DELAWARE PUBLIC EMPLOYEES' RETIREMENT SYSTEM

AUDIT COMMITTEE MEETING AUGUST 30, 2006
WILMINGTON, DELAWARE

ATTENDEES

AUDIT COMMITTEE	KPMG	PENSION OFFICE
Robert Allen	Robert Steen	David Craik
Bill Markell	Evelyn Zerenner	Kim Vincent
Joel Poorman		Alice Simon
Harold Smith		Kathy Kunkle
	ASHFORD CONSULTING GROUP	
STATE AUDITOR	Robert Gooderham	ATTORNEY GENERAL
Ron Draper	Garry Musto	Marsha Kramarck

PURPOSE OF THE MEETING

Review the 2006 Audit report and a draft of the proposed Management letter; review and comment on the Delaware Public Employee's Retirement System's Annual Report for the fiscal year ended June 30, 2006; review the securities lending program undertaken by the Investment Committee with Northern Trust.

2006 AUDIT REPORT

Overview—The Audit opinion will be a clean opinion. The Management Letter is not completed but will be finished within the week. This year's audit was much more complicated than in earlier years because of new guidelines for auditing investments without a readily determinable fair value [e.g. alternative investments]. The audit opinion contains a paragraph highlighting the fact that 12% of the fair value of the net assets has been estimated by management. There is also a footnote on the use of estimates and the valuation procedures.

At the time of the meeting KPMG had not completed the valuation testing of the investments with Mellon nor received the Actuarial valuation review. There were also problems reconciling the contributions between CRIS and the State system.

The auditor is now required [SAS 61] to issue a letter to the Audit Committee defining their professional responsibilities---reasonable assurance there are no material misstatements and consideration of the internal controls in determining their audit procedures. They state that the valuation of the alternative investments is reasonable "in relation to the financial statements taken as a whole". There were no disagreements with management or any significant difficulties with management in performing the audit.

Two significant changes have occurred--the change in custodian bank from Mercantile to Northern Trust and the change in actuaries from Milliman to Cheiron. Both were effective July 1, and thus not covered by this audit.

There was an extended discussion on the valuation and review of alternative investments. Previously Ashford Consulting Group visited and in some cases served on committees of the Ventures. In the future there will have to be review and analysis by Pension Office personnel of these meetings as well as greater review of SAS 70's received from the Money Managers/ Custodian.

ANNUAL FINANCIAL REPORT

A draft of the Thirty-Fifth Comprehensive Annual Financial Report had been sent to members of the Audit Committee prior to the meeting. Various editorial revisions were suggested and the general presentation of the report discussed.

SECURITIES LENDING PROGRAM

Members of Ashford Capital reviewed the securities lending program. This program is through Northern Trust using the Core USA Cash Collateral Pool. The estimated earnings for DPERS range from $2.2million to $0.9million plus additional custodial fee savings from $250thousand to $25thousand. Earnings are split 80% for DPERS and 20% for Northern Trust. The range of earnings is dependent on how much of the DPERS portfolio is included in the program.

Currently DPERS engages in securities lending through commingled accounts with Mellon. Northern Trust's program has 45 approved borrowers; however DPERS may restrict any of these selected borrowers. The top 10 borrowers account for 83% of the programs total loan volume and all have A+ or better long-term S&P rating. Northern Trust contractually indemnifies DPERS against collateral losses [e.g. if the borrower defaults or provides collateral other than cash]. The greatest risk is the quality of the "collateral pool" and the investment pool earnings vs. the rebate rate. This risk is reduced since the collateral pool is actively managed and comprised of high quality investments. However the movement of interest rates can not be controlled. Northern Trust reviews rates weekly and limits the duration of the loans to an average of 30 days to reduce exposure to rate movements. The estimated maximum cash pool exposure is $200,000-$400,000. Maximum exposure for the program can not be estimated.

Northern Trust has never experienced a loss due to borrower default or insufficient collateral in a collateral pool. Nor have they experienced an investment loss or had a negative spread in any collateral pool. The program has senior management oversight and dedicated resources [e.g. borrower assessment, credit research and portfolio management] plus daily reporting and a sophisticated risk management and compliance system. These factors support going into the program.

Cc: Audit Committee Members
Philip Reese
David Craik
Kathy Kunkle