Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)

Financial Statements
and Supplementary Information
for the year ended June 30, 2011

Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)
Financial Statements and Supplementary Information
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Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)
Board of Retirement
June 30, 2011

County Treasurer

Shari Schapmire, Vice Chairperson

Appointed by the Mendocino County Board of Supervisors

Dr. Donald Coursey

Bob Mirata, Chairperson

Ted Stephens

Kendall Smith

Elected Members

Randy Goodman

Dennis Huey, Secretary

Craig Walker

Lloyd Weer

Timothy J. Knudsen, Retiree Alternate

Administration

Jim Andersen - Retirement Administrator

GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report

To the Board of Retirement
Mendocino County Employees' Retirement Association
Ukiah, California

We have audited the accompanying statement of net assets available for benefits of Mendocino County Employees' Retirement Association ("MCERA"), a component unit of the County of Mendocino, as of June 30, 2011, and the related statement of changes in net assets available for benefits for the year then ended. These financial statements are the responsibility of MCERA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Governmental 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MCERA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 MCERA as of June 30, 2011, 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.

Management's Discussion and Analysis on pages 4 and 5, and other required supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

Gallina LLP

Rancho Cordova, California
February 7, 2012

The following section provides an overview and analysis of the Mendocino County Employees' Retirement Association ("MCERA") financial activities for the year ended June 30, 2011. We encourage readers to take into account the information presented here in conjunction with additional information we have furnished in the financial statements.

Assets and Revenues

MCERA's net assets as of June 30, 2011 are $355 million. This amount reflects an increase of 18.3% in net assets during Fiscal Year 2010-2011. Revenues (additions to plan assets) for the year were $79.1 million. This was comprised of $9.6 million of employer contributions, $5.4 million of member contributions and an investment return of $64.1 million. Expenses (deductions in plan assets) for the year were $24.1 million.

MCERA's net assets increased 18.3% in fiscal year 2010-11, reflecting a one year investment return on the total portfolio of 21.87% as reported in the June 30, 2011 quarterly review by Callan Associates. Investment returns can vary significantly from year to year. MCERA maintains a diversified investment portfolio and asset allocation that is structured to meet the long term funding requirements of the plan within an acceptable level of investment risk. The five year investment returns, net of fees, are 5.76%. For the fiscal year ending 2007, excess earnings were declared in the amount of $6.008 million, and were set aside to pay for retiree health benefits.

The MCERA Board reviewed and selected four new managers in 2010-11 to address fixed income, large cap value domestic equities, international equities, and real estate investment targets. The MCERA Board terminated two separate fixed income managers and invested the proceeds in a fixed income mutual fund. MCERA also terminated one passive small cap value domestic equity fund and one international fund. The total portfolio return was 0.28% above its weighted benchmarks for 2010-2011, with 1.24% being attributable to manager performance and (1.53%) attributable to asset allocation. Considering both manager performance and asset allocation, international equities and cash produced a drag on the total return of the portfolio.

The primary sources to finance the benefits MCERA provides to its members are accumulated through income on investments and through the collection of employee and employer contributions. These income sources for the fiscal year ended June 30, 2011 totaled $79.1 million. The increase in revenues can be attributed primarily to investments. The total balance of investment assets increased from approximately $301 million in 2010 to $355 million in 2011. Subsequent to June 30, 2011, asset values have declined to approximately $325 million as of November 30, 2011. Employer contributions are declining due to reductions in the size of the workforce as well as wage concessions from employee bargaining units. MCERA has initiated discussions with its actuary and employers regarding the one year period between the fiscal year end valuation study and the effective date of the recommended employer and employee contribution rates.

Liabilities and Expenses

The primary uses of MCERA assets are the payment of benefits to retirees and their beneficiaries, refunds of contributions to terminated employees, and the cost of administering the system. Benefits paid to retirees increased $0.9 million over the previous fiscal year. An aging work force, management directed reductions in the workforce, wage concessions, and pension reform efforts may result in an acceleration of retirements by members. The most recent triennial actuarial study recommended a reduction in the assumed retirement age. However, the availability of retiree medical benefits and access to medical care may also impact the age at which retirements occur.

