SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Financial Statements and Supplemental Schedules

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

WILLIAMS, ADLEY & COMPANY, LLP

Certified Public Accountants
and
Management Consultants

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WILLIAMS, ADLEY & COMPANY, LLP
Certified Public Accountants
Management Consultants

Independent Auditors' Report

The Honorable Mayor and Board of Supervisors
City and County of San Francisco:

We have audited the accompanying financial statements of the San Francisco City and County Employees' Retirement System (the Retirement System), a department of the City and County of San Francisco, California (the City and County) as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note 1, the financial statements present only the Retirement System and do not purport to, and do not, present fairly the financial position of the City and County as of June 30, 2006 and 2005, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 2(a) to the basic financial statements, in the year ended June 30, 2005, the Retirement System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3.*

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

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Management Consultants

The Management's Discussion and Analysis on pages 3 through 13 and the Schedules of Funding Progress and Employer Contributions on pages 33 and 34 are not required parts of the basic financial statements of the Retirement System, 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.

Williams, Adley & Company, LLP

November 17, 2006

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2006 and 2005

The management of the City and County of San Francisco Employees' Retirement System (SFERS or the Plan) is pleased to provide this overview and analysis of the financial activities of SFERS for the years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with the *Financial Statements and Required Supplemental Information*, which follow this discussion. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights

Fiscal Year 2006

- The assets of SFERS exceeded its liabilities at the close of the year ended June 30, 2006. The Plan held $14,497,022 of net assets in trust for pension benefits. All of the net assets are available to meet SFERS' ongoing obligations to plan participants and their beneficiaries.

- SFERS' funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2005, the date of the last actuarial valuation, the funded ratio for SFERS was 108%. In general, this indicates that for every dollar of benefits due, we have approximately $1.08 of assets available for payment.

- For the year ended June 30, 2006, SFERS' net investment earnings of $1,678,719 represent a 12.8% increase in plan net assets compared to the 2005 investment earnings of $1,534,997, which represent a 12.9% increase in plan net assets. (These returns are based on the plan net assets as of the beginning of the respective fiscal years.)

- Total net assets held in trust for pension benefits increased by $1,361,759 or 10.4%, primarily due to the Plan's investment gain offset against the net difference between contributions received by the Plan and benefit payments made from the Plan.

- Members' contributions to the Plan amounted to $162,693 compared to $164,365 in the prior year, a decrease of $1,672 or 1.0%.

- In order to maintain the fiscal soundness of the Plan, the City and County of San Francisco (the City and County) was required to make employer contributions to the Plan that totaled $126,533 for the year ended June 30, 2006.

- Total deductions increased from $555,121 in the prior year to $606,186 an increase of 9.2%, due to increased benefits paid during the fiscal year.

Fiscal Year 2005

- The assets of SFERS exceeded its liabilities at the close of the year ended June 30, 2005. The Plan held $13,135,263 of net assets in trust for pension benefits. All of the net assets are available to meet SFERS' ongoing obligations to plan participants and their beneficiaries.

- SFERS' funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2004, the date of the last actuarial valuation, the funded ratio for SFERS was 104%. In general, this indicates that for every dollar of benefits due, we have approximately $1.04 of assets available for payment.

- For the year ended June 30, 2005, SFERS' net investment earnings of $1,534,997 represent a 12.9% increase in plan net assets compared to the 2004 investment earnings of $1,710,888, which represent a 16.2% increase in plan net assets. (These returns are based on the plan net assets as of the beginning of the respective fiscal years.)

- Total net assets held in trust for pension benefits increased by $1,227,905, or 10.3%, primarily due to the Plan's investment gain offset against the net difference between contributions received by the Plan and benefit payments made from the Plan.

- Members' contributions to the Plan amounted to $164,365 compared to $170,550 in the prior year, a decrease of $6,185, or 3.6%.

- In order to maintain the fiscal soundness of the Plan, the City and County was required to make employer contributions to the Plan that totaled $83,664 for the year ended June 30, 2005.

- Total deductions increased from $507,093 in the prior year to $555,121, an increase of 9.5%, due to increased benefits paid during the fiscal year.

Overview of Financial Statements

The following discussion and analysis are intended to serve as an introduction to SFERS' financial statements, which are comprised of the following components:

1. ***Statements of Plan Net Assets*** are a snapshot of account balances as of the close of the year – June 30, 2006 and 2005. It indicates the total assets as of June 30, 2006 and 2005 respectively, total liabilities at those dates and the net assets available for future payment of retirement benefits and operating expenditures.

2. ***Statements of Changes in Plan Net Assets***, on the other hand, provide a view of additions and deductions to the Plan during the years ended June 30, 2006 and 2005 respectively.

3. ***Notes to Financial Statements*** provide additional information that is essential to a full understanding of the data provided in the financial statements.

Both statements and the notes thereto are in compliance with Governmental Accounting Standard Board (GASB) Pronouncements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans; No. 28 Accounting and Financial Reporting for Securities Lending Transactions; No. 34, Basic Financial Statements – and Management's Discussion and Analysis; No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and No. 40, Deposit and Investment Risk Disclosures. SFERS complies with all material requirements of these pronouncements.

The statements of plan net assets and the statements of changes in plan net assets report information about the Retirement System's financial activities, prepared using the accrual basis of accounting. Contributions to the Plan are recognized when due and benefits and refunds are recognized and payable in accordance with the terms of the Plan. Investments are reported at fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates as of June 30, 2006 and 2005. Investments that do not have an established market are reported at estimated fair value. Purchases and sales of investments are recorded on a trade date basis. The fair value of real estate

holdings are estimated based primarily on appraisals prepared by third-party appraisers. The fair values of venture capital investments are estimated based primarily on audited financial statements provided to the individual fund managers. Investments in forward currency contract investments are commitments to purchase and sell stated amounts of foreign currency. Changes in market value of open contracts are immediately recognized as gains or losses. The market value of forward currency contracts are determined by quoted currency prices from national exchanges.

Results of Actuarial Valuation

Fiscal Year 2006

SFERS' July 1, 2005 (the date of the latest actuarial valuation) funding ratio is 108%, which means SFERS' fund has approximately $1.08 available for each $1.00 of benefit obligations.

Fiscal Year 2005

SFERS' July 1, 2004 (the date of the latest actuarial valuation) funding ratio is 104%, which means SFERS' fund has approximately $1.04 available for each $1.00 of benefit obligations.

Financial Analysis

The Plan's net assets may serve over time as a useful indication of SFERS' financial position. The assets of SFERS exceeded its liabilities at the close of the years ended June 30, 2006 and 2005. All of the Plan's net assets are available to meet SFERS' on-going obligation to plan participants and their beneficiaries.

SFERS net assets for the years ended June 30, 2006, 2005, and 2004 are represented in the chart below:

Net Assets Summary – Years ended June 30, 2006 and 2005

(Dollars in thousands)

	2006	2005	2004	FY 2006 Inc./(Dec.)	FY 2005 Inc./(Dec.)
Other assets	$ 209,411	116,383	155,552	93,028	(39,169)
Investments at fair value	16,661,122	14,812,132	13,764,381	1,848,990	1,047,751
Total assets	16,870,533	14,928,515	13,919,933	1,942,018	1,008,582
Total liabilities	2,373,511	1,793,252	2,012,575	580,259	(219,323)
Net assets	$ 14,497,022	13,135,263	11,907,358	1,361,759	1,227,905

Fiscal Year 2006

The Plan's combined net assets held in trust for pension benefits increased by 10.4% for the year, primarily due to continued improvement in the financial market conditions. The SFERS Retirement Board and the consulting actuary concur that SFERS remains in a strong financial position to meet its obligations to the plan participants and beneficiaries. The current financial position results from a strong and successful investment program, risk management, and strategic long-run perspective of capital markets. With an improving market environment, the value of total equity assets increased during the fiscal year. Concerns still remain related to the economy, fears over further terrorist activities, and military conflicts in the Middle East. The SFERS Retirement Board, Retirement staff and our investment consultants are continuously monitoring the Plan's investment strategies which comply with "prudent expert" standards to secure the Plan's funding status.

