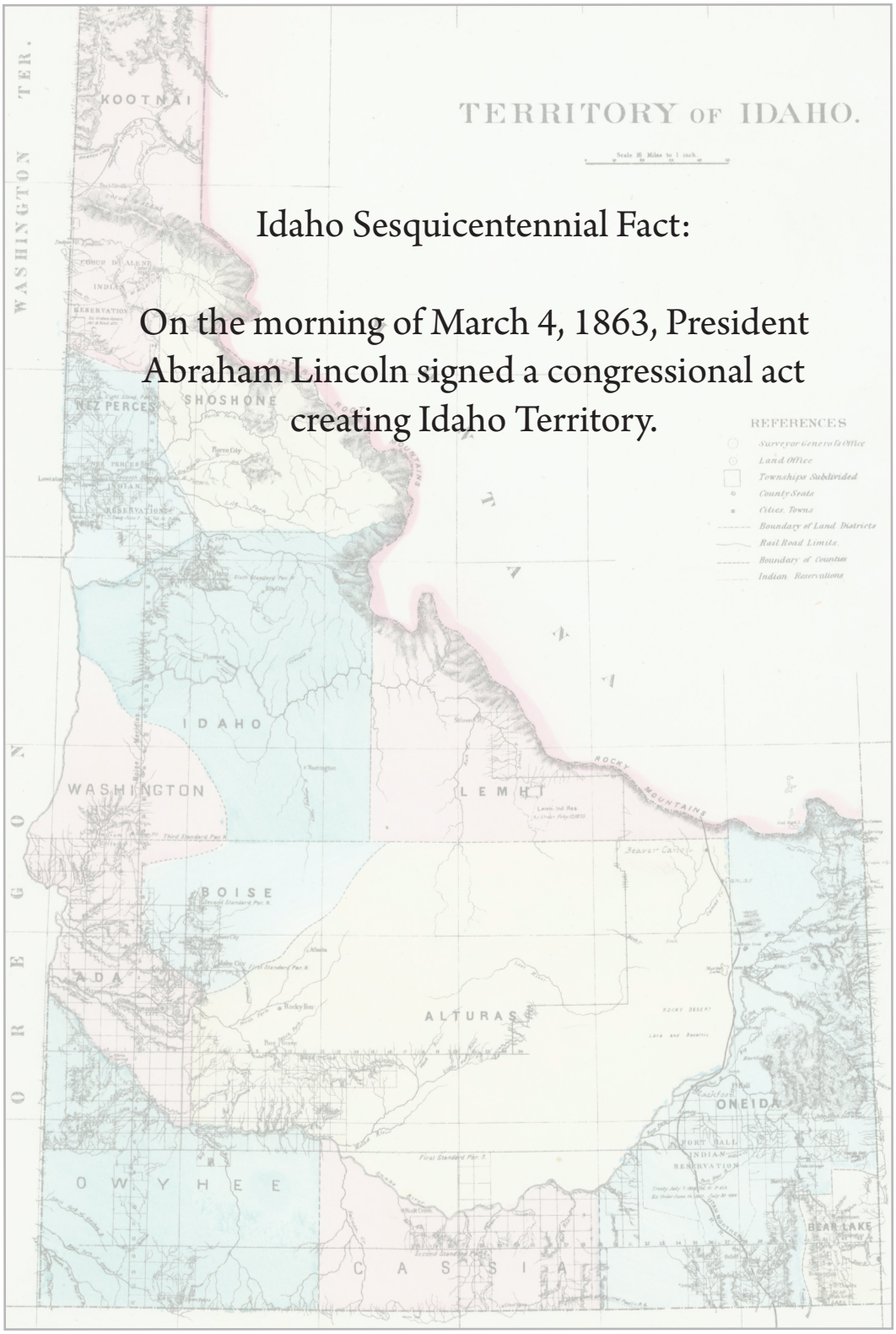
Introductory Section



Idaho Sesquicentennial Fact:

On the morning of March 4, 1863, President Abraham Lincoln signed a congressional act creating Idaho Territory.

Helping Idaho public employees build a secure retirement.

PERSI MISSION STATEMENT

To provide a sound retirement system and high quality service and education to help Idaho public employees build a secure retirement.

CORE VALUES

VISION

To be the premier public retirement system, respected by customers, peers, and the community, and known for professional service, technological advancement, and fund stability.

FIDUCIARY DUTY OF LOYALTY

The primary duty of the Retirement Board and PERSI staff, as fiduciaries, is that of loyalty, or acting with an "eye single" to the interests of the beneficiaries. PERSI is required by law to make all its decisions solely in the interest of the beneficiaries and to avoid, at all costs, serving the interests of any other party not a beneficiary of the system.

