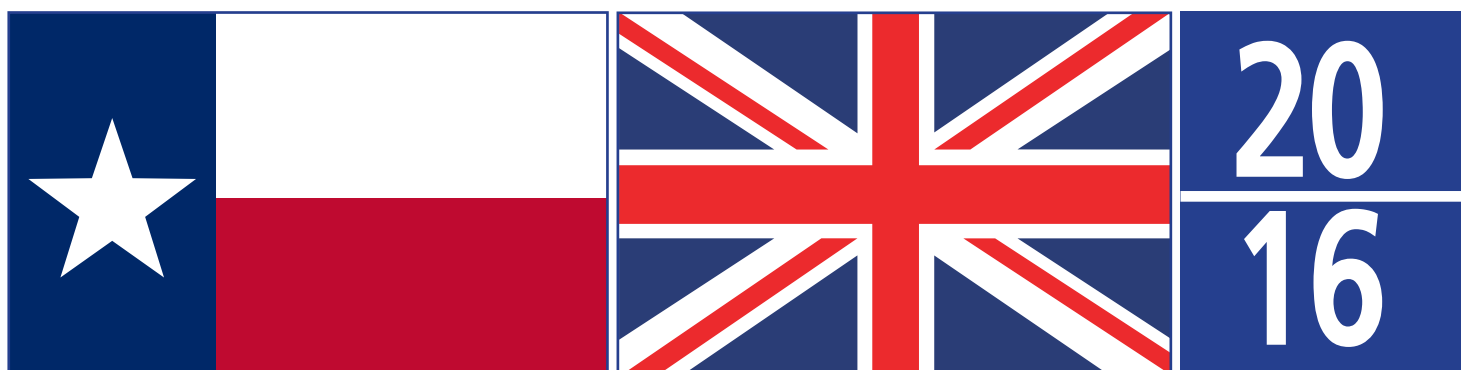


TRICOT

Teacher Retirement Investment Company of Texas



Annual Financial Report

**A Component Unit of the Teacher Retirement System of Texas
Period Ended August 31, 2016**

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Teacher Retirement Investment Company of Texas Ltd.

Annual Financial Report
For the Period Ended August 31, 2016

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Teacher Retirement Investment Company of Texas Ltd. Management's Discussion and Analysis (Unaudited)

The following is Management's Discussion and Analysis (MD&A) of the Teacher Retirement Investment Company of Texas Ltd.'s (TRICOT) financial activities for the fiscal year ended August 31, 2016. The information presented here should be considered in conjunction with other areas of the *TRICOT Annual Financial Report*.

FINANCIAL HIGHLIGHTS

Teacher Retirement Investment Company of Texas Ltd., (TRICOT), a private limited company incorporated in the United Kingdom (UK) began operations in fiscal year 2016. TRICOT, as a separate legal entity, is a wholly owned subsidiary and blended component unit of the Teacher Retirement System of Texas (TRS) Pension Trust Fund.

- TRICOT's primary purpose is to increase the size and number of investment opportunities for the TRS portfolio, especially in private equity funds, real assets funds, and co-investments for either of those investment types.
- To further support the preferred destination effort, the Investment Management Division (IMD) opened Teacher Retirement System's (TRS) first international office in London on November 1, 2015. The presence in London was designed to strengthen TRS's overall knowledge of markets in the United Kingdom and Europe; and it has proven particularly valuable in navigating through the market movements surrounding the Brexit referendum, providing an insider perspective of the long-term impact from Britain's decision to exit from the European Union. As a result of the work by the London team to deepen relationships with TRS's general partners, three new investments have been made to date, and TRS is on track to increase the number of private markets deal opportunities by 50% over the prior year. TRS will continue to build upon its reputation as a leading institutional investor and strengthen investment relationships with key players overseas.
- TRICOT's net position was \$101,086 as of August 31, 2016.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to TRICOT's financial presentation, which consists of the following components:

- Fund financial statements
- Notes to the financial statements
- Required supplementary information

Collectively, this information presents the net position restricted for fiduciary activities as of August 31, 2016, and summarizes any changes in net position for the year then ended. The information available in each of these sections is summarized as follows:

Teacher Retirement Investment Company of Texas Ltd. Management's Discussion and Analysis (Unaudited)

Fund Financial Statements

Fiduciary fund financial statements are presented as of August 31, 2016 and for the year then ended. The fiscal year ended August 31, 2016 is TRICOT's first year end, thus no comparative data is presented.

