



AUDIT COMMITTEE

2018 September 6

TABLE OF CONTENTS

<u>Tab No.</u>	<u>Title</u>
1	<u>Agenda</u>
2	<u>Approval of Minutes Memo</u> a) <u>May 16, 2018</u>
3	<u>KPMG FY18 Audit Report Memo</u> a) <u>Presentation: KPMG FY18 Audit Report</u>
4	<u>Review of FY18 Year-End Financial Statements Memo</u> a) <u>Presentation: FY18 Statements</u> b) <u>FY18 Management's Discussion & Analysis</u> c) <u>FY18 Financial Statements</u> d) <u>FY18 Financial Statements Notes</u> e) <u>Policy on Other than Temporary Impairment Memorandum</u>

01_Audit Commitee_Agenda

AUDIT COMMITTEE MEETING OF THE BOARD OF TRUSTEES
Thursday, September 6, 2018**Atwood Building – Room 106**
550 West 7th Avenue, Anchorage, AK 99501**Teleconference Access****Call-in toll-free number: 1-844-740-1264 / Access Code (Meeting Number): 807 727 652***Please call in from a hard line telephone (not speaker phone or cell) to prevent audio feedback.***AGENDA****THURSDAY, SEPTEMBER 6, 2018**

- 8:30 a.m. CALL TO ORDER
- ROLL CALL (ACTION)
- APPROVAL OF AGENDA (Action)
- APPROVAL OF MINUTES (Action)
- Audit Committee Minutes – May 16, 2018
- SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION
- 8:35 a.m. KPMG AUDIT REPORT (Information)
- Beth Stuart, Engagement Partner, KPMG
- Melissa Beedle, Engagement Manager, KPMG
- 9:15 a.m. DETAILED REVIEW OF FY18 YEAR-END FINANCIAL STATEMENTS
- John Seagren, Controller, AFPC
- FY18 MD&A
 - FY18 Financial Statements
 - FY18 Financial Statements Notes
- 9:45 a.m. OTHER MATTERS / FUTURE AGENDA ITEMS / TRUSTEE COMMENTS
- 10:00 a.m. ADJOURNMENT

NOTE: TIMES MAY VARY AND THE CHAIR MAY REORDER AGENDA ITEMS
(Please telephone Danielle Graham at 907.796.1519 with agenda questions.)

02_Approval of Minutes Memo

SUBJECT: Approval of Minutes

ACTION: X

DATE: September 6th, 2018

INFORMATION: X

BACKGROUND:

Staff reviewed the following Board of Trustees meeting summary minutes, draft copies are attached for your approval.

- May 16, 2018 Audit Committee Meeting

RECOMMENDATION:

Approval of the summary minutes of the Board of Trustees meetings listed above.

02a_May 16 Audit Committee Minutes

ALASKA PERMANENT FUND CORPORATION

AUDIT COMMITTEE MEETING

**May 16, 2018
10:30 a.m.**

**Location of Meeting:
Alaska Mental Health Trust Authority
3745 Community Park Loop
Anchorage, Alaska**

SUMMARY MINUTES

Trustees Present: Marty Rutherford, Chair
Craig Richards
Bill Moran
Carl Brady

Staff Present: Angela Rodell, CEO
Valerie Mertz, CFO
Danielle Graham
Nellie Metcalfe

Other participants: Melissa Beedle KPMG
Beth Stuart, KPMG

PROCEEDINGS

CALL TO ORDER

CHAIR RUTHERFORD called the meeting to order and asked for a roll call.

ROLL CALL

A quorum was formed with TRUSTEES RICHARDS and RUTHERFORD present, and TRUSTEES MORAN and BRADY appearing via conference call.

CEO RODELL introduced Danielle Graham as the new board liaison and executive assistant. She started work at the Permanent Fund Corporation a week ago, coming to us from payroll services at the Division of Personnel and Labor Relations.

CHAIR RUTHERFORD welcomed Ms. Graham and moved to the approval of the agenda.

APPROVAL OF AGENDA

MOTION: TRUSTEE RICHARDS made a motion to approve the agenda, seconded by TRUSTEE RUTHERFORD.

The MOTION was APPROVED.

APPROVAL OF MINUTES (September 7, 2017)

MOTION: TRUSTEE RICHARDS moved to approve the minutes of September 7, 2017, seconded by TRUSTEE RUTHERFORD.

The MOTION was APPROVED.

SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION

There were no scheduled appearances or public participation.

CHAIR RUTHERFORD moved to the Audit Preview, and introduced Beth Stuart from KPMG.

FY18 AUDIT PREVIEW AND RISK ASSESSMENT REVIEW

MS. STUART began with a brief presentation that explained the audit plan for the upcoming June 30, 2018, year-end audit. She stated that the engagement team is identical to last year, and she will serve as the lead audit engagement partner. She added that this will be her ninth year serving as the lead audit engagement partner on the account; and it is time to think about partner rotation. She continued that the company has a ten-year policy that is not required by law, but KPMG believes it is a best practice to have audit partner rotation from time to time. The firm policy is that the lead audit partner is allowed for ten years, then another partner steps in for at least two years before the engagement partner can serve again. She stated that Melissa Beedle, who is based in Juneau and has worked for the KPMG Anchorage office for nearly 15 years, will continue to serve as the audit senior manager. She continued that Nick Katsanos, the valuation specialist, is based in New York City and spends his entire year working with audit engagements, on alternative investment, valuation, and audit procedures, and is an important part of the engagement team. She added that there is always a second partner on the account who does a cold review of the financial statements prior to issuance, Mike Hayhurst in this case, who was the managing partner of the Anchorage office of KPMG, and has served as the engagement partner for the State of Alaska Treasury and Retirement Systems audit for a few years. He is currently based as the managing partner in the Boise office. She stated that, from a risk assessment perspective, summarized are the areas identified as having the most significant risk to the audit. The first item is presumed risk for all audits and is not specific to the Permanent Fund. It does not give any kind of view on management's likelihood of overriding controls. She continued that the audits are designed to identify material fraud that exists from the override of internal controls, which is consistent with each year and across all audits. She stated that there are also two specific risks related to the Permanent Fund and the makeup of the investment portfolio: One related to the valuation of alternative investment, nonpublic investments, securities and investment form types; the other, within that group, the real estate investments. She added that both are more complex investment structures and have a higher degree of subjectivity. Specific procedures are designed to address the risk, particularly the valuation risk of real estate and the other nonpublic investments.

TRUSTEE RICHARDS asked if the valuation of investments are done, or is it an audit of the Permanent Fund's valuation.

MS. STUART replied that the Permanent Fund's valuation is audited.

TRUSTEE RICHARDS asked who did the valuations.

MS. STUART answered that a variety of entities do. For the nonpublic, primarily, the investment manager is providing a valuation. Management of the Permanent Fund is reviewing that valuation for reasonableness, and then third-party appraisers are auditing as it relates to real estate; management is reviewing that for reasonableness, and then the evaluation is audited.

MS. MERTZ added that all of the private investments are required to have an annual audit. The valuation would be audited as part of their audit; and then it passes through the financials, which are then audited.

MS. STUART stated that those audits typically are as of the 12/31 valuation date and added; that was a focus of the procedures. She continued that part of the audit strategy will involve the service organization like New York Mellon, as the investment custodian. They have an internal control report issued over their internal processes. Also reviewed are the Permanent Fund's internal controls that are necessary to integrate with the service organization's processes to get to accurate financial reporting within the Permanent Fund's report. She then went over the timeline on the audit plan.

CHAIR RUTHERFORD asked if any of the trustees had any questions or comments. There being none, she moved on to the next step.

MS. STUART stated that one of the things in the audit plan is to gain an understanding of the Audit Committee's perspectives on fraud or of any fraudulent financial reporting or any concerns that have happened during the year. She continued that if anything like that came up to the Audit Committee, she requested to be informed of that and to help design the audit plan.

CHAIR RUTHERFORD and TRUSTEE RICHARDS both replied that they had no concerns about fraud or fraudulent financial reporting or other concerns.

CHAIR RUTHERFORD stated that the agenda has a peer-review type of discussion for best practices for an audit committee scheduled for later.

MS. STUART stated that if things do come up over the course of the audit, her practice would be to work through management to reach out directly to the Audit Committee chair. She added that she would like to confirm that that is the right approach if there is anything that requires any immediate discussion or concern.

TRUSTEE RICHARDS stated that one of the questions that he will have when going through the new audit presentation is to talk about any areas of concerns historically and how they were addressed.

CEO RODELL stated that it is important for the Chair of the Audit Committee to have a standalone relationship with Ms. Stuart as the audit manager, and to not have herself or

Ms. Mertz as part of the discussion. She added, that maintains the integrity of the audit by being able to do that, and part of the Audit Committee is to establish that dialogue between the auditor and the committee chair.

MS. STUART emphasized that it is important and underscores that the audit firm works for the Audit Committee. The contract may be signed by management, but the responsibility is directly to the Audit Committee, not management. She asked if there are any other concerns or areas that may be particularly risky in the audit that have not been identified.

CEO RODELL stated that staff relies on what the Bank of New York is doing, what is being done internally as much as could be done with staff data integrity. She asked if they are also getting representations because that is what is being relied on for valuations and things like that in the financial statements.

MS. STUART replied that one way is a confirmation directly with them, as well as their internal control report. She stated that the biggest risk of data-breach-type cyber issues is keeping personal information safe. The Permanent Fund has a different really big risk, and from a pure financial statement perspective, it is easier to audit around because there are third-party custodians. She moved on and discussed the status as a firm with PCOB, the regulator, the Public Company Accounting/Oversight Board, the division of the SEC that regulates public accounting firms. She stated that, in February of 2017, a current employee of the PCOB had shared a list of upcoming inspections with some members of the KPMG senior leadership. These were important because that is how the PCOB evaluates their work. This information was shared with an employee of KPMG, who shared it internally. Some of those members were in the audit leadership group and did not say that this information should not be had. In the investigation it came out that information was used to try and help engagement teams do better in the inspection process. When this came to light, the CEO immediately fired seven partners, including the head of the audit department and the head of the inspections department. She continued that an internal investigation was started that went through last fall and all the results were shared with the SEC. The Department of Justice has pressed charges against the individuals involved, both the former KPMG partners and employees, as well as the former PCOB employees. The process is working its way through the court system. She added that there has been no indication that charges will be pressed against the firm because it was not a systemic issue. The firm's response was decisive and swift to terminate the people involved. She stated that a civil penalty is expected and accrued for. It will be a big number, and there is insurance. It will hit the press when it does come out. She continued that internal restructuring has been made, and we have a new head of audit, a new head of inspections, and we have made employee changes. She moved on and stated that every three years every audit firm has a peer review done, and it was done by PWC. A response was issued that we passed except for a tone-at-the-top issue that if the head of the Audit Department was willing to use this information he should not have. She added that the response to that was a letter that described the changes that were made, and the AICPA accepted and issued a letter saying that the peer review and response was accepted, and has considered it closed.

CHAIR RUTHERFORD stated that KPMG responded quickly and appropriately. It was interesting that partners involved in that particular area would be so willing to participate. She calls a break.

(Break.)

CHAIR RUTHERFORD called the meeting back to order and moved to the year-to-date financial statements.

FY18 YEAR-TO-DATE FINANCIAL STATEMENT REVIEW

MS. MERTZ began by walking through the financial results for the first three quarters of fiscal '18. She stated that the first page showed the balance sheet and the income statement, which is highly summarized for simplicity. The top page showed the net assets as of March 31st at \$64.6 billion, which is a \$4.8 billion increase since the beginning of the year; an amazing performance. She continued that there was some volatility, particularly in the public markets, that caused that value to bounce around in the last quarter. She continued that the net asset balance is affected by valuation movement in the investment and is also impacted by in-flows into the fund from interest, dividends, gains, and the mineral royalty deposits that affect the balance. She added that there is also an allocation of the unrealized gains held in the portfolio that are allocated between principal and earnings reserves. As of March 31, there were \$40.1 billion in deposits and an allocation of unrealized gains of about \$7 billion. The principal is sitting at about \$47 billion in total; which is the corpus.

CEO RODELL stated that the audit findings will be presented at the Audit Committee meeting in September.

CHAIR RUTHERFORD asked if the committee needed some guidance on the issue prior to that.

CEO RODELL stated that there were two choices: One is to change it now for fiscal year '18; or because SB 26 takes effect FY19, to work on this over the course of the year and start it in FY19.

CHAIR RUTHERFORD asked what needed to occur to help understand this. She stated that it seems there is a need for some discussion within the internal corporation and KPMG, with some feedback about this so that an informed decision can be made, but also, in this discussion, to see how SB 26 will affect us.

TRUSTEE RICHARDS stated that a practical question if there is a stressed situation with the ERA balance, to know what the rules are around what is done with unrealized gain in the corpus.

MS. STUART stated that financial statements are being issued as they have been with the disclosure that says SB 26, effective July 1st, will be evaluating the impact of that on the classification of fund balance.

TRUSTEE RICHARDS asked for this to be pursued so that discussion can be had at the September meeting.

MS. STUART replied that there is a direct contact with a partner in the Department of Professional Practice, which is the think-tank office in New York. His name is Jeff Parker who has served on the GASB board and has an understanding of the Permanent Fund from the '09 attorney general's opinion. He was involved in helping interpret the accounting that came out of that AG opinion, and is always available.

MS. MERTZ moved on to the second component of fund balance, the committed portion of the fund balance and earnings reserve. These are amounts that are set aside during the course of the year for payments for the dividend, inflation-proofing, and for transfer to the Alaska Capital Income Fund. She stated that the zero on the dividend line is reflective of the fact that the fiscal '18 dividend transfer had already taken place, so nothing needs to be set aside for that. She continued that it is already reflected on the detailed income statement. There is a zero showing for inflation-proofing because there was no appropriation for that purpose in the fiscal '18 budget. She added that \$33 million was set aside for transfer of realized earnings related to the Amerada Hess principal that, by statute, gets transferred to the Alaska Capital Income Fund. She stated that the final component of fund balance is basically everything that is left over. This is the amount that is available for future appropriation. She continued that this has two components: The net realized earnings line, which is the cumulative earnings of the fund since inception, with an amount of \$15 billion. Then the allocation of the unrealized gains relating to that balance. She moved to the income statement section which showed the components of statutory net income. She explained that it started with statutory net income and then added back any unrealized gains that have been experienced in the portfolio during the year. She moved on and explained the charts that gave a visual comparison of the past few years. She wrapped up the financial review and moved on to updates on staffing and the finance team.

