

FINANCIAL STATEMENTS

SOUTH CAROLINA  
RETIREMENT SYSTEMS

Columbia, South Carolina

Year Ended June 30, 2007

*State of South Carolina*



*Office of the State Auditor*

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October 19, 2007

The Honorable Mark Sanford, Governor  
and  
Members of the State Budget and Control Board  
State of South Carolina  
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Retirement Systems for the fiscal year ended June 30, 2007 was issued by Rogers Laban, PA, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert, Jr.", written in a cursive style.

Richard H. Gilbert, Jr., CPA  
Deputy State Auditor

RHGjr/trb

# South Carolina Retirement Systems

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## INDEPENDENT AUDITOR'S REPORT

Mr. Richard H. Gilbert, Jr., CPA,  
Deputy State Auditor  
• State of South Carolina  
Columbia, South Carolina

We have audited the financial statements of the South Carolina Retirement Systems (the "Systems") as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of the South Carolina Retirement Systems' 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. 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 described in Note I to the financial statements, the Systems' financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the financial reporting entity of the State of South Carolina that is attributable to the transactions of the System. They do not purport to and do not present the financial position of the State of South Carolina as of June 30, 2007, and 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, and do not include other agencies, divisions, or component units of the State of South Carolina.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the South Carolina Retirement Systems, as of June 30, 2007, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note VIII to the financial statements, the Systems is a party to legal actions claiming amounts due for legal fees and additional retirement benefits and for certain retirement contributions that have been collected inappropriately. The ultimate outcomes of the litigation cannot be presently determined. Accordingly, no provision for any liability has been made in the accompanying financial statements.

Management's Discussion and Analysis on pages 3 - 8 and the required supplementary information on pages 31 and 32 are not a required part of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the 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 September 28, 2007 on our consideration of the Systems' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 Governmental Auditing Standards and should be considered in assessing the results of our audit.

.Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The other supplementary information on pages 33 - 39 are presented for the purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

*Rogers Laban, PA*

September 28, 2007

# Management's Discussion and Analysis

Management offers the following discussion and analysis to provide a narrative introduction to the basic financial statements and an analytical overview of the South Carolina Retirement Systems' financial activities for the fiscal year ended June 30, 2007. This narrative is intended as a supplement and should be read in conjunction with the financial statements.

The Retirement Systems' financial statements provide information about the activities of the five defined benefit pension plans administered (listed below), in addition to comparative summary information about the activities of the Retirement Systems as a whole:

- *South Carolina Retirement System (SCRS)* – A member contributory multi-employer plan covering teachers, as well as state and municipal employees;
- *Police Officers Retirement System (PORS)* – A member contributory multi-employer plan covering state and local law enforcement personnel and firefighters;
- *The Retirement System for Members of the General Assembly (GARS)* – A member contributory plan providing benefits to the members of the South Carolina General Assembly;
- *The Retirement System for Judges and Solicitors (JSRS)* – A member contributory plan covering Judges and Solicitors; and
- *National Guard Retirement System (NGRS)* – A non-contributory supplemental benefit plan for members of the South Carolina National Guard.

## Overview of the Financial Statements

The Retirement Systems is a part of the primary government of the state of South Carolina and is included in the comprehensive annual financial report of the state. The Plan's financial statements include the following components:

- Statement of Plan Net Assets
- Statement of Changes in Plan Net Assets
- Notes to the Financial Statements
- Required Supplementary Information
- Other Supplementary Information

The *Statement of Plan Net Assets* presents the Plan's assets and liabilities and the resulting net assets, which are held in trust for pension benefits. This statement reflects a year-end snapshot of the Plan's investments, at fair value, along with cash and short-term investments, receivables and other assets and liabilities.

The *Statement of Changes in Plan Net Assets* presents information showing how the Plan's net assets held in trust for pension benefits changed during the year. This statement includes additions for contributions by members and employers and investment earnings and deductions for annuity payments, refunded contributions, group life insurance payments and administrative expenses.

*Notes to the Financial Statements* are an integral part of the financial statements and provide additional information that is necessary in order to gain a comprehensive understanding of data reported in the financial statements.

*Required Supplementary Information* presents information concerning the Retirement Systems' funding progress and its obligations to provide pension benefits to members. A schedule of re-

quired employer contributions and a summary of actuarial assumptions and methods are also presented and are useful in evaluating the condition of the plans.

*Other Supplementary Information* includes Schedules of Changes in Plan Net Assets by system, as well as schedules of administrative expenses, professional and consultant fees, and investment fees and expenses.

## **Financial Highlights**

- The consolidated pension trust funds administered by the South Carolina Retirement Systems generated an aggregate return of 13.35 percent for the combined investment portfolios for fiscal year 2007. This return can be compared to a combined return of 5.13 percent for the prior fiscal year. The actuarial assumed rate of return for the plans for investment purposes is 7.25 percent.
- In November 2006, South Carolina voters passed a referendum to amend the state constitution to allow full diversification of the Systems' investment portfolio and the General Assembly ratified the referendum in February 2007. The South Carolina Retirement Systems was previously prohibited from investing in international equity and private equity investments. Since its inception in October 2005, the Retirement System Investment Commission has made significant progress in implementing a complete restructuring of the state's investment program for the pension trust funds. The Commission is transitioning the fixed income assets from the State Treasurer's Office to the Commission and is continuing the process of restructuring the Systems' portfolio through the development of private equity in the form of limited partnerships, portable alpha, global fixed income, real estate, and domestic and international equity portfolios. The Commission also contracted with New England Pension Consultants (NEPC) for general investment consulting services. The complete restructuring progress and the elimination of previous restrictions should allow the trust funds to be on a level playing field with other public retirement funds and permit our performance to rank among the best state retirement plans in the nation.
- Net assets of the plans are held in trust to meet future benefit payments. Total plan net assets for all five pension trust funds administered by the South Carolina Retirement Systems increased from \$25.4 billion to \$28 billion during fiscal year 2007, primarily as a result of positive investment returns and increased contributions from employers, active members and working retirees. A significant portion of the investment portfolio was classified as cash and cash equivalents at year-end as a result of the Commission's transition and reallocation process. In addition, unsettled investments that were in the process of being transitioned to the beta overlay manager at year-end were reflected as an increase in accounts receivable and accounts payable because they represent a transfer between investment managers.
- During the prior fiscal year, the South Carolina Retirement Systems assumed administrative responsibilities for the National Guard Retirement System (NGRS) which was previously administered by the Office of the Adjutant General. This defined benefit pension plan provides supplemental benefits to National Guard members who served in South Carolina. The plan had been closed to new entrants since July 1, 1993; however, legislation reopened the plan effective January 1, 2007. Historically the NGRS funds were invested strictly in the fixed income market, but in fiscal year 2007, under the administration of the Retirement Systems, the Commission began the process of reallocating, pooling together and investing the NGRS pension trust fund in the same manner as the funds of the other four pension trust funds administered by the Retirement Systems.

- As passed by the South Carolina General Assembly in 2005, Act 153 increased the employee contribution rate of the South Carolina Retirement System (SCRS) from 6.25 percent to 6.50 percent effective July 1, 2006. This act also increased the SCRS employer contribution rate from 7.55 percent to 8.05 percent effective July 1, 2006.
- Despite challenges and program changes, the TERI program continues to be a popular option for members; however, participation declined somewhat during the year. TERI is a deferred retirement option program that was implemented in January 2001, allowing retired members to accumulate deferred annuity benefits for up to five years while continuing employment. The amount of assets held in trust for future payment of accrued benefits decreased slightly to \$642 million during fiscal year 2007, with the number of active TERI participants decreasing from 10,025 to 9,049 members at fiscal year end.
- Although participation in TERI slightly declined during the year, growth has been experienced in the number of retirees returning to covered employment after retirement. Retired members of SCRS and PORS are allowed to return to work after retirement and draw an annuity benefit with no limit on their earnings. Retirees who return to work for a covered employer pay employee contributions, which partially fund guaranteed cost-of-living adjustments (COLAs) under SCRS and also help provide funding for ad hoc COLAs under SCRS and PORS. In addition, group life insurance benefits for working retirees were increased and as a result, the plan experienced an increase in group life expense.
- The number of retired members and beneficiaries receiving monthly benefits under the Retirement Systems' plans increased to more than 115,000 annuitants during the year. The increase in volume, coupled with adjustments for COLAs, caused the amount of benefit payments to increase almost 7 percent from the prior year from \$1.8 billion to \$1.9 billion.

## **Condensed Financial Information**

In order to ensure the Retirement Systems' ability to properly fund the payments of retirement benefits to members in future years, it is necessary to accumulate funds on a regular and systematic basis. The five defined benefit plans provide benefits to eligible employees of state, public school, local and municipal government, state legislative, judicial and National Guard employers in South Carolina.

The principal sources from which the Systems derives revenues are employee contributions, employer contributions and earnings on investments. Required annual contributions for the NGRS are funded through an annual state appropriation. Expenses of the Systems consist primarily of payments of monthly annuities to retired members and their beneficiaries and refunds of member contributions and interest paid upon termination. Other programs administered by the Systems include a group life insurance plan for both active and retired members and an accidental death plan for members of PORS.

Summary comparative financial statements of the pension trust funds are presented as follows:

**Plan Net Assets**  
**June 30**  
*(Amounts expressed in thousands)*

<b>Assets</b>	<u>2007</u>	<u>2006</u>	<u>% Increase/ (Decrease)</u>
Cash and cash equivalents, receivables and prepaid expenses	\$ 6,855,459	\$ 2,078,394	229.84%
Investments, at fair value	22,188,448	24,114,946	(7.99%)
Securities lending cash collateral invested	5,085,506	4,372,175	16.32%
Property, net of accumulated depreciation	3,577	3,696	(3.22%)
<b>Total Assets</b>	<u>34,132,990</u>	<u>30,569,211</u>	11.66%
<b>Liabilities</b>			
Deferred retirement benefits	641,750	670,527	(4.29%)
Obligations under securities lending	5,085,506	4,372,175	16.32%
Other liabilities	356,954	144,561	146.92%
<b>Total Liabilities</b>	<u>6,084,210</u>	<u>5,187,263</u>	17.29%
<b>Total Net Assets</b>	<u>\$ 28,048,780</u>	<u>\$ 25,381,948</u>	10.51%

**Changes in Plan Net Assets**  
**Year Ended June 30**  
*(Amounts expressed in thousands)*

<b>Additions</b>	<u>2007</u>	<u>2006</u>	<u>% Increase/ (Decrease)</u>
Employee contributions	\$ 578,019	\$ 567,908	1.78%
Employer contributions	760,167	686,431	10.74%
State-appropriated contributions	3,948	-	100.00%
Investment income	3,397,801	1,282,360	164.96%
Other income	3,382	5,399	(37.36%)
<b>Total Additions</b>	<u>4,743,317</u>	<u>2,542,098</u>	86.59%
<b>Deductions</b>			
Annuities	1,947,789	1,823,085	6.84%
Refunds	89,825	121,841	(26.28%)
Group Life	18,253	16,837	8.41%
Administrative & other expenses	20,618	20,898	(1.34%)
<b>Total Deductions</b>	<u>2,076,485</u>	<u>1,982,661</u>	4.73%
<b>Increase in Net Assets before Transfer</b>	<u>2,666,832</u>	<u>559,437</u>	376.70%
<b>Transfer from State Adjutant General's Office</b>	<u>-</u>	<u>14,064</u>	(100.00%)
<b>Total Increase in Net Assets</b>	<u>2,666,832</u>	<u>573,501</u>	365.01%
Beginning Net Assets	25,381,948	24,808,447	2.31%
<b>Ending Net Assets</b>	<u>\$ 28,048,780</u>	<u>\$ 25,381,948</u>	10.51%

## **Analysis of the Plan's Financial Position and Results of Operations**

On a combined basis, plan net assets were \$28 billion at June 30, 2007, representing a 10.5 percent increase in net assets from the previous fiscal year-end. Investment income is a major revenue source which corresponded to approximately 71.6 percent of total plan income. Accordingly, the increase in plan net assets is due primarily to our positive investment performance during fiscal year 2007. Our total combined investment return for fiscal year 2007 was 13.35 percent, which was substantially greater than our assumed actuarial investment return of 7.25 percent. For fiscal year 2007, a total return of 18.69 percent was produced on the equity segment of the portfolio, and a return of 7.02 percent on the fixed income segment of our investment portfolio. In comparison, the prior fiscal year 2006 produced a combined total investment return of 5.13 percent, with 10.34 percent and 0.69 percent returns for the equity and fixed income segments respectively.

