STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Financial Statements

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
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(A Pension Trust Fund of the State of Alaska)

June 30, 2007 and 2006

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KPMG LLP
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Independent Auditors' Report

Alaska Retirement Management Board and
Division of Retirement and Benefits
Retiree Health Fund:

We have audited the accompanying statements of fiduciary net assets of the State of Alaska Retiree Health Fund, a Pension Trust Fund of the State of Alaska, as of June 30, 2007 and 2006, and the related statements of changes in fiduciary net assets 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 Retiree Health 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 Retiree Health Fund, a Pension Trust Fund of the State of Alaska, as of June 30, 2007 and 2006, and the changes in financial position 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 8 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

This section presents management's discussion and analysis (MD&A) of the Retiree Health 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 $332,799,401 and $238,849,491 at the close of fiscal years 2007 and 2006, respectively.

The Plan's net assets as of June 30, 2007 and 2006 increased by $93,949,910 and $2,553,624 or 39.3% and 1.1% over the closing balances of those assets in fiscal years 2006 and 2005, respectively.

Total health premiums received totaled $364,107,013 and $343,437,335 during fiscal years 2007 and 2006, increases of $20,669,678 and $28,326,473 or 6.0% and 9.0% from fiscal years 2006 and 2005, respectively.

Net investment earnings increased from $12,572,055 to $36,364,601 during fiscal year 2007 and decreased from $14,142,830 to $12,572,055 during fiscal year 2006; reflecting an increase of 189.2% and a decrease of 11.1% from fiscal years 2006 and 2005, respectively.

Benefit expenses totaled $301,285,999 and $294,608,159 during fiscal years 2007 and 2006, increases of $6,677,840 and $35,174,829 or 2.3% and 13.6% 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 three components: (1) statement of fiduciary net assets, (2) statement of changes in fiduciary net assets, and (3) notes to financial statements.

Statement of Fiduciary 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 Changes in Fiduciary Net Assets – This statement presents how the Plan's net assets changed during the fiscal year as a result of contributions, investment income, benefit payments, administrative deductions, and transfers.

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 and schedules to better understand the Plan's financial statements.

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Notes to the Financial Statements

June 30, 2007 and 2006

Condensed Financial Information

Net Assets

Description	2007	2006	Increase/(decrease) Amount	Percentage	2005
Assets:					
Cash and receivables	$ 122,003,590	47,526,134	74,477,456	156.7%	62,279,511
Securities lending collateral	14,346,159	29,889,665	(15,543,506)	(52)	14,383,422
Investments, at fair value	270,081,512	248,608,714	21,472,798	8.6	222,679,571
Total assets	406,431,261	326,024,513	80,406,748	24.7	299,342,504
Liabilities:					
Claims Payable	54,983,905	55,727,785	(743,880)	1.3	37,628,287
Accrued expenses	2,803,877	326,441	2,477,436	129.03	9,393,474
Securities lending collateral payable	14,346,159	29,889,664	15,543,505	52.0	14,383,422
Other liabilities	1,497,919	1,231,132	266,787	(22)	1,641,454
Total liabilities	73,631,860	87,175,022	(13,543,162)	(16)	63,046,637
Total net assets	$ 332,799,401	238,849,491	93,949,910	39.3%	236,295,867

Changes in Net Assets

Description	2007	2006	Increase/(decrease) Amount	Percentage	2005
Net assets, beginning of year	$ 238,849,491	236,295,867	2,553,624	1.1%	173,957,575
Additions:					
Healthcare premiums and other	371,832,120	347,904,982	23,927,138	6.9	319,221,517
Net investment income	36,364,601	12,572,055	23,792,546	189.2	14,142,830
Total additions	408,196,721	360,477,037	47,719,684	13.2	333,364,347
Deductions:					
Benefits	301,285,999	294,608,159	6,677,840	2.3	259,433,330
Administrative	12,960,812	13,315,254	(354,442)	(2.7)	11,592,725
Transfer to retirement systems	—	50,000,000	(50,000,000)	(100.0)	—
Total deductions	314,246,811	357,923,413	(43,676,602)	(12.2)	271,026,055
Increase in net assets	93,949,910	2,553,624	91,396,286	3,579.1	62,338,292
Net assets, end of year	$ 332,799,401	238,849,491	93,949,910	39.3%	236,295,867

Financial Analysis of the Plan

The Statements of Fiduciary Net Assets as of June 30, 2007 and 2006 showed total assets exceeding total liabilities by $332,799,401 and $238,849,491, respectively. These amounts represent the total plan assets held in trust for postemployment healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligations to pay benefits for its members and their beneficiaries.

