EMPLOYEES' RETIREMENT SYSTEM
OF THE
STATE OF HAWAII

COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

EMPLOYEES'
RETIREMENT SYSTEM
OF THE
STATE OF HAWAII

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Prepared by the Staff of the:
Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813
(808) 586-1735 • (808) 586-1650
Facsimile (808) 586-1677 • http://www4.hawaii.gov/ers/

DAVID Y. SHIMABUKURO, Administrator
WESLEY K. MACHIDA, Assistant Administrator
T. KIMO BLAISDELL, Chief Investment Officer

STATE OF HAWAII
1959
UA MAU KE EA O KA AINA I KA PONO

Table of Contents

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

INTRODUCTORY SECTION

Certificate of Acheivement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Employees Retirement System of the State of Hawaii

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

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

President

Executive Director

Letter from the Chair

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 29, 2006

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

Dear Governor Lingle:

On behalf of the board of trustees, I am pleased to present the Employees' Retirement System's (ERS) Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006. This report provides information on the financial status of the ERS and highlights significant changes from the past fiscal year.

We are pleased to report that total assets grew to $9.9 billion as of June 30, 2006 and our investment return was 11.1% for the past fiscal year. This is our third consecutive year of double digit investment earnings.

The ERS' unfunded actuarial accrued liability on June 30, 2006 was $5.1 billion and the funded ratio was 65%. The major reasons for the large unfunded liability include the past diversion of ERS' investment earnings that were used to balance the State and counties' budgets, the increased life expectancies of ERS retirees, and active member pay increases which exceeded the statutory salary increase assumption. The diversion of ERS' investment earnings prevented the ERS from establishing a reserve to weather the years of poor investment returns like the recent 2000-2002 bear market. Fortunately, your Administration and the Legislature stopped the practice of diverting funds and recently adopted a new long-term financial funding methodology that will strengthen the ERS.

During the past fiscal year, we implemented a new hybrid defined benefit contributory retirement plan which will greatly improve the retirement security of our members at no additional cost to the employers. In addition, we completed the first phase of a multi-year computer and office automation project, and sent special statements to members requesting confirmation of the retirement data in our computer systems.

This has been an exciting and challenging year for everyone with the changes underway. At this time, the Trustees and I want to thank the dedicated staff, investment managers, consultants and the many others for their commitment to continually improve the retirement program for our members.

Respectfully submitted,

Jackie Ferguson-Miyamoto

Jackie Ferguson-Miyamoto, Chair
Board of Trustees

City Financial Tower • 201 Merchant Street, Suite 1400 • Honolulu, Hawaii 96813-2980
Telephone (808) 586-1735 • Fax (808) 586-1677 • http://www4.hawaii.gov/ers

Letter of Transmittal

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 29, 2006

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

Dear Board Members:

We are pleased to submit the Comprehensive Annual Financial Report (CAFR) of the Employees' Retirement System of the State of Hawaii (ERS) for the fiscal year ended June 30, 2006. The report is a complete review of the financial, investment and actuarial conditions of the programs administered by the ERS. Responsibility for both the accuracy of the data, as well as the completeness and fairness of the presentation, rests with the management of the ERS.

STRUCTURE OF REPORT

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

This report is divided into five sections:

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

The Management's Discussion and Analysis (MD&A), located in the Financial Section of this report, provides a narrative introduction, overview, and analysis to accompany the basic financial statements. This Letter of Transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A may be found immediately following the report of the independent auditor.

City Financial Tower • 201 Merchant Street, Suite 1400 • Honolulu, Hawaii 96813-2980
Telephone (808) 586-1735 • Fax (808) 586-1677 • http://www4.hawaii.gov/ers

Letter of Transmittal (continued)

BACKGROUND

The ERS was established by the Legislature in 1925 to administer the retirement, disability and survivor benefits program for State and county employees including teachers, professors, police officers, firefighters, judiciary employees, judges, and elected officials. The ERS is a qualified defined benefit public pension plan covered under Section 401(a) of the Internal Revenue Code. Hawaii Revised Statutes Chapter 88 contains the actual language governing the pension trust. The plan covers all full-time State and county employees in the State of Hawaii. The ERS is funded on an actuarial reserve basis. Benefit funding comes from employer and member contributions, and investment earnings.

On March 31, 2006, the ERS' total membership of 103,537 was comprised of 64,069 active members, 5,164 inactive vested members, and 34,304 retirees and beneficiaries. This represents a 2% growth in the total membership over the past year. The number of retirees and beneficiaries had the largest increase while there was a modest increase in the number of active members. Participating employers include the State of Hawaii, City and County of Honolulu, and the counties of Hawaii, Maui and Kauai.

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

MAJOR ACCOMPLISHMENTS AND INITIATIVES IN 2006

Hybrid Plan - The Hybrid Plan is the biggest retirement program change in the last 22 years. A comprehensive communications campaign was conducted to help approximately 60,000 members make an informed decision as to whether they should remain in their current retirement plan or switch to the Hybrid Plan. The Hybrid Team, with the assistance of a consulting firm, conducted 183 statewide meetings; prepared personalized booklets which highlighted the major features between the Hybrid Plan and the member's individual retirement plan; developed website videos for those who couldn't attend meetings; operated a call center; and sent electronic files to update the State and county government payroll and personnel systems for the 26,948 members who joined the Hybrid Plan in July 2006. This represented about 45% of the eligible members. Although the member's retirement benefit formula will be greater than under the Noncontributory Plan, the Hybrid Plan will not increase the State and county governments' retirement costs since the enhanced benefits are being financed by member contributions.

An important issue for many Hybrid Plan members is the ability to convert their Noncontributory Plan service credits to the new Hybrid Plan. In this regard, we worked with several national public pension plan organizations and the Hawaii Congressional delegation, and were able to secure federal legislation which enables Hybrid Plan members to convert all or part of their Noncontributory service credits to the Hybrid Plan. ERS tax attorneys are reviewing the Pension Protection Act of 2006 and a recent Internal Revenue Service notice to determine how to move forward with a conversion plan including methods members can use to pay for the conversion.

Pension Management Information System –The second priority is the replacement of ERS' legacy computer systems that have been in use since the late 1980's. A computer consulting firm was hired to design and install a new computer and office automation system which will include the administration of the Contributory, Noncontributory, and new Hybrid retirement plans; imaging; workflow; accounting; etc. The new computer system will improve operational efficiencies and membership service. The accounting and Hybrid Plan pension administration were implemented in July 2006. The design and installation of all systems are expected to be completed in 2008.

Member Statement Project –The third major initiative at the ERS was the issuance of special member statements to 66,000 active and inactive vested members. Detailed statements reporting membership service credits, contribution balances (for Contributory Plan members), and other retirement information were sent to members. The statements included a correction sheet for members to identify discrepancies. The long term goal of this project is to purify (by researching and correcting service data) the membership data in our computer systems.

The actuary completed an actuarial experience study of the ERS for the five year period ending June 30, 2005. The study showed that ERS retirees were living longer than actuarially anticipated and active members' annual salary increases were exceeding the 4% statutory salary increase assumption. As the result of the study, new actuarial assumptions were adopted by the Board of Trustees in August 2006, and legislation is being submitted to implement other recommendations by the actuary.

ACHIEVEMENT AWARDS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Employees' Retirement System of the State of Hawaii for its comprehensive annual financial report for the year ended June 30, 2005. This was the 15th year the ERS has received this prestigious award. In order to be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report that satisfies both generally accepted accounting principles and applicable legal requirements.

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

ACCOUNTING SYSTEM AND REPORTS

The accrual basis of accounting is used in recording financial transactions. Expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they and earned and become measurable. Interest earned is accrued on a monthly basis. Accounts receivable at year-end, in addition to accrued interest receivable, reflect accrued employer charges and investment proceeds due on sales that have not yet settled. Investments are recorded at fair value. Fixed assets are recorded at cost less accumulated depreciation.

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

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

INVESTMENT ACTIVITIES

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

Professional investment managers have been retained to execute the Board's investment strategies and have full discretion within statutory provisions, Board policies and their respective guidelines. The investment managers retained by the Board as of June 30, 2006 are listed in the Investment Section.

Investment income, including dividends, interest, other investment earnings, and gains/losses on the sale of investments, is a significant revenue source for the ERS, and totaled $988 million for FY 2006, net of investment related expenses. This resulted in an 11.1% return on investments for the year, using time-weighted rate of return methodologies that are generally accepted by the CFA Institute.

FUNDING AND ACTUARIAL OVERVIEW

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

The actuarial accrued liability of the ERS is determined by the actuary. It is a measure of the present value of actuarial accrued liabilities estimated to be payable in the future to current retirees, beneficiaries, and employees for service earned to date. The unfunded actuarial accrued liability increased to $5.1 billion as of June 30, 2006 from $4.1 billion as of June 30, 2005. As discussed in the actuarial section, the unfunded actuarial accrued liability increase was due primarily to the longer life expectancies of ERS retirees and active members annual salary increases which exceeded the 4% statutory salary increase assumption.

The percentage computed by dividing the actuarial value of net assets available for benefits by the actuarial accrued liability is generally referred to as the "funded ratio". This ratio provides an indication of the funded status of the ERS on a going-concern basis and generally the greater the percentage, the stronger the pension trust. A higher level of funding gives the participants a greater degree of assurance that their pension benefits are secure. The funded ratio on an actuarial basis decreased to 65.0% on June 30, 2006 from 68.6% on June 30, 2005. The funded status and progress for the ERS are presented in the Required Supplementary Information Schedules of Funding Progress.

With the implementation of the percentage of payroll methodology for employer contributions funding in FY 2006, one of the main purposes of the valuation process is to determine if the current employer contribution rate is sufficient to amortize the UAAL with a specific number of years. The benchmark funding period for the UAAL that is used in accordance with GASB Statement No. 25 is 30 years. Since the aggregate funding period for the ERS as of June 30, 2006 was 35.2 years, the ERS is submitting legislation to increase the employer contribution rate.

PROFESSIONAL SERVICES

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

ACKNOWLEDGEMENTS

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

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

Respectfully yours,

David Shimabukuro

David Shimabukuro
Administrator

Board of Trustees

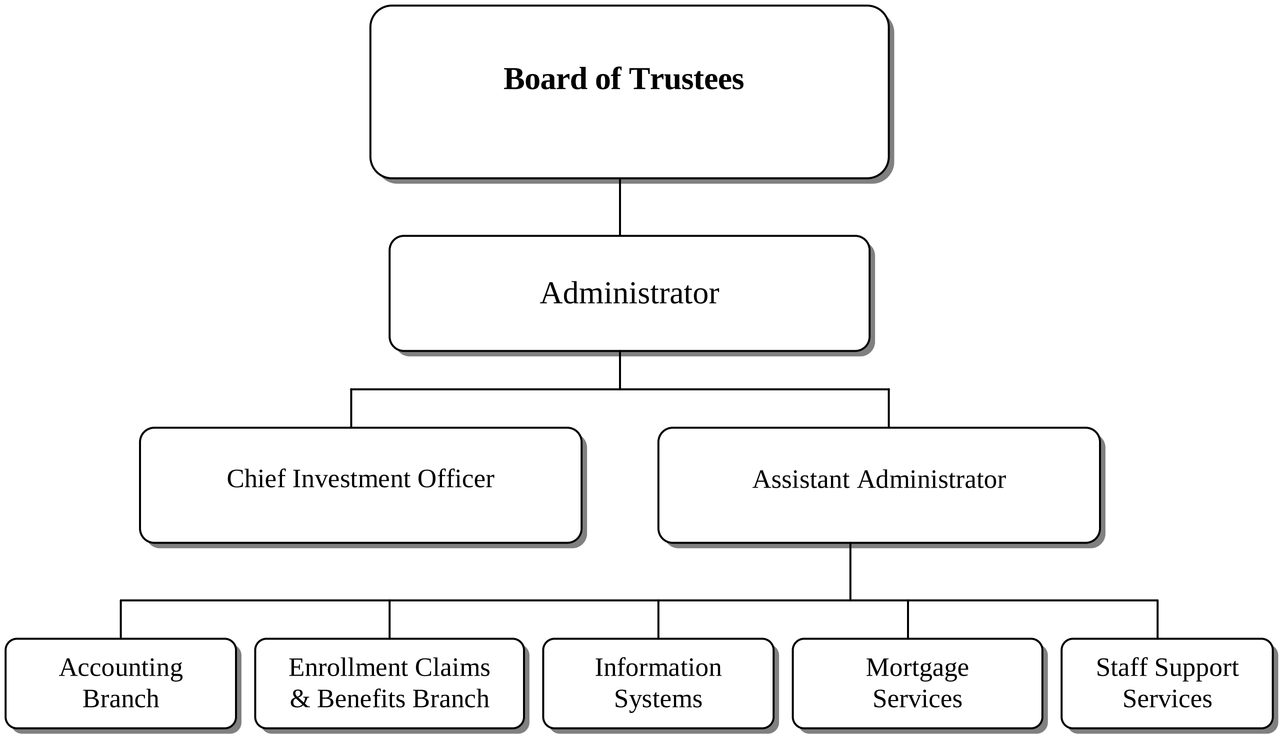
The Board of Trustees is the governing body of the Employees' Retirement System of the State of Hawaii, with certain areas of administrative control vested in the State Department of Budget and Finance.

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

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

	Date Current Term Began	**Date Term Ends**
Elected:		
Ms. Jackie Ferguson-Miyamoto, Chair	January 2, 2002	January 1, 2008
Ms. Odetta U. Fujimori	January 2, 2002	January 1, 2008
Ms. Pilialoha E. Lee Loy	January 2, 2004	January 1, 2010
Mr. Darwin J. Hamamoto	January 2, 2006	January 1, 2012
Appointed:		
Mr. Colbert M. Matsumoto	May 14, 2001	January 1, 2007
Mr. Henry F. Beerman	July 1, 2003	January 1, 2009
Mr. Alton T. Kuioka	March 31, 2005	January 1, 2011
Ex-Officio:		
Ms. Georgina K. Kawamura	December 2, 2002	

Organizational Structure



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

Actuary
Gabriel, Roeder, Smith and Company

Auditors
KPMG LLP

Legal Advisor
Attorney General of the State of Hawaii

Medical Board
Dr. Patricia L. Chinn, Chair
Dr. Howman Lam, Member
Dr. Gerald J. McKenna, Member

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

Plan Summary

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

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

As of June 30, 2006, members are covered by the provisions of the Contributory or Noncontributory retirement plan. Effective July 1, 2006, a new Hybrid Plan was implemented. Certain members of the Contributory and Noncontributory Plans were eligible to elect to transfer to the Hybrid Plan effective July 1, 2006. Almost all new employees from July 1, 2006 are required to join the Hybrid Plan, except certain positions which are required to be members of the Contributory Plan.

Those in the Contributory Plan are required to make contributions to the ERS and may also be covered by Social Security. Employees in the following occupational groups are required to be members of the Contributory Plan: police officers, firefighters, judges, elected officials, legislative officers, State and County department heads and deputies, attorney general investigators, and narcotics enforcement investigators. As of March 31, 2006, 8,592 active employees were enrolled in the Contributory Plan, or 13% of our active members.

Members of the Noncontributory Plan do not make contributions to the ERS and are covered by Social Security. The Noncontributory Plan covers most employees hired from July 1, 1984 to June 30, 2006, as well as employees hired before July 1, 1984 who elected to join the plan. As of March 31, 2006, there were 55,477 active employees in the Noncontributory Plan, which represents almost 87% of all active members on this date.

On July 1, 2006, the new Hybrid Plan became effective pursuant to Act 179/2004. Members in the Hybrid Plan will be eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the Hybrid Plan. The benefit payment options are similar to the current Contributory Plan.

Approximately, 26,228 of eligible members active on March 31, 2006 elected to transfer the Hybrid Plan effective July 1, 2006, including 261 from the Contributory Plan and 25,967 members from the Noncontributory Plan. Based on these member elections; if the Hybrid Plan were in effect on March 31, 2006 the membership counts would be 8,331 Contributory members, 29,510 Noncontributory members, and 26,228 Hybrid members, or 13%, 46% and 41% of active membership, respectively. The Hybrid Plan membership will continue to increase going forward as most new employees hired from July 1, 2006 will be required to join the Hybrid Plan.

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

Summary of Retirement Benefit Plan Provisions

	Noncontributory Plan	Contributory Plan
Employee Contributions	No employee contributions	7.8% of salary
Normal Retirement		
Eligibility	Age 62 and 10 years credited service *or* Age 55 and 30 years credited service	Age 55 and 5 years credited service
Benefit	1-1/4% of average final compensation times years of credited service (Average final compensation or AFC is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation or if ERS membership occurred prior to 1/1/71, AFC may be an average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation.)	2% of average final compensation times years of credited service (Average final compensation or AFC is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation or if ERS membership occurred prior to 1/1/71, AFC may be an average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation.)
Early Retirement		
Eligibility	Age 55 and 20 years credited service	Any age and 25 years credited service
Benefit	Maximum allowance reduced 6% per year under age 62	Maximum allowance reduced 5% per year under age 55 plus 4% per year under age 50, plus 3% per year under age 45, plus 2% per year under age 40
Deferred Retirement		
Requirements	10 years credited service	5 years credited service and contributions left in the ERS
Benefit	Accrued maximum allowance payable at age 65	Accrued maximum allowance payable at age 55
Ordinary Disability		
Eligibility	10 years credited service	10 years credited service
Benefit	Accrued maximum allowance with a minimum of 12.5% AFC, unreduced for age	1-3/4% AFC for each year of credited service with a minimum of 30% AFC unreduced for age

Summary of Retirement Benefit Plan Provisions (continued)

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

Summary of Retirement Benefit Plan Provisions (continued)

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

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

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

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

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

Post Retirement Benefit

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

Taxation of Benefits

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

Additional Benefits

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

Summary of Retirement Benefit Plan Provisions (continued)

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

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

Applying for Retirement

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

Oahu Office
City Financial Tower
201 Merchant Street, Suite 1400
Honolulu, HI 96813
Phone: (808) 586-1735
Fax: (808) 587-5766

Kauai Office
3060 Eiwa Street, Room 302
Lihue, Hawaii 96766
Phone: (808) 274-3010
Fax: (808) 241-3193

Hawaii Office
101 Aupuni Street, Suite 208
Hilo, Hawaii 96720
Phone: (808) 974-4076
Fax: (808) 974-4078

Maui Office
54 S. High Street, Room 218
Wailuku, Hawaii 96793
Phone: (808) 984-8181
Fax: (808) 984-8183

Molokai and Lanai
Toll-free to Oahu:
1-800-468-4644, ext 61735

Continental U.S. only
Toll free to Oahu
1-888-659-0708

Counseling Service

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

Retirement Options

CONTRIBUTORY PLAN

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

Option One: The member receives a reduced lifetime allowance based on age and at death, the difference between the initial insurance reserve and the retirement allowance paid prior to death is paid to the designated beneficiary(ies) or estate. In lieu of the lump-sum balance, the beneficiary may elect to receive an allowance for life based on the value of the balance; provided that the allowance is not less than $100 per month.

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

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

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

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

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

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

Retirement Options (continued)

CONTRIBUTORY PLAN (continued)

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

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

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

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

NONCONTRIBUTORY PLAN

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

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

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

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

Effective for retiree deaths on or after July 1, 2004 regardless of the Noncontributory Option selected, should death occur during the first year of retirement, the designated beneficiary may elect to receive benefits under Option B subject to certain limitations in lieu of the death benefits described above.

Legislative Highlights 2006

The following Acts were passed by the 2006 Legislature and approved by the Governor:

Act 40 – Federal Tax Compliance

- Excludes members who previously received in-service refunds of their contributions on a pre-tax basis from joining the Hybrid Plan.
- Repeals the provisions that allowed the withdrawal of member contributions due to hardship.

Act 169 – Retirement Plan Changes

- Requires the employers of members who are called to active military duty to make the member's contributions to the ERS within 60 days after the member returns to work. Otherwise, the employer will be assessed 4 ½% interest on late contributions.
- Clarifies that ordinary death benefits are payable if the member dies while on active military duty.
- Allows members who are out of the State while on active military duty on February 28, 2006 to have 30 days to make the Hybrid Plan election upon return to regular employment.
- Changes the June 30, 2006 deadline for members to claim Noncontributory Plan membership service for conversion to the Hybrid Plan to an unspecified date to be determined by the Board of Trustees.
- Allows inactive vested Contributory Plan members to withdraw their contributions at any time.
- Allows returning nonvested Contributory Plan members to withdraw their contributions within 30 days. Otherwise, members are unable to withdraw funds until they retire, terminate service or attain age 62. This amendment is needed to comply with federal tax laws.
- Allows inactive nonvested Contributory Plan members whose accumulated contributions exceed $1,000 to leave their contributions in the ERS until they reach the age of 62.
- Requires the filing of accidental and ordinary death benefit claims within three years of the member's death.
- Includes various housekeeping amendments to clarify and conform existing statutes to current practice.

Act 185 – Ordinary Disability

- Allows Contributory and Noncontributory Plan members who apply for ordinary disability retirement and continue to work, to be able to terminate service and retire at any time following the approval by the Board of Trustees.

Act 286 – Retired Teachers and Administrators

- Allows the Department of Education and Charter Schools to rehire retired teachers and administrators in shortage areas after one year in retirement while allowing them to continue to receive their retirement and medical benefits without penalty.

Act 309 – Membership Change

- Requires directors of the Offices of Council Services to be in the Contributory Plan if the member was in service prior to July 1, 2006.

Hybrid Plan Implementation

The Hybrid Plan, which went into effect on July 1, 2006, provides improved retirement security to members at no additional cost to the employers. With the assistance of a consultant, the Hybrid Plan Project Team conducted an extensive state-wide communication campaign to inform 60,000 members about the benefits and costs of enrolling in this new retirement plan. For their efforts, they received the 2006 "Team of the Year Award" for the Department of Budget and Finance.

Back Row (L-R):	Lynn Bell, Sheri Kunioka-Volz, Paula Alquiza, Carolyn Maeshiro, Rhoda Miyashiro, Lori Misaki, and Wes Machida.
Front Row (L-R):	Paul George, Colleen Shibano, Alan Nakamoto, and David Shimabukuro.

