Est. 1919

PSERS

Partners for your Future

Public School Employees' Retirement System

Comprehensive Annual Financial Report

Fiscal year ended June 30, 2007

A Component Unit of the
Commonwealth of Pennsylvania

Public School Employees' Retirement System

(A Component Unit of the Commonwealth of Pennsylvania)

PO Box 125

Harrisburg, Pennsylvania 17108-0125

Telephone:

Toll-Free **-** 1-888-773-7748
1-888-PSERS4U

Local **-** 717-787-8540

Comprehensive Annual Financial Report

for the

Fiscal Year Ended June 30, 2007

Report prepared by the Public School Employees' Retirement System staff

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Certificate of Achievement for Excellence in Financial Reporting

Presented to

Public School

Employees' Retirement System

Pennsylvania

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

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

President

Executive Director

PPCC

Public Pension Coordinating Council

Public Pension Standards

2007 Award

Presented to

Pennsylvania Public School Employees' Retirement System

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

Presented by the Public Pension Coordinating Council, a confederation of

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

Alan H. Winkle

Alan H. Winkle
Program Administrator

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT BOARD

MELVA S. VOGLER
Chairman

STEVEN R. NICKOL
Vice Chairman

December 1, 2007

The Honorable Edward G. Rendell
Governor of Pennsylvania

Members of the Legislature
Members of the Retirement System
Members of the Boards of PSERS' Employers

Dear Governor Rendell, Legislators, Members, and Employer Board members:

On behalf of the Board of Trustees of the Pennsylvania Public School Employees' Retirement System (the System, PSERS), I am pleased to present this eighty-eighth *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2007. The report provides an in-depth review of the financial, actuarial, and investment status of the Retirement Fund and PSERS' postemployment healthcare programs.

As the System's report details, as of June 30:

1. The funded status of the pension plan as reported in the System's June 30, 2006 Actuarial Valuation was 81.2%.
2. The net assets held in trust for pension benefits were $67.3 billion.
3. Net assets held in trust for postemployment healthcare benefits were $181.7 million.
4. The active contributing membership of the System numbered approximately 264,000.
5. The number of annuitants totaled approximately 168,000 and received nearly $4.3 billion in pension and postemployment healthcare benefits during the fiscal year.

The Board of Trustees is committed to prudent management of the System's assets for the benefit of the membership. At the same time, we are aware of our responsibilities to the Commonwealth, its taxpayers, and the System's employers.

The Board of Trustees appreciates the cooperation extended to it by the Governor's Office and the Legislature which enables and empowers us to meet the challenges which face us currently and make timely provisions for the challenges ahead.

The Board of Trustees pledges to continue to administer the affairs of the Pennsylvania Public School Employees' Retirement System in the most competent and efficient manner possible.

Melva S. Vogler

Melva S. Vogler
Chairman
Board of Trustees

• 5 North 5th Street • PO Box 125 • Harrisburg, Pennsylvania 17108-0125 •

INTRODUCTORY

Mission Statement

The Board of Trustees and the employees of the Public School Employees' Retirement System serve the members and stakeholders of the System by:

- *Prudently investing the assets of the System*
- *Maintaining a financially sound System*
- *Providing timely and accurate payment of benefits*
- *Clearly communicating members' and employers' rights and responsibilities, and*
- *Effectively managing the resources of the System*

adopted 12/9/2005

Letter of Transmittal

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Mailing Address
PO Box 125
Harrisburg PA 17108-0125

Toll-Free - 1-888-773-7748
(1-888-PSERS4U)
Local - (717) 787-8540

Building Location
5 North 5th Street
Harrisburg PA 17101

December 1, 2007

The Board of Trustees
Pennsylvania Public School Employees' Retirement System
Harrisburg, PA 17101

We are pleased to present the eighty-eighth edition of the *Comprehensive Annual Financial Report* for the Pennsylvania Public School Employees' Retirement System (the System, PSERS) for the year ended June 30, 2007. The management of the System is solely responsible for the accuracy and completion of this report, pursuant to section 24 Pa.C.S. §8502(n) of the Public School Employees' Retirement Code (Retirement Code).

The System was established on July 18, 1917 to provide retirement benefits to public school employees of the Commonwealth of Pennsylvania. The System has experienced various benefit modifications throughout its existence.

The members eligible to participate in the System include all full-time public school employees, part-time hourly public school employees who render at least 500 hours of service in the school year, and part-time per diem public school employees who render at least 80 days of service in the school year for any of the 739 reporting entities in Pennsylvania. As of June 30, 2007, the System had approximately 264,000 active members with an estimated annual active payroll of $11.8 billion.

The annuitant membership at June 30, 2007 was comprised of approximately 168,000 retirees and beneficiaries who receive nearly $277 million each month. The average yearly benefit paid to annuitants is $20,970. The average benefits for each option type are detailed in the **Statistical Section** of this report.

The System is a governmental cost-sharing multi-employer defined benefit pension plan, to which 739 reporting units contribute. PSERS is administered by a staff of 306. The System is headquartered in Harrisburg, Pennsylvania, and maintains eight field offices in strategic areas of the Commonwealth to enable direct contact with the membership and the System's employers.

This report has been prepared in accordance with accounting principles generally accepted in the United States of America. Sufficient internal controls exist to provide reasonable assurance regarding the safekeeping of assets and the fair presentation of the financial statements and suporting schedules.

PSERS was established by law as an independent administrative board, directed by a governing board of trustees (Board) which exercises control and management of the System, including the investment of its assets. PSERS is considered a component unit of the Commonwealth of Pennsylvania as defined by the Governmental Accounting Standards Board (GASB). An annual audit of the System by a certified public accounting firm is required by the Retirement Code. PSERS has contracted with Clifton Gunderson LLP for this audit of its financial statements and has received an unqualified opinion as evidenced in the **Independent Auditors' Report** in the **Financial Section** of this report.

Economic Summary

Investment market conditions showed continued strength during the fiscal year ended June 30, 2007 (FY 2007) enabling PSERS' investment portfolio to generate a rate of return of 22.93%. The total net assets of the System increased from $57.4 billion to $67.5 billion from July 1, 2006 to June 30, 2007. The increase is primarily attributable to net investment income and member and employer contributions combined that exceeded the payment of pension benefits and administrative expenses.

The Board has continued to fulfill its mission to maintain stability and the long-term optimum value of the Fund. This is evidenced in the long-term growth of the System's assets and the actuarial soundness of the Fund with respect to its funding status. Of utmost importance to the Board is the assurance that the required reserves are available for payment of current and prospective retirement benefits. PSERS has maintained its position among the top twenty-five largest pension systems in the nation.

Major Initiatives

Shrinking the Projected Employer Contribution Rate Increase

One of the most widely publicized events at PSERS over the past several years has been the employer contribution rate increase that is projected to occur in the 2012-2013 fiscal year. The rate increase was first projected in the June 30, 2003 actuarial valuation. This projection took into consideration the actuarial impact of the pension benefit enhancement enacted in 2001 (Act 9 of 2001), a major downturn in the investment markets between 2001 and 2003 and a series of legislative actions (Act 38 of 2002 and Act 40 of 2003) that changed the basic funding methodologies for PSERS and suppressed the employer contribution rate for a period of ten years.

PSERS' outstanding investment returns have continued to dramatically decrease the projected employer contribution rate in fiscal year 2012-2013. PSERS' investment returns over the past four years have reduced the projected fiscal year 2012-2013 employer contribution rate by more than 50 percent, from a projected high of over 27 percent to the current projected rate of 11.23 percent and have decreased the projected amount of contributions needed from school employers and Commonwealth taxpayers in fiscal year 2012-2013 by $2.3 billion.

New Pension Administration System (NPAS)

PSERS' continues to make progress in its efforts to implement the NPAS. Testing the remaining core benefit processing functions, including retirement benefit, death benefit, and refund calculations and related processes, has been very productive. PSERS is committed to taking the necessary time to properly test and prepare for this last major phase of the project.

As the testing process of this phase continues, PSERS is excited to see the many benefits NPAS has to offer and looks forward to its full implementation. Previous phases included the successful implementation of Employer Reporting functions (how public school employers report public school employee information to PSERS) and Employer Accounting functions (how employer and member contribution billing and payment information is maintained), the Member Accounting functions (how member account information is maintained), the Statement of Account functions (how member account information is reported to members), the Benefit Payment functions (how disbursement of all PSERS benefits, including the monthly retirement benefit payroll as well as refund and death benefit payments are processed), and the Purchase of Service functions (how members purchase any of PSERS' twenty creditable types of service).

Financial Highlights

The System maintains a full accrual accounting system. More specific accounting information is detailed in the **Summary of Significant Accounting Policies (Note 2)** in the notes to the financial statements found in the **Financial Section** of this report.

The System has established policies and procedures for the review and verification of all payments made by PSERS.

The fair value of the System's net assets totaled $67.5 billion as of June 30, 2007. The System is the 16th largest public pension fund in the nation and the 23rd largest among public and corporate pension funds in the nation. More specific information on the System's assets is detailed in the Statements of Plan Net Assets and Management's Discussion and Analysis included in the **Financial Section** of this report.

The System's administrative budget request is appropriated by the Pennsylvania General Assembly and funded by the investment income of the System. For FY 2007, the appropriation was $39.5 million.

Funding

Funding is the process of specifically setting aside money for current and future use. Proper funding entails an actuarial examination of the fund balances to ensure money will be available for future and current benefit payments.

The results of the latest published actuarial valuation (as of June 30, 2006) indicated that the rates of contribution payable by the members and employers, when taken together with the current assets of the System, are adequate to fund the actuarial liabilities on account of all benefits payable under the System at that date. The actuarial valuation measures the progress toward funding pension obligations of the System by comparing the actuarial assets to the actuarial liabilities of the System. The funded status as of the latest actuarial valuation was 81.2%. Additional comparative information on the funded status of PSERS can be found in the **Actuarial Section** and MD&A in the **Financial Section** of this report.

Investments

Income from the investment portfolio represents the major source of revenue to the System, accounting for nearly 81% of total revenues over the period from FY 1998 to FY 2007. During FY 2007 net investment income was $12.7 billion. The investment portfolio totaled $68.5 billion, at fair value, as of June 30, 2007. For FY 2007, the time-weighted rate of return on the System's investments was 22.93%.

The investment portfolio is well diversified to emphasize a long-term investment approach. The overall objective of the System is to provide benefits to its members through a carefully planned and well-executed investment program. The return objectives are to (i) realize a return sufficient to achieve funding adequacy on an inflation-adjusted basis and that exceeds the Policy Index (the Policy Index is a custom benchmark based on the Board-established asset allocation structure to generate a return that meets the actuarial rate of return assumption); and (ii) invest the assets to maximize returns for the level of risk taken. The risk objectives are to (i) diversify the assets of the System to minimize the risk of losses within any one asset class, investment type, industry or sector distribution, maturity date, or geographic location; and (ii) invest the assets so that the probability of investment losses (as measured by the Policy Index) in excess of 12.0% in any one year is no greater than 2.5% (or two standard deviations below the expected return).

Additional information on the System's investments is contained in the **Investment Section** of this report.

Federal and State Tax Status

The System is a qualified trust fund under Section 401(a) of the Internal Revenue Code (IRC). As a result of the qualified status, the trust fund is entitled to an exemption, under Section 501(a) of the IRC, from federal income taxation on its investment earnings. Additionally, contributions made on behalf of the active members are tax deferred under Section 414(h) of the IRC. The trust fund and any benefits accruing to the members of PSERS are exempt from Pennsylvania state and municipal taxes.

Professional Services

Professional consultants are appointed by the Board of Trustees to perform services essential to the efficient operation of the System. An annual audit by an independent certified public accounting firm and annual valuation by an actuarial consultant attest to the financial and actuarial soundness of PSERS. The investment performance of the System is reviewed by an investment evaluation firm on a quarterly basis. The consultants providing services to the System are listed in the **Financial Section** and **Investment Section** of this report.

Other Information

In compliance with the Retirement Code, actuarial tables and the computational procedures used by the System in calculating annuities and other benefits were published in the *Pennsylvania Bulletin* (Vol. 31, No.14). This information can be found on the World Wide Web at http://www.pabulletin.com/secure/data/vol31/31-14/index.html.

System Awards

Government Finance Officers Association of the United States and Canada
Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a *Certificate of Achievement for Excellence in Financial Reporting* to PSERS for its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2006 (FY 2006). The *Certificate of Achievement* is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports. To be awarded a *Certificate of Achievement*, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a comprehensive annual financial report must satisfy both generally accepted accounting principles and applicable legal requirements.

A *Certificate of Achievement* is valid for a period of one year only. PSERS has received a *Certificate of Achievement* for 24 consecutive years from FY 1983 to FY 2006. The System believes the current report continues to conform to the *Certificate of Achievement* program requirements and will be submitting this report to GFOA to determine eligibility for the 2007 certificate.

A reproduction of this award appears in the **Introductory Section** of this report. Its attainment represents a significant accomplishment by the System, whose Office of Financial Management holds general responsibility for the compilation and validity of the financial data presented in the *Comprehensive Annual Financial Report*.

Public Pension Coordinating Council – Public Pension Standards Award

The Public Pension Coordinating Council has awarded its Public Pension Standards Award to PSERS for 2007. This award is in recognition of meeting professional standards for plan design and administration as set forth in the Public Pension Standards.

The Public Pension Coordinating Council was formed in 1990 to assist the public employee retirement community. The Council is composed of representatives from three national associations whose members are directly involved in the administration of public employee retirement systems: the National Association of State Retirement Administrators (NASRA); the National Conference on Public Employee Retirement Systems (NCPERS); and the National Council on Teacher Retirement (NCTR).

A reproduction of this award appears in the **Introductory Section.**

Acknowledgements

The preparation of this report reflects the combined efforts of PSERS staff under the direction of the PSERS Board. It is intended to provide complete and reliable information in conformance with accepted standards and to document responsible stewardship of the System's assets.

Respectfully submitted,

Jeffrey B. Clay	Arthur J. Granito
Executive Director	Chief Financial Officer

Administrative Organization
PSERS Board of Trustees

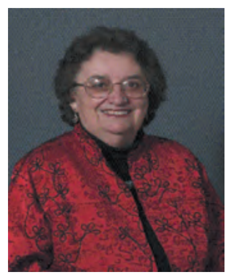
Secretary of Education
Gerald R. Zahorchak
(ex officio)

Executive Director Pennsylvania School Boards Association
Thomas J. Gentzel
(ex officio)

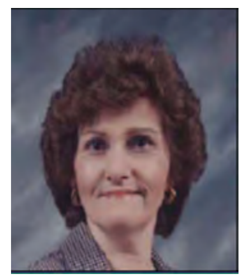
Treasurer of the Commonwealth of Pennsylvania
Honorable Robin L. Wiessmann
(ex officio)

Two members appointed by the Governor
Arthur J. Rooney, II **Tina Byles-Williams**

One member elected by retired members
Sally J. Turley



Three members elected by active certified contributors
Glen S. Galante **James M. Sando** **Melva S. Vogler**
Chair



One member elected by active noncertified contributors
Patricia A. Tozer

Two members appointed by the Speaker of the Pennsylvania House of Representatives
Honorable Dwight Evans **Honorable Steven R. Nickol**
Vice-Chair

One member elected by members of Pennsylvania Public School Boards
Richard N. Rose

Two members appointed by the President *Pro Tempore* of the Pennsylavania Senate
Honorable Vincent J. Fumo **Honorable Robb Wonderling**

PSERS Board of Trustees

as of June 30, 2007

Treasurer of the Commonwealth of Pennsylvania (ex officio)

Honorable Robin L. Wiessmann

Secretary of Education of the Commonwealth of Pennsylvania (ex officio)

Dr. Gerald R. Zahorchak, Ph.D.

Executive Director of the Pennsylvania School Boards Association, Inc. (ex officio)

Mr. Thomas J. Gentzel

Two members appointed by the Governor of the Commonwealth of Pennsylvania

Mr. Arthur J. Rooney, II (term expired 12/31/2006)
Ms. Tina Byles-Williams (term expires 12/31/2008)

Three members elected from among the certified contributors of the System for a term of three years

Mr. Glenn S. Galante (term expires 12/31/2009)
Mr. James M. Sando (term expires 12/31/2010)
Ms. Melva S. Vogler, *Chairman* (term expires 12/31/2008)

One member elected from among the noncertified contributors of the System for a term of three years

Ms. Patricia A. Tozer (term expires 12/31/2009)

One member elected from among the annuitants of the System for a term of three years

Mrs. Sally J. Turley (term expires 12/31/2007)

One member elected by the members of Pennsylvania Public School Boards from among their number for a term of three years

Mr. Richard N. Rose (term expires 12/31/2008)

Two members appointed by the Speaker of the House from the Pennsylvania House of Representatives, one representing the Majority Party and one representing the Minority Party

Honorable Dwight Evans (term expires 02/12/2009)
Honorable Steven R. Nickol, *Vice-Chairman* (term expires 02/12/2009)

Two members appointed by the President Pro Tempore of the Pennsylvania Senate, one representing the Majority Party and one representing the Minority Party

Honorable Vincent J. Fumo (term expires 02/12/2009)
Honorable Rob Wonderling (term expires 02/10/2011)

2007 Board Committees

as of June 30, 2007

Appeals / Member Services

Ms. Tozer, Chair
Mr. Gentzel
Representative Nickol
Mr. Rose
Mr. Sando
Mrs. Turley

Audit / Budget

Mr. Galante, Chair
Representative Evans
Senator Fumo
Mr. Gentzel
Mr. Rooney
Mr. Rose

Bylaws / Policy

Representative Nickol, Chair
Ms. Byles-Williams
Representative Evans
Mr. Sando
Mrs. Turley
Treasurer Wiessmann

Corporate Governance

Mr. Sando, Chair
Ms. Byles-Williams
Mr. Galante
Mr. Rose
Treasurer Wiessmann
Dr. Zahorchak

Elections

Dr. Zahorchak, Chair
Representative Evans
Mr. Rooney
Ms. Tozer

Finance

Mr. Rose, Chair

Committee is comprised
of all Board members.

Health Care

Mrs. Turley, Chair
Representative Evans
Mr. Gentzel
Representative Nickol
Mr. Rose
Ms. Tozer

Personnel

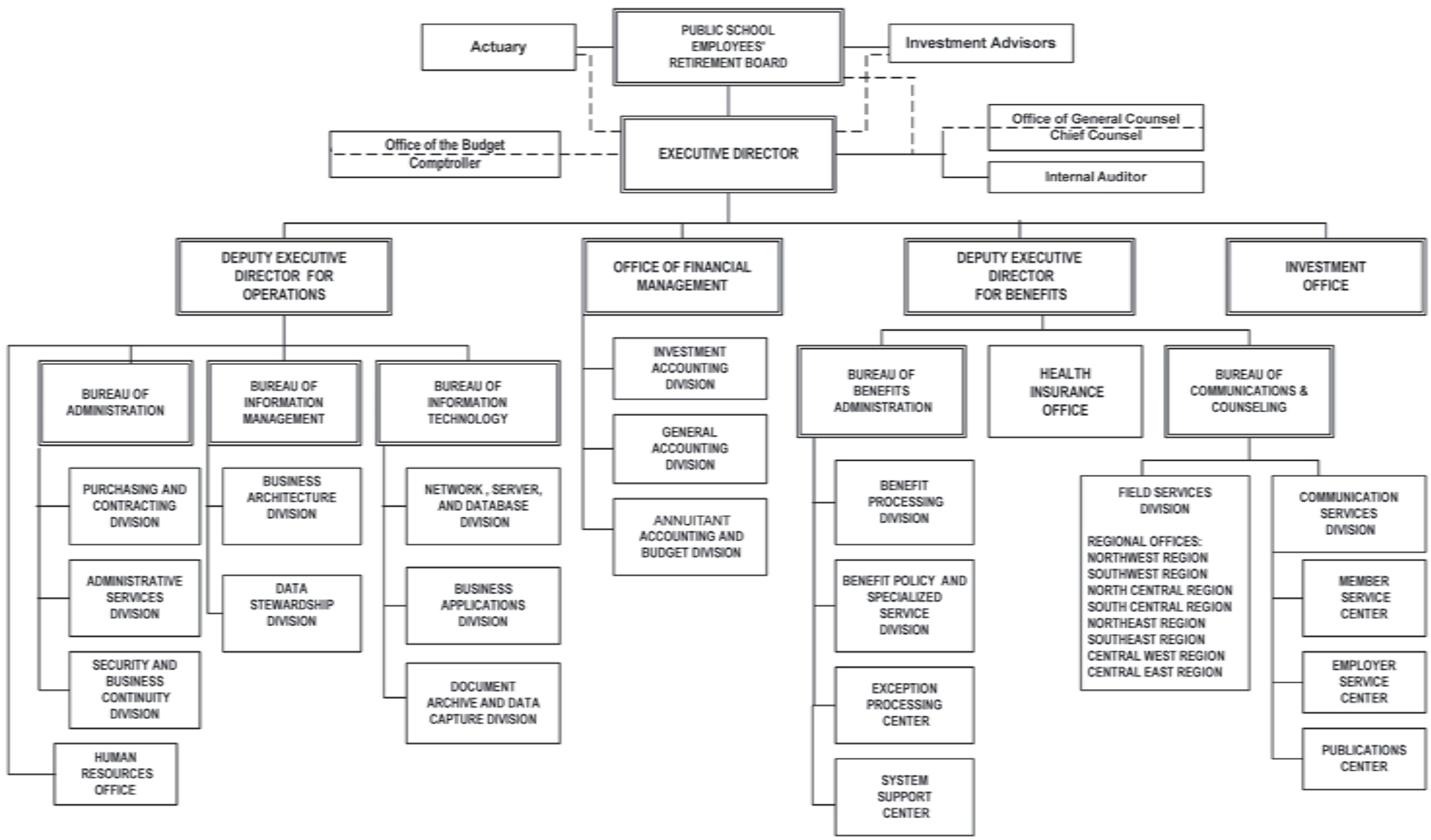
Mr. Gentzel, Chair
Ms. Byles-Williams
Representative Evans
Mrs. Turley
Treasurer Wiessmann
Representative Wonderling
Dr. Zahorchak

Technology Steering

Senator Fumo, Chair
Ms. Byles-Williams
Representative Evans
Mr. Galante
Treasurer Wiessmann
Dr. Zahorchak

NOTE: The chair of the Board of Trustees is a voting *ex-officio* member of all committees.

Organizational Chart of the Public School Employees' Retirement System



Organizational Structure of the Public School Employees' Retirement System

Executive Office

The Executive Office is responsible for the overall management of the Public School Employees' Retirement System (PSERS) to achieve the primary objectives of the Fund as established by the Board of Trustees (Board). Reporting directly to the Executive Director are the Deputy Executive Director for Operations, Deputy Executive Director for Benefits, Chief Investment Officer, Chief Financial Officer, Internal Auditor, Press Secretary, Board Liaison, and Legislative Liaison. The Executive Director serves as chief executive officer responsible for the establishment, installation, and maintenance of modern management techniques to provide an efficient control of funds for and services to the active members and annuitants of the System.

The Executive Office monitors the operation of the investment portfolio and evaluates portfolio performance for consideration by the Board, certifies expenditures of the Fund, and measures performance of professional individuals or firms with whom the Board contracts for specialized services. The Executive Office also apprises the Board of any development that will in any way affect the System and its operation.

Investment Office

The Investment Office is responsible for the investment activities of the System. In accordance with the investment policy established by the Board, PSERS' investment assets are allocated to numerous external professional investment advisors and internal investment professionals. Refer to the **Investment Section** Pages 81 to 87 for lists of professional investment advisors and Page 64 in the **Financial Section** for a summary of investment expenses.

Office of Chief Counsel

Legal services are provided by a team of professional personnel under the Governor's Office of General Counsel. The legal staff is responsible for representing the System in all administrative hearings and other litigation matters and providing counsel on a wide variety of matters including the interpretation of the Retirement Code, the form and legality of all System contracts, corporate governance issues and the structure and implementation of the System's varied financial investments.

Internal Auditor's Office

The Internal Auditor's Office performs systematic reviews of the various activities of PSERS, testing for compliance with applicable laws, policies and procedures. The Internal Auditor makes recommendations on the improvement of the System's internal control system.

Office of Financial Management

The Office of Financial Management has responsibility for planning, organizing and directing a complete accounting and financial reporting system in conformance with accounting principles generally accepted in the United States of America. Oversight is provided for new systems development and maintenance of existing systems, and ensuring appropriate accounting controls. The Office is the liaison for other state and federal agencies, reporting units, financial consultants, actuaries, and investment advisors for all accounting matters. The Office is organized into three divisions: General Accounting, Annuitant Accounting and Budget, and Investment Accounting.

General Accounting Division

The General Accounting Division has the responsibility of recording all financial transactions for the pension and health care operations of the system. It maintains PSERS' General Ledger, audits and processes administrative expenses, and prepares interim and annual financial statements. It bills and collects contributions due to the Fund from its employers. It provides accounts receivable services to the System for member debts. It also interacts with the other divisions in the Office of Financial Management to assure that the basic financial statements of the System include all financial activity monitored and controlled by those accounting divisions.

Annuitant Accounting and Budget Division

The Annuitant Accounting and Budget Division analyzes, controls and issues the System's benefit payments to retirees, members and other parties such as beneficiaries and the IRS. The Division also has the responsibility of monitoring and recording Postemployment Healthcare transactions. It reconciles and monitors the financial activities of the third party administrator of the Health Options Program. Additionally, the Division is responsible for developing and monitoring the System's annual budget.

Investment Accounting Division

The Investment Accounting Division (IAD) has responsibility for processing, monitoring, and recording all investment transactions. It contracts with a third-party application service provider to assist with monitoring the overall internal control structure for investments and assure adequate custody of all investment assets. It serves as intermediary with the custodian bank, the State Treasury Department, brokers, investment managers, the investment evaluator, and investment consultants. It audits and approves investment expenses, prepares monthly investment financial reports and processes all investment funding allocations.

The IAD is also responsible for directing and administering the Class Action Revenue Recovery, the Foreign Cash Overdraft and the Foreign Tax Reclaim Collection programs as part of PSERS' investment activities. It also supports PSERS' Investment Office and the Board in achieving investment objectives and monitoring compliance with investment policy. The Division is comprised of the Public Market Reporting and Analysis, Special Investment Reporting and Analysis, and Treasury and Manager Administration sections.

Deputy Executive Director, Operations

The Deputy Executive Director for Operations administers the facilities, technologies, data and records, policies and procedures, human resource, and procurement activities necessary to support, secure and optimize agency operations. Organizational units overseen by this position include the Human Resources Office, the Bureau of Administration, the Bureau of Information Management, and the Bureau of Information Technology.

Human Resources Office

The Human Resources Office is responsible for supporting management and staff to facilitate the accomplishment of the agency's mission. It administers all human resources programs and ensures compliance with labor law and Commonwealth regulations. Programs include position classification, labor relations, recruitment and placement, employee benefits, employee compensation and pay, training and staff development, time and attendance, performance management, organizational development and support, employee transactions, Equal Employment Opportunity and other miscellaneous programs.

Bureau of Administration

The Bureau of Administration provides facilities, purchasing and contracting, business continuity, automotive, mail, imaging, and other administrative services necessary to support agency functions.

Purchasing and Contracting Division

The Purchasing and Contracting Division procures materials, supplies, and services needed to support organizational goals and develops, monitors, processes and evaluates contract usage in the agency.

Administrative Services Division

The Administrative Services Division manages building and grounds for the agency both at the headquarters and at the regional locations.

It provides mail, imaging, and work introduction services, asset management, automotive, and other administrative services to the agency.

Security and Business Continuity Division

The Security and Business Continuity Division develops and implements those policies, programs and procedures necessary to ensure that PSERS' human, technology, and capital resources are secure and to ensure that PSERS is prepared to quickly recover and continue critical operations in the event of a disaster.

Bureau of Information Management

PSERS' organization, business processes, data, and information systems are inextricably intertwined with each other. To understand PSERS' business, as it exists, as well as the impact of change and potential for improvements, each of these components must be understood on their own, within the context of each other, and in context of PSERS' mission, vision, values and goals.

The goal of the Bureau of Information Management is to understand, analyze, document, and improve PSERS' organization, business rules, processes, information systems, data and the relationships among these components so that PSERS is able to:

- conduct its business consistently and according to established rules
- understand each component, its relationship to each of the other components and to PSERS' mission, vision, values and goals
- fully, yet quickly analyze and understand the impact of potential change to one or more of these components on the others
- more effectively identify inefficient, duplicate, or suspect processes, data, or technologies
- account for its organization, business rules and processes, information systems and technologies, and data
- best manage its electronic data records, imaged records, paper and film/fiche records
- understand the meaning and know the location of its data
- ensure that PSERS' data, information systems, and business processes meet established quality goals
- manage PSERS' forms
- ensure that PSERS' data, forms, information systems, and business processes are in support of its business.

Business Architecture Division

The Division of Business Architecture includes analysts who collect, analyze, and document PSERS' organization, business rules, processes, information systems, and data, and perform detailed impact analysis as and when change is proposed. Additionally, staff in this unit confirm that changes have been applied correctly. Staff in this unit also look for opportunities for improvement, lead the development of business requirements and serve as liaisons between PSERS' end-users and Information Technology staff.

This division serves as the repository for PSERS' business knowledge and makes that knowledge available and understandable to agency processing and technology staff.

This division also receives and responds to data queries from agency staff and investigates system, data, or process problems. Finally, this division maintains responsibility for PSERS' records and forms management programs.

Data Stewardship Division

PSERS has realized that poor data quality and/or the lack of data can be a significant inhibitor to timely and efficient processing. Staff in the Division of Data Stewardship are the trustees and primary maintainers of PSERS' member and employer data, working to make this data most usable to agency processing staff. Specifically, this group maintains PSERS' member demographic information, affiliate information, and is responsible for correctly applying monetary and non-monetary adjustments to member accounts.

Bureau of Information Technology

The Bureau of Information Technology is responsible for planning, coordinating, administering, implementing, and supporting information technology resources within PSERS and for providing operational support for those technologies. The Bureau is organized into three Divisions: The Network, Server, and Database Division, the Business Applications Division and the Document Archive and Data Capture Division.

Network, Server, and Database Division

The Network, Server, and Database Division is responsible for administering those information technology resources that collectively provide the fundamental hardware, software, and network components and services required to support PSERS various applications.

Business Applications Division

The Business Applications Division provides consultative, technical, and operational support in the planning, design, specification, configuration, development, implementation, operation, support, and troubleshooting of PSERS' business applications.

Document Archive and Data Capture Division

The Document Archive and Data Capture Division provides consultative, technical, and operational support in the planning, design, specification, configuration, development, implementation, operation, support, and troubleshooting of PSERS' enterprise archive application software, scanning software, and data capture software as well as the interfaces of those applications with PSERS' various business applications. This division also develops and implements archive project solutions for the PSERS using a variety of archive tools and applications.

Deputy Executive Director, Benefits

The Deputy Executive Director for Benefits oversees the administration of the benefits programs for all active and retired members of the System and oversees the development and implementation of the communications and counseling programs. Organizational units under the management of the Deputy include the Bureau of Benefits Administration, the Bureau of Communications and Counseling and the Health Insurance Office.

Bureau of Benefits Administration

The Bureau of Benefits Administration (BBA) is responsible for administering a comprehensive pension benefits program for PSERS. The bureau provides professional and technical services to individuals who are employed full-time and part-time in one of Pennsylvania's 739 public schools or institutions. They also provide services to retirees, their beneficiaries and persons legally authorized to act on their behalf.

Benefit Processing Division

The Benefit Processing Division is responsible for handling a high volume of benefit requests. It houses the following centers:

Retirement Processing Center

The Retirement Processing Center determines eligibility and calculates estimated retirement benefits, creates payroll records, and originates the initial benefit payments and direct rollovers. When employers report final salary and service data, staff conduct in-depth reviews of accounts and calculate finalized benefits.

Purchase of Service and Refund Center

The Purchase of Service and Refund Center determines eligibility and calculates the cost to the members and to the employers for the purchase of additional service credit. Staff also process requests to refund contributions and interest from members terminating from the system.

Exception Processing Division

The Exception Processing Division is responsible for a variety of benefit requests which involve manual or special processing. It houses the following centers:

Manual Processing and Multiple Service Membership Center

The Manual Processing and Multiple Service Membership Center is responsible for a variety of benefit requests such as frozen annuity calculations, intent to change recalculations, cost of living increases and the calculation of retirement benefits for Multiple Service (MS) members who are retiring from SERS or PSERS. The MS Membership Section processes requests for MS membership eligibility and the calculation of purchase of service requests.

Disability and Death Benefit Center

The Disability and Death Benefit Center handles all requests for disability benefits. Medical examiners work with staff to obtain sufficient and current medical information. Staff are responsible for the review of annual earnings affidavit and for the calculation of both initial and final disability retirement benefits. Staff are also responsible for the payment of death benefits when members die prior to retirement. These payments frequently exceed $1 million and involve extensive communication with beneficiaries, survivors and estate representatives. Last, this area also processes survivor and death benefits when members die subsequent to retirement. Because approximately 5,000 retired members die each year, the Center responds to high volumes of requests. The process includes the return of checks issued after death, collection of premium assistance, and the calculation and payment of death benefits.

Benefits Policy and Exception Processing Division

The Benefit Policy and Exception Processing Division has responsibility for creating and writing all benefits policies, procedures, business rules and calculations and presenting policies to the Executive staff and the Board's Appeals/ Members Services Committee; for coordinating all requests for legal analyses and legal opinions; and for working with the System's actuaries regarding benefit calculations and audits. The staff also manages the first level of the member's administrative appeal process.

This division makes determinations relative to membership eligibility, retirement covered compensation and emergency employment where circumstances are suspect or atypical. To insure compliance with the Retirement Code, the division is also responsible for the review and approval of domestic relations orders.

