

Public Education Employees' Health
Insurance Fund

(A Component Unit of the State of Alabama)

FINANCIAL STATEMENTS

For the Fiscal Year Ended September 30, 2006

135 South Union Street • P. O. Box 302150 • Montgomery, Alabama 36130-2150
(334) 832-4140 or 1-800-214-2158 • <http://www.rsa.state.al.us>



KPMG LLP
Suite 1800
420 20th Street North
Birmingham, AL 35203

Independent Auditors' Report

The Public Education Employees'
Health Insurance Board:

We have audited the accompanying balance sheet of the Public Education Employees' Health Insurance Fund (a component unit of the State of Alabama) as of September 30, 2006, and the related statements of revenues, expenses, and changes in fund equity and cash flows for the year then ended. These financial statements are the responsibility of the management of the Public Employees' Health Insurance Fund. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Public Employees' Health Insurance Fund's 2005 financial statements and, in our report dated March 8, 2006, we expressed an unqualified opinion on such financial statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Public Education Employees' Health Insurance Fund (a component unit of the State of Alabama) as of September 30, 2006, and its changes in fund equity for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 4 and the claims development information on page 15 are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 15, 2007

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

The Public Education Employees' Health Insurance Fund (PEEHIF) is a health insurance plan for active and retired employees' of state educational institutions. The following discussion provides an overview of the financial position and results of operation for the PEEHIF as of and for the year ended September 30, 2006, respectively. For more detailed information, please refer to the financial statements, including the Notes to the Financial Statements and the Required Supplementary Information.

Financial Statements and Required Supplementary Information

The financial statements include the Balance Sheet, Statement of Revenues, Expenses, and Changes in Fund Equity and the Statement of Cash Flows. The Notes to the Financial Statements are considered an integral part of the financial statements. The financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred, regardless of when cash is received or expended. Investments are reported at fair value.

Balance Sheet – Includes all assets and liabilities of the PEEHIF and provides a snapshot of the financial position of the PEEHIF as of the end of the fiscal year. Assets equal liabilities plus fund equity.

Statement of Revenues, Expenses, and Changes in Fund Equity – Reports all revenues and expenses of the PEEHIF for the fiscal year. Revenues include premiums, changes in the fair value of investments, and interest income. Expenses are principally made up of claims. Revenues minus expenses provide the income/(loss) for the fiscal year. Income/(loss) plus the beginning fund equity provides the fund equity at fiscal year-end.

Cash Flow Statement – Provides information about the cash receipts and cash payments of the PEEHIF during the year. The cash flow statement is divided into two sections – operating and investing activities. Also, a reconciliation of operating income to net cash provided by operating activities is presented. The PEEHIF had no activities related to noncapital financing or capital and related financing during the fiscal year. The PEEHIF cash flow statement was prepared using the direct method, as required by GASB Statement Number 34. Under the direct method, major classes of receipts and payments are displayed. The net change in cash during the year plus the cash at the beginning of the year equals the cash at the end of the year.

The Notes to the Financial Statements include a description of the organization, a summary of significant accounting policies, a description of contract administrators including the methods in which fees are determined, credit risk disclosures for cash and investments, concentration of investments disclosures, and disclosures concerning unpaid claims liabilities.

The Required Supplementary Information following the Notes to the Financial Statements provides information pertaining to claims development. A table is used to illustrate the ten-year historical trend information on how PEEHIF's earned revenues and interest income compare to related costs of loss and other expenses assumed by PEEHIF as of the year-end.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

