MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

FINANCIAL STATEMENTS
WITH ACCOMPANYING INFORMATION

YEAR ENDED JUNE 30, 2008

WITH

REPORT OF CERTIFIED PUBLIC ACCOUNTANT

V. James Sligh
Certified Public Accountant
413 W. Standley St., Suite A
Ukiah, CA 95482

MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

YEAR ENDED JUNE 30, 2008

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Board of Retirement

County Treasurer

Shari Schapmire

Appointed by the Mendocino County Board of Supervisors

Dr. Don Coursey

Bob Mirata, Vice-Chairperson

Eloise Grothe

Kendall Smith

Elected Members

Randy Goodman, Director

Dennis Huey, Secretary

Timothy Pearce, Chairperson

Lloyd Weer, Director

Timothy J. Knudsen, Retiree Alternate

Administration

Jim Andersen - Retirement Administrator
Timothy J. Knudsen - Interim Administrator
Sue Thornhill - Retirement Division Coordinator

V. James Sligh

Certified Public Accountant

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Ukiah, CA 95482
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Independent Auditor's Report

Board of Retirement
Mendocino County EmployeesC Retirement Association
Ukiah, California

I have audited the accompanying statements of plan net assets of the Mendocino County Employees' Retirement Association (Association) as of June 30, 2008, and the related statements of changes in plan net assets for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the Association's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my 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 I 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. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Mendocino County Employees' Retirement Association as of June 30, 2008, and the changes in plan net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated December 31, 2008, on my consideration of the Association's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.

The ManagementCs Discussion and Analysis, 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. I 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, I did not audit the information and express no opinion on it.

V. James Sligh

V. James Sligh, CPA
Ukiah, California
December 31, 2008

Management's Discussion and analysis

The following section provides an overview and analysis of the Mendocino County Employee's Retirement Association (MCERA) financial activities for the year ended June 30, 2008. We encourage readers to take into account the information presented here in conjunction with additional information we have furnished in the financial statements.

FINANCIAL HIGHLIGHTS

MCERA net assets as of June 30, 2008 are $331 million. This amount reflects a decrease of 6.5 % in net assets during Fiscal Year 2007-2008, primarily as a result of a net investment loss of $15.8 million from the prior year.

MCERA's funding objective is to meet the long-term benefit obligations through contributions and investment income. As of June 30, 2008 the date of our last actuarial valuation, the funding ratio was 94.5%. In general, this indicates that for every dollar of benefits owed we had approximately $.94 ½ of assets available for payment as of that date.

Revenues (additions to plan assets) for the year were $-1.7 million. This was comprised of $ 7.3 million of employer contributions, $ 6.6 million of member contributions and an investment return of $-15.8 million. The employer contributions increased by 00.5. %, due to increased contribution rates paid by the county, and employee contributions increased by 10.2 % during the fiscal year.

Expenses (deductions in plan assets) for the year were $ 21.1 million, an increase of $ 2.2 million or 11.4 % over the prior year. The majority of the increase in expenses came from a $ 2.1 million (12.1 %) increase in pension benefits. Administrative expenses increased $10,600 (2.5 %) from the prior year.

OVERVIEW OF FINANCIAL STATEMENTS

The following discussion and analysis are intended to serve as an introduction to MCERA's financial statements, which are comprised of the following components:

- Statement of Plan Net Assets (page 7)
- Statement of Changes in Plan Net Assets (page 8)
- Notes to the Financial Statements (page 9)

The Statement of Plan Net Assets is a snapshot of account balances at year-end. It indicates the assets available for future payments to retirees and any current liabilities owed at this time.

The Statement of Changes in Plan Net Assets provided a view of the current year additions to and deductions from the plan. This statement covers the activity over a one-year period of time.

Both statements are in compliance with Government Accounting Standards Board (GASB) Statements No. 25, 28, 33, 34, 37, and 38. These pronouncements require certain disclosures and also require the state and local governments to report the full accrual method of accounting. MCERA complies with all material aspects of the pronouncements.

The Statement of Plan Net Assets and Statement of Changes in Plan Net Assets report information about MCERA activities. These statements include all assets and liabilities, using the full accrual basis of accounting which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid. All investment gains and losses are shown at trade date, not settlement date. In addition, both realized and unrealized gains and losses are shown on investments. All capital assets are depreciated over their useful lives.