AUDIT COMMITTEE NEW MEMBER ONBOARDING

MS. MERTZ stated that Andrew Cloward has been added as a team member to the trade operations group supporting the internal trading. She continued that he is an Alaskan with a degree from UAF in business administration, finance, and he had been working on mortgage loans in Orlando. He was happy to have an opportunity to come back to Alaska. She moved on to the summer college intern, Zach Hebert, from Juneau, who is going to be a junior at Washington State University studying accounting and finance. She moved on to the table of contents that she brought before the committee in September for a reference guide to help walk through what an audit committee does. She stated that the reference guide was divided into sections: The first section is the Audit Committee charter; then the minutes from the prior two meetings to allow new members to understand what the issues and discussions are about; then, the meeting schedule for the current and next year; then, a series of sample reports that support the Audit Committee's role in governing their portion of the operations; following that are several documents related to the external; and at the back is KPMG's Audit Committee Institute Guide. She stated that the charter outlines the operating procedures for the committee and also defines three roles of the Audit Committee in the governance of the corporation; supporting each of those roles are some duties and responsibilities that the board decided are important for the Audit Committee to fulfill. She moved to operating procedures. The charter states that the board will have an Audit Committee which will consist of at least three members of the board. It will meet twice annually, and minutes of those meetings are required. It also requires the self-assessment to be performed annually. She moved to the roles of the Audit Committee and stated that there are three defined in the charter. The first is to monitor the integrity of the financial

reporting process and the system of controls that are in place for that reporting. The duties and responsibilities defines are to review the audited financial statements prior to distribution; second is to support the role of the financial reporting process. Together with the auditors and management, the committee needs to consider the integrity of the reporting process. Third is the committee is required to discuss significant changes to accounting principles, and annually review any legal matters that could impact the financial statements or compliance with laws and regulations that are in place. She moved on to the cash transfer report, which is the standard report in the quarterly board packets. It is a great way to see the movements of cash and the other assets of the portfolio. She went through and summarized the report and moved to the current investment management fee report. This breaks out what is being paid in each asset class through net-of-fee arrangements. These are fees that are paid by the manager, netting the management fee expense out of the income of the investment.

TRUSTEE RICHARDS asked why public equity was showing up in performance but is not showing in terms of a cost.

MS. MERTZ replied that when it is recognized as a fee it is recorded as a fee in the financial statements. She explained that visibility is not available for all of the managers.

TRUSTEE RICHARDS stated that there is always a lot of dialogue in justifying whether or not more staff for the fund makes sense. He continued that, in general, the total fee charges are with the public equity and we want to be able to understand that the management fees are truly paid.

MS. MERTZ stated that information is tracked, and the net-of-fees are broken out by asset class. She suggested changing the report to break out the funded by appropriation to show asset class, which will give a better picture of what everything is costing. She added that she will look at some ideas on that and bring that back to the committee. She continued that following fees there is the monthly performance report. These are Callan's calculations of the fund returns, as well as the corresponding benchmarks. This report is e-mailed out to all the trustees when it is finalized each month. It is also published on the website, and included in the board packet, the quarter-end reports. She stated that following the monthly performance report there is the daily dashboard; which is emailed to staff and trustees. She continued that the front page has asset allocation information, some performance information, and is a quick way to see what is going on with the portfolio each day.

CEO RODELL asked if that included Mental Health Trust moneys.

MS. MERTZ replied that it does, and the following pages are asset allocation, comparing them to the target allocations per policy. Last in this reporting section is the daily performance report that is produced by Bank of New York Mellon and emailed out every morning. She stated that those are the sample reports, and if there is an area of interest that more information is needed, that will be provided.

TRUSTEE RICHARDS stated that the daily flash report is very useful because it is a level of information that can be consumed in a day and is not overwhelming.

MS. MERTZ moved to the final two roles that are defined in the charter for the committee and are related to the external audit. Those are to review the performance and the independence of the external auditor. She stated that it is the Audit Committee's task to gauge how they are doing and to make sure that they are independent in order to conduct an audit. The third role is to provide an avenue of communication, which has been discussed. She continued that there is a list of things that the charter lays out to support the committee in fulfilling two roles: One is to review the external audit plan; second is to consider the auditor's judgments about the quality and appropriateness of the accounting principles that are applied; third is to discuss with management and auditors the quality of the underlying estimates that are used in the financials. She added that the committee is also tasked with discussing with the auditors the clarity of the financial disclosure practices. It is also the committee that would review the performance and independence of the external auditors; recommend an appointment of a new auditor; discharge an existing auditor. She stated that the last one related to audit is to make sure that the committee understands all significant relationships that the auditors have with APFC.

MS. STUART stated that they have a global database, where she, as lead partner, has the responsibility to ensure that under Alaska Permanent Fund Corporation she listed all of the investments required to maintain independence. She continued that in order to perform any service for any company that is listed within the family tree, she has to approve that service ahead of time.

CHAIR RUTHERFORD asked about the standard of the review to make that determination.

MS. STUART replied that she reviewed the draft of the engagement letter that they would be providing that governs KPMG's scope of work. In general, audit services do not impair auditor independence because they have to be independent.

MS. MERTZ moved on to some more information regarding the audit component event of all of this with a variety of documents related to the external audit. She stated that first is the engagement letter, which is the contract with KPMG that outlines the scope of services, deliverables, and all the normal things expected to be seen in a contract. Following the engagement letter are the reports that were issued as a result of the FY17 audit. Then, following the full audit report there is the management representation letter. She included a schedule of unadjusted audit differences because it has been a topic of conversation at the audit review meeting for the last few years. She stated that there is no lag in the financial reporting and GAAP requires reporting fair value as of the end of the period. She clarified that the lag is only for performance reporting.

MS. STUART stated that there is a lag, but the accounting rules do not allow for that. She explained that this is capturing the difference between what has to happen to have the books closed and what should happen in the world of perfect accounting.

MS. MERTZ stated that finally in this section there is provided contact information for both Beth and Melissa. It is important to keep communication between the committee and the external auditor open, and she encouraged it.

TRUSTEE RICHARDS asked if there have been any auditing issues that were a big deal; a red flag.

MS. STUART replied not with the Permanent Fund. The issue is the reporting lag; the reporting numbers are getting bigger, and the level of estimation within the financial statements is growing every year as the move toward private markets increases.

CHAIR RUTHERFORD asked what the resolution is when that becomes significant.

MS. STUART replied that the resolution would ultimately be to record an adjustment.

CHAIR RUTHERFORD stated that this is a guide that was developed at KPMG. She asked if that is because they actually do training for audit committees.

MS. STUART replied yes, there is a group within the firm called the Audit Committee Institute. Audit committee training and audit committee member conferences are done. There are also committee member roundtables in a handful of cities around the country with small groups. There are also quarterly webcasts designed for audit committee members. There are a lot of resources available, and we spend a lot of time with audit committees.

CHAIR RUTHERFORD asked if the webcasts are free and if the committee could be notified of what is coming up over the course of the next six months.

MS. STUART answered yes, that she will keep her eyes on it. A lot of the material focuses on SEC registrants, and the last few focused on the level of accounting change on the corporate side. She explained that considered best practice with audit committees is to have an executive session without management present. The reason for that is to give an opportunity to speak freely without management present. Most audit committees have an executive session at every audit committee meeting as a matter of routine.

CHAIR RUTHERFORD replied that is something to consider. She asked for anything else. There being none, the committee moved into the self-assessment.

AUDIT COMMITTEE SELF-ASSESSMENT

CHAIR RUTHERFORD asked if this was done real-time last year.

MS. MERTZ stated that it was during the regular meeting. In the past, it was done any way the Chair wanted.

CHAIR RUTHERFORD asked if there was a specific timing associated with this.

MS. MERTZ replied that the requirement in the charter is to do it annually.

CEO RODELL suggested doing this in May, prior to the start of the audit, because there are charter-specific questions, general questions that can lead to raising an issue that is helpful for the external auditor to know. She stated that this was done last year because a new audit charter was being adopted.

CHAIR RUTHERFORD suggested giving themselves a couple of weeks, and asked Ms. Mertz to send a reminder that it is due by a specific date.

MS. STUART mentioned that one of the responsibilities as part of the charter is to evaluate the auditor. She stated that there is a third-party organization, the Center for Audit Quality, that is unaffiliated with any of the firms, and has published a document to help audit committees do that evaluation.

MS. MERTZ stated that she had that and would forward it.

TRUSTEE RICHARDS thanked all for a good meeting.

CHAIR RUTHERFORD agreed and stated that there are other matters and future items. We have talked about how to deal with the issue of unrealized gains as reflected in the financial statements. That will be an item that is on the September agenda.

CEO RODELL stated that a confidential presentation on the audit of the Mental Health Trust will be sent next week.

CHAIR RUTHERFORD thanked staff for putting this together.

MS. MERTZ stated that any feedback for next time would be greatly appreciated.

CHAIR RUTHERFORD adjourned the meeting.

(Alaska Permanent Fund Audit Committee meeting adjourned at 12:46 p.m.)

03_KPMG Audit Report Memo

SUBJECT: Report of Annual Audit

ACTION: _____

DATE: September 6, 2017

INFORMATION: X

BACKGROUND:

The corporate governance manual requires the Audit Committee to review the annual audited financial statements prior to filing or distribution of the final report.

STATUS:

The financial audit for fiscal year 2018 was completed by KPMG with a report date of September 6th. The results of the audit will be presented by Beth Stuart, engagement partner, and Melissa Beedle, engagement manager. Their presentation is included here.

03a_KPMG Audit Presentation SEP2018



Alaska Permanent Fund Corporation

Audit results

Financial statements as of and for the year ended June 30, 2018

September 6, 2018



Introduction

To the Audit Committee the Alaska Permanent Fund Corporation

We are pleased to have the opportunity to meet with you September 6, 2018 to discuss the results of our audit of the financial statements of the Alaska Permanent Fund (the Fund) as of and for the year ended June 30, 2018. Our audit was conducted in accordance with the terms established in the audit engagement letter dated March 1, 2015.

We are providing this document in advance of our meeting to enable you to consider our findings and hence enhance the quality of our discussions. This document should be read in conjunction with our audit plan, presented on May 16, 2018. We will be pleased to elaborate on the matters covered in this document when we meet.

Our audit is substantially complete. Subject to the Committee's approval, we expect to be in a position to complete our audit of the Fund's financial statements on September 7, 2018, provided that the outstanding matters noted on page 14 of this document are satisfactorily resolved.

We draw your attention to the following communications included in the appendix to this document (page #):

- Outstanding matters (15)
- Responsibilities (16-18)

Content

Our audit results	2
Draft auditors' report	3
Audit matters	4
Audit misstatements	8
Internal control related matters	9
Required communications and other matters	11
Audit fees	12
Independence	13
Supplemental communications	14

Our audit results

<p>Auditors' report Page 3</p> <p>As of August 22, do we expect to</p> <ul style="list-style-type: none"> — modify the opinion in our auditors' report? No — include an emphasis-of-matter or other-matter paragraph in our auditors' report? Yes 	<p>Audit matters Pages 4-7</p> <p><i>Were any significant financial statement matters identified related to:</i></p> <p>Significant accounting practices</p> <ul style="list-style-type: none"> — Accounting policies? No — Accounting estimates? Yes <ul style="list-style-type: none"> -Valuation of Alternative Investments -Valuation of Real Estate Investments — Financial statement disclosures? No <p>Other matters No</p>
<p>Uncorrected audit misstatements Page 8</p> <p>To be provided on September 6, 2018</p>	
<p>Control deficiencies Page 10</p> <p>Material weaknesses No</p>	

Modification of auditors' report

We expect our report to reflect an unmodified opinion on the financial statements.

We expect our report to include the following modifications from the standard report, both of which are consistent with previous years:

Emphasis of matter paragraph

As discussed in note 1, the financial statements present only the Alaska Permanent Fund and do not purport to, and do not, present fairly the financial position of the State of Alaska as of June 30, 2018 and 2017, or changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other matter paragraph

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages X-X be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operation, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Significant accounting policies

Description of significant accounting policies

- The Fund's policies are disclosed in Note 2 to the financial statements and are consistent with prior years.
- Governmental Accounting Standards (specifically GASB Statement No. 54) provides guidance on the classification of Fund Balance. While there has been no change in the Standard or Corporation policy, fund balance classification appears different in FY18's financial statements.

Audit findings

Qualitative aspects

- We did not identify indication of significant elements of management bias when reviewing these policies.
- The budget appropriation for the FY19 general fund draw was passed by the Legislature and signed by the Governor in May 2018. The budget takes effect on July 1, 2018 and appropriates \$2.7 billion to the state of Alaska general fund.
- The FY19 appropriation commits that portion of the Permanent Fund Earnings Reserve to a specific purpose at the time it was signed by the Governor (prior to June 30, 2018).
- The FY19 appropriation becomes a liability of the Permanent Fund when it becomes a "present obligation" (July 1, 2018).
- Management believes, and we agree, that the amount appropriated in the budget is "committed" fund balance.

Audit matters

Significant risks

Our audit response and findings

Significant risks	Our audit response and findings
Management override of controls	<ul style="list-style-type: none">• Assessed management's design and implementation of controls over journal entries and post-closing adjustments• Assessed management's design and implementation of the Controller review of accounting estimates for evidence of management bias.• Assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates• Made inquiries of Alaska Permanent Fund Corporation staff throughout our audit procedures.• Test journal entries throughout the year under audit and all post closing journal entries to ensure entries are properly supported and approved
Valuation of alternative investments	<ul style="list-style-type: none">• See detailed audit response on next slide• No exceptions were identified in our testing, and we did not identify management bias or a shift from previous years.• The effect of the reporting lag for investments are included as an uncorrected misstatement.

Significant accounting estimate

Significant accounting estimate	Balance (\$m)	PY balance (\$m)	Year over year change (\$m)
Valuation of private investments	\$16,833,119	\$14,955,268	\$1,877,851

Our conclusions regarding the reasonableness of the significant accounting estimate were based on the following audit response:

- Assessed management’s design and implementation of internal controls over the valuation of alternative investments
- We performed substantive audit procedures over the inputs used to prepare these estimates, including:
 - Confirmation of selected investments with fund managers and agreed the recorded investment market value to capital statements provided by external fund managers.
 - Obtained audited financial statements of the selected investments:
 - Performed an overall analysis of the reputability of the auditors of the underlying investments and reviewed the audit opinion.
 - Recalculated the fund’s Net Asset Value utilizing the audited financial statements and the Fund’s ownership percentage
 - Performed a hindsight market value analysis by comparing the recalculated NAV from audited financial statements to market value recorded by the Fund as of the investment balance sheet date.
- Obtained a roll-forward of the Fund’s market value from the audited financial statement date, and vouched fund contributions and distributions.
- Evaluated unrealized gain/loss from the audited financial statement date to the lag date for reasonableness by inquiring of management and reviewing management’s detailed analysis of changes in fair value of investments.
- We performed benchmarking analysis comparing year to date returns to market performance.

Management’s process to develop the significant accounting estimate	Change(s) to the process	Reasons for the change(s)	Effect(s) of the change(s)
Management receives periodic capital statements from external fund managers. Management uses these capital statements as a starting point to estimate fair value of each private investment by: <ul style="list-style-type: none"> starting with net asset value provided by the external fund manager adjusting for any contributions or distributions made during the quarter adjusting for any other factors management believes impact fair value 	None	N/A	N/A

Significant assumptions with high degree of subjectivity	Change(s) to significant assumptions?	Reasons for the change(s)	Effect(s) of the change(s)
None			

Audit matters

Significant accounting estimate

Significant accounting estimate	Balance (\$m)	PY balance (\$m)	Year over year change (\$m)
Valuation of directly owned real estate investments	\$3,945,204	\$5,513,870	\$(1,568,666)

Our conclusions regarding the reasonableness of the significant accounting estimate were based on the following audit response:

- We performed substantive testing over acquisitions and sales of real estate during FY18.
- We reviewed the Corporation's policy on evaluating real estate properties for impairment and performed an impairment analysis of the holdings using that policy.
- We obtained independent appraisal reports and involved KPMG specialists to assist in the review of the inputs to these appraisals.
- No exceptions were identified in our testing.

