Arizona State Retirement System

A COMPONENT UNIT OF THE STATE OF ARIZONA





Comprehensive Annual Financial Report
for Fiscal Year Ended June 30, 2006

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 Staff of the Arizona State Retirement System

Paul Matson, Director

2006

Comprehensive Annual Financial Report
for Fiscal Year Ended June 30, 2006

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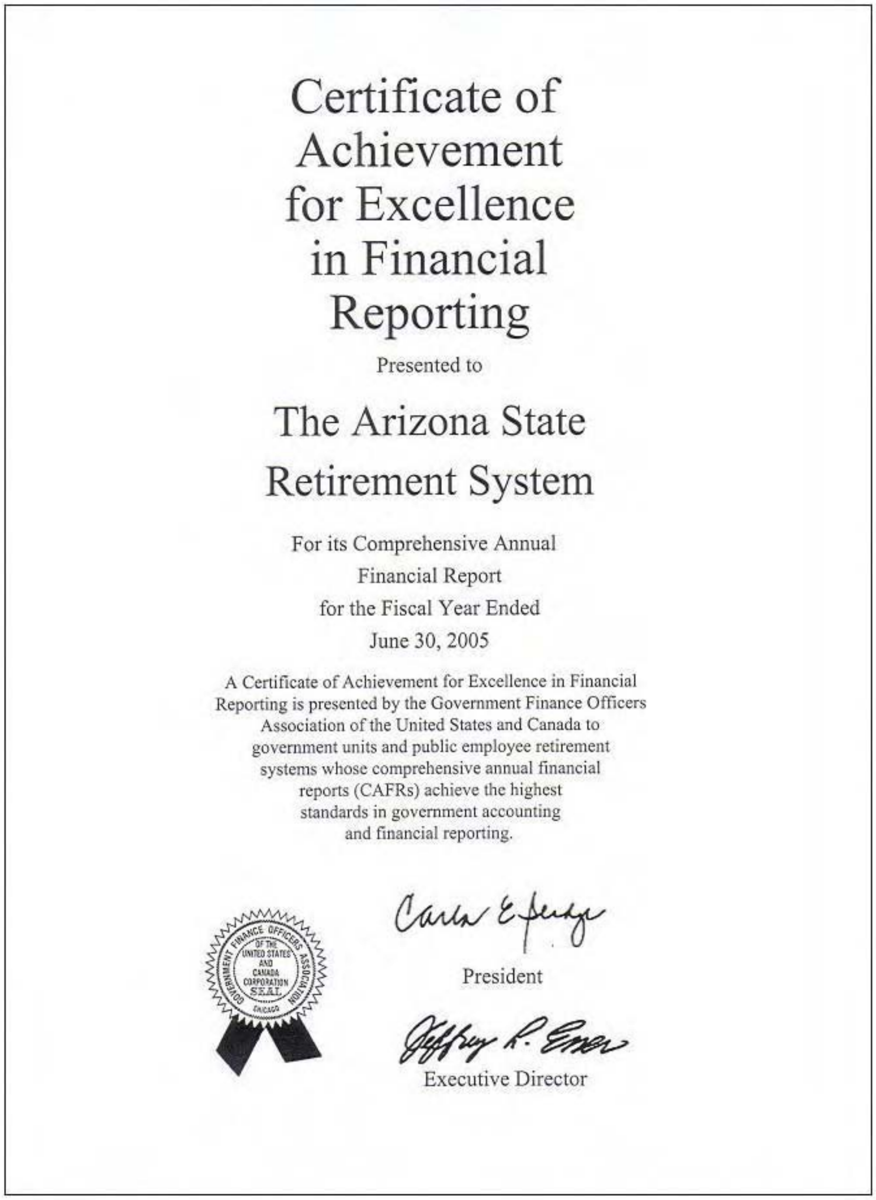
Arizona State Retirement System

A Component Unit of the State of Arizona

2006

Introductory Section

Certificate of Achievement for Excellence in Financial Reporting



Certificate of Achievement for Excellence in Financial Reporting

Presented to

The Arizona State Retirement System

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

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

Carla E. Lounge

President

Jeffrey R. Esser

Executive Director

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, 2005. This was the 17th 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
Toll Free Outside Metro Phoenix and Tucson 1-800-621-3778

Paul Matson
Director

November 20, 2006

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, it is my pleasure to present you with the fifty-third Comprehensive Annual Financial Report of the Arizona State Retirement System. 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 Buck Consultants LLC., as of June 30, 2005 reveals that the ASRS achieved an actuarial funded status of 85.3 percent.

During the fiscal year ended June 30, 2006, the total rate of return on investments was 9.8 percent. The annualized 10-year rate of return was 8.7 percent. Each of these rates of return exceeds our actuarially-assumed rate of return of 8 percent. The ASRS Fund stood at just over $24 billion.

The contribution rate, as determined by actuarial analysis, is designed to ensure the ASRS funds remain adequate to meet current and future obligations to our retirees. The actuarially recommended rate for fiscal year 2006-07 is 9.1 percent for both the employer and employee, which includes 8.6 percent for the defined benefit pension plan and health insurance supplement and 0.50 percent for the long term disability plan. The contribution rate is scheduled to increase for the 2007-08 fiscal year to 9.6 percent, which includes 9.10 percent for the pension fund and 0.50 for the long term disability plan.

Due to a variety of factors, including past benefit enhancements, lower mid-term investment returns, low historic contribution rates, and changing demographics, the pension plan contribution rate continues on an upward trend. That trend, however, shows future increases in contribution rates on a much slower scale, with a peak around the 2012 fiscal year, with a slow decline in subsequent years.

Letter from the Chairman

We intend to keep a watchful eye on any proposed plan modifications in the near future in an effort to hold down the contribution rate as much as possible. Actuarial projections show the combined pension and health insurance contribution rate approaching 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 retirement system operates efficiently and effectively. This is an on-going process of program, policy and legislative review and changes that have been implemented have resulted in significant cost reductions to the ASRS and its members.

Our members can be confident that the ASRS is poised to meet obligations of providing a lifelong income and a range of additional benefits when they retire, including a retiree medical and dental insurance plan and the premium benefit program which helps pay a portion of the insurance plans' premiums.

In recent months, two independent auditors reviewed ASRS operations and issued largely favorable reports.

The Arizona Auditor General's Office conducted an extensive review of the agency and submitted its report to the Legislature as part of the Sunset Review process, with the Legislature passing this past session legislation for continuation of the ASRS through July 2016.

And, the Joint Legislative Budget Committee received an independent actuarial audit that affirmed the ASRS actuarial methodologies that are used to determine such things as contribution rates and funded status. The report noted that the actuarial methods employed by the ASRS are "appropriate and reliable."

The ASRS has also been engaged in a concerted effort to improve member services, including automation of many services, improved website services and an advanced imaging system of records. These improvements have not only led to increased member satisfaction as measured by regular surveys, but cost savings as well.

I would like to note that the total membership of the ASRS, including active, in-active, disabled and retired members, reached a record 487,518 as of June 30, 2006. Also during that fiscal year, more than 85,000 retirees, survivors and disabled members received in excess of $1.7 billion in benefits. The ASRS Board is committed to prudent management of the Retirement System's 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 Arizona State Retirement System 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

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

Paul Matson
Director

November 20, 2006

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-third 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, 2006.

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, 2006. 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 of the ASRS membership. More than 80 percent voted to transfer to the defined benefit plan, which became effective July 1, 1971.

Letter of Transmittal from the Director

At FYE 2006, total ASRS membership, including active, inactive, disabled and retired members is 487,518. ASRS employer members total 745, 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 2005-06, more than 85,097 retired annuitants, their survivors, and disabled members received a monthly benefit totaling in excess of $129.68 million. More than 33,114 retired members are enrolled in the ASRS-sponsored medical or dental plans.

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 2005-06, Governor Janet Napolitano appointed the following ASRS Board Trustees to the Board:

- Mr. David Byers, re-appointed as a representative of state employees; term to expire on January 19, 2009.
- Dr. Keith Meredith, re-appointed as a member at large; term to expire on January 19, 2009.
- Mr. Larry Trachtenberg, re-appointed as a representative of the public, term to expire on January 19, 2009.

Major Initiatives

Investments:

- Reviewed and modified ASRS Investment Goals and Objectives. As part of the Board-approved ASRS Strategic Plan, each investment goal contains a measurable objective which quantifies the expected investment results the ASRS seeks to achieve. Achieving these goals and objectives are consistent with ASRS Purpose, Vision and Investment Principles.
- Conducted a comprehensive review of the ASRS International Equity Asset Class. The review resulted in the adoption of a broader investment opportunity universe which is expected to provide enhanced returns and diversification. Specifically, two International Small Cap Equity managers and two MSCI ACWI ex-U.S. International Large Cap Equity Managers were hired.
- Implemented the ASRS institutional real estate investment program. Funded six externally-managed real estate mandates and one internally-managed REIT portfolio. Also, modifications to the ASRS Real Estate Program Plan were made that improved the structure of the program which serves as the framework for making tactical real estate investment decisions.
- Initiated an Asset Allocation Study which defines the mix of investment assets that are anticipated to maximize the ASRS total fund return for an acceptable level of risk. The study is expected to be completed in the 4th quarter of calendar year 2006.

Letter of Transmittal from the Director

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. The ASRS maintains its investment assets in accordance with Board approved strategic asset allocation policy. Investment assets are managed in 33 external and six internal portfolios which are diversifiable in U.S. equities, U.S. fixed income, international equities and real estate.

For Fiscal Year Ended June 30, 2006, the ASRS achieved a 9.8 percent rate-of-return which outperformed the ASRS Total Fund policy benchmark and actuarial assumed investment rate of return by 1.0 percent and 1.8 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, 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.

Benefits:

- During FY 2005-06, the ASRS continued its freeze of retiree medical plan premiums, offered no change in plan provisions, expanded medical and ancillary health services, and increased choice of medical plans in rural Arizona for Medicare eligible retirees. This freeze, which is through calendar year 2006, caps a five 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 for the benefit of our retirees and their families.

Administration:

- The ASRS Board adopted a three year Strategic Plan for the period of January 1, 2006 – December 31, 2008. The Plan outlines the goals and objectives the agency is striving to achieve over a three year period. It provides a dynamic, forward looking framework for the planning and implementation process. At the conclusion of the three year period, the agency will assess its success in meeting the goals it has outlined and review and update the Plan once again.
- The ASRS Business Re-engineering and Information Technology Plan (IT Plan) was 75 percent complete as of the close of the Fiscal Year. The IT Plan is expected to help the agency achieve the goals it has outlined in its strategic plan by automating and re-engineering all of the agency's major business processes and by also making new services available to members and employers through the website.

Letter of Transmittal from the Director

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, 2005, the actuarial value of total plan assets was $23.8 billion and the actuarial accrued liability was $27.9 billion. The unfunded actuarial accrued liability of $4.1 billion results in an actuarial funding ratio of 85.3 percent for the total plan. The change in funding percentage from last year's 91.2 percent is primarily due to continued recognition of investment losses for fiscal years 2001, 2002 and 2003. The funding ratio for the individual components of the total plan are as follows: retirement - defined benefit 86.1 percent, and health insurance premium benefit (HBS) 70.6 percent. The funding ratio for the retirement - defined contribution and long term disability (LTD) are 107.07 percent and 28.55 percent respectively.

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 approximately $184 million per year, which is equivalent to approximately $2.0 billion in liability savings for the group of all current employees, or approximately $3.9 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 2.4 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, 2005. The ASRS has received this prestigious award in each of the last 17 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.

In addition, the Public Pension Coordinating Council awarded a Pension Standards Award for 2006 to the ASRS for meeting professional standards for plan design and administration. To be awarded the Pension Standards Award, a public employee retirement system must certify that it meets requirements in six areas of

Letter of Transmittal from the Director

assessment. Those areas are: comprehensive benefit program, funding adequacy, actuarial, audit, investments and communications. The Pension Standards Award is valid for one year. This is the second year the ASRS has received this award.

Acknowledgments

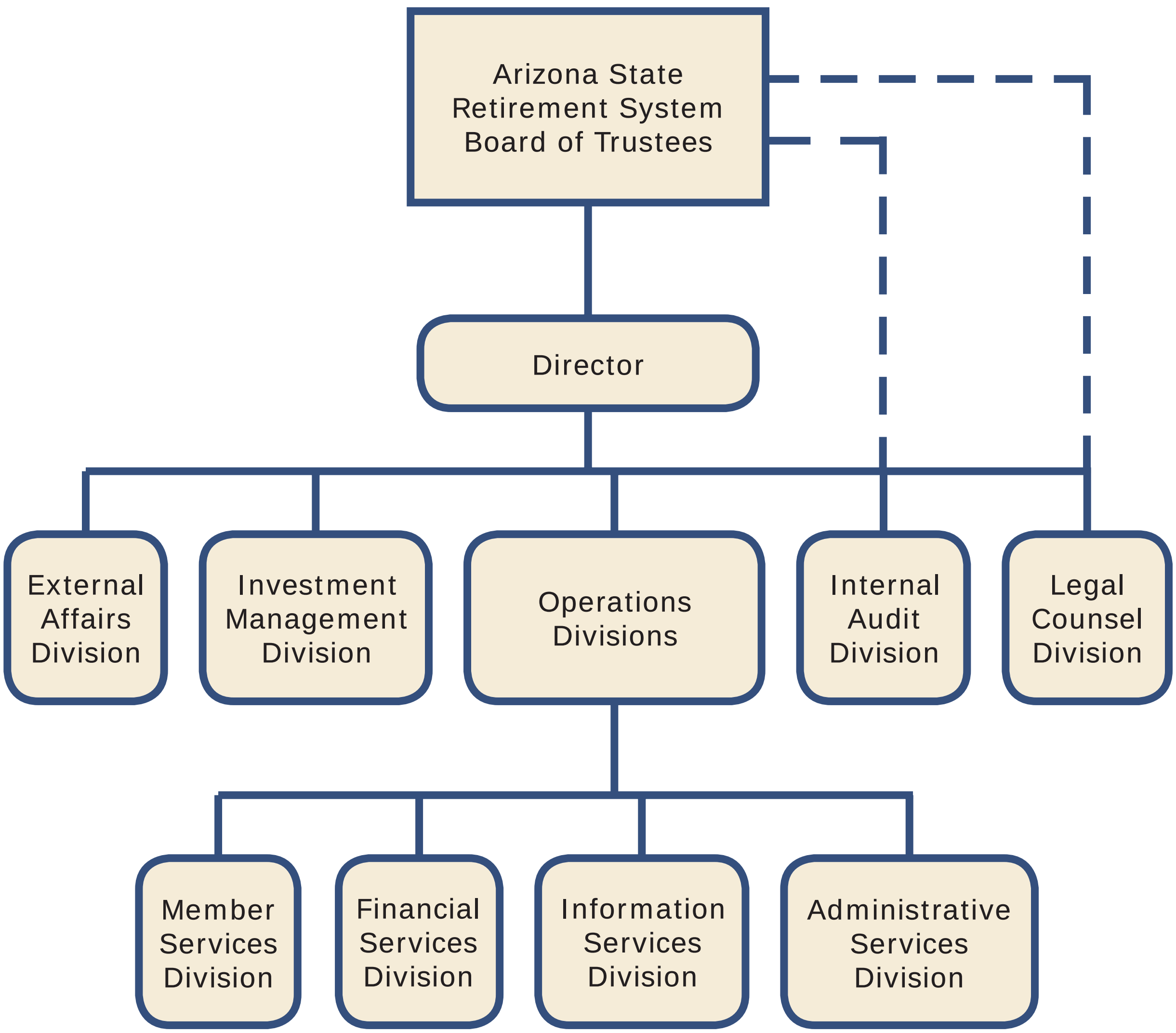
This report represents the culmination of hours of hard work by the ASRS General Accounting and External Affairs staff. It is intended to provide complete and reliable information for decision making, to insure compliance with legal requirements, and is a means of measuring the responsible stewardship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

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

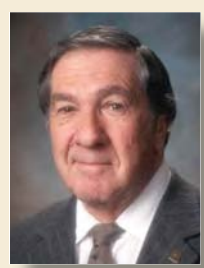
Jaime Gutierrez
Tucson, Educators

Christopher Harris
Phoenix, Public

Anne Marriucci
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
Phoenix, AZ

LONG TERM DISABILITY BENEFITS
VPA, a Sedgwick CMS Company
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 71

Summary of 2006 Retirement Legislation

Senate Bill 1167 – Optional Forms of Retirement

- Limits the ability of a retired member of the ASRS to alternate between retirement benefit options.
- The ASRS is awaiting a private letter ruling from the Internal Revenue Service that is required prior to implementation of this statute.
- Effective date dependent upon a private letter ruling from the IRS

Senate Bill 1168 – Federal Conforming Changes

- Modifies state statutes to conform to federal law regarding:

    Contributions paid for qualifying active members called to active military service

    Beneficiaries and payments made when no beneficiary survives the member

    Survivor benefit calculations

    Granting the ASRS Board the authority to determine a rate

    Minimum required distributions of retirement benefits

- Effective Sept. 21, 2006

House Bill 2082 – Spousal Notification

- Requires a member to notify their current spouse at any time a beneficiary is designated, if the beneficiary designated is someone other than the current spouse.
- Requires a member to notify their current spouse at any time a change to their beneficiary or annuity option is made, if the current spouse is a beneficiary.
- Effective Sept. 21, 2006

House Bill 2103 – Termination Incentive Program

- Clarifies statutory language put in place last year by changing the term "retirement" to "termination." The statute requires employers to pay any liability incurred by the ASRS as a result of an employee termination incentive program
- Effective Sept. 21, 2006

House Bill 2113 – Continuation of the ASRS

- Extends the statutory life of the ASRS for 10 years through July 1, 2016.
- Effective Sept. 21, 2006

Summary of 2006 Retirement Legislation

House Bill 2340 – Repeal of the ASRS Modified DROP Program

- Repeals statutes passed into law in 2001 and modified in 2003 that allowed for the creation of a Deferred Retirement Option Plan to be offered through the ASRS.
- Effective Sept. 21, 2006

Arizona State Retirement System

A Component Unit of the State of Arizona

2006

Financial Section

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Independent Auditors' Report

Deloitte.

