MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION BOARD MEETING AGENDA
MARCH 20, 2013 – 8:30 A.M.

ROLL CALL (8:30 a.m.)

PUBLIC COMMENT (Estimated Time 5 min.)

Members of the public are welcome to address the board on subjects within the jurisdiction of the Board of Retirement regarding items both on and off the agenda. The board is prohibited by law from taking action on matters not on the agenda, but may ask questions to clarify the speaker's comment and/or briefly answer questions. The board limits testimony on matters not on the agenda to 5 minutes per person and not more than 10 minutes for a particular subject at the discretion of the Chair of the Board. To best facilitate public expression please complete the speaker form available at the entrance to the boardroom and present to the Clerk to the Board. If you wish to submit written comments please provide 13 copies to the Clerk to the Board prior to the start of the meeting. Public speakers are reminded to announce their names before they address the board.

1) APPROVAL OF THE MINUTES OF THE BOARD MEETING HELD FEBRUARY 20, 2013 (Estimated Time 5 min.)

2) DISCUSSION AND POSSIBLE ACTION REGARDING ACTUARIAL FUNDING POLICY, THE SEGAL COMPANY (Estimated Time 90 min.)

BREAK (Estimated Time 10 min.)

3) BENEFITS AND OPERATIONS (Estimated Time 20 min.)

- **Report on Active Membership and Retirements as of February 28, 2013**
  Active Members = 1037 Retired Members = 1259 Retired Deceased = 2
  New Members = 22 Terminations = 18 Withdrawn Not Vested = 1 $153.27
  Withdrawn Vested = 1 $38,584.03
- **Retirement Benefits Presentation on the Calculation of a Member's Retirement Benefits**

4) AUDIT AND BUDGET COMMITTEE REPORT (Estimated Time 20 min.)
- Audit and Budget Committee Agenda for March 12, 2013
- Audit and Budget Committee Minutes for January 28, 2013
- Discussion and possible direction regarding the Comprehensive Annual Financial Report, CAFR, for the year ended June 30, 2012.

5) DISCUSSION AND POSSIBLE ACTION REGARDING ADOPTION OF CHARTERS AND POLICIES (Estimated Time 45 min.)
- Adoption of Retirement Board Charter
- Adoption of Retirement Administrator Charter
- Adoption of Assessment and Determination of Compensation Enhancements Policy
- Re-adoption of Overpayment Policy

6) DISCUSSION AND UPDATE ON STRATEGIC PLAN (Estimated Time 10 min.)
- Discussion and possible direction on implementation of goals and objectives progress report.

7) MONTHLY FINANCIAL REPORT (Estimated Time 10 min.)
- Financial Reports for January 2013

LUNCH RECESS (Approximately 12:05 noon)

RECONVENE (Approximately 1:05 p.m.)

8) MONTHLY INVESTMENT REPORT (Estimated Time 10 min.)
- Investment Goal Statement
- Monthly Investment Reports
- Investment Manager Information
- MCERA Trust Fund Performance Information

9) RETIREMENT ADMINISTRATOR'S REPORT (Estimated Time 20 min.)
- Meetings Attended
- PEPRA Update
- Error Correction Project Update
- FPPC Form 700 Filing Deadline Reminder
- Future Meeting Attendance
- IRS Voluntary Correction Program Update

10) CLOSED SESSION (Estimated Time 20 min.)
- Pending disability applications update
- Potential Litigation pursuant to Government Code Section 54956.9(d)(4) - 1 case – Craig Lindburg overpayment

REPORT OUT FROM CLOSED SESSION (Estimated Time 5 min.)

11) COMMUNICATIONS (Estimated Time 5 min.)

12) GENERAL BOARD MEMBER DISCUSSION (Estimated Time 5 min.)

ADJOURNMENT (Approximate Time 2:05 p.m.)

(Pursuant to Government Code Section 54954, this agenda was posted 72 hours prior to the meeting.)

♦MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION♦
BOARD OF RETIREMENT MEETING MINUTES
♦FEBRUARY 20, 2013 AT 8:30 A.M.♦

CALL TO ORDER

Shari Schapmire, Board Chair, called the meeting to order at 8:32 a.m.

ROLL CALL

Roll call was conducted with the following members present: Shari Schapmire, Lloyd Weer, Ted Stephens, Tim Knudsen, Supervisor John McCowen, Randy Goodman, Richard Shoemaker, John Sakowicz, Bob Mirata. Members absent: Craig Walker. Also present: Rich White, Retirement Administrator, Jeff Berk, Legal Counsel, Judy Zeller, Board Clerk, Greg Ungerman and Greg DeForrest, Callan Associates.

PUBLIC COMMENT: None

Supervisor McCowen requested the Board to consider amendments to the Audit and Budget Committee Charter and the Budget Adoption policy before approval. Copies of suggested changes were distributed by Judy Zeller for the Board to review and agenda item 8 was discussed prior to agenda item 6.

1) APPROVAL OF THE MINUTES OF THE BOARD MEETING HELD JANUARY 16, 2013
Upon motion by Supervisor McCowen, seconded by Mr. Goodman; IT IS ORDERED that the minutes of the JANUARY 16, 2013 Board meeting are approved as amended by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 1.

2) INVESTMENT REPORT

- **Quarterly Performance Report, Callan Associates**

Please visit www.co.mendocino.ca.us/retirement/reports.htm for the Investment Measurement Service Quarterly Review Dec 31, 2012.

Presenter/s: Greg DeForrest and Greg Ungerman, Callan Associates, referenced the quarterly performance report previously distributed to the Board highlighting certain aspects of their report and addressing the changes due to rebalancing of investments. New investment will continue to change due to the recent decision to invest with Black Rock as additional sales will need to be accomplished in order to fund this investment during this quarter. Overall MCERA did well for the quarter with a total return of 2.78% and total return for the year at 14.53%, which is 1.5% above our benchmark. The Board asked questions regarding Active vs. Passive mangers, Fixed Income and Equity.

Craig Walker entered the meeting at 8:50 a.m.

Andy Yeung, The Segal Company, entered the meeting at 9:30 a.m. Crystal Ekanayake, Gallina LLP, joined the meeting via telephone conference call at 9:40 a.m.

3) DISCUSSION AND POSSIBLE ACTION REGARDING THE JUNE 30, 2012 INDEPENDENT AUDIT REPORT, GALLINA LLP

Please visit www.co.mendocino.ca.us/retirement/reports.htm for the Financial Statements and Supplementary Information for the year ended June 30, 2012.

Presenter/s: Crystal Ekanayake, Gallina LLP, referenced the June 30, 2012 Independent Audit Report previously distributed to the Board. Mr. White referenced an Audit and Budget Committee recommendation to amend page 6 of the report by adding a sentence to the last paragraph as follows: These returns include periods during which MCERA recognized and posted excess earnings to the pension fund that were used to provide retiree health benefits.

Board members participated in a thorough review of the draft report. Mr. Sakowicz, Supervisor McCowen, and Mr. Stephens were prepared with many questions and comments. There was good dialogue between all participants resulting in amendments to the report.

Board Direction: The report will be amended by the following: A sentence will be added to the last paragraph on page 6, page 13 will include heading change to market and credit risk; Real Estate-property on page 9 will be described as 625 Kings Court, Ukiah, CA and in note 3 on page 16; page 10 will list the distribution of employee and employer contributions by normal cost and UAAL; note 1 on page 12 will state that payments were previously made from a special reserve; note 7 on page 23 will include $9.6 million as the amount of posted excess earnings and the reference to market value will be changed to fair value; page 24 will include explanation of the 6/30/10 91% percentage contributed; page 4 will include the percentage of administrative expense of the .21% actuarial accrued liability.

Staff will verify date of action to hold remaining funds while participating in VCP and the date of County Counsel Opinion regarding ultimate responsibility for the retiree health plan.

Board Action: Motion was made by Mr. Sakowicz to approve the June 30, 2012 Independent Audit Report with the proposed changes, with the approval of tax counsel. Mr. Walker seconded the motion and it was approved by the following vote: Ayes 9 Noes 0 Abstain 0 Absent 0. (Motion approved) (Tax counsel, Hanson Bridgett, agreed with the inclusion of the amount of posted excess earnings.)

BREAK (10:55 a.m.)

4) DISCUSSION AND POSSIBLE ACTION REGARDING THE JUNE 30, 2012 ACTUARIAL VALUATION, THE SEGAL COMPANY

Please visit www.co.mendocino.ca.us/retirement/reports.htm for the Actuarial Valuation and Review as of June 30, 2012.

Presenter/s: Andy Yeung, The Segal Company, referenced the June 30, 2012 Actuarial Valuation Report previously distributed to the Board briefly recapping areas which had been previously discussed. After adoption all employee tiers and rates, including PEPRA, will be included in future valuation reports. This valuation report and the PEPRA Tier rates for 2013/14 will be presented to the Board of Supervisors on Tuesday February 26, 2013.

Mr. Knudsen asked about future employer rates when we will know that they are paid at 100%. Mr. Yeung stated that using their methodology they would only report employer contributions at 100%, unless a sponsor could not afford the approved contributions and requests approval to pay less or if a sponsor makes a large overpayment for some reason.

Supervisor McCowen asked about the process of valuation adoption by the Board of Retirement and then by the Board of Supervisors to clarify his understanding. The Board felt that County Counsel should provide information to the Board of Supervisors on this process to ensure a good understanding.

Board Action: Motion was made by Mr. Mirata to approve June 30, 2012 Actuarial Valuation Report. Mr. Knudsen seconded the motion and it was approved by the following vote: Ayes 9 Noes 0 Abstain 0 Absent 0. (Motion approved)

5) DISCUSSION AND POSSIBLE ACTION REGARDING THE APRIL 1, 2013 COST OF LIVING ADJUSTMENT (COLA), THE SEGAL COMPANY

Presenter/s: Rich White and Andy Yeung, The Segal Company, referenced information previously distributed to the Board. Mr. Yeung mentioned that the Board does not have an option regarding approval of the cost of living adjustment as it is a fixture of the plan. PEPRA tiers will not have a cost of living increase.

Board Action: Motion was made by Mr. Mirata to approve the Cost of Living Adjustments (COLA) as calculated by the Segal Company as of April 1, 2013. Supervisor McCowen seconded the motion and it was approved by the following vote: Ayes 9 Noes 0 Abstain 0 Absent 0. (Motion approved)

6) MONTHLY FINANCIAL REPORT
- **Financial Statements**
- **Discussion and Possible Action regarding MCERA Staff Training Plan, Budget Item**
- **CALAPRS 2013 Leadership Academy**

Presenter/s: Rich White referenced financial statements previously distributed to the Board. Mr. Knudsen asked about the plan net assets and the change due to rebalancing which was noted in the Unrealized Gain/(Loss) Investments. Mr. Stephens added that accounting services must be brought back to the Board for further discussion when we begin planning our budget.

Mr. White discussed the Staff Training Plan with the Board and the proposed budget for this training. Mr. Goodman asked whether there was a certificate program available for staff training. Mr. White agreed that there is a program available through CEBS that could be an option.

Board Direction: An online certificate program will be sought for staff training, the budget for the Staff Training Plan will be increased from $5,000 to $15,000, and the Retirement Administrator will decide which trainings staff will attend.

Board Action: Motion was made by Mr. Stephens to approve the Staff Training Plan as amended with a budget increase to $15,000. Mr. Weer seconded the motion and it was approved by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 1. (Motion approved)

Supervisor McCowen left the meeting and did not participate in voting on the Staff Training Plan.

7) DISCUSSION AND POSSIBLE ACTION REGARDING STRATEGIC PLAN
- **Review of Goals and Objectives**

Presenter/s: Rich White referenced the Board Strategic Plan Goals and Objectives timeline previously distributed to the Board highlighting items included in the timeline that have already started or that have planned implementation.

Board Action: Motion was made by Mr. Walker to approve the time line plan for the implementation of Board Strategic Plan Goals and Objectives. Mr. McCowen seconded the motion and it was approved unanimously. (Motion approved)

8) AUDIT AND BUDGET COMMITTEE REPORT
- **Discussion and Direction to Staff regarding Preparation of Reports**
- **Discussion and Possible Action regarding Audit and Budget Committee Charter**
- **Discussion and Possible Action regarding Budget Adoption Policy**

Presenter/s: Rich White referenced information previously distributed to the Board. He proposed a change to the timing and completion of our valuation and independent audit reports and mentioned that our service providers approve of this change. This would allow the latest approved actuarial valuation from the previous period to be used in the completion of the current fiscal year financial statements. Mr. Stephens stated that as an Audit and Budget Committee member he does not support this. The proposed change would allow old data to be used in our reports which would not be accurate. As the Audit and Budget Committee continues to be formed and meet, he hopes that the current report process will become more efficient.

Board Direction: Staff will allow the Budget and Audit Committee to address this item and the reporting process at a future meeting.

Mr. White discussed the Audit and Budget Committee Charter with the Board and suggested changes proposed by Supervisor McCowen. Mr. Stephens liked the fact that committee members would increase to four. Committee meetings will be noticed as a public meeting and will require an agenda and minutes.

Board Direction: The charter will be amended as follows: Introduction 2. will include the annual financial audit and budget; Introduction 3. will change to four members of the Board to the; item 4. will be deleted; Duties and Responsibilities 1a. will delete approve and replace with recommend to the Board for approval; Duties and Responsibilities 1f. will include or recruitment; Duties and Responsibilities 1h. will delete and approve; Monitoring and Reporting 1c. will delete to the Board of Retirement on its activities and will add and make recommendations as deemed appropriate.

Board Action: Motion was made by Mr. Mirata to approve the Audit and Budget Committee Charter as amended. Mr. Sakowicz seconded the motion and it was approved unanimously. (Motion approved)

Chair Schapmire asked Mr. Stephens and Mr. Weer to continue as committee members. She then appointed Mr. Goodman and Mr. Mirata to the committee and asked Mr. Weer to act as Chair per the adopted charter.

Mr. White discussed the Budget Adoption Policy and the suggested changes proposed by Supervisor McCowen. Questions were asked regarding administrative authority to move funds within a category in the budget. The Board wanted to limit this ability not to exceed $10,000 within a category which is consistent with County policy. Mr. Weer requested an addition of a quarterly review to be presented by the retirement administrator.

Board Direction: The policy will be amended as follows: Background and Purpose 1. will delete or $2 million, whichever is greater and replace with ,unless authorized by a separate vote of the

Board.; Guidelines 1. will include review and recommendation by the Budget and Audit Committee during April and for adoption by the Board; 3. will be changed to read and shall be reported to the Board in a timely manner.; 4. will include not to exceed a limit of $10,000 and will be changed to read and shall be reported to the Board in a timely manner.; will add 6. The Retirement Administrator shall endeavor not to exceed expenditure levels specified in the approved or amended budget.; will add 7. The Retirement Administrator shall provide quarterly budget reports to the Board of Retirement.

Board Action: Motion was made by Mr. McCowen to approve the Budget adoption policy with the redline changes and the amendments listed in the above Board Direction. Mr. Sakowicz seconded the motion and it was approved unanimously. (Motion approved)

9) BENEFITS AND OPERATIONS

- **Membership as of January 31, 2013:**
  Active Members = 1015 Retired Members = 1253 Retired Deceased = 2
  New Members = 15 Terminations = 12 Withdrawn Not Vested = 5 $37,655.90
  Withdrawn Vested= 2 $25,040.52
- **Membership information staff report**

Presenter/s: Rich White and Judy Zeller referenced the above membership totals and provided a brief staff report on membership over the last 5 years.

10) RETIREMENT ADMINISTRATOR'S REPORT

- **Legislative Update**
- **PEPRA Update**
- **Tax Forms**
- **Public Records Request**
- **Scheduled Education Attendance**
- **VCP Update**

Presenter/s: Rich White referenced information previously distributed to the Board.

Legislative Update
(Provided by Julie Wyne, OCERS Assistant CEO, External & Legal Operations)
There are four bills related to PEPRA cleanup beginning with SB13 and SB24, both introduced December 3, 2012, SB54, introduced December 21, 2012, and AB 160, introduced January 22, 2013. Please visit www.co.mendocino.ca.us/retirement/meetings.htm to view the complete report.

PEPRA
The County disbanded the ad hoc PEPRA working group as most of the objectives have been completed. The PEPRA legislation website will now be maintained by the Retirement Association.

<u>**Tax Forms**</u>
Staff has produced and distributed the 1099s in January as required by law.
<u>**Public Record Request**</u>
Staff received and complied with a request for investment returns from 1996 to present from The Bay Citizen, a media group.
<u>**Determination Letter/Voluntary Compliance Program Filings**</u>
Our tax counsel, Hanson Bridgett, informed us that the IRS has communicated with them about the filings with the 37 Act systems and they expect review of the filings in the very near future.

LUNCH RECESS (12:00 noon)

RECONVENE (1:01 p.m.)

11) CLOSED SESSION

- **Pending disability applications update**
- **Public Employee Performance Evaluation - Retirement Administrator – Pursuant to Government Code Section 54957**
- **Potential Litigation pursuant to Government Code Section 54956.9(a) - 1 case – Martin Bradley vs Mendocino County Employees' Retirement Association**

Mr. Shoemaker left the meeting at 3:30 p.m.

REPORT OUT FROM CLOSED SESSION

An update on pending disability applications was provided and information was shared regarding the public employee performance evaluation.

Board Direction: Direction was given to staff to resolve the Bradley litigation matter by crediting interest in the amount of $8,825.36.

GENERAL BOARD MEMBER DISCUSSION

Mr. Sakowicz announced that his Friday radio show will host a speaker on public banking. This may seem unrelated to pension systems, but both Sonoma County and CalPERS are interested in this topic.

ADJOURNMENT (3:47 p.m.)

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date:	March 20, 2013
To:	Board of Retirement
From:	Richard White, Retirement Administrator RAW
Subject:	DISCUSSION AND POSSIBLE ACTION OF ACTUARIAL FUNDING POLICY

Summary:

Paul Angelo and Andy Yeung of The Segal Company will review current funding practices and possible modifications to the actuarial funding policy of MCERA. The Board of Retirement will consider action to incorporate these into a formalized policy document.

Staff Recommendation:

Adopt new MCERA statement of actuarial funding policy.

An alternative action for Board to consider would be to defer any action for a later time to allow for further discussions. The current written funding policy no longer fully reflects the current practice used by the Board in establishing the contribution rate requirements. A revision of the language in the policy to reflect MCERA's current practice with modifications to reflect emerging best practice is recommended. This review was delayed at the end of last year to await the implementation of the recent pension reform legislation which shortened an already narrow time frame ahead of the implementation of new GASB accounting standards reporting requirements.

Background:

The Segal Company provides actuarial services to the Retirement Association such as the annual actuarial valuation and the triennial actuarial experience study. Another aspect of their actuarial practice is a review of the funding policy elements utilized by MCERA.

This review incorporates MCERA's current funding policy elements and reviews those policies in light of emerging model actuarial practice and in consideration of recently adopted standards by the Governmental Accounting Standards Board (GASB) and the California Actuarial Advisory Panel. This type of review has been performed by The Segal Company for other public pension plan clients.

Discussion:

A pension plan funding policy is designed to determine how much should be contributed each year in total by the employer and the active members to provide for the secure funding of benefits in a systematic fashion.

The Segal Company prepared a letter which contains the discussion points to be considered by the Board of Retirement in the establishment of an actuarial funding policy which include:

- General Funding Policy Goals
- General Discussion of Pension Plan Funding Policies
  - Actuarial Cost Method
  - Asset smoothing method
  - Amortization policy

A desired outcome of this discussion is for the Board of Retirement to adopt a statement of funding policy which will be used to meet the new GASB reporting requirements which become effective for the Retirement Association for plan year 2013/2014 and fiscal year 2014/2015 for the employer.

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Attachments

RECEIVED BY

MAR 11 2013

The Mendocino County Employees' Retirement Association

SEGAL

THE SEGAL COMPANY
100 Montgomery Street Suite 500 San Francisco, CA 94104-4308
T 415.263.8283 F 415.263.8290 www.segalco.com

VIA E-MAIL AND USPS

COPY

March 7, 2013

Mr. Richard A. White
Retirement Administrator
Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

**Re: Mendocino County Employees' Retirement Association
Proposed Significant Provisions for a Statement of Actuarial Funding Policy**

Dear Richard:

We have prepared this discussion of the significant provisions that would comprise a statement of actuarial funding policy for MCERA. This review incorporates MCERA's current funding policy elements and reviews those policies in light of emerging model actuarial practice in this area. We have also included some alternative policy choices for the amortization component of the funding policy that may be considered by the Board for future actuarial valuations.

Another consideration in undertaking this funding policy review is that the Governmental Accounting Standards Board (GASB) recently adopted Statements 67 and 68 accounting reporting requirements for governmental pension plans and their sponsors[1] to identify the "actuarially determined (employer) contributions" determined using the funding policy adopted by the governing body. One of the by-products of this review is that MCERA will have a readily accessible comprehensive statement of funding policy to use in meeting the new GASB requirements. A sample statement of actuarial funding policy is provided in Attachment #3.

We note that a review of MCERA's current interest crediting policy is not included in this review of the actuarial funding policy, as that review will be provided under a separate cover later this year. As part of that review, we will discuss the Association's current practice of maintaining reserves and crediting of interest to those reserves using book value of assets. We

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1 Statement 67 replaces Statement 25 for use in reporting by the pension plan and Statement 68 replaces Statement 27 for use in reporting by the plan sponsor. In the case of MCERA, these new Statements will be effective for plan year 2013/2014 for the Retirement Association and fiscal year 2014/2015 for the employer.

will also discuss procedures recently adopted by other 1937 Act County Retirement Systems to keep track of shortfall in interest crediting, etc.

GENERAL FUNDING POLICY GOALS

This report starts with a general discussion of pension plan funding policy followed by detailed discussion of specific policy components along with various policy recommendations. This discussion is based on the following high level policy goals:

1. Future contributions and current plan assets should be sufficient to provide for all benefits expected to be paid to current active, inactive and retired members. This means that contributions should include the cost of current service plus a series of payments to fully fund (or recognize) any unfunded (or prefunded) past service costs.

2. The funding policy should seek a reasonable allocation of the cost of benefits to the years of service and the funding of such cost by the employer. This includes the goal that annual contributions should, at a minimum, maintain a close relationship to the cost of each year of service, and that the current service cost should bear a stable relationship to compensation.

3. The funding policy should seek to manage and control future employer contribution volatility to the extent reasonably possible, consistent with other policy goals.

4. The funding policy should support the general public policy goals of accountability and transparency. While these terms can be difficult to define in general, here the meaning includes that the funding policy should be clear both as to intent and effect, and that it should allow an assessment of whether, how and when the plan sponsor will meet the funding requirements of the plan.

Policy objectives 2 and 3 reflect two aspects of the general policy objective of "interperiod equity" (IPE). The "demographic matching" goal of policy objective 2 promotes ***intergenerational*** IPE, which seeks to have each generation of taxpayers incur the cost of benefits for the employees who provide services to those taxpayers, rather than deferring those costs to future taxpayers. The "volatility management" goal of policy objective 3 promotes ***period-to-period*** IPE, which seeks to have the cost incurred by taxpayers in any period compare equitably to the cost for just before and after.

GENERAL DISCUSSION OF PENSION PLAN FUNDING POLICIES

A pension plan funding policy is designed to determine how much should be contributed each year in total by the employer and the active members to provide for the secure funding of benefits in a systematic fashion. The funding policy starts with an actuarial cost method that allocates a portion of the total present value of the members' benefits to each year of service. In theory, contributing that "Normal Cost" for each year of service will be sufficient to fund all plan benefits, assuming that all actuarial assumptions are met including the assumed rate of investment return. In that ideal situation, plan assets will always be exactly equal to the value today of all the past Normal Costs less benefit payments (the Actuarial Accrued Liability or AAL), and the current contribution will be only the current Normal Cost.

In practice, for a variety of reasons, the assets will be greater than or less than the AAL, leaving the plan overfunded (i.e., with a surplus) or underfunded (i.e., with an Unfunded Actuarial Accrued Liability or UAAL). The funding policy adjusts contributions to reflect any surplus or UAAL in a way that reduces short term, year-by-year volatility, but still assures that future contributions, together with current assets, will be enough to provide all future benefits.

A comprehensive funding policy is generally made up of three components:

1. An **actuarial cost method,** which allocates the total present value of future benefits to each year (Normal Cost) including all past years (AAL).

2. An **asset smoothing method**, which reduces the effect of short term market volatility while still tracking the overall movement of the market value of plan assets.

3. An **amortization policy**, which determines the length of time and the structure of the payments for the contributions required to systematically pay off the plan's UAAL.

Each of these policy components is currently in effect for MCERA. The Entry Age Normal (EAN) actuarial cost method currently used by the Board is the industry standard for governmental defined benefit plans, and we recommend its continued use. We also are not recommending any change to the asset smoothing method that was adopted by the Board as of June 30, 2005 (with an expansion of the market value corridor to 25% that was adopted as of June 30, 2009). However, we are recommending a change in the current single layer amortization policy. Accordingly, the next sections briefly review all three policy components, including a detailed discussion of the amortization policy.

ACTUARIAL COST METHOD

The ultimate cost (ignoring expenses) for the plan is determined by the actual benefits paid from the plan, offset by actual investment income. Each year, an actuarial valuation is completed to develop the next year's annual contribution for the pension plan. The valuation uses a funding method to allocate the ultimate expected costs for active members to each year of service, and thus among past service, current service, and future service. The cost attributed to the current year of service is the plan's Normal Cost. The accumulated cost attributed to past service is the plan's AAL. The plan's annual contribution is the Normal Cost, plus an amount to fund or "amortize" the plan's UAAL.

Currently, the plan is funded using the Entry Age Normal (EAN) cost method. This method is considered a reasonable funding method under the Actuarial Standards of Practice and is the only acceptable funding method under the recently adopted Statements 67 and 68 accounting standards promulgated by GASB. This method produces individual Normal Costs that are determined as a level percentage of covered payroll over each member's career. The AAL is calculated on an individual basis and is based on each individual's past Normal Costs, allocated as a level percent of compensation. We would recommend that for funding purposes the Board continue the current EAN actuarial cost method.

ASSET SMOOTHING METHOD

We understand that the Board adopted a modification to the asset smoothing method as part of the June 30, 2005 valuation[2]. Under that modification, the difference between the actual market return and the expected return on the market value is recognized over a five-year period. The smoothed assets were further adjusted, if necessary, to be within 20% of the market value of assets (MVA). We understand that this market value corridor was expanded from 20% to 25% effective with the June 30, 2009 valuation.

