EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2005

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Prepared by the Staff of the:
Employees' Retirement System of the State of Hawaii
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WESLEY K. MACHIDA, Assistant Administrator
T. KIMO BLAISDELL, Chief Investment Officer

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EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

INTRODUCTORY SECTION

Certificate of Acheivement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Employees Retirement System of the State of Hawaii

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2004

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

Letter from the Chair

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 29, 2005

Honorable Linda Lingle
Governor, State of Hawaii
Honolulu, Hawaii 96813

Dear Governor Lingle:

It is my pleasure to submit the Employees' Retirement System's (ERS) Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005. This report provides information on the financial status of the ERS and highlights significant changes that occurred during the past fiscal year.

We are pleased to report that total assets grew to $9.2 billion as of June 30, 2005 and our investment portfolio generated an 11.3% return during the past fiscal year. While we are encouraged by the positive earnings, the actuarial funded ratio declined to 68.6% at the end of the fiscal year. This is primarily the result of the past diversion of excess investment earnings which prevented the ERS from establishing a rainy day fund for the years of poor investment returns. The decline in the funded ratio was also caused by the four-year "smoothing" methodology used by the ERS actuary to determine the unfunded liability which included the effects of unfavorable investment returns in FY 2001 and FY 2002. However, in the absence of a severe market decline and in the absence of future major actuarial losses, the actuary believes that the new employer contribution approach will increase the funded ratio and reduce the ERS' unfunded liability.

We launched several significant multi-year projects that will improve the services and benefits to our members. A comprehensive communications campaign is being developed for a new defined benefit contributory hybrid plan which will go into effect in July 2006. This new retirement plan will provide 58,000 active members with a chance to "shore-up" their retirement income at no additional cost to the employers. We are also designing a new pension management information computer system to replace many of the ERS computer systems that have been in place since the late 1980s. Another project team is working to secure and purify historical membership service credit and financial data to help members make informed retirement decisions.

It has been a very challenging year for everyone. At this time, the Trustees and I want to thank the dedicated staff, investment managers, consultants and the many others for their commitment to continually improve the retirement program for our members.

Respectfully submitted,

Jackie Ferguson-Miyamoto

Jackie Ferguson-Miyamoto, Chair
Board of Trustees

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Letter of Transmittal

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 29, 2005

Board of Trustees
Employees' Retirement System
of the State of Hawaii

Dear Board Members:

We are pleased to submit the Comprehensive Annual Financial Report (CAFR) of the Employees' Retirement System of the State of Hawaii (ERS) for the fiscal year ended June 30, 2005. The report is a complete review of the financial, investment and actuarial conditions of the programs administered by the ERS. Responsibility for both the accuracy of the data, as well as the completeness and fairness of the presentation, rests with the management of the ERS.

STRUCTURE OF REPORT

This report complies with generally accepted accounting principles as established by the Government Accounting Standards Board (GASB), including the financial reporting model established by GASB Statement 34 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and the new Statement 40 *Deposit and Investment Risk Disclosures.*

This report is divided into five sections:

(1) Introductory - includes transmittal letters, the ERS' organizational structure, a summary of benefit provisions and retirement options, and recent legislation affecting the ERS;
(2) Financial - contains the report of independent auditors, management's discussion and analysis regarding operations, the audited financial statements of the ERS, required supplementary information and supplemental financial schedules;
(3) Investment - includes reports of investment activity, investment policies, investment results, and various other investment schedules;
(4) Actuarial - contains the report of the independent actuary, the results of the annual actuarial valuation, and supporting schedules; and
(5) Statistical – contains information regarding ERS' participants and finances.

BACKGROUND

The ERS was established by the Legislature in 1925 to administer the retirement, disability and survivor benefits program for State and county employees including teachers, professors, police officers, firefighters, judiciary employees, judges, and elected officials. The ERS is a qualified defined benefit public pension plan covered under Section 401(a) of the Internal Revenue Code. Hawaii Revised Statutes

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Letter of Transmittal (continued)

Chapter 88 contains the actual language governing the pension trust. The plan covers all full-time State and county employees in the State of Hawaii. The ERS is funded on an actuarial reserve basis. Benefit funding comes from employer and member contributions, and investment earnings.

On March 31, 2005, the ERS' total membership of 101,312 was comprised of 63,073 active members, 4,938 inactive vested members, and 33,301 retirees and beneficiaries. This represents a 2% growth in the total membership over the past year. The number of retirees and beneficiaries had the largest increase while the number of active members remained fairly constant. Participating employers include the State of Hawaii, City and County of Honolulu, and the counties of Hawaii, Maui and Kauai.

The ERS is also responsible for the custody of the Social Security Contribution Fund for the State of Hawaii. This fund receives and invests the State's employer share of Social Security taxes, and makes payment to the Internal Revenue Service. The Social Security contributions withheld from employees are remitted directly to the Internal Revenue Service by the State. As an agency type fund that is custodial in nature, the ERS has limited discretion in the management of this fund.

MAJOR ACCOMPLISHMENTS AND INITIATIVES IN 2005

During the past fiscal year, we concentrated on the planning and design phases of three major multi-year projects that will greatly enhance member service in the future, and increase ERS' operational efficiencies.

The first important project is the implementation of a new defined benefit contributory hybrid plan which will go into effect in July 2006. The Hybrid Plan will be the biggest change in the State's retirement program in the last 20 years. Over 58,000, or approximately 92% of active members, will be given the opportunity to switch to this new retirement plan. A consulting firm was retained to conduct a comprehensive communications campaign to help members make an informed decision by March 31, 2006 as to whether they should switch to the Hybrid Plan or remain in their current retirement plan. Most of the new employees hired after June 30, 2006 will be required to join this new contributory plan. Although the member's retirement benefit formula will be greater, the new Hybrid Plan will not increase the State and county governments' retirement costs.

One important issue (in looking at this new contributory plan) for many of the 58,000 members is the ability to convert their previous Noncontributory Plan service to the new Contributory (Hybrid) Plan. Our tax attorneys have determined that federal tax issues must be resolved and federal legislation may be required before conversion of Noncontributory Plan service is allowed. A private letter ruling from the Internal Revenue Service (IRS) was requested in January 2005 to address specific tax issues and the ERS is supporting federal legislation that will facilitate the conversion of Noncontributory Plan service from 1.25% to the 2% benefit formula in the Hybrid Plan. A response from the IRS and action by Congress are still pending. We will continue to work with the IRS and Hawaii Congressional Members.

The second major project is the replacement of ERS' computer systems that have been in use since the late 1980's. A computer vendor was hired to design and install a new computer and office automation system which will include the pension administration of the Contributory, Noncontributory, and new Contributory (Hybrid) Plans; imaging; workflow; accounting; etc. The new system will improve operational efficiencies, but more importantly, provide improved service to members. The design and installation of all systems is expected to be completed in FY 2008.

A third important project is the issuance of members' statements to over 66,000 active and inactive vested State and county government employees and former employees. A project team is working with a computer consultant to secure and purify historical membership service credit and financial data as of June 30, 2005. Detailed statements reporting years of service and contribution balances (for Contributory Plan members) were sent to members in October 2005. The goal of this project is to communicate and provide accurate retirement information to members so that they can make informed decisions affecting their retirement. In addition, we need to ensure that accurate membership service credit data and other retirement information are available for the new computer system.

Other important initiatives enacted by the ERS included new actuarial retirement factors to reflect members' longer life expectancies and a "pop up" feature for the joint and survivor retirement options, both of which became effective on December 1, 2004. With the "pop up" feature, a member who retires on a joint and survivor option after November 2004 will have an increased monthly pension if the beneficiary passes away before the retiree. The actuarial retirement factors are also age-specific instead of using five-year age groupings. These changes are generally expected to have a favorable impact on members' retirement benefits.

Legislation was also enacted (signed into law on May 17, 2005) authorizing the ERS Board of Trustees to include the effect of the annual post retirement allowance as an actuarial assumption in determining members' retirement benefit options. Since the effective date of this new law was retroactive to December 1, 2004, ERS staff recalculated the pensions of those who retired after November 2004 and also recalculated the retirement estimates for members who filed or were planning to retire after June 30, 2005. The internal and website retirement benefit calculators were reprogrammed to reflect the change. Special letters and newsletters were also sent to members.

ACHIEVEMENT 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 Employees' Retirement System of the State of Hawaii for its comprehensive annual financial report for the year ended June 30, 2004. This was the 14th year the ERS has received this prestigious award. In order to be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report that satisfies both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for only one year. We believe our current report continues to meet the Certificate of Achievement Program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

FINANCIAL INFORMATION

Please refer to Management's Discussion and Analysis in the Financial Section for condensed financial information and activities of the current and prior fiscal years. We encourage you to read it in conjunction with this letter and the financial statements and notes for a better understanding of the ERS.

ACCOUNTING SYSTEM AND REPORTS

The accrual basis of accounting is used in recording financial transactions. Expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and

Letter of Transmittal (continued)

earned and become measurable. Interest earned is accrued on a monthly basis. Accounts receivable at year-end, in addition to accrued interest receivable, reflect accrued employer charges and investment proceeds due on sales that have not yet settled. Investments are recorded at fair value. Fixed assets are recorded at cost less accumulated depreciation.

The *Notes to the Financial Statements (Notes)* contain additional detailed information on the statutory provisions under which the ERS operates. In addition, the *Notes* include a summary of significant accounting policies, and provide explanatory information to help readers better understand the data contained in the financial statements.

The management of the ERS is responsible for and has implemented systems of internal accounting controls designed to provide reasonable assurances for the safeguarding of assets and the reliability of financial records. We believe that the internal accounting controls currently in place are adequate to meet the purpose for which they were intended. To the best of our knowledge and belief, the enclosed data, including the financial statements, supporting schedules and statistical tables is accurate in all material respects and is reported in a manner that fairly presents the financial position and results of the ERS' operations.

INVESTMENT ACTIVITIES

The Board of Trustees has diversified the ERS' investment portfolio to secure consistent, positive long-term investment returns while preserving capital. The diversification of investments through a long-term asset allocation strategy is generally regarded as the most important decision made in the investment process. A summary of the ERS' long-term asset allocation strategy can be found in the Investment Section of this report, in addition to a report by our Chief Investment Officer and investment consultant.

Professional investment managers have been retained to execute the Board's investment strategies and have full discretion within statutory provisions, Board policies and their respective guidelines. The investment managers retained by the Board as of June 30, 2005 are listed in the Investment Section.

Investment income, including dividends, interest, other investment earnings, and gains/losses on the sale of investments, is a significant revenue source for the ERS, and totaled $932 million for FY 2005, net of investment related expenses. This resulted in an 11.3% return on investments for the year, using time-weighted rate of return methodologies that are generally accepted by the Association for Investment Management and Research.

FUNDING AND ACTUARIAL OVERVIEW

The overall objective of the ERS is to accumulate sufficient funds to meet current and future retirement, disability and death benefit obligations to retirees and beneficiaries. The accumulated balance is referred to as the "net assets held in trust for pension benefits" in the audited financial statements in the Financial Section of this report. The actuarial accrued liability is disclosed in the required supplementary schedules following the notes to the financial statements. These schedules show the actuarial value of assets, which is based on a four-year smoothed valuation that recognizes the excess or shortfall of investment income over or under the 8% actuarial investment assumption. This is the value of assets used by the actuary each year to determine the employer contribution requirements to the ERS. Member contribution rates are established by statute and discussed in note E to the financial statements.

Letter of Transmittal (continued)

The actuarial accrued liability of the ERS is determined by the actuary. It is a measure of the present value of actuarial accrued liabilities estimated to be payable in the future to current retirees, beneficiaries, and employees for service earned to date. The unfunded actuarial accrued liability increased to $4.1 billion from $3.5 billion on June 30, 2004. The unfunded actuarial accrued liability is primarily the result of the poor investment climate during the 2000-2002 bear market, and the previous use of the ERS' excess investment earnings to reduce State and county government contributions to the ERS.

The percentage computed by dividing the actuarial value of net assets available for benefits by the actuarial accrued liability is generally referred to as the "funded ratio". This ratio provides an indication of the funded status of the ERS on a going-concern basis and generally the greater the percentage, the stronger the pension trust. A higher level of funding gives the participants a greater degree of assurance that their pension benefits are secure. Although the ERS had an 11.3% investment return during the past year, the funded ratio on an actuarial basis decreased to 68.6% on June 30, 2005 from 71.7% the previous year. The decrease in the funded ratio is the result of the four-year smoothing effect of unfavorable investment returns in prior years. The funded status and progress for the ERS are presented in the Required Supplementary Information Schedules of Funding Progress.

PROFESSIONAL SERVICES

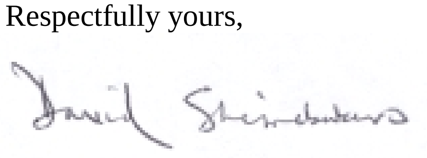
Professional consultants are appointed by the Board to perform professional services that are essential to the effective and efficient operation of the ERS. Opinions from the certified public accounting firm, KPMG LLP, and the actuary, Gabriel, Roeder, Smith & Company, are included in this report. Callan Associates Inc. is our investment consultant and their report on the ERS' investment program and performance results is also included in this report.

ACKNOWLEDGEMENTS

This report represents the dedicated collaborative efforts of the ERS staff and consultants to provide extensive and reliable information as a basis for making management decisions, determining compliance with legal provisions, and for determining responsible stewardship of the assets contributed by the ERS' members and their employers. This report will be provided to legislators, State and county officials, and other interested parties.

We would like to take this opportunity to express our gratitude to the Board of Trustees, the Staff, the advisors, and to the many people who work so diligently to help our members.

Respectfully yours,



David Shimabukuro
Administrator

Board of Trustees

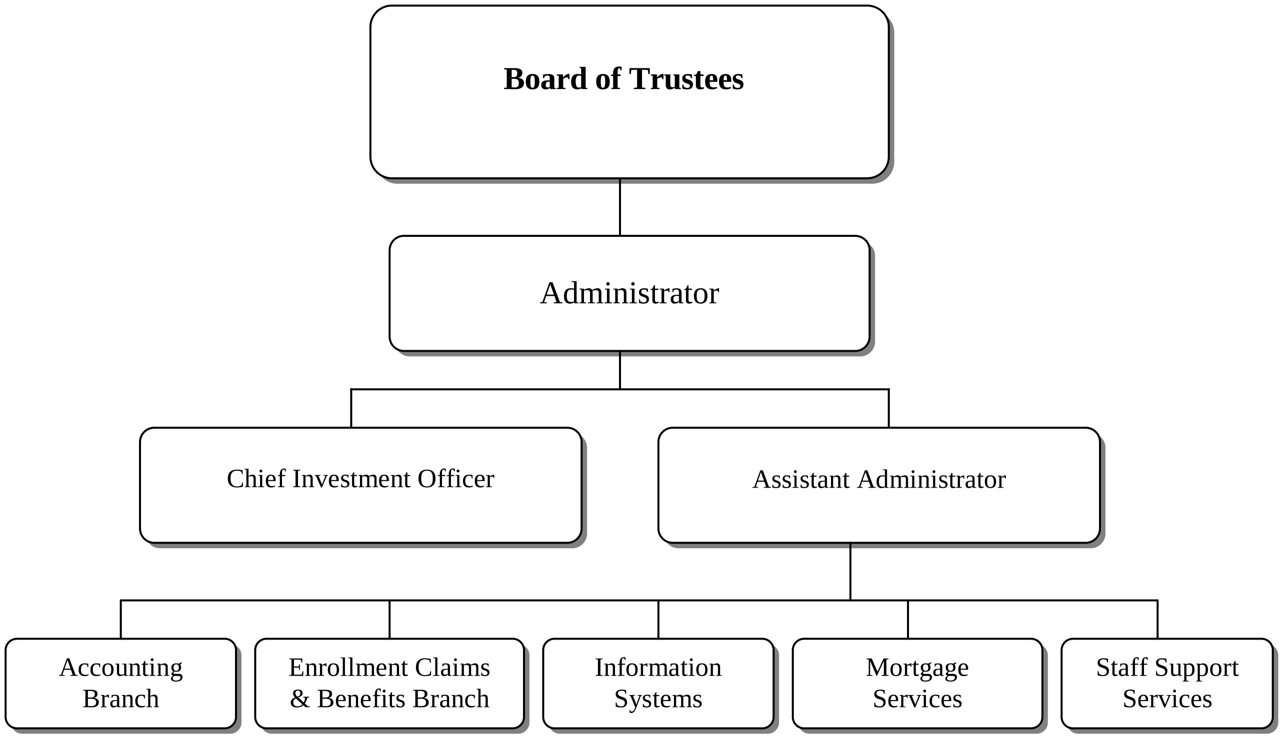
The Board of Trustees is the governing body of the Employees' Retirement System of the State of Hawaii, with certain areas of administrative control vested in the State Department of Budget and Finance.

Four of the eight members on the Board are elected by the membership: two general employees, a teacher and a retiree. Three members are citizens of the State, one of whom is an officer of a bank authorized to do business in the State or a person of similar experience, who are not employees and are appointed by the Governor. The State Director of Finance is an ex-officio member by statute.

Back Row (L-R): Darwin J. Hamamoto; Henry F. Beerman; Alton T. Kuioka, Jackie Ferguson-Miyamoto, Chair; Colbert M. Matsumoto.
Front Row (L-R) Georgina K. Kawamura; Pilialoha E. Lee Loy; Odetta U. Fujimori.

	Date Current Term Began	**Date Term Ends**
Elected:		
Mr. Darwin J. Hamamoto	January 2, 2000	January 1, 2006
Ms. Jackie Ferguson-Miyamoto, Chair	January 2, 2002	January 1, 2008
Ms. Odetta U. Fujimori	January 2, 2002	January 1, 2008
Ms. Pilialoha E. Lee Loy	January 2, 2004	January 1, 2010
Appointed:		
Mr. Colbert M. Matsumoto	May 14, 2001	January 1, 2007
Mr. Henry F. Beerman	July 1, 2003	January 1, 2009
Mr. Alton T. Kuioka	March 31, 2005	January 1, 2011
Ex-Officio:		
Ms. Georgina K. Kawamura	December 2, 2002	

Organizational Structure



Administrator	David Y. Shimabukuro
Assistant Administrator	Wesley K. Machida
Chief Investment Officer	T. Kimo Blaisdell

Actuary
Gabriel, Roeder, Smith and Company

Auditors
KPMG LLP

Legal Advisor
Attorney General of the State of Hawaii

Medical Board
Dr. Patricia L. Chinn, Chair
Dr. Gerald J. McKenna, Member
Dr. Inam U.R. Rahman, Member

** A list of investment professionals is located in the *Investment Section* of this CAFR.

Plan Summary

The Employees' Retirement System (ERS) of the State of Hawaii was established by the Legislature in 1925 to provide retirement, disability and survivor benefits for State employees, teachers, professors, county employees, police officers, firefighters, judges and elected officials.

The ERS is a qualified defined benefit pension plan under Section 401(a) of the Internal Revenue Code. As such, the ERS is exempt from federal income taxation on its investment earnings. Since January 1, 1988, member contributions have been tax deferred under Section 414(h) of the Internal Revenue Code.

Members are covered by the provisions of the Contributory or Noncontributory retirement plan. Those in the Contributory Plan are required to make contributions to the ERS and may also be covered by Social Security. Employees in the following occupational groups are required to be members of the Contributory Plan: police officers, firefighters, judges, elected officials, legislative officers, State and County department heads and deputies, attorney general investigators, and narcotics enforcement investigators. As of March 31, 2005, 8,897 active employees were enrolled in the Contributory Plan, or 14% of our active members.

Members of the Noncontributory Plan do not make contributions to the ERS and are covered by Social Security. The Noncontributory Plan covers most employees hired from July 1, 1984, as well as employees hired before that date who elected to join the plan. As of March 31, 2005, there were 54,176 active employees in the Noncontributory Plan, which represents almost 86% of all active members. Since most new employees are currently required to become members of the Noncontributory Plan, these numbers will continue to increase until June 2006.

On July 1, 2006, a new Hybrid Contributory Plan will become effective pursuant to Act 179/2004. Members in the Hybrid Plan will be eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the Hybrid Plan. The benefit payment options are similar to the current Contributory Plan. Almost 58,000 current members, all members of the Noncontributory Plan and certain members of the Contributory Plan, will be eligible to join the new Hybrid Plan. Most of the new employees hired from July 1, 2006 will be required to join the Hybrid Plan.

A summary of the general retirement benefits, including retirement options, for Contributory and Noncontributory members are on the following pages. For more detailed and current information on the Hybrid Plan please visit the ERS website at http://www4.hawaii.gov/ers/.

Summary of Retirement Benefit Plan Provisions

	Noncontributory Plan	**Contributory Plan**
Employee Contributions	No employee contributions	7.8% of salary
Normal Retirement		
Eligibility	Age 62 and 10 years credited service *or* Age 55 and 30 years credited service	Age 55 and 5 years credited service
Benefit	1-1/4% of average final compensation times years of credited service (Average final compensation or AFC is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation or if ERS membership occurred prior to 1/1/71, AFC may be an average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation.)	2% of average final compensation times years of credited service (Average final compensation or AFC is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation or if ERS membership occurred prior to 1/1/71, AFC may be an average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation.)
Early Retirement		
Eligibility	Age 55 and 20 years credited service	Any age and 25 years credited service
Benefit	Maximum allowance reduced 6% per year under age 62	Maximum allowance reduced 5% per year under age 55 plus 4% per year under age 50
Deferred Retirement		
Requirements	10 years credited service	5 years credited service and contributions left in the ERS
Benefit	Accrued maximum allowance payable at age 65	Accrued maximum allowance payable at age 55
Ordinary Disability		
Eligibility	10 years credited service	10 years credited service
Benefit	Accrued maximum allowance unreduced for age	1-3/4% AFC for each full year of credited service with a minimum of 30% AFC unreduced for age

Summary of Retirement Benefit Plan Provisions (continued)

	Noncontributory Plan	Contributory Plan
Service-Connected Disability (due to accident on the job)		
Eligibility	Any age or credited service	Any age or credited service
Benefit	35% of AFC unreduced for age for accidents on or after July 1, 2004	50% of AFC unreduced for age, and return of contributions for accidents on or after July 7, 1998.
	For accidents prior to July 1, 2004, accrued maximum allowance, but not less than 15% AFC unreduced for age	For accidents prior to July 7, 1998: Totally disabled: lifetime pension of 66-2/3% AFC plus annuity, unreduced for age. *or* Occupationally disabled: same benefit (66-2/3% of AFC plus annuity) paid for 3 years and then pension is reduced to 33-1/3% AFC if not totally disabled, unreduced for age.
Ordinary Death		
Eligibility	Active employee at time of death with at least 10 years of credited service	Active employee at time of death with at least 1 year of service
Benefit	Surviving spouse/reciprocal beneficiary and dependent children receive a benefit equal to a percentage of member's accrued maximum allowance unreduced for age or if member was eligible for retirement at the time of death, Option B (100% Joint and Survivor) benefit for surviving spouse/ reciprocal beneficiary and a percentage of member's accrued maximum allowance unreduced for age for the dependent children	Return of member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death or Option 2 (100% Joint and Survivor) benefit if member was eligible for retirement at the time of death and one beneficiary designated or Option 3 (50% Joint and Survivor) benefit if member was not eligible for retirement at the time of death, credited with 10 years of service, and one beneficiary designated
Service-Connected Death (due to accident on the job)		
Eligibility	Any age or service	Any age or service
Benefit	Surviving spouse/reciprocal beneficiary receive a pension of 30% AFC and each dependent children under age 18 receives a percentage of member's accrued maximum allowance or AFC, whichever is higher (the benefit is higher if there is no surviving spouse/ reciprocal beneficiary).	Return of member's contributions, and accrued interest plus pension of 50% AFC to surviving spouse, dependent children or dependent parents

Summary of Retirement Benefit Plan Provisions (continued)

The plan provisions summarized above apply to teachers and most State and County employees. Special provisions applicable to other groups of employees are outlined below:

A) Police officers, firefighters, investigators of the Department of the Prosecuting Attorney and the Attorney General, and narcotic enforcement investigators, contribute 12.2% of their monthly salary to the ERS instead of 7.8%. These members may retire at age 55 with 10 years of credited service or at any age with 25 years of credited service and receive a retirement benefit of 2-1/2% of average final compensation (AFC) for each year of such service up to a maximum of 80% AFC, provided the last 5 years is credited service in any of these occupations.

B) Judges, elected officials, and legislative officers may retire at age 55 with at least 5 years of credited service, or at any age with at least 10 years of credited service and receive a pension of 3-1/2% of AFC for each year of such service plus an annuity from their contributions allocable to the period of such service. This benefit cannot exceed 75% of the AFC. Judges hired after June 30, 1999 need 25 years of credited service in order to retire before age 55.

C) Sewer workers in specified classifications and water safety officers may retire at any age if they are credited with 25 years of such service with the last 5 or more years in these occupations.

D) Emergency medical technicians (EMT) may retire at any age if they are credited with 30 years of such service with the last 5 or more years in these occupations effective June 30, 2003. The years of service to qualify for early retirement is gradually being reduced through June 30, 2008 when 25 years of EMT service will qualify these members for early retirement.

