Arizona State Retirement SYSTEM

A COMPONENT UNIT OF THE STATE OF ARIZONA ■ DELIVERING SERVICE WITH PRIDE

2007

Comprehensive Annual Financial Report
for Fiscal Year June 30, 2007

DELIVERING SERVICE WITH...

PRIDE

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
- Investment Performance
- Funded Status
- Operational Effectiveness

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

OUR VALUES

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

Results.
A results-oriented approach to operations will *energize* 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.

Excellence.
A commitment to service excellence will *permeate* the organization.

ARIZONA STATE
RETIREMENT SYSTEM

Arizona State
Retirement System

A COMPONENT UNIT OF THE STATE OF ARIZONA

Mr. Michael Townsend, Chair
Dr. Keith Meredith, Vice Chair

Report Prepared by the Staff of the Arizona State Retirement System

Paul Matson, Director

2007

Comprehensive Annual Financial Report
for Fiscal Year Ended June 30, 2007

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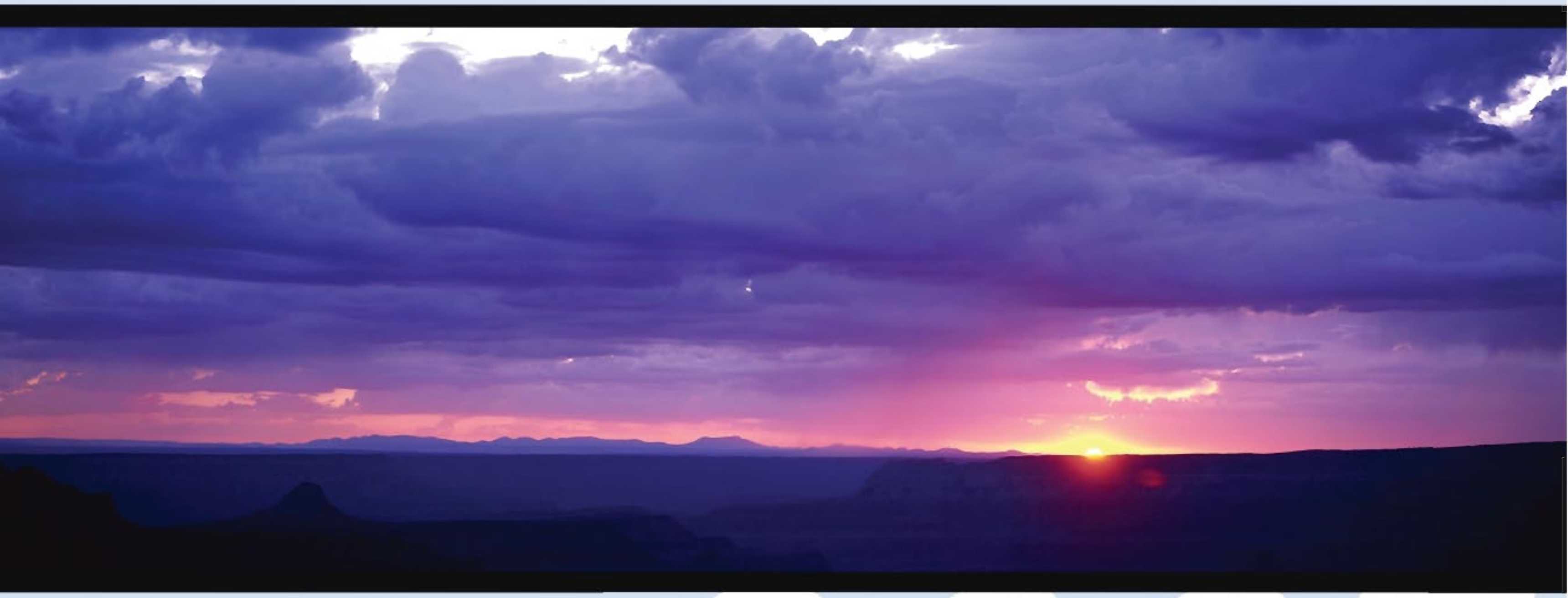
Arizona State Retirement System
A Component Unit of the State of Arizona

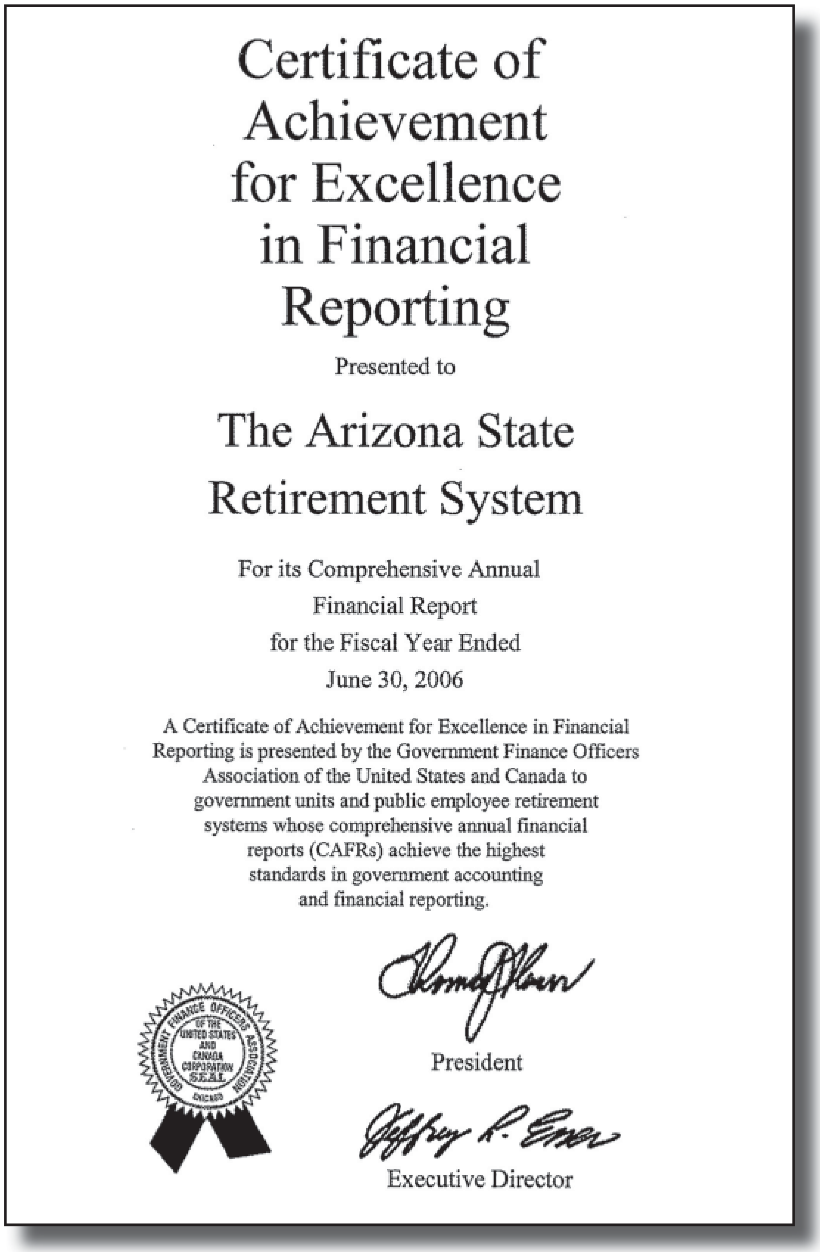


2007

Introductory Section

Grand Canyon, Arizona

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, 2006

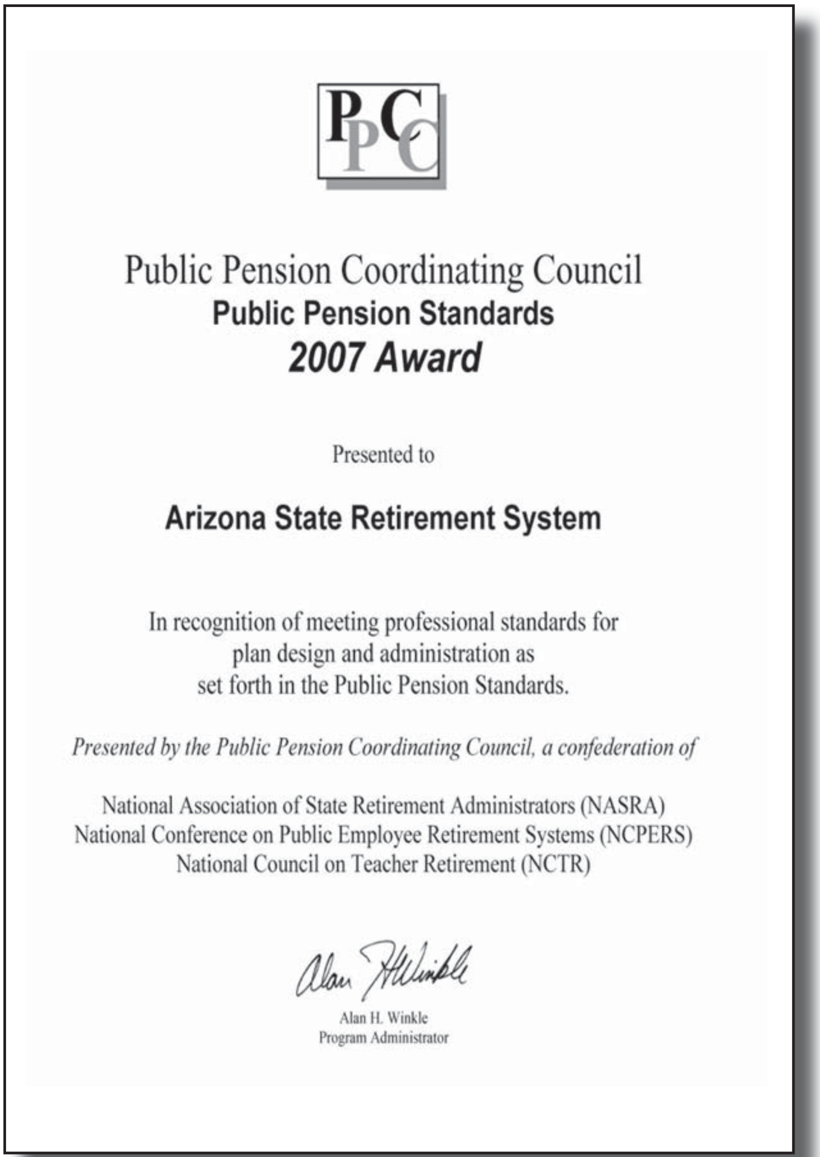
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards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

President

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 the Arizona State Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2006. This was the 18th consecutive year that the Arizona State Retirement System has achieved this prestigious award.

Public Pension Standards Award for Plan Design and Administration



PPCC

Public Pension Coordinating Council

Public Pension Standards

2007 Award

Presented to

Arizona State Retirement System

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle
Alan H. Winkle
Program Administrator

The National Association of State Retirement Administrators (NASRA), National Conference on Public Employee Retirement Systems (NCPERS), and the National Council on Teacher Retirement (NCTR) awarded a Public Pension Standards Award to the Arizona State Retirement System for plan design and administration as set forth in the Public Pension Standards for 2007. This was the 3rd consecutive year that the Arizona State Retirement System 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
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TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1-800-621-3778

Paul Matson
Director

December 14, 2007

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 (ASRS) Board of Trustees, it is my pleasure to present you with the fifty-fourth 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 for the fiscal year ended June 30, 2007. 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., is as of June 30, 2006 and indicates that the ASRS total plan achieved an actuarial funded status of 83.7 percent, down from 85.3 percent the previous year. The 2006 market value funded status for total plan assets of 79.6 percent reflects an increase over the prior year. The change in market value funding percentage from the prior year's 78.4 percent is a result of higher than expected market value returns during 2006. The market value funded status for the total plan is 86.4 percent for the period ending June 30, 2007.

During the fiscal year ended June 30, 2007, the total rate of return on investments was 17.8 percent. The annualized three, five, ten and inception rates of return were 11.9 percent, 11.0 percent, 8.4 percent, and 11.0 percent, respectively. Each of these rates of return exceeds our actuarially-assumed rate of return of 8 percent. As of June 30, 2007, the ASRS Fund stood at nearly $28.5 billion, $4 billion more than at the same time the previous year.

The contribution rate, as determined by actuarial analysis, is designed to ensure the ASRS fund remains adequate to meet current and future obligations to members. The actuarially recommended rate for fiscal year 2007-08 is 9.6 percent for both the employer and employee, which includes 9.1 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 projected to decrease to 9.45 percent for the 2008-09 fiscal year, which includes 8.95 percent

Letter from the Chairman

for the pension fund and 0.50 for the long term disability plan. This decrease is a result of both significantly higher investment returns as well as program modifications.

After a five-year period in which the contribution rate increased significantly due to a variety of factors, it appears to have leveled off, with a modest decrease determined for the fiscal year beginning July 1, 2008.

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 liability reductions over the past several years.

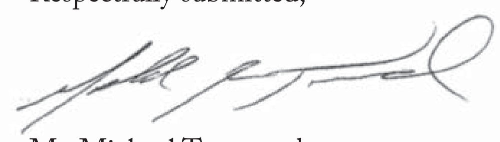
Our members can be confident that the ASRS is poised to meet obligations of providing a lifelong income and a range of additional benefits when they retire, including a retiree medical and dental insurance plan and the premium benefit program which helps pay a portion of the insurance plans' premiums.

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 and avoidances as well. We are approaching the final stages of an ambitions information technology improvement program that will continue to pay dividends for the near- and long-term.

I would like to note that the total membership of the ASRS, including active, inactive, disabled and retired members, reached a record 523,012 as of June 30, 2007. Also during that fiscal year, more than 88,000 retirees, survivors and disabled members received in excess of $1.8 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,



Mr. Michael Townsend
Board Chair
Arizona State Retirement System

Letter of Transmittal from the Director

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

December 14, 2007

Mr. Michael Townsend, Chair
Arizona State Retirement System Board of Trustees
3300 North Central Avenue, 14th Floor
Phoenix, Arizona 85012

Dear Mr. Townsend:

I am pleased to present the fifty-fourth 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, 2007.

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 the 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.

Heinfeld, Meech & Co., P.C. has issued an unqualified ("clean") opinion on the ASRS financial statements for the year ended June 30, 2007. 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 June 30, 2007, total ASRS membership, including active, inactive, disabled and retired members is 523,012. There are 745 employers participating in the ASRS, including school districts, charters 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 and disabled members and their eligible dependents. Active members receive long-term disability insurance coverage equal to two-thirds of pay at the time of disablement.

During FY 2006-07, more than 88,000 retired annuitants, their survivors, and disabled members received in excess of $1.8 billion in benefits. As of June 30, 2007 there were 31,717 retired members and their families enrolled in the ASRS-sponsored medical program and 28,281 retired members and their families enrolled in dental plans through the ASRS.

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 and each trustee who represents an ASRS member group shall have no less than five years of administrative management experience. There is no limit on the number of terms an ASRS Board Trustee may serve. During FY 2006-07, Governor Janet Napolitano appointed the following ASRS Board Trustees to the Board:

- Mr. Jaime Gutierrez, re-appointed as a representative of educators; term to expire on January 18, 2010;
- Mr. Tom Connelly, appointed as a representative of the public; term to expire on January 18, 2010;
- Mr. James McLaughlin, appointed as a representative of the public, term to expire on January 18, 2010.

Major Initiatives

Investments:

During FY 2006-07, ASRS has:

- Developed and implemented an ASRS Investment Performance Evaluation Framework, which codified the decision-making process and performance expectations for the entire life cycle of an investment manager: hiring, retention and possibly termination.
- Completed an Asset Allocation Study, which was initiated in 2006. Strategic policy changes to the fund included: allocating 5% to private equity; increasing the allocations to both U.S. mid and small cap equity to 7%; increasing the non-U.S. equity allocation to 18%; and creating an opportunistic asset class and absolute return classification, each with target allocations of 0% and ranges of 0%-5%.
- Selected and implemented a risk budgeting system to measure total fund active return and active risk. The risk budgeting system will be used as a tool in portfolio construction decisions.
- Implemented the ASRS private equity investment program. Retained an ASRS private equity consultant and developed the ASRS private equity strategic plan.

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 37 externally managed and 7 internally managed portfolios, which are diversified in U.S. equities, U.S. fixed income, international equities and real estate.

After deducting investment expenses, the ASRS achieved one, three, five, ten year and inception net rates of return for the period ended June 30, 2007:

Annualized Rates of Return
(Retirement & Health Benefit Supplement)

	1 Year	3 Year	5 Year	10 Year	Inception (June 30, 1975)
ASRS Total Fund	17.8%	11.9%	11.0%	8.4%	11.0%

The ASRS adheres to all statutory requirements set by Arizona State law. In addition the ASRS established investment guidelines for its internal and 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 responsibilities reside with the ASRS Board. Details of investments are contained in the Investment Section of this report.

Benefits

During FY 2006-07:

- New retirees began receiving their first benefit check within 10 days of their retirement date. Previously new retirees waited as long as 90 days to receive their first benefit check. This improved service places the ASRS within the best practices category for public pension funds.
- The ASRS rolled out a new retirement benefit estimate service that members can access via the web. The new service provides members the choice of calculating a retirement benefit based on their current ASRS account or based on projected values. In addition, active members are now able to change their addresses and beneficiaries via the web.
- The Board adopted a Supplemental Retirement Savings Plan for non-state active ASRS members. This plan enables active members to save additional tax deferred money for retirement and is qualified under Section 401(a) of the Internal Revenue Code. Participants may elect to defer up to 100 percent of pay or $45,000, whichever is lower. In addition, the plan permits loans, which many 457 and 403(b) plans do not.

Letter of Transmittal from the Director

Administration:

- The ASRS completed an agency-wide Risk Assessment Study for the two-year period ending June 30, 2009. The Assessment was conducted in accordance with principles espoused in the 2004 Committee of Sponsoring Organizations of the Treadway Commission-Integrated Framework of Internal Controls. The assessment provides reasonable assurance that the ASRS is taking appropriate steps to mitigate risks which threaten its administrative effectiveness.

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, 2006, the actuarial value of total plan assets was $24.9 billion and the actuarial accrued liability was $29.7 billion. The unfunded actuarial accrued liability of $4.8 billion results in an actuarial funding ratio of 83.7 percent for the total plan. The change in funding percentage from last year's 85.3 percent is primarily due to continued recognition of investment losses for fiscal years 2002 and 2003. The actuarial funding ratios for the individual components of the total plan are as follows: retirement – defined benefit 84.3 percent, and health insurance premium benefit (HBS) supplement 72.1 percent. The funding ratios for the defined contribution retirement system – and the long term disability (LTD) program are 109.1 percent and 33.8 percent respectively.