Funded Status and Actuarial Reporting

For the fiscal year ending June 30, 2011, the UAAL for MCERA was $124,912,676. This is an increase of $33,128,063 from the prior year. MCERA contracted with a new actuary, The Segal Group, to perform its actuarial valuation and review. A portion of the increase in UAAL can be attributed to changes in actuarial methodology. The funded status dropped from 78.9% to 73.6%. The primary reason for the increase in UAAL is smoothing in investment losses from 2008/09, resulting in an increase of $15,265,854. The new actuaries reallocated a portion of the normal cost to UAAL, resulting in an increase of $9,034,607. Finally, changes in actuarial assumptions (economic and demographic) from the experience study for fiscal years ending June 30, 2009 through 2011 resulted in an increase of $24,042,855. Actuarial gains serving to offset a portion of the increase in UAAL included: actual employer salaries being less than anticipated ($11,362,669); COLA adjustments for retirees being less than expected ($5,886,554); and a reflection that General Members only receive enhanced benefits for future service ($5,604,507).

Request for Information

The financial report is designed to provide the Retirement Board, our membership, tax payers, investment managers and creditors with a general overview of MCERA finances and to account for the money it receives. Questions concerning any of the information in this report or requests for additional financial information should be addressed to:

MCERA
625 B Kings Court
Ukiah, CA 95482

Respectfully submitted,

James Andersen
Retirement Administrator

Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)
Statement of Net Assets Available for Benefits
June 30, 2011

Assets

Investments, at fair value:		
Mutual funds	$ 353,565,325	
Cash equivalents	1,189,486	
Total investments, at fair value		$ 354,754,811
Receivables:		
Member contributions receivable	76,187	
Employer contributions receivable	229,617	
Other receivables	57,574	
Total receivables		363,378
Other assets		3,786
Total assets		$ 355,121,975

Net Assets Available for Benefits

Liabilities:		
Accounts payable	$ 14,829	
Accrued expenses and other liabilities	64,623	
Total liabilities		$ 79,452
Net assets available for benefits		$ 355,042,523

See accompanying notes.

Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)
Statement of Changes in Net Assets Available for Benefits
for the year ended June 30, 2011

Additions to net assets attributed to:			
Investment income:			
Net realized and unrealized appreciation in fair value of investments	$ 56,130,687		
Rent income, net of expenses	24,761		
Interest income	2,460,864		
Dividend income	5,863,549		
Investment expenses	(404,760)		
Total investment income, net		$ 64,075,101	
Contributions:			
Member contributions	5,446,964		
Employer contributions	9,553,955		
Total contributions		15,000,919	
Total additions			$ 79,076,020
Deductions from net assets attributed to:			
Benefits paid to retirees		23,436,295	
Administrative expenses		639,764	
Total deductions			24,076,059
Net increase			54,999,961
Net assets available for benefits:			
Beginning of year			300,042,562
End of year			$ 355,042,523

See accompanying notes.

Note 1: Description of Plan:

Description of Association and Applicable Provisions of the Law:

The Mendocino County Employees' Association ("MCERA" or "the Plan") is an integrated public retirement system established under and subject to the legislative authority of the State of California as enacted and amended the County Retirement Act of 1937 (Chapter 677 Statutes of 1937). MCERA a multiple-employer cost sharing defined benefit plan for the County of Mendocino, the Mendocino County Courts, and the Russian River Cemetery District. MCERA was approved by the Board of Supervisors to become effective January 1, 1948, and was integrated with Social Security on January 1, 1956.

Membership in the Plan at June 30, 2011 consisted of the following:

Retirees and beneficiaries receiving benefits	1,129
Terminated plan members entitled to but not yet receiving benefits	389
Active plan members	1,129
Total	2,647
Number of participating employers	3

A cost-sharing multiple employer plan is a single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members. Other special districts within Mendocino County are eligible, but have not elected to participate.

All permanent employees who work at least 32 hours per week become members of the Plan on the first day of the pay period following employment. Employees are classified as either general or safety (law enforcement) members, and are assigned to one of three tiers based on entry date and job classification.

Retirement benefits offered by the Plan include normal retirement, disability retirement and service-connected disability retirement. A death benefit is available to beneficiaries. An annual cost of living adjustment of no more than 3 percent may be granted by the Board of Retirement. For 2011, the Board of Retirement approved cost of living increases ranging from 1.5% to 3.0%, depending on date of retirement, and became effective April 1, 2011.