Comparative Summary Statements

Summary Comparative Balance Sheet
As of September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>% Increase (Decrease)</u>
<i>Assets</i>				
Cash	\$ 1,080,198	\$ 247,687	\$ 832,511	336.11
Receivables	3,456,002	1,130,979	2,325,023	205.58
Investments	292,256,941	136,229,270	156,027,671	114.53
Deposits with Claims-Paying Agent	<u>20,393,366</u>	<u>1,804,138</u>	<u>18,589,228</u>	1,030.37
Total Assets	<u>\$ 317,186,507</u>	<u>\$ 139,412,074</u>	<u>\$ 177,774,433</u>	127.52
<i>Liabilities</i>				
Payables	\$ 18,296,828	\$ 22,168,749	\$ (3,871,921)	(17.47)
Claims Incurred but not Reported	<u>52,355,000</u>	<u>56,041,000</u>	<u>(3,686,000)</u>	(6.58)
Total Liabilities	70,651,828	78,209,749	(7,557,921)	(9.66)
Fund Equity	<u>246,534,679</u>	<u>61,202,325</u>	<u>185,332,354</u>	302.82
Total Liabilities and Fund Equity	<u>\$ 317,186,507</u>	<u>\$ 139,412,074</u>	<u>\$ 177,774,433</u>	127.52

Summary Comparative Statement of Revenues, Expenses, and Changes in Fund Equity
For the Fiscal Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>% Increase (Decrease)</u>
<i>Operating Revenues</i>				
Premiums	\$ 1,022,077,378	\$ 868,149,703	\$ 153,927,675	17.73
Interest Income	11,142,597	3,314,974	7,827,623	236.13
Net (Decrease)/Increase in Fair Value of Investments	<u>(57,716)</u>	<u>1,908,739</u>	<u>(1,966,455)</u>	(103.02)
Total Operating Revenues	<u>1,033,162,259</u>	<u>873,373,416</u>	<u>159,788,843</u>	18.30
<i>Operating Expenses</i>				
Claims	845,221,339	784,654,834	60,566,505	7.72
Administrative	<u>2,608,566</u>	<u>3,343,107</u>	<u>(734,541)</u>	(21.97)
Total Operating Expenses	<u>847,829,905</u>	<u>787,997,941</u>	<u>59,831,964</u>	7.59
Operating Income	185,332,354	85,375,475	99,956,879	117.08
Fund Equity/(Deficit) - Beginning of Year	<u>61,202,325</u>	<u>(24,173,150)</u>	<u>85,375,475</u>	353.18
Fund Equity - End of Year	<u>\$ 246,534,679</u>	<u>\$ 61,202,325</u>	<u>\$ 185,332,354</u>	302.82

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

Financial Analysis

- Premiums receivable increased as a result of premiums received after the year end cut-off date that had to be deposited after the fiscal year end.
- The increase in Deposits with Claims-Paying Agent resulted from several Express Scripts rebates received throughout the fiscal year.
- The increase in the employer cost rate resulted in additional cash and investments. Also, premiums increased as a result of an increase in the employer cost rate.
- Interest receivable and interest income increased as a result of additional investments.
- Rising interest rates resulted in a decrease in fair value of existing fixed income securities.

Financial Highlights

- The significant increase in fund equity was a result of an increase in the employer rate and the implementation of new cost-saving measures. The employer rate established by the Legislature has increased 15% from \$583 for 2005 to \$668 for 2006. The fund equity of the PEEHIF at September 30, 2006 was \$246,534,679.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Balance Sheet
September 30, 2006 with comparative figures for 2005

	2006	2005
<i>Assets</i>		
Cash (Note 1)	\$ 1,080,198	\$ 247,687
Receivables		
Premiums	2,026,017	698,944
Interest	1,429,985	432,035
Total Receivables	3,456,002	1,130,979
Deposit with Claims-Paying Agent	20,393,366	1,804,138
Investments, at Fair Value (Note 4)	292,256,941	136,229,270
Total Assets	\$ 317,186,507	\$ 139,412,074
 <i>Liabilities</i>		
Accounts Payable	\$ 12,148	\$ 4,124
Employee Benefits Payable	440,240	301,757
Reported Claims Payable (Note 5)	17,844,440	21,862,868
Claims Incurred but not Reported (Note 5)	52,355,000	56,041,000
Total Liabilities	70,651,828	78,209,749
 <i>Fund Equity</i>		
Expense	620,510	(70,962)
Insurance	245,914,169	61,273,287
Total Fund Equity	246,534,679	61,202,325
Total Liabilities and Fund Equity	\$ 317,186,507	\$ 139,412,074