The projected actuarial funding ratios for the period ended June 30, 2007 for the individual components of the total plan are as follows: retirement - defined benefit 83.2 percent, and the health insurance premium benefit supplement (HBS) 72.7 percent. The funding ratios for the defined contribution retirement system and the long term disability (LTD) program are 119.8 percent and 38.3 percent, respectively.

The market value funding ratios for the period ending June 30, 2006 for the individual components of the total plan is as follows: retirement defined benefit 80.4 percent, and health insurance premium benefit supplement (HBS) 64.5 percent. The market value funding ratios for the defined contribution retirement system and the long term disability (LTD) program are 109.1 percent and 34.1 percent, respectively.

The market value funding ratios for the period ending June 30, 2007 for the individual components of the total plan is as follows: retirement - defined benefit 87.1 percent, and health insurance premium benefit supplement (HBS) 72.4 percent. The market value funding ratios for the defined contribution retirement system and the long term disability (LTD) program are 119.8 percent and 40.3 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, on page 46.

Letter of Transmittal from the Director

Estimated Impact of ASRS Cost Reduction Initiatives as of June 30, 2007, Valuation Date

Amounts in Millions of Dollars

Action	Reduction in Total Contribution Rate	Annual Reduction in Total Contribution Amount	Present Value of Savings on Actuarial Valuation Basis
Cost Savings Initiatives Contained in Current Valuation & Reflected in Lower Current Contribution			
Change basis for service purchases from normal cost to actuarial present value	0.60%	$43.80	$338.90
Decrease interest credited on withdrawn contributions from 8% to 4%	0.30%	$21.90	$191.30
Correction of Permanent Benefit Increase reserve	0.05%	$3.50	$42.00
Sub-total, savings in current valuation	**0.95%**	**$69.20**	**$572.20**
Cost Savings Initiatives Contained in Future Valuation & Reflected in Lower Future Contribution			
Increase interest rate on payroll deduction agreements from 0% to 8%	0.20%	$14.60	$177.40
Pop-up restrictions	0.46%	$36.90	$448.40
Reimbursements for early retirement incentives	0.22%	$16.10	$195.20
Rescinding modified Deferred Retirement Option Plan	0.56%	$44.90	$545.90
Long Term Disability program design changes	0.03%	$2.20	$26.60
Long Term Disability -- changes to offsets and pre-existing condition period	0.18%	$13.20	$159.70
Sub-total, savings in future valuation	**1.65%**	**$127.90**	**$1,553.20**
GRAND TOTAL	**2.60%**	**$197.10**	**$2,125.40**

Note: 2004 LTD Design Changes included limiting total income to 100% of pre-disability income, requiring members to participate in rehabilitation programs, and restricting "own occupation" disabilities to 24 total months.

Cost Saving Initiatives

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 that have been implemented are estimated to have reduced total contributions to the ASRS by approximately $197 million per year, which is equivalent to approximately $2.1 billion in liability savings for the group of all current employees, or approximately $4.2 billion in liability savings for the group of all current and future employees. Over the long term, these very significant savings will reduce future increases in contribution rates to both employees and employers by an average of approximately 2.6 percent in total each year.

Letter of Transmittal from the Director

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, 2006. The ASRS has received this prestigious award in each of the last 18 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 2007 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 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 third year the ASRS has received this award.

Acknowledgements

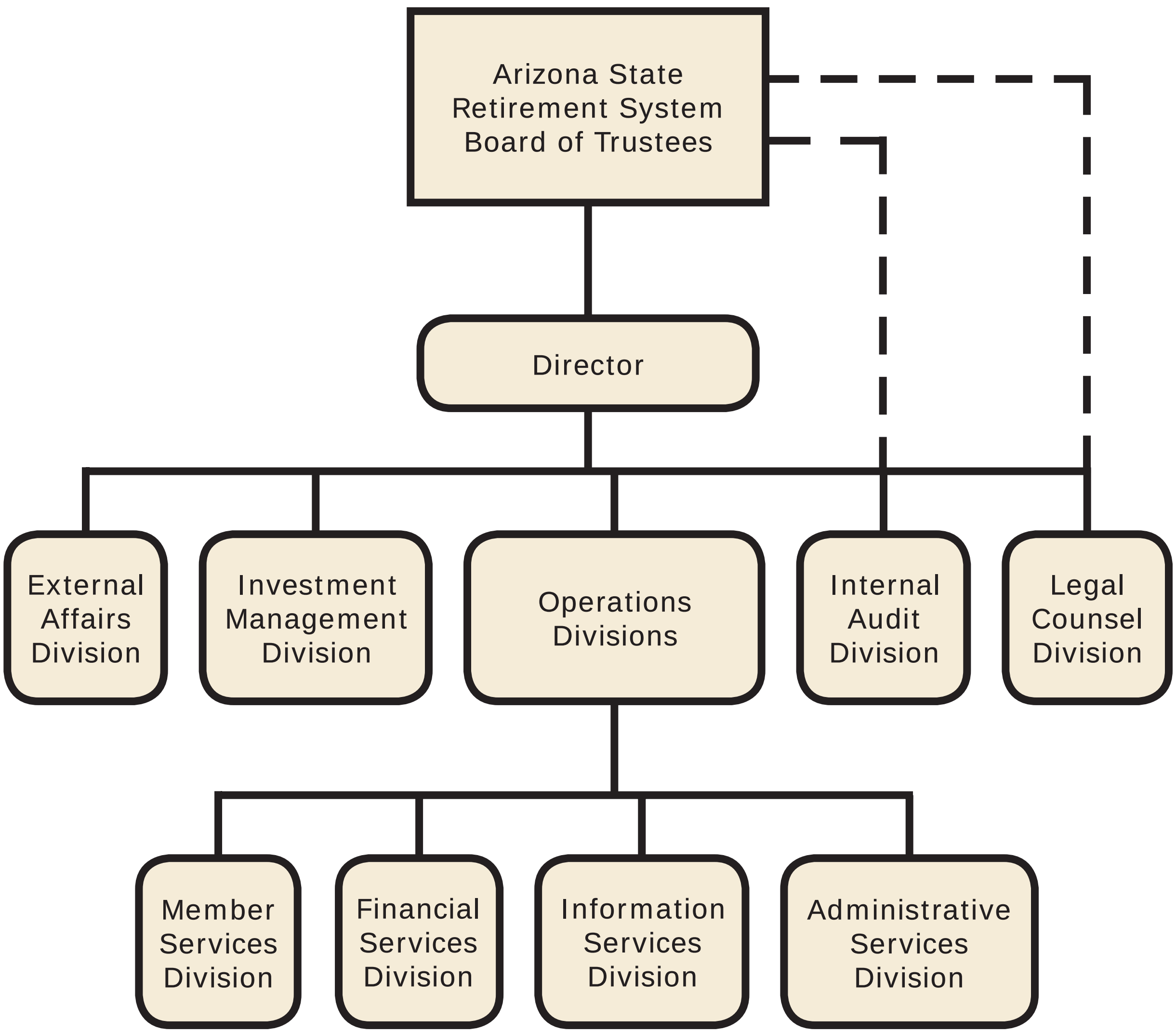
This report represents the culmination of hours of hard work by the ASRS General Accounting and External Affairs staff. It is intended to provide complete and reliable information for decision making, to insure compliance with legal requirements, and is a means of measuring the responsible stewardship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

Respectfully submitted,

Paul Matson
Director

Organizational Chart



ASRS Board of Trustees

Michael Townsend
CHAIR
Flagstaff, Political Subdivisions

Dr. Keith Meredith
VICE CHAIR
Tucson, Member at Large

David Byers
Phoenix, State Employees

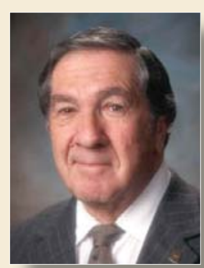
Thomas Connelly
Phoenix, Public

Jaime Gutierrez
Tucson, Educators

Christopher Harris
Phoenix, Public

James McLaughlin
Gilbert, Public

Lawrence Trachtenberg
Scottsdale, Public

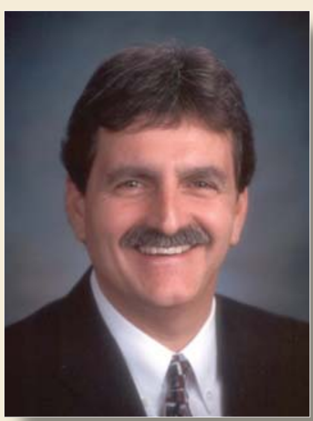


Steven Zeman
Phoenix, Retirees

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
Sedgwick CMS Company
Calabasas, CA

CUSTODIAL BANK
Mellon Global Securities Services
Pittsburgh, PA

INDEPENDENT AUDITORS
Heinfeld, Meech & Co., P.C.
Tucson, 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 2007 Retirement Legislation

The 48th Legislature-First Regular Session adjourned June 20, 2007. Below is a brief summary of bills that have been passed into law that may affect ASRS members and employers. To view legislation in its entirety, visit the Arizona State Legislature website at www.azleg.gov. All bills listed below are effective on the general effective date (September 19, 2007) unless otherwise noted.

Senate Bill 1200 – Public Supplemental Defined Contribution Plans (Laws 2007, Chapter 98)

- Allows the employee to determine whether employer matching money will be made to the plan in which the employee participates or to any other savings plan of the employer (i.e., 403(b), 457, 401(a)).
- Removes the 1% minimum employee contribution.
- Clarifies that an employee may contribute either a percentage of gross compensation, a fixed dollar amount, an amount specified in the plan, or some other definitive amount that may not be modified or revoked by the employee, rather than only a percentage of compensation.

Senate Bill 1556 – ASRS Postdoctoral Scholars (Laws 2007, Chapter 173)

- Exempts postdoctoral scholars from ASRS membership.

House Bill 2145 – ASRS Long Term Disability Amendments (Laws 2007, Chapter 114)

- Modifies the Social Security offsets from 64% of SS Disability and 83% of SS Retirement to 85% for a member who becomes disabled on or after July 1, 2008, but excludes from the offsets attorney fees approved by SS rules, reasonable documented costs of securing a disability benefit, and any COLAs from the offsets.
- Modifies the pre-existing condition look back provisions from 3 months to 6 months for a member hired on or after July 1, 2008.
- Requires the ASRS to recover overpaid money by reducing a benefit owed to any member, beneficiary, or alternate payee.

Summary of 2007 Retirement Legislation

House Bill 2147 – ASRS Investment Management (Laws 2007, Chapter 270)

- Removes the requirement that a fund manager must have $250 million currently under advisement, but clarifies that experienced employees within a firm meet the 3-year experience requirement.
- Establishes that proprietary commercial information connected with ASRS's investments is confidential and not a public record if the information would not customarily be released to the public by the person or entity from whom the information was obtained.
- Increases the total foreign investment cap from 20% to 30%.

House Bill 2148 – ASRS Active Military Service Credit (Laws 2007, Chapter 244)

- Changes the term "presidential" call-up to "military" call-up.
- Adds that a death or disability may be "during" active military service in addition to "as a result of" active service.
- Allows a member who was activated into U.S. military service and became disabled as a result of or during the service to purchase that active service time from the date service started through one year after the member's date of disability. Provision effective until June 30, 2009.
- Makes other technical and conforming changes.
- Note: Effective retroactively to July 1, 2007.

House Bill 2311 – Retiree Health Insurance-Rural Subsidy (Laws 2007, Chapter 253)

- Extends the rural health insurance subsidy for Medicare-eligible ASRS, EORP, PSPRS and CORP retirees for an additional 2 years through fiscal year 2009, from July 1, 2007 through June 30, 2009.
- Specifies that a member living in a non-service area who is enrolled in a managed care program is not eligible for the premium benefit supplement.

Arizona State Retirement System

A Component Unit of the State of Arizona

2007

Financial Section

Monument Valley, Arizona

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II. Financial Section

Independent Auditors' Report

HEINFELD, MEECH & CO., P.C.
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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 Plan Net Assets of the funds of the Arizona State Retirement System (ASRS), a component unit of the State of Arizona, as of and for the year ended June 30, 2007, and the related Statement of Changes in Plan Net Assets of the funds for the year then ended. These basic financial statements are the responsibility of ASRS's management. Our responsibility is to express an opinion on these financial statements based on our audit. The comparative totals as of and for the year ended June 30, 2006, presented in the basic financial statements were audited by other accountants and are included for additional analysis only. Neither we nor the other accountants have performed any auditing procedures on this information since the date of their report.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the net assets of the funds of the Arizona State Retirement System, a component unit of the State of Arizona, as of June 30, 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2007, on our consideration of the Arizona State Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Independent Auditors' Report

The Management's Discussion and Analysis on pages 20 through 25 and the Schedule of Funding Progress and Schedule of Employer Contributions on page 46 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise ASRS's basic financial statements. The Introductory Section, Additional Supplementary Information, Investment Section, Actuarial Section and Statistical Section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Additional Supplementary Information, as listed in the table of contents under the Financial Section, has been subjected to the auditing procedures applied 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 Section, Actuarial Section and Statistical Section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
Certified Public Accountants

November 19, 2007

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, 2007. 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 2007, 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.

- The ASRS rate of return on investments for FY 2007 was 17.8 percent compared to 9.8 percent FY 2006. 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 held in trust for pension benefits increased by 16.8 percent at FYE June 30, 2007 compared to FYE 2006. The increase in the combined total net assets is due to positive returns in the global securities markets during the fiscal year.
- The ASRS received a total of $1.6 billion in employee and employer contributions during FY 2007 compared to $1.2 billion in FY 2006. The 32.6 percent increase is due primarily to a contribution rate increase effective July 1, 2006, an increase in active non-retired members average annual salary, and an increase in active membeships.
- The ASRS paid $1.8 billion in pension, disability, health insurance and survivor benefits during FY 2007 compared to $1.7 billion in FY 2006. The 7.0 percent increase is due to an increase in the number of retirements and an increase in pre-retirement members' average annual salary.
- As of June 30, 2006, the most recent actuarial valuation, the Retirement and Health Benefit Supplement Funds combined were 83.7 percent funded. This compares to a combined funding ratio of 85.3 percent as of June 30, 2005. The change in funding percentage is primarily due to continued recognition of investment losses for fiscal years 2002 and 2003. Liability experience losses also affected the funded status of the plans during this valuation. Investment losses are recognized over a period of time while liability experience losses are recognized fully and immediately during the period in which they occured.

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, 2007. 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, 2007, financial statements are presented for the funds administered by the

Management's Discussion and Analysis

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, 2007 with combined total comparative information as of June 30, 2006. This financial statement reflects the resources available 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, 2007 with comparative information for the year ended June 30, 2006. This statement reflects the changes in resources available to pay benefits to retirees and other beneficiaries for 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 28-45 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 and professional investment income by manager and 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, 2007 were $28.5 billion, a 16.8 percent increase from $24.4 billion at June 30, 2006. The increase in net assets is primarily due to positive returns in the global securities markets during the fiscal year. The retirement fund net assets were $27.1 billion compared to $23.2 billion last year, a 16.8 percent increase. The HBS fund net assets were $1.2 billion at year end compared to $970 million in FYE 2006, a 23.7 percent increase. The LTD fund net assets were $243 million at year end compared to $196 million last year, a 24.0 percent increase.

Net investments totaled $28.3 billion at FYE 2007 compared to $24.2 billion at FYE 2006. The 16.9 percent increase was primarily due to positive returns in the global securities markets. Cash, receivables and prepaids of $2.3 billion reflects an 8.0 percent decrease compared to last year's $2.5 billion and is primarily due to a decrease in forward contracts receivable. Liabilities of $6.4 billion represents an increase of 28 percent compared to $5.0 billion last year. This is due to an increase in payables for securi-

Management's Discussion and Analysis

Net Assets - ASRS

	2007	2006	Change	% Change
Assets				
Cash, receivables and prepaids	$2,297,724	$2,507,500	$(209,776)	-8.4%
Investments at fair value	29,003,567	24,696,458	4,307,109	17.4%
Security lending	3,543,247	2,265,754	1,277,493	56.4%
Total assets	34,844,538	29,469,712	5,374,826	18.2%
Liabilities				
Payables for investments	2,825,294	2,818,564	6,730	0.2%
Securities Lending	3,543,247	2,265,754	1,277,493	56.4%
Total Liabilities	6,368,541	5,084,318	1,284,223	25.3%
Total Net Assets	$28,475,997	$24,385,394	$4,090,603	16.8%

ties purchased and for securities lending collateral.

Changes in Net Assets. For the 2007 fiscal year, employer and member contributions totaled $1.6 billion, a 32.6 percent increase over the 2006 fiscal year contributions of $1.2 billion. This is primarily attributed to an increase in the contribution rate effective July 1, 2006.

For FY 2007, the ASRS recognized net investment income of $4.3 billion which compares to net investment income of $2.2 billion in the previous year. This 95.5 percent increase in investment income is due to positive returns in the global equity markets during the fiscal year.

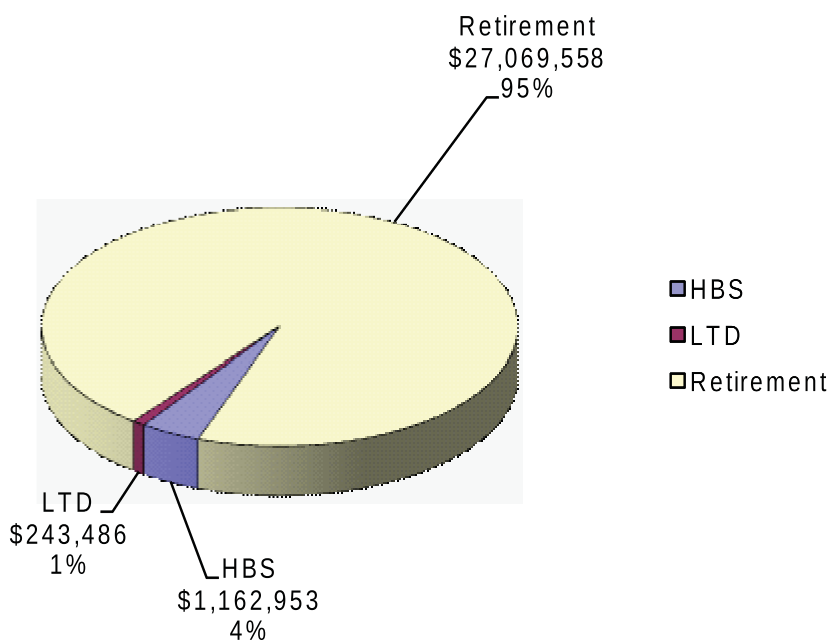
Deductions from the ASRS net assets held in trust for benefits consist primarily of pension, disability, health insurance and survivor benefits, member refunds and administrative expenses. For the 2007 fiscal year, pension, disability, health insurance and survivor benefits totaled $1.8 billion, an increase of 5.9 percent over the $1.7 billion paid during FY 2006. Pension payments totaled $1.6 billion in FY 2007 compared to $1.5 billion in the previous year. The 6.67 percent increase is explained by a 4.3 percent increase in retirees. Refunds and transfers to other plans totaled $88 million in 2007, a 34.6 percent increase from the $65.4 million paid out in 2006. For FY 2007, the cost of administering the ASRS benefits totaled $33.6 million, an increase of 4.0 percent from the $32.1 million paid in FY 2006. This increase is a result of fewer vacant positions, statutorily approved salary increases and funding for IT projects. The following tables show the principal ASRS net assets and changes in net assets for fiscal years 2007 and 2006, in thousands of dollars:

Management's Discussion and Analysis

Change in Net Assets - ASRS

	2007	2006	Change	% Change
ADDITIONS				
Employee contributions	$ 811,480	$ 612,121	$ 199,359	32.6%
Employer contributions	811,535	612,121	199,414	32.6%
Service credit purchase and transfers in	107,548	125,751	(18,203)	-14.5%
Investment and security lending income	4,512,326	2,366,186	2,146,140	90.7%
Investment and security lending expense	(201,808)	(135,247)	(66,561)	49.2%
Total additions	6,041,081	3,580,932	2,460,149	68.7%
DEDUCTIONS				
Benefits	1,803,275	1,686,090	117,185	7.0%
Survivor benefits	21,590	17,125	4,465	26.1%
Refunds and transfers	88,027	65,442	22,585	34.5%
Administration and other	37,586	34,266	3,320	9.7%
Total deductions	1,950,478	1,802,923	147,555	8.2%
NET CHANGE	**4,090,603**	**1,778,009**	**2,312,594**	**130.1%**
Net assets beginning of year	24,385,394	22,607,385	1,778,009	7.9%
Net assets end of year	$28,475,997	$ 24,385,394	$4,090,603	16.8%

Net Assets by Fund - June 30, 2007



Management's Discussion and Analysis

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, 2006.