This page intentionally left blank

EMPLOYEES'
RETIREMENT SYSTEM
OF THE
STATE OF HAWAII

FINANCIAL SECTION

Independent Auditors' Report

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

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

We have audited the accompanying combining statements of plan net assets – all trust and agency funds of the Employees' Retirement System of the State of Hawaii (the ERS) as of June 30, 2006 and 2005, and the related statements of changes in plan net assets – all trust funds for the years then ended. These financial statements are the responsibility of the ERS' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the ERS as of June 30, 2006 and 2005, and its changes in plan net assets for the years then ended in conformity with U.S. generally accepted accounting principles.

Independent Auditors' Report (continued)

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

In accordance with Government Auditing Standards, we have also issued our report dated December 28, 2006, on our consideration of the ERS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 26 through 33 and the schedules of funding progress and employer contributions on pages 56 and 57 are not a required part of the basic financial statements, but are 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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the ERS taken as a whole. The supplementary information included in schedules 1 through 4 for the years ended June 30, 2006 and 2005, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory, investment, actuarial, and statistical sections have not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we express no opinion on them.

KPMG LLP

Honolulu, Hawaii
December 28, 2006

Management's Discussion and Analysis (MD&A) of the Employees' Retirement System of the State of Hawaii (the ERS) provides highlights and comparisons of the financial position and performance of ERS as of and for the years ended June 30, 2006 and 2005. The MD&A is presented as a narrative overview and analysis in conjunction with the Letter of Transmittal, which is included in the Introductory Section of the ERS Comprehensive Annual Financial Report (CAFR). For more detailed information pertaining to the ERS' financial activities, the reader should also review the actual financial statements, including the notes and supplementary schedules.

Overview of the Financial Statements

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

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

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

- The combining statements of plan net assets provide a snapshot of the financial position of the ERS at June 30, 2006 and 2005. These financial statements reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal years reported.
- The statements of changes in plan net assets summarize the ERS' financial activities that occurred during the fiscal year from July 1, 2005 to June 30, 2006 (FY 2006) and the fiscal year from July 1, 2004 to June 30, 2005 (FY 2005). The financial statements measure the changes in the resources available to pay pension benefits to members, retirees, and beneficiaries for fiscal years 2006 and 2005.
- The notes to financial statements provide additional information that is essential to a full understanding of the financial statements. The notes are an integral part of the financial statements and include detailed information that is essential to a full understanding of the data provided in the basic financial statements.
- The required supplementary information immediately following the notes to financial statements provides two schedules showing historical actuarial information concerning the funded status of the ERS and the employer contributions, along with related notes.
- The remaining supplementary information provides additional detailed information concerning the changes in operating funds established by legislation, and the operating and investment related expenses of the ERS.

Financial Highlights

- The pension plan net assets of the ERS increased by $736.5 million, or 8.0%, during fiscal year ended June 30, 2006 to $9.9 billion, from $9.2 billion as of June 30, 2005. During fiscal year ended June 30, 2005, plan net assets grew $630.5 million, or 7.4% from $8.6 billion as of June 30, 2004. The asset growth continued due to positive investment earnings and an increase in employer contributions as discussed below. Net assets increased $878.2 million, or 11.4% in the fiscal year ended June 30, 2004.

- The ERS earned an 11.1% return on the pension plan net assets in FY 2006 compared to 11.3% return in FY 2005 and 15.8% in FY 2004. The equity and real estate investments were the stronger performing asset classes during these years.

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

- Although the ERS had its third consecutive year of good investment performance, the actuarial funded ratio on June 30, 2006 decreased to 65.0%. The actuarial funded ratio as of June 30, 2005 and June 30, 2004, was 68.6% and 71.7%, respectively. The corresponding unfunded actuarial accrued liability (UAAL) of the ERS was $5.1 billion, $4.1 billion, and $3.5 billion on June 30, 2006, 2005, and 2004, respectively.

  Based on the statutory employer contribution rates effective on July 1, 2005, the remaining amortization period for the UAAL is 35.2 years as of June 30, 2006. Since this exceeds the standard of 30 years established by the Governmental Accounting Standards Board, the ERS is submitting legislation to have the statutory employer contribution rates increased.

  The June 30, 2006 actuarial valuation reflects increased fund liabilities and actuarial losses due to the ERS' retirees and beneficiaries living longer and members are retiring earlier than previously expected; salary increases that have exceeded the four percent statutorily set assumption rate; and a one-time charge related to Hybrid Plan benefits, for members that converted from the Noncontributory Plan. The actuarial losses are partially offset by actuarial gains on investments that exceeded the statutory eight-percent assumption. The decrease in the funded ratio during FY 2005 and FY 2004 was driven by the four-year smoothing methodology used by the actuary, which contains the unfavorable investment climate of the 2000 to 2002 bear market, when the investment returns were less than the 8.0% actuarial investment assumption.

- Total employee and employer contributions increased by $93.9 million, or 24.3% during FY 2006, after experiencing an increase of $95 million, or 32.7%, during the FY 2005. Most of the increases during the three years are from increase in required employer contributions rates.

  Effective July 1, 2005, employer contributions to the ERS are based on a fixed percentage of payroll methodology to provide employers with a more predictable and consistent budgetary requirements for their contributions. The employer contributions for FY 2005 and FY 2004 were based on the actuarial valuations as of June 30, 2002, and 2001.

Employee contributions remained relatively level as pay raises for active employees generally offset the decreasing number of active contributory members due to retirements. Employee contributions will increase in the future years since almost 27,000 existing members of the Noncontributory Plan elected to transfer to the new Hybrid Plan and will make contributions effective July 1, 2006. With the implementation of the Hybrid Plan, almost all new ERS members will be required to make contributions as a member of either the Hybrid Plan or Contributory Plan, based on their job class.

- Total pension plan benefit payouts increased $44.2 million or 6.5% during FY 2006 to $720.5 million, compared to an increase of $40.1 million or 6.3% during FY 2005 to $676.3 million. The increase is a result of increasing number of retirees and beneficiaries (34,304 in 2006, 33,301 in 2005 and 32,297 in 2004), an increase in the average pension benefit for new retirees, and the annual 2.5% post retirement increase.
- Administrative expenses increased by $1.2 million to $8.5 million in FY 2006 after experiencing a decrease of $3.2 million, to $7.3 million in FY 2005 from $10.5 million in FY 2004. Administrative expenses for all years were within the ERS' budgeted amounts. Most of the FY 2006 increase is related to three significant multi-year projects undertaken by the ERS in late-FY 2005 to improve the services and benefits to our members – develop a communications and election campaign for the new Hybrid Plan that became effective on July 1, 2006; preliminary costs associated with the design and implementation of a new pension management information computer system; and the member statement project. The categories experiencing larger increases were other professional services for the hiring of a vendor to assist with the Hybrid Plan communications campaign and member election process, postage for increased mailing of statements and hybrid plan informational packages, and staff overtime due to an increased workload. There was also an increase in personnel costs due to negotiated pay raises for employees, new and established positions, an increase in the accrued vacation liability, and an increase in the fringe benefit rate.

Analysis of Plan Net Assets for Pension Trust

Summary of Plan Net Assets
June 30, 2006, 2005, and 2004
(Dollars in millions)

	2006	2005	FY 2006 % change	2004	FY 2005 % change
Assets:					
Cash and short-term investments	$ 576.1	$ 531.7	8.4 %	$ 694.7	(23.5) %
Receivables	107.0	105.6	1.3	60.8	73.7
Investments	9,738.9	8,841.0	10.2	8,002.0	10.5
Invested securities lending collateral	1,131.8	607.1	86.4	637.1	(4.7)
Capital assets	7.8	3.2	143.8	1.5	113.3
Total assets	11,561.6	10,088.6	14.6	9,396.1	7.4
Liabilities:					
Securities lending liability	1,131.8	607.1	86.4	637.1	(4.7)
Investment accounts and other payables	497.4	285.6	74.2	193.6	47.5
Total liabilities	1,629.2	892.7	82.5	830.7	7.5
Plan net assets	$ 9,932.4	$ 9,195.9	8.0	$ 8,565.4	7.4

Summary of Changes in Plan Net Assets
June 30, 2006, 2005, and 2004
(Dollars in millions)

	2006	2005	FY 2006 % change	2004	FY 2005 % change
Additions:					
Contributions	$ 479.7	$ 385.8	24.3 %	$ 290.8	32.7 %
Net investments income	988.3	931.7	6.1	1,236.4	(24.6)
Total additions	1,468.0	1,317.5	11.4	1,527.2	(13.7)
Deductions:					
Retirement benefit payments	720.5	676.3	6.5	636.2	6.3
Refund of contributions	2.5	3.4	(26.5)	2.3	47.8
Administrative expenses	8.5	7.3	16.4	10.5	(30.5)
Total deductions	731.5	687.0	6.5	649.0	5.9
Increase in plan net assets	$ 736.5	$ 630.5	16.8	$ 878.2	(28.2)

Investments, Investment Income, and Investment Expense

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

The ERS pension trust assets earned 11.1% on the investment portfolio in FY 2006, following a return of 11.3% in FY 2005. International equity, alternative investments and real estate, were the stronger performing asset classes with returns of 26.5%, 24.6%, and 18.4%, respectively. The strength of the equity markets contributed to the increase in net investment income of $988.3 million in FY 2006, compared to net investment income of $931.7 million in FY 2005, and $1,236.4 million in FY 2004.

The asset distribution of the ERS' investment securities for the pension trust, excluding pending trade settlements and securities lending collateral, at June 30, 2006, 2005, and 2004 are presented below at fair market value. The actual investment mixtures will change over time based on market sectors performance and our rebalancing efforts to maintain asset allocation targets. Please refer to the Investment Section of the CAFR for a discussion on asset allocation plan targets and investments by investment strategy.

Investments in short-term securities and cash are held by external investment managers for liquidity to settle pending trades and investments, and should not exceed ten percent of the investments. Fluctuations will occur based on the trading activity and timing of the settlements. The allocation to equity securities, including index funds and alternative investments, continued to decline in accordance with the asset allocation strategy as investment earnings were used to pay pension benefits and fund real estate and fixed income managers. Based on the positive investment earnings, net investments in equities increased about $447.7 million and $326 million during FY 2006 and FY 2005, respectively.

June 30, 2006, 2005, and 2004
(Dollars in millions)

	2006	%	2005	%	2004	%
Short term investments and cash	$ 576.1	5.6 %	$ 531.7	5.7 %	$ 694.7	8.0 %
Equity securities	6,059.9	58.7	5,682.6	60.6	5,382.2	61.9
Fixed income	2,347.9	22.8	2,083.5	22.2	1,722.5	19.8
Real estate	957.1	9.3	762.2	8.1	609.2	7.0
Alternative investments	370.0	3.6	299.6	3.2	274.0	3.2
Real estate mortgages	4.0	0.0	13.0	0.1	14.1	0.2
Total	$ 10,315.0	100.0	$ 9,372.6	100.0	$ 8,696.7	100.0

The net allocation to fixed income increased in accordance with the asset allocation strategy to pay pension benefits and fund real estate and fixed income managers. The manager funding was offset by weak investment returns in the bond markets during FY 2006, with the global securities earning a 1.0% return and the domestic allocation having a slight loss of -0.1%. Fixed income holdings increased by $264.4 million or 22.8% of investments as of June 30, 2006, and as of June 30, 2005 increased over $361.0 million to about 22.2% of the investment portfolio, compared to June 30, 2004. In FY 2004, the allocation to fixed income investments decreased since the asset class was used to pay for pension benefits in accordance with ERS' asset allocation strategy.

Real estate related investments increased in FY 2006 and FY 2005 with the strong performance of the asset class, and funding of an additional investment manager after remaining relatively stable for several years.

Investment expenses consist primarily of investment management fees paid to external investment advisor firms that oversee the ERS investment portfolio. There were substantial increases in the investment expenses in FY 2006 and FY 2005 due to the incentive fees accrued for real estate manager returns that beat their benchmark returns. Incentive fees are only paid to real estate managers upon the final disposition of the asset, although the net increase/decrease in the estimated fee is accrued for financial statement presentation annually. Net changes in the incentive fees are included in liability for accounts and other payables on the combined statements of plan net assets.

ERS requires external managers to provide the ERS with a "most favored nations" contract clause that guarantees the ERS with the lowest management fees the managers offer their clients for investment accounts with similar investment mandates and similar account size. Certain investment managers may receive an incentive fee for superior investment returns while maintaining an acceptable level of investment risk.

Contributions

Contributions from employers and employees totaled $479.7 million, $385.8 million, and $290.8 million during FY 2006, FY 2005, and FY 2004, respectively. This represents an increase of $93.9 million, $95.0 million, and $43.0 million for the three years, respectively, primarily from an increase in the employer contribution requirement. The FY 2006 increase is due to a change in the funding methodology that established statutory rates for employers as a fixed percentage of covered payroll. The funding method was changed to help provide the employers with a consistent year-to-year rate for budgetary purposes and provide consistent cash flows to the ERS. Effective July 1, 2005, employers contribute 15.75% of covered payroll for police officers and firefighters and 13.75% for all other employees.

The employer contributions for FY 2005 and FY 2004 were based on the actuarial valuation dated June 30, 2002 and June 30, 2001, respectively. During these years a specified dollar amount was calculated for the employer contributions as part of the actuarial valuation process. Please refer to the Actuarial Section in the ERS 2006 and 2005 CAFR for more information.

After remaining relatively consistent for the past several years, member contributions are expected to increase in the future with the implementation of the Hybrid Plan on July 1, 2006.

Pension Plan Benefits and Expenses

Pension benefit payments continue to be the primary expense of the ERS with payments totaling $720.5 million during FY 2006, $676.3 million in FY 2005, and $636.2 million for FY 2004. Pension benefits continued to increase during the three fiscal years due to the additional number of new retirees, higher pension benefits for recent retirees; and the annual post retirement increase for our retirees.

Refunds of employee contributions are in line with the declining number of contributory plan members. Refunds to terminating members are expected to increase next year with the increase in the number of members making contributions under the Hybrid Plan.

The $1.2 million increase in administrative expenses during FY 2006 to $8.5 million reflects the ERS long-term investment to improve members' services and benefits. This compares to administrative expenses of $7.3 million during FY 2005 and $10.5 million in FY 2004. Expenses for FY 2006 include the one-time cost required to implement the first phase of the new Hybrid Plan effective July 1, 2006 – to conduct a communications campaign for over 58,000 existing members eligible to transfer to the new plan, conduct the membership election process, and to educate employers on the new retirement plan. Administrative expenses also include the impact of increased workload related to the preliminary cost to design and implement a new computer system and researching membership inquiries from a member statement project. This year's administrative expenses largest increases occurred in other professional fees to hire a vendor to assist with the Hybrid Plan communications and elections effort; postage to mail Hybrid Plan informational packages, comprehensive member statements, and trustee election ballots; overtime due to increased workload for the three multi-year projects; salary and fringe benefit rate increases. These were offset slightly by a decrease in repairs and maintenance costs.

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

Pension Plan Changes

Pension plan changes, including legislative and Board of Trustees' actions, are summarized in the Introductory Section and Actuary Report Section of the CAFR. The new "contributory" Hybrid Plan is being implemented, effective July 1, 2006 that provides benefit enhancements to the members compared to the Noncontributory Plan, and is being implemented on a cost-neutral basis to the employers.

Except for certain actuarial disclosures, the Hybrid Plan implementation on July 1, 2006 does not affect information reported in these financial statements for FY 2006 and FY 2005.

Actuarial Valuations and Funded Status

The ERS uses an actuarial reserve type of funding that is financed by member contributions, employer contributions, and earnings from invested assets. An independent actuarial valuation of the ERS actuarial assets and liabilities is performed annually. As part of this valuation, the progress toward funding pension obligations of the retirement system is measured by comparing the actuarial value of assets to actuarial accrued liability. This measurement is referred to as the funded ratio or funded status.

The actuarial funded status declined to 65.0% as of June 30, 2006, from 68.6% as of June 30, 2005 and 71.7% on June 30, 2004. The ERS' unfunded actuarial accrued liability increased to $5.1 billion on June 30, 2006, up from $4.1 billion on June 30, 2005, and $3.5 billion on June 30, 2004. The difference between the actuarial value of the assets and the market value of the assets on June 30, 2006 was $403 million as of June 30, 2006 and about $281 million as of June 30, 2005. This compares with $232 million in actuarially deferred losses as of June 30, 2004. The actuarially deferred gains as of June 30, 2006 and 2005 will be recognized by the actuary over the next three actuarial valuations.

The large increase in the UAAL, and corresponding decline in the funded ratio, during FY 2006 was primarily due to changes in the non-statutory actuarial assumptions to reflect that ERS retirees are living longer than previously estimated, and to a lesser extent that active members are retiring earlier than previously estimated. The ERS' Board of Trustees adopted the revised non-statutory actuarial assumptions proposed by the ERS actuary as part of the five-year Experience Study process, which was completed in accordance with Section 88-105 of the Hawaii Revised Statutes.

There was also an increase attributable to the reflection of the implementation of the Hybrid Plan which caused a one-time adjustment to be recognized and there was an increase due to liability experience losses resulting from gross salary increases, including negotiated pay raises, being larger than the statutory 4% assumption. While the implementation of the Hybrid Plan on July 1, 2006 resulted in a one-time liability adjustment or increase to be recognized for purposes of calculating the UAAL and funded ratio, it is important to note these calculations do not reflect the value or impact of the future employee contributions in the computation. Overall, the value of the future employee hybrid contributions offsets the one-time adjustment so that the Hybrid Plan is being implemented on a cost-neutral basis to employers. These FY 2006 losses were partially offset by an actuarial gain since the actuarial investment return exceeded the 8% statutory rate.

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

With the implementation of the percentage of payroll methodology for employer contribution funding, one of the primary purposes of the valuation report is to determine the adequacy of the current employer contribution rates is sufficient to amortize the UAAL within a specific number of years. Under the standards established by the Governmental Accounting Standards Board Statement No. 25 (GASB No. 25) that the ERS implemented in 1997, the standard for funding periods of the UAAL is 30 years.

The aggregate funding period, including the value of future employer and employee contributions, for the ERS as of June 30, 2006 was 35.2 years. This compares to 25.7 years and 22.6 years as of June 30, 2005 and June 30, 2004, respectively. Based on recommendations by the actuary, and approval of the Board of Trustees, the ERS is submitting legislation to increase the employer contribution rate that is set by state statute.

Requests for Information

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

Financial Statements (continued)

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

June 30, 2006 and 2005

	2006		
	Pension Trust	Agency	
	Employees' Retirement System	Social Security Contribution	Total
Assets			
Cash and short-term investments (notes C(2) and F)			
Cash	$ 41,820,194	$ 7,100,059	$ 48,920,253
Short-term investments	534,263,505	11,527,246	545,790,751
	576,083,699	18,627,305	594,711,004
Receivables			
Accounts receivable and others	866,446	-	866,446
Investment sales proceeds	63,817,198	-	63,817,198
Accrued investment income	34,141,528	-	34,141,528
Employer appropriations	7,697,385	-	7,697,385
Member contributions	467,666	-	467,666
	106,990,223	-	106,990,223
Investments, at fair value (notes C(2) and F)			
Equity securities	6,059,893,274	-	6,059,893,274
Fixed income securities	2,347,886,480	-	2,347,886,480
Real estate investments	957,103,640	-	957,103,640
Alternative investments	370,047,793	-	370,047,793
Real estate mortgages	4,005,372	-	4,005,372
	9,738,936,559	-	9,738,936,559
Other			
Invested securities lending collateral (note F)	1,131,774,282	-	1,131,774,282
Equipment, at cost, net of depreciation	7,789,383	-	7,789,383
	1,139,563,665	-	1,139,563,665
Total assets	11,561,574,146	18,627,305	11,580,201,451
Liabilities			
Disbursements in excess of cash balances (note F)	993,681	-	993,681
Accounts and other payables	48,944,703	-	48,944,703
Investment commitments payable	447,450,259	-	447,450,259
Payable to Internal Revenue Service	-	697,190	697,190
Due to employers	-	17,930,115	17,930,115
Securities lending collateral (note F)	1,131,774,282	-	1,131,774,282
Total liabilities	1,629,162,925	18,627,305	1,647,790,230
Commitments and contingencies (notes F, G, and H)			
Net assets held in trust for pension benefits (note D) (a schedule of funding progress is presented on page 56)	$ 9,932,411,221	$ -	$ 9,932,411,221

See accompanying notes to financial statements

Financial Statements

2005		
Pension Trust	Agency	
Employees' Retirement System	Social Security Contribution	Total
$ 19,178,328	$ 1,082,875	$ 20,261,203
512,510,416	5,558,867	518,069,283
531,688,744	6,641,742	538,330,486
592,522	-	592,522
74,899,497	-	74,899,497
29,593,513	-	29,593,513
-	6,108,225	6,108,225
493,167	-	493,167
105,578,699	6,108,225	111,686,924
5,682,674,719	-	5,682,674,719
2,083,543,825	-	2,083,543,825
762,233,064	-	762,233,064
299,573,729	-	299,573,729
12,989,435	-	12,989,435
8,841,014,772	-	8,841,014,772
607,087,118	-	607,087,118
3,205,207	-	3,205,207
610,292,325	-	610,292,325
10,088,574,540	12,749,967	10,101,324,507
1,751,105	-	1,751,105
25,425,475	-	25,425,475
258,442,902	-	258,442,902
-	6,910,793	6,910,793
-	5,839,174	5,839,174
607,087,118	-	607,087,118
892,706,600	12,749,967	905,456,567
$ 9,195,867,940	$ -	$ 9,195,867,940

Financial Statements (continued)

Statements of Changes in Plan Net Assets – All Trust Funds

Years ended June 30, 2006 and 2005

	2006	2005
Additions		
Appropriations and contributions (notes A(4) and E)		
Employers	$ 423,445,597	$ 328,716,718
Members	56,257,953	57,054,621
Total contributions	479,703,550	385,771,339
Investment income (note F)		
From investing activities		
Net appreciation in fair value of investments	733,211,743	716,329,575
Interest on fixed income securities	102,065,483	88,214,234
Income on real estate investments	52,724,157	42,342,885
Dividends on equity securities	73,197,504	68,500,487
Interest on short-term investments	21,966,701	6,018,488
Alternative investment income	45,851,453	33,763,274
Interest and fees on real estate mortgages, net	863,762	747,985
Miscellaneous	1,954,028	3,001,093
	1,031,834,831	958,918,021
Less investment expenses	46,253,674	28,303,374
Net investment income from investing activities	985,581,157	930,614,647
From securities lending activities		
Securities lending income	38,563,326	11,959,363
Securities lending expenses		
Borrower rebates	35,105,016	10,589,988
Management fees	691,630	273,839
Less securities lending activities expense	35,796,646	10,863,827
Net investment income from securities lending activities	2,766,680	1,095,536
Total net investment income	988,347,837	931,710,183
Total additions	1,468,051,387	1,317,481,522
Deductions		
Benefit payments (note A(3))	720,542,990	676,316,347
Refunds of member contributions	2,487,279	3,442,466
Administrative expenses	8,477,837	7,259,906
Total deductions	731,508,106	687,018,719
Net increase in net assets	736,543,281	630,462,803
Net assets held in trust for pension benefits (note D)		
Beginning of year	9,195,867,940	8,565,405,137
End of year	$ 9,932,411,221	$ 9,195,867,940

See accompanying notes to financial statements.

