# IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM

## FINANCIAL STATEMENTS
## WITH
## INDEPENDENT AUDITOR'S REPORT

## FOR THE FISCAL YEARS
## ENDED JUNE 30, 2012 AND 2011

**IMPERIAL COUNTY EMPLOYEES'**
**RETIREMENT SYSTEM**
**JUNE 30, 2012 AND 2011**

## TABLE OF CONTENTS

BROWN
ARMSTRONG

CERTIFIED
PUBLIC
ACCOUNTANTS

MAIN OFFICE
4200 TRUXTUN AVENUE
SUITE 300
BAKERSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

560 CENTRAL AVENUE
SHAFTER, CALIFORNIA 93263
TEL 661.746.2145
FAX 661.746.1218

8050 N. PALM AVENUE
SUITE 300
FRESNO, CALIFORNIA 93711
TEL 559.476.3592
FAX 559.476.3593

790 E. COLORADO BLVD.
SUITE 908B
PASADENA, CALIFORNIA 91101
TEL 626.240.0920
FAX 626.240.0922

5250 CLAREMENT AVENUE
SUITE 237
STOCKTON, CA 95207
TEL 209.451.4833

Member of
PKF
North America
An association of legally independent firms

REGISTERED with the Public Company Accounting Oversight Board and MEMBER of the American Institute of Certified Public Accountants

BROWN ARMSTRONG
*Certified Public Accountants*

# INDEPENDENT AUDITOR'S REPORT

Board of Retirement
Imperial County Employees' Retirement System
El Centro, California

We have audited the accompanying statement of plan net assets of the Imperial County Employees' Retirement System (ICERS) as of June 30, 2012 and 2011, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of ICERS' 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 *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of ICERS as of June 30, 2012 and 2011, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with G*overnment Auditing Standards*, we have also issued our report dated January 7, 2013, on our consideration of ICERS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with G*overnment Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, the schedule of funding progress, and schedule of employer contributions be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Auditing Standards Board (GASB), who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to this required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION
Brown Armstrong
Accountancy Corporation

Bakersfield, California
January 7, 2013

# IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM
## MANAGEMENT'S DISCUSSION AND ANALYSIS
## JUNE 30, 2012 AND 2011

This Management's Discussion and Analysis (MD&A) of the financial activities of Imperial County Employees' Retirement System's (ICERS) is an overview of its fiscal operations for the year ended June 30, 2012. Readers are encouraged to consider the information presented in conjunction with the Financial Statements and Notes to the Financial Statements.

We are pleased to provide this overview and analysis of the financial activities of ICERS for the year ended June 30, 2012. ICERS is the public employee retirement system established by Imperial County on July 1, 1951, and is administered by the Board of Retirement to provide retirement, disability, and death and survivor benefits for its employees under the County Employees Retirement Act of 1937.

### Financial Highlights

ICERS' plan net assets as of June 30, 2012, were $544,660,982. The plan net assets are held in trust for payment of pension benefits to participants and their beneficiaries and all of the net assets are available to meet ICERS' ongoing obligations.

- Net assets decreased by $7,546,208; primarily due to negative investment performance.

- Total additions, as reflected in the Statement of Changes in Plan Net Assets decreased $101,306,890, primarily as a result of the net depreciation in the fair value of investments.

- Deductions in plan net assets increased from $25,230,961 to $27,852,426 versus the prior year. The increase was due to an increase in retiree pension benefits.

- ICERS' funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2012, the date of the last actuarial evaluation, the funded ratio for all ICERS agencies was 89.81%. In general, this indicates that for every dollar of benefits due ICERS had approximately $.90 of assets available for payment as of that date. The contribution ratios of the employer entities that participate in ICERS were 100%.

### Overview of the Financial Statements

This MD&A serves as an introduction to the basic financial statements. ICERS has two basic financial statements, the notes to the financial statements, and two required supplementary schedules of historical trend information. The basic financial statements and the required disclosures are in compliance with the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board, utilizing the accrual basis of accounting.

The Statement of Plan Net Assets is the first basic financial report. This is a snapshot of account balances at fiscal year-end. This statement reflects assets available for future payments to retirees and their beneficiaries and any current liabilities that are owed as of fiscal year-end. The Net Assets Held in Trust for Pension Benefits, which are the assets less the liabilities, reflects the funds available for future use.

The Statement of Changes in Plan Net Assets is the second financial report. This report reflects all the activities that occurred during the fiscal year, and shows the impact of those activities as Additions or Deductions to the plan. The trend of Additions versus Deductions to the plan will indicate the condition of ICERS' financial position over time.

Both statements are in compliance with Governmental Accounting Standard Board Statements (GASB) Pronouncements 25, 26, 28, 33, 34, 40, 44, 50, 55, and 56. These pronouncements require certain disclosures and also require the state and local governments to report using the full accrual method of accounting. ICERS complies with all material requirements of these pronouncements.

The Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets report information about ICERS' activities. These statements include all assets and liabilities using the full accrual basis of accounting as practiced by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. Investment gains and losses are reported on a trade-date basis and both realized and unrealized gains and losses on investments are shown.

These two statements report ICERS' net assets held in trust for pension benefits (net assets) – the difference between assets and liabilities – as one way to measure ICERS financial position. Over time, increases and decreases in ICERS' 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 ICERS' overall health.

The Notes to the Financial Statements (Notes) are an integral part of the financial reports. The Notes provide detailed discussion of key policies, programs and activities that occurred during the year.

The *Schedule of Funding Progress* required supplementary schedule includes historical trend information about the actuarially funded status of ICERS, and the progress made in accumulating sufficient assets to pay benefits when due. The other required supplementary schedule, the *Schedule of Employer Contributions*, presents historical trend information about the annual required contributions of the employer and the actual contributions made. These schedules provide information to help promote understanding of the changes in the funded status of ICERS over time.