At June 30, 2006 the total funded status of the ASRS retirement and health benefit supplement funds decreased to 83.7 percent from 85.3 percent at FYE 2005. At FYE 2006 ASRS actuarial liabilities exceeded actuarial assets for the retirement and health benefit supplement funds by $4.8 billion. This compares to an excess of actuarial assets over actuarial liabilities of $4.1 billion at FYE 2006. This decrease in funded status is related primarily to recognition of investment losses in fiscal years 2002 and 2003 and to a change in actuarial assumptions.

Investments. During the FY 2007, the ASRS funds remained broadly diversified with investments in domestic and international equities, domestic fixed income, real estate 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.

At June 30, 2007, the ASRS held total investments of $28.3 billion, an increase of $4.1 billion from FY 2006. The $4.1 billion increase in total investments is primarily due to an increase in the global securities markets. The combined investment portfolio experienced a return of 17.8 percent compared to the benchmark return of 18.6 percent. During the implementation of ASRS's real estate and private equity program, an interim benchmark which prorates the 6 percent allocation to institutional real estate is being used. The interim benchmark consists of 39 percent S&P 500 Index, 7 percent S&P 400 Index, 7 percent S&P Index, 27 percent Lehman Brother Aggregate Index, 19 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, 2007, the ASRS held $15.9 billion in domestic equities and $3.7 billion in international equities, an increase of 28.2 percent in domestic equities and a 15.0 percent decrease in international equities from FYE 2006. The FY 2007 rate of return for ASRS domestic equities was 19.8 percent compared to 10.0 percent in FY 2006 reflecting an increase in the domestic equity markets. The ASRS domestic equities benchmark, comprised of a custom combination of S&P 400, S&P 500 and the S&P 600, had a return of 21.6 percent for FY 2007.

The FY 2007 rate of return for ASRS international equities was 27.9 percent compared to 24.3 percent in FY 2006, reflecting an increase in the international equity markets. The ASRS international equities benchmark, MSCI ACWI EX-US, had a rate of return of 30.1 percent for FY 2007. 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, 2007, the ASRS held $6.3 billion in domestic fixed income securities, an increase of $314 million from FY 2006. The rate of return was 6.1 percent compared to -0.4 percent in the previous year, reflecting an increase in performance in the fixed income markets. The ASRS domestic fixed income benchmark, the Lehman Aggregate, had a rate of return of 6.1 percent for FY 2007. This benchmark is representative of the returns that could be expected in a similar investing environment.

At June 30, 2007, the ASRS held $597.3 million in real estate assets, an increase of $351.5 million from FY 2006. The rate of return was 19.7 percent. The ASRS real estate benchmark, the

Management's Discussion and Analysis

NCREIF+100bps, had a rate of return of 18.3 percent for FY 2007. 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 2007 was $6.9 million compared to $5.8 million for FY 2006. The 19.0% 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 Financial Services Division, 3300 North Central Ave., Phoenix, AZ 85012.

Basic Financial Statements

Combined Statement of Plan Net Assets

June 30, 2007 with Comparative Totals for 2006
(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund (Note 8)	Long-Term Disability Fund (Note 8)	Combined 2007	Combined 2006
ASSETS:					
Cash (Note 3)	$18,299	$789	$4,621	$23,709	$27,066
Prepaid Benefits	129,917	-	-	129,917	120,076
RECEIVABLES:					
Accrued interest & dividends	56,296	2,426	19	58,741	57,466
Securities sold (Note 3)	663,703	28,607	-	692,310	371,018
Forward contracts (Note 5)	1,288,258	55,526	-	1,343,784	1,889,592
Contributions (Note 7)	35,216	2,553	2,196	39,965	31,388
Due from Other Funds	-	-	1,917	1,917	6,323
Other	5,364	205	1,812	7,381	4,571
Total Receivables	2,048,837	89,317	5,944	2,144,098	2,360,358
INVESTMENTS AT FAIR VALUE (Note 3)					
Temporary investments	2,491,214	107,375	6	2,598,595	1,876,609
Temporary investments from securities lending collateral (Note 4)	3,396,838	146,409	-	3,543,247	2,265,754
U.S. government obligations	3,864,743	166,577	35,341	4,066,661	3,858,714
Corporate bonds	2,064,607	88,988	22,949	2,176,544	1,972,262
Common and preferred stocks	18,604,089	801,866	158,485	19,564,440	16,743,086
Real estate mortgages & contracts	556,954	24,006	16,367	597,327	245,787
Total Investments	30,978,445	1,335,221	233,148	32,546,814	26,962,212
TOTAL ASSETS	33,175,498	1,425,327	243,713	34,844,538	29,469,712
LIABILITIES:					
Payable for securities purchased (Note 3)	1,389,184	59,876	-	1,449,060	895,749
Payable for securities lending collateral (Note 4)	3,396,838	146,409	-	3,543,247	2,265,754
Forward contracts payable (Note 5)	1,292,189	55,695	-	1,347,884	1,895,845
Due to Other funds	1,917	-	-	1,917	6,323
Other	25,812	394	227	26,433	20,647
Total Liabilities	6,105,940	262,374	227	6,368,541	5,084,318
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:	$27,069,558	$1,162,953	$243,486	$28,475,997	$24,385,394

(A Schedule of Funding Progress is presented on page 46)
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, 2007 with Comparative Totals for 2006
(Dollars in Thousands)

	Retirement Fund	Health Benefit Supplement Fund (Note 8)	Long-Term Disability Fund (Note 8)	Combined 2007	Combined 2006
ADDITIONS:					
Contributions:					
Member Contributions (Note 7)	$ 766,962	$ -	$ 44,518	$ 811,480	$ 612,121
Employer contributions (Note 7)	663,544	103,473	44,518	811,535	612,121
Transfers from other plans	9,685	-	-	9,685	1,727
Member reimbursements	97,863	-	-	97,863	124,024
Total Contributions:	1,538,054	103,473	89,036	1,730,563	1,349,993
Income from investment activities:					
Net appreciation (depreciation) in fair value	3,584,175	152,519	29,395	3,766,089	1,758,899
Interest	290,703	12,370	176	303,249	271,299
Dividends	262,559	11,173	14	273,746	232,692
Real estate	11,997	511	-	12,508	8,150
Other	7,064	(51)	941	7,954	6,062
Total income from investment activities:	4,156,498	176,522	30,526	4,363,546	2,277,102
Less investment activity expenses:					
Investment management fees and monitoring services	50,841	2,173	-	53,014	46,779
Real estate	6,596	281	-	6,877	5,178
Total investment activity expenses:	57,437	2,454	-	59,891	51,957
Net income from investment activities	4,099,061	174,068	30,526	4,303,655	2,225,145
From securities lending activities (Note 4):					
Security loan program	142,707	6,073	-	148,780	89,084
Security loan interest expense	136,124	5,793	-	141,917	83,290
Net income from securities lending activities	6,583	280	-	6,863	5,794
Total net investment income	4,105,644	174,348	30,526	4,310,518	2,230,939
TOTAL ADDITIONS	5,643,698	277,821	119,562	6,041,081	3,580,932
DEDUCTIONS					
Retirement and disability benefits	1,650,818	83,236	69,221	1,803,275	1,686,090
Survivor benefits	21,590	-	-	21,590	17,125
Refunds to withdrawing members, including interest	77,910	-	-	77,910	60,313
Administrative expenses	29,817	1,270	2,575	33,662	32,145
Transfers to other plans	10,117	-	-	10,117	5,129
Other	3,534	108	282	3,924	2,121
TOTAL DEDUCTIONS	1,793,786	84,614	72,078	1,950,478	1,802,923
NET INCREASE (DECREASE)	3,849,912	193,207	47,484	4,090,603	1,778,009
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:					
Beginning of year	23,219,646	969,746	196,002	24,385,394	22,607,385
End of year	$27,069,558	$1,162,953	$243,486	$28,475,997	$24,385,394

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 that 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 of Trustees (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, 2007, the number of participating employers and employees totaled:

EMPLOYER UNITS	2007	2006
School Districts	235	235
Charter Schools	172	180
Cities and Towns	76	74
Counties	15	15
Special Districts	85	81
Community College Districts	10	10
Universities	3	3
State Government	1	1
TOTAL	**597***	**599**
EMPLOYEE MEMBERS		
Retirees (including Beneficiaries)	83,603	80,129
Non Active Fully Vested	209,667	184,460
Long-Term Disability recipients	4,976	4,968
CURRENT EMPLOYEES:		
Active	224,766	217,961
TOTAL	**523,012**	**487,518**

* The 597 Employer Reporting Units represent 745 total employers. Of the retirees and LTD recipients noted above, 53,970 are receiving health insurance premium benefits.

Costs of administering the funds are financed through contributions, state appropriations and investment earnings of the funds.

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 employ¬ment, 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 contribu¬tions 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, 2007, 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, 2006, 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, 2006, from which the summarized information was derived.

3. Cash And Investments

Cash – Cash deposits are subject to custodial risk. Custodial risk is the risk that in the event of a bank failure, ASRS's deposits may not be returned to it. Arizona state statutes require state agency deposits to be covered by collateral pledged by the bank. The board has not adopted a more restrictive policy. At June 30, 2007, $100,000 of the ASRS' cash deposits were covered with federal depository insurance funds. The remainder was collateralized with securities held by the pledging bank's trust department in the ASRS' name.

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

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 2007, 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 develop¬ment projects authorized as eligible for such investment by the Arizona State Department of Commerce. During fiscal year 2007 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.

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 $692.3 million and a payable for securities purchased of $1.45 billion at June 30, 2007.

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.

Notes to the Basic Financial Statements

The following table shows the investments by investment type:

INVESTMENTS
at June 30, 2007
(Dollars in Thousands)

Investment	Retirement HBS	LTD	2007 Fair Value
Temporary Investments including US Treasury Bills	$ 2,580,083	$ 6	$ 2,580,089
Foreign Bonds including Temporary Investments	18,506	-	18,506
Total Temporary Investments	2,598,589	6	2,598,595
Corporate Bonds	2,153,595	22,949	2,176,544
Domestic Common and Preferred Stock	15,730,799	158,485	15,889,284
Foreign Common and Preferred Stock	3,675,156	-	3,675,156
Total Common and Preferred Stock	19,405,955	158,485	19,564,440
US Government Obligations	3,421,563	35,341	3,456,904
US Agency Obligations	609,757	-	609,757
Total US Government Obligations	4,031,320	35,341	4,066,661
Real Estate Mortgages & Contracts	580,960	16,367	597,327
U. S. Government Obligations	119,976	-	119,976
U. S. Agency Obligations	373,809	-	373,809
Corporate Obligations – Domestic	51,940	-	51,940
Preferred and Common Stock- Domestic	2,127,430	-	2,127,430
Preferred and Common Stock –Foreign	870,092	-	870,092
Total Securities Lending Obligations	3,543,247	-	3,543,247
TOTAL INVESTMENTS AT FAIR VALUE	**32,313,666**	**233,148**	**32,546,814**
*Short Term Investment Recievables	2,098,232	19	2,098,251
**Short Term Investment Payables	6,349,727	-	6,349,727
INVESTMENTS AT FAIR VALUE - NET	**$28,062,171**	**$ 233,167**	**$28,295,338**

* Includes $62 other receivables

** Includes $9,536 other liabilities

Notes to the Basic Financial Statements

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, 2007 categorized to give an indication of the level of risk assumed by ASRS:

DEBT SECURITIES
CREDIT QUALITY RISK (FIXED INCOME SECURITIES)
Fair Value at June 30, 2007
(Dollars in Thousands)

Investment	Fair Value	AAA	AA	A	BBB	BB	B
Asset Backed Securities	$ 165,519	$ 157,858	$4,099	$2,306	$ 877	$ -	$ 379
Commercial Mortgage Backed Securities	531,022	527,988	1,991	280	763	-	-
Corporate Bonds	1,354,427	133,270	164,007	731,710	270,829	39,785	14,826
Non-Government Backed CMO's	125,576	125,545	-	31	-	-	-
Total Corporate Bonds	**$2,176,544**	**$ 944,661**	**$170,097**	**$734,327**	**$272,469**	**$39,785**	**$15,205**
Government Agencies	500,359	491,060	9,299	-	-	-	-
Government Agencies CMO	109,398	109,398	-	-	-	-	-
Government Bonds	948,615	902,688	4,825	17,896	21,131	2,075	-
Government Mortgage Backed	2,508,289	2,508,289	-	-	-	-	-
Total Government Bonds	**$4,066,661**	**$4,011,435**	**$ 14,124**	**$ 17,896**	**$ 21,131**	**$ 2,075**	**$ -**
Total Debt Securities	**$6,243,205**	**$4,956,096**	**$184,221**	**$752,223**	**$293,600**	**$41,860**	**$15,205**

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
at June 30, 2007
(Dollars in Thousands)

INVESTMENT	FAIR VALUE	EFFECTIVE DURATION (in years)
Domestic Fixed Income Investments		
Asset Backed Securities	$165,519	2.0
Commercial Mortgage Backed	531,022	4.1
Corporate Bonds	1,354,427	3.4
Non-Government Backed CMO's	125,576	2.2
Total Corporate Bonds	**$2,176,544**	
Government Agencies	500,359	4.5
Government Agencies CMO	109,398	2.5
Government Bonds	948,615	1.8
Government Mortgage Backed	2,508,289	4.2
Total Government Bonds	**$4,066,661**	
Total Debt Securities	**$6,243,205**	

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 (U.S. dollars):

Foreign Currency Risk
Fair Value at June 30, 2007
(Dollars in Thousands)

Currency Type	Temporary Investments	Fixed Income	Equities	Real Estate	Total
Australian Dollar	$208	$-	$86,454	$-	$86,662
British Pound Sterling	148	-	692,300	-	692,448
Canadian Dollar	349	-	13,938	-	14,287
Czech Koruna	-	-	5,610	-	5,610
Danish Krone	529	-	26,488	-	27,017
Euro Currency Unit	1,950	-	1,351	51	3,352
Hong Kong Dollar	205	-	53,236	58	53,499
Indonesian Rupian	-	-	4,597	-	4,597
Japanese Yen	13,537	9,183	907,890	-	930,610
New Mexican Peso	-	1,687	-	-	1,687
New Taiwan Dollar	-	-	26,136	-	26,136
New Zealand Dollar	338	2,849	14,225	-	17,412
Norwegian Krone	288	-	21,171	-	21,459
Singapore Dollar	459	-	33,825	351	34,635
South Korean Won	-	-	81,282	-	81,282
Swedish Krona	3	-	23,196	-	23,199
Swiss Franc	492	-	345,882	-	346,374
Thailand Baht	-	-	1,980	-	1,980
Total	**$18,506**	**$13,719**	**$2,339,561**	**$460**	**$2,372,246**

Notes to the Basic Financial Statements

4. Securities Lending Program

Arizona Revised Statutes Section 38-715(D)(3) allows 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. 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, 2007, the ASRS had $3.5 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.

Notes to the Basic Financial Statements

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, 2007, the ASRS had $1.6 billion in temporary investments held as collateral for equity and fixed income derivatives which may have a positive or negative notional value.

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, 2006 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. The unfunded accrued liability is amortized over a thirty-year rolling period.

The Long-Term Disability Plan valuation uses a projected unit cost method of funding. 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.

All assumptions used in the actuarial valuations are based on five year experience studies. The ASRS Board approves all actuarial assumptions and methods.

Notes to the Basic Financial Statements

6a. Funding Status and Progress-OPEB Plans

The funded status of each plan as of the most recent actuarial valuation date 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	UAAL 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%
2006	$1,085	$1,505	$420	72.1%	$8.312	5.1%
Long Term Disability Program						
2005	$165	$577	$413	28.6%	$8,032	5.1%
2006	$194	$575	$380	33.8%	$8,312	4.6%

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 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.

Notes to the Basic Financial Statements

7. Contributions Required and Contributions Made

The A.R.S. provides statutory authority for determining the employees' and employers' contribution amounts as a percentage of covered payrolls. Employers are required to contribute at the same rate as employees. Through FYE 2005, the actuarial computation is made two years in advance, based on the June 30 information (the rate for FYE 2005 was based on June 30, 2002 information). New legislation which became law as of July 1, 2005 requires annual contribution rate calculations for all fiscal years beginning after FYE 2007. The actuarial assumptions used in this measure are those adopted by the ASRS' Board in 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.

