MERS Story

Celebrating MERS Growth

MERS story began in 1946 when a small group of municipalities banded together, selected a Board of Directors, and formed a group that wanted to pool their resources and save money on the cost of administering pensions.

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, 2006, 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 2005 financial statements and, in our report dated April 24, 2006, 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, 2006, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2007 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, contracts, 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.

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The Management's Discussion and Analysis (MD&A) on pages 22 through 27 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 Introductory, Investment, Actuarial, and Statistical Sections and the required supplementary information and supporting schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The Introductory, Investment, Actuarial, and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Andrews Hooper & Pavlik P.L.C.

Okemos, Michigan
June 20, 2007

Management's Discussion and Analysis

This narrative overview and analysis of MERS financial condition for fiscal year ended December 31, 2006, is presented in conjunction with the Chief Executive Officer's Letter of Transmittal. The financial section is comprised of the Independent Auditor's Report, Management's Discussion and Analysis, two basic financial statements with explanatory notes, two required supplementary schedules with explanatory notes and three supplementary expense schedules.

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 Plan, Defined Contribution Plan, Investment Services Program, 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.

Basic Financial Statements

1. Statement of Plan Net Assets (pages 28-29)
2. Statement of Changes in Plan Net Assets (pages 30-31)
3. Notes to Basic Financial Statements (pages 32-48)
4. Comparison Statement of Plan Net Assets (page 24)
5. Comparison Statement of Changes in Plan Net Assets (page 25)

The Defined Benefit Plan, Defined Contribution Plan, Investment Services Program, Health Care Savings Program and Retiree Health Funding Vehicle 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 685 individual municipal Defined Benefit Plans, 133 individual municipal Defined Contribution Plans, 56 Health Care Savings Programs, 40 Retiree Health Funding Vehicle Plans and 2 Investment Services Programs administered by MERS.

The "Comparison Statement of Plan Net Assets" and "Comparison Statement of Changes in Plan Net Assets" presented later in the Management's Discussion and Analysis provide a comparative summary of the financial condition of the Retirement System as a whole.

Required Supplemental Information

1. Schedule of Funding Progress (page 49)
2. Schedule of Employer Contributions (page 49)
3. Notes to the Schedules of Required Supplementary Information (pages 50-51)

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 (page 52)
2. Schedule of Investment Expenses (page 53)
3. Schedule of Payments to Consultants (page 54)

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, 2006:

- Total plan net assets for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle and Investment Services Program increased by $773 million during the 2006 fiscal year. This was primarily due to net gains in investments of $659 million dollars.

- Total pension benefits paid to retirees and beneficiaries increased $31 million to a total of $315 million. While contributions exceeded pension benefit payments by $124 million in 2006 (primarily due to new municipalities joining MERS and transfers into the Retiree Health Funding Vehicle and Investment Services Program), the cash flow trend in the past few years has shown pension benefit payments are increasingly exceeding contributions. This is normal plan cycling as the Defined Benefit 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 $600 thousand.

- Transfers from the Defined Benefit Plan to the Defined Contribution Plan increased by $729 thousand. The number of new hires in Defined Contribution continues to increase relative to the Defined Benefit Plan members. See page 96.

- Total employer contributions increased by 48% to $348 million, and employee contributions increased by 18% to $91 million. Again, much of these increases were due to new municipalities joining MERS Defined Benefit Plan, Defined Contribution Plan, Retiree Health Funding Vehicle, Investment Services Program and Health Care Savings Program. Employer and employee contributions from new municipalities were $99 million in 2006 compared to $49 million in 2005. Employer contributions in the Defined Benefit Plan have increased in recent years due to municipalities adopting enhanced benefits and the market declines of 2000-2002.

- Administrative expenses totaled $13 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 the Defined Benefit Plan with 65,100 members and Defined Contribution Plan with 6,831 members.

- Investment expenses totaled $17 million. The largest expense is due to higher investment manager fees increasing to $16 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 28-31) provide financial information about the activities of the 901 individual municipal plans administered by MERS in its Defined Benefit Plan, Defined Contribution Plan, Retiree Health Funding Vehicle, Health Care Savings Program and Investment Services Program, as well as comparative summary information about these activities for the Retirement System as a whole.

The "Schedule of Funding Progress" (page 49) includes historical trend information about the actuarially funded status of the Defined Benefit Plans 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 49) 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 Defined Benefit Plans.

Comparison Statement of Plan Net Assets

Assets	As of December 31, 2006	As of December 31, 2005	Increase (Decrease) Amount	Increase (Decrease) Percent
Cash and Short-Term Investments	$ 225,530,136	$ 266,259,383	$ (40,729,247)	-15.30%
Receivables	224,851,017	157,534,335	67,316,682	42.73%
Interfund Receivables	1,202,304	434,593	767,711	176.65%
Investments, at fair value	5,769,420,916	4,985,756,769	783,664,147	15.72%
Invested Securities Lending Collateral	905,007,240	719,094,377	185,912,863	25.85%
Other Assets/Prepaids	337,474	433,475	(96,001)	-22.15%
Net Capital Assets	6,641,104	3,878,603	2,762,501	71.22%
Total Assets	7,132,990,191	6,133,391,535	999,598,656	16.30%
Liabilities				
Purchase of Investments	348,526,226	317,984,276	30,541,950	9.60%
Securities Lending Collateral	905,007,240	719,094,377	185,912,863	25.85%
Administrative and Investment Costs	15,890,222	6,563,876	9,326,346	142.09%
Interfund Payables	1,202,304	434,593	767,711	176.65%
Other Accounts Payable	16,843	711	16,132	2268.95%
Total Liabilities	1,270,642,835	1,044,077,833	226,565,002	21.70%
Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others	$ 5,862,347,356	$ 5,089,313,702	$ 773,033,654	15.19%