Notes to Financial Statements

June 30, 2006 and 2005

Note A – Description of the ERS

1. General

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

Employer, pensioner, and employee membership data as of March 31, 2006 and 2005:

	2006	2005
Employers:		
State	1	1
County	4	4
Total employers	5	5
Pensioners and beneficiaries currently receiving benefits:		
Pensioners currently receiving benefits:		
Police and firefighters	2,782	2,700
All other employees	29,417	28,644
Total pensioners	32,199	31,344
Beneficiaries currently receiving benefits:		
Police and firefighters	153	144
All other employees	1,952	1,813
Total beneficiaries	2,105	1,957
Total pensioners and beneficiaries	34,304	33,301
Terminated vested members entitled to benefits but not yet receiving benefits:		
Police and firefighters	165	176
All other employees	4,999	4,762
Total terminated vested members	5,164	4,938
Current employees:		
Vested:		
Police and firefighters	3,878	3,766
All other employees	31,957	32,209
Nonvested:		
Police and firefighters	932	920
All other employees	27,302	26,178
Total current employees	64,069	63,073

Note A – Description of the ERS (continued)

2. The Financial Reporting Entity

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

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

3. Benefits

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

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

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

Note A – Description of the ERS (continued)

3. Benefits (continued)

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

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

4. The ERS as Employer

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

The required pension contributions by the ERS for the years ended June 30, 2006, 2005, and 2004, were $513,880, $359,320, and $293,331, respectively, which represented 13.8%, 10.8%, and 9.1%, of covered payroll and were equal to the required contributions for each year.

Note B – Social Security Contribution Fund

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

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

2. To receive any appropriations to the Contribution Fund;

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

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

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

Note C – Summary of Accounting Policies

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

1. Basis of Accounting

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

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

2. Investments

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

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

Notes to Financial Statements (continued)

Note C – Summary of Accounting Policies (continued)

3. Interest and Earnings Allocation

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

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

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

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

4. Risk Management

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

5. New Accounting Pronouncements

During 2006, the ERS adopted the provisions of the Government Accounting Standards Board Statement (GASB) No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1*. The Statement establishes the objectives of the statistical section and the five categories of information it contains: financial trends, revenue capacity, debt capacity, demographic and economic, and operating. The adoption of this Statement had no material impact on the ERS' financial position or results of operations.

The following GASB pronouncements have been issued but are not required to be implemented at this time:

GASB Statement No. 43, *Postemployment Benefit Plans Other Than Pension Plans*: This Statement establishes accounting and financial reporting standards for plans that provide other post-employment benefits (OPEB) other than pension benefits (for example, health insurance and life insurance). Implementation will be required in the FY 2007 annual report. The adoption of this Statement is not anticipated to have a material effect on the ERS' financial position or results of operations.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*: This Statement addresses how state and local governments should account for and report their costs and obligations related to OPEB, including post-employment benefits healthcare and other non-pension benefits. Implementation will be required in the FY 2007 annual report. The adoption of this Statement is not anticipated to have a material effect on the ERS' financial position or results of operations.

Note C – Summary of Accounting Policies (continued)

6. Use of Estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments in venture capital and other alternative assets tend to be illiquid and the underlying assets are generally not publicly traded companies. Because of the inherent uncertainty in valuing privately held securities, the fair value may differ from the values that would have been used had a ready market for such securities existed, and the difference can be material. Accordingly, the realized value received upon the sale of the asset may differ from the recorded fair value.

7. Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation. Such reclassifications had no effect on previously reported changes in plan net assets.

Note D – Description of Funds

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

1. Pension Accumulation Fund

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

2. Annuity Savings Fund

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

3. Expense Fund

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

Notes to Financial Statements (continued)

Note D – Description of Funds (continued)

Net assets held in trust for pension benefits as of June 30, 2006 and 2005 are as follows:

	2006	2005
Pension Accumulation Fund	$ 9,009,981,148	$ 8,274,890,093
Annuity Savings Fund	906,344,123	903,554,875
Expense Fund	16,085,950	17,422,972
Total net assets held in trust for pension benefits	$ 9,932,411,221	$ 9,195,867,940

Note E – Contributions

The ERS' funding policy provides for periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that the employer contributions, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate sufficient assets to pay benefits when due. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability. Employers contribute 15.75% for their police officers and firefighters, and 13.75% for all other employees. Prior to this, the actuary calculated an annual contribution amount for the employer contribution consisting of the "normal cost" plus the level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029. The employer normal cost is the level percentage of payroll contribution required to pay all benefits. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer unfunded accrued liability.

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

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

Note F – Deposits and Investment Risk Disclosures

1. Deposits

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

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

1. Deposits (continued)

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

At June 30, 2006 and 2005, the carrying amount of deposits totaled approximately $47,926,572 and $18,510,098, respectively, and the corresponding bank balance was $52,115,813 and $22,230,054, respectively, of which $43,901,861 and $21,152,158, respectively, were exposed to custodial credit risk. The following shows the aggregate book and bank balances of all cash accounts.

	June 30, 2006	June 30, 2005
Carrying Amounts of Deposit - Book		
Cash	$ 48,920,253	$ 20,261,203
Disbursements in excess of cash balances	(993,681)	(1,751,105)
Total book balances	$ 47,926,572	$ 18,510,098
Depository Account - Bank Investment Custodian		
Insured	$ 8,213,952	$ 1,077,896
Subject to custodial credit risk		
Uninsured and collateral held by pledging bank's trust department not in the ERS' name (in name of Director of Finance, State of Hawaii)	12,798,556	5,028,325
Uninsured and uncollateralized	31,103,295	16,123,833
Total subject to custodial credit risk	43,901,851	21,152,158
Total bank balances	$ 52,115,803	$ 22,230,054

2. Investments

As a long-term investor, the ERS has established through its investment policy that preservation of capital as the primary goal of the ERS. Preservation of capital is to be attained with a consistent, positive return for the fund by diversifying the investment portfolio. The ERS recognizes risk associated for individual securities or asset classes may be reduced through diversification. Investments will be prudent and consistent with the best investment practices, in accordance with the Board's asset allocation strategy, assigned investment mandate, and in compliance with Chapter 88, Hawaii Revised Statutes, as amended. The following table shows the investments of the ERS by investment type as of June 30, 2006 and 2005. Please refer to Note C(2) above for a discussion of fair value on investments.

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

2. Investments (continued)

Investments	June 30, 2006	June 30, 2005
Short-term securities pool, Social Security Contribution Fund	$ 11,527,246	$ 5,558,867
Short-term securities, domestic	228,870,098	230,184,928
Short-term securities, international	3,939,162	-
Short-term securities pools	287,172,632	238,496,311
Fixed income securities, domestic	1,385,139,577	1,130,889,396
Fixed income securities, international	657,182,526	712,835,289
Equity securities, domestic	2,533,557,201	2,164,913,504
Equity securities, international	1,306,215,490	344,136,227
Mortgage loans	4,005,372	12,989,435
Real estate investments	957,103,640	762,233,064
Alternative investments	370,047,793	299,573,729
Equity securities, domestic (pooled including index funds)	1,120,572,134	1,522,856,309
Equity securities, international (pooled including index funds)	310,776,949	1,343,170,907
Investments held by broker-dealers under securities lending program (excluding securities sold, pending trade settlement):		
Short-term investments, domestic	14,281,613	43,829,177
Fixed income securities, domestic	242,241,561	234,062,589
Fixed income securities, international	63,322,816	5,756,551
Equity securities, domestic	448,120,920	230,515,880
Equity securities, international	340,650,580	77,081,892
Total investments	$ 10,284,727,310	$ 9,359,084,055
Securities lending collateral pool	$ 1,131,774,282	$ 607,087,118

3. Credit Risk Debt Securities

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

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

Note F – Deposits and Investment Risk Disclosures (continued)

3. Credit Risk Debt Securities (continued)

- International managers may:
  - Not invest in U.S. dollar denominated securities, with the exception of cash equivalents.
  - Invest in foreign government securities and foreign corporate debt issues as described above for domestic securities.
  - Foreign debt securities are restricted to BBB or better quality rating.
  - Invest up to 10% of portfolio in emerging market debt and emerging market currency.

A table of the ERS fixed income securities as of June 30, 2006 and 2005 is below. The weighted quality rating average of the domestic debt securities, excluding pooled investments, at June 30, 2006 is AA and the fair value of below grade investments is $62,826,077 or 3.9% of the domestic securities in the portfolio. The weighted average of the international debt securities investments at June 30, 2006 is AA and the fair value of below grade investments is $10,509,817 or 1.5% of the international allocation. On June 30, 2005, the weighted quality rating average of the domestic debt securities, excluding pooled investments, is AA and the fair value of below grade investments is $109,788,049 or 8.0% of the domestic securities. The weighted average of the international debt securities investments is AA and the fair value of below grade investments is $44,797,191 or 6.2% of the international section. All short-term investments, not held in a pooled investment, are rated A1/P1 or better.

4. Custodial Credit Risk

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

5. Concentrations of Credit Risk

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

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

At June 30, 2006 and 2005, there was no single issuer exposure within the ERS portfolio that comprises over 5% of the overall portfolio, or an investment that exceeded the above manager guidelines, and therefore, there is no concentration of credit risk.

Notes to Financial Statements (continued)

Note F – Deposits and Investment Risk Disclosures (continued)

5. Concentrations of Credit Risk (continued)

Quality Rating	June 30, 2006			June 30, 2005		
	Domestic	International	Total	Domestic	International	Total
AAA	$ 1,102,900,525	$ 443,269,730	$ 1,546,170,255	$ 711,854,681	$ 452,815,506	$ 1,164,670,187
AA	30,863,362	158,685,903	189,549,265	14,026,362	129,328,361	143,354,723
A	89,739,513	69,147,312	158,886,825	90,943,675	64,149,420	155,093,095
BBB	106,594,840	38,892,580	145,487,420	139,282,769	27,501,362	166,784,131
BB	30,524,398	7,941,061	38,465,459	78,179,478	16,165,912	94,345,390
B	30,112,753	2,568,756	32,681,509	19,272,735	3,415,863	22,688,598
CCC	103,250	-	103,250	4,995,500	-	4,995,500
CC	-	-	-	2,273,499	-	2,273,499
C	2,085,676	-	2,085,676	-	-	-
Not rated	-	-	-	5,066,837	25,215,416	30,282,253
Total credit risk debt securities	1,392,924,317	720,505,342	2,113,429,659	1,065,895,536	718,591,840	1,784,487,376
U.S. government and agencies	234,456,821	-	234,456,821	299,056,449	-	299,056,449
Total debt securities investment	$ 1,627,381,138	$ 720,505,342	$ 2,347,886,480	$ 1,364,951,985	$ 718,591,840	$ 2,083,543,825

6. Interest Rate Risk

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

Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. At June 30, 2006 and 2005, the table below shows fixed income investment securities by investment type, amount, and the effective weighted duration for the ERS total portfolio. Interest rate risk associated with swaps and other derivative instruments are discussed in the derivatives disclosure below:

Note F – Deposits and Investment Risk Disclosures (continued)

6. Interest Rate Risk (continued)

Effective Duration of Fixed Income Assets by Security Type

	June 30, 2006		June 30, 2005	
	Fair value	Effective Weighted Duration (Years)	Fair Value	Effective Weighted Duration (Years)
Domestic Fixed Income Securities				
Asset backed securities	$ 109,490,128	0.8	$ 78,430,255	0.9
Commercial mortgage backed securities	55,947,839	5.4	54,506,607	4.9
Corporate bonds	302,679,901	4.7	329,492,561	4.8
Fixed income options, futures, and swaps	(3,896,407)	n/a	(115,938)	n/a
Government agencies	28,634,631	7.2	40,811,964	2.2
Government bonds	47,140,380	2.2	41,236,609	7.8
Government mortgage backed securities	707,292,362	4.4	505,392,909	2.5
Municipal/provincial bonds	9,192,351	6.9	16,963,708	10.1
Non-government backed CMOs	136,719,692	0.9	42,856,330	2.8
Other fixed income	-		1,152,180	2.6
U.S. Treasuries	234,180,261	5.8	254,224,800	6.8
Total fixed income securities, domestic	$ 1,627,381,138	4.1	$ 1,364,951,985	4.1
International Fixed Income Securities				
Asset backed securities	$ 6,115,327	4.1	$ 4,382,439	7.5
Corporate bonds	180,318,913	5.1	198,684,866	5.2
Fixed income options, futures, and swaps	997,130	n/a	(6,862,928)	n/a
Government agencies	1,636,671	2.9	1,745,803	3.9
Government bonds	504,296,444	6.1	498,469,724	6.6
Non-government backed CMOs	27,140,857	4.3	19,180,933	1.1
Other fixed income	-	n/a	2,991,003	0.0
Total fixed income securities, international	$ 720,505,342	5.9	$ 718,591,840	6.1

7. Foreign Currency Risk

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

The following table summarizes the ERS' exposure to foreign currency risk in U.S. dollars as of June 30, 2006 and 2005. (Amounts are in millions, and securities denominated in U.S. dollars are not presented.)

Note F – Deposits and Investment Risk Disclosures (continued)

7. Foreign Currency Risk (continued)

Currency (dollars in millions)	June 30, 2006 Cash & STIF	June 30, 2006 Fixed Income	June 30, 2006 Equity	June 30, 2006 Total	June 30, 2005 Cash & STIF	June 30, 2005 Fixed Income	June 30, 2005 Equity	June 30, 2005 Total
Australian Dollar	$ 1	$ 11	$ 31	$ 43	$ -	$ -	$ 7	$ 7
Brazilian Real	-	-	9	9	-	-	1	1
Canadian Dollar	-	12	8	20	-	17	1	18
Swiss Franc	-	-	98	98	-	-	20	20
Czech Koruna	-	-	2	2	-	-	2	2
Danish Krone	-	4	13	17	-	5	1	6
Euro	9	346	513	868	1	405	91	497
British Pound Sterling	2	43	255	300	-	39	39	78
Hong Kong Dollar	3	-	65	68	-	-	17	17
Hungarian Forint	-	-	2	2	-	-	3	3
Indonesian Rupiah	-	-	1	1	-	-	1	1
Japanese Yen	15	142	270	427	6	104	35	145
Korean Won	-	-	36	36	-	-	21	21
Mexican Peso	-	-	3	3	-	-	3	3
Malaysian Ringgit	-	-	8	8	-	-	3	3
Norwegian Krone	1	-	12	13	-	-	4	4
New Zealand Dollar	-	20	4	24	-	32	-	32
Philippines Peso	-	-	-	-	-	-	-	-
Polish Zloty		24	14	38	1	15	10	26
Romanian Leu	-	-	2	2	-	-	1	1
Swedish Krona	-	-	16	16	-	-	9	9
Singapore Dollar	-	32	14	46	-	13	4	17
Thai Baht	-	-	8	8	-	-	4	4
New Turkish Lira	-	-	8	8	-	-	11	11
New Taiwan Dollar	1	-	19	20	-	-	10	10
South African Rand	-	4	7	11	-	-	6	6
Pooled investments (multi-currency)	-	-	311	311	-	-	1,343	1,343
Total	$ 32	$ 638	$ 1,729	$ 2,399	$ 8	$ 630	$ 1,647	$ 2,285

8. Securities Lending

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

Note F – Deposits and Investment Risk Disclosures (continued)

8. Securities Lending (continued)

loaned equity securities not denominated in U.S. dollars or whose primary trading market was not located in the U.S., 105% of the market value of the loaned securities. The collateral was marked to market daily. If the market value of the collateral fell below the minimum collateral requirements, additional collateral was provided. Securities on loan for cash collateral with the broker dealers are identified in the schedule of investments above; securities on loan for securities collateral are classified according to the underlying security. At June 30, 2006 and 2005, the ERS had no credit risk exposure to borrowers because the market value of collateral held by the ERS exceeded the market value of securities loaned. As of June 30, 2006 and 2005, the market value of securities loaned amounted to approximately $1,108,617,490 and $591,246,089, respectively, and the associated collateral amounted to approximately $1,131,774,282 and $607,087,118, respectively. In addition, the bank custodians indemnified the ERS by agreeing to purchase replacement securities or return cash collateral in the event the borrower failed to return the loaned security or failed to pay the ERS for income distributions by the securities' issuers while the securities are on loan.

The ERS did not impose any restrictions on the amount of loans the bank custodian made on behalf of the ERS. Also, the ERS and the borrowers maintained the right to terminate securities lending transactions on demand. Cash collateral is invested in the lending agent's short-term investment pool. As such, the maturities of the investments made with cash collateral generally did not match the maturities of the securities loans. The extent of such mismatch as of June 30, 2006 and 2005 was 54 and 33 days, respectively.

9. Derivative Financial Instruments

Derivatives are instruments (securities or contracts) whose value is dependent on such things as stock or bond prices, interest rate levels, or currency exchange rates. These are financial arrangements between two parties whose payment are based on or "derived" from the performance of some agreed-upon benchmark. As with any investment, derivative contracts are subject to various types of credit and market risks. Notably, these would include the possible inability of a counterparty to meet the terms of the contract, changes in the market value of the underlying collateral, or changes in the interest rate environment. The ERS enters into various derivative investment contracts to hedge, for the minimization of transaction costs and as a means of implementing value added strategies to enhance returns as authorized by Board policy.

Generally, derivatives are subject both to market risk and counterparty risk. The derivatives utilized by the ERS typically have no greater risk than their physical counterparts, and in many cases are offset by exposures elsewhere in the portfolio. Counterparty risk, the risk that the "other party" to a contract will default, is managed by utilization of exchange traded futures and options where practicable (in which case the futures exchange is the counterparty and guarantees performance) and by careful screening of counterparties where use of exchange traded products is impractical or uneconomical. The ERS anticipates that counterparties will be able to satisfy their obligations under the contracts.

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Derivative securities are priced and accounted for at their fair value. For exchange traded securities such as futures and options, closing prices from the securities exchanges are used. For fixed income derivatives such as collateralized mortgage obligations (CMOs), commercial pricing services (where available) or bid-side prices from a broker/dealer are used. Foreign exchange contracts are valued at the price at which the transaction could be settled by offset in the forwards markets.

The tables on the following pages summarize certain of the ERS' investments in derivative securities and contracts, held at June 30, 2006 and 2005, and their associated credit and market risks are described as follows: including currency forwards, futures, options and swaps. The notional values associated with these derivative instruments are generally not recorded in the financial statements; however, the amounts for the exposure (unrealized gains/losses) on these instruments are recorded. Interest risks associated with these investments are included in the tables. Investments in limited partnerships and commingled funds may include derivatives that are not shown in the derivative totals.

Forward Currency Exchange Contracts

The ERS enters into various forward currency exchange contracts to manage exposure to changes in foreign currency exchange rates and to facilitate the settlement of foreign security transactions. A forward contract is an agreement to buy or sell a specific amount of currency at a specific delivery or maturity date for an agreed-upon price. Risks associated with such contracts include movements in the value of the foreign currency relative to the U.S. dollar and the ability of the counterparty to perform in accordance with the terms of the contract. Changes in the market value of open and closed forward contracts are recorded as net appreciation (depreciation) in fair value of investments in the Statement of Changes in Plan Net Assets – All Trust Funds. The fair value of forward currency exchange contracts outstanding at June 30, 2006 and 2005 is as follows:

	June 30, 2006	June 30, 2005
Forward currency purchases	$ 410,123,441	$ 563,769,287
Forward currency sales	(409,727,813)	(564,594,135)
Unrealized gains (losses)	$ 395,628	$ (824,848)

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Futures

Futures represent commitments to purchase (asset) or sell (liability) securities at a future date and at a specified price. Futures contracts are traded on organized exchanges (exchange traded) thereby minimizing the ERS' credit risk. The net change in the futures contracts value is settled daily in cash with the exchanges. Net gains or losses arising from the daily settlements are included in the net appreciation in fair value of securities in the Statement of Changes in Plan Net Assets – All Trust Funds. At June 30, 2006 and 2005, the ERS' investments had the following balances:

Futures Contracts *(Notional Value)*	**June 30, 2006**	**June 30, 2005**
Long - cash and cash equivalents - futures	$ 942,637,238	$ 371,903,250
Short - cash and cash equivalents - futures	-	(1,815,500)
Long - debt securities - futures	149,934,017	14,123,527
Short - debt securities - futures	(30,734,512)	-
Unrealized gains	$ 1,061,836,743	$ 384,211,277

Options

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

At June 30, 2006 and 2005, the ERS' investments had the following option balances:

Options - Value Covered by Contract	**June 30, 2006**	**June 30, 2005**
Cash and cash equivalents purchased call options	$ 838	$ -
Cash and cash equivalents written call options	(21,619)	-
Cash and cash equivalents written put options	(1,536,156)	-
Fixed income purchased call options	366,981	-
Fixed income written call options	(511,470)	(81,358)
Fixed income written put options	(124,886)	(34,580)
Unrealized losses	$ (1,826,312)	$ (115,938)

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Mortgage-Backed Securities

The ERS invests in mortgage-backed securities issued or backed by the U.S. government or its agencies, or corporate issues rated AAA by at least one of the major rating agencies. A mortgage-backed security depends on the underlying pool of mortgage loans to provide the cash flow to make principal and interest payments on the security. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. For example, if interest rates decline and homeowners refinance mortgages, thereby prepaying the mortgages underlying these securities, the cash flows from interest payments are reduced and the value of these securities declines. Conversely, if homeowners pay on mortgages longer than anticipated, the cash flows are greater and the return on the investment would be higher than anticipated. A collateralized mortgage obligation (CMO) is a mortgage-backed security that is comprised of classes of bonds created by prioritizing the cash flows of the underlying mortgage pool. Mortgage-backed securities held by the ERS as of June 30, 2006 and 2005 are presented in the tables within this note.