Note 1: Description of Plan, continued:

Health 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 health care for the retired employees of the County of Mendocino, and will be responsible for the cost of health care when MCERA earnings on investments are not in excess of required transfers of earnings to retirement reserve accounts. For eligibility for health care coverage, prior to September 1, 1998, retirees must have served 10 years prior to retirement with the County of Mendocino, and retire as an active member. The retiree health benefit program qualifies under section 401(h) of the Internal Revenue Code. Health care payments to reimburse the County of Mendocino for the cost of retiree health care are made from a special reserve that has been established as a result of prior excess earnings. This health care subsidy amounted to $1,709,166 for the year ended June 30, 2011, and is included in the line item for benefit payments and subsidies on the statement of changes in net assets held in trust for pension benefits. This subsidy is net of all health care payments by retirees.

Note 2: Summary of Significant Accounting Policies:

Reporting Entity:

MCERA is governed by the Board of Retirement and is considered an independent entity. The Association is a component unit of the County of Mendocino and is being reported as a Pension Trust Fund in the County's Financial Report in accordance with Governmental Accounting Standards Board Statement No. 14.

Basis of Accounting:

The Association follows Governmental Accounting Standards Board ("GASB") accounting principles and reporting guidelines, and financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Retirement Administrator to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Note 2: Summary of Significant Accounting Policies, continued:

Derivatives:

MCERA's investment policy permits the use of derivative instruments to minimize the exposure of certain of its investments to adverse fluctuations in financial and currency markets and enhance yields. MCERA does not use derivatives for speculative use or to create leverage.

During the year ended June 30, 2011 MCERA had no derivatives in its portfolio.

Custodial Credit Risk:

Custodial risk for deposits in the Mendocino County trust is assumed by the County of Mendocino. Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, MCERA would not be able to recover the value of the investment or collateral securities that are in possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in MCERA's name, and held by the counterparty. MCERA's investment securities are not exposed to custodial credit risk because all securities are held by MCERA's custodial bank in MCERA's name, or by other qualified third party administrator trust accounts.

Except for a statement that duties of the Board of Retirement, MCERA officers and employees shall be discharged with care, skill, prudence, and diligence, MCERA has no formal policy for managing custodial credit risk.

Credit Risk:

Credit risk is the risk that an issuer or other counterparty to a debt instrument will not fulfill its obligations. This is measured by the assignment of ratings by nationally recognized statistical rating organizations. Investment allocation guidelines according to the investment policy are as follows:

	Allowable Range	Current Allocation
U.S. Equity	33% - 43%	38%
Non-U.S. Equity	20% - 30%	25%
U.S. Fixed Income	23% - 33%	28%
Real Estate	4% - 14%	9%

Note 2: Summary of Significant Accounting Policies, continued:

Credit Risk, continued:

MCERA's Investment Policy does not allow for a single investment in real estate that is in excess of 5% of total assets. With respect to common stocks, MCERA has a goal of diversifying the portfolio among a cross-section of industries that have sound long-term growth potential. Similar restrictions apply to fixed income securities.

Interest Rate Risk:

Interest rate risk is the risk that changes in the interest rate will adversely affect the fair value of an investment. MCERA has not adopted a formal policy to manage interest rate risk.

Member Termination:

Upon separation from MCERA, members' accumulated contributions are refundable with interest accrued through the prior June 30 or December 31. Interest on member accounts is credited semiannually on June 30 and December 31. Withdrawal of such accumulated contributions results in forfeiture of the related vested benefits.

Plan Termination:

MCERA is administered in accordance with the provisions of California Government Code Section 31450 and accompanying code sections. California Government Code Section 31483 allows the governing body of the County, the County Courts, or special district, through the adoption of an ordinance or resolution, to terminate the applicability of the plan to employees of the County, Courts, or district whose services commence after a given future date.

Risk Management:

MCERA is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; natural disasters; and major downturns in financial markets. For the past several years, MCERA has obtained coverage from commercial insurance companies for errors and omissions coverage related to activities of the Board of Retirement, but all other risks of loss, except losses due to depreciation in the fair market value of investments, is assumed by the sponsoring employers. MCERA has effectively managed risk through various employee education and prevention programs and careful selection of investments. Expenditures and claims are recognized when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

Note 2: Summary of Significant Accounting Policies, continued:

Risk Management, continued:

The Mendocino County Department of Human Resources has assumed the duties of administering the health care claims of retirees. During the fiscal year ended June 30, 2011 MCERA came into full compliance with Internal Revenue Code Section 401(h) for any flow of funding.

Based on Mendocino County Board of Supervisors Resolution No. 98-147, County Counsel concluded that the County Board of Supervisors was ultimately responsible for the funding, administration and decision-making dealing with all aspects of the Plan. As a result, no incurred but not reported claims were included as liabilities on the financial statements for the year ended June 30, 2011. For the year ended June 30, 2011, MCERA had no excess earnings that can be used for the payment of retiree health benefits.

