

ARIZONA STATE RETIREMENT SYSTEM

A Component Unit of the State of Arizona



COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Year Ended June 30, 2005

VISION & VALUES

OUR VISION

For the benefit of our members, the Arizona State Retirement System will be a leading state benefit plan administrator in the areas of:

- Core Member Services
- Funded Status
- Investment Performance
- Operational Effectiveness

This will be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity.

OUR VALUES

Our organizational culture will be based upon the following Values:

Service: A commitment to service excellence will permeate the organization.

Professionalism: A highly capable workforce will promote a professional and respectful environment and lead the organization.

Improvement: A climate of continuous quality improvement and enhanced efficiencies will drive the organization.

Diversity: Engagement of diversity by the appreciation, recognition, and support for all people will propel the organization to ever greater achievement.

Results: A results-oriented approach to operations will energize the organization.

ARIZONA STATE RETIREMENT SYSTEM

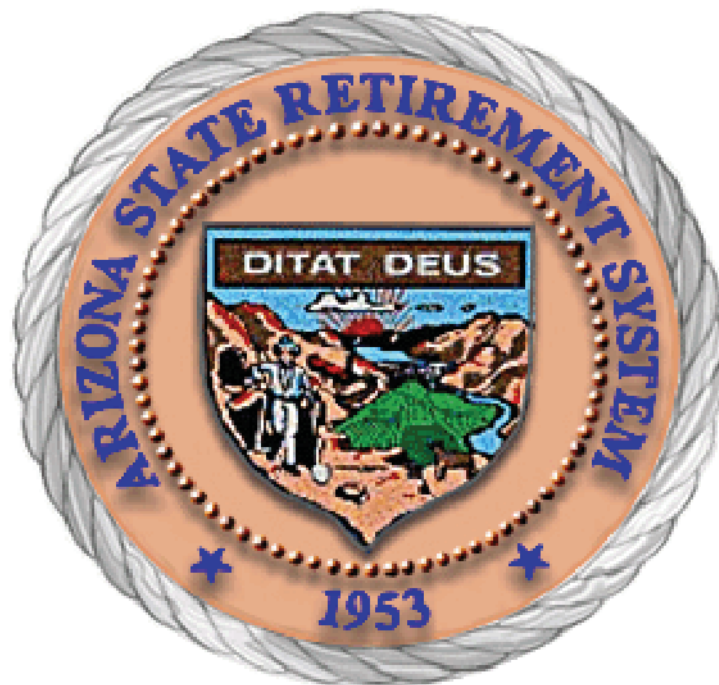
A Component Unit of the State of Arizona

Dr. Keith Meredith, Chair

Mr. Karl L. Polen Jr., Vice Chair

Report prepared by the
Arizona State Retirement System staff

Paul Matson, Director



COMPREHENSIVE ANNUAL FINANCIAL REPORT
For the Year Ended June 30, 2005

TABLE OF CONTENTS

I. Introductory Section

Certificate of Achievement for Excellence in Financial Reporting....	1
Letter from the Chairman.....	2
Letter of Transmittal from the Director.....	4
Administrative Organization:	
Organizational Chart.....	9
ASRS Board of Trustees.....	10
Executive Staff.....	11
Outside Professional Services.....	12
Summary of 2004 Retirement Legislation.....	13

II. Financial Section

Financial Section Table of Contents.....	15
Independent Auditors' Report.....	16
Management's Discussion and Analysis.....	18
Basic Financial Statements:	
Combined Statement of Plan Net Assets.....	24
Combined Statement of Changes in Plan Net Assets.....	25
Notes to the Basic Financial Statements.....	26
Required Supplementary Information:	
Schedule of Funding Progress.....	44
Schedule of Employer Contributions.....	44
Notes to Required Supplementary Information.....	45
Additional Supplementary Information:	
Combining Schedule of Retirement Net Assets.....	49
Combining Schedule of Changes in Retirement Net Assets.....	50
Schedule of Additions by Source.....	51
Schedule of Deductions by Type.....	51
Schedule of Administrative Expenses.....	52
Schedules of Cash Receipts and Cash Disbursements.....	53
Schedule of Professional Consultant Fees.....	54
Schedule of Total Investment Income by Manager.....	55
Schedule of Total Investment Expenses.....	56

III. Investment Section

Investment Section Table of Contents.....	57
Investment Report.....	58
Investment Results:	
Performance Accounting/Computation Standards.....	61
Annualized Rates of Return.....	61

TABLE OF CONTENTS

Historical Rates of Return.....	61
Monthly Returns.....	62
Net Income from Investments.....	62
Ten Year Review of Investment Income.....	63
Asset Allocation:	
Schedule of Investments.....	64
Equity Portfolio Profile.....	65
Fixed Income Portfolio Profile.....	67
Schedule of Broker Commissions - Domestic Equity Trades.....	69
Schedule of Broker Commissions - Foreign Equity Trades.....	71

IV. Actuarial Section

Actuarial Section Table of Contents.....	73
Actuarial Certification.....	74
Actuarial Valuation of the ASRS Plan as of June 30, 2004.....	77
General Actuarial Information.....	80
Summary of Benefit Provisions.....	83
Statement of Actuarial Methods and Assumptions.....	97
Schedule of Plan Active Member Valuation Data.....	102
Schedule of Plan Retirees Added to and Removed from Rolls.....	102
Schedule of Unfunded (Over) Accrued Liabilities - Plan.....	103
Solvency Test.....	104
Schedule of Recommended vs. Actual Plan Contributions.....	104
Analysis of Financial Experience for the Plan.....	105

V. Statistical Section

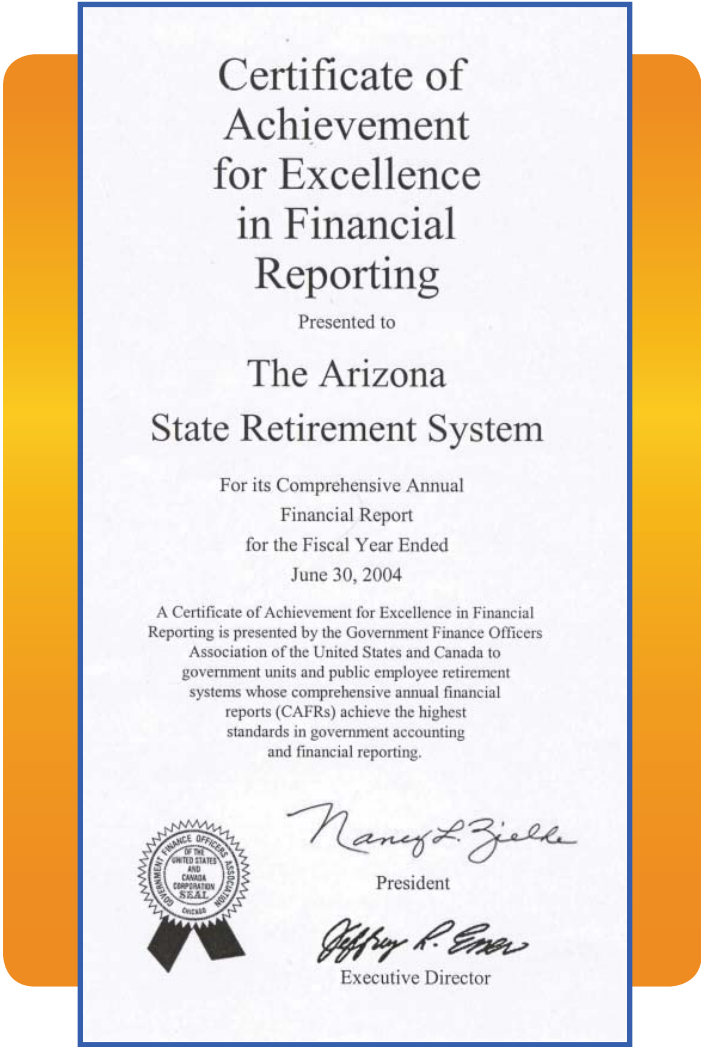
Statistical Section Table of Contents.....	107
List of Employers.....	108
Contributions Received.....	115
Actual Contribution Rates.....	115
Total Benefit Payments.....	116
Total Reserves for Benefits.....	117
Non-Retired & Retired Members.....	118
Revenues by Source.....	119
Expenses by Type.....	120
Benefit Payments by Type.....	120
Average Benefit Payments for Retirees Under the Plan.....	121
Retirement Benefit Options.....	122
Retired Members by Type of Benefit Option.....	123

INTRODUCTORY SECTION

3300 NORTH CENTRAL AVENUE
PHOENIX, ARIZONA 85012



CERTIFICATE OF ACHIEVEMENT
FOR EXCELLENCE IN FINANCIAL REPORTING



The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Arizona State Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2004. This was the 16th consecutive year that the government has achieved this prestigious award.

LETTER FROM THE CHAIRMAN



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100

Paul Matson
Director

TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1-800-621-3778

November 4, 2005

The Honorable Janet Napolitano
Governor of Arizona
State Capitol
1700 W. Washington St.
Phoenix, Arizona 85007

Dear Governor Napolitano:

On behalf of the Arizona State Retirement System Board of Trustees (the Board), it is my pleasure to present you with the fifty-second *Comprehensive Annual Financial Report* of the Arizona State Retirement System (the ASRS). This report provides an in-depth review of the financial statements, investment information, actuarial calculations and statistical data of the Arizona State Retirement System. The report also includes 10-year summaries of a variety of indicators that affect or reflect the ASRS operations.

The actuarial valuation performed by Mellon Human Resources & Investor Solutions as of June 30, 2004 indicates that the ASRS defined benefit plan achieved an actuarial funded status of 91.2 percent.

During the fiscal year ended June 30, 2005, the total rate of return on investments was 8.5 percent. The annualized 10-year rate of return was 9.4 percent. Each of these rates of return exceeds our actuarially-assumed rate of return of 8 percent. The ASRS Fund stood at just over \$22.4 billion.

The contribution rate, as determined through actuarial study, is designed to ensure the ASRS remains adequately funded to meet current and future obligations to our retirees. The actuarially recommended rate for fiscal year 2005-06 is 7.4 percent for both the employer and employee, which includes 6.9 percent for the pension plan and 0.50 percent for the Long Term Disability plan. The contribution rate is scheduled to increase for the 2006-07 fiscal year to 9.1 percent, which includes 8.6 percent for the pension plan and 0.50 for the Long Term Disability plan.

The ASRS continues to face a number of challenges. The Defined Benefit Plan and the Long Term Disability Plan remain underfunded. Rising health care costs continue to place stresses on our retiree health insurance program. Due to a variety of factors, including benefit enhancements, lower mid-term investment returns and changing demographics, the pension plan contribution rate continues on an upward trend.

LETTER FROM THE CHAIRMAN

We intend to keep a watchful eye on any proposed benefit enhancements in the near future in an effort to hold down the contribution rate as much as possible. Actuarial projections show the contribution rate surpassing the 10 percent range within the next few years.

The ASRS continues to be engaged in program and policy review and, when appropriate, will be seeking legislative changes to ensure the ASRS operates efficiently and effectively. This is an on-going process of program, policy and legislative review. Changes that have been implemented have resulted in significant cost reductions to the ASRS. Members have benefited through contribution rates kept significantly lower - fully 1.4 percent - than had recent changes not been implemented.

Our members can be confident that the ASRS is poised to meet our obligation of providing the full range of benefits when they retire. Recently, the ASRS was ranked as the 100th largest pension plan in the world - public or private - by a survey published in *Pensions & Investments* magazine.

I would like to note that the total membership of the ASRS, including active, inactive and retired members, reached a record 442,790 as of June 30, 2005. Also during the most recent fiscal year, more than 80,582 retirees, survivors and disabled members received in excess of \$1.4 billion in benefits. The Board is committed to prudent management of the ASRS assets for the benefit of our members. At the same time, we are aware of our responsibilities to the State of Arizona, its taxpayers, and our member employers.

The Board of Trustees appreciates the cooperation extended to it by the Governor's Office and the State Legislature, which enables and empowers us to meet the challenges we face in today's economic climate. The Board pledges to continue to administer the affairs of the ASRS in the most competent and efficient manner possible.

Respectfully submitted,



Dr. Keith Meredith
Board Chair
Arizona State Retirement System

LETTER OF TRANSMITTAL FROM THE DIRECTOR



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100

Paul Matson
Director

TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1-800-621-3778

November 4, 2005

Dr. Keith Meredith, Chair
Arizona State Retirement System Board of Trustees
3300 North Central Avenue, 14th Floor
Phoenix, Arizona 85012

Dear Dr. Meredith:

I am pleased to present the fifty-second *Comprehensive Annual Financial Report (CAFR)* of the Arizona State Retirement System (ASRS), a component unit of the State of Arizona, for the fiscal year ended June 30, 2005.

Title 38 of the Arizona Revised Statutes requires the ASRS Board of Trustees (ASRS Board) to submit an annual report to the Governor and the Legislature within eight months of the close of each fiscal year. This report complies with all legal requirements governing the preparation and content of annual reports.

Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the ASRS management. Management relies on a comprehensive framework of internal controls to provide reasonable, rather than absolute assurance that the financial statements are free of any material misstatements.

Deloitte & Touche LLP has issued an unqualified ("clean") opinion on the ASRS financial statements for the year ended June 30, 2005. The Independent Auditors' Report is located at the front of the financial section of this report.

Management's discussion and analysis (MD&A) immediately follows the Independent Auditors' Report and provides a narrative introduction, overview, and analysis of the basic financial statements. MD&A complements this letter of transmittal and should be read in conjunction with it.

History and Overview

The ASRS was created in 1953 to provide defined contribution retirement benefits to employees of the state of Arizona, Arizona universities, and political subdivisions. During calendar year 1954, Arizona teachers voted to join the ASRS effective January 1, 1955. In 1970, the state legislature authorized the creation of a defined benefit plan, contingent upon the election to transfer a minimum 70 percent

LETTER OF TRANSMITTAL FROM THE DIRECTOR

of the ASRS membership. More than 80 percent voted to transfer to the defined benefit plan, which became effective July 1, 1971.

At FYE 2005, total ASRS membership, including active, inactive, and retired members is 442,790. ASRS employer members total 735, which includes school districts, charter schools, state colleges and universities, and local, county and state governments.

In addition to pension benefits, the ASRS provides a health insurance premium benefit and sponsors medical and dental coverage for retired members. Active members receive long-term disability insurance coverage equal to two-thirds of pay at the time of disablement.

During FY 2004-05, more than 80,582 retired annuitants, their survivors, and disabled members received a monthly benefit totaling in excess of \$119.6 million. More than 31,024 retired members are enrolled in the ASRS-sponsored medical or dental plans.

All expenditures of the ASRS are appropriated by the Arizona State Legislature with the exception of investment fees, consulting fees necessary to meet the ASRS Board's investment objectives, rent and retiree payroll. For FY 2004-05, the ASRS had an appropriated lump sum operating budget of approximately \$23.8 million.

ASRS Board Trustees are appointed to three-year terms by the governor and confirmed by the Arizona State Senate. Four trustees of the ASRS Board must have a minimum of 10 years investment experience. There is no limit on the number of terms an ASRS Board Trustee may serve. During FY 2004-05, Governor Janet Napolitano appointed the following ASRS Board Trustees to the Board:

- ♦ Mr. David Byers, appointed as a representative of state employees; term to expire on January 16, 2006.
- ♦ Mr. Christopher Harris, appointed as a representative of the public; term to expire on January 21, 2008.
- ♦ Mr. Michael Townsend, re-appointed as a representative of political subdivisions, term to expire on January 21, 2008.
- ♦ Mr. Steve Zeman, appointed as a representative of retirees, term to expire on January 21, 2008.

Major Initiatives

Investments:

- ♦ Began implementing an institutional real estate investment program; eight (8) real estate managers and one (1) internally managed REIT portfolio were selected for hire. Funding of real estate managers will begin in the third quarter of calendar year 2005. The real estate investment program will serve to enhance the pension plan's return and diversification.
- ♦ Initiated a comprehensive review of the ASRS International Equity Asset Class for the purpose of broadening the diversification of the asset class.
- ♦ Modified and tested an ASRS Investment Management Business Continuation Plan. The Plan enables the ASRS Investment Division to continue its operations without interruption in the event of an unexpected closure of its business offices.

LETTER OF TRANSMITTAL FROM THE DIRECTOR

- ♦ Implemented a Board-adopted conflict of interest policy and procedure for investment consultants. The new policy and procedure ensures that the ASRS will benefit from the independent judgment of its investment consultants.

Benefits:

- ♦ During FY 2004-05, the ASRS negotiated a freeze in medical plan premiums, no changes in plan provisions, expanded medical and ancillary health services, and increased choice of medical plans in rural Arizona for Medicare eligible retirees through calendar year end 2006. This freeze in plan premiums caps a 5 year period during which the ASRS has maintained premiums at 2002 levels. In an era of annual double-digit rate increases for health care plans experienced by both private and public sector employers, the ASRS is quite proud of its efforts to maintain premiums and manage its various retiree medical plans effectively.

Administration:

- ♦ Members received re-engineered account statements during FY 2004-05. The statements have more precise calculations and estimates than previous statements and provide members with more information than ever before about their account transactions. Our new statement was one of those recently recognized as a "Best Practice" example by Cost Effectiveness Measurement Inc, an independent firm that reviewed more than 60 examples from five countries. By the end of calendar year 2005, the statements will be available via the web.
- ♦ Senate Bill 1521 adjusts the setting of the ASRS contribution rate from a biennial to an annual basis effective June 30, 2007. It also modified biennial rate requirements to allow the rate to be stepped in over a two year period for FYE 2006 and 2007. The step-in provisions allow for employers and employees to plan for the rate increase in their budgets and also ensure that the ASRS collects the correct amount of contributions over the two year period, keeping the pension plan actuarially sound.

Investment Policies

An integral part of the overall investment policy is the strategic asset allocation policy, which is designed to optimize returns while minimizing risk. Funds are managed by internal and external investment money managers. The total portfolio is kept diversified between broad asset classes of U.S. equities, U.S. fixed income, international equities and real estate.

The ASRS Investment Management Division (IMD) oversaw 26 externally-managed portfolios and managed 5 portfolios internally. Of these 31 total portfolios, 14 external and 4 internal portfolios outperformed their benchmarks. For FYE June 30, 2005, the ASRS achieved an 8.5 percent rate-of-return which outperformed the ASRS total fund benchmark and actuarial assumed rate by 0.7 percent and 0.5 percent, respectively.

The ASRS adheres to all statutory requirements set forth by Arizona state law. In addition the ASRS establishes investment guidelines for its external investment managers and a complete set of policies,

LETTER OF TRANSMITTAL FROM THE DIRECTOR

procedures, compliance requirements, and oversight of internal investment management to ensure that investment assets are prudently managed. Both internal and external compliance procedures are in place. Oversight and direction responsibilities reside with the ASRS Board. Details of investments are contained in the Investment Section of this report.

Funding

Any excess of additions, which include contributions and investment earnings, over deductions, which include benefits and administrative expenses, is accumulated by the ASRS in order to meet future benefit obligations due to retirees and beneficiaries. State statutes require the ASRS to conduct an annual actuarial valuation of its plan assets and liabilities. Legislation passed by the State legislature during FY 2005 changed actuarial determination of contribution rates from a biennial process to an annual one effective June 30, 2007.

The funding objective of the ASRS is to maintain reasonably stable contribution rates and to achieve an ultimate funded status of 100 percent. According to the ASRS' most recently available actuarial valuation, dated June 30, 2004, the actuarial value of plan assets was \$23.6 billion and the actuarial accrued liability was \$25.9 billion. The unfunded actuarial accrued liability of \$2.3 billion results in an actuarial funding ratio of 91.2 percent. The change in funding percentage from last year's 96.8 percent is primarily due to continued recognition of investment losses for fiscal years 2001, 2002 and 2003.

A detailed discussion of funding is provided in the Actuarial Section of this report. Funding status and progress for the ASRS based on the most currently available valuation is presented in the Required Supplementary Information, Schedule of Funding Progress.

In order to both increase the funded status of the pension plan as well as mitigate future increases in contribution rates, the ASRS has been engaged in significant program and policy review. While this is an on-going process - program, policy and legislative initiatives have been successfully implemented that have reduced total contributions to the ASRS by more than \$100 million per year, which is equivalent to approximately \$1.0 billion in liability savings for the group of all current employees, or approximately \$2.4 billion in liability savings for the group of all current and future employees. These very significant savings will reduce future increases in contribution rates to both employees and employers by an average of approximately 1.4 percent in total each year.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the ASRS for its CAFR for the fiscal year ended June 30, 2004. The ASRS has received this prestigious award in each of the last 16 years.

To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR that satisfies both accounting principles generally accepted in the United States of America and applicable legal requirements. A Certificate of Achievement is valid only for one year. We believe this report continues to conform to the Certificate of Achievement Program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

LETTER OF TRANSMITTAL FROM THE DIRECTOR

Acknowledgments

This report represents the culmination of hours of hard work by the ASRS General Accounting and Strategic Planning staff. It is intended to provide complete and reliable information for decision making, to insure compliance with legal requirements, and is a means of measuring the responsible stewardship of the assets of the ASRS.

I would like to express my gratitude to the ASRS Board for its support for and leadership in planning and conducting the financial affairs of the ASRS in a responsible and progressive manner. The ASRS Board, along with the ASRS Executive and Senior Management and the entire staff of the ASRS has been instrumental in maintaining the quality of service and performance which has become the standard for the ASRS.

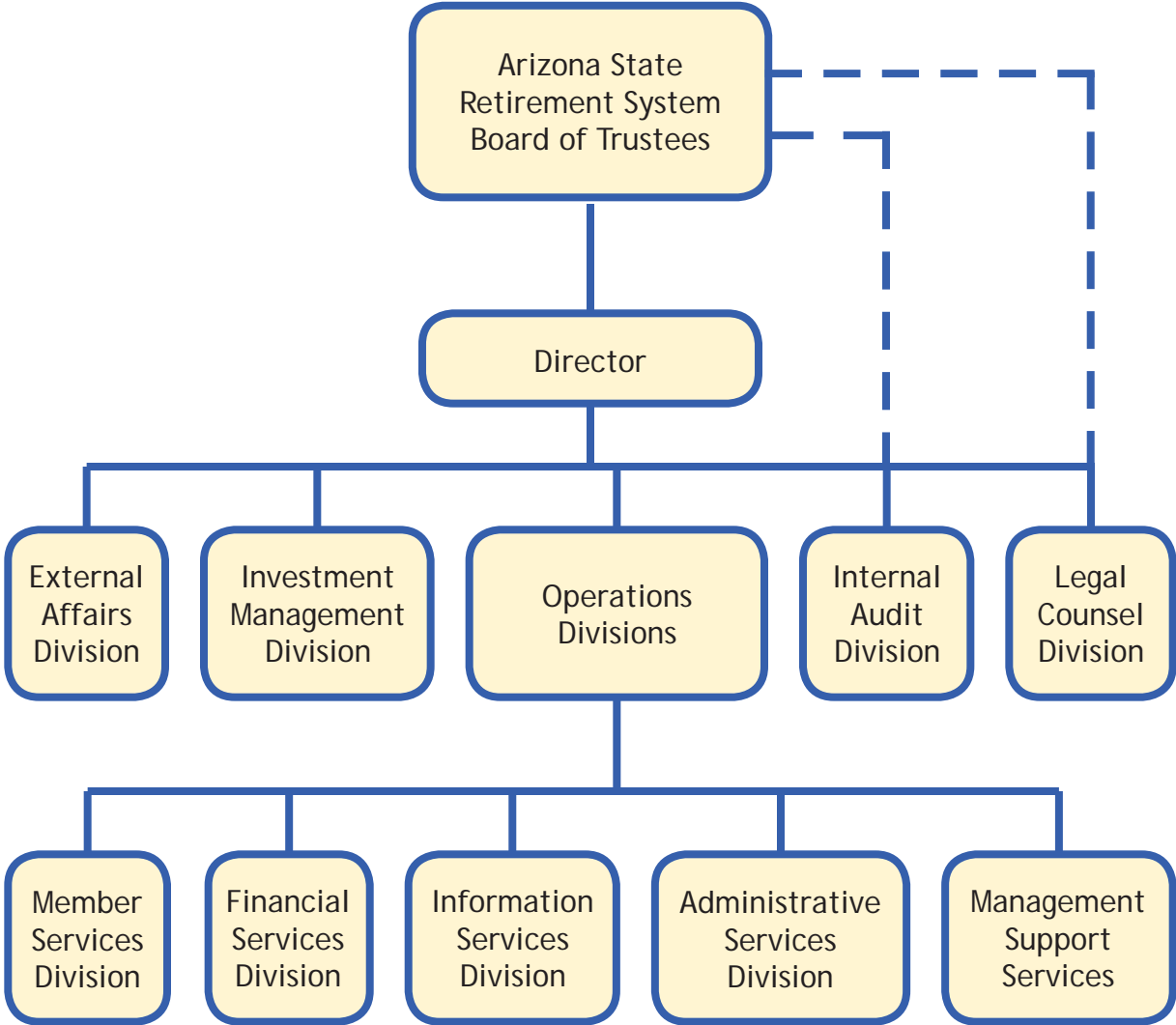
Respectfully submitted,

A handwritten signature in cursive script that reads "Paul Matson".

Paul Matson

Director

ORGANIZATIONAL CHART



ASRS BOARD OF TRUSTEES



Dr. Keith Meredith
Chair
Tucson, Member at Large



Karl L. Polen Jr.
Vice-Chair
Phoenix, Public



David Byers
Phoenix,
State Employees



Jaime Gutierrez
Tucson,
Educators



Christopher Harris
Phoenix,
Public



Anne Mariucci
Phoenix,
Public



Michael Townsend
Flagstaff,
Political Subdivisions



**Lawrence
Trachtenberg**
Scottsdale, Public



Steven Zeman
Phoenix,
Retirees

EXECUTIVE STAFF



Paul Matson
Director



Gary R. Dokes
Chief
Investment Officer



Anthony Guarino
Deputy Director,
Chief Operations Officer

OUTSIDE PROFESSIONAL SERVICES

ACTUARY

Buck Consultants, LLC
(formerly Mellon Human Resources & Investor Solutions)
Phoenix, AZ

LONG TERM DISABILITY BENEFITS

VPA
Calabasas, CA

CUSTODIAL BANK

Mellon Global Securities Services
Pittsburgh, PA

INDEPENDENT AUDITORS

Deloitte & Touche LLP
Phoenix, AZ

GENERAL INVESTMENT CONSULTANT

William M. Mercer Investment Consulting, Inc.
Los Angeles, CA

INVESTMENT MANAGERS

Investment managers are listed in the *Schedule of Broker Commissions*
see page 69

SUMMARY OF 2005 RETIREMENT LEGISLATION

House Bill (HB) 2472 - Payroll Deduction Agreements

- ♦ Mandates that an ASRS member's Payroll Deduction Agreement must continue when the member transfers employment between participating ASRS employers.
- ♦ Specifies the federal retirement or deferred compensation plans in which university employees, school and community college districts can participate.
- ♦ Requires employers to invest contributions in appropriate federal retirement or deferred compensation plan if their employee chooses to participate in a salary reduction contribution or the governing board elects to make non-elective employer contributions.
- ♦ Limits the use of public monies to purchase any annuity or deferred compensation to specific purposes.
- ♦ Allows monies contributed for the replacement of unused leave pay to buy out negotiated contracts or to provide early retirement incentives to be contributed in a federal retirement or deferred contribution plan.
- ♦ Treats accumulated vacation or annual leave, sick leave, compensatory time or other forms of termination pay as compensation for certain ASRS members.
- ♦ Specifies that an individual's long-term disability will not be offset by a Public Safety Personnel Retirement System, Corrections Officer Retirement Plan or Elected Officials Retirement Plan pension annuity.
- ♦ Corrects a typographical error from previous section to bring state statute into compliance with federal law.
- ♦ Effective Aug. 12, 2005.

HB 2562 - Investments

- ♦ Requires the ASRS to submit each year the list of U.S. companies that have, or are reasonably known to have, business activities in or with countries as designated by Section 6J of the federal Export Administration Act, and the total amount invested in each.
- ♦ Effective Aug. 12, 2005

SUMMARY OF 2005 RETIREMENT LEGISLATION

HB 2621 - Retiree Health Insurance Rural Subsidy

- ♦ Extends the rural healthcare subsidy for an additional two years for areas in the state where a health services organization which is not a PPO or indemnity plan is not available.
- ♦ Eliminates the additional rural benefit supplement for retirees in the Arizona retirement systems who are not eligible for Medicare.
- ♦ Appropriates \$28,000 for administrative expenses.
- ♦ Passed with an emergency clause; effective July 1, 2005.

HB 2772 - State Budget Procedures - ASRS Contribution Rates

- ♦ Changes the time period the ASRS contribution rate is set from biennial to annual.
- ♦ Notwithstanding the change, sets the contribution rate for the next two fiscal years on a stepped basis with 6.9 percent pension contribution rate for fiscal year 2005-06, and 8.6 percent for fiscal year 2006-07.
- ♦ Temporarily raises the floor (lowest allowable contribution rate) from 2 percent to 4 percent for the next two years.
- ♦ Effective July 1, 2005.

Senate Bill 1360 - Retiree Health Insurance Committee

- ♦ A Retiree Health Insurance Committee is formed to evaluate the options for retiree health insurance coverage analyzed by the private entity retained by the Legislative Council pursuant to Laws 2004, Chapter 325, Sec. 8 (H2542).
- ♦ A report by this Committee is due by the end of 2005.
- ♦ Effective Aug. 12, 2005.