Deloitte & Touche LLP
Suite 1200
2901 N. Central Avenue
Phoenix, AZ 85012-2799
USA

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www.deloitte.com

INDEPENDENT AUDITORS' REPORT

The Honorable Janet Napolitano
Governor of the State of Arizona, and
Members of the Legislature

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, 2006, 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, 2005, 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, 2006, 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. This supplementary information is the responsibility of ASRS' management. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary 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 a required part of the basic financial statements. The

Member of
Deloitte Touche Tohmatsu

Independent Auditors' Report

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 15, 2006

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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, 2006. 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), and the basic financial statements and notes to the basic financial statements presented in the Financial Section of the CAFR.

Financial Highlights

During FY 2006, 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 8.8 percent.

- The ASRS rate of return on investments for FY 2006 was 9.8 percent compared to 8.5 percent in FY 2005. The increase in the rate of return reflects positive returns in the global securities markets during the fiscal year.
- The ASRS combined total net assets increased by 7.9 percent at FYE June 30, 2006 compared to FYE 2005. The increase in the net assets is due to an increase in the global securities markets during the fiscal year.
- The ASRS received a total of $1.2 billion in employee and employer contributions during FY 2006 compared to $885 million in FY 2005. The 38.3 percent increase is due primarily to an increase in active membership, in active members average annual salary and a 29.8 percent contribution rate increase effective July 1, 2005.
- The ASRS paid $1.7 billion in pension, disability, health insurance and survivor benefits during FY 2006 compared to $1.6 billion in FY 2005. The 8.0 percent increase is due to an increase in the number of retirements.
- As of June 30, 2005, the most recent actuarial valuation, the Retirement and Health Benefit Supplement Funds combined were 85.3 percent funded. This compares to a combined funding ratio of 91.2 percent as of June 30, 2004. The change in funding percentage is primarily due to continued recognition of investment losses for fiscal years 2001, 2002, 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 statements, 3) required supplementary information and 4) other supplementary schedules. Collectively, this information presents the combined net assets held in trust for pension benefits which includes health benefit supplements and long term disability for each of the funds administered by the ASRS as of June 30, 2006. 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, 2006, 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, 2006 with combined total comparative information as of June 30, 2005. This statement reflects the resources available

Management's Discussion and Analysis

to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal year.

- The Combined Statement of Changes in Plan Net Assets is presented for the year ended June 30, 2006 with comparative information for the year ended June 30, 2005. This statement reflects the changes in resources available to pay benefits to retirees and other beneficiaries for the year.

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 26-44 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 Schedules.** 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 investment income by manager and investment expenses. The ASRS Plan, a defined benefit plan, and the System, a defined contribution plan, are separate 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, 2006 were $24.4 billion, a 7.9 percent increase from $22.6 billion at June 30, 2005. 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 $23.2 billion compared to $21.6 billion last year, a 7.6 percent increase. The HBS fund net assets were $970 million at year end compared to $872 million in FYE 2005, a 11.3 percent increase. The LTD fund net assets were $196 million at year end compared to $165 million last year, an 18.9 percent increase.

Net investments totaled $24.2 billion at FYE 2006 compared to $23 billion at FYE 2005. The 7.4 percent increase was primarily due to positive returns in the global securities markets. Cash, receivables and prepaids of $2.4 billion reflects a 14.5 percent increase compared to last year's $2.2 billion and is primarily due to an increase in forward contracts receivable and prepaid pension benefits. Liabilities of $5.1 billion represents an increase of 4.5 percent compared to $4.9 billion last year. This increase is due to an increase in forward contracts payable.

Changes in Net Assets. For the 2006 fiscal year, employer and member contributions totaled $1.2 billion, a 38.3 percent increase over the 2005 fiscal year contributions of $885 million. A 29.8 percent increase in the contribution rate effective July 1, 2005 is primarily responsible for the increased contributions.

Management's Discussion and Analysis

For FY 2006, the ASRS recognized net investment income of $2.2 billion which compares to net investment income of $1.8 billion in the previous year. This 23.7% percent increase in investment income is due to positive returns in the global equity 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 2006 fiscal year, pension, disability, health insurance and survivor benefits totaled $1.7 billion, an increase of 8.0 percent from the $1.6 billion paid during FY 2005. Pension payments totaled $1.5 billion in FY 2006 compared to $1.4 billion in the previous year. The 9.4 percent increase is explained by a 5.9 percent increase in retirees. Refunds and transfers to other plans totaled $65.4 million dollars in 2006, a 34.3 percent increase from the $48.7 million paid out in 2005. For FY 2006, the cost of administering the ASRS benefits totaled $32.1 million, an increase of 26.9 percent from the $25.3 million paid in FY 2005. This increase is a result of the addition of 24 new permanent positions, statutory approved salary increases and several new information technology projects. The following tables shows the principal ASRS net assets and changes in net assets for fiscal years 2006 and 2005, in thousands of dollars:

Net Assets

	2006	2005	Change	% Change
Assets				
Cash, receivables & prepaids	$2,507,500	$2,190,345	$317,155	14.5%
Investments at fair value	24,696,458	23,000,280	1,696,178	7.4%
Security lending	2,265,754	2,279,978	(14,224)	(0.6%)
Total assets	29,469,712	27,470,603	1,999,109	7.3%
Liabilities				
Payables for investments	2,818,564	2,583,240	235,324	9.1%
Securities Lending	2,265,754	2,279,978	(14,224)	(0.6%)
Total Liabilities	5,084,318	4,863,218	221,100	4.5%
Total Net Assets	**$24,385,394**	**$22,607,385**	**$1,778,009**	**7.9%**

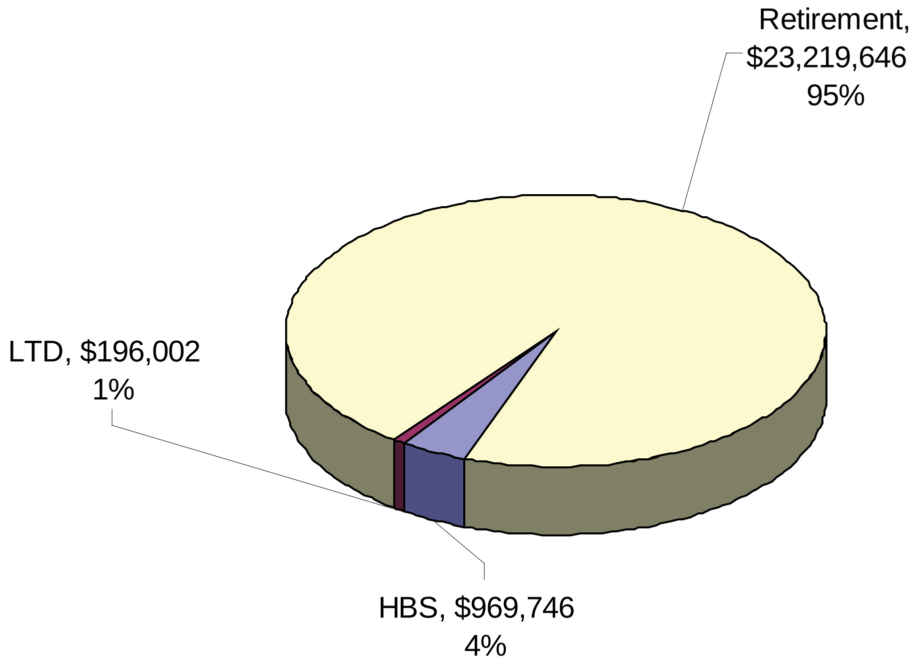
Management's Discussion and Analysis

Changes in Net Assets

	2006	2005	Change	% Change
Additions				
Employee contributions	$612,121	$442,643	$169,478	38.3%
Employer contributions	612,121	442,643	169,478	38.3%
Service credit purchase and transfers in	125,751	141,932	(16,181)	(11.4%)
Investment and security lending income	2,366,186	1,878,072	488,114	26.0%
Investment and security lending expense	(135,247)	(74,680)	(60,567)	81.1%
Total additions	3,580 ,932	2,830,610	750,322	26.5%
Deductions				
Benefits	1,686,090	1,558,332	127,758	8.2%
Death benefits	17,125	18,402	(1,277)	(6.9%)
Refunds and transfers	65,442	48,745	16,697	34.3%
Administration and other	34,266	28,845	5,421	18.8%
Total deductions	1,802,923	1,654,324	148,599	9.0%
Net Change	1,778,009	1,176,286	601,723	51.2%
Net assets beginning of year	22,607,385	21,431,099	1,176,286	5.5%
Net assets end of year	**$24,385,394**	**$22,607,385**	**$1,778,009**	**7.9%**

Management's Discussion and Analysis

Net Assets by Fund –June 30, 2006



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, 2005.

At June 30, 2005 the total funded status of the ASRS retirement and health benefit supplement funds decreased to 85.3 percent from 91.2 percent at FYE 2004. At FYE 2005 ASRS actuarial liabilities exceeded actuarial assets for the retirement and health benefit supplement funds by $4.1 billion. This compares to an excess of actuarial assets over actuarial liabilities of $2.3 billion at FYE 2004. 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 2006, 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 allocated to domestic and international equity securities, and no more than 20 percent of the fund may be allocated solely to international equity securities.

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.

Management's Discussion and Analysis

At June 30, 2006, the ASRS held total investments of $24.2 billion, an increase of $1.6 billion from FYE 2005. The $1.6 billion increase in total investments is primarily due to an increase in the global securities markets. The combined investment portfolio experienced a return of 9.8 percent compared to the benchmark return of 8.8 percent. During the implementation of ASRS's real estate program, an interim benchmark which prorates the 6 percent allocation to institutional real estate is being used. The interim benchmark consists of 55 percent S&P 500 Index, 28 percent Lehman Brother Aggregate Index, 16 percent MSCI EAFE Index prior to 10/1/2005 and the MSCI ACW Ex. US Index thereafter, and 1 percent NCREIF+ 100 bps.

At June 30, 2006, the ASRS held $12.4 billion in domestic equities and $4.3 billion in international equities, a decrease of 1.6 percent in domestic equities and a 10.3 percent increase in international equities from FYE 2005. The FY 2006 rate of return for ASRS domestic equities was 10.0 percent compared to 8.1 percent in FY 2005 reflecting an increase in the domestic equity markets. The ASRS domestic equities benchmark, S&P 500, had a return of 8.6 percent for FY 2006. The benchmark is representative of the returns that could be expected in a similar investing environment.

The FY 2006 rate of return for ASRS international equities was 24.3 percent compared to 11.1 percent in FY 2005, reflecting an increase in the international equity markets. The ASRS international equities benchmark, MSCI EAFE, had a rate of return of 26.8 percent for FY 2006. 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, 2006, the ASRS held $5.8 billion in domestic fixed income securities, an increase of $100 million from FYE 2005. The rate of return was -0.4 percent compared to 6.9 percent in the previous year, reflecting a decrease in performance in the fixed income markets. The ASRS domestic income benchmark, the Lehman Aggregate, had a rate of return of -0.8 percent for FY 2006. 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 to brokers. This is done on a pooled basis by our custodial bank, Mellon Trust. The brokers provide collateral and generally use the borrowed securities to cover short sales and failed trades. Security lending income for FY 2006 was $5.8 million compared to $5.7 million for FY 2005. The 2.3% increase in security lending income is a result of the larger asset base and increased borrower demand for some securities.

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, 2006 with Comparative Totals for 2005
(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund (Note 8)	Long-Term Disability Fund (Note 8)	Combined 2006	Combined 2005
ASSETS:					
Cash (Note 3)	$21,847	$ -	$5,219	$27,066	$18,363
Prepaid Benefits	120,076	-	-	120,076	-
RECEIVABLES:					
Accrued interest & dividends	55,145	2,321	-	57,466	55,103
Securities sold (Note 3)	356,035	14,983	-	371,018	510,583
Forward contracts (Note 5)	1,813,282	76,310	-	1,889,592	1,573,699
Contributions (Note 7)	26,870	2,397	2,121	31,388	21,147
Due from Other Funds	-	-	6,323	6,323	7,023
Other	2,920	73	1,578	4,571	4,427
Total Receivables	2,254,252	96,084	10,022	2,360,358	2,171,982
INVESTMENTS AT FAIR VALUE (Note 3)					
Temporary investments	1,800,824	75,785	-	1,876,609	2,040,185
Temporary investments from securities lending collateral (Note 4)	2,174,253	91,501	-	2,265,754	2,279,978
U.S. government obligations	3,707,347	151,367	-	3,858,714	2,564,711
Corporate bonds	1,859,791	66,899	45,572	1,972,262	2,617,193
Common and preferred stocks	15,932,481	686,517	124,088	16,743,086	15,751,417
Real estate mortgages & contracts	224,995	9,469	11,323	245,787	26,774
Total investments	25,699,691	1,081,538	180,983	26,962,212	25,280,258
TOTAL ASSETS	28,095,866	1,177,622	196,224	29,469,712	27,470,603
LIABILITIES:					
Payable for securities purchased (Note 3)	859,575	36,174	-	895,749	984,476
Payable for securities lending collateral (Note 4)	2,174,253	91,501	-	2,265,754	2,279,978
Forward contracts payable (Note 5)	1,819,283	76,562	-	1,895,845	1,578,003
Due to Other funds	6,323	-	-	6,323	7,023
Other	16,786	3,639	222	20,647	13,738
Total Liabilities	4,876,220	207,876	222	5,084,318	4,863,218
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:	$23,219,646	$969,746	$196,002	$24,385,394	$22,607,385

(A Schedule of Funding Progress is presented on page 45)
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, 2006 with Comparative Totals for 2005
(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund (Note 8)	Long-Term Disability Fund (Note 8)	Combined 2006	Combined 2005
ADDITIONS:					
Contributions:					
Member Contributions (Note 7)	$570,933	$ -	$41,188	$612,121	$442,643
Employer contributions (Note 7)	477,472	93,461	41,188	612,121	442,643
Transfers from other plans	1,727	-	-	1,727	1,773
Member reimbursements	124,024	-	-	124,024	140,159
Total Contributions:	1,174,156	93,461	82,376	1,349,993	1,027,218
Income from investment activities:					
Net appreciation (depreciation) in fair value	1,672,710	68,239	17,950	1,758,899	1,382,587
Interest	260,548	10,629	122	271,299	225,710
Dividends	223,564	9,120	8	232,692	212,174
Real estate	7,831	319	-	8,150	6,113
Other	5,972	90	-	6,062	4,731
Total income from investment activities:	2,170,625	88,397	18,080	2,277,102	1,831,315
Less investment activity expenses:					
Investment management fees and monitoring services	44,945	1,834	-	46,779	27,576
Real estate	4,975	203	-	5,178	6,008
Total investment activity expenses:	49,920	2,037	-	51,957	33,584
Net income from investment activities	2,120,705	86,360	18,080	2,225,145	1,797,731
From securities lending activities (Note 4):					
Security loan program	85,592	3,492	-	89,084	46,757
Security loan interest expense	80,025	3,265	-	83,290	41,096
Net income from securities lending activities	5,567	227	-	5,794	5,661
Total net investment income	2,126,272	86,587	18,080	2,230,939	1,803,392
TOTAL ADDITIONS	3,300,428	180,048	100,456	3,580,932	2,830,610
DEDUCTIONS					
Retirement and disability benefits	1,538,992	80,827	66,271	1,686,090	1,558,332
Survivor benefits	17,125	-	-	17,125	18,402
Refunds to withdrawing members, including interest	60,313	-	-	60,313	44,164
Administrative expenses	28,054	1,074	3,017	32,145	25,275
Transfers to other plans	5,129	-	-	5,129	4,581
Other	2,083	38	-	2,121	3,570
TOTAL DEDUCTIONS	1,651,696	81,939	69,288	1,802,923	1,654,324
NET INCREASE (DECREASE)	1,648,732	98,109	31,168	1,778,009	1,176,286
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:					
Beginning of year	21,570,914	871,637	164,834	22,607,385	21,431,099
End of year	$23,219,646	$969,746	$196,002	$24,385,394	$22,607,385

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.