**Financial Analysis**

The reserves needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and through earnings on investment income (net of investment expense). Net assets as of June 30, 2012, totaled $544,660,982, a decrease of $7,546,208 over the prior year. ICERS' assets exceeded its liabilities at the end of the year. The Total Plan Net Assets represent funds available for future payments. However, of importance, is the fact that unlike private pension funds, public pension funds are not required to report the future liability of obligations owed to retirees. Only current liabilities are reported in the Statement of Plan Net Assets. Below is a comparison of current and prior year balances:

| | 2012 | 2011 | Increase (Decrease) 2012/2011 |
|---|---|---|---|
| Investments at Fair Value | $ 533,558,994 | $ 542,643,728 | $ (9,084,734) |
| Cash and Short-term Investments | 5,811,525 | 6,142,113 | (330,588) |
| Capital Assets (Net of Accumulated Depreciation) | 3,757,566 | 3,222,078 | 535,488 |
| Collateral Held for Securities Loaned | 24,177,868 | 20,481,944 | 3,695,924 |
| Receivables and Other Assets | 10,861,813 | 4,415,225 | 6,446,588 |
| Total Assets | 578,167,766 | 576,905,088 | 1,262,678 |
| Total Liabilities | 33,506,784 | 24,697,898 | 8,808,886 |
| Net Assets | $ 544,660,982 | $ 552,207,190 | $ (7,546,208) |

In order to determine whether Plan Net Assets will be sufficient to meet future obligations, the actuarial funded status needs to be calculated. An actuarial valuation is similar to an inventory process. On the valuation date, the assets available for the payment of retirement benefits are appraised. These assets are compared with the actuarial liabilities, which are the actuarial present value of all future benefits expected to be paid for each member. The purpose of the valuation is to determine what future contributions by the members and Imperial County are needed to pay all expected future benefits.

ICERS' independent actuary, The Segal Company, performed an actuarial valuation as of June 30, 2012, and determined that the funded ratio of the actuarial assets to the actuarial accrued liability is 89.81%. The actuarial valuation as of June 30, 2011, determined the funded ratio to be 90%.

**Additions to Plan Net Assets**

There are three primary sources of funding for ICERS retirement benefits: earnings (losses) on investments of assets and employer and employee contributions. Income sources for the fiscal years June 30, 2012 and 2011, totaled $20,306,218 and $121,613,108, respectively.

| | 2012 | 2011 | Increase (Decrease) 2012/2011 |
|---|---|---|---|
| Employer Contributions | $ 12,673,236 | $ 12,982,633 | $ (309,397) |
| Plan Member Contributions | 8,297,628 | 8,460,354 | (162,726) |
| Net Investment Income (Loss) | (694,258) | 100,136,757 | (100,831,015) |
| Miscellaneous Income | 29,612 | 33,364 | (3,752) |
| Total Additions | $ 20,306,218 | $ 121,613,108 | $ (101,306,890) |

**Deductions from Plan Net Assets**

ICERS was created to provide lifetime retirement annuities, survivor benefits, and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, as designated by the plan, refund of contributions to terminated employees, and the cost of administration. Below is a comparison of selected current and prior year balances:

| | 2012 | 2011 | Increase (Decrease) 2012/2011 |
|---|---|---|---|
| Retirement Benefits | $ 25,998,698 | $ 23,504,532 | $ 2,494,166 |
| Refund of Contributions | 564,854 | 606,411 | (41,557) |
| Lump Sum Death Benefits | 263,065 | 129,802 | 133,263 |
| Administrative Expenses | 887,446 | 820,588 | 66,858 |
| Legal Expenses | 52,086 | 74,695 | (22,609) |
| Actuarial Expenses | 86,277 | 94,933 | (8,656) |
| Total Deductions | $ 27,852,426 | $ 25,230,961 | $ 2,621,465 |

**The Retirement Fund as a Whole**

Despite variations in the stock market, Management believes that ICERS is in reasonably sound financial position to meet its obligations to the retired and current employees. The current financial position results from a diversified investment program that prudently manages risk to minimize loss, an effective system of cost control and strategic planning. Management believes there will continue to be sufficient assets to meet all benefit obligations.

**Requests for Information**

This financial report is designed to provide the Retirement Board, our membership, taxpayers, and investment managers with a general overview of ICERS finances and to demonstrate ICERS' accountability for the funds under its stewardship

Please address any questions about this report or requests for additional financial information to:

Imperial County Employees' Retirement System
1221 State Street
El Centro, CA 92243

Respectively submitted,

Scott W. Jarvis
Accountant/Auditor

# BASIC FINANCIAL STATEMENTS

**IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM**
**STATEMENT OF PLAN NET ASSETS**
**AS OF JUNE 30, 2012 AND 2011**

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 5,811,525 | $ 6,142,113 |
| Security lending cash collateral | 24,177,868 | 20,481,944 |
| Total Cash | 29,989,393 | 26,624,057 |
| Receivables | | |
| Contributions receivable | 1,016,154 | 982,265 |
| Accounts receivable - sale of investments | 3,317,003 | 2,724,980 |
| Accrued interest and dividends | 1,481,317 | 688,086 |
| Forward currency contracts receivable | 5,036,136 | - |
| Accounts receivable - other | 11,203 | 19,894 |
| Total Receivables | 10,861,813 | 4,415,225 |
| Investments at fair value | | |
| Fixed income | 171,132,203 | 165,207,991 |
| Domestic equities | 190,490,953 | 188,528,771 |
| International equities | 98,493,795 | 118,443,272 |
| Private equity | 42,217,104 | 41,909,592 |
| Real estate | 31,224,939 | 28,554,102 |
| Total Investments | 533,558,994 | 542,643,728 |
| Capital assets (net of accumulated depreciation) | 3,757,566 | 3,222,078 |
| Total Assets | 578,167,766 | 576,905,088 |
| **Liabilities** | | |
| Accounts payable - purchase of investments | 3,387,926 | 3,845,964 |
| Collateral payable for securities lending | 24,177,868 | 20,481,944 |
| Forward currency contracts payable | 5,180,237 | - |
| Accounts payable - other | 760,753 | 369,990 |
| Total Liabilities | 33,506,784 | 24,697,898 |
| **Net Assets Held in Trust for Employees' Pension Benefits** | $ 544,660,982 | $ 552,207,190 |

A schedule of funding progress is presented in the Required Supplementary Information in this Financial Section.

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

**IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM**
**STATEMENT OF CHANGES IN PLAN NET ASSETS**
**FOR YEARS ENDED JUNE 30, 2012 AND JUNE 30, 2011**

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| **Additions** | | |
| Contributions | | |
| Employer | $ 12,673,236 | $ 12,982,633 |
| Plan member | 8,297,628 | 8,460,354 |
| Total Contributions | 20,970,864 | 21,442,987 |
| Investment income | | |
| Net appreciation (depreciation) in fair value of investments | (13,084,157) | 88,896,423 |
| Interest and dividends | 9,959,385 | 10,689,031 |
| Real estate operating income, net | 4,143,654 | 2,363,293 |
| Alternative income | 1,136,975 | 782,970 |
| Total investment income | 2,155,857 | 102,731,717 |
| Less investment expenses | 2,910,637 | 2,652,613 |
| Net Investment Income (Loss) | (754,780) | 100,079,104 |
| Securities lending activities | | |
| Securities lending income | 170,875 | 161,220 |
| Less expenses from securities lending activities | 110,353 | 103,567 |
| Net Securities Lending Income | 60,522 | 57,653 |
| Total Net Investment Income | (694,258) | 100,136,757 |
| Miscellaneous | 29,612 | 33,364 |
| Total Additions | 20,306,218 | 121,613,108 |
| **Deductions** | | |
| Retirement benefits | 25,998,698 | 23,504,533 |
| Refunds of contributions | 564,854 | 606,412 |
| Lump sum death benefits | 263,065 | 129,802 |
| Administrative expenses | 887,446 | 820,586 |
| Legal expenses | 52,086 | 74,695 |
| Actuarial expenses | 86,277 | 94,933 |
| Total Deductions | 27,852,426 | 25,230,961 |
| Net Increase (Decrease) | (7,546,208) | 96,382,147 |
| Net Assets Held in Trust for Employees' Pension Benefits, Beginning of Year | 552,207,190 | 455,825,043 |
| Net Assets Held in Trust for Employees' Pension Benefits, End of Year | $ 544,660,982 | $ 552,207,190 |

