Montgomery County
Employee Retirement Plans

Comprehensive Annual Financial Report

Employees' Retirement System
Retirement Savings Plan
Deferred Compensation Plan

(*Trust Funds of Montgomery County, Maryland*)

Fiscal Year 2006
July 1, 2005 – June 30, 2006

Prepared by the Board of Investment Trustees
101 Monroe Street, 15th Floor
Rockville, Maryland 20850

Montgomery County, Maryland
EMPLOYEE RETIREMENT PLANS
Fiscal Year Ended June 30, 2006
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INTRODUCTION SECTION

OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

December 8, 2006

Honorable County Executive and
Members of the Montgomery County Council

I am pleased to present to you the Comprehensive Annual Financial Report (CAFR) of the Montgomery County, Maryland (County) Employee Retirement Plans (Plans) for the fiscal year ended June 30, 2006. This annual report is designed to assist you in understanding the structure and current status of the Plans.

FORMAL TRANSMITTAL OF THE CAFR

This report was prepared pursuant to the provisions of Section 33-51(b) of the Montgomery County Code, 2001, as amended (Code), and includes the independent auditors' report, issued by the County Council's appointed independent public accounting firm. Responsibility for the accuracy of the presented data and the completeness and fairness of the presentation including all disclosures rests with the County. We believe the data, as presented, is accurate in all material respects; that it is presented in a manner designed to fairly set forth the plan net assets and the changes in plan net assets and financial position of the Plans; and that all disclosures necessary to enable the reader to gain the maximum understanding of the financial affairs of the Plans have been included.

The accompanying report consists of five sections: an **Introduction Section** which contains the Certificate of Achievement, this transmittal letter, and the organization structure; a **Financial Section** which contains the report of the independent auditors, the management's discussion and analysis, the financial statements of the Plans and required supplementary information; an **Investment Section** which contains investment results for the Employees' Retirement System (System) defined benefit pension plan; an **Actuarial Section** which contains the independent actuary's certification letter, a summary of the results of the actuarial valuation, including actuarial procedures and assumptions for the System; and a **Statistical Section** which contains information on the System's membership.

PROFILE OF THE RETIREMENT PLANS

History

The System was established in 1965, as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of the County and other agencies or political subdivisions who elect to participate. Participating agencies and subdivisions include the: Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,362 active members and 4,848 retirees participating in the System as of June 30, 2006.

101 Monroe Street • Rockville, Maryland 20850
240-777-2500 • 240-777-2544 TTY • 240-777-2518 FAX
www.montgomerycountymd.gov

The Retirement Savings Plan (RSP) was established in 1994, as a cost-sharing multiple-employer defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. Employees covered by the System may make an irrevocable decision to transfer to the RSP. At June 30, 2006, there were 3,791 active plan members.

The Deferred Compensation Plan (County Plan) was established pursuant to Section 457 of the Internal Revenue Code, as amended. During Fiscal Year (FY) 1999, in accordance with Federal legislation, the assets of the County Plan were placed in trust for the sole benefit of participants and their beneficiaries.

Benefit Provisions

The benefit provisions of the System are established by the Code. The System provides for normal service retirement and early service retirement benefits for members who attain age and service requirements. The System also provides options for disability and death benefits to eligible participants. Members are vested after five years of service.

The RSP provides for immediate vesting of employee contributions and employer contributions are vested after three years of service or upon death, disability or reaching retirement age.

Major Initiatives

During FY 2006, the Board of Investment Trustees (Board) expanded the investments within the alternatives asset class by hiring a private equity secondary fund-of-funds manager and hired two private real estate managers. The Board amended their strategic asset allocation to increase international equities to 20 percent and decrease domestic equities to 40 percent. Other initiatives during FY 2006 include: a search for a currency overlay manager and implementation of the risk management program to actively manage the inherent risks associated with the investment process to achieve the highest possible risk adjusted return.

In addition, the Board increased the investment offerings under the RSP to include two additional life cycle funds and a self directed brokerage account option.

INFORMATION USEFUL IN ASSESSING THE RETIREMENT PLANS' ECONOMIC CONDITION

Financial Information

Accounting System and Reports

The Plans' financial statements have been prepared under the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plans.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A), which can be found on pages 15 to 19 of this report, provides a brief analysis of the financial performance of the Plans and an introduction to the financial statements of the Plans for the year ended June 30, 2006.

Investments

Montgomery County has established a Board to be responsible for the investment management of the Plans' assets for the exclusive benefit of the members and participants. The Board consists of thirteen members appointed by the County Council.

In overseeing the management of the assets of the Plans, the Board has developed sound and prudent investment policies. The Board believes an appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the defined benefit plan. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. To achieve this objective, System assets are allocated to a broad array of investment sectors as follows: domestic equities 40 percent, alternative investments 5 percent, international equities 20 percent, domestic fixed income 20 percent, and inflation index bonds 10 percent, and real estate 5 percent. For the twelve months ended June 30, 2006, the total return achieved by the System's investments was 9.18 percent, compared to the System's benchmark index return of 8.96 percent and the actuarial assumed rate of return of 8.0 percent.