Both the Health Benefit Supplement Fund (HBS) and the Long-Term Disability Fund (LTD) are benefit cost-sharing, multiple-employer post-employment benefit plans. Although the assets of the HBS Fund are commingled with assets of the Retirement Fund, each plan's assets may be used only for the payment of benefits to the members of the plan, in accordance with the terms of the plan.

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, survivor annuities, health insurance supplements and long-term disability 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, 2006, the number of participating employers and employees totaled:

EMPLOYER UNITS:	
School Districts	235
Charter Schools	180
Cities and Towns	74
Counties	15
Special Districts	81
Community College Districts	10
Universities	3
State Government	1
TOTAL	**599***
EMPLOYEE MEMBERS:	
Retirees (including Beneficiaries)	80,129
Non Active Fully Vested	184,460
Long-Term Disability recipients	4,968
CURRENT EMPLOYEES:	
Active Fully Vested**	217,961
TOTAL	**487,518**

Of the retirees and LTD recipients noted above, 48,449 are receiving health insurance premium benefits.

* The 599 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 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.

Notes to the Basic Financial Statements

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 earnings. 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 4 percent. 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

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.

Notes to the Basic Financial Statements

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 retirement health benefit supplement and long-term disability plan.

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

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.

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

Notes to the Basic Financial Statements

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, 2006, 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, 2005, 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, 2005, from which the summarized information was derived.

New Accounting Pronouncements – The ASRS implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* for the year ended June 30, 2006. GASB Statement No. 43 addressed the financial reporting and disclosure for other postemployment benefits plans.

The ASRS implemented GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section,* for the year ended June 30, 2006. GASB Statement No. 44 requires additional information and schedules in the statistical section of the Comprehensive Annual Financial Report (CAFR).

The ASRS implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* for the fiscal year ended June 30, 2006. GASB No. 45 requires employer governments to account for and report the annual cost of other postemployment benefits in the same manner as they do for pensions.

The ASRS complies with GASB Statement No. 42, A*ccounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* for the year ended June 30, 2006. The statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

The ASRS complies with GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation—an Amendment of GASB Statement No. 34,* for the year ended June 30, 2006. The Statement establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation of reporting certain net assets as restricted net assets.

Notes to the Basic Financial Statements

The ASRS complies with GASB Statement No. 47, *Accounting for Termination Benefits,* for the year ended June 30, 2006. GASB 47 gives accounting and reporting guidance for early retirement incentives, severance payments for involuntary terminations and termination benefits affecting defined benefit postemployment benefits.

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, 2006, $100,000 of the ASRS' cash deposits was 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.

Notes to the Basic Financial Statements

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

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 2006, 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 2006 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, 2006
(Dollars in Thousands)

Investment	2006 Fair Value
Temporary Investments including US Treasury Bills	$ 1,854,416
Foreign Bonds including Temporary Investments	22,193
Total Temporary Investments	1,876,609
Domestic Corporate Bonds	1,972,262
Domestic Common and Preferred Stock	12,423,575
Foreign Common and Preferred Stock	4,319,511
Total Common and Preferred Stock	16,743,086
US Government Obligations	706,679
US Agency Obligations	3,152,035
Total US Government Obligations	3,858,714
Real Estate Mortgages & Contracts	245,787
U. S. Government Obligations	483,178
U. S. Agency Obligations	372,147
Corporate Obligations – Domestic	776,185
Preferred and Common Stock- Domestic	43,068
Preferred and Common Stock –Foreign	591,176
Total Securities Lending Obligations	2,265,754
TOTAL INVESTMENTS AT FAIR VALUE	26,962,212
*Short Term Investment Recievables	2,319,889
**Short Term Investment Payables	(5,070,709)
INVESTMENTS AT FAIR VALUE - NET	**$24,211,392**

* Includes $1,813 other receivables.
** Includes $12,566 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 $371 million and a payable for securities purchased of $895.7 million at June 30, 2006.

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, 2006 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, 2006
(Dollars in Thousands)

Investment	Fair Value	AAA/P1	AA	A	BBB	BB	B	Not Rated
Asset Backed Securities	253,388	$228,300	$5,498	$5,328	$1,574	-	$1,079	11,609
Bond Funds	36,043	36,043	-	-	-	-	-	-
CMO's of Government Sponsored Entities	423,889	96,392	-	-	-	-	-	327,497
Commercial Mortgage Backed Securities	390,780	348,568	1,121	277	-	-	-	40,814
Commercial Paper	157,443	157,443	-	-	-	-	-	-
Corporate Bonds	1,043,042	78,349	193,306	219,829	251,140	24,642	10,818	264,958
Dollar Denominated Debt of Foreign Companies	55,906	809	3,759	27,291	22,753	1,294	-	-
Dollar Denominated Debt of Foreign Countries	45,329	23,740	2,638	2,573	16,378	-	-	-
Fixed Income Strips incl US strips	37,434	37,434	-	-	-	-	-	
GNMA Pools	116,187	116,187	-	-	-	-	-	-
Government Sponsored Entity Debt	311,866	291,446	20,420	-	-	-	-	-
Indexed Linked Government Bond Funds	1,092,671	-	-	-	-	-	-	1,092,671
Indexed Linked Treasury Bonds	16,337	16,337	-	-	-	-	-	-
Municipal Bonds	1,260	-	1,260	-	-	-	-	-
Non-government Backed CMO's	168,515	164,493	-	41	-	-	-	3,981
Pools of Government Sponsored Entities	1,414,300	1,414,300						
Short Term Money Markets	1,697,024							1,697,024
US Treasury Debt including treasury bills	630,702	630,702						
Total Domestic Debt Securities	$7,892,116	$3,640,543	$228,002	$255,339	$291,845	$25,936	$11,897	$3,438,554
Corporate Bonds	$849	849	-	-	-	-	-	-
Government Bonds	6,172	5,894	-	-	278	-	-	-
Provincial Bonds	3,307	-	3,307	-	-	-	-	-
Margin Accounts	1,605	-	-	-	-	-	-	1,605
Total Foreign Debt Securities	$11,933	$6,743	$3,307	$-	$278	$-	$-	$1,605
Total Debt Securities	**$7,904,049**	**$3,647,286**	**$231,309**	**$255,339**	**$292,123**	**$25,936**	**$11,897**	**$3,440,159**

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, 2006
(Dollars in Thousands)

INVESTMENT	FAIR VALUE	EFFECTIVE DURATION
Domestic Fixed Income Investments		
Asset Backed Securities	$253,388	1.66
Bond Funds	36,043	8.53
CMO's of Government Sponsored Entities	423,889	3.86
Commercial Mortgage Backed Securities	390,780	3.91
Commercial Paper	157,443	0.03
Corporate Bonds	1,043,042	4.27
Dollar Denominated Debt of Foreign Companies	55,906	6.86
Dollar Denominated Debt of Foreign Countries	45,329	6.54
Fixed Income Strips	37,434	7.88
GNMA Pools	116,187	3.45
Government Sponsored Entity Debt	311,866	4.21
Indexed Linked Government Bond Funds	1,092,671	0.00
Indexed Linked Treasury Bonds	16,337	4.73
Municipal Bonds	1,260	14.89
Non-government Backed CMO's	168,515	2.36
Pools of Government Sponsored Entities	1,414,300	4.11
Short Term Investments	1,697,024	0.08
US Treasury Debt	630,702	4.20
Total Domestic Debt Securities	$7,892,116	3.28
Foreign Debt Securities		
Corporate Bonds	$849	6.77
Government Bonds	6,172	0.33
Provincial Bonds	3,307	6.77
Margin Accounts	1,605	0.08
Total Foreign Debt Securities	$11,933	2.54
Total Debt Securities	$7,904,049	

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, 2006
(Dollars in Thousands)

Currency Type	Temporary Investments	Fixed Income	Equities	Real Estate	Total
Australian Dollar	$628	$-	$53,308	$-	$53,936
British Pound Sterling	(938)	-	572,484	-	571,546
Canadian Dollar	106	-	16,131	-	16,237
Danish Krone	1,898	-	21,434	-	23,332
Euro Currency Unit	6,346	$5,894	1,071,646	45	1,083,931
Hong Kong Dollar	352	-	72,859	-	73,211
Indonesian Rupian	-	-	4,284	-	4,284
Japanese Yen	17,091	-	688,921	-	706,012
New Mexican Peso	296	278	-	-	574
New Taiwan Dollar	-	-	21,650	-	21,650
New Zealand Dollar	488	3,307	10,947	-	14,742
Norwegian Krone	22	-	7,660	-	7,682
Singapore Dollar	135	-	65,094	19	65,248
South Korean Won	-	-	28,050	-	28,050
Swedish Krona	577	-	30,421	-	30,998
Swiss Franc	538	-	268,992	-	269,530
Thailand Baht	-	-	4,293	-	4,293
Total	**$27,539**	**$9,479**	**$2,938,174**	**$64**	**$2,975,256**

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 ASRS owes the borrowers exceeds the amount the borrowers owe the ASRS.

Notes to the Basic Financial Statements

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, 2006, 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 typically have no greater market risk than their physical counterparts, and in many cases are offset by exposure elsewhere in the portfolio. As of June 30, 2006, the ASRS had $1.2 billion in temporary investments held as collateral for equity and fixed income derivatives which may have a positive or negative notional value.

Notes to the Basic Financial Statements

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, 2005 Actuarial Valuation for the Retirement Plan and the Health Insurance Premium Benefit, the most recent actuarial valuation available, include: a rate of return on investment of present and future assets of 8 percent, compounded annually, projected salary increases ranging from 4.5 percent to 9.5 percent per year, inflation rate assumption of 4.25 percent, rates of disability, rates of withdrawal, rates of retirement, mortality rates, mortality rates after disability, valuation of assets using fair value less ten-year phase-in (five-year phase-in before FY 2002) of excess (shortfall), investment income, projected unit-credit funding method

For the 2005 Long-Term Disability Plan valuation, the funding method was changed to projected unit cost method. Assets are valued at market, less (or plus) an adjustment to reflect investment gains (or losses) over a 10-year period. The unfunded actuarial accrued liability is amortized over a rolling 15 years in level dollar payments.

6a. Funded Status and Progress-OPEB Plans

The funded status of each plan as of the most recent actuarial valuation data is as follows (dollar amounts in millions):

Actuarial Valuation Date 30-Jun	Actuarial Value of Assets a	Actuarial Accrued Liability Projected Unit-Credit b	(Overfunded) Unfunded Actuarial Accrued Liability (b - a)	Funded Ratio (a/b)	Covered Payroll c	UUAL as a Percentage of Covered Payroll [(b-a)/c]
Health Insurance Premium Benefit						
2005	$1,028	$1,456	$428	70.6%	$8.032	5.3%
Long Term Disability Program						
2005	$165	$577	$412	28.6%	$8.032	5.1%

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

The accompanying schedules of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB

Notes to the Basic Financial Statements

Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a thirty year rolling period for the HBS plan and over fifteen years in level dollar payments for the LTD plan.

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

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). 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 for the retirement, the health insurance premium supplement and the long term disability plans were actuarially determined using the Projected Unit Credit (PUC) funding method. 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 for the retirement plan and the health insurance supplement plan. The long term disability plan uses a rolling 15 year period to reflect the shorter duration of LTD benefits.

Notes to the Basic Financial Statements

The contribution rates for the years ended June 30, 2006 and 2005 were as follows:

	For the contribution period ending June 30, 2006 (2004 Valuation)		For the contribution period ending June 30, 2005 (2002 Valuation)	
	Amount	Percent of Covered Payroll	Amount	Percent of Covered Payroll
Normal cost	$889,752,558	11.87%	$754,573,606	10.80%
Amortization of (over)under-funded past service liability	187,139,751	2.50 %	(104,840,085)	(1.50)%
RETIREMENT TOTAL	1,076,892,309	14.37%	649,733,521	9.30%
Health Premium Benefit	84,702,645	1.13%	76,925,947	1.10%
Long Term Disability	73,313,962	1.00%	72,854,831	1.00%
ACTUARIAL TOTAL	$1,234,908,916	16.50%*	$799,514,299	11.40%
Contributions made as a percentage of the current year covered payroll:				
Employers' Retirement	$477,471,507	5.77%	$318,311,081	4.10%
Employees' Retirement	570,932,683	6.90%	403,661,156	5.20%
Employers' Health Premium Benefit	93,461,175	1.13%	85,350,073	1.10%
Employers' Long Term Disability	41,188,441	0.50%	38,981,702	0.50%
Employees' Long Term Disability	41,188,441	0.50%	38,971,702	0.50%
TOTAL	**$1,224,242,247**	**14.80 %***	**$885,275,714**	**11.40%**

*The actuarial calculations establish a total benefit cost of 16.5 percent. Legislative action set the contribution rate for 2006 at 14.8 percent.

The 2004 valuation calculated a rate of 7.75 percent to become effective July 1, 2005. The Legislature adopted a stair-step approach to increasing contribution rates, and set the rate at 7.4 percent (6.9 percent retirement and .50 percent for long-term disability) for fiscal year 2006 and 9.1 percent (8.6 percent for retirement and .50 percent for long-term disability) for fiscal year 2007.

The statutory contribution rate and the actuarially determined contribution rate for the year ended June 30, 2005 was 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

Notes to the Basic Financial Statements

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 each contributed .50 percent of compensation in FY 2006 and .50 in FY 2005 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 48,499 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.

In FY 2006 the employer's retirement contribution of 6.9 percent of compensation included 1.13 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:

		Without Medicare		With Medicare A & B		Combinations	
Years of Credited Service	Percent of Premium Benefit	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, 2005 through June 30, 2006. This benefit is not available for retirees who are not Medicare eligible. These additional increases are listed in the table below:

Notes to the Basic Financial Statements

With Medicare A & B			Combinations
Years of Credited Service	Retiree Only	Retiree & Dependents	Medicare Eligible Retiree with at least one Non-Medicare Dependent
5.0-5.9	$85	$175	$235
6.0-6.9	102	210	282
7.0-7.9	119	245	329
8.0-8.9	136	280	376
9.0-9.9	153	315	423
10.0+	170	350	470

The ASRS reimbursed approximately $80.8 million and $89.6 million towards the cost of group health insurance coverage for the years ended June 30, 2006 and 2005, 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 and GASB Statement No. 43 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. Refer to Note 1 of these financial statements for information regardign current participating employers and employee members. The ASRS is administered in accordance with Title 38, Chapter 5 of the Arizona Revised

Notes to the Basic Financial Statements

Statutes (A.R.S.).

The ASRS Retirement Plan provides retirement, health insurance premium benefits, disability benefits, and survivor benefits to members and their beneficiaries. Both the health insurance premium benefits and disability benefits are post-employment benefit plans. 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, 2006 was 7.4 (6.9 percent retirement and .5 percent LTD) and 2005 was 5.7 percent (5.2 percent retirement and .5 percent LTD). All eligible employees were required to contribute 7.4 percent of their annual covered salary, and the ASRS, as the employer, was required to match these contributions.

The ASRS employer Contributions for the past three years are presented in the following table:

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. 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.

Refer to Note 6 of these financial statements for current information regarding the funding status and progress of the health insurance premium benefit plan and the long term disability plan.