Swaps

Swaps represent an agreement between two or more parties to exchange sequences of cash flows over a period in the future. At June 30, 2006 and 2005, the ERS had interest rate and credit default swaps as allowed by Board policy. In the most common type of interest rate swap arrangement, one party agrees to pay fixed-interest payments on designated dates to a counterparty who, in turn, agrees to make return interest payments that float with some reference rate. Credit default swaps are the most common global credit market derivative that allows flexibility as an active portfolio management tool based on its ability to customize the exposure to corporate credit such as credit spreads and default risks. Credit default spreads are also used to gain access to global markets that do not have the transparency or efficiency of the U.S. credit markets. Gains and losses from swaps are determined on market values and are included in the net appreciation in fair value of securities in the Statement of Changes in Plan Net Assets – All Trust Funds.

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

Note F – Deposits and Investment Risk Disclosures (continued)

9. Derivative Financial Instruments (continued)

Swaps (continued)

On June 30, 2006 and 2005, the ERS investments had the following market value balances as shown in the tables below:

Swaps - Value Covered by Contract by Currency	June 30, 2006	June 30, 2005
Interest rate swaps		
in Australian Dollars	$ 15,496	$ 20,330
in British Pound Sterling	(706,486)	634,077
in Canadian Dollars	(176,052)	(773,218)
in Euro	1,448,115	(5,658,363)
in Japanese Yen	504,409	(1,085,754)
in United States Dollars	(2,177,600)	-
total	(1,092,118)	(6,862,928)
Credit default swaps		
in United States Dollars	19,153	-
total	19,153	-
Unrealized losses	$ (1,072,965)	$ (6,862,928)

Note G – Risk Management

The ERS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. As required by state law, the ERS participates in coverage with the State of Hawaii. The State retains various risks and insures certain excess layers with commercial insurance policies. The excess layers are consistent with the prior fiscal year. Settled claims for the State have not exceeded the coverage provided by commercial insurance policies during the fiscal years ended June 30, 2006 and 2005. Losses not covered by insurance are generally paid from legislative appropriations.

1. Torts

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

2. Property and Liability Insurance

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

Notes to Financial Statements (continued)

Note G – Risk Management (continued)

3. Workers' Compensation Policy

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

Note H – Commitments

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

For the ERS asset allocation plan for investments, the ERS has future financial commitments of up to an additional $350,637,000 as of June 30, 2006, consisting of $144,858,000 in real estate and $205,779,000 in alternative investments. Investment-related financial commitments were $1,820,362,000 as of June 30, 2005, consisting of $212,300,000 in real estate, $183,062,000 in alternative investments, $425,000,000 in domestic fixed-income, and $1,000,000,000 in international equities, including emerging markets.

Note I – Deferred Compensation Plan

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

Required Supplementary Information

June 30, 2006

Schedule of Funding Progress
(In thousands)

Actuarial Valuation Date	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)*	Unfunded Actuarial Accrued Liability (3)*= (2)-(1)	Funded Ratio (4)=(1)/(2)	Annual Covered Payroll (5)	UAAL as a Percentage of Annual Covered Payroll (6)=(3)/(5)
June 30:						
2006	$ 9,529,371	$ 14,661,399	$ 5,132,028	65.0%	$ 3,238,267	158.5%
2005	8,914,839	12,985,989	4,071,150	68.6%	3,041,083	133.9%
2004	8,797,133	12,271,331	3,474,198	71.7%	2,865,106	121.3%
2003	9,073,960	11,952,057	2,878,097	75.9%	2,826,682	101.8%
2002	9,415,160	11,210,226	1,795,066	84.0%	2,671,689	67.2%
2001	9,515,957	10,506,913	990,956	90.6%	2,444,200	40.5%

Note: Assumption changes and new Hybrid Plan effective June 30, 2006.

Schedule of Employer Contributions
(In thousands)

	Annual Required Contribution	Actual Contribution	Percentage Contributed
Fiscal year ended June 30,:			
2006 *	$ 423,446	$ 423,446	100.0%
2005	328,717	328,717	100.0%
2004	235,686	235,686	100.0%
2003	190,586	190,586	100.0%
2002	167,459	167,459	100.0%
2001	164,397	8,132	4.9%

* Effective July 1, 2005, the required contributions are based on contribution rates and not specific dollar amounts.

Notes to Required Supplementary Information (continued)

June 30, 2006

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

Valuation date	June 30, 2006
Actuarial cost method	Entry Age Normal
Amortization method	Level percent, open
Remaining amortization period as of June 30, 2006	35.2 years
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return (set by statute)*	8.0%
Projected salary increases (set by statute)*	4.0% ***
* Includes inflation at 3.0%	
Cost-of-living adjustments (COLAs) **	2.5% (not compounded)

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

*** Since the current 4% salary scale assumption is specified by ERS statutes, the formal valuation results must reflect that assumption. An experience study conducted by the ERS' actuary indicated that salary increases have exceeded the 4% statutorily set assumption. The following sets forth the impact of the actuary recommended salary scale assumptions.

- The UAAL would be increased marginally from $5.132 billion to $5.185 billion.
- The funded ratio would be decreased marginally from 65.0% to 64.8%.
- The total normal cost would increase from 11.75% of pay to 12.43% of pay, and the employer normal cost would increase from 5.11% of pay to 5.77% of pay.
- The funding period based on the current 13.95% composite employer contribution rate would increase from 35.2 years to 43.0 years.
- The GASB ARC for 30-year funding would increase from 14.63% of pay to 15.29% of pay.

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

Years ended June 30, 2006 and 2005

	2006			
	Pension Accumulation Fund	**Annuity Savings Fund**	**Expense Fund**	**Total**
Additions				
Appropriations and contributions:				
Employers	$ 423,445,597	$ -	$ -	$ 423,445,597
Members	-	56,257,953	-	56,257,953
Net investment income	988,347,837	-	-	988,347,837
Total additions	1,411,793,434	56,257,953	-	1,468,051,387
Deductions				
Benefit payments	720,542,990	-	-	720,542,990
Refunds of member contributions	-	2,487,279	-	2,487,279
Administrative expenses	-	-	8,477,837	8,477,837
Total deductions	720,542,990	2,487,279	8,477,837	731,508,106
Other changes in net assets held in trust for pension benefits:				
Transfer due to retirement of members	89,648,445	(89,648,445)	-	-
Transfer of interest allocation	(38,667,019)	38,667,019	-	-
Transfer to pay administrative expenses	(8,209,420)	-	8,209,420	-
Return of unrequired funds due to savings in administrative expenses	1,068,605	-	(1,068,605)	-
	43,840,611	(50,981,426)	7,140,815	-
Net increase (decrease)	735,091,055	2,789,248	(1,337,022)	736,543,281
Net assets held in trust for pension benefits:				
Beginning of year	8,274,890,093	903,554,875	17,422,972	9,195,867,940
End of year	$ 9,009,981,148	$ 906,344,123	$ 16,085,950	$ 9,932,411,221

See accompanying independent auditors' report.

Supplementary Information

Schedule 1

2005			
Pension Accumulation Fund	**Annuity Savings Fund**	**Expense Fund**	**Total**
$ 328,716,718	$ -	$ -	$ 328,716,718
-	57,054,621	-	57,054,621
931,710,183	-	-	931,710,183
1,260,426,901	57,054,621	-	1,317,481,522
676,316,347	-	-	676,316,347
-	3,442,466	-	3,442,466
-	-	7,259,906	7,259,906
676,316,347	3,442,466	7,259,906	687,018,719
95,132,500	(95,132,500)	-	-
(38,531,707)	38,531,707	-	-
(19,697,619)	-	19,697,619	-
262,603	-	(262,603)	-
37,165,777	(56,600,793)	19,435,016	-
621,276,331	(2,988,638)	12,175,110	630,462,803
7,653,613,762	906,543,513	5,247,862	8,565,405,137
$ 8,274,890,093	$ 903,554,875	$ 17,422,972	$ 9,195,867,940

Supplementary Information (continued)

Schedule 2

Social Security Contribution Fund

Statements of Changes in Assets and Liabilities

Years ended June 30, 2006 and 2005

	2006			
	Beginning Balance	**Additions**	**Deductions**	**Ending Balance**
Assets				
Cash	$ 1,082,875	$ 188,562,805	$ 182,545,621	$ 7,100,059
Short-term investments	5,558,867	6,534,363	565,984	11,527,246
Employer appropriations receivable	6,108,225	176,844,908	182,953,133	-
Total assets	$ 12,749,967	$ 371,942,076	$ 366,064,738	$ 18,627,305
Liabilities				
Payable to Internal Revenue Service	$ 6,910,793	$ 165,177,603	$ 171,391,206	$ 697,190
Due to employers	5,839,174	177,270,287	165,179,346	17,930,115
Total liabilities	$ 12,749,967	$ 342,447,890	$ 336,570,552	$ 18,627,305

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

See accompanying independent auditors' report.

Supplementary Information (continued)

Schedule 3

Schedules of Administrative Expenses

Years ended June 30, 2006 and 2005

	2006	2005
Personnel services		
Salaries and wages	$ 3,737,305	$ 3,320,889
Fringe benefits	1,253,895	999,773
Net change in unused vacation credits	232,649	89,356
Total personnel services	5,223,849	4,410,018
Professional services		
Actuarial	103,744	105,066
Auditing and tax consulting	98,954	126,061
Disability hearing expenses	26,605	17,298
Legal services	326,403	334,899
Medical	311,214	389,821
Other services	761,939	71,731
Total professional services	1,628,859	1,044,876
Communication		
Postage	231,844	95,274
Printing and binding	32,464	16,750
Telephone	37,152	32,471
Travel	36,805	48,665
Total communication	338,265	193,160
Rentals		
Rental of equipment	41,502	44,260
Rental of premises	16,388	13,470
Total rentals	57,890	57,730
Other		
Armored car service	8,201	7,411
Computer and office automation systems	355,397	676,022
Equipment	10,407	25,398
Microfilm	-	8,552
Repairs and maintenance	83,626	159,432
Stationery and office supplies	34,852	44,135
Miscellaneous	93,552	103,597
Total other	586,035	1,024,547
Depreciation	642,939	529,575
	$ 8,477,837	$ 7,259,906

See accompanying independent auditors' report.

Supplementary Information (continued)

Schedule 4

Schedules of Investment Expenses

Years ended June 30, 2006 and 2005

		2006		**2005**
Investment expenses				
Investment manager/advisor fees	$	45,408,011	$	27,672,025
Bank custodian fees		310,000		310,000
Other investment expenses		535,663		321,349
Total investment expenses		46,253,674		28,303,374
Securities lending expenses				
Borrower rebates		35,105,016		10,589,988
Management fees		691,630		273,839
Total securities lending expenses		35,796,646		10,863,827
	$	82,050,320	$	39,167,201

See accompanying independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

INVESTMENT SECTION

This page is intentionally left blank.

Letter from Chief Investment Officer

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

December 29, 2006

Aloha Kakou,

It is my honor and privilege to present the Investment Section of the Comprehensive Annual Financial Report for the fiscal year ending June 30, 2006. The following are a few ERS investment highlights:

- As of June 30, 2006, ERS was one of the 125 largest defined benefit plans in the United States with total assets of over $9.9 billion.
- The fund returned 11.12% for the fiscal year 2006, outperforming the benchmark return of 10.98% by 0.14%.
- Over the last three years the fund returned 12.72%, surpassing the S&P 500 return of 11.22% over that same time period.
- As part of our standard practices, we are conducting a search for a firm to provide investment consulting services and a decision is expected by the end of 2006.

With the close of fiscal year 2006 the ERS investment portfolio has put together a string of three straight years with double digit gains. This streak of performance is understandable given the events of the past three years. Following the 2001 terrorist attacks, the stock market collapse and the national recession, the Federal Reserve lowered interest rates to historically low levels. What followed was a period of tame inflation, low interest rates and surging economic output. As one market observer put it, "investors have been buoyed by a swell of money that lifted all boats."

While the markets have continued to perform well in the first half of fiscal year 2007, one has to wonder how long this will last. Just as day gives way to night it is inevitable that fear will give way to greed. The cycle of fear and greed, of up and down markets, will continue as it always has. To paraphrase the poet Edna St. Vincent Millay, "Life isn't one thing after another, it is the same thing again and again."

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

- Diversify among asset classes to ensure a consistent level of performance. Diversification among asset classes, including investment size and style, dampens overall portfolio volatility and improves performance over the long run. ERS has a diversified investment portfolio that ranges from conventional stock and bond investments to real estate and venture capital.

City Financial Tower • 201 Merchant Street, Suite 1400 • Honolulu, Hawaii 96813-2980
Telephone (808) 586-1735 • Fax (808) 586-1677 • http://www4.hawaii.gov/ers

Letter from Chief Investment Officer (continued)

- Systematically rebalance the portfolio back to target allocations. It is contrary to human nature to "sell the good ones" and "buy the bad ones." People possess built-in biases in the way they make decisions, and those biases may cause them to act counter to their own best interests. By systematically selling better performing assets and using the proceeds to buy more of the underperforming assets we are following the golden rule of "selling high and buying low."
- Investing is a process that requires conviction and discipline. Through our disciplined investment process ERS has developed and implemented a strategy to prudently invest the assets of our members to provide for current and future retirement benefits. As with any strategy, there will be periods of underperformance in the short-term. Given the long time horizon of the ERS we will avoid giving in to the short-term momentum that drives the market and most of its participants.

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

Aloha pumehana,

T. Kimo Blaisdell

T. Kimo Blaisdell
Chief Investment Officer

Letter from Investment Consultant

CALLAN ASSOCIATES INC

December 1, 2006

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

San Francisco
New Jersey
Chicago
Atlanta
Denver

Dear Trustees:

Enclosed is our report on investment activity for the Hawaii Employees' Retirement System for periods ended June 30, 2006, as requested by the Government Financial Officers' Association (GFOA).

Hawaii ERS-Total Fund Performance

The total assets of the Retirement System were $9.9 billion as of June 30, 2006, an increase of roughly $700 million for the fiscal year. The increase in assets was primarily due to outstanding investment results for the year. The investment return for the total fund expressed as a time-weighted total rate of return was +11.1% for the 2006 fiscal year, compared to the benchmark's return of +11.0%. For the three-year period ending June 30, 2006 the total fund returned +12.7% per annum versus the benchmark's +12.6%, and for the trailing five-year period the total fund posted a return of +6.9% per annum versus the benchmark's +6.9%.

Asset Class Performance

Domestic equity returned +9.4% for the fiscal year, versus the S&P 500 Index's +8.6% and the Callan Domestic Equity Database median of +11.7%. Domestic fixed-income was down 0.1% for the year, ahead of the Lehman Brothers Aggregate return of -0.8% and below the Callan Fixed-Income Database median return of +0.3%. International equity returned +26.5% for the 2006 fiscal year versus the MSCI EAFE Index return of +26.6%, whereas international fixed-income returned +1.0% versus the Citigroup Non-US Government Bond Index gain of 0.0%. Real Estate gained 18.4% for the year ending June 30, 2006 versus the NCREIF Total Index gain of +18.7%. Alternative investments were a positive contributor to performance, returning +24.6% for the fiscal year.

Market Conditions

The fiscal year began with the US stock market recording its best quarterly returns in a year despite two devastating hurricanes and higher energy prices. After a flat fourth quarter, the market rallied in the first quarter of 2006 to what many felt were unsustainable levels. The primary impetus for this rally was strong GDP data and an increase in consumer spending.

71 STEVENSON STREET, SUITE 1300, SAN FRANCISCO, CALIFORNIA 94105 Telephone 415.974.5060 Fax 415.512.0524

Letter from Investment Consultant (continued)

Employees' Retirement System of the State of Hawaii
December 1, 2005
Page 2

In the second quarter of 2006, robust economic data combined with rising inflation numbers and led the market to presume additional Federal Reserve rate increases would occur. The market fell sharply for roughly a six-week period on this sentiment. Overall for the fiscal year the S&P 500 returned +8.6%. The fiscal year saw less divergence in the performance of key sectors of the equity market than the prior year. Eight of the ten sectors of the market were positive for the year, compared with just four of ten in fiscal year 2005. Telecom returned +14.4% for the year and was the top performing sector. The energy sector returned +12.2% for the year, and other late cycle sectors materials (+8.1%) and industrials (+9.0%) also did well. Value stocks outpaced growth stocks for the period, and small cap stocks led large cap stocks, continuing a recent trend.

The domestic bond market had a flat year as the yield curve made the parallel shifts upward that had been expected the prior year. Bellwether bond index Lehman Aggregate (-0.8%) was in negative territory for the fiscal year. The bond market was hurt by a rise in interest rates across the entire maturity spectrum and a Federal Reserve tightening cycle that was longer than expected.

International equities outpaced US equities once again for the year ended June 30, 2006 as non-US stocks continued from a protracted period of strong performance. The MSCI EAFE Index was up +26.6% for the fiscal year. The dollar mixed throughout the year, but finished slightly lower, aiding international results. Local returns made up 23.7% of the index's return for the period. Once again driving returns for many active managers in the non-US equity space were the outstanding returns from emerging markets. International bonds were flat, though slightly better than their US counterparts due to a slightly weaker dollar.

Fiscal year 2007 has been strong so far, with positive equity market performance combined with good returns from bonds. Economic indicators have continued to show steady strength, but the housing market has slowed and the market is carefully watching to see whether the Federal Reserve is done raising interest rates for the time being. Throughout the variable market conditions of the past few years, with its constant review and oversight, the Board continues to position the Retirement System for competitive performance consistent with its objectives.

Callan Associates Inc.

Callan Associates Inc.

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

Prepared by Callan Associates Inc.
December 2006

Outline of Investment Policies

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

Expected Annualized Return and Risk

Based on 2006 capital market projections for 5 years, the target allocation is expected to achieve an average annualized return of 8.0% (5.25% real return with expected inflation of 2.75%). The annual nominal return over this five-year period is expected to fall within a range of –4.4% and 20.4% two-thirds of the time.

Long-range Asset Allocation Target

The ERS will strategically invest in the following asset classes:

	Lower Limit	**Strategic Allocation**	Upper Limit
Domestic Equity	27%	**32%**	37%
Small/Mid Cap Equity	6%	**9%**	12%
International Equity	13%	**17%**	21%
Domestic Fixed-Income	19%	**21%**	23%
International Fixed-Income	5%	**7%**	9%
Mortgages	NA	**0%** ***	NA
Equity Real Estate	0%	**9%** *	9%
Alternative Investments	0%	**5%** **	5%

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

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

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

Report on Investment Activity by Investment Consultant (continued)

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

Portfolio Evaluation Benchmark

To monitor the total fund result, a special target index has been constructed to measure the fund's performance based on the current target mix. This serves as a minimum performance objective for the Fund. The target is adjusted quarterly to reflect the assets actually invested in real estate and alternative investments. The target index objective is included in all quarterly evaluation reports of the ERS. The composition of the index as of June 30, 2006 is:

- 33.6% of the Standard & Poor's 500 Stock Index
- 4.5% of the Standard & Poor's Mid Cap 400
- 4.5% of the Russell 2000 Index
- 21.0% of the Lehman Brothers Aggregate Bond Index
- 14.5% of the Morgan Stanley Capital International EAFE Index
- 2.5% of the Morgan Stanley Capital International Emerging Markets Index
- 7.0% of the Citigroup Non-U.S. World Government Bond Index
- 8.6% of the NCREIF Total Index
- 3.8% of the Alternatives Investment Program

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

Manager Evaluation

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

Report on Investment Activity by Investment Consultant (continued)

Investment Practices

The full Investment Policy Statement (IPS) describes in detail acceptable investment practices, manager reporting requirements, manager performance guidelines, the distribution of brokerage commissions, and securities lending guidelines. The IPS was revised in July 2006.