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

## NOTE 1 – PENSION PLAN DESCRIPTION

The Imperial County Employees' Retirement System (ICERS) was formed July 1, 1951, by the adoption of the County Employees' Retirement Law of 1937 (State of California Government Code Section §31502) by the Imperial County Board of Supervisors pursuant to a vote of the people of Imperial County to provide retirement benefits to the employees of Imperial County and various special districts. ICERS, with its' own governing boards, is an independent governmental entity separate and distinct from the County of Imperial (County). ICERS' Annual Financial Statements are included in the County's Annual Financial Report as a pension trust fund. Maintaining appropriate controls and preparing the financial statements are the responsibility of ICERS management. On January 1, 2006, June 20, 2006, and November 16, 2011, the Superior Court of California County of Imperial, the Local Agency Formation Commission, and the Imperial County Transit Commission became participants in the program, respectively.

The Plan is an agent multiple-employer public employee retirement system (PERS). Such plans cover employees of more than one employer and pool administrative and investment functions as a common investment and administrative agent for each employer. Administrative costs of ICERS are financed through investment earnings and paid by ICERS. As required under California Government Code Section §31520.1, ICERS is governed by the following Board of Retirement:

| | Term Expires |
|---|---|
| Ann McDonald, General Member Employee | 6/30/2013 |
| Geoff Holbrook, General Member Employee | 6/30/2014 |
| Jack Terrazas, County Supervisor | 12/31/2012 |
| Norma Jauregui, Public Member | 6/30/2014 |
| Robert Williams, Public Member | 12/31/2014 |
| Herbert Bumgart, Safety Member Employee | 12/31/2014 |
| Barbara McFetridge | 12/31/2014 |
| James E. Rhodes, Public Member | 12/31/2014 |
| Pompeyo Tabarez, Jr., Alternate Safety Member | 12/31/2014 |
| Charles L. Jernigan, Alternate Retiree Member | 12/31/2014 |
| Karen Vogel, Ex-Officio Member | Ex-Officio |

ICERS' membership consisted of the following as reported in the most recent actuarial valuation dated June 30, 2012 and 2011:

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| Active Members (Vested and Non-Vested) | 1,921 | 1,947 |
| Retired Members and Beneficiaries | 977 | 924 |
| Terminated Vested (Deferred) | 332 | 247 |
| Total Membership | 3,230 | 3,118 |

As required by state statutes and ICERS by-laws, all regular-hire employees considered at least three-quarter time must participate in the County's pension plan, except for elected officials and those members over 60 years of age as outlined under Government Code Section §31552. Under the provisions of the County's pension plan, pension benefits vest after five years of credited service. Employees are eligible to receive benefits upon reaching the age of 50 and 10 years of credited service or after 30 years of service (Safety, 20 years of service). Pension benefit amounts vary based on the individual's age and number of years in the retirement system. The maximum pension benefit is 100% of final compensation. Also, the pension plan provides for death benefits and disability benefits. All pension, death and disability benefits are determined in accordance with state statutes.

**NOTE 1 – PENSION PLAN DESCRIPTION** (Continued)

Contributions are determined based on a percentage of compensation for each entry age so as to provide a lifetime annuity commencing at age 50.

All retirees and survivors are eligible for health insurance benefits. Eligibility for payment of these premiums is outlined on pages 23-24 of the Retirement System's Benefit Booklet. Premiums are collected by ICERS and forwarded to the County of Imperial.

Employer and employee contributions are based on actuarial valuations that cover the mortality, service, and compensation experience of the members and beneficiaries, and the evaluation of the assets and liabilities of the retirement fund. The Board of Supervisors makes the necessary changes in County contribution rates and interest rates based upon the valuations and recommendations of the actuary. According to the June 30, 2012, actuarial valuation, depending on the age and classification at hire date, employees' weighted contributions are 10.91% of covered payroll for the County.

Retiree and survivor benefits are adjusted annually for cost of living by the annual increase or decrease in the Consumer Price Index (CPI). In years when the CPI either increases or decreases more than the specified limit, the positive or negative excess is accumulated and applied to future years when the change in the CPI is outside those limits. The following limits are currently in effect: maximum benefit/deficit is +/- 2%.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

ICERS follows the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board (GASB).

The 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 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.

Investments are reported at fair value, except that short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates or by various outside pricing sources. The fair value of real estate investments is based on independent appraisals.

Typically, the fair value of alternative investments is determined by the fund manager in good faith and in compliance with the definition of fair value under U.S. generally accepted accounting principles or "GAAP" (FASB Accounting Standards Codification, Topic 820). The measure of fair value by the fund manager is typically conducted on a quarterly basis.

Cash

Cash includes deposits with various financial institutions, the County trust fund, and international currency holdings, which have original maturities of less than 90 days, translated to U.S. dollars using the exchange rates in effect at June 30, 2012 and 2011.

Capital Assets

Capital assets are valued at historical cost less accumulated depreciation. Capital assets with an initial cost of more than $7,500 and an estimated useful life in excess of one year are depreciated. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets. Equipment has a useful life of five years, leasehold improvements and office space forty years, and twelve years for the Pension Administration System (PAS), which is currently being created.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Use of Estimates

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

Reclassifications

Comparative data for the prior year has been presented in the selected sections of the accompanying Statements of Plan Net Assets and Changes in Plan Net Assets. Also, certain accounts presented in the prior year's data may have been reclassified in order to be consistent with the current year's presentation.

Reserves

The reserves represent the components of ICERS' net assets. Reserves are established from member and employer contributions and the accumulation of investment income after satisfying investment and administrative expenses. The reserves do not represent the present value of assets needed, as determined by actuarial valuation, to satisfy requirements and other benefits as they become due.