The contribution rates for the years ended June 30, 2007 and 2006 were as follows:

	For the contribution period ending June 30, 2007 (2004 Valuation)		For the contribution period ending June 30, 2006 (2004 Valuation)	
	Amount	Percent of Covered Payroll	Amount	Percent of Covered Payroll
Normal cost	$889,752,558	11.87%	$889,752,558	11.87%
Amortization of (over)under-funded past service liability	187,139,751	2.50%	187,139,751	2.50%
RETIREMENT TOTAL	1,076,892,309	14.37%	1,076,892,309	14.37%
Health Premium Benefit	84,702,645	1.13%	84,702,645	1.13%
Long Term Disability	73,313,962	1.00%	73,313,962	1.00%
ACTUARIAL TOTAL	$1,234,908,916	16.50%*	1,234,908,916	16.50%*
Contributions made as a percentage of the current year covered payroll:				
Employers' Retirement	$663,544,344	7.55%	$477,471,507	5.77%
Employees' Retirement	766,961,939	8.60%	570,932,683	6.90%
Employers' Health Premium Benefit	103,473,474	1.05%	93,461,175	1.13%
Employers' Long Term Disability	44,518,495	0.50%	41,188,441	0.50%
Employees' Long Term Disability	44,518,495	0.50%	41,188,441	0.50%
TOTAL	**$1,623,016,747**	**18.20%***	**$1,224,242,247**	**14.80%***

* The actuarial calculations establish a total benefit cost of 16.5 percent. Legislative action set the contribution rate for 2006 and 2007 at 14.8 percent and 18.2 percent, respectively.

Notes to the Basic Financial Statements

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, 2006 was 7.4 percent (6.9 percent retirement and .50 percent long-term disability) for both the employers' and employees' portion. This was determined by the 2004 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 compen¬sation paid to active employees on which contributions to a pension plan are based.

8. Additional Benefits

In addition to the pension benefits described, the ASRS offers the Retiree Group Insurance Program and the Health Insurance Premium Benefit Program to eligible retired and disabled members. A retired member is defined as a member actively receiving an annuity benefit and a disabled member is defined as a member receiving a Long-Term Disability (LTD) benefit through the LTD program administered by the ASRS or through their former member employer's group LTD plan. The employees and member employers each contributed .50 percent of compensation in FY 2007 and .50 in FY 2006 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. As of June 30, 3007, more than 53,970 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 2007 the employer's retirement contribution of 8.6 percent of compensation included 1.05 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:

Notes to the Basic Financial Statements

Years of Credited Service	Percent of Premium Benefit	Without Medicare		With Medicare A & B		Combinations	
		Retiree Only	Retiree & Dependents	Retiree Only	Retiree & Dependents	Retiree & Dependent, One with Medicare, the other without	Retiree & Dependent with Medicare, other dependent without
5.0-5.9	50 percent	$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 2005 Arizona Legislature passed, and the Governor signed, legislation to provide an additional temporary premium benefit effective July 1, 2006 through June 30, 2008. This benefit is not available for retirees who are not Medicare eligible.

These additional increases are listed in the table below:

Years of Credited Service	With Medicare A & B		Combinations
	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

Notes to the Basic Financial Statements

These additional increases are listed in the table below:

The ASRS reimbursed approximately $83.2 million and $80.8 million towards the cost of group health insurance coverage for the years ended June 30, 2007 and 2006, 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. Commitments

In connection with the purchase of various partnership interests in the real estate portfolio, the ASRS has remaining unfunded commitments of approximately $486.7 million as of June 30, 2007.

11. Transfers To and From Other Funds

Due to/from other funds includes that need to be transferred after the year end contribution reconciliation.

12. Required Supplementary Schedules

Historical trend information designed to provide information about the ASRS' prog¬ress in accumulating sufficient assets to pay benefits when due is required supplementary information. Required supplementary infor¬mation 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.

13. ASRS Employer Retirement Plans

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

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

Effective July 1, 1995, the ASRS has estab¬lished an account for each benefit program and has reported those funds in the combined financial statements. The financial state¬ments 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, 2007 was 9.1 percent (8.6 percent retirement and .5 percent LTD) and 2006 was 7.4 (6.9 percent retirement and .5 percent LTD). All eligible employees were required to contribute 9.1 percent of their annual covered salary, and the ASRS, as the employer, was required to match these contributions.

Notes to the Basic Financial Statements

The ASRS, as the employer, made contributions for the past three years as follows:

FISCAL YEAR	SALARY BASE	RETIREMENT CONTRIBUTIONS	HBS CONTRIBUTIONS	LTD CONTRIBUTIONS	TOTAL CONTRIBUTIONS	% OF REQUIRED CONTRIBUTIONS
2007	$10,549,141	$873,146	$117,773	$51,488	$1,042,407	100%
2006	10,917,002	629,911	123,362	54,585	807,858	100%
2005	8,164,530	334,746	89,810	40,823	465,378	100%

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 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.

Required Supplementary Information

Schedule of Funding Progress
For Year Ended June 30, 2007
(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						
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
2006	23,767	28,192	4,426	84.3	8,312	53.2
HEALTH INSURANCE PREMIUM BENEFIT						
2005	1,028	1,456	428	70.6	8,032	5.3
2006	1,085	1,505	420	72.1	8,312	5.1
LONG-TERM DISABILITY BENEFIT						
2005	165	577	413	28.6	8,032	5.1
2006	194	575	380	33.8	8,312	4.6

Schedule of Employer Contributions
For Year Ended June 30, 2007
(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
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
2007	663,544	100	103,473	100	44,518	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, 2006. The unfunded actuarial 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 prior to 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 a rate of 4.50 percent to 9.50 percent per annum, depending on the length of service. The permanent benefit increase (PBI) reserve was zero as of June 30, 2007, as a result of 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.

Notes to Required Supplementary Information

Health Insurance Premium Benefit. Increases the health insurance premium benefit for members of the eligible state retirement systems by the following amounts:

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

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

- Medicare eligible member $170 per month
- Non-Medicare eligible member $300 per month
- Non-Medicare family coverage $600 per month
- Medicare eligible family coverage $350 per month
- Combination Medicare and non-Medicare eligible $470 per month

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

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

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

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

Notes to Required Supplementary Information

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 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.

Notes to Required Supplementary Information

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.

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.

2006

The Legislature limited the ability of ASRS retirees to rescind their elections after retirement. Specifically, members who have chosen a form with a death benefit can "pop up" once to the single life form, but are then not allowed to "pop down" to a death benefit form. Implementation of this change is pending the receipt of a Private Letter Ruling from the Internal Revenue Service.

2007

The Legislature changed the Long Term Disability program Social Security disability offsets and pre-existing condition requirements. The social security disability offsets were changed from 64 percent to 85 percent and the social security retirement benefits were changed from 83 percent to 85 percent. The pre-existing condition requirement was changed from three months to six months.

Additional Supplementary Information

Combining Schedule of Retirement Net Assets
For the Year Ended June 30, 2007
(Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2007
ASSETS:			
Cash	$ 17,896	$ 403	$ 18,299
Prepaid benefits	129,917	-	129,917
RECEIVABLES:			
Accrued interest & dividends	55,055	1,241	56,296
Securities sold	649,070	14,633	663,703
Forward contracts	1,259,855	28,403	1,288,258
Contributions	35,216	-	35,216
Other	5,269	95	5,364
Total Receivables	$ 2,004,465	$44,372	$2,048,837
INVESTMENTS AT FAIR VALUE :			
Temporary investments	2,436,289	54,925	2,491,214
Temporary investments from securities lending collateral	3,321,946	74,892	3,396,838
U. S. government obligations	3,779,534	85,209	3,864,743
Corporate bonds	2,019,087	45,520	2,064,607
Common and preferred stocks	18,193,912	410,177	18,604,089
Real estate mortgages & contracts	544,674	12,280	556,954
Total Investments	$30,295,442	$683,003	$30,978,445
TOTAL ASSETS	$32,447,720	$727,778	$33,175,498
LIABILITIES:			
Payable for securities purchased	1,358,556	30,628	1,389,184
Payable for securities lending collateral	3,321,946	74,892	3,396,838
Forward contracts payable	1,263,699	28,490	1,292,189
Due to Other funds	1,917	-	1,917
Other	25,532	280	25,812
Total Liabilities	$5,971,650	$134,290	$6,105,940
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$26,476,070	$593,488	$27,069,558

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, 2007
(Dollars in Thousands)

	Retirement Plan	Retirement System	Combined 2007
ADDITIONS			
Contributions			
Member contributions	$ 766,625	$ 337	$ 766,962
Employer contributions	663,207	337	663,544
Transfers from other plans	9,685	-	9,685
Member reimbursements	97,863	-	97,863
Total Contributions	1,537,380	674	1,538,054
Income from investment activities			
Net appreciation in fair value	3,501,973	82,202	3,584,175
Interest	284,036	6,667	290,703
Dividends	256,537	6,022	262,559
Real Estate	11,722	275	11,997
Other	7,069	(5)	7,064
Total income from investment activities	4,061,337	95,161	4,156,498
Less investment activity expenses			
Investment management fees and monitoring services	49,670	1,171	50,841
Real estate	6,445	151	6,596
Total investment activity expenses	56,115	1,322	57,437
Net income from investment activities	4,005,222	93,839	4,099,061
From securities lending activities			
Security loan program	139,434	3,273	142,707
Security loan interest expense	133,002	3,122	136,124
Net income from securities lending activities	6,432	151	6,583
Total net investment income	4,011,654	93,990	4,105,644
TOTAL ADDITIONS	$5,549,034	$94,664	$5,643,698
DEDUCTIONS			
Retirement and disability benefits	1,603,503	47,315	1,650,818
Survivor benefits	21,186	404	21,590
Refunds to withdrawing members, including interest	76,121	1,789	77,910
Administrative expenses	29,133	684	29,817
Transfers to other plans	10,117	-	10,117
Other	3,474	60	3,534
TOTAL DEDUCTIONS	$1,743,534	$50,252	$1,793,786
NET INCREASE	$3,805,500	$44,412	$3,849,912
Net assets held in trust for pension benefits:			
Beginning of year	22,670,570	549,076	23,219,646
End of year	$26,476,070	$593,488	$27,069,558

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
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
2007	811,480	811,535	4,310,518	107,548	6,041,081

Schedule of Deductions by Type
(Dollars in Thousands)

Year	Benefits	Refunds	Administration, Transfers and Other	Total
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
2007	1,824,865	77,910	47,703	1,950,478

Additional Supplementary Information

Schedule of Administrative Expenses
For Year Ended June 30, 2007
(Dollars in Thousands)

	Retirement and Health Benefit Supplement	Long-Term Disability	Combined 2007
PERSONNEL SERVICES			
Salaries	$10,598	$-	$10,598
Retirement Contributions	884	-	884
Other Employee Related Expenses	2,800	-	2,800
Total Personnel Services	**14,282**	**-**	**14,282**
PROFESSIONAL SERVICES			
Actuary & Benefit Consulting	690	-	690
Audit, Consulting & Legal Fees	799	-	799
Programming Costs	6,875	-	6,875
Other Outside Services	3,008	2,575	5,583
Total Professional Services	**11,372**	**2,575**	**13,947**
COMMUNICATIONS			
Postage	823	-	823
Printing	140	-	140
Telephone	420	-	420
Advertising	22	-	22
Total Communications	**1,405**	**-**	**1,405**
MISCELLANEOUS			
Office Rent	1,691	-	1,691
Furniture & Equipment	408	-	408
Software & Support	982	-	982
Repair & Maintenance	113	-	113
Travel	113	-	113
Operating Supplies	92	-	92
Insurance	148	-	148
Dues & Subscriptions	118	-	118
Education & Training	7	-	7
Miscellaneous	356	-	356
Total Miscellaneous	**4,028**	**-**	**4,028**
TOTAL	**$31,087**	**$2,575**	**$33,662**

Additional Supplementary Information

Schedule of Professional Consultant Fees
For Year Ended June 30, 2007
(Dollars in Thousands)

Professional / Consultant	Nature Of Service	Expenses
SEDGWICK CLAIMS MANAGMENT SERVICES	LTD ADMINISTRATIVE SERVICES	$2,576
H L YOH CO, LLC	IT CONSULTING SERVICES	1,920
MELLON BANK TRUST & INVESTMENTS	PENSION PAYMENT SERVICES	1,067
COMSYS INFORMATION TECHNOLOGY SERVICES, INC	IT CONSULTING SERVICES	1,006
INT TECHNOLOGIES LLC	IT CONSULTING SERVICES	919
FIRST NATIONAL INFORMATION SOLUTIONS, INC.	IT CONSULTING SERVICES	907
SPHERION CORPORATION	IT CONSULTING SERVICES	688
BUCK CONSULTANTS LLC	ACTUARIAL SERVICES	670
COMPUTER INFORMATION TECHNOLOGY CORP	IT CONSULTING SERVICES	571
ABLEST INC	IT CONSULTING SERVICES	513
THE TOWNSEND GROUP	INVESTMENT CONSULTING SERVICES	375
GLOTEL INC	IT CONSULTING SERVICES	366
ARIZONA ATTORNEY GENERAL OFFICE	LEGAL SERVICES	279
KELLY SERVICES INC	TEMPORARY AGENCY	272
MERCER HUMAN RESOURCE CONSULTING	INVESTMENT CONSULTING	231
DATAMAVENS, INC	IT CONSULTING SERVICES	226
TECH KNOWLEDGY STORE LLC	IT CONSULTING SERVICES	111
COX CASTLE AND NICHOLSON	INVESTMENT LEGAL SERVICES	108
SABER SOLUTIONS INC	IT CONSULTING SERVICES	106
MORRISON AND FOERSTER LLP	INVESTMENT LEGAL SERVICES	100
DELOITTE CONSULTING	AUDIT SERVICES	94
NEW ENGLAND PENSION CONSULTANTS	INVESTMENT CONSULTING	72
PROVALIANT INC	IT CONSULTING SERVICES	71
MUNIS INC	IT CONSULTING SERVICES	62
FOSTER PEPPER AND SHEFELMAN PLLC	INVESTMENT LEGAL SERVICES	58
INSTITUITONAL SHAREHOLDER SERVICES INC	INVESTMENT CONSULTING	58
RIDENOUR HIENTON KELHOFFER LEWIS & GARTH	INVESTMENT LEGAL SERVICES	50
CHARLES W WHETSTINE	LEGAL SERVICES	48
ENNIS, KNUPP & ASSOCIATES, INC.	INVESTMENT CONSULTING	47
KEANE INC	IT CONSULTING SERVICES	43
RANDSTAD	TEMPORARY AGENCY	37
CEM BENCHMARKING INC	PLAN ADMINISTRATION CONSULTING	35
MELLON BANK TRUST & INVESTMENTS	INVESTMENT CONSULTING	31
THE GMARIE GROUP INC	CONSULTING SERVICES	27
HEINFELD MEECH AND CO PC	AUDIT SERVICES	23
LEWIS AND ROCA	INVESTMENT LEGAL SERVICES	23
CORPORATE JOB BANK PERSONNEL SERVICES	TEMPORARY AGENCY	22
BEHAVIOR RESEARCH CENTER	CONSULTING SERVICES	21
MERCER HUMAN RESOURCE CONSULTING	ACTUARIAL CONSULTING	20
GOODMANS INC	OFFICE SPACE DESIGN AND INSTALLATION	17
SKADDEN ARPS SLATE MEAGHER AND FLOM LLP	INVESTMENT LEGAL SERVICES	16
TECH KNOWLEDGY STORE LLC	IT CONSULTING SERVICES	15
OTHER CONSULTING FEES (less than ten thousand dollars)	MISCELLANEOUS CONSULTING SERVICES	46
	TOTAL	**$13,947**

Additional Supplementary Information

Schedule of Total Investment Income by Manager
For Year Ended June 30, 2007
(Dollars in Thousands)

Manager	Market Appreciation (Depreciation)	Interest	Dividends	Real Estate	Other	Total Investment Income
ASRS INTERNAL	$1,033,186	$107,488	$134,845	$6,616	$8,825	$1,290,961
AXA ROSENBERG	60,438	6,997	95	-	-	67,530
BANK OF IRELAND	-	-	-	-	-	-
BANK OF NEW YORK	369	158	-	-	-	526
BARCLAYS GLOBAL INVESTORS	667,428	14	209	-	-	667,651
BATTERYMARCH	4,660	278	96	-	-	5,034
BLACKROCK	(2,464)	-	51,257	-	(494)	48,299
BRANDES	356,718	43,155	2,368	-	-	402,241
BRANDYWINE	66	-	-	-	-	66
BRIDGEWATER	191,103	528	49,187	-	-	240,818
CAPITAL GUARDIAN	1	-	-	-	-	1
CIM	-	519	-	40	-	559
COLUMBIA	61	-	-	-	-	61
CRM	28,283	1,564	371	-	-	30,218
DFA	45,432	4,320	36	-	-	49,788
DIMENSIONAL	85,387	7,615	196	-	-	93,198
DUNE	-	-	-	3,356	-	3,356
FRANKLIN	174,623	19,708	226	-	-	194,557
FRONTIER	1	-	-	-	-	1
GOLDMAN SACHS	167,991	-	2,384	-	-	170,375
HANSBERGER	190,977	12,268	493	-	-	203,738
HEITMAN	141	-	-	(136)	-	5
HINES	2,744	-	-	1,434	-	4,177
ING	2,590	1,418	37	-	-	4,045
INTECH	76,664	11,592	253	-	-	88,509
JACOBS LEVY	16,780	2,547	(76)	-	-	19,251
JP MORGAN	6,397	-	34,643	-	(377)	40,663
LSV ASSET MANAGEMENT	127,965	13,844	193	-	-	142,002
MELLON	65,438	7	13	-	-	65,458
MFS INTERNATIONAL	176,328	24,733	553	-	-	201,614
NORTHPOINTE	24,296	546	168	-	-	25,010
PLA RETAIL FDI	3,372	-	-	334	-	3,706
PYRAMIS GLOBAL	5,552	8	24,392	-	-	29,952
ROTHSCHILD	9,248	445	-	2,324	-	12,017
RREEF	459	-	99	(1,671)	-	(1,113)
STATE STREET GLOBAL	107,363	6,760	119	-	-	114,242
TIMESQUARE	48,449	1,686	653	-	-	50,788
TISHMAN	15,848	-	-	278	-	16,126
URDANG	5,019	2,455	63	-	-	7,537
WELLINGTON	67,177	3,093	376	-	-	70,646
WESTBROOK	-	-	-	(67)	-	(67)
TOTAL	**$3,766,090**	**$273,746**	**$303,249**	**$12,508**	**$7,954**	**$4,363,546**

Additional Supplementary Information

Schedule of Total Investment Expenses

For the Year Ended June 30, 2007
(Dollars in Thousands)