These amounts also represent increases in net assets of $93,949,910 and $2,553,624, or 39.3% and 1.1% over fiscal years 2006 and 2005, respectively. Over the long term, healthcare premiums collected 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.

The investment of Plan assets is a long–term undertaking. On an annual basis, the Commissioner of Revenue reviews the asset allocation policies related to Plan assets and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the Plan's constraints and objectives. In fiscal year 2007, the Department of Revenue allocated Retiree Major Medical assets in the following manner: 38% in the short–term fixed income pool, 42% in the broad market fixed income pool, 14% in the domestic equity pool and 6% in the international equity pool. In fiscal year 2006, Retiree Major Medical assets were allocated in the following manner: 26% in the short–term fixed income pool, 30% in the intermediate–term fixed income pool and 44% in the broad market fixed income pool. In fiscal year 2007, long-term care assets were allocated in the following manner: 31% in the broad market fixed income pool, 19% in the international equity pool, 49% in the domestic equity pool, and 1% in the short–term fixed income pool. In fiscal year 2006, long-term care assets were allocated in the following manner: 33% in the broad market fixed income pool, 18% in the international equity pool, 48% in the domestic equity pool and 1% in the short–term fixed income pool. In fiscal years 2007 and 2006, Dental, Visual and Audio assets were invested in the general fund and other non–segregated investments pool.

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 a calendar year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop recommended premiums for the next calendar year.

(Continued)

Healthcare Premiums and Investment Income

The additions required to fund postemployment healthcare benefits are accumulated through a combination of pension system health premiums, member health premiums, drug rebates and investment income.

Additions

	2007	2006	Increase/(decrease) Amount	Percentage	2005
Employer health premiums	$ 322,313,472	304,239,895	18,073,577	5.9%	279,110,797
Member health premiums	41,793,541	39,197,440	2,596,101	6.6	36,000,065
Other	7,725,107	4,467,647	3,257,460	72.9	4,110,655
Net investment income	36,364,601	12,572,055	23,792,546	189.2	14,142,830
Total	$ 408,196,721	360,477,037	47,719,684	13.2%	333,364,347

Premiums remain at $876 per month per person for calendar year 2006 and 2007. Premiums were $806 in 2004. Increases are the result of rising healthcare costs related to covered benefits.

Other income represents prescription drug rebates which have increased in the last two years due to greater drug utilization as well as an increasing number of Plan members.

The Plan was approved for participation in the Medicare Part D retiree drug subsidy (RDS) program starting in calendar year 2006. One of the provisions of Medicare Part D provides sponsors of pension healthcare plans the opportunity to receive a payment, the retiree drug subsidy (RDS) if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit. The RDS is equal to twenty–eight percent of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, by virtue of continuing to be covered by the sponsor's plan. The RDS for calendar year 2007 was $3,311,236.00. The data required for the RDS program is based on a calendar year; therefore, data for the six month period ended June 30, 2007, cannot be reasonably estimated and is not recorded in the financial statements for the period ended June 30, 2007.

Net investment income increased by $23,792,546 or 189.2% over amounts recorded in fiscal year 2006. Net investment income decreased by $1,570,775 or 11.1% over amounts recorded in fiscal year 2005. The Plan had more than eighty-three percent of invested assets in the broad market fixed income and domestic fixed income markets in both 2007 and 2006. The broad market fixed income pool had a return of 5.8% in fiscal year 2007 compared to -0.2% in fiscal year 2006. The non–retirement domestic equity pool had a return of 20.7% in fiscal year 2007 compared to 9.6 % in fiscal year 2006.

Benefits and Deductions

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

Deductions

			Increase/(decrease)		
	2007	**2006**	**Amount**	**Percentage**	**2005**
Healthcare benefits	$ 301,285,999	294,608,159	6,677,840	2.3%	259,433,330
Administrative deductions	12,960,812	13,315,254	(354,442)	(2.7)	11,592,725
Transfer to retirement systems	—	50,000,000	(50,000,000)	(100.0)	—
Total	$ 314,246,811	357,923,413	(43,676,602)	(12.2)%	271,026,055

Benefit expenses increased $6,677,840 and $35,174,829 or 2.3% and 13.6% from fiscal years 2006 and 2005. With healthcare costs continuing to trend higher as well as increases in the number of retirees each fiscal year, further increases to healthcare benefit payments are expected. The Plan's benefit consultants identified and developed premiums necessary to cover the increased claims costs.