The staff of this division also handles the benefits determinations that are more complex, more time-sensitive or have a significant impact on the agency or the members. This work includes divorce transactions, death benefits for in-service members, frozen annuity calculations, computations that must comply with special IRS regulations, multiple service eligibility and calculations, post finalized benefit adjustments, calculating cost of living increases and processing changes to annuitant or survivor gross benefits.

System Support Center

The System Support Center's primary responsibility is to work with technical staff in the Bureau of Information Technology to enhance automated business systems and the use of technology within the business areas. Enhancements are the result of changing technology as well as changes to legislation, court decisions and board policies. Work involves workflow analysis, requirements definition, testing and implementation. The Center is also responsible for reporting and providing assistance to resolve all problems with production, hardware and software.

Bureau of Communications & Counseling

The Bureau of Communications and Counseling is responsible for professionally communicating accurate and timely information. The goal is to promote the understanding of PSERS' benefits and processes to the members, the employers, the Legislature, the Governor's Office, other government organizations, professional organizations and the public.

Field Services Division

The Field Services Division provides services to both active and retired PSERS' members through eight regional offices located throughout the Commonwealth of Pennsylvania. The regional representatives conduct various meetings and workshops for members and employers and provide counseling services.

Communication Services Division

The Communication Services Division provides information to the members, employers, and the general public through the telephone, on-site visits, the worldwide web and various publications. There are four centers within this division:

Member Service Center

This center answers the PSERS' toll-free telephone number, responding to general inquiries about the benefits and processes of the System as well as specific inquiries related to members' accounts.

Employer Service Center

Staffing of the center includes customer service representatives to answer phone calls and emails, as well as field representatives to visit employers and conduct workshops, to provide assistance and training for proper reporting to the System.

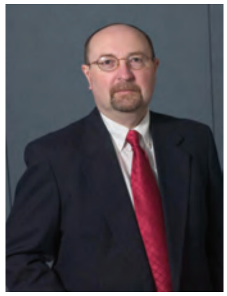
Publications Center

This center is responsible for the development, production, and distribution of all printed and audiovisual materials for the System. Publications include newsletters, handbooks, pamphlets, annual reports, mass communications to the membership, and presentation material. Staff also responds to general correspondence and email inquiries.

Health Insurance Office

This office is responsible for all aspects of the PSERS' Health Options Program and administering the annuitants' health insurance premium assistance benefits. HOP is a voluntary statewide plan that provides group health insurance coverage for school retirees, their spouses, and eligible dependents.

Administrative Staff



Jeffrey B. Clay
Executive Director

Gerald Gornish
Chief Counsel

Arthur J. Granito
Chief
Financial Officer

Terrill J. Savidge
Deputy Executive
Director, Operations

Veronica P. Thomas
Deputy Executive
Director, Benefits

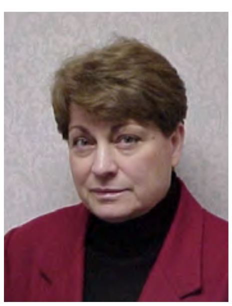
Alan H. Van Noord
Chief
Investment Officer

Douglas A. Bonsall
Director of Communications
& Counseling

Deborah L. Garraway
Director of Information
Management

Donald J. Halke, II
Internal Auditor

Helen D. Hosler
Director of Benefits
Administration



Maribel La Luz
Director of Human
Resources

James F. Noone
Director of Administration

Mark F. Schafer
Director of Health Insurance

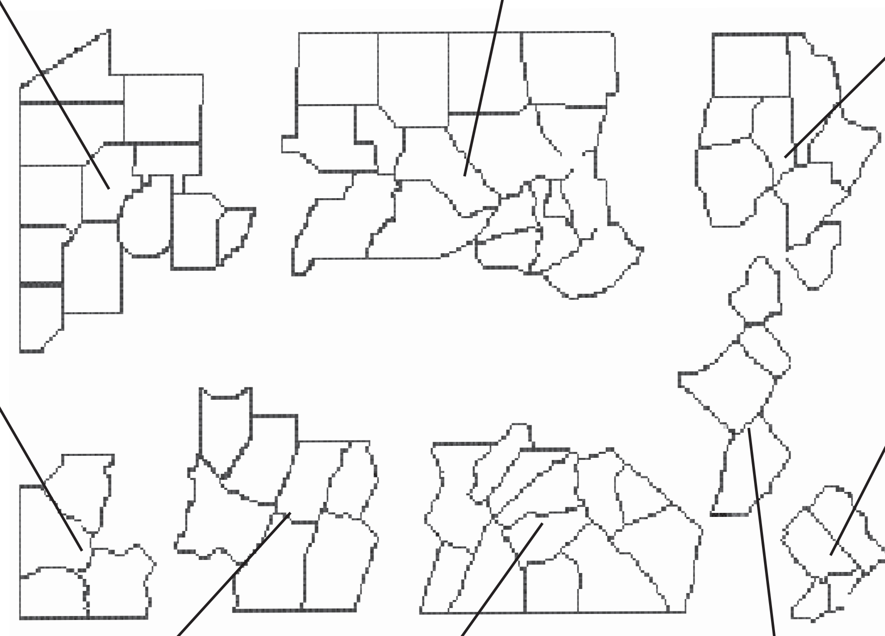
PSERS REGIONAL OFFICES

NORTHWEST
Penn Wood Center, Suite C
464 Allegheny Blvd.
Franklin, PA 16323-6210
Local (814) 437-9845
FAX (814) 437-5826
Toll Free 1-888-773-7748 ext. 5175

NORTHCENTRAL
Suite 201
300 Bellefonte Avenue
Lock Haven, PA 17745-1903
Local (570) 893-4410
FAX (570) 893-4414
Toll Free 1-888-773-7748 ext. 5275

NORTHEAST
Market Street Victorian Square
33 S Wilkes Barre Blvd., Suite 20
Wilkes Barre, PA 18702-5144
Local (570) 826-2003
FAX (570) 820-4868
Toll Free 1-888-773-7748 ext. 5375

SOUTHWEST
900 Sarah Street, Suite 208
Pittsburgh, PA 15203-1106
Local (412) 488-2031
FAX (412) 488-2338
Toll Free 1-888-773-7748 ext. 5775



SOUTHEAST
605 Louis Drive, Suite 500
Warminster, PA 18974-2825
Local (215) 443-3495
FAX (215) 443-3487
Toll Free 1-888-773-7748 ext. 5575

CENTRALWEST
636 Scalp Avenue
Johnstown, PA 15904-1640
Local (814) 262-7715
FAX (814) 262-7625
Toll Free 1-888-773-7748 ext. 5875

SOUTHCENTRAL
Three Crossgate Drive, Suite 101
Mechanicsburg, PA 17050-2459
Local (717) 795-9270
FAX (717) 795-9281
Toll Free 1-888-773-7748 ext. 5675

CENTRALEAST
110 West Arch Street, Suite 204
Fleetwood, PA 19522-1321
Local (610) 944-9113
FAX (610) 944-9275
Toll Free 1-888-773-7748 ext. 5475

PSERS Headquarters Building

The headquarters of the Public School Employees' Retirement System is located at 5 North Fifth Street in downtown Harrisburg, Pennsylvania within the State Capitol complex. Regional field offices are also maintained in Fleetwood, Franklin, Johnstown, Lock Haven, Mechanicsburg, Pittsburgh, Warminster and Wilkes Barre.

The building was built and first occupied by the Retirement System in 1987 and is its first home built specifically for its use. It is owned by the Five North Fifth Street Corporation, a holding entity formed by PSERS, and is managed by Property Management Inc.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

The Board of Trustees
Public School Employees' Retirement System
Harrisburg, Pennsylvania

We have audited the accompanying basic financial statements of the Public School Employees' Retirement System (PSERS), a component unit of the Commonwealth of Pennsylvania as of and for the years ended June 30, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the PSERS' 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, PSERS' plan net assets as of June 30, 2007 and 2006, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and Required Supplemental Schedules of Funding Progress and Employer Contributions (Schedules 1 and 2) 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 made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Supplemental Schedules 1 through 3 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Supplemental Schedules 1 through 3 have been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, are presented fairly, in all material respects, in relation to the basic financial statements taken as a whole.

The Chairman's Report, Introductory Section, Investment Section, Actuarial Section and Statistical Section as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Chairman's Report and the Introductory, Investment, Actuarial and Statistical Sections have not been subject to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Clifton Gunderson LLP

Baltimore, Maryland
September 27, 2007

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Offices in 17 states and Washington, DC

Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) of the Commonwealth of Pennsylvania Public School Employees' Retirement System's (PSERS) for the fiscal year ended June 30, 2007, provides a narrative summary of PSERS' financial position and performance, including highlights and comparative data. The MD&A is presented as required supplemental information to the financial statements and should be read in conjunction with the letter of transmittal, the financial statements, the notes to financial statements and the supplementary schedules.

Overview of Financial Statements

PSERS is primarily responsible for administering a defined benefit pension plan for public school employees in the Commonwealth of Pennsylvania. PSERS also administers two postemployment healthcare programs, the Health Insurance Premium Assistance Program (Premium Assistance) and the Health Options Program (HOP), for its annuitants. The financial statements present the financial activities for the pension plan and the two postemployment healthcare programs.

The *Statements of Plan Net Assets* provide a snapshot of the financial position of PSERS at June 30, 2007, including comparative amounts for the prior year.

The *Statements of Changes in Plan Net Assets* summarize PSERS' financial activities that occurred during the fiscal period from July 1, 2006 to June 30, 2007, including comparative amounts for the prior year.

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 not readily evident in the basic financial statements.

The *Required Supplemental Schedules* immediately following the notes to financial statements provide two schedules showing historical information concerning the funded status of PSERS and the employer contributions.

The remaining supplemental schedules provide additional detailed information concerning the operating expenses, investment expenses and payments to non-investment consultants. All of this supplemental information is considered useful in understanding and evaluating the financial activities of PSERS.

Financial Highlights

- PSERS' total plan net assets increased by $10.1 billion from $57.4 billion at June 30, 2006 to $67.5 billion at June 30, 2007, the highest fiscal year-end total in PSERS' history. The increase is primarily attributable to net investment income and member and employer contributions combined that exceeded the payment of pension benefits and administrative expenses. The increase in plan net assets from $52.1 billion to $57.4 billion in the year ended June 30, 2006, was also attributed to net investment income and member and employer contributions combined that exceeded the payment of pension benefits and administrative expenses.

Management's Discussion and Analysis (Continued)

- PSERS' funded ratio as of the latest actuarial valuation dated June 30, 2006 decreased from 83.6% at June 30, 2005 to 81.2% at June 30, 2006. The decrease is primarily due to the residual effect of an actuarial asset loss caused by the downturn in the financial markets from 2001 to 2003. The funded ratio at June 30, 2004 was 91.2%.
- The rate of return on investments was 22.93% for the fiscal year ended June 30, 2007 (FY 2007), 15.26% for the fiscal year ended June 30, 2006 (FY 2006) and 12.87% for the fiscal year ended June 30, 2005 (FY 2005).
- Total member contributions increased from $983 million in FY 2006 to $1 billion in FY 2007 due to a slight increase in the average member contribution rate and an increase in the active member payroll. Total member contributions also increased between FY 2005 and FY 2006 because of the same factors.
- Total employer contributions increased from $531 million in FY 2006 to $746 million in FY 2007. The net increase is primarily attributable to an increase in the total employer contribution rate from 4.69% in FY 2006 to 6.46% in FY 2007. Total employer contributions increased from FY 2005 to FY 2006 due to an increase in the total employer contribution rate from 4.23% to 4.69%.
- Total PSERS' benefit payouts increased by $200 million from $4.1 billion in FY 2006 to $4.3 billion in FY 2007. The increase is primarily attributable to an increase in the number of retirees and beneficiaries currently receiving benefits. Benefit payouts also increased by $200 million from FY 2005 to FY 2006 due to an increase in the number of retirees added to the payroll.
- Total administrative expenses increased by $1.9 million from $48.6 million in FY 2006 to $50.5 million in FY 2007 primarily due to higher administrative expenses for Premium Assistance and HOP. Administrative expenses increased by $6 million between FY 2005 and FY 2006 primarily due to the carry-over of expenditures for the New Pension Administration System Project and an increase in expenditures for HOP in FY 2006. Administrative expenses were within PSERS' budgeted amounts for each of the fiscal years.

Funded Status

PSERS 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 PSERS' actuarial assets and liabilities is performed annually. As part of this valuation, the progress toward funding pension obligations of PSERS is measured by comparing the actuarial value of assets to the actuarial accrued liability. This measurement is referred to as the funded ratio or funded status. The most recent actuarial valuation reports that PSERS is 81.2% funded as of June 30, 2006. The results of operations for FY 2007 will be reflected in the actuarial valuation for the year ended June 30, 2007. Due to the normal lag time for completion of the actuarial valuation, the resulting funded status will be available at the end of the 2007 calendar year and will be reported in the financial statements for the fiscal year ended June 30, 2008 (FY 2008).

Management's Discussion and Analysis (Continued)

Analysis of Plan Net Assets

Summary of Plan Net Assets:	**FY 2007**	Increase (Decrease)	FY 2006	Increase (Decrease)	FY 2005
Assets:					
Receivables	**$ 1,766,906**	$ 180,343	$ 1,586,563	$ 64,569	$ 1,521,994
Investments	**68,526,533**	9,807,264	58,719,269	5,781,217	52,938,052
Securities lending collateral pool	**8,806,979**	2,469,806	6,337,173	(263,511)	6,600,684
Fixed assets	**870**	227	643	(230)	873
Total Assets	**$ 79,101,288**	12,457,640	66,643,648	5,582,045	61,061,603
Liabilities:					
Payables and other liabilities	**2,771,605**	(117,569)	2,889,174	539,681	2,349,493
Obligations under securities lending	**8,806,979**	2,469,806	6,337,173	(263,511)	6,600,684
Total Liabilities	**11,578,584**	2,352,237	9,226,347	276,170	8,950,177
Plan Net Assets	**$ 67,522,704**	$ 10,105,403	$57,417,301	$ 5,305,875	$ 52,111,426
Summary of Changes in Plan Net Assets:					
Additions:					
Contributions	**$ 1,773,604**	$ 245,874	$ 1,527,730	$ 114,413	$ 1,413,317
Net investment income	**12,702,721**	4,760,082	7,942,639	1,861,142	6,081,497
Total Additions	**14,476,325**	5,005,956	9,470,369	1,975,555	7,494,814
Deductions:					
Benefit payments	**4,320,440**	204,575	4,115,865	238,023	3,877,842
Administrative expenses	**50,482**	1,853	48,629	5,984	42,645
Total Deductions	**4,370,922**	206,428	4,164,494	244,007	3,920,487
Changes in Plan Net Assets	**$ 10,105,403**	$ 4,799,528	$ 5,305,875	$ 1,731,548	$ 3,574,327

Investments

PSERS is a long-term investor and manages the pension fund with long-term objectives in mind. A primary element of PSERS' investment philosophy is that diversification among various asset classes is the best way to achieve its goals. PSERS makes estimates of future long-term market returns and establishes an asset allocation plan taking into account the risk associated with each asset class as well as the financial objectives of the Fund.

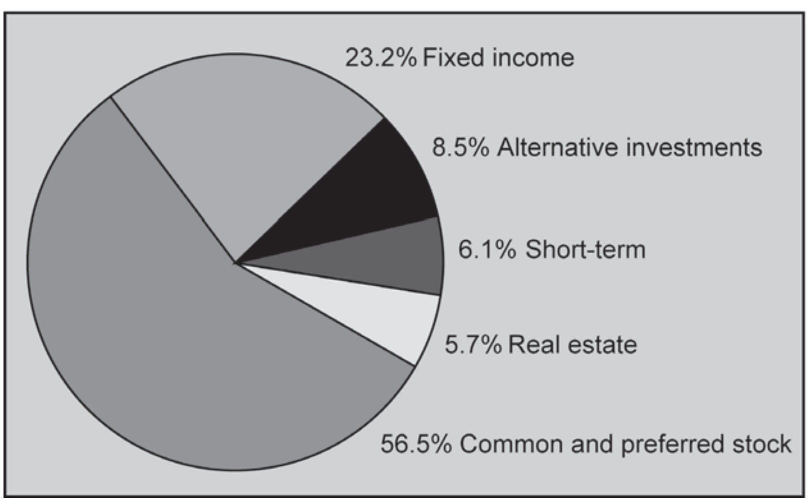
Management's Discussion and Analysis (Continued)

For FY 2007, PSERS' rate of return on investments was 22.93%. The FY 2007 investment return exceeded PSERS' total fund policy index of 18.48% and placed PSERS' performance in the top one percent of the Public Fund Universe prepared by the System's investment consultant, Wilshire Associates Inc. (Wilshire). The annualized rate of return over the past three and five-year periods ended June 30, 2007 was 16.94% and 14.48%, respectively. The annualized rate of return for the ten-year period ended June 30, 2007 was 9.67%. PSERS' long-term actuarial investment rate of return assumption is 8.50%.

The asset distribution of PSERS' investment portfolio at June 30, 2007 and June 30, 2006, at fair value, including postemployment healthcare assets, was:

	(Dollar Amounts in Thousands)			
Asset Class	**2007**	**%**	2006	%
Short-term	**$ 4,164,010**	**6.1**	$ 4,061,926	6.9
Fixed income	**15,919,998**	**23.2**	13,962,196	23.8
Common and preferred stock	**38,715,473**	**56.5**	32,951,976	56.1
Real estate	**3,887,986**	**5.7**	2,542,399	4.3
Alternative investments	**5,839,066**	**8.5**	5,200,772	8.9
Total	**$68,526,533**	**100.0**	$ 58,719,269	100.0

Asset Distribution
At June 30, 2007



Management's Discussion and Analysis (Continued)

Short-term investments (cash and cash equivalents) at the close of FY 2007 increased by $100 million from $4.1 billion in FY 2006 to $4.2 billion in FY 2007. Short-term investments remained high as the Fund continued to maintain a portion of its fixed income allocation in cash and cash equivalents due to favorable short-term yields and a relatively flat yield curve at the end of FY 2007. Fixed income investments increased by $1.9 billion from $14.0 billion in FY 2006 to $15.9 billion in FY 2007 due to favorable investment returns partially reinvested in fixed income, additional allocations to the asset class and as the result of several investment managers shifting a portion of their short-term investments to fixed income. Common and preferred stock investments increased by $5.7 billion from $33.0 billion in FY 2006 to $38.7 billion in FY 2007. The increase was primarily due to strong positive returns in the domestic and international equity markets that were reinvested in the asset class. This increase was partially offset by allocation reductions to the asset class during FY 2007 in accordance with PSERS' asset allocation plan. Real estate investments increased by $1.4 billion from $2.5 billion in FY 2006 to $3.9 billion in FY 2007 due to very strong returns and net allocation increases to new and existing real estate partnerships. Alternative investments increased by $600 million from $5.2 billion in FY 2006 to $5.8 billion in FY 2007 due to the addition of new investment partnerships, drawdowns of commitments to existing partnerships and market value appreciation.

Contributions and Investment Income

Employer pension contributions increased by $202.6 million from $456.9 million in FY 2006 to $659.5 million in FY 2007. The increase is attributable to the increase in the employer pension contribution rate from 4.00% in FY 2006 to 5.67% in FY 2007. Member pension contributions increased by $27.7 million from $827.6 million in FY 2006 to $855.3 million in FY 2007 as a result of the increase in the total participant salary base and the average member contribution rate increasing from 7.16% in FY 2006 to 7.21% in FY 2007. The employer contributions for health insurance premium assistance increased by $12.7 million from $74.1 million in FY 2006 to $86.8 million in FY 2007 due to the increase in the employer health insurance premium assistance contribution rate from 0.69% in FY 2006 to 0.74% in FY 2007. Contributions from the Centers for Medicare and Medicaid Services (CMS) increased from $13.9 million in FY 2006 to $27.8 million in FY 2007. FY 2007 was the first full year of contributions as PSERS became a Prescription Drug Plan (PDP) on January 1, 2006. Net investment income increased by $4.8 billion from $7.9 billion in FY 2006 to $12.7 billion in FY 2007, which correlates to the increase in the investment rate of return from 15.26% for FY 2006 to 22.93% for FY 2007. The 22.93% investment return for FY 2007 placed PSERS' performance in the top one percent of the Wilshire Public Fund Universe. The annual investment returns for FY 2006 and FY 2005 were also strong at 15.26% and 12.87%, respectively. Net investment income also includes investment expenses as a deduction. The "Total PSERS Benefits and Expenses" section that follows includes an analysis of investment expenses.

In the 2003 actuarial valuation, the employer contribution rate was projected to sharply increase to 27.73% of payroll for the 2012-2013 fiscal year. In the subsequent time period, PSERS has experienced four consecutive years of exceptionally strong performance in its investment returns.

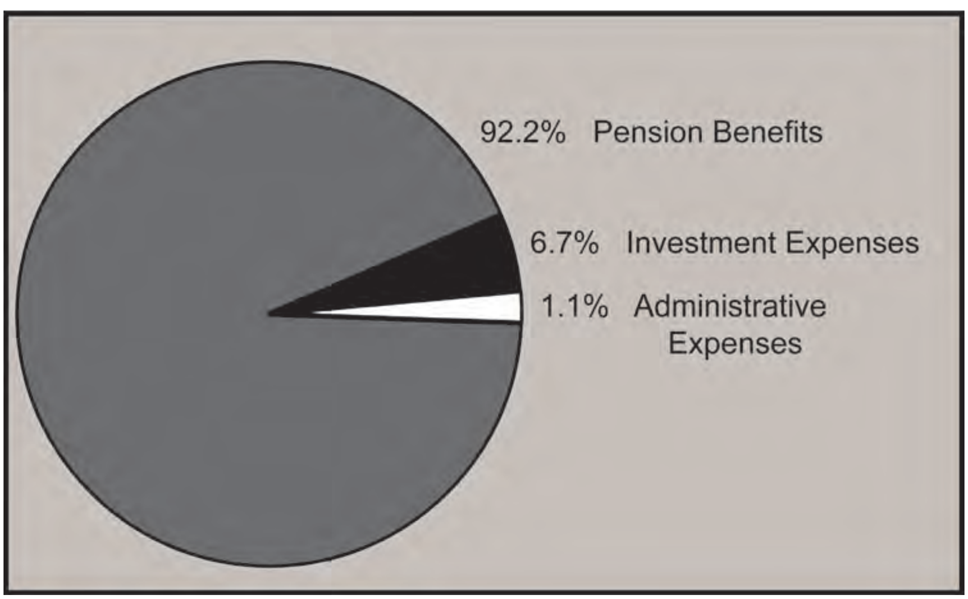
Management's Discussion and Analysis (Continued)

The investment returns for the fiscal years ended June 30, 2004, 2005, 2006 and 2007 were 19.67%, 12.87%, 15.26% and 22.93%, respectively. Factoring in this strong investment performance over the past four years, the 2012-2013 employer contribution rate projection is expected to decrease to below 12.00% of payroll upon completion of the 2007 actuarial valuation. The sub-12.00% of payroll rate represents a substantial improvement over the original projection of 27.73% of payroll.

Total PSERS' Benefits and Expenses

The primary source of expense during FY 2007 was for the payment of benefits totaling $4.3 billion. This compares to benefit payments of $4.1 billion during FY 2006 and $3.9 billion for FY 2005. Investment expenses increased by $102.5 million from $211.3 million in FY 2006 to $313.8 in FY 2007 due primarily to increased manager fees in public and private markets. The higher fees were due to increases in the total Fund value as well as new investments in various portable alpha strategies and private market partnerships, which have higher manager fees. Investment expenses increased by $18.6 million from $192.7 million during FY 2005 to $211.3 million during FY 2006, consistent with the increase in the total Fund value. Investment expenses are reported as a reduction in net investment income on the Statements of Changes in Plan Net Assets. Administrative expenses increased by $1.9 million from $48.6 million during FY 2006 compared to $50.5 million during FY 2007. The increase was due to higher administrative expenses for Premium Assistance and HOP. Administrative expenses for FY 2005 totaled $42.6 million.

Total PSERS' Benefits and Expenses
Fiscal Year Ended June 30, 2007



Statements of Plan Net Assets

June 30, 2007 and 2006

(Dollar Amounts in Thousands)

	2007			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Assets:				
Receivables:				
Members	**$ 256,932**	**$ 545**	**$ 77**	**$ 257,554**
Employers	**234,947**	**28,152**	**-**	**263,099**
Investment income	**229,320**	**387**	**401**	**230,108**
Investment proceeds	**1,013,317**	**-**	**-**	**1,013,317**
Miscellaneous	**2,802**	**26**	**-**	**2,828**
Total Receivables	**1,737,318**	**29,110**	**478**	**1,766,906**
Investments, at fair value:				
Short-term	**3,983,285**	**68,869**	**111,856**	**4,164,010**
Fixed income	**15,919,998**	**-**	**-**	**15,919,998**
Common and preferred stock	**38,715,473**	**-**	**-**	**38,715,473**
Real estate	**3,887,986**	**-**	**-**	**3,887,986**
Alternative investments	**5,839,066**	**-**	**-**	**5,839,066**
Total Investments	**68,345,808**	**68,869**	**111,856**	**68,526,533**
Securities lending collateral pool	**8,806,979**	**-**	**-**	**8,806,979**
Capital assets (net of accumulated depreciation of $10,656)	**870**	**-**	**-**	**870**
Total Assets	**78,890,975**	**97,979**	**112,334**	**79,101,288**
Liabilities:				
Accounts payable and accrued expenses	**78,742**	**292**	**1,404**	**80,438**
Benefits payable	**201,916**	**395**	**11,913**	**214,224**
Premium advances	**-**	**-**	**14,602**	**14,602**
Investment purchases and other liabilities	**2,462,341**	**-**	**-**	**2,462,341**
Obligations under securities lending	**8,806,979**	**-**	**-**	**8,806,979**
Total Liabilities	**11,549,978**	**687**	**27,919**	**11,578,584**
Net assets held in trust for pension and postemployment healthcare benefits (Schedules of funding progress are presented on Required Supplemental Schedule 1)	**$67,340,997**	**$ 97,292**	**$ 84,415**	**$67,522,704**

The accompanying notes are an integral part of the financial statements.

Statements of Plan Net Assets

June 30, 2007 and 2006

(Dollar Amounts in Thousands)

	2006			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Assets:				
Receivables:				
Members	$ 236,005	$ 400	$ 276	$ 236,681
Employers	164,377	27,733	-	192,110
Investment income	193,699	300	353	194,352
Investment proceeds	960,102	224	-	960,326
Miscellaneous	2,357	737	-	3,094
Total Receivables	1,556,540	29,394	629	1,586,563
Investments, at fair value:				
Short-term	3,880,369	64,706	116,851	4,061,926
Fixed income	13,962,196	-	-	13,962,196
Common and preferred stock	32,951,976	-	-	32,951,976
Real estate	2,542,399	-	-	2,542,399
Alternative investments	5,200,772	-	-	5,200,772
Total Investments	58,537,712	64,706	116,851	58,719,269
Securities lending collateral pool	6,337,173	-	-	6,337,173
Capital assets (net of accumulated depreciation of $10,402)	643	-	-	643
Total Assets	66,432,068	94,100	117,480	66,643,648
Liabilities:				
Accounts payable and accrued expenses	42,059	325	3,062	45,446
Benefits payable	159,390	811	11,709	171,910
Premium advances	-	-	13,852	13,852
Investment purchases and other liabilities	2,657,779	187	-	2,657,966
Obligations under securities lending	6,337,173	-	-	6,337,173
Total Liabilities	9,196,401	1,323	28,623	9,226,347
Net assets held in trust for pension and postemployment healthcare benefits (Schedules of funding progress are presented on Required Supplemental Schedule 1)	$57,235,667	$ 92,777	$ 88,857	$57,417,301

The accompanying notes are an integral part of the financial statements.

Statements of Changes in Plan Net Assets

Years ended June 30, 2007 and 2006

(Dollar Amounts in Thousands)

	2007			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Additions:				
Contributions:				
Members	$ 855,322	$ -	$ 144,185	$ 999,507
Employers	659,545	86,763	-	746,308
Centers for Medicare & Medicaid Services	-	-	27,789	27,789
Total contributions	1,514,867	86,763	171,974	1,773,604
Investment income:				
From investing activities:				
Net appreciation in fair value of investments	10,457,473	88	-	10,457,561
Short-term	181,462	2,517	5,821	189,800
Fixed income	713,257	-	-	713,257
Common and preferred stock	1,019,322	-	-	1,019,322
Real estate	334,264	-	-	334,264
Alternative investments	276,350	-	-	276,350
Total investment activity income	12,982,128	2,605	5,821	12,990,554
Investment expenses	(313,726)	(32)	-	(313,758)
Net income from investing activities	12,668,402	2,573	5,821	12,676,796
From securities lending activities:				
Securities lending income	419,762	-	-	419,762
Securities lending expense	(393,837)	-	-	(393,837)
Net income from securities lending activities	25,925	-	-	25,925
Total net investment income	12,694,327	2,573	5,821	12,702,721
Total Additions	14,209,194	89,336	177,795	14,476,325
Deductions:				
Benefits	4,044,435	82,031	169,784	4,296,250
Refunds of contributions	18,180	-	-	18,180
Net transfer to State Employees' Retirement System	6,010	-	-	6,010
Administrative expenses	35,239	2,790	12,453	50,482
Total Deductions	4,103,864	84,821	182,237	4,370,922
Net increase (decrease)	10,105,330	4,515	(4,442)	10,105,403
Net assets held in trust for pension and postemployment healthcare benefits:				
Balance, beginning of year	57,235,667	92,777	88,857	57,417,301
Balance, end of year	$ 67,340,997	$ 97,292	$ 84,415	$ 67,522,704

The accompanying notes are an integral part of the financial statements.

Statements of Changes in Plan Net Assets

Years ended June 30, 2007 and 2006

(Dollar Amounts in Thousands)

	2006			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Additions:				
Contributions:				
Members	$ 827,647	$ -	$ 155,199	$ 982,846
Employers	456,878	74,065	-	530,943
Centers for Medicare & Medicaid Services	-	-	13,941	13,941
Total contributions	1,284,525	74,065	169,140	1,527,730
Investment income:				
From investing activities:				
Net appreciation (depreciation) in fair value of investments	5,969,223	(480)	123	5,968,866
Short-term	129,788	3,362	3,641	136,791
Fixed income	694,449	-	439	694,888
Common and preferred stock	771,276	-	-	771,276
Real estate	285,333	-	-	285,333
Alternative investments	273,808	-	-	273,808
Total investment activity income	8,123,877	2,882	4,203	8,130,962
Investment expenses	(211,247)	(32)	-	(211,279)
Net income from investing activities	7,912,630	2,850	4,203	7,919,683
From securities lending activities:				
Securities lending income	270,447	-	-	270,447
Securities lending expense	(247,491)	-	-	(247,491)
Net income from securities lending activities	22,956	-	-	22,956
Total net investment income	7,935,586	2,850	4,203	7,942,639
Total Additions	9,220,111	76,915	173,343	9,470,369
Deductions:				
Benefits	3,860,658	79,298	151,117	4,091,073
Refunds of contributions	16,330	-	-	16,330
Net transfer to State Employees' Retirement System	8,462	-	-	8,462
Administrative expenses	35,391	1,977	11,261	48,629
Total Deductions	3,920,841	81,275	162,378	4,164,494
Net increase (decrease)	5,299,270	(4,360)	10,965	5,305,875
Net assets held in trust for pension and postemployment healthcare benefits:				
Balance, beginning of year	51,936,397	97,137	77,892	52,111,426
Balance, end of year	$ 57,235,667	$ 92,777	$ 88,857	$ 57,417,301

The accompanying notes are an integral part of the financial statements.

Notes To Financial Statements

June 30, 2007 and 2006

1. Organization and Description of the System

(a) Organization

The System was established on July 18, 1917, under the provisions of Pamphlet Law 1043, No. 343 as a governmental cost-sharing multiple-employer plan that provides retirement allowances and other benefits to its members. Membership in the System is mandatory for nearly all qualifying public school employees in the Commonwealth of Pennsylvania (Commonwealth). At June 30, 2007, there were 739 participating employers, generally school districts. Membership as of June 30, 2006, the most recent year for which actual amounts are available, consisted of:

Currently employed members:		
Vested	177,000	
Nonvested	86,000	
Total currently employed members		**263,000**
Retirees and beneficiaries currently receiving benefits	162,000	
Inactive members and vestees entitled to but not receiving benefits	94,000	
Total retirees and other members		**256,000**
Total number of members		**519,000**

All members are fully vested in their individual balance in the Members' Savings Account which is described in Note 3.

The System is established by state law as an independent administrative board of the Commonwealth, which is directed by the Public School Employees' Retirement Board (the Board) that exercises control and management of the System, including the investment of its assets. The System's board has fifteen members including the Commonwealth's Secretary of Education, the State Treasurer, the Executive Director of the Pennsylvania School Boards Association, two members appointed by the Governor, six elected members (three from among the System's certified members, one from among the System's non-certified members, one from among the System's annuitants, and one from among school board members in Pennsylvania), two members from the Senate, and two members from the House of Representatives.

The State Treasurer is the custodian of the System's fund. The retirement plan of the System is a contributory defined benefit plan for which the benefit payments to members and contribution provisions by employers and employees are specified in the Pennsylvania Public School Employees' Retirement Code (the Code). Changes in benefit and contribution provisions for the retirement plan must be made by legislation. Pursuant to state law, all legislative bills and amendments proposing to change the System's retirement plan are to be accompanied with an actuarial note prepared by an enrolled pension actuary providing an estimate of the cost and actuarial effect of the proposed change.

Based upon criterion of financial accountability as defined by governmental accounting standards, the System is considered a component unit of the Commonwealth of Pennsylvania financial reporting entity and is included in the Comprehensive Annual Financial Report of the Commonwealth of Pennsylvania.

(b) Pension Benefits

Under the provisions of the 1975 revision of the Code by the Pennsylvania General Assembly, members are eligible for monthly retirement benefits upon reaching (a) age 62 with at least 1 year of credited service: (b) age 60 with 30 or more years of credited service; or (c) 35 or more years of service regardless of age.