Comparison Statement of Changes in Plan Net Assets

	Year ended December 31, 2006	Year ended December 31, 2005	Increase (Decrease) Amount	Increase (Decrease) Percent
Additions				
Contributions	$ 439,052,040	$ 312,245,705	$ 126,806,335	40.61%
Transfers from Defined Benefit Plan	751,160	22,573	728,587	3227.69%
Transfers from Other Plans and Other Items	8,112,862	2,084,281	6,028,581	289.24%
Investment net income investing activities	656,892,178	300,666,864	356,225,314	118.48%
Investment net income-securities lending	2,524,348	2,135,791	388,557	18.19%
Miscellaneous Income	790,789	6,026,437	(5,235,648)	-86.88%
Total Additions	1,108,123,377	623,181,651	484,941,726	77.82%
Deductions				
Benefits	314,764,086	283,629,190	31,134,896	10.98%
Refunds of Contributions	4,711,038	4,157,567	553,471	13.31%
Special Expenses and Fees	542,942	398,690	144,252	36.18%
Transfers to Defined Contribution Program	751,161	22,573	728,588	3227.70%
Medical Disbursements Paid to Members	144,699	51,832	92,867	179.17%
Disbursements Paid to Municipalities	1,109,386	95,470	1,013,916	1062.03%
Forfeited Employer Contributions	44,724		44,724	100.00%
Administrative Expense	13,021,687	11,833,630	1,188,057	10.04%
Total Deductions	335,089,723	300,188,952	34,900,771	11.63%
Net Increase	773,033,654	322,992,699	450,040,955	139.33%
Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others				
Balance Beginning of Year	5,089,313,702	4,766,321,003	322,992,699	6.78%
Balance End of Year	$ 5,862,347,356	$ 5,089,313,702	$ 773,033,654	15.19%

Analysis of Plan Net Assets

Combined plan net assets increased by $773 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 an 11% increase in pension benefit payouts due to a greater number of retirees and post retirement cost-of-living increases.

Employer and employee contributions increased $127 million due chiefly to municipalities joining MERS plans bringing in $99 million. The remaining increases were due to higher required actuarial contribution rates resulting from increases in salaries, benefit enhancements, plan modifications, and an increase in the number of employees.

In determining contribution rates through 2006, MERS actuary used a five-year smoothing method to recognize market gains and losses. This has tempered many of the market losses over the three down market 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 was to be recognized in four equal dollar installments in 2004-2007. In 2004, the normal five-year smoothing method was reinstituted. On December 31, 2005, with prospective application, the MERS Board adopted a ten-year smoothing method for calculating valuation assets to further reduce the volatility of employer contribution rates. Employers are also shifting more of the responsibility for contribution requirements on to employees to pay for better benefit plans.

MERS has capital assets of approximately $7 million, mostly comprised of software and computer servers needed to run the Retirement System's pension and financial programs.

MERS has no long-term liabilities. The bulk of MERS liabilities at year end related to investment purchases that did not settle until early in 2007 and securities lending collateral.

Investment Activities

The total fund investment performance on a comparative basis to the benchmarks was excellent. The positive gross return of 13.6% was above the long-term net 8% actuarial return assumption target for the year. On both a five and ten year basis, the gross returns of 9.8% and 8.8%, respectively, compared favorably to the actuarial return assumption. Net investment income (net increase in fair value, plus investment earnings, less investment administrative expenses) was $659 million for the year. The stock market is in its fourth year of positive returns after three years of negative returns. A further detailed analysis of investment returns may be found in the Investment Section.

MERS 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 a 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, 2006, is found on page 17 of this report. A summary of the total Retirement System's assets can be found on page 66.

Historical Trends

Accounting standards require that the "Statement of Plan Net Assets" state investment 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 49). 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 77% to 76% for the 2005 valuation. The decline, while slight, was expected. Primarily, municipalities adopting better benefit plans and to a lesser extent, investment losses from 2000-2002, combined to influence the funded ratio. This percentage has declined over the last six years. The actuarial assumptions used in the most recent valuation are identified in the "Notes to the Schedules of Required Supplementary Information" (page 50).

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 49). This schedule indicates that employers are meeting their actuarially required contribution payments.

MERS overall financial condition improved for the fiscal year ended 2006, and the plan remains stable and viable for the years to come. The market upturn in 2006 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 a funding methodology for the Retirement System to achieve the following major objectives:

- To develop level required contribution rates as a percentage of payroll;
- To finance benefits earned by present employees on a current basis;
- To accumulate assets to enhance members’ benefit security;
- To produce investment earnings and interest on accumulated assets to help meet future benefit costs;
- To make it possible to estimate the long-term actuarial cost of proposed amendments to System provisions; and
- To 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 71. 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, 2006

Assets	Defined Benefit*	Defined Contribution
Cash and Short-Term Investments	$ 198,471,201	$ 26,938,960
Receivables		
Employer Contributions	32,289,390	
Plan Member Contributions	9,045,805	
Sale of Investments	170,354,735	
Investment Income	11,181,004	
Loans		1,914,278
Interfund Receivables	673,283	
Other	65,805	
Total Receivables	223,610,022	1,914,278
Investments, at fair value		
Domestic Fixed Income	1,306,649,221	8,723,670
Domestic Equities	2,260,091,490	65,290,520
International Bonds	572,197,723	
International Equities	930,995,230	6,358,588
Real Estate	455,994,696	
Balanced Funds		93,889,086
Total Investments	5,525,928,360	174,261,864
Invested Securities Lending Collateral	905,007,240	-
Prepaid Expenses	337,474	-
Capital Assets, at cost, net of accumulated depreciation	6,641,104	-
Total Assets	**6,859,995,401**	**203,115,102**
Liabilities		
Purchase of Investments	348,526,226	
Securities Lending Collateral	905,007,240	
Administrative and Investment Costs	15,890,222	
Interfund Payables	529,021	
Other Accounts Payable		
Total Liabilities	**1,269,952,709**	**-**
Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others	**$ 5,590,042,692**	**$ 203,115,102**