	Management and Monitoring Fees	Real Estate Expense	Total
AMERICAN STOCK EXCHANGE	$1	$-	$1
ASRS INTERNAL	1,928	5,419	7,347
AXA ROSENBERG	2,112	-	2,112
BARCLAYS GLOBAL INVESTORS	4,056	-	4,056
BARRA INC	113	-	113
BATTERYMARCH	608	-	608
BLACKROCK	1,551	-	1,551
BLOOMBERG	89	-	89
BRANDES	6,183	-	6,183
BRIDGEWATER	3,822	-	3,822
CARLYLE GROUP, THE	695	-	695
CIM	186	-	186
COX CASTLE AND NICHOLSON LLP	80	-	80
CRAMER ROSENTHAL MCGYNN	1,274	-	1,274
CREDITSIGHTS INC	16	-	16
DIMENSIONAL FUND ADVISORS	1,542	-	1,542
DOW JONES AND COMPANY	1	-	1
DUNE	1,438	596	2,034
ENHANCED INVESTMENT TECHNOLOGIES LLC	2,500	-	2,500
FIDELITY/PYRAMIS	893	-	893
FOSTER PEPPER AND SHEFELMAN PLLC	45	-	45
FRANKLIN	1,281	-	1,281
GOLDMAN SACHS	4,534	-	4,534
HANSBERGER	1,636	-	1,636
HINES-SUMISEI US CORE OFFICE FUND LP	127	169	296
ING CLARION	238	-	238
INSTITUITONAL SHAREHOLDER SVCS INC	58	-	58
J.P. MORGAN	991	-	991
JACOBS LEVY	645	-	645
LSV ASSET MANAGEMENT	1,256	-	1,256
MATTHEW BENDER & CO INC	2	-	2
MELLON	515	-	515
MERCER	467	-	467
MFS INSTITUTIONAL ADVISORS INC	1,994	-	1,994
MOODYS	15	-	15
MORGAN STANLEY	2	-	2
MORRISON AND FOERSTER LLP	49	-	49
NEW ENGLAND PENSION CONSULTANTS	72	-	72
NEW YORK STOCK EXCHANGE	2	-	2
NORTHPOINTE	601	-	601
PENSION FUND DATA EXCHANGE LTD	1	-	1
PLA	578	291	869
RREEF	289	382	671
RIDENOUR HIENTON HARPER	38	-	38
ROTHSCHILD	2,667	20	2,687
SKADDEN ARPS SLATE MEAGHER AND FLOM LLP	16	-	16
STANDARD AND POORS	25	-	25
STATE STREET	620	-	620
SUNGARD	3	-	3
TIMES SQUARE CAPITAL	1,247	-	1,247
TISHMAN SPEYER	2,655	-	2,655
TOWNSEND GROUP, THE	281	-	281
TRADEWEB LLC	26	-	26
URDANG	283	-	283
WELLINGTON MANAGEMENT	667	-	667
TOTALS	**$53,014**	**$6,877**	**$59,891**

Arizona State Retirement System

A Component Unit of the State of Arizona

2007

Investment
Section

Flagstaff, Arizona

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III. Investment Section

Investment Report

U.S. Economy and Capital Markets FY 2006-07

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

3rd Quarter 2006

Economic expansion continued in the third quarter despite the slowing housing market. GDP growth came in at 2.0%. Oil prices were high early in the quarter, but dropped toward the end of the quarter, which helped consumer confidence. The Consumer Price Index rose 2.1% year-over-year, the increase was less than previous quarters as energy prices declined. The Fed left the Fed Funds rate unchanged at 5.25% in August ending a period of 17 consecutive rate increases. Unemployment remained at 4.6%.

Equity markets rallied. The S&P 500 Index gained 5.7%. Technology stocks rebounded to lead all sectors, while the energy sector posted the weakest results. Small cap stocks lagged large cap issues. The S&P 600 Index declined 0.9% and the Russell 2000 Index was up just 0.4%. International markets performed well during the quarter. Emerging markets outpaced their developed counterparts. The MSCI EAFE Index gained 4.0% in dollar terms. The MSCI ACWI ex US Index increased 3.9% in dollar terms. The European markets were strong during the quarter. An appreciating dollar detracted from performance. The MSCI Emerging Markets Index gained 5.0% during the quarter.

The Lehman Brothers Aggregate Bond Index gained 3.8% during the quarter. Longer-term issues outperformed shorter-term issues as the yield curve shifted down and flattened. Lower quality issues outperformed higher-quality issues in the investment grade market. High yield outperformed the broad fixed income market. Mortgages and Treasuries increased 3.6% and 3.7% respectively during the quarter.

Both private real estate and REITs rose during the third quarter. The NCREIF Property Index gained 3.5%. The MSCI U.S. REIT Index returned 9.6%.

4th Quarter 2006

Economic growth was moderate during the quarter, GDP grew at 2.5%. The housing market seemed to stabilize and inflation measures were low. Oil prices remained fairly steady following the third quarter. The Consumer Price Index rose 2.5% year-over-year despite declines in energy and transportation prices. The Fed held the Fed Funds rate unchanged at 5.25%. Unemployment fell to 4.5%.

Equity markets continued to experience strong returns. The S&P 500 Index rose 6.7%. Small cap stocks led large caps. The S&P 600 Index returned 7.8% and the Russell 2000 Index gained 8.9%. Value stocks outperformed growth stocks. The international equity markets continued to outpace US equity. The MSCI EAFE gained 10.4% in US dollar terms and was led by the Nordic countries and Pacific ex Japan region. The MSCI ACWI ex US Index gained 11.2%. Emerging markets continued to outpace the developed markets. The MSCI Emerging Markets Index returned 17.6% in US dollar terms.

An inverted yield curve had little effect on performance as short-term and long-term performed nearly equally. Lower quality issues continued to outperform higher quality issues in the investment grade credit market. The Lehman Brothers Aggregate Bond Index returned 1.2%. Mortgages gained 1.6%, while Treasuries advanced 0.7%.

Investment Report

REITs posted strong returns; the MSCI U.S. REIT Index returned 9.3%. Private real estate also performed well, the NCREIF Property Index gained 4.5%.

1st Quarter 2007

Economic growth moderated during the quarter, GDP was 0.7%. The economy struggled with continued problems in the housing market, especially within the sub-prime sector; higher energy prices; an increase in inflation; and a partially inverted yield curve. However, these issues were somewhat mitigated by continuing job growth and wage gains. Unemployment decreased to 4.4%. The Consumer Price Index increased 2.8% year-over-year as energy prices climbed from the end of 2006. The Fed remained concerned with inflation, but left the Fed Funds rate unchanged during the quarter at 5.25%.

The end of the quarter brought substantial volatility to U.S. Equities. The S&P 500 Index gained 0.6%. The markets returned modest gains, but sector performance was mixed. Small cap stocks outperformed large cap stocks, and mid cap stocks outperformed both large and small caps. The S&P 600 SmallCap Index returned 3.2% and the S&P 400 MidCap Index returned 5.8%. International equity market returns remained robust. The MSCI EAFE Index returned 4.1% in US dollar terms. Nordic countries and Pacific Free ex Japan continued to outperform all other international indices. The MSCI ACWI ex US Index returned 3.8%. Emerging markets underperformed developed markets for the quarter, returning 2.3% in US dollar terms.

The Lehman Brothers Aggregate Bond Index returned 1.5% for the quarter. The inverted yield curve impacted returns as short-term issues outperformed long-term issues. Mortgages gained 1.6%, while Treasuries advanced 1.5%.

Private real estate continued to advance; the NCREIF Property Index returned 3.6%. REITs also posted gains; the MSCI U.S. REIT Index gained 3.4%.

2nd Quarter 2007

Despite continued weakness in the housing market, rising energy costs and increasing inflation concerns, the preliminary estimate of second quarter GDP growth was 3.4%. The unemployment rate increased slightly, but remained extremely low at 4.5%. The Consumer Price Index grew 2.7% year-over-year. The increase in consumer prices was attributed to rising energy prices. The Fed continued to hold the Fed Funds rate unchanged at 5.25% Inflation remained a primary concern.

Domestic equity rose sharply in the second quarter. The S&P 500 reached an all-time closing high in early June. The S&P 500 Index returned 6.3% for the quarter. Large cap stocks outperformed both mid and small caps. The S&P 400 MidCap Index returned 5.8% and the S&P 600 SmallCap Index gained 5.2%. Growth stocks outperformed value across the cap spectrum. International equity continued to perform well. The MSCI EAFE Index returned 6.7% in U.S dollar terms for the quarter. The MSCI ACWI ex US returned 8.4%. Portugal and Germany led all developed markets in US dollar terms. Emerging markets substantially outperformed their developed counterparts. The MSCI Emerging Markets Index returned 15.0% in US dollar terms.

The Lehman Brothers Aggregate Bond Index was down 0.5% during the second quarter. Shorter-term issues continued to outpace long-term issues. AAA issues outperformed lower-quality issues in the investment grade credit space. High-yield bonds gained 0.2% during the quarter. Mortgages lost 0.5%, while Treasuries fell 0.4%.

Investment Report

REITs struggled in the second quarter; the MSCI US REIT Index declined 9.3%. Private real estate fared better; the NCREIF Property Index posted a 4.6% return.

Investment Goals

1. Achieve a total fund rate of return equal to or greater than the actuarial assumed interest 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

Effective January 2007, the ASRS asset allocation policy targets and ranges are as follows:

U.S. Equity	45%	(40-50%)
U.S. Fixed Income	26%	(21-31%)
International Equity	18%	(13-20%)
Real Estate *	6%	(4-8%)
Private Equity *	5%	(3-7%)

*Pro-rated into other asset classes during the program(s) implementation.

Additionally, the ASRS asset allocation includes Opportunistic Asset Classes and Absolute Return Strategies each of which have a 0% target allocation and ranges of 0-5%.

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 37 externally managed and 7 internally managed portfolios, which are diversifiable in U.S. equities, U.S. fixed income, international equities and real estate.

For the Fiscal Year Ended June 30, 2007, the ASRS achieved a 17.8% rate-of-return, which outperformed the ASRS actuarial assumed investment rate of return by 9.8%.

The ASRS adheres to all statutory requirements set by Arizona State law. In addition the ASRS established investment guidelines for its internal and 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.

Investment Results

The Total Fund returned 17.8 percent in the fiscal year ended June 30, 2007.

Investment Results

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 the 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	10 Year	Inception June 30, 1975
ASRS Total Fund	17.8%	11.9%	11.0%	8.4%	11.0%
ASRS Domestic Equity	19.8%	12.5%	11.7%	8.3%	
S&P Custom Index	21.6%	12.0%	10.9%	7.2%	
ASRS Domestic Fixed Income	6.1%	4.1%	4.6%	6.1%	
Lehman Aggregate Index	6.1%	4.0%	4.5%	6.0%	
ASRS International Equity	27.9%	20.9%	17.2%	9.8%	
MSCI ACWI ex-US/EAFE Index	30.1%	23.5%	18.6%	8.2%	
ASRS Real Estate	19.7%	0.0%	0.0%	0.0%	
NPI+ 100 Index	18.3%	19.0%	15.4%	14.1%	

Historical Rates of Return

(Retirement & HBS)

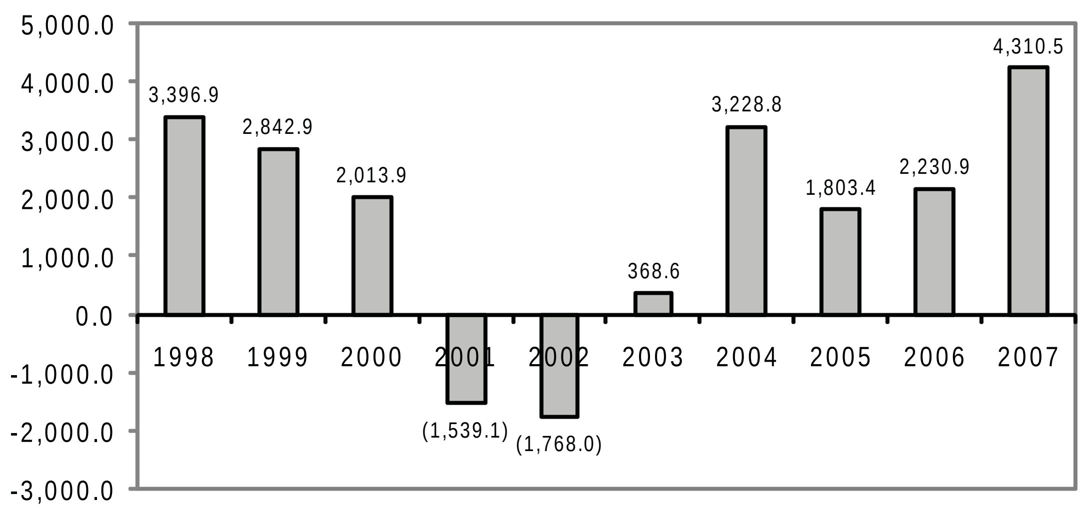
Fiscal Year	Return	Fiscal Year	Return	Fiscal Year	Return
2006-07	17.80%	1998-99	16.80%	1990-91	7.99%
2005-06	9.80%	1997-98	21.30%	1989-90	9.52%
2004-05	8.50%	1996-97	20.60%	1988-89	14.33%
2003-04	17.50%	1995-96	16.70%	1987-88	3.10%
2002-03	2.40%	1994-95	17.78%	1986-87	11.80%
2001-02	-8.20%	1993-94	1.89%	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%

Investment Results

Monthly Returns
(Retirement & HBS)

	Total Fund	US Equity	Fixed Inc	Intl Equity
7/31/2006	0.32%	-0.41%	1.38%	0.88%
8/31/2006	2.07%	2.18%	1.48%	3.10%
9/30/2006	1.50%	2.15%	0.85%	0.69%
10/31/2006	2.71%	3.56%	0.70%	3.27%
11/30/2006	2.04%	2.14%	1.12%	3.34%
12/31/2006	1.11%	1.06%	-0.57%	3.05%
1/31/2007	1.15%	1.93%	0.07%	0.57%
2/28/2007	-0.23%	-1.37%	1.52%	1.28%
3/31/2007	1.31%	1.21%	-0.02%	2.57%
4/30/2007	3.18%	3.89%	0.56%	4.34%
5/31/2007	2.34%	3.87%	-0.78%	2.02%
6/30/2007	-0.94%	-1.77%	-0.34%	-0.16%

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
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
2006-07	604,320		3,766,089		59,891		4,310,518

Asset Allocation

Schedule Of Investments

(Dollars in Thousands)

	Investments at Fair Value	Receivables	Payables	Total	% of Total
Corporate Equity Securities	$19,564,440	$-	$-	$19,564,440	70.4%
Fixed Income Securities					
Corporate Debt Securities	2,176,544	-	-	2,176,544	7.9%
U.S. Treasury & Government Securities	4,066,661	-	-	4,066,661	14.1%
Real Estate	597,327	3,354	-	600,681	0.8%
Securities Lending	3,543,247	-	3,543,247	-	0.0%
Temporary Investments*	2,598,595	2,094,897 *	2,806,480 *	1,887,012	6.8%
Total Fixed Income Securities	12,982,374	2,098,251	6,349,727	8,730,898	29.6%
Total Investments	**$32,546,814**	**$2,098,251**	**$6,349,727**	**$28,295,338**	**100.0%**

***Receivables Include:**	
Accrued Int & Dividends	$ 58,741
Securities Sold	692,310
Forward Contracts Rec	1,343,784
Other Receivables	62
Total	**$2,094,897**

***Payables Include:**	
Payable for Securities Purchased	$1,449,060
Forward Contract Payable	1,347,884
Other Payables	9,536
Total	**$2,806,480**

Equity Portfolio Profile

Equity Portfolio Profile

(Dollars in Thousands)

Equity Sub-Sector Allocation	Percent of Fund	Dollar Value
US Large Cap Equity	42.21%	$11,888,492
US Mid Cap Equity	7.29%	2,024,781
US Small Cap Equity	7.11%	1,976,011
Total US Equity	**56.61%**	**15,889,284**
International Equity	**19.59%**	**3,675,156**
Total Equity	**76.20%**	**$19,564,440**

Ten Largest Domestic Equity Holdings

	% Of Domestic Equity Portfolio
EXXON MOBIL CORP	1.91%
GENERAL ELEC CO COM	1.35%
BANK OF AMERICA CORP	1.02%
CITIGROUP INC COM	1.01%
AT & T INC COM	1.01%
MICROSOFT CORP COM	0.86%
CHEVRON CORPORATION COM	0.80%
PFIZER INC COM STK USD0.05	0.77%
JOHNSON & JOHNSON COM	0.75%
JPMORGAN CHASE & CO COM	0.75%
Total	**10.23%**

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	19.09%	20.79%
Health Care	12.23	11.67
Utilities	3.83	3.51
Consumer Discretionary	13.26	10.20
Consumer Staples	7.29	9.29
Energy	9.37	10.79
Information Technology	15.15	15.45
Materials	3.87	3.12
Telecommunication Services	2.78	3.75
Industrials	13.13	11.43
Total	**100.00%**	**100.00%**

Ten Largest International Equity Holdings

	% Of International Equity Portfolio
NESTLE SA CHF1	2.17%
GLAXOSMITHKLINE ORD GBP0.25	1.48%
DEUTSCHE TELEKOM AG NPV (REGD)	1.35%
UNILEVER NV CVA EUR0.16	1.11%
AHOLD (KON) NV EUR0.25	1.02%
ALCATEL EUR2 SER'A'	1.02%
FRANCE TELECOM EUR4	1.01%
ASTRAZENECA ORD USD0.25	0.95%
MORRISON (W) SUPMKT ORD 10P	0.94%
SANOFI-AVENTIS EUR2	0.92%
Total	**11.97%**

Summary of Broker Commissions

	Commission
Domestic Equity	$6,044,521
International Equity	3,252,388

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

Fixed Income Porfolio Profile

Distribution By Sector

	Percent
Asset Backed Securities	2.7%
Commercial Mortgage Backed	8.5%
Corporate Bonds	21.7%
Government Agencies	8.0%
Government Agencies CMO	1.8%
Government Bonds	15.2%
Government Mortgage Backed	40.1%
Non-Government Backed CMO's	2.0%
Total	**100.0%**

Distribution By Coupon

	Percent
0.00% - 6.50%	89.1%
6.51% - 7.50%	6.9%
7.51% - 9.0%	2.7%
> 9.00%	1.3%
Total	**100.0%**

Distribution By Maturity

	Percent
0 to 2 years	10.2%
2 to 3 years	4.4%
3 to 4 years	4.6%
4 to 5 years	6.8%
5 to 6 years	2.1%
6 to 8 years	4.8%
> 8 years	67.1%
Total	**100.0%**

Fixed Income Porfolio Profile

Ten Largest Domestic Fixed Income Holdings

	Coupon	Maturity	Par Value	Market Value	Percent
COMMIT TO PUR FNMA SF MTG	5.50%	7/1/2037	$65,000,000	$62,695,100	1.08%
COMMIT TO PUR FNMA SF MTG	6.00	7/1/2020	61,535,000	61,805,754	1.06%
COMMIT TO PUR FNMA SF MTG	6.00	7/1/2037	55,000,000	54,418,100	0.93%
FNMA POOL #0725205	5.00	3/1/2034	55,987,531	52,759,417	0.91%
COMMIT TO PUR FNMA SF MTG	6.00	7/1/2037	50,100,000	49,552,008	0.85%
COMMIT TO PUR FNMA SF MTG	5.50	7/1/2037	49,300,000	47,544,920	0.82%
U S TREASURY NOTES	3.38	11/15/2008	47,000,000	46,011,591	0.79%
FNMA POOL #0786458	5.00	5/1/2034	46,552,709	43,818,030	0.75%
FNMA POOL #0868243	5.00	3/1/2036	43,260,152	40,532,123	0.70%
U S TREASURY BONDS	11.25	2/15/2015	29,000,000	40,331,461	0.69%
Total					**8.58%**

