


Memorandum

To: Board of Retirement
From: Jim Andersen, Retirement Administrator 
Date: March 18, 2009
Re: Results of Pension Systems Survey

Introduction

On October 16, 2008, John Dickerson released a report entitled ***Mendocino County's Long-Term-Debt***. Before and after the release of the full report, Mr. Dickerson also wrote a number of newspaper articles, has been a guest of other media, and maintains a website, ***YourPublicMoney.Com***, describing his findings and defending the conclusions of his report. The report itself is quite broad, with many of the issues falling outside the authority and activities of the Mendocino County Employees' Retirement Association (MCERA). However, the report does contain serious assertions about the performance of the Board of Retirement, its staff and its financial advisor that need to be addressed. This is especially true given the legal fiduciary responsibility of the Board of Retirement for the prudent safeguarding of the pension assets. Failure to respond to Mr. Dickerson could result in the erosion of confidence from the public, the County as the sponsoring agency, and active and retired members relative to the management and security of their pension assets. As I just mentioned, the report is broad, and this memorandum is intended to address only one significant assertion made by Mr. Dickerson: "... the County Pension Fund's return on investment was the worst of any county system in the State." This claim was one of three fundamental points put forward by Mr. Dickerson in his article ***Mendocino County - \$300 Million of Crushing Debt***. So, I liken this process of responding to his data, findings, and conclusions, whether by the Association or the County, to systematically going through the house, looking in every closet and under every bed to assure the household that the boogey man is not hiding there. This is simply the first closet to be opened.

I should note that the Board of Retirement believes in the transparency of the operations of the Association and supports a review of our comparative performance to other pension systems. This attitude pre-dates my short tenure as the Retirement Administrator (since November of 2008), however it has been further reinforced by the recent creation of a website, www.co.mendocino.ca.us/retirement, and televising board meetings in cooperation with Ukiah Valley Television. In addition, the Association has actively encouraged its professional association, the State Association of County Retirement Systems (SACRS), to conduct a comparative study of county pension systems on a recurring basis. Santa Barbara County Employees' Retirement Association will be undertaking the next study for December 31, 2008; the first was completed by MCERA.

Finally, before launching into our report methodology and findings, I should acknowledge that Mr. Dickerson spent a great deal of time researching the issues in his report, and his effort to create a community dialogue that ultimately results in a more engaged and informed citizenry is a good thing. Notwithstanding this contribution to a community dialogue, there is some question of his intent. Mr. Dickerson refers to the State Controller's Office (SCO) in his report and SCO staff as confirming his data. Betty Moya, Manager, Local Government Reporting Section, states in a memo dated November 25, 2008 (Attachment B) on behalf of John Chaing, State Controller, "In emails to us, Mr. Dickerson, admitted earlier that his timing of the website's release was political and that he was trying to get some board members removed and replaced with others. Along that line, the wording and the tone of his website and reports appear inflammatory." The same tone and effort to ascribe blame can be found throughout Mr. Dickerson's report, and, as such, any reader may wish to view the report and its contents as much a political commentary as an analytical work product.

Methodology

In preparing to respond to the assertion of Mr. Dickerson that the Association's return on investment was the worst in the state, the Association began with a few fundamental questions:

1. Is there an industry standard, or best practice, for measuring return on investment? If so, what are the measurements (or metrics)?
2. Can we collect this data from all pension systems, and what would be the best approach given our interests in accuracy, defensibility and timeliness?
3. Is the data publicly available, so that any interested member of the public could replicate our analysis and arrive at the same findings and conclusions?

Is there an industry standard, or best practice, for measuring return on investment? If so, what are the measurements (or metrics)?

The short answer to the first question is, "Yes." There are industry standards for measuring the performance of an investment portfolio. The starting point for evaluating the performance is the **Total Return**. *Barron's Dictionary of Finance and Investment Terms* defines Total Return as, "...annual return on an investment including appreciation, dividends, or interest, or other distributions." In lay terms, it's everything you get back from what you invested (including the market value increase at time of measurement). There are other methods used to evaluate return on your investment, such as your "risk adjusted" returns, returns net of fees, etc., and these measures can be very helpful to managing an investment portfolio, however, Total Return is the standard measurement. Given its simplicity, Total Return is also the metric least likely to suffer from variability in computations between investment consultants. Total Return is computed as a measurement for one, three and five year time horizons, with quarterly returns for the most recent year. As a result, in our research we focused on the comparable Total Returns of all county sponsored pension systems in California, both those created under the County Employees' Retirement Law of 1937 (1937 Act) and CalPERS.

Mr. Dickerson used Yield on Assets (AY) as calculated by the State Controller's Office (SCO). Betty Moya, in her letter noted above, did communicate to Mr. Dickerson that it appeared that he had copied the AY information correctly, however, she went on to express "that the analysis and conclusions were

Mr. Dickerson's." Ms. Moya also wrote, "The average yield (AY) (*data used in his report*) is not the actual interest earned or the return on investments ... **the calculated AY was less than MCERA's actual return on investment ... so your term 'actual yield on assets' may be misleading and it's definitely not the ROI** (*emphasis added*). A disclaimer should be noted."