Benefits are generally equal to 2% or 2.5%, depending upon membership class, of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service. In most cases after completion of five years of service, a member's right to the defined benefit is vested and early retirement benefits may be elected. Under certain features of the System, active members may purchase credit for various types of prior school and non-school service on a lump-sum, installment purchase basis, or through an actuarially calculated benefit reduction.

In addition to regular retirement benefits, the System also provides for disability retirement benefits and death benefits. Participants are eligible for disability retirement benefits after completion of five years of credited service. Such benefits are generally equal to 2% or 2.5%, depending upon membership class, of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service, but not less than one-third of such salary nor greater than the benefit the member would have had at normal retirement age. Members over normal retirement age may apply for disability benefits. Certain exceptions apply to normal disability retirements.

Death benefits are payable upon the death of an active member who has reached age 62 or who has at least five years of credited service. Such benefits are actuarially equivalent to the benefit that would have been effective if the member had retired on the day before death.

Members with credited service in the Commonwealth of Pennsylvania State Employees' Retirement System (SERS) may elect to transfer service to the Public School Employees' Retirement System upon commencement of employment in the public school system. Similarly, a member with credited service in the System may transfer such service to SERS upon becoming a member of that system.

Upon termination of a member's employment in the public school sector, the member's accumulated contributions plus interest are refundable from the Members' Savings Account which is described in Note 3.

(c) Postemployment Healthcare Benefits

The System provides a Health Insurance Premium Assistance Program (premium assistance) for all eligible annuitants who elect to participate. Under this program, employer contribution rates for premium assistance are established to provide reserves in the Health Insurance Account that are sufficient for the payment of premium assistance benefits for each succeeding year. Effective January 1, 2002, under the provisions of Act 9 of 2001, participating eligible annuitants are entitled to receive premium assistance payments equal to the lesser of $100 per month or their out-of-pocket monthly health insurance premium. To receive premium assistance, eligible annuitants must obtain their health insurance through either their school employer or the PSERS' Health Options Program (HOP).

Notes to Financial Statements (Continued)

The HOP is a PSERS-sponsored voluntary health insurance program for the sole benefit of annuitants of PSERS, spouses of annuitants, survivor annuitants and their dependents. Benefits are provided by managed care providers or by PSERS self-funded fee for service plans. All retirees are eligible to participate in the Enhanced or Basic Options (indemnity plans) regardless of their residence. The managed care plans are available to retirees residing in the plan's service area. The HOP is funded exclusively by the premiums paid by its participants for the benefit coverage they elect. The hospital, medical/surgical and major medical benefits of the Enhanced and Basic Options are self-funded. PSERS uses a third-party administrator to process these claims. An independent actuarial consulting firm sets the rates for the self-funded benefits so that the combination of contributions and the claims fluctuation reserve equal 125% of expected annual incurred claims. The HOP maintains a reserve for claims that are incurred but not reported (IBNR). At June 30, 2007 and 2006, PSERS recorded $10,665,000 and $9,151,000, respectively, in IBNR which is included in benefits payable. Effective January 1, 2006, PSERS made significant changes to HOP, in response to the Medicare Modernization Act. PSERS entered into an Employer/Union Entity contract with the Centers for Medicare and Medicaid Services to operate a voluntary Medicare Prescription Drug Plan (PDP). Monthly contributions are received from CMS covering the 37,000 participants in the PDP. The PSERS pension fund assets are not available to fund or satisfy obligations of the HOP.

(d) Contributions

The contribution policy is set by the Code and requires contributions by active members, employers, and the Commonwealth. The System's funding policy provides for periodic employer and Commonwealth contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay retirement benefits when due. Level percentage of payroll employer contribution rates are determined using the entry age normal actuarial funding method. This method determines the amount of contributions necessary to (1) fully fund all current costs, which represents the estimated amount necessary to pay for the benefits earned by the employees during the current service year; and (2) liquidate the prior service cost for service earned prior to the current service year and subsequent benefit increases, which represents the amount necessary to fund accrued liabilities over the appropriate amortization periods.

Contribution rates for active members are set by law (redefined with the provisions of Act 9 of 2001) and are dependent upon members' class. In most cases, the contribution rates based on qualified member compensation are as follows:

Membership Class T-C	Active members hired before July 22, 1983	5.25%
Membership Class T-C	Active members hired on or after July 22, 1983	6.25%
Membership Class T-D	Active members hired before July 22, 1983	6.50%
Membership Class T-D	Active members hired on or after July 22, 1983	7.50%

Active members newly hired after July 1, 2001, the effective date of Act 9 of 2001, are automatically Class T-D. The contribution rates for all members in Membership Class T-D were effective January 1, 2002.

Notes to Financial Statements (Continued)

The total contribution rate for the employers and the Commonwealth was 6.46% and 4.69% of qualified compensation for the years ended June 30, 2007 and 2006, respectively. According to requirements established in Act 29 of 1994, the Commonwealth reimburses school entity employers a portion of the employer contributions paid to the System. The Commonwealth remits employer contributions for employers other than school entities directly to the System. All contributions from employers and the Commonwealth are shown as employer contributions on the Statements of Changes in Plan Net Assets.

A portion of each employer and Commonwealth contribution to the System is set aside for the funding of the health insurance premium assistance program. The premium assistance contribution rate is set at a level necessary to establish reserves sufficient to provide premium assistance payments for all participating eligible members for the subsequent fiscal year. The portion of the total contribution rate for employers and the Commonwealth used to fund premium assistance was 0.74% and 0.69% for the years ended June 30, 2007 and 2006, respectively.

2. Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial statements of the System are prepared on 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, and investment purchases and sales are recorded as of their trade date. Member and employer contributions are recognized in the period for which employees' salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions in plan net assets during the reporting period. Actual results could differ from those estimates.

(b) Investments

The System's investments are reported at fair value. Fair value is the amount that the System can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Short-term securities are carried at cost, which approximates fair value, unless they have published market prices or quotations from national security exchanges or securities pricing services, in which case they are valued at the published market price. Fixed income securities and common and preferred stocks are generally valued based on published market prices and quotations from national security exchanges or securities pricing services. Securities which are not traded on a national security exchange are valued by the respective fund manager or other third parties based on similar sales.

Notes to Financial Statements (Continued)

Directly-owned real estate investments are primarily valued based on appraisals performed by independent appraisers or, for properties not appraised, at cost or the present value of the projected future net income stream. Real estate owned investments are reported net of related debt borrowed against the market value of the property. As of June 30, 2007 and 2006, $132,000,000 in line of credit advances were netted against the related property valuation. The line of credit balance is due on March 14, 2009. The line is payable at an interest rate equivalent to the lender's commercial paper rate plus 30 basis points and is collateralized by certain fixed income investments of the System.

Alternative investments which include private equity, private debt, venture capital and equity real estate investments are valued based on estimated fair value amounts established by valuation committees which includes cash flow activity through June 30. Futures contracts, foreign exchange contracts, and options are marked-to-market daily with changes in market value recognized as part of net appreciation/depreciation in the fair value of investments. Initial margin requirements for such financial instruments are provided by investment securities pledged as collateral or by cash.

Collective trust fund investments (CTF) consist primarily of domestic and international institutional funds. The funds do not pay interest or dividends to shareholders and reinvest all income earned on securities held by the fund. The fair value of CTF is based on the reported share value of the respective fund. CTF are managed by state chartered banks for which various state banking departments have regulatory oversight and investment advisors for which the Securities and Exchange Commission has regulatory oversight.

Investment expenses consist of investment manager fees and those administrative expenses directly related to the System's investment operations. Unsettled investment sales are reported as investment proceeds receivable and unsettled investment purchases are included in investment purchases and other liabilities.

(c) Capital Assets

Capital assets, consisting primarily of data processing equipment and software, are recorded at historical cost. The System depreciates capital assets using the straight-line method over an estimated useful life of seven years.

(d) Benefits Payable

Benefits payable identifies the obligations of the System, on an accrual basis, for the estimated retirement and death benefits payable to PSERS' members or members' beneficiaries at the end of the fiscal year. It also includes the HOP $10,665,000 IBNR claims reserve and a $1,246,000 prescription drug benefit payable at June 30, 2007.

(e) Compensated Absences

The System uses the accrual basis of accounting for measuring vacation leave, sick leave, and other compensated absences liabilities. Employees of the System are paid for accumulated vacation leave upon termination or retirement. Retiring employees of the System that meet service, age, or disability requirements are paid between 30% and 100% of sick days available at retirement, up to 163 maximum days paid. As of June 30, 2007 and 2006, $2,762,000 and $2,946,000,

Notes to Financial Statements (Continued)

respectively, was accrued for unused vacation and sick leave for the System's employees and included in "Accounts payable and accrued expenses" on the Statements of Plan Net Assets.

(f) Participant Premium Advances

Premium advances in 2007 are for HOP and CMS premiums related to health care and prescription drug coverage to be provided in 2007. Premium advances in 2006 are for HOP premiums related to health care coverage provided in 2006.

(g) Federal Income Taxes

The Internal Revenue Service (IRS) issued a determination letter dated March 3, 1978 which stated that the plan and its underlying trust qualify under the provisions of Section 501(a) of the *Internal Revenue Code* (IRC) and therefore are exempt from federal income taxes. The plan has been amended since receiving that determination letter. Additionally, the IRS issued a 1982 ruling which concluded that the fund and the board are integral parts of the Commonwealth, and are therefore not subject to federal income tax. In the opinion of management, the System has operated within the terms of the plan and remains qualified under the applicable provisions of the IRC.

Federal tax legislation was enacted in 2001 that modified the rules for making rollovers to or from pension systems and also established maximum amounts of retirement benefits that can be paid from pension systems. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expanded the opportunity for members to roll over funds received from PSERS at retirement to a wider variety of plans including, but not limited to, 403(b) tax sheltered annuities and government sponsored 457 deferred compensation plans. The Act permits the rollover of after-tax contributions from PSERS. EGTRRA provided for periodic increases in the annual compensation limits for qualified retirement plans.

The annual compensation limits for 2006 and 2007 were $220,000 and $225,000, respectively. EGTRRA also provided for periodic increases in the annual benefit limits for qualified defined benefit plans. The maximum annual defined benefit limits at age 62 for 2006 and 2007 were $175,000 and $180,000, respectively.

(h) Risk Management

The System is exposed to various liabilities and risks of loss, including, without limitation, the ordinary risks of investment losses, risks related to theft or destruction of assets, liabilities resulting from injuries to employees, and liabilities resulting from court challenges to fiduciary decisions. As an administrative agency of the Commonwealth of Pennsylvania, the System is accorded sovereign immunity. For claims not shielded by sovereign immunity, the System participates in certain Commonwealth pooled insurance programs and requires asset managers to carry certain insurance coverage for the protection of the System. The System has implemented a self-insurance program for fiduciary and director and officer liability coverage. During the past three fiscal years, insurance settlements did not exceed insurance coverage.

(i) Reclassifications

Certain 2006 balances have been reclassified in conformity with the 2007 presentation.

Notes to Financial Statements (Continued)

(j) Members Receivables

Member's receivables include an amount for members' obligations to the System for the purchase of service credit in the amount of $149,363,923. Members have a variety of options to remit purchase of service payments:

- Remit a lump sum payment.
- Request an installment plan from one to seven years where the member's employer establishes a payroll deduction process. The member's employer then forwards quarterly payments of the withheld amounts to PSERS.
- Accept an actuarial reduction debt through which the amount of the purchase plus accumulated interest will reduce the member's retirement or death benefit.
- Rollover funds from an eligible distribution.

Because members have control over the timing of their remittances to the System, many purchases of service receivables extend beyond one year. An estimated $133,608,420 of the $256,932,000 member's pension receivables at June 30, 2007 are expected to be collected by the System subsequent to June 30, 2008.

(k) Adoption of New Accounting Standards

During the year ended June 30, 2006, the System adopted Governmental Accounting Standards Board Statement No. 44, *Economic Condition Reporting: The Statistical Section (an amendment of NCGA Statement 1*) ("GASB 40"). The adoption of GASB 44 requires the System to meet reporting standards in the Statistical Section of its CAFR. These standards are designed to enhance the provision of information for the assessment of the financial position and the financial condition of the System.

During the year ended June 30, 2007 the System adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* ("GASB 43"). GASB 43 established reporting standards for the annual financial reports of postemployment benefit plans other than pension plans. These reporting requirements apply to the Health Insurance Premium Assistance Program. The adoption of GASB 43 required the System to include disclosures for premium assistance in the Required Supplemental Information's Schedule of Funding Progress and Schedule of Employer Contributions.

3. Description of Accounts

The Code requires the System to maintain the following accounts which represent reserves held for future and current benefit payments as follows:

Notes to Financial Statements (Continued)

(a) State Accumulation Account

The State Accumulation Account is credited with the contributions of the Commonwealth and the employers. Additionally, interest earnings of the System (after crediting the Members' Savings Account with 4% interest and the reserve for retirement with 5.50% statutory interest) are credited to this account. Each year, the necessary amounts, as determined by the actuary for the payment of retirement, disabilities, and death benefits, are transferred from the State Accumulation Account to the Reserve for Retirement Account increasing the reserve credit to the 8.5% valuation assumption rate determined by the actuary. All administrative expenses necessary for the operation of the System, except for premium assistance and HOP expenses are paid from the State Accumulation Account.

(b) Members' Savings Account

The Members' Savings Account is credited with all contributions made by active members of the System. Interest is added to the member's individual account at an annual rate of 4%.

Upon death or retirement of a member, the accumulated contributions, plus interest are transferred to the Reserve for Retirement Account for subsequent payment of benefits.

(c) Reserve for Retirement Account

The Reserve for Retirement Account represents the amounts transferred from the Members' Savings and State Accumulation Accounts, plus additional contributions made by the Commonwealth and employers for the payment of supplemental annuities and cost-of-living increases. All death, disability, and retirement benefits are paid from this account. Annual interest of 5.50% is credited to the Reserve for Retirement Account.

(d) Health Insurance Account

The Health Insurance Account is credited with contributions of the Commonwealth and the employers for the health insurance premium assistance program. Effective January 1, 2002, under the provisions of Act 9 of 2001, participating eligible annuitants are entitled to receive premium assistance payments equal to the lesser of $100 per month or their out-of-pocket monthly health insurance premium. The Health Insurance Account pays all administrative expenses necessary to operate the health insurance premium assistance program.

(e) Health Insurance Program Account

The Health Insurance Program Account is credited with contributions from members of the HOP and from CMS. All benefits related to the HOP (premium payments to the insurance companies and self-funded benefits) are paid from this account. The Health Insurance Program Account pays all administrative expenses necessary to operate the HOP.

(f) Pension and Postemployment Healthcare Net Assets

Net assets held in trust for pension and postemployment healthcare benefits at June 30 follows:

	(Dollar Amounts in Thousands)	
	2007	2006
Pension:		
State accumulation account	**$ 25,839,716**	$ 17,370,947
Members' savings account	**10,183,433**	9,571,668
Reserve for retirement account	**31,317,848**	30,293,052
Total pension	**$ 67,340,997**	$ 57,235,667
Postemployment healthcare:		
Health insurance account	**$ 97,292**	$ 92,777
Health insurance program account	**84,415**	88,857
Total postemployment healthcare	**$ 181,707**	$ 181,634

4. Investments

(a) Summary of Investments

The Board has the responsibility to invest and reinvest available funds of the System in accordance with the guidelines and limitations set forth in the Code and other applicable state law. The Board accomplishes the daily management of the System's investments through investment advisors who act as agents for the System and through internal investment managers.

The Board invests the funds of the System using the "prudent investor" standard which allows the Board to consider the probable safety of investments, avoid speculative investments, and invest as people of prudence, discretion, and intelligence would manage their own affairs. The Board has adopted its investment policy to formally document investment objectives and responsibilities. This policy, as well as applicable state law, establishes guidelines for permissible investments of the System.

Notes to Financial Statements (Continued)

A summary of the fair value of investments at June 30 follows:

	(Dollar Amounts in Thousands) 2007	2006
Pension investments:		
Short-term:		
Pennsylvania Treasury Domestic Short-Term Investment Fund	**$ 3,148,246**	$ 2,848,280
Other domestic short-term	**724,343**	683,350
International short-term	**110,696**	348,739
	3,983,285	3,880,369
Fixed income:		
Domestic mortgage-backed securities	**6,190,646**	5,670,890
U.S. government and agency obligations	**2,608,384**	3,152,963
Domestic corporate and taxable municipal bonds	**3,633,248**	2,880,975
Miscellaneous domestic fixed income	**150,039**	170,880
Collective trust funds	**1,202,848**	304,949
International fixed income	**2,134,833**	1,781,539
	15,919,998	13,962,196
Common and preferred stock:		
Domestic common and preferred stock	**15,185,715**	13,647,660
Collective trust funds	**4,564,836**	6,272,121
International common and preferred stock	**18,964,922**	13,032,195
	38,715,473	32,951,976
Real estate:		
Equity real estate	**3,566,959**	2,255,291
Directly-owned real estate	**321,027**	287,108
	3,887,986	2,542,399
Alternative investments:		
Private equity	**4,140,276**	3,634,938
Private debt	**1,093,256**	992,673
Venture capital	**605,534**	573,161
	5,839,066	5,200,772
Pension investments at fair value	**$68,345,808**	$58,537,712
Postemployment Healthcare investments:		
Premium Assistance:		
Pennsylvania Treasury Domestic Short-Term Investment Fund	**$ 21,363**	$ 14,563
Other domestic short-term	**47,506**	50,143
	68,869	64,706
Health Options Program:		
Pennsylvania Treasury Domestic Short-Term Investment Fund	**66,538**	72,553
Other domestic short-term	**45,318**	44,298
	111,856	116,851
Postemployment Healthcare investments at fair value	**$ 180,725**	$ 181,557

Notes to Financial Statements (Continued)

(b) Deposit and Investment Risk Disclosures

i. Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System would not be able to recover the value of the deposits. The State Treasury Department is the custodian of the System's fund. State Treasury Department deposits must be held in insured depositories approved by the Commonwealth's Board of Finance and Revenue and must be fully collateralized.

The System, through its third party administrator, maintains certain bank deposits for the operation of its voluntary health insurance program. These deposits are not required to be collateralized by statute or policy. These deposits totaled $45,318,000 and $44,928,000 at June 30, 2007 and 2006, respectively, and are under the custody of M&T Bank which has an A Deposit/ Debt rating by Standard and Poor's (S&P) and an A2 rating by Moody's Investor Services (Moody's).

ii. Investment Risks

The System's investments may be subject to various risks. Among these risks are concentration of credit risk, custodial credit risk, credit risk, interest rate risk, and foreign currency risk. The policies addressing each one of these risks, discussed in more detail below, are contained within the Investment Policy Statement, Objectives, and Guidelines reviewed and approved annually by the Board.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. As of June 30, 2007 and 2006 the System has no single issuer that exceeds 5% of total investments. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System would not be able to recover the value of investment or collateral securities that are in the possession of an outside party. In accordance with a contractual relationship between the Commonwealth's Treasury Department and its custodial agent, substantially all investments, where securities are used as evidence of the investment, are held by the custodian in book-entry form in the System's name. Those investments are defined as insured or registered investments for which the securities are held by the System or its agent and, therefore, have very minimal level of custodial credit risk. The remaining investments, which do not have securities that are used as evidence of the investment, are primarily in collective trust funds and limited partnerships, which include real estate and alternative investments.

Notes to Financial Statements (Continued)

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally recognized statistical rating organizations (NRSRO) such as Fitch Investor Services (Fitch), Moody's, and S&P. Annually, the Board establishes an asset allocation plan. This plan manages the overall credit risk of the fixed income asset class through a clearly defined long-term asset allocation policy. This policy establishes a long-term target allocation of the fixed income asset class at 22% of the investment portfolio. The fixed income target allocation consists of:

- An allocation of 13.7% of the portfolio has been made to the domestic core plus and high yield segments of the fixed income asset class benchmarked to the Lehman Brothers U.S. Universal Index. The domestic core plus allocation is composed of primarily investment grade, relatively liquid, public domestic bonds with an overall weighted-average NRSRO credit rating of A or better while the high yield allocation focuses on less liquid public non-investment grade fixed income securities with an overall weighted-average NRSRO credit rating of BB+ or less;
- An allocation of 5% of the portfolio has been made to the Treasury Inflation-Protected Securities (TIPS) segment of the fixed income asset class benchmarked to the Lehman U.S. TIPS Index and composed of primarily government issued TIPS with an overall weighted-average NRSRO credit rating of AA or better;
- An allocation of 3.3% of the portfolio has been made to the global core plus fixed income asset class benchmarked to the Lehman Brothers Multiverse Index composed of primarily investment grade, relatively liquid U.S. and non-U.S. public bonds with an overall weighted-average NRSRO credit rating of A or better.

Notes to Financial Statements (Continued)

The following table discloses aggregate market value by credit quality rating category. Many securities have ratings from more than one NRSRO and sometimes those ratings differ from one NRSRO to another. The data listed below uses the rating (expressed as S&P equivalent); available from Fitch, Moody's and/or S&P that indicates the greatest degree of risk at June 30, 2007 and 2006.

	(Dollar Amounts in Thousands)	
Quality Rating	**2007 Fair Value**	**2006 Fair Value**
AAA	**$ 7,608,036**	$ 6,445,960
AA	**907,907**	1,072,388
A	**1,254,699**	1,260,292
BBB	**1,291,445**	1,152,165
BB and below	**957,173**	854,747
NR*	**5,206,707**	3,801,658
Total Exposed to Credit Risk	**17,225,967**	14,587,210
U.S. Government Guaranteed**	**2,858,041**	3,436,912
Total Fixed Income and Short-Term Investments	**$ 20,084,008**	**$ 18,024,122**

* Not Rated securities include $1,202,848 and $304,949 in collective trust funds at June 30, 2007 and 2006, respectively. Also included are $3,236,147 and $2,935,396 at June 30, 2007 and 2006, respectively, in the Pennsylvania (PA) Treasury Domestic Short-Term Investment Fund (STIF), a pooled investment fund for which ratings were unavailable. The STIF pool is comprised of short-term, high credit quality securities which are mainly U.S. Treasuries, agencies or repurchase agreements.

** Composed of U.S. government and agency obligations explicitly guaranteed by the U.S. government and not considered to have credit risk.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a fixed income investment. The System manages its interest rate risk by diversifying the fixed income portfolio and maintaining the fixed income portfolio at an effective duration range between 65 and 135 percent of the benchmark index.

Duration is a measure of the approximate sensitivity of a bond's value to interest rate changes. The higher the duration, the greater the changes in fair value when interest rates change. For example, a duration of 4.0 would mean that, given a 100-basis point change up/down in rates, a bond's price would move down/up approximately 4.0 percent. PSERS measures interest rate risk using option-adjusted duration, which recognizes the fact that yield changes may change the expected cash flows due to embedded options.

Notes to Financial Statements (Continued)

At June 30, 2007 and 2006, the System's fixed income portfolio had the following option-adjusted durations by fixed income sector:

	(Dollar Amounts in Thousands)			
	2007		2006	
Investment Type	**Option-Adjusted Duration**	**Fair Value**	**Option-Adjusted Duration**	**Fair Value**
Domestic mortgage-backed securities	3.3	$ 6,190,646	3.1	$ 5,670,890
U.S. government and agency obligations	6.6	2,608,384	5.1	3,152,963
Domestic corporate and taxable municipal bonds	3.0	3,633,248	3.4	2,880,975
Miscellaneous domestic fixed income	1.0	150,039	1.0	170,880
Fixed income collective trust funds	4.2	1,202,848	3.8	304,949
International fixed income	5.2	2,134,833	6.2	1,781,539
PA Treasury Domestic Short-Term Investment Fund	0.1	3,236,147	0.1	2,935,396
Total fixed income & PA Treasury Domestic Short-Term Investment Fund	3.4*	19,156,145	3.3*	16,897,592
Total adjustment for futures contracts	0.1**	-	0.2**	-
Total fixed income & PA Treasury Domestic Short-Term Investment Fund	3.5**	$ 19,156,145	3.5**	$16,897,592

* The option-adjusted duration of 3.4 and 3.3 at June 30, 2007 and 2006, respectively, for the total fixed income & PA Treasury Domestic Short-Term Investment Fund portfolio is calculated by weighting the option-adjusted duration of each investment type by market value.

** Fixed income investment managers enter into futures contracts to adjust the durations of their portfolios as a whole rather than any particular investment type within the portfolio. In total, the futures contracts have adjusted PSERS' total fixed income & PA Treasury Domestic Short-Term Investment Fund portfolio duration upward by 0.1 and 0.2 at June 30, 2007 and 2006, respectively.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. As part of the System's program to manage risk and enhance returns, the System invests in non-U.S. markets. Investment managers in non-U.S. equity and global fixed income may hedge their non-U.S. foreign currency exposure back to U.S. dollars. The System also reduces the exposure to currency risk by hedging up to 30% of MSCI EAFE Index country currencies to the U.S. dollar. At June 30, 2007 and 2006 PSERS had the following non-U.S. currency exposure:

Notes to Financial Statements (Continued)

2007
(Dollar Amounts in Thousands)

Currency	Equity	Fixed Income	Alternative Investments	Short-Term*	Currency Hedge	Total Fair Value
Euro	$ 4,543,147	$ 924,033	$ 720,273	$ (232,932)	$ (1,864,314)	**$ 4,090,207**
British pound sterling	3,330,681	242,722	67,078	596,752	(864,825)	**3,372,408**
Japanese yen	3,096,446	218,152	-	(177,619)	(1,056,235)	**2,080,744**
Australian dollar	779,589	7,225	-	244,290	-	**1,031,104**
Canadian dollar	845,365	127,283	15,675	(120,701)	-	**867,622**
Hong Kong dollar	856,048	-	-	6,503	(86,725)	**775,826**
South Korean won	529,302	12,076	-	38,661	-	**580,039**
Swedish krona	475,061	75,172	-	(64,834)	-	**485,399**
New Zealand dollar	13,059	14,251	-	316,422	-	**343,732**
Taiwan dollar	298,257	-	-	40,574	-	**338,831**
South African rand	305,065	-	-	10,776	-	**315,841**
Norwegian krone	169,799	3,156	-	129,486	-	**302,441**
Other non-U.S. currencies	2,544,082	99,498	-	(697,691)	(363,529)	**1,582,360**
Total	$ 17,785,901	$ 1,723,568	$ 803,026	$ 89,687	$ (4,235,628)	**$ 16,166,554**

2006
(Dollar Amounts in Thousands)

Currency	Equity	Fixed Income	Alternative Investments	Short-Term*	Currency Hedge	Total Fair Value
Euro	$ 3,213,586	$ 796,778	$ 678,328	$ (775)	$ (1,346,075)	**$ 3,341,842**
British pound sterling	2,271,685	177,855	66,613	85,278	(792,495)	**1,808,936**
Japanese yen	2,497,865	132,200	-	20,222	(895,990)	**1,754,297**
Canadian dollar	680,242	98,029	11,692	39,068	-	**829,031**
South Korean won	402,962	12,068	-	51,739	-	**466,769**
Swedish krona	292,826	38,141	-	22,711	-	**353,678**
Hong Kong dollar	407,870	-	-	2,093	(87,275)	**322,688**
Swiss franc	706,145	-	-	(74,409)	(314,409)	**317,327**
Australian dollar	360,776	5,309	-	131,491	(200,827)	**296,749**
Other non-U.S. currencies	1,349,383	127,742	-	151,258	-	**1,628,383**
Total	$ 12,183,340	$ 1,388,122	$ 756,633	$ 428,676	$ (3,637,071)	**$ 11,119,700**

* Includes investment receivables and payables.

Notes to Financial Statements (Continued)

(c) Securities Lending

In accordance with a contract between the Commonwealth and its custodial agent, the System participates in a securities lending program. Under this program, the custodian, acting as the lending agent, loans securities (equities, fixed income issues and money market instruments) to independent brokers and dealers in exchange for collateral in an amount not less than 102% of the fair value of any securities loaned except for non-U.S. corporations for which 105% of the fair value is required. For Euro fixed income debt issues, for which the Commonwealth receives Euros as collateral and international fixed income debt issues denominated in U.S. dollars, the collateral required to be exchanged is in an amount not less than 102% of the fair value of any securities loaned. Collateral is marked-to-market daily. If the fair value of the collateral held falls below the minimum guidelines for securities loaned, additional collateral is obtained. In lieu of certain approved securities or cash, the borrower may deliver to the lending agent irrevocable bank letters of credit as collateral. If the collateral obtained consists in whole or in part of cash, the lending agent may use or invest the cash in accordance with reinvestment guidelines approved by the Commonwealth.

As of June 30, 2007 and 2006, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceeded the amounts the borrowers owed the System. Under the securities lending program, the lending agent provides indemnification to the Commonwealth if the same borrowers fail to return the underlying securities (and the collateral is inadequate to replace the loaned securities) or fail to pay income distributions on them. There were no losses during the fiscal years ended June 30, 2007 and 2006, resulting from a default of the borrowers or the lending agent.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loan is one day. There were no term loans as of June 30, 2007 and 2006.

Cash collateral is invested in the lending agent's short-term investment pool and is not subject to custodial credit risk. The System's income from securities lending represents its pro-rata share from participating in the program. The weighted-average maturity of the investments in the pool was 36 days and 31 days at June 30, 2007 and 2006, respectively. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of the securities loans made by other entities that use the lending agent's pool, which the System cannot determine. The System cannot pledge or sell collateral securities received unless the borrower defaults. In the event of a default, the lending agent may use the collateral to replace the loaned securities.

As of June 30, 2007, the fair value of loaned securities was $9,843,769,000, which includes $1,345,657,000 of loaned securities, which are collateralized by securities and irrevocable letters of credit that are not included in the Statements of Plan Net Assets. The fair value of the associated collateral was $10,209,493,000 of which $8,806,979,000 was cash. As of June 30, 2006, the fair value of loaned securities was $7,028,659,000, which includes $818,469,000 of loaned securities which are collateralized by securities and irrevocable letters of credit that are not included in the Statements of Plan Net Assets. The fair value of the associated collateral was $7,166,598,000 of which $6,337,173,000 was cash.

Notes to Financial Statements (Continued)

5. Derivative and Other Similar Investments

The System enters into a variety of financial contracts, which include options and futures. The System also enters into foreign exchange positions, such as forward and spot contracts to obtain or hedge foreign currency exposure; swap agreements to gain exposure to certain sectors of the equity and fixed income markets; collateralized mortgage obligations (CMOs); other forward contracts, and U.S. Treasury strips. The System is not a dealer, but an end-user of these instruments. The contracts are used primarily to enhance performance and reduce the volatility of the portfolio. The System is exposed to credit risk in the event of non-performance by counterparties to financial instruments. As the System generally enters into transactions only with high quality institutions, no losses associated with counterparty nonperformance on derivative financial instruments have been incurred. Legal risk is mitigated through selection of executing brokers and review of all documentation. The System is exposed to market risk, the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with risk limits set by senior management, through buying or selling instruments or entering into offsetting positions.

The notional or contractual amounts of derivatives indicate the extent of the System's involvement in the various types and uses of derivative financial instruments and do not measure the System's exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The following table summarizes the aggregate notional or contractual amounts for the System's derivative financial instruments at June 30, 2007 and 2006 (in thousands):

	2007	2006
Futures contracts – long	**$ 11,887,271**	$ 11,547,597
Futures contracts – short	**4,528,407**	3,828,194
Foreign exchange forward and spot contracts, gross	**21,675,965**	10,161,833
Options – calls purchased	**1,622,129**	25,109
Options – puts purchased	**278,896**	-
Options – calls sold	**1,675,223**	23,230
Options – puts sold	**363,893**	53,167
Swaps – total return	**949,347**	-
Swaps – interest rate	**183,000**	-

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery of a specific financial instrument at a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that a counterparty will not pay and generally requires margin payments to minimize such risk. In addition, the System enters into short sales, sales of securities it does not presently own, to neutralize the market risk of certain equity positions. Initial margin requirements on futures contracts and collateral for short sales are provided by investment securities pledged as collateral and by cash held by various brokers. Although the System has the right to access individual pledged securities, it must maintain the amount pledged by substituting other securities for those accessed. The value of securities pledged and the amount of cash held at June 30, 2007 and 2006 represent a restriction on the amount of assets available as of year-end for other purposes.

Notes to Financial Statements (Continued)

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. The System generally uses exchange listed currency, index, stock, and futures options. The System has authorized an investment manager to write covered call stock index option spreads up to a notional amount of $1,500,000,000.

Foreign exchange contracts involve an agreement to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. The contracts reported above primarily include forwards. The $21,675,965,000 of foreign currency contracts outstanding at June 30, 2007 consist of “buy” contracts, which represent the U.S. dollar equivalents of commitments to purchase foreign currencies of $9,327,473,000 and “sell” contracts, which represent U.S. dollar equivalents of commitments to sell foreign currencies of $12,348,492,000. The $10,161,833,000 of foreign currency contracts outstanding at June 30, 2006 consist of “buy” contracts of $3,869,444,000 and “sell” contracts of $6,292,389,000. The unrealized gain (loss) on contracts of $26,459,000 and $(52,689,000) at June 30, 2007 and 2006, respectively, is included in the Statements of Plan Net Assets and represents the fair value of the contracts. The System has authorized an investment manager to manage a currency hedge portfolio consisting of foreign exchange spot and forward contracts, currency futures, and currency options to hedge up to a notional amount of $5,100,000,000 of the MSCI EAFE Index currencies to U.S. dollars.