Real Estate Portfolio Profile

Ten Largest Real Estate Holdings

(Dollars in Thousands)

	Dollar Value	% of Real Estate Percent
URDANG	$56,910	9.80%
ASRS OWNED/OCCUPIED REAL ESTATE	56,725	9.76
ROTHSCHILD FIVE ARROWS FUND	45,970	7.91
E2 MODEL	41,067	7.07
ASRS E5	38,612	6.65
ING LONG	36,288	6.25
E6	34,972	6.02
TISHMAN	25,892	4.46
ING LONG/SHORT	23,060	3.97
HINES	22,293	3.84
Total	**$381,789**	**55.93%**

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	59,362,995	1,508,759	0.02	27,187
ACCESS SEC INC, STAMFORD	112,668,185	2,573,000	0.02	64,179
BAIRD, ROBERT W & CO INC, MILWAUKEE	28,367,218	843,056	0.04	36,064
BANC OF AMERICA SECS LLC, CHARLOTTE	33,535,561	977,183	0.04	34,216
BEAR STEARNS & CO INC, NY	93,646,043	2,343,200	0.03	79,458
BEAR STEARNS SEC CORP, BROOKLYN	590,947,074	16,979,089	0.01	220,400
BERNSTEIN SANFORD C & CO, NEW YORK	93,891,079	2,229,445	0.03	64,524
BNY BROKERAGE, NEW YORK	13,239,051	553,122	0.05	26,310
BNY CONVERGEX, NEW YORK	78,447,207	2,522,134	0.02	39,350
CANACCORD ADAMS INC, BOSTON	15,684,454	549,532	0.04	21,182
CANTOR FITZGERALD & CO INC, NEW YORK	123,374,853	4,056,508	0.03	105,262
CAP INSTL SVCS INC-EQUITIES, DALLAS	78,298,587	2,216,235	0.03	65,698
CIBC WORLD MARKETS CORP, NEW YORK	76,286,511	2,065,784	0.03	71,677
CITATION GROUP, NY	18,144,528	554,945	0.04	21,605
CITIGROUP GBL MKTS INC, NEW YORK	375,428,147	9,556,727	0.01	120,649
CREDIT SUISSE, NEW YORK (CSFBUS33XXX)	181,536,536	5,512,154	0.03	147,764
DEUTSCHE BK SECS INC, NY (NWSCUS33)	249,401,248	5,689,680	0.02	141,384
FIDELITY CAP MKTS (DIV OF NFSC), BOSTON	140,335,531	3,804,866	0.03	131,096
FIRST ALBANY CAPITAL INC, ALBANY	39,667,131	1,312,700	0.03	42,377
FRANCIS P MAGLIO & CO INC, NEW YORK	31,173,560	696,600	0.02	12,263
FRANK RUSSELL SEC INC, NEW YORK	46,118,504	1,329,500	0.03	39,885
GOLDMAN SACHS & CO, NY	178,146,644	4,501,230	0.03	131,660
GOLDMAN SACHS EXECUTION & CLEARING, NY	22,718,934	1,160,985	0.01	7,657
GUZMAN & CO, NEW YORK	219,722,401	4,884,334	0.02	112,685
INSTINET CORP, NY	409,755,738	12,967,637	0.02	257,104
INVESTMENT TECHNOLOGY GROUPS, NEW YORK	$2,335,631,015	84,270,427	0.01	$959,250
JEFFERIES & CO INC, NEW YORK	722,776,489	20,471,971	0.01	189,225
JNK SECURITIES INC, NEW YORK	258,762,293	7,809,320	0.02	117,181
JONES & ASSOCIATES INC, WESTLAKE VILLAGE	61,433,904	1,828,064	0.03	50,458
JONESTRADING INSTL SVCS LLC, WESTLAKE	25,830,679	739,576	0.03	23,724
KEEFE BRUYETTE AND WOODS, JERSEY CITY	18,590,872	383,470	0.03	11,787
KEYBANC CAPITAL MARKETS INC, NEW YORK	20,943,852	563,980	0.03	19,425
LA BRANCHE FINANCIAL SVCS/HBI, NEW YORK	246,351,146	5,779,900	0.03	159,741
LEHMAN BROS INC, NEW YORK	848,046,226	22,862,116	0.01	300,007
LIQUIDNET INC, BROOKLYN	191,018,944	5,747,548	0.02	125,260
LYNCH JONES & RYAN INC, HOUSTON	239,252,789	5,775,189	0.02	120,765

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 EQ AUST LTD, SYDNEY	8,901,974	150,343	0.089	13,333
ABN AMRO SECS LLC, NEW YORK	24,320,291	545,312	0.074	40,550
BEAR STEARNS & CO INC, NY	33,832,321	2,896,972	0.013	38,732
CALYON SECURITIES, NEW YORK	14,359,147	14,386,000	0.002	24,175
CANADIAN IMPERIAL BK COMMERCE, LONDON	18,221,881	1,142,010	0.026	29,273
CANTOR FITZGERALD EUROPE, LONDON	66,694,892	12,966,385	0.002	26,626
CITIGROUP GBL MKTS INC, NEW YORK	24,490,092	3,916,015	0.021	81,662
CITIGROUP GBL MKTS/SALOMON, NEW YORK	70,267,165	6,063,885	0.012	74,964
CITIGROUP GLOBAL MARKETS LTD, LONDON	77,393,934	17,105,672	0.005	87,800
CREDIT AGRICOLE INDOSUEZ CHX, FRANCE	42,306,311	1,808,269	0.026	47,333
CREDIT LYONNAIS SECS, SINGAPORE	25,110,771	1,252,391	0.027	34,186
CREDIT SUISSE (EUROPE), LONDON	32,464,618	674,649	0.078	52,628
CREDIT SUISSE, NEW YORK (CSFBUS33XXX)	113,308,035	10,422,560	0.013	132,138
DAIWA SECS AMER INC, NEW YORK	67,489,012	5,650,630	0.006	35,974
DEUTSCHE BK INTL EQ, LONDN (DEUTGB22EEQ)	33,229,890	4,189,554	0.002	10,175
DEUTSCHE BK SECS INC, NY (NWSCUS33)	151,495,358	12,221,630	0.018	222,331
DEUTSCHE SEC ASIA LTD, HONG KONG	14,321,551	3,662,784	0.008	27,857
DRESDNER KLEINWORT SECS LTD (KBENGB22)	33,731,434	2,547,694	0.020	50,591
DRESDNER KLEINWORT SECURITIES LLC, NY	8,511,266	138,558	0.123	17,057
EXANE, PARIS (EXANFRPP)	12,964,613	144,018	0.180	25,898
FOX PITT KELTON LTD, LONDON	8,433,503	471,327	0.029	13,550
GOLDMAN SACHS & CO, NY	193,251,077	12,405,659	0.021	262,153
GOLDMAN SACHS ASIA SEC LTD, HONG KONG	5,363,340	1,243,000	0.012	14,798
HSBC SECS INC, NEW YORK	14,324,665	698,100	0.043	30,230
INSTINET CORP, LONDON	30,817,817	6,527,665	0.002	15,124
ITG (EUROPE) LTD, DUBLIN	55,340,679	8,604,281	0.003	22,130
J P MORGAN SEC LTD/STOCK LENDING, LONDON	10,656,809	373,947	0.044	16,381
J P MORGAN SECS LTD, LONDON	58,353,685	2,776,726	0.027	74,883
JP MORGAN BROKING (HK) LTD, HONG KONG	4,196,310	2,221,500	0.005	10,622
LEHMAN BROS INC, NEW YORK	73,671,140	4,461,569	0.016	69,368
LEHMAN BROS INTL, LONDON	165,448,451	12,458,842	0.019	236,433
LEHMAN BROS SECS ASIA LTD, HONG KONG	23,103,033	6,391,039	0.007	44,000
MACQUARIE SECS (SINGAPORE), SINGAPORE	25,253,106	4,109,600	0.014	56,948
MACQUARIE SECURITIES LIMITED, HONG KONG	75,285,743	6,051,405	0.011	65,313
MERRILL LYNCH GILTS LTD, LONDON	13,222,817	607,801	0.032	19,527
MERRILL LYNCH INTL LONDON EQUITIES	153,473,453	8,769,393	0.022	197,155
MERRILL LYNCH PIERCE FENNER SMITH INC NY	28,703,498	586,788	0.028	16,374

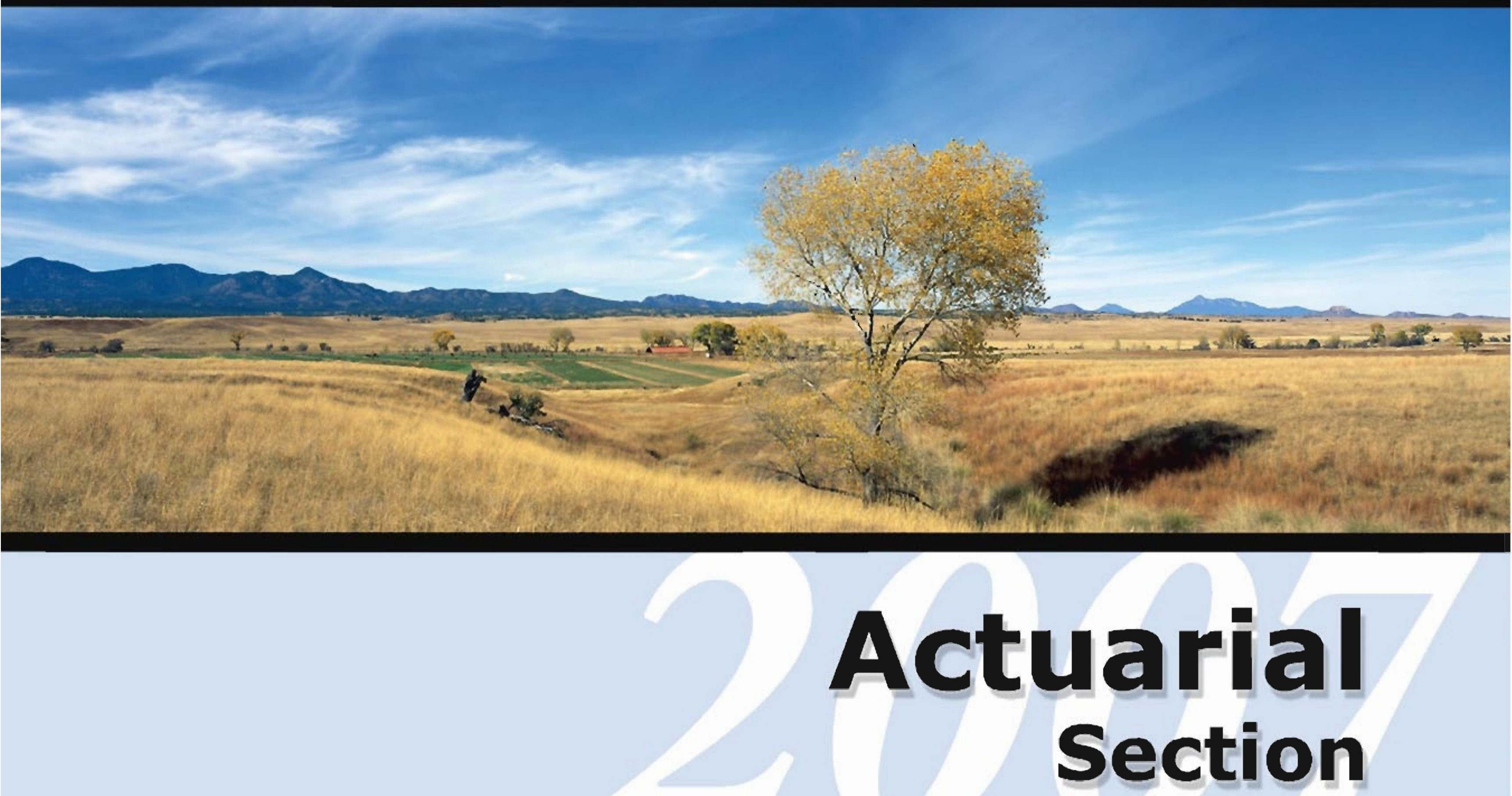
Schedule of Broker Commissions - Foreign Equity Trades

Domestic Broker Name	Total Dollar Amount of Trades	Number of Shares	Average Commission Per Share	Commission
MERRILL LYNCH PIERCE FENNER, WILMINGTON	101,840,283	17,534,056	0.006	100,202
MITSUBISHI UFJ SECS LTD, HONG KONG	12,811,480	242,100	0.066	15,998
MIZUHO SECURITIES USA INC. NEW YORK	29,228,412	1,690,800	0.022	36,981
MORGAN J P SECS INC, NEW YORK	12,191,351	802,607	0.033	26,416
MORGAN STANLEY & CO INC, NY	222236845	10,364,281	0.034	356649
NESBITT BURNS, TORONTO (NTDT)	7,544,709	1,814,171	0.018	32,016
NOMURA INTERNATIONAL (HK) LTD, HONG KONG	8,972,870	2,985,563	0.004	10,854
NOMURA SECS INTL INC, NEW YORK	48,648,015	1,242,770	0.035	43,895
PERSHING DIVISION OF DLJ,NY	12,071,990	313,098	0.051	16,113
SALOMON BROS UK EQUITY TALISMAN	32,731,699	2,070,942	0.016	33,600
SG SEC (LONDON) LTD, LONDON	51,678,434	2,148,784	0.039	83,011
UBS EQUITIES, LONDON	120,719,611	6,917,519	0.027	186,062
UBS SECURITIES CANADA, TORONTO (BWIT)	10,845,484	2,339,442	0.021	49,734
UBS SECURITIES HONG KONG LTD, HONG KONG	9,624,964	10,318,400	0.002	18,776
UBS WARBURG ASIA LTD, HONG KONG	63,853,718	9,197,308	0.008	76,947
OTHER	368,757,188	123,082,748	0.002	258,381
TOTAL				**$3,252,388**

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



2007 Actuarial Section

San Rafael Valley, Arizona

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IV. Actuarial Section

Actuarial Certification - Plan and HBS

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, 2006.

Actuarial calculations have been made with respect to a total of 464,719 members – 217,676 active employees, 163,527 inactive members, 78,498 retired members and beneficiaries, and 5,018 members on long term disability. In addition, there are 686 System retirees receiving ad hoc benefits from Plan assets.

The actuarial calculations establish a total benefit cost of 18.20% of the annual compensation of employees. The total normal cost rate is 13.41% of compensation, and the required amortization payment determined in accordance with Section 38-737 is 4.79% of compensation.

The actuarial cost factors as of June 30, 2006 are as follows:

I. Actuarial accrued liabilities	
A. Liabilities due to member's benefits	
1. Active members	
a. Retirement benefits	$12,081,068,875
b. Health insurance premium supplement	925,980,765
c. Disability deferred retirement benefits	231,056,573
d. Pre-retirement death benefits	281,283,613
e. Withdrawal benefits	465,307,150
f. Total active members	$13,984,696,976
2. Inactive members	1,135,187,031
3. Retired members and beneficiaries	14,175,090,544
4. Disabled members (deferred retirement)	391,353,515
5. Benefit increases for other-than-plan participants	10,303,196
6. Total present value of benefits	$29,696,631,262
B. Other miscellaneous liabilities and reserves	0
C. Reserve for future PBIs	0
D. Total actuarial accrued liability	$29,696,631,262
II. Actuarial value of assets	$24,851,522,776
III. Unfunded actuarial accrued liability (Item I - Item II)	4,845,108,486
IV. Amortization of unfunded actuarial accrued liability (per Section 38-737)	$398,500,483
V. Normal cost for the year	1,113,619,050
VI. Total contribution for the year (Item IV + Item V)	$1,512,119,533
VII. Total covered payroll (projected to 2005/2006 plan year)	8,311,869,615

VIII. Total contribution for fiscal years 2008 as a percentage of covered payroll

	401(a) Account	401(h) Account	Total
A. Employee Portion	9.10%	0.00%	9.10%
B. Employer Portion	8.05%	1.05%	9.10%
C. Total	17.15%	1.05%	18.20%

Actuarial Certification - Plan and HBS

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 - Plan and HBS

	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, as prescribed in Arizona Revised Statutes Section 38.757A.

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, FSA, EA, MAAA
Principal and Consulting Actuary

Actuarial Valuation of The Plan as of June 30, 2006

January 12, 2007

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

Dear Retirement Board Members:

Actuarial Valuation of the Plan as of June 30, 2006

We certify that the information contained in the attached 2006 actuarial valuation report is accurate and fairly presents the actuarial position of the Arizona State Retirement Plan (the Plan) as of June 30, 2006.

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, members of the American Academy of Actuaries and Fellows of the Society 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' 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 rate calculated becomes effective for the next Plan year. For example, the rate calculated in June 30, 2006 valuation report (9.10% for each member and each employer) is applicable for the fiscal year beginning July 1, 2007.

Actuarial Valuation of The Plan as of June 30, 2006

Funding Progress

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. The 2006 valuation calculates a rate of 9.10%, to become effective July 1, 2007. 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, except for fiscal 2006 and 2007, continue to contribute the actuarially determined amounts. Contributing these amounts ensures the realization of funding objectives.

Section 38-737 of the Arizona Revised Statutes 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 Legislature limited the ability of ASRS retirees to rescind their elections after retirement. Specifically, members who have chosen a form with a death benefit can "pop up" once to the single life form, but are then not allowed to "pop down" to a death benefit form. ASRS will implement this change upon receipt of a private letter ruling from the Internal Revenue Service.

2 State statues were modified to conform to federal regulations regarding military service purchases, optional forms of retirement benefits, and minimum required distributions.

3 The legislature repealed the modified Deferred Retirement Option Plan (DROP).

Section 11 gives details of benefit provisions.

Assumptions and Methods

We performed an experience 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, 2006. 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, 2006

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

Matthew A. Strom, FSA, MAAA, EA
Senior Consultant

General Actuarial Information - Plan and HBS

The following charts prepared by the actuary 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, 2006

Active Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of members (active)	46,508	71,178	99,990	217,676
Average age	45.4	43.7	45.0	44.7
Average annual salary	$40,328	$43,770	$32,211	$38,185
Average years of service	9.0	9.9	7.3	8.5

As of June 30, 2006

Retired Members	State Employees	Teachers	Political Subdivision Employees	Total
Number of retirees	19,646	24,446	34,406	78,498
Average age	70.6	68.0	70.1	69.6
Average monthly benefit	$1,371	$2,220	$1,212	$1,566
Average years of service	18.0	23.7	17.2	19.4

Of all plan retirees at June 30, 2006, 58.3 % received annuities of more than $1,000 per month. 10.1 % received less than $300 per month. Of the retirees 16.6 % are less than 60.0 years old and 55.2 % 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, 2006), the average salary level for state employees, for teachers, and for political subdivision employees other than teachers, and the average for all groups combined.