The other measures that are fundamental to evaluating the performance of an investment portfolio, in this case a pension fund, are **Standard Deviation** and the **Sharpe Ratio**. Standard Deviation, for a portfolio is calculated by taking the average Total Return over three or five years, and then determining the range to which annual Total Returns varied from this average. The outcome is a measurement of variability, or risk. How much variability (risk) was involved in achieving your Total Return? A higher Standard Deviation signifies a higher level of risk. The Sharpe Ratio is a calculation of the reward to the risk, how much return did you get for the risk that you took; the higher the ratio the more return you received for the risk taken. Again referring to **Barron's**, the Sharpe Ratio is calculated by subtracting the risk free return from the average return, and dividing by the standard deviation of return. While I know that some of this may sound like Greek, we understand that the audience for this information ranges from those who would like a simple answer to those who are well versed in investment theory and wish to understand if we have taken such metrics into account. Where possible, we have collected the Standard Deviation for 5 years from other systems, and calculated the Sharpe Ratios as well.

Before I go on to the final two methodology questions, it is important to describe the use of indices in evaluating the investment performance of a portfolio, or pension system. When an investment portfolio is constructed, there is an evaluation of the number of asset classes, or types, into which investments are made. For example, what percentage stocks (equities), bonds, real estate, and other asset classes? Within these asset classes, the allocation is further broken down. For example, within equities, there is a range of small cap, medium cap, large cap and foreign stocks, which help to manage risk and achieve a targeted return. Even within those asset classes, decisions are made about growth and value equities. For each of these asset classes, and sub classes, there are industry accepted "indices" or "benchmarks" that assist in understanding how your asset class is performing against a much broader group of assets in each category. Ultimately, all indices are rolled up, on a weighted average based on the dollars allocated to each asset class, to produce a "Policy Index." That is the benchmark for your entire portfolio of assets. As you will see in our findings, we also collected the Policy Index for each system to show how Total Returns compared to the broader market (given each county's unique allocation of assets).

Can we collect this data from all pension systems, and what would be the best approach given our interests in accuracy, defensibility and timeliness?

Yes, we can collect this information from all systems. Given that a calculation of the Total Return for one, three and five year periods is a standard in the industry, all systems receive this information from their investment advisors (either internal or external). The information is also typically found in the Comprehensive Audited Financial Report (CAFR) for each retirement association. In an effort to collect the information in as timely a manner as possible, Mr. Tim Knudsen sent out a survey to each retirement system requesting the Total Return and Standard Deviation information. As of the writing of this report, all counties except Marin and Orange had responded. We were also able to obtain information from CalPERS from their CAFR. The source documents containing the survey results can be found at the MCERA office, and will be posted to its website as soon as possible. Also, the

information can be found from the respective county retirement system, located through SACRS, at www.sacrs.org.

Is the data publicly available, so that any interested member of the public could replicate our analysis and arrive at the same findings and conclusions?

Yes, all of the information that we received is public record, and could be collected by anyone interested in replicating our study. As noted, the information is normally found in each Association's CAFR, and/or in quarterly investment reports to the respective boards of retirement. Again, please go to www.sacrs.org for contact information for all SACRS pension systems. No manipulation of the data is needed (with the exception of arithmetically calculating Sharpe Ratios), so outcomes should be consistent for any and all inquiries.

Findings

The results of our survey are found in Attachment A. Briefly, what the survey results show is:

1. For the five year period ending June 30, 2008, the Mendocino County Employees' Retirement Association Total Return exceeded all retirement systems that responded except three: San Diego, Los Angeles and San Bernardino. The Total Return for the five year period was 10.74%, against a Policy Index of 9.9%. For the three and one year periods ending June 30, 2008, the Total Returns of 8.36% and (3.82%) were only exceeded by three and four systems, respectively.
2. For each of those time periods, the Association's Total Return exceeded that of CalPERS, which creates a comparison to the Total Return of the 37 California counties that were not formed under the 1937 Act or are independent.
3. The Standard Deviation for the Association during the past five years was 7.32%, which was within the range of the Standard Deviation for those systems surveyed (5.00% to 8.40%). The Standard Deviation achieved essentially the same level of risk as our benchmark, varying by 0.12%. In addition, the Sharpe Ratio of 1.05 was only exceeded by 4 of the 14 counties providing the Standard Deviation needed to perform the calculation.
4. The collective findings above demonstrate the assertion by Mr. Dickerson that the MCERA has the lowest return on investment is false. Furthermore, the returns were received within the Standard Deviation range of other county systems.

Assumptions and Disclosures

In producing any analysis, it is appropriate to disclose assumptions or disclosures that should be known when evaluating its validity. The following are assumptions and disclosures that I believe are pertinent:

1. Mr. Dickerson's assertion that the Association's return on investment was the lowest of any of the 1937 Act counties over the past ten years is being rebutted with a five year analysis. As noted above, the standard in the industry is to review the past five years Total Return, and as such, we have taken that approach. We have demonstrated that the Association

performed extremely well comparatively during that period. We have not, and do not anticipate at this time, doing the same analysis for the prior five year period. Therefore, the time horizons in our analyses differ. We do believe that it is a reasonable hypothesis, though not tested, that our comparative position would not differ greatly for the previous five year period, as it did not vary much during the most recent five years.

