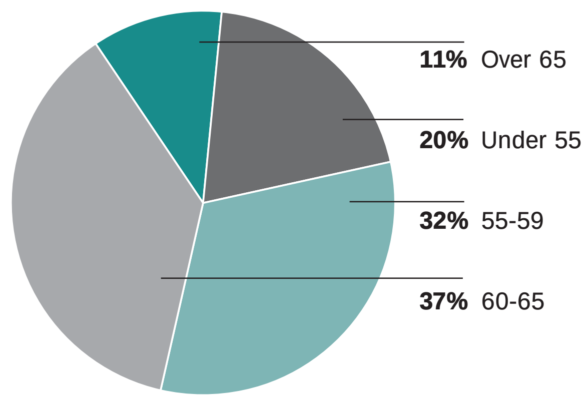


Distribution of Retirees by Age at Retirement

ALL RETIREES AT JUNE 30, 2006

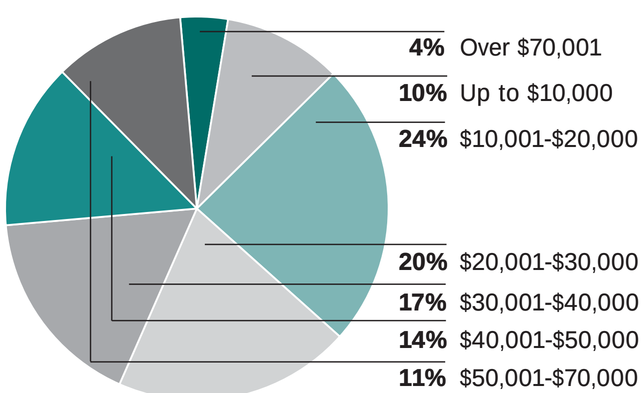


2006 RETIREES

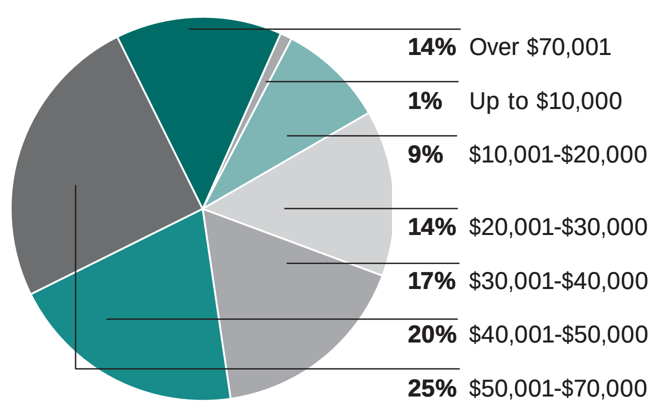


Distribution of Retirees by Average Final Compensation

ALL RETIREES AT JUNE 30, 2006



2006 RETIREES



Other Employee Benefit Trust Funds

Schedule of Group Insurance Additions by Source

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Contributions: State	Contributions: Teacher	Contributions: Political Subdivisions	Contributions: Sub-Total	Investment Income (Loss)	Other	**Total**
2006*	$ (2)	$ –	$ 54	$ 52	$ 92,187	$ –	$ 92,239
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

* *The group life insurance contribution rates for fiscal years 2006, 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 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Active Claims	Retired Claims	**Total**
2006	$ 43,140	$ 68,350	$ 111,490
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

Schedule of Retiree Health Insurance Credit Additions and Reimbursements

FISCAL YEARS 1997-2006 (EXPRESSED IN THOUSANDS)

Year Ended June 30	Additions: Contributions	Additions: Investment Income (Loss)	Additions: Other	**Total**	**Health Insurance Reimbursements**
2006	$ 86,913	$ 17,018	$ –	$ 103,931	$ 72,482
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

* *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, 2006

Political Subdivisions (429)

