



**ALASKA STATE PENSION  
INVESTMENT BOARD**

June 30, 2006 and 2005

**PUBLIC EMPLOYEES'  
RETIREMENT SYSTEM**



**Public Employees' Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

**(With Independent Auditors' Report Thereon)**

**Public Employees' Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

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## **Independent Auditors' Report**

Alaska Retirement Management Board:

We have audited the accompanying schedules of invested assets of the Public Employees' Retirement System as of June 30, 2006 and 2005 and of investment income and changes in invested assets of the Public Employees' Retirement System for the years then ended (schedules). These schedules are the responsibility of the Division of Treasury's management. Our responsibility is to express an opinion on these schedules 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 schedules 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 Public Employees' Retirement System's 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 schedules, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying schedules were prepared to present the invested assets of the Public Employees' Retirement System, which is established under the State of Alaska Public Employees Retirement System (PERS). The schedules are not intended to present the financial status of PERS.

As explained in note 2, the financial statements include investments valued at approximately \$1,816,443,000 (19% of net assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In our opinion, the schedules referred to above present fairly, in all material respects, the invested assets of the Public Employees' Retirement System as of June 30, 2006 and 2005, and the investment income and changes in invested assets for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

October 27, 2006

**PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

**SCHEDULES OF INVESTED ASSETS**

**June 30, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Investments (at Fair Value)</b> (Note 4)		
<b>Cash and Cash Equivalents</b>		
Short-term Fixed Income Pool (Note 3)	\$ 559,886	\$ 653,551
Securities Lending Collateral (Note 7)	929,519,157	659,801,022
Total Cash and Cash Equivalents	<u>930,079,043</u>	<u>660,454,573</u>
<b>Marketable Debt Securities</b> (Note 3)		
Domestic Fixed Income Pool	2,026,056,547	1,910,374,412
International Fixed Income Pool (Note 5)	196,326,644	319,300,896
High Yield Pool	146,295,725	138,443,544
Total Marketable Debt Securities	<u>2,368,678,916</u>	<u>2,368,118,852</u>
<b>Equity Securities</b> (Note 3)		
Domestic Equity Pool	3,579,904,406	3,296,280,295
International Equity Pool (Note 5)	1,426,751,643	1,337,642,720
Emerging Markets Equity Pool	180,324,387	134,075,977
Private Equity Pool	565,342,638	379,843,136
Absolute Return Pool	239,130,193	210,613,031
Total Equity Securities	<u>5,991,453,267</u>	<u>5,358,455,159</u>
<b>Other Investments Pool</b> (Note 3)	<u>71,033,502</u>	<u>31,763,002</u>
<b>Real Estate Investments</b>		
Real Estate Pool (Note 3)	940,936,275	827,537,553
Mortgages (Note 2)	1,507	10,335
Total Real Estate Investments	<u>940,937,782</u>	<u>827,547,888</u>
<b>Total Invested Assets</b>	<u>10,302,182,510</u>	<u>9,246,339,474</u>
Securities Lending Collateral Payable (Note 7)	<u>929,519,157</u>	<u>659,801,022</u>
<b>Net Invested Assets</b>	<u>\$ 9,372,663,353</u>	<u>\$ 8,586,538,452</u>

**PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

**SCHEDULES OF INVESTMENT INCOME  
AND CHANGES IN INVESTED ASSETS**

**Years ended June 30, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Investment Income</b>		
Short-term Fixed Income Pool	\$ 339,085	\$ 72,448
Securites Lending (net of \$31,559,751 and \$13,221,426 expense for the years ended) June 30, 2006 and 2005, respectively)	1,992,580	1,535,860
Domestic Fixed Income Pool	189,693	141,266,215
International Fixed Income Pool	(2,288,024)	29,657,869
High Yield Pool	7,688,502	2,159,769
Domestic Equity Pool	303,158,846	149,825,900
International Equity Pool	362,506,165	175,658,609
Emerging Markets Equity Pool	46,248,411	35,141,474
Private Equity Pool	105,769,140	54,974,867
Absolute Return Pool	22,505,186	5,115,692
Other Investments Pool	4,800,839	1,084,939
Real Estate Pool	143,059,478	114,263,074
Mortgages	<u>10,546</u>	<u>22,004</u>
<b>Total Investment Income</b>	995,980,447	710,778,720
<b>Total Invested Assets, Beginning of Year</b>	8,586,538,452	8,175,491,756
<b>Net Withdrawals</b>	<u>(209,855,546)</u>	<u>(299,732,024)</u>
<b>Total Invested Assets, End of Year</b>	\$ <u><u>9,372,663,353</u></u>	\$ <u><u>8,586,538,452</u></u>

# Public Employees' Retirement System Invested Assets

## Notes to Schedules June 30, 2006 and 2005

### (1) THE ACCOUNTING ENTITY

The Public Employees' Retirement System Invested Assets (PERS Invested Assets) is the investment portfolio of the State of Alaska Public Employees' Retirement System (PERS). PERS is a multiple employer, joint contributory, agent-defined benefit system established for the payment of retirement, disability and death benefits to, or on behalf of, qualified employees of the State of Alaska (State) or a political subdivision within the State. These schedules are those of PERS Invested Assets and not PERS taken as a whole. Fiduciary responsibility for PERS Invested Assets resides with the Alaska Retirement Investment Board (Board), pursuant to Alaska Statutes 37.10.210-390.

Alaska Statutes 39.35.080 and 37.10.071 provide that investments 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 Board. Treasury has created a pooled environment by which it manages the investments the Board has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The Board 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, 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, real estate investment trust holdings and cash holdings of certain external managers in addition to acting as oversight manager for all externally managed investments.

The Short-term Fixed Income Pool is a State pool managed by Treasury.

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Accounting

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and employees, net of benefits paid to PERS participants as well as administrative and investment management expenses. Contributions, benefits paid and all expenses are recorded on a cash basis.

#### Valuation

##### Investments with Readily Determinable Fair Values

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 a 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.

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.



# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

##### Valuation (Cont.)

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, 2006 and 2005, 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.

Private equity securities are valued periodically by the general partners. Underlying private equity investments that are listed on a national exchange are valued using quoted market prices. Securities for which there are not market quotations available are initially carried at original cost and subsequently valued at fair value as determined by the general partners. In determining fair value, the financial condition, operating results and projected operating cash flow of the underlying portfolio companies, prices paid in private sales of such securities, the nature and duration of restrictions on disposition of the securities, the expenses and delay that would be involved in registration, the price and extent of public trading in similar securities, the existence of merger proposals or tender offers affecting securities, reports prepared by analysts are considered as appropriate. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

Absolute return investments are carried at fair value as determined by the pro-rata interest in the net assets of the underlying investment funds. These investment funds are valued periodically by the general partners and the managers of the underlying investments. The net asset value represents the amount that would be expected to be received if it were to liquidate its interests subject to liquidity or redemption restrictions. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

The energy related investments in the Other Investments Pool consist primarily of loans and preferred stock that are valued at the lower of cost or fair value. The agricultural investments in the Other Investments Pool consist primarily of farmland investments that are stated at fair value based upon independent appraisals performed periodically. In years when an independent appraisal is not performed, the valuation is reviewed by an independent advisor. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

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 once every three years, in conjunction with the property's purchase anniversary date, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

##### Income Allocation

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

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.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS

##### Short-term Fixed Income Pool

PERS Invested Assets include participation in the State's internally managed Short-term 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 participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. At June 30, 2006 and 2005, PERS Invested Assets included a 0.02% and .03% direct ownership in the Short-term Fixed Income Pool which included interest receivable of \$21,543 and \$8,927 respectively. PERS Invested Assets included a 9.28% and 3.35% indirect ownership in the Short-term Fixed Income Pool at June 30, 2006 and 2005, respectively.

##### Domestic Fixed Income Pool

The Domestic Fixed Income Pool is comprised of an internally managed and an externally managed pool.

##### Retirement Fixed Income Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,843. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.04% and 67.32% ownership in the Retirement Fixed Income Pool, respectively.

##### External Domestic Fixed Income Pool

PERS Invested Assets include participation in the Board's externally managed Domestic Fixed Income Pool which was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,548. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 67.43% and 66.86% ownership in the External Domestic Fixed Income Pool, respectively.

##### International Fixed Income Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,791. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.29% and 67.81% ownership in the International Fixed Income Pool, respectively.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### High Yield Pool

PERS Invested Assets include participation in the Board's externally managed High Yield Pool which was established April 15, 2005, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,072. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.22% and 68.14% 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 an External Small Cap Domestic Equity Pool.

##### Large Cap Domestic Equity Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,132. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.13% and 67.63% ownership in the Large Cap Domestic Equity Pool, respectively.

##### Small Cap Domestic Equity Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,173. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.14% and 67.70% ownership in the Small Cap Domestic Equity Pool, respectively.

##### International Equity Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$3,364. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, PERS Invested Assets included a 68.50% and 68.00% ownership in the International Equity Pool, respectively.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### Emerging Markets Equity Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$2,615. 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 participant. 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, 2006 and 2005, PERS Invested Assets included a 65.00% ownership in the Emerging Markets Equity Pool.

##### Private Equity Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,719. 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 participant. 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, 2006 and 2005, PERS Invested Assets included a 68.62% and 68.15% ownership in the Private Equity Pool, respectively.

##### Absolute Return Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,135. 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 participant. 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, 2006 and 2005, PERS Invested Assets included a 68.21% and 68.15% ownership in the Absolute Return Pool, respectively.

##### Other Investments Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$1,156. 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 participant. 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, 2006 and 2005, PERS Invested Assets included a 68.62% and 68.15% ownership in the Other Investments Pool.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### Real Estate Pool

PERS Invested Assets include participation in the Board'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, 2006, was \$2,483. 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 participant. 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, 2006 and 2005, PERS Invested Assets included a 68.17% and 67.70% ownership in the Real Estate Pool, respectively.

# Public Employees' Retirement System Invested Assets

## Notes to Schedules June 30, 2006 and 2005

### (4) DEPOSIT AND INVESTMENT RISK

At June 30, 2006, PERS Invested Assets included the following:

	Fair Value (in thousands)					Total
	Short-term	Domestic	International	High Yield	Other	
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	33,256
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	-	2,720
Yankees:						
Government	-	15,603	-	-	-	15,603
Corporate	2,669	1,360	-	4,662	-	8,692
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:						
Equity	-	-	-	-	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	(209,003)
Other Pool Ownership	(242,711)	210,049	-	-	32,662	-
PERS Invested Assets	\$ 560	\$ 2,026,056	\$ 196,327	\$ 146,296	\$ 7,932,944	\$ 10,302,183

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

At June 30, 2005, PERS Invested Assets included the following:

	Fair Value (in thousands)					Total
	Fixed Income Pools					
	Short-term	Domestic	International	High Yield	Other	
Deposits	\$ -	\$ -	\$ 6,587	\$ -	\$ 3,052	\$ 9,639
Overnight Sweep Account	88	935	-	37,348	-	38,371
Money Market Fund	-	-	-	-	659,801	659,801
Short-term Investment Fund	-	-	2,220	-	22,460	24,680
Commercial Paper	4,920	9,216	-	-	-	14,136
U. S. Treasury Bills	3,852	-	-	-	-	3,852
U. S. Treasury Notes	3,346	101,314	-	-	-	104,660
U. S. Treasury Bonds	-	123,573	-	-	-	123,573
U. S. Treasury Strips	-	25,160	-	-	-	25,160
U.S. Government Agency						
Discount Notes	851	7,245	-	-	-	8,096
U.S. Government Agency	-	125,170	-	-	-	125,170
Municipal Bonds	-	969	-	-	-	969
Foreign Government Bonds	-	-	212,977	-	-	212,977
Mortgage-backed	9,721	917,260	-	-	-	926,981
Other Asset-backed	27,264	112,094	-	272	-	139,630
Corporate Bonds	12,365	429,452	99,155	94,720	-	635,692
Convertible Bonds	-	-	-	1,445	-	1,445
Yankees:						
Government	-	9,502	-	-	-	9,502
Corporate	474	6,915	-	2,917	-	10,306
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	177,777	177,777
Equity	-	-	-	-	3,074,626	3,074,626
International Equity Pool:						
Convertible Bonds	-	-	-	-	313	313
Equity	-	-	-	-	1,311,369	1,311,369
Emerging Markets Equity Pool	-	-	-	-	134,076	134,076
Private Equity Pool:						
Limited Partnerships	-	-	-	-	379,843	379,843
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	210,613	210,613
Other Investments Pool:						
Limited Partnerships	-	-	-	-	15,097	15,097
Agricultural Holdings	-	-	-	-	16,666	16,666
Real Estate Pool:						
Real Estate	-	-	-	-	473,584	473,584
Commingled Funds	-	-	-	-	172,117	172,117
Limited Partnerships	-	-	-	-	104,288	104,288
Real estate investment trusts	-	-	-	-	76,249	76,249
Mortgages	-	-	-	-	10	10
Net Other Assets (Liabilities)	637	16,443	(1,638)	1,742	7,887	25,071
Ownership by Other Pools	(62,864)	25,126	-	-	37,738	-
PERS Invested Assets	\$ 654	\$ 1,910,374	\$ 319,301	\$ 138,444	\$ 6,877,566	\$ 9,246,339

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### 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 twelve-month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three 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 Board'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, 2006, was 4.80 years.