While the fluctuations in returns between market segments exemplify the need for an optimally diversified investment portfolio, the Retirement Systems' investment performance has been limited in the past by our state constitution and state statute. However, South Carolina's recently modernized retirement investment policies and practices will allow for a more diversified target allocation under the oversight of the Investment Commission and its Chief Investment Officer. The target mix is comparable to our peer public pension funds and is expected to increase long-term rates of return. In May 2007, the Commission engaged a beta overlay manager as an efficient, low-cost solution for opportunistic value and immediate market exposure. The overall structural changes and investment mechanisms were not implemented until mid-year, thus the current year's investment performance is not necessarily attributable to the diversification as the Commission continues the process of transitioning the investment portfolio.

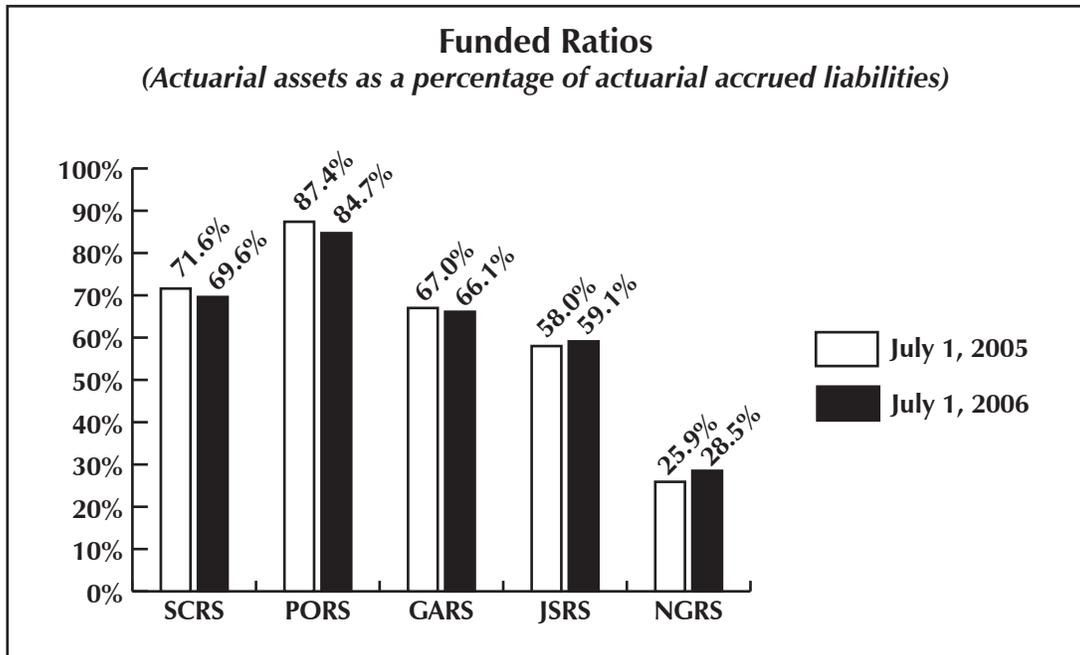
During fiscal year 2007, the total dollar amount of retirement annuities paid increased nearly 7 percent when compared with the previous fiscal year. This was due primarily to the continued effects of 28-year retirement in SCRS and our liberal return to work provisions. A 3.5 percent COLA granted to SCRS and PORS annuitants effective July 1, 2006, also contributed to the increase in the total annuity expense. The General Assembly enacted legislation to guarantee a 1 percent COLA and further allow for additional COLAs that are conditional under SCRS as COLAs are a very important benefit to our retirees. Ad hoc COLAs have historically been granted and funded with either unanticipated actuarial gains or an extension of the system's unfunded actuarial accrued liability (UAAL) amortization period. As of the most recent actuarial valuation dated July 1, 2006, the UAAL amortization period for SCRS was 30 years, and any additional ad hoc COLAs in the future would necessitate either additional contributions or increased investment returns.

## **Funding Status**

An overall objective in the funding of a defined benefit retirement system is to accumulate sufficient funds to meet long-term obligations to pay benefits to participants when due. The primary sources of assets to fund benefits include investment income, member contributions, employer contributions, and state-appropriated contributions. A five-year smoothing method is used in actuarially valuing assets to mitigate the impact of market volatility and allow changes in market conditions to be recognized (smoothed) over several years.

The ratio of actuarial assets to actuarial liabilities provides an indication as to whether sufficient assets are accumulated to pay benefits when due. The greater the level of funding, the larger the ratio of actuarial assets to actuarial accrued liabilities. The most recent actuarial valuations prepared as of July 1, 2006, and adopted by the Budget and Control Board, indicate that the funded

ratios of three of the five individual plans declined slightly from the previous valuations, which were completed as of July 1, 2005. All of the plans continued to recognize actuarial losses in the market value of investments that occurred in fiscal years 2000 through 2002 and 2005 through 2006. As of July 1, 2006, funding levels of all the plans are such that annual contributions are sufficient for the valuation to find the plans in good actuarial condition. Changes in the levels of funding do not affect the availability of fund resources for future use, and actuarial projections indicate that unfunded liabilities will be amortized and funded within acceptable funding guidelines. The funded ratios of the five plans are presented in the following graph.



### Requests for Information

This financial report is designed to provide a general overview of the Retirement Systems' finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional financial information should be directed as follows:

Financial Services  
South Carolina Retirement Systems  
PO Box 11960  
Columbia, SC 29211-1960  
(803) 737-6800  
[www.retirement.sc.gov](http://www.retirement.sc.gov)

**South Carolina Retirement Systems**  
**Statement of Plan Net Assets**  
**June 30, 2007**  
**With comparative totals for June 30, 2006**  
*(Amounts expressed in thousands)*

	SCRS	PORS	GARS	JSRS	NGRS	TOTAL	TOTAL 2006
<b>ASSETS</b>							
Cash and cash equivalents	\$ 5,314,145	\$ 708,521	\$ 10,481	\$ 29,160	\$ 2,614	\$ 6,064,921	\$ 1,729,183
Receivables							
Due from other Systems	185	346	4	136		671	878
Employee and employer contributions	150,695	15,528	61	569		166,853	152,365
Employer contributions long-term	845	22				867	1,461
Accrued investment income	114,178	16,592	222	669	80	131,741	142,437
Unsettled investment sales	418,554	50,017	787	2,160	340	471,858	51,857
Other investment receivables	15,987	1,948	33	83	3	18,054	
Total receivables	<u>700,444</u>	<u>84,453</u>	<u>1,107</u>	<u>3,617</u>	<u>423</u>	<u>790,044</u>	<u>348,998</u>
Investments, at fair value							
Short-term securities	201,695	26,668	407	1,116	86	229,972	54,633
United States Government securities	290,161	42,970	557	1,718	219	335,625	713,525
United States Government agencies and government-insured	3,122,153	462,357	5,993	18,482	2,362	3,611,347	3,805,598
Corporate bonds	3,063,224	453,630	5,880	18,134	2,317	3,543,185	4,289,977
Convertible bonds							162
Financial and other	1,112,800	164,793	2,136	6,588	842	1,287,159	1,721,962
Common trust funds	7,348,540	877,028	13,464	37,894	7,271	8,284,197	7,317,383
Common stocks	4,319,996	521,160	9,050	22,325		4,872,531	6,211,706
Limited Partnerships	21,452	2,804	43	119	14	24,432	
Total investments	<u>19,480,021</u>	<u>2,551,410</u>	<u>37,530</u>	<u>106,376</u>	<u>13,111</u>	<u>22,188,448</u>	<u>24,114,946</u>
Prepaid administrative expenses	349	46	1	2	96	494	213
Securities lending cash collateral invested	4,396,622	651,091	8,440	26,027	3,326	5,085,506	4,372,175
Capital assets, net of accumulated depreciation	<u>3,223</u>	<u>329</u>	<u>10</u>	<u>15</u>		<u>3,577</u>	<u>3,696</u>
Total assets	<u>29,894,804</u>	<u>3,995,850</u>	<u>57,569</u>	<u>165,197</u>	<u>19,570</u>	<u>34,132,990</u>	<u>30,569,211</u>
<b>LIABILITIES</b>							
Due to other Systems	416	174	81			671	878
Accounts payable - unsettled investment purchases	250,188	30,448	477	1,305	184	282,602	44,162
Investment fees payable	6,745	811	14	35		7,605	7,274
Obligations under securities lending	4,396,622	651,091	8,440	26,027	3,326	5,085,506	4,372,175
Deferred retirement benefits	641,750					641,750	670,527
Due to Employee Insurance Program	33,611	647				34,258	29,911
Benefits payable	1,701	225		263	3	2,192	9,359
Negative cash balances							32,734
Other liabilities	<u>20,602</u>	<u>8,473</u>	<u>11</u>	<u>376</u>	<u>164</u>	<u>29,626</u>	<u>20,243</u>
Total liabilities	<u>5,351,635</u>	<u>691,869</u>	<u>9,023</u>	<u>28,006</u>	<u>3,677</u>	<u>6,084,210</u>	<u>5,187,263</u>
Net assets held in trust for Pension Benefits (a schedule of funding progress for each plan is presented on Page 31)	<u>\$ 24,543,169</u>	<u>\$ 3,303,981</u>	<u>\$ 48,546</u>	<u>\$ 137,191</u>	<u>\$ 15,893</u>	<u>\$ 28,048,780</u>	<u>\$ 25,381,948</u>

The accompanying notes are an integral part of these financial statements.

**South Carolina Retirement Systems**  
**Statement of Changes in Plan Net Assets**  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	SCRS	PORS	GARS	JSRS	NGRS	TOTAL	TOTAL 2006
<b>Additions</b>							
Contributions							
Employee	\$ 505,122	\$ 70,641	\$ 551	\$ 1,705	\$ -	\$ 578,019	\$ 567,908
Employer	644,350	106,753	2,358	6,706		760,167	686,431
State appropriated					3,948	3,948	
Total contributions	<u>1,149,472</u>	<u>177,394</u>	<u>2,909</u>	<u>8,411</u>	<u>3,948</u>	<u>1,342,134</u>	<u>1,254,339</u>
Investment Income							
Net appreciation (depreciation) in fair value of investments	2,306,678	276,937	4,559	11,915	1,270	2,601,359	583,888
Interest and dividend income	714,352	100,175	1,436	4,209	727	820,899	717,311
Investment expense	(31,988)	(3,921)	(66)	(167)	(5)	(36,147)	(29,837)
Net income from investing activities	<u>2,989,042</u>	<u>373,191</u>	<u>5,929</u>	<u>15,957</u>	<u>1,992</u>	<u>3,386,111</u>	<u>1,271,362</u>
From securities lending activities:							
Securities lending income	254,471	36,380	527	1,523	224	293,125	194,823
Securities lending expense	(244,304)	(34,948)	(506)	(1,463)	(214)	(281,435)	(183,825)
Net income from securities lending activities	<u>10,167</u>	<u>1,432</u>	<u>21</u>	<u>60</u>	<u>10</u>	<u>11,690</u>	<u>10,998</u>
Total net investment income	<u>2,999,209</u>	<u>374,623</u>	<u>5,950</u>	<u>16,017</u>	<u>2,002</u>	<u>3,397,801</u>	<u>1,282,360</u>
Supplemental retirement benefits funded by the State	1,532	55				1,587	1,801
State appropriations for administrative expenses					50	50	300
Transfers of contributions from other Systems		<u>1,614</u>	<u>52</u>	<u>79</u>		<u>1,745</u>	<u>3,298</u>
Total additions	<u>4,150,213</u>	<u>553,686</u>	<u>8,911</u>	<u>24,507</u>	<u>6,000</u>	<u>4,743,317</u>	<u>2,542,098</u>
<b>Deductions</b>							
Refunds of contributions to members	77,212	12,543	70			89,825	121,841
Transfers of contributions to other Systems	1,745					1,745	3,298
Regular retirement benefits	1,505,080	180,135	5,935	10,348	2,926	1,704,424	1,498,727
Deferred retirement benefits	240,580					240,580	321,374
Supplemental retirement benefits	1,532	55				1,587	1,801
Group life insurance claims	15,948	1,919	5	381		18,253	16,837
Accidental death benefits		1,198				1,198	1,183
Depreciation	107	11		1		119	118
Administrative expenses	16,402	2,168	34	91	59	18,754	17,482
Total deductions	<u>1,858,606</u>	<u>198,029</u>	<u>6,044</u>	<u>10,821</u>	<u>2,985</u>	<u>2,076,485</u>	<u>1,982,661</u>
Net increase before transfer	2,291,607	355,657	2,867	13,686	3,015	2,666,832	559,437
Transfer from the State Adjutant General's Office							<u>14,064</u>
Net increase	2,291,607	355,657	2,867	13,686	3,015	2,666,832	573,501
Net assets held in trust for Pension Benefits							
Beginning of year	22,251,562	2,948,324	45,679	123,505	12,878	25,381,948	24,808,447
End of year	<u>\$ 24,543,169</u>	<u>\$ 3,303,981</u>	<u>\$ 48,546</u>	<u>\$ 137,191</u>	<u>\$ 15,893</u>	<u>\$ 28,048,780</u>	<u>\$ 25,381,948</u>

The accompanying notes are an integral part of these financial statements.

