

Public Employees' Individual Retirement  
Account Fund/Deferred Compensation Plan  
(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 20<sup>th</sup> Street North  
Birmingham, AL 35203

## **Independent Auditors' Report**

The Board of Control  
Public Employees' Individual Retirement  
Account Fund/Deferred Compensation Plan:

We have audited the accompanying statement of fiduciary net assets of the Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan (a component unit of the State of Alabama) as of September 30, 2006, and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the management of the Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan. 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' Individual Retirement Account Fund/Deferred Compensation Plan'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' Individual Retirement Account Fund/Deferred Compensation Plan'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 Employees' Individual Retirement Account Fund/Deferred Compensation Plan (a component unit of the State of Alabama) as of September 30, 2006, and its changes in fiduciary net assets 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 and 3 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 7, 2007

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Management's Discussion and Analysis**

The Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan (PEIRAF/DCP) operates as a deferred compensation plan as defined in Section 457 of the Internal Revenue Code of the United States. The following discussion provides an overview of the financial position and results of operation for the PEIRAF/DCP 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.

**Financial Statements**

The financial statements include the Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets. 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.

Statement of Fiduciary Net Assets – Includes all assets and liabilities of the PEIRAF/DCP and provides a snapshot of the financial position of the PEIRAF/DCP as of the end of the fiscal year. Assets less liabilities results in the net assets held in trust for members at fiscal year-end.

Statement of Changes in Fiduciary Net Assets – Reports all additions and deductions of the PEIRAF/DCP for the fiscal year. Additions are primarily comprised of member contributions and investment income. Deductions are principally made up of normal distributions. Additions minus deductions provide the change in fiduciary net assets for the fiscal year. The change in fiduciary net assets plus the beginning fiduciary net assets results in the fiduciary net assets held in trust for members at fiscal year-end.

The Notes to the Financial Statements include plan descriptions, a summary of significant accounting policies, credit risk disclosures for cash and investments, concentration of investments disclosures, and securities lending disclosures.

**Comparative Summary Statements**

**Summary Comparative Statement of Fiduciary Net Assets  
As of September 30, 2006 and 2005**

|  | <u>2006</u>           | <u>2005</u>           | <u>Variance</u>      | <u>% Increase<br/>(Decrease)</u> |
|--|-----------------------|-----------------------|----------------------|----------------------------------|
| <i>Assets</i>  |                       |                       |                      |                                  |
| Cash   | \$ 2                  | \$ -                  | \$ 2                 | -                                |
| Member Contributions Receivable  | 5,438                 | -                     | 5,438                | -                                |
| Interest Receivable  | 11,043,432            | 10,538,786            | 504,646              | 4.79                             |
| Investments  | 928,277,989           | 870,163,849           | 58,114,140           | 6.68                             |
| Invested Securities Lending Collateral                                 | <u>147,428,391</u>    | <u>122,971,577</u>    | <u>24,456,814</u>    | 19.89                            |
| <b>Total Assets</b>  | <u>1,086,755,252</u>  | <u>1,003,674,212</u>  | <u>83,081,040</u>    | 8.28                             |
| <i>Liabilities</i>   |                       |                       |                      |                                  |
| Securities Lending Collateral  | <u>147,428,391</u>    | <u>122,971,577</u>    | <u>24,456,814</u>    | 19.89                            |
| <b>Total Liabilities</b>   | <u>147,428,391</u>    | <u>122,971,577</u>    | <u>24,456,814</u>    | 19.89                            |
| <b>Net Assets Held in Trust for<br/>Deferred Compensation Benefits</b> | <u>\$ 939,326,861</u> | <u>\$ 880,702,635</u> | <u>\$ 58,624,226</u> | 6.66                             |

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Management's Discussion and Analysis**