Post Retirement Benefit

Each retiree's original retirement allowance is increased by 2.5% on each July 1 beginning the calendar year after retirement. This cumulative benefit is not compounded and increases each year by another 2.5% of the original retirement allowance without a ceiling (i.e., 2.5% of the original retirement allowance the first year, 5% the second year, 7.5% the third year, etc.).

Taxation of Benefits

All retirement benefits are subject to Federal income taxes but are exempt from Hawaii State income tax. Certain occupational (work related) disability benefits are exempt from Federal income taxes. Arrangements to initiate voluntary withholding of Federal income tax can be made at any time. The ERS also provides retirees with a 1099-R tax form on or before January 31 of each year.

Additional Benefits

Retirees, their spouses and dependent children under age 19 are eligible to receive life insurance, medical, dental, vision, and prescription drug coverage from the Employer-Union Health Benefits Trust Fund (EUTF) if they were hired before July 1, 1996, and retire with at least 10 years of continuous credited service. If they were first hired after June 30, 1996, health benefits are available on a cost-sharing basis as long as the member retires with at least 10 years of continuous service. A dependent of a retiree who is a full-time student at an accredited college, university or technical school and who is 19 through 23 years old is also eligible for coverage. A retiree with a hire date after July 1, 2001 will only receive coverage for him or herself on a cost sharing basis.

Summary of Retirement Benefit Plan Provisions (continued)

Unused sick leave is excluded from credited service in determining health benefit coverage.

Retirees will be responsible for premiums in excess of the amount of employer contributions. Retirees and their spouses are also eligible to receive a reimbursement of the Medicare Part B medical insurance premium. More information is available on the EUTF's website at http://www.eutf.hawaii.gov .

Applying for Retirement

A service retirement application can be filed with the ERS 150 days but no less than 30 days prior to the effective date of retirement. Once the application has been filed, cancellation prior to the effective date of retirement is permitted; however, the law requires mandatory retirement upon the third application. Members residing on the neighbor islands may obtain retirement information and application forms at the following locations:

Hawaii District Office
101 Aupuni Street, Suite 208
Hilo, Hawaii 96720

Kauai District Office
3060 Eiwa Street, Room 302
Lihue, Hawaii 96766

Maui District Office
54 S. High Street, Room 218
Wailuku, Hawaii 96793

Counseling Service

It is the policy of the ERS to render every possible service to its members; however, as thousands of inquiries are received and answered annually, in addition to the actual processing of claims and benefits, present staff and appropriations restrict this service to those members whose immediate welfare is dependent upon the prompt settlement of benefits. Members who are not planning immediate retirement but who are interested in their benefit status, should contact the ERS for the estimate worksheets that will enable them to do their own calculations. Members who are definite about retirement should contact the ERS to request formal retirement estimates. A retirement benefit calculator for members and other retirement information are also available on the ERS' website at http://www4.hawaii.gov/ers/ .

Retirement Options

CONTRIBUTORY PLAN

Maximum Allowance: The member receives a lifetime maximum allowance and at death, the difference between the value of the member's contributions at the time of retirement and the retirement allowance paid prior to death is paid to the designated beneficiary(ies) or estate.

Option One: The member receives a reduced lifetime allowance based on age and at death, the difference between the initial insurance reserve and the retirement allowance paid prior to death is paid to the designated beneficiary(ies) or estate.

Option Two (100% Joint and Survivor): The member receives a reduced lifetime allowance based on ages of both the member and the sole beneficiary and at death; the same allowance is paid to the designated beneficiary for life. Should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease at the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Option Three (50% Joint and Survivor): This plan is similar to Option Two. The member receives a reduced lifetime allowance which is higher than Option Two and is based on ages of both the member and the sole beneficiary; however, at death one-half of the allowance is paid to the designated beneficiary for life. Like Option Two, should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease at the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Option Four: This option allows the member to devise a plan that will provide a benefit according to the member's specifications. It requires certification by the Actuary and approval of the Board of Trustees. The following Option Four plans have been approved:

Combination of Options Five and Maximum Allowance: The member receives a reduced lifetime allowance and is allowed to withdraw the pre-1987 nontaxable contributions, 50% of accumulated contributions, or 75% of accumulated contributions; at death, the difference between the value of the member's contributions at the time of retirement and the retirement allowance paid prior to death is paid to the designated beneficiary(ies) or estate.

Combination of Options Five and One: The member receives a reduced lifetime allowance and is allowed to withdraw the pre-1987 nontaxable contributions, 50% of accumulated contributions, or 75% of accumulated contributions; at death, the difference between the initial insurance reserve and the retirement allowance paid prior to death is paid to the designated beneficiary(ies) or estate.

Combination of Options Five and Two: The member receives a reduced lifetime allowance based on ages of both the member and the sole beneficiary, and is allowed to withdraw the pre-1987 nontaxable contributions, 50% of accumulated contributions, or 75% of accumulated contributions; at death, the same allowance is paid to the designated beneficiary for life. As in the case of Option Two, should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease at the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Retirement Options (continued)

CONTRIBUTORY PLAN (continued)

Combination of Options Five and Three: The member receives a reduced lifetime allowance based on ages of both the member and the sole beneficiary, and is allowed to withdraw the pre-1987 nontaxable contributions, 50% of accumulated contributions, or 75% of accumulated contributions; at death, one-half of the allowance is paid to the designated beneficiary for life. As in the case of Option Three, should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease at the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Option Five: The member receives a reduced lifetime allowance and is allowed to withdraw all accumulated contributions; at death, the prorated amount from the last pension payment through the date of death is payable to the beneficiary(ies) or estate.

Option Four and Option Five are restricted to those members with at least ten years of credited service excluding unused sick leave credit.

Regardless of the option selected, should death of a Contributory member occur during the first year of retirement, the designated beneficiary may elect to receive benefits as if death had occurred immediately prior to retirement in lieu of the death benefits described above.

NONCONTRIBUTORY PLAN

Maximum Allowance: The member receives a lifetime pension and at death, the prorated amount from the last pension payment through the date of death is payable to the beneficiary(ies) or estate.

Option A (50% Joint and Survivor): The member receives a reduced lifetime pension and at death, one-half of the pension is paid to the sole designated beneficiary for life. Should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease upon the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Option B (100% Joint and Survivor): The member receives a reduced lifetime pension and at death, the same pension is paid to the sole designated beneficiary for life. Like Option A, should the designated beneficiary predecease the retiree, another beneficiary cannot be named and all payments will cease upon the retiree's death. For retirements on or after December 1, 2004, should the beneficiary predecease the retiree, the retiree’s reduced pension “pops up” or increases to the corresponding Maximum Allowance instead of remaining at the reduced amount.

Option C (Ten-Year Guarantee): The member receives a reduced lifetime pension. Should death occur within ten years of retirement, the same pension will be paid to the designated beneficiary for the balance of the ten-year period. Should the designated beneficiary predecease the retiree, another beneficiary can be named.

Effective for retiree deaths on or after July 1, 2004 regardless of the Noncontributory Option selected, should death occur during the first year of retirement, the designated beneficiary may elect to receive benefits as if death had occurred immediately prior to retirement in lieu of the death benefits described above.

Legislative Highlights 2005

The following Acts, sponsored by the ERS, were passed by the 2005 Legislature and approved by the Governor:

Act 56 — Actuarial Changes

- Authorizes the Board of Trustees to use the effect of the annual post retirement allowance as an actuarial assumption in determining retirement benefit options.

Act 57 — Authority to Settle Claims

- Allows the Board of Trustees with the approval of the Attorney General, to settle claims instead of having to litigate the claim through the courts.

Act 58 — Retirement Plan Changes

- Applies federal tax limits on compensation in determining ordinary death benefits.
- If federal tax issues are resolved, the member's cost to convert noncontributory service to the Hybrid Plan will be based on the member's membership service credits, age, and base pay on June 30, 2006.
- Eliminates deadlines to claim and purchase qualifying membership service credits in the Hybrid Plan.
- Requires contributions from the State and counties to be remitted to the ERS on a monthly basis.
- Includes various housekeeping amendments to clarify and conform existing statutes to current practice.

EMPLOYEES'
RETIREMENT SYSTEM
OF THE
STATE OF HAWAII

FINANCIAL SECTION

Independent Auditors' Report

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

The Board of Trustees
Employees' Retirement System of the State of Hawaii:

We have audited the accompanying combining statements of plan net assets – all trust and agency funds of the Employees' Retirement System of the State of Hawaii (the ERS) as of June 30, 2005 and 2004, and the related statements of changes in plan net assets – all trust funds for the years then ended. These financial statements are the responsibility of the ERS' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ERS' internal control over financial reporting. Accordingly, we express no such opinion. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the ERS as of June 30, 2005 and 2004, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Independent Auditors' Report (continued)

The Board of Trustees
Employees' Retirement System of the State of Hawaii

In accordance with *Government Auditing Standards,* we have also issued our report dated December 22, 2005, on our consideration of the ERS' 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 audits.

The management's discussion and analysis on pages 24 through 29 and the schedules of funding progress and employer contributions on pages 52 and 53 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 audits were conducted for the purpose of forming an opinion on the basic financial statements of the ERS taken as a whole. The supplementary information included in schedules 1 through 4 for the years ended June 30, 2005 and 2004, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic financial statements taken as whole for the years ended June 30, 2005 and 2004. The introductory, investment, actuarial, and statistical sections have not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we express no opinion on them.

KPMG LLP

Honolulu, Hawaii
December 22, 2005

Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) of the Employees' Retirement System of the State of Hawaii (the ERS) provides highlights and comparisons of the financial position and performance of ERS as of and for the years ended June 30, 2005 and 2004. The MD&A is presented as a narrative overview and analysis in conjunction with the Letter of Transmittal, which is included in the Introductory Section of the ERS Comprehensive Annual Financial Report (CAFR). For more detailed information pertaining to the ERS' financial activities, the reader should also review the actual financial statements, including the notes and supplementary schedules.

Overview of the Financial Statements

The ERS is responsible for administering a defined benefit pension plan for state, local government, and public education employees in the State of Hawaii (the State). The ERS also oversees short-term investment of the federal Social Security employer contributions for the State in the Social Security Contribution Fund (Contribution Fund).

The ERS financial statements include fiduciary type funds that are used to account for resources held for the benefit of parties outside of the ERS. The primary fund is defined as a pension trust fund as these assets are held for the benefit of its members and their beneficiaries for the payment of pension benefits, while the Contribution Fund is an agency type fund that is custodial in nature. Throughout this discussion and analysis, units of measure (i.e., billions, millions, and thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

This discussion and analysis is intended to serve as an introduction to the ERS financial reporting which is comprised of the following components:

- The combining statements of plan net assets provide a snapshot of the financial position of the ERS at June 30, 2005 and 2004. These financial statements reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal years reported.
- The statements of changes in plan net assets summarize the ERS' financial activities that occurred during the fiscal year from July 1, 2004 to June 30, 2005 (FY 2005) and the fiscal year from July 1, 2003 to June 30, 2004 (FY 2004). The financial statements measure the changes in the resources available to pay pension benefits to members, retirees, and beneficiaries for fiscal years 2005 and 2004.
- The notes to financial statements provide additional information that is essential to a full understanding of the financial statements. The notes are an integral part of the financial statements and include detailed information that is essential to a full understanding of the data provided in the basic financial statements.
- The required supplementary information immediately following the notes to financial statements provides two schedules showing historical actuarial information concerning the funded status of the ERS and the employer contributions, with related notes.
- The remaining supplementary information provides additional detailed information concerning the changes in operating funds established by legislation, and the operating and investment related expenses of the ERS.

Financial Highlights

- The plan net assets of the ERS increased by about 7.4% during the fiscal year ended June 30, 2005 to $9.2 billion, from $8.6 billion as of June 30, 2004, after experiencing an increase of 11.4% during fiscal year ended June 30, 2004. Net assets at June 30, 2003 were slightly less than $7.7 billion. The increase for the two recent fiscal years was largely attributed to the positive investment earnings of 11.3% in FY 2005 and 15.8% in FY 2004. The increase in net assets in FY 2005 was also attributed to higher employer contributions as discussed below. In FY 2003, investments returned only 3.0% and helped contribute to a decrease in net assets during the fiscal year.

- No significant legislation was enacted during the 2005 or 2004 legislative sessions that had a material impact on the financial position of the Pension Trust. Although legislation passed in 2004 to offer future retirees enhanced benefits with the enactment of a new contributory "Hybrid Plan" on July 1, 2006, there is no material effect on the ERS' financial position since these benefits are being offered on a cost-neutral basis to the employers. Please visit our website at www4.state.hi/ers for more information. See the "Legislative Highlights 2005" in the Introductory Section of the CAFR for a summary of the 2005 legislative changes affecting the ERS and its membership. There is also a historical summary of significant legislation impacting the ERS actuarial valuations in the "Summary of Plan Changes" located in the Actuarial Section of the CAFR.

- The actuarial funded ratio on June 30, 2005 decreased to 68.6% from 71.7% as of June 30, 2004, and 75.9% on June 30, 2003. The decrease in the funded ratio of the ERS continues to be driven by the four-year smoothing methodology used by the actuary which contains the unfavorable investment climate of the 2000 to 2002 bear market, when the investment returns were less than the 8.0% actuarial investment assumption. The remainder of unrecognized actuarial losses will be fully recognized during the next actuarial valuation as discussed below. The actuarial experience of the ERS is discussed in more detail as part of the actuarial section in the ERS' 2005 and 2004 CAFR.

- Total employee and employer contributions increased by approximately $95 million, or 32.7%, during the FY 2005 due primarily from an increase in the employer contributions. In FY 2004, there was an increase of almost $43 million, or 17.4%, from the prior year. The employer contributions for the past three years were based on the actuarial valuations as of June 30, 2002, 2001, and 2000. Employee contributions increased in FY 2005 as compared to FY 2004 due to pay raises, after experiencing a decrease in FY 2004 as compared to FY 2003. Employee contributions decreased slightly in FY 2004 as compared to FY 2003, with the continued decline in active contributory members due to retirements. Since 1984, almost all new members of the ERS are required to be enrolled in the Noncontributory Plan.

- Total pension plan benefit payouts continued their upward trend with a 6.3% increase during FY 2005 to $676.3 million as compared to FY 2004, after increasing 5.5% in FY 2004 as compared to FY 2003. The upward trend is expected to continue because of the increasing number of retirees and beneficiaries (33,301 in 2005 compared to 32,297 in 2004; and 31,389 in 2003), an increase in the average pension benefit for new retirees, and the annual 2.5% post retirement increase.

- Administrative expenses decreased by $3.2 million, to $7.3 million in FY 2005 from $10.5 million in FY 2004 after increasing by $3.7 million from $6.8 million in FY 2003. The amounts for all years were within the ERS budgeted amounts. Administrative expenses for the last three years peaked when certain capitalized assets relating to an office automation system were expensed in FY 2004. Legal expenses continued their downward trend during the three years as several lawsuits were completed. Categories that experienced increases during the three fiscal yeas are personnel related –negotiated pay raises, new positions, fringe benefits increases, and overtime – and medical board costs.

In FY 2005, the ERS started three significant multi-year projects that will improve the services and benefits to our members – develop a communications campaign for the new Hybrid Contributory Plan that becomes effective on July 1, 2006; design and implementation of a new pension management information computer system; and the member statement project.

Analysis of Plan Net Assets for Pension Trust

Summary of Plan Net Assets
June 30, 2005, 2004 and 2003
(Dollars in millions)

	2005	2004	FY 2005 % change	2003	FY 2004 % change
Assets					
Cash and short-term investments	$ 531.7	$ 694.7	(22.5)%	$ 521.6	33.2 %
Receivables	105.6	60.8	73.7	169.4	(64.1)
Investments	8,841.0	8,002.0	10.5	7,504.3	6.6
Invested securities lending collateral	607.1	637.1	(4.7)	486.0	31.1
Capital assets	3.2	1.5	113.7	4.8	(68.8)
Total assets	10,088.6	9,396.1	7.4	8,686.1	8.2
Liabilities					
Securities lending liability	607.1	637.1	(4.7)	486.0	31.1
Investment accounts and other payables	285.6	193.6	47.5	512.9	(62.3)
Total liabilities	892.7	830.7	7.5	998.9	(16.8)
Plan net assets	$ 9,195.9	$ 8,565.4	7.4	$ 7,687.2	11.4

Summary of Changes in Plan Net Assets
Years ended June 30, 2005, 2004,and 2003
(Dollars in millions)

	2005	2004	FY 2005 % change	2003	FY 2004 % change
Additions:					
Contributions	$ 385.8	$ 290.8	32.7 %	$ 247.8	17.4 %
Net investment income	931.7	1,236.4	(24.6)	146.1	746.3
Total additions	1,317.5	1,527.2	(13.7)	393.9	287.7
Deductions					
Retirement benefit payments	676.3	636.2	6.3	602.8	5.5
Refunds of contributions	3.4	2.3	49.7	2.6	(11.5)
Administrative expenses	7.3	10.5	(30.9)	6.8	54.4
Total deductions	687.0	649.0	5.9	612.2	6.0
Increase (decrease) in plan net assets	$ 630.5	$ 878.2	(28.2)	$ (218.3)	502.3

Investments, Investment Income, and Investment Expense

The ERS is a long-term investor and manages its pension assets with long-term objectives in mind. A primary element of the ERS' investment philosophy is diversification among various asset classes. The ERS makes estimates of long-term market returns and establishes an asset allocation strategy taking into account the risks associated with each asset class.

For FY 2005, the ERS earned 11.3% on its pension trust investments. Real estate, alternative investments, and international equity lead the investment classes with returns of 25.2%, 17.9%, and 17.1%, respectively. Due to the strong equity markets, net investment income increased in FY 2004 by almost $1.1 billion over FY 2003. Net investment income also includes net income from securities lending activities as an addition and investment expenses as a deduction.

The asset distribution of the ERS investment securities for the pension trust, excluding pending trade settlements and securities lending collateral, at June 30, 2005, 2004, and 2003 at fair market value is presented below. This presents a "snap shot in time" and will change throughout the year based on market returns and our rebalancing efforts. Please refer to the Investment Section of the CAFR for a discussion on asset allocation plan targets and investments by investment strategy.

Asset Class
June 30, 2005, 2004, and 2003
(Dollars in millions)

	2005	%	2004	%	2003	%
Short-term investments and cash	$ 531.7	5.7%	$ 694.7	8.0%	$ 521.6	6.5%
Equity securities	3,043.0	32.5	3,776.5	43.4	3,356.8	41.8
Fixed income	2,083.5	22.2	1,722.5	19.8	2,094.6	26.1
Index funds	2,639.6	28.2	1,605.7	18.4	1,178.7	14.7
Real estate	762.2	8.1	609.2	7.0	587.5	7.3
Real estate mortgages	13.0	0.1	14.1	0.2	37.1	0.5
Alternative investments	299.6	3.2	274.0	3.2	249.6	3.1
Total	$ 9,372.7	100.0	$ 8,696.7	100.0	$ 8,025.9	100.0

Investments in short-term securities and cash are held by external investment managers for liquidity to settle pending trades and investments, and should not exceed ten percent of the investments. Fluctuations will occur based on the trading activity and timing of the settlements. Although the total value of equity securities, including index funds and alternative investments, increased about $326 million during FY 2005 due to strong investment returns, the investment allocation decreased slightly as of June 30, 2005 with the funding of real estate managers. In FY 2004, the allocation to equities remained relatively constant after experiencing a slight decline in FY 2003 when the ERS experienced negative returns in both the domestic and international markets.

Fixed income holdings as of June 30, 2005 increased over $361 million to about 22.2% of the investment portfolio, compared to 19.8% on June 30, 2004. In FY 2004, the allocation to fixed income investments decreased since the asset class was used to pay for pension benefits in accordance with ERS' asset allocation strategy. The fixed income asset class was slightly higher on June 30, 2003 due to the strong performance in the fiscal year then ended.

Real estate related investments increased in FY 2005 with the strong performance of the asset class, and funding of an additional investment manager after remaining relatively stable during the past several years.

Investment expenses consist primarily of investment management fees paid to external investment advisor firms that oversee the ERS investment portfolio. Total investment expenses increased by over $2 million than the previous fiscal year, in both FY 2005 and FY 2004, due to the upward trend of asset values and related increase in performance fees for certain managers that have out performed their benchmarks.

ERS requires external managers to provide the ERS with a "most favored nations" contract clause that guarantees the ERS with the lowest management fees the managers offer their clients for investment accounts with similar investment mandates and similar account size. In FY 2003, investment expenses included litigation costs due to several foreclosures by ERS on loans secured by real estate.

Contributions

During FY 2005, contributions from employers and employees totaled $385.8 million compared to $290.8 million during FY 2004. The $93 million increase in employer contributions is in accordance with results of the actuarial valuation dated June 30, 2002. The increase in FY 2004 employer contributions of $23.1 million was based on the June 30, 2001 actuarial valuations. The ERS uses a four-year market smoothing actuarial methodology to calculate employer contributions and to help dampen some of the year-to-year fluctuations in investment earnings. Refer to the Actuarial Section in the ERS 2005 and 2004 CAFR for more information.

Employer contributions for FY 2004 also include the cost of a one-time lump sum bonus of $200 for certain retirees as a result of Act 233/2002.

Receipts from members have stayed relatively level during the last three years although there is a continuing decrease in number of contributory members.

Pension Plan Benefits and Expenses

The major expense during FY 2005 was for the payment of pension benefits totaling $676.3 million, $636.2 million during FY 2004, and $602.8 million in FY 2003. Pension benefits continued to increase during the three fiscal years due to the additional number of new retirees, higher pension benefits for recent retirees; and the annual post retirement increase for our retirees. Pension benefits for FY 2004 also included a one-time payment of $200 to certain pensioners in accordance with Act 233/2002. Refunds of employee contributions are in line with the declining number of contributory plan members.

Administrative expenses totaled almost $7.3 million during FY 2005 as compared to $10.5 million in FY 2004 and $6.8 million in FY 2003. Overall increases for the three years were primarily due to an increase in office automation projects, the expensing of certain assets previously capitalized, and filling of new staff positions. As discussed above, most of the FY 2004 office automation project expense was for the expensing of certain software development costs that were capitalized over the previous four years, in accordance with generally accepted accounting principles. Legal expenses continued the downward trend in FY 2005, after peaking in FY 2003, with the settlement of several lawsuits.

The FY 2005 decrease in office automation and legal expenses was offset by an increase in personnel-related costs; medical board costs and general expense increases related to member and pensioner communications, new projects, overtime, and staff training. Personnel-related costs also increased due to negotiated pay raises for employees, fewer vacant positions in FY 2005, and an increase in the fringe benefit rates. The FY 2005 administrative expenses include the initial costs related to three significant multi-year projects that will improve the services and benefits to our members – the new Hybrid Contributory Plan , a new computer system, and the member statement project costs.

Management's Discussion and Analysis (continued)

The FY 2004 administrative expense included an increase in personnel costs due to negotiated pay raises for employees, new authorized and established positions, fewer vacant positions during FY 2003, overtime, and an increase in the fringe benefit rate. Repairs and maintenance decreased in FY 2004 with the retirement of old computer equipment that was in service for 10 to 15 years.

Pension Plan Changes

Pension plan changes, including legislative and Board of Trustees' actions, are summarized in the Introductory Section and Actuary Report Section of the CAFR. Benefit enhancements approved in FY 2004 for members are being implemented on a cost-neutral basis to the employers.

Actuarial Valuations and Funded Status

The ERS uses an actuarial reserve type of funding that is financed by member contributions, employer contributions, and earnings from invested assets. An independent actuarial valuation of the ERS actuarial assets and liabilities is performed annually. As part of this valuation, the progress toward funding pension obligations of the retirement system is measured by comparing the actuarial value of assets to actuarial accrued liability. This measurement is referred to as the funded ratio or funded status. The actuarial funded status declined to 68.6% as of June 30, 2005 from 71.7% on June 30, 2004. The actuarial funded status at June 30, 2003 was 75.9%. The decrease in the funded ratio is primarily the result of the four-year smoothing methodology and includes the effects of unfavorable investment returns in FY 2002 and FY 2003.

At June 30, 2005, the ERS's unfunded actuarial accrued liability increased to $4.1 billion from $3.5 billion on June 30, 2004. The difference between the actuarial value of the assets and the market value of the assets on June 30, 2005 was about $281 million. This compares with $232 million in actuarially deferred losses as of June 30, 2004 and $1.2 billion actuarially deferred losses at June 30, 2003. The actuarially deferred gains as of June 30, 2005 will be recognized by the actuary over the next three actuarial valuations.

The employers' past practice of using the ERS' excess investment earnings to reduce their contributions also had an adverse impact on the ERS' funded ratio and unfunded actuarial accrued liability. The diversion prevented the ERS from establishing reserves to weather periods of weak investment returns and capturing the earnings potential of the contributions when markets rise.