The 5-year asset smoothing period currently used by the Board is still the industry standard and is by far the most common period used by public plans. That 5-year period, in our opinion, also meets the Actuarial Standards of Practice of being "sufficiently short," which allows the Board substantial flexibility in setting the MVA corridor, including no MVA corridor. For those reasons, we believe it is reasonable for the Board to continue the asset smoothing policy adopted in 2005, along with the corridor modification adopted in 2009.

One observation we have made is that a period of significant market change may be followed by a period of market correction. Depending on the magnitude of the market change and subsequent market correction, it may be advisable to perform an ad-hoc adjustment to change the pattern of the recognition of the deferred investment gains or losses. That was exactly what happened when we recommended that the Board combine the deferred investment gains as of June 30, 2011 and recognize those in level amounts over a 4-year period. We would recommend to the Board that the Statement of Funding Policy reserve to the Board the right to consider such future adjustments upon receiving the necessary analysis from its actuary. The funding policy could also describe in general terms the conditions that would typically lead to such an ad-hoc adjustment.

AMORTIZATION POLICY

General Discussions

With the exception that UAAL has to be amortized over a period not to exceed 30 years under Section 31453.5 of the 1937 CERL[3], governmental or public defined benefit plans, like MCERA, are not subject to specific external funding or funding policy requirements such as those established for single employer (corporate) and multiemployer (Taft-Hartley) defined

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2 Prior to the June 30, 2005 valuation, only realized and unrealized appreciations were subject to smoothing. Furthermore, all such amounts were smoothed irrespective of the difference between actual and expected market returns for the plan year.

3 Note that Section 7522.52 was recently enacted as part of the California Public Employees' Pension Reform Act (CalPEPRA) of 2013. Under that Section of the Act, a public pension plan has to have at least a 120% funded ratio, and meet other conditions, before any negative UAAL (or surplus) may be amortized and used to reduce the Normal Cost of the plan.

benefit pension plans under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC). The prior accounting standards promulgated by GASB under GASB Statements 25 and 27 define an Annual Required Contribution (ARC) that, despite its name, is actually the amount of expense that the employer must recognize each year. Also, the prior GASB accounting standards provide considerable policy latitude when determining the ARC[4].

Even though this leaves governmental or public plans relatively free to set funding policy, it is worth noting that all long term funding policy structures – corporate, multiemployer and GASB – take the same form, at least for underfunded plans (plans with a UAAL):

1. Contribute the Normal Cost for the year, and
2. Contribute an additional amount that will fully fund ("amortize") any UAAL over a period of years.

Implicit in this form of policy is *a funding target of 100 percent*, since at the end of the amortization period the plan will be fully funded. This is in contrast to "corridor" or "collar" methods that allow contributions equal to only the Normal Cost as long as the plan is within, for example, 10 percent of being fully funded. The funding policy presented in this discussion is based on the UAAL amortization method because it targets 100 percent funding of the AAL, and accordingly is well established for all types of pension plans.

For MCERA, the UAAL amortization period was reset to 30 years by the Board at the time of the June 30, 2009 valuation. Before that reset, the amortization period was down to 9 years as of June 30, 2008.

A general review of the UAAL amortization policy would include both the amortization periods and the structure of the amortization payments. A detailed discussion of the selection of the UAAL amortization period and structure is presented in the following sections. For now, we note only a distinction between the amortization of UAAL and the amortization of surplus.

For plans with a UAAL, longer amortization periods result in lower current contributions and a longer period before the contribution reverts to the Normal Cost. Longer periods also produce lower contribution volatility. In contrast, shorter amortization periods get to full funding more rapidly but at the price of higher current contributions and higher contribution volatility.

That leaves the question of funding policy for overfunded plans, those that have a surplus instead of a UAAL. The policy structure used by most public plans when determining

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4 As previously discussed, GASB has recently adopted Statements 67 and 68 that replace Statements 25 and 27 for accounting and financial reporting standards for governmental pension plans. The new Statements completely eliminate the linkage between actuarial funding and financial reporting found in the prior Statements. In this discussion, unless noted otherwise, all references to GASB standards relate to the prior standards, which were viewed as an authoritative guide to the range and limits of current funding policy practices used by most public plans before GASB adopted the new reporting standards.

contribution amounts when there is a surplus is that the surplus is amortized the same way as a UAAL, except that instead of producing an amortization *charge*, there is an amortization *credit*. This means that the contribution amount is the Normal Cost *minus* an amount that will in effect spend down the surplus over the amortization period.

Unlike for UAAL, longer amortization periods now result in a lower amortization credit, and so produce a higher current contribution (but still less than the Normal Cost). Shorter amortization periods for surplus take credit for the surplus more quickly. This produces a lower contribution, but it also means a shorter period before the contribution reverts up to the full Normal Cost.

While this policy structure still reflects a funding target of 100 percent, amortizing surplus results in an annual contribution that is less than the Normal Cost. This can lead to a full or partial "contribution holiday" where contributions are less than the regular, ongoing cost of current service, especially if the surplus amortization period is relatively short. Recent history has led to a reevaluation of this condition for public pension plans.

One of the most significant changes in industry thinking and practice to come from the market experience around the turn of the 21st century is the way surplus is recognized in public pension funding policy. In many cases, short amortization period for surplus in the late 1990s led to reductions in contributions below the level of Normal Cost, sometimes even to complete "contributions holidays" of zero contributions. As the market reversals in the early 2000s led to resumption of contributions in most pension plans, the general lesson was that a contribution level less than the Normal Cost (that is, funding the Normal Cost out of surplus) should always be viewed with caution, as ultimately the Normal Cost will reemerge as the basic cost of the plan.

Selection of Amortization Structure and Methods

Setting an amortization policy involves a few policy decisions and considerations in addition to selecting the amortization periods. Here is a brief description of those issues, followed by a detailed discussion of amortization periods. That discussion includes the current MCERA UAAL amortization policy elements and some possible alternatives that may be considered by the Board.

- Single amortization layer for the entire UAAL or surplus, or separate amortization layers for each source of UAAL or surplus.
- Closed (fixed) period amortization or open (rolling) period amortization.
- Level dollar or level percent of pay amortization payments.
- For separate amortization layers, when is it appropriate to "restart" or otherwise combine the amortization layers.

Single vs. Multiple Amortization Layers and Fixed vs. Rolling Amortization Periods

Historically many public pension systems (including MCERA) amortized their UAAL as a single amount. Because new amounts of UAAL arise each year (due to gains and losses, assumption changes and plan amendments) this requires a policy choice as to how to determine the remaining amortization period each year.

A "closed" or fixed period works like a home mortgage and so gets shorter each year. However, unlike a home mortgage, for a pension plan this eventually leads to an unstable situation where each year's gain or loss (or other UAAL changes) is amortized over a shorter and shorter period. Eventually the policy needs to be amended to restart the amortization period at something like its original period. This is the situation that arose at MCERA in 2009, when the single layer fixed amortization period was reset to 30 years.

To avoid this need to periodically revisit the policy, some systems use an "open" or rolling amortization period. This is analogous to refinancing your home mortgage each year, but including any new UAALs arising each year. While this is a stable policy, it also means that there is no date by which the UAAL is fully amortized, which raises questions of accountability and intergenerational equity.

To address both the stability and the accountability issues, many public systems have adopted the "layered" approach used by all corporate and multiemployer pension plans. Here each new amount of UAAL is amortized over a separate, fixed period. This approach also has the advantage of identifying the source of each dollar of current UAAL, as well as when each portion of UAAL will be fully amortized.

The current MCERA policy uses a single layer closed period amortization for all sources of UAAL. Under that approach, the entire UAAL is amortized over a single layer fixed amortization period, with 27 years remaining as of the June 30, 2012 valuation. This single layer approach does not provide information as to when each new separate portion of underfunding originated and how much of each such original amount of UAAL remains unamortized. It also lacks the flexibility to allow underfunding from different sources to be amortized over different periods of time. Finally, as occurred with MCERA in 2009, this policy needs to be reset periodically when the single, fixed remaining amortization period becomes too short to be practical.

All of those short comings can be addressed by using a multiple layers approach to amortizing the UAAL. We note that this is the structure required by the ERISA/IRC rules for corporate and multiemployer plans, and is increasingly common for public pension plans, especially in California.

Based on all of the information above, we recommend that a layered approach be adopted by MCERA for all future changes in UAAL.

Level Dollar vs. Level Percent of Pay Amortization

The amortization payments may be patterned in one of two ways, as a level dollar amount or as a level percentage of pay. The ERISA/IRC rules for corporate and multiemployer plans require level dollar amortization, similar to a typical home mortgage. However, by far most public plans use level percent of pay amortization where the payments increase each year in proportion to the assumed payroll growth for the entire active workforce. That means they start lower than the corresponding level dollar payments, but then increase until they are higher. The level dollar method is more conservative in that it funds the UAAL faster in the early years. For the same reason, it also incurs less interest cost over the amortization period.

The current MCERA policy uses level percent of pay amortization. The justification for using level percent of pay payments is that it is consistent with the Normal Cost (which for pay related plans like MCERA is almost always determined as a percentage of pay) and that it provides a total cost that remains level as a percentage of pay. In contrast, level dollar amortization of UAAL will produce a total cost that decreases as a percentage of pay over the amortization period. Note that both these results depend on actual payroll growth meeting the assumed payroll growth assumptions.

We are not recommending any change to MCERA's current use of level percent of pay amortization.

Negative Amortization

Another important aspect of level percent of pay amortization is that, unlike a level dollar amortization, under level percent of pay amortization the UAAL may increase during the early years of the amortization period even though contributions are being made to amortize the UAAL. This happens because with level percent of pay amortization, the lower early payments can actually be less than interest on the outstanding balance, so that the outstanding balance increases instead of decreases. For typical public plan assumptions (including MCERA), this happens whenever the amortization period is longer than about 18 years. This means that the outstanding balance of the UAAL does not decrease until there are 18 or fewer years left in the amortization period. It also means that the outstanding balance will not fall below the original amount until some years after that time.

A comparison of the contributions under different periods using level percent of payroll amortization is provided in Attachment 1. Attachment 2 shows the resulting UAAL balances for a sample starting UAAL layer of $1 million under various level percent of pay amortization periods. While there is nothing inherently wrong with negative amortization, the Board should be aware of its consequences, especially for amortization periods substantially longer than 18 years.

When is it Appropriate to "Restart" the Amortization Layers?

Segal would recommend to the Board that MCERA continue to amortize its current UAAL of \$126.5 million as of June 30, 2012 over a single fixed period but that any new increases or decreases in underfunding would be amortized over separate, multiple layers each with its own fixed amortization periods, as further discussed below.

Under this recommended approach, there will be a series of these layers, one for the original UAAL from the June 30, 2012 valuation and one from each year's gain or loss as well as from any other changes in the UAAL. This is a perfectly manageable procedure and in fact provides a history of sources of the plan's UAAL in any year. Also note that in practice the number of layers will be limited by the length of the amortization period as eventually layers are fully amortized, and so are no longer part of the series of layers.

Under the recommended amortization policy, there may be conditions where the Board would want to consider action whereby all the amortization layers are wiped out ("considered fully amortized") and the series is restarted. For example, this would very likely be appropriate when the plan goes from surplus to UAAL or from UAAL to surplus. This would be done to avoid possible anomalies that may appear unreasonable.

In particular, under the layered approach, it is possible for a plan with a UAAL to, nevertheless, have a net amortization credit in the current year. While that result is actuarially consistent, it is also very counterintuitive, since a UAAL would seem to require a net amortization charge. In this situation, the Board may want to consider combining all the UAAL layers and restarting the amortization.

The above is only one example of when the amortization layers might be restarted or combined. Another is when there are alternating years of gains and losses of relatively equal size. To address these situations as part of its funding policy, the Board should reserve the right to restart or otherwise combine the amortization layers whenever appropriate circumstances arise. In particular, we recommend that all amortization layers be restarted whenever the plan switches from an underfunded position to surplus or vice versa.

Amortization Periods

The UAAL amortization periods for public plans typically range from 15 to 30 years, with 30 years being the maximum allowable period under the prior GASB accounting standards. As discussed above under "General Funding Policy Goals," the amortization period should not be set so short that it creates too much volatility in the contributions yet it should not be so long that it constitutes a shift of cost to future funding sources. Balancing these two conflicting considerations is a key element of setting amortization periods. Another consideration is how much and in what circumstances negative amortization is an acceptable consequence of using longer amortization periods.

Plans that amortize the UAAL in layers by source sometimes use different amortization periods for different sources of UAAL. Generally such plans amortize actuarial gains or losses over shorter periods (15 to 20 years or less) and UAAL changes due to assumption or method changes and plan amendments over longer periods (often the 30-year prior GASB limit). We will discuss that further in the following sections.

Selection of Amortization Periods for Actuarial Gains or Losses

When selecting the gain or loss amortization period, a review of both historical practices and recent experience is instructive. For amortizing actuarial gains or losses, a 15-year amortization period has been used in the ERISA/IRC rules for multiemployer plans and also for corporate plans prior to the 1987 overhaul of the corporate pension funding rules. By the late 1990s, as plans came close to being fully funded or even overfunded there was a trend toward amortization periods as short as 10 or even 5 years. For example, in 1987, the ERISA/IRC rules for corporate plans were changed to reduce the amortization period for gains and losses from the original 15 years to 5 years. This led to rapid reductions in contributions when the large investment gains from that period were recognized over such short periods. The investment losses in the early 2000s led to similar cost increases except for public plans that lengthened their amortization periods substantially once those losses started to emerge.

Based on this experience, we recommend a balance between reducing contribution volatility by using a longer amortization period and maintaining a closer relationship between contributions and routine changes in the UAAL by using a shorter amortization period. Using a shorter amortization period also reduces or avoids negative amortization as previously discussed. Based on these three considerations we generally recommend gains and losses amortization periods in the range of 15 to 20 years.

Selection of Amortization Periods for Assumption or Method Changes

Assumption or method changes, such as a modification in the mortality assumption to anticipate an improvement in life expectancy for current active members when they retire, often include a long term remeasurement of plan costs and liabilities. For assumption changes, in effect, such changes take gains or losses that are expected to occur in the future and build them into the cost and liability measures today. For method changes, such changes fundamentally redetermine how costs are allocated to years of service for active members. In either case the long term nature of these changes could justify using a longer amortization period than that used for actuarial gains or losses, in the range of 20 to 25 years for assumption changes or even 30 years for method changes[5].

Selection of Amortization Periods for Plan Amendments

While some plans have used 30 years to amortize the UAAL from plan amendments, recent actuarial practice has evolved to use a much shorter period. As discussed above, amortization generally involves a balance between matching member demographics and managing

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[5] Note that the longer amortization for method changes would be most appropriate for substantial changes, such as going from Projected Unit Credit method to the Entry Age Normal (EAN) method. This is not a consideration for MCERA as the Association is already using the EAN method.

contribution volatility. However, for plan amendments, volatility control is not a consideration. That leads to the following arguments and considerations for using a short amortization period:

- Matching the amortization period to the average future working lifetime of the active members receiving the benefit improvement
- Matching the amortization period to the average life expectancy of the retired members receiving the benefit improvement
- Avoiding "negative amortization" for UAAL changes that are within the control of or result from actions taken by the plan sponsor
- Considering any special circumstances that may apply to a specific benefit improvement

The first two considerations would usually lead to at most a 15 to 20-year amortization period while the third consideration would limit the period to around 18 years or less. Accordingly, we would recommend that the Board consider a maximum amortization period for plan amendments of 15 years.

As an example of the fourth consideration, current practice clearly favors shorter amortization periods for Golden Handshakes or early retirement incentive type programs (ERIP) due to the relatively short period of expected financial impact. For example, a GFOA 2004 Recommended Practice states that "the incremental costs of an ERIP should be amortized over a short-term payback period, such as three to five years. This payback period should match the period in which the savings are realized". Recent comments to GASB by public plan actuaries are consistent with this view.

A demographically based amortization period for an ERIP could range from 0 years (for an immediate recognition of the entire UAAL due to the ERIP) to a period of 10 years. These different periods corresponded to various alternative periods of cost savings or benefit payments under such a program. We recommend that the actuarial funding policy include a relatively short default amortization period for an ERIP (such as five years) along with a statement that a recommendation by the actuary to the Board on the amortization period be included as part of the required actuarial cost study for such ERIP.

Amortization of Surplus

As discussed above, one of the most significant changes in industry thinking and practice to come from the market experience around the turn of the 21st century is the way surplus is recognized in public pension funding policy. Generally, current practice is reflected in the goal of keeping contributions close to the cost of current service, i.e., the Normal Cost.

One possible response would be to require that contributions never fall below the Normal Cost level. However, that would be inconsistent both with the current GASB accounting standards and with the actuarial principle that funding policy should target 100 percent funding, and not sustain a level that is either higher or lower than 100 percent. That leads to the general conclusion that surplus should be amortized over the longest currently permissible period of 30 years. For example, CalPERS uses a 30-year amortization period when there is a surplus. This same 30-year period can also be found as Recommendation 7 in the Report of the (California) Public Employees Post-Employment Benefits Commission. We recommend that the actuarial funding policy include a 30-year period for surplus amortization[6].

Selection of Amortization Periods for Past vs. Future UAAL

As the Board deliberates modifying the amortization periods in its current funding policy, we recommend that the Board separate the discussions between (1) the amortization of the current (past) UAAL and (2) amortization of future changes in the UAAL. Most of the detailed discussion above relates to amortization periods for future changes in the UAAL.

As noted earlier in this discussion, as of June 30, 2012, the UAAL for the pension plan was $126.5 million. Based on the policy considerations underlying this discussion, we do not believe there is compelling reason or justification to lengthen the current fixed 27-year amortization period for the UAAL as of June 30, 2012. The current period is significantly higher than the 15-20 year range that we would recommend for gains and losses, and is somewhat outside of the range of 20-25 years that we would recommend for assumption changes. Also, any change to a longer amortization period would not provide substantial contribution rate relief and would produce additional negative amortization in the next few years.

However, if the Board wishes to accelerate the plan's progress to 100% funding, the most direct way to do so would be to reamortize the current UAAL over a period shorter than 27 years.

Alternative Amortization Periods for Future Changes in UAAL

Based on the above discussions, here are some alternative sets of amortization periods that the Board may want to consider with respect to any future changes in UAAL.

	Current Policy*	Alternative #1	Alternative #2	Alternative #3
Actuarial Gains or Losses	27	15	20	20
Assumption or Method Changes	27	20	20	25
Plan Amendments	27	15	15	15
ERIPs	27	5	5	5
Actuarial Surplus	27	30	30	30

* *Years remaining as of the June 30, 2012 actuarial valuation. The original period was 30 years as of June 30, 2009.*

6 Since CalPEPRA has imposed a new requirement that surplus be amortized only when the funded ratio is at least 120%, along with other conditions, we would propose that a reference be made in the Board's funding policy to that requirement.

Consistent with the above discussion, all the alternatives use relatively short amortization periods for plan amendments and ERIPs and a long period for surplus. The alternatives differ only in their treatment of the annual gains and losses and the less frequent remeasurements of the UAAL (assumption and method changes).

Alternative #2 is based on using the same period for both gains and losses and assumptions and method changes. Alternative #1 uses the shorter end of the recommended ranges, while Alternative #3 uses the long end of the ranges if the Board wants to apply different periods for these sources of changes in UAAL.

Please note that with all of the above alternatives, we are continuing to recommend that the Board maintain its current policies of using closed (fixed) amortization periods and level percent of pay amortization.

Recent Developments Related to Actuarial Funding/Reporting From the CAAP

While systems can no longer look to GASB for guidance on funding policy, there is another source of guidance that is in the process of development. The California Actuarial Advisory Panel (CAAP) was created by the passage of Senate Bill 1123 of the 2008/2009 legislative session and consists of eight public sector actuaries appointed by the various appointing powers pursuant to Section 7507.2 of the Government Code. We note that one of Segal's principal actuaries, Paul Angelo, serves on the CAAP as an appointee of the University of California.

The CAAP has been studying actuarial funding policies for some time and recently issued a comment draft of a statement of model funding policies. While the recommendations and opinions of the Panel are nonbinding and advisory only, such viewpoints are still anticipated to have an influence on the retirement systems that operate in California as they select and finalize their individual funding approaches.

Because the CAAP's work in this area is based on Segal's and other actuaries' experience with California plans like MCERA, it is no coincidence that the elements of the funding policy developed by Segal for MCERA are in compliance with the CAAP model policies. In particular, those model policies include preferred ranges for amortization periods that are similar to the three alternatives presented in the above section[7].

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7 The "model" funding periods are expressed as a range in the draft model actuarial funding policy. Those periods are as follows:

Actuarial Gains or Losses	15 to 20 years
Assumption or Method Changes	15 to 25 years
Plan Amendments	Up to 15 years
ERIPs	5 years or less
Actuarial Surplus	30 years

Cost Impact – Future Changes in UAAL

It is not possible to quantify in advance the full future cost impact associated with adopting any of the alternative amortization periods simply because the plan's future changes in UAAL are not yet identified. However, for amortizing actuarial gains or losses we can measure the effect that a change from the current 27 years (as of the June 30, 2012 valuation) to the 15-20 year recommended range would have on MCERA's $23.2 million in unrecognized investment losses as of June 30, 2012. Over the next four valuations, such a change in the gain/loss amortization period would increase the annual payroll cost required to amortize that $23.2 million in unrecognized investment losses from about 2.1% of payroll (paid for 27 years) to about 3.1% of payroll (paid for 15 years) or 2.5% of payroll (paid for 20 years)[8].

Cost Impact – Reamortization of Past UAAL

As discussed above, the Board may consider reamortizing the total UAAL over a shorter single period to accelerate the plan's progress to 100% funding. Under alternative amortization periods, the changes in the current employer UAAL contribution rate of 13.16% determined in the June 30, 2012 valuation would be as follows:

Single 25-year period:	Increases the total UAAL contribution rate by 0.63% of payroll
Single 20-year period:	Increases the total UAAL contribution rate by 2.80% of payroll
Single 18-year period:	Increases the total UAAL contribution rate by 4.02% of payroll
Single 15-year period:	Increases the total UAAL contribution rate by 6.49% of payroll

For another illustration of cost impact, the charts in Attachments #1 and #2 compare the annual UAAL payments and the outstanding balance of the UAAL for a sample change in UAAL of $1 million under different amortization periods. Please note that these Attachments have been prepared using the assumptions approved for the most recent valuation as of June 30, 2012.

Adjustment for 12-Month Delay in Rate Implementation

In order to allow the employers to more accurately budget for pension contributions and other practical considerations, the contribution rates determined in each actuarial valuation (as of June 30) will apply to the fiscal year beginning 12 months after the valuation date. As a result of that scheduled delay, the UAAL contribution rates in a subsequent valuation will have to be adjusted to reflect either a gain or a loss when the actual contribution rate paid is higher or lower than the contribution rate calculated in the prior year's valuation.

Note that the contribution gain or loss as a result of this anticipated delay in implementing the contribution rate may be built into the development of the UAAL rate for the current valuation, rather than waiting until the following valuation and reflecting the delay as a gain or loss in the UAAL. MCERA's current practice, which is the most common practice, is to reflect the delay

8 In calculating these contribution rates, we have offset the $23.2 million in unrecognized investment losses with the $3.4 million Contingency Reserve.

as a gain or loss in the following valuation, rather than building the anticipated delay into the development of the current rate. We recommend no change to this practice for MCERA at this time based on the expectation that in the long term, there would be about the same number of occurrences of contribution gains or losses.

We are members of the American Academy of Actuaries and we meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

We look forward to discussing this with you and the Board.