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

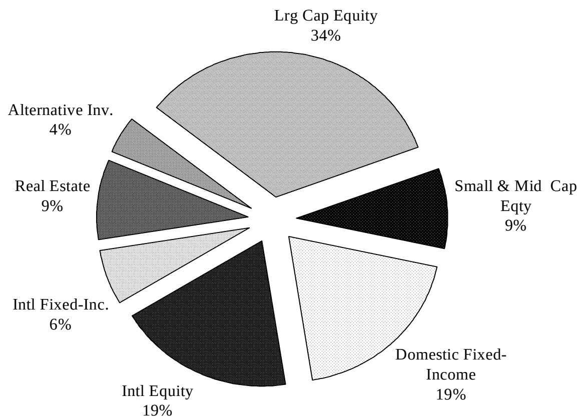
Investment Results as of June 30, 2006:

	Year Ended June 30,					Three Years Ended	Five Years Ended
	2006	2005	2004	2003	2002	6/2006	6/2006
Domestic Equity	**9.39%**	**8.87%**	**21.80%**	**(0.39%)**	**(14.57%)**	**13.20%**	**4.30%**
Standard & Poor's 500	8.63%	6.32%	19.11%	0.25%	(17.99%)	11.22%	2.49%
CAI Total Domestic Equity DB	11.66%	9.60%	23.55%	(0.14%)	(13.78%)	15.64%	6.34%
Domestic Fixed-Income	**(0.13%)**	**7.21%**	**(1.45%)**	**11.12%**	**8.82%**	**1.81%**	**4.99%**
Lehman Bros. Aggregate	(0.81%)	6.80%	0.32%	10.40%	8.63%	2.05%	4.97%
CAI Domestic Fixed DB	0.34%	6.76%	0.75%	10.55%	7.98%	2.39%	5.17%
International Equity	**26.52%**	**17.12%**	**28.02%**	**(7.90%)**	**(12.25%)**	**23.79%**	**8.92%**
MSCI EAFE Index	26.56%	13.65%	32.37%	(6.46%)	(9.49%)	23.94%	10.02%
CAI Non-U.S. Equity DB	27.82%	14.98%	31.13%	(5.70%)	(7.74%)	24.74%	11.61%
International Fixed-Income	**0.96%**	**7.17%**	**7.87%**	**20.43%**	**16.84%**	**5.29%**	**10.43%**
Citigroup Non-U.S. Government Bond	(0.01%)	7.75%	7.60%	17.90%	15.73%	5.05%	9.61%
CAI Non-U.S. Fixed DB	0.28%	9.10%	7.62%	18.24%	15.65%	5.20%	9.75%
Real Estate	**18.35%**	**25.21%**	**12.26%**	**6.89%**	**3.09%**	**18.49%**	**12.88%**
NCREIF Total Property Index	18.67%	18.02%	10.83%	7.64%	5.50%	15.79%	12.00%
CAI Real Estate Funds	20.53%	16.64%	9.54%	7.89%	5.77%	15.54%	11.46%
Alternative Investments	**24.56%**	**17.92%**	**18.51%**	**(11.26%)**	**(13.40%)**	**20.29%**	**5.99%**
Mortgages	8.33%	12.75%	(56.24%)	3.17%	15.41%	(18.84%)	(8.64%)
Lehman Mortgage Index	0.39%	6.14%	2.23%	5.72%	8.98%	2.89%	4.65%
Total Fund	**11.12%**	**11.30%**	**15.81%**	**2.97%**	**(5.52%)**	**12.72%**	**6.86%**
Composite Benchmark	10.98%	10.04%	16.75%	3.51%	(5.36%)	12.55%	6.91%

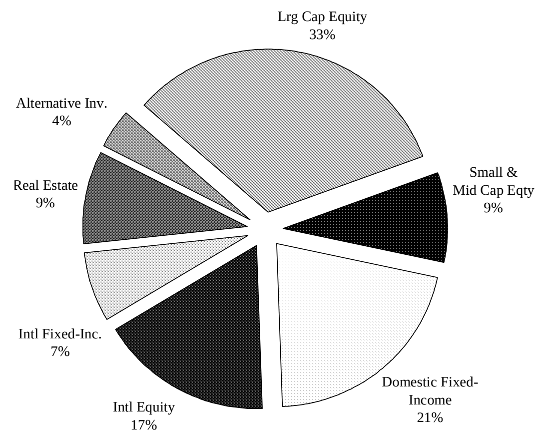
Report on Investment Activity by Investment Consultant (continued)

Asset Allocation as of June 30, 2006:

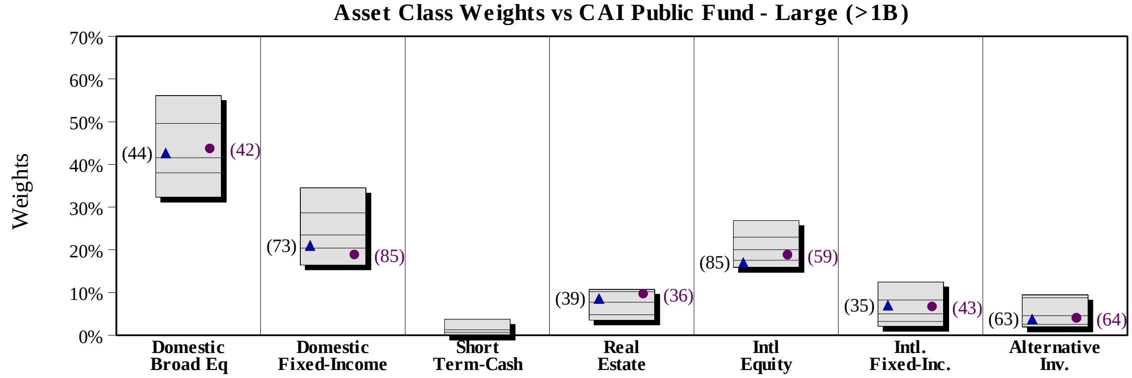
Actual Asset Allocation



Target Asset Allocation



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



	Domestic Broad Eq	Domestic Fixed-Income	Short Term-Cash	Real Estate	Intl Equity	Intl. Fixed-Inc.	Alternative Inv.
10th Percentile	56.12	34.50	3.75	10.76	26.82	12.48	9.46
25th Percentile	49.61	28.69	1.29	10.18	23.00	8.28	8.80
Median	41.55	23.50	0.64	7.70	20.07	5.05	4.55
75th Percentile	38.03	20.44	0.19	4.82	17.60	3.21	2.59
90th Percentile	32.35	16.46	0.03	3.55	15.88	2.09	1.93
Fund ●	43.39	18.58	-	9.38	18.50	6.41	3.74
Target ▲	42.64	21.00	-	8.59	17.00	7.00	3.77

The Target Benchmark as of June 30, 2006 was 33.6% S&P 500, 4.5% S&P Mid Cap 400, 4.5% Russell 2000, 21.0% Lehman Aggregate, 8.6% NCREIF Total Index, 3.8% Alternative Investments Program, 14.5% MSCI EAFE Index, 2.5% MSCI Emerging Index, and 7.0% Citigroup Non-US Government Bond Index. Monies to be allocated to long-term real estate and alternatives are considered to be "parked" in domestic equities until drawn down.

Investment Professionals

INVESTMENT MANAGERS

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

REAL ESTATE
Clarion Partners
Heitman Capital Management
Invesco Realty Advisors
LaSalle Investment Management

INTERNATIONAL EQUITIES
Acadian Asset Management
JP Morgan Chase
Julius Baer Investment Management
Mercator Asset Management
New Star Institutional Managers
Philadelphia International Advisors
Rexiter Capital Management
State Street Global Advisors

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

ALTERNATIVE INVESTMENTS
Abbott Capital Management, LLC
Hancock Timber Resource Group

INTERNATIONAL FIXED-INCOME
Oechsle International Advisors
Pacific Investment Management Company

OTHER SERVICE PROVIDERS

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

CUSTODIAL BANK
State Street Bank & Trust Company

INVESTMENT ADVISOR
Callan Associates Inc.

Investment Schedules

List of Assets Directly Held (by fair value)*

as of June 30, 2006 (excludes investments in pooled vehicles)

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

	Par / Shares	Security	Coupon	Maturity	Standard & Poors	Fair Value
Domestic Fixed Income						
1	111,940,000	Federal Nat Mortg (TBA July 30 Single Family)	5.000%	12/1/2099	AAA	$ 104,637,661
2	67,861,000	Federal Nat Mortg (TBA July 30 Single Family)	5.500%	12/1/2099	AAA	65,151,860
3	56,877,000	Federal Nat Mortg (TBA July 30 Single Family)	6.000%	12/1/2099	AAA	55,966,081
4	46,603,383	Federal National Mortg (Pool 735224)	5.500%	2/1/2035	AAA	44,923,112
5	20,830,000	United States Treasury Note	4.380%	12/31/2007	AAA	20,582,644
6	19,072,188	Federal National Mortg (REMIC)	6.390%	5/25/2036	AAA	19,374,400
7	19,130,000	United States Treasury Note	4.500%	11/15/2010	AAA	18,687,619
8	16,620,000	United States Treasury Bond	6.125%	8/15/2029	AAA	18,481,959
9	19,000,000	Gov't Nat Mortg (TBA July 30 Single Family)	5.000%	12/1/2099	AAA	17,977,266
10	17,874,000	United States Treasury Note	2.750%	8/15/2007	AAA	17,389,447
International Fixed Income						
1	26,660,000	Republic of Italy	4.500%	5/1/2009	AA	34,777,396
2	18,400,000	Federal Republic of Germany	4.250%	7/4/2014	AAA	23,891,826
3	25,649,000	Government of Singapore	2.625%	4/1/2010	AAA	15,862,853
4	25,500,000	Government of Singapore	1.500%	4/1/2008	AAA	15,714,263
5	12,286,000	Republic of France	2.250%	3/12/2007	AAA	15,605,023
6	12,230,000	Federal Republic of Germany	3.500%	10/9/2009	AAA	15,530,767
7	12,000,000	Republic of France	4.000%	4/25/2014	AAA	15,342,263
8	11,511,000	Republic of Ireland	4.600%	4/18/2016	AAA	15,336,716
9	1,717,000,000	Eksportfinans (A/S)	1.800%	6/21/2010	AA	15,327,809
10	12,772,000	Caisse d Amortissement Reg S	3.750%	10/25/2020	AAA	15,302,067
Domestic Equities						
1	1,723,720	Microsoft Corp				40,162,676
2	773,484	Bank of America Corp				37,204,580
3	480,100	Altria Group Inc				35,253,743
4	730,756	Citigroup Inc				35,251,669
5	865,045	Qualcomm Inc				34,662,353
6	710,896	Wal Mart Stores Inc				34,243,860
7	482,455	Pepsico Inc				28,966,598
8	1,221,451	Pfizer Inc				28,667,455
9	437,202	Amgen Inc				28,518,686
10	578,682	First Data Corp				26,063,837
International Equities						
1	495,115	Total SA				32,571,898
2	1,163,975	Glaxosmithkline				32,529,264
3	940,000	ENI				27,680,465
4	376,358	Schlumberger Ltd				24,504,669
5	645,110	AXA				21,166,157
6	535,005	ING Groep NV				21,021,902
7	191,419	Sanofi Aventis				18,675,024
8	8,647,595	Vodafone Group				18,433,271
9	109,310	Roche Holdings AG				18,033,919
10	1,591,400	Sumitomo Trust & Banking				17,401,478

Investment Schedules (continued)

Investments Summary

(Dollar values expressed in thousands)

		Fair Value as of June 30, 2006	Percentage		Fair Value as of June 30, 2005	Percentage
Equity securities						
Common stock	$	3,141,030	32.25%	$	2,714,354	30.70%
Index funds		1,294,968	13.30%		2,639,649	29.90%
Pooled and others		1,623,895	16.67%		328,672	3.70%
		6,059,893	62.22%		5,682,675	64.30%
Fixed income securities						
Mortgage-backed securities		899,960	9.24%		602,756	6.80%
U.S. Government bonds		281,321	2.89%		295,461	3.40%
Foreign bonds		720,505	7.40%		718,592	8.10%
U.S. corporate bonds		302,680	3.11%		329,493	3.70%
Asset backed securities		109,490	1.12%		78,430	0.90%
Pooled and others		33,930	0.35%		58,812	0.70%
		2,347,886	24.11%		2,083,544	23.6%
Others						
Real estate equities		957,104	9.83%		762,233	8.60%
Real estate mortgages		4,005	0.04%		12,989	0.10%
Alternative investments		370,048	3.80%		299,574	3.40%
		1,331,157	13.67%		1,074,796	12.1%
Total, investments at fair value	$	9,738,936	100.00%	$	8,841,015	100.00%

Schedule of Investment Fees

by Asset Class Allocation

(Dollar values expressed in thousands)

		Fair value as of June 30, 2006		Total FY 2006 Investment Fees	Basis Points
Equities					
U.S. equities	$	4,312,189	$	11,077	26 bp
International equities		1,838,743		6,817	37
		6,150,932		17,894	29
Fixed Income					
U.S. bonds		1,843,241		2,960	16
International bonds		636,714		1,490	23
		2,479,955		4,450	18
Other Asset Allocations					
Real estate		942,005		20,581	218
Real estate mortgages		4,005		21	52
Alternative investments		371,850		1,942	52
		1,317,860		22,544	171
Other Investment Services					
Custodian fees				310	n/a
Investment consultant fees				520	n/a
Total	$	9,948,747	$	45,718	46

Investment Schedules (continued)

Schedule of Broker Commissions

The Employees' Retirement System participates in a Commission Recapture Program with four brokerage firms for equity trades, which are listed in the Investment Professionals section. Domestic and international investment managers are required to direct at least 35% of all brokerage transactions to participating brokers. Commissions charged per share are based on the investment manager's normal rate schedule. All commissions recaptured are used exclusively by the ERS for the benefit of its members and beneficiaries. ERS does not guarantee participating brokers any minimums, required volumes or fees. During the fiscal year ended June 30, 2006 the ERS recaptured $827,343 in commissions.

The following is a list of brokers who received $40,000 or more in commissions during Fiscal Year 2006. A complete list of all commissions is available for review upon request.

Brokerage Firms	Shares Traded	Dollar Volume of Trades	Commission Dollar Amount	Commission Per Share
Citigroup	20,514,429	$ 330,834,856	$ 489,151	$ 0.024
Lynch Jones and Ryan	10,990,248	425,467,769	469,862	0.043
Merrill Lynch, Pierce Fenner & Smith	13,045,683	238,558,029	338,354	0.026
Credit Suisse First Boston	24,071,034	290,407,688	319,318	0.013
Broadcourt Capital	6,964,326	250,008,147	270,712	0.039
Bear Stearns & Co	11,121,564	194,546,738	259,864	0.023
JP Morgan Chase	17,005,524	253,971,739	257,862	0.015
UBS AG	9,218,507	150,864,497	228,226	0.025
Morgan Stanley	34,181,623	170,619,252	227,103	0.007
Deutsche Bank	23,117,744	149,071,350	212,524	0.009
Lehman Brothers	16,711,405	190,625,446	209,576	0.013
La Branche Financial	14,144,929	541,197,056	145,923	0.010
Goldman Sachs & Co	15,318,939	105,186,637	131,503	0.009
Sanford C Bernstein Ltd	2,645,735	98,633,446	109,186	0.041
BNY Brokerage	2,468,298	101,020,923	105,886	0.043
Investment Technology Group	6,224,953	223,422,359	104,489	0.017
Rochdale Securities	2,329,403	100,014,329	89,555	0.038
Instinet	6,615,857	148,609,998	87,727	0.013
Banc / America	1,908,161	57,757,964	80,444	0.042
Weeden & Co	2,934,537	106,399,958	76,992	0.026
Suntrust Capital Markets	1,622,101	52,130,765	75,359	0.046
Bridge Trading Company	2,848,700	126,902,894	74,432	0.026
Edwards	1,427,120	47,907,218	70,142	0.049
Liquidnet	3,115,618	102,761,235	66,873	0.021
Weeden & Co	3,946,293	40,837,834	61,262	0.016
Jefferies & Co	1,622,964	32,855,428	60,603	0.037
B-Trade Services	3,590,088	74,076,016	54,335	0.015
Pershing DLJ	1,050,392	21,903,165	46,571	0.044
HSBC Securities (James Capel)	1,859,024	18,675,492	41,783	0.022
Prudential	1,196,138	44,043,145	41,683	0.035
Others (includes firms)	2,664,815	58,374,927	73,914	0.028
Commissioned equity trades	266,476,152	$ 4,747,686,300	$ 4,881,214	
Less commissions recaptured			(827,343)	
Trades at net commission	266,476,152	$ 4,747,686,300	$ 4,053,871	$ 0.015

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

ACTUARIAL SECTION

Letter from the Actuary

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries
5605 N. MacArthur Blvd.
Suite 870
Irving, TX 75038-2631
469.524.0000 phone
469.524.0003 fax
www.gabrielroeder.com

December 11, 2006

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

Dear Trustees:

Subject: Actuarial Valuation as of June 30, 2006

We certify that the information contained in the 2006 actuarial valuation report is accurate and fairly presents the actuarial position of the Employees' Retirement System of the State of Hawaii (ERS) as of June 30, 2006, subject to our comments on the results based on the Statutory salary scale assumption versus the recommended salary scale assumptions.

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

Actuarial valuations

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

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

Financing objectives

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

Progress toward realization of financing objectives

The actuarial accrued liability, the unfunded actuarial accrued liability (UAAL), and the calculation of

Letter from the Actuary (continued)

Trustees
December 11, 2006
Page 2

the resulting funding period illustrate the progress toward the realization of financing objectives. Based on this actuarial valuation as of June 30, 2006 (including the Statutory 4% Salary Scale Assumption), ERS's underfunded status has increased because of a liability experience loss due to higher than expected salary increases. The UAAL is now $5.132 billion.

Based on the statutory employer contribution rate of 15.75% for Police and Fire employees, 13.75% for All Other Employees, and Employee contributions, the remaining amortization period is 35.2 years. Because this period is greater than 30 years, the financing objectives of ERS are not being realized.

Benefit provisions and Legislative Changes

There was no legislation enacted since the prior valuation that had a material actuarial impact on the valuation.

Although enacted by a prior Legislature, the new Hybrid Plan became effective as of July 1, 2006. In conjunction with the window for eligible active members there were 26,228 general employees and teachers who elected to transfer to the Hybrid Plan as of June 30, 2006. As such this is the first actuarial valuation reflecting the new Hybrid Plan provisions and members.

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

Assumptions and methods

With the exception of the assumptions for the investment return and for the salary scale, the actuarial assumptions used were adopted by the Board on August 14, 2006 based on the recommendations provided by an Experience Study performed by us. The investment return assumption and the salary scale assumption are set by legislative action. Further detail on the assumptions and methods may be found in the *Summary of Actuarial Methods and Assumptions* of this report.

In our opinion, the assumptions other than the Statutory 4% Salary Scale Assumption are internally consistent and are reasonably based on the actual experience of ERS. These assumptions are also in full compliance with all parameters established by GASB No. 25.

The study made no recommendation to change the Statutory 8% investment return assumption, but it did find that the Statutory 4% Salary Scale Assumption was no longer consistent with other economic assumptions and was no longer sufficient to reflect expected future salary increases. It was our recommendation to remove the salary scale assumption from ERS statutes and allow the Board to adopt a more reasonable assumption based on the actuary's recommendations, as it does with other assumptions.

We have tested the June 30, 2006 valuation results using the salary scale recommended in our Experience Study. While the use of that salary scale does not have a material impact on the UAAL or the funded ratio, it does have a significant impact on the GASB ARC, increasing it from 14.63% of pay to 15.29%.

The results of the actuarial valuation are dependent on the actuarial assumptions used. Actual results can and almost certainly will differ, as actual experience deviates from the assumptions. Even seemingly minor changes in the assumptions can materially change the liabilities, calculated contribution rates and

Letter from the Actuary (continued)

Trustees
December 11, 2006
Page 3

funding periods. The actuarial calculations are intended to provide information for rational decision making. As noted above, we no longer consider the Staturory salary scale assumption to be sufficient, and great care should be taken in evaluating modifications to the System.

Data

Member data for retired, active, and inactive participants was supplied as of March 31, 2006, by ERS's staff. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior year's data. Asset information was supplied by ERS's staff.

Responsibility for Tables and Schedules

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

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

The following exhibits and tables were prepared by the Actuary:

- Executive Summary
- Actuarial Certification Statement
  - Disclosure of Results based on Recommended Salary Scale Assumption
- Exhibit 1 – Development of Employer Cost
- Exhibit 2 – Actuarial Present Value of Future Benefits
- Exhibit 3 – Analysis of Normal Cost
- Exhibit 4 – Development of Actuarial Value of Assets
- Exhibit 5 – Total Experience Gain or Loss
- Exhibit 6 – Investment Experience Gain or Loss
- Exhibit 7 – Highlights of Last Five Annual Actuarial Valuations
- Ten-Year Actuarial Schedules
  - Membership Data, March 31, 2006
  - Historical Summary of Active Member Data

Sincerely,
Gabriel, Roeder, Smith & Company

Joe Newton, FSA, EA
Consultant

Lewis Ward
Consultant

W. Michael Carter
Senior Consultant

Executive Summary

The following summarizes the key results of the June 30, 2006 actuarial valuation of the Employees' Retirement System of the State of Hawaii (ERS). These results are based on the Statutory 4% Salary Scale Assumption.

Item	**2006**	**2005**
Membership		
• Number of		
- Active members	64,069	63,073
- Retirees and beneficiaries	34,304	33,301
- Inactive, vested	5,164	4,938
- Total	103,537	101,312
• Covered payroll for active members	$3,113.7 million	$2,924.5 million
• Actual benefit payments and refunds	$723.0 million	$679.8 million
Assets		
• Actuarial value	$9,529.4 million	$8,914.8 million
• Market value	$9,932.4 million	$9,195.9 million
• Return on actuarial value	9.8%	4.8%
• Return on market value	10.8%	11.1%
• Employer contributions during fiscal year	$423,445,597	$328,716,718
• External cash flow %	(2.5%)	(3.3%)
Actuarial Information		
• Total normal cost % (employee + employer	11.75%	7.25%
• Unfunded actuarial accrued liability (UAAL)	$5,132.0 million	$4,071.1 million
• Funded ratio (based on actuarial assets)	65.0%	68.6%
• Funded ratio (based on market assets)	67.7%	70.8%
• Funding period (years)	35.2	25.7
• Employer contribution rate % of projected payroll *	13.95%	13.95%
• GASB ARC % of projected payroll	14.63%	13.95%

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

Actuarial Certification Statement

		Police and Firefighters June 30, 2006		All Other Employees June 30, 2006		All Employees June 30, 2006
1. Gross normal cost as a percentage of pay		16.89%		11.17%		11.75%
2. Present value of future benefits						
a. Active employees	$	1,653,288,103	$	7,549,882,721	$	9,203,170,824
b. Inactive members		18,589,433		226,094,901		244,684,334
c. Pensioners and beneficiaries		1,161,932,796		6,296,513,813		7,458,446,609
d. Total	$	2,833,810,332	$	14,072,491,435	$	16,906,301,767
3. Present value of future employee and employer contributions						
a. Present value of future normal costs	$	446,641,040	$	1,798,261,959	$	2,244,902,999
b. Present value of future employee contributions		323,458,793		673,715,484		997,174,277
c. Present value of future employer normal cost (Item 3a - Item 3b)	$	123,182,247	$	1,124,546,475	$	1,247,728,722
4. Actuarial accrued liability (Item 2d - Item 3a)	$	2,387,169,292	$	12,274,229,476	$	14,661,398,768
5. Actuarial value of assets						
a. Annuity Savings Fund	$	505,171,523	$	401,172,600	$	906,344,123
b. Pension Accumulation Fund		1,218,269,520		7,404,757,621		8,623,027,141
c. Total	$	1,723,441,043	$	7,805,930,221	$	9,529,371,264
6. Unfunded actuarial accrued liability	$	663,728,249	$	4,468,299,255	$	5,132,027,504
7. Adequacy of contribution rates						
a. Statutory Contribution Rate as of July 1, 2006		15.75%		13.75%		13.95%
b. Funding Period in years as of June 30, 2006		39.5		34.7		35.2

The actuarial valuation as of June 30, 2006 is based on the provisions of GASB 25, except for the salary increase assumption and the amortization period of the unfunded actuarial accrued liability. The assumptions used in the cost calculations were those adopted by the Board of Trustees on August 14, 2006 based on statutory requirements and on the actuary's actuarial experience investigation report covering the five-year period July 1, 2000 – June 30, 2005. The actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures.