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

Town of Wakefield
Town of Warrenton
Town of Warsaw
Town of Waverly
Town of Weber City
Town of West Point
Town of Windsor
Town of Wise
Town of Woodstock
Town of Wytheville
Accomack-Northampton Planning District Commission
Albemarle County Service Authority
Albermarle-Charlottesville Regional Jail
Alexandria Redevelopment & Housing Authority
Alexandria Sanitation Authority
Alleghany Highlands Community Services Board
Amherst County Service Authority
Anchor Commission
Appalachian Juvenile Commission
Appomattox Regional Library
Appomattox River Water Authority
Augusta County Service Authority
Bedford County Public Service Authority
Bedford Public Library
Big Stone Gap Redevelopment & Housing Authority
Big Walker Soil & Water Conservation District
Blacksburg-Christiansburg-VPI Water Authority
Blacksburg-VPI Sanitation Authority
Blue Ridge Juvenile Detention Center
Blue Ridge Regional Jail Authority
Bristol Redevelopment & Housing Authority
Brunswick Industrial Development Authority
Campbell County Utilities & Service Authority
Capital Regional Airport Commission
Central Rappahannock Regional Library
Central Virginia Community Services Board
Central Virginia Regional Jail
Central Virginia Waste Management Authority
Charles Pickney Jones Memorial Library
Charlottesville-Albemarle Airport Authority
Charlottesville Redevelopment & Housing Authority
Chesapeake Bay Bridge & Tunnel District
Chesapeake Redevelopment & Housing Authority
Chesterfield County Health Center Commission
Clinch Valley Soil & Water Conservation District
Coeburn-Norton-Wise Regional Water Treatment Authority
Colonial Services Board
Colonial Soil & Water Conservation District
Commonwealth Regional Council
Crater Juvenile Detention Home Commission
Culpeper Soil & Water Conservation District
Cumberland Mountain Community Services Board
Cumberland Plateau Regional Housing Authority
Daniel Boone Soil & Water Conservation District
Danville-Pittsylvania Community Services Board
Danville Redevelopment & Housing Authority
Dinwiddie County Water Authority
District 19 Community Services Board
Eastern Shore Community Services Board
Eastern Shore Public Library
Eastern Shore Soil & Water Conservation District
Evergreen Soil & Water Conservation District
Fauquier County Water & Sanitation Authority
Ferrum Water & Sewage Authority
Franklin Redevelopment & Housing Authority
Frederick County Sanitation Authority
Fredericksburg-Stafford Park Authority
Giles County Public Service Authority
Goochland-Powhatan Community Services Board
Greensville County Water & Sewer Authority
Greensville-Emporia Department of Social Services
Hampton-Newport News Community Services Board
Hampton Redevelopment & Housing Authority
Hampton Roads Planning District Commission
Hampton Roads Regional Jail Authority
Hampton Roads Sanitation District
Hampton Roads Transit
Handley Library Board
Harrisonburg-Rockingham Community Services Board
Harrisonburg-Rockingham Regional Sewer Authority
Henricopolis Soil & Water Conservation District
Henry County Public Service Authority
Holston River Soil & Water Conservation District
Hopewell Redevelopment & Housing Authority
Industrial Development Authority of Henrico County
Institute for Advanced Learning and Research
James City Service Authority
John Marshall Soil & Water Conservation District
Lee County Redevelopment & Housing Authority
Lee County Public Service Authority
Lenwisco Planning District Commission
Lonesome Pine Regional Library
Loudoun County Sanitation Authority
Massanuttan Regional Library
Meherrin Regional Library
Middle Peninsula-Northern Neck Community Services Board
Middle Peninsula Regional Security Center
Monacan Soil & Water Conservation District
Montgomery Regional Solid Waste Authority
Nelson County Service Authority
New River Resource Authority
New River Soil & Water Conservation District
New River Valley Community Services Board
New River Valley Juvenile Detention Home Commission
New River Valley Planning District Commission
New River Valley Regional Jail
Norfolk Airport Authority
Norfolk Redevelopment & Housing Authority
Northern Neck-Essex County Group Home Commission
Northern Neck Planning District Commission
Northern Neck Regional Jail
Northern Shenandoah Valley Regional Commission
Northern Virginia Health Care Center Commission
Northern Virginia Juvenile Detention Home
Northwestern Community Services Board
Opportunity Inc. of Hampton Roads
Pamunkey Regional Jail
Peaks of Otter Soil & Water Conservation District
Peninsula Airport Commission
Pepper's Ferry Regional Wastewater Authority
Peter Francisco Soil & Water Conservation District
Petersburg Redevelopment & Housing Authority
Peumansend Creek Regional Jail
Piedmont Regional Jail
Piedmont Regional Juvenile Detention Center
Pittsylvania County Service Authority
Planning District One Behavioral Health Services Board
Potomac and Rappahannock Transportation Commission
Potomac River Fisheries Commission
Prince William County Service Authority
Prince William Soil & Water Conservation District
Rappahannock Area Community Services Board
Rappahannock Juvenile Center
Rappahannock-Rapidan Community Services Board
Rappahannock-Rapidan Regional Planning District Commission
Rappahannock Regional Jail
Region Ten Community Services Board
Richmond Metropolitan Authority
Richmond Redevelopment & Housing Authority
Richmond Regional Planning District Commission
Rivanna Solid Waste Authority
Rivanna Water & Sewer Authority
Riverside Regional Jail
Roanoke Higher Education Authority
Roanoke River Service Authority
Robert E. Lee Soil & Water Conservation District
Rockbridge Area Community Services Board
Rockbridge Area Social Services Department
Rockbridge County Public Service Authority
Rockbridge Regional Library
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 Soil & Water Conservation District
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 (230)