During fiscal year 2006 and 2004, a review was conducted of all medical reserve amounts. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. The result was excess reserve balances over those deemed necessary for the continued operation of the Plan. The excess amount was allocated to participating plans. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive.

Based on the review completed during fiscal year 2006, the Plan transferred $50,000,000 in fiscal year 2006, to the four participating retirement systems as follows:

Public Employees' Retirement System	$ 34,635,000
Teachers' Retirement System	15,175,000
Judicial Retirement System	125,000
Elected Public Officials Retirement System	65,000

No transfer occurred in 2007.

Funding

Postemployment healthcare benefits are funded by premiums received from the respective retirement systems and plan members as well as from income earned on Plan investments. Healthcare premiums are recommended each year by the Division's consultant with the governing body's concurrence and the Administrator's approval.

(Continued)

Economic Conditions, Market Environment, and Results

There are three plans offered through the Retiree Health Fund: major medical (mostly paid by participating retirement funds), Dental–Vision–Audio (DVA) and Long–Term Care (LTC) plans (both paid by retirees). The overall objective of the Plan is to have sufficient funds to meet current and future claim costs. The premiums for the major medical and DVA plans are calculated each 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. The amount of reserves is considered when setting the premiums. The premiums for the LTC plan have been developed to provide future benefits for the retirees, much like an annuity. The LTC plan will accumulate large reserves to pay future benefits.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for all 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
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Statements of Fiduciary 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	$ 16,462,653	14,521,004
Short-term fixed income pool	99,848,528	32,263,447
Securities lending collateral	14,346,159	29,889,665
Total cash and cash equivalents	130,657,340	76,674,116
Investments (notes 3 and 4):		
Broad market fixed income pool	122,379,594	117,338,875
Domestic equity account	104,336,057	59,173,539
Intermediate-term fixed income pool	—	45,995,169
International equity pool	43,365,861	26,101,131
Total investments	270,081,512	248,608,714
Other:		
Premiums receivable	152,269	473,096
Interest and dividends receivable	412,374	197,630
Other receivables	5,127,766	70,957
Total other	5,692,409	741,683
Total assets	406,431,261	326,024,513
Liabilities:		
Claims payable (note 5):		
Medical, dental, visual and audio	45,811,905	46,790,785
Long-term Care	9,172,000	8,937,000
Total claims payable	54,983,905	55,727,785
Accrued expenses (note 5)	2,803,877	326,441
Due to State of Alaska General Fund (note 5)	1,497,919	1,231,132
Securities lending collateral payable (note 4)	14,346,159	29,889,664
Total liabilities	73,631,860	87,175,022
Contingency (note 8)		
Held in trust for postemployment healthcare benefits:		
Major medical	167,644,571	109,070,299
Dental, visual and audio	11,738,761	11,270,931
Long-term care	153,416,069	118,508,261
Total net assets held in trust for postemployment healthcare benefits	$ 332,799,401	238,849,491

See accompanying notes to basic financial statements.

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2007 and 2006

	2007	2006
Additions:		
Contributions:		
Employer health insurance premiums	$ 322,313,472	304,239,895
Member health insurance premiums	41,793,541	39,197,440
Total contributions	364,107,013	343,437,335
Other	7,725,107	4,467,647
Investment income:		
Net appreciation in fair value (note 3)	21,568,646	922,223
Interest	12,325,870	10,092,271
Dividends	2,577,900	1,665,501
Total investment income	36,472,416	12,679,995
Less investment expense	145,173	151,013
Net investment income before securities lending activities	36,327,243	12,528,982
Securities lending income (note 4)	1,016,182	1,726,690
Less securities lending expense (notes 4)	978,824	1,683,617
Net income from securities lending activities	37,358	43,073
Net investment income	36,364,601	12,572,055
Total additions	408,196,721	360,477,037
Deductions:		
Benefits	301,285,999	294,608,159
Administrative	12,960,812	13,315,254
Transfer to retirement system (note 6)	—	50,000,000
Total deductions	314,246,811	357,923,413
Net change in fiduciary net assets	93,949,910	2,553,624
Net assets, beginning of year	238,849,491	236,295,867
Net assets, end of year	$ 332,799,401	238,849,491

See accompanying notes to basic financial statements.