Through the Board'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 Non-U.S. World Government Bond Index. The effective duration for the Citigroup Non-U.S. World Government Bond Index at June 30, 2006, was 6.08 years.

Through the Board'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, 2006, was 4.59 years. The High Yield Pool was funded April 15, 2006. Investment managers were in the transition period at year end working towards fully investing allocated funds. Funds not invested at year end have no duration causing the pool's duration to be lower than the policy limit.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis 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.



# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Interest Rate Risk (Cont.)

At June 30, 2006, the effective duration of the fixed income pools, by investment type, was as follows:

	<u>Effective Duration (in years)</u>		
	<u>Domestic</u>	<u>International</u>	<u>High Yield</u>
U.S. Treasury Notes	2.65	-	-
U.S. Treasury Bonds	9.73	-	-
U.S. Treasury Strips	20.17	-	-
U.S. Government Agency	3.61	-	-
Municipal Bonds	11.98	-	-
Foreign Government Bonds	-	6.41	-
Mortgage-backed	3.57	-	-
Other Asset-backed	1.78	-	4.73
Corporate Bonds	5.21	4.12	3.76
Convertible Bonds	-	-	2.40
Yankees	-	-	-
Government	9.67	-	-
Corporate	2.18	-	4.43
Portfolio Effective Duration	3.83	5.45	3.43

##### Credit Risk

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

The PERS 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, Short-term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed 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.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Credit Risk (Cont.)

The Board'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;

##### Domestic Fixed Income (cont.):

- Corporate, asset-backed 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. Asset-backed 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.

##### International Fixed Income:

- Corporate debt and asset-backed 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 ten percent of the portfolio's assets may be invested in securities rated A3 or higher.
- No more than twenty-five percent of the portfolio's assets may be invested in securities rated below B3.
- No more than five percent 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 Board does not consider this investment subject to the credit risk limitations above.

# Public Employees' Retirement System Invested Assets

## Notes to Schedules June 30, 2006 and 2005

### (4) DEPOSIT AND INVESTMENT RISK (Cont.)

#### Credit Risk (Cont.)

At June 30, 2006, PERS Invested Assets consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool			
		Short-term	Domestic	International	High Yield
Overnight Sweep Account	Not Rated	-	-	-	8%
Short-term Investment					
Account	Not Rated	5%	-	-	-
Commercial Paper	A-1	9%	-	-	-
U. S. Government Agency					
Discount Notes	Not Rated	-	5%	-	-
U. S. Government Agency	Not Rated	-	10%	-	-
Foreign Government	AAA	-	-	51%	-
Foreign Government	AA	-	-	3%	-
Foreign Government	A	-	-	3%	-
Mortgage-backed	AAA	-	42%	-	-
Mortgage-backed (Agency)	Not Rated	8%	11%	-	-
Other Asset-backed	AAA	48%	6%	-	-
Other Asset-backed	AA	-	1%	-	-
Other Asset-backed	BB	-	-	-	-
Corporate Bonds	AAA	2%	1%	26%	-
Corporate Bonds	AA	16%	4%	13%	-
Corporate Bonds	A	9%	10%	-	1%
Corporate Bonds	BBB	-	8%	-	1%
Corporate Bonds	BB	-	-	-	18%
Corporate Bonds	B	-	-	-	53%
Corporate Bonds	CCC	-	-	-	12%
Corporate Bonds	D	-	-	-	1%
Convertible Bonds	B	-	-	-	2%
Yankees:					
Government	AAA - BBB	-	1%	-	-
Corporate	AA	1%	-	-	-
Corporate	BB	-	-	-	-
Corporate	B	-	-	-	3%
No credit exposure		2%	1%	4%	1%
		<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

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

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Board does not have a policy in relation to custodial credit risk for deposits. At June 30, 2006, PERS Invested Assets had the following uncollateralized and uninsured deposits:

	<u>Amount</u> (in thousands)
International Equity Pool	\$ <u>3,356</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 Board'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 Non-U.S. World Government Bond Index. In addition, the Board's asset allocation policy permits PERS to hold up to four percent of total investments in international fixed income.

The Board's policy with regard to foreign currency risk in the International Equity Pool and the Emerging Markets Pool is to permit PERS to hold up to eighteen percent of total investments in these two pools combined.

The Board's policy with regard to foreign currency risk in the Private Equity Pool is to permit PERS to hold up to ten percent of total investments in private equity.

At June 30, 2006, PERS had exposure to foreign currency risk with the following deposits:

<u>Currency</u>	<u>Amount (in thousands)</u>
	<u>International Equity Pool</u>
Canadian Dollar	\$ 3
Euro Currency	1,261
Hong Kong Dollar	45
Japanese Yen	1,675
New Zealand Dollar	3
Norwegian Krone	138
Pound Sterling	345
Singapore Dollar	17
Swedish Krona	122
Swiss Franc	36
	\$ <u>3,645</u>

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Foreign Currency Risk (Cont.)

At June 30, 2006, PERS had exposure to foreign currency risk with the following investments:

Currency	Amount (in thousands)			
	Fixed Income		International Equity Pool	Private Equity Pool
	International Fixed Income Pool			
	Foreign Government	Corporate	Equity	Limited Partnerships
Australian Dollar	\$ 11,765	\$ -	\$ 25,555	\$ -
Canadian Dollar	-	-	28,389	-
Danish Krone	-	-	1,038	-
Euro Currency	88,695	-	514,356	36,780
Hong Kong Dollar	-	-	14,638	-
Hungarian Forint	-	-	2,703	-
Japanese Yen	5,979	76,247	289,393	-
New Taiwan Dollar	-	-	3,135	-
New Zealand Dollar	-	-	2,173	-
Norwegian Krone	-	-	16,506	-
Polish Zloty	5,304	-	-	-
Pound Sterling	-	-	238,640	6,430
Singapore Dollar	-	-	12,076	-
South African Rand	-	-	7,243	-
South Korean Won	-	-	14,967	-
Swedish Krona	168,044	-	20,881	-
Swiss Franc	-	-	94,723	-
	\$ <u>279,787</u>	\$ <u>76,247</u>	\$ <u>1,286,416</u>	\$ <u>43,210</u>

At June 30, 2006, PERS 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 Short-term 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 Board'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, 2006, PERS invested assets included \$756 million in Federal National Mortgage Association securities which represented 8% of total PERS invested assets. Federal National Mortgage Association securities are not classified as corporate bonds.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (5) 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>2006</u>	<u>2005</u>
Net Realized Gain on Foreign currency	\$ 21,661,967	122,903,509
Net Unrealized Loss on Foreign currency	(26,077)	(26,827)
Net Realized Gain (Loss) on Foreign Exchange Contracts	252,345	(217,279)

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 twenty-four days. PERS had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2006</u>	<u>2005</u>
Contract Sales	\$ 2,976,479	6,587,214
Less: Fair Value	2,984,540	6,302,248
Net unrealized Gains (Losses) on Contracts	<u>\$ (8,061)</u>	<u>284,966</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 non-performance 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.

#### (6) COMMITMENTS AND CONTINGENCIES

The Board entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2006, PERS Invested Asset's share of the unfunded commitment totaled \$69,729,977. This commitment can be withdrawn annually in December with ninety days notice.

The Board 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, 2006, PERS Invested Asset's share of these unfunded commitments totaled \$507,540,902. These commitments are estimated to be paid within up to ten years from agreement date.

The Board 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, 2006, PERS Invested Asset's share of this unfunded commitment totaled \$23,056,852 to be paid through the year 2007.

The Board 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, 2006, PERS Invested Asset's share of these unfunded commitments totaled \$228,703,629 to be paid through the year 2010.

# Public Employees' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (7) SECURITIES LENDING

Alaska Statute 37.10.071 authorizes the Board to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Board has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the Board'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, 2006 and 2005, the fair value of securities on loan allocable to PERS Invested Assets totaled \$915,963,861 and \$642,524,010, respectively. There is no limit to the amount that can be loaned and the Board is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. All other security loans are collateralized at not less than 102 percent 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 \$929,519,157 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 \$3,972,138 may be pledged or sold upon borrower default. Since the Board does not have the ability to pledge or sell collateral securities unless the borrower defaults, they are not recorded on the financial schedules. Securities under loan, cash collateral and cash collateral payable are recorded on the financial schedules at fair value. The bank, PERS and the borrower receive a fee from earnings on invested collateral. The bank and PERS 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 Board 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 Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

**TEACHERS' RETIREMENT  
SYSTEM**





**Teachers' Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

**(With Independent Auditors' Report Thereon)**

**TEACHERS' RETIREMENT SYSTEM**

**Invested Assets**

**June 30, 2006 and 2005**

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**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

## **Independent Auditors' Report**

Alaska Retirement Management Board and  
State of Alaska, Department of Revenue  
Division of Treasury:

We have audited the accompanying schedules of invested assets of the Teachers' Retirement System as of June 30, 2006 and 2005 and of investment income and changes in invested assets of the Teachers' Retirement System for the years then ended (schedules). These schedules are the responsibility of the Division of Treasury's management. Our responsibility is to express an opinion on these schedules 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 schedules 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 Teachers' Retirement System's 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 schedules, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying schedules were prepared to present the invested assets of the Teachers' Retirement System, which is established under the State of Alaska Teachers Retirement System (TRS). The schedules are not intended to present the financial status of TRS.

As explained in note 2, the financial statements include investments valued at approximately \$830,593,000 (19% of net invested assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In our opinion, the schedules referred to above present fairly, in all material respects, the invested assets of the Teachers' Retirement System as of June 30, 2006 and 2005, and the investment income and changes in invested assets for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

October 27, 2006

**TEACHERS' RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTED ASSETS**

**June 30, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Investments (at Fair Value) (Note 4)</b>		
<b>Cash and Cash Equivalents</b>		
Short-term Fixed Income Pool (Note 3)	\$ 516,688	\$ 585,538
Securities Lending Collateral (Note 7)	423,385,155	308,846,667
Total Cash and Cash Equivalents	<u>423,901,843</u>	<u>309,432,205</u>
<b>Marketable Debt Securities (Note 3)</b>		
Domestic Fixed Income Pool	933,047,461	905,760,247
International Fixed Income Pool	89,709,413	149,204,976
High Yield Pool	66,894,932	64,726,075
Total Marketable Debt Securities	<u>1,089,651,806</u>	<u>1,119,691,298</u>
<b>Equity Securities (Note 3)</b>		
Domestic Equity Pool	1,636,960,222	1,540,569,818
International Equity Pool (Note 5)	638,689,896	615,742,632
Emerging Markets Equity Pool	97,105,245	72,200,331
Private Equity Pool	258,508,381	177,495,095
Absolute Return Pool	109,341,816	98,416,990
Total Equity Securities	<u>2,740,605,560</u>	<u>2,504,424,866</u>
<b>Other Investments Pool (Note 3)</b>	<u>32,481,308</u>	<u>14,843,683</u>
<b>Real Estate Investments</b>		
Real Estate Pool (Note 3)	430,261,807	386,709,217
Mortgages (Note 2)	32,672	47,635
Total Real Estate Investments	<u>430,294,479</u>	<u>386,756,852</u>
<b>Total Invested Assets</b>	<u>4,716,934,996</u>	<u>4,335,148,904</u>
Securities Lending Collateral (Note 7)	<u>423,385,155</u>	<u>308,846,667</u>
<b>Net Invested Assets</b>	<u>\$ 4,293,549,841</u>	<u>\$ 4,026,302,237</u>

See accompanying notes to schedules

**TEACHERS' RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTMENT INCOME**  
**AND CHANGES IN INVESTED ASSETS**

**Years ended June 30, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Investment Income</b>		
Short-term Fixed Income Pool	\$ 103,378	\$ 31,113
Securities Lending (net of \$14,438,459 and \$6,213,581 expense)	911,598	721,678
Domestic Fixed Income Pool	260,041	66,862,907
International Fixed Income Pool	(1,100,647)	14,161,532
High Yield Pool	3,551,536	1,009,850
Domestic Equity Pool	141,065,373	69,969,516
International Equity Pool	164,926,103	82,379,323
Emerging Markets Equity Pool	24,904,914	18,923,783
Private Equity Pool	48,806,006	25,859,603
Absolute Return Pool	10,376,212	2,414,329
Other Investments Pool	2,203,919	504,902
Real Estate Pool	66,035,719	53,834,611
Mortgages	6,197	9,729
	<hr/>	<hr/>
<b>Total Investment Income</b>	<b>\$ 462,050,349</b>	<b>\$ 336,682,876</b>
	<hr/> <hr/>	<hr/> <hr/>
<b>Total Invested Assets, Beginning of Year</b>	4,026,302,237	3,908,888,915
<b>Net Withdrawals</b>	(194,802,745)	(219,269,554)
	<hr/>	<hr/>
<b>Total Invested Assets, End of Year</b>	<b>\$ 4,293,549,841</b>	<b>\$ 4,026,302,237</b>
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to schedules

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (1) THE ACCOUNTING ENTITY

The Teachers' Retirement System Invested Assets (TRS Invested Assets) is the investment portfolio of the State of Alaska Teachers' Retirement System (TRS). TRS is a multiple employer, joint contributory, agent-defined benefit system established for the payment of retirement, disability and death benefits to, or on behalf of, qualified employees of the State of Alaska (State) or a political subdivision within the State. These schedules are those of TRS Invested Assets and not TRS taken as a whole. Fiduciary responsibility for TRS Invested Assets resides with the Alaska Retirement Management Board(Board), pursuant to Alaska Statutes 37.10.210-390.