2. Mr. Dickerson's report focused attention on whether or not the Association met its earning assumption of 8% over the past ten years, and, if not, then the return on investment would be a contributor to an increase in unfunded liabilities for the pension system. The most recent quarterly analysis of our pension assets, as of December 31, 2008, that takes into account much of the economic meltdown of the past year, shows a five year Total Return on the investments of 2.67%, against a Policy Index of 2.25%. Looking back at June 30, 2005, the five year Total Return is 5.24%. With two recessionary periods in the past ten years, the Association may not have achieved its 8% earning target during that period. However, the assertion that the Association performed poorly compared to other retirement systems, the specific subject of this study, is still not accurate. In addition, actuaries view the earnings target over the life of the members and their beneficiaries. It is not uncommon to achieve earnings above the target during some periods and below the target during others. The five year investment data assists the Board of Retirement in making informed decisions about its asset allocation strategy, which is formally revisited every three years and less formally reviewed on an ongoing basis. The three and five year investment review and planning horizons are a tool within a larger plan – to assess and reconsider investment strategies to support the 8% return assumption over a much longer actuarial time horizon.
3. As noted in my introduction, this study addresses the assertion that "... the County Pension Fund's return on investment was the worst of any county system in the State." Given the breadth and number of assertions in Mr. Dickerson's report, the anxiety and doubt that it could produce in the public, sponsoring agency, and the members, and the fiduciary success of the Board of Retirement that is brought into question, I believe it is necessary to address this issue independently and in a timely fashion. However, there is a risk that biting off pieces of Mr. Dickerson's report could result in missing the broader dialogue of establishing public policy with a disciplined eye toward future costs (including actuarial liabilities). It is not the desire of the Association to avoid such discussions; in fact it is quite the opposite. The Board of Retirement views ongoing dialogue as helpful in ensuring the proper assessment of proposed policies and their impact on any of its underlying actuarial assumptions.
4. Finally, I noted in my introduction Mr. Dickerson's admission of his political motivations when writing his report, articles, website, etc. It is only appropriate that I disclose my role from 1999 to 2004 in the County Administrative Office as the County Administrative Officer. The reader should be aware of that as well. I have done my best to produce an analysis that is consistent with industry practices and, very importantly, is replicable by any other individual. In that manner, any reader who may wonder if this analysis may be skewed due to my involvement in previous policy recommendations can readily test the MCERA analysis.

Concluding Remarks

The data show clearly that the Mendocino County Employees' Retirement Association's investments are being managed in a fashion that provides returns on investments that are competitive with any system in the state. Not only are Total Returns competitive, but the Board of Retirement, working with current and past administrators, and our investment consultant, has established an asset allocation strategy that manages risk in a fashion that does not unduly inhibit returns while protecting future pension payments to active and retired members.

Finally, I would like to acknowledge Tim Knudsen, retired Treasurer/Tax-Collector and Retirement Administrator for conducting the survey and doggedly pursuing timely responses from agencies that are busy addressing the recent economic crisis. I would also like to thank those counties that responded and assisted us in completing the survey. A copy of the survey results will be distributed to each county system.

I look forward to the community dialogue on this issue, and the others raised in Mr. Dickerson's report.

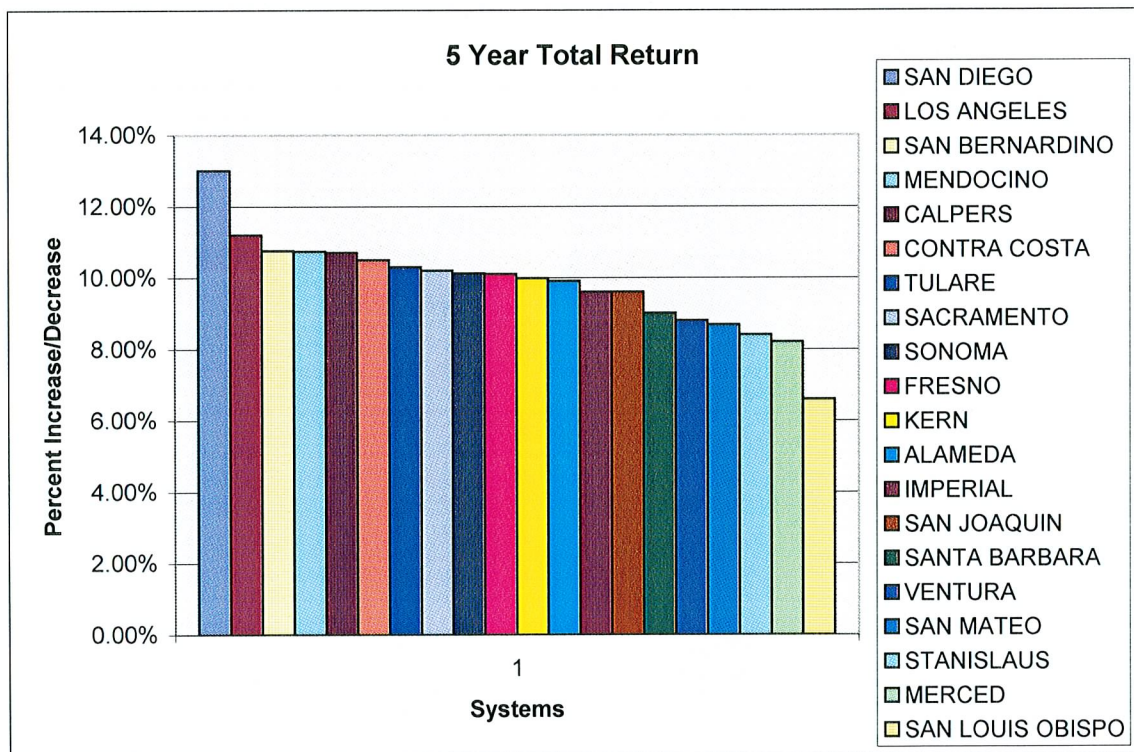
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Attachments