FISCAL YEAR	SALARY BASE	RETIREMENT CONTRIBUTIONS	HBS CONTRIBUTIONS	LTD CONTRIBUTIONS	TOTAL CONTRIBUTIONS	% OF REQUIRED CONTRIBUTIONS
2006	$10,917,002	$629,911	$123,362	$54,585	$807,858	100%
2005	8,164,530	334,746	89,810	40,823	465,379	100%
2004	8,050,253	327,680	90,968	40,217	458,865	100%

Required Supplementary Information

Schedule of Funding Progress

For Year Ended June 30, 2006
(in Millions)

Actuarial Valuation Date 30-Jun	Actuarial Value of Assets a	Actuarial Accrued Liability Projected Unit-Credit b	(Overfunded) Unfunded Actuarial Accrued Liability (b - a)	Funded Ratio (a / b)	Covered Payroll c	(Overfunded) Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll [(b-a) / c]
RETIREMENT FUND						
2000	$20,292	$16,854	($3,438)	120.4%	$5,894	(58.3%)
2001	21,888	19,012	(2,876)	115.1	6,357	(45.2)
2002	22,642	21,285	(1,357)	106.4	6,989	(19.4)
2003	22,572	22,935	363	98.4	7,297	5.0
2004	22,659	24,506	1,847	92.5	7,486	24.7
2005	22,808	26,486	3,678	86.1	8,032	45.8
HEALTH INSURANCE PREMIUM BENEFIT						
2005	$1,028	$1,456	$428	70.6%	$8,032	5.3%
LONG-TERM DISABILITY BENEFIT						
2005	$ 165	$ 577	$412	28.16%	$8,032	5.1%

Schedule of Employer Contributions

For Year Ended June 30, 2006
(in Thousands)

	Retirement Fund		Health Insurance Premium Benefit		Long Term Disability Program	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2001	$ 77,196	100%	$56,308	100%	$29,938	100%
2002	131,234	100	4,041	100	32,938	100
2003	138,100	100	4,256	100	34,800	100
2004	297,770	100	79,662	100	36,026	100
2005	318,311	100	85,350	100	38,982	100
2006	477,472	100	93,461	100	41,188	100

See notes to required supplemental 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 valuations for the period ended June 30, 2005. The unfunded actuarially accrued liability is amortized over a 30-year rolling period for the Retirement Fund and the Health Insurance Premium Benefit. The Long-Term Disability (LTD) Program's unfunded actuarial accrued liability is amortized over a rolling 15-year period to reflect the shorter duration of LTD benefits. 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 $305 million as of June 30, 2005, before the payment of the 2005 PBI.

Significant Factors Affecting Identification of Trends

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 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

Notes to Required Supplementary Information

- 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 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:

- 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 %

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

Notes to Required Supplementary Information

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 who choose the 5, 10, or 15 period certain options to rescind the election 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.

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 Premium Benefit. 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% 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 liability associated with 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, when appropriate, 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.
- The legislature pegged the contribution rates for fiscal year 2006 and fiscal year 2007 at 6.90 percent and 8.60 percent respectively. After fiscal year 2007, contribution rates are to be determined annually.
- Eliminated the rural health insurance premium benefit for retirees in the Arizona retirement system who are not eligible for Medicare.

Notes to Required Supplementary Information

2006

Temporary Rural Health Insurance Premium Benefit. The Legislature extended the temporary Rural Health Insurance Subsidy for a two year period, from July 1, 2005, to June 30, 2007. The benefit is provided to Medicare-eligible retirees and disabled members who live in Arizona counties with no Health Maintenance Organization (HMO) service area and who have at least 10 years of credited service.

Additional Supplementary Information

Combining Schedule of Retirement Net Assets
For the Year Ended June 30, 2006
(Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2006
ASSETS:			
Cash	$21,847	$ -	$21,847
Prepaid benefits	120,076	-	120,076
RECEIVABLES:			
Accrued interest & dividends	53,830	1,315	55,145
Securities sold	347,546	8,489	356,035
Forward contracts	1,770,050	43,232	1,813,282
Contributions	26,870	-	26,870
Other	2,850	70	2,920
Total Receivables	2,201,146	53,106	2,254,252
INVESTMENTS AT FAIR VALUE :			
Temporary investments	1,757,889	42,935	1,800,824
Temporary investments from securities lending collateral	2,122,415	51,838	2,174,253
U. S. government obligations	3,621,592	85,755	3,707,347
Corporate bonds	1,821,890	37,901	1,859,791
Common and preferred stocks	15,543,545	388,936	15,932,481
Real estate mortgages & contracts	219,631	5,364	224,995
Total investments	25,086,962	612,729	25,699,691
TOTAL ASSETS	27,430,031	665,835	28,095,866
LIABILITIES:			
Payable for securities purchased	839,081	20,494	859,575
Payable for securities lending collateral	2,122,415	51,838	2,174,253
Forward contracts payable	1,775,908	43,375	1,819,283
Due to Other funds	6,323	-	6,323
Other	15,734	1,052	16,786
Total Liabilities	4,759,461	116,759	4,876,220
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	**$22,670,570**	**$549,076**	**$23,219,646**

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, 2006
(Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2006
ADDITIONS			
Contributions			
Member contributions	$570,581	$352	$570,933
Employer contributions	477,120	352	477,472
Transfers from other plans	1,727	-	1,72
Member reimbursements	124,024	-	124,024
Total Contributions	1,173,452	704	1,174,156
Income from investment activities			
Net appreciation in fair value	1,631,693	41,017	1,672,710
Interest	254,159	6,389	260,548
Dividends	218,082	5,482	223,564
Real Estate	7,639	192	7,831
Other	5,826	146	5,972
Total income from investment activities	2,117,399	53,226	2,170,625
Less investment activity expenses			
Investment management fees and monitoring services	43,843	1,102	44,945
Real estate	4,853	122	4,975
Total investment activity expenses	48,696	1,224	49,920
Net income from investment activities	2,068,703	52,002	2,120,705
From securities lending activities			
Security loan program	83,493	2,099	85,592
Security loan interest expense	78,062	1,963	80,025
Net income from securities lending activities	5,431	136	5,567
Total net investment income	2,074,134	52,138	2,126,272
TOTAL ADDITIONS	3,247,586	52,842	3,300,428
DEDUCTIONS			
Retirement and disability benefits	1,495,180	43,812	1,538,992
Survivor benefits	16,945	180	17,125
Refunds to withdrawing members, including interest	59,696	617	60,313
Administrative expenses	27,393	661	28,054
Transfers to other plans	5,129	-	5,129
Other	2,067	16	2,083
TOTAL DEDUCTIONS	1,606,410	45,286	1,651,696
NET INCREASE	1,641,176	7,556	1,648,732
Net assets held in trust for pension benefits:			
Beginning of year	21,029,394	541,520	21,570,914
End of year	$22,670,570	$549,076	$23,219,646

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
1997	$173,508	$173,508	$2,832,718	$11,481	$3,191,215
1998	176,769	176,769	3,405,203	15,462	3,774,203
1999	179,087	179,087	2,848,321	46,171	3,252,666
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	(1,380,301)
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
2006	612,121	612,121	2,230,939	125,751	3,580,932

Schedule of Deductions by Type
(Dollars in Thousands)

Year	Benefits	Refunds	Administration, Transfers and Other	Total
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	878,051
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	1,296,417
2004	1,396,481	36,212	35,745	1,468,438
2005	1,576,734	44,164	33,426	1,654,324
2006	1,703,215	60,313	39,395	1,802,923

Additional Supplementary Information

Schedule of Administrative Expenses
For Year Ended June 30, 2006
(Dollars in Thousands)

	Retirement and Health Benefit Supplement	Long-Term Disability	Combined 2006
Personnel Services			
Salaries	$9,585	$ -	$9,585
Compensated Balances	761	-	761
Retirement Contributions	632	-	632
Other Employee Related Expenses	2,058	-	2,058
Total Personnel Services	**13,036**	**-**	**13,036**
Professional Services			
Actuary & Benefit Consulting	1,800	-	1,800
Audit, Consulting & Legal Fees	280	-	280
Retiree Payroll Costs	1,376	-	1,376
Programming Costs	6,466	-	6,466
Other Outside Services	1,887	2,593	4,480
Total Professional Services	**11,809**	**2,593**	**14,402**
Communications			
Postage	347	-	347
Printing	176	-	176
Telephone	279	-	279
Advertising	41	-	41
Total Communications	**843**	**-**	**843**
Miscellaneous			
Board & Council	13	-	13
Office Rent	1,951	-	1,951
Furniture & Equipment	315	-	315
Software & Support	78	-	78
Repair & Maintenance	550	-	550
Travel	77	-	77
Operating Supplies	103	-	103
Insurance	147	-	147
Dues & Subscriptions	17	-	17
Education & Training	126	-	126
Miscellaneous	63	424	487
Total Miscellaneous	**3,440**	**424**	**3,864**
TOTAL	**$29,128**	**$3,017**	**$32,145**

Additional Supplementary Information

Schedule of Cash Receipts and Cash Disbursements
Year Ended June 30, 2006
(Dollars in Thousands)

CASH BALANCE, beginning of year	**$18,363**
RECEIPTS:	
Member contributions	606,256
Employer contributions	606,890
Purchase of back service (membership reimbursements)	124,024
Transfers from other retirement systems	1,727
Short-term securities matured and sold	31,289,018
Investments matured and sold	30,378,392
Building revenue	8,082
Securities lending program	89,150
Interest	139,763
Dividends	233,622
Miscellaneous	3,337
TOTAL RECEIPTS	**$63,480,261**
DISBURSEMENTS:	
Retirement, disability and subsidy payments	1,683,056
Prepaid benfits	120,076
Death benefits	17,124
Refunds to withdrawing members	60,313
Transfers to other retirement systems	5,129
Short-term investments purchased	13,348,145
Investment purchases	48,068,142
Securities lending program charges	83,289
Investment manager fees	46,821
Building expenses	5,322
Administrative expenses	28,199
Miscellaneous	5,942
TOTAL DISBURSEMENTS	**$63,471,558**
CASH BALANCE, end of year	**$27,066**

Additional Supplementary Information

Schedule of Professional Consultant Fees
For Year Ended June 30, 2006
(Dollars in Thousands)

Professional / Consultant	Nature Of Service	Expenses
VOLUNTARY PLAN ADMINISTRATION	LTD CONSULTING SERVICES	$2,593
H L YOH CO LLC	IT CONSULTING SERVICES	1,993
MELLON BANK TRUST & INVESTMENTS	PENSION PAYMENT SERVICES	1,319
FIRST NATIONAL INFORMATION	DOCUMENT IMAGING SERVICES	1,230
INT TECHNOLOGIES LLC	IT CONSULTING SERVICES	991
COMSYS INFORMATION TECHNOLOGY	IT CONSULTING SERVICES	665
BUCK CONSULTANTS LLC	ACTURIAL SERVICES	598
KELLY SERVICES INC	TEMPORARY AGENCY	558
SPHERION CORPORATION	IT CONSULTING SERVICES	553
COMPUTER INFORMATION TECHNOLOGIES	IT CONSULTING SERVICES	504
MUNIS INC	IT CONSULTING SERVICES	442
DATA MAVENS INC	IT CONSULTING SERVICES	397
KEANE INC	IT CONSULTING SERVICES	397
GLOTEL	IT CONSULTING SERVICES	372
ATTORNEY GENERAL OFFICE	LEGAL SERVICES	247
WELLS FARGO BUSINESS CREDITORS	IT CONSULTING	225
ABLEST INC	IT CONSULTING SERVICES	203
STAFFMARK INC	TEMPORARY AGENCY	125
PROVALIANT INC	IT CONSULTING SERVICES	131
MERCER HUMAN RESOURCE	INVESTMENT CONSULTING	122
TECH KNOWLEDGY STORE LLC	IT CONSULTING SERVICES	99
TECHSTAR	IT CONSULTING SERVICES	96
DELOITTE & TOUCHE	AUDIT SERVICES	90
ANALYSTS INTERNATIONAL CO	IT CONSULTING SERVICES	63
COST EFFECTIVENESS MEASUREMENT INC	PLAN ADMINISTRATIVE CONSULTING	58
RANDSTAD	TEMPORARY AGENCY	57
CORPORATE JOB BANK	TEMPORARY AGENCY	37
BIBBY FINANCIAL SERVICES	IT CONSULTING SERVICES	31
COVANSYS CORPORATION	IT CONSULTING SERVICES	31
CHARLES W WHETSTINE	LEGAL SERVICES	28
COMPUCOM SYSTEMS INC	IT CONSULTING SERVICES	25
BEHAVIOR RESEARCH CENTER	CONSULTING SERVICES	24
GOODMANS INC	BUILDING SERVICES	15
MELLON CONSULTANTS INC	INVESTMENT CONSULTING	15
PALAYEKAR COMPANIES INC	IT CONSULTING SERVICES	13
SULLIVAN ROGERS AND COMPANY	IT CONSULTING SERVICES	12
OTHER CONSULTING FEES (less than ten thousand dollars)	MISCELLANEOUS CONSULTING SERVICES	43
Total		**$14,402**

Additional Supplementary Information

Schedule of Total Investment Income by Manager
For Year Ended June 30, 2006
(Dollars in Thousands)

Manager	Market Appreciation (Depreciation)	Interest	Dividends	Real Estate / Other	Total Investment Income
ASRS INTERNAL	$ 225,106	$117,823	$ 87,168	$10,135	$ 440,232
AXA ROSENBERG	42,081	181	5,789	-	48,051
BANK OF IRELAND	(20)	2	3	-	(15)
BANK OF NEW YORK	27,237	38	511	119	27,905
BARCLAYS GLOBAL INVESTORS	438,379	4	8	-	438,391
BATTERYMARCH	12,479	88	494	-	13,061
BLACKROCK	(41,113)	43,414	46	1	2,348
BRANDES	280,220	956	33,799	-	314,975
BRANDYWINE	-	-	-	104	104
BRIDGEWATER	58,552	49,695	400	-	108,647
BYRAM	16,620	201	2,995	7	19,823
CAPITAL GUARDIAN	(13)	-	87	48	122
COLUMBIA	-	-	-	24	24
CRM	12,892	257	868	-	14,017
DFA	21,526	114	3,104	-	24,744
DIMENSIONAL	70,150	166	7,205	93	77,614
FIDELITY	(19,763)	21,520	-	-	1,757
FORTSMANN-LEFF ASSOC	2,823	15	13	-	2,851
FRANKLIN	81,884	172	21,679	-	103,735
FRONTIER	3,126	11	38	-	3,175
GOLDMAN SACHS	125,098	3,554	(34)	-	128,618
HANSBERGER	67,765	215	8,936	-	76,916
HINES	3,050	2	1,008	284	4,344
ING	7,214	32	858	-	8,104
INTECK	37,413	167	9,856	-	47,436
JP MORGAN	(30,452)	28,560	31	267	(1,594)
LSV ASSET MANAGEMENT	56,627	135	12,293	-	69,055
MELLON	57,409	2,536	-	1,355	61,300
MFS INTERNATIONAL	92,513	520	23,597	-	116,630
NORTHPOINTE	4,740	68	950	-	5,758
ROTHSCHILD	-	-	51	1,775	1,826
STATE STREET GLOBAL	57,433	140	7,031	-	64,604
TIMESQUARE	20,749	337	877	-	21,963
TISHMAN	1,461	138	-	-	1,599
URDANG	5,876	62	1,395	-	7,333
WELLINGTON	19,837	176	1,636	0	21,649
TOTAL	**$1,758,899**	**$271,299**	**$232,692**	**$14,212**	**$2,277,102**

Additional Supplementary Information

Schedule of Total Investment Expenses

For the Year Ended June 30, 2006
(Dollars in Thousands)

	Management and Monitoring Fees	Real Estate Expense	Total
AMERICAN STOCK EXCHANGE	$ 1	$ -	$ 1
ASRS INTERNAL	15	4,821	4,836
AXA ROXENBERG	1,704		1,704
BANK OF NEW YORK	243		243
BARCLAYS GLOBAL INVESTORS	3,431		3,431
BARRA INC	100		100
BATTERYMARCH	930		930
BLACKROCK	1,449		1,449
BLOOMBERG	113		113
BRANDES	4,856		4,856
BRIDGEWATER	5,480		5,480
BYRAM	614		614
COURTLAND	101		101
COX CASTLE AND NICHOLSON LLP	43		43
CRAIN COMMUNICATIONS INC	2		2
CRAMER ROSENTHAL MCGYNN	572		572
DIMENSIONAL FUND ADVISORS	1,687		1,687
ENHANCED INVESTMENT TECHNOLOGIES LLC	2,383		2,383
FIDELITY	1,028		1,028
FLA ASSET MANAGEMENT LLC	32		32
FOSTER PEPPER	225		225
FRANKLIN	1,909		1,909
GOLDMAN SACHS	6,375		6,375
HANSBERGER	1,909		1,909
HINES-SUMISEI US CORE OFFICE FUND LP	328	357	685
ING CLARION	135		135
INSTITUITONAL SHAREHOLDER SVCS INC	43		43
INSTITUTIONAL INVESTOR	1		1
INVESTMENT RELATED TRAVEL	6		6
JP MORGAN	1,264		1,264
LSV ASSET MANAGEMENT	1,486		1,486
MARKET AXESS CORP	5		5
MATTHEW BENDER & CO INC	5		5
MELLON	544		544
MERCER HUMAN RESOURCE	246		246
MFS INSTITUTIONAL ADVISORS INC	1,805		1,805
MOODYS	41		41
MORGAN STANLEY	3		3
MORNING STAR INC	1		1
MORRISON AND FOERSTER LLP	34		34
NEW YORK STOCK EXCHANGE	3		3
NORTHPOINTE	458		458
PENLEY INC	1		1
PENSION FUND DATA EXCHANGE LTD	1		1
RIDENOUR HIENTON HARPER	105		105
ROTHSCHILD	1,819		1,819
RV KUHNS AND ASSOCIATES INC	61		61
SKADDEN ARPS SLATE MEAGHER AND FLOM LLP	20		20
STATE STREET	741		741
SUNGARD	5		5
TIMES SQUARE CAPITAL	1,161		1,161
TISHMAN	193		193
TRADEWEB LLC	23		23
URDANG	214		214
WELLINGTON MANAGEMENT	825		825
TOTAL	**$46,779**	**$5,178**	**$51,957**

Arizona State Retirement System
A Component Unit of the State of Arizona

2006

Investment
Section

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Investment Report

U.S. Economy and Capital Markets FY 2005-06

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

3rd Quarter 2005

Economic growth was moderate during the quarter, GDP growth was 4.2%. Hurricane damage along the U.S. gulf coast had a major impact on oil refining and transportation capabilities, and oil prices almost reached $70/barrel. Increasing interest rates, housing costs, credit card debt and higher gas prices contributed to lower consumer confidence during the quarter. The Consumer Price Index increased 4.7% year-over-year, largely driven by the soaring energy costs. Core CPI (excluding food and energy) increased by 2.0%. Unemployment rose to 5.1%. Housing starts and building permits remained strong. Amid inflation concerns, the Fed increased the Fed Funds rate twice to 3.75%.