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Statement Of Revenues, Expenses And Changes In Fund Equity
For the Fiscal Year Ended September 30, 2006 with comparative figures for 2005

	<u>2006</u>	<u>2005</u>
<i>Operating Revenues</i>		
Premiums	\$ 1,011,949,735	\$ 868,149,703
Medicare Part D Reimbursement	10,127,643	-
Interest Income	11,142,597	3,314,974
Net (Decrease)/Increase in Fair Value of Investments	<u>(57,716)</u>	<u>1,908,739</u>
 <i>Total Operating Revenues</i>	 <u>1,033,162,259</u>	 <u>873,373,416</u>
 <i>Operating Expenses</i>		
Claims (Notes 2 and 5)	845,221,339	784,654,834
Administrative	<u>2,608,566</u>	<u>3,343,107</u>
 <i>Total Operating Expenses</i>	 <u>847,829,905</u>	 <u>787,997,941</u>
 <i>Operating Income</i>	 185,332,354	 85,375,475
 <i>Fund Equity</i>		
Beginning of Year	<u>61,202,325</u>	<u>(24,173,150)</u>
End of Year	<u>\$ 246,534,679</u>	<u>\$ 61,202,325</u>

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Statement Of Cash Flows
For the Fiscal Year Ended September 30, 2006 with comparative figures for 2005

	2006	2005
<i>Cash Flows From Operating Activities</i>		
Receipts from Participants	\$ 1,010,622,662	\$ 877,363,148
Receipts from Medicare Part D	10,127,643	-
Payments to Suppliers	(999,199)	(2,213,616)
Payments to Employees	(1,462,860)	(1,140,574)
Claims Paid	(871,514,994)	(797,732,317)
<i>Net Cash Provided by Operating Activities</i>	146,773,252	76,276,641
 <i>Cash Flows from Investing Activities</i>		
Interest from Investments	10,144,646	4,925,309
Purchases of Investments	(3,501,968,075)	(2,388,008,048)
Sales and Maturities of Investments	3,345,882,688	2,306,387,719
<i>Net Cash Used by Investing Activities</i>	(145,940,741)	(76,695,020)
<i>Net Increase/(Decrease) in Cash</i>	832,511	(418,379)
Cash at Beginning of Year	247,687	666,066
<i>Cash at End of Year</i>	\$ 1,080,198	\$ 247,687
 <i>Reconciliation of Operating Income to Net Cash</i>		
<i>Provided by Operating Activities</i>		
Operating Income	\$ 185,332,354	\$ 85,375,475
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Interest Income	(11,142,597)	(3,314,974)
Net Decrease/(Increase) in Fair Value of Investments	57,716	(1,908,739)
(Increase)/Decrease in Assets:		
Premium Receivable	(1,327,072)	9,213,446
Deposit with Claims Paying Agent	(18,589,228)	(523,862)
Increase/(Decrease) in Liabilities:		
Accounts Payable	8,024	(55,266)
Employee Benefits Payable	138,483	44,182
Reported Claims Payable	(4,018,428)	(9,670,621)
Claims Incurred but not Reported	(3,686,000)	(2,883,000)
<i>Net Cash Provided by Operating Activities</i>	\$ 146,773,252	\$ 76,276,641
 <i>Noncash Investing Activities</i>		
Unrealized Decrease in Fair Value of Investments	\$ (46,805)	\$ (60,640)
Increase in Interest Receivable	997,950	366,999