Over time, increases and decreases in MCERA's net assets are one indicator of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should also be considered in measuring MCERA's overall financial health.

Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. Please note that this report also contains other supplemental information in addition to the basic financial statements themselves.

MCERA NET ASSETS

Dollars in Thousands	6/30/08	6/30/07	Increase/ (Decrease)	% Change
Cash and Short Term Investments	12,552	9,638	2,914	30%
Receivables	3,996	16,598	(12,602)	(75.9)%
Investments, at fair value (3.8)%	316,696	329,355	(12,659)	(3.8)
Total Assets	333,244	355,591	(22,347)	(6.3)%
Accounts Payable	77	108	(31)	(28.7)%
Accrued Expenses	4	0	4	0 %
Investment Purchases	1,810	1,310	500	(38.2)%
Total Liabilities	1,891	1,418	473	(33.3)%
Net Assets Held in Trust for benefits	331,352	354,172	(22,820)	(6.4)%

The Retirement Fund as Whole

MCERA's net assets decreased 6.4 % in 2008 reflecting negative investment returns of -3.8 % . However, 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. Despite variations in the stock market, 5 year investment returns, net of fees, are 10.74%. This illustrates the importance of a long-term investment strategy incorporating structured diversification and a balanced investment portfolio. MCERA Management and Actuary concur that MCERA remains in a financial position that will enable the plan to meet its obligations to participants and beneficiaries. The current financial position results from a strong and successful investment program, risk management and strategic planning.

Investment Analysis

Investment returns decrreased in 2008 with a negative -3.8 % return at the total portfolio level. The period 2000 through 2002 included a very unusual three-year double digit decline in the U.S. stock market. Even with this unusual U.S. stock market cycle, the five year annualized portfolio return was 10.74%, net of fees. MCERA's asset allocation includes 39% U.S. equities, 20%

international equities, 31% fixed income and 10% real estate. MCERA's asset allocation is based on a comprehensive investment policy. MCERA's total portfolio returns were -3.82%, 8.36% and 10.74% for the one, three and five year periods ended June 30, 2008, respectively. Real estate, included in the total portfolio percentage mentioned above, returned 19.2% from October 2003 through June 30, 2008.

MCERA RESERVES

(Dollars in Thousands)	6/30/08	6/30/07	6/30/06
Member Reserve	62,347	58,036	54,037
Employer Reserve	3,458	10,687	18,271
Annuitant Reserve	150,148	132,687	117,116
Cost of Living Reserve	83,594	78,488	74,861
Contingency Reserve	3,314	3,530	3,068
Total	**302,867**	**283,432**	**267,353**

Reserves

MCERA's reserves are established from contributions and the accumulation of investment income after satisfying investment and administrative expenses. Under GASB 25, investments are stated at fair value instead of cost and include the recognition of unrealized gains and losses in the current period. MCERA has adopted a five-year smoothing methodology for investment gains and loses. This has the effect of smoothing both positive and negative fluctuations in investment performance versus assumptions and has a stabilizing effect on contribution rates. An understanding of the smoothing methodology is an essential part in measuring MCERA's overall financial health.

CHANGES IN MCERA NET ASSETS

(Dollars in Thousands)	6/30/08	6/30/07	Increase (Decrease)	% Change
Additions				
Employer Contributions	$ 7,269	$7,231	$ 38	00.5%
Member Contributions	$ 6,612	$6,002	$ 610	10.2%
Net Investment Income	$(15,846)	$52,299	$(68,145)	(103.5)%
Total Additions	$ (1,672)	$65,829	$(67,501)	(102.5)%
Deductions				
Retirement Benefits	$15,640	$14,153	$ 1,487	10.5%
Health Benefits	$ 4,017	$ 3,382	$ 635	18.8%
Refund of Contributions	$ 1,064	$ 1,036	$ 28	2.7%
Administrative Expenses	$ 426	$ 416	$ 10	2.4%
Total Deductions	$21,147	$18,987	$ 2,160	11.3%
Change in Net Assets	$(22,819)	$46,842	$(69,661)	(148.7)%

Revenues (Additions to Plan Assets)