Sincerely,

Paul Angelo ay

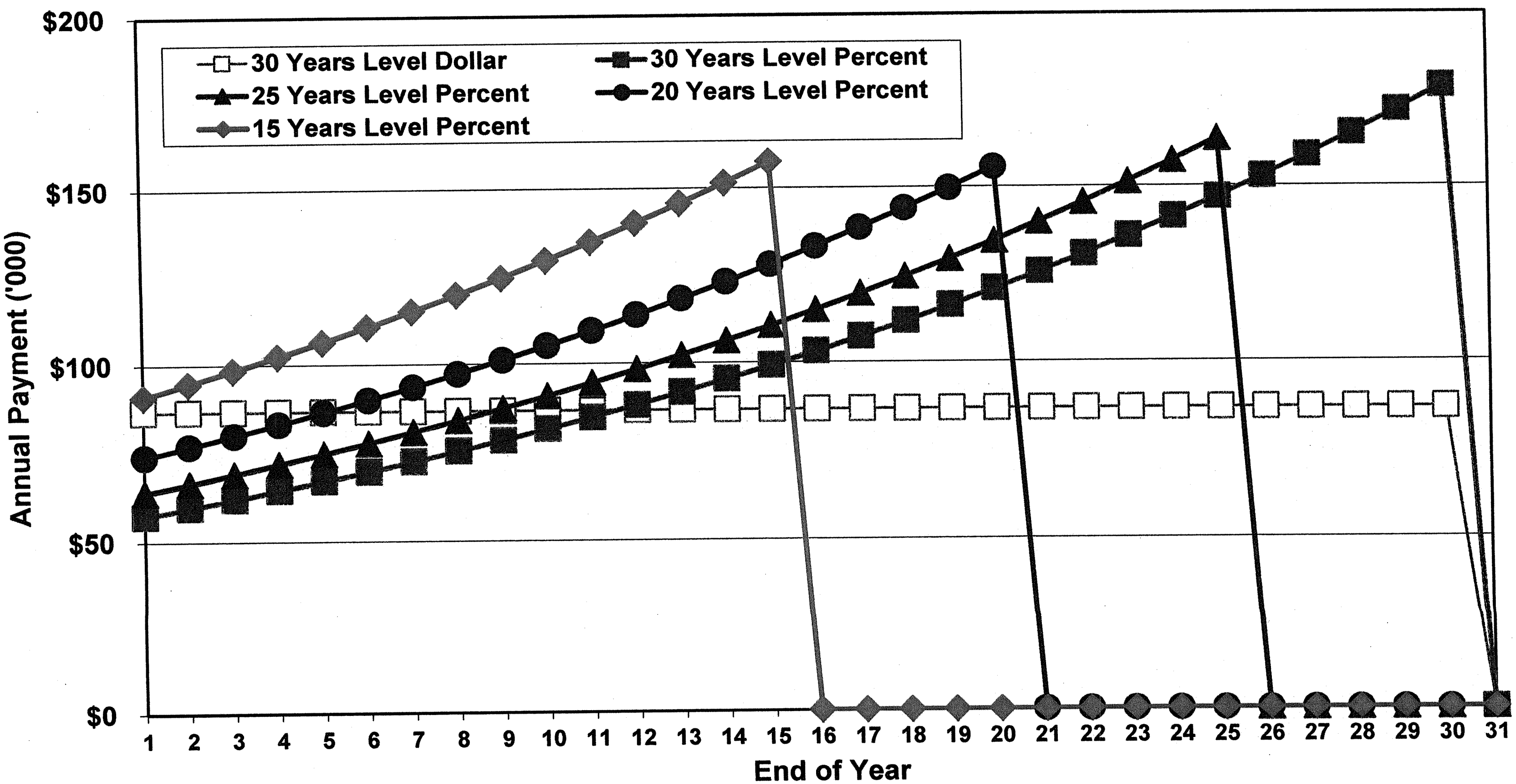
Andy Yeung

Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President and Actuary

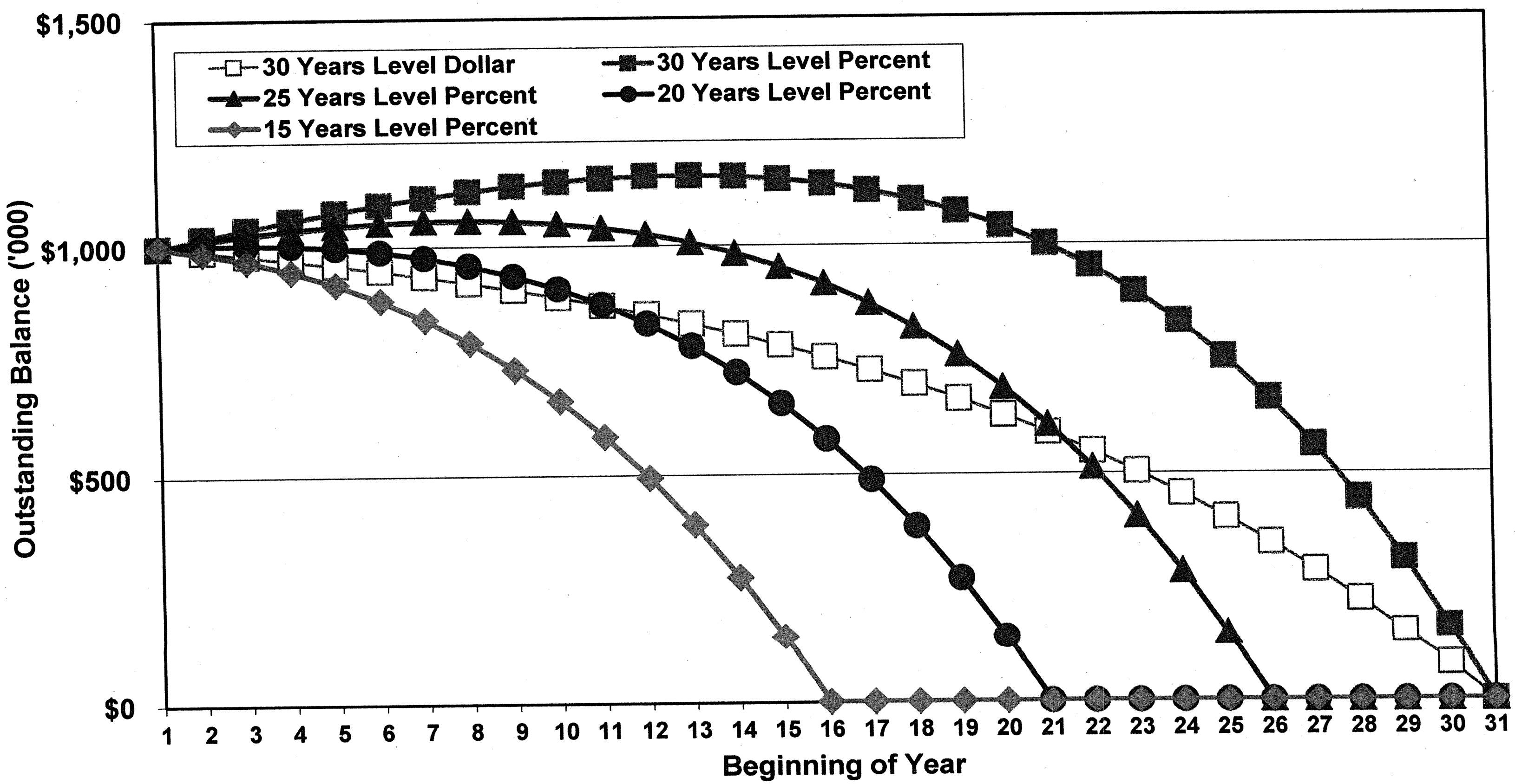
Andy Yeung, ASA, MAAA, FCA, EA
Vice President and Associate Actuary

DNA/gxk
Enclosures

Attachment #1 - Illustration of Payments Under Different Amortization Periods (on $1 million UAAL)



Attachment #2 - Illustration of Outstanding UAAL Balance Under Different Amortization Periods



Attachment #3

Mendocino County Employees' Retirement Association

Draft of Statement of Actuarial Funding Policy

Introduction

The purpose of this Statement of Actuarial Funding Policy is to record the funding objectives and policies set by the Board of Retirement (Board) for the Mendocino County Employees' Retirement Association (MCERA). The Board establishes this Statement of Actuarial Funding Policy to help ensure future benefit payments for members of MCERA. In addition, this document records certain policy guidelines established by the Board to assist in administering MCERA in a consistent and efficient manner.

This Statement of Actuarial Funding Policy supersedes any previous statements. It is a working document and may be modified as the Board deems necessary.

Goals of Actuarial Funding Policy

1. To achieve long-term full funding of the cost of benefits provided by MCERA;
2. To seek reasonable and equitable allocation of the cost of benefits over time; and,
3. To minimize volatility of the plan sponsor's contribution to the extent reasonably possible, consistent with other policy goals.

Funding Requirement and Policy Components

MCERA's annual funding requirement is comprised of a payment of the Normal Cost and a payment on the Unfunded Actuarial Accrued Liability (UAAL). The Normal Cost and the amount of payment on UAAL are determined by the following three components of this funding policy:

I. Actuarial Cost Method: the techniques to allocate the cost/liability of retirement benefit to a given period;

II. Asset Smoothing Method: the techniques that spread the recognition of investment gains or losses over a period of time for the purposes of determining the Actuarial Value of Assets used in the actuarial valuation process; and

III. Amortization Policy: the decisions on how, in terms of duration and pattern, to reduce the difference between the Actuarial Accrued Liability and the Valuation Value of Assets in a systematic manner.

I. Actuarial Cost Method:

The Entry Age Normal method shall be applied to the projected retirement benefits in determining the Normal Cost and the Actuarial Accrued Liability.

II. Asset Smoothing Method:

The investment gains or losses of each valuation period, as a result of comparing the actual market return and the expected return on Valuation Value of Assets, shall be recognized in level amount over 5 years in calculating the Actuarial Value of Assets. Deferred investment gains or losses cannot exceed 25% of the Market Value of Assets.

The Board reserves the right to consider future ad-hoc adjustments to change the pattern of the recognition of the deferred investment gains or losses after a period of significant market change followed by a period of market correction upon receiving the necessary analysis from its actuary.

III. Amortization Policy:

- The UAAL, (i.e., the difference between the Actuarial Accrued Liability and the Valuation Value of Assets), as of June 30, 2012 shall continue to be amortized over its declining 30-year schedule (with 27 years remaining as of June 30, 2012);
- Any new UAAL as a result of actuarial gains or losses identified in the annual valuation as of June 30 will be amortized over a period of __ years;
- Any new UAAL as a result of change in actuarial assumptions or methods will be amortized over a period of __ years;
- Unless an alternative amortization period is recommended by the Actuary and accepted by the Board based on the results of an actuarial analysis:
    a. with the exception noted in b. below, the increase in UAAL as a result of any plan amendments will be amortized over a period of 15 years;
    b. the increase in UAAL resulting from a temporary retirement incentive will be funded over 5 years;
- UAAL shall be amortized over "closed" amortization periods so that the amortization period for each layer decreases by one year with each actuarial valuation;
- UAAL shall be amortized as a level percentage of payroll so that the amortization amount in each year during the amortization period shall be expected to be a level percentage of covered payroll, taking into consideration the current assumption for general payroll increase; and
- If an overfunding exists (i.e., the total of all UAAL becomes negative so that there is a surplus and the amount of such surplus is in excess of 20% of the AAL per Section 7522.52 of CalPEPRA), such actuarial surplus and any subsequent surpluses will be amortized over an "open" amortization period of 30 years. Any prior UAAL amortization layers will be considered fully amortized, and any subsequent UAAL will be amortized as the first of a new series of amortization layers, using the above amortization periods.

Other Policy Considerations

A. Lag between Date of Actuarial Valuation and Date of Contribution Rate Implementation

In order to allow the employer to more accurately budget for pension contributions and other practical considerations, the contribution rates determined in each valuation (as of June 30) will apply to the fiscal year beginning 12 months after the valuation date. Any shortfall or excess contributions as a result of the implementation lag will be amortized as part of MCERA's UAAL in the following valuation.

Any change in contribution rate requirement that results from plan amendment is generally implemented as of the effective date of the plan amendment or as soon as administratively feasible.

B. Actuarial Assumptions Guidelines

The actuarial assumptions directly affect only the timing of contributions; the ultimate contribution level is determined by the benefits and the expenses actually paid offset by actual investment returns. To the extent that actual experience deviates from the assumptions, experience gains and losses will occur. These gains (or losses) then serve to reduce (or increase) the future contribution requirements.

Actuarial assumptions are generally grouped into two major categories:

- Demographic assumptions – including rates of withdrawal, service retirement, disability retirement, mortality, etc.
- Economic assumptions – including price inflation, wage inflation, investment return, salary increase, etc.

The actuarial assumptions represent the Board's best estimate of anticipated experience under MCERA and are intended to be long term in nature. Therefore, in developing the actuarial assumptions, the Board considers not only past experience but also trends, external forces and future expectations.

C. Glossary of Terms

<u>Actuarial Funding Method</u> – A technique to allocate present value of projected benefits among past and future periods of service.

<u>Actuarial Accrued Liability</u> – The portion of the present value of projected benefits that is attributed to past service by the actuarial funding method.

<u>Normal Cost</u> – The portion of the present value of projected benefits that is attributed to current service by the actuarial funding method.

<u>Entry Age Normal Actuarial Cost Method</u> – A funding method that calculates MCERA's Normal Cost a level percentage of pay over the working lifetime of the plan's members.

MCERA - Actuarial Funding Policy

Actuarial Funding Policy
March 20, 2013

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Senior Vice President and Actuary
ANDY YEUNG, ASA
Vice President and Associate Actuary
The Segal Company

5238944

Funding Policy Components

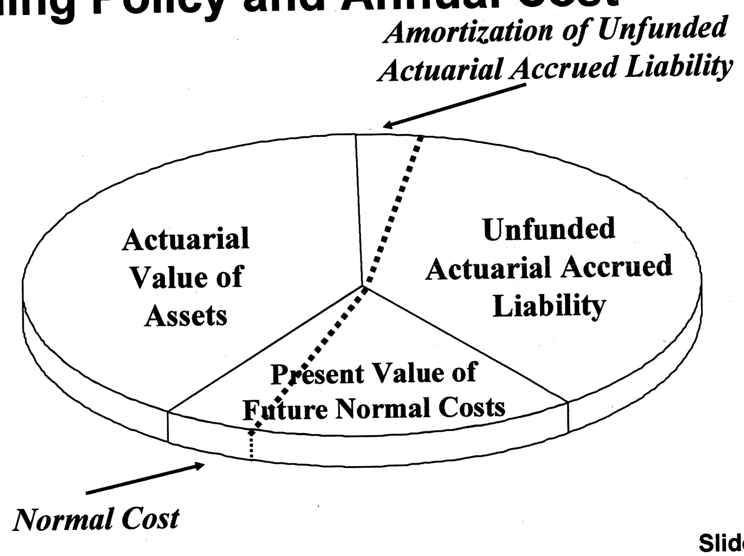
- **Actuarial Cost (Funding) Method** – allocates costs to time periods, past vs. future
- **Asset Smoothing Method** – assigns a value to assets for determining contribution requirements
- **UAAL Amortization Policy** – how, and how long to fund difference between liabilities and assets

- Interest crediting and excess earnings policy
  - Unique to 1937 Act county systems
  - Generally separate from funding policy

SEGAL

SEGAL | **MCERA – Actuarial Funding Policy**

Funding Policy and Annual Cost



Slide 3

SEGAL | **MCERA – Actuarial Funding Policy**

General Policy Objectives

1. Future contributions plus current assets sufficient to fund all benefits for current members
   - Contributions = Normal Cost + full UAAL payment
2. Reasonable allocation of cost to years of service
   - Both expected costs and variations from expected costs
3. Reasonable management and control of future employer contribution volatility
   - Consistent with other policy objectives

Slide 4

SEGAL | MCERA – Actuarial Funding Policy

General Policy Objectives

4. Support public policy goals of accountability and transparency
   - Clear in intent and effect
   - Allow assessment of whether, how and when sponsor will meet funding requirements
   - Enhance credibility and objectivity of cost calculations

Slide 5

SEGAL | MCERA – Actuarial Funding Policy

General Policy Objectives

- Policy objectives 2 and 3 reflect two aspects of the general policy objective of "interperiod equity" (IPE).
- Objective 2 promotes "demographic matching"
  - intergenerational interperiod equity
- Objective 3 promotes "volatility management"
  - period-to-period interperiod equity
- These two aspects of IPE tend to move funding policy in opposite directions.
  - policy objectives 2 and 3 combine to seek to balance intergenerational and period-to-period IPE
  - demographic matching vs. volatility management

Slide 6

MCERA Current Funding Policy

- Cost method
  - Entry Age Normal (EAN)
- Asset smoothing method
  - 5-year smoothing period with 25% market value corridor (20% before 6/30/2009 valuation)
  - Reaffirmed by the Board in 2009
- UAAL amortization policy
  - UAAL amortized as a single layer
  - Reset from 9 years (in 6/30/2008 valuation) to 30 years (in 6/30/2009 valuation)
    - 27 years left in 6/30/2012 valuation
  - Level percent of pay amortization

Review of MCERA Funding Policy

- Review all three current funding policy components
  - Cost method, asset smoothing, UAAL amortization
  - Incorporate all components into a comprehensive statement of funding policy
    - Review and adoption by the Board
    - Increased importance due to GASB changes
- Separate topic not a part of this review
  - Interest crediting & excess earnings allocation policy
    - MCERA uses book value for calculating interest and maintaining reserves
    - Will be reviewed later this year

SEGAL | MCERA – Actuarial Funding Policy

Funding Policy Recommendations

- No change to Entry Age Normal cost method
- No change to asset smoothing method
- Emerging model practices for UAAL amortization
  - Separate amortization layers for each source of UAAL
  - Plan Amendments
    - Shorter periods than for other sources of UAAL
    - Particularly for Early Retirement Incentive Programs
  - Surplus
    - Longer periods than for UAAL
    - Allows consideration of other Surplus management tools
      - Minimum surplus requirement

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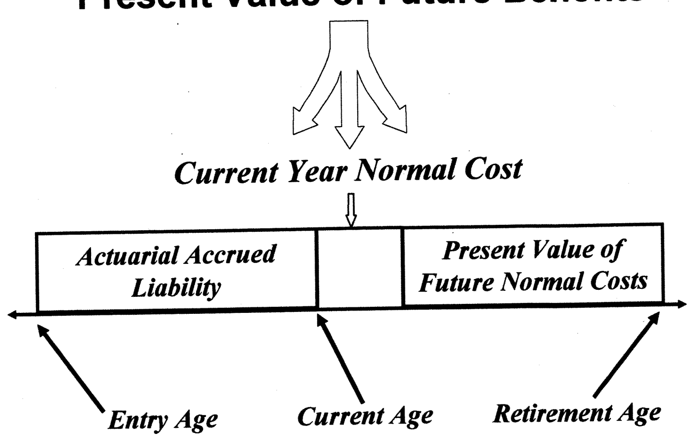
Actuarial Cost Method

Present Value of Future Benefits



Slide 10

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Entry Age Normal Method (EAN)

- Direct allocation of cost
- Designed to produce Normal Cost that stays level as a percentage of pay
  - Normal Cost Percentage = percentage of future payroll for each active member needed to fund PV of member's projected benefits at retirement
  - Normal Cost = NC% times current pay
- Model practice and consistent with version endorsed by GASB Statements 67/68
- Normal cost is <u>not</u> just the value of benefit earned

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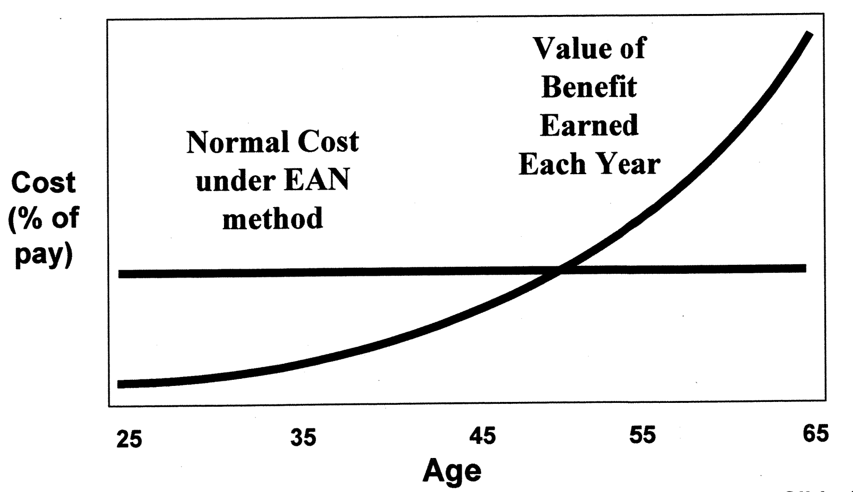
Normal Cost vs Earned Benefit



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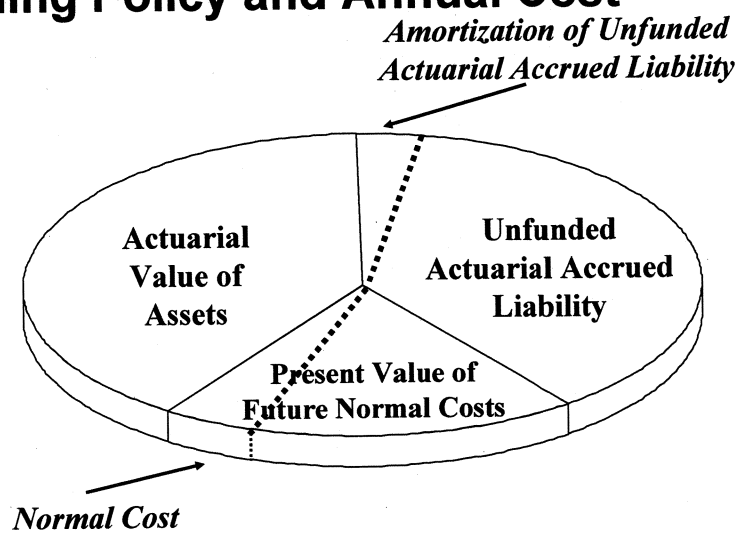
Managing Contribution Volatility

- Asset allocation – volatility at the source
- Asset smoothing
  - Specific to investment return volatility
- Direct contribution rate smoothing
  - Contribution collar – limits increases or decreases
  - Contribution rate phase-in – delays full impact
- UAAL amortization – assets and liabilities
  - More than just asset volatility control

Funding Policy and Annual Cost



Asset Smoothing Methods

- Objectives
  - Reflect market value of assets
  - Smooth out fluctuations in market values
  - Produce smoother pattern of contributions
- Features
  - Practical to both understand and model
  - Consistently lead or lag market
  - Treatment of realized vs. unrealized gains
  - Consistency with other investment policies
  - "Return to Market" conditions
- Smoothing methods and periods
  - Including "Market Value Corridor"

Income Smoothing Methods

- Contributions and benefits recognized immediately
- Split income into Immediate and Deferred portions
  - Deferred portion gets "smoothed"
- Smooth over n years, n = 3, 4 or 5 … or 10 or 15!
- Decide what part of earnings gets smoothed
  - Unrealized gains/losses
  - All capital gains/losses
  - **Total return above or below assumed earnings**

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Example: one good year*

Year	1	2	3	4	5	6	7
MVA return	13%	8%	8%	8%	8%	8%	8%
Deferred	(5%)						
Recognized	1%	1%	1%	1%	1%		
AVA return	9%	9%	9%	9%	9%	8%	8%

* Using 8% as assumed return.

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Example: one good, then one bad year*

Year	1	2	3	4	5	6	7
MVA return	13%	3%	8%	8%	8%	8%	8%
Deferred	(5%)	5%					
Recognized	1%	1%	1%	1%	1%		
		(1%)	(1%)	(1%)	(1%)	(1%)	
AVA return	9%	8%	8%	8%	8%	7%	8%

* Using 8% as assumed return.

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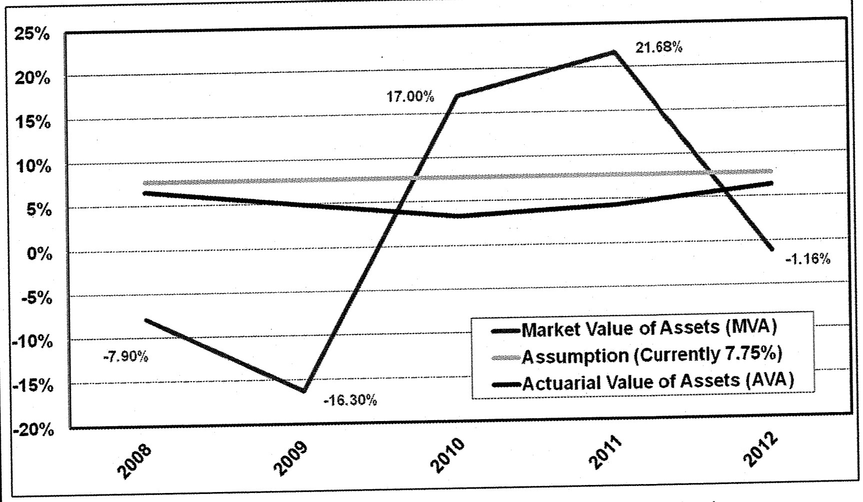
MCERA Investment Rates of Return



Notes: (1) The Board adopted a 7.75% assumption effective with the June 30, 2011 valuation. Prior to that, the assumption was 8.00%. (2) The rates of return prior to 2011 were determined by the prior actuary.

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Asset Smoothing Mechanics

- When MVA return is **greater** than assumed
  - Smoothing "defers gains"
  - Smoothed value (AVA) is **less** than MVA
  - UAAL and contributions are **larger**
- When MVA return is **less** than assumed
  - Smoothing "defers losses"
  - Smoothed value (AVA) is **greater** than MVA
  - UAAL and contributions are **smaller**

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SEGAL | MCERA – Actuarial Funding Policy

MCERA Actuarial Value of Assets as of June 30, 2008

6/30/2008 Valuation ($ thousands)

Year-end	Market Value Gain/(Loss)	Percent Not Recognized	Amount Not Recognized
Jun-08	($56,142)	80%	($44,914)
Jun-07	$26,673	60%	$16,004
Jun-06	$8,757	40%	$3,503
Jun-05	$4,340	20%	$868
Net total LOSSES not yet recognized			($24,539)
Net market value of assets			$332,208
LESS LOSSES not yet recognized			$24,539
Actuarial value of assets (incl. non-val reserves)			$356,747
AVA/MVA Ratio			107.4%

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MCERA Actuarial Value of Assets as of June 30, 2009

6/30/2009 Valuation ($ thousands)

Year-end	Market Value Gain/(Loss)	Percent Not Recognized	Amount Not Recognized
Jun-09	($79,790)	80%	($63,832)
Jun-08	($56,142)	60%	($33,685)
Jun-07	$26,673	40%	$10,669
Jun-06	$8,757	20%	$1,751
Net total LOSSES not yet recognized			($85,097)
Net market value of assets			$271,188
LESS LOSSES not yet recognized			$85,097
Actuarial value of assets (incl. non-val reserves)			
Before applying 125% MVA corridor			$356,285
After applying 125% MVA corridor			$338,985
AVA/MVA Ratio (before applying 125% MVA ratio)			131.4%

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MCERA Actuarial Value of Assets as of June 30, 2010

6/30/2010 Valuation ($ thousands)

Year-end	Market Value Gain/(Loss)	Percent Not Recognized	Amount Not Recognized
Jun-10	$23,164	80%	$18,531
Jun-09	($79,790)	60%	($47,874)
Jun-08	($56,142)	40%	($22,457)
Jun-07	$26,673	20%	$5,335
Net total LOSSES not yet recognized			($46,465)
Net market value of assets			$299,741
LESS LOSSES not yet recognized			$46,465
Actuarial value of assets (incl. non-val reserves)			$346,206
AVA/MVA Ratio			115.5%

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SEGAL | MCERA – Actuarial Funding Policy

MCERA Actuarial Value of Assets as of June 30, 2011

6/30/2011 Valuation ($ thousands)

Year-end	Market Value Gain/(Loss)	Percent Not Recognized	Amount Not Recognized
Jun-11	$40,435	80%	$32,348
Jun-10	$23,164	60%	$13,898
Jun-09	($79,790)	40%	($31,916)
Jun-08	($56,142)	20%	($11,228)
Net total GAINS not yet recognized			$3,102
Net market value of assets			$355,043
LESS GAINS not yet recognized			($3,102)
Actuarial value of assets (incl. non-val reserves)			$351,941
AVA/MVA Ratio			99.1%

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MCERA Actuarial Value of Assets as of June 30, 2012

6/30/2012 Valuation ($ thousands)

Year-end	Market Value Gain/(Loss)	Percent Not Recognized	Amount Not Recognized
Jun-12	($31,275)	80%	($25,020)
Jun-11 & Prior Combined	$2,451	75%	$1,838

Net total LOSSES not yet recognized	($23,182)
Net market value of assets	$342,737
LESS LOSSES not yet recognized	$23,182
Actuarial value of assets (incl. non-val reserves)	$365,919
AVA/MVA Ratio	106.8%

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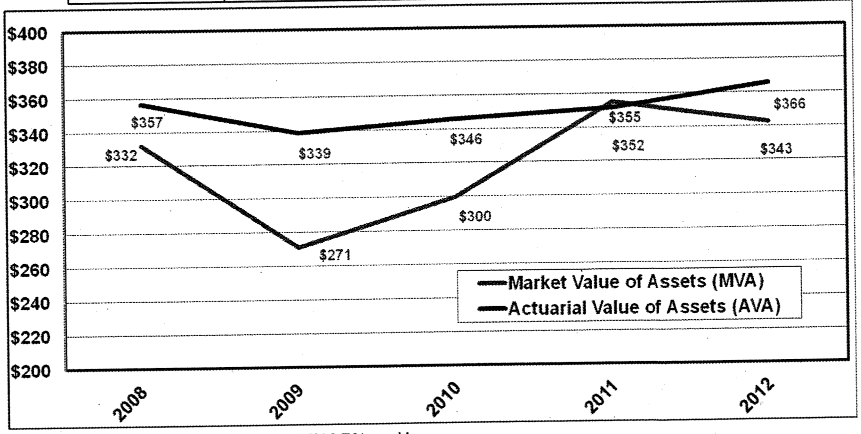
MCERA AVA vs. MVA ($ in millions)

AVA to MVA Ratio

2008	2009	2010	2011	2012
107.4%	125.0%*	115.5%	99.1%	106.8%



* The ratio is 131.4% before applying the 125% MVA corridor.