Requests for Information

This financial report is designed to provide a general overview of the Employees' Retirement System of the State of Hawaii's finances. For questions concerning any information in this report or for additional information, contact the Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Financial Statements

Combining Statements of Plan Net Assets – All Trust and Agency Funds

June 30, 2005 and 2004

	2005		
	Pension Trust	Agency	
	Employees' Retirement System	Social Security Contribution	Total
Assets			
Cash and short-term investments (notes C(2) and F)			
Cash	$ 19,178,328	$ 1,082,875	$ 20,261,203
Short-term investments	512,510,416	5,558,867	518,069,283
	531,688,744	6,641,742	538,330,486
Receivables			
Accounts receivable and others	592,522	-	592,522
Investment sales proceeds	74,899,497	-	74,899,497
Accrued investment income	29,593,513	-	29,593,513
Employer appropriations	-	6,108,225	6,108,225
Member contributions	493,167	-	493,167
	105,578,699	6,108,225	111,686,924
Investments, at fair value (notes C(2) and F)			
Equity securities	3,043,025,609	-	3,043,025,609
Fixed income securities	2,083,543,825	-	2,083,543,825
Index funds	2,639,649,110	-	2,639,649,110
Real estate investments	762,233,064	-	762,233,064
Alternative investments	299,573,729	-	299,573,729
Real estate mortgages	12,989,435	-	12,989,435
	8,841,014,772	-	8,841,014,772
Other			
Invested securities lending collateral (note F)	607,087,118	-	607,087,118
Equipment, at cost, net of depreciation	3,205,207	-	3,205,207
	610,292,325	-	610,292,325
Total assets	10,088,574,540	12,749,967	10,101,324,507
Liabilities			
Disbursements in excess of cash balances (note F)	1,751,105	-	1,751,105
Accounts and other payables	25,425,475	-	25,425,475
Investment commitments payable	258,442,902	-	258,442,902
Payable to Internal Revenue Service	-	6,910,793	6,910,793
Due to employers	-	5,839,174	5,839,174
Securities lending collateral (note F)	607,087,118	-	607,087,118
Total liabilities	892,706,600	12,749,967	905,456,567
Commitments and contingencies (notes F, G, and H)			
Net assets held in trust for pension benefits (note D) (a schedule of funding progress is presented on page 52)	$ 9,195,867,940	$ -	$ 9,195,867,940

See accompanying notes to financial statements.

Financial Statements

2004		
Pension Trust	Agency	
Employees' Retirement System	Social Security Contribution	Total
$ 34,555,603	$ 1,023,206	$ 35,578,809
660,118,573	1,341,713	661,460,286
694,674,176	2,364,919	697,039,095
1,129,902	-	1,129,902
31,519,740	-	31,519,740
27,583,055	-	27,583,055
-	5,733,390	5,733,390
574,383	-	574,383
60,807,080	5,733,390	66,540,470
3,776,482,422	-	3,776,482,422
1,722,464,847	-	1,722,464,847
1,605,690,512	-	1,605,690,512
609,169,471	-	609,169,471
274,046,792	-	274,046,792
14,174,954	-	14,174,954
8,002,028,998	-	8,002,028,998
637,120,873	-	637,120,873
1,479,796	-	1,479,796
638,600,669	-	638,600,669
9,396,110,923	8,098,309	9,404,209,232
3,200,030	-	3,200,030
18,683,515	-	18,683,515
171,701,368	-	171,701,368
-	6,696,432	6,696,432
-	1,401,877	1,401,877
637,120,873	-	637,120,873
830,705,786	8,098,309	838,804,095
$ 8,565,405,137	$ -	$ 8,565,405,137

Financial Statements (continued)

Statements of Changes in Plan Net Assets – All Trust Funds

Years ended June 30, 2005 and 2004

	2005	2004
Additions		
Appropriations and contributions (notes A(4) and E)		
Employers	$ 328,716,718	$ 235,685,796
Members	57,054,621	55,116,452
Total contributions	385,771,339	290,802,248
Investment income (note F)		
From investing activities		
Net appreciation in fair value of investments	716,329,575	1,010,011,713
Interest on fixed income securities	88,214,234	87,975,406
Dividends on equity securities	68,500,487	87,501,229
Interest and fees on real estate mortgages, net	747,985	2,930,482
Interest on short-term investments	6,018,488	1,599,794
Income on real estate investments	42,342,885	45,399,209
Alternative investment income	33,763,274	23,506,976
Miscellaneous	3,001,093	2,002,347
	958,918,021	1,260,927,156
Less investment expenses	28,303,374	26,015,189
Net investment income from investing activities	930,614,647	1,234,911,967
From securities lending activities		
Securities lending income	11,959,363	6,953,448
Securities lending expenses		
Borrower rebates	10,589,988	5,074,777
Management fees	273,839	375,711
Less securities lending activities expense	10,863,827	5,450,488
Net investment income from securities lending activities	1,095,536	1,502,960
Total net investment income	931,710,183	1,236,414,927
Total additions	1,317,481,522	1,527,217,175
Deductions		
Benefit payments (note A3)	676,316,347	636,214,617
Refunds of member contributions	3,442,466	2,328,796
Administrative expenses	7,259,906	10,468,508
Total deductions	687,018,719	649,011,921
Net increase in net assets	630,462,803	878,205,254
Net assets held in trust for pension benefits (note D)		
Beginning of year	8,565,405,137	7,687,199,883
End of year	$ 9,195,867,940	$ 8,565,405,137

See accompanying notes to financial statements.

June 30, 2005 and 2004

Note A – Description of the ERS

1. General

The Employees' Retirement System of the State of Hawaii (the ERS) began operations on January 1, 1926, having been established by the Territorial Legislature in the preceding year. The ERS is a cost-sharing, multiple-employer public employee retirement system established to administer a pension benefits program for all State and county employees, including teachers, police officers, firefighters, correction officers, judges, and elected officials.

Employer, pensioner, and employee membership data as of March 31, 2005 and 2004:

	2005	2004
Employers:		
State	1	1
Counties	4	4
Total employers	5	5
Pensioners and beneficiaries currently receiving benefits:		
Pensioners currently receiving benefits:		
Police and firefighters	2,700	2,636
All others	28,644	27,867
Total pensioners	31,344	30,503
Beneficiaries currently receiving benefits:		
Police and firefighters	144	136
All others	1,813	1,658
Total beneficiaries	1,957	1,794
Total pensioners and beneficiaries	33,301	32,297
Terminated vested members entitled to benefits but not yet receiving benefits:		
Police and firefighters	176	140
All others	4,762	4,361
Total terminated vested members	4,938	4,501
Current employees:		
Vested:		
Police and firefighters	3,766	3,634
All other employees	32,209	32,569
Nonvested:		
Police and firefighters	920	1,086
All other employees	26,178	25,284
Total current employees	63,073	62,573

Note A – Description of the ERS (continued)

2. The Financial Reporting Entity

As required by accounting principles generally accepted in the United States of America, these financial statements present the ERS (the primary government) as a separate reporting entity from the State of Hawaii (the State). The ERS is not part of the State's financial reporting entity because it is a separate legal entity that is fiscally independent of the State. The ERS was established by Chapter 88 of the Hawaii Revised Statutes and is governed by a board of trustees (the Board) as discussed below. The ERS is comprised of the Employees' Retirement System and Social Security Contribution Funds.

The Board administers the ERS on behalf of public employees of both the State and county governments. Except for limited administrative functions, the State does not have the power to supervise or control the Board in the exercise of its functions, duties, and powers. The Board consists of eight members. The State Director of Finance is a statutory member of the Board. Four members of the Board are elected by members of the ERS and the other three members of the Board are appointed by the Governor. Decisions are made with the concurring vote of five members of the Board. The Board appoints the Administrator and Chief Investment Officer and engages actuarial and other services required to transact the business of the ERS.

3. Benefits

Members of the ERS belong to either the contributory or noncontributory plan. All assets of the ERS (in the Pension Trust) may be used to pay benefits to any member of the ERS. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Most members of the contributory plan are required to contribute 7.8% of their salary. Both plans provide a monthly retirement allowance based on the member's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, or three highest paid years of service, excluding the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively.

Ordinary disability retirement benefits require a minimum of ten years of service, whereas service-connected disability resulting from a job-related accident does not have any service requirement. Under both plans, there is no age requirement.

Ordinary death benefits under the contributory and noncontributory plans require at least one year and ten years of service, respectively. Under both plans, there is no service requirement for service-connected death benefits.

Notes to Financial Statements (continued)

Note A – Description of the ERS (continued)

3. Benefits (continued)

Retirement benefits for certain groups of contributory members, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees. All contributions, benefits, and eligibility requirements are governed by Chapter 88 of the Hawaii Revised Statutes.

Every retiree's original retirement allowance is increased by 2-1/2% on each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2-1/2% of the original retirement allowance without a ceiling (2-1/2% of the original retirement allowance the first year, 5% the second year, 7-1/2% the third year, etc.).

4. The ERS as Employer

As an employer, the ERS participates in its pension benefits program, through the State of Hawaii. The ERS provides benefits for all of its full-time employees through the Contributory or Noncontributory Plan. Contributions are calculated as part of the State's total contribution requirements and are reimbursed to the State's General Fund as part of the fringe benefit rate on ERS employees' actual salaries.

The required pension contributions by the ERS for the years ended June 30, 2005, 2004, and 2003, were $359,320, $293,331, and $284,666, respectively, which represented 10.8%, 9.1%, and 8.9% of covered payroll and were equal to the required contributions for each year.

Note B – Social Security Contribution Fund

The Social Security Contribution Fund (Contribution Fund) was established under Section 88-224 of the Hawaii Revised Statutes for the following purposes:

1. To receive all federal Social Security employers' contributions from the State and interest and penalties on unpaid amounts;

2. To receive any appropriations to the Contribution Fund;

3. To pay amounts required to be paid to the Internal Revenue Service (IRS); and

4. To invest and collect income on resources held by the Contribution Fund.

All other non-State governmental agencies remit Social Security contributions directly to the IRS. Social Security contributions withheld from employees are remitted directly to the IRS by the employers. The Contribution Fund is considered an agency fund for financial reporting purposes.

Note C – Summary of Accounting Policies

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows:

1. Basis of Accounting

Fiduciary funds are used to account for assets held by the ERS in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds. The fiduciary fund types used by the ERS are a pension trust fund and an agency fund. Each of the fiduciary funds is considered a separate fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, equity, revenues and expenditures, or expenses, as appropriate. The accounting and reporting treatment applied to a fund is determined by its measurement focus. The Pension Trust Fund is accounted for on a flow of economic resources measurement focus. As an agency fund, the Contribution Fund is custodial in nature and does not measure results of operations.

The financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

2. Investments

Pursuant to Sections 88-119 and 88-119.5 of the Hawaii Revised Statutes, the Pension Trust may invest in real estate loans and mortgages; preferred and common stocks; government obligations; corporate obligations; certain other debt obligations (such as obligations secured by collateral of certain other authorized securities listed here, obligations issued or guaranteed by certain development banks, insurance company obligations); real property; alternative investments; and other securities and futures contracts. The investment decision is further dictated by internal investment policies and asset allocation established by the Board of Trustees. Assets in the Pension Trust may be invested in any of these assets, while investments in the Contribution Fund are limited to investment grade, short-term marketable securities.

Investments are reported at fair value. Where appropriate, the fair value includes disposition costs. Short-term investments are reported at cost, which approximates fair value. Securities (categorized as fixed-income, equity, index funds, and alternative investments) traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments. The fair value of real estate investments is based on independent appraisals and estimated values. Investments that do not have an established market are reported at estimated fair value.

Notes to Financial Statements (continued)

Note C – Summary of Accounting Policies (continued)

3. Interest and Earnings Allocation

Pursuant to Sections 88-21 and 88-107 of the Hawaii Revised Statutes, the Board shall annually allocate interest and other earnings of the Pension Trust to the funds of the Pension Trust, as follows:

a. Annuity Savings Fund – Fixed at 4-1/2% regular interest rate

b. Expense Fund – To be credited with all money to pay the administrative expenses of the ERS

c. Pension Accumulation Fund – To be credited with any remaining investment earnings.

4. Risk Management

The ERS reports liabilities, as discussed in note G, related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters, and injuries to employees) when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

5. New Accounting Pronouncements

During 2005, the ERS adopted the provisions of the Government Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No.3*. The provisions of this statement update the custodial credit risk disclosure requirements of Statement No. 3 and establish more comprehensive disclosure requirements addressing other common risks of deposits and investments of state and local governments. The effect of this disclosure does not have a material effect on the ERS' financial statements.

6. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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.

7. Reclassifications

Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation. Such reclassifications had no effect on previously reported changes in plan net assets.

Note D – Description of Funds

Section 88-109 of the Hawaii Revised Statutes requires the establishment and maintenance of specific funds within the ERS. The funds in the Pension Trust and their purposes are described hereunder:

1. **Pension Accumulation Fund**

   To accumulate contributions made by the State and counties, transfers of retired members' contributions plus related interest income from the Annuity Savings Fund and income from investments. All pension benefits, including the pensioners' bonus, are paid through this fund.

2. **Annuity Savings Fund**

   To accumulate members' contributions and related interest income. Upon a member's retirement, the accumulated contributions and related interest income are transferred to the Pension Accumulation Fund or refunded to the member upon termination.

3. **Expense Fund**

   To pay all the expenses necessary in connection with the administration and operation of the ERS. The Board estimates the amount of money necessary to be paid into the expense fund for the ensuing biennium to provide for the expense of operation of the ERS, and pays that amount into the expense account from the investment earnings of the ERS, subject to review by the legislature and approval by the Governor.

Net assets held in trust for pension benefits as of June 30, 2005 and 2004 are as follows:

	2005	2004
Pension Accumulation Fund	$8,274,890,093	$7,653,613,762
Annuity Savings Fund	903,554,875	906,543,513
Expense Fund	17,422,972	5,247,862
Total net assets held in trust for pension benefits	$9,195,867,940	$8,565,405,137

Note E – Contributions

The ERS' funding policy provides for periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that the employer contributions, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate sufficient assets to pay benefits when due. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contribution is comprised of the "normal cost" plus the level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029. The employer normal cost is the level percentage of payroll contribution required to pay all benefits. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer unfunded accrued liability.

Notes to Financial Statements (continued)

Note E – Contributions (continued)

Most members of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary.

Employer and member contributions are governed by Chapter 88 of the Hawaii Revised Statutes. The annual required employer contributions for the years ended June 30, 2005 and 2004, were determined as part of actuarial valuations dated June 30, 2002 and 2001, respectively.

Note F – Deposits and Investment Risk Disclosures

1. Deposits

Custodial Credit Risk for Deposits is the risk that in the event of a bank failure, the ERS' deposits may not be returned to them. The ERS' policy is to deposit cash in excess of operating requirements in income producing investments to maximize investment income.

The deposits are held in several financial institutions, including the custodian bank for processing investment transactions. Deposits, held by banks located in the State of Hawaii, in excess of Federal Deposit Insurance Corporation ("FDIC") coverage are guaranteed by securities pledged as collateral by the bank with the State Director of Finance. Uninsured and uncollateralized amounts are primarily cash held by the investment custodian for settlement of investment transactions. The float caused by outstanding checks in the operating funds is invested, thus causing a possible negative book balance. Deposits are presented in the basic financial statements at cost, which represents market or fair value. The float for outstanding checks is included in the liabilities section of the Combining Statement of Plan Net Assets.

At June 30, 2005 and 2004, the carrying amount of deposits totaled approximately $18,510,098 and $32,378,779, respectively, and the corresponding bank balance was $22,230,054 and $35,432,747, respectively, of which $21,152,158 and $34,757,390, respectively, were exposed to custodial credit risk. The following shows the aggregate book and bank balances of all cash accounts.

Carrying Amount of Deposits	**Book**	
	June 30, 2005	June 30, 2004
Cash	$20,261,203	$35,578,809
Disbursements in excess of cash balances	(1,751,105)	(3,200,030)
Total book balances	$18,510,098	$32,378,779

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

1. Deposits (continued)

Depository Account	**Bank/Investment Custodian** June 30, 2005	June 30, 2004
Insured	$ 1,077,896	$ 675,357
Subject to custodial credit risk		
Uninsured and collateral held by pledging bank's trust department not in the ERS' name (in name of Director of Finance, State of Hawaii)	5,028,325	1,993,064
Uninsured and uncollateralized	16,123,833	32,764,326
Total subject to custodial credit risk	21,152,158	34,757,390
Total bank balances	$22,230,054	$35,432,747

2. Investments

As a long-term investor, the ERS has established through its investment policy that preservation of capital as the primary goal of the ERS. Preservation of capital is to be attained with a consistent, positive return for the fund by diversifying the investment portfolio. The ERS recognizes risk associated for individual securities or asset classes may be reduced through diversification. Investments will be prudent and consistent with the best investment practices, in accordance with the Board's asset allocation strategy, assigned investment mandate, and in compliance with Chapter 88, H.R.S. The following table shows the investments of the ERS by investment type as of June 30, 2005 and 2004. Please refer to Note A2 above for a discussion of fair value on investments.

Investments	June 30, 2005	June 30, 2004
Short-term securities pool, Social Security Contribution Fund	$ 5,558,867	$ 1,341,713
Short-term securities	230,184,928	327,594,833
Short-term securities pools	238,496,311	217,232,482
Debt securities, domestic	1,130,889,396	968,560,416
Debt securities, international	712,835,289	595,607,037
Equity securities, domestic	2,164,913,504	2,611,701,056
Equity securities, international	344,136,227	571,611,162
Mortgage loans	12,989,435	14,174,954
Real estate investments	762,233,064	609,169,471
Alternative investments	299,573,729	274,046,792
Equity securities, domestic (pooled including index funds)	1,522,856,309	1,006,501,032
Equity securities, international (pooled including index funds)	1,343,170,907	859,932,238
Investments held by broker-dealers under securities lending program (excluding securities sold, pending trade settlement):		
Short-term investments	43,829,177	115,291,258
Debt securities, domestic	234,062,589	156,361,840
Debt securities, international	5,756,551	1,935,554
Equity securities, domestic	230,515,880	203,547,366
Equity securities, international	77,081,892	128,880,080
Total investments	$ 9,359,084,055	$ 8,663,489,284
Securities lending collateral pool	$ 607,087,118	$ 637,120,873

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

3. Credit Risk Debt Securities

The ERS fixed-income managers are assigned a domestic - "core bond" or "core bond plus" – or an international mandate by the Board. ERS expects its debt securities investment managers to maintain diversified portfolios by using the following guidelines:

- Securities with a quality rating of below BBB are considered below investment grade.
- Invest in commercial paper (rated A1/P1); certificates of deposits and bankers acceptance; U.S. government and agency securities; 144A private placements; convertible bonds; collateralized mortgage obligations and asset backed securities; and corporate debt issues rated BBB or better.
- Domestic managers assigned a "core bond plus" mandate may:
  - Invest in preferred stock up to 10% of portfolio market value.
  - Allocate up to 15% in below investment grade or nonrated instruments, but the average credit rating for this "high yield" portion may not be below B rating.
    - Emerging market debt of up to 7.5% of portfolio (counted against the 15% below investment grade limit) must be owned by U.S. dollar denominated issues only; must be B rating or higher; and limited to countries in the JP Morgan Emerging Bond Index.
  - Allocate up to 15% of portfolio to non-U.S. dollar bonds (exclusive of any emerging market debt, which is applied to high yield allocation as outlined above).
- International managers may:
  - Not invest in U.S. dollar denominated securities, with the exception of cash equivalents.
  - Invest in foreign government securities and foreign corporate debt issues as described above for domestic securities.
  - Foreign debt securities are restricted to BBB or better quality rating.
  - Invest up to 10% of portfolio in emerging market debt and emerging market currency.

A table of the ERS debt securities as of June 30, 2005 and 2004 is below. The weighted quality rating average of the domestic debt securities, excluding pooled investments, at June 30, 2005 is AA and the fair value of below grade investments is $109,788,049 or 8.0% of the domestic section in the portfolio. The weighted average of the international debt securities investments at June 30, 2005 is AA and the fair value of below grade investments is $44,797,191 or 6.2% of the international section. On June 30, 2004, the weighted quality rating average of the domestic debt securities, excluding pooled investments, is AA and the fair value of below grade investments is $67,099,876 or 6.0% of the domestic section in the portfolio. The weighted average of the international debt securities investments is AA and the fair value of below grade investments is $7,039,963 or 1.2% of the international section. All short-term investments, not held in a pooled investment, are rated A1/P1 or better.

4. Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the ERS will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. All securities, except certain pooled funds, are registered in the name of the ERS and are held in the possession of the ERS custodial bank, State Street Bank and Trust. Pooled funds not held by the custodial bank, such as certain equity investments, are registered in the name of the ERS.

Note F – Deposits and Investment Risk Disclosures (continued)

5. Concentrations of Credit Risk

The ERS debt securities managers are expected to maintain diversified portfolios by sector, quality, and maturity as discussed above in Credit Risk Debt Securities.

Equity securities shall be diversified by industry and in number. An investment manager may not hold more than 5% an individual company's stock; if that company's securities represent less than 3% of the investment manager's respective benchmark. (If those securities constitute more than 3% of the respective benchmark, then the manager shall not hold more than the benchmark weight plus 2 percentage points.)

At June 30, 2005 and 2004, there was no single issuer exposure within the ERS portfolio that comprises over 5% of the overall portfolio, or an investment that exceeded the above manager guidelines, and therefore, there is no concentration of credit risk.

Quality Rating	June 30, 2005			June 30, 2004		
	Domestic	International	Total	Domestic	International	Total
AAA	$ 711,854,681	$452,815,506	$1,164,670,187	$ 556,779,621	$303,664,243	$ 860,443,864
AA	14,026,362	129,328,361	143,354,723	22,988,085	178,309,803	201,297,888
A	90,943,675	64,149,420	155,093,095	81,283,455	85,803,285	167,086,740
BBB	139,282,769	27,501,362	166,784,131	204,335,569	22,725,297	227,060,866
BB	78,179,478	16,165,912	94,345,390	40,952,525	6,840,522	47,793,047
B	19,272,735	3,415,863	22,688,598	18,831,125	-	18,831,125
CCC	4,995,500	-	4,995,500	4,740,875	-	4,740,875
CC	2,273,499	-	2,273,499	2,173,579	-	2,173,579
Not rated	5,066,837	25,215,416	30,282,253	401,772	199,441	601,213
Total credit risk debt securities	1,065,895,536	718,591,840	1,784,487,376	932,486,606	597,542,591	1,530,029,197
U.S. government and agencies	299,056,449	-	299,056,449	192,435,650	-	192,435,650
Total debt securities investments	$1,364,951,985	$718,591,840	$2,083,543,825	$1,124,922,256	$597,542,591	$1,722,464,847

6. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The ERS has not adopted a formal policy that limits investment maturities as a means of managing its exposure to fair value changes arising from changing interest rates. External investment managers are given full discretion within their operational guidelines and are expected to maintain a diversified portfolio between and within sectors, quality, and maturity.

Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. At June 30, 2005 and 2004, the table below

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

6. Interest Rate Risk (continued)

shows debt investment securities by investment type, amount, and the effective weighted duration for the ERS total portfolio. Interest rate risk associated with swaps and other derivative instruments are discussed in the derivatives disclosure below:

Effective Duration of Fixed Income Assets by Security Type

	June 30, 2005		June 30, 2004	
Domestic Debt Investment	Fair value	Effective Weighted Duration (Years)	Fair value	Effective Weighted Duration (Years)
Asset backed securities	$ 78,430,255	0.9	$ 75,171,821	1.0
Commercial mortgage backed securities	54,506,607	4.9	30,400,264	4.6
Corporate bonds	329,492,561	4.8	347,393,695	4.7
Fixed income options, futures, and swaps	(115,938)	n/a	(1,843,657)	n/a
Government agencies	40,811,964	2.2	53,944,018	7.9
Government bonds	41,236,609	7.8	55,661,641	2.7
Government mortgage backed securities	505,392,909	2.5	375,344,678	3.3
Municipal/provincial bonds	16,963,708	10.1	27,606,616	8.3
Non-government backed C.M.O's	42,856,330	2.8	23,463,619	2.9
Other fixed income	1,152,180	2.6	1,005,553	0.0
U.S. Treasuries	254,224,800	6.8	136,774,008	5.5
Total debt securities investments, domestic	$ 1,364,951,985	4.1	$ 1,124,922,256	4.2

	June 30, 2005		June 30, 2004	
International Debt Investment	Fair value	Effective Weighted Duration (Years)	Fair value	Effective Weighted Duration (Years)
Asset backed securities	$ 4,382,439	7.5	$ 744,801	0.0
Corporate bonds	198,684,866	5.2	164,319,544	4.9
Fixed income options, futures, and swaps	(6,862,928)	n/a	(2,493,945)	n/a
Government agencies	1,745,803	3.9	2,200,567	14.1
Government bonds	498,469,724	6.6	403,238,137	5.6
Non-government backed C.M.O's	19,180,933	1.1	21,617,970	3.8
Other fixed income	2,991,003	0.0	7,915,517	6.1
Total debt securities investments, international	$ 718,591,840	6.1	$ 597,542,591	5.4

7. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The foreign currency risk exposure to the ERS arises from the international fixed income and international equity investment holdings. External investment managers authorized to invest in these securities are given full discretion for what action to take regarding their respective portfolio's foreign currency exposures, including using currency forward contracts, as established by their investment mandate.