FINANCIAL SECTION

3300 NORTH CENTRAL AVENUE
PHOENIX, ARIZONA 85012



TABLE OF CONTENTS

II. Financial Section

Independent Auditors' Report	16
Management's Discussion and Analysis	18
Basic Financial Statements	24
Combined Statement of Plan Net Assets	24
Combined Statement of Changes in Plan Net Assets	25
Notes to the Basic Financial Statements	26
Required Supplementary Information	44
Schedule of Funding Progress	44
Schedule of Employer Contributions	44
Notes to Required Supplementary Information	45
Additional Supplementary Information	49
Combining Schedule of Retirement Net Assets	49
Combining Schedule of Changes in Retirement Net Assets	50
Schedule of Additions by Source	51
Schedule of Deductions by Type	51
Schedule of Administrative Expenses	52
Schedule of Cash Receipts and Cash Disbursements	53
Schedule of Professional Consultant Fees	54
Schedule of Total Investment Income by Manager	55
Schedule of Total Investment Expenses	56

INDEPENDENT AUDITORS' REPORT



DELOITTE & TOUCHE LLP
SUITE 1200
2901 N. CENTRAL AVENUE
PHOENIX, AZ 85012-2799
USA

TEL: +1 602 234 5100
FAX: +1 602 234 5186
WWW.DELOITTE.COM

Operations Committee of the
Arizona State Retirement System Board
and Auditor General of the State of Arizona
Phoenix, Arizona

We have audited the accompanying statement of net assets of the funds of the Arizona State Retirement System (ASRS), a component unit of the State of Arizona, as of June 30, 2005 and the related statement of changes in net assets of the funds for the year then ended. These basic financial statements are the responsibility of the ASRS' management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The comparative totals as of and for the year ended June 30, 2004 presented in the basic financial statements are included for additional analysis only.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 ASRS' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such basic financial statements present fairly, in all material respects, the net assets of the funds of ASRS as of June 30, 2005, and the changes in net assets of the funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and Required Supplementary Information as listed in the table of contents are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board (GASB). This supplementary information is the responsibility of ASRS' management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplemen-

INDEPENDENT AUDITORS' REPORT

tary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Introductory Section, Additional Supplementary Information, Investment Portfolio Section, Actuarial Section and Statistical Section as listed in the foregoing table of contents are also presented for the purposes of additional analysis and are not required part of the basic financial statements. The Additional Supplementary Information as listed in the foregoing table of contents under the Financial Section have been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The Introductory Section, Investment Portfolio Section, Actuarial Section and Statistical Section have not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we express no opinion on them.

Deloitte & Touche LLP

November 4, 2005

Member of
Deloitte Touche Tohmatsu

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's discussion and analysis (MD&A) of the Arizona State Retirement System's (ASRS) plan net assets and changes in plan net assets for the fiscal year ended June 30, 2005. It is presented as a narrative overview and analysis. The discussion and analysis should be read in conjunction with the Letter of Transmittal included in the Introductory Section of the ASRS' *Comprehensive Annual Financial Report* (CAFR), the basic financial statements and notes to the basic financial statements presented in the Financial Section of the CAFR.

Financial Highlights

During FY 2005, ASRS assets grew primarily as the result of continuing positive returns in financial markets. Over this period the ASRS' investment results outperformed its assumed actuarial investment rate of return of 8 percent and its strategic asset allocation benchmark of 7.8 percent.

- ♦ The ASRS rate of return on investments for FY 2005 was 8.5 percent compared to 17.5 percent FY 2004. The decrease in the rate of return reflects a slowing of returns in the global securities markets during the fiscal year.
- ♦ The ASRS combined total net assets increased by 5.5 percent at June 30, 2005 compared to FYE 2004. The increase in the net assets is due to continued positive returns from the global securities markets during the fiscal year.
- ♦ During FY 2005, approximately \$2 billion of the ASRS investment portfolio was moved into commingled accounts. Of that amount, approximately \$1 billion was fixed income assets and \$1 billion international equity. The international equity amount reflects the defunding of 2 external managers and the temporary housing of those assets during a search for new managers.
- ♦ The ASRS received a total of \$885 million in employee and employer contributions during FY 2005 compared to \$827 million in FY 2004. The 7.1 percent increase is due primarily to an increase in active membership.
- ♦ The ASRS paid \$1.6 billion in pension, disability, health insurance and survivor benefits during FY 2005 compared to \$1.4 billion in FY 2004. The 12.9 percent increase is due to an increase in retirements, number of deaths and enhanced retirement benefits such as the optional partial lump sum disbursement.
- ♦ As of June 30, 2004, the most recent actuarial valuation, the Retirement and Health Benefit Supplement Funds combined were 91.2 percent funded. This compares to a combined funding ratio of 96.8 percent as of June 30, 2003. The change in funding percentage is primarily due to continued recognition of investment losses for fiscal years 2001, 2002 and 2003.

Overview of the Financial Statements

The MD&A is intended to serve as an introduction and overview of the ASRS financial section of the CAFR which comprise the following components: 1) basic financial statements, 2) notes to the basic financial

MANAGEMENT'S DISCUSSION AND ANALYSIS

statements, 3) required supplementary information and 4) other supplementary information. Collectively, this information presents the combined net assets held in trust for pension benefits which includes HBS and LTD for each of the funds administered by the ASRS as of June 30, 2005. This financial information also summarizes the combined changes in net assets held in trust for pension benefits for the year then ended. The information available in each of these sections is briefly summarized as follows:

1. **Fund financial statements.** For the fiscal year ended June 30, 2005, financial statements are presented for the funds administered by the ASRS. These fiduciary funds are used to account for resources held for the benefit of the ASRS members.
 - ♦ The Combined Statement of Plan Net Assets is presented as of June 30, 2005 with combined total comparative information as of June 30, 2004. These financial statements reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the years reported. Net investments totaled \$23 billion at FYE 2005 compared to \$22 billion at FYE 2004. The 5.3 percent increase was primarily due to positive returns in the global securities markets. Receivables of \$2.2 billion reflect no change compared to last year's \$2.2 billion. Liabilities of \$4.9 billion represents a decrease of 5.4 percent compared to \$5.1 billion last year. This decrease is a result of moving \$2 billion of fixed income and international equity assets to commingled funds
2. **Notes to the Basic Financial Statements.** The notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 26-43 of this report.
3. **Required Supplementary Information.** The required supplementary information consists of two schedules and related notes concerning actuarial information, funded progress and required contributions of the defined benefit pension systems administered by the ASRS.
4. **Additional Supplementary Information.** These schedules include a Combining Schedule of Net Assets and Changes in Net Assets for the ASRS Plan and System retirement programs, detailed information about additions and deductions, administrative expenses incurred by the ASRS administered funds, cash receipts and cash disbursements and professional and investment expenses. The ASRS Plan, a defined benefit plan, and the System, a defined contribution plan, are separate

which are not eligible for direct ASRS custody bank lending.

- ♦ The Combined Statement of Changes in Plan Net Assets is presented for the year ended June 30, 2005 with comparative information for the year ended June 30, 2004. These financial statements reflect the changes in resources available to pay benefits to retirees and other beneficiaries for the FY 2005 and 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS

components administered within the same pension plan.

Financial Analysis of the ASRS Funds

The ASRS administers retirement, health and long term disability benefits for teachers and state, county and other public municipal employees. ASRS benefits are funded by member and employer contributions and by earnings on investments. The ASRS has three funds, Retirement, Health Benefit Supplement (HBS) and Long Term Disability (LTD), to which the contributions are distributed according to actuarially determined contribution rates.

Plan Net Assets. The total ASRS net assets held in trust for benefits at June 30, 2005 were \$22.6 billion, a 5.5 percent increase from \$21.4 billion at June 30, 2004. The increase in net assets is primarily due to an increase in the global securities markets during the fiscal year. The retirement fund net assets were \$21.6 billion compared to \$20.5 billion last year, a 5.4 percent increase. The HBS fund net assets were \$872 million at year end compared to \$808 million in FYE 2004, a 7.9 percent increase. The LTD fund net assets were \$164 million at year end compared to \$138 million last year, an 18.8 percent increase.

Changes in Net Assets. For the 2005 fiscal year, employer and member contributions totaled \$885 million, a 7.1 percent increase over the 2004 fiscal year contributions of \$827 million. An increase in active membership is primarily responsible for the increased contributions.

For FY 2005, the ASRS recognized net investment income of \$1.8 billion which compares to net investment income of \$3.2 billion in the previous year. This 43.8 percent decrease in investment income is due to a slowing of returns in the global securities markets during the fiscal year.

Deductions from the ASRS net assets held in trust for benefits consist primarily of pension, disability, health insurance and survivor benefits, member refunds and administrative expenses. For the 2005 fiscal year, pension, disability, health insurance and survivor benefits totaled \$1.6 billion, an increase of 12.9 percent from the \$1.4 billion paid during FY 2004. Pension payments totaled \$1.4 billion in FY 2005 compared to \$1.2 billion in the previous year. The 16.7 percent increase is explained by a 6.7 percent increase in retirees, 75,650 compared to 70,878 in 2004, and the partial lump sum benefit which allows members to take up to 36 months of retirement payments in a lump sum at retirement. Partial lump sum payments totaled \$81.6 million for the 2005 fiscal year compared to \$58 million last year. Refunds and transfers to other plans totaled \$48.7 million in 2005, a 26.5 percent increase from the \$38.5 million paid out in 2004. For FY 2005, the cost of administering the ASRS benefits totaled \$25.3 million, a decrease of 5.6 percent from the \$26.8 million paid in FY 2004. This decrease is a result of a general decrease in administrative expenses due to a reduced appropriated administrative budget.

The following tables show the ASRS net assets and changes in net assets for fiscal years 2005 and 2004:

MANAGEMENT'S DISCUSSION AND ANALYSIS

Net Assets

(In thousands)

	2005	2004	Change	% Change
Assets				
Cash and receivables	\$2,190,345	\$2,232,468	(\$42,123)	(1.9%)
Investments at fair value	23,000,280	22,049,392	950,888	4.3%
Securities lending	2,279,978	2,289,996	(10,018)	(0.4%)
Total assets	<u>27,470,603</u>	<u>26,571,856</u>	<u>898,747</u>	3.4%
Liabilities				
Payables for investments	2,583,240	2,850,761	(267,521)	(9.4%)
Securities Lending	2,279,978	2,289,996	(10,018)	(0.4%)
Total liabilities	<u>4,863,218</u>	<u>5,140,757</u>	<u>(277,539)</u>	(5.4%)
Total Net Assets	<u><u>\$22,607,385</u></u>	<u><u>\$21,431,099</u></u>	<u><u>\$1,176,286</u></u>	5.5%

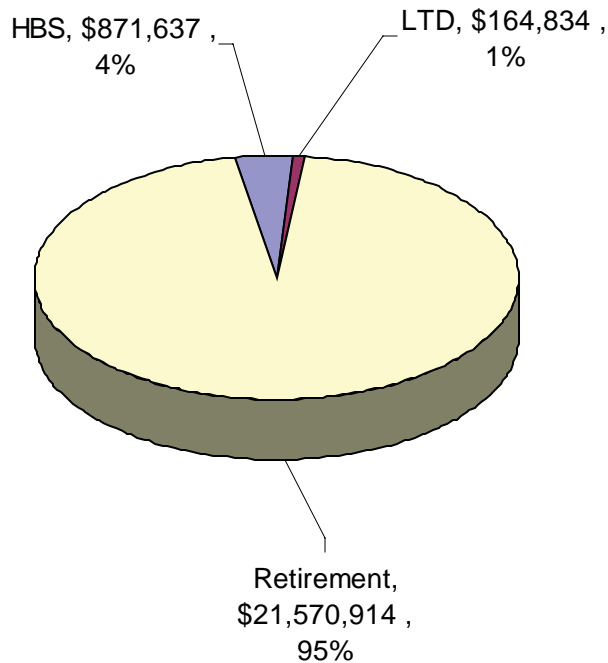
Changes in Net Assets

(In thousands)

	2005	2004	Change	% Change
Additions				
Employee contributions	\$442,643	\$413,462	\$29,181	7.1%
Employer contributions	442,643	413,458	29,185	7.1%
Member reimbursements and transfers from other plans	141,932	113,944	27,988	24.6%
Investment and securities lending income	1,878,072	3,280,722	(1,402,650)	(42.8%)
Investment and securities lending expense	(74,680)	(51,937)	(22,743)	43.8%
Total additions	<u>2,830,610</u>	<u>4,169,649</u>	<u>(1,339,039)</u>	(32.1%)
Deductions				
Retirement and disability benefits	1,558,332	1,381,622	176,710	12.8%
Survivor benefits	18,402	14,859	3,543	23.8%
Refunds and transfers	48,745	38,548	10,197	26.5%
Administration and other	28,845	33,409	(4,564)	(13.7%)
Total deductions	<u>1,654,324</u>	<u>1,468,438</u>	<u>185,886</u>	12.7%
Net Change	1,176,286	2,701,211	(1,524,925)	(56.5%)
Net assets beginning of year	21,431,099	18,729,888	2,701,211	14.4%
Net assets end of year	<u><u>\$22,607,385</u></u>	<u><u>\$21,431,099</u></u>	<u><u>\$1,176,286</u></u>	5.5%

MANAGEMENT'S DISCUSSION AND ANALYSIS

Net Assets by Fund - June 30, 2005



Funded Status. Actuarial valuations of the ASRS assets and benefit obligations for the retirement and health benefit supplement funds combined are performed annually. The most recent actuarial valuation available is as of June 30, 2004.

At June 30, 2004 the total funded status of the ASRS retirement and health benefit supplement funds decreased to 91.2 percent from 96.8 percent at FYE 2003. At FYE 2004 ASRS actuarial liabilities exceeded actuarial assets for the retirement and health benefit supplement funds by \$2.3 billion. This compares to a deficit of actuarial assets

over actuarial liabilities of \$787 million at FYE 2003. This decrease in funded status is related primarily to recognition of investment losses in fiscal years 2001, 2002 and 2003 and to a change in actuarial assumptions.

Investments. During the FY 2005, the ASRS funds remained broadly diversified with investments in domestic and international equities, domestic fixed income, and cash equivalent securities. According to statutory restrictions, no more than 80 percent of the fund may be invested in equity securities, and no more than 20 percent may be invested solely in international equity securities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Retirement and HBS funds are combined in a commingled investment pool. Investment income is allocated to the HBS Fund in accordance with its respective ownership share of the total investment pool. The LTD investments are held in a separate fund.

At June 30, 2005, the ASRS held net investments of \$22.6 billion, an increase of \$1.0 billion from FYE 2004. The \$1.0 billion increase in total investments is primarily due to an increase in the global securities markets. The combined investment portfolio experienced a return of 8.5 percent compared to the benchmark return of 7.8 percent. During the implementation of ASRS's real estate program, an interim benchmark is being used. The interim benchmark consists of 56 percent S&P 500, 28 percent Lehman Brother Aggregate and 16 percent MSCI EAFE indices which prorates the 6 percent allocation to institutional real estate.

At June 30, 2005, the ASRS held \$12.6 billion in domestic equities and \$3.9 billion in international equities, an increase of 6.7 percent in domestic equities and a 2.6 percent increase in international equities from FYE 2004. The FY 2005 rate of return for ASRS domestic equities was 8.1 percent compared to 22.6 percent in FY 2004 reflecting a slower increase in the domestic equity markets. The ASRS domestic equities benchmark, S&P 500, had a return of 6.3 percent for FY 2005.

The FY 2005 rate of return for ASRS international equities was 11.1 percent compared to 34.3 percent in FY 2004, reflecting a slower increase in the international equity markets.

The ASRS international equities benchmark, MSCI EAFE, had a rate of return of 14.1 percent for FY 2005. The benchmarks for both domestic and international equities are representative of the returns that could be expected in a similar investing environment.

At June 30, 2005, the ASRS held \$5.7 billion in domestic fixed income securities, an increase of \$100.0 million from FYE 2004. The rate of return was 6.9 percent compared to 0.2 percent in the previous year, reflecting an increase in performance in the fixed income markets. The ASRS domestic income benchmark, the Lehman Aggregate, had a rate of return of 6.8 percent for FY 2005. This benchmark is representative of the returns that could be expected in a similar investing environment.

The ASRS earns additional investment income by lending investment securities. This is done on a pooled basis by our custodial bank, Mellon Trust. The borrowers provide collateral and generally use the borrowed securities to cover short sales and failed trades. Direct custody securities lending income for FY 2005 was \$5.7 million compared to \$6.6 million for FY 2004. The 13.6 percent decline in securities lending income is a result of the movement of approximately \$2.0 billion in assets into commingled funds, removing them from lending eligibility.

Additional information is available upon request. Please direct your request to the ASRS, 3300 North Central Ave., Phoenix, AZ 85012.

BASIC FINANCIAL STATEMENTS

Combined Statement of Plan Net Assets

June 30, 2005 with Comparative Totals for 2004

(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund (Note 8)	Long-Term Disability Fund (Note 8)	Combined	
				2005	2004
ASSETS:					
Cash (Note 3)	\$14,680	\$ -	\$3,683	\$18,363	\$19,145
RECEIVABLES:					
Accrued interest & dividends	52,966	2,137	-	55,103	65,186
Securities sold (Note 3)	490,785	19,798	-	510,583	309,235
Forward contracts (Note 5)	1,512,678	61,021	-	1,573,699	1,817,679
Contributions (Note 7)	17,252	2,040	1,855	21,147	18,474
Due from Other Funds	-	-	7,023	7,023	1,030
Other	2,883	65	1,479	4,427	1,719
Total Receivables	2,076,564	85,061	10,357	2,171,982	2,213,323
INVESTMENTS AT FAIR VALUE (Note 3)					
Temporary investments	1,961,075	79,110	-	2,040,185	1,993,462
Temporary investments from securities lending collateral (Note 4)	2,191,570	88,408	-	2,279,978	2,289,996
U. S. government obligations	2,465,262	99,449	-	2,564,711	3,143,563
Corporate bonds	2,479,642	100,029	37,522	2,617,193	2,204,732
Common and preferred stocks	15,031,542	606,372	113,503	15,751,417	14,680,860
Real estate mortgages & contracts	25,736	1,038	-	26,774	26,775
Total investments	24,154,827	974,406	151,025	25,280,258	24,339,388
TOTAL ASSETS	26,246,071	1,059,467	165,065	27,470,603	26,571,856
LIABILITIES:					
Payable for securities purchased (Note 3)	946,302	38,174	-	984,476	1,021,706
Payable for securities lending collateral (Note 4)	2,191,570	88,408	-	2,279,978	2,289,996
Forward contracts payable (Note 5)	1,516,815	61,188	-	1,578,003	1,821,026
Due to other funds	7,023	-	-	7,023	1,030
Other	13,447	60	231	13,738	6,999
Total Liabilities	4,675,157	187,830	231	4,863,218	5,140,757
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	\$21,570,914	\$871,637	\$164,834	\$22,607,385	\$21,431,099

(A Schedule of Funding Progress is presented on page 44)
The accompanying notes are an integral part of these statements.

BASIC FINANCIAL STATEMENTS

Combined Statement of Changes in Plan Net Assets

For the Year Ended June 30, 2005 with Comparative Totals for 2004

(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund	Long-Term Disability Fund	Combined	
				2005	2004
ADDITIONS					
Contributions:					
Member contributions (Note 7)	\$403,661	\$ -	\$38,982	\$442,643	\$413,462
Employer contributions (Note 7)	318,311	85,350	38,982	442,643	413,458
Transfers from other plans	1,773	-	-	1,773	1,906
Member reimbursements	140,159	-	-	140,159	112,038
Total contributions	863,904	85,350	77,964	1,027,218	940,864
Income from investment activities:					
Net appreciation in fair value	1,316,361	52,635	13,591	1,382,587	2,811,047
Interest	216,980	8,676	54	225,710	239,355
Dividends	204,011	8,157	6	212,174	190,865
Real estate	5,878	235	-	6,113	6,958
Other	4,611	120	-	4,731	3,826
Total income from investment activities	1,747,841	69,823	13,651	1,831,315	3,252,051
Less investment activity expenses:					
Investment management fees and monitoring services	26,516	1,060	-	27,576	24,824
Real estate	5,777	231	-	6,008	5,061
Total investment activity expenses	32,293	1,291	-	33,584	29,885
Net income from investment activities	1,715,548	68,532	13,651	1,797,731	3,222,166
From securities lending activities (Note 4):					
Securities loan program	44,959	1,798	-	46,757	28,670
Securities loan interest expense	39,516	1,580	-	41,096	22,051
Net income from securities lending activities	5,443	218	-	5,661	6,619
Total net investment income	1,720,991	68,750	13,651	1,803,392	3,228,785
TOTAL ADDITIONS	2,584,895	154,100	91,615	2,830,610	4,169,649
DEDUCTIONS					
Retirement and disability benefits	1,406,547	89,602	62,183	1,558,332	1,381,622
Survivor benefits	18,402	-	-	18,402	14,859
Refunds to withdrawing members, including interest	44,164	-	-	44,164	36,212
Administrative expenses	21,940	875	2,460	25,275	26,834
Transfers to other plans	4,581	-	-	4,581	2,336
Other	3,536	34	-	3,570	6,575
TOTAL DEDUCTIONS	1,499,170	90,511	64,643	1,654,324	1,468,438
NET INCREASE	1,085,725	63,589	26,972	1,176,286	2,701,211
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:					
Beginning of year	20,485,189	808,048	137,862	21,431,099	18,729,888
End of year	\$21,570,914	\$871,637	\$164,834	\$22,607,385	\$21,431,099

The accompanying notes are an integral part of these statements.

NOTES TO THE BASIC FINANCIAL STATEMENTS

1. Description of the System

Organization - The Arizona State Retirement System (ASRS) is a component unit of the State of Arizona. The ASRS is a cost-sharing, multiple-employer, defined benefit pension plan established by the State of Arizona to provide pension benefits for employees of the State and employees of participating political subdivisions and school districts. The ASRS is administered in accordance with Title 38, Chapter 5 of the Arizona Revised Statutes (A.R.S.).

The ASRS administers the Arizona State Retirement System (the System, a defined contribution plan) and the Arizona State Retirement Plan (the Plan, a defined benefit plan). The System and Plan are separate components of the same pension plan. The System was established by the Arizona Legislature in 1953 to provide retirement and other benefits for state employees and teachers, together with employees of political subdivisions that elected coverage. In 1943, the Legislature had established the Arizona Teachers' Retirement System (the Teachers' System) to provide benefits for teachers. After the establishment of the ASRS, teachers who were, or later became, eligible through employment to be covered by the ASRS were transferred to the System. The Teachers' System then became inactive, except for continuation of retirement benefits already being paid and obligations to teacher members who did not become eligible for the ASRS.

The Plan, enacted by the Legislature in 1970, became effective July 1, 1971. Effective July 1, 1981, all non-retired members of the System became members of the Plan as prescribed by Laws of 1980, Chapter 238.

A.R.S. 38-783 and A.R.S. 38-797 require separate accounts be established for health insurance premium benefits and long-term disability benefits, respectively. Effective July 1, 1995, the ASRS has established an account for each benefit program and has reported those funds in the basic financial statements.

Reporting Entity - The financial statements of the ASRS include the financial activities of all the above funds. The ASRS Retirement Board (the Board), appointed by the governor and confirmed by the Arizona State Senate, oversees the ASRS.

Contributions - Participating employers and their employees contribute percentages of employees' salaries for retirement annuities and survivor annuities in accordance with Arizona Revised Statutes. Employee contributions are excluded from gross income for federal and state income tax purposes. Employers collect contributions from the employees, add their matching share and remit the total amounts to the Plan.

State statutes allow the purchase of eligible service credit for which no benefit could be paid by another qualified plan. Purchasable services include military service, leave of absence, previously forfeited service under ASRS and other public service employment.

NOTES TO THE BASIC FINANCIAL STATEMENTS

At June 30, 2005, the number of participating employers and employees totaled:

EMPLOYER UNITS:

School Districts	233
Charter Schools	184
Cities and Towns	72
Counties	14
Special Districts	81
Community College Districts	10
Universities	3
State Government	1

TOTAL **598***

EMPLOYEE MEMBERS:

Retirees (including Beneficiaries)	75,650
Non Active Fully Vested	149,933
Long-Term Disability recipients	4,932

CURRENT EMPLOYEES:

Active Fully Vested**	212,275
-----------------------	---------

TOTAL **442,790**

* The 598 Employer Reporting Units represent 735 total employers.

** Plan members are deemed fully vested when retirement contributions are made.

Benefits - The Plan provides benefits under formulas and provisions described in Arizona state law. Benefits and administrative expenses are paid from funds contributed by members and employers and from earnings on the invested funds. The Plan provides for retirement, disability, health insurance premium supplemental benefits, and survivor benefits.

Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit, which is established on a fiscal year basis (July 1 to June 30). Members are eligible for full retirement benefits on (a) their 65th birthday, (b) their 62nd birthday and completion of at least 10 years of credited service, or (c) the first day that the sum

NOTES TO THE BASIC FINANCIAL STATEMENTS

of their age plus total credited service equals 80. The benefit is based on a percentage of average monthly compensation multiplied by the years of service credit.

The percentage of average monthly compensation varies with years of service credit according to the following schedule:

- ♦ 0-19.99 years - 2.1 percent
- ♦ 20-24.99 years - 2.15 percent
- ♦ 25-29.99 years - 2.2 percent
- ♦ 30 or more years of service - 2.3 percent

Average monthly compensation is defined as the period of 36 consecutive months during which a participant receives the highest compensation within the last 120 months of service during which the employee made retirement contributions as required by law. The compensation does not include lump sum payments on termination of employment for accumulated vacation or annual leave, sick leave, compensatory time or any other form of termination pay. Members who began participation in the Plan prior to January 1, 1984, may choose to have average monthly compensation determined based upon the period of 60 consecutive months during which the member receives the highest compensation within the last 120 months of service, including lump sum payments as described above. Persons who attain age 50 with at least five years of total credited service may take an early retirement, but the amount of their retirement benefit is actuarially reduced.

Effective July 1, 1988, members of the ASRS are eligible for a Long Term Disability (LTD) benefit in the event they become unable to perform their work. The monthly benefit is equal to two-thirds of their monthly earn-

ings. Participants continue to earn service credit up to their normal retirement dates. For those on disability after June 30, 1999, the years of service credited can not exceed the greater of 30 years or the total years of service credited on the start of their disability.

The Retiree Group Insurance Program offers health insurance coverage for retired and disabled members who are no longer covered by insurance administered by their former member employers. Commencing January 1, 1989, retired and disabled members of ASRS became eligible for the Health Insurance Premium Supplement Benefit Program. A detailed explanation of both programs is presented in the additional benefits section (Note 8).

Termination - Upon termination of employment, members can elect to receive all of their contributions made to the Plan, plus accrued interest at 8 percent (changing to 4 percent effective July 1, 2005). Members can receive a percentage of employer contributions to the plan based on years of service as follows:

- ♦ 5 to 5.9 years of service - 25 percent of employer contributions
- ♦ 6 to 6.9 years of service - 40 percent of employer contributions
- ♦ 7 to 7.9 years of service - 55 percent of employer contributions
- ♦ 8 to 8.9 years of service - 70 percent of employer contributions
- ♦ 9 to 9.9 years of service - 85 percent of employer contributions
- ♦ 10 or more years of service - 100 percent of employer contributions

NOTES TO THE BASIC FINANCIAL STATEMENTS

Withdrawal of such accumulated contributions results in forfeiture of the member's accrued benefits in the Plan; however, state law provides for reinstatement of a member's forfeited service upon repayment of the accumulated contributions plus interest if a former member returns to covered service.

2. Summary of Significant Accounting Policies

Basis of Accounting – The financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred and revenues are recorded in the accounting period in which they are earned and become measurable. Employee contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Contributions from employees and employers for service through June 30 are accrued. These contributions are considered to be fully collectible and, accordingly, no allowance for uncollectible receivables is reflected in the financial statements.

Benefit and refund payments are recognized when due and payable in accordance with the terms of the plan.

Investment income is recognized when earned and refunds and other expenditures are recorded when incurred.

New Accounting Pronouncements

The ASRS implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, for the year ended June 30, 2005. GASB No. 40 amends GASB No. 3, *Deposits with Financial Institutions, Investments (includ-*

ing Repurchase Agreements), and Reverse Repurchase Agreements by expanding the disclosure requirements for credit risk, interest rate risk and foreign currency risk.

The following statements have been issued by GASB, but not yet implemented by the ASRS:

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

In May 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 addressed the financial reporting for other postemployment benefits plans.

In June 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*. The adoption of GASB Statement No. 44 will require some additional information and schedules in the statistical section of Comprehensive Annual Financial Report (CAFR).

In August 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB No. 45 required that employer governments to account for and report that annual cost of other postemployment benefits the same manner as they do for pensions.

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation—an Amendment of GASB Statement No. 34*. The Statement defines legally enforceable in the requirement of

NOTES TO THE BASIC FINANCIAL STATEMENTS

reporting certain net assets as restricted net assets.

In December 2004, GASB issues Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*. The Bulletin clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 45 for recognition of pension and other postemployment benefit (OPEB) expenditures/expense and liabilities by cost-sharing employers.

In June of 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. GASB 47 gives accounting and reporting guidance for early retirement incentives, severance payments for involuntary terminations and termination benefits affecting defined benefit postemployment benefits.

The effective date of these statements ranges from fiscal years beginning after December 15, 2004 to fiscal years beginning after December 15, 2006.

The ASRS is in the process of evaluating the above statements.

Investments – Investments include U.S. government and government agency obligations, real estate, commercial mortgages, corporate bonds and equity obligations.

