

FINANCIAL AUDIT
OF THE
MICHIGAN JUDGES RETIREMENT SYSTEM

DEPARTMENT OF MANAGEMENT AND BUDGET

October 1, 1994 through September 30, 1996

EXECUTIVE DIGEST

MICHIGAN JUDGES RETIREMENT SYSTEM

INTRODUCTION

This report contains the results of our financial audit* of the Michigan Judges Retirement System (MJRS), Office of Retirement Systems, Department of Management and Budget, for the period October 1, 1994 through September 30, 1996.

AUDIT PURPOSE

This financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

MJRS was created by Act 234, P.A. 1992, which consolidated the Michigan Judges and Michigan Probate Judges Retirement Systems. MJRS is a single employer, Statewide public employee retirement plan, created and governed by the State of Michigan to provide retirement, survivor, and disability benefits* to judges in the judicial branch of State government. MJRS also includes the Governor, Lieutenant Governor, Secretary of State, Attorney General, Legislative Auditor General, and the Constitutional Court Administrator. A five-member retirement board oversees MJRS.

* See glossary on page 48 for definition.

MJRS retirement provisions allow members to receive retirement benefits at age 55 with 18 years of credited service, the last 6 continuous, or at age 60 with 8 or more years of credited service. Members may receive retirement benefits at any age with 25 years of service, with the last 6 continuous.

There were 481 people (retirees and beneficiaries) on the pension payroll as of September 30, 1996 and September 30, 1995. The pension payroll for the fiscal years ended September 30, 1996 and September 30, 1995 was approximately \$12.8 million and \$12.3 million, respectively.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To assess the adequacy of MJRS's internal control structure*.

Conclusion: Our assessment of the internal control structure did not disclose any material weaknesses* . However, we noted certain reportable conditions* in the areas of pension payroll internal controls and fund balance reconciliations (Findings 1 and 2).

Audit Objective: To assess MJRS's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and Department policies and procedures.

Conclusion: Our assessment of MJRS's compliance with applicable statutes, the *Michigan Administrative Code*, policies, and procedures did not disclose any instances of noncompliance that could have a material effect on MJRS's financial statements.

* See glossary on page 48 for definition.

Audit Objective: To audit MJRS's financial statements as of and for the fiscal years ended September 30, 1996 and September 30, 1995.

Conclusion: We expressed an unqualified opinion on MJRS's financial statements. However, we noted a reportable condition regarding the annual financial report (Finding 3).

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the Michigan Judges Retirement System for the period October 1, 1994 through September 30, 1996. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 3 findings and 4 corresponding recommendations. The agency preliminary response indicated that it has either complied with or taken steps to comply with all the recommendations.

MJRS has complied with 3 of the 6 prior audit recommendations. Two of the prior audit recommendations are repeated in this report, and one is no longer applicable.

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Mr. Lyle VanHouten, Chairman
Michigan Judges Retirement System Board
General Office Building
Lansing, Michigan
and
Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. VanHouten and Ms.Phipps:

This is our report on the financial audit of the Michigan Judges Retirement System, Department of Management and Budget, for the period October 1, 1994 through September 30, 1996.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and independent auditor's reports on the internal control structure, on compliance with laws and regulations, and on the financial statements. This report also contains the Michigan Judges Retirement System financial statements, notes to financial statements, required supplementary information, supplemental schedules, and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after the release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Agency

The Michigan Judges Retirement System (MJRS) was created by Act 234, P.A. 1992, which consolidated the Michigan Judges and Michigan Probate Judges Retirement Systems. MJRS is a single employer, Statewide public employee retirement plan, created and governed by the State of Michigan to provide retirement, survivor, and disability benefits to judges in the judicial branch of State government. MJRS also includes the Governor, Lieutenant Governor, Secretary of State, Attorney General, Legislative Auditor General, and the Constitutional Court Administrator. A five-member retirement board oversees MJRS.

MJRS retirement provisions allow members to receive retirement benefits at age 55 with 18 years of credited service, the last 6 continuous, or at age 60 with 8 or more years of credited service. Members may receive retirement benefits at any age with 25 years of service, with the last 6 continuous.

There were 481 people (retirees and beneficiaries) on the pension payroll as of September 30, 1996 and September 30, 1995. The pension payroll for the fiscal years ended September 30, 1996 and September 30, 1995 was approximately \$12.8 million and \$12.3 million, respectively.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial audit of the Michigan Judges Retirement System (MJRS), Office of Retirement Systems, Department of Management and Budget, had the following objectives:

1. To assess the adequacy of MJRS's internal control structure.
2. To assess MJRS's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and Department policies and procedures.
3. To audit MJRS's financial statements as of and for the fiscal years ended September 30, 1996 and September 30, 1995.

Audit Scope

Our audit scope was to examine the financial and other records of the Michigan Judges Retirement System for the period October 1, 1994 through September 30, 1996. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 3 findings and 4 corresponding recommendations. The agency preliminary response indicated that it has either complied with or taken steps to comply with all the recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

MJRS has complied with 3 of the 6 prior audit recommendations. Two of the prior audit recommendations are repeated in this report, and one is no longer applicable.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the adequacy of the Michigan Judges Retirement System's (MJRS's) internal control structure.

Conclusion: Our assessment of MJRS's internal control structure did not disclose any material weaknesses. However, we noted certain reportable conditions in the areas of pension payroll internal controls and fund balance reconciliations.

The Michigan Administrative Information Network (MAIN) is the Statewide financial management system implemented in fiscal year 1994-95. Individual State agencies are not responsible for the design of the Statewide policies and controls of MAIN. However, because MAIN is a Statewide system, which all State agencies are required to use, the internal control structure of each agency, including MJRS, is affected to varying degrees by MAIN.

Because MJRS's internal control structure is affected by this Statewide system, professional auditing standards required our assessment of internal controls in MJRS to include elements reviewed in our financial related audit of MAIN for the period October 1, 1994 through April 30, 1996. That audit reported 29 reportable conditions, including 3 material weaknesses, which are more fully explained in our separately issued report dated August 31, 1996.

FINDING

1. Pension Payroll Internal Controls

MJRS employees did not adhere to the internal control procedures over the pension payroll. Our review disclosed:

- a. Of 14 sampled retiree files, there were 7 instances in which only one employee computed the pension allowance. MJRS procedures require two employees to independently compute the pension allowance.

- b. Of 21 sampled retiree files, there were 2 instances in which only one employee verified the information for entry into the pension payroll. MJRS procedures require two employees to independently verify the information used to place retirees onto the pension payroll.

Although we noted no errors in pension benefits paid to members, the failure to adhere to internal control procedures increases the risk of inaccurate pension benefits.

RECOMMENDATION

We recommend that MJRS ensure that all employees adhere to internal control procedures over the pension payroll.

AGENCY PRELIMINARY RESPONSE

MJRS agreed with this recommendation and informed us that it has complied. Two employees are computing the pension allowance in the newly formed Finance and Administration Division.