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

W. Michael Carter

W. Michael Carter, FSA, EA
Senior Consultant

Gabriel Roeder Smith & Company

Actuarial Certification Statement (continued)

Disclosure of Results Based on Recommended Salary Scale Assumption

The actuarial valuation results summarized in the Actuarial Certification Statement and discussed in this report are based on the recently adopted new actuarial assumptions, but they still reflect the Statutory 4% Salary Scale Assumption. As the Experience Study points out, the Statutory 4% Salary Scale Assumption is not adequate.

Since the current 4% salary scale assumption is specified by ERS statutes, the formal valuation results must reflect that assumption. In our opinion, however, we need to disclose the impact of using the recommended salary scale assumptions. These alternative results are as follow:

- The UAAL would be increased marginally from $5.132 billion to $5.185 billion.
- The funded ratio would be decreased marginally from 65.0% to 64.8%.
- The total normal cost would increase from 11.75% of pay to 12.43% of pay, and the employer normal cost would increase from 5.11% of pay to 5.77% of pay.
- The funding period based on the current 13.95% composite employer contribution rate would increase from 35.2 years to 43.0 years.
- The GASB ARC for 30-year funding would increase from 14.63% of pay to 15.29% of pay.

Summary of 2006 Actuarial Valuation

Exhibit 1
Development of Employer Cost

		Police and Firefighters June 30, 2006	All Other Employees June 30, 2006	All Employees June 30, 2006
1.	Payroll (adjusted for one year's pay increase)	$ 319,218,413	$ 2,919,048,335	$ 3,238,266,748
2.	Gross Normal Cost (Exhibit 3)	16.89%	11.17%	11.75%
3.	Employer normal cost rate (Exhibit 3)	4.69%	5.16%	5.11%
4.	Present value future benefits (Exhibit 2)	$ 2,833,810,332	$ 14,072,491,435	$ 16,906,301,767
5.	Present value future employer contributions	$ 123,182,247	$ 1,124,546,475	$ 1,247,728,722
6.	Present value future employee contributions	$ 323,458,793	$ 673,715,484	$ 997,174,277
7.	Actuarial accrued liability (Item 4 - Item 5 - Item 6)	$ 2,387,169,292	$ 12,274,229,476	$ 14,661,398,768
8.	Actuarial value of assets	$ 1,723,441,043	$ 7,805,930,221	$ 9,529,371,264
9.	Unfunded actuarial accrued liability (UAAL) (Item 7 - Item 8)	$ 663,728,249	$ 4,468,299,255	$ 5,132,027,504
10.	Funding period			
	a. Statutory Contribution Rate Beginning July 1, 2006	15.75%	13.75%	13.95%
	b. Less Employer normal cost	-4.69%	-5.16%	-5.11%
	c. Employer Amortization payment (level %) (Item 10a – Item 10b)	11.06%	8.59%	8.84%
	d. Funding Period in years	39.5	34.7	35.2

		Police and Firefighters June 30, 2005	All Other Employees June 30, 2005	All Employees June 30, 2005
1.	Payroll (adjusted for one year's pay increase)	$ 301,669,173	$ 2,739,413,977	$ 3,041,083,150
2.	Present value of future benefits (Exhibit 2)	$ 2,553,900,908	$ 12,052,394,283	$ 14,606,295,191
3.	Gross normal cost at June 30, 2005 (Exhibit 3)	16.56%	6.20%	7.25%
4.	Present value future normal cost	$ 411,270,963	$ 1,209,035,723	$ 1,620,306,686
5.	Actuarial accrued liability (Item 2 – Item 4)	$ 2,142,629,945	$ 10,843,358,560	$ 12,985,988,505
6.	Present value future employee contributions	$ 303,784,692	$ 91,205,087	$ 394,989,779
7.	Weighted effective employee contribution % (Exhibit 3)	12.20%	0.44%	1.70%
8.	Employer normal cost rate (Item 3 - Item 7)	4.36%	5.76%	5.55%
9.	Actuarial value of assets	$ 1,584,825,706	$ 7,330,013,557	$ 8,914,839,263
10.	Unfunded actuarial accrued liability (UAAL) (Item 5 - Item 9)	$ 557,804,239	$ 3,513,345,003	$ 4,071,149,242
11.	Funding period			
	a. Statutory Contribution Rate Beginning July 1, 2005	15.75%	13.75%	13.95%
	b. Less Employer normal cost	-4.36%	-5.76%	-5.55%
	c. Employer Amortization payment (level %) (Item 11a – Item 11b)	11.39%	7.99%	8.40%
	d. Funding Period in years	26.1	25.6	25.7

Gabriel Roeder Smith & Company

Summary of 2006 Actuarial Valuation (continued)

Exhibit 2
Actuarial Present Value of Future Benefits

	Police and Firefighters June 30, 2006	All Other Employees June 30, 2006	All Employees June 30, 2006
1. Active members			
a. Service retirement benefits	$ 1,562,992,111	$ 6,990,595,676	$ 8,553,587,787
b. Deferred termination benefits	36,626,047	191,900,588	228,526,635
c. Refunds	22,763,624	214,598,191	237,361,815
d. Survivor benefits	23,124,916	88,791,128	111,916,044
e. Disability retirement benefits	7,781,405	63,997,138	71,778,543
f. Total	$ 1,653,288,103	$ 7,549,882,721	$ 9,203,170,824
2. Retired members			
a. Service retirement	$ 1,096,483,513	$ 5,971,400,521	$ 7,067,884,034
b. Disability retirement	24,210,182	102,946,359	127,156,541
c. Beneficiaries	41,239,101	222,166,933	263,406,034
d. Total	$ 1,161,932,796	$ 6,296,513,813	$ 7,458,446,609
3. Inactive members			
a. Vested terminations	$ 14,972,009	$ 216,979,699	$ 231,951,708
b. Nonvested terminations	3,617,424	9,115,202	12,732,626
c. Total	$ 18,589,433	$ 226,094,901	$ 244,684,334
4. Total actuarial present value of future benefits	$ 2,833,810,332	$ 14,072,491,435	$ 16,906,301,767

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

Gabriel Roeder Smith & Company

Summary of 2006 Actuarial Valuation (continued)

Exhibit 3
Analysis of Normal Cost

	Police and Firefighters June 30, 2006	All Other Employees June 30, 2006	All Employees June 30, 2006
1. Normal cost as a percent of pay			
a. Service retirement benefits	14.09%	7.76%	8.41%
b. Deferred termination benefits	0.59%	1.09%	1.04%
c. Refunds	1.64%	1.95%	1.92%
d. Disability retirement benefits	0.15%	0.17%	0.17%
e. Survivor benefits	0.42%	0.20%	0.21%
f. Total	16.89%	11.17%	11.75%
2. Employee contribution rate	12.20%	6.01%	6.64%
3. Effective employer normal cost rate (Item 1f – Item 2c)	4.69%	5.16%	5.11%

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

Summary of 2006 Actuarial Valuation (continued)

Exhibit 4
Development of Actuarial Value of Assets

			Year Ending June 30, 2006
1.	Market value of assets at beginning of year	$	9,195,867,940
2.	Net new investments		
	a. Contributions	$	479,703,550
	b. Benefits paid		(720,542,990)
	c. Refunds		(2,487,279)
	d. Subtotal		(243,326,719)
3.	Market value of assets at end of year	$	9,932,411,221
4.	Net earnings (Item 3 - Item 1 - Item 2)	$	979,870,000
5.	Assumed investment return rate		8.00%
6.	Expected return	$	725,936,366
7.	Excess return (Item 4 – Item 6)	$	253,933,634
8.	Deferred amount as of June 30, 2006:		

Period End		Excess Return	Percent Deferred		Deferred Amount
June 30, 2006 (Item 7 above)	$	253,933,634	75%	$	190,450,226
June 30, 2005 (From 2005 report)		232,439,124	50%		116,219,562
June 30, 2004 (From 2004 report)		385,480,675	25%		96,370,169
June 30, 2003 (From 2003 report)		(300,575,565)	0%		-
				$	403,039,957

9.	Actuarial value of assets as of June 30, 2006 (Item 3 - Item 8)	$	9,529,371,264
10.	Ratio of actuarial value to market value		95.9%

Summary of 2006 Actuarial Valuation (continued)

Exhibit 5
Total Experience Gain or Loss

Item	Police and Firefighters June 30, 2006	All Other Employees June 30, 2006	All Employees June 30, 2006
A. Calculation of total actuarial gain or loss			
1. Unfunded actuarial accured liability (UAAL), as of June 30, 2005	$ 557,804,239	$ 3,513,345,003	$ 4,071,149,242
2. Restated June 30, 2005 UAAL after adoption of new assumptions	$ 661,570,149	$ 4,068,547,436	$ 4,730,117,585
3. Normal cost for the year (employer and employee) (based on new assumptions)	$ 50,559,753	$ 168,200,018	218,759,771
4. Less: Contributions and assessments for the year	$ (87,582,727)	$ (392,120,823)	$ (479,703,550)
5. Interest at 8%			
a. On UAAL	$ 52,925,612	$ 325,483,795	$ 378,409,407
b. On normal cost	2,022,390	6,728,001	8,750,391
c. On contributions	(3,503,309)	(15,684,833)	(19,188,142)
d. Total	$ 51,444,693	$ 316,526,963	$ 367,971,656
6. Expected UAAL aso fo June 30, 2006 (Sum of Items 2 – 5)	$ 675,991,868	$ 4,161,153,594	$ 4,837,145,462
7. Actual UAAL as of June 30, 2006	$ 663,728,249	$ 4,468,299,255	$ 5,132,027,504
8. Total gain (loss) for the year (Item 6 – Item 7)	$ 12,263,619	$ (307,145,661)	$ (294,882,042)
B. Source of gains and losses			
9. Asset gain (loss) for the year (Exhibit 6)	$ 27,066,885	$ 127,337,762	$ 154,404,647
10. Liability gain (loss) for the year	$ (14,803,266)	$ (175,298,087)	$ (190,101,353)
11. Change in benefit provisions	-	(259,185,336)	(259,185,336)
12. Total gain (loss) for the year	$ 12,263,619	$ (307,145,661)	$ (294,882,042)

Summary of 2006 Actuarial Valuation (continued)

Exhibit 6
Investment Experience Gain or Loss

Item	June 30, 2006		June 30, 2005	
1. Actuarial assets, beginning of year	$	8,914,839,264	$	8,797,133,149
2. Total contributions during year	$	479,703,550	$	385,771,339
3. Benefits and refunds paid	$	(723,030,269)	$	(679,758,813)
4. Assumed net investment income at 8%				
a. Beginning of year assets	$	713,187,141	$	703,770,652
b. Contributions		19,188,142		15,430,854
c. Benefits and refunds paid		(28,921,211)		(27,190,353)
d. Total	$	703,454,072	$	692,011,153
5. Expected actuarial assets, end of year (Sum of Items 1 through 4)	$	9,374,966,617	$	9,195,156,828
6. Actual actuarial assets, end of year	$	9,529,371,264	$	8,914,839,264
7. Asset gain (loss) for year (Item 6 – Item 5)	$	154,404,647	$	(280,317,564)
8. Asset gain (loss) as a percent of actuarial value of assets, end of year (Item 7 / Item 6)		1.62%		(3.14%)

Summary of 2006 Actuarial Valuation (continued)

Exhibit 7
Highlights of Last Five Annual Actuarial Valuations
2002 through 2006

Item	Valuation Date: June 30, 2002	2003	2004	2005	2006
Number of active members	62,208	62,292	62,573	63,073	64,069
Number of inactive members	3,835	4,150	4,501	4,938	5,164
Number of pensioners	28,770	29,730	30,503	31,344	32,199
Number of beneficiaries	1,560	1,659	1,794	1,957	2,105
Average monthly contributory plan pension amount	$ 1,571	$ 1,559	$ 1,636	$ 1,717	$ 1,792
Average monthly noncontributory plan pension amount	$ 1,208	$ 1,237	$ 1,272	$ 1,305	$ 1,335
Average monthly beneficiary amount	$ 875	$ 909	$ 950	$ 966	$ 989
Total actuarial value of assets ($millions)	$ 9,415	$ 9,074	$ 8,797	$ 8,915	$ 9,529
Unfunded actuarial accrued liabilities ($millions)	$ 1,795.1	$ 2,878.1	$ 3,474.2	$ 4,071.1	$ 5,132.0
Funding Period (in years) (1)	27.0	26.0	22.6	25.7	35.2

Item (Dollar amounts in millions)	Fiscal Year 2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
Total calculated appropriations	$ 193.1	$ 180.4	$ 229.8	$ 322.8	$ 423.4 (2)
EIR Program appropriations	8.1	8.1	5.9	5.9	-
Excess investment earnings credit	(33.7)	-	-	-	-
Net employers appropriations	$ 167.5	$ 188.5	$ 235.7	$ 328.7	$ 423.4 (2)

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

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

Gabriel Roeder Smith & Company

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

I. *Valuation Date*

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

II. *Actuarial Cost Method*

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

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

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

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

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

III. *Funding of Unfunded Actuarial Accrued Liability*

All of the following concepts will be discussed on an aggregate basis with regards to the contributory, the Hybrid, and the noncontributory plans. The total normal cost for benefits provided by ERS is 11.75% of payroll, which is 8.84% of payroll less than the total contributions required by Law (13.95% from employers plus 6.64% in the aggregate from employees). Since only 5.11% of the employer’s 13.95% contribution is required to meet the normal cost (6.64% comes from the employee contribution), it is intended that the remaining 8.84% of payroll will be used to amortize any unfunded actuarial accrued liabilities over a period of years in the future, assuming that total payroll increases by 3.50% per year.

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

IV. *Actuarial Value of Assets*

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

V. *Actuarial Assumptions*

A. Economic Assumptions

1. Investment return: 8% per year, compounded annually, composed of an assumed 3.00% inflation rate and a 5.00% net real rate of return. (Set by legislative action.)
2. Payroll growth rate: 3.50% per annum.
3. Salary increase rate: 4% per year, compounded annually. (Set by legislative action.)

B. Demographic Assumptions

1. Post-Retirement Mortality rates

General Employees

a. Healthy males – Client Specific Table for males, 90% multiplier.
b. Healthy females - Client Specific Table for females, 90% multiplier.
c. Disabled males - 1994 US Group Annuity Mortality Static Table for males, set forward ten years.
d. Disabled females - 1994 US Group Annuity Mortality Static Table for males, set forward eleven years.

Teachers

a. Healthy males – Client Specific Table for male teachers, 75% multiplier.
b. Healthy females - Client Specific Table for female teachers, 65% multiplier.
c. Disabled males - 1994 US Group Annuity Mortality Static Table for males, set forward four years.
d. Disabled females - 1994 US Group Annuity Mortality Static Table for males, set forward six years.

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

Police and Fire

a. Healthy males – 1994 US Group Annuity Mortality Static Table for males, 85% multiplier.

b. Healthy females - 1994 US Group Annuity Mortality Static Table for females, 85% multiplier.

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

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

2. Pre-retirement Mortality Rates

The male pre-retirement mortality rates are multiples of a table that has the RP-2000 Male Employee rates for ages 1 to 70 and the RP-2000 Combined Male rates for ages above 70. Similarly, the female pre-retirement rates are multiples of a table that has the RP-2000 Female Employee rates for ages 1 to 70 and the RP-2000 Combined Female rates for ages above 70. The following table shows the factors that are used in conjunction with the tables described above to derive the final ordinary and accidental death rates.

	General Employees	Teachers	Police and Fire
Type	Male and Females	Male and Females	Male and Females
Ordinary	40%	35%	15%
Accidental	10%	5%	35%

3. Disability rates – The assumed total disability rates for employees covered by the contributory plan, hybrid plan, and the noncontributory plan at select ages are multiples of the client specific table that follows:

Age	Male & Female
25	0.000%
30	0.001%
35	0.008%
40	0.026%
45	0.064%
50	0.146%
55	0.198%
60	0.217%

Note: The disability rates project the percentage of employees at each age that is assumed to become disabled before retiring. Multiples of the rates above are assumed

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

to be ordinary disability or accidental disability, and vary by employee group as follows:

Type	General Employees Male	General Employees Female	Teachers Male	Teachers Female	Police and Fire Male & Female
Ordinary	150%	95%	40%	40%	70%
Accidental	20%	5%	5%	5%	35%

4. Termination Rates - Separate male and female rates, based on both age and service, developed from 2006 Experience Study. Rates reflect terminations for causes other than death, disability or retirement. Employees eligible for retirement are assumed to have no probability of termination. Sample rates are shown below:

<u>For first 6 years of service</u>

Expected Terminations per 100 lives

Years of Service	General Employees Male	General Employees Female	Teachers Male	Teachers Female	Police and Fire Male & Female
0	15.5	18.5	32.0	28.0	22.0
1	12.5	16.5	22.0	22.0	15.0
2	10.5	12.5	14.0	15.0	8.0
3	9.0	10.0	12.0	14.0	8.0
4	7.0	8.0	10.0	11.0	8.0
5	6.5	7.0	9.0	8.0	8.0

<u>After first 6 years of service</u>

Expected Terminations per 100 lives

Years of Service

Age	General Employees Male	General Employees Female	Teachers Male	Teachers Female	Police and Fire Male & Female
25	6.08	7.38	4.35	6.50	2.00
30	5.04	4.82	4.12	5.80	2.82
35	4.03	3.75	3.80	4.41	2.50
40	3.36	3.02	3.38	3.32	1.66
45	2.81	2.49	2.57	2.65	0.94
50	2.58	2.62	2.56	2.60	0.66
55	3.67	3.92	4.53	4.97	0.00
60	4.00	4.24	5.59	4.66	0.00

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

4. Retirement rates - Separate male and female rates, based on age, developed from the 2006 Experience Study. Sample rates are shown below:

Expected Retirements per 100 Lives

	Contributory Plan and Hybrid Plan					Noncontributory Plan			
	General Employees		Teachers		Police and Fire	General Employees		Teachers	
Age	Male	Female	Male	Female	Male & Female	Male	Female	Male	Female
45	1	0	0	0	18	0	0	0	0
46	1	0	0	0	18	0	0	0	0
47	1	0	0	0	18	0	0	0	0
48	1	0	0	0	18	0	0	0	0
49	1	0	0	0	18	0	0	0	0
50	2	1	1	0	18	0	0	0	0
51	2	1	1	0	18	0	0	0	0
52	2	1	1	1	18	0	0	0	0
53	2	1	4	1	18	0	0	0	0
54	6	5	7	4	25	0	0	0	0
55	20	20	20	22	25	10	10	10	13
56	15	10	15	18	22	9	10	9	12
57	15	10	15	18	22	9	10	9	12
58	15	10	15	18	22	9	10	9	15
59	15	12	15	18	22	9	10	9	18
60	15	12	14	18	30	10	15	10	18
61	18	15	14	18	30	18	15	10	18
62	35	35	14	25	30	30	25	15	30
63	20	25	14	18	30	30	25	10	16
64	20	20	14	18	30	25	25	10	16
65	35	45	25	25	100	40	30	24	30
66	25	25	25	25	100	35	30	18	20
67	30	30	25	30	100	30	25	15	20
68	25	40	25	40	100	30	25	15	20
69	25	40	25	40	100	30	25	15	20
70	25	25	25	25	100	20	25	15	25
71	25	25	25	25	100	20	25	15	25
72	25	25	25	25	100	20	25	15	25
73	25	25	25	25	100	20	25	15	25
74	25	25	25	25	100	20	25	15	25
75	100	100	100	100	100	100	100	100	100

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

C. Other Assumptions

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

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

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

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

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

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

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

8. Sick Leave: It is assumed that all members will have their benefit service increased by sick leave and the following loads will be applied by group:

General Employees	3.75%
Teachers	4.25%
Police and Fire	5.00%

9. COLA delay: It is assumed that the first COLA will be received 9 months after retirement.

10. There will be no recoveries once disabled.

11. No surviving spouse will remarry and there will be no children's benefit.

12. Pay increase timing: Beginning of (fiscal) year. This is equivalent to assuming that reported pays represent amounts paid to members during the year ended on the valuation date.

13. Decrement timing: Retirements and terminations of Teachers are assumed to occur at the beginning of the year. All other decrements are assumed to occur mid-year.

Summary of Actuarial Methods and Assumptions (continued)
(Adopted on August 14, 2006)

14. Eligibility testing: Eligibility for benefits is determined based upon the age nearest birthday and service nearest whole year on the date the decrement is assumed to occur.

15. Decrement relativity: Decrement rates are used directly from the Experience Study, without adjustment for multiple decrement table effects.

16. Incidence of Contributions: Contributions are assumed to be received continuously throughout the year based upon the computed percent of payroll shown in this report, and the actual payroll payable at the time contributions are made.

17. Benefit Service: All members are assumed to accrue 1 year of service each year. Exact fractional service is used to determine the amount of benefit payable.

VI. Participant Data

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

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

VII. Dates of Adoption of Assumptions and Methods

Generally, actuarial assumptions and methods were adopted by the Board of Trustees on August 14, 2006 as recommended by Gabriel, Roeder, Smith & Company. The legislature sets the investment return assumption and the salary scale assumption in the statutes governing the ERS.