The Contingency Reserve is established as required by the County Employees' Retirement Law to absorb possible future losses on investments. The reserve balance, per the County Employees' Retirement Law, is 1% of the total market value of assets if excess earnings exist. ICERS' policy sets the targeted rate at 2%. The Contingency Reserve is 0% and 0% of the market value of total assets at June 30, 2012 and 2011, respectively. During fiscal year 2012, still recovering from the severe financial crisis, ICERS did not have excess earnings to fund the Contingency Reserve.

New Accounting Pronouncements

**GASB Statement No. 64 –** *Derivative Instruments: Application of Hedge Accounting Termination Provisions* amends current accounting and financial reporting related to terminations of swap agreements due to default or other termination events. In certain instances where swap counterparties or credit support providers are replaced, hedge accounting may continue, rather than cease. The provisions of GASB Statement No. 64 are effective for financial statements beginning after June 15, 2011. Because ICERS' does not currently enter into hedge agreements with swap providers for the purpose of managing risk beyond investment return, GASB Statement No. 64 does not apply at this time.

**GASB Statement No. 65 –** *Items Previously Reported as Assets and Liabilities* establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2012. ICERS has not yet determined its effect on the financial statements.

**GASB Statement No. 66 –** *Technical Corrections—2012—an Amendment of GASB Statements No. 10 and No. 62* is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2012. ICERS has not yet determined its effect on the financial statements.

**GASB Statement No. 67 –** *Financial Reporting for Pension Plans—an Amendment of GASB Statement No. 25* improves financial reporting by state and local governmental pension plans. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2013. ICERS expects the implementation of this statement to have a significant effect on the financial statements.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

**GASB Statement No. 68 –** *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27* improves accounting and financial reporting by state and local governments for pensions. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2014. ICERS does expect the implementation of this statement to have a significant effect on the financial statements.

**NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE**

The County Employees' Retirement Law of 1937 (CERL) vests the Board of Retirement with exclusive control over ICERS' investment portfolio. The Board of Retirement established an Investment Policy Statement in accordance with applicable local, State, and Federal laws. The Board of Retirement members exercise authority and control over the management of ICERS' assets (the Plan) by setting policy which the Investment Staff executes either internally, or through the use of external prudent experts. The Board of Retirement oversees and guides the Plan subject to the following basic fiduciary responsibilities:

- Solely in the interest of, and for the exclusive purpose of, providing economic benefits to participants and their beneficiaries.
- With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character with like objectives.
- Diversify the investments of the Plan so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances, it is clearly prudent not to do so. Diversification is applicable to the deployment of the assets as a whole.

The Investment Policy Statement encompasses the following:

- Criteria for Selecting & Terminating Investment Managers
- Investment Objective & Guidelines by Asset Class
- Duties & Responsibilities of ICERS' Board of Retirement
- Duties & Responsibilities of Staff, Investment Managers, Custodian & Investment Consultant
- Proxy Voting
- Statement of Objectives, Guidelines & Procedures for each Investment Manager

The Fixed Income Portfolio includes the following components:

- US Core Income – This portion of the portfolio will provide exposure to the US fixed income market (maturities greater than 1 year) including, but not limited to, Treasury and government agency bonds, corporate debt, mortgage bonds (including CMOs), Yankees and asset-backed securities. The portfolio will be comprised predominantly of investment grade issues.
- US Core Plus Fixed Income – This portfolio will provide exposure to the US fixed income market (maturities greater than 1 year) including, but not limited to, Treasury and government agency bonds, corporate debt, mortgage bonds (including CMOs), Yankees, asset-backed securities, Eurodollar bonds, private placements and emerging market bonds. The portfolio will be comprised of both investment grade and below-investment grade issues.

**NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE** (Continued)

Credit Quality Ratings of Investments in Fixed Income Securities

The credit quality of investments in fixed income securities as rated by nationally recognized ratings organizations as of June 30, 2012 and 2011, are as follows:

| Quality Ratings | Fair Value 2012 | Fair Value 2011 |
|---|---|---|
| AAA | $ 13,026,918 | $ 15,920,341 |
| AA+ | 1,856,927 | 343,276 |
| AA | 307,407 | 417,578 |
| AA- | 177,713 | 390,154 |
| A+ | 1,860,470 | 1,737,788 |
| A | 794,404 | 3,551,945 |
| A- | 5,073,890 | 2,392,558 |
| BBB+ | 2,729,106 | 3,175,736 |
| BBB | 5,772,826 | 5,966,377 |
| BBB- | 6,036,583 | 6,308,894 |
| BB+ | 2,351,132 | 2,396,419 |
| BB | 2,039,540 | 2,324,211 |
| BB- | 1,156,901 | 1,911,867 |
| B+ | 1,154,675 | 1,634,606 |
| B | 694,359 | 744,980 |
| B- | 621,960 | 546,733 |
| <CCC+ | - | 352,901 |
| N/R | 2,317,023 | 7,617,351 |
| N/A* | 123,160,369 | 107,474,276 |
| **Total Investments in Fixed Income Securities** | $ 171,132,203 | $ 165,207,991 |

N/R represents securities that are not rated.

N/A* represents securities that are not applicable to the rating disclosure requirements and partially consist of securities within commingled funds.

Credit Risk

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. ICERS seeks to maintain a diversified portfolio of fixed income instruments in order to obtain the highest total return for the fund at an acceptable level of risk within this asset class.

ICERS has adopted policies specific to each investment manager (asset class) to manage credit risk. In general, fixed income securities should be well diversified to avoid undue exposure to any single economic sector, industry or individual security. In addition, the portfolio's average risk level, as measured by quality ratings of recognized rating services, is expected to approximate AA or its equivalent.

Custodial Credit Risk

Custodial Credit Risk for deposits is the risk that in the event of a financial institution's failure, ICERS would not be able to recover its deposits. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. ICERS' deposits are not exposed to custodial credit risk as its deposits are eligible for and covered by "pass-through insurance" in accordance with applicable law and FDIC rules and regulations. Additional insurance against loss and theft is provided through a Financial Institution Bond.

## NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE (Continued)

Custodial Credit Risk (Continued)

Custodial Credit Risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, ICERS would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in ICERS' name, and held by the counterparty. ICERS' investment securities are not exposed to custodial credit risk because all securities are held by ICERS' custodial bank in ICERS' name. ICERS has investments in commingled funds that are not held by ICERS' custodial bank. However, investments 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. ICERS has no general policy on custodial credit risk for deposits.

Concentration of Credit Risk

As of June 30, 2012 and 2011, ICERS did not hold any investments in any one issuer that would represent five percent (5%) or more of total investments. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from this requirement.

Interest Rate Risk

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of the price sensitivity of a fixed income portfolio to changes in interest rates. It is calculated as the weighted average time to receive a bond's coupon and principal payments. The longer the duration of a portfolio, the greater its price sensitivity to changes in interest rates.