**Summary Comparative Statement of Changes in Fiduciary Net Assets  
For the Fiscal Years Ended September 30, 2006 and 2005**

|   | <u>2006</u>           | <u>2005</u>           | <u>Variance</u>      | <u>% Increase<br/>(Decrease)</u> |
|---|-----------------------|-----------------------|----------------------|----------------------------------|
| <i><b>Additions</b></i>   |                       |                       |                      |                                  |
| Member Contributions  | \$ 74,002,222         | \$ 66,287,771         | \$ 7,714,451         | 11.64                            |
| Interest and Dividend Income  | 47,894,489            | 41,921,848            | 5,972,641            | 14.25                            |
| Net (Decrease)/Increase in Fair Value of Investments  | (1,938)               | 2,484,775             | (2,486,713)          | (100.08)                         |
| Net Income from Securities Lending Activities   | <u>283,235</u>        | <u>392,261</u>        | <u>(109,026)</u>     | <u>(27.79)</u>                   |
| Total Additions   | <u>122,178,008</u>    | <u>111,086,655</u>    | <u>11,091,353</u>    | <u>9.98</u>                      |
| <i><b>Deductions</b></i>  |                       |                       |                      |                                  |
| Normal Distributions  | 62,951,274            | 37,542,151            | 25,409,123           | 67.68                            |
| Emergency Withdrawals   | <u>602,508</u>        | <u>484,890</u>        | <u>117,618</u>       | <u>24.26</u>                     |
| Total Deductions  | <u>63,553,782</u>     | <u>38,027,041</u>     | <u>25,526,741</u>    | <u>67.13</u>                     |
| <i><b>Increase in Fiduciary Net Assets</b></i>  | 58,624,226            | 73,059,614            | (14,435,388)         | (19.76)                          |
| Net Assets Held in Trust for Deferred<br>Compensation Benefits - Beginning of Year          | <u>880,702,635</u>    | <u>807,643,021</u>    | <u>73,059,614</u>    | <u>9.05</u>                      |
| <i><b>Net Assets Held in Trust for Deferred<br/>Compensation Benefits - End of Year</b></i> | <u>\$ 939,326,861</u> | <u>\$ 880,702,635</u> | <u>\$ 58,624,226</u> | <u>6.66</u>                      |

**Financial Analysis**

- Member contributions increased in fiscal year 2006 primarily as a result of Deferred Retirement Option Program (DROP) rollovers. Fiscal year 2006 was the first full year of DROP distributions. A significant amount of DROP distributions were rolled into PEIRAF/DCP.
- Interest income increased primarily as a result of higher interest rates.
- The fair value of investments decreased due to higher interest rates and valuations of publicly and privately traded debt securities.
- The decrease in securities lending income resulted from an increase in borrower rebates.
- Normal distributions increased in fiscal year 2006 mainly as a result of rollovers to other plans.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND**  
**DEFERRED COMPENSATION PLAN**  
**Statement of Fiduciary Net Assets**  
**September 30, 2006 with comparative figures for 2005**

|  | <u>2006</u>               | <u>2005</u>               |
|--|---------------------------|---------------------------|
| <i>Assets</i>  |                           |                           |
| Cash   | \$ 2                      | \$ -                      |
| Member Contributions Receivable  | 5,438                     | -                         |
| Interest Receivable  | 11,043,432                | 10,538,786                |
| Investments, at Fair Value (Note 2)                                    |                           |                           |
| Commercial Paper   | 120,993,198               | 52,494,354                |
| Money Market and Mutual Funds  | 23,437,831                | 34,212,042                |
| U. S. Government Guaranteed Bonds                                      | 83,516,705                | 98,069,162                |
| U. S. Agency Securities  | 176,871,765               | 193,536,312               |
| Mortgage-backed Securities   | 3,717,348                 | 4,092,859                 |
| Corporate Bonds  | 298,832,262               | 291,139,892               |
| Private Placements   | 65,840,190                | 78,232,951                |
| Common Stocks  | <u>155,068,690</u>        | <u>118,386,277</u>        |
| Total Investments  | <u>928,277,989</u>        | <u>870,163,849</u>        |
| Invested Securities Lending Collateral                                 | <u>147,428,391</u>        | <u>122,971,577</u>        |
| <br>Total Assets   | <br><u>1,086,755,252</u>  | <br><u>1,003,674,212</u>  |
| <br><i>Liabilities</i>   |                           |                           |
| Securities Lending Collateral  | <u>147,428,391</u>        | <u>122,971,577</u>        |
| <br>Total Liabilities  | <br><u>147,428,391</u>    | <br><u>122,971,577</u>    |
| <br><i>Net Assets Held in Trust for Deferred Compensation Benefits</i> | <br><u>\$ 939,326,861</u> | <br><u>\$ 880,702,635</u> |