Current and Future Accounting Pronouncements:

GASB Statement No. 53 - *Accounting and Reporting for Derivative Instruments* became effective for all years beginning after June 15, 2009. This statement provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. If MCERA invests in derivative instruments in the future, this statement will be used to measure, recognize, and disclose those transactions.

GASB Statement No. 61 - *The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34*, modifies certain requirements for inclusion of component units in the financial reporting entity, and amends the criteria for reporting component units as if they were part of the primary government. Although the provisions for this statement are effective for fiscal years beginning after June 15, 2012, it seems to clarify and confirm the existing relationship of MCERA as a component unit of the County of Mendocino.

GASB Statement No. 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for periods beginning after December 15, 2011, will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source.

Subsequent Events:

Management has evaluated all subsequent events through February 7, 2012, the date the financial statements were available to be issued. See Note 7 for additional information.

Note 3: Cash and Investments:

Investments are reported at fair value. Investments that do not have an established market are reported at estimated fair value. All investments listed in the Statement of Net Assets Available for Benefits are registered securities held by the Association's agent in the Association's name. The Board of Retirement has exclusive control over all investments of the Association and is responsible for establishing investment objectives, strategies and policies.

The Board of Retirement has adopted an Investment Policy, which provides the framework for the management of MCERA's investments. The Investment Policy establishes MCERA's investment objectives and defines the principal duties of the Board of Retirement and the investment managers. The asset allocation plan is an integral part of the Investment Policy and is designed to provide an optimum and diversified mix of asset classes with return expectations to satisfy expected liabilities while minimizing risk exposure. MCERA currently employs investment managers to manage its assets subject to the provisions of the investment Policy.

Cash equivalents consist of cash in trust with the Treasurer of the County of Mendocino. Cash from deposits and cash needed for daily operational purposes is held in a pooled account with other County funds. The County Treasurer is responsible for the management, control, and safekeeping of all investments in the pooled fund. Interest on funds in the County investment pool is computed quarterly based on average daily balance. A deposit in the pooled account approximates fair value.

Security transactions are accounted for on a trade date basis. Interest income is recognized when earned and dividend income is recognized on the ex dividend date. Stock dividends or stock splits are recorded as memo items and not affect the total value of the securities. Unrealized gains and losses investments are reported as "net appreciation (depreciation) in the fair value of investments." The calculation of realized gains and losses is independent of the calculation of net appreciation (depreciation) in the fair value of plan investments.

Note 3: Cash and Investments, continued:

The Association's cash and investments stated at fair value as of June 30, 2011, are as follows:

Cash in trust- Mendocino County	$ 1,189,486
Total cash equivalents	1,189,486
U.S. Government and corporate bonds	97,682,320
International equities	85,501,443
Domestic equities - small cap	21,760,587
Domestic equities - mid cap	22,610,177
Domestic equities - large cap	95,465,563
Real estate	30,545,235
Total investments	353,565,325
Total cash equivalents and investments	$ 354,754,811

Note 4: Fair Value Measurement of Investments:

The Financial Accounting Standards Board ("FASB"), establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observed for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2011.

Mutual funds: Valued at the net asset value ("NAV") of shares held by the Plan at year end.

Real estate – property: Valued at cost, which approximates fair value.

The methods described above may produce a fair value calculation that may not be as indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 4: Fair Value Measurement of Investments, continued:

The following tables set forth by level, within the fair value hierarchy, MCERA's investments at fair value as of June 30, 2011:

	Investments at Fair Value as of June 30, 2011			
	Level 1	Level 2	Level 3	Total
Mutual Funds				
Bonds	$ 97,682,320	$ -	$ -	$ 97,682,320
International securities	85,501,443	-	-	85,501,443
Domestic securities	139,836,328	-	-	139,836,328
Real estate	29,806,242	-	738,992	30,545,234
Total investments at fair value	$ 352,826,333	$ -	$ 738,992	$ 353,565,325

The following table sets forth a summary of changes in the fair value of the Plan's Level 3 investments for the year ending June 30, 2011 is as follows:

	Real Estate - Property
Balance, beginning of year	$ 738,992
Unrealized gains (losses)	-
Purchases, sales, issuances and settlements (net)	-
Balance, end of year	$ 738,992

Note 5: Contributions:

Actuarially determined member contribution rates averaged 9.84 percent for the year ended June 30, 2011. The actual rate depends on the member's age at the time of hire, whether regular or safety, and tier. Employers are also required to contribute an actuarially determined rate, averaging 13.25 percent of salary for the year ended June 30, 2011. The employers' rate is adjusted periodically to maintain the appropriate funding status of the plan. The recommended rates for employees and employers for the year ended June 30, 2012 are 9.69 and 19.08 percent, respectively. The employer rates are actuarially determined to provide for the balance of the contributions needed to fund the benefits promised (basic and cost of living), and the amortization of the unfunded actuarial accrued liability.