# South Carolina Retirement Systems

## Notes to Financial Statements

### I. Basis of Presentation and Summary of Significant Accounting Policies

#### Description of the Entity

The financial statements of the South Carolina Retirement Systems (Systems) presented herein contain the following funds:

#### Pension Trust Funds

- South Carolina Retirement System (SCRS)
- South Carolina Police Officers Retirement System (PORS)
- Retirement System for Members of the General Assembly of the State of South Carolina (GARS)
- Retirement System for Judges and Solicitors of the State of South Carolina (JSRS)
- National Guard Retirement System (NGRS)

Each pension trust fund operates on an autonomous basis; funds may not be utilized for any purpose other than for the benefit of each plan's participants.

The Retirement Systems are part of the state of South Carolina's primary government and are included in the *Comprehensive Annual Financial Report of the State of South Carolina*. In making this determination, factors of financial accountability, governance and fiduciary responsibility of the state were considered.

#### Plan Descriptions

The South Carolina Retirement System, a cost-sharing multiple-employer defined benefit pension plan, was established effective July 1, 1945, pursuant to the provisions of Section 9-1-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for teachers and employees of the state and political subdivisions thereof.

The South Carolina Police Officers Retirement System, a cost-sharing multiple-employer defined benefit pension plan, was established effective July 1, 1962, pursuant to the provisions of Section 9-11-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for police officers and firemen of the state and its political subdivisions.

The Retirement System for Members of the General Assembly of the State of South Carolina, a single-employer defined benefit pension plan, was created effective January 1, 1966, pursuant to the provisions of Section 9-9-20 of the South Carolina Code of Laws to provide retirement allowances and other benefits for members of the General Assembly.

The Retirement System for Judges and Solicitors of the State of South Carolina, a single-employer defined benefit pension plan, was created effective July 1, 1979, pursuant to the provisions of Section 9-8-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for judges and solicitors of the state.

The National Guard Retirement System, a single-employer defined benefit pension plan, was created effective July 1, 1975, pursuant to the provisions of Section 25-1-3210 of the South Carolina Code of Laws for the purpose of providing supplemental retirement benefits to certain members who served in the South Carolina National Guard. Effective January 1, 2006, Section 25-1-3210 was repealed and replaced by Section 9-10-30. This legislation transferred administrative responsibility of the plan from the Adjutant General's Office to the South Carolina Retirement Systems.

A summary of information related to participating employers and active members as of June 30, 2007, follows (dollar amounts expressed in thousands):

	<u>State<sup>1</sup></u>	<u>School</u>	<u>Other</u>	<u>Total</u>
<b>SCRS</b>				
Number of Employers	110	104	579	793
Annual Covered Payroll	\$ 2,116,417	\$ 2,939,297	\$ 1,666,090	\$ 6,721,804
Average Number of Contributing Members	56,007	87,276	52,823	196,106
<b>PORS</b>				
Number of Employers	50	4	270	324
Annual Covered Payroll	\$ 350,681	\$ 164	\$ 580,962	\$ 931,807
Average Number of Contributing Members	10,495	5	15,861	26,361
<b>GARS</b>				
Number of Employers	2			2
Annual Covered Payroll	\$ 3,191			\$ 3,191
Number of Elected Positions	170			170
<b>JSRS</b>				
Number of Employers	2			2
Annual Covered Payroll	\$ 15,894			\$ 15,894
Average Number of Contributing Members	128			128
<b>NGRS</b>				
Number of Employers	1			1
Annual Covered Payroll <sup>2</sup>	N/A			N/A
Average Number of Active Members	11,088			11,088

<sup>1</sup>Each state agency is considered a separate employer for reporting purposes. Institutions of Higher Education are reported in this category.

<sup>2</sup>Annual covered payroll is not applicable for NGRS because it is a non-contributory plan.

Based upon the most recent actuarial valuations adopted by the Budget and Control Board, membership in the Systems was as follows:

	<u>SCRS</u>	<u>PORS</u>	<u>GARS</u>	<u>JSRS</u>	<u>NGRS</u>
Retirees and beneficiaries currently receiving benefits	97,205	10,134	317	144	2,903
Terminated members entitled to but not yet receiving benefits	151,510	10,464	63	5	3,142
Total active, elected positions, and other special contributing members	<u>184,282</u>	<u>24,813</u>	<u>197</u>	<u>128</u>	<u>2,502</u>
Total membership	<u><u>432,997</u></u>	<u><u>45,411</u></u>	<u><u>577</u></u>	<u><u>277</u></u>	<u><u>8,547</u></u>

Membership and benefit requirements are prescribed in Title 9 of the South Carolina Code of Laws. A brief summary of each is presented below.

## Membership

### SCRS

Generally, all employees of covered employers are required to participate in and contribute to the system as a condition of employment. This plan covers general employees and teachers.

### State ORP

As an alternative to membership in SCRS, newly hired state, public school, and higher education employees have the option to participate in the State Optional Retirement Program (State ORP), which is a defined contribution plan. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. The SCRS assumes no liability for State ORP benefits. Rather, the benefits are the liability of the investment providers. For this reason, State ORP programs are not considered part of the Systems for financial statement purposes.

Contributions to the State ORP are at the same rates as SCRS. A direct remittance is required from the employers to the investment providers for the employee contribution (6.50 percent) and a portion of the employer contribution (5 percent). A direct remittance is also required to the SCRS for a portion of the employer contribution (3.05 percent) and a group life contribution (.15 percent), which is retained by the SCRS. The activity for the State ORP is as follows:

**State ORP Activity**  
**Year Ended June 30, 2007**  
*(Dollar amounts expressed in thousands)*

Average Number of Contributing Participants	16,081
Annual Covered Payroll	\$ 715,979
Employer Contributions Retained by SCRS	21,837
Group Life Contributions Retained by SCRS	1,074
Employee Contributions to Investment Providers	46,539
Employer Contributions to Investment Providers	35,799

### PORS

To be eligible for PORS membership, an employee must be required by the terms of his employment, by election or appointment, to preserve public order, protect life and property, and detect crimes in the state; to prevent and control property destruction by fire; be a coroner in a full-time permanent position; or be a peace officer employed by the Department of Corrections, the Department of Juvenile Justice, or the Department of Mental Health. Probate judges and coroners may elect membership in PORS. Magistrates are required to participate in PORS for service as a magistrate. PORS members, other than magistrates and probate judges, must also earn at least \$2,000 per year and devote at least 1,600 hours per year to this work, unless exempted by statute.

### GARS

All members of the Senate and the House of Representatives are required to participate in and contribute to the system upon taking office as a member of the South Carolina General Assembly.

### JSRS

All solicitors, judges of a Circuit or Family Court and justices of the Court of Appeals and Supreme Court are required to participate in and contribute to the system upon taking office.

### NGRS

Membership consists of individuals who serve in the South Carolina National Guard.

## Pension Benefits

### SCRS

A monthly pension is payable at age 65 or with 28 years credited service regardless of age. Reduced pension benefits are payable at age 55 with 25 years of service credit. A member is eligible to receive a reduced deferred annuity at age 60 with five years earned service. Group life insurance benefits are also available to active and retired members with at least one year of service, provided their employer participates in the program.

Eligible retirees receive an automatic cost-of-living adjustment of up to 1 percent and may also receive an additional ad hoc cost-of-living adjustment of up to 3 percent annually based on increases in the Consumer Price Index. The State Budget and Control Board grants ad hoc increases in accordance with its funding policies and state statute.

### **PORS**

A monthly pension is payable at age 55 with a minimum of five years earned service or with 25 years of service regardless of age. A member is eligible to receive a deferred annuity at age 55 with five years earned service. Group life insurance benefits are also available to members with at least one year of service provided their employer participates in the program. An additional accidental death benefit is also offered to members killed in the line of duty while working for a covered employer.

Eligible retirees may receive ad hoc cost-of-living adjustments of up to 4 percent annually based on increases in the Consumer Price Index. The State Budget and Control Board grants ad hoc increases in accordance with its funding policies and state statute.

### **GARS**

A member is eligible for a monthly pension at age 60 or with 30 years credited service. A member who has attained age 70 or has 30 years of service is eligible to retire and draw an annuity while continuing to serve in the General Assembly. A member is eligible to receive a deferred annuity with eight years of service. A group life insurance benefit is also provided to members with at least one year of service.

Retirees receive increases in benefits based upon increases in the current salary of their respective active positions.

### **JSRS**

A pension benefit is payable at age 70 with 15 years service, age 65 with 20 years service, age 65 with four years in a JSRS position and 25 years other service with the state,

25 years service regardless of age for a judge or 24 years of service for a solicitor regardless of age. A judge is vested in the system after attaining 10 years of earned service in the position of judge, and a solicitor is vested in the system after attaining eight years of earned service as a solicitor. A group life insurance benefit is also provided to members with at least one year of service.

Retirees receive increases in benefits based upon increases in the current salary of their respective active positions.

### **NGRS**

A monthly pension is payable at age 60 provided the member was honorably discharged from active duty with at least 20 years of total creditable military service. Of the 20 years total creditable military service, at least 15 must have been served in the South Carolina National Guard. Additionally, the last 10 years of service must have been served in the South Carolina National Guard. No cost-of-living increases are provided to NGRS retirees.

## **Summary of Significant Accounting Policies Fund Structure**

The Systems' accounts are maintained in accordance with the principles of fund accounting. This is the procedure whereby resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. Separate pension trust funds (fiduciary fund type) are used to account for the activities of the five public employee retirement systems administered by the Systems.

### **Basis of Accounting**

All funds are accounted for using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Benefit and refund expenses are recognized when due and payable in accordance with the terms of the plan.

## Administrative Expenses

The State Budget and Control Board's Office of Internal Operations maintains an internal service fund to account for the administrative costs of operating the Systems. All accounting and corresponding disclosures related to administrative expense, which include employee salaries and associated employee benefits, are the responsibility of the internal service fund administered by the Board. Administrative expenses are funded by both employer contributions and investment earnings and are assessed to each of the pension trust funds based on its respective portion of total assets in order to pay for actual expenses incurred during the year. Administrative expenses of the Retirement Systems include transfers to the Investment Commission to fund investment operations and investment related obligations for the trust funds.

## Cash and Cash Equivalents

The Systems classifies cash on deposit in financial institutions and cash on deposit in the state's internal cash management pool as cash and cash equivalents. The Systems also classifies certain short-term highly liquid securities as cash equivalents if the date of maturity is three months or less from the date of acquisition.

## Contributions

Employee, employer, and state-appropriated contributions are recognized in the period in which they are due, pursuant to formal commitments as well as statutory requirements. Substantially all contributions receivable are collected within 30 days of year-end.

## Investments

The Retirement System Investment Commission invests and reinvests the funds of the retirement system subject to all the terms, conditions, limitations, and restrictions imposed by Section 16, Article X of the South Carolina Constitution and Section 9-1-1310 (B) and Title 9 Section 16 of the South Carolina Code of Laws. Investments of the pension trust funds are reported at fair value in the Statement of Plan Net Assets.