The S&P 500 Index was up 3.6% for the quarter. Consumer discretionary and financial stocks suffered as a result of increasing interest rates. The energy sector was up 17% as a result of earnings and higher energy prices. Technology and utilities sectors also performed well. Small cap stocks performed better than their large cap counterparts. The Russell 2000 Index gained 4.7%. International equities had a strong quarter despite global economic concern. The MSCI EAFE Index returned 10.4%. Japanese, European and Australian equities all had large gains. The MSCI Emerging Markets Index gained 18% for the quarter.

The Lehman Aggregate Bond Index was down 0.7% as shorter-term issues outperformed their longer-term counterparts. The Lehman Treasury Index lost 1.1%. The yield curve flattened across all maturities. High yield bonds led the market, gaining 0.9%. Asset backed and mortgaged backed issues posted small losses.

Both private real estate and REITs rose during the third quarter. The NCREIF Index gained 4.4%. MSCI U.S. REIT Index returned 3.6%.

4th Quarter 2005

Economic expansion continued in the fourth quarter, GDP growth came in at 1.8%. Consumer spending and the housing market showed signs of slowing as interest rates continued to rise. The Fed tightened monetary policy, increasing the Fed Funds rate twice to 4.25%. The yield curve inverted at the end of December. Inflation concerns increased. CPI was 3.4% on an annualized basis. The domestic savings rate turned negative for the first time since 1933. Unemployment declined to 4.9 %.

U.S. equities did not benefit from the fourth quarter as they typically do. The S&P 500 Index was up 2.1% for the quarter and 4.9% for the year. The S&P P/E ratio finished the year at 18, a lower multiple than seen in recent years. International markets had a strong year. The MSCI EAFE Index returned 4.1% for the quarter and 14% for the year, and MSCI ACWI ex US Index returned 4.4% for the quarter and 17.1% for 2005. Foreign currency continued to appreciate relative to the dollar. International growth stocks had a strong quarter. Japan, Germany, France and Switzerland all had double digit returns for 2005. The MSCI Emerging Markets Index returned 7.2% for the quarter.

The yield curve inverted, as shorter-term maturities increased more than the longer-term maturities. The Lehman Aggregate Bond Index increased

Investment Report

0.6% during the quarter and 2.4% over the year. The Lehman Treasuries outperformed corporate issues and mortgage backed securities. High yield issues continued to perform well gaining 0.7%.

Private real estate had strong returns, the NCREIF Index rose 5.4%. MSCI U.S. REIT Index gained 1.7%. Spreads between REITs and 10 Year T-Bills contracted.

1st Quarter 2006

In an environment of rising interest rates, higher oil prices, a cooling housing market and increasing inflation concerns, GDP was significantly above average at 5.6%. Higher energy costs pushed the Consumer Price Index to 3.4% on an annualized basis. The personal savings rate was negative for the 5th consecutive month. Unemployment fell to 4.7%. The Fed hiked interest rates twice during the quarter, increasing the Fed Funds rate to 4.75%.

Equities rallied in the first quarter. The S&P 500 Index gained 4.2%, the Russell 1000 Index rose 4.5% and the Russell 2000 Index increased 13.9%. The producer durables sector posted the highest return at 10.2%. Small cap issues outperformed large cap. The MSCI EAFE Index returned 9.5% and MSCI ACWI ex US Index gained 9.8% in dollar terms. Norway, Finland and Sweden all contributed strong quarters, as Europe led all other regions. Emerging markets outpaced developed markets. The MSCI Emerging Markets Index rose 12.1% in dollar terms.

The fixed income market saw shorter-term issues outpace longer-term issues. The Lehman Aggregate Bond Index declined 0.6%. Higher quality issues outperformed lower quality issues in the investment grade market. High yield led the market with a 2.9% return. The Lehman Treasury Index declined 1.2%.

Real estate stocks rallied, as the MSCI U.S. REIT Index rose 15.2%. Private real estate also gained, the NCREIF Property Index was up 3.6%.

2nd Quarter 2006

The initial estimate of GDP was moderate at 2.5%; the slowing growth is attributed to higher interest rates, a dramatically slowing housing market and higher oil prices. Commodity prices, particularly oil and metals, climbed. The Consumer Price Index increased 4.3% year-over-year. The Fed continued increasing rates at a 25 basis points per meeting pace, pushing the rate to 5.25%. The unemployment rate dropped to 4.6%, its lowest level since 2001.

Domestic equities were lower for the quarter. The S&P 500 Index lost 1.4% and the Russell 2000 Index fell 5.0%. Energy and utilities sectors outperformed during the quarter, increasing 5.3% and 4.3%, respectively. Healthcare and Technology underperformed, losing 4.7% and 10.0%, respectively. Growth stocks underperformed value stocks across all market caps. International equities were helped by the weakening of the U.S. Dollar. The MSCI EAFE Index returned 0.9% for the quarter in U.S. Dollar terms, but lost 4.0% in local currency. Japanese equities had a tough quarter, falling 4.6%. The UK equities gained 4.9%. The MSCI Emerging Markets Index was down 4.3% in dollar terms.

Amid inflation concerns and uncertainty surrounding the Fed's next move, bonds were also down. The Lehman Aggregate Bond Index was down 0.1% for the quarter. Long-term Treasuries fell 1.2%, but intermediate-term Treasuries gained 0.3%. Performance was flat for mortgage backed securities.

Real estate stocks modestly declined for the quarter. MSCI U.S. REIT Index was down 1.5%. The NCREIF Index continued to deliver strong returns posting 4.0% gain for the second quarter.

Investment Report

Investment Goals

1. Achieve a total fund rate of return equal to or greater than the actuarial assumed investment rate.
2. Achieve a total fund rate of return equal to or greater than the asset allocation benchmark.
3. Achieve a total fund rate of return equal to or greater than the amount projected in the most recent asset allocation study.
4. Achieve asset class net rates of return equal to or greater than their respective broad asset class benchmarks.
5. Achieve portfolio-level net rates of return equal to or greater than their respective portfolio benchmarks.
6. Ensure sufficient monies are available to meet cash flow requirements.

Asset Allocation Targets

Established in October 2003, the ASRS asset allocation policy targets and ranges are as follows:

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

The Real Estate allocation is pro-rated into the other asset classes during the implementation of the Real Estate program.

Investment Policies

The ASRS maintains its investment assets in accordance with Board approved strategic asset allocation policy. Investment assets are managed in 33 externally- and six internally-managed portfolios which are diversifiable in U.S. equities, U.S. fixed income, international equities and real estate.

For Fiscal Year Ended June 30, 2006, the ASRS achieved a 9.81 percent rate-of-return which outperformed the ASRS Total Fund policy benchmark and actuarial assumed investment rate of return by 1.0 percent and 1.8 percent, respectively.

The ASRS adheres to all statutory requirements set forth by Arizona state statute. In addition, the ASRS establishes 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. Details of ASRS investments are contained in the Investment Section of this report.

Investment Results

The Total Fund returned 9.8 percent in the fiscal year ended June 30, 2006.

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 benchmark used to compare performance.

Annualized Rates of Return

(Retirement & HBS)

	1 Year	3 Year	5 Year	Inception to Date
ASRS Total Fund	9.8%	11.8%	5.6%	10.8%
ASRS Domestic Equity	10.0%	13.3%	4.0%	12.2%
S&P 500 Index	8.6%	11.2%	2.5%	12.3%
ASRS Domestic Fixed Income	-0.4%	2.2%	5.1%	9.2%
Lehman Aggregate Index	-0.8%	2.1%	5.0%	6.8%
ASRS International Equity	24.3%	22.9%	9.7%	7.6%
MCSI EAFE Index	26.8%	24.3%	10.4%	6.8%

Historical Rates of Return

(Retirement & HBS)

Fiscal Year	Return	Fiscal Year	Return	Fiscal Year	Return
2005-06	9.80%	1997-98	21.30%	1989-90	9.52%
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%

Investment Results

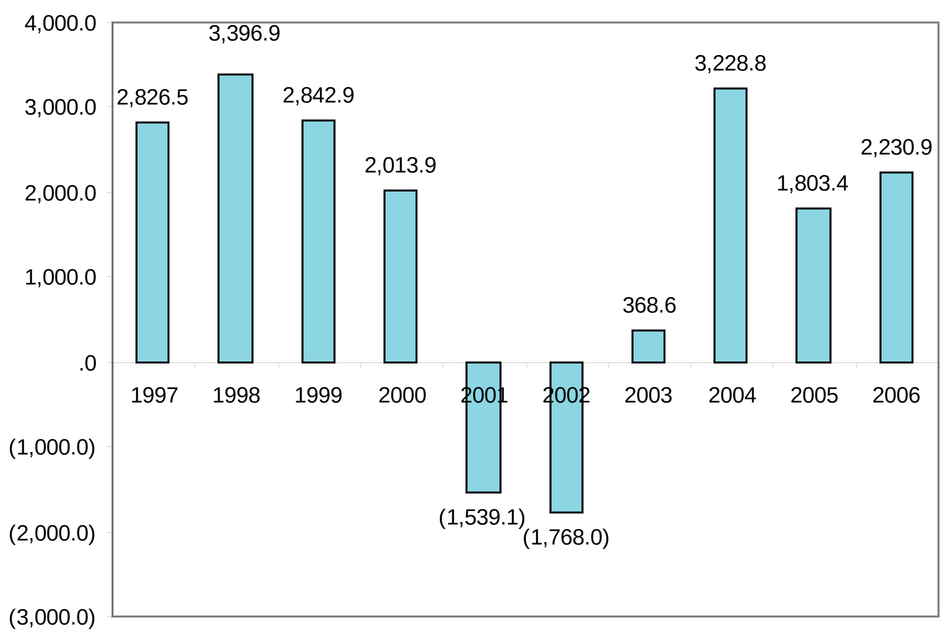
Monthly Returns

(Retirement & HBS)

Month	Total Fund	US Equity	Fixed Inc	Intl Equity
Jul 2005	2.67%	4.10%	-0.76%	3.09%
Aug 2005	0.06%	-0.99%	1.19%	2.06%
Sep 2005	0.93%	0.72%	-0.96%	4.08%
Oct 2005	-1.69%	-1.85%	-0.74%	-2.74%
Nov 2005	2.91%	4.11%	0.47%	2.63%
Dec 2005	1.12%	0.24%	0.95%	4.36%
Jan 2006	3.12%	3.89%	0.06%	5.13%
Feb 2006	0.15%	-0.06%	0.37%	0.34%
Mar 2006	1.43%	1.84%	-0.95%	3.38%
Apr 2006	1.52%	1.19%	-0.11%	4.76%
May 2006	-2.67%	-3.39%	-0.10%	-4.18%
Jun 2006	0.03%	0.10%	0.19%	-0.42%

Net Income from Investments

(Dollars in Millions)



Investment Results

Ten Year Review of Investment Income

(Dollars in Thousands)

Year	Invest Income	Market Appr	Invest Expense	Net Income
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
2005-06	523,997	1,758,899	51,957	2,230,939

Asset Allocation

Shedule Of Investments

(Dollars in Thousands)

	Investments at Fair Value	Receivables	Payables	Total	% of Total
Corporate Equity Securities	$16,743,086	-	-	$16,743,086	69.2%
Fixed Income Securities					
Corporate Debt Securities	1,972,262	-	-	1,972,262	8.2%
US Treasury & Govt Securities	3,858,714	-	-	3,858,714	15.9%
Real Estate & Mortgages	245,787	-	-	245,787	1.0%
Securities Lending	2,265,754	-	(2,265,754)	-	0.0%
Temporary Investments*	1,876,609	2,319,889	(2,804,955)	1,391,543	5.7%
Total Fixed Income Securities	10,219,126	2,319,889	(5,070,709)	7,468,306	
Total Investments	**$26,962,212**	**$2,319,889**	**($5,070,709)**	**$24,211,392**	**100.0%**

* Includes 1,813 other receivables and $12,566 other liabilities

Equity Portfolio Profile

Equity Portfolio Profile
(Dollars in Thousands)

Equity Sub-Sector Allocation	Percent of Fund	Dollar Value
US Large Cap Equity	39.01%	$9,446,183
US Mid Cap Equity	6.02%	1,457,471
US Small Cap Equity	6.28%	1,519,921
Total US Equity	**51.31%**	**12,423,575**
International Equity	**17.84%**	**4,319,511**
Total Equity	**69.15%**	**$16,743,086**

Ten Largest Domestic Equity Holdings

	% Of Domestic Equity Portfolio
EXXON MOBIL CORP	1.73%
GENERAL ELEC CO COM	1.52%
BANK OF AMERICA CORP	1.23%
CITIGROUP INC COM	1.07%
MICROSOFT CORP COM	0.87%
JOHNSON & JOHNSON COM	0.84%
PFIZER INC COM STK USD0.05	0.70%
PROCTER & GAMBLE CO COM	0.63%
JPMORGAN CHASE & CO COM	0.63%
HEWLETT PACKARD CO COM	0.61%
Total	**9.83%**

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

Equity Portfolio Profile

Distribution by Market Sector

	ASRS Domestic Equity	S&P 500 Index
Financials	21.38%	21.74%
Health Care	12.16%	12.52%
Utilities	3.64%	3.47%
Consumer Discretionary	11.97%	10.13%
Consumer Staples	7.30%	9.85%
Energy	9.18%	9.24%
Information Technology	15.20%	15.24%
Materials	3.74%	3.14%
Telecommunication Services	2.60%	3.42%
Industrials	12.83%	11.25%
Total	**100.00%**	**100.00%**

Ten Largest International Equity Holdings

	% Of International Equity Portfolio
NESTLE SA CHF1 (REGD)	2.20%
UNICREDITO ITALIAN EUR0.50	1.21%
DEUTSCHE TELEKOM AG NPV (REGD)	1.13%
GLAXOSMITHKLINE ORD GBP0.25	1.11%
NIPPON TEL & TEL CORP Y50000	1.02%
UNILEVER NV EUR0.16	1.00%
DAIICHI SANKYO COMPANY LIMITED	0.98%
BRITISH SKY BRDCSTG	0.90%
TELEFONICA SA EUR1	0.90%
ALCATEL EUR2 SER'A'	0.89%
Total	**11.34%**

Summary of Broker Commissions

	Commission
Domestic Equity	$6,044,522
International Equity	3,596,068

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Fixed Income Porfolio Profile

Distribution By Sector

	Percent
US Treasury & Government Agency	27.3%
Corporates	23.3%
Mortgage Backed Securities	42.1%
Asset Backed Securities	7.3%
Total	**100.0%**