Note 5: Contributions, continued:

The Plan had an unfunded actuarially accrued liability of $47,154,000 at June 30, 2001. This unfunded liability was being amortized through June 30, 2017, at which time it was anticipated the Plan would be fully funded. In December, 1996, the County of Mendocino issued pension obligation bonds, of which $30,112,488 of the proceeds were contributed to the Plan. In December, 2002, due to a continued downward spiral of market values for MCERA investments, the County of Mendocino issued additional pension obligation bonds. The total of bonds sold was $92,208,602, of which $76,299,000 was transferred to the Plan for additional investment, $13,220,061 was used to defease fifty percent of the 1996 pension obligation bonds, and the remainder of $2,689,541 was used to pay the costs of issuing the bonds. The proceeds from the 2002 pension obligation bonds reduced the unfunded pension liability to less than 10 percent of the actuarially accrued liability at June 30, 2004. The funding agreement in effect prior to July 1, 2009 indicated that the County was not required to fund the UAAL that was not in excess of the target of 10 percent of the total pension liability. In November 2009, that funding agreement was voided by mutual agreement between the Association Board of Retirement and the Mendocino County Board of Supervisors. Subsequent to the funding agreement, the Board of Retirement stipulated that the County of Mendocino must amortize the UAAL over a 30-year period from June, 2009.

For the actuarial valuation for the year ended June 30, 2010, the actuary changed their assumptions regarding withdrawals by inactive members. This change in assumption affected the projected number of inactive members who would withdraw their contributions and forego a retirement, compared to those who would leave their contributions and vested benefits with the Plan and retire at a later date. The actuary formerly used each inactive member's age when determining who would withdraw their funds; now the actuary uses age and years of service for all inactive members. The result was an increase of $3.3 million in the County's contribution for the fiscal year ended June 30, 2012.

The UAAL as of June 30, 2011 is $124.9 million, which the County of Mendocino is required to amortize in the future. The funded ratio at June 30, 2011 is 73.6%, as indicated on the Schedule of Funding Progress on Page 21. The *Actuarial Valuation and Review* report issued by The Segal Company as of June 30, 2011 recommended employer and member contribution rates of 23.3% and 9.84%, respectively. The increase in contribution rates is due to a combination of factors, including lower than expected investment returns, amortization of the unfunded actuarial accrued liability over a smaller than previously projected total payroll and errors made by the previous actuary as described in Note 7.

Note 5: Contributions, continued:

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 follows:

Valuation Date	June 30, 2011
Actuarial cost method	Entry age normal cost method
Amortization method	Level % of payroll for total unfunded liability
Remaining amortization period	28 years (declining) for all UAAL
Asset valuation method	Market value of assets less unrecognized returns in each of the last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five year period, further adjusted, if necessary, to be within 25% of the market value. The valuation value of assets is the actuarial value of assets reduced by the value of the non-valuation reserves.
Actuarial assumptions:	
Investment rate of return	7.75%
Inflation rate	3.50%
Real across-the-board salary increase	0.50%
Projected salary increases *	4.50% to 9.00%
* Includes inflation at	4.00%
Cost of living adjustments	3.00% of retirement income
Years of life expectancy after retirement	General members - RP2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females Safety/Probation members - RP2000 Combined Healthy Mortality Table for males and females with no set back for males and 1 year set forward for females.
Years of life expectancy after disability	General members - RP2000 Combined Healthy Mortality Table for males and females, set forward 2 years. Safety/Probation members - RP2000 Combined Healthy Mortality Table for males and females set forward 4 years.

Note 5: Contributions, continued:

Life expectancy after retirement for employee contribution rate purposes	General members - RP2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females. Safety/Probation members - RP2000 Combined Healthy Mortality Table for males and females with no set back for males and 1 year set forward for females.