Notes to the Financial Statements

The financial statement notes provide additional information that is essential to a full understanding of the data provided in the TRICOT financial statements. Information available in the notes to the financial statements is described below:

- Note 1 provides a general description of TRICOT and a summary of significant accounting policies, including the basis of accounting, budgets and appropriations, and explanations of major asset and liability classes.
- Note 2 provides information on capital assets.
- Note 3 describes cash, deposits and deposit risk factors.
- Note 4 provides information on operating leases.
- Note 5 presents tax disclosure information.

Required Supplementary Information

Required supplementary information for TRICOT consists of Management's Discussion and Analysis.

FINANCIAL ANALYSIS OF TRICOT

Net position restricted for fiduciary activities at August 31, 2016 was \$101,086.

Additions from amounts paid on behalf of TRICOT and transfers in from Teacher Retirement System of Texas (TRS) totaled \$1,983,800.

Deductions from TRICOT's net position restricted for fiduciary activities are predominantly administrative expenses. During fiscal year 2016, administrative expenses totaled \$1,882,714.

***Teacher Retirement Investment Company of Texas Ltd.
Management's Discussion and Analysis (Unaudited)***

Statement of Fiduciary Net Position (Condensed)

August 31, 2016

	Fiscal Year 2016
Assets	
Cash and Receivables	\$125,616
Capital Assets	9,831
TOTAL ASSETS	\$135,447
Liabilities	
Accounts Payables and Other	\$34,361
TOTAL LIABILITIES	\$34,361
Total Fiduciary Net Position	\$101,086

Changes in Fiduciary Net Position (Condensed)

For the Fiscal Year Ended August 31, 2016

	Fiscal Year 2016
Additions	
Amounts Paid on Behalf of TRICOT	\$702,077
Transfers In from Teacher Retirement System of Texas	1,281,723
TOTAL ADDITIONS	\$1,983,800
Deductions	
Administrative Expenses	\$1,882,714
TOTAL DEDUCTIONS	\$1,882,714
Change in Fiduciary Net Position	\$101,086

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Teacher Retirement Investment Company of Texas Ltd. (TRICOT) for those with an interest in TRICOT's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Communications Department of the Teacher Retirement System of Texas, 1000 Red River Street, Austin, Texas 78701.

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Teacher Retirement Investment Company of Texas Ltd.

Statement of Fiduciary Net Position

AS OF AUGUST 31, 2016

ASSETS

Cash

Cash in Bank (Note 3)	\$	35,597
TOTAL CASH	\$	35,597

Receivables and Other Assets (Note 1E)

Due from Teacher Retirement System of Texas	\$	286
VAT (Value Added Tax) Receivable		16,693
Corporate Taxes Receivable		3,432
Prepaid Expenses		5,774
Deposits and Other Assets		63,834
TOTAL RECEIVABLES AND OTHER ASSETS	\$	90,019

Capital Assets (Note 2)

Depreciable Assets	\$	11,989
Less Accumulated Depreciation		(2,158)
TOTAL CAPITAL ASSETS	\$	9,831

TOTAL ASSETS	\$	135,447
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LIABILITIES (Note 1E)

Accounts Payable	\$	2,354
Taxes Payable		32,007
TOTAL LIABILITIES	\$	34,361

NET POSITION

Net Investment in Capital Assets	\$	9,831
Restricted for Fiduciary Activities		91,255

NET POSITION RESTRICTED FOR FIDUCIARY ACTIVITIES	\$	101,086
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The accompanying Notes to the Financial Statements are an integral part of this financial statement.