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, 2008 totaled $ -1.7 million. The decrease in revenues can be attributed primarily to a negative investment income offset by slightly higher employee contributions, caused by the enhancement of benefits in

October 2003. The decrease in investment income is primarily a result of a negative return in equity markets following an unusual three year up market cycle. The total balance of investment assets decreased from approximately $329 million in 2007 to $317 in 2008 due to a dramatic decrease in the market value of all investment categories at the end of the fiscal year. The return on investment was a negative return of -3.82% in 2008

Expenses (Deductions in Plan Assets)

The primary uses of MCERA assets are the payment of benefits to retirees and their beneficiaries, refund of contributions to terminated employees, and the cost of administering the system. These expenses for the fiscal year ended June 30, 200 were $426 thousand, an increase of $10 thousand (2.4%), compared to expenses of $416 thousand for the year ended June 30, 2007. Pension benefits increased 10.5% primarily due to a 6.1% increase in the number of retirees.

Fiduciary Responsibility

MCERA's Board and Staff are fiduciaries of the pension fund. Under the California Constitution the assets can only be used for the benefit of plan participants and the beneficiaries.

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

Statement of Plan Net Assets

June 30, 2008

ASSETS	
Cash and cash equivalents	$12,552,229
Receivables	
Employers	87,337
Investment sales	2,493,284
Interest and dividends receivable	1,410,953
Other receivables	4,266
Total receivables	3,995,840
Investments, at fair value	
U.S Government obligations	61,810,789
International bonds	1,316,105
Domestic corporate bonds	38,428,796
Domestic stocks	120,170,521
International stocks	61,304,551
Real estate	33,665,190
Total invesments	316,695,952
Total assets	333,244,021
LIABILITIES	
Accounts payable	77,055
Accrued expenses	4,324
Investment purchases	1,809,925
Total liabilities	1,891,304
Net assets held in trust for pension benefits (A schedule of funding progress is presented on page 18)	$331,352,717

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

Mendocino County Employees' Retirement Association

Statement of Changes in Plan Net Assets

For the Year Ended June 30, 2008

Additions	
Contributions	
Employer	$7,269,154
Plan members	6,612,780
Total contributions	13,881,934
Other income	
Employer reimbursement of administrative expenses	292,428
Employer reimbursement of health insurance costs	0
Total other income	292,428
Investment income	
Net appreciation (depreciation) in fair value of investments	-24,961,998
Building income, net of expenses	34,570
Interest	6,505,308
Dividends	2,936,213
	-15,485,907
Less investment expense	360,647
Net investment income (Loss)	-15,846,554
Total additions	-1,672,192
Deductions	
Benefit payments & subsidies	19,656,734
Refunds of contributions	1,064,287
Administrative expense	426,194
Total deductions	21,147,215
Net increase (decrease)	-22,819,407
Net assets held in trust for pension benefits	
Beginning of year	354,172,124
End of year	$331,352,717

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

Summary of Significant Accounting Policies

Basis of Accounting

The Mendocino County Employees' Retirement Association (Association) 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.

Cash and Investments

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgage securities are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value. All investments listed in the Statement of Plan Net Assets 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 the Association's investments. The Investment policy establishes the Association'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. The Association currently employs investment managers to manage its assets subject to the provisions of the Investment Policy.

Cash and Cash Equivalents

Cash and 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. Cash and cash equivalents are highly liquid investments with a short maturity and are recorded at cost, which 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 do not affect the total value of the securities. Unrealized gains and losses on affect the total value of the securities. Unrealized gains and losses on 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.

The Association's cash and investments stated at fair value as of June 30, 2008, are as follows:

Cash in Trust - Mendocino County	$ 12,552,229
Short-Term Investments - LAIF	0
Total Cash Equivalents	12,552,229
U.S. Government and Agency Bonds	61,810,789
International Bonds	1,316,105
Corporate Bonds	38,428,796
Domestic Stocks - Mutual Funds	113,101,198
Domestic Stocks	7,069,323
International Stocks - Mutual Funds	61,604,551
Real Estate	33,665,190
Total Investments	316,695,952
Total Cash Equivalents and Investments	$329,248,181

In addition, at June 30, 2008, there are short-term investments of $1,309,282 at the Bank of New York that are reported in the financial statements as interest, dividends, and investment sales receivable because these amounts represent current period earnings and securities sales that are to be immediately transferred to the Association. At June 30, 2008 the Association was owed $2,493,284 by investment managers for sales of securities.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that in the event of a failure in a depository financial institution, a government will not be able to recover its deposits or recover collateral securities that are in the possession of an outside party.