(1) Description

The following brief description of the State of Alaska Retiree Health Fund (Plan), a pension trust fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

General

The Plan was established to provide self–insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is a pension trust fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2007 and 2006, there were approximately 29,900 and 28,600 retirees, respectively, excluding dependents, covered by the Plan.

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

Benefits

The Plan offers major medical, voluntary dental–visual–audio (DVA) and voluntary long–term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

Medical

The Plan provides medical benefits to qualified benefit recipients of the Retirement Systems. The Retirement Systems pay the medical premiums for the benefit recipients, except for the following who must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) first hired under the PERS on or after July 1, 1986, who are under age 60, are not receiving a disability benefit, and had less than 25 years of peace officer/firefighter service or less than 30 years of other service.
- Benefit recipients of the Teachers' Retirement System (TRS) first hired under the TRS on or after July 1, 1990, who are under age 60, are not receiving a disability benefit, and had less than 25 years of service.
- Benefit recipients of the PERS first hired under the PERS on or after July 1, 1996, who are age 60 or older and do not have at least 10 years of credited service.
- Alternate payees under a Qualified Domestic Relations Order (QDRO).

The State also pays the medical premiums for benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986.

(1) Description (Cont.)

Voluntary DVA and LTC

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, Premera, to process all medical, dental, and prescription drug claims.

Funding

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

Due to State of Alaska General Fund

Due to the State of Alaska General Fund represent reimbursements to be made by the Plan to other funds for net payments made by other funds on behalf of the Plan.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the economic resource 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.

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 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

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

fair value. Dividend income on domestic and international equity securities is accrued on the ex–dividend date.

In fiscal year 2005, Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposits and Investment Risk Disclosures* (GASB 40) 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.

Fixed income and international equity securities are valued each business day using an independent pricing service. The securities underlying the domestic equity account are valued each business day by the Trustee Committee in good faith and pursuant to procedures established by the Trustee. The domestic equity account's net asset value per share is determined by dividing the fair value of its underlying assets by the number of units that represent total ownership. Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Money markets are valued at amortized cost, which approximates fair value.

The cost of securities is determined on the average cost basis.

With the exception of general fund and other non–segregated investments (GeFONSI) and short–term fixed income pool investments, income from pooled securities is allocated daily to each pool participant on a pro rata basis. Income in the short–term fixed income pool is calculated daily and credited monthly to each participant on a pro rata basis. GeFONSI income is distributed to pool participants monthly if prescribed by statute or if appropriated by state legislature. Domestic equity income is distributed quarterly.

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.

(3) Investments

The State has created a pooled environment by which it manages investments. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division, or by contracted external investment managers. The Plan invests in the State's internally managed GeFONSI, short–term, intermediate term and broad marked fixed income pools as well as the State's externally managed domestic equity account and international equity pool. A complete description of the investment policy for each pool is included in the *Department of Revenue, Treasury Division, Policies and Procedures Manual*.

(3) Investments (Cont.)

General Fund and Other Non–Segregated Investment (GeFONSI) Pool

The Plan participates in the State's internally managed GeFONSI pool which consists of investments in the State's internally managed short–term and intermediate–term fixed income pools. At June 30, 2007 and 2006, the Plan had a 0.37% and 0.51% direct ownership in the GeFONSI.

Short–Term Fixed Income Pool

The Plan participates in the State's internally managed short–term fixed income pool which was established March 15, 1993, with a start up and maintained share price of $1. Treasury staff determines the allocation between permissible securities. Each participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. Participants include the intermediate–term and broad market fixed income pools and a number of other funds, some of which are not under the fiduciary responsibility of the Commissioner. At June 30, 2007 and 2006, the Plan had a 3.7% and 1.59% direct ownership in the short–term fixed income pool.

Broad Market Fixed Income Pool

The Plan participates in the State's internally managed broad market fixed income pool which was established July 1, 1994, with a start up share price of $1,000. The share price at June 30, 2007, was $2,269. Treasury staff determines the allocation between permissible securities. When compared to the short or intermediate–term fixed income pools, this pool has a longer time horizon, a more limited need for liquidity, a moderate need for long–term inflation protection, and can be invested at a high risk level. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the Plan had a 12.07% and 13.19% direct ownership in the broad market fixed income pool.