Investments other than commercial mortgages are reported at fair values determined by the custodial agents. The agents' determination of fair values includes, among other things, using pricing services or prices quoted by independent brokers at current exchange rates. The ASRS invests in two types of derivatives, currency forward contracts and futures contracts. The fair value of currency

forward contracts is determined by interpolating the spot rate and the forward rates based upon number of days to maturity. The interpolated rate is used to determine the unrealized gain/loss at the valuation date. The fair value of futures contracts is determined by calculating the difference between the closing Bloomberg market price on valuation date and the original futures trade price. Futures are settled daily. The fair value of real estate investments is based on independent appraisals or estimated value.

Commercial mortgages have been valued on an amortized cost basis, which approximates fair value. No allowance for loan loss has been provided as all loans are considered by management to be fully collectible. Short-term investments are reported at cost plus accrued interest, which approximates fair value. For investments where no readily ascertainable fair value exists, management, in consultation with their investment advisors, has determined the fair values for the individual investments based on anticipated maturity dates and current interest rates commensurate with the investment's degree of risk.

Security transactions and any resulting gains or losses are accounted for on a trade date basis.

Net investment income includes net appreciation (depreciation) in the fair value of investments, interest income, dividend income and total investment expense, which includes investment management and custodial fees and all other significant investment related costs.

There are certain market risks, credit risks, liquidity risks, foreign currency exchange risks, and event risks which may subject ASRS to economic changes occurring in certain industries, sectors, or geographies.

NOTES TO THE BASIC FINANCIAL STATEMENTS

HBS and retirement investments are pooled. Realized and unrealized gains are allocated monthly based on net investment balances at the end of the month.

Capital Assets - The ASRS does not record property and equipment (principally office furniture and fixtures) as assets, but includes the cost of such items in administrative expenditures in the year purchased due to the insignificant total cost.

Federal Income Tax Status - During the year ended June 30, 2005, the ASRS qualified under Section 401(a) of the Internal Revenue Code (IRC) and was exempt from federal income taxes under Section 501(a) of the IRC.

Actuarial Valuation - The information included in the required supplemental schedules is based on the actuarial valuations performed as of June 30, 2004, which is the latest available information. Significant actuarial assumptions used in the valuations are included in the notes to the required supplemental schedules.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Comparative Data - The accompanying financial statements include certain prior-year summarized comparative information in total but not by fund. Such information should be read in conjunction with the ASRS' financial statements for the year ended

June 30, 2004, from which the summarized information was derived.

3. Cash And Investments

Cash - Cash deposits are subject to custodial risk. Custodial risk is the risk that in the event of a bank failure, ASRS's deposits may not be returned to it. Arizona state statutes require state agency deposits to be covered by collateral pledged by the bank. The board has not adopted a more restrictive policy. At June 30, 2005 \$100,000 of the ASRS' cash deposits were covered with federal depository insurance funds. The remainder was collateralized with securities held by the pledging bank's trust department in the ASRS' name.

Investments - Investments are subject to a number of risks including custodial credit risk, concentration of credit risk, credit quality risk, interest rate risk and foreign currency risk. Statutes enacted by the Arizona State Legislature (the Statutes) authorize the ASRS to make investments in accordance with the "Prudent Expert" rule. Section 38-719 (B) of the Arizona Revised Statutes interprets the rule to be that investment management shall discharge the duties of their position with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person acting in enterprise of a like character and with like aims as that of the system, subject to certain statutory limitations and restrictions. Within this broad framework, the ASRS has chosen to invest in short-term securities, obligations of the U.S. government or agencies of the U.S. government, corporate bonds, common and preferred stocks (domestic and foreign), mortgages and real estate.

The Statutes place the following restrictions on the ASRS' investment fund portfolio:

NOTES TO THE BASIC FINANCIAL STATEMENTS

1. No more than 80 percent of the ASRS' total assets may be invested at any given time in corporate stocks or equity equivalents, based on cost value of the stocks or equity equivalents irrespective of capital appreciation.
2. No more than 5 percent of the ASRS' assets may be invested in securities issued by any one institution, agency or corporation, other than securities issued as direct obligations of or fully guaranteed by the U.S. government or mortgage backed securities and agency debentures issued by federal agencies. During 2005, ASRS did not own securities of any organization that was more than 5 percent of ASRS' assets.
3. No more than 5 percent of the voting stock of any one corporation may be owned.
4. No more than 20 percent of the ASRS' assets may be invested in foreign equity securities, and those investments shall be made only by investment managers with demonstrated expertise in such investments.
5. No more than 10 percent of the ASRS' assets may be invested in bonds or other evidences of indebtedness of those multinational development banks in which the United States is a member nation, including the International Bank for Reconstruction and Development, the African Development Bank, the Asian Development Bank, and the Inter-American Development Bank.
6. No more than 1 percent of ASRS assets may be invested in economic development projects authorized as eligible for such investment by the Arizona State Department of Commerce. During fiscal year 2005 the ASRS had no investments in economic development projects.

The Board has not formally adopted more restrictive policies for the various types of risks. The Management of ASRS believes it has complied with the above guidelines. Management does expect the money managers to abide by contract requirements much more restrictive than the statute.

NOTES TO THE BASIC FINANCIAL STATEMENTS

The following table shows the investments by investment type:

Investments at June 30, 2005

(Dollars in Thousands)

Investment	Fair Value
Temporary Investments including US Treasury Bills	\$2,030,099
Foreign Bonds including Temporary Investments	10,086
Total Temporary Investments	<u>2,040,185</u>
Domestic Corporate Bonds	2,617,193
Domestic Common and Preferred Stock	14,713,922
Foreign Common and Preferred Stock	1,037,495
Total Common and Preferred Stock	<u>15,751,417</u>
US Government Obligations	707,622
US Agency Obligations	1,857,089
Total US Government Obligations	<u>2,564,711</u>
Real Estate Mortgages & Contracts	26,774
U. S. Government Obligations	548,608
U. S. Agency Obligations	483,740
Corporate Obligations - Domestic	62,382
Preferred and Common Stock- Domestic	983,148
Preferred and Common Stock -Foreign	202,100
Total Securities Lending Obligations	<u>2,279,978</u>
TOTAL INVESTMENTS AT FAIR VALUE	25,280,258
*Short Term Investment Receivables	2,141,053
**Short Term Investment Payables	<u>(4,845,787)</u>
INVESTMENTS AT FAIR VALUE - NET	<u><u>\$22,575,524</u></u>

*Includes \$1,668 other receivables

**Includes \$3,228 other liabilities

NOTES TO THE BASIC FINANCIAL STATEMENTS

Due to the flow of securities to and from transfer agents and the security lending program, securities occasionally cannot be delivered for a sale or received for a purchase, resulting in a "failed" transaction. Securities with trade dates in June and settlement dates in July result in "outstanding" transactions. Since these securities have contractually changed ownership, receivables and payables result from these transactions. Such transactions resulted in a receivable for securities sold of \$510.6 million and a payable for securities purchased of \$984.5 million at June 30, 2005.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of a failure of a counter party, the ASRS will not be able to recover the value of its investment or the collateral securities that are in the possession of an outside party. All securities are registered in the name of the ASRS including loaned securities.

Concentration of Credit Risk: Concentration of credit risk is the risk of substantial loss if

investments are concentrated in one issuer. Arizona state statute requires that no more than 5 percent of the assets can be invested in one issuer, except for the US government and its agencies. The Board has not adopted a more restrictive policy. No investments, other than short term mutual funds, account for 5 percent or more of their assets.

Credit Quality Risk: Credit quality risk is the risk that the issuer will not fulfill its obligations to the purchaser of its debt instruments. Arizona state statutes are not specific as to the credit ratings of the investments of the ASRS. The statutes require the Prudent Expert Rule. The Board has not adopted a formal policy on credit ratings. The present management policy is to set standards for each portfolio manager based on an assessment of their expertise. The following table presents the fixed income investments at June 30, 2005 categorized to give an indication of the level of risk assumed by ASRS:

NOTES TO THE BASIC FINANCIAL STATEMENTS

Debt Securities

Fair Value at June 30, 2005

(Dollars in Thousands)

Investment	Fair Value	AAA/P1	AA	A	BBB	BB	B	Not Rated
Asset Backed Securities	\$240,254	\$227,061	\$5,476	\$5,244	\$1,462	\$ -	\$1,011	\$ -
Bond Funds	322,906	-	-	-	-	-	-	322,906
CMO's of Government Sponsored Entities	74,599	74,599	-	-	-	-	-	-
Commercial Mortgage Backed Securities	211,200	209,733	1,177	290	-	-	-	-
Commercial Paper	122,644	122,644	-	-	-	-	-	-
Corporate Bonds	838,230	74,074	107,544	283,144	311,459	38,278	23,728	3
Dollar Denominated Debt of Foreign Companies	57,330	-	3,299	37,556	12,373	2,162	1,940	-
Dollar Denominated Debt of Foreign Countries	71,347	35,124	15,037	2,744	17,352	-	1,090	-
Fixed Income Strips incl US strips	8,142	8,142	-	-	-	-	-	-
GNMA Pools	138,092	138,092	-	-	-	-	-	-
Government Sponsored Entity Debt	462,654	444,976	17,678	-	-	-	-	-
Indexed Linked Government Bond Funds	774,263	-	-	-	-	-	-	774,263
Indexed Linked Treasury Bonds	37,381	37,381	-	-	-	-	-	-
Municipal Bonds	2,370	881	1,489	-	-	-	-	-
Non-government Backed CMO's	117,806	117,593	165	48	-	-	-	-
Pools of Government Sponsored Entities	1,283,948	1,283,948	-	-	-	-	-	-
Short Term Money Markets	1,787,462	-	-	-	-	-	-	1,787,462
US Treasury Debt including treasury bills	635,320	635,320	-	-	-	-	-	-
Total Domestic Debt Securities	7,185,948	3,409,568	151,865	329,026	342,646	40,440	27,769	2,884,634
Corporate Bonds	8,742	-	-	-	-	-	-	8,742
Government Bonds	14,626	9,793	-	-	4,833	-	-	-
Provincial Bonds	2,687	-	2,687	-	-	-	-	-
Margin Accounts	10,086	-	-	-	-	-	-	10,086
Total Foreign Debt Securities	36,141	9,793	2,687	-	4,833	-	-	18,828
Total Debt Securities	\$7,222,089	\$3,419,361	\$154,552	\$329,026	\$347,479	\$40,440	\$27,769	\$2,903,462

NOTES TO THE BASIC FINANCIAL STATEMENTS

Interest Rate Risk: Interest rate risk is the risk that debt securities will lose value due to rising interest rates. Arizona state statutes are silent regarding interest rate risk. The board has not adopted a specific formal policy for the interest rate risk. It does set more restrictive requirements in its contracts with money managers. The Arizona State Retirement System uses effective duration

to identify and manage its interest rate risk. Effective duration measures the expected change in value of a fixed income security for a given change in interest rate. The method takes in to account the likely timing and amounts of variable cash flows for bonds with call options and prepayment provisions. The following table shows the effective duration by investment type:

Interest Rate Risk Fair Value at June 30, 2005

(Dollars in Thousands)

INVESTMENT	FAIR VALUE	EFFECTIVE DURATION
Domestic Fixed Income Investments		
Asset Backed Securities	\$240,254	1.47
Bond Funds	322,906	5.59
CMO's of Government Sponsored Entities	74,599	2.40
Commercial Mortgage Backed Securities	211,200	4.13
Commercial Paper	122,644	0.06
Corporate Bonds	838,230	5.83
Dollar Denominated Debt of Foreign Companies	57,330	7.08
Dollar Denominated Debt of Foreign Countries	71,347	6.80
Fixed Income Strips	8,142	8.86
GNMA Pools	138,092	2.43
Government Sponsored Entity Debt	462,654	3.83
Indexed Linked Government Bond Funds	774,263	4.44
Indexed Linked Treasury Bonds	37,381	8.20
Municipal Bonds	2,370	14.79
Non-government Backed CMO's	117,806	2.02
Pools of Government Sponsored Entities	1,283,948	2.29
Short Term Investments	1,787,462	0.08
US Treasury Debt	635,320	4.16
Total Domestic Debt Securities	7,185,948	2.90
Foreign Debt Securities		
Corporate Bonds	8,742	0.13
Government Bonds	14,626	11.34
Provincial Bonds	2,687	7.32
Margin Accounts	10,086	0.08
Total Foreign Debt Securities	36,141	5.19
Total Debt Securities	\$7,222,089	

NOTES TO THE BASIC FINANCIAL STATEMENTS

Foreign Currency Risk: Foreign currency risk is the risk that changes in the foreign exchange rate will adversely impact the fair value of an investment. The ASRS is allowed to invest part of its assets in foreign investments. According to Arizona state statutes, no more than 20 percent of ASRS assets may be invested in foreign equity securities and the investments must be made by investment

managers with expertise in those investments. The Board has not adopted a formal policy that is more restrictive. Management does have certain policies in the contracts with the money managers permitted to invest in foreign denominated securities. The following table shows the system's exposure to foreign currency risk (in US dollars):

Foreign Currency Risk Fair Value at June 30, 2005

(Dollars in Thousands)

Currency Type	Temporary Investments	Fixed Income	Equities	Total
Australian Dollar	\$1,418	\$ -	\$ -	\$1,418
British Pound Sterling	176	-	164,307	164,483
Canadian Dollar	880	-	8,809	9,689
Danish Krone	-	-	1,569	1,569
Euro Currency Unit	2,339	7,685	468,552	478,576
Hong Kong Dollar	247	-	-	247
Japanese Yen	1,599	8,742	252,583	262,924
New Mexican Peso	288	4,833	-	5,121
New Taiwan Dollar	-	-	6,008	6,008
New Zealand Dollar	2,233	4,795	13,302	20,330
Singapore Dollar	2	-	24,561	24,563
Swiss Franc	904	-	97,804	98,708
Total	\$10,086	\$26,055	\$1,037,495	\$1,073,636

4. Securities Lending Program

Arizona Revised Statutes Section 38-715(D)(3) allow the ASRS to participate in a securities lending program. The ASRS' custodial bank enters into agreements with counterparts to loan securities and have the same securities redelivered at a later date. All securities are eligible for loan (U.S fixed income securities,

U.S equities, international equities) with a higher percentage of U.S. Treasuries on loan than most other security types. The ASRS currently receives as collateral at least 102 percent of the market value of the loaned securities and maintains collateral at no less than 100 percent for the duration of the loan. At year-end, the ASRS had no credit risk exposure to borrowers because the amount the

NOTES TO THE BASIC FINANCIAL STATEMENTS

ASRS owes the borrowers exceeds the amount the borrowers owe the ASRS. Securities loaned are initially fully collateralized by cash (USD and Euro), irrevocable letters of credit, U.S. Government or Agency securities, or sovereign debt. Initial cash collateral may be reinvested (under certain constraints) in:

- a) instruments issued or fully guaranteed by the U.S. Government, Federal agencies, or sponsored agencies or sponsored corporations
- b) instruments issued by domestic corporations including corporate notes and floating rate notes
- c) obligations of approved domestic and foreign banks
- d) U.S. dollar-denominated instruments issued by sovereigns, sovereign supported credits, and instruments of foreign banks and corporations
- e) yankee securities
- f) repurchase agreements
- g) insurance company funding agreements, guaranteed investment contracts and bank investment contracts
- h) asset-backed securities
- i) money market mutual funds

The ASRS records the cash collateral received and the same amount as an obligation for securities on loan. Any cash collateral received is invested in short-term investments. The maturities of the investments are closely matched to those of the security loans to avoid interest rate exposure. The ASRS receives a spread for its lending activities. Investments made with cash collateral are classified as an asset on the Statement

of Plan Net Assets. A corresponding liability is recorded as the ASRS must return the cash collateral to the borrower upon expiration of the loan. At June 30, 2005, the ASRS had \$2.3 billion outstanding as payable for securities on loan. The ASRS does not have the ability to pledge or sell the collateral unless there is a borrower default. There are no restrictions on the dollar amount of security loans that may be made by the ASRS. The ASRS is indemnified against gross negligence and borrower default by the lending agents. There were no defaults during the current fiscal year.

5. Derivatives

A derivative instrument is a financial instrument or other contract with all three of the following characteristics:

- a) It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some case whether or not a settlement is required.
- b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- c) Its terms require or permit net settlement, it can readily be settled net by means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Generally, derivatives are subject to both market risk and counterparty risk. The derivatives utilized by ASRS managers typi-

NOTES TO THE BASIC FINANCIAL STATEMENTS

cally have no greater market risk than their physical counterparts, and in many cases are offset by exposure elsewhere in the portfolio.

The ASRS believes that it is unlikely that any of the derivatives used by its managers could have a material adverse effect on the financial conditions of the ASRS.

6. Funding Status and Progress

Significant actuarial assumptions used in the June 30, 2004 Actuarial Valuation, the most recent actuarial valuation available, include:

- a) a rate of return on investment of present and future assets of 8 percent, compounded annually
- b) projected salary increases ranging from 4.5 percent to 9.5 percent per year
- c) rates of disability
- d) rates of withdrawal
- e) rates of retirement
- f) mortality rates
- g) mortality rates after disability
- h) valuation of assets using fair value less ten-year phase-in (five-year phase-in before FY 2002) of excess (shortfall) investment income
- i) projected unit-credit funding method

For the current year, there were no changes in the actuarial funding or methods. There were two changes in actuarial assumptions. They were:

- ♦ Method of calculating service purchase cost changed from normal cost to actuarial present value.

- ♦ Interest accruals on forfeited balances changed from 8 percent to 4 percent after June 30, 2005.

7. Contributions Required and Contributions Made

The A.R.S. provides statutory authority for determining the employees' and employers' contribution amounts as a percentage of covered payrolls. Employers are required to contribute at the same rate as employees. Through FYE 2005, the actuarial computation is made two years in advance, based on the June 30 information (the rate for FYE 2005 was based on June 30, 2002 information). New legislation which became law as of July 1, 2005 requires annual contribution rate calculations for all fiscal years beginning after fye 2007. The actuarial assumptions used in this measure are those adopted by the ASRS' Board on November 2003. The contribution rates were actuarially determined using the Projected Unit Credit (PUC) funding method, the use of which was established by legislative action in 1989. Each employer and each member contribute at a rate of one-half the percent of pay needed to pay the normal cost of the Plan and to amortize the unfunded actuarial accrued liability over a rolling 30 year period.

NOTES TO THE BASIC FINANCIAL STATEMENTS

The contribution rates for the years ended June 30, 2005 and 2004, actuarially determined in 2002, were as follows:

	For the contribution period <u>ended June 30, 2005</u>		For the contribution period <u>ended June 30, 2004</u>	
	(2002 Valuation)		(2002 Valuation)	
	Amount	Percent of Covered Payroll	Amount	Percent of Covered Payroll
Normal cost	\$831,499,553	11.90%	\$831,499,553	11.90%
Amortization of (over) under-funded past service liability	(104,840,085)	(1.50)%	(104,840,085)	(1.50)%
	726,659,468	10.40%	726,659,468	10.40%
Long Term Disability	72,854,831	1.00%	72,854,831	1.00%
Actuarial Total	\$799,514,299	11.40%	\$799,514,299	11.40%
Contributions made as a percentage of the current year covered payroll:				
Employers' share	\$442,642,857	5.70%	\$413,457,804	5.70%
Employees' share	442,642,857	5.70%	413,462,100	5.70%
Current Year Total	\$885,285,714	11.40%	\$826,919,904	11.40%

The statutory contribution rate and the actuarially determined contribution rate for the year ended June 30, 2005 is 5.7 percent (5.2 percent retirement and .50 percent long-term disability) for both the employers' and employees' portion. This was determined by the 2002 actuarial valuation. This rate is applied to the covered payroll to determine the employee and employer contributions. GASB Statement No. 25 defines covered payroll as all elements included in compensation paid to active employees on which contributions to a pension plan are based.

8. Additional Benefits

In addition to the pension benefits described, the ASRS offers the Retiree Group Insurance Program and the Health Insurance Premium Benefit Program to eligible retired and disabled members. A retired member is defined as a member actively receiving an annuity benefit and a disabled member is defined as a member receiving a Long-Term Disability (LTD) benefit through the LTD program administered by the ASRS or through their former member employer's group LTD plan. The employees and member employers

NOTES TO THE BASIC FINANCIAL STATEMENTS

each contributed .50 percent of compensation in FY 2005 and .50 in FY 2004 to the LTD fund.

Pursuant to A.R.S. 38-782, the Retiree Group Insurance Program makes available group health insurance coverage to eligible retired and disabled members and their dependents. Retired and disabled members of the ASRS, University Optional Retirement Plans, the Public Safety Personnel Retirement System, the Elected Officials' Retirement Plan, and the Corrections Officer Retirement Plan are eligible for health insurance benefits through the ASRS. More than 44,000 coverage agreements currently exist for retired and disabled members and their dependents.

Pursuant to A.R.S. 38-783, retired and disabled members with at least five years of credited service are eligible to participate in the Health Insurance Premium Benefit Program. This assistance is provided to those members who elect group coverage through either the Retiree Group Insurance Program or their former member employer. The employers' retirement contribution in FY 2005 and in FY 2004 of 5.2 percent of compensation included 1.10 percent for the Health Premium Insurance Supplement.

The following chart illustrates the maximum amount of the monthly available benefit for eligible members and their dependents:

Years of Credited Service	Percent of Premium Benefit	Without Medicare		With Medicare A & B		Combinations	
		Retiree Only	Retiree & Dependents	Retiree Only	Retiree & Dependents	Retiree & Dependent, One with Medicare, the other without	Retiree & Dependent with Medicare, other dependent without
5.0-5.9	50 percent	\$75	\$130	\$50	\$85	\$107.50	\$107.50
6.0-6.9	60 percent	90	156	60	102	129.00	129.00
7.0-7.9	70 percent	105	182	70	119	150.50	150.50
8.0-8.9	80 percent	120	208	80	136	172.00	172.00
9.0-9.9	90 percent	135	234	90	153	193.50	193.50
10.0+	100 percent	150	260	100	170	215.00	215.00

Members who retire after December 31, 2003, can elect to receive a reduced premium benefit so that an eligible contingent annuitant may continue to receive a premium benefit after the member's death.

For qualified retirees who are participating in a medical program provided by the ASRS or an ASRS employer and who live in

areas of Arizona where no managed care (HMO) program is offered, the 2003 Arizona Legislature passed, and the Governor signed, legislation to provide an additional temporary premium benefit effective July 1, 2003 through June 30, 2005. These additional increases are listed in the table below:

NOTES TO THE BASIC FINANCIAL STATEMENTS

Years of Credited Service	Percent of Premium Benefit	Without Medicare		With Medicare A & B		Combinations	
		Retiree Only	Retiree & Dependents	Retiree Only	Retiree & Dependents	Retiree & Dependent, One with Medicare, the other without	Retiree & Dependent with Medicare, other dependent without
5.0-5.9	50 percent	\$150	\$300	\$85	\$175	\$235	\$235
6.0-6.9	60 percent	180	360	102	210	282	282
7.0-7.9	70 percent	210	420	119	245	329	329
8.0-8.9	80 percent	240	480	136	280	376	376
9.0-9.9	90 percent	270	540	153	315	423	423
10.0+	100 percent	300	600	170	350	470	470

The ASRS reimbursed approximately \$89.6 million and \$83.6 million towards the cost of group health insurance coverage for the years ended June 30, 2005 and 2004, respectively.

9. Contingent Liabilities

The ASRS is also a party in various litigation matters. While the final outcome cannot be determined at this time, management is of the opinion that the final obligation, if any, for these legal actions will not have a material adverse effect on the ASRS' financial position or results of operations.

10. Transfers To and From Other Funds

Due to/from other funds includes LTD cash deposits held at Bank of America at year end and amounts that need to be transferred after the year end contribution reconciliation.

11. Required Supplementary Schedules

Historical trend information designed to provide information about the ASRS' progress in accumulating sufficient assets to pay benefits when due is required supplementary information. Required supplementary information for the years available in accordance with the parameters of GASB Statement No. 25 is included immediately following the notes to the financial statements.

12. Retirement Plans

All eligible retirement system employees are covered by the Arizona State Retirement Plan. The Plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State of Arizona to provide pension benefits for employees of the State and employees of participating political subdivisions and school districts. The ASRS is administered in accordance with Title 38, Chapter 5 of the Arizona Revised Statutes (A.R.S.).

NOTES TO THE BASIC FINANCIAL STATEMENTS

The ASRS Retirement Plan provides retirement and disability benefits, annual cost of living adjustments and survivor benefits to members and their beneficiaries. A.R.S. 38-783 and A.R.S. 38-797 require separate accounts be established for health insurance premium benefits and long-term disability (LTD) benefits, respectively.

Effective July 1, 1995, the ASRS has established an account for each benefit program and has reported those funds in the combined financial statements. The financial statements of the ASRS include the financial activities of all the above funds. The ASRS Retirement Board, appointed by the governor and confirmed by the Arizona State Senate, manages the ASRS.

The contribution rate is established and may be amended by the Board of Trustees. The statutory contribution rate for the years ended June 30, 2005 and 2004 was 5.7 percent (5.2 percent retirement and .5 percent LTD). All eligible employees were required to contribute 5.7 percent of their annual covered salary, and the ASRS, as the employer, was required to match these contributions.

The ASRS annual regular 2005 base salary was \$8,164,531. The employer contributions to the Retirement Plan totaled \$465,378 for 2005, \$458,864 for 2004 and \$192,137 for 2003. The contributions were equal to the required contributions. ASRS collects the contributions and remits them to the Plan.

Employee contributions are excluded from gross income for federal and state income tax purposes, and earn interest at the rate of 8 percent per annum. Prior to July 1, 2005, upon termination of employment, member contributions made to the Plan, plus accrued interest at 8 percent per annum, are refundable. After June 30, 2005 contributions made to the Plan plus accrued interest of 4 percent per annum are refundable upon termination of employment.

The Plan provides benefits under formulas and provisions described in the law. Benefits and administrative expenses are paid from funds contributed by members and employers and from earnings on the invested funds. The Plan provides for retirement, disability, health insurance premium benefits, and survivor benefits.

Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit, which is established on a fiscal year basis (July 1 to June 30). The benefit is based on a percentage of average monthly compensation multiplied by the years of service credit.

Eligible retirement system employees are eligible for a LTD benefit in the event they become unable to perform their work. The Retiree Group Insurance Program offers health insurance coverage for both retired and disabled members.

REQUIRED SUPPLEMENTARY INFORMATION

Required Supplementary Information

For Year Ended June 30, 2005

(In Millions)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability Projected Unit-Credit	(Overfunded) Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	(Overfunded) Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
30-Jun	a	b	(b - a)	(a/b)	c	[(b-a)/c]
1999	\$18,043	\$15,476	(\$2,567)	116.60%	\$5,488	(46.8%)
2000	20,292	16,854	(3,438)	120.40	5,894	(58.3)
2001	21,888	19,012	(2,876)	115.10	6,357	(45.2)
2002	22,642	21,285	(1,357)	106.40	6,989	(19.4)
2003	22,572	22,935	363	98.40	7,297	5.0
2004	22,659	24,506	1,847	92.50	7,486	24.7

The accrued actuarial assets for the Health Benefit Supplement have been excluded from this presentation.

Schedule of Employer Contributions

Year Ended June 30	Employer Contributions Required*	Percentage Contributed
2000	\$152,957,449	100%
2001	163,441,724	100
2002	168,212,536	100
2003	177,156,746	100
2004	413,457,702	100
2005	442,642,857	100

*Includes contributions for long-term disability.

See notes to required supplementary information.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

1. Actuarial Methods and Assumptions For Valuations Performed

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

The Projected Unit Credit (PUC) method is the actuarial cost method used in the valuation for the period ended June 30, 2004. The unfunded actuarial accrued liability is amortized over a 30-year rolling period. The amortization method is the Level Dollar Method. The actuarial value of assets is the market value adjusted to phase in the recognition of investment gains and losses over a period of time. For years before fiscal 2002, the period is five years. For 2002 and later years, the period is ten years. The investment return rate assumption is 8 percent per annum, compounded annually. The inflation rate assumption is 4.25 percent per annum. Members' salaries are assumed to increase at from 4.50 percent to 9.50 percent per annum, depending on the length of service. The permanent benefit increase (PBI) reserve was \$687.2 million as of June 30, 2004, before the payment of the 2004 PBI and Enhanced PBI.

Significant Factors Affecting Identification of Trends

1999

Enhanced Refund Option

Employees who terminate prior to eligibility for retirement may elect to receive a refund of their employee contributions with interest. If the employee has at least five years of service, the employee is also entitled to a share of the employer contributions with interest. The share is 25 percent with five

years of service and increases 15 percent for each additional year of service to a maximum of 100 percent for 10 or more years of service.

Benefit Multiplier Increased to 2.1 percent

The benefit multiplier increased from 2.0 percent to 2.1 percent effective July 1, 2000.

5 percent Ad Hoc Increase

A 5 percent retiree ad hoc increase for retirees and beneficiaries effective July 1, 2000.

Increase in Maximum Service While on LTD

Increase in the maximum amount of service that may be accrued while on LTD from 25 to 30 years.

Changes in Permanent Benefit Increase COLA

- a) The maximum aggregate COLA was increased from 3 percent to 4 percent.
- b) The threshold for determining "Excess Earnings" was lowered from 9 percent to 8 percent.
- c) The limitation of the COLA to the increase in the CPI was removed.

2000

The age restriction on eligibility for the PBI was removed.

2001

Return to Work

Permits retired members of the ASRS to return to work and still be eligible to receive retirement benefits if they have been terminated from employment for a period of 12 months. The members who take this option will not be eligible for LTD benefits nor will they contribute to the ASRS or accrue

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

additional benefits during the period of re-employment. This act is repealed June 30, 2003.