Distribution By Coupon

	Percent
0.00% - 6.50%	90.3%
6.51% - 7.50%	5.5%
7.51% - 9.00%	2.7%
> 9.00%	1.5%
Total	**100.0%**

Distribution By Maturity

	Percent
0 to 2 years	31.7%
2 to 3 years	4.5%
3 to 4 years	3.2%
4 to 5 years	6.6%
5 to 6 years	3.2%
6 to 8 years	2.4%
> 8 years	48.4%
Total	**100.0%**

Fixed Income Porfolio Profile

Ten Largest Domestic Fixed Income Holdings

	Coupon	Maturity	Par Value	Market Value	Percent
U S TREASURY NOTES	4.88%	5/31/2005	$99,280	$98,725	1.68%
U S TREASURY BONDS	11.25%	2/15/2015	34,500	49,013	0.83%
FNMA POOL #0786458	5.00%	5/1/2034	51,526	48,344	0.82%
U S TREASURY NOTES	3.38%	11/15/2008	47,000	45,156	0.77%
COMMIT TO PUR FNMA SF MTG	6.00%	7/1/2036	44,000	43,299	0.74%
U S TREASURY NOTES	3.38%	2/28/2007	42,000	41,480	0.71%
COMMIT TO PUR FHLMC GOLD SFM	6.00%	8/1/2036	41,850	41,155	0.70%
U S TREASURY NOTES	3.75%	9/15/2009	39,000	37,015	0.63%
FNMA POOL #0255451	5.00%	10/1/2019	37,045	35,749	0.61%
FEDERAL HOME LN MTG CORP DEB	5.25%	4/18/2016	36,000	35,193	0.60%
Total					**8.09%**

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	$ 20,801,935	473,904	0.03	$ 14,268
ACCESS SEC INC, STAMFORD	131,123,310	3,214,870	0.03	100,078
AVIAN SECURITIES INC, BOSTON	15,875,854	841,072	0.03	26,820
B TRADE SVCS LLC, NEW YORK	60,443,126	1,724,714	0.01	21,355
BAIRD, ROBERT W & CO INC, MILWAUKEE	10,146,193	358,975	0.04	16,006
BANC OF AMERICA SECS LLC, CHARLOTTE	21,650,223	875,528	0.04	30,755
BEAR STEARNS SEC CORP, BROOKLYN	470,667,128	15,834,017	0.02	333,799
BERNSTEIN SANFORD C & CO, NEW YORK	41,662,046	1,054,114	0.03	30,614
BNY BROKERAGE INC, NEW YORK	168,104,088	4,823,387	0.02	102,794
BRIDGE TRADING COMPANY, ST LOUIS	13,022,244	535,426	0.05	25,024
CANACCORD ADAMS INC, BOSTON	17,184,405	625,602	0.05	28,981
CANTOR FITZGERALD & CO INC, NEW YORK	147,096,997	4,766,913	0.03	149,745
CAP INSTL SVCS INC-EQUITIES, DALLAS	128,914,479	3,216,563	0.03	98,556
CIBC WORLD MARKETS CORP, NEW YORK	64,931,668	2,076,888	0.04	76,245
CITATION GROUP, NY	17,253,100	505,290	0.04	20,293
CITIGROUP GBL MKTS INC, NEW YORK	426,783,448	13,598,124	0.01	129,109
CREDIT SUISSE, NEW YORK (CSFBUS33XXX)	227,967,667	6,706,098	0.03	220,873
DEUTSCHE BK SECS INC, NY (NWSCUS33)	209,065,449	5,012,892	0.02	104,722
FIDELITY CAP MKTS (DIV OF NFSC), BOSTON	156,216,979	4,929,927	0.04	198,770
FRANCIS P MAGLIO & CO INC, NEW YORK	28,026,626	644,300	0.02	14,573
FRANK RUSSELL SEC INC, NEW YORK	344,317,965	9,774,400	0.03	328,879
GOLDMAN SACHS & CO, NY	560,137,072	13,532,902	0.03	340,224
GOLDMAN SACHS EXECUTION & CLEARING, NY	13,427,622	768,010	0.01	5,448
GUZMAN & CO, NEW YORK	239,112,918	5,470,582	0.02	117,201
INSTINET CORP, NY	571,743,289	17,766,796	0.02	339,447
INVESTMENT TECHNOLOGY GROUPS, NEW YORK	893,821,480	30,306,782	0.02	549,322
JEFFERIES & CO INC, NEW YORK	129,617,111	5,073,048	0.03	143,882
JNK SECURITIES INC, NEW YORK	229,988,553	5,849,208	0.02	102,524
JONES & ASSOCIATES INC, WESTLAKE VILLAGE	53,308,335	1,655,041	0.04	61,920
KEEFE BRUYETTE AND WOODS, JERSEY CITY	16,309,666	421,100	0.03	12,316
KNIGHT SEC BROADCORT, JERSEY CITY	13,543,461	463,841	0.03	16,174
LA BRANCHE FINANCIAL SVCS/HBI, NEW YORK	283,452,216	7,104,554	0.03	198,544
LEHMAN BROS INC, NEW YORK	466,623,248	12,298,317	0.02	242,639
LIQUIDNET INC, BROOKLYN	119,542,014	4,299,855	0.02	86,231
LYNCH JONES & RYAN INC, HOUSTON	49,525,992	2,024,869	0.03	69,515

Schedule of Broker Commissions - Domestic Equity Trades

Domestic Broker Name	Total Dollar Amount of Trades	Number of Shares	Average Commission Per Share	Commission
MCDONALD & CO, NEW YORK	42,396,662	1,326,214	0.03	41,568
MERRILL LYNCH PIERCE FENNER SMITH INC NY	219,326,743	5,475,433	0.02	108,338
MERRILL LYNCH PROFESSIONAL CLRG, PURCHAS	173,450,509	4,759,417	0.03	140,721
MILETUS TRADING LLC, BROOKLYN	11,628,395	510,945	0.02	7,853
MORGAN J P SECS INC, NEW YORK	26,663,370	850,066	0.04	32,620
MORGAN STANLEY & CO INC, NY	44,190,312	1,218,320	0.03	33,308
NUTMEG SECURITIES, WESTPORT	14,444,140	452,000	0.06	25,174
PIPER JAFFRAY & CO, MINNEAPOLIS	14,197,387	486,611	0.03	15,160
PRUDENTIAL EQUITY GROUP, NEW YORK	76,338,800	2,180,592	0.03	71,578
PULSE TRADING LLC, BOSTON	19,222,034	799,099	0.02	14,346
RAYMOND JAMES & ASSOC INC, ST PETERSBURG	15,617,974	670,770	0.05	31,080
ROCHDALE SECURITIES CORP	73,700,944	2,084,853	0.04	76,408
ROSENBLATT SECURITIES INC, JERSEY CITY	220,010,358	4,974,785	0.02	102,839
RUSSELL, FRANK SECS, NEW YORK	37,217,106	1,460,752	0.04	52,972
S G COWEN & CO LLC, NEW YORK	14,165,538	413,590	0.04	17,194
STATE STREET BROKERAGE SVCS, BOSTON	10,253,870	370,678	0.02	9,014
STEPHEN M FERRETTI INC, NEW YORK	16,981,294	531,776	0.02	11,588
THOMAS WEISEL PARTNERS, SAN FRANCISCO	35,299,337	1,768,954	0.02	41,821
UBS SECURITIES LLC, STAMFORD	195,888,034	5,704,657	0.03	173,258
UNX COM, NEW YORK	16,566,346	798,602	0.02	15,932
WACHOVIA CAPITAL MARKETS LLC, CHARLOTTE	16,389,559	606,486	0.04	27,182
WEEDEN & CO, NEW YORK	253,798,796	9,204,890	0.02	220,879
WILLIAM BLAIR & CO, CHICAGO	11,323,567	278,956	0.05	12,785
OTHER	286,817,754	10,191,094	-	403,257
TOTAL				**$6,044,521**

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
ABN AMRO BANK NV, LONDON	$ 10,019,773	2,187,034	0.00	$ 8,658
ABN AMRO SECS LLC, NEW YORK	38,282,072	1,528,363	0.05	71,774
BEAR STEARNS & CO INC, NY	33,146,549	4,824,982	0.01	42,373
BERENBERG GOSSLER & CIE, HAMBURG	21,090,140	731,919	0.01	8,436
BERNSTEIN SANFORD C & CO, NEW YORK	14,081,321	250,060	0.07	17,714
CANTOR FITZGERALD EUROPE, LONDON	74,784,712	20,981,992	0.00	29,855
CAZENOVE & CO, LONDON	19,001,133	2,608,600	0.01	30,097
CHEVREUX DE VIRIEU	20,493,312	1,788,576	0.01	23,303
CITIGROUP GBL MKTS INC, NEW YORK	36,454,629	1,742,676	0.03	48,496
CITIGROUP GBL MKTS/SALOMON, NEW YORK	134,938,244	18,745,857	0.01	117,623
CREDIT AGRICOLE INDOSUEZ CHX, FRANCE	19,652,624	912,291	0.03	24,623
CREDIT SUISSE (EUROPE), LONDON	37,999,844	1,612,314	0.04	66,377
CREDIT SUISSE, NEW YORK (CSFBUS33XXX)	98,886,582	8,033,535	0.02	129,771
DAIWA SECS AMER INC, NEW YORK	16,409,333	996,511	0.02	17,073
DEUTSCHE BK AG, LONDON	18,897,704	3,501,046	0.00	2,682
DEUTSCHE BK INTL EQ, LONDN (DEUTGB22EEQ)	47,526,996	6,463,970	0.00	8,260
DEUTSCHE BK SECS INC, NY (NWSCUS33)	112,365,217	7,259,222	0.02	114,335
DEUTSCHE SEC ASIA LTD, HONG KONG	10,772,838	10,781,840	0.00	8,669
DRESDNER KLEINWORT BENSON, NEW YORK	20,993,596	544,603	0.07	40,833
E TRADE SECURITIES INC, PALO ALTO	15,663,055	562,700	0.01	5,627
EXANE, PARIS (EXANFRPP)	20,812,877	627,073	0.07	41,643
GOLDMAN SACHS & CO, NY	137,631,766	24,569,887	0.01	272,665
HSBC SECS INC, NEW YORK	20,122,934	1,204,491	0.03	36,307
INSTINET CORP, LONDON	45,093,115	8,129,321	0.00	33,999
ITG (EUROPE) LTD, DUBLIN	151,335,841	26,259,186	0.00	60,759
IXIS SECURITIES, PARIS	17,471,311	461,913	0.02	9,482
J P MORGAN SEC LTD/STOCK LENDING, LONDON	20,786,326	876,100	0.04	35,431
J P MORGAN SECS LTD, LONDON	40,821,054	1,227,566	0.03	42,727
JAMES CAPEL ASIA LTD, HONG KONG	11,186,076	8,392,095	0.00	27,136
JP MORGAN SECS ASIA PACIFIC, HONG KONG	13,161,404	11,541,584	0.00	5,683
KLEINWORT BENSON SECS, LONDON (KBENGB22)	34,500,569	2,908,821	0.02	49,838
LEHMAN BROS INC, NEW YORK	1,989,464,897	133,476,284	$0.00	614,440
LEHMAN BROS INTL, LONDON	110,530,936	11,358,826	0.01	115,540

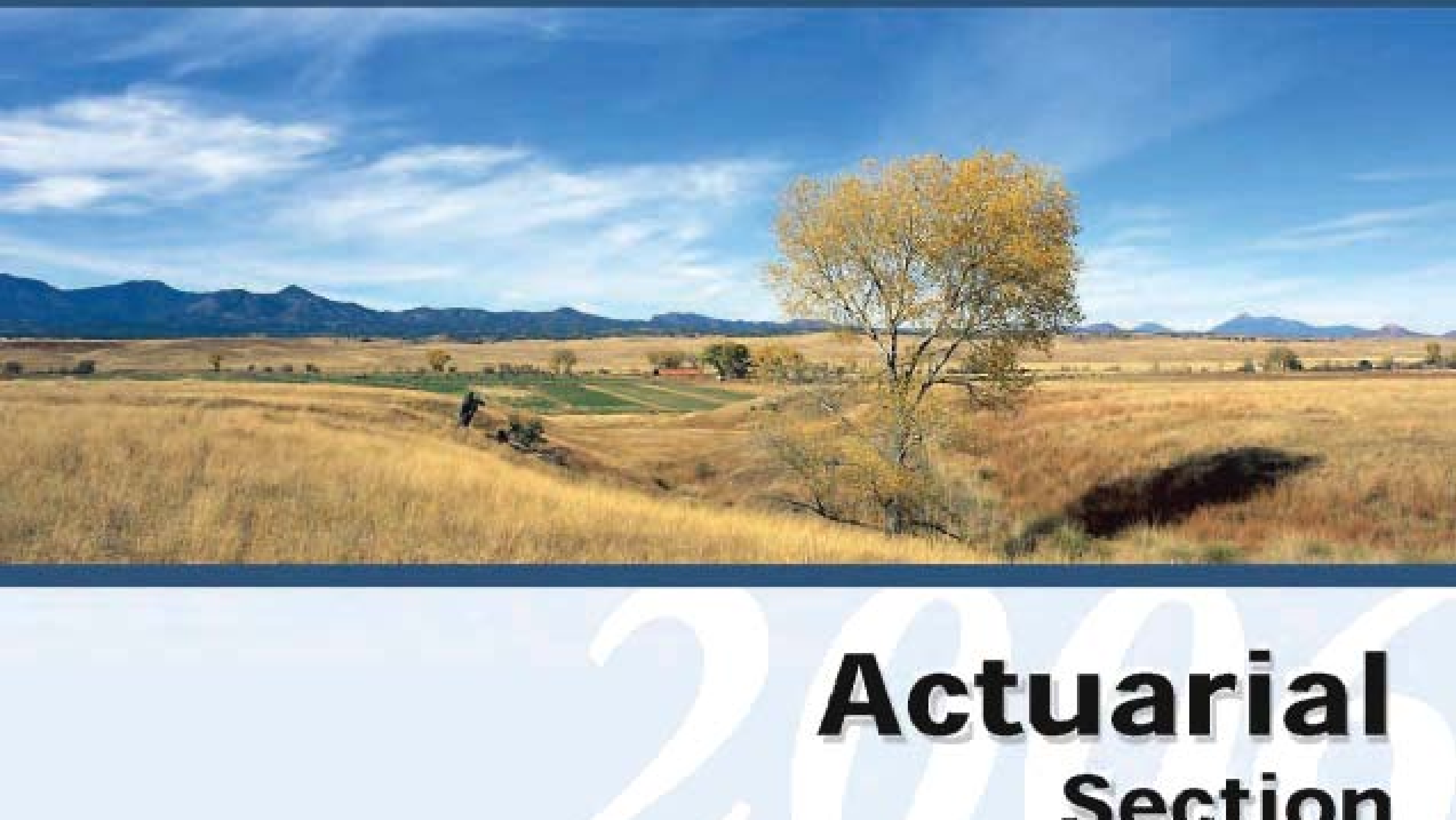
Schedule of Broker Commissions - Foreign Equity Trades

Domestic Broker Name	Total Dollar Amount of Trades	Number of Shares	Average Commission Per Share	Commission
MACQUARIE EQUITIES LTD, SYDNEY	10,157,880	5,183,814	0.00	4,217
MACQUARIE SECURITIES LIMITED, HONG KONG	14,688,710	17,697,659	0.00	21,392
MERRILL LYNCH INTL LONDON EQUITIES	83,407,069	8,870,051	0.01	123,997
MERRILL LYNCH PIERCE FENNER SMITH INC NY	10,045,178	336,630	0.03	11,370
MERRILL LYNCH PIERCE FENNER, WILMINGTON	97,468,059	21,148,828	0.00	82,256
MIZUHO SECURITIES USA INC. NEW YORK	20,300,117	1,523,635	0.02	31,698
MORGAN J P SECS INC, NEW YORK	26,777,417	3,309,481	0.01	45,461
MORGAN STANLEY & CO INC, NY	111,748,258	4,410,630	0.05	207,566
MORGAN STANLEY & CO, LONDON (MSLNGB2X)	17,199,565	1,354,655	0.01	14,161
NOMURA INTERNATIONAL (HK) LTD, HONG KONG	15,804,914	4,162,278	0.01	22,480
NOMURA SECS INTL INC, NEW YORK	24,314,608	3,223,544	0.01	18,173
NOMURA SECS INTL, LONDON	118,609,609	17,793,033	0.00	16,942
PERSHING SECURITIES LTD, LONDON	16,901,266	1,396,229	0.01	18,894
SALOMON BROS INTL LTD, LONDON	62,366,477	10,739,575	0.01	72,621
SG SEC (LONDON) LTD, LONDON	44,639,381	695,700	0.13	89,357
UBS EQUITIES, LONDON	89,225,700	6,563,869	0.02	149,579
UBS SECURITIES LLC, STAMFORD	18,293,387	497,850	0.05	26,795
UBS WARBURG ASIA LTD, HONG KONG	59,954,814	11,181,651	0.00	49,531
UNION BANK SWITZERLAND SECS, LONDON	12,239,821	1,451,396	0.00	2,518
OTHERS	269,957,630	113,724,689		424,831
TOTAL				**$3,596,068**

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

Arizona State Retirement System

A Component Unit of the State of Arizona



2006 Actuarial Section

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IV. Actuarial Section

Actuarial Certification

Actuarial Certification Statement

This is to certify that Buck Consultants has prepared an actuarial valuation of the Arizona State Retirement Plan as of June 30, 2005.