Alaska Statutes 14.25.180 and 37.10.071 provide that investments 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 Board. Treasury has created a pooled environment by which it manages the investments the Board has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The Board 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, 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, real estate investment trust holdings and cash holdings of certain external managers in addition to acting as oversight manager for all externally managed investments.

The Short-term Fixed Income Pool is a State pool managed by Treasury.

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Basis of Accounting

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and employees, net of benefits paid to TRS participants as well as administrative and investment management expenses. Contributions, benefits paid and all expenses are recorded on a cash basis.

##### Valuation

###### Investments with Readily Determinable Fair Values

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 a 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.

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.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

##### Valuation (Cont.)

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, 2006 and 2005, the allowance for loan loss totaled \$28,022 and \$28,904, respectively and is considered by management to be sufficient to cover any losses to the mortgage loan portfolio.

##### Investments with Estimated Fair Values

Private equity securities are valued periodically by the general partners. Underlying private equity investments that are listed on a national exchange are valued using quoted market prices. Securities for which there are not market quotations available are initially carried at original cost and subsequently valued at fair value as determined by the general partners. In determining fair value, the financial condition, operating results and projected operating cash flow of the underlying portfolio companies, prices paid in private sales of such securities, the nature and duration of restrictions on disposition of the securities, the expenses and delay that would be involved in registration, the price and extent of public trading in similar securities, the existence of merger proposals or tender offers affecting securities, reports prepared by analysts are considered as appropriate. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

Absolute return investments are carried at fair value as determined by the pro-rata interest in the net assets of the underlying investment funds. These investment funds are valued periodically by the general partners and the managers of the underlying investments. The net asset value represents the amount that would be expected to be received if it were to liquidate its interests subject to liquidity or redemption restrictions. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

The energy related investments in the Other Investments Pool consist primarily of loans and preferred stock that are valued at the lower of cost or fair value. The agricultural investments in the Other Investments Pool consist primarily of farmland investments that are stated at fair value based upon independent appraisals performed periodically. In years when an independent appraisal is not performed, the valuation is reviewed by an independent advisor. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

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 once every three years, in conjunction with the property's purchase anniversary date, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

##### Income Allocation

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

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.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS

##### Short-term Fixed Income Pool

TRS Invested Assets include participation in the State's internally managed Short-term 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 participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. At June 30, 2006 and 2005, TRS Invested Assets included a .02% and 0.03% direct ownership in the Short-term Fixed Income Pool which included interest receivable of \$15,402 and \$7,098, respectively. TRS Invested Assets included a 4.29% and 1.58% indirect ownership in the Short-term Fixed Income Pool at June 30, 2006 and 2005, respectively.

##### Domestic Fixed Income Pool

The Domestic Fixed Income Pool is comprised of an internally managed and an externally managed pool.

##### Retirement Fixed Income Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,843. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 31.38% and 32.08% ownership in the Retirement Fixed Income Pool, respectively.

##### External Domestic Fixed Income Pool

TRS Invested Assets include participation in the Board's externally managed Domestic Fixed Income Pool which was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,548. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 30.92% and 31.33% ownership in the External Domestic Fixed Income Pool, respectively.

##### International Fixed Income Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,791. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 31.20% and 31.68% ownership in the International Fixed Income Pool, respectively.



# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS, (CONT.)

##### High Yield Pool

TRS Invested Assets include participation in the Board's externally managed High Yield Pool which was established April 15, 2005, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,072. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 31.20% and 31.86% 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 an External Small Cap Domestic Equity Pool.

##### Large Cap Domestic Equity Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,132. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 31.16% and 31.61% ownership in the Large Cap Domestic Equity Pool, respectively.

##### Small Cap Domestic Equity Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,173. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 31.15% and 31.64% ownership in the Small Cap Domestic Equity Pool, respectively.

##### International Equity Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$3,364. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, TRS Invested Assets included a 30.66% and 31.30% ownership in the International Equity Pool, respectively.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### Emerging Markets Equity Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$2,615. 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 participant. 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, 2006 and 2005, TRS Invested Assets included a 35.00% ownership in the Emerging Markets Equity Pool.

##### Private Equity Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,719. 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 participant. 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, 2006 and 2005, TRS Invested Assets included a 31.38% and 31.85% ownership in the Private Equity Pool, respectively.

##### Absolute Return Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,135. 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 participant. 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, 2006 and 2005, TRS Invested Assets included a 31.19% and 31.85% ownership in the Absolute Return Pool, respectively.

##### Other Investments Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$1,156. Underlying assets in the pool are comprised of limited partnership interests 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 participant. 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, 2006 and 2005, TRS Invested Assets included a 31.38% and 31.85% ownership in the Other Investments Pool.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### Real Estate Pool

TRS Invested Assets include participation in the Board'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, 2006, was \$2,483. 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 participant. 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, 2006 and 2005, TRS Invested Assets included a 31.17% and 31.64% ownership in the Real Estate Pool, respectively.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK

At June 30, 2006, TRS Invested Assets included the following:

	Fair Value (in thousands)					Total
	Fixed Income Pools				Other	
	Short-term	Domestic	International	High Yield		
Deposits	\$ -	\$ -	\$ -	\$ -	\$ 1,533	\$ 1,533
Overnight Sweep Account	196	337	-	5,684	-	6,217
Money Market Fund	-	-	-	-	423,385	423,385
Short-term Investment Fund	4,836	-	543	-	9,679	15,057
Commercial Paper	9,698	3,118	-	-	-	12,816
U. S. Treasury Notes	-	51,257	-	-	-	51,257
U. S. Treasury Bonds	-	54,944	-	-	-	54,945
U. S. Treasury Strips	-	5,268	-	-	-	5,268
U.S. Government Agency						
Discount Notes	-	44,097	-	-	-	44,097
U.S. Government Agency	-	81,000	-	-	-	81,000
Municipal Bonds	-	649	-	-	-	649
Foreign Government Bonds	-	-	51,060	-	-	51,060
Mortgage-backed	8,349	442,660	-	-	-	451,009
Other Asset-backed	58,054	54,315	-	114	-	112,483
Corporate Bonds	30,036	193,195	34,840	57,165	-	315,236
Convertible Bonds	-	-	-	1,244	-	1,244
Yankees:						
Government	-	7,180	-	-	-	7,180
Corporate	1,233	624	-	2,132	-	3,988
Fixed Income Pools:						
Equity	-	-	-	17	-	17
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	91,729	91,729
Equity	-	-	-	-	1,526,971	1,526,971
International Equity Pool:						
Equity	-	-	-	-	628,800	628,800
Emerging Markets Equity Pool	-	-	-	-	97,105	97,105
Private Equity Pool:						
Limited Partnerships	-	-	-	-	258,509	258,509
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	109,342	109,342
Other Investments Pool:						
Limited Partnerships	-	-	-	-	12,620	12,620
Agricultural Holdings	-	-	-	-	19,862	19,862
Real Estate Pool:						
Real Estate	-	-	-	-	243,968	243,968
Commingled Funds	-	-	-	-	87,312	87,312
Limited Partnerships	-	-	-	-	67,306	67,306
Real estate investment trusts	-	-	-	-	31,247	31,247
Mortgages	-	-	-	-	33	33
Net Other Assets (Liabilities)	(58 )	(102,489 )	3,266	539	2,431	(96,310 )
Other Pool Ownership	(111,827 )	96,892	-	-	14,935	-
Total Invested Assets	\$ 517	\$ 933,047	\$ 89,709	\$ 66,895	\$ 3,626,767	\$ 4,716,935

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

At June 30, 2005, TRS Invested Assets included the following:

	Fair Value (in thousands)					Total
	Fixed Income Pools				Other	
	Short-term	Domestic	International	High Yield		
Deposits	\$ -	\$ -	\$ 3,078	\$ -	\$ 1,405	\$ 4,483
Overnight Sweep Account	42	438	-	17,461	-	17,941
Money Market Fund	-	-	-	-	308,847	308,847
Short-term Investment Fund	-	-	1,038	-	10,356	11,394
Commercial Paper	2,336	4,319	-	-	-	6,655
U. S. Treasury Bills	1,831	-	-	-	-	1,831
U. S. Treasury Notes	1,590	48,100	-	-	-	49,690
U. S. Treasury Bonds	-	58,628	-	-	-	58,628
U. S. Treasury Strips	-	11,949	-	-	-	11,949
U.S. Government Agency						
Discount Notes	404	3,422	-	-	-	3,826
U.S. Government Agency	-	59,322	-	-	-	59,322
Municipal Bonds	-	454	-	-	-	454
Foreign Government Bonds	-	-	99,521	-	-	99,521
Mortgage-backed	4,621	435,195	-	-	-	439,816
Other Asset-backed	12,960	52,868	-	127	-	65,955
Corporate Bonds	5,878	203,649	46,334	44,284	-	300,145
Convertible Bonds	-	-	-	676	-	676
Yankees:						
Government	-	4,501	-	-	-	4,501
Corporate	225	3,259	-	1,364	-	4,848
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	83,089	83,089
Equity	-	-	-	-	1,436,975	1,436,975
International Equity Pool:						
Convertible Bonds	-	-	-	-	144	144
Equity	-	-	-	-	603,648	603,648
Emerging Markets Equity Pool	-	-	-	-	72,200	72,200
Private Equity Pool:						
Limited Partnerships	-	-	-	-	177,452	177,452
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	98,417	98,417
Other Investments Pool:						
Limited Partnerships	-	-	-	-	7,055	7,055
Agricultural Holdings	-	-	-	-	7,788	7,788
Real Estate Pool:						
Real Estate	-	-	-	-	221,307	221,307
Commingled Funds	-	-	-	-	80,431	80,431
Limited Partnerships	-	-	-	-	48,734	48,734
Real estate investment trusts	-	-	-	-	35,631	35,631
Mortgages	-	-	-	-	48	48
Net Other Assets (Liabilities)	309	7,684	(766 )	814	3,707	11,748
Ownership by Other Pools	(29,610 )	11,972	-	-	17,638	-
TRS Invested Assets	\$ 586	\$ 905,760	\$ 149,205	\$ 64,726	\$ 3,214,872	\$ 4,335,149

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### 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 twelve-month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three 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 Board'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, 2006, was 4.80 years.

Through the Board'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 Non-U.S. World Government Bond Index. The effective duration for the Citigroup Non-U.S. World Government Bond Index at June 30, 2006, was 6.08 years.

Through the Board'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, 2006, was 4.59 years. The High Yield Pool was funded April 15, 2006. Investment managers were in the transition period at year end working towards fully investing allocated funds. Funds not invested at year end have no duration causing the pool's duration to be lower than the policy limit.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis point change in interest rates. The duration, for 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.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Interest Rate Risk (Cont.)

At June 30, 2006, the effective duration of the domestic fixed income portfolio, by investment type, was as follows:

	<u>Effective Duration (in years)</u>		
	<u>Domestic</u>	<u>International</u>	<u>High Yield</u>
U.S. Treasury Notes	2.65	-	-
U.S. Treasury Bonds	9.73	-	-
U.S. Treasury Strips	20.17	-	-
U.S. Government Agency	3.61	-	-
Municipal Bonds	11.98	-	-
Foreign Government Bonds	-	6.41	-
Mortgage-backed	3.57	-	-
Other Asset-backed	1.78	-	4.73
Corporate Bonds	5.21	4.12	3.76
Convertible Bonds	-	-	2.40
Yankees	-	-	-
Government	9.67	-	-
Corporate	2.18	-	4.43
Portfolio Effective Duration	3.83	5.45	3.43

##### Credit Risk

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

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

With the exception of the sweep account, Short-term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed 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.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Credit Risk (Cont.)

The Board'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, asset-backed 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. Asset-backed 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.

##### International Fixed Income:

Corporate and asset-backed obligations 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 ten percent of the portfolio's assets may be invested in securities rated A3 or higher.

No more than twenty-five percent of the portfolio's assets may be invested in securities rated below B3.

No more than five percent 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 Board does not consider this investment subject to the credit risk limitations above.



# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Credit Risk (Cont.)

