KPMG

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND

(An Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

June 30, 2007 and 2006

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KPMG LLP
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Independent Auditors' Report

Division of Retirement and Benefits
Group Health and Life Fund:

We have audited the accompanying statements of net assets of the State of Alaska Group Health and Life Fund, an Internal Service Fund of the State of Alaska, as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the State of Alaska Group Health and Life Fund and do not purport to and do not present fairly the financial position of the State of Alaska as of June 30, 2007 and 2006, changes in its financial position and cash flows, where applicable, for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Group Health and Life Fund, an Internal Service Fund of the State of Alaska, as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The accompanying required supplementary information of management's discussion and analysis on pages 3 to 6 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.

KPMG LLP

January 23, 2008

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2007 and 2006

This section presents management's discussion and analysis (MD&A) of the Group Health and Life Fund's (Plan) financial condition and performance for the years ended June 30, 2007 and 2006. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to the financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2007 and 2006. Information for fiscal year 2005 is presented for comparative purposes.

Financial Highlights

The Plan's total assets exceeded its total liabilities by $34,531,621 and $26,087,071 at the close of fiscal years 2007 and 2006, respectively.

The Plan's net assets as of June 30, 2007 and 2006 increased by $8,444,550 and $7,532,084 or 32.4% and 40.6% in fiscal years 2007 and 2006, respectively.

Total health premiums received totaled $70,023,372 and $66,771,432 during fiscal years 2007 and 2006; reflecting an increase of $3,251,940 and $7,433,396 or 4.9% and 12.5% from fiscal years 2006 and 2005, respectively.

Investment earnings increased from $1,025,641 in 2006 to $2,383,959 in 2007 and increased from $702,515 in 2005 to $1,025,641 in 2006; reflecting an increase of 132.4% and 46.0% in 2006 and 2005, respectively.

Benefit expense totaled $61,859,256 and $58,201,639 during fiscal years 2007 and 2006; reflecting an increase of $3,657,617 or 6.3% and an increase of $7,666,994 or 15.2% from fiscal years 2006 and 2005, respectively.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's basic financial statements are comprised of four components: (1) statement of net assets, (2) statement of additions, deductions and changes in net assets, (3) statement of cash flows, and (4) notes to financial statements.

Statement of Net Assets – This statement presents information regarding the Plan's assets, liabilities, and net assets. Net assets represent the total amount of assets less the total amount of liabilities.

Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents how the Plan's net assets changed during the fiscal year as a result of health premiums, investment income, and operating deductions.

Statement of Cash Flows – This statement presents cash flows from operations and investing activities. The Plan presents its cash flows statement using the direct method for reporting cash received and disbursed during the fiscal year.

The above statements represent resources available for investment and payment of benefits as of the fiscal year–end and the sources and uses of those funds during the fiscal year.

Notes to Financial Statements – The notes to the financial statements are an integral part of the financial statements and provide additional detailed information to better understand the Plan's financial statements.

Condensed Financial Information

Net Assets

Description		2007	2006	Increase/(decrease) Amount	Increase/(decrease) Percentage	2005
Assets:						
Cash and cash equivalents	$	47,396,359	36,244,917	11,151,442	30.8%	27,045,398
Securities lending collateral		9,438,417	7,020,235	2,418,182	34.4	224,037
Receivables		480,925	323,909	157,016	48.5	34,325
Total assets		57,315,701	43,589,061	13,726,640	31.5	27,303,760
Liabilities:						
Claims payable		12,407,841	10,364,766	2,043,075	19.7	6,733,800
Due to State of Alaska General Fund		276,043	—	276,043	100.0	—
Accrued expenses		661,779	116,989	544,790	465.7	1,790,936
Securities lending collateral payable		9,438,417	7,020,235	2,418,182	34.4	224,037
Total liabilities		22,784,080	17,501,990	5,282,090	30.2	8,748,773
Net assets	$	34,531,621	26,087,071	8,444,550	32.4%	18,554,987