Teacher Retirement Investment Company of Texas Ltd.
Statement of Changes in Fiduciary Net Position

FOR THE FISCAL YEAR ENDED AUGUST 31, 2016

ADDITIONS

Amounts Paid On Behalf of TRICOT	\$	702,077
Transfers In from Teacher Retirement System of Texas		1,281,723
TOTAL ADDITIONS	\$	1,983,800

DEDUCTIONS

Administrative Expenses		
Salaries and Benefits - Seconded Employees	\$	597,627
Professional Fees and Services		709,847
Materials and Supplies		42,960
Communications and Utilities		6,358
Repairs and Maintenance		14,248
Travel		16,186
Rentals and Leases		366,791
Printing and Reproduction		430
Tax Expense		98,324
Foreign Transaction Losses and Fees		787
Depreciation Expense		2,158
Other Expenses		26,998
TOTAL DEDUCTIONS	\$	1,882,714

Net Change in Net Position	\$	101,086
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NET POSITION RESTRICTED FOR FIDUCIARY ACTIVITIES-BEGINNING OF YEAR	\$	0
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NET POSITION RESTRICTED FOR FIDUCIARY ACTIVITIES-END OF YEAR	\$	101,086
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The accompanying Notes to the Financial Statements are an integral part of this financial statement.

Teacher Retirement Investment Company of Texas Ltd.
Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

The accompanying financial statements reflect the financial position of the Teacher Retirement Investment Company of Texas Ltd., (TRICOT), a private limited company incorporated in the United Kingdom (UK). TRICOT, as a separate legal entity, is a wholly owned subsidiary and blended component unit of the Teacher Retirement System of Texas (TRS) Pension Trust Fund. The primary purpose of TRICOT is to increase the size and number of investment opportunities for the TRS portfolio, especially in private equity funds, real assets funds, and co-investments for either of those investment types. TRICOT's Board of Directors is composed of one Managing Director. This Managing Director position is appointed by the Executive Director of TRS.

TRICOT provides investment advisory services exclusively to TRS pursuant to an intercompany agreement. TRICOT does not make investment decisions or enter into investment contracts and has no authority to legally bind TRS. All investment opportunities are referred to TRS for consideration, due diligence, decision-making, and authorization.

B. MEASUREMENT FOCUS, BASIS OF PRESENTATION AND BASIS OF ACCOUNTING

The financial statements present only the financial position and changes in financial position of TRICOT and include all activities for which TRICOT exercises fiscal control and responsibility. They are not intended to, and do not, present fairly the financial position or changes in financial position of TRS. The reporting period is for the fiscal year ended August 31, 2016.

As a blended component unit of TRS Pension Fund, TRICOT reports its accounts in the same manner, which is as a fiduciary fund. *Fiduciary* funds are used to report assets held in a trustee or agency capacity on behalf of others. TRICOT operations are accounted for with a self-balancing set of accounts that comprise its assets, liabilities, additions and deductions. The fiduciary financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Additions are recognized when earned, and deductions are recognized when the liability is incurred, regardless of the timing of related cash flows. All economic resources, including financial and capital assets, and related liabilities, both current and long-term, and the changes therein are reported in the fund financial statements

TRICOT is not an employer under UK law and does not make contributions to any retirement plans. TRS employees are seconded from the Austin, TX headquarters to TRICOT and remain employees and members of TRS for all purposes, including health insurance, pension contributions, benefits, Social Security and Medicare taxes. The salary and benefit costs to TRS for seconded employees are allocated and transferred to TRICOT for transfer pricing and UK corporate income tax reporting purposes. Additionally, TRS employees provide legal, accounting and administrative services for TRICOT. When non-seconded TRS employees perform work on

Teacher Retirement Investment Company of Texas Ltd.
Notes to the Financial Statements

behalf of TRICOT, the proportionate cost of that labor is allocated to TRICOT. No allocation of the pension liabilities and expense for non-seconded TRS employees is necessary or required. TRS' risk management programs apply to TRICOT.