FINDING

2. Fund Balance Reconciliations

MJRS internal control procedures did not ensure the reconciliation of the fund balances reserve for member contributions and reserve for employer contributions with the total of the individual member and employer contribution accounts. Our review disclosed:

- a. MJRS did not reconcile the fund balance reserve for member contributions with the individual member contribution account balances for fiscal year 1995-96. MJRS attempted to reconcile the fund balance reserve to the individual member contribution account balances at the end of the fiscal year 1994-95. The reconciliation disclosed that the total of the individual member contribution accounts exceeded the fund balance reserve by \$66,419.

The fund balance reserve for member contributions represents the combined individual active member contributions and interest. Members contribute between 3.5% and 7.0% of their salaries for retirement and annually receive

interest on their accumulated contributions. For fiscal years 1995-96 and 1994-95, the fund balance reserve was approximately \$38.8 million and \$34.4 million, respectively.

Reconciling the fund balance reserve with the individual member contribution account balances would provide a basic internal control to help ensure the accuracy of accounting for member contributions. In our prior audit, we recommended that MJRS reconcile the fund balance reserve with individual member contribution account balances. MJRS concurred and was to comply with the recommendation by June 1, 1994, but it did not.

- b. MJRS did not reconcile the fund balance reserve for employer contributions with the subsidiary ledger of employer contributions. We reconciled the subsidiary ledger of employer contributions to the court fee deposits. Our reconciliation disclosed that the court fee deposits exceeded the subsidiary ledger total by \$193,715 and \$53,735 for fiscal years 1995-96 and 1994-95, respectively. MJRS was unable to explain the reason for the differences.

The fund balance reserve for employer contributions represents the combined court filing fee contributions, annual interest allocation, and budget appropriation. For fiscal years 1995-96 and 1994-95, the fund balance reserve for employer contributions was approximately \$79.5 million and \$76.9 million, respectively. Reconciling the fund balance reserve for employer contributions with the subsidiary ledger of employer contributions would help ensure the accuracy of accounting for employer contributions.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT MJRS STRENGTHEN THE INTERNAL CONTROLS OVER ACCOUNTING FOR MEMBER BALANCES BY DEVELOPING SUFFICIENT METHODS TO RECONCILE THE FUND BALANCE RESERVE FOR MEMBER CONTRIBUTIONS WITH THE INDIVIDUAL MEMBER CONTRIBUTION ACCOUNT BALANCES.

We also recommend that MJRS strengthen the internal controls over accounting for employer contributions by reconciling the fund balance reserve for employer contributions with the subsidiary ledger of employer contributions.

AGENCY PRELIMINARY RESPONSE

MJRS agreed with these recommendations. MJRS informed us that it will implement a monthly reconciliation process by June 30, 1998.

COMPLIANCE WITH LAWS AND REGULATIONS

COMMENT

Audit Objective: To assess MJRS's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and Department policies and procedures.

Conclusion: Our assessment of MJRS's compliance with applicable statutes, the *Michigan Administrative Code*, policies, and procedures did not disclose any instances of noncompliance that could have a material effect on MJRS's financial statements.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit MJRS's financial statements as of and for the fiscal years ended September 30, 1996 and September 30, 1995.

Conclusion: We expressed an unqualified opinion on MJRS's financial statements. However, we noted a reportable condition regarding the annual financial report.

FINDING

3. Annual Financial Report

The Finance and Administration Division, Office of Retirement Systems, did not ensure that the annual financial report for MJRS presented all information in a clearly written manner.

We noted the following conditions which need improvement in future MJRS annual financial reports:

- a. The Finance and Administration Division did not disclose contingency information required by generally accepted accounting principles (GAAP) in the notes to the financial statements.
- b. The notes to the financial statements contained several incorrect references which, when compared to the financial statements, made the annual financial report difficult to understand.
- c. The Finance and Administration Division generally reported two-year comparative information in the financial statements; however, the Division did not consistently follow this desirable practice. For example:
 - (1) The statement of revenues, expenses, and changes in fund balance reported the subfund details for the most recent fiscal year but not for the prior fiscal year.
 - (2) The Division did not always report the most recent and prior fiscal year information in the notes to the financial statements.

Although the noted deficiencies were not material, they could reduce the reader's level of understanding of the information presented.

Similar deficiencies were reported in our prior two audits of MJRS. MJRS responded that it would comply with our prior audit recommendation by May 31, 1995 with submission of the fiscal year 1993-94 financial statements, but it did not.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE FINANCE AND ADMINISTRATION DIVISION, OFFICE OF RETIREMENT SYSTEMS, PRESENT THE INFORMATION IN THE MJRS ANNUAL FINANCIAL REPORT IN A CLEARLY WRITTEN MANNER.

AGENCY PRELIMINARY RESPONSE

The Division agreed with this recommendation and informed us that it has complied.

Independent Auditor's Report on
the Internal Control Structure

October 31, 1997

Mr. Lyle VanHouten, Chairman
Michigan Judges Retirement System Board
General Office Building
Lansing, Michigan
and
Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. VanHouten and Mr. Murray:

We have audited the financial statements of the Michigan Judges Retirement System, Department of Management and Budget, as of and for the fiscal years ended September 30, 1996 and September 30, 1995 and have issued our report thereon dated October 31, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government 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.

The management of the Michigan Judges Retirement System and the management of the Department of Management and Budget are responsible for establishing and maintaining an internal control structure, which operates in conjunction with the Statewide internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute,

assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements for the fiscal years ended September 30, 1996 and September 30, 1995, we obtained an understanding of the Michigan Judges Retirement System's internal control structure and internal control elements reviewed as part of our financial related audit of the Michigan Administrative Information Network. The Michigan Administrative Information Network is the Statewide financial management system implemented in fiscal year 1994-95 and, as such, affects the Michigan Judges Retirement System's internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed the control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Michigan Judges Retirement System's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are more fully described in Findings 1 and 2.

Also, our financial related audit of the Michigan Administrative Information Network for the period October 1, 1994 through April 30, 1996 noted 29 reportable conditions on the internal control structure which are more fully explained in our separately issued report on the Michigan Administrative Information Network dated August 31, 1996. Although the Michigan Judges Retirement System, Department of Management and Budget, is not responsible for the design of the Statewide policies and controls of the Michigan Administrative Information Network, which all State agencies are required to use, these reportable conditions affected the Michigan Judges Retirement System's internal control structure.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected

within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the Michigan Judges Retirement System's reportable conditions described above is a material weakness. Three of the 29 reportable conditions identified in our financial related audit of the Michigan Administrative Information Network were material weaknesses. These conditions were considered in determining the nature, timing, and extent of the procedures performed in our audit of the financial statements for the fiscal years ended September 30, 1996 and September 30, 1995.