Fiscal Year 2005

The Plan's combined net assets held in trust for pension benefits increased by 10.3% for the year, primarily due to continued improvement in the financial market conditions. The SFERS Retirement Board and the consulting actuary concur that SFERS remains in a strong financial position to meet its obligations to the plan participants and beneficiaries. The current financial position results from a strong and successful investment program, risk management, and strategic long-run perspective of capital markets. With an improving market environment, the value of total equity assets increased during the fiscal year. Concerns still remain related to the economy, fears over further terrorist activities, and military conflicts in the Middle East. The SFERS Retirement Board, Retirement staff and our investment consultants are continuously monitoring the Plan's investment strategies which comply with "prudent expert" standards to secure the Plan's funding status.

Highlights of Changes in Net Assets – Years ended June 30, 2006 and 2005

(Dollars in thousands)

		2006	2005	2004	FY 2006 increase (decrease)	FY 2005 increase (decrease)
Additions:						
Member contributions	$	162,693	164,365	170,550	(1,672)	(6,185)
City and County contributions		126,533	83,664	—	42,869	83,664
Interest		227,637	188,854	161,531	38,783	27,323
Dividends		144,493	121,030	95,691	23,463	25,339
Securities lending income		77,358	34,183	15,391	43,175	18,792
Net appreciation (depreciation) in fair value of investments		1,337,830	1,245,926	1,470,606	91,904	(224,680)
Repurchase agreement income		5,467	4,923	3,083	544	1,840
Investment expenses		(40,785)	(28,228)	(24,700)	(12,557)	(3,528)
Securities lending borrower rebates and expenses		(67,909)	(27,135)	(8,786)	(40,774)	(18,349)
Other investment expenses		(5,372)	(4,556)	(1,928)	(816)	(2,628)
Total additions		1,967,945	1,783,026	1,881,438	184,919	(98,412)
Deductions:						
Benefits		586,245	535,963	488,448	50,282	47,515
Refunds of contributions		8,719	8,565	7,935	154	630
Administrative expenses		11,222	10,593	10,710	629	(117)
Total deductions		606,186	555,121	507,093	51,065	48,028
Net increase (decrease)	$	1,361,759	1,227,905	1,374,345	133,854	(146,440)

Fiscal Year 2006

- Member contributions for the year ended June 30, 2006 decreased $1,672, and were 1.0% lower than the prior year. This is consistent with the continued tapering off of the number of members participating in the purchase of service credit and repayment of account shortages buyback program through tax deferred transfers between the City and County's Deferred Compensation (457) Program and the Plan as a result of the 2001 changes in federal tax laws (Economic Growth and Tax Reconciliation Act of 2001).

- In order to maintain the fiscal soundness of the Plan, employer contributions were required from the City and County during the year ended June 30, 2006. This was the second year since the year ended June 30, 1997 in which employer contributions were required.

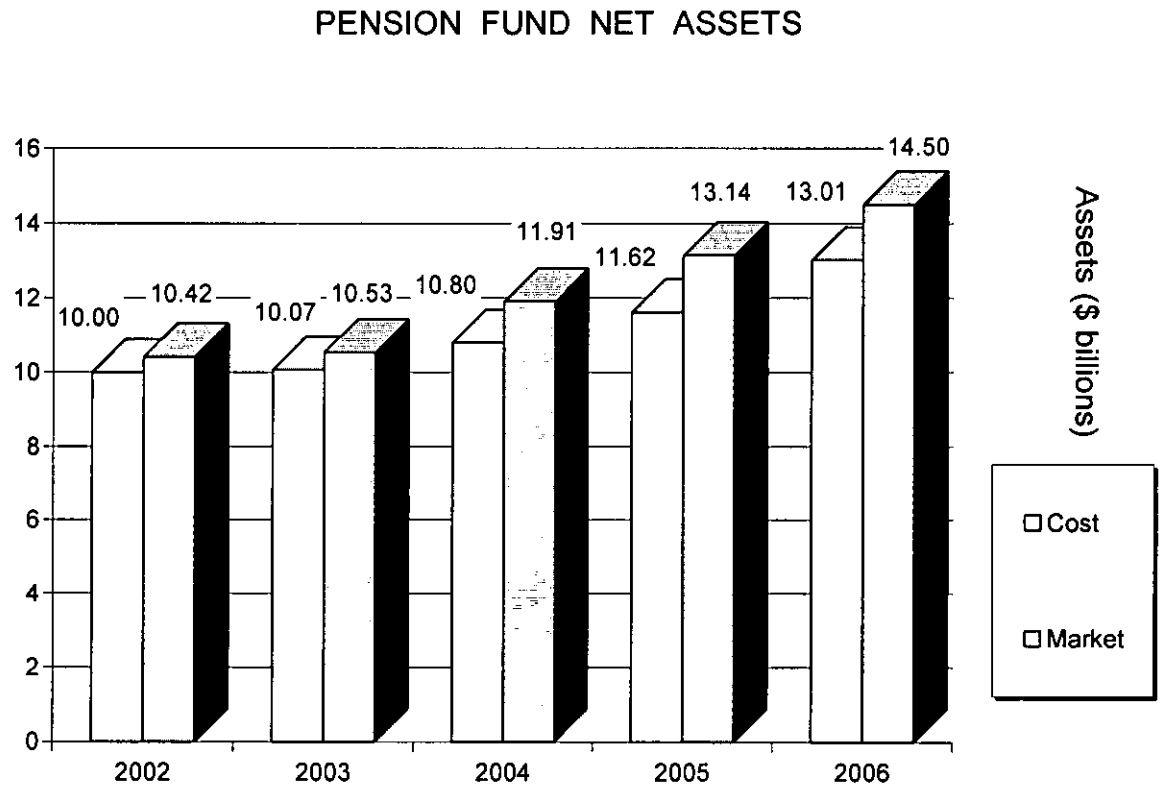
- Investment expenses for the year increased by $12,557 or 44.5%, reflecting the funding of new investment managers, the transaction fee increase in expenses due to interest rate swaps on a higher volume of transactions, and higher asset values held by the external investment managers during the year ended June 30, 2006.
- Benefit payments to Plan participants increased by $50,282 or 9.4%, consistent with the payment of the Supplemental COLA during the year ended June 30, 2006, as well as the continued increase in the number of retirement allowances paid during the year.
- Refunds of contributions increased by $154 or 1.8%, which reflects a similar increase in the number of inactive accounts in the Plan.
- Administrative expenses increased by $629 or 5.9%, primarily due to an increase in the cost of medical reports required under SFERS' disability program and other professional services obtained during the year.

