



FINANCIAL SECTION



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KPMG LLP
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Independent Auditors' Report

Alaska Retirement Management Board and
Division of Retirement and Benefits
State of Alaska Public Employees' Retirement System
Defined Benefit Retirement Pension and Post Employment Healthcare Plans
Defined Contribution Retirement Pension Plan

We have audited the accompanying statements of net assets of the State of Alaska Public Employees' Retirement System's Defined Benefit Retirement Pension and Post Employment Healthcare Plan and Defined Contribution Retirement Pension Trust Fund, as of June 30, 2007 and 2006, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Defined Benefits Retirement Pension and Post Employment Healthcare Plan and the Defined Contribution Retirement Pension Trust Fund and do not purport and do not present the net assets of the Public Employee Retirement System, a Component Unit of the State of Alaska, as of June 30, 2007 and 2006, and the changes in net assets for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the State of Alaska Public Employees' Retirement System's Defined Benefit Retirement Pension and Post Employment Healthcare Plan and Defined Contribution Retirement Pension Trust Fund, as of June 30, 2007 and 2006, and the changes in net assets for the years then ended in conformity with U.S. generally accepted accounting principles.



The accompanying required supplementary information of management's discussion and analysis on pages 13 to 21 and schedules of funding progress and employer contributions on pages 63 to 71 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedules 1 and 2 on pages 70 and 71 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. This information is the responsibility of management, has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The introductory section on pages 1 through 10 and investment, actuarial and statistical data on pages 73-127 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such additional information has not been subject to the auditing procedures applied in the audit of the basic financial statements and accordingly, we express no opinion on it.

KPMG LLP

November 30, 2007

STATE OF ALASKA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Defined Benefit Retirement Pension and
Post Employment Healthcare Plan
Defined Contribution Retirement Pension Trust Fund
(A Component Unit of the State of Alaska)

Management's Discussion and Analysis

June 30, 2007 and 2006

This section presents management's discussion and analysis (MD&A) of the Public Employees' Retirement Systems' Defined Benefit Pension and Post Employment Healthcare Plan (DB) and the Defined Contribution Retirement Pension Trust Fund (DCR) financial position and performance for the years ended June 30, 2007 and 2006. The DCR plan was established July 1, 2006. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements, notes to the financial statements, required supplementary and additional information to better understand the financial condition and performance of the Plans during the fiscal years ended June 30, 2007 and 2006. Information for fiscal year 2005 is presented for comparative purposes.

Financial Highlights

The DB Plan's total assets exceeded its total liabilities by \$10,929,964,000 and \$9,379,471,000 at the close of fiscal years 2007 and 2006, respectively. The DCR Pension Trust Fund's total assets exceeded its total liabilities by \$8,770,000 at the close of fiscal year 2007.

The DB Plan's "Net assets held in trust for pension and post employment healthcare benefits" as of June 30, 2007 and 2006 increased by \$1,550,493,000 or 16.5% and \$788,719,000 or 9.2% in fiscal years 2006 and 2005, respectively. The DCR Pension Trust Fund's "Net assets held in trust for pension and post employment healthcare benefits" as of June 30, 2007 totaled \$8,770,000.

The DB Plan's contributions received totaled \$474,981,000 and \$391,915,000 during fiscal years 2007 and 2006; an increase of \$83,066,000 and \$99,070,000 or 21.2% and 33.8% from fiscal years 2006 and 2005, respectively. The DCR Pension

Trust Fund's contributions received totaled \$8,769,000 during fiscal year 2007.

The DB Plan's net investment income increased from \$974,006,000 in 2006 to \$1,731,393,000 in 2007 and from \$692,303,000 in 2005 to \$974,006,000 in 2006; reflecting an increase of 77.8% and 40.7% from fiscal years 2006 and 2005, respectively. The DCR Pension Trust Fund's net investment income for fiscal year 2007 was \$364,000.

The DB Plan's pension benefit and post employment healthcare payments totaled \$635,098,000 and \$592,285,000 during fiscal years 2007 and 2006 reflecting an increase of \$42,813,000 and \$42,173,000 or 7.2% and 7.7% from fiscal years 2006 and 2005, respectively.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the DB Plan's and DCR Pension Trust Fund's basic financial statements. The Plans basic financial statements are comprised of three components: (1) statement of net assets, (2) statement of changes in net assets, and (3) notes to financial statements. This report also contains required supplementary information in addition to the basic financial statements.

Statements of Net Assets—These statements present information regarding the assets, liabilities, and net assets of the DB Plan and DCR Pension Trust Fund. Net assets represent the total amount of assets less the total amount of liabilities.

Statements of Changes in Net Assets—These statements present how the net assets changed during the fiscal year as a result of contributions, investment income, operating deductions, and transfers.

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The above statements represent resources available for investment and payment of benefits as of the fiscal yearend and the sources and uses of those funds during the fiscal year.

Notes to Financial Statements – The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules to better understand the DB Plan and DCR Pension Trust Fund's financial statements.

Required Supplementary Information – The required supplementary information consists of three schedules and related notes concerning the funded status of the DB Plan and actuarial assumptions and methods used in the actuarial valuation.

Other Supplementary Schedules – Other supplementary schedules include detailed information on administrative and investment deductions incurred by the DB Plan and payments to consultants for professional services.

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Condensed Financial Information

NET ASSETS
(Dollars in thousands)

| Description | Defined Benefit Plan | | | | 2005 | Defined Contribution Pension Trust Fund 2007 |
|---|----------------------|---------------------|---------------------|--------------|------------------|--|
| | 2007 | 2006 | Increase/(Decrease) | | | |
| | | | Amount | Percentage | | |
| Assets: | | | | | | |
| Cash, cash equivalents and receivables | \$ 46,279 | 15,169 | 31,110 | 205.1% | 12,275 | \$ 1,458 |
| Securities lending collateral Investments, at fair value | 1,191,168 | 929,519 | 261,649 | 28.1 | 659,801 | - |
| Other assets | 4 | 4 | - | - | 12 | - |
| Total assets | 12,128,312 | 10,316,794 | 1,811,518 | 17.6 | 9,257,964 | 8,961 |
| Liabilities: | | | | | | |
| Accrued expenses | 7,180 | 7,329 | (149) | (2.0) | 6,541 | 179 |
| Securities lending collateral payable | 1,191,168 | 929,519 | 261,649 | 28.1 | 659,801 | - |
| Other liabilities | - | 475 | (475) | (100.0) | 870 | 12 |
| Total liabilities | 1,198,348 | 937,323 | 261,025 | 27.8 | 667,212 | 191 |
| Net Assets | \$10,929,964 | \$ 9,379,471 | 1,550,493 | 16.5% | 8,590,752 | 8,770 |

CHANGES IN NET ASSETS
(Dollars in thousands)

| | | | | | | |
|--------------------------------------|---------------------|------------------|------------------|--------------|------------------|-----------------|
| Net assets, beginning of year | \$9,379,471 | 8,590,752 | 788,719 | 9.2% | 8,177,306 | \$ - |
| Additions: | | | | | | |
| Contributions | 474,981 | 391,915 | 83,066 | 21.2 | 292,845 | 8,769 |
| Net investment income | 1,731,393 | 947,006 | 757,387 | 77.8 | 692,303 | 364 |
| Other additions | 84 | 312 | (228) | (73.1) | 3 | - |
| Transfer from Retiree Health Fund | - | 34,635 | (34,635) | (100.0) | - | - |
| Total additions | 2,206,458 | 1,400,868 | 805,590 | 57.5 | 985,151 | 9,133 |
| Deductions: | | | | | | |
| Benefits | 635,098 | 592,285 | 42,813 | 7.2 | 550,112 | - |
| Refunds | 14,621 | 14,063 | 558 | 4.0 | 16,587 | 332 |
| Administrative | 6,246 | 5,801 | 445 | 7.7 | 5,006 | 31 |
| Total deductions | 655,965 | 612,149 | 43,816 | 7.2 | 571,705 | 363 |
| Increase in net Assets | 1,550,493 | 788,719 | 761,774 | 96.6 | 413,446 | 8,770 |
| Net assets, end of year | \$10,929,964 | 9,379,471 | 1,550,493 | 16.5% | 8,590,752 | \$ 8,770 |

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June 30, 2007 and 2006

Financial Analysis of the Plans

The Statement of Net Assets as of June 30, 2007 and 2006 showed total DB Plan's assets exceeding total liabilities by \$10,929,964,000 and \$9,379,471,000. The Statement of Net Assets as of June 30, 2007 showed total DCR Pension Trust Fund assets exceeding liabilities by \$8,770,000. These amounts represent the "Net assets held in trust for pension and post employment healthcare benefits". The entire amount is available to cover the DB Plan's and DCR Pension Trust Fund's obligations to pay pension and post employment healthcare benefits to its members and their beneficiaries.

These amounts also represent an increase in the DB Plan's "Net assets held in trust for pension and post employment healthcare benefits" of \$1,550,493,000 or 16.5% and \$788,719,000 or 9.2% from fiscal years 2007 and 2006, respectively. The DCR Pension Trust Fund's "Net Assets held in trust for pension and post employment healthcare benefits" for fiscal year 2007 totaled \$8,770,000. Over the long term, plan member and employer contributions, as well as investment income earned, are expected to sufficiently fund the pension benefit and post employment healthcare costs.

The investment of pension funds is a longterm undertaking. On an annual basis, the Alaska Retirement Management Board (ARMB) reviews and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the DB Plan's constraints and objectives. During fiscal year 2007, the ARMB adopted an asset allocation for the DB Plan that includes 36% in domestic equities, 14% in international equities, 20% in domestic fixed income, 2% in international fixed income, 10% in real estate, 7% in private equity, 2% in high yield, 2% in emerging market equity, 4% in absolute return, and 3% in other investments. This

asset allocation is expected to provide a five year median return of 7.83%. The ARMB adopted an asset allocation for the DCR Pension Trust Fund that includes 100% cash as the plan was in a startup year with minimal expense activity. This asset allocation is expected to provide a five year median return of 4.00%.

For fiscal years 2007 and 2006, the DB Plan's investments generated an 18.87% and an 11.74% rate of return, respectively. The DB Plan's annualized rate of return was 13.11% over the last three years and 11.54% over the last five years. For fiscal year 2007, the DCR Pension Trust Fund was invested in cash and cash equivalents from July 1st through October 2006. The fiscal year 2007, rate of return for the DCR Pension Trust Fund was not calculated by the Division of Treasury.

Actuarial Valuations and Funding Progress – DB Plan

The overall objective of a pension fund is to accumulate sufficient funds to meet all expected future obligations to members. The employer contribution requirements are actuarially determined as a percentage of eligible salaries, and reflect the cost of benefits accruing in fiscal year 2006 and a fixed amortization of the unfunded accrued liability. The amortization period is recommended by the Actuary and adopted by the ARMB. Employer contribution levels are recommended by the Actuary and adopted by the ARMB annually. Increasing healthcare costs and contribution shortfalls continue to impact the DB Plan's funding ratio. The ratio of assets to liabilities was 62.8%, at June 30, 2006 (the date of the DB Plan's latest actuarial valuation report). The goal for the DB Plan is to make progress toward achieving the funding objectives of the DB Plan.

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A summary of the actuarial assumptions and methods is presented in the Notes to Required Supplementary Information. The assumptions, when applied in combination, fairly represent past and anticipated future experience of the DB Plan.

For fiscal year 2008, the employer consolidated normal cost rate increased from 13.32% to 14.48%, the average past service rate increased from 14.87% to 18.03%, thus producing a total fiscal year 2008 average annual required contribution rate for all employers in the DB Plan of 32.51%. The ARMB adopted an average employer contribution rate of 32.51% for fiscal year 2008.

| | Valuation Year | |
|--------------------------------------|-------------------------------|-------------|
| | (Dollars in thousands) | |
| | <u>2006</u> | <u>2005</u> |
| Valuation Assets | \$ 9,040,908 | 8,442,919 |
| Accrued Liabilities (total benefits) | 14,388,413 | 12,844,841 |
| Funding ratio | 62.8% | 65.7% |

Contributions, Investment Income and Transfer

The additions required to fund retirement benefits are accumulated through a combination of employer and plan member contributions, investment income and a transfer.

| | Additions (in thousands) | | | | | |
|-----------------------------------|---------------------------------|------------------|----------------|-------------------|----------------|---------------------|
| | Defined Benefit Plan | | | | | Defined |
| | Increase/(Decrease) | | | | | Contribution |
| | <u>2007</u> | <u>2006</u> | <u>Amount</u> | <u>Percentage</u> | <u>2005</u> | <u>2007</u> |
| Plan member contributions | \$ 121,103 | 119,566 | 1,537 | 1.3% | 114,640 | \$ 5,175 |
| Employer contributions | 335,296 | 253,922 | 81,374 | 32.0 | 178,205 | 3,594 |
| State of Alaska | 18,582 | 18,427 | 155 | 0.8 | - | - |
| Net investment income | 1,731,393 | 974,006 | 757,387 | 77.8 | 692,303 | 364 |
| Other additions | 84 | 312 | (228) | (73.1) | 3 | - |
| Transfer from Retiree Health Fund | - | 34,635 | (34,635) | (100.0) | - | - |
| Total | <u>\$2,206,458</u> | <u>1,400,868</u> | <u>805,590</u> | <u>57.5%</u> | <u>985,151</u> | <u>\$ 9,133</u> |

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DB Plan

The DB Plan's employer contributions increased from \$253,922,000 in fiscal year 2006 to \$335,296,000 in fiscal year 2007 an increase of \$81,374,000 or 32.0%. Employer contributions increased from \$178,205,000 in fiscal year 2005 to \$253,922,000 in fiscal year 2006 an increase of \$75,717,000 or 42.5%. Increases experienced in fiscal year 2007 are largely due to the contribution shortfall related to contributions made in fiscal year 2005 and 2006. Increases experienced in fiscal year 2007 are largely due to changes in actuarial assumptions and methods implemented in the valuation for the period ending June 30, 2004 (the valuation year used to set fiscal year 2007 employer contribution rates).

The DB Plan's net investment income in fiscal year 2007 increased by \$757,387 or 77.8% from amounts recorded in fiscal year 2006. Net investment income in fiscal year 2006 increased by \$281,703,000 or 40.7% from amounts recorded in fiscal year 2005. The DB Plan's total returns were 18.87%, 11.74% and 8.95% for the years ending 2007, 2006 and 2005, respectively. Changes in both years are due to the performance of the equity markets. The domestic equity pool realized a return of 20.1% in 2007 compared to 9.2% in 2006. The international equity pool realized a return of 27.9% in 2007 compared to 28.7% in 2006. The real estate pool realized a return of 20.7% in 2007 compared to 18.6% in 2006. The private equity pool realized a return of 28.7% in 2007 compared to 25.9% in 2006. The emerging markets equity pool realized a return of 48.0% in 2007 compared to 34.5 in 2006. The high yield pool realized a return of 10.9% in 2007 compared to 5.6% in 2006. The other investments pool realized a return of 11.3% in 2007 compared to 8.6% in 2006. More than seventy-six percent of invested assets were invested in these pools.

Over the long term, investment income has been a major component of additions to plan assets. During fiscal year 2007, the DB Plan continued to record significant rates of return on investments. The rate of return used in the actuarial valuation report to determine liabilities of the DB Plan was 8.25%. The actual rate of return exceeded the actuarial rate of return for the third consecutive year.

