FINANCIAL AUDIT
OF THE

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM

October 1, 2000 through September 30, 2002

03-140-03

"...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Michigan Legislative Retirement System

October 1, 2000 through September 30, 2002

Report Number:
03-140-03

Released:
October 2003

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with State compliance requirements material to the financial statements. This financial audit of the Michigan Legislative Retirement System (MLRS) was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the MLRS financial statements.

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Internal Control Over Financial Reporting

We did not identify any material weaknesses in internal control over financial reporting.

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Noncompliance Material to the Financial Statements

We did not identify any instances of noncompliance applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

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Background:

MLRS is a single employer, Statewide public employee, defined benefit retirement plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, as amended (Sections 38.1001 - 38.1080 of the *Michigan Compiled Laws*). MLRS was established by the State of Michigan for the purpose of providing retirement, survivor, and disability benefits to eligible legislators in the legislative branch of State government. An 11-member Board of Trustees administers MLRS.

A defined benefit retirement plan specifies the amount of pension benefits to be provided at a future date or after a certain period of time; the pension amount is usually dependent on factors such as a retiree's age, years of service, and compensation. Act 486, P.A. 1996, amended the MLRS enabling statute to mandate that persons elected to the Michigan Legislature after March 31, 1997 participate in a Statewide defined contribution retirement plan. The Statewide defined contribution retirement plan operates in a manner similar to a 401(k) plan in which contributions are made to a member's account. The amount received by the member at retirement depends only on the amounts contributed and the investment earnings on those contributions. The MLRS defined benefit retirement plan is a closed plan, and all new legislators are automatically enrolled in the Statewide defined contribution retirement plan.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

October 14, 2003

The Honorable R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

This is our report on the financial audit of the Michigan Legislative Retirement System for the period October 1, 2000 through September 30, 2002.

This report contains our report summary, our independent auditor's report on the financial statements, management's discussion and analysis, and the Michigan Legislative Retirement System financial statements and notes to the financial statements. This report also contains our independent auditor's report on compliance and on internal control over financial reporting, required supplementary information, and a glossary of acronyms and terms.

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

AUDITOR GENERAL

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

May 9, 2003

The Honorable R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

We have audited the financial statements of the Michigan Legislative Retirement System as of and for the fiscal years ended September 30, 2002 and September 30, 2001, as identified in the table of contents. These financial statements are the responsibility of the Michigan Legislative Retirement System'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 *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 the 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 described in Note 1a, the financial statements present only the Michigan Legislative Retirement System and do not purport to, and do not, present fairly the financial position of the State of Michigan or its pension trust funds as of September 30, 2002 and September 30, 2001 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Legislative Retirement System as of September 30, 2002 and September 30, 2001 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2a, the Michigan Legislative Retirement System adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments;* Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus;* and Statement No. 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 9, 2003 on our tests of the Michigan Legislative Retirement System's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying schedule of funding progress and schedule of employer contributions are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

AUDITOR GENERAL

The management's discussion and analysis of the Michigan Legislative Retirement System (MLRS) provides an overview of the financial activities and performance for the fiscal years ended September 30, 2002 and September 30, 2001. This information should be read in conjunction with the financial statements and the required supplementary information. MLRS's management is responsible for the financial statements, notes to the financial statements, required supplementary information, and this discussion.

Using the Financial Report

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments.*

- The new reporting standards require a statement of net assets and a statement of revenues, expenses, and changes in fund net assets.

- The fiscal year 2001-02 and 2000-01 financial statements differ in form compared with the prior years' financial statements to comply with GASB Statement No. 34.

This financial report includes the report of independent auditors, management's discussion and analysis, the basic financial statements in the new format, notes to the financial statements, and required supplementary information.

Financial Overview

Statement of Pension Plan and Postemployment Healthcare Plan Net Assets:

The statement of pension plan and postemployment healthcare plan net assets presents information on MLRS's assets and liabilities using the accrual basis of accounting. Over time, increases or decreases in net assets may serve as a useful indicator of MLRS's financial strength or weakness. MLRS's plan net assets for the fiscal years ended September 30, 2002 and September 30, 2001 decreased by $17.7

million and $25.4 million, respectively, which was primarily because of the decrease in the fair value of MLRS investments.

Condensed Financial Information From the
Statement of Pension Plan and Postemployment
Healthcare Plan Net Assets
As of September 30
(In Thousands)

	2002	2001	Increase (Decrease)	Percentage Increase (Decrease)
Assets				
Cash	$ 2,994	$ 4,054	$ (1,060)	(26.1)%
Receivables	731	532	199	37.4%
Investments	137,618	154,500	(16,882)	(10.9)%
Total Assets	$ 141,343	$ 159,087	$ (17,744)	(11.2)%
Liabilities				
Warrants outstanding	$ 35	$ 37	$ (2)	(5.4)%
Accounts payable and other accrued liabilities	877	656	221	33.7%
Total Liabilities	$ 912	$ 693	$ 219	31.6%
Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits	$ 140,431	$ 158,393	$ (17,962)	(11.3)%

Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets:

The statement of changes in pension plan and postemployment healthcare plan net assets presents how MLRS's net assets changed during the fiscal year.

Additions to Plan Net Assets

The reserves needed to finance benefits provided by MLRS are accumulated through member contributions, State appropriations, the collection of circuit and district court fees, and earnings on investments. The decrease in the total additions to plan net assets for the fiscal years ended September 30, 2002 and September 30, 2001 totaled $7.8 million and $14.6 million, respectively. The decrease in the total additions to plan net assets related primarily to the net decrease in the fair value of MLRS investments.

Deductions From Plan Net Assets

The primary expenses of MLRS include the payment of retirement and life insurance benefits to members and beneficiaries; the payments for health, dental, and vision insurance benefits for retirees and beneficiaries; the refund or transfer of contributions to former members; and the costs of administering MLRS. Total deductions from plan net assets for the fiscal years ended September 30, 2002 and September 30, 2001 totaled $10.2 million and $9.5 million, respectively. The increase in the total deductions from plan net assets related primarily to the increase in retirement and healthcare benefit expenses.

Condensed Financial Information From the Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

For the Fiscal Years Ended September 30

(In Thousands)

	2002	2001	Increase (Decrease)	Percentage Increase (Decrease)
Additions				
Member contributions	$ 358	$ 380	$ (22)	(5.8)%
Employer contributions	3,116	3,348	(232)	(6.9)%
Court fees	1,095	1,068	27	2.5%
Net investment income/loss	(12,322)	(19,387)	7,065	36.4%
Total Additions	$ (7,753)	$(14,591)	$ 6,838	46.9%
Deductions				
Retirement benefits	$ 6,540	$ 6,085	$ 455	7.5%
Healthcare benefits	3,116	2,956	160	5.4%
Death benefits	287	189	98	51.9%
Refunds of member contributions and interest		12	(12)	(100.0)%
Administrative expenses	266	260	6	2.3%
Total Deductions	$ 10,209	$ 9,502	$ 707	7.4%
Net Increase (Decrease)	$(17,962)	$(24,093)	$ 6,131	25.4%

Overall Financial Analysis

The past year's financial markets declined, in part, because of numerous corporate governance scandals and uncertainty over international war possibilities. These market issues have adversely affected MRLS's investments. Despite these troubles, MLRS is still well positioned to withstand market traumas and continues to be able to meet current and foreseen future obligations.

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM
Statement of Pension Plan and
Postemployment Healthcare Plan Net Assets
As of September 30

	2002			2001		
	Pension Fund	Postemployment Healthcare Fund	Total	Pension Fund	Postemployment Healthcare Fund	Total
ASSETS						
Cash	$ 2,851,929	$ 141,698	$ 2,993,627	$ 3,908,685	$ 145,785	$ 4,054,470
Receivables:						
Employer	$ 92,344	$ 4,589	$ 96,933	$ 80,771	$ 3,013	$ 83,784
Interest and dividends	53,023	2,634	55,657	243,814	9,094	252,908
Sale of investments	551,037	27,378	578,415	188,222	7,020	195,242
Total Receivables	$ 696,404	$ 34,601	$ 731,005	$ 512,807	$ 19,127	$ 531,934
Investments:						
Bonds	$	$	$ 0	$ 17,635,501	$ 657,765	$ 18,293,266
Common stock	41,546,369	2,064,235	43,610,604	61,419,155	2,290,798	63,709,953
Mutual funds	89,557,924	4,449,692	94,007,616	69,890,309	2,606,753	72,497,062
Total Investments	$ 131,104,293	$ 6,513,927	$ 137,618,220	$ 148,944,965	$ 5,555,316	$ 154,500,281
Total Assets	$ 134,652,626	$ 6,690,226	$ 141,342,852	$ 153,366,457	$ 5,720,228	$ 159,086,685
LIABILITIES						
Warrants outstanding	$ 33,227	$ 1,651	$ 34,878	$ 35,941	$ 1,341	$ 37,282
Accounts payable and other accrued liabilities	835,380	41,506	876,886	632,463	23,589	656,052
Total Liabilities	$ 868,607	$ 43,157	$ 911,764	$ 668,404	$ 24,930	$ 693,334
NET ASSETS						
Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits*	$ 133,784,019	$ 6,647,069	$ 140,431,088	$ 152,698,053	$ 5,695,298	$ 158,393,351

* A schedule of funding progress is presented as required supplementary information.

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

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM
Statement of Changes in Pension Plan and
Postemployment Healthcare Plan Net Assets
For the Fiscal Years Ended September 30

	2002			2001		
	Pension Fund	Postemployment Healthcare Fund	Total	Pension Fund	Postemployment Healthcare Fund	Total
ADDITIONS						
Member contributions:						
Other contributions	$ 26,979	$ 330,294	$ 357,273	$ 43,450	$ 324,935	$ 368,385
Military contributions	1,023		1,023	12,021		12,021
Employer contributions		3,115,600	3,115,600		3,347,600	3,347,600
Court fees		1,094,971	1,094,971		1,067,874	1,067,874
Total Contributions	$ 28,002	$ 4,540,865	$ 4,568,867	$ 55,471	$ 4,740,409	$ 4,795,880
Investment income (loss):						
Net increase (decrease) in the fair value of investments	$ (16,293,566)	$	$ (16,293,566)	$ (24,578,531)	$	$ (24,578,531)
Interest, dividends, and other	4,856,063	(473,493)	4,382,570	6,428,175	(734,029)	5,694,146
Total Investment Income (loss)	$ (11,437,503)	$ (473,493)	$ (11,910,996)	$ (18,150,356)	$ (734,029)	$ (18,884,385)
Less investment activity expense	(410,876)		(410,876)	(502,557)		(502,557)
Net Investment Income (Loss)	$ (11,848,379)	$ (473,493)	$ (12,321,872)	$ (18,652,913)	$ (734,029)	$ (19,386,942)
Total Additions	$ (11,820,377)	$ 4,067,372	$ (7,753,005)	$ (18,597,442)	$ 4,006,380	$ (14,591,062)
DEDUCTIONS						
Benefits and refunds paid to members and beneficiaries:						
Retirement benefits	$ 6,540,490	$	$ 6,540,490	$ 6,085,368	$	$ 6,085,368
Health benefits		2,833,686	2,833,686		2,677,979	2,677,979
Dental benefits		281,914	281,914		278,247	278,247
Death benefits	286,780		286,780	188,500		188,500
Refunds of member contributions and interest	93		93	12,164		12,164
Administrative expenses	266,295		266,295	260,026		260,026
Total Deductions	$ 7,093,658	$ 3,115,600	$ 10,209,258	$ 6,546,058	$ 2,956,226	$ 9,502,284
Net Increase (Decrease)	$ (18,914,035)	$ 951,772	$ (17,962,263)	$ (25,143,500)	$ 1,050,154	$ (24,093,346)
Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits:						
Beginning of fiscal year	152,698,053	5,695,298	158,393,351	177,841,553	4,645,144	182,486,697
End of fiscal year	$ 133,784,019	$ 6,647,069	$ 140,431,088	$ 152,698,053	$ 5,695,298	$ 158,393,351

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

Note 1 Plan Description

a. Reporting Entity and Presentation

The Michigan Legislative Retirement System (MLRS) is a single employer, Statewide public employee, defined benefit retirement plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, as amended (Sections 38.1001 - 38.1080 of the *Michigan Compiled Laws*). A defined benefit retirement plan specifies the amount of pension benefits to be provided at a future date or after a certain period of time; the pension amount is usually dependent on factors such as a retiree's age, years of service, and compensation. MLRS was established by the State of Michigan for the purpose of providing retirement, survivor, and disability benefits to eligible legislators in the legislative branch of State government. An 11-member Board of Trustees administers MLRS.

MLRS is considered part of the State of Michigan financial reporting entity and its financial statements are included in the *State of Michigan Comprehensive Annual Financial Report* as a pension trust fund. MLRS operates within the legislative branch of State government. The MLRS Board of Trustees appoints the director, who serves as the executive secretary to the MLRS Board of Trustees and is responsible for the daily administration of the retirement system.

Act 486, P.A. 1996, amended the MLRS enabling statute to mandate that persons elected to the Michigan Legislature after March 31, 1997 participate in a Statewide defined contribution retirement plan. The Statewide defined contribution retirement plan operates in a manner similar to a 401(k) plan, in which contributions are made to a member's account, and is accounted for in the State Employees' Defined Contribution Retirement Fund. The amount received by a member at retirement depends only on the amounts contributed and the investment earnings on those contributions. The MLRS defined benefit retirement plan is a closed plan, and all new legislators are automatically enrolled in the Statewide defined contribution retirement plan.

MLRS and the MLRS Board of Trustees do not exercise oversight responsibility over the State Employees' Defined Contribution Retirement Fund or any other entities; therefore, MLRS is the only entity included in this financial report. The accompanying financial statements present only MLRS. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the State of Michigan or its pension trust funds in conformity with generally accepted accounting principles.

b. Membership

At September 30, 2002 and September 30, 2001, MLRS membership consisted of:

	2002	2001
Retirees* and beneficiaries currently receiving benefits*:		
Regular benefits	174	171
Survivor benefits	73	71
Disability benefits	0	0
Total	247	242
Inactive members* with vested deferred benefits	72	80
Current employees:		
Vested	52	33
Nonvested	1	21
Total	53	54
Total of all members	372	376

Note: The number of retirees and beneficiaries currently receiving benefits includes 6 domestic relations order* alternate payees*.

c. Benefit Provisions

Regular Retirement:

A member may retire and receive retirement benefits based on age and service after: (1) attaining age 50, if age and years of credited service combined are equal to or greater than 70; or (2) attaining age 55 with 5 or more years of credited service if elected, qualified, and seated not less

* *See glossary at end of report for definition.*

than (a) 3 full or partial terms in the House of Representatives, (b) 2 full or partial terms in the Senate, or (c) 1 term in the House of Representatives and 1 term in the Senate.

For those legislators who first became members on or before January 1, 1995, the retirement benefit is calculated by multiplying 20% of a member's highest salary earned for the first 5 years of service, plus 4% of the member's highest salary for each of the next 11 years of service, plus 1% of the member's highest salary for each additional year.

For those legislators who first became members after January 1, 1995, the retirement benefit is calculated by multiplying 3% of the highest salary for each year of service.

Post Retirement Benefit Adjustment:
For those legislators who first became members on or before January 1, 1995, the annual retirement benefit payable to a retiree or a retiree's survivor is increased by 4% compounded annually. The adjustment is effective each January 1.

For those legislators who first became members after January 1, 1995, the annual retirement benefit payable to a retiree or a retiree's survivor is increased by 4%, but is not compounded annually. The adjustment is effective each January 1.

Disability Benefit:
A member or deferred vested member* who becomes disabled as determined by at least two licensed physicians appointed by the MLRS Board of Trustees is eligible for a disability benefit computed in the same manner described under a regular retirement.

Survivor Benefit:
Upon the death of a vested member or deferred vested member who meets the service but not the age requirements for a regular retirement or upon the death of a retiree, the surviving spouse shall be entitled to a benefit equal to 66 2/3% of the benefit the member would have received

* *See glossary at end of report for definition.*

or was receiving at the time of death. Special provisions apply to surviving minor children and surviving spouses with minor children.

Refunds:
A member who leaves legislative service may request a refund of the member's contributions. A member who receives a refund of contributions forfeits all rights to any future benefits. Members who return to legislative service and who previously received a refund of their contributions may reinstate their service through repayment of the refund plus interest in accordance with the statute.

d. Other Postemployment Benefits
Under Sections 50a and 50b of the Michigan Legislative Retirement System Act, all retirees and their survivors and dependents have the option of continuing health, dental, vision, and hearing insurance coverage. MLRS also provides health, dental, vision, and hearing insurance coverage for deferred vested members who were members on or before January 1, 1995 and for their survivors and dependents. In addition, in accordance with State law, MLRS provides health insurance coverage to eligible former legislators and their dependents who meet certain vesting requirements and who belong to the Statewide defined contribution pension plan. MLRS funds the health, dental, vision, and hearing insurance benefits on a pay-as-you-go basis*; however, the State has begun to advance fund the program for future health insurance costs.

MLRS provides $150,000 in life insurance coverage to active members. Deferred vested members and retirees are covered by varying amounts of life insurance, ranging from $2,500 to $150,000. The life insurance plan is included in the pension fund of the MLRS financial statements. The

* *See glossary at end of report for definition.*

number of plan participants and other relevant financial information is as follows:

Health/Dental/Vision Plans	Fiscal Year 2001-02		2000-01	
Eligible participants	326		330	
Participants receiving benefits	325	(1)	329	(2)
Expense for year	$ 3,115,600		$ 2,956,226	
Net assets available for benefits	$ 6,647,069		$ 5,695,298	
Life Insurance Plan				
Participants receiving benefits	284		292	
Actuarial accrued liabilities*	$ 8,081,970		$ 8,151,632	
Net assets available for benefits	$11,212,361		$12,512,515	
Life insurance payments	$ 286,780		$ 188,500	

(1) Includes 15 defined contribution pension plan participants, who are receiving healthcare insurance through MLRS in accordance with State statute.

(2) Includes 14 defined contribution pension plan participants, who are receiving healthcare insurance through MLRS in accordance with State statute.

e. Term Limits

Michigan's constitutional term-limit amendment limits members of the House of Representatives to six years in office and members of the Senate to eight years in office. All new legislators are automatically enrolled in the State of Michigan Defined Contribution Plan.

Note 2 Summary of Significant Accounting Policies and Plan Asset Matters

a. Measurement Focus and Basis of Accounting

The MLRS financial statements are presented using the economic resources measurement focus and the accrual basis of accounting as provided by generally accepted accounting principles applicable to governments. Under the accrual basis of accounting, contributions from the State and participating legislators are recognized as revenue in the period in which service is provided. Retirement benefits and refunds are

* *See glossary at end of report for definition.*

recognized when due and payable in accordance with the terms of the retirement plan.

New accounting standards were adopted in the fiscal year 2000-01. MLRS adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* as amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures.* Statement No. 34, as amended and modified, commonly referred to as the new reporting model, retained much of the old reporting and disclosure requirements under the prior reporting model, with certain modifications and newly added information. The most significant effect on the MLRS financial statements was the addition of the management's discussion and analysis as required supplementary information.

b. Contributions and Reserves

The Michigan Legislative Retirement System Act provides for several funds. These funds and the contributions and other monies allocated to them are described below:

(1) Members' Savings Fund (MSF). Members who first became members on or before January 1, 1995 contributed 7% of their salary to MSF for a period not to exceed 20 years. Members who first became members after January 1, 1995 contributed 5% of their salary to MSF. During the period January 1, 1999 through December 31, 2000, members who first became members after December 1, 1994 and on or before January 1, 1995 contributed an additional 4% of their salary to MSF. After January 1, 1999, there were no member contributions allocated to MSF from the pre-December 1, 1994 members or the post-January 1, 1995 members. Members may make other contributions to MSF to purchase military service credit or to repay previously refunded contributions. MSF represents active member and deferred vested member contributions (and interest credited from the Income Fund) less amounts transferred to the Members' Retirement Fund for retirement and amounts refunded to terminated members. Fund

balances for MSF for the fiscal years ended September 30, 2002 and September 30, 2001 were $4,362,488 and $4,514,622, respectively.

(2) Members' Retirement Fund (MRF). MRF represents the reserves for payment of retirement benefits to retired members and deferred vested members. At retirement, a member's accumulated contributions (with interest) are transferred to MRF (from MSF). Interest is credited to MRF (from the Income Fund), and monthly allowances are debited. At each fiscal year-end, an actuarial valuation determines the 100% funding requirements for MRF. Any amounts required to fund MRF 100% are transferred in the next fiscal year. Fund balances for MRF for the fiscal years ended September 30, 2002 and September 30, 2001 were $79,980,744 and $92,577,320, respectively.

(3) Survivors' Retirement Fund (SRF). Until January 1, 1999, all members with less than 20 years of service contributed 0.5% of their salary to SRF. After January 1, 1999, there are no member contributions allocated to SRF. Interest is credited annually to SRF (from the Income Fund), and member savings are transferred to SRF from MSF upon the death of a vested member, and additional State contributions may be made in order to fund SRF 100%. Survivors' monthly retirement allowances are paid from SRF upon the death of vested members, deferred vested members, and retirees. Fund balances for SRF for the fiscal years ended September 30, 2002 and September 30, 2001 were $38,228,425 and $43,093,596, respectively.

(4) Insurance Revolving Fund (IRF). Until January 1, 1999, all members contributed 0.5% of their salary to IRF. After January 1, 1999, there are no member contributions allotted to IRF. State contributions, if any, and interest from the Income Fund are credited to IRF. IRF pays lump sum death benefits to beneficiaries of members, deferred vested members, and retirees. Fund balances for IRF for the fiscal years ended September 30, 2002 and September 30, 2001 were $11,212,361 and $12,512,515, respectively.

(5) Health Insurance Fund (HIF). Until January 1, 1999, all members contributed 1% of their salary to HIF. After January 1, 1999, members' contributions are made as follows: members who first became members on or before January 1, 1995 contribute 9% to HIF and members who first became members after January 1, 1995 contribute 7% to HIF. Funds from HIF pay for health care expenses and are accumulated to fully fund the future health insurance liabilities. Fund balances for HIF for the fiscal years ended September 30, 2002 and September 30, 2001 were $6,647,070 and $5,695,298, respectively.

(6) Income Fund. The Income Fund is credited with all investment earnings, and all investment and administrative expenses are reimbursed from the Fund. Interest transfers are made annually to other funds.

c. Related Party Transactions

The cash account, which represents funds deposited in a common cash investment pool maintained for various State operating funds, included $2,993,627 and $4,054,470 on September 30, 2002 and September 30, 2001, respectively. The participating funds in the common cash investment pool earn interest at various rates, depending upon prevailing short-term interest rates. Earnings from these activities amounted to $87,017 and $441,067 for the fiscal years ended September 30, 2002 and September 30, 2001, respectively.

d. Fixed Assets

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.

Note 3 Investments

All investments made are subject to approval by the MLRS Board of Trustees, which has investment authority under the controlling act. Investments made are subject to statutory regulation imposed under the Public Employee Retirement System Investment Act (Act 314, P.A. 1965, as amended). MLRS also contracts with independent investment advisors and the State Treasurer acts as custodian for MLRS investments.

a. Methods Used to Value Investments. Plan investments are presented at fair value. Securities traded on a national exchange are valued at the last reported sales price. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Other investments that do not have an established market are recorded at estimated fair value. Short-term investments are carried at cost, which approximates fair value.

b. Investment Income. Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as net increase (decrease) in the fair value of investments. Purchases and sales of investments are recorded as of the trade date.

c. Investments Exceeding 5% of Net Assets. At September 30, 2002 and September 30, 2001, MLRS did not hold any individual investment that exceeded 5% of net assets available for benefits, as defined in Act 314, P.A. 1965, as amended.

d. Categories of Investment Risk. Governmental Accounting Standards Board Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements,* requires classification of investments into 1 of 3 categories based upon credit risk. Category 1 includes investments that are insured or registered or that are held by MLRS or its agent in MLRS's name. Category 2 includes uninsured and unregistered investments that are held by the counter party's trust department or agent in MLRS's name. Category 3 includes uninsured and unregistered investments that are held by the counter party, its trust department or agent, but not in MLRS's name. MLRS did not hold any investments classified in Category 2 or 3.

   Certain types of investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. Mutual funds are noncategorized investments. MLRS held $94.0 million and

$72.5 million in mutual funds on September 30, 2002 and September 30, 2001, respectively.

e. Derivatives and Securities Lending. MLRS did not have any investments in derivatives or securities lending activities, as defined in Act 314, P.A. 1965, as amended.

Note 4 Funding Status and Progress

Presented at the end of this note is the total actuarial accrued liability of projected pension benefits for MLRS. The actuarial accrued liability is a measure intended to help users (a) assess a pension fund's funding status on a going-concern basis, (b) assess progress being made toward accumulating the assets needed to pay benefits as due, and (c) make comparisons among public employee retirement systems.

The actuarial accrued liability of projected pension benefits consists of: (a) the actuarial present value* of credited benefits payable for current active members, (b) the actuarial present value of projected benefits payable to current retirees and beneficiaries, and (c) the actuarial present value of projected benefits payable to terminated vested members.

The standardized measure of the pension and insurance benefit obligations as of September 30, 2002 and September 30, 2001 (excluding the reserve for health insurance) is as follows:

	2002	2001
Actuarial accrued liability:		
Active members	$ 28,267,254	$ 25,557,175
Retirees and beneficiaries currently receiving benefits	91,221,364	86,234,923
Inactive members with vested deferred benefits	24,369,533	26,828,592
Total actuarial accrued liability	$ 143,858,151	$ 138,620,690
Actuarial value of assets (fair value: 2002, $133,784,019; 2001, $152,698,053)*	167,158,154	168,398,584
Unfunded (overfunded) actuarial accrued liability*	$ (23,300,003)	$ (29,777,894)

* Excludes reserve for health insurance.

* *See glossary at end of report for definition.*

Note 5 Contributions Required and Contributions Made

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

As a result of the closure of the defined benefit plan and a favorable investment performance, actuary reports indicate that MLRS is now more than fully funded for all pension and life insurance benefits to be paid to existing active members, deferred vested members, retirees, and beneficiaries. A schedule of funding progress is presented as required supplementary information.

Active members continue to make contributions to designated funds based upon the requirements set forth in the enabling statute and as described in Note 2.

Note 6 Required Supplementary Information

Governmental Accounting Standards Board Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, requires the disclosure of certain historical trend information. Trend information is intended to help users assess the funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems. This trend information is presented as required supplementary information.

Note 7 Legislative Salary Increases

Effective February 1, 2001, legislative salaries increased approximately 36%. These salary increases will have a direct effect on the retirement benefit amounts paid to active MLRS members upon retirement or upon payment of retirement benefits to their survivors. The effect of the salary increases on MLRS's actuarial accrued liability was determined in the MLRS actuarial valuations.

* *See glossary at end of report for definition.*

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance and
on Internal Control Over Financial Reporting

May 9, 2003

The Honorable R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

We have audited the financial statements of the Michigan Legislative Retirement System as of and for the fiscal years ended September 30, 2002 and September 30, 2001, as identified in the table of contents, and have issued our report thereon dated May 9, 2003. 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 *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether the Michigan Legislative Retirement System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, 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*.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Michigan Legislative Retirement System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial

statements and not to provide assurance on internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud 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. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress
(In Thousands)

Each time a higher level of benefit is adopted, unfunded obligations are created. Sections 38.1020(4) and 38.1022(5) of the *Michigan Compiled Laws* require that these additional obligations be financed systematically over a period of future years.

Analysis of the dollar amounts of the actuarial value of assets, actuarial accrued liability, or unfunded actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides one indication of the Michigan Legislative Retirement System's (MLRS's) 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 the percentage, the stronger the system. Trends in unfunded actuarial accrued liability expressed as a percentage of annual covered payroll approximately adjust for the effects of inflation and aid analysis of MLRS progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller the percentage, the stronger the system.

Valuation Date September 30	Actuarial Value of Assets (1) (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (2) (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1993	$ 88,074	$ 82,579	$ (5,495)	107%	$ 6,871	
1993 (3)(4)	$ 86,660	$ 88,144	$ 1,484	98%	$ 6,871	22%
1994	$ 93,264	$ 99,974	$ 6,710	93%	$ 7,202	93%
1995	$103,660	$ 105,866	$ 2,206	98%	$ 7,419	30%
1996	$113,633	$ 112,571	$ (1,062)	101%	$ 7,654	
1997	$126,819	$ 116,263	$ (10,556)	109%	$ 7,836	
1998	$131,836	$ 112,934	$ (18,902)	117%	$ 6,610	
1999	$146,141	$ 127,096	$ (19,045)	115%	$ 4,195	
2000	$160,254	$ 128,472	$ (31,782)	125%	$ 4,344	
2001	$168,399	$ 138,621	$ (29,778)	121%	$ 4,284	
2002	$167,158	$ 143,858	$ (23,300)	116%	$ 4,331	

(1) Excludes reserve for health insurance.
(2) October-based payroll.
(3) After changes in actuarial assumptions.
(4) After reflecting the impact of term limits.

Schedule of Employer Contributions
(In Thousands)

Fiscal Year	Valuation Date September 30	Required Contribution as a Percentage of Payroll	Actual Payroll	Dollar Contributions For Fiscal Year Required	Actual (1)
1992-93	1992	33.06%	$ 6,821	$ 2,255	$ 2,458
1993-94	1993	30.74%	$ 7,055	$ 2,169	$ 2,347
1993-94	1993 (2)	31.62%	$ 7,055	$ 2,231	$ 2,347
1993-94	1993 (3)	45.48%	$ 7,055	$ 3,209	$ 2,347
1994-95	1994	45.45%	$ 7,370	$ 3,350	$ 3,419
1994-95	1994 (4)	29.43%	$ 7,370	$ 2,169	$ 3,419
1995-96	1995	26.97%	$ 7,565	$ 2,040	$ 2,152
1996-97	1996	25.51%	$ 7,737	$ 1,974	$ 2,070
1997-98	1997	19.79%	$ 8,197	$ 1,622	$ 2,083
1997-98	1997 (5)	0.00%	$ 8,197	$ 0	$ 2,083
1998-99	1998	0.00%	$ 6,610	$ 0	$ 0
1999-2000	1999	0.00%	$ 4,195	$ 0	$ 0
2000-01	2000	0.00%	$ 4,344	$ 0	$ 0
2001-02	2001	0.00%	$ 4,284	$ 0	$ 0

(1) Actual contributions are public-financed contributions, less health insurance premiums and less noninvestment administrative expenses for fiscal years 1992-93 and 1993-94.
(2) After changes in actuarial assumptions/methods.
(3) After reflecting the impact of term limits.
(4) After changes in benefit provisions.
(5) After closing the defined benefit plan to new members.

Notes to the Required Supplementary Information

Note A Description

The 10-year historical trend information is designed to provide information about the Michigan Legislative Retirement System's (MLRS's) progress made in accumulating sufficient assets to pay benefits when due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, and accounting policies and other changes that usually affect trends in contribution requirements.

The schedule of funding progress and schedule of employer contributions are reported as historical trend information. The schedule of funding progress is presented to measure the progress made to accumulate sufficient assets to pay benefits when due. The schedule of employer contributions is presented to show the responsibility of the employer in meeting the actuarial requirements to maintain MLRS on a sound financial basis.

Note B Summary of Actuarial Assumptions

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

Valuation date	September 30, 2002	September 30, 2001
Actuarial cost method	Entry Age	Entry Age
Amortization method	Level Percent of Payroll	Level Percent of Payroll
Amortization period	12 Years	12 Years
Asset valuation method	5-Year Smoothed Market	5-Year Smoothed Market
Actuarial assumptions:		
Investment rate of return	7%	7%
Projected salary increases	4%	4%
Inflation	4%	4%
Cost-of-living adjustments	4%	4%

Glossary of Acronyms and Terms

actuarial accrued liability (AAL) — The difference between the actuarial present value of pension plan benefits and the actuarial present value of future normal costs; also referred to as "past service liability."

actuarial cost method — A mathematical budgeting procedure for allocating the dollar amount of the "actuarial present value of future benefits" between future normal costs and actuarial accrued liability; sometimes referred to as the "actuarial funding method."

actuarial present value — The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest and by probabilities of payment.

alternate payee — A spouse of a participant under a judgment of separate maintenance or a former spouse, child, or dependent of a participant, who is named in an eligible domestic relations order.

benefits — Payments to which participants may be entitled under the pension plan, including pension benefits, death benefits, and benefits due on termination of office.

deferred vested member — A member who leaves office and meets the service requirement but not the age requirement or a member who defers receipt of a retirement allowance until a future date.

domestic relations order — A judgment, decree, or order of the court made pursuant to the domestic relations law of the State and relating to the provision of alimony payments, child support, or marital property rights to a spouse of a participant under a judgment of separate maintenance or to a former spouse, child, or dependent of a participant.

entry age normal actuarial cost method	A method under which the actuarial present value of the projected benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings or service of the individual between entry age and assumed exit age.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
HIF	Health Insurance Fund.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IRF	Insurance Revolving Fund.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
member	A person elected to the Michigan House of Representatives or the Michigan Senate.
MLRS	Michigan Legislative Retirement System.
MRF	Members' Retirement Fund.

MSF Members' Saving Fund.

normal cost The portion of the actuarial present value of future pension plan benefits that is allocated to the current year by the actuarial cost method; sometimes referred to as "current service cost."

pay-as-you-go basis A method of financing a pension plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.

reportable condition A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.

retiree A member who separated from office and retired with a retirement allowance payable from the Michigan Legislative Retirement System.

SRF Survivors' Retirement Fund.

unfunded actuarial accrued liability (UAAL) The difference between the actuarial accrued liability and the actuarial value of assets.