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 Accumulation Plan Assets

YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
Plan Assets on July 1	$ 728,544,490	$ 620,849,351
Contributions	107,199,887	91,408,590
Distributions	(33,198,867)	(33,076,187)
Plan Transfers[1]	766,405	578,403
Third-Party Administration Fees[2]	(2,175,759)	(1,786,993)
Period Earnings	63,136,355	50,571,326
Plan Assets on June 30	**$ 864,272,511**	**$ 728,544,490**

[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.*

Deferred Compensation Plan - Operational Overview

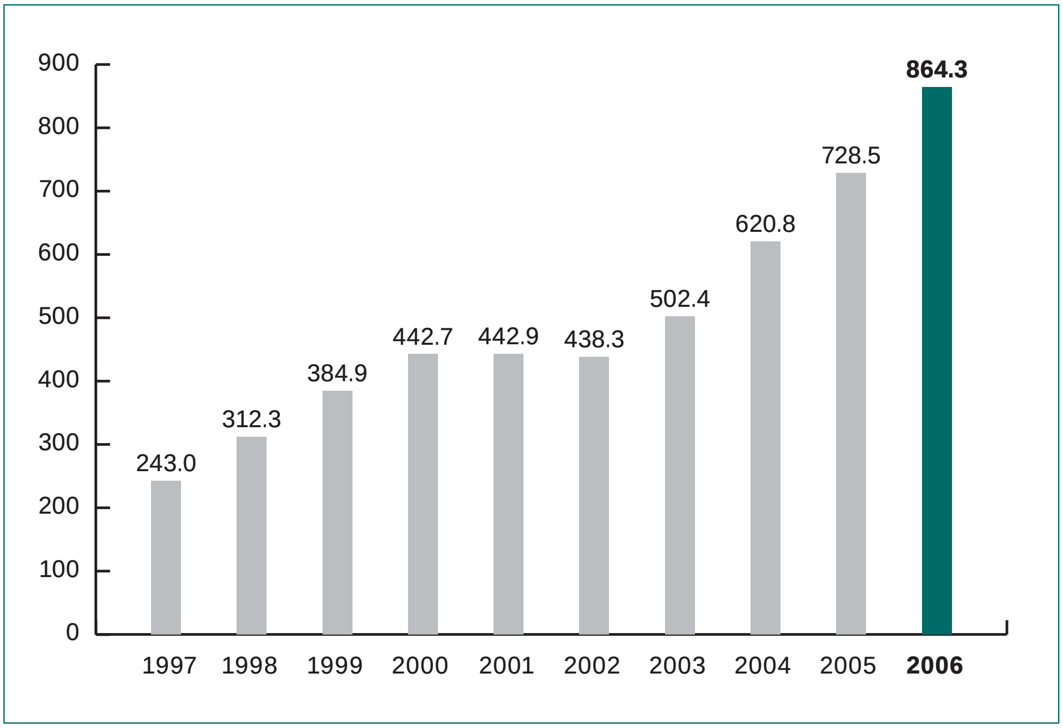
A total of 5,420 employees enrolled in the Commonwealth's 457 Deferred Compensation Plan during the 2005-2006 fiscal year. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became effective January 1, 2002, allowing increased tax-deferred savings and to have increased portability of benefits. Contributions to the plan during FY 2006 increased to $107,199,887 from $91,408,590 in FY 2005.