This is similar to the bill passed in 2000 allowing retired teachers to return to work, and it does not affect the requirements of that program.

Transferring Credits

Permits an inactive member who has not retired to transfer credited service from one state plan to their current or former retirement plan if the inactive member is not eligible for membership in the ASRS and has not withdrawn contributions from the ASRS.

Health Insurance Premium Benefit

Increases the health insurance premium benefit for members of the eligible state retirement systems by the following amounts:

- ♦ Medicare eligible member from \$65 to \$100
- ♦ Non-Medicare eligible member from \$95 to \$150
- ♦ Non-Medicare family coverage from \$175 to \$260
- ♦ Medicare eligible family coverage from \$115 to \$170
- ♦ Combination Medicare and non-Medicare eligible from \$145 to \$215

Rural Health Insurance Premium Benefit

In addition to the premium benefit paid to ASRS retired and disabled members, provides for retired and disabled members who live in areas of the state not served by a managed care program (HMO) and who have 10 years of credited service in the following amounts:

- ♦ Medicare eligible member \$170 per month
- ♦ Non-Medicare eligible member \$300 per month

- ♦ Non-Medicare family coverage \$600 per month
- ♦ Medicare eligible family coverage \$350 per month
- ♦ Combination Medicare and non-Medicare eligible \$470 per month

Also provides that a retired or disabled member may elect to purchase individual coverage and receive a payment of the increased subsidy through the member's employer if the employer assumes the administrative function associated with the payment including verification that the payment is used for health insurance.

Supplemental Defined Contribution (DC) Plans

Repeals the provisions for the alternate DC retirement programs established in 1998 for exempt state employees (non-merit service employees), legislative agency employees and certain term limited elected officials. Persons already participating in those programs are grandfathered into them.

Provides that the ASRS, the Public Safety Personnel Retirement System (PSPRS) and their employers may establish a 401(a) defined contribution supplementary program. Employers may elect to match contributions to the supplementary program on an annual basis. Employer and member contributions to the supplement are vested immediately with the member.

Modified Deferred Retirement Option Plan (DROP) Program

Permits an employer to offer a member who has reached normal retirement (80 points, age 62 with 10 years, or age 65) a contract to work up to an additional three years. Retirement contributions are not made to ASRS during the contract period; however LTD contributions still continue to be paid

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

to the ASRS. During the contract period, the member and employer contribute to a supplemental DC Plan at a rate negotiated between the member and the employer. Upon completing the additional service, the employee must purchase an equivalent amount of service from the ASRS in order to receive credit for the three years worked.

Partial Lump Sum Option

Beginning July 1, 2002, a member may elect a partial lump sum payment at retirement equal to not more than 36 months of the member's calculated retirement benefit. The life annuity amount then would be adjusted actuarially to a reduced amount to offset the lump sum payment.

Graded Multiplier

Provides a variable multiplier in the retirement benefit formula, increasing with years of service according to the following:

- ♦ 00.00 to 19.99 Years of Service: 2.10 %
- ♦ 20.00 to 24.99 Years of Service: 2.15 %
- ♦ 25.00 to 29.99 Years of Service: 2.20 %
- ♦ 30.00 or More Years of Service: 2.30 %

Supplemental Defined Contribution (DC) Retirement Plan

Permits the four state retirement plans to establish a 401(a) defined contribution program as a supplement to the state defined benefit programs. Repeals the alternative DC programs for term-limited state elected officials and state employees exempted from state personnel rules. Employees may make contributions to IRS limits with a match by the employer. Each employer member of the ASRS would be permitted to choose its own match rate.

Permanent Benefit Increase (PBI) Enhancement

Provides that interest at a rate of 8 percent be paid on the funds held in reserve for the PBI. The interest accrued to the reserve is used to fund an enhanced PBI based on the number of years a member has been retired. A member who has at least 10 years of service would be eligible for an incremental increase for each five years of retirement.

PSPRS membership; park rangers

Transfers state and county park rangers from the ASRS to the PSPRS.

Community colleges; optional retirement; contributions

Permits a community college that has an optional retirement program to increase employer and employee contributions to seven percent. It provides a window for ASRS members to transfer to the optional programs from October 1, 2001 through December 31, 2001. The ASRS shall transfer their contributions plus interest to the optional program.

Removal of requirement that purchase of military service be only for which the member is not receiving a benefit.

Allows for ASRS members to purchase military service time for which they may already be receiving benefits.

Pop-Up for members choosing a life certain option

Allows for retirees that choose the 5, 10, or 15 period certain options to rescind the election of and thereafter, receive a straight life annuity, including postretirement increases. The member may again elect a period certain and life annuity subject to the same provision previously elected by the member.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

2002

No material changes.

2003

Change to Phase-in Period

Prior to the 2002 valuation, actuarial assets were equal to market, less a five-year phase-in of the excess of expected investment return over actual investment return. For 2002 and future years, the Board changed the five-year phase-in period to a ten-year period. So, the 2002 valuation recognizes only 10 percent of the 2002 investment loss. The years prior to 2002 remain on their original five-year schedules.

Extension of the Rural Health Insurance Subsidy

The Arizona Legislature passed legislation that extends the Rural Health Insurance Subsidy for a period of two additional years.

2004

Service Purchase Program

The Arizona Legislature revised the method of calculating the cost of service purchases, so that future purchases would be made at true actuarial present value. ASRS began to charge interest at 8 percent per annum for service purchases under payroll deduction agreements.

Early Retirement Incentive Programs

The Arizona Legislature provided that employers that participate in ASRS and offer early retirement incentives to their employees must notify ASRS of the incentives. ASRS will determine the cost of the incentives and the employers will pay the cost.

Long-Term Disability Program

The Arizona Legislature revised and clarified LTD provisions so that disabled members will be required to participate in rehabilitation programs and to pursue obtaining Social Security disability benefits. In addition, the legislation limited the receipt of disability benefits on the basis of a member's "own occupation" to 24 months, rather than to 24 consecutive months.

2005

Refund of Contributions

The Board reduced the rate of interest accruals on forfeited balances from 8 percent to 4 percent effective July 1, 2005.

The Arizona Legislature:

- ♦ Changed contribution rate calculations from biennial to annual for all fiscal years beginning after FYE 2007. It also modified biennial rate requirements to allow the rate to be stepped in over a two year period for FYE 2006 and 2007.
- ♦ Eliminated the rural benefit supplement for retirees in the Arizona retirement system who are not eligible for Medicare.

ADDITIONAL SUPPLEMENTARY INFORMATION

Combining Schedule of Retirement Net Assets

June 30, 2005

(Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2005
ASSETS:			
Cash	\$14,680	\$ -	\$14,680
RECEIVABLES:			
Accrued interest & dividends	51,635	1,331	52,966
Securities sold	478,455	12,330	490,785
Forward contracts	1,474,675	38,003	1,512,678
Contributions	17,252	-	17,252
Other	2,810	73	2,883
Total Receivables	2,024,827	51,737	2,076,564
INVESTMENTS AT FAIR VALUE :			
Temporary investments	1,911,807	49,268	1,961,075
Temporary investments from securities lending collateral	2,136,511	55,059	2,191,570
U. S. government obligations	2,403,327	61,935	2,465,262
Corporate bonds	2,417,346	62,296	2,479,642
Common and preferred stocks	14,653,903	377,639	15,031,542
Real estate mortgages & contracts	25,089	647	25,736
Total investments	23,547,983	606,844	24,154,827
TOTAL ASSETS	25,587,490	658,581	26,246,071
LIABILITIES:			
Payable for securities purchased	922,528	23,774	946,302
Payable for securities lending collateral	2,136,511	55,059	2,191,570
Forward contracts payable	1,478,708	38,107	1,516,815
Due to other funds	7,023	-	7,023
Other	13,326	121	13,447
Total Liabilities	4,558,096	117,061	4,675,157
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	\$21,029,394	\$541,520	\$21,570,914

In accordance with GASB 25, for financial reporting purposes the Retirement Plan and The Retirement System are presented in one column, Retirement Fund, in the ASRS basic financial statements because they are administered within a single pension plan. The Combining Schedule of Retirement Net Assets and Changes in Retirement Net Assets are presented here to provide members with more detailed information about the two plan components.

ADDITIONAL SUPPLEMENTARY INFORMATION

Combining Schedule of Changes in Retirement Net Assets For the Year Ended June 30, 2005 (Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2005
ADDITIONS			
Contributions			
Member contributions	\$403,269	\$392	\$403,661
Employer contributions	317,919	392	318,311
Transfers from other plans	1,773	-	1,773
Member reimbursements	140,159	-	140,159
Total Contributions	863,120	784	863,904
Income from investment activities			
Net appreciation in fair value	1,282,196	34,165	1,316,361
Interest	211,349	5,631	216,980
Dividends	198,716	5,295	204,011
Real Estate	5,725	153	5,878
Other	4,491	120	4,611
Total income from investment activities	1,702,477	45,364	1,747,841
Less investment activity expenses			
Investment management fees and monitoring services	25,828	688	26,516
Real estate	5,627	150	5,777
Total investment activity expenses	31,455	838	32,293
Net income from investment activities	1,671,022	44,526	1,715,548
From securities lending activities			
Securities loan program	43,792	1,167	44,959
Securities loan interest expense	38,490	1,026	39,516
Net income from securities lending activities	5,302	141	5,443
Total net investment income	1,676,324	44,667	1,720,991
TOTAL ADDITIONS	2,539,444	45,451	2,584,895
DEDUCTIONS			
Retirement and disability benefits	1,360,661	45,886	1,406,547
Survivor benefits	18,402	-	18,402
Refunds to withdrawing members, including interest	42,026	2,138	44,164
Administrative expenses	21,374	566	21,940
Transfers to other plans	4,581	-	4,581
Other	3,530	6	3,536
TOTAL DEDUCTIONS	1,450,574	48,596	1,499,170
NET INCREASE (DECREASE)	1,088,870	(3,145)	1,085,725
Net assets held in trust for pension benefits:			
Beginning of year	19,940,524	544,665	20,485,189
End of year	<u>\$21,029,394</u>	<u>\$541,520</u>	<u>\$21,570,914</u>

In accordance with GASB 25, for financial reporting purposes the Retirement Plan and The Retirement System are presented in one column, Retirement Fund, in the ASRS basic financial statements because they are administered within a single pension plan. The Combining Schedule of Retirement Net Assets and Changes in Retirement Net Assets are presented here to provide members with more detailed information about the two plan components.

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Additions by Source

(Dollars in Thousands)

Year	Employee Contribution Made	Employer Contribution Made	Net Investment Income	Member Reimbursements and Other	Total
1996*	\$172,848	\$172,848	\$2,063,878	\$4,376	\$2,413,951
1997	173,508	173,508	2,832,718	11,481	3,191,215
1998	176,769	176,769	3,405,203	15,462	3,774,202
1999	179,087	179,087	2,848,321	46,171	3,252,665
2000	152,957	152,958	2,035,312	35,348	2,376,575
2001	163,442	163,442	(1,528,691)	37,687	(1,164,120)
2002	168,213	168,213	(1,768,077)	51,350	(1,380,302)
2003	177,157	177,157	368,631	93,552	816,497
2004	413,462	413,458	3,228,785	113,944	4,169,649
2005	442,643	442,643	1,803,392	141,932	2,830,610

*Investment income restated at fair value for 1996. Investment income reported at fair value for subsequent years.

Schedule of Deductions by Type

(Dollars in Thousands)

Year	Benefits	Refunds	Administration, Transfers and Other	Total
1996	\$542,525	\$26,376	\$8,245	\$577,146
1997	596,308	31,282	12,308	639,898
1998	652,567	29,769	12,541	694,877
1999	713,871	26,108	15,353	755,332
2000	787,553	70,754	19,744	878,052
2001	909,615	98,535	24,640	1,032,790
2002	1,069,044	42,765	28,105	1,139,914
2003	1,222,564	35,976	37,877	1,296,418
2004	1,396,481	36,212	35,745	1,468,438
2005	1,576,734	44,164	33,426	1,654,324

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Administrative Expenses

For Year Ended June 30, 2005

(Dollars in Thousands)

	Retirement and Health Benefit Supplement	Long-Term Disability	Combined 2005
Personnel Services			
Salaries	\$8,713	\$ -	\$8,713
Retirement Contributions	427	-	427
Other Employee Related Expenses	1,739	-	1,739
Total Personnel Services	10,879	-	10,879
Professional Services			
Actuary & Benefit Consulting	913	-	913
Audit, Consulting & Legal Fees	429	-	429
Retiree Payroll Costs	1,412	-	1,412
Programming Costs	4,189	-	4,189
Other Outside Services	870	2,460	3,330
Total Professional Services	7,813	2,460	10,273
Communications			
Postage	291	-	291
Printing	121	-	121
Telephone	253	-	253
Advertising	27	-	27
Total Communications	692	-	692
Miscellaneous			
Board & Council	6	-	6
Office Rent	1,638	-	1,638
Furniture & Equipment	851	-	851
Software & Support	405	-	405
Repair & Maintenance	95	-	95
Equipment Rental	1	-	1
Travel	67	-	67
Operating Supplies	108	-	108
Insurance	115	-	115
Dues & Subscriptions	37	-	37
Education & Training	104	-	104
Miscellaneous	4	-	4
Total Miscellaneous	3,431	-	3,431
TOTAL	\$22,815	\$2,460	\$25,275

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Cash Receipts and Cash Disbursements

Year Ended June 30, 2005

(Dollars in Thousands)

CASH BALANCE, beginning of year	\$19,145
 RECEIPTS:	
Member contributions	440,924
Employer contributions	442,412
Purchase of back service (membership reimbursements)	140,159
Transfers from other retirement systems	1,773
Short-term securities matured and sold	8,317,838
Investments matured and sold	29,966,321
Building revenue	5,660
Securities lending program	46,765
Interest	233,714
Dividends	214,244
Miscellaneous	3,580
TOTAL RECEIPTS	39,813,390
 DISBURSEMENTS:	
Retirement, disability and subsidy payments	1,558,254
Death benefits	18,402
Refunds to withdrawing members	44,164
Transfers to other retirement systems	4,581
Short-term investments purchased	10,284,801
Investment purchases	27,803,710
Securities lending program charges	41,097
Investment manager fees	27,576
Building expenses	6,008
Administrative expenses	22,700
Miscellaneous	2,879
TOTAL DISBURSEMENTS	39,814,172
 CASH BALANCE, end of year	 \$18,363

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Professional Consultant Fees

For Year Ended June 30, 2005

(Dollars in Thousands)

Professional/Consultant	Nature Of Service	Expenses
VOLUNTARY PLAN ADMINISTRATION	LTD ADMINISTRATIVE SERVICES	\$2,460
MELLON BANK TRUST & INVESTMENTS	PENSION PAYMENT SERVICES	1,412
COMSYS INFORMATION TECHNOLOGY	IT CONSULTING SERVICES	695
KELLY SERVICES INC	TEMPORARY AGENCY	612
H L YOH CO LLC	IT CONSULTING SERVICES	581
COVANSYS CORPORATION	IT CONSULTING SERVICES	446
ABLEST INC	IT CONSULTING SERVICES	443
MELLON CONSULTANTS INC	ACTUARIAL SERVICES	420
SPHERION CORPORATION	IT CONSULTING SERVICES	356
WELLS FARGO BUSINESS CREDITORS	IT CONSULTING SERVICES	347
GLOTEL	IT CONSULTING SERVICES	317
DATA MAVENS INC	IT CONSULTING SERVICES	297
ATTORNEY GENERAL OFFICE	LEGAL SERVICES	289
STAFFMARK INC	TEMPORARY AGENCY	237
KEANE INC	IT CONSULTING SERVICES	234
INT TECHNOLOGIES LLC	IT CONSULTING SERVICES	190
ICC INTERNATIONAL	IT CONSULTING SERVICES	184
ANALYSTS INTERNATIONAL CO	IT CONSULTING SERVICES	136
MERCER HUMAN RESOURCE	INVESTMENT CONSULTING	90
COMPUTER INFORMATION TECHNOLOGIES	IT CONSULTING SERVICES	86
DELOITTE & TOUCHE LLP	AUDIT SERVICES	85
TECH KNOWLEDGY STORE LLC	IT CONSULTING SERVICES	79
MILLIMAN USA	IT CONSULTING SERVICES	60
FIRST NATIONAL	IT CONSULTING SERVICES	38
COST EFFECTIVENESS MEASUREMENT INC	PLAN ADMINISTRATIVE CONSULTING	30
CHARLES W WHETSTINE	LEGAL SERVICES	28
RIDENOUR HIENTON HARPER	LEGAL SERVICES	28
WATSON WYATT & COMPANY	PLAN ADMINISTRATIVE CONSULTING	26
AVAYA INC	IT CONSULTING SERVICES	25
PROVALIANT INC	IT CONSULTING SERVICES	23
BEHAVIOR RESEARCH CENTER	CONSULTING SERVICES	12
OTHER CONSULTING FEES	MISCELLANEOUS CONSULTING SERVICES	7
Total		<u>\$10,273</u>

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Total Investment Income by Manager

For Year Ended June 30, 2005

(Dollars in Thousands)

Manager	Market Appreciation (Depreciation)	Interest	Dividends	Real Estate/ Other	Total Investment Income
ASRS INTERNAL	\$261,363	\$115,032	\$86,582	\$10,844	\$473,821
BANK OF IRELAND	30,226	63	2,852	-	33,141
BANK OF NEW YORK	98,675	128	30,043	-	128,846
BARCLAYS GLOBAL INVESTORS	264,707	54	7	-	264,768
BLACKROCK	19,573	38,955	-	-	58,528
BRANDES	104,030	427	28,901	-	133,358
BRIDGEWATER	92,605	24,147	496	-	117,248
BYRAM	17,630	75	2,946	-	20,651
CAPITAL GUARDIAN INTERNATIONAL	62,672	80	5,132	-	67,884
COLUMBIA MANAGEMENT COMPANY	(26,912)	9	20	-	(26,883)
CRM	12,456	131	1,869	-	14,456
DIMENSIONAL FUND ADVISORS	48,713	91	3,830	-	52,634
FIDELITY FUND ADVISORS	8,265	21,932	-	-	30,197
FORTSMANN-LEFF ASSOC	8,084	66	325	-	8,475
FRANKLIN PORTFOLIO	84,912	81	19,460	-	104,453
FRONTIER CAPITAL	4,903	81	290	-	5,274
GOLDMAN SACHS	81,918	2,150	4,494	-	88,562
INTECH	7,275	44	5,690	-	13,009
JP MORGAN	19,396	21,864	-	-	41,260
LSV ASSET MANAGEMENT	58,842	54	10,980	-	69,876
MELLON DOMESTIC	40,993	-	964	-	41,957
STATE STREET GLOBAL	52,069	72	5,664	-	57,805
TIMESQUARE	8,175	111	216	-	8,502
WELLINGTON MGT CO	22,017	63	1,413	-	23,493
	<u>\$1,382,587</u>	<u>\$225,710</u>	<u>\$212,174</u>	<u>\$10,844</u>	<u>\$1,831,315</u>

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule of Total Investment Expenses

For the Year Ended June 30, 2005

(Dollars in Thousands)

	MANAGEMENT AND MONITORING FEES	REAL ESTATE EXPENSE	TOTAL
AMERICAN STOCK EXCHANGE	\$ 1	\$ -	\$ 1
ASRS INTERNAL	-	6,008	6,008
BANK OF IRELAND	569	-	569
BANK OF NEW YORK	1,005	-	1,005
BARCLAYS GLOBAL	1,263	-	1,263
BARRA INC	108	-	108
BATTERY MARCH	141	-	141
BLACKROCK	1,392	-	1,392
BLOOMBERG	108	-	108
BRANDES	4,138	-	4,138
BRIDGEWATER	3,882	-	3,882
BYRAM	676	-	676
CAPITAL GUARDIAN	1,234	-	1,234
COLUMBIA MANAGEMENT	59	-	59
COURTLAND PARTNERS LTD	223	-	223
CRAMER ROSENTHAL MCGYNN	509	-	509
DIMENSIONAL FUND ADVISORS	740	-	740
FIDELITY	592	-	592
FORSTMANN-LEFF ASSOCIATES	241	-	241
FOSTER PEPPER	29	-	29
FRANKLIN PORTFOLIO	1,245	-	1,245
FRONTIER CAPITAL	604	-	604
GOLDMAN SACHS	2,907	-	2,907
INTECH	1,384	-	1,384
J.P. MORGAN	1,019	-	1,019
LEWIS & ROCA	10	-	10
LEXIS NEXIS	2	-	2
LSV ASSET MANAGEMENT	1,305	-	1,305
MARKET AXESS CORP	7	-	7
MELLON	213	-	213
MERCER HUMAN RESOURCE	226	-	226
MOODYS	39	-	39
MORNINGSTAR INC	1	-	1
NEW YORK STOCK EXCHANGE	5	-	5
RIDENOUR HIENTON HARPER	76	-	76
STATE STREET BANK	643	-	643
SUNGARD	4	-	4
TIMES SQUARE CAPITAL	269	-	269
TRADEWEB LLC	12	-	12
WELLINGTON MANAGEMENT	695	-	695
	<u>\$ 27,576</u>	<u>\$ 6,008</u>	<u>\$ 33,584</u>



INVESTMENT SECTION



3300 NORTH CENTRAL AVENUE
PHOENIX, ARIZONA 85012

TABLE OF CONTENTS

III. Investment Section

Investment Report	58
Investment Results.....	61
Performance Accounting/Computation Standards	61
Annualized Rates of Return	61
Historical Rates of Return.....	61
Monthly Returns	62
Net Income from Investments	62
Ten Year Review of Investment Income	63
Asset Allocation	64
Schedule Of Investments.....	64
Equity Portfolio Profile	65
Fixed Income Portfolio Profile	67
Schedule of Broker Commissions - Domestic Equity Trades	69
Schedule of Broker Commissions - Foreign Equity Trades	71

INVESTMENT REPORT

U.S. Economy and Capital Markets - FY 2004-05

*By Lawrence Trachtenberg, Investment Committee Chairman, and
Gary R. Dokes, Chief Investment Officer*

3rd Quarter 2004

Economic growth was moderate during the third quarter, with GDP coming in at 4 percent. While a slowdown in employment growth and inflation figures tempered near-term inflationary fears, crude oil prices nearing \$50 per barrel raised concerns of inflationary forces re-emerging in the future. The Fed continued with its tightening at a "measured pace," and hiked short-term rates by 25 basis points at both Fed meetings during the quarter, leaving the Fed Funds rate at 1.75 percent at quarter end.

Domestic equities were lower for the quarter as geo-political concerns, tighter monetary policy and higher oil prices led to lower earnings growth expectations. Large cap and small cap stocks lost value during the quarter, with the S&P 500 index losing 1.87 percent, the Russell 1000 index down by 1.81 percent and the Russell 2000 negative by 2.86 percent. International equities fared slightly better, losing only 0.2 percent.

The decrease in inflationary fears helped the bond market during the quarter, even in the face of continued Fed rate hikes. The Lehman Aggregate Bond Index returned 3.2 percent during the quarter, with corporate bonds outpacing Treasury issues.

4th Quarter 2004

Steady economic growth continued in the fourth quarter, with a 3.8 percent GDP growth rate. Crude oil prices retreated to \$43 per

barrel and other inflation figures were relatively benign. The Fed continued raising rates at a 25 basis point per meeting pace, and the Fed Funds rate stood at 2.25 percent at year end. Despite Asian central bank activity, the U.S. Dollar declined against major currencies, driven by low domestic savings rates and budget and current account deficits.

Equities rallied in the fourth quarter, helped along by a smooth U.S. election, an increase in mergers and acquisitions, and a softening in oil prices. The S&P 500 index rose 9.2 percent for the quarter, to finish the year up 10.9 percent. Small cap stocks outpaced large cap stocks for the sixth straight year, with the Russell 2000 index gaining 14.1 percent for the quarter and 18.3 percent for the year. Helped by foreign currency appreciation versus the U.S. Dollar, international equities outperformed domestic equities for the quarter and year. As measured by the MSCI EAFE index, international equities rose 15.4% for the quarter and 20.7 percent for the year.

The domestic fixed income market overcame a rise in short-term yields to finish slightly higher for the year. The Lehman Aggregate Bond index ended the quarter 1.0 percent higher and the year 4.3 percent higher. The yield curve continued to flatten through the end of the quarter, and for the year, the short end of the curve rose 125 basis points, the middle of the curve fell by 3 basis points, and the long end of the curve fell by 22 basis points.

INVESTMENT REPORT

1st Quarter 2005

Fears of inflation built during the first quarter, as the price of oil rose 27.5 percent. Higher energy costs helped the Producer Price Index jump by 2.1 percent, which in turn caused core consumer prices to post their biggest increase in two years. The Fed hiked interest rates twice more in the quarter, as the Fed Funds rate hit 2.75 percent. Rising interest rates caused the dollar to rally during the quarter, and GDP growth, after an initial estimate of 3.1 percent, came in at a more robust 3.8 percent increase.

Investor concerns over rising commodity prices, inflation and slowing corporate earnings growth led to a decrease in major equity indices during the quarter. The S&P 500 index ended down 2.2 percent, the Russell 2000 index ended down 5.3 percent, and the MSCI EAFE index ended flat at -0.1 percent for the quarter. While the overall market finished lower, select sectors, such as energy, utilities, materials and consumer staples were able to register gains during the quarter.

The Lehman Aggregate Bond index fell 0.5 percent during the quarter, weighed down by rising prices, inflation fears, and negative headlines. GM's profit warning in March sparked a flight to quality trade into Treasury securities, leading to large losses in corporate issues. The long end of the Treasury curve continued to be well bid as the curve continued to flatten.

2nd Quarter 2005

The initial estimate of second quarter GDP growth came in at 3.4 percent, indicating an economy still on solid ground. The unemployment rate fell to 5.0 percent in June, though jobs growth data trailed last year's figures. Oil continued to trend higher during the quarter, though a relatively benign CPI reading indicated that inflation was still under control. The Fed raised short-term rates twice during the quarter, leaving the Fed Funds rate at 3.25 percent at quarter end.

Positive economic data during the quarter led to a rebound in domestic equities. The S&P 500 gained 1.4 percent during the quarter, led by utility stocks, with growth stocks outpacing value stocks. Small cap stocks outperformed large caps, as the Russell 2000 advanced 4.32 percent. While international equities increased in local currency terms, the strength of the dollar relative to other currencies caused a decrease in the MSCI EAFE index of 0.8 percent.

Despite continued Fed rate hikes and downgrades of Ford and GM debt to non-investment grade status, the Lehman Brothers Aggregate Bond index posted a gain of 3.0 percent during the quarter. The 10-year Treasury bond closed the quarter with a yield of 3.9 percent. The Treasury yield curve continued to flatten, as spread between the 2-year and 10-year Treasury bonds narrowed to 28 basis points.

INVESTMENT REPORT

Investment Goals

For the period ending June 30, 2005 the following were the ASRS Investment Goals:

1. Retain safety as the principle consideration in the investment of the ASRS assets.
2. Achieve the actuarial investment return of 8 percent.
3. Maintain a minimum funded status of 100 percent.
4. Support excess earnings Permanent Benefit Increase (PBI) (formerly known as cost of living allowance or COLA)
5. Maintain a relatively stable contribution rate.

Investment Policies

The ASRS adheres to all statutory requirements set forth by Arizona state law, which applies upper limits to the portions of the fund that may be invested in any single entity, international equities, or total equities. The ASRS has also established investment guidelines for its external investment managers and a complete set of policies, procedures, compliance requirements, and oversight of internal investment management to ensure that investment assets are prudently managed. Both internal and external audit procedures are in place. Oversight and direction responsibilities are ensconced with the Board.

Asset Allocation Targets

Effective October 2003, the ASRS determined the asset allocation policy targets and ranges are as follows:

U.S. Equity	53% +/- 5%
U.S. Fixed Income	26% +/- 5%
International Equity	15% +/- 5%
Real Estate	6% +/- 2%

The Real Estate allocation is pro-rated into the other asset classes until investments are made into this asset class.

INVESTMENT RESULTS

The Total Fund returned 8.5 percent in the fiscal year ended June 30, 2005.

Performance Accounting/ Computation Standards

The ASRS investment performance rates of return are calculated on a total return basis, using time-weighted rates of return, based upon market values. Performance is

calculated on an accrual basis provided that the accrual information is available from the custodian or record-keeper. The rates of return are generated by asset class and include cash holdings.

Below are rates of return on the overall portfolio, as well as specific asset classes, along with the benchmarks used to compare performance.