During 2006 a review was conducted of all DB Plan's medical reserve amounts in the Retiree Health Fund. No transfer occurred in 2007. However, in 2006 there was an excess reserve balance over those deemed necessary for the continued operation of the Retiree Health Fund. The excess amount was allocated to plans participating in the Retiree Health Fund. In fiscal year 2006, the Plan recognized a transfer of \$34,635,000 from the Retiree Health Fund.

DCR Pension Trust Fund

The DCR Pension Trust Fund's Employer contributions in fiscal year 2007 totaled \$8,769,000. The DCR Pension Trust Fund's employer contribution rate for fiscal year 2007 was established by Alaska Statute 39.35.750 and adopted by the ARMB at 5.0%.

The DCR Pension Trust Fund's net investment income in fiscal year 2007 was \$364,000. For fiscal year 2007, the DCR Pension Trust Fund was maintained on a cash basis from July 1st through October 2006; therefore, no rate of return was calculated by the Division of Revenue.

Benefits and Other Deductions

The primary deduction of the DB Plan and DCR Pension Trust Fund is the payment of pension benefits. These benefit payments, together with post

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employment healthcare premiums paid, lump sum refunds made to former plan members, and the cost of administering the DB Plan and DCR Pension Trust Fund comprise the costs of operations. The DCR Pension Trust Fund started July 1, 2006.

| | Deductions (in thousands) | | | | | Defined Contribution Pension Trust Fund |
|--------------------------|---------------------------|---------|----------------------|------------|---------|--|
| | | | Defined Benefit Plan | | | |
| | | | Increase/(Decrease) | | | |
| | 2007 | 2006 | Amount | Percentage | 2005 | |
| Pension benefits | \$ 410,545 | 381,672 | 28,873 | 7.6% | 357,763 | \$ - |
| Healthcare benefits | 224,553 | 210,613 | 13,940 | 6.6 | 192,349 | - |
| Refunds of contributions | 14,621 | 14,063 | 558 | 4.0 | 16,587 | 332 |
| Administrative | 6,246 | 5,801 | 445 | 7.7 | 5,006 | 31 |
| Total | \$ 655,965 | 612,149 | 43,816 | 7.2% | 571,705 | 363 |

The DB Plan's pension benefit payments in 2007 and 2006 increased \$28,873,000 and \$23,909,000 or 7.6% and 6.7% from fiscal years 2006 and 2005, respectively. The majority of the increase in pension benefits was the result of a continuing increase in the number of retirees as well as a continuing increase in average benefits.

The DB Plan's post employment healthcare benefits in 2007 and 2006 increased \$13,940,000 and \$18,264,000 or 6.6% and 9.5% from fiscal years 2006 and 2005, respectively. Healthcare costs continue to rise year over year and this increase is directly related to the number of new retirees in the DB Plan.

The DCR Pension Trust Fund reflected \$15,000 in administrative expenses, which are management services paid out in fiscal year 2007 for managed account fees.

Funding

Retirement benefits are financed by accumulations from employer and plan member contributions and income earned on Plans investments.

- The employer contributions are calculated by the DB Plan's consulting actuaries and approved by the ARMB annually. For fiscal year 2007 and 2008, the DCR Pension Trust Fund's employer contribution rate was established by Alaska Statute 39.35.750 and adopted by the ARMB.
- Plan member contributions are set by Alaska Statute 39.35.160. for the DB Plan and Alaska Statute 39.35.730 for the DCR Pension Trust Fund.
- The ARMB works with an external consultant to determine the proper asset allocation strategy.

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Legislation

During the fiscal year 2007 legislative session, two laws were enacted that affect the DB Plan and DCR Pension Trust Fund:

Senate Bill 123, passed by the twenty-fifth Alaska State Legislature, created the Alaska Retiree Healthcare Trust and conformed amendments between the DB Plan and DCR Pension Trust Fund.

Senate Bill 53, passed by the twenty-fifth Alaska State Legislature, appropriating \$185 million from the general fund to the Department of Administration for deposit in the DB Plan's accounts in the public employee's retirement plan as partial payment of the participating public employee's retirement plan employers' contributions for the fiscal year ending June 30, 2008. This appropriation is intended to be the amount required to set the effective employer contribution rate of all public employee's retirement plan employers for the fiscal year ending June 30, 2008, at the lower of the level percentage of pay rate approved by the ARMB or 22.00% but not lower than 14.48%.

During the fiscal year 2006 second session of the twenty-fourth Alaska State Legislature, Senate Bill 231 passed, appropriating \$18.6 million from the general fund to the Department of Administration to reduce the contributions required from participating political subdivisions as a result of contribution rate increases for the year ended June 30, 2007.

During fiscal year 2005 Senate Bill 46, passed by the first special session of the twentyfourth Alaska State Legislature, appropriated \$18.4 million from the general fund to the Department of Administration to reduce the contributions required from participating political subdivisions as a result of contribution rate increases for the year ended June 30, 2006.

During the fiscal year 2005 legislative session, a law was enacted that closes the PERS defined benefit plan. Senate Bill 141, effective July 1, 2006 closed the PERS defined benefit plan to new members and creates a PERS defined contribution plan for members first hired on or after July 1, 2006.

Economic Conditions, Future Contribution Rates, and Status of Unfunded Liability

The financial market environment continues to challenge investors. With the threat of inflation, interest rate increases by the Federal Reserve Bank, and continued turmoil in the Middle East, many forces once again pose challenges to Plan investments. The ARMB continues to diversify the portfolio of the DB Plan to maintain an optimal risk/return ratio.

The return on the DB Plan's investments exceeded its' actuarially assumed return of 8.25% for the third consecutive year. Even with investment returns exceeding the actuarial rate of return, the DB Plan will continue to see an increase in employer contribution rates due to rising medical costs and the contribution shortfall in fiscal year 2005 and 2006. In addition, employer contribution rates will rise in fiscal year 2008. Effective with the 2004 valuation, the assumptions used to value liabilities for retiree medical benefits were changed. The revised methods and assumptions more accurately measured retiree medical liabilities and incorporated the expected impact on the PERS liabilities of changes in the Medicare program.

The consulting actuary recommended an increase from the average employer contribution rate of 25.63% in fiscal year 2006 to 28.19% in fiscal year 2007. The ARMB adopted an average employer contribution rate of 21.77% for fiscal year 2007, up 5 points from the fiscal year 2006 ARMB adopted employer contribution rate of 16.77%. The reason for the five point

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change in the average employer contribution rate is the Plan's regulation, 2 AAC 35.900 Maximum Employer Contribution Rate Change, which states "The maximum change in the contribution rate from one year to the next shall be no more than five percentage points, as actuarially calculated, whether the change is an increase or a decrease." Despite a modest 2.56 point change in the calculated average employer contribution rates from fiscal year 2006 to 2007 prescribed by the DB Plan's consulting actuary, regulations prohibit more than a five point change from year to year, so the ARMB was limited in its capacity to increase the employer contribution rates. This regulation was put in place to reduce the volatility that employer contribution rates could have in market conditions similar to those in 2001 and 2002, as well as conditions that are beyond the control of the Plan, such as rising healthcare costs. Regulation 2 AAC 35.900 was repealed effective July 20, 2006.

The June 30, 2006, actuarial valuation for the DB Plan reported a funding ratio of 62.8% and an unfunded liability of \$5.3 billion.

For fiscal year 2007, the DCR Pension Trust Fund's employer contribution rate was set at 5.00%. The DCR Pension Trust Fund's fiscal year 2008 employer contribution rate has remained at 5.00%.

Requests for Information

This financial report is designed to provide a general overview of the finances for all those with interest in the finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Alaska Public Employees' Retirement System, Division of Retirement & Benefits, Accounting Section, P.O. Box 110203, Juneau, Alaska 99811-0203.

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Statements of Plan Net Assets
June 30, 2007 and 2006 (in thousands)

| | Defined Benefit | | | | | |
|---|--------------------|-----------------------------------|-------------------|------------------|-----------------------------------|-------------------|
| | 2007 | | | 2006 | | |
| | Pension | Post- employment Healthcare | Total | Pension | Post- employment Healthcare | Total |
| Assets: | | | | | | |
| Cash and Cash Equivalents (notes 3 and 5): | | | | | | |
| Short-Term Fixed Income Pool | \$ 12,170 | 8,582 | 20,752 | 336 | 224 | 560 |
| Securities Lending Collateral | 698,584 | 492,584 | 1,191,168 | 557,143 | 372,376 | 929,519 |
| Great-West / Participant Directed Deposit | - | - | - | - | - | - |
| Total Cash and Cash Equivalents | <u>710,754</u> | <u>501,166</u> | <u>1,211,920</u> | <u>557,479</u> | <u>372,600</u> | <u>930,079</u> |
| Receivables: | | | | | | |
| Contributions | 10,614 | 7,484 | 18,098 | 8,740 | 5,842 | 14,582 |
| Due from State of Alaska General Fund | 4,357 | 3,072 | 7,429 | 14 | 9 | 23 |
| Other Account Receivable | - | - | - | 2 | 2 | 4 |
| Total Receivables | <u>14,971</u> | <u>10,556</u> | <u>25,527</u> | <u>8,756</u> | <u>5,853</u> | <u>14,609</u> |
| Investments (notes 3, 4, 5 and 8): | | | | | | |
| Collective investment funds, at fair value: | | | | | | |
| Great-West participant directed | - | - | - | - | - | - |
| Domestic Equity Pool | 3,346,520 | 604,618 | 3,951,138 | 3,091,953 | 487,950 | 3,579,903 |
| Domestic Fixed Income Pool | 1,140,609 | 804,265 | 1,944,874 | 1,214,397 | 811,660 | 2,026,057 |
| International Equity Pool | 1,084,261 | 764,533 | 1,848,794 | 855,180 | 571,572 | 1,426,752 |
| Real Estate Pool | 695,894 | 490,688 | 1,186,582 | 563,987 | 376,949 | 940,936 |
| International Fixed Income Pool | 118,280 | 83,402 | 201,682 | 117,676 | 78,651 | 196,327 |
| Private Equity Pool | 427,896 | 301,717 | 729,613 | 338,860 | 226,483 | 565,343 |
| Emerging Markets Equity Pool | 166,513 | 117,411 | 283,924 | 108,084 | 72,240 | 180,324 |
| Treasury Inflation Protection Pool | - | - | - | - | - | - |
| Other Investments Pool | 74,947 | 52,847 | 127,794 | 42,577 | 28,457 | 71,034 |
| High Yield Pool | 113,398 | 79,959 | 193,357 | 87,688 | 58,608 | 146,296 |
| Absolute Return Pool | <u>248,137</u> | <u>174,966</u> | <u>423,103</u> | <u>143,332</u> | <u>95,798</u> | <u>239,130</u> |
| Total Investments | <u>7,416,455</u> | <u>3,474,406</u> | <u>10,890,861</u> | <u>6,563,734</u> | <u>2,808,368</u> | <u>9,372,102</u> |
| Other: | | | | | | |
| Loans and Mortgages, Net of Allowance for Loan Losses of \$5 for both 2007 and 2006 | - | - | - | 1 | 1 | 2 |
| Other | <u>2</u> | <u>2</u> | <u>4</u> | <u>2</u> | <u>-</u> | <u>2</u> |
| Total Other | <u>2</u> | <u>2</u> | <u>4</u> | <u>3</u> | <u>1</u> | <u>4</u> |
| Total Assets | <u>8,142,182</u> | <u>3,986,130</u> | <u>12,128,312</u> | <u>7,129,972</u> | <u>3,186,822</u> | <u>10,316,794</u> |
| Liabilities: | | | | | | |
| Accrued Expenses | 4,211 | 2,969 | 7,180 | 4,393 | 2,936 | 7,329 |
| Due to State of Alaska General Fund | - | - | - | 285 | 190 | 475 |
| Securities Lending Collateral Payable (note 5) | <u>698,584</u> | <u>492,584</u> | <u>1,191,168</u> | <u>557,144</u> | <u>372,375</u> | <u>929,519</u> |
| Total Liabilities | <u>702,795</u> | <u>495,553</u> | <u>1,198,348</u> | <u>561,822</u> | <u>375,501</u> | <u>937,323</u> |
| Commitments and Contingencies (note 8) | | | | | | |
| Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits | <u>\$7,439,387</u> | <u>3,490,577</u> | <u>10,929,964</u> | <u>6,568,150</u> | <u>2,811,321</u> | <u>9,379,471</u> |

(Schedules of funding progress are presented on pages 63 and 64.)

See accompanying notes to financial statements.

(continued)

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PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Defined Benefit Retirement Pension and
Post Employment Healthcare Plan
Defined Contribution Retirement Pension Trust Fund
(A Component Unit of the State of Alaska)
Statements of Plan Net Assets
June 30, 2007 and 2006 (in thousands)

| | Defined Contribution | | |
|---|---------------------------------|--|--------------|
| | 2007 | | |
| | Participant Directed | Occupational Death and Disability | Total |
| Assets: | | | |
| Cash and Cash Equivalents (notes 3 and 5): | | | |
| Short-Term Fixed Income Pool | 604 | 13 | 617 |
| Securities Lending Collateral | - | - | - |
| Great-West / Participant Directed Deposit | 29 | - | 29 |
| Total Cash and Cash Equivalents | <u>633</u> | <u>13</u> | <u>646</u> |
| Receivables: | | | |
| Contributions | 537 | 12 | 549 |
| Due from State of Alaska General Fund | 245 | 18 | 263 |
| Other Account Receivable | - | - | - |
| Total Receivables | <u>782</u> | <u>30</u> | <u>812</u> |
| Investments (notes 3, 4, 5 and 8): | | | |
| Collective investment funds, at fair value: | | | |
| Great-West participant directed | 7,348 | - | 7,348 |
| Domestic Equity Pool | - | 66 | 66 |
| Domestic Fixed Income Pool | - | 21 | 21 |
| International Equity Pool | - | 29 | 29 |
| Real Estate Pool | - | 14 | 14 |
| International Fixed Income Pool | - | 3 | 3 |
| Private Equity Pool | - | - | - |
| Emerging Markets Equity Pool | - | 6 | 6 |
| Treasury Inflation Protection Pool | - | 16 | 16 |
| Other Investments Pool | - | - | - |
| High Yield Pool | - | - | - |
| Absolute Return Pool | - | - | - |
| Total Investments | <u>7,348</u> | <u>155</u> | <u>7,503</u> |
| Other: | | | |
| Loans and Mortgages, Net of Allowance for Loan Losses of \$5 for both 2007 and 2006 | - | - | - |
| Other | - | - | - |
| Total Other | <u>-</u> | <u>-</u> | <u>-</u> |
| Total Assets | <u>8,763</u> | <u>198</u> | <u>8,961</u> |
| Liabilities: | | | |
| Accrued Expenses | 179 | - | 179 |
| Due to State of Alaska General Fund | - | 12 | 12 |
| Securities Lending Collateral Payable (note 5) | - | - | - |
| Total Liabilities | <u>179</u> | <u>12</u> | <u>191</u> |
| Commitments and Contingencies (note 8) | | | |
| Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits | <u>8,584</u> | <u>186</u> | <u>8,770</u> |