AUDITOR GENERAL

Independent Auditor's Report on
Compliance With Laws and Regulations

October 31, 1997

Mr. Lyle VanHouten, Chairman
Michigan Judges Retirement System Board
General Office Building
Lansing, Michigan
and
Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. VanHouten and Mr. Murray:

We have audited the financial statements of the Michigan Judges Retirement System, Department of Management and Budget, as of and for the fiscal years ended September 30, 1996 and September 30, 1995 and have issued our report thereon dated October 31, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government 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.

Compliance with laws, regulations, contracts, and grants applicable to the Michigan Judges Retirement System is the responsibility of the Michigan Judges Retirement System management and the Department of Management and Budget management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Michigan Judges Retirement System's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

October 31, 1997

Mr. Lyle VanHouten, Chairman
Michigan Judges Retirement System Board
General Office Building
Lansing, Michigan
and
Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. VanHouten and Mr. Murray:

We have audited the accompanying balance sheet of the Michigan Judges Retirement System, Department of Management and Budget, as of September 30, 1996 and September 30, 1995 and the related statement of revenues, expenses, and changes in fund balance for the fiscal years then ended. These financial statements are the responsibility of the Michigan Judges Retirement System management and the Department of Management and Budget management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

As discussed in Note 1a, the accompanying financial statements present only the Michigan Judges Retirement System and are not intended to present fairly the financial position and results of operations of the State of Michigan or its pension trust funds.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Judges Retirement System as of September 30, 1996 and September 30, 1995 and the results of its operations for the fiscal years then ended on the basis of accounting described in Note 2a.

Our audit was made for the purpose of forming an opinion on the Michigan Judges Retirement System's financial statements. The required supplementary information and supplemental schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the financial statements referred to in the first paragraph. The required supplementary information and supplemental schedules for the fiscal years ended September 30, 1996 and September 30, 1995, except for the annual covered payroll and the unfunded pension benefit obligation as a percentage of the annual covered payroll, have been subjected to the auditing procedures applied in our audit of the Michigan Judges Retirement System's financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the financial statements. This audit did not comprehend the annual covered payroll, the unfunded pension benefit obligation as a percentage of the annual covered payroll, and the required supplementary information for the fiscal years ended September 30, 1994 and before and, accordingly, we express no opinion concerning such information.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 31, 1997 on our consideration of the Michigan Judges Retirement System's internal control structure and a report dated October 31, 1997 on its compliance with laws and regulations.

AUDITOR GENERAL

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MICHIGAN JUDGES RETIREMENT SYSTEM

Balance Sheet
As of September 30

| | 1996 | 1995 |
|---|-----------------------|-----------------------|
| Assets: | | |
| Cash (Note 2d(2)) | \$ 2,808,024 | \$ 5,695,770 |
| Accounts receivable | 2,516,300 | 1,518,703 |
| Total cash and accounts receivable | \$ 5,324,324 | \$ 7,214,473 |
| Investments - book value: (Note 2c(1)) | | |
| Short - term investment, at cost | \$ 17,226,129 | \$ 23,120,515 |
| (market value:1996,\$17,352,916; 1995, \$23,220,660) | | |
| Bonds and mortgages, at amortized cost | 78,620,617 | 65,926,169 |
| (market value:1996,\$80,590,088; 1995, \$69,361,950) | | |
| Common stock, at cost | 75,805,052 | 70,216,105 |
| (market value:1996,\$116,899,603; 1995, \$98,057,586) | | |
| Real estate, at cost | 15,077,570 | 14,015,873 |
| (market value:1996,\$16,030,138; 1995, \$14,378,030) | | |
| Alternative investments, at cost | 11,990,918 | 8,886,184 |
| (market value:1996,\$17,705,395; 1995, \$13,048,471) | | |
| International investments, at cost | 9,915,626 | 7,965,407 |
| (market value:1996,\$11,141,032; 1995,\$8,491,573) | | |
| Subtotal investments | \$ 208,635,913 | \$ 190,130,253 |
| (market value:1996,\$259,719,172; 1995,\$226,558,270) | | |
| Total Assets | \$ 213,960,237 | \$ 197,344,726 |
| Liabilities: | | |
| Accounts payable and other accrued liabilities | \$ (831,138) | \$ (277,016) |
| Net Assets Available for Benefits | \$ 213,129,099 | \$ 197,067,710 |
| Fund Balance: | | |
| Actuarial present value of credited projected pension benefits payable to current retirants and beneficiaries | \$ 96,632,845 | 96,574,234 |
| Actuarial present value of credited projected pension benefits payable to terminated vested participants | 4,015,224 | 3,569,229 |
| Actuarial present value of credited projected pension benefits for active employees | | |
| Member contributions | 38,766,204 | 34,358,270 |
| Employer - financed portion | 72,867,792 | 68,522,927 |
| Total credited projected pension benefit obligations | \$ 212,282,065 | \$ 203,024,660 |
| Pension benefit obligation in excess of net assets | \$ 847,034 | (5,956,950) |
| Fund Balance (Note 3) | \$ 213,129,099 | \$ 197,067,710 |

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

MICHIGAN JUDGES RETIREMENT SYSTEM
Statement of Revenues, Expenses, and Changes in Fund Balance
For the Fiscal Years Ended September 30
Reserves For

| | Member Contributions | | Employer Contributions | | Retirement Benefits | |
|--------------------------------------|----------------------|---------------|------------------------|---------------|---------------------|---------------|
| | 1996 | 1995 | 1996 | 1995 | 1996 | 1995 |
| Operating Revenues: | | | | | | |
| Member contributions: | | | | | | |
| Other | \$ 2,905,265 | \$ 2,808,908 | \$ | \$ | \$ | \$ |
| Military and prior services | | 38,632 | | | | |
| Employer contributions (Note 4): | | | | | | |
| Court fees | | | 4,635,563 | 5,263,142 | | |
| General Fund financing | | | 1,556,044 | 1,614,633 | | |
| Investment income (Note 2c(2)) | | | | | | |
| Miscellaneous | | | | | | |
| Total Operating Revenues | \$ 2,905,265 | \$ 2,847,540 | \$ 6,191,607 | \$ 6,877,775 | \$ 0 | \$ |
| Operating Expenses: | | | | | | |
| Real estate | \$ | \$ | \$ | \$ | \$ | \$ |
| Administrative | | | | | | |
| Refunds of contributions | 16,266 | 92,461 | | (600) | | |
| Retirement allowances | | | | | 12,759,261 | 12,285,8 |
| Health insurance | | | | | | |
| Total Operating Expenses | \$ 16,266 | \$ 92,461 | \$ 0 | \$ (600) | \$ 12,759,261 | \$ 12,285,8 |
| Net Operating Income | \$ 2,888,999 | \$ 2,755,079 | \$ 6,191,607 | \$ 6,878,375 | \$ (12,759,261) | \$ (12,285,8) |
| Other Changes in Reserves: | | | | | | |
| Interest allocation | \$ 2,577,017 | \$ 2,254,604 | \$ 5,667,750 | \$ 5,409,160 | \$ 7,256,450 | \$ 6,979,5 |
| Transfers for retirements (Note 2b) | (1,058,081) | (3,015,562) | (9,216,467) | (4,047,422) | 10,274,548 | 7,062,9 |
| Total Other Changes in Reserves | \$ 1,518,936 | \$ (760,958) | \$ (3,548,717) | \$ 1,361,738 | \$ 17,530,998 | \$ 14,042,5 |
| Net Fund Balance Additions | \$ 4,407,935 | \$ 1,994,121 | \$ 2,642,891 | \$ 8,240,113 | \$ 4,771,737 | \$ 1,756,6 |
| Fund Balances - Beginning of Year | 34,358,269 | 32,364,148 | 76,892,692 | 68,652,579 | 87,357,766 | 85,601,0 |
| Fund Balances - End of Year (Note 3) | \$ 38,766,204 | \$ 34,358,269 | \$ 79,535,583 | \$ 76,892,692 | \$ 92,129,503 | \$ 87,357,7 |