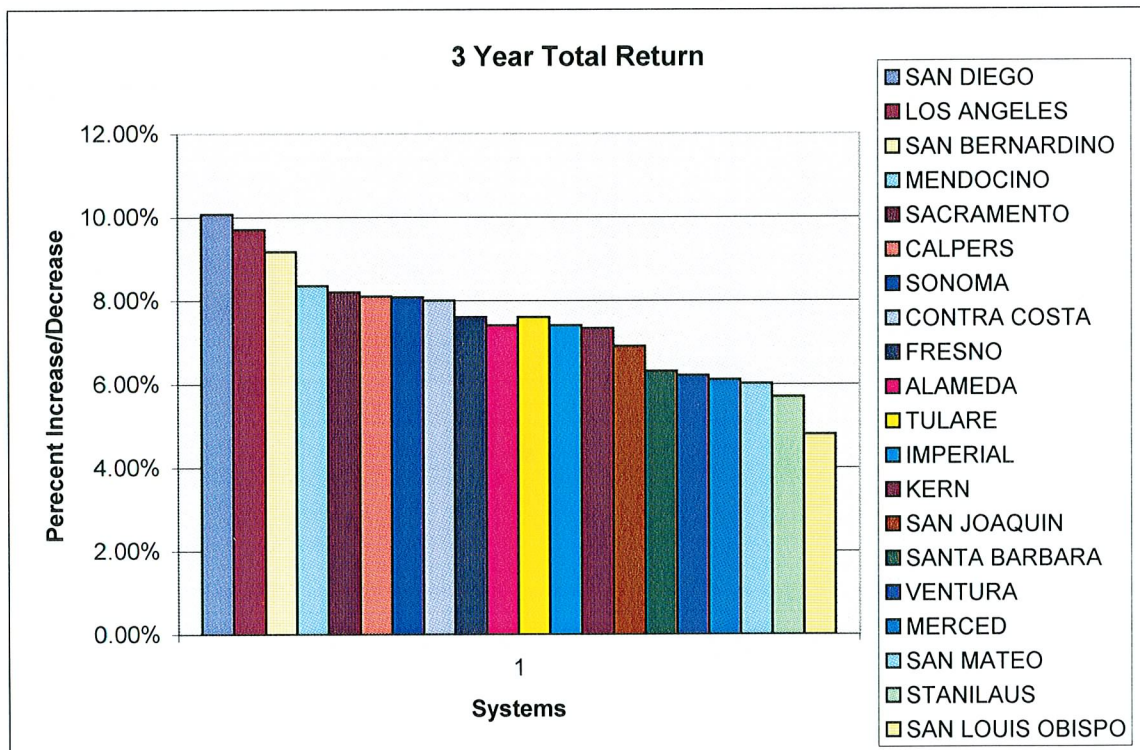
Copy Board of Supervisors
 Peter Chan, Investment Consultant
 Betty Moya, State Controller's Office

ATTACHMENT A

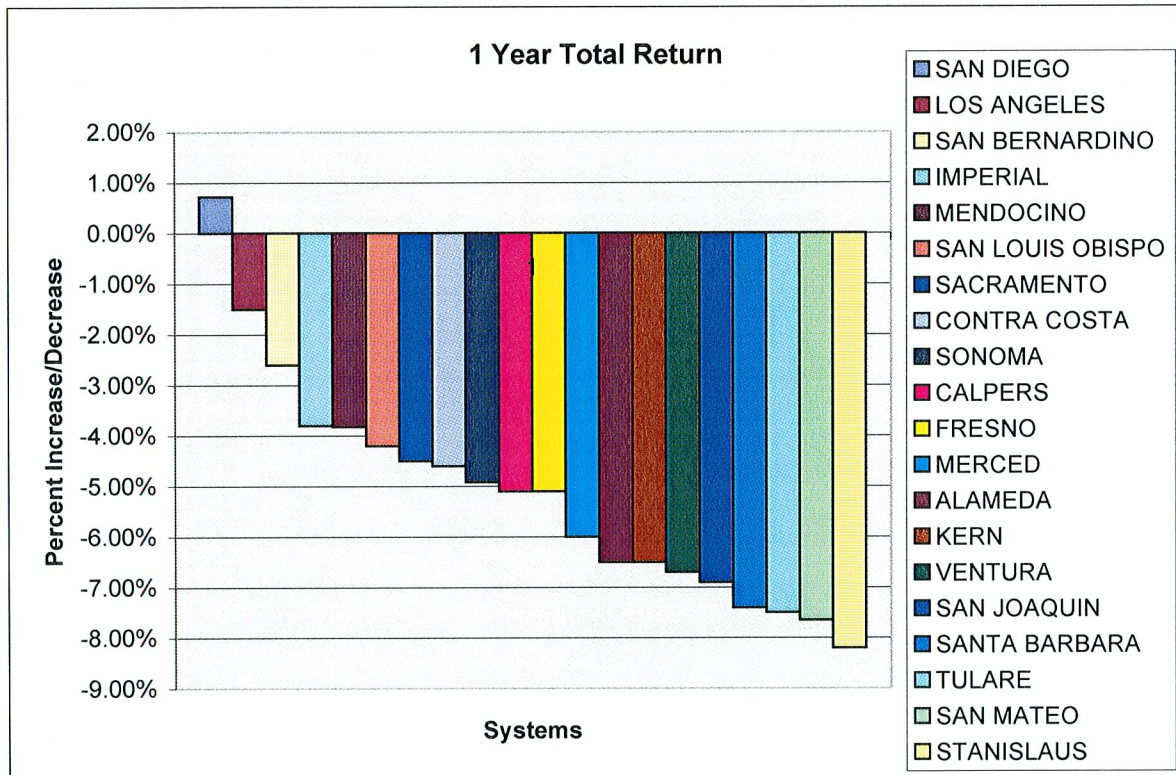
	5 YEAR TOTAL POLICY RETURN	5 YEAR POLICY BENCH MARK	VARIANCE
1 SAN DIEGO	13.00%	12.09%	0.91%
2 LOS ANGELES	11.20%	10.10%	1.10%
3 SAN BERNARDINO	10.76%	10.18%	0.58%
4 MENDOCINO	10.74%	9.90%	0.84%
5 CALPERS	10.70%	10.40%	0.30%
6 CONTRA COSTA	10.50%	6.20%	4.30%
7 TULARE	10.30%	9.90%	0.40%
8 SACRAMENTO	10.20%	10.30%	-0.10%
9 SONOMA	10.12%	9.63%	0.49%
10 FRESNO	10.10%	9.00%	1.10%
11 KERN	9.98%	9.96%	0.02%
12 ALAMEDA	9.90%	10.20%	-0.30%
13 IMPERIAL	9.60%	8.00%	1.60%
14 SAN JOAQUIN	9.60%	9.30%	0.30%
15 SANTA BARBARA	9.00%	9.90%	-0.90%
16 VENTURA	8.80%	9.80%	-1.00%
17 SAN MATEO	8.68%	9.40%	-0.72%
18 STANISLAUS	8.40%	8.70%	-0.30%
19 MERCED	8.20%	7.50%	0.70%
20 SAN LOUIS OBISPO	6.60%	7.20%	-0.60%