Note: The figures prior to 2011 were determined by the prior actuary.

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Asset Smoothing and "MVA Corridor"

- Many plans limit how far the AVA can get from the MVA by limiting the AVA ratio
- A "25% MVA corridor" means the AVA must be between 75% and 125% of MVA
  - Maximum deferred gain or loss is 25% of MVA
  - Hitting the MVA corridor effectively stops smoothing
- In 2009, some Boards decided to widen the MVA corridor
  - MCERA: Widened from 20% to 25%
  - Others decided to continue to use no MVA corridors

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Actuarial Standards of Practice No. 44

- ASOP 44 focuses on two key features
  - How close does AVA stay to MVA
    - Ratio of AVA to MVA ("AVA Ratio")
  - How long before AVA returns to MVA
    - Smoothing period
- ASOP 44 also provides some structure
  - If "likely" to be "reasonable", both are required
  - If "sufficiently close" or "sufficiently short" then only one or the other is required

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5-year Smoothing and MVA Corridor

- Under ASOP 44, 5 years is "sufficiently short"
  - Widespread use, industry opinions
  - Assumes employer ability to pay
- Other reasons to consider MVA corridor
  - Accelerates contribution increases
    - Market timing – more contributions in down market
    - Cash flow – avoid selling assets to pay benefits
    - Solvency – if contributions ever stop, increased plan assets could secure more benefits (extreme case)
- Recommend no change to asset smoothing method

QUESTIONS

Amortization Policy

- Component of Annual Contribution
  - Normal cost plus amortization of unfunded liability
- Sources of Unfunded Liability
  - Plan changes
  - Assumption or method changes
  - Gains / losses
- Amortization policy includes:
  - Structure: Single UAAL or in layers
    - Also: fixed (closed) or rolling (open) amortization
  - Payment pattern: level dollar or level percent of pay
  - Periods: how long to fund the UAAL

Amortization Structure

- UAAL amortized as a single layer
- Model approach: multiple amortization layers
  - First layer: current UAAL (as of policy adoption)
  - Each year, new layer of UAAL for gain/loss, assumption/method changes, plan amendments
  - Can use different periods for different sources of UAAL
- Key issue: current UAAL as of July 1, 2012
  - Current schedule: 27 years as of June 30, 2012
  - Could continue current declining amortization period
  - Or adopt a shorter period – with immediate cost impact

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Illustration of Amortization Methods

7.75% interest 4.00% salary incr.	30 years Flat dollar	30 years % of pay	25 years % of pay	20 years % of pay	15 years % of pay
Increase in AAL	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Amortization factor	11.5286	17.4526	15.6672	13.5359	10.9916
(first year)	0.086741	0.057298	0.063827	0.073878	0.090979
Amortization amount					
Year 1	$ 86,741	$ 57,298	$ 63,827	$ 73,878	$ 90,979
Year 15	$ 86,741	$ 99,222	$ 110,529	$ 127,932	$ 157,546
Year 20	$ 86,741	$ 120,718	$ 134,475	$ 155,649	$ 0
Year 30	$ 86,741	$ 178,692	$ 0	$ 0	$ 0
Total amount paid					
Principal	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
Interest	1,602,221	2,213,555	1,658,153	1,199,933	821,719
Total	$ 2,602,221	$ 3,213,555	$ 2,658,153	$ 2,199,933	$ 1,821,719

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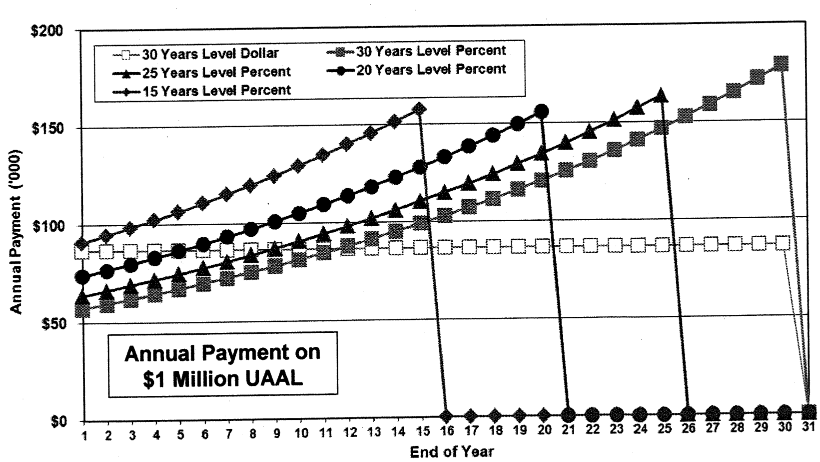
Illustration of Amortization Periods – Annual Payment ($ in 000s)



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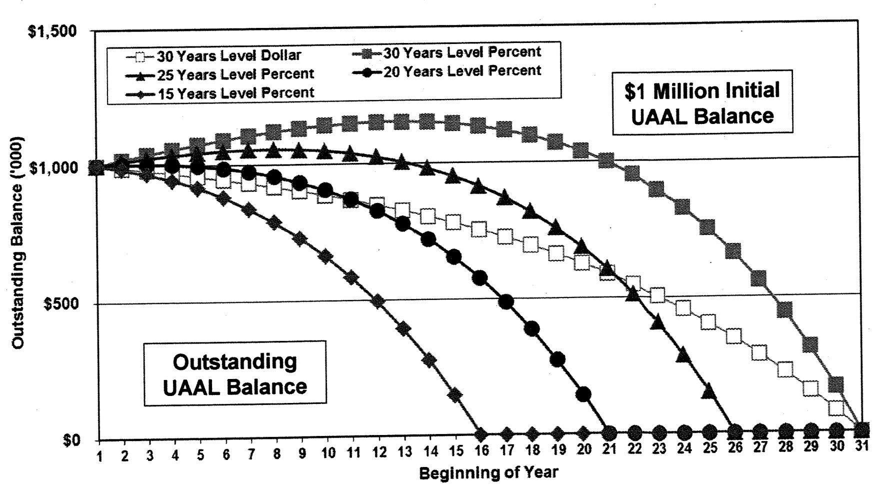
Negative Amortization

- $1,000,000 liability, 7.75% interest
- First year interest only is $77,500
- With level dollar payments, payments are always greater than interest
- With level percentage payments, early payments can be less than interest
  - UAAL increases (but not as a percentage of payroll!)
  - Eventually larger payments cover interest plus increased UAAL

SEGAL | MCERA – Actuarial Funding Policy

Illustration of Amortization Periods – Outstanding UAAL Balance ($ in 000s)



Model Fixed Layer Periods

- Tradeoff between demographic matching and volatility management
  - Two aspects of "interperiod equity"
  - Constraint: consideration of negative amortization
  - Exception: volatility generally N/A for plan changes
- Under 15 years: too volatile
- Over 20 (25?) years: too much neg. amortization
  - 25 is the new 30: "out of bounds marker"
  - 30 years reserved for surplus
    - Normal Cost requires UAAL/surplus "asymmetry"

Model Amortization Periods

- Gains and losses: 15 to 20 years
  - Volatility management, but avoid too long a period
- Assumption and method changes: 20 to 25 years
  - Long term remeasurements, so could justify longer amortization
- Plan amendments: demographic (15 yrs. or less)
  - Avoid any negative amortization since changes are within control of plan sponsor
  - Demographic matching for actives or inactives
  - Much shorter for Early Retirement Incentives (< 5 yrs)

Contributions when Plan has surplus

- Usual contribution is NC plus UAAL amortization
- Surplus: contribute NC minus Surplus amortization
- Short surplus amortization periods means contribution holidays, even with modest surplus
  - See late 1990s for real life examples
- Recommended approach: minimum contribution
  - 30 year amortization of surplus
- CalPEPRA further limits amortization of surplus
  - Funded ratio has to be > 120%

Alternative Periods for Future UAALs

- Applies only to future changes in UAAL
  - No immediate impact to contribution rates
    - Any changes would be implemented in 6/30/2013 valuation and would apply to any new changes in UAAL after 7/1/2012

Source	Current*	Alt #1	Alt #2	Alt #3
Actuarial Gains or Losses	27	15	20	20
Assumptions or Method Changes	27	20	20	25
Plan Amendments	27	15	15	15
ERIPs	27	5	5	5
Actuarial Surplus	27	30	30	30

* 27 years used in June 30, 2012 valuation

Alternative Periods for Current UAAL

- Board may consider shorter amortization period for current UAAL
- Most clear and direct actuarial policy action to accelerate plan's progression to 100% funding
- Impact of shorter amortization for current UAAL
  - Any change would not be implemented until 6/30/13 valuation
  - Re-amortize UAAL as of 7/1/12

Alternative Periods for Current UAAL

- Impact of shorter amortization for current UAAL on employer rate:

	Change in ER Rate (% of Pay)			
	15 Yrs	18 Yrs	20 Yrs	25 Yrs
Based on 6/30/12 Valuation	6.49%	4.02%	2.80%	0.63%

Adjustment for 12-Month Delay in Rate Implementation

- One-year delay in implementing contribution rates
  - Example: employer rates developed in 6/30/2012 valuation applied in 2013/2014 fiscal year
  - Short term impact:
    - Actuarial loss (when contribution rates increase)
    - Actuarial gain (when contribution rates decrease)
  - Long term impact: relatively small as losses are expected to offset gains
- Possible to anticipate even short term loss or gain and build into contribution rate
  - Not common among 1937 Act systems

Funding Policy Recommendations

- EAN Cost method
  - No changes recommended
- Asset smoothing method
  - No changes recommended
- UAAL amortization policy
  - For UAALs established after 6/30/2012
    - Consider one of the alternative sets of amortization periods
  - For UAAL established prior to 7/1/2012
    - No change recommended unless the Board wishes to accelerate plan's progress to 100% funding

SEGAL | MCERA – Actuarial Funding Policy

Other MCERA Funding Policy Elements

- Elements of funding policy dated July 19, 2006
  - Minimum contribution rate:
    - Compares AVA with "Accrued Benefit Obligation" (ABO). Eliminates shortfall in 3 years
    - Compares AVA with 75% of "Pension Benefit Obligation (PBO)". Eliminates shortfall in 5 years
  - Maximum contribution rate:
    - Compares AVA with 125% of PBO. Eliminates surplus in 5 years.
  - ABO and PBO are NOT calculated using EAN method
    - No actuarial justifications for these calculations

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Other MCERA Funding Policy Elements

- Elements of funding policy dated July 19, 2006
  - Contribution rate phase-in – delays full employer rate impact from change in assumptions
    - Less than 0.25% of payroll: No phase-in
    - Between 0.25% and 0.50%: Over 2 years
    - More than 0.50%: Over 3 years
  - Not referenced by prior actuary when assumptions were changed in 6/30/2008 and 6/30/2010 valuations
  - Consider MCERA funding status and other factors
    - Not recommending phase-in as an automatic feature of actuarial funding policy

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QUESTIONS

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date:	March 20, 2013
To:	Board of Retirement
From:	Richard White, Retirement Administrator RAW
Subject:	Retirement Benefits Presentation on the Calculation of a Member's Retirement Benefit

The Board asked for information on the method used to calculate the retirement benefit of a member of MCERA. The presentation will be given by Katy Richardson, Senior Retirement Specialist and Christie O'Ferrall, Retirement Specialist II.

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date:	March 20, 2013
To:	Audit and Budget Committee
From:	Richard White, Retirement Administrator RAW
Subject:	Audit and Budget Committee Report

Summary:

The Audit and Budget Committee met on March 12, 2013. The agenda for the meeting is included in this report as are the approved minutes from their meeting of January 28, 2013.

The Committee also reviewed the Comprehensive Annual Financial Report (CAFR) for year ended June 30, 2012, in draft format in preparation of submitting the final draft of the CAFR to the Board of Retirement at this meeting.

The Board will review and comment on the CAFR in draft format at this meeting. The CAFR will also be reviewed by Gallina, LLP prior to submission to the GFOA.

Staff Recommendation:

Direct staff to finalize the 2012 Comprehensive Annual Financial Report (CAFR) and submit it to the GFOA.

Background:

The Comprehensive Annual Financial Report (CAFR) is a critical annual report which details important information about the Mendocino County Employees' Retirement Association for our members, plan sponsors and other stakeholders in our community. The GFOA states that, "authoritative standards encourage governments to issue their basic financial statements in the broader context of a comprehensive annual financial report (CAFR)."

The Comprehensive Annual Financial Report (CAFR) incorporates the audited financial statements prepared by Gallina, the actuarial valuation prepared by The Segal Company, and the quarterly investment report prepared by Callan Associates and is prepared in accordance with guidelines established by the Government Finance Officers Association (GFOA).

The CAFR is divided into five sections:

- **The Introductory Section** describes the organization and structure of MCERA, including this transmittal letter and a list of professional consultants.
- **The Financial Section** presents the basic financial statements, report of the independent auditor, management discussion and analysis and supplemental schedules and notes to the financial statements.
- **The Investment Section** reports on investment activity, investment policy, asset allocation and diversification and historical investment performance.
- **The Actuarial Section** communicates the Plan's funding status and presents related actuarial information. It also contains the actuarial certification, actuarial assumptions and statistics and general plan information.
- **The Statistical Section** presents information pertaining to MCERA's operations on a multi-year basis

Discussion:

- Last year's CAFR was approved by the Board of Retirement on June 20, 2012 and received the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting.
- The deadline for submission to the GFOA for this year's award cycle in March 31, 2013 (which is an extended date beyond the December 31, 2012 deadline).

Raw
Attachments

Mendocino County Board of Retirement
Audit and Budget Committee Meeting Agenda
March 12, 2013
10:00 a.m.

Roll Call

Public Comment

Members of the public are welcome to address the committee on subjects both on and off the agenda. The committee is prohibited from taking action on matters not on the agenda, but may ask questions and/or briefly answer questions. Public comment is limited to 5 minutes per person and not more than 10 minutes for a particular subject at the discretion of the Committee Chair. Please complete a speaker form, available at the entrance to the conference room and present to the Clerk. Public speakers are required to state their name before they begin. If you wish to submit written comments please provide 7 copies to the Clerk prior to the start of the meeting.

1) Approval of the January 28, 2013 Committee meeting minutes.

2) Discussion and Recommendation regarding the Comprehensive Annual Financial Report, CAFR, for year end June 30, 2012.

3) Confirm Scheduling of the next Audit & Budget Committee meeting on April 30, 2013.

Meeting Adjourned (Approximate Time 11:30 a.m.)

(Pursuant to Government Code Section 54954, this agenda was posted 72 hours prior to the meeting.)

TELECONFERENCE LOCATION: Office of Ted Stephens at 1101 College Avenue Suite 210, Santa Rosa, CA 95404 Phone: 707-545-8646 Fax: 707-544-8020

MEETING LOCATION: Retirement Association Conference Room at 625-B Kings Court Ukiah, CA 95482 Phone: 707-463-4328 Fax: 707-467-6472
Retirement Association Website: www.co.mendocino.ca.us/retirement

Mendocino County Board of Retirement
Budget and Audit Committee Meeting Minutes
January 28, 2013
11:00 a.m.

11:00 a.m.

Participants: Board Members Ted Stephens and Lloyd Weer, Crystal Ekanayake and Dan Matzinger, Gallina LLP, Andy Yeung, The Segal Company, Rich White, Retirement Administrator, and Judy Zeller, Clerk to the Board.

Public Comment: None

Supervisor John McCowen observed the meeting.

1) Discussion and Approval of the draft June 30, 2012 Audit Report by Gallina LLP

Crystal Ekanayake and Dan Matzinger of Gallina LLP referenced the draft annual financial audit of MCERA for the year ended June 30, 2012. Andy Yeung and of The Segal Company also provided comments on the information included in the report.

Mr. Stephens asked many questions about the report totals and whether Gallina had compared their totals with other totals included in the report which had been provided by The Segal Company and Callan Associates. Ms. Ekanayake stated that Gallina prepares the financial statements independently using source documents. Gallina reviews for large inconsistencies and otherwise small discrepancies that are not material are not further examined. Gallina does not audit the other providers work nor are the internally prepared documents reviewed. The figures in the financial reports are within "materiality' and material differences are noted.

Mr. Stephens questioned page 9 of the report and Investments at fair value. It was agreed by all that Real Estate and Non Mutual Fund investment totals should be separated out of the Mutual Fund total.

Mr. Weer asked about the information included on page 20 of the audit regarding assumptions and if there was a material change because of the unused sick leave assumption change. Mr. Yeung stated that the assumption change will impact the year end of June 30, 2012 and that it is premature to change in this audit report.

Mr. Stephens asked why information regarding health benefits for retired employees was included on page 12 of the report. Ms. Ekanayake stated that this information had been included in previous audit reports and should be left in because of the VCP discussed on page 23 and the undesignated reserves listed on page 22. Mr. Weer and Mr. White agreed.

Mr. Stephens asked why page 13 of the report stated that there were no derivatives as of June 30, 2012. Ms. Ekanayake explained that derivatives are not purchased directly by the fund; they are within the fund investments. The report will be amended to say that MCERA owned no derivatives directly in its portfolio.

Mr. Stephens questioned the second paragraph on page 15 and why it stated that there were no excess earnings that can be used for the payment of retiree health benefits. Ms. Ekanayake said that this information had been included in last year's report and the 3rd sentence was to reemphasize that there were no excess earnings, which complies with 401(h). Mr. Yeung added that the statement fits with the VCP filing and how benefits were provided. This is a true statement to back up the content of the paragraph.

Mr. Stephens asked that levels on page 17 be changed to be consistent with the change to page 9. Mr. Weer agreed.

The information on page 22, the discrepancy in Employer Reserves in the fiscal years 2009 and 2010, was discussed. It was agreed that Employer reserves would be footnoted with an asterisk noting that the percentage contributed was based on data reported by the prior actuary. Mr. Weer stated that he had knowledge that Employer contributions had been paid 100% for each year.

The committee approved the draft annual financial audit report dated June 30, 2012 with the suggested changes unanimously and the revised draft audit report will be presented to the full Board on February 20, 2013 for approval.

2) Discussion and Direction to staff regarding the Comprehensive Annual Financial Report (CAFR) and Audit Process

a) Timing and Preparation of Reports

Mr. White began the discussion regarding a suggested change to our current process of compiling information for our valuation and audit. He referenced a timeline Segal prepared which outlined the Actuarial Valuation completion dates and the Financial Audit completion dates for MCERA.

Mr. Yeung added that the current process used by the Actuary and the Auditor are co-dependent upon each other and that the reports are passed between both the actuary and the auditor to ensure accuracy and completeness using the latest data. The process does not lend itself to getting the reports completed on time at the end of each year. The June 30, 2012 audit timeline was used as an example.

A suggested approach is the auditor could use the Board approved actuarial valuation from the previous period for completion of the current fiscal year financial audit. This ensures that the information from the actuarial valuation has been reviewed by the Audit and Budget Committee and is approved by the Board of Retirement before the information is used in the completion of the financial audit. This approach would likely put the completion of the financial audit on a different and more efficient timeline.

Ms. Ekanayake stated that the timeliness of the reporting is very important and a revised process could benefit MCERA and assist Gallina in the preparation of the financial audit. It was suggested that Gallina could have a draft audit report available for the staff in September. This would allow the Audit and Budget Committee to review a final draft report in October/November with the Board of Retirement having the audit report for approval in November/December. Timely reporting would be beneficial since this year's valuation was not available until December.

Mr. Yeung added that the down side to this suggested approach is that the use of the prior year actuarial valuation means that the financial audit would be using one actuarial valuation report two years in a row during the transition to this process, though it would happen only once.

Cost associated with the proposed change was discussed and both Gallina and The Segal Company stated that there should not be an additional cost. In fact there may be even less cost due to non approval of reports and that there may be a savings with a different process.

Mr. Weer asked if this is a common practice. Mr. Yeung replied that others have a long lead period.

The Committee agreed that this issue should be brought to the full Board for discussion in February.

b) Preparation of CAFR and Audit Report.

Mr. White referenced preparation of the CAFR and the audit process. Current process has been preparing an Audit report and a CAFR each fiscal year and the cost for both. Combining reports in one document, CAFR, could potentially save costs and staff time. Gallina mentioned that their amount of work and review time would be identical. Mr. Stephens felt that this would be a procedural direction to implement and that we should wait and revisit later.

The Committee thanked Gallina LLP and The Segal Company for their participation in this meeting.

3) Discussion and Approval of the draft Budget and Audit Committee Charter

Rich White referenced the draft Audit and Budget Committee Charter. The need for four members was discussed. Mr. White felt that this number gives a better vote, functionality, flexibility, and different representation. Mr. Weer and Mr. Stephens wondered why budget was included in the charter. Mr. White stated that this was a legacy issue for MCERA and that the process would help form the budget for the Administration and that answers regarding the budget would come from the Committee members in addition to the Administrator.

The Committee recommendation was to approve the draft Audit and Budget Committee Charter and present to the Board on February 20, 2013 for approval and adoption.

4) Discussion and Approval of the draft Budget Adoption Policy

Rich White referenced the draft Budget Adoption Policy. Mr. Stephens questioned page 2 item 3 and why the Retirement Administrator would be granted the authority to determine which purchases exceeding $25,000.00 are to be treated as capital expenses and which are to be expensed in the year of purchase. Both Mr. Stephens and Mr. Weer felt that this should be amended to read not exceeding $5,000.00.

The Committee recommendation was to approve the draft Budget Adoption Policy as amended and present the policy to the full Board on February 20, 2013 for approval and adoption.

5) Schedule the next Audit and Budget Committee meeting

The next Budget and Audit Committee meeting will be held on Tuesday March 12, 2013 at 10:00 a.m. in the Retirement Association conference room.

Meeting Adjourned (12:30 p.m.)

MENDOCINO COUNTY EMPLOYEES'RETIREMENT ASSOCIATION
(A Pension Trust Fund and Component Unit of the County of Mendocino, California)

MCERA
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2012

Mendocino County Employees' Retirement Association

A Pension Trust Fund and Component Unit of the County of Mendocino, California

Comprehensive Annual Financial Report

For the fiscal years ended June 30, 2012 and 2011

Prepared by: RICHARD A. WHITE, JR.
Retirement Administrator

MCERA
625-B Kings Court
Ukiah, California 95482
(707)463-4328
www.co.mendocino.ca.us/retirement/

Mendocino County Employees' Retirement Association
"MCERA"

MCERA is a retirement system, organized under the County Employees Retirement Law of 1937, which provides retirement, disability, and death benefits to the employees, retirees and former employees of the County of Mendocino, the Mendocino County Superior Court and the Russian River Cemetery District.

MCERA's principal responsibilities include: management of the trust fund; delivery of retirement, disability and death benefits to eligible members; administration of cost-of-living programs; and general assistance in retirement and related benefits.

Mission Statement

To provide members and their beneficiaries with sustainable benefits and exceptional service through professional plan administration and prudent investment practices.

Goals

- Enhance communications and customer service provided by the Association
- Increase the effectiveness of internal operations
- Establish optimal board governance
- Explore ways to ensure prudent management of contributions and investment of retirement fund assets

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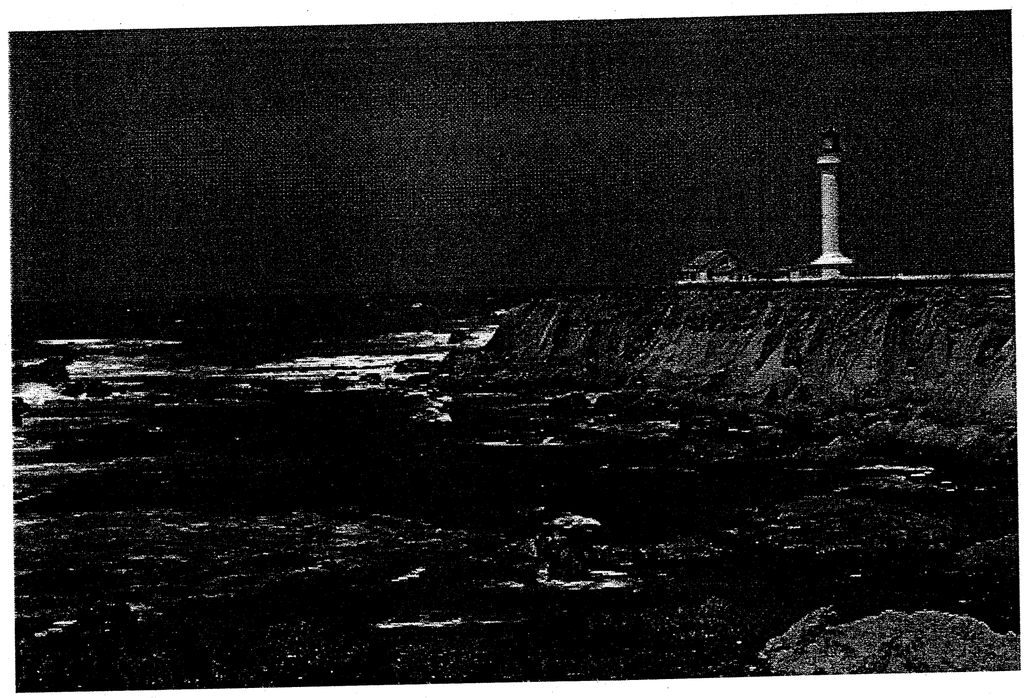
Introductory Section



Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

LETTER OF TRANSMITTAL

March 14, 2013

Board of Retirement
Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

Dear Board Members:

It is with great pleasure that we submit the Comprehensive Annual Financial Report (CAFR) of the Mendocino County Employees' Retirement Association (MCERA or System) as of and for the fiscal year ending June 30, 2012, the System's 64th year of operation.

