FOR THE FISCAL YEAR ENDED JUNE 30, 2006

COMPREHENSIVE ANNUAL FINANCIAL REPORT

2006

FAIRFAX COUNTY EMPLOYEES' RETIREMENT SYSTEM

A PENSION TRUST FUND OF FAIRFAX COUNTY, VIRGINIA

TABLE OF CONTENTS

THIS PAGE INTENTIONALLY LEFT BLANK

FAIRFAX COUNTY

V I R G I N I A

BOARD OF TRUSTEES
EMPLOYEES' RETIREMENT SYSTEM
10680 Main Street, Suite 280
Fairfax, Virginia 22030-3812

Telephone: (703) 279-8200 (800) 333-1633 FAX: (703) 273-3185

January 31, 2007

Dear Members of the Board of Trustees:

I am pleased to submit to you the annual report of the Fairfax County Employees' Retirement System (System) for the fiscal year ended June 30, 2006. This annual report is provided as an aid to understanding the structure and evaluating the status of the System. The System's management is responsible for the accuracy of financial information contained herein.

The annual report for fiscal 2006 consists of five sections: (1) an Introductory Section that contains this transmittal letter along with the organization structure and review of plan provisions; (2) a Financial Section that contains the opinion of the independent auditors, management's discussion and analysis, the financial statements of the System and required supplementary information; (3) an Investment Section that contains investment results; (4) an Actuarial Section that includes the independent actuary's certification letter, a summary of the results of the actuarial valuation, and actuarial procedures and assumptions; and (5) a Statistical Section that contains information regarding the System membership.

History

The Fairfax County Supplemental Retirement System was established on July 1, 1955. On February 26, 2001 the name of the System was changed to the Fairfax County Employees' Retirement System. The System is a cost-sharing multiple-employer public employee retirement system providing defined benefit pension plan coverage to full-time and certain part-time Fairfax County and Fairfax County Public Schools employees who are not covered by the Fairfax County Police Officers Retirement System, the Fairfax County Uniformed Retirement System, the Educational Employees' Supplementary Retirement System of Fairfax County (ERFC) or the Virginia Retirement System (VRS). There were 14,507 active members and 5,119 retirees participating in the System as of June 30, 2006.

Benefit Provisions

The benefit provisions of the System are established by County Ordinance. The System provides normal service retirement and early service retirement benefits for members who attain age or service requirements. Coverage for service-connected disability benefits is immediate upon membership in the System. Ordinary (non-service related) disability benefits are provided after the attainment of five years of service. Members are vested after five years of service and are eligible for benefits at the early or normal service retirement date.

Capital Markets and Economic Conditions

Fiscal 2006 was a year of solid growth in the economy and the domestic equity markets advanced at a moderate pace. The international equity markets outpaced the returns in the U.S. market. The S&P 500 Index rose 8.6% during fiscal 2006, while the smaller-capitalization Russell 2000 Index advanced 14.6%. International equity returns were quite a bit higher with the developed markets index (EAFE) up 27.1% and the emerging markets index up 35.9%. Returns on REITs were also excellent with the NAREIT index up 19.1%. Only bonds experienced negative returns for the year, as the Lehman Brothers Aggregate Bond Index declined 0.8%.

The diversified fund of the Employees' Retirement System returned 9.0% for fiscal 2006, after management fees. This return placed the fund in the 4th quartile of the Russell/Mellon public fund universe for 2006. The fund's relative performance over longer periods has been outstanding with the returns for the three, five and ten-year periods all in the first or second quartile of the public funds universe.

After accounting for all cash flows, including contributions, expenses and benefit payments, the market value of the System's assets increased 6.7%, from $2.307 billion on June 30, 2005 to $2.461 billion on June 30, 2006.

Major Initiatives

Significant progress was made on the project to replace the existing legacy computer systems. At the end of the fiscal year, the final changes were being made to a comprehensive defined benefit administration software application package, with plans to conduct final testing and parallel processing during the first half of FY 2007. The new system will interface with County and Schools systems for maintaining salary and service records of active members and will provide automated benefit calculations, support retiree recordkeeping and payroll functions and will include capabilities for internet access.

The Deferred Retirement Option Program (DROP) went live on July 1, 2005. At the end of the fiscal year, 207 employees were enrolled in DROP and education and individual counseling on the new program are now part of our services to active members.

As of July 1, 2005, public safety communications positions were moved from the Employees' Retirement System to the Uniformed Retirement System. Employees in those positions at the time were given the option to remain in the Employees' System or move to the Uniformed System, with a number of options related to paying the additional employee cost. Of the 144 employees eligible to change systems, 125 transferred membership effective October 1, 2005. To reflect this change in System membership, $11,750,084, the funded portion of the reduction in liability for the Employees' System was transferred to the Uniformed System.

A five-year actuarial experience study was completed. Based on the results of the study, changes were made to the actuarial assumptions for terminations and retirements. These changes were included in the final July 1, 2005 valuation and the employer contribution rate for FY 2007.

We continued to focus on improving the risk/return efficiency of the investment strategy, with a focus on active risk management and market exposures. The U.S. Large-cap Equity allocation was revised to include diversified absolute return strategies combined with market exposure using derivatives. In implementing this program, investments were made with Deerfield Capital, Front-Point Partners, First Quadrant, and Deephaven Asset Management. In addition to this diversification of our active risk, our market exposures were further diversified by a number of changes, including the establishment of a 5% allocation to commodity futures, implemented with PIMCO; an increase from 5% to 10% in the allocation to Bridgewater Associates All-Weather product; an investment in the TCW Worldwide Opportunity Fund to diversify the emerging markets allocation to include emerging market debt; and the addition of non-U.S. REITs with Cohen & Steers.

Internal and Budgetary Controls

The System's management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America.

Funded Status

An actuarial valuation of the System to determine funding requirements is performed annually. The System's funding policy provides for periodic employer contributions at actuarially determined rates which will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the costs of benefit payments when due. The valuation of the System performed as of July 1, 2005 indicated that the ratio of assets accumulated by the System to total actuarial accrued liabilities for benefits decreased from 84.2% to 82.3%. The actuarial section contains further information on the results of the July 1, 2005 valuation.

Based on the July 1, 2005 actuarial valuation, the employer contribution rate increased from 8.15% to 9.16%. With the two ordinance changes mentioned earlier (creation of DROP and the change in public safety communication position membership) that occurred after the valuation, the final employer contribution rate for FY 2007 will be 9.25%.

Investment Policies and Strategies

The Board of Trustees has an adopted Statement of Investment Objectives and Policy. This Statement establishes the investment goals, guidelines, constraints and performance standards that the Board of Trustees uses when exercising its fiduciary duties to manage the investment assets of the System. The Board operates in conformity with the standard of care required in making investments as stated in the Code of Virginia §51.1-803.

The Board receives quarterly reporting from staff to ensure compliance with its stated objectives and policy. Staff also monitors the performance of the System and its investment managers. Rate of return information is included in the Investment Section.

Securities of the System except for the pooled funds and the County's pooled cash and temporary investments are held by Mellon Global Securities Services as agent, in the System's name. Mellon Financial Corporation, the parent company, carries Financial Institution bond insurance coverage including a Computer Crime Policy. An additional Excess Securities policy covers all risk of physical loss to securities.

Other Information

Independent Audit and Actuarial Certifications

The independent auditors' report and certifications from the actuary are included in this report.

Acknowledgements

The annual report of the Employees' Retirement System was prepared by the System's staff under the leadership of the Board of Trustees. I would like to thank the entire staff who have worked hard throughout the year to provide service to our members and to ensure the successful operation of the System. This report is intended to provide complete and reliable information for determining the financial status of the System. It is being submitted to the Board of Supervisors and other interested parties and is available to the public via the County's website located at www.fairfaxcounty.gov/retbrd/.

Respectfully submitted,

Laurnz A. Swartz

Laurnz A. Swartz
Executive Director

BOARD OF TRUSTEES

Robert C. Carlson
Chairman
Board of Supervisors Appointee
Term Expires: August 31, 2009

Kevin L. North
Vice Chairman
Deputy Superintendent
Fairfax County Public Schools
Ex officio Trustee

Robert L. Mears
Treasurer
Fairfax County Director of Finance
Ex officio Trustee

Gordon R. Trapnell, FSA
Board of Supervisors Appointee
Term Expires: June 30, 2007

Randy R. Creller
Elected Member Trustee
Term Expires: June 30, 2009

Peter J. Schroth
Fairfax County Director of Human Resources
Ex officio Trustee

Frank M. Alston
Board of Supervisors Appointee
Term Expires: July 31, 2006

Thomas M. Stanners
Board of Supervisors Appointee
Term Expires: July 31, 2008

Walter Leppin
Fairfax County Public Schools
Elected Member Trustee
Term Expires: June 30, 2007

John M. Yeatman
Elected Retiree Trustee
Term Expires: December 31, 2006

ADMINISTRATIVE ORGANIZATION

ADMINISTRATIVE STAFF

Laurnz A. Swartz
Executive Director

Andrew J. Spellar
Investment Manager

Philip R. Langham
Retirement Administrator

PROFESSIONAL SERVICES

ACTUARY

CHEIRON
Actuaries
McLean, VA

AUDITOR

KPMG LLP
Certified Public Accountants
Washington, DC

INVESTMENT MANAGERS

Barclays Global Investors
San Francisco, CA

BNY Currency Overlay
London, UK

Brandywine Asset Management
Philadelphia, PA

Bridgewater Associates
Westport, CT

The Clifton Group
Minneapolis, MN

Cohen & Steers Capital Management
New York, NY

Columbia Wanger Asset Management
Chicago, IL

Deerfield Capital Management
Chicago, IL

DePrince, Race & Zollo
Winter Park, FL

Enhanced Investment Technologies, LLC
(INTECH)
Palm Beach Gardens, FL

First Quadrant Partners
Pasadena, CA

FrontPoint Partners
Greenwich, CT

JP Morgan Investment Management
New York, NY

Julius Baer Investment Management
New York, NY

LSV Asset Management
Chicago, IL

MacKay Shields LLC
New York, NY

Peregrine Capital Management
Minneapolis, MN

PIMCO
Newport Beach, CA

Post Advisory Group LLC
Los Angeles, CA

Robert E. Torray & Co.
Bethesda, MD

Sands Capital Management
Arlington, VA

Shenkman Capital Management
New York, NY

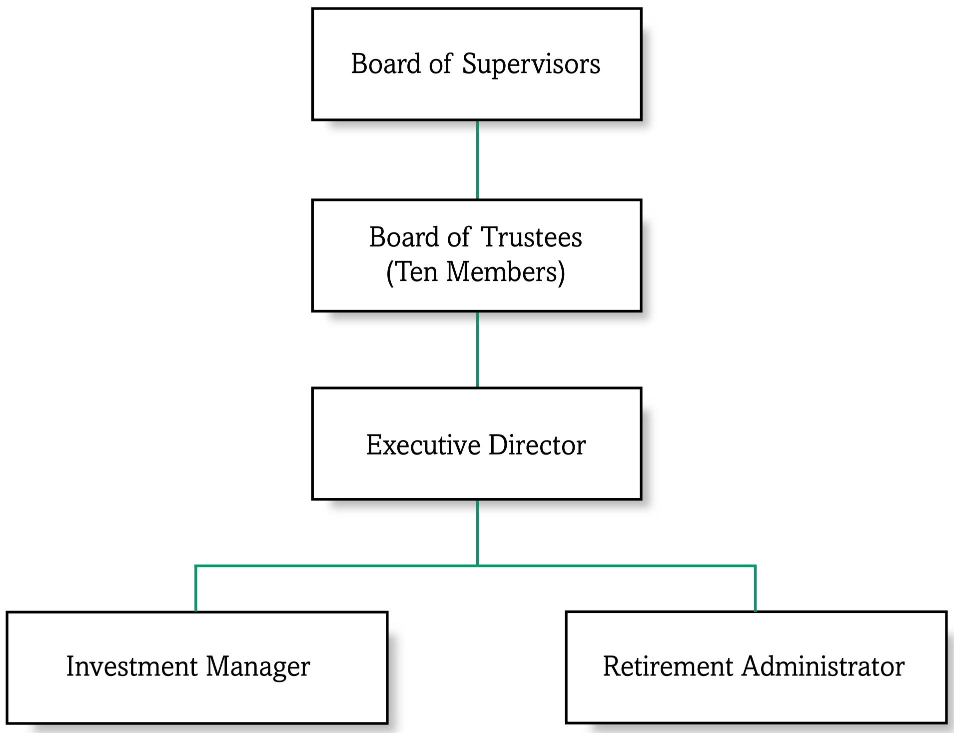
Standish Mellon Asset Management
Pittsburgh, PA

Trust Company of the West
Los Angeles, CA

CUSTODIAL BANK

Mellon Global Securities Services
Pittsburgh, PA

ORGANIZATIONAL CHART



SUMMARY OF PLAN PROVISIONS

Membership in the Fairfax County Employees' Retirement System includes most County employees working at least 20 hours per week as well as part-time and support staff employees from the Fairfax County Public Schools. The System consists of two Plans, Plan A and Plan B, which have slightly different employee contribution rates and slightly different benefits. In all other respects, the Plans are identical. The employee has the option to enroll in either Plan within 30 days of employment. This choice is irrevocable. Employees who make no election default to Retirement Plan A.

The general provisions of the Employees' Retirement System follow:

Plan A

Contribution Rate:

4% of base salary up to the maximum Social Security wage base plus 5.333% of base salary over the wage base.

Benefit:

1.8% of average final compensation (highest consecutive three years) up to the Social Security Breakpoint times creditable service plus 2% of average final compensation which exceeds the Social Security Breakpoint times creditable service. The total benefit is then increased by 3%. The Social Security Breakpoint is an average of Social Security wage bases for the last 35 years before a member reaches age 65.

In addition, at the time of normal service retirement, a Pre-Social Security Benefit is payable at the rate of 1% of average final compensation up to the Social Security Breakpoint times creditable service. This benefit will be payable until the member reaches the age of eligibility for unreduced Social Security benefits. The total benefit is then increased by 3%.

Plan B

Contribution Rate:

5.333% of base salary.

Benefit:

2% of average final compensation (highest consecutive three years) times creditable service. The total benefit is then increased by 3%.

In addition, at the time of normal service retirement, a Pre-Social Security Benefit is payable at the rate of 1% of average final compensation up to the Social Security Breakpoint times creditable service. This benefit will be payable until the member reaches the age of eligibility for unreduced Social Security benefits. The total benefit is then increased by 3%.

Both Plans

Normal Retirement:

is either age 65 with at least 5 years of service or at least age 50 when the member's age plus creditable service (including sick leave) totals 80 or more.

Deferred Retirement Option (DROP):

Those eligible for normal retirement may enter DROP, during which time the member continues to work and receive a salary for up to three years. In lieu of continuing to earn service credit, DROP participants accumulate a lump sum, including interest, payable at retirement.

Early Retirement:

is at age 50 or older when the member's age plus creditable service totals 75 or more. Reduction factors are applied to the basic formula for early retirement and no Pre-Social Security Benefit is payable.