<i>Annualized Rates of Return</i>				
(Retirement & HBS Funds)				
	1 Year	3 Year	5 Year	10 Year
ASRS Total Fund	8.5%	9.2%	2.2%	9.4%
ASRS Domestic Equity	8.1%	9.7%	(0.4%)	10.7%
S&P 500 Index	6.3%	8.3%	(0.2%)	9.9%
ASRS Domestic Fixed Income	6.9%	5.8%	7.4%	6.9%
Lehman Aggregate Index	6.8%	5.8%	7.4%	6.8%
ASRS International Equity	11.1%	11.7%	0.5%	7.4%
MCSI EAFE Index	14.1%	12.5%	(0.2%)	5.6%

<i>Historical Rates of Return</i>					
(Retirement & HBS Funds)					
Fiscal Year	Return	Fiscal Year	Return	Fiscal Year	Return
2004-05	8.50%	1996-97	20.60%	1988-89	14.33%
2003-04	17.50%	1995-96	16.70%	1987-88	3.10%
2002-03	2.40%	1994-95	17.78%	1986-87	11.80%
2001-02	(8.20%)	1993-94	1.89%	1985-86	31.50%
2000-01	(6.70%)	1992-93	16.74%	1984-85	32.10%
1999-00	10.00%	1991-92	14.62%	1983-84	(5.20%)
1998-99	16.80%	1990-91	7.99%	1982-83	40.30%
1997-98	21.30%	1989-90	9.52%	1981-82	2.40%

INVESTMENT RESULTS

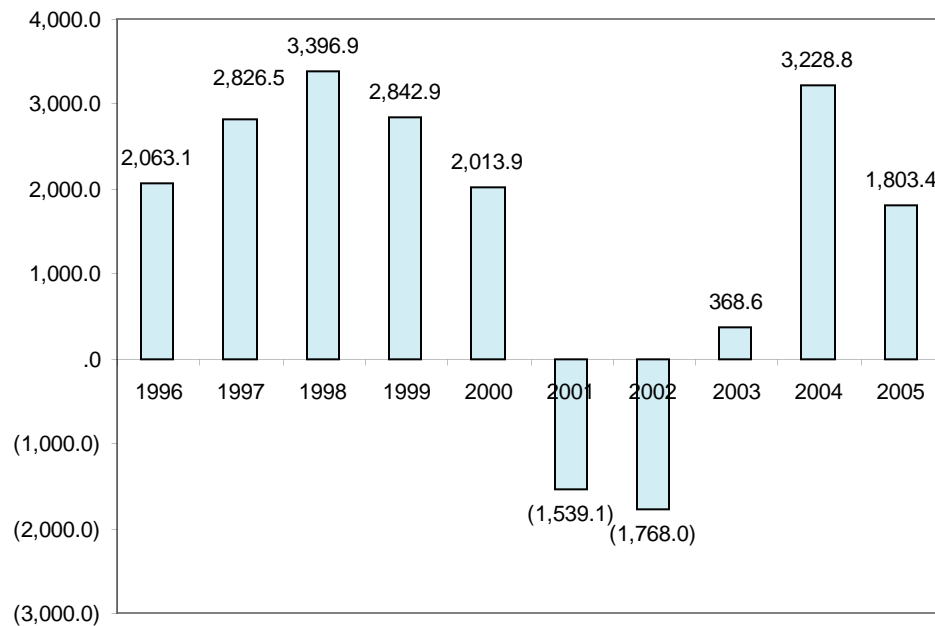
Monthly Returns

(Retirement & HBS Funds)

Month	Total Fund	US Equity	Fixed Income	International Equity
Jul 2004	-2.47%	-3.86%	0.99%	-3.22%
Aug 2004	0.69%	0.29%	1.94%	0.02%
Sep 2004	1.45%	1.95%	0.30%	2.13%
Oct 2004	1.77%	1.51%	0.88%	3.88%
Nov 2004	3.68%	4.90%	-0.71%	6.37%
Dec 2004	2.73%	3.34%	0.91%	0.35%
Jan 2005	-1.55%	-2.48%	0.62%	-1.94%
Feb 2005	1.92%	2.29%	-0.53%	4.26%
Mar 2005	-1.61%	-1.80%	-0.55%	-2.52%
Apr 2005	-1.54%	-2.69%	1.29%	-2.41%
May 2005	2.50%	3.93%	1.04%	0.22%
Jun 2005	0.78%	0.90%	0.55%	0.93%

Net Income from Investments

(Dollars in Millions)



INVESTMENT RESULTS

Ten Year Review of Investment Income

(Dollars in Thousands)

Fiscal Year	Investment Income	Market Appreciation	Investment Expense	Net Income From Investments
1995-96	\$523,566	\$1,562,575	\$22,990	\$2,063,151
1996-97	566,750	2,282,015	22,264	2,826,501
1997-98	325,329	3,094,012	22,377	3,396,964
1998-99	394,337	2,474,779	26,215	2,842,901
1999-00	416,594	1,625,595	28,273	2,013,916
2000-01	527,329	(2,038,932)	27,525	(1,539,128)
2001-02	485,535	(2,228,394)	25,218	(1,768,077)
2002-03	442,870	(51,437)	22,801	368,632
2003-04	447,623	2,811,047	29,885	3,228,785
2004-05	454,389	1,382,587	33,584	1,803,392

ASSET ALLOCATION

Schedule Of Investments

(Dollars in Thousands)

	Investments at Fair Value	Receivables	Payables	Total	% of Total
Corporate Equity Securities	\$15,751,417	\$ -	\$ -	\$15,751,417	69.8%
Fixed Income Securities					
Corporate Debt Securities	2,617,193	-	-	2,617,193	11.6
US Treasury & Govt Securities	2,564,711	-	-	2,564,711	11.4
Real Estate & Mortgages Securities Lending	26,774	-	-	26,774	0.1
Temporary Investments*	2,279,978	-	(2,279,978)	-	0.0
Temporary Investments*	2,040,185	2,141,053	(2,565,809)	1,615,429	7.2
Total Fixed Income Securities	9,528,841	2,141,053	(4,845,787)	6,824,107	30.2
Total Investments	\$25,280,258	\$2,141,053	\$(4,845,787)	\$22,575,524	100.0%

*Includes 1,668 other receivables and \$3,228 other liabilities

EQUITY PORTFOLIO PROFILE

Equity Portfolio Profile

(Dollars in Thousands)

Equity Sub-Sector Allocation	Percent Of Fund	Dollar Value
US Large Cap Equity	43.89%	\$9,909,283
US Mid Cap Equity	5.73	1,293,922
US Small Cap Equity	<u>5.03</u>	<u>1,135,459</u>
Total US Equity	54.66%	12,338,664
International Equity	<u>15.12%</u>	<u>3,412,752</u>
Total Equity	<u>69.77%</u>	<u>\$15,751,417</u>

Ten Largest Domestic Equity Holdings

	% Of Domestic Equity Portfolio
EXXON MOBIL CORP	1.92%
GENERAL ELEC CO COM	1.61
MICROSOFT CORP COM	1.23
CITIGROUP INC COM	1.09
BANK OF AMERICA CORP	1.08
JOHNSON & JOHNSON COM	1.00
WAL MART STORES INC COM	0.86
PFIZER INC COM STK USD0.05	0.82
INTEL CORP	0.78
CHEVRON CORPORATION COM	0.72
Total	11.11%

EQUITY PORTFOLIO PROFILE

Distribution By Market Sector

	ASRS Domestic Equity	S&P 500 Index
Financials	20.04%	20.33%
Health Care	12.19	13.39
Utilities	3.74	3.47
Consumer Discretionary	14.52	11.43
Consumer Staples	8.73	10.12
Energy	8.24	8.78
Information Technology	14.61	15.14
Materials	3.63	2.95
Telecommunication Services	2.42	3.19
Industrials	11.86	11.19
Total	100.00%	100.00%

Ten Largest International Equity Holdings

	% Of International Equity Portfolio
NESTLE SA CHF1	1.33%
UNILEVER NV CVA NLG1.12	1.14
DEUTSCHE TELEKOM AG NPV (REGD)	1.07
NIPPON TEL & TEL CORP Y50000	0.88
BT GROUP ORD GBPO.05	0.86
MORRISON (W) SUPMKT ORD 10P	0.85
MILLEA HOLDINGS IN NPV	0.83
GLAXOSMITHKLINE ORD GBPO.25	0.80
AKZO NOBEL NV EUR2	0.79
BP PLC SPONSORED ADR	0.77
Total	9.32%

Summary Of Broker Commissions

	Commission
Domestic Equity	\$5,692,175
International Equity	1,730,829

Note: A detail listing of investments is available upon request. Direct inquiries to: ASRS, 3300 North Central Avenue, Phoenix, AZ 85012.

FIXED INCOME PORTFOLIO PROFILE

Distribution By Sector

	Percent
US Treasury & Government Agency	32.9%
Corporates	22.1
Mortgage Backed Securities	39.4
Asset Backed Securities	5.6
Total	100.0%

Distribution By Coupon

	Percent
0.00% - 6.50%	51.6%
6.51% - 7.50%	37.5
7.51% - 9.00%	8.9
> 9.00%	2.0
Total	100.0%

Distribution By Maturity

	Percent
0 to 2 years	20.7%
2 to 3 years	2.9
3 to 4 years	5.6
4 to 5 years	6.3
5 to 6 years	3.8
6 to 8 years	4.1
> 8 years	56.6
Total	100.0%

FIXED INCOME PORTFOLIO PROFILE

Ten Largest Domestic Fixed Income Holdings

	Coupon	Maturity	Par Value	Market Value	Percent
COMMIT TO PUR FNMA SF MTG	5.50%	7/1/2035	\$130,700	\$132,451,380	2.91%
U S TREASURY NOTES	3.75%	3/31/2007	100,525	100,677,798	2.21
FNMA POOL #0786458	5.00%	5/1/2034	58,651	58,668,883	1.29
U S TREASURY NOTES	3.38%	11/15/2008	57,000	56,422,590	1.24
U S TREASURY BONDS	11.25%	2/15/2015	34,500	54,467,565	1.20
U S TREASURY NOTES	2.63%	11/15/2006	55,000	54,274,000	1.19
COMMIT TO PUR FNMA SF MTG	6.00%	8/1/2035	51,900	53,148,820	1.17
U S TREASURY NOTES	3.13%	1/31/2007	50,865	50,462,149	1.11
FNMA POOL #0796020	6.00%	9/1/2034	48,983	50,229,890	1.10
FEDERAL HOME LN MTG CORP DEB	5.00%	7/15/2014	46,000	48,545,019	1.07
Total					14.49%

Note: A detail listing of investments is available upon request. Direct inquiries to: ASRS, 3300 North Central Avenue, Phoenix, AZ 85012.

SCHEDULE OF BROKER COMMISSIONS – DOMESTIC EQUITY TRADES

Domestic Broker Name	Total Dollar Amount Of Trades	Number Of Shares	Average Commission Per Share	Commission
ABEL NOSER CORP, NEW YORK	\$63,730,625	1,699,968	\$0.02	\$31,575
ACCESS SEC INC, STAMFORD	114,016,804	2,857,800	0.04	109,616
AVIAN SECURITIES INC, BOSTON	17,894,669	951,648	0.04	41,967
B TRADE SVCS LLC, NEW YORK	83,871,813	3,082,155	0.02	53,958
BAIRD, ROBERT W & CO INC, MILWAUKEE	15,209,837	425,770	0.05	20,896
BANC OF AMERICA SECS LLC, CHARLOTTE	27,883,447	1,005,010	0.05	45,148
BEAR STEARNS & CO INC, NY	377,940,573	22,146,494	0.02	357,106
BEAR STEARNS SEC CORP, BROOKLYN	531,267,176	13,530,522	0.02	329,407
BERNSTEIN SANFORD C & CO, NEW YORK	20,732,430	627,020	0.04	23,359
BOSTON INSTITUTIONAL SVCS INC,	30,070,223	1,075,895	0.05	51,298
BRIDGE TRADING CO, ST LOUIS	17,472,467	754,600	0.05	36,502
CANTOR FITZGERALD & CO INC, NEW YORK	147,151,413	4,247,015	0.04	157,030
CAP INSTL SVCS INC-EQUITIES, DALLAS	123,207,989	3,627,779	0.03	116,883
CIBC WORLD MARKETS CORP, NEW YORK	42,930,535	1,217,087	0.04	52,004
CITATION GROUP, NY	45,938,339	1,678,684	0.05	81,878
CITIGROUP GBL MKTS INC, NEW YORK	32,812,226	1,522,797	0.03	41,535
CREDIT SUISSE, NEW YORK	177,189,422	5,314,415	0.04	236,400
DEUTSCHE BANC ALEX BROWN INC, NEW	161,762,398	4,091,290	0.02	92,015
EXECUTION SERVICES INC, NEW YORK	173,060,954	5,277,802	0.04	201,098
FIDELITY CAP MKTS (DIV OF NFSC),	161,589,207	5,153,677	0.04	218,496
FRANCIS P MAGLIO & CO INC, NEW YORK	30,014,312	725,862	0.03	18,380
GOLDMAN SACHS & CO, NY	179,902,607	4,803,298	0.03	140,882
GOLDMAN SACHS EXECUTION & CLEARING,	11,364,891	455,800	0.01	5,103
GUZMAN & CO, NEW YORK	115,113,560	2,413,209	0.02	49,518
INSTINET CORP, NY	313,501,851	10,260,479	0.02	193,219
INVESTMENT TECHNOLOGY GROUPS, NEW	326,928,345	9,402,152	0.02	193,853
JEFFERIES & CO INC, NEW YORK	195,588,458	5,325,242	0.03	140,912
JNK SECURITIES INC, NEW YORK	110,021,830	3,560,745	0.03	88,900
JONES & ASSOCIATES INC, WESTLAKE	32,986,299	1,200,326	0.05	53,698
LA BRANCHE FINANCIAL SVCS/HBI, NEW	267,940,143	7,081,045	0.03	208,480
LEHMAN BROS INC, NEW YORK	276,260,867	7,819,834	0.03	238,556
LIQUIDNET INC, BROOKLYN	70,017,552	2,731,506	0.02	55,070

SCHEDULE OF BROKER COMMISSIONS – DOMESTIC EQUITY TRADES

Domestic Broker Name	Total Dollar Amount Of Trades	Number Of Shares	Average Commission Per Share	Commission
LYNCH JONES & RYAN INC, HOUSTON	64,130,679	2,402,248	0.05	116,040
MCDONALD & CO, NEW YORK	11,110,455	385,855	0.05	19,373
MERRILL LYNCH PIERCE FENNER SMITH	303,826,462	9,091,965	0.04	368,959
MERRILL LYNCH PROFESSIONAL CLRG,	143,633,810	5,115,117	0.03	152,476
MORGAN J P SECS INC, NEW YORK	22,253,292	848,837	0.05	38,800
MORGAN STANLEY & CO INC, NY	61,808,539	1,654,560	0.04	63,539
NUTMEG SECURITIES, WESTPORT	17,872,010	979,070	0.05	49,284
PRUDENTIAL EQUITY GROUP, NEW YORK	57,304,583	1,693,290	0.04	70,297
PULSE TRADING LLC, BOSTON	15,801,450	740,987	0.02	11,919
RAYMOND JAMES & ASSOC INC, ST	28,602,029	1,530,381	0.05	72,402
RBC CAPITAL MARKETS CORP, NEW YORK	13,140,157	348,275	0.05	15,840
ROCHDALE SECURITIES CORP	74,150,553	2,659,227	0.04	115,449
ROSENBLATT SECURITIES INC, JERSEY CITY	154,987,563	3,565,300	0.02	71,306
S G COWEN & CO LLC, NEW YORK	10,467,867	344,983	0.05	16,886
SCHWAB CHARLES & CO INC, SAN	40,337,926	1,649,001	0.04	58,822
SUNTRUST CAPITAL MARKETS INC,	13,667,847	539,337	0.05	26,004
THOMAS & WEISEL INC, SAN FRANCISCO	15,573,141	545,333	0.05	26,598
UBS SECURITIES LLC, STAMFORD	115,507,592	3,826,065	0.03	127,634
WACHOVIA CAPITAL MARKETS LLC,	14,112,891	422,600	0.05	19,938
WEEDEN & CO, NEW YORK	146,893,698	4,592,297	0.02	102,660
OTHERS	254,365,843	10,438,795		463,207
TOTAL				<u><u>\$5,692,175</u></u>

Note: A detail listing of broker commissions is available upon request. Direct inquiries to: ASRS, 3300 North Central Avenue, Phoenix, AZ 85012.

SCHEDULE OF BROKER COMMISSIONS – FOREIGN EQUITY TRADES

Domestic Broker Name	Total Dollar Amount Of Trades	Number Of Shares	Average Commission Per Share	Commission
NATEXIS BLEICHROEDER INC, NEW YORK	\$280,723,835	12,517,799	\$0.02	\$280,800
CREDIT SUISSE (EUROPE), LONDON	144,137,114	7,749,211	0.01	53,296
CREDIT SUISSE, NEW YORK	123,916,334	9,432,809	0.02	147,556
CREDIT SUISSE EQUITIES, LONDON	74,281,716	10,735,036	0.00	23,778
GOLDMAN SACHS & CO, NY	68,583,034	6,270,555	0.02	153,608
SALOMON BROS INTL LTD, LONDON	51,770,115	2,122,699	0.04	87,118
MERRILL LYNCH PIERCE FENNER,	47,257,716	9,062,331	0.01	44,815
MERRILL LYNCH INTL LONDON EQUITIES	40,639,025	5,847,280	0.01	56,337
DEUTSCHE BANC ALEX BROWN INC, NEW	39,192,376	1,623,690	0.04	60,313
UBS SECURITIES LLC, STAMFORD	36,870,816	1,070,456	0.04	42,768
CITIGROUP GBL MKTS/SALOMON, NEW YORK	34,767,828	5,684,614	0.01	48,215
LEHMAN BROS INTL, LONDON	33,084,501	1,054,326	0.05	53,070
ABN AMRO SECS LLC, NEW YORK	32,190,697	3,122,008	0.02	53,905
MORGAN STANLEY & CO INC, NY	29,887,340	3,140,272	0.01	45,033
UBS EQUITIES, LONDON	22,668,138	902,230	0.04	33,444
DRESDNER KLEINWORT BENSON, NEW YORK	21,994,558	3,888,518	0.01	31,590
MIZUHO SECURITIES USA INC. NEW YORK	21,864,836	1,411,224	0.01	16,779
BEAR STEARNS & CO INC, NY	21,199,732	1,294,326	0.02	31,634
SOCIETE GENERALE, NEW YORK	20,533,582	742,680	0.04	32,830
NOMURA SECS INTL INC, NEW YORK	17,331,189	1,140,430	0.02	17,290
UBS WARBURG LLC, STAMFORD	14,348,514	1,781,532	0.02	41,277
MERRILL LYNCH INTL (3L GLOSS), LONDON	13,633,162	578,465	0.04	24,691
J P MORGAN SECS LTD, LONDON	13,567,581	684,850	0.02	16,678
UNION BANK SWITZERLAND SECS, LONDON	13,416,033	2,493,427	0.01	18,038
MORGAN STANLEY & CO INTL, LONDON	13,272,221	1,053,974	0.02	18,069
LEHMAN BROS INC, NEW YORK	12,820,219	2,630,617	0.01	14,600
GOLDMAN SACHS INTL, LONDON	11,971,259	390,860	0.03	13,365
DEUTSCHE BK AG (INTL EQUITIES), LONDON	11,307,226	778,118	0.02	12,914
HOARE GOVETT SECS LTD, LONDON	10,712,556	720,807	0.02	14,559
OTHERS	148,474,655	10,717,531		242,459
TOTAL				<u>\$1,730,829</u>

Note: A detail listing of broker commissions is available upon request. Direct inquiries to: ASRS, 3300 North Central Avenue, Phoenix, AZ 85012.

ACTUARIAL SECTION

3300 NORTH CENTRAL AVENUE
PHOENIX, ARIZONA 85012



TABLE OF CONTENTS

IV. Actuarial Section

Actuarial Certification 74

Actuarial Valuation of the Plan as of June 30, 2004..... 77

General Actuarial Information 80

Summary of Benefit Provisions 83

Statement of Actuarial Methods and Assumptions 97

Schedule of Plan Active Member Valuation Data..... 102

Schedule of Plan Retirees Added To and Removed From Rolls 102

Schedule of Unfunded (Over) Accrued Liabilities - Plan 103

Solvency Test 104

Schedule of Recommended vs. Actual Plan Contributions..... 104

Analysis of Financial Experience for the Plan 105

ACTUARIAL CERTIFICATION

Actuarial Certification Statement

This is to certify that Mellon Human Resources & Investor Solutions has prepared an actuarial valuation of the Arizona State Retirement Plan as of June 30, 2004.

Actuarial calculations have been made with respect to a total of 415,650 members - 205,482 active employees, 136,435 inactive members, and 69,049 retired members and beneficiaries, and 4,684 members on long term disability. In addition, there are 705 System retirees receiving ad hoc benefits from Plan assets.

The actuarial calculations establish a total benefit cost of 15.50 percent of the annual compensation of employees. The total normal cost rate is 13.02 percent of compensation, and the required amortization payment determined in accordance with Section 38-737 is 2.50 percent of compensation.

The actuarial cost factors as of June 30, 2004 are as follows:

I.	Actuarial accrued liabilities			
	A. Liabilities due to member's benefits			
	1. Active members			
	a. Retirement benefits	\$10,893,474,050		
	b. Health insurance premium supplement	878,900,986		
	c. Disability deferred retirement benefits	214,579,320		
	d. Pre-retirement death benefits	248,143,268		
	e. Withdrawal benefits	342,756,931		
	f. Total active members		\$12,577,854,555	
	2. Inactive members		918,524,304	
	3. Retired members and beneficiaries		11,374,777,957	
	4. Disabled members (deferred retirement)		348,086,799	
	5. Benefit increases for other-than-plan participants		11,867,731	
	6. Total present value of benefits		\$25,231,111,346	
	B. Other miscellaneous liabilities and reserves		0	
	C. Reserve for future PBIs		687,218,159	
	D. Total actuarial accrued liability		\$25,918,329,505	
II.	Actuarial value of assets			23,642,904,763
III.	Unfunded actuarial accrued liability (Item I -- Item II)			2,275,424,742
IV.	Amortization of unfunded actuarial accrued liability (per Section 38-737)		187,139,751	
V.	Normal cost for the year		974,455,203	
VI.	Total contribution for the year (Item IV + Item V)			1,161,594,954
VII.	Total covered payroll (projected to 2004/2005 plan year)			7,485,590,038
VIII.	Total contribution for fiscal years 2006 and 2007 as a percentage of covered payroll			
		401(a) Account	401(h) Account	Total
	A. Employee Portion	7.75%	0.00%	7.75%
	B. Employer Portion	6.61%	1.14%	7.75%
	C. Total	14.36%	1.14%	15.50%

ACTUARIAL CERTIFICATION

The Board adopted a new asset valuation method on November 15, 2002, to be effective for valuations on and after June 30, 2002.

On November 21, 2003, the Board adopted assumptions to be effective for valuations on and after June 30, 2003.

These assumptions are as follows:

1. Investment yield - 8% per annum.
2. Salary increases

Years of Service	Merit Component	Total Salary Increase
1	5.00%	9.50%
2	4	8.5
3	2.5	7
4	1.8	6.3
5	1.4	5.9
6	1.25	5.75
7	1	5.5
8	0.8	5.3
9	0.75	5.25
10	0.5	5
11 to 19	0.25	4.75
20 or more	0	4.5

3. Rates of disability

Age	Males	Females
20	0.06%	0.07%
30	0.07%	0.10%
40	0.21%	0.21%
50	0.51%	0.49%
60	1.20%	1.09%

4. Rates of withdrawal - Sample ages and years of service

Age	Years of Service: Male Members				
	1	2	5	8	10+
20	36.42%	28.95%	13.64%	7.11%	12.77%
30	20.55	16.12	9.43	5.14	5.65
40	16.98	10.11	6.65	4.00	2.27
50	16.92	9.04	5.02	3.45	1.55
60	18.24	9.63	3.71	2.61	1.08

ACTUARIAL CERTIFICATION

Age	Years of Service: Female Members				
	1	2	5	8	10+
20	30.53%	26.40%	20.77%	13.80%	21.48%
30	19.37	16.52	10.89	8.11	8.21
40	16.93	11.74	6.61	4.61	2.39
50	14.57	9.27	5.22	2.87	1.67
60	14.32	9.39	4.66	2.37	0.88

5. Rates of retirement - Sample ages and years of service

Age	Years of Service				
	10-14	20-24	25	30	31+
50	3.00%	4.00%	7.00%	17.50%	12.50%
55	3	6	16.25	17.5	12.5
60	7	23.75	26.75	35	30
62	30	40	43	55	50
65	30	30	33	35	30
66+	30	30	33	35	30

6. Mortality rates - 1994 GAM - Static, Projected to 2005 with Projection Scale AA, with no setback.
7. Mortality rates after disability - Post disablement mortality rates are based on experience of other large public sector system and ASRS' own experience.
8. Valuation assets - Market value less ten year phase-in of Excess (Shortfall) Investment income.
9. Funding method - Projected unit-credit.

Qualified actuaries have performed the actuarial calculations in accordance with accepted actuarial procedures, based on the current provisions of the Plan and on the actuarial assumptions adopted by the Board.

ASRS prepared all trend data schedules in the financial section and the supporting schedules in the actuarial section of its Comprehensive Annual Financial Report.



Charles E. Chittenden, FSA, EA, MAAA
Principal and Consulting Actuary

ACTUARIAL VALUATION OF THE PLAN AS OF JUNE 30, 2004

October 4, 2005

Retirement Board
Arizona State Retirement System
3300 North Central Avenue
14th Floor
Phoenix, Arizona 85012

Dear Retirement Board Members:

We certify that the information contained in the attached 2004 actuarial valuation report is accurate and fairly presents the actuarial position of the Arizona State Retirement Plan (the Plan) as of June 30, 2004.

We have made all calculations for this report in conformity with generally accepted actuarial principles and practices, and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion, the report's results comply with the requirements of the Arizona Constitution and statutes and, where applicable, the Internal Revenue Code, the Employee Retirement Income Security Act of 1974 (ERISA), and the Statements of the Governmental Accounting Standards Board. The undersigned actuaries are independent. They are both Enrolled Actuaries and Fellows of the Society of Actuaries. Eva Yum is a Fellow of the Canadian Institute of Actuaries and Charlie Chittenden is a member of the American Academy of Actuaries. Both are experienced in performing valuations for large public retirement systems.

Actuarial Valuations

The primary purpose of the valuation report is to determine the required member and employer contribution rates, to describe the current financial condition of the Plan, and to analyze changes in the Plan's condition. In addition, the report provides information that ASRS requires in connection with Governmental Accounting Standards Board Statement Number 25 (GASB No. 25), and it summarizes census data.

Valuations are performed annually, as of June 30, the last day of both the Plan year and ASRS' fiscal year.

Funding Objectives

The actuarial valuation calculates the contribution rates payable by members and participating employers. These rates, when applied to payroll, yield contribution amounts sufficient to provide for the normal cost and to amortize the Unfunded Actuarial Accrued Liability (UAAL) over the period specified in the statutes. The rates calculated in even numbered years are in effect

ACTUARIAL VALUATION OF THE PLAN AS OF JUNE 30, 2004

for the next two Plan years. For example, the rate calculated in June 30, 2004 valuation report (7.75 percent for each member and each employer) will apply in the fiscal years beginning July 1, 2005, and July 1, 2006. The rates calculated in odd-numbered years are purely advisory until June 2008.

Funding Progress

The actual contribution rate in fiscal 2004 and 2005 is 5.20 percent for each member and each employer, as the 2002 valuation report calculated. This 2003 valuation calculates a hypothetical rate of 6.96 percent. This 2004 valuation calculates a rate of 7.75 percent, to become effective July 1, 2005. These rates do not include contributions to the LTD program. Actual contributions have matched the calculated contributions in recent years and we assume that members and employers will continue to contribute the actuarially determined amounts. Contributing these amounts ensures the realization of funding objectives.

Section 38-737 specifies that the UAAL is to be amortized over a rolling 30-year period once the surplus disappears. As of June 30, 2003, the ASRS Plan no longer has a surplus, so the amortization period for this valuation (and all future valuations) is 30 years.

Benefit Provisions

This valuation reflects two changes in Plan provisions:

- ♦ The legislature changed the basis for service purchase calculations to actuarial present value, instead of average normal cost, and
- ♦ The Board reduced the interest rate to be credited on withdrawn contributions from 8 percent to 4 percent, effective for withdrawals after June 30, 2005.

Section 11 gives details of benefit provisions.

Assumptions and Methods

We performed an experienced study for the five-year period ended June 30, 2002, and recommended assumption changes based on the findings. On November 21, 2003, the Board adopted our recommended actuarial assumptions, to be effective June 30, 2003. On November 15, 2002, the Board adopted a change in the method of valuing actuarial assets - namely, the Board removed the requirement that actuarial assets be within 20 percent of market value and prospectively changed the period for recognizing investment gains or losses from five to ten years. Section 9 of this report provides details of the assumptions and methods. The assumptions are internally consistent and are reasonably based on the actual experience of the Plan. These assumptions are in full compliance with GASB No. 25.

ACTUARIAL VALUATION OF THE PLAN AS OF JUNE 30, 2004

Data

ASRS staff supplied census data for retired, active, and inactive participants as of June 30, 2004. We have not audited these data, but have examined them for reasonableness and consistency with the prior year's data. ASRS staff also supplied asset information.

Trend Data and Supporting Schedules

ASRS prepared all trend data schedules in the financial section of ASRS' *Comprehensive Annual Financial Report* (CAFR). ASRS also prepared all supporting schedules in the actuarial section of the CAFR.

We look forward to discussing this report with you at your convenience.

Sincerely,



Charles E. Chittenden, FSA, MAAA, EA
Principal and Consulting Actuary



Eva S. Yum, FSA, EA
Director and Consulting Actuary

GENERAL ACTUARIAL INFORMATION

The following charts will serve to indicate some of the more important statistics regarding the retirement program; each chart will identify each membership category separately where possible.

As of June 30, 2004

Active Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of members (active)	44,589	65,967	94,926	205,482
Average age	45.4	44.0	44.8	44.7
Average annual salary	\$35,461	\$40,253	\$29,775	\$34,372
Average years of service	9.1	10.2	7.2	8.6

As of June 30, 2004

Retired Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of retirees	17,591	21,276	30,064	68,931
Average age	70.3	67.8	69.8	69.3
Average monthly benefit	\$1,307	\$2,124	\$1,141	\$1,487
Average years of service	17.6	23.5	16.9	19.1

Of all plan retirees at July 1, 2004, 56.8 percent received annuities of \$1,000 or more per month. 9.8 percent receives less than \$300 per month. Of the retirees 15.4 percent are less than 60.0 years old and 53.4 percent are less than 75.