The following section provides an overview and analysis of the Mendocino County Employees' Retirement Association (MCERA) financial activities for the year ended June 30, 2012. We encourage readers to take into account the information presented here in conjunction with additional information we have furnished in the financial statements.

Mendocino County Employees' Retirement Association (MCERA)

MCERA provides service retirement, disability, death and survivor benefits and is administered in accordance with the County Employees Retirement Law of 1937 (Government Code Section 31450, et seq.) Pursuant to certain provisions of the County Employees Retirement Law, MCERA is a multi-agency public employees' retirement system, established by the County of Mendocino on January 1, 1948, and is an independent district within the County of Mendocino, with a separate operating budget and professional staff.

The California Constitution gives the Board of Retirement (Board) plenary authority over the administration of the system, which includes administering plan benefits and managing the assets. The Board of Retirement and MCERA staff members are committed to act for the exclusive benefit of the plan and its participants, manage the assets of the plan prudently and administer benefits with impartiality.

To fulfill this mandate, MCERA employs a skilled professional staff and independent consultants that operate under a system of governance, operational and fiduciary policies and procedures.

Participating agencies in MCERA include the County of Mendocino, the Superior Court of Mendocino and the Russian River Cemetery District.

FINANCIAL HIGHLIGHTS

Net assets available for benefits decreased to $342.7 million. This amount reflects a decrease of 3.46% in net assets during Fiscal Year 2011-12. Additions to plan assets for the fiscal year were $ 12.6 million. This was comprised of $ 11.8 million of employer contributions, $ 4.8 million of member contributions and a net investment loss of $ 4.0 million. Expenses (deductions in plan assets) for the year were $24.8 million which included $24.1 million in benefit payments to retirees and beneficiaries and $0.7 million in administrative expenses.

ADMINISTRATIVE EXPENSES

The Board of Retirement approves MCERA's annual budget. The County Employees Retirement Law (CERL) limits MCERA's annual administrative expenses, excluding the costs of administration for computer software and hardware and computer technology consulting services (IT costs), to twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability or $2 Million, whichever is greater. Previously, the limit was eighteen hundredths of one percent (0.18%) of MCERA's total assets.

MCERA's actual administrative expense was $698,463 which represented 0.14% of MCERA's actuarial accrued liability or 34.92% of the $2 million statutory cap. Other expenses incurred but excluded under the CERL from the administrative statutory cap were technology expenses of $210,118.

OVERVIEW OF THE FINANCIAL STATEMENTS

Managements' Discussion and Analysis (MD & A) serves as an introduction and overview of the MCERA Basic Financial Statements. The Basic Financial Statements and required disclosures are prepared in accordance with accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board (GASB). MCERA's Basic Financial Statements are comprised of the following:

Statement of Net Assets
The Statement of Net Assets Available for Benefits is a snapshot of account balances at year-end. It presents major categories of assets and liabilities at fiscal year end. The difference between assets and liabilities, "Net Assets Held in Trust for Pension Plan", represents funds available to pay benefits. The Statement of Fiduciary Net Assets includes prior year-end balances for comparative purposes. Increases and decreases in Net Assets Held in Trust for Pension Plan, when analyzed over time, may serve as an indicator of whether MCERA's financial position is improving or deteriorating.

Statement of Changes in Net Assets
The Statement of Changes in Net Assets Available for Benefits provides information on the financial activities that increased and decreased Plan Net Assets. For comparative purposes, prior year-end balances are also provided. a view of the current year additions to and deductions from the plan. This statement covers the activity over a one-year period of time.

Notes to the Basic Financial Statements
The Notes to the Financial Statements are an integral part of the basic financial statements and provide background and detailed information regarding MCERA's policies, programs and activities.

Required Supplemental Information
The Required Supplemental Information contains supporting schedule pertaining to MCERA's Pension actuarial methods, assumptions, funded status and annual required contributions.

Other Supplemental Information
Other supplemental information includes schedules pertaining to administrative expenses and investment expenses.

MANAGEMENT RESPONSIBILITY OF FINANCIAL REPORTING

MCERA management is responsible for the complete and fair presentation of the financial information in accordance with generally accepted accounting principles (GAAP) in the United States. To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to fairly present the financial position and operating results of MCERA.

MAJOR INITIATIVES AND SIGNIFICANT EVENTS

Several major initiatives were undertaken during the year including:

- Negotiated a settlement agreement with the Association's former actuary for errors and omissions in prior reports and to finance the cost of correcting an error in employee contribution rates from July 2009 to January 2012.
- Significant progress was made in the project to determine the extent of overpayments or underpayments by members from July 2009 to January 2012, and to correct any errors in compliance with all Internal Revenue Service regulations.
- Engaged a new actuary to conduct a triennial experience study of economic and demographic assumptions, the recommendations of which were incorporated into the June 30, 2011 valuation study and used in the June 30, 2012 actuarial valuation.
- The recruitment and selection process for a Retirement Administrator to succeed the current administrator who retired was completed on June 4, 2012.
- Implemented several new policies to bring the Association closer to best management practices, including a cash management policy, Internal Revenue Service compliant retiree health care policy, overpayment collection policy, and placement agent policy.
- Engaged in a memorandum of understanding with the Assessor/Clerk Recorder for fiscal and accounting services.

INVESTMENT AND ECONOMIC SUMMARY

In accordance with state constitutional mandates, the Board adopts a strategic asset allocation policy designed to ensure diversification among asset classes and achieve MCERA's long-term investment objectives. Although MCERA invests on a long term horizon, short term returns are important to keep in mind.

Investment returns in Fiscal Year 2011/12 fluctuated throughout the year along with the overall market conditions. The portfolio was down -1.04% for the fiscal year compared with the favorable returns in 2011 of 21.87%. Returns for the first quarter (2012) were 9.82% and for the second quarter were negative 3.19% reflecting the lost momentum in the economic recovery in the U.S.

Total portfolio returns were 11.35%, 2.09% and 5.63% for three, five and seven year periods ending June 30, 2012, respectively. These returns include periods during which MCERA recognized and posted excess earnings to the pension fund that were used to provide retiree health benefits. The Association maintains an assumed net rate of investment return of 7.75% per year. The rate of return on MCERA's investment portfolio in an integral component of the annual additions to the pension plan as total investment income is typically the largest contributor to the plan's annual additions to retirement plan assets.

FUNDED STATUS AND ACTUARIAL REPORTING

MCERA maintains a funding goal to establish contributions that fully fund the System's liabilities, and that, as a percentage of payroll, remain as level as possible for each generation of active members. Actuarial valuations are performed annually with actuarial experience investigations conducted triennially in accordance with state statute. The use of realistic assumptions is important in maintaining the necessary funding while paying promised benefits. Each year the actual experience of the System is compared to our assumptions and the differences are studied to determine whether changes in the contribution requirements are necessary. In addition, triennially, the actuarial experience investigation is undertaken to review the actuarial assumptions and compare the actual experience during the preceding three year period with that expected under those assumptions.

Mendocino County issued $31 million of pension obligation bonds in December 1996 and $76 million of pension obligation bonds in December 2002 to satisfy the Unfunded Accrued Actuarial Liability (UAAL) for the County, calculated as of that date.

The current outstanding amount of Pension Obligation Bond debt was $79,575,000 and the current annual debt payment of this debt is $7,914,199.

In the June 30, 2012 valuation, the ratio of actuarial value of assets to the actuarial value of liabilities was 74.1% which was an increase from the prior year's valuation funded ratio of 73.6%. The Association's unfunded actuarial liability (UAAL) as of June 20, 2012 was $126,527,019. As of June 30, 2012, there are 27 years remaining in the declining 30-year amortization period of the UAAL.

The aggregate employer rate calculated in this valuation increased to 25.65% of payroll from 23.57% in last year's valuation. The aggregate employee rate increased to 9.76% of payroll from 9.73% in last year's valuation.

AWARDS AND ACHIEVEMENTS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement of Excellence in Financial Reporting to MCERA for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2011. The Certificate of Achievement is the highest form of recognition in governmental accounting and financial reporting, and its attainment represents a significant accomplishment by a government and its management.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, whose contents conform to program standards. Such basic financial statements must satisfy both accounting principles generally accepted in the United States of America and legal requirements.

ACKNOWLEDGEMENTS

I would like to take this opportunity to thank the members of the System for their continued confidence in MCERA during the past year. Also, I would like to express my thanks to the Board of Retirement for its dedicated effort in supporting the System throughout this past year. Finally, I would like to thank the consultants, professional service providers and staff for their commitment to MCERA and their diligent work to assure the System's continued success.

REQUEST FOR INFORMATION

The financial report is designed to provide the MCERA Board of Retirement, our membership, taxpayers, investment managers and creditors with a general overview of MCERA finances and to account for the money it receives. Questions concerning any of the information in this report or requests for additional financial information should be addressed to:

Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

Respectfully submitted,

Richard A White

Richard A. White, Jr.
Retirement Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Mendocino County

Employees' Retirement Association

California

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

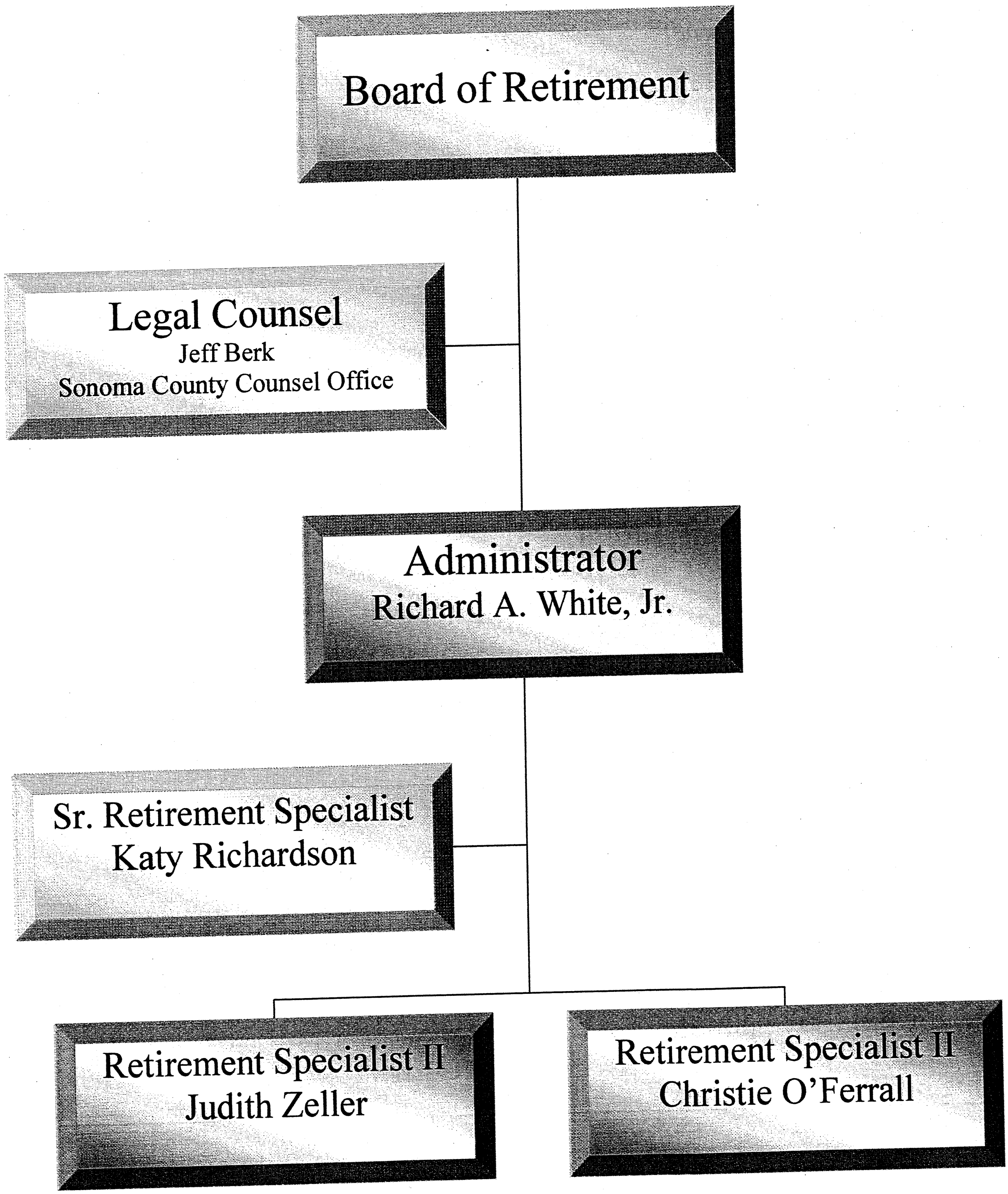
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards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

President

Executive Director

BOARD OF RETIREMENT
JUNE 30, 2012

MCERA ORGANIZATION CHART
AS OF JUNE 30, 2012



List of Professional Consultants
As of June 30, 2012

Actuary
The Segal Company

Disability Counsel
Law Office of Tony Graham

Fiduciary Counsel
Manatt, Phelps & Phillips, LLP

Investment Consultant
Callan Associates, Inc.

Independent Auditor
Gallina, LLP

Legal Counsel
County Counsel, County of Sonoma

Tax Counsel
Hanson Bridgett, LLP

Note: List of Investment Managers is located on page 49 of the Investment Section of this report.

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Financial Section

GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report

To the Board of Retirement
Mendocino County Employees' Retirement Association
Ukiah, California

We have audited the accompanying statement of net assets available for benefits of Mendocino County Employees' Retirement Association (MCERA), a component unit of the County of Mendocino, as of June 30, 2012, and the related statement of changes in net assets available for benefits for the year then ended. These financial statements are the responsibility of MCERA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of MCERA as of June 30, 2012, and the changes in its financial status for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis on pages 4 through 8, and other required supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Gallina LLP

Rancho Cordova, California
January 29, 2013

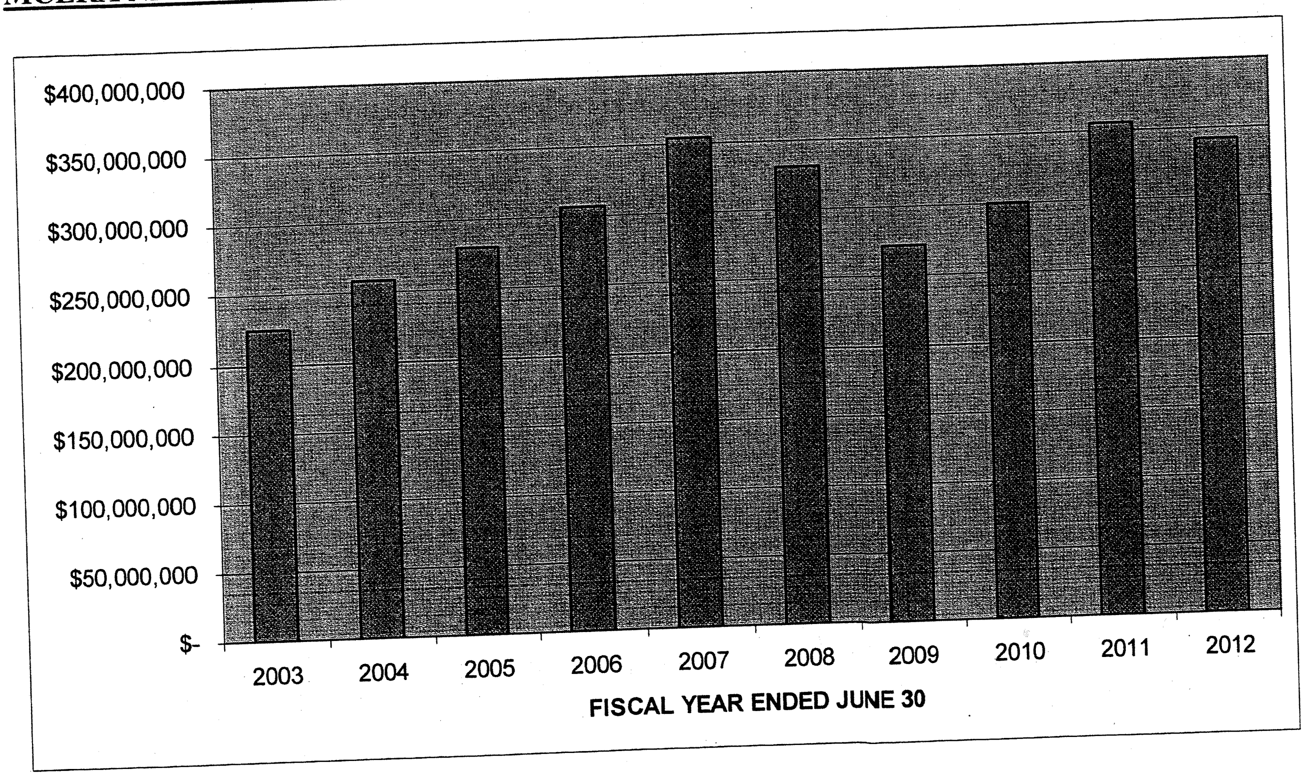
MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents Management's Discussion and Analysis (MD&A) of Mendocino County Employees' Retirement Association (MCERA or system) financial performance and a summary of MCERA's financial position and activities as of and for the fiscal year ended June 30, 2012. It is a narrative overview and analysis that is presented, in conjunction with the Retirement Administrator's Letter of Transmittal found in the Introductory Section, provides the financial statement reader with a clear picture of the System's overall financial status.

FINANCIAL HIGHLIGHTS

- MCERA's net assets available for benefits as of June 30, 2012 were $342 million which was a decrease from the prior fiscal year net asset value of $355 million, a decrease of 3.47%.
- Additions to plan assets amounted to $12.5 million as of June 30, 2012 which represented an 84% decrease from the previous fiscal year. This was comprised of $ 11.8 million of employer contributions, $ 4.8 million of member contributions and a net investment loss of $ 4.0 million.
- Expenses (deductions in plan assets) for the year were $24.8 million, an 3.33% increase from the previous fiscal year, which included $24.1 million in benefit payments to retirees and beneficiaries and $0.7 million in administrative expenses.
- MCERA funding status for the pension plan, as measured by the ratio of actuarial value of assets to the actuarial value of liabilities, increased to 74.1% as of June 30, 2012 from the previous fiscal year funding ratio of 73.6%.

MCERA NET ASSETS HELD IN TRUST FOR PENSION BENEFITS



OVERVIEW OF THE FINANCIAL STATEMENTS

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Statement of Changes in Net Assets
The Statement of Changes in Net Assets Available for Benefits provides information on the financial activities that increased and decreased Plan Net Assets. For comparative purposes, prior year-end balances are also provided. a view of the current year additions to and deductions from the plan. This statement covers the activity over a one-year period of time.

Notes to the Basic Financial Statements
The Notes to the Financial Statements are an integral part of the basic financial statements and provide background and detailed information regarding MCERA's policies, programs and activities.

Required Supplemental Information
The Required Supplemental Information contains supporting schedule pertaining to MCERA's Pension actuarial methods, assumptions, funded status and annual required contributions.

Other Supplemental Information
Other supplemental information includes schedules pertaining to administrative expenses and investment expenses.

FINANCIAL ANALYSIS

Table #1 and #2 compare and summarize MCERA's financial activity for the current and prior fiscal years.

Table #1: MCERA NET ASSETS
As of June 30, 2012 and 2011

(Dollars in Thousands)	06/30/2012	06/30/2011	Amount Increase/ (Decrease)	% Change Increase/ (Decrease)
Cash and Short Term Investments	$ 3	$ 1,190	$ (1,187)	-99.7%
Receivables	280	367	(87)	-23.7%
Investments, at Fair Value	342,853	353,565	(10,712)	-3.03%
Total Assets	**343,136**	**355,122**	**(11,986)**	**-3.38%**
Accounts Payable	142	15	127	846.7%
Accrued Expenses	257	64	193	301.6%
Total Liabilities	**399**	**79**	**320**	**405.0%**
Net Assets Held in Trust for Benefits	$ 342,737	$ 355,043	$ (12,306)	-3.47%

Table #2: CHANGES IN MCERA NET ASSETS
As of June 30, 2012 and 2011

(Dollars in Thousands)	2012	2011	Increase (Decrease) Amount	% Change
Additions				
Employer Contributions	$ 11,811	$ 9,554	$ 2,257	24%
Member Contributions	4,840	5,447	(607)	-11%
Net Investment Income	(4,079)	64,075	(68,154)	-106%
Total Additions	**12,573**	**79,076**	**(66,503)**	**-84%**
Deductions				
Retirement Benefits [(1)]	22,955	22,269	1,911	9%
Refund of Contributions	1,225	1,167		%
Administrative Expenses	698	640	58	9%
Total Deductions	**24,879**	**24,076**	**803**	**3%**
Net Increase/Decrease	**(12,306)**	**55,000**	**(67,306)**	**-122%**
Net Assets at Beginning of Year	**355,043**	**300,043**	**55,000**	**18%**
Net Assets at End of Year	**$ 342,737**	**$ 355,043**	**$ (12,306)**	**-3.47%**

(1) Retirement benefits include transfers to Human Resources for retiree health care costs.

ADDITIONS TO PLAN ASSETS

The primary sources to finance the benefits MCERA provides to its members are accumulated through income on investments and through the collection of employee and employer contributions. These income sources for the fiscal year ended June 30, 2012 totaled $12.6 million and June 30, 2011 totaled $79.1 million. The decrease in revenues from 2011 to 2012 can be attributed primarily to losses in the fair value of investments. The total balance of net assets decreased from approximately $355 million in 2011 to $343 million in 2012.

DEDUCTIONS IN PLAN ASSETS

The primary uses of MCERA assets are the payment of benefits to retirees and their beneficiaries, refunds of contributions to terminated employees, and the cost of administering the system. These expenses for the fiscal years ended June 30, 2012 and June 30, 2011 were $24.9 million and $24.1 million respectively. The MCERA Board continues to review staffing levels and information technology needs during the upcoming year.

MCERA Financial Reserves

Table #3: MCERA RESERVES
As of June 30, 2012 and 2011

(Dollars in Thousands)	06/30/2012	06/30/2011
Member Reserve	$ 62,998	$ 64,911
Employer Reserve	(35,311)	(25,775)
Annuitant Reserve	180,571	179,185
Cost of Living Reserve	90,402	84,867
Undesignated Reserve (1)	659	659
Contingency Reserve	3,551	3,551
Miscellaneous Reserves	257	22
Total Reserves	**$ 303,127**	**$ 307,420**

MCERA's reserves are established from contributions and the accumulation of investment income after satisfying investment and administrative expenses. Under GASB 25, investments are stated at fair value instead of cost and include the recognition of unrealized gains and losses in the current period. MCERA has adopted a five-year smoothing methodology for investment gains and losses. This has the effect of smoothing both positive and negative fluctuations in investment performance versus assumptions and has a stabilizing effect on contribution rates.

(1) The undesignated reserve used historically for health care benefits of retirees was derived from excess earnings of the Association in prior years. The disposition of this reserve is still under review by MCERA's legal, actuarial, and fiscal advisors. It is still reflected in the actuarial report as "Retiree Health Insurance Reserve."

INVESTMENT AND ECONOMIC SUMMARY

Investment returns in Fiscal Year 2012 flucuated throughout the year along with the overall market conditions. The portfolio was down -1.04% for the fiscal year compared with the favorable returns in 2011 with a 21.87%. Returns for the first quarter (2012) were 9.82% and for the second quarter were negative 3.19% reflecting the lost momentum in the economic recovery in the U.S.

Total portfolio returns were 11.35%, 2.09% and 5.63% for three, five and seven year periods ended June 30, 2012, respectively. These returns include periods during which MCERA recognized and posted excess earnings to the pension fund that were used to provide retiree health benefits.

The rate of return on MCERA's investment portfolio in an integral component of the annual additions to the pension plan as total investment income is typically the largest contributor to the plan's annual additions to retirement plan assets.

STATEMENT OF PLAN NET ASSETS
As of June 30, 2012 and 2011

ASSETS	2012	2011
Investments, at fair value:		
Mutual Funds	333,396,451	339,258,626
Cash equivalents	2,354,860	1,189,486
Real estate partnership	6,362,464	13,567,707
Real estate – 625 Kings Court, Ukiah, Ca	738,992	738,992
Total Investments, at fair value	342,852,767	354,754,811
Receivables:		
Member contributions receivable	75,196	76,187
Employer contributions receivable	204,466	229,617
Other receivables	-0-	57,574
Total Receivables	279,662	363,378
Other assets	3,786	3,786
TOTAL ASSETS	**$ 343,136,215**	**$ 355,121,975**
LIABILITIES		
Liabilities:		
Accounts payable	142,052	14,829
Accrued expenses and other liabilities	257,351	64,623
TOTAL LIABILITIES	**$ 399,403**	**$ 79,452**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	**$ 342,736,812**	**$ 355,042,523**

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF CHANGES IN PLAN NET ASSETS
As of June 30, 2012 and 2011

	2012	2011
Additions to net assets attributed to:		
Investment income:		
Net realized and unrealized appreciation in fair value of investments	(11,133,208)	56,130,687
Rent income, net of expenses	45,644	24,761
Interest income	64,384	2,460,864
Dividend income	7,260,965	5,863,549
Investment expenses	(316,274)	(404,760)
Total investment income, net	(4,078,489)	64,075,101
Contributions:		
Member contributions	4,840,275	5,446,964
Employer contributions	11,811,076	9,553,955
Total contributions	16,651,351	15,000,919
Total additions	**$ 12,572,862**	**$ 79,076,020**
Deductions from net assets attributed to:		
Benefits paid to retirees	24,180,110	23,436,295
Administrative expenses	698,463	639,764
Total deductions	**$ 24,878,573**	**$ 24,076,059**
Net increase	(12,305,711)	54,999,961
Net Assets Held in Trust for Pension Benefits Balance at Beginning of Year	**$ 355,042,523**	**$ 300,042,562**
Balance at End of Year	**$ 342,736,812**	**$ 355,042,523**

The accompanying notes to the financial statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS
For the Year ended June 30, 2012

Note 1: Summary of Significant Accounting Policies:

Reporting Entity:

MCERA is governed by the Board of Retirement and is considered an independent entity. The Association is a component unit of the County of Mendocino and is being reported as a Pension Trust Fund in the County's Financial Report in accordance with Governmental Accounting Standards Board Statement No. 14.