Swap agreements provide for periodic payments at predetermined future dates between parties based on the change in value of underlying indexes or interest rates. During the year ended June 30, 2007, the System entered into total return swaps and interest rate swaps. Under the total return swap arrangements, the System receives the net return of certain equity indexes in exchange for a short-term rate minus a spread. The payable on the total return swap contracts of $(7,110,000) and $0 at June 30, 2007 and 2006, respectively, is included in the Statements of Plan Net Assets and represents the fair value of the contracts. The contracts have varying maturity dates ranging from January 30, 2008 to April 11, 2008. Interest rate swap agreements involve the exchange by the System with another party of their respective commitments to pay or receive interest, e.g. an exchange of floating rate payments for fixed rate payments with respect to a notional amount of principal. The System uses interest rate swaps as the most cost-effective way to gain exposure to certain sectors of the fixed income market. The receivable on the interest rate swap contracts of $2,424,000 and $0 at June 30, 2007 and 2006, respectively, is included in the Statements of Plan Net Assets and represents the fair value of the contracts. The contracts have varying maturity dates ranging from April 15, 2010 to April 15, 2028.

The System also invests in mortgage-backed securities (MBS) such as CMOs and MBS forwards to maximize yields. These securities are sensitive to prepayments of mortgages, which may result from a drop in interest rates. The MBS forwards are subject to credit risk in the event of nonperformance by counterparties. The fair value of CMOs at June 30, 2007 and 2006 is $2,566,980,000 and $2,295,764,000, respectively.

The System invests in U.S. Treasury strips which essentially act as zero coupon bonds and are subject to market volatility from a rise or drop in interest rates.

Through certain collective trust funds, the System also indirectly holds various derivative financial instruments. The collective trust funds invest in futures and options thereon; forward foreign currency contracts; options; interest rate, currency, equity, index, and total return swaps; interest-only strips; and CMOs, to enhance the performance and reduce the volatility of their portfolios.

Notes to Financial Statements (Continued)

6. Pension Plan for Employees of the System

The System contributes to the Commonwealth's State Employees' Retirement System (SERS), a cost-sharing multiple-employer defined benefit pension plan. SERS provides retirement, death, and disability benefits to plan members and beneficiaries according to Commonwealth statute. SERS issues a publicly available financial report that can be obtained by writing to SERS, 30 N. Third Street, P. O. Box 1147, Harrisburg, Pennsylvania 17108-1147.

The contribution requirements of plan members and the System are mandated by Commonwealth statute. Most SERS plan members are required to contribute 5% or 6.25% of their annual covered payroll depending upon service class. The System is required to contribute at an actuarially determined rate.

The rates applied to annual covered payroll were 3.23% at June 30, 2007 and 2.37% at June 30, 2006. The System's contributions to SERS for the year ended June 30, 2007 and 2006 were $533,000 and $418,000, respectively, which were equal to the required contributions each year.

7. Litigation and Contingencies

The System is subject to various threatened and pending lawsuits. These lawsuits include issues related to benefit calculations and eligibility including challenges to amendments to the Public School Employees' Retirement Code which increased retirement benefits for certain active public school employees but did not provide for increased benefits for employees who retired before the effective date of the amendments It is the opinion of management that the ultimate liability arising from such threatened and pending litigation will not have a material effect on the financial position of the System. The System is exposed to various other liabilities and risks related to fiduciary responsibilities of directors and officers.

Required Supplemental Schedule 1
Schedule of Funding Progress*

(Unaudited - see accompanying auditors' report)
(Dollar Amounts in Millions)

Pension

Valuation as of June 30	(1) Actuarial accrued liabilities (AAL)	(2) Actuarial value of assets	(3) (Funded) Unfunded actuarial accrued liabilities (FAAL) or UAAL (1) – (2)	(4) Ratio of assets to AAL (2) / (1)	(5) Covered payroll	(6) (FAAL) or UAAL as a percentage of covered payroll (3) / (5)
2006	$ 64,627.3	$ 52,464.7	$ 12,162.6	81.2%	$ 11,419.0	106.5%
2005	61,129.4	51,122.1	10,007.3	83.6%	10,527.7	95.1%
2004	56,978.1	51,949.6	5,028.5	91.2%	10,030.7	50.1%
2003	54,313.3	52,770.0	1,543.3	97.2%	9,652.9	16.0%
2002	51,693.2	54,193.1	(2,499.9)	104.8%	9,378.9	(26.7)%
2001	47,870.9	54,783.9	(6,913.0)	114.4%	9,414.9	(73.4)%

Premium Assistance

Valuation as of June 30	(1) Actuarial accrued liabilities (AAL)	(2) Actuarial value of assets	(3) (Funded) Unfunded actuarial accrued liabilities (FAAL) or UAAL (1) – (2)	(4) Ratio of assets to AAL (2) / (1)	(5) Covered payroll	(6) (FAAL) or UAAL as a percentage of covered payroll (3) / (5)
2006	$ 1,056.2	$ 92.8	$ 963.4	8.8%	$ 11,419.0	8.4%

* The amounts reported in the Schedule of Funding Progress do not include assets or liabilities for the HOP.

See accompanying notes to required supplemental schedules.

Required Supplemental Schedule 2
Schedule of Employer Contributions*

(Unaudited - see accompanying auditors' report)
(Dollar Amounts in Thousands)

Pension

Year ended June 30	Annual Required Contributions	Actual Employer Contributions	Percentage Contributed
2007	$ 1,708,821	$ 659,545	39%
2006	1,328,373	456,878	34%
2005	945,107	431,556	46%
2004	321,091	321,091	100%
2003	20,831	20,831	100%
2002	539	539	100%

Premium Assistance

Year ended June 30	Annual Required Contributions	Actual Employer Contributions	Percentage Contributed
2007	$ 94,970	$ 86,763	91%

The Board adopted all contribution rates as recommended by the Actuary pursuant to the prevailing provisions of the Retirement Code for each year.

See accompanying notes to required supplemental schedules.

Notes to Required Supplemental Schedules

June 30, 2007 and 2006

(Unaudited - see accompanying auditors' report)

1. Description of Schedules of Funding Progress

Each time a new benefit is added which applies to service already rendered, an "unfunded accrued liability" is created. The laws governing PSERS require that these additional liabilities be financed systematically over a period of future years. Also, if actual financial experiences are less favorable than assumed financial experiences, the difference is added to unfunded accrued liabilities.

In an inflationary economy, the value of the dollar is decreasing. In this environment, employees pay in greater dollar amounts, resulting in a dollar increase in unfunded accrued liabilities. This occurs at a time when the actual substance of these items may be decreasing. Looking at just the dollar amounts of unfunded accrued liabilities can be misleading. Unfunded accrued liabilities divided by active employee payroll provides an index which clarifies understanding. The smaller the ratio of unfunded liabilities to covered payroll, the stronger the system. Observation of this relative index over a period of years will give an indication of whether the system is becoming financially stronger or weaker.

2. Actuarial Assumptions and Methodologies

(a) Funding Method

An entry-age normal actuarial cost method of valuation is used in determining benefit liabilities and normal cost. The outstanding balance of the June 30, 2001 unfunded accrued liability is being amortized over a closed 10-year period commencing July 1, 2002, with level dollar funding. Changes in the unfunded accrued liability, including actuarial gains and losses, subsequent to June 30, 2001 are being amortized over a closed period of 10 years from the first day of July next following the change, with level dollar funding.

(b) Asset Valuation Method

For actuarial purposes, assets are valued using a five-year moving market average value that will recognize the 8.5% actuarial expected investment return immediately and spread the difference between actual and expected investment return (beginning with fiscal year ending June 30, 2001) over a period of five years (adopted as of June 30, 2001). Previously, PSERS immediately recognized interest and dividends when earned, and recognized realized and unrealized gains and losses on the market value of assets over a three-year period.

(c) Actuarial Assumptions

Significant actuarial assumptions employed by the actuary for funding purposes as of June 30, 2006, the date of the most recent actuarial valuation include:

- Investment return – 8.5%, includes inflation at 3.25%

Notes to Required Supplemental Schedules (Continued)

- Salary increases – 6.00%, which reflects an allowance for inflation of 3.25%, national productivity of 1%, and merit or seniority increases of 1.75%
- Amortization method – level dollar funding
- Remaining amortizations period (closed) – 10 years and 30 years in accordance with Act 40 of 2003
- Benefit payments – no postretirement benefit increases assumed in the future
- Multiple Decrement Tables – mortality, vesting, retirement age, and withdrawal estimates are based upon tables provided by the actuary

The System's actuarial values are calculated separately for retirees and beneficiaries and for active and inactive members.

The actuarial present value of benefits to be paid to retirees and beneficiaries currently receiving benefits and deferred survivor beneficiaries, whose benefits have been determined, is calculated using the assumptions noted above. The Reserve for Retirement Account with interest credited thereon at an annual rate of 5.50% is compared to the actuarial accrued liability for the remaining lifetimes of the retirees and beneficiaries and any deficiency is then funded by a transfer from the State Accumulation Account. Consequently, all such determined benefits are fully funded.

The actuarial accrued liability for active and inactive members is calculated on the projected benefit basis using the entry-age normal actuarial cost method under which the present value of each member's expected benefit payable at retirement or death is determined. The assets of the Members' Savings Account, State Accumulation Account and the fair value adjustment are subtracted from this present value to arrive at the funded or unfunded actuarial accrued liability.

3. Actuarial Assumptions and Methodologies – Health Insurance Premium Assistance Plan

The health insurance liability and funding provisions of the PSERS Code differ from the GASB disclosure requirements. As a result, there are different determinations of actuarial liability and contribution requirements for GASB accounting purposes and for Commonwealth funding purposes. For purposes of funding, the actuarial liability equals the assets in the health insurance account, and the contribution required is the amount necessary to establish reserves sufficient to provide premium assistance payments to all participating eligible annuitants during the fiscal year that immediately follows the year the employer contribution is made. For GASB accounting purposes, the actuarial liability has been determined under the entry age actuarial cost method, and the annual required contribution of employers (ARC) is equal to the entry age normal cost for health insurance plus an amount that will amortize the entry age unfunded actuarial liability for health insurance over a period of 30 years. (The entry age actuarial cost method was selected for this calculation because it meets the GASB parameters for determining actuarial liability and normal cost, and is the cost method specified by the PSERS Code for the PSERS pension plan.)

The Schedules of Funding Progress shows that as of June 30, 2006, the health insurance premium assistance assets were $92,777,000, measured on a market value basis.

Supplemental Schedule 1
Schedule of Operating Expenses
Fiscal Year Ended June 30, 2007

(Dollar Amounts in Thousands)

	Administrative expenses (1)	Investment expenses (2)	Total
Personnel costs:			
Salaries and wages	$ 13,867	$ 2,375	**$ 16,242**
Social security contributions	1,100	181	**1,281**
Retirement contributions	435	99	**534**
Employees' insurance contributions	4,129	438	**4,567**
Other employee benefits	629	736	**1,365**
Total personnel costs	20,160	3,829	**23,989**
Operating costs:			
Investment managers' fees	-	304,728	**304,728**
Custodian fees	-	352	**352**
Specialized services	21,243	-	**21,243**
Rental of real estate, electricity	1,768	139	**1,907**
Consultant and legal fees	978	2,461	**3,439**
Treasury and other Commonwealth services	1,025	117	**1,142**
Postage	1,024	-	**1,024**
Contracted maintenance and repair services	305	152	**457**
Office supplies	452	11	**463**
Rental of equipment and software	954	137	**1,091**
Printing	567	1	**568**
Travel and training	265	47	**312**
Telecommunications	516	10	**526**
Equipment (not capitalized)	287	33	**320**
Miscellaneous expenses	203	1,741	**1,944**
Total operating expenses	29,587	309,929	**339,516**
Fixed charges:			
Furniture and fixtures	481	-	**481**
Depreciation	254	-	**254**
Total fixed charges	735	-	**735**
Total operating expenses	$ 50,482	$ 313,758	**$ 364,240**

(1) Includes administrative expenses of $2,790 related to Postemployment Healthcare Premium assistance and $12,453 related to Postemployment Healthcare Health Options Program for the fiscal year ended June 30, 2007.

(2) Does not include $32,673 in capitalized broker commissions for the fiscal year ended June 30, 2007.

Supplemental Schedule 2
Summary of Investment Expenses
Fiscal Year Ended June 30, 2007

(Dollar Amounts in Thousands)

	Assets under management*	Fees
External management		
Domestic equity	$ 7,311,000	$ 89,014
International equity	14,513,000	56,421
Fixed income	9,926,000	14,124
Real estate	5,020,000	45,607
Private equity and debt	5,233,000	79,763
Venture capital	606,000	16,252
Commodities	1,669,000	3,547
Total external management	44,278,000	304,728
Total internal management	23,030,000	6,217
Total investment management	$ 67,308,000	$ 310,945
Custodian fees		352
Consultant and legal fees		2,461
Total investment expenses		$ 313,758

* Net asset value of investments at June 30, 2007

Supplemental Schedule 3
Schedule of Payments to Non-Investment Consultants
Fiscal Year Ended June 30, 2007

(Payment amounts greater than $50,000)

Consultant	Fees	Services Provided
CoreSource, Inc.	$ 8,787,242	Postemployment healthcare benefits administration and claims adjudication
Benecard Services, Inc.	3,658,757	Administration of postemployment healthcare benefits and prescription drug plan
Tier Technologies, Inc.	3,343,374	NPAS project development
The Segal Company	1,198,345	Actuarial services and consulting for HOP and prescription drug plan
Vitech Systems Group, Inc.	1,000,000	NPAS project development
Rx Solutions, Inc.	810,594	Administration of postemployment healthcare benefits and prescription drug plan
Buck Consultants LLC	501,494	Pension benefit actuarial services
Independent Pharmaceutical Consultants, Inc.	209,810	Administration of postemployment healthcare benefits and prescription drug plan
Independent Fiduciary Services, Inc.	111,875	Auditing services
Clifton Gunderson LLP	111,000	Financial audit of pension system and postemployment healthcare programs

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

ALAN H. VAN NOORD, CFA
Chief Investment Officer

Investment Overview

Authority and Fiduciary Standard

The Board has the responsibility to invest funds of the System in accordance with guidelines and limitations set forth in the Code and other applicable state law. As fiduciaries, the members of the Board and Staff must act solely in the interests of the members of the System and for the exclusive benefit of the System's members. In the performance of their duties, the members of the Board and Staff delegated with investment authority shall be held to the Prudent Investor Standard.

The Prudent Investor Standard, as articulated in the Code, means "the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are familiar with such matters exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the fund, considering the probable income to be derived therefrom as well as the probable safety of their capital."

The Prudent Investor Standard requires a trustee to act prudently and with caution, discretion, loyalty, and care but does not restrict the assets in which the Board can invest. Under the Prudent Investor Standard, which recognizes modern portfolio theory, the Board's investment and management decisions with respect to individual assets shall be considered in the context of the portfolio as a whole and as part of an overall investment strategy, and not in isolation. No specific investment or course of action, taken alone, shall be considered inherently prudent or imprudent. This Standard recognizes the trade-off between risk and return.

Policies and Objectives

The Board is responsible for the formulation of investment policies for the System. The overall investment objectives of the System are as follows:

- **Return Objectives** – the overall return objective is to realize a return sufficient to achieve funding adequacy on an inflation-adjusted basis. Funding adequacy is achieved when the actuarial market value of assets is at least equal to the System's projected benefit obligations. The System has a return objective of meeting or exceeding the targeted actuarial rate of return (currently 8.5%) over the long-term. In addition, the Board has the following broad objectives:

    1. The assets of the System shall be invested to maximize the returns for the level of risk taken; and,
    2. The System shall strive to achieve a return that exceeds the Policy Index (the Policy Index, which is based on the Board-established asset allocation structure, is a custom benchmark designed to generate a return that meets the actuarial rate of return assumption).

- **Risk Objectives**

1. The assets of the System shall be diversified to minimize the risk of losses within any one asset class, investment type, industry or sector distribution, maturity date, or geographic location. Failure to do so could impair the System's ability to achieve its funding and long-term investment goals and objectives; and,
2. The System's assets shall be invested so that the probability of investment losses (as measured by the Policy Index) in excess of 12% in any one year is no greater than 2.5% (or two standard deviations below the expected return).

To achieve these objectives, the Board meets at least once per year to review the overall asset allocation plan and investment policies for the System. Implementation of investment policies is accomplished through the use of external investment management firms who act as agents for the System and through internal investment managers. The Board also retains various investment consultants to assist with the formulation and implementation of investment policies.

Operations

The Board provides oversight of investment activities through the Finance Committee that makes recommendations to the Board. The Finance Committee generally conducts seven meetings per year but may meet more frequently as needed. Investment Office staff, as well as external investment advisors, internal investment managers, and Investment Accounting staff, assist the Board in achieving investment objectives and monitoring compliance with investment policies. For the fiscal year ended June 30, 2007, Wilshire Associates Incorporated (Wilshire) served as the general investment consultant to assist the Board in formalizing investment objectives, establishing an asset allocation plan, conducting investment advisor searches, reviewing performance, and commenting on compliance with investment policies. In addition, the Board utilized Courtland Partners, Ltd. as the real estate consultant and Portfolio Advisors, LLC as the alternative investment consultant. Alternative investments generally consist of investments in private debt, private equity, and venture capital limited partnerships. Investment Office staff implement the investment decisions within the Investment Policy Statement, Objectives and Guidelines regarding asset allocation, security selection, and other objectives directed by the Board.

The Board employs both external investment management firms and internal investment managers to manage the investment portfolio of the System. At year end, 49 external investment management firms were managing $34.7 billion in assets of the System, $23.0 billion in assets were managed by the System's internal investment managers, and the remaining $10.8 billion in assets were managed by numerous emerging, alternative investment, and real estate managers. The performance of each external investment management firm and each internal manager is monitored quarterly against a pre-established benchmark as well as the performance of its peer group.

Asset Allocation

The Board reviews the long-term asset allocation targets of the System at least annually, usually in the first quarter of the calendar year. The Board will consult with its actuary, consultants, Investment Office staff, and other sources of information it deems appropriate in formulating the asset allocation plan. The Board believes that the level of risk assumed by the System is largely determined by the Board's strategic asset allocation plan. The Board, in determining its long-term asset allocation, shall take the following factors into consideration:

- The System's investment time horizon;
- The demographics of the plan participants and beneficiaries;
- The cash flow requirements of the System;
- The actuarial assumptions approved by the Board;
- The funded status of the System;
- The Board's willingness and ability to take risk; and,
- The employers' (Commonwealth and school districts) financial strength.

In establishing the asset allocation for the System, the Board considers capital market expectations for expected return, volatility, and asset class correlations as prepared by its general investment consultant. The current long-term, top-down asset allocation targets of the Board are discussed in the following paragraphs.

The long-term target allocation as of June 30, 2007 included an equity target allocation of **58.5%** consisting of publicly traded stocks. Specific targets have been established for U.S. equity exposure (29.25%) and international equity exposure (29.25%). Within the U.S. equity target, the portfolios are diversified between large, small and micro capitalization investment managers, and growth and value investment managers. The international equity exposure included both developed and emerging markets portfolios as well as large and small capitalization investment managers.

The fixed income target allocation of **22.0%** consisted of U.S. core fixed income exposure (12.6%), Treasury Inflation-Protected Securities exposure (5.0%), high yield fixed income exposure (1.1%), and global fixed income exposure (3.3%). Within these categories, all sectors of the bond market are represented.

The real estate target allocation of **8.0%** consisted primarily of opportunistic limited partnerships and publicly traded real estate securities. During the second quarter of the fiscal year ended June 30, 2007, the Board eliminated the home country bias in the publicly traded real estate securities portfolio by converting the overall investment objective from U.S. real estate to global real estate.

Alternative investments had a target of **9.0%**. The primary vehicle used to invest funds in this asset class is the limited partnership. The partnerships are established by individual management groups that have been selected by the System for the purpose of investing in and managing private equity and unlisted subordinated debt positions on behalf of PSERS and other limited partners.

The commodities target allocation of **2.5%** consisted primarily of commodity futures and commodity and commodity-related publicly traded stocks. The commodities allocation was added during the second quarter of the fiscal year ended June 30, 2007. The Board added commodities to diversify the System's total portfolio risk.

Finally, unallocated cash of the System has an asset allocation target of **0.0%** since cash historically represents the lowest returning asset class over time.

Investment Results

As of June 30, 2007, the fair value of the investment portfolio was $68.5 billion, an increase of $9.8 billion over last year's value. This increase came primarily from net investment income ($12.7 billion), which was partially offset by benefit payments in excess of member and employer contributions ($2.5 billion) and net changes in other investment assets and liabilities ($0.4 billion). The investment portfolio, as invested, was composed of 60.3% common and preferred stocks (equity), 20.5% fixed income investments, 8.0% real estate, 8.7% alternative investments, and 2.5% commodities at June 30, 2007. The table on page 74 illustrates a more detailed description of the investment portfolio's asset classes in dollars and as a percentage of the total investment portfolio.

The past fiscal year saw positive market returns across all major asset classes. Markets that enjoyed particularly strong returns included international equities (developed, small cap, and emerging markets), global publicly traded real estate, and U.S. equities. International equities were up 28.83% during the fiscal year according to the Morgan Stanley Capital International (MSCI) All-Country World Index (ACWI) ex. U.S., an international equity index (30% hedged to the U.S. dollar). International small capitalization equities, which are included in PSERS International Stock Portfolios, were up 35.91% according to the S&P/Citigroup Global ex. U.S. Extended Market Index. Emerging market equities, a sub-sector of the MSCI ACWI ex. U.S., were up 45.45% during the fiscal year according to the MSCI Emerging Markets Index. The strength in these markets can be partially attributed to the strength in commodity prices during the past fiscal year, especially oil, and the weakness of the U.S. dollar. In addition, strong economic growth and corporate profits have also driven these markets to higher levels. Global publicly traded real estate securities were up 25.36% during the fiscal year according to the FTSE EPRA/NAREIT Global Real Estate Index, a free-float index designed to track the performance of listed real estate companies and real estate investment trusts worldwide. The strength in the returns of this index occurred during the first half of the fiscal year, primarily from international markets which returned 34.67% during this period. The Dow Jones Wilshire 5000 Index, a U.S. equity index, returned 20.46% for the fiscal year. The U.S. continued to exhibit strong economic growth, stable consumer confidence, and a low unemployment rate in the face of a weakening housing market towards the latter half of the fiscal year.

The Domestic Fixed Income Policy Index, a U.S. bond index, was up 6.15% while the Global Fixed Income Policy Index, a global bond index, was up 4.73%. Modest returns in these indexes were driven by relatively stable monetary policies in the U.S. and international markets. In the U.S., the Federal Reserve left the Federal Funds rate unchanged at 5.25% during the fiscal year ended June 30, 2007.

As a result of the strong positive returns from equities, real estate, and alternative investments, the System was able to generate a total return of 22.93% for the one-year period ended June 30, 2007. This return exceeded the total fund Policy Index return of 18.48% by 445 basis points. Annualized total returns for the three- and five-year periods ended June 30, 2007 were 16.94% and 14.48%, respectively. These returns exceeded the total fund Policy Index returns for the three- and five-year periods ended June 30, 2007 by 331 and 252 basis points, respectively. As of June 30, 2007, the System had posted positive returns in 16 of the past 17 quarters.

Wilshire calculates the total investment return of the System as well as the performance of each external investment management firm and each internal investment manager employed by the Board to invest the System's assets. Performance is calculated using a time-weighted return methodology.

The following table provides the System's total investment return for each major asset class and the total portfolio, including, where applicable and available, respective benchmark indexes used by asset class and median performance by asset class:

	Annualized Total Returns (%) Net of Fees Ended June 30, 2007		
	1 Year	3 Years	5 Years
PSERS Total Portfolio	**22.93**	**16.94**	**14.48**
Total Fund Policy Index	18.48	13.63	11.96
Median Public Defined Benefit Plan (DBP) Fund Universe (Wilshire Database)	17.46	12.87	11.64
PSERS Domestic Stock Portfolios	**20.37**	**12.59**	**11.72**
Dow Jones Wilshire 5000 Index	20.46	12.73	11.96
Median Public DBP Fund Universe - Domestic Equities (Wilshire Database)	19.96	12.69	11.94
PSERS International Stock Portfolios	**31.33**	**26.18**	**20.39**
MSCI All-Country World Index Ex. U.S. (1)	28.83	24.60	19.68
Median Public DBP Fund Universe - International Equities (Wilshire Database)	30.58	24.68	19.24
PSERS Domestic Fixed Income Portfolios	**5.76**	**4.81**	**6.10**
Domestic Fixed Income Policy Index (2)	6.15	3.99	4.49
Median Public DBP Fund Universe - Domestic Bonds (Wilshire Database)	6.86	4.93	5.85
PSERS Global Fixed Income Portfolios	**4.71**	**4.69**	**7.15**
Global Fixed Income Policy Index (3)	4.73	4.13	6.49
Median Public DBP Fund Universe - Global Bonds (Wilshire Database)	6.01	5.05	8.16
PSERS Real Estate (4)	**29.99**	**31.38**	**24.05**
Blended Real Estate Index (5)	18.45	19.51	15.43
Median Public DBP Fund Universe - Real Estate (Wilshire Database)	16.30	19.87	17.69
PSERS Alternative Investments (4)	**36.11**	**27.65**	**19.71**
Venture Economics Median Return, Vintage Year Weighted	13.90	11.48	6.68
Median Public DBP Fund Universe - Private Equity (Wilshire Database)	25.25	23.95	15.05

(1) 30% hedged to the U.S. dollar effective July 1, 2006
(2) Lehman Brothers U.S. Universal Index effective April 1, 2007; previously was the Lehman Brothers Aggregate Bond Index
(3) Lehman Brothers Multiverse Index effective April 1, 2007; previously was the Lehman Brothers Global Aggregate Bond Index
(4) Returns reported on a one-quarter lag, except for publicly traded real estate security investments.
(5) Returns presented are a blend of the FTSE EPRA/NAREIT Global Real Estate Index (25%) and the NCREIF Index (75%). The NCREIF Index is reported on a one-quarter lag. Prior to October 1, 2007, the Dow Jones Wilshire Real Estate Securities Index was used in place of the FTSE EPRA/NAREIT Global Real Estate Index.

The System also is involved in a securities lending program administered by The Bank of New York Mellon Corporation. This program provides incremental income to the System by lending securities in the System's portfolio to securities dealers in exchange for either cash collateral, which can be reinvested to generate income, or non-cash collateral plus a cash fee. This program generated $25.9 million in additional net income during the year.

Accomplishments

The System's returns during the fiscal year ended June 30, 2007 not only exceeded its total fund Policy Index, but also placed the System in the top 10% of all public defined benefit pension funds in the country as measured by Wilshire for the one-, three-, five-, and ten-year periods ended June 30, 2007. Strong returns such as these can be attributed to the combined efforts of the Board, the System's Investment Office and Investment Accounting staff, and its external consultants and investment advisors. Without their efforts, accomplishments such as this would not be possible.

The System continued its efforts to diversify its market exposures during FY 2007. To recognize the complete opportunity set available, the System converted its publicly traded real estate equity portfolio from a home country biased U.S. objective to a global objective. In addition, the System added commodities to its asset allocation as a risk diversifier.

The System continued its multi-year project to implement an independent accounting book of record for the System's investment transactions and holdings. In FY 2007, the System completed preparation work to convert all of its real estate and alternative investment portfolios from an Excel-based accounting system to its internal accounting software provided by Financial Control Systems, Inc. and continued to develop various management reports using the internal accounting software.

Summary

The System had a tremendous fiscal year ended June 30, 2007, as the returns generated by the System were in the top 10% of all public defined benefit pension plan returns. Strong returns generated in U.S. and international equity markets, real estate, and alternative investments helped produce outstanding results for the System. For the fiscal year ended June 30, 2007, the System exceeded its long-term actuarial investment rate of return assumption of 8.5% on a one-, three-, five, and ten-year basis. In addition, we continue to believe that the System's asset allocation is structured to generate a long-term return that meets or exceeds the targeted actuarial rate of return assumption of the System for years to come.

Alan H. Van Noord, CFA
Chief Investment Officer

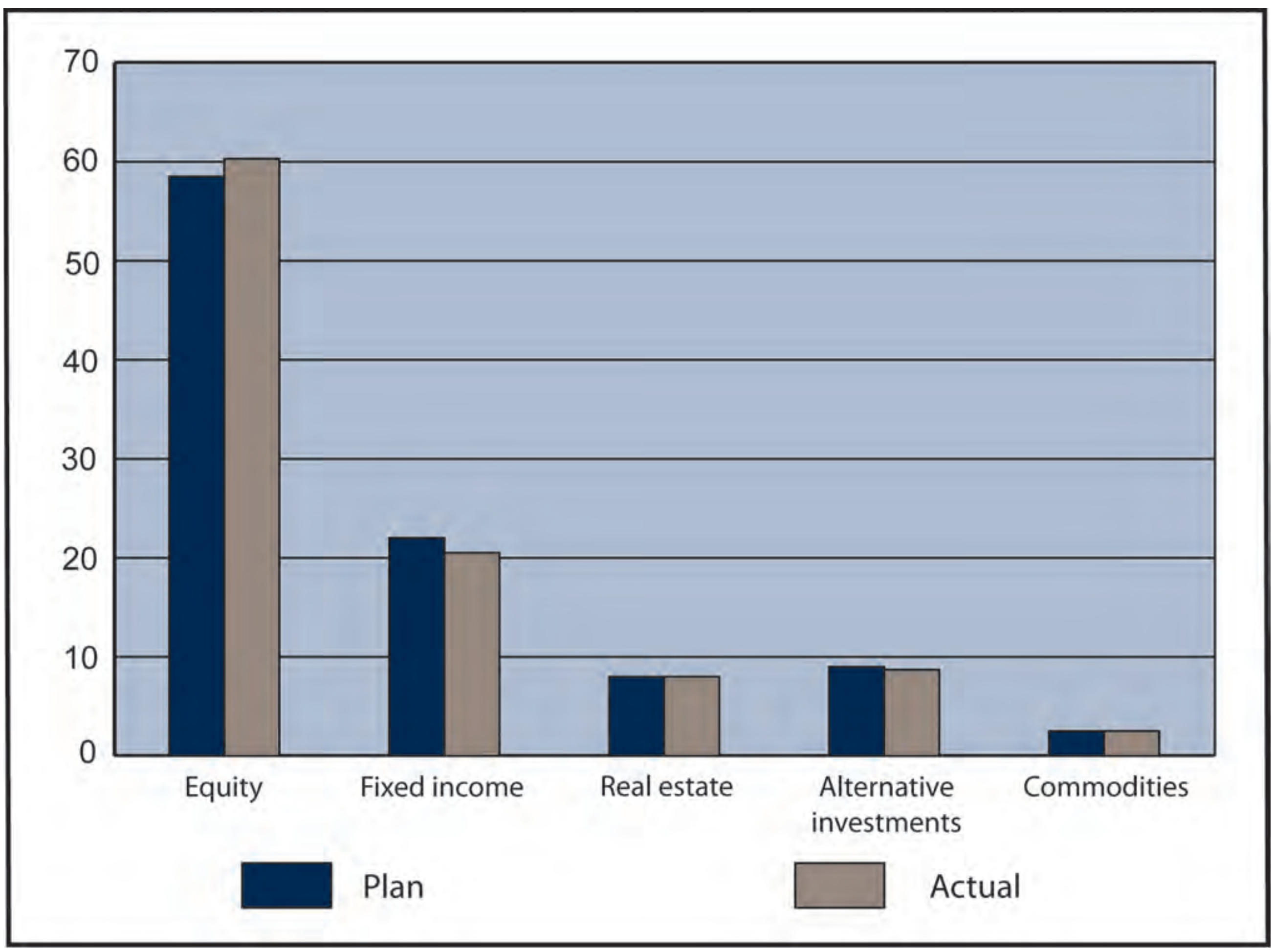
Portfolio Summary Statistics
Asset Allocation
As of June 30, 2007
(Dollar Amounts in Thousands)

Pension investments	Fair Value ($)	% Fair Value
Common and preferred stock (Equity):		
Domestic common and preferred stock	$ 15,185,715	22.6%
Collective trust funds	4,564,836	6.8%
International common and preferred stock	18,964,922	28.3%
Subtotal per Statement of Plan Net Assets	38,715,473	57.7%
Net Asset Allocation Adjustment*	1,769,224	2.6%
Total Common and preferred stock - Asset Allocation Basis	**40,484,697**	**60.3%**
Fixed income:		
Domestic mortgage-backed securities	6,190,646	9.2%
U.S. government and agency obligations	2,608,384	3.9%
Domestic corporate and taxable municipal bonds	3,633,248	5.4%
Miscellaneous domestic fixed income	150,039	0.2%
Collective trust funds	1,202,848	1.8%
International fixed income	2,134,833	3.2%
Subtotal per Statement of Plan Net Assets	15,919,998	23.7%
Net Asset Allocation Adjustment*	(2,149,390)	(3.2)%
Total Fixed income - Asset Allocation Basis	**13,770,608**	**20.5%**
Real estate:		
Equity real estate	3,566,959	5.3%
Directly-owned real estate	321,027	0.5%
Subtotal per Statement of Plan Net Assets	3,887,986	5.8%
Net Asset Allocation Adjustment*	1,478,319	2.2%
Total Real estate - Asset Allocation Basis	**5,366,305**	**8.0%**
Alternative investments:		
Private equity	4,140,276	6.2%
Private debt	1,093,256	1.6%
Venture capital	605,534	0.9%
Total Alternative investments - Asset Allocation Basis	**5,839,066**	**8.7%**
Commodities:		
Net Asset Allocation Adjustment*	1,665,428	2.5%
Total Commodities - Asset Allocation Basis	**1,665,428**	**2.5%**
Pension investments - Asset Allocation Basis	**$ 67,126,104**	**100.0%**
Net pension investment payable	1,219,704	
Pension investments per Statement of Plan Net Assets	**$ 68,345,808**	
Postemployment Healthcare investments	**$ 180,725**	**100.0%**

* - Includes Short-term investments which are allocated to the asset class of the investment manager which holds them, reclassifications of certain investments between asset classes and investment receivables\payables to adjust the Statement of Plan Net Assets' classification to the basis used to measure Asset Allocation. See the table and graph which follow.