Fiscal Year 2005

- Member contributions for the year ended June 30, 2005 decreased $6,185, and were 3.6% lower than the prior year. This is consistent with the slight reduction in Plan membership and the corresponding decrease in covered payroll, as well as the continued tapering off of the number of members participating in the purchase of service credit and repayment of account shortages buyback program through tax deferred transfers between the City and County's Deferred Compensation (457) Program and the Plan as a result of the 2001 changes in federal tax laws (Economic Growth and Tax Relief Reconciliation Act of 2001).
- In order to maintain the fiscal soundness of the Plan, employer contributions were required from the City and County during the year ended June 30, 2005. This was the first year since the year ended June 30, 1997 in which employer contributions were required.
- Investment expenses for the year increased by $3,528 or 14.3% reflecting higher asset values held by the external investment managers during the year ended June 30, 2005.
- Benefit payments to Plan participants increased by $47,515 or 9.7% consistent with the payment of the Supplemental COLA during the year ended June 30, 2005, as well as the continued increase in the number of retirement allowances paid during the year. The Supplemental COLA was last paid in the year ended June 30, 2003.
- Refunds of contributions increased by $630 or 7.9%, which reflects a similar increase in the number of inactive accounts in the Plan.
- Administrative expenses decreased by $117 or 1.1%, primarily due a continuing reduction in the Department of Telecommunications and Information Services work order as a result of substantial completion of information systems development projects.

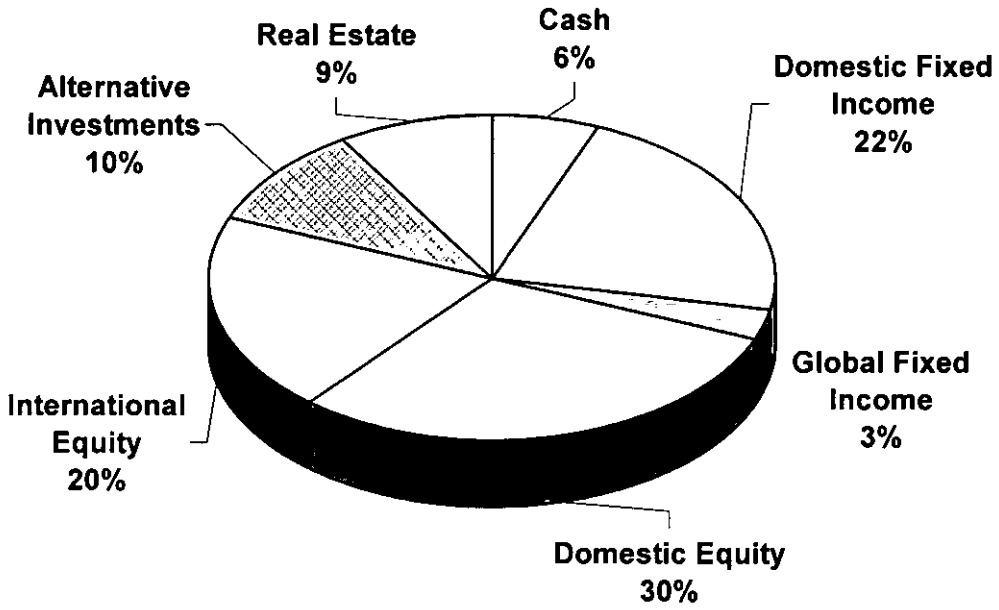
Fiscal Year 2006

SFERS net assets for years ended June 30, 2002 through 2006 expressed at cost and fair market value are represented in the chart below:



SFERS asset allocation at market value as of June 30, 2006 is represented in the chart below:

Asset Allocation as of June 30, 2006 - Market Value

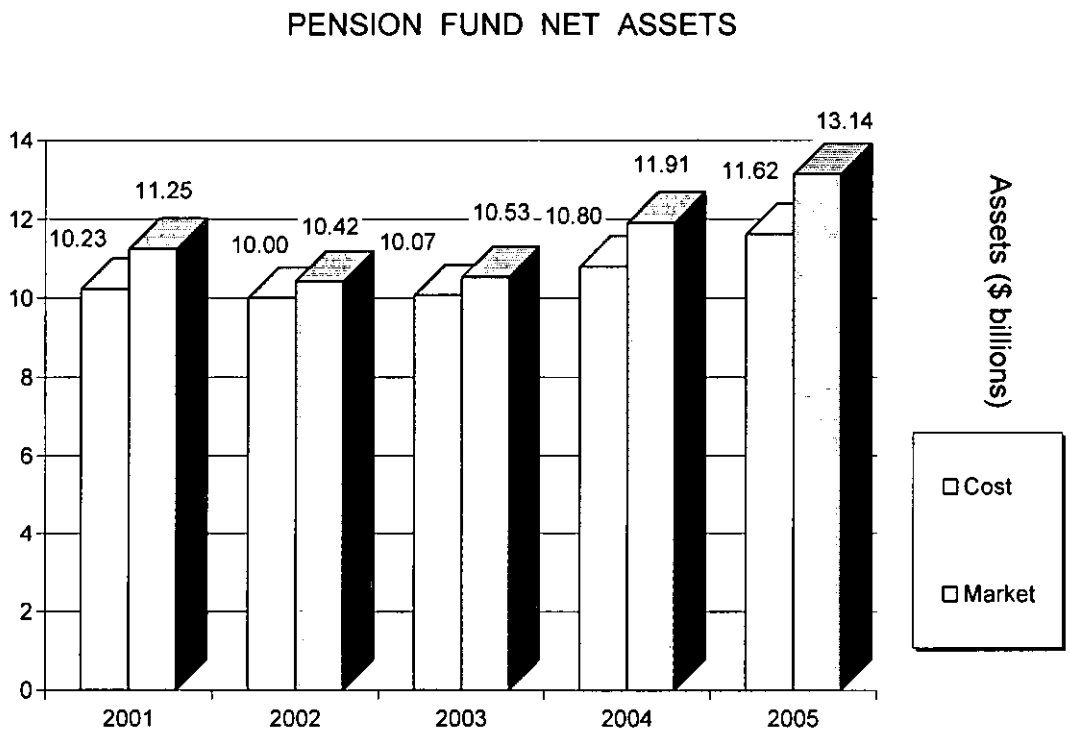


Other Information

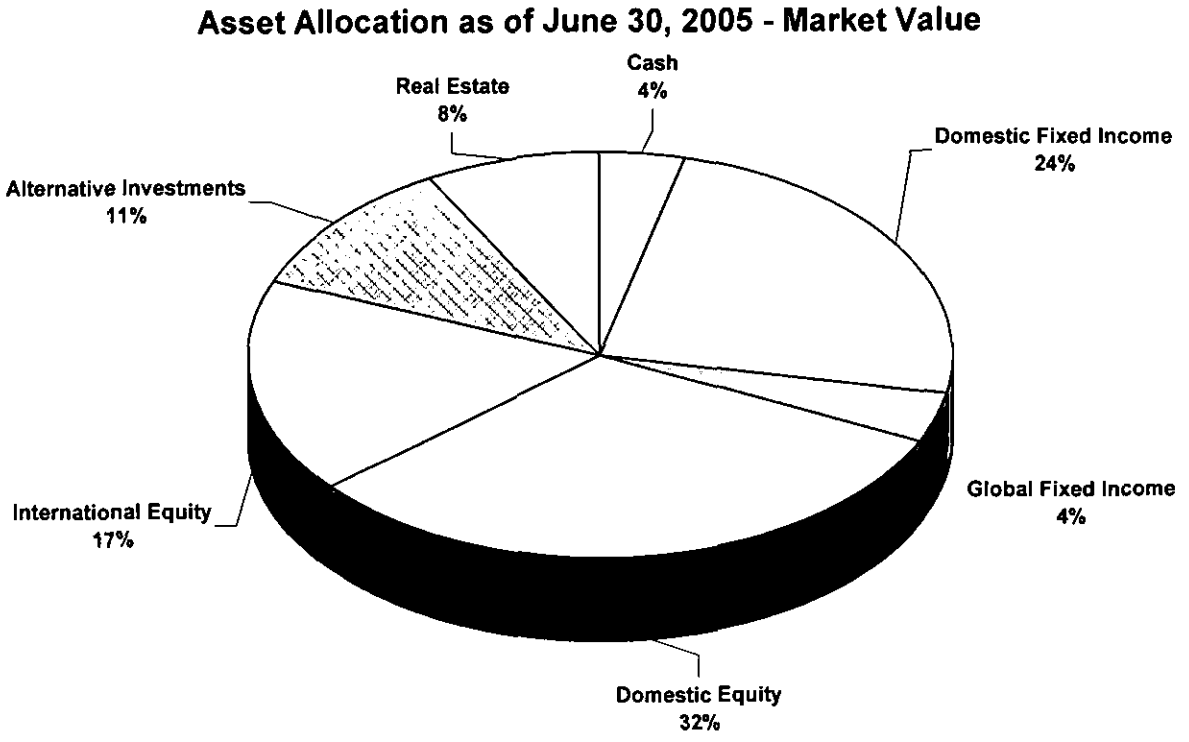
SFERS was successful in the trial court in the two class-action lawsuits related to Plan final compensation. One lawsuit was resolved in favor of the Retirement System during the year ended June 30, 2006. The second class-action lawsuit is on appeal. SFERS continues to vigorously protect the assets of the trust.

Fiscal Year 2005

SFERS net assets for years ended June 30, 2001 through 2005 expressed at cost and fair market value are represented in the chart below:



SFERS asset allocation at market value as of June 30, 2005 is represented in the chart below:



Other Information

There continue to be on-going lawsuits against SFERS related to the benefits being paid. SFERS continues to vigorously defend these lawsuits to protect the assets of the trust.

Requests for information

This financial report is designed to provide a general overview of the City and County of San Francisco Employees' Retirement System's finances for the years ended June 30, 2006 and 2005. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to:

Executive Director
San Francisco Employees' Retirement System
30 Van Ness Avenue, Suite 3000
San Francisco, CA 94102

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Statements of Plan Net Assets
June 30, 2006 and 2005
(in thousands)

		2006	2005
Assets			
Deposits	$	24,728	17,986
Contributions receivable-members		5,688	4,922
Contributions receivable-City and County		4,720	2,736
Investment income receivable:			
Interest		30,864	26,616
Dividends		8,662	8,096
Securities lending		1,048	1,579
Dollar roll		424	201
Receivable from brokers, general partners and others		133,277	54,247
Investments at fair value:			
Short-term bills and notes		943,168	622,621
Debt securities:			
U.S. government securities		1,151,022	1,372,895
Other debt securities		2,518,880	2,256,332
Equity securities		7,197,575	6,425,337
Real estate		1,316,852	1,084,786
Venture capital		1,492,752	1,436,796
Foreign currency contracts, net		-	13,254
Investment in lending agent's short-term investment pool		2,040,873	1,600,111
Total investments		16,661,122	14,812,132
Total assets		16,870,533	14,928,515
Liabilities:			
Payable to brokers		209,422	98,585
Obligations under fixed coupon dollar repurchase agreements		99,141	85,000
Foreign currency contracts, net		12,825	-
Other liabilities		11,250	9,556
Payable to borrowers of securities		2,040,873	1,600,111
Total liabilities		2,373,511	1,793,252
Net assets held in trust for pension benefits	$	14,497,022	13,135,263

(A schedule of funding progress is presented on page 33.)

See accompanying notes to financial statements.

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Statements of Changes in Plan Net Assets
Years ended June 30, 2006 and 2005
(in thousands)

		2006	2005
Additions:			
Members contributions			
Miscellaneous	$	136,665	139,442
Police		14,715	14,233
Fire		11,313	10,690
Total member contributions		162,693	164,365
City and County contributions			
Miscellaneous		104,064	69,123
Police		12,773	8,356
Fire		9,696	6,185
Total City and County contributions		126,533	83,664
Investment income (expenses)			
Interest		227,637	188,854
Dividends		144,493	121,030
Net appreciation in fair value of investments		1,337,830	1,245,926
Securities lending income		77,358	34,183
Fixed coupon dollar repurchase agreement income		5,467	4,923
Investment expenses		(40,785)	(28,228)
Securities lending borrower rebates and expenses		(67,909)	(27,135)
Fixed coupon dollar repurchase agreement finance charges and expenses		(5,372)	(4,556)
Investment income, net		1,678,719	1,534,997
Total additions		1,967,945	1,783,026
Deductions:			
Benefits		586,245	535,963
Refunds of contributions		8,719	8,565
Administrative expenses		11,222	10,593
Total deductions		606,186	555,121
Net increase		1,361,759	1,227,905
Net assets held in trust for pension benefits			
Beginning of year		13,135,263	11,907,358
End of year	$	14,497,022	13,135,263

See accompanying notes to financial statements.

(1) Plan Description

(a) General

The San Francisco City and County Employees' Retirement System (the Retirement System) is a single-employer defined benefit pension plan established to provide pension benefits for substantially all employees of the City and County of San Francisco (the City and County) and certain classified and certificated employees of the Community College and Unified School Districts. The Retirement System provides service retirement, disability, and death benefits based on specified percentages of defined final average monthly salary and annual cost-of-living adjustments after retirement. While the Retirement System's pension plan (the Plan) is not subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), it is a tax-qualified plan under Internal Revenue Code provisions. The San Francisco City and County Charter (the Charter) and Administrative Code are the authorities that establish and amend the benefit provisions and employer obligations of the Plan.

The Retirement System is an integral part of the City and County, and the accompanying financial statements are included as part of the primary government in the Comprehensive Annual Financial Report (CAFR) prepared by the City and County. A copy of the City and County's CAFR can be obtained from City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, CA 94102.

(b) Retirement Benefits

The Retirement System pays benefits according to the category of employment and the type of benefit coverage provided by the City and County. The three main categories of Plan membership are:

Miscellaneous Members – staff, operational, supervisory, and all other eligible employees who are not in special membership categories.

Firefighter Members – firefighters and other employees whose principal duties are in fire prevention and suppression work or who occupy positions designated by law as firefighter member positions.

Police Members – police officers and other employees whose principal duties are in active law enforcement or who occupy positions designated by law as police member positions.

Service Retirement

Miscellaneous Members qualify for a service retirement benefit if they are at least 50 years old and have at least 20 years of credited service or if they are at least 60 years old and have at least 10 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 75% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan before November 2, 1976 qualify for a service retirement benefit if they are at least 50 years old and have at least 25 years of credited service. The service retirement benefit is calculated using the member's final compensation (monthly salary earnable at the rank or position the member held for at least one year immediately prior to retiring) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan on or after November 2, 1976 qualify for a service retirement benefit if they are at least 50 years old and have at least 5 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

Disability Retirement

Miscellaneous Members are eligible to apply for a disability retirement benefit, regardless of age, when they have 10 or more years of credited service and they sustain an injury or illness that prevents them from performing their duties. The disability retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by the member's years of credited service times the disability factor (1.8) up to a maximum of 75% of the member's final compensation.