Note F – Deposits and Investment Risk Disclosures (continued)

7. Foreign Currency Risk (continued)

The following table summarizes the ERS' exposure to foreign currency risk in U.S. dollars as of June 30, 2005 and 2004. (Amounts are in millions, and securities denominated in U.S. dollars are not presented.)

	June 30, 2005				June 30, 2004			
Currency (dollars in millions)	Cash	Fixed Income	Equity	Total	Cash	Fixed Income	Equity	Total
Australian Dollar	$ -	$ -	$ 7	$ 7	$ 1	$ -	$ 13	$ 14
Brazilian Real	-	-	1	1	-	-	-	-
Canadian Dollar	-	17	1	18	-	27	6	33
Swiss Franc	-	-	20	20	-	-	69	69
Czech Koruna	-	-	2	2	-	-	-	-
Danish Krone	-	5	1	6	-	5	-	5
Euro	1	405	91	497	4	374	217	595
British Pound Sterling	-	39	39	78	1	56	137	194
Hong Kong Dollar	-	-	17	17	-	-	17	17
Hungarian Forint	-	-	3	3	-	25	-	25
Indonesian Rupiah	-	-	1	1	-	-	1	1
Japanese Yen	6	104	35	145	26	82	111	219
Korean Won	-	-	21	21	-	-	18	18
Mexican Peso	-	-	3	3	-	-	1	1
Malaysian Ringgit	-	-	3	3	-	-	-	-
Norwegian Krone	-	-	4	4	-	-	1	1
New Zealand Dollar	-	32	-	32	-	1	-	1
Philippines Peso	-	-	-	-	-	-	1	1
Polish Zloty	1	15	10	26	-	8	-	8
Romanian Leu	-	-	1	1	-	-	-	-
Swedish Krona	-	-	9	9	-	4	6	10
Singapore Dollar	-	13	4	17	-	-	7	7
Thai Baht	-	-	4	4	-	-	-	-
New Turkish Lira	-	-	11	11	-	-	1	1
New Taiwan Dollar	-	-	10	10	-	-	-	-
South African Rand	-	-	6	6	-	-	-	-
Pooled investments (multi-currency)	-	-	1,343	1,343	-	-	860	860
Total	$ 8	$ 630	$ 1,647	$ 2,285	$ 32	$ 582	$ 1,466	$ 2,080

8. Securities Lending

The ERS participated in a securities lending program administered by its bank custodian. Under this program, which is permissible under Chapter 88 of the Hawaii Revised Statutes, certain equity and fixed-income securities of the ERS were lent to participating broker-dealers and banks (borrowers). In return, the ERS received cash, securities issued or guaranteed by the U.S. government, and/or letters of credit as collateral. The ERS did not have the ability to pledge or sell collateral securities absent of borrower default. Borrowers were required to deliver collateral for each loan equal to: (a) in the case of loaned securities denominated in U.S. dollars or whose primary trading market was located in the U.S., 102% of the market

Note F – Deposits and Investment Risk Disclosures (continued)

8. Securities Lending (continued)

value of the loaned securities; and (b) in the case of loaned securities not denominated in U.S. dollars or whose primary trading market was not located in the U.S., 105% of the market value of the loaned securities. The collateral was marked to market daily. If the market value of the collateral fell below the minimum collateral requirements, additional collateral was provided. Securities on loan for cash collateral are presented as unclassified in the preceding schedule of custodial credit risk; securities on loan for securities collateral are classified according to the underlying security. At June 30, 2005 and 2004, the ERS had no credit risk exposure to borrowers because the market value of collateral held by the ERS exceeded the market value of securities loaned. As of June 30, 2005 and 2004, the market value of securities loaned amounted to approximately $591,969,875 and $615,894,012, respectively, and the associated collateral amounted to approximately $607,087,118 and $637,120,873, respectively. In addition, the bank custodians indemnified the ERS by agreeing to purchase replacement securities or return cash collateral in the event the borrower failed to return the loaned security or failed to pay the ERS for income distributions by the securities' issuers while the securities are on loan.

The ERS did not impose any restrictions on the amount of loans the bank custodian made on behalf of the ERS. Also, the ERS and the borrowers maintained the right to terminate securities lending transactions on demand. Cash collateral is invested in the lending agent's short-term investment pool. As such, the maturities of the investments made with cash collateral generally did not match the maturities of the securities loans. The extent of such mismatch as of June 30, 2005 and 2004, was 33 and 52 days, respectively.

9. Derivative Financial Instruments

The ERS enters into various derivative investment contracts to hedge, reduce costs, and enhance liquidity as authorized by Board policy. Derivatives are financial arrangements between two parties whose payment are based on or "derived" from the performance of some agreed-upon benchmark. As with any investment, derivative contracts are subject to various types of credit and market risks. Notably, these would include the possible inability of a counterparty to meet the terms of the contract, changes in the market value of the underlying collateral, or changes in the interest rate environment. The ERS anticipates that counterparties will be able to satisfy their obligations under the contracts. The tables on the following pages summarize certain of the ERS' investments in derivative securities and contracts, held at June 30, 2005 and 2004, and their associated credit and market risks are described as follows: including currency forwards, futures, options and swaps. Interest risks associated with these investments are included in the tables. Investments in limited partnerships and commingled funds may include derivatives that are not shown in the derivative totals.

Forward Currency Exchange Contracts

The ERS enters into various forward currency exchange contracts to manage exposure to changes in foreign currency exchange rates and to facilitate the settlement of foreign security transactions. A forward contract is an agreement to buy or sell a specific amount of currency at a specific delivery or maturity date for an agreed-upon price. Risks associated

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Forward Currency Exchange Contracts (continued)

with such contracts include movements in the value of the foreign currency relative to the U.S. dollar and the ability of the counterparty to perform in accordance with the terms of the contract. Changes in the market value of open and closed forward contracts are recorded as net appreciation (depreciation) in fair value of investments in the Statement of Changes in Plan Net Assets – All Trust Funds. The fair value of forward currency exchange contracts outstanding at June 30, 2005 and 2004 is as follows:

	June 30, 2005	June 30, 2004
Forward currency purchases	$ 563,769,287	$ 367,345,715
Forward currency sales	(564,594,135)	(367,699,394)
Unrealized losses	$ (824,848)	$ (353,679)

Futures

Futures represent commitments to purchase (asset) or sell (liability) securities at a future date and at a specified price. Futures contracts are traded on organized exchanges (exchange traded) thereby minimizing the ERS' credit risk. The net change in the futures contracts value is settled daily in cash with the exchanges. Net gains or losses arising from the daily settlements are included in the net appreciation in fair value of securities in the Statement of Changes in Plan Net Assets – All Trust Funds. At June 30, 2005 and 2004, the ERS' investments had the following balances:

Futures Contracts *(Notional Value)*	June 30, 2005	June 30, 2004
Long - cash and cash equivalents - futures	$ 371,903,250	$ 112,569,401
Short - cash and cash equivalents - futures	(1,815,500)	(365)
Long - debt securities - futures	14,123,527	332,147,034
Unrealized gains	$ 384,211,277	$ 444,716,070

Options

Options represent or give the buyers the right, but not the obligation, to buy or sell an asset at a preset price over a specified period. The option's price is usually a small percentage of the underlying asset's value. As a writer of financial options, the ERS receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. As a purchaser of financial options, the ERS pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable instrument underlying the option.

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Options (continued)

At June 30, 2005 and 2004, the ERS' investments had the following option balances:

	Value Covered by Contract	
	June 30, 2005	June 30, 2004
Cash and cash equivalents written call options	$ -	$ (450)
Fixed income written call options	(81,358)	(74,093)
Fixed income written put options	(34,580)	(53,016)
Unrealized losses	$ (115,938)	$ (127,559)

Mortgage-Backed Securities

The ERS invests in mortgage-backed securities issued or backed by the U.S. government or its agencies, or corporate issues rated AAA by at least one of the major rating agencies. A mortgage-backed security depends on the underlying pool of mortgage loans to provide the cash flow to make principal and interest payments on the security. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. For example, if interest rates decline and homeowners refinance mortgages, thereby prepaying the mortgages underlying these securities, the cash flows from interest payments are reduced and the value of these securities declines. Conversely, if homeowners pay on mortgages longer than anticipated, the cash flows are greater and the return on the investment would be higher than anticipated. A collateralized mortgage obligation (CMO) is a mortgage-backed security that is comprised of classes of bonds created by prioritizing the cash flows of the underlying mortgage pool. Mortgage backed securities held by the ERS as of June 30, 2005 and 2004, are presented in the tables within this note.

Swaps

Swaps represent an agreement between two or more parties to exchange sequences of cash flows over a period in the future. At June 30, 2005 and 2004, the ERS had interest rate swaps as allowed by Board policy. In the most common type of interest rate swap arrangement, one party agrees to pay fixed interest payments on designated dates to a counterparty who, in turn, agrees to make return interest payments that float with some reference rate. Gains and losses from swaps are determined on market values and are included in the net appreciation in fair value of securities in the Statement of Changes in Plan Net Assets – All Trust Funds.

Derivatives, such as interest rate swaps and total return swaps, are a tool or instrument used to manage interest rate and yield curve exposures of the investments. In certain situations, derivatives may result in a lower overall cost to the portfolio than owning individual securities underlying the derivatives. When evaluating securities, risk and return are measured at the security and portfolio levels.

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Swaps (continued)

On June 30, 2005 and 2004, the ERS investments had the following market value balances as shown in the tables below:

Interest Rate Swaps as of June 30, 2005 by Currency

Counterparty	ERS Pays	ERS Receives	Yield Curve	Maturity Date	Outstanding Notional Value	Exposure
in Australian Dollars						
Citibank	6.00%	6-Mon LIBOR	06/15/05	06/15/15	$ 5,564,425	$ (155,226)
Citibank	6-Mon LIBOR	6.00%	06/15/05	06/15/10	9,680,575	167,596
UBS	6.00%	6-Mon LIBOR	06/15/05	06/15/15	4,421,050	(124,313)
UBS	6-Mon LIBOR	6.00%	06/15/05	06/15/10	7,622,500	132,273
in British Pound Sterling						
Barclays Bank	5.00%	6-Mon LIBOR	06/18/14	06/18/34	537,735	(30,585)
Barclays Bank	5.00%	6-Mon LIBOR	03/15/17	03/15/32	1,075,470	(45,823)
Barclays Bank	5.00%	6-Mon LIBOR	09/15/05	09/15/15	1,971,695	(83,755)
Barclays Bank	6-Mon LIBOR	5.00%	09/15/05	09/15/10	25,632,035	693,782
Citibank	5.00%	6-Mon LIBOR	12/16/14	12/16/19	358,490	(5,390)
HSBC Bank USA	5.00%	6-Mon LIBOR	06/18/14	06/18/34	1,075,470	(61,170)
HSBC Bank USA	6-Mon LIBOR	5.00%	09/15/05	09/15/10	4,481,125	121,291
JP Morgan Chase	6-Mon LIBOR	5.00%	09/15/05	09/15/10	896,225	24,258
JP Morgan Chase	5.00%	6-Mon LIBOR	03/15/17	03/15/32	1,971,695	(84,010)
Merrill Lynch	6-Mon LIBOR	5.00%	09/15/05	09/15/10	179,245	4,852
Morgan Stanley	5.00%	6-Mon LIBOR	09/15/05	09/15/15	5,018,860	(213,196)
Morgan Stanley	6-Mon LIBOR	5.00%	09/15/05	09/15/10	14,160,355	383,278
UBS	6-Mon LIBOR	5.00%	09/15/05	09/15/10	537,735	14,555
UBS	5.00%	6-Mon LIBOR	03/15/17	03/15/32	1,971,695	(84,010)
in Canadian Dollar						
Bank of America	3-Mth CBK	6.00%	12/16/14	12/16/19	489,876	9,902
Merrill Lynch	5.00%	3-Mth CBK	06/18/03	06/18/08	14,696,277	(783,120)
in Euro						
Barclays Bank	6-Mon EBOR	6.00%	03/15/17	03/15/32	726,390	89,063
Barclays Bank	4.00%	6-Mon LIBOR	06/17/05	06/17/10	4,322,021	(281,906)
JP Morgan Chase	6-Mon LIBOR	6.00%	06/18/14	06/18/34	1,815,975	311,245
JP Morgan Chase	6-Mon EBOR	6.00%	03/15/17	03/15/32	2,784,495	341,410
JP Morgan Chase	6.00%	6-Mon EBOR	03/15/02	03/15/31	8,837,745	(3,341,061)
Merrill Lynch	6-Mon LIBOR	6.00%	06/18/14	06/18/34	968,520	165,997
Merrill Lynch	4.00%	6-Mon LIBOR	12/15/05	12/15/14	13,559,280	(806,715)
Morgan Stanley	4.50%	6-Mon LIBOR	06/17/05	06/17/15	5,932,185	(651,550)
Morgan Stanley	4.00%	6-Mon LIBOR	12/15/05	12/15/09	35,108,850	(1,830,052)
UBS	6-Mon LIBOR	4.00%	06/17/05	06/17/10	968,520	63,172
UBS	6-Mon LIBOR	6.00%	03/15/17	03/15/32	2,300,235	282,034
in Japanese Yen						
Goldman Sachs	2.00%	6-Mon LIBOR	06/15/05	06/15/12	1,165,057	(98,301)
Goldman Sachs	2.00%	6-Mon LIBOR	06/15/05	06/15/12	1,173,179	(98,987)
Lehman	2.00%	6-Mon LIBOR	12/20/04	12/20/13	4,918,329	(404,953)
Morgan Stanley	2.00%	6-Mon LIBOR	06/15/05	06/15/12	1,173,179	(98,987)
UBS	2.00%	6-Mon LIBOR	06/15/05	06/15/12	4,557,350	(384,526)
		Total			$ 192,653,843	$ (6,862,928)
		2005 Total Swaps			**$ 192,653,843**	**$ (6,862,928)**

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Interest Rate Swaps as of June 30, 2004 by Currency

Counterparty	ERS Pays	ERS Receives	Yield Curve	Maturity Date	Outstanding Notional Value	Exposure
in British Pound Sterling						
Barclays Bank	5.25%	6-Mon LIBOR	09/17/13	09/17/18	$ 725,400	$ 303
Goldman Sachs	5.00%	6-Mon LIBOR	03/20/13	03/20/18	725,400	5,772
Goldman Sachs	5.00%	6-Mon LIBOR	03/15/12	03/15/17	4,533,750	44,281
Goldman Sachs	5.50%	6-Mon LIBOR	03/15/11	03/15/16	8,704,800	(27,590)
JP Morgan Chase	5.00%	6-Mon LIBOR	03/15/12	03/15/17	906,750	8,856
JP Morgan Chase	5.00%	6-Mon LIBOR	03/15/17	03/15/32	2,720,250	(31,793)
Merrill Lynch	5.00%	6-Mon LIBOR	03/15/12	03/15/17	1,813,500	17,712
Merrill Lynch	5.00%	6-Mon LIBOR	03/20/13	03/20/18	1,994,850	15,874
Morgan Stanley	5.50%	6-Mon LIBOR	03/15/02	03/15/16	15,886,260	(50,352)
UBS	5.00%	6-Mon LIBOR	03/15/12	03/15/17	1,632,150	15,941
UBS	5.00%	6-Mon LIBOR	03/15/17	03/15/32	1,994,850	(23,315)
UBS	5.00%	6-Mon LIBOR	03/20/13	03/20/18	6,347,250	50,508
in Canadian Dollar						
Merrill Lynch	5.00%	3-Mon CBK	06/18/03	06/18/08	13,425,322	(363,125)
in Euro						
Barclays Bank	6-Mon LIBOR	4.00%	06/17/05	06/17/10	608,325	(6,432)
Barclays Bank	6-Mon LIBOR	4.00%	03/15/05	03/15/07	2,554,965	27,255
Barclays Bank	4.00%	6-Mon LIBOR	06/17/05	06/17/10	6,533,410	69,088
Goldman Sachs	6-Mon LIBOR	6.00%	03/20/13	03/20/18	486,660	5,917
Goldman Sachs	6-Mon LIBOR	6.00%	03/15/12	03/15/17	6,813,240	98,728
Goldman Sachs	6-Mon LIBOR	4.00%	06/17/05	06/17/08	10,584,855	34,545
Goldman Sachs	4.00%	6-Mon LIBOR	12/15/04	12/15/09	35,282,850	(20,178)
JP Morgan Chase	6-Mon EBOR	6.00%	03/15/12	03/15/17	851,655	12,341
JP Morgan Chase	6-Mon EBOR	6.00%	03/15/17	03/15/32	3,284,955	65,348
JP Morgan Chase	6.00%	6-Mon EBOR	03/15/02	03/15/31	8,881,545	(1,353,146)
JP Morgan Chase	6-Mon LIBOR	4.00%	12/21/05	12/21/07	12,373,330	13,831
Merrill Lynch	6-Mon LIBOR	6.00%	03/15/12	03/15/17	1,581,645	22,841
Merrill Lynch	6-Mon LIBOR	4.00%	06/17/05	06/17/10	3,771,615	(39,880)
Merrill Lynch	6-Mon LIBOR	4.00%	03/15/05	03/15/07	6,813,240	72,490
Morgan Stanley	6-Mon LIBOR	5.50%	03/15/11	03/15/16	31,876,230	34,575
UBS	6-Mon LIBOR	6.00%	03/15/17	03/15/32	2,311,635	45,985
UBS	6-Mon LIBOR	6.00%	03/20/13	03/20/18	5,109,930	62,131
UBS	5.00%	6-Mon LIBOR	12/15/04	12/15/14	38,446,140	(1,263,565)
in Japanese Yen						
Goldman Sachs	1.30%	6-Mon JPY	03/21/02	09/21/11	3,665,857	32,818
Lehman	2.00%	6-Mon LIBOR	12/20/04	12/20/13	4,994,730	(51,397)
in Swedish Krona						
Barclays Bank	6-Mon LIBOR	4.50%	06/17/05	06/17/08	2,867,403	(6,719)
JP Morgan Chase	3-Mon LIBOR	4.50%	06/17/05	06/17/08	2,920,503	(6,843)
Merrill Lynch	3-Mon STB	4.50%	06/17/05	06/17/08	2,880,678	(6,750)
in US Dollar						
Bank of America	3-Mon LIBOR	4.00%	12/15/04	12/15/09	34,400,000	(1,016,016)
Barclays Bank	3-Mon LIBOR	4.00%	12/15/04	12/15/06	7,000,000	36,804
UBS	3-Mon LIBOR	4.00%	12/15/04	12/15/06	3,300,000	17,314
UBS	3-Mon LIBOR	4.00%	12/15/04	12/15/09	25,900,000	(765,264)
	Total				$ 327,505,928	$ (4,221,107)
Lehman Corporate MBS Total Return to LIBOR						
Bank of America	1-Mon LIBOR	Lehman CMBS	07/31/04	07/31/04	$ 500,000	$ 2,066
Bear Stearns	minus 65 bp	Lehman CMBS	07/30/04	07/30/04	700,000	2,892
Bear Stearns	“	Lehman CMBS	08/31/04	08/31/04	400,000	1,653
Bear Stearns	“	Lehman CMBS	07/01/04	07/01/04	500,000	2,066
Morgan Stanley	“	Lehman CMBS	09/30/04	09/30/04	1,200,000	2,387
	Total				$ 3,300,000	$ 11,064
	2004 Total Swaps				**$ 330,805,928**	**$ (4,210,043)**

Notes to Financial Statements (continued)

Note G – Risk Management

The ERS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. As required by state law, the ERS participates in coverage with the State of Hawaii. The State retains various risks and insures certain excess layers with commercial insurance policies. The excess layers are consistent with the prior fiscal year. Settled claims for the State have not exceeded the coverage provided by commercial insurance policies in any of the three fiscal years prior to June 30, 2005. Losses not covered by insurance are generally paid from legislative appropriations.

1. Torts

The ERS is involved in various litigation and claims, including claims regarding retirement benefits, the outcome of which cannot be presently determined. In the opinion of management, the outcome of these actions will not have a material adverse effect on the ERS' financial position.

2. Property and Liability Insurance

The ERS also purchased property and liability insurance for all real estate owned from outside carriers. During the past three fiscal years, no loss settlements exceeded insurance coverages.

3. Workers' Compensation Policy

The State has a self-insured workers' compensation policy. Workers' compensation claims are paid from legislative appropriations.

Note H – Commitments

In the normal course of business, the ERS enters into commitments with associated risks. The ERS adheres to the same credit policies, financial and administrative controls, and risk limiting and monitoring procedures for these commitments as for all investments.

For the ERS asset allocation plan for investments, the ERS has future financial commitments of up to an additional $1,820,362,000 as of June 30, 2005, consisting of $212,300,000 in real estate, $183,062,000 in alternative investments, $425,000,000 in domestic fixed-income, and $1,000,000,000 in international equities, including emerging markets. Investment-related financial commitments were $257,359,000 as of June 30, 2004, including $92,561,000 in real estate and $164,798,000 in alternative investments. These commitments result primarily from the ERS' portfolio rebalancing efforts and funding new managers in the process of being hired.

Notes to Financial Statements (continued)

Note I – Deferred Compensation Plan

The ERS does not sponsor a deferred compensation program. The ERS employees are eligible to participate in the deferred compensation plan sponsored by the State of Hawaii. The State-sponsored plan was created in accordance with Internal Revenue Code Section 457. The plan, available to all ERS employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to the employees until termination, retirement, death, or an unforeseeable emergency. All compensation deferred under the plan is held in trust by a custodian for the exclusive benefit of participants and beneficiaries.

Required Supplementary Information

June 30, 2005

Schedule of Funding Progress
(In thousands)

Actuarial Valuation Date	Actuarial value of assets (1)	Actuarial Accrued Liability (AAL) (2)*	Unfunded actuarial accrued liability (3)*= (2)-(1)	Funded ratio (4)=(1)/(2)	Annual covered payroll (5)	UAAL as a percentage of annual covered payroll (6)=(3)/(5)
June 30:						
2005	$8,914,839	$12,985,989	$4,071,150	68.6%	$3,041,083	133.9%
2004	8,797,133	12,271,331	3,474,198	71.7	2,865,106	121.3
2003	9,073,960	11,952,057	2,878,097	75.9	2,826,682	101.8
2002	9,415,160	11,210,226	1,795,066	84.0	2,671,689	67.2
2001	9,515,957	10,506,913	990,956	90.6	2,444,200	40.5
2000	9,204,707	9,748,033	543,316	94.4	2,275,298	23.9

* Note: Items (2) and (3) include the unfunded liabilities related to the Early Incentive Retirement (EIR) Program retirees who retired on December 31, 1994 and June 30, 1995.

In June 2000 and June 1999, the Legislature of the State of Hawaii enacted Acts 216 and 100, respectively, which amend Sections 88-107 and 88-122 of the Hawaii Revised Statutes related to assumptions used in determining the actuarial valuation. The amounts have been revised to be in compliance with these acts and a related lawsuit settlement agreement.

Schedule of Employer Contributions
(In thousands)

	Annual Required Contribution	Actual contribution	Percentage Contributed
Year ended June 30,:			
2005	$328,717	$328,717	100.0%
2004	235,686	235,686	100.0
2003	190,586	190,586	100.0
2002	167,459	167,459	100.0
2001	164,397	8,132	4.9
2000	172,255	22,392	13.0

Note to Required Supplementary Information

June 30, 2005

The information presented in the required supplementary schedules was determined as part of the annual actuarial valuation. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2005
Actuarial cost method	Entry age normal
Amortization method	Level percent, open
Remaining amortization period as of June 30, 2005	25.7 years
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return (set by statute)*	8.0%
Projected salary increases (set by statute)*	4.0%
*Includes inflation at 4.0%	
Cost-of-living adjustments (COLAs) **	2.5% (not compounded)

** COLAs are not compounded; they are based on original pension amount.

In 2002, the Legislature of the State of Hawaii approved a bill changing the remaining amortization period to be fully amortized by June 30, 2029. Prior to that, the unfunded actuarial accrued liability was to be fully amortized by 2016.

The annual required contribution for the year ended June 30, 2005, was determined as part of an actuarial valuation dated June 30, 2002 that is consistent with the current actuarial valuation.

Supplementary Information

Combining Schedules of Changes in Plan Net Assets – All Trust Funds

Years ended June 30, 2005 and 2004

	2005			
	Pension Accumulation Fund	**Annuity Savings Fund**	**Expense Fund**	**Total**
Additions				
Appropriations and contributions:				
Employers	$ 328,716,718	$ -	$ -	$ 328,716,718
Members	-	57,054,621	-	57,054,621
Net investment income	931,710,183	-	-	931,710,183
Total additions	1,260,426,901	57,054,621	-	1,317,481,522
Deductions				
Benefit payments	676,316,347	-	-	676,316,347
Refunds of member contributions	-	3,442,466	-	3,442,466
Administrative expenses	-	-	7,259,906	7,259,906
Total deductions	676,316,347	3,442,466	7,259,906	687,018,719
Other changes in net assets held in trust for pension benefits:				
Transfer due to retirement of members	95,132,500	(95,132,500)	-	-
Transfer of interest allocation	(38,531,707)	38,531,707	-	-
Transfer to pay administrative expenses	(19,697,619)	-	19,697,619	-
Return of unrequired funds due to savings in administrative expenses	262,603	-	(262,603)	-
	37,165,777	(56,600,793)	19,435,016	-
Net increase (decrease)	621,276,331	(2,988,638)	12,175,110	630,462,803
Net assets held in trust for pension benefits:				
Beginning of year	7,653,613,762	906,543,513	5,247,862	8,565,405,137
End of year	$ 8,274,890,093	$ 903,554,875	$ 17,422,972	$ 9,195,867,940

See accompanying independent auditors' report.