Note 6: Reserves:

The Association had contingency reserves of $3,550,728, at June 30, 2011 to fund transfers to retirement reserve accounts in the event that sufficient earnings on investments are not received in the future to fulfill the requirement of transferring current earnings to the extent of 8 percent of retiree reserve balances to those reserves.

Member and employer contributions are allocated to various legally required reserve accounts based on actuarial determinations. A summary of the various reserve accounts, which comprise net assets available for pension and other benefits at June 30, 2011 (under the five-year smoothed market asset valuation method for actuarial valuation purposes) is as follows:

Employee reserves	$ 64,911,013
Employer reserves	(25,774,820)
Retiree reserves	264,051,864
Undesignated reserves (see Note 7)	658,654
1% contingency reserves	3,550,728
Miscellaneous reserves	22,475
Total reserves	307,419,914
Cummulative unallocated net unrealized gain on investments	44,520,819
Total allocated reserves (smoothed market actuarial value after corridor limits)	351,940,733
Net assets in excess (deficit of reserves)	3,101,790
Net assets held in trust for pension benefits	$ 355,042,523

Note 6: Reserves, continued:

The undesignated reserve used historically for health care benefits of retirees was derived from excess earnings of the Association in prior years. See Note 7.

Note 7: Subsequent Events:

Subsequent events are those events or transactions that occur subsequent to the effective date of the financial statements, but prior to the issuance of final reports, which may have a material effect on the financial statements or disclosures therein.

The market value of assets in MCERA's portfolio has decreased from $353 million to $327 million between July 1, 2011 and December 31, 2011. Capital markets continue to be highly volatile resulting in significant swings market value, both positive and negative.

Since July 1, 2011, MCERA's new actuary, The Segal Company ("Segal"), determined that the employee basic contribution rate for fiscal years 2009-10, 2010-11 and 2011-12 was higher in the aggregate than it should have been. This resulted in a corresponding underpayment by employers during the same period. MCERA is working with a team of external and internal professionals to reimburse overpayments and collect underpayments to the pension fund "as if" the rates had been correct, and in accordance with all tax laws and regulations. Corrected rates will be in effect January 8, 2012, and the project is expected to be completed before the end of fiscal year 2011-12.

MCERA has reached a settlement agreement with its former actuary, Buck Consultants, for errors and omissions. The settlement agreement was for $587,000, which included the estimated cost of the correction project described above.

Segal completed its triennial experience study of the years ending June 30, 2009 through 2011. Significant changes to economic assumptions included reducing the assumed earnings rate from 8% to 7.75% and introducing a wage rate percent increase. Significant changes to demographic assumptions included earlier retirement ages, mortality tables that assume retirees are living longer, more conservative assumptions on withdrawals from the pension system, and reduced expectations of disability retirements.

MCERA submitted a Voluntary Correction Program ("VCP") filing with the IRS, stating that it recognized and posted excess earnings for fiscal years ending June 30, 2004 through 2006 may not have been fully consistent with Government Code Section 31529.4 and/or IRC 401(h). The residual amount of excess earnings recognized and posted over this time period has been classified as “Undesignated reserves” and was $658,654 at June 30, 2011. The excess earnings postings are being reviewed by tax counsel, actuary, and an accounting firm to develop findings and recommendations for submission to the IRS.

Mendocino County Employees' Retirement Association
(A Component Unit of the County of Mendocino)
Required Supplementary Information (unaudited)
June 30, 2011

Schedule of Funding Progress (dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability ("AAL") - Entry Age (b)	Unfunded AAL ("UAAL") (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b - a) / c)
6/30/2005	$ 253,487	$ 289,467	$ 35,980	87.6%	$ 57,664	62.4%
6/30/2006	288,461	320,123	31,662	90.1%	57,664	54.9%
6/30/2007	317,937	358,259	40,322	88.7%	65,899	61.2%
6/30/2008	353,421	373,832	20,411	94.5%	70,880	28.8%
6/30/2009	336,263	403,196	66,933	83.4%	72,235	92.7%
6/30/2010	343,202	434,987	91,785	78.9%	69,004	133.0%
6/30/2011	347,732	472,644	124,912	73.6%	64,144	194.7%

Schedule of Employer Contributions
(dollar amounts in thousands)

Year Ended	Annual Required Contribution	Percentage Contributed
6/30/2005	$ 3,221	47%
6/30/2006	4,996	79%
6/30/2007	7,533	100%
6/30/2008	7,232	100%
6/30/2009	6,046	141%
6/30/2010	9,571	91%
6/30/2011	9,554	100%