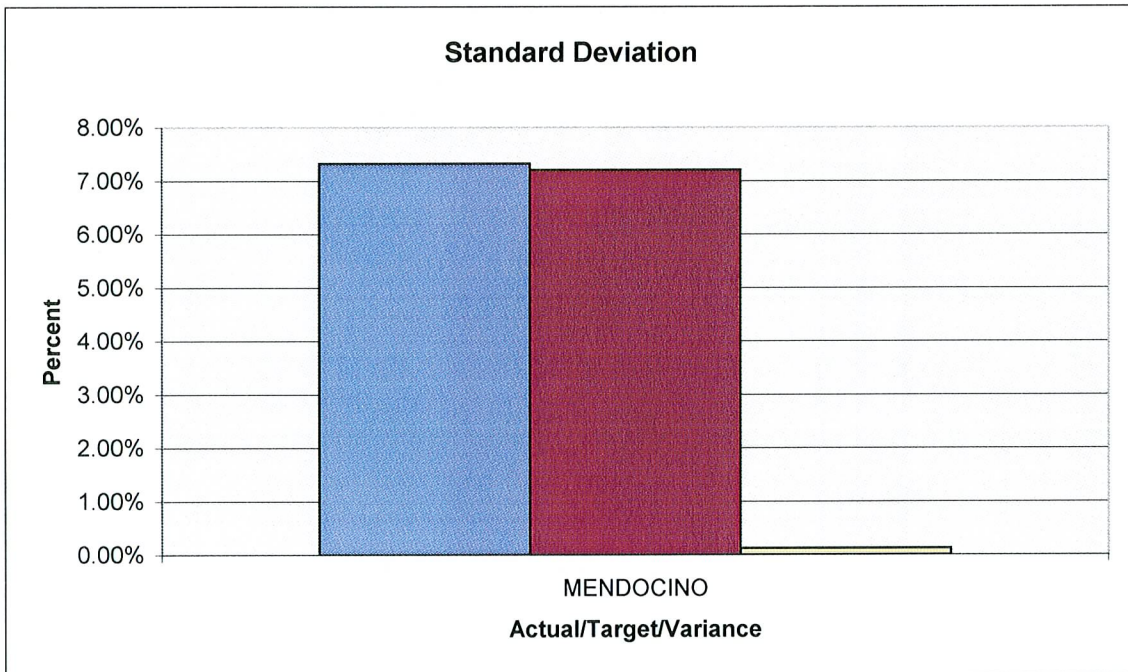
	3 YEAR TOTAL POLICY RETURN	3 YEAR POLICY BENCH MARK	VARIANCE
1 SAN DIEGO	10.07%	9.96%	0.11%
2 LOS ANGELES	9.70%	8.20%	1.50%
3 SAN BERNARDINO	9.17%	8.49%	0.68%
4 MENDOCINO	8.36%	7.12%	1.24%
5 SACRAMENTO	8.20%	8.20%	0.00%
6 CALPERS	8.10%	8.40%	-0.30%
7 SONOMA	8.08%	7.54%	0.54%
8 CONTRA COSTA	8.00%	5.80%	2.20%
9 FRESNO	7.60%	6.60%	1.00%
10 ALAMEDA	7.40%	8.00%	-0.60%
11 TULARE	7.60%	7.60%	0.00%
12 IMPERIAL	7.40%	6.40%	1.00%
13 KERN	7.33%	7.82%	-0.49%
14 SAN JOAQUIN	6.90%	7.20%	-0.30%
15 SANTA BARBARA	6.30%	7.30%	-1.00%
16 VENTURA	6.20%	7.60%	-1.40%
17 MERCED	6.10%	5.70%	0.40%
18 SAN MATEO	6.01%	7.03%	-1.02%
19 STANILAUS	5.70%	6.40%	-0.70%
20 SAN LOUIS OBISPO	4.80%	5.40%	-0.60%