SUMMARY OF PLAN PROVISIONS *(continued)*

Deferred Vested Retirement:

is available for vested members (vesting is at 5 years of creditable service) who leave their contributions in the System when they terminate. These members are entitled to their normal retirement benefit based on service with the County at age 65 or a reduced benefit earlier when they reach age 50 and age plus years of creditable service equal 75. This benefit is then increased by 3%.

Service-Connected Disability Retirement:

is available for members, regardless of their length of service, who become disabled as a result of a job-related illness or injury. Benefits are $66^2/_3$% of average final compensation.

Ordinary Disability Retirement:

is available for vested members who become disabled due to an injury or illness that is not job-related. Benefits are 2% of average final compensation (highest consecutive three years) times creditable service. The total benefit is then increased by 3%.

Death Benefits:

Before Retirement — If the member is vested and the spouse is the beneficiary, the spouse may elect to receive 50% of the normal retirement benefit earned as of the date of the member's death. This benefit ceases if the spouse remarries before age 60. If this benefit is not elected, a refund of the member's contributions and interest is payable to the named beneficiary.

After Retirement — A refund of any of the member's contributions and interest not already paid in benefits will be payable to the named beneficiary(ies) unless the member has elected the irrevocable Joint and Last Survivor Option which provides a benefit to the member's spouse for life. At retirement, the member may choose to have his or her spouse receive 50%, $66^2/_3$%, 75% or 100% of the member's reduced annuity upon the member's death. The member's annuity is reduced by a percentage based on the difference in age between the member and his or her spouse. If the spouse pre-deceases the member, the annuity is restored to what it would have been if this option had not been elected.

Service-Connected Death Benefit — A $10,000 lump-sum payment is made to the beneficiary if the member's death is due to a job-related illness or injury.

Cost of Living Benefit:

Annual cost of living adjustments are provided to retirees and beneficiaries equal to the lesser of 4% or the percentage increase in the Consumer Price Index for the Washington Consolidated Metropolitan Statistical Area.

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The Board of Supervisors
County of Fairfax, Virginia

The Board of Trustees
of the Fairfax County Employees' Retirement System:

We have audited the statement of plan net assets of the Fairfax County Employees' Retirement System (the System), a pension trust fund of the County of Fairfax, Virginia, as of June 30, 2006 and the related statement of changes in plan net assets for the year then ended. These basic financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets as of June 30, 2006 and the changes in plan net assets for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 13 and 14 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

Other required supplementary information on pages 23 and 24 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. Other required supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is
a member of KPMG International, a Swiss association.

KPMG

Our audit was conducted for the purpose of forming an opinion on the System's basic financial statements. The introductory, investment, actuarial, and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The information in these sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on it.

KPMG LLP

May 29, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's discussion and analysis of the Fairfax County Employees Retirement System's ("System" or "plan") financial performance and provides an overview of the financial activities for the fiscal year ended June 30, 2006. The information in this section should be reviewed in conjunction with the letter of transmittal provided in the Introductory Section of this report.

Overview of Financial Statements and Accompanying Information

Basic Financial Statements.
The System presents the Statement of Plan Net Assets as of June 30, 2006 and Statement of Changes of Plan Net Assets for the year then ended. These statements reflect the resources available for the payment of benefits as of year-end and the sources and uses of these funds during the year.

Notes to Financial Statements.
The Notes to Financial Statements are an integral part of the financial statements and include additional information and schedules to provide a better understanding of the financial statements. The Notes to Financial Statements immediately follow the basic financial statements.

Required Supplementary Information.
The Required Supplementary Information and related notes provide information regarding the System's funding progress and employer contributions. The Required Supplementary Information and related notes are immediately following the Notes to Financial Statements.

Financial Analysis

Summary of Plan Net Assets.
As indicated in the following Summary Statement of Plan Net Assets, the net assets held in the System increased $153.6 million or 6.7% during fiscal 2006. This change was primarily due to increases in fair value of investments during fiscal 2006.

Return on Investments.
The System's return on investments net of investment management fees for fiscal 2006 was 9.0%. The System's domestic equities had a 9.4% return. The international developed equity portfolios returned 28.0%. Emerging markets returned 32.2% for the year. The System's fixed income investments returned a negative 0.3%. The System's REIT portfolio returned 24.6% for the year. Additional investment market commentary is provided in the Investment Section of this document.

Additions.
Total additions decreased $64.7 million from fiscal 2005 to 2006 primarily due to investment returns. Employer contributions increased $2.5 million or 5.3% from fiscal 2005 to 2006. This increase was attributable to an increase in the employer contribution rate in 2006 and an increase in the covered payroll base during the year. The System experienced net investment gains during fiscal 2006. The net appreciation in the fair value of investments was $136.8 million during the fiscal year. Interest and dividend income was $78.1 million during fiscal 2006. Investment activity expense increased $580 thousand during the fiscal year due to investment management fees computed on the increasing investment values. Net securities lending income increased $203 thousand or 38.0% from fiscal 2005 to 2006.

Deductions.
Benefit payments increased 10.4% during fiscal 2006. The number of retirees and beneficiaries collecting benefits and the amount of the average benefit increased in both years and were responsible for the increase in the expense. Retirees received cost of living increases of 3.9% as of July, 2005. Refunds and other expenses decreased 6.4% from fiscal 2005 to 2006. The amount of refunds varies from year to year based on changes in employee turnover rates and decisions of former employees.

The actuarial valuation performed as of July 1, 2005 showed the System's funded status at 82.3%, a decrease of 1.9 percentage points from the July 1, 2004 funded percentage of 84.2%.

MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

Contacting the System's Financial Management

This financial report is designed to provide our membership, the Board of Trustees and the County's Board of Supervisors with a general overview of the System's financial condition. If you have any questions about this report or need additional information, contact the Fairfax County Retirement Administration Agency, 10680 Main Street, Suite 280, Fairfax, Virginia 22030. This report can also be found on the County's internet site at www.fairfaxcounty.gov/retbrd/.

SUMMARY STATEMENT OF PLAN NET ASSETS

	2006	2005	Difference
Assets			
Total cash and investments	$2,787,837,817	$2,517,714,995	$270,122,822
Total receivables	193,449,802	69,175,794	124,274,008
Total Assets	2,981,287,619	2,586,890,789	394,396,830
Liabilities	520,336,121	279,569,186	240,766,935
Net Assets	$2,460,951,498	$2,307,321,603	$153,629,895

SUMMARY OF ADDITIONS AND DEDUCTIONS

	2006	2005	Difference
Additions			
Contributions			
Employer	$ 49,436,463	$ 46,958,113	$ 2,478,350
Plan members	27,605,933	27,563,754	42,179
Net investment income	204,149,214	271,340,627	(67,191,413)
Total additions	281,191,610	345,862,494	(64,670,884)
Deductions			
Benefit payments	108,735,741	98,494,430	10,241,311
Transfer of assets to URS	11,750,084	-	11,750,084
Refunds and other	7,075,889	7,561,786	(485,897)
Total Deductions	127,561,715	106,056,216	21,505,499
Net Change	$153,629,895	$239,806,278	$(86,176,383)

FINANCIAL STATEMENTS

STATEMENT OF PLAN NET ASSETS

as of June 30, 2006

Assets		
Cash and short-term investments		
Equity in County's pooled cash and temporary investments	$ 2,482,345	
Cash collateral received for securities on loan	286,516,288	
Short-term investments	271,058,273	
Total cash and short-term investments		$ 560,056,906
Receivables		
Contributions	2,035,096	
Accrued interest and dividends	10,932,974	
Securities sold	180,481,732	
Total receivables		193,449,802
Investments, at fair value		
Corporate bonds	221,830,746	
U.S. Government obligations	261,266,996	
Asset-backed securities	114,971,952	
Common and preferred stock	953,463,482	
Pooled and mutual funds	676,247,735	
Total investments		2,227,780,911
Total assets		2,981,287,619
Liabilities		
Purchase of investments	230,196,716	
Cash collateral received for securities on loan	286,516,288	
Accounts payable and accrued expenses	3,623,117	
Total liabilities		520,336,121
Net assets held in trust for pension benefits		$2,460,951,498

(A schedule of funding progress is presented on page 23)

See accompanying notes to financial statements.

FINANCIAL STATEMENTS *(continued)*

STATEMENT OF CHANGES IN PLAN NET ASSETS

For the Year Ended June 30, 2006

Additions		
Contributions		
Employer	$ 49,436,463	
Plan members	27,605,933	
Total contributions		$ 77,042,396
Investment income from investment activities		
Net appreciation in fair value of investments	136,756,746	
Interest	53,484,168	
Dividends	24,643,824	
Total investment income	214,884,738	
Investment activity expense		
Management fees	10,636,792	
Custodial fees	291,798	
Consulting fees	36,000	
Allocated administration expense	508,146	
Total investment expense	11,472,736	
Net income from investment activities		203,412,002
From securities lending activities		
Securities lending income	12,412,181	
Securities lending expenses		
Borrower rebates	11,345,516	
Management fees	329,453	
Total securities lending activities expense	11,674,969	
Net income from securities lending activities		737,212
Total net investment income		204,149,214
Total additions		281,191,610
Deductions		
Annuity benefits	100,083,209	
Disability benefits	6,215,705	
Survivor benefits	2,436,827	
Refunds	6,059,597	
Transfers of assets	11,750,084	
Administrative expense	1,016,293	
Total deductions		127,561,715
Net increase		153,629,895
Net assets held in trust for pension benefits		
Beginning of fiscal year		2,307,321,603
End of fiscal year		$2,460,951,498

See accompanying notes to financial statements.

Notes to the Financial Statements

For the year ended June 30, 2005

The Fairfax County Employees' Retirement System ("System" or "plan") is considered part of the County of Fairfax, Virginia's ("County") reporting entity and its financial statements are included in the County's basic financial statements as a pension trust fund.

A. Summary of Significant Accounting Policies

Basis of Accounting.

The System's financial statements have been prepared under the accrual basis of accounting in accordance with accounting principles applicable to governmental units in the United States of America. Member and employer contributions to the plan are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the plan. The cost of administering the plan is paid by the System.

Method Used to Value Investments.

Short-term investments are reported at cost, which approximates fair value. All other investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Asset-backed securities are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The System records investment purchases and sales as of the trade date. These transactions are not finalized until the settlement date, which occurs approximately three business days after the trade date. The amounts of trade receivables and payables are shown as receivables and payables on the Statements of Plan Net Assets. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County's pooled cash and temporary investments.

The System maintains cash with the County, which invests cash and allocates interest earned, net of a management fee, on a daily basis to the System based on the System's average daily balance of equity in pooled cash. As of June 30, 2006 the bank balance of the County's public deposits was either insured by the Federal Deposit Insurance Corporation or through the State Treasury Board pursuant to the provisions of the Security for Public Deposit Act.

B. Plan Description and Contribution Information

Membership.

At July 1, 2005, the date of the latest actuarial valuation, membership in the System consisted of:

Retirees and beneficiaries receiving benefits	4,889
Terminated plan members entitled to but not yet receiving benefits	373
Active plan members	14,378
Total	19,640

Plan Description.

The System is a cost-sharing multiple-employer defined benefit pension plan which covers employees of the County and its component units. The plan covers full-time and certain part-time County, Public Schools, Economic Development Authority and Fairfax County Redevelopment and Housing Authority employees who are not covered by other plans of the County or the Virginia Retirement System. Benefit provisions are established and may be amended by County ordinance. All benefits vest at five years of service. To be eligible for normal retirement, an individual must meet the following criteria: (a) attain the age of 65 with five years of service, or (b) attain the age of 50 with age plus years of service being greater than or equal to 80. The normal retirement is calculated using average final compensation (i.e., the highest consecutive three years) and years, or partial years, of service at date of termination. The plan provides that unused sick leave credit may be used in the calculation of average final compensation by projecting the final salary during the unused sick leave period. The benefit for early retirement is actuarially reduced and payable at early termination.

Annual cost-of-living adjustments are provided to retirees and beneficiaries equal to the lesser of 4 percent or the percentage increase in the Consumer Price Index for the Washington Consolidated Metropolitan Statistical Area.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

Contributions.

The contribution requirements of the System members are established and may be amended by County ordinances. Members may elect to join Plan A or Plan B. Plan A requires member contributions of 4 percent of compensation up to the social security wage base and 5.33 percent of compensation in excess of the wage base. Plan B requires member contributions of 5.33 percent of compensation. The County is required to contribute at an actuarially determined rate; the rates for the years ended June 30, 2006 and 2005 were 8.24 percent and 8.08 percent of annual covered payroll.

Deductions.

The deductions from the System included the payment of retiree and beneficiary payments, the refund of employee contributions to former members and other expenses. A one-time transfer of $11.8 million was made to the Uniformed Retirement System to cover funded liabilities of the public safety communications workers that moved from the Employees' System to the Uniformed System.

C. Investments

The authority to establish the System is set forth in Section 51.1-800 *Code of Virginia* (Code). Section 51.1-803 of the Code authorizes fiduciaries of the System to purchase investments *with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with the same aims. The Board shall also diversify such investments as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.*

The System has adopted the Employees' Retirement System Investment Policy Statement to provide a well-managed investment program to meet the long-term needs of the System. Investment decisions for these assets are made by the Board of Trustees or investment managers selected by the Board. The overall investment policies do not address specific levels of credit risk, interest rate risk or foreign currency risk. The Board of Trustees believes that risks can be managed, but not eliminated by establishing constraints on the investment portfolio and by properly monitoring the investment markets, the System's asset allocation and the investment managers hired by the System. Each individual investment portfolio is managed by an investment management firm selected by the Board. Each investment manager has a specific benchmark and investment guidelines appropriate for the type of mandate they are managing and that fits within the total risk tolerance of the fund. The interest rate risk for the fixed income accounts is controlled by limiting the credit quality of the securities held and the duration of the portfolio against the duration of the benchmark. While the System is not subject to the provisions of the Employment Retirement Income Security Act (ERISA), the Board wishes to comply with the spirit of ERISA to the extent that it does not conflict with the Code of Virginia. The investment policy states that the securities of any one issuer shall not exceed 10% at market value. At June 30, 2006 the System did not have investments (other than U.S. Government and U.S. Government guaranteed obligations) in any one organization that represented 5 percent or more of net assets available for benefits. All investments, except for the mutual funds, short-term investment fund and a short-term collateral investment pool are held by an unaffiliated custodian. There is no custodial credit risk since the custodian's records establish the System's interest in the securities.