C.L. "Butch" Otter, Governor, State of Idaho

RETIREMENT BOARD

Jody B. Olson, Chairman
Term expires July 1, 2017

Jeff Cilek
Term expires July 1, 2015

William "Bill" Deal
Term expires July 1, 2013

Joy Fisher
Term expires July 1, 2014

J. Kirk Sullivan
Term expires July 1, 2016

PERSI ADMINISTRATIVE STAFF

Donald D. Drum, Executive Director
Cheri Campbell, Human Resources
Joanna Guilfoy, Deputy Attorney General
Robert M. Maynard, Chief Investment Officer
Ray Polzin, Deputy Director
Patrice Perow, Public Information Officer
Wayne Ellis, Project Manager
James E. Monroe, Chief Financial Officer
Debbie Buck, Financial Operations Manager
Diane Kaiser, Defined Contribution Manager
Larry Sweat, Information Technology Manager
Kimberlee Hall Member Services Manager
Lisa Conn, Retirement Services Supervisor
Melody Hodges, Answer Center and Processing Center Supervisor

PROFESSIONAL CONSULTANTS

Actuary: Milliman, Inc., Boise, ID

Auditor: Eide Bailly LLP, Boise, ID

Medical: Sedgwick CMS, Memphis, TN
United Review Services, Inc., Piscataway, NJ

Investment: Callan Associates, Inc., San Francisco, CA
CS Capital Management, Inc., Atlanta, GA
Berkadia Commercial Mortgage, LLC Horsham, PA
Hamilton Lane Advisors, LLC, Philadelphia, PA
Alban Row, LLC, Mt. Pleasant, SC
Robert Storer, Juneau, AK
Chartwell Consulting, LLC, Bedford, NH

Legal: Foster Pepper, PLLC, Seattle, WA
Ice Miller, LLP, Columbus, OH
Whiteford, Taylor & Preston, LLP, Baltimore, MD

Other: Xerox HR Solutions, LLC, Woburn MA
Mellon Transition Management Services, San Francisco, CA

Investment Custodians: Bank of New York Mellon Asset Servicing, Pittsburgh, PA
Wells Fargo Bank of Idaho, Boise, ID

Investment Managers:

Advent International Corp., Boston, MA
Adelante Capital Management LLC, Berkeley, CA
American Securities Opportunities Associates, LLC, New York, NY
Apollo Management, LP, Purchase, NY
Bank of New York Mellon, San Francisco, CA
Baring America Asset Management, Inc., Boston, MA
Blackstone Group, LP, New York, NY
Brandes Investment Partners, LP, San Diego, CA
Bridgepoint Capital LTD, London
Capital Guardian Trust Company, Brea, CA
Cascade Affordable Housing, LLC Seattle, WA
Cerberus Capital Management, L.P., New York, NY
Clearwater Advisors LLC, Boise, ID
CVC Capital Partners Advisory Co. LTD, London
D.B. Fitzpatrick & Co., Inc., Boise, ID
Donald Smith & Co., Inc., New York, NY
Endeavour Capital Partners, L.P., Portland, OR
Enhanced Equity Partners, LLC, New York, NY
EPIC Ventures, LLC, Salt Lake City, UT
First Reserve Corporation, Greenwich, CT
Frazier Technology Ventures Management, LP, Seattle, WA
FS Private Investments, LLC, New York, NY
Galen Management, LLC, Stamford, CT
Genesis Asset Managers, LTD, London
Goense Bounds Management, LP, Chicago, IL
Hamilton Lane Advisors, LLC, Baja Cynwyd, PA
Hamilton Lane, G.P., Baja Cynwyd, PA
Highway 12 Capital Partners, LLC, Boise, ID
Ida-West Operating Services, Inc., Boise, ID
JH Whitney Equity Partners VI, LLC, New Canaan, CT
Kohlberg Kravis Roberts & Co., LP, New York, NY
Kohlberg Management, LLC, Mt Kisko NY
Leonard Green & Partners, LP, Los Angeles, CA
Lindsay Goldberg & Bessemer, LLC, New York, NY
Littlejohn Associates, LLC, Greenwich, CT
Longview Partners, LP, London
McCown De Leeuw & Co. IV, LLC, Menlo Park, CA
Mondrian Investment Partners, LTD., London
Mountain Pacific Investment Advisers, Inc., Boise, ID
Nautic Partners, LLC, Providence, RI
Olympic Investors, LLC, Seattle, WA
Pareto Partners, LLC, London
Peregrine Capital Management, Inc., Minneapolis, MN
Providence Equity Partners, LLC, Providence, RI
Prudential Investment Management LLC, Newark, NJ
Sanford C. Bernstein & Co. LLC, New York, NY
State Street Global Advisors, Boston, MA
TPG Capital, LP, Fort Worth, TX
The Gores Group, LLC, Los Angeles, CA
The Koll Company, LLC, Newport Beach CA
Tukman Grossman Capital Management, Inc., Larkspur, CA
Veritas Capital, LP New York, NY
W. Capital Partners, LLC, New York, NY
Western Asset Management Co., Pasadena, CA
Zesiger Capital Group, LLC, New York, NY

Additional information on the above-mentioned investment professionals can be found on pages 68-69 in the Investment Section of this report.