Section 33-125 of the Montgomery County Code authorizes the Board to establish, for members of the RSP, a diversified slate of mutual and commingled investment funds from which participants may select options. The Board has developed an investment policy outlining its oversight of the investment products offered.

The Board has also established a diversified slate of mutual and commingled funds for the County Plan which offers a range of options from which participants may select. The Board has constructed an investment policy stipulating investment objectives and oversight by the Board.

Funding

The System's actuary uses a five-year smoothed market-related value to determine the actuarial value of assets. The smoothing prevents extreme volatility in employer contribution rates due to short-term fluctuations in the investment markets. For the June 30, 2006 valuation, the actuarial value of assets was $2.2 billion. The aggregate actuarial liability was $2.9 billion. The Schedule of Funding Progress included as Required Supplementary Information in the Financial Section, expresses the System's actuarial value of assets as a percentage of the actuarial accrued liability, providing one indication of the System's funding status on a going-concern basis. The actuary has determined that the present net asset base, expected future contributions and investment earnings thereon, are sufficient to provide for full payment of future benefits under the projected unit credit actuarial cost method.

Internal Control Structure and Budgetary Controls

The Plans' management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in conformity with U.S. generally accepted accounting principles. We believe the internal controls in effect during the fiscal year ended June 30, 2006 adequately safeguard the Plans' assets and provide reasonable assurance regarding the proper recording of financial transactions. In addition, the Board, in conjunction with the Chief Administrative Officer, approves and actively monitors the annual budgets for each plan.

Independent Audit and Actuarial Certification

An independent auditors' report and actuarial certification are included in this report.

AWARDS AND ACKNOWLEDGEMENTS

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montgomery County Employee

Retirement Plans for its comprehensive annual financial report for the fiscal year ended June 30, 2005. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The Montgomery County Employee Retirement Plans have received the Certificate of Achievement for the last six consecutive years. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement program requirements and we are submitting it to the GFOA.

Acknowledgements

The Plans' CAFR was prepared by the Board of Investment Trustees staff in conjunction with staff support from the County's Department of Finance and Office of Human Resources. I would like to express my appreciation to the employees who have worked hard throughout the year to ensure the successful operation of the Plans.

Respectfully submitted,

Timothy L. Firestine
Chief Administrative Officer
Plan Administrator

BOARD OF INVESTMENT TRUSTEES

ADMINISTRATIVE ORGANIZATION

Administrative Staff

Joseph Adler
Director – Office of
Human Resources

Timothy L. Firestine
Director of Finance

Linda A. Herman
Executive Director

Professional Services

Actuary

Mercer Human Resource
Consulting
Washington, DC

Investment Consultant

Wilshire Associates
Pittsburgh, PA

Auditor

KPMG LLP
Certified Public Accountants
Washington, DC

Investment Managers-Employees' Retirement System

Gryphon International Investment
Toronto, Canada

Numeric Investors
Cambridge, MA

Adams Street Partners
Chicago, IL

Marathon London
United Kingdom

Wellington Management
Boston, MA

RhumbLine Advisors
Boston, MA

Mondrian Investment Partners Ltd.
United Kingdom

Goldman Sachs
New York, NY

Systematic Financial Management
Teaneck, NJ

BlackRock Financial Management
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Fidelity Investments
Hebron, KY