Basis of Accounting:

The Association follows Governmental Accounting Standards Board (GASB) accounting principles and reporting guidelines, and financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the Plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Retirement Administrator to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Derivatives:

MCERA's investment policy permits the use of derivative instruments to minimize the exposure of certain of its investments to adverse fluctuations in financial and currency markets and enhance yields. MCERA does not use derivatives for speculative use or to create leverage.

During the year ended June 30, 2012 MCERA owned no derivatives directly in its portfolio.

Custodial Credit Risk:

Custodial risk for deposits in the Mendocino County trust is assumed by the County of Mendocino. Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, MCERA would not be able to recover the value of the investment or collateral securities that are in possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in MCERA's name, and held by the counterparty. MCERA's investment securities are not exposed to custodial credit risk because all securities are held by MCERA's custodial bank in MCERA's name, or by other qualified third party administrator trust accounts.

Note 1: Summary of Significant Accounting Policies, continued:

Except for a statement that duties of the Board of Retirement, MCERA officers and employees shall be discharged with care, skill, prudence, and diligence, MCERA has no formal policy for managing custodial credit risk.

Market and Credit Risk:

Credit risk is the risk that an issuer or other counterparty to a debt instrument will not fulfill its obligations. This is measured by the assignment of ratings by nationally recognized statistical rating organizations. Investment allocation guidelines according to the investment policy are as follows:

	Allowable Range	Current Allocation
U.S. Equity	33% - 43%	41%
Non-U.S. Equity	20% - 30%	23%
U.S. Fixed Income	23% - 33%	27%
Real Estate	4% - 14%	9%

MCERA's Investment Policy does not allow for a single investment in real estate that is in excess of 5% of total assets. With respect to common stocks, MCERA has a goal of diversifying the portfolio among a cross-section of industries that have sound long-term growth potential. Similar restrictions apply to fixed income securities.

Interest Rate Risk:

Interest rate risk is the risk that changes in the interest rate will adversely affect the fair value of an investment. MCERA has not adopted a formal policy to manage interest rate risk.

Member Termination:

Upon separation from MCERA, members' accumulated contributions are refundable with interest accrued through the prior June 30 or December 31. Interest on member accounts is credited semiannually on June 30 and December 31. Withdrawal of such accumulated contributions results in forfeiture of the related vested benefits.

Plan Termination:

MCERA is administered in accordance with the provisions of California Government Code Section 31450 and accompanying code sections. California Government Code Section 31483 allows the governing body of the County, the County Courts, or special district, through the adoption of an ordinance or resolution, to terminate the applicability of the Plan to employees of the County, Courts, or district whose services commence after a given future date.

Note 1: Summary of Significant Accounting Policies, continued:

Risk Management:

MCERA is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; natural disasters; and major downturns in financial markets. For the past several years, MCERA has obtained coverage from commercial insurance companies for errors and omissions coverage related to activities of the Board of Retirement, but all other risks of loss, except losses due to depreciation in the fair market value of investments, is assumed by the sponsoring employers. MCERA has effectively managed risk through various employee education and prevention programs and careful selection of investments. Expenditures and claims are recognized when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

The Mendocino County Department of Human Resources has assumed the duties of administering the health care claims of retirees. During the fiscal year ended June 30, 2011 MCERA came into full compliance with Internal Revenue Code Section 401(h) for any flow of funding.

Based on Mendocino County Board of Supervisors Resolution No. 98-147, County Counsel concluded that the County Board of Supervisors was ultimately responsible for the funding, administration and decision-making dealing with all aspects of the Plan. As a result, no incurred but not reported claims were included as liabilities on the financial statements for the year ended June 30, 2012. For the year ended June 30, 2012, MCERA had no excess earnings that can be used for the payment of retiree health benefits.

Current and Future Accounting Pronouncements:

GASB Statement No. 53 - Accounting and Reporting for Derivative Instruments became effective for all years beginning after June 15, 2009. This statement provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. If MCERA invests in derivative instruments in the future, this statement will be used to measure, recognize, and disclose those transactions.

GASB Statement No. 61 - The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34, modifies certain requirements for inclusion of component units in the financial reporting entity, and amends the criteria for reporting component units as if they were part of the primary government. Although the provisions for this statement are effective for fiscal years beginning after June 15, 2012, it seems to clarify and confirm the existing relationship of MCERA as a component unit of the County of Mendocino.

GASB Statement No. 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for periods beginning after December 15, 2011, will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source.

Note 1: Summary of Significant Accounting Policies, continued:

Subsequent Events:

Management has evaluated all subsequent events through January 29, 2013, the date the financial statements were available to be issued. See Note 7 for additional information.

Note 2: Description of Plan:

Description of Association and Applicable Provisions of the Law:

The Mendocino County Employees' Retirement Association (MCERA or the Plan) is an integrated public retirement system established under and subject to the legislative authority of the State of California as enacted and amended by the County Retirement Act of 1937 (Chapter 677 Statutes of 1937). MCERA is a multiple-employer cost sharing defined benefit plan for the County of Mendocino, the Mendocino County Courts, and the Russian River Cemetery District. MCERA was approved by the Board of Supervisors to become effective January 1, 1948, and was integrated with Social Security on January 1, 1956.

Membership in the Plan at June 30, 2012 consisted of the following:

	2012	2011
Retirees and beneficiaries receiving benefits	1,217	1,129
Terminated plan members entitled to but not yet receiving benefits	356	389
Active plan members	1,069	1,129
Total	2,642	2,647
Number of participating employers	3	3

A cost-sharing multiple employer plan is a single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members. Other special districts within Mendocino County are eligible, but have not elected to participate.

All permanent employees who work at least 32 hours per week become members of the Plan on the first day of the pay period following employment. Employees are classified as either General or Safety (Law Enforcement or Probation) members, and are assigned to one of three tiers based on entry date and job classification.

Retirement benefits offered by the Plan include normal retirement, disability retirement and service-connected disability retirement. A death benefit is available to beneficiaries. An annual cost of living adjustment of no more than 3 percent may be granted by the Board of Retirement. For 2012, the Board of Retirement approved a cost of living increase of 3.0%, depending on date of retirement, which became effective April 1, 2012.

Note 2: Description of Plan, continued:

Description of Association and Applicable Provisions of the Law, continued:

Health benefits for retired employees have been funded by the Plan in the past. As of September 1, 1998, the County of Mendocino had assumed responsibility for partial funding of the cost of health care for the retired employees of the County of Mendocino, and will be responsible for the cost of health care when MCERA earnings on investments are not in excess of required transfers of earnings to retirement reserve accounts. On September 22, 2009, the Board of Supervisors adopted a superceding resolution which stated that retiree health care would only be paid from earnings in excess of transfers to the retirement reserve accounts or by the retirees in the form of a premium. For eligibility for health care coverage, prior to September 1, 1998, retirees must have served 10 years prior to retirement with the County of Mendocino, and retire as an active member. The retiree health benefit program qualifies under section 401(h) of the Internal Revenue Code. Health care payments to reimburse the County of Mendocino for the cost of retiree health care were formally made from a special reserve that has been established as a result of prior excess earnings. There were no health care subsidy amounts paid during the year ended June 30, 2012.

Note 3: Cash and Investments:

Investments are reported at fair value. Investments that do not have an established market are reported at estimated fair value. All investments listed in the Statement of Net Assets Available for Benefits are registered securities held by the Association's agent in the Association's name. The Board of Retirement has exclusive control over all investments of the Association and is responsible for establishing investment objectives, strategies and policies.

The Board of Retirement has adopted an Investment Policy, which provides the framework for the management of MCERA's investments. The Investment Policy establishes MCERA's investment objectives and defines the principal duties of the Board of Retirement and the investment managers. The asset allocation plan is an integral part of the Investment Policy and is designed to provide an optimum and diversified mix of asset classes with return expectations to satisfy expected liabilities while minimizing risk exposure. MCERA currently employs investment managers to manage its assets subject to the provisions of the investment Policy.

Cash equivalents consist of cash in trust with the Treasurer of the County of Mendocino. Cash from deposits and cash needed for daily operational purposes is held in a pooled account with other County funds. The County Treasurer is responsible for the management, control and safekeeping of all investments in the pooled fund. Interest on funds in the County investment pool is computed quarterly based on average daily balance. A deposit in the pooled account approximates fair value.

Security transactions are accounted for on a trade date basis. Interest income is recognized when earned and dividend income is recognized on the ex-dividend date. Stock dividends or stock splits are recorded as memo items and do not affect the total value of the securities. Unrealized gains and losses on investments are reported as "net appreciation (depreciation) in the fair value of investments." The calculation of realized gains and losses is independent of the calculation of net appreciation (depreciation) in the fair value of Plan investments.

Note 3: Investments, continued:

The Association's cash and investments stated at fair value as of June 30, 2012, are as follows:

	2012	2011
Cash in Trust - Mendocino County	2,354,860	1,189,486
Total Cash Equivalents	2,354,860	1,189,486
U.S. Government and corporate Bonds	92,893,393	97,682,320
International equities	77,140,774	85,501,443
Domestic equities – small cap	21,518,466	21,760,587
Domestic equities – mid cap	21,744,297	22,610,177
Domestic equities – large cap	96,725,492	95,465,563
Real Estate	23,374,029,	16,238,536
Total Mutual Funds	333,396,451	339,258,626
Real estate partnerships	6,362,464	13,567,707
Real estate – 625 Kings Court, Ukiah, CA	738,992	738,992
Total Cash Equivalents and Investments	342,852,767	354,754,811

Note 4: Fair Value Measurement of Investments:

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Note 4: Fair Value Measurement of Investments, continued:

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for investments measured at fair value. There have been no changes in the methodologies used at June 30, 2012.

Mutual funds and real estate partnership: Valued at the net asset value of shares held by the Plan at year end.

Real estate – 625 Kings Court, Ukiah, CA: Valued at cost, which approximates fair value.

The methods described above may produce a fair value calculation that may not be as indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth by level, within the fair value hierarchy, MCERA's investments at fair value as of June 30, 2012:

	Investments at Fair Value as of June 30, 2012			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Bond funds	$ 92,893,393	$ -	$ -	$ 92,893,393
International securities	77,140,774	-	-	77,140,774
Domestic securities	139,988,255	-	-	139,988,255
Real estate	23,374,029	-	-	23,374,029
Total mutual funds	333,396,451	-	-	333,396,451
Real estate partnership	6,362,464	-	-	6,362,464
Real estate - 625 Kings Court, Ukiah, CA	-	-	738,992	738,992
Total investments at fair value	$ 339,758,915	$ -	$ 738,992	$ 340,497,907

Note 4: Fair Value Measurement of Investments, continued:

The following table sets forth a summary of changes in the fair value of the Plan's Level 3 investments for the year ending June 30, 2012 as follows:

	Real Estate - 625 Kings Court, Ukiah, CA
Balance, beginning of year	$ 738,992
Unrealized gains (losses)	-
Purchases	-
Sales	-
Issuances	-
Settlements	-
Balance, end of year	$ 738,992

Note 5: Contributions:

The actuarially determined member contribution rates payable for fiscal year 2013-14 averaged 9.76 percent of payroll and 9.73 for the year ended June 30, 2011. The actual member rate depends on the member's age at the time of hire, General, Safety, or Probation membership, and tier. For fiscal year 2013-14, employers are also required to contribute an actuarially determined rate of 25.65 percent of payroll in aggregate. The employer aggregate rate was 23.57 percent of payroll for the year ended June 30, 2011. The actual employer rate depends on General, Safety, or Probation membership, and tier. The member and employer contribution rates are adjusted annually to maintain the appropriate funding status of the Plan. The employer contribution rate is actuarially determined to provide for the balance of the contributions needed to fund the annual normal cost (basic and cost of living) and the amortization of the unfunded actuarial accrued liability.

The Plan had an unfunded actuarial accrued liability of $47,154,000 at June 30, 2001. This unfunded liability was being amortized through June 30, 2017, at which time it was anticipated the Plan would be fully funded. In December, 1996, the County of Mendocino issued pension obligation bonds, of which $30,112,488 of the proceeds were contributed to the Plan. In December, 2002, due to a continued downward spiral of market values for MCERA investments, the County of Mendocino issued additional pension obligation bonds. The total of bonds sold was $92,208,602, of which $76,299,000 was transferred to the Plan for additional investment, $13,220,061 was used to defease fifty percent of the 1996 pension obligation bonds, and the remainder of $2,689,541 was used to pay the costs of issuing the bonds. The proceeds from the 2002 pension obligation bonds reduced the unfunded pension liability to less than 10 percent of the actuarial accrued liability at June 30, 2004. The funding agreement in effect prior to July 1, 2009 indicated that the County was not required to fund the UAAL that was not in excess of the target of 10 percent of the total pension liability.

Note 5: Contributions, continued:

In November 2009, that funding agreement was voided by mutual agreement between the Association Board of Retirement and the Mendocino County Board of Supervisors. Subsequent to the funding agreement, the Board of Retirement stipulated that the County of Mendocino must amortize the UAAL over a 30-year period from June, 2009.

For the actuarial valuation for the year ended June 30, 2010, the prior actuary changed their assumptions regarding withdrawals by inactive members. This change in assumption affected the projected number of inactive members who would withdraw their contributions and forego a retirement, compared to those who would leave their contributions and vested benefits with the Plan and retire at a later date. The result was an estimated increase of $3.3 million in the County's contribution for the fiscal year ended June 30, 2012.

The UAAL as of June 30, 2012 is $126.5 million, which the County of Mendocino is required to amortize in the future. The funded ratio at June 30, 2012 is 74.1%, as indicated on the Schedule of Funding Progress on Page 24. The Actuarial Valuation and Review report issued by The Segal Company as of June 30, 2012 recommended employer and member contribution rates that aggregate to 25.65% and 9.76%, respectively.

Note 5: Contributions, continued:

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

Valuation date	June 30, 2012
Actuarial cost method	Entry age normal cost method (individual basis)
Amortization method	Level % of payroll for total unfunded liability
Remaining amortization period	27 years (declining/closed) for all UAAL
Asset valuation method	Market value of assets less unrecognized returns in each of the last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five year period, further adjusted, if necessary, to be within 25% of the market value. The valuation value of assets is the actuarial value of assets reduced by the value of the non-valuation reserves.
Actuarial assumptions:	
Investment rate of return	7.75%
Inflation rate	3.50%
Real across-the-board salary increase	0.50%
Projected salary increases *	4.50% to 9.00%
* Includes inflation at	3.50% + 0.50% across-the-board salary increases
Cost of living adjustments	3.00% of retirement income
Years of life expectancy after retirement	General members: RP-2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, with no setback for males and 1 year set forward for females.
Years of life expectancy after disability	General members: RP-2000 Combined Healthy Mortality Table for males and females, set forward 2 years. Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, set forward 4 years.

Note 5: Contributions, continued:

Life expectancy after retirement for employee contribution rate purposes	General members: RP-2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females weighted 30% male and 70% female. Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, with no setback for males and 1 year set forward for females weighted 80% male and 20% female.

Using the projected payroll amounts for MCERA's membership groups and tiers that were used in the June 30, 2010 actuarial valuation, management has estimated the contributions are comprised of the following for the year ended June 30, 2012:

Estimated employer normal cost contributions	$ 6,859,383
Estimated UAAL contributions	4,951,693
Total	$ 11,811,076

Using the projected payroll amounts for MCERA's membership groups and tiers that were used in the June 30, 2010 actuarial valuation, management has estimated the contributions are comprised of the following for the year ended June 30, 2012:

Estimated employer normal cost contributions	$ 6,859,383
Estimated UAAL contributions	4,951,693
Total	$ 11,811,076

Note 6: Reserves:

The Association had contingency reserves of $3,550,728, at June 30, 2012 to fund transfers to retirement reserve accounts in the event that sufficient earnings on investments are not received in the future to fulfill the requirement of transferring current earnings to the extent of 7.75 percent of retirement reserve balances to those reserves.

Member and employer contributions are allocated to various legally required reserve accounts based on actuarial determinations. A summary of the various reserve accounts, which comprise net assets available for pension and other benefits at June 30, 2012 (under the five-year smoothed asset valuation method for actuarial valuation purposes) is as follows:

		2012	2011
Employee reserves	$	62,997,613	64,911,013
Employer reserves		(35,311,033)	(25,774,820)
Retiree reserves		270,972,746	264,051,864
Undesignated reserves (see Note 7)		658,654	658,654
1% Contingency reserve		3,550,728	3,550,728
Settlement reserve		248,093	-0-
Miscellaneous reserves		9,259	22,475
Total reserves		303,126,060	307,419,914
Cumulative unallocated net unrealized gain on investments		62,792,624	44,520,819
Total allocated reserves (smoothed market actuarial value after corridor limits)		365,918,684	351,940,733
Net assets in excess (deficit) of reserves		(23,181,872)	3,101,790
Net assets available for pension benefits, at fair value	$	342,736,812	355,042,523

The undesignated reserve used historically for providing health care benefits of retirees was derived from excess earnings of the Association in prior years.

Note 7: Subsequent Events:

Subsequent events are those events or transactions that occur subsequent to the effective date of the financial statements, but prior to the issuance of final reports, which may have a material effect on the financial statements or disclosures therein.

The fair value of assets in MCERA's portfolio has increased from $343 million to $357 million between July 1, 2012 and December 31, 2012. Capital markets continue to be highly volatile resulting in significant swings in market value, both positive and negative.

Note 7: Subsequent Events, continued:

Since July 1, 2011, MCERA's new actuary, The Segal Company (Segal), determined that the employee basic contribution rate for fiscal years 2009-10, 2010-11 and 2011-12, as calculated by the prior actuary, was higher in the aggregate than it should have been. This resulted in a corresponding underpayment by employers during the same period. MCERA is working with a team of external and internal professionals to reimburse overpayments and collect underpayments to the pension fund based on the corrected rates, and in accordance with all tax laws and regulations. Corrected rates will be in effect January 8, 2012, and the project is expected to be completed before the end of fiscal year 2012-13.

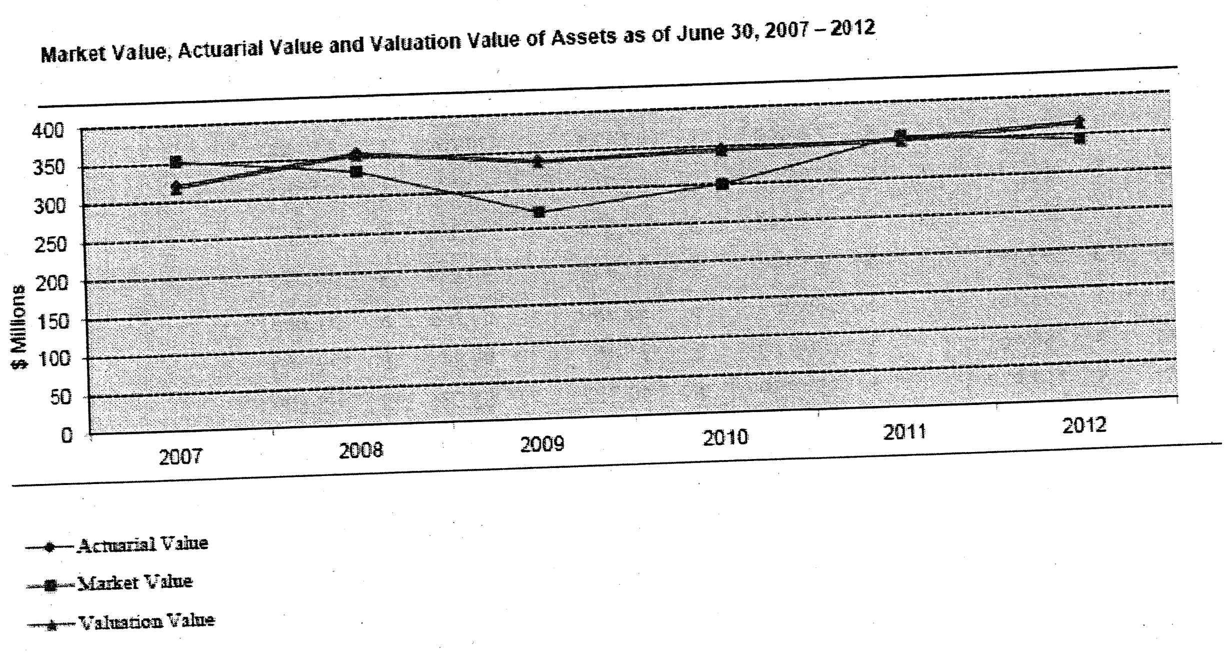
MCERA submitted a Voluntary Correction Program (VCP) filing with the IRS, stating that it recognized and posted excess earnings of $9.6 million, for fiscal years ending June 30, 2004 through 2006 that may not have been fully consistent with Government Code Section 31529.4 and/or IRC Section 401(h). The residual amount of excess earnings recognized and posted over this time period has been classified as "Undesignated reserves" and was $658,654 at June 30, 2012. The excess earnings postings are being reviewed by tax counsel, actuary, and an accounting firm to develop findings and recommendations for submission to the IRS. The IRS review on issues common to retirement systems such as MCERA that are maintained under the County Employees' Retirement Law of 1937 has begun. The IRS review, including any issues specific to MCERA, is expected to be completed sometime in calendar year 2013.

Required Supplementary Information

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability as a measure that is influenced by the choice of actuarial cost method. Historical trend information is presented in the following schedules.

This information was determined as part of the actuarial valuations at the dates indicated. Governmental Accounting Standard Board (GASB) requires the Actuarially Required Contributions (ARC) and the Funding Status Schedules to be included and we do so in the following schedules.

This chart shows the change in market value, actuarial value and the valuation value of assets over the past six years.



The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

SCHEDULE OF FUNDING PROGRESS [1]
GASB 25
(Dollar amounts in thousands)

Actuarial Valuation Date	Valuation Assets		Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll		UAAL as a Percent of Covered Payroll
7/1/93	$ 72,062		$ 105,866	$ 33,804	68.1%	$ 25,930		130.4%
7/1/94	$ 75,976		$ 112,535	$ 36,559	67.5%	$ 27,185		134.5%
7/1/95	$ 79,322		$ 121,027	$ 41,705	65.5%	$ 29,603		140.9%
7/1/96	$ 84,992		$ 130,036	$ 45,044	65.4%	$ 29,587		152.2%
7/1/97	$ 124,286		$ 140,783	$ 16,497	88.3%	$ 32,481		50.8%
7/1/98	$ 134,836		$ 154,263	$ 19,427	87.4%	$ 35,586		54.6%
7/1/99	$ 142,775		$ 173,250	$ 30,475	82.4%	$ 39,209		77.7%
7/1/00	$ 150,056		$ 185,423	$ 35,367	80.9%	$ 44,132		80.1%
7/1/01	$ 157,545		$ 204,699	$ 47,154	77.0%	$ 53,188		88.7%
7/1/02	$ 158,115	(2)	$ 226,883	$ 68,768	69.7%	$ 57,701		119.2%
7/1/03	$ 233,764	(3)	$ 243,342	$ 9,578	96.1%	$ 59,865		16.0%
7/1/04	$ 239,191		$ 265,141	$ 25,950	90.2%	$ 59,075		43.9%
7/1/05	$ 253,487		$ 289,467	$ 35,980	87.6%	$ 57,664		62.4%
7/1/06	$ 288,461		$ 320,123	$ 31,662	90.1%	$ 57,665		54.9%
7/1/07	$ 317,937		$ 358,259	$ 40,322	88.7%	$ 65,899		61.2%
7/1/08	$ 353,421		$ 373,832	$ 20,411	94.5%	$ 70,880		28.8%
7/1/09	$ 336,263		$ 403,196	$ 66,933	83.4%	$ 72,235		92.7%
7/1/10	$ 343,202		$ 434,987	$ 91,785	78.9%	$ 69,004		133.0%
7/1/11	$ 347,732		$ 472,644	$ 124,912	73.6%	$ 64,144	(4)	194.7%
7/1/12	$ 362,487		$ 489,014	$ 126,527	74.1%	$ 56,596		223.6%

(1) Information prior to 2011 has been extracted from the previous actuary's past valuation reports.

(2) Excludes proceeds from Pension Obligation Bonds issued in December 2002.

(3) Includes proceeds from Pension Obligation Bonds issued in December 2002 in the amount of 76,299,000.

(4) 6/30/2011 payroll includes a projection for expected salary increases during 2011/2012 under the actuarial assumptions used in valuation.

SCHEDULE OF EMPLOYER CONTRIBUTIONS
GASB 25
(dollar amounts in thousands)

Year Ended	Annual Recommended Contribution	Percentage Contributed
12/31/92	$ 2,939	100%
12/31/93	$ 2,939	100%
6/30/95 (1)	$ 5,182	100%
6/30/96	$ 4,348	100%
6/30/97	$33,691 (2)	100%
6/30/98	$ 2,661	100%
6/30/99	$ 3,165	100%
6/30/00	$ 3,787	100%
6/30/01	$ 7,216	100%
6/30/02	$ 6,348	100%
6/30/03	$ 6,663	100%
6/30/04	$ 4,158	63%
6/30/05	$ 3,221	47%
6/30/06	$ 4,996	79%
6/30/07	$ 7,533	100%
6/30/08	$ 7,232	100%
6/30/09	$ 6,046	141%
6/30/10	$ 9,571	91%
6/30/11	$ 9,554	100%
6/30/12	$ 11,811	100%

(1) Reflects 18 months of contributions due to a change in the financial reporting year.
(2) Includes proceeds from Pension Obligation Bonds.

SCHEDULE OF ADMINISTRATIVE EXPENSES
For the Year ended June 30, 2012 and 2011

	2012	2011
Personnel Services:		
Salaries and Wages	250,273	259,776
Other Benefits	65,571	57,332
Salaries, Wages & Benefits Charged to Investments	-0-	-0-
Employee Retirement	59,935	47,748
Total Personnel Services	375,779	364,856
Professional Services:		
Outside Legal Counsel – Disability	60,897	57,069
Disability Hearing Officer/Medical Exams	70,887	61,785
External Audit Fees	22,935	17,924
Automation & Software	6,262	24,543
Total Professional Services	160,981	161,321
Miscellaneous:		
Office Expenses *	33,712	14,798
New Building Equipment	-0-	-0-
Insurance General	976	1,021
Memberships	4,500	4,500
Prof & Spec Services – Other	99,580	78,276
Transportation & Travel	22,935	14,992
Total Miscellaneous	161,703	113,587
Total Administrative Expenses	698,463	639,764

* Includes 1/2 of Building Expenses.