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Public Employee Retirement System of Idaho

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011

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

President

Executive Director

Public Pension Coordinating Council

Public Pension Standards Award For Funding and Administration

2012

Presented to

Public Employee Retirement System of Idaho

In recognition of meeting professional standards for
plan funding and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle
Program Administrator

Organizational Chart

Retirement Board

Donald D. Drum
Executive Director

Cheri Campbell
Human Resources/Mgmt. Asst.

Erin Duran
Admin. Assist.1

Joanne Guilfoy
Deputy Attorney General

Robert M. Maynard
Chief Investment Officer

Richelle Sugiyama
Investment Officer

Rose Marie Sawicki
Administrative Assistant 1

Investment Managers
See Investment Section for a managers list
pp 68-69

Ray Polzin
Deputy Director

Patrice Perow
Public Information Officer

Mike Mitchell
Training Specialist

Vacant
Training Specialist

Steve Jones
Technical Writer

Wayne Ellis
Project Manager

James E. Monroe
Chief Financial Officer

Cecile McMonigle
Portfolio Accountant

Mike Young
Portfolio Accountant

Tess Myers
Admin. Assist. 1

JoAnne Dieffenbach
Financial Technician

Sharon Simon
Financial Support Technician

Debbie Buck
Financial Operations Manager

Alice Brown
Financial Technician

Barbara Weirick
Financial Technician

Vacant
Financial Technician

Vacant
Financial Technician

Brenda Cronin
Financial Specialist Sr.

Bev Ross
Financial Technician

Linda Whitney
Financial Technician

Diane Kaiser
DC Plan Manager

Daryl King
Admin. Assist. 1

Larry Sweat
Information Technology Manager

Nancy Fauver
IT Database Analyst

Joy Fereday
IT Programmer Analyst Sr.

Ryan Evey
IT Programmer Analyst Sr.

Kris Colt
IT Production Spec.

Branden Kennah
IT Information Sys Tech Sr.

Stacy Parr
Web Developer

Randy Graybeal
IT Network Analyst

Kimberlee Hall
Member Services Manager

Lisa Conn, Supervisor
Member Services Retirement Center

Catherine Atchison
Retirement Specialist

Susan Strouth
Retirement Specialist

Lisa Mabe
Retirement Specialist

Sherry Slocum
Admin. Assist. 1

Lynn Duncan
Retirement Specialist

Jennifer Whitley
Retirement Specialist

Kari Caven
Retirement Specialist

Kathi Kaufman
Customer Service. 2

Cindy Eastman
Retirement Specialist

Shasta Luper
Retirement Specialist

Open
Retirement Specialist

Linda Parker
Customer Service. 2

Melody Hodges, Supervisor
Member Services Answer & Processing Center

Andrea Colglazier
Customer Service 2

Brett Harper
Customer Service 2

Katherine Pearce
Customer Service. 2

Stephen Mytrysak
Customer Service 2

Gerry Sjol
Customer Service 2

Lenna Strohmeyer
Technical Records Specialist 1

JD Stewart
Technical Records Specialist 1

Dotty Cluck
Customer Service 1

Cathy Andrews
Imaging Specialist

Kay Prince
Technical Records Specialist 1

Denice McGee
Technical Records Specialist 1

Vacant
Quality Assurance

THE SYSTEM

The Public Employee Retirement System of Idaho (the System) is the administrator of six fiduciary funds. This includes two defined benefit retirement plans, the Public Employee Retirement Fund Base Plan (PERSI Base Plan) and the Firefighters' Retirement Fund (FRF); two defined contribution plans, the Public Employee Retirement Fund Choice Plan 401(k) and 414(k) (PERSI Choice Plans); and two Sick Leave Insurance Reserve Trust Funds – one for state employers and one for school district employers.

The Retirement Board consists of five members, each appointed by the Governor to fulfill a 5-year term. The Board meets monthly to conduct System business, usually on the fourth Tuesday of each month at 8:30 a.m. at PERSI's headquarters office in downtown Boise.

Administrative expenditures consisting of the personnel costs, operating expenditures, and capital outlay necessary to operate the System are limited to those approved and appropriated by the Legislature for that purpose. In Fiscal Year 2012 (FY12), these costs totaled $6,335,771 including $237,917 in depreciation, which is not a cash expenditure and, therefore, not appropriated.