Supplementary Information

Schedule 1

2004			
Pension Accumulation Fund	Annuity Savings Fund	Expense Fund	Total
$ 235,685,796	$ -	$ -	$ 235,685,796
-	55,116,452	-	55,116,452
1,236,414,927	-	-	1,236,414,927
1,472,100,723	55,116,452	-	1,527,217,175
636,214,617	-	-	636,214,617
-	2,328,796	-	2,328,796
-	-	10,468,508	10,468,508
636,214,617	2,328,796	10,468,508	649,011,921
91,272,896	(91,272,896)	-	-
(38,524,729)	38,524,729	-	-
(16,644,244)	-	16,644,244	-
12,985,647	-	(12,985,647)	-
49,089,570	(52,748,167)	3,658,597	-
884,975,676	39,489	(6,809,911)	878,205,254
6,768,638,086	906,504,024	12,057,773	7,687,199,883
$ 7,653,613,762	$ 906,543,513	$ 5,247,862	$ 8,565,405,137

Supplementary Information (continued)

Schedule 2

Social Security Contribution Fund

Statements of Changes in Assets and Liabilities

Years ended June 30, 2005 and 2004

	2005			
Assets	**Beginning balance**	**Additions**	**Deductions**	**Ending balance**
Cash	$ 1,023,206	$ 165,804,792	$ 165,745,123	$ 1,082,875
Short-term investments	1,341,713	4,468,889	251,735	5,558,867
Employer appropriations receivable	5,733,390	166,179,627	165,804,792	6,108,225
Total assets	$ 8,098,309	$ 336,453,308	$ 331,801,650	$ 12,749,967
Liabilities				
Payable to Internal Revenue Service	$ 6,696,432	$ 161,838,763	$ 161,624,402	$ 6,910,793
Due to employers	1,401,877	166,277,945	161,840,648	5,839,174
Total liabilities	$ 8,098,309	$ 328,116,708	$ 323,465,050	$ 12,749,967

	2004			
Assets	**Beginning balance**	**Additions**	**Deductions**	**Ending Balance**
Cash	$ 259	$ 156,073,728	$ 155,050,781	$ 1,023,206
Short-term investments	1,383,589	2,974,127	3,016,003	1,341,713
Employer appropriations receivable	9,478,289	151,727,229	155,472,128	5,733,390
Total assets	$ 10,862,137	$ 310,775,084	$ 313,538,912	$ 8,098,309
Liabilities				
Payable to Internal Revenue Service	$ 6,568,665	$ 154,651,954	$ 154,524,187	$ 6,696,432
Due to employers	4,293,472	151,761,879	154,653,474	1,401,877
Total liabilities	$ 10,862,137	$ 306,413,833	$ 309,177,661	$ 8,098,309

See accompanying independent auditors' report.

Supplementary Information (continued)

Schedule 3

Schedules of Administrative Expenses

Years ended June 30, 2005 and 2004

	2005	2004
Personnel services		
Salaries and wages	$ 3,320,889	$ 3,209,310
Fringe benefits	999,773	929,649
Net change in unused vacation credits	89,356	46,672
Total personnel services	4,410,018	4,185,631
Professional services		
Actuarial	105,066	113,769
Auditing and tax consulting	126,061	101,896
Disability hearing expenses	17,298	18,825
Legal services	334,899	453,766
Medical	389,821	220,188
Other services	71,731	25,626
Total professional services	1,044,876	934,070
Communication		
Postage	95,274	86,804
Printing and binding	16,750	12,053
Telephone	32,471	31,462
Travel	48,665	32,030
Total communication	193,160	162,349
Rentals		
Rental of equipment	44,260	28,350
Rental of premises	13,470	7,039
Total rentals	57,730	35,389
Other		
Armored car service	7,411	6,578
Computer and office automation systems	676,022	4,276,579
Equipment	25,398	15,091
Microfilm	8,552	5,638
Repairs and maintenance	159,432	143,747
Stationery and office supplies	44,135	57,027
Miscellaneous	103,597	98,661
Total other	1,024,547	4,603,321
Depreciation	529,575	547,748
	$ 7,259,906	$ 10,468,508

See accompanying independent auditors' report.

Supplementary Information (continued)

Schedule 4

Schedules of Investment Expenses
Years ended June 30, 2005 and 2004

	2005	2004
Investment expenses		
Investment manager/advisor fees	$ 27,672,025	$ 25,249,872
Bank custodian fees	310,000	310,000
Other investment expenses	321,349	455,317
Total investment expenses	28,303,374	26,015,189
Securities lending expenses		
Borrower rebates	10,589,988	5,074,777
Management fees	273,839	375,711
Total securities lending expenses	10,863,827	5,450,488
	$ 39,167,201	$ 31,465,677

See accompanying independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

INVESTMENT SECTION

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Letter from Chief Investment Officer

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 15, 2005

Aloha Kakou,

Once again it is my honor and privilege to present the Investment Section of the Comprehensive Annual Financial Report for the fiscal year ending June 30, 2005. The following are a few ERS investment highlights of the past fiscal year:

- As of June 30, 2005, ERS was one of the 150 largest defined benefit plans in the United States with total assets of $9.2 billion.
- The fund returned 11.30% for the fiscal year 2005 and has an 8.21% return over the last ten years. In both the short and long term the fund has produced returns in excess of our actuarial target return of 8%.
- Over the last three years the fund returned 9.90%, surpassing the S&P 500 return of 8.28% over that same time period.

As fiscal year 2005 came to a close one of the major economic concerns was the housing market. It was believed that any retreat in the housing market could have profound implications for consumer spending and the economy as a whole. In late September we experienced the most expensive natural disaster in U.S. history with Hurricane Katrina. Not surprisingly, energy prices rose to record levels and the Federal Reserve continued to raise interest rates. In spite of these events, the consensus expectation is for the current economic expansion to continue as the stock market continues its ascent as the Dow nears 11,000. Back to back years of strong investment performance and an economy that keeps on rolling despite potential pitfalls has led some to believe that the "good times are here again".

George Santayanna, the philosopher, is famous for having said, "Those who cannot remember the past are condemned to repeat it." When good times are here investors eagerly cast aside the stodgy "rules" of investing and embrace the latest and greatest ideas of the day. The deadly combination of greed and optimism repeatedly leads people to pursue strategies they believe will produce high returns without high risk. Investors forget that markets overshoot, both on the upside and downside.

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Letter from Chief Investment Officer (continued)

Experience has demonstrated that investment success cannot be achieved by predicting the movements of the markets, and it is important to always maintain focus and discipline. At the ERS, we continue to base our decisions on a few guiding principles fundamental to prudent investment management.

- Diversify among asset classes to ensure a consistent level of performance. Diversification among asset classes, including investment size and style, dampens overall portfolio volatility and improves performance over the long run. ERS has a diversified investment portfolio that ranges from conventional stock and bond investments to real estate and venture capital.
- Systematically rebalance the portfolio back to target allocations. It is contrary to human nature to “sell the good ones” and “buy the bad ones.” People possess built-in biases in the way they make decisions, and those biases may cause them to act counter to their own best interests. By systematically selling better performing assets and using the proceeds to buy more of the underperforming assets you are following the golden rule of “selling high and buying low.”
- Investing is a process that requires conviction and discipline. Through our disciplined investment process ERS has developed and implemented a strategy to prudently invest the assets of our members to provide for current and future retirement benefits. As with any strategy, there will be periods of underperformance in the short-term. Given the long time horizon of the ERS we will avoid giving in to the short-term momentum that drives the market and most of its participants.

We are committed to the interests of our members and will continue to manage the assets of ERS in a prudent fashion, seeking reasonable market rates of return while attempting to avoid unnecessary risk. We will not succumb to the greed that easily overwhelms investors when markets go up. We stand behind our investment process, which has been tested in both bull and bear markets. While we cannot guarantee future results, our disciplined investment process will allow us to maintain consistent performance for the long run. Our patience and discipline have paid off and we will continue to strive to produce investment results necessary to meet the long-term needs of our members.

Aloha pumehana,

T. Kimo Blaisdell

T. Kimo Blaisdell
Chief Investment Officer

Letter from Investment Consultant

CALLAN ASSOCIATES INC

December 7, 2005

Board of Trustees
Employees' Retirement System of the State of Hawaii
City Financial Tower
201 Merchant Street, Suite 1400
Honolulu, HI 96813-2980

San Francisco
New Jersey
Chicago
Atlanta
Denver

Dear Trustees:

Enclosed is our report on investment activity for the Hawaii Employees' Retirement System for periods ended June 30, 2005, as requested by the Government Financial Officers' Association (GFOA).

Hawaii ERS-Total Fund Performance

The total assets of the Retirement System were $9.2 billion as of June 30, 2005, an increase of roughly $600 million for the fiscal year. The increase in assets was primarily due to outstanding investment results for the year. The investment return for the total fund expressed as a time-weighted total rate of return was +11.30% for the 2005 fiscal year, compared to the benchmark's return of +10.04%. For the three-year period ending June 30, 2005 the total fund returned +9.90% per annum versus the benchmark's +9.97%, and for the trailing five-year period the total fund posted a return of +3.17% per annum versus the benchmark's +3.16%.

Asset Class Performance

Domestic equity returned +8.87% for the fiscal year, versus the S&P 500 Index's +6.32% and the Callan Domestic Equity Database median of +9.60%. Domestic fixed-income was up 7.21% for the year, ahead the Lehman Brothers Aggregate return of +6.80% and the Callan Fixed-Income Database median return of +6.76%. International equity returned +17.12% for the 2005 fiscal year versus the MSCI EAFE Index return of +13.65%, whereas international fixed-income returned +7.17% versus the Citigroup Non-US Government Bond Index gain of +7.75%. Real Estate gained +25.21% for the year ending June 30, 2005 versus the NCREIF Total Index gain of +18.02%. Alternative investments were a positive contributor to performance, returning +17.92% for the fiscal year.

Market Conditions

The fiscal year began with a flat third quarter 2004 followed by a late year rally in the equity markets. A decisive outcome in the nation's presidential election as well as continued

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Letter from Investment Consultant (continued)

Employees' Retirement System of the State of Hawaii
December 7, 2005
Page 2

economic improvement helped ignite the year-end rally. For the fiscal year the S&P 500 returned +6.32%. The fiscal year saw a wide divergence in the performance of key sectors of the equity market. The energy sector returned +43.56% for the year and utilities, highly leveraged to energy, returned +22.47%. Other than these two sectors, only consumer staples (+3.42%) was in positive territory for the year. Value stocks outpaced growth stocks for the period, but not by the margin seen in recent years. Small cap stocks led to large cap stocks, continuing a recent trend.

For the first quarter of the fiscal year, the threat of rising interest rates, high energy prices and the Iraq war continued to weigh on the minds of investors, joined by the uncertainty surrounding a tight presidential election. The market got a boost when the presidential election was decided decisively and quickly. While energy prices did rise to record levels, the overall rapid rise in interest rates predicted did not materialize despite the Federal Reserve's frequent action in raising rates at the short end of the curve. Furthermore, inflation was effectively curbed by the Fed action as well as global overcapacity and a lack of pressure from wages.

The domestic bond had a surprisingly strong year as the yield curve flattened significantly allowing intermediate and long bonds to rally. Bellwether bond index Lehman Aggregate (+6.80% for the fiscal year) returned to positive territory after a slightly negative fiscal year 2004. The bond market benefited from improving credit fundamentals, record high corporate cash balances, and strong overseas demand.

International equities outpaced US equities for the year ended June 30, 2005 as non-US stocks continued from a protracted period of strong performance. The MSCI EAFE Index was up +13.65% for the fiscal year. The dollar reversed course and strengthened towards the second half of the fiscal year, but local returns were strong enough to overcome this headwind. Once again driving returns for many active managers in the non-US equity space were the outstanding returns from emerging markets. International bonds started the year strong, but slumped at the end as the dollar rallied.

Fiscal year 2006 has been mixed so far, with positive equity market performance combined with slow going for bonds. Economic indicators have continued to show steady strength, but there are also several obstacles to positive market performance, including the continued high cost of the energy and rising interest rates. Throughout the variable market conditions of the past few years, with its constant review and oversight, the Board continues to position the Retirement System for competitive performance consistent with its objectives.

Callan Associates Inc.

Callan Associates Inc.

Report on Investment Activity for the
Employees' Retirement System of the State of Hawaii

Prepared by Callan Associates Inc.
December 2005

Outline of Investment Policies

The primary goal of the Plan is the preservation of capital. The Board of Trustees seeks preservation of capital with a consistent, positive return for the Fund. Although pure speculation is to be avoided, the Board appreciates the fact that an above average return is associated with a certain degree of risk. Risk to be assumed must be considered appropriate for the return anticipated and consistent with the total diversification of the Fund.

Expected Annualized Return and Risk

Based on 2005 capital market projections for 5 years, the target allocation is expected to achieve an average annualized return of 7.9% (5.3% real return with expected inflation of 2.6%). The annual nominal return is expected to fall within a range of –4.5% and 20.3% two-thirds of the time.

Long-range Asset Allocation Target

The ERS only invests in the following asset classes:

	Lower Limit	**Strategic Allocation**	Upper Limit
Domestic Equity	29%	**32%**	35%
Small/Mid Cap Equity	7%	**9%**	11%
International Equity	15%	**17%**	19%
Domestic Fixed-Income	19%	**21%**	23%
International Fixed-Income	5%	**7%**	9%
Mortgages	NA	**0%** ***	NA
Equity Real Estate	0%	**9%** *	9%
Alternative Investments	0%	**5%** **	5%

* The real estate target will be the percentage actually invested up to 9% of the total fund. Changes in the real estate target will be offset by an equal percentage change in the large cap domestic equity target.

** The alternatives target will be the percentage actually invested up to 5% of the total fund. Changes in the alternatives target will be offset by an equal percentage change in the large cap domestic equity target.

*** The mortgage target will be the percentage of the total fund actually invested. Changes in the mortgage target will be offset by an equal change in the domestic bond target.

Adjustments in the above targets take place annually in conjunction with the annual asset allocation review. The target is evaluated on the basis of assets designated to each asset class by the Board, rather than on a current invested position. The target is to be pursued primarily by cash flow on a long-term basis and be revised if significant changes occur within the economic and/or capital market environment according to the rebalancing guidelines. The target is to be reviewed annually for reasonableness relative to significant economic and market changes. A formal asset allocation/liability study is conducted at least every three years to verify or amend the targets. The last formal asset allocation/liability study was completed in the first half of 2005. At that time, the Board chose to maintain the current strategic asset allocation implemented July 1, 2000. The target was again reviewed in early 2006 and 2007. A full asset/liability study will next take place in early 2008.

Portfolio Evaluation Benchmark

To monitor the total fund result, a special target index has been constructed to measure the fund's performance based on the current target mix. This serves as a minimum performance objective for the Fund. The target is adjusted quarterly to reflect the assets actually invested in real estate and alternative investments. The target index objective is included in all quarterly evaluation reports of the ERS. The composition of the index as of June 30, 2005 is:

- 36.1% of the Standard & Poor's 500 Stock Index
- 4.5% of the Standard & Poor's Mid Cap 400
- 4.5% of the Russell 2000 Index
- 21.0% of the Lehman Brothers Aggregate Bond Index
- 14.5% of the Morgan Stanley Capital International EAFE Index
- 2.5% of the Morgan Stanley Capital International Emerging Markets Index
- 7.0% of the Citigroup Non-U.S. World Government Bond Index
- 6.6% of the NCREIF Total Index
- 3.3% of the Alternatives Investment Program

Individual investment managers are not to be measured against this total fund objective. However, it is expected that the sum of their efforts exceeds the objective over time.

Manager Evaluation

Individual domestic and international equity and bond managers are measured against relevant indexes and their respective peer groups of managers. Market indices and peer group benchmarks are assigned to each manager and are intended as a guide for the investment manager to understand the risk/reward posture of their portfolio. Real Estate managers are measured against the median performance of the Callan Associates Real Estate database and the NCREIF Total Index. Managers have full discretion to manage the risk posture of their portfolios relative to their designated market index and may, with conviction and appropriate expertise, execute security strategies not reflected by their market index as long as they conform to the investment guidelines and the laws of the State of Hawaii.

Report on Investment Activity by Investment Consultant (continued)

Investment Practices

The full Investment Policy Statement describes in detail acceptable investment practices, manager reporting requirements, manager performance guidelines, the distribution of brokerage commissions, and securities lending guidelines. The IPS was revised in July 2005.

All rates of return are calculated using methodologies that are generally accepted by the CFA Institute. All domestic equity manager returns are daily, time-weighted rates of return based on custodial data. International equity, domestic fixed-income, and international fixed-income returns are monthly, time-weighted returns. Real estate returns are calculated using statements received directly from the manager. This ensures that the performance is based on accurate cash flows and appraisal values.

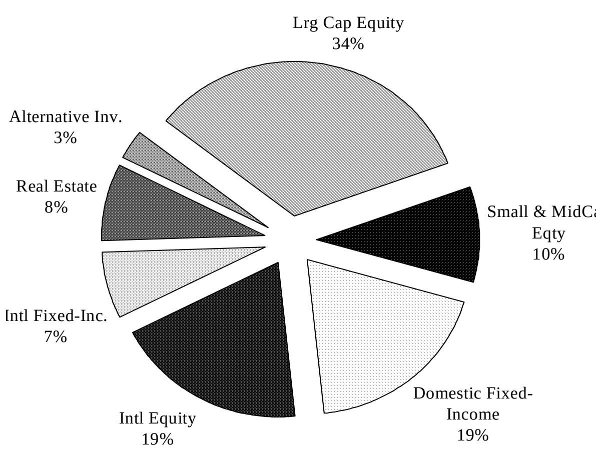
Investment Results as of June 30, 2005:

	Year Ended June 30,					Three Years Ended	Five Years Ended
	2005	2004	2003	2002	2001	6/2005	6/2005
Domestic Equity	**8.87%**	**21.80%**	**(0.39%)**	**(14.57%)**	**(10.11%)**	**9.72%**	**0.28%**
Standard & Poor's 500	6.32%	19.11%	0.25%	(17.99%)	(14.83%)	8.28%	(2.37%)
CAI Total Domestic Equity DB	9.60%	23.55%	(0.14%)	(13.78%)	(6.76%)	11.09%	3.64%
Domestic Fixed-Income	**7.21%**	**(1.45%)**	**11.12%**	**8.82%**	**11.18%**	**5.49%**	**7.27%**
Lehman Bros. Aggregate	6.80%	0.32%	10.40%	8.63%	11.22%	5.76%	7.40%
CAI Domestic Fixed DB	6.76%	0.75%	10.55%	7.98%	11.05%	5.94%	7.37%
International Equity	**17.12%**	**28.02%**	**(7.90%)**	**(12.25%)**	**(23.27%)**	**11.36%**	**(1.45%)**
MSCI EAFE Index	13.65%	32.37%	(6.46%)	(9.49%)	(23.60%)	12.06%	(0.55%)
CAI Non-U.S. Equity DB	14.98%	31.13%	(5.70%)	(7.74%)	(23.47%)	12.80%	1.37%
International Fixed-Income	**7.17%**	**7.87%**	**20.43%**	**16.84%**	**(4.34%)**	**11.66%**	**9.25%**
Citigroup Non-U.S. Government Bond	7.75%	7.60%	17.90%	15.73%	(7.43%)	10.98%	7.93%
CAI Non-U.S. Fixed DB	9.10%	7.62%	18.24%	15.65%	(6.16%)	11.32%	8.30%
Real Estate	**25.21%**	**12.26%**	**6.89%**	**3.09%**	**5.65%**	**14.53%**	**10.35%**
NCREIF Total Property Index	18.02%	10.83%	7.64%	5.50%	11.57%	12.08%	10.63%
CAI Real Estate Funds	16.64%	9.54%	7.89%	5.77%	11.21%	11.47%	9.47%
Alternative Investments	**17.92%**	**18.51%**	**(11.26%)**	**(13.40%)**	**7.68%**	**7.44%**	**2.95%**
Mortgages	12.75%	(56.24%)	3.17%	15.41%	8.56%	(20.15%)	(8.60%)
Lehman Mortgage Index	6.14%	2.23%	5.72%	8.98%	11.29%	4.68%	6.83%
Total Fund	**11.30%**	**15.81%**	**2.97%**	**(5.52%)**	**(6.80%)**	**9.90%**	**3.17%**
Composite Benchmark	10.04%	16.75%	3.51%	(5.36%)	(7.18%)	9.97%	3.16%

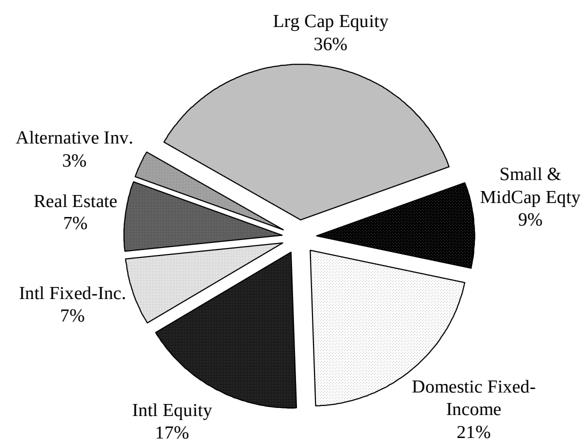
Report on Investment Activity by Investment Consultant (continued)

Asset Allocation as of June 30, 2005:

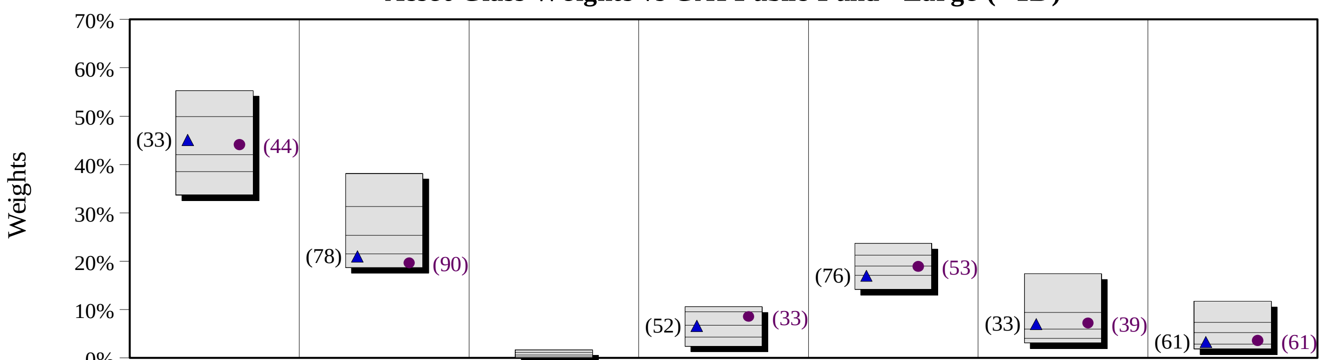
Actual Asset Allocation



Target Asset Allocation



Asset Class Weights vs CAI Public Fund - Large (>1B)



	Domestic Broad Eq	Domestic Fixed-Income	Short Term/Cash	Real Estate	Intl Equity	Intl. Fixed-Inc.	Alternative Inv.
10th Percentile	55.30	38.15	1.67	10.58	23.67	17.40	11.71
25th Percentile	49.89	31.32	1.11	9.53	21.25	9.43	7.38
Median	42.05	25.36	0.59	6.75	18.97	6.00	5.25
75th Percentile	38.55	21.49	0.25	4.35	17.08	4.06	2.85
90th Percentile	33.70	18.72	0.03	2.41	14.14	3.12	1.83
Fund ●	43.77	19.31	-	8.22	18.58	6.86	3.25
Target ▲	45.06	21.00	-	6.63	17.00	7.00	3.31

The Target Benchmark as of June 30, 2005 was 36.18% S&P 500, 4.5% S&P Mid Cap 400, 4.5% Russell 2000, 21.0% Lehman Aggregate, 6.6% NCREIF Total Index, 3.3% Alternative Investments Program, 14.5% MSCI EAFE Index, 2.5% MSCI Emerging Index, and 7.0% Citigroup Non-US Government Bond Index. Monies to be allocated to long-term real estate and alternatives are considered to be "parked" in domestic equities until drawn down.