Domestic and International Equity Account

The Plan participates in the State's externally managed domestic and international equity account. The participants in this account hold shares in the Russell 3000 and Morgan Stanley Capital Investment (MSCI) Europe Australian and Far East (EAFE), Index Common Trust Fund (Trust), a passively managed commingled index fund. The Trust includes other non–State institutional investors. The investment objective of the Trust is to replicate, as closely as possible, the return of the Russell 3000 Stock Index and the MSCI EAFE Stock Index, and thus is comprised of securities included in that index. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the common trust by the number of shares of the common trust outstanding on the valuation date. Ownership in a common trust is based on the number of shares held by each participant. Contributions to and withdrawals from a common trust are based on the beginning of the day net asset value per share on the day of the transaction.

(3) Investments (Cont.)

Intermediate–Term Fixed Income Pool

The Plan participates in the State's internally managed intermediate–term fixed income pool which was established July 1, 1994, with a start up share price of $1,000. The share price at June 30, 2007, was $1,983. Treasury staff determines the allocation between permissible securities. The pool has an intermediate time horizon, a more limited need for liquidity than the money invested in the short–term fixed income pool, a limited need for inflation protection, and can be invested at a moderate risk level. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the Plan had a 0% and 1.50% direct ownership in the intermediate–term fixed income pool.

International Equity Pool

The Plan participates in the State's externally managed international equity pool, which was established in April 2000, with a start up share price of $1,000. The share price at June 30, 2007, was $1,465. The external manager independently determines the allocation between permissible securities. The pool has a time horizon that is longer than any of the fixed income investment pools limited liquidity, long term inflation protection and a high risk tolerance. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2007 and 2006, the Plan had an 18.77% and 16.03% direct ownership in the international equity pool.

(3) Investments (Cont.)

At June 30, 2007, the Plan had the following investments:

	Fair value				
Investment type	**Short-term Fixed Income Pool**	**Intermediate-term Fixed Income Pool**	**Broad Market Fixed Income Pool**	**Other**	**Total**
Overnight Sweep Account	$ 774,741	—	—	—	774,741
Money Market	—	—	—	14,346,159	14,346,159
Short-term Investment Fund	5,041,653	1,023,775	7,243,235	—	13,308,663
Commercial Paper	11,167,541	—	110,002	—	11,277,543
U.S. Treasury Bonds	—	—	6,102,136	—	6,102,136
U.S. Treasury Notes	—	3,081,209	10,293,524	—	13,374,733
U.S. Government Agency	—	2,692,010	2,706,007	—	5,398,017
Mortgage-backed	8,627,948	1,404,718	68,088,241	—	78,120,907
Other Asset-backed	61,994,822	377,555	6,436,408	—	68,808,785
Corporate Bonds	32,144,365	910,855	23,650,047	—	56,705,267
Yankees:					
Government	—	117,079	505,513	—	622,592
Corporate	6,780,307	308,697	2,735,543	—	9,824,547
Domestic Equity	—	—	—	104,336,057	104,336,057
International Equity	—	—	—	43,875,974	43,875,974
Total Invested Assets	126,531,377	9,915,898	127,870,656	162,558,190	426,876,121
Pool related net assets (liabilities)	(516,477)	(1,304,667)	(23,806,424)	(510,113)	(26,137,681)
Other pool ownership	(18,315,362)	—	18,315,362	—	—
GeFONSI	(7,851,010)	(8,611,231)	—	16,462,241	—
Participant Unallotted Cash	—	—	—	412	412
Total	$ 99,848,528	—	122,379,594	178,510,730	400,738,852

(3) Investments (Cont.)

At June 30, 2006, the Plan had the following investments:

Investment type		Fair value			
	Short-term Fixed Income Pool	Intermediate-term Fixed Income Pool	Broad market Fixed Income Pool	Other	Total
Overnight Sweep Account	$ 94,119	—	—	—	94,119
Short-term Investment Fund	2,317,687	—	—	—	2,317,687
Money Market	—	—	—	29,889,664	29,889,664
Commercial Paper	4,648,437	—	—	—	4,648,437
U.S. Treasury Bills	—	—	—	—	—
U.S. Treasury Notes	—	26,519,876	6,251,264	—	32,771,140
U.S. Treasury Bonds	—	—	6,926,176	—	6,926,176
U.S. Government Agency discount notes	—	—	1,856,577	—	1,856,577
U.S. Government Agency	—	9,865,945	12,872,060	—	22,738,005
Mortgage-backed	4,001,544	5,850,739	54,836,341	—	64,688,624
Other Asset-backed	27,825,337	1,318,968	2,130,104	—	31,274,409
Corporate Bonds	14,396,412	8,673,512	26,816,455	—	49,886,379
Yankees:					
Government	—	—	652,693	—	652,693
Corporate	590,838	288,575	1,756,603	—	2,636,016
Domestic Equity	—	—	—	59,173,539	59,173,539
International Equity	—	—	—	26,138,185	26,138,185
Total Invested Assets	53,874,374	52,517,615	114,098,273	115,201,388	335,691,650
Pool Related Net Assets (Liabilities)	12,089	(143,868)	(10,239,988)	(37,053)	(10,408,820)
Other Pool Ownership	(15,500,873)	2,020,283	13,480,590	—	—
GeFONSI	(6,122,143)	(8,398,861)	—	14,521,004	—
Total	$ 32,263,447	45,995,169	117,338,875	129,685,339	325,282,830

Interest Rate Risk

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

(3) Investments (Cont.)

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–month prepay speeds for other securities. At June 30, 2007, the expected average life of individual fixed rate securities ranged from three days to seven months and the expected average life of floating rate securities ranged from less than one year to three years.

Intermediate–Term and Broad Market 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 other fixed income pool portfolios to the following:

> Intermediate–term fixed income pool – ± 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, 2007, was 2.24 years.
>
> Broad market fixed income pool – ± 20% of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2007, was 4.70 years.

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

	Effective duration (in years)	
	Intermediate-term fixed income pool	**Broad market fixed income pool**
U.S. treasury notes	2.41	3.92
U.S. treasury bonds	—	11.26
U.S. government and agency securities	1.76	5.79
Mortgage-backed	3.10	4.22
Other asset-backed	1.56	5.53
Corporate bonds	2.73	5.26
Yankees:		
Government	4.29	10.87
Corporate	3.58	5.84
Portfolio effective duration	1.93	4.06

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.

(3) Investments (Cont.)

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.

Treasury has no policy with regard to interest rate risk for the money market balance held in the International Equity Pool.

Credit Risk

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

There is limited credit risk associated with the lending transactions since the Commissioner of Revenue (Commissioner) is indemnified by State Street Corporation (Bank) against any loss resulting from counterparty failure or default on a loaned security or its related income distributions.

The Bank further indemnifies the Commissioner 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.

The Plan is subject to limited credit risk associated with securities lending transaction since the Commissioner 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 earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

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

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 and broad market 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) Investments (Cont.)

The Russell 3000 Index Common Trust Fund (Trust), a passively managed commingled index fund, may lend assets or transfer securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agree to return the collateral for the same securities in the future. There is credit risk associated with the lending transactions. The risk exists that an issuer or other counterparty to an investment will not fulfill its obligations and a loss results from counterparty failure or default on a loaned security.

Some funds participate in the State's externally managed Domestic and International Equity account. The participants in this account hold shares in the Russell 3000 and Morgan Stanley Capital International (MSCI) Europe Australian and Far East (EAFE), Index Common Trust Funds (Trusts), a passively managed commingled index fund. The Trust includes other, non-State institutional investors. The investment objective of the Trust is to replicate, as closely as possible, the return of the Russell 3000 Stock Index and the MSCI EAFE Stock Index, and thus is comprised of securities included in that index. The net asset value per share

Treasury has no policy with regard to credit risk for the money market balance held in the international equity pool.

(3) Investments (Cont.)