The majority of the System's 63 staff works in the headquarters office located at 607 North 8th Street, Boise, Idaho. There are two staff members in the Coeur d'Alene office, and three in the Pocatello office. The Executive Director and investment personnel are exempt positions appointed by the Retirement Board to serve at its pleasure. The Deputy Director and Public Information Officer are exempt positions serving under the Executive Director. The Deputy Attorney General is assigned to PERSI by the Office of the Attorney General. All other staff members serve under statutes and personnel rules governing classified state service.

The System staff oversees the investment of the trust corpus and new contributions with professional investment managers and funding agents. The Retirement Board maintains fiduciary responsibility for investment policy, asset allocation, and the selection of individual investment managers as discussed in the Investment Section.

SUMMARY OF PLAN PROVISIONS

DEFINED BENEFIT "BASE PLAN" PROVISIONS

Note: The items in parentheses are the provisions applicable to members designated as either PERSI firefighters or as PERSI police officer members for retirement purposes.

MEMBER CONTRIBUTION RATE

The employee contribution rate is set by statute at 60% (72%) of the employer rate. As of June 30, 2012, it was 6.23% (7.69%).

EMPLOYER CONTRIBUTION RATE

The employer contribution rate set by the Retirement Board was 10.39% (10.73%) as of June 30, 2012.

SERVICE RETIREMENT

ELIGIBILITY

Five years of service and age 65 (age 60 or between 60 and 65, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE

For each year of credited service, the monthly service retirement allowance as of June 30, 2012, was 2% (2.3% for police/firefighters) of the monthly average salary of the member's highest 42 consecutive months.

MINIMUM MONTHLY BENEFIT ALLOWANCE

Until February 29, 2012: for each year of service, the monthly minimum benefit allowance was $23.68 ($28.41) to a maximum of the member's accrued benefit. Effective March 1, 2012, the monthly minimum benefit allowance was $23.91 ($28.70).

NORMAL FORM

Regular retirement allowance for retiree's life only, plus a lump sum death benefit if the retiree dies before allowances are paid, total accumulated employee contributions and interest.

OPTIONAL FORMS

Retirees may also choose 50% or 100% contingent annuitant options as well as Social Security “bridge” options. These are actuarial equivalents of the normal form based on the mortality and interest assumptions adopted by the Retirement Board. The allowance is payable for the life of the retiree and designated contingent annuitant.

EARLY RETIREMENT

ELIGIBILITY

Five years of service and age 55 (age 50 or between 50 and 55, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE

Unreduced accrued service retirement allowance if age plus service, upon separation from employment, total 90 (80, or between 80 and 90, depending on the ratio of police officer/firefighter service to total credited service); otherwise, the accrued service retirement allowance is reduced 3% for each of the first 5 years by which the early retirement date precedes the date the member would be eligible to receive the unreduced benefit, and by 5.75% for each additional year to a maximum of a second 5 years. The unreduced benefit entitlement may be either at the service retirement eligibility date or the date eligible for the rule of 90(80).

FORMS

Regular retirement allowance; contingent annuitant allowances for the life of the retiree and a designated contingent annuitant; Social Security level income option for the life of the retiree only or for the life of the retiree and designated survivor.

DISABILITY RETIREMENT

ELIGIBILITY

Active members must have 5 years of service, be unable to perform work of *any* kind, and be expected to remain disabled for life. They are eligible from first day on the job if the disability is due to occupational causes.

AMOUNT OF ALLOWANCE

Projected service retirement allowance based on the highest 42-consecutive month average salary at the time of disability. The benefit is calculated using the accrued service at the time of disability plus the service which would have accrued through service retirement age had the disability not occurred. If a member has less than 360 months of service as of the date he is eligible for disability retirement, he will be given credit for the months of service he would have earned from the date of disability to the date he would have reached Service Retirement Age (65 for general members/62 for police and firefighters) had he not become disabled (360 months of credited service maximum). In other words, PERSI will give members up to 30 years of credit or to Service Retirement Age, whichever comes first. Monthly allowance is payable after all temporary compensation ceases and is offset by the amount payable as income benefit under worker's compensation law, except when offset by Social Security. Effective July 1, 2009, public safety officers who are injured in the line of duty and determined to be permanently disabled under Idaho Code 59-1302(12), may be eligible to receive a one-time, lump-sum payment of $100,000.

NORMAL FORM

Regular retirement allowance to normal service retirement age when retirement benefit changes to service retirement allowance with its optional forms available.

DEATH BENEFITS

AFTER RETIREMENT

Under the normal form of the retirement allowance, a Social Security adjustment option, or a disability retirement, the balance, if any, of the member's accumulated contributions and interest at retirement over all payments received is paid to the beneficiary in a lump sum. In the case of a disability retirement, the beneficiary may waive the lump sum if the retiree is married so that the spouse will receive a lifetime monthly allowance, or the beneficiary may take a lump-sum payment of two times the amount in the member’s account at the time of disability retirement minus any amount paid. Under the contingent annuitant options, the designated annuitant receives a lifetime monthly benefit following the member's death. If the survivor dies before the balance of the member's accumulated contributions and interest has been paid, the balance will be paid to the beneficiary in a lump sum. If the member's designated contingent annuitant predeceases him/her, the member's allowance will be recalculated to a single life payment.