At June 30, 2006, TRS Invested Assets consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool			
		Short-term	Domestic	International	High Yield
Overnight Sweep Account	Not Rated	-	-	-	8%
Short-term Investment					
Account	Not Rated	5%	-	-	-
Commercial Paper	A-1	9%	-	-	-
U. S. Government Agency					
Discount Notes	Not Rated	-	5%	-	-
U. S. Government Agency	Not Rated	-	10%	-	-
Foreign Government	AAA	-	-	51%	-
Foreign Government	AA	-	-	3%	-
Foreign Government	A	-	-	3%	-
Mortgage-backed	AAA	-	42%	-	-
Mortgage-backed (Agency)	Not Rated	8%	11%	-	-
Other Asset-backed	AAA	48%	6%	-	-
Other Asset-backed	AA	-	1%	-	-
Other Asset-backed	BB	-	-	-	-
Corporate Bonds	AAA	2%	1%	26%	-
Corporate Bonds	AA	16%	4%	13%	-
Corporate Bonds	A	9%	10%	-	1%
Corporate Bonds	BBB	-	8%	-	1%
Corporate Bonds	BB	-	-	-	18%
Corporate Bonds	B	-	-	-	53%
Corporate Bonds	CCC	-	-	-	12%
Corporate Bonds	D	-	-	-	1%
Convertible Bonds	B	-	-	-	2%
Yankees:					
Government	AAA - BBB	-	1%	-	-
Corporate	AA	1%	-	-	-
Corporate	BB	-	-	-	-
Corporate	B	-	-	-	3%
No credit exposure		2%	1%	4%	1%
		<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

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

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Board does not have a policy in relation to custodial credit risk for deposits. At June 30, 2005, TRS Invested Assets had the following uncollateralized and uninsured deposits:

	<u>Amount</u> <u>(in thousands)</u>
International Equity Pool	\$ <u>1,503</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 Board'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 Non-U.S. World Government Bond Index. In addition, the Board's asset allocation policy permits TRS to hold up to four percent of total investments in international fixed income.

The Board's policy with regard to foreign currency risk in the International Equity Pool and the Emerging Markets Pool is to permit TRS to hold up to eighteen percent of total investments in these two pools combined.

The Board's policy with regard to foreign currency risk in the Private Equity Pool is to permit TRS to hold up to ten percent of total investments in private equity.

At June 30, 2006, TRS had exposure to foreign currency risk with the following deposits:

<u>Currency</u>	<u>Amount (in</u> <u>thousands)</u>
	International
	Equity Pool
Canadian Dollar	2
Euro Currency	565
Hong Kong Dollar	20
Japanese Yen	750
New Zealand Dollar	2
Norwegian Krone	62
Pound Sterling	154
Singapore Dollar	7
Swedish Krona	54
Swiss Franc	16
	<u>1,632</u>

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Foreign Currency Risk (Cont.)

At June 30, 2006, TRS had exposure to foreign currency risk with the following investments:

Currency	Amount (in thousands)			
	Fixed Income		International Equity Pool	Private Equity Pool
	International Fixed Income Pool			
	Foreign Government	Corporate	Equity	Limited Partnerships
Australian Dollar	\$ 5,376	\$ -	\$ 11,440	\$ -
Canadian Dollar	-	-	12,708	-
Danish Krone	-	-	465	-
Euro Currency	40,528	-	230,253	16,818
Hong Kong Dollar	-	-	6,553	-
Hungarian Forint	-	-	1,210	-
Japanese Yen	2,732	34,840	129,548	-
New Taiwan Dollar	-	-	1,403	-
New Zealand Dollar	-	-	973	-
Norwegian Krone	-	-	7,389	-
Polish Zloty	2,424	-	-	-
Pound Sterling	-	-	106,828	2,940
Singapore Dollar	-	-	5,406	-
South African Rand	-	-	3,242	-
South Korean Won	-	-	6,700	-
Swedish Krona	78,525	-	9,347	-
Swiss Franc	-	-	42,403	-
	<u>\$ 129,585</u>	<u>\$ 34,840</u>	<u>\$ 575,868</u>	<u>\$ 19,758</u>

At June 30, 2006, TRS 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 Short-term 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 Board'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, 2006, TRS invested assets included \$348 million in Federal National Mortgage Association securities which represented 8% of total TRS invested assets. Federal National Mortgage Association securities are not classified as corporate bonds.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (5) FOREIGN EXCHANGE CONTRACTS AND OFF-BALANCE SHEET RISK

	<u>2006</u>	<u>2005</u>
Net Realized Gain on Foreign currency	\$ 13,922,461	57,329,781
Net Unrealized Gain (Loss) on Foreign currency	(13,005)	(12,800)
Net Realized Gain (Loss) on Foreign Exchange Contracts	117,351	(106,656)

The International Fixed Income and International Equity Pool's investment income includes the following at June 30:

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 twenty-four days. TRS had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2006</u>	<u>2005</u>
Contract Sales	\$ 1,405,109	3,047,799
Less: Fair Value	1,408,914	2,915,950
Net unrealized Gains (Losses) on Contracts	<u>\$ (3,805)</u>	<u>131,849</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 non-performance 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.

#### (6) COMMITMENTS AND CONTINGENCIES

The Board entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2006, TRS Invested Asset's share of the unfunded commitment totaled \$31,886,112. This commitment can be withdrawn annually in December with ninety days notice.

The Board 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, 2006, TRS Invested Asset's share of these unfunded commitments totaled \$232,081,930. These commitments are estimated to be paid within up to ten years from agreement date.

The Board 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, 2006, TRS Invested Asset's share of this unfunded commitment totaled \$10,543,148 to be paid through the year 2007.

The Board 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, 2006, TRS Invested Asset's share of these unfunded commitments totaled \$104,579,278 to be paid through the year 2010.

# Teachers' Retirement System

## Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (7) SECURITIES LENDING

Alaska Statute 37.10.071 authorizes the Board to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Board has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the Board'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, 2006 and 2005, the fair value of securities on loan allocable to TRS Invested Assets totaled \$417,202,476 and \$300,770,734, respectively. There is no limit to the amount that can be loaned and the Board is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. All other security loans are collateralized at not less than 102 percent 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 \$423,385,155 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 \$1,778,140 may be pledged or sold upon borrower default. Since the Board does not have the ability to pledge or sell collateral securities unless the borrower defaults, they are not recorded on the financial schedules. Securities under loan, cash collateral and cash collateral payable are recorded on the financial schedules at fair value. The Bank, TRS and the borrower receive a fee from earnings on invested collateral. The bank and TRS 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 Board 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 Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

# **JUDICIAL RETIREMENT SYSTEM**



**Judicial Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

**(With Independent Auditors' Report Thereon)**

**Judicial Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

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**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

## **Independent Auditors' Report**

Alaska Retirement Management Board and  
Division of Treasury:

We have audited the accompanying schedules of invested assets of the Judicial Retirement System as of June 30, 2006 and 2005 and of investment income and changes in invested assets of the Judicial Retirement System for the years then ended (schedules). These schedules are the responsibility of the Division of Treasury's management. Our responsibility is to express an opinion on these schedules 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 schedules 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 Judicial Retirement System's 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 schedules, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying schedules were prepared to present the invested assets of the Judicial Retirement System, which is established under the State of Alaska Judicial Retirement System (JRS). The schedules are not intended to present the financial status of JRS.

As explained in note 2, the financial statements include investments valued at approximately \$11,177,000 (14% of net assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In our opinion, the schedules referred to above present fairly, in all material respects, the invested assets of the Judicial Retirement System as of June 30, 2006 and 2005, and the investment income and changes in invested assets for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

October 27, 2006

**JUDICIAL RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTED ASSETS**

**June 30, 2006 and 2005**

	<u><b>2006</b></u>	<u><b>2005</b></u>
<b>Investments (at Fair Value) (Note 4)</b>		
<b>Cash and Cash Equivalents</b>		
Short-term Fixed Income Pool (Note 3)	\$ 50,743	\$ 103,196
Securities Lending Collateral (Note 7)	8,007,877	6,146,096
Total Cash and Cash Equivalents	<u>8,058,620</u>	<u>6,249,292</u>
<b>Marketable Debt Securities (Note 3)</b>		
Domestic Fixed Income Pool	17,563,426	19,278,071
International Fixed Income Pool	1,467,636	2,403,878
High Yield Pool	1,255,228	-
Total Marketable Debt Securities	<u>20,286,290</u>	<u>21,681,949</u>
<b>Equity Securities (Note 3)</b>		
Domestic Equity Pool	32,400,324	31,622,372
International Equity Pool (note 5)	15,360,970	12,221,349
Absolute Return Pool	2,093,307	-
Total Equity Securities	<u>49,854,601</u>	<u>43,843,721</u>
<b>Real Estate Investments (Note 3)</b>		
Real Estate Pool	<u>9,084,043</u>	<u>8,044,257</u>
<b>Total Invested Assets</b>	<u>87,283,554</u>	<u>79,819,219</u>
Securities Lending Collateral (Note 7)	<u>8,007,877</u>	<u>6,146,096</u>
<b>Net Invested Assets</b>	<u>\$ 79,275,677</u>	<u>\$ 73,673,123</u>

See accompanying notes to schedules

**JUDICIAL RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTMENT INCOME**  
**AND CHANGES IN INVESTED ASSETS**

**Years ended June 30, 2006 and 2005**

<b>Investment Income</b>	<b><u>2006</u></b>	<b><u>2005</u></b>
Short-term Fixed Income Pool	\$ 6,989	\$ 1,928
Securities Lending (net of \$300,429 and \$132,758 expense for the years ending June 30, 2006 and 2005, respectively)	18,968	15,313
Domestic Fixed Income Pool	65,598	1,255,948
International Fixed Income Pool	(17,387)	224,835
High Yield Pool	36,228	-
Domestic Equity Pool	2,800,661	1,397,211
International Equity Pool	3,768,584	1,786,043
Absolute Return Pool	163,897	-
Real Estate Pool	<u>1,385,234</u>	<u>1,113,630</u>
<b>Total Investment Income</b>	8,228,772	5,794,908
<b>Total Invested Assets, Beginning of Year</b>	73,673,123	70,426,984
<b>Net Withdrawals</b>	<u>(2,626,218)</u>	<u>(2,548,769)</u>
<b>Total Invested Assets, End of Year</b>	<u>\$ 79,275,677</u>	<u>\$ 73,673,123</u>

See accompanying notes to schedules

# Judicial Retirement System Invested Assets

## Notes to Schedules June 30, 2006 and 2005

### (1) THE ACCOUNTING ENTITY

The Judicial Retirement System Invested Assets (JRS Invested Assets) is the investment portfolio of the State of Alaska Judicial Retirement System (JRS). JRS is a single-employer defined benefit system established for the payment of retirement, disability and death benefits to, or on behalf of, eligible State judges and justices. These schedules are those of JRS Invested Assets and not JRS taken as a whole. Fiduciary responsibility for JRS Invested Assets resides with the Alaska Retirement Management Board (Board), pursuant to Alaska Statutes 37.10.210-390.

Alaska Statutes 14.25.180, 22.25.048(c) and 37.10.071 provide that investments 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 Board. Treasury has created a pooled environment by which it manages the investments the Board has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The Board 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, External Domestic Fixed Income Pool, International Fixed Income Pool, Domestic Equity Pool, International Equity 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, real estate investment trust holdings and cash holdings of certain external managers in addition to acting as oversight manager for all externally managed investments.

The Short-term Fixed Income Pool is a State pool managed by Treasury.

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of Accounting**

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and employees, net of benefits paid to JRS participants as well as administrative and investment management expenses. Contributions, benefits paid and all expenses are recorded on a cash basis.

#### **Valuation**

##### **Investments with Readily Determinable Fair Values**

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 a pricing service or prices quoted by one or more independent brokers.

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.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

##### Investments with Estimated Fair Values

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 once every three years, in conjunction with the property's purchase anniversary date, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

Absolute return investments are carried at fair value as determined by the pro-rata interest in the net assets of the underlying investment funds. These investment funds are valued periodically by the general partners and the managers of the underlying investments. The net asset value represents the amount that would be expected to be received if it were to liquidate its interests subject to liquidity or redemption restrictions. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

##### Income Allocation

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

Income in the Real Estate Pool is allocated to pool participants monthly on a pro rata basis.

#### (3) POOLED INVESTMENTS

##### Short-term Fixed Income Pool

JRS Invested Assets include participation in the State's internally managed Short-term 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 participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. At June 30, 2006 and 2005, JRS Invested Assets included a .002% and 0.005% direct ownership in the Short-term Fixed Income Pool which included interest receivable of \$439 and \$220, respectively. JRS Invested Assets included a 0.05% and 0.02% indirect ownership in the Short-term Fixed Income Pool at June 30, 2006 and 2005, respectively.

##### Domestic Fixed Income Pool

The Domestic Fixed Income Pool is comprised of an internally managed and an externally managed pool.

##### Retirement Fixed Income Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$1,843. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.27% and 0.30% ownership in the Retirement Fixed Income Pool, respectively.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### External Domestic Fixed Income Pool

JRS Invested Assets include participation in the Board's externally managed Domestic Fixed Income Pool which was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,548. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 1.41% and 1.55% ownership in the External Domestic Fixed Income Pool.

##### International Fixed Income Pool

JRS Invested Assets include participation in the Board'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, 2006 was \$1,791. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.51% ownership in the International Fixed Income Pool.

##### Domestic Equity Pool

The Domestic Equity Pool is comprised of an External Large Cap Domestic Equity Pool and an External Small Cap Domestic Equity Pool.