Management's process to develop the significant accounting estimate	Change(s) to the process	Reasons for the change(s)	Effect(s) of the change(s)
<p>Management receives quarterly discounted cash flow analyses and annual independent appraisals for each directly owned property. When valuations are received from the third party advisors, management reviews the assumptions used within the valuation for reasonableness. Management uses the annual appraisals as a starting point to estimate fair value of each real estate holding by:</p> <ul style="list-style-type: none"> • starting with value provided by the external advisor • adjusting for any contributions or distributions made since that time • adjusting for any other factors management believes impact fair value, including the quarterly discounted cash flow analyses. 	None	N/A	N/A
Significant assumptions with high degree of subjectivity	Change(s) to significant assumptions?	Reasons for the change(s)	Effect(s) of the change(s)
None			

Audit misstatements

Uncorrected audit misstatements

A summary of uncorrected audit misstatements will be provided during the meeting.

We expected uncorrected audit misstatements relating to the lag in reporting for private investments.

Internal control related matters

KPMG responsibilities

- The purpose of our audit was to express an opinion on the financial statements
- Our audit included consideration of internal control over financial reporting in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control.
- We are not expressing an opinion on the effectiveness of internal control
- Our consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified.

Material weakness

A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A reasonably possibility exists when the likelihood of an event occurring is either reasonably possible or probably. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than likely. Probable is defined as the future event or events are likely to occur.

Significant deficiency

A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Significant deficiencies and material weaknesses in internal control

Material weaknesses

Description	Potential effects	Status
<i>None identified</i>		

Significant deficiencies

Description	Potential effects	Status
<i>None identified</i>		

Required communications and other matters

Type	Response
Related parties	No significant findings and issues arising during the audit in connection with the entity's related parties.
Fraud	No actual or suspected fraud involving management, employees with significant roles internal control, or others were identified during the audit.
Noncompliance with laws and regulations	No matters to report.
Subsequent events	No matters to report.
Other Information	We will review the annual report for consistency with the audited financial statements, when available.

Type	Response
Significant difficulties, if any, encountered during the audit	No matters to report.
Disagreements with management, if any	No matters to report.
Significant findings or issues discussed, or the subject of correspondence, with management	No matters to report.
Management's consultation with other accountants	No matters to report.
Other findings or issues	No matters to report.
Written representations	Management representation letter, including summary of uncorrected misstatements.

Audit fees

	2018	2017
Audit	\$ 145,500	\$139,000
Audit-related services	0	0
Tax services	0	0
All other services	0	0
Total fees	\$ 145,500	\$ 139,000

Independence

Relationships that may reasonably be thought to bear on independence include:

Relationship	Description of relationship/service	Fees (for services)
None noted		

In our professional judgment, we are independent with respect to the Alaska Permanent Fund, as that term is defined by the professional standards.



Supplemental communications

Contents

Outstanding matters

Responsibilities

Page

15

16

Outstanding matters

Outstanding matters expected as of September 6, 2018:

- Management
 - Management representation letter

Any other outstanding matters as of September 6, 2018 will be provided at the audit committee meeting.

Responsibilities

Management responsibilities – Financial statements	<ul style="list-style-type: none"> — Preparation and fair presentation of the financial statements, including disclosures in conformity with U.S. GAAP — Adjusting the financial statements to correct material misstatements and affirming in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole
Management responsibilities – ICFR	<ul style="list-style-type: none"> — Design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
Management responsibilities – Other	<ul style="list-style-type: none"> — To provide the auditor with: <ol style="list-style-type: none"> 1) access to all information of which management is aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters; 2) additional information that the auditor may request from management for the purpose of the audit; and 3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence — Identifying and ensuring that the Fund complies with laws and regulations applicable to its activities, and for informing the auditor of any known material violations of such laws and regulations — Providing the auditor with a letter confirming certain representations made during the audit, that includes but is not limited to management’s: <ol style="list-style-type: none"> 1) disclosure of all significant deficiencies, including material weaknesses, in the design or operation of internal controls that could adversely affect the Company’s financial reporting 2) acknowledgement of their responsibility for the design, implementation, and maintenance of internal controls to prevent and detect fraud
Audit Committee responsibilities	<ul style="list-style-type: none"> — Oversight of the financial reporting process and ICFR — Oversight of the establishment and maintenance by management of programs and controls designed to prevent, deter, and detect fraud
Management and the Audit Committee responsibilities	<ul style="list-style-type: none"> — Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards — Ensuring that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in the entity’s financial statements.

The audit does not relieve management or the Audit Committee of their responsibilities.

Responsibilities (continued)

KPMG – Audit objectives	<ul style="list-style-type: none"> — Forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of the Audit Committee are prepared, in all material respects, in accordance with U.S. GAAP
KPMG responsibilities – Audit	<ul style="list-style-type: none"> — Performing the audit in accordance with U.S. GAAS and U.S. Government Auditing standards and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements as a whole are free from material misstatement — Performing an audit of financial statements 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 entity’s internal control over financial reporting
KPMG responsibilities – Other information in documents containing financial statements	<ul style="list-style-type: none"> — The auditors’ report on the financial statements does not extend to other information in documents containing audited financial statements, excluding required supplementary information — The auditor’s responsibility is to make appropriate arrangements with management or the Audit Committee to obtain information prior to the report release date and to read the other information to identify material inconsistencies with the audited financial statements or misstatement of facts — Any material inconsistencies or misstatement of facts that are not resolved prior to the report release date, and that require revision of the other information, may result in KPMG modifying or withholding the auditors’ report or withdrawing from the engagement — Communicate any procedures performed relating to the other information and the results of those procedures.

Responsibilities (continued)

KPMG responsibilities – Communications

- Communicating significant matters related to the financial statement audit that are in our professional judgment, relevant to the responsibilities of the Audit Committee in overseeing the financial process. U.S. GAAS does not require us to design procedures for the purpose of identifying matters to communicate to the Audit Committee
- Communicating if we suspect or identify noncompliance with laws and regulations exist, unless matters are clearly inconsequential
- Communicating to management and the Audit Committee in writing all significant deficiencies and material weaknesses in internal control identified during the audit, including those that were remediated during the audit and reporting to management in writing all deficiencies noted during our audit that, in our professional judgment, are of sufficient importance to merit management’s attention. The objective of our audit of the financial statements is not to report on the Corporation’s internal control
- Conducting the audit in accordance with professional standards and complying with the rules and responsibility of the Code of Professional Conduct of the American Institute of Certified Public Accountants and the official standards of relevant CPA Societies, and relevant state boards of accountancy
- Communicating to the Audit Committee circumstances, if any, that affect the form and content of the auditors’ report
- Communicating if we plan to withdraw from the engagement and the reasons for the withdrawal
- Communicating to the Audit Committee if we conclude no reasonable justification for a change of the terms of the audit engagement exists and we are not permitted by management to continue the original audit engagement
- When applicable, we are also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement
- Communicating if we have identified or suspect fraud involving; (a) management, (b) employees who have significant roles in internal control, (c) others, when the fraud results in a material misstatement in the financial statements, and (d) other matters related to fraud that are, in the auditors’ professional judgment, relevant to the responsibilities of the Audit Committee
- Communicating significant findings and issues arising during the audit in connection with the entity’s related parties.
- Communicating conditions and events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time



KPMG Audit Innovation

KPMG is raising the bar on audit quality and the audit experience through our proprietary tools and use of advanced technologies such as data and analytics, robotic process automation, and cognitive. Automation and use of advanced analytical tools allows us to:



010101010
01101110
01010110
100101000

Quickly analyze greater quantities of data



Obtain greater visibility into trends and anomalies across all geographies and businesses



Review data at a higher level of precision so we can better focus our audit procedures on specific risks



KPMG Audit Innovation

Collaboration tools that better connect our Audit teams and your organization



Reducing the burden on your organization and providing greater transparency and accountability

D&A tools allow us to obtain greater visibility into trends and anomalies



Increases operational insights and, over time, an opportunity to drive audit efficiency

Cost-effective Centralized Services allow us to deliver an efficient and higher quality audit



Increases audit efficiency to speed the closure of your critical accounting areas

KPMG's investment in simulation and micro-learnings will lead to extraordinary audit professionals



Your team benefits from a “smarter audit”



Questions?

Beth Stuart
Office Managing Partner
907-265-1248
emstuart@kpmg.com

Melissa Beedle
Senior Manager
907-265-1257
mbeedle@kpmg.com

For additional information and Audit Committee resources, including National Audit Committee Peer Exchange series, a Quarterly webcast, and suggested publications, please visit KPMG's Audit Committee Institute (ACI) at www.kpmg.com/ACI.

This presentation to the Audit Committee is intended solely for the information and use of the Audit Committee and management and is not intended to be and should not be used by anyone other than these specified parties. This presentation is not intended for general use, circulation or publication and should not be published, circulated, reproduced or used for any purpose without our prior written permission in each specific instance.

04_FY18 Year-End Financial Statements Memo

SUBJECT: FY18 Year-End Financial Statements

ACTION: X

DATE: September 6, 2018

INFORMATION: X

BACKGROUND:

The corporate governance manual requires the Audit Committee to review the annual audited financial statements prior to filing or distribution of the final report.

STATUS:

The financial audit for fiscal year 2018 was completed by KPMG with a report date of September 6th. The reports were still being finalized at the packet deadline. A draft of management's discussion and analysis, the financial statements and the footnotes are included here. Significant changes, if any, will be highlighted during the presentation of FY2018 year-end results.

04a_FY18 Financial Statement Presentation

The logo for the Alaska Permanent Fund Corporation (APFC) features the letters "APFC" in a white, serif font, centered within a dark blue rectangular box. The background of the slide is a teal-tinted photograph of a large, multi-story building with many windows.

APFC

ALASKA PERMANENT
FUND CORPORATION

Detailed Review of FY18 Year-End Financial Statements

September 6, 2018

46/101

Highlights

- 10.74% return
- Excess of revenue over expenditures: \$5.5b
- Dividend amount transferred, \$726m
- FY18 legislation passed transferring \$2.7b from Earnings Reserve to General Fund in FY19
- Mineral revenues deposited to corpus: \$353m
- Inflation rate for FY18 2.13%
- No appropriation for inflation proofing

Analysis

- Fund assets increased by 9%
- Receivables increased by 22%
- FY18 dividend funded in FY18; no liability
- Alaska Capital Income Fund transfer up 73%
- Fund balance increased by 9%
- FY18 cash flow revenue all-time high

Balance Sheet (millions)

Assets		
	Cash	\$4,906.0
	Receivables	664.1
	Investments	60,089.4
	Securities Lending Collateral	<u>2,011.8</u>
	Total Assets	\$67,671.3

Balance Sheet (millions) continued

Liabilities		
	Accounts Payable	\$721.8
	Income Distributable	43.4
	Securities Lending Collateral	<u>2,011.8</u>
	Total Liabilities	\$2,777.0

Balance Sheet (millions) continued

Fund balances		
	Nonspendable	\$46,030.0
	Committed	2,722.6
	Assigned	<u>16,141.7</u>
	Total fund balances	<u>\$64,894.3</u>
	Total liabilities and fund balances	\$67,671.3

Statements of revenue, expenditures and changes in fund balances (millions)

Revenues		
	Interest	\$459.4
	Dividends	640.6
	Real estate and other income	<u>480.5</u>
	Total interest, dividends & other income	\$1,580.5
	Total increase in fair value of investments	<u>4,091.0</u>
	Total Revenues	\$5,671.5

Statements of revenue, expenditures and changes in fund balances (millions)

Expenditures		
	Operating expenditures	\$(138.8)
	Other legislative appropriations	<u>(7.2)</u>
	Total expenditures	<u>\$(146.0)</u>
	Excess of revenues over expenditures	\$5,525.5

Statements of revenue, expenditures and changes in fund balances (millions)

Other financing sources (uses)		
	Transfers in	\$353.1
	Transfers out	<u>(769.4)</u>
	Net change in fund balances	\$5,109.2
Fund balances	Beginning of period	\$59,785.1
	End of period	\$64,894.3

General Fund Appropriations

- In FY18 the Legislature passed Senate Bill 26, which creates a percent of market value draw on the earnings reserve account
- Alaska Statute 37.13.140 was amended to specify the formula for percent of market value as:
 - 5.25% of the average market value of the fund for the first five of the preceding six fiscal years, including the fiscal year just ended
 - Computed annually for each fiscal year in accordance with generally accepted accounting principles
 - “Average market value of the fund” includes the earnings reserve account, but not the principal attributed to the settlement of State v. Amerada Hess
- Amount appropriated as transferrable to the general fund is shown as committed fund balance on the financial statements at June 30

General Fund Transfer Calculation

ALASKA PERMANENT FUND			
GENERAL FUND COMMITMENT			
FISCAL YEAR ENDING JUNE 30, 2018			
(millions)			
FISCAL YEAR	GAAP MARKET VALUE	STATE vs AMERADA HESS	APFC MARKET VALUE
2013	44,853	424	44,429
2014	51,214	424	50,790
2015	52,800	424	52,376
2016	52,770	424	52,346
2017	59,785	424	59,361
2018	64,894	424	64,470
Average market value of first five fiscal years			51,860
PERCENTAGE from AS 37.13.140(b)			5.25%
Amount available for appropriation per AS 37.13.140(b)			2,723

Fair Value Measurement

- GASB 72 effective June 30, 2016
- Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date
- Establishes a hierarchy of inputs used to value assets

Fair Value Measurement continued

- Level 1 – Quoted prices for identical assets in an active market
- Level 2 – Inputs, other than quoted prices, that are observable
- Level 3 – Unobservable inputs
- Investments measured using net asset value (NAV) per share as a practical expedient to fair value are not categorized into input levels

Fair Value Measurement continued

Alaska Permanent Fund

- Level 1 inputs – 52%
- Level 2 inputs – 18%
- Level 3 & NAV – 30%

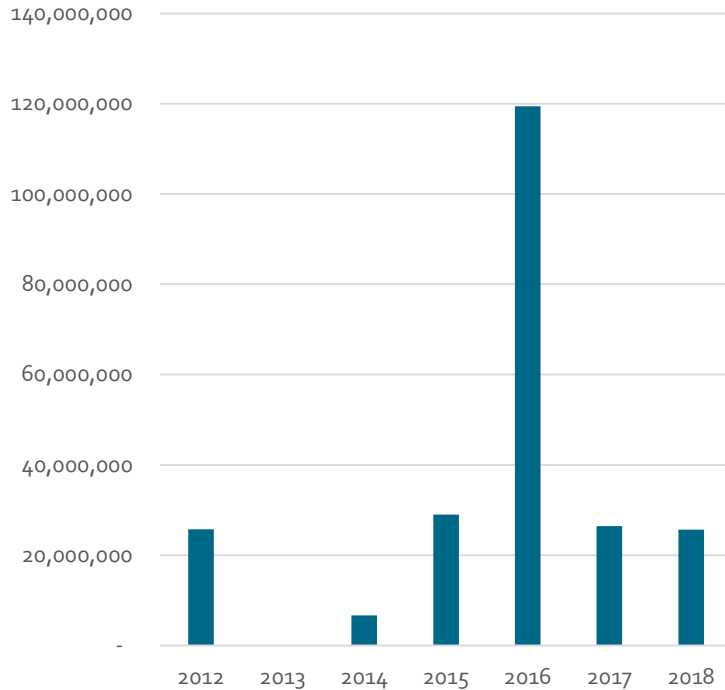
APFC actions to confirm valuations

- All managers of hard to value assets have yearly third party audits
- APFC reviews audits
- Private Equity uses external advisors who also review fair value estimates
- Annual other than temporary impairment reviews
- Outside firm to oversee real estate valuations

Other than Temporary Impairment

- Cost written down to market value
- Transfers loss from unrealized to realized
- No impact on carrying value
- Impacts statutory net income
- Policy established October, 2012

Impairment to date



62/101



Summary

- Fund performed above average in FY18
- New legislation will create a larger yearly draw
- Management continually monitors valuations of hard to value assets

04b_FY18 MD&A

Management's Discussion and Analysis

The Alaska Permanent Fund Corporation ("APFC") management is pleased to provide this Management's Discussion and Analysis ("MD&A") of the financial activities of the Alaska Permanent Fund ("Fund" or "Permanent Fund") for the fiscal years ended June 30, 2018 and June 30, 2017. This narrative is intended to provide management's insight into the results of operations from the past two fiscal years and highlight specific factors that contributed to those results. The MD&A is comprised of three sections: financial highlights, discussion regarding use of the financial statements, and analysis of the financial statements; the sections should be reviewed together with the financial statements and related notes that follow it.