The policy states that the System's fixed income portfolio shall be, on average, comprised of high-quality issues and limits are imposed on investment managers' below-investment-grade holdings. Unless otherwise specified, if any security has a split rating, the lower of the two ratings is used for the purposes of meeting minimum quality standards.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

The System's investments quality ratings at June 30, 2006 are as follows:

Type of Investment	Fair Value	Ratings	Percent of Fixed
U.S. Government Obligations	$ 261,266,996	AAA	43.7%
Corporates and others	35,856,604	AAA	6.0%
	1,495,291	AA	0.3%
	10,104,263	A	1.7%
	1,699,805	BBB	0.3%
	41,580,479	BB	7.0%
	95,250,147	B	15.9%
	24,530,747	CCC	4.1%
	335,650	C	0.1%
	253,735	D	0.0%
	10,724,025	unrated	1.8%
Asset-backed	114,905,628	AAA	19.2%
	66,324	BB	0.0%
Total fixed income	598,069,694	A	100.0%
Short-term	271,058,273	AAA	
Cash collateral investment pool	286,516,288	N/A	
Common and preferred stock	953,463,482	N/A	
Pooled and mutual funds	676,247,735	N/A	
Equity in County's pooled cash	2,482,345	N/A	
Total Investments	$2,787,837,817		

As of June 30, 2006 the fixed income portfolio excluding pooled funds exhibited an overall credit quality rating of "A", and approximately 27% of the total fixed income portfolio was invested in below-investment grade securities.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

The Lehman Brothers Aggregate Bond Index (LAGG) is the standard benchmark against which the industry and the System's Board measures its fixed income portfolio performance and volatility. The System's fixed income managers have discretion, within circumscribed limits, to extend the duration of their portfolios beyond that of the LAGG if they forecast falling interest rates (and thus higher bond prices). Conversely, if managers anticipate that the general level of interest rates will rise, they have the ability to shorten the duration of their portfolio and thus reducing the portfolio's sensitivity to rising rates. The System's investments' sensitivity to interest rates at June 30, 2006 follows:

Investment Type	Fair Value	Effective Duration in Years	Percentage of Fixed
US Government obligations	$ 261,266,996	4.4	43.7%
Corporate and other	221,830,746	2.2	37.1%
Asset-backed	114,971,952	17.9	19.2%
Total fixed income	598,069,694	6.2	100.0%
Short-term investments	271,058,273	0.1	
Cash collateral investment pool	286,516,288	0.1	
Common and preferred stock	953,463,482	N/A	
Pooled and mutual funds	676,247,735	N/A	
Equity in County's pooled cash	2,482,345	N/A	
Total investments	$2,787,837,817		

As of June 30, 2006 the System's overall fixed income portfolio excluding pooled funds duration was 6.2 years compared with 4.8 years duration of the Lehman Brothers Aggregate Bond Index.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the investment. The System's investments at June 30, 2006 held in currencies other than US dollars were as follows:

International Securities	Equity	Fixed Income	Short-term and Other	Total US Dollar
European currency unit	$ 87,323,144	$ 8,937,660	$ 731,973	$ 96,992,777
Japanese Yen	43,965,217	-	16,007,775	59,972,992
British pound sterling	44,060,530	3,005,206	9,652,453	56,718,189
Swiss franc	14,869,494	-	501,836	15,371,330
Swedish Krona	8,316,628	5,232,775	1,338,663	14,888,066
Hong Kong Dollar	13,129,100	-	414,925	13,544,025
Canadian dollar	882,664	3,272,238	9,181,078	13,335,980
Polish zloty	4,548,784	5,085,574	(333,914)	9,300,444
Other currencies	26,452,907	24,461,069	(12,312,064)	38,601,912
Total international	243,548,468	49,994,522	25,182,725	318,725,716
Securities held in US dollars	1,389,100,109	554,030,542	198,099,177	2,141,229,829
Total investments	$1,632,648,577	$604,025,064	$223,281,902	$2,459,955,545

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

Derivative Financial Instruments.
As permitted by the Code described above, the System holds off-financial-statement derivatives in the form of exchange-traded financial futures, interest rate swaps, options on futures and swaps, inverse floating rate notes, and currency forwards in accordance with Board of Trustees' policy. These strategies are employed by one or more of the System's fixed income investment managers. Use of these instruments may involve certain costs and risks, including the risk that a portfolio could not close out a position when it would be most advantageous to do so. Portfolios investing in derivatives could lose more than the principal amount invested.

An exchange-traded financial futures contract is a legally-binding agreement to buy or sell a financial instrument in a designated future month at a price agreed upon by the buyer and seller at initiation of the contract. Futures contracts are standardized according to quality, quantity and delivery time. The System uses Money Market Futures Contracts as a means of managing interest rate exposure at the short end of the yield curve in an efficient manner with low transaction costs. The System also uses Bond Futures Contracts as a substitute for physical securities. The market and interest rate risks of holding exchange-traded futures contracts arise from adverse changes in market prices and interest rates. These risks are equivalent to holding exposure to the underlying security. Counterparty credit risk is modest because the futures clearinghouse becomes the counterparty to all transactions, and the futures exchanges provide multiple layers of protection such as the collection of variation margin on a daily basis and the use of standardized contracts to facilitate liquidity.

An Options Contract is a financial instrument that, in exchange for the option price, gives the option buyer the right, but not the obligation, to buy (or sell) a financial asset at the exercise price from (or to) the option seller within a specified time period, or on a specified date (expiration date). The System employs Options on Treasury Futures as well as Options on Swaps (Swaptions). Options on Treasury Futures are used to manage interest rate and volatility exposure as well as generate income. Swaptions have similar investment characteristics to other options but have the advantage of being more customized instruments that can serve more specific applications in a portfolio. Swaptions are used in an attempt to generate income by writing puts and calls to manage swap rates or swap rate volatility. A most important characteristic of options is that they can cause the effective duration of a portfolio to change with movements in interest rates. To control interest rate risk, the duration change potential of options positions over a wide range of best and worst case interest rate scenarios are measured and controlled. The use of options is aimed at assuring that any subsequent duration change on a total return portfolio will be modest under reasonable worst case scenarios and option strategies will not be employed which have the potential to move the portfolio's duration outside an appropriate range.

Currency forward contracts are used as a cost effective way to hedge or create foreign currency exposure in the portfolio. The manager monitors its exposure to foreign currency in the context of total contribution to volatility and tracking error. Foreign currency can add significant volatility to a portfolio's return, so any sizeable position will be carefully considered in the context of the portfolio's entire risk budget.

An interest rate swap is a binding agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. Interest rate swaps provide an effective means by which to quickly adjust portfolio duration, maturity mix, and sector exposure. The System also uses interest rate swaps as risk-neutral substitutes for physical securities, or to obtain non-leveraged exposure in markets where no physical securities are available, such as an interest rate index. The market risk is equivalent to holding the exposure to the index. The counterparty credit risk is equal to the amount of profit or loss that has not yet been realized. This risk is controlled by the System's investment guidelines and limited by periodic resets to the swap that allow the unrealized profit and loss to be realized. Counterparty risk is limited by execution under standardized International Swap and Derivatives Association (ISDA) Agreements. These standardized contracts reduce legal risk and increase speed of execution that, in turn, improves liquidity.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

As of June 30, 2006 the System held the following derivatives contracts.

Derivative	Notional Value Par or Local Face	Fair Value Dollars	Maturity
Money Market Futures	$ 43,000,000	$ 40,623,288	12/06 – 12/07
Government Futures	46,412,508	45,838,423	9/06
Equity Futures	292,823,442	292,421,547	9/06
Foreign Currency Futures	(20,663,309)	(20,715,920)	9/06
Options	(28,600,000)	(57,450)	7/06 – 6/07
Currency Forwards	N/A	(4,555,538)	7/06 – 10/06
Swaps	$202,429,655	$ 4,409,380	7/06 – 6/36

Securities Lending.

Board of Trustees' policies permits the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the plan's domestic securities for collateral of 102 percent and international securities of 105 percent of fair value. The custodian receives cash or securities as collateral from the borrower. All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in the lending agents' collective collateral investment pool, which at June 30, 2006 had a weighted average maturity of 31 days. The relationship between the maturities of the investment pool and the System's loan is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool.

The following represents the balances relating to the securities lending transactions at June 30, 2006.

Securities Lent	Underlying Securities	Securities Collateral Value	Cash Collateral Investment Value
Lent for Cash Collateral			
US Government obligations	$152,611,740		$154,788,965
Asset-backed securities			
Corporate and other bonds	24,973,258		25,758,282
Common and preferred stock	99,021,697		103,121,474
Lent for Other Collateral			
US Government obligations	34,952,062	$35,495,228	
Corporate and other bonds	5,517,243	5,641,963	
Common and preferred stock	2,922,823	3,153,178	
Total	$319,998,822	$44,290,369	$283,668,721

The System did not impose any restrictions during fiscal 2006 on the amounts of loans the lending agent made on its behalf. At year end, 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. The custodian provides full indemnification to the System for any losses that might occur in the program due to the failure of a broker/dealer to return a borrowed security or failure to pay the System income earned on the securities while on loan.

D. Income Taxes

The Internal Revenue Service issued a determination letter on November 24, 2003, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes.

REQUIRED SUPPLEMENTARY INFORMATION

Seven-year historical trend information about the System is presented here as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets *(in thousands)* (a)	Actuarial Accrued Liability-AAL Entry Age *(in thousands)* (b)	Unfunded AAL-UAAL *(in thousands)* (b-a)	Funded Ratio (a/b)	Covered Payroll *(in thousands)* (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
7/1/1999	1,523,311	1,467,044	(56,267)	103.84%	399,732	-14.08%
7/1/2000	1,694,416	1,690,538	(3,878)	100.23%	449,232	-0.86%
7/1/2001	1,807,813	1,857,802	49,989	97.31%	476,327	10.49%
7/1/2002	1,854,089	2,051,677	197,588	90.37%	507,905	38.90%
7/1/2003	1,903,970	2,251,187	347,217	84.58%	530,216	65.49%
7/1/2004	2,030,539	2,411,135	380,596	84.22%	552,738	68.86%
7/1/2005	2,202,515	2,676,418	473,903	82.29%	565,063	83.87%

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing plan net assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system.

Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2000	27,133,595	100%
2001	29,960,984	100%
2002	31,083,805	100%
2003	36,408,121	88%
2004	51,992,031	66%
2005	67,996,277	69%
2006	74,548,972	66%

Notes To Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

Valuation date	July 1, 2005
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	15 years
Asset valuation method	3-year smoothed market
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.0%-6.5%%
*Includes inflation at	4.0%
Cost of living adjustments	3.0%

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

The actuarial assumptions used have been recommended by the actuary and adopted by the System's Board of Trustees based on the most recent review of the System's experience, completed in 2005.

The rate of employer contributions to the plan is composed of normal cost, amortization of the unfunded actuarial accrued liability and an allowance for administrative expenses. The normal cost is a level percent of payroll cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial accrued liability is that portion of the present value of projected benefits that will not be paid by future normal employer costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial accrued liability. The allowance for administrative costs is based upon the plan's actual administrative expenses.

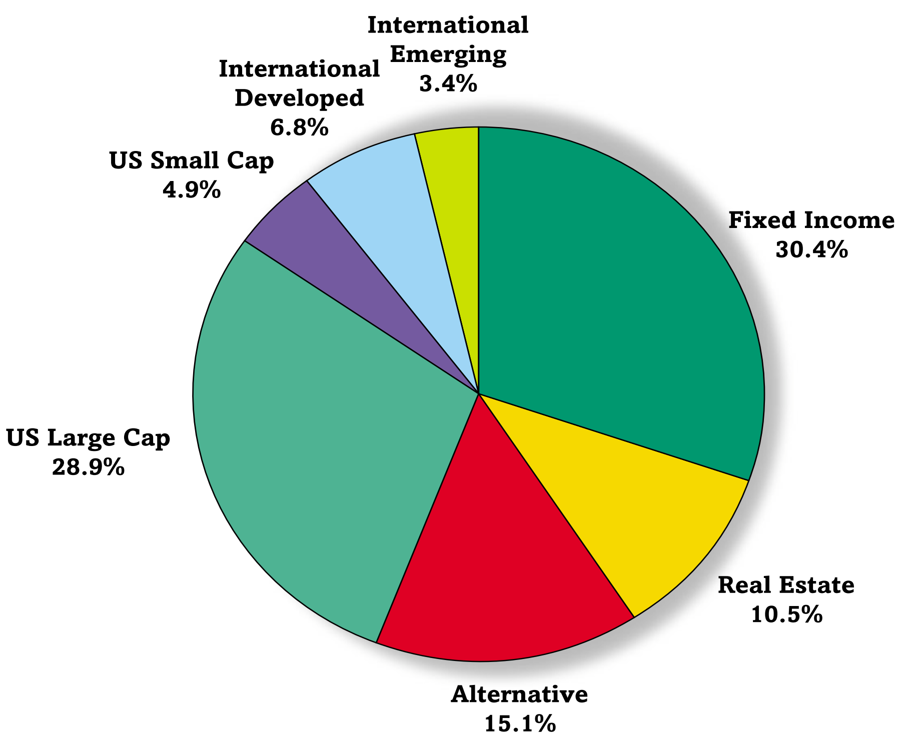
The actuarial valuation performed as of July 1, 2005 resulted in a contribution rate of 13.13% for fiscal 2007 per the GASB methodology, an increase of 0.84% over the fiscal 2006 rate of 12.29% per the GASB methodology. Beginning with fiscal 2003, the funding policy was revised to further stabilize the contribution rate. The methodology now in place sets the employer contribution rate equal to the normal cost and allowance for administrative expense. Amortization of the unfunded liability is included in the contribution rate only for any benefit and actuarial assumption changes or if the actuarial funding ratio falls outside a corridor of 90% and 120%. Use of the corridor method, with adjustments for plan changes effective after the valuation date, results in an adopted rate of 9.25% for fiscal 2007, an increase of 1.01% over the fiscal 2006 adopted rate of 8.24%.

OVERVIEW

The Board of Trustees has established an investment policy for the System to identify investment objectives, guidelines and performance standards of the System. The objectives are formulated in response to the anticipated needs of the System, the risk tolerance of the System and the desire of the Board of Trustees to define and fulfill their fiduciary responsibility over System assets.

The Board has established its asset class strategic target allocations which it believes will achieve the return requirements of the System at an appropriate level of risk and maintain a comfortable risk tolerance. Further, a disciplined rebalancing policy was adopted to ensure that market movements do not cause asset class weightings to unintentionally stray too far from the target percentages. The actual asset allocation at market is reviewed weekly and if asset class weightings fall outside the "no rebalancing range," transfers between asset classes are initiated to rebalance the asset allocations to within the target ranges. The following graph shows the actual asset allocations as of June 30, 2006.

EMPLOYEES' RETIREMENT SYSTEM
ASSET ALLOCATION AS OF 6/30/06



The Board of Trustees hires investment management firms and provides each firm with a specific investment mandate, and assigns a benchmark index or a blend of indices against which the performance of the account is measured. Each managed account has its own investment guidelines outlining the nature of investments to be held in the account and detailing allowed and/or prohibited transactions. Investment managers are requested to submit a written statement describing their proposed investment strategy and tactics for achieving the investment goals and objectives that are required by their guidelines. Investment manager performance is monitored monthly by staff and reviewed by the Board of Trustees quarterly.