* 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

Health Care Savings Program	Retiree Health Funding Vehicle	Investment Services Program	Year Ended December 31, 2006	Year Ended December 31, 2005
$ 45,029	$ 74,946		$ 225,530,136	$ 266,259,383
			32,289,390	23,443,765
			9,045,805	6,419,675
			170,354,735	113,122,130
			11,181,004	11,384,979
			1,914,278	3,163,786
		$ 529,021	1,202,304	434,593
			65,805	
-	-	529,021	226,053,321	157,968,928
1,720,112	10,935,902	3,714,127	1,331,743,032	1,294,365,392
2,975,252	18,915,665	6,424,271	2,353,697,198	2,243,373,943
753,258	4,788,966	1,626,462	579,366,409	217,678,374
1,225,590	7,791,894	2,646,338	949,017,640	793,630,194
600,285	3,816,413	1,296,157	461,707,551	364,806,912
			93,889,086	71,901,954
7,274,497	46,248,840	15,707,355	5,769,420,916	4,985,756,769
-	-	-	905,007,240	719,094,377
-	-	-	337,474	433,475
-	-	-	6,641,104	3,878,603
7,319,526	**46,323,786**	**16,236,376**	**7,132,990,191**	**6,133,391,535**
			348,526,226	317,984,276
			905,007,240	719,094,377
			15,890,222	6,563,876
538,266	135,017		1,202,304	434,593
15,341	1,502		16,843	711
553,607	**136,519**	**-**	**1,270,642,835**	**1,044,077,833**
$ 6,765,919	**$ 46,187,267**	**$ 16,236,376**	**$ 5,862,347,356**	**$ 5,089,313,702**

Statement of Changes in Plan Net Assets for the Year Ended as of December 31, 2006

Additions	Defined Benefit	Defined Contribution	Health Care Savings Program
Contributions and Transfers In			
Employer Contributions	$ 286,227,456	$ 15,962,041	$ 1,415,669
Plan Member Contributions	84,124,396	5,543,549	885,628
Employer Transfers In		646,754	
Plan Member Transfers In		104,407	
Transfers from Other Plans and Other Items		8,112,861	
Total Contributions and Transfers In	370,351,852	30,369,612	2,301,297
Investment Income			
Net Appreciation in Fair Value of Investments	551,193,919		
Interest Income	49,381,422		
Dividend Income	34,417,629		
Real Estate Operating Income, net	13,445,618		
Commission Recapture Income	228,362		
DC Plan Investment Income		19,224,093	
Investment Income			752,559
Service Charge Revenue			59,046
Miscellaneous Revenue			32,772
	648,666,950	19,224,093	844,377
Less Investment Expense	17,032,361		
Net Investment Income Before Securities Lending Activities	631,634,589	19,224,093	844,377
Security Lending Activities			
Security Lending Income	43,559,939		
Security Lending Expenses			
Borrower Rebates	40,405,059		
Management Fees	630,532		
Total Securities Lending Expenses	41,035,591		
Net Income from Security Lending Activities	2,524,348		
Total Net Investment Income	634,158,937	19,224,093	844,377
Miscellaneous Income	790,789		
Total Additions	**1,005,301,578**	**49,593,705**	**3,145,674**
Deductions			
Benefits	304,172,625	10,591,461	
Refunds of Contributions			
Plan Member	4,711,038		
Special Expenses and Fees	526,047		
Transfers to Defined Contribution Plan			
Employer	646,754		
Plan Member	104,407		
Medical Disbursements Paid to Members			144,699
Disbursements Paid to Municipalities			
Forfeited Employer Contributions			44,723
Administrative Expenses	12,540,010		256,246
Total Deductions	**322,700,881**	**10,591,461**	**445,668**
Net Increase	**682,600,697**	**39,002,244**	**2,700,006**
Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others			
Balance Beginning of Fiscal Period	4,907,441,995	164,112,858	4,065,913
Balance End of Fiscal Period	**$ 5,590,042,692**	**$ 203,115,102**	**$ 6,765,919**

Retiree Health Funding Vehicle	Investment Services Program	Year Ended December 31, 2006	Year Ended December 31, 2005
$ 29,366,165	$ 15,527,136	$ 348,498,467	$ 236,172,943
		90,553,573	76,072,762
		646,754	21,609
		104,407	964
		8,112,861	2,084,281
29,366,165	15,527,136	447,916,062	314,352,559
		551,193,919	227,115,851
		49,381,422	46,461,321
		34,417,629	29,773,002
		13,445,618	4,538,596
		228,362	229,939
		19,224,093	8,427,281
4,359,685	726,136	5,838,380	615,360
89,055		148,101	
14,243		47,015	5,989
4,462,983	726,136	673,924,539	317,167,339
		17,032,361	16,500,475
4,462,983	726,136	656,892,178	300,666,864
		43,559,939	22,620,518
		40,405,059	19,951,189
		630,532	533,538
		41,035,591	20,484,727
		2,524,348	2,135,791
4,462,983	726,136	659,416,526	302,802,655
		790,789	6,026,437
33,829,148	**16,253,272**	**1,108,123,377**	**623,181,651**
		314,764,086	283,629,190
		4,711,038	4,157,567
	16,895	542,942	398,690
		646,754	21,609
		104,407	964
		144,699	51,832
1,109,386		1,109,386	95,470
		44,724	
225,431		13,021,687	11,833,630
1,334,817	**16,895**	**335,089,723**	**300,188,952**
32,494,331	**16,236,376**	**773,033,654**	**322,992,699**
13,692,936	-	5,089,313,702	4,766,321,003
$ 46,187,267	**$ 16,236,376**	**$ 5,862,347,356**	**$ 5,089,313,702**

Notes to Basic Financial Statements

Year ended December 31, 2006

1. Reporting Entity and Plan Description

The Municipal Employees' Retirement System (MERS) is an agent multiple-employer, statewide, public employee pension plan created under Public Act 135 of 1945, repealed and replaced by successor Municipal Employees' Retirement Act of 1984 (PA 427), as last amended by 2004 PA 490, and the MERS Plan Document, as revised. MERS was established to provide a pooled program for 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 Plan, Defined Contribution Plan, Investment Services Program, Health Care Savings Program and a Retiree Health Funding Vehicle. See Note 6 for the Defined Contribution Plan (page 45). See Note 7 for the Health Care Savings Program and Retiree Health Funding Vehicle (page 46). See Note 8 for the Investment Services Program (page 47).

