



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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

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

Audit report information can be accessed at:

<http://audgen.michigan.gov>



Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

Michigan Legislative Retirement System

October 1, 2004 through September 30, 2006

Report Number:
900-0140-07

Released:
August 2007

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 in accordance with Section 38.1041 of the Michigan Compiled Laws 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 report any findings related to internal control over financial reporting.

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Noncompliance and Other Matters

Material to the Financial Statements

We did not identify any instances of noncompliance or other matters 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, public employee, defined benefit retirement plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, and provides retirement and ancillary benefits to eligible current and former State legislators. MLRS's financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

MLRS operates within the legislative branch of State government. The MLRS Board of Trustees appoints the director who serves as executive secretary to the MLRS Board, with whom the general oversight of MLRS resides. Act 486, P.A. 1996, amended the MLRS enabling statute to mandate that persons elected to the Michigan Legislature after March 30, 1997 participate in a Statewide defined

contribution plan administered by the Department of Management and Budget. The defined contribution plan operates in a manner similar to a 401(k) plan as part of the State Employees' Defined Contribution 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: <http://audgen.michigan.gov>



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201 N. Washington Square
Lansing, Michigan 48913

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

August 31, 2007

The Honorable R. Robert Geake, Chair
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 (MLRS) for the period October 1, 2004 through September 30, 2006.

This report contains our report summary, our independent auditor's report on the financial statements, the MLRS management's discussion and analysis, and the MLRS financial statements and required supplementary information. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters and a glossary of acronyms and terms.

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

AUDITOR GENERAL

TABLE OF CONTENTS

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT	
Independent Auditor's Report on the Financial Statements	8
MANAGEMENT'S DISCUSSION AND ANALYSIS	
Management's Discussion and Analysis	11
FINANCIAL STATEMENTS	
Michigan Legislative Retirement System Financial Statements	
Statement of Pension Plan and Postemployment Healthcare Plan Net Assets	16
Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets	17
Notes to the Financial Statements	18
REQUIRED SUPPLEMENTARY INFORMATION	
Schedule of Funding Progress	33
Schedule of Contributions From the Employer and Other Contributing Entities	34
Notes to Required Supplementary Information	35

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	38
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GLOSSARY

Glossary of Acronyms and Terms	41
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INDEPENDENT AUDITOR'S REPORT



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

Independent Auditor's Report on the Financial Statements

The Honorable R. Robert Geake, Chair
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 accompanying financial statements of the Michigan Legislative Retirement System as of and for the fiscal years ended September 30, 2006 and September 30, 2005, 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 2, 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, 2006 and September 30, 2005 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, 2006 and September 30, 2005 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 4, 2007 on our consideration of the Michigan Legislative Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 13 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying required supplementary information, as identified in the table of contents, is not a required part of the Michigan Legislative Retirement System's financial statements but is supplementary information required by the Governmental Accounting Standards Board. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

May 4, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2006 and September 30, 2005. This information should be read in conjunction with the financial statements and required supplementary information. MLRS's management is responsible for the financial statements, notes to the financial statements, required supplementary information, and this discussion.

Financial Overview

Statement of Pension Plan and Postemployment Healthcare Plan Net Assets

The statement of 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, 2006 and September 30, 2005 **increased** by \$3,604,320 (2.0%) and \$11,692,227 (7.0%), respectively, primarily because of the increase in the investments.

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

	<u>2006</u>	<u>Increase (Decrease) Amount</u>	<u>Increase (Decrease) Percentage</u>	<u>2005</u>	<u>Increase (Decrease) Amount</u>	<u>Increase (Decrease) Percentage</u>	<u>2004</u>
Assets							
Cash	\$ 3,629	\$ 763	26.6%	\$ 2,866	\$ (582)	(16.9%)	\$ 3,448
Receivables	594	(70)	(10.5%)	664	304	84.4%	360
Investments	180,204	3,447	2.0%	176,757	11,704	7.1%	165,053
Total assets	<u>\$184,427</u>	<u>\$ 4,140</u>	2.3%	<u>\$180,287</u>	<u>\$ 11,426</u>	6.8%	<u>\$168,861</u>
Liabilities							
Warrants outstanding	\$ 31	\$ 21	210.0%	\$ 10	\$ (21)	(67.7%)	\$ 31
Accounts payable	883	514	139.3%	369	(245)	(39.9%)	614
Total liabilities	<u>\$ 914</u>	<u>\$ 535</u>	141.2%	<u>\$ 379</u>	<u>\$ (266)</u>	(41.2%)	<u>\$ 645</u>
Total net assets	<u>\$183,513</u>	<u>\$ 3,605</u>	2.0%	<u>\$179,908</u>	<u>\$ 11,692</u>	7.0%	<u>\$168,216</u>

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

Additions to Plan Net Assets

The reserves needed to finance benefits* provided by MLRS are accumulated through the collection of court fees and member* and employer contributions and through earnings on investments. Contributions and investment income/loss for fiscal year 2005-06 totaled \$17,478,848. Total additions to plan net assets **decreased** by \$7.5 million (30.0%) from the prior year primarily because of the decrease in the market value of MLRS investments at year-end, which negatively affected investment income/loss in comparison to the prior year. Contributions and investment income/loss for fiscal year 2004-05 totaled \$24,984,271. Total additions to plan net assets **increased** by \$1.6 million (6.8%) from the prior year primarily because employer contributions, investment income, and miscellaneous income increased.

Deductions From Plan Net Assets

The expenses of MLRS include the payments of pension and life insurance benefits to members and beneficiaries; the payments for health, dental, and vision benefits; the refund or transfer of contributions to former members; and the cost of administering MLRS. Total expenses for fiscal year 2005-06 were \$13,874,529, an **increase** of 4.4% over fiscal year 2004-05 expenses. Total expenses for fiscal year 2004-05 were \$13,292,044, an **increase** of 8.1% over fiscal year 2003-04 expenses. The increases are primarily because retirement and health benefits increased.

* See glossary at end of report for definition.

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

	2006	Increase (Decrease) Amount	Increase (Decrease) Percentage	2005	Increase (Decrease) Amount	Increase (Decrease) Percentage	2004
Additions							
Member contributions	\$ 191	\$ (4)	(2.1%)	\$ 195	\$ (2)	(1.0%)	\$ 197
Defined contribution health premiums	11	6	120.0%	5	5	N/A	N/A
Employer contributions	3,340	65	2.0%	3,275	328	11.1%	2,947
Court fees	1,216	10	0.8%	1,206	(25)	(2.0%)	1,231
Net investment income (loss)	12,299	(7,378)	(37.5%)	19,677	667	3.5%	19,010
Miscellaneous income	400	(226)	(36.1%)	626	626	N/A	
Nonoperating revenue	22	22	N/A			N/A	
Total additions	<u>\$ 17,479</u>	<u>\$ (7,505)</u>	(30.0%)	<u>\$ 24,984</u>	<u>\$ 1,599</u>	6.8%	<u>\$ 23,385</u>
Deductions							
Retirement benefits	\$ 8,943	\$ 541	6.4%	\$ 8,402	\$ 527	6.7%	\$ 7,875
Health and dental benefits	4,446	206	4.9%	4,240	275	6.9%	3,965
Death benefits	150	(170)	(53.1%)	320	179	127.0%	141
Refunds of contributions and interest	5	1	25.0%	4	(12)	(75.0%)	16
Administrative expenses	331	5	1.5%	326	22	7.2%	304
Total deductions	<u>\$ 13,875</u>	<u>\$ 583</u>	4.4%	<u>\$ 13,292</u>	<u>\$ 991</u>	8.1%	<u>\$ 12,301</u>
Net increase (decrease)	<u>\$ 3,604</u>	<u>\$ (8,088)</u>	(69.2%)	<u>\$ 11,692</u>	<u>\$ 608</u>	5.5%	<u>\$ 11,084</u>
Ending net assets	<u>\$ 183,513</u>	<u>\$ 3,605</u>	2.0%	<u>\$ 179,908</u>	<u>\$ 11,692</u>	7.0%	<u>\$ 168,216</u>

Overall Financial Analysis

The economy slowed in the second half of fiscal year 2005-06 after showing very robust growth toward the end of 2005 and early 2006. The slowing was reflected in housing sales and consumer spending as volatile energy prices and the ongoing tightening monetary policy began to impact the consumer. Nevertheless, the MLRS pension fund met its actuarial assumed rate of return and retained its actuarial overfunded status.

FINANCIAL STATEMENTS

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

	2006			2005		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
ASSETS						
Cash	\$ 3,363,221	\$ 265,367	\$ 3,628,588	\$ 2,675,530	\$ 190,006	\$ 2,865,536
Receivables:						
Employer	\$ 97,774	\$ 7,715	\$ 105,489	\$ 104,458	\$ 7,418	\$ 111,876
Interest and dividends	46,853	3,697	50,550	59,706	4,240	63,946
Sale of investments	405,783	32,017	437,800	456,094	32,390	488,484
Total receivables	\$ 550,410	\$ 43,429	\$ 593,839	\$ 620,258	\$ 44,048	\$ 664,306
Investments:						
Common stock	\$ 66,795,795	\$ 5,270,358	\$ 72,066,153	\$ 66,349,229	\$ 4,711,865	\$ 71,061,094
Mutual funds	100,229,875	7,908,390	108,138,265	98,687,743	7,008,421	105,696,164
Total investments	\$ 167,025,670	\$ 13,178,748	\$ 180,204,418	\$ 165,036,972	\$ 11,720,286	\$ 176,757,258
Total assets	\$ 170,939,301	\$ 13,487,544	\$ 184,426,845	\$ 168,332,760	\$ 11,954,340	\$ 180,287,100
LIABILITIES						
Warrants outstanding	\$ 28,975	\$ 2,286	\$ 31,261	\$ 9,626	\$ 684	\$ 10,310
Accounts payable and other liabilities	818,216	64,559	882,775	343,879	24,421	368,300
Total liabilities	\$ 847,191	\$ 66,845	\$ 914,036	\$ 353,505	\$ 25,105	\$ 378,610
Net assets held in trust for pension and healthcare benefits	\$ 170,092,110	\$ 13,420,699	\$ 183,512,809	\$ 167,979,255	\$ 11,929,235	\$ 179,908,490

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

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

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

	2006			2005		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
ADDITIONS						
Member contributions:						
Other member contributions	\$ 18,793	\$ 171,581	\$ 190,374	\$ 23,192	\$ 171,581	\$ 194,773
Military contributions	775		775			
Defined contribution health premiums		10,609	10,609		5,445	5,445
Employer contributions		3,340,100	3,340,100		3,274,600	3,274,600
Court fees		1,215,803	1,215,803		1,205,846	1,205,846
Total contributions	<u>\$ 19,568</u>	<u>\$ 4,738,093</u>	<u>\$ 4,757,661</u>	<u>\$ 23,192</u>	<u>\$ 4,657,472</u>	<u>\$ 4,680,664</u>
Investment income (loss):						
Net increase (decrease) in fair value of investments	\$ 7,278,787	\$	\$ 7,278,787	\$ 14,583,303	\$	\$ 14,583,303
Interest, dividends, and other	4,808,154	799,017	5,607,171	4,500,909	1,141,548	5,642,457
Total investment income (loss)	<u>\$ 12,086,941</u>	<u>\$ 799,017</u>	<u>\$ 12,885,958</u>	<u>\$ 19,084,212</u>	<u>\$ 1,141,548</u>	<u>\$ 20,225,760</u>
Less investment expenses	(586,364)		(586,364)	(548,350)		(548,350)
Net investment income (loss)	<u>\$ 11,500,577</u>	<u>\$ 799,017</u>	<u>\$ 12,299,594</u>	<u>\$ 18,535,862</u>	<u>\$ 1,141,548</u>	<u>\$ 19,677,410</u>
Miscellaneous income	\$	\$ 400,000	\$ 400,000	\$ 48,775	\$ 577,422	\$ 626,197
Nonoperating revenue	21,593		21,593			
Total additions	<u>\$ 11,541,738</u>	<u>\$ 5,937,110</u>	<u>\$ 17,478,848</u>	<u>\$ 18,607,829</u>	<u>\$ 6,376,442</u>	<u>\$ 24,984,271</u>
DEDUCTIONS						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement benefits	\$ 8,942,596	\$	\$ 8,942,596	\$ 8,402,490	\$	\$ 8,402,490
Health benefits		4,115,879	4,115,879		3,918,592	3,918,592
Dental benefits		329,767	329,767		321,609	321,609
Death benefits	150,000		150,000	319,580		319,580
Refund of contribution and interest	5,367		5,367	3,707		3,707
Administrative expenses	330,920		330,920	326,066		326,066
Total deductions	<u>\$ 9,428,883</u>	<u>\$ 4,445,646</u>	<u>\$ 13,874,529</u>	<u>\$ 9,051,843</u>	<u>\$ 4,240,201</u>	<u>\$ 13,292,044</u>
Net increase (decrease)	\$ 2,112,855	\$ 1,491,464	\$ 3,604,319	\$ 9,555,986	\$ 2,136,241	\$ 11,692,227
Net assets held in trust for pension and healthcare benefits:						
Beginning of year	<u>167,979,255</u>	<u>11,929,235</u>	<u>179,908,490</u>	<u>158,423,269</u>	<u>9,792,994</u>	<u>168,216,263</u>
End of year	<u>\$ 170,092,110</u>	<u>\$ 13,420,699</u>	<u>\$ 183,512,809</u>	<u>\$ 167,979,255</u>	<u>\$ 11,929,235</u>	<u>\$ 179,908,490</u>

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

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

Notes to the Financial Statements

Note 1 Plan Description

a. Organization

The Michigan Legislative Retirement System (MLRS) is a single employer, public employee, defined benefit retirement plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, and provides retirement and ancillary benefits to eligible current and former State legislators. MLRS's financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

MLRS operates within the legislative branch of State government. The MLRS Board of Trustees appoints the director who serves as executive secretary to the MLRS Board, with whom the general oversight of MLRS resides. Act 486, P.A.1996, amended the MLRS enabling statute to mandate that persons elected to the Michigan Legislature after March 30, 1997 participate in a Statewide defined contribution plan administered by the Department of Management and Budget. Thus, the defined benefit plan is a closed plan. The defined contribution plan operates in a manner similar to a 401(k) plan as part of the State Employees' Defined Contribution Plan.

b. Membership

At September 30, 2006 and September 30, 2005, MLRS's membership consisted of the following:

	2006	2005
Retirees and beneficiaries currently receiving benefits:		
Regular benefits	208	198
Survivor benefits	68	70
Disability benefits	0	0
Total	276*	268*
Current members:		
Vested	23	23
Nonvested	1	1
Total	24	24
Inactive members entitled to benefits and not yet receiving them	51	62
Total all members	351	354

* Includes 9 domestic relations order* alternate payees for 2006 and 8 domestic relations order alternate payees for 2005.

* See glossary at end of report for definition.

MLRS provides health, dental, vision, and life insurance benefits. The number of plan participants at September 30, 2006 and September 30, 2005 is as follows:

	2006	2005
Health/Dental/Vision Plan:		
Eligible participants	349**	349**
Participants receiving benefits	341**	342**
Life Insurance Plan:		
Participants receiving benefits	325	331

** Includes 28 defined contribution plan participants for 2006 and 26 defined contribution plan participants for 2005 who are receiving health care insurance through MLRS in accordance with State statute. There were 7 defined contribution plan participants in 2006 and 6 defined contribution plan participants in 2005 who were eligible for health care insurance and declined to receive the benefits.

c. Benefit Provisions

(1) Introduction:

Act 261, P.A. 1957, as amended (the Michigan Legislative Retirement System Act), establishes eligibility and benefit provisions for this defined benefit plan.

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. Effective March 31, 1997, Act 486, P.A. 1996, closed MLRS to new legislators. The Act provides certain re-elected former legislators the option to rejoin MLRS. All legislators who first take office after 1997 are automatically enrolled in the State's defined contribution plan.

(2) 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 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.

A member's retirement benefit is computed using a benefit formula prescribed by the enabling statute and described in the next two paragraphs. The benefit is paid on a monthly basis.

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

(3) Postretirement Benefit Adjustment:

For those legislators who first became members on or before January 1, 1995, the annual retirement benefit payable to a retiree and/or his/her survivor is increased by 4% compounded annually. The adjustment is effective each January.

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

(4) Other Postemployment Benefits:

MLRS provides \$150,000 in life insurance coverage to active members. Deferred vested members* are covered by varying amounts of life insurance, ranging from \$5,000 to \$150,000, depending on the member's date of deferral and, in some instances, the payment of an annual premium. Retirees are covered by varying amounts of life insurance, ranging from \$2,500 to \$75,000, depending on their retirement dates and, in some instances, the payment of an annual premium. MLRS prefunds life insurance benefits using the entry age normal actuarial cost method*. The life insurance plan and the pension plan use the actuarial assumptions stated in Note B of the required supplementary information section.

Under Sections 50a and 50b of the Michigan Legislative Retirement System Act, all retirees and their dependents and survivors receive 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 established by statute and who belong to the State's defined contribution plan. MLRS pays for health, dental, vision, and hearing benefits on a modified pay-as-you-go basis*; however, the State has begun to advance funds for future MLRS health insurance costs.

(5) 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 "Regular Retirement."

(6) Survivor Benefit:

Upon the death of a vested member or deferred vested member who meets the service, but not the age, requirement for regular retirement

* See glossary at end of report for definition.

(see "Regular Retirement"), or upon the death of a retiree, a surviving spouse shall be entitled to a benefit equal to 66.67% of the benefit the member would have received or was receiving at the time of death. Special provisions apply to surviving minor children and surviving spouses with minor children.

(7) Refunds:

A member who leaves legislative service may request a refund of his/her contributions from the Members' Savings Fund. A member who receives a refund of contributions forfeits all rights to any future MLRS 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.

Note 2 Summary of Significant Accounting Policies

a. Measurement Focus, Basis of Accounting, and Presentation

The MLRS financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting, as provided by accounting principles generally accepted in the United States of America. Contributions are recognized as revenue in the period in which service is provided, and expenses are recorded when incurred regardless of when payment is made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

b. Contributions and Reserves

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

- (1) Members' Savings Fund (MSF) - Until January 1, 1999, members who first became members before December 1, 1994, with less than 20 years of service, contributed approximately 7% of salary to MSF, and members who first became members on or after January 1, 1995 contributed 5% of salary to MSF. After January 1, 1999, there were no member contributions allocated to MSF, except for a short-term

additional 4% of salary contributed (from January 1, 1999 through December 31, 2000) by members who first became members on January 1, 1995, in accordance with legislation. Eligible members may make other contributions to MSF to purchase special service credit or to repay previously refunded contributions. MSF represents active member contributions (and interest credited from the Income Fund) less amounts transferred to reserves for retirement and amounts refunded to terminated members.

- (2) Members' Retirement Fund (MRF) - MRF represents the reserves for payment of retirement benefits. 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 100% fund MRF are transferred in the next fiscal year.
- (3) Survivors' Retirement Fund (SRF) - Until January 1, 1999, all members with less than 20 years of service contributed 0.5% of salary to SRF. After January 1, 1999, there were no member contributions allocated to SRF. Interest is credited annually to SRF (from the Income Fund), 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 make SRF 100% funded. Survivors' monthly retirement allowances are paid from this fund upon the death of vested members, deferred vested members, and retirants.
- (4) Insurance Revolving Fund (IRF) - Until January 1, 1999, all members contributed 0.5% of salary to IRF. After January 1, 1999, there were no member contributions allocated to IRF. State contributions, if any, and interest from the Income Fund are credited to IRF. Life insurance benefits are paid from IRF to beneficiaries of members, deferred vested members, and retirants.
- (5) Health Insurance Fund (HIF) - Until January 1, 1999, all members contributed 1% of salary to HIF. After January 1, 1999, member

contributions are made as follows: (1) members who first became members on or before January 1, 1995 contribute 9% to HIF; and (2) members who first became members after January 1, 1995 contribute 7% to HIF. Funds from this reserve are used to pay health care expenses and are accumulated to fully fund the future health insurance liabilities for MLRS.

- (6) Income Fund (IF) - IF is credited with all investment earnings and other miscellaneous income. Interest transfers are made annually to the other reserves. IF also accounts for investment and administrative expenses and interest on refunds and transfers.

c. Fair Value of Investments

Plan investments are presented at fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. 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.

d. Reporting Entity

MLRS is a pension trust fund of the State of Michigan. As such, MLRS is considered part of the State and is included in the *State of Michigan Comprehensive Annual Financial Report* as a pension trust fund. MLRS and the MLRS Board of Trustees are not financially accountable for any other entities. Accordingly, MLRS is the only entity included in this financial report.

e. Investment Income

Dividend income is recognized on the ex-dividend date, and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date.

f. Related Party Transactions

The cash account included \$3,628,588 and \$2,865,536 on September 30, 2006 and September 30, 2005, respectively, 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 \$195,238 and \$90,614 for the fiscal years ended September 30, 2006 and September 30, 2005, respectively.

g. 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.

h. Excess Benefits

Section 415 of the Internal Revenue Code requires that, for individuals who receive retirement benefits in excess of established limits, these benefits be recorded and reported outside of the pension fund in order to keep the qualified status of the plan. This includes coordination of benefits issued where a retiree participates in more than one qualified plan. MLRS provided excess benefits to two retirees, for a total amount of \$29,399 as of September 30, 2006 and \$13,501 as of September 30, 2005.

Note 3 Contributions

a. Member Contributions

Until January 1, 1999, the following contributions were made by members of MLRS:

Members who first became members on or before December 1, 1994 contributed 9% of their salaries to MLRS. The contributions were placed in the following reserves created by the enabling statute: 7% to the MSF for the first 20 years of service; 0.5% to the SRF for the first 20 years of service; 0.5% to the IRF; and 1% to the HIF.

Members who first became members after December 1, 1994 contributed 7% of their salaries to MLRS. The contributions were placed in the following reserves created by the enabling statute: 5% to the MSF; 0.5% to the SRF; 0.5% to the IRF; and 1% to the HIF.

After January 1, 1999, the following contributions are made by the members of MLRS:

Members who first became members on or before December 1, 1994 contribute 9% of their salaries to MLRS. The contributions are placed in HIF in accordance with the enabling statute.

Members who first became members on January 1, 1995 contributed 13% of their salaries to MLRS. The contributions were placed in the following reserves in accordance with the enabling statute: 9% to HIF and 4% to MSF until December 31, 2000. After December 31, 2000, these members contribute 9% of their salaries to MLRS. The contributions are placed in HIF in accordance with the enabling statute.

Members who first became members after January 1, 1995 contribute 7% of their salaries to MLRS. The contributions are placed in HIF in accordance with the enabling statute.

Member contributions are tax-deferred through the provisions of Section 414(h)(2) of the Internal Revenue Code.

b. State Contributions

State contributions are made on the basis of actuarial requirements as determined by the MLRS actuary and approved by the MLRS Board of Trustees. Through the annual State budgetary process, the Legislature annually appropriates, and the Governor approves, the State contributions along with certain court fee revenues, which are paid to MLRS pursuant to State statute. A chart showing State contributions is presented as required supplementary information.

Note 4 Investments

a. Investment Authority

All investments made are subject to approval by the MLRS Board of Trustees, which has investment authority under the Michigan Legislative Retirement System Act. Investments made are subject to statutory regulations imposed under the Public Employee Retirement System

Investment Act (Act 314, P.A. 1965, as amended). MLRS also contracts with independent investment advisors.

b. Derivatives and Securities Lending

The plan did not have any investments in prohibited derivatives as defined in Act 314, P.A. 1965, as amended, as of September 30, 2006 or September 30, 2005. Also, the plan did not participate in securities lending activities.

c. Investments Exceeding 5% of Plan Net Assets

MLRS did not hold an individual investment that exceeded 5% of net assets available for benefits at September 30, 2006 or September 30, 2005.

d. Deposit and Investment Risk

(1) Custodial credit risk associated with common cash deposits:

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, MLRS deposits may not be recovered. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are: (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name. At September 30, 2006 and September 30, 2005, all MLRS common cash deposits were covered by depository insurance or collateralized with securities held by the State's agent in the State's name.

To lessen the custodial credit risk with common cash deposits, the State Treasurer's policy requires all financial institutions holding the State's money to pledge collateral equal to the amount of the account balance for all demand and time deposits to secure the State funds. A bank, savings and loan association, or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan. No deposit in any financial organization may be in excess of 50% of the net worth of the organization.

(2) Foreign currency risk associated with common cash deposits:

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits. Act 35, P.A. 1997, requires State deposits be held in a financial institution that maintains a principal office or branch office located in the State of Michigan. MLRS had no common cash deposits subject to foreign currency risk at September 30, 2006 or September 30, 2005.

(3) Custodial credit risk associated with investments:

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3), investments also require certain disclosures regarding policies and procedures with respect to the risks associated with them. The custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, MLRS will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either: (a) the counterparty or (b) the counterparty's trust department or agent but are not in the government's name. The State Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2006 and September 30, 2005, MLRS investments were not exposed to custodial credit risk as they were all registered in MLRS's name.

(4) Interest rate risk associated with investments:

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MLRS has a 25% target allocation of fixed income securities, which are affected by interest rates because they are a debt investment. At September 30, 2006 and September 30, 2005, the fair value was \$46,106,326 and \$68,472,377, with the investment activity for the year producing a total rate of return of 3.5% and 3.8% and a rate of return since inception of 6.8% and 7.4%, respectively. The projected

duration is 5.45 and 4.41 years, respectively. MLRS debt investments are mutual funds, not direct debt investments. MLRS does not have a policy for controlling interest rate risk.

(5) Foreign currency risk associated with investments:

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments. MLRS invests in various foreign securities. These investments are limited to 20% of the total assets of the system and are additionally limited to 5% of the outstanding foreign securities of any single issuer. No investment is allowed in a country that has been identified by the U.S. Department of State as engaging in or sponsoring terrorism. These limits are set forth in Act 314, P.A. 1965, as amended. The types of foreign securities can include equities, fixed income, mutual funds, and limited partnerships. As of September 30, 2006 and September 30,

2005, MLRS held the following common stock and mutual fund investments subject to foreign currency risk:

Foreign Currency Risk

		Value in U.S. Dollars As of September 30	
Country	Currency	2006	2005
<u>America</u>			
Brazil	Real	\$	\$ 376,037
Mexico	Peso	245,275	359,268
<u>Europe</u>			
European Union	Euro	1,838,048	1,374,526
United Kingdom	Sterling	1,746,386	2,665,008
<u>Various</u>			
Mutual funds		36,152,314	20,273,862
Total		\$39,982,023	\$25,048,701

Note: International derivatives market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2005 through September 2008 with an average maturity of 1.5 years.

Note 5 Accounting Change and Future Accounting Pronouncement

In fiscal year 2004-05, the State implemented GASB Statement No. 40, which addresses common deposit and investment risks disclosure. The new requirements are effective for fiscal periods beginning after June 15, 2004.

GASB has issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which established uniform standards of financial reporting by state and local government entities for postemployment benefit plans. MLRS is required to implement GASB Statement No. 43 in financial statements for the fiscal year ended September 30, 2007.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress

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

Analysis of the dollar amounts of actuarial value of assets*, actuarial accrued liability* (AAL), or unfunded actuarial accrued liability* (UAAL) in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the AAL provides one indication of the MLRS funding status on a going-concern basis. Generally, the greater this percentage, the stronger the system. Analysis of the UAAL expressed as a percentage of active covered payroll indicates the significance of the UAAL relative to the capacity to pay it. Because MLRS is overfunded, the ratio of UAAL as a percentage of active covered payroll is not applicable. These two analyses provide information about whether the financial strength of the plan is improving or deteriorating over time.

Retirement Benefits (In Thousands)

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 (3) ((b-a)/c)
1997	\$ 126,819	\$ 116,263	\$ (10,556)	109%	\$ 7,836	N/A
1998	\$ 131,836	\$ 112,934	\$ (18,902)	117%	\$ 6,610	N/A
1999	\$ 146,141	\$ 127,096	\$ (19,045)	115%	\$ 4,195	N/A
2000	\$ 160,254	\$ 128,472	\$ (31,782)	125%	\$ 4,344	N/A
2001	\$ 168,399	\$ 138,621	\$ (29,778)	121%	\$ 4,284	N/A
2002	\$ 167,158	\$ 143,858	\$ (23,300)	116%	\$ 4,331	N/A
2003	\$ 164,950	\$ 147,431	\$ (17,519)	112%	\$ 2,016	N/A
2004	\$ 161,905	\$ 151,938	\$ (9,967)	107%	\$ 2,016	N/A
2005	\$ 157,456	\$ 154,650	\$ (2,806)	102%	\$ 2,016	N/A
2006	\$ 159,347	\$ 158,407	\$ (940)	101%	\$ 2,016	N/A

(1) Excludes reserve for health insurance.

(2) October-based payroll.

(3) Percentage of covered payroll is not applicable (N/A) as MLRS is overfunded and no contribution is required.

See notes to required supplementary information.

* See glossary at end of report for definition.

Schedule of Contributions From the Employer
and Other Contributing Entities

Fiscal Year	Valuation Date September 30	Required Contributions as a Percentage of Payroll (1)	Actual Payroll	Dollar Contribution For Fiscal Year	
				Required	Actual
1997 - 1998	1997	19.79%	\$ 8,197,494	\$ 1,622,284	
1997 - 1998	1997 (2)	N/A	\$ 8,197,494		\$ 2,082,694
1998 - 1999	1998	N/A	\$ 6,610,424		
1999 - 2000	1999	N/A	\$ 4,194,546		
2000 - 2001	2000	N/A	\$ 4,343,975		
2001 - 2002	2001	N/A	\$ 4,284,113		
2002 - 2003	2002	N/A	\$ 4,330,963		
2003 - 2004	2003	N/A	\$ 2,016,113		
2004 - 2005	2004	N/A	\$ 2,016,113		
2005 - 2006	2005	N/A	\$ 2,016,113		
2006 - 2007	2006	19.59%	\$ 2,016,113	\$ 394,957	

(1) N/A indicates no contribution was required after considering the overfunded status of the plan as of the valuation date.

(2) After closing the defined benefit plan to members.

See notes to required supplementary information.

Notes to Required Supplementary Information

Note A Description

Ten-year historical trend information designed to provide information about the Michigan Legislative Retirement System's (MLRS's) progress in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. This information is presented to enable the interested parties to assess the progress made by MLRS in accumulating sufficient assets to pay pension benefits as they become due.

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.

The schedule of funding progress and schedule of contributions from the employer and other contributing entities are reported as historical trend information. The schedule of funding progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The schedule of contributions from the employer and other contributing entities is presented to show the responsibility of the State 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 follows:

Valuation date	September 30, 2006
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent-of-Payroll
Amortization period	5 years open
Asset valuation method	5-Year Smoothed Market
Actuarial assumptions:	
Investment rate of return	7%
Projected salary increases	4%
Cost-of-living adjustments	4% - Annually compounded (non-compounded for legislators who first became members after January 1, 1995)

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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

The Honorable R. Robert Geake, Chair
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, 2006 and September 30, 2005, as identified in the table of contents, and have issued our report thereon dated May 4, 2007. 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.

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 an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control 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 the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

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

May 4, 2007

GLOSSARY

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 value of assets	The value placed at any particular date on the assets and liabilities of a retirement fund by the actuary responsible for the valuation of the assets and liabilities.
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 services 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.
IF	Income 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 of 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' Savings Fund.
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 initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.
SRF	Survivors' Retirement Fund.
unfunded actuarial accrued liability (UAAL)	The difference between the actuarial accrued liability and the actuarial value of assets.
unqualified opinion	<p>An auditor's opinion in which the auditor states that:</p> <ul style="list-style-type: none"> a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing this "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves.