CAPITAL MARKETS AND ECONOMIC CONDITIONS

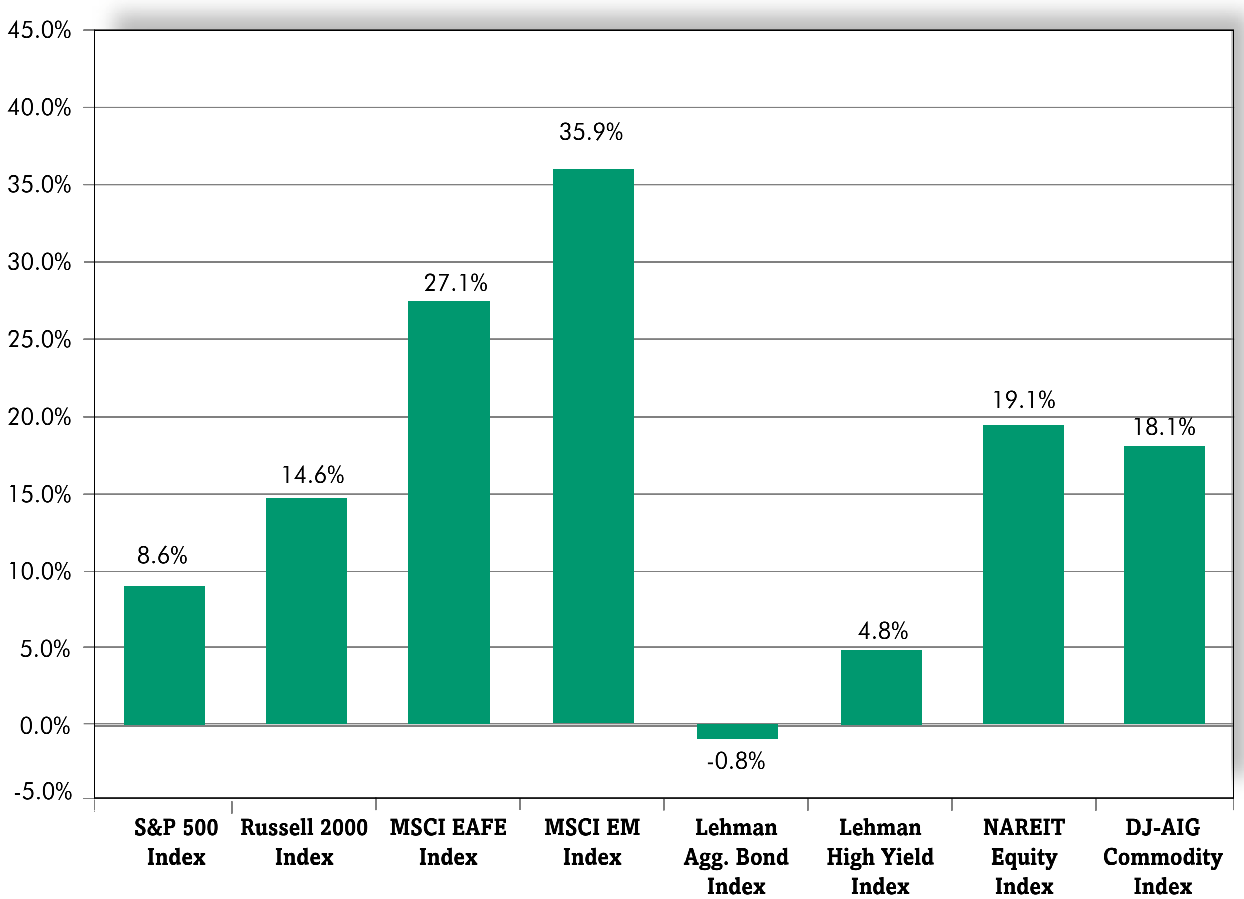
Financial and Economic Summary

Worldwide capital markets produced mixed results in fiscal 2006 ending June 30, 2006. Global equity markets achieved reasonably solid performance during the fiscal year, marking the fourth year of recovery from the 2000-2002 bursting of the dot-com bubble. International equity markets performed exceptionally well, partially due to results benefiting from translating foreign gains back into a weaker US dollar. Macroeconomic conditions made for turbulent fixed income markets, however, as rising energy prices, inflation concerns, and a destructive hurricane season dominated investor sentiment.

Economy

The US economy grew at a good clip during fiscal 2006. Real gross domestic product increased by 4.1% in the third quarter of 2005, 1.7% in the fourth quarter of 2005, 5.6% in the first quarter of 2006, and 2.6% in the second quarter of 2006. For the second consecutive year corporate earnings advanced at double-digit rates every quarter of the year. Businesses increased capital spending as productivity gains slowed. Retail sales remained strong as consumer incomes grew and consumer spending continued to outpace income, resulting in another year of negative savings for the nation. The threat of rising inflation was again the main

ASSET CLASS RETURNS



CAPITAL MARKETS AND ECONOMIC CONDITIONS *(continued)*

concern of federal monetary policy. Dr. Alan Greenspan departed as Chairman of the Federal Reserve Board, and Dr. Ben Bernanke took his place vowing to maintain a measured pace of monetary tightening in the war on inflation. During the year, eight consecutive increases elevated the Fed Funds Rate from 3.25% to 5.25%. Global demand for commodities spiked a surge in prices, jumpstarting the economies of several emerging markets producers and pushing the spot price of oil to an historic high of $75 a barrel by the end of the year. The Consumer Price Index (adjusted) rose 4.2% over the past year off of forty-year lows. As productivity gains waned and capacity became more constrained, businesses picked up their rate of hiring, creating over a million new jobs and effectively reducing the national unemployment rate from 5.0% at the beginning of the year to 4.6% by year end.

Equity Markets

Broad US equity benchmarks posted gains over the trailing year, with positive returns in three of four quarters. The S&P 500 Index posted a total return of 8.6%, and for the third consecutive year the small-cap Russell 2000 Index was the strongest of the major domestic indexes, rising 14.6%. Value and growth were evenly matched among small stocks, but value led in the mid- and large-cap segments by 1.3 and 7.7 percentage points, respectively. Boosted by record-high fuel prices, Energy was the S&P's strongest sector over the past year, returning 24.5% and accounting for 41% of the index's positive performance. Health Care was the S&P's worst performer and was the only sector (at -1.1%) to post a negative return. Other strong sectors included Materials (+21.2%), Industrials (+14.4%) and Financials (+12.5%).

International equity benchmarks posted spectacular results over the past year. The MSCI EAFE Index, a broad index of international developed countries, returned 27.1% for fiscal 2006, while the commodity-driven MSCI Emerging Markets Free Index returned a stunning 35.9%. Asian and Latin American markets fueled the largest increases in performance. Foreign results were boosted by 2.9% due to translating foreign currencies back into a weaker US dollar.

Real Estate Markets

With rising interest rates and moderating capital flows, real estate investments were forecasted to have a lackluster year. However, strengthening underlying fundamentals (occupancies, rents) coupled with increased merger and acquisition activity kept the sector in the forefront of investor interest. The public real estate market had another outstanding year as measured by the 19.1% return of the NAREIT Equity Index. This marks the seventh consecutive year that the REIT Index has outperformed the S&P 500 Index. Private real estate, which often lags the REIT market due to the lag of the property appraisal cycle, kept pace this fiscal year with a strong 18.2% return.

Fixed Income Markets

Domestic investment grade bonds recorded negative returns over the past twelve months as yields rose across the curve. The Lehman Brothers Aggregate Bond Index returned a negative 0.8% for fiscal 2006. High yield bonds were the best performing sector, returning 4.8% for the year, followed by asset-backed and mortgage securities, which were marginally positive. Due to strong balance sheets, corporate yield spreads over Treasuries remained tighter than historical averages. Long bonds suffered the most, as the dramatic upward shift in the yield curve saw long yields rise the most over the past year. Global bonds posted slightly negative returns for the year as most developed-market central banks raised interest rates through the course of the year in line with rising global growth.

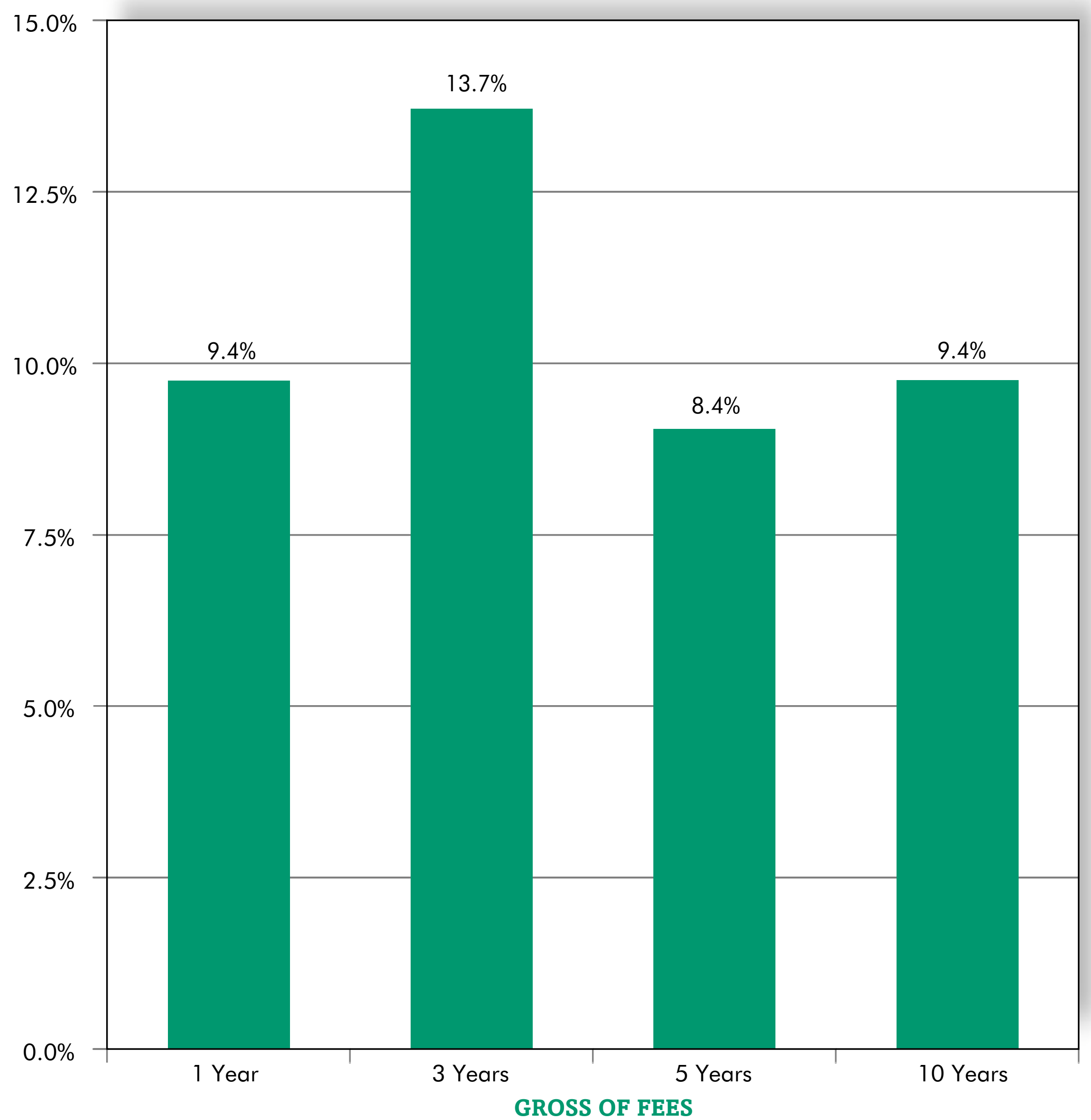
System

The Employees' Retirement System operates a sound and diversified investment program with disciplined asset re-balancing to achieve strategic long-term goals. That disciplined investment process has been effective in achieving a long-term record of consistent asset growth.

On a market value basis, the total net assets held in trust rose from $2,307.3 million at June 30, 2005 to $2,461.0 million at June 30, 2006. For fiscal 2006, investments provided a return of +9.0%, net of fees, reflecting an expansionary economic environment. The System's annualized rate of return, net of fees, was +13.4% over the last three years and +8.1% over the last five years. These System returns ranked in the fourth quartile of a universe of public plans for 2006, in the second quartile of returns for the 3-year period, and in the first quartile of public plans for the last 5 years. The Employees' Retirement System's annualized ten-year net return of 9.1% has handily surpassed the 7.5% long-term threshold return used for actuarial purposes.

CAPITAL MARKETS AND ECONOMIC CONDITIONS *(continued)*

COMPOUND ANNUAL RETURN ON INVESTMENT PORTFOLIO



During the past twelve months, several changes were made to the asset allocation targets of the System to help further diversify the investment program. To better diversify against rising inflation and falling growth economic environments, the System's All-Weather allocation was increased from 5% to 10%, and a 5% strategic allocation to Collateralized Commodity Futures was implemented in the form of PIMCO's Commodity Real Return Strategy. The System also added absolute return strategies run by Deerfield Capital, FrontPoint Partners, and First Quadrant Partners as part of its Large Cap Overlay strategy. Finally, the System diversified its Real Estate segment in allocating a portion of the Cohen & Steers REIT portfolio to International Real Estate securities.

ASSET ALLOCATION BY CATEGORY AND INVESTMENT MANAGER

June 30, 2005

ASSET CLASS Manager	Investment Style	Total Assets	% of Total Net Assets
DOMESTIC EQUITIES			
Columbia Wanger Asset Mgt.	Small Cap Core	$ 146,635,124	6.0%
DePrince, Race & Zollo	Large Cap Value	120,047,685	4.9%
Enhanced Inv. Technologies (INTECH)	Large Cap Growth	115,735,183	4.7%
Robert E. Torray & Co.	Large Cap Value	110,691,043	4.5%
Sands Capital Management	Large Cap Growth	37,958,419	1.5%
DOMESTIC EQUITY OVERLAY			
The Clifton Group	S&P 500 Futures	77,858,006	3.2%
BGI Global Ascent Fund*	Global Macro Hedge Fund	73,151,583	3.0%
FrontPoint Partners*	Multi-Strategy Hedge Fund	50,116,150	2.0%
First Quadrant Partners*	Global Macro Hedge Fund	48,847,550	2.0%
Deerfield Capital Mgt.	Long/Short Duration Mgt.	44,657,751	1.8%
INTERNATIONAL EQUITIES			
LSV Asset Management	Developed Markets Value	99,733,683	4.1%
Julius Baer Investment Mgt.	Developed Markets	98,528,467	4.0%
BGI Emerging Markets Fund*	Emerging Markets Index	55,919,639	2.3%
TCW Worldwide Opportunity Fund*	Emerging Markets	27,311,533	1.1%
BNY Currency Overlay	Currency Overlay Program	(250,228)	0.0%
FIXED INCOME			
Bridgewater Associates	Enhanced TIPS Index	140,497,337	5.7%
Peregrine Capital	Duration Management	107,841,167	4.4%
Trust Company of the West	Mortgage-Backed Securities	105,712,053	4.3%
JP Morgan Investment Mgt.	Investment-Grade Bonds	103,529,535	4.2%
Brandywine Asset Mgt.	Global Bonds	74,122,440	3.0%
Post Advisory	High Yield Bonds	61,316,100	2.5%
MacKay Shields	High Yield Bonds	60,394,507	2.5%
Shenkman Capital Mgt.	High Yield Bonds	57,009,118	2.3%
ALTERNATIVE INVESTMENTS			
Cohen & Steers Capital Mgt.	US Real Estate Inv. Trusts	201,354,624	8.2%
Cohen & Steers Capital Mgt.	Int'l Real Estate Securities	50,301,312	2.0%
Bridgewater Associates	Enhanced Multi-Asset Real Return	247,766,804	10.1%
Pacific Investment Mgt. Co. (PIMCO)	Collateralized Commodity Futures	124,896,150	5.1%
SHORT-TERM			
The Clifton Group	Policy Implementation Overlay	10,780,264	0.4%
Standish Mellon	Plan Level Cash Accounts	7,492,546	0.3%
Cash Held at County Treasurer	Operating Cash Account	2,482,345	0.1%
Net Assets		$2,462,437,890	100.0%