Investment Professionals

INVESTMENT MANAGERS

U.S. EQUITIES
- Ark Asset Management Co.
- Bank of Hawaii
- Barrow, Hanley, Mewhinney & Strauss
- Bishop Street Capital Management
- CM Bidwell & Associates
- Denver Investment Advisors
- Goldman Sachs Asset Management
- Independence Investment Associates
- Jennison Associates
- Mellon Capital Management Corporation
- Oppenheimer Capital Corporation
- T. Rowe Price

REAL ESTATE
- Clarion Partners
- C.B. Richard Ellis Investors
- Heitman Capital Management
- Invesco Realty Advisors
- LaSalle Investment Management

INTERNATIONAL EQUITIES
- Acadian Asset Management
- Capital International, Inc.
- Julius Baer Investment Management
- Mercator Asset Management
- State Street Global Advisors

U.S. FIXED-INCOME
- Bishop Street Capital Management
- Bradford and Marzec
- Pacific Income Advisers
- Pacific Investment Management Company

ALTERNATIVE INVESTMENTS
- Abbott Capital Management, LLC
- Hancock Timber Resource Group

INTERNATIONAL FIXED-INCOME
- Oechsle International Advisors
- Pacific Investment Management Company

OTHER SERVICE PROVIDERS

COMMISSION RECAPTURE BROKERS
- Donaldson & Co., Incorporated
- Rochdale Securities Corporation
- Lynch, Jones & Ryan/Instinet
- SunTrust Robinson Humphrey

CUSTODIAL BANK
- State Street Bank & Trust Company

INVESTMENT ADVISOR
- Callan Associates Inc.

List of Assets Directly Held (by fair value)*

as of June 30, 2005 (excludes investments in pooled vehicles)

** A complete list of holdings is available for review upon request.*

Rank	Par / Shares	Security	Coupon	Due	Standard & Poors	Fair Value
Domestic Fixed Income						
1	57,o62,837	Federal National Mortg (Pool 735227)	5.500%	2/01/2035	AAA	$ 58,854,920
2	57,253,000	Federal Home Loan Bank	4.200%	2/05/2007	AAA	58,102,852
3	50,424,000	United States Treasury Note	4.125%	5/15/2015	AAA	49,490,369
4	34,848,000	Federal Natl Mortg (TBA Jul30 SingleFamily)	5.000%	12/01/2099	AAA	35,506,197
5	30,350,000	United States Treasury Note	3.500%	8/15/2009	AAA	35,478,565
6	21,640,117	Federal National Mortg (REMIC)	8.000%	7/25/2021	AAA	23,919,382
7	20,400,000	Federal Natl Mortg (TBA Jul15 SingleFamily)	5.000%	12/01/2099	AAA	20,370,250
8	16,969,954	Federal National Mortg (Pool 814911)	5.500%	2/01/2035	AAA	17,215,222
9	14,459,288	Federal National Mortg (Pool 814911)	5.500%	11/01/2034	AAA	14,686,827
10	13,923,714	Federal National Mortg (Pool 814911)	5.000%	2/01/2020	AAA	14,124,955
International Fixed Income						
1	26,660,000	Republic of Italy	4.500%	5/01/2009	AA-	$ 34,767,612
2	12,470,000	Bundesrepublik Deutsche (Germany)	6.500%	7/04/2027	AAA	21,648,808
3	15,500,000	Federal Republic of Germany	5.000%	1/04/2012	AAA	21,237,362
4	12,655,000	Federal Republic of Germany	3.750%	7/04/2013	AAA	16,180,263
5	12,000,000	Republic of France	4.000%	4/25/2014	AAA	15,573,793
6	11,300,000	Federal Republic of Germany	5.250%	1/04/2011	AAA	15,506,662
7	12,230,000	Federal Republic of Germany	3.500%	10/09/2009	AAA	15,442,910
8	11,480,000	Kingdom of Spain	5.150%	7/30/2009	AAA	15,372,581
9	1,598,000,000	DSL Bank	1.75%	10/07/2009	AAA	15,326,725
10	11,190,000	Republic of Ireland	4.600%	4/18/2016	AAA	15,320,490
Domestic Equities						
1	1,586,213	Microsoft Corp				$ 39,401,531
2	1,141,471	Pfizer Inc.				31,481,770
3	756,050	General Electric Co				26,197,133
4	942,130	MBNA Corp				24,646,121
5	455,358	Pepsico Inc				24,557,457
6	316,550	Occidental Pete Corp				24,352,192
7	393,160	ConocoPhillips				22,602,768
8	654,060	Qualcomm Inc				21,590,520
9	454,056	Citigroup Inc				20,991,008
10	435,342	Bank America Corp				19,855,949
International Equities						
1		Carnival Corp – Paired 1 Com Carn & 1 Tr Sh Ben				$ 21,688,988
2	170,100	XL Capital Ltd				12,658,842
3	2,235,380	Vodafone Group Ord USD0.10				5,424,876
4	212,938	GlaxoSmithKline				5,143,426
5	6,786,000	PetroChina Co				5,019,683
6	10,286	Samsung Electronics				4,916,579
7	75,600	Nabors Industries				4,582,872
8	92,500	Royal Carribean Cruises				4,473,300
9	73,452	HOLCIM				4,472,138
10	142,080	Korea Electrical Power				4,357,945

Investment Schedules (continued)

Investments Summary

(Dollar values expressed in thousands)

	Fair Value as of June 30, 2005	Percentage	Fair Value as of June 30, 2004	Percentage
Equity securities				
Common stock	$ 2,714,354	30.7%	$ 3,390,994	42.4%
Index funds	2,639,649	29.9%	1,605,691	20.1%
Pooled and others	328,672	3.7%	385,488	4.8%
	5,682,675	64.3%	5,382,173	67.3%
Fixed income securities				
Mortgage-backed securities	602,756	6.8%	429,209	5.4%
U.S. Government bonds	295,461	3.4%	192,436	2.4%
Foreign bonds	718,592	8.1%	597,543	7.5%
U.S. corporate bonds	329,493	3.7%	347,394	4.3%
Asset backed securities	78,430	0.9%	75,172	0.9%
Pooled and others	58,812	0.7%	80,711	1.0%
	2,083,544	23.6%	1,722,465	21.5%
Others				
Real estate equities	762,233	8.6%	609,169	7.6%
Real estate mortgages	12,989	0.1%	14,175	0.2%
Alternative investments	299,574	3.4%	274,047	3.4%
	1,074,796	12.1%	897,391	11.2%
Total, investments at fair value	$ 8,841,015	100.0%	$ 8,002,029	100.0%

Schedule of Investment Fees

by Asset Class Allocation

(Dollar values expressed in thousands)

	Fair value as of June 30, 2005	Total FY 2005 Investment Fees	Basis Points
Equities			
U.S. equities	$ 4,030,930		
International equities	1,710,796		
	5,741,726	$ 15,054	
Fixed Income			
U.S. bonds	1,652,014		
International bonds	632,167		
	2,284,181	3,722	
Other Asset Allocations			
Real estate	762,233		
Real estate mortgages	12,989		
Alternative investments	299,573		
	1,074,795	8,376	
Other Investment Services			
Custodian fees		310	
Investment consultant fees		520	
Total	$ 9,100,702	$ 27,982	31 bp

Investment Schedules (continued)

Schedule of Broker Commissions

The Employees' Retirement System participates in a Commission Recapture Program with four brokerage firms for equity trades, which are listed in the Investment Professionals section. Domestic and international investment managers are required to direct at least 35% of all brokerage transactions to participating brokers. Commissions charged per share are based on the investment manager's normal rate schedule. All commissions recaptured are used exclusively by the ERS for the benefit of its members and beneficiaries. ERS does not guarantee participating brokers any minimums, required volumes or fees. During the fiscal year ended June 30, 2005 the ERS recaptured $985,053 in commissions.

The following is a list of brokers who received $40,000 or more in commissions during Fiscal Year 2005. A complete list of all commissions is available for review upon request.

			Commission	
Brokerage Firms	**Shares Traded**	**Dollar Volume of Trades**	**Dollar Amount**	**Per Share**
Lynch Jones & Ryan	12,848,274	$ 433,075,085	$ 634,902	$ 0.049
Citigroup / Salomon Brothers	321,354,581	256,766,989	412,362	0.001
Bear Stearns & Co.	8,681,385	288,239,292	385,243	0.044
Merrill Lynch Pierce Fenner & Smith	511,963,831	521,100,684	336,436	0.001
Lehman Brothers	15,132,305	169,050,852	196,746	0.013
Credit Suisse First Boston	27,037,178	157,385,371	195,907	0.007
Morgan Stanley Dean Witter	10,487,310	160,611,516	190,281	0.018
UBS Warburg	26,058,444	134,917,566	188,159	0.007
Donaldson & Co	3,498,900	126,695,619	165,554	0.047
Pershing	15,525,067	247,316,851	151,505	0.010
JP Morgan Chase	3,261,006	86,333,747	133,338	0.041
ABN AMRO	1,019,813,951	97,072,582	127,959	0.000
Deutsche Bank Morgan Grenfell	29,768,569	128,804,468	127,261	0.004
Citation Group	2,434,670	82,359,223	121,463	0.050
Goldman Sachs	2,954,401	86,408,617	100,904	0.034
Broadcort Capital	1,914,350	65,718,588	89,454	0.047
Bank of New York	1,848,332	68,943,665	87,385	0.047
B-Trade Services	5,350,993	81,434,603	85,459	0.016
Banc America	1,810,740	44,638,523	85,158	0.047
Suntrust Capital	2,002,510	36,270,415	81,884	0.041
Rochdale Securities	1,591,740	55,572,012	74,006	0.046
Sanford C Bernstein	1,659,022	55,125,078	73,400	0.044
Prudential	1,707,730	39,751,533	69,118	0.040
Thomas Weisdel Partners	1,056,270	27,271,756	48,024	0.045
SG Cowen & Co	1,051,088	28,639,266	47,999	0.046
Cantor Fitzgerald	1,438,040	29,902,997	45,123	0.031
Knight Securities	1,347,990	16,076,423	44,148	0.033
Jefferies Company	1,590,727	40,352,714	43,854	0.028
Others (includes 162 firms)	695,316,522	841,708,120	1,183,916	0.002
Commissioned equity trades	2,730,505,926	$4,407,544,155	$5,520,163	$0.002
Less commissions recaptured			(985,053)	
Trades at net commission	2,730,505,926	$4,407,544,155	$4,535,110	$0.001

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

ACTUARIAL SECTION

Letter from the Actuary

GRS Gabriel Roeder Smith & Company
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November 15, 2005

Board of Trustees
Employees' Retirement System of
The State of Hawaii
City Financial Tower
201 Merchant St., Ste. 1400
Honolulu, HI 96813-2980

Dear Trustees:

Subject: Actuarial Valuation as of June 30, 2005

We certify that the information contained in the 2005 actuarial valuation report is accurate and fairly presents the actuarial position of the Employees' Retirement System of the State of Hawaii (ERS) as of June 30, 2005.

All calculations have been made 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 results presented comply with the requirements of the Hawaii statutes and, where applicable, the Internal Revenue Code, ERISA, and the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries. One or more of them are an Enrolled Actuary and/or a Member of the American Academy of Actuaries. All are experienced in performing valuations for large public retirement systems.

Actuarial valuations

The primary purpose of the valuation report is to determine the adequacy of the current employer contribution rate through measuring the resulting funding period, to describe the current financial condition of ERS, and to analyze changes in ERS's condition. In addition, the report provides information required by ERS in connection with Governmental Accounting Standards Board Statement No. 25 (GASB No. 25), and it provides various summaries of the data.

Valuations are prepared annually, as of June 30th of each year, the last day of ERS's plan year and fiscal year.

Financing objectives

Contribution rates are established by Law that, over time, are intended to remain level as a percent of payroll. The employee and employer contribution rates have been set by Law and are intended to provide for the normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability (UAAL) over a period not in excess of 30 years

Letter from the Actuary (continued)

Trustees
November 15, 2005
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Progress toward realization of financing objectives

The actuarial accrued liability, the unfunded actuarial accrued liability (UAAL), and the calculation of the resulting funding period illustrate the progress toward the realization of financing objectives. Based on this actuarial valuation as of June 30, 2005, ERS's underfunded status has increased because of (i) further recognition of the deferred investment losses that occurred as a result of the poor investment markets in FY2002 and FY2003, and (ii) a liability experience loss due to higher than expected salary increases. The UAAL is now $4.071 billion.

Based on the statutory employer contribution rate of 15.75% for Police and Fire employees, 13.75% for All Other Employees, and Employee contributions, the remaining amortization period is 25.7 years. Because this period is less than 30 years, the financing objectives of ERS are being realized.

Benefit provisions and Legislative Changes

Act 56/2005 was enacted by the Legislature. This legislation allows the automatic cost-of-living-adjustment to be reflected in the determination of actuarial equivalent optional forms of payment. There was no legislation enacted since the prior valuation that had a material actuarial impact on the valuation.

See the Summary of Retirement Benefit Plan Provisions in the Introductory Section of this CAFR for more details on the benefit provisions.

Assumptions and methods

With the exception of the assumptions for the investment return and for the salary scale, the actuarial assumptions used were adopted based on the recommendations provided by an experience study performed by the prior actuary. The investment return assumption and the salary scale assumption were set by legislative action. Further detail on the assumptions and methods may be found in the *Summary of Actuarial Methods and Assumptions* of this report. In our opinion, the assumptions that are based on the actuaries' recommendations are internally consistent and are reasonably based on the actual experience of ERS. These assumptions are also in full compliance with all parameters established by GASB No. 25.

The results of the actuarial valuation are dependent on the actuarial assumptions used. Actual results can and almost certainly will differ, as actual experience deviates from the assumptions. Even seemingly minor changes in the assumptions can materially change the liabilities, calculated contribution rates and funding periods. The actuarial calculations are intended to provide information for rational decision making.

Data

Member data for retired, active, and inactive participants was supplied as of March 31, 2005, by ERS's staff. We have not subjected this data to any auditing procedures, but have examined the data

Letter from the Actuary (continued)

Trustees
November 15, 2005
Page 3

for reasonableness and consistency with the prior year's data. Asset information was supplied by ERS's staff.

Responsibility for Tables and Schedules

The actuary is responsible for the information with respect to years after 1999 in the Required Supplementary Information, the Schedule of Employer Contributions, and the Notes To Required Supplementary Information in the Financial Section of the ERS's Comprehensive Annual Financial Report (CAFR). Information with respect to years prior to 2000 was supplied by ERS.

Tables and schedules in the Actuarial Section of the CAFR were generally prepared directly by the Actuary. Certain of these tables, however, were prepared by ERS utilizing information from this report. When those tables were prepared by ERS from our report, they are so noted.

The following exhibits and tables were prepared by the Actuary:

- Executive Summary
- Actuarial Certification Statement
- Exhibit 1 – Development of Employer Cost
- Exhibit 2 – Actuarial Present Value of Future Benefits
- Exhibit 3 – Analysis of Normal Cost
- Exhibit 4 – Development of Actuarial Value of Assets
- Exhibit 5 – Total Experience Gain or Loss
- Exhibit 6 – Investment Experience Gain or Loss
- Exhibit 7 – Highlights of Last Five Annual Actuarial Valuations
- Ten-Year Actuarial Schedules
    - Membership Data, March 31, 2005
    - Historical Summary of Active Member Data

Sincerely,

Gabriel, Roeder, Smith & Company

Joe Newton

Joe Newton, ASA, EA
Consultant

Lewis Ward

Lewis Ward
Consultant

W. Michael Carter

W. Michael Carter, FSA, EA
Senior Consultant

klb

Executive Summary

The following summarizes the key results of the June 30, 2005 actuarial valuation of the Employees' Retirement System of the State of Hawaii (ERS).

Item	**2005**	**2004**
Membership		
• Number of		
- Active members	63,073	62,573
- Retirees and beneficiaries	33,301	32,297
- Inactive, vested	4,938	4,501
- Total	101,312	99,371
• Covered payroll for active members	$2,924.5 million	$2,755.5 million
• Actual benefit payments and refunds	$679.8 million	$638.5 million
Assets		
• Actuarial value	$8,914.8 million	$8,797.1 million
• Market value	$9,195.9 million	$8,565.4 million
• Return on actuarial value	4.8%	0.8%
• Return on market value	11.1%	16.5%
• Employer contributions during fiscal year	$328,716,718	$235,685,796
• External cash flow %	(3.3%)	(4.2%)
Actuarial Information		
• Total Normal cost % (Employee & Employer	7.25%	7.32%
• Unfunded actuarial accrued liability (UAAL)	$4,071.1million	$3,474.2 million
• Funded ratio (based on actuarial assets)	68.6%	71.7%
• Funded ratio (based on market assets)	70.8%	69.8%
• Funding period (years)	25.7	22.6
• Employer contribution rate % of projected payroll *	13.95%	13.95%

* Weighted average of 15.75% Contribution Rate for Police and Firefighters and 13.75% Contribution Rate for All Other Employees.

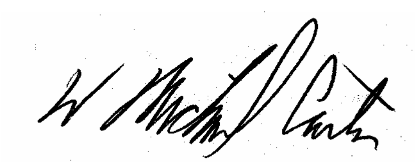
** Act 181/2004 changed the funding policy from a fixed amortization period to a fixed contribution rate. The fixed contribution rate is effective beginning July 1, 2005.

Actuarial Certification Statement

	Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
1. Gross normal cost as a percentage of pay	16.56%	6.20%	7.25%
2. Present value of future benefits			
a. Active employees	$ 1,513,029,158	$ 6,224,868,342	$ 7,737,897,500
b. Inactive members	18,764,722	207,989,467	226,754,189
c. Pensioners and beneficiaries	1,022,107,028	5,619,536,474	6,641,643,502
d. Total	$ 2,553,900,908	$ 12,052,394,283	$ 14,606,295,191
3. Present value of future employee and employer contributions			
a. Present value of future normal costs	$ 411,270,963	$ 1,209,035,723	$ 1,620,306,686
b. Present value of future employee contributions	303,784,692	91,205,087	394,989,779
c. Present value of future employer normal costs (Item 3a – Item 3b)	$ 107,486,271	$ 1,117,830,636	$ 1,225,316,907
4. Actuarial accrued liability (Item 2d – Item 3a)	$ 2,142,629,945	$ 10,843,358,560	$ 12,985,988,505
5. Actuarial value of assets			
a. Annuity Savings Fund	$ 461,392,075	$ 442,162,800	$ 903,554,875
b. Pension Accumulation Fund	1,123,433,631	6,887,850,757	8,011,284,388
c. Total	$ 1,584,825,706	$ 7,330,013,557	$ 8,914,839,263
6. Unfunded actuarial accrued liability	$ 557,804,239	$ 3,513,345,003	$ 4,071,149,242
7. Adequacy of contribution rates			
a. Statutory Contribution Rate as of July 1, 2005	15.75%	13.75%	13.95%
b. Funding Period in years as of June 30, 2005	26.1	25.6	25.7

The actuarial valuation as of June 30, 2005 is based on the provisions of Chapter 88 of the Hawaii Revised Statutes, as amended. The assumptions used in the cost calculations were those adopted by the Board of Trustees based on statutory requirements and on the prior actuary's actuarial experience investigation report covering the 1995-2000 period. The actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures.

In our opinion, the contributions required to meet the ERS's liabilities were calculated in accordance with the provisions of Chapter 88 regarding the funding of the Employees' Retirement System on an actuarial reserve basis.



W. Michael Carter, FSA, EA
Senior Consultant

Gabriel Roeder Smith & Company

Summary of 2005 Actuarial Valuation

Exhibit 1
Development of Employer Cost

		Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
1.	Payroll (adjusted for one year's pay increase)	$ 301,669,173	$ 2,739,413,977	$ 3,041,083,150
2.	Present value of future benefits (Exhibit 2)	$ 2,553,900,908	$ 12,052,394,283	$ 14,606,295,191
3.	Gross normal cost at 6/30/2004 (Exhibit 3)	16.56%	6.20%	7.25%
4.	Present value future normal cost	$ 411,270,963	$ 1,209,035,723	$ 1,620,306,686
5.	Actuarial accrued liability (Item 2 – Item 4)	$ 2,142,629,945	$ 10,843,358,560	$ 12,985,988,505
6.	Present value future employee contributions	$ 303,784,692	$ 91,205,087	$ 394,989,779
7.	Weighted effective employee contribution % (Exhibit 3)	12.20%	0.44%	1.70%
8.	Employer normal cost rate (Item 3 - Item 7)	4.36%	5.76%	5.55%
9.	Actuarial value of assets	$ 1,584,825,706	$ 7,330,013,557	$ 8,914,839,263
10.	Unfunded actuarial accrued liability (UAAL) (Item 5 - Item 9)	$ 557,804,239	$ 3,513,345,003	$ 4,071,149,242
11.	Funding period			
	a. Statutory Contribution Rate Beginning July 1, 2006	15.75%	13,75%	13.95%
	b. Less Employer normal cost	- 4.36%	- 5.76%	- 5.55%
	c. Employer Amortization payment (level %) (Item 11a – Item 11b)	11.39%	7.99%	8.40%
	d. Funding Period in years	26.1	25.6	25.7

		Police and Firefighters June 30, 2004	All Other Employees June 30, 2004	All Employees June 30, 2004
1.	Payroll (adjusted for one year's pay increase)	$ 288,245,533	$ 2,576,860,398	$ 2,865,105,931
2.	Present value of future benefits (Exhibit 2)	$ 2,411,627,156	$ 11,482,670,519	$ 13,894,297,675
3.	Gross normal cost at 6/30/2004 (Exhibit 3)	16.61%	6.25%	7.32%
4.	Present value future normal cost	$ 397,572,685	$ 1,225,394,100	$ 1,622,966,785
5.	Actuarial accrued liability (Item 2 – Item 4)	$ 2,014,054,471	$ 10,257,276,419	$ 12,271,330,890
6.	Present value future employee contributions	$ 294,587,249	$ 99,501,677	$ 394,088,926
7.	Weighted effective employee contribution % (Exhibit 3)	12.20%	0.50%	1.78%
8.	Employer normal cost rate (Item 3 - Item 7)	4.41%	5.75%	5.54%
9.	Actuarial value of assets	$ 1,537,465,340	$ 7,259,667,809	$ 8,797,133,149
10.	Unfunded actuarial accrued liability (UAAL) (Item 5 - Item 9)	$ 476,589,131	$ 2,997,608,610	$ 3,474,197,741
11.	Funding period			
	a. Statutory Contribution Rate Beginning July 1, 2005	15.75%	13,75%	13.95%
	b. Less Employer normal cost	- 4.41%	- 5.75%	- 5.54%
	c. Employer Amortization payment (level %) (Item 11a – Item 11b)	11.34%	8.00%	8.41%
	d. Funding Period in years	23.2	22.5	22.6

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Summary of 2005Actuarial Valuation (continued)

Exhibit 2
Actuarial Present Value of Future Benefits

	Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
1. Active members			
a. Service retirement benefits	$ 1,414,436,075	$ 5,535,071,903	$ 6,949,507,978
b. Deferred termination benefits	22,074,576	267,229,260	289,303,836
c. Refunds	25,400,130	4,694,538	30,094,668
d. Survivor benefits	36,317,583	143,333,850	179,651,433
e. Disability retirement benefits	14,800,794	274,538,791	289,339,585
f. Total	$ 1,513,029,158	$ 6,224,868,342	$ 7,737,897,500
2. Retired members			
a. Service retirement	$ 962,958,373	$ 5,325,513,086	$ 6,288,471,459
b. Disability retirement	24,019,559	96,875,437	120,894,996
c. Beneficiaries	35,129,096	197,147,951	232,277,047
d. Total	$ 1,022,107,028	$ 5,619,536,474	$ 6,641,643,502
3. Inactive members			
a. Vested terminations	$ 14,711,248	$ 198,249,771	$ 212,961,019
b. Nonvested terminations	4,053,474	9,739,696	13,793,170
c. Total	$ 18,764,722	$ 207,989,467	$ 226,754,189
4. Total actuarial present value of future benefits	$ 2,553,900,908	$ 12,052,394,283	$ 14,606,295,191

	Police and Firefighters June 30,2004	All Other Employees June 30, 2004	All Employees June 30, 2004
1. Active members			
a. Service retirement benefits	$ 1,332,961,920	$ 5,322,887,861	$ 6,655,849,781
b. Deferred termination benefits	21,149,767	260,159,387	281,309,154
c. Refunds	25,568,570	5,189,093	30,757,663
d. Survivor benefits	33,676,618	129,425,620	163,102,238
e. Disability retirement benefits	12,596,987	258,295,129	270,892,116
f. Total	$ 1,425,953,862	$ 5,975,957,090	$ 7,401,910,952
2. Retired members			
a. Service retirement	$ 913,558,257	$ 5,040,846,669	$ 5,954,404,926
b. Disability retirement	23,037,586	87,330,858	110,368,444
c. Beneficiaries	33,229,717	180,593,291	213,823,008
d. Total	$ 969,825,560	5,308,770,818	6,278,596,378
3. Inactive members			
a. Vested terminations	$ 11,998,851	$ 187,505,709	$ 199,504,560
b. Nonvested terminations	3,848,883	10,436,902	14,285,785
c. Total	$ 15,847,734	$ 197,942,611	$ 213,790,345
4. Total actuarial present value of future benefits	$ 2,411,627,156	$ 11,482,670,519	$ 13,894,297,675

Gabriel Roeder Smith & Company

Summary of 2005 Actuarial Valuation (continued)