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Statements of Changes in Plan Net Assets
June 30, 2007 and 2006 (in thousands)

| | Defined Benefit | | | | | |
|---|--------------------|-----------------------------------|-------------------|------------------|-----------------------------------|------------------|
| | 2007 | | | 2006 | | |
| | Pension | Post- employment Healthcare | Total | Pension | Post- employment Healthcare | Total |
| Additions: | | | | | | |
| Contributions: | | | | | | |
| Employers | \$ 196,641 | 138,655 | 335,296 | 152,198 | 101,724 | 253,922 |
| Plan Members | 71,023 | 50,080 | 121,103 | 71,666 | 47,900 | 119,566 |
| State of Alaska | 10,898 | 7,684 | 18,582 | 11,045 | 7,382 | 18,427 |
| Total contributions | <u>278,562</u> | <u>196,419</u> | <u>474,981</u> | <u>234,909</u> | <u>157,006</u> | <u>391,915</u> |
| Investment Income: | | | | | | |
| Net Appreciation in Fair Value (note 3) | 814,276 | 574,161 | 1,388,437 | 424,780 | 283,908 | 708,688 |
| Interest | 74,433 | 52,485 | 126,918 | 72,259 | 48,296 | 120,555 |
| Dividends | 138,326 | 97,536 | 235,862 | 99,085 | 66,224 | 165,309 |
| Net Mortgage Loan Recovery | - | - | - | - | - | - |
| Total Investment Income | <u>1,027,035</u> | <u>724,182</u> | <u>1,751,217</u> | <u>596,124</u> | <u>398,428</u> | <u>994,552</u> |
| Less Investment Expense | <u>13,175</u> | <u>9,290</u> | <u>22,465</u> | <u>13,510</u> | <u>9,028</u> | <u>22,538</u> |
| Net Investment Income Before Security Lending Activities | <u>1,013,860</u> | <u>714,892</u> | <u>1,728,752</u> | <u>582,614</u> | <u>389,400</u> | <u>972,014</u> |
| Securities Lending Income (note 5) | 30,765 | 21,693 | 52,458 | 20,111 | 13,441 | 33,552 |
| Less Securities Lending Expenses (note 5) | <u>29,216</u> | <u>20,601</u> | <u>49,817</u> | <u>18,917</u> | <u>12,643</u> | <u>31,560</u> |
| Net Income from Securities Lending Activities | <u>1,549</u> | <u>1,092</u> | <u>2,641</u> | <u>1,194</u> | <u>798</u> | <u>1,992</u> |
| Net Investment Income | <u>1,015,409</u> | <u>715,984</u> | <u>1,731,393</u> | <u>583,808</u> | <u>390,198</u> | <u>974,006</u> |
| Other: | | | | | | |
| Other | 49 | 35 | 84 | 187 | 125 | 312 |
| Transfer from Retiree Health Fund (note 6) | - | - | - | 20,760 | 13,875 | 34,635 |
| Total Additions | <u>1,294,020</u> | <u>912,438</u> | <u>2,206,458</u> | <u>839,664</u> | <u>561,204</u> | <u>1,400,868</u> |
| Deductions: | | | | | | |
| Benefits | 410,545 | 224,553 | 635,098 | 381,672 | 210,613 | 592,285 |
| Refunds of Contributions | 8,575 | 6,046 | 14,621 | 8,429 | 5,634 | 14,063 |
| Administrative | 3,663 | 2,583 | 6,246 | 3,477 | 2,324 | 5,801 |
| Total Deductions | <u>422,783</u> | <u>233,182</u> | <u>655,965</u> | <u>393,578</u> | <u>218,571</u> | <u>612,149</u> |
| Net Increase | 871,237 | 679,256 | 1,550,493 | 446,086 | 342,633 | 788,719 |
| Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits: | | | | | | |
| Balance, Beginning of Year | <u>6,568,150</u> | <u>2,811,321</u> | <u>9,379,471</u> | <u>6,122,064</u> | <u>2,468,688</u> | <u>8,590,752</u> |
| Balance, End of Year | <u>\$7,439,387</u> | <u>3,490,577</u> | <u>10,929,964</u> | <u>6,568,150</u> | <u>2,811,321</u> | <u>9,379,471</u> |

See accompanying notes to financial statements.

(continued)

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Statements of Changes in Plan Net Assets
June 30, 2007 and 2006 (in thousands)

| | Defined Contribution 2007 | | |
|---|----------------------------------|--|--------------|
| | Participant Directed | Occupational Death and Disability | Total |
| Additions: | | | |
| Contributions: | | | |
| Employers | 3,413 | 181 | 3,594 |
| Plan Members | 5,175 | - | 5,175 |
| State of Alaska | - | - | - |
| Total contributions | <u>8,588</u> | <u>181</u> | <u>8,769</u> |
| Investment Income: | | | |
| Net Appreciation in Fair Value (note 3) | - | 4 | 4 |
| Interest | 359 | 1 | 360 |
| Dividends | - | - | - |
| Net Mortgage Loan Recovery | - | - | - |
| Total Investment Income | <u>359</u> | <u>5</u> | <u>364</u> |
| Less Investment Expense | - | - | - |
| Net Investment Income Before Security Lending Activities | <u>359</u> | <u>5</u> | <u>364</u> |
| Securities Lending Income (note 5) | - | - | - |
| Less Securities Lending Expenses (note 5) | - | - | - |
| Net Income from Securities Lending Activities | - | - | - |
| Net Investment Income | <u>359</u> | <u>5</u> | <u>364</u> |
| Other: | | | |
| Other | - | - | - |
| Transfer from Retiree Health Fund (note 6) | - | - | - |
| Total Additions | <u>8,947</u> | <u>186</u> | <u>9,133</u> |
| Deductions: | | | |
| Benefits | - | - | - |
| Refunds of Contributions | 332 | - | 332 |
| Administrative | 31 | - | 31 |
| Total Deductions | <u>363</u> | <u>-</u> | <u>363</u> |
| Net Increase | 8,584 | 186 | 8,770 |
| Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits: | | | |
| Balance, Beginning of Year | - | - | - |
| Balance, End of Year | <u>8,584</u> | <u>186</u> | <u>8,770</u> |

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June 30, 2007 and 2006

(1) Description

The following brief description of the State of Alaska Public Employees' Retirement System (PERS) Defined Benefit Retirement Pension and Post Employment Healthcare Plan (DB) and Defined Contribution Retirement Pension Trust Fund (DCR). PERS is a Component Unit of the State of Alaska. The DB Plan and DCR Pension Trust Fund do not purport and do not present the net assets of the PERS as of June 30, 2007 and 2006 and the changes in net assets of the years then ended. The DCR Pension Trust Fund also consists of a Retiree Medical Fund and a Health Reimbursement Arrangement Fund, both of which are reported in separate financial statements. Members should refer to the Plan agreement for more complete information than that noted in the notes to the financial statements.

At June 30, the number of participating local government employers and public organizations including the State was:

| | <u>2007</u> | <u>2006</u> |
|------------------|-------------|-------------|
| State of Alaska | 1 | 1 |
| Municipalities | 77 | 77 |
| School districts | 53 | 53 |
| Other | <u>29</u> | <u>29</u> |
| | <u>160</u> | <u>160</u> |

Inclusion in the DB Plan and DCR Pension Trust Fund is a condition of employment for eligible State employees, except as otherwise provided, for judges, elected officers and certain employees of the Alaska Marine Highway System. Any local government in the State may elect to have its permanent general and peace officer and firefighter employees covered by the Plans.

Defined Benefit Retirement Plan

General

The DB Plan is a defined benefit, agent, multiple employer plan within the PERS established and administered by the State of Alaska (State) to provide pension and post employment healthcare benefits for eligible State and local government employees. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature. The DB Plan is a plan within PERS. PERS is a component unit of the State financial reporting entity and is included in the State's Comprehensive Annual Financial Report pension trust fund. The State employees who administer the DB Plan and DCR Pension

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Trust Fund participate in both. With the passing of SB141, the PERS DB Plan is closed to all new members effective July 1, 2006.

At June 30, DB Plan's membership consisted of:

| | <u>2007</u> | <u>2006</u> |
|---|----------------------|----------------------|
| Retirees and beneficiaries currently receiving benefits | 22,992 | 21,852 |
| Terminated plan members entitled to future benefits | <u>6,277</u> | <u>6,102</u> |
| Total current and future benefits | <u>29,269</u> | <u>27,954</u> |
| Active plan members: | | |
| General | 29,300 | 31,865 |
| Peace officer and firefighter | <u>2,709</u> | <u>2,795</u> |
| Total active plan membership | <u>32,009</u> | <u>34,660</u> |
| | <u>61,278</u> | <u>62,614</u> |
| Active plan members: | | |
| Vested: | | |
| General | 17,860 | 17,336 |
| Peace officer and firefighter | 1,898 | 1,815 |
| Nonvested: | | |
| General | 11,440 | 14,529 |
| Peace officer and firefighter | <u>811</u> | <u>980</u> |
| Total active plan membership | <u>32,009</u> | <u>34,660</u> |

Pension Benefits

Members hired prior to July 1, 1986, with five or more paidup years of credited service are entitled to monthly pension benefits beginning at normal retirement age, fiftyfive, or early retirement age, fifty. For members first hired after June 30, 1986, the normal and early retirement ages are sixty and fiftyfive, respectively. Members with thirty or more years of credited service (twenty years for peace officers and firefighters) may retire at any age and receive a normal benefit.

The normal monthly pension benefit is based on years of service and average monthly compensation. For members hired prior to July 1, 1996, and all peace officer and firefighter, the average monthly compensation is based upon the members' three highest, consecutive years' salaries. For all other members hired after June 30, 1996, average monthly compensation is based upon the members' five highest, consecutive years' salaries.

The benefit related to all years of service prior to July 1, 1986, and for years of service through a total of ten years for general members is equal to 2% of the member's average monthly compensation for each year of service. The benefit for each year over ten years of service subsequent to June 30, 1986, is equal to 21/4% of the member's average monthly compensation for the second ten years and 21/2% for all remaining years of service. For peace officer and firefighters, the benefit for years of service through a total of ten years is equal to 2% of the member's average monthly compensation and 21/2% for all remaining years of service.

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Minimum benefits for members eligible for retirement are \$25 per month for each year of credited service.

Married members must receive their benefits in the form of a joint and survivor annuity unless their spouse consents to another form of benefit or another person is eligible for benefits under a qualified domestic relations order.

The DB Plan has two types of postretirement pension adjustments (PRPA). The automatic PRPA is issued annually to all eligible benefit recipients, when the cost of living increases in the previous calendar year. The automatic PRPA increase is paid beginning July 1 of each year. The discretionary PRPA may be granted to eligible recipients by the DB Plan's Administrator if the funding ratio of the DB Plan meets or exceeds one hundred and five percent. If both an automatic and discretionary PRPA are granted, and a retiree is eligible for both adjustments, the one that provides the retiree the greater increase will be paid.

Post employment Healthcare Benefits

Major medical benefits are provided to retirees without cost for all members hired before July 1, 1986. Members hired after July 1, 1986 with five years of credited service (or ten years of credited service for those first hired after July 1, 1996) must pay the full monthly premium if they are under age sixty, and receive benefits at no premium cost if they are over age sixty or are receiving disability benefits. Peace officers and firefighters with 25 years of membership service also receive benefits at no premium cost.

Prior to July 1, 1997, post employment healthcare benefits were provided by the payment of premiums to an insurance company. Beginning July 1,

1997, the Retiree Health Fund (RHF), a pension trust fund of the State, was established. The RHF is selffunded and provides major medical coverage to retirees of the DB Plan. Retirees of three other State administered retirement plans also participate in the RHF. The DB Plan, along with the other participating plans, retains the risk of loss of allowable claims. The RHF issues a publicly available financial report, which may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

Death Benefits

If an active general DB Plan member dies from occupational causes, the spouse may receive a monthly pension equal to 40% of the DB Plan's member's salary. If an active peace officer or firefighter DB Plan member dies from occupational causes, the spouse may receive a monthly pension equal to 50% of the DB Plan's member's salary or 75% of the member's retirement benefit calculated as if the member had survived until normal retirement age, whichever is greater. When death is due to occupational causes and there is no surviving spouse, the DB Plan's member's dependent child(ren) may receive the monthly pension until they are no longer dependents. If the member does not have a spouse or dependent children at the time of death, a lump sum death benefit is payable to the named beneficiary(ies). The amount of the occupational death pension changes on the date the DB Plan member's normal retirement would have occurred if the DB Plan member had lived. The new benefit is based on the Plan member's average monthly compensation at the time of death and the credited service, including service that would have accrued if the DB Plan member had lived

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and continued to work until normal retirement. If the death was from non-occupational causes, and the DB Plan member was vested, the spouse may receive a monthly 50% joint and survivor option benefit based on the member's credited service and average monthly compensation at the time of death. If the DB Plan member is not married or vested, a lump sum death benefit is payable to the named beneficiary(ies).

Disability Benefits

Active DB Plan members who become permanently disabled due to occupational or nonoccupational causes receive disability benefits until normal retirement age, or when the service requirement for normal retirement is met. Although there are no minimum service requirements for Plan members to be eligible for occupational disability, DB Plan members must be vested to receive non-occupational disability benefits. The monthly occupational disability benefit is equal to 40% of the DB Plan's member's salary at the time of the disability. The non-occupational disability benefit is based on the DB Plan member's service and salary at the time of disability. At normal retirement age, a disabled general DB Plan member receives normal retirement benefits. A peace officer or firefighter Plan member may elect to receive normal retirement benefits calculated under the occupational disability benefit rules.

Contributions

Defined Benefit Plan Member Contributions

The DB Plan's member contribution rates are 7.5% for peace officers and firefighters, 9.6% for some school district employees, and 6.75% for general DB Plan members, as required by statute. The DB Plan's member contributions are

deducted before federal income tax is withheld. Contributions are collected by employers and remitted to the DB Plan. The DB Plan's member contributions earn interest at the rate of 4.5% per annum, compounded semiannually.

Employer Contributions

The DB Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as a percent of annual covered payroll, are sufficient to accumulate assets to pay both pension and post employment healthcare benefits when due. Employer contribution rates are determined using the entry age normal actuarial funding method. The DB Plan uses the level percentage of pay method to amortize the unfunded liability over a twentyfive year fixed period. Regulation 2AAC 35.900 Maximum Employer Contribution Rate Change, prohibits the ARMB from increasing or decreasing employer contribution rates by more than five percentage points over the rate adopted in the prior year. Regulation 2 AAC 35.900 was repealed effective July 20, 2006.

Contributions from the State of Alaska

Senate Bill 53, passed by the twenty-fifty Alaska State Legislature, appropriated \$185 million from the general fund to the Department of Administration for deposit in the DB Plan's accounts in the public employee's retirement plan as partial payment of the participating public employee's retirement plan employers' contributions for the fiscal year ending June 30, 2008. This appropriation is intended to be the amount required to set the effective employer contribution rate of all public employee's retirement plan employers for the fiscal year ending June 30, 2008, at the lower of the level percentage of pay rate approved by the ARMB or 22.00% but not lower than 14.48%.

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Senate Bill 231, passed by the first special session of the twentyfourth Alaska State Legislature, appropriated \$18.6 million from the general fund to the Department of Administration to reduce the contributions required from participating political subdivisions as a result of contribution rate increases for the year ended June 30, 2007.

Senate Bill 46, passed by the first special session of the twentyfourth Alaska State Legislature, appropriated \$18.4 million from the general fund to the Department of Administration to reduce the contributions required from participating political subdivisions as a result of contribution rate increases for the year ended June 30, 2006.