See accompanying Notes to the Financial Statements.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND**  
**DEFERRED COMPENSATION PLAN**  
**Statement of Changes in Fiduciary Net Assets**  
**For the Fiscal Year Ended September 30, 2006 with comparative figures for 2005**

|  | <u>2006</u>                   | <u>2005</u>                   |
|--|-------------------------------|-------------------------------|
| <i><b>Additions</b></i>  |                               |                               |
| Member Contributions   | \$ 74,002,222                 | \$ 66,287,771                 |
| Investment Income  |                               |                               |
| <i>From Investing Activities</i>   |                               |                               |
| Interest and Dividends   | 47,894,489                    | 41,921,848                    |
| Net (Decrease)/Increase in Fair Value of Investments                           | <u>(1,938)</u>                | <u>2,484,775</u>              |
| Total Investment Income from Investing Activities                              | <u>47,892,551</u>             | <u>44,406,623</u>             |
| <i>From Securities Lending Activities</i>                                      |                               |                               |
| Securities Lending Income  | 6,103,996                     | 3,610,016                     |
| Less Securities Lending Expenses:  |                               |                               |
| Borrower Rebates   | 5,770,781                     | 3,152,675                     |
| Management Fees  | <u>49,980</u>                 | <u>65,080</u>                 |
| Total Securities Lending Expenses  | <u>5,820,761</u>              | <u>3,217,755</u>              |
| Net Income from Securities Lending Activities                                  | <u>283,235</u>                | <u>392,261</u>                |
| Total Investment Income  | <u>48,175,786</u>             | <u>44,798,884</u>             |
| <br><i><b>Total Additions</b></i>  | <br><u><b>122,178,008</b></u> | <br><u><b>111,086,655</b></u> |
| <br><i><b>Deductions</b></i>   |                               |                               |
| Normal Distributions   | 62,951,274                    | 37,542,151                    |
| Emergency Withdrawals  | <u>602,508</u>                | <u>484,890</u>                |
| <br><i><b>Total Deductions</b></i>   | <br><u><b>63,553,782</b></u>  | <br><u><b>38,027,041</b></u>  |
| <br><i><b>Net Increase</b></i>   | <br><b>58,624,226</b>         | <br><b>73,059,614</b>         |
| <br><i><b>Net Assets Held in Trust for Deferred Compensation Benefits:</b></i> |                               |                               |
| Beginning of Year  | <u>880,702,635</u>            | <u>807,643,021</u>            |
| End of Year  | <u><b>\$ 939,326,861</b></u>  | <u><b>\$ 880,702,635</b></u>  |

See accompanying Notes to the Financial Statements.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN**  
**Notes to the Financial Statements**  
**For the Fiscal Year Ended September 30, 2006**

**1) Organization and Summary of Significant Accounting Policies**

**A. Plan Description**

On November 26, 1986, the Public Employees' Individual Retirement Account Fund (PEIRAF or "The Board") Board of Control established the Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan (PEIRAF/DCP) under the provision of Act 86-685 of the 1986 Legislature to afford the PEIRAF members the greatest possible tax benefits under the federal income tax laws. The PEIRAF/DCP operates as a deferred compensation plan as defined in Section 457 of the Internal Revenue Code of the United States and began receiving deferred portions of employees' income on January 1, 1987. The responsibility for the general administration and operation of the PEIRAF/DCP is vested in its Board of Control. In accordance with the Governmental Accounting Standards Board (GASB), the PEIRAF/DCP is considered a component unit of the State of Alabama (State) and is included in the State's *Comprehensive Annual Financial Report*.

Effective January 1, 2006, each member may defer a maximum of \$15,000 per calendar year. Any member, age 50 and older, may make additional deferrals of \$5,000 for calendar year 2006. Since its creation, PEIRAF/DCP funds have been invested in fixed income investments such as corporate bonds, U.S. agency obligations, government national mortgage association securities, and commercial paper. However, in an effort to give members more flexibility within their portfolios, members have been offered the opportunity to invest in an S & P 500 Index Fund since January 1, 2001.

All members of the Teachers' Retirement System of Alabama, Employees' Retirement System of Alabama, Judicial Retirement Fund, and employees of employers eligible to participate in the Employees' Retirement System pursuant to provisions of Section 36-27-6, *Code of Alabama 1975*, and public officials and employees of the State of Alabama or any political subdivision thereof (collectively, participating employers) are members of the PEIRAF/DCP and are eligible to participate. At September 30, 2006, there were 30,417 participants.