ICERS does not have a general policy to manage interest rate risk. To manage Interest Rate Risk, the modified adjusted duration of the Domestic Fixed Income Core and Core Plus Portfolios are restricted to +/- 25% of the Barclays Capital Aggregate Bond Index's modified adjusted duration. Deviations from any of the stated guidelines require prior written authorization from ICERS.

As of June 30, 2012, ICERS' Core fixed income manager had an effective duration of 4.68 years, while ICERS' Core Plus Fixed Income manager had an effective duration of 4.8 years.

Fixed Income Securities - Duration

As of June 30, 2012 and 2011, ICERS had the following securities:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| Investment Type | Market Value | Effective Duration (in years) | Market Value | Effective Duration (in years) |
| Asset Backed Securities | $ 2,881,934 | 6.78 | $ 1,797,059 | 6.51 |
| Commercial Mortgage Backed Securities | 3,338,230 | 10.21 | 7,574,384 | 5.32 |
| Collateralized Mortgage Obligation Corporate | 2,317,122 | 3.50 | 3,749,322 | 2.81 |
| Corporates and Other Credit | 29,671,718 | 5.42 | 31,509,832 | 4.88 |
| Government | 18,887,050 | 5.25 | 14,080,554 | 0.47 |
| Mortgage Backed-Agency | 20,774,342 | 17.31 | 12,278,269 | 14.19 |
| Non U.S. | 3,991,796 | 4.48 | 3,819,726 | 6.16 |
| Sub-total | 81,862,192 | | 74,809,146 | |
| High Yield Fixed Income Fund[1] | 74,277,565 | 4.82 | 62,894,588 | 4.37 |
| Treasury Inflation Protected Securities[1] | 14,992,446 | 8.14 | 27,504,257 | 7.63 |
| Other Securities | - | | - | |
| Total | $ 171,132,203 | | $ 165,207,991 | |

[1] Investment in Commingled Bond Fund

**NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE** (Continued)

Foreign Currency Risk

Foreign Currency Risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. Although ICERS does not have a specific policy regarding foreign currency risk, ICERS seeks to mitigate this risk through its investment policy constraints. ICERS' international equity managers are permitted to invest in authorized countries. Forward currency contracts and currency futures (maturity ranging from at least 30 days and not to exceed one year for either instrument) are permitted for defensive currency hedging. Non-U.S. equity investments are targeted at 25% of the investment portfolio with a maximum investment of 35%.

International Investment Securities at Fair Value

ICERS' exposure to Foreign Currency Risk in U.S. dollars for equity and fixed income investments as of June 30, 2012 is as follows:

| Currency Type | Equity | Fixed Income | Cash | Total |
|---|---|---|---|---|
| Australian Dollar | $ 1,983,784 | $ 2,347,223 | $ - | $ 4,331,008 |
| Brazilian Real | 4,457,886 | - | - | 4,457,886 |
| British Pound | 13,295,126 | - | 56 | 13,295,182 |
| Canadian Dollar | 871,415 | 1,193,297 | - | 2,064,713 |
| Chilean Peso | 539,244 | - | - | 539,244 |
| Chinese RNB | 6,926,345 | - | - | 6,926,345 |
| Czech Republic Koruna | 89,874 | - | - | 89,874 |
| Danish Krone | 265,260 | - | - | 265,260 |
| Euro Currency Unit | 23,581,471 | - | 17,132 | 23,598,603 |
| Hong Kong Dollar | 2,377,122 | - | - | 2,377,122 |
| Hungarian Forint | 149,790 | - | - | 149,790 |
| Indian Rupee | 3,589,103 | - | - | 3,589,103 |
| Indonesian Rupiah | 1,078,488 | - | - | 1,078,488 |
| Israeli Shekel | 133,764 | - | - | 133,764 |
| Japanese Yen | 6,352,904 | - | - | 6,352,904 |
| Malaysian Ringgit | 1,078,488 | - | - | 1,078,488 |
| Mexican Peso | 2,097,060 | - | - | 2,097,060 |
| New Zealand Dollar | 29,473 | 1,250,510 | - | 1,279,983 |
| Norwegian Krone | 2,089,004 | - | - | 2,089,004 |
| Philippine Peso | 359,496 | - | - | 359,496 |
| Polish Zloty | 449,370 | - | - | 449,370 |
| Russian Ruble | 1,497,900 | - | - | 1,497,900 |
| Singapore Dollar | 2,164,527 | - | - | 2,164,527 |
| South African Rand | 2,546,430 | - | - | 2,546,430 |
| South Korean Won | 7,048,031 | - | - | 7,048,031 |
| Swedish Krona | 1,257,728 | - | - | 1,257,728 |
| Swiss Franc | 5,493,159 | - | - | 5,493,159 |
| Taiwan Dollar | 5,222,742 | - | - | 5,222,742 |
| Thailand Baht | 838,825 | - | - | 838,825 |
| Turkish Lira | 748,950 | - | - | 748,950 |
| Total Securities Subject to Foreign Currency Risk | 98,612,759 | 4,791,032 | 17,188 | 103,420,975 |
| U.S. Dollar (Securities held by International Managers) | 412,776 | - | - | 412,776 |
| Private Equity Held in Foreign Currency | (531,740) | - | - | (531,740) |
| Total International Investment Securities | $ 98,493,795 | $ 4,791,032 | $ 17,188 | $ 103,302,013 |

**NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE** (Continued)

International Investment Securities at Fair Value (Continued)

ICERS' exposure to Foreign Currency Risk in U.S. dollars for equity and fixed income investments as of June 30, 2011, is as follows:

| Currency Type | Equity | Fixed Income | Cash | Total |
|---|---|---|---|---|
| Australian Dollar | $ 2,269,703 | $ 1,601,222 | $ - | $ 3,870,925 |
| Brazilian Real | 6,412,044 | - | - | 6,412,044 |
| British Pound | 14,028,753 | 605,046 | 57 | 14,633,856 |
| Canadian Dollar | 1,245,664 | 816,446 | - | 2,062,110 |
| Chilean Peso | 799,574 | - | - | 799,574 |
| Chinese RNB | 7,600,911 | - | - | 7,600,911 |
| Czech Republic Koruna | 114,225 | - | - | 114,225 |
| Danish Krone | 272,574 | - | - | 272,574 |
| Euro Currency Unit | 30,879,388 | - | - | 30,879,388 |
| Hong Kong Dollar | 2,554,301 | - | - | 2,554,301 |
| Hungarian Forint | 342,675 | - | - | 342,675 |
| Indian Rupee | 5,230,086 | - | - | 5,230,086 |
| Indonesian Rupiah | 1,294,548 | - | - | 1,294,548 |
| Israeli Shekel | 186,084 | - | - | 186,084 |
| Japanese Yen | 7,106,811 | - | - | 7,106,811 |
| Malysian Ringgit | 1,256,473 | - | - | 1,256,473 |
| Mexican Peso | 2,094,122 | - | - | 2,094,122 |
| New Zealand Dollar | 34,072 | 1,134,391 | - | 1,168,463 |
| Norwegian Krone | 2,023,138 | - | - | 2,023,138 |
| Philippine Peso | 304,600 | - | - | 304,600 |
| Polish Zloty | 761,499 | - | - | 761,499 |
| Russian Ruble | 2,017,972 | - | - | 2,017,972 |
| Singapore Dollar | 2,238,052 | - | - | 2,238,052 |
| South African Rand | 3,045,996 | - | - | 3,045,996 |
| South Korean Won | 7,855,623 | - | - | 7,855,623 |
| Swedish Krona | 1,635,353 | - | - | 1,635,353 |
| Swiss Franc | 6,737,835 | - | - | 6,737,835 |
| Taiwan Dollar | 6,141,247 | - | - | 6,141,247 |
| Thailand Baht | 799,574 | - | - | 799,574 |
| Turkish Lira | 723,424 | - | - | 723,424 |
| Total Securities Subject to Foreign Currency Risk | 118,006,321 | 4,157,105 | 57 | 122,163,483 |
| U.S. Dollar (Securities held by International Managers) | 649,911 | - | - | 649,911 |
| Private Equity Held in Foreign Currency | (212,960) | - | - | (212,960) |
| Total International Investment Securities | $ 118,443,272 | $ 4,157,105 | $ 57 | $ 122,600,434 |

Derivatives

The Board of Retirement's Investment Policy Statement and Manager Guidelines allow the use of derivatives by certain investment managers. Derivatives are financial instruments that derive their value, usefulness and marketability from an underlying instrument which represents direct ownership of an asset or an obligation of an issuer whose payments are based on or "derived" from the performance of some agreed-upon benchmark. Managers are required to mark-to-market derivative positions daily. Substitution, risk control, and arbitrage are the only derivative strategies permitted: leverage is prohibited.

Derivatives (Continued)

Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Gains and losses from derivatives are included in net investment income. The following types of derivatives are permitted: Futures contracts, currency forward contracts and covered call options.

1. Futures Contracts

   A futures contract represents an agreement to buy (long position) or sell (short position) and underlying asset at a specified future date for a specified price. Payment for the transaction is delayed until a future date, which is referred to as the settlement or expiration date. Futures contracts are standardized contracts traded on organized exchanges.

2. Forward Currency Contracts

   A forward contract represents an agreement to buy or sell an underlying asset at a specified date in the future at a specified price. Payment for the transaction is delayed until the settlement or expiration date. A forward contract is a non-standardized contract that is tailored to each specific transaction. Forward currency contracts are used to control currency exposure and facilitate the settlement of international security purchase and sale transactions.

3. Option Contracts

   An option contract is a type of derivative security in which a buyer (purchaser) has the right, but not the obligation, to buy or sell a specified amount of an underlying security at a fixed price by exercising the option before its expiration date. The seller (writer) has an obligation to buy or sell the underlying security if the buyer decided to exercise the option.

Fair values of derivatives contracts are obtained through ICERS custodian bank, JP Morgan. JP Morgan uses an independent third party pricing service for these price quotes.

| | 2012 | | 2011 | | |
|---|---|---|---|---|---|
| Derivative Type | Notional Value | Fair Value | Notional Value | Fair Value | Change in Fair Value |
| Bond Index Futures | $ 5,123,024 | $ 5,121,812 | $ 4,823,721 | $ 4,832,258 | $ 289,554 |
| Equity Index Futures | 12,204,920 | 12,686,505 | 12,807,573 | 13,259,430 | (572,925) |
| Forward Currency Contracts | - | (144,101) | - | - | (144,101) |
| Total | $ 17,327,944 | $ 17,664,216 | $ 17,631,294 | $ 18,091,688 | $ (427,472) |

## NOTE 4 – SECURITIES LENDING PROGRAM

The Board of Retirement's policies authorize ICERS to participate in a securities lending program. Securities lending is an investment management activity that mirrors the fundamentals of a loan transaction. Securities are lent to brokers and dealers (borrower) and in turn, ICERS receives cash as collateral. ICERS pays the borrower interest on the collateral received and invests the collateral with the goal of earning a higher yield than the interest rate paid to the borrower. Earnings generated above and beyond the interest paid to the borrower represent the net income to ICERS from the transaction.

ICERS' securities lending program is managed by JP Morgan Cash Collateral Investment Fund (CCIF) and primarily invests collateral received from ICERS in short-term debt obligations, including but not limited to bonds, notes, asset-backed securities, repurchase agreements, annuity contracts, and money-market investments. JP Morgan CCIF loans are collateralized at 102 percent (102%).

## NOTE 4 – SECURITIES LENDING PROGRAM (Continued)

The collateral under the relationship with JP Morgan is marked-to-market daily and if the market value of the securities rises, ICERS receives additional collateral. The income earned from the investments made by JP Morgan is split between ICERS and JP Morgan, based on contractual agreements.

Under the terms of the lending agreement, the lending agent provides borrower default indemnification in the event a borrower does not return securities on loan. The terms of the lending agreements entitle ICERS to terminate all loans upon the occurrence of default and purchase a like amount of "replacement securities." In the event the purchase price of replacement securities exceeds the amount of collateral, the lending agent shall be liable to ICERS for the amount of such excess, with interest. Either ICERS or the borrower of the security can terminate a loan on demand.

At year-end, ICERS had no credit risk exposure to borrowers because the amount of collateral received exceeded the value of securities on loan. As of June 30, 2012, ICERS collateral was slightly below the 102% requirement, but ICERS had no losses on securities lending transactions resulting from the default of a borrower for the years ended June 30, 2012 and 2011. As of June 30, 2012, the fair value of securities on loan was $28,032,326 with the value of cash collateral received of $24,177,868 and non-cash collateral of $4,542,175. As of June 30, 2011, the fair value of securities on loan was $20,670,510 with the value of cash collateral received of $20,481,944 and non-cash collateral of $576,871. ICERS' income, net of expenses from securities lending, was $60,522 and $57,653 for the years ended June 30, 2012 and 2011, respectively. Non-cash collateral, and related repayment obligation, is not recorded on the books of ICERS, as there is no ability to pledge or sell the collateral absent borrower default.