Firefighter Members and Police Members are eligible to apply for an industrial disability retirement benefit from their first day on the job in firefighter or police service if their disability is caused by an illness or injury that they received while performing their duties. The industrial disability retirement benefit is based on the member's final compensation (monthly salary earnable at the rank or position the member held for at least one year immediately prior to retiring) multiplied by the permanent disability rating (from 50% to 90%) or the member's service retirement benefit if the member is eligible for a service retirement.

Firefighter Members and Police Members are eligible to apply for an ordinary disability retirement benefit, regardless of age, when they have 10 or more years of credited service and they sustain an injury or illness that is not caused by their work, but that prevents them from performing their duties.

(c) Separation and Death Benefits

Separation from Employment

At permanent separation from employment, **Miscellaneous Members, Firefighter Members, and Police Members** may either elect to withdraw their accumulated contributions from the Plan or, if they have 5 or more years of credited service, elect to leave their accumulated contributions in the Plan and receive a vesting benefit that is first payable at or after age 50.

Death Benefits Prior to Retirement

Generally, upon the death of an active employee who is eligible for a service retirement, the Retirement System provides continuation benefits to a qualified surviving spouse or qualified domestic partner equal to 50% to 100% of the member's retirement allowance that the member would have received had he or she retired on the date of death.

For qualified surviving spouses and qualified domestic partners of **Firefighter Members and Police Members** who die prior to becoming eligible for service retirement and whose death is due to an injury received in or illness caused by the performance of duty, salary continuation is provided to the qualified survivor until such time as the member would have qualified for service retirement had he or she lived at which time a continuation benefit equal to 100% of the member's service retirement allowance is provided to the qualified survivor.

A lump sum death payment equal to 6 months' earnable salary plus the member's accumulated contributions is provided upon the death of an active employee not yet eligible for a service retirement to the member's named beneficiary or estate.

Death Benefits after Retirement

Generally, upon the death of a retired member, the Retirement System provides continuation benefits to a qualified surviving spouse or qualified domestic partner equal to 50% to 100% of the member's retirement allowance as of the date of death.

(d) Cost of Living Adjustments (COLA)

Basic COLA

Miscellaneous Members receive a benefit adjustment each July 1 equal to the percentage increase in the Consumer Price Index (CPI) rounded to the nearest 1%, up to a maximum of 2% of the member's original retirement benefit. Decreases are also possible if the CPI decreases in a particular year; however, a member's monthly retirement benefit will never decrease below the original amount.

Firefighter Members and Police Members who became members of the Plan before November 2, 1976 receive a benefit adjustment each July 1 equal to 50% of the actual dollar increase or decrease in the salary of the rank or position on which the member's retirement benefit is based. Although decreases are possible in a given year, a member's monthly benefit will never decrease below the original amount.

Firefighter Members and Police Members who became members of the Plan on or after November 2, 1976 receive a benefit adjustment each July 1 equal to the percentage increase in the CPI rounded up to the nearest 1%, up to a maximum of 2% of the member's original retirement benefit. Decreases are also possible if the CPI decreases in a particular year; however, a member's monthly retirement benefit will never decrease below the original amount.

Supplemental COLA

Proposition C, passed by the voters in November 1996, provides for a Supplemental COLA in years when there are sufficient "excess" investment earnings on the Retirement Trust. The Supplemental COLA, payable on July 1 in those years when they are paid, bring the total monthly benefit adjustment (including the Basic COLA) up to 3% of the member's current monthly retirement benefit. Proposition C provided that, in any year when a Supplemental COLA is not paid, a member's retirement benefit would decrease to what it would have been if only Basic COLA had been paid in all previous years; however, Proposition B, passed by the voters in November 2001, amended Proposition C to provide that all Supplemental COLAs paid to retired members will continue into the future in the event an additional Supplemental COLA is not payable in any given year.

(e) Legislative Changes to the Plan

In June 2005, the Board of Supervisors voted, by super majority, to extend the Proposition F early retirement program through June 30, 2007, the final year allowed under Proposition F approved by the voters in November 2003. **Proposition F** provides a targeted early retirement for employees who are in job classifications in which positions are being eliminated through the City and County budget process. Employees who are eligible to receive the early retirement benefit would have an additional three years of service and three years of age included in their service retirement calculation.

In November 2004, the voters approved **Proposition E** which equalizes survivor continuation benefits payable to the qualified survivor of a police office or firefighter member who dies in the line of duty at 100% of the member's retirement benefits regardless of when the police officer or fire fighter was hired.

(f) Membership

Membership of the Retirement System consisted of the following as of July 1, 2005, the date of the latest actuarial valuation:

	Police	Fire	Miscellaneous	Total
Retirees and beneficiaries currently receiving benefits	2,079	1,900	16,114	20,093
Active members:				
Vested	1,841	1,371	19,271	22,483
Nonvested	252	261	6,168	6,681
Subtotal	2,093	1,632	25,439	29,164
Total	4,172	3,532	41,553	49,257

As of July 1, 2005, there were 2,833 terminated members entitled to, but not yet receiving benefits.

(2) Summary of Significant Accounting Policies

(a) Implementation of New Accounting Principle

During the year ended June 30, 2005, the Retirement System adopted the provisions of Government Accounting Standards Board (GASB) Statement No. 40, Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. To address an element of interest rate risk, this statement also requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Disclosure of deposit and investment policies related to identified risks is also required. Implementation of GASB Statement No. 40 had no effect on Plan net assets.

(b) Basis of Presentation

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB). In addition, the Retirement System applies all applicable pronouncements issued by the Financial Accounting Standards Board (FASB) on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Member contributions are recognized in the period in which the contributions are due. Employer contributions and member contributions made by the employer to the Plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

(c) Investments

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value. Purchases and sales of investments are recorded on a trade date basis.

The fair values of real estate holdings are estimated based primarily on appraisals prepared by third-party appraisers. Such market value estimates involve subjective judgments, and the actual market price of the real estate can only be determined by negotiation between independent third parties in a sales transaction.

The fair values of venture capital investments are estimated based primarily on audited financial statements provided to the individual fund managers. Such market value estimates involve subjective judgments, and the actual market price of the investments can only be determined by negotiation between independent third parties in a sales transaction.

The Charter and Retirement Board policies permit the Retirement System to use investments of the Plan to enter into securities lending transactions – loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. The collateral may consist of cash or noncash; noncash collateral is generally U.S. treasuries or other U.S. government obligations. The Retirement System's securities custodians are agents in lending the Plan's domestic securities for cash collateral of 102% and international securities for cash collateral of 105%. Contracts with the lending agents require them to indemnify the Retirement System if the borrowers fail to return the securities (and if the collateral were inadequate to replace the securities lent) or fail to pay the Retirement System for income distributions by the securities' issuers while the securities are on loan. Noncash collateral cannot be pledged or sold unless the borrower defaults.

All securities loans can be terminated on demand by either the Retirement System or the borrower, although the average term of the loans is 75 days. In lending domestic securities, cash collateral is invested in the lending agent's short-term investment pool, which at year-end had a weighted average maturity of 84 days. In lending international securities, cash collateral is invested in a separate short-term investment pool, which at year-end had a weighted average maturity of 39 days. The relationship between the maturities of the investment pools and the Retirement System's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the Retirement System cannot determine. Cash collateral may also be invested separately in term loans, in which case the maturity of the loaned securities matches the term of the loan.