Exhibit 3
Analysis of Normal Cost

		Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
1.	Normal cost as a percent of pay			
	a. Service retirement benefits	13.73%	4.89%	5.79%
	b. Deferred termination benefits	0.35%	0.64%	0.61%
	c. Refunds	1.59%	0.14%	0.29%
	d. Disability retirement benefits	0.23%	0.33%	0.32%
	e. Survivor benefits	0.66%	0.20%	0.24%
	f. Total	16.56%	6.20%	7.25%
2.	Weighted average employee contribution rate			
	a. Present value of employee contributions (in $000)	$ 303,785	$ 91,205	$ 394,990
	b. Present value of future salary (in $000)	$ 2,490,039	$ 20,804,288	$ 23,294,326
	c. Effective employee contribution rate (a / b)	12.20%	0.44%	1.70%
3.	Effective employer normal cost rate (Item 1f – Item 2c)	4.36%	5.76%	5.55%

		Police and Firefighters June 30, 2004	All Other Employees June 30, 2004	All Employees June 30, 2004
1.	Normal cost as a percent of pay			
	a. Service retirement benefits	13.80%	4.93%	5.85%
	b. Deferred termination benefits	0.35%	0.66%	0.63%
	c. Refunds	1.60%	0.16%	0.31%
	d. Disability retirement benefits	0.21%	0.32%	0.31%
	e. Survivor benefits	0.65%	0.18%	0.22%
	f. Total	16.61%	6.25%	7.32%
2.	Weighted average employee contribution rate			
	a. Present value of employee contributions (in $000)	$ 294,587	$ 99,502	$ 394,089
	b. Present value of future salary (in $000)	$ 2,414,650	$ 19,760,692	$ 22,175,342
	c. Effective employee contribution rate (a / b)	12.20%	0.50%	1.78%
3.	Effective employer normal cost rate (Item 1f – Item 2c)	4.41%	5.75%	5.54%

Summary of 2005 Actuarial Valuation (continued)

Exhibit 4
Development of Actuarial Value of Assets

		June 30, 2005		June 30, 2004
1. Actuarial value at beginning of year	$	8,797,133,149	$	9,073,960,399
2. Contributions		385,771,339		290,802,248
3. Benefits and refunds paid		(679,758,813)		(638,543,413)
4. Expected investment return		692,011,153		712,007,185
5. Preliminary actuarial value of assets at end of year	$	9,195,156,828	$	9,438,226,419
6. Market value at end of year	$	9,195,867,940	$	8,565,405,137
7. Market value excess (Item 6 – Item 5)	$	711,112	$	(872,821,282)
8. Determination of market value excess for current year				
a. Balance from 3 years ago	$	(316,633,122)	$	(302,665,924)
b. Balance from 2 years ago		(300,575,565)		(633,266,245)
c. Balance from 1 year ago		385,480,675		(450,863,347)
d. Balance from current year		232,439,124		513,974,234
9. Amortization of market value excess				
a. Write-up from 3 years ago	$	(316,633,122)	$	(302,665,924)
b. Write-up from 2 years ago		(150,287,782)		(316,633,123)
c. Write-up from 1 year ago		128,493,559		(150,287,782)
d. Write-up from current year		58,109,781		128,493,559
e. Total excess investment return	$	(280,317,564)	$	(641,093,270)
10. Actuarial value at end of year (Item 5 + Item 9e)	$	8,914,839,264	$	8,797,133,149
11. Annuity Savings Fund	$	903,554,875	$	906,543,513
12. Pension Accumulation Fund (Item 10 – Item 11)	$	8,011,284,389	$	7,890,589,636
13. Reserve for future years (Item 6 – Item 10)	$	281,028,676	$	(231,728,012)

Gabriel Roeder Smith & Company

Summary of 2005 Actuarial Valuation (continued)

Exhibit 5
Total Experience Gain or Loss

Item	Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
A. Calculation of total actuarial gain or loss			
1. Unfunded actuarial accrued liability (UAAL), previous year	$ 476,589,131	$ 2,997,608,610	$ 3,474,197,741
2. Normal cost for the year (employer and employee)	$ 47,881,786	$ 161,137,192	$ 209,018,978
3. Less: contributions and assessments for the year	$ (70,869,727)	$ (314,901,612)	$ (385,771,339)
4. Interest at 8%			
a. On UAAL	$ 38,127,130	$ 239,808,689	$ 277,935,819
b. On normal cost	1,915,271	6,445,488	8,360,759
c. On contributions	(2,834,789)	(12,596,064)	(15,430,853)
d. Total	$ 37,207,612	$ 233,658,113	$ 270,865,725
5. Expected UAAL (Sum of Items 1 – 4)	$ 490,808,802	$ 3,077,502,303	$ 3,568,311,105
6. Actual UAAL	$ 577,804,239	$ 3,513,345,003	$ 4,071,149,242
7. Total gain (loss) for the year (Item 5 – Item 6)	$ (66,995,437)	$ (435,842,700)	$ (502,838,137)
B. Source of gains and losses			
8. Asset gain (loss) for the year (Exhibit 6)	$ (48,751,732)	$ (231,565,832)	$ (280,317,564)
9. Liability gain (loss) for the year	$ (18,243,705)	$ (204,276,868)	$ (222,520,573)
10. Change in benefit provisions	-	-	-
11. Total gain (loss) for the year	$ (66,995,437)	$ (435,842,700)	$ (502,838,137)

Summary of 2005 Actuarial Valuation (continued)

Exhibit 6
Investment Experience Gain or Loss

Item	June 30, 2005	June 30, 2004
1. Actuarial assets, beginning of year	$ 8,797,133,149	$ 9,073,960,399
2. Total contributions during year	$ 385,771,339	$ 290,802,248
3. Benefits and refunds paid	$ (679,758,813)	$ (638,543,413)
4. Assumed net investment income at 8%		
a. Beginning of year assets	$ 703,770,652	$ 725,916,832
b. Contributions	15,430,854	11,632,090
c. Benefits and refunds paid	(27,190,353)	(25,541,737)
d. Total	$ 692,011,153	$ 712,007,185
5. Expected actuarial assets, end of year (Sum of Items 1 through 4)	$ 9,195,156,828	$ 9,438,226,419
6. Actual actuarial assets, end of year	$ 8,914,839,264	$ 8,797,133,149
7. Asset gain (loss) for year (Item 6 – Item 5)	$ (280,317,564)	$ (641,093,270)
8. Asset gain (loss) as a percent of actuarial value of assets, end of year (Item 7 / Item 6)	(3.14%)	(7.29%)

Summary of 2005 Actuarial Valuation (continued)

Exhibit 7
Highlights of Last Five Annual Actuarial Valuations
2001 through 2005

Item	Valuation Date: June 30, 2001	2002	2003	2004	2005
Number of active members	59,992	62,208	62,292	62,573	63,073
Number of inactive members	3,416	3,835	4,150	4,501	4,938
Number of pensioners	28,210	28,770	29,730	30,503	31,344
Number of beneficiaries	1,450	1,560	1,659	1,794	1,957
Average monthly contributory plan pension amount	$ 1,475	$ 1,571	$ 1,559	$ 1,636	$ 1,717
Average monthly noncontributory plan pension amount	$ 1,170	$ 1,208	$ 1,237	$ 1,272	$ 1,305
Average monthly beneficiary amount	$ 838	$ 875	$ 909	$ 950	$ 966
Total actuarial value of assets ($millions)	$ 9,516	$ 9,415	$ 9,074	$ 8,797	$ 8,915
Unfunded actuarial accrued liabilities ($millions)	$ 991.0	$ 1,795.1	$ 2,878.1	$ 3,474.2	$ 4,071.1
Funding period (in years) [(1)]	28.0	27.0	26.0	22.6	25.7

Item (Dollar amounts in millions)	Fiscal Year 2000 -2001	2001 -2002	2002 -2003	2003 -2004[(2)]	2004 -2005
Total calculated appropriations	$ 156.3	$ 193.1	$ 180.4	$ 229.8	$ 322.8[(3)]
EIR Program appropriations	8.1	8.1	8.1	5.9	5.9
Excess investment earnings credit	(156.3)	(33.7)	-	-	-
Net employers appropriations	$ 8.1	$ 167.5	$ 188.5	$ 235.7	$ 328.7[(3)]

(1) Beginning with the 2004 valuation, the purpose of the valuation is to determine the remaining amortization period based on the statutory contribution rates. Prior valuations determined the dollar amount needed to amortize the UAAL over a fixed period of time.

(2) Figure from 2001 valuation has been revised to reflect reamortization to 6/30/2029 under Act 147/2002.

(3) Beginning with fiscal year beginning July 1, 2005 a dollar contribution amount is not determined under the provisions of Act 181/2004. Instead a fixed percentage of payroll will be contributed (15.75% for Police and Fire, 13.75% for All Others).

Gabriel Roeder Smith & Company

Summary of Actuarial Methods and Assumptions)

I. *Valuation Date*

The valuation date is June 30th of each plan year. This is the date as of which the actuarial present value of future benefits and the actuarial value of assets are determined.

II. *Actuarial Cost Method*

The funding period required to amortize the unfunded actuarial accrued liability (UAAL) is determined using the Entry Age Actuarial Cost Method. This method assigns the plan's total unfunded liabilities (the actuarial present value of future benefits less the actuarial value of assets) to various periods. The unfunded actuarial accrued liability is assigned to years prior to the valuation, and the normal cost is assigned to the year following the valuation. The remaining costs are assigned to future years.

The normal cost is the level percentage of payroll contribution required to accumulate the needed funds to pay all expected benefits. This percentage of payroll is then applied to the total compensation for the prior year for all active members, and is then adjusted for the payroll growth assumption.

The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability (UAAL) is the excess of the actuarial accrued liability over the actuarial value of assets.

Since the State statutes governing the System establish the current employee and State contribution rates, the actuarial valuation determines the number of years required to amortize (or fund) the UAAL on a level percentage of payroll basis, taking into account the payroll growth assumption and the normal cost expressed as a percent of pay.

Because of this amortization procedure, any change in the unfunded actuarial accrued liability due to (i) actuarial gains and losses, (ii) changes in actuarial assumptions, or (iii) amendments, affects the funding period.

III. *Funding of Unfunded Actuarial Accrued Liability*

All of the following concepts will be discussed on an aggregate basis with regards to the contributory and noncontributory plans. The total normal cost for benefits provided by ERS is 7.25% of payroll, which is 8.40% of payroll less than the total contributions required by Law (13.95% from employers plus 1.70% from employees). Since only 5.55% of the employer’s 13.95% contribution is required to meet the normal cost (1.70% comes from the employee contribution), it is intended that the remaining 8.40% of payroll will be used to amortize any unfunded actuarial accrued liabilities over a period of years in the future, assuming that total payroll increases by 4.0% per year.

Summary of Actuarial Methods and Assumptions (continued)

IV. Actuarial Value of Assets

The actuarial value of assets is equal to the market value, adjusted for a four-year phase in of actual investment return in excess of expected investment return. The actual return is calculated net of investment and administrative expenses, and the expected investment return is equal to the assumed investment return rate multiplied by the prior year's market value of assets, adjusted for contributions, benefits paid, and refunds.

V. Actuarial Assumptions

A. Economic Assumptions

1. Investment return: 8% per year, compounded annually, composed of an assumed 4.00% inflation rate and a 4.00% net real rate of return. (Set by legislative action.)
2. Salary increase rate: 4% per year, compounded annually. (Set by legislative action.)
3. Payroll growth rate: 4% per annum.

B. Demographic Assumptions

1. Mortality rates

General Employees

a. Healthy males – 1994 US Group Annuity Mortality Static Table for males, set back one year.
b. Healthy females - 1994 US Group Annuity Mortality Static Table for females.
c. Disabled males - 1994 US Group Annuity Mortality Static Table for males, set forward ten years.
d. Disabled females - 1994 US Group Annuity Mortality Static Table for males, set forward eleven years.

Teachers

a. Healthy males – 1994 US Group Annuity Mortality Static Table for males, set back three years.
b. Healthy females - 1994 US Group Annuity Mortality Static Table for females, set back one year.
c. Disabled males - 1994 US Group Annuity Mortality Static Table for males, set forward four years.
d. Disabled females - 1994 US Group Annuity Mortality Static Table for males, set forward six years.

Police and Fire

a. Healthy males – 1994 US Group Annuity Mortality Static Table for males, set forward two years.

b. Healthy females - 1994 US Group Annuity Mortality Static Table for females, set forward two years.

c. Disabled males - 1994 US Group Annuity Mortality Static Table for males, set forward five years.

d. Disabled females - 1994 US Group Annuity Mortality Static Table for males, set forward five years.

2. Disability rates – The assumed total disability rates for employees covered by the contributory plan and the noncontributory plan at select ages are as follows:

	General Employees	Teachers	Police and Fire
Age	Male & Female	Male & Female	Male & Female
25	0.025%	0.008%	0.010%
30	0.025%	0.008%	0.010%
35	0.030%	0.010%	0.012%
40	0.045%	0.015%	0.018%
45	0.090%	0.030%	0.036%
50	0.200%	0.066%	0.080%
55	0.425%	0.139%	0.170%
60	0.870%	0.285%	0.348%

Note: The disability rates project the percentage of employees at each age that is assumed to become disabled before retiring. The percentage of disabilities assumed to be ordinary disability as opposed to accidental disability varies by employee group as follows:

	General Employees	Teachers	Police and Fire
Type	Male & Female	Male & Female	Male & Female
Ordinary	85%	100%	50%
Accidental	15%	0%	50%

Summary of Actuarial Methods and Assumptions (continued)

3. Termination Rates - Separate male and female rates, based on both age and service, developed from 2000 Experience Study. Rates reflect terminations for causes other than death, disability or retirement. Sample rates are shown below:

General Employees

	Expected Terminations per 100 Lives							
	Male Members				Female Members			
	Years of Service				Years of Service			
Age	0	1	2	3 or more	0	1	2	3 or more
25	19.02	12.34	9.39	6.08	21.80	17.26	15.63	8.97
30	16.37	12.64	10.38	5.65	21.62	15.50	14.16	7.23
35	15.24	11.75	9.66	4.54	19.57	14.39	12.25	5.35
40	14.87	11.22	8.71	3.70	16.63	13.02	10.31	3.68
45	13.99	10.47	8.45	2.95	16.64	11.97	9.27	2.95
50	12.52	9.16	7.86	2.45	18.15	12.11	8.89	2.61
55	11.53	8.48	6.65	1.98	20.67	13.14	9.24	2.32
60	12.54	9.53	5.25	1.69	23.88	15.62	11.38	1.96

Teachers

	Expected Terminations per 100 Lives							
	Male Members				Female Members			
	Years of Service				Years of Service			
Age	0	1	2	3 or more	0	1	2	3 or more
25	24.33	10.12	13.20	7.97	20.12	12.62	13.16	8.61
30	23.04	12.60	12.75	6.62	21.78	15.04	15.25	7.25
35	24.32	14.33	12.20	5.07	23.58	16.33	16.75	5.62
40	27.14	15.40	11.29	4.33	24.54	15.93	15.95	4.16
45	30.24	15.67	10.52	3.53	24.73	15.14	13.98	2.80
50	33.50	15.43	9.97	2.49	25.71	15.70	13.25	2.00
55	37.79	14.99	9.56	1.92	27.19	16.91	12.94	1.61
60	43.72	14.18	9.24	1.76	28.47	17.93	12.13	1.87

Police and Fire

	Expected Terminations per 100 Lives							
	Male Members				Female Members			
	Years of Service				Years of Service			
Age	0	1	2	3 or more	0	1	2	3 or more
25	6.43	2.58	2.69	3.71	6.43	2.58	2.69	3.71
30	7.46	3.33	3.66	3.35	7.46	3.33	3.66	3.35
35	9.33	4.39	4.48	2.54	9.33	4.39	4.48	2.54
40	11.44	6.36	4.76	1.56	11.44	6.36	4.76	1.56
45	12.83	9.31	4.30	0.79	12.83	9.31	4.30	0.79
50	13.45	12.47	3.57	0.39	13.45	12.47	3.57	0.39
55	13.79	15.38	2.77	0.32	13.79	15.38	2.77	0.32
60	14.10	18.19	1.95	0.45	14.10	18.19	1.95	0.45

4. Retirement rates - Separate male and female rates, based on age, developed from the 2000 Experience Study. Sample rates are shown below:

Expected Retirements per 100 Lives

	Contributory Plan					Noncontributory Plan			
	General Employees		Teachers		Police and Fire	General Employees		Teachers	
Age	Male	Female	Male	Female	Male & Female	Male	Female	Male	Female
45	3	1	1	1	20	8	8	5	8
46	3	1	1	1	20	8	8	5	8
47	3	1	1	1	20	8	8	5	8
48	3	1	1	1	20	8	8	5	8
49	3	1	1	1	18	8	8	5	8
50	3	1	1	1	18	8	8	5	8
51	3	1	1	1	18	8	8	5	8
52	3	1	1	1	18	8	8	5	8
53	3	1	1	1	18	8	8	5	8
54	10	10	5	2	23	8	8	5	8
55	20	20	20	20	30	8	8	5	8
56	10	10	10	15	25	5	6	5	8
57	10	10	10	15	30	5	6	5	8
58	10	10	10	15	20	5	6	6	10
59	12	12	10	15	20	5	5	6	12
60	12	12	10	15	40	8	8	5	15
61	18	15	10	15	40	15	15	6	15
62	35	35	15	25	100	40	40	15	25
63	20	25	15	15		25	25	5	15
64	20	20	15	15		30	25	5	15
65	45	45	25	25		70	50	15	30
66	25	25	25	25		40	35	20	20
67	30	30	30	30		40	35	25	25
68	40	40	40	40		40	35	25	25
69	40	40	40	40		40	35	25	25
70	100	100	100	100		100	100	100	100

Summary of Actuarial Methods and Assumptions (continued)

C. *Other Assumptions*

1. Percent married: 77% of male employees and 57.6% of female employees are assumed to be married.

2. Age difference: Male members are assumed to be four years older than their spouses, and female members are assumed to be four years younger than their spouses.

3. Percent electing annuity on death for contributory participants (when eligible): All of the spouses of married participants who die after becoming eligible for a retirement benefit are assumed to elect an annuity or a refund, whichever is more valuable at time of participant's death.

4. Percent electing deferred termination benefit: vested terminating members are assumed to elect a refund or a deferred benefit, whichever is more valuable at the time of termination.

5. Assumed age for commencement of deferred benefits: Members electing to receive a deferred benefit are assumed to commence receipt when eligible for early retirement.

6. Administrative expenses: The assumed investment return rate represents the anticipated net return after payment of all investment and administrative expenses.

7. Reemployment, purchase of service, transfers: No recognition is made of (i) future member reimbursements upon reemployment, (ii) future purchase of additional service, or (iii) special transfer provisions.

VI. *Participant Data*

Participant data was supplied on CD-ROM for (i) active members, (ii) inactive vested members, who are entitled to a future deferred benefit, (iii) members and beneficiaries receiving benefits.

Salary supplied for the current year was based on the earnings for the March preceding the valuation date. This salary was compared to March base pay plus a twelve-month average of overtime, with the greater of the two being used for valuation pay.

VII. *Dates of Adoption of Assumptions and Methods*

Generally, actuarial assumptions and methods were adopted by the Board of Trustees in 2000 as recommended by the Segal Company, the prior actuary, with respect to the assumptions, and by Gabriel, Roeder, Smith & Company with respect to the methods. These assumptions and methods were first reflected in the 2001 actuarial valuation. The legislature sets the investment return assumption and the salary scale assumption in the statutes governing the ERS.

Summary of Plan Changes

Act 65, effective July 1, 1999

Requires judges who enter or re-enter service after June 30, 1999 to be at least 55 years old and five years of service or have 25 years of service to retire.

Act 100, effective June 30, 1999

Uses actuarial investment earnings in excess of a ten percent (10%) actuarial investment yield rate to reduce the employer's contribution requirements by $147.0 million and $50.6 million for fiscal years ending June 30, 2000 and 2001, respectively.

Act 284, effective June 30, 2001

Provide an increase in pension benefits for current retirees with military service who retired prior to July 2, 1989. A retirant who rendered honorable active military service could be granted up to 4 years of military service credits based upon his/her years of credited service under the ERSf, not to exceed his/her actual years of military service. The years of military service credits granted are based on the following schedule:

- 0 years for retirants with less than 8 years of credited service
- Up to 2 years of retirants with 8 years or more of credited service
- Up to 3 years of retirants with 20 years or more of credited service
- Up to 4 years of retirants with 25 years or more of credited service

For each year of military service credits granted on the schedule above, the retirant will be provided a $36.00 increase is his/her monthly pension or retirement allowance.

Act 199, effective June 30, 2003

Emergency Medical Technicians (EMTs) are allowed to retire with an unreduced benefit after 25 years of service regardless of age, of which the last five or more years prior to retirement must be in that capacity. This feature is phased in one year at a time, July 1, 2003 through June 30, 2008.

Act 177, effective July 1, 2004

This Act allows police officers with a permanent service-connected disability to retain the 2-1/2% benefit multiplier for each year of service as a police officer.

Act 179, effective July 1, 2004

This Act increased the Noncontributory service-connected disability formula to 35% of average final compensation. The Act also changed the methodology for crediting interest on contributions for terminated members so that interest continues to accrue until the date of refund. The Act adds a "pop-up" feature to the joint & survivor benefit options if the beneficiary pre-deceases the retiree.

This Act also created the new Hybrid Plan which will become effective July 1, 2006.

Summary of Actuarial Methods and Assumptions (continued)

Summary of Plan Changes (continued)

Act 181, effective July 1, 2004

This Act establishes fixed employer contribution rates as a percentage of compensation effective July 1, 2005. Employers will contribute 15.75% for their police officers and firefighters and 13.75% for other employees.

Act 183, effective July 1, 2004

This Act amends the ERS statutes to comply with the federal tax limits on compensation retroactive to July 1, 1996.

Act 56, effective December 1, 2004

This Act amends the ERS statutes to allow the automatic cost-of-living-adjustment to be reflected when determining actuarial equivalent optional forms of payment.

Ten Year Actuarial Schedules
1996 to 2005

- Retirement System Membership **
  - 2004 Membership Data *
- Historical Summary of Active Member Data *
- Pensioners, Average Annual Pension and Active Member/Ptensioner Comparison **
- Number of Retirants and Beneficiaries **
- Solvency Test **
- Employer Contribution Rates as a Percentage of Payroll **
- Employer Appropriations to Pension Accumulation Fund, Appropriation Years 1997-1998 to 2006-2007 **

Note: * Prepared by Gabriel, Roeder, Smith & Company
** Compiled by ERS Staff from actuary reports, or other data.

Retirement System Membership **
1995 to 2004

March 31,	Active Members	Inactive Vested Members	Pensioners & Beneficiaries	Total Membership
1996	56,985	2,290	26,926	86,201
1997	57,044	2,456	27,173	86,673
1998	57,797	2,650	27,403	87,850
1999	58,387	2,777	27,950	89,114
2000	59,191	3,016	28,715	90,922
2001	59,992	3,416	29,660	93,068
2002	62,208	3,835	30,330	96,373
2003	62,292	4,150	31,389	97,831
2004	62,573	4,501	32,297	99,371
2005	63,073	4,938	33,301	101,312

** Schedule compiled by ERS Staff from actuary reports.

Ten-Year Actuarial Schedules (continued)

2005 Membership Data *

March 31, 2005

	Police and Firefighters		All Other Employees		All Employees	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
1. Active members						
a. Number	4,686	4,720	58,387	57,853	63,073	62,573
b. Total payroll	$ 290,173,445	$277,266,099	$2,634,374,882	$2,478,279,311	$2,924,548,327	$2,755,545,410
c. Average salary	$ 61,923	$ 58,743	$ 45,119	$ 42,838	$ 46,368	$ 44,037
d. Average age	40.5	40.1	46.7	46.5	46.3	46.0
e. Average service	13.3	13.0	13.0	13.0	13.0	13.0
2. Inactive members						
a. Number	176	140	4,762	4,361	4,938	4,501
b. Total annual deferred benefits	$ 2,694,379	$ 2,078,098	$ 30,373,239	$ 28,741,491	$ 33,067,618	$ 30,819,589
c. Average annual deferred benefit	$ 15,309	$ 14,844	$ 6,378	$ 6,591	$ 6,697	$ 6,847
3. Service retirees						
a. Number	2,533	2,469	27,487	26,801	30,020	29,270
b. Total annual benefits	$ 86,191,368	$ 81,302,080	$ 527,568,988	$ 495,242,143	$ 613,760,356	$ 576,544,223
c. Average annual benefit	$ 34,027	$ 32,929	$ 19,193	$ 18,478	$ 20,445	$ 19,697
4. Disabled retirees						
a. Number	167	167	1,157	1,066	1,324	1,233
b. Total annual benefits	$ 2,432,795	$ 2,350,058	$ 10,071,800	$ 9,172,727	$ 12,504,595	$ 11,522,785
c. Average annual benefit	$ 14,568	$ 14,072	$ 8,705	$ 8,605	$ 9,445	$ 9,345
5. Beneficiaries						
a. Number	144	136	1,813	1,658	1,957	1,794
b. Total annual benefits	$ 3,134,050	$ 2,930,878	$ 19,541,675	$ 17,512,021	$ 22,675,725	$ 20,442,899
c. Average annual benefit	$ 21,764	$ 21,551	$ 10,779	$ 10,562	$ 11,587	$ 11,395

* Prepared by Gabriel, Roeder, Smith & Company

Historical Summary of Active Member Data *

1996 to 2005

Year Ending June 30,	Active Members		Covered Payroll		Average Salary			
	Number	Percent Increase	Amount in $Millions	Percent Increase	$ Amount	Percent Increase	Average Age	Average Service
1996	56,985	-2.6%	1,990.1	-4.5%	34,923	-1.9%		
1997	57,044	0.1%	2,019.3	1.5%	35,399	1.4%		
1998	57,797	1.3%	2,135.9	5.8%	36,955	4.4%		
1999	58,387	0.9%	2,186.5	2.4%	37,448	1.3%		
2000	59,191	1.4%	2,275.3	4.1%	38,440	2.6%	45.5	13.0
2001	59,992	1.4%	2,350.2	3.3%	39,175	1.9%	45.6	13.3
2002	62,208	3.7%	2,568.7	9.3%	41,292	5.4%	45.8	13.2
2003	62,292	0.1%	2,718.4	5.8%	43,640	5.7%	46.0	13.1
2004	62,573	0.5%	2,755.5	1.4%	44,037	0.9%	46.0	13.0
2005	63,073	0.8%	2,924.5	6.1%	46,368	5.3%	46.3	13.0

* Prepared by Gabriel, Roeder, Smith & Company

Ten-Year Actuarial Schedules (continued)

Pensioners, Average Annual Pension and Active Member/Pensioner Comparison **
1996 to 2005

March 31,	Number of Pensioners	Average Annual Pension (1)	Ratio of Active Members per Pensioner
1996	25,975	$14,364	2.4
1997	26,152	$14,976	2.2
1998	26,257	$15,552	2.2
1999	26,709	$16,116	2.2
2000	27,357	$16,632	2.2
2001	28,210	$16,853	2.1
2002	28,770	$17,898	2.1
2003	29,730	$18,601	2.1
2004	30,503	$19,279	2.1
2005	31,344	$19,980	2.0

** Schedule compiled by ERS Staff from actuary reports.

(1) Pension amount includes base pension plus 2.5% post-retirement increases (excludes other bonuses and cost-of-living adjustments).