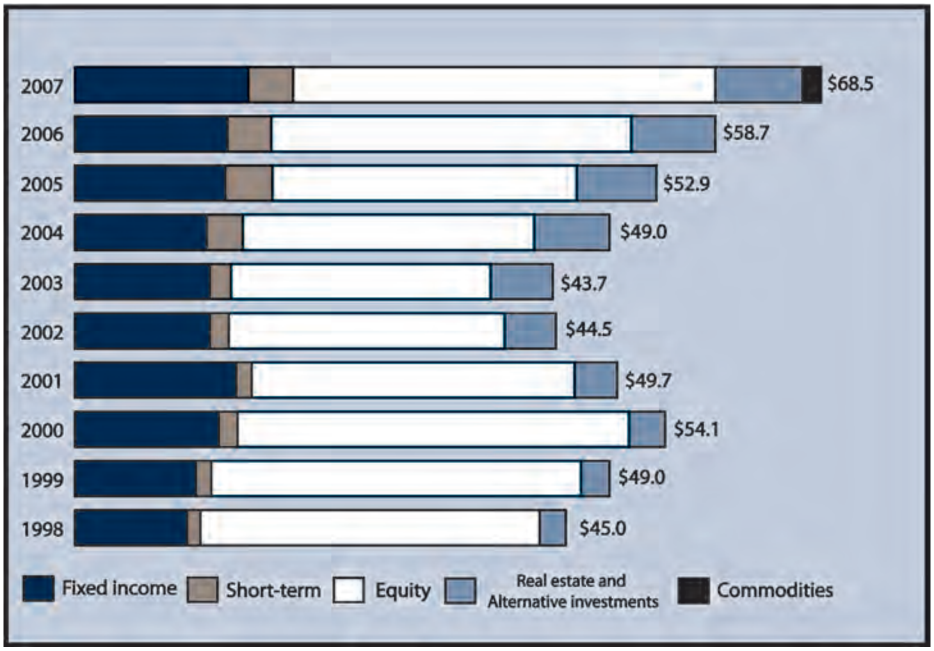
Comparison of Actual Portfolio Distribution to Asset Allocation Plan As of June 30, 2007

Asset Category	Plan	Actual
Common and preferred stock (Equity)	58.5%	60.3%
Fixed income	22.0%	20.5%
Real estate	8.0%	8.0%
Alternative investments	9.0%	8.7%
Commodities	2.5%	2.5%
Total	100.0%	100.0%



Portfolio Distribution 10 Year Trend

(Fair Value - Dollar Amounts in Billions)



The following lists of portfolio detail statistics present the ten largest holdings by descending order of fair value for the largest asset classes. Information on the complete holdings of the System is available by writing to the Public School Employees' Retirement System, Press Secretary, P. O. Box 125, Harrisburg PA 17108.

Domestic Common and Preferred Stock

10 Largest Holdings in Descending Order by Fair Value

As of June 30, 2007

(Dollar Amounts and Shares in Thousands)

Description	No. of Shares	Fair Value ($)
Exxon Mobil Corporation	4,516	378,793
Security Capital Preferred Growth	9,674	299,204
General Electric Company	7,522	287,938
AT&T Inc.	4,493	186,446
Citigroup Inc.	3,633	186,356
Microsoft Corporation	6,179	182,099
Bank of America Corporation	3,209	156,902
Chevron Corporation	1,720	144,871
Procter & Gamble Company	2,278	139,374
American International Group, Inc.	1,917	134,258
Total of 10 Largest Holdings		**2,096,241**
Total System Holdings - Domestic Common and Preferred Stock		**15,185,715**

Collective Trust Funds - Common and Preferred Stock

10 Largest Holdings in Descending Order by Fair Value

As of June 30, 2007

(Dollar Amounts and Shares in Thousands)

Description	No. of Shares	Fair Value ($)
Bridgewater Pure Alpha Fund II Ltd.	690	722,887
Barclays Global Ascent Ltd.	500	641,940
Morgan Stanley Capital International Emerging Markets Free Index	15,336	599,338
First Quadrant Global Macro Fund Ltd.	5,491	584,184
AQR Offshore Multi-Strategy Fund Ltd.	6	555,251
Wellington Trust Company Commodities Portfolio	21,368	317,102
Barclays Global Investors Structured Tier Emerging Market Index	6,247	259,622
Martin Currie Business Trust Global Emerging Markets Fund	19,936	244,217
Barclays Global Investors Emerging Markets Strategic Index Fund	3,784	157,244
Goldman Sachs Blended Currency Fund	12,415	131,638
Total of 10 Largest Holdings		**4,213,423**
Total System Holdings - Collective Trust Funds - Common and Preferred Stock		**4,564,836**

International Common and Preferred Stock

10 Largest Holdings in Descending Order by Fair Value

As of June 30, 2007

(Dollar Amounts and Shares in Thousands)

Description	No. of Shares	Fair Value ($)
BP PLC	14,577	176,359
Vodafone Group PLC	49,718	167,382
Nestle SA	398	151,142
UBS AG	2,374	142,551
Siemens AG	951	136,238
Glaxosmithkline PLC	4,867	127,423
Royal Bank of Scotland	9,982	126,772
E.ON AG	755	126,092
Ericsson	29,527	118,243
Toyota Motor Corporation	1,864	117,750
Total of 10 Largest Holdings		**1,389,952**
Total System Holdings - International Common and Preferred Stock		**18,964,922**

Domestic and International Fixed Income

10 Largest Holdings in Descending Order by Fair Value

As of June 30, 2007

(Dollar Amounts and Shares in Thousands)

Description	Maturity Date	Interest Rate (%)	Par Value($) or No. of Shares	Fair Value ($)
U.S. Treasury - Inflation Index	01/15/25	2.375	241,567	232,281
U.S. Treasury - Inflation Index	07/15/13	1.875	224,097	214,959
U.S. Treasury - Inflation Index	01/15/26	2.000	211,057	191,171
Germany (Federal Republic)	09/14/07	2.250	140,774	189,423
U.S. Treasury - Inflation Index	07/15/12	3.000	183,318	186,870
U.S. Treasury - Inflation Index	07/15/14	2.000	188,710	181,147
U.S. Treasury - Inflation Index	07/15/15	1.875	180,328	170,410
U.S. Treasury - Inflation Index	01/15/15	1.625	172,873	160,691
U.S. Treasury - Inflation Index	01/15/11	3.500	142,534	146,643
FNMA Pool # 0745275	02/01/36	5.000	144,608	135,867
Total of 10 Largest Holdings				**1,809,462**
Total System Holdings - Domestic and International Fixed Income				**15,919,998**

Postemployment Healthcare Investments

10 Largest Holdings in Descending Order by Fair Value

As of June 30, 2007

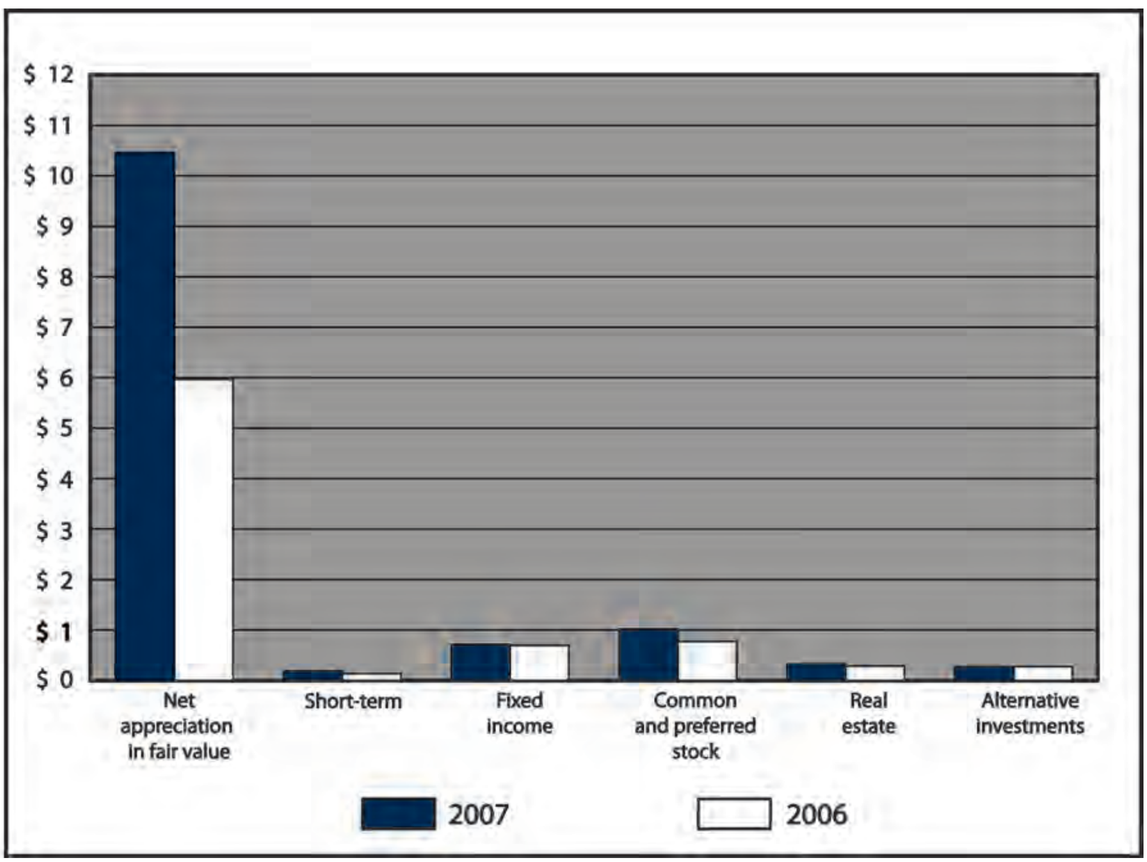
(Dollar Amounts in Thousands)

Description	Maturity Date	Interest Rate (%)	Par Value ($)	Fair Value ($)
PA Treasury Domestic Short-Term Investment Fund	Various	Various	87,901	87,901
M & T Bank Repurchase Agreement	07/01/07	4.375	18,821	18,821
M & T Bank Repurchase Agreement	07/01/07	4.739	7,602	7,602
U.S. Treasury - Inflation Index	01/15/08	3.625	6,395	6,399
FHLB Discount Note	07/20/07	4.950	4,973	4,973
FHLB Discount Note	07/05/07	4.922	4,972	4,972
FNMA Discount Note	08/08/07	4.953	4,970	4,970
FHLMC Multiclass 2714 Class TR	01/15/23	3.250	4,687	4,620
M & T Bank Repurchase Agreement	07/01/07	4.739	3,876	3,876
Daimler Chrysler Auto Trust 2004-A Class A4	04/08/09	2.580	3,076	3,059
Total of 10 Largest Holdings				**147,193**
Total System Holdings - Postemployment Healthcare Investments				**180,725**

Comparison of Investment Activity Income
For Fiscal Years Ended June 30, 2007 and 2006
(Dollar Amounts in Thousands)

Investing Activities	2007	2006
Net appreciation in fair value of investments	**$ 10,457,561**	$ 5,968,866
Short-term	**189,800**	136,791
Fixed income	**713,257**	694,888
Common and preferred stock	**1,019,322**	771,276
Real estate	**334,264**	285,333
Alternative investments	**276,350**	273,808
Total investment activity income	**$ 12,990,554**	$ 8,130,962

(Dollar Amounts in Billions)



Brokers' fees on equity investment transactions for the fiscal year ended June 30, 2007 were $32.7 million. The System has commission recapture contracts with several brokers. These contracts generally stipulate that the brokers rebate a percentage of commissions earned on investment transactions directly to the System. During the fiscal year ended June 30, 2007, the System earned $1.2 million from a commissions recapture program. A list of the brokers receiving fees in excess of $100,000 during the fiscal year follows:

Summary Schedule of Brokers' Fees
(Cumulative Fiscal Year Amounts Exceeding $100,000)
Fiscal Year Ended June 30, 2007

Broker Name	Fees Paid ($)	Broker Name	Fees Paid ($)
Merrill Lynch	2,858,015	Cantor, Fitzgerald & Company	270,862
UBS Warburg	2,431,715	Daiwa Securities	262,642
Citigroup/Salomon	1,937,819	Exane BNP Paribas	238,740
Bear, Stearns & Company	1,737,971	Cazenove Inc.	230,156
Morgan Stanley & Company	1,712,923	Jefferies & Company Inc.	218,666
Deutsche Bank	1,689,636	Credit Agricole	176,886
J.P. Morgan, Inc.	1,648,072	BNY ConvergEx	175,587
Lehman Brothers	1,332,509	Weeden & Company	155,161
Credit Suisse First Boston	1,225,647	UNX	153,212
Barclays Global Investors	1,108,008	Sanford Bernstein & Company	146,522
Goldman Sachs & Company	1,262,831	Fox Pitt Kelton	143,190
ABN AMRO	876,806	Enskilda Securities	141,685
Nomura Securities International	698,123	Salomon Smith Barney	141,158
MacQuaries Equities	561,792	Samsung Securities	131,620
SG Securities	548,505	Stifel Nicolaus & Company	126,500
Dresdner	483,122	Santander	115,810
Liquidnet Inc.	467,704	RBC Dominion	115,624
Knight Securities	423,804	Helvea	115,501
Credit Lyonnais Securities	421,001	DBS Securities	114,381
Instinet Corporation	383,852	Execution Limited	109,097
HSBC Securities Inc.	298,488	Susquehanna Financial Group	102,928
ITG Securities LTD	288,112	Bank of America	101,644

Professional Consultants

External Investment Advisors
As of June 30, 2007

U.S. Enhanced Equity Index Managers

- Acorn Derivatives Management Corporation
- AQR Capital Management, LLC
- Barclays Global Investors
- Bridgewater Associates, Inc.
- First Quadrant, LP
- Pacific Investment Management Company
- Smith Breeden Associates, Inc.

U.S. Style-Oriented Small Cap Equity Managers

- Boston Company Asset Management, LLC (The)
- Emerald Advisors, Inc.
- First Pacific Advisors, Inc.
- Mellon Equity Associates
- NorthPointe Capital
- Wellington Management Company, LLP
- William Blair & Company, LLC

Enhanced U.S. Mid Cap Equity Manager

- Barclays Global Investors

U.S. Micro Cap Equity Managers

- Donald Smith & Company, Inc.
- NorthPointe Capital
- Oberweis Asset Management, Inc.
- Thomson Horstmann & Bryant, Inc.
- Turner Investment Partners

Enhanced Commodity Index Manager

- Credit Suisse Asset Management

Full Discretion Commodity Program Managers

- Deutsche Asset Management, Inc.
- Wellington Management Company, LLP

Publicly-Traded Real Estate Securities Managers

- Cohen & Steers Capital Management, Inc.
- European Investors, Inc.
- LaSalle Investment Management

Professional Consultants (Continued)

Publicly-Traded Real Estate Securities Managers (Continued)

- Morgan Stanley Investment Management, Inc.
- Security Capital Research & Management, Inc.

Non-U.S. Emerging Market Equity Managers

- Batterymarch Financial Management, Inc.
- Boston Company Asset Management, LLC (The)
- Templeton Investment Counsel, Inc.
- Wellington Management Company, LLP
- William Blair & Company, LLC

Non-U.S. Large Cap Equity Managers

- AllianceBernstein Institutional Investment Management
- Baillie Gifford Overseas Ltd.
- Barclays Global Investors
- Boston Company Asset Management, LLC (The)
- Marathon Asset Management Limited
- Martin Currie, Inc.
- Mercator Asset Management, LP

Non-U.S. Small Cap Equity Managers

- Acadian Asset Management
- AXA Rosenberg Investment Management
- Boston Company Asset Management, LLC (The)
- GlobeFlex Capital, LP
- Wasatch Advisors, Inc.

Active Currency Hedging Overlay Program Manager

- Pareto Investment Management, Ltd.

Active Currency Program Managers

- FX Concepts, Inc.
- Goldman Sachs Asset Management
- Mellon Capital Management

U.S. Core Plus Fixed Income Managers

- Aberdeen Asset Management, Inc.
- Barclays Global Investors
- BlackRock Financial Management, Inc.
- Delaware Investment Advisers
- Pacific Investment Management Company
- Western Asset Management Company

Professional Consultants (Continued)

U.S. High Yield Fixed Income Manager

- MacKay-Shields Financial Corporation

Treasury Inflation-Protected Securities Managers

- Bridgewater Associates, Inc.
- Brown Brothers Harriman & Co.

Global Core Plus Fixed Income Managers

- Aberdeen Asset Management, Inc.
- Fischer Francis Trees & Watts, Inc.
- Rogge Global Partners

Real Estate Advisors

- Charter Oak Advisors, Inc.
- GF Management, Inc.
- Grosvenor Investment Management U.S., Inc.
- L&B Realty Advisors, LLP
- Laureate Capital, LLC

Real Estate Partnerships

- Apollo Real Estate Finance Corporation
- AvalonBay Value Added Fund, LP
- Avenue Real Estate Fund Parallel, LP
- Berwind Investment Partnership IV, V, & VI
- Blackstone Real Estate Partners V & VI.TE.1, LP
- BPG Co-Investment Partnership, LP
- Broadway Partners Parallel Fund P II & III, LP
- Carlyle Realty Partners III, IV & V, LP
- Centerline Diversified Risk CMBS Fund I & II, LLC
- Centerline RE Special Situations Mortgage Fund, LLC
- CSFB Strategic Partners II & III RE, LP
- DLJ Real Estate Capital Partners II & III, LP
- Fortress Investment Fund IV, LP
- Fortress PSERS Investment, LP
- Hines U.S. Office Value Added Fund, LP
- LF Strategic Realty Investors I & II, LP
- Legg Mason Real Estate Capital I & II, Inc.
- Lehman Brothers / PSERS Real Estate, LP
- Lehman Brothers Real Estate Pension Partners II, LP
- LEM Real Estate Mezzanine Fund II, LP
- Lubert-Adler Real Estate Fund II, III, IV, & V, LP
- Madison Marquette Retail Enhancement Fund, LP
- Morgan Stanley Real Estate Fund II, LP

Professional Consultants (Continued)

Real Estate Partnerships (Continued)

- Morgan Stanley Real Estate Fund IV Special Domestic, LP
- Morgan Stanley Real Estate Fund IV & V, Special International, LP
- Morgan Stanley Real Estate Fund V, Special U.S., LP
- O'Connor North American Property Partners, LP
- Peabody Global Real Estate Partners, LP
- Prime Property Fund, LLC
- PRISA
- ProLogis North American Industrial Fund, LP
- RREEF America REIT II, Inc.
- Stockbridge Real Estate Fund I & II, LP
- Strategic Partners Value Enhancement Fund, LP
- UBS RESA
- Westbrook Real Estate Fund, LP
- Whitehall Street Real Estate, LP V, V-S, & VII
- William E. Simon & Sons Realty Partners, LP

Farmland Advisor

- Prudential Agricultural Group

Private Equity/Venture Capital Partnerships

- ABS Capital Partners II, LP
- Adams Capital Management, LP
- Aisling Capital II, LP
- Allegheny New Mountain Partners, LP
- Baring Asia Private Equity Fund III, LP
- Bear Stearns Merchant Banking Partners II & III, LP
- BG Media Investors, LP
- Blue Point Capital Partners (B), LP
- Bridgepoint Capital II Partnership, LP
- Bridgepoint Europe IA, IIA, & IIIA, LP
- Bruckmann, Rosser, Sherrill & Company, LP
- Capital International Private Equity Fund V, LP
- Catterton Partners V & VI, LP
- Cinven Fund (Fourth), LP (The)
- Clarity Partners, LP
- Co-Investment 2000 Fund, LP (The)
- Co-Investment Fund II, LP (The)
- Commonwealth Venture Partners I & II
- Credit Suisse First Boston Equity Partners, LP
- Credit Suisse First Boston International Equity Partners, LP
- Crestview Capital Partners, LP
- Cross Atlantic Technology Fund I & II, LP
- CSFB Strategic Partners II, III-B, & III-VC, LP
- Deutsche European Partners IV, LP

Professional Consultants (Continued)

Private Equity/Venture Capital Partnerships (Continued)

- DLJ Merchant Banking Partners III, LP
- DLJ Strategic Partners, LP
- Dubin Clark Fund II, LP
- Edgewater Growth Capital Partners, LP
- Edgewater Private Equity Fund III, LP
- Edison Venture Fund III, LP
- Evergreen Pacific Partners, LP
- First Reserve Fund XI, LP
- Franklin Capital Associates III, LP
- Furman Selz Investors II & III, LP
- Graham Partners Investments (B), LP
- Green Equity Investors II, LP
- Greenpark International Investors III, LP
- Greenwich Street Capital Partners II, LP
- GS Mezzanine Partners, LP
- Halifax Capital Partners, LP
- Heritage Fund I, LP
- Jefferies Capital Partners IV, LP
- Jefferson Partners Fund IV (PA), LP
- KBL Partnership, LP
- KKR 2006, Fund, LP
- KRG Capital Fund I, II & III, LP
- Landmark Equity Partners II, III, IV, V & XIII
- Landmark Mezzanine Partners, LP
- Lehman Brothers Communications Investors, LP
- Lehman Brothers Merchant Banking Partners II, LP
- Lehman Brothers Venture Partners 2003-P, LP
- Lexington Capital Partners I, LP
- Lindsay, Goldberg & Bessemer, LP
- LLR Equity Partners I & II, LP
- Milestone Partners II, LP
- Morgan Stanley Dean Witter Capital Partners IV, LP
- Navis Asia Fund V, LP
- NEPA Venture Fund II
- New Mountain Partners, LP
- New York Life Capital Partners, I, II & III, LP
- P/A Fund (The)
- PAI Europe III & IV, LP
- Palladium Equity Partners II-A, LP
- Pennsylvania Early Stage Partners I & II, LP
- Permira IV, LP
- Perseus-Soros BioPharmaceutical Fund, LP
- Platinum Equity Capital Partners-A, LP
- PNC Equity Partners I & II, LP
- Providence Equity Partners VI, LP
- Psilos Group Partners III, LP
- Quadrangle Capital Partners I & II, LP

Professional Consultants (Continued)

Private Equity/Venture Capital Partnerships (Continued)

- Quaker BioVentures I & II, LP
- SCP Private Equity Partners I & II, LP
- StarVest Partners, LP
- Sterling Capital Partners, LP
- Sterling Venture Partners, LP
- Sunrise Capital Partners, LP
- TDH III, LP
- Technology Leaders, LP
- TL Ventures III, LP
- TPG Partners I, II & V, LP
- U.S. Equity Partners I & II, LP
- Wicks Communications & Media Partners, LP
- Willis Stein & Partners, LP

Private Debt Partnerships

- Avenue Special Situations Fund II, III & IV, LP
- Avenue Asia Special Situations Fund II, III & IV, LP
- Cerberus Institutional Partners, LP (Series Two, Three and Four)
- Chrysalis Capital Partners, LP
- Gleacher Mezzanine Fund I & II, LP
- Gold Hill Venture Lending 03-A, LP
- GSC Partners CDO Investors III & IV, LP
- GSC Recovery II, LP
- NYLIM Mezzanine Partners Parallel Fund I & II, LP
- Windjammer Senior Equity Fund III, LP

Public Market Emerging Investment Program Managers

- Biondo Group, LLC (The)
- Charter Financial Group, Inc.
- Conestoga Capital Advisors
- Connors Investor Services, Inc.
- Denali Advisors, LLC
- EDMP, Inc.
- Global Capital Management, Inc.
- Hanseatic Management Services, Inc.
- John Hsu Capital Group, Inc.
- Opus Capital Management
- Piedmont Investment Advisors
- Piedra Capital, Inc.
- Profit Investment Management
- Pugh Capital Management, Inc.
- Shah Capital Management, Inc.
- Smithbridge Asset Management, Inc.
- West Chester Capital Advisors

Professional Consultants (Continued)

Alternative Investment Consultant

- Portfolio Advisors, LLC

Custodian and Securities Lending Agent

- The Bank of New York Mellon Corporation

Investment Accounting Application Service Provider

- Financial Control Systems, Inc.

Investment Evaluator and General Investment Consultant

- Wilshire Associates Inc.

Proxy Voting Agent

- Glass, Lewis & Co., LLC

Real Estate Investment Consultant

- Courtland Partners, Ltd.

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January 28, 2007

The Retirement Board
Public School Employees'
Retirement System of Pennsylvania
P.O. Box 125
Harrisburg, Pennsylvania 17108

Ladies and Gentlemen:

This report presents the results of the annual actuarial valuation of the Public School Employees' Retirement System of Pennsylvania as of June 30, 2006.

The valuation takes into account all of the promised benefits to which members are entitled as of June 30, 2006, including pension and survivor benefits; and as required by the Retirement Code is the basis for the contribution rate for fiscal year 2007/2008.

The valuation was based on the actuarial assumptions and methods as adopted by the Board of Trustees, including a valuation interest rate of 8½% per annum compounded annually. The actuarial assumptions and methods for funding are unchanged from the prior valuation.

GASB Statement No. 43 requires PSERS to commence financial reporting for postemployment benefit plans other than pension plans with the June 30, 2006 valuation, and the required disclosure for the PSERS Health Insurance Premium Assistance plan is contained in this valuation report. The Health Insurance funding provisions of the PSERS code differ from the GASB disclosure requirements: For purposes of funding, the Health Insurance actuarial liability is equal to the assets in the Health Insurance account, while for purposes of GASB 43 disclosure, the Health Insurance actuarial liability has been determined under the entry age actuarial cost method. (The entry age actuarial cost method meets the GASB parameters for determining actuarial liability and normal cost, and is the cost method specified by the PSERS code for the PSERS pension plan.)

Assets and Membership Data

The Retirement System reported the individual data for members of the System as of the valuation date to the actuary. While we did not verify the data at their source, we did perform tests for internal consistency and reasonableness. The amount of assets in the trust fund taken into account in the valuation was based on statements prepared for us by the Retirement System.

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312.846.3000 • 312.846.3999 (fax)

Funding Adequacy

The valuation results determine that the employer contribution rate for fiscal year 2007/2008 is 7.13%. As of June 30, 2006, the total funded ratio of the plan (for Pensions and Health Insurance combined) is 81.2%, based on the accrued liability and actuarial value of assets calculated under the funding requirements of Section 8328 of the Retirement Code.

Financial Results and Membership Data

Detailed summaries of the financial results of the valuation and membership data used in preparing the valuation are shown in the valuation report. The actuary prepared supporting schedules included in the Actuarial and Statistical Section of the PSERS Comprehensive Annual Financial Report (CAFR), and also prepared the trend data schedules included in the Financial Section of the CAFR.

Qualified actuaries completed the valuation in accordance with accepted actuarial procedures as prescribed by the Actuarial Standards Board. The qualified actuaries are members of the American Academy of Actuaries and are experienced in performing actuarial valuations of public employee retirement systems. To the best of our knowledge, this report is complete and accurate and has been prepared in accordance with generally accepted actuarial principles and practice.

Respectfully submitted,

Kim M. Nicholl, F.S.A.
Principal, Consulting Actuary

S. Lynn Hill
Director, Retirement Consulting

Joshua Shapiro
Senior Consultant

Executive Summary

This report presents the actuarial valuation as of June 30, 2006 for the Public School Employees' Retirement System of Pennsylvania.

The principal valuation results include:

- The employer contribution rate for fiscal year 2007/2008, which is 7.13%.
- The total funded ratio of the plan determined as of June 30, 2006 under the funding requirements of Section 8328 of the Retirement Code, which is 81.2% based on the accrued liability and the actuarial value of assets for Pensions and Health Insurance as of that date.
- The determination of the actuarial gain or loss as of June 30, 2006, which is a loss of $0.9 billion.
- Annual disclosures as of June 30, 2006 as required by Statements No. 25 and 43 of the Governmental Accounting Standards Board.

The valuation was completed based upon membership and financial data submitted by the Retirement System. Detailed summaries of the financial results of the valuation and membership data used in preparing the valuation are included in the valuation report. The actuary prepared supporting schedules included in the Actuarial and Statistical Section of the PSERS Comprehensive Annual Financial Report (CAFR), and also prepared the trend data schedules included in the Financial Section of the CAFR.

Changes Since Last Year

Legislative and Administrative Changes

There were no legislative or administrative changes since the prior valuation.

The benefit provisions and contribution provisions are summarized in Table 13.

Actuarial Assumptions and Methods

There were no significant changes to the actuarial assumptions or methods since the prior valuation. Based on a suggestion contained in the actuarial audit completed in the spring of 2006, a minor change was made in the programming of the actuarial early retirement factors in the actuarial valuation. As expected, the effect on the valuation results was de minimus.

The actuarial assumptions and methods are outlined in Table 12.

Contribution Rates

The results of the valuation as of June 30, 2006 determine the employer contribution rate for fiscal year 2007/2008. The calculated employer contribution rate for the 2007/2008 fiscal year is 7.13%, and the Board of Trustees certified this rate at their December 2006 meeting.

The average contribution rate payable by the members is 7.25%. Effective January 1, 2002, the employee contribution rate for members who elected to have prior school service and intervening military service converted to Class T-D service increased by 1.25%. However, anyone who enrolls (or re-enrolls) in PSERS on or after July 1, 2001 is *automatically* a member of Class T-D with regard to all subsequent school service and subsequent intervening military service, with a member rate equal to 7.5%. The average member contribution rate of 7.25% is a pay-weighted average of member rates that vary based on date of hire and based on Class T-D membership.

Reasons for Change in the Rate

The employer contribution rate calculated by the actuary increased from 6.41% for fiscal year 2006/2007 to 7.13% for fiscal year 2007/2008. The increase of 0.72% is due to the following sources:

▪ Increase due to change in normal rate	0.06
▪ Increase due to payroll growth	0.07
▪ Increase due to actuarial loss on assets	0.24
▪ Increase due to actuarial loss on liabilities	0.46
▪ Decrease due to change in health insurance contribution rate	(0.05)
▪ Decrease due to effect of 4% floor on FY 2006 pension contribution	(0.06)
▪ Total	0.72%

Summary of Principal Results

Summarized below are the principal financial results for the Public School Employees' Retirement System based upon the actuarial valuation as of June 30, 2006. Comparable results from the June 30, 2005 valuation are also shown.

Item	June 30, 2005	June 30, 2004
Demographics		
Active Members		
· Number	263,350	255,465
· Average Annual Pay	$ 43,361	$ 41,210
Annuitants		
· Number	161,813	156,519
· Average Annual Benefit Payment	$ 20,236	$ 19,343
Contribution Rates (as a Percentage of Payroll)	(Fiscal Year 2007/2008)	(Fiscal Year 2006/2007)
Employer Contribution Rate:		
· Total Pension Contribution Rate	6.44%	5.67%
· Health Insurance Contribution Rate	0.69	0.74
· Total Contribution Rate Calculated by Actuary	7.13%	6.41%
· Total Contribution Rate Certified by Board	7.13%	6.46%
Member Average Contribution Rate	7.25	7.21
· Total Rate	14.38%	13.67%
Actuarial Funded Status*		
· Accrued Liability	$ 64,720.1 Mil	$ 61,226.6 Mil
· Actuarial Value of Assets	52,557.5	51,219.3
· Unfunded Accrued Liability	$ 12,162.6	$ 10,007.3
· Funded Ratio	81.2 %	83.7 %

* Pensions and Health Insurance combined

Five-Year History of Principal Financial Results

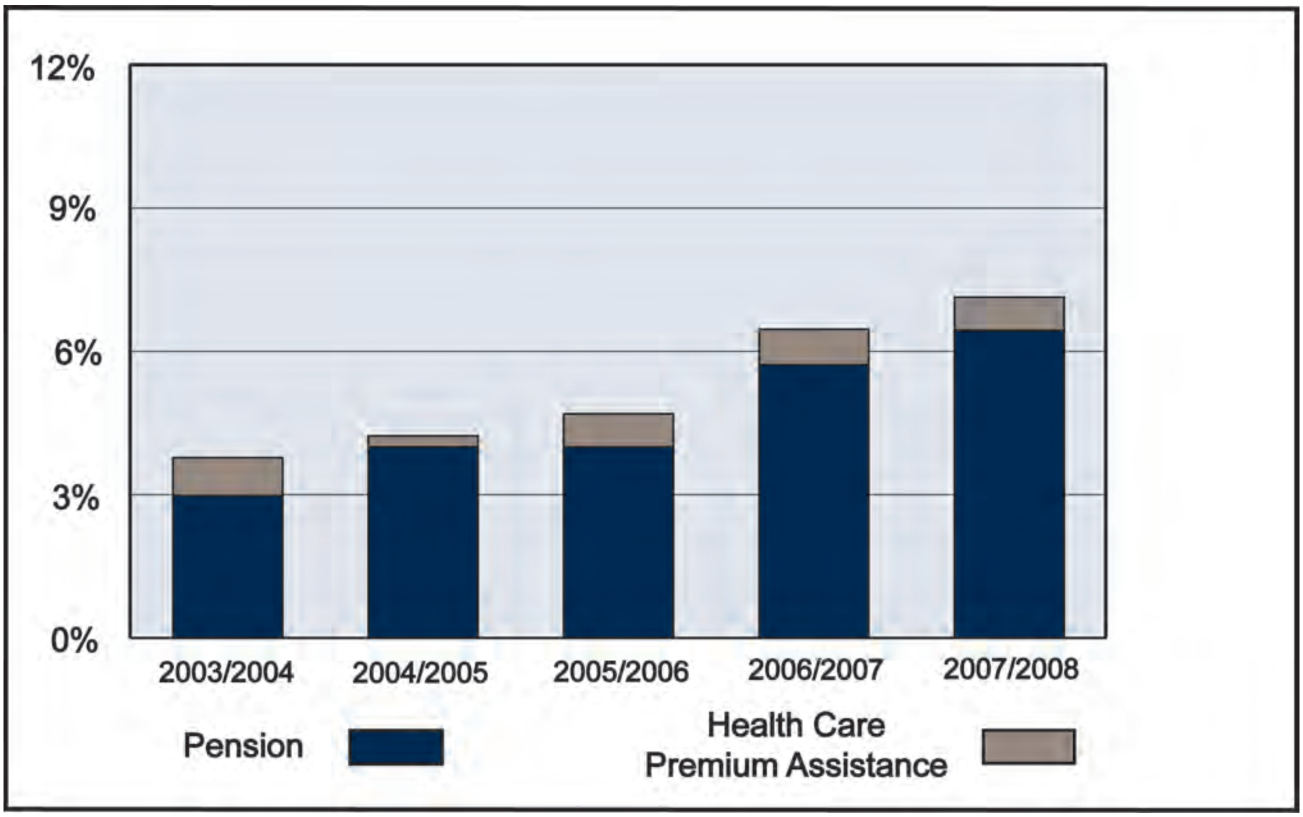
Five-Year History of Contribution Rates

(As a % of Payroll)

Fiscal Year	Member Contributions	Employer Contributions			
		Normal Cost	Unfunded Accrued Liability	Health Care	Total *
2007/2008	7.25%	6.68%	(0.24)%	0.69%	7.13%
2006/2007	7.21	6.62	(0.95)	.74	6.46
2005/2006	7.16	7.61	(4.28)	.69	4.69
2004/2005	7.12	7.48	(7.10)	.23	4.23
2003/2004	7.08	7.25	(4.27)	.79	3.77

* Certified by the Board.