At June 30, 2007, the 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	Broad market 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-1	3.09	-	-
Commercial paper	Not Rated	3.86	-	-
U.S. government agency discount not	Not Rated	-	11.83	6.96
U.S. government agency	AAA	-	31.21	1.82
U.S. government agency	BBB	-	-	0.16
U.S. government agency	Not Rated	-	0.05	0.62
Mortgage-backed	AAA	6.50	14.75	55.14
Mortgage-backed	A	0.32	-	-
Mortgage-backed (agency)	Not Rated	-	1.57	10.39
Other asset-backed	AAA	40.98	2.46	4.73
Other asset-backed	AA	0.91	-	-
Other asset-backed	A	6.34	0.88	0.09
Other asset-backed	BBB	-	0.29	1.37
Other asset-backed	Not Rated	0.78	0.76	-
Corporate bonds	AAA	1.97	0.93	2.14
Corporate bonds	AA	15.13	4.01	4.25
Corporate bonds	A	8.31	2.98	7.47
Corporate bonds	BBB	-	2.51	7.57
Corporate bonds	Not Rated	-	0.14	1.29
Yankees – Government	AAA - BBB	-	1.36	0.49
Yankees – Corporate	AAA	-	1.84	0.26
Yankees – Corporate	AA	3.09	1.21	-
Yankees – Corporate	A	1.75	0.29	1.45
Yankees – Corporate	BBB	-	0.25	0.92
Yankees – Corporate	Not Rated	0.52	-	-
No credit exposure		-	20.63	(7.12)
		100.00 %	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) Investments (Cont.)

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. Treasury's policy with regard to custodial credit risk is to collateralize state deposits to the extent possible. At June 30, 2007, the Plan's deposits were uncollateralized and uninsured.

Foreign Currency Risk

The Commissioner formally adopts asset allocation policies for the Plan at the beginning of each fiscal year which places policy limitations on the amount of international securities the Plan is allowed to hold. The following policy was in place during fiscal year 2007 and invested assets included the following holdings at June 30, 2007, for the Plan's investment in the international equity Pool:

	Policy	Actual
Retiree Health Insurance Fund, Long-term Care	19% ± 4%	19.53%
Retiree Health Insurance Fund, Major Medical	6% ± 4%	5.58%

At June 30, 2007, the Plan had exposure to foreign currency risk as follows:

Currency		Amount
Deposits:		
Euro Currency	$	1,490
Japanese Yen		15,521
		17,011
Investments – international equity:		
Euro Currency		17,023,749
Japanese Yen		6,438,061
New Zeland Dollar		404,125
Pound Sterling		12,008,822
Singapore Dollar		766,545
Swedish Krona		635,964
Swiss Franc		3,667,404
		40,944,670
Total	$	40,961,681

(3) Investments (Cont.)

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than 5.0% of a pool's holdings in corporate bonds of any one company or affiliated group. At June 30, 2007, the Plan had more than 5.0% of their investments in Federal Home Loan Mortgage Corporation and Federal National Mortgage Association as follows:

	Fair Value	Percent of Total plan Investments
Federal National Mortgage Association	$ 41,742,592	10%

The Plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in value as follows:

	2007	2006
Broad market fixed income pool	$ 775,097	(5,558,659)
Domestic equity account	11,211,729	3,943,190
Intermediate-term fixed income pool	444,879	(1,343,655)
International equity pool	5,789,442	3,881,347
Domestic Equity Pool	3,347,499	—
	$ 21,568,646	922,223

(4) Securities Lending

Alaska Statute 37.10.071 authorizes the Commissioner 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 fixed income and equity securities. 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 $14,046,248 and $29,466,271, respectively.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. International equity security loans are collateralized at not less than 105% of their fair value. Fixed income security 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.

(4) Securities Lending (cont.)

Cash collateral of $14,346,159 is invested in a registered 2(a)–7 money market fund, which is valued at amortized cost, approximating fair value. 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 collateral of $37,223 may be pledged or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the securities collateral unless the borrower defaults, they are not recorded in the financial statements. Securities on loan, cash collateral and cash collateral payable are recorded in the financial statements. 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.

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 the loaned security or is related income distribution. The Bank further indemnifies the ARMB against loss due to borrower rebates in excess of earning on cash collateral. Indemnifications are subject to limitation related 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 or failures by any borrowers to return loaned securities.

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Notes to the Financial Statements

June 30, 2007 and 2006

(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, 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 follows:

		2007	**2006**
Beginning of year:			
Due to State of Alaska General Fund for			
Outstanding warrants	$	1,246,397	1,641,454
Outstanding claims received but not paid		12,359,785	664,063
Incurred but not reported		43,368,000	46,270,000
Total, beginning of year		56,974,182	48,575,517
Benefit deductions		301,285,999	294,608,159
Benefits paid		(301,778,357)	(286,209,494)
Total, end of year	$	56,481,824	56,974,182
End of year:			
Due to State of Alaska General Fund for			
Outstanding warrants	$	1,497,919	1,246,397
Outstanding claims received but not paid		811,905	12,359,785
Incurred but not reported		54,172,000	43,368,000
Total, end of year	$	56,481,824	56,974,182

(6) Transfer to Retirement Systems

During fiscal years 2004 and 2006, a review was conducted of all medical reserve amounts. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred, but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. The result was excess reserve balances over those deemed necessary for the continued operation of the Plan. The excess amount was allocated to participating plans. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive.