Effective October 1, 1997, the PEIRAF/DCP adopted Trust status in compliance with The Small Business Job Protection Act of 1996. Deferred income and investment earnings are held in trust for the exclusive benefit of the plan's participants and their beneficiaries.

**B. Cash**

Cash consists of deposits held by the State Treasurer in the PEIRAF/DCP'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.



**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Notes to the Financial Statements  
For the Fiscal Year Ended September 30, 2006**

**C. Basis of Accounting**

The PEIRAF/DCP is a private purpose trust fund that operates under the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred, regardless of the timing of the cash flows in accordance with standards of the Governmental Accounting Standards Board.

**D. Investments**

The Board of Control has the authority and responsibility to invest and reinvest available funds, through the secretary-treasurer of the Employees' Retirement System, in bonds, mortgage-backed securities, common and preferred stocks, or 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 investments are carried at fair value. Securities traded on national exchanges are valued at the last reported sales price at current exchange rates. Money market securities with a remaining maturity of one year or less at the time of purchase are reported at cost, which approximates fair value. Mortgage-backed securities are reported based on future principal and interest payments discounted at the prevailing interest rate for similar instruments. 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.

**E. Income Distribution**

All investment income earned on the accrual basis is posted monthly to member accounts based on average daily balances. Income posted to member accounts was at an annual rate of 4.50 percent for the fixed investment option and 10.59 percent for the stock investment option.

**F. Administrative Costs**

Under the provisions of Legislative Act 2001-1061, the administrative costs incurred directly for the operation of the PEIRAF/DCP are provided from the expense funds of the Teachers' Retirement System and the Employees' Retirement System.

**G. Distribution Policy**

An employee may retire or terminate service and receive a lump-sum distribution, a partial distribution followed by equal monthly payments, or a monthly disbursement. Current Internal Revenue Code and Regulations require that distributions to the member begin not later than April 1 of the calendar year following the calendar year in which the employee attains age 70-1/2 or retires, whichever is later. Generally, distributions may begin at any age following retirement or separation of service.

Normal distributions include monthly benefit disbursements, lump-sum distributions upon retirement or separation of service, and rollovers to other qualified plans. Member withdrawals include emergency disbursements.



**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Notes to the Financial Statements  
For the Fiscal Year Ended September 30, 2006**

**H. Comparative Statements**

The basic financial statements include the prior year Statement of Fiduciary Net Assets and Statement of Changes in Fiduciary Net Assets (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 PEIRAF/DCP's prior year financial report from which the prior year Statements were derived.

**2) 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.

**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 PEIRAF/DCP's custodial credit risk policy requires the custodial agent to hold or direct its agents or subcustodians to hold, for the account of the PEIRAF/DCP 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 PEIRAF/DCP's safekeeping agent holds all investments of the PEIRAF/DCP in the PEIRAF/DCP'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.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Notes to the Financial Statements  
For the Fiscal Year Ended September 30, 2006**

**A. Investment Risks, Continued**

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 Fixed Income portfolio.
- International Fixed Income – Limited to 10% of the market value of the Fixed Income portfolio.
- Domestic Equity – Limited to 100% of the market value of the Equity portfolio.
- International Equity – The aggregate market value of international equities is limited to 15% of the aggregate market value of the Equity portfolio. Also, the Fund may not purchase or hold more than 5% of any class of the outstanding stock of a company.
- Alternative Investments (mezzanine financing, LBO's, venture capital, limited partnerships, futures, commodities and derivative investments) – Limited to 5% of the book value of the respective Fixed Income and Equity portfolios.
- Short-term Investments – Limited to 20% of the market value of the respective Fixed Income and Equity portfolios.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN**