One of the most critical factors bearing on retirement costs is that of changes in the average salary level of active participants. The following chart will show, for five fiscal years (fiscal year ending June 30, 2004), the average salary level for state employees, for teachers, and for political subdivision employees other than teachers, and the average for all groups combined.

	1999-00	2000-01	2001-02	2002-03	2003-04
State employees	\$31,380	\$32,392	\$33,746	\$35,262	\$35,461
Teachers	\$35,356	\$36,634	\$39,302	\$40,119	\$40,253
Political subdivision employees	\$25,924	\$27,116	\$28,470	\$29,181	\$29,775
All groups	\$30,163	\$31,281	\$33,130	\$33,998	\$34,372

GENERAL ACTUARIAL INFORMATION

Financing Objective

The financing objective of the Arizona State Retirement System is to maintain reasonable stable contribution rates and to achieve an ultimate funded status of 100 percent. As of June 30, 2004, the date of the most recent actuarial valuation, this funding level is 91.2 percent. When the present actuarial asset of \$23.642 billion is compared to the actuarial liabilities, the asset side of the actuarial balance sheet is below the amount of actuarial liabilities by the amount of \$2.275 billion.

A statutory change effective in 1998 requires that an actuarial valuation be performed only following even-numbered years, rather than annually. This biannual valuation recommends contribution rates for a two-year period. Effective July 1, 2005, additional statutory changes require annual valuations after fiscal year ended June 30, 2007. The 2004 valuation determined a contribution rate of 7.75 percent, which would have applied for fiscal years ended June 30, 2006 and June 30, 2007. The legislature set the rates for these two years at 6.9 percent and 8.6 percent respectively, so that the same total contribution rate, 15.5 percent, would be paid during the biennium. The contribution rates recommended in the valuation for the fiscal year ended June 30, 2004 will remain in effect through the fiscal year that ends June 30, 2005. These rates are described below.

Normal Costs and Required Contribution Rates

The Plan's normal cost for fiscal year (FY) 2003-2004 is 13.02 percent and for FY 2002-2003 is 13.03 percent. The normal cost represents the present value cost, expressed as a percentage of pay, of the current level of benefits provided by the Plan. The Plan has a positive unfunded actuarial accrued liability (an actuarial deficit), which is treated as a debit on the Plan's required contribution rate. Because of the actuarial deficit, the required contribution rate is higher than the normal cost. If the actuarial value of assets and liabilities was equal, the required contribution rate would be the same as the normal cost. Components of the normal cost are as follows:

Retirement benefits	9.73%
Health insurance premium supplement	0.72
Survivor benefits	0.29
Withdrawals	0.83
Long-term disability benefit	0.33
Total, normal cost	11.90
Amortization of the UAAL	(1.50)
Required contribution rate for 2003/2004	10.40%
Shared by employee and employer	
Required contribution rate for 2003/2004	10.40%
Shared by employee and employer	Divided by 2
Required matching contribution rate	5.20%

GENERAL ACTUARIAL INFORMATION

Asset Valuation

The ASRS actuary determines the actuarial value of assets by recognizing investment gains and losses over a period of time. For gains and losses that occurred before fiscal 2002, the period is five years. For gains and losses that occurred in fiscal 2002, or later years, the period is ten years. The gradual recognition of investment gains and losses reduces volatility in the year-to-year level of contribution rates.

Long-Term Disability Benefit

In addition to pension, health insurance, and survivor benefits, the ASRS also offers a long-term disability benefit.

Effective October 1, 1995, to comply with Internal Revenue Code requirements, liabilities associated with the long-term disability benefit were separated from the Plan. No assets were transferred to the LTD fund. Accordingly, the objectives of the funding method that the Board adopted for the LTD program have been:

- ♦ To produce a positive cash flow
- ♦ To maintain reasonably stable contribution rates
- ♦ To build up the assets gradually

The funding method splits the liability for all incurred LTD claims at the valuation date into Current Costs and Amortization components, as explained below:

Current Cost Component

This component equals expected cash payments for benefits and expenses for the 12-month period following the valuation date, less expected income from LTD assets for that period.

Amortization Component

This component equals an amortization payment for the excess of the total liability for LTD claims expected to be paid more than one year after the valuation date over the market value of LTD assets. The amortization period is a rolling 15-year period.

The LTD contribution rate for fiscal year 2004 and fiscal year 2003 is 1.00 percent, shared equally by employees and employers. Of this amount, 0.74 percent funds current liabilities, and 0.26 percent amortizes the liabilities transferred from the Plan in 1995. The program's liabilities are scheduled to be amortized on a rolling 15-year period.

As of June 30, 2004 and June 30, 2003, LTD assets were \$137.9 million, \$110.2 million respectively. Benefit payments were 59.0 million for fiscal year 2004 and 54.7 million for fiscal year 2003.

Excerpt from Table 17 Actuarial Valuation, June 30, 2004

The Arizona State Retirement Plan makes provision for the retirement, disability, and death and survivor benefits to all employees of the State, instrumentalities of the State and certain political subdivisions. The major provisions of the Plan may be summarized as follows:

SUMMARY OF BENEFIT PROVISIONS

A. RETIREMENT BENEFITS

1. Normal Retirement Date (the earliest of the following):

- a) an employee's sixty-fifth birthday,
- b) an employee's sixty-second birthday and completion of at least ten years of credited service, or
- c) the first day immediately following the day that the sum of the employee's age and his years of total credited service equals eighty.

2. Monthly Life Annuity

The product of a benefit multiplier (as determined below) and the participant's best 36-month average compensation (in last 120 months) multiplied by his or her years of total credited service.

Note: Members hired after the effective date of the adoption of the graded multiplier have a maximum benefit equal to 80 percent of their 36-month final average earnings.

Years of Credited Service	Benefit Multiplier
Less than 20	2.10%
20.0 to 24.99	2.15%
25.0 to 29.99	2.20%
30 or more	2.30%

3. Normal Retirement Benefits

The sum of the monthly life annuity and any prior service benefits to which the employee was entitled under the System.

4. Early Retirement

Age 50 with 5 or more years of credited service.

5. Early Retirement Benefits

If not eligible for normal retirement and at least age 50 with 5 years of total credited service, normal retirement benefit earned to the date of retirement, reduced according to the following table:

Provided, however, that if the employee meets the Rule of 77 (but not the Rule of 80), the reduction will be 3 percent for each unit below 80.

Years of Service	Age at Date of Retirement															
	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65
5-10	35%	40%	45%	50%	55%	60%	65%	70%	75%	80%	85%	88%	91%	94%	97%	100%
10-19	44%	49%	54%	59%	64%	69%	74%	79%	84%	89%	94%	97%	100%	100%	100%	100%
20+	50%	55%	60%	65%	70%	75%	80%	85%	90%	95%	100%	100%	100%	100%	100%	100%

SUMMARY OF BENEFIT PROVISIONS

6. Normal Form of Benefit

Straight life annuity payable monthly with benefits commencing on the day following the date of termination of employment.

7. Optional Forms:

- a) joint and contingent annuity (with Pop-up) with either 100 percent, 66-2/3 percent or 50 percent of the reduced retirement income payable for the life of the contingent annuitant upon the death of the retiring participant,
- b) period certain and life annuity with either five or ten years of payments guaranteed,
- c) partial lump sum up to 36 months of benefit and an actuarially reduced remaining benefit, or
- d) social security leveling option combined with any of the other forms of payment.

8. Minimum Benefit

The minimum monthly benefit payable to a retired member who is at least age 75 and who has 20 or more years of service is \$600.

B. DISABILITY BENEFITS (for disability after June 30, 1988)

1. Long Term Disability

Monthly benefit equal to two-thirds of monthly compensation, reduced by any social security disability or workers' compensation benefits, payable commencing six months after date of disability until the earlier of:

- a) date of cessation of total disability, or
- b) normal retirement date.

This benefit is paid by a separate LTD plan.

2. Disability Payments if Participant Remains Disabled Through Normal Retirement Date

Monthly benefit participant would have received if service had continued to normal retirement date assuming the participant's salary remained at the level it was at his or her date of disability, also provided that the amount of total credited service is limited to 30 years unless he or she had more than 30 years at date of disability.

3. The minimum monthly benefit payable to a disabled participant is \$50.00.

C. DISABILITY BENEFITS (for disability before July 1, 1988)

1. Eligibility

SUMMARY OF BENEFIT PROVISIONS

Age 50 with 5 years of service.

2. Benefit Amount

A life annuity that can be provided by the employee's contribution account. Disability payments after normal or early retirement eligibility are reduced by the actuarial value of the disability payments made up to the date of normal or early retirement eligibility.

D. PRE-RETIREMENT DEATH BENEFITS

1. Eligibility

Applicable if death occurs prior to retirement.

2. Benefit

Any one of the following, at the option of the beneficiary:

a) a lump sum equal to the sum of (i) and (ii):

- i) two times participant's contributions to the plan, with interest, and
- ii) the amount of the participant's employee and employer accounts, along with supplemental credits, if any, transferred from the System to the Plan, with interest

b) if (a) is greater than \$5,000, the beneficiary may elect to receive a monthly income for five or ten years certain and life thereafter which is actuarially equivalent to the amount in (a).

3. Death of an Active Participant After 15 Years of Credited Service or After Eligibility for Early Retirement

Beneficiary receives a benefit in the form of a survivor annuity equal to the benefit that would have been payable to the beneficiary if the participant had retired on the date of his or her death and elected to receive an annuity payable in the form of joint and 100 percent survivor with the beneficiary named as the joint pensioner.

E. VESTING OF BENEFITS

1. Vesting

A participant is fully vested in his or her accrued benefit.

2. Benefits Upon Vesting

A fully vested participant is entitled to either:

SUMMARY OF BENEFIT PROVISIONS

- a) the enhanced refund option, or
- b) the retirement benefit payable at normal retirement earned to the date of participant's termination.

The enhanced refund option allows employees who terminate prior to eligibility for retirement to receive a refund of their employee contributions with interest. In addition, if an employee has at least five years of service, he or she is also entitled to a share of the employer contributions with interest. The share is 25 percent for employees with five years of service and increases 15 percent for each additional year of service up to a maximum of 100 percent for ten or more years of service. The Board reduced the interest rate to be credited on refund of contributions from 8 percent to 4 percent, effective June 30, 2005.

F. RETIREE HEALTH INSURANCE PREMIUM SUPPLEMENT

1. Eligibility

Retirement or disability after 5 years of credited service and covered by an employer-sponsored group insurance program for which the retired or disabled member must pay part of the cost. Employees who elect the enhanced refund option are not eligible for this benefit.

2. Benefit

The benefit is payable only with respect to allowable health insurance premiums for which the participant is responsible. The maximum benefits for participants with 10 or more years of service are:

- a) with respect to premiums paid for retirees with member only coverage:
 - \$150 per month if the retiree is under age 65
 - \$100 per month if the retiree is 65 or over
- b) with respect to premiums paid for retirees with family coverage:
 - \$260 per month if the member and dependents are under age 65
 - \$170 per month if the member and dependents are 65 or over
 - \$215 per month if the member is over age 65 and the dependent is under age 65
 - \$215 per month if the member is under age 65 and the dependent is over age 65

For employees with five to nine years of service the benefits are the same dollar amounts as above multiplied by a vesting fraction equal to 10 percent for each completed year of service (i.e., 50 percent to 90 percent).

SUMMARY OF BENEFIT PROVISIONS

See Section W for a discussion of the temporary benefit payable to retirees in "Rural" coverage areas.

G. AUTOMATIC COST OF LIVING ADJUSTMENT BASED ON EXCESS INVESTMENT EARNINGS

1. Permanent Benefit Increase (PBI)

Retirees who have been retired one year and LTD members are eligible for a COLA up to a maximum aggregate of a 4 percent increase. The COLA is paid from a reserve of "Excess Investment Earnings." If there are no "Excess Investment Earnings" in reserve then no COLA is paid.

2. Permanent Benefit Increase Enhancement

Provides retired members with at least ten years of service who have been retired five or more years an additional benefit. For each complete 5-year period the member has been retired an incremental benefit is paid if monies to pay the benefit are available. This benefit is funded by an interest credit of 8.0 percent of the reserve for future PBIs.

H. EMPLOYEE AND EMPLOYER CONTRIBUTIONS

The contribution rate for the biennium beginning on July 1st of the odd numbered year is based on the results of the most recent actuarial valuation as of the last day of the even numbered plan year preceding the biennium. Participants' contribution rate is equal to the required employer contribution rate. For the biennium July 1, 2003 to June 30, 2005, the required contribution rate is 5.20 percent. For the biennium July 1, 2005 to June 30, 2007, the actuarially determined contribution rate is 7.75 percent. By legislation the contribution rates will be 6.90 percent for FYE June 30, 2006 and 8.60 percent for FYE June 30, 2007.

I. LEGISLATED PLAN CHANGES ENACTED BY THE 1989 LEGISLATURE OF THE STATE OF ARIZONA

1. Projected United Credit (PUC) Funding Method

Beginning with the June 30, 1989 actuarial valuation, the total employee and employer contributions payable beginning July 1, 1990 shall be determined using the Projected Unit-Credit (PUC) funding method.

2. \$12,000 Minimum Average Compensation for Current Retirees

Recalculation of the retirement benefit for all plan members retired before June 30, 1989 who had 10 years of credited service using a minimum average compensation of one thousand dollars per month.

SUMMARY OF BENEFIT PROVISIONS

3. 2.0 Percent Ad Hoc COLAs

Effective July 1, 1989, all members retired on or before June 30, 1988 shall receive a 2.0 percent permanent benefit increase to their December 31, 1988 base benefit.

Effective July 1, 1990, all members retired on or before June 30, 1989 shall receive a 2.0 percent permanent benefit increase to their June 30, 1990 base benefit.

4. Early Retirement Window

During the period of May 15, 1989 through November 14, 1989 a member who is eligible for either Normal Retirement or Early Retirement with age plus credited service at least equal to 80, may retire and receive a benefit calculated using a 2.2 percent multiplier instead of the 2.0 percent multiplier in effect at that time.

5. 3.0 Percent Tax Equity Allowance

Retroactive to the later of January 1, 1989 or the date payments commence, each member retiring on or before September 14, 1989 shall receive a tax equity benefit allowance consisting of a permanent increase of 3.0 percent in his or her January 1, 1989 base benefit.

J. LEGISLATED PLAN CHANGES ENACTED BY THE 1990 LEGISLATURE OF THE STATE OF ARIZONA

1. Rule of 82

Effective May 1, 1990, the number of points (sum of member's age and years of service) required to be eligible for normal retirement shall be reduced from 85 to 82. Also, the early retirement reduction factor for employees with 77 or more points but less than 82 points shall be 3 percent for each point or fraction thereof less than 82.

2. 3.0 Percent Tax Equity Allowance

Each member who retires between September 15, 1989 and September 14, 1990 shall receive a tax equity benefit allowance consisting of a permanent increase of 3.0 percent in his or her base benefit, retroactive to the date of retirement.

3. Graded Vesting for Health Insurance Premium Supplement

The Health Insurance Premium Supplement is extended to those qualifying members with between five and nine years of service. The member will be eligible to receive 10 percent of the benefit for each completed year of service (i.e., 50 percent to 90 percent).

SUMMARY OF BENEFIT PROVISIONS

K. LEGISLATED PLAN CHANGES ENACTED BY THE 1991 LEGISLATURE OF THE STATE OF ARIZONA

1. 3.0 Percent Tax Equity Allowance

Each member who retires between September 15, 1990 and September 14, 1991 shall receive a tax equity benefit allowance consisting of a permanent increase of 3.0 percent in his or her base benefit, retroactive to the date of retirement.

2. Recalculation of Retiree Benefits Using 2.0 Percent Benefit Multiplier

Each retired member with at least 10 years of service who retired prior to June 30, 1985 shall have his or her benefit recomputed. The recomputed benefit shall be equal to 2 percent times final average earnings times credited service plus an additional \$2 for each year of service. The retired member will receive the larger of the recalculated benefit or his/her current benefit. This increase is effective October 1, 1991.

3. 2.3 Percent Ad Hoc Increase

Effective July 1, 1991 all members retired on or before June 30, 1990 shall receive a 2.3 percent permanent benefit increase in their June 30, 1991 base benefit.

4. Rule of 80

Effective July 1, 1992, the number of points (sum of member's age and years of service) required to be eligible for normal retirement shall be reduced from 82 to 80. (For continuation purposes this legislation is not reflected until the 1993/94 fiscal year).

5. Pop-up Option

A pop-up option is added for retiring members who first participate in the Plan on or after December 31, 1991.

L. LEGISLATED PLAN CHANGES ENACTED BY THE 1992 LEGISLATURE OF THE STATE OF ARIZONA

1. 3.0 Percent Tax Equity Allowance

Each member who retires between September 15, 1991 and September 14, 1992 shall receive a tax equity benefit allowance consisting of a permanent increase of 3.0 percent in his or her base benefit, retroactive to the date of retirement.

2. Minimum Retiree Benefit

Each retiree of the Arizona State Retirement Plan who is at least age 75 on December 31, 1992 and who had at least ten years of service upon retirement from the plan ten years of service upon retirement from the plan shall be eligible for a minimum benefit. If the eligible retiree had at least ten years of service but less than fifteen years, his minimum benefit is \$350 a month. If the eligible retiree had at least fifteen years of

SUMMARY OF BENEFIT PROVISIONS

service but less than twenty, his minimum benefit is \$500. If the eligible retiree had at least twenty years of service his minimum benefit is \$600. The minimum benefit shall be compared to the retiree's current benefit (including all ad hoc increases).

3. 5 Percent Ad Hoc Increase

Effective November 1, 1992 all members retired on or before October 31, 1992 shall receive a 5 percent permanent benefit increase in their October 31, 1992 benefit.

4. Forfeited Service Repurchase

Any present active member who has previously forfeited service has until December 31, 1994 to repurchase the forfeited service by paying the Plan the employee and employer contributions (accumulated with interest) which would have been contributed during the member's period of forfeited service.

5. Repurchase of Service Due to Reduction in Force

Any present active member who was terminated prior to December 31, 1992 as a result of a required reduction in force may purchase the credited service for the following period of unemployment if the member had five or more years of service at the time of termination and resumed employment with a participating employer within two years of termination. The cost of the repurchase is the total of the employee and employer contribution (accumulated with interest) which would have been contributed during the member's period of unemployment.

6. Change in Section 38-781.05 Funding Method

Section 38-781.05 of the plan was amended so that the funding period for the Plan would continue to be the period between valuation and June 30, 2003 as long as the Plan has a negative Unfunded Actuarial Accrued Liability. If the Plan were to have a positive UAAL, then the old funding mechanism would apply.

M. LEGISLATED PLAN CHANGES ENACTED BY THE 1993 LEGISLATURE OF THE STATE OF ARIZONA

1. No benefit changes were passed by the 1993 Legislature. However, the Legislature passed legislation to reduce the required contribution rate of 4.09 percent down to 3.14 percent.

N. LEGISLATED PLAN CHANGES ENACTED BY THE 1994 LEGISLATURE OF THE STATE OF ARIZONA

1. Minimum LTD Benefit

Each member on long term disability will receive a minimum monthly benefit of \$50.

SUMMARY OF BENEFIT PROVISIONS

2. Minimum Retiree Benefit

Each retiree of the Arizona State Retirement Plan who is at least age 75 and who had 20 or more years of service at retirement will receive a minimum monthly benefit of \$600.

3. Pop-up Benefit

Members who retired prior to January 1, 1992 and who elected a Joint and Survivor option shall receive a "Pop-up" in their retirement income if their beneficiary predeceases them.

4. Excess Investment Earnings COLA

Retirees at least age 55 who have been retired at least one year and members on long-term disability are eligible to receive a cost-of-living adjustment equal to one-half the increase in CPI for the prior calendar year. The COLA will be paid from a reserve of Excess Investment Earnings. If there are no Excess Investment Earnings in reserve, no COLA will be granted.

5. Change in Section 38-737 Funding Period

Section 38-737 was amended to change the funding period of the Plan to a rolling 30-year period. The change is to be phased-in over the next nineteen years. If the Plan ceases to have a surplus, the funding period would immediately go to 30-years.

O. LEGISLATED PLAN CHANGES ENACTED BY THE 1995 LEGISLATURE OF THE STATE OF ARIZONA

1. Change in Maximum Increase Provided by Excess Investment Earnings COLA

The maximum COLA payable from Excess Investment Earnings was increased from 50 percent to 100 percent of the increase in the CPI.

2. Removal of LTD Benefit from the Plan

The Legislature established a new LTD program and removed the LTD benefit from the Plan. Liabilities for current LTD recipients will be transferred to the new LTD program effective October 1, 1995.

3. Creation of Separate Account for the Health Premium Supplement

The Health Premium Supplement benefit is to be separated into a 401(h) account. The assets and liabilities associated with the Health Premium Supplement will be accounted for separately.

SUMMARY OF BENEFIT PROVISIONS

P. LEGISLATED PLAN CHANGES ENACTED BY THE 1996 LEGISLATURE OF THE STATE OF ARIZONA

1. No material changes.

Q. LEGISLATED PLAN CHANGES ENACTED BY THE 1997 LEGISLATURE OF THE STATE OF ARIZONA

1. Creation of family Health Supplement. Allows unused portion of the Health Supplement of a member or dependent to be used to pay the other recipient's health insurance premium.
2. The calculation methodology for the Excess Investment Earnings COLA was modified.
3. The contribution rate will be determined on a biennial cycle beginning with the 2000 fiscal year.

R. LEGISLATED PLAN CHANGES ENACTED BY THE 1998 LEGISLATURE OF THE STATE OF ARIZONA

1. No material changes.

S. LEGISLATED PLAN CHANGES ENACTED BY THE 1999 LEGISLATURE OF THE STATE OF ARIZONA

1. Enhanced Refund Option

Employees who terminate prior to eligibility for retirement may elect to receive a refund of their employee contributions with interest. If the employee has at least five years of service, the employee is also entitled to a share of the employer contributions with interest. The share is 50 percent with five years of service and increases 10 percent for each additional year of service to a maximum of 100 percent for ten or more years of service.

2. Benefit Multiplier Increased to 2.1 percent

The benefit multiplier increased from 2.0 percent to 2.1 percent effective July 1, 2000.

3. 5 Percent Ad Hoc Increase

A 5 percent retiree ad hoc increase for retirees and beneficiaries effective July 1, 2000.

SUMMARY OF BENEFIT PROVISIONS

4. Increase in Maximum Service While on LTD

Increase in the maximum amount of service that may be accrued while on LTD from 25 to 30.

5. Changes in Permanent Benefit Increase COLA

- a) The maximum aggregate COLA was increased from 3 percent to 4 percent.
- b) The threshold for determining "Excess Earnings" was lowered from 9 percent to 8 percent.
- c) The limitation of the COLA to the increase in the CPI was removed.

T. LEGISLATED PLAN CHANGES ENACTED BY THE 2000 LEGISLATURE OF THE STATE OF ARIZONA

1. The age restriction on the Permanent Benefit Increase was eliminated.

U. LEGISLATED PLAN CHANGES ENACTED BY THE 2001 LEGISLATURE OF THE STATE OF ARIZONA

1. Health Insurance Premium Benefit Increase

Increases the health insurance premium benefit for eligible members as follows:

- ♦ Benefit for Medicare eligible member with member only coverage increased from \$65 to \$100
- ♦ Benefit for non-Medicare eligible member with member only coverage increased from \$95 to \$150
- ♦ Benefit for family coverage where member and dependent are non-Medicare eligible increased from \$175 to \$260
- ♦ Benefit for family coverage where member and dependent are Medicare eligible increased from \$115 to \$170
- ♦ Benefit for family coverage where member is Medicare eligible and dependent is non-Medicare eligible increased from \$145 to \$215
- ♦ Benefit for family coverage where member is non-Medicare eligible and dependent is Medicare eligible increased from \$145 to \$215

SUMMARY OF BENEFIT PROVISIONS

2. Graded Multiplier

Provides a graded multiplier in the retirement benefit formula, increasing with years of service according to the following:

0.00 to 19.99 Years of Service	2.10%
20.00 to 24.99 Years of Service	2.15%
25.00 to 29.99 Years of Service	2.20%
30.00 or More Years of Service	2.30%

3. Employer Option Service Purchase Incentive

Permits an employer to offer a member who is eligible to retire under the Rule of 80 a contract to work an additional three years of employment. No contributions are made to ASRS during the contract. If the employee completes the contract, then they receive an additional three years of service with the option to purchase three more years of service.

4. Permanent Benefit Increase Enhancement

Provides that interest at a rate of 8% be credited on the funds held in reserve for the permanent benefit increase (PBI). This interest will then be used to fund an additional increase for retirees who have at least 10 years of service and who have been retired at least five years. The increase is incremental for each five years of retirement.

5. Temporary Rural Health Insurance Premium Benefit

In addition to the premium benefit paid to ASRS retired and disabled members, the Legislature granted a temporary benefit for retired and disabled members who live in areas of the state not served by a managed care program (HMO) and who have 10 years of credited service in the following amounts:

- ♦ Benefit for Medicare eligible member with member only coverage of \$170 per month
- ♦ Benefit for non-Medicare eligible member with member only coverage of \$300 per month
- ♦ Benefit for Medicare eligible members with Medicare eligible dependent with family coverage of \$350 per month
- ♦ Benefit for non-Medicare eligible members with non-Medicare eligible dependent with family coverage of \$600 per month
- ♦ Benefit for Medicare eligible members with non-Medicare eligible dependent with family coverage of \$470 per month
- ♦ Benefit for non-Medicare eligible members with Medicare eligible dependent with family coverage of \$470 per month

SUMMARY OF BENEFIT PROVISIONS

6. Partial Lump Sum Option

Allows a retiring member to receive a portion of his benefit in a lump sum payment. The lump sum is limited to a maximum of 36 monthly payments. The member's monthly annuity is actuarially reduced to reflect the lump sum payment.

7. Maximum Benefit

Members who are hired after the date the graded multiplier became law have a maximum benefit equal to 80 percent of the member's 36-month final average earnings.

V. LEGISLATED PLAN CHANGES ENACTED BY THE 2002 LEGISLATURE OF THE STATE OF ARIZONA

1. No material changes.

W. LEGISLATED PLAN CHANGES ENACTED BY THE 2003 LEGISLATURE OF THE STATE OF ARIZONA

1. Temporary Rural Health Insurance Premium Benefit

The Legislature extended the additional temporary Rural Health Insurance Subsidy for two years, beginning July 1, 2003 and ending June 30, 2005. The full benefit is provided to retired and disabled members who live in areas of the state not served by a Health Maintenance Organization (HMO) and who have 10 years of credited service. The Rural Health Insurance Subsidy now requires "minimum out-of-pocket" payments ranging from \$100 to \$425 per month, depending on the plan and coverage selected.

Rural Health Insurance Subsidy	Insurance Coverage Without Medicare Parts A & B		Insurance Coverage With Medicare Parts A & B*	
	Single	Family	Single	Family
July 1, 2003-June 30, 2005	Single	Family	Single	Family
Required Minimum Out-of-Pocket Payment	\$125	\$425	\$100	\$200
Rural Health Insurance Subsidy (Maximums)	Up to \$300	Up to \$600	Up to \$170	Up to \$350

*Combination plans that include Medicare eligible and non-Medicare eligible retiree and dependent coverage require a \$400 monthly out-of-pocket payment.

SUMMARY OF BENEFIT PROVISIONS

X. LEGISLATED PLAN CHANGES ENACTED BY THE 2004 LEGISLATURE OF THE STATE OF ARIZONA

1. Service Purchase Program

The Arizona Legislature revised the method of calculating the cost of service purchases, so that future purchases would be made at true actuarial present value.

2. Early Retirement Incentive Programs

The Arizona Legislature provided that employers that participate in ASRS and offer early retirement incentives to their employees must notify ASRS of the incentives. ASRS will determine the cost of the incentives and the employers will pay the cost.

3. Long-Term Disability Program

The Arizona Legislature revised and clarified LTD provisions so that disabled members will be required to participate in rehabilitation programs and to pursue obtaining Social Security disability benefits. In addition, the legislation limited the receipt of disability benefits on the basis of a member's "own occupation" to 24 months, rather than to 24 consecutive months.

**STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
USED IN DETERMINING COST**

(ADOPTED BY BOARD ACTION ON NOVEMBER 21, 2003)

EFFECTIVE AS OF JUNE 30, 2003

A. ACTUARIAL ASSUMPTIONS

1. Investment Yield Rate 8% per annum, compounded annually

2. Mortality

a) Pre-retirement 1994 GAM - Static Table, Projected to 2005 with Projected Scale AA, with no age setback. Rates at representative ages are shown below.