Number of Retirants and Beneficiaries **
1996 to 2005

As of Mar 31,	Added	Average Added to Rolls	Removed	Average Removed from Rolls	Total	Average Pension	% Chg
Retirants							
1996 [1]	2,249	n/a	683	n/a	26,926	$14,364	6.8%
1997 [1]	943	n/a	696	n/a	27,173	$14,976	4.3%
1998 [1]	1,013	n/a	783	n/a	27,403	$15,552	3.9%
1999 [1]	1,311	n/a	764	n/a	27,950	$16,116	3.6%
2000 [1]	1,549	n/a	784	n/a	28,715	$16,632	3.2%
2001 [1]	1,668	n/a	723	n/a	29,660	$16,853	1.3%
2002	1,229	$18,707	739	$12,559	28,770	$17,898	4.1%
2003	1,723	$20,292	763	$12,836	29,730	$18,601	3.9%
2004	1,630	$20,136	857	$13,596	30,503	$19,279	3.6%
2005	1,694	$21,228	853	$12,608	31,344	$19,980	3.6%
Beneficiaries [1]							
2002	176	$11,904	66	$ 6,660	1,560	$10,499	4.5%
2003	147	$12,137	48	$ 6,068	1,659	$10,909	3.9%
2004	177	$12,588	42	$7,596	1,794	$11,395	4.5%
2005	220	$10,395	57	$8,756	1,957	$11,587	1.7%

Notes: [1] Beneficiary counts are included in retirant counts through 2001. As of March 31, 2001, there were 28,210 retirants and 1,450 beneficiaries, receiving annual retirement benefits of $17,202 and $10,050, respectively.

n/a Information not available.

** Schedule compiled by ERS staff from actuary reports.

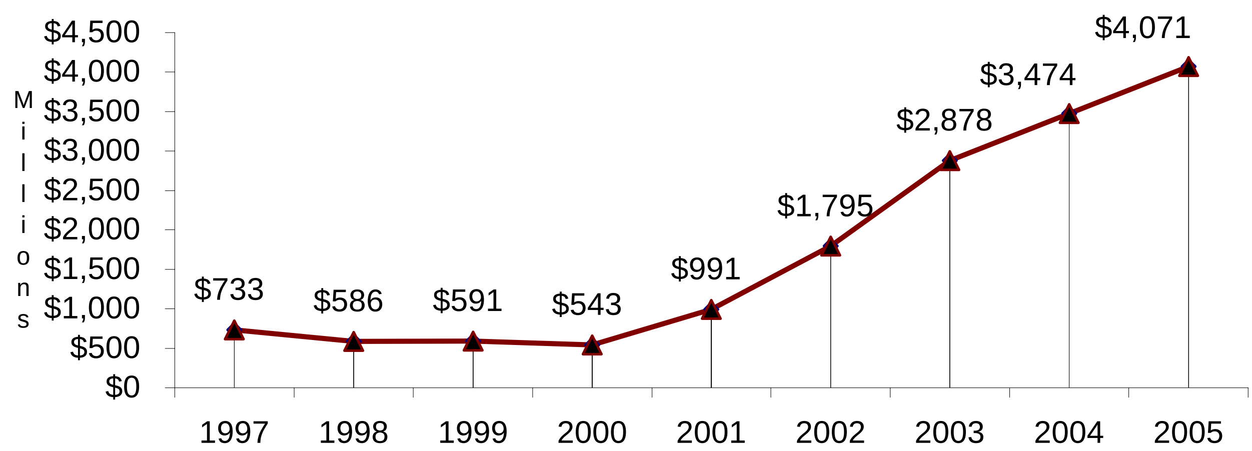
Ten-Year Actuarial Schedules (continued)

Solvency Test **
1996 to 2005

	Actuarial Accrued Liabilities (AAL)				Cumulative Portion of Actuarial Accrued Liabilities Covered by Assets		
June 30,	Active Member Contributions	Retirees, Beneficiaries, and Inactive Vested Members	Active and Inactive Members Employer Financed Portion	Actuarial Value of Assets	Column (1)	Column (2)	Column (3)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1996	811.6	4,091.3	2,496.8	6,084.8	100%	100%	47.3%
1997	830.7	4,369.8	2,716.9	7,268.5	100%	100%	76.1%
1998	883.5	4,472.7	3,053.5	7,916.2	100%	100%	83.5%
1999	902.2	4,682.2	3,517.2	8,590.8	100%	100%	85.5%
2000	938.0	4,914.5	3,817.8	9,204.7	100%	100%	87.8%
2001	876.0	5,232.4	4,398.5	9,516.0	100%	100%	77.5%
2002	889.9	5,499.4	4,820.9	9,415.2	100%	100%	62.7%
2003	872.3	5,912.3	5,167.5	9,074.0	100%	100%	44.3%
2004	870.3	6,278.6	5,122.4	8,797.1	100%	100%	32.2%
2005	864.9	6,641.6	5,479.5	8,914.8	100%	100%	25.7%

** Schedule compiled by ERS Staff from actuary reports.

Unfunded Actuarial Accrued Liability FY 1997-2005



Ten-Year Actuarial Schedules (continued)

Employer Contribution Rates as a Percentage of Payroll **

1996 to 2005

Actuarial Valuation as of June 30,	Police and Firefighters			All Other Employees			All Active Employees		
	Normal Cost Rate	Amortization Percent	Total Employer Rate	Normal Cost Rate	Amortization Percent	Total Employer Rate	Normal Cost Rate	Amortization Percent	Total Employer Rate
1996	14.23%	1.23%	15.46%	3.76%	3.19%	6.95%	4.76%	3.00%	7.76%
1997	18.40%	-11.36%	7.04%	3.87%	-3.45%	0.42%	5.38%	-4.27%	1.11%
1998	11.47%	-11.22%	0.25%	4.28%	-3.88%	0.40%	4.99%	-4.61%	0.38%
1999	18.01%	-2.53%	15.48%	5.19%	1.61%	6.80%	6.46%	1.20%	7.66%
2000	13.17%	-8.82%	4.35%	6.03%	3.72%	9.75%	6.72%	2.50%	9.22%
2001	3.88%	4.16%	8.04%	5.59%	4.86%	10.45%	5.42%	4.78%	10.20%
2002	3.88%	6.46%	10.34%	5.62%	5.87%	11.49%	5.45%	5.93%	11.38%
2003	4.27%	11.06%	15.33%	5.73%	8.74%	14.47%	5.59%	8.96%	14.55%
2004	4.41%	11.34%	15.75%	5.75%	8.00%	13.75%	5.54%	8.41%	13.95%
2005	4.36%	11.39%	15.75%	5.76%	7.99%	13.75%	5.55%	8.40%	13.95%

Note: Beginning 1995, Amortization Percent includes EIR payment percentage and Excess Investment Earnings Credit percentage. Also, beginning 1995, the funding method was changed from Frozen Initial Liability Actuarial Cost Method to Entry Age Normal Actuarial Cost Method. Beginning in 1997, the actuarial value of assets was changed from book value to a market related value.

Effective with the June 30, 2004 valuation, the employer contribution rate is statutorily changed to a percentage of pay of 15.75% of actual pay for Police and Fire and 13.75% of actual pay for All Other Employees, per Act 181/2004 SLH.

** Schedule compiled by ERS Staff from actuary reports.

Ten-Year Actuarial Schedules (continued)

Employer Appropriations to Pension Accumulation Fund **

Appropriation Years 1998-1999 to 2007-2008

(Amounts in Millions)

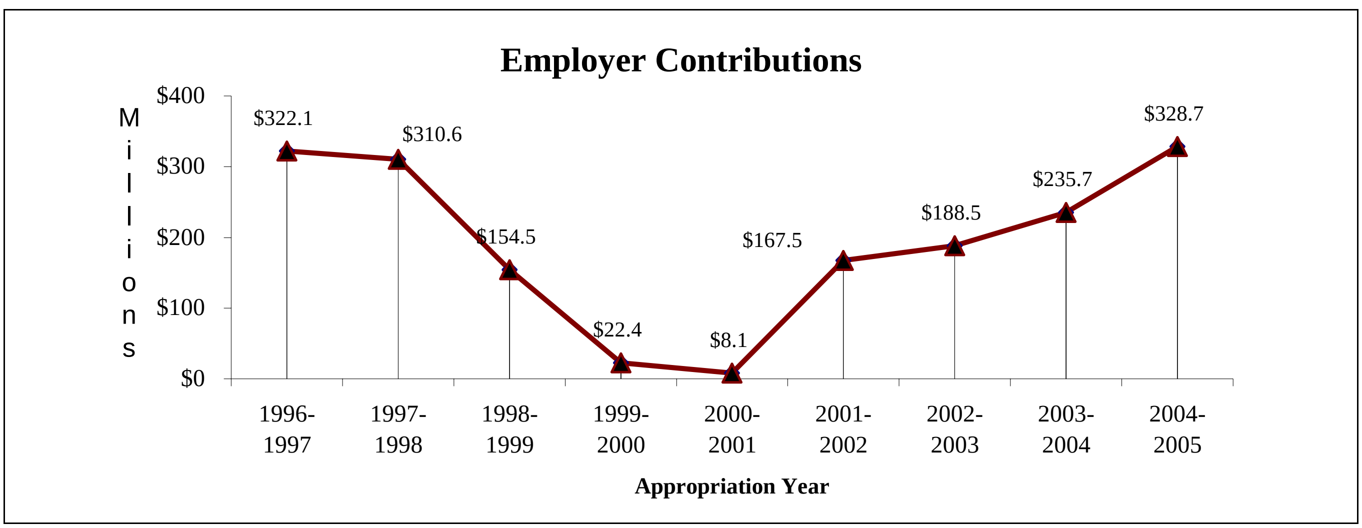
	Investment Yield Rate					
Fiscal Year	Assumed for Actuarial Valuation	Actuarial Investment Return	Appropriation Year	Total Calculated Contribution (1)	Investment Earnings Adjustment	Employer Appropriations
1995-1996	8.0%	9.99%	1998-1999	$245.2	$(90.7)	$154.5
1996-1997	8.0%	13.72%	1999-2000	179.3	(156.9)	22.4
1997-1998	8.0%	11.68%	2000-2001	164.4	(156.3)	8.1
1998-1999	8.0%	12.33%	2001-2002	201.2	(33.7)	167.5
1999-2000	8.0%	12.58%	2002-2003	188.5	-	188.5
2000-2001	8.0%	8.91%	2003-2004	235.7	-	235.7
2001-2002	8.0%	2.62%	2004-2005	328.7	-	328.7
2002-2003	8.0%	0.18%	2005-2006	N/A	-	N/A
2003-2004	8.0%	0.80%	2006-2007	N/A	-	N/A
2004-2005	8.0%	4.76%	2007-2008	N/A	-	N/A

Notes: (1) Beginning in appropriation year 1997-98, total calculated contribution includes appropriations for the Early Incentive Retirement program. 2001 results adjusted for reamortization of Unfunded Actuarial Accrued Liability and Early Incentive Retirement Program to June 30, 2029 under Act 147/2002.

(2) Beginning with the valuation for fiscal year 1996-97 (appropriation fiscal year 1999-2000), the actuarial investment income is the sum of the expected net investment income based on the actuarial assumption of 8% and a four-year smoothing of the difference between the market value of assets at year-end and the expected actuarial value of assets. In prior years, the actuarial investment income was the sum of interest, dividends, and net realized gains less net realized losses and investment expenses.

(3) Beginning fiscal year 2005/2006 employers will contribute 15.75% of actual payroll for Police and Fire and 13.75% for All Other Employees, per Act 181/2004 SLH.

** Schedule compiled by ERS Staff from actuary reports.



State Retirement System's Funded Ratios

100% or more	5	Florida FRS	112.1%	Indiana PERF	102.9%
		North Carolina TSERS	108.1%	Minnesota MSRS	100.1%
		Delaware SEPP	103.0%		
90% to 99%	15	Tennessee SETHEEPP	99.8%	Pennsylvania PSERS	96.1%
		Wisconsin WRS	99.2%	North Dakota PERS	94.0%
		South Dakota SDRS	97.7%	New Mexico PERA	93.0%
		Vermont VSRS	97.6%	Utah URS	92.4%
		Georgia ERS	97.6%	Idaho PERS	91.7%
		Texas ERS	97.3%	New Jersey PERS	91.5%
		Arizona ASRS	96.8%	Maryland MSRPS	91.2%
		Virgina VRS	96.4%		
80% to 89%	15	Alabama ERS	89.7%	Wyoming WRS	85.0%
		Michigan MSERS	88.8%	Missouri MOSERS	84.6%
		Arkansas PERS	88.7%	Massachusetts SERS	83.9%
		Iowa PERS	88.6%	South Carolina SCRS	82.8%
		California PERS	87.7%	Washington PERS	80.6%
		Montana PERS	86.7%	Nevada PERS	80.5%
		Oregon PERS	86.1%	West Virginia PERS	80.0%
		Ohio PERS	85.3%		
70% to 79%	8	Oklahoma PERS	76.1%	**Hawaii ERS ***	**71.7%**
		Kansas PERS	75.2%	New Hampshire NHRS	71.1%
		Mississippi PERS	74.9%	Kentuucky KERS	70.9%
		Alaska PERS	72.8%	Colorado PERA	70.1%
Less than 70%	5	Maine MSRS	67.4%	Louisiana LASERS	59.3%
		Rhode Island ERSRI	65.1%	Illinois SERS	54.2%
		Connecticut SERS	61.6%		

Source: Compiled from various sources by Gabriel, Roeder, Smith & Company

Note: GASB 25 funded ratios are shown for 48 general state retirement systems for valuation year(s) through January 1, 2005. A funded ratio is not shown for the Nebraska System because it is a defined contribution plan. A funded ratio for the New York System does not exist because of the use of the Aggregate Cost Method.

*** Hawaii's GASB 25 funded ratio for the fiscal year ended June 30, 2005 was 68.6%.**

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

STATISTICAL SECTION

Participating Employers and Active Members

As of March 31,

	2005		2004	
	Active Members	Percentage	Active Members	Percentage
State of Hawaii	49,203	78%	48,704	78%
City & County of Honolulu	8,101	13	8,158	13
- Board of Water Supply	568	1	554	1
Hawaii County	2,097	3	2,081	3
Kauai County	1,067	2	1,051	2
Maui County	2,037	3	2,025	3
	63,073	100%	62,573	100%

Revenues by Source

Year ended June 30	Employer appropriations (1)	Employer appropriations as a percentage of covered payroll (2)	Member contributions	Net investment income (3)	Total
1996	$288,070,687	14.48%	$53,766,483	$ 1,176,991,469 *	$1,518,828,639
1997	322,141,010	15.59	54,364,380	1,293,952,952	1,670,458,342
1998	310,627,135	14.54	56,168,443	1,251,839,166	1,618,634,744
1999	154,469,844	7.06	55,702,647	904,809,348	1,114,981,839
2000	22,392,100	0.98	57,358,185	695,151,054	744,901,339
2001	8,131,900	0.39	54,489,895	(679,605,059)	(616,983,264)
2002	167,458,900	6.52	55,451,218	(503,995,090)	(281,084,977)
2003	190,586,276	7.01	57,214,521	146,140,751	393,941,548
2004	235,685,796	8.55	55,116,452	1,236,414,927	1,527,217,175
2005	328,716,718	11.24	57,054,621	931,710,183	1,317,481,522

(1) Employer appropriations were made in accordance with actuarially determined contributions requirements. Prior to Fiscal Year 1996, employer appropriations included funding for administrative expenses.

(2) Covered payroll as reported by the actuary, effective March 31 of each year.

(3) Prior to Fiscal Year 1997, assets were reported at cost, thus net investment income includes only realized gains and losses, plus dividends, interest and other earnings. Effective July 1, 1996, the ERS adopted GASB Statement 25 changing the methodology of reporting investments at cost to reporting investments at fair value (includes unrealized gains and losses).

* Includes recognition of previously deferred income and net unrealized gains and losses totaling $594,325,421 as a result of adoption of GASB Statement 25.

Expenses by Type

Year ended June 30,	Total Benefit Payments	Refunds to Members	Administrative Expenses	Other	Total
1995	$454,078,620	$3,634,085	$2,960,240	$ -	$460,672,945
1996	432,732,753	3,963,721	3,217,348	-	439,913,822
1997	442,997,525	3,791,848	3,331,700	-	450,121,073
1998	478,744,074	4,454,658	3,775,942	29,272	487,003,946
1999	514,401,221	4,318,654	4,168,717	-	522,888,592
2001	544,906,809	3,892,377	4,893,712	-	553,692,898
2002	565,559,305	3,244,334	5,754,832	-	574,558,471
2003	602,805,080	2,605,602	6,780,824	2,800	612,194,306
2004	636,214,617	2,328,796	10,468,508	-	649,011,921
2005	676,316,347	3,442,466	7,259,906	-	687,018,719

Benefit Payments by Type

Year ended June 30,	Pension Benefit Payments				Refund Option Payments	Total Benefit Payments
	Service	Disability	Death	Subtotal		
1996	$376,976,563	$6,399,486	$3,358,029	$386,734,078	$70,978,627	$454,078,620
1997	398,471,144	7,424,424	4,626,452	410,522,020	22,210,733	432,732,753
1998	410,622,492	7,633,183	3,770,474	422,026,149	20,971,376	442,997,525
1999	431,410,418	8,055,791	4,581,030	444,047,239	34,696,835	478,744,074
2000	460,293,937	8,305,398	2,644,579	471,243,914	43,157,307	514,401,221
2001	491,957,932	8,950,018	2,369,546	503,277,496	41,629,313	544,906,809
2002	518,579,831	9,336,267	2,465,179	530,381,277	35,178,028	565,559,305
2003	557,439,020	10,046,637	1,749,855	569,235,512	33,568,568	602,805,080
2004	594,915,346	10,502,637	3,147,690	608,565,175	27,649,442	636,214,617
2005	632,088,342	11,780,739	2,793,149	646,662,230	29,654,117	676,316,347

Average Monthly Service Pensions
by Years of Credited Service

As of March 31,		0-9	10-14	15-19	20-24	25-29	30-34	35+	All
		Years of Credited Service							
1996	Average Monthly Benefit	$196	$387	$629	$911	$1,467	$1,170	$1,882	$1,220
	Number of Active Retirants	1,554	2,865	2,724	3,090	6,068	5,758	2,867	24,926
1997	Average Monthly Benefit	$201	$400	$659	$943	$1,539	$1,852	$1,985	$1,276
	Number of Active Retirants	1,515	2,903	2,781	3,152	6,146	5,741	2,839	25,077
1998	Average Monthly Benefit	$207	$411	$685	$978	$1,590	$1,918	$2,060	$1,321
	Number of Active Retirants	1,457	2,932	2,823	3,190	6,181	5,764	2,826	25,173
1999	Average Monthly Benefit	$212	$421	$710	$1,010	$1,645	$1,986	$2,143	$1,369
	Number of Active Retirants	1,409	3,012	2,882	3,266	6,306	5,879	2,854	25,608
2000	Average Monthly Benefit	$221	$426	$730	$1,032	$1,691	$2,044	$2,210	$1,414
	Number of Active Retirants	1,368	3,107	2,941	3,336	6,435	6,139	2,936	26,262
2001	Average Monthly Benefit	$225	$435	$746	$1,058	$1,739	$2,101	$2,269	$1,462
	Number of Active Retirants	1,322	3,192	3,001	3,416	6,598	6,508	3,052	27,089
2002	Average Monthly Benefit	$241	$467	$800	$1,140	$1,837	$2,200	$2,380	$1,523
	Number of Active Retirants	1,366	3,443	3,098	3,459	6,970	6,592	2,669	27,597
2003	Average Monthly Benefit	$241	$449	$788	$1,125	$1,837	$2,216	$2,384	$1,533
	Number of Active Retirants	1,298	3,535	3,166	3,581	7,127	7,037	2,802	28,546
2004	Average Monthly Benefit	$246	$463	$804	$1,156	$1,892	$2,298	$2,494	$1,597
	Number of Active Retirants	1,238	3,635	3,207	3,654	7,180	7,439	2,917	29,270
2005	Average Monthly Benefit	$255	$473	$823	$1,187	$1,951	$2,386	$2,599	$1,663
	Number of Active Retirants	1,193	3,738	3,244	3,715	7,233	7,806	3,091	30,020

Benefit Payments by Retirement Type and Option

As of March 31, 2005

Retired Contributory Members

Monthly Benefit	Number of Recipients	Type of Retirement *					Retirement Option						
		1	2	3	4	5	Max	Opt. 1	Opt. 2	Opt. 3	Opt. 4	Opt. 5	Other
$ 1 - 300	1,611	1,359	20	10	3	219	420	458	177	62	169	319	6
301 - 600	2,819	2,380	150	52	10	227	330	268	152	64	792	1,209	4
601 - 900	2,726	2,316	102	82	12	214	301	198	128	56	1,016	1,022	5
901 - 1,200	2,596	2,294	43	84	9	166	246	184	103	49	1,041	967	6
1,201 - 1,500	2,404	2,224	22	51	6	101	197	136	98	32	1,032	905	4
1,501 - 1,800	2,265	2,134	11	37	6	77	155	121	83	27	991	882	6
1,801 - 2,100	2,215	2,128	2	21	5	59	126	74	58	16	925	1,011	5
2,101 - 2,400	2,152	2,078	6	13	2	53	136	49	52	25	833	1,055	2
2,401 - 2,700	1,918	1,868	2	6	2	40	146	56	57	29	898	730	2
2,701 - 3,000	1,461	1,433	-	3	2	23	136	46	54	29	818	377	1
3,001	3,401	3,334	-	8	4	55	467	123	179	131	1,881	620	-
	25,568	23,548	358	367	61	1,234	2,660	1,713	1,141	520	10,396	9,097	41

Retired Noncontributory Members

Monthly Benefit	Number of Recipients	Type of Retirement *					Retirement Option				
		1	2	3	4	5	Max	Opt. A	Opt. B	Opt. C	Other
$ 1 - 300	825	544	77	23	75	106	315	130	248	51	81
301 - 600	1,787	1,307	231	39	50	160	936	240	451	111	49
601 - 900	995	761	118	12	25	79	550	151	208	65	21
901 - 1,200	683	581	46	1	5	50	366	132	129	52	4
1,201 - 1,500	572	500	34	1	1	36	314	106	110	42	-
1,501 - 1,800	535	502	9	-	3	21	286	93	101	55	-
1,801 - 2,100	737	713	7	-	2	15	492	99	67	78	1
2,101 - 2,400	713	701	1	-	-	11	531	76	43	63	-
2,401 - 2,700	361	354	-	-	-	7	253	50	33	25	-
2,701 - 3,000	216	210	-	-	1	5	134	46	28	8	-
3,001	309	299	-	-	1	9	199	66	32	12	-
	7,733	6,472	523	76	163	499	4,376	1,189	1,450	562	156

* Type of Retirement

1 – Normal retirement for age & service
2 – Ordinary disability retirement
3 – Occupational disability retirement
4 – Survivor payment – death in service
5 – Survivor payment – normal or disability retirement

Note: Refer to Plan Summary in the Introductory Section for descriptions of the types of retirements and benefit options selected by the members.