	2001-02	**2002-03**	**2003-04**	**2004-05**	**2005-06**
State employees	$33,746	$35,262	$35,461	$40,270	$40,328
Teachers	39,302	40,119	40,253	43,348	43,770
Political subdivision employees	28,470	29,181	29,775	32,877	33,211
All groups	33,130	33,998	34,372	37,853	38,185

General Actuarial Information - Plan and HBS

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 %. As of June 30, 2006, the date of the most recent actuarial valuation, this funding level is 83.7%. When the present actuarial asset of $24,852 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 $4,845.1 billion.

A statutory change effective in 1998 requires that an actuarial valuation be performed only following even-numbered years, rather than annually. This biannual valuation recommends contribution rates for a two-year period. Effective July 1, 2005, additional statutory changes require annual valuations after fiscal year ended June 30, 2007. These rates do not include contributions to the LTD program.

Normal Costs and Required Contribution Rates

The Plan's normal cost for fiscal year (FY) 2005-2006 is 13.41 % and for FY 2004-2005 is 13.16 %. 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	10.21%
Health insurance premium supplement	0.63
Survivor benefits	0.35
Withdrawals	1.84
Long-term disability benefit	0.38
Total, normal cost	13.41
Amortization of the UAAL	4.79
Required contribution rate for FY 2008	18.20%
Shared by employee and employer	
Required contribution rate for FY 2008	9.10%
Shared by employee and employer	Divided by 2
Required matching contribution rate	9.10%
Legislative required contribution rate shared by employee and employer for FY 2006	6.90%
Legislative required contribution rate shared by employee and employer for FY 2007	8.60%

General Actuarial Information - Plan and HBS

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) an adjustment to reflect investment gains (or losses) over a 10-year period. This method applies to gains and losses incurred in fiscal 2006 and later years. The unfunded actuarial accrued liability is amortized over 15 years in level dollar payments.

Summary of Benefit Provisions - Plan and HBS

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 equal 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:

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

Summary of Benefit Provisions - Plan and HBS

AGE AT DATE OF RETIREMENT

Years of Service	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%

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 more than 30 years at date of disability.

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

Summary of Benefit Provisions - Plan and HBS

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:

   (a) the enhanced refund option, or

   (b) the retirement benefit payable at normal retirement earned to the date of participant's termination.

Summary of Benefit Provisions - Plan and HBS

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 areas.

Summary of Benefit Provisions - Plan and HBS

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. Legislative action pegged the contribution rate for fiscal 2006 and 2007 at 6.90% and 8.60%, respectively. For the fiscal year beginning July 1, 2007, the required contribution rate will be 9.10% based on the 2006 actuarial valuation.

Statement of Actuarial Methods and Assumptions Used in Determining Cost - Plan and HBS

(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 - Plan and HBS

(Adopted by Board Action on November 21, 2003)

Effective as of June 30, 2004

RATES OF MORTALITY

Age	Male Participants Non-Disabled	Male Participants Disabled	Female Participants Non-Disabled	Female Participants Disabled
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 - Plan and HBS

(Adopted by Board Action on November 21, 2003)

Effective as of June 30, 2004

RATES OF DECREMENT DUE TO WITHDRAWAL

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

5. **Salary Scales** — A Select and ultimate salary scale made up of a merit component and general salary increase component as follows:

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

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

Statement of Actuarial Methods and Assumptions Used in Determining Cost - Plan and HBS

(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 - Plan and HBS

(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, 2006 actuarial valuation, the period is 30 years.

D. Data for Valuation

In preparing the June 30, 2006 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.

Plan and HBS Schedules

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**
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
2006	217,676	8,311,869,615	38,185	0.9

SCHEDULE OF PLAN RETIREES ADDED TO AND REMOVED FROM ROLLS
Last 6 Years

	Retirants and Beneficiaries Added to Rolls		**Retirants and Beneficiaries Removed from Rolls**		**Retirants and Beneficiaries Rolls End of Year**			
Year Ended	No.	Annual Allowance	No.	Annual Allowance	No.	Annual Allowance	% Increase in Annual Allowances*	Average Annual Allowances
2001	4,224	N/A	3,342	N/A	58,920	N/A	7.6%	14,532
2002	3,954	N/A	2,528	N/A	60,346	N/A	13.2	16,457
2003	5,955	N/A	1,604	N/A	64,697	N/A	2.2	16,812
2004	6,430	169,063,326	2,196	26,982,679	68,931	1,230,025,859	6.1	17,844
2005	7,005	136,009,712	2,083	29,472,225	73,853	1,336,563,347	1.4	18,098
2006	7,143	170,867,676	2,498	32,717,257	78,498	1,474,713,766	3.8	18,787

Plan and HBS Schedules

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
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
2006	29,696,631,262	24,851,522,776	84	4,845,108,486	8,311,869,615	58.3

Plan and HBS Schedules

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)
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
2006	4,168,243,157	14,576,747,255	10,951,640,850	24,851,522,776	100	100	55.8

Plan and HBS Schedules

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
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
2006	8,312,000,000	570,581,044	6.90	7.75

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

Plan and HBS Schedules

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
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)
2006	4,106.08	1,075.46	(1,265.19)	328.49	86.04	(50.61)	363.92	4,280.27	4,845.11	(564.84)

Actuarial Certification - LTD

buckconsultants
an ACS company

January 5, 2007

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

Valuation of the ASRS Long Term Disability Program as of June 30, 2006

Dear Retirement Board Members:

We certify that the information contained in the attached 2006 actuarial valuation report is accurate and fairly presents the actuarial position of the Arizona State Retirement System Long Term Disability Program (the LTD Program) as of June 30, 2006.

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, members of the American Academy of Actuaries and Fellows of the Society 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 LTD Program, and to analyze changes in the LTD Program's condition. In addition, the report provides information that ASRS requires for its Comprehensive Annual Financial Report, and it summarizes census data.

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

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Actuarial Certification - LTD

Retirement Board
January 5, 2007
Page 2

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 fund the normal cost plus the amortization of unfunded actuarial accrued liability over a rolling 15-year period. For years after fiscal 2006, the contribution rate will be set annually, based on the valuation of the preceding year. The rate calculated in this report (0.52% for each employer and employee) will apply in the fiscal year beginning July 1, 2007. The LTD program is meeting its funding objectives.

Experience Studies

Most of the assumptions of the LTD program are also assumptions of the ASRS Plan. The actuary performs experience studies for the Plan every five years. Historically, no separate LTD experience studies have been performed, although ASRS had an actuarial audit of the LTD program's 2003 valuation. In the future, ASRS intends to perform experience studies for the LTD program on the same five-year cycle that it uses for the Plan. The first such study will cover the period from July 1, 2002, to June 30, 2007, and is expected to be completed in the first quarter of 2008.

Benefit Provisions

There have been no changes in benefit provisions since the last valuation. The terms of the LTD Program are summarized on pages 10 to 12 of this report. There is no provision for LTD benefits to increase for cost-of-living adjustments.

Assumptions and Methods

The Board adopted, on April 15, 2005, the actuarial method that the actuary recommended, to be effective June 30, 2005. The recommendations were:

1. ASRS should align its funding method with one of the acceptable cost methods under Governmental Accounting Standards Board Statement No. 43 (GASB #43).

2. ASRS should commence implementation of a GASB #43 method on July 1, 2005.

3. ASRS should adopt the Projected Unit Credit method for LTD valuations – the same method it uses for the valuation of its defined benefit pension plan (the Plan).

4. ASRS should determine the actuarial value of LTD assets using a prospective 10-year asset smoothing procedure, in the same way that it determines the actuarial value of Plan assets.

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5. ASRS should use a rolling 15-year period for the amortization of the unfunded actuarial accrued liabilities of the LTD program. This period is shorter than the period used for amortizing Plan liabilities to reflect the shorter duration of LTD liabilities.

This valuation reflects the Board's actions as described above. It is the second valuation performed according to GASB #43 methods.

The assumptions are generally consistent with Plan and previous LTD Program assumptions. Under GASB #43, the actuary needs to estimate disability incidence rates for active members, and this valuation uses the same incidence assumption that the Plan does. We also must estimate offsets to future LTD claims due to income from other sources. We assume that these offsets reduce the gross benefits by 32% since that is the average reduction for current open claims. For current LTD claims within the first three years of receipt, benefits have been adjusted to reflect future offsets as well. We must estimate administrative expense reserves for the future claims of active members. We assume that the expense reserve will be 2.8% of the claim liabilities – the same percentage that applies for current open claims. These assumptions became effective as of July 1, 2005.

We have introduced an assumption this year on future offsets for disabled members who are in their first three years of LTD payment status and do not presently have an offset. This assumption is first effective for the valuation as of July 1, 2006.

The actuary originates the assumptions, in consultation with the ASRS Director and other ASRS staff members, and recommends the assumptions to the Board which makes the ultimate decision on which assumptions and methods to use.

The Board elected to use the projected unit credit method. Under this method, actuarial gains (or losses) are subtracted from (or added to) the unfunded actuarial accrued liability.

Data

ASRS staff and VPA (the administrator of the LTD program) supplied census data for participants as of June 30, 2006. We have not audited these data, but have examined them for reasonableness and consistency with the prior year's data. ASRS staff also supplied asset information.

Trend Data and Supporting Schedules

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

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

Sincerely,

Charles E. Chittenden, FSA, MAAA, EA

Matthew A. Strom, FSA, MAAA, EA

CEC/MAS:pl

General Actuarial Information - LTD

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 following table summarizes the key results of the June 30, 2006, actuarial valuation of the Arizona State Retirement System (ASRS) Long Term Disability (LTD) Program. The 2005 figures are from a GASB #43 valuation of the LTD Program as of June 30, 2005.

(Amounts in 000s)	2005	2006
Normal Cost	$44,870	$45,907
Actuarial Accrued Liability	577,405	574,701
Valuation Assets	164,834	194,297
Funded Status	28.55%	33.81%
Unfunded Actuarial Accrued Liability (UAAL)	412,572	380,404
Past Service Cost	44,630	41,151
Annual Required Contribution (ARC)	89,500	87,058
Payroll	8,032,458	8,311,870
ARC as % of payroll for each employer and each member	0.56%	0.52%
UAAL as % of payroll	5.10%	4.60%

The following chart will serve to indicate some of the more important statistics regarding the long-term disability program.

Number of LTD Open Claim Members	5,018
Average Age	54
Average Monthly Benefit	$1,068

Summary of Benefit Provisions - LTD

Summary of Benefit Provisions

The Arizona State Retirement System (ASRS) Long Term Disability (LTD) Program began on July 1, 1995. The program covers ASRS LTD Program participants who become disabled on or after July 1, 1995. ASRS members who were receiving LTD benefits prior to July 1, 1995, were transferred to the program on October 1, 1995. Contributions began July 1, 1995, and are paid 50% by employers and 50% by active members.

Below we have summarized the main provisions of the LTD Program.

Effective Date: The plan was established effective July 1, 1995.

Participation: To be eligible, members must be actively at work and engaged to work at least 20 weeks in a fiscal year and at least 20 hours each week. Coverage is contingent on payment of premiums.

Contributions: Members are required to contribute to the LTD Program in accordance with the schedule ratified each year by the Board. The current rate is .50% of payroll. Employers have equal contributions, and the Board allocates all contributions to the LTD Program's depository.

Qualifications for Benefit: Monthly benefits are not payable until a member has been totally disabled for a period of six consecutive months. Monthly benefits are not payable to a member whose disability is due to the following:

1. an intentionally self-inflected injury
2. war, whether declared or not
3. an injury incurred while engaged in a felonious criminal act or enterprise
4. an injury or sickness for which the member received medical treatment within three months before the date of the member's coverage under the LTD Program. The restriction does not apply to a member who was employed by a participating employer for twelve continuous months nor does it apply to a member who was employed by an employer as of June 30, 1988.

Monthly benefits are not payable to a member who is receiving retirement benefits from ASRS.

Totally Disabled: A member is considered totally disabled if:

1. during the first thirty months of a period of disability, the member is unable to perform all duties of the position held by the member when the member became totally disabled; and
2. for a member who has received monthly benefits for 24 or more total months, that a member is unable to perform any work for compensation or gain for which the member is reasonably qualified by education, training, or experience.

Benefit Amount: Benefits payable from the plan equal two-thirds of a member's monthly compensation at the time of disability. Benefits are offset by:

1. 64% of social security disability benefits that the member or the member's dependents are eligible to receive;
2. 83% of social security retirement benefits that the member is eligible to receive;
3. all of any worker's compensation benefits;

Summary of Benefit Provisions - LTD

4. all of any payments for a veteran's disability if both of the following apply:
   a) the veteran's disability payment is for the same condition or a condition related to the condition currently causing the member's total disability;
   b) the veteran's disability is due to service in the armed forces of the United States;
5. all of any other benefits by reason of employment that are financed partly or wholly by an employer, including payments for sick leave; and
6. 50% of any salary, wages, commissions, or similar pay that the member receives or is entitled to receive from any gainful employment in which the member engages.

Benefit Period: Monthly benefits cease to be payable to a member at the earliest of the following:

1. the date the member ceases to be totally disabled;
2. the date the member ceases to be under the direct care of a doctor or refuses to undergo any medical examination requested by the company selected by the Board to administer the LTD Program;
3. the date the member withdraws employee contributions with interest and ceases to be a member; and
4. the later of following:
   a) the member's normal retirement date;
   b) the month following 60 months of payments if disability occurs before age 65;
   c) the month following attainment of age 70 if disability occurs at age 65 or after but before age 69;
   d) the month following twelve-months of payments if disability occurs at or after age 69.

Expenses: Expenses associated with the operation of the LTD Program are payable by the LTD Program.

Statement of Actuarial Methods and Assumptions Used in Determining Cost - LTD

Statement of Actuarial Methods and Assumptions

We have prepared this report on our actuarial valuation of the assets and liabilities of the Arizona State Retirement System LTD Program as of June 30, 2006, in accordance with generally accepted actuarial principles, and with the requirements of GASB #43.

The actuarial assumptions and methods on which our valuation has been based are, in our opinion, appropriate for the purpose of our current valuation. The ASRS Board has adopted them in its meetings of April 14, 2006, and November 17, 2006.

We have not audited the data or the asset information used in this valuation, but believe them to be complete and accurate.

Summary of Actuarial Method

The actuarial cost method is the projected unit credit method. Assets are valued at market, less (or plus) an adjustment to reflect investment gains 9or losses) over a 10-year period. The unfunded actuarial accrued liability is amortized over 15 years in level dollar payments.

Summary of Actuarial Assumptions

The majority of the assumptions used in LTD valuation are the same as those used in the valuation of the Plan and are based on the most recent experience study which covers the five year period from July 1, 1997 through June 30, 2002. Those assumptions include the mortality table used for post retirement mortality, the assumed retirement age, the probabilities of withdrawal from active service before age and service retirement, the pay increase assumptions and the extent to which total active member payroll is expected to increase as a result of inflation.

The assumptions unique to the LTD valuation were as follows:

Discount Rate

8% per annum

Rates of Termination of Claims in Payment due to Death or Recovery

1987 Commissioners' Group Long Term Disability Valuation Table (1987 CGDT), applicable to plans with a six-month elimination period.

Disability Incidence Rates for Active Members

Age- and sex-based rates as developed for the Plan. Rates at representative ages are given below:

Age	Males	Females
20	0.06%	0.70%
30	0.07%	0.10%
40	0.21%	0.21%
50	0.51%	0.49%
60	1.20%	1.09%

Statement of Actuarial Methods and Assumptions Used in Determining Cost - LTD

Offsets for Disabled Members	We are assuming that the amounts that VPA reports as offsets (other than overpayment offsets) will continue to apply to each member's benefit until that benefit expires. For members within first three years of receipt of LTD benefits, we have adjusted benefit amounts to reflect future offsets.
Offsets for Active Members	We assume that LTD Program benefits, after all applicable offsets, are 68% of the benefits before the offsets. This is the percentage that applies for currently disabled members.
Administrative Expense Reserve for Active Members	2.8% of projected claim liabilities. This is the percentage that applies for currently disabled members.

LTD Schedules

SCHEDULE OF BENEFIT RECIPIENTS ADDED TO AND REMOVED FROM ROLLS
Last 5 Years

	Retirants and Beneficiaries Added to Rolls		Retirants and Beneficiaries Removed from Rolls		Retirants and Beneficiaries Rolls End of Year			
Valuation As Of June 30	No.	Annual Allowance	No.	Annual Allowance	No.	Annual Allowance	% Increase in Annual Allowances	Average Annual Allowances
2002	N/A	N/A	N/A	N/A	4,290	55,341,168	N/A	12,900
2003	1,001	13,286,461	730	12,430,021	4,561	56,197,608	1.5%	12,321
2004	865	14,403,292	742	9,301,684	4,684	61,299,216	9.1%	13,087
2005	926	15,285,111	671	11,000,763	4,939	65,583,564	7.0%	13,279
2006	840	16,021,268	761	17,279,900	5,018	64,324,932	-1.9%	12,819

Information prior to 2002 is not available.

SCHEDULE OF UNFUNDED (OVER) ACCRUED LIABILITIES - PLAN
LAST 3 YEARS *(in thousands)*

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
2004	$544,205	$137,861	25.3%	$406,344	$7,458,590	5.4%
2005	577,405	164,834	28.5%	412,572	8,032,458	5.1%
2006	574,701	194,297	33.8%	380,404	8,311,870	4.6%

Information prior to 2004 is not available.

LTD Schedules

SOLVENCY TEST
Last 5 Years

Year Ended June 30	Aggregate Accrued Liabilities for (1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed Portion)		Net Assets Available for Benefits	Portion of Accrued Liabilities Covered by Net Assets Available for Benefits (1)	(2)	(3)
2002	-	208,806,380	22,398,485		116,808,750	100%	56%	0%
2003	-	222,703,620	26,415,435		110,201,395	100%	49%	0%
2004	-	243,713,353	300,491,725	*	137,861,118	100%	57%	0%
2005	-	258,735,220	318,670,078		164,833,736	100%	64%	0%
2006	-	247,576,703	327,124,018		194,296,619	100%	78%	0%

* The 2004 valuation resilts are from a study of the effects of adopting GASB #43. The formal valuation report did not use the GASB methodology.