Short term securities categorized as cash or cash equivalents are reported at fair value. The Systems holds domestic equity securities traded on national exchanges and these are valued by the investment custodian using the last reported sales price on a trade-date basis. Fair values of limited partnership investments are based on valuations of the underlying companies of the limited partnerships as reported by the general partner. Fixed income investments are combined in a commingled investment pool, with each system owning a percentage of the pool and receiving proportionate investment income in accordance with their respective ownership percentage. Investment income includes realized and unrealized appreciation (depreciation) in the fair value of investments, interest income earned, dividend income earned, less investment expense, plus income from securities lending activities, less deductions for securities lending expenses.

## Capital Assets

Capital assets are capitalized at cost and depreciated on a straight-line basis over an estimated useful life of forty years.

## II. Contributions and Reserves

Contributions to each of the Plans are prescribed in Title 9 of the South Carolina Code of Laws.

Plan members are required to contribute at statutorily established rates. The rates applicable for fiscal year 2007 follow:

<b>SCRS</b>	<b>6.5% of earnable compensation</b>
<b>PORS</b>	<b>6.5% of earnable compensation</b>
<b>GARS</b>	<b>10% of earnable compensation</b>
<b>JSRS</b>	<b>10% of earnable compensation</b>
<b>NGRS</b>	<b>Non-contributory</b>

Employer contributions are established by the State Budget and Control Board at the actuarially determined rates recommended by the Systems' actuaries.

Contributions for the NGRS are to be provided by state appropriations based on the

annual required contribution determined by the Systems' actuary on an annual basis.

In accordance with provisions of the 2006-2007 State Appropriations Act, an additional employer contribution surcharge of 3.35 percent of covered payroll was added to the contribution rate applicable to state and local governments, and public school entities covered by the Employee Insurance Program. This assessment is for the purpose of providing retiree health and dental insurance coverage and is not a part of the actuarially established contribution rates for retirement funding purposes. Functioning as a collecting agent, SCRS and PORS collected (amounts expressed in thousands) \$214,622 and \$12,440 respectively in retiree insurance surcharges (\$23,907 of which was applicable to the State ORP) and remitted these funds to the Employee Insurance Program.

Net Assets of each plan are required to be reserved in the following accounts:

The **Employer Fund** is credited with all employer retirement contributions and investment earnings of the Employee and Employer Funds. Upon retirement, all member account balances and contributions are transferred to the Employer Fund as all annuities and administrative expenses of the Systems are paid from this fund. Annual state appropriations to the NGRS are also credited to the Employer fund to provide funding of the annual required contribution, payment of annuity benefits and administrative expenses.

The **Employee Fund** is credited with all contributions made by active members of the Systems. Interest is credited to each member's individual account at an annual rate of 4 percent by transferring funds from the Employer Fund to the Employee Fund. At termination of employment prior to retirement, employee contributions and accumulated interest may be refunded from this fund to the member. At retirement, employee contributions and interest are transferred from the Employee Fund to the Employer Fund for subsequent payment of benefits.

The **Group Life Insurance Fund** (SCRS and PORS only) is the fund to which participating employers contribute for the purpose of providing a life insurance benefit to active and retired members of the Systems. Employer group life contributions and investment earnings are credited to this fund. Group life insurance benefit payments and administrative expenses are paid from this fund.

The **Accidental Death Fund** (PORS only) is the fund to which participating employers contribute for the purpose of providing annuity benefits to beneficiaries of members of PORS killed in the actual performance of their duties. This fund and its benefits are independent of any other retirement benefit available to the beneficiary. Employer contributions and investment earnings are credited to this fund. Monthly survivor annuities and administrative expenses are paid from this fund.

Balances in the respective reserves at June 30, 2007, were as follows (amounts expressed in thousands):

	<u>SCRS</u>	<u>PORS</u>	<u>GARS</u>	<u>JSRS</u>	<u>NGRS</u>
Employee Fund	\$ 5,464,756	\$ 658,023	\$ 7,735	\$ 18,999	
Employer Fund	18,947,441	2,587,457	40,811	118,192	\$ 15,893
Group Life Insurance Fund	130,972	26,115			
Accidental Death Fund		32,386			
	<u>\$ 24,543,169</u>	<u>\$ 3,303,981</u>	<u>\$ 48,546</u>	<u>\$ 137,191</u>	<u>\$ 15,893</u>

### III. Deposits and Investments

#### Deposit and Investment Risk Disclosures

The tables presented on Pages 18-23 include disclosures of credit and interest rate risk in accordance with Governmental Accounting Standards Board Statement 40 and are designed to inform financial statement users about investment risks which could affect the Systems' ability to meet its obligations. These tables classify investments by risk type, while the financial statements disclose investments by asset class. The table amounts were provided by the custodian bank and may vary from the Statement of Plan Net Assets primarily because the amounts reported include accrued interest receivable.

#### Custodial Credit Risk

##### Deposits

Custodial credit risk for deposits is the risk that in the event of a bank failure, the Systems' deposits may not be recovered. As prescribed by statute, the State Treasurer is the custodian of all deposits and is responsible for securing all deposits held by banks or savings and loan associations. These deposits must be secured by deposit insurance, surety bonds, collateral securities, or letters of credit to protect the state against loss in the event of insolvency or liquidation of the institution or for any other cause. All deposits are required to be insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000 or collateralized with securities held by the state or its agent in the State Treasurer's name as custodian.

The total amount of the Systems' deposits at June 30, 2007, was as follows (amounts expressed in thousands):

	<u>Carrying Amount</u>
SCRS	\$ 14,309
PORS	2,299
GARS	19
JSRS	54
NGRS	11
<b>Total</b>	<u>\$ 16,692</u>

#### Investments

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Systems will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. Investing for the Systems is governed by Section 16, Article X of the South Carolina Constitution and Sections 11-9-660 and 9-1-1310 of the South Carolina Code of Laws. Funds held in trust for the Retirement Systems may be invested and reinvested in a variety of instruments including, but not limited to, fixed income instruments of the United States, foreign fixed income obligations, futures and options, collateralized mortgage obligations, domestic and international equity securities, private equity, real estate, and fund of funds.

Corporate obligations must bear an investment grade rating by at least two nationally recognized rating services. Collateral held for certificates of deposit or repurchase agreements must be obligations of the United States or investment grade corporate obligations and held by a third party as escrow

agent or custodian and of a market value not less than the amount of either the certificate of deposit so secured, including interest, or the amount of the repurchase agreement so collateralized, including interest. At June 30, 2007, all of the Systems' investments were insured or collateralized.

The following table presents the fair value of investments as of June 30, 2007:

**Statement of Invested Assets**  
**June 30, 2007**  
*(Amounts expressed in thousands)*

<u>Investment Type</u>	<u>Fair Value</u>
<b><u>Short Term Investments</u></b>	
Money Market Funds	\$ 2,657
Commercial Paper	313,109
Repurchase Agreements	5,413,509
U.S. Treasury Bills	228,244
U.S. Government Agencies	325,941
Total Short Term Investments	6,283,460
<b><u>Domestic Equity</u></b>	
Common Stocks	4,802,227
Real Estate Investment Trusts	74,606
Commingled Equity Funds	8,284,196
Limited Partnerships	24,433
Total Domestic Equity	13,185,462
<b><u>Domestic Fixed Income</u></b>	
<b>U.S. Government:</b>	
U.S. Government Treasury Notes and Bonds	340,536
U.S. Government Agencies	47,793
<b>Mortgage Backed:</b>	
Government National Mortgage Association	3,558,312
Federal National Mortgage Association	5,254
Collateralized Mortgage Obligations	267,543
<b>Corporate:</b>	
Corporate Bonds	3,655,568
Asset Backed Securities	150,927
<b>Private Placements</b>	847,150
Total Domestic Fixed Income	8,873,083
<b>Total Invested Assets</b>	<b>\$ 28,342,005</b>

## Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. This risk is managed within the portfolio using effective duration. Effective duration is a measure of the price sensitivity of a bond or a portfolio of bonds to interest rate movements given a 50 basis point change in interest rates. It takes into account that expected cash flows will fluctuate as interest rates change and provides a measure of risk that changes proportionately with market rates.

The Systems invests in mortgage-backed securities which are reported at fair value in the Statement of Plan Net Assets and are based on cash flows from principal and interest payments of the underlying mortgages. These securities are sensitive to prepayments, which are likely in an environment of declining interest rates, and thereby reduce the value of the security. The Systems invests in these securities to diversify the fixed income portfolio and minimize risk.

Disclosures for interest rate risk can be found below.

### South Carolina Retirement Systems Interest Rate Sensitivity - Effective Duration June 30, 2007 (Amounts expressed in thousands)

<u>Investment Type</u>	<u>Fair Value</u>	<u>Effective Duration</u>
<b><u>Short Term Investments</u></b>		
Commercial Paper	\$ 313,109	0.08
Repurchase Agreements	5,413,509	0.00
U.S. Treasury Bills	228,244	0.24
U.S. Government Agencies	325,941	0.06
Total Short Term Investments	<u>6,280,803</u>	0.02
<b><u>Domestic Fixed Income Investments</u></b>		
<b>U.S. Government:</b>		
U.S. Government Treasury Notes and Bonds	340,536	2.84
U.S. Government Agencies	47,793	0.66
Total U.S. Government	<u>388,329</u>	2.57
<b>Mortgage Backed:</b>		
Government National Mortgage Association	3,558,312	4.79
Federal National Mortgage Association	5,254	5.91
Collateralized Mortgage Obligations	267,543	3.70
Total Mortgage Backed	<u>3,831,109</u>	4.71
<b>Corporate:</b>		
Corporate Bonds	3,655,568	8.73
Asset Backed Securities	150,927	1.95
Total Corporates	<u>3,806,495</u>	8.46
<b>Private Placements</b>	847,150	9.40
Total Domestic Fixed Income Investments	<u>8,873,083</u>	6.67
<b>Total Invested Assets</b>	<u><u>\$ 15,153,886</u></u>	
<b>Total Portfolio Effective Duration</b>		3.91

## Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Systems. The investment policy for credit quality of debt securities states that securities must bear an investment grade rating from at least two of the national rating agencies. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and disclosure is not required. Credit quality of cash reserves must carry a rating of A1/P1/F1 or D1 from at least two nationally recognized rating services. In the event that the rating of a security falls below investment grade, that security may continue to be held contingent upon an evaluation of the longer term investment merits of the security. As of June 30, 2007, the Systems' rated debt investments were rated by Standard & Poor's and are presented below:

### South Carolina Retirement Systems Credit Risk - S&P Quality Ratings June 30, 2007 (Amounts expressed in thousands)

Investment Type and Fair Value	AAA	AA	A	BBB	BB	B	A-1	NR
<b>Short Term Investments</b>								
Money Market Funds	\$ 343	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	2,314
Commercial Paper							313,109	
Repurchase Agreements							5,413,509	
<b>Domestic Fixed Income Investments</b>								
<b>U.S. Government:</b>								
U.S. Government Treasury Notes and Bonds	186,449							
U.S. Government Agencies	16,987							
<b>Mortgage Backed:</b>								
Government National Mortgage Association	4,188							
<b>Corporate:</b>								
Corporate Bonds	55,840	156,357	1,533,349	1,762,631	121,171	6,140		11,942
Asset Backed Securities	106,245		13,439	31,243				
Private Placements	50,447	138,622	357,197	242,948	2,996			54,941
<b>Totals</b>	<b>\$ 420,499</b>	<b>\$ 294,979</b>	<b>\$ 1,903,985</b>	<b>\$ 2,036,822</b>	<b>\$ 124,167</b>	<b>\$ 6,140</b>	<b>\$ 5,726,618</b>	<b>\$ 69,197</b>

## Concentration of Credit Risk – Investments

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Systems' policy for reducing this risk is to comply with the Statement of Investment Objectives as amended and adopted by the Retirement System Investment Commission which states that "Except for United States Treasury and Agency obligations, the fixed income portfolio shall contain no more than 5 percent exposure to any single issuer." At June 30, 2007, the Systems had approximately 18.43 percent of its investments in an overnight repurchase agreement with the Bank of Amer-

ica that was fully collateralized by United States Treasury and Agency obligations.

## Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The Systems participates in foreign markets to diversify assets, reduce risk and enhance returns. Exposure to foreign investments has, to date, been achieved synthetically using financial futures and forwards. Currency forwards are used to manage currency fluctuations and are permitted by investment policy. Policy, however, forbids speculating in forwards and other derivatives.

The table below presents the Systems' exposure to foreign currency risk in U.S. dollars as of June 30, 2007, (amounts expressed in thousands):

<u>Currency</u>	<u>Cash</u>	<u>Cash Equivalents</u>	<u>Forward Contracts</u>
Australian Dollar	\$ (1,849)	\$ 501	\$ 97,382
British Pound Sterling	2,278	(4,277)	431,236
Canadian Dollar	1,487	(1,980)	163,639
Euro Currency	17,785	(439)	1,558,815
Hong Kong Dollar	236	1,440	
Japanese Yen	(961)	(965)	689,183
<b>Totals</b>	<u>\$ 18,976</u>	<u>\$ (5,720)</u>	<u>\$ 2,940,255</u>

## Derivatives

Derivatives are financial instruments whose value is derived from underlying assets or data. They generally take the form of contracts in which two parties agree to make payments at a later date based on the value of the underlying assets or data. The main types of derivatives that are common in today's financial markets are futures, forwards, options, and swaps.

Futures are contractual obligations that require the buyer (seller) to buy (sell) assets

at a predetermined date at a predetermined price. These contracts are standardized and traded on an organized exchange with gains and losses settled daily thereby minimizing credit and default risk. To comply with the requirements of multiple exchanges, \$230 million in performance bonds (U.S. Treasury Bills) were held in trust by the clearing broker on June 30, 2007. These assets represent the required margin amount to establish the Systems' futures exposure. As of June 30, 2007, the Systems had the following exposure to futures contracts:

<b>Futures Contracts</b>	<b>Expiration</b>	<b>Long/Short</b>	<b>Quantity</b>	<b>Notional Value*</b>
MTF CAC40 10EU	July	Long	1,710	\$ 140,585,054
EURX DAX INDEX	September	Long	470	128,543,880
EURX ER STX 50	September	Long	7,181	439,061,636
NEW FTSE 100	September	Long	2,783	371,096,753
HKFE - HSI	July	Long	264	36,933,998
IBEX 35 PLUS	July	Long	250	50,186,652
IDEM S&P/MIB	September	Long	175	50,199,348
TSE TOPIX	September	Long	2,370	341,512,421
ME S&P CAN 60	September	Long	935	141,276,797
SFE SPI 200	September	Long	745	99,290,920
Total International Equity				<b>1,798,687,459</b>
CAN GOVT BOND	September	Long	227	23,611,920
EURX EUR-BOBL	September	Long	1,185	170,213,393
EURX EUR-BUND	September	Long	2,440	365,945,466
EURX E-SHATZ	September	Long	1,631	226,380,727
TSE 10 YR JGB	September	Long	325	348,297,207
LIF LONG GILT	September	Long	328	68,346,286
Total International Fixed Income				<b>1,202,794,999</b>
S&P 500 INDEX	September	Short	(546)	(206,852,100)
EMINI S&P 500	September	Short	(9,020)	(683,445,400)
Total Large Cap Equity				<b>(890,297,500)</b>
IMM MINI RUSL	September	Short	(181)	(15,242,010)
IMM EMINI MDCP	September	Short	(179)	(16,185,180)
Total Small/Mid Cap Equity				<b>(31,427,190)</b>
<b>Total</b>				<b>\$ 2,079,757,768</b>

\*Notional value is the nominal or face amount that is used to calculate payments made on derivative instruments (futures, forwards, swaps, etc.). This amount generally does not change hands and is thus referred to as notional. The notional amount represents the economic equivalent to an investment in the physical securities represented by the derivative contract.

Forwards are contractual obligations that require the delivery of assets at a fixed price on a predetermined date. These contracts are “over-the-counter” instruments, meaning they are not traded on an organized exchange. As of June 30, 2007, the Systems had the following forward exposures, listed by counterparty:

Broker	Notional Value*	Base Gain/(Loss)	Base Exposure
Morgan Stanley	\$ 575,904,132	\$ (790,588)	19.33%
Bank of America	557,858,984	416,872	18.72%
UBS	472,027,890	1,409,695	15.84%
Royal Bank of Scotland	407,330,990	1,877,430	13.67%
Brown Brothers Harriman	247,755,868	(1,007,170)	8.32%
HSBC	240,663,397	1,456,968	8.08%
Deutsche Bank	189,027,339	(535,063)	6.34%
Lehman Brothers	175,218,266	531,304	5.88%
State Street Global Advisors	92,860,890	584,292	3.12%
Goldman Sachs	20,966,030	27,505	0.70%
Totals	<u>\$ 2,979,613,786</u>	<u>\$ 3,971,245</u>	<u>100.00%</u>

\*Notional value is the nominal or face amount that is used to calculate payments made on derivative instruments (futures, forwards, swaps, etc.). This amount generally does not change hands and is thus referred to as notional. The notional amount represents the economic equivalent to an investment in the physical securities represented by the derivative contract.

Counterparty risk, or default risk, is the risk that either party will not honor its contractual obligations. The Systems seeks to actively manage its counterparty risk by thorough analysis and evaluation of all potential counterparties by investment staff and the independent overlay manager. Risk is further minimized through diversification among counterparties with high credit ratings.

As of June 30, 2007, the Systems was exposed to counterparty risk through currency forwards. The Systems, however, does not anticipate any default in our contractual positions.

### Limited Partnerships

To further diversify Systems assets, the Commission approved commitments in private equities. These investments are legally structured as limited partnerships. In this structure, the Systems is one of several limited partners, while the investment manager serves as the general partner. Investing in limited partnerships legally obligates the Systems to invest the committed amount until the investment is fully funded. As of June 30, 2007, the Systems had completed an initial funding of one limited partnership to Aquiline Capital Partners, LP, for \$25,900,000.

### Commitments

During the year and subsequent to year-end, the Systems entered into commitment agreements with numerous investment managers for future funding of various asset classes including private equity, hedge fund and global fixed income investments. There are varying degrees and understandings regarding the commitments across the individual managers. The total amount of investment commitments outstanding as of June 30, 2007 was \$6,457,850,000 (US dollars) and € 55,750,000 (Euros), with an additional amount of \$3,030,000,000 (US dollars) subsequent to year-end. The commitment agreements represent the Investment Commission’s continued reallocation and transition efforts for investments.

## Securities Lending

Through a custodial agent, SCRS, PORS, GARS, JSRS, and NGRS participate in a securities lending program whereby securities are loaned for the purpose of generating additional income to the Systems. The Systems lends securities from its investment portfolios on a collateralized basis to third parties, primarily financial institutions. The market value of the required collateral must initially meet or exceed 102 percent of the market value of the securities loaned, providing a margin against a decline in the market value of the collateral, and requires additional collateral if the collateral value falls below 100 percent.

There are no restrictions on the amount of securities that may be loaned. The types of securities available for loan during the year ended June 30, 2007, included U. S. Government securities, U. S. Government agencies, corporate bonds, convertible bonds, and equities. The contractual agreement with the Systems' custodial bank provides indemnification in the event the borrower fails to return the securities lent or fails to pay the Systems income distribution by the securi-

ties' issuers while the securities are on loan. Cash and U.S. Government securities were received as collateral for these loans. The Systems cannot pledge or sell collateral securities without a borrower default. The Systems invests cash collateral received; accordingly, investments made with cash collateral appear as an asset. A corresponding liability is recorded as the Systems must return the cash collateral to the borrower upon the expiration of the loan.

With regard to custodial credit risk, the Systems' cash collateral invested is held by the counterparty and is uninsured. All securities loaned can be terminated on demand by either the Systems or the borrower. At year end the average number of days the loans were outstanding was 21 days. The average weighted maturity of investments made with cash collateral was 23 days. At June 30, 2007, there had been no losses resulting from borrower defaults and the Systems had no credit risk exposure to borrowers because the amounts the Systems owed the borrowers exceeded the amounts the borrowers owed the Systems.

The following table presents the fair value (amounts expressed in thousands) of the underlying securities and the total collateral received for securities on loan at June 30, 2007.

	June 30, 2007						June 30, 2006
	SCRS	PORS	GARS	JSRS	NGRS	TOTALS	TOTALS
<b>Securities lent for cash collateral:</b>							
U.S. Government securities	\$ 282,335	\$ 41,811	\$ 542	\$ 1,671	\$ 214	\$ 326,573	\$ 374,764
U.S. Government agencies	2,779,436	411,604	5,335	16,454	2,102	3,214,931	2,528,371
Corporate bonds	23,198	3,435	45	137	18	26,833	48,679
Common Stock	1,202,491	178,076	2,308	7,118	910	1,390,903	1,303,745
Total securities lent for cash collateral	<u>\$ 4,287,460</u>	<u>\$ 634,926</u>	<u>\$ 8,230</u>	<u>\$ 25,380</u>	<u>\$ 3,244</u>	<u>\$ 4,959,240</u>	<u>\$ 4,255,559</u>
<b>Cash collateral invested as follows:</b>							
Repurchase agreements	\$ 876,952	\$ 129,867	\$ 1,683	\$ 5,191	\$ 664	\$ 1,014,357	\$ 522,114
Corporate bonds	2,008,446	297,428	3,856	11,890	1,519	2,323,139	1,821,270
Asset Backed Securities	1,215,006	179,929	2,332	7,193	919	1,405,379	1,475,260
Bank Notes	296,218	43,867	569	1,753	224	342,631	553,531
Total for cash collateral invested	<u>\$ 4,396,622</u>	<u>\$ 651,091</u>	<u>\$ 8,440</u>	<u>\$ 26,027</u>	<u>\$ 3,326</u>	<u>\$ 5,085,506</u>	<u>\$ 4,372,175</u>

Certain short-term, highly liquid securities, which were insured or registered by the Systems or in the Systems' name, with the date of maturity three months or less from the date of acquisition, are considered cash equivalents in accordance with Governmental Accounting Standards Board Statement 9. These investments at June 30, 2007, were composed of the following (amounts expressed in thousands):

### Cash Equivalents

	<u>Repurchase Agreements</u>	<u>Money Market Funds</u>	<u>Commercial Paper</u>	<u>Discount Notes</u>	<u>Totals 2007</u>	<u>Totals 2006</u>
SCRS	\$ 4,745,326	\$ 2,025	\$ 270,695	\$ 281,790	\$ 5,299,836	\$ 1,360,464
PORS	624,156	249	40,087	41,730	706,222	350,794
GARS	9,397	4	520	541	10,462	1,143
JSRS	25,825	11	1,602	1,668	29,106	6,121
NGRS	2,185		205	213	2,603	5,148
<b>Totals</b>	<u>\$ 5,406,889</u>	<u>\$ 2,289</u>	<u>\$ 313,109</u>	<u>\$ 325,942</u>	<u>\$ 6,048,229</u>	<u>\$ 1,723,670</u>

The Systems maintains a portfolio of short-term securities in order to actively manage all funds waiting to be placed in a more permanent investment. As of June 30, 2007, the Systems held the following short-term investments with maturities three months or less from the date of acquisition (amounts expressed in thousands):

### Short-term Securities

	<u>Forward Contracts</u>	<u>U.S. Treasury Bills</u>	<u>Totals 2007</u>	<u>Totals 2006</u>
SCRS	\$ 2,267	\$ 199,428	\$ 201,695	\$ 49,643
PORS	289	26,379	26,668	4,990
GARS	4	403	407	
JSRS	12	1,104	1,116	
NGRS	1	85	86	
<b>Total</b>	<u>\$ 2,573</u>	<u>\$ 227,399</u>	<u>\$ 229,972</u>	<u>\$ 54,633</u>

Effective May 26, 1998, legislation was passed implementing the 1996 public vote amending the State Constitution to allow the Retirement Systems to invest in equity securities. This legislation established a five-member investment panel responsible for defining and developing the investment objectives and the types of equity investments to be purchased. The Act also specified that a maximum of 40 percent of assets may be invested in equities.

During fiscal year 2005, the South Carolina General Assembly passed Act 153, the State Retirement System Preservation and Investment Reform Act, which became effective July 1, 2005. This Act established a six-member Investment Commission made up of financial experts, the State Treasurer, and a nonvoting retired member. Fiduciary responsibility for all investments was moved to the Commission. Act 153 also created the position of chief investment officer and stated that equity investments cannot exceed 70 percent of the total portfolio.

As of June 30, 2007, the Retirement Systems' assets were invested in domestic equities as follows (amounts expressed in thousands):

### Equity Investments

	Common Trust Funds					
	S&P 500 Index Fund	Russell 2000 Index Fund	Barclays Global Investors	Common Stock	Totals 2007	Totals 2006
<b>SCRS</b>	\$ 6,438,669	\$ 405,155	\$ 504,716	\$ 4,319,996	\$ 11,668,536	\$ 12,004,816
<b>PORS</b>	768,696	48,071	60,261	521,160	1,398,188	1,437,296
<b>GARS</b>	12,005	475	984	9,050	22,514	25,106
<b>JSRS</b>	33,214	2,076	2,604	22,325	60,219	61,871
<b>NGRS</b>	5,576	1,434	261	-	7,271	-
<b>Total</b>	\$ 7,258,160	\$ 457,211	\$ 568,826	\$ 4,872,531	\$ 13,156,728	\$ 13,529,089

The Systems retains a consultant to provide investment consulting services necessary to fulfill the duties for investing the Systems' portfolio. As of June 30, 2007, individual agreements were in place between the Systems and 19 investment managers.

On June 30, 2007, the Systems held collateralized mortgage obligations (CMOs) in its portfolios. The CMOs consist of the planned amortizations class-1 (PAC-1) and the very accurately defined maturity (VADM) tranches of these issues. The PAC-1 and VADM tranche CMO structure securities were entered into for several reasons: (1) to protect the Retirement Systems' portfolios from principal prepayment risk during an environment of declining interest rates, (2) to provide incremental yield above that available on corporate securities with similar terms, (3) to provide diversification in the portfolios, (4) to maintain the high quality of government-sponsored credits in the portfolios, and (5) to utilize the estimated future term cash flows provided by these securities to match the term of the liabilities of the Retirement Systems. These securities are all rated AAA by the major rating agencies. The PAC-1 and VADM structures are highly marketable securities.

The Systems held the following CMOs included in the financial and other category (amounts expressed in thousands):

#### Collateral Mortgage Obligations (CMOs)

	June 30, 2007	June 30, 2006
	<u>Fair Value</u>	<u>Fair Value</u>
SCRS	\$ 224,739	\$ 265,678
PORS	33,281	23,194
GARS	431	134
JSRS	1,331	106
NGRS	170	-
<b>Total</b>	<u>\$ 259,952</u>	<u>\$ 289,112</u>

On June 30, 2007, the Systems also held asset-backed securities in its portfolios. These securities had an average life of one to three years with a legal final maturity of two to five years. These securities represent an undivided ownership interest in a trust consisting of auto loan receivables. These securities are rated AAA by the major rating agencies. In addition, under the asset-backed securities category, the Systems held bonds issued by the South Carolina Tobacco Settlement Revenue Management Authority. These securities are rated Baa2/BBB and have an average life of 4.12 years with a legal maturity of 2016.

The Systems held the following asset-backed securities included in the financial and other category (amounts expressed in thousands):

#### Asset Backed Securities

	June 30, 2007	June 30, 2006
	<u>Fair Value</u>	<u>Fair Value</u>
SCRS	\$ 136,521	\$ 137,609
PORS	20,217	24,299
GARS	262	621
JSRS	808	1,764
NGRS	103	495
<b>Total</b>	<u>\$ 157,911</u>	<u>\$ 164,788</u>

In addition to CMOs and asset-backed securities, the financial and other category primarily consisted of corporate financial paper as follows (amounts expressed in thousands):

#### Corporate Financial Paper

	June 30, 2007	June 30, 2006
	<u>Fair Value</u>	<u>Fair Value</u>
SCRS	\$ 751,540	\$ 1,112,379
PORS	111,295	145,909
GARS	1,443	2,281
JSRS	4,449	5,469
NGRS	569	2,024
<b>Total</b>	<u>\$ 869,296</u>	<u>\$ 1,268,062</u>

## IV. Capital Assets

Capital assets at June 30, 2007, consist of the following amounts (expressed in thousands). There were no additions or dispositions of capital assets during the year.

	<u>SCRS</u>	<u>PORS</u>	<u>GARS</u>	<u>JSRS</u>	<u>TOTALS</u>	<u>TOTALS</u> <u>2006</u>
Land	\$ 524	\$ 54	\$ 1	\$ 3	\$ 582	\$ 582
Building	4,279	437	13	20	4,749	4,749
Total Capital Assets	<u>4,803</u>	<u>491</u>	<u>14</u>	<u>23</u>	<u>5,331</u>	<u>5,331</u>
Less: Accumulated Depreciation	<u>(1,580)</u>	<u>(162)</u>	<u>(4)</u>	<u>(8)</u>	<u>(1,754)</u>	<u>(1,635)</u>
Net Capital Assets	<u>\$ 3,223</u>	<u>\$ 329</u>	<u>\$ 10</u>	<u>\$ 15</u>	<u>\$ 3,577</u>	<u>\$ 3,696</u>

## V. Transfers Between Systems

Transfers between systems are statutorily authorized transfers of contributions and service credit from one retirement system to another retirement system that result from members voluntarily initiating the transfer when certain conditions are met.

Transfers made during the fiscal year ended June 30, 2007, were as follows (amounts expressed in thousands):

Transfers from	Transfers to					
	<u>SCRS</u>	<u>PORS</u>	<u>GARS</u>	<u>JSRS</u>	<u>NGRS</u>	<u>Totals</u>
SCRS	\$ -	\$ 1,614	\$ 52	\$ 79	\$ -	\$ 1,745
PORS						-
GARS						-
JSRS						-
NGRS						-
<b>Totals</b>	<u>\$ -</u>	<u>\$ 1,614</u>	<u>\$ 52</u>	<u>\$ 79</u>	<u>\$ -</u>	<u>\$ 1,745</u>

The following schedule reflects amounts due to or from other systems as of June 30, 2007, (amounts expressed in thousands):

Due from	Due to					
	<u>SCRS</u>	<u>PORS</u>	<u>GARS</u>	<u>JSRS</u>	<u>NGRS</u>	<u>Totals</u>
SCRS	\$ -	\$ 346	\$ -	\$ 70	\$ -	\$ 416
PORS	170		4			174
GARS	15			66		81
JSRS						-
NGRS						-
<b>Totals</b>	<u>\$ 185</u>	<u>\$ 346</u>	<u>\$ 4</u>	<u>\$ 136</u>	<u>\$ -</u>	<u>\$ 671</u>

## VI. Related Party Transactions

The pension plans provide pension and other fringe benefits to employees of all state agencies. Revenues attributed to these agencies are recorded in the financial statements as employee and employer contributions and constitute approximately 34 percent of combined contribution revenues. In addition, the Systems receives custodial and related services from the State Treasurer.

At June 30, 2007, liabilities of approximately \$34.3 million were due to other state departments and agencies, and contributions receivable of approximately \$18.67 million were due from other state departments and agencies.

The National Guard Retirement System received state-appropriated contributions in the amount of \$3.9 million during the fiscal year. This amount was made up of the annual required contribution plus \$926,000 to fund the reopening of the plan effective January 1, 2007, to guardsmen who became members of the South Carolina National Guard after June 30, 1993. In addition, the Systems received state appropriations in the amount of \$50,000 to cover some of the costs associated with the administration of the plan.

As discussed in Note III, the Retirement System Investment Commission was established

by Act 153 with an effective date of October 1, 2005. The Investment Commission is considered a separate state agency; however, the expenses of the Commission are funded by transfers from the Systems. Transfers in the amount of approximately \$2.3 million were made to the Commission during the fiscal year.

## VII. Teacher and Employee Retention Incentive Program

The Teacher and Employee Retention Incentive (TERI) program, implemented effective January 1, 2001, is a deferred retirement option plan available to active SCRS members eligible for service retirement on or after January 1, 2001. When a member enters TERI, the member's status changes from an active member to a retiree even though the employee continues to work at his regular job and earn his regular salary for a period of up to five years. TERI participants who entered the program after June 30, 2005, must continue to contribute at the same rate as active members. Those who entered prior to July 1, 2005, make no employee contributions while participating in TERI. No additional service credit is earned during this period and participants are ineligible for disability retirement benefits. During the TERI participation period, the retiree's monthly benefits are accrued and accumulate in the trust account. Upon termination of employment or at the end of the TERI period (whichever is earlier), the retiree may elect to roll over his funds into a qualified, tax-sheltered, retirement plan or to receive a single-sum distribution (or a combination thereof). No interest is paid on the participant funds accumulated in the TERI account.

A total of 9,049 members were actively participating in the TERI program at June 30, 2007. The activity for this program is reflected in the following schedule:

### Schedule of TERI Activity Year Ended June 30, 2007 (Amounts expressed in thousands)

Beginning Liability Balance	\$ 670,527
Additions	240,580
TERI Distributions	<u>(269,357)</u>
Ending Liability Balance	<u>\$ 641,750</u>

## VIII. Litigation

1. *Howard Duvall v. South Carolina Budget and Control Board, South Carolina Retirement Systems*, 03-ALJ-30-0448, is an appeal from a contested case in the Administrative Law Court. The Petitioner is the Executive Director of the Municipal Association of South Carolina, who received payment for excess annual leave (above the allowable 45 days). The Retirement Systems excluded these payments from the Petitioner's average final compensation for determining retirement benefits. The Administrative Law Judge agreed with the Retirement Systems and the Petitioner filed an appeal to the Court of Commons Pleas for Richland County. The Circuit Court ruled in favor of the Retirement Systems and Petitioner has appealed to the South Carolina Court of Appeals. After briefs were served and filed with the Court of Appeals by both parties, the Supreme Court took the case. We are awaiting notice from the Supreme Court regarding when they will decide the matter. If the Petitioner prevails in the appeal, his monthly retirement benefit would increase significantly retroactive to October 1, 2003. The Board and the Retirement Systems vigorously oppose the appeal and will seek to have the decision by the Circuit Court affirmed. A favorable outcome is expected.

2. *Nancy Layman et al. v. South Carolina Retirement System and the State of South Carolina*, Case Number 05-CP-40-2785. In May, 2006, the Supreme Court ruled that Act 153, which had been enacted by the General Assembly in 2005, and which required certain retirees, including participants in the Teacher and Employee Retention Incentive (TERI) program, to remit employee contributions to the Retirement Systems, violated the contract rights of the TERI participants who were in the program on or before June 30, 2005. The Supreme Court ordered that all contributions from the TERI participants that had been collected since July 1, 2005, should be refunded, with interest, and that no future contributions from the TERI participants be collected. The Supreme Court remanded to the trial court the question of whether the Retirement Systems is liable for Plaintiffs' attorneys' fees. The trial court awarded \$8.66 million in favor of the Plaintiffs' attorneys. The Retirement Systems has appealed, as have the Plaintiffs. The Plaintiffs claim that the trial court erred in not awarding fees of approximately \$20 million. The Retirement Systems' position with regard to this unprecedented award is that no fees should have been shifted to the State or the agency as our defense of the Plaintiffs' claims was substantially justified and, in the alternative, the amount of the award is unreasonable. Oral arguments before the Supreme Court in the fee matter were held on September 19, 2007.

2(a). As part of the *Layman* decision, the Supreme Court also remanded the claims of persons enrolled in the "working retiree program" for determination by the trial court, although the Supreme Court found that the statute creating the working retiree program did not create a contract between the state and the participants in that program. Discovery regarding these issues is underway, and it is premature to estimate any potential loss associated with them. However, as of August 20, 2007, the Retirement Systems had collected approximately \$20.4 million

in the form of retirement contributions from members of the South Carolina Retirement System who retired prior to July 1, 2005, and returned to work. If the Plaintiffs were to prevail, these contributions would be refunded to the members and no future contributions could be collected from them. The Retirement Systems intends to vigorously contest these claims.

3. *Arnold et al. v. the South Carolina Police Officers Retirement System, the South Carolina Retirement System and the State of South Carolina*, Civil Action Number 2005-CP-22-756, is a putative class action case, filed on August 9, 2005, alleging that provisions in Act 153 requiring working retirees in the Police Officers Retirement System and the South Carolina Retirement System to make employee contributions are unconstitutional and illegal. Specifically, the plaintiffs allege that the provisions of Act 153 requiring working retirees to make contributions impairs contractual rights, constitutes an unlawful taking of property, and violates due process. Plaintiffs seek a declaration that provisions in Act 153 affecting members who retired prior to July 1, 2005, are unconstitutional, an injunction enjoining the defendants from collecting employee contributions from plaintiffs, and a refund of all contributions paid by working retirees under Act 153, including attorney's fees. As of August 20, 2007, the Retirement Systems had collected approximately \$6.4 million in the form of retirement contributions from members of the South Carolina Police Officers Retirement System who retired prior to July 1, 2005 and returned to work. If the plaintiffs were to prevail, these contributions would be refunded to the members of the Police Officers Retirement System and no future contributions could be collected from them. (See 2(a) for an explanation of the South Carolina Retirement System's exposure). The defendants believe their defense is meritorious and will vigorously contest the case.

# South Carolina Retirement Systems Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuations as of the dates indicated.

## Schedule of Funding Progress (Amounts expressed in thousands)

Actuarial Valuation Date	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)
<b>SCRS</b>						
7/01/06	\$22,293,446	\$32,018,519	\$9,725,073	69.6%	\$6,733,379	144.4%
7/01/05	21,625,510	30,217,471	8,591,961	71.6%	6,356,489	135.2%
7/01/04	20,862,659	25,977,852	5,115,193	80.3%	6,180,599	82.8%
7/01/03	20,197,936	24,398,931	4,200,995	82.8%	6,240,768	67.3%
7/01/02	19,298,174	22,446,574	3,148,400	86.0%	6,147,712	51.2%
7/01/01	18,486,773	21,162,147	2,675,374	87.4%	6,017,537	44.5%
<b>PORS</b>						
7/01/06	2,935,841	3,466,281	530,440	84.7%	931,815	56.9%
7/01/05	2,774,606	3,173,930	399,324	87.4%	850,610	46.9%
7/01/04	2,616,835	2,984,584	367,749	87.7%	822,448	44.7%
7/01/03	2,511,369	2,744,849	233,480	91.5%	800,394	29.2%
7/01/02	2,351,100	2,527,876	176,776	93.0%	757,393	23.3%
7/01/01	2,197,982	2,324,257	126,275	94.6%	757,335	16.7%
<b>GARS</b>						
7/01/06	46,075	69,734	23,659	66.1%	3,854	613.9%
7/01/05	46,316	69,161	22,845	67.0%	3,853	592.9%
7/01/04	45,087	68,332	23,245	66.0%	3,839	605.5%
7/01/03	44,682	66,619	21,937	67.1%	3,844	570.8%
7/01/02	43,841	73,046	29,205	60.0%	4,515	646.9%
7/01/01	42,788	68,291	25,503	62.7%	4,761	535.6%
<b>JSRS</b>						
7/01/06	124,837	211,384	86,547	59.1%	15,929	543.3%
7/01/05	118,888	204,847	85,959	58.0%	15,465	555.8%
7/01/04	112,016	185,052	73,036	60.5%	14,870	491.2%
7/01/03	106,114	166,655	60,541	63.7%	14,437	419.3%
7/01/02	100,074	166,440	66,366	60.1%	14,211	467.0%
7/01/01	94,795	159,246	64,451	59.5%	14,109	456.8%
<b>NGRS</b>						
7/01/06	14,046	48,755	34,709	28.8%	N/A	N/A
6/30/05	12,151	46,985	34,835	25.9%	N/A	N/A
6/30/04	13,567	47,281	33,714	28.7%	N/A	N/A
6/30/02	12,608	44,678	32,069	28.2%	N/A	N/A
6/30/00*	11,089	43,427	32,338	25.5%	N/A	N/A
6/30/98	8,640	41,478	32,839	20.8%	N/A	N/A
6/30/96	6,259	36,756	30,497	17.0%	N/A	N/A

\*As of April 30, 2000

# South Carolina Retirement Systems Required Supplementary Information (continued)

## Schedule of Employer Contributions (Amounts expressed in thousands)

Year Ended June 30,	SCRS		PORS		GARS		JSRS		NGRS	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Pension Cost <sup>1</sup>	Percentage Contributed
2007	\$644,350	100%	\$106,753	100%	\$2,358	100%	\$6,706	100%	\$3,948	130.6%
2006	577,468	100%	100,281	100%	2,171	100%	6,511	100%	2,969	132.8%
2005	538,809	100%	90,528	100%	2,890	100%	6,260	100%	2,887	69.2%
2004	515,996	100%	87,922	100%	2,731	100%	6,078	100%	2,796	71.4%
2003	512,345	100%	86,563	100%	2,577	100%	6,014	100%	2,804	71.2%
2002	509,044	100%	88,608	100%	2,627	100%	5,993	100%	2,938	72.6%

<sup>1</sup>The Annual Pension Cost (APC) for the National Guard Retirement System includes both the Annual Required Contribution (ARC) and the discounted present value of the balance of the net pension obligation.

## Notes to Required Supplementary Information

Additional information as of the latest actuarial valuations follows.

### Actuarial Assumptions and Methods

	SCRS	PORS	GARS	JSRS	NGRS
Valuation date	07/01/06	07/01/06	07/01/06	07/01/06	07/01/06
Actuarial cost method	Entry age				
Amortization period	Level percent open	Level percent open	Level percent closed	Level percent open	Level dollar open
Remaining amortization period	30 years	18 years	19 years	29 years	30 years
Asset valuation method	5-year smoothed market				
Actuarial assumptions:					
Investment rate of return	7.25%	7.25%	7.25%	7.25%	7.25%
Projected salary increases	4.00% - 8.00%	4.50% - 11.50%	None	3.25%	None
Includes inflation at	3.00%	3.00%	3.00%	3.00%	3.00%
Cost-of-living adjustments	Automatic 1% <sup>2</sup>	None	None	3.25%	None

<sup>2</sup>Beginning the July 1st following one year of receiving benefits, the monthly benefit amount will increase by the calendar year change in CPI but not to exceed 1 percent. Additional ad hoc COLAs may be paid as approved by the State Budget and Control Board and based upon the financial condition of the System.

**South Carolina Retirement Systems**  
**Schedule of Changes in Plan Net Assets**  
**SCRS Pension Trust Fund**  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	EMPLOYEE FUND	EMPLOYER FUND	GROUP LIFE FUND	TOTALS	TOTALS 2006
<b>Additions</b>					
Employee contributions					
State department employees	\$ 155,481	\$ 7,003		\$ 162,484	\$ 169,870
Public school employees	208,029	16,991		225,020	219,093
Other political subdivision employees	114,331	3,287		117,618	109,482
Employer contributions					
State department employees		210,108	\$ 4,371	214,479	194,626
Public school employees		280,667	5,423	286,090	254,878
Other political subdivision employees		141,514	2,267	143,781	127,964
Total contributions	<u>477,841</u>	<u>659,570</u>	<u>12,061</u>	<u>1,149,472</u>	<u>1,075,913</u>
Investment Income					
Net appreciation (depreciation) in fair value of investments		2,294,350	12,328	2,306,678	519,348
Interest and dividend income		710,540	3,812	714,352	632,106
Investment expense		(31,817)	(171)	(31,988)	(26,458)
Net income from investing activities		<u>2,973,073</u>	<u>15,969</u>	<u>2,989,042</u>	<u>1,124,996</u>
From securities lending activities:					
Securities lending income		253,111	1,360	254,471	171,278
Securities lending expense		(242,998)	(1,306)	(244,304)	(161,635)
Net income from securities lending activities		<u>10,113</u>	<u>54</u>	<u>10,167</u>	<u>9,643</u>
Total net investment income		<u>2,983,186</u>	<u>16,023</u>	<u>2,999,209</u>	<u>1,134,639</u>
Supplemental retirement benefits funded by the State		1,532		1,532	1,741
Transfers of contributions from other Systems					13
Total additions	<u>477,841</u>	<u>3,644,288</u>	<u>28,084</u>	<u>4,150,213</u>	<u>2,212,306</u>
<b>Deductions</b>					
Refunds of contributions to members	77,212			77,212	108,569
Transfers of contributions to other Systems	1,166	579		1,745	3,233
Regular retirement benefits		1,505,080		1,505,080	1,316,123
Deferred retirement benefits		240,580		240,580	321,374
Supplemental retirement benefits		1,532		1,532	1,741
Group life insurance claims			15,948	15,948	14,875
Depreciation		107		107	107
Administrative expense		16,314	88	16,402	15,205
Total deductions	<u>78,378</u>	<u>1,764,192</u>	<u>16,036</u>	<u>1,858,606</u>	<u>1,781,227</u>
Interfund transfers according to statutory requirements					
Contributions by members at retirement	(361,671)	361,671			
Interest credited to members' accounts	197,789	(197,789)			
Net interfund transfers	<u>(163,882)</u>	<u>163,882</u>			
Net increase	235,581	2,043,978	12,048	2,291,607	431,079
Net assets held in trust for Pension Benefits					
Beginning of year	5,229,175	16,903,463	118,924	22,251,562	21,820,483
End of year	<u>\$ 5,464,756</u>	<u>\$ 18,947,441</u>	<u>\$ 130,972</u>	<u>\$ 24,543,169</u>	<u>\$ 22,251,562</u>

**South Carolina Retirement Systems**  
**Schedule of Changes in Plan Net Assets**  
**PORS Pension Trust Fund**  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	EMPLOYEE FUND	EMPLOYER FUND	GROUP LIFE FUND	ACCIDENTAL DEATH FUND	TOTALS	TOTALS 2006
<b>Additions</b>						
Employee contributions						
State department employees	\$ 25,346	\$ 1,171			\$ 26,517	\$ 24,898
Public school employees	34	122			156	166
Other political subdivision employees	41,174	2,794			43,968	42,330
Employer contributions						
State department employees		38,181	\$ 740	\$ 740	39,661	37,310
Public school employees		210	4	4	218	174
Other political subdivision employees		64,526	1,210	1,138	66,874	62,797
Total contributions	66,554	107,004	1,954	1,882	177,394	167,675
Investment Income						
Net appreciation (depreciation) in fair value of investments		272,118	2,175	2,644	276,937	61,997
Interest and dividend income		98,437	785	953	100,175	79,680
Investment expense		(3,853)	(31)	(37)	(3,921)	(3,190)
Net income from investing activities		366,702	2,929	3,560	373,191	138,487
From securities lending activities:						
Securities lending income		35,747	286	347	36,380	22,411
Securities lending expense		(34,340)	(274)	(334)	(34,948)	(21,113)
Net income from securities lending activities		1,407	12	13	1,432	1,298
Total net investment income		368,109	2,941	3,573	374,623	139,785
Supplemental retirement benefits funded by the State		55			55	60
Transfers of contributions from other Systems	1,035	579			1,614	3,026
Total additions	67,589	475,747	4,895	5,455	553,686	310,546
<b>Deductions</b>						
Refunds of contributions to members	12,543				12,543	13,248
Transfers of contributions to other Systems						
Regular retirement benefits		180,135			180,135	165,834
Supplemental retirement benefits		55			55	60
Group life insurance claims			1,919		1,919	1,821
Accidental death benefits				1,198	1,198	1,183
Depreciation		11			11	11
Administrative expense		2,130	17	21	2,168	1,957
Total deductions	12,543	182,331	1,936	1,219	198,029	184,114
Interfund transfers according to statutory requirements						
Contributions by members at retirement	(42,520)	42,520				
Interest credited to members' accounts	23,489	(23,489)				
Net interfund transfers	(19,031)	19,031				
Net increase	36,015	312,447	2,959	4,236	355,657	126,432
Net assets held in trust for Pension Benefits						
Beginning of year	622,008	2,275,010	23,156	28,150	2,948,324	2,821,892
End of year	\$ 658,023	\$ 2,587,457	\$ 26,115	\$ 32,386	\$ 3,303,981	\$ 2,948,324

**South Carolina Retirement Systems**  
**Schedule of Changes in Plan Net Assets**  
**GARS Pension Trust Fund**  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	EMPLOYEE FUND	EMPLOYER FUND	TOTALS	TOTALS 2006
<b>Additions</b>				
Contributions				
Employee contributions - State departments	\$ 551		\$ 551	\$ 543
Employer contributions - State departments		\$ 2,358	2,358	2,171
Total contributions	551	2,358	2,909	2,714
Investment Income				
Net appreciation (depreciation) in fair value of investments		4,559	4,559	657
Interest and dividend income		1,436	1,436	1,472
Investment expense		(66)	(66)	(54)
Net income from investing activities		5,929	5,929	2,075
From securities lending activities:				
Securities lending income		527	527	217
Securities lending expense		(506)	(506)	(206)
Net income from securities lending activities		21	21	11
Total net investment income		5,950	5,950	2,086
Transfers of contributions from other Systems	52		52	41
Total additions	603	8,308	8,911	4,841
<b>Deductions</b>				
Refunds of contributions to members	70		70	
Transfers of contributions to other Systems				65
Regular retirement benefits		5,935	5,935	5,726
Group life insurance claims		5	5	17
Depreciation				
Administrative expense		34	34	33
Total deductions	70	5,974	6,044	5,841
Interfund transfers according to statutory requirements				
Contributions by members at retirement	(1,194)	1,194		
Interest credited to members' accounts	302	(302)		
Net interfund transfers	(892)	892		
Net increase (decrease)	(359)	3,226	2,867	(1,000)
Net assets held in trust for Pension Benefits				
Beginning of year	8,094	37,585	45,679	46,679
End of year	\$ 7,735	\$ 40,811	\$ 48,546	\$ 45,679

**South Carolina Retirement Systems**  
**Schedule of Changes in Plan Net Assets**  
*JSRS Pension Trust Fund*  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	EMPLOYEE FUND	EMPLOYER FUND	TOTALS	TOTALS 2006
<b>Additions</b>				
Contributions				
Employee contributions - State departments	\$ 1,705		\$ 1,705	\$ 1,526
Employer contributions - State departments		\$ 6,706	6,706	6,511
Total contributions	<u>1,705</u>	<u>6,706</u>	<u>8,411</u>	<u>8,037</u>
Investment Income				
Net appreciation (depreciation) in fair value of investments		11,915	11,915	2,139
Interest and dividend income		4,209	4,209	3,711
Investment expense		(167)	(167)	(135)
Net income from investing activities		<u>15,957</u>	<u>15,957</u>	<u>5,715</u>
From securities lending activities:				
Securities lending income		1,523	1,523	910
Securities lending expense		(1,463)	(1,463)	(864)
Net income from securities lending activities		<u>60</u>	<u>60</u>	<u>46</u>
Total net investment income		<u>16,017</u>	<u>16,017</u>	<u>5,761</u>
Transfers of contributions from other Systems	79		79	218
Total additions	<u>1,784</u>	<u>22,723</u>	<u>24,507</u>	<u>14,016</u>
<b>Deductions</b>				
Refunds of contributions to members				20
Regular retirement benefits		10,348	10,348	9,677
Group life insurance claims		381	381	124
Depreciation		1	1	
Administrative expense		91	91	83
Total deductions		<u>10,821</u>	<u>10,821</u>	<u>9,904</u>
Interfund transfers according to statutory requirements				
Contributions by members at retirement	(5,326)	5,326		
Interest credited to members' accounts	684	(684)		
Net interfund transfers	<u>(4,642)</u>	<u>4,642</u>		
Net increase (decrease)	(2,858)	16,544	13,686	4,112
Net assets held in trust for Pension Benefits				
Beginning of year	<u>21,857</u>	<u>101,648</u>	<u>123,505</u>	<u>119,393</u>
End of year	<u>\$ 18,999</u>	<u>\$ 118,192</u>	<u>\$ 137,191</u>	<u>\$ 123,505</u>

**South Carolina Retirement Systems**  
**Schedule of Changes in Plan Net Assets**  
*NGRS Pension Trust Fund*  
**Year Ended June 30, 2007**  
**With comparative totals for the year ended June 30, 2006**  
*(Amounts expressed in thousands)*

	<b>TOTALS</b> <b>2007</b>	<b>TOTALS</b> <b>2006</b>
<b>Additions</b>		
Contributions		
State appropriated contributions	\$ 3,948	\$ -
Total contributions	3,948	-
Investment Income		
Net appreciation (depreciation) in fair value of investments	1,270	(253)
Interest income	727	342
Investment expense	(5)	
Income from investing activities	1,992	89
From securities lending activities:		
Securities lending income	224	7
Securities lending expense	(214)	(7)
Net income from securities lending activities	10	-
Total net investment income	2,002	89
State Appropriation for Administrative Expenses	50	300
Total additions	6,000	389
<b>Deductions</b>		
Regular retirement benefits	2,926	1,371
Administrative charges	59	204
Total deductions	2,985	1,575
Net increase (decrease) before transfer	3,015	(1,186)
Transfer from the State Adjutant General's Office	-	14,064
Net increase	3,015	12,878
Net assets held in trust for Pension Benefits		
Beginning of year	12,878	-
End of year	\$ 15,893	\$ 12,878

## Schedule of Administrative Expenses

### For the Year Ended June 30, 2007

*(Amounts expressed in thousands)*

	SCRS	PORS	GARS	JSRS	NGRS	TOTALS
<b>Personal Services</b>						
Salaries and Wages	\$ 7,396	\$ 978	\$ 15	\$ 41	\$ 4	\$ 8,434
Employee Benefits	1,991	263	4	11	1	2,270
<b>Contractual Services</b>						
Data Processing Services	1,404	186	3	8	16	1,617
Medical & Health Services	636	84	1	4	1	726
Financial Audit	27	4			3	34
Actuarial Services	232	31	1	1	32	297
Other Professional Services	133	18		1		152
Legal Services	258	34	1	1		294
<b>Operating Expenses</b>						
Facilities Management	380	50	1	2		433
Intergovernmental Services	566	75	1	3		645
Transfers to Investment Commission	2,029	268	4	11	1	2,313
Telephone	89	11		1		101
Insurance	42	5		1		48
Postage	379	50	1	2		432
Supplies	213	28	1	1		243
<b>Other Miscellaneous Expenses</b>	627	83	1	3	1	715
	<u>\$ 16,402</u>	<u>\$ 2,168</u>	<u>\$ 34</u>	<u>\$ 91</u>	<u>\$ 59</u>	<u>\$ 18,754</u>

## Schedule of Professional and Consultant Fees

### For the Year Ended June 30, 2007

*(Amounts expressed in thousands)*

Professional/Consultant	Nature of Service	Amounts
Adobe Systems	IT Maintenance & Support	\$ 11
Alphanumeric Systems	IT Maintenance	31
Beeline.com	Application Development Resources	753
Cavanaugh Macdonald Consulting	Actuary Services	32
Cost Effectiveness Measurement	Benchmarking Services	35
Document Systems Inc.	IT Tape Storage & Imaging Records Storage	17
EMC Corp	IT Maintenance & Support	29
Gergel Nickles & Solomon PA	Legal Services	9
Helma Bernardini	IT Maintenance	11
Hewlett Packard	IT Equipment & Maintenance	125
Hollenbeck & Associates LLC	Disability Case Evaluations	22
Leonard & Associates	Disability Case Evaluations	16
Liebert Corp	IT Maintenance & Support	11
Milliman USA	Actuary Services	266
Oracle Corp	Database License & Support Maintenance	24
Piggly Wiggly Carolina Co Inc (Tri-State Printing)	Printing - Popular Annual Financial Report	31
Professional Printers	Printing - Comprehensive Annual Financial Report	7
Psychological & Training Services	Disability Case Evaluations	14
Rogers & Laban	Financial Audit	34
SAP Public Services	SAP Software Licenses & Maintenance	10
Software AG Inc.	IT Enterprise License & Maintenance	65
Southern Imaging Group	Annual Member Statements	40
Sowell Gray Stepp & Laffitte	Attorney Fees	276
Summit Strategies Inc	Optional Retirement Plan Consultants	65
Sunguard Availability Service	IT Disaster Recovery	24
TeamIA Inc	Imaging Maintenance/Auditing	179
The RL Bryan Co	Printing - Member Handbooks	24
Vocational Rehabilitation	Disability Case Evaluations	726
		<u>\$ 2,887</u>

**South Carolina Retirement Systems**  
**Schedule of Investment Fees and Expenses**  
**Year Ended June 30, 2007**  
*(Amounts expressed in thousands)*

	SCRS	PORS	GARS	JSRS	NGRS	TOTALS
<b>Equity Investment Managers Fees:</b>						
AllianceBernstein, LP (Large Cap Value) <sup>1</sup>	\$ 938	\$ 110	\$ 2	\$ 5		\$ 1,055
AllianceBernstein, LP (Large Cap Growth) <sup>1</sup>	337	41	1	1		380
Aquiline Capital Partners, LLC <sup>2</sup>	2,101	275	4	12	\$ 1	2,393
Barclays Global Investors, N.A.	1,256	150	2	6	1	1,415
Batterymarch Financial Management, Inc.	1,230	145	3	6		1,384
Wells Capital Management, Inc. (Benson Value Team)	2,110	257	5	11		2,383
ClariVest Asset Management, LLC	1,088	128	2	6		1,224
Fidelity Management Trust Company	2,266	270	5	11		2,552
Flippin, Bruce & Porter, Inc. <sup>3</sup>	696	83	1	4		784
Integrity Asset Management, LLC	878	103	2	4		987
Legg Mason Capital Management, Inc.	1,439	176	3	7		1,625
Pzena Investment Management, LLC	1,750	215	4	9		1,978
Russell Investment Group <sup>4</sup>	82	10		1		93
Sands Capital Management, LP <sup>5</sup>	1,514	185	3	8		1,710
State Street Global Advisors Russell 2000 Index Fund	134	16		1		151
State Street Global Advisors S&P 500 Index Fund	165	20	1	1		187
TimesSquare Capital Management, LLC	2,355	287	5	12		2,659
Thompson, Siegel & Walmsley, Inc.	1,405	165	3	7		1,580
Turner Investment Partners, Inc.	1,556	182	3	8		1,749
WCM Investment Management	2,447	300	5	13		2,765
Wellington Management Company, LLP <sup>6</sup>	2,672	320	5	14		3,011
Totals	28,419	3,438	59	147	2	32,065
<b>Investment Expenses:</b>						
Limited Partnership Expenses	2,195	287	4	12	2	2,500
Bank Fees	1,374	196	3	8	1	1,582
Totals	\$ 31,988	\$ 3,921	\$ 66	\$ 167	\$ 5	\$ 36,147
<b>Securities Lending Expenses:</b>						
Borrower Rebates	\$ 244,304	\$ 34,948	\$ 506	\$ 1,463	\$ 214	\$ 281,435
<b>Total Investment Fees and Expenses</b>	\$ 276,292	\$ 38,869	\$ 572	\$ 1,630	\$ 219	\$ 317,582

<sup>1</sup>The contract with AllianceBernstein, LP (large cap value and large cap growth) was terminated June 2007.

<sup>2</sup>Aquiline Capital Partners, LLC was funded March 28, 2007.

<sup>3</sup>The contract with Flippin, Bruce & Porter, Inc., was terminated June 2007.

<sup>4</sup>Russell Investment Group was funded May 29, 2007.

<sup>5</sup>The contract with Sands Capital Management, LP, was terminated June 2007.

<sup>6</sup>The contract with Wellington Management Company, LP, was terminated June 2007.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT  
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

Mr. Richard H. Gilbert, Jr., CPA,  
Deputy State Auditor State  
of South Carolina  
Columbia, South Carolina

We have audited the financial statements of the South Carolina Retirement Systems (the "Systems") as of and for the year ended June 30, 2007, and have issued our report thereon dated September 28, 2007. 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.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Systems' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Systems' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Systems' internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Systems' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of the State Auditor and management of the Systems and is not intended to be and should not be used by anyone other than these specified parties.

*Rogers Laban, PA*

September 28, 2007