RATES OF MORTALITY (ACTIVE)

Age	Male Participants	Female Participants
20	0.000411	0.000238
25	0.000592	0.000249
30	0.000758	0.000314
35	0.000805	0.000423
40	0.000981	0.000600
45	0.001366	0.000815
50	0.002112	0.001183
55	0.003583	0.002100
60	0.006679	0.004201
65	0.012447	0.008173
70	0.020095	0.012993

b) Post-retirement Non Disabled rates are based on the 1994 GAM - Static Table, Projected to 2005 with Projection Scale AA with no age setback. Disabled rates are based on the experience of other large public sector retirement systems and ASRS' own experience. Rates at representative ages are shown below:

**STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
USED IN DETERMINING COST**

(ADOPTED BY BOARD ACTION ON NOVEMBER 21, 2003)
EFFECTIVE AS OF JUNE 30, 2003

RATES OF MORTALITY

Age	Non-Disabled	Disabled	Non-Disabled	Disabled
	Male Participants		Female Participants	
20	0.000411	0.034940	0.000238	0.026939
25	0.000592	0.038887	0.000249	0.027444
30	0.000758	0.051102	0.000314	0.038302
35	0.000805	0.063544	0.000423	0.053927
40	0.000981	0.058807	0.000600	0.056984
45	0.001366	0.040921	0.000815	0.037586
50	0.002112	0.034742	0.001183	0.025696
55	0.003583	0.031356	0.002100	0.022836
60	0.006679	0.031109	0.004201	0.018029
65	0.012447	0.030861	0.008173	0.013934
70	0.020095	0.033730	0.012993	0.012993

3. Disability Rates

Sample rates are shown below.

RATES OF DECREMENT DUE TO DISABILITY

Age	Male Participants	Female Participants
20	0.000575	0.000734
25	0.000638	0.000804
30	0.000730	0.001014
35	0.001096	0.001563
40	0.002111	0.002111
45	0.003358	0.003171
50	0.005128	0.004865
55	0.007715	0.007022
60	0.011992	0.010913

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
 USED IN DETERMINING COST

(ADOPTED BY BOARD ACTION ON NOVEMBER 21, 2003)

EFFECTIVE AS OF JUNE 30, 2003

4. Withdrawal Rates
 (for causes other than death,
 disability, or retirement)

Select and ultimate withdrawal rates are used.
 Rates at representative ages are shown below.

RATES OF DECREMENT DUE TO WITHDRAWAL

Age	Years of Service										
	0	1	2	3	4	5	6	7	8	9	10+
Male Employees											
20	0.3731	0.3642	0.2895	0.2545	0.1508	0.1364	0.0910	0.0840	0.0710	0.0760	0.1277
30	0.2267	0.2055	0.1612	0.1547	0.0917	0.0943	0.0710	0.0680	0.0510	0.0510	0.0565
40	0.1931	0.1698	0.1011	0.1015	0.0601	0.0665	0.0550	0.0540	0.0400	0.0380	0.0227
50	0.1892	0.1692	0.0904	0.0820	0.0458	0.0502	0.0460	0.0350	0.0340	0.0310	0.0155
60	0.2219	0.1824	0.0963	0.0848	0.0445	0.0371	0.0330	0.0330	0.0260	0.0240	0.0108
70	0.2604	0.2282	0.1320	0.1229	0.0616	0.0549	0.0360	0.0310	0.0220	0.0200	0.0180
Female Employees											
20	0.3316	0.3053	0.2640	0.2596	0.2101	0.2077	0.1680	0.1405	0.1380	0.1285	0.2148
30	0.2015	0.1937	0.1652	0.1456	0.1094	0.1089	0.0930	0.0813	0.0811	0.0760	0.0821
40	0.1720	0.1693	0.1174	0.0930	0.0666	0.0661	0.0563	0.0482	0.0461	0.0417	0.0239
50	0.1698	0.1457	0.0927	0.0722	0.0528	0.0522	0.0426	0.0335	0.0287	0.0227	0.0167
60	0.1805	0.1432	0.0939	0.0731	0.0508	0.0466	0.0357	0.0275	0.0237	0.0190	0.0088
70	0.1916	0.1666	0.1199	0.0955	0.0622	0.0508	0.0363	0.0293	0.0311	0.0358	0.0144

5. Salary Scales

A select and ultimate salary scale made up of
 a merit component and general salary increase
 component as follows:

Years of Service	Merit Component	Total Salary Increase*
(1)	(2)	(3)
1	5.00%	9.50%
2	4.00%	8.50%
3	2.50%	7.00%
4	1.80%	6.30%
5	1.40%	5.90%
6	1.25%	5.75%
7	1.00%	5.50%
8	0.80%	5.30%
9	0.75%	5.25%
10	0.50%	5.00%
11 to 19	0.25%	4.75%
20 or more	0.00%	4.50%

*Total salary increase rate = inflation (or growth) rate (4.25%) + productivity increase rate (0.25%) + merit component

**STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
USED IN DETERMINING COST**

(ADOPTED BY BOARD ACTION ON NOVEMBER 21, 2003)

EFFECTIVE AS OF JUNE 30, 2003

- 6. Retirement Age:** Select and ultimate retirement rates are used. Rates at representative ages and years of service are shown below:

Rates of Decrement Due to Retirement

Age	Years of Service								
	0-4	5-9	10-14	15-19	20-24	25	26-29	30	31+
50	0.0000	0.0200	0.0300	0.0350	0.0400	0.0700	0.0625	0.1750	0.1250
55	0.0000	0.0200	0.0300	0.0350	0.0600	0.1625	0.1300	0.1750	0.1250
60	0.0000	0.0400	0.0700	0.0900	0.2375	0.2675	0.2000	0.3500	0.3000
62	0.0000	0.0500	0.3000	0.3400	0.4000	0.4300	0.4000	0.5500	0.5000
65	0.0300	0.1000	0.3000	0.3000	0.3000	0.3300	0.3000	0.3500	0.3000
66+	0.0300	0.1000	0.3000	0.3000	0.3000	0.3300	0.3000	0.3500	0.3000

7. Future Retirees Eligible for the Health Insurance Premium Supplement

It is assumed that 75 percent of future retirees will be eligible to receive the post-retirement health insurance premium supplement and that 60 percent of those retirees will be eligible for the dependent premium supplement.

8. Proportion of Vested Termination Members Who Will Not Withdraw Their Contributions

It is assumed that members who terminate with 5 or more years of service (but prior to eligibility for retirement) will choose to receive the enhanced refund option if the value of the enhanced refund option is greater than the present value of the deferred benefit, otherwise the employees are assumed to elect to receive the deferred benefit. If the employee is assumed to elect the enhanced refund option, then it is also assumed that the employee forfeits the supplement.

Employees who terminate with less than five years of service are assumed to withdraw their employee contributions with interest.

Employees who terminate eligible for early retirement are assumed to commence payments.

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
USED IN DETERMINING COST

(ADOPTED BY BOARD ACTION ON NOVEMBER 21, 2003)

EFFECTIVE AS OF JUNE 30, 2003

9. Service Purchase

Members can buy service at average normal cost rate, although members who buy service are above average in age. We assume a load of 2.15 percent on years of credit service earned per year.

B. Actuarial Value of Assets

The actuarial value of assets is equal to the market value of assets less a ten-year phase-in (five-year phase-in prior to June 30, 2002) of the Excess (Shortfall) between expected investment return and actual income.

C. Actuarial Funding Method

Costs are determined under the projected unit-credit method. The unfunded actuarial accrued liability is funded on a level dollar basis over the period of time described in Section 38-737. For the June 30, 2003 actuarial valuation, the period is 30 years.

Schedule of Plan Active Member Valuation Data

Last 6 Years

Valuation As of June 30	Contributing Active Members			Increase in Average Pay
	Number	Annual Payroll	Annual Average Pay	
1999	176,368	\$5,487,933,600	\$31,116	3.0%
2000	183,924	5,750,294,662	31,265	0.0
2001	191,252	6,356,698,800	33,237	3.7
2002	198,970	6,989,339,000	35,128	5.7
2003	202,398	7,296,827,756	36,052	2.6
2004	205,482	7,485,590,038	36,429	1.0

Schedule of Plan Retirees Added To and Removed From Rolls

Last 6 Years

Year Ended	Retirants and Beneficiaries Added to Rolls	Retirants and Beneficiaries Removed from Rolls	Retirants and Beneficiaries End of Year	Percentage Increase in Annual Benefits	Average Benefit
1999	4,380	1,193	55,104	4.3%	\$12,288
2000	4,822	1,888	58,038	9.9	13,500
2001	4,224	3,342	58,920	7.6	14,532
2002	3,954	2,528	60,346	13.2	16,457
2003	5,955	1,604	64,697	2.2	16,812
2004	6,430	2,196	68,931	6.1	17,844

Schedule of Unfunded (Over) Accrued Liabilities - Plan
Last 10 Years

Year Ended June 30	Aggregate Accrued Liabilities Plan	Actuarial Value of Net Plan Assets	Assets as a % of Accrued Liabilities Plan	Unfunded (over) Accrued Liabilities Plan (UAL)	Active Member Payroll	UAL as a % of Active Member Payroll
1995	\$10,303,617,000	\$11,520,933,300	112%	(\$1,217,316,300)	\$4,228,264,800	(28.8%)
1996	11,110,688,400	12,578,870,100	113	(1,468,181,700)	4,465,496,000	(32.9)
1997	12,385,445,400	14,169,191,400	114	(1,783,746,000)	4,674,843,500	(38.2)
1998	13,638,356,506	16,168,476,400	119	(2,530,119,894)	4,968,476,529	(50.9)
1999	16,121,899,529	18,760,959,854	116	(2,639,060,325)	5,487,933,600	(48.1)
2000	17,548,523,131	21,126,877,491	120	(3,578,354,360)	5,750,294,662	(62.2)
2001	20,268,514,444	22,855,143,539	113	(2,586,629,095)	6,356,698,800	(40.7)
2002	22,586,920,751	23,623,015,969	105	(1,036,095,218)	6,989,339,000	(14.8)
2003	24,303,639,447	23,516,898,511	97	786,740,936	7,296,827,756	10.8
2004	25,918,329,505	23,642,904,763	91	2,275,424,742	7,485,590,038	30.4

Solvency Test

Last 10 Years

Year Ended June 30	Aggregate Accrued Liabilities for			Net Assets Available for Benefits	Portion of Accrued Liabilities Covered by Net Assets Available for Benefits		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed Portion)		(1)	(2)	(3)
1995	\$2,465,878,000	\$4,257,018,600	\$3,580,720,400	\$11,520,933,300	100%	100%	134.0%
1996	2,422,775,000	4,740,637,300	3,947,275,600	12,578,870,100	100	100	137.2
1997	2,442,205,300	5,122,420,700	4,820,819,400	14,169,191,400	100	100	137.0
1998	2,571,206,900	5,530,497,100	5,536,652,506	16,168,476,400	100	100	145.7
1999	2,679,011,640	6,454,089,795	6,988,798,093	18,760,959,854	100	100	137.8
2000	2,758,428,341	8,817,967,086	7,233,553,039	21,126,877,491	100	100	132.0
2001	2,876,445,119	9,589,562,912	7,427,960,808	22,855,143,539	100	100	139.8
2002	3,046,008,125	10,597,364,389	8,943,548,237	23,623,015,969	100	100	112.0
2003	3,110,690,039	11,428,652,014	9,764,297,394	23,516,898,511	100	100	91.9
2004	3,407,611,954	12,421,950,646	10,088,766,905	23,642,904,763	100	100	77.4

Schedule of Recommended vs. Actual Plan Contributions

Last 10 Years

Year Ended June 30	Active Member Payroll	Employee Contributions	Employer Retirement Contribution Rate - Actual	Actuary Recommended Contribution
1995	\$4,432,000,000	\$158,559,931	3.75%	3.75%
1996	4,632,000,000	150,854,417 *	3.36	3.95
1997	4,836,000,000	150,500,186 *	3.20	3.20
1998	5,164,000,000	152,375,838 *	3.05	3.05
1999	5,488,000,000	152,916,525	2.85	2.85
2000	5,750,000,000	124,930,657	2.17	2.17
2001	6,564,000,000	133,504,099	2.00	2.00
2002	6,989,000,000	135,274,945	2.00	2.00
2003	7,297,000,000	142,356,325	5.20	5.20
2004	7,486,000,000	377,436,100	5.20	5.20

* Excludes contributions of \$884,669, \$905,200 and \$926,800 for ASRS System members who contributed 7.49 percent during 1998, 1997 and 1996 respectively.

Analysis of Financial Experience for the Plan

Last 10 Years

(In Millions)

Year Ended June 30	Unfunded Actuarial Liability (UAAL), Prior Year	Normal Cost for the Year	Contributions for the Year	Interest at 8% on UAAL	On Normal Cost	On Contributions	Total	Expected UAAL	Actual UAAL	Gain (Loss) for the Year
1995	(\$872.43)	\$448.92	(\$324.93)	(\$69.79)	\$35.91	(\$13.00)	(\$46.88)	(\$795.31)	(\$1,217.32)	\$422.01
1996	(1,217.32)	460.39	(299.72)	(97.39)	36.83	(11.99)	(72.54)	(1,129.19)	(1,468.18)	338.99
1997	(1,468.18)	482.42	(309.39)	(117.45)	38.59	(12.38)	(91.24)	(1,386.39)	(1,783.75)	397.36
1998	(1,783.75)	506.17	(321.35)	(142.70)	40.49	(12.85)	(115.06)	(1,713.98)	(2,530.12)	816.14
1999	(2,530.12)	540.46	(347.97)	(202.41)	43.24	(13.92)	(173.09)	(2,510.72)	(2,639.06)	128.34
2000	(2,639.06)	601.15	(283.77)	(211.12)	48.09	(11.35)	(174.38)	(2,496.06)	(3,578.35)	1,082.29
2001	(3,578.35)	631.66	(367.20)	(286.27)	50.53	(14.69)	(250.42)	(3,564.30)	(2,586.63)	(977.67)
2002	(2,586.63)	746.91	(321.78)	(206.93)	59.75	(12.87)	(160.05)	(2,321.54)	(1,036.10)	(1,285.44)
2003	(1,036.10)	831.73	(375.52)	(82.89)	66.54	(15.02)	(31.37)	(611.26)	786.74	(1,397.97)
2004	786.74	950.78	(865.97)	62.94	76.06	(34.64)	104.36	975.91	2,275.42	(1,299.51)



STATISTICAL SECTION



3300 NORTH CENTRAL AVENUE
PHOENIX, ARIZONA 85012

TABLE OF CONTENTS

V. Statistical Section

List of Employers.....	108
Contributions Received	115
Actual Contribution Rates	115
Total Benefit Payments.....	116
Total Reserves for Benefits	117
Non-Retired & Retired Members	118
Revenues by Source	119
Expenses by Type	120
Benefit Payments by Type	120
Average Benefit Payments for Retirees Under the Plan.....	121
Retirement Benefit Options	122
Retired Members by Type of Benefit Options	123

LIST OF EMPLOYERS

Public Schools

Agua Fria UHS Dist. 216
Aguila Elem. Dist. 63
Ajo Unified Dist. 15
Alhambra Elem. Dist. 68
Alpine Elem. Dist. 7
Altar Valley Dist. 51
Amphitheater Unified Dist. 10
Antelope UHS Dist. 50
Apache Elem. Dist. 42
Apache Junction Unified Dist. 43
Arlington Elem. Dist. 47
Ash Creek Elem. Dist. 53
Ash Fork Unified Dist. 31
Avondale Elem. Dist. 44
Bagdad Unified Dist. 20
Balsz Elem. Dist. 31
Beaver Creek Elem. Dist. 26
Benson Elem. Dist. 9
Benson UHS Dist. 9
Bicentennial UHS Dist. 76
Bisbee Unified Dist. 2
Blue Elem. Dist. 22
Blue Ridge Unified Dist. 32
Bonita Elem. Dist. 16
Bouse Elem. Dist. 26
Bowie Unified Dist. 14
Buckeye Elem. Dist. 33
Buckeye UHS Dist. 201
Bullhead City Elem. Dist. 15
Camp Verde Unified Dist. 28
Canon Elem. Dist. 50
Cartwright Elem. Dist. 83
Casa Grande Elem. Dist. 4
Casa Grande UHS Dist. 82
Catalina Foothills Unified Dist. 16
Cave Creek Unified Dist. 93
Cedar Unified Dist. 25
Chandler Unified Dist. 80
Chevelon Butte Elem. Dist. 5
Chinle Unified Dist. 24
Chino Valley Unified Dist. 51
Chloride Elem. Dist. 11
Clarkdale-Jerome Elem. Dist. 3
Clifton Unified Dist. 3
Cobre Valley Institute
Cochise Elem. Dist. 26
Cochise Technology Dist. #01
Coconino Assoc of Vocational and Ind. Tech
Colorado City Unified Dist. 14
Colorado River Union H.S. Dist. 2
Combs (J.O.) Elem. Dist. 44
Concho Elem. Dist. 6
Congress Elem. Dist. 17
Continental Elem. Dist. 39
Coolidge Unified Dist. 21
Cottonwood-Oak Creek Elem. Dist. 6
Crane Elem. Dist. 13
Creighton Elem. Dist. 14
Crown King Elem. Dist. 41
Dan Hinton School
Deer Valley Unified Dist. 97
Double Adobe Elem. Dist. 45
Douglas Unified Dist. 27
Duncan Unified Dist. 2
Dysart Unified Dist. 89
Eagle Elem. Dist. 45
East Valley Technical Institute
Elfrida Elem. Dist. 12
Eloy Elem. Dist. 11
Esperanza Academy Accommodation School
Fisher (Ruth) Elem. Dist. 90
Flagstaff Unified Dist. 1
Florence Unified Dist. 1
Flowing Wells Unified Dist. 8
Ft. Huachuca Accom School
Ft. Thomas Unified Dist. 7
Fountain Hills Unified Dist. 98
Fowler Elem. Dist. 45
Fredonia-Moccasin Unified Dist. 6
Gadsden Elem. Dist. 32
Ganado Unified Dist. 20
Gila Bend Unified Dist. 24
Gila County Special Services
Gila Institute for Technology
Gilbert Unified Dist. 41
Glendale Elem. Dist. 40
Glendale UHS Dist. 205

LIST OF EMPLOYERS

Globe Unified Dist. 1	Nadaburg Elem. Dist. 81
Grand Canyon Unified Dist. 4	Navajo County Accomodation Schools
Hackberry Elem. Dist. 3	Nogales Unified Dist. 1
Hayden-Winkelman Unified Dist. 41	Oracle Elem. Dist. 2
Heber Overgaard USD No. 6	Osborn Elem. Dist. 8
Higley Elem. Dist. 60	Owens Whitney Elem. Dist. 6
Hillside Elem. Dist. 35	Page Unified Dist. 8
Holbrook Unified Dist. 3	Palo Verde Elem. Dist. 49
Humboldt Unified Dist. 22	Paloma Elem. Dist. 94
Hyder Elem. Dist. No. 16	Palominas Elem. Dist. 49
Indian Oasis-Baboquivari 40	Paradise Valley Dist. 69
Isaac Elem. Dist. 5	Parker Unified Dist. 27
Joseph City Unified Dist. 2	Patagonia Elem. Dist. 6
Kayenta Unified Dist. 27	Patagonia UHS Dist. 20
Kingman Elem. Dist. 4	Payson Unified Dist. 10
Kirkland Elem. Dist. 23	Peach Springs Elem. Dist. 8
Klondyke School Dist. 09	Peach Springs High School 7
Kyrene Elem. Dist. 28	Pearce Elem. Dist. 22
Lake Havasu Unified Dist. 1	Pendergast Elem. Dist. 92
Laveen Elem. Dist. 59	Peoria Unified Dist. 11
Liberty Elem. Dist. 25	Phoenix Elem. Dist. 1
Litchfield Elem. Dist. 79	Phoenix UHS Dist. 210
Littlefield Elem. Dist. 9	Picacho Elem. Dist. 33
Littleton Elem. Dist. 65	Pima Unified Dist. 6
Madison Elem. Dist. 38	Pine Elem. Dist. 12
Maine Cons. Elem. Dist. 10	Pinon Unified Dist. 4
Mammoth-San Manuel Unified Dist. 8	Pomerene Elem. Dist. 64
Marana Unified Dist. 6	Prescott Unified Dist. 1
Maricopa Unified Dist. 20	Quartzsite Elem. Dist. 4
Mayer Unified Dist. 43	Queen Creek Unified Dist. 95
McNary Elem. Dist. 23	Rainbow School
McNeal Elem. Dist. 55	Ray Unified Dist. 3
Mesa Unified Dist. 4	Red Mesa Unified Dist. 27
Miami Unified Dist. 40	Red Rock Elem. Dist. 5
Mingus UHS Dist. 4	Riverside Elem. Dist. 2
Mobile Elem. Dist. 86	Roosevelt Elem. Dist. 66
Mohave Educational Svcs Coop	Round Valley Unified Dist. 10
Mohave UHS Dist. 30	Sacaton Elem. Dist. 18
Mohave Valley Elem. Dist. 16	Safford Unified Dist. 1
Mohawk Valley Elem. Dist. 17	Sahuarita Unified Dist. 30
Morenci Unified Dist. 18	St. David Unified Dist. 21
Morristown Elem. Dist. 75	St. Johns Unified Dist. 1
Murphy Elem. Dist. 21	Salome Cons. Elem. Dist. 30
Naco Elem. Dist. 23	San Carlos Unified Dist. 20

LIST OF EMPLOYERS

San Fernando Elem. Dist. 35
San Simon Unified Dist. 18
Sanders Unified Dist. 18
Santa Cruz Elem. Dist. 28
Santa Cruz Valley Dist. 35
Santa Cruz Valley UHS Dist. 840
Scottsdale Unified Dist. 48
Sedona - Oak Creek School Dist. 9
Seligman Unified Dist. 40
Sentinel Elem. Dist. 71
Show Low Unified Dist. 10
Sierra Vista Unified Dist. 68
Skull Valley Elem. Dist. 15
Snowflake Unified Dist. 5
Solomonville Elem. Dist. 5
Somerton Elem. Dist. 11
Sonoita Elem. Dist. 25
Stanfield Elem. Dist. 24
Sunnyside Unified Dist. 12
Superior Unified Dist. 15
Tanque Verde Unified Dist. 13
Tempe Elem. Dist. 3
Tempe UHS Dist. 213
Thatcher Unified Dist. 4
Tolleson Elem. Dist. 17
Tolleson UHS Dist. 214
Toltec Elem. Dist. 22
Tombstone Unified Dist. 1
Tonto Basin School Dist. 33
Topock Elem. Dist. 12
Tuba City Unified Dist. 15
Tucson Unified Dist. 1
Union Elem. Dist. 62
Vail Elem. Dist. 20
Valentine Elem. Dist. 22
Valley UHS Dist. 22
Vernon Elem. Dist. 9
Villa Oasis Inter School
Walnut Grove School District
Washington Elem. Dist. 6
Wellton Elem. Dist. 24
Wenden Elem. Dist. 19
Western Maricopa Education Center
Whiteriver Unified Dist. 20

Wickenburg Unified Dist. 9
Willcox Unified Dist. 13
Williams Unified Dist. 2
Williamson Valley Elem. Dist. 2
Wilson Elem. Dist. 7
Window Rock Unified Dist. 8
Winslow Unified Dist. 1
Yarnell Elem. Dist. 52
Yavapai County Accomodation School Dist #99
Young Elem. Dist. 5
Yuma County Accommodation School
Yucca Elem. Dist. 13
Yuma Elem. Dist. 1
Yuma UHS Dist. 70

Charter Schools

Accelerated Learning Center
Accelerated Learning Center Laboratory
Acclaim Charter School
Academy of Excellence, Inc.
Academy of Tucson
Adalberto Guerrero Middle School
Aha Macav High School
American Heritage Academy Chart. School
AmeriSchools
Arizona Charter Academy
Arizona Conservatory for Arts & Academics
Arizona Montessori Charter School
Arizona School for the Arts
Arizona Southwest Preparatory Academy
AZ Agribusiness & Equine Center Chart. Sch.
AZ Institute of Bus. and Technology (AIBT)
Aztec Academy
Aztlan Academy, Inc.
Ball Charter School
Basis Middle School
Benchmark Elementary
Benjamin Franklin Charter School
Blackwater Comm School (K-2)
Blackwater Comm School (3-4)
Burke Basic Charter School
Canyon Rose Academy
Career Pathways Academy
Carmel Comm. Integrated Arts Chart. Sch.

LIST OF EMPLOYERS

Carpe Diem Collegiate High School
 Casey Country Day Charter School
 Central Arizona Valley Inst of Technology
 Challenge School, Inc.
 Children Reaching for the Sky
 Chester Newton Charter and Montessori Sch.
 City High School
 CI Wilson Academy
 Country Gardens Charter School
 Davis Education Center
 Desert Technology High School
 Desert Rose Academy
 Desert Springs Academy Charter School
 Destiny Schools, Inc.
 Discovery Academy of St. Johns
 Discovery Plus Academy Charter School
 Dobson Academy
 Dragonflye Charter School
 EAGLE Academy Charter School
 Eagles Aerie Schools
 East Valley Academy Charter Sch.
 Ecotech Agricultural Charter School
 Edge EDE Charter School
 EDU Preneurship Charter School
 EDU-Prize Charter School
 Enterprise Academy Charter School
 Esperanza Montessori Academy
 Excalibur Charter School
 Excel Education Centers Chino Valley, LLC
 Excel Education Centers Cottonwood, LLC
 Excel Education Centers Flagstaff, LLC
 Excel Education Centers Fort Mohave, LLC
 Excel Education Centers Prescott, LLC
 Excel Education Centers Prescott Valley, LLC
 Excel Education Centers San Carlos, LLC
 Entity Z Accounts
 Flagstaff Arts & Leadership Academy
 Flagstaff Jr. Academy Charter School
 Franklin Phonetic Primary School
 Gan Yaladeem, the Looking Glass
 Genesis Academy Charter School
 Gila County Transition Charter School
 Gila Preparatory
 G.R.A.D.E. Charter School
 Great Expectation Charter School
 Happy Valley School, Inc.
 Ha:San Preparatory and Leadership School
 Humanistic Ed Authentic Rigorous Transcendent
 Heritage Academy Inc.
 Horizon Charter School
 Humanities and Science Institute Inc.
 Intelli-School Charter School
 Intelli-School Charter School (PAS Charter)
 Intelli-School Charter School (RSD Charter)
 Intelli-School Charter School (SC Jensen)
 International Commerce Institute Inc.
 JWJ Academy
 James Sandoval Preparatory High School
 Juniper Tree Academy
 Khalsa School
 Kids at Hope Academy, Inc.
 Kingman Academy of Learning
 Lake Havasu Charter School
 Lake Powell Academy Inc.
 La Paloma Academy
 Learning Crossroads Basic Academy
 Learning Institute
 Life Skills Center of Arizona
 Luz Academy of Tucson
 Masada Charter School, Inc
 MESA (Mountain English Spanish Academy)
 Metropolitan Arts Institute
 Mexicayotl Academy
 Mingus Mountain Academy
 Mingus Springs Charter School
 Mohave Accelerated Learning Center
 Mohave Accelerated Elem School
 Mohave Educational Services, Inc
 Mountain Rose Academy, Inc.
 Mountain Oak School Charter School, Inc.
 Mountain School, Inc.
 Mountaineer Academy, LLC
 Multi-Dimensional Literacy Corp
 New School for the Arts
 New School for the Arts Middle School
 New West Charter School
 Northern AZ Academy for Career Development
 Northern Arizona Voc. Institute of Technology

LIST OF EMPLOYERS

Northland Preparatory Academy	Southern AZ Community Academy Charter Sch
North Star Charter School	Southside Community School
Northwest Az Tech Institute of Vocational Ed	Starshine Academy
Nosotros Academy	Stepping Stones Academy
Paradise Education Center	Sunnyside Charter and Montessori School
Paramount Academy	Superior School
Park View Middle School	Tag Elementary Inc.
Pathfinder Academy, LLC	Telani Lake Elementary Sch Academy
Pathways Charter Schools, Inc	Telesis Center for Learning, Inc.
Paulden Elementary School	Tertulia Charter School
PCAE-Edge	Tolchi' Kooh Charter School Inc.
Peak School, Inc.	Tri-City Prep High School
Phoenix Academy of Performing Arts South	Tri-City Vo-Tech High School
Phoenix School of Academic Excellence	Tucson Country Day School
Pima Prevention Partnership	Tucson Preparatory School
Pine Forest Charter School	Triumphant Learning Center
Pinnacle Ed Day Star Academy, LLC	Valley Academies Inc.
Pinnacle Ed East Valley No 1, LLC	Valley Academy for Career & Technology Ed
Pinnacle Ed East Valley No. 2, LLC	Ventana Academic School
Pinnacle Ed Freedom Academy, LLC	Visions Unlimited Academy Inc.
Pinnacle Ed Kino Academy, LLC	Westwind Academy
Pinnacle Ed Pinal, LLC	Willow Creek
Pinnacle Ed Westmark Arizona Ave., LLC	Wilson High School
Pinnacle Ed Westmark Chandler Blvd, LLC	Young Scholars Academy Chart. Sch. Corp.
Point Educational Services	
Presidio School	<i>Colleges</i>
Project YES Middle School, LLC	Arizona Western College
Redwood Elementary Academy, LLC	Central Arizona College
Renaissance Education Consort, Inc.	Cochise College
Salt River Pima-Maricopa Indian Chart. Sch	Coconino County Community College
Scholars' Academy Charter School	Eastern Arizona College
Scottsdale Educational Enrichment School	Maricopa County Comm.
Sedona Charter School	Mohave Community College
Self Development Charter School	Northland Pioneer College
Sequoia Charter School	Pima Community College
Sequoia Choice School, LLLP	Yavapai College
Sequoia Ranch School, LLC	<i>Universities</i>
Sequoia School LLC Charter School	Arizona State University
Sequoia Sch for Deaf and Hard of Hearing LLC	Northern Arizona University
Sequoia Village School	University of Arizona
Sierra Oaks Schools, Inc.	<i>Cities and Towns</i>
Skyline Technical High School	City of Apache Junction
Skyview Charter School	City of Avondale
Sonoran Desert School	