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

1) Organization and Summary of Significant Accounting Policies

A. General

The Public Education Employees' Health Insurance Fund (PEEHIF) was established in 1983 under the provisions of Act 83-455 of the Alabama Legislature to provide a uniform plan of health insurance for employees and retired employees of state educational institutions which provide instruction at any combination of grades K-14 (collectively eligible employees), and to provide a method for funding the benefits related to the plan. The four-year universities are eligible and may elect to participate in the plan. At this time, Jacksonville State is the only university that has elected to participate in the plan. Responsibility for the establishment of the health insurance plan and its general administration and operations is vested in the Public Education Employees' Health Insurance Board (PEEHIB). In accordance with the Governmental Accounting Standards Board (GASB), the PEEHIF is considered a component unit of the State of Alabama (State) and is included in the State's *Comprehensive Annual Financial Report*.

The Public Education Employees' Health Insurance Plan (PEEHIP) offers a basic hospital/medical plan that provides basic medical coverage for up to 365 days of care during each hospital confinement. The basic hospital/medical plan also provides for physicians' benefits, outpatient care, prescription drugs, and mental health benefits. Major medical benefits under the basic hospital/medical plan are subject to a lifetime contract maximum of \$1,000,000 for each covered individual.

Also available through the PEEHIP is an option to enroll in a health maintenance organization (HMO) in lieu of the basic hospital/medical plan. The HMO generally provides the same coverage as the basic hospital/medical plan.

Optional plans which may be selected in addition to or in lieu of the basic hospital/medical plan or HMO include: Hospital Indemnity, Cancer, Dental, and Vision. The Hospital Indemnity Plan provides a per day benefit for hospital confinement, maternity, intensive care, cancer and convalescent care. The Cancer Plan provides a per day benefit for each hospital confinement related to cancer only. The Dental Plan covers diagnostic and preventive services as well as basic and major services based on reasonable and customary charges up to \$1,000 per year per person with dependent coverage (\$1,250 per year per person with employee coverage only). The Vision Plan covers annual eye examinations as well as the cost of either eyeglasses or contact lenses.

The State contributes a specified amount (the employer rate) monthly to each respective participating school system. Each participating school system must then pay the employer rate to the PEEHIF each month. That rate was \$668 per participant per month for 2006. In addition to the employer payments each month, the employee pays certain premium amounts. Participants should refer to the PEEHIP's contracts for a more complete description of the PEEHIP's provisions. During fiscal year 2003, the Legislature passed Act 2003-473 (effective October 1, 2003) which requires universities that do not participate in PEEHIP to pay the health insurance costs of its retirees to the PEEHIF.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

A. General, Continued

The monthly employer premium established by the Legislature in the 2006 Budget was paid in accordance with the recommendation by the PEEHIP management. The recommendation was based on the determination made by the third party actuary.

The Teachers' Retirement System of Alabama (TRS) has been appointed as the administrator of the PEEHIF.

B. Basis of Accounting

The PEEHIF is a proprietary fund that operates under the accrual basis of accounting. The PEEHIF has elected to exercise paragraph 6 of Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting." Statement 20, paragraph 6, requires that all proprietary activities should apply all applicable GASB pronouncements as well as any Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure (CAP) issued on or before November 30, 1989, unless such FASB, APB, and CAP pronouncements conflict with or contradict GASB pronouncements. FASB pronouncements issued after November 30, 1989, even if they modify an applicable FASB, APB, or CAP pronouncement, are not applicable unless adopted by a GASB pronouncement.