Pursuant to 1996 PA 220, on August 15, 1996, MERS became an independent non-profit public 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. Since then, MERS is solely administered 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, who are 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, is appointed by the Retirement Board.
>
> 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 by the delegates to an Annual Meeting of the Retirement System.
>
> 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 by the delegates to an Annual Meeting of the Retirement System.

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.

MERS Participating Municipalities as of December 31, 2006

Counties	66
Cities and Villages	260
Townships	82
County Road Commissions	57
Authorities, Districts and Others	203
Closed Groups	17
Total	685

Any "municipality" as that term is defined by Section 2b (2) of the Retirement Act, Michigan Compiled Law 38.1502b (2), 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, 2006

Retirees and Beneficiaries Currently Receiving Benefits	
Retirement annuities	16,879
Survivor annuities	3,528
Disability annuities	1,098
Total	21,505
Vested former members	5,769
Current active employees	37,826
Total Membership	65,100

Benefit plans and provisions that are available for adoption 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. 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. Employees may retire after reaching several combinations of age and years of service to receive reduced early retirement benefits. MERS also provides non-duty disability and non-duty 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 Article 9 Section 24 of 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 MERS programs have been determined to be a governmental plan that is a tax-qualified trust, under Internal Revenue Code Section 401(a), and tax exempt under Section 501(a). The most recent Letter of Favorable Determination for MERS was issued by the IRS on June 15, 2005. These regulations include the preferential deferred taxability of contributions, accumulated earnings, 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 employer and employee contributions. Compensation in excess of the 401(a) (17) limit (currently $220,000 for 2006 and increasing to $225,000 in 2007) will not be credited by MERS. 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 the MERS 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 by the trust under the terms of the plan. Internal Revenue Service approval of the QEBA was pursuant to Private Letter Ruling issued December 15, 2003. 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 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 15, 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 15, 1996, when it began independent payroll processing separate and apart from the state.

The Retirement Board, as an employer, elected after separation in 1996 to become a participating municipality in MERS Defined Benefit Plan to provide pension benefits for MERS staff. Vesting occurs after 6 years of credited service. Normal retirement age is age 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 12.52% of compensation in 2006; employees contributed 2% of compensation in 2006.

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

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)
2003	$ 2,012,358	$ 2,393,016	$ 380,658	84.10%	$ 2,678,027	14.21%
2004	2,591,903	3,694,402	1,102,499	70.16	3,603,548	30.59%
2005	3,454,714	4,773,326	1,318,612	72.40	4,410,167	29.90%

Actuarial Accrued Liability from December 31, 2005 and December 31, 2004 Actuarial Valuations

	2005	2004
Retirees and beneficiaries currently receiving benefits	$ 525,441	$ 376,442
Vested former members not yet receiving benefits	41,211	23,557
Nonvested terminated employees (pending refunds of accumulated member contributions)	17,801	15,397
Current employees		
Accumulated employee contributions, including allocated investment income	509,802	404,576
Employer financed	3,679,071	2,874,430
Total Actuarial Accrued Liability	4,773,326	3,694,402
Net assets available for benefits at actuarial value ($3,363,679 and $2,530,006 at market value for December 31, 2005, and 2004, respectively)	3,454,714	2,591,903
Unfunded actuarial accrued liability	$ 1,318,612	$ 1,102,499

Three-Year Trend Information Schedule of Employer Contributions

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2004	$ 192,024	100%	-
December 31, 2005	259,500	100	-
December 31, 2006	451,164	100	-

Changes in Accounting Principles

The Plan adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 44 issued in May 2004, "Economic Condition Reporting: The Statistical Section, an Amendment of NCGA Statement 1" effective for periods beginning after June 15, 2005. Statement No. 44 modifies and adds certain ten year statistical reporting requirements previously established by NCGA Statement 1. Statement No. 44 has had an impact on the presentation of the schedules in the statistical section of the Comprehensive Annual Financial Report, but no effect on net assets or the changes in net assets in the prior or current year.

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.

Capital Assets

Leasehold improvements, office furniture, equipment, and software with a value of $5,000 or more are carried at cost, less accumulated depreciation. The capital assets are depreciated using the straight-line method over the estimated useful lives of the related assets varying from three- to five-year spans. The table below is a schedule of the capital asset account balances as of December 31, 2005, and December 31, 2006, and changes to those account balances during the year ended December 31, 2006.