Custodial risk for deposits in the Mendocino County trust is assumed by the County of Mendocino. Short-term investments with the Bank of New York are not insured and are subject to risk of loss through market fluctuations, but risk of loss for fraudulent acts and lack of fidelity on the part of investment managers is covered by fidelity bonds for the Bank of New York investments. All the above short-term investments are stated at fair value. In accordance with GASB Statement No. 40 disclosure requirements, cash invested in external investment pools and in open-end mutual funds are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the government will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Except for a statement that duties of the Board of Retirement, Association officers and employees shall be discharged with care, skill, prudence, and diligence, the Association 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 risk is measured by the assignment of ratings by nationally recognized statistical rating organizations. Investment allocation guidelines according to the investment policy is as follows:

	Minimum	Maximum	Target
Fixed Income	30%	50%	31%
United States Stocks	25%	45%	35%
United States Small Cap Stocks	5%	15%	7%
International Stocks	0%	25%	17%
Real Estate	0%	10%	10%
Short Term Cash	0%	5%	0%

The AssociationCs Investment Policy does not allow for a single investment in real estate that is in excess of 5% of total assets. No single common stock investment, based on cost, shall exceed 2% of the assets of the Association, and may not exceed 5% of the shares outstanding. With respect to common stocks, the Association 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. Single security restrictions do not apply to investments in mutual funds. For fixed income investments, corporate debt issues must be rated "A" or better by the Standard and Poor corporation (S&P). An exception to this policy is that one particular fixed income investment manager is authorized to purchase corporate debt issues with a "BBB" rating by S&P to the extent of 25% of the total portfolio if the weighted average rating of the portfolio remains at "AA". Other fixed income securities allowed by the Association are instruments issued by agencies of, or guaranteed by, the U.S. Government; United States Treasury Bonds, Notes and Bills; certificates of deposit and Banker's Acceptances; Commercial paper of the highest quality. No more than 20% of the portfolio managed by one particular investment manager shall be invested in non-U.S. dollar bonds.

As of June 30, 2008, the Association's quality distribution of fixed income investments was as follows:

Quality (S%P)	Percentage of Total Fixed Income Securities
U.S. Treasury	8.8%
Government Agency	45.3%
AAA	11.2%
AA	5.4%
A	14.5%
BAA	11.9%
BA	.5%
Other	1.8%
	100%

Interest Rate Risk

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

As of June 30, 2008, the Association had the following fixed income investments:

Investment Type	Fair Value	Weight of Total Fixed Income	Effective Duration (In Years)
U.S. Treasuries	$ 8,882,431	8.75%	2.10
Government Agencies	3,464,092	3.41%	5.07
Asset-Backed Securities	2,728,296	2.69%	.37
Corporate Bonds	35,550,576	35.00%	6.94
Mortgages	49,614,190	48.85%	3.20
International	1,538,832	1.30%	5.74
Total Fair Value	$101,555,690	100.00%	
Portfolio Effective Duration			4.09

Highly Sensitive Investments

As of June 30, 2008, there were no investments that were sensitive to interest rate fluctuations.

Derivatives

The Association'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. The Association does not use derivatives for speculative use or to create leverage.

At June 30, 2008 The Association had no derivatives in its portfolio.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The following tables represent securities held in a foreign currency as of June 30, 2008:

Local Currency Name	Cash	Equity	Fixed Income	Total
Australian Dollars	$ 720	$0	$ 320,210	$ 320,930
Canadian Dollars	0	0	352,735	352,735
United Kingdom Pounds	0	0	643,160	643,160
Total	$ 720	$0	$1,316,105	$1,316,825

Foreign currency is comprised of international investment proceeds and income to be repatriated into U.S. dollars and funds available to purchase international securities. Foreign currency is not held as a form of investment, but held temporarily in foreign accounts until it is repatriated or expended.