##### Large Cap Domestic Equity Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$1,132. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.61% and 0.67% ownership in the Large Cap Domestic Equity Pool, respectively.

##### Small Cap Domestic Equity Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$1,173. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.63% and 0.58% ownership in the Small Cap Domestic Equity Pool, respectively.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (3) POOLED INVESTMENTS (CONT.)

##### High Yield Pool

JRS Invested Assets include participation 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, 2006 was \$1,072. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets had 0.58% and 0% ownership in the high yield pool, respectively.

##### International Equity Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$3,364. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.74% and 0.62% ownership in the International Equity Pool, respectively.

##### Absolute Return Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$1,135. 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 participant. 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, 2006, JRS Invested Assets included a 0.60% ownership in the Absolute Return Pool.

##### Real Estate Pool

JRS Invested Assets include participation in the Board'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, 2006, was \$2,483. 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 determine the permissible real estate investment trusts to invest in. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, JRS Invested Assets included a 0.66% ownership in the Real Estate Pool.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK

At June 30, 2006, JRS Invested Assets included the following:

	Fair Value (in thousands)					Total
	Fixed Income Pools					
	Short-term	Domestic	International	High Yield	Other	
Deposits	\$ -	\$ -	\$ -	\$ -	\$ 37	\$ 37
Overnight Sweep Account	2	15	-	107	-	124
Money Market Fund	-	-	-	-	8,008	8,008
Short-term Investment Fund	51	-	9	-	230	290
Commercial Paper	103	142	-	-	-	245
U. S. Treasury Notes	-	1,290	-	-	-	1,290
U. S. Treasury Bonds	-	1,141	-	-	-	1,141
U. S. Treasury Strips	-	240	-	-	-	240
U.S. Government Agency						
Discount Notes	-	1,959	-	-	-	1,959
U.S. Government Agency	-	966	-	-	-	966
Municipal Bonds	-	30	-	-	-	30
Foreign Government Bonds	-	-	835	-	-	835
Mortgage-backed	88	7,745	-	-	-	7,834
Other Asset-backed	614	1,731	-	2	-	2,347
Corporate Bonds	318	2,979	570	1,073	-	4,939
Convertible Bonds	-	-	-	23	-	23
Yankees:						
Government	-	172	-	-	-	172
Corporate	13	28	-	40	-	81
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	1,806	1,806
Equity	-	-	-	-	30,231	30,231
International Equity Pool:						
Equity	-	-	-	-	15,123	15,123
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	2,093	2,093
Real Estate Pool:						
Real Estate	-	-	-	-	5,151	5,151
Commingled Funds	-	-	-	-	1,843	1,843
Limited Partnerships	-	-	-	-	1,421	1,421
Real estate investment trusts	-	-	-	-	660	660
Net Other Assets (Liabilities)	-	(1,715)	54	10	46	(1,606)
Other Pool Ownership	(1,138)	840	-	-	298	-
Total Invested Assets	\$ 51	\$ 17,563	\$ 1,468	\$ 1,255	\$ 66,947	\$ 87,283



# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

At June 30, 2005, JRS Invested Assets included the following:

	Fair Value (in thousands)				
	Fixed Income Pools				Total
	Short-term	Domestic	International	Other	
Deposits	\$ -	\$ -	\$ 50	\$ 28	\$ 78
Overnight Sweep Account	1	22	-	-	23
Money Market Fund	-	-	-	6,146	6,146
Short-term Investment Fund	-	-	17	207	224
Commercial Paper	45	214	-	-	259
U. S. Treasury Bills	35	-	-	-	35
U. S. Treasury Notes	30	868	-	-	898
U. S. Treasury Bonds	-	1,155	-	-	1,155
U. S. Treasury Strips	-	206	-	-	206
U.S. Government Agency					
Discount Notes	7	105	-	-	112
U.S. Government Agency	-	1,321	-	-	1,321
Municipal Bonds	-	22	-	-	22
Foreign Government Bonds	-	-	1,603	-	1,603
Mortgage-backed	87	8,545	-	-	8,632
Other Asset-backed	245	1,799	-	-	2,044
Corporate Bonds	111	4,252	746	-	5,108
Yankees:					
Government	-	105	-	-	105
Corporate	4	118	-	-	122
Domestic Equity Pool:					
Limited Partnership	-	-	-	1,753	1,753
Equity	-	-	-	29,455	29,455
International Equity Pool:					
Convertible Bonds	-	-	-	3	3
Equity	-	-	-	11,981	11,981
Real Estate Pool:					
Real Estate	-	-	-	4,603	4,603
Commingled Funds	-	-	-	1,673	1,673
Limited Partnerships	-	-	-	1,014	1,014
Real estate investment trusts	-	-	-	741	741
Net Other Assets (Liabilities)	6	434	(12)	73	502
Ownership by Other Pools	(468)	112	-	356	-
JUD Invested Assets	\$ 103	\$ 19,278	\$ 2,404	\$ 58,033	\$ 79,819

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### 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 twelve-month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three 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 Board'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, 2006, was 4.80 years.

Through the Board'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 Non-U.S. World Government Bond Index. The effective duration for the Citigroup Non-U.S. World Government Bond Index at June 30, 2006, was 6.08 years.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis 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.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Interest Rate Risk (Cont.)

At June 30, 2006, the effective duration of the domestic fixed income portfolio, by investment type, was as follows:

	<u>Effective Duration (in years)</u>		
	<u>Domestic</u>	<u>International</u>	<u>High Yield</u>
U.S. Treasury Notes	2.65	-	-
U.S. Treasury Bonds	9.73	-	-
U.S. Treasury Strips	20.17	-	-
U.S. Government Agency	3.61	-	-
Municipal Bonds	11.98	-	-
Foreign Government Bonds	-	6.41	-
Mortgage-backed	3.57	-	-
Other Asset-backed	1.78	-	4.73
Corporate Bonds	5.21	4.12	3.76
Convertible Bonds	-	-	-
Yankees			
Government	9.67	-	4.43
Corporate	2.18	-	3.43
Portfolio Effective Duration	3.83	5.45	2.40

##### Credit Risk

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

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

With the exception of the sweep account, Short-term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed 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.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Credit Risk (Cont.)

The Board'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, asset-backed 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. Asset-backed 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.

##### International Fixed Income:

Corporate and asset-backed obligations must be investment grade.

##### Domestic and International Equity:

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

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

At June 30, 2006, JRS Invested Assets consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool			
		Short-term	Domestic	International	High Yield
Overnight Sweep Account	Not Rated	-	-	-	8%
Short-term Investment					
Account	Not Rated	5%	-	-	-
Commercial Paper	A-1	9%	-	-	-
U. S. Government Agency					
Discount Notes	Not Rated	-	5%	-	-
U. S. Government Agency	Not Rated	-	10%	-	-
Foreign Government	AAA	-	-	51%	-
Foreign Government	AA	-	-	3%	-
Foreign Government	A	-	-	3%	-
Mortgage-backed	AAA	-	42%	-	-
Mortgage-backed (Agency)	Not Rated	8%	11%	-	-
Other Asset-backed	AAA	48%	6%	-	-
Other Asset-backed	AA	-	1%	-	-
Corporate Bonds	AAA	2%	1%	26%	-
Corporate Bonds	AA	16%	4%	13%	-
Corporate Bonds	A	9%	10%	-	1%
Corporate Bonds	BBB	-	8%	-	1%
Corporate Bonds	BB	-	-	-	18%
Corporate Bonds	B	-	-	-	53%
Corporate Bonds	CCC	-	-	-	12%
Corporate Bonds	D	-	-	-	1%
Convertible Bonds	B	-	-	-	2%
Yankees:					
Government	AAA - BBB	-	1%	-	-
Corporate	AA	1%	-	-	-
Corporate	B	-	-	-	3%
No credit exposure		2%	1%	4%	2%
		<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

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

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Board does not have a policy in relation to custodial credit risk for deposits. At June 30, 2006, JRS Invested Assets had the following uncollateralized and uninsured deposits:

	<b>Amount</b> <u>(in thousands)</u>
International Equity Pool	\$ <u>36</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 Board'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 Non-U.S. World Government Bond Index. In addition, the Board's asset allocation policy permits JRS to hold up to five percent of total investments in international fixed income.

The Board's policy with regard to foreign currency risk in the International Equity Pool is to permit JRS to hold up to twenty-one percent of total investments in international equity.

At June 30, 2006, JRS had exposure to foreign currency risk with the following deposits:

<u>Currency</u>	<b>Amount</b> <u>International</u> <u>Equity Pool</u>
Canadian Dollar	\$ 37
Danish Krone	1
Euro Currency	13,579
Hong Kong Dollar	487
Japanese Yen	18,036
New Zealand Dollar	36
Norwegian Krone	1,489
Pound Sterling	3,714
Singapore Dollar	178
South Korean Won	2
Swedish Krona	1,311
Swiss Franc	386
	\$ <u>39,256</u>

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Foreign Currency Risk (Cont.)

At June 30, 2006, JRS had exposure to foreign currency risk with the following investments:

Currency	Amount (in thousands)		
	Fixed Income		International
	International Fixed Income Pool		Equity Pool
	Foreign		
	Government	Corporate	Equity
Australian Dollar	\$ 88	\$ -	\$ 275
Canadian Dollar	-	-	306
Danish Krone	-	-	11
Euro Currency	663	-	5,538
Hong Kong Dollar	-	-	157
Hungarian Forint	-	-	29
Japanese Yen	45	570	3,116
New Taiwan Dollar	-	-	34
New Zealand Dollar	-	-	23
Norwegian Krone	-	-	178
Polish Zloty	40	-	-
Pound Sterling	-	-	2,569
Singapore Dollar	-	-	130
South African Rand	-	-	78
South Korean Won	-	-	161
Swedish Krona	1,265	-	225
Swiss Franc	-	-	1,020
	<u>\$ 2,101</u>	<u>\$ 570</u>	<u>\$ 13,850</u>

##### Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk for the Short-term 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 Board's policy with regard to concentration of credit risk for the Domestic Fixed Income and International Fixed Income 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, 2006, JRS invested assets included \$5.3 million in Federal National Mortgage Association securities which represented 7% of total JRS invested assets. Federal National Mortgage Association securities are not classified as corporate bonds.

# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (5) 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>2006</u>	<u>2005</u>
Net Realized Gain (Loss) on Foreign currency	\$ (401,353)	1,243,967
Net Unrealized Gain (Loss) on Foreign currency	20	(347)
Net Realized Gain (Loss) on Foreign Exchange Contracts	2,229	(1,735)

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 twenty-four days. JRS had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2006</u>	<u>2005</u>
Contract Sales	\$ (140,832)	68,843
Less: Fair Value	<u>(141,213)</u>	<u>65,865</u>
Net unrealized Gains on Contracts	<u>\$ 381</u>	<u>2,978</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 non-performance 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.

#### (6) COMMITMENTS AND CONTINGENCIES

The Board entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2006, JRS Invested Asset's share of the unfunded commitment totaled \$627,726. This commitment can be withdrawn annually in December with ninety days notice.

The Board 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, 2006, JRS Invested Asset's share of these unfunded commitments totaled \$2,207,964 to be paid through the year 2010.

#### (7) SECURITIES LENDING

Alaska Statute 37.10.071 authorizes the Board to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Board has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the Board'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.



# Judicial Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2006 and 2005

#### (7) SECURITIES LENDING (CONT.)

At June 30, 2006 and 2005, the fair value of securities on loan allocable to JRS Invested Assets totaled \$7,892,613 and \$5,989,934, respectively. There is no limit to the amount that can be loaned and the Board is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. All other security loans are collateralized at not less than 102 percent 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 \$8,007,877 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 \$42,766 may be pledged or sold upon borrower default. Since the Board does not have the ability to pledge or sell collateral securities unless the borrower defaults, they are not recorded on the financial schedules. Securities under loan, cash collateral and cash collateral payable are recorded on the financial schedules at fair value. The Bank, JRS and the borrower receive a fee from earnings on invested collateral. The bank and JRS 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 Board 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 Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

# **MILITARY RETIREMENT SYSTEM**



**Military Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

**(With Independent Auditors' Report Thereon)**

**Military Retirement System**

**Invested Assets**

**June 30, 2006 and 2005**

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**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

## **Independent Auditors' Report**

Alaska Retirement Management Board:

We have audited the accompanying schedules of invested assets of the Military Retirement System as of June 30, 2006 and 2005 and of investment income and changes in invested assets of the Military Retirement System for the years then ended (schedules). These schedules are the responsibility of the Division of Treasury's management. Our responsibility is to express an opinion on these schedules 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 schedules 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 Military Retirement System's 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 schedules, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying schedules were prepared to present the invested assets of the Military Retirement System, which is established under the State of Alaska National Guard and Naval Militia Retirement System (NG & NMRS). The schedules are not intended to present the financial status of NG & NMRS.