TRICOT's accounting records are maintained in U.S. dollars. Purchases and receipts made in Great Britain Pounds (GBP) are translated into U.S. dollars at the exchange rate on the dates of the transactions.

C. NEW ACCOUNTING PRONOUNCEMENTS

The accompanying financial statements were prepared in conformity with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). TRICOT did not implement any new GASB statements in fiscal year 2016.

D. BUDGETS AND APPROPRIATIONS

The administrative costs and capital asset outlay for TRICOT are controlled by annual budgets approved by TRS and the Managing Director of TRICOT.

E. ASSETS AND LIABILITIES

Receivables

Receivables represent the amount of money owed to TRICOT for goods or services delivered or used for which payments have not been received at fiscal year-end.

- *Due from Teacher Retirement System of Texas* represents amounts owed to TRICOT by TRS for intercompany services.
- *Value Added Tax (VAT)* receivables represent amounts owed at fiscal year-end to TRICOT by the United Kingdom for the refund of value added taxes that will not be received until the next fiscal year.
- *Corporate Taxes* receivables represent amounts owed to TRICOT at fiscal year-end but not received from the United Kingdom until the next fiscal year.

Prepaid and Other Assets

Prepaid expenses reflect payment for expenses related to rental and lease costs applicable to a future accounting period. Other Assets are deposits made to retain services and rental properties.

Capital Assets

Capital assets associated with TRICOT's activities are included in the statement of fiduciary net position. Purchases of capital assets by the fund are reported at cost on the acquisition date. Depreciation of all exhaustible capital assets is charged as an expense against the fund's

Teacher Retirement Investment Company of Texas Ltd.
Notes to the Financial Statements

operations. Depreciation is calculated using the reducing balance basis over the asset's useful life for tax purposes in the UK and for presentation purposes for consistency in financial reporting. Note 2 includes a table identifying the capitalization threshold and estimated useful life by asset type.

Liabilities

Liabilities represent the amount of money owed by TRICOT for goods or services received at fiscal year-end for which payment has not been made as of August 31, 2016.

- *Accounts Payable* represents the liability for assets or services received at fiscal year-end for which payment has not been made.
- *Taxes Payable* represents amounts owed by TRICOT at fiscal year-end but not paid to the United Kingdom until the next fiscal year.

Interfund Transactions

Transfers in from TRS represent contributions for operational expenses, net of any reimbursements from TRICOT back to TRS. They are comprised of cash transfers to provide operating funds to TRICOT and expense transfers which represent monies paid directly by TRS then allocated to TRICOT for reporting purposes. For fiscal year 2016, TRS contributed \$1,281,723. Amounts due from TRS totaled \$286 at the end of fiscal year 2016 and arise from expenses paid by TRICOT, however funding has not transferred from TRS.

NOTE 2: CAPITAL ASSETS

Capital assets are presented at historical cost or, if not purchased, at fair value at the date of acquisition. To the extent assets are purchased by TRICOT for use in TRICOT's trade, assets qualify for capital allowances (tax depreciation) of 18% per year on a reducing balance basis. This depreciation method is permitted by the Texas Comptroller of Public Accounts who allows agencies to calculate depreciation expense on a basis other than the straight-line method used by the State Property Accounting (SPA) system. Capitalization thresholds for all capital asset classes and useful lives for exhaustible assets are shown below:

Asset Class	Capitalization Threshold	Depreciable Life
Furniture and Equipment	\$5,000	Various
Other Capital Assets	Various	Various

Teacher Retirement Investment Company of Texas Ltd.
Notes to the Financial Statements

The table below presents the composition of TRICOT's capital assets.