The investments of the Association are governed primarily by an investment authority known as "The prudent person rule." The prudent person rule, as set forth in Section 31595 of the California Government Code, establishes a standard for all fiduciaries, which includes anyone that has authority with respect to the Association.

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.

Plan Description and Contribution Information

Membership in the plan consisted of the following:

Retirees and beneficiaries receiving benefits	962
Terminated plan members entitled to but not yet receiving benefits	411
Active plan members	1,410
Total	2,783
Number of participating employers	3

Plan Description. The Association is administered under the authority of the County Employees Retirement Law of 1937 and is a cost-sharing multiple employer plan that administers a defined benefit pension plan for the County of Mendocino, the Mendocino County Courts, and the Russian River Cemetery District. 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.

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 Association 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 the last 10 years prior to retirement with the County of Mendocino. The retiree health benefit program qualifies under section 401(h) of the Internal Revenue Code. A payment reserve of $510 for each eligible retiree is set aside each month for health care costs. Health care claim payments to providers are made from this reserve. This health care subsidy amounted to $4,021,403 for the year ended June 30, 2008, and is included in the line item for benefit payments and subsidies on the Statement of Changes in Plan Net Assets. The reserve is adjusted to actual medical costs at the end of each fiscal year.

Contributions. Actuarially determined member contribution rates averaged 9.82 percent for the year ended June 30, 2008. The actual rate depends on the member's age at the time of hire, and tier. Employers are also required to contribute an actuarially determined rate, averaging 10.35 percent of salary for the year ended June 30, 2008. 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, 2009 are 8.53 and 9.85 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).

Administrative costs of the plan (excluding investment expenses) are paid by the plan, and partially reimbursed by the employers, using an additional contribution rate calculated for that purpose.

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 Association 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 Association 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 funding agreement between the County of Mendocino and the Association indicates that the Association will keep the County of Mendocino informed of current investments, and that any unfunded pension liability will be eliminated in a timely manner. 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 indicates that the County is not required to fund the unfunded actuarially accrued liability (UAAL) if the UAAL does not exceed 10 percent of the total pension liability.

The UAAL as of June 30, 2008 is $20.4 million, less than the target balance of $37.4 million, therefore the county is not required to make a contribution to fund the UAAL. As a result, the actuaries have recommended employer and employee contribution rates for the year ended June 30, 2009 that are approximately the same as that of the prior fiscal year. The funded ratio at June 30, 2008 is 94.5%, as indicated on the Schedule of Funding Progress on Page 18.

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2008
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent Open

Remaining amortization period	11 Years from June 30, 2006
Asset valuation method	Smoothed Market Value
Actuarial assumptions:	
Investment rate of return*	8%
Interest credited to employees	8%
Projected salary increases*	Standard salary scale
*Includes inflation at	4.75%
Cost-of-living adjustments	Automatic 3% for all members
Spouses and Dependents	90% of male employees and 50% of female employees assumed married at retirement, with wives assumed three years younger than husbands.
Rates of employment termination	Standard tables
Years of life expectancy after retirement	Standard tables
Years of life expectancy after disability	Standard tables
Life expectancy after retirement For employee contribution rate Purposes	General members - 1994 Group Annuity Table for Males, setback 3 years. Safety members - 1994 Group Annuity Table for Males, with no setback.
Reciprocity assumption	50% of members who terminate with a vested benefit are assumed to enter a reciprocal system.
Deferral Age for vested Terminations	62 for general members, 55 for safety.
Sex	All safety members are assumed to be male.

Reserves

As of June 30, 2008, the plan has no reserves of plan assets for future health care benefits of retirees. The plan had contingency reserves of $3,313,527, at June 30, 2008 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, 2008 (under the five-year smoothed market asset valuation method for actuarial valuation purposes) is as follows:

Employee reserves	$ 62,347,909
Employer reserves	3,458,878
Retiree reserves	233,742,128
Retiree health care benefit reserves	-
1% contingency reserve	3,313,527
Miscellaneous reserves	4,324
Total reserves	302,866,766
Excess earnings - undesignated	53,880,353
Total allocated reserves (smoothed market actuarial value)	356,747,119
Net assets in excess (deficit) of reserves	(25,394,402)
Net assets available for benefits, at fair value	$331,352,717

Risk Management

The Association 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, the Association 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. The Association 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.