In our opinion, the schedules referred to above present fairly, in all material respects, the invested assets of the Military Retirement System as of June 30, 2006 and 2005, and the investment income and changes in invested assets for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

October 27, 2006

**MILITARY RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTED ASSETS**

**June 30, 2006 and 2005**

	<u><b>2006</b></u>	<u><b>2005</b></u>
<b>Investments (at Fair Value)</b> (Note 4)		
<b>Cash and Cash Equivalents</b>		
Short-term Fixed Income Pool (Note 3)	\$ 24,997	\$ 24,556
Securities Lending Collateral (Note 7)	1,740,198	1,572,835
Total Cash and Cash Equivalents	<u>1,765,195</u>	<u>1,597,391</u>
<b>Marketable Debt Securities</b> (Note 3)		
Domestic Fixed Income Pool	<u>8,642,845</u>	<u>8,261,554</u>
<b>Equity Securities</b> (Note 3)		
Domestic Equity Pool	4,971,107	4,511,413
International Equity Pool (Note 5)	2,034,314	1,803,186
Total Equity Securities	<u>7,005,421</u>	<u>6,314,599</u>
<b>Total Invested Assets</b>	<u>17,413,461</u>	<u>16,173,544</u>
Securities Lending Collateral (Note 7)	<u>1,740,198</u>	<u>1,572,835</u>
<b>Total Net Assets</b>	<u><u>\$ 15,673,263</u></u>	<u><u>\$ 14,600,709</u></u>

See accompanying notes to schedules

**MILITARY RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTMENT INCOME**  
**AND CHANGES IN INVESTED ASSETS**  
**Years ended June 30, 2006 and 2005**

<b>Investment Income</b>	<b><u>2006</u></b>	<b><u>2005</u></b>
Short-term Fixed Income Pool	\$ 6,073	\$ 1,635
Securities Lending (net of \$49,257 and \$22,347 expense for the years ending June 30, 2006 and 2005, respectively)	3,110	2,562
Domestic Fixed Income Pool	(15,742)	605,206
Domestic Equity Pool	412,552	192,465
International Equity Pool	<u>508,086</u>	<u>222,915</u>
<b>Total Investment Income</b>	914,079	1,024,783
<b>Total Invested Assets, Beginning of Year</b>	14,600,709	13,473,061
<b>Net Contributions (Withdrawals)</b>	<u>158,475</u>	<u>102,865</u>
<b>Total Invested Assets, End of Year</b>	<u>\$ 15,673,263</u>	<u>\$ 14,600,709</u>

See accompanying notes to schedules

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2006 and 2005**

### **(1) THE ACCOUNTING ENTITY**

The Military Retirement System Invested Assets (MRS Invested Assets) is the investment portfolio of the State of Alaska National Guard and Naval Militia Retirement System (NG & NMRS). NG & NMRS is a single-employer defined benefit system established for the payment of retirement, disability and death benefits to, or on behalf of, qualified members of the Alaska National Guard, Alaska Naval Militia and Alaska Air Guard. These Schedules are those of MRS Invested Assets and not NG & NMRS taken as a whole. Fiduciary responsibility for MRS Invested Assets resides with the ALASKA RETIREMENT MANAGEMENT BOARD (Board), pursuant to Alaska Statutes 37.10.210-390.

Alaska Statutes 14.25.180, 26.05.228(c) and 37.10.071 provide that investments 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 Board. Treasury has created a pooled environment by which it manages the investments the Board has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The Board 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, External Domestic Fixed Income Pool, Domestic Equity Pool and the International Equity Pool are managed by external management companies. Treasury manages the Alaska Retirement Fixed Income Pool and cash holdings of certain external domestic equity managers in addition to acting as oversight manager for all externally managed investments.

The Short-term Fixed Income Pool is a State pool managed by Treasury.

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of Accounting**

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and employees, net of benefits paid to NG & NMRS participants 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 a pricing service or prices quoted by one or more independent brokers.

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.



# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2006 and 2005**

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)**

#### **Income Allocation**

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

### **(3) POOLED INVESTMENTS**

#### **Short-term Fixed Income Pool**

MRS Invested Assets include participation in the State's internally managed Short-term 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 participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. At June 30, 2006 and 2005, MRS Invested Assets included a 0.001% direct ownership in the Short-term Fixed Income Pool which included interest receivable of \$71 and \$29, respectively. MRS Invested Assets included a .04% and .01% indirect ownership in the Short-term Fixed Income Pool at June 30, 2006 and 2005, respectively.

#### **Domestic Fixed Income Pool**

The Domestic Fixed Income Pool is comprised of an internally managed and an externally managed pool.

#### **Retirement Fixed Income Pool**

MRS Invested Assets include participation in the Board'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, 2006, was \$1,843. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, MRS Invested Assets included a 0.30% and 0.31% ownership in the Retirement Fixed Income Pool, respectively.

#### **External Domestic Fixed Income Pool**

MRS Invested Assets include participation in the Board's externally managed Domestic Fixed Income Pool which was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,548. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, MRS Invested Assets included a 0.25% and 0.25% ownership in the External Domestic Fixed Income Pool, respectively.

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2006 and 2005**

### **(3) POOLED INVESTMENTS (CONT.)**

#### **Domestic Equity Pool**

The Domestic Equity Pool is comprised of an External Large Cap Domestic Equity Pool and an External Small Cap Domestic Equity Pool.

#### **Large Cap Domestic Equity Pool**

MRS Invested Assets include participation in the Board'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, 2006, was \$1,132. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, MRS Invested Assets included a 0.10% and 0.09% ownership in the Large Cap Domestic Equity Pool, respectively.

#### **Small Cap Domestic Equity Pool**

MRS Invested Assets include participation in the Board'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, 2006, was \$1,173. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, MRS Invested Assets included a 0.08% ownership in the Small Cap Domestic Equity Pool.

#### **International Equity Pool**

MRS Invested Assets include participation in the Board'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, 2006, was \$3,364. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. 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, 2006 and 2005, MRS Invested Assets included a 0.10% and 0.09% ownership in the International Equity Pool, respectively.

# Military Retirement System Invested Assets

## Notes to Schedules June 30, 2006 and 2005

### (4) DEPOSITS AND INVESTMENT RISK

At June 30, 2006, MRS Invested Assets included the following:

	Fair Value (in thousands)			
	Fixed Income Pools		Other	Total
	Short-term	Domestic		
Deposits	\$ -	\$ -	\$ 5	\$ 5
Overnight Sweep Account	2	3	-	4
Money Market Fund	-	-	1,740	1,740
Short-term Investment Fund	44	-	31	74
Commercial Paper	87	25	-	112
U. S. Treasury Bills	-	-	-	-
U. S. Treasury Notes	-	460	-	460
U. S. Treasury Bonds	-	504	-	504
U. S. Treasury Strips	-	43	-	43
U.S. Government Agency Discount Notes	-	358	-	358
U.S. Government Agency Municipal Bonds	-	775	-	775
Mortgage-backed	75	4,127	-	4,202
Other Asset-backed	522	472	-	993
Corporate Bonds	270	1,819	-	2,089
Yankees:				
Government	-	65	-	65
Corporate	11	5	-	16
Domestic Equity Pool:				
Limited Partnership Equity	-	-	287	287
Equity	-	-	4,630	4,630
International Equity Pool:				
Equity	-	-	2,003	2,003
Net Other Assets (Liabilities)	(1 )	(959 )	6	(953 )
Other Pool Ownership	(985 )	941	43	-
Total Invested Assets	\$ 25	\$ 8,643	\$ 8,745	\$ 17,413

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSITS AND INVESTMENT RISK (CONT.)

At June 30, 2005, MRS Invested Assets included the following:

	Fair Value (in thousands)			
	Fixed Income Pools		Other	Total
	Short-term	Domestic		
Deposits	\$ -	\$ -	\$ 4	\$ 4
Overnight Sweep Account	-	3	-	3
Money Market Fund	-	-	1,573	1,573
Short-term Investment Fund	-	-	30	30
Commercial Paper	15	34	-	49
U. S. Treasury Bills	12	-	-	12
U. S. Treasury Notes	10	445	-	455
U. S. Treasury Bonds	-	539	-	539
U. S. Treasury Strips	-	111	-	111
U.S. Government Agency Discount Notes	3	30	-	33
U.S. Government Agency	-	539	-	539
Municipal Bonds	-	4	-	4
Mortgage-backed	29	3,999	-	4,028
Other Asset-backed	82	455	-	537
Corporate Bonds	37	1,861	-	1,898
Yankees:				
Government	-	41	-	41
Corporate	1	28	-	29
Domestic Equity Pool:				
Limited Partnership	-	-	249	249
Equity	-	-	4,204	4,204
International Equity Pool:				
Convertible Bonds	-	-	-	-
Equity	-	-	1,769	1,769
Net Pool related assets (liabilities)	2	58	7	67
Net Other Assets (Liabilities)	(166)	115	51	-
MIL Invested Assets	\$ <u>25</u>	\$ <u>8,262</u>	\$ <u>7,887</u>	\$ <u>16,174</u>

#### Interest Rate Risk

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

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2006 and 2005**

### **(4) DEPOSIT AND INVESTMENT RISK (CONT.)**

#### **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 twelve-month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three days to seven months and the expected average life of floating rate securities ranged from less than one year to three years.

#### **Domestic Fixed Income Pool**

Through the Board'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, 2006, was 4.80 years.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis 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.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Interest Rate Risk (Cont.)

At June 30, 2006, the effective duration of the domestic fixed income portfolio, by investment type, was as follows:

	<b>Effective Duration</b> (in years)
	<b>Domestic</b>
U.S. Treasury Notes	2.65
U.S. Treasury Bonds	9.73
U.S. Treasury Strips	20.17
U.S. Government Agency	3.61
Municipal Bonds	11.98
Mortgage-backed	3.57
Other Asset-backed	1.78
Corporate Bonds	5.21
Yankees	
Government	9.67
Corporate	2.18
Portfolio Effective Duration	3.83

##### Credit Risk

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

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

With the exception of the sweep account, Short-term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed 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.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Credit Risk (Cont.)

The Board'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, asset-backed 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. Asset-backed 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.

##### Domestic and International Equity:

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

At June 30, 2006, MRS Invested Assets consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool	
		Short-term	Domestic
Short-term Investment Account	Not Rated	5%	-
Commercial Paper	A-1	9%	-
U. S. Government Agency			
Discount Notes	Not Rated	-	5%
U. S. Government Agency	Not Rated	-	10%
Foreign Government	AAA	-	-
Foreign Government	AA	-	-
Foreign Government	A	-	-
Mortgage-backed	AAA	-	42%
Mortgage-backed (Agency)	Not Rated	8%	11%
Other Asset-backed	AAA	48%	6%
Other Asset-backed	AA	-	1%
Other Asset-backed	BB	-	-
Corporate Bonds	AAA	2%	1%
Corporate Bonds	AA	16%	4%
Corporate Bonds	A	9%	10%
Corporate Bonds	BBB	-	8%
Yankees:			
Government	AAA - BBB	-	1%
Corporate	AA	1%	-
No credit exposure		2%	1%
		<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

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

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Custodial Credit Risk – Deposits

	<u>Amount</u> <u>(in thousands)</u>
International Equity Pool	\$ <u>5</u>

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Board does not have a policy in relation to custodial credit risk for deposits. At June 30, 2006, MRS Invested Assets had the following uncollateralized and uninsured deposits:

##### Foreign Currency Risk

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

The Board's policy with regard to foreign currency risk in the International Equity Pool is to permit MRS to hold up to fifteen percent of total investments in international equity.

At June 30, 2006, MRS investment in the International Equity Pool had exposure to foreign currency risk with the following deposits:

<u>Currency</u>	<u>Amount</u>
Canadian Dollar	\$ 5
Danish Krone	0
Euro Currency	1,798
Hong Kong Dollar	65
Japanese Yen	2,389
New Zealand Dollar	5
Norwegian Krone	197
Pound Sterling	492
Singapore Dollar	24
South Korean Won	0
Swedish Krona	173
Swiss Franc	51
	\$ <u>5,199</u>



## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (4) DEPOSIT AND INVESTMENT RISK (CONT.)

##### Foreign Currency Risk (Cont.)

At June 30, 2006, MRS investment in the International Equity Pool had exposure to foreign currency risk with the following investments:

Currency	Amount Equity
Australian Dollar	\$ 36,438
Canadian Dollar	40,477
Danish Krone	1,480
Euro Currency	733,387
Hong Kong Dollar	20,871
Hungarian Forint	3,854
Japanese Yen	412,627
New Taiwan Dollar	4,470
New Zealand Dollar	3,098
Norwegian Krone	23,535
Pound Sterling	340,262
Singapore Dollar	17,219
South African Rand	10,328
South Korean Won	21,341
Swedish Krona	29,772
Swiss Franc	135,060
	\$ 1,834,219

##### Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk for the Short-term 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 Board's policy with regard to concentration of credit risk for the Domestic 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.