		1 YEAR TOTAL POLICY RETURN	1 YEAR POLICY BENCH MARK	VARIANCE
1	SAN DIEGO	0.72%	1.66%	0.10%
2	LOS ANGELES	-1.50%	-1.60%	0.89%
3	SAN BERNARDINO	-2.60%	-1.31%	-0.20%
4	IMPERIAL	-3.80%	-3.90%	-1.40%
5	MENDOCINO	-3.82%	-4.71%	-0.90%
6	SAN LOUIS OBISPO	-4.20%	-4.00%	-0.42%
7	SACRAMENTO	-4.50%	-3.10%	-2.80%
8	CONTRA COSTA	-4.60%	-3.70%	0.30%
9	SONOMA	-4.92%	-4.50%	-0.20%
10	CALPERS	-5.10%	-2.30%	-2.80%
11	FRESNO	-5.10%	-5.40%	-2.67%
12	MERCED	-6.00%	-5.80%	-2.60%
13	ALAMEDA	-6.50%	-3.70%	-2.50%
14	KERN	-6.50%	-3.83%	-1.80%
15	VENTURA	-6.70%	-4.10%	-3.00%
16	SAN JOAQUIN	-6.90%	-4.40%	-2.73%
17	SANTA BARBARA	-7.40%	-5.60%	-3.10%
18	TULARE	-7.50%	-4.50%	0.00%
19	SAN MATEO	-7.65%	-4.92%	0.00%
20	STANISLAUS	-8.20%	-5.10%	0.00%

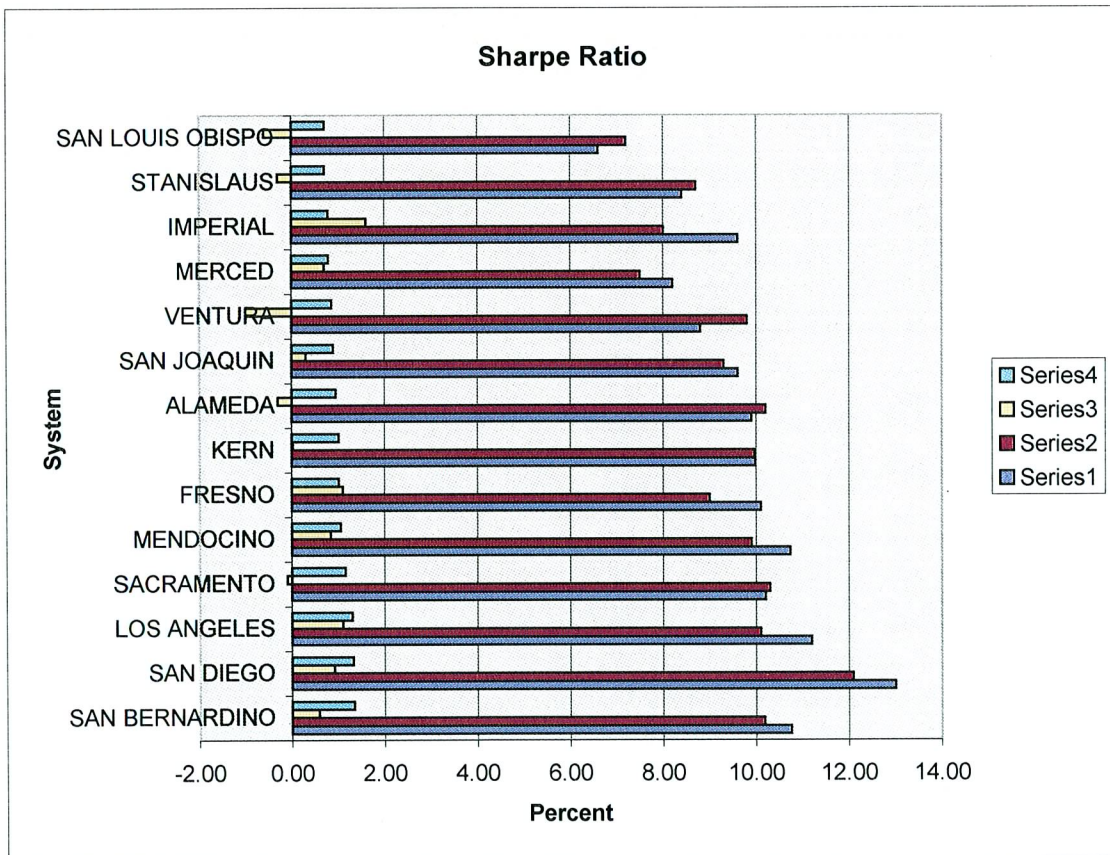


	5 YEAR STANDARD DEVIATION	5 YEAR SD POLICY INDEX	VARIANCE
SAN LOUIS OBISPO	5.00%	5.10%	-0.10%
FRESNO	7.00%	6.90%	0.10%
SAN BERNARDINO	5.77%	5.89%	-0.12%
MENDOCINO	7.32%	7.20%	0.12%
SACRAMENTO	6.20%	6.00%	0.20%
KERN	6.90%	6.55%	0.35%
MERCED	6.50%	6.10%	0.40%
VENTURA	6.70%	6.20%	0.50%
LOS ANGELES	6.26%	5.72%	0.54%
SAN DIEGO	7.56%	8.11%	-0.55%
ALAMEDA	7.20%	6.60%	0.60%
IMPERIAL	8.40%	7.70%	0.70%
STANISLAUS	7.50%	6.60%	0.90%
SAN JOAQUIN	7.40%	6.50%	0.90%