Refunds

DB Plan member contributions may be voluntarily or, under certain circumstances, involuntarily refunded to the member or a garnishing agency sixty days after termination of employment. Voluntary refund rights are forfeited on July 1 following the member's 75th birthday or within fifty years of the member's last termination date. Members who have had contributions refunded forfeit all retirement benefits, including post employment healthcare benefits. Members are allowed to reinstate refunded service due to involuntary refunds by repaying the total involuntary refunded balance and accrued interest. Members are allowed to reinstate voluntarily refunded service by repaying the voluntarily refunded balance and accrued interest, as long as they reestablish an employee relationship with a participating DB Plan employer before July 1, 2010. Members who have not reestablished an employee relationship with a participating DB Plan

employer by June 30, 2010, will not be eligible to reinstate voluntarily refunded service and will forfeit any claim to DB Plan' membership rights. Balances refunded to members accrue interest at the rate of 7.0% per annum, compounded semiannually.

Administrative Costs

Administrative costs are financed through investment earnings.

Due from (to) State of Alaska General Fund

Amounts due from (to) the State of Alaska General Fund represent the net difference between amounts paid by the DB Plan on behalf of others and amounts paid by others on behalf of the DB Plan.

Defined Contribution Retirement Pension Trust Fund

General

The DCR Pension Trust Fund is a defined contribution, agent, multiple employer public employee retirement plan established and administered by the State of Alaska (State) to provide pension and post employment healthcare benefits for eligible State and local government employees. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature. The DCR Pension Trust Fund was created by State of Alaska Statutes effective July 1, 2006. A defined contribution plan is a plan in which savings are accumulated in an individual retirement account for the exclusive benefit of the member or beneficiaries.

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At June 30, DCR Pension Trust Fund membership consisted of:

| | <u>2007</u> |
|---|---------------------|
| Retirees and beneficiaries currently receiving benefits | — |
| Terminated plan members entitled to future benefits: | |
| 25% Vested | - |
| 50% Vested | 7 |
| 75% Vested | 5 |
| 100% Vested | <u>6</u> |
| Total terminated plan members entitled to future benefits | <u>18</u> |
| Total current and future benefits | <u>18</u> |
| Active plan members: | |
| General | 2,678 |
| Peace officer and firefighter | <u>166</u> |
| Total active members | <u>2,844</u> |
| Active plan members: | |
| Vested General: | |
| 25% Vested | 4 |
| 50% Vested | 5 |
| 75% Vested | 4 |
| 100% Vested | <u>6</u> |
| Total vested general | <u>19</u> |
| Vested peace officer and firefighter | |
| 25% Vested | - |
| 50% Vested | - |
| 75% Vested | - |
| 100% Vested | <u>-</u> |
| Total vested peace officer and firefighter | <u>-</u> |
| Nonvested: | |
| General | 2,659 |
| Peace officer and firefighter | <u>166</u> |
| Total nonvested general and peace officer and firefighter | <u>2,825</u> |
| Total | <u>2,862</u> |

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Pension Benefits

A participating member is immediately and fully vested in that member's contributions and related earnings. A member shall be fully vested in the employer contributions made on that member's behalf, and related earnings, after five years of service. A member is partially vested in the employer contributions made on that member's behalf, and the related earnings, in the ratio of a) 25% with two years of service, b) 50% with three years of service; c) 75% with four years of service; and d) 100% with five years of service.

Post employment Healthcare Benefits

Major medical benefits available to eligible persons are access to the retiree major medical insurance plan and to the health reimbursement arrangement plan. Access to the retiree major medical insurance plan means that an eligible person may not be denied insurance coverage except for failure to pay the required premium.

Death Benefits

If (1) the death of an employee occurs before the employee's retirement and before the employee's normal retirement date, (2) the proximate cause of death is a bodily injury sustained or a hazard undergone while in the performance and within the scope of the employee's duties, and (3) the injury or hazard is not the proximate result of willful negligence of the employee, a monthly survivor's pension shall be paid to the surviving spouse. If there is no surviving spouse or if the spouse later dies, the monthly survivor's pension shall be paid in equal parts to the dependent children of the employee.

The monthly survivor's pension section for survivors of employees who were not peace officers or fire fighters is 40% of the employee's monthly compensation in the month in which the employee dies. The monthly survivor's pension for survivors of employees who were peace officers or fire fighters is 50% of the monthly compensation in the month in which the employee dies. While the monthly survivor's pension is being paid, the employer shall make contributions on behalf of the employee's beneficiaries based on the deceased employee's gross monthly compensation at the time of occupational death.

Disability Benefits

An employee is eligible for an occupational disability benefit if employment is terminated because of a total and apparently permanent occupational disability before the employee's normal retirement date. The occupational disability benefits accrue beginning the first day of the month following termination of employment as a result of the disability and are payable the last day of the month. If a final determination granting the benefit is not made in time to pay the benefit when due, a retroactive payment shall be made to cover the period of deferment.

Contributions

DCR Pension Trust Fund Member Contributions

Contribution rates are 8.0% for DCR Pension Trust Fund members, as required by statute. The employer shall deduct the contribution from the member's compensation at the end of each payroll period, and the contribution shall be credited by the plan to the member's individual

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account. The contributions shall be deducted from the member's compensation before the computation of applicable federal taxes.

Employer Contributions

An employer shall contribute to each member's individual account an amount equal to 5.0% of the member's compensation.

Each participant designates how contributions are to be allocated among the investment options. Each participant's account is credited with the participant's contributions and the appreciation or depreciation in unit value for the investment funds. Investment options are disclosed in note 3.

Recordkeeping/administrative fees consisting of a fixed amount, applied in a lumpsum each calendar year, and a variable amount, applied monthly, are deducted from each participant's account, applied pro rata to all the funds in which the employee participates. This fee is for all costs incurred by the record keeper and by the State. The investment management fees are netted out of the funds' performance.

Refunds

A member is eligible to elect distribution of the member's account in accordance with this section 60 days after termination of employment. Distributions that are being paid to a member may not be affected by the member's subsequent reemployment with the employer. Upon reemployment, a new individual account shall be established for the member to whom any future contributions shall be allocated.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized in the period in which they are due. Benefits and refunds are recognized when due and payable.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

GASB Statements No. 25 and No. 43

The DB Plan and DCR Pension Trust Fund follow the provisions of Government Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* (GASB 25). GASB 25 establishes a financial reporting framework for defined benefit plans that distinguishes between two separate categories of information: (a) current financial information about plan assets and financial activities and (b) actuarially determined information, from a long-term perspective, about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due.

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During the fiscal year, the DB Plan adopted GASB Statement No. 43, *Financial Reporting for Post employment Benefit Plans Other Than Pension Plans* (GASB 43). GASB 43 establishes uniform financial reporting standards for Other Post-employment Benefit Plans (OPEB) and supersedes the interim guidance included in GASB Statement No. 26, *Financial Reporting or Post Employment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed by GASB 43 is generally consistent with the approach adopted in GASB 25, with modifications to reflect differences between pension and OPEB plans.

Investments

Investments are carried at fair value in accordance with GASB 31. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade date (ownership) basis at the current fair value. Dividend income on equity securities is accrued on the exdividend date. Net appreciation (depreciation) is determined by calculating the change in the fair value of investments between the end of the year and the beginning of the year, less purchases of investments at cost, plus sales of investments at fair value. Investment deductions consist of those administrative deductions directly related to the Plan's investment operations.

In fiscal year 2005, GASB Statement No. 40, *Deposits and Investment Risk Disclosures* (GASB 40) was implemented. GASB 40 addresses disclosures on deposits and invest-

ments, focusing on common investment risks related to interest rate risk, credit risk, foreign currency risk and concentration of credit risk.

Basis of Accounting

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and members, net of benefits paid to DB and DCR Pension Trust

Fund members as well as administrative and investment management expenses. Contributions, benefits paid and all expenses are recorded on a cash basis.

Valuation

Fixed income securities are valued each business day using prices obtained from a pricing service when such prices are available; otherwise, such securities are valued at the most current sale price or based on a valuation provided by investment managers.

Domestic and international equity securities are valued each business day using prices obtained from pricing service or prices quoted by one or more independent brokers.

Emerging markets securities are valued on the last business day of each month by the investment managers.

Private equity securities are valued quarterly by the general partners and investment sponsors. The private equity oversight manager is held to

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a standard of reasonable care in verifying that the valuations reasonably reflect the underlying fair value of the investments.

Absolute return investments are valued monthly by the general partners. The fund administrators are held to a standard of reasonable care in verifying that the valuations reasonably reflect the underlying fair value of the investments.

The energy related investments in the other investments pool are valued quarterly by the general partner. The agricultural investments are valued quarterly by investment managers. Valuations are based on market conditions and knowledge of industry trends. Agricultural holdings are appraised once every three years, in conjunction with the purchase anniversary date, by independent appraisers.

With the exception of real estate investment trust holdings, real estate investments are valued quarterly by investment managers based on market conditions and their knowledge of industry trends. Separate account real estate investments are appraised at least once every three years, in conjunction with the properties purchase anniversary date, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Forward currency contracts are valued at the mid point of representative quoted bid and asked prices.

Mortgage loans are valued at their principal balance (cost) less an allowance for loan loss, the net result of which approximates fair value. At June 30, 2007 and 2006, the allowance for loan loss totaled \$5,221 and is considered by management to be sufficient to cover any losses to the mortgage loan portfolio.

ERISA commingled and mutual funds are valued daily. Equity investments for which market quotations are readily available are valued at the last reported sale price on their principal exchange on valuation date, or official close for certain markets. If no sales are reported for that day, investments are valued at the more recent of the last published sale price or the mean between the last reported bid and asked prices, or at fair value as determined in good faith by the Trustee.

Collective investment funds are stated at fair value based on the unit value as reported by the Trustees multiplied by the number of units held by the Plans. The unit value is determined by the Trustees based on fair value of the underlying assets. Purchases and sales of securities are recorded on a trade-date basis.

Pooled investment funds, held in trust, are stated at fair valued based on the unit value as reported by the Trustees multiplied by the number of units held by the Plans. The unit value is determined by the Trustees based on fair value of the underlying assets. Purchases and sales of securities are recorded on a trade-date basis.

Income Allocation

Income in the fixed income and domestic and international equity pools is allocated to pool participants daily on a pro rata basis.

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Income, in the emerging markets, private equity, absolute return, other investments, and real estate pools is allocated to pool participants monthly on a pro rata basis.

Income for the ERISA commingled and mutual funds is credited to the fund's net asset value on a daily basis and allocated to pool participants on a pro rata basis.

Income for the pooled investment and collective investment funds is credited to the fund's net asset value on a daily basis and allocated to pool participants on a pro rata basis.

Contributions Receivable

Contributions from the DB Plan and DCR Pension Trust Fund members and employers for service through June 30 are accrued. These contributions are considered fully collectible and, accordingly, no allowance for uncollectible receivables is reflected in the financial statements.

Federal Income Tax Status

The DB Plan and DCR Pension Trust Fund are qualified plans under Section 401(a) and 414(d) of the Internal Revenue Code and are exempt from federal income taxes under Section 501(a).

(3) Investments

The Alaska Retirement Management Board (ARMB) has statutory oversight of the DB Plan and DCR Pension Trust Fund investments. As the fiduciary, the ARMB has the statutory authority to invest the assets under the Prudent Investor Rule. Alaska Statute provides that invest-

ments shall be made with the judgment and care under circumstances then prevailing that an institutional investor of ordinary professional prudence, discretion and intelligence exercises in managing large investment portfolios.

The Department of Revenue, Treasury Division (Treasury) provides staff for the ARMB. Treasury has created a pooled environment by which it manages the investments the ARMB has fiduciary responsibility for. Additionally, Treasury manages mix of ERISA Commingled, Collective Investment, and Mutual Funds for the Defined Contribution Plan, which includes the Occupational Death and Disability benefits. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division, or by contracted external investment managers. The ARMB has developed investment guidelines, policies and procedures for Treasury staff and external investment managers to adhere to when managing investments. Specifically, the Securities Lending Collateral, Collective Investment Pools, ERISA Commingled and Mutual Funds, External Domestic Fixed Income Pool, International Fixed Income Pool, High Yield Pool, Domestic Equity Pool, International Equity Pool, Emerging Markets Equity Pool, Private Equity Pool, Absolute Return Pool, Other Investments Pool and, with the exception of real estate investment trust holdings the Real Estate Pool are managed by external management companies. Treasury manages the Alaska Retirement Fixed Income Pool, Short-term Fixed Income Pool, real estate investment trust holding and cash holding of certain external managers in addition to acting as oversight manager for all externally managed investments.

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Short-Term Fixed Income Pool

Both the DB Plan and DCR Pension Trust Fund's invested assets include participation in the State's internally managed shortterm fixed income pool which was established March 15, 1993, with a start up and maintained share price of \$1. Treasury staff determines the allocation between permissible securities. Each member owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Member shares also change at the beginning of each month when income is paid. At June 30, 2007 and 2006, the Plan had a 0.55% and 0.38% direct ownership in the shortterm fixed income pool which included interest receivable of \$26,850 and \$21,543, respectively. The Plan had a 9.15% and 9.28% indirect ownership in the shortterm fixed income pool at June 30, 2007 and 2006, respectively.

DB Plan Pools

Enhanced Cash Fixed Income Pool

The DB Plan participates in the State's internally managed enhanced cash fixed income pool which was established on June 27, 2007 with a startup price of \$1,000. The share price at June 30, 2007 was \$1,000. Treasury staff determines the allocation between permissible securities. Each member owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Member shares also change at the beginning of each month when income is paid. At year end only one pool, the domestic fixed income pool was invested in the enhanced cash fixed income pool. At June 30, 2007 the DB Plan's invested assets included a 68.76% direct ownership in the enhanced cash fixed income pool.

Domestic Fixed Income Pool

The DB Plan participates in the ARMB's internally managed retirement fixed income pool which was established March 1, 1996, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,958. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan's invested assets included a 68.50% and 68.04% ownership in the retirement fixed income pool, respectively.

International Fixed Income Pool

The DB Plan participates in the ARMB's externally managed international fixed income pool which was established March 3, 1997, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,826. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.50% and 68.29% ownership in the international fixed income pool, respectively.

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High Yield Pool

The DB Plan participates in the ARMB's externally managed high yield fixed income pool which was established April 15, 2005, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,189. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.76% and 68.22% ownership in the high yield pool, respectively.

Domestic Equity Pool

The domestic equity pool is comprised of an external large cap domestic equity pool and external small cap domestic equity pool.

Large Cap Domestic Equity Pool

The DB Plan participates in the ARMB's externally managed large cap domestic equity pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,368. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the

pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.65% and 68.13% ownership in the large cap domestic equity pool, respectively.

Small Cap Domestic Equity Pool

The DB Plan participates in the ARMB's externally managed small cap domestic equity pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,375. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 69.15% and 68.14% ownership in the small cap domestic equity pool, respectively.

International Equity Pool

The DB Plan participates in the ARMB's externally managed international equity pool which was established January 1, 1992, with a start up share price of \$1,000. The share price at June 30, 2007, was \$4,301. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing

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the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.64% and 68.50% ownership in the international equity pool, respectively.

Emerging Markets Equity Pool

The DB Plan participates in the ARMB's externally managed emerging markets equity pool which was established May 2, 1994, with a start up share price of \$1,000. The share price at June 30, 2007, was \$3,870. The pool participates in two externally managed commingled investment funds through ownership of equity shares. The commingled funds, comprised of various institutional investors, invest in the securities markets of developing countries. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the

transaction. At June 30, 2007 and 2006, the DB Plan had a 68.76% and 65.00% ownership in the emerging markets equity pool, respectively.

Private Equity Pool

The DB Plan participates in the ARMB's externally managed private equity pool which was established April 24, 1998, with a start up share price of \$1,000. The share price at June 30,

2007, was \$2,214. Underlying assets in the pool are comprised of venture capital, buyouts, restructuring, and special situation investments through limited partnership agreements. Each manager independently determines the limited partnerships to invest in. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 69.04% and 68.62% ownership in the private equity pool, respectively.