Changes in Net Assets

Description		2007	2006	Increase/(decrease) Amount	Increase/(decrease) Percentage	2005
Net assets, beginning of year	$	26,087,071	18,554,987	7,532,084	40.6%	10,818,638
Operating revenues:						
Health premiums		70,023,372	66,771,432	3,251,940	4.9	59,338,036
Other revenues		1,169,559	1,311,765	(142,206)	(10.8)	1,267,623
Total operating revenues		71,192,931	68,083,197	3,109,734	4.6	60,605,659
Operating deductions:						
Benefits		61,859,256	58,201,639	3,657,617	6.3	50,534,645
Administrative		3,273,084	3,375,115	(102,031)	(3.0)	3,037,180
Total operating deductions		65,132,340	61,576,754	3,555,586	5.8	53,571,825
Operating income		6,060,591	6,506,443	(445,852)	(6.9)	7,033,834
Nonoperating revenues:						
Net investment income		2,383,959	1,025,641	1,358,318	132.4	702,515
Changes in net assets		8,444,550	7,532,084	912,466	12.1	7,736,349
Net assets, end of year	$	34,531,621	26,087,071	8,444,550	32.4%	18,554,987

Financial Analysis of the Plan

The Statement of Net Assets as of June 30, 2007 and 2006 showed total assets exceeding total liabilities by $34,531,621 and $26,087,071, respectively. These amounts represent the total plan assets held in trust for healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligations to pay healthcare benefits for its members and their beneficiaries.

These amounts also represent increases in net assets of $8,444,550 and $7,532,084, or 32.4% and 40.6% over fiscal years 2006 and 2005, respectively. Over the long term, healthcare premiums collected and investment income earned are expected to cover all claims costs. With continued increases in healthcare costs, the Plan must continue to accumulate assets to meet current and future claims costs.

Premium Calculations

The overall objective of the Plan is to have sufficient funds to meet claim costs. The premiums are recommended each year by the Division of Retirement and Benefits' (Division) benefit consultant with the governing body's concurrence and the Administrator's approval. Premiums are based on the Plan's fiscal year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to recommend premiums for the next fiscal year.

Healthcare Premiums and Investment Income

The revenues required to fund healthcare benefits are accumulated through a combination of employer health premiums, member health premiums and net investment income.

			Revenues Increase/(decrease)		
	2007	2006	Amount	Percentage	2005
Health insurance premiums	$ 70,023,372	66,771,432	3,251,940	4.9%	59,338,036
Other income	1,169,559	1,311,765	(142,206)	(10.8)	1,267,623
Net investment income	2,383,959	1,025,641	1,358,318	132.4	702,515
Total	$ 73,576,890	69,108,838	4,468,052	6.5%	61,308,174

Over the long term, health premiums collected and investment income is expected to cover all costs of the Plan.

Healthcare premiums increased from $820 per month per person in fiscal year 2006 to $835 per month per person in fiscal year 2007. Premiums were $742 in fiscal year 2005. Increases are the result of rising healthcare costs related to covered benefits. Premiums are based on historical and anticipated experience.

Other income represents prescription drug rebates, which decreased in 2007 due to a change in the coordination of benefits (COB) recommended by the Plan's prior consultant. The COB change resulted in a rebate reduction to the Plan, but had no financial impact on members of the Plan.

(Continued)

Healthcare Premiums and Investment Income (Cont.)

Net investment income increased by $1,358,318 or 132.4% from amounts recorded in fiscal year 2006 and increased by $323,126 or 46.0% from amounts recorded in fiscal year 2005. These increases are due to higher returns on investments as well as a higher invested balance. Investments earned 5.6% in fiscal year 2007, 2.9% in fiscal year 2006 and 2.8% in fiscal year 2005. The invested balance increased $11,151,442, $9,199,519 and $7,436,872 in fiscal years 2007, 2006 and 2005, respectively.

Benefits and Expenses

The primary expense of the Plan is the payment of healthcare benefits. These benefit costs and the cost of administering the Plan comprises the costs of operation.

			Expenses Increase/(decrease)		
	2007	2006	Amount	Percentage	2005
Healthcare benefits	$ 61,859,256	58,201,639	3,657,617	6.3%	50,534,645
Administrative	3,273,084	3,375,115	(102,031)	(3.0)	3,037,180
Total	$ 65,132,340	61,576,754	3,555,586	5.8%	53,571,825

Benefit expense increased $3,657,617 and increased $7,666,994 or 6.3% and 15.2% from fiscal years 2006 and 2005. The increase in fiscal year 2007 was due to increasing healthcare costs and covered members.

Increases to healthcare benefit expenses are expected in the future. The Plan's benefit consultants have identified and developed premiums necessary to cover the anticipated increased claims costs.

Economic Conditions, Market Environment, and Results

The overall objective of the Plan is to have sufficient funds to meet current and future claim costs. The premiums are calculated each fiscal year based on the anticipated claims and administrative costs for the following year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State of Alaska, Division of Retirement and Benefits, Accounting Section, P.O. Box 110203, Juneau, Alaska 99811–0203.

STATE OF ALASKA
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Statements of Net Assets

June 30, 2007 and 2006

		2007	2006
Assets:			
Cash and cash equivalents (notes 3 and 4):			
Investment in State of Alaska General Fund and other Nonsegregated Investments Pool	$	47,396,359	36,244,917
Securities lending collateral (note 4)		9,438,417	7,020,235
Due From State of Alaska General Fund		—	33,873
Premiums receivable		480,925	290,036
Total assets		57,315,701	43,589,061
Liabilities:			
Claims payable (note 5)		12,407,841	10,364,766
Due to State of Alaska General Fund		276,043	—
Accrued expenses (note 5)		661,779	116,989
Securities lending collateral payable (note 4)		9,438,417	7,020,235
Total liabilities		22,784,080	17,501,990
Unrestricted net assets	$	34,531,621	26,087,071

See accompanying notes to financial statements.

STATE OF ALASKA
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2007 and 2006

	2007	2006
Operating revenues:		
Employer health premiums	$ 57,455,431	54,572,925
Member health premiums	12,567,941	12,198,507
Other	1,169,559	1,311,765
Total operating revenues	71,192,931	68,083,197
Operating expenses:		
Benefits	61,859,256	58,201,639
Administrative	3,273,084	3,375,115
Total operating expenses	65,132,340	61,576,754
Operating income	6,060,591	6,506,443
Nonoperating revenues:		
Investment income	2,380,330	1,021,387
Net investment income before securities lending activities	2,380,330	1,021,387
Securities lending income (note4)	332,801	170,540
Less securities lending expense (note 4)	329,172	166,286
Net income from securities lending activities	3,629	4,254
Net investment income	2,383,959	1,025,641
Change in net assets	8,444,550	7,532,084
Total net assets, beginning of year	26,087,071	18,554,987
Total net assets, end of year	$ 34,531,621	26,087,071

See accompanying notes to financial statements.

STATE OF ALASKA
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Statements of Cash Flows

Years ended June 30, 2007 and 2006

		2007	2006
Operating activities:			
Cash received for premiums within the states' entity	$	69,633,819	66,358,717
Cash received from others for premiums		358,574	427,806
Cash received from third-party administrator		1,009,650	1,040,964
Cash payments to third-party administrator for benefits		(59,540,137)	(56,215,980)
Cash payments to employees		(185,829)	(68,518)
Cash payments to suppliers		(2,508,594)	(3,369,111)
Net cash provided by operating activities		8,767,483	8,173,878
Investing activities:			
Net investment income received		2,383,959	1,025,641
Net cash provided by investing activities		2,383,959	1,025,641
Net increase in cash and cash equivalents		11,151,442	9,199,519
Cash and cash equivalents, beginning of year		36,244,917	27,045,398
Cash and cash equivalents, end of year	$	47,396,359	36,244,917
Operating activities:			
Operating income	$	6,060,591	6,506,443
Adjustments to reconcile operating income to net cash provided by operating activities:			
Decrease in assets:			
Premiums receivable		(190,889)	(255,711)
Due from State of Alaska		33,873	(33,873)
Increase in liabilities:			
Claims payable		2,043,075	1,291,200
Due to State of Alaska general fund		276,043	(20,068)
Accrued expenses		544,790	685,887
Net cash provided by operating activities	$	8,767,483	8,173,878

See accompanying notes to financial statements.

(1) Description

The following brief description of the State of Alaska Group Health and Life Fund (Plan), an internal service fund of the State of Alaska (State), is provided for general information purposes only. Members should refer to the Select Benefits Information Booklet for more complete information.

General

The Plan was established on July 1, 1997 to provide self–insured healthcare benefits to eligible employees of the State of Alaska. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial reports. As of June 30, 2007 and 2006, there were approximately 5,759 and 5,649 employees, excluding dependents, covered by the Plan, respectively.

Prior to July 1, 1997, healthcare benefits for State employees were fully insured through the payment of premiums to an insurance company.

Benefits

The Plan offers medical, dental, vision and audio benefits to eligible State employees and their dependents.

Eligibility

This Plan does not provide benefits to members of the following collective bargaining units, who chose to receive health coverage through a union trust:

- Labor, Trades and Crafts Unit
- Public Safety–Airport Security Unit
- Public Safety–Troopers Unit
- Correspondence Teachers Unit
- Masters Mates and Pilots
- Mt. Edgecumbe Teachers Unit
- General Government Unit

All other permanent employees of the State are covered by the Plan, including permanent seasonal and permanent part–time employees who elect coverage.

The Plan also provides coverage for State legislators and elected officials.

Flexible Benefits

Employees who are not covered through a union trust are eligible for flexible healthcare benefits. Under this program, employees are provided benefit credits by the State. Employees can use the benefit credits to purchase the benefits they want. Benefit credits equal the amount that the State contributes towards health

(1) Description (Cont.)

benefits for all employees. The amount of benefit credits each employee receives is decided by the legislature and/or the appropriate collective bargaining agreement and can be adjusted each year. Each of the available options offers different benefits or pays benefits at different rates. If the cost of the benefit option selected by an employee exceeds the amount of their benefit credits, the difference is funded by the employee through pre–tax payroll deductions. If the cost of the benefit options selected by an employee is less than the amount of their benefit credits, the remaining benefit credits are contributed to a health care reimbursement account for that employee.

Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, Aetna, to process all medical, dental, and prescription drug claims. Some of the managed–care vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

Funding

The Plan is self–insured for all benefits. The Plan's funding policy provides for the collection of premiums from employees, if applicable, and the State. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The State retains the risk of loss of allowable claims.

Due From (To) State of Alaska General Fund

Amounts due from (to) the State of Alaska General Fund represent the net difference between amounts paid by the Plan on behalf of others and amounts paid by others on behalf of the Plan.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

Financial Statement Presentation

The Plan distinguishes operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with the Plan's principal ongoing operations. The principal operating revenues of the Plan are employer and member contributions. Operating expenses for the Plan include benefits and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and

(Continued)

(2) Summary of Significant Accounting Policies (Cont.)

liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

Investments

Investments are recorded at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade date (ownership) basis at the current fair value.

In fiscal year 2005, Governmental Accounting Standards Board (GASB) Statement 40, *Deposits and Investment Risk Disclosures* was implemented. GASB Statement No. 40 addresses disclosures on deposits and investments, focusing on common investment risks related to interest rate risk, credit risk, foreign currency risk and concentration of credit risk.

The Plan participates in the State General Fund and Other Nonsegregated Investments (GeFONSI) pool. GeFONSI invests in fixed income securities that are valued each business day using an independent pricing service. Money market funds are valued at amortized cost, which approximates fair value.

GeFONSI investment income is distributed to pool members monthly if prescribed by statute or if appropriated by state legislature.

Statement of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in the GeFONSI, which includes appreciation (depreciation) at June 30, 2007 and 2006. This investment pool has the general characteristics of a demand deposit account.

Federal Income Tax Status

The Plan is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code.

Reclassifications

Certain reclassifications not affecting changes in fiduciary net assets have been made to 2006 amounts in order to conform to the 2007 presentation.

 (Continued)

(3) Cash and Cash Equivalents

The Plan invests in the State's internally managed General Fund and other nonsegregated investments pool (GeFONSI). GeFONSI consists of investments in the State's internally managed short–term and intermediate–term fixed income pools. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division. A complete description of the investment policy for each pool is included in the *Department of Revenue, Treasury Division, Policies and Procedures Manual*.

At June 30, 2007, the Plan's share of pool investments was as follows:

	Fair value			
Investment type	**Short-term fixed income pool**	**Intermediate-term fixed income pool**	**Securities lending collateral**	**Total**
Overnight sweep account	$ 137,984	-	-	137,984
Money market	-	-	9,438,417	9,438,417
Short-term Investment Fund	897,937	2,947,120	-	3,845,057
Commercial paper	1,988,980	-	-	1,988,980
U.S. treasury notes	-	8,869,811	-	8,869,811
U.S. government agency	-	7,749,434	-	7,749,434
Mortgage-backed	1,536,670	4,043,732	-	5,580,402
Other asset-backed	11,041,508	1,086,860	-	12,128,368
Corporate bonds	5,725,031	-	-	5,725,031
Yankees:		2,622,058	-	2,622,058
Government	-	337,033	-	337,033
Corporate	1,207,598	888,641	-	2,096,239
Total Invested assets	22,535,708	28,544,689	9,438,417	60,518,814
Pool related net assets (liabilitites)	73,297	(3,755,718)	-	(3,682,421)
Net invested assets	22,609,005	24,788,971	9,438,417	56,836,393
Participant unalloted cash	1,617	-	-	1,617
Net cash and cash equivalents	22,607,388	24,788,971	9,438,417	56,834,776

(3) Cash and Cash Equivalents (Cont.)

At June 30, 2006, the Plan share of pool investments was as follows:

		Fair value			
Investment type		**Short-term fixed income pool**	**Intermediate-term fixed income pool**	**Securities lending collateral**	**Total**
Overnight sweep account	$	26,509	-	-	26,509
Money market		-	-	7,020,235	7,020,235
Short-term Investment Fund		652,795	-	-	652,795
Commercial paper		1,309,269	-	-	1,309,269
U.S. treasury notes		-	10,615,813	-	10,615,813
U.S. government agency		-	3,949,303	-	3,949,303
Mortgage-backed		1,127,067	2,342,030	-	3,469,097
Other asset-backed		7,837,229	527,978	-	8,365,207
Corporate bonds		4,054,865	3,471,977	-	7,526,842
Yankees – corporate		166,414	115,516	-	281,930
Total invested assets		15,174,148	21,022,617	7,020,235	43,217,000
Pool related net assets (liabilities)		104,817	(57,590)	-	47,227
Net invested assets		15,278,965	20,965,027	7,020,235	43,264,227
Participant unallotted cash		925	-	-	925
Net cash and cash equivalents	$	15,279,890	20,965,027	7,020,235	43,265,152

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Short–Term Fixed Income Pool

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve months prepay speeds for other securities. At June 30, 2007, the expected average life of individual fixed rate securities ranged from four days to seven months and the expected average life of floating rate securities ranged from less than one year to three years.

3) Cash and Cash Equivalents (Cont.)

Intermediate–Term Fixed Income Pools

Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its intermediate–term fixed income pool to ± 20% of the Merrill Lynch 1–5 year Government Bond Index. The effective duration for the Merrill Lynch 1–5 year Government Bond Index at June 30, 2006, was 2.28 years.

At June 30, 2007, the effective duration by investment type was as follows:

	Effective duration (In years)
U.S. treasury notes	2.41
U.S. government and agency securities	1.76
Mortgage-backed	3.10
Other asset-backed	1.56
Corporate bonds	2.73
Yankees:	
Government	4.29
Corporate	3.58
Portfolio effective duration	1.93

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100–basis point change in interest rates. The duration of a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry–standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options and other variable cash flows for purposes of the effective duration calculation.

Credit Risk

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

The Plan is subject to limited credit risk associated with securities lending transactions since the Commission is indemnified by State Street Corporation (the Bank) against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the ARMB against loss due to borrower rebates in excess of earning on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of Bank.

Treasury's investment policy has the following limitations with regard to credit risk:

(3) Cash and Cash Equivalents (Cont.)

With the exception of the sweep account, short–term fixed income pool investments are limited to instruments with a long–term credit rating of at least A3 or equivalent and instruments with a short–term credit rating of at least A1 or equivalent. For securities with long–term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset–backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

Intermediate–term fixed income pool investments are limited to securities with a long–term credit rating of at least BBB3 or equivalent and securities with a short–term credit rating of at least A1 or equivalent. For securities with long–term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is BBB3 or equivalent. Asset–backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA.

(3) Cash and Cash Equivalents (Cont.)