Financial Highlights

- At 10.74 percent total return, fiscal year ("FY") 2018 results were not quite as strong as the 12.89 percent of FY2017 but still significantly higher than the average over the Fund's history. Total fund return for FY2018 outperformed the performance benchmark of 8.20 percent by more than 250 basis points. Closest to the FY2018 performance was FY2013 with a 10.93 percent return. FY2018's results are substantially above the mid-point of the range of returns since 1985, which have ranged from -17.96 percent to 25.58 percent.
- FY2018's excess of revenues over expenditures (net income) was \$5.5 billion. This represents a decrease from FY2017 of \$1.2 billion but is significantly higher than FY2016's level of \$398 million.
- Alaska Statutes dictate that the Alaska Permanent Fund dividend is calculated using a five-year rolling total of net income as defined by Statutes, which excludes unrealized gains and losses (statutory net income). The dividend transfer is subject to Legislative appropriation, which may be made for an amount equal to the statutory calculation, or may be made for another amount. The transfer amount for FY2018, as appropriated, was \$726 million, which is less than 50 percent of the transfer amount calculated per Alaska Statutes.
- During FY2018, legislation was passed which provides for a transfer from the Earnings Reserve Account to the General Fund to help balance the State's budget. The amount of the transfer is based upon a percentage of the average market value of the Fund at the end of the first five of the preceding six fiscal years. The legislation took effect on July 1, 2018. The FY2018 balance sheet reflects a commitment of fund balance of \$2.7 billion for this purpose in FY2019.
- The portion of dedicated State of Alaska revenues deposited into the principal of the Fund is based on mineral prices and production. In FY2018, this amount came in at \$353 million, just below FY2017's deposits of \$365 million.
- Inflation proofing of the Fund's corpus is outlined in Alaska Statute and, like the dividend transfer, is subject to appropriation. In FY2018, the inflation rate was 2.13 percent. For the third consecutive year, there was no appropriation for this purpose so no transfer to the corpus was made. The inflation-proofing transfer for FY2018 as defined in Statute would have been \$856 million. In FY2017, the statutory inflation rate was 1.26 percent which would have resulted in a transfer to principal of \$502 million.

Using the Financial Statements

This section of the MD&A aims to provide an introduction to the Fund's required financial statement components which include: Balance Sheets; Statements of Revenues, Expenditures and Changes in Fund Balances; and Notes to the Financial Statements.

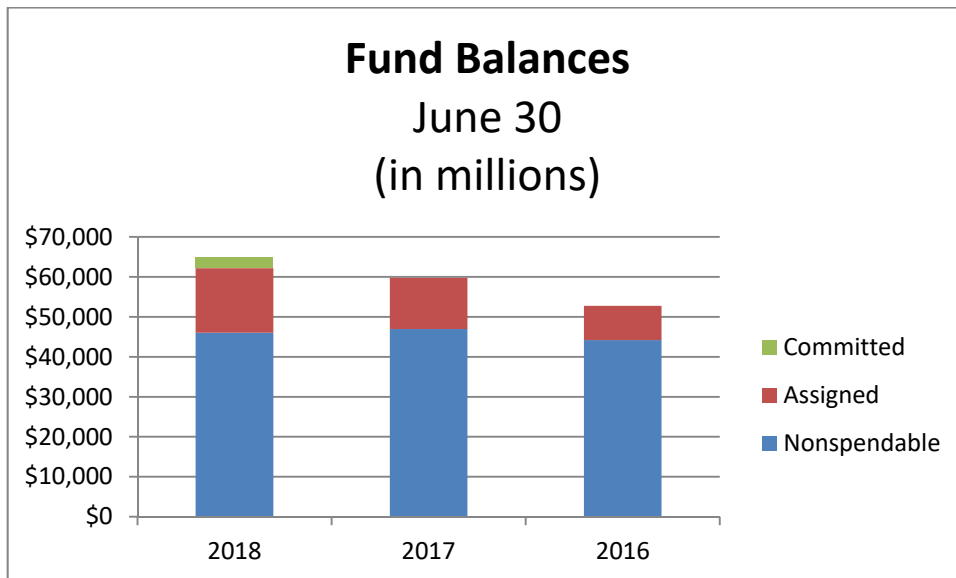
Balance Sheets

The Balance Sheets present all assets, liabilities and fund balances of the Fund as of June 30, 2018, as well as the prior fiscal year's ending balances at June 30, 2017.

Assets are grouped into broad categories for ease of readability and analysis. Receivables include cash not yet received from the sale of investments, as well as dividends and interest receivable from stock and bond holdings. Investments are broken out by traditional asset class and are shown at market value. The securities lending cash collateral (cash received from the borrower on loans of securities that is returned to the borrower once the loan is terminated without default) is shown as an asset.

Liabilities on the Balance Sheets primarily consist of obligations for (i) investments purchased but not yet settled (shown in the accounts payable grouping), (ii) the amount payable to the State of Alaska for the Alaska Capital Income Fund, and (iii) the securities lending cash collateral that is returned to borrowers of the Fund’s stocks and bonds when the borrowers return those loaned assets to the Fund.

In the graph set forth below, fund balances are shown in three categories: non-spendable, committed, and assigned. The largest category is non-spendable (71 percent as of June 30, 2018) and is not available for government appropriation by the State of Alaska. New legislation, effective in FY2019, which provides for a percent-of-market-value transfer from the Earnings Reserve Account to the General Fund, results in a commitment of fund balance for FY2018. The remaining balance (the assigned fund balance) is available for government appropriation. The assigned fund balance increased by 26 percent from FY2017 to FY2018, from \$12.8 billion to \$16.1 billion. Generally, five factors contribute significantly to changes in the assigned fund balance: investment cash flow income including transactional realized gains and losses (statutory net income); the State of Alaska dividend payout; the State of Alaska general fund transfer; inflation proofing (a transfer of assets from the assigned to the non-spendable fund balance); and the change in unrealized gains and losses allocated to the assigned fund balance. During FY2018, the amounts contributing to the net increase of approximately \$3 billion in the assigned fund balance were (i) realized income of \$5.6 billion; (ii) the dividend payout of \$726 million; (iii) the commitment of \$2.7 billion for transfer to the General Fund; and (iv) the allocation of a portion of unrealized gains and losses, which increased from FY2017 to FY2018 by \$450 million, to a balance of \$2.4 billion.



Statements of Revenues, Expenditures and Changes in Fund Balances

The Statements of Revenues, Expenditures and Changes in Fund Balances present the financial activity of the Fund over the 12 months in FY2018 and FY2017.

Revenues are shown in two sections on the statement, separating cash receipts of various investment holdings such as interest, dividends, and real estate rental income, from the change in value of investment holdings. The first section of the revenues also includes miscellaneous income such as class action litigation proceeds and securities lending income. The second section of revenues (“Net increase (decrease) in the fair value of investments”) includes both realized and unrealized gains and losses on investments. Realized gains and losses are produced only through the sale of investments, while unrealized gains and losses are the result of changes in the fair value of investments without a sale of those investments. Realized and unrealized gains and losses are summarized by asset class to match the groupings on the Balance Sheets and represent the total net increase or decrease for the year in each asset category.

To derive the total net change in fund balances from the prior year to the current year, the statements of revenues, expenditures and changes in fund balances also includes the Fund’s expenditures and other sources and uses of funds. Operating expenditures include fees paid to external investment managers, salaries of APFC employees, and other routine operating costs such as rent, travel, and legal fees. Other legislative appropriations made through the State’s annual budget process are obligations for support services received from other State of Alaska departments.

Dedicated State revenues transferred into the Fund’s principal are based on a percentage of mineral revenues that the State receives. Transfers out of the Fund are to pay (i) the Permanent Fund dividend and (ii) the annual deposit to the Alaska Capital Income Fund (ACIF).

Notes to the Financial Statements

The Notes to the Financial Statements are an essential element to fully understanding all financial aspects of the Fund and to interpreting the major components of the financial statements. The Notes to the Financial Statements can be found immediately following the Statements of Revenues, Expenditures and Changes in Fund Balances.

Financial Statement Analysis

This section of the MD&A is intended to provide an analysis of past fiscal years’ activities and specific contributors to changes in the net assets of the Fund. The fund balance serves to provide a gauge of the financial strength of the Fund. While assets of the Fund exceeded liabilities each year by double-digit ratios (excluding securities lending collateral, held separately by the custodian for repayment to the borrower upon a loan’s completion), the non-spendable fund balance is unavailable for appropriation. The table set forth below was derived from the Balance Sheets of the Fund, and provides a comparison of the change between balances of June 30, 2018 and 2017.

Balance Sheets	June 30		Net change	Percent
	2018	2017		
Assets				
Cash and temporary investments	\$ 4,906,054,000	2,653,513,000	2,252,541,000	85%
Receivables, prepaid expenses and other assets	664,105,000	544,753,000	119,352,000	22%
Investments	60,089,408,000	57,311,078,000	2,778,330,000	5%
Securities lending collateral invested	2,011,760,000	1,314,953,000	696,807,000	53%
Total assets	\$ 67,671,327,000	61,824,297,000	5,847,030,000	9%
Liabilities				
Accounts payable	\$ 721,827,000	699,180,000	22,647,000	3%
Income distributable to the State of Alaska	43,395,000	25,067,000	18,328,000	73%
Securities lending collateral	2,011,760,000	1,314,953,000	696,807,000	53%
Total liabilities	2,776,982,000	2,039,200,000	737,782,000	36%
Fund balances				
Nonspendable:				
Permanent Fund corpus - contributions and appropriations	40,167,394,000	39,814,299,000	353,095,000	1%
Not in spendable form - unrealized appreciation on invested assets	5,862,598,000	7,155,294,000	(1,292,696,000)	(18)%
Total nonspendable	46,029,992,000	46,969,593,000	(939,601,000)	(2)%
Committed:				
General Fund Commitment	2,722,654,000	—	2,722,654,000	n/a
Total committed	2,722,654,000	—	2,722,654,000	n/a
Assigned for future appropriations:				
Realized earnings	13,739,046,000	10,863,205,000	2,875,841,000	26%
Unrealized appreciation on invested assets	2,402,653,000	1,952,299,000	450,354,000	23%
Total assigned	16,141,699,000	12,815,504,000	3,326,195,000	26%
Total fund balances	64,894,345,000	59,785,097,000	5,109,248,000	9%
Total liabilities and fund balances	\$ 67,671,327,000	61,824,297,000	5,847,030,000	9%

The value of the Fund's assets, excluding securities lending collateral, increased by 9 percent between June 30, 2017 and June 30, 2018. Losses were experienced in the U.S. aggregate, U.S. corporate and emerging market fixed income portfolios with returns of -0.41 percent, -0.72 percent, and -1.49 percent, respectively. Public equities, real estate, and absolute return more than offset those losses, contributing 11.67 percent, 6.99 percent, and 5.95 percent, respectively. Private equity & special opportunities and infrastructure & income opportunities were the strongest performers with returns of 32.7 percent and 16.68 percent, respectively.

The value of the Fund's assets, excluding securities lending collateral, increased by 11 percent between June 30, 2016 and June 30, 2017. Small losses were seen in the non-domestic fixed income and TIPS portfolios, with returns of -1.57 percent and -0.62 percent, respectively. All other mandates experienced gains during FY2017. The strongest performance occurred in the international, global and domestic equity portfolios, with returns of 22.57 percent, 18.77 percent, and 20.08 percent, respectively. Private equity was also a significant contributor at 20.98 percent for the fiscal year.

Primarily due to timing of transactions, receivables increased by 22 percent from FY2017 to FY2018, going from \$545 million to \$664 million. The ending values of securities lending collateral invested and the related liability are dependent upon the amount of securities out on loan on any particular day. These values can change significantly from day to day and year to year, depending on activity in the market. The average value of assets on loan during FY2018 was \$7.7 billion, with a low of \$6.8 billion and a high of \$8.1 billion. The Fund had earnings from securities lending of \$26.3 million during FY 2018, a significant increase from \$17.1 million received in FY2017.

In the liability section of the Balance Sheets, accounts payable primarily consist of obligations due, but not yet settled, on securities purchased. The open transactions can vary widely from day to day and are usually the largest portion of Fund payables, representing 96 percent of the FY2018 and FY2017 accounts payable balances. The increase of \$22.7 million from FY2017 to FY2018 was due to an increase in pending public equities and alternatives purchases of \$108.6 million and \$4 million, respectively, offset by a decrease in pending operating payables, bond and real estate purchases of \$2.3 million, \$17.1 million, and \$70.5 million, respectively.

In past years, income distributable to the State of Alaska included the amount appropriated to fund the dividend program. Recent legislation changed the accounting treatment of this transfer, so the FY2018 dividend amount was paid in the Fall of 2018. Therefore, there is no liability for this purpose at the end of the fiscal year.

The sole amount due to the State of Alaska at the end of FY2018 is the transfer to the Alaska Capital Income Fund (ACIF). This amount is calculated based on realized earnings and was \$43.5 million for FY2018 and \$25.1 million for FY2017. The \$18.4 million dollar increase from the prior year is caused by significantly higher realized returns in FY2018 versus FY2017. The transfer due for FY2016 was \$18 million.

Total fund balance increased by 9 percent from FY2017 to FY2018, with an increase of \$5.1 billion, consistent with the total return for the year 10.74 percent. Components of this increase were increases of \$1.6 billion for cash flow income, \$353 million in dedicated mineral deposits, and an increase in the fair value of the portfolio of \$4.1 billion, offset by operating expenses of \$146 million, and the dividend transfer of \$726 million. Deposits from the State of Alaska were down 3 percent from the FY2017 dedicated revenues of \$365 million.

The total fund balance increase from FY2016 to FY2017 was due to the net of the transfers in (State dedicated mineral revenues of \$365 million) and the transfer out (ACIF of \$25 million), with the other contributor being net income of the fund of \$6.7 billion.

The table below is derived from the Statements of Revenues, Expenditures and Changes in Fund Balances, and shows the annual activity of the Fund. The differences in activity in FY2018 as compared to FY2017 are shown in both dollars and percentages.