As of June 30, 2012 and 2011, ICERS had the following securities lending (dollars in thousands):

| | 2012 | | 2011 | |
|---|---|---|---|---|
| Securities on Loan | Market Value of Securities on Loan | Collateral Received | Market Value of Securities on Loan | Collateral Received |
| U.S. Government, Agencies, and Mortgage-Backed Securities | $ 4,410,593 | $ 4,542,030 | $ 1,255,104 | $ 1,290,253 |
| U.S. Equities | 16,483,566 | 16,887,786 | 11,563,279 | 11,763,730 |
| U.S. Corporate Fixed-Income | 7,138,167 | 7,290,227 | 7,852,127 | 8,004,832 |
| Total | $ 28,032,326 | $ 28,720,043 | $ 20,670,510 | $ 21,058,815 |

## NOTE 5 – REAL ESTATE

The following is a listing of California real estate indirectly held through ICERS shares in the respective investment companies:

| | Appraised Value | |
|---|---|---|
| Location | 2012 | 2011 |
| Separate Properties: | | |
| ICERS El Centro Inc | $ 1,526,012 | $ 1,713,458 |
| Clarion Partners (formerly ING Clarion) | 14,289,705 | 12,748,648 |
| RREEF American REIT II | 15,409,222 | 14,091,996 |
| Total Properties | 29,698,927 | 26,840,644 |
| Total Real Estate | $ 31,224,939 | $ 28,554,102 |

**NOTE 5 – REAL ESTATE** (Continued)

ICERS, like all who invest in the real estate arena has seen substantial losses in the real estate portfolio. While the trend has begun to recover, it is a slow process due to the lag period between appraisals of properties in the various portfolios.

The commercial real estate investment has suffered from a severe credit crunch for commercial sectors, sustained job losses and weak consumer spending, although the decline appears to be slowing. The national economy has begun a slow and cautious recovery, but the labor market, which often lags the broader economy, will turn around only gradually with sustained improvement. Because commercial real estate lags the labor market, it still has a ways to go before reaching its own low point.

ICERS continues to closely monitor the real estate portfolio and expect improvement to assessed values later this year.

**NOTE 6 – CAPITAL ASSETS**

The changes in capital assets for the year ended June 30, 2012, are shown below.

| | Balance June 30, 2011 | Additions | Deductions | Balance June 30, 2012 |
|---|---|---|---|---|
| Equipment | $ 107,193 | $ - | $ - | $ 107,193 |
| Work-in-Progress | 3,188,770 | 552,142 | - | 3,740,912 |
| Totals | 3,295,963 | 552,142 | - | 3,848,105 |
| Less: Accumulated Depreciation | | | | |
| Equipment | 73,885 | 16,654 | - | 90,539 |
| Work-in-Progress | - | - | - | - |
| Totals | 73,885 | 16,654 | - | 90,539 |
| Capital Assets-Net | $ 3,222,078 | $ 535,488 | $ - | $ 3,757,566 |

Depreciation expense at June 30, 2012, was $16,654.

The Work-in-Progress of the pension system software increased by $552,142. Planned implementation of the system is scheduled for the 2012 – 2013 fiscal year.

The changes in capital assets for the year ended June 30, 2011, are shown below.

| | Balance June 30, 2010 | Additions | Deductions | Balance June 30, 2011 |
|---|---|---|---|---|
| Equipment | $ 107,193 | $ - | $ - | $ 107,193 |
| Work-in-Progress | 2,345,800 | 842,970 | - | 3,188,770 |
| Totals | 2,452,993 | 842,970 | - | 3,295,963 |
| Less: Accumulated Depreciation | | | | |
| Equipment | 55,031 | 18,854 | - | 73,885 |
| Work-in-Progress | - | - | - | - |
| Totals | 55,031 | 18,854 | - | 73,885 |
| Capital Assets-Net | $ 2,397,962 | $ 824,116 | $ - | $ 3,222,078 |

Depreciation expense at June 30, 2011, was $18,854.

**NOTE 7 – CONCENTRATIONS**

ICERS has entered into a custodial agreement with JP Morgan. JP Morgan custodies securities, and collects income for ICERS. The value of ICERS' investments under JP Morgan's custodianship at June 30, 2012 and 2011, was approximately $532,032,982 and $540,353,489, respectively.

The following firms professionally manage ICERS' investments:

| | Value of Investments | |
|---|---|---|
| | 2012 | 2011 |
| BlackRock | $ 201,591,204 | $ 220,615,562 |
| Bradford & Marzec | 73,344,430 | 64,819,332 |
| Clifton Group | 3,584,036 | 4,004,761 |
| Dimensional | 29,958,003 | 38,074,947 |
| Franklin Templeton Institutional | 45,863,970 | 54,159,286 |
| HarbourVest Partners, LLC | 1,463,127 | 474,509 |
| KKR | 3,727,693 | 2,510,372 |
| PIMCO | 88,728,844 | 76,069,638 |
| T. Rowe Price | 22,835,196 | 21,980,419 |
| TimesSquare Capital | 27,554,937 | 27,243,786 |
| Clarion Partners | 14,289,705 | 12,254,613 |
| RREEF | 15,409,222 | 13,455,489 |
| JP Morgan | 3,682,615 | 4,690,775 |
| Total Managed | $ 532,032,982 | $ 540,353,489 |

**NOTE 8 – ADMINISTRATIVE EXPENSES**

California Government Code §31580.2 requires that the Board of Retirement may expend no more than the greater of the following:

1) Twenty-one hundredths of 1 percent (.21%) of the accrued actuarial liability of the retirement system.

2) Two million dollars ($2,000,000), as adjusted annually by the amount of the annual cost-of-living adjustment computed in accordance with Article 16.5 (commencing with Section 31870).

Due to the repeal of Section 31580.3, expenditures for computer software, computer hardware, and computer technology consulting services in support of these computer products shall not be considered a cost of administration of the retirement system for purposes of this section.

Due to ICERS' limited budget needs, ICERS has chosen to adopt Section 2 of the Government Code with an annual limit of $2,000,000. For the years ended June 30, 2012 and 2011, administrative expenses were $887,446 and $820,586, respectively. Administrative costs of the plan are financed through investment plan assets.

**NOTE 9 – RISK MANAGEMENT**

ICERS is exposed to various risks of loss related to torts, theft or damage to, or destruction of, assets, injuries to employees, and errors and omissions. To address these risk items, ICERS is covered by the following policies and programs:

Liability Coverage
Carl Warran
1st Layer: $200,000 - $10,000,000
2nd Layer: $10,000,000 - $25,000,000

**NOTE 9 – RISK MANAGEMENT** (Continued)

Workers' Compensation
York Insurance Services Group
No cap on workman's compensation

For each of the above self-insurance coverage limits, the County maintains a separate Internal Service Fund. Funding for each fund is actuarially determined.