Cash received as collateral on securities lending transactions is reported as an asset, and liabilities from these transactions are reported in the statement of plan net assets. Additionally, the costs of securities lending transactions, such as borrower rebates and fees are recorded as expenses.

The Charter and Retirement Board policies permit the Retirement System to use investments to enter into fixed coupon dollar repurchase agreements, that is, a sale of securities with a simultaneous agreement to repurchase similar securities in the future at a lower price that reflects a financing rate. The fair value of the securities underlying fixed coupon dollar repurchase agreements equals the cash received. If the dealers default on their obligations to resell these securities to the Retirement System at the agreed-upon buy back price, the Retirement System could suffer an economic loss if the securities have to be purchased at a higher price (than the agreed-upon buy back price) in the open market. This credit exposure at June 30, 2006 was $734.

(d) Actuarial Valuation

The provisions of the Charter state that an actuarial valuation shall occur at least every even-numbered year and that actuarial experience investigations shall occur as determined necessary by the Retirement Board. Actuarial valuations and a limited experience analysis are generally carried out each year. The latest actuarial valuation of the Retirement System was completed in January 2006 by the actuarial firm of Towers Perrin and was based upon employee data and asset information as of July 1, 2005.

(e) Administrative Expenses

All costs to administer the Retirement System are borne by the Retirement System.

(f) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(3) Funding Policy

Contributions are made to the Plan by both the City and County (as the employer) and the participating employees. Employee contributions are mandatory as required by the Charter. Employee contribution rates for 2006 and 2005 as a percentage of gross salary were as follows:

Participants entering the Retirement System prior to November 2, 1976	
Police and fire	7.0%
Miscellaneous	8.0%
Participants entering the Retirement System after November 2, 1976	7.5%

For the year ended June 30, 2005, most employee groups agreed through collective bargaining for employees to contribute a portion of the employee contributions, per memorandums of understanding (MOU's), on a pretax basis. For the year ended June 30, 2006, The City and County agreed to pay a larger portion of the employee contributions on behalf of employees through collective bargaining.

Prior to the early 1950s, all Retirement System members were covered by the Federal Old-Age and Survivors Disability Insurance provisions of the Federal Social Security Act. In the early 1950s, the City and County agreed to exclude uniformed police officers and firefighters from Social Security coverage. Prior to 1990, Miscellaneous members covered by Social Security were able to elect to reduce the above stated rate of employee contribution in consideration of their anticipated Social Security benefit payments. All participants who elected such reduction must repay the amount of unpaid employee contributions with interest or there will be an appropriate actuarial reduction in benefits.

Participants terminating service with the City and County may withdraw employee contributions plus interest. The Retirement Board reviews and sets the crediting interest rate for the Plan on an annual basis. Interest for the years ended June 30, 2006 and 2005 accumulated at 5.00%.

The basic City and County contributions are the amounts deemed necessary on an actuarial basis using the entry age normal cost method to provide the Retirement System with assets sufficient to pay the basic benefits that are not provided for by employees' contributions. Contribution rates used in fiscal years 2006 and 2005 were based on a schedule of rates determined from actuarial studies by the consulting actuary as of July 1, 2005 and 2004, respectively. Required and actual employer contribution rates for 2006 and 2005 as a percentage of covered payrolls averaged the following:

	2006	2005
Police plan members	6.58%	4.48%
Fire plan members	6.58%	4.48%
Miscellaneous plan members	6.58%	4.48%

In order to comply with Internal Revenue Code Section 414(h)(2), and the City ordinance, the Retirement System implemented a tax-deferred contribution plan during the year ended June 30, 1990. Under this plan, participants may irrevocably elect a tax-deferred treatment of their contributions.

(4) Deposits and Investments

(a) Deposits

Deposits are carried at cost, which approximates fair value. Deposits consisted of the following as of June 30:

		2006	2005
Pooled funds with City and County Treasurer	$	2,017	-
Bank accounts		22,711	17,986
	$	24,728	17,986

The custodial risk categorization and bank balances for the pooled funds with the City and County Treasurer are discussed in the City and County's Comprehensive Annual Financial Report.

(b) Investments

The Retirement System's investments are invested pursuant to investment policy guidelines as established by the Retirement Board. The objective of the policy is to maximize the expected return of the fund at an acceptable level of risk. The Retirement Board has established percentage guidelines for types of investments to ensure the portfolio is diversified.

The investment policy permits investments in domestic and international debt and equity securities; real estate; and alternative investments, which include investments in a variety of commingled partnership vehicles.

Interest Rate Risk

Interest rate risk is the risk that changes in the interest rates will adversely affect the fair value of an investment. The Retirement System does not have a specific policy to manage interest rate risk, but requires investment managers to diversify by issue, maturity, sector, coupon and geography. Investment managers retained by the Retirement System follow specific investment guidelines and are evaluated against specific market benchmarks that represent their investment style. Any exemption from general guidelines requires approval from the Retirement Board.

Below is a table depicting the segmented time distribution for fixed income investments based upon the expected maturity (in years) as of June 30, 2006.

Interest Rate Risk

Investment Type	Fair Value	Less than 1 year	1-6 years	6-10 years	10+ years
Asset Backed Securities	$ 82,077	-	4,176	6,537	71,364
Commercial Mortgage-Backed	469,713	-	11,577	43,743	414,393
Commercial Paper	1,116	1,116	-	-	-
Corporate Bonds	511,778	23,035	202,833	202,684	83,226
Corporate Convertible Bonds	178,396	755	18,961	7,486	151,194
Government Agencies	315,860	-	298,281	13,319	4,260
Government Bonds	915,297	17,482	551,438	174,627	171,750
Government Mortgage Backed Securities	178,824	-	-	196	178,628
Index Linked Government Bonds	57,720	-	166	25,556	31,998
Loans	15,344	-	15,344	-	-
Mortgages	69,575	-	31,053	12,098	26,424
Municipal/Provincial Bonds	8,252	-	4,385	3,821	46
Non Government Backed Collaterized Mortgage Obligations	99,106	400	9,575	2,250	86,881
Other Fixed Income	3,000	3,000	-	-	-
Short Term Bills and Notes	75,114	75,114	-	-	-
Total	$ 2,981,172	120,902	1,147,789	492,317	1,220,164

Credit Risk – Investments

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Fixed income managers are expected to adhere to the following guidelines as a means of limiting credit risk. Fixed income managers are limited within their portfolios to no more than 10% exposure in any single security, with the exception of United States Treasury and government agencies.

The following table illustrates the Retirement System's exposure to credit risk as of June 30, 2006.