At June 30, 2007, the State's internally managed pools consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard and Poor's Corporation rating scale):

Investment type	Rating[1]	Short-term fixed income pool		Intermediate-term fixed income pool	
Overnight Sweep Account	Not Rated	0.61	%	—	%
Short-term Investment Account	Not Rated	3.96		0.05	
Commercial Paper	AA	1.88		—	
Commercial Paper	A	3.09		—	
Commercial Paper	Not Rated	3.86		—	
U.S. Government Agency discount notes	Not Rated	—		11.83	
U.S. Government Agency	AAA	—		31.21	
U.S. Government Agency	Not Rated	—		0.05	
Mortgage-backed	AAA	6.50		14.75	
Mortgage-backed	A	0.32		—	
Mortgage-backed (agency)	Not Rated	—		1.57	
Other asset-backed	AAA	40.98		2.46	
Other asset-backed	AA	0.91		—	
Other asset-backed	A	6.34		0.88	
Other asset-backed	BBB	—		0.29	
Other asset-backed	Not rated	0.78		0.76	
Corporate Bonds	AAA	1.97		0.93	
Corporate Bonds	AA	15.13		4.01	
Corporate Bonds	A	8.31		2.98	
Corporate Bonds	BBB	—		2.51	
Corporate Bonds	Not Rated	—		0.14	
Yankees – Government	AAA - BBB	—		1.36	
Yankees – Corporate	AAA	—		1.84	
Yankees – Corporate	AA	3.09		1.21	
Yankees – Corporate	A	1.75		0.29	
Yankees – Corporate	BBB	—		0.25	
Yankees - Corporate	Not Rated	0.52		—	
No credit exposure		—		20.63	
		100.00	%	100.00	%

[1] Rating modifiers are not disclosed.

At June 30, 2007, the securities lending collateral was invested in a registered 2(a)–7 money market fund that was not rated.

(3) Cash and Cash Equivalents (Cont.)

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than five percent of a pool's holdings in corporate bonds of any one company or affiliated group. Federal national Mortgage Association and Federal Home Loan Mortgage Corporation securities are not classified as corporate bonds. At June 30, 2007, the Plan had more than five percent of their investments in Federal Home Loan Mortgage Corporation and Federal National Mortgage Association as follows:

	Fair value	Percent of total investments
Federal Home Loan Mortgage Corporation	$ 12,013,404	21%
Federal National Mortgage Association	6,668,712	11

(4) Securities Lending

Alaska Statute 37.10.071 authorizes the Commissioner of Revenue to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Commissioner entered into an agreement with the Bank to lend securities in the Short-term and Intermediate-term fixed income pools. The Bank, acting as the Commissioner's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2007 and 2006, the fair value of securities on loan allocable to the Plan totaled $9,290,343 and $6,891,150, respectively.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. Loans are collateralized at not less than 102% of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral of $9,438,417 and $7,020,235 at June 30, 2007 and 2006, respectively, is invested in a registered 2(a)–7 money market fund. Maturities of investments in the money market fund generally do not match the maturities of the loaned securities because the lending agreements are terminable at will. Securities on loan, cash collateral and cash collateral payable are recorded in the financial statements. Collateral securities may be pledge or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the collateral securities unless the borrower defaults, they are not recorded in the financial statements. Securities under loan, cash collateral and cash collateral payable are recorded in the financial statements at fair value. The Bank, the Plan and the borrower receive a fee from earnings on invested collateral. The Bank and the Plan share a fee paid by the borrower for loans not collateralized with cash.

(4) Securities Lending (Cont.)

There is limited credit risk associated with the lending transactions since the Commissioner is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2007, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

(5) Claims Payable

The liability for claims incurred but not reported represents the estimated amounts necessary to settle all outstanding claims, incurred but not reported (IBNR), as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. Claims are reevaluated periodically to consider the effects of inflation, claims settlement trends and other economic factors. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the healthcare business.

Changes in the balances of claims liabilities during the years ended June 30 were as follows:

		2007	2006
Beginning of year:			
Due to State of Alaska General Fund for outstanding warrants	$	—	20,068
Outstanding claims included in accrued expenses		2,339,766	159,039
Incurred but not reported		8,025,000	8,200,000
Total, beginning of year		10,364,766	8,379,107
Benefit deduction		61,859,256	58,201,639
Benefits paid		(59,540,138)	(56,215,980)
Total, end of year	$	12,683,884	10,364,766
End of year:			
Due to State of Alaska General Fund for outstanding warrants	$	276,043	—
Outstanding claims included in claims payable		207,841	2,339,766
Incurred but not reported		12,200,000	8,025,000
Total, end of year	$	12,683,884	10,364,766