Absolute Return Pool

The DB Plan participates in the ARMB's externally managed absolute return pool which was established October 31, 2004, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,248. Underlying assets in the pool are comprised of hedge fund limited partnership agreements. Each manager independently determines the limited partnerships to invest in. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.74% and 68.21% ownership in the absolute return pool, respectively.

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Other Investments Pool

The DB Plan participates in the ARMB's externally managed other investments pool which was established March 18, 2004, with a start up share price of \$1,000. The share price at June 30, 2007, was \$1,286. Underlying assets in the pool are comprised of a limited partnership interest in an energy related venture capital operating company and two agricultural entities. Each manager independently determines which permissible investments are made. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 69.15% and 68.62% ownership in the other investments pool, respectively.

Real Estate Pool

The DB Plan participates in the ARMB's externally managed real estate pool which was established June 27, 1997, with a start up share price of \$1,000. The share price at June 30, 2007, was \$3,006. Underlying assets in the pool are comprised of separate accounts, commingled accounts, limited partnerships, and real estate investment trust holdings. With the exception of investments in real estate investment trusts, each manager independently determines which permissible investments are made. Treasury staff determines the permissible real estate investment trusts to invest in. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is

determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the DB Plan had a 68.47% and 68.17% ownership in the real estate pool, respectively.

Participant – Directed DCR Pension Trust Fund Investments

Pooled Investment Funds

The ARMB contracts with an external investment manager who is given the authority to invest funds in a wholly-owned pooled environment to accommodate 4 participant-directed funds.

T. Rowe Alaska Balanced Fund

On July 1, 2006 the DCR Pension Trust Fund began participation in the Alaska Balanced Trust. The purpose of this fund is to provide a balanced and diversified mix of U.S. and international stocks, investment-grade bonds, federally guaranteed mortgages and money market instruments for investors with a low to average risk tolerance. At June 30, 2007 the DCR Pension Trust Fund invested assets included a .01% ownership in the Alaska Balanced Trust.

T. Rowe Long-Term Balanced Fund

On July 1, 2006 the DCR Pension Trust Fund began participation in the Long-Term Balanced Trust. The purpose of this fund is to provide a balanced and diversified mix of stocks, bonds, federally guaranteed mortgages and money

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market instruments for investors with an average risk tolerance. At June 30, 2007 the DCR Pension Trust Fund invested assets included a .01% ownership in the Long-Term Balanced Trust.

T. Rowe Alaska Money Market Fund

On July 1, 2006 the DCR Pension Trust Fund began participation in the Alaska Money Market Trust. Underlying assets are comprised of cash equivalent instruments with maturities of less than one year which include commercial paper, banker acceptances, certificates of deposit with ratings of A1/P1 or better; as well as, obligations of the US Government and its agencies, and repurchase agreements collateralized by

US Treasury Instruments with the goal of maintaining a \$1.00 unit price. At June 30, 2007 the DCR Pension Trust Fund invested assets included an 83.58% ownership in the Alaska Money Market Trust

T. Rowe Alaska Target 2025 Fund

On July 1, 2006 the DCR Pension Trust Fund began participation in the Target 2025 Trust. The purpose of this fund is to provide a diverse mix of stocks, bonds, and cash for long-term investors with a high tolerance for risk. Underlying investments are comprised of domestic and international stocks, investment grade bonds, federally guaranteed mortgages, and money market instruments. At June 30, 2007 the DCR Pension Trust Fund invested assets included a .15% ownership in the Alaska Target 2025 Trust.

Erisa Commingled and Mutual Funds

The ARMB contracts with external investment managers who maintain ERISA Commingled and Mutual Funds. Managers selected are subject to the provision of the ERISA Commingled and Mutual Funds the Board has selected.

SSGA Domestic Large Cap

The purpose of this fund is to replicate the returns and characteristics of the Russell 1000® Index through buying, holding securities, and trading only when there is a change to the composition of the Index or when cash flow activity occurs in the Strategy.

SSGA Domestic Small Cap

The purpose of this fund is to replicate the returns and characteristics of the Russell 2000® Index through buying, holding securities, and trading only when there is a change to the composition of the Index or when cash flow activity occurs in the Strategy.

SSGA International Equity

The purpose of this fund is to replicate the returns and characteristics of the MSCI EAFE Index through investing in 21 individual MSCI country funds which, in turn, own the Index securities in market-weighted proportion.

SSGA Domestic Fixed Income

The purpose of this fund is to create a well diversified portfolio that is representative of the domestic investment grade bond market. The

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Passive Bond Market Index Strategy seeks to replicate the returns and characteristics of the Lehman Brothers Aggregate Bond Index through individual security selection based upon criteria generated by SSGA's credit and research group, security availability, and the analysis of its impact on the portfolio's weightings.

SSGA International Fixed Income

The purpose of this fund is to create a well diversified portfolio that is representative of the international government bond market. The Passive World Government Bond Ex-US Index Strategy seeks to replicate

the returns and characteristics of the Citigroup World Government Bond Ex-US Index by matching duration, quality and the sector of the Index.

SSGA Treasury Inflation Protection Securities (TIPS)

The U.S. Treasury Inflation Protected Securities Index Strategy seeks to replicate the returns and characteristics of the Lehman Brothers Inflation Notes Index.

SSGA Real Estate

The REIT Index Strategy seeks to replicate the returns and characteristics of the Dow Jones Wilshire REIT Index. To accomplish this, SSGA's strategy is to buy and hold securities, trading only when there is a change to the composition of the Index or when cash flow activity occurs in the Strategy.

Lazard Emerging Markets Equity Fund

The purpose of this fund is to meet or exceed the MSCI Emerging Markets Index by 3% per annum over a rolling five-year period. Underlying investments are comprised of domestic and global equities as well as alternative assets.

Collective Investment Funds

The ARMB contracts with external investment managers who maintain collective investment funds. Managers selected are subject to the provisions of the collective investment fund the Board has selected.

SSGA Government/Corporate

The purpose of this fund is to match or exceed the return of the Lehman Brothers Government/Credit Bond Index

SSGA S&P Stock Index Fund

The purpose of this fund is to provide income and capital appreciation matching the total return of the Standards & Poor's Composite Stock Price Index

Global Balanced Fund

This fund invests in stocks and bonds of U.S. and international companies and government bonds issued by the U.S. and other governments.

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Brandes Institutional International Equity Fund

The purpose of this fund is to provide long-term capital appreciation. This fund invests principally in common and preferred stocks of foreign companies and securities that are convertible into such common stocks.

Citizens Core Growth Fund

This fund invests primarily in U.S. large cap growth stocks, with an emphasis on those that are managed in a socially responsible manner

T. Rowe Small Cap Stock Fund

The purpose of this fund is to provide long-term capital growth by investing primarily in stocks of small companies. This fund invests at least 65% of its total assets in the stocks and equity-related securities of small companies.

Money Market Fund

Consists of nonparticipant directed funds used to pay administrative costs of the plan.

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At June 30, 2007, the DB Plan and DCR Pension Trust Fund's investments included the following:

| | Fair value (In thousands) | | | | | Defined Contribution Pension Trust Fund | | |
|---------------------------------------|---|-------------------|------------------|----------------|----------------|---|------------------|-------------------|
| | Defined Benefit Plan Fixed Income Pools | | | | | Pooled Investment | | Total |
| | Short-term | Enhanced cash | Domestic | Intern'l | High yield | Funds | Other | |
| Deposits | \$ - | - | - | 842 | - | (1) | 48,540 | \$49,381 |
| Overnight sweep account | 2,319 | - | - | - | 11,801 | - | - | 14,120 |
| Money market fund | - | - | - | - | - | - | 1,191,209 | 1,191,209 |
| Short-term investment fund | 15,092 | - | - | 716 | - | - | - | 15,808 |
| Commercial paper | 33,429 | - | 2,238 | - | 3,419 | 41 | - | 39,127 |
| Domestic Equity | - | - | - | - | - | 45 | - | 45 |
| International Equity | - | - | - | - | - | 3 | - | 3 |
| Collective Investment Funds | - | - | - | - | - | - | 7,100 | 7,100 |
| U. S. Treasury bills | - | - | - | - | - | - | 3,757 | 3,757 |
| U. S. Treasury notes | - | - | 211,629 | - | - | 13 | - | 211,642 |
| U. S. Treasury strips | - | - | 171 | - | - | - | - | 171 |
| U. S. Treasury bonds | - | - | 94,840 | - | - | - | - | 94,840 |
| U.S. Treasury - TIPS | - | - | - | - | - | - | - | - |
| U.S. Government agency discount notes | - | - | 132,603 | - | - | - | - | 132,603 |
| U.S. Government agency | - | - | 845 | - | - | 1 | - | 846 |
| Municipal bonds | - | - | 1,269 | - | - | - | - | 1,269 |
| Foreign government bonds | - | - | - | 121,311 | - | - | - | 121,311 |
| Mortgage-backed | 25,827 | - | 1,092,721 | - | - | 21 | - | 1,118,569 |
| Other asset-backed | 185,578 | 1,250 | 124,587 | - | 459 | - | - | 311,874 |
| Corporate bonds | 96,222 | 1,749 | 350,802 | 75,586 | 155,141 | 19 | - | 679,519 |
| Convertible bonds | - | - | - | - | 2,909 | - | - | 2,909 |
| Yankees: | | | | | | | | |
| Government | - | - | 10,921 | - | - | 1 | - | 10,922 |
| Corporate | 20,296 | - | 39,010 | - | 15,136 | 1 | - | 74,443 |
| Fixed income pools: | | | | | | | | |
| Equity | - | - | - | - | 1,623 | - | - | 1,623 |
| Domestic equity pool: | | | | | | | | |
| Limited partnership | - | - | - | - | - | - | 325,064 | 325,064 |
| Equity | - | - | - | - | - | - | 3,561,923 | 3,561,923 |
| International Equity Pool: | | | | | | | | |
| Equity | - | - | - | - | - | - | 1,796,404 | 1,796,404 |
| Emerging markets equity pool | - | - | - | - | - | - | 283,924 | 283,924 |
| Private equity pool: | | | | | | | | |
| Limited partnerships | - | - | - | - | - | - | 729,171 | 729,171 |
| Absolute return pool: | | | | | | | | |
| Limited partnerships | - | - | - | - | - | - | 423,103 | 423,103 |
| Other investments pool: | | | | | | | | |
| Limited partnerships | - | - | - | - | - | - | 52,291 | 52,291 |
| Agricultural holdings | - | - | - | - | - | - | 75,503 | 75,503 |
| Real estate pool: | | | | | | | | |
| Real estate | - | - | - | - | - | - | 382,579 | 382,579 |
| Commingled funds | - | - | - | - | - | - | 221,159 | 221,159 |
| Limited partnerships | - | - | - | - | - | - | 519,634 | 519,634 |
| Real estate investment trusts | - | - | - | - | - | - | 62,416 | 62,416 |
| DCR ERISA commingled funds | - | - | - | - | - | - | 155 | 155 |
| Net other assets (liabilities) | (1,693) | (530) | (417,494) | 3,227 | 2,869 | - | 8,042 | (408,444) |
| Other pool ownership | (356,318) | (2,469) | 300,732 | - | - | - | 58,055 | - |
| Unallocated deposits in transit | - | - | - | - | - | - | 93 | 93 |
| Total invested assets | <u>\$ 20,752</u> | <u> </u> | <u>1,944,874</u> | <u>201,682</u> | <u>193,357</u> | <u>144</u> | <u>9,750,122</u> | <u>12,110,930</u> |

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At June 30, 2006, the DB Plan's investments included the following:

| | Fair value (In thousands) | | | | | Total |
|---------------------------------------|---------------------------|--------------------|----------------|----------------|------------------|-------------------|
| | Short-term | Fixed Income Pools | | | Other | |
| | | Domestic | International | High yield | | |
| Deposits | \$ - | - | - | - | 3,425 | 3,425 |
| Overnight sweep account | 425 | 734 | - | 12,431 | - | 13,590 |
| Money market fund | - | - | - | - | 929,519 | 929,519 |
| Short-term investment fund | 10,472 | - | 1,188 | - | 21,597 | 33,257 |
| Commercial paper | 21,002 | 6,800 | - | - | - | 27,802 |
| U. S. Treasury notes | - | 111,417 | - | - | - | 111,417 |
| U. S. Treasury bonds | - | 119,347 | - | - | - | 119,347 |
| U. S. Treasury strips | - | 11,488 | - | - | - | 11,488 |
| U.S. Government agency discount notes | - | 96,151 | - | - | - | 96,151 |
| U.S. Government agency | - | 175,690 | - | - | - | 175,690 |
| Municipal bonds | - | 1,415 | - | - | - | 1,415 |
| Foreign government bonds | - | - | 111,744 | - | - | 111,744 |
| Mortgage-backed | 18,079 | 961,003 | - | - | - | 979,082 |
| Other asset-backed | 125,717 | 118,192 | - | 250 | - | 244,159 |
| Corporate bonds | 65,044 | 419,280 | 76,247 | 125,017 | - | 685,588 |
| Convertible bonds | - | - | - | 2,720 | - | 2,750 |
| Yankees: | | | | | | |
| Government | - | 15,603 | - | - | - | 15,603 |
| Corporate | 2,669 | 1,360 | - | 4,662 | - | 8,691 |
| Fixed income pools: | | | | | | |
| Equity | - | - | - | 38 | - | 38 |
| Domestic equity pool: | | | | | | |
| Limited partnership | - | - | - | - | 200,597 | 200,597 |
| Equity | - | - | - | - | 3,339,373 | 3,339,373 |
| International equity pool: | | | | | | |
| Convertible bonds | - | - | - | - | 1,404,660 | 1,404,660 |
| Emerging markets equity pool | - | - | - | - | 180,324 | 180,324 |
| Private equity pool: | | | | | | |
| Limited partnerships | - | - | - | - | 565,343 | 565,343 |
| Absolute return pool: | | | | | | |
| Limited partnerships | - | - | - | - | 239,130 | 239,130 |
| Other investments pool: | | | | | | |
| Limited partnerships | - | - | - | - | 27,598 | 27,598 |
| Agricultural holdings | - | - | - | - | 43,435 | 43,435 |
| Real estate pool: | | | | | | |
| Real estate | - | - | - | - | 533,531 | 533,531 |
| Commingled funds | - | - | - | - | 190,943 | 190,943 |
| Limited partnerships | - | - | - | - | 147,192 | 147,192 |
| Real estate investment trusts | - | - | - | - | 68,333 | 68,333 |
| Mortgages | - | - | - | - | 2 | 2 |
| Net other assets (liabilities) | (137) | (222,473) | 7,148 | 1,178 | 5,280 | (209,004) |
| Other pool ownership | (242,711) | 210,049 | - | - | 32,662 | - |
| Total invested assets | <u>\$ 560</u> | <u>2,026,056</u> | <u>196,327</u> | <u>146,296</u> | <u>7,932,944</u> | <u>10,302,183</u> |

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Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Short-Term Fixed Income Pool

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelvemonth prepay speeds for other securities. At June 30, 2007, the expected average life of individual fixed rate securities ranged from four days to seven months and the expected average life of floating rate securities ranged from less than one year to three years.

Other Fixed Income Pools

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the enhanced cash income portfolio to one year.

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the domestic fixed income portfolio to $\pm 20\%$ of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2007, was 4.70 years.