Statements of Revenues, Expenditures and Changes in Fund Balances	Year Ended June 30		Net change	Percent
	2018	2017		
Revenues				
Interest, dividends, real estate and other income	\$ 1,580,508,000	1,254,067,000	326,441,000	26%
Increase/(decrease) in the fair value of investments	<u>4,090,948,000</u>	<u>5,551,355,000</u>	<u>(1,460,407,000)</u>	<u>(26)%</u>
Total revenues	5,671,456,000	6,805,422,000	(1,133,966,000)	(17)%
Expenditures				
Operating expenditures	(138,799,000)	(121,260,000)	(17,539,000)	14%
Other Legislative appropriations	<u>(7,159,000)</u>	<u>(8,578,000)</u>	<u>1,419,000</u>	<u>(17)%</u>
Total expenditures	(145,958,000)	(129,838,000)	(16,120,000)	12%
Excess of revenues over expenditures	5,525,498,000	6,675,584,000	(1,150,086,000)	(17)%
Other financing sources (uses)				
Transfers in – dedicated State revenues	353,095,000	364,893,000	(11,798,000)	(3)%
Transfers out – appropriations	<u>(769,345,000)</u>	<u>(25,067,000)</u>	<u>(744,278,000)</u>	<u>2,969%</u>
Net change in fund balances	5,109,248,000	7,015,410,000	(1,906,162,000)	(27)%
Fund balances				
Beginning of period	<u>59,785,097,000</u>	<u>52,769,687,000</u>	<u>7,015,410,000</u>	<u>13%</u>
End of period	\$ <u>64,894,345,000</u>	<u>59,785,097,000</u>	<u>5,109,248,000</u>	<u>9%</u>

During FY2018, cash flow revenue from interest, dividends, real estate, and other sources was at an all-time high, mostly due to the growing size of the portfolio as well as the gradual increase in interest rates. Total cash flow income was higher than for FY2017 at \$132 million per month on average, up from \$105 million per month on average in FY2017. The change in the fair value of investments decreased by 26% from \$6.8 billion in FY2017 to a \$5.7 billion gain in FY2018. Operating expenditures experienced a notable increase from FY2017 to FY2018 of 14 percent. This increase was about the same as between FY2016 and FY2017 at 15 percent. Manager fees in FY2018 totaled \$119 million (approximately 19 basis points) and in FY2017 were \$103 million (approximately 18 basis points). Total fees paid out in FY2016 were \$91 million, approximately 17 basis points. Investment management fees are largely based upon assets under management so, as the fund grows, so do fees to manage it.

Transfers in of dedicated State revenues decreased from FY2017 to FY2018 by 3 percent (\$12 million) and totaled \$353 million compared to \$365 million in FY2017. These transfers totaled \$284 million in FY2016.

Historically, transfers out of the Fund are for two purposes: 1) an appropriation to fund the Permanent Fund dividend payment, and 2) an appropriation to fund the Alaska Capital Income Fund (ACIF). The dividend transfer is subject to Legislative appropriation. The amount appropriated for 2018 dividends was \$726 million. In future years, the dividend will be funded as a portion of the appropriated percent-of-market-value transfer from the Earnings Reserve Account to the General Fund. The ACIF transfer is based on realized earnings for only one year; it is not averaged over multiple years. ACIF realized earnings of \$43.4 million in FY2018 and \$25.1 million in FY2017. The earnings for FY2016 were \$18.1 million.

Economic, Investment, and Political Factors

The market value of and earnings from the Fund's assets are directly impacted by the volatility of the financial markets, as well as investment decisions made by the Trustees, internal Fund management, and external Fund investment managers. Diversification of asset allocation and diversification of investments within each allocation are intended to mitigate the risk of volatility of the financial markets. The APFC, as a component unit of the State of Alaska, is subject to changes in the Alaska Statutes that govern the APFC and the Fund.

Additional Information

This financial report is designed to provide an overview of the Alaska Permanent Fund's ending net asset balances and fiscal year financial activities. This report does not include any other funds owned or managed by the State of Alaska or APFC. Due to the potential volatility of the financial markets, Fund values and income may vary greatly from period to period. For more information on the Fund, both current and historical, readers are encouraged to visit www.apfc.org, or send specific information requests to the Alaska Permanent Fund Corporation at P.O. Box 115500, Juneau, Alaska 99811-5500.

04c_FY18 Financial Statements

Alaska Permanent Fund

Balance sheets

	<i>June 30,</i>	
	2018	2017
Assets		
Cash and temporary investments	\$ 4,906,054,000	2,653,513,000
Receivables, prepaid expenses and other assets	664,105,000	544,753,000
Investments:		
Marketable debt securities	11,546,620,000	10,114,640,000
Preferred and common stock	26,248,730,000	25,354,335,000
Real estate	5,460,939,000	6,886,835,000
Absolute return	5,288,072,000	4,567,024,000
Private equity	7,198,347,000	6,818,147,000
Infrastructure	3,035,277,000	2,458,345,000
Private credit	1,311,423,000	1,111,752,000
Total investments	60,089,408,000	57,311,078,000
Securities lending collateral invested	2,011,760,000	1,314,953,000
Total assets	\$ 67,671,327,000	61,824,297,000
Liabilities		
Accounts payable	\$ 721,827,000	699,180,000
Income distributable to the State of Alaska	43,395,000	25,067,000
Securities lending collateral	2,011,760,000	1,314,953,000
Total liabilities	2,776,982,000	2,039,200,000
Fund balances		
Nonspendable:		
Permanent Fund corpus - contributions and appropriations	40,167,394,000	39,814,299,000
Not in spendable form - unrealized appreciation on invested assets	5,862,598,000	7,155,294,000
Total nonspendable	46,029,992,000	46,969,593,000
Committed:		
General Fund Commitment	2,722,654,000	—
Total committed	2,722,654,000	—
Assigned for future appropriations:		
Realized earnings	13,739,046,000	10,863,205,000
Unrealized appreciation on invested assets	2,402,653,000	1,952,299,000
Total assigned	16,141,699,000	12,815,504,000
Total fund balances	64,894,345,000	59,785,097,000
Total liabilities and fund balances	\$ 67,671,327,000	61,824,297,000

See accompanying notes to the financial statements.

Alaska Permanent Fund

Statements of revenues, expenditures and changes in fund balances

Year Ended June 30,

	2018	2017
Revenues		
Interest	\$ 459,393,000	310,709,000
Dividends	640,620,000	563,012,000
Real estate and other income	480,495,000	380,346,000
Total interest, dividends, real estate and other income	1,580,508,000	1,254,067,000
Net increase (decrease) in the fair value of investments —		
Marketable debt securities	(424,610,000)	(62,397,000)
Preferred and common stock	2,362,762,000	4,125,607,000
Real estate	65,591,000	102,594,000
Absolute return	221,732,000	351,810,000
Private equity	1,599,786,000	1,056,562,000
Infrastructure	337,403,000	259,221,000
Private credit	62,492,000	85,281,000
Foreign currency forward exchange contracts and futures	(19,519,000)	69,069,000
Currency	(114,689,000)	(436,392,000)
Total net increase (decrease) in the fair value of investments	4,090,948,000	5,551,355,000
Total revenues	5,671,456,000	6,805,422,000
Expenditures		
Operating expenditures	(138,799,000)	(121,260,000)
Other Legislative appropriations	(7,159,000)	(8,578,000)
Total expenditures	(145,958,000)	(129,838,000)
Excess of revenues over expenditures	5,525,498,000	6,675,584,000
Other financing sources (uses)		
Transfers in - dedicated State revenues	353,095,000	364,893,000
Transfers out - statutory and Legislative appropriations	(769,345,000)	(25,067,000)
Net change in fund balances	5,109,248,000	7,015,410,000
Fund balances		
Beginning of period	59,785,097,000	52,769,687,000
End of period	\$ 64,894,345,000	59,785,097,000

See accompanying notes to the financial statements.

04d_FY18 Financial Statements Notes

NOTES TO THE FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. ENTITY

The Constitution of the State of Alaska (“State”) was amended by public referendum in 1976 to dedicate a portion of certain natural resource revenues to the Alaska Permanent Fund (“Fund”). Contributions to the Fund are to be invested in income-producing investments authorized by law. In 1980, the Alaska State Legislature (“Legislature”) established the Alaska Permanent Fund Corporation (“APFC”), a State governmental instrumentality within the Department of Revenue, to manage and invest Fund assets. The APFC is managed by a six-member board of trustees (“Trustees” or “Board”) consisting of the Commissioner of Revenue, one other head of a principal state department, and four public members with recognized competence and experience in finance, investments, or other business management related fields. The Governor appoints the public members to staggered four-year terms, and can remove public members only for cause. The Board employs an executive director who in turn employs additional staff as necessary. The Fund’s assets are diversified across a wide variety of investments in accordance with statutes, regulations, and APFC’s investment policy. The Fund’s investment performance is generally related to the success of the financial markets. While diversification aims to mitigate volatility, significant period-to-period fluctuations in investment performance may occur.

By annual appropriation, the APFC transfers (i) a portion of the Fund’s realized earnings to the State’s dividend fund, (ii) a portion of realized earnings sufficient to offset the effect of inflation on contributions and appropriations to the nonspendable balance of the Fund, and (iii) realized earnings on the balance of the North Slope royalty case settlement money (*State v. Amerada Hess, et al.*) to the Alaska Capital Income Fund (ACIF). The remaining balance of the Fund’s realized earnings (referred to in Alaska Statute as the earnings reserve account) is held in the assigned fund balance by the APFC and is subject to appropriation by the Legislature. The nonspendable fund balance (referred to in the Alaska Constitution as the principal) includes the historical cost basis of contributions and appropriations. Because the Alaska Constitution specifies that principal can only be used for income-producing investments, it is unavailable for appropriation by the Legislature. Unrealized gains and losses (appreciation/depreciation) on Fund assets are allocated proportionately between the nonspendable fund balance and the assigned fund balance. The unrealized amounts allocated to contributions and appropriations are considered a component of principal and are nonspendable, unless and until they become realized, at which point they will be transferred to the assigned (realized earnings) fund balance. All assets are aggregated for investment purposes.

2. SIGNIFICANT ACCOUNTING POLICIES

The Fund’s financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. In preparing the financial statements, APFC management is required to make estimates and assumptions as of the date of the balance sheet that affect the reported amounts of assets and liabilities and the disclosure of contingent assets, liabilities, revenues, and expenses for the period. The fair value of real estate, real return, absolute return, private equity, infrastructure, and private credit investments and the related unrealized gains and losses thereon are particularly sensitive estimates. Actual results could differ from those estimates.

Cash and temporary investments

The amounts shown on the balance sheets as cash and temporary investments include cash on deposit at the custodian bank, cash swept to overnight investment funds, cash held at futures brokers, petty cash, U.S. Treasury bills, and the net fair value of foreign exchange forward contracts. The APFC’s asset allocation includes 1.9 percent

to cash. APFC's investment policy specifies that funds dedicated to this portion of the asset allocation will be invested in money market funds or fixed income securities with weighted-average maturities of no greater than 24 months.

Dividend appropriations

Statutory net income excludes realized earnings from contributions made in the North Slope royalty case settlement (*State v. Amerada Hess, et al.*) and unrealized gains and losses on the Fund's investments. Typically the annual appropriation from the earnings reserve account to the dividend fund follows the formula set out in Alaska Statute 37.13.140, which provides for the smaller of: (i) 21 percent of the Fund's five-year rolling statutory net income or (ii) the assigned fund balances at fiscal year-end. Based on advice from the Alaska Department of Law, the annual dividend transfer may occur only by legislative appropriation, and the Legislature may establish the amount of appropriation as a lump-sum dollar amount rather than a formula. Dividend appropriations are recognized in the Fund's financial statements as of the date the Legislature indicates the transfer to the dividend fund should occur. Dividend appropriations that are directed by the Legislature for a future transfer date are recognized as Assigned Fund balance. FY18 is the last year a direct appropriation from the earnings reserve account to the dividend fund will take place due to legislative changes.

General Fund appropriations

In FY18 the Legislature passed Senate Bill 26, which creates a percent of market value draw on the earnings reserve account. Alaska Statute 37.13.140 was amended to specify the formula for percent of market value as 5.25% of the average market value of the fund for the first five of the preceding six fiscal years, including the fiscal year just ended, computed annually for each fiscal year in accordance with generally accepted accounting principles. The average market value of the fund includes the earnings reserve account, but not the principal attributed to the settlement of *State v. Amerada Hess*. The amount appropriated as transferrable to the general fund is shown as committed fund balance on the financial statements at June 30.

Forward exchange contracts

Fund managers enter into a variety of forward currency contracts in their trading activities and management of foreign currency exchange rate risk exposure. These contracts are typically intended to neutralize the effect of foreign currency fluctuations, and the contract amounts do not appear on the balance sheet. Realized gains and losses are included in the net increase/decrease in the fair value of investments at the time the contract is settled and determined based on the difference between the contract rate and the market rate at the time of maturity or closing. Unrealized gains and losses are also included in the net increase/decrease in the fair value of investments, and are calculated based on the difference between the contract rate and a forward market rate determined as of the balance sheet date.

A portion of forward exchange contracts is intended to manage, rather than neutralize, foreign currency fluctuations. Certain managers seek to control the effect of fluctuations in foreign exchange rates within their overall portfolio strategy rather than on a security by security basis. They attempt to optimize their foreign currency exposure in a market rather than accept the natural geographical exposure to the market's currency.

Fund balance unrealized gains and losses

A State of Alaska Attorney General's Opinion dated June 16, 2009 clarified the accounting treatment of the Fund's unrealized gains and losses by providing that unrealized appreciation or depreciation on invested assets should be allocated proportionately to nonspendable fund balances and assigned fund balances.

Futures

Certain equity and fixed income managers for the Fund are permitted to buy and sell equity and interest rate index futures. The gross contract and fair value of futures do not appear in the balance sheets. The net unrealized gain or loss on open futures trades is included in investments on the balance sheets, based on the difference between the future's purchase price and the current value of such index futures. Realized gains and losses on futures are

included in the net increase in the fair value of investments at the time the futures contract expires. The net change in unrealized gains and losses is included in the net increase in the fair value of investments.

Income taxes

In the opinion of legal counsel, the Fund should not be subject to federal income taxation under the doctrine of implied statutory immunity for states because it is an integral part of the State, and the APFC should not be subject to federal income taxation because it is an integral part of the State and it performs an essential governmental function, with its income, if any, accruing to the State.

Inflation proofing

Alaska statutes require that the contributions and appropriations of the Fund be adjusted annually to offset the effect of inflation on Fund principal during the fiscal year. Based on advice from the Alaska Department of Law, an annual intra-fund inflation proofing transfer (from the assigned to the nonspendable fund balance) should occur only by legislative appropriation. The APFC measures inflation by (i) computing the percentage change in the averages of the monthly United States Consumer Price Index for all urban consumers for the two previous calendar years and (ii) applying that percentage to the total of the nonspendable fund balance, excluding unrealized gains and losses, at the end of the fiscal year. Using this formula, the inflation proofing rates for the years ended June 30, 2018 and 2017 were 2.13 percent and 1.26 percent, respectively; however, no transfers were made due to the lack of legislative appropriation for this purpose.