LIST OF EMPLOYERS

City of Benson	Town of Duncan
City of Bisbee	Town of Eager
City of Casa Grande	Town of Florence
City of Chandler	Town of Fredonia
City of Coolidge	Town of Gila Bend
City of Cottonwood	Town of Gilbert
City of Douglas	Town of Guadalupe
City of El Mirage	Town of Hayden
City of Eloy	Town of Kearny
City of Flagstaff	Town of Miami
City of Glendale	Town of Oro Valley
City of Globe	Town of ParadiseValley
City of Goodyear	Town of Parker
City of Holbrook	Town of Patagonia
City of Kingman	Town of Payson
City of Lake Havasu	Town of Pima
City of Litchfield Park	Town of Queen Creek
City of Mesa	Town of Sahuarita
City of Maricopa	Town of Snowflake
City of Nogales	Town of Springerville
City of Peoria	Town of Superior
City of Prescott	Town of Taylor
City of Safford	Town of Thatcher
City of San Luis	Town of Wellton
City of Scottsdale	Town of Wickenburg
City of Sedona	Town of Youngtown
City of Show Low	
City of Sierra Vista	<i>Counties</i>
City of Somerton	Apache County
City of South Tucson	Cochise County
City of Surprise	Coconino County
City of Tempe	Gila County
City of Tolleson	Graham County
City of Tombstone	Greenlee County
City of Willcox	Maricopa County
City of Williams	Mohave County
City of Winslow	Navajo County
City of Yuma	Pima County
Town of Buckeye	Pinal County
Town of Camp Verde	Santa Cruz County
Town of Carefree	Yavapai County
Town of Chino Valley	Yuma County
Town of Clarkdale	
Town of Clifton	<i>Other</i>
	Apache Jct. Fire District

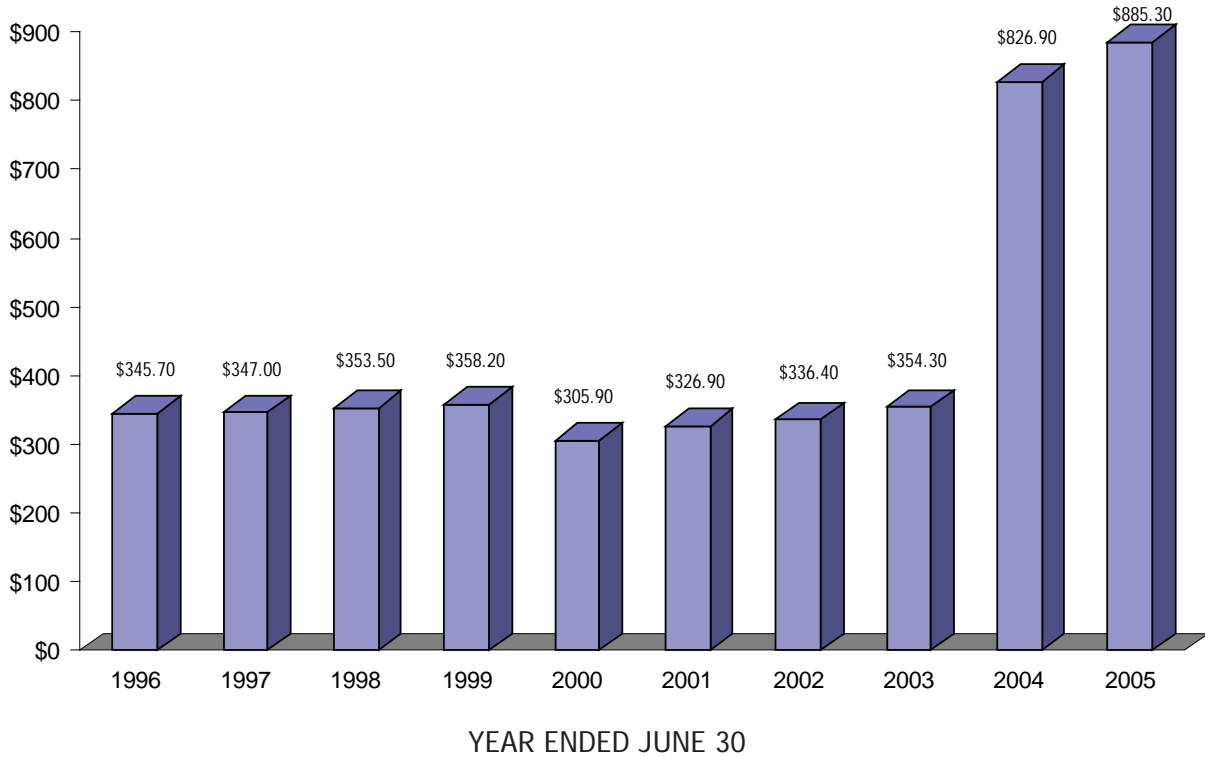
LIST OF EMPLOYERS

Arizona Association of Counties	New Magma Irrigation and Drainage District
Arizona City Sanitary District	Northern Apache County Special Healthcare District
Arizona Counties Insurance Pool	Northern Arizona Assoc. of Governments (NACOG)
Arizona Interscholastic Association	Northwest Fire District
Arizona Municipal Water Users Assoc	Phoenix and Tucson Job Corps
Arizona Prosecuting Attorney Advisory Council	Picture Rock Fire District
Avra Valley Fire District	Pima Association of Governments (PAG)
Buckeye Valley Fire District	Pima Home Health
Buckeye Water Conservation & Drainage Dist	Pinetop Volunteer Fire District
Bullhead City Fire District	Pinewood Fire Department
Central Arizona Assoc of Governments (CAAG)	Pinewood Sanitary District
Central Arizona Project	Ponderosa Domestic Water Improvement Dist.
Central Yavapai Fire District	Posada del sol Health
Chino Valley Fire District	Puerco Valley Fire District
Christopher Kohls Fire District	Queen Valley Domestic Water Impr. Dist.
City of Eloy Housing Authority	Queen Valley Sanitary District
City of Yuma Housing Authority	Roosevelt Irrigation District
Colorado River Sewage System	San Carlos Irrigation & Drain
County Supervisors Association of Arizona	Sedona-Oakcreek Airport Authority, Inc
Crown King Fire District	Southeastern Arizona Governments Organization (SEAGO)
Diamond Star Fire District	State of Arizona
Drexel Heights Fire District	Sun City Fire District
El Frida Fire District	Sun Lakes Fire District
Eloy Fire District	Summit Fire District
Fire District of Sun City West	Superstition Mtn Community Facilities Dist
Flagstaff Housing Authority	Three Points Fire District
Fort Mojave Mesa Fire Department	Tourism and Sports Authority
Gila Resources	Tucson Airport Authority
Green Valley Domestic Water Improvement District	Tusayan Fire District
Golder Ranch Fire District	Verde Valley Fire District
Groom Creek Fire District	Water Utilities Community District
Harquahala Valley Irrigation District	Western Arizona Council of Governments
Heber-Overgaard Fire District	Whetstone Fire District
Lakeside Fire District	White Mountain Regional Corp
League of Arizona Cities and Towns	White Mountain Summer Home Water Improvement District
Linden Fire District	Williams Gateway Airport Authority
Marana Domestic Water Improvement District	Yuma County Airport Authority
Maricopa Association of Governments (MAG)	Yuma Mesa Irrigation District
Maricopa Integrated Health System	
Maricopa Special Health Care District	
Maricopa Water District	
Metropolitan Domestic Water Improve. Dist.	
Montezuma-Rimrock Fire District	

Source: Arizona State Retirement System

CONTRIBUTIONS RECEIVED

(Dollars in Millions)



ACTUAL CONTRIBUTION RATES

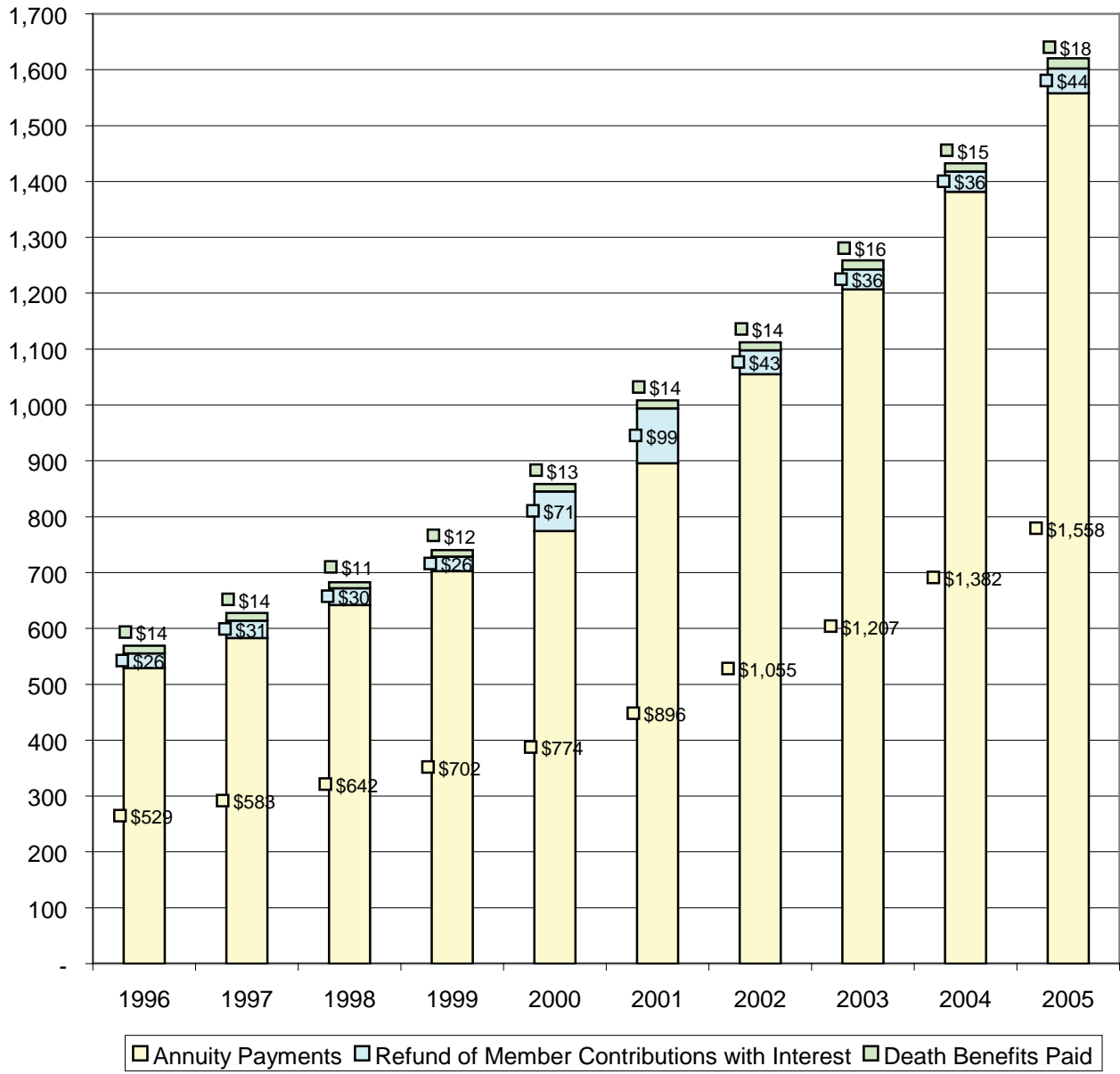
In Percentage of Payroll*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Employer	3.85	3.69	3.54	3.34	2.66	2.66	2.49	2.49	5.7	5.7
Employee	3.85	3.69	3.54	3.34	2.66	2.66	2.49	2.49	5.7	5.7

*Represents contribution rates for the Plan and includes long-term liability. System members and their employers each pay a 7.5% contribution rate, which includes 0.50% for long-term disability. In addition, employers pay 1.1% for health insurance.

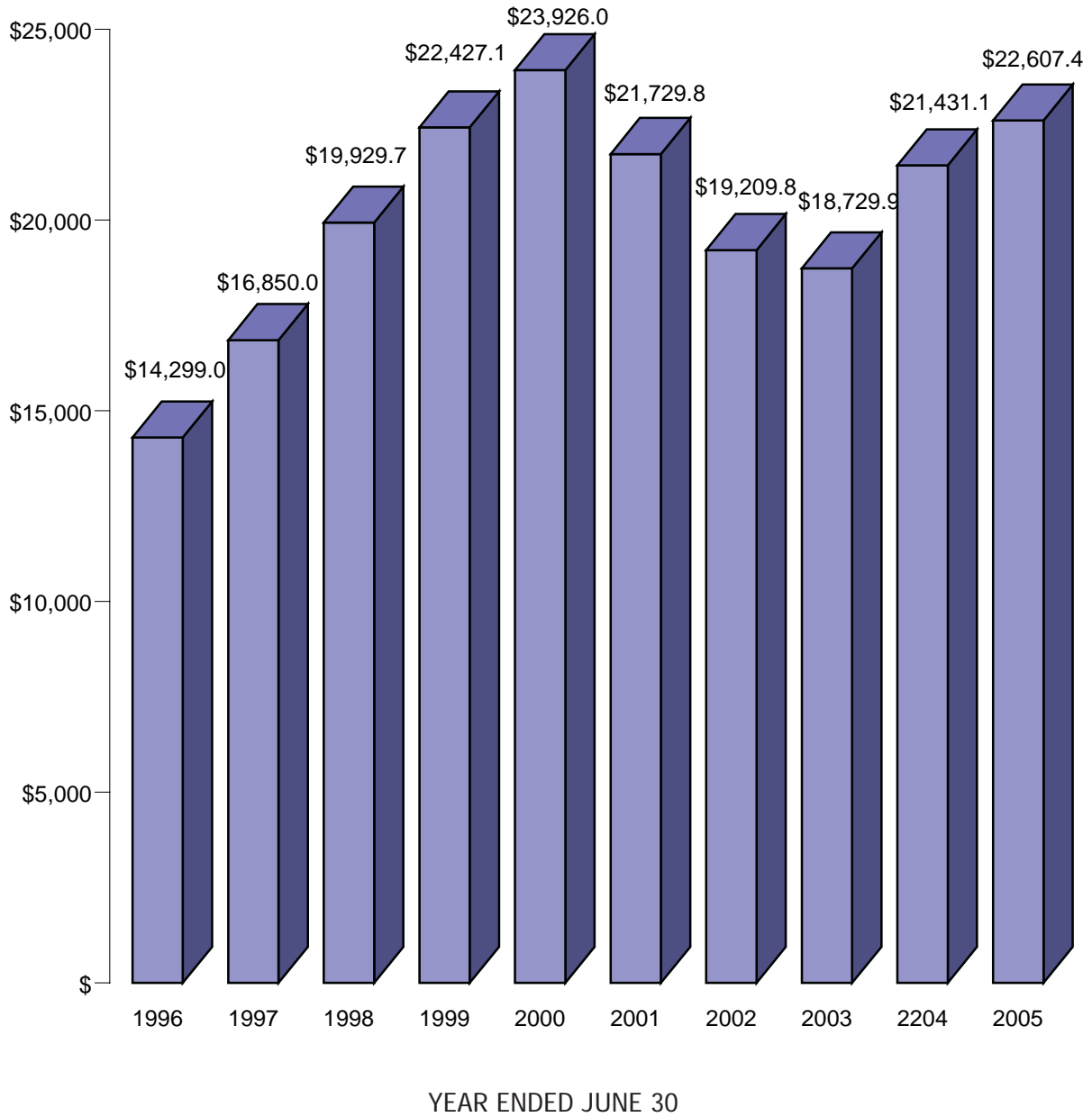
Source: Buck Consultants, LLC

TOTAL BENEFIT PAYMENTS (Dollars in Millions)



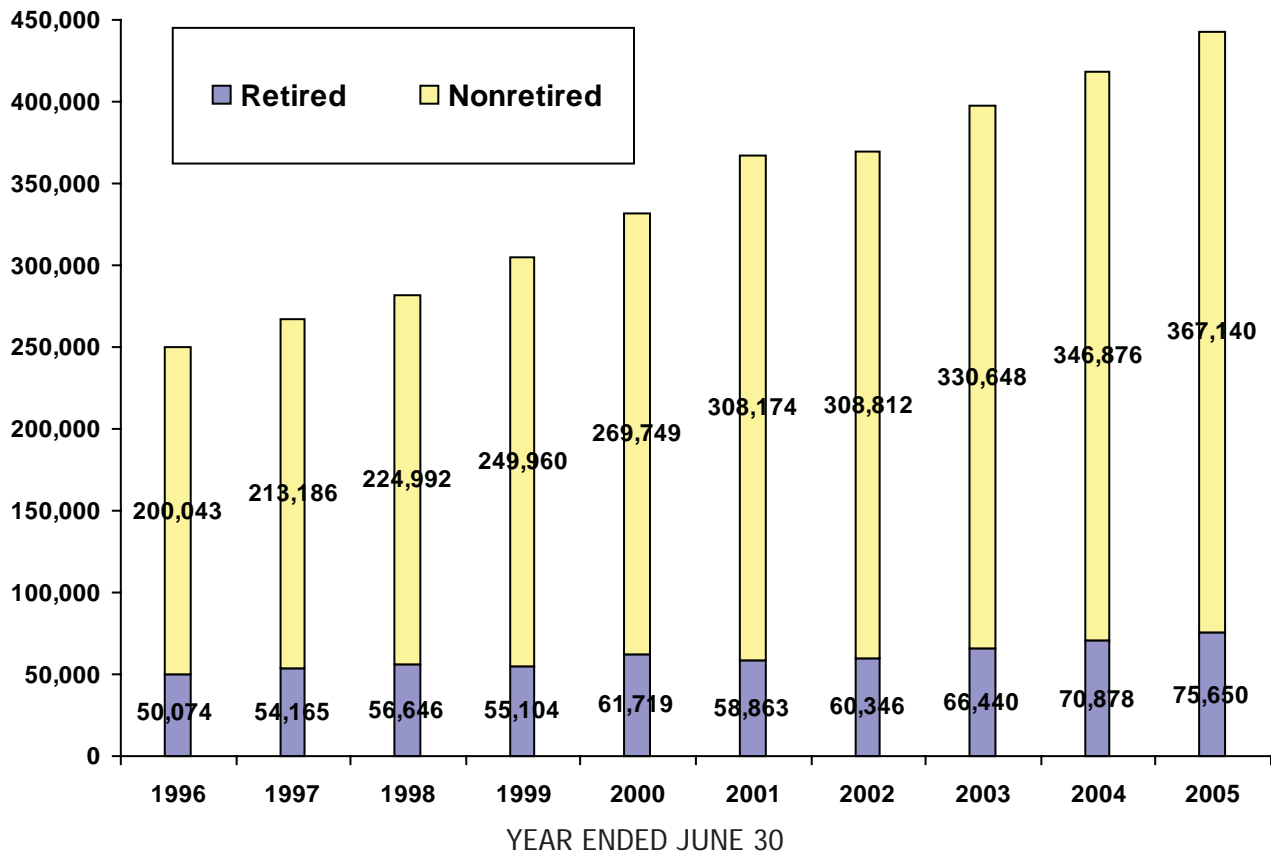
YEAR ENDED JUNE 30

TOTAL RESERVES FOR BENEFITS
 At Market*
 (Dollars in Millions)



*For 1996, total reserves for benefits have previously been reported at cost. These reserves have been restated to fair value in accordance with GASB 25, amended by GASB 31.

NON-RETIRED & RETIRED MEMBERS



The category of retired members includes survivors of former members, who have qualified for monthly benefit payments rather than for single death benefit payments.

REVENUES BY SOURCE
(Dollars In Thousands)

Fiscal Year	Employer/Employee Contribution Rate*	Employer/Employee Long-Term Disability Rate*	Employee Contributions as a Percent of Covered Payroll	Employer Contribution Amount	Employee Contribution Amount	Member Reimbursements and Other	Net Investment Income	Total Additions
1996	3.36%	0.49%	100.00%	\$172,848	\$172,848	\$4,376	\$2,063,878	\$2,413,951
1997	3.20	0.49	100.00	173,508	173,508	11,481	2,832,718	3,191,215
1998	3.05	0.49	100.00	176,769	176,769	15,462	3,405,203	3,774,202
1999	2.85	0.49	100.00	179,087	179,087	46,171	2,848,321	3,252,665
2000	2.17	0.49	100.00	152,957	152,958	35,348	2,035,312	2,376,575
2001	2.17	0.49	100.00	163,442	163,442	39,535	(1,528,691)	(1,162,273)
2002	2.00	0.49	100.00	168,213	168,213	50,833	(1,768,077)	(1,380,819)
2003	2.00	0.50	100.00	177,157	177,157	93,552	368,631	816,497
2004	5.20	0.50	100.00	413,458	413,462	113,944	3,228,784	4,169,649
2005	5.20	0.50	100.00	442,643	442,643	141,932	1,803,392	2,830,610

*Represents contribution rates for the Plan. System members and their employers each pay a 7.5% contribution rate, which includes 0.50% for long-term disability. In addition, employers pay 1.1% for health insurance.

EXPENSES BY TYPE
(Dollars in Thousands)

Fiscal Year	Benefit Payments	Administrative and Other	Total
1996	\$568,901	\$8,245	\$577,146
1997	627,591	12,308	639,898
1998	682,336	12,541	694,877
1999	739,979	15,353	755,332
2000	858,308	19,744	878,052
2001	1,008,150	24,640	1,032,790
2002	1,111,809	28,105	1,139,914
2003	1,258,540	37,878	1,296,418
2004	1,432,693	35,745	1,468,438
2005	1,620,898	33,426	1,654,324

BENEFIT PAYMENTS BY TYPE
(Dollars in Thousands)

Fiscal Year	Retirement Benefits	Death Benefits	Long-Term Disability	Health Benefit Supplement	Refunds of Contributions	Total
1996	\$480,697	\$13,593	\$20,281	\$27,953	\$26,377	\$568,901
1997	522,525	13,583	30,052	30,149	31,282	627,591
1998	574,230	10,558	35,112	32,668	29,769	682,336
1999	627,612	11,485	39,839	34,935	26,108	739,979
2000	695,426	13,256	41,220	37,651	70,755	858,308
2001	809,133	14,134	45,848	40,500	98,535	1,008,150
2002	924,172	14,078	54,804	75,990	42,765	1,111,809
2003	1,067,481	15,861	54,688	84,534	35,976	1,258,540
2004	1,238,966	14,859	58,976	83,680	36,212	1,432,693
2005	1,406,547	18,402	62,183	89,602	44,164	1,620,898

AVERAGE BENEFIT PAYMENTS FOR RETIREES UNDER THE PLAN *

	YEARS OF CREDITED SERVICE										TOTAL
	0-4	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40-44	45+	
Fiscal year 1995											
Average monthly benefit	\$125	\$232	\$454	\$717	\$1,069	\$1,598	\$2,034	\$2,004	\$1,399	\$1,135	\$878
Number of retirees	855	7,345	9,444	7,965	7,274	6,065	3,287	853	260	30	43,378
AVERAGE CREDITED SERVICE											17.9
Fiscal year 1996											
Average monthly benefit	\$123	\$239	\$470	\$741	\$1,118	\$1,669	\$2,119	\$2,125	\$1,506	\$1,230	\$920
Number of retirees	918	7,781	9,849	8,334	7,791	6,654	3,498	884	240	26	45,975
AVERAGE CREDITED SERVICE											17.9
Fiscal year 1997											
Average monthly benefit	\$0	\$244	\$481	\$759	\$1,151	\$1,719	\$2,172	\$2,197	\$1,613	\$1,270	\$945
Number of retirees	1,034	8,446	10,611	8,967	8,421	7,296	3,756	947	240	25	49,743
AVERAGE CREDITED SERVICE											18.0
Fiscal year 1998											
Average monthly benefit	\$122	\$254	\$499	\$789	\$1,196	\$1,785	\$2,248	\$2,318	\$1,749	\$1,565	\$982
Number of retirees	1,149	8,788	11,050	9,305	8,786	7,718	3,908	965	226	22	51,917
AVERAGE CREDITED SERVICE											18.0
Fiscal year 1999											
Average monthly benefit	\$120	\$259	\$511	\$806	\$1,230	\$1,846	\$2,332	\$2,448	\$1,969	\$1,771	\$1,024
Number of retirees	1,251	9,180	11,581	9,653	9,393	8,475	4,294	1,039	217	21	55,104
AVERAGE CREDITED SERVICE											18.2
Fiscal year 2000											
Average monthly benefit	\$125	\$278	\$550	\$872	\$1,328	\$2,013	\$2,541	\$2,732	\$2,339	\$2,011	\$1,125
Number of retirees	1,321	9,454	12,076	10,061	9,944	9,169	4,683	1,106	207	17	58,038
AVERAGE CREDITED SERVICE											17.6
Fiscal year 2001											
Average monthly benefit	\$130	\$293	\$600	\$939	\$1,414	\$2,119	\$2,694	\$2,956	\$2,694	\$2,671	\$1,211
Number of retirees	1,338	9,450	12,164	10,033	10,115	9,611	4,891	1,120	180	18	58,920
AVERAGE CREDITED SERVICE											18.2
Fiscal year 2002											
Average monthly benefit	\$142	\$317	\$664	\$1,042	\$1,578	\$2,368	\$2,990	\$3,286	\$3,195	\$3,958	\$1,371
Number of retirees	1,397	9,357	12,188	10,145	10,443	10,023	5,399	1,193	182	19	60,346
AVERAGE CREDITED SERVICE											18.6
Fiscal year 2003											
Average monthly benefit	\$149	\$328	\$695	\$1,068	\$1,571	\$2,312	\$2,957	\$3,314	\$3,535	\$4,335	\$1,401
Number of retirees	1,555	9,744	12,811	10,568	11,103	10,838	6,477	1,373	203	25	64,697
AVERAGE CREDITED SERVICE											18.9
Fiscal year 2004											
Average monthly benefit	\$139	\$345	\$726	\$1,109	\$1,629	\$2,384	\$3,092	\$3,499	\$3,863	\$4,413	\$1,487
Number of retirees	1,716	10,153	13,268	10,984	11,747	11,567	7,607	1,611	248	30	68,931
AVERAGE CREDITED SERVICE											19.1

Source: Buck Consultants, LLC. *Statistics are not available for System retirees of the ASRS

RETIREMENT BENEFIT OPTIONS

Life Annuity - Refund Provision

Provides member monthly benefit for life. If death occurs before all member contributions, plus interest, have been paid, the remaining balance will be paid in a lump sum or at the same monthly amount in effect at the time of the member's death to the designated beneficiary.

Life Annuity - Five Years Certain

Provides member monthly benefit for life. If death occurs before the retired member receives 60 monthly payments, the remaining monthly payments (or balance of the 60 payments) will be paid to the retired member's designated beneficiary. Members under the age of 103 at retirement are eligible to choose this option.

Life Annuity - Ten Years Certain

Provides member monthly benefit for life. If death occurs before the retired member receives 120 monthly payments, the remaining monthly payments (or balance of the 120 monthly payments) will be paid to the retired member's designated beneficiary. Members under the age of 91 are eligible to choose this option.

Life Annuity - Fifteen Years Certain

Provides member monthly benefit for life. If death occurs before the retired member receives 180 monthly payments, the remaining monthly payments (or balance of the 180 monthly payments) will be paid to the designated beneficiary. Members under the age of 84 are eligible to choose this option.

Joint Annuity - 100 Percent To Contingent Survivor

Provides member monthly benefit for life then also provides a life annuity equal to 100 percent of the member's monthly benefit for one designated beneficiary should the beneficiary survive the member. Members may choose this option (1) if the beneficiary is the member's spouse, or (2) if the beneficiary is not the spouse and the member is not more than 10 years older than the beneficiary.

Joint Annuity - 66 2/3 Percent To Contingent Survivor

Provides member monthly benefit for life then also provides a life annuity equal to 66 2/3 percent of the member's monthly benefit for one designated beneficiary should the beneficiary survive the member. Members may choose this option (1) if the beneficiary is the member's spouse, or (2) if the beneficiary is not the spouse and the member is not more than 24 years older than the beneficiary.

Joint Annuity - 50 Percent To Contingent Survivor

Provides member monthly benefit for life then also provides a life annuity equal to 50 percent of the member's monthly benefit for one designated beneficiary should the beneficiary survive the member.

Members who choose a joint annuity payment option may rescind the option at any time and revert to the Life Annuity - Refund Provision or change the contingent annuitant. A member who reverted to the life annuity may later change back to the same joint annuity option originally elected and name the same or a new contingent annuitant. The member's benefit will be adjusted to reflect any change made.

RETIREED MEMBERS BY TYPE OF BENEFIT OPTIONS
Year Ended June 30, 2005

Amount of Monthly Benefit	Options*						
	1	2	3	4	5	6	7
\$1- 299	4,797	308	393	520	1,395	117	213
300 - 499	4,189	382	590	452	1,330	170	258
500 - 999	9,207	872	1,504	943	2,699	616	954
1000 - 1499	6,090	760	1,319	562	2,172	674	924
1500 - 1999	3,773	449	696	439	1,573	539	732
2000 & Over	9,915	743	1,201	1,248	4,399	1,668	2,068
Totals	37,971	3,514	5,703	4,164	13,568	3,784	5,149

* Options key

- 1 Life annuity - refund provision
- 2 Life annuity - 5 years certain and life
- 3 Life annuity - 10 years certain and life
- 4 Life annuity - 15 years certain and life
- 5 Joint annuity - 100 percent to contingent survivor
- 6 Joint annuity - 66 2/3 percent to contingent survivor
- 7 Joint annuity - 50 percent to contingent survivor

The above schedule does not include system retirees