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the international fixed income portfolio to $\pm 25\%$ of the Citigroup NonU.S. World Government Bond Index. The effective duration for the Citigroup NonU.S. World Government Bond Index at June 30, 2007, was 6.00 years.

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the high yield portfolio to $\pm 20\%$ of the Merrill Lynch U.S. High Yield Master II Index. The effective duration for the Merrill Lynch U.S. High Yield Master II Index at June 30, 2007, was 4.59 years.

Defined Contribution Pooled Investment Funds

The ARMB contracts with an external investment manager who is given the authority to invest funds in a wholly owned pooled environment to accommodate four participant directed funds. Through the ARMB's investment policy, exposure to fair value losses arising from increasing interest rates is managed by limiting the duration as follows:

For government and corporate debt securities, duration is limited to ± 0.25 years of the Lehman Brothers Government/Credit Index. At June 30, 2007, the duration of the government and corporate debt securities was 5.12 years and the duration of the Lehman Brothers Government Credit Index was 5.01 years.

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For mortgage-backed securities, duration is limited to ± 0.25 years of the Lehman GNMA Index. At June 30, 2007, the duration of the mortgage-backed securities was 4.29 years and the duration of the Lehman GNMA Index 4.31 years.

The weighted average maturity of the money market portfolio was fifty-three days at June 30, 2007.

The ARMB does not have a policy to limit interest rate risk for funds held in foreign currency, the custodian's short-term investment fund or commercial paper.

ERISA Commingled and Mutual Funds

The ARMB does not have a policy to limit interest rate risk for these investments. The weighted average maturity of the ERISA commingled investment funds that consists solely of debt securities, domestic fixed income, international fixed income, and TIPS were 4.70, 6.16, and 7.80 years at June 30, 2007, respectively.

Collective Investment Funds

The ARMB does not have a policy to limit interest rate risk for these investments. The weighted average maturity of the collective investment fund that consisted solely of debt securities, the government/corporate bond fund, was 5.33 years at June 30, 2007.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100basis point change in interest rates. The duration of a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, options and other variable cash flows for purposes of the effective duration calculation.

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At June 30, 2007, the effective duration of the DB Plan's fixed income pools, by investment type, was as follows:

| | Effective duration (In years) | | | |
|------------------------------|--------------------------------------|-----------------|----------------------|-------------------|
| | Enhanced Cash | Domestic | International | High Yield |
| U.S. Treasury notes | — | 4.07 | — | — |
| U.S. Government agency | — | 4.52 | — | — |
| Municipal bonds | — | 12.33 | — | — |
| Mortgage-backed | — | 4.26 | — | — |
| Other asset-backed | 1.84 | 4.82 | — | 4.39 |
| Corporate bonds | 0.22 | 5.36 | 3.80 | 4.21 |
| Convertible bonds | — | — | — | 2.20 |
| Yankees: | | | | |
| Government | — | 6.46 | — | — |
| Corporate | — | 11.03 | 8.86 | 3.88 |
| Portfolio effective duration | 0.08 | 3.99 | 4.81 | 3.82 |

Credit Risk

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

The ARMB does not have a policy to limit the concentration of credit risk for the collective investment, ERISA commingled, and mutual funds.

The DCR Pension Trust Fund's invested assets in externally managed pools may lend assets or transfer securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agree to return the collateral for the same securities in the future. There is credit risk associated with the lending transactions. The risk exists that an issuer or other counter party to an investment will not fulfill its obligations and a loss results from counterparty failure or default on a loaned security.

Treasury's investment policy has the following limitations with regard to credit risk:

With the exception of the sweep account, shortterm fixed income pool investments are limited to instruments with a longterm credit rating of at least A3 or equivalent and instruments with a shortterm credit rating of at least A1 or equivalent. For securities with longterm credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Assetbacked and non-agency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

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The ARMB's investment policy has the following limitations with regard to credit risk:

Domestic fixed income:

Commercial paper must carry a rating of at least A1 or equivalent;

Corporate debt securities must be investment grade;

Corporate, assetbacked and non-agency mortgage securities must be investment grade. Investment grade is defined as the median rating of Standard & Poor's Corporation, Moody's and Fitch. Assetbacked and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA. Corporate bonds may be purchased if rated by two of these agencies.

Enhanced Cash Fixed Income:

Commercial paper must carry a rating of at least A1 or equivalent;

No more than five percent of the portfolio's assets may be invested in securities rated below investment grade as determined by the Lehman Brothers rating methodology.

No more than two percent of the portfolio's assets may be invested in the bonds of any non-U.S. government agency or instrumentality rated below investment grade.

International fixed income:

Corporate debt and assetbacked securities must be investment grade.

Domestic and international equity:

Corporate debt obligations must carry a rating of at least A or equivalent.

High yield:

No more than 10% of the portfolio's assets may be invested in securities rated A3 or higher.

No more than 25% of the portfolio's assets may be invested in securities rated below B3.

No more than 5% of the portfolio's assets may be invested in unrated securities.

The lower of any Standard & Poor's Corporation, Moody's or Fitch rating will be used for limits on securities rated below B3 and the higher rating will be used for limits on securities rated A3 or higher.

Daily cash surpluses that arise in this pool are invested in the custodian's repurchase agreement sweep account. This account is secured by U.S. Government or Agency securities. As such, the ARMB does not consider this investment subject to the credit risk limitations above.

Defined Contribution Pooled Investments Funds:

All government and corporate fixed income securities must be rated BBB or better at the time of purchase

All mortgage-backed securities must be issued by the Government National Mortgage Association and

Commercial paper and other short-term debt obligations must be rated A1 or equivalent

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At June 30, 2007, the DB Plan and DCR Pension Trust Fund's investments consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

| Defined Benefit | | | | | | |
|--|---------------------------|-------------------|----------------------|-----------------|-----------------------|-------------------|
| Internally managed fixed income pools | | | | | | |
| | Rating¹ | Short-term | Enhanced cash | Domestic | Inter-national | High yield |
| Overnight sweep account | Not Rated | 0.61% | -% | -% | -% | 6.10% |
| Money market fund | Not Rated | - | - | - | - | - |
| Short-term investment account | Not Rated | 3.96 | - | - | 0.36 | - |
| Commercial paper | AA | 1.88 | - | - | - | - |
| Commercial paper | A | 3.09 | - | - | - | 1.77 |
| Commercial paper | Not Rated | 3.86 | - | 0.14 | - | - |
| U. S. government agency discount notes | Not Rated | - | - | 8.07 | - | - |
| U. S. government agency | AAA | - | - | - | - | - |
| U. S. government agency | Not Rated | - | - | 0.05 | - | - |
| Mortgage-backed | AAA | 6.50 | - | 51.10 | - | - |
| Mortgage-backed | A | 0.32 | - | - | - | - |
| Mortgage-backed (agency) | Not Rated | - | - | 15.36 | - | - |
| Other asset-backed | AAA | 40.98 | 2.65 | 5.14 | - | - |
| Other asset-backed | AA | 0.91 | - | 0.27 | - | - |
| Other asset-backed | A | 6.34 | - | 0.09 | - | - |
| Other asset-backed | BBB | - | 1.00 | 0.74 | - | - |
| Other asset-backed | BB | - | - | - | - | 0.24 |
| Other asset-backed | Not Rated | 0.78 | - | 1.34 | - | - |
| Municipal bonds | AA | - | - | 0.08 | - | - |
| Corporate bonds | AAA | 1.97 | - | 1.89 | 25.92 | - |
| Corporate bonds | AA | 15.13 | 0.60 | 4.28 | 11.43 | - |
| Corporate bonds | A | 8.31 | 3.46 | 6.98 | - | - |
| Corporate bonds | BBB | - | 1.04 | 7.15 | - | 1.56 |
| Corporate bonds | BB | - | - | - | - | 21.55 |
| Corporate bonds | B | - | - | - | - | 41.49 |
| Corporate bonds | CCC | - | - | - | - | 11.57 |
| Corporate bonds | D | - | - | - | - | 0.48 |
| Corporate bonds | Not Rated | - | - | 1.03 | 0.28 | 3.59 |
| Convertible bonds | BBB | - | - | - | - | 0.20 |
| Convertible bonds | BB | - | - | - | - | 0.06 |
| Convertible bonds | B | - | - | - | - | 1.19 |
| Convertible bonds | D | - | - | - | - | 0.05 |
| Yankees: | | | | | | |
| Government | AAA-BBB | - | - | 0.66 | 56.57 | - |
| Government | Not Rated | - | - | - | 3.83 | - |
| Corporate | AAA | 3.09 | - | - | - | - |
| Corporate | AA | 1.75 | - | - | - | - |
| Corporate | A | - | - | 1.47 | - | - |
| Corporate | BBB | - | - | 0.61 | - | 0.35 |
| Corporate | BB | - | - | - | - | 1.06 |
| Corporate | B | - | - | - | - | 5.88 |
| Corporate | CCC | - | - | - | - | 0.21 |
| Corporate | Not Rated | 0.52 | - | 0.30 | - | 0.32 |
| No credit exposure | | - | 91.25 | (6.75) | 1.61 | 2.33 |
| | | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> |

¹Rating modifiers are not disclosed

(continued)

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| | <u>Defined Contribution</u> | | | <u>Collective</u> |
|--|--------------------------------|------------------|---------------------|-------------------------|
| | <u>Pooled investment funds</u> | | | |
| | <u>GNMA</u> | <u>Govt/Corp</u> | <u>Money market</u> | <u>Investment funds</u> |
| Overnight sweep account | -% | -% | -% | -% |
| Money market fund | - | - | - | 0.58 |
| Short-term investment account | 7.40 | 0.84 | - | - |
| Commercial paper | - | - | - | - |
| Commercial paper | - | - | - | - |
| Commercial paper | - | - | 6.22 | - |
| U. S. government agency discount notes | - | - | 83.66 | - |
| U. S. government agency | - | 2.42 | - | - |
| U. S. government agency | - | - | - | - |
| Mortgage-backed | 88.91 | 17.08 | - | - |
| Mortgage-backed | - | - | - | - |
| Mortgage-backed (agency) | 3.69 | - | - | - |
| Other asset-backed | - | - | - | - |
| Other asset-backed | - | - | - | - |
| Other asset-backed | - | - | - | - |
| Other asset-backed | - | - | - | - |
| Other asset-backed | 0.24 | - | - | - |
| Other asset-backed | - | - | - | - |
| Municipal bonds | - | - | - | - |
| Corporate bonds | - | 1.67 | 3.13 | - |
| Corporate bonds | - | 6.70 | 3.13 | - |
| Corporate bonds | - | 15.45 | 6.25 | - |
| Corporate bonds | - | 11.42 | - | - |
| Corporate bonds | - | - | - | - |
| Corporate bonds | - | - | - | - |
| Corporate bonds | - | - | - | - |
| Corporate bonds | - | - | - | - |
| Corporate bonds | - | - | - | - |
| Convertible bonds | - | - | - | - |
| Convertible bonds | - | - | - | - |
| Convertible bonds | - | - | - | - |
| Convertible bonds | - | - | - | - |
| Yankees: | | | | |
| Government | - | 2.85 | - | - |
| Government | - | - | - | - |
| Corporate | - | 0.27 | - | - |
| Corporate | - | 0.96 | - | - |
| Corporate | - | 0.91 | - | - |
| Corporate | - | 0.71 | - | - |
| Corporate | - | - | - | - |
| Corporate | - | - | - | - |
| Corporate | - | - | - | - |
| Corporate | - | - | - | - |
| No credit exposure | - | 38.72 | (2.39) | 90.42 |
| | <u>100.00%</u> | <u>100.00%</u> | <u>100.0%</u> | <u>100.0%</u> |

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Securities lending collateral was invested in a registered 2(a) 7 money market fund that was not rated.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The ARMB does not have a policy in relation to custodial credit risk for deposits. At June 30, 2007, the DB Plan had the following uncollateralized and uninsured deposits:

| | Amount (In thousands) |
|---------------------------|----------------------------------|
| International equity pool | \$ <u>3,677</u> |

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment.

The ARMB's policy with regard to foreign currency risk in the international fixed income pool is to restrict obligations to those issued in the currencies of countries represented in the Citibank NonU.S. World Government Bond Index. In addition, the ARMB's asset allocation

policy permits the DB Plan to hold up to four percent of total investments in international fixed income.

The ARMB's policy with regard to foreign currency risk in the international equity pool and the emerging markets pool is to permit the DB Plan to hold up to eighteen percent of total investments in these two pools combined.

The ARMB's policy with regard to foreign currency risk in the private equity pool is to permit the DB Plan to hold up to ten percent of total investments in private equity.

The ARMB has no policy regarding foreign currency risk in the Defined Contribution Investment Trust Pool.

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At June 30, 2007, the DB Plan had exposure to foreign currency risk with the following investment pools:

| Currency | Amount (In thousands) | |
|--------------------|--|--------------------------------------|
| | Defined Benefit | |
| | International fixed income pool | International equity pool |
| Australian Dollar | \$ - | 353 |
| Canadian Dollar | - | 2 |
| Euro Currency | - | (967) |
| Hong Kong Dollar | - | 451 |
| Japanese Yen | 257 | 2,406 |
| Mexican Peso | 584 | - |
| New Zealand Dollar | - | 7 |
| Norwegian Krone | - | 116 |
| Pound Sterling | - | 1,240 |
| Singapore Dollar | - | 1 |
| Swedish Krona | - | 67 |
| Swiss Franc | - | 1 |
| | \$ 841 | 3,677 |

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| <u>Currency</u> | <u>Amount (In thousands)</u> | | | | |
|--------------------|--|------------------|----------------------------------|-----------------------------|---------------------------------|
| | <u>Defined Benefit</u> | | | <u>Defined Contribution</u> | |
| | <u>Fixed income</u> | | | <u>Private equity pool</u> | <u>International trust pool</u> |
| | <u>International fixed income pool</u> | | <u>International equity pool</u> | | |
| | <u>Foreign government</u> | <u>Corporate</u> | <u>Equity</u> | <u>partnerships</u> | <u>Limited Equity</u> |
| Australian Dollar | \$ 4,080 | 1,929 | 40,213 | - | - |
| Canadian Dollar | - | - | 36,062 | - | - |
| Danish Krone | - | - | 2,052 | - | - |
| Euro Currency | 95,510 | - | 672,454 | 60,765 | 1 |
| Hong Kong Dollar | - | - | 246 | - | - |
| Japanese Yen | 17,824 | 73,657 | 3,466 | - | 1 |
| Mexican Peso | 3,897 | - | — | - | - |
| New Taiwan Dollar | - | - | 6,485 | - | - |
| New Zealand Dollar | - | - | 70 | - | - |
| Norwegian Krone | - | - | 133 | - | - |
| Pound Sterling | - | - | 334,160 | 7,104 | - |
| Singapore Dollar | - | - | 17,969 | - | - |
| South African Rand | - | - | 1,384 | - | - |
| South Korean Won | - | - | 27,069 | - | - |
| Swedish Krona | - | - | 31,346 | - | - |
| Swiss Franc | - | - | 112,797 | - | - |
| | <u>\$ 121,311</u> | <u>75,586</u> | <u>1,285,906</u> | <u>67,869</u> | <u>2</u> |

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At June 30, 2007, the DB Plan also had exposure to foreign currency risk in the emerging markets equity pool. This pool represents an investment in commingled investment funds; therefore, no disclosure of specific currencies is made.