**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:

| Type of Investment            | INVESTMENTS                     |                       |                       |                       | Total Fair Value             | Cost                         |
|-------------------------------|---------------------------------|-----------------------|-----------------------|-----------------------|------------------------------|------------------------------|
|                               | Maturity in Years at Fair Value |                       |                       |                       |                              |                              |
|                               | Less Than 1                     | 1-5                   | 6-10                  | More Than 10          |                              |                              |
| <i>Fixed Maturity</i>         |                                 |                       |                       |                       |                              |                              |
| Domestic                      |                                 |                       |                       |                       |                              |                              |
| Commercial Paper              | \$ 120,993,198                  | \$ -                  | \$ -                  | \$ -                  | \$ 120,993,198               | \$ 120,993,198               |
| U.S. Agency                   | -                               | 65,435,011            | 109,778,770           | 1,657,984             | 176,871,765                  | 179,255,549                  |
| U.S. Government Guaranteed    | -                               | -                     | 83,516,705            | -                     | 83,516,705                   | 84,247,072                   |
| Corporate Bonds               | 4,012,475                       | 105,091,584           | 97,796,560            | 91,931,643            | 298,832,262                  | 295,615,794                  |
| Private Placements            | -                               | 5,742,839             | 18,274,780            | 41,822,571            | 65,840,190                   | 85,366,498                   |
| GNMAs                         | -                               | -                     | -                     | 1,406,523             | 1,406,523                    | 1,337,306                    |
| CMOs                          | -                               | -                     | 798,307               | 1,512,518             | 2,310,825                    | 2,304,542                    |
| Money Market Funds            | 23,437,831                      | -                     | -                     | -                     | 23,437,831                   | 23,437,831                   |
| Total Domestic Fixed Maturity | <u>\$ 148,443,504</u>           | <u>\$ 176,269,434</u> | <u>\$ 310,165,122</u> | <u>\$ 138,331,239</u> | <u>773,209,299</u>           | <u>792,557,790</u>           |
| <i>Equities</i>               |                                 |                       |                       |                       |                              |                              |
| Domestic                      |                                 |                       |                       |                       | <u>155,068,690</u>           | <u>143,241,141</u>           |
| <b>Total Investments</b>      |                                 |                       |                       |                       | <u><b>\$ 928,277,989</b></u> | <u><b>\$ 935,798,931</b></u> |

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN**

**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 credit risk:

**RATINGS OF FIXED MATURITIES**

| <u>Moody's Ratings</u>                | <u>Fair<br/>Value</u> | <u>Cost</u>           | <u>Fair Value as a<br/>Percent of Total<br/>Fixed Maturity<br/>Fair Value</u> |
|---------------------------------------|-----------------------|-----------------------|---|
| AAA                                   | \$ 201,085,633        | \$ 203,441,910        | 26.007  |
| AA1                                   | 2,589,600             | 2,572,455             | 0.335   |
| AA2                                   | 3,061,515             | 3,030,062             | 0.396   |
| AA3                                   | 23,561,226            | 23,593,068            | 3.047   |
| A1+                                   | 23,437,831            | 23,437,831            | 3.031   |
| A1                                    | 29,519,271            | 29,542,392            | 3.818   |
| A2                                    | 12,760,710            | 12,574,531            | 1.650   |
| A3                                    | 24,706,837            | 25,142,240            | 3.195   |
| BAA1                                  | 44,647,674            | 44,121,105            | 5.774   |
| BAA2                                  | 55,366,610            | 53,853,946            | 7.161   |
| BAA3                                  | 28,065,742            | 27,565,732            | 3.630   |
| BA1                                   | 37,004,560            | 35,380,935            | 4.786   |
| BA3                                   | 3,122,760             | 2,878,920             | 0.404   |
| B1                                    | 1,275,227             | 1,128,349             | 0.165   |
| B2                                    | 4,988,541             | 5,118,829             | 0.645   |
| B3                                    | 7,451,155             | 7,160,757             | 0.964   |
| CAA                                   | 8,887,500             | 9,000,000             | 1.149   |
| P-1                                   | 14,998,785            | 14,998,785            | 1.940   |
| P-2                                   | 105,994,412           | 105,994,412           | 13.708  |
| BBB+(SP)                              | 5,889,612             | 4,823,321             | 0.762   |
| BBB(SP)                               | 1,980,960             | 2,000,000             | 0.256   |
| U.S. Government Guaranteed Securities | 84,923,228            | 85,584,378            | 10.983  |
| ‡ Not Rated                           | 47,889,910            | 69,613,832            | 6.194   |
| Totals                                | <u>\$ 773,209,299</u> | <u>\$ 792,557,790</u> | <u>100.000</u>  |

‡ Primarily consists of private placements.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Notes to the Financial Statements  
For the Fiscal Year Ended September 30, 2006**

**B. Concentration of Investments**

As of September 30, 2006, the PEIRAF/DCP did not own any debt securities that represented more than 5% of the total fair value of investments.