SCHEDULE OF RECOMMENDED VS. ACTUAL LTD CONTRIBUTIONS
LAST 10 YEARS

Year Ended June 30	Active Member Payroll	Employee Contributions	Employer Retirement Contribution Rate Actual	Actuary Recommended Contribution
1997	$4,836,000,000	$24,180,000	0.50%	0.50%
1998	5,164,000,000	23,007,894	0.50%	0.50%
1999	5,488,000,000	26,170,117	0.50%	0.50%
2000	5,750,000,000	28,027,181	0.50%	0.50%
2001	6,564,000,000	29,937,541	0.50%	0.50%
2002	6,989,000,000	32,937,592	0.50%	0.50%
2003	7,297,000,000	34,800,421	0.50%	0.50%
2004	7,486,000,000	36,021,857	0.50%	0.50%
2005	8,032,000,000	38,981,702	0.50%	0.50%
2006	8,312,000,000	41,188,441	0.50%	0.50%

LTD Schedules

ANALYSIS OF FINANCIAL EXPERIENCE FOR LTD

1. Change in Open Claims Reserves

The increase in the reserves for payments not yet due on disabled lives may be summarized as follows:

		Lives	Reserves
(a)	Open Claims Reserve liability on July 1, 2005	4,939	$252,418,690
(b)	Change in reserve on 4,178 continuing disabled lives	N/A	(38,796,711)
(c)	Reserves released on terminated lives	(761)	(24,778,247)
(d)	Reserves added on new lives	840	52,439,528
(e)	Open Claims Reserve liability on June 30, 2006 = (a) + (b) + (c) + (d)	5,018	241,283,260

2. Development of Liability (Gain)/Loss

(a)	Actuarial Accrued Liability as of July 1, 2005	$577,405,298
(b)	Normal Cost for 2005	44,869,965
(c)	Expected Benefit Payment for 2005	64,186,000
(d)	Expected Actuarial Accrued Liability on June 30, 2006 = ((a)+(b)) x 1.08 – (c) x 1.04	605,303,844
(e)	Liability (Gain)/Loss	(30,603,123)
(f)	Actual Actuarial Accrued Liability on June 30, 2006 = (d) + (e)	574,700,721

The liability gains are mainly attributable to additional amounts of offsets.

3. Development of Actuarial Value of Assets

(a)	Excess (Shortfall) of Investment Income: (i) Current Year	$1,895,241
(b)	Deferral of Excess (Shortfall):	
	(i) Current Year (90% Deferral)	1,705,717
	(ii) Total Deferred for Year	1,705,717
(c)	Market Value of Assets as of June 30, 2006	196,002,336
(d)	Actuarial Value of Assets s of June 30, 2006 = (c) - (b)(ii)	194,296,619

LTD Schedules

4. Development of Asset (Gain)/Loss

(a)	Actuarial Value of Assets as of July 1, 2005	$164,833,736
(b)	Contributions	82,376,881
(c)	Actual Benefit Payments for 2005	66,695,172
(d)	Expenses (Other than Investment)	-
(e)	Expected Investment Income at 8% Return	13,591,650
(f)	Expected Actuarial Assets as of June 30, 2006 = (a) + (b) - (c) + (d) + (e)	194,107,095
(g)	Gain/(Loss) on Actuarial Assets	189,524
(h)	Actuarial Assets as of June 30, 2006 = (f) + (g)	194,296,619

The asset gain is due to investment earnings on actuarial assets in excess of expected.

The actual net return on actuarial assets was 8.11%, compared to the assumption of 8%.

5. Analysis of Incurred But Not Open (IBNO) Reserves

(a)	IBNO Reserves as at 7/1/2005	$26,830,397
(b)	Reserve for Newly Opened Claims as of 7/1/2006 with Disability Date between 1/1/2005 and 7/1/2005	23,084,556
(c)	Reserve for Newly Open Claims as of 7/1/2006 with Disability Date prior to 1/1/2005	7,994,694
(d)	(Gain)/Loss = (b) + (c) - (a)	4,248,853

6. Analysis of VPA Offsets

Description of Offset from VPA	Amount of Monthly Offsets	Number With Offsets
Social Security Disability	$2,153,895	3,611
Social Security Retirement	127,437	171
Other	427,494	1,012
Total	2,713,620	4,794

Summary of Legislative Plan Changes

A. 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% 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.

B. 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.

Summary of Legislative Plan Changes

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%).

C. 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.

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.

Summary of Legislative Plan Changes

D. 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

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.

Summary of Legislative Plan Changes

E. 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%.

F. 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

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.

Summary of Legislative Plan Changes

G. 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.

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

1. No material changes.

I. 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.

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

1. No material changes.

Summary of Legislative Plan Changes

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

1. Enhanced Refund Option

Employees who terminate prior to eligibility for retirement may elect to receive a refund of their employee contributions with interest. If the employee has at least five years of service, the employee is also entitled to a share of the employer contributions with interest. The share is 50% with five years of service and increases 10% 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.

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

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

Summary of Legislative Plan Changes

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

1. Health Insurance Premium Benefit Increase

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

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

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.

Summary of Legislative Plan Changes

5. Temporary Rural Health Insurance Premium Benefit

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

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

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.

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

1. No material changes.

Summary of Legislative Plan Changes

O. 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 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.

P. 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.

Summary of Legislative Plan Changes

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.

Q. 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 and 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.

R. LEGISLATED PLAN CHANGES ENACTED BY THE 2006 LEGISLATURE OF THE STATE OF ARIZONA

1. Elections After Retirement

Legislature limited the ability of ASRS retirees to rescind their elections after retirement. Specifically, members who have chosen a form with a death benefit can "pop up" once to the single life form, but are then not allowed to "pop down" to a death benefit form. ASRS will implement this provision upon receipt of a private letter ruling from the Internal Revenue Service.

2. Conformance with Certain Federal Regulations

State statutes were modified to conform to federal regulations regarding military service purchases, optional forms of retirement benefits, and minimum required distributions.

3. Repeal of Deferred Retirement Option Plan

The Legislature repealed the modified Deferred Retirement Option Plan (DROP).

Arizona State Retirement System

A Component Unit of the State of Arizona

2007 Statistical Section

Oak Creek Canyon, Arizona

Table of Contents

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									
ASSETS	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Cash, Receivables, and Prepaids	$87,279	$257,569	$317,058	$290,502	$307,934	$414,382	$2,139,601	$2,091,244	$2,396,175	$2,197,053
Investments at Fair Value	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	30,978,445
Total Assets	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	33,175,498
LIABILITIES										
Investments Payable	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	6,078,211
Other Payables	23	955	475	5,503	569	3,423	7,822	20,470	23,108	27,729
Total Liabilities	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	6,105,940
Total Net Assets	**$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**	**$27,069,558**

HBS NET ASSETS (in thousands)

	FISCAL YEAR									
ASSETS	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Cash, Receivables, and Prepaids	$4,315	$11,112	$9,959	$10,597	$12,276	$15,451	$85,226	$85,061	$96,084	$90,106
Investments at Fair Value	716,840	853,254	953,418	899,282	843,856	805,430	917,308	974,406	1,081,538	1,335,221
Total Assets	721,155	864,366	963,377	909,879	856,132	820,881	1,002,534	1,059,467	1,177,622	1,425,327
LIABILITIES										
Investments Payable	36,591	56,591	67,496	70,833	87,285	122,775	194,486	187,770	204,237	261,980
Other Payables	1	16	19	14	-	-	-	60	3,639	394
Total Liabilities	36,592	56,607	67,515	70,847	87,285	122,775	194,486	187,830	207,876	262,374
Total Net Assets	**$684,563**	**$807,759**	**$895,862**	**$839,032**	**$768,847**	**$698,106**	**$808,048**	**$871,637**	**$969,746**	**$1,162,953**

LTD NET ASSETS (in thousands)

	FISCAL YEAR									
ASSETS	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Cash, Receivables, and Prepaids	$1,431	$1,424	$4,645	$13,214	$5,184	$4,145	$7,641	$14,040	$15,241	$10,565
Investments at Fair Value	54,607	71,344	93,409	80,143	90,048	108,364	130,428	151,025	180,983	233,148
Total Assets	56,038	72,768	98,054	93,357	95,232	112,509	138,069	165,065	196,224	243,713
LIABILITIES										
Investments Payable	-	-	-	-	-	-	-	-	-	-
Other Payables	394	3,461	10,374	173	1,228	2,308	207	231	222	227
Total Liabilities	394	3,461	10,374	173	1,228	2,308	207	231	222	227
Total Net Assets	**$55,644**	**$69,307**	**$87,680**	**$93,183**	**$94,004**	**$110,201**	**$137,862**	**$164,834**	**$196,002**	**$243,486**

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

RETIREMENT CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
ADDITIONS	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Member Contributions	$152,376	$152,917	$124,931	$133,504	$135,275	$142,356	$377,436	$403,661	$570,933	$766,962
Employer Contributions	78,842	86,707	72,256	77,196	131,234	138,100	297,770	318,311	477,472	663,544
Member Reimbursements/Transfers	15,462	46,171	35,348	39,535	50,832	93,552	113,944	141,932	125,751	107,548
Net Investment Income	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	4,105,644
Total Additions	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	5,643,698
DEDUCTIONS										
Retirement Benefits	574,230	627,612	695,426	809,133	924,172	1,067,481	1,238,966	1,406,547	1,538,992	1,650,818
Survivor Benefits	10,558	11,485	13,256	14,134	14,078	15,861	14,859	18,402	17,125	21,590
Refunds/Transfers	31,436	27,117	75,637	108,692	51,382	43,433	38,548	48,745	65,442	88,027
Administration and Other	9,980	12,222	12,841	12,370	16,708	27,345	29,948	25,476	30,137	33,351
Total Deductions	626,204	678,436	797,160	944,329	1,006,340	1,154,120	1,322,321	1,499,170	1,651,696	1,793,786
NET CHANGE	**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**	**3,849,912**
Net assets beginning 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
NET ASSETS END OF YEAR	**$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**	**$27,069,558**

HBS CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
ADDITIONS	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Employer Contributions	$73,534	$66,209	$52,674	$56,308	$4,041	$4,256	$79,662	$85,350	$93,461	$103,473
Net Investment Income	103,183	91,986	73,146	(72,558)	1,811	10,436	114,906	68,750	86,587	174,348
Total Additions	176,717	158,195	125,820	(16,250)	5,852	14,692	194,568	154,100	180,048	277,821
DEDUCTIONS										
Health Premium Benefits	32,668	34,935	37,652	40,500	75,990	84,534	83,680	89,602	80,827	83,236
Administration and Other	40	64	65	80	47	899	946	909	1,112	1,378
Total Deductions	32,708	34,999	37,717	40,580	76,037	85,433	84,626	90,511	81,939	84,614
NET CHANGE	**144,009**	**123,196**	**88,103**	**(56,830)**	**(70,185)**	**(70,741)**	**109,942**	**63,589**	**98,109**	**193,207**
Net assets beginning of year	540,554	684,563	807,759	895,862	839,032	768,847	698,106	808,048	871,637	969,746
NET ASSETS END OF YEAR	**$684,563**	**$807,759**	**$895,862**	**$839,032**	**$768,847**	**$698,106**	**$808,048**	**$871,637**	**$969,746**	**$1,162,953**

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

LTD CHANGES IN NET ASSETS (in thousands)

	FISCAL YEAR									
	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
ADDITIONS										
Member Contributions	$24,393	$26,170	$28,027	$29,938	$32,938	$34,801	$36,026	$38,982	$41,188	$44,518
Employer Contributions	24,393	26,170	28,027	29,938	32,938	34,800	36,026	38,982	41,188	44,518
Net Investment Income	2,566	3,219	5,493	(6,492)	(7,519)	3,461	17,100	13,651	18,080	30,526
Total Additions	51,352	55,559	61,547	53,384	58,357	73,062	89,152	91,615	100,456	119,562
DEDUCTIONS										
Disability Benefits	35,112	39,839	41,220	45,848	54,804	54,688	58,976	62,183	66,695	69,221
Administration and Other	855	2,057	1,954	2,033	2,732	2,177	2,515	2,460	2,593	2,857
Total Deductions	35,967	41,896	43,174	47,881	57,536	56,865	61,491	64,643	69,288	72,078
NET CHANGE	**15,385**	**13,663**	**18,373**	**5,503**	**821**	**16,197**	**27,661**	**26,972**	**31,168**	**47,484**
Net assets beginning of year	40,259	55,644	69,307	87,680	93,183	94,004	110,201	137,862	164,834	196,002
NET ASSETS END OF YEAR	**$55,644**	**$69,307**	**$87,680**	**$93,183**	**$94,004**	**$110,201**	**$137,862**	**$164,834**	**$196,002**	**$243,486**

Financial Trends: Benefits Paid - Last 10 Fiscal Years

RETIREMENT BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Retirement Benefits	$574,230	$627,612	$695,426	$809,133	$924,172	$1,067,481	$1,238,966	$1,406,547	$1,538,992	$1,650,818
Survivor Benefits	10,558	11,485	13,256	14,134	14,078	15,861	14,859	18,402	17,125	21,590
Total Benefits	$584,788	$639,097	$708,682	$823,267	$938,250	$1,083,342	$1,253,825	$1,424,949	$1,556,117	$1,672,408
Refunds due to Separation	$29,769	$26,108	$70,755	$98,535	$42,765	$35,976	$36,212	$44,164	$60,313	$77,910

HBS BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Health Premium Benefits	$32,668	$34,935	$37,651	$40,500	$75,990	$84,534	$83,680	$89,602	$80,827	$83,236

LTD BENEFITS PAID (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Disability Benefits	$35,112	$39,839	$41,220	$45,848	$54,804	$54,688	$58,976	$62,183	$66,271	$69,221

Revenues: Contributions Received - Last 10 Fiscal Years

RETIREMENT CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member Contributions	$152,376	$152,917	$124,931	$133,504	$135,275	$142,356	$377,436	$403,661	$570,933	$766,962
Employer Contributions	78,842	86,707	72,256	77,196	131,234	138,100	297,770	318,311	477,472	663,544
Total Contributions	**$231,218**	**$239,624**	**$197,187**	**$210,700**	**$266,509**	**$280,456**	**$675,206**	**$721,972**	**$1,048,405**	**$1,430,506**

HBS CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Employer Contributions	$73,534	$66,209	$52,674	$56,308	$4,041	$4,256	$79,662	$85,350	$93,461	$103,473

LTD CONTRIBUTIONS RECEIVED (in thousands)

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member Contributions	$24,393	$26,170	$28,027	$29,938	$32,938	$34,801	$36,026	$38,982	$41,188	$44,518
Employer Contributions	24,393	26,170	28,027	29,938	32,938	34,800	36,026	38,982	41,188	44,518
Total Contributions	**$48,786**	**$52,340**	**$56,054**	**$59,876**	**$65,875**	**$69,601**	**$72,052**	**$77,964**	**$82,376**	**$89,036**

Revenues: Actual Contributions Rates - Last 10 Fiscal Years

RETIREMENT CONTRIBUTION RATES

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Employee	3.05	2.85	2.17	2.17	2.00	2.00	5.20	5.20	6.90	8.60
Employer	1.57	1.61	1.25	1.25	1.94	1.94	4.10	4.10	5.77	7.55

HBS CONTRIBUTION RATES

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Employer	1.48	1.24	0.92	0.92	0.06	0.06	1.10	1.10	1.13	1.05

LTD CONTRIBUTION RATES

	FISCAL YEAR									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Employee	0.49	0.49	0.49	0.49	0.49	0.49	0.50	0.50	0.50	0.50
Employer	0.49	0.49	0.49	0.49	0.49	0.49	0.50	0.50	0.50	0.50

Operations: Members by Type of Benefit
As of June 30, 2007

RETIREMENT MONTHLY BENEFIT	OPTIONS* 1	2	3	4	5	6	7
$1- 299	5,031	294	351	546	1,397	122	215
300 - 499	4,368	386	551	457	1,432	171	284
500 - 999	9,524	877	1,406	970	2,772	612	971
1000 - 1499	6,500	760	1,238	599	2,308	666	934
1500 - 1999	4,073	469	695	441	1,739	589	799
2000 & Over	11,120	879	1,275	1,380	5,081	1,846	2,370
Totals	**40,616**	**3,665**	**5,516**	**4,393**	**14,729**	**4,006**	**5,573**

*** 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	50,357
200-299	3,041
300-399	490
400 & Over	82
Total	**53,970**

Source: ASRS Pension Administration System

LTD MONTHLY BENEFIT	MEMBERS
$1-299	397
300-499	391
500-999	1,643
1000-1499	1,218
1500-1999	722
2000 & over	605
Totals	**4,976**

Source: Sedgewick CMS

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 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
Fiscal year 2006										
Average monthly benefit	$126	$334	$702	$1,746	$2,079	$2,541	$3,001	$3,190	$3,427	$3,255
Number of retirees	1,889	10,789	13,986	19,845	18,680	9,419	3,215	592	81	2

Average final 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	$65	$71	$81	$86	$103	$130
Number of HBS participants	1,008	861	872	869	895	47,117
Fiscal year 2007						
Average monthly benefit	$57	$69	$83	$89	$96	$130
Number of HBS participants	1,046	877	903	885	891	49,368

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
Fiscal year 2007	
Average monthly benefit	$1,743
Number of LTD participants	4,976

Note: Long term disability payments are based on salary and not years of credited service. Information for prior to 2006 is not available.

Source: Sedgewick CMS

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

	2007			1998		
Participating Employer	**Covered Employees**	**Rank**	**% of Membership**	**Covered Employees**	**Rank**	**% of Membership**
Dept Of Administration	32,230	1	14.34%	29,446	1	19.99%
Maricopa County	10,653	2	4.74%	8,171	2	5.55%
Mesa Unified Dist 4	8,487	3	3.78%	4,005	7	2.72%
Tucson Unified Dist 1	7,860	4	3.50%	3,944	8	2.68%
University Of Arizona	7,087	5	3.15%	6,758	4	4.59%
Pima County	6,399	6	2.85%	4,922	5	3.34%
Maricopa County Community College District	5,904	7	2.63%	3,546	9	2.41%
Arizona State University	5,620	8	2.50%	4,365	6	2.96%
Gilbert Unified Dist 41	4,684	9	2.08%	1,358		0.92%
Peoria Unified Dist 11	3,757	10	1.67%	1,717		1.17%
Maricopa County School Office				7,238	3	4.91%
Maricopa County Health Services				2,882	10	1.96%
*All other	132,085		58.76%	68,962		46.80%
Total	**224,766**		**100.00%**	**147,314**		**100.00%**

* In 2007, "All Other" consisted of:

Type	**Number**	**Employees**
Public Schools	235	87,768
Charter Schools	172	4,003
Cities	76	18,947
Counties	15	9,143
Higher Education	13	5,754
Other	76	6,470
	587	132,085

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

Source: ASRS Pension Administration System