Fiduciary Liability Insurance
RLI Insurance Company
$10,000,000 – Aggregate Limit of Liability (Including Defense Costs)
$150,000 – Sublimit of Liability for Cap (IRS) Penalties
$100,000 – HIPAA Sublimit

In addition to the above, each investment manager and the fund's custodian carries a separate fidelity bond as well as errors and omissions insurance at levels consistent with their total funds under management.

## NOTE 10 – ACTUARIAL VALUATIONS

Pursuant to provisions in the County Employees' Retirement Law of 1937 (CERL), ICERS engages an independent actuarial firm to perform an annual actual valuation. The economic and non-economic assumptions are updated at the time each triennial valuation is performed. Triennial valuations serve as the basis for changes in member contribution rates necessary to properly fund ICERS. ICERS also hires and independent actuarial firm to audit the results of each triennial valuation.

The information displayed below presents the funded status of the most recent actuarial valuation. The Schedule of Funding Progress in the Required Supplementary Information section immediately following the notes to the financial statements presents multiyear trend information regarding whether the actual value of plan assets is increasing or decreasing over time, relative to the actuarial accrued liability of benefits.

Funded Status as of the Most Recent Actuarial Valuation Date
(In Thousands)

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Annual Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 6/30/2012 | $ 577,753 | $ 643,322 | $ 65,569 | 89.81% | $ 100,356 | 65.34% |

**NOTE 10 – ACTUARIAL VALUATIONS** (Continued)

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

| | |
|---|---|
| Valuation date | June 30, 2012 |
| Actuarial cost method | Entry age normal cost method |
| Amortization method | Level percentage of payroll for total unfunded actual accrued liability |
| Asset valuation method | 5-year smoothing process |
| Annual inflation rate | 3.50% |
| Investment rate of return | 7.75% |
| Postretirement benefit increase assumptions | COLA, maximum of 2.0% |
| Projected salary increases | General: 4.75% to 8.0%<br>Safety: 4.75% to 11.50% |
| Remaining amortization periods | 20 years (declining) for UAAL<br>Over period ending June 30, 2031 |

**NOTE 11 – FEDERAL INCOME TAX STATUS**

ICERS currently does not have a favorable tax determination letter. ICERS has filed an application for a tax determination letter and hopes to obtain it within the near future. The plan administrator believes the plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code.

**NOTE 12 – COMMITMENTS AND CONTINGENCIES**

Litigation

ICERS is a plaintiff in one lawsuit and a defendant in other claims arising in the ordinary course of its operations. ICERS management and legal counsel estimate the ultimate outcome of such litigation will not have a material effect on ICERS financial statements.

Capital Commitments

ICERS' real estate and private equity investment managers identify and acquire investments on a discretionary basis. Each manager's investment activity and discretion is controlled by ICERS' Investment Policy and the guidelines and limitations set forth in the contract, subscription agreement, limited partnership agreement and/or other contractual documents applicable to each manager. Such investments are further restricted by the amount of capital allocated or committed to each manager. ICERS' Investment Policy, contractual obligations, and capital commitments are subject to approval by the Board of Retirement and may be updated as often as necessary to reflect ICERS' investment preferences, as well as changes in market conditions.

**NOTE 12 – COMMITMENTS AND CONTINGENCIES** (Continued)

Capital Commitments (Continued)

As of June 30, 2012, outstanding capital commitments consisted of:

| Investment Manager | Investment Type | Total Capital Commitment | Outstanding Capital Commitment |
|---|---|---|---|
| HarbourVest | Private Equity | $ 20,000,000 | $ 17,891,073 |
| KKR | Private Equity | 10,000,000 | 6,526,995 |
| PIMCO | Private Equity | 10,000,000 | 3,923,542 |

As of June 30, 2011, outstanding capital commitments consisted of:

| Investment Manager | Investment Type | Total Capital Commitment | Outstanding Capital Commitment |
|---|---|---|---|
| HarbourVest | Private Equity | $ 20,000,000 | $ 19,492,040 |
| KKR | Private Equity | 10,000,000 | 7,632,237 |
| PIMCO | Private Equity | 10,000,000 | 7,773,542 |

**NOTE 13 – REQUIRED SUPPLEMANTARY INFORMATION**

The schedule of ICERS' funding progress against the actuarial accrued liability and the schedule of required employer Annual Required Contribution (ARC) and the percentage of the ARC recognized by ICERS are presented, where available, on the following pages as Required Supplementary Information.

**NOTE 14 – SUBSEQUENT EVENTS**

Subsequent events have been evaluated through January 7, 2013, which is the date the financial statements were issued. On September 12, 2012, Governor Jerry Brown signed Assembly Bill 340, known as the California Public Employees' Pension Reform Act of 2013 (CalPEPRA), into law. The new law is complex and broad-reaching and takes effect on January 1, 2013. ICERS is currently working with the County to analyze CalPEPRA and determine how it will apply in Imperial County. On October 17, 2012, the ICERS Board of Retirement has adopted a new determination of pensionable compensation for members hired on or after January 1, 2013, in preparation of this law.

# REQUIRED SUPPLEMENTAL INFORMATION

## IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM
## SCHEDULE OF FUNDING PROGRESS
## (AMOUNTS IN THOUSANDS)

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Annual Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| June 30, 2012 | $ 577,753 | $ 643,322 | $ 65,569 | 89.81% | $ 100,356 | 65.34% |
| June 30, 2011 | 552,209 | 613,584 | 61,375 | 90.00% | 101,610 | 60.40% |
| June 30, 2010 | 524,522 | 546,342 | 21,820 | 96.01% | 98,085 | 22.25% |
| June 30, 2009 | 487,411 | 507,631 | 20,220 | 96.02% | 93,493 | 21.63% |
| June 30, 2008 | 449,745 | 466,427 | 16,682 | 96.42% | 85,966 | 19.41% |
| June 30, 2007 | 420,938 | 437,816 | 16,878 | 96.14% | 77,886 | 21.67% |
| June 30, 2006 | 390,297 | 401,985 | 11,688 | 97.09% | 71,731 | 16.29% |

## IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM
## SCHEDULE OF EMPLOYER CONTRIBUTIONS
## (AMOUNTS IN THOUSANDS)

| Fiscal Year Ended | Annual Required Contribution | Actual Contribution | Percentage Contributed |
|---|---|---|---|
| June 30, 2012 | $ 13,000 | $ 13,000 | 100% |
| June 30, 2011 | 13,000 | 13,000 | 100% |
| June 30, 2010 | 12,000 | 12,000 | 100% |
| June 30, 2009 | 11,000 | 11,000 | 100% |
| June 30, 2008 | 9,000 | 9,000 | 100% |
| June 30, 2007 | 8,000 | 8,000 | 100% |
| June 30, 2006 | 5,000 | 5,000 | 100% |