Actuarial calculations have been made with respect to a total of 440,762 members – 212,202 active employees, 149,768 inactive members, and 73,853 retired members and beneficiaries, and 4,939 members on long term disability. In addition, there are 765 System retirees receiving ad hoc benefits from Plan assets.

The actuarial calculations establish a total benefit cost of 17.40% of the annual compensation of employees. The total normal cost rate is 13.16% of compensation, and the required amortization payment determined in accordance with Section 38-737 is 4.2% of compensation.

The actuarial cost factors as of June 30, 2005 are as follows:

I. Actuarial accrued liabilities				
A. Liabilities due to member's benefits				
1. Active members				
a. Retirement benefits	$11,605,799,504			
b. Health insurance premium supplement	904,119,388			
c. Disability deferred retirement benefits	226,127,610			
d. Pre-retirement death benefits	266,206,539			
e. Withdrawal benefits	387,484,834			
f. Total active members		$13,389,737,875		
2. Inactive members		1,029,957,682		
3. Retired members and beneficiaries		12,831,725,476		
4. Disabled members (deferred retirement)		374,502,413		
5. Benefit increases for other-than-plan participants		11,200,495		
6. Total present value of benefits			$27,637,123,941	
B. Other miscellaneous liabilities and reserves			0	
C. Reserve for future PBIs			305,477,344	
D. Total actuarial accrued liability				$27,942,601,285
II. Actuarial value of assets				$23,836,519,123
III. Unfunded actuarial accrued liability (Item I - Item II)				4,106,082,162
IV. Amortization of unfunded actuarial accrued liability (per Section 38-737)			$337,717,046	
V. Normal cost for the year			1,056,741,114	
VI. Total contribution for the year (Item IV + Item V)				$1,394,458,160
VII. Total covered payroll (projected to 2003/2004 plan year)				8,032,457,947

VIII. Total contribution for fiscal years 2004 and 2005 as a percentage of covered payroll

	401(a) Account	401(h) Account	Total
A. Employee Portion	8.70%	0.00%	8.70%
B. Employer Portion	7.62%	1.08%	8.70%
C. Total	16.32%	1.08%	17.40%

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	4.00	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

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

	Years of Service: Male Members				
Age	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

	Years of Service: Female Members				
Age	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

	Years of Service				
Age	10-14	20-24	25	30	31+
50	3.00%	4.00%	7.00%	17.50%	12.50%
55	3.00	6.00	16.25	17.50	12.50
60	7.00	23.75	26.75	35.00	30.00
62	30.00	40.00	43.00	55.00	50.00
65	30.00	30.00	33.00	35.00	30.00
66 and above	30.00	30.00	33.00	35.00	30.00

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 systems 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.

The actuarial calculations have been performed by qualified actuaries 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

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

Independent Actuarial Limited Scope Audit Opinion

SEGAL

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DIRECT DIAL NUMBER
416-969-3958

E-MAIL ADDRESS
tlevy@segalco.com

October 5, 2006

Mr. Richard Stavneak
Director
Arizona Joint Legislative Budget Committee
1716 West Adams
Phoenix, AZ 85007

Re: **Actuarial Auditing Services for the Arizona Joint Legislative Budget Committee (Arizona State Retirement System June 30, 2005 Actuarial Valuation)**

Dear Mr. Stavneak:

We are pleased to present the results of this limited-scope audit of the June 30, 2005 actuarial valuation. The purpose of this audit is to conduct a review of the actuarial methods and procedures employed by the Arizona State Retirement System. This audit includes the following:

1. *Report review* – this report includes a review of the valuation results and how they comply with actuarial standards, and whether such valuation reflects appropriate disclosure information under any required reporting.

2. *Methods and assumptions review* – this audit provides an analysis and a review of the actuarial assumptions and methods utilized in determining the funded status and accrued liability as of June 30, 2005.

3. *Assumptions and test lives review and reconciliation* – this audit discusses the procedures used to validate the participant data and the test lives selected, with a detailed review of the findings.

This review was conducted under the supervision of Thomas D. Levy, a Fellow of the Society of Actuaries, Member of the American Academy of Actuaries and an Enrolled Actuary under ERISA. This review was conducted in accordance with the standards of practice prescribed by the Actuarial Standards Board.

Benefits, Compensation and HR Consulting ATLANTA BOSTON CHICAGO CLEVELAND DENVER HARTFORD HOUSTON LOS ANGELES MINNEAPOLIS NEW ORLEANS NEW YORK PHILADELPHIA PHOENIX SAN FRANCISCO SEATTLE TORONTO WASHINGTON, DC

Multinational Group of Actuaries and Consultants AMSTERDAM BARCELONA GENEVA HAMBURG JOHANNESBURG LONDON MELBOURNE MEXICO CITY OSLO PARIS

Independent Actuarial Limited Scope Audit Opinion

Mr. Richard Stavneak
October 5, 2006
Page 2

The assistance of Buck Consultants, an ACS Company (Buck), Arizona State Retirement System (ASRS), and the Arizona Joint Legislative Budget Committee (JLBC) staff is gratefully acknowledged.

Overall, the results of this audit are quite favorable, and indicate that the procedures used by ASRS and its consulting actuary are appropriate and reliable in determining the Plan's actuarial funding levels.

We appreciate the opportunity to be retained as the independent actuarial auditors for Arizona JLBC and we are available to answer any questions you may have on this report.

Sincerely,

Thomas D. Levy, FSA, FCIA, MAAA, EA
Senior Vice President and Chief Actuary

Susan M. Hogarth, MAAA, EA
Consulting Actuary

/dqm

cc: Brad E. Ramirez, FSA, MAAA, EA

146445/08305.001

Actuarial Valuation of The Plan as of June 30, 2005

December 20, 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 2005 actuarial valuation report is accurate and fairly presents the actuarial position of the Arizona State Retirement Plan (the Plan) as of June 30, 2005.

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 and 43 (GASB Nos. 25 and 43), and it summarizes census data.

Valuations are performed annually, as of June 30, the last day of both the Plan year and ASRS's 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 for the next two Plan years. For example, the rate calculated in June 30, 2004 valuation report (7.75% for each member and each employer) would have applied in the fiscal years beginning July 1, 2005, and July 1, 2006. (Legislative action changed the rates in these tow years.) The rates calculated in odd-numbered years are purely advisory – they never take effect.

Actuarial Valuation of The Plan as of June 30, 2005

Funding Progress

The actual contribution rate in fiscal 2004 and 2005 is 5.20% for each member and each employer, as the 2002 valuation report calculated. This 2004 valuation calculates a hypothetical rate of 7.75%, to become effective July 1, 2005. The Legislature adopted a stair-step approach to increasing contribution rates, and set the rate at 6.9% for fiscal year 2006 and 8.6% for fiscal year 2007. This valuation calculates a hypothetical rate of 8.70%. 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.

Benefit Provisions

This valuation reflects the following changes in Plan provisions:

1. The legislature extended the temporary rural health insurance premium benefit to Medicare eligible retirees who live in Arizona counties not served by an HMO.
2. The legislature pegged the contribution rate, for each active member and each employer, to be 6.9% for fiscal year 2006 and 8.6% for fiscal year 2007. After fiscal year 2007, contribution rates are to be determined annually.

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% 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 Nos. 25 and 43.

Data

ASRS staff supplied census data for retired, active, and inactive participants as of June 30, 2005. 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.

Actuarial Valuation of The Plan as of June 30, 2005

Trend Data and Supporting Schedules

ASRS prepared all trend data schedules in the financial section of ASRS's 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, 2005

Active Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of members (active)	45,891	68,437	97,874	212,202
Average age	45.5	43.9	45.0	44.7
Average annual salary	$40,270	$43,348	$32,877	$37,853
Average years of service	9.0	10.1	7.2	8.5

As of June 30, 2005

Retired Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of retirees	18,683	22,970	32,200	73,853
Average age	70.4	68.0	70.2	69.6
Average monthly benefit	$1,322	$2,152	$1,157	$1,508
Average years of service	17.8	23.6	17.0	19.3

Of all plan retirees at July 1, 2005, 56.8 percent received annuities of more than $1,000 per month. 9.8 percent receives less than $300 per month. Of the retirees 17.6 percent are less than 60.0 years old and 55.3 percent are between 60 and 75 years old.

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, 2005), the average salary level for state employees, for teachers, and for political subdivision employees other than teachers, and the average for all groups combined.

	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**
State employees	$32,392	$33,746	$35,262	$35,461	$40,270
Teachers	36,634	39,302	40,119	40,253	43,348
Political subdivision employees	27,116	28,470	29,181	29,775	32,877
All groups	31,281	33,130	33,998	34,372	37,853

General Actuarial Information

Funding Objective

The funding 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, 2005, the date of the most recent actuarial valuation, this funding level is 85.3 percent. When the present actuarial asset of $23.836 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 $4,106.1 million.

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) 2004-2005 is 15.52 percent and for FY 2003-2004 is 13.02 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. Because liabilities exceed assets, the required contribution rate is higher than the normal cost.

Components of the normal cost are as follows:

Retirement benefits	10.27%
Health insurance premium supplement	0.67
Survivor benefits	0.31
Withdrawals	1.38
Long-term disability benefit	0.39
Total, normal cost	13.02
Amortization of the UAAL	2.50
Required contribution rate for FY 2003/2004	15.52%
Shared by employee and employer	
Required contribution rate for FY 2003/2004	15.52%
Shared by employee and employer	Divided by 2
Required matching contribution rate	7.76%

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 LTD contribution rate for fiscal year 2005 and fiscal year 2004 is 1.00 percent, shared equally by employees and employers.

Summary of Actuarial Method for Long-Term Disability Benefit

The actuarial cost method is changed, effective for the 2005 valuation, to the projected credit method. Assets are valued at market, less (or plus) and adjustment to reflect investment gains (or losses) over a 10-year period. Since 2005 is the first year of applying this valuation method, actuarial assets as of June 30, 2005, are equal to the market value of assets. The unfunded actuarial accrued liability is amortized over 15 years in level dollar payments.

Summary of Benefit Provisions

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:

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. Members who commenced membership prior to 1984 can use a 60-month average and include additional types of compensation, if doing so produces a larger result.

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%

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

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:

Summary of Benefit Provisions

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%

If the employee meets the Rule of 77 (but not the Rule of 80), the reduction will be 3% for each unit below 80.

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%, 66-2/3% or 50% 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, or

   (c) a 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

Summary of Benefit Provisions

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

   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% 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% for employees with five years of service and increases 15% for each additional year of service up to a maximum of 100% 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).

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

Summary of Benefit Provisions

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 of a 4% 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% 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%. For the biennium July 1, 2005 to June 30, 2007, the required contribution rate is 7.75%. 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 Unit 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.

3. 2.0% Ad Hoc COLAs

   - Effective July 1, 1989, all members retired on or before June 30, 1988 shall receive a 2.0%

Summary of Benefit Provisions

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% 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% multiplier instead of the 2.0% multiplier in effect at that time.

5. 3.0% 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% 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% for each point or fraction thereof less than 82.

2. 3.0% 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% 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% of the benefit for each completed year of service (i.e., 50% to 90%).

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

1. 3.0% 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% in his or her base benefit, retroactive to the date of retirement.

Summary of Benefit Provisions

2. Recalculation of Retiree Benefits Using 2.0% 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% 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% Ad Hoc Increase

   Effective July 1, 1991 all members retired on or before June 30, 1990 shall receive a 2.3% 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% 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% 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 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% Ad Hoc Increase

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

4. Forfeited Service Repurchase

Summary of Benefit Provisions

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% down to 3.14%.

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.

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 pre-deceases them.

4. Excess Investment Earnings COLA

Summary of Benefit Provisions

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% to 100% 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.

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.

Summary of Benefit Provisions

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 25% with five years of service and increases 15% for each additional year of service to a maximum of 100% for ten or more years of service.

2. Benefit Multiplier Increased to 2.1%

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

3. 5% Ad Hoc Increase

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

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% to 4%.

   b. The threshold for determining "Excess Earnings" was lowered from 9% to 8%.

   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

Summary of Benefit Provisions

- 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

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 and 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

Summary of Benefit Provisions

- 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

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% 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. Additional Temporary Health Insurance Premium Benefit (Rural Subsidy)

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 With Medicare Parts A & B		Insurance Coverage With Medicare Parts A & B*	
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 purchased 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 the 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 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.

Y. LEGISLATED PLAN CHANGES ENACTED BY THE 2005 LEGISLATURE OF THE STATE OF ARIZONA

1. Temporary Rural Health Insurance Premium Benefit

   The Legislature extended the temporary Rural Health Insurance Subsidy for the next two years, from July 1, 2005, to June 30, 2007. The benefit is provided to Medicare-eligible retirees and disabled members who live in Arizona counties with no Health Maintenance Organization (HMO) service area who have 10 years of credited service.

2. Contribution Rates

   The Legislature pegged the contribution rates for fiscal 2006 and 2007 at 6.90% and 8.60% respectively. After fiscal 2007, contribution rates are to be determined annually.

Statement of Actuarial Methods and Assumptions Used in Determining Cost

(Adopted by Board Action on November 21, 2003)

Effective as of June 30, 2004

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, 2004

RATES OF MORTALITY

	Non-Disabled	Disabled	Non-Disabled	Disabled
Age	**Male Participants**		**Female Participants**	
20	0.000411	0.034940	0.000238	0.026939
25	0.000592	0.038887	0.000249	0.274440
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**

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

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

Select and ultimate withdrawal rates are uses. 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, 2004

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 (1)	Merit Component (2)	Total Salary Increase* (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 percent) + productivity increase rate (0.25 percent) + 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, 2004

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

RATES OF DECREMENT DUE TO RETIREMENT

	Years of Service								
Age	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.

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.

Statement of Actuarial Methods and Assumptions Used in Determining Cost

(Adopted by Board Action on November 21, 2003)

Effective as of June 30, 2004

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, 2005 actuarial valuation, the period is 30 years.

D. Data for Valuation

In preparing the June 30, 2005 actuarial valuation, the actuary has relied on data and assets provided by the staff of the Arizona State Retirement System. While not verifying the data at their source, the actuary has performed tests for consistency and reasonableness.

SCHEDULE OF PLAN ACTIVE MEMBER VALUATION DATA
Last 6 Years

	Contributing Active Members			
Valuation As of June 30	**Number**	**Annual Payroll**	**Annual Average Pay**	**Increase in Average Pay**
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	1.1
2005	212,202	8,032,457,947	37,853	3.9

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
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
2005	7,005	2,083	73,853	1.4	18,097

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
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
2005	27,942,601,285	23,836,519,123	85	4,106,082,162	8,032,457,947	51.1

SOLVENCY TEST
Last 10 Years

	Aggregate Accrued Liabilities for				Portion of Accrued Liabilities Covered by Net Assets Available for Benefits		
	(1)	(2)	(3)				
Year Ended 30-Jun	Active Member Contributions	Retirees and Beneficiaries	Active Members (Employer Financed Portion)	Net Assets Available for Benefits	(1)	(2)	(3)
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
2005	3,717,945,957	13,522,905,728	10,701,749,600	23,836,519,123	100	100	61.6

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
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	377,432,100	5.20	5.20
2005	8,032,000,000	403,661,191	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
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)
2005	2,275.42	1,010.22	(946.70)	182.03	80.82	(37.87)	224.98	2,563.94	4,106.08	(1,542.15)

Arizona State Retirement System

A Component Unit of the State of Arizona

2006

Statistical Section

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V. Statistical Section

This part of the Arizona State Retirement System's (ASRS's) comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required summary information says about the ASRS's overall financial health.

Financial Trends

These schedules contain trend information to help the reader understand how the ASRS's financial performance has changed over time.