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, 2006, the number of college and university employee plan accounts increased from 287 in FY 2001 (the baseline year) to 3,158 in FY 2006.

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, 2006, 146 plan participants used the trustee-to-trustee provision to buy VRS service credit with $765,454 transferring from the 457 Plan to the defined benefit plan. This reflects the general decline in the purchase of VRS service credit.

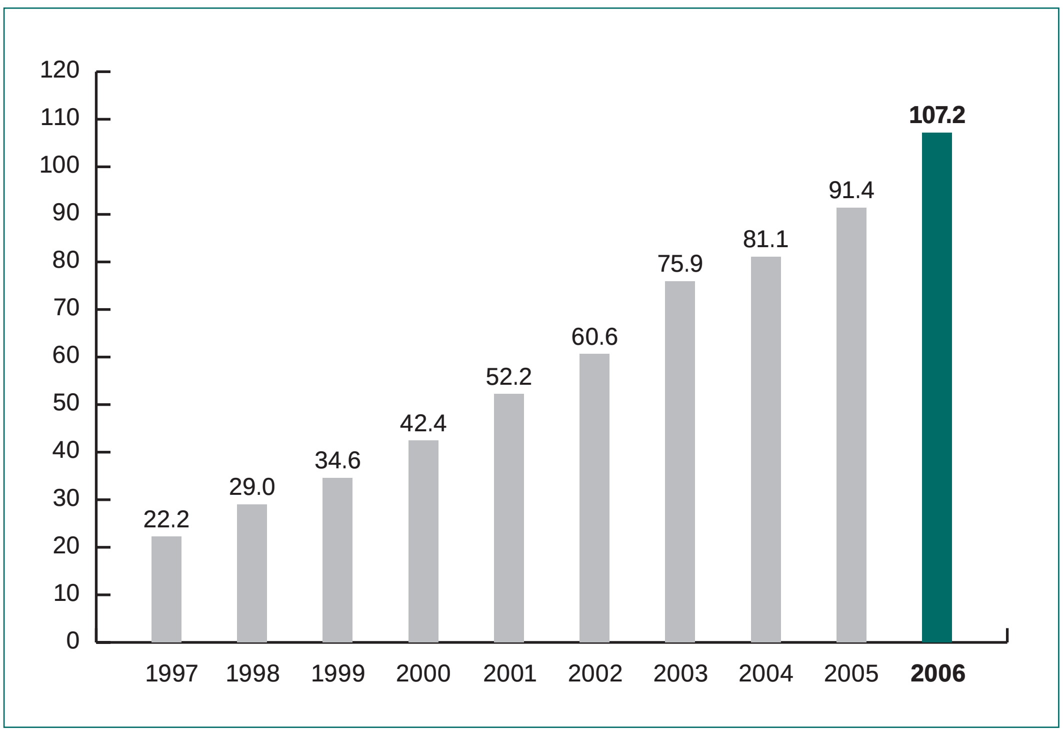
Deferred Compensation Plan Assets

(MILLIONS OF DOLLARS)



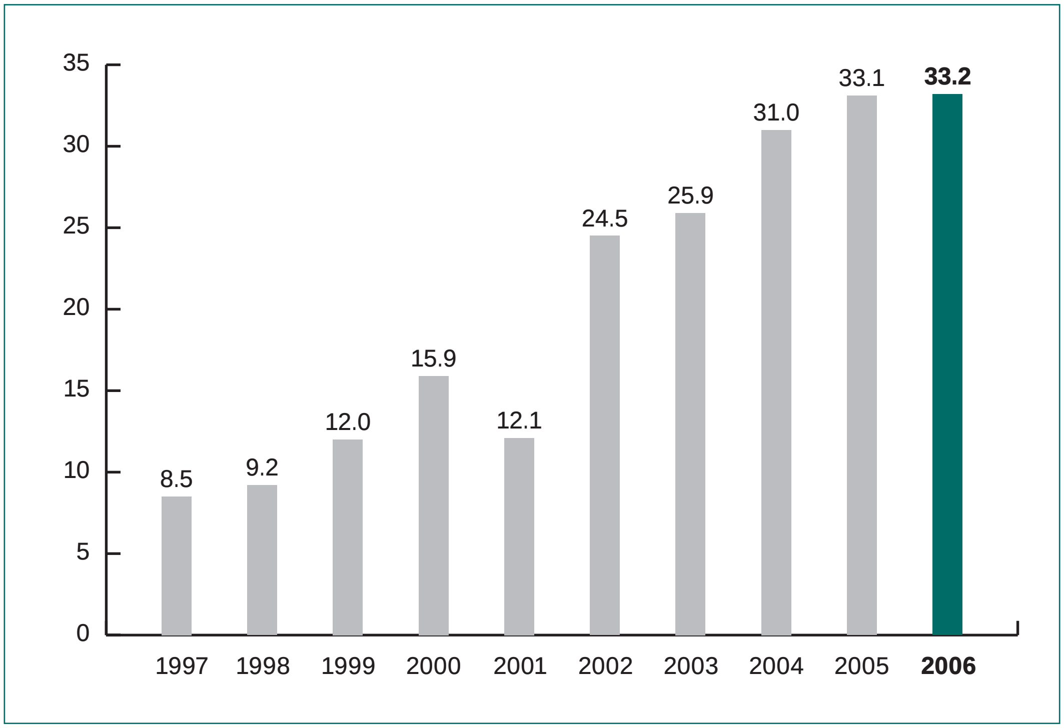
Contributions to the Deferred Compensation Plan