**C. Securities Lending Program**

The PEIRAF/DCP is authorized by the Board of Control to participate in a securities lending program. The Plan's custodian, State Street Bank and Trust Company, administers the program. Certain securities from the PEIRAF/DCP are loaned to borrowers approved by the Plan. Approved borrowers of securities provide acceptable collateral in the form of cash, securities issued or guaranteed by the United States government or its agencies or instrumentalities, sovereign debt, Canadian Provincial debt, convertible bonds, irrevocable bank letters of credit by a person other than the borrower or an affiliate of the borrower if State Street determines to be appropriate, and such other collateral as the parties may agree to in writing from time to time. All security loans are open loans and can be terminated on demand by the PEIRAF/DCP or borrower. The initial collateral received shall have (i) in the case of loaned securities denominated in United States Dollars or whose primary trading market is located in the United States, sovereign debt issued by foreign governments (other than Canada) or corporate bonds that are not denominated in United States Dollars (other than those issued in Canada), a value of 102% of the fair value of the loaned securities, or (ii) in the case of loan securities which are not denominated in United States Dollars or whose primary trading market is not located in the United States (and are not referenced in (i)), a value of 105% of the fair value of the loaned securities, or (iii) in the case of loaned securities comprised of UK gilts, a value of 102.5% of the fair value of the loaned securities, or (iv) in all other cases, such value, not less than 102% of the fair value of the loaned securities, as may be applicable in the jurisdiction in which such loaned securities are customarily traded. Pursuant to the terms of the applicable securities loan agreement, State Street shall, in accordance with State Street's reasonable and customary practices, mark loaned securities and collateral to their fair value each business day based upon the fair value of the collateral and the loaned securities at the close of the business employing the most recently available pricing information and receive and deliver collateral in order to maintain the value of the collateral at no less than 100% of the fair value of the loaned securities.

The PEIRAF/DCP cannot pledge or sell collateral securities received unless the borrower defaults. Cash collateral is invested in the State Street Quality D Short-term Investments Fund (QDF).

The following describes the QDF's fund guidelines. The QDF's average effective duration is restricted to 120 days or less. The maximum option-adjusted duration of any variable rate security investment of the QDF shall be five years or less. All fixed rate instruments must have an option-adjusted duration not to exceed 30 months. At the time of purchase, all securities with maturities of 13 months or less must qualify as first tier securities and all securities with maturities in excess of 13 months will be rated A or better by at least two nationally recognized statistical rating organizations (NRSROs), or, if not rated, be of comparable quality. The QDF may invest in other State Street managed investment vehicles provided they conform to QDF guidelines.

**PUBLIC EMPLOYEES' INDIVIDUAL RETIREMENT ACCOUNT FUND/  
DEFERRED COMPENSATION PLAN  
Notes to the Financial Statements  
For the Fiscal Year Ended September 30, 2006**

**C. Securities Lending Program, Continued**

As of September 30, 2006, the average term of the loans was 23 days. Cash collateral investments in the QDF are matured as needed to fulfill loan obligations. There is no direct matching of the maturities of the loans with the investments made with cash collateral.

At September 30, 2006, the fair value of the securities on loan was \$144,320,164. The fair value of the collateral pledged by the borrowers was \$147,428,391. Since the amounts owed by the PEIRAF/DCP exceeded the amounts the borrowers owed to the PEIRAF/DCP, there was no credit risk exposure as of September 30, 2006. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Investments purchased with cash collateral are held by the custodial agent, but not in the name of the Fund. Securities pledged as collateral are held by the custodial agent, but not in the name of the Fund. Letters of credit pledged as collateral are issued by the borrower's bank and are irrevocable. The following table provides information as of September 30, 2006, concerning securities lent:

**SECURITIES LENDING  
INVESTMENTS LENT AND COLLATERAL RECEIVED  
(at Fair Value)**

| Type of Investment Lent                                   | Totals                |
|---|-----------------------|
| Domestic Fixed Income                                     | \$ 138,728,706        |
| Domestic Equity   | 5,591,458             |
| <b>Total Securities Lent</b>                              | <b>\$ 144,320,164</b> |
| <b>Type of Collateral Received</b>                        |                       |
| Cash Collateral - Invested in State Street Quality D Fund | <b>\$ 147,428,391</b> |

**D. Mortgage-backed Securities**

As of September 30, 2006, the PEIRAF/DCP had investments in mortgage-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments by the obligors of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obligors tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of the mortgage-backed securities.