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk for the shortterm fixed income pool is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

The ARMB's policy with regard to concentration of credit risk for the domestic fixed income, international fixed income and high yield pools is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

At June 30, 2007, the DB Plan had \$557 million in Federal National Mortgage Association securities which represented 5% of the DB Plan's total investments. Federal National Mortgage Association securities are not classified as corporate bonds.

The DB Plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in value as follows (in thousands) for the year ended June 30:

| | <u>2007</u> | <u>2006</u> |
|---------------------------------|---------------------------|-----------------------|
| Domestic equity pool | \$618,798 | 253,306 |
| Domestic fixed income pool | 16,046 | (98,600) |
| International equity pool | 356,859 | 319,293 |
| Real estate pool | 161,815 | 103,690 |
| International fixed income pool | (3,363) | (12,328) |
| Private equity pool | 132,696 | 99,185 |
| Emerging markets equity pool | 58,077 | 20,300 |
| Absolute return pool | 39,207 | 25,794 |
| High yield pool | 2,242 | (3,687) |
| Other investments pool | <u>6,060</u> | <u>1,735</u> |
| | <u>\$1,388,437</u> | <u>708,688</u> |

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Collective Investment Funds

The DCR Pension Trust Fund's investments include the following collective investment funds at June 30:

| | <u>Units</u> <u>owned</u> | <u>2007</u> <u>Unit</u> <u>value</u> | <u>Balance</u> <u>(In thousands)</u> |
|--|------------------------------|--|---|
| Global balanced fund | \$3,486 | \$35.090 | \$122 |
| Alaska balanced trust | 2,169 | 33.828 | 73 |
| Brandes INST international equity fund | 75,900 | 26.700 | 2,027 |
| Citizens core growth fund | 77,076 | 19.150 | 1,476 |
| Alaska target 2025 trust | 1,011 | 12.649 | 13 |
| S&P 500 stock index fund | 63,805 | 28.304 | 1,806 |
| Alaska long-term balanced trust | 1,091 | 14.285 | 16 |
| Daily government/corporate bond fund | 92 | 21.757 | 2 |
| T. Rowe Price small cap stock trust | 36,179 | 46.090 | 1,668 |
| Money market fund | 42,155 | 1.000 | 42 |
| Unallocated Deposits in Transit | - | - | <u>103</u> |
| Total collective investment funds | | | <u>\$7,348</u> |

(4) Foreign Exchange, Foreign Exchange Contracts and Off-Balance Sheet Risk

The international fixed income and international equity pool's investment income includes the following at June 30:

| | <u>2007</u> | <u>2006</u> |
|---|--------------|-------------|
| Net realized gain on foreign currency | \$43,067,735 | 21,661,967 |
| Net unrealized loss on foreign currency | (13,875) | (26,077) |
| Net realized gain on foreign exchange contracts | 215,198 | 252,345 |

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The international equity pool includes foreign currency forward contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing security positions. The maturity periods for these contracts range from eight to one hundred and twentyfour days. The DB Plan had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

| | <u>2007</u> | <u>2006</u> |
|--------------------------------------|------------------------|-----------------------|
| Net contract sales | \$1,379,172 | 2,976,479 |
| Less fair value | <u>1,370,948</u> | <u>2,984,540</u> |
| Net unrealized gains (losses) | <u>\$ 8,224</u> | <u>(8,061)</u> |

The counterparties to the foreign currency forward contracts consist of a diversified group of financial institutions. Credit risk exposure exists to the extent of nonperformance by these counterparties; however, the risk of default is considered to be remote. The market risk is limited to the difference between contractual rates and forward rates at the balance sheet date.

(5) Securities Lending

Alaska Statute 37.10.071 authorizes the ARMB to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The ARMB has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the ARMB's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2007 and 2006, the fair value of securities on loan allocable to the DB Plan's invested assets totaled \$1,226,646,651 and \$915,963,861, respectively. There is no limit to the amount that can be loaned and the ARMB is able to sell securities on loan. International equity security loans are collateralized at not less than 105% of their fair value. All other security loans are collateralized at not less than 102% of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral in the amount of \$1,191,167,776 is invested in a registered 2(a) 7 money market fund. Maturities of investments in the money market fund generally did not match the maturities of the loaned securities because the lending agreements are terminable at will. Collateral securities in the amount of \$72,719,147 may be pledged or sold upon borrower default. Since the ARMB does not have the ability to pledge or sell securities collateral unless the borrower defaults, they are not recorded on the financial statements. Securities on loan, cash collateral and cash collateral payable are recorded on the financial statements at fair value. The Bank, the DB Plan and the borrower receive a fee from earnings on invested collateral. The Bank and the DB Plan share a fee paid by the borrower for loans not collateralized with cash.

There is limited credit risk associated with the lending transactions since the ARMB is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the ARMB against loss due to borrower rebates in excess of earnings on cash

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collateral. Indemnifications are subject to limitations relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the years ended June 30, 2007 and 2006, there were no losses incurred as a result of securities lending transactions and there were neither significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

(6) Transfer to Retirement Systems

During fiscal year 2006, a review was conducted of all medical reserve amounts in the Retiree Health Fund. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive. The result was no excess reserve balances over those deemed necessary for the continued operation of the Retiree Health Fund. No review or transfer occurred in fiscal year 2007.

(7) Funded Status and Funding Progress - DB Plan

The funding status of the DB Plan is as follows:

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) - Entry Age | Unfunded Actuarial Accrued Liability (UAAL) | Funded Ratio | Covered Payroll | UAAL as a percentage of Covered Payroll |
|---|--|--|--|-------------------------|----------------------------|--|
| June 30, 2006 | \$2,709,843 | 11,455,015 | 8,745,172 | 23.7% | \$1,590,693 | 549.8% |

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trend. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

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The accompanying schedule of employer contributions presents trend information about the amounts contributed to the plan by employers in comparison to the actuarially required contribution (ARC), an amount that is actuarially determined in accordance with the parameters of GASB 43. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial report purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The actuarial method and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

| | |
|-------------------------------|---------------------------------|
| Valuation date | June 30, 2006 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level percentage of pay, closed |
| Remaining amortization period | 24 years |
| Asset valuation method | 5 year smoothed market |

Actuarial Assumptions

Investment rate of return 4.50%

Health cost trend –

| | <u>Medical</u> | <u>Prescription Drugs</u> |
|----------------|----------------|-------------------------------|
| FY07 | 9.0% | 13.0% |
| FY08 | 8.5% | 12.0% |
| FY09 | 8.0% | 11.0% |
| FY10 | 7.5% | 10.0% |
| FY11 | 7.0% | 9.0% |
| FY12 | 6.5% | 8.0% |
| FY13 | 6.0% | 7.0% |
| FY14 | 5.5% | 6.0% |
| FY15 | 5.0% | 5.0% |
| FY16 and later | 5.0% | 5.0% |

GASB 43 requires that the discount rate used in the actuarial valuation be the estimated long-term yield on investments that are expected to finance post employment benefits. Depending on the method by which a plan is financed, the relevant investments could be plan assets, employer assets, or a combination of plan and employer assets. The investment return should reflect the nature and the mix of both current and expected investments and the basis used to determine the actuarial value of assets.

PERS' retiree healthcare benefits are partially funded. GASB 43 outlines two reasonable methods of developing a blended discount rate when a plan is partially funded. These methods base the proportion of assumed plan and employer asset returns on 1) the funded ratio and 2) the percentage of annual required contributions actually being contributed to the plan. The State of

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Alaska has utilized the second methodology to develop a discount rate of 4.50% as of June 30, 2006 to be used for fiscal year 2007 disclosure.

(8) Commitments and Contingencies

Commitments

The ARMB entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2007, the DB Plan's share of the unfunded commitment totaled \$8,892,586. This commitment can be withdrawn annually in December with ninety days notice.

The ARMB entered into agreements through external investment managers to provide capital funding for limited partnerships as it continues to build the private equity portfolio. At June 30, 2007, the DB Plan's share of these unfunded commitments totaled \$495,067,445. These commitments are estimated to be paid through 2014.

The ARMB entered into an agreement through an external investment manager to provide capital funding for a limited partnership as it continues to build the other investment portfolio. At June 30, 2007, the DB Plan's share of this unfunded commitment totaled \$62,924,790 to be paid through the year 2017.

The ARMB entered into agreements through external investment managers to provide capital funding for real estate investments as it continues to build the real estate portfolio. At June 30, 2007, the DB Plan's share of these unfunded commitments totaled \$318,407,443 to be paid through the year 2011.

Contingencies

The Department of Administration determined that statutory changes were needed to ensure that the Defined Benefit Retiree Health Program is funded in compliance with the Internal Revenue Code. Consequently, during the fiscal year 2007 legislative session, a law was enacted that created the Alaska Retiree Health Care Trusts (ARHCT), two separate irrevocable trusts. Senate Bill 123 (SB 123), effective June 7, 2007, directs all separately calculated employer contributions for the retiree health benefits, and appropriations, earning and reserves for payment of retiree medical obligations, to be credited to the ARHCT. Pursuant to SB 123, Treasury and the Department of Administration established and implemented the ARHCT effective as of July 1, 2007. The ARHCT will be funded through contributions from employers and premiums paid by retirees.

The Department of Administration intends to seek a tax determination letter from the Internal Revenue Service during the filing cycle beginning on February 1, 2008, and ending on January 31, 2009, concerning the status of the pension plans it administers as qualified governmental plans under Internal Revenue Code Sections 401(a) and 414(d). The Department of Administration also intends to seek private letter rulings regarding the status of the ARHCT. Finally, The Department of Administration intends to seek rulings and/or guidance from the Internal Revenue Service with respect to the prior structure of the Defined Benefit Retiree Health Program. As a result, invested assets may need to be reallocated between net assets available for pension benefits and net assets available for retiree health

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benefits, which could require a transfer of assets included in the accompanying schedule of invested assets into the ARHCT. At this time, The Department of Administration is unable to predict the exact timing of the making of its intended filing with the Internal Revenue Service, the timing of any guidance that may be obtained from the Internal Revenue Service, the results or impact of such guidance on the statements of invested assets and changes therein, or the amount of a transfer, if any to the ARHCT.

Approximately 50 Plan members have filed administrative challenges to the DB Plan administrator's refusal to include leave cashin payments in the compensation used to calculate the members' retirement benefits. The members were all first hired by DB Plan employers before July 1, 1977, and claim that they have a constitutional right, based on the DB Plan statutes in effect before that date, to have leave cashin payments included. The DB Plan's prior board, which heard appeals from decisions of the Plan administrator, had ruled on two of the appeals, and those rulings had in turn been appealed to the Alaska Superior Court. The remaining appeals have been stayed by the DB Plan's board. In addition, a class action lawsuit, raising the same issues, had been filed in the superior court, but has been put on hold until final resolution of the members' claim. On January 27, 2006, the Alaska Supreme Court decided one such member's case in the State's favor. The administrator intends to vigorously contest all of the remaining claims and believes that the State's success to date will result in dismissal of the remaining cases and pending claims. The Plan has not recorded an accrual related to any of these cases or pending claims, because an unfavorable outcome in these matters is, in management's opinion, not considered probable

but rather only possible, and the potential loss, if any, cannot be reasonably estimated at this time. If an unfavorable outcome occurs, the costs would be passed through to employers through the normal contribution process.

The State was a defendant in a class action lawsuit involving a constitutional challenge to DB Plan statutes that provide a 10% cost of living adjustment (COLA) to retirees and other benefit recipients who reside in the state of Alaska. The plaintiffs claimed that these statutes violate the right to travel of nonresident benefit recipients, and therefore, the 10% COLA should be paid to all benefit recipients, regardless of residence. On summary judgment motions, the Superior Court first ruled in favor of the plaintiffs on the issue of whether, if the residency requirements are unconstitutional, the residency requirements are severable from the COLA statutes. On summary judgment motions addressing the constitutionality of the statutes, the Superior Court ruled against the state, holding that the COLA statutes violate the constitutional right to travel. The court ordered payment of COLA to retirees and survivors in high-cost areas of other states. The State appealed to the Alaska Supreme Court. The Superior Court ruled against the plaintiffs on the issue of past damages, and has cross-appealed to the Alaska Supreme Court. On December 29, 2006, the State received a favorable ruling from the Alaska Supreme Court that reversed the Superior Court's ruling against the plaintiffs on the issue.

An IRS assessment may eventually result from the statutory provision and the Plan's practice under which retiree medical benefits were paid to some survivors' spouses and dependents who were not eligible dependents under the IRC, or from the manner in which retiree health benefits

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were funded before June 6, 2007. However, management believes that any such assessment would be paid from the State's general fund, not from the Plan's assets. Furthermore, the Plan's statutes under which payment of medical benefits was made for ineligible dependents was corrected by SB 141, effective January 1, 2006, and the funding of retiree medical benefits was clarified and corrected by SB 123, which was effective June 6, 2007. Finally, although there were press reports of possible legal action regarding amendments to the PERS and TRS statutes by HB 161 (rehired retiree legislation), no litigation has been served on the Plan challenging provisions of that legislation. Management is not aware of any other specific unasserted claims or assessments against the Plan.

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Required Supplementary Information (Unaudited)

Schedule of Funding Progress
Pension Benefits

June 30, 2007
(Dollars in thousands)

| <u>Actuarial Valuation Date as of June 30</u> | <u>Actuarial Value of Plan Assets</u> | <u>Actuarial Accrued Liabilities (AAL)</u> | <u>Funded Excess (FE) (Unfunded Actuarial Accrued Liabilities) (UAAL)</u> | <u>Funded Ratio</u> | <u>Covered Payroll</u> | <u>FE/(UAAL) as a Percentage of Covered Payroll</u> |
|---|---|--|---|-------------------------|----------------------------|---|
| 2001 | \$5,579,440 | 5,528,026 | 51,414 | 100.9% | 1,208,700 | 4.3% |
| 2002 | 4,611,170 | 6,133,182 | (1,522,012) | 75.2 | 1,245,054 | (122.2) |
| 2003 | 4,607,673 | 6,330,541 | (1,722,868) | 72.8 | 1,300,041 | (132.5) |
| 2004 | 4,709,592 | 6,711,507 | (2,001,915) | 70.2 | 1,305,670 | (153.3) |
| 2005 | 4,658,413 | 7,087,191 | (2,428,778) | 65.7 | 1,404,043 | (173.0) |
| 2006 | 6,331,065 | 8,094,043 | (1,762,978) | 78.2 | 1,590,693 | (110.8) |

See accompanying notes to required supplementary information and independent auditors' report.

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**Schedule of Funding Progress
Postemployment Healthcare Benefits**

June 30, 2007
(Dollars in thousands)

| <u>Actuarial Valuation Date as of June 30</u> | <u>Actuarial Value of Plan Assets</u> | <u>Actuarial Accrued Liabilities (AAL)</u> | <u>Funding Excess (FE) (Unfunded Actuarial Accrued Liabilities) (UAAL)</u> | <u>Funded Ratio</u> | <u>Covered Payroll</u> | <u>FE/(UAAL) as a Percentage of Covered Payroll</u> |
|---|---|--|--|-------------------------|----------------------------|---|
| 2001 | \$2,362,316 | 2,340,548 | 21,768 | 100.9% | 1,208,700 | 1.8% |
| 2002 | 2,801,663 | 3,726,409 | (924,746) | 75.2 | 1,245,054 | (74.3) |
| 2003 | 3,079,608 | 4,231,112 | (1,151,504) | 72.8 | 1,300,041 | (88.6) |
| 2004 | 3,320,822 | 4,732,409 | (1,411,587) | 70.2 | 1,305,670 | (108.1) |
| 2005 | 3,784,506 | 5,757,650 | (1,973,144) | 65.7 | 1,404,043 | (140.5) |
| 2006 | 2,709,843 | 11,455,015 | (8,745,172) | 23.7 | 1,590,693 | (549.8) |

See accompanying notes to required supplementary information and independent auditors' report.