Investments and related policies

Carrying value of investments

The Fund considers all of its ownership interests in securities and other assets to be investments because they are held for the purpose of income or profit and have a present service capacity based solely on their ability to generate cash or be sold to generate cash. Investments are reported at fair value in the financial statements. Investments without a readily determinable fair value are generally reported by using the net asset value per share (or its equivalent) of the investment. Securities transactions are recorded on the trade date that securities are purchased or sold. Unrealized gains and losses are reported as components of net change in fund balance.

State investment regulations

In accordance with Alaska Statute 37.13.120(a), the Trustees have adopted regulations designating the types of eligible investments for Fund assets. The regulations follow the prudent investor rule, requiring the exercise of judgment and care under the circumstances then prevailing that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the designation and management of large investments entrusted to it, not in regard to speculation, but in regard to the permanent disposition of funds, considering preservation of the purchasing power of the Fund over time while maximizing the expected total return from both income and the appreciation of capital.

Investment policy – Asset allocation

The Trustees have established a long-term goal of achieving a five percent real rate of return over time on the Fund's investment portfolio. To help achieve this goal, the Trustees allocate the Fund's investments among various asset classes. At June 30, 2018, the APFC's strategic asset allocation targets were as follows:

Asset Class	Asset Class Target
Public Equities	39%
Fixed Income Plus	22%
Private Equity/Growth Opportunities	11%
Real Estate	11%
Private Credit/Infrastructure/Income Opportunities	6%
Absolute Return	5%
Asset Allocation	6%

To allow for market fluctuations and to minimize transaction costs, the Trustees have adopted ranges that permit percentage deviations from the strategic asset allocation targets in accordance with specified reporting requirements and other procedures. Generally, for each risk and asset class, the APFC’s chief investment officer has discretionary authority to permit target deviations within one specified range (referred to as the “green zone” in the investment policy), the APFC’s executive director can approve target deviations for up to 90 days within a broader range (the “yellow zone”), and the Board can approve operating for longer than 30 days within a third range (the “red zone”). For example, the target dollar allocation for the public equities class is 40 percent, with the green zone range set at 35-45 percent, the yellow zone range set at 30-35 and 45-55 percent, and red zone ranges set at allocations of less than 30 percent or greater than 55 percent. In a similar manner, the APFC investment policy also requires the APFC to monitor relative risk (the expected investment portfolio’s risk and return relative to the risk benchmark using standard industry risk measures), active budget risk (risk due to active management decisions made by managers), and limits on private investments and future commitments.

Concentration of credit risk

Concentration of credit risk is the risk of loss attributable to holding investments from a single issuer. The APFC manages the Fund’s concentration of credit risk by following its strategic asset allocation policy, diversifying investments among managers with varying investment styles and mandates, and monitoring tracking error. Tracking error is a measure of how closely a portfolio follows the index to which it is benchmarked. The APFC’s policy for mitigating this risk of loss for fixed income and equity investments is to ensure compliance with APFC investment policy and investment manager contracts. There is no single-issuer exposure within the APFC portfolio that comprises 5% or more of the overall portfolio. Therefore, no concentration of credit risk is reported in the notes to the financial statements.

Credit risk

Credit risk is the risk that an issuer or other counterparty to a marketable debt investment will not fulfill its obligations. The APFC requires that its investment grade fixed income managers, both internal and external, invest in domestic and non-domestic bonds that have an explicit or implied investment grade rating. Should the required ratings on an existing fixed income security fall below the minimum standards, the security must be sold within seven months. Certain high yield investment managers are allowed to invest a specified amount of funds in bonds rated below investment grade.

Custodial credit risk

Custodial credit risk is the risk that in the event of a bank failure the Fund’s deposits may not be returned. The APFC generally requires that all investment securities at custodian banks be held in the name of the Fund or the APFC (on behalf of the Fund). For the Fund’s non-domestic securities held by most sub-custodians, the APFC’s primary custodian provides contractual indemnities against sub-custodial credit risk. Excess cash in custodial accounts is swept daily to a money market fund. Late deposits of cash which miss the money market sweep deadline are deposited to an interest bearing account at the custodian.

Foreign currency risk

Foreign currency risk is the risk of loss from adverse changes in foreign currency exchange rates. Foreign currency risk is managed through foreign currency forward contracts, and by diversifying assets into various countries and currencies.

Interest rate risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The APFC manages the Fund's exposure to interest rate risk in part through tracking error guidelines set forth in the APFC's investment policy. Duration is an indicator of a portfolio's market sensitivity to changes in interest rates. In general, the major factors affecting duration are, in order of importance, maturity, prepayment frequency, level of market interest rates, size of coupon, and frequency of coupon payments. Rising interest rates generally translate into the value of fixed income investments declining, while falling interest rates are generally associated with increasing value. Effective duration attempts to account for the price sensitivity of a bond to changes in prevailing interest rates, including the effect of embedded options. As an example, for a bond portfolio with a duration of 5.0, a one percentage point parallel decline in interest rates would result in an approximate price increase on that bond portfolio of 5.0 percent.

At June 30, 2018, the Fund held fixed income investments with floating, variable, and step interest rates, valued at \$995,628,000. These fixed income investments were both domestic and non-domestic, and had current annual interest rates ranging from 0 to 38 percent.

Transfers in

Contributions from dedicated State revenues are recorded when certain revenues defined by statute are received or reported by the Alaska Department of Natural Resources. Contributions from appropriations and other sources are recorded when received.

Transfers out

Transfers out to other State agencies are recorded when measurable.

3. CASH AND TEMPORARY INVESTMENTS

Cash and temporary investments, which include the market values of foreign currency (FX) and FX forward exchange contracts, are summarized as follows at June 30:

	2018	2017
Cash	\$ 323,264,000	154,954,000
Pooled funds	3,963,473,000	1,614,620,000
U.S. Treasury bills	619,317,000	883,939,000
Total cash and temporary investments	\$ 4,906,054,000	2,653,513,000

Uninvested cash was held at the custodian, sub-custodian, or futures broker banks, primarily in interest-bearing accounts. All pooled funds were invested in a money market fund. U.S. Treasury bills are explicitly guaranteed by the U.S. government.

4. RECEIVABLES, PREPAID EXPENSES AND OTHER ASSETS

Receivables, prepaid expenses and other assets at June 30 are as follows:

	2018	2017
Interest receivable	\$ 106,942,000	79,768,000
Dividends receivable	72,891,000	57,866,000
Sales receivable	430,975,000	365,086,000
Dedicated state revenues receivable	53,297,000	42,033,000
Total receivables, prepaid expenses and other assets	\$ 664,105,000	544,753,000

5. MARKETABLE DEBT SECURITIES

Marketable debt securities at June 30 are summarized as follows, categorized by debt instrument type and by country of registration:

	2018	Cost	Fair value	Unrealized gains (losses)
Treasury and government notes/bonds	\$	1,689,759,000	1,669,265,000	(20,494,000)
Mortgage-backed securities		1,002,636,000	986,045,000	(16,591,000)
Corporate bonds		5,196,562,000	5,004,894,000	(191,668,000)
Commercial mortgage/asset-backed securities		251,070,000	244,405,000	(6,665,000)
Non-U.S. treasury and government bonds		2,060,999,000	1,973,013,000	(87,986,000)
Non-U.S. corporate bonds		996,029,000	982,828,000	(13,201,000)
Bond-backed exchange traded funds		714,402,000	686,170,000	(28,232,000)
Total marketable debt securities	\$	11,911,457,000	11,546,620,000	(364,837,000)
2017				
Treasury and government notes/bonds	\$	2,723,899,000	2,708,765,000	(15,134,000)
Mortgage-backed securities		830,131,000	827,944,000	(2,187,000)
Corporate bonds		3,974,333,000	4,069,185,000	94,852,000
Commercial mortgage/asset-backed securities		214,880,000	214,868,000	(12,000)
Non-U.S. treasury and government bonds		1,140,881,000	1,126,710,000	(14,171,000)
Non-U.S. corporate bonds		950,278,000	971,864,000	21,586,000
Bond-backed exchange traded funds		193,598,000	195,304,000	1,706,000
Total marketable debt securities	\$	10,028,000,000	10,114,640,000	86,640,000

6. MARKETABLE DEBT CREDIT RATINGS

To manage credit risk for marketable debt securities, the APFC monitors fair values of all securities daily and routinely reviews its investment holdings' credit ratings. For accounts with an investment grade mandate (approximately 80 percent of bond mandates at June 30, 2018), issues falling below the minimum standards are required to be sold within seven months of the downgrade date. Minimum standards are a Standard & Poor's Corporation rating BBB or better, or Moody's Investors Service, Inc. rating of Baa or better, or a comparable rating by another Nationally Recognized Statistical Rating Organizations (NRSRO) or by a recognized rating service in the jurisdiction of the issuer. Managers with high yield mandates (approximately 20 percent of bond mandates at June 30, 2018) are allowed to hold positions in assets with below investment grade ratings (high yield bonds) based on the terms of their contracts. For purposes of this note, if credit ratings differ among the NRSROs used, the rating with the highest degree of risk (the lowest rating) is reported. At June 30, 2018, the Fund's credit ratings for its marketable debt securities are as follows:

NRSRO quality ratings	Domestic	Non-domestic	Total Fair Value	Percentage of holdings
AAA	\$ 351,659,000	308,071,000	659,730,000	5.71%
AA	404,527,000	430,644,000	835,171,000	7.23%
A	1,260,457,000	847,545,000	2,108,002,000	18.26%
BBB	2,100,356,000	764,994,000	2,865,350,000	24.82%
BB	544,882,000	240,119,000	785,001,000	6.80%
B	449,737,000	149,386,000	599,123,000	5.19%
CCC	103,826,000	60,330,000	164,156,000	1.42%
CC	10,034,000	-	10,034,000	0.09%
C	1,109,000	-	1,109,000	0.01%
D	-	15,394,000	15,394,000	0.13%
Total fair value of rated debt securities	5,226,587,000	2,816,483,000	8,043,070,000	69.66%
Commingled bond funds	503,153,000	245,571,000	748,724,000	6.48%
Not rated	(21,688,000)	139,358,000	117,670,000	1.02%
U.S. government explicitly backed by the U.S. government (AA)	1,948,424,000		1,948,424,000	16.87%
U.S. government implicitly backed by the U.S. government (AA)	688,732,000		688,732,000	5.96%
Total fair value debt securities	\$ 8,345,208,000	3,201,412,000	11,546,620,000	100.00%

7. MARKETABLE DEBT DURATION

To manage its interest rate risk on marketable debt securities, the APFC monitors fair values daily and routinely reviews portfolio effective duration in comparison to established benchmarks. At June 30, 2018, the effective duration by investment type, based on fair value, is as follows:

	Percent of bond holdings	Duration
Domestic bonds		
Treasury and government notes/bonds	20.00%	5.41
Mortgage-backed securities	11.82%	6.23
Corporate bonds	59.97%	7.30
Commercial mortgage and asset-backed securities	2.93%	3.61
Bond-backed exchange traded funds	5.28%	—
Total domestic bonds	100.00%	6.30
Non-domestic bonds		
Non-U.S. treasury and government bonds	61.63%	7.05
Non-U.S. corporate bonds	30.70%	5.84
Bond-backed exchange traded funds	7.67%	—
Total non-domestic bonds	100.00%	6.13

8. PREFERRED AND COMMON STOCK

Direct investments in preferred and common stock are held by the APFC's custodian bank on behalf of the Fund. The Fund also invests in commingled stock funds, which are held by the custodian bank of the fund manager on behalf of fund investors, and equity index futures, which are held at the prime broker.

Preferred and common stocks and commingled stock funds at June 30 are summarized as follows, which include the net fair value of equity index futures of -\$7.9 million as of June 30, 2018 and -\$6.1 million as of June 30, 2017:

	Cost	Fair value	Unrealized holding gains (losses)
2018			
Direct investments			
Domestic stock	\$ 11,351,254,000	13,773,474,000	2,422,220,000
Non-domestic stock	10,744,402,000	12,081,136,000	1,336,734,000
Commingled funds	355,180,000	394,120,000	38,940,000
Total preferred and common stock	\$ 22,450,836,000	26,248,730,000	3,797,894,000
2017			
Direct investments			
Domestic stock	\$ 8,552,817,000	10,634,263,000	2,081,446,000
Non-domestic stock	12,522,527,000	14,371,920,000	1,849,393,000
Commingled funds	320,217,000	348,152,000	27,935,000
Total preferred and common stock	\$ 21,395,561,000	25,354,335,000	3,958,774,000

9. FOREIGN CURRENCY EXPOSURE

Foreign currency risk arises when a loss could result from adverse changes in foreign currency exchange rates. Foreign currency risk is managed by the international investment managers in part through their decisions to enter into foreign currency forward contracts. Foreign currency risk is also managed through the diversification of assets into various countries and currencies. At June 30, 2018, the Fund's cash holdings, foreign currency forward contracts, non-domestic public and private equity, and debt securities had exposure to foreign currency risk as follows (shown in U.S. dollar equivalent at fair value and based on the currency in which the securities are held and traded):

Foreign currency	Cash and equivalents	Foreign exchange forward contracts	Public/private equity, real estate, infrastructure	Debt	Total foreign currency exposure
Argentina Peso	\$ 204,000	—	—	6,086,000	6,290,000
Australian Dollar	10,185,000	82,888,000	448,165,000	24,067,000	565,305,000
Brazil Real	2,137,000	(14,186,000)	157,092,000	36,305,000	181,348,000
Canadian Dollar	2,648,000	327,221,000	604,430,000	27,838,000	962,137,000
Chilean Peso	493,000	(20,536,000)	9,992,000	21,657,000	11,606,000
Chinese Yuan Renminbi	1,274,000	(33,000)	123,492,000	—	124,733,000
Colombian Peso	576,000	—	3,580,000	15,642,000	19,798,000
Czech Koruna	398,000	(24,353,000)	1,934,000	23,659,000	1,638,000
Danish Krone	1,549,000	(5,941,000)	133,524,000	2,149,000	131,281,000
Dominican Republic Peso	—	—	—	1,118,000	1,118,000
Egyptian Pound	8,286,000	—	143,000	3,485,000	11,914,000
Euro Currency	1,367,000	(854,445,000)	3,014,689,000	481,372,000	2,642,983,000
Ghanaian Cedi	415,000	—	—	6,395,000	6,810,000
Hong Kong Dollar	727,000	2,467,000	1,167,526,000	—	1,170,720,000
Hungarian Forint	15,000	—	10,258,000	—	10,273,000
Indian Rupee	(1,000,000)	(33,800,000)	289,722,000	42,099,000	297,021,000
Indonesian Rupiah	899,000	(4,151,000)	70,134,000	25,156,000	92,038,000
Israeli Shekel	236,000	(23,121,000)	50,668,000	—	27,783,000
Japanese Yen	4,931,000	(381,526,000)	1,780,959,000	430,880,000	1,835,244,000
Kenyan Shilling	66,000	—	—	2,796,000	2,862,000
Malaysian Ringgit	1,394,000	(3,732,000)	67,359,000	22,771,000	87,792,000
Mexican Peso	672,000	(16,016,000)	63,608,000	56,113,000	104,377,000
New Taiwan Dollar	3,126,000	(21,000)	227,787,000	—	230,892,000
New Zealand Dollar	2,039,000	97,276,000	28,412,000	5,249,000	132,976,000
Nigerian Naira	5,640,000	—	—	8,728,000	14,368,000
Norwegian Krone	885,000	9,476,000	72,088,000	5,697,000	88,146,000
Pakistan Rupee	—	—	101,000	—	101,000
Peruvian Sol	117,000	—	—	10,423,000	10,540,000
Philippines Peso	51,000	—	7,799,000	—	7,850,000
Polish Zloty	998,000	(22,287,000)	17,522,000	38,290,000	34,523,000
Pound Sterling	13,241,000	(134,104,000)	1,979,773,000	117,856,000	1,976,766,000
Qatari Riyal	7,000	—	23,581,000	—	23,588,000
Romanian Leu	66,000	—	—	7,140,000	7,206,000
Russian Ruble	664,000	—	60,000	29,190,000	29,914,000
Singapore Dollar	1,329,000	(65,570,000)	108,401,000	18,290,000	62,450,000
South African Rand	1,405,000	(12,639,000)	153,592,000	34,460,000	176,818,000
South Korean Won	3,797,000	(61,044,000)	304,473,000	60,039,000	307,265,000
Swedish Krona	(404,000)	(206,362,000)	179,276,000	5,560,000	(21,930,000)
Swiss Franc	4,507,000	(389,175,000)	340,309,000	—	(44,359,000)
Thailand Baht	2,957,000	1,256,000	129,132,000	20,007,000	153,352,000
Turkish Lira	1,072,000	(5,645,000)	45,174,000	17,035,000	57,636,000
Uae Dirham	84,000	—	18,470,000	—	18,554,000
Uruguayan Peso	—	—	—	9,216,000	9,216,000
Zambia Kwacha	128,000	—	—	3,016,000	3,144,000
	\$ 79,181,000	(1,758,103,000)	11,633,225,000	1,619,784,000	11,574,087,000

Cash amounts in the schedule above include receivables, payables, certificates of deposit, and cash balances in each related currency. If payables exceed receivables and cash balances in a currency, then the total cash balance for that currency will appear as a negative value. The remaining Fund assets are invested in U.S. cash, equities, and debt, as well as in direct real estate properties, absolute return and similar funds, and infrastructure, all of which are denominated in U.S. dollars, and are not included in the schedule above.