The following chart shows a five-year history of employer contribution rates:



Funded Ratio

The financing objective of the System is to:

- — Fully fund all current costs based on the normal contribution rate determined under the funding method; and
- — Liquidate the unfunded accrued liability based on the amortization schedules as required by the retirement code, i.e., a schedule of 10 or 30 years for each change in the unfunded accrued liability according to Act 40.

The total contribution rate of 7.13% of payroll payable by employers, when taken together with the contributions payable by the members and asset returns, is sufficient to achieve the financing objective.

The System's total funded ratio on the funding basis is measured by comparing the actuarial value of assets (based on a 5-year moving average market value) with the accrued liability. The accrued liability for Pensions is the present value of benefits accumulated to date under the System's funding method and reflects future pay increases for active employees. The accrued liability for Health Insurance equals the assets in the Health Insurance account.

On this basis, the System's total funded ratio (for Pensions and Health Insurance combined) is 81.2% as of June 30, 2006. This funded ratio is based on an actuarial value of assets of $52.6 billion and an accrued liability of $64.7 billion. The funded ratio for Pensions alone is also 81.2% as of June 30, 2006, based on an actuarial value of assets of $52.5 billion, and an accrued liability of $64.6 billion.

<u>Reasons for Change in the Funded Ratio</u>

The total funded ratio decreased from 83.7% as of June 30, 2005 to 81.2% as of June 30, 2006. This decrease is due to the fact that contributions in 2006 were less than the normal cost plus interest on the unfunded liability as of June 30, 2005, and also to experience losses on the assets and liabilities that occurred during the past year.

Five-Year History of Total Funded Ratio*

(Dollar Amounts in Millions)

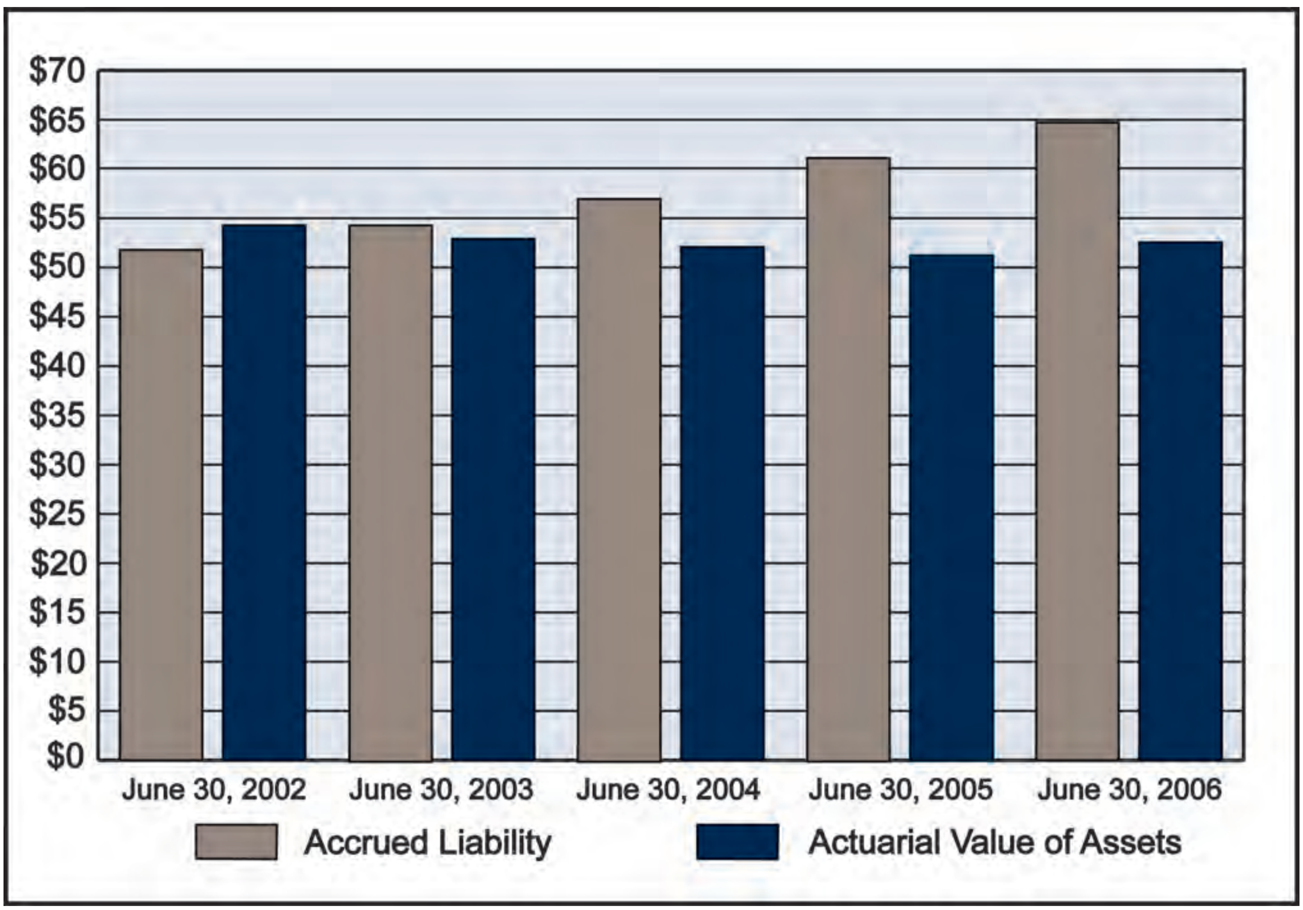
Valuation as of June 30	Accrued Liability	Actuarial Value of Assets	Unfunded Accrued Liability	Funded Ratio
2006	$ 64,720.1	$ 52,557.5	$ 12,162.6	81.2%
2005	61,226.6	51,219.3	10,007.3	83.7
2004	57,123.0	52,094.5	5,028.5	91.2
2003	54,443.8	52,900.5	1,543.3	97.2
2002	51,796.5	54,296.4	(2,499.9)	104.8

* For Pensions and Health Insurance (under the funding provisions of the PSERS code)

The following chart shows a five-year history of the accrued liability and the actuarial value of assets:

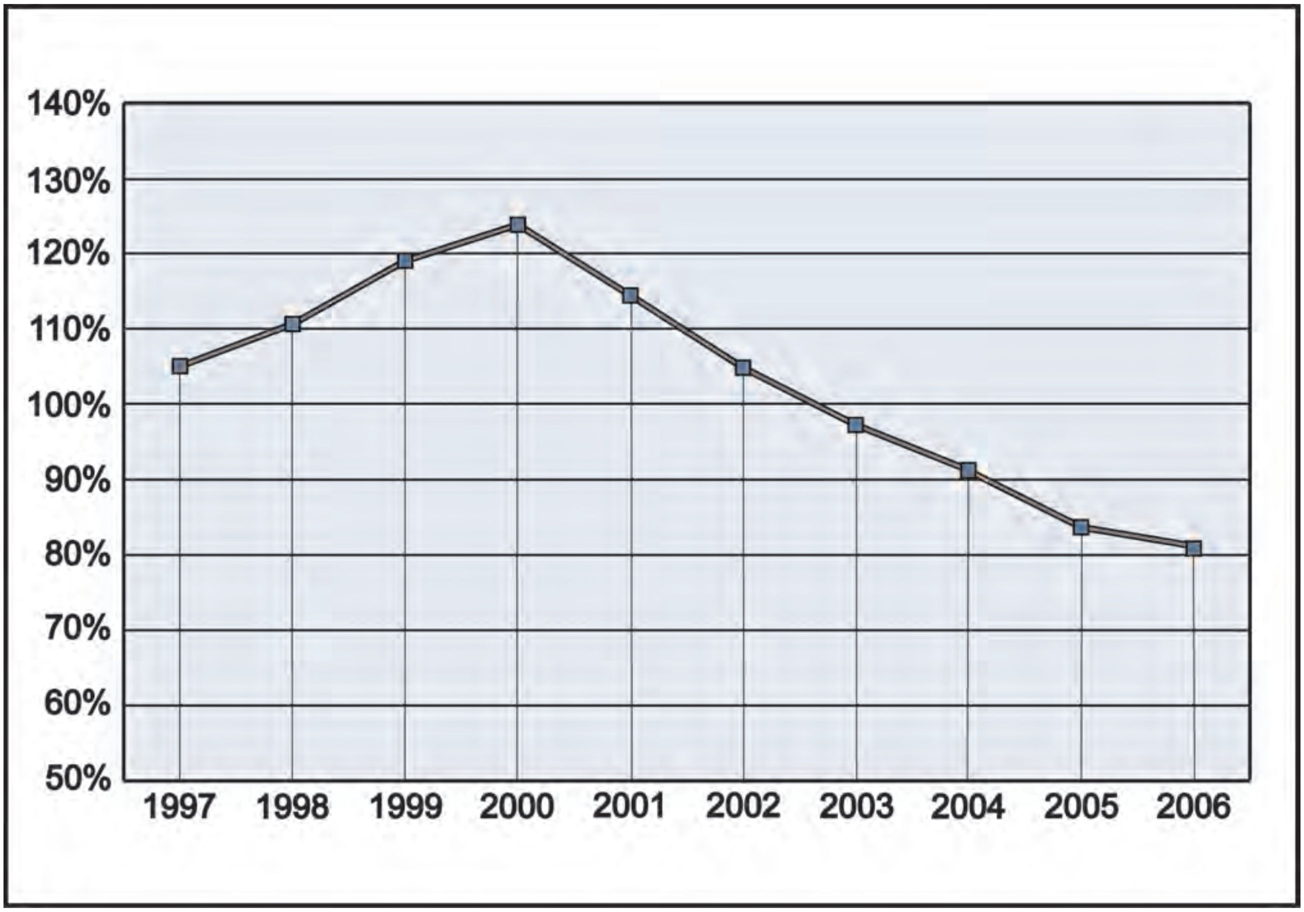
Five-Year History of Accrued Liability and Actuarial Value of Assets

(Dollar Amounts in Billions)



The following chart shows a ten-year history of the total funded ratio for Pensions and Health Insurance:

Ten-Year History of Funded Ratio
(1997 - 2006)



GASB No. 25 Disclosure

Statement No. 25 of the Governmental Accounting Standards Board (GASB) established reporting standards for the annual financial reports of defined benefit pension plans. The System complied with Statement No. 25 beginning with the June 30, 1996 valuation. The statement requires disclosure of the "schedule of funding progress" and the "schedule of employer contributions" in the System's financial statements.

The "schedule of funding progress" shows historical trend information about the System's actuarial value of pension assets, the actuarial accrued liability for pensions and the unfunded actuarial accrued liability for pensions. The actuarial funded ratio for pensions is measured by comparing the actuarial value of pension assets (based on a 5-year moving average market value) with the accrued liability for pensions. The accrued liability is the present value of pension benefits accumulated to date under the System's funding method and reflects future pay increases for active employees. On this basis, the System's funded ratio for pensions is 81.2% as of June 30, 2006. This funded ratio is based on an actuarial value of pension assets of $52.5 billion and an accrued liability for pensions of $64.6 billion. See Table 7 for more detail.

The pension contribution requirements of the PSERS code differ from the GASB disclosure requirements. As a result, there may be different determinations of contribution requirements for GASB accounting purposes and for State funding purposes. For GASB accounting purposes, the Annual Required Contribution (ARC) equals the employer normal cost for pensions (determined under the PSERS funding provisions) plus, for fiscal years ending on or before June 30, 2006, an amount that will amortize the unfunded actuarial accrued liability for pensions over a period no longer than 40 years. The maximum amortization period for calculating the GASB ARC decreases to 30 years commencing with the contribution for fiscal year 2006/2007. Although the employer normal cost for GASB accounting equals the PSERS normal cost for funding, section 8328 of the PSERS code specifies different amortization periods for the unfunded accrued liability: each change in the unfunded accrued liability is amortized over either a 10 or 30-year period, and the resulting equivalent single amortization period may be any number of years.

The "schedule of employer contributions" for pensions shows historical trend information about the GASB ARC and the percentage of the ARC contributed to the System. The actual employer pension contributions for the five fiscal years ending June 30, 2004 are equal to 100% of the GASB ARC. The actual employer pension contribution for the fiscal year ending June 30, 2005 is 46% of the ARC, and the actual employer pension contribution for the fiscal year ending June 30, 2006 is 34% of the ARC. See Table 8a for additional detail.

GASB No. 43 Disclosure

GASB Statement No. 43 established reporting standards for the annual financial reports of postemployment benefit plans other than pension plans, and these reporting requirements apply to the PSERS health insurance premium assistance plan. The System complied with Statement No. 43 beginning with the current June 30, 2006 valuation. The statement requires disclosure of the "schedule of funding progress" and the "schedule of employer contributions" in the System's financial statements.

The health insurance liability and funding provisions of the PSERS code differ from the GASB disclosure requirements. As a result, there are different determinations of actuarial liability and contribution requirements for GASB accounting purposes and for State funding purposes. For purposes of funding, the actuarial liability equals the assets in the health insurance account, and the contribution required is the amount necessary to establish reserves sufficient to provide premium assistance payments to all participating eligible annuitants during the fiscal year that immediately follows the year the employer contribution is made. For GASB accounting purposes, the actuarial liability has been determined under the entry age actuarial cost method, and the Annual Required Contribution (ARC) is equal to the entry age normal cost for health insurance plus an amount that will amortize the entry age unfunded actuarial liability for health insurance over a period of 30 years. (The entry age actuarial cost method was selected for this calculation because it meets the GASB parameters for determining actuarial liability and normal cost, and is the cost method specified by the PSERS code for the PSERS pension plan.)

The GASB 43 "schedule of funding progress" shows that as of June 30, 2006, the health insurance assets were $92,777,000, measured on a market value basis, while the GASB 43 health insurance liabilities were $1,056,154,000, resulting in a funded ratio of 8.8%.

The GASB 43 "schedule of employer contributions" will first apply to fiscal year 2006/2007, and will not be calculated until June 30, 2007.

Rate of Return

The investment return of the trust fund (i.e. total return including both realized and unrealized gains and losses) for fiscal years 2001/2002 through 2005/2006 is shown in the table below. The return based on the actuarial value of assets used for determining annual contribution rates is also shown.

The rate of return on market value reflects the investment earnings on the market value of assets from the beginning of the fiscal year to the end of the fiscal year. The actuarial assets are the assets recognized for valuation purposes. Actuarial assets are based on a smoothed market value that spreads the difference between the actual and expected return (beginning with the 2001/2002 fiscal year) over a period of five years. The rate of return on the actuarial value of assets is a measure of the increase in the actuarial value of assets from the beginning of the fiscal year to the end of the fiscal year.

Fiscal Year	Rate of Return Based on	
	Market Value *	Actuarial Value
2005/2006	15.3%	7.9%
2004/2005	12.9	3.2
2003/2004	19.7	2.6
2002/2003	2.7	1.4
2001/2002	(5.3)	2.7

* Market value rate of return provided by Wilshire Associates Incorporated, the PSERS investment consultant.

Table 1
Summary of Results of Actuarial Valuation
As of June 30, 2006
(Dollar Amounts in Thousands)

Item	Amount
Member Data	
1. Number of Members	
a) Active Members	263,350
b) Inactive Members and Vestees	94,071
c) Annuitants, Beneficiaries and Survivor Annuitants	161,813
d) Total	519,234
2. Annualized Salaries	$ 11,419,049
3. Annual Annuities	$ 3,274,451
Valuation Results	
4. Present Value of Future Pension Benefits	
a) Active Members	$ 50,310,197
b) Inactive Members and Vestees	823,575
c) Annuitants, Beneficiaries and Survivor Annuitants	29,117,164
d) Total	$ 80,250,936
5. Present Value of Future Pension Normal Cost	
a) Active Members	$ 8,131,437
b) Employer	7,492,138
c) Total	$ 15,623,575
6. Pension Accrued Liability	
a) Active Members (4a) - (5c)	$ 34,686,622
b) Inactive Members and Vestees	823,575
c) Annuitants, Beneficiaries and Survivor Annuitants	29,117,164
d) Total	$ 64,627,361
7. Health Insurance Assets for Premium Assistance	$ 92,777
8. Total Accrued Liability (6) + (7)	$ 64,720,138
9. Actuarial Value of Assets	$ 52,557,503
10. Funded Status (9) / (8)	81.2 %
11. Unfunded Accrued Liability (8) - (9)	$ 12,162,635
12. Total Normal Cost Rate	13.93 %
13. Member Contribution Rate	7.25 %
14. Employer Normal Cost Rate (12 - (13)	6.68 %
Employer Annual Funding Requirement for Fiscal 2007/2008	
15. Employer Contribution Rate Calculated by Actuary	
a) Normal	6.68 %
b) Unfunded Accrued Liability	(0.24)
c) Preliminary Pension Rate	6.44 %
d) Preliminary Pension Rate with 4% Floor	6.44
e) Health Insurance Premium Assistance	0.69
f) Total Rate	7.13 %

Table 2
Summary of Sources of Employer Contribution Rate
As of June 30, 2006
(Dollar Amounts in Thousands)

	Funding Period	Funding Period Beginning July 1	Initial Amount of Liability	Outstanding Balance as of July 1, 2006	Annual Payment Amount	Annual Payment Percent *
1. Amortization of:						
a) July 1, 2001 Fresh Start Unfunded Base	10 Years	2002	$ (9,137,130)	$ (6,880,185)	$ (1,510,937)	(11.73)%
b) Asset Method Change at July 1, 2001 due to Act 38	10 Years	2002	(4,638,306)	(3,492,607)	(767,001)	(5.95)%
c) 2001 Changes	30 Years	2002	7,570,507	6,917,683	668,111	5.19%
d) 2002 Changes	30 Years	2003	3,014,171	2,993,930	286,101	2.22 %
e) 2002 COLA	10 Years	2003	463,795	392,561	76,694	0.59 %
f) 2003 COLA	10 Years	2004	754,524	763,406	135,375	1.05 %
g) 2003 Changes	30 Years	2004	3,229,593	3,445,290	326,059	2.53 %
h) 2004 Changes	30 Years	2005	2,903,093	3,124,498	293,096	2.27 %
i) 2005 Changes	30 Years	2006	3,765,745	4,085,833	380,189	2.95 %
j) 2006 Changes	30 Years	2007	812,226	812,226	82,002	0.64 %
Total Amortization Payments				12,162,635	(30,311)	(0.24)%
2. Employer Normal Cost Rate						6.68 %
3. Preliminary Pension Rate (1) + (2)						6.44 %
4. Preliminary Pension Rate with 4% Floor -- Maximum of (3) and 4%						6.44 %
5. Health Insurance Premium Assistance Rate						0.69 %
6. Final Total Employer Contribution Rate Calculated by Actuary (4) + (5)						7.13 %

* Based on Estimated Employer Payroll for Fiscal Year Ending 2008 of $12,881,244.

Table 3
Determination of Health Insurance Contribution Rate For Fiscal Year 2007/2008
(Dollar Amounts in Thousands)

Item	Amount
1. Estimated Number of Eligible Annuitants in FiscalYear 2008/2009	116,300
2. Estimated Number of Eligible Annuitants Who Elect Coverage	75,595
3. Estimated Annual Health Insurance Premium Assistance Payments During Fiscal Year 2008/2009 (2) x $100 x 12	$ 90,714
4. Estimated Health Insurance Premium Assistance Administrative Expenses During Fiscal Year 2008/2009	2,282
5. Total Estimated Health Insurance Premium Assistance Account Disbursements During Fiscal Year 2008/2009 (3) + (4)	$ 92,996
6. Estimated Balance in Health Insurance Premium Assistance Account for Prior Fiscal Year	$ 5,249
7. Estimated Shortfall in Health Insurance Premium Assistance Account (5) - (6)	$ 87,747
8. Required Health Insurance Premium Assistance Contribution Rate	
(a) Estimated 2007/2008 Payroll	$ 12,881,244
(b) Required Health Insurance Premium Assistance Contribution Rate (7) / (8a) (rounded up)	0.69%

Table 4
Summary of Market Value of Plan Assets
As of June 30, 2006
(Dollar Amounts in Thousands)

Market Value	
1. Market Value of Assets as of June 30, 2005	$ 52,033,534
2. Contributions During Fiscal Year 2005/2006	1,358,590
3. Disbursements During Fiscal Year 2005/2006	3,964,748
4. Investment Return During Fiscal Year 2005/2006	
a) Net Investment Return	$ 7,938,436
b) Administrative Expenses	37,368
c) Investment Return After Expenses (a) - (b)	$ 7,901,068
5. Market Value of Assets as of June 30, 2006	
(1) + (2) - (3) + (4c)	$ 57,328,444
6. Rate of Return (per Wilshire)	15.26 %
Asset Allocation by Account	
1. Members' Savings Account	$ 9,571,668
2. Annuity Reserve Account	29,117,164
3. State Accumulation Account	18,546,835
4. Health Care Account	92,777
5. Total (1) + (2) + (3) + (4)	$ 57,328,444

Table 5
Derivation of Actuarial Value of Assets
As of June 30, 2006
(Dollar Amounts in Thousands)

1. Market Value of Assets as of June 30, 2006					$ 57,328,444
2. Determination of Deferred Gain (Loss)					
	Return on Assets				
Year	Actual	Expected	Difference	% Deferred	Deferred Amount
2005/2006	$ 7,901,068	$ 4,242,878	$ 3,658,190	80%	$ 2,926,552
2004/2005	6,044,305	4,321,981	1,722,324	60%	1,033,394
2003/2004	8,201,871	4,404,561	3,797,310	40%	1,518,924
2002/2003	985,646	4,525,288	(3,539,642)	20%	(707,929)
					$ 4,770,941
3. Actuarial Value of Assets (1) - (2)					$ 52,557,503
4. Actuarial Rate of Return *					7.90%

* The actuarial rate of return is the investment return based on the change in the actuarial value of the assets from the June 30, 2005 valuation to the June 30, 2006 valuation.

Table 6
Analysis of Change in Unfunded Accrued Liability
As of June 30, 2006
(Dollar Amounts in Thousands)

Item	Amount
1. Unfunded Accrued Liability at June 30, 2005	$ 10,007,288
2. Interest Credit at 8.50% to June 30, 2006	850,619
3. Contributions toward Unfunded Accrued Liability	(492,502)
4. Change due to Effect of 4% Floor on FY 2006 Pension Contribution	(77,084)
5. Expected Unfunded Accrued Liability at June 30, 2006 (1) + (2) - (3) + (4)	$ 11,273,325
6. Actual Unfunded Accrued Liability at June 30, 2006	$ 12,162,635
7. Increase (Decrease) from Expected (6) - (5)	$ 889,310
8. Reasons for Increase (Decrease)	
(a) Experience (Gains) Losses	
(i) Loss from Investment Return on Actuarial Value of Assets	$ 298,510
(ii) Loss from Salary Increases Greater than Expected	423,116
(iii) Loss from Retirement and Other Separation Experience	175,573
(iv) Loss from Annuitants' Mortality Experience	(7,889)
Subtotal	$ 889,310
(b) Changes in Assumptions and Funding Method	-
(c) Grand Total	$ 889,310

Table 7
Schedule of Funding Progress For Pensions *
GASB Statement No. 25 Disclosure
(Dollar Amounts in Thousands)

Valuation as of June 30	Actuarial Value of Assets	Actuarial Accrued Liability	Funded (Unfunded) Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Accrued Liability as a Percentage of Covered Payroll
2006	$ 52,464,726	$ 64,627,361	$ (12,162,635)	81.2 %	$ 11,419,049	(106.5) %
2005	51,122,156	61,129,444	(10,007,288)	83.6	10,527,668	(95.1)
2004	51,949,622	56,978,143	(5,028,521)	91.2	10,030,705	(50.1)
2003	52,770,018	54,313,328	(1,543,310)	97.2	9,652,881	(16.0)
2002	54,193,064	51,693,207	2,499,857	104.8	9,378,944	26.7
2001	54,783,928	47,870,922	6,913,006	114.4	9,414,884	73.4

* The amounts reported above include assets and liabilities for Pensions.

Schedule of Funding Progress For Postemployment Benefits Other Than Pensions *
GASB Statement No. 43 Disclosure
(Dollar Amounts in Thousands)

Valuation as of June 30	Actuarial Value of Assets	Actuarial Accrued Liability	Funded (Unfunded) Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Accrued Liability as a Percentage of Covered Payroll
2006	$ 92,777	$ 1,056,154	$ (963,377)	8.8 %	$ 11,419,049	(8.4) %

* The amounts reported above include assets and liabilities for Health Insurance Premium Assistance. The health insurance liabilities for GASB 43 disclosure have been calculated under the entry age normal cost method, which provides liabilities that differ from those determined under the funding requirements of the PSERS code.

Table 8a
Schedule of Employer Contributions for Pensions
GASB Statement No. 25 Disclosure
(Dollar Amounts in Thousands)

Fiscal Year Ended June 30	Annual Required Contribution	Actual Employer Contribution	Percentage Contributed
2006	$ 1,328,373	$ 456,878	34 %
2005	945,107	431,556	46 %
2004	321,901	321,091	100 %
2003	20,831	20,831	100 %
2002	539	539	100 %
2001	158,193	158,193	100 %

The information presented above was determined as part of the actuarial valuation as of two years prior to the dates indicated (i.e. the contribution determined by the valuation completed as of June 30, 2002 was contributed in the fiscal year ending June 30, 2004).

Additional information as of the latest actuarial valuation follows:

Valuation Date:	6/30/2006
Actuarial Cost Method:	Entry Age
Amortization Method:	Level dollar open
Remaining Amortization Period:	30 years
Asset Valuation Method:	5-year smoothed market

Actuarial Assumptions:

- Investment Rate of Return *	8.50%
- Projected Salaried Increases *	6.00%

* Includes Inflation at:	3.25%

Table 8b
Schedule of Employer Contributions for Postemployment Benefits Other than Pensions GASB Statement No. 43 Disclosure
(Dollar Amounts in Thousands)

The June 30, 2006 valuation represents the first calculation of the GASB 43 contribution. This valuation will determine the Annual Required Contribution for the 2006/2007 fiscal year. However, the final calculation of the Annual Required Contribution and the Actual Employer contribution cannot be completed until the end of the fiscal year.

Additional information as of the latest actuarial valuation follows:

Valuation Date:	6/30/2006
Actuarial Cost Method:	Entry Age
Amortization Method:	Level dollar open
Remaining Amortization Period:	30 years
Asset Valuation Method:	5-year smoothed market
Actuarial Assumptions:	
- Investment Rate of Return *	8.50%
- Projected Salaried Increases *	6.00%
* Includes Inflation at:	3.25%

Table 9
Solvency Test
Comparative Summary of Accrued Liability and Actuarial Value of Assets*
(Dollar Amounts in Thousands)

Valuation as of June 30	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Member Employer Financed	Actuarial Value of Assets	Portion of Accrued Liability Covered by Valuation Assets (1)	(2)	(3)
2006	$ 9,571,668	$ 29,209,941	$ 25,938,529	$ 52,557,503	100%	100%	53%
2005	9,116,347	27,051,245	25,058,989	51,219,293	100%	100%	60%
2004	8,755,109	24,482,234	23,885,657	52,094,479	100%	100%	79%
2003	8,282,753	22,094,109	24,066,913	52,900,465	100%	100%	94%
2002	7,780,370	19,978,567	24,037,574	54,296,368	100%	100%	100%
2001	7,464,404	15,802,140	24,650,750	54,830,300	100%	100%	100%

* The amounts reported include assets and liabilities for both Pensions and Health Insurance.

Table 10
History and Projection of Contribution Rates and Funded Ratios *

Fiscal Year	Employer Payroll	Contribution Rates: Member	Employer Normal Cost Rate	Unfunded Liability Rate	Preliminary Employer Pension Rate	Health Insurance Rate	Total Employer Rate	Funded Ratio
1998/1999	$ 8,247,602	5.69 %	6.33 %	(0.44) %	5.89 %	0.15 %	6.04 %	119.0 %
1999/2000	8,939,598	5.72	6.40	(2.04)	4.36	0.25	4.61	123.8
2000/2001	9,414,884	5.77	6.29	(4.65)	1.64	0.30	1.94	114.4
2001/2002	9,378,944	6.43	5.63	(6.05)	(0.42)	1.09	1.09	104.8
2002/2003	9,652,881	7.10	7.20	(10.03)	1.00	0.97	1.15	97.2
2003/2004	10,030,705	7.08	7.25	(4.27)	2.98	0.79	3.77	91.2
2004/2005	11,062,589	7.12	7.48	(7.10)	4.00	0.23	4.23	83.7
2005/2006	11,505,093	7.16	7.61	(4.28)	4.00	0.69	4.69	81.2
2006/2007	11,821,951	7.21	6.62	(0.95)	5.67	0.74	6.46	82.1
2007/2008	**12,881,244**	**7.25**	**6.68**	**(0.24)**	**6.44**	**0.69**	**7.13**	**84.2**
2008/2009	13,218,270	7.28	6.64	(1.16)	5.48	0.72	6.20	85.1
2009/2010	13,545,642	7.30	6.62	(2.61)	4.01	0.73	4.74	85.2
2010/2011	13,870,025	7.32	6.60	(3.47)	3.13	0.73	4.73	84.4
2011/2012	14,207,928	7.34	6.59	(4.05)	2.54	0.73	4.73	83.4
2012/2013	14,567,273	7.37	6.56	11.45	18.01	0.72	18.73	84.6
2013/2014	14,946,464	7.39	6.54	10.40	16.94	0.72	17.66	85.7
2014/2015	15,355,101	7.40	6.53	9.20	15.73	0.71	16.44	86.6
2015/2016	15,799,234	7.42	6.51	8.91	15.42	0.70	16.12	87.4
2016/2017	16,286,901	7.43	6.50	8.64	15.14	0.69	15.83	88.2
2017/2018	16,821,401	7.44	6.49	8.36	14.85	0.67	15.52	89.1

* The projection of contribution rates is based on the assumption that there are no changes in demographics or economic assumptions, no changes in benefit provisions, and no actuarial gains or losses other than gains or losses on the actuarial value of assets that result from recognizing currently deferred gains or losses on the market value of assets.

Table 11
History and Projection of Annuitants, Beneficiaries, Survivor Annuitants and Active Members

Valuation as of June 30	New Annuitants During the Year	Annuitant Deaths During the Year	Annuitants at End of Year	Beneficiaries and Survivor Annuitants at End of Year	Total Annuitants, Beneficiaries and Survivor Annuitants	Active Members
1997			118,137	5,987	124,124	215,077
1998			120,665	6,149	126,814	220,703
1999			126,448	6,421	132,869	223,495
2000			127,404	6,654	134,058	234,210
2001			125,880	6,836	132,716	243,311
2002			134,300	7,114	141,414	242,616
2003			138,383	7,310	145,693	246,700
2004			143,997	7,555	151,552	247,901
2005			148,727	7,792	156,519	255,465
2006			**153,757**	**8,056**	**161,813**	**263,350**
2007	13,351	4,195	162,913	8,486	171,399	263,350
2008	11,526	4,389	170,050	8,871	178,921	263,350
2009	12,054	4,541	177,563	9,207	186,770	263,350
2010	12,289	4,719	185,133	9,505	194,638	263,350
2011	12,154	4,910	192,377	9,784	202,161	263,350
2012	11,853	5,079	199,151	10,038	209,189	263,350
2013	11,806	5,384	205,573	10,266	215,839	263,350
2014	11,741	5,621	211,693	10,489	222,182	263,350
2015	11,617	5,830	217,480	10,725	228,205	263,350
2016	11,395	6,009	222,866	10,967	233,833	263,350

Table 12
Description of Actuarial Assumptions and Methods

ASSUMPTIONS

Interest Rate: 8½% per annum, compounded annually (adopted as of June 30, 1990). The components are 3.25% for inflation and 5.25% for the real rate of return (both adopted as of June 30, 2005). Actuarial equivalent benefits are determined based on 4% (since 1960).

Separation From Service: Illustrative rates of assumed separation from service are shown in the following table. (Rates of non-vested withdrawal, of death, and of disability were adopted as of June 30, 2005; other rates were adopted as of June 30, 2000):

	Annual Rate of:						
		Vested Withdrawal*					
Age	Non-Vested Withdrawal	Less than 10 Years of Service	10 or More Years of Service	Death	Disability	Early Retirement**	Superannuation Retirement
				Males			
25	12.40 %	5.50 %	1.40 %	.042 %	.024 %		
30	10.00	3.00	1.40	.057	.024		
35	11.00	3.00	1.10	.062	.100		
40	11.00	3.00	.80	.072	.180		
45	11.00	3.00	.50	.100	.180		
50	11.00	3.00	1.78	.152	.280		24.00 %
55	10.50	3.00	3.50	.252	.430	10.00 %	24.00
60	10.00	2.40	4.50	.467	.580	10.00	28.00
65				.870	.100		20.00
69				1.335	.100		20.00
				Females			
25	14.10 %	9.50 %	4.00 %	.019 %	.040 %		
30	14.10	7.50	4.00	.023	.040		
35	14.10	5.50	2.00	.031	.080		
40	10.90	3.50	1.00	.043	.130		
45	10.90	3.00	.55	.061	.180		
50	10.90	3.00	1.50	.085	.250		10.00 %
55	10.90	3.00	3.00	.146	.480	10.00	10.00
60	10.90	3.50	5.90	.284	.480	15.00	25.00
65				.561	.160		28.00
69				.866	.160		20.00

* Vested Withdrawal - At least 5 years service but not eligible for Early or Superannuation retirement.