Summary of Plan Changes

Act 65, effective July 1, 1999

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

Act 100, effective June 30, 1999

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

Act 284, effective June 30, 2001

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

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

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

Act 199, effective June 30, 2003

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

Act 177, effective July 1, 2004

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

Act 179, effective July 1, 2004

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

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

Summary of Plan Changes (continued)

Act 181, effective July 1, 2004

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

Act 183, effective July 1, 2004

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

Act 56, effective December 1, 2004

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

Ten Year Actuarial Schedules
1997 to 2006

- Retirement System Membership **
  - 2006 Membership Data *
- Historical Summary of Active Member Data *
- Pensioners, Average Annual Pension and Active Member/Ptensioner Comparison **
- Number of Retirants and Beneficiaries **
- Solvency Test **
- Employer Contribution Rates as a Percentage of Payroll **
- Employer Appropriations to Pension Accumulation Fund, Appropriation Years 1999-2000 to 2008-2009 **

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

Retirement System Membership **
1997 to 2006

March 31,	Active Members	Inactive Vested Members	Pensioners & Beneficiaries	Total Membership
1998	57,797	2,650	27,403	87,850
1999	58,387	2,777	27,950	89,114
2000	59,191	3,016	28,715	90,922
2001	59,992	3,416	29,660	93,068
2002	62,208	3,835	30,330	96,373
2003	62,292	4,150	31,389	97,831
2004	62,573	4,501	32,297	99,371
2005	63,073	4,938	33,301	101,312
2006	64,069	5,164	34,304	103,537

** Schedule compiled by ERS Staff from actuary reports.

Ten-Year Actuarial Schedules (continued)

2006 Membership Data *
March 31, 2006

	Police and Firefighters		All Other Employees		All Employees	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
1. Active members						
a. Number	4,810	4,686	59,259	58,387	64,069	63,073
b. Total payroll	$ 306,940,757	$ 290,173,445	$2,806,776,437	$2,634,374,882	$3,113,737,194	$2,924,548,327
c. Average salary	$ 63,813	$ 61,923	$ 47,365	$ 45,119	$ 48,599	$ 46,368
d. Average age	40.6	40.5	46.9	46.7	46.4	46.3
e. Average service	13.3	13.3	13.0	13.0	13.0	13.0
2. Inactive members						
a. Number	165	176	4,999	4,762	5,164	4,938
b. Total annual deferred benefits	$ 2,420,586	$ 2,694,379	$ 35,456,789	$ 30,373,239	$ 37,877,375	$ 33,067,618
c. Average annual deferred benefit	$ 14,670	$ 15,309	$ 7,093	$ 6,378	$ 7,335	$ 6,697
3. Service retirees						
a. Number	2,615	2,533	28,209	27,487	30,824	30,020
b. Total annual benefits	$ 91,869,873	$ 86,191,368	$ 557,683,108	$ 527,568,988	$ 649,552,981	$ 613,760,356
c. Average annual benefit	$ 35,132	$ 34,027	$ 19,770	$ 19,193	$ 21,073	$ 20,445
4. Disabled retirees						
a. Number	167	167	1,208	1,157	1,375	1,324
b. Total annual benefits	$ 2,459,597	$ 2,432,795	$ 10,750,743	$ 10,071,800	$ 13,210,340	$ 12,504,595
c. Average annual benefit	$ 14,728	$ 14,568	$ 8,900	$ 8,705	$ 9,608	$ 9,445
5. Beneficiaries						
a. Number	153	144	1,952	1,813	2,105	1,957
b. Total annual benefits	$ 3,500,861	$ 3,134,050	$ 21,468,037	$ 19,541,675	$ 24,968,898	$ 22,675,725
c. Average annual benefit	$ 22,881	$ 21,764	$ 10,998	$ 10,779	$ 11,862	$ 11,587

* Prepared by Gabriel, Roeder, Smith & Company

Historical Summary of Active Member Data *
1997 to 2006

Year Ending June 30,	Active Members		Covered Payroll		Average Salary			
	Number	Percent Increase	Amount in $ Millions	Percent Increase	$ Amount	Percent Increase	Average Age	Average Service
1997	57,044	0.1%	2,019.3	1.5%	35,399	1.4%		
1998	57,797	1.3%	2,135.9	5.8%	36,955	4.4%		
1999	58,387	0.9%	2,186.5	2.4%	37,448	1.3%		
2000	59,191	1.4%	2,275.3	4.1%	38,440	2.6%	45.5	13.0
2001	59,992	1.4%	2,350.2	3.3%	39,175	1.9%	45.6	13.3
2002	62,208	3.7%	2,568.7	9.3%	41,292	5.4%	45.8	13.2
2003	62,292	0.1%	2,718.4	5.8%	43,640	5.7%	46.0	13.1
2004	62,573	0.5%	2,755.5	1.4%	44,037	0.9%	46.0	13.0
2005	63,073	0.8%	2,924.5	6.1%	46,368	5.3%	46.3	13.0
2006	64,069	1.6%	3,113.7	6.5%	48,599	4.8%	46.4	13.0

* Prepared by Gabriel, Roeder, Smith & Company

Gabriel Roeder Smith & Company

Ten-Year Actuarial Schedules (continued)

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

1997 to 2006

March 31,	Number of Pensioners	Average Annual Pension (1)	Ratio of Active Members per Pensioner
1997	26,152	$14,976	2.2
1998	26,257	$15,552	2.2
1999	26,709	$16,116	2.2
2000	27,357	$16,632	2.2
2001	28,210	$16,853	2.1
2002	28,770	$17,898	2.1
2003	29,730	$18,601	2.1
2004	30,503	$19,279	2.1
2005	31,344	$19,980	2.0
2006	32,199	$20,052	1.9

** Schedule compiled by ERS Staff from actuary reports.

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

Number of Retirants and Beneficiaries **

1997 to 2006

As of Mar 31,	Added	Average Added to Rolls	Removed	Average Removed from Rolls	Total	Average Pension	% Chg
Retirants [1]							
1997	943	n/a	696	n/a	27.173	$14.976	4.30%
1998	1,013	n/a	783	n/a	27,403	$15,552	3.90%
1999	1,311	n/a	764	n/a	27,950	$16,116	3.60%
2000	1,549	n/a	784	n/a	28,715	$16,632	3.20%
2001	1,668	n/a	723	n/a	29,660	$16,853	1.30%
2002	1,229	$18,707	739	$12,559	28,770	$17,898	4.10%
2003	1,723	$20,292	763	$12,836	29,730	$18,601	3.90%
2004	1,630	$20,136	857	$13,596	30,503	$19,279	3.60%
2005	1,694	$21,228	853	$12,608	31,344	$19,980	3.60%
2006	1,664	$20,562	809	$14,032	32,199	$20,583	3.02%
Beneficiaries [1]							
2002	176	$11,904	66	$ 6,660	1,560	$10,499	4.50%
2003	147	$12,137	48	$ 6,068	1,659	$10,909	3.90%
2004	177	$12,588	42	$7,596	1,794	$11,395	4.50%
2005	220	$10,395	57	$8,756	1,957	$11,587	1.70%
2006	214	$11,819	66	$10,455	2,105	$11,862	2.37%

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

n/a Information not available.

** Schedule compiled by ERS staff from actuary reports.

Ten-Year Actuarial Schedules (continued)

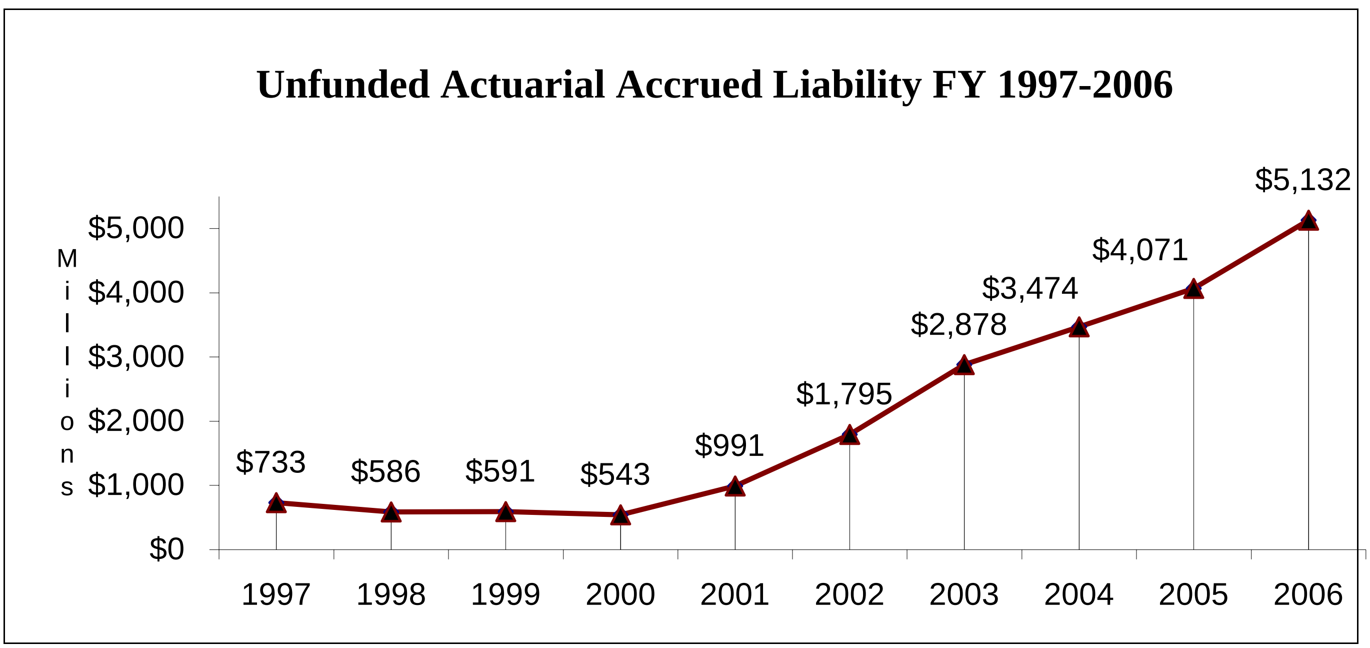
Solvency Test **

1997 to 2006

June 30,	Actuarial Accrued Liabilities (AAL) Active Member Contributions (1)	Retirees, Beneficiaries, and Inactive Vested Members (2)	Active and Inactive Members Employer Financed Portion (3)	Actuarial Value of Assets (4)	Cumulative Portion of Actuarial Accrued Liabilities Covered by Assets Column (1) (5)	Column (2) (6)	Column (3) (7)
1997	$830.7	$4,369.8	$2,716.9	$7,268.5	100%	100%	76.1%
1998	883.5	4,472.7	3,053.5	7,906.2	100%	100%	83.5%
1999	902.2	4,682.2	3,517.2	8,590.8	100%	100%	85.5%
2000	938.0	4,914.5	3,817.8	9,204.7	100%	100%	87.8%
2001	876.0	5,232.4	4,398.5	9,516.0	100%	100%	77.5%
2002	889.9	5,499.4	4,820.9	9,415.2	100%	100%	62.7%
2003	872.3	5,912.3	5,167.5	9,074.0	100%	100%	44.3%
2004	870.3	6,278.6	5,122.4	8,797.1	100%	100%	32.2%
2005	864.9	6,641.6	5,479.5	8,914.8	100%	100%	25.7%
2006	844.0	7,458.4	6,359.0	9,529.4	100%	100%	19.3%

(Amounts in $millions)

** Schedule compiled by ERS Staff from actuary reports



Ten-Year Actuarial Schedules (continued)

Employer Contribution Rates as a Percentage of Payroll **

1997 to 2006

Actuarial Valuation as of June 30,	Police and Firefighters			All Other Employees			All Active Employees		
	Normal Cost Rate	Amortization Percent	Total Employer Rate	Normal Cost Rate	Amortization Percent	Total Employer Rate	Normal Cost Rate	Amortization Percent	Total Employer Rate
1997	18.40%	-11.36%	7.04%	3.87%	-3.45%	0.42%	5.38%	-4.27%	1.11%
1998	11.47%	-11.22%	0.25%	4.28%	-3.88%	0.40%	4.99%	-4.61%	0.38%
1999	18.01%	-2.53%	15.48%	5.19%	1.61%	6.80%	6.46%	1.20%	7.66%
2000	13.17%	-8.82%	4.35%	6.03%	3.72%	9.75%	6.72%	2.50%	9.22%
2001	3.88%	4.16%	8.04%	5.59%	4.86%	10.45%	5.42%	4.78%	10.20%
2002	3.88%	6.46%	10.34%	5.62%	5.87%	11.49%	5.45%	5.93%	11.38%
2003	4.27%	11.06%	15.33%	5.73%	8.74%	14.47%	5.59%	8.96%	14.55%
2004	4.41%	11.34%	15.75%	5.75%	8.00%	13.75%	5.54%	8.41%	13.95%
2005	4.36%	11.39%	15.75%	5.76%	7.99%	13.75%	5.55%	8.40%	13.95%
2006	4.69%	11.06%	15.75%	5.16%	8.59%	13.75%	5.11%	8.84%	13.95%

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

** Schedule compiled by ERS Staff from actuary reports.

Ten-Year Actuarial Schedules (continued)

Employer Appropriations to Pension Accumulation Fund **

Appropriation Years 1999-2000 to 2008-2009

(Amounts in Millions)

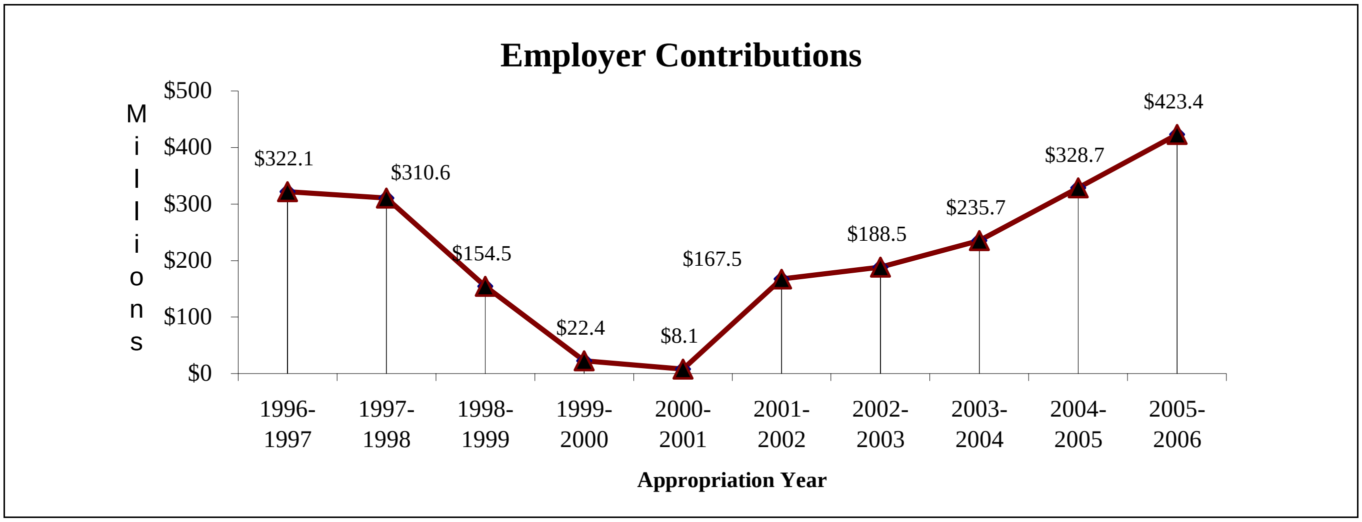
	Investment Yield Rate					
Fiscal Year	Assumed for Actuarial Valuation	Actuarial Investment Return	Appropriation Year	Total Calculated Contribution (1)	Investment Earnings Adjustment	Employer Appropriations
1996-1997	8.0%	13.72%	1999-2000	$179.3	$(156.9)	$ 22.4
1997-1998	8.0%	11.68%	2000-2001	164.4	(156.3)	8.1
1998-1999	8.0%	12.33%	2001-2002	201.2	(33.7)	167.5
1999-2000	8.0%	12.58%	2002-2003	188.5	-	188.5
2000-2001	8.0%	8.91%	2003-2004	235.7	-	235.7
2001-2002	8.0%	2.62%	2004-2005	328.7	-	328.7
2002-2003	8.0%	0.18%	2005-2006	N/A	-	N/A
2003-2004	8.0%	0.80%	2006-2007	N/A	-	N/A
2004-2005	8.0%	4.76%	2007-2008	N/A	-	N/A
2005-2006	8.0%	9.76%	2008-2009	N/A	-	N/A

Notes: (1) 2001 results adjusted for reamortization of Unfunded Actuarial Accrued Liability and Early Incentive Retirement Program to June 30, 2029 under Act 147/2002.

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

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

** Schedule compiled by ERS Staff from actuary reports.



State Retirement System's Funded Ratios

100% or more	4	North Carolina TSERS	108.1%	Delaware SEPP	101.6%
		Florida FRS	107.3%	Indiana PERF	100.1%
90% to 99%	16	Tennessee SETHEEPP	99.8%	Texas ERS	94.8%
		Wisconsin WRS	99.4%	Idaho PERS	94.2%
		Vermont VSRS	97.8%	Utah URS	93.2%
		Georgia ERS	97.2%	Pennsylvania PSERS	92.9%
		South Dakota SDRS	96.6%	Arizona ASRS	92.5%
		Oregon PERS	96.1%	New Mexico PERA	91.6%
		Minnesota MSRS	95.6%	North Dakota PERS	90.8%
		Wyoming WRS	95.1%	Virgina VRS	90.3%
80% to 89%	13	Iowa PERS	88.7%	Michigan MSERS	84.5%
		Ohio PERS	87.6%	Alabama ERS	84.0%
		California PERS	87.3%	West Virginia PERS	83.6%
		Maryland MSRPS	86.7%	Massachusetts SERS	82.8%
		Montana PERS	85.5%	Arkansas PERS	81.6%
		New Jersey PERS	85.3%	South Carolina SCRS	80.3%
		Missouri MOSERS	84.9%		
70% to 79%	8	Nevada PERS	77.3%	Mississippi PERS	72.4%
		Washington PERS	77.2%	Oklahoma PERS	72.0%
		Kentuucky KERS	74.6%	New Hampshire NHRS	71.8%
		Colorado PERA	72.9%	Alaska PERS	70.2%
Less than 70%	7	Kansas PERS	69.8%	Rhode Island ERSRI	59.4%
		Hawaii ERS *	**68.6%**	Illinois SERS	54.4%
		Maine MSRS	68.3%	Connecticut SERS	53.3%
		Louisiana LASERS	61.5%		

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

Note: GASB 25 funded ratios are shown for 48 general state retirement systems for valuation year(s) through January 1, 2006. A funded ratio is not shown for the Nebraska System because it is a defined contribution plan. A funded ratio for the New York System does not exist because of the use of the Aggregate Cost Method.

*** Hawaii's GASB 25 funded ratio for the fiscal year ended June 30, 2006 was 65.0%.**

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII

STATISTICAL SECTION

Summary

Plan Membership

Membership in the ERS increased by 2,225 to 103,537 for FY 2006, or slightly more than two percent for the year. Active members increased by 996, retired members and beneficiaries increased by 1,003, and terminated-vested members increased by 226. Membership data for the last ten years ended June 30, 2006 may be found on the following pages.

Net Assets vs. Liabilities

The charts on page 110-111 graphically represent the funding progress of the ERS for the ten years ended June 30, 2006. The area charts show the portion of the pension liabilities that are unfunded compared to the portion covered by assets in the pension trust and illustrate the funded ratio of the ERS for the ten years ended June 30, 2006.

The existence of the unfunded actuarial accrued liabilities is not necessarily an indication of the inability to meet financial obligations, but the existence of the unfunded actuarial accrued liabilities is important and must be monitored and controlled.

The remainder of this section contains various statistical and historical data considered useful in evaluating the condition of the ERS.

All nonaccounting data is taken from ERS' internal sources except for that information which is derived from the actuarial valuations.