Loomis Sayles & Co. L.P.
Boston, MA

JP Morgan Investment Management
New York, NY

Bridgewater Associates
Westport, CT

Morgan Stanley Asset Management
New York, NY

Barclays Global Investors
San Francisco, CA

HarbourVest Partners
Boston, MA

Nomura Corporate Research & Asset
Management
New York, NY

Landmark Partners Inc.
Simsbury, CT

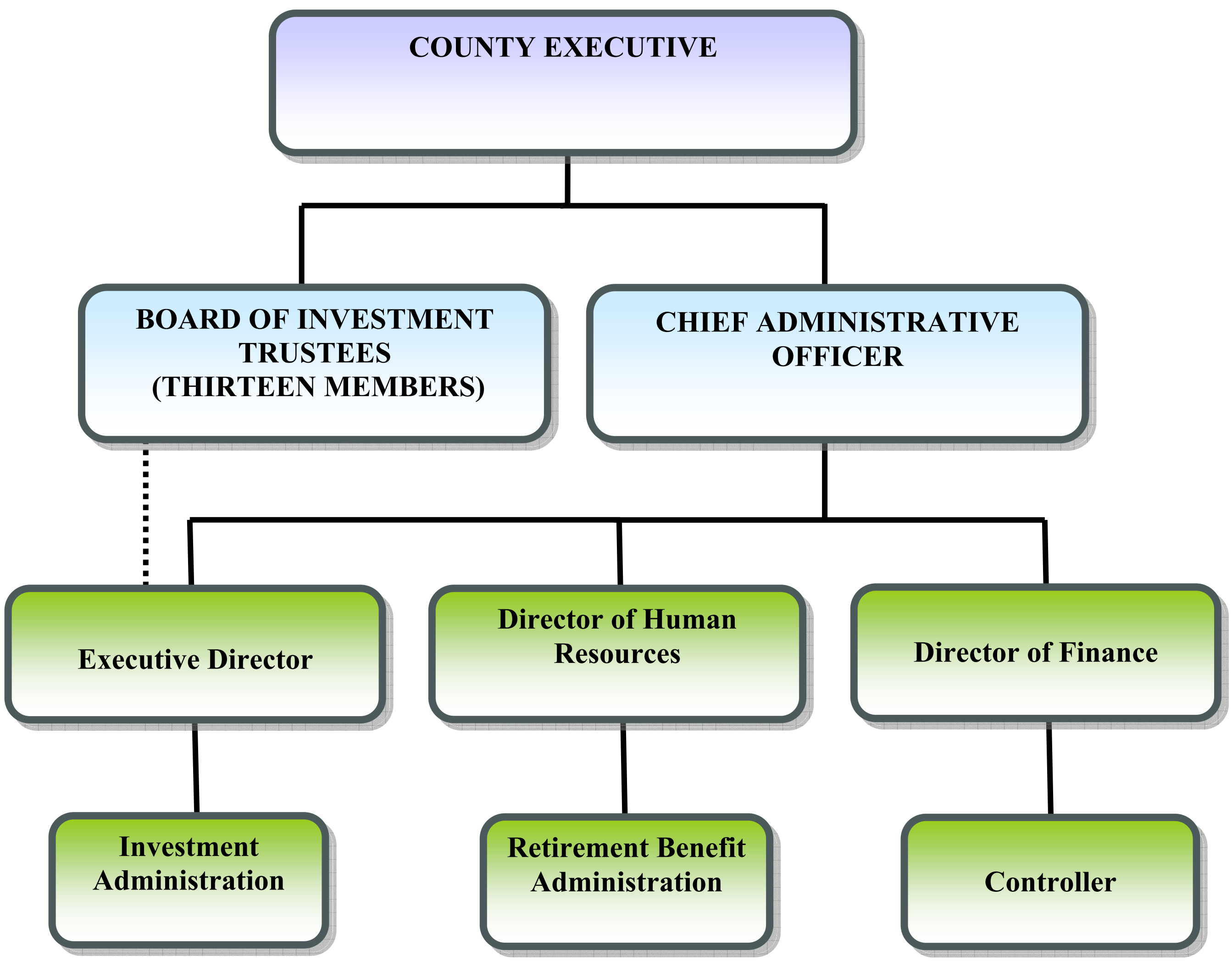
AEW Partners
Boston, MA

TA Associates Advisors LLC
Boston, MA

Custodial Bank-Employees' Retirement System

The Northern Trust Company
Chicago, IL

Administrative Organization Chart



FINANCIAL SECTION

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The County Council of Montgomery County, Maryland

The Board of Trustees
Montgomery County Employees' Retirement Plans:

We have audited the accompanying statements of plan net assets of the Montgomery County Employees' Retirement Plans (the Plans) as of June 30, 2006 and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plans' 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plans' internal control over financial reporting. Accordingly, we express no such opinion. 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 the Plans as of June 30, 2006 and the changes in the plan net assets for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2006 on our consideration of the Plans' internal control over financial reporting and 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 *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 15 through 19 and the schedule of funding progress and notes thereto, on pages 32 and 33, are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the 2006 basic financial statements. The 2006 supplementary information on pages 34 through 41 is presented for purposes of additional analysis and is not a required part of the 2006 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2006 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2006 basic financial statements taken as whole. The information included in the introduction, investment, actuarial, and statistical sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on such information.

We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the statements of plan net assets of the Plans as of June 30, 2005, and the related statements of changes in plan net assets for the year then ended (none of which is presented herein), and we expressed an unqualified opinion on those financial statements. The supplementary information included on pages 36 through 41 related to the Plans' 2005 financial statements was subjected to auditing procedures applied in the audit of those basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements from which it has been derived.

KPMG LLP

December 8, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The following Management's Discussion and Analysis (MD&A) of the Montgomery County Employee Retirement Plans (Plans) financial performance provides an introduction to the financial statements of the Plans as of and for the year ended June 30, 2006. Since the MD&A is designed to focus on current activities, resulting changes and current known facts, it should be read in conjunction with the transmittal letter in the Introduction Section on page 4, the financial statements, required supplementary information, and other supplementary information which follow this discussion.

Required Financial Statements

The financial statements for the Plans have been prepared under the accrual basis of accounting in conformity with U.S. generally accepted accounting principles, promulgated by the Governmental Accounting Standards Board. The Statements of Plan Net Assets comprise the Plans' assets and liabilities and provide information about the nature and amount of investments, as well as the liabilities distinguished as long-term and other liabilities. The Statements of Changes in Plan Net Assets report the changes of the Plans' net assets, measured by the additions by major sources and deductions by type. Comparative financial statements of the three plans are presented in the latter part of the financial section.

Financial Analysis of the Montgomery County Employee Retirement