10. REAL ESTATE

The Fund holds a variety of real estate interests, including directly owned real estate, real estate investment trusts, multi-family and industrial real estate operating companies, and other entities in which the assets consist primarily of real property. The Fund's directly owned real estate is through ownership of interests in corporations, limited liability companies, and partnerships that hold title to the real estate. External institutional real estate management firms administer the Fund's directly owned real estate investments.

The APFC periodically reviews real estate investments for other than temporary impairment. There was no impairment recognized in FY2018 or FY2017.

Real estate investments at June 30 are summarized as follows:

2018	Cost	Fair value	Unrealized holding gains (losses)
Real estate investment trusts	\$ 1,228,746,000	1,354,127,000	125,381,000
American Homes 4 Rent II	135,208,000	161,608,000	26,400,000
Directly owned real estate -			
Retail	883,168,000	1,892,975,000	1,009,807,000
Office	1,114,183,000	1,383,865,000	269,682,000
Hotel	59,413,000	67,980,000	8,567,000
Industrial	177,156,000	281,137,000	103,981,000
Multifamily	220,278,000	319,247,000	98,969,000
Total real estate	\$ 3,818,152,000	5,460,939,000	1,642,787,000
2017			
Real estate investment trusts	\$ 1,084,165,000	1,209,891,000	125,726,000
American Homes 4 Rent II	134,037,000	163,074,000	29,037,000
Directly owned real estate -			
Retail	850,351,000	1,844,958,000	994,607,000
Office	1,155,929,000	1,441,693,000	285,764,000
Hotel	59,099,000	67,626,000	8,527,000
Industrial	189,127,000	263,334,000	74,207,000
Multifamily	1,192,292,000	1,896,259,000	703,967,000
Total real estate	\$ 4,665,000,000	6,886,835,000	2,221,835,000

11. ALTERNATIVE INVESTMENTS

Alternative investments include the Fund's investments in or through real return mandates, absolute return strategies, private equity, infrastructure, and private credit. The APFC periodically reviews alternative investments for other than temporary impairment.

The objective for the real return mandate was to produce a 5 percent real return (in excess of inflation) over the longer of one business cycle or five years. Each manager's contract specifies permitted investments and liquidity guidelines. Investments are generally in commingled proprietary funds structured as limited partnerships. During FY2017, the real return mandate was discontinued and the remaining managers in this category were moved to the absolute return portfolio.

Absolute return strategies are investments in specialized funds that seek to deliver returns that are largely uncorrelated with traditional market driven asset classes. The Fund is invested in three existing limited partnerships, in which the Fund is the only limited partner ("fund-of-one"). The Fund also holds direct hedge fund

investments, in which the Fund is one of many limited partners. External investment management services are provided by institutional investment managers who have acknowledged their status as fiduciaries to the Fund. In FY2017, it was decided to redeem the fund-of-one accounts and move toward more direct hedge fund investments. The liquidation of these accounts is expected to take time, given the illiquid nature of some of the underlying funds. Because of the off-exchange and private nature of many absolute return strategies, investments may have no readily determinable fair value, and the estimated fair values could differ significantly from values that would be obtained in a market transaction for the assets. Each manager provides the Fund with fair value estimates of partnership interests and undergoes an annual independent audit.

The Fund holds private equity through investments in limited liability companies and limited partnerships that typically invest in unlisted, illiquid common and preferred stock and, to a lesser degree, subordinated and senior debt of companies that are in most instances privately held. The APFC has hired external advisors to select private equity holdings diversified by geography and strategy. Private equity is funded slowly over time as opportunities are identified by the external advisors and the underlying fund managers. The underlying private equity funds provide the Fund with fair value estimates of the investments utilizing the most current information available. In addition, the external advisors review the fair value estimates, and the underlying private equity funds undergo annual independent audits. Private equity investments by their nature generally have no readily determinable fair value, and the estimated fair values may differ significantly from values that would be obtained in a market transaction for the assets. During FY2018 it was determined that eight private equity funds were impaired and would not recover their carrying cost over the remaining estimated holding period of the assets. In order to reflect the impairment in statutory net income and fund balance classifications, \$25.7 million of unrealized losses were realized through a write-down of cost to fair value. In FY2017, nine private equity funds were impaired with a related write-down of \$26.4 million. These impairments have no impact on the carrying value of investments or on the net increase (decrease) in the fair value of private equity investments.

Infrastructure investments involve ownership or operating agreements in essential long-term service assets with high barriers to entry. Examples of infrastructure assets include: toll roads; airports; deep water ports; communication towers; and energy generation, storage and transmission facilities. Investments in this asset class are expected to have inflation protection attributes and exhibit low correlations with other major asset classes in the Fund's investment strategy. The Fund holds infrastructure investments through commingled funds organized as limited partnerships whose investment managers provide periodic fair value estimates, as well as through securities listed on public exchanges. The limited partnerships undergo annual independent audits. Infrastructure investments by their nature generally have no readily determinable fair value, and the estimated fair values may differ significantly from values that would be obtained in a market transaction for the assets. During FY2018 and FY2017 it was determined that no infrastructure funds were impaired.

The Fund invests in private credit through limited partnerships that invest either directly in distressed or mezzanine debt, or in commingled limited liability funds with a distressed debt or credit opportunity focus. These investments are funded over time, as opportunities arise. The limited partnerships and funds undergo annual independent audits. Private credit investments by their nature generally have no readily determinable fair value, and the estimated fair values may differ significantly from values that would be obtained in a market transaction for the assets.

Alternative investments at June 30 are summarized as follows:

2018	Cost	Fair value	Unrealized holding gains
Absolute return	4,543,075,000	5,288,072,000	744,997,000
Private equity	5,423,697,000	7,198,347,000	1,774,650,000
Infrastructure	2,453,999,000	3,035,277,000	581,278,000
Private credit	1,251,673,000	1,311,423,000	59,750,000
Total alternative investments	\$ 13,672,444,000	16,833,119,000	3,160,675,000
2017			
Absolute return	3,935,373,000	4,567,024,000	631,651,000
Private equity	5,211,043,000	6,818,147,000	1,607,104,000
Infrastructure	1,963,488,000	2,458,345,000	494,857,000
Private credit	995,381,000	1,111,752,000	116,371,000
Total alternative investments	\$ 12,105,285,000	14,955,268,000	2,849,983,000

As of June 30, 2018, the APFC, on behalf of the Fund, had outstanding future funding commitments of \$4.1 billion for private equity, \$1.5 billion for infrastructure, and \$1.7 billion for private credit investments. Many alternative investments have liquidity constraints and may not be available for cash withdrawal until a specified period of time has elapsed.

12. SECURITIES LENDING

State regulations at 15 AAC 137.510 and APFC investment policy authorize the APFC to enter into securities lending transactions on behalf of the Fund. Through a contract with the Bank of New York Mellon (the Bank), the Fund lends marketable debt and equity securities to borrowers who are banks and broker-dealers. The loans are collateralized with cash or certain marketable securities. Under APFC's contract with the Bank, the Bank must mark the loaned securities and collateral to the market daily, and the loan agreements require the borrowers to maintain the collateral at not less than 102 percent of the fair value of the loaned securities for domestic securities (and non-domestic loaned securities denominated in U.S. dollars) and not less than 105 percent of the fair value for other non-domestic loaned securities. The APFC can sell securities that are on loan. If a borrower fails to return the loaned securities (borrower default), the Bank can use cash collateral (and the proceeds on the sale of any non-cash collateral) to purchase replacement securities. Generally, the APFC is protected from credit risk associated with the lending transactions through indemnification by the Bank against losses resulting from counterparty failure, the reinvestment of cash collateral, default on collateral investments, or a borrower's failure to return loaned securities.

Cash collateral received for loaned securities is reported on the Fund's balance sheets and invested by the Bank on behalf of the Fund. As of June 30, 2018, such investments were in overnight repurchase agreements that had a weighted-average-maturity of one day. The average term of the loans was also one day. At June 30, the value of securities on loan is as follows:

	2018	2017
Fair value of securities on loan, secured by cash collateral	\$ 1,962,327,000	1,282,709,000
Cash collateral	2,011,760,000	1,314,953,000
Fair value of securities on loan, secured by non-cash collateral	4,032,717,000	4,977,243,000
Non-cash collateral	\$ 4,452,279,000	5,397,734,000

The Fund receives 80 percent of earnings derived from securities lending transactions, and the Bank retains 20 percent. During the years ended June 30, 2018 and 2017, the Fund incurred no losses from securities lending transactions. The Fund received income of \$26,285,000 and \$17,889,000 from securities lending for the years ended June 30, 2018 and 2017, respectively, which is recorded in real estate and other income on the statements of revenues, expenditures and changes in fund balances.

13. ACCOUNTS PAYABLE

Accounts payable include trades entered into on or before June 30 that settle after fiscal year end. Cash held for trade settlements is included in cash and short-term investments. Accounts payable at June 30 are summarized as follows:

	2018	2017
Accrued liabilities	\$ 27,065,000	29,423,000
Securities purchased	694,762,000	669,757,000
Total accounts payable	\$ 721,827,000	699,180,000

14. INCOME DISTRIBUTABLE TO THE STATE OF ALASKA

The Legislature appropriates portions of the Fund's statutory net income to the Permanent Fund Dividend Fund (Dividend Fund), a sub-fund of the State's general fund created in accordance with Alaska Statute 43.23.045 and administered by the Alaska Department of Revenue. The Dividend Fund is used primarily for the payment of dividends to qualified Alaska residents. In addition, the Legislature has appropriated a portion of the dividend distribution to fund various other agency activities. During the year ended June 30, 2017, the legislative appropriation directed the timing of funding for the Dividend Fund to be from the next fiscal year (i.e. an appropriation from the year ending June 30, 2018), so there was no income distributable from the year ended June 30, 2017. In FY2018 \$725,950,000 was transferred to the Dividend Fund on September 7, 2017. Per statute, realized earnings on the principal balance of the dedicated State revenues from the North Slope royalty case settlements (*State v. Amerada Hess, et al.*) have been appropriated from the Fund to the Alaska Capital Income Fund (ACIF) established under Alaska Statute 37.05.565. Funds in the ACIF may be further appropriated for any public purpose. During years with net realized losses, no funds are transferred to the ACIF. Income distributable to the State at June 30 is summarized as follows:

	2018	2017
Dividends	\$ 688,409,000	—
Appropriation to the Departments of:		
Health and Social Services	17,725,000	—
Revenue	8,323,000	—
Corrections	11,493,000	—
Total to Dividend Fund	725,950,000	—
Alaska Capital Income Fund	43,395,000	25,067,000
Total income distributable	\$ 769,345,000	25,067,000

15. FUND BALANCES

Fund balance activity during the years ended June 30 is summarized as follows:

	2018	2017
Nonspendable		
Balance, beginning of year	\$ 46,969,593,000	44,199,667,000
Dedicated State revenues	353,096,000	364,893,000
Inflation proofing transfer from assigned fund balance	—	—
Change in unrealized appreciation on invested assets	(1,292,697,000)	2,405,033,000
Balance, end of year	\$ 46,029,992,000	46,969,593,000
Committed		
Balance, beginning of year	—	—
General Fund Commitment	2,722,654,000	—
Current fiscal year inflation proofing	—	—
Current fiscal year AK Capital Income Fund	—	—
Balance, end of year	2,722,654,000	—
Assigned		
Balance, beginning of year	\$ 12,815,504,000	8,570,020,000
Inflation proofing transfer to nonspendable fund balance	—	—
Dividends paid or payable to the Permanent Fund Dividend Fund	—	—
Settlement earnings payable to the ACIF	(43,395,000)	(25,067,000)
Realized earnings, net of operating expenditures	6,367,840,000	3,239,255,000
Change in unrealized appreciation on invested assets	(2,998,250,000)	1,031,296,000
Balance, end of year	\$ 16,141,699,000	12,815,504,000
Total		
Balance, beginning of year	\$ 59,785,096,000	52,769,686,000
Dedicated State revenues	353,096,000	364,893,000
Dividends paid or payable to the Permanent Fund Dividend Fund	(725,950,000)	—
Settlement earnings payable to the ACIF	(43,395,000)	(25,067,000)
Excess of investment revenues over expenditures	5,525,498,000	6,675,584,000
Balance, end of year	\$ 64,894,345,000	59,785,096,000

The composition of the contributions and appropriations in the nonspendable fund balance at June 30 is shown as follows:

	2018	2017
Dedicated State revenues	\$ 16,892,308,000	16,539,212,000
Special appropriations	6,885,906,000	6,885,906,000
Inflation proofing	16,236,269,000	16,236,269,000
Settlement earnings	152,911,000	152,911,000
Total contributions and appropriations	\$ 40,167,394,000	39,814,298,000

On June 16, 2009, the Alaska Attorney General issued a legal opinion clarifying the accounting treatment of unrealized gains and losses. Based on the opinion, proportionate values of the unrealized appreciation or depreciation of invested assets should be allocated to nonspendable fund balances and assigned fund balances. As of June 30, 2018, the Fund's net unrealized gain was \$8,265,251,000, of which \$5,862,598,000 was allocated to the nonspendable fund balance and \$2,402,653,000 was allocated to the assigned fund balance. As of June 30, 2017, the Fund's net unrealized gain was \$9,107,593,000, of which \$7,155,294,000 was allocated to the nonspendable fund balance and \$1,952,299,000 was allocated to the assigned fund balance.