The Mendocino County Department of Risk Management has assumed the duties of administering the health care claims of retirees. The Association no longer pays a flat amount per covered retiree, but pays claims to health care providers as the health care services are performed and billed.

Based on Mendocino County Board of SupervisorsC 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, 2008.

Due to the 5-year smoothing actuarial method of calculating the net actuarial value of assets as of June 30, 2008, the Association has $53,880,353 in excess earnings that can be used for the payment of retiree health benefits. The calculation using the 5-year smoothing will be performed every year, to arrive at a new determination of excess earnings.

Member Termination

Upon separation from the Association, 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

The Association 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 or special district, through the adoption of an ordinance or resolution, to terminate the applicability of the plan to employees of the County or district whose services commence after a given future date.

Current and Future Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) recently released GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans;* and GASB Statement No. 50, *Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27.*

GASB Statement No. 43 provides uniform financial reporting standards for plans that provide postemployment benefits such as health care benefits, if the health care plans qualify as a trust or agency fund. Based on the effective dates of the statement, the Association would be required to implement GASB Statement No. 43 during the current year ended June 30, 2008. However, this requirement is not applicable to the Association because no trust or agency fund has been established and assets are not held in a trustee capacity for others. Accordingly, no trust or agency fund is presented for the fiscal year ended June 30, 2008.

The Association adopted GASB Statement No. 50, *Pension Disclosures*, an amendment of applicable note disclosure and Required Supplementary Information (RSI) of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers,* effective for the year ended June 30, 2008. The required information is disclosed in the note regarding contributions.

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.

Financial Change - Since June 30, 2008, the U.S. and International equity markets have experienced a significant decline in market value. In this environment, the Association's assets declined in value over $74 million, or 24%, to a value at December 31, 2008, of just over $236 million. The asset allocation of the portfolio was reviewed and adjusted in 2008. Equities, especially Small Cap and International, have suffered the greatest losses relative to other asset classes. This has resulted in the allocation of fixed income assets exceeding targets. The board of retirement is not rebalancing its portfolio at this time due to the realized losses that would be incurred, but continues to monitor the asset allocation closely.

Management Change - In November, 2008, the Association hired a new Retirement Administrator, Jim Andersen, to replace outgoing, long-time Administrator Tim Knudsen. Mr. Andersen is a former County Administrator for Mendocino County, and Assistant County Administrator for Sonoma and Mendocino Counties. Mr. Knudsen continues to provide services to the Association, document policies and procedures, and to assure the smooth transition to new leadership.

Mendocino County Employees' Retirement Association

Required Supplementary Information (Unaudited)
June 30, 2008

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 Percentage of Covered Payroll ((b-a)/c)
7/1/03	$233,764 **	$242,342	$9,578	96.1%	$59,865	16.0%
7/1/04	$239,191	$265,141	$25,950	90.2%	$59,075	43.9%
7/1/05	$253,487	$289,467	$35,980	87.6%	$57,664	62.4%
7/1/06	$288,461	$320,123	$31,662	90.1%	$57,665	54.9%
7/1/07	$317,937	$358,259	$40,322	88.7%	$65,899	61.2%
7/1/08	$353,421	$373,832	$20,411	94.5%	$70,880	28.8%

** Includes proceeds from pension obligation bonds issued in December, 2002 in the amount of $76,299,000.

Schedule of Employer Contributions

(dollar amounts in thousands)

Year Ended	Annual Required Contribution	Percentage Contributed
6/30/03	$6,663	100%
6/30/04	$4,158	63%
6/30/05	$3,221	47%
6/30/06	$4,996	79%
6/30/07	$7,533	100%
6/30/08	$7,232	106%

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

I have audited the statement of plan net assets of the Mendocino County Employees' Retirement Association (Association) as of June 30, 2008, and the related statement of changes in plan net assets for the year then ended, and have issued my report thereon dated December 31, 2008. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Association's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Association's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Association's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Association's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined above.

Compliance

As part of obtaining reasonable assurance about whether the Association's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Retirement, the management of the Mendocino County Employees' Retirement Association, and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties.

V. James Sligh

V. James Sligh, CPA
Ukiah, California
December 31, 2008