C. Cash

Cash consists of deposits held by the State Treasurer in the PEEHIF's name. Deposits are entirely insured by Federal depository insurance or protected under the Security for Alabama Funds Enhancement (SAFE) Program. The *Code of Alabama 1975* requires all State organizations to participate in the SAFE Program. The SAFE Program is a multiple financial institution collateral pool. The SAFE Program requires all public funds to be deposited in a financial institution designated by the State Treasurer as a qualified public depository. Each qualified public depository is required to pledge collateral in accordance with the rules established by the SAFE Board of Directors. In the event that a qualified public depository defaults or becomes insolvent and the pledged collateral is insufficient to satisfy the claims of public depositors, the *Code of Alabama 1975, Section 41-14A-9(3)* authorizes the State Treasurer to make assessments against the other qualified public depositories in the pool so that there will be no loss of public funds. Cash restricted for payment of administrative expenses at September 30 was \$1,072,897.

D. Expense Fund

The PEEHIB designated \$3,300,000 of premiums received to be used for the payment of administrative expenses.

The administrative costs incurred directly for the operation of the PEEHIF are paid from the expense fund. No indirect costs are allocated to the PEEHIF by the TRS.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

E. Investments

The Board of Control of the PEEHIF has the responsibility and authority to invest and reinvest available funds, through the secretary-treasurer and investment committee, in bonds, mortgage-backed securities, mortgages, common and preferred stock, and other investment vehicles with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use. All plan assets are carried at fair value. U.S. agency obligations and corporate bonds are reported at the last reported sales price. Commercial paper is reported at cost, which approximates fair value. Generally, private placements are valued based on the selling price of similar investments sold in the open market. In those instances where there are no similar investments sold in the open market, an appraisal is performed to determine the fair value of the private placements.

F. Premiums

Premium revenue is recognized in the period in which the related coverage is provided. Premium payments that have not been received by the end of a coverage period are recorded as premium receivable. Likewise, premiums received before the month of coverage are recorded as unearned premiums.

G. Medicare Part D

Medicare Part D reimbursements are the result of PEEHIP continuing prescription drug coverage for Medicare beneficiaries and qualifying for the Medicare subsidy.

H. Unpaid Claims Liabilities

Claims liabilities are established based on the actual cost of claims reported but not settled, and estimates of claims that have been incurred but not reported. Actual claims costs ultimately incurred may vary from estimated claims liabilities should the nature and frequency of actual claims vary from historical claims experience on which the estimates are based. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

I. Employee Benefits

The PEEHIF records a liability and charge to expense for all compensated absences attributable to services already rendered and that are not contingent on specific events outside the control of the employer or employee.

J. Equity

Expense equity is allocated for the payment of administrative expenses. Insurance equity is allocated for the payment of insurance benefits.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

K. Comparative Statements

The basic financial statements include the prior year Balance Sheet, Statement of Revenues, Expenses and Changes in Fund Equity, and Statement of Cash Flows (Statements) for comparative purposes only. Prior year Note Disclosures are not included. Therefore, the prior year basic financial statement presentation does not meet the minimum level of detail required for a presentation in conformity with generally accepted accounting principles. Accordingly, the prior year Statements should be read in conjunction with the PEEHIF's prior year financial report from which the prior year Statements were derived.

2) Contract Administrators

Blue Cross and Blue Shield of Alabama (BCBS), under contract with the PEEHIB, administered medical claims incurred in accordance with the plan. BCBS administrative fee was \$8.00 per month per contract subject to a maximum of 2.55 percent of paid claims. The \$8.00 per member per month fee was charged to the PEEHIF.

Express Scripts, Inc., under contract with the PEEHIB, administered claims under the prescription drug plan. Express Scripts administrative fee was \$.74 per prescription. Certain additional fees are based on specific services directed by PEEHIB. The \$.74 per prescription fee was charged to the PEEHIF.

Southland National Corporation (Southland), under contract with the PEEHIB, administered claims under the optional plans. The PEEHIF paid Southland an amount equal to covered charges plus processing fees. The processing fees per month per contract were \$.80 for Group Hospital Indemnity, \$.65 for Group Cancer, \$1.15 for Group Vision, and \$1.49 for Group Dental.

3) Facilities

The PEEHIF operates in facilities provided at no cost by the Retirement Systems of Alabama.