**Pooled fund*

LARGEST HOLDINGS FOR SEPARATELY MANAGED (NON-POOLED) ACCOUNTS

ASSET CLASS / **Manager** / Security	**Market Value**	**% of Account**
DOMESTIC EQUITIES		
DePrince, Race & Zollo		
General Electric Co.	$2,864,224	2.39%
Chevron Corp.	$2,697,003	2.25%
Du Pont E.I. De Nemours & Co	$2,568,925	2.14%
Lilly Eli & Co.	$2,460,510	2.05%
Washington Mutual Inc.	$2,456,762	2.05%
INTECH		
Microsoft Corp.	$4,001,589	3.46%
Johnson & Johnson	$3,279,721	2.84%
General Electric Co.	$3,128,827	2.71%
Express Scripts Inc.	$2,166,548	1.87%
Altria Group Inc.	$2,084,971	1.80%
Sands Capital Mgt.		
Google Inc.	$3,899,769	10.33%
Starbucks Corp.	$3,455,040	9.15%
Genentech Inc.	$2,617,600	6.93%
Ebay Inc.	$2,226,040	5.90%
Chicago Mercantile Exchange Holdings	$2,062,830	5.46%
Robert E. Torray & Co.		
Lilly Eli & Co.	$4,758,747	4.30%
Medtronic Inc.	$4,588,776	4.15%
Ambac Financial Group Inc.	$4,582,150	4.14%
United Technologies Corp.	$4,572,582	4.13%
Emerson Electric Co.	$4,467,073	4.04%
Wanger Asset Mgt.		
American Tower Corp.	$2,800,800	1.91%
Western Gas Resources Inc.	$2,513,700	1.72%
Expeditors Int’l of Washington Inc.	$2,240,400	1.53%
Pride International Inc.	$2,186,100	1.49%
Chico’s Inc.	$2,158,400	1.47%
INTERNATIONAL EQUITIES		
Julius Baer Investment Mgt.		
Powszechna Kasa Oszczed Bank	$1,638,144	1.81%
Sanofi-Aventis	$1,386,537	1.53%
Komercni Banka	$1,305,967	1.44%
Total SA	$1,255,668	1.39%
Nestle SA	$1,246,041	1.38%

LARGEST HOLDINGS FOR SEPARATELY MANAGED (NON-POOLED) ACCOUNTS *(continued)*

ASSET CLASS **Manager** Security	**Market Value**	**% of Account**
INTERNATIONAL EQUITIES *(continued)*		
LSV Asset Mgt.		
Toyota Motor Corp.	$ 2,185,041	2.26%
Credit Suisse Group	$ 1,998,955	2.07%
Royal Dutch Shell	$ 1,914,321	1.98%
HBOS PLC	$ 1,776,826	1.84%
Total SA	$ 1,710,450	1.77%
REAL ESTATE SECURITIES		
Cohen & Steers Capital Mgt. (US)		
Vornado Realty Trust	$13,052,190	6.49%
Equity Office Properties Trust	$11,534,057	5.74%
Boston Properties Inc.	$11,037,840	5.49%
Avalonbay Communitys Inc.	$10,351,930	5.15%
Equity Residential	$10,301,319	5.12%
Cohen & Steers Capital Mgt. (Int'l)		
Mitsubishi Estate Co.	$ 3,294,843	5.92%
Westfield Group	$ 2,832,571	5.09%
Mitsui Fudosan Co.	$ 2,565,105	4.61%
Cheung Kong Holdings	$ 2,221,031	3.99%
Land Securities Group	$ 1,990,856	3.58%
CORE FIXED INCOME		
Brandywine Global Asset Mgt.		
US Treasury Bonds, 6.125%, 11/15/2027	$10,041,787	13.77%
Kingdom of Sweden Bonds, 6.5%, 5/5/2008	$ 5,183,171	7.11%
Government of Poland Bonds, 5.75%, 6/24/2008	$ 5,081,137	6.97%
Government of Singapore Notes, 2.625%, 10/1/2007	$ 4,191,601	5.75%
US Treasury Bonds, 6.5%, 11/15/2006	$ 3,872,813	5.31%
Bridgewater Associates		
US Treasury Inflation Index Notes, 2.0%, 7/15/2014	$21,721,594	15.69%
US Treasury Inflation Index Notes, 4.25%, 1/15/2010	$15,901,906	11.49%
US Treasury Inflation Index Notes, 0.875%, 4/15/2010	$10,735,933	7.76%
US Treasury Inflation Index Notes, 1.875%, 7/15/2013	$ 9,169,101	6.62%
US Treasury Inflation Index Bonds, 3.625%, 4/15/2028	$ 3,991,219	2.88%
Peregrine Capital Mgt.		
US Treasury Bonds, 6.25%, 5/15/2030	$10,764,688	10.04%
Landesbank Baden (Germany) Notes, Variable Rate, 3/30/2007	$ 6,489,795	6.05%
Federal Home Loan Banks Bonds. 3.375%, 12/15/2006	$ 5,350,050	4.99%
Federal Home Loan Mortgage Corp. Discount Notes, 7/11/2006	$ 5,245,846	4.89%
Superior Wholesale Inventory Finance Notes, Variable Rate, 5/15/2009	$ 5,147,425	4.80%

LARGEST HOLDINGS FOR SEPARATELY MANAGED (NON-POOLED) ACCOUNTS *(continued)*

ASSET CLASS **Manager** Security	**Market Value**	**% of Account**
CORE FIXED INCOME *(continued)*		
TCW Asset Mgt.		
FHLMC Multiclass Mortgage, 5.0%, 4/15/2033	$ 5,777,060	5.50%
FNMA REMIC, 5.0%, 10/25/2035	$ 3,060,908	2.91%
FHLMC Multiclass Mortgage, Variable Rate, 2/15/2032	$ 2,922,183	2.78%
FHLMC Multiclass Mortgage, Variable Rate, 5/15/2034	$ 2,874,550	2.73%
FHLMC Multiclass Mortgage, Variable Rate, 12/15/2032	$ 2,753,910	2.62%
HIGH YIELD FIXED INCOME		
MacKay Shields, LLC		
General Motors Acceptance Corp. Note, 8.0% 11/1/2031	$ 1,095,643	1.79%
Calpine Corp. 2nd Priority Note 144A, 8.5%, 7/15/2010	$ 1,012,380	1.66%
KoSa Lux Finance BV 144A, 9.25%, 5/1/2012	$ 798,000	1.31%
LNR Property Corp. Term Loan, 5.59%, 2/3/2008	$ 721,136	1.18%
El Paso Production Oil & Gas Holding Co. Senior Note, 7.75%, 6/1/2013	$ 690,138	1.13%
Post Advisory		
Insight Communications Inc. Senior Discount Note, 2/15/2011	$ 1,321,875	2.19%
Advanstar Communications Inc. Senior Subordinated Note, 12.0% 2/15/2011	$ 894,625	1.48%
EchoStar DBS Corp. Senior Note 144a, 7.125%, 2/1/2016	$ 770,000	1.28%
Allied Waste North America Inc., 9.25%, 9/1/2012	$ 768,500	1.27%
CPI Holdco Inc. Senior Note, Variable Rate, 2/1/2015	$ 765,000	1.27%
Shenkman Capital Mgt.		
Brickman Group Ltd. Senior Subordinated Note, 11.75%, 12/15/2009	$ 537,500	0.95%
KB Home Senior Subordinated Note, 9.5%, 2/15/2001	$ 522,500	0.92%
Chumash Casino & Resort 144A, Variable Rate, 7/15/2010	$ 521,875	0.92%
Rural Cellular Corp. Senior Secured Note, 8.25%, 3/15/2012	$ 513,125	0.91%
Edison Mission Energy Senior Note, 7.73%, 6/15/2009	$ 503,750	0.89%
ALTERNATIVE ASSETS & STRATEGIES		
PIMCO Commodity Real Return		
US Treasury Inflation Index Notes, 1.875%, 7/15/2015	$ 30,769,120	18.85%
US Treasury Inflation Index Notes, 3.625%, 1/15/2008	$ 23,572,041	14.44%
US Treasury Inflation Index Notes, 3.0%, 7/15/2012	$ 20,312,039	12.44%
US Treasury Inflation Index Notes, 0.875%, 4/15/2010	$ 20,167,500	12.35%
US Treasury Inflation Index Notes, 3.5%, 1/15/2011	$ 13,804,838	8.46%
Deerfield Capital Mgt. RPM		
Mitsubishi Bank NY Repurchase Agreement, 4.95%, 7/3/2006	$ 10,032,188	20.79%
US Treasury Bonds, 7.25%, 5/15/2016	$ 9,844,063	20.40%
Federal Home Loan Mortgage Corp. Debentures, 4.75%, 11/17/2015	$ (9,675,401)	-20.05%
BNY Currency Overlay		
Japanese Yen Forward Foreign Exchange Contracts	$(18,720,748)	n/a
British Pound Sterling Forward Foreign Exchange Contracts	$ 8,035,808	n/a
Euro Currency Forward Foreign Exchange Contracts	$ 7,263,675	n/a
Australian Dollar Forward Foreign Exchange Contracts	$ (7,014,903)	n/a
Canadian Dollar Forward Foreign Exchange Contracts	$ 5,544,142	

CHEIRON Classic Values, Innovative Advice

February 16, 2006

Fairfax County Employees'
Retirement System
10680 Main Street, Suite 280
Fairfax, Virginia 22030-3812

Dear Members of the Board:

At your request, we have conducted our annual actuarial valuation of the Fairfax County Employees' Retirement System as of July 1, 2005. The results of the valuation are contained in this report.

Funding Objective

The funding objective of the System is to establish contribution rates which, over time, will remain level as a percent of payroll. In order to achieve a more stable contribution rate the County implemented a Corridor Funding Method on July 1, 2002 (based on the July 1, 2001 valuation results). Under this approach the contribution rate is based on the normal cost rate and expense rate on July 1, 2001, adjusted for subsequent plan changes, including a 15 year amortization of any UAL impact. The rate will otherwise remain at this level as long as the actuarial funded ratio remains within a corridor of 90% to 120%. Since the funding ratio is currently below 90%, additional contributions are being made by the County.

Assumptions

The actuarial assumptions used in performing the July 1, 2005 valuation were recommended by the actuary and adopted by the Board of Trustees based on our most recent review of the System's experience for the five year period ending June 30, 2005. The assumptions reflect our understanding of the likely future experience of the System and the assumptions as a whole represent our best estimate for the future experience of the System. The results of this report are dependent upon future experience conforming to these assumptions. To the extent that future experience deviates from these assumptions, the true cost of the System could vary from our results. Several assumptions were changed in conjunction with the aforementioned experience review.

The assumptions and methods used in performing this valuation meet the parameters set by Government Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans.*

Reliance on Others

In preparing our report, we relied without audit, on information (some oral and some written) supplied by the System's staff. This information includes, but is not limited to, plan provisions, employee data, and financial information. The census data provided was reviewed for reasonableness and for consistency with prior year's data.

8200 Greensboro Drive, Suite 1125, McLean, VA 22102 Tel: 877 CHEIRON (243.4766) Fax: 703.893.2006 www.cheiron.us

ACTUARIAL

February 16, 2006
Fairfax County Employees' Retirement System
Page 2

Supporting Schedules
We are responsible for all supporting schedules to be found in the Actuarial Section.

We are responsible for the 2004 and 2005 information in the Schedule of Funding Progress, Schedule of Employer Contributions and Notes to Trend Data shown in the Financial Section.

Compliance with Code of Virginia §51.1-800
Code of Virginia §51.1-800 requires that the benefits provided to a retiree at age 65 from a local retirement system equal or exceed two-thirds of the allowance to which the employee would be entitled under the provisions of the Virginia Retirement System (VRS). The Board of Trustees of the VRS is to determine whether a local system satisfies this condition, taking into account differences in member contributions between the local system and the VRS.

Although there is no formal procedure for making this comparison, we compared the least valuable rate under the Employees' System to the most valuable accrual rate under the VRS, making adjustments for the fact that employee contributions are required in excess of the VRS 5% rate. The employer provided accrual rates do exceed two-thirds of the employer provided accrual rates under the VRS plan.

I certify that, to the best of my knowledge and understanding, the Fairfax County Employees' Retirement System satisfies the requirements of the Code of Virginia §51.1-800.

Certification
I, Fiona Liston, am a consulting actuary for Cheiron. I am also a member of the American Academy of Actuaries and meet their Qualification Standards to render the actuarial opinion contained herein.

I hereby certify that, to the best of my knowledge, this report is complete and accurate and was prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the applicable Code of Professional Conduct, amplifying opinions, and supporting recommendations and interpretations of the Actuarial Standards Board.

Sincerely,
CHEIRON

Fiona E. Liston

Fiona E. Liston, FSA
Consulting Actuary

CHEIRON

SUMMARY OF VALUATION RESULTS

Overview

This report presents the results of the July 1, 2005 actuarial valuation of the Fairfax County Employees' Retirement System. The primary purposes of performing the annual actuarial valuation are to:

- ★ Measure and disclose, as of the valuation date, the financial condition of the Plan;
- ★ Indicate trends in the financial progress of the Plan;
- ★ Determine the contribution rate to be paid by the County for Fiscal Year 2007;
- ★ Provide specific information and documentation required by the Government Accounting Standards Board (GASB).

This section of the report presents a summary of the above information in the form of:

- ★ The actuary's comments;
- ★ The prior year's experience of the System's assets, liabilities, contributions, and membership;
- ★ A series of graphs which highlight key trends experienced by the System; and
- ★ A summary of all principal results from this year's valuation, compared to last year's, in a single table, intended for quick reference purposes.

General Comments

Fairfax County's annual contribution to this System is determined by using a Corridor Funding Method. Under this funding approach, the County's contribution rate is based on the normal cost rate plus expense rate determined as of the implementation date of the corridor method (July 1, 2001) 5.85% of payroll plus an expense rate, currently 0.15% of payroll. This rate is adjusted for benefit and assumption changes, but otherwise will remain the same as long as the System's actuarial funded ratio remains within a corridor of 90% to 120%.

The County's contribution rate will change when benefits are increased or modified or assumptions are changed. The new rate will reflect the change in normal cost rate and the change in actuarial liability amortized over 15 years. Since the inception of the Corridor Funding Method the 2002 ad hoc COLA added 0.13% to the contribution rate and the 2005 assumption changes added 1.28% to the contribution rate. The basic Corridor Funding Contribution is currently 7.41% of payroll. The normal cost rate and actuarial accrued liability will continue to be measured using the entry age funding method. If the funded status falls outside the corridor, a credit (if above 120%) or charge (if below 90%) will be established based on a 15-year amortization equal to the amount necessary to re-enter the corridor. Once the funded status is within the corridor, the contribution rate will return to the normal cost rate plus expense rate, and any remaining amortization for benefit or assumption changes.

The valuation as of July 1, 2005 shows that the actuarial funded ratio of this plan (including a credit for the amortization piece of prior benefit increases and assumption changes) has fallen out of the corridor and there is a required increase in the rate at this time of 1.75% of payroll.