Credit Risk

Investment Type	Fair Value	AAA	AA	A	BBB	BB	B	C	Not Rated
Asset Backed Securities	$ 82,077	17,954	-	-	2,065	9,080	763	-	52,215
Commercial Mortgage-Backed	469,712	61,276	16,600	10,198	26,756	42,680	9,424	761	302,017
Corporate Bonds	1,395,642	15,709	16,323	52,867	75,844	95,080	148,486	30,101	961,232
Corporate Convertible Bonds	178,395	-	4,584	13,234	35,732	24,370	14,405	2,669	83,401
Government Agencies	315,861	259,760	3,478	470	-	-	-	-	52,153
Government Bonds	337,865	143,801	12,858	68,950	45,921	29,863	10,870	373	25,229
Government Mortgage-Backed Securities	183,684	-	-	-	-	-	-	-	183,684
Index Linked Government Bonds	11,805	3,137	-	-	-	-	-	-	8,668
Mortgages	121,428	-	-	-	-	-	-	-	121,428
Municipal/Provincial Bonds	8,252	-	8,065	187	-	-	-	-	-
Non-Government Backed Collateralized Mortgage Obligations	99,105	25,362	480	924	3,041	4,428	3,430	-	61,440
Other Fixed Income	18,344	-	-	-	-	-	-	-	18,344
Short Term Bills and Notes	72,594	-	-	-	-	-	-	-	72,594
Total	$ 3,294,764	526,999	62,388	146,830	189,359	205,501	187,378	33,904	1,942,405

The ratings are the lower of the ratings by Moody's Investors Service (Moody's) and Standard & Poor's (S&P). Investments not rated by either Moody's or S&P are shown as not rated in the above table. Obligations of the U.S. government and those explicitly guaranteed by the U.S. government are not included in the above table.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a Retirement System investment in a single issuer. Guidelines for investment managers restrict a position to become no more than 5% (at market) of the investment manager's portfolio. Securities issued or guaranteed by the U.S. government or its agencies are exempt from this limit.

As of June 30, 2006, the Retirement System has no investments of a single issuer that equal or exceed 5% of total System net assets.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Retirement System does not have a specific policy addressing custodial credit risk for deposits. As of June 30, 2006, $15,198 of the Retirement System's bank balance of $24,728 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Cash received as securities lending collateral is invested in a securities lending collateral investment pool and is not exposed to custodial credit risk.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Retirement System does not have a specific policy addressing custodial credit risk for investments, but it is the practice of the Retirement System that all investments are insured, registered, or held by the Retirement System or its agent in the Retirement System's name. As of June 30, 2006, $5,717 of the Retirement System's investments were exposed to custodial credit risk because they were not insured or registered in the name of the Retirement System, and were held by the counterparty's trust department or agent but not in the Retirement System's name.

Securities Lending

The Retirement System lends U.S. government obligations, domestic and international bonds, and equities to various brokers with a simultaneous agreement to return collateral for the same securities plus a fee in the future. The securities lending agent manages the securities lending program and receives securities and cash as collateral. Collateral cash is pledged at 102% and securities at 105% of the fair market value of domestic securities and international securities lent. There are no restrictions on the amount of securities that can be lent at one time. The term to maturity of the loaned securities is generally not matched with the term to maturity of the investment of the said collateral.

The Retirement System lent $2,350,346 in securities and received collateral of $364,213 and $2,040,873 in securities and cash, respectively from borrowers. The Retirement System's securities lending transactions as of June 30, 2006, are summarized in the following table.

Securities Lending

Security Type	Fair Value of Loaned Securities	Cash Collateral	Fair Value of Non-Cash Collateral
Securities Loaned for Cash Collateral			
International Corporate Fixed	$ 5,650	5,842	-
International Equities	416,062	428,695	-
International Government Fixed	23,431	23,954	-
US Agencies	321,877	327,556	-
US Corporate Fixed	158,598	161,201	-
US Equities	514,048	523,569	-
US Government Fixed	560,925	570,056	-
			-
Securities Loaned with Non-Cash Collateral			
International Equities	275,659	-	287,816
International Government Fixed	43,837	-	45,547
International UK Gilt	6,314	-	6,498
US Agencies	2,812	-	2,859
US Corporate Fixed	7,162	-	7,278
US Equities	10,297	-	10,479
US Government Fixed	3,674	-	3,736
Total	**$ 2,350,346**	**2,040,873**	**364,213**

The Retirement System does not have the ability to pledge or sell collateral securities unless a borrower defaults. As of June 30, 2006, the Retirement System has no credit risk exposure to borrowers because the amounts the Retirement System owes them exceed the amounts they owe the Retirement System. As with other extensions of credit, the Retirement System may bear the risk of delay in recovery or of rights in the collateral should the borrower of securities fail financially. In addition, the lending agent indemnifies the Retirement System against all borrower defaults.

Foreign Currency Risk

The Retirement System's investment policy allows international managers to enter into foreign exchange contracts, which are limited to hedging currency exposure existing in the portfolio. The Retirement System's exposure to foreign currency risk derives from its positions in foreign currency denominated international equity and fixed income investments. The Retirement System's net exposure to foreign currency risk is as follows:

Foreign Currency Risk

CURRENCY	CASH	EQUITY	FIXED INCOME	VENTURE CAPITAL	SWAPS	TOTAL
Argentine peso	$ -	-	4,621	-	-	4,621
Australian dollar	157,323	72,271	-	-	-	229,594
Brazilian real	(3,618)	19,573	2,467	-	8,092	26,514
British pound sterling	192,440	427,263	47,495	2,783	-	669,981
Canadian dollar	133,927	94,841	14,679	-	-	243,447
Chilean peso	3,617	-	-	-	-	3,617
Chinese yuan renminbi	80,555	-	-	-	-	80,555
Czech koruna	(2,991)	7,729	-	-	-	4,738
Danish krone	(2,181)	19,690	788	-	-	18,297
Egyptian pound	16	1,777	-	-	2,233	4,026
Euro	(508,138)	795,899	109,050	113,130	-	509,941
Hong Kong dollar	(8,632)	86,565	-	-	-	77,933
Hungarian forint	50	5,920	-	-	-	5,970
Indian rupiah	(245)	3,040	-	-	-	2,795
Japanese yen	(1,848)	624,967	86,849	9,390	-	719,358
Kazakhstan tenge	-	-	-	-	1,435	1,435
Malaysian ringgit	63	17,039	-	-	-	17,102
Mexican peso	113	9,135	3,269	-	-	12,517
New Israeli shekel	108	8,946	-	-	-	9,054
New Romanian Leu	5,004	-	-	-	-	5,004
New Taiwan dollar	9,343	-	-	-	-	9,343
New Zealand dollar	(39,204)	2,509	3,137	-	-	(33,558)
Nigerian naira	10	-	-	-	4,155	4,165
Norwegian krone	57,698	21,475	-	-	-	79,173
Peruvian nuevo sol	831	-	-	-	-	831
Philippine peso	3,056	-	-	-	-	3,056
Polish zloty	7,795	10,553	5,995	-	-	24,343
Russian ruble (new)	10,167	-	6,113	-	2,444	18,724
Singapore dollar	10,112	19,032	-	-	-	29,144
South African rand	(2,214)	43,487	-	-	-	41,273
South Korean won	(1,744)	100,929	-	-	-	99,185
Swedish krona	(28,950)	37,402	1,151	-	-	9,603
Swiss franc	46,331	149,627	-	-	-	195,958
Thai baht	(2,749)	10,996	-	-	-	8,247
Turkish lira	4,095	3,312	-	-	-	7,407
Uruguayan peso	46	-	2,725	-	-	2,771
TOTAL	**$ 120,186**	**2,593,977**	**288,339**	**125,303**	**18,359**	**3,146,164**

Currency Overlay Program

On July 1, 2005 the Retirement System implemented a currency overlay program managed by three investment managers. The objectives of the program are to: 1) Systematically manage currency exposure in an effort to reduce overall plan volatility; 2) Systematically manage currency exposure to reduce the volatility of its international equity portfolio; and 3) Enhance diversification since the excess returns of currency trading has historically had a low correlation to the excess returns of traditional equity and fixed income asset classes.