During the fiscal years 1990 through 1999, the Fund received dedicated State revenues from North Slope royalty case settlements (*State v. Amerada Hess, et al.*). Accumulated settlement related activity, included in the contributions and appropriations balance of the Fund at June 30, is \$424,399,000. By statute, realized earnings from these settlement payments are to be treated in the same manner as other Fund income, except that these settlement earnings are excluded from the dividend calculation and are not subject to inflation proofing. Since 2005, the Legislature has appropriated these settlement earnings to the Alaska Capital Income Fund (ACIF). Prior to 2005, the statute required such earnings to be appropriated to Fund principal. The Fund realized earnings on settlement principal of \$43,395,000 during FY2018 and \$25,067,000 during FY2017.

16. FAIR VALUE MEASUREMENT

Various inputs are used in valuing the investments held by the Fund. GAAP establishes a hierarchy of inputs used to value investments emphasizing observable inputs and minimizing unobservable inputs. These input levels are summarized as follows:

Level 1 – Quoted prices for identical assets in an active market

Level 2 – Inputs, other than quoted prices, that are observable for the asset, either directly or indirectly

Level 3 – Unobservable inputs. Unobservable inputs should only be used to the extent that observable inputs are not available for a particular asset.

Investments measured using net asset value (NAV) per share as a practical expedient to fair value are not categorized into input levels. The input levels used to measure the Fund's investments and derivative instruments at June 30 are summarized as follows:

2018	Measured using input levels			Measured using	
	Level 1	Level 2	Level 3	NAV	Total
Marketable debt securities	\$ 2,316,765,000	9,229,855,000	—	—	11,546,620,000
Preferred and common stock	26,248,730,000	—	—	—	26,248,730,000
Real estate	1,354,428,000	—	—	4,106,511,000	5,460,939,000
Absolute return	765,039,000	1,677,382,000	43,971,000	2,801,680,000	5,288,072,000
Private equity	—	—	—	7,198,347,000	7,198,347,000
Infrastructure	640,754,000	—	—	2,394,523,000	3,035,277,000
Private credit	—	—	—	1,311,423,000	1,311,423,000
Total investments	\$ 31,325,716,000	10,907,237,000	43,971,000	17,812,484,000	60,089,408,000

2017	Measured using input levels			Measured using	
	Level 1	Level 2	Level 3	NAV	Total
Marketable debt securities	\$ 2,868,376,000	7,246,264,000	—	—	10,114,640,000
Preferred and common stock	25,354,335,000	—	—	—	25,354,335,000
Real estate	1,210,334,000	—	—	5,676,501,000	6,886,835,000
Absolute return	713,610,000	1,599,809,000	65,796,000	2,187,809,000	4,567,024,000
Private equity	—	—	—	6,818,147,000	6,818,147,000
Infrastructure	557,439,000	—	—	1,900,906,000	2,458,345,000
Private credit	—	—	—	1,111,752,000	1,111,752,000
Total investments	\$ 30,704,094,000	8,846,073,000	65,796,000	17,695,115,000	57,311,078,000

Marketable debt securities and preferred and common stock classified as level 1 are valued using prices quoted in active markets for those securities. Debt securities classified as level 2 are valued using matrix pricing. Pricing is sourced from various sources.

Publicly traded real estate investment trusts are valued using prices quoted in active markets and are reported as level 1. Directly owned real estate through ownership of interests in corporations, limited liability companies, and partnerships that hold title to real estate are reported at the NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions. Directly owned real estate investments are subject to annual appraisals and audits. American Homes 4 Rent II is reported at the NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions, and does not allow redemptions until the company is wound-up and dissolved.

Absolute return investments are reported at the NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions. Former External Chief Investment Officer (ECIO) investments are now grouped with Absolute return investments. These investments have readily determinable fair values and are therefore reported by level. Level 2 valuations are a result of liquidity terms as well as the pricing transparency of the investments held. Level 3 valuations are provided by managers and audited by third party auditing firms. Absolute return investments undergo annual independent financial statement audits. The redemption notice period is from 1-91 days and the frequency of redemption is daily to quarterly.

Private credit investments are reported at NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions. Private credit investments undergo annual independent financial statement audits. Redemptions are not allowed and the usual life of these investments is 5-7 years.

Private equity investments are reported at the NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions. Private equity investments undergo annual independent financial statement audits. Redemptions are not allowed and the usual life of these investments is 10-12 years.

Publicly traded infrastructure investments are classified as level 1 and are valued using prices quoted in active markets for those securities. The majority of infrastructure investments are reported at the NAV of the capital account balance nearest to the balance sheet date, adjusted for subsequent contributions and distributions. Infrastructure investments undergo annual independent financial statement audits. Redemptions are not allowed and the usual life of these investments is 5-7 years.

17. STATUTORY NET INCOME

By Alaska law, statutory net income is computed in accordance with U.S. generally accepted accounting principles (GAAP), excluding settlement income from the North Slope royalty case (*State v. Amerada Hess, et al.*) and any unrealized gains or losses. However, the excess of revenues over expenditures is required by GAAP to include unrealized gains and losses and income, regardless of source. Consequently, GAAP excess of revenues over expenditures and statutory net income differ.

The APFC periodically reviews investments for other than temporary impairment of value. Investments with fair values significantly less than costs over multiple reporting periods may be considered impaired if the cost basis will not be recovered over the investment's remaining estimated holding period. If an other-than-temporary impairment is determined to exist for an investment, a realized loss will be recorded which will replace the previously recorded unrealized loss. Carrying value will not be affected, but the reclassification of the loss from unrealized to realized will affect the statutory net income of the Fund. During FY2018, approximately \$26 million of impairments were recorded. During FY2017, approximately \$27 million of impairments were recorded.

Statutory net income for the years ended June 30 is calculated as follows:

	2018	2017
Excess of revenues over expenditures	\$ 5,525,498,000	6,675,584,000
Unrealized (gains) losses	842,343,000	(3,436,329,000)
Settlement earnings	(43,395,000)	(25,067,000)
Statutory net income	\$ 6,324,446,000	3,214,188,000

18. INVESTMENT INCOME BY SOURCE

Investment income during the years ended June 30 is summarized as follows:

	2018	2017
Interest		
Marketable debt securities	\$ 377,001,000	294,327,000
Short-term domestic and other	82,392,000	16,382,000
Total interest	\$ 459,393,000	310,709,000
Total dividends	\$ 640,620,000	563,012,000
Real estate and other income		
Directly owned real estate net rental income	\$ 225,651,000	187,562,000
Real estate investment trust dividends	61,753,000	31,764,000
Absolute return management expenses, net of dividend and interest income	22,150,000	7,902,000
Private credit interest income, net of fees	22,622,000	25,291,000
Infrastructure interest and dividend income, net of fees	80,929,000	60,207,000
Private equity dividend income, net of management expenses	39,344,000	33,627,000
Class action litigation income	1,361,000	8,026,000
Loaned securities, commission recapture and other income	26,685,000	25,967,000
Total real estate and other income	\$ 480,495,000	380,346,000

19. FOREIGN EXCHANGE CONTRACTS, FUTURES, AND OFF-BALANCE SHEET RISK

Certain APFC external investment managers enter into foreign currency forward exchange contracts (FX forward contracts) to buy and sell specified amounts of foreign currencies for the Fund at specified rates and future dates for the purpose of managing or optimizing foreign currency exposure. The maturity periods for outstanding contracts at June 30, 2018 ranged between one and 121 days.

The counterparties to the FX forward contracts consisted of a diversified group of financial institutions. The Fund is exposed to credit risk to the extent of non-performance by these counterparties. The Fund's market risk as of June 30, 2018 is limited to the difference between contractual rates and forward market rates determined at the end of the fiscal year.

Activity and balances related to FX forward contracts for fiscal year 2018 and 2017 are summarized as follows:

	2018	2017
Balances at June 30		
Face value of FX forward contracts	\$ 4,723,992,000	2,183,950,000
Net unrealized holding gains (losses) on FX forward contracts	21,230,000	(13,700,000)
Fair value of FX forward contracts	\$ 4,745,222,000	2,170,250,000
Activity for fiscal years ending June 30		
Change in unrealized holding gains	\$ (34,893,000)	(34,592,000)
Realized gains	22,027,000	29,193,000
Net (decrease) in fair value of FX forward contracts	\$ (12,866,000)	(5,399,000)

Certain APFC equity investment managers are permitted to trade in equity index futures for the Fund's account, and the internal fixed income management team trades U.S. Treasury index futures. Equity index futures are traded in both domestic and non-domestic markets based on an underlying stock exchange value. Equity and fixed income index futures are settled with cash for the net difference between the trade price and the settle price.

Activity and balances related to futures in equity accounts for fiscal year 2018 and 2017 is summarized as follows:

	2018	2017
Balances at June 30		
Face value of equity index futures	\$ 80,090,000	187,859,000
Net unrealized holding losses on futures	<u>(7,895,000)</u>	<u>(6,091,000)</u>
Fair value of equity index futures	<u>\$ 72,195,000</u>	<u>181,768,000</u>
Activity for fiscal years ending June 30		
Change in unrealized holding losses	\$ (4,996,000)	(4,997,000)
Realized gains	<u>58,998,000</u>	<u>59,009,000</u>
Net increase in fair value of equity index futures	<u>\$ 54,002,000</u>	<u>54,012,000</u>

Activity and balances related to futures in fixed income accounts for fiscal year 2018 and 2017 is summarized as follows:

	2018	2017
Balances at June 30		
Face value of U.S. Treasury index futures	\$ 2,177,855,000	(120,483,000)
Net unrealized holding (losses) on futures	<u>(42,512,000)</u>	<u>(1,664,000)</u>
Fair value of U.S. Treasury index futures	<u>\$ 2,135,343,000</u>	<u>(122,147,000)</u>
Activity for fiscal years ending June 30		
Change in unrealized holding gains	\$ 40,796,000	8,678,000
Realized gains	<u>16,961,000</u>	<u>9,138,000</u>
Net increase in fair value of U.S. Treasury index futures	<u>\$ 57,757,000</u>	<u>17,816,000</u>

The face value of FX forward contracts and futures shown in these schedules is not required to be included in the Fund's balance sheets. All other balance and activity amounts shown above are included in the Fund's financial statements within the net increase in fair value of investments on the Statement of Revenues, Expenditures and Changes in Fund Balances.

20. EXPENDITURES

Fund expenditures for the years ended June 30 are summarized as follows:

	2018	2017
APFC operating expenditures		
Salaries and benefits	\$ 9,303,000	8,815,000
Communications and electronic services	3,848,000	3,959,000
Consulting fees	3,152,000	2,390,000
Training, supplies, services and other	503,000	634,000
Rent	501,000	490,000
Travel	589,000	413,000
Legal and audit fees	1,243,000	876,000
Property and equipment	203,000	294,000
Public information and subscriptions	119,000	141,000
Subtotal APFC operating expenditures	19,461,000	18,012,000
Investment management and custody fees		
Investment management fees	117,994,000	102,006,000
Custody and safekeeping fees	1,344,000	1,242,000
Subtotal investment management and custody fees	119,338,000	103,248,000
Total operating expenditures, investment management and custody fees	138,799,000	121,260,000
Other Legislative appropriations from corporate receipts		
Department of Natural Resources	5,956,000	5,897,000
Department of Law	1,117,000	2,587,000
Department of Revenue	86,000	94,000
Total other Legislative appropriations	7,159,000	8,578,000
Total expenditures	\$ 145,958,000	129,838,000

Through the appropriations and budget process, the Legislature allocates corporate receipts to other State departments to compensate these departments for work done on behalf of the Fund during the year.

21. PENSION PLANS

All APFC full-time, regular employees participate in the State of Alaska Public Employees Retirement System (PERS). PERS is a multiple-employer public employee retirement system established and administered by the State to provide pension and post-employment healthcare benefits to eligible retirees. The PERS financial report can be obtained from the State of Alaska's Retirement and Benefits website. Benefit and contribution provisions are established by state law and can be amended only by the Legislature.

PERS consists of Defined Contribution Retirement (PERS-DCR) and Defined Benefit Retirement (PERS-DBR) plans. Employees who entered the system on or after July 1, 2006 participate in the PERS-DCR plan. Employees who entered the system prior to July 1, 2006 participate in the PERS-DBR plan. PERS-DBR employees contribute 6.75 percent of their annual salaries to PERS and PERS-DCR members contribute 8 percent.

As an integrated cost sharing plan, the PERS system requires employers to pay a uniform contribution rate of 22 percent of eligible employee salaries for the benefit of PERS members. Total salaries subject to PERS for the years ended June 30, 2018 and 2017 amounted to \$6,400,000 and \$6,099,000, respectively.

In addition to the pension plan discussed above, all APFC employees and Trustees participate in the Alaska Supplemental Benefits System Supplemental Annuity Plan (SBS-AP). The SBS-AP is a multiple-employer defined contribution plan created pursuant to Internal Revenue Code section 401(a) to provide benefits in lieu of those provided by the Federal Social Security System. Each year, APFC employees and Trustees contribute 6.13 percent of salaries or honoraria, up to a specified maximum, to SBS-AP. The APFC contributes a matching 6.13 percent. Participants are eligible to withdraw from SBS-AP 60 days after termination of employment or service as a Trustee. Total salaries and honoraria for individuals subject to SBS-AP for the years ended June 30, 2018 and 2017 amounted to \$4,607,000 and \$4,514,000, respectively.

04e_Policy on Other Than Temporary Impairment Memorandum OCT242012



Alaska Permanent Fund Corporation

P. O. Box 115500 Juneau, AK 99811-5500

Tel: (907) 796-1500 Fax: (907) 586-2057

MEMORANDUM

TO: Michael J. Burns, CEO
FROM: Julie Hamilton, CFO
DATE: October 24, 2012
SUBJECT: Policy on Other than Temporary Impairment

Investments will be reviewed annually for other than temporary impairment status. If it is determined that over the remaining holding period of the asset the cost basis will not be recovered, then a loss will be realized on the APFC's books equal to the difference between the estimated current fair value and the cost basis (book value) of that asset.

Real Estate:

If the estimated current fair value of a real estate asset is equal to or less than 75% of its book value for the current and prior two fiscal years ended June 30, an undiscounted cash flow (CF) projection for the estimated remaining holding period will be requested from the RE advisor. If the CF shows that cost will not be recovered, then a loss will be realized.

Private Assets (other than Real Estate):

If the estimated current fair value of a private asset (other than a real estate asset) is equal to or less than 80% of its book value for the current and prior fiscal years ended June 30, and the APFC has held the asset for at least three years, then the advisor will be contacted to assess the holding period and potential for recovery of cost. If the remaining holding period is relatively short (approximately five years or less), and the advisor has no definitive reason why the asset should not be impaired, then a loss will be realized. Investment asset reports may also be reviewed for references to estimated holding periods and possible cost recovery. If a cash flow analysis is available for the asset, then it can be used for the impairment decision-making process in addition to the advisor's professional judgment.

Public Assets:

If a circumstance arises for a publicly traded investment which points toward possible impairment of the asset (e.g. bankruptcy of a bond issuer), APFC staff should consult with the investment manager holding the asset, as well as experts at the custodian bank to analyze the holding period and potential recovery in value. If impairment is determined to have occurred, APFC will work with the custodian bank to realize a loss on the asset, which will flow through to APFC's books.

cc: