Financial




"I am not bound to win, but I am bound to be true. I am not bound to succeed, but I am bound to live by the light that I have. I must stand with anybody that stands right, and stand with him while he is right, and part with him when he goes wrong."

—Abraham Lincoln

Independent Auditor's Report

ANDREWS HOOPER & PAVLIK P.L.C.
Certified Public Accountants

Independent Auditor's Report

Municipal Employees' Retirement System of Michigan Retirement Board:

We have audited the accompanying statements of plan net assets of the Municipal Employees' Retirement System of Michigan as of December 31, 2004, and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the management of the Municipal Employees' Retirement System of Michigan. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the 2003 financial statements and, in our report dated April 29, 2004, we expressed an unqualified opinion on those financial statements.

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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Municipal Employees' Retirement System of Michigan as of December 31, 2004, and the changes in its financial status for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information and supporting schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The required supplementary information and supporting schedules are the responsibility of the Municipal Employees' Retirement System of Michigan's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audit of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental 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 this supplemental information. However, we did not audit the information and express no opinion on it. The Introductory, Investment, Actuarial, and Statistical Sections were not audited by us and, accordingly, we express no opinion on those sections.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 20, 2005 on our consideration of the Municipal Employees' Retirement System of Michigan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. 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.

Andrews Hooper & Pavlik P.L.C.

Okemos, Michigan
May 20, 2005

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Management's Discussion and Analysis

This narrative overview and analysis of MERS financial condition for fiscal year ended December 31, 2004, is presented in conjunction with the Chief Executive Officer's Letter of Transmittal. The Financial Section is comprised of two basic financial statements with explanatory notes, two required supplementary schedules with explanatory notes, three expense schedules, summation of 2004 financial highlights, analysis of plan net assets, investment activity, historical trends, and funding status.

MERS was created to provide retirement, survivorship, and disability benefits to qualified members and their beneficiaries. The cost of administering such benefits includes: (1) payment of monthly benefits as designated by the Defined Benefit, Defined Contribution Plans, Health Care Savings Program and Retiree Health Funding Vehicle (2) refund of member contributions requested by employees that separate from employment, and (3) payment of all administrative and investment costs associated with administering the plans.

Financial Statements

1. Statement of Plan Net Assets (p.24)
2. Statement of Changes in Plan Net Assets (p. 25)
3. Notes to Basic Financial Statements (p. 26)
4. Comparison Statement of Plan Net Assets (p. 20)
5. Comparison Statement of Changes in Plan Net Assets (p. 21)

The Defined Benefit, Defined Contribution Plan, Health Care Savings Program, and Retiree Health Funding Vehicle Program are premised upon long-term investing. Therefore, current financial statements alone do not provide the total perspective to properly assess the retirement system's long-term financial condition.

The "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" provide the current financial condition of the 619 individual municipal Defined Benefit Plans, 92 individual municipal Defined Contribution Plans, seven Health Care Savings Programs, and three Retiree Health Funding Vehicle Programs administered by MERS. The "Comparison Statement of Plan Net Assets" and "Comparison Statement of Changes in Plan Net Assets" provide a comparative summary of the financial condition of the retirement system as a whole.

Required Supplemental Information

1. Schedule of Funding Progress (p. 38)
2. Schedule of Employer Contributions (p. 38)
3. Notes to the Schedules of Required Supplementary Information (p. 39)

The "Schedule of Funding Progress" shows the progress MERS has made in accumulating sufficient assets to pay future retirement benefits when due. The schedule sets forth the actuarially funded status of the Defined Benefit Plan with historical trends in funding. The "Schedule of Employer Contributions" shows the current annual employer contributions and the historical trend of employer contributions. From a long-term investment perspective, these schedules provide a better understanding of the changes over time in the funded status of the plan.

Expense Schedules

1. Schedule of Administrative Expenses (p. 40)
2. Schedule of Investment Expenses (p. 41)
3. Schedule of Payments to Consultants (p. 42)

The expense schedules summarize all expenses associated with administering the Defined Benefit Plan.

Financial Highlights

The following financial highlights occurred during fiscal year ended December 31, 2004:

- Total plan net assets increased by $577 million during the 2004 fiscal year. This was primarily due to net gains in investments of $597 million dollars.

- Total Defined Benefit and Defined Contribution Plan pension benefits paid to retirees and beneficiaries increased $29 million to a total of $254 million. Combined Defined Contribution and Defined Benefit pension payments exceeded employer and employee contributions by a slight margin in 2004. The cash flow trend in the past few years has shown pension benefit payments exceeding contributions. This is normal plan cycling as the plan matures and is due in large part to baby boomers reaching retirement age and drawing pension benefits.

- Refunds of Defined Benefit Plan employee contributions paid to former members upon termination of employment increased over the previous year by $1.7 million.

- Transfers from the Defined Benefit Plan to the Defined Contribution Plan decreased by $4 million.

- Total Defined Benefit and Defined Contribution employee contributions decreased by 9% to $60 million, and employer contributions increased by 6% to $183 million. Again, the majority of these increases were due to new municipalities joining MERS. Employer and employee contributions from new municipalities were $14 million in 2004 compared to $33 million in 2003. Employer contributions have increased in recent years due to municipalities adopting enhanced benefits and the market declines of 2000-2002.

- Administrative expenses totaled $10 million. Much of this increase was due to the added costs of hiring additional staff and depreciation of software, computer servers and office equipment used in administering its Defined Benefit Plan to 61,346 members and Defined Contribution Plan to 5,754 members.

- Investment expenses totaled $12 million. The biggest expense is due to higher investment manager fees increasing to $11 million. This is not unexpected with the market increases of the past year.

Using this Financial Report

Because of the long-term nature of a defined benefit plan, financial statements alone cannot provide sufficient information to properly reflect the retirement system's ongoing plan perspective. This financial report consists of two financial statements and two required schedules of historical trend information. The "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" (pages 24-25) provide information about the activities of the 619 individual municipal pension plans administered by MERS in its Defined Benefit Plan and the 82 individual municipal plans in the Defined Contribution Plan, as well as comparative summary information about these activities for the retirement system as a whole.

The "Schedule of Funding Progress" (page 38) includes historical trend information about the actuarially funded status of the plan from a long-term, ongoing plan perspective, and the progress made in accumulating sufficient assets to pay benefits when due. The "Schedule of Employer Contributions" (page 38) presents historical trend information about the annual actuarially required contributions of employers and the actual contributions made by employers in relation to this requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

Comparison Statement of Plan Net Assets

Assets	As of December 31, 2004	As of December 31, 2003	Increase (Decrease) Amount	Increase (Decrease) Percent
Cash and Short-Term Investments	$ 197,094,797	$ 249,823,568	$ (52,728,771)	-21.11%
Receivables	119,378,154	164,218,943	(44,840,789)	-27.31%
Interfund Receivables	436,427	-	436,427	100.00%
Investments, at fair value	4,610,306,560	4,035,732,696	574,573,864	14.24%
Invested Securities Lending Collateral	659,513,777	401,662,820	257,850,957	64.20%
Other Assets/Prepaids	465,270	608,994	(143,724)	-23.60%
Net Capital Assets	2,772,594	3,010,286	(237,692)	-7.90%
Total Assets	5,589,967,580	4,855,057,307	734,910,273	15.14%
Liabilities				
Purchase of Investments	159,923,488	259,995,239	(100,071,751)	-38.49%
Securities Lending Collateral	659,513,777	401,662,820	257,850,957	64.20%
Administrative and Investment Costs	3,772,173	3,920,891	(148,718)	-3.79%
Interfund Payables	436,427	-	436,427	100.00%
Unspecified Contributions	711	-	711	100.00%
Total Liabilities	823,646,576	665,578,950	158,067,626	23.75%
Net assets held in trust for pension benefits	$ 4,766,321,004	$ 4,189,478,357	$ 576,842,647	13.77%

Comparison Statement of Changes in Plan Net Assets

	Year ended December 31, 2004	Year ended December 31, 2003	Increase (Decrease) Amount	Increase (Decrease) Percent
Additions				
Contributions	$ 243,019,370	$ 238,651,367	$ 4,368,003	1.83%
Transfers from Defined Benefit Plan	321,966	3,839,296	(3,517,330)	-91.61%
Transfers from Other Plans and Other Items	5,356,930	199,702	5,157,228	2582.46%
Investment net income(loss) investing activities	596,008,057	816,110,067	(220,102,010)	-26.97%
Investment net income-securities lending	1,341,339	827,198	514,141	62.15%
Miscellaneous Income	819,466	822,347	(2,881)	-0.35%
Total Additions	846,867,128	1,060,449,977	(213,582,849)	-20.14%
Deductions				
Benefits	253,918,782	225,227,429	28,691,353	12.74%
Refunds of Contributions	5,252,652	3,542,264	1,710,388	48.29%
Special Expenses and Fees	387,031	378,334	8,697	2.30%
Transfers to Defined Contribution Program	321,966	3,839,296	(3,517,330)	-91.61%
Administrative Expense	10,144,051	8,049,500	2,094,551	26.02%
Total Deductions	270,024,482	241,036,823	28,987,659	12.03%
Net Increase (decrease)	576,842,646	819,413,154	(242,570,508)	-29.60%
Net assets held in trust for pension benefits				
Balance Beginning of Year	4,189,478,357	3,370,065,203	819,413,154	24.31%
Balance End of Year	$ 4,766,321,003	$ 4,189,478,357	$ 576,842,646	13.77%

Analysis of Plan Net Assets

Combined plan net assets increased by $577 million over the previous fiscal year. Looking at additions to and deductions from plan net assets, the increase in net assets was primarily attributable to economic conditions (the stock market's rise) and municipalities increasing benefit multipliers and adopting benefit enhancements resulting in higher employer/employee contributions. Deductions from plan net assets were attributable to a 13% increase in pension benefit payouts to a greater number of retirees and post-retirement cost-of-living increases.

Employer and employee contributions increased $4 million because of higher required actuarial contribution rates resulting from increases in salaries, benefit enhancements, and an increase in the number of employees.

In determining contribution rates, MERS actuary normally uses a five-year smoothing method to record market gains and losses, and this has tempered many of the market losses over the past three years. For 2003, the Retirement Board adopted a one time ad hoc adjustment to aggregate the yet unrecognized market gains and losses from 1999-2002 with the 2003 market gain. For 2003 no gain or loss was recognized. The aggregate loss amount of $388,778,035 will be recognized in four equal dollar installments in 2004-2007. In 2004, the normal five-year smoothing method was reinstituted. Employers are also shifting more of the responsibility for contribution requirements onto employees to pay for better benefit plans.

MERS has capital assets of approximately $3 million, most of which are software and computer servers needed to run the retirement system's programs.

MERS has no long-term liabilities. The bulk of MERS liabilities at year end related to investment purchases that did not settle until 2005.

Investment Activities

The total fund investment performance on a relative basis to benchmarks was excellent. The positive gross return of 14.9% was substantially above the long-term net 8% actuarial return assumption target for the year. On both a three- and five-year basis, the average returns of 9.5% and 4.6%, respectively, compared favorably to the benchmarks. Net investment income (net increase in fair value, plus investment earnings, less investment administrative expenses) was $596 million for the year. The stock market is in its second year of positive returns after three years of negative returns. A further detailed analysis of investment returns may be found in the Investment Section.

Retirement system investments are managed to control the extent of downside risk to which assets are exposed while maximizing long-term gain potential. This positions the retirement system to limit the impact of adverse market conditions. Portfolio diversification by asset class and style is an important element of investment risk control.

Investment activity is governed by the "prudent person rule." The prudent person rule establishes a standard for all fiduciaries that includes anyone who has authority with respect to the retirement system. The prudent person rule states that fiduciaries shall discharge their duties solely in the interest of the retirement system participants and beneficiaries and with the degree of diligence, care, and skill that a prudent person would ordinarily exercise under similar circumstances.

The prudent person rule permits the Board to establish an investment policy based upon certain investment criteria and allows for the delegation of investment authority to professional investment managers. Investment constraints are outlined, including the appropriate degree of risk. Investment managers are hired to execute the investment policy. They have full discretion for investment decisions within statutory authority, Board policy, and their respective guidelines. A list of investment managers under contract with the retirement system as of December 31, 2004, is found on page 16 of this report. A summary of the total retirement system's assets can be found on page 24.

Historical Trends

Accounting standards require that the "Statement of Plan Net Assets" state asset values at fair value and include only benefits and refunds due plan members and beneficiaries and accrued investment and administrative expenses as of the reporting date. Information regarding the actuarial funding status of the Defined Benefit Plan is provided in the "Schedule of Funding Progress" (page 38). The asset value stated in the "Schedule of Funding Progress" is the actuarial value of assets as determined by calculating the ratio of market value to book value of assets over a five-year period. The funded ratio declined from 80% to 79% for the 2003 valuation. The decline, while slight, was expected. Investment losses from 2000-2002, combined with municipalities adopting better benefit plans, influenced the funded ratio. This percentage has declined over the last five years. The actuarial assumptions used in the most recent valuation are identified in "Notes to the Schedules of Required Supplementary Information" (page 39).

Annual required employer contributions as determined by the actuary and the actual contributions made by employers are provided in the "Schedule of Employer Contributions" (page 38). This schedule indicates that employers are meeting their actuarially required contribution payments.

MERS overall financial condition improved for the fiscal year ended 2004, and the plan remains stable and viable for the years to come. The market upturn in 2004 and the downturns of 2000-2002 are historically considered to be normal market cycles in the overall economic process.

Funding Status

A pension plan is well funded when it has sufficient assets invested to meet all expected future obligations to participants. The greater the level of funding, the larger the ratio of assets to actuarial accrued liability. While the plan is not totally funded, annual contributions are being made at an actuarially determined rate to reach full funding. There is no single all-encompassing test for measuring a retirement system's funding progress and current funded status. However, some common indicators of the progress that a retirement system has achieved in funding their obligations include observing the changes over time of the ratio of valuation assets to actuarial accrued liabilities, and the pattern of the unfunded actuarial accrued liability as a percentage of active payroll. These ratios and numbers are found in the Required Supplementary Information.

MERS Retirement Board has adopted funding methodology for the retirement system to achieve the following major objectives:

- Develop level required contribution rates as a percentage of payroll;
- Finance benefits earned by present employees on a current basis;
- Accumulate assets to enhance members' benefit security;
- Produce investment earnings and interest on accumulated assets to help meet future benefit costs;
- Make it possible to estimate the long-term actuarial cost of proposed amendments to system provisions; and
- Assist in maintaining the retirement system's long-term financial viability.

The actuarial method for calculating the accrued liability for all plans is Entry Age Normal with the objective of maintaining employer contributions approximately level as a percent of member payroll. A detailed discussion of the funding method is provided in the Actuarial Section of this report starting on page 59. Based upon the valuation results, MERS continues to be in sound financial health in accordance with actuarial principles of level percent of payroll financing.

Statement of Plan Net Assets as of December 31, 2004

	December 31, 2004					December 31, 2003
	Defined Benefit Plan	**Defined Contribution Plan**	**Health Care Savings Program**	**Retiree Health Funding Vehicle**	**Total Trust Funds**	**Total Trust Funds**
Assets						
Cash and Short-Term Investments	$ 175,271,234	$ 21,808,563	$ 15,000		$ 197,094,797	$ 249,823,568
Receivables						
Employer Contributions	21,266,351				21,266,351	16,305,155
Plan Member Contributions	4,647,766				4,647,766	3,309,342
Sale of Investments	81,792,243				81,792,243	129,187,161
Investment Income	9,074,331				9,074,331	10,701,627
Interfund Receivables	198,458		129,272	$ 108,697	436,427	
Loans/Other	1,406,014	1,191,449			2,597,463	4,715,658
Total Receivables	118,385,163	1,191,449	129,272	108,697	119,814,581	164,218,943
Investments, at fair value						
Domestic Fixed Income	1,208,428,240	6,676,517	370,470	353,523	1,215,828,750	1,271,149,597
International Fixed Income	222,265,853		68,141	65,023	222,399,017	
Domestic Equities	2,026,965,116	48,144,948	621,411	592,984	2,076,324,459	1,897,349,411
Hedged Fund	38,312,497		11,746	11,208	38,335,451	
International Equities	661,750,804	2,741,138	202,874	193,594	664,888,410	528,667,831
Private Equity	67,884,364		20,811	19,859	67,925,034	68,652,270
Real Estate	260,928,156		79,993	76,334	261,084,483	221,889,457
Balanced Funds		63,520,956			63,520,956	48,024,130
Total Investments	4,486,535,030	121,083,559	1,375,446	1,312,525	4,610,306,560	4,035,732,696
Invested Securities Lending Collateral	659,513,777				659,513,777	401,662,820
Prepaid Expenses	465,270				465,270	608,994
Fixed Assets, at cost, net of accum. depreciation	2,772,594				2,772,594	3,010,286
Total Assets	5,442,943,068	144,083,571	1,519,718	1,421,222	5,589,967,580	4,855,057,307
Liabilities						
Purchase of Investments	159,923,488				159,923,488	259,995,239
Securities Lending Collateral	659,513,777				659,513,777	401,662,820
Administrative and Investment Costs	3,772,173				3,772,173	3,920,891
Interfund Payables	237,969		195,888	2,570	436,427	
Unspecified Contributions			711		711	
Total Liabilities	823,447,407	-	196,599	2,570	823,646,576	665,578,950
Net assets held in trust for pension benefits	$ 4,619,495,661	$ 144,083,571	$ 1,323,119	$ 1,418,652	$ 4,766,321,003	$ 4,189,478,357

The "Schedule of Funding Progress" is presented in the Required Supplementary Information in the Financial Section of this report. The accompanying notes are an integral part of these Financial Statements.

Statement of Changes in Plan Net Assets for the year ended December 31, 2004

	Year Ended December 31, 2004					Year Ended December 31, 2003
	Defined Benefit Plan	Defined Contribution Plan	Health Care Savings Program	Retiree Health Funding Vehicle	Total Trust Funds	Total Trust Funds
Additions						
Contributions						
Employer Contributions	$ 167,942,936	$ 12,664,264	$ 1,300,103	$ 1,312,526	$ 183,219,829	$ 172,387,579
Plan Member Contributions	55,408,705	4,301,952	88,884		59,799,541	66,263,788
Transfers from Defined Benefit Plan						
Employer		320,682			320,682	3,732,569
Plan Member		1,284			1,284	106,727
Transfers from Other Plans and Other Items		5,356,930			5,356,930	199,702
Total Contributions and Transfers	223,351,641	22,645,112	1,388,987	1,312,526	248,698,266	242,690,365
Investment Income						
Net Appreciation (Depreciation) in Fair Value of Plan Investments	526,860,970	10,410,317	128,680	108,716	537,508,683	754,270,000
Interest Income	41,906,168		1,340		41,907,508	43,599,842
Dividend Income	23,447,373				23,447,373	23,123,127
Real Estate Operating Income, net	4,727,762				4,727,762	4,151,174
Commission Recapture Income	478,380				478,380	704,733
	597,420,653	10,410,317	130,020	108,716	608,069,706	825,848,876
Less Investment Expenses	12,061,649				12,061,649	9,738,809
Net Investment Income (Loss)	585,359,004	10,410,317	130,020	108,716	596,008,057	816,110,067
From Security Lending Activities						
Security Lending Income	7,513,231				7,513,231	5,294,319
Security Lending Expenses						
Borrower Rebates	5,725,036				5,725,036	4,112,667
Management Fees	446,856				446,856	354,454
Total Securities Lending Expenses	6,171,892	-	-	-	6,171,892	4,467,121
Net Income from Security Lending Activities	1,341,339	-	-	-	1,341,339	827,198
Total Net Investment Income (Loss)	586,700,343	10,410,317	130,020	108,716	597,349,396	816,937,265
Miscellaneous Income	819,466				819,466	822,347
	810,871,450	33,055,429	1,519,007	1,421,242	846,867,128	1,060,449,977
Deductions						
Benefits	247,454,263	6,453,035	11,484		253,918,782	225,227,429
Refunds of Contributions						
Employer	1,727,570				1,727,570	
Plan Member	3,525,082				3,525,082	3,542,264
Special Expenses and Fees	387,031				387,031	378,334
Transfers to Defined Contribution Plan						
Employer	320,682				320,682	3,732,569
Plan Member	1,284				1,284	106,727
Administrative Expense	9,957,057		184,404	2,590	10,144,051	8,049,500
	263,372,969	6,453,035	195,888	2,590	270,024,482	241,036,823
Net Increase (decrease)	547,498,481	26,602,394	1,323,119	1,418,652	576,842,646	819,413,154
Net assets held in trust for pension benefits						
Balance Beginning of Year	4,071,997,180	117,481,177	-	-	4,189,478,357	3,370,065,203
Balance End of Year	$ 4,619,495,661	$ 144,083,571	$ 1,323,119	$ 1,418,652	$ 4,766,321,003	$ 4,189,478,357

The accompanying notes are an integral part of these Financial Statements.

Notes to Basic Financial Statements

Year Ended December 31, 2004

1. Reporting Entity and Plan Description

The Municipal Employees' Retirement System of Michigan (MERS) is an agent multiple-employer, statewide, public employee pension plan created under Public Act 135 of 1945, and now operates under Public Act 220 of 1996, and the MERS Plan Document, as revised. MERS was established to provide retirement, survivor, and disability benefits on a voluntary basis to the State of Michigan's local government employees. The MERS Plan Document provides for Defined Benefit and Defined Contribution Plans, and Health Care Savings and Retiree Health Funding Vehicle Programs. See Notes 6-8 for the Defined Contribution Plan, Health Care Savings Program, and Retiree Health Funding Vehicle (pages 35-36).

Pursuant to Act 220, on August 15, 1996, MERS became an independent public non-profit corporation, which is an instrumentality of the participating municipalities and courts. Prior to that time, MERS was a component unit of the State of Michigan and operated within the Department of Management and Budget. MERS is now administered solely by a nine-member Retirement Board consisting of the following members, each of whom, except for the retiree member and the Retirement Board appointees, shall be from a different county at the time of election:

Two members appointed by the Retirement Board who have knowledge or experience in retirement systems, administration of retirement systems, or investment management or advisory services.

One member who is a retiree of the retirement system, nominated by the Retirement Board and elected by the delegates to an annual meeting of the retirement system.

Three members of the retirement system, who are officers of a participating municipality or of a participating court, who shall be elected as officer board members.

Three employee members of the retirement system who are not officers of a participating municipality or of a participating court, who shall be elected as employee board members.

MERS Participating Municipalities as of December 31, 2004

Counties	65
Cities and Villages	241
Townships	64
County Road Commissions	56
Authorities, Districts and Others	177
Closed Groups	16
Total	619

The regular term of office for members of the Retirement Board is three years. Members of the Retirement Board serve without compensation with respect to their duties, but are reimbursed by the retirement system for their actual and necessary expenses incurred in the performance of their duties.

Any municipality within the state may elect to become a participating member of MERS by a majority vote of the municipality's governing body or by an affirmative vote of the qualified electors. A municipality may elect to terminate participation by an affirmative vote of the qualified electors. Changes in benefit coverage are available to bargaining units after approval by a majority vote of the municipality's governing body.

MERS Defined Benefit Membership as of December 31, 2004

Retirees and Beneficiaries Currently Receiving Benefits	
Retirement annuities	15,045
Survivor annuities	3,220
Disability annuities	1,008
Total	19,273
Vested former members	5,301
Current active employees	36,772
Total Membership	61,346

Benefit plans and provisions are established by the Retirement Board. All benefits vest after six, eight or ten years of service depending on the plan adopted by the municipality's governing body. The standard retirement age is 60 years. However, employees may retire after reaching several combinations of age and years of service to receive reduced early retirement benefits. Municipalities may also adopt various other benefit plan options allowing retirement at an earlier age with unreduced benefits based upon combinations of age and years of service, or just years of service. MERS also provides nonduty disability and nonduty death benefits to employees after vesting requirements are met. The vesting requirements provision is waived for duty disability and duty death benefits. Benefits are paid monthly over the employee's or survivor's lifetime and are equal to a specific percentage of the employee's final average compensation times the number of years of credited service. The specific percentage depends on the benefit plan or plans adopted by each municipality for its employees.

Pursuant to the Constitution of the State of Michigan, "The accrued financial benefits of each pension plan and retirement system of the State and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities." Employees contribute to the retirement system at rates that range from 0 to 22.80% depending on the benefit plan adopted by the municipality. If an employee leaves employment or dies before becoming eligible for retirement benefits, accumulated employee contributions (plus interest) are refunded to the employee or designated beneficiary upon application.

The Defined Benefit Plan is tax-qualified and subject to the Internal Revenue Code (IRC). These regulations include the taxability of pensions, annual compensation limits, and benefit limitations.

Under the Code, the major portion of a retiree's pension is immediately taxable upon distribution. Pursuant to IRC section 72(d), any "after tax contributions" are recovered tax-free over the life expectancy of the retiree (or beneficiary, if applicable).

IRC section 401(a)(17) limits the amount of compensation that an active employee can receive for pension credit and, correspondingly, limits the amount of employee contributions. Compensation in excess of the 401(a)(17) limit (currently $205,000 for 2004 and increasing to $210,000 in 2005) will not be credited by MERS. Employee contributions in excess of the IRS limit will not be collected or accepted, nor figure into final average compensation for benefit purposes.

In addition, IRC section 415 imposes certain limitations on pension benefit payments. Any amounts that exceed the limitations shall be paid from a Qualified Excess Benefit Plan Arrangement (QEBA), as authorized by IRC section 415(m) and Michigan Compiled Law 38.1686. The QEBA shall be a separate portion of the plan and is annually funded by the affected participating municipality or court. The Retirement Board established a QEBA in 2003 solely for the purpose of providing to retirees and beneficiaries that portion of the retirement allowance exceeding the section 415 limits and otherwise not payable under the terms of the plan. Retirees and beneficiaries do not have an election, directly or indirectly, to defer compensation to the QEBA.

2. Summary of Significant Accounting Policies

Reporting Entity

The Retirement Board is responsible for administration of the retirement system, has fiduciary responsibility for the investment of assets, and oversees all funds included in these financial statements. The Retirement Board appoints the Chief Executive Officer who manages and administers the retirement system under the supervision and direction of the Board.

Since MERS is an independent public corporation, MERS financial statements are not included in the financial statements of any other organization. MERS is the only entity included in this financial report.

The costs of administering the plan are allocated out to the municipalities along with investment gains and losses on a quarterly basis.

Basis of Accounting

The financial statements for MERS are prepared on the accrual basis in accordance with U.S. Generally Accepted Accounting Principles (GAAP). Employer and employee contributions are recognized when due pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

GASB 27

Governmental Accounting Standards Board (GASB) Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers," requires certain changes in reporting pensions by employers. The following section is required and pertains to MERS staff only. Prior to separation from the State of Michigan on August 25, 1996, the pension liability for MERS staff remained the obligation of its official employer, the State of Michigan. Therefore, MERS has no pension liability for staff prior to August 25, 1996, when it privatized and began independent payroll processing.

The Retirement Board, as an employer, elected to become a participating municipality in MERS Defined Benefit Plan to provide pension benefits for MERS staff. Vesting occurs after six years of credited service. Normal retirement age is 60, although an employee may retire at age 55 with 30 years of credited service. The annual pension benefit is calculated by multiplying the employee's years of credited service by 2.25% and then multiplying it by the Final Average Compensation (FAC) based on the highest consecutive three years of compensation. MERS contributed 9.92% of compensation in 2004; employees contributed 2% of compensation in 2004.

The following pension information for GASB 27 applies to MERS staff only:

Actuarial Accrued Liability from December 31, 2003 and December 31, 2002, Actuarial Valuations

	2003	2002
Retirees and beneficiaries currently receiving benefits	$ 141,105	$ 143,315
Vested former members not yet receiving benefits	17,358	16,015
Nonvested terminated employees (pending refunds of accumulated member contributions)	12,660	-
Current employees		
Accumulated employee contributions, including allocated investment income	380,673	246,835
Employer financed	1,841,220	1,246,034
Total Actuarial Accrued Liability	2,393,016	1,652,199
Net assets available for benefits at actuarial value ($1,837,500 and $1,163,459 at market value for December 31, 2003, and 2002, respectively)	2,012,358	1,464,160
Unfunded actuarial accrued liability	$ 380,658	$ 188,039

Three-Year Trend Information Schedule of Employer Contributions

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2002	$ 146,906	100%	$ -
December 31, 2003	162,168	100%	-
December 31, 2004	192,024	100%	-

Schedule of Funding Progress

Actuarial Valuation December 31	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2001	$ 1,068,314	$ 1,243,965	$ 175,651	85.80%	$ 1,970,436	8.91%
2002	1,464,160	1,652,199	188,039	88.60	2,305,146	8.16
2003	2,012,358	2,393,016	380,658	84.10	2,678,027	14.21

Fair Value of Investments
In accordance with GASB 25, plan investments are presented at fair value. Short-term investments are valued at cost plus accrued interest, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based upon equivalent values of comparable securities with similar yield and risk. Independent appraisals are the basis for valuing the fair value of real estate. Other investments that do not have established markets are recorded at an estimated fair value.

Property and Equipment
Property and equipment are carried at cost, less accumulated depreciation. Items of software, equipment, and leasehold improvements are capitalized if the value exceeds $5,000. These assets are depreciated on a straight-line basis and their estimated lives are either three or five years. Office equipment, software, and computers have a three- to five-year life.

Total Columns on Statements
"Total" columns on the "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" are presented to facilitate financial analysis. Amounts in these columns do not present the plan net assets and changes in plan net assets in conformity with the U.S. GAAP nor is such data comparable to a consolidation. Transactions between the Defined Benefit Plan, the Defined Contribution Plan, Health Care Savings Program and Retiree Health Funding Vehicle have not been eliminated from the "Total" columns.

3. Contributions and Reserves

Contributions
Contribution funding requirements are actuarially determined using the "entry age normal" actuarial cost method and are based upon the benefit plan adopted by the municipality. Some municipalities fund their entire pension obligations solely from employer contributions. Other municipalities jointly fund pension obligations from employee and employer contributions. Monthly employee contributions are based upon a percentage of actual compensation as determined by an annual actuarial valuation. Employer contributions are based upon projected compensation as determined by an annual actuarial valuation. Employee contributions are held in individual member accounts that are currently credited with 1.5% interest annually. The employee contribution rates vary from 0% to 22.80% according to the benefit plan adopted. See "Schedule of Employer Contributions" (page 38).

Reserves
Three Reserves have been established pursuant to the MERS Defined Benefit Plan Document. See "Schedule of Changes in Reserves" (page 81).

- Reserve for Employee Contributions: Employee contributions and interest are credited to this reserve. Also credited to the reserve are monies received from the purchase of service credit and monies received in repayment of previously refunded contributions. The reserve is reduced by amounts paid to employees who terminate employment and request refunds and by amounts transferred into the "Reserve for Employer Contributions and Benefit Payments" upon an employee's retirement. Interest is credited to each employee's account in December of each year based on the accumulated balance from the prior December 31. The current allocation rate of interest is set by the Retirement Board at 1.5%. The reserve's balance at year end December 31, 2004, is $434,232,821. The "Reserve for Employee Contributions" was fully funded as of the December 31, 2003, actuarial valuation.

- Reserve for Employer Contributions and Benefit Payments: All employer contributions are credited to this reserve. Net income is allocated to this reserve from the "Reserve for Expenses and Undistributed Income." At retirement, an employee's accumulated contributions, if any, including interest, are transferred into this reserve from the "Reserve for Employee Contributions." Monthly benefits paid to retirees reduce this reserve. The December 31, 2004, balance is $4,185,262,840. The unfunded liability was $1,208,255,375 (based on the actuarial value of assets) as of the December 31, 2003, Actuarial Valuation.

- Reserve for Expenses and Undistributed Investment Income: All investment earnings and all other monies received that are not dedicated to other reserves are credited to this reserve. All administrative and investment expenses are paid from this reserve. Transfers from this reserve to the "Reserve for Employer Contributions and Benefit Payments" are at allocation rates determined by the Retirement Board. In 2004, the Retirement Board allocated 100% from the "Reserve for Expenses and Undistributed Investment Income" to the "Reserve for Employer Contributions and Benefit Payments" leaving a zero balance at year end.

4. Investments

Investments
The Retirement Board has the fiduciary responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to manage the retirement system's assets. All investment decisions are subject to statutory regulations imposed under the Michigan Public Employees Retirement Systems' Investment Act, 1965 PA 314, as amended, and the investment policy established by the Retirement Board. Michigan law allows diverse investment in stocks, corporate and government bonds, mortgages, real estate, alternative investments, and other investments. The act sets forth prudence standards and requires that the assets of a retirement system be invested solely in the interest of the participants and beneficiaries. The investments shall be made for the exclusive purpose of providing benefits to the participants and the participants' beneficiaries, and defraying reasonable expenses of the retirement system.

The Retirement Board's investment policy requires independent performance measurement of investment managers and establishes total return objectives for the total portfolio and major categories of investments. As of December 31, 2004, all securities held met the required statutory provisions and Retirement Board policy. As of the same dates, no investments were in default or subject to bankruptcy proceedings. MERS did not hold a single organization's securities that exceeded 5% of the plan's net assets available for benefits as of December 31, 2004.

Cash and Deposits
Cash deposits are classified according to credit risk to give an indication of the level of risk assumed by MERS. For custodial credit risk, the bank balances of deposits are disclosed.

Category 1 Insured or collateralized with securities held by MERS or its agent in MERS name.

Category 2 Collateralized with securities held by the pledging financial institution's trust department or agent in MERS name.

Category 3 Uncollateralized or collateralized with securities held by the pledging financial institution or by its trust department or agent but not in MERS name.

MERS Cash as of December 31, 2004

(Expressed in thousands)	Category			Bank Balances Not Subject to Classification	Bank Balance	Book Value
	1	2	3			
Operating Cash			$ 920		$ 920	$ 1,172
Investment Cash			253		253	49
	$ -	$ -	$ 1,173	$ -	$ 1,173	$ 1,221

Securities Lending
MERS policy authorizes participation in securities lending program administered by its global custodian, the Northern Trust Company. MERS receives income as the owner of securities, as well as income from the lending of those securities. There are no dividends or coupon payments owing on the securities on loan. Securities lending earnings are credited to participating clients on approximately the fifteenth day of the following month. The securities loans are open contracts and, therefore, could be terminated at anytime by either party.

The borrower collateralizes the loan with either cash or securities of 102% of market value plus accrued interest on domestic securities and 105% of market value plus accrued interest on international securities loaned. Cash open collateral is invested in a short-term investment pool, the Core Collateral Section, which had an average weighted maturity of 28 days as of December 31, 2004. Due to the nature of the program's collateralization of U.S. fixed income securities loans at 102% plus accrued interest, we believe that there is no credit risk per GASB 28 since the lender owes the borrower more than the borrower owes the lender. Cash collateral is invested for MERS in a dedicated short-term investment fund consisting of investment grade fixed income securities. The custodian provides for full indemnification to MERS for any losses that might occur in the event of borrower default resulting from negligence or intentional misconduct. Securities on loan are marked to market daily to ensure the adequacy of the collateral. There are no restrictions on the amount of securities that can be loaned at one time. Neither MERS nor the custodian has the ability to pledge or sell collateral securities delivered unless the borrower is in default.

MERS also invests in six commingled funds that participate in securities lending on a pooled basis.

MERS has never experienced a loss on securities lending transactions resulting from the default of a borrower or lending agent since it commenced lending securities in March 1995. The average number of days that MERS securities were borrowed was approximately 62 days as of December 31, 2004, producing a net income of $1,341,339 in 2004.

Collateral Held and Fair Value of Securities on Loan as of December 31, 2004

Dollars In Thousands

Fair Value of Securities on Loan	Nature of Collateral	Collateral Held
$ 643,989,099	Cash	$ 659,513,777
81,404,516	Non-Cash	84,343,256
$ 725,393,615		$ 743,857,033

Derivatives and Structured Financial Instruments

In accordance with investment policy, the active international manager may, when deemed prudent, enter into forward foreign currency exchange contracts in the international portfolio to match settlement deadlines or to take advantage of favorable currency moves in the market. Forward contracts are used to hedge against changes in the exchange rates related to foreign equities, primarily denominated in European and Asian currencies. Forward currency contracts were used in the international large cap portfolio to hedge the United Kingdom sterling, the book cost as of December 31, 2004, was $16,731,001, and the fair market value was $15,886,752. This is used to reduce the risk of currency exposure in the portfolio. As of December 31, 2004, there were no positions in forward currency contracts held in the portfolio.

Derivatives are neither used for speculation nor are they used to leverage the investment portfolio. The retirement system does not use swap agreements, stock options, caps/floors, or floating rate securities that are priced from underlying collateral. All derivatives are presented at fair value in the financial statements.

MERS uses futures contracts to equitize cash allocated to private equity markets that is awaiting investment. A futures contract is an agreement to buy or sell a specific amount of a commodity, currency, or financial instrument at a specified future date. Futures are exchange traded and the exchange assumes the risk of nonperformance by a counterparty. MERS is required to pledge to the broker cash or U.S. government securities (the initial margin) equal to a certain percentage of the contract amount. The fair value of cash collateral was $3,490,155 as of December 31, 2004. Subsequent payments, known as "variation margin," are made or received by MERS each day, depending on the daily fluctuations in the value of the underlying security. Such variation margin is recorded as realized gain or loss in the financial statements. The fair value of the futures contract was $45,513,750 as of December 31, 2004.

Categories of Investment Risk

The following table represents the total investments held as of December 31, 2004, categorized to give an indication of the level of risk assumed by MERS. All investments are governed primarily by an investment doctrine known as the prudent person rule. The prudent person rule establishes a standard for all fiduciaries, which includes anyone who has authority with respect to the funds. The Governmental Accounting Standards Board Statement Number 3 requires disclosure of investment securities within the following three categories of custodial risk. The category descriptions follow:

Category 1 Insured or registered securities held by MERS or its agent in MERS name.

Category 2 Uninsured and unregistered securities collateralized with securities held by the counterparty's trust department or agent in MERS name.

Category 3 Uninsured and unregistered securities with securities held by the counter party, its trust department, or agent, but not in MERS name.

A security, for purposes of classification in the listed categories, is a transferable financial instrument that evidences ownership or creditorship. Securities do not include investments made with another party, real or direct investments in mortgages and other loans. Investments in mutual funds, annuity contracts, and guaranteed investment contracts are also not considered securities for purposes of custodial credit risk classification. Such investments are shown as not subject to classification.

There are no Category 2 investments. The Real Estate section consists of real estate equity holdings (REITs) and real estate. The Defined Contribution Plan assets are participant-directed mutual funds, which are not subject to GASB Statement No. 3 credit risk classification. The Short-Term Investment Funds that are Category 3 investments are in foreign currencies. The Domestic Equities, Fixed Income, International Equities that are not subject to classification below are investments that are unregistered, pending trades, mutual index funds, guaranteed investment contracts, and direct investments in mortgages and other loans.

Credit Risk of Investments as of December 31, 2004

(Expressed in Thousands)	Category			Securities not subject	
	1	2	3	to Classification	Fair Values
Domestic Fixed Income	$ 926,540		$ 3,490	$ 279,122	$ 1,209,152
International Fixed Income				222,399	222,399
Domestic Equities	1,525,058			503,122	2,028,180
Hedged Fund				38,336	38,336
International Equities	349,014			313,133	662,147
Private Equity				67,925	67,925
Real Estate	69,228			191,856	261,084
Commercial Paper	172,942				172,942
Short Term Investments	540		2,102	(1,486)	1,156
Defined Contribution Plan				121,084	121,084
Securities Lending Collateral				659,514	659,514
	$ 3,043,322	$ -	$ 5,592	$ 2,395,005	$ 5,443,919

Reconciliation to Investments on Statement of Plan Net Assets

Totals above	$ 5,443,919
Less Commercial Paper	(172,942)
Less Short Term Investments	(1,156)
Less Sec Lending Cash Collateral	(659,514)
	$ 4,610,307

5. Commitments and Contingencies

In the normal course of business, benefit claims by members or employers are in various stages of determination through established administrative procedures with Retirement Board and judicial review thereafter. MERS does not anticipate any material loss as a result of these claims. Furthermore, the cost of successful benefit claims is ultimately the responsibility of the affected municipality and becomes its funding obligation. MERS maintains insurance for workers' compensation, owned and leased vehicles, blanket property, fiduciary, fidelity, and faithful performance to cover other risk of loss such as personal injury to employees or others, property damage, or other liability.

6. Defined Contribution Plan

Plan Description

MERS Defined Contribution Plan became operative July 8, 1997, under Section 401(a) of the Internal Revenue Code. MERS has contracted with International City Management Association-Retirement Corporation (ICMA-RC) to serve as the third-party administrator for the plan. The plan is available to all MERS participating municipalities and may be adopted on a division-by-division basis. Plan provisions and requirements are specified in the MERS Plan Document.

Contributions to the Defined Contribution Plan are remitted directly to ICMA-RC by the participating municipalities and are separate from contributions made to the MERS Defined Benefit Plan. Both employer contributions and employee voluntary contributions are governed by the percentages allowable under the Internal Revenue Code. Employees electing to be in the Defined Contribution Plan may not change their contribution as a percent of payroll after enrollment. Participating municipalities may offer current Defined Benefit Plan employees an opportunity to opt into the Defined Contribution Plan. MERS then transfers the actuarial present value of the employee's accrued benefit in the Defined Benefit Plan into the employee's account in the Defined Contribution Plan (at a stipulated funded ratio that shall not exceed 100%). Employees direct their contributions to various investment options offered by ICMA-RC and may transfer their account balances between investment categories or make changes to the percentage allocation on a daily basis. As of December 31, 2004, there were 92 plans that had adopted the Defined Contribution Plan with 5,754 member accounts totaling $144.1 million.

ICMA-RC offers a variety of investment opportunities for the Defined Contribution Plan. The Vantage Trust Funds include nine actively managed funds; five index funds; and five model portfolio funds. The Mutual Fund Series includes 14 segregated accounts, each with a different investment strategy.

Significant Accounting Policies

The Defined Contribution Plan financial statements are prepared using a cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Plan participants select from over 30 investment options.

Reserve for Defined Contribution Plan

All additions to and deductions from the Defined Contribution Plan are recorded in this reserve. ICMA-RC maintains the individual employee account records.

7. *Health Care Savings Program*

Plan Description

MERS Health Care Savings Program became operational in 2004 with a Private Letter Ruling from the Internal Revenue Service. It is a post employment defined contribution program designed to let employers and employees invest contributions in MERS total portfolio to be used to reimburse the members for future medical expenses/health insurance premiums after they have terminated employment. There can be four types of contributions: 1. Employer paid (tax free); 2. Mandatory employee salary reduction (tax free), 3. Mandatory leave conversion (tax free), and 4. Employee paid (post tax). As a result of a Private Letter ruling from the IRS, post employment benefits are tax-exempt. The plan is available to all MERS participating municipalities and may be adopted on a division-by-division basis. Plan provisions and requirements are specified in the MERS Plan Document. Contribution rates are determined by collective bargaining agreements and employer personnel policies.

Significant Accounting Policies

The Health Care Savings Program financial statements are prepared using a cash basis of accounting for contributions and benefit payments (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Plan members invest in the MERS total portfolio.

Reserve for Health Care Savings Program

All additions to and deductions from the Health Care Savings Program are recorded in this reserve. MERS maintains the individual employee account records.

8. *Retiree Health Funding Vehicle*

Plan Description

MERS Retiree Health Funding Vehicle is a program whereby participating municipalities can invest monies in a governmental trust that was established under Section 115 of the Internal Revenue Code. These funds constitute a health care fund, which enable municipalities to accumulate funds to provide for the funding of health benefits for retirees and beneficiaries. Plan provisions and requirements are specified in the MERS Plan Document.

Significant Accounting Policies

The Retiree Health Funding Vehicle Program financial statements are prepared using a cash basis of accounting for contributions and benefit payments (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Plan members invest in the MERS total portfolio. Contributions are pooled subject to the Public Employee Retirement System Investment Act ("PERSIA"), 1965 PA 314.

Reserve for Retiree Health Funding Vehicle

All additions to and deductions from the Retiree Health Funding Vehicle Program are recorded in this reserve. MERS maintains the municipality employer account records.

9. Interfund Receivables and Payables

As of December 31, 2004, interfund receivables and payables were:

Interfund Receivables and Payables

	Interfund Receivables	Interfund Payables
Defined Benefit Plan	$ 198,458	$ 237,969
Defined Contribution Plan	-	-
Health Care Savings Program	129,272	195,888
Retiree Health Funding Vehicle	108,697	2,570
Totals	$ 436,427	$ 436,427

Required Supplementary Information

Schedule of Funding Progress

(Dollars in Millions)

Actuarial Valuation December 31	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1998	$ 3,030.4	$ 3,592.0	$ 561.6	84.40%	$ 1,163.1	48.30%
1999	3,464.9	3,835.5	370.6	90.30	1,179.3	31.40
2000	3,787.2	4,397.0	609.8	86.10	1,226.0	49.70
2001	4,034.4	4,783.9	749.5	84.30	1,271.6	58.90
2002	4,133.0	5,181.2	1,048.2	79.80	1,327.4	79.00
2003	4,459.5	5,667.7	1,208.2	78.70	1,381.2	87.50

Schedule of Employer Contributions

(Dollars in Millions)

Fiscal Year (See Note 1)	Annual Required Contribution	Accelerated Funding Credit	Percentage Contributed Before Credit	Percentage Contributed After Credit
1998	116.9	14.3	99%	113%
1999	119.6	6.8	111	118
2000	124.9	8.4	106	113
2001	118.2	14.5	103	118
2002	124.7	7.7	102	109
2003	133.2	4.5	121	125
2004	155.7	2.3	108	109

See notes to the Schedules of Required Supplementary Information.

Required Supplementary Information

Notes to the Schedules of Required Supplementary Information

1. **Actuarial Valuation -** Actuarial valuations are prepared annually, as of December 31, for each participating municipality. To facilitate budgetary planning needs, employer contribution requirements are provided for each municipality's unique fiscal year that commences after the following calendar year end. For example, the contribution requirements for fiscal years that began in 2004 were determined by actuarial valuations, as of December 31, 2002.

   Approximately 75% of the participating municipalities have fiscal years that begin January 1 or July 1.

   The "Annual Required Contribution" and "Accelerated Funding Credit" shown in the preceding schedule represent the summation of each participating municipality's contribution requirements for its fiscal year commencing in the year stated. However, the calculations to determine the Percentage Contributed use contributions recorded during MERS fiscal year.

2. **Accelerated Funding Credits -** An Accelerated Funding Credits (AFC) Program was first established by the Retirement Board in 1984, and has since been modified several times. The current modified AFC program in effect reduces 2004 required contribution rates of municipalities with funded percentages in excess of 100%.

3. **Summary of Actuarial Methods and Assumptions -** The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation may be found in the Actuarial Section.

   Summary Information follows:

Valuation Date	December 31, 2003
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percent of Payroll, Open
Remaining Amortization Period	30 years (For new municipalities that first joined MERS prior to 2000, the amortization period was greater than 30 years and will decline one year annually until the period reaches 30 years.)
Asset Valuation Method	5-Year Smoothed Market (For 2003, the Retirement Board adopted a one time ad hoc adjustment to aggregate the yet unrecognized market gains and losses from 1999-2002 with the 2003 market gain. No gain or loss has been recognized for 2003. The aggregate loss amount of $388,778,035 will be recognized in four equal dollar installments in 2004-2007.)
Actuarial Assumptions	
Investment Rate of Return	8%
Projected Salary Increases	4.5% for base inflation, plus 0.0% to 4.16% percent per year attributable to merit and longevity.
Post-Retirement Benefit Adjustment	2.5% annual post-retirement benefit adjustments if adopted by individual municipality.

Schedule of Administrative Expenses for the Year Ended December 31, 2004

Administrative Expenses	
Personnel Services	
Salaries	$ 2,716,711
Social Security	213,858
Retirement	296,881
Insurance	515,367
Total Personnel Services	3,742,817
Professional Services	
Actuarial Services	583,484
Audit Services	54,950
Commercial Banking	98,355
Legal Services	117,510
Medical Advisory Services	49,230
Data Processing	15,443
Computer Maintenance	9,709
Consultants	134,965
Temporary Personnel	25,287
Recruitment Fees	32,074
Total Professional Services	1,121,007
Communications	
Copying	115,994
Record Retention	89,849
Mail & Postage	80,798
Promotional Supplies	9,537
Telephone / Communications	113,229
Travel and Meetings	133,685
Annual Meeting	214,266
Total Communications	757,358
Rentals	
Equipment Rental	142,726
Office Rental	604,500
Total Rentals	747,226
Miscellaneous	
Payroll Processing	4,259
Office Supplies	75,019
Operating Expenses	310,957
Equipment Expense	96,907
Software	39,546
Software Maintenance	581,173
Professional Development and Tuition	286,924
Insurance	201,036
Maintenance	230,756
Depreciation	1,762,072
Total Miscellaneous	3,588,649
Total Administrative Expenses	$ 9,957,057

Schedule of Investment Expenses for the Year Ended December 31, 2004

Investment Expenses	
Personnel Services	
Salaries	$ 380,094
Social Security	28,140
Retirement	39,303
Insurance	65,735
Total Personnel Services	513,272
Professional Services	
Commercial Banking	255,475
Investment Managers	10,919,534
Investment Performance Expense	79,500
Other Consultants	38,500
Total Professional Services	11,293,009
Communication	
Travel and Meetings	32,413
Training and Subscriptions	73,972
Total Communication	106,385
Miscellaneous	
Operating Expenses	12,402
Equipment Expense	1,194
Software Maintenance	111,214
Depreciation	24,173
Total Miscellaneous	148,983
Total Investment Expenses	$ 12,061,649

Schedule of Payments to Consultants for the Year Ended December 31, 2004

FIRM	NATURE OF SERVICE	FEE
Gabriel, Roeder, Smith and Co.	Actuary and System Implementation	$ 2,749,911
PeopleSoft	Systems Implementation and Maintenance	439,313
Andrews, Hooper & Pavlik P.L.C.	Auditor	50,025
Associated Physicians	Medical Advisors	34,625
Karoub Associates	Legislative Advisors	30,000
New London Management Associates	Personnel and Human Resource Advisors	27,365
Miller, Canfield, Paddock and Stone, PLC	Legal Counsel	22,434
Consulting Physicians	Medical Advisors	21,505
Deborah Allen	System Implementation	20,000
Total Payments to Consultants		$ 3,395,178

Note: Fees paid to investment managers are included in the Investment Section.