(MILLIONS OF DOLLARS)

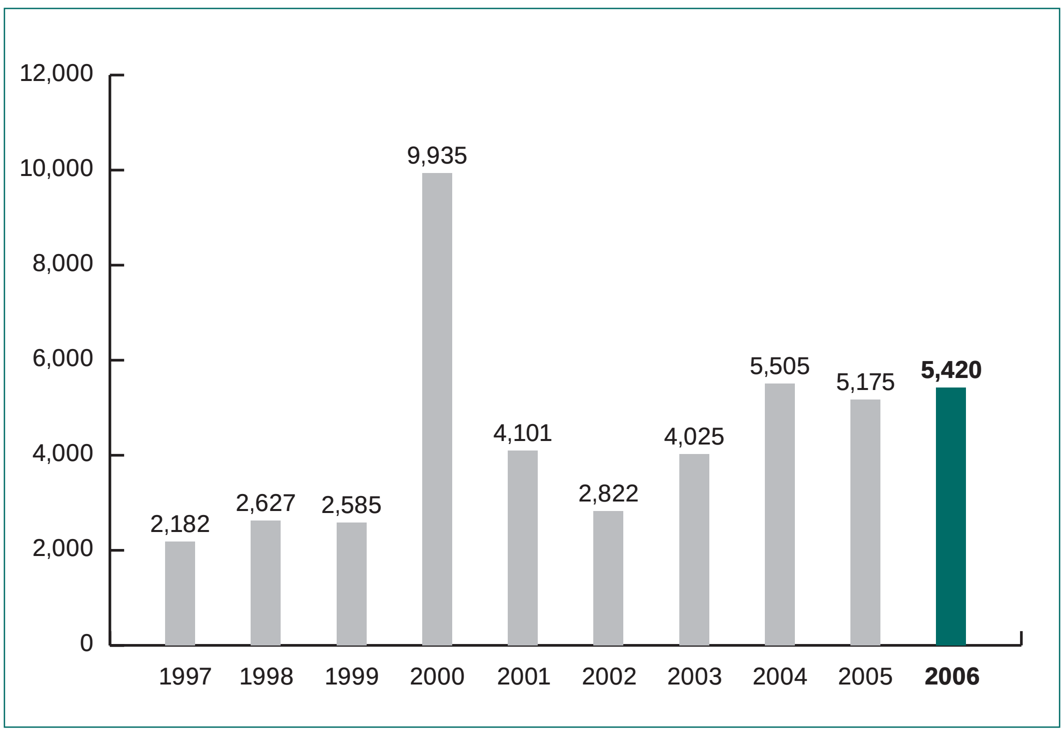


Distributions from the Deferred Compensation Plan

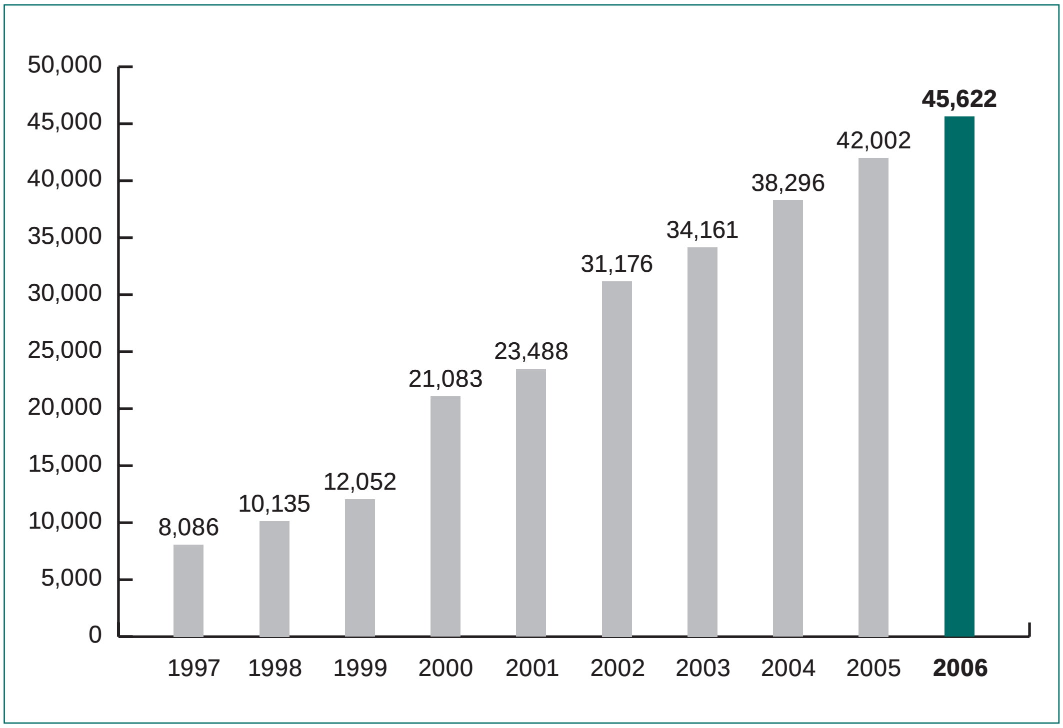
(MILLIONS OF DOLLARS)



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	5,052	International Equity Index Fund	7,674
Balanced Growth Fund	10,160	Money Market Fund	2,937
Long-Term Growth Fund	7,038	Active Inflation-Protected Bond Fund	1,922
Bond Index Fund	5,425	Active Bond Fund	4,315
S&P 500 Index Fund	23,284	Active High Yield Bond Fund	1,373
Russell 1000 Value Index Fund	6,161	Active Small/Mid Cap Equity Fund	6,434
Russell 1000 Growth Index Fund	3,364	Active Global Equity Fund	2,019
Russell 3000 Index Fund	848	Stable Value Fund	18,348
Real Estate Investment Trust Fund	6,610	Self-Directed Brokerage	74
Small/Mid Cap Equity Index Fund	7,457		

** The number of participant accounts will exceed the number of participants since a participant may invest in more than one fund.*

Plan Assets

Accumulation Plan Assets represent funds invested among the 18 core investment options and self-directed brokerage option. Below is a schedule that shows how these investments are distributed among the available options.