Revenues

These schedules contain information to help the reader understand the ASRS's funding over time.

Operations

These schedules provide contextual information about the ASRS's operations.

Financial Trends: Net Assets - Last 10 Fiscal Years

RETIREMENT NET ASSETS (in thousands)

FISCAL YEAR	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
ASSETS										
Cash, Receivables, and Prepaids	$ 116,405	$ 87,279	$ 257,569	$ 317,058	$ 290,502	$ 307,934	$ 414,382	$ 2,139,601	$ 2,091,244	$ 2,396,175
Investments at Fair Value	16,796,291	20,353,678	22,805,992	24,340,442	22,267,217	20,120,799	20,659,916	23,291,652	24,154,827	25,699,691
Total Assets	16,912,696	20,440,957	23,063,561	24,657,500	22,557,719	20,428,733	21,074,298	25,431,253	26,246,071	28,095,866
LIABILITIES										
Investments Payable	642,935	1,251,394	1,512,590	1,714,961	1,753,889	2,081,206	3,149,294	4,938,242	4,654,687	4,853,112
Other Payables	151	23	955	475	5,503	569	3,423	7,822	20,470	23,108
Total Liabilities	$ 643,086	$ 1,251,417	$ 1,513,545	$ 1,715,436	$ 1,759,392	$ 2,081,775	$ 3,152,717	$ 4,946,064	$ 4,675,157	$ 4,876,220
Total Net Assets	**$16,269,610**	**$19,189,540**	**$21,550,016**	**$22,942,064**	**$20,798,327**	**$18,346,958**	**$17,921,581**	**$20,485,189**	**$21,570,914**	**$23,219,646**

HBS NET ASSETS (in thousands)

FISCAL YEAR	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
ASSETS										
Cash, Receivables, and Prepaids	$ 4,658	$ 4,316	$ 11,112	$ 9,959	$ 10,596	$ 12,276	$ 15,451	$ 85,226	$ 85,061	$ 96,084
Investments at Fair Value	554,227	716,840	853,254	953,418	899,282	843,856	805,430	917,308	974,406	1,081,538
Total Assets	558,885	721,155	864,366	963,377	909,879	856,132	820,881	1,002,534	1,059,467	1,177,622
LIABILITIES										
Investments Payable	18,331	36,592	56,607	67,515	70,847	87,285	122,520	194,486	187,850	207,876
Total Net Assets	**$540,554**	**$684,563**	**$807,759**	**$895,862**	**$839,032**	**$768,847**	**$698,106**	**$808,048**	**$871,637**	**$969,746**

LTD NET ASSETS (in thousands)

FISCAL YEAR	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
ASSETS										
Cash, Receivables, and Prepaids	$ 1,523	$ 1,431	$ 1,424	$ 4,645	$ 13,214	$ 5,184	$ 4,145	$ 7,641	$ 14,040	$ 15,241
Investments at Fair Value	38,968	54,607	71,344	93,409	80,143	90,048	108,364	130,428	151,025	180,983
Total Assets	40,492	56,039	72,768	98,054	93,357	95,232	112,509	138,069	165,065	196,224
LIABILITIES										
Investments Payable	232	394	3,461	10,374	173	1,228	2,308	207	231	222
Total Net Assets	**$40,259**	**$55,644**	**$69,307**	**$87,680**	**$93,183**	**$94,004**	**$110,201**	**$137,862**	**$164,834**	**$196,002**

Financial Trends: Changes in Net Assets - Last 10 Fiscal Years

RETIREMENT CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
ADDITIONS	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Member Contributions	$ 150,500	$ 152,376	$ 152,917	$ 124,931	$ 133,504	$ 135,275	$ 142,356	$ 377,436	$ 403,661	$ 570,933
Employer Contributions	90,662	78,842	86,707	72,256	77,196	131,234	138,100	297,770	318,311	477,472
Member Reimbursements / Transfers	11,481	15,462	46,171	35,348	39,535	50,832	93,552	113,944	141,932	125,751
Net Investment Income	2,748,704	3,299,454	2,753,117	1,956,673	(1,449,643)	(1,762,370)	354,735	3,096,779	1,720,991	2,126,272
Total Additions	3,001,347	3,546,134	3,038,912	2,189,208	(1,199,408)	(1,445,029)	728,743	3,885,929	2,584,895	3,300,428
DEDUCTIONS										
Retirement Benefits	522,525	574,230	627,612	695,426	809,133	924,172	1,067,481	1,238,966	1,406,547	1,538,992
Survivor Benefits	13,583	10,558	11,485	13,256	14,134	14,078	15,861	14,859	18,402	17,125
Refunds / Transfers	33,406	31,436	27,117	75,637	108,692	51,382	43,433	38,548	48,745	65,442
Administrative / Other	9,224	9,980	12,222	12,841	12,370	16,708	27,345	29,948	25,476	30,137
Total Deductions	578,738	626,204	678,436	797,160	944,329	1,006,340	1,154,120	1,322,321	1,499,170	1,651,696
NET CHANGE	**2,422,609**	**2,919,930**	**2,360,476**	**1,392,048**	**(2,143,737)**	**(2,451,369)**	**(425,377)**	**2,563,608**	**1,085,725**	**1,648,732**
Net Assets Beginning of Year	13,847,001	16,269,610	19,189,540	21,550,016	22,942,064	20,798,327	18,346,958	17,921,581	20,485,189	21,570,914
NET ASSETS END OF YEAR	**$16,269,610**	**$19,189,540**	**$21,550,016**	**$22,942,064**	**$20,798,327**	**$18,346,958**	**$17,921,581**	**$20,485,189**	**$21,570,914**	**$23,219,646**

HBS CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
ADDITIONS	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Employer Contributions	$ 59,838	$ 73,534	$ 66,209	$ 52,674	$ 56,308	$ 4,041	$ 4,256	$ 79,662	$ 85,350	$ 93,461
Net Investment Income	82,421	103,183	91,986	73,146	(72,558)	1,811	10,436	114,906	68,750	86,587
Total Additions	142,259	176,717	158,195	125,820	(16,250)	5,852	14,692	194,568	154,100	180,048
DEDUCTIONS										
Health Premium Benefits	30,149	32,668	34,935	37,651	40,500	75,990	84,534	83,680	89,602	80,827
Administration / Other	39	40	64	65	80	47	899	946	909	1,112
Total Deductions	30,188	32,708	34,999	37,717	40,581	76,036	85,433	84,626	90,511	81,939
NET CHANGES	**112,072**	**144,009**	**123,196**	**88,103**	**(56,830)**	**(70,185)**	**(70,741)**	**109,942**	**63,589**	**98,109**
Net Assets Beginning of Year	428,483	540,554	684,563	807,759	895,862	839,032	768,847	698,106	808,048	871,637
NET ASSETS END OF YEAR	**$540,554**	**$684,563**	**$807,759**	**$895,862**	**$839,032**	**$768,847**	**$698,106**	**$808,048**	**$871,637**	**$969,746**

Financial Trends: Changes in Net Assets - Last 10 Fiscal Years

LTD CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
ADDITIONS	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Member Contributions	$23,008	$24,393	$26,170	$28,027	$29,938	$32,938	$ 34,801	$ 36,026	$ 38,982	$ 41,188
Employer Contributions	23,008	24,393	26,170	28,027	29,938	32,938	34,800	36,026	38,982	41,188
Net Investment Income	1,593	2,566	3,218	5,493	(6,490)	(7,518)	3,461	17,100	13,651	18,079
Total Additions	47,608	51,352	55,559	61,547	53,385	58,357	73,062	89,152	91,615	100,456
DEDUCTIONS										
Disability Benefits	30,052	35,112	39,839	41,220	45,848	54,804	54,688	58,976	62,183	66,271
Administration / Other	921	855	2,057	1,954	2,033	2,732	2,177	2,515	2,460	3,017
Total Deductions	30,972	35,967	41,896	43,174	47,881	57,536	56,865	61,491	64,643	69,288
NET CHANGES	**16,636**	**15,385**	**13,662**	**18,373**	**5,504**	**821**	**16,197**	**27,661**	**26,972**	**31,169**
Net Assets Beginning of Year	23,623	40,259	55,644	69,307	87,680	93,183	94,004	110,201	137,862	164,834
NET ASSETS END OF YEAR	**$40,259**	**$55,644**	**$69,307**	**$87,680**	**$93,183**	**$94,004**	**$110,201**	**$137,862**	**$164,834**	**$196,002**

Financial Trends: Benefits Paid - Last 10 Fiscal Years

RETIREMENT BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Retirement Benefits	$522,525	$574,230	$627,612	$695,426	$809,133	$924,172	$1,067,481	$1,238,966	$1,406,547	$1,538,992
Survivor Benefits	13,583	10,558	11,485	13,256	14,134	14,078	15,861	14,859	18,402	17,125
Total Benefits	536,108	584,788	639,097	708,682	823,267	938,250	1,083,342	1,253,825	1,424,949	1,556,117
Refunds of Contributions	$ 31,282	$ 29,769	$ 26,108	$ 70,755	$ 98,535	$ 42,765	$ 35,976	$ 36,212	$ 44,164	$ 60,313

HBS BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Health Premium Benefits	$30,149	$32,668	$34,935	$37,651	$40,500	$75,990	$84,534	$83,680	$89,602	$80,827

LTD BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Disability Benefits	$30,052	$35,112	$39,839	$41,220	$45,848	$54,804	$54,688	$58,976	$62,183	$66,271

Revenues: Contributions Received - Last 10 Fiscal Years

RETIREMENT CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Member Contributions	$ 150,500	$ 152,376	$ 152,917	$ 124,931	$ 133,504	$ 135,275	$ 142,356	$ 377,436	$ 403,661	$ 570,933
Employer Contributions	90,662	78,842	86,707	72,256	77,196	131,234	138,100	297,770	318,311	477,472
TOTAL	**$241,162**	**$231,218**	**$239,624**	**$197,187**	**$210,700**	**$266,509**	**$280,456**	**$675,206**	**$721,972**	**$1,048,405**

HBS CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employer Contributions	$59,838	$73,534	$66,209	$52,674	$56,308	$4,041	$4,256	$79,662	$85,350	$93,461

LTD CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Member Contributions	$ 23,008	$ 24,393	$ 26,170	$ 28,027	$ 29,938	$ 32,938	$ 34,801	$ 36,026	$ 38,982	$ 41,188
Employer Contributions	23,008	24,393	26,170	28,027	29,938	32,938	34,800	36,026	38,982	41,188
TOTAL	**$46,016**	**$48,786**	**$52,340**	**$56,054**	**$59,875**	**$65,875**	**$69,601**	**$72,052**	**$77,964**	**$82,377**

Revenues: Actual Contributions Rates - Last 10 Fiscal Years

RETIREMENT CONTRIBUTION RATES

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employee	3.20	3.05	2.85	2.17	2.17	2.00	2.00	5.20	5.20	6.90
Employer	1.92	1.57	1.61	1.25	1.25	1.94	1.94	4.10	4.10	5.77

HBS CONTRIBUTION RATES

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employer	1.28	1.48	1.24	0.92	0.92	0.06	0.06	1.10	1.10	1.13

LTD CONTRIBUTION RATES

	FISCAL YEAR									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employee	0.49	0.49	0.49	0.49	0.49	0.49	0.49	0.50	0.50	0.50
Employer	0.49	0.49	0.49	0.49	0.49	0.49	0.49	0.50	0.50	0.50

Operations: Members by Type of Benefit
As of June 30, 2006

RETIREMENT 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.

Source: Buck Consultants, LLC

HBS MONTHLY BENEFITS	MEMBERS
$1-199	39,710
200-299	8,141
300-399	465
400 & Over	133
TOTAL	**48,449**

Source: ASRS Pension Administration System

LTD MONTHLY BENEFIT	MEMBERS
$1-299	18
300-499	59
500-999	656
1000-1499	1,559
1500-1999	1,314
2000 & over	1,362
TOTALS	**4,968**

Source: VPA

Operations: Average Benefit Payments - Last 10 Fiscal Years

RETIREMENT

	Years of Credited Service									
	0-4	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40-44	45+
Fiscal year 1996										
Average monthly benefit	$123	$239	$470	$741	$1,118	$1,669	$2,119	$2,125	$1,506	$1,230
Number of retirees	918	7,781	9,849	8,334	7,791	6,654	3,498	884	240	26
Fiscal year 1997										
Average monthly benefit	$0	$244	$481	$759	$1,151	$1,719	$2,172	$2,197	$1,613	$1,270
Number of retirees	1,034	8,446	10,611	8,967	8,421	7,296	3,756	947	240	25
Fiscal year 1998										
Average monthly benefit	$122	$254	$499	$789	$1,196	$1,785	$2,248	$2,318	$1,749	$1,565
Number of retirees	1,149	8,788	11,050	9,305	8,786	7,718	3,908	965	226	22
Fiscal year 1999										
Average monthly benefit	$120	$259	$511	$806	$1,230	$1,846	$2,332	$2,448	$1,969	$1,771
Number of retirees	1,251	9,180	11,581	9,653	9,393	8,475	4,294	1,039	217	21
Fiscal year 2000										
Average monthly benefit	$125	$278	$550	$872	$1,328	$2,013	$2,541	$2,732	$2,339	$2,011
Number of retirees	1,321	9,454	12,076	10,061	9,944	9,169	4,683	1,106	207	17
Fiscal year 2001										
Average monthly benefit	$130	$293	$600	$939	$1,414	$2,119	$2,694	$2,956	$2,694	$2,671
Number of retirees	1,338	9,450	12,164	10,033	10,115	9,611	4,891	1,120	180	18
Fiscal year 2002										
Average monthly benefit	$142	$317	$664	$1,042	$1,578	$2,368	$2,990	$3,286	$3,195	$3,958
Number of retirees	1,397	9,357	12,188	10,145	10,443	10,023	5,399	1,193	182	19
Fiscal year 2003										
Average monthly benefit	$149	$328	$695	$1,068	$1,571	$2,312	$2,957	$3,314	$3,535	$4,335
Number of retirees	1,555	9,744	12,811	10,568	11,103	10,838	6,477	1,373	203	25
Fiscal year 2004										
Average monthly benefit	$139	$345	$726	$1,109	$1,629	$2,384	$3,092	$3,499	$3,863	$4,413
Number of retirees	1,716	10,153	13,268	10,984	11,747	11,567	7,607	1,611	248	30
Fiscal year 2005										
Average monthly benefit	$125	$326	$687	$1,742	$1,995	$2,460	$2,894	$3,035	$3,082	$2,817
Number of retirees	1,697	10,290	13,540	19,674	16,813	8,394	2,815	550	77	3

Average final average salary information is not available.

Source: Buck Consultants, LLC

Operations: Average Benefit Payments - Last 10 Fiscal Years

HBS

	Years of Credited Service					
	5	6	7	8	9	10 or more
Fiscal year 2006						
Average monthly benefit	$145	$160	$166	$176	$191	$255
Number of HBS participants	961	805	840	839	855	44,149

Note: Information for prior years is not available.

Source: ASRS Pension Administration System

LTD

Fiscal year 2006	
Average monthly benefit	$1,689
Number of LTD participants	4,968

Note: Long term disability payments are based on salary and not years of credited service. Information for prior fiscal years is not available.

Source: VPA

Operations: Principal Participating Employers - Current Year and Nine Years Ago

	2006			1997		
Participating Employer	Covered Employees	Rank	% of Membership	Covered Employees	Rank	% of Membership
Dept Of Administration	32,070	1	14.71%	29,065	1	20.40%
Maricopa County School Office	11,452	2	5.25	11,030	2	7.74
Maricopa County	8,286	3	3.80	7,045	3	4.94
Mesa Unified Dist 4	6,852	4	3.14	6,668	4	4.68
Tucson Unified Dist 1	6,245	5	2.87	4,771	5	3.35
University Of Arizona	6,143	6	2.82	4,203	6	2.95
Pima County	5,609	7	2.57	3,980	7	2.79
Maricopa County Community College District	5,503	8	2.52	3,900	8	2.74
Arizona State University	5,039	9	2.31	3,332	9	2.34
Pinal County School Office	4,142	10	1.90	2,037	10	1.43
*All other	126,620		58.09	66,456		46.64
Total	**217,961**		**100.00%**	**142,487**		**100.00%**

* In 2006, "All Other" consisted of:

Type	Number	Employees
Public Schools	229	83,515
Charter Schools	184	3,160
Cities	72	18,269
Counties	12	7,888
Higher Education	10	6,331
Other	82	7,457
	589	126,620

Note: All participating employers participate in the retirement, HBS and LTD plans.

Source: ASRS Pension Administration System