** Early Retirement - Age 55 with 25 years service, but not eligible for Superannuation retirement.

Description of Actuarial Assumptions and Methods (Continued)

Death After Retirement: The Uninsured Pensioners 1994 Mortality Table (UP94) with mortality improvements projected 10 years, and with age set back one year for males and females, adopted in 2005, are used to project mortality for healthy annuitants and for dependent beneficiaries. Special mortality tables based on PSERS' experience are used for disability retirements. (The 1995 George B. Buck Mortality Tables, rated forward one year for males and unadjusted for females, adopted in 2000, are used to determine actuarial equivalent benefits.)

Salary Increase: Effective average of 6% per annum, compounded annually (adopted as of June 30, 2005). The components are 3.25% for inflation, 1% for real wage growth and 1.75% for merit or seniority increases (adopted as of June 30, 2000). Representative values are as follows:

Age	Annual Rate of Salary Increase
20	12.00 %
30	9.00
40	7.00
50	4.75
55	4.50
60	4.25
65	4.25
70	4.25

MISCELLANEOUS

Option 4 Elections: 100% of members are assumed to elect a refund of contributions and a reduced annuity.

Withdrawal Annuity: 90% of members are assumed to commence payment immediately and 10% are assumed to defer payment to superannuation age.

Health Insurance

Elections: 65% of eligible retirees are assumed to elect premium assistance.

Administrative Expenses: Assumed equal to 2% of contributions made during the year.

METHODS

Calculations: The actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures, based on the current provisions of the retirement system, and on actuarial assumptions that are internally consistent and reasonably based on the actual experience of the System.

Asset Valuation Method: A five-year moving market average value of assets that recognizes the 8.5% actuarial expected investment return immediately and spreads the difference between the

Description of Actuarial Assumptions and Methods (Continued)

actual and expected return (beginning with the 2000/2001 fiscal year) over a period of five years (adopted as of June 30, 2001).

Actuarial Cost Method for Pension Funding: Entry Age Normal Cost Method (modified slightly as of June 30, 2005 to use a pay-weighted average normal contribution rate). The results of each June 30 valuation normally determine the employer contribution rate for the second succeeding fiscal year. The outstanding balance of the unfunded accrued liability as of June 30, 2001 and the decrease in the unfunded accrued liability due to the actuarial asset method change provided by Act 38 continue to be amortized over a 10-year period, with level dollar funding, beginning July 1 2002. The increases in the unfunded accrued liability due to the July 1, 2002 and July 1, 2003 cost-of-living adjustments provided by Act 38 were both recognized at June 30, 2002 and continue to be amortized over a 10-year period, with level dollar funding starting on July 1, 2003 and July 1, 2004, respectively. All other changes in the unfunded accrued liability at June 30, 2002 – including the Act 9 benefit changes – are amortized over a 30-year period, with level dollar funding starting on July 1, 2003. Post June 30, 2002 benefit improvements for active members and retirees are amortized over a 10-year period with level dollar funding. Post June 30, 2002 gains and losses, and changes in the unfunded accrued liability resulting from changes in actuarial assumptions and methods, are amortized over a 30-year period with level dollar funding. Act 40 also provided a 4.00% floor on the employer pension rate.

Actuarial Cost Method for GASB 25 Accounting for Pensions: Same as for pension funding, except that in fiscal years in which the amortization requirements of the PSERS code result in an equivalent single amortization period that is longer than the maximum allowable period specified by GASB 25 (40 years for fiscal years ending on or before June 30, 2006; and 30 years for subsequent fiscal years), the GASB 25 amortization payment will be set equal to the level dollar amount that will amortize the unfunded accrued liability over a period equal to the maximum allowable period specified by GASB 25.

Actuarial Cost Method for Health Insurance Funding: The actuarial liability equals the assets in the health insurance account, and the results of the June 30 valuation determine the contribution rate for the second succeeding fiscal year. The rate so determined is the rate necessary to establish reserves sufficient to cover administrative expenses and provide premium assistance payments for all participating eligible annuitants during the third fiscal year that follows the valuation date.

Actuarial Cost Method for GASB 43 Accounting for Health Insurance: The actuarial liability is determined under the entry age actuarial cost method, and the Annual Required Contribution (ARC) for the fiscal year that follows the valuation date is equal to the entry age normal cost for health insurance plus an amount that will amortize the entry age unfunded actuarial liability for health insurance over a period of 30 years.

Determination of Health Care Contribution Rate: This is the rate necessary to establish reserves sufficient to provide premium assistance payments to all participating eligible annuitants during the fiscal year that immediately follows the year the employer contribution is made.

DATA

Census and Assets: The valuation was based on members of the System as of June 30, 2005 and does not take into account future members. All census data was supplied by the System and was subject to reasonable consistency checks. The actuary adjusts the data to account for service and pay earned by members on or before the valuation that is not reported by the System until after the actuarial valuation is performed. Asset data was supplied by the System.

Table 13
Summary of Benefit and Contribution Provisions

MEMBERSHIP

For valuation purposes, all employees are considered to be full coverage. All employees who become members on and after January 1, 1966 are members of the dual coverage group. Dual coverage members contribute to both PSERS and to Social Security.

BENEFITS

Superannuation Annuity

Eligibility	Age 62, or age 60 with 30 years of service, or 35 years of service regardless of age.
Amount	2.5% of final average salary times years of school service and intervening military service. 2% of final average salary for non-school service and for members who do not elect Class T-D coverage. Minimum of $100 per year of service. "Final average salary" means the highest average annual salary for any 3 years of service. Annual salary is subject to a limit of $200,000, as adjusted under Section 401(a)(17). As of June 30, 2006, the adjusted limit is $220,000. For members who elect coverage under Class T-D, the maximum benefit is equal to the limit established by Section 415 of the Internal Revenue Code.

Early Retirement Annuity

Eligibility	Age 55 with 25 years of service.
Amount	Accrued benefit as of date of retirement, reduced 1/4% for each month by which commencement of payments precedes Superannuation Age. For members who elect coverage under Class T-D, the maximum benefit is equal to the limit established by Section 415 of the Internal Revenue Code.

Withdrawal Annuity

Eligibility	5 years of service.
Amount	Accrued benefit deferred to superannuation retirement age or an actuarially reduced benefit payable immediately. Actuarially equivalent benefits are based on 4% interest and the 1995 George B. Buck mortality tables, rated forward one year for males and unadjusted for females.

Summary of Benefit and Contribution Provisions (Continued)

Disability Annuity

Eligibility	5 years of service.
Amount	The standard single life annuity if the total number of credited service is greater than 16.667, otherwise the standard single life annuity multiplied by the lesser of the following ratios: (Y*/Y) or (16.667/Y) where Y is the number of years of credited service and Y* is the total years of credited service if the member were to continue as a school employee until superannuation retirement age (or at current age, if later). Minimum of $100 per year of service.

Return of Contributions

Eligibility	Death or separation from service and member does not qualify for other benefits.
Amount	Refund of accumulated deductions includes interest (less annuity payments received prior to death in the case of a retired member).

Death Benefit

Eligibility	Death of an active member or vestee who was eligible to receive an annuity.
Amount	The present value of the annuity which would have been effective if the member retired on the day before death. Option 1 (see below) assumed payable if no other option elected.

Normal and Optional Forms of Benefits

Normal Form:	Life annuity with a guaranteed payment equal to member contributions with interest.
Option 1:	Reduced benefit with refund of balance of present value of annuity at retirement over payments received. If balance is less than $5,000, benefit is paid in lump sum; otherwise, beneficiary may elect annuity and/or lump sum.
Option 2:	Joint and 100% survivorship annuity.
Option 3:	Joint and 50% survivorship annuity.
Option 4:	Benefit of equivalent actuarial value, including lump sum payment of member contributions.

Summary of Benefit and Contribution Provisions (Continued)

Postemployment Health Care Insurance Premium Assistance

Eligibility	Retired members who: (a) have 24½ or more years of service, or (b) are disability annuitants, or (c) have 15 or more years of service and who both terminated school service and retired after attaining superannuation age and (d) participate in the PSERS Health Options Program or in an employer-sponsored health insurance program.
Amount	Participating eligible annuitants receive health insurance premium assistance payments from the Health Insurance Account equal to the lesser of $100 per month or the actual monthly premium. All administrative expenses necessary to operate the health insurance premium assistance program are to be funded by the Health Insurance Account. The Health Insurance Account is credited with contributions of the Commonwealth and the employers.

CONTRIBUTIONS

By Members	Members who elected coverage under Class T-D and who were most recently enrolled prior to July 22, 1983 contribute at a rate of 6½% of compensation, while members who elected coverage under Class T-D and who were most recently enrolled on or after July 22, 1983 contribute at a rate of 7½% of compensation. Members who did not elect coverage under Class T-D and who were most recently enrolled prior to July 22, 1983 contribute at a rate of 5¼% of compensation, while members who did not elect coverage under Class T-D and who were most recently enrolled on or after July 22, 1983 and prior to July 1, 2001 contribute at a rate of 6¼% of compensation. Anyone who enrolls or re-enrolls on or after July 1, 2001 automatically has coverage under class T-D for subsequent school service and subsequent intervening military service, and must contribute at a rate of 7½% of compensation. Reduction in rate for a joint coverage member: 40% of Social Security tax, exclusive of disability and medical coverage portion.
By Commonwealth and employers	Balance of required contribution determined as normal contribution, accrued liability contribution, supplemental annuity contribution, experience adjustment factor and premium assistance contribution, is funded by the Commonwealth and the employers.

Table 14
Summary of Membership Data
As of June 30, 2006
(Dollar Amounts in Thousands)

Active Members *

Item	Male	Female	Total
Number of Members	72,621	190,729	263,350
Annual Salaries **	$ 3,569,567	$ 7,849,482	$ 11,419,049
Average Age	44.6	44.7	44.7
Average Service	12.0	10.7	11.1

* Excludes 94,071 inactive members and vestees.

** These salaries shown in the table above represent a rate of pay for members who were in active service on June 30, 2006.

Annuitants and Beneficiaries

Item	Number	Annual Annuities	Average Annuities	Average Age
Annuitants (Normal, Early and Withdrawal)	146,582	$ 3,089,351	$ 21,076	69.7
Survivors and Beneficiaries	8,056	71,434	8,867	75.7
Disabled Annuitants	7,175	113,666	15,842	62.3
Total	161,813	$ 3,274,451	20,236	69.7

Exhibit I

Active Membership Data as of June 30, 2006
Number and Average Annual Salary

Age	Years of Service									Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 - 34	35 - 39	40 +	
Under 25	8,784	70								8,854
	$28,425	$26,478								$28,410
25 - 29	19,744	5,678	33							25,455
	$35,796	$45,458	$39,602							$37,956
30 - 34	9,654	13,465	2,657	47						25,823
	$33,696	$48,365	$55,335	$41,150						$43,585
35 - 39	9,685	8,584	8,462	2,160	61					28,952
	$26,300	$45,522	$58,577	$60,318	$43,306					$44,007
40 - 44	11,221	7,796	4,709	5,341	1,962	115				31,144
	$22,100	$34,832	$51,711	$63,254	$61,475	$43,965				$39,383
45 - 49	10,881	9,831	5,740	4,459	4,840	2,839	128			38,718
	$21,668	$31,482	$42,121	$56,500	$65,319	$66,180	$45,256			$40,002
50 - 54	7,458	8,189	6,671	6,054	4,722	7,923	6,397	53		47,467
	$24,189	$32,989	$41,568	$51,682	$62,336	$71,639	$72,684	$44,888		$49,930
55 - 59	5,009	4,553	4,488	5,183	5,005	3,730	7,790	1,995	27	37,780
	$22,653	$32,738	$40,148	$47,781	$58,010	$66,103	$76,100	$79,020	$44,743	$52,380
60 - 64	2,319	1,938	1,706	2,043	1,966	1,523	793	619	159	13,066
	$18,867	$27,799	$34,440	$41,570	$47,698	$52,409	$59,489	$79,972	$81,536	$40,146
Over 64	1,742	1,099	840	738	600	489	311	137	135	6,091
	$13,177	$19,410	$24,409	$29,607	$33,772	$35,300	$39,533	$50,429	$70,680	$25,104
Total	86,497	61,203	35,306	26,025	19,156	16,61	15,419	2,804	321	263,350
	$27,525	$38,845	$47,189	$53,383	$59,414	$66,441	$72,835	$77,188	$73,876	$43,361

Exhibit II

The Number and Average Annual Annuity
As of June 30, 2006

Retired on Account of Superannuation, Early Retirement and Those in Receipt of Withdrawal Annuities

Age	Years of Service									Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 - 34	35 - 39	40 +	
Under 50	1	1,592	1,327	411	116	32				3,479
	$854	$762	$1,610	$3,910	$8,522	$15,105				$1,848
50-54		365	1,133	513	279	296	213	17		2,816
		$1,360	$1,498	$4,291	$9,815	$20,833	$32,172	$32,833		$7,355
55-59		306	2,511	1,294	792	1,530	7,948	3,739	3	18,123
		$2,121	$1,803	$5,368	$10,694	$25,669	$41,690	$52,653	$42,491	$32,457
60-64	136	523	2,651	2,155	1,672	2,604	10,330	6,829	215	27,115
	$917	$2,980	$2,934	$7,380	$14,463	$25,934	$36,768	$51,220	$56,823	$31,676
65-69	495	832	2,665	2,718	2,859	3,417	6,514	4,662	746	24,908
	$856	$2,716	$3,818	$7,849	$13,038	$21,459	$31,381	$40,196	$53,334	$23,140
70-74	557	953	2,717	2,658	2,946	3,175	3,999	3,099	1,556	21,660
	$613	$2,074	$3,479	$6,485	$10,951	$17,611	$26,397	$35,325	$42,421	$18,385
75-79	606	1,091	2,658	2,725	3,032	3,111	3,151	2,129	1,375	19,878
	$528	$1,775	$3,373	$6,072	$10,666	$16,330	$23,515	$31,094	$40,736	$15,455
80-84	472	1,001	2,322	2,460	2,302	2,137	1,675	1,540	656	14,565
	$502	$1,554	$3,279	$5,990	$10,251	$15,051	$20,158	$25,586	$36,705	$12,163
85-89	298	670	1,591	1,473	1,305	1,141	849	955	357	8,639
	$564	$1,614	$3,366	$5,955	$9,380	$13,394	$18,332	$22,599	$29,232	$10,474
Over 89	158	477	805	791	676	697	548	690	557	5,399
	$699	$2,155	$3,980	$6,978	$10,610	$13,820	$18,126	$21,672	$25,330	$12,162
Total	2,723	7,810	20,380	17,198	15,979	18,140	35,227	23,660	5,465	146,582
	$634	$1,761	$2,988	$6,443	$11,344	$19,326	$32,967	$41,683	$40,764	$21,076

Exhibit III

The Number and Average Annual Annuity
As of June 30, 2006

Beneficiaries and Survivor Annuitants

Age	Years of Service									Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 - 34	35 - 39	40 +	
Under 50	1	17	51	47	48	34	34	18	18	268
	$240	$1,740	$1,756	$3,160	$5,266	$6,967	$13,785	$16,498	$11,264	$6,440
50 - 54	2	12	17	20	29	32	41	25	11	189
	$365	$1,099	$1,987	$3,999	$6,527	$11,356	$13,221	$12,813	$10,673	$8,784
55 - 59	2	10	38	35	42	56	110	103	19	415
	$291	$2,272	$3,039	$3,512	$6,352	$12,197	$14,784	$18,714	$13,377	$12,095
60 - 64	5	14	46	43	50	68	165	142	32	565
	$454	$1,492	$2,833	$4,671	$6,181	$12,293	$17,057	$20,316	$14,273	$13,549
65 - 69	6	20	92	92	78	81	163	161	53	746
	$619	$1,923	$3,225	$4,872	$7,327	$11,751	$15,302	$19,538	$18,450	$11,968
70 - 74	12	36	114	101	115	102	209	160	107	956
	$645	$1,755	$2,724	$4,330	$6,852	$9,599	$12,498	$16,720	$21,009	$10,587
75 - 79	24	62	161	178	168	171	207	241	124	1,336
	$575	$1,544	$2,852	$4,059	$6,762	$8,385	$12,286	$13,309	$17,115	$8,783
80 - 84	21	91	216	189	175	204	212	289	120	1,517
	$616	$1,283	$2,542	$3,739	$6,075	$7,945	$9,574	$10,973	$15,199	$7,313
85 - 89	14	101	180	128	137	129	170	251	149	1,259
	$532	$1,157	$2,153	$3,402	$5,341	$7,339	$9,007	$10,374	$11,493	$6,730
Over 89	1	50	85	69	69	74	93	182	182	805
	$514	$1,098	$2,012	$3,385	$4,782	$5,606	$6,854	$8,421	$9,054	$6,239
Total	88	413	1,000	902	911	951	1,404	1,572	815	8,056
	$568	$1,386	$2,543	$3,920	$6,189	$8,903	$12,321	$13,846	$14,188	$8,867

Exhibit IV
The Number and Average Annual Annuity
As of June 30, 2006

Retired on Account of Disability

Age	Years of Service									Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 - 34	35 - 39	40 +	
Under 50		243	174	108	54	16				595
		$10,358	$12,793	$17,251	$21,056	$25,990				$13,713
50 - 54		179	212	157	159	166	28			901
		$8,950	$11,951	$16,021	$22,936	$36,320	$45,643			$19,539
55 - 59		243	282	253	262	389	232	3		1,664
		$8,025	$10,614	$15,129	$22,349	$33,519	$45,838	$49,415		$23,106
60 - 64		221	296	267	294	268	71	2		1,419
		$6,352	$8,727	$12,054	$19,054	$27,760	$39,124	$47,306		$16,292
65 - 69		165	241	224	186	117	17	2		952
		$5,089	$7,669	$10,008	$15,163	$24,692	$28,928	$42,997		$11,782
70 - 74		131	184	147	120	73	16	1		672
		$4,411	$6,563	$8,489	$13,116	$20,512	$27,341	$43,179		$9,799
75 - 79		92	142	89	95	52	5	1	1	477
		$3,440	$5,490	$8,570	$13,123	$18,135	$20,788	$24,751	$54,601	$8,872
80 - 84		69	71	47	57	35	10	1		290
		$3,609	$6,159	$7,925	$10,848	$15,910	$20,818	$29,135		$8,522
85 - 89		26	31	24	25	15	14			135
		$3,264	$5,553	$7,878	$10,421	$14,870	$22,560			$9,226
Over 89		6	22	23	9	5	5			70
		$2,961	$5,443	$8,311	$9,766	$14,698	$18,870			$8,349
Total		1,375	1,655	1,339	1,261	1,136	398	10	1	7,175
		$6,952	$9,003	$12,270	$18,120	$29,143	$41,059	$42,592	$54,601	$15,842

Exhibit V

Annuitant and Beneficiary Membership Data
As of June 30, 2006

Number and Average Annual Benefit
Excludes Partial Lump Sum Payments

Age Last Birthday	Number	Annual Benefit (Dollars in Thousands)	Average Annual Benefit (Dollars)
Annuitants			
(Normal, Early and Withdrawal)			
Under 60	24,418	$ 615,355	$ 25,201
60 - 64	27,115	858,883	31,676
65 - 69	24,908	576,382	23,140
70 - 74	21,660	398,222	18,385
75 - 79	19,878	307,216	15,455
Over 79	28,603	333,293	11,652
Total	146,582	$ 3,089,351	$ 21,076
Survivors and Beneficiaries			
Under 60	872	$ 8,406	$ 9,640
60 - 64	565	7,655	13,549
65 - 69	746	8,928	11,968
70 - 74	956	10,121	10,587
75 - 79	1,336	11,734	8,783
Over 79	3,581	24,590	6,867
Total	8,056	$ 71,434	$ 8,867
Disabled Annuitants			
Under 60	3,160	$ 64,212	$ 20,320
60 - 64	1,419	23,119	16,292
65 - 69	952	11,217	11,783
70 - 74	672	6,585	9,799
75 - 79	477	4,232	8,872
Over 79	495	4,301	8,689
Total	7,175	$ 113,666	$ 15,842
Grand Total Average Annual Benefit	161,813	$ 3,274,451	$ 20,236

Exhibit VI

10 Year History of Membership Data

Active Members

Valuation as of June 30	Number of Active Members	Percentage Change in Membership	Total Annual Payroll (Dollars in Thousands)	Percentage Change in Payroll
2006	263,350	3.09%	$ 11,419,049	8.47%
2005	255,465	3.05%	10,527,668	4.95%
2004	247,901	0.49%	10,030,705	3.91%
2003	246,700	1.68%	9,652,881	2.92%
2002	242,616	(0.29%)	9,378,944	(0.38%)
2001	243,311	3.89%	9,414,884	5.32%
2000	234,210	4.79%	8,939,598	8.39%
1999	223,495	1.27%	8,247,602	1.93%
1998	220,703	2.62%	8,091,481	4.47%
1997	215,077	0.55%	7,745,001	1.69%

Annuitant and Survivor Annuitant Members

Year Ended June 30	Number on roll	Additions	Deletions	Percentage Change in Membership	Annual Annuities (Dollars in Millions)	Percentage Change in Annuities
2006	161,813	10,637	5,343	3.38%	$ 3,274.5	8.16%
2005	156,519	10,050	5,083	3.28%	3,027.6	8.20%
2004	151,552	10,526	4,667	4.02%	2,798.2	9.94%
2003	145,693	9,079	4,800	3.03%	2,545.1	13.20%
2002	141,414	13,003	4,305	6.55%	2,248.3	20.10%
2001	132,716	3,140	4,482	(1.00)%	1,872.0	0.00%
2000	134,058	5,923	4,734	0.89%	1,880.6	2.73%
1999	132,869	10,609	4,554	4.77%	1,830.6	10.77%
1998	126,814	7,132	4,442	2.17%	1,652.6	14.21%
1997	124,124	9,787	4,389	4.55%	1,447.0	11.74%

Statistical Section
Narrative

To assist readers in the assessment of the System's economic condition, The Statistical Section of this Comprehensive Annual Financial Report presents information to add historical perspective, context, and detail to the financial statements, notes to financial statements, and required supplementary information presented in the preceding sections. To provide historical perspective and a sense of trend, the exhibits in this Section are presented in multiple-year formats. The information is categorized into four topical groups: *Financial Trends, Revenue Capacity, Demographic and Economic Information, and Operating Information*.

Financial Trends

The ***Schedule of Trend Data*** provides key financial, actuarial, and demographic information for a ten-year period ending June 30, 2007.

The ***Schedule of Total Changes in Plan Net Assets*** shows the historical combined effects of the additions and deductions of plan net assets over the ten-year period ending June 30, 2007.

The schedule of ***Additions to Plan Net Assets*** provides tabular and visual details of the additions to the System's plan net assets over the ten-year period ending June 30, 2007.

The schedule of ***Deductions from Plan Net Assets*** provides tabular and visual details of the deductions from the System's plan net assets over the ten-year period ending June 30, 2007.

Revenue Capacity

The ***Schedule of Investment Income*** provides a ten-year perspective on the System's largest source of revenue - Net Investment Income.

Demographic and Economic Information

The ***Schedule of Summary Membership Data*** provides general populations and statistics relating to the System's active membership over the ten-year period ending June 30, 2007.

The ***Schedule of Summary Annuity Data*** provides general populations and statistics relating to the System's annuitants over the ten-year period ending June 30, 2007.

The schedule of ***Components of Total Contribution Rate*** provides a long-term historical perspective of the actuarially required contribution rates to the System's members and employers.

The ***Schedule of Retired Members by Type of Benefit*** provides summary statistics relating to the PSERS annuitants' receipt of annuities over the ten-year period ending June 30, 2007.

Operating Information

The list of ***Ten Largest Employers*** shows the System's ten largest employers in terms of reported members. Due to the stable comparable populations of school employees in PSERS' employers over the years, a single presentation provides perspective for a ten-year period.

The ***Schedule of Employers*** provides the full list of PSERS' employers.

Schedule of Trend Data*

For years ending June 30,	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Contribution Rates: %										
Total Employer	6.46	4.69	4.23	3.77	1.15	1.09	1.94	4.61	6.04	8.76
Health Care Premium Insurance	.74	.69	.23	.79	.97	1.09	.30	.25	.15	.15
Average Member	7.21	7.16	7.12	7.08	7.10	6.43	5.77	5.72	5.69	5.65
Contributions:										
Employer $	746,308	530,943	457,808	406,722	116,456	109,450	185,716	412,783	526,960	731,131
Member $	999,507	982,846	955,509	944,422	897,307	805,567	721,725	680,040	646,507	578,322
Average Annual Member Compensation $	43,217	43,361	41,210	40,463	39,128	38,658	38,695	38,169	36,903	36,662
Market Value of Assets $	67,438,000	57,328,000	52,033,534	48,484,506	42,446,826	43,576,553	48,143,327	53,412,950	48,971,751	44,851,838
Actuarial Value of Assets $	57,155,000	52,558,000	51,219,300	52,094,500	52,900,500	54,296,400	54,830,300	49,293,047	44,606,526	39,968,957
Accrued Actuarial Liability $	66,593,000	64,720,000	61,129,444	56,978,143	54,313,328	51,693,207	47,870,922	39,771,604	37,499,115	36,136,163
Funded Ratio %	85.8	81.2	83.7	91.2	97.2	104.8	114.4	123.8	119.0	110.6
Total Benefits & Refunds $	4,320,440	4,115,865	3,877,842	3,497,365	3,102,684	2,913,163	2,297,332	2,382,277	2,456,383	2,015,309
Average Pension $	20,970	20,236	19,343	18,464	17,469	15,899	14,105	14,029	13,777	13,032
Annuitants & Beneficiaries	168,026	161,813	156,519	151,552	145,693	141,414	132,716	134,058	132,869	126,814
Active Members	264,023	263,350	255,465	247,901	246,700	242,616	243,311	234,210	223,495	220,703

* All dollar amounts are in thousands, except Average Annual Member Compensation and Average Pension.

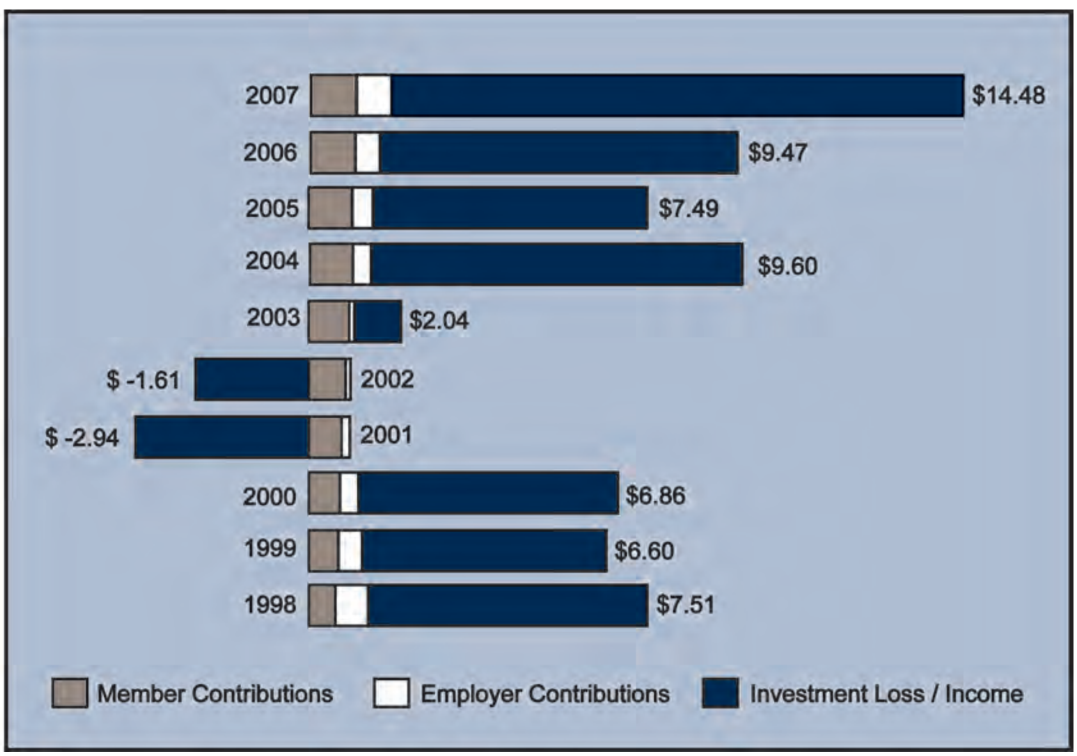
Schedule of Total Changes in Plan Net Assets
10 Year Trend
(Dollar Amounts in Thousands)

	Additions to Plan Net Assets				Deductions from Plan Net Assets						
Year Ending June 30,	Member Contributions	Employer Contributions	Net Investment Income	Total Additions	Benefits	Lump-Sum and Installment	Refunds of Contributions	Administrative	Net Transfers	Total Deductions	Net Increase / (Decrease)
2007	$ 999,507	$ 774,789	$ 12,702,721	$ 14,476,325	$ 3,440,819	$ 855,431	$ 18,180	$ 50,482	$ 6,010	$ 4,370,922	$ 10,105,403
2006	982,846	544,884	7,942,639	9,470,369	3,260,712	830,361	16,330	48,629	8,462	4,164,494	5,305,875
2005	955,509	457,808	6,081,497	7,494,814	3,158,661	692,089	16,233	42,645	10,859	3,920,487	3,574,327
2004	944,422	406,722	8,244,604	9,595,748	2,906,344	559,939	14,767	49,202	16,315	3,546,567	6,049,181
2003	897,307	116,456	1,022,467	2,036,230	2,591,130	485,495	13,943	42,278	12,116	3,144,962	(1,108,732)
2002	805,567	109,450	(2,523,025)	(1,608,008)	2,293,687	595,184	14,858	35,373	9,434	2,948,536	(4,556,544)
2001	721,725	185,716	(3,843,713)	(2,936,272)	2,087,868	176,228	22,369	34,854	10,867	2,332,186	(5,268,458)
2000	680,040	412,783	5,765,133	6,857,956	2,048,792	306,329	22,446	29,333	4,710	2,411,610	4,446,346
1999	646,507	526,960	5,428,659	6,602,126	1,834,494	591,532	20,110	27,786	10,247	2,484,169	4,117,957
1998	578,322	731,131	6,195,893	7,505,346	1,611,137	376,575	20,503	29,947	7,094	2,045,256	5,460,090

Additions to Plan Net Assets
10 Year Trend
(Dollar Amounts in Thousands)

		Employers, Commonwealth, & CMS Contributions			
Fiscal Year	Members Contributions	Dollar Amount	Percentage of Covered Payroll	Net Investment Income / (Loss)	Total Additions
2007	$ 999,507	$ 774,097	6.46 %	$ 12,702,721	$ 14,476,325
2006	982,846	544,884	4.69	7,942,639	9,470,369
2005	955,509	457,808	4.23	6,081,497	7,494,814
2004	944,422	406,722	3.77	8,244,604	9,595,748
2003	897,307	116,456	1.15	1,022,467	2,036,230
2002	805,567	109,450	1.09	(2,523,025)	(1,608,008)
2001	721,725	185,716	1.94	(3,843,713)	(2,936,272)
2000	680,040	412,783	4.61	5,765,133	6,857,956
1999	646,507	526,960	6.04	5,428,659	6,602,126
1998	578,322	731,131	8.76	6,195,893	7,505,346

(Dollar Amounts in Billions)

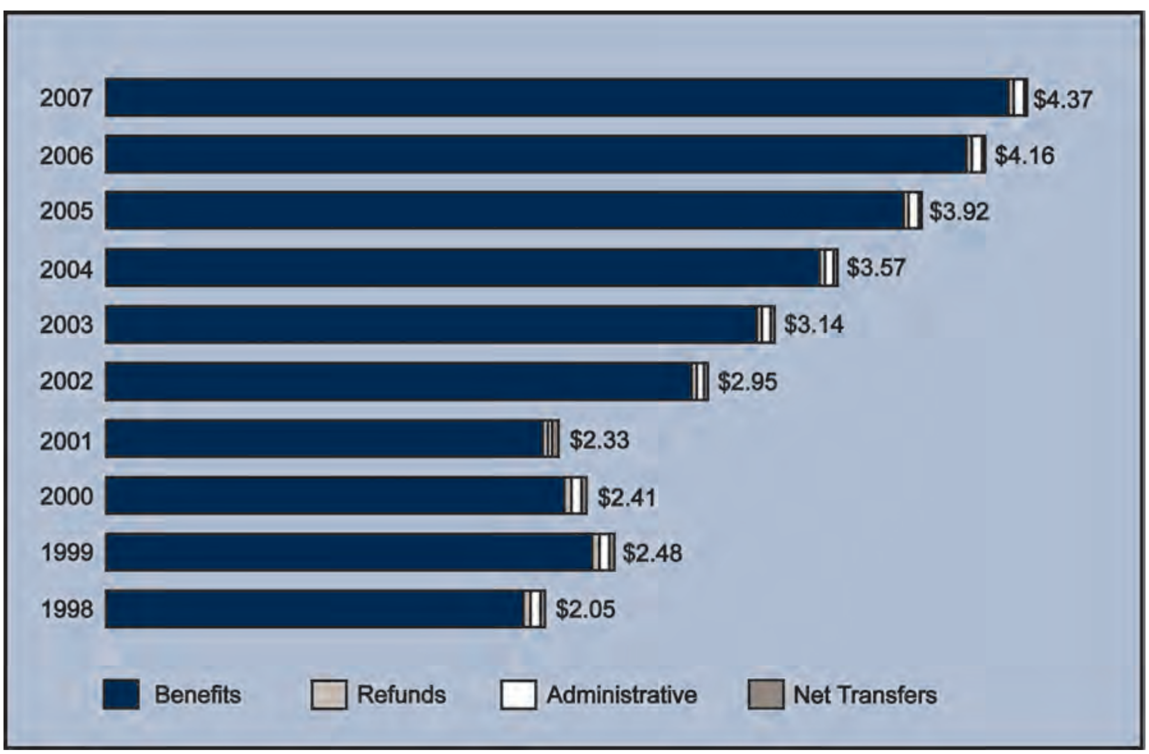


Deductions from Plan Net Assets
10 Year Trend
(Dollar Amounts in Thousands)

Fiscal Year	Benefits	Lump-Sum and Installment	Refunds	Administrative	Net Transfers*	Total Deductions
2007	$ 3,440,819	$ 855,431	$ 18,180	$ 50,482	$ 6,010	$ 4,370,922
2006	3,260,712	830,361	16,330	48,629	8,462	4,164,494
2005	3,158,661	692,089	16,233	42,645	10,859	3,920,487
2004	2,906,344	559,939	14,767	49,202	16,315	3,546,567
2003	2,591,130	485,495	13,943	42,278	12,116	3,144,962
2002	2,293,687	595,184	14,858	35,373	9,434	2,948,536
2001	2,087,868	176,228	22,369	34,854	10,867	2,332,186
2000	2,048,792	306,329	22,446	29,333	4,710	2,411,610
1999	1,834,494	591,532	20,110	27,786	10,247	2,484,169
1998	1,611,137	376,575	20,503	29,947	7,094	2,045,256

* Net transfers to the Commonwealth of Pennsylvania, State Employees' Retirement System.