Deferred Compensation Accumulation Plan Assets

	FY 2006	FY 2005
Allocation by Fund Manager:		
Active Global Equity Fund	$ 10,221,140	$ 2,277,058
International Equity Index Fund	40,728,065	23,535,209
Active Small/Mid Cap Equity Fund	44,109,083	39,309,967
Small/Mid Cap Equity Index Fund	44,322,834	31,408,699
Russell 1000 Growth Index Fund	11,102,812	9,082,117
Russell 1000 Value Index Fund	36,455,838	25,886,038
Russell 3000 Index Fund	3,190,547	1,825,549
S & P 500 Index Fund	233,056,607	217,327,814
Balanced Growth Fund	99,966,407	94,860,829
Income & Growth Fund	13,472,331	10,920,330
Long-Term Growth Fund	25,656,207	18,886,727
Active High-Yield Bond Fund	2,887,450	2,307,638
Active Inflation-Protected Bond Fund	6,776,266	5,354,507
Active Bond Fund	14,350,084	13,507,951
Bond Index Fund	29,615,901	29,033,677
Stable Value Fund (Gilliard)	198,414,360	170,009,028
Money Market Fund	11,075,499	7,964,189
Real Estate Investment Trust	34,282,602	21,696,115
Self-Directed Brokerage	4,588,478	3,351,048
Total Accumulation Plan Assets:	**$ 864,272,511**	**$ 728,544,490**

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%

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.