BEFORE RETIREMENT

1 Non-vested Members:

   a Beneficiary receives a lump sum payment of the member's accumulated contributions plus interest.

2 Vested Members:

   a Beneficiary receives a lump sum payment of two times the member's accumulated contributions plus interest.

   b If the member is married, and the spouse is the sole beneficiary, the spouse may select a lump sum payment or a lifetime monthly benefit.

   c If the member is married, but the spouse is not the sole beneficiary, the beneficiary may waive the lump sum, in which case, a lifetime monthly benefit is available to the surviving spouse.

3 A $100,000 death benefit for duty-related deaths for police officers/firefighters became effective July 1, 2003.

SEPARATION BENEFIT

Accumulated member contributions with regular interest is payable upon becoming an inactive member separated from eligible employment. The Regular Interest Rate in effect for FY12 was 18.16% from January 1 through June 30, 2012 (10.74% from July 1 through December 31, 2011) compounded monthly per annum.

POSTRETIREMENT ADJUSTMENTS

An annual postretirement adjustment based on and limited by a cost-of-living factor reflecting the changes in the Consumer Price Index (CPI) is effective in March each year. If the CPI change from August of the previous year to August of the second previous year is 1% or more, a 1% mandatory adjustment is made. The Board may authorize additional discretionary adjustments based on the CPI increase (up to a total maximum annual COLA of 6% or the CPI rate, whichever is lower) if it determines that the System can do so and still maintain an appropriately funded position as required by Idaho Code Section 59-1355(1). When discretionary COLA adjustments in excess of the 1% are authorized by the Board, they are reported to the Legislature. If the Legislature has not acted on the Board adjustment by the 45th day of the legislative session, the discretionary COLA, if any, becomes effective on March 1 of that year.

The Board is also authorized to award postretirement adjustments for prior years in which the actual amount of adjustment was less than the CPI for those years. If the CPI change is downward, in no event will any benefit be reduced below its initial amount.

The net COLA authorized and implemented March 1, 2012 was 1%.

PERSI
Public Employee Retirement System of Idaho

Governor C.L. "Butch" Otter

Retirement Board
Jody B. Olson, Chairman
Jeff Cilek
William W. Deal
Joy Fisher
J. Kirk Sullivan

Executive Director
Donald D. Drum

PHONES
Answer Center 208-334-3365
Fax 208-334-3805
Toll-free:1-800-451-8228

Employer Service Center
1-866-887-9525

Mailing Address
P.O. Box 83720
Boise, ID 83720-0078

BOISE
607 North 8th Street
Boise, ID 83702-5518

POCATELLO
850 East Center, Ste. "D"
Pocatello, ID 83201

COEUR D' ALENE
2005 Ironwood Pkwy.
Coeur d' Alene, ID 83814

Choice Plan Record Keeper
1-866-437-3774

November 19, 2012

Dear Governor Otter, Legislators, and Members of the Retirement System:

We are pleased to present to you the Public Employee Retirement System of Idaho (the System) comprehensive annual financial report, for the fiscal year ended June 30, 2012 (FY12). This financial report is a historical perspective of benefits, services, and fiscal activities of the System. Included is a summary of our actuarial valuations, an independent auditors' report, an investment summary, and a statistical section.

Generally accepted accounting principles require management to provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the independent auditors' report.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a *Certificate of Achievement for Excellence in Financial Reporting* to PERSI for its comprehensive annual financial report for the fiscal year ended June 30, 2011. This was the 21st consecutive year PERSI has achieved this prestigious award. To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

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

For the 10th consecutive year, PERSI has been awarded the *Public Pension Coordinating Council Standards Award*. This award signifies that PERSI complies with the standard benchmarks for public defined benefit systems in the United States. The standards require a high level for the following: comprehensive benefit program, funding adequacy, accepted actuarial and audit practices, investment policy and evaluation, and member communications. This award is given to 50 to 60 public retirement systems each year.

This Letter of Transmittal is intended to serve as an overview of the System and to convey information on the topics that follow.

PLAN HISTORY

The Public Employment Retirement System of Idaho (PERSI) was created by the thirty-seventh Legislature, Regular Session of 1963 with funding effective July 1, 1965. It is a tax qualified, defined benefit system to which both the member and the employer contribute. Participation in the System is mandatory for eligible state and school district employees and available to other public employers and their employees on a contractual basis.