4) Investments

A. Investment Risks

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, and foreign currency risk. The following describes those risks:

Interest Rate Risk – The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. However, the Fund's intent is to hold all fixed maturity investments until maturity, and as such, fixed maturity investments are classified in the following tables as if they were held to maturity.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

A. Investment Risks, Continued

Custodial Credit Risk – For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The PEEHIF's custodial credit risk policy requires the custodial agent to hold or direct its agents or subcustodians to hold, for the account of the PEEHIF all securities and other non-cash property other than securities in the Federal Reserve book-entry system, in a clearing agency which acts as a securities depository, or in another book-entry system. The PEEHIF's safekeeping agent holds all investments of the PEEHIF in the PEEHIF's name.

Credit Quality – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. Domestic fixed-maturity investments may consist of rated or non-rated securities. International fixed-maturity investments may consist of securities with a rating of at least A by one of the principal rating agencies at the time of purchase or acquisition, except that up to 2% of the fair value of the Fund's total portfolio may be invested in obligations of sovereign countries with a rating of BBB or BAA at the time of purchase. The Fund may hedge against the possible adverse effects of currency fluctuations on the Fund's portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A-2 and/or P-2, repurchase agreements, short-term U.S. securities, and other money market investments.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by the Fund, the issuing company must be incorporated in a country whose debt securities are eligible for purchase as discussed above, and the market value of the aggregate outstanding equity of the issuing company must be at least \$100 million.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments. The policy limits are as follows:

- Domestic Fixed Income – Limited to 100% of the market value of the aggregate portfolio for the Fund.
- International Fixed Income – Limited to 10% of the market value of the Fund's total portfolio.
- Domestic Equity – Limited to 65% of the market value of the Fund's aggregate portfolio.
- International Equity – The aggregate market value of international equities is limited to 15% of the aggregate market value of the Fund's total portfolio. Also, the Fund may not purchase or hold more than 5% of any class of the outstanding stock of a company.
- Real Estate – The suggested limit is 10% of the book value of the Fund's portfolio.
- Alternative Investments (mezzanine financing, LBO's, venture capital, limited partnerships, futures, commodities and derivative investments) – Limited to 5% of the book value of the Fund's aggregate portfolio.
- Short-term Investments – Limited to 100% of the market value of the Fund's aggregate portfolio in order to maintain adequate liquidity for payment of member health care benefits.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2006

A. Investment Risks, Continued

The following table provides information as of September 30, 2006, concerning the fair value of investments and interest rate risk:

INVESTMENTS						
Maturity in Years at Fair Value						
Type of Investment	Less Than 1	1-5	6-10	More Than 10	Total Fair Value	Cost
Commercial Paper	\$ 274,211,725	\$ -	\$ -	\$ -	\$ 274,211,725	\$ 274,211,725
U.S. Agency	-	27,162	425,104	-	452,266	457,938
U.S. Government	-	-	174,161	-	174,161	173,826
Corporate Bonds	-	3,145,494	4,939,150	1,424,139	9,508,783	9,523,744
Private Placements	-	599,114	-	-	599,114	528,902
Money Market Funds	7,310,892	-	-	-	7,310,892	7,310,892
Total Investments	\$ 281,522,617	\$ 3,771,770	\$ 5,538,415	\$ 1,424,139	\$ 292,256,941	\$ 292,207,027

The following table provides information as of September 30, 2006, concerning credit risk:

RATINGS OF FIXED MATURITIES

Moody's Ratings	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
AAA	\$ 960,511	\$ 956,053	0.328
AA2	1,123,884	1,112,338	0.385
AA3	2,596,810	2,532,543	0.889
A1+	7,310,892	7,310,892	2.502
A1	2,257,526	2,238,637	0.772
A2	1,204,713	1,209,411	0.412
BAA2	1,218,983	1,212,242	0.417
BAA3	1,197,736	1,249,360	0.410
P-1	38,324,244	38,324,244	13.113
P-2	235,887,480	235,887,480	80.712
US Govt Guaranteed Securities	174,162	173,827	0.060
Totals	\$ 292,256,941	\$ 292,207,027	100.000