Mortgage-Backed Securities - 35%	CMBS - 4%
Treasury - 25%	Non-US Credit (Yankee) - 4%
Agency - 12%	Utility - 2%
Industrial - 9%	Asset-Backed Securities - 1%
Finance - 8%	

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.

Financials - 22%	Energy - 10%
Information Technology - 15%	Consumer Staples - 10%
Health Care - 12%	Telecommunication Services - 3%
Industrials - 12%	Utilities - 3%
Consumer Discretionary - 10%	Materials - 3%

Russell 1000 Value Index Fund: Seeks to track the performance of the Russell 1000 Value Index. This Index is comprised of stocks in the Russell 1000 that have lower price-to-book ratios and lower forecasted growth values.

Financials - 36%	Health Care - 7%
Energy - 14%	Utilities - 6%
Consumer Discretionary - 8%	Telecommunication Services - 6%
Consumer Staples - 8%	Materials - 4%
Industrials - 7%	Information Technology - 4%

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.

Information Technology - 26%	Financials - 8%
Health Care - 17%	Energy - 5%
Industrials - 15%	Materials - 3%
Consumer Discretionary - 14%	Utilities - 1%
Consumer Staples - 10%	Telecommunication Services - 1%

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.

Financials - 22%	Energy - 9%
Information Technology - 15%	Consumer Staples - 8%
Health Care - 12%	Utilities - 4%
Industrials - 12%	Materials - 4%
Consumer Discretionary - 11%	Telecommunication Services - 3%

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.

Apartments - 20%	Industrial - 7%
Office - 19%	Industrial Mixed - 6%
Retail Malls - 15%	Self Storage - 4%
Retail Strip Centers - 12%	Manufactured Homes - 1%
Hotels - 8%	Factory Outlets - 1%
Diversified - 7%	

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.

Financials - 23%	Energy - 8%
Consumer Discretionary - 16%	Utilities - 5%
Information Technology - 14%	Materials - 4%
Industrials - 14%	Consumer Staples - 2%
Health Care - 12%	Telecommunication Services - 2%

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 - 29%	Consumer Staples - 8%
Consumer Discretionary - 12%	Information Technology - 6%
Industrials - 10%	Telecommunication Services - 5%
Materials - 8%	Utilities - 5%
Energy - 8%	Other - 1%
Health Care - 8%	

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.

Bank Notes/Corporates/MTNs - 30%	Floating Rate Corporate Notes - 11%
Commercial Paper - 22%	Fixed Rate ABS - 7%
CDs, ECDs, TDs, BAs - 15%	Other Short-Term Instruments - 2%
Repurchase Agreements - 13%	

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.

US Treasury/Agency - 98%
Other - 2%

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 - 53%	Corporate - 4%
Cash & Equivalents - 33%	Emerging Markets ($US) - 2%
US Treasury/Agency - 7%	Other - 1%

Active High Yield Bond Fund: Seeks to provide a high level of current income and provide 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 - 20%	Energy - 8%
Consumer Cyclical - 17%	US Treasury/Agency - 4%
Utilities - 13%	Technology - 4%
Basic Industry - 10%	Transportation - 3%
Consumer Non-Cyclical - 9%	Finance - 2%
Capital Goods - 9%	Industrial Other - 1%

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 - 24%	Energy - 7%
Consumer Discretionary - 16%	Materials - 4%
Information Technology - 14%	Utilities - 4%
Industrials - 13%	Consumer Staples - 3%
Health Care - 13%	Telecommunication Services - 2%

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 developed market.