Administrative Budget: Government Code § 31580.2 states in part, "*...the respective board or boards shall annually adopt a budget covering the entire expense of administration of the retirement system which expense shall be charged against the earnings of the retirement fund. The expense incurred in any year may not exceed the greater of the following: 1) Twenty-one hundredths of 1 percent of the accrued actuarial liability of the retirement system. 2) Two million dollars ($2,000,000)...*" MCERA's administrative expenses met the requirements of this section in Fiscal Year 2011/12 as the expenses were 14/100% of the actuarial accrued liability.

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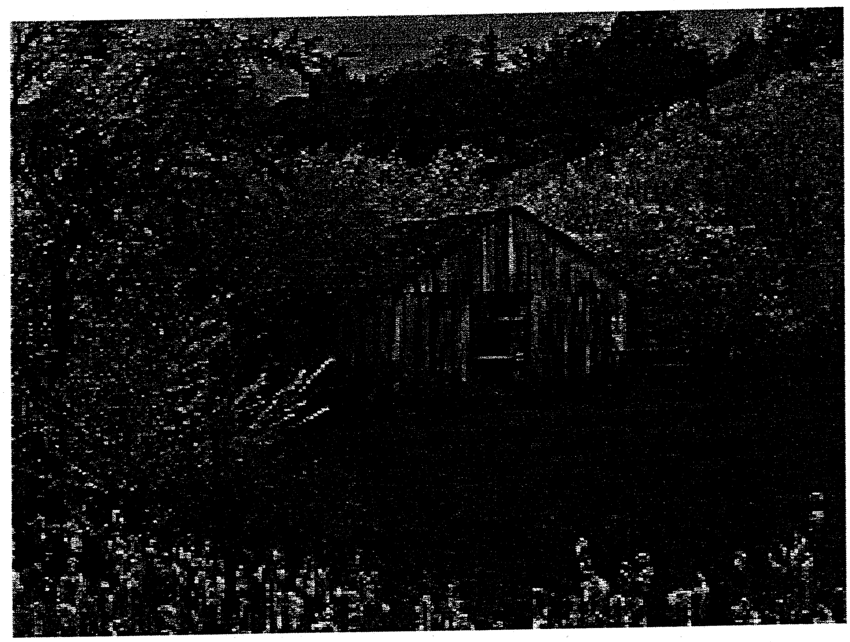
Investment Section



Callan

FUND
SPONSOR
CONSULTING

Performance
Summary

Mendocino County Employees' Retirement Association
Executive Summary
Fiscal Year Ended June 30, 2012

General Economic Conditions and Capital Markets Overview

The fiscal year ended June 30, 2012 was characterized by marked volatility. After falling sharply in the first quarter of the fiscal year, equities notably recovered through the second and third quarters only to shed ground again in the final quarter. For the full fiscal year, broad market asset class returns were widely mixed, with double-digit negative returns from international equities and strong mid to high single-digit gains from fixed income.

As the fiscal year commenced, the U.S. Congress was embroiled in a bitter debate about the debt ceiling. The 11th hour resolution in early August averted a default on government obligations. However, much damage was done to credibility and confidence on both sides of the aisle. In a sharply-worded announcement, Standard & Poor's downgraded the credit rating of U.S. Treasury obligations from AAA to AA+ based on concerns surrounding the "effectiveness, stability, and predictability of American policymaking and political institutions." The market impact of the downgrade was rather interesting – while traditional expectations are that a downgrade would negatively impact bond prices, the flight to quality status of US Treasuries overrode the credit rating decline and pushed bond prices higher.

Turmoil in Europe continued to be a major headline right up to the final day of the fiscal year. In June both Spain and Cyprus formally requested bailout funds from the European Central Bank. Spain's bailout represented the fourth bailout of the five PIIGS countries, joining Portugal, Ireland, and Greece. After initially denying the need for bailout funds, Spain requested $125 billion (€100 billion) to shore up its faltering banking system. Italy, the remaining "I" in PIIGS, has avoided a bailout due in part to stronger fiscal position; despite a very high debt-to-GDP ratio (120%) Italy currently runs a budget surplus. While Cyprus is a small sovereign nation, it enjoyed a large banking sector due to a favorable tax landscape for Greek nationals. Cyprus requested approximately €2 billion or 10% of its GDP. In an interesting counterpoint to the PIIGS moniker coined in 2009, "FANGs" (Finland, Austria, Netherlands, Germany) has come to the fore as an acronym for the wealthy northern-European countries who's more stable economies may be relied upon to backstop the bailouts of the PIIGS.

While Europe captured many headlines, it was by no means quiet on the domestic front. Worries in the US surrounded the "fiscal cliff," the combination of spending cuts triggered by the failure of the 2011 "super committee," the expiration of enhanced jobless benefits, and the expiration of the Bush tax cuts and payroll tax holiday (among other things).

In the bond market, the Fed continued to hold short term rates at near zero levels while also remaining active in the longer portion of the yield curve as Operation Twist, set to expire at the end of June, was extended through the end of 2012. The continuation of Twist, coupled with significant demand for safe haven investments, has driven the yield on the 10-year US Treasury bond to historic lows. Other sovereign Treasury instruments considered safe havens have experienced similarly low yields.

Inflation data remain fairly benign throughout the fiscal year. Falling energy prices pulled the headline CPI rate down to 1.7% for the 12-months ended May 2012 and core CPI remained within the Federal Reserve's targeted range and well below the long term average of just over 4%.

The following table highlights the various asset class benchmark returns by quarter and for the fiscal year.

Index	**Q1**	**Q2**	**Q3**	**Q4**	**Fiscal Year**
US Equity (Russell 3000)	(15.3%)	12.1%	12.9%	(3.2%)	3.8%
Intl Equity (MSCI ACWI ex-US)	(19.8%)	3.8%	11.3%	(7.4%)	(14.2%)
Real Estate (NFI-ODCE)	3.3%	2.8%	2.6%	2.4%	11.5%
Fixed Income (BC Aggregate)	3.8%	1.1%	0.3%	2.1%	7.5%

Asset Allocation

As of June 30, 2012, the assets of MCERA were valued at $343.9 million, down from the total asset value at the start of the fiscal year, July 1, 2011, of $355.2 million. Approximately $3.8 million in investment losses and $7.6 million in net withdrawals accounted for the decline in assets. The Fund ended the quarter slightly overweight relative to its policy target in domestic equity and cash while being slightly underweight to fixed income and international equity. The Fund's domestic real estate allocation was nearly in line with that of the policy target. All asset classes remain within their permitted ranges.

Asset Class	$000s Actual	Percent Actual	Percent Target	Percent Difference	$000s Difference
Domestic Equity	139,988	40.7%	38.0%	2.7%	9,320
International Equity	77,141	22.4%	25.0%	(2.6%)	(8,825)
Domestic Fixed Income	92,893	27.0%	28.0%	(1.0%)	(3,388)
Domestic Real Estate	30,658	8.9%	9.0%	(0.1%)	(290)
Cash	3,183	0.9%	0.0%	0.9%	3,183
Total	343,864	100.0%	100.0%		

Total Fund Performance

MCERA's Total Fund returned -1.0% for the fiscal year ending June 30, 2012, 2.3% behind the Fund's benchmark return.

As is shown in the fiscal year attribution below, both active management and the effect of asset allocation hindered relative performance during the period. The final quarter of the fiscal year posed a very difficult environment for active management; amid a "risk off" environment, most domestic equity index returns ranked in the top quartile of Callan's actively managed style groups, indicating that the majority of active managers in each space underperformed the index.

However, despite a sharply negative absolute return, MCERA's international equity allocation actually contributed to relative returns for the fiscal year as the portfolio held a slight underweight to the asset class.

One Year Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Domestic Equity	39%	38%	0.22%	3.84%	(1.35%)	(0.07%)	(1.42%)
Domestic Fixed Income	28%	28%	6.45%	7.47%	(0.45%)	(0.29%)	(0.74%)
Domestic Real Estate	9%	9%	7.93%	9.52%	(0.12%)	0.00%	(0.12%)
International Equity	23%	25%	(14.54%)	(14.15%)	(0.06%)	0.17%	0.11%
Cash	1%	0%	0.32%	0.32%	0.00%	(0.16%)	(0.16%)
Total			**(1.04%) =**	**1.30% +**	**(2.01%) +**	**(0.34%)**	**(2.34%)**

Summary

Marked by falling interest rates and ensuing volatility within equity markets, the recent fiscal year was challenging for the MCERA portfolio. Still, the Fund remains well diversified across the broad capital markets and across many different investment strategies, which we believe will continue to lead to strong long-term investment results.

Consistent with the broad markets, MCERA has benefitted from the positive returns experienced during the first half of the fiscal year ended June 30, 2013; as of December 31, 2012, the Fund was up 7.7% for the fiscal year to date compared to 6.8% for the policy target. Still, we continue to forecast muted returns and increased volatility across asset classes. Due diligence reviews and an adherence to a well-developed investment policy remain the most prudent long-term course for investors.

Submitted by:

Greg T. Ungerman, CFA
Senior Vice President

Greg F. DeForrest, CFA
Senior Vice President

Outline of Investment Policies

The Board of Retirement (Board) has exclusive control of all investments of the retirement system and is responsible for establishing investment objectives, strategies and policies.

Pursuant to the California Constitution and the 1937 County Employees' Retirement Act, the Board is authorized to invest in any form or type of investment deemed prudent in the informed judgment of the Board. In making decisions regarding the MCERA investment portfolio, the Board acts in a fiduciary capacity and must discharge its duties in accordance with fiduciary principles. In this regard, investment decisions are to be made in the sole interest and for the exclusive purpose of providing benefits to participants in the retirement system and their beneficiaries and defraying the reasonable expenses of administering the retirement system.

The Board of Retirement has adopted an Investment Policy, which provides the framework for the management of MCERA's investments. The Investment Policy establishes the general goals of the investment program, the policies and procedures for management of the investments, specific assets allocations, rebalancing procedures and investment guidelines, performance objectives and risk controls. The Investment Policy also defines the principal duties of the Board, MCERA's investment consultant and MCERA's investment managers. The Board makes revisions to the Investment Policy as necessary.

Pursuant to the Investment Policy, the basic goal of MCERA's investment program is to obtain a fully funded plan status, while assuming a risk posture consistent with the Board's risk tolerance. In pursuing this goal, the Board has adopted a long-term investment horizon in which the chances and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets. The primary investment objective is to exceed the actuarial assumption for return on assets. The risk assumed in the pursuit of this investment objective must be appropriate for the return anticipated and consistent with the total diversification of the fund. All transactions undertaken will be for the sole benefit of MCERA's members and beneficiaries and for the exclusive purpose of providing benefits to them, minimizing contributions to the Plan and defraying reasonable associated administrative expenses.

The asset allocation plan adopted by the Board is an integral part of MCERA's investment program. It is designed to provide an optimum, diversified mix of asset classes with return expectations to satisfy expected liabilities, while minimizing risk exposure.

INVESTMENT RETURNS
FOR THE YEAR ENDED JUNE 30, 2012

	Market Value	% of Assets	Current Yr Return	3 Year Return	5 Year Return
Domestic Equities	**139,988,256**	**40.71%**	**0.22%**	**16.47%**	**0.79%**
Russell 3000 Index			3.84%	16.73%	0.39%
Large Cap Equities	**96,725,492**	**28.13%**			
Selected American	10,473,772	3.05%	(0.10%)	13.03%	(2.03%)
Investment Co of America	10,984,909	3.19%	2.83%	12.77%	(0.51%)
Vanguard Growth & Income	11,498,316	3.34%	6.16%	16.43%	(0.78%)
S&P 500 Index			5.45%	16.40%	0.22%
Dodge & Cox Stock	15,650,480	4.55%	(0.91%)	14.40%	(3.64%)
Robeco	14,932,945	4.34%	3.05%	-	-
S&P 500 Index			5.45%	16.40%	0.22%
Russell 1000 Value Index			3.01%	15.80%	(2.19%)
Growth Fund of America	10,787,740	3.14%	0.23%	12.45%	(0.15%)
Harbor Cap Appreciation	11,594,743	3.37%	2.88%	15.52%	3.53%
Janus Research	10,802,586	3.14%	(1.67%)	15.77%	1.53%
S&P 500 Index			5.45%	16.40%	0.22%
Russell 1000 Growth Index			5.76%	17.50%	2.87%
Mid Cap Equities	**21,744,297**	**6.32%**			
Fidelity Low Priced Stock	5,443,063	1.58%	(1.00%)	17.21%	1.72%
Royce Total Return	5,197,692	1.51%	(2.73%)	15.71%	0.70%
Russell 2000 Index			(2.08%)	17.80%	0.54%
Russell MidCap Value Index			(0.37%)	19.92%	(0.13%)
Morgan Stanley	5,358,956	1.56%	(10.92%)	19.12%	4.04%
Janus Enterprise	5,744,596	1.67%	(0.14%	19.00%	-
Russell MidCap Growth Index			(2.99%)	19.01%	1.90%
Small Cap Equities	**14,506,094**	**4.22%**			
Prudential Small Cap Value	6,530,308	1.90%	(2.79%)	-	-
US Small Cap Value Index			(0.65%)	18.82%	0.43%
Russell 2000 Value Index			(1.44%)	17.43%	(1.05%)
Alliance US Small Growth	4,294,108	1.25%	3.48%	25.85%	5.88%
RS Investments	3,681,678	1.07%	(5.19%)	20.39%	2.32%
Russell 2000 Growth Index			(2.71%)	18.09%	1.99%
Micro Cap Equities					
Managers Inst Micro Cap	7,012,372	2.04%	0.03%	17.02%	2.03%
Russell Microcap Index			(0.54%)	16.71%	(2.19%)
Russell Micro Growth Index			(3.44%)	15.93%	(1.16%)

	Market Value	% of Assets	Current Yr Return	3 Year Return	5 Year Return
International Equities	**77,140,774**	**22.43%**	**(14.54%)**	**8.44%**	**(2.71%)**
EuroPacific	15,969,498	4.64%	(12.62%)	7.51%	(2.27%)
Harbor International	14,985,381	4.36%	(11.92%)	10.83%	(2.09%)
Columbia Acorn Int'l	8,118,937	2.36%	(9.31%)	12.57%	(0.85%)
Janus Overseas	12,124,351	3.53%	(27.68%)	0.33%	(5.50%)
Oakmark International	11,652,196	3.39%	(13.64%)	10.68%	(2.36%)
Mondrian International	14,290,411	4.16%	(9.98%)	-	-
MSCI EAFE Index			(13.83%)	5.96%	(6.10%)
MSCI ACWI ex-US Index			(14.15%)	7.43%	(4.18%)
Domestic Fixed Income	**92,893,393**	**27.01%**	**6.45%**	**7.89%**	**7.37%**
Dodge & Cox Income	46,261,236	13.45%	5.93%	8.55%	7.70%
PIMCO	46,632,157	13.56%	6.96%	8.69%	-
BC Aggregate Index			7.47%	6.93%	6.79%
Real Estate	**30,658,144**	**8.92%**	7.93%	16.18%	(1.00%)
RREEF Public Fund	6,362,464	1.85%	11.57%	32.54%	2.22%
NAREIT			12.40%	31.21%	2.03%
RREEF Private Fund	12,996,625	3.78%	9.70%	9.25%	(2.04%)
Cornerstone Patriot Fund	10,560,063	3.07%	-	-	-
NFI-ODCE Equal Weight Index			11.46%	6.78%	(2.12%)
625 Kings Court	738,992	0.21%	2.22%	(2.43%)	(1.46%)
Cash	3,182,951	0.93%			
Total Fund	**343,863,518**	**100.00%**	**(1.04%)**	**11.35%**	**2.09%**
Total Fund Benchmark*			1.30%	11.74%	1.53%

Note: The 1, 3 & 5 year returns are from the Callan Associates performance report dated June 30, 2012. Returns are reported Net of Fees and are calculated on a time-weighted basis.

* Current Quarter Target= 38.0% Russell 3000 Index, 28.0% Barclays Aggregate Index, 25.0% MSCI ACWI ex-US Index, 7.2% NFI-ODCE Equal Weight Net and 1.8% NAREIT.

Asset Allocation

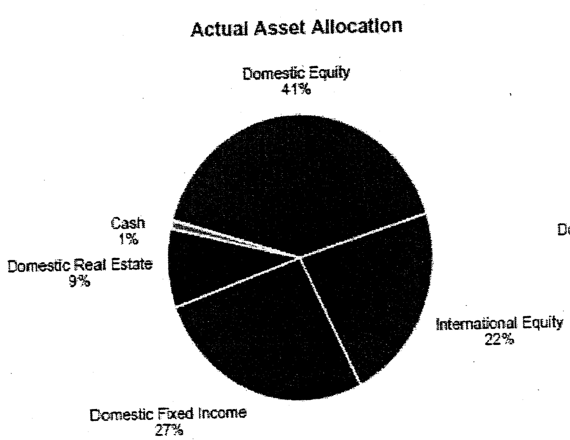
The Board reviews the Association's investment results each quarter. Periodically, the Board reviews the asset allocation, taking into consideration the latest actuarial study. Based on this review, the Board adopts an asset allocation mix with the goal of helping the Association achieve a fully funded status. Each asset class has a target allocation. The Association treats these targets as long-term funding objectives. Adhering to these targets allows the Association to keep investment risk at a manageable level and minimizes investment costs.

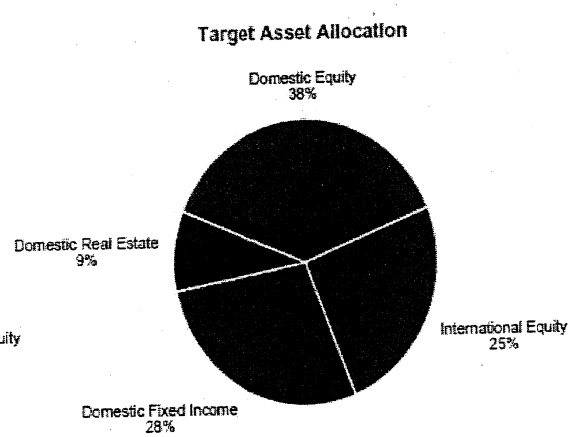
One keystone of asset allocation is diversification among asset classes. Diversification helps to maintain risk at a tolerable level. Therefore, the Board reviews the investment performance and volatility of each asset class on a regular basis over various time periods (quarterly, annually, multi-year) to ensure that the current allocation continues to meet the Association's needs.

Over time, the Board implements the asset allocation plan by hiring investment managers to invest assets on behalf of the Association, subject to investment guidelines incorporated into each firm's investment management contract.

TARGET ASSET VS. ACTUAL ASSET ALLOCATION

The top left chart shows the Fund's asset allocation as of June 30, 2012. The top right chart shows the Fund's target asset allocation as outlined in the investment policy statement. The bottom chart ranks the fund's asset allocation and the target allocation versus the CAI Public Fund Sponsor Database.





ASSET ALLOCATION
JUNE 30, 2012 [1]

Asset Class	Market Value	Actual Allocation	Target Allocation
Domestic Equities	139,988,256	40.7%	38.0%
International Equities	77,140,774	22.4%	25.0%
Domestic Fixed Income	92,893,393	27.0%	28.00%
Domestic Real Estate	30,658,144	8.92%	9.00%
Total Portfolio	343,863,518	100.00%	100.00%

Notes:
[1] Does not include cash; accounts receivables, or prepaid expenses

SCHEDULE OF INVESTMENT MANAGEMENT FEES AND OTHER INVESTMENT EXPENSES
For the Year ended June 30, 2012

Investment Management Fees:		$ 2,169,025
Large Cap Funds	$ 466,080	
Mid Cap Funds	$ 174,141	
Small/Micro Funds	$ 214,917	
International Equity Funds	$ 601,994	
Fixed Income Funds	$ 413,431	
Real Estate	$ 298,462	
Investment Consultant Fees		$ 140,000
Investment Custodial Fees		-0-
Fiduciary Insurance		$ 34,500
Actuary Fees		$122,809
Other Investment Expense		-0-
Total Investment Expenses		$2,466,334

LIST OF INVESTMENT MANAGERS

Fixed Income
Dodge & Cox
PIMCO

Large Cap Equity
Selected American
Investment Co. of America
Vanguard Growth & Inc
Dodge & Cox Stock
Robeco
Growth Fund of America
Harbor Capital Appreciation
Janus Research

Mid Cap Equity
Morgan Stanley
Janus Enterprise
Fidelity Low Priced Stock
Royce Total Return

Small Cap Equity
Vanguard
Prudential Target
Alliance
R S Investments
Managers Inst Micro Cap

International Equity
Europacific
Harbor International
Columbia Alcorn International
Janus Overseas
Mondrian
Oakmark

Real Estate
RREEF Commingled Fund
RREEF America REIT II

Actuarial Section

SEGAL

THE SEGAL COMPANY
100 Montgomery Street Suite 500 San Francisco, CA 94104-4308
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March 8, 2013

Board of Retirement
Mendocino County Employees ' Retirement Association 625-B Kings Court
Ukiah, CA 95482-5027

Re: Actuarial Valuation for the Mendocino County Employees' Retirement Association

Dear Members of the Board:

The Segal Company prepared the June 30, 2012 actuarial valuation of the Mendocino County Employees' Retirement Association. We certify that the valuation was performed in accordance with generally accepted actuarial principles and practices. In particular, it is our understanding that the assumptions and methods used for funding purposes meet the parameters of the Governmental Accounting Standards Board Statement No. 25.

As part of the June 30, 2012 actuarial valuation , The Segal Company (Segal) conducted an examination of all participant data for reasonableness. Summaries of the employee data used in performing the actuarial valuations over the past several years are provided in our valuation report. We did not audit the Association's financial statements. For actuarial valuation purposes, Plan assets are valued at actuarial value. Under this method, the assets used to determine employer contribution rates take into account market value by recognizing the differences between the total return at market value and the expected investment return on market value over a five-year period. The full value of market fluctuations is not recognized in a single year and, as a result, the asset value and the plan costs are more stable.

One of the general goals of an actuarial valuation is to establish rates which, over time, will remain level as a percentage of payroll unless plan benefit provisions are changed. Actuarial funding is based on the Entry Age Normal Cost Method. Under this method , the employer contribution rate provides for current cost (normal cost) plus a level percentage of payroll to amortize any unfunded actuarial accrued liability (UAAL).

The entire balance of the UAAL as of June 30, 2012 is amortized as a level percentage of payroll over a declining 30-year period effective with the June 30, 2009 valuation. As of June 30, 2012, there are 27 years remaining in that 30-year schedule.

Board of Retirement
Mendocino County Employees' Retirement Association
March 8, 2013
Page 2

A listing of supporting schedules Segal prepared for inclusion in the Actuarial and Financial Sections of the Association's CAFR is provided below:

1. Summary of Assumptions and Funding Method;
2. Schedule of Active Member Valuation Data;
3. Schedule of Retirees and Beneficiaries Added To and Removed From Retiree Payroll;
4. Solvency Test;
5. Actuarial Analysis of Financial Experience;
6. Development of Actuarial Value of Assets; and
7. Summary of Plan Provisions.

The valuation assumptions included in the Actuarial Section were adopted by the Retirement Board based on our recommendations following the June 30, 2011 Experience Analysis. It is our opinion that the assumptions used in the June 30, 2012 valuation produce results, which, in the aggregate, reflect the future experience of the Plan. Actuarial valuations are performed on an annual basis. An experience analysis is performed every three years. The next experience analysis is due to be performed as of June 30, 2014.

In the June 30, 2012 valuation, the ratio of the valuation assets to actuarial accrued liabilities increased from 73.6% to 74.1%. The employer's aggregate contribution rate has increased from 23.57% of payroll to 25.65% of payroll. The employee's aggregate rate has increased from 9.73% of payroll to 9.76% of payroll due to a change in membership demographics.

In the June 30, 2012 valuation, the actuarial value of assets included $23.2 million in unrecognized deferred investment losses, which represent 7% of the market value of assets. If these deferred investment losses were recognized immediately in the actuarial value of assets, the funded percentage would decrease from 74.1% to 70.1% and the aggregate employer contribution rate, expressed as a percentage of payroll, would increase from 25.65% to about 27.7%.

The undersigned are Members of the American Academy of Actuaries and meet the qualification requirements to render the actuarial opinion contained herein.

Sincerely,

Paul Angelo
Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President & Actuary

Andy Yeung
Andy Yeung, ASA, MAAA, FCA, EA
Vice President & Associate Actuary

JRC/bqb
Enclosures

SUMMARY OF ASSUMPTIONS AND FUNDING METHOD

Entry Age Normal Actuarial Cost Method was used in conjunction with the following actuarial assumptions. The funding policy adopted by the Board is to amortize the Association's entire balance of the unfunded actuarial accrued liability (UAAL) as of the valuation date over a declining 30-year period effective with the June 30, 2009 valuation. As of June 30, 2012, there are 27 years remaining in that 30-year schedule. The Board has adopted the following economic assumptions for the June 30, 2012 valuation:

ASSUMPTIONS

Valuation Interest Rate	7.75%
Inflation Rate	3.50%
Across the Board Salary Increase	0.50%
Interest Credited to Member Accounts	7.75%
Consumer Price Index	Increases of 3.50% per year, retiree COLA increases due to CPI subject to a 3% maximum change per year
Cost-of-Living Adjustments	3.00% of retirement income
Asset Valuation	Smoothed actuarial value

The following demographic and salary increase assumptions were used for the actuarial valuation as of June 30, 2012. The assumptions were selected by the actuary and approved by the Board.

Post-Retirement Mortality	
(a) *Healthy*	
General Members	RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females
Safety and Probation Members	RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females
All Beneficiaries	Same as General Members
(b) *Disabled*	
General Members	RP-2000 Combined Healthy Mortality Table for Males and Females set forward two years
Safety and Probation Members	RP-2000 Combined Healthy Mortality Table for Males and Females set forward four years
(c) *For Employee Contribution Rate Purposes*	
General Members	RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females, weighted 30% male and 70% female
Safety and Probation Members	RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females, weighted 80% male and 20% female
Pre-Retirement Mortality	
(a) *General Members*	RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females
(b) *Safety and Probation Members*	RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females
Termination Rates	Based upon the Experience Analysis as of 6/30/2011 (Table 1)
Disability Rates	Based upon the Experience Analysis as of 6/30/2011 (Table 1)
Service Retirement Rates	Based upon the Experience Analysis as of 6/30/2011 (Table 1)
Reciprocity Assumption	60% of members who terminate with a vested benefit are assumed to enter a reciprocal system. For reciprocals, 4.50% compensation increases per annum are assumed.
Salary Scales	As shown in Table 2
Spouses and Dependents	80% of male employees and 50% of female employees assumed married at retirement, with wives assumed three years younger than husbands
Deferred Vested Retirement Age	60 for General members; 55 for Safety and Probation members. For future deferred vested members who terminate with less than five years of service and are not vested, it is assumed they will retire at age 70 if they decide to leave their contributions on deposit.
Future Benefit Accruals	1.0 year of service per year of employment plus 0.019 years of additional service to anticipate conversion of unused sick leave for each year of employment, for members expected to retire directly from active employment and to receive a service retirement benefit.