When the Teachers Retirement System of Idaho was abolished, members of that system were integrated into PERSI, and all other eligible school district employees became PERSI members effective July 1, 1967.

Legislative amendments since 1965 have made it possible for municipal police officer retirement funds to merge with the System, and two of the five police officer systems have since merged. The other three are being phased out, and police officers hired since 1969 have become PERSI members.

Legislation in 1979 mandated the Firefighters' Retirement Fund be administered by PERSI effective October 1, 1980. Paid firefighters who were members of the original system retained their original benefit entitlement, while paid firefighters hired after October 1, 1980, were entitled to PERSI benefits. An actuarial valuation of the firefighter member benefit entitlement is conducted at least every other year, separate from the annual PERSI valuation.

In January 2001, PERSI implemented a "Gain Sharing" program as a way to distribute $155 million in excess investment earnings back to our active members, retirees, and employer members. Retirees received their gain sharing as a "13th check." Employers received their share as a contribution "holiday." Some 53,000 eligible active members received their portion as deposits into newly created defined contribution (DC) accounts. This new plan, named the "PERSI Choice 401 (k) Plan," supplemented PERSI's traditional Defined Benefit (DB) "Base" Plan. It allowed employees for the first time to actively participate in saving for their retirement.

At the time of inception, the Choice Plan was somewhat unique in the public sector. PERSI obtained permission from the Internal Revenue Service to expand a grandfathered State 401(k) to our members statewide. While some public employees were familiar with 457 or 403(b) plans, a 401(k) was something new to them. Many of our members had never had the opportunity to make such pre-tax voluntary contributions.

SERVICES PROVIDED

The ability of the System to serve both employee and employer members at the local level through the Boise, Pocatello, and Coeur d' Alene offices remains a key factor for efficient administration. The merging of other retirement systems with PERSI, plus statutory amendments over the years, have produced both multiple and diverse member benefit entitlements and administrative requirements. These can best be analyzed and explained to the members through personal contact with knowledgeable System staff members.

In its 47th year of operation, the System continued a wide range of services to both employee and employer members. Members may visit the PERSI Web site, call, email, or visit one of the three offices for personal information and assistance regarding credited service, account balances, eligibility, benefit options and amounts, and other retirement matters.

Members receive advance notice of service retirement qualification and are provided with estimates of monthly allowances. They also receive information regarding the availability of alternate forms of retirement payments. Retirement applications are processed in a timely fashion, and monthly payments are made promptly. Direct deposit of benefit payments is available to retired members as is withholding for income tax, medical insurance, or other purposes.

System retirees are provided notices whenever their net benefit amount changes. This notice gives retirees a list of their itemized deductions from their gross benefit. Retirees may also access the past 24 monthly notices on the PERSI secure web site, as well as past 1099 tax statements.

Separation and death benefits are paid in an orderly manner and as rapidly as possible. Employee contributions and earned interest are posted to individual member accounts each month, and an annual statement is provided to each member confirming their average monthly salary, credited service, contributions, and earned interest. In addition, a report of benefits accrued to date is provided along with an estimate of benefits projected ahead to various retirement ages.

PERSI's employer units are responsible for reporting and handling retirement transactions and activities. They are provided regular training and assistance through monthly newsletters, employer training sessions throughout the State, and personal contacts with PERSI staff, as needed. Employer records and reporting procedures are reviewed each year for accuracy and compliance with statutory provisions.

Upon request, public employers interested in affiliation with the System are counseled and provided with information regarding employee benefits, cost, and procedures associated with joining. Conversely, employers considering withdrawal are provided information and employee benefit projections to enable them to make an informed decision.

Pre-retirement and financial planning workshops, offered on a regular basis throughout the State, cover financial planning, budgeting, investment basics, and Social Security, Medicare, and System benefits.

EMPLOYEE AND EMPLOYER MEMBERSHIP

During FY 2012, the number of active PERSI members decreased from 65,798 to 65,270. The number of retired members or annuitants receiving monthly allowances increased from 35,334 to 37,150. The number of inactive members who have not been paid a separation benefit increased from 25,489 to 26,682. Of these inactive members, 10,823 have achieved vested eligibility. Total membership in PERSI increased from 126,621 to 129,102 during the fiscal year. There are currently 752 public employers in Idaho who are PERSI members. Participating employers are listed in the Statistical Section of this report.

MANAGEMENT RESPONSIBILITY

The System's management is responsible for the complete and fair presentation of the data and the accompanying disclosures in this report. The financial statements and supplemental schedules included in this report have been prepared in accordance with generally accepted accounting principles for governmental accounting and reporting as pronounced or adopted by the Governmental Accounting Standards Board.

INDEPENDENT AUDIT

The System is audited annually, and for the fiscal year ended June 30, 2012, the audit was conducted by Eide Bailly, LLP, an independent firm of Certified Public Accountants. Refer to the Independent Auditors' Report for their audit opinion.