The County's contribution rate for FY 2007 will increase from 8.15% to 9.16% of payroll, on the basis of this valuation's results. Due to the budgeting process, two additional changes will be recognized in the FY 2007 rate, an increase of 0.13% of payroll for the DROP Plan effective July 9, 2005, and a decrease of 0.04% of payroll to recognize the transfer of Department of Public Safety Communication members to the Uniformed Retirement System. The resulting rate will be 9.25% of payroll.

The calculated contribution rate for Governmental Accounting Standards Board (GASB) purposes is based on a rolling 15-year amortization of the actuarial unfunded liability.

Trends

The financial markets performed above expectation during the fiscal year ending in 2005, which produced an actuarial gain on the asset side of the System. The actual return on a market value basis was approximately 13.22%. On an actuarial value basis, the assets returned 10.10% compared with an assumed rate of return of 7.5%. The gain recognized for funding purposes was $52 million.

The measurement of liabilities produced a loss this year in the amount of $49 million. This loss was due to past

SUMMARY OF VALUATION RESULTS *(continued)*

service for new hires (loss of $7 million), retiree experience ($7 million), demographic experience (loss of $32 million), a base retiree COLA more than 3% ($8 million), and offset due to increases in pay lower than assumed ($5 million gain).

Finally, the assumptions used to value plan liabilities were adjusted this year to reflect the findings of the quinquennial experience study recently completed. This added an additional $82 million to the liabilities.

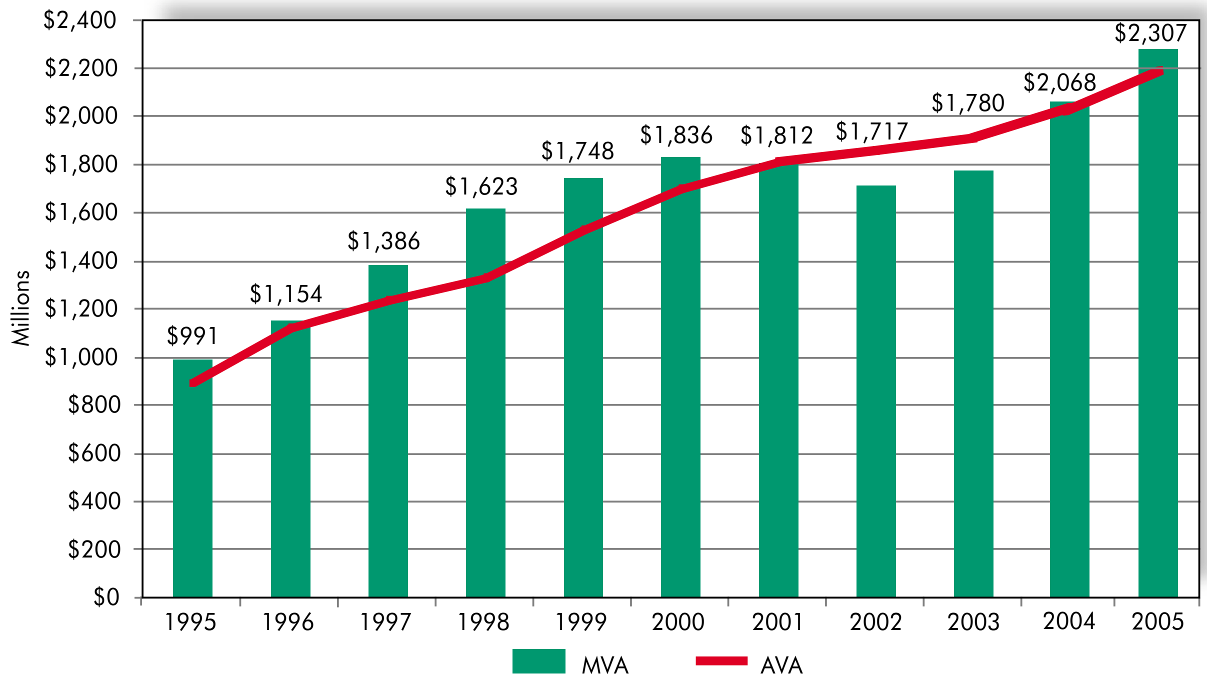
The combination of these components over the last year produced a deterioration in the System's funding ratio (actuarial value of assets over actuarial accrued liability) from 84.2% at July 1, 2004 to 82.3% at July 1, 2005. For purposes of measuring whether the System remains within the funding corridor, an adjusted funding ratio is used. In this ratio there is an additional asset recognized in the amount of the Unfunded Actuarial Liability (UAL) payments being made by the County to pay for benefit increases and assumption changes. On this basis, the System's actuarial funded ratio increased from 84.5% at July 1, 2004 to 85.6% at July 1, 2005.

It is important to take a step back from the latest results and view them in the context of the System's recent history. A series of charts follow which display key factors in the valuations over the last ten years. After the historical review we present a few projection graphs, showing the possible condition of the System over the next 15 years under various market return scenarios.

The following is a key to the abbreviations used in the actuarial graphs:

PVAB – Present value of accrued benefits	**MVA** – Market value of assets
PSL – Past service liability	**AVA** – Actuarial value of assets
PVFB – Present value of future benefits	**DROP** – Deferred Retirement Option Program

GROWTH IN ASSETS

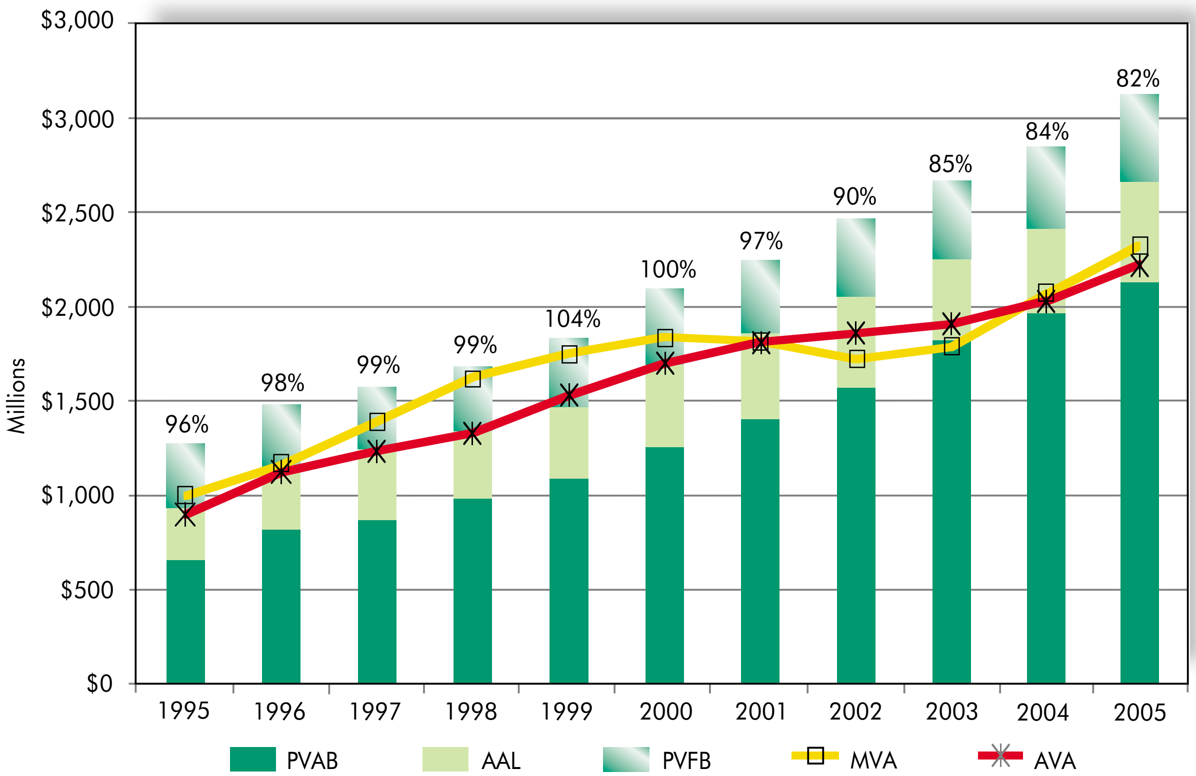


The positive growth in the market value of assets (MVA) continued with a large return of over 13%. Due to the asset smoothing method in place, the actuarial value of assets did not increase by as much as the market value, since a portion of this year's excess investment return is being held for future recognition.

Over the period July 1, 1995 to June 30, 2005 the System's assets returned approximately 9.8% per year measured at Actuarial Value, compared to a valuation assumption of 7.5% per year.

SUMMARY OF VALUATION RESULTS *(continued)*

ASSETS AND LIABILITIES

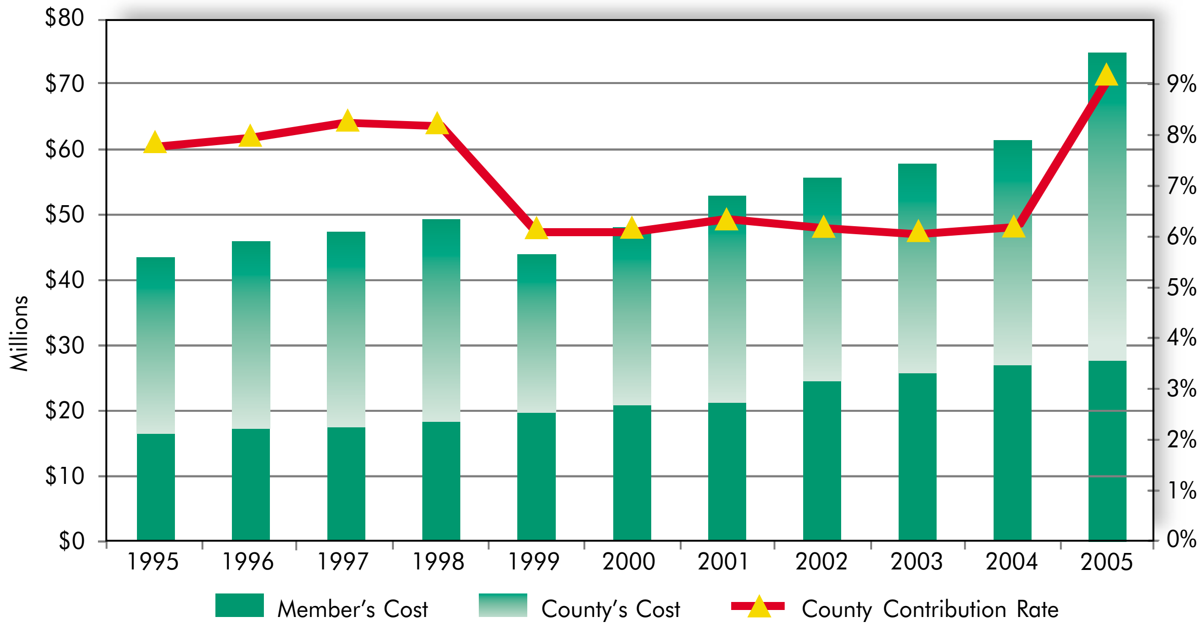


The three colored bars represent the three different measures of liability mentioned in this report. For funding purposes, the target amount is represented by the top of the light green (AAL) bar. We compare the actuarial value of assets to this measure of liability in developing the funded percent. These are the percentages shown in the graph labels.

As you can see, the System had its highest funded percentage (104%) at July 1, 1999, before a combination of benefit improvements, actuarial liability losses and the three-year market slide at the beginning of the decade. The amount represented by the top segment of the green bars, the Present Value of Future Benefits (PVFB), is the amount needed to provide all benefits for the current participants and their beneficiaries. If the System had assets equal to the PVFB no contributions would, in theory, be needed for the current members.

SUMMARY OF VALUATION RESULTS *(continued)*

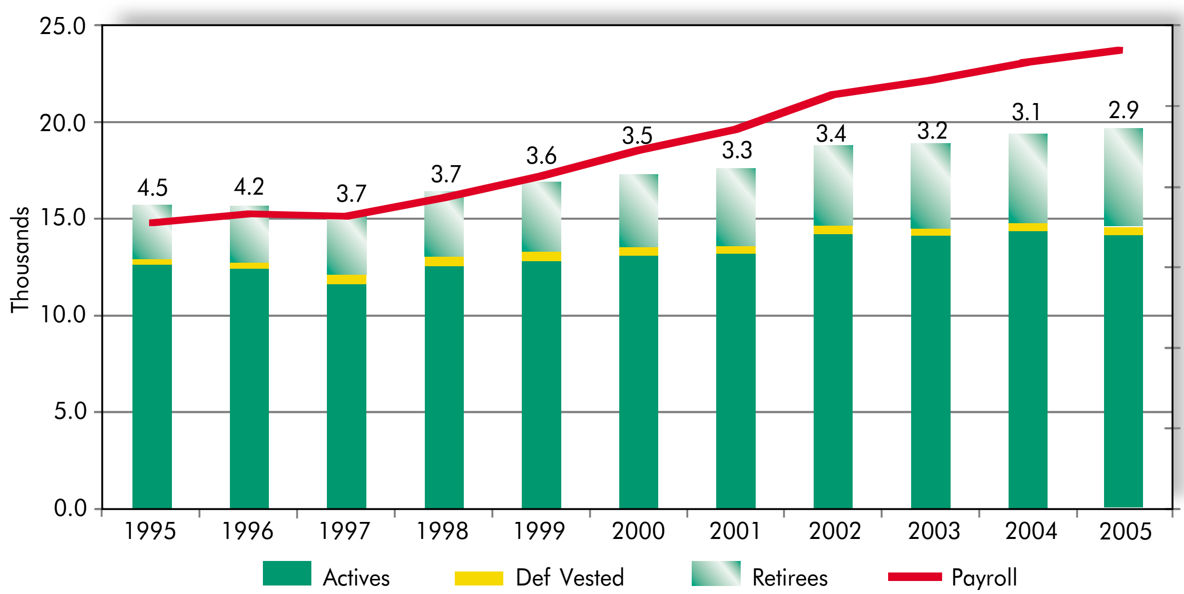
CONTRIBUTION RATES



The stacked bars in this graph show the contributions made by both the County and the members (left hand scale). The red line shows the County contribution rate as a percent of payroll (right hand scale).

The member contribution rate is set by the County Ordinance, depending on which plan the member participates in. The County contribution rate is set by the actuarial process, as constrained by the Corridor Method. Please note there is a lag in the rate shown. For example, the 2005 value is the rate prepared by the 2003 valuation and implemented for the period July 1, 2004 to June 30, 2005.

PARTICIPANT TRENDS



As with many funds in this country, there has been a steady growth in the number of retired members as the System has matured. The active-to-inactive ratio has decreased from 4.5 actives to each inactive in 1995 to 2.9 actives for each inactive today. While this would be an alarming trend in a pay-as-you-go system, the pool of invested assets has been established in anticipation of this development.

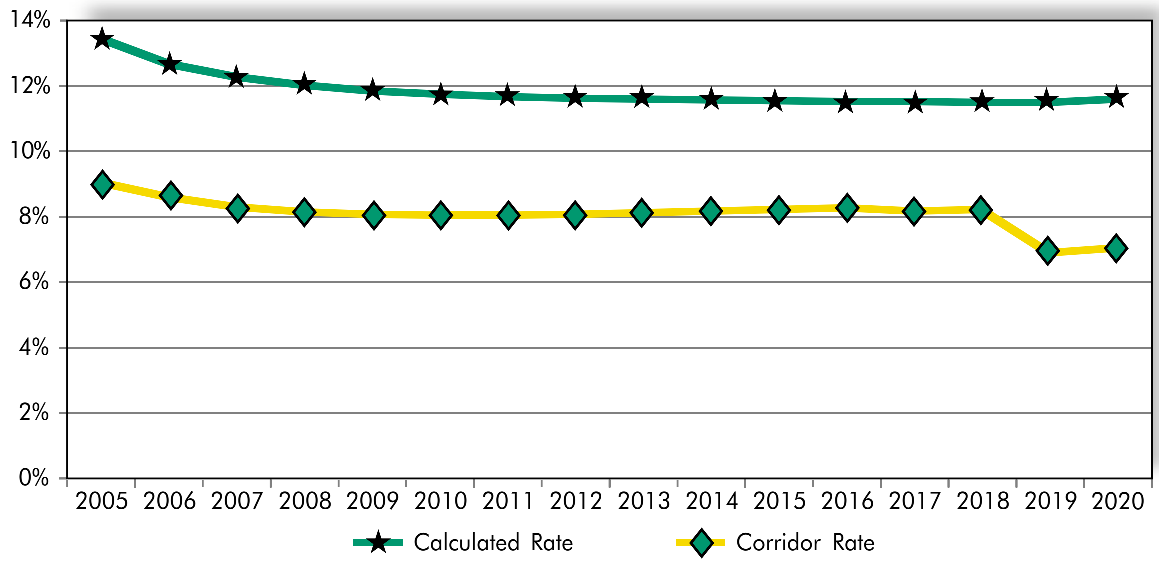
SUMMARY OF VALUATION RESULTS *(continued)*

Future Outlook

Base Line Projections

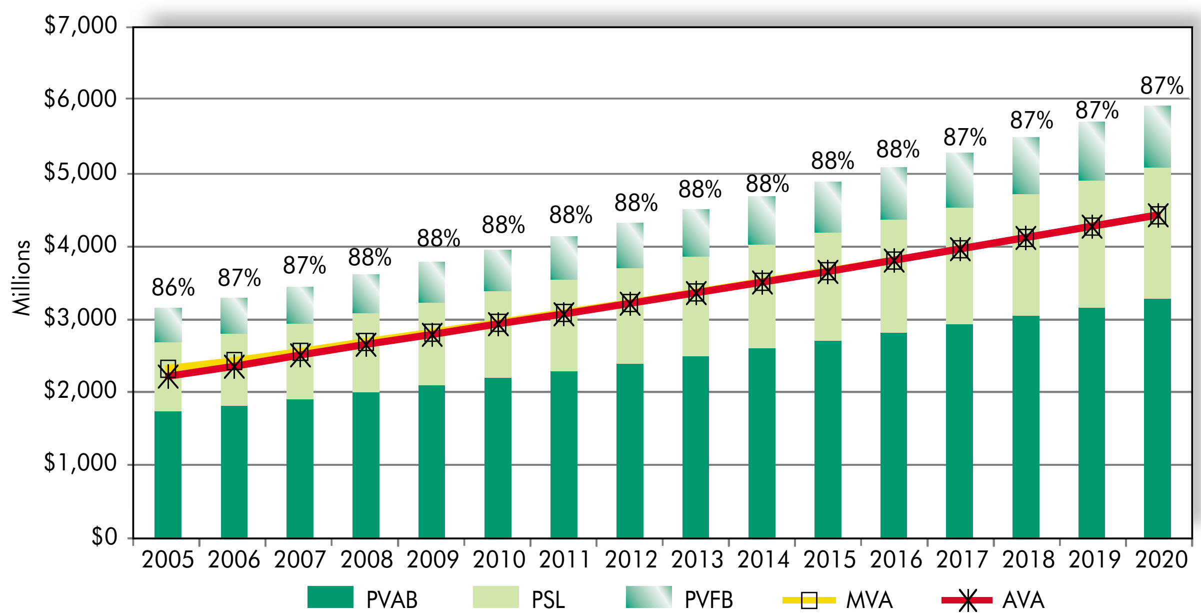
The two graphs below show the expected progress of the Plan over the next 15 years assuming the System's assets earn 7.5% on their *market value*. The chart entitled "Plan Funding" shows the System not re-entering the corridor (if all other actuarial assumptions are met as well as the 7.5% interest rate). The green line shows the actuarially calculated rate if the corridor were not in place.

PLAN FUNDING



The "Assets and Liabilities" graph shows the projected funding status over the next 15 years. Note that the 2005 funded level differs from that shown earlier, the ratio used here reflects the corridor method. Since last year's excellent market return has erased the prior losses, resulting in a market value slightly in excess of the actuarial value, the System's funded status is projected to increase slightly from the current level of 86%.

ASSETS AND LIABILITIES

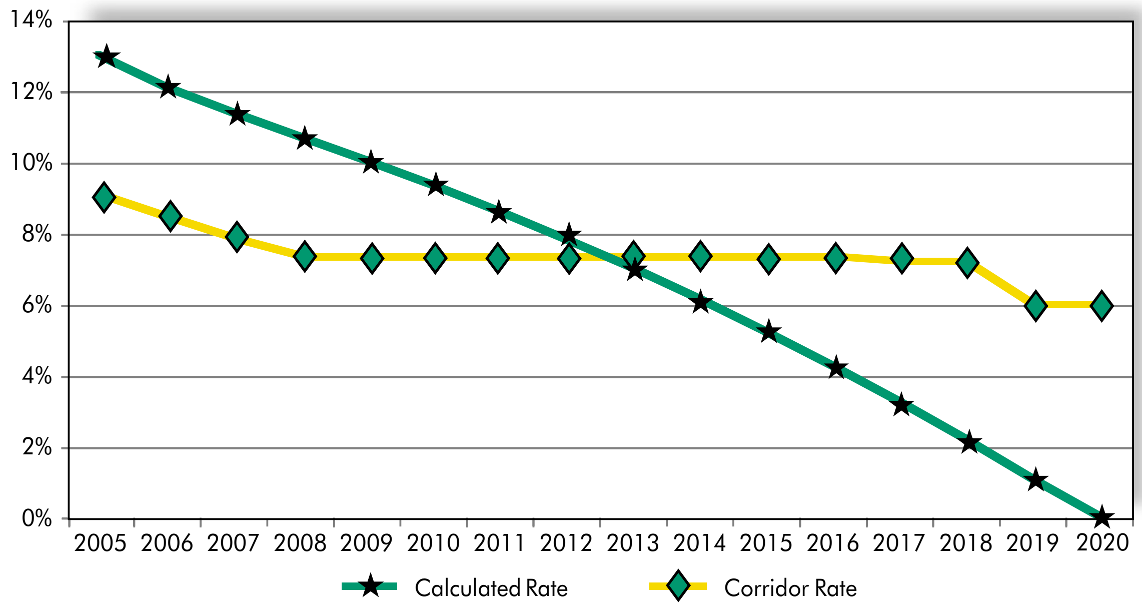


SUMMARY OF VALUATION RESULTS *(continued)*

Projections With Asset Returns of 9.0%

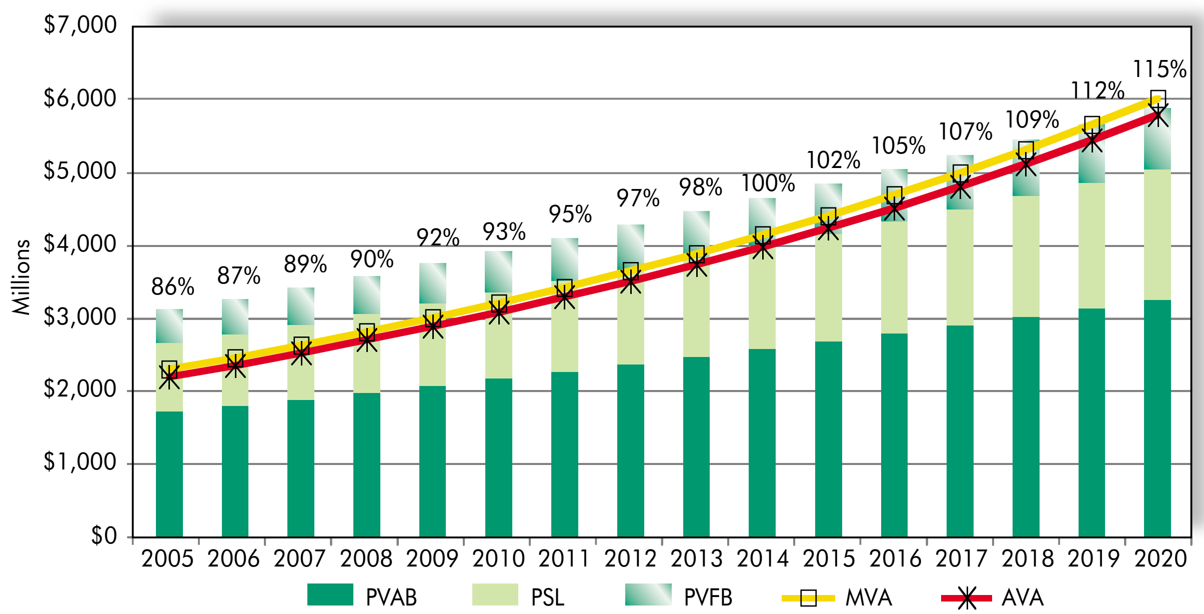
The future funding status of this System will be largely driven by the investment earnings. Due to the size of assets, as compared to liabilities, the System is in a highly leveraged position. This means that relatively minor changes in the market returns can have significant effects on the System's status. The next two charts show what the next 15 years would look like with a 9.5% annual return in each year. The System has earned an average 9.8% per year over the ten-year period ending June 30, 2005.

PLAN FUNDING



As you can see, the System would re-enter the corridor by 2008, and would be fully funded by 2014. The contribution rate slowly drops back down to reflect the level of the System's normal cost plus expenses, and the calculated (or GASB) contribution rate eventually reaches zero by the end of the period.

ASSETS AND LIABILITIES

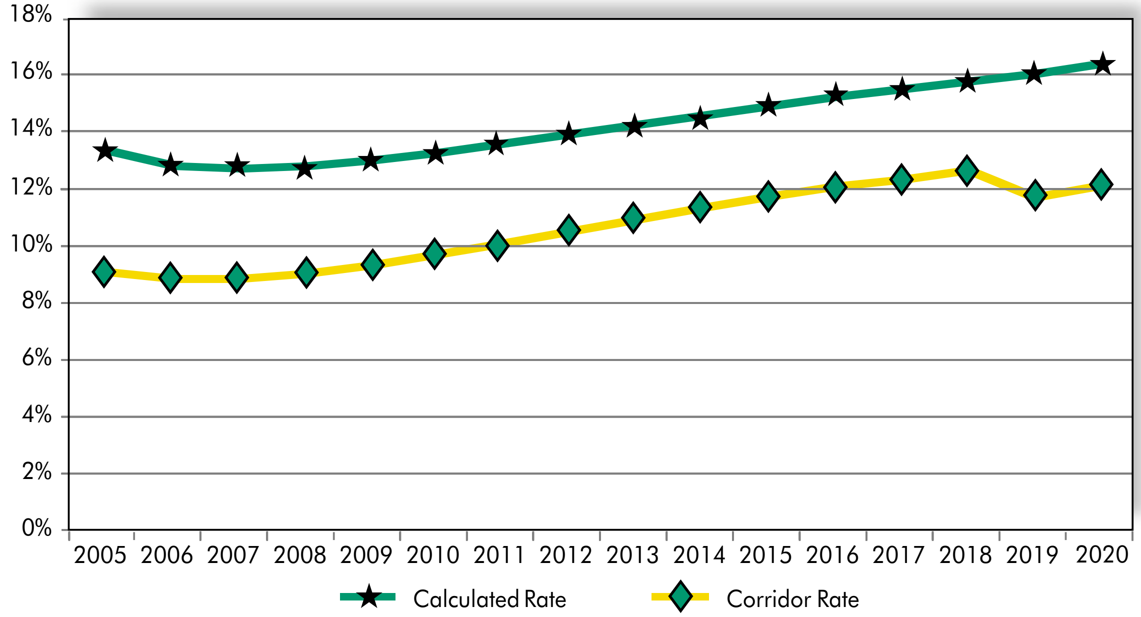


SUMMARY OF VALUATION RESULTS *(continued)*

Projections with asset returns of 6.0%

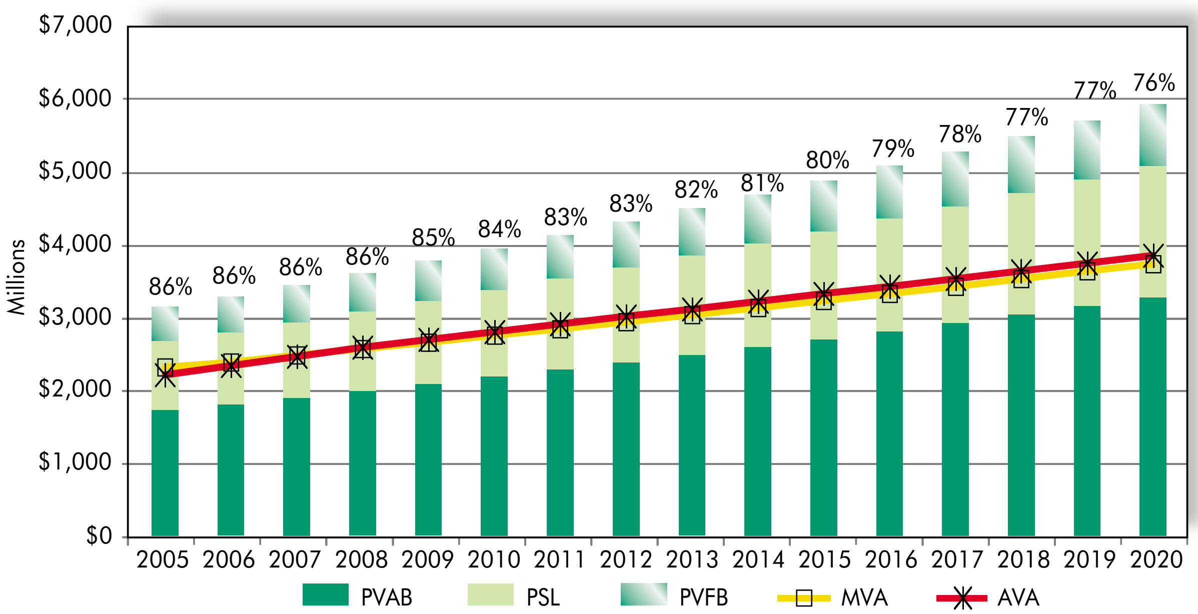
To further demonstrate how the future funding of this System will be driven by investment earnings, we show below the anticipated plan funding projections if the invested assets earn 6.0% per year over the entire 15 year period. Under this scenario, both the corridor contribution required of the County and the calculated rate used in GASB disclosures would increase.

PLAN FUNDING



The projection shows a deterioration of the System's funded status from the current 86% down to 76% by the end of the period.

ASSETS AND LIABILITIES



SUMMARY OF VALUATION RESULTS *(continued)*

FAIRFAX COUNTY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF PRINCIPAL PLAN RESULTS

This table presents the principal plan results for the valuations as of:

Participant Counts	**July 1, 2004**	**July 1, 2005**	**% Change**
Actives	14,330	14,378	0.3%
Terminated Vesteds	398	373	-6.3%
In Pay Status	4,619	4,889	5.8%
Total	19,347	19,640	1.5%
Annual Salaries of Active Members	$ 552,738,459	$ 565,062,951	2.2%
Annual Retirement Allowances for Retired Members and Beneficiaries *(Base amount only — not supplements)*	$ 78,711,773	$ 87,471,764	11.1%
Assets and Liabilities			
Total Accrued Liability	$2,411,135,460	$2,676,418,358	11.0%
Assets for Valuation Purposes	2,030,538,870	2,202,525,466	8.5%
Unfunded Actuarial Liability	$ 380,596,590	$ 473,902,892	24.5%
Funding Ratio	84.2%	82.3%	
Present Value of Accrued Benefits	$1,966,094,149	$2,136,682,785	8.7%
Market Value of Assets	2,067,515,325	2,307,321,603	11.6%
Unfunded FASB Accrued Liability *(not less than $0)*	$ 0	$ 0	
Accrued Benefit Funding Ratio	105.2%	108.0%	

Contributions as a Percentage of Payroll	**Fiscal Year 2006**	**Fiscal Year 2007**
GASB Method:		
Normal Cost Contribution	5.85%	5.90%
Unfunded Actuarial Liability Contribution	6.29%	7.08%
Administrative Expense	0.15%	0.15%
Total Contribution	12.29%	13.13%
Corridor Method:		
Normal Cost Contribution	5.85%	5.90%
Increase Due to Amortized Changes	0.13%	1.36%
Amortization of Amount Outside Corridor	2.02%	1.75%
Administrative Expense	0.15%	0.15%
Corridor Method	8.15%	9.16%

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

Funding Method

The funding method used for GASB disclosure purposes is the "aggregate accrual modification of the entry age normal cost method." Under this method, the employer contribution has three components — the normal cost, the payment toward the unfunded actuarial liability, and the expense rate.

The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The level percent developed is called the normal cost rate and the product of that rate and payroll is the normal cost.

The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and funds accumulated as of the same date is referred to as the unfunded actuarial liability.

The expense rate is added to cover the System's administrative expenses.

The County contributions are calculated using the same basic actuarial method (EAN). However, in order to produce a more level contribution rate, the System has adopted a Corridor Funding Method.

Under the Corridor Funding Method, the County's total contribution rate is equal to the normal cost rate plus rate changes due to amendments passed since June 30, 2002 plus the expense rate as long as the System's actuarial funded status remains within a corridor of 90% to 120%. If the funded status falls outside the corridor, a credit (if above 120%) or charge (if below 90%) will be established based on a 15-year amortization equal to the amount necessary to re-enter the corridor. Once the funded status is within the corridor, the contribution rate will return to normal cost rate, plus post-2002 plan changes, plus expense rate.

Actuarial Value of Assets

For purposes of determining the County contribution to the plan, we use an actuarial value of assets. The asset adjustment method dampens the volatility in asset values that could occur because of fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process.

In determining the actuarial value of assets, we calculate an expected actuarial value based on cash flow for the year and imputed returns at the actuarial assumption. This expected value is compared to the market value and one-third of the difference is added to the preliminary actuarial value to arrive at the final actuarial value.

Changes Since Last Valuation

There have been no changes since the last valuation to the Funding Method or Actuarial Value of Assets.

LONG-TERM ASSUMPTIONS USED
to Determine System Costs and Liabilities

Demographic Assumptions

MORTALITY

1994 Uninsured Pensioners Mortality Table

*Annual Deaths Per 1,000 Members**

Age	Male Deaths	Female Deaths	Age	Male Deaths	Female Deaths
20	1	0	65	16	9
25	1	0	70	26	15
30	1	0	75	40	24
35	1	1	80	67	42
40	1	1	85	105	73
45	2	1	90	164	125
50	3	2	95	251	200
55	5	2	100	341	297
60	9	5	105	441	415

**5% of deaths are assumed to be service-connected.*

Annual Deaths per 1,000 Disabled Members

Age	Male Deaths	Female Deaths
45	43	24
50	48	28
55	53	33
60	58	38
65	64	44
70	73	51
75	89	63
80	107	80

TERMINATION OF EMPLOYMENT: *(Prior to Normal Retirement Eligibility)*

Annual Termination per 1,000 Members — MALE

Years of Employment with County

Age	0-3	3-5	5 or more
20	283	174	80
25	270	150	80
30	210	122	65
35	130	103	50
40	125	89	35
45	125	74	20
50	125	59	20
55	125	50	20

Annual Termination per 1,000 Members — FEMALE

Years of Employment with County

Age	0-3	3-5	5 or more
20	333	150	150
25	320	150	150
30	260	150	150
35	180	138	100
40	175	125	50
45	168	113	50
50	160	100	50
55	153	100	50

It is assumed that members who terminated before age 45 with age plus service equal to 60 elect to receive a refund of contributions instead of vested benefits.

LONG-TERM ASSUMPTIONS USED *(continued)*

DISABILITY

*Annual Disabilities per 10,000 Members**

Age	Male	Female
25	3	2
30	3	2
35	3	3
40	6	4
45	15	12
50	28	22
55	43	34
60	53	43

** 30% of disabilities are assumed to be service-connected. Of these, 5% are assumed to receive Social Security benefits and 31% are assumed to receive Workers' Compensation benefits.*

RETIREMENT

*Annual Retirements per 1,000 Eligible Members **
(Male and Female)

Age	Early	Normal
50	0	500
51	0	450
52	25	400
53	25	350
54	25	320
55	25	290
56	25	260
57	28	230
58	31	230
59	34	230
60	40	250
61	60	200
62	80	200
63	100	200
64	125	200
65	N/A	250
66	N/A	150
67	N/A	150
68	N/A	150
69	N/A	150
70	N/A	1,000

** To further account for unused sick leave we are assuming that members can retire early on Rule of 74 (instead of Rule of 75) and normal on Rule of 79 (instead Rule of 80).*

MERIT/SENIORITY SALARY INCREASE

(in addition to across-the-board increase)

Service	Merit/Seniority Increase
0	2.50%
5	1.45%
10	1.20%
15	0.90%
20	0.40%
25	0.00%
30	0.00%

FAMILY COMPOSITION

For purposes of valuing the pre-retirement death benefit, an assumption is made that 80% of employees are married at death while active and that the female spouse is 3 years younger than the male spouse.

SICK LEAVE CREDIT

Active members are assumed to receive an additional 2% of service credit due to sick leave and an additional 1.8% for average final compensation.

LONG-TERM ASSUMPTIONS USED *(continued)*

ECONOMIC ASSUMPTIONS

Investment Return:	7.5% compounded per annum.
Rate of General Wage Increase:	4.00% compounded per annum.
Rate of Increase in Cost-of-Living:	4.00% compounded per annum. *(Benefit increases limited to 4% per year. Post-retirement cost-of-living increases are assumed to be 3% per year.)*
Total Payroll Increase (For amortization):	4.00% compounded per annum.
Administrative Expenses:	0.15% of payroll.

CHANGES SINCE LAST VALUATION

a. Termination was grouped into more service buckets, the prior assumption was:

Annual Termination per 1,000 Members — MALE

Years of Employment with County

Age	0-1	1-2	2-3	3-4	4-5	5 or more
20	150	150	150	191	174	80
25	150	150	150	165	150	80
30	150	150	150	135	122	66
35	150	150	150	114	103	53
40	150	150	150	99	89	42
45	150	150	150	86	78	37
50	150	150	150	77	69	33
55	150	150	150	69	64	29

Annual Termination per 1,000 Members — FEMALE

Years of Employment with County

Age	0-1	1-2	2-3	3-4	4-5	5 or more
20	200	200	200	158	150	132
25	200	200	200	158	150	120
30	200	200	200	158	150	102
35	200	200	200	158	150	85
40	200	200	200	158	150	70
45	200	200	200	158	150	58
50	200	200	200	158	150	50
55	200	200	200	158	150	40

It is assumed that members who terminated before age 45 with age plus service equal to 60 elect to receive a refund of contributions instead of vested benefits.

LONG-TERM ASSUMPTIONS USED *(continued)*

b. Retirement was split into whether or not the member was first eligible for retirement. We have now switched to early and normal. The prior assumption was:

Age	First Year	Thereafter
50	400	N/A
51	400	200
52	400	200
53	400	200
54	400	200
55	400	200
56	250	200
57	250	200
58	250	200
59	250	200
60	250	200
61	250	200
62	250	200
63	250	200
64	250	200
65	250	333
66	250	250
67	250	250
68	250	250
69	250	250
70	1,000	1,000

c. Merit/Seniority Salary Income (in addition to across-the-board increase) was a flat 0.5% at all ages. We have now switched to a service based table for this assumption.

d. The prior assumption for sick leave credit was that active members were assumed to receive an additional 1.5% of service credit and an additional 1.6% of average final compensation due to sick leave.

ANALYSIS OF FINANCIAL EXPERIENCE

GAIN AND LOSS IN ACCRUED LIABILITY DURING YEARS ENDED JUNE 30

Resulting from Differences Between Assumed Experience and Actual Experience

	Gain (or Loss) for Year Ending June 30			
Type of Activity	**2002**	**2003**	**2004**	**2005**
Investment Income	$ (68,576,480)	$ (61,928,161)	$18,488,228	$ 52,403,068
Combined Liability Experience	(70,933,718)	(75,750,842)	(28,137,367)	(48,719,014)
Gain (or Loss) During Year From Financial Experience	(139,510,198)	(137,679,003)	(9,649,139)	3,684,054
Non-Recurring Items	(7,877,508)	-	-	(82,052,042)
Composite Gain (or Loss) During Year	$(147,387,706)	$(137,679,003)	$ (9,649,139)	$(78,367,988)

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

	Added to Rolls		*Removed From Rolls*		*On Rolls @ Yr. End*			
Year Ended June 30	**No.**	**Annual Allowance**	**No.**	**Annual Allowance**	**No.**	**Annual Allowance**	**% Increase Allowance**	**Average Allowance**
2000	285	$7,669,426	118	$1,807,025	3,757	$58,782,760	11.08%	$15,646
2001	353	9,384,327	136	1,544,050	3,974	66,623,037	13.34%	16,765
2002	298	9,757,867	108	1,129,458	4,164	75,251,446	12.95%	18,072
2003	375	11,302,793	149	1,766,319	4,390	84,787,920	12.67%	19,314
2004	365	11,473,126	136	2,478,847	4,619	93,782,199	10.61%	20,304
2005	410	13,203,836	140	2,578,496	4,888	104,407,539	11.33%	21,356

SOLVENCY TEST

AGGREGATE ACCRUED LIABILITIES

	Aggregate Accrued Liabilities for				**Portion of Accrued Liabilities Covered by Reported Assets**		
Valuation Date	**(1) Active Member Contributions**	**(2) Retirees Vested Terms, Beneficiaries**	**(3) Active Members (Employer Financed Portion)**	**Reported Assets**	**(1)**	**(2)**	**(3)**
07/01/00	$189,751,068	$ 671,715,760	$ 829,070,935	$1,694,416,094	100%	100%	100%
07/01/01	194,412,262	731,698,653	931,691,000	1,807,813,497	100%	100%	95%
07/01/02	207,072,630	820,951,804	1,023,653,031	1,854,088,532	100%	100%	81%
07/01/03	229,276,020	945,552,585	1,076,358,791	1,903,970,061	100%	100%	68%
07/01/04	243,581,448	1,046,687,178	1,120,866,834	2,030,538,870	100%	100%	66%
07/01/05	260,335,634	1,155,976,307	1,260,106,417	2,202,515,466	100%	100%	62%

SCHEDULE OF ADDITIONS BY SOURCE

Fiscal Year	Plan Member Contributions	Employer Contributions	Employer Contributions % of covered Payroll	Net Investment Income (loss)	Total Additions
2000	$20,561,280	$27,133,595	6.04%	$101,648,889)	$149,343,764
2001	22,553,731	29,960,984	6.29%	(9,245,125)	43,269,590
2002	24,217,436	31,083,805	6.12%	(75,059,747)	(19,758,506)
2003	25,467,082	31,983,708	6.00%	89,440,289	146,891,079
2004	27,716,595	34,418,051	6.13%	319,741,487	381,876,133
2005	27,563,754	46,958,113	8.08%	271,340,627	345,862,494
2006	27,605,933	49,436,463	8.24%	204,149,213	281,191,609

SCHEDULE OF DEDUCTIONS BY TYPE

Fiscal Year	Benefit Payments	Refunds of Contributions	Administrative Expenses	Transfers	Total Deductions
2000	$ 55,452,114	$5,123,873	$ 754,136		$ 61,330,123
2001	62,431,928	4,503,567	776,563		67,712,058
2002	70,703,829	3,774,942	807,528		75,286,299
2003	79,442,355	3,425,017	845,537		83,712,909
2004	89,675,104	3,780,390	1,019,054		94,474,548
2005	98,494,430	6,545,800	1,015,986		106,056,216
2006	108,735,741	6,059,597	1,016,292	$11,750,084	127,561,714

STATISTICAL

SCHEDULE OF BENEFIT PAYMENTS BY TYPE

Fiscal Year Ended June 30	Annuity	Service-Connected Disability	Ordinary Disability	Survivor	Total
2000	$ 49,250,201	$2,430,337	$2,403,449	$1,368,127	$ 55,452,114
2001	55,890,164	2,469,474	2,503,087	1,569,203	62,431,928
2002	63,723,688	2,553,198	2,738,462	1,688,480	70,703,828
2003	71,933,909	2,634,434	2,918,607	1,955,406	79,442,356
2004	81,795,303	2,749,554	3,155,573	1,974,674	89,675,104
2005	90,329,194	2,748,877	3,257,053	2,159,306	98,494,430
2006	100,083,209	2,736,141	3,479,564	2,436,827	108,735,741

SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE

Fiscal Year Ended June 30	Annuity	Service-Connected Disability	Ordinary Disability	Survivor	Total
2000	$3,075	175	360	147	$3,757
2001	3,274	176	361	163	3,974
2002	3,459	174	366	165	4,164
2003	3,674	172	364	178	4,388
2004	3,888	168	375	188	4,619
2005	4,137	167	378	207	4,889
2006	4,365	156	378	220	5,119

SCHEDULE OF AVERAGE MONTHLY BENEFIT AMOUNTS

Fiscal Year Ended June 30	Annuity	Service-Connected Disability	Ordinary Disability	Survivor	Average
2000	$1,420	$1,173	$568	$838	$1,304
2001	1,521	1,223	593	886	1,397
2002	1,629	1,259	680	879	1,500
2003	1,750	1,326	687	886	1,610
2004	1,840	1,333	708	915	1,692
2005	1,932	1,401	740	939	1,780
2006	1,987	1,460	777	998	1,839

FAIRFAX COUNTY RETIREMENT ADMINISTRATION AGENCY

10680 MAIN STREET, SUITE 280 • FAIRFAX, VIRGINIA 22030