At June 30, 2006, MRS invested assets included \$3.2 million in Federal National Mortgage Association securities and \$0.9 million in Federal Home Loan Mortgage Corporation which represented 18% and 5% of total MRS invested assets, respectively. Federal National Mortgage Association securities are not classified as corporate bonds.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2006 and 2005

#### (5) FOREIGN EXCHANGE, FOREIGN EXCHANGE CONTRACTS AND OFF-BALANCE SHEET RISK

The International Equity Pool's investment income includes the following at June 30:

	<u>2006</u>	<u>2005</u>
Net Realized Gain (Loss) on Foreign currency	\$ (29,519)	134,365
Net Unrealized Gain on Foreign currency	141	-
Net Realized Gain on Foreign Exchange Contracts	334	91

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 twenty-four days. MRS had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2006</u>	<u>2005</u>
Contract Sales	\$ 3,912	8,719
Less: Fair Value	3,923	8,342
Net unrealized Gains (Losses) on Contracts	<u>\$ (11)</u>	<u>377</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 non-performance 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.

#### (6) COMMITMENTS AND CONTINGENCIES

The Board entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2006, MRS Invested Asset's share of the unfunded commitment totaled \$99,660. This commitment can be withdrawn annually in December with ninety days notice.

#### (7) SECURITIES LENDING

Alaska Statute 37.10.071 authorizes the Board to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Board has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the Board'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, 2006 and 2005, the fair value of securities on loan allocable to MRS Invested Assets totaled \$1,714,761 and \$1,535,521, respectively. There is no limit to the amount that can be loaned and the Board is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. All other security loans are collateralized at not less than 102 percent 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.

## **Military Retirement System Invested Assets**

### **Notes to Schedules June 30, 2006 and 2005**

#### **(7) SECURITIES LENDING (CONT.)**

Cash collateral in the amount of \$1,740,198 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 \$5,664 may be pledged or sold upon borrower default. Since the Board does not have the ability to pledge or sell collateral securities unless the borrower defaults, they are not recorded on the financial schedules. Securities under loan, cash collateral and cash collateral payable are recorded on the financial schedules at fair value. The Bank, MRS and the borrower receive a fee from earnings on invested collateral. The Bank and MRS 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 Board 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 Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

**LETTER TO THE ALASKA STATE  
PENSION INVESTMENT BOARD**



**STATE OF ALASKA,  
DEPARTMENT OF REVENUE  
TREASURY DIVISION**

Letter to the Alaska Retirement Management Board

October 27, 2006



**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

October 27, 2006

Alaska Retirement Management Board

Ladies and Gentlemen:

We have audited the schedules of invested assets and the schedules of investment income (loss) and changes in invested assets (schedules) of the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Judicial Retirement System (JRS), and Military Retirement System (collectively, 'Systems'), for the year ended June 30, 2006, and have issued our reports thereon dated October 27, 2006. Under our professional standards, we are providing you with the attached information related to the conduct of our audits.

### **Our Responsibility Under Professional Standards**

We have a responsibility to conduct our audit of the schedules in accordance with professional standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the schedules are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the schedules are detected.

In addition, in planning and performing our audit of the schedules, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit of the schedules does not include examining the effectiveness of internal control and does not provide assurance on internal control.

### **Significant Accounting Policies**

The significant accounting policies used by the Systems are described in note 2 to the schedules. No new accounting policies were adopted and the application of existing policies was not changed during 2006.

### **Significant Transactions**

We noted no transactions entered into by the Systems during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

### **Management Judgments and Accounting Estimates**

Accounting estimates are an integral part of the financial schedules prepared by management and are based upon management's current judgments. Certain accounting estimates are particularly sensitive because of their significance to the schedules and because of the possibility that future events affecting them may differ markedly from management's current judgments.



Alaska Retirement Management Board

October 27, 2006

Page 2

The investment portfolio is carried at fair value as determined primarily by the Treasury Division's custodial agent. The fair values obtained from the custodial agent are reviewed by management. The agent's determination of fair values for debt and equity investment securities involves, among other things, using pricing services or prices quoted by independent brokers. The fair values of real estate equity investments are valued quarterly by general partners or investment sponsors based on market conditions and their knowledge of industry trends. 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 once every three years, in conjunction with the purchase date anniversary, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

Private equity securities are valued periodically by the general partners. Underlying private equity investments that are listed on a national exchange are valued using quoted market prices. Securities for which there are not market quotations available are initially carried at original cost and subsequently valued at fair value as determined by the general partners. In determining fair value, the financial condition, operating results and projected operating cash flow of the underlying portfolio companies, prices paid in private sales of such securities, the nature and duration of restrictions on disposition of the securities, the expenses and delay that would be involved in registration, the price and extent of public trading in similar securities, the existence of merger proposals or tender offers affecting securities, reports prepared by analysts are considered as appropriate. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

Absolute return investments are carried at fair value as determined by the pro-rata interest in the net assets of the underlying investment funds. These investment funds are valued periodically by the general partners and the managers of the underlying investments. The net asset value represents the amount that would be expected to be received if it were to liquidate its interests subject to liquidity or redemption restrictions. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

The energy related investment in the Other Investments Pool consists primarily of loans and preferred stock that are valued at the lower of cost or fair value. The agricultural investments in the Other Investments Pool consist primarily of farmland investments that are stated at fair value based upon independent appraisals performed periodically. In years when an independent appraisal is not performed, the valuation is reviewed by an independent advisor. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

We evaluated the key factors and assumptions used to develop management's judgments and estimates in determining that amounts recorded were reasonable in relation to the schedules of the Treasury Division taken as a whole.



### **Significant Audit Adjustments and Uncorrected Misstatements**

We did not propose any corrections to the schedules that, in our judgment, either individually or in the aggregate, had a significant effect on the Systems' financial reporting process. Five audit adjustments, totaling a net decrease of appreciation of \$17.7 million (\$12.4 million related to PERS invested assets, \$5.4 million related to TRS invested assets, and \$(100) thousand related to JRS) to increase the carrying value of the real estate pool, and decrease the fair value of the private equity pool were identified but not recorded in the schedules. It is the Treasury Division's policy to record such market adjustments on a one-quarter lag as the information is received after the year's books are closed. The effect of this policy is not material to the schedules of invested assets for PERS, TRS, or JRS. As a result, the Treasury Division's records did not reflect the June 30, 2006 market values, since the information had not yet been provided. We recommend that at least annually the Treasury Division assess the extent of such market adjustments that are not yet recorded to determine whether or not they are material to the schedules of invested assets for PERS, TRS, and JRS.

### **Other information in Documents Containing Audited Financial Statements**

Our responsibility for other information in documents containing the Systems' schedules and our report thereon does not extend beyond the schedules identified in our report and we have no obligation to perform any procedures to corroborate other information contained in these documents.

### **Disagreements with Management**

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our report on the Systems' 2006 schedules.

### **Consultation with Other Accountants**

To the best of our knowledge management has not consulted with or obtained opinions, written or oral, from other independent accountants during the past year that were subject to the requirements of Statement on Auditing Standards No. 50, *Reports on the Application of Accounting Principles*.

### **Major Issues Discussed with Management Prior to Retention**

We generally discuss a variety of matters with management prior to retention each year as the Systems' auditors. However, these discussions occurred in the normal course of our professional relationship and the result of the discussions was not a condition to our retention.

### **Difficulties Encountered in Performing the Audit**

We encountered no difficulties in dealing with management in performing our audits.

### **Material Written Communication**

Attached to this report please find copies of the following material written communications between management and us:

- 1) Management Letter
- 2) Management Representation Letter





Alaska Retirement Management Board  
October 27, 2006  
Page 4

This report is intended solely for the information and use of the Alaska State Retirement Management Board and the State of Alaska, Department of Revenue, Treasury Division and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP



**ALASKA RETIREMENT MANAGEMENT BOARD**

Management Letter

October 27, 2006

Public Employees' Retirement System Invested Assets

Teachers' Retirement System Invested Assets

Military Retirement System Invested Assets

Judicial Retirement System Invested Assets



**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

October 27, 2006

Alaska Retirement Management Board

Ladies and Gentlemen:

We have audited the schedules of invested assets and the schedules of investment income (loss) and changes in invested assets of the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Military Retirement System and the Judicial Retirement System (schedules), for the year ended June 30, 2006, and have issued our reports thereon dated October 27, 2006. In planning and performing our audits of the schedules, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the schedules. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. We have not considered internal control since the date of our report. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above. We do offer the following suggestion for your consideration.

PERS and TRS invest in private equity funds, absolute return funds and other alternative investments. These investments have grown as a percentage of the invested assets, approximating 20% currently including real estate. The American Institute of Certified Public Accountants has recently published guidance, not only for auditors but for those responsible for oversight of alternative investments. This guidance contains information regarding the types of internal controls and processes that should be in place, and many organizations are in the process of evaluating their current procedures in light of these guidelines.



Alaska Retirement Management Board  
October 27, 2006  
Page 2

Alternative investments are not listed on national exchanges or over-the-counter markets, therefore quoted market prices are not available. However, these investments must be reflected in financial statements of PERS and TRS at their estimated fair value. Alternative investments therefore present unique challenges to the holder of the securities and the auditors due to the difficulty in obtaining appropriate evidence regarding fair value.

Management of the Treasury Division is responsible for making the fair value measurements and disclosures included in the financial statements. Although management may look to the fund manager for the mechanics of the valuation, management must also have sufficient information to evaluate and independently challenge the valuation. Taking responsibility for the valuation of the alternative investments will necessitate that management understands the nature of the underlying investments, the portfolio strategy of the alternative investments and the method and significant assumptions used by the fund manager to value the underlying investments. The Treasury Division certainly has insight as to the nature of the investments and the portfolio strategy, and therefore has most of the information required to assess the valuation performed by the fund managers. However we recommend that Treasury formalize a process to review and challenge the valuation on a periodic basis. The extent of the process utilized by management should reflect the significance of the alternative investments to the financial statements. Example procedures could include:

- Review valuation policy used by the manager and monitor and approve changes.
- Review annual audit reports and verify that:
  - An unqualified opinion has been rendered on the financial statements.
  - The financial statements have been prepared in accordance with generally accepted accounting principles.
- Compare the fund manager's statement of value as of year end to the value based upon the audited financial statements and investigate significant discrepancies.
- Review available interim financial reports for any unusual change in activity.

We recommend that Treasury assess their internal policies and procedures to ensure that there is adequate oversight of the valuation for these alternative investments.

This report is intended solely for the information and use of the Alaska Retirement Management Board and the Treasury Division and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

# STATE OF ALASKA

## DEPARTMENT OF REVENUE

TREASURY DIVISION

FRANK H. MURKOWSKI, GOVERNOR

333 WILLOUGHBY AVENUE, 11TH FLOOR  
P.O. BOX 110405  
JUNEAU, ALASKA 99811-0405  
PHONE: (907) 465-4399  
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KPMG LLP  
701 West 8<sup>th</sup> Avenue, Suite 600  
Anchorage, AK 99501

October 27, 2006

Ladies and Gentlemen:

We are providing this letter in connection with your audits of the schedule of invested assets of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System, Military Retirement System, and combined schedule of invested assets under the investment authority of the Commissioner of Revenue (Treasury) as of June 30, 2006, and the related schedules of investment income (loss) and changes in invested assets for the year then ended for the purpose of expressing an opinion as to whether these schedules present fairly, in all material respects, the financial position and results of operations of the Treasury in conformity with U.S. generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits:

1. The schedules and notes to the schedules referred to above are fairly presented in conformity with U.S. generally accepted accounting principles.
2. We have made available to you:
  - a. All financial records and related data.
  - b. All minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.

Page 2

- c. All reports from the Treasury's service organizations.
3. Except as disclosed to you in writing, there have been no:
  - a. Circumstances that have resulted in communications from the Treasury's external legal counsel to the Treasury reporting evidence of a material violation of securities law or breach of fiduciary duty, or similar violation by the Treasury or any agent thereof.
  - b. Communications from other governmental entities or agencies (e.g., the U.S. Department of Treasury) concerning noncompliance with, or deficiencies in, financial reporting practices.
  - c. Allegations, either written or oral, of misstatements or other misapplications of accounting principles in the Treasury's schedules and notes to the schedules referred to above.
  - d. Allegations, either written or oral, of deficiencies in internal controls that could have a material effect on the Treasury's schedules.
4. There are no:
  - a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the schedules or as a basis for recording a loss contingency.
  - b. Violations or possible violations of specific requirements of contracts, grants and budgetary procedures, the effects of which should be considered for disclosure in the schedules or as a basis for recording a loss contingency.
  - c. Unasserted claims or assessments that our General Counsel or the U.S. Department of Justice General Counsel has advised us are probable of assertion and must be disclosed in accordance with the Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, as amended, that have not been disclosed.
  - d. Other liabilities or gain or loss contingencies that have not been accrued or disclosed that are required to be accrued or disclosed by the Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, as amended.

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- e. Material transactions that have not been properly recorded in the accounting records underlying the schedules.
  - f. Events that have occurred subsequent to June 30, 2006, and through the date of this letter that would require adjustment to or disclosure in the schedules.
5. We believe that the effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the schedules taken as a whole.
6. There are no reportable conditions in the design or operation of internal control over financial reporting which could adversely affect the Treasury's ability to record, process, summarize and report financial data, and we have identified no material weaknesses in internal control over financial reporting.
7. We acknowledge our responsibility for the design and implementation of programs and controls to prevent, deter and detect fraud. We understand that the term "fraud" includes misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

Misstatements arising from fraudulent financial reporting are intentional misstatements, or omissions of amounts or disclosures in financial statements to deceive financial statement users. Misstatements arising from misappropriation of assets involve the theft of the Treasury's assets where the effect of the theft causes the schedules not to be presented in conformity with U.S. generally accepted accounting principles.