INTERNAL ACCOUNTING CONTROL

As an agency of the State of Idaho, the System's administrative expenses are subject to the State's budget controls. Management is responsible for maintaining a system of internal accounting control designed to provide reasonable assurance transactions are executed in accordance with management's general or specific authorization and are recorded as needed to maintain accountability for assets to permit preparation of financial statements. Internal controls have inherent limitations and their costs should not outweigh their benefits. Internal control procedures have been established, and a budget report is prepared for the Board. We believe the internal controls in effect during FY 2012 adequately safeguard the assets and provide reasonable assurance regarding the proper recording of financial transactions.

FINANCIAL HIGHLIGHTS

Collection of employer and employee contributions, as well as income and gains from investments, provides the reserves necessary to finance retirement benefits. These income sources totaled $684,704,181 for all pension funds during the fiscal year ended June 30, 2012.

ADDITIONS:	
Contributions	$ 521,269,612
Transfers/Rollovers In	9,576,929
INVESTMENT INCOME:	
Net Appreciation (Depreciation) in Fair Value of Investments	(101,608,701)
Interest, Dividends and Other Investment Income	297,899,261
Less: Investment Expenses	(42,461,439)
Net Investment Income	153,829,121
OTHER INCOME	28,519
Total Additions	$ 684,704,181

The payment of benefits is the primary expense of a retirement system. The payments, together with the expenses to administer the Plan, constitute the total expenses of the System. Expenses for FY 2012 are as follows:

DEDUCTIONS:	
Benefits and Refunds	$ 686,091,409
Administrative Expenses	6,335,771
Transfers/Rollovers Out	14,943,046
Total Deductions	$ 707,370,226

ACTUARIAL PRESENT VALUE OF FUTURE BENEFITS

Future benefits include all benefits estimated to be payable to plan members (retirees and beneficiaries, terminated employees entitled to benefits but not yet receiving them, and current active members) as a result of their service through the valuation date and their expected future salary. The actuarial present value of future benefits as of the valuation date is the present value of the cost to finance benefits payable in the future, discounted to reflect the expected effects of the time value (present value) of money and the probabilities of payment. Simply put, it is the amount that would have to be invested on the valuation date so the amount invested plus investment earnings will provide sufficient assets to pay total future benefits when due.

The actuarial present value was calculated as part of an actuarial valuation at July 1, 2012. Significant actuarial assumptions used include: a gross investment return rate of present and future assets of 7.5% compounded annually, (7.0% plus 0.50% for expenses); projected salary increases of 3.75% per year compounded annually, attributable to general wage increases; additional projected salary increases attributable to seniority/merit, up to 6.5% per year, depending on service and employee classification, and; 1.00% per year attributable to postretirement benefit increases.

At June 30, 2012, the unfunded actuarial liability on a current contribution basis was as follows:

Unfunded Actuarial Liability on Current Contribution Basis (in millions):

	Valuation Date:	July 1, 2012
	Benefit Date:	July 1, 2012
A.	Actuarial Present Value of All Future Benefits for Contributing Members, Former Contributing Members and Their Survivors	$ 16,830.5
B.	Actuarial Present Value of Total Future Normal Costs for Present Members	$ 3,433.8
C.	Actuarial Liability [A - B]	$ 13,396.7
D.	ORP Contributions	$ 47.0
E.	Actuarial Liability Funded by PERSI Contributions [C-D]	$ 13,349.7
F.	Actuarial Value of Assets Available for Benefits	$ 11,306.2*
G.	Unfunded Actuarial Liability (funding excess) [E-F]	$ 2,043.5
H.	Amortization Period on Valuation Date, Based on Contribution Rate Established as of Benefit Date	14.8 years
I.	Funded Ratio [F/E]	84.7%**

* The total available assets are $11.617.4 billion, but are reduced by $311.2 million for assets used in plan operations and funds earmarked to provide excess benefits to former members of the Firefighters' Retirement Fund and the Idaho Falls Police Retirement Fund.

** Recognizes the impact of the March 1, 2012 COLA and the scheduled contribution rate increases adopted during the 2011-2012 year.

ECONOMIC CONSIDERATIONS

The System operates within a dynamic economic environment, as do all investment funds. The objective of the Retirement Board is to minimize the effect of these external influences, where possible, by diversifying among a broad range of asset classes and investment management styles, both domestically and internationally. Such diversification, combined with prudent management by experienced investment professionals, increases the probability the earnings objective will be achieved. The investment return for Fiscal Year 2012 was 1.2% net of investment expenses.