The accompanying notes are on integral part of the financial statements.

| Health Benefits | | Investment Income | | Total | |
|------------------|------------------|----------------------|----------------------|----------------------|----------------------|
| 1996 | 1995 | 1996 | 1995 | 1996 | 1995 |
| \$ 69,974 | \$ 67,795 | \$ | \$ | \$ 2,975,239 | \$ 2,876,703 |
| | | | | | 38,632 |
| | | | | 4,635,563 | 5,263,142 |
| | | | | 1,556,044 | 1,614,633 |
| | | 20,360,725 | 14,731,010 | 20,360,725 | 14,731,010 |
| | | 6 | 62 | 6 | 62 |
| <u>\$ 69,974</u> | <u>\$ 67,795</u> | <u>\$ 20,360,731</u> | <u>\$ 14,731,072</u> | <u>\$ 29,527,577</u> | <u>\$ 24,524,182</u> |
| | | | | | |
| \$ | \$ | \$ 57,988 | \$ 41,052 | \$ 57,988 | \$ 41,052 |
| | | | | | |
| | | 514,406 | 470,760 | 514,406 | 470,760 |
| | | | | | 91,861 |
| | | | | 16,266 | |
| | | | | 12,759,261 | 12,285,850 |
| <u>118,267</u> | <u>118,457</u> | | | <u>118,267</u> | <u>118,457</u> |
| \$ 118,267 | \$ 118,457 | \$ 572,394 | \$ 511,812 | \$ 13,466,188 | \$ 13,007,980 |
| | | | | | |
| \$ (48,294) | \$ (50,662) | \$ 19,788,337 | \$ 14,219,260 | \$ 16,061,389 | \$ 11,516,202 |
| | | | | | |
| \$ 550 | \$ 4,100 | \$ (15,501,767) | \$ (14,647,409) | \$ 0 | \$ 0 |
| | | | | 0 | 0 |
| \$ 550 | \$ 4,100 | \$ (15,501,767) | \$ (14,647,409) | \$ 0 | \$ 0 |
| | | | | | |
| \$ (47,743) | \$ (46,562) | \$ 4,286,570 | \$ (428,149) | \$ 16,061,389 | \$ 11,516,202 |
| | | | | | |
| <u>35,444</u> | <u>82,006</u> | <u>(1,576,462)</u> | <u>(1,148,313)</u> | <u>197,067,710</u> | <u>185,551,508</u> |
| \$ (12,299) | \$ 35,444 | \$ 2,710,108 | \$ (1,576,462) | \$ 213,129,099 | \$ 197,067,710 |

Notes to the Financial Statements

Note 1 Plan Description

a. Reporting Entity and Retirement Benefits

The Michigan Judges Retirement System (MJRS) is a single employer, Statewide public employee retirement plan governed by the State of Michigan and created under Act 234, P.A. 1992, as amended. MJRS was established by the State of Michigan for the purpose of providing retirement, survivor, and disability benefits to the State's elected and appointed judges and probate judges. MJRS also includes the Governor of the State of Michigan, Lieutenant Governor, Secretary of State, Attorney General, Legislative Auditor General, and the Constitutional Court Administrator.

MJRS is considered part of the State of Michigan financial reporting entity and is included in the *State of Michigan Comprehensive Annual Financial Report* as a pension trust fund. MJRS operates within the Office of Retirement Systems, Department of Management and Budget. The Department director appoints the Office director, who serves as executive secretary to the MJRS Board, with whom general oversight of the retirement system resides. The State Treasurer serves as the investment officer and custodian for MJRS's assets.

MJRS and its respective board do not exercise oversight responsibility over any other entities; therefore, MJRS is the only entity included in these financial statements. Accordingly, the accompanying financial statements are not intended to present fairly the financial position and results of operations of the State of Michigan or its pension trust funds.

At September 30, 1996 and September 30, 1995, MJRS membership consisted of:

| | 1996 | 1995 |
|---|-------------------|-------------------|
| Retirees and beneficiaries | <u> </u> | <u> </u> |
| currently receiving benefits: | | |
| Retirement annuities | 326 | 330 |
| Survivor annuities | 144 | 140 |
| Disability annuities | 11 | 11 |
| Total | <u>481</u> | <u>481</u> |
| | | |
| Inactive employees entitled to benefits and not yet receiving them | <u>28</u> | <u>26</u> |
| | | |
| Current employees: | | |
| Vested | 400 | 358 |
| Nonvested | 210 | 256 |
| Total | <u>610</u> | <u>614</u> |

All benefits vest after 8 years of service. Members may receive retirement benefits at age 55 with 18 years of credited service, the last 6 years continuous, or at age 60 with 8 or more years of credited service. Members may receive retirement benefits at any age with 25 years of service, the last 6 years continuous. The system also provides disability and death benefits after 8 years of service. Benefits are paid monthly and are equal to 3% of final average compensation times years of service for up to 11 years of service or 50% of salary after 12 years, increased 2.5% for each additional year up to a maximum of 60% of salary.

Members contribute between 3.5% and 7.0% of salary. If a member leaves employment or dies before becoming eligible for a pension, accumulated member contributions are refunded to the employee or designated beneficiary upon request.

b. Other Postemployment Benefits

Under Section 509 of the Judges Retirement Act, all non-trial court judges and elected or appointed officials who retire on or after January 1, 1983 have the option of continuing health and dental/vision coverage. The employer and members fund health benefits. Dental/vision benefit premiums are fully paid on a pay-as-you-go basis by the retirants* . Retirees with this coverage contribute 5% for the health coverage. The number of plan participants and other relevant financial information is as follows:

| Health and Dental/Vision Plans | Fiscal Year | |
|---------------------------------|-------------|------------|
| | 1996 | 1995 |
| Eligible participants | 25 | 25 |
| Participants receiving benefits | 25 | 25 |
| Expenses for the year | \$ 118,267 | \$ 118,457 |
| Payroll contribution rate | 0.2% | 0.2% |

Note 2 Summary of Significant Accounting Policies and Plan Asset Matters

a. Accrual Basis

MJRS financial statements are prepared on the accrual basis of accounting. The accrual basis of accounting, which emphasizes the measurement of total financial position and results of operations, is explained in more detail in the *State of Michigan Comprehensive Annual Financial Report*. Contributions from the State are recognized as revenue in the period in which service is provided. The Governmental Accounting Standards Board (GASB) has issued Statement Nos. 25, 26, and 28. GASB Statement Nos. 25 and 26 establish the financial reporting framework for pension plans, which includes fair value accounting for investments, recognition of unrealized investment gains and losses, and amortization of unfunded actuarial liabilities for 40 years and requires certain additional disclosures regarding postemployment healthcare benefits. GASB Statement No. 28 establishes accounting and financial reporting standards for recognizing assets and liabilities arising from collateralized securities lending transactions in which governmental

* See glossary on page 48 for definition.

entities (lenders) transfer their securities to broker-dealers and other entities (borrowers). The above statements are to be adopted by MJRS for fiscal year 1996-97.

b. Fund Accounting

- (1) MJRS is an integral part of the State of Michigan reporting entity. As such, MJRS financial statements are reported in the *State of Michigan Comprehensive Annual Financial Report* as a pension trust fund.
- (2) Reserve for Member Contributions. Members' required contributions and payments for the purchase of special service credit or repayment of previously refunded contributions are credited to this reserve. The Reserve for Member Contributions represents active member contributions and interest less amounts transferred to the Reserve for Retirement Benefits or amounts refunded to terminated members.
- (3) Reserve for Employer Contributions. All employer contributions are credited to the Reserve for Employer Contributions. Interest is credited annually to the Reserve for Employer Contributions (from the Reserve for Investment Income) and transfers are made to the Reserve for Retirement Benefits annually in order to 100% fund the Reserve for Retirement Benefits. In addition, the Reserve for Employer Contributions transfers court fees to the Supreme Court in accordance with statutory requirements.
- (4) Reserve for Retirement Benefits. The Reserve for Retirement Benefits represents the reserves for the payment of future retirement benefits to persons already on the retirement rolls. At retirement, a member's accumulated contributions (with interest) are transferred to the Reserve for Retirement Benefits (from the Reserve for Member Contributions).

Interest is credited to the Reserve for Retirement Benefits (from the Reserve for Investment Income) and monthly allowances are

debited. At the end of each fiscal year, an actuarial valuation determines the 100% funding requirements for the Reserve for Retirement Benefits. Any amounts required to 100% fund the Reserve for Retirement Benefits are transferred in the next fiscal year. Based on the September 30, 1996 valuation showing liabilities of \$96,632,845, a transfer of \$4,503,342 was required. This transfer was made in fiscal year 1996-97. Based on the September 30, 1995 valuation showing liabilities of \$96,574,234, a transfer of \$9,216,467 was required. The transfer was made during fiscal year 1995-96.

- (5) Reserve for Health Benefits. The member contributions for health benefits are deposited into this reserve. MJRS disburses from this reserve the premiums for hospital and sick care benefits.
- (6) Reserve for Investment Income. The Reserve for Investment Income is credited with all investment earnings. Interest transfers are made annually to the other reserves. Administrative expenses are paid from this reserve.
- (7) Fixed assets, which are immaterial in amount, are not recognized on the accounting records. Administrative disbursements are treated as expenses and equipment expenses are not capitalized.
- (8) Court Fees. Courts submit a portion of each case filing fee to MJRS for the purpose of funding the retirement system. If court fees exceed an amount needed to fund the system, the remainder of the court fees are transferred to the Department of Treasury. For fiscal year 1995-96, MJRS received \$8,394,100 in court fees and transferred \$3,758,537 to the Department of Treasury. For fiscal year 1994-95, MJRS received \$7,571,338 in court fees and transferred \$2,308,196 to the Department of Treasury. Court fees were recorded net of the amount transferred to the Department of Treasury in the MJRS financial statements.

c. Investments

Under the Executive Reorganization Act of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act (Act 314, P.A. 1965, as amended), which authorizes, with certain restrictions, the investment of system assets in stock, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purpose of providing benefits to active members, retired members, and beneficiaries and defraying expenses of investing the assets.

- (1) Book Value. Bonds, notes, and mortgages are carried at amortized cost. Short-term investments, common and preferred stock, and derivatives for equities are carried at cost. Real estate owned directly is recorded at depreciated cost. Investments in limited partnership interests are recorded on the equity method. The amortized cost of investments sold is determined using the average cost of these securities. Alternative investments include bonds, limited partnerships, and common and preferred stock.
- (2) Investment Income. Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. All gains and losses on investments are recognized at the point of sale and are included in investment income. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for the purchase and sale of mortgages, real estate, and alternative investments, which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.
- (3) Market Values. Market values for common and preferred stock are based on September 30, 1996 and September 30, 1995 closing market quotations. Market values for derivatives are based on the

- (4) value of the underlying investment and the value of the derivative instrument. Fixed debt quotations are provided from a national brokerage pricing service. Mortgage market values are determined on the basis of comparable yield available in the marketplace. Market values for limited partnership interests are based on periodic appraisals. Market values of alternative investments are based on periodic assessment of the underlying investments. At September 30, 1996, the market value of the investment portfolio exceeded the book value by \$51,083,259, including gross unrealized gains of \$54,692,654 and gross unrealized losses of \$3,609,395. At September 30, 1995, the market value of the investment portfolio exceeded the book value by \$36,428,017 including gross unrealized gains of \$39,605,112 and gross unrealized losses of \$3,177,095.
- (5) Alternative Investments. Act 55, P.A. 1982, amended Act 314, P.A. 1965 (Section 38.1140d of the *Michigan Compiled Laws*), to permit the investment of up to 5% of MJRS's assets in alternative investments and up to 15% of MJRS's assets not otherwise qualified under Act 314, P.A. 1965.
- (6) International Investments. To further diversify the pension fund portfolio into international equities, the State Treasurer has entered into swap agreements with AAA-rated counterparties that are tied to stock market indices in 12 foreign countries. Based on the agreements, MJRS will pay interest indexed to the three-month London Inter Bank Offer Rate (LIBOR) on the notional amounts* stated in the agreements. At maturity, the pension funds will either receive the increase in the value of the international equity indices or pay the decrease in the value of the indices. Derivatives are used for a small amount of the pension trust fund portfolios. However, derivatives are not used for speculation and they are not used to leverage the investment portfolios. Less than 5% of the total pension trust funds portfolio has been invested from time to time in futures contracts, collateralized mortgages, and swap agreements. Swap

* See glossary on page 48 for definition.

agreements represent the largest category of derivatives used and approximately 4% of the total portfolio. The notional amounts of the swap agreements at September 30, 1996 and September 30, 1995 were \$9.9 million and \$8.0 million, respectively. The swap agreements are carried at cost, which is not materially different than fair value, of \$11.1 million and \$8.5 million at September 30, 1996 and September 30, 1995, respectively. One half of the notional amount is denominated in foreign currencies. Maturities range from January 1997 to December 1999. U.S. Domestic-LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

- (7) Investments Exceeding 5% of Net Assets. At September 30, 1996 and September 30, 1995, MJRS did not hold any individual investment that exceeded 5% of net assets available for benefits.
- (8) Categories of Investment Risk. GASB Statement No. 3 requires classification of investments into one of three categories based upon credit risk. Category 1 includes investments that are insured or registered or which are held by MJRS or its agent in MJRS's name. Category 2 includes uninsured and unregistered investments which are held by the counterparty's trust department or agent in MJRS's name. Category 3 includes uninsured and unregistered investments which are held by the counterparty, its trust department, or agent, but not in MJRS's name. At September 30, 1996 and September 30, 1995, all investments of MJRS were classified in Category 1, except for certain investments not categorized but classified as real estate,

alternative investments, mortgages, and bonds on the balance sheets:

Investments Not Categorized

| | Book Value | | Market Value | |
|--|---------------|---------------|---------------|---------------|
| | 1996 | 1995 | 1996 | 1995 |
| Real estate, alternative investments, mortgages, and bonds | \$ 34,448,766 | \$ 30,900,194 | \$ 40,868,208 | \$ 35,585,470 |

(8) **Securities Lending.** The State Treasurer participated in security lending with an agreement through the bank custodian. The types of securities loaned were government securities, corporate bonds, and equities. In return, MJRS received collateral in the amount of 102% of the fair market value of the underlying securities. There were no restrictions on the amount of the loans. MJRS did not have the ability to sell or pledge collateral. The fair market value of the underlying securities and earnings for the fiscal year from securities lending were \$13,566,505 and \$9,998 respectively, as of September 30, 1996. There was no securities lending for the fiscal year ended September 30, 1995.

d. Related Party Transactions

(1) **Leases and Other.** MJRS leases operating space and is provided certain administrative services by the State. The costs for such services are charged to the fund:

| | Fiscal Year | |
|--|-------------|-----------|
| | 1996 | 1995 |
| Building rental at \$11.22 (1996) and \$10.91 (1995) per square foot | \$ 3,478 | \$ 2,182 |
| Administrative services | \$ 43,960 | \$ 27,400 |
| Data processing | \$ 5,786 | \$ 32,264 |

- (2) Common Cash Pool. The cash includes \$2,808,024 at September 30, 1996 and \$5,695,770 at September 30, 1995, which represents funds deposited in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to \$157,129 for fiscal year 1995-96 and \$186,193 for fiscal year 1994-95.

Note 3 Funding Status and Progress

Presented at the end of this note is the total pension benefit obligation of MJRS. The amount of the total pension benefit obligation is based on a standardized measurement established by GASB Statement No. 5 that, with some exceptions, must be used by public employee retirement systems (PERS). The standardized measurement is the actuarial present value of credited projected benefits. The pension valuation method reflects the present value of estimated pension benefits that will be paid in future years as a result of employee services performed to date and is adjusted for the effects of projected salary increases. A standardized measure of the pension benefit obligation was adopted by GASB to enable readers of the PERS financial statements to (a) assess the PERS funding status on a going-concern basis, (b) assess progress made in accumulating sufficient assets to pay benefits when due, and (c) make comparisons among PERS. Based on this measurement and the book value of assets, MJRS is 100.4% funded as of September 30, 1996 and 97.1% funded as of September 30, 1995.

The actuarial present value of projected benefits consists of: (a) the actuarial present value of projected benefits payable to current retirants and beneficiaries, (b) the actuarial present value of projected benefits payable to terminated vested participants, and (c) the actuarial present value of credited projected benefits for active participants. The actuarial present value of credited projected benefits for active participants represents a portion of the actuarial present value of projected total benefits, giving effect to estimated salary increases to date of retirement. The portion assumed to be credited is the portion represented by the ratio of (a) the number of years of covered

service rendered as of the date of the valuation to (b) the total covered service which will have been rendered as of the expected date of retirement.

The standardized measure of the pension benefit obligation as of September 30, 1996 and September 30, 1995 is as follows:

| | 1996 | 1995 |
|--|----------------|----------------|
| Pension benefit obligation: | | |
| Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits | \$ 100,648,069 | \$ 100,143,463 |
| Current employees: | | |
| Accumulated employee contributions including allocated investment income | 38,766,204 | 34,358,270 |
| Employer-financed vested | 60,665,360 | 53,869,629 |
| Employer-financed nonvested | 12,202,432 | 14,653,298 |
| Total pension benefit obligation | \$ 212,282,065 | \$ 203,024,660 |
| Net assets available for benefits | 213,129,099 | 197,067,710 |
| (market value: 1996, \$264,212,358; 1995, \$233,495,727) | | |
| Overfunded (unfunded) pension benefit obligation | \$ 847,034 | \$ (5,956,950) |

Because the standardized measure is used only for disclosure purposes by MJRS, the measurement is independent of the actuarial computation made to determine contributions to MJRS. The entry age normal actuarial method used to determine contributions to MJRS will yield different actuarial liability totals because different actuarial cost methods* yield different results.

Note 4 Contributions Required and Contributions Made

Periodic employer contributions to the pension plan are determined on an actuarial basis using the entry age cost method. Normal cost* is funded on a current basis. Periodic contributions for both normal cost and the amortization of the unfunded actuarial accrued liabilities* are based on the level percentage of payroll method so that contribution rates do not have to increase over decades of time.

* See glossary on page 48 for definition.

MJRS employer contributions during the year were made on the basis of 40-year financing of unfunded actuarial accrued liabilities which required a contribution rate of 12.24% and 13.82% for fiscal years 1995-96 and 1994-95, respectively. MJRS employer contributions (net of health insurance) were \$6,191,607 and \$6,877,775, representing 12.65% and 14.50% of the annual active member payroll of \$48,959,955 and \$47,464,198 for fiscal years 1995-96 and 1994-95, respectively. The statute requires an annual reconciliation of receipts with actuarial requirements and an adjustment of the subsequent year's budget request for overfunding or underfunding.

Significant actuarial assumptions used to compute pension contribution requirements are the same as those used to determine the standardized measure of the pension obligation. The significant assumptions used in the actuarial valuations as of September 30, 1996 and September 30, 1995 were:

- (a) A rate of return on the investment of present and future assets of 8.0% per year compounded annually.
- (b) Projected salary increases of 5.0% per year compounded annually, attributable to inflation.
- (c) Pre- and post-retirement life expectancies of participants based upon the 1971 Group Annuity Mortality Table. Future pension payments reflect no post-retirement benefit increases, except for MJRS members who were active judges prior to September 8, 1961, whose benefits increase in proportion to active judges' salaries.
- (d) Rates of non-death withdrawal from active service before retirement, rates of disability, and expected retirement ages.
- (e) For the 1993 valuation and later, the excess (shortfall) of actual investment income (including interest, dividends realized, and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which gets spread over five years.

Note 5 Subsequent Events

Act 523, P.A. 1996, was signed into law on January 12, 1997. This legislation establishes a defined contribution plan for judges appointed or elected after March 31, 1997 and closes the existing defined benefit plan to newly appointed or elected judges after that date. The defined contribution plan will operate in a manner similar to a 401(k) plan. Under the new law, the State of Michigan, as the employer, will contribute 4% of each member's salary into an individual account which will be invested by the member. In addition, the State of Michigan will make a matching contribution of up to 3% if the member voluntarily contributes to his/her own account. A member fully vests in both employer and employee contributions after 4 years of service. These contributions and their investment return shall constitute the member's benefit on his/her date of retirement. Retiree health insurance will also be available to members with 4 years of service who retire under the defined contribution plan.

Note 6 Required Supplementary Information

This information is presented to enable the reader to assess the progress made by MJRS in accumulating sufficient assets to pay pension benefits as they become due. Ten-year historical information that relates to MJRS's progress in accumulating sufficient assets to pay benefits when due is presented on the following pages as required supplementary information.

Act 234, P.A. 1992, consolidated the Michigan Judges and Michigan Probate Judges Retirement Systems. Prior period supplementary information in this report has been restated to reflect this consolidation on a retroactive basis.

Note 7 Contingencies

MJRS is currently undergoing litigation in the *Paul Harvey and Bruce A. Fox (Michael F. Merritt) v the State of Michigan* case, the outcome of which is not determinable at this time. On January 3, 1997, the Court of Appeals remanded the case to a circuit court. An actuarial firm engaged by MJRS estimated in December 1992 that, should the claimants prevail in this case, the MJRS public-financed annual contribution requirement would increase by \$3 million.

REQUIRED SUPPLEMENTARY INFORMATION

Analysis of Funding Progress

Each time the employer adopts a higher level of benefit, unfunded obligations are created. The law governing the Michigan Judges Retirement System (MJRS) requires that these additional obligations be financed systematically over a period of future years.

Analysis of the dollar amounts of net assets available for benefits, pension benefit obligation, and unfunded pension benefit obligation in isolation can be misleading. Expressing the net assets available for benefits as a percentage of the pension benefit obligation provides one indication of MJRS funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in unfunded pension benefit obligation and annual covered payroll are both affected by inflation. Expressing the unfunded pension benefit obligation as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of MJRS progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

| Valuation Date <u>September 30</u> | Net Assets Available for Benefits | Pension Benefit Obligation (PBO) | Assets as a % of PBO | Unfunded (Overfunded) PBO | Annual Covered Payroll * | Unfunded PBO as % of Annual Covered Payroll |
|--|---|---|----------------------------|---------------------------------|--------------------------------|---|
| 1986 | \$ 88,652 | \$ 110,972 | 80% | \$ 22,320 | \$ 32,022 | 70% |
| 1987 | 105,258 | 132,811 | 79 | 27,553 | 37,009 | 74 |
| 1988 | 116,176 | 145,149 | 80 | 28,973 | 39,481 | 73 |
| 1989 | 129,819 | 155,417 | 84 | 25,598 | 41,895 | 61 |
| 1990 | 142,570 | 163,896 | 87 | 21,326 | 43,082 | 50 |
| 1991 | 154,085 | 171,646 | 90 | 17,561 | 43,906 | 40 |
| 1992 | 164,077 | 179,941 | 91 | 15,864 | 43,841 | 36 |
| 1993 | 175,843 | 193,690 | 91 | 17,847 | 44,473 | 40 |
| 1993+ | 175,843 | 189,045 | 93 | 13,202 | 44,473 | 30 |
| 1994 | 185,552 | 196,096 | 95 | 10,544 | 46,277 | 23 |
| 1995 | 197,068 | 203,025 | 97 | 5,957 | 48,196 | 12 |
| 1996 | 213,129 | 212,282 | 100 | (847) | 49,351 | (2) |

* October based payrolls.

+ Revised actuarial assumptions.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

Revenue by Source

| Fiscal Year Ended September 30 | Member Contributions | Net Court Fees | Employer Contributions* | Investment and Other Income | Total |
|--------------------------------------|-------------------------|----------------------|----------------------------|-----------------------------------|---------------|
| 1986 | \$ 1,963,227 | \$ 6,342,873 | \$ (317,414) | \$ 9,690,171 | \$ 17,678,857 |
| 1987 | 2,151,806 | 6,520,465 | (40,831) | 14,331,902 | 22,963,342 |
| 1988 | 2,303,120 | 5,335,942 | 1,398,693 | 8,502,543 | 17,540,298 |
| 1989 | 2,470,749 | 5,806,693 | 1,463,451 | 11,572,603 | 21,313,496 |
| 1990 | 2,566,065 | 5,998,713 | 1,563,791 | 10,888,359 | 21,016,928 |
| 1991 | 2,813,871 | 6,346,425 | 1,576,712 | 10,287,067 | 21,024,075 |
| 1992 | 2,547,250 | 6,414,857 | 1,581,331 | 9,530,772 | 20,074,210 |
| 1993 | 2,833,083 | 6,101,841 | 1,588,274 | 12,426,114 | 22,949,312 |
| 1994 | 2,811,231 | 4,926,397 | 1,650,598 | 12,001,125 | 21,389,351 |
| 1995 | 2,915,335 | 5,263,142 | 1,614,633 | 14,731,072 | 24,524,182 |
| 1996 | 2,975,239 | 4,635,563 | 1,556,044 | 20,360,731 | 29,527,577 |

* Net of court financing deducts transferred to the Supreme Court.

Expenses by Type

| Fiscal Year Ended September 30 | Benefits | Refunds | Administrative Expenses | Real Estate Operating Expense | Total |
|--------------------------------------|--------------|-----------|----------------------------|-------------------------------------|--------------|
| 1986 | \$ 4,732,359 | \$ 20,319 | \$ 268,981 | \$ | \$ 5,021,659 |
| 1987 | 6,011,818 | 26,637 | 318,713@ | | 6,357,168 |
| 1988 | 6,275,614 | 53,318 | 292,923@ | | 6,621,855 |
| 1989 | 7,236,904 | 101,563 | 332,201@ | | 7,670,668 |
| 1990 | 7,811,812 | 72,319 | 381,684@ | | 8,265,815 |
| 1991 | 8,905,532 | 120,343 | 450,426@ | 19,182 | 9,495,483 |
| 1992 | 9,522,704 | 18,366 | 509,002@ | 31,418 | 10,081,490 |
| 1993 | 10,598,915 | 25,639 | 533,900@ | 25,245 | 11,183,699 |
| 1994 | 11,041,755 | 28,444 | 568,180@ | 42,209 | 11,680,588 |
| 1995 | 12,404,307 | 91,861 | 470,760@ | 41,052 | 13,007,980 |
| 1996 | 12,877,528 | 16,266 | 514,406@ | 57,988 | 13,466,188 |

@ Includes health insurance.

Employer Contributions - Computed and Actual

| Fiscal Year | Valuation Date September 30 | Computed Contributions As a % of Payroll | Actual Payroll | Public-Financed Dollar Contributions For Fiscal Year | |
|-------------|--------------------------------|--|----------------|---|--------------|
| | | | | Computed | Actual |
| 1985-86 | 1984 | 17.42% | \$ 31,577,074 | \$ 5,500,562 | \$ 6,025,460 |
| 1986-87 | 1985 | 17.60 | 35,837,525 | 6,307,695 | 6,479,634 |
| 1987-88 | 1986 | 18.78 | 38,587,600 | 7,246,946 | |
| 1987-88 | 1986+ | 17.40 | 38,587,600 | 6,713,147 | |
| 1987-88 | 1987 | 17.35 | 38,587,600 | 6,696,361 | 16,734,634 |
| 1988-89 | 1988 | 17.31 | 41,079,762 | 7,111,349 | 7,270,143 |
| 1989-90 | 1989 | 16.97 | 42,887,107 | 7,276,275 | 7,562,504 |
| 1990-91 | 1990 | 16.70 | 45,295,073 | 7,566,113 | 7,923,138 |
| 1991-92 | 1991 | 16.27 | 43,877,303 | 7,137,221 | 7,996,188 |
| 1992-93 | 1992 | 15.07 | 44,205,246 | 6,661,731 | 7,690,115 |
| 1993-94 | 1993 | 14.55 | 45,622,749 | 6,638,110 | 6,576,996 |
| 1994-95 | 1994 | 13.82 | 47,464,198 | 6,559,552 | 6,877,775 |
| 1995-96 | 1995 | 12.24 | 48,959,955 | 5,992,698 | 6,191,607 |

+ Revised asset valuation method.

SUPPLEMENTAL SCHEDULES

MICHIGAN JUDGES RETIREMENT SYSTEM
 Comparative Summary Schedule of Cash Receipts and Disbursements
Fiscal Years Ended September 30

| | <u>1996</u> | <u>1995</u> |
|-----------------------------------|-----------------------|-----------------------|
| Cash balance at beginning of year | \$ 5,695,770 | \$ 2,569,030 |
| Add receipts: | | |
| Member contributions | \$ 2,988,042 | \$ 2,828,282 |
| Employer contributions | 6,191,607 | 7,526,740 |
| Investment income | 19,051,166 | 14,530,813 |
| Investment, sales and redemptions | 193,082,324 | 155,717,643 |
| Total cash receipts | <u>\$ 221,313,139</u> | <u>\$ 180,603,478</u> |
| Less disbursements: | | |
| Benefit payments | \$ 12,860,780 | \$ 13,024,286 |
| Administrative expenses | 560,367 | 504,450 |
| Investments purchased | 210,763,471 | 163,855,541 |
| Refunds | 16,267 | 92,461 |
| Total cash disbursements | <u>\$ 224,200,885</u> | <u>\$ 177,476,738</u> |
| Cash balance at end of year | <u>\$ 2,808,024</u> | <u>\$ 5,695,770</u> |

MICHIGAN JUDGES RETIREMENT SYSTEM
Comparative Summary of Administrative Expenses
Fiscal Years Ended September 30

| | <u>1996</u> | <u>1995</u> |
|--|-------------------|-------------------|
| Personnel Services: | | |
| Staff salaries | \$ 92,655 | \$ 93,504 |
| Retirement and social security | 21,870 | 21,678 |
| Other fringe benefits | 13,430 | 15,438 |
| Total | <u>\$ 127,955</u> | <u>\$ 130,620</u> |
| Professional Services: | | |
| Actuarial | \$ 18,000 | \$ 17,508 |
| Accounting, records management, and mail | 124,416 | 92,224 |
| Data processing | 13,193 | 35,258 |
| Attorney General | 29,175 | 28,485 |
| Audit | 50,700 | 43,700 |
| Investment | 64,296 | 65,001 |
| Medical | 9,351 | 237 |
| Total | <u>\$ 309,131</u> | <u>\$ 282,413</u> |
| Building and Equipment: | | |
| Building rentals | \$ 3,478 | \$ 2,182 |
| Equipment purchases, maintenance, and rental | 2,384 | 4,651 |
| Total | <u>\$ 5,862</u> | <u>\$ 6,833</u> |
| Miscellaneous: | | |
| Office administrative support | \$ 18,564 | \$ 13,163 |
| Department administrative support | 43,960 | 27,400 |
| Travel and meetings | 744 | 279 |
| Postage, telephone, and other | 8,190 | 10,051 |
| Total | <u>\$ 71,457</u> | <u>\$ 50,893</u> |
| Total Administrative Expenses | <u>\$ 514,406</u> | <u>\$ 470,759</u> |

Glossary of Acronyms and Terms

| | |
|------------------------------------|--|
| actuarial accrued liability | The portion of the actuarial present value of pension plan benefits and expenses which is not provided through future normal costs. The actuarial accrued liability, at any particular time, is equal to the present value of future benefits less the present value of future normal costs. |
| actuarial cost method | The benefits budgeting process that assigns a cost of the benefits payable under the system, to prior, current, and subsequent plan years. The cost of the benefits payable as of a specific date is referred to as the present value of benefits. |
| benefits | Payments to which participants may be entitled under the pension plan, including pension benefits, death benefits, and benefits due on termination of employment. |
| financial audit | An audit that is designed to provide reasonable assurance about whether the financial statements/schedules of an audited entity are fairly presented in conformity with generally accepted accounting principles. |
| GAAP | generally accepted accounting principles. |
| GASB | Governmental Accounting Standards Board. |
| internal control structure | The management control environment, accounting system, and control policies and procedures established by management to provide reasonable assurance that resources are safeguarded; that resources are used in compliance with laws and regulations; and that financial transactions are properly accounted for and reported. |

| | |
|---|--|
| LIBOR | London Inter Bank Offer Rate. |
| MAIN | Michigan Administrative Information Network. |
| material weakness | A serious reportable condition in which the design or operation of one or more of the internal control structure elements (including management controls) does not reduce to a relatively low level the risk that errors or irregularities, of a magnitude that would be material in relation to the financial statements, would not be prevented or detected. |
| MJRS | Michigan Judges Retirement System. |
| normal cost | The portion of the actuarial present value of pension plan benefits and expenses allocated to a valuation year by the actuarial cost method. |
| notional amounts | Nominal value of the agreement used to calculate SWAP payments. |
| PERS | public employee retirement systems. |
| PBO | pension benefit obligation. |
| reportable condition | A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure. |
| retirants | Members who separate from service and retire with a retirement allowance payable from the appropriate reserve of MJRS. |
| unfunded actuarial accrued liability | The excess of the actuarially accrued liability over the actuarial value of assets. |