Based on this review, the Plan transferred $50,000,000 to the four participating retirement systems in fiscal year 2006. The transfers were as follows:

Public Employees' Retirement System	$	34,635,000
Teachers' Retirement System		15,175,000
Judicial Retirement System		125,000
Elected Public Officials Retirement System		65,000

No transfers have been made for 2007.

(7) Contingency

The Department of Administration determined that statutory changes were needed to ensure that the Defined Benefit Retiree Health Program is funded in compliance with the Internal Revenue Code. Consequently, during the fiscal year 2007 legislative session, a law was enacted that created the Alaska Retiree Health Care Trusts (ARHCT), two separate irrevocable trusts. Senate Bill 123 (SB 123), effective June 7, 2007, directs all separately calculated employer contributions for the retiree health benefits, and appropriations, earning and reserves for payment of retiree medical obligations, to be credited to the ARHCT. Pursuant to SB 123, Treasury and the Department of Administration established and implemented the ARHCT effective as of July 1, 2007. The ARHCT will be funded through contributions from employers and premiums paid by retirees.

The Department of Administration intends to seek a tax determination letter from the Internal Revenue Service during the filing cycle beginning on February 1, 2008, and ending on January 31, 2009, concerning the status of the pension plans it administers as qualified governmental plans under Internal Revenue Code Sections 401(a) and 414(d). The Department of Administration also intends to seek private letter rulings regarding the status of the ARHCT. Finally, The Department of Administration intends to seek rulings and/or guidance from the Internal Revenue Service with respect to the prior structure of the Defined Benefit Retiree Health Program. As a result, invested assets may need to be reallocated between net assets available for pension benefits and net assets available for retiree health benefits, which could require a transfer of assets included in the accompanying schedule of invested assets into the ARHCT. At this time, The Department of Administration is unable to predict the exact timing of the making of its intended filing with the Internal Revenue Service, the timing of any guidance that may be obtained from the Internal

(7) Contingency (Cont.)

Revenue Service, the results or impact of such guidance on the statements of invested assets and changes therein, or the amount of a transfer, if any to the ARHCT.

Approximately 50 Plan members have filed administrative challenges to the DB Plan administrator's refusal to include leave cash-in payments in the compensation used to calculate the members' retirement benefits. The members were all first hired by DB Plan employers before July 1, 1977, and claim that they have a constitutional right, based on the DB Plan statutes in effect before that date, to have leave cash-in payments included. The DB Plan's prior board, which heard appeals from decisions of the Plan administrator, had ruled on two of the appeals, and those rulings had in turn been appealed to the Alaska Superior Court. The remaining appeals have been stayed by the DB Plan's board. In addition, a class action lawsuit, raising the same issues, had been filed in the superior court, but has been put on hold until final resolution of the members' claim. On January 27, 2006, the Alaska Supreme Court decided one such member's case in the State's favor. The administrator intends to vigorously contest all of the remaining claims and believes that the State's success to date will result in dismissal of the remaining cases and pending claims. The Plan has not recorded an accrual related to any of these cases or pending claims, because an unfavorable outcome in these matters is, in management's opinion, not considered probable but rather only possible, and the potential loss, if any, cannot be reasonably estimated at this time. If an unfavorable outcome occurs, the costs would be passed through to employers through the normal contribution process.

(8) Medicare Part D Retiree Drug Subsidy

One of the provisions of Medicare Part D provides sponsors of pension healthcare plans the opportunity to receive a payment, retiree drug subsidy (RDS), if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit. The RDS is equal to twenty–eight percent of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, by virtue of continuing to be covered by the sponsor's plan. The Plan was approved for participation in the Medicare Part D program beginning calendar year 2006. The RDS for calendar year 2006 was $3,311,236 as a receivable in the financial statements for period ended June 30, 2007. The RDS for the six month period ended June 30, 2007, cannot be reasonably estimated and therefore is not recorded in the financial statements for the period ended June 30, 2007.