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Schedule of Contributions from Employers and the State of Alaska
Pension and Postemployment Healthcare Benefits

June 30, 2007
(Dollars in thousands)

| Year Ended June 30 | Actuarial Valuation Date as of June 30 ⁽¹⁾ | Annual Required Contribution | | | Pension Percentage Contributed | | Post-employment Healthcare Percentage Contributed | | Total Percentage Contributed (note 3) |
|-----------------------|--|------------------------------|----------------------------|---------|--------------------------------|--------------------------------|---|--------------------------------|--|
| | | Pension | Post-employment Healthcare | Total | by Employer (note 3) | by State of Alaska (note 3) | by Employer (note 3) | by State of Alaska (note 3) | |
| 2002 | 1999 | \$ 65,485 | 26,613 | 92,098 | 102.9% | -% | 102.9% | -% | 102.9% |
| 2003 | 2000 | 63,283 | 26,651 | 89,934 | 110.3 | - | 110.3 | - | 110.3 |
| 2004 | 2001 | 74,178 | 31,407 | 105,585 | 100.0 | - | 100.0 | - | 100.0 |
| 2005 | 2002 | 234,361 | 142,393 | 376,754 | 47.3 | - | 47.3 | - | 47.3 |
| 2006 | 2003 | 249,488 | 166,749 | 416,237 | 61.0 | 4.4 | 61.0 | 4.4 | 65.4 |
| 2007 | 2005 | 268,742 | 189,495 | 458,237 | 73.2 | 4.1 | 73.2 | 4.1 | 77.3 |

⁽¹⁾ Actuarial valuation related to annual required contribution for fiscal year.

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(1) Description of Schedule of Funding Progress

Each time a new benefit is added which applies to service already rendered, an "unfunded actuarial accrued liability" is created. Laws governing the Plan require that these additional liabilities be financed systematically over a period of future years. Also, if actual financial experiences are less favorable than assumed financial experiences, the difference is added to the unfunded actuarial accrued liability.

In an inflationary economy, the value of the dollar is decreasing. This environment results in employee pay increasing in dollar amounts resulting in unfunded actuarial accrued liabilities increasing in dollar amounts, all at a time when the actual value of these items, in real terms, may be decreasing.

(2) Actuarial Assumptions and Methods

The actuarial valuation was prepared by Buck Consultants. The significant actuarial assumptions used in the valuation as of June 30, 2006 are as follows:

- (a) Actuarial cost method – entry age, unfunded actuarial accrued liability or funding excess amortized over a fixed 25-year period as a level percentage of expected payroll.
- (b) Valuation of assets – recognizes 20% of the investment gain or loss in each of the current and preceding four years and phased in over the next five years. All assets are valued at market value. Valuation assets are constrained to a range of 80% to 120% of the market value of assets.
- (c) Valuation of medical and prescription drug benefits – base claims cost rates are incurred healthcare cost expressed as a rate per member per year. Separate analysis is limited by the availability and credibility of cost and enrollment data for each component of cost. This valuation reflects non-prescription claims separated by Medicare status, including eligibility of free Part A coverage. Prescription costs are analyzed separately as in prior valuations. Administrative costs are assumed in the final per capita claims cost rates used for valuation purposes. Analysis to date on Medicare Part A coverage is limited since Part A coverage is not available by individual, nor is this status incorporated into historical claim data. Valuation assumes 7.5% of the current retiree population does not receive Part A coverage.
- (d) Investment return/Discount Rate – 8.25% per year, compounded annually, net of expenses.
- (e) Salary scale – inflation 3.5% per year. Peace Officer/Firefighter - Merit 2.5% per year for the first 6 years of employment, 0.5% thereafter. Productivity 0.5% per year. Others: Merit – 5.5% per year grading down to 1.5% after 5 years; for more than 6 years of service, 1.0% grading down to 0%. Productivity – 0.5% per year.
- (f) Payroll Growth – 4.0% per year.
- (g) Total inflation – total inflation as measured by the Consumer Price Index for urban and clerical workers for Anchorage is assumed to increase 3.5% annually.

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- (h) Mortality (Pre-retirement) – Peace Officer/Firefighters: 1994 Group Annuity Mortality Basic Table for males and females, 1994 base year. Others: based upon the 2001-2005 actual experience. 42% of 1994 Group Annuity Table 1994 Base Year for males and females. Deaths are assumed to be occupation 75% of the time for Peace Officer/Firefighters, 50% of the time for Others.
- (i) Mortality (Post-retirement) – 1994 Group Annuity Table Base Year for males and females, 1994 Base year.
- (j) Turnover – based upon the 2001–2005 actual withdrawal experience.
- (k) Disability – incidence rates based upon the 2001–2005 actual experience. Post-disability mortality in accordance with the 1974 Pension Benefit Guaranty Corporation Disability Mortality Table to reflect mortality of those receiving disability benefits under Social Security. Disabilities are assumed to be occupational 75% of the time for Peace Officers/Firefighters, 50% of the time for Others.
- (l) Retirement – retirement rates based on the 2001–2005 actual experience. Deferred vested members are assumed to retire at their earliest retirement date.
- (m) Marriage and age difference – wives are assumed to be three years younger than husbands. 80% of male members and 70% of female members are assumed to be married.
- (n) Dependent children – benefits to dependent children have been valued assuming members who are married and between the ages of 25 and 45 have two dependent children.
- (o) Contribution refunds – 15% of those terminating are assumed to have their contributions refunded.
- (p) Cost of Living Allowance (COLA) – of those benefit recipients who are eligible for the COLA, 60% are assumed to remain in Alaska and receive the COLA.
- (q) Post-Retirement Pension Adjustment (PRPA) – 50% and 75% of assumed inflation, of 1.75% and 2.625% respectively, is valued for the annual automatic PRPA as specified in the statute.
- (r) Expenses – all expenses are included in the investment return assumption.
- (s) Part-time status – part-time members are assumed to earn 1.00 years of credited service per year for Peace Officer/Firefighters and 0.65 years for credited service per year for Other members.
- (t) Per capita claims cost – sample claims cost rates for FY07 medical benefits are shown below:

| | Medical | Prescription Drugs |
|----------------------|----------------|-------------------------------|
| Total | \$ 9,095 | \$ 2,414 |
| Medicare Part A & B | \$ 8,133 | N/A |
| Medicare Part B Only | \$ 7,171 | N/A |
| Medicare Part D | N/A | \$ 516 |

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(u) Health cost trend –

| <u>Fiscal year</u> | <u>Medical</u> | <u>Prescription</u> |
|--------------------|----------------|---------------------|
| 2007 | 9.0% | 13.0% |
| 2008 | 8.5 | 12.0 |
| 2009 | 8.0 | 11.0 |
| 2010 | 7.5 | 10.0 |
| 2011 | 7.0 | 9.0 |
| 2012 | 6.5 | 8.0 |
| 2013 | 6.0 | 7.0 |
| 2014 | 5.5 | 6.0 |
| 2015 | 5.0 | 5.0 |
| 2016 and later | 5.0 | 5.0 |

For the June 30, 2005 valuation, graded Healthcare Cost Trend Rates (HCCTR) were reinitialized. A survey of healthcare trends in the past year has revealed a general lowering of HCCTR. No reinitialization is required this year, so the trend rates will follow the same pattern as of the 2005 valuation.

(v) Aging Factors –

| <u>Age</u> | <u>Medical</u> | <u>Prescription Drugs</u> |
|------------|----------------|-------------------------------|
| 0-44 | 2.0% | 4.5% |
| 45-54 | 2.5% | 3.5% |
| 55-64 | 3.5% | 3.0% |
| 65-74 | 4.0% | 1.5% |
| 75-84 | 1.5% | 0.5% |
| 85+ | 0.5% | 0.0% |

(w) Retired member contributions for medical Benefits—currently contributions are required for PERS members who are under age 60 and have less than 30 years of service (25 for Peace Officer/ Firefighter). Eligible Tier 1 members are exempt from contribution re-

quirements. Annual FY07 contributions based on monthly rates shown below for calendar 2006 and 2007 are assumed based on the coverage category for current retirees. The composite rate shown is used for current active and inactive members assumed to retire prior to age 60 with less than 30 years of service:

| <u>Coverage Category</u> | <u>FY07 Annual Contribution</u> | <u>Calendar 2007 Monthly Contribution</u> | <u>Calendar 2006 Monthly Contribution</u> |
|------------------------------|-------------------------------------|---|---|
| Retiree Only | \$ 7,080 | \$ 590 | \$ 590 |
| Retiree and Spouse | \$14,148 | \$1,179 | \$1,179 |
| Retiree and Child(ren) | \$ 9,996 | \$ 883 | \$ 883 |
| Retiree and Family | \$17,076 | \$1,423 | \$1,423 |
| Composite | \$10,512 | \$ 876 | \$ 876 |

(x) Trend Rate for Retired Member Contributions –

| | |
|----------------|------|
| FY08 | 8.0% |
| FY09 | 7.7% |
| FY10 | 7.3% |
| FY11 | 7.0% |
| FY12 | 6.7% |
| FY13 | 6.3% |
| FY14 | 6.0% |
| FY15 | 5.7% |
| FY16 | 5.3% |
| FY17 and later | 5.0% |

Graded trend rates for retired member medical contributions were reinitialized for the June 30, 2005 valuation. A study of the required contribution history along with assumptions related to the impact of recent accounting regulations leads us to recommend the new assumptions above for the contribution trends. Note that actual FY07 retired member medical contributions are

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Notes to Required Supplementary Information

June 30, 2007

reflected in the valuation so trend on such contribution during FY07 is not applicable.

The assumptions and methods, when applied in combination, fairly represent past and anticipated future experience of the Plan. The foregoing actuarial assumptions are based on the presumption that the Plan will continue. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated benefits.

Effective June 30, 2006, there was a change in the actuarial cost methods. The cost method was changed from Projected Unit Credit to Entry Age Normal. The ARMB adopted the changes to the demographic and economic assumptions recommended by the actuary based on the results of an experience analysis performed of the population experience from June 30, 2001 through June 30, 2005. The changes in assumptions were adopted by the ARMB during the October 2006 ARMB meeting.

Changes in Assumptions since the Last Valuation

- (a) Salary scale – Other: based on actual experience from 2001 to 2005. Peace Officer/Firefighter: rates are increased for the first 6 years. Based on actual experience 2001 to 2005.
- (b) Payroll Growth – 4.0%
- (c) Pre-retirement mortality – Peace Officers/Firefighter: no change. Others: 42.0% of the 1994 GAM table, 1994 base year.
- (d) Turnover – rates adjusted based on actual experience from 2001 to 2005.
- (e) Disability – Peace Officer/Firefighter: no change. Others: male/female rates increased by 5% based on actual experience from 2001 to 2005.
- (f) Retirement – rates adjusted based on actual experience from 2001 to 2005.
- (g) Marriage and age difference – male 80% married, female 70% married, and males 3 years older.
- (h) Dependent children – married members have two dependent children from age 25 through 45.
- (i) Contribution refunds – 15% for all ages and vested status.
- (j) COLA – of all benefit recipients who are eligible for the COLA, 60% are assumed to remain in Alaska and receive COLA.
- (k) Part-time status – part-time employees are assumed to earn 0.65 years of credited service per year. All Peace Officer/Firefighters are assumed to be full-time.
- (l) Occupational death and disability – other 50% and Peace Officers/Firefighters 75%.
- (m) Healthcare – included effect of Medicare Part A & B vs. Medicare Part B only. Active employees hired after April 1, 1986 are assumed to be covered by Medicare Parts A& B. 7.5% of current retirees are assumed to be covered by Part B only. Changed the assumed lag between medical claims incurred and paid dates from 3 months to 2 lag months. Changed trend rate table for retiree medical contributions to start at 8.0% and grade down to 5.0%.

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Schedule of Administrative and Investment Deductions

Years ended June 30, 2007
with Summarized Financial Information for 2006
(In thousands)

| | Administrative | Investment | Totals | |
|---|----------------------------|--------------------------|--------------------------|--------------------------|
| | | | 2007 | 2006 |
| Personal Services: | | | | |
| Wages | \$ 2,101 | 1,174 | 3,275 | 2,927 |
| Benefits | <u>1,548</u> | <u>539</u> | <u>2,087</u> | <u>1,500</u> |
| Total Personal Services | <u>3,649</u> | <u>1,713</u> | <u>5,362</u> | <u>4,427</u> |
| Travel: | | | | |
| Transportation | 35 | 77 | 112 | 121 |
| Per Diem | 8 | 11 | 19 | 15 |
| Honorarium | <u>-</u> | <u>-</u> | <u>-</u> | <u>8</u> |
| Total Travel | <u>43</u> | <u>88</u> | <u>131</u> | <u>144</u> |
| Contractual Services: | | | | |
| Management and Consulting | 521 | 19,122 | 19,643 | 20,504 |
| Accounting and Auditing | 31 | 912 | 943 | 946 |
| Data Processing | 380 | 304 | 684 | 744 |
| Communications | 211 | 43 | 254 | 172 |
| Advertising and Printing | 111 | 3 | 114 | 100 |
| Rental/leases | 164 | 45 | 209 | 202 |
| Legal | 648 | 94 | 742 | 493 |
| Medical Specialists | 29 | - | 29 | 12 |
| Repairs and Maintenance | 6 | 11 | 17 | 65 |
| Transportation | 3 | 3 | 6 | 6 |
| Securities Lending | - | 49,817 | 49,817 | 31,560 |
| Other Services | <u>284</u> | <u>33</u> | <u>317</u> | <u>255</u> |
| Total Contractual Services | <u>2,388</u> | <u>70,387</u> | <u>72,775</u> | <u>55,059</u> |
| Other: | | | | |
| Equipment | 78 | 15 | 93 | 163 |
| Supplies | <u>88</u> | <u>77</u> | <u>165</u> | <u>106</u> |
| Total Other | <u>166</u> | <u>92</u> | <u>258</u> | <u>269</u> |
| Total Administrative and Investment Deductions | <u>\$ 6,246</u> | <u>72,280</u> | <u>78,526</u> | <u>59,899</u> |

See accompanying independent auditors' report.

Schedule 2

STATE OF ALASKA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Defined Benefit Retirement Pension and
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Defined Contribution Retirement Pension Trust Fund
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Schedule of Payments to Consultants
Other than Investment Advisors

Years ended June 30, 2007 and 2006
(In thousands)

| <u>Firm</u> | <u>Services</u> | <u>2007</u> | <u>2006</u> |
|------------------------------------|-----------------------------|-----------------|--------------|
| State Street Corporation | Custodian Banking Services | \$ 897 | 1,319 |
| Deloitte and Touche LLP | Benefits Consultation | 15 | 24 |
| Buck Consultant LLP | Actuarial Services | 370 | 256 |
| Mercer Human Resource Consulting | Actuarial Services | - | 190 |
| Systems Central Services, Inc. | Data Processing Consultants | 216 | 237 |
| Wostmann & Associates | Data Processing Consultants | 26 | 130 |
| State of Alaska, Department of Law | Legal Services | 406 | 307 |
| First National Bank Alaska | Banking Services | 40 | 20 |
| KPMG LLP | Auditing Services | 25 | 21 |
| | | <u>\$ 1,995</u> | <u>2,504</u> |

See accompanying independent auditors' report.



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