Defined benefit pension systems plan for and make decisions based on the long term (20 to 25 year) nature of pension funding and benefits. PERSI is funded on a sound actuarial basis, which protects future benefits for participants. Over the long-term, the Plan's investment assets have exceeded their expected returns. Short-term fluctuations in investment performance make good headline news, but are much less important when viewed in the long range context of pension plans. Sound investment strategies that are, in the words of CIO Bob Maynard, "Simple, Transparent, and Focused" along with reasonable actuarial assumptions are the key ingredients to a successful, well funded pension plan.

INVESTMENT STRATEGY AND POLICIES

The Retirement Board utilizes and directs agents to provide whatever investment management and custodial functions best achieve the System's investment objectives. The Board establishes asset

allocation policy, diversification guidelines, custodial functions including safe-guarding of investments, and investment guidelines and restrictions. Each money manager is generally granted full discretion in making investment decisions within their guidelines. The Board, staff, and consultants monitor and evaluate investment results. The Board, in its administration of this System and management of the investment program, is guided by the fiduciary standards in Section 59-1301 of the Idaho Code and the Idaho Uniform Prudent Investor Act, in Sections 68-501 through 68-514 of the Idaho Code and is empowered in its sole discretion to limit, control, and designate the types, kinds, and amounts of investments.

PERSI's total fund return was 1.2% net of all expenses for Fiscal Year 2012 due to a struggling investment market. The policy benchmark return is 7.0%, net of all expenses. PERSI continues to rank in the top quartile over the long term when compared to our peer universe of other state-wide public pension funds across the country.

The investment mix at fair value as of the end of Fiscal Year 2012 was 59% domestic equity and global equity, 14% international equity, 27% percent fixed income. The System's investment outlook is long term, allowing the portfolio to take advantage of the favorable risk-return characteristics of equities by placing more emphasis on this category. The portfolio is broadly diversified with additional diversification achieved through domestic and international investing. See the Management's Discussion and Analysis and Investment Section of this report for more detailed analysis and information.

FUNDING STATUS

The funding objective of PERSI is to accumulate sufficient assets to ensure funds will be available to meet current and future benefit obligations to participants on a timely basis. If the level of funding is high, the ratio of assets to the actuarial accrued liability is also greater, which means better investment income potential. Each year an independent actuary engaged by PERSI calculates the amount of the annual contribution the plans must make to fully meet their obligations to retired employees. As of June 30, 2012, the PERSI Base Plan had an amortization period of 14.8 years and a funding ratio of 84.7% of the present value of the projected benefits earned by employees. The closed Firefighters' Retirement Fund remains at an amortization period of 1.6 years, as of the last valuation in 2011. For GASB reporting purposes, the Notes to Required Supplemental Schedules on page 53 provides detailed information on each plan's remaining amortization period. The actuarial method for calculating accrued liability for both plans is Entry Age Normal with the objective of maintaining employer contributions approximately level as a percent of member payroll. For a more in-depth discussion of PERSI's funding, see Management's Discussion and Analysis and the Actuarial Section of this report.

MAJOR INITIATIVES

To ensure high-level operations going forward, early in 2012 PERSI reorganized. Even small changes can be difficult; but it can be especially hard when reporting lines and responsibilities are affected. Few of PERSI's operational areas have gone untouched, yet the staff proved to be resilient. The existing Retirement Service Center and the Answer and Processing Center were reorganized into a single Member Services Center. The Fiscal Department, which already included the Employer Service Center, added the Choice 401(k) Plan staff to its operations, and the Communications and Education Departments became a single team. These changes had the goals of improved productivity, fewer redundancies, and better communications among the PERSI staff.

PERSI knew for some time its pension administration system was nearing the end of its lifespan. Without decisive action, it would only be a matter of time until our ability to offer efficient and effective customer service to members could be compromised. We began identifying what it would take for PERSI to successfully meet the challenges of a growing retiree population and to process the ever-increasing amount of data associated with that growth. After identifying our goals and establishing a

plan, PERSI got approval from the Idaho Legislature in fiscal year 2012 to begin the three-year, $13 million project to replace its ailing pension administration system. Implementation of the first phase of the Idaho Retirement Information System (IRIS) began in earnest in FY2012 with the employer-reporting component. It is critical to have an easy accurate way for employers to transmit payroll information to PERSI. With the new system, every employer will begin full reporting and will have tools to assist in eligibility determination, an enhancement welcomed by everyone. The IRIS upgrade was necessary to ensure PERSI's ability to accurately process the data required to maintain retirement records and pay benefits to thousands of Idaho public employees. The project is on schedule for full implementation in January 2015.

ACKNOWLEDGMENTS

This financial report of the Public Employee Retirement System of Idaho was prepared by staff under the leadership of the Retirement Board. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a method of determining responsible stewardship for the assets contributed by the members and their employers.

This report is being sent to the Governor, State Legislators, and other interested parties.

Respectfully submitted,

Jody B. Olson, Chairman | Donald D. Drum, Executive Director | James E. Monroe, Financial Officer