Capital Assets

Capital Assets	Office Building	Leasehold Improvements	Office Furniture and Equipment	Software	Total Capital Assets
Balances December 31, 2005	$ 15,183	$ 361,437	$ 2,312,989	$ 13,155,421	$ 15,845,030
Additions	2,159,262		90,337	3,922,942	6,172,541
Deletions	(1,974,540)	(361,437)	(428,188)	(81,303)	(2,845,468)
Balances December 31, 2006	199,905	-	1,975,138	16,997,060	19,172,103
Accumulated Depreciation					
Balances December 31, 2005		361,437	1,877,651	9,727,339	11,966,427
Depreciation Expense			176,583	1,258,917	1,435,500
Deletions		(361,437)	(428,188)	(81,303)	(870,928)
Balances December 31, 2006	-	-	1,626,046	10,904,953	12,530,999
Net Capital Assets December 31, 2006	**$ 199,905**	**$ -**	**$ 349,092**	**$ 6,092,107**	**$ 6,641,104**

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, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle and Investment Services Program 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 credited with interest annually. Pursuant to Board Resolution adopted November 9, 2005, the interest rate for each year beginning in 2005 is the one year T-bill rate as of December 1 each year for the ensuing December 31st employee interest calculation. It is also for interest calculations for the subsequent year for those employees requesting a refund of their contributions. The employee contribution rates vary from 0% to 22.80% according to the benefit plan adopted. See “Schedule of Employer Contributions” (page 49).

Reserves

Three reserves have been established pursuant to the MERS Plan Document for the Defined Benefit Plan. See “Schedule of Changes in Reserves” (pages 98-99).

- 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, as provided in the Board’s November 9, 2005 Resolution. The reserve’s balance at year end December 31, 2006, is $532,327,092. The “Reserve for Employee Contributions” was fully funded as of the December 31, 2005 MERS Consolidated 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, 2006, balance is $5,057,715,600. The unfunded liability was $1,583,027,787 (based on the actuarial value of assets) as of the December 31, 2005 MERS Consolidated 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 2006, 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 guidelines 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 prudent standards and requires that the assets of a retirement system be invested solely in the interest of the participants and beneficiaries. Under Plan Document Section 55(6), and 1965 PA 314, and Section 401(a)(2) of the Internal Revenue Code, the investments shall be made for the exclusive purpose of providing benefits to the participants and their 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, 2006, 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 that had not been previously written down.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to MERS. Credit risk exposure is dictated by each investment manager's agreement. Other criteria for active managers based on MERS Retirement Board Investment policy, includes that if a security is downgraded below investment grade after purchase, a review with a written explanation shall be forwarded to the investment staff. Board policy also allows that when calculating the average rating of the portfolio, the manager may utilize the highest rating of the major rating agencies to calculate the average. Board policy in regards to global fixed income securities is that no more than 10% of the portfolio may be invested in corporate bonds or sovereign bonds rated below investment grade, as defined by Moody's and Standard & Poors. Board policy for global fixed income securities, is that the average weighted credit of the portfolio will be a minimum of A-. When calculating the average rating of the global portfolio, the manager may utilize the highest rating of the major agencies to calculate the average. Board policy in regards to global non-investment grade fixed income securities includes criteria that credit quality must maintain a minimum of 10% of the portfolio in investment grade fixed income with at least two ratings of BBB-/Baa3 or higher (as assigned by Standard & Poors or Moody's). Each portfolio is managed in accordance with investment guidelines that are specific as to permissible credit quality ranges, exposure levels within individual security quality rating tiers, and/or the average credit quality of the overall portfolio.

As of December 31, 2006, the domestic fixed income portfolio consisted of the following fixed income investments with respective quality ratings, excluding those obligations of the U.S. Government. Investments issued by or explicitly guaranteed by the U.S. Government are not considered to have credit risk. The Plan's exposure to credit risk as of December 31, 2006, is presented on page 40, by investment category as rated by Standard & Poor's.

Credit Ratings Summary – December 31, 2006

Quality Rating	Corporate Bonds	Bond Index Fund	Mortgages	U.S. Agency Bonds	Municipals	Global Fixed Income	Total	% of Portfolio
AAA	$ 44,879,906	$ 28,695,172	$ 65,010,528	$ 126,101,384	$ 2,659,556	$ 149,051,751	$ 416,398,296	35%
AA+	1,046,093						1,046,093	0%
AA	2,185,765					22,076,825	24,262,590	2%
AA-	6,730,608						6,730,608	1%
A+	9,115,030					1,705,457	10,820,487	1%
A	14,976,377	45,177,109		836,187		27,337,830	88,327,502	7%
A-	9,166,745					1,571,396	10,738,141	1%
BBB+	25,199,840					22,394,226	47,594,066	4%
BBB	21,182,974	55,295,517				18,789,307	95,267,798	8%
BBB-	14,663,578						14,663,578	1%
BB+	6,906,891					8,069,531	14,976,422	1%
BB	2,090,917					24,753,680	26,844,597	2%
BB-	1,315,612					14,456,938	15,772,549	1%
B+	1,956,172					3,185,728	5,141,900	0%
B	10,372,814					8,181,955	18,554,768	2%
B-	527,250						527,250	0%
CCC+	1,096,425						1,096,425	0%
CCC						1,983,731	1,983,731	0%
CCC-							-	0%
CC							-	0%
C							-	0%
D						2,749,633	2,749,633	0%
NR	80,867,720	8,576,931	22,882,590	197,870,306		71,004,424	381,201,971	32%
Totals	254,280,718	137,744,729	87,893,118	324,807,876	2,659,556	377,312,410	1,184,698,407	100%
Govt & Agencies*	4,825,410	257,505,570	26,977,897	226,324,489			515,633,366	
Total Fixed Income	$ 259,106,128	$ 395,250,299	$ 114,871,015	$ 551,132,365	$ 2,659,556	$ 377,312,410	$ 1,700,331,773	

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates that will adversely affect the fair value of an investment. Interest rate risk is controlled through diversification of portfolio management styles. Some investments' sensitivity to changing interest rates may derive from prepayment options embedded in an investment. Some corporate bonds with asset backed securities, collateralized mortgage obligations and mortgage backed securities are pass through securities, that represent pooled debt obligations repackaged as securities that pass income and principal from debtors through the intermediary to investors. MERS Retirement Board Investment policy in regards to interest rate risk is that the effective duration of the domestic portfolio shall be (+/-) 20% of the Lehman Brothers Aggregate Index or the Lehman Universal Bond Index. MERS Retirement Board Investment policy in regards to interest rate risk is that the effective duration of the global fixed income portfolio shall be (+/-) 20% of the Lehman Brothers Global Aggregate Index. Board policy in regards to global non-investment grade fixed income securities is that the portfolio's duration is (+/-) 2 years of the benchmark duration. The benchmark for global non-investment grade fixed income securities is 1/3 Lehman Brothers U.S. Treasury Inflation Protected Securities Index, 1/3 Citigroup High Yield Market Index and 1/3 JP Morgan Emerging Markets Global Bond Index. As of December 31, 2006, the Defined Benefit Plan exposure to interest rate risk as measured by the segmented time distribution maturity summary is listed below by investment class.

Segmented Time Distribution – December 31, 2006

Investment Type	Market Value	Less than 1 Year	1 to 6 Years	6 to 10 Years	10+ Years	Maturity not Determined
Corporate and Global Bonds	$ 636,418,538	$ 49,449,804	$ 275,102,053	$ 157,877,796	$ 97,423,894	$ 56,564,992
Government Agencies	367,953,124	16,959,592	129,790,674	90,393,346	130,809,512	
Government Bonds	183,179,241	290,749	62,308,518	63,183,310	56,115,138	1,281,526
Mortgages	114,871,015		3,373,278	2,171,792	109,325,945	
Municipal/Provincial Bonds	2,659,556		1,639,417		1,020,139	
Bond Index*	395,250,299		3,130,993	2,015,804	71,357,466	
Total	**$ 1,700,331,773**	**$ 66,700,145**	**$ 475,344,933**	**$ 315,642,048**	**$ 466,052,094**	**$ 57,846,518**

* The Bond Index information on the segmented time distribution was unavailable. The effective duration in years for the Bond Index was 4.5 years. Effective duration is a measure of the price sensitivity of a debt investment to changes in interest rates. It is calculated based on the weighted average of the present value for all cash flows.

Concentration of Credit Risk Debt Securities

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer. MERS Retirement Board Investment Policy states securities representing debt and equity of any one company shall not exceed 5% of the fair value of the Plan's portfolio. MERS did not hold a single organization's securities that exceeded 5% of the Plan's net assets available for benefits other than those issued or explicitly guaranteed by the U.S. Government as of December 31, 2006.

Custodial Credit Risk for Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, MERS will not be able to recover the value of investments or collateral securities that are in the possession of an outside third party. As of December 31, 2006, MERS had deposits of $5,889,124 that were exposed to credit risk with The Northern Trust that were uninsured and uncollateralized. MERS also had investment securities and other investments of $31,353,143 where the exposure to custodial credit risk was not determined.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. MERS currency risk exposure, or exchange rate risk, is primarily derived from its holdings in foreign currency denominated equities, and fixed income investments. MERS Retirement Board Investment Policy for the global non investment grade fixed income portfolio allows currency hedging to mitigate currency exposure. Hedging the non U.S. dollar currency exposure of the portfolio is permitted. The portfolio will be limited to the maximum net currency exposure of 25% at any given time.

MERS exposure to foreign currency risk in U.S. dollars as of December 31, 2006 is summarized below.

Foreign Currency Risk – December 31, 2006

Currency	Equities	Fixed Income	Cash	Total
Australian dollar	$ 43,871,025	$ 30,538,957	$ 1,945	$ 74,411,927
Brazilian real		3,164,496		3,164,496
British pound sterling	86,164,627	45,170,249	55,265	131,390,140
Canadian dollar	4,582,392	44,455,840	281,091	49,319,324
Columbian peso		1,979,035		1,979,035
Danish krone	768,490	30,991,700	298,131	32,058,320
Euro	173,922,988	12,422,925	175,944	186,521,858
Hong Kong dollar	11,910,700	9,078,886	572	20,990,157
Hungarian forint		9,026,047		9,026,047
Indonesian rupiah	132,707	1,232,029		1,364,736
Japanese yen	97,110,704		3,997,377	101,108,082
Malaysian ringgit	480,816			480,816
Mexican peso		9,923,859	404,201	10,328,059
New Israeli shekel			226	226
New Taiwan dollar	6,491,318		10,532	6,501,850
New Zealand dollar	3,398,989	16,164,583	673,305	20,236,877
Norwegian krone	1,959,411	15,069,672	9,500	17,038,582
Polish zloty		9,109,369		9,109,369
Singapore dollar	6,318,313	9,145,913	189,938	15,654,164
South African rand			216	216
South Korean won	6,491,270		26	6,491,296
Swedish krona	3,267,539	30,732,369	305,736	34,305,644
Swiss franc	8,466,940		255,714	8,722,654
Thai baht	152,295			152,295
Turkish lira	1,534,701	2,630,207	65,841	4,230,749
Uruguayan peso		1,491,532		1,491,532
Total subject to foreign currency risk	457,025,224	282,327,667	6,725,560	746,078,452
Investments in International Securities payable in United States dollars	664,660,726	94,984,743		759,645,469
Total International Investment Securities	$ 1,121,685,950	$ 377,312,410	$ 6,725,560	$ 1,505,723,921

Securities Lending

MERS policy authorizes participation in a 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 39 days as of December 31, 2006. 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 three 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 154 days as of December 31, 2006, producing a net income of $2,524,348 in 2006.

Collateral Held and Fair Value of Securities on Loan as of December 31, 2006

Dollars In Thousands

Fair Value of Securities on Loan	Nature of Collateral	Collateral Held
$ 878,650,563	Cash	$ 905,007,240
43,966,632	Non-Cash	45,780,966
$ 922,617,195		$ 950,788,206

Derivatives and Structured Financial Instruments
Derivatives are complex financial instruments that MERS employs to obtain exposure to commodities, international currency, and to invest in the S&P 500.

MERS does not use derivatives for speculation, nor are they used to leverage the investment portfolio. The Retirement System does not use stock options, interest rate caps/floors, or floating rate securities that are priced from underlying collateral. All derivatives are presented at fair value as of December 31, 2006 in the financial statements. Derivative values fluctuate on a daily basis.

In accordance with the Board Investment Guidelines, our international managers may, when deemed prudent, enter into forward foreign currency transactions to hedge currency risk or take advantage of favorable market conditions. As of December 31, 2006, the following forward foreign exchange transactions were in place:

Forward Foreign Exchange Transactions – December 31, 2006

Type	Currency Exchange	Nominal Value	Cost	Market Value	Gain/(Loss)
Sell	CAD vs. USD	$ (25,940,000)	$ 22,867,520	$ 22,296,622	$ 570,898
Buy	DKK vs. USD	175,454,000	30,812,757	31,052,093	239,337
Sell	DKK vs. USD	(175,454,000)	29,735,130	31,052,093	(1,316,963)
Buy	HUF vs. EUR	6,869,981	9,198,262	9,093,756	(104,506)
Sell	USD vs. AUD	(39,750,000)	29,521,331	31,324,432	(1,803,101)
Buy	USD vs. AUD	20,162,000	15,662,850	15,888,382	225,533
Sell	USD vs. GBP	(12,875,000)	24,319,735	25,200,789	(881,054)
Buy	USD vs. GBP	1,060,000	2,047,931	2,074,746	26,816
Sell	USD vs. NZD	(22,640,000)	15,151,594	15,871,773	(720,179)
Sell	EUR vs. USD	(2,394,975)	3,033,094	3,164,474	(131,380)
Sell	GBP vs. USD	(6,369,500)	12,130,824	12,468,704	(337,880)

MERS uses S&P 500 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 the 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 $2,998,140 as of December 31, 2006. 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 $53,565,000 as of December 31, 2006.

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 the Retirement Board making the final decision, which may be subject to 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. It is on this date that the MERS Plan Document of 1996 was first determined by Internal Revenue Service Letter of Favorable Determination to meet qualifications as a "governmental plan" trust under Code Section 401(a), and tax exempt under Section 501(a). MERS has contracted with International City/County 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 upon adoption of a Defined Contribution resolution for new hires 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, 2006, there were 133 plans that had adopted the Defined Contribution Plan with 6,831 member accounts totaling $203.1 million.

The MERS Defined Contribution Plan with ICMA-RC offers a variety of investment opportunities, including the MERS Total Market Fund, (the same diversified fund utilized for its Defined Benefit portfolio) for the Defined Contribution Plan participants. In addition, there are other funds offered from selected mutual fund families including the Vantage Trust Funds, which 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 35 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. MERS Health Trust Programs

On January 13, 2004, MERS received a Private Letter Ruling allowing establishment of an Internal Revenue Code Section 115 "Integral Governmental Trust." MERS created two programs from this Trust, the Health Care Savings Program and the Retiree Health Funding Vehicle.

A. Health Care Savings Program

Plan Description

The MERS Health Care Savings Program is available to all municipalities in Michigan and became operational in June of 2004. The employer sponsored program provides medical reimbursement accounts to the participating employees for reimbursement of their medical expenses, as defined in Code Section 213, once they terminate employment, are on medical leave for six months or longer, or are on disability from any public pension plan. There are four types of contributions that may be used in the program: 1. Basic Employer (tax-favored), 2. Mandatory Salary Reductions (tax-favored), 3. Mandatory Leave Conversions (tax-favored), and 4. Voluntary Employee Contributions (post-tax). As a result of the Private Letter Ruling, Code Section 213, reimbursements are tax-exempt for the employee, their spouse, and/or Code Section 152 dependent(s). The Health Care Savings Program accounts are invested in the MERS Total Market Fund portfolio and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document, and Trust.

Significant Accounting Policies

The Health Care Savings Program financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a commingled basis subject to the Public Employee Retirement System Investment Act ("PERSIA"), 1965 PA 314, and pursuant to the Public Employee Health Care Fund Investment Act, 1999 PA 149.

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 separate individual member account records.

B. Retiree Health Funding Vehicle

Plan Description

The MERS Retiree Health Funding Vehicle is available to all municipalities in Michigan and became operational in the fall of 2004. Participating municipalities can contribute monies to the Trust and no contribution method other than "pay as you go" cash funding is required or imposed on the participating employer. These funds constitute a health care fund, which enable municipalities to accumulate funds to provide or subsidize health benefits for retirees and beneficiaries as defined by Code Section 213. The Retiree Health Funding Vehicle accounts are invested in the MERS Total Market Fund portfolio and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document and Trust.

Significant Accounting Policies
The Retiree Health Funding Vehicle financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a commingled basis subject to 1965 PA 314, and 1999 PA 149.

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

8. Investment Services Program

Plan Description
The Investment Services Program (ISP) is a trust fund that is available to all municipalities to invest funds through the MERS portfolio while maintaining administrative functions at the municipal level. Assets are pooled with the existing $5 billion currently in MERS fund, resulting in reduced costs and increased investment return opportunities for municipalities. The program was established by MERS Board in March 2006 and began operations in June of 2006. MERS offers to any "municipality" (Plan Section 2b(4); MCL 38.1502B(2) pension, "ancillary benefits, health and welfare benefits, and other post employment benefit programs" (Plan section 36(2)(a); MCL 38.1536(2)(a)). The Investment Services Program trust fund complies with all the requirements imposed by the Public Employee Retirement System Investment Act, 1965 Public Act 314. Participation in the Investment Services Program does not qualify as membership in MERS pension plans, and the participating employer is not able to vote at the MERS Annual Meeting.

Significant Accounting Policies
The Investment Services Program financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a commingled basis subject to 1965 PA 314.

Reserve for Investment Services Program
All additions to and deductions from the Investment Services Program are recorded in this reserve. MERS maintains the separate municipality employer account records.

9. Interfund Receivables and Payables

The Defined Benefit Plan, Retiree Health Funding Vehicle, Investment Services Program, and the Health Care Savings Program are separate trusts with their own general ledgers and financial statements. Interfund receivables and payables have been created as an avenue for the Defined Benefit Plan to handle all transactions for the various funds.

As of December 31, 2006, interfund receivables and payables were:

Interfund Receivables and Payables

	Interfund Receivables	Interfund Payables
Defined Benefit Plan	$ 673,283	$ 529,021
Defined Contribution Plan		
Health Care Savings Program		538,266
Investment Service Program	529,021	
Retiree Health Funding Vehicle		135,017
Totals	$ 1,202,304	$ 1,202,304

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)
1999	$ 3,464.9	$ 3,835.5	$ 370.6	90.30%	$ 1,179.3	31.4 %
2000	3,787.2	4,397.0	609.8	86.10	1,226.0	49.7
2001	4,034.4	4,783.9	749.5	84.30	1,271.6	58.9
2002	4,133.0	5,181.2	1,048.2	79.80	1,327.4	79.0
2003	4,459.5	5,667.7	1,208.2	78.70	1,381.2	87.5
2004	4,731.4	6,164.8	1,433.4	76.70	1,437.2	99.7
2005	5,026.1	6,609.1	1,583.0	76.05	1,462.4	108.2

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
2001	$ 118	$ 15	103 %	118 %
2002	125	8	102	109
2003	133	5	121	125
2004	156	2	108	109
2005	170	-	108	108
2006	199	-	107	107

See notes to the Schedules of 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 2006 were determined by actuarial valuations as of December 31, 2004.

   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 been modified several times. The program reduced required contribution rates of municipalities with funded percentages in excess of 100%. The program was discontinued beginning with the fiscal year 2005 but is useful for the reader for the Schedule of Employer Contributions.

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 as follows:

Valuation Date	December 31, 2005
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percent of Payroll, Open
Remaining Amortization Period	30 years for positive unfunded liabilities and 10 years for negative unfunded liabilities. For divisions that are closed to new hires, the amortization period for positive unfunded liabilities is decreased annually by 2 years until the period reaches 5 years. Beginning in 2006, there will be a gradual reduction of the amortization period for open divisions from 30 years to 25 years

Asset Valuation Method	10-Year Smoothed Market Asset Valuation Method was adopted December 31, 2005 with prospective application. Prior to 2006 a five year smoothed method was used. (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 was recognized for 2003. The aggregate loss amount of $388,778,035 was to 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 8.4% per year attributable to merit and longevity.
Post Retirement Benefit	2.5% annual post retirement benefit adjustments if adopted by individual municipality.

Schedule of Administrative Expenses for the Year Ended December 31, 2006

Administrative Expenses		
Personnel Services		
Salaries	$	4,223,025
Social Security		309,694
Retirement		544,387
Insurance		651,292
Total Personnel Services		5,728,398
Professional Services		
Actuarial Services		786,106
Audit Services		57,000
Commercial Banking		90,118
Computer Maintenance		42,836
Consultants		36,491
Legal Services		122,815
Medical Services		50,025
Total Professional Services		1,185,391
Communication		
Advertising		4,576
Annual Meeting		249,758
Library and Records Storage		84,192
Postage / Shipping		115,868
Printing and Copying Services		96,646
Promotional Supplies		7,153
Telephone / Communications		97,841
Travel and Meetings*		253,093
Total Communication		909,127
Rentals		
Equipment Rental		150,462
Office Rental		704,500
Total Rentals		854,962
Miscellaneous		
Depreciation		1,415,160
Equipment Purchases		87,099
Insurance		231,953
Maintenance		236,218
Office Supplies		89,216
Operating Expenses		823,957
Payroll Processing		12,424
Professional Development & Tuition		324,927
Software Purchases and Maintenance		641,178
Total Miscellaneous		3,862,132
Total Administrative Expenses	$	12,540,010

* MERS Board members serve without compensation and are only reimbursed for their travel expenses.

Schedule of Investment Expenses for the Year Ended December 31, 2006

Investment Expenses		
Personnel Services		
Salaries	$	447,622
Social Security		39,295
Retirement		71,718
Insurance		72,014
Total Personnel Services		630,649
Professional Services		
Commercial Banking		471,511
Investment Managers		15,531,233
Investment Performance		79,500
Total Professional Services		16,082,244
Communication		
Travel		40,981
Total Communication		40,981
Miscellaneous		
Depreciation		20,340
Operating Expenses		3,131
Software Purchases/Maintenance		255,016
Total Miscellaneous		278,487
Total Investment Expenses	$	17,032,361

Schedule of Payments to Consultants for the Year Ended December 31, 2006

Firm	Nature of Service		Fee
Gabriel, Roeder, Smith & Company	Actuary and System Implementation	$	2,908,422
Robbins-Gioia, LLC	FileNet System Implementation		197,000
Oracle (PeopleSoft) Corporation	System Implementation and Maintenance		170,541
Ice Miller	Legal Counsel		82,396
SunGard Availabilty Services	Disaster Recovery		55,200
Consulting Physicians, PC	Medical Advisors		45,400
Andrews Hooper & Pavlick P.L.C.	Auditor		38,500
Karoub Associates	Legislative Advisors		30,000
Slater and Slater, Inc.	System Security Advisor		30,000
New London Management	Human Resource and Career Advisors		29,290
Service Express	Hardware Maintenance		26,762
Matt Wesaw	Tribal Government Consultant		16,500
Ideal Solutions	Web Design Service		13,222
eVestment Alliance	Investment Analytics System		11,000
		$	3,654,233

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