(Dollar Amounts in Billions)



Schedule of Investment Income
10 Year Trend
(Dollar Amounts in Thousands)

For years ending June 30,	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Investment income:										
From investing activities:										
Net appreciation (depreciation) in fair value of investments	$ 10,457,561	$ 5,968,866	$ 4,462,384	$ 6,871,417	$ (172,506)	$ (3,826,705)	$ (5,137,619)	$ 4,129,236	$ 4,068,463	$ 4,893,203
Investment income	2,532,993	2,162,096	1,795,687	1,549,791	1,358,997	1,450,203	1,413,964	1,739,049	1,431,399	1,371,511
Total investment activity income (loss)	12,990,554	8,130,962	6,258,071	8,421,208	1,186,491	(2,376,502)	(3,723,655)	5,868,285	5,499,862	6,264,714
Investment expenses	(313,758)	(211,279)	(192,677)	(191,300)	(179,056)	(162,777)	(143,685)	(124,576)	(88,929)	(88,816)
Net income (loss) from investing activities	**12,676,796**	**7,919,683**	**6,065,394**	**8,229,908**	**1,007,435**	**(2,539,279)**	**(3,867,340)**	**5,743,709**	**5,410,933**	**6,175,898**
From securities lending activities:										
Securities lending income	419,762	270,447	125,882	46,075	43,870	57,391	147,852	161,416	163,445	319,903
Securities lending expense	(393,837)	(247,491)	(109,779)	(31,379)	(28,838)	(41,137)	(124,225)	(139,992)	(145,719)	(299,908)
Net income from securities lending activities	**25,925**	**22,956**	**16,103**	**14,696**	**15,032**	**16,254**	**23,627**	**21,424**	**17,726**	**19,995**
Total net investment income (loss)	**12,702,721**	**7,942,639**	**6,081,497**	**8,244,604**	**1,022,467**	**(2,523,025)**	**(3,843,713)**	**5,765,133**	**5,428,659**	**6,195,893**

Schedule of Summary Membership Data
10 Year Trend
(Dollar Amounts in Thousands)

	Male			Female			
For year ended June 30,	Average Age	Average Service	Average Annual Salaries	Average Age	Average Service	Average Annual Salaries	Total Number of Active Members
2007	44.5	11.7	49,220	44.7	10.5	40,958	264,023
2006	44.6	12.0	49,153	44.7	10.7	41,155	263,350
2005	44.9	12.6	47,416	45.0	11.0	38,832	255,465
2004	45.1	13.0	47,103	45.1	11.1	37,901	247,901
2003	45.1	13.5	45,947	45.0	11.2	36,465	246,700
2002	45.2	14.0	45,182	44.9	11.3	36,073	242,616
2001	45.5	14.6	45,686	44.9	11.6	35,852	243,311
2000	45.2	14.4	45,049	44.6	11.3	35,331	234,210
1999	45.2	14.6	43,498	44.7	11.5	34,132	223,495
1998	45.4	15.2	43,239	44.7	11.7	33,799	220,703

Schedule of Summary Annuity Data
10 Year Trend

For year ended June 30,	Number of Annuitants & Beneficiaries	Total Annual Annuities	Average Annual Annuity
2007	168,026	$ 3,523,000	$ 20,970
2006	161,813	3,274,000	20,236
2005	156,519	3,027,550	19,343
2004	151,552	2,798,211	18,464
2003	145,693	2,545,135	17,469
2002	141,414	2,248,291	15,899
2001	132,716	1,871,995	14,105
2000	134,058	1,880,644	14,029
1999	132,869	1,830,582	13,777
1998	126,814	1,652,645	13,032

Total Annual Annuities dollars expressed in Millions.

Components of Total Contribution Rate

(In Percentages)

Employer Year	Employer Payroll	Member Contribution (Average)	Employer Contribution: Normal Requirement (A)	Employer Contribution: (Funded) / Unfunded Accrued Liability (B)	Employer Contribution: Preliminary Employer Pension Rate	Employer Contribution: Heath Insurance Premium Assistance Contribution (C)	Employer Contribution: Total Employer Rate	Grand Total Contribution Rate
2007-2008	12,881,244	7.25	6.68	(0.24)	6.44	.69	7.13	14.38
2006-2007	11,821,951	7.21	6.62	(0.95)	5.67	.74	6.46	13.67
2005-2006	11,505,093	7.16	7.61	(4.28)	4.00	.69	4.69	11.85
2004-2005	11,062,589	7.12	7.48	(7.10)	4.00	.23	4.23	11.35
2003-2004	10,030,705	7.08	7.25	(4.27)	2.98	.79	3.77	10.85
2002-2003	9,652,881	7.10	7.20	(10.03)	1.00	.97	1.15	8.25
2001-2002	9,378,944	6.43	5.63	(6.05)	(0.42)	1.09	1.09	6.89
2000-2001	9,414,884	5.77	6.29	(4.65)	1.64	.30	1.94	7.71
1999-2000	8,939,598	5.72	6.40	(2.04)	4.36	.25	4.61	10.33
1998-1999	8,247,602	5.69	6.33	(0.44)	5.89	.15	6.04	11.73
1997-1998	8,091,481	5.65	6.44	2.17	8.61	.15	8.76	14.41
1996-1997	7,745,001	5.62	6.44	3.56	10.00	.60	10.60	16.22
1995-1996	7,616,585	5.59	6.43	4.67	11.10	.62	11.72	17.31
1994-1995	7,378,342	5.55	6.43	4.18	10.61	.45	11.06	16.61
1993-1994	6,885,337	5.51	7.34	5.58	12.92	.25	13.17	18.68
1992-1993	6,348,565	5.48	7.90	5.84	13.74	.50	14.24	19.72
1991-1992	6,098,222	5.46	8.00	6.40	14.40	.50	14.90	20.36
1990-1991	5,744,798	5.69	8.28	10.90	19.18		19.18	24.87
1989-1990	5,363,535	5.53	8.44	11.24	19.68		19.68	25.21
1988-1989	5,055,793	5.37	8.63	10.64	19.27		19.27	24.64
1987-1988	4,586,367	5.34	8.72	10.82	19.54		19.54	24.88
1986-1987	4,415,102	5.29	9.13	10.77	19.90		19.90	25.19
1985-1986	4,066,471	5.27	9.16	10.88	20.04		20.04	25.31

The total contribution rate is the total of the employer and member rates actuarially required for the funding of PSERS' pension and postemployment health insurance premium assistance benefits.

The total employer rate is comprised of a normal requirement, an accrued liability requirement and a postemployment healthcare insurance premium assistance requirement.

(A) The normal requirement portion is the percentage of compensation necessary to fund any prospective pension benefits payable to the member.

(B) The total funded / unfunded accrued liability portion is the percentage of compensation necessary to fund past pension benefit enhancements, cost-of-living adjustments and other acturial gains and losses.

(C) The postemployment healthcare insurance premium assistance portion is the percentage of compensation necessary to fund the postemployment health insurance premium assistance program established under the provisions of Act 23 - 1991.

Schedule of Retired Members by Type of Benefit

Year	Retirement Type**	Option M* Number of Retirees	Option M* Average Mo. Benefit	Option 1* Number of Retirees	Option 1* Average Mo. Benefit	Option 2, 3* Number of Retirees	Option 2, 3* Average Mo. Benefit
2007	S	49,971	$1,868	11,727	$1,576	19,926	$2,144
	W	44,620	1,695	12,218	1,338	12,622	1,967
	D	5,689	1,271	6	743	1,691	1,606
	R	0	0	0	0	0	0
	B	513	955	0	0	7,036	753
		100,793		**23,951**		**41,275**	
2006	S	49,831	$1,813	11,081	$1,514	19,085	$2,067
	W	43,328	1,656	10,948	1,269	11,477	1,872
	D	5,544	1,244	8	629	1,569	1,571
	R	1	5	0	0	0	0
	B	473	951	1	1,675	6,785	728
		99,177		**22,038**		**38,916**	
2005	S	49,508	$1,737	10,385	$1,420	18,206	$1,965
	W	42,096	1,611	9,754	1,187	10,492	1,778
	D	5,455	1,198	9	656	1,450	1,539
	R	1	5	0	0	0	0
	B	405	908	1	1,072	6,646	690
		97,465		**20,149**		**36,794**	
2004	S	49,424	$1,648	9,706	$1,312	17,321	$1,842
	W	40,944	1,556	8,582	1,073	9,551	1,669
	D	5,327	1,154	9	656	1,304	1,508
	R	1	5	0	0	0	0
	B	324	899	2	1,072	6,502	648
		96,020		**18,299**		**34,678**	
2003	S	49,231	$1,560	8,999	$1,186	16,408	$1,725
	W	39,707	1,494	7,541	964	8,696	1,569
	D	5,170	1,105	9	656	1,156	1,459
	R	1	5	0	0	0	0
	B	258	881	11	542	6,348	614
		94,367		**16,560**		**32,608**	
2002	S	49,368	$1,431	8,422	$1,064	15,695	$1,572
	W	38,679	1,389	6,696	820	7,948	1,415
	D	5,049	1,017	11	700	1,015	1,305
	R	1	5	0	0	0	0
	B	232	814	11	557	6,206	586
		93,329		**15,140**		**30,864**	
2001	S	47,982	$1,241	7,681	$857	14,453	$1,334
	W	36,628	1,287	5,656	653	7,051	1,275
	D	4,864	909	13	567	895	1,167
	R	1	4	0	0	0	0
	B	175	790	7	426	6,029	562
		89,650		**13,357**		**28,428**	
2000	S	49,367	$1,225	7,923	$860	14,768	$1,326
	W	36,620	1,288	5,623	660	7,063	1,281
	D	4,740	886	14	545	847	1,141
	R	1	4	0	0	0	0
	B	144	762	3	435	5,879	544
		90,872		**13,563**		**28,557**	
1999	S	49,255	$1,183	8,046	$ 855	14,641	$1,309
	W	36,002	1,281	5,514	670	6,958	1,278
	D	4,587	854	14	545	782	1,105
	R	1	4	0	0	0	0
	B	120	754	1	1,160	5,655	519
		89,965		**13,575**		**28,036**	
1998	S	49,081	$1,151	8,134	$ 858	14,558	$1,293
	W	31,568	1,131	5,253	636	6,300	1,209
	D	4,439	828	15	541	724	1,074
	R	1	4	0	0	0	0
	B	84	792	1	1,160	5,421	493
		85,173		**13,403**		**27,003**	

*** OPTIONS:**

M - Maximum Option - Highest monthly allowance with guarantee of accumulated deductions only
1 - Option 1 - Maximum allowance reduced for Death Benefit protection
2, 3 - Option 2 & 3 - Joint and survivor annuities
SO - Special Option - Plan approved by actuary
BO - Beneficiary options - Life, 5 and 10 year certain annuity plans

Schedule of Retired Members by Type of Benefit (Continued)

Year	Retirement Type**	Option SO* Number of Retirees	Option SO* Average Mo. Benefit	Option BO* Number of Retirees	Option BO* Average Mo. Benefit	Total Retirees	% Increase of Retirees
2007	S	848	$3,490	0	$ 0	82,472	2.0%
	W	437	2,912	0	0	69,897	5.6%
	D	11	1,848	0	0	7,397	3.7%
	R	0	0	0	0	0	0.0%
	B	175	3,281	536	713	8,260	3.8%
		1,471		**536**		**168,026**	**3.7%**
2006	S	849	$3,324	0	$ 0	80,846	4.8%
	W	418	2,761	0	0	66,171	11.4%
	D	12	1,785	0	0	7,133	7.3%
	R	0	0	0	0	1	0.0%
	B	162	865	534	688	7,955	6.3%
		1,441		**534**		**162,106**	**7.6%**
2005	S	740	$3,306	0	$ 0	78,839	2.2%
	W	355	2,710	0	0	62,697	5.6%
	D	8	1,513	0	0	6,922	4.1%
	R	0	0	0	0	1	0.0%
	B	157	804	526	657	7,735	3.3%
		1,260		**526**		**156,194**	**3.7%**
2004	S	675	$3,135	0	$ 0	77,126	2.5%
	W	313	2,622	0	0	59,390	5.7%
	D	7	1,482	0	0	6,647	4.9%
	R	0	0	0	0	1	0.0%
	B	144	694	514	622	7,486	3.2%
		1,139		**514**		**150,650**	**3.9%**
2003	S	613	$2,984	0	$ 0	75,261	1.6%
	W	266	2,494	1	336	56,210	5.0%
	D	3	2,211	0	0	6,338	4.3%
	R	0	0	0	0	1	0.0%
	B	146	637	489	517	7,252	2.6%
		1,028		**490**		**145,062**	**6.0%**
2002	S	562	$2,727	0	$ 0	74,047	4.9%
	W	235	2,312	0	0	53,558	8.1%
	D	3	2,099	0	0	6,078	5.3%
	R	0	0	0	0	1	0.0%
	B	148	559	475	553	7,072	3.5%
		948		**475**		**140,756**	**6.0%**
2001	S	473	$2,412	0	$ 0	70,589	-2.7%
	W	202	2,186	1	336	49,538	0.1%
	D	2	2,151	0	0	5,774	3.1%
	R	0	0	0	0	1	0.0%
	B	149	513	476	517	6,836	2.6%
		826		**477**		**132,738**	**-1.2%**
2000	S	480	$2,389	0	$ 0	72,538	0.2%
	W	207	2,180	1	336	49,514	1.7%
	D	2	2,151	0	0	5,603	4.1%
	R	0	0	0	0	1	0.0%
	B	146	481	488	500	6,660	3.8%
		835		**489**		**134,316**	**1.1%**
1999	S	444	$2,379	0	$ 0	72,386	0.3%
	W	207	2,167	0	0	48,681	12.5%
	D	1	1,109	0	0	5,384	4.0%
	R	0	0	0	0	1	0.0%
	B	142	427	496	475	6,414	4.5%
		794		**496**		**132,866**	**4.8%**
1998	S	433	$2,365	0	$ 0	72,206	0.5%
	W	163	2,063	0	0	43,284	4.9%
	D	0	0	0	0	5,178	2.7%
	R	0	0	0	0	1	0.0%
	B	146	392	487	426	6,139	2.7%
		742		**487**		**126,808**	**2.2%**

**** RETIREMENT TYPE:**

S - Superannuation or Normal Retirement
W - Withdrawal or Early Retirement
D - Disability Benefit
R - Refund Annuity
B - Beneficiaries Receiving Annuities

Ten Largest Employers

(Based on count of reported members)

		Percentage of Total Active Members
1.	City of Philadelphia School District	10.5 %
2.	Pittsburgh School District	2.2
3.	Central Bucks School District	.9
4.	Reading School District	.8
5.	Allentown City School District	.8
6.	North Penn School District	.7
7.	Bethlehem Area School District	.7
8.	Pocono Mountain School District	.6
9.	Erie City School District	.6
10.	Pennsbury School District	.6

The top ten employers in PSERS through the years has not varied significantly. Philadelphia School District and Pittsburgh School District each year represent the largest portion of reported members from the employer population. After these two employers, the remainder of the more than 700 employers of the System each comprise less than 1% of the total active membership in PSERS.

Schedule of Employers
School Districts

A

Abington
Abington Heights
Albert Gallatin
Aliquippa
Allegheny-Clarion Valley
Allegheny Valley
Allentown City
Altoona Area
Ambridge Area
Annville-Cleona
Antietam
Apollo-Ridge
Armstrong
Athens Area
Austin Area
Avella Area
Avon Grove
Avonworth

B

Bald Eagle Area
Baldwin-Whitehall
Bangor Area
Beaver Area
Bedford Area
Belle Vernon Area
Bellefonte Area
Bellwood-Antis
Bensalem Township
Benton Area
Bentworth
Berlin Brothers Valley
Bermudian Springs
Berwick Area
Bethel Park
Bethlehem Area
Bethlehem-Center
Big Beaver Falls Area
Big Spring
Blackhawk
Blacklick Valley
Blairsville-Saltsburg
Bloomsburg Area
Blue Mountain
Blue Ridge
Boyertown Area
Bradford Area
Brandywine Heights Area
Brentwood Boro
Bristol Boro
Bristol Township
Brockway Area
Brookville Area
Brownsville Area
Burgettstown Area
Burrell
Butler Area

C

California Area
Cambria Heights
Cameron County
Camp Hill
Cannon-McMillan
Canton Area
Carbondale Area
Carlisle Area
Carlynton
Carmichaels Area
Catasaqua
Centennial
Center Area
Central Bucks
Central Cambria
Central Columbia
Central Dauphin
Central Fulton
Central Greene
Central York
Chambersburg Area
Charleroi Area
Chartiers-Houston
Chartiers Valley
Cheltenham Township
Chester-Upland
Chestnut Ridge
Chichester
Clairton
Clarion Area
Clarion-Limestone Area
Claysburg-Kimmel
Clearfield Area
Coatesville Area
Cocalico
Colonial
Columbia Boro
Commodore Perry
Conemaugh Township Area
Conemaugh Valley
Conestoga Valley
Conewago Valley
Conneaut
Connellsville Area
Conrad Weiser Area
Cornell
Cornwall-Lebanon
Corry Area
Coudersport Area
Council Rock
Cranberry Area
Crawford Central
Crestwood
Cumberland Valley
Curwensville Area

Dallas
Dallastown Area
Daniel Boone Area
Danville Area
Deer Lakes
Delaware Valley
Derry Area
Derry Township
Donegal
Dover Area
Downingtown Area
DuBois Area
Dunmore
Duquesne City

E

East Allegheny
East Lycoming
East Penn
East Pennsboro Area
East Stroudsburg
Eastern Lancaster County
Eastern Lebanon County
Eastern York
Easton Area
Elizabeth Forward
Elizabethtown Area
Elk Lake
Ellwood City Area
Ephrata Area
Erie City
Everett Area
Exeter Township

F

Fairfield Area
Fairview
Fannett-Metal
Farrell Area
Ferndale Area
Fleetwood Area
Forbes Road
Forest Area
Forest City Regional
Forest Hills
Fort Cherry
Fort Le Boeuf
Fox Chapel Area
Franklin Area
Franklin Regional
Frazier
Freedom Area
Freeport Area

Schedule of Employers (Continued)

G

Galeton Area
Garnet Valley
Gateway
General McLane
Gettysburg Area
Girard
Glendale
Governor Mifflin
Great Valley
Greater Johnstown
Greater Latrobe
Greater Nanticoke Area
Greencastle-Antrim
Greensburg Salem
Greenville Area
Greenwood
Grove City Area

H

Halifax Area
Hamburg Area
Hampton Township
Hanover Area
Hanover Public
Harbor Creek
Harmony
Harrisburg City
Hatboro-Horsham
Haverford Township
Hazleton Area
Hempfield
Hempfield Area
Hermitage
Highlands
Hollidaysburg Area
Homer Center
Hopewell Area
Huntingdon Area

I

Indiana Area
Interboro
Iroquois

J

Jamestown Area
Jeannette City
Jefferson-Morgan
Jenkintown
Jersey Shore Area
Jim Thorpe Area
Johnsonburg Area
Juniata County
Juniata Valley

K

Kane Area
Karns City Area
Kennett Consolidated
Keystone
Keystone Central
Keystone Oaks
Kiski Area
Kutztown Area

L

Lackawanna Trail
Lake Lehman
Lakeland
Lakeview
Lampeter-Strasburg
Lancaster City
Laurel
Laurel Highlands
Lebanon
Leechburg Area
Lehighton Area
Lewisburg Area
Ligonier Valley
Line Mountain
Littlestown
Lower Dauphin
Lower Merion
Lower Moreland
Loyalsock Township

M

Mahanoy Area
Manheim Central
Manheim Township
Marion Center Area
Marple Newtown
Mars Area
McGuffey
McKeesport Area
Mechanicsburg Area
Mercer Area
Methacton
Meyersdale Area
Mid Valley
Midd-West
Middletown Area
Midland Boro
Mifflin County
Mifflinburg Area
Millcreek Township
Millersburg Area
Millville Area
Milton Area
Minersville Area
Mohawk Area
Monaca
Monessen
Moniteau
Montgomery Area
Montour
Montoursville Area
Montrose Area
Moon Area
Morrisville Boro
Moshannon Valley
Mount Carmel Area
Mount Lebanon
Mount Pleasant Area
Mount Union Area
Mountain View
Muhlenberg
Muncy

N

Nazareth Area
Neshaminy
Neshannock Township
New Brighton Area
New Castle Area
New Hope-Solebury
New Kensington-Arnold
Newport
Norristown Area
North Allegheny
North Clarion County
North East
North Hills
North Penn
North Pocono
North Schuylkill
North Star
Northampton Area
Northeast Bradford
Northeastern York County
Northern Bedford County
Northern Cambria
Northern Lebanon
Northern Lehigh
Northern Potter
Northern Tioga
Northern York County
Northgate
Northwest Area
Northwestern
Northwestern Lehigh
Norwin

O

Octorara Area
Oil City Area
Old Forge
Oley Valley

Schedule of Employers (Continued)

Oswayo Valley
Otto Eldred
Owen J. Roberts
Oxford Area

P

Palisades
Palmerton Area
Palmyra Area
Panther Valley
Parkland
Pen Argyl Area
Penn Cambria
Penn Crest
Penn Delco
Penn Hills
Penn Manor
Penn Trafford
Pennridge
Penns Manor
Penns Valley Area
Pennsbury
Pequea Valley
Perkiomen Valley
Peters Township
Philadelphia
Philipsburg-Osceola
Phoenixville Area
Pine Grove Area
Pine-Richland
Pittsburgh
Pittston Area
Pleasant Valley
Plum Boro
Pocono Mountain
Port Allegany
Portage Area
Pottsgrove
Pottstown
Pottsville Area
Punxsutawney Area
Purchase Line

Q

Quaker Valley
Quakertown Community

R

Radnor Township
Reading
Red Lion Area
Redbank Valley
Reynolds
Richland
Ridgway Area
Ridley
Ringgold
Riverside
Riverside Beaver County
Riverview
Rochester Area
Rockwood Area
Rose Tree Media

S

Saint Clair Area
Saint Marys Area
Salisbury-Elk Lick
Salisbury Township
Saucon Valley
Sayre Area
Schuylkill Haven Area
Schuylkill Valley
Scranton City
Selinsgrove Area
Seneca Valley
Shade-Central City
Shaler Area
Shamokin Area
Shanksville-Stonycreek
Sharon City
Sharpsville Area
Shenandoah Valley
Shenango Area
Shikellamy
Shippensburg Area
Slippery Rock Area
Smethport Area
Solanco
Somerset Area
Souderton Area
South Allegheny
South Butler County
South Eastern
South Fayette Township
South Middleton
South Park
South Side Area
South Western
South Williamsport Area
Southeast Delco
Southeastern Greene
Southern Columbia Area
Southern Fulton
Southern Huntingdon
Southern Lehigh
Southern Tioga
Southern York County
Southmoreland
Spring Cove
Spring-Ford Area
Spring Grove Area
Springfield
Springfield Township
State College Area
Steel Valley
Steelton-Highspire
Sto-Rox
Stroudsburg Area
Sullivan County
Susquehanna Community
Susquehanna Township
Susquenita

T

Tamaqua Area
Titusville Area
Towanda Area
Tredyffrin-Easttown
Tri-Valley
Trinity Area
Troy Area
Tulpehocken Area
Tunkhannock Area
Turkeyfoot Valley
Tuscarora
Tussey Mountain
Twin Valley
Tyrone Area

U

Union
Union Area
Union City Area
Uniontown Area
Unionville-Chadds Ford
United
Upper Adams
Upper Darby
Upper Dauphin Area
Upper Dublin
Upper Merion Area
Upper Moreland
Upper Perkiomen
Upper Saint Clair

V

Valley Grove
Valley View

W

Wallenpaupack Area
Wallingford Swarthmore
Warren County
Warrior Run
Warwick
Washington
Wattsburg Area
Wayne Highlands

Schedule of Employers (Continued)

Waynesboro Area
Weatherly Area
Wellsboro Area
West Allegheny
West Branch Area
West Chester Area
West Greene
West Jefferson Hills
West Middlesex Area
West Mifflin Area
West Perry
West Shore
West York Area
Western Beaver County
Western Wayne
Westmont Hilltop
Whitehall-Coplay
Wilkes-Barre Area
Wilkinsburg
William Penn
Williams Valley
Williamsburg Community
Williamsport Area
Wilmington Area
Wilson
Wilson Area
Windber Area
Wissahickon
Woodland Hills
Wyalusing Area
Wyoming Area
Wyoming Valley West
Wyomissing Area

Y

York
York Suburban
Yough

Area Vocational Technical Schools

A. W. Beattie Career Center
Admiral Peary AVTS
Beaver County AVTS
Bedford County Technical Center
Berks Career and Technical Center
Bethlehem AVTS
Bucks County AVTS
Butler County AVTS
Carbon County AVTS
Career Institute of Technology
Central Montgomery County CTS
Central Westmoreland CTC
Central PA Institute for Science and Technology
Clarion County Career Center
Clearfield County CTC
Columbia-Montour AVTS
Crawford County AVTS
CTC of Lackawanna County
Cumberland-Perry AVTS
Dauphin County Technical School
Delaware County AVTS
Eastern Center for Arts and Technology
Eastern Westmoreland CTC
Erie County Technical School
Fayette County AVTS
Forbes Road Career and Technology Center
Franklin County CTC
Fulton County AVTS
Greater Altoona CTC
Greater Johnstown AVTS
Greene County AVTS
Huntingdon County CTC
Indiana County Technology Center
Jefferson County-DuBois AVTS
Juniata - Mifflin County AVTS
Lancaster County CTC
Lawrence County AVTS
Lebanon County AVTS
Lehigh Career and Technical Institute
LENAPE AVTS
Lycoming County Career Consortium
Mercer County AVTS
Middle Bucks Institute of Technology
Mon Valley CTC
Monroe County AVTS
Northern Tier Career Center
North Fayette County AVTS
North Montco Technical Career Center
North Westmoreland County AVTS
Northumberland County AVTS
Parkway West AVTS
Reading-Muhlenberg AVTS
Schuylkill County AVTS
Somerset County Technology Center
Steel Center AVTS
SUN Area CTC
Susquehanna County CTC
Upper Bucks County AVTS
Venango Technology Center
West Side AVTS
Western Area CTC
Western Center for Technical Studies
Wilkes-Barre AVTS
York County AVTS

Schedule of Employers (Continued)

Intermediate Units

Allegheny #3
Appalachia #8
Arin #28
Beaver Valley #27
Berks County #14
Blast #17
Bucks County #22
Capital Area #15
Carbon Lehigh #21
Central #10
Central Susquehanna #16
Chester County #24
Colonial Northampton #20
Delaware County #25
Intermediate Unit #1
Lancaster Lebanon #13
Lincoln #12
Luzerne #18
Midwestern #4
Montgomery County #23
Northeastern Education #19
Northwest Tri County #5
Pittsburgh Mt. Oliver #2
Riverview #6
Schuylkill #29
Seneca Highlands #9
Tuscarora #11
Westmoreland #7

Colleges / Universities

State System of Higher Education
- Bloomsburg University
- California University
- Cheyney University
- Clarion University
- East Stroudsburg University
- Education Resource
- Edinboro University
- Indiana University
- Kutztown University
- Lock Haven University
- Mansfield University
- Millersville University
- Shippensburg University
- Slippery Rock University
- West Chester University

Bucks County Community College
Butler County Community College
Community College of Allegheny County
Community College of Beaver County
Community College of Delaware County
Community College of Philadelphia
Harrisburg Area Community College
Lehigh Carbon Community College
Luzerne County Community College
Montgomery County Community College
Northampton County Area Community College
Pennsylvania College of Technology
Pennsylvania State University
Reading Area Community College
Westmoreland County Community College

Other

Berks County Earned Income Tax Bureau
Department of Corrections - Commonwealth of Pennsylvania
Department of Education - Commonwealth of Pennsylvania
Lancaster County Academy
Overbrook School for the Blind
Pennsylvania School Boards Association
Pennsylvania School for the Deaf
Scotland School for Veterans Children
Thaddeus Stevens School of Technology
Washington County Alternative School
Western Pennsylvania School for the Blind
Western Pennsylvania School for the Deaf
York County High

Schedule of Employers (Continued)

Charter Schools (C.S.)

21st Century Cyber C.S.
Achievement House C.S.
Ad Prima C.S.
Agora Cyber C.S.
Alliance for Progress C.S.
Architecture & Design C.S.
Avon Grove C.S.
Bear Creek Community C.S.
Beaver Area Academic C.S.
Belmont C.S.
Bucks County Montessori C.S.
Career Connections C.S.
Center for Student Learning C.S. at Pennsbury
Central PA Digital Learning Foundation C.S.
Centre Learning Community C.S.
Chester County Family Academy C.S.
Christopher Columbus C.S.
City Charter High School
Collegium C.S.
Commonwealth Connections Academy C.S.
Crispus Attucks Youthbuild C.S.
Delaware Valley C.S.
Discovery C. S.
Dr. Robert Ketterer C.S.
Erin Dudley Forbes C.S.
Eugenio Maria de Hostos Community Bilingual C.S.
Evergreen Community C.S.
Family C.S.
Fell C.S.
First Philadelphia C.S. for Literacy
Folk Arts - Cultural Treasures C.S.
Franklin Towne C.S.
Freire C.S.
GECAC Community C.S.
Germantown Settlement C.S.
Graystone Academy C.S.
Green Woods C.S.
Hope C.S.
Imani Education Circle C.S.
IMHOTEP Institute C.S.
Independence C.S.
Infinity C.S.
Keystone Education Center C.S.
Khepera C.S.
KIPP Academy C.S.
La Academia: The Partnership C.S.
Laboratory C.S.
Leadership Learning Partners C.S.
Lehigh Valley Academy Regional C.S.
Lehigh Valley C.S. for the Performing Arts
Lincoln C.S.
Lincoln Park Performing Arts C. S.
Manchester Academic C.S.
Mariana Bracetti Academy C.S.
Maritime Academy C.S.
Mastery Charter High School
Mastery Charter High School - Shoemaker Campus
Mastery Charter High School - Thomas Campus
MaST Community C.S.
Math, Civics & Sciences C.S.
Montessori Regional C.S.
Multi-Cultural Academy
New Foundations C.S.
New Media Technology C.S.
Nittany Valley C.S.
Northside Urban Pathways C.S.
Northwood Academy C.S.
Nueva Esperanza Academy C.S.
PA Distance Learning C.S.
PA Learners Online Regional Cyber C.S.
Pennsylvania Cyber C.S.
Pennsylvania Leadership C.S.
Pennsylvania Virtual C.S.
People for People C.S.
Perseus House C.S. of Excellence
Philadelphia Academy C.S.
Philadelphia Community Academy of PA C.S.
Philadelphia Electrical & Technology Charter High School
Philadelphia Harambee Institute of Science and Technology C.S.
Philadelphia Montessori C.S.
Philadelphia Performing Arts C.S.
Pocono Mountain C.S.
Preparatory Charter of Mathematics, Science, Technology and Careers School
Propel C.S. - East
Propel C.S. - Homestead
Propel C.S. - McKeesport
Raising Horizons Quest C.S.
RAPAH - Edison C.S.
Renaissance C.S.
Renaissance Advantage C.S.
Renaissance Academy - Edison C.S.
Richard Allen Preparatory C.S.
Roberto Clemente C.S.
Russell Byers C.S.
Sankofa Academy C.S.
School Lane C.S.
Souderton C.S. Collaborative
Spectrum C.S.
Sugar Valley C.S.
SUSQ-CYBER C.S.
Sylvan Heights Science C.S.
Tidioute Community C.S.
Tuscarora Blended Learning C.S.
Universal Institute C.S.
Urban League of Pittsburgh C.S.
Village C.S. of Chester-Upland
Wakisha C.S.
West Oak Lane C.S.
West Philadelphia Achievement Charter Elementary School
Wissahickon C.S.
Wonderland C.S.
World Communications C.S.
Young Scholars C.S.
Young Scholars of Central PA C.S.