Changes in Plan Net Assets

Last Ten Fiscal Years

Fiscal Year Ended June 30,:	1997	1998	1999	2000	2001
Additions					
Employer Contributions	$ 322,141,010	$ 310,627,135	$ 154,469,844	$ 22,392,100	$ 8,131,900
Member contributions	54,364,380	56,168,443	55,702,647	57,358,185	54,489,895
Investment income (net of expense)	1,293,952,952	1,251,839,166	904,809,348	695,151,054	(679,605,059)
Total additions to plan net assets	1,670,458,342	1,618,634,744	1,114,981,839	774,901,339	(616,983,264)
Deductions					
Benefits	432,732,753	447,897,525	478,744,074	514,401,221	544,906,809
Refunds	3,963,721	3,791,848	4,454,658	4,318,654	3,892,377
Administrative expenses	3,217,348	3,331,700	3,775,942	4,168,717	4,893,712
Other	-	-	29,272	-	-
Total deductions from plan net assets	439,913,822	455,021,073	487,003,946	522,888,592	553,692,898
Change in plan net assets	$1,230,544,520	$1,163,613,671	$ 627,977,893	$ 252,012,747	$ (1,170,676,162)
Plan net assets, beginning of year	6,657,623,420	7,888,167,940	9,051,781,611	9,679,759,504	9,931,772,251
Plan net assets, end of year	$7,888,167,940	$9,051,781,611	$9,679,759,504	$9,931,772,251	$ 8,761,096,089

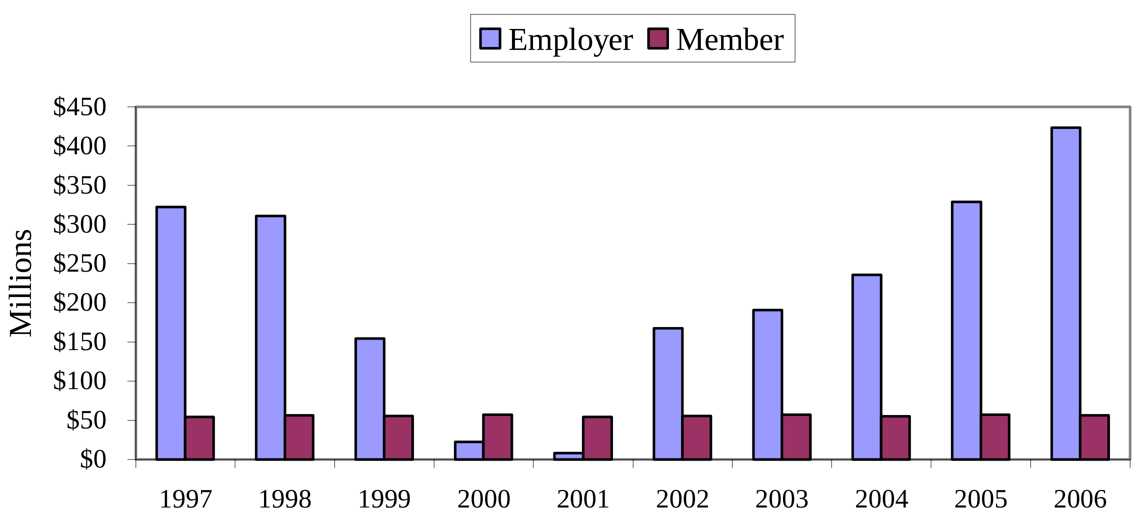
Fiscal Year Ended June 30,:	2002	2003	2004	2005	2006
Additions					
Employer Contributions	$ 167,458,900	$ 190,586,276	$ 235,685,796	$ 328,716,718	$ 423,445,597
Member contributions	55,451,216	57,214,521	55,116,452	57,054,621	56,257,953
Investment income (net of expense)	(503,995,093)	146,140,751	1,236,414,927	931,710,183	988,347,837
Total additions to plan net assets	(281,084,977)	393,941,548	1,527,217,175	1,317,481,522	1,468,051,387
Deductions					
Benefits	565,559,305	602,805,080	636,214,617	676,316,347	720,542,990
Refunds	3,244,334	2,605,602	2,328,796	3,442,466	2,487,279
Administrative expenses	5,754,832	6,780,824	10,468,508	7,259,906	8,477,837
Other	-	2,800	-	-	-
Total deductions from plan net assets	574,558,471	612,194,306	649,011,921	687,018,719	731,508,106
Change in plan net assets	$ (855,643,448)	$ (218,252,758)	$ 878,205,254	$ 630,462,803	$ 736,543,281
Plan net assets, beginning of year	8,761,096,089	7,905,452,641	7,687,199,883	8,565,405,137	9,195,867,940
Plan net assets, end of year	$7,905,452,641	$7,687,199,883	$8,565,405,137	$9,195,867,940	$ 9,932,411,221

Contributions

Contribution Rates as a Percentage of Payroll

Fiscal Year	Police & Firefighters	All Other Employees	Composite Rate
1997	7.04%	0.42%	1.11%
1998	0.25%	0.40%	0.38%
1999	15.48%	6.80%	7.66%
2000	4.35%	9.75%	9.22%
2001	8.04%	10.45%	10.20%
2002	10.34%	11.49%	11.38%
2003	15.33%	14.47%	14.55%
2004	15.75%	13.75%	13.95%
2005	15.75%	13.75%	13.95%
2006	15.75%	13.75%	13.95%

Contributions



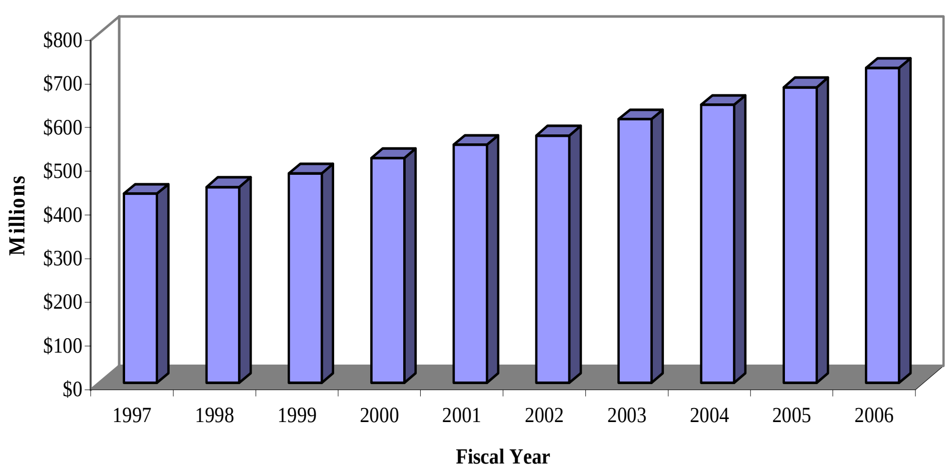
Deductions from Plan Net Assets for Benefit Payments by Type

Last Ten Fiscal Years

Fiscal Year Ended June 30,:	1997	1998	1999	2000	2001
Recurring benefit payments					
Service	$ 398,471,144	$ 415,522,492	$ 431,410,418	$ 460,293,937	$ 491,957,932
Disability	7,424,424	7,633,183	8,055,791	8,305,398	8,950,018
Death	4,626,452	3,770,474	4,581,030	2,644,579	2,369,546
subtotal	410,522,020	426,926,149	444,047,239	471,243,914	503,277,496
Refund Option payments (one-time)	22,210,733	20,971,376	34,696,835	43,157,307	41,629,313
Total benefit payments	$ 432,732,753	$ 447,897,525	$ 478,744,074	$ 514,401,221	$ 544,906,809

Fiscal Year Ended June 30,:	2002	2003	2004	2005	2006
Recurring benefit payments					
Service	$ 518,579,831	$ 557,439,020	$ 594,915,118	$ 632,088,342	$ 673,165,361
Disability	9,336,267	10,047,637	10,502,367	11,780,739	12,666,891
Death	2,465,179	1,749,855	3,147,690	2,793,149	3,875,024
subtotal	530,381,277	569,236,512	608,565,175	646,662,230	689,707,276
Refund Option payments (one-time)	35,178,028	33,568,568	27,649,442	29,654,117	30,835,714
Total benefit payments	$ 565,559,305	$ 602,805,080	$ 636,214,617	$ 676,316,347	$ 720,542,990

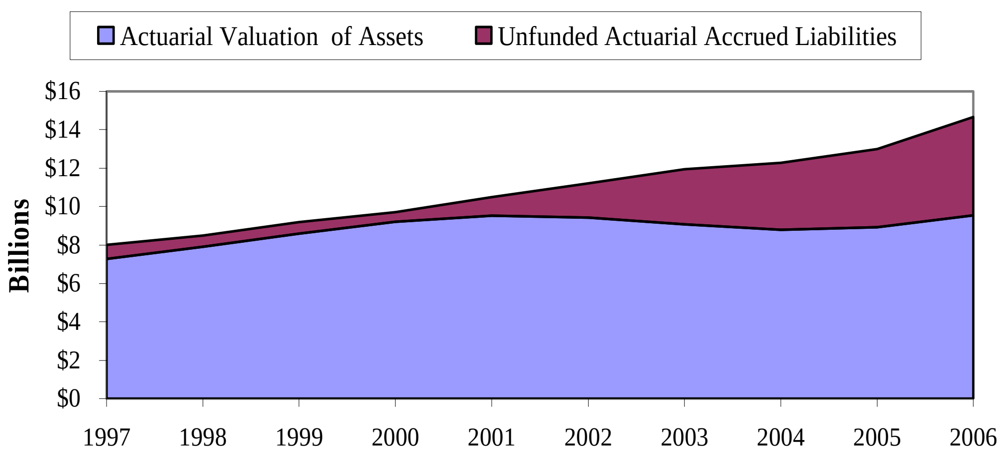
Benefit Payments



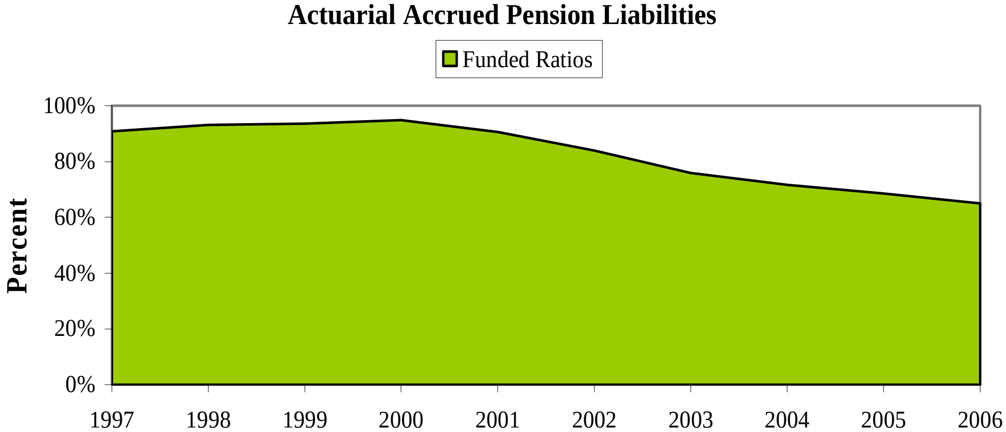
Actuarial Valuation of Assets vs. Actuarial Pension Liabilities

	Dollars in Billions			
Fiscal Year	Actuarial Valuation of Assets	Unfunded Actuarial Liabilities	Actuarial Accrued Liabilities	Funded Ratios
1997	$ 7.269	$ 0.733	$ 8.002	90.8%
1998	7.906	0.586	8.492	93.1%
1999	8.591	0.591	9.182	93.6%
2000	9.205	0.494	9.699	94.9%
2001	9.516	0.991	10.507	90.6%
2002	9.415	1.795	11.210	84.0%
2003	9.074	2.878	11.952	75.9%
2004	8.797	3.474	12.271	71.7%
2005	8.915	4.071	12.986	68.6%
2006	9.529	5.132	14.661	65.0%

Actuarial Accrued Liabilities



Actuarial Valuation of Assets as a Percent of Actuarial Accrued Pension Liabilities

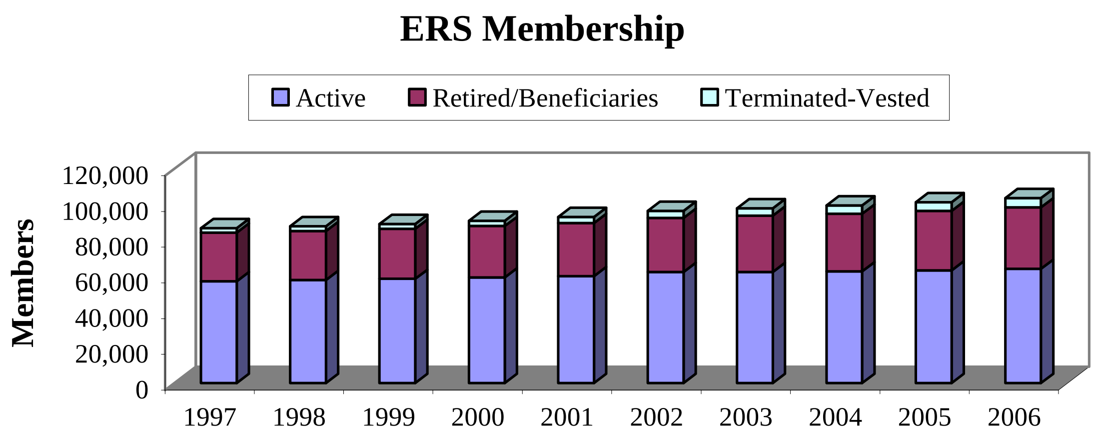


Participating Employers and Membership in ERS

Last Ten Fiscal Years

ERS Membership

As of March 31,:	Active	Retired/Beneficiaries	Terminated-Vested	Totals
1997	57,044	27,173	2,456	86,673
1998	57,797	27,403	2,650	87,850
1999	58,387	27,950	2,777	89,114
2000	59,191	28,715	3,016	90,922
2001	59,992	29,660	3,416	93,068
2002	62,208	30,330	3,835	96,373
2003	62,292	31,389	4,150	97,831
2004	62,573	32,297	4,501	99,371
2005	63,073	33,301	4,938	101,312
2006	64,069	34,304	5,164	103,537



Participating Employers and Active Members

As of March 31,:	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
State of Hawaii	43,259	43,900	44,645	45,451	46,185	48,242	48,445	48,704	49,203	49,973
City & County of Honolulu	8,375	8,385	8,215	8,190	8,236	8,323	8,223	8,158	8,101	8,167
- Board of Water Supply	664	670	673	657	616	589	568	554	568	560
Hawaii County	1,946	1,982	1,998	2,034	2,043	2,056	2,028	2,081	2,097	2,226
Kauai County	968	979	978	992	1,000	1,042	1,034	1,051	1,067	1,088
Maui County	1,832	1,881	1,878	1,867	1,912	1,956	1,994	2,025	2,037	2,055
Total	57,044	57,797	58,387	59,191	59,992	62,208	62,292	62,573	63,073	64,069

Benefit Payments by Retirement Type and Option

As of March 31, 2006

Retired Contributory Members

Monthly Benefit	Number of Recipients	Type of Retirement * 1	2	3	4	5	Retirement Option Max	Opt. 1	Opt. 2	Opt. 3	Opt. 4	Opt. 5	Other
$ 1 - 300	1,520	1,270	18	9	2	221	400	431	178	61	157	287	6
301 - 600	2,628	2,206	134	50	10	228	306	250	149	61	736	1,122	4
601 - 900	2,621	2,212	97	79	12	221	281	185	128	52	994	975	6
901 - 1,200	2,533	2,226	42	85	9	171	242	182	107	56	1,024	917	5
1,201 - 1,500	2,300	2,116	21	52	8	103	201	124	101	29	989	850	6
1,501 - 1,800	2,274	2,127	14	42	6	85	156	114	98	32	977	891	6
1,801 - 2,100	2,149	2,061	2	18	5	63	129	76	59	16	910	954	5
2,101 - 2,400	2,135	2,061	5	16	2	51	142	49	58	26	826	1,032	2
2,401 - 2,700	1,980	1,925	3	5	4	43	149	60	65	36	861	805	4
2,701 - 3,000	1,537	1,502	-	5	1	29	144	44	56	28	854	410	1
3,001	3,858	3,777	-	7	4	70	521	136	200	148	2,172	681	-
	25,535	23,483	336	368	63	1,285	2,671	1,651	1,199	545	10,500	8,924	45

Retired Noncontributory Members

Monthly Benefit	Number of Recipients	Type of Retirement * 1	2	3	4	5	Retirement Option Max	Opt. A	Opt. B	Opt. C	Other
$ 1 - 300	829	528	77	23	85	116	298	133	259	48	91
301 - 600	2,007	1,478	250	49	53	177	1,035	266	531	123	52
601 - 900	1,178	894	138	12	29	105	616	185	280	71	26
901 - 1,200	816	691	57	2	7	59	429	157	167	58	5
1,201 - 1,500	648	569	40	1	2	36	348	115	140	44	1
1,501 - 1,800	577	539	9	-	2	27	312	101	110	54	-
1,801 - 2,100	772	743	11	-	3	15	480	125	92	74	1
2,101 - 2,400	828	812	2	-	-	14	588	110	53	77	-
2,401 - 2,700	469	459	-	-	-	10	327	66	46	30	-
2,701 - 3,000	262	258	-	-	1	3	159	63	31	9	-
3,001	383	370	-	-	1	12	246	75	45	17	-
	8,769	7,341	584	87	183	574	4,838	1,396	1,754	605	176

* Type of Retirement

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

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

Average Monthly Service Pensions
by Years of Credited Service

		Years of Credited Service							
As of March 31,		0-9	10-14	15-19	20-24	25-29	30-34	35+	All
1997	Average Monthly Benefit	$201	$400	$659	$943	$1,539	$1,852	$1,985	$1,276
	Number of Active Retirants	1,515	2,903	2,781	3,152	6,146	5,741	2,839	25,077
1998	Average Monthly Benefit	$207	$411	$685	$978	$1,590	$1,918	$2,060	$1,321
	Number of Active Retirants	1,457	2,932	2,823	3,190	6,181	5,764	2,826	25,173
1999	Average Monthly Benefit	$212	$421	$710	$1,010	$1,645	$1,986	$2,143	$1,369
	Number of Active Retirants	1,409	3,012	2,882	3,266	6,306	5,879	2,854	25,608
2000	Average Monthly Benefit	$221	$426	$730	$1,032	$1,691	$2,044	$2,210	$1,414
	Number of Active Retirants	1,368	3,107	2,941	3,336	6,435	6,139	2,936	26,262
2001	Average Monthly Benefit	$225	$435	$746	$1,058	$1,739	$2,101	$2,269	$1,462
	Number of Active Retirants	1,322	3,192	3,001	3,416	6,598	6,508	3,052	27,089
2002	Average Monthly Benefit	$241	$467	$800	$1,140	$1,837	$2,200	$2,380	$1,523
	Number of Active Retirants	1,366	3,443	3,098	3,459	6,970	6,592	2,669	27,597
2003	Average Monthly Benefit	$241	$449	$788	$1,125	$1,837	$2,216	$2,384	$1,533
	Number of Active Retirants	1,298	3,535	3,166	3,581	7,127	7,037	2,802	28,546
2004	Average Monthly Benefit	$246	$463	$804	$1,156	$1,892	$2,298	$2,494	$1,597
	Number of Active Retirants	1,238	3,635	3,207	3,654	7,180	7,439	2,917	29,270
2005	Average Monthly Benefit	$255	$473	$823	$1,187	$1,951	$2,386	$2,599	$1,663
	Number of Active Retirants	1,193	3,738	3,244	3,715	7,233	7,806	3,091	30,020
2006	Average Monthly Benefit	$261	$489	$843	$1,210	$2,007	$2,446	$2,679	$1,719
	Number of Active Retirants	1,149	3,790	3,330	3,813	7,346	8,083	3,313	30,824

Retirees and Beneficiaries

(Recurring Benefit Payments)

Tabulated by Fiscal Year of Retirement as of March 31, 2006

Valuation Year	Number	Total Annual Benefits	Monthly Average Benefit	Valuation Year	Number	Total Annual Benefits	Monthly Average Benefit
1930	1	$ 373	$ 31	1980	489	$ 6,771,440	$ 1,154
1947	1	3,622	302	1981	632	8,608,664	1,135
1953	3	3,532	98	1982	653	9,323,755	1,190
1955	3	6,455	179	1983	727	11,308,708	1,296
1957	2	15,063	628	1984	786	12,489,832	1,324
1958	5	33,252	554	1985	877	14,740,048	1,401
1959	5	29,422	490	1986	945	16,625,095	1,466
1960	7	42,765	509	1987	1,393	26,100,546	1,561
1961	8	49,876	520	1988	810	12,539,372	1,290
1962	6	45,788	636	1989	973	17,047,855	1,460
1963	10	53,689	447	1990	1,034	19,674,143	1,586
1964	16	106,747	556	1991	1,158	22,855,780	1,645
1965	11	94,693	717	1992	1,055	22,575,764	1,783
1966	23	187,168	678	1993	1,100	25,108,278	1,902
1967	26	256,572	822	1994	1,153	25,479,363	1,842
1968	30	267,148	742	1995	2,140	57,711,520	2,247
1969	59	516,283	729	1996	2,016	51,269,558	2,119
1970	62	613,300	824	1997	812	15,314,602	1,572
1971	74	678,441	764	1998	838	15,092,405	1,501
1972	136	1,498,531	918	1999	1,177	24,289,718	1,720
1973	158	1,784,783	941	2000	1,386	30,003,828	1,804
1974	151	1,552,947	857	2001	1,610	34,553,410	1,788
1975	211	2,389,336	944	2002	1,332	28,909,304	1,809
1976	251	3,206,256	1,064	2003	1,709	40,693,183	1,984
1977	355	4,798,238	1,126	2004	1,659	36,716,125	1,844
1978	367	5,015,185	1,139	2005	1,734	38,133,452	1,833
1979	429	5,827,886	1,132	2006	1,696	34,719,044	1,706
				Total	34,304	$ 687,732,143	$ 20,048

Total Benefits Payable

(Recurring Benefit Payments)

Tabulated by Attained Ages of Benefit Recipients as of March 31, 2006

	Service Retirement		Disability Retirement		Survivors and Beneficiaries		Total	
Attained Ages	No.	Annual Benefits	No.	Annual Benefits	No.	Annual Benefits	No.	Annual Benefits
Under 20	-	-	-	-	54	$ 127,250	54	$ 127,250
20-24	-	-	-	-	9	61,188	9	61,188
25-29	-	-	-	-	18	148,919	18	148,919
30-34	-	-	1	$ 2,618	28	277,651	29	280,269
35-39	-	-	9	66,713	43	444,052	52	510,765
40-44	4	$ 134,623	40	347,487	68	753,749	112	1,235,859
45-49	71	2,429,807	96	787,859	77	670,253	244	3,887,919
50-54	306	10,602,878	163	1,550,018	130	1,472,660	599	13,625,556
55-59	2,769	79,602,824	279	2,863,682	223	2,777,171	3,271	85,243,677
60-64	5,310	135,809,486	275	2,517,019	247	3,401,668	5,832	141,728,173
65-69	5,752	129,716,925	162	1,618,104	243	3,528,075	6,157	134,863,104
70-74	5,618	115,593,091	101	990,445	254	3,325,673	5,973	119,909,209
75-79	4,859	88,379,642	104	1,125,274	294	3,842,249	5,257	93,347,165
80-84	3,492	53,949,266	86	814,150	209	2,136,012	3,787	56,899,428
85-89	1,782	23,593,401	41	390,809	141	1,454,546	1,964	25,438,756
90-94	650	7,400,986	14	96,106	53	474,020	717	7,971,112
95-99	190	2,118,449	3	31,402	12	69,796	205	2,219,647
100	11	118,390	-	-	1	3,638	12	122,028
101	3	31,095	-	-	-	-	3	31,095
102	3	35,043	1	8,654	1	328	5	44,029
103	2	24,989	-	-	-	-	2	24,989
104	1	6,516	-	-	-	-	1	6,516
105	1	5,570	-	-	-	-	1	5,490
Total	30,824	$ 649,552,981	1,375	$ 13,210,340	2,105	$ 24,968,898	34,304	$ 687,732,143