PROBABILITIES OF SEPARATION FROM ACTIVE SERVICE - TABLE 1

General Members

Years of Service	Termination[1] (Less Than 5 Years of Service)
0	.1450
1	.1150
2	.1050
3	.0950
4	.0850

Age	Termination[1] (5+ Years of Service)	Mortality Male[2]	Mortality	Disability[4]	Service
20	.0450	.0003	.0002	.0001	.0000
30	.0450	.0004	.0002	.0002	.0000
40	.0450	.0010	.0006	.0006	.0000
50	.0450	.0019	.0016	.0053	.0500
60	.0220	.0053	.0044	.0074	.1000

Safety and Probation Members

Years of Service	Termination[1] (Less Than 5 Years of Service)
0	.1100
1	.0950
2	.0750
3	.0650
4	.0550

Age	Termination[1] (5+ Years of Service)	Mortality Male[3]	Mortality	Disability[5]	Service
20	.0500	.0003	.0002	.0020	.0000
30	.0390	.0004	.0003	.0034	.0000
40	.0320	.0011	.0008	.0114	.0000
50	.0110	.0021	.0019	.0248	.0500
60	.0000	.0067	.0058	.0000	1.000

(1) *For members with less than five years of service, 85% of all terminated members will choose a refund of contributions and 15% will choose a deferred vested benefit. For members with five or more years of service, 25% of all terminated members will choose a refund of contributions and 75% will choose a deferred vested benefit. No termination is assumed after a member is eligible for retirement.*

(2) *10% of General deaths are assumed to be service connected deaths. The other 90% are assumed to be non-service connected deaths.*

(3) *50% of Safety and Probation deaths are assumed to be service connected deaths. The other 50% are assumed to be non-service deaths.*

(4) *50% of General disabilities are assumed to be service connected disabilities. The other 50% are assumed to be non-service connected disabilities.*

(5) *90% of Safety and Probation disabilities are assumed to be service connected disabilities. The other 10% are assumed to be non-service connected disabilities.*

The probabilities shown for each cause of separation represent the likelihood that a given member will separate at a particular age for the indicated reason. For example, if the probability of termination of a General member at age 30 with at least 5 years of service is 0.0450, then we are assuming that 4.50% of the active General members at age 30 with at least 5 years of service will terminate with vested rights during the next year.

ACTUARIAL ASSUMPTIONS FOR MERIT AND PROMOTIONAL SALARY INCREASE RATES - TABLE 2

As of June 30, 2012

Consists of the sum of three parts: A uniform inflation component of 3.50%; plus "across the board" salary increases of 0.50% per year; plus a service-related component for merit and promotion, summarized as follows:

Years of Service	General Members	Safety and Probation Members
0	5.00%	5.00%
1	3.75%	3.75%
2	3.50%	3.00%
3	2.75%	2.25%
4	2.25%	1.00%
5+	0.50%	0.50%

SCHEDULE OF ACTIVE MEMBER VALUATION DATA[1]

Valuation Date	Plan Type	Number	Annual Payroll $	Monthly Average Pay $	Percentage of Increase in Average Pay[2]
6/30/2007					
	General	1,199	55,268,122	3,841	
	Safety	147	8,177,920	4,636	
	Probation	49	2,452,547	4,171	
	Total	1,395	65,898,589	3,937	7.5%
6/30/2008					
	General	1,207	59,194,561	4,087	6.4%
	Safety	156	9,157,574	4,892	5.5%
	Probation	47	2,528,198	4,483	7.5%
	Total	1,410	70,880,333	4,189	6.4%
6/30/2009					
	General	1,164	60,045,883	4,299	5.2%
	Safety	143	9,057,202	5,278	7.9%
	Probation	62	3,132,010	4,210	-6.1%
	Total	1,369	72,235,095	4,397	5.0%
6/30/2010[3]					
	General	1,071			
	Safety	130			
	Probation	53			
	Total	1,254	69,004,002[4]	4,586[4]	4.3%
6/30/2011					
	General	955	53,294,624	4,650	
	Safety	122	8,238,933	5,628	
	Probation	52	2,610,208	4,183	
	Total	1,129	64,143,765	4,735	-0.7%[5]
6/30/2012					
	General	895	45,850,427	4,269	-8.2%
	Safety	120	8,021,174	5,570	-1.0%
	Probation	54	2,724,487	4,204	0.5%
	Total	1,069	56,596,088	4,412	-6.8%

(1) *Information for 6/30/2007 - 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.*

(2) *Reflects the increase in average salary for members at the beginning of the year versus those at the end of the year. It does not reflect the average individual salary increases received by members who worked the full year.*

(3) *The payroll information presented in this schedule is not separated by plan type in the previous actuary's June 30, 2010 valuation report.*

(4) *Based on Segal's June 30, 2011 valuation report, total compensation, including a projection for expected salary increases during 2010/2011 under the actuarial assumptions used in the valuation, is $71,729,795. Monthly average pay with the projection equates to $4,767.*

(5) *Determined using Segal's calculation of monthly average pay with projection as of June 30, 2010 (i.e., $4,767, pursuant to footnote 4 above).*

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM RETIREE PAYROLL (1)

	Added to Rolls		Removed from Rolls		Rolls-End of Year			
Valuation Date	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	Increase in Annual Allowances	Average Annual Allowances
6/30/2007					907	$14,827,000		$16,347
6/30/2008	82	$1,624,000	27	$252,000	962	16,199,000	9.3%	16,839
6/30/2009	77	1,921,000	31	352,000	1,008	17,768,000	9.7%	17,627
6/30/2010(2)					1,083	19,125,661(3)	7.6%	17,660
6/30/2011	71	1,624,933	25	205,558(4)	1,129	21,296,641	7.1%(4)	18,863
6/30/2012	108	2,599,055	20	388,743	1,217	23,506,953	10.4%	19,315

Note: Statutory COLAs are included in the "Added to Rolls" column.

(1) *Information from 6/30/2007 - 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.*

(2) *Information regarding members added to and removed from roll was not provided in the previous actuary's June 30, 2010 valuation report.*

(3) *This is the amount shown in the previous actuary's June 30, 2010 valuation report. Segal subsequently revised this amount to be $19,877,266 (which equates to an average annual allowance of $18,354) to correct for the annualization of the current service portion of the benefit for beneficiary records.*

(4) *Determined using Segal's corrected annual allowance as of 6/30/2010 of $19,877,266.*

SOLVENCY TEST(1)

(Dollars in Thousands)

	Aggregate Accrued Liabilities for					Portion of Accrued Liabilities Covered by Reported Assets		
	(1)	(2)	(3)					
Valuation Date	Active Member Contributions	Retired/ Vested Members	Active Members (Employer Financed Portion)	Total	Actuarial Value of Assets	(1)	(2)	(3)
6/30/2007				$358,259	$317,937			
6/30/2008	$62,348	$199,072	$112,412	373,832	353,421	100%	100%	82%
6/30/2009	64,102	218,613	120,481	403,196	336,263	100%	100%	44%
6/30/2010(2)				434,987	343,202			
6/30/2011	53,600	287,201	131,843	472,644	347,732	100%	100%	5%
6/30/2012	51,090	312,531	125,393	489,014	362,487	100%	100%	0%

This exhibit includes actuarially funded liabilities and assets.

(1) *Information as of 6/30/2007 has been extracted from the previous actuary's June 30, 2007 valuation report. Information as of 6/30/2008 & 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.*

(2) *The breakdown of the aggregate accrued liabilities was not provided in the previous actuary's June 30, 2010 valuation report.*

ACTUARIAL ANALYSIS OF FINANCIAL EXPERIENCE(1)

Items Impacting Unfunded Actuarial Accrued Liability (UAAL)

(Dollars in Thousands)

Plan Year Ending 6/30	2012	2011	2010[2]	2009	2008	2007[2]
Beginning of the Year UAAL Liability (Surplus)	$124,913	$91,785	$66,933	$20,411	$40,322	$31,662
Effect of Differences in Methods and Procedures Due to Change in Actuaries	-	9,035		-	-	
Expected Change	6,929	7,638		805	(5,320)	
Liability (Gain)/Loss	1,937	-		19,978[3]	2,449[3]	
Asset Return (Gain)/Loss	3,647	15,266		29,934	(17,040)	
Salary Increase (Gain)/Loss	(13,844)	(11,363)		-	-	
Retiree COLA Increase (Gain)/Loss	-	(5,887)		-	-	
Change in Actuarial Assumptions and Procedures	2,945	24,043		-	-	
(Gain)/Loss Due to Reflecting Future Service Only Improvement for General Members	-	(5,604)		-	-	
Change in Method to Determine Actuarial Value of Assets	-	-		(4,195)	-	
End of the Year UAAL Liability (Surplus)	$126,527	$124,913	$91,785	$66,933	$20,411	$40,322

(1) *Information as of 6/30/2007 has been extracted from the previous actuary's June 30, 2007 valuation report. Information as of 6/30/2008 & 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.*

(2) *The UAAL reconciliation was not provided in the previous actuary's valuation reports.*

(3) *Combined effect of liability (gain)/loss and change in actuarial assumptions.*

DEVELOPMENT OF ACTUARIAL VALUE OF ASSETS(1)

(Dollars in Thousands)

	Actual Market Return (net)	Expected Market Return (net)	Investment Gain / (Loss)	Deferred Factor	Deferred Return
1. Market value of assets as of June 30, 2012					$342,737
2. Calculation of deferred return:					
(a) Year ended June 30, 2008	$(15,554)	$28,043	$(43,597)	see footnote (2) below	
(b) Year ended June 30, 2009	(51,893)	26,211	(78,104)		
(c) Year ended June 30, 2010	38,133	21,358	16,774		
(d) Year ended June 30, 2011	64,075	23,640	40,435	75%	1,839
(e) Year ended June 30, 2012	(4,078)	27,197	(31,275)	80%	(25,020)
(f) Total unrecognized return					$(23,182)
3. Preliminary actuarial value of assets as of June 30, 2012: (1) – (2f)					$365,919
4. Adjustment to be within 25% corridor of market value					$0
5. Final actuarial value of assets as of June 30, 2012: (3) + (4)					$365,919
6. Actuarial value as a percentage of market value: (5) / (1)					106.8%
7. Non-pension reserves:					
Contingency reserve					$3,431
8. Valuation value of assets: (5) – (7)					$362,487

Actuarial Value of Assets:
For purposes of calculating the required contribution rates for the valuation, a modified market value of the fund's assets is used. Under this approach, recognition is given each year to total earnings of the fund to date. The current method adjusts market value to recognize, over a five-year period, differences between assumed and actual investment return.

(1) *At the request of the Board, actual and expected market returns on assets on or before June 30, 2010 have been restated based on MCERA's audited financial statements. After the restatement, the unrecognized deferred gain as of June 30, 2011 was reduced from $3,101,790 to $2,451,350.*

(2) *Based on action taken by the Board in 2012, the total deferred return through June 30, 2011 (restated, based on the information in footnote 1 above) has been recognized in four level amounts, with three years of recognition remaining after the June 30, 2012 valuation.*

Note: Amounts may not total exactly due to rounding.

SUMMARY OF PLAN PROVISIONS

Briefly summarized below are the major provisions of the County Employees' Retirement Law of 1937, as amended through June 30, 2012.

Membership
Membership usually begins with the first day of the pay period following the date of entrance into service.

Final Compensation
For Tier 1, final compensation is defined as the highest consecutive twelve months of compensation earnable. For Tier 2 and Tier 3, final compensation is defined as the highest consecutive thirty-six months of compensation earnable.

Return of Contributions
If a member should resign or die before becoming eligible for retirement, his or her contribution plus interest may be refunded. In lieu of receiving a return of contributions, a member may elect to leave his or her contributions on deposit. Members with five years of service may choose to receive a deferred vested benefit when eligible for retirement.

Service Retirement Benefit
Members are eligible to retire at age 50 with 10 years of service, or age 70 regardless of service, or after 30 years of service (20 years for Safety and Probation), regardless of age.

Basis of Benefit Payments
Benefits are based upon a combination of age, years of service, final compensation, and the benefit payment option selected by the member. The maximum benefit payable to a member or beneficiary is 100% of final compensation.

Cost of Living Benefit
Future cost of living benefit changes are based on the Consumer Price Index (CPI) up to a maximum of 3% per year. Any excess CPI is "banked."

Disability Benefit
Members with 5 years of service, regardless of age, are eligible for a non-service connected disability. The benefit is 1.8% of final compensation for each year of service. Generally, the maximum benefit is 1/3 of final compensation. The benefit for a service connected disability is the greater of 50% of final compensation or the service retirement benefit (if eligible).

Death Benefit - Prior to Retirement
In addition to the return of contributions, a death benefit is payable to the member's beneficiary or estate equal to one month's salary for each completed year of service under the retirement system. The death benefit is based on the salary earned during the last twelve months preceding the member's death, but not to exceed 6 month's salary.

If a member dies while eligible for service retirement or non-service connected disability, his or her spouse or domestic partner receives 60% of the allowance that the member would have received for retirement on the day of his or her death.

If a member dies in the performance of duty, the spouse or domestic partner will receive a lifetime benefit equal to 50% of the member's final compensation or a service retirement benefit whichever is higher.

Death Benefit - After Retirement
As part of the retirement process, members are required to select among several options for benefits continuation upon the member's death. For married retirees, the most common retirement option is the unmodified option, which pays the retiree's eligible spouse or domestic partner a lifetime benefit equal to 60% of the benefit the retiree was receiving.

Member's Contributions
Contribution rates for the employer and its covered employees are established and may be amended by the MCERA Board of Retirement, and then adopted by the County Board of Supervisors. The contribution rates are determined based on the benefit structure established by the employer. Members are required to contribute a percentage of their annual covered salary and their particular contribution rate is based upon age at entry into the Association. The employer is required to contribute the remaining amount necessary to finance the coverage of their employees through periodic contributions at actuarially determined rates.

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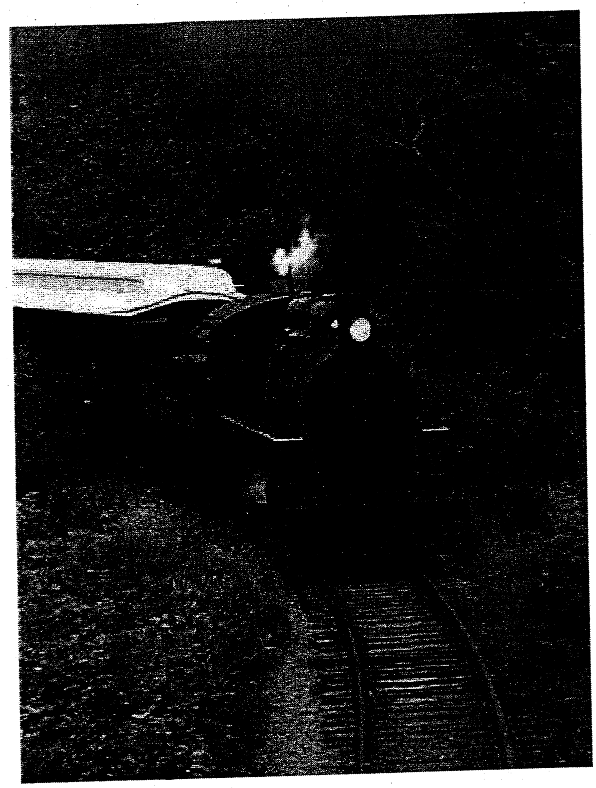
Statistical Section



This Section provides additional detailed information in order to promote a more comprehensive understanding of this year's financial statements, note disclosures, and supplemental information. In addition, this section provides multiyear trends of the financial and operation information in order to facilitate the understanding of how the organization's financial position and performance have changed over time. This section provides contextual data for MCERA's changes in nets assets, benefit expenses, retirement types benefit payments and membership data.

SCHEDULE OF CHANGES IN NET ASSETS
(Last Ten Fiscal Years)

(Dollars in Thousands)	2012	2011	2010	2009	2008
Additions					
Employer Contributions	$ 11,811	$ 9,554	$ 8,234	$ 8,561	$ 7,269
Member Contributions	4,840	5,447	6,502	6,836	6,613
Net Investment Income	(4,078)	64,075	38,128	(52,214)	(15,846)
Total Additions	**12,573**	**79,076**	**52,864**	**(36,817)**	**(1,964)**
Deductions					
Benefits Payments	22,955	22,269	23,161	21,480	15,640
Refunds of Contributions	1,225	1,167	1,061	734	1,064
Health Benefits [(1)]	-	-	-	-	4,017
Administrative Expenses	698	640	641	280	134
Total Deductions	**24,879**	**24,076**	**24,863**	**22,494**	**20,855**
Change in Plan Net Assets	**$ (12,305)**	**$ 55,000**	**$ 28,001**	**$(59,311)**	**$(22,819)**

(Dollars in Thousands)	2007	2006	2005	2004	2003
Additions					
Employer Contributions	$ 7,231	$ 6,464	$ 6,481	$ 6,299	$ 82,960
Member Contributions	6,002	5,998	6,618	6,649	5,341
Net Investment Income	52,299	32,079	24,019	34,487	7,433
Total Additions	**65,532**	**44,541**	**37,118**	**47,435**	**95,734**
Deductions					
Benefits Payments	14,153	12,878	11,269	10,234	9,353
Refunds of Contributions	1,036	1,068	933	728	962
Health Benefits	3,382	3,410	2,680	2,759	2,257
Administrative Expenses	119	82	40	158	76
Total Deductions	**18,690**	**17,438**	**14,922**	**13,879**	**12,648**
Change in Plan Net Assets	**$ 46,842**	**$ 27,103**	**$ 22,196**	**$33,556**	**$83,086**

(1) For years 2009 – 2011, amounts for health benefits are included in benefit payments.

REVENUE BY SOURCE

(Dollars in Thousands)

Fiscal Year Ended 6/30	Employee Contributions	Employer/Other Contributions	Investment Net Income	Total
2003	5,341	82,960 (1)	7,433	95,734
2004	6,649	6,299	34,487	47,435
2005	6,618	6,481	24,019	37,118
2006	5,998	6,464	32,079	44,541
2007	6,002	7,231	52,299	65,532
2008	6,613	7,269	(15,846)	(1,964)
2009	6,836	8,561	(52,214)	(36,817)
2010	6,502	8,234	38,128	52,864
2011	5,447	9,554	64,075	79,076
2012	4,840	11,811	(4,078)	12,573

EXPENSES BY TYPE

(Dollars in Thousands)

Fiscal Year Ended 6/30	Benefits	Administrative/ Other Expenses	Refunds	Total
2003	9,353	2,333	962	12,648
2004	10,234	2,917	728	13,879
2005	11,269	2,720	933	14,922
2006	12,878	3,492	1,068	17,438
2007	14,153	3,501	1,036	18,690
2008	15,640	4,151	1,064	20,855
2009	21,480	280	734	22,494
2010	23,161	641	1,061	24,863
2011	22,269	640	1,167	24,076
2012	22,955	698	1,225	24,879

(1) The Employer Contribution for 2003 includes $76,299,000 from proceeds of Pension Obligation Bonds the County issued to reduce Unfunded Actuarial Accrued Liability.

SCHEDULE OF BENEFIT EXPENSES BY TYPE

(Dollars in Thousands)

	2012	2011(1)	2010	2009	2008
Service Retirement Payroll:					
General	14,864	$ 13,197	$ 12,112	$ 10,808	$ 9,960
Safety	2,500	2,477	2,267	1,799	1,664
Total	17,364	15,674	14,379	12,607	11,624
Disability Retirement Payroll:					
General	2,074	1,987	1,970	1,815	1,751
Safety	1,903	1,832	1,823	1,654	1,590
Total	3,977	3,819	3,793	3,469	3,341
Beneficiary Payroll:					
General	1,487	1,335	679	1,269	1,171
Safety	485	471	275	422	404
Total	1,972	1,806	954	1,691	1,575
Total Benefit Expense:					
General	18,425	16,519	14,761	13,892	12,882
Safety	4,889	4,780	4,365	3,875	3,658
Total	23,313	$ 21,299	$ 19,126	$ 17,767	$ 16,540

	2007	2006	2005	2004	2003
Service Retirement Payroll:					
General	$ 8,688	$ 7,855	$ 7,321	$ 6,143	$ 5,890
Safety	1,532	1,129	822	563	337
Total	10,220	8,984	8,143	6,706	6,227
Disability Retirement Payroll:					
General	1,683	1,566	1,410	1,273	1,161
Safety	1,432	1,346	1,176	1,113	1,039
Total	3,115	2,912	2,586	2,386	2,200
Beneficiary Payroll:					
General	1,138	1,001	971	886	826
Safety	359	352	314	297	278
Total	1,497	1,353	1,285	1,183	1,104
Total Benefit Expense:					
General	11,509	10,422	9,702	8,302	7,877
Safety	3,323	2,827	2,312	1,973	1,654
Total	$ 14,832	$13,249	$12,014	$10,275	$ 9,531

(1) **Estimated Based upon Annualized Benefit Amounts as of June 30, 2011.**

Source of Data: Actuarial Valuation Reports (2003 – 2012)

SCHEDULE OF RETIREE MEMBERS BY TYPE OF BENEFIT
(Summary of Monthly Allowances Being Paid – As of June 30, 2012)

(Dollars in Thousands)

2011	General Members Number	General Members Monthly Allowance	Safety Members Number	Safety Members Month Allowance	Total Number	Total Monthly Allowance
Retired Members						
Service Retirement	747	$ 1,100	77	$ 206	824	$ 1,306
Disability	113	165	56	153	169	318
Beneficiaries	107	111	29	39	136	150
Total Retired Members	967	$ 1,376	162	$ 398	1,129	$ 1,774

(Dollars in Thousands)

2012	General Members Number	General Members Monthly Allowance	Safety Members Number	Safety Members Month Allowance	Total Number	Total Monthly Allowance
Retired Members						
Service Retirement	822	$ 1,239	83	$ 208	905	$ 1,447
Disability	114	173	56	159	170	332
Beneficiaries	113	124	29	40	142	164
Total Retired Members	1,049	$ 1,536	168	$ 407	1,217	$ 1,943

Source of data: June 30, 2011 and June 30, 2012 Actuarial Valuation Report

SCHEDULE OF AVERAGE BENEFIT PAYMENT AMOUNTS

	Number of Years Since Retirement						
	0-4	5-9	10-14	15-19	20-24	25-29	30 +
Valuation date 06/30/12							
Average Monthly Benefit	$ 1,771	$1,683	$1,343	$1,452	$1,613	$1,314	$1,297
Number of Retirees	426	319	151	113	93	70	45
Valuation date 06/30/11							
Average Monthly Benefit	$ 1,777	$ 1,577	$ 1,379	$ 1,488	$ 1,429	$ 1,462	$ 975
Number of Retirees	396	271	157	126	83	56	40
Valuation date 06/30/10							
Average Monthly Benefit	$ 1,699	$ 1,363	$ 1,361	$ 1,429	$ 1,280	$ 1,324	$ 1,123
Number of Retirees	387	243	152	123	82	57	39
Valuation date 06/30/09							
Average Monthly Benefit	$ 1,707	$ 1,296	$ 1,361	$ 1,473	$ 1,337	$ 1,135	$ 1,229
Number of Retirees	371	190	154	117	80	62	34
Valuation date 06/30/08							
Average Monthly Benefit	$ 1,687	$ 1,262	$ 1,302	$ 1,533	$ 1,177	$ 1,150	$ 1,120
Number of Retirees	356	183	141	103	85	70	22
Valuation date 06/30/07							
Average Monthly Benefit	$ 1,564	$ 1,284	$ 1,288	$ 1,433	$ 1,116	$ 1,061	$ 967
Number of Retirees	322	171	130	111	88	63	22
Valuation date 06/30/06							
Average Monthly Benefit	$ 1,454	$ 1,307	$ 1,267	$ 1,276	$ 1,174	$ 909	$ 863
Number of Retirees	275	172	149	104	78	56	18
Valuation date 06/30/05							
Average Monthly Benefit	$ 1,345	$ 1,321	$ 1,293	$ 1,157	$ 1,061	$ 876	$ 705
Number of Retirees	248	170	142	100	84	51	14
Valuation date 06/30/04							
Average Monthly Benefit	$ 1,163	$ 1,219	$ 1,270	$ 1,137	$ 964	$ 902	$ 585
Number of Retirees	199	171	134	100	91	42	12
Valuation date 06/30/03							
Average Monthly Benefit	$ 1,169	$ 1,096	$ 1,305	$ 1,028	$ 975	$ 780	$ 811
Number of Retirees	198	154	123	107	92	36	7

Source of data: Actuarial Valuation Reports (2003 – 2012). Data on Final Average Salary is not available and not included in this table.

SCHEDULE OF PARTICIPATING EMPLOYERS AND ACTIVE MEMBERS
As of June 30

	Total Employees	County of Mendocino	Russian River Cemetery District	Superior Court
Year 2012				
Number of Covered Employees	1,069	1,011	4	54
Percentage to Total System	100%	94.57%	.37%	5.05%
Year 2011				
Number of Covered Employees	1,129	1,065	4	60
Percentage to Total System	100%	94.33%	.35%	5.32%
Year 2010				
Number of Covered Employees	1,254	1,186	5	63
Percentage to Total System	100%	94.58%	.40%	5.02%
Year 2009				
Number of Covered Employees	1,369	1,294	5	70
Percentage to Total System	100%	94.52%	.37%	5.11%
Year 2008				
Number of Covered Employees	1,410	1,335	5	70
Percentage to Total System	100%	94.68%	.36%	4.96%
Year 2007				
Number of Covered Employees	1,395	1,314	5	76
Percentage to Total System	100%	94.19%	.36%	5.45%
Year 2006				
Number of Covered Employees	1,312	1,225	5	82
Percentage to Total System	100%	93.37%	.38%	6.25%
Year 2005				
Number of Covered Employees	1,333	1,258	6	69
Percentage to Total System	100%	94.37%	.45%	5.18%
Year 2004				
Number of Covered Employees	1,400	1,338	6	56
Percentage to Total System	100%	95.57%	.43%	4.00%
Year 2003				
Number of Covered Employees	1,472	1,418	5	49
Percentage to Total System	100%	96.33%	.34%	3.33%

Source of data: MCERA systems.