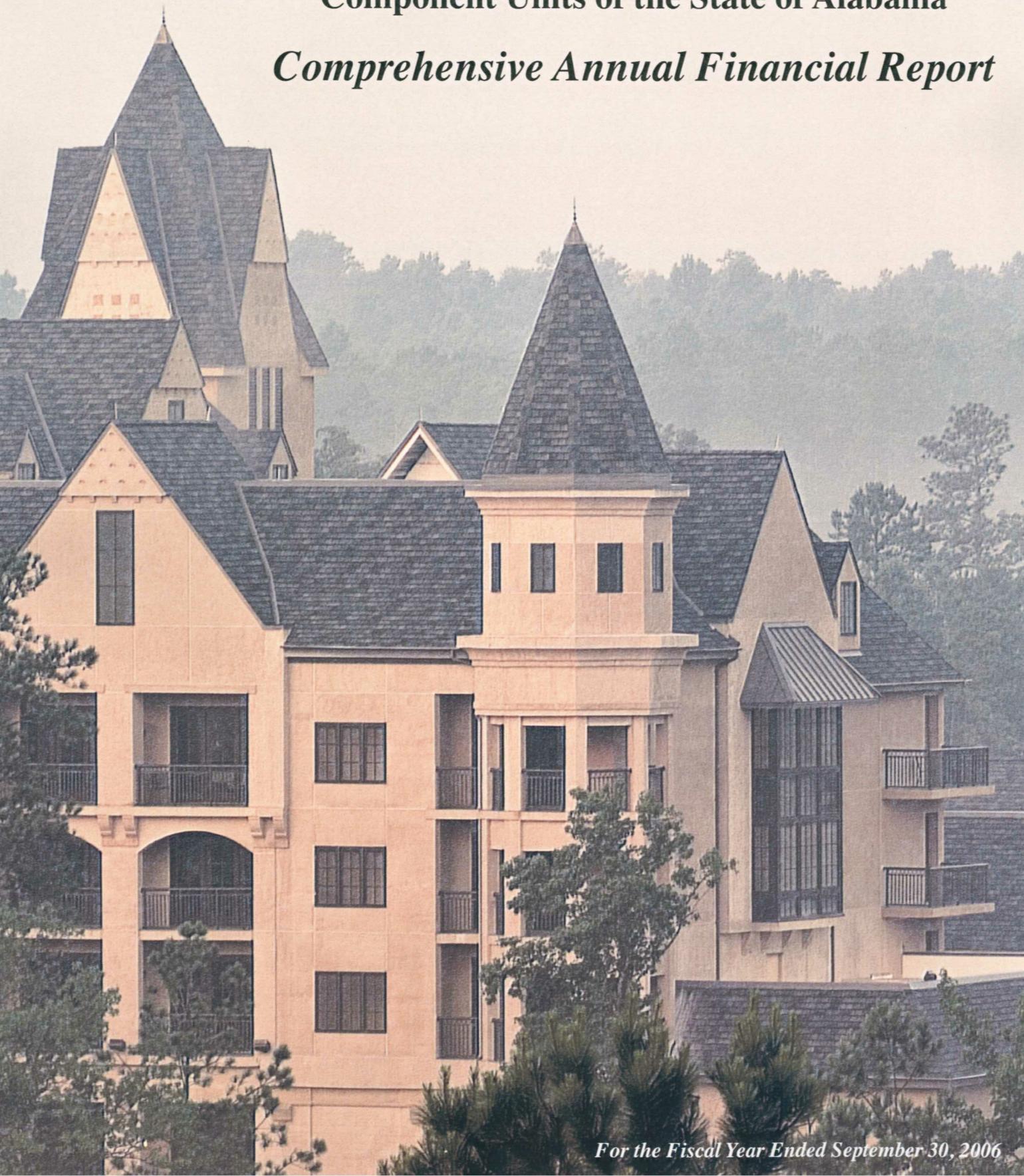


The Retirement Systems of Alabama

Component Units of the State of Alabama

Comprehensive Annual Financial Report



For the Fiscal Year Ended September 30, 2006

FRONT COVER: *Robert Trent Jones Golf Trail*
Renaissance Ross Bridge Golf Resort & Spa / Birmingham / Courtesy of Michael Clemmer

BACK COVER: *Robert Trent Jones Golf Trail*
Renaissance Ross Bridge Golf Resort & Spa / Birmingham / Ross Bridge 5 & 6 / Courtesy of Michael Clemmer

The Retirement Systems of Alabama

Component Units of the State of Alabama

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended September 30, 2006

The Retirement Systems of Alabama
Consists of:

TEACHERS' RETIREMENT SYSTEM of ALABAMA
EMPLOYEES' RETIREMENT SYSTEM of ALABAMA
JUDICIAL RETIREMENT FUND

(Each a Component Unit of The State of Alabama)

David G. Bronner, Ph.D., J.D., Chief Executive Officer

135 South Union Street • P. O. Box 302150 • Montgomery, Alabama 36130-2150
(334) 832-4140 or 1-800-214-2158 • <http://www.rsa.state.al.us>

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INTRODUCTORY SECTION



Retirement Systems of Alabama



Teachers'
Paul R. Hubbert, Chair
Sarah Swindle, Vice Chair

David G. Bronner, CEO
Marcus H. Reynolds, Jr., Deputy

Employees'
State State Police Public Judicial
Bob Riley, Chair
John H. Wilkerson, Jr., Vice Chair

March 19, 2007

The Boards of Control
Teachers' Retirement System of Alabama
Employees' Retirement System of Alabama
135 South Union Street
Montgomery, AL 36130

Dear Board Members:

It is with great pleasure that I submit the Comprehensive Annual Financial Report (CAFR) of the Retirement Systems of Alabama (RSA or Systems) for the fiscal year ended September 30, 2006. The Retirement Systems of Alabama includes the Teachers' Retirement System of Alabama (TRS), the Employees' Retirement System of Alabama (ERS), and the Judicial Retirement Fund (JRF). Each system is considered a component unit of the State of Alabama for financial reporting purposes, and, as such, the financial statements contained in this report are also included in the State of Alabama Comprehensive Annual Financial Report.

Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the management of the Systems. Sufficient internal controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements, supporting schedules, and statistical tables. I trust that you and the members of the Systems will find this report helpful in understanding your retirement system.

Report Contents

The 2006 Comprehensive Annual Financial Report is divided into the following five sections:

- The *Introductory Section*, which contains this letter of transmittal and general information regarding the operations and administrative structure of the RSA.
- The *Financial Section*, which contains the Independent Auditors' Report by KPMG LLP, Management's Discussion and Analysis, financial statements, required supplementary information, and supporting schedules for the TRS, ERS, and JRF.
- The *Investment Section*, which contains a report on investment activity, an outline of investment policies, investment results, and various investment schedules.
- The *Actuarial Section*, which contains the certification letter of the independent consulting actuary, Cavanaugh Macdonald Consulting, LLC, for the TRS, ERS, and JRF, as well as summaries of the results of the most recent actuarial valuations.
- The *Statistical Section*, which contains significant statistical information regarding the TRS, ERS, and JRF.

Administration and Plan History

The TRS, ERS, and JRF operate under common management and are collectively referred to as the Retirement Systems of Alabama (RSA). In addition to executive management, the TRS, ERS, and JRF share investment management, accounting, and information system services, the costs of which are allocated to the funds on an equitable basis. The TRS was established under the provisions of Act 419 of the Legislature of 1939 to provide benefits to qualified persons employed by State-supported educational institutions. The ERS was established under the provisions of Act 515 of the Legislature of 1945 to provide benefits to State employees, State police, and, on an elective basis, to qualified persons of cities, towns, and quasi-public organizations. The JRF was established under the provisions of Act 1163 of the Legislature of 1973 to provide benefits to qualified judges and justices. Additional information regarding the administration and history of each system, including laws establishing each plan and services provided, can be found in the *Financial Section - Notes to the Financial Statements* portion of this report.

Financial Information

Accounting Method - As required by Generally Accepted Accounting Principles (GAAP), the financial information of the TRS, ERS, and JRF is reported on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the corresponding liability is incurred. Investments are reported at fair value.

Internal Controls - The management of the RSA is responsible for maintaining the system of internal controls (system). The system provides management with reasonable, but not absolute, assurance regarding the safeguarding of assets against loss or unauthorized disposition and the reliability of the financial records from which the financial reports are prepared. The concept of reasonable assurance recognizes that the cost of a control should not exceed the resulting benefits.

Summary Comparative Data – Management’s Discussion and Analysis (MD&A) includes a narrative introduction, an overview of the financial statements, including the notes, and required supplementary information, and summary comparative data for fiscal years 2006 and 2005. Also, an analysis of significant variances between fiscal years 2006 and 2005 is provided in the MD&A.

Plan Financial Condition

The funding objective of the RSA pension trust funds is to meet long-term benefit requirements through contributions, which remain relatively level as a percent of member payroll over time, and through investment earnings. Historical information concerning funding progress is presented in the *Required Supplementary Information* - “Schedule of Funding Progress” on page 39.

At the date of the latest actuarial valuations, as presented in the *Notes to the Required Supplementary Information* on page 41, the number of participants in the TRS, ERS, and JRF was 214,008, 126,055, and 663, respectively. The TRS’s, ERS’s, and JRF’s last valuations were performed as of September 30, 2005. The TRS’s funded percentage decreased from 89.6% at September 30, 2004 to 83.6% at September 30, 2005. The ERS’s funded percentage decreased from 89.7% at September 30, 2004 to 84.0% at September 30, 2005. The JRF’s funded percentage decreased from 85.9% at September 30, 2004 to 85.5% at September 30, 2005.

Investment Activity

Total investments for the RSA increased in fiscal year 2006, primarily due to increases in the fair value of investments. Investment balances for the TRS, ERS, and JRF at September 30, 2006 were \$19.0 billion, \$8.9 billion and \$243.8 million, respectively, compared to investment balances for the TRS, ERS, and JRF at September 30, 2005 of \$18.0 billion, \$8.4 billion, and \$231.0 million, respectively. Total pension fund investments managed by the RSA increased from \$26.6 billion at September 30, 2005 to \$28.1 billion at September 30, 2006, a 5.6% increase.

Interest and dividend income for the TRS, ERS, and JRF for the fiscal year ended September 30, 2006 was \$703.2 million, \$329.5 million, and \$9.6 million, respectively, compared to \$624.4 million, \$295.6 million, and \$7.4 million, respectively, for the fiscal year ended September 30, 2005. The increase in fair value of investments for the TRS, ERS, and JRF for the fiscal year ended September 30, 2006 was \$878.7 million, \$375.0 million and \$11.2 million, respectively, compared to the increase in fair value of investments of \$1.2 billion, \$545.8 million, and \$11.9

RETIREMENT SYSTEMS OF ALABAMA

Introductory Section

Letter of Transmittal (Continued)

million, respectively, for the fiscal year ended September 30, 2005. Additional information concerning investments, including investment policies and procedures are located in the Investment Section.

The staff will continue to purchase and develop investments that will facilitate the mission of the RSA and serve the interests of our members by preserving the excellent benefits and soundness of the RSA while providing these at the least expense to the State of Alabama and all Alabama taxpayers. With the continued cooperative efforts of the Boards of Control, the RSA staff, and the Legislature, this goal will be achieved.

Management's Discussion and Analysis

GASB Statement No. 34 requires that management provide a narrative introduction, overview, and analysis to accompany the Financial Statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is intended to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditors' Report.

Legislation Enacted During Fiscal-Year 2006

Act 2006-230 authorized Marion Military Institute (MMI), formerly a private school, to become a state institution under the governance of the State Department of Postsecondary Education. This change became effective June 1, 2006. Current employees of MMI will be eligible for all the same benefit plans as other employees of postsecondary institutions. No provision was made to provide retirement credit or other benefits for periods of time prior to June 1, 2006.

Act 2006-510 provides for and authorizes a cost-of-living adjustment (COLA) in benefits for those ERS retirees who retired prior to October 1, 2005. The COLA became effective October 1, 2006. The COLA is 7% of the current gross benefit with a minimum increase of \$25 per month. Retirees as well as their beneficiaries received this COLA. If Medicaid benefits are impaired by this COLA, the individual will not be eligible for the increase. The COLA is automatically effective for State retirees. However, the local governing boards of local retirees' units must elect by resolution to come under the provisions of the Act and agree to bear the cost of the COLA.

Act 2006-310 provides for and authorizes a cost-of-living adjustment in benefits for those TRS retirees who retired prior to October 1, 2005. The COLA became effective October 1, 2006. The COLA is 7% of the current gross benefit with a minimum increase of \$25 per month. Retirees as well as their beneficiaries received this COLA. If Medicaid benefits are impaired by this COLA, the individual will not be eligible for the increase.

Legislation was passed to allow the sheriffs of Cherokee and Dekalb counties to participate in the ERS.

Professional Services

Professional consultants are appointed by the Boards of Control to perform professional services that are essential to the effective operation of the TRS, ERS, and JRF. The certification letters from the independent actuary are included in this report. The professional consultants appointed by the Boards of Control are listed on page 9 of this report.

Financial Statement Audit

KPMG LLP, Certified Public Accountants, have issued an unqualified ("clean") opinion on the RSA's financial statements for the fiscal year ended September 30, 2006. The independent auditors' report is located at the front of the financial section of this report.

Highlights and Initiatives

55 Water Street, the RSA-owned building in Lower Manhattan, was honored with two awards within two months during the fiscal year. The Municipal Art Society of New York recognized "The Elevated Acre" plaza as the "best privately owned public space" in New York. The multi-level park provides recreational space for Lower Manhattan residents and commuters and houses a 25 foot by 25 foot glass beacon which is lit every evening as a welcoming lantern. The Friends of the Vietnam Veterans Plaza awarded the other 55 Water Street plaza with the "Honoree of the Year Award" for the rehabilitation of the official New York City Vietnam Memorial.

In other RSA real estate news, construction continues on the Battle House Tower in Mobile. When completed in early 2007, the 35-story office tower will be the tallest building in the state of Alabama. The project in downtown

RETIREMENT SYSTEMS OF ALABAMA

Introductory Section

Letter of Transmittal (Continued)

Montgomery that includes a 12-story, 347-room hotel, spa and performing arts theater as well as the expansion of the Montgomery Civic Center and a 600-car parking deck is progressing; the project is expected to be completed by early 2008. The hotel will feature similar characteristics of the Plaza Hotel in New York City. Finally, a new eight-story office building will be added to the State Capitol Complex. The 280,000 square foot structure is expected to be completed in early 2008. The RSA will occupy part of this new building

During the fiscal year, the RSA's holdings in the media sector grew once again. Community Newspaper Holdings Inc., one of the nation's largest newspaper companies by number of papers, expanded during the year by purchasing six daily newspapers from the Dow Jones & Company. With this acquisition, the Company will now own and operate 94 daily newspapers as well as 49 non-daily newspapers and numerous specialty publications across 22 states. Raycom Media now owns and operates 36 stations in 18 states, covering 10.2% of U. S. television households.

The staff will continue to purchase and develop investments that will facilitate the mission of the RSA. Our aim is to serve the interests of our members by preserving the excellent benefits and soundness of the Systems while providing these at the least expense to the State of Alabama and all Alabama taxpayers. With the continued cooperative efforts of the Boards of Control, the RSA staff, and the Legislature, this goal will be achieved.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Retirement Systems of Alabama for its comprehensive annual financial report for the fiscal year ended September 30, 2005. The Certificate of Achievement is a prestigious national award, which recognizes conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive financial report whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to the GFOA.

Acknowledgments

The compilation of this report reflects the combined effort of the staff under the leadership of the Boards of Control. It is intended to provide extensive and reliable information as a basis for making management decisions, determining compliance with legal provisions, and determining responsible stewardship of the funds of the TRS, ERS, and JRF.

I would like to take this opportunity to express my gratitude to the staff, the Boards of Control, the consultants, the Legislature, and to the many people who have worked so diligently through continued cooperative efforts to assure the successful operation and financial soundness of the TRS, ERS, and JRF.

Sincerely,

Norman D. Turnipseed

Norman D. Turnipseed, CPA
Chief Accountant & Fiscal Officer

David G. Bronner

David G. Bronner, Ph.D., J.D.
Chief Executive Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

The Retirement Systems of Alabama

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2005

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



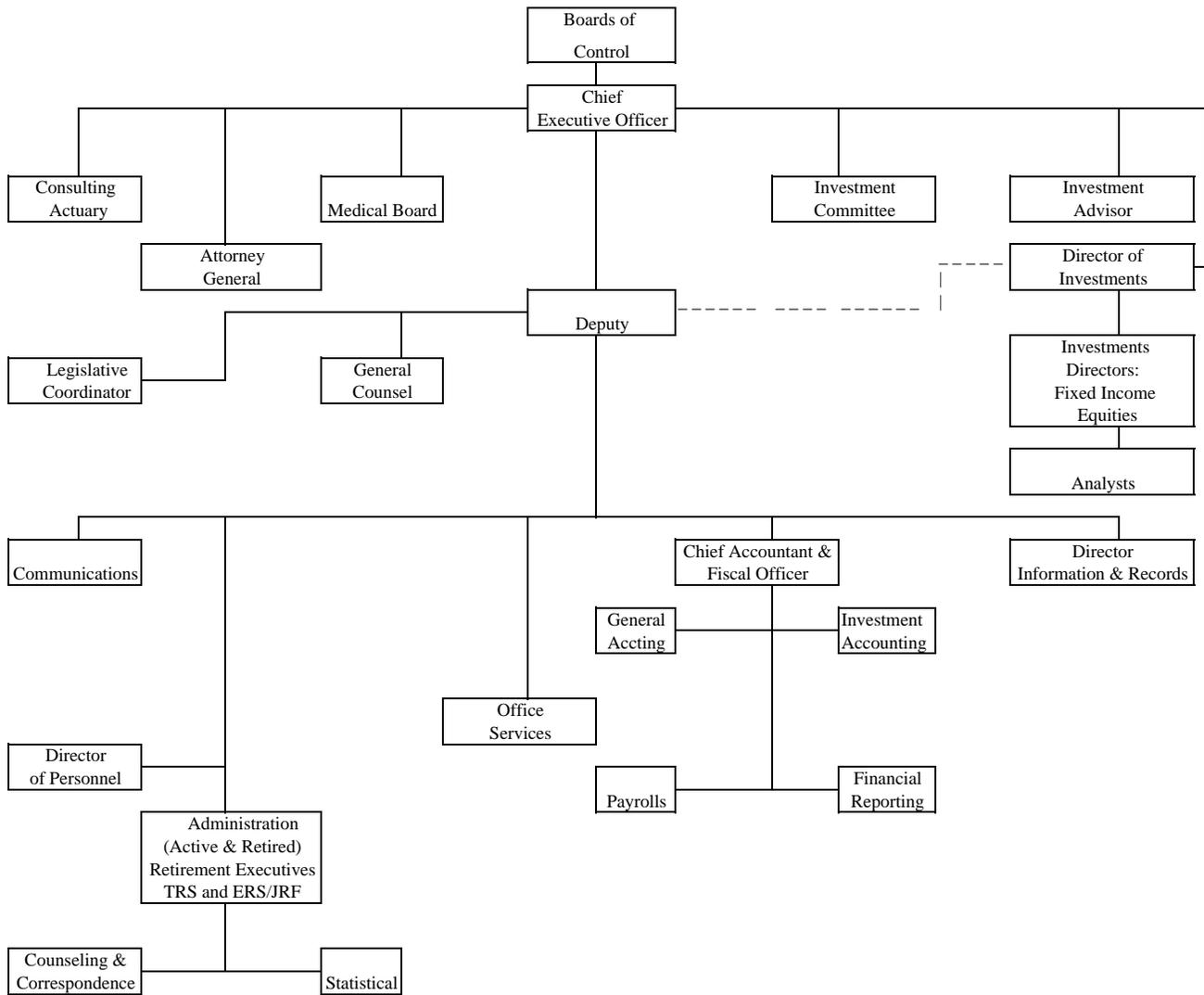
President

Executive Director

RETIREMENT SYSTEMS OF ALABAMA

Introductory Section

Organization Chart



Teachers' Retirement System Board of Control

Ex Officio Members

Chairman, Dr. Paul R. Hubbert, Executive Secretary, AEA
Jim Main, State Finance Director
Kay Ivey, State Treasurer
Dr. Joseph Morton, State Superintendent of Education

Elected Members

Vice-Chairman, Mrs. Sarah Swindle, Retired Position
Ms. Judy Rigdon, Teacher Position
Dr. Susan Williams Brown, Postsecondary Position
Ms. Judy West Bell, Teacher Position
Dr. J. Terry Jenkins, Superintendent Position
Dr. Carl Ponder, Principal Position
Ms. Sallie B. Cook, Retired Position
Mr. Russell J. Twilley, Support Personnel Position
Mrs. Peggy K. Lamb, Teacher Position
Mrs. Sharon P. Saxon, Support Personnel Position

Employees' Retirement System Board of Control**

Ex Officio Members

Chairman, Bob Riley, Governor
Jim Main, State Finance Director
Kay Ivey, State Treasurer
Jackie Graham, State Personnel Director

Elected Members

Mr. Clyde Sellers, Retired Local Employee
Mrs. Ann Gant, Active Local Employee
Mr. Ronald Matthews, Active Local Employee
Ms. Mary Lou Foster, Retired State Employee
Ms. Alice Thornton, Active State Employee
Mr. Stephen C. Walkley, Active State Employee

Appointed Members

Vice-Chairman, Mr. John H. Wilkerson, Jr.
Mr. Robert H. Pruitt
Mr. Robert S. Miller

** The Employees' Retirement System Board of Control is responsible for the administration of both the Employees' Retirement System and the Judicial Retirement Fund.

RETIREMENT SYSTEMS OF ALABAMA

Introductory Section

Staff, Advisors, and Medical Board

Staff, Advisors, and Medical Board

David G. Bronner, Ph.D., J.D., Chief Executive Officer

Marcus H. Reynolds, Jr., J.D., Deputy Director

Administrative Staff

Chief Accountant and Fiscal Officer, Norman D. Turnipseed, M.B.A., C.P.A.

Director of Information Technology Services, Peggi L. Douglass, M.B.A.

Teachers' Retirement Executive, Donald L. Yancey, M.P.A., J.D.

Employees' & Judicial Retirement Executive, R. Donald Nelson, M.S.

Legislative Counsel, Lindy J. Beale, J.D.

General Counsel, William F. Kelley, Jr., J.D.

General Counsel, William T. Stephens, J.D.

Director of Communications, Michael E. Pegues, M.A.

Investment Staff

Director of Investments, Marc Green, M.B.A., C.F.A.

Director of Private Placements, M. Hunter Harrell, M.B.A., J.D., C.F.A.

Assistant Director of Equities, Steven R. Lambdin, M.B.A., C.P.A., C.F.A.

Assistant Director of Equities, Eric J. Fox, M.B.A., C.F.A.

Director of Fixed Income, Julie S. Barranco, M.B.A., C.F.A.

Equity Analyst, Zach Turnage, M.B.A., C.F.A.

Equity Analyst, G. Allan Carr Jr., M.B.A., C.F.A.

Equity Analyst, Kevin W. Gamble, M.B.A., C.F.A.

Equity Analyst, Keith Buchanan, M.B.A.

Equity Analyst, Adam Rogers, M.B.A.

Fixed Income Analyst, C. Lance Lachney, M.B.A., C.F.A.

Fixed Income Analyst, Joseph G. Walker, M.B.A., C.F.A.

Cash Management & Operations, Nancy H. Sprayberry

Advisors

Independent Certified Public Accountants, KPMG LLP

Regions Bank., Mr. Brian Sullivan, Investment Consultant

State Street, Investment Custodian

Cavanaugh Macdonald, Mr. Edward A. Macdonald

Attorney General, Mr. Troy King

Chief Examiner, Mr. Ronald L. Jones

Medical Board

Chairman, Neil Stronach, M.D.

Malcolm Brown, M.D.

Glen Yates, M.D.