Asset Category	Balance 09/01/2015	Additions	Deletions	Balance 08/31/2016
Depreciable Capital Assets				
Furniture and Equipment	\$	\$ 11,989	\$	\$ 11,989
Less Accumulated Depreciation				
Furniture and Equipment	\$	\$ 2,158	\$	\$ 2,158
Total Capital Assets	<u>\$ 0</u>	<u>\$ 9,831</u>	<u>\$ 0</u>	<u>\$ 9,831</u>

NOTE 3: DEPOSITS

A. CASH AND DEPOSITS

Cash and deposits of TRICOT are maintained in demand deposit accounts with J.P. Morgan Chase Bank, N.A. in the United States (US) and the United Kingdom (UK). As of August 31, 2016, the balances in these accounts totaled \$35,597.

B. DEPOSIT RISK FACTORS

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the system will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. TRICOT does not have a formal deposit policy for custodial credit risk.

Deposits in US bank accounts are covered by the Federal Deposit Insurance Corporation (FDIC) which insures bank balances less than \$250,000. Deposits in UK bank accounts are covered by the Financial Services Compensation Scheme (FSCS) which insures bank balances less than £75,000. Deposits in excess of these insured amounts are uninsured and uncollateralized. As of August 31, 2016, deposits in the TRICOT US and UK bank accounts were not exposed to custodial credit risk.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or an investment. The TRICOT does not have a formal deposit policy for foreign currency risk. As of August 31, 2016, the TRICOT held \$30,480 cash in British Pounds (GBP).

Teacher Retirement Investment Company of Texas Ltd.

Notes to the Financial Statements

NOTE 4: OPERATING LEASES

In fiscal year 2016, TRICOT entered into a non-cancelable operating lease agreement for office building space which expires September 29, 2017. Rental expenses related to the lease for the fiscal year ended August 31, 2016 were \$273,417.

In fiscal year 2016, TRICOT entered into operating lease agreements for two apartments for the TRS seconded employees, cancelable after the first twelve months. The first lease expires August 14, 2017. The second lease expires November 15, 2017. Rental expenses related to the leases for the fiscal year ended August 31, 2016 totaled \$83,007.

NOTE 5: TAXES

A. TAX ON ORDINARY ACTIVITIES

For the period ended August 31, 2016 TRICOT had tax on profit on ordinary activities. The 2016 income tax charge is made up as follows:

• Current tax	
UK corporation tax at 20%	\$32,007
Tax overprovided in previous years	<u>0</u>
Taxes Payable	\$32,007
• Deferred tax	
Origination and reversal of timing differences	<u>\$ (3,432)</u>
Total deferred tax	<u>\$ (3,432)</u>
Tax on profit on ordinary activities	<u>\$ 28,575</u>

B. FACTORS AFFECTING THE 2016 TOTAL TAX CHARGE

The tax assessed on profit/loss on ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 20%. The differences are reconciled below:

Loss on ordinary activities before taxation	<u>\$139,060</u>
Profit on ordinary activities at standard United Kingdom corporation tax rate of 20%	\$27,812
Effects of:	
Expenses not deductible for tax purposes	\$583
Effect of tax rate changes	<u>\$180</u>
Total tax expense	<u>\$28,575</u>

Teacher Retirement Investment Company of Texas Ltd.
Notes to the Financial Statements

C. FACTORS THAT MAY AFFECT FUTURE TAX CHARGES

The UK Government legislated in the Finance (No.2) Act 2015 which received royal assent on November 18, 2015 to reduce the standard rate of UK corporation tax to 19% from April 1, 2017 and further to 18% from April 1, 2020. The reduced rates of UK corporation tax will affect future cash tax payments to be made and have been taken into account in calculating deferred tax.

In the 2016 Finance Bill, the UK Government announced a further reduction in the rate of UK corporation tax to 17% from April 1, 2020.

D. 2016 DEFERRED TAX

Deferred tax credit/ (charge) to income statement	<u>\$3,432</u>
Deferred tax asset at August 31, 2016	<u>\$3,432</u>
Made up of:	
Depreciation in excess of capital allowances	\$3,432

E. OTHER TAX EXPENSE

Tax expense also includes \$69,749 paid to Her Majesty's Revenue and Customs office by TRS for seconded employees working in the UK.