At June 30, 2006, the Retirement System's allocation to international equities (including cash and other assets) totaled $3,076,413 which represented 21.2% of plan net assets, virtually all of which is denominated in foreign currencies. Hence, currency volatility is a significant contributor to overall portfolio risk. The Retirement System's international equity managers do not actively manage the underlying currency risk. Currency risk can be reduced through an active currency overlay program.

Each currency overlay manager manages currency risk through foreign exchange, spot, and forward contracts, and currency options. Only international equities are subject to the currency overlay program. The Retirement System's global fixed income currency exposure is actively managed by two global bond managers.

For the year ended June 30, 2006, the currency overlay program lost $16,438 or 0.60% of the average international equity portfolio and 0.12% of the Retirement System's average total portfolio.

Pending Currency Trades

Investments in forward currency contract investments are commitments to purchase or sell stated amounts of foreign currency. Changes in market value of open contracts are immediately recognized as gains or losses. The fair values of forward currency contracts are determined by quoted currency prices from national exchanges. As of June 30, 2006 and 2005, the fair value of open contracts can be summarized as follows:

		2006	2005
Purchase contracts	$	6,808,465	1,132,367
Sales contracts		(6,821,290)	(1,119,113)
Net fair value	$	(12,825)	13,254

The Retirement System utilized these contracts to hedge (or decrease) the currency risk of foreign investments, to increase investment exposure in foreign currencies beyond the amounts reported as international investment securities, or to settle trades. Additionally, contracts may be used to effectively cancel previous contracts. The impact on market risk of these contracts can be summarized as follows:

		2006	2005
Contracts used to hedge or to settle trades, net	$	(1,387,002)	(509,479)
Contracts used to increase investment exposure in a foreign currency or to settle trades, net		1,374,177	522,733
Net fair value	$	(12,825)	13,254

(5) Investments in Debt Securities

The Retirement System's investments in debt securities as of June 30, 2006 and 2005 are summarized as follows:

		2006	% of total		2005	% of total
U.S. government and agencies	$	1,151,022	31%	$	1,372,895	38%
U.S. corporate		2,080,693	57%		1,773,910	49%
International government		329,792	9%		319,682	9%
International corporate		90,030	2%		162,740	4%
Other international investments		18,365	1%		—	0%
	$	3,669,902	100%	$	3,629,227	100%

(6) Investments in Equity Securities

The Retirement System's investments in equity securities as of June 30, 2006 and 2005 are summarized as follows:

		2006	% of total		2005	% of total
Domestic	$	4,300,868	60%	$	4,225,420	66%
International		2,896,707	40%		2,199,917	34%
	$	7,197,575	100%	$	6,425,337	100%

(7) Investments in Real Estate Holdings

The Retirement System has invested in certain real estate holdings, which are accounted for at fair value. The changes in these investments during the years ended June 30, 2006 and 2005 are summarized as follows:

		2006	2005
Investments:			
Beginning of the year	$	1,084,785	958,368
Capital investments		397,297	212,173
Equity in net earnings		43,635	50,043
Net appreciation in fair value		159,176	91,113
Capital distributions		(368,041)	(226,911)
End of the year	$	1,316,852	1,084,786

(8) Benefits

Allowances and benefits paid during the year are summarized as follows:

		2006	2005
Service retirement benefits	$	431,915	394,807
Disability retirement benefits		114,348	105,495
Death allowances		4,058	3,983
Death benefits paid by the City and County		2,253	2,331
Normal contributions paid as death benefit		2,972	1,988
Other death benefits		1,294	1,474
Proposition C payments		29,405	25,885
	$	586,245	535,963

(9) Commitments and Contingencies

(a) Investments

The Retirement System has unfunded commitments to contribute capital for real estate in the amount of $287,908 and alternative investments in the amount of $554,400 totaling $842,308 as of June 30, 2006.

(b) Legal

During the year ended June 30, 2006, the Retirement System was involved in two class action type lawsuits: one filed by Police and Fire members and the other filed by the Veteran Police Officers Association (VPOA). Both of these lawsuits involve issues related to "final compensation" as defined by the Plan. The Police and Fire members have made claims for special pay types specific to their employee groups to be included in the calculation of "final compensation" at the time of retirement. The Police and Fire lawsuit has been resolved in favor of the Retirement System during the year ended June 30, 2006. The VPOA lawsuit alleges that the Retirement System should include Police Officer Standard Training (POST) pay in pension calculations for those police officers who retired prior to the creation of the POST ranks. The Retirement System was successful in defending the VPOA lawsuit in the trial court. The VPOA lawsuit is on appeal. The potential loss to the Retirement System should there be a successful appeal is estimated to be less than $100 million.

The Retirement System is a plaintiff in two securities fraud cases. The first lawsuit is against Enron Corporation, its officers and its accountants. In the second case, the Retirement System joined a coalition of government pension funds in a securities fraud suit against various investment banks for losses relating to WorldCom bonds. As these cases are in the preliminary stage, it is premature to determine the amount of recovery for the Retirement System in these matters.

The Retirement System is involved in various other petitions, lawsuits, and threatened lawsuits relating to individuals' benefits due under the Retirement System which management does not expect to have a material impact on the net assets available for pension benefits. The results of such actions are included in the Retirement System's experience factors used in its actuarial valuations and, accordingly, are eventually considered in establishing the City and County's required annual contributions.

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Schedule of Funding Progress
June 30, 2006
(Dollars in thousands)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) - entry age (b)	Underfunded (overfunded) AAL (b-a)	Funded ratio (a/b)	Covered payroll (c)	Underfunded (overfunded) AAL as a percentage of covered payroll (b-a)/c)
July 1, 2005	$ 12,659,698	$ 11,765,737	$ (893,961)	107.6%	$ 2,052,862	(43.5)%
July 1, 2004	11,299,997	10,885,455	(414,542)	103.8%	2,155,252	(19.2)%
July 1, 2003	11,173,636	10,249,896	(923,740)	109.0%	2,130,071	(43.4)%
July 1, 2002	11,102,516	9,415,905	(1,686,611)	117.9%	2,019,097	(83.5)%
July 1, 2001	10,797,024	8,371,843	(2,425,181)	129.0%	1,858,365	(130.5)%
July 1, 2000	10,076,469	7,258,394	(2,818,075)	138.8%	1,727,127	(163.2)%

Unaudited - See accompanying independent auditors' report and notes to schedules of funding progress and employer contributions.

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Schedule of Employer Contributions
June 30, 2006
(Dollars in thousands)

Year ended June 30	Annual required contribution	Percentage contributed
2006	$ 126,533	100%
2005	83,664	100%
2004	-	N/A
2003	-	N/A
2002	-	N/A
2001	-	N/A

Unaudited - See accompanying independent auditors' report and notes to schedules of funding progress and employer contributions.

SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM

Note to Schedules of Funding Progress and
Employer Contributions

(Dollars in thousands)

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

Valuation date	July 1, 2005
Actuarial cost method	Entry age normal
Unfunded liability amortization method	Level percentage of payroll
Unfunded liability amortization period	Actuarial gains and losses, assumption changes, and purchasable services are amortized over 15 years; plan amendments are amortized over 20 years
Asset valuation method	5-year market value smoothing - transition period began July 1, 2004
Actuarial assumptions:	
Investment rate of return	8.00%
Projected salary increases:	
Cost of living component	3.50%
Merit and promotion component	4.50%

Unaudited – See accompanying independent auditors' report.