8. We have no knowledge of any fraud or suspected fraud affecting the entity involving:
- a. Management,
  - b. Employees who have significant roles in internal control over financial reporting, or
  - c. Others where the fraud could have a material effect on the schedules and notes to the schedules referred to above.
9. We have no knowledge of any allegations of fraud or suspected fraud affecting the Treasury received in communications from employees, former employees, regulators, or others.

Page 4

10. We have no knowledge of any officer or (member of ARMB) of the Treasury, or any other person acting under the direction thereof, taking any action to fraudulently influence, coerce, manipulate or mislead you during your audit.
11. The Treasury has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
12. The Treasury has not, directly or indirectly, including through a component entity, extended or maintained credit, arranged for the extension of credit, or renewed an extension of credit in the form of a personal loan to or for any management member of the Treasury.
13. The following have been properly recorded or disclosed in the schedules.
  - a. Related party transactions including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments and amounts receivable from or payable to related parties.

We understand that the term “related party” refers to affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

- b. Guarantees, whether written or oral, under which the Treasury is contingently liable, including guarantee contracts and indemnification agreements pursuant to FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.



- c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.

Significant estimates are estimates at the balance sheet date, which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which it is reasonably possible that events could occur which would significantly disrupt normal finances within the next year. Concentrations include material sources of financing, including off-balance sheet arrangements and transactions with unconsolidated, limited purpose entities, and contingencies inherent in the arrangements, that are reasonably likely to affect the continued availability of liquidity and financing.

- d. Off-balance sheet activities, including accounting policies relating to non-consolidation and revenue recognition. Specifically, for those off-balance sheet activities in which the Treasury is a sponsor or transferor, the majority owners of the off-balance sheet vehicle are independent third parties who have made and maintained a substantive capital investment in the vehicle, control the vehicle and have substantive risks and rewards of the assets of the vehicle, including residuals.
- e. Variable interest entities, and significant variable interests in variable interest entities in which the Treasury is not deemed the primary beneficiary, pursuant to either FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), or FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R).
- f. Significant common ownership or management control relationships requiring disclosure.
- g. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and lines of credit or similar arrangements.
- h. Agreements to repurchase assets previously sold, including sales with recourse.
- i. Changes in accounting principle affecting consistency.

- j. Declines in values of certain investments that are considered not to be other-than-temporary in accordance with EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*.
14. The Treasury has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.
  15. The Treasury is responsible for the identification of and compliance with all aspects of laws, regulations, contracts, or grants that could have a material effect on the determination of the schedule amounts in the event of noncompliance and has disclosed those aspects of laws, regulations, contracts, or grants to you.
  16. The Treasury has complied, in all material respects, with applicable laws, regulations, contracts and grants that could have a material effect on the schedules in the event of noncompliance. We have disclosed to you all known instances of noncompliance with such laws, regulations, contract, and grants.
  17. Receivables reported in the schedules represent valid claims against debtors for sales or other charges arising on or before the date of the schedules of invested assets and have been appropriately reduced to their estimated net realizable value.
  18. The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the schedules:
    - a. Extent, nature, and terms of financial instruments with off-balance-sheet risk;
    - b. The amount of credit risk of financial instruments with off-balance-sheet credit risk, and information about the collateral supporting such financial instruments; and
    - c. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments.
  19. The Treasury is responsible for determining the fair value of financial instruments as required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*. The amounts disclosed represent the Treasury Division's best estimate of fair value of financial instruments required to be disclosed under the SFAS No. 107 (and other assets or liabilities, if separately disclosed). The Treasury also has disclosed the methods and significant assumptions used to estimate the fair value of financial instruments.

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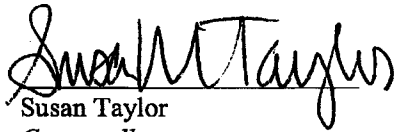
20. We are responsible for making the fair value measurements and disclosures included in the financial statements, including determining the fair value of investments for which a readily determinable fair value does not exist. As part of fulfilling this responsibility, we have established an accounting and financial reporting process for determining the fair value measurements and disclosures, considered the appropriateness of valuation methods, adequately supported any significant assumptions used, and ensured that the presentation and disclosure of the fair value measurements are in accordance with generally accepted accounting principles. We believe the assumptions and methods used by us, including those used by specialists engaged by us, are appropriate in the circumstances and we do not feel a valuation is necessary.
21. We have no material derivative and hedging activities that would need to be calculated in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*
22. Deposit and investment securities are properly classified and reported.
23. The Treasury has identified and properly accounted for all nonexchange transactions.
24. Fund balance with Treasury and investment securities are properly classified and reported.
25. During the fiscal years ended June 30, 2006 and 2005, the Treasury did not exceed its Congressionally-approved budgetary authorities.
26. The Treasury is responsible for determining the fair value of certain investments as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The amounts reported represent the Treasury Division's best estimate of fair value of investments required to be reported under the Statement. The Treasury also has disclosed the methods and significant assumptions used to estimate the fair value of its investments, and the nature of investments reported at amortized cost.

Further, we confirm that we are responsible for the fair presentation in the schedules of invested assets and the related schedules of investment income (loss) and changes in invested assets in conformity with U.S. generally accepted accounting principles.

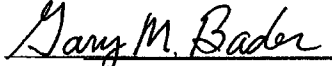
Very truly yours,

State of Alaska, Department of Revenue, Treasury Division

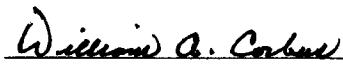
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Susan Taylor  
*Comptroller*



Gary Bader  
*Chief Investment Officer*



William A. Corbus  
*Commissioner*

State of Alaska Division of Treasury  
 Public Employees' Retirement System  
 Summary of Uncorrected Misstatements  
 June 30, 2006

Impact of Adjustments on Schedule Captions - Increase (Decrease)		Statement of Investment Income and			Statement of Invested Assets		
		Changes in Invested Assets			Total	Receivables	Total
Description		Uncorrected misstatements arising in			Investments	(Payables)	Invested Assets
		Current Year	Prior Year	Total			
<b>Pre-tax Adjustments:</b>							
PY	Investment Income Real Estate Pool Investments		(19,683,979)	(19,683,979)	(19,683,979)		
	<i>Current year effect of prior year uncorrected misstatement</i>						
1	Real Estate Pool Investments Investment Income (Loss), Real Estate Pool <i>To properly show real estate investments at market value as of June 30, 2006</i>	28,903,111		28,903,111	28,903,111		
PY	Private Equity Investments Investment Income		(38,365,674)	(38,365,674)	(38,365,674)		
	<i>Current year effect of prior year uncorrected misstatement</i>						
2	Investment Income Private Equity Investments <i>To properly show private equity investments at mv at 6/30/06</i>	16,760,025		16,760,025	16,760,025		
		45,663,136	(58,049,653)	(12,386,517)	(12,386,517)		
<b>Schedule amounts</b>				995,980,447	9,372,663,353		
<b>Impact as a percentage of schedule amounts</b>				-1.24%	-0.13%		

State of Alaska Division of Treasury  
 Teachers' Retirement System  
 Summary of Uncorrected Misstatements  
 June 30, 2006

Impact of Adjustments on Schedule Captions - Increase (Decrease)						
Description	Statement of Investment Income and			Statement of Invested Assets		
	Changes in Invested Assets			Total Investments	Receivables (Payables)	Total Invested Assets
	Uncorrected misstatements arising in					
	Current Year	Prior Year	Total			
<b>Pre-tax Adjustments:</b>						
PY Investment Income (Loss), Real Estate Pool Real Estate Pool Investments		(9,198,357)	(9,198,357)	(9,198,357)		
<i>Current year effect of prior year uncorrected misstatement</i>						
1 Real Estate Pool Investments Investment Income (Loss), Real Estate Pool <i>To properly show real estate investments at market value as of June 30, 2006</i>	13,506,390		13,506,390	13,506,390		
PY Private Equity Investments Investment Income		(17,236,752)	(17,236,752)	(17,236,752)		
<i>Current year effect of prior year uncorrected misstatement</i>						
2 Investment Income Private Equity Investments <i>To properly show private equity investments at mv at 6/30/06</i>	7,529,867		7,529,867	7,529,867		
				21,036,257	(26,435,109)	(5,398,852)
						(5,398,852)
<b>Schedule amounts</b>				462,050,349		4,293,549,841
<b>Impact as a percentage of schedule amounts</b>				-1.17%		-0.13%

State of Alaska Division of Treasury  
 Judicial Retirement System  
 Summary of Uncorrected Misstatements  
 June 30, 2006

Impact of Adjustments on Schedule Captions - Increase (Decrease)						
Description	Statement of Investment Income and Changes in Invested Assets			Statement of Invested Assets		
	Uncorrected misstatements arising in			Total Investments	Receivables (Payables)	Total Invested Assets
	Current Year	Prior Year	Total			
<b>Pre-tax Adjustments:</b>						
PY Investment Income (Loss), Real Estate Pool Real Estate Pool Investments <i>To show current year effect of prior year uncorrected misstatement</i>	280,903	(191,334)	(191,334)	(191,334)		
1 Real Estate Pool Investments Investment Income (Loss), Real Estate Pool <i>To properly show real estate investments at market value as of June 30, 2006</i>			280,903	280,903		
	280,903	(191,334)	89,569	89,569		
<b>Schedule amounts</b>			8,228,772	79,275,677		
<b>Impact as a percentage of schedule amounts</b>			1.09%	0.11%		

State of Alaska Division of Treasury  
 Military Retirement System  
 Summary of Uncorrected Misstatements  
 June 30, 2006

Impact of Adjustments on Schedule Captions - Increase (Decrease)					
Description	Statement of Investment Income and Changes in Invested Assets			Statement of Invested Assets	
	Uncorrected misstatements arising in			Total Investments	Total Invested Assets
	Current Year	Prior Year	Total		
<b>Pre-tax Adjustments:</b>					
1 NONE					
<b>Schedule amounts</b>					
<b>Impact as a percentage of schedule amounts</b>					



**MANAGEMENT  
LETTER**



**ALASKA RETIREMENT MANAGEMENT BOARD**

Management Letter

October 27, 2006

Public Employees' Retirement System Invested Assets

Teachers' Retirement System Invested Assets

Military Retirement System Invested Assets

Judicial Retirement System Invested Assets



**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

October 27, 2006

Alaska Retirement Management Board

Ladies and Gentlemen:

We have audited the schedules of invested assets and the schedules of investment income (loss) and changes in invested assets of the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Military Retirement System and the Judicial Retirement System (schedules), for the year ended June 30, 2006, and have issued our reports thereon dated October 27, 2006. In planning and performing our audits of the schedules, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the schedules. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. We have not considered internal control since the date of our report. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above. We do offer the following suggestion for your consideration.

PERS and TRS invest in private equity funds, absolute return funds and other alternative investments. These investments have grown as a percentage of the invested assets, approximating 20% currently including real estate. The American Institute of Certified Public Accountants has recently published guidance, not only for auditors but for those responsible for oversight of alternative investments. This guidance contains information regarding the types of internal controls and processes that should be in place, and many organizations are in the process of evaluating their current procedures in light of these guidelines.



Alaska Retirement Management Board  
October 27, 2006  
Page 2

Alternative investments are not listed on national exchanges or over-the-counter markets, therefore quoted market prices are not available. However, these investments must be reflected in financial statements of PERS and TRS at their estimated fair value. Alternative investments therefore present unique challenges to the holder of the securities and the auditors due to the difficulty in obtaining appropriate evidence regarding fair value.

Management of the Treasury Division is responsible for making the fair value measurements and disclosures included in the financial statements. Although management may look to the fund manager for the mechanics of the valuation, management must also have sufficient information to evaluate and independently challenge the valuation. Taking responsibility for the valuation of the alternative investments will necessitate that management understands the nature of the underlying investments, the portfolio strategy of the alternative investments and the method and significant assumptions used by the fund manager to value the underlying investments. The Treasury Division certainly has insight as to the nature of the investments and the portfolio strategy, and therefore has most of the information required to assess the valuation performed by the fund managers. However we recommend that Treasury formalize a process to review and challenge the valuation on a periodic basis. The extent of the process utilized by management should reflect the significance of the alternative investments to the financial statements. Example procedures could include:

- Review valuation policy used by the manager and monitor and approve changes.
- Review annual audit reports and verify that:
  - An unqualified opinion has been rendered on the financial statements.
  - The financial statements have been prepared in accordance with generally accepted accounting principles.
- Compare the fund manager's statement of value as of year end to the value based upon the audited financial statements and investigate significant discrepancies.
- Review available interim financial reports for any unusual change in activity.

We recommend that Treasury assess their internal policies and procedures to ensure that there is adequate oversight of the valuation for these alternative investments.

This report is intended solely for the information and use of the Alaska Retirement Management Board and the Treasury Division and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**KPMG LLP**