SHARPE RATIO OF 1937 ACT COUNTIES FOR 5-YEAR PERIOD ENDING 6/08

	5 YEAR PLAN RETURN	5 YEAR PLCY INDEX RETURN	ABSOLUTE VALUE ADDED RETURN	SHARPE RATIO
CALPERS	10.70	10.40	0.30	NA
CONTRA COSTA	10.50	6.20	4.30	NA
TULARE	10.30	9.90	0.40	NA
SONOMA	10.12	9.63	0.49	NA
SANTA BARBARA	9.00	9.90	-0.90	NA
SAN MATEO	8.68	9.40	-0.72	NA
SAN BERNARDINO	10.76	10.18	0.58	1.34
SAN DIEGO	13.00	12.09	0.91	1.32
LOS ANGELES	11.20	10.10	1.10	1.30
SACRAMENTO	10.20	10.30	-0.10	1.15
MENDOCINO	10.74	9.90	0.84	1.05
FRESNO	10.10	9.00	1.10	1.01
KERN	9.98	9.96	0.02	1.01
ALAMEDA	9.90	10.20	-0.30	0.95
SAN JOAQUIN	9.60	9.30	0.30	0.89
VENTURA	8.80	9.80	-1.00	0.86
MERCED	8.20	7.50	0.70	0.79
IMPERIAL	9.60	8.00	1.60	0.78
STANISLAUS	8.40	8.70	-0.30	0.71
SAN LOUIS OBISPO	6.60	7.20	-0.60	0.71



ATTACHMENT B



JOHN CHIANG
California State Controller
Division of Accounting and Reporting

November 25, 2008

John Dickerson
Your Public Money
P.O. Box 301
Redwood Valley, CA 95470

Re: Questions Concerning MCERA and Your Website

Dear Mr. Dickerson:

This is in response to the e-mail you sent to me on November 3, 2008, where you asked for our comments regarding your website entitled YourPublicMoney.com where you compare Mendocino County Employees' Retirement Association (MCERA) to other county retirement systems. You asked several questions about whether the data you copied from several years of SCO's Public Retirement Systems Annual Report was copied correctly, whether you interpreted it correctly, and whether your additional analysis was sound.

Sharon Wurst reviewed your questions and the data provided in your email in order to reply to your questions (see attached). Sharon has been the primary reviewer of the Public Retirement Systems Annual Report for the last several years and is familiar with the data involved.

In the future, please do not ask us to proof the data supplied, and subsequent analysis, on a political website as we do not have extra staff, or time, available to address these issues. If you have any questions, please contact me at (916) 324-8363.

Sincerely,

BETTY J. MOYA, Manager
Local Government Reporting Section

Attachment

cc: Timothy J. Knudsen
Interim Retirement Administrator

BJM:sw

Attachment

To: Betty Moya, Manager
Local Government Reporting Section

Mr. John Dickerson has started a new website, YourPublicMoney.com where he plans on providing information on all local governments, taken from our publications and other sources, in order for concerned citizens to see how their own local government compares to others. As a citizen of Mendocino County, Mr. Dickerson started there first and released his website early with an abridged version of only Mendocino County. In emails to us, Mr. Dickerson, admitted earlier that his timing of the website's release was political and that he was trying to get some board members removed and replaced with others. Along that line, the wording and the tone of his website and reports appear inflammatory.

We have been contacted by Mendocino County and asked if the information reported was factual. We replied that the data itself appeared to have been taken directly from our publications but that the analysis and conclusions were Mr. Dickerson's. Shortly afterwards, Mr. Dickerson asked us to review the data and his analysis.

I have reviewed and analyzed the data submitted and have attempted to answer Mr. Dickerson's questions fairly and without taking sides. Mr. Dickerson's questions and my answers follow:

1. Did I correctly copy the Yield on Assets values for MCERA?

Yes, I traced the majority of the data to the "Summary of Average Yield's Table" in SCO's published Public Retirement Systems Annual Reports.

2. Do these values substantially represent MCERA's actual Yield on Assets, or Return on Investments, over these years?

The average yield (AY) is not the actual interest earned or return on investments. It is a simplified method using "Investment Income divided by $\frac{1}{2}$ (Beginning of year fair value of total assets, less current liabilities plus End of year fair value of total assets, less current liabilities minus Investment Income earned during the year)" to approximate the rate earned. The calculated AY is less than MCERA's actual return on investment (ROI). For example, in 2004 the AY calculated to 15.7%, but the actual ROI earned was 18.05%. While in 2005 the AY was calculated to 9.6%, but the actual ROI earned was 10.87%.

So your term "actual yield on assets" may be misleading and it's definitely not the ROI. A disclaimer should be noted.

3. Did I correctly copy the Yield on Assets values for the other Counties?

Yes, I traced the majority of the data to the "Summary of Average Yield's Table" in SCO's published Public Retirement Systems Annual Reports.

Attachment

4. **Do these values substantially represent these systems' actual Yield on Assets, or Return on Investments, over these years?**

See answer to question #2. However, not every county has a target rate of 8%. Also, the 8% is actuarially determined and is an estimated return on investments taking into consideration future estimated salary increases, inflation, and the composition of investments.

5. **In General, is it "rationally" (that is "mathematically") valid to compare MCERA's average Yield on Assets to those of the other 20 County Systems in this Way?**

If all were calculated in the same manner, then in most cases the answer would be yes. However, in the past, the assets of several counties included healthcare assets because they were unable to separately identify them when they reported to us, so that could distort the presentation. In addition, the title on your Figure 1 is misleading. First, these are not independent counties – they are 1937 Act Counties with one independent county – San Luis Obispo (SLO). Secondly, it should not be called the ROI – it is the Average Yield. I think that's an important distinction (ROI is actual and Average Yield is an average). Also, on Figure 2, I believe the SLO bar graph is incorrect (difference between SLO's 7% and target 8% is 1%. $1\%/8\% = -12.5\%$).