Financials - 22%	Telecommunication Services - 7%
Consumer Discretionary - 12%	Information Technology - 7%
Other (Cash & Equivalents) - 11%	Health Care - 6%
Materials - 8%	Industrials - 6%
Consumer Staples - 8%	Utilities - 5%
Energy - 8%	

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 - 24%
JP Morgan Chase Bank Security Backed Contract - 23%
Union Bank of Switzerland AG Security Backed Contract - 22%
AIG Financial Products Security Backed Contract - 16%
Royal Bank of Canada - 15%

Tier IV: Self-Directed Brokerage Option

The Self-Directed Brokerage (SDB) option offered through Ameritrade Corporate Services 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, 2006

(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	**2.21%**	**4.94%**	**5.02%**	**0.07%**
Benchmark (75% Lehman Bros. Aggregate Bond Index, 22% Russell 3000, 3% MSCI EAFE)	2.22%	5.00%	5.05%	
Balanced Growth Fund	**5.42%**	**7.99%**	**4.94%**	**0.07%**
Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE)	5.44%	8.05%	5.02%	
Long-Term Growth Fund	**8.72%**	**11.08%**	**4.71%**	**0.08%**
Benchmark (25% Lehman Bros. Aggregate Bond Index, 64% Russell 3000, 11% MSCI EAFE)	8.72%	11.14%	4.85%	
Tier II: Passively Managed Funds [1,2]				
Bond Index Fund	**-0.80%**	**2.02%**	**5.01%**	**0.05%**
Lehman Bros. Aggregate Bond Index	-0.81%	2.05%	4.97%	
S&P 500 Index Fund	**8.64%**	**11.22%**	**2.50%**	**0.02%**
S&P 500 Index	8.63%	11.22%	2.49%	
Russell 1000 Value Index Fund	**12.06%**	**15.64%**	**6.82%**	**0.09%**
Russell 1000 Value Index	12.10%	15.70%	6.89%	
Russell 1000 Growth Index Fund	**6.11%**	**8.24%**	**-0.89%**	**0.09%**
Russell 1000 Growth Index	6.12%	8.35%	-0.76%	
Russell 3000 Index Fund	**9.58%**	**12.48%**	**3.43%**	**0.09%**
Russell 3000 Index	9.57%	12.56%	3.53%	
Real Estate Investment Trust Index Fund	**21.80%**	**27.22%**	**19.58%**	**0.21%**
Dow Jones Wilshire REIT Index	22.01%	27.68%	20.16%	
Small/Mid Cap Equity Index Fund [3]	**13.98%**	**18.47%**	**7.80%**	**0.10%**
Russell Small Cap Completeness Index	13.93%	18.55%	7.88%	
International Equity Index Fund [4,5]	**26.46%**	**23.85%**	**9.12%**	**0.14%**
MSCI EAFE Index	26.56%	23.94%	10.02%	

Investment Option Performance Summary, continued

Investment Options	1 Year	3 Years	5 Years	Expense Ratio
Tier III: Actively Managed Funds				
Money Market Fund	**4.23%**	**2.45%**	**2.30%**	**0.12%**
91-Day Treasury Bill Average	4.36%	2.56%	2.26%	
Active Inflation-Protected Bond Fund	**-1.47%**	**3.57%**	**6.85%**	**0.08%**
Lehman Bros. US Treas. Inflation Notes Index	-1.64%	3.76%	7.00%	
Active Bond Fund	**-0.82%**	**2.57%**	**5.91%**	**0.43%**
Lehman Bros. Aggregate Bond Index	-0.81%	2.05%	4.97%	
Active High-Yield Bond Fund [7]	**3.15%**	**6.24%**	**6.29%**	**0.12%**
Benchmark (95% Lehman Bros. High Yield ex-CCC, 5% Leman Bros. 1-3 Year Treasury Index)	3.96%	7.58%	7.65%	
Active Small/Mid Cap Equity Fund [1, 3]	**12.24%**	**17.98%**	**8.35%**	**0.57%**
Russell Small Cap Completeness Index	13.93%	18.55%	7.88%	
Active Global Equity Fund [4]	**21.80%**	**22.45%**	**12.63%**	**0.50%**
MCSI World Index	16.93%	16.86%	5.72%	
Stable Value Fund [6]	**5.48%**	**5.25%**	**5.34%**	**0.18%**
The Stable Value Fund current yield as of June 30, 2006 was 5.36% [7]				

[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.**

VRS modernization

Moving toward the future.

The Board of Trustees approved the launch of a six-year modernization program that will update systems, business processes and customer services. Among the objectives of modernization is to provide customers near "24/7" access to VRS. The ultimate vision of the program is "to create a workplace where skilled and confident staff routinely deliver superior customer service in a collaborative work environment that encourages and supports continuous improvement."

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