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

B. Concentration of Investments

As of September 30, 2006, the PEEHIF owned debt securities of Wellpoint Health Networks Inc., General Mills Inc., Fortune Brands Inc., and Devon Energy Corporation, which represented approximately 10.26%, 9.87%, 8.52%, and 6.84%, respectively, of the total fair value of investments. Also, the PEEHIF owned debt securities of Lennar Corporation, Erac USA Finance Company, Henkel Corporation, and Georgia Transmission Corporation, which represented approximately 5.13%, 5.13%, 5.13%, and 5.09%, respectively, of the total fair value of investments.

5) Unpaid Claims Liabilities

As discussed in note 1, the PEEHIB establishes a liability for both reported and unreported insured claims, which includes provisions for both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities for the PEEHIF for 2006.

Unpaid Claims and Claim Adjustment Expenses at Beginning of Year	<u>\$ 77,903,868</u>
Incurred Claims and Claim Adjustment Expenses:	
Provision for Insured Events of the Current Year	858,906,241
Decrease in Provision for Insured Events for Prior Years	<u>(13,684,902)</u>
Total Incurred Claims and Claim Adjustment Expenses	<u>845,221,339</u>
Payments:	
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Current Year	788,706,800
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Prior Years	<u>64,218,967</u>
Total Payments	<u>852,925,767</u>
Total Unpaid Claims and Claim Adjustment Expenses at the End of the Year	<u>\$ 70,199,440</u>

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Required Supplementary Information

Claims Development Information

The table below illustrates the ten-year historical trend information designed to provide information on how PEEHIF's earned revenues and interest income compare to related costs of loss and other expenses assumed by PEEHIF as of year end. The lines of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of PEEHIF including overhead and claims expense not allocable to individual claims. (3) This line shows PEEHIF's incurred claims and allocated claim adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year). (4) This line shows the cumulative amounts paid as of the end of successive years for each policy year. (5) This line shows how each policy years incurred claims increased or decreased as of the end of successive years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for each policy year matures, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of estimated incurred claims currently recognized.

	Fiscal and Policy Year Ended									
	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Net Eamed Required Contribution &										
Investment Revenue	1,033,162,259	873,373,416	718,715,820	634,410,480	595,952,446	521,723,278	477,884,011	413,668,819	360,342,883	267,583,308
Unallocated Expenses	2,608,566	3,343,107	1,260,963	1,025,558	974,241	983,990	937,250	963,340	860,141	781,676
Estimated Incurred Claims & Expense, End of Policy Year	858,906,241	802,623,937	743,386,649	669,577,643	585,644,385	513,357,060	481,793,561	423,521,222	366,969,637	334,665,168
Paid (Cumulative) As Of:										
End of Policy Year	788,706,800	724,720,069	652,929,160	596,615,950	521,678,377	457,395,191	428,697,525	369,264,166	329,040,044	298,566,573
One Year Later	-	788,939,036	725,417,546	661,597,558	582,642,812	508,554,859	476,492,804	418,497,511	366,394,973	334,841,113
Reestimated Incurred Claims & Expense, End of Policy Year	858,906,241	802,623,937	743,386,649	669,577,643	585,644,385	513,357,060	481,793,561	423,521,222	366,969,637	334,665,168
One Year Later	-	788,939,036	725,417,546	661,597,558	582,642,812	508,554,859	476,492,804	418,497,511	366,394,973	334,841,113
Increase (Decrease) in Estimated Incurred Claims & Expenses										
End of Policy Year	-	(13,684,902)	(17,969,103)	(7,980,085)	(3,001,573)	(4,802,201)	(5,300,757)	(5,023,711)	(574,664)	175,945