6. **Do you know if Retiree Healthcare payments (in the form of reimbursements to the County) are included in the Service Retirement Benefit Payments for MCERA values in the SCO Annual Report?**

First, the following phrasing is used in the audited financial report for MCERA – "Health insurance benefits for retired employees have been funded by the plan in the past. As of September 1, 1998, the County of Mendocino has assumed responsibility for funding the cost of healthcare for the retired employees of the County of Mendocino, and will be responsible for the cost of healthcare when the Association's (MCERA) healthcare reserves have been totally depleted and earnings on investments are not in excess of required transfers of earnings to retirement reserve accounts."

Second, I can't confirm your Table 3 – Healthcare Payments data, as we don't have those figures for all years. For the years we do, our numbers don't agree with what you reported. However, healthcare benefits have not been included in the SCO Retirement Annual Report for Mendocino County. Our retirement publication is designed to only reflect Pension Benefits, not Other Post Employment Benefits (OPEB). In 2001 and 2002 the healthcare fund was reported separately in MCERA's audited financial statements so it was easy for us to just report the pension fund. I think it is safe to say that prior years would have been presented in the same fashion. But starting in 2003 they were combined with the pension benefits into one column. We had to remove the OPEB from the financial statements so they would not be reflected in the publication. We footnoted this in the 2003, 2004, and 2006 publications. In 2005, we were able to clearly identify the OPEB and remove it from the financial statement presentation and therefore did not need to footnote it.

Therefore, we believe your Table 4 is incorrect, misleading, and should be changed.

Attachment

7. **If a County Retirement System includes Retiree Healthcare Payments in its Service Retirement Benefit Payments, is it supposed to indicate to SCO that they are included even if they can't provide a breakdown? (I assume MCERA did not provide such a note.)**

We state in our guidelines and instructions that we only want the pension benefits reported. In addition, during our reviews, when we find OPEB included in the report we remove it and inform the systems not to include it again. However, the independent auditors address OPEB in the notes to the financials so we can generally determine if it is included. MCERA's audits also clearly showed the Healthcare Plan separately in 2001 and 2002 (I am unable to confirm the prior years as we no longer have those independent audit reports for MCERA). From 2003 forward, the auditor, V. James Sligh, showed healthcare benefit contributions and deductions in the financials so we could identify the amounts. However, since 2003 we have been asking to have the two plans shown separately as they did in prior years and not commingled. As of 2007, the two plans are still commingled.

8. **Is there a "standard" definition SCO uses for "Excess Earnings" in a Retirement Benefits System that relates to this situation (payments for benefits other than pensions that are only supposed to be paid if there are "Excess Earnings")?**

No. On your Table 5, the investment earnings should be called net investment earnings since the investment expenses are deducted. The target ROI of 8% is at estimated gross earnings.

9. **Do the values, either directly or derived from SCO Annual Report, allow a determination of whether or not there were "Excess Earnings" above the 8% target rate of return?**

Currently, we do not show the actual rate of return earned on the investments as reported in the agency's audited financial report under Management's Discussion & Analysis. However, starting with SCO's 2007 Public Retirement Systems Annual Report we are considering including a table showing the estimated rate of return along with the actual ROI for that year along with a 3-year and 5-year average.

10. **Is It accurate to say that there were not adequate Excess Earnings in 5 of those years to fully fund retiree healthcare payments?**

This question would be better addressed by an actuary.

11. **Is it accurate to say that across those 8 years MCERA did not earn enough "Excess Earnings" for that to be the sole source of funds used to reimburse the County's retiree healthcare payments?**

This question would be better addressed by an actuary.

Attachment

12. **Do you see something I don't (a pension accounting rule for example) that would show that MCERA really did have Excess Earnings adequate to pay the retiree healthcare reimbursements to the County?**

As of June 30, 2002, the Healthcare Plan had \$3,334,517 of Net Assets Held in Trust for Post-employment Healthcare Benefits. As of June 30, 2004, there was only \$987,525 remaining excess earnings from prior years, so the county paid the balance of OPEB costs. From that point forward, I am unable to completely identify the pension from the OPEB assets since the pension fund's auditor, V. James Sligh, presents them combined in one column. However, every year OPEB healthcare costs are shown as a separate line item, which suggests to us that MCERA is paying for the costs.

GASB 43 & 45 were established in July 2004. Until then, the majority of retirement systems did not reflect their OPEB liability in their financials. In fact, growing concerns over these invisible liabilities is what led to the passage of GASB 43 and 45. Most retirement systems simply paid the OPEB costs as they occurred on a pay-as-you-go basis. While GASB does not require it, very few systems have set aside specific funds to pay for these costs. However, more and more systems are beginning to provide some kind of pre-funding to help offset the rising costs.

Mendocino County, with annual revenues of over \$100 million should be implementing GASB 45 for fiscal year ending 6/30/08. Once the Actuarial Valuation Report is completed, the results should be stated in the notes to the financials. (See GASB's *Other Post-employment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45.*)

You questioned, "I assume Refunds occur primarily when a former employee transfers the value assigned to "his" or "her" pension to another retirement program?" Actually, we use that category for non-vested members only. It's used for the employee's contributions, including interest, upon separation of service that is being refunded or returned to the employee. Vested members' payments from employer contributions, prior to normal or early retirement, are shown under other benefit payments.

Response in general to the Debt Report:

At one point, you state that MCERA's return on its investments were 17% less than required over 10 years. Actually, the target rate of 8% is estimated and not required.

There's another paragraph where you state, "Excess Earnings would mean the Pension Fund had earned a higher rate of return on its investments than needed to be fully funded." In reality, "excess earnings" simply means the earnings above the targeted 8%. Also stated is the following, "It would mean the Pension Fund can pay all future pension payments that have been earned by employees and have money left over." Again, the 8% target investment rate along with the contribution rates is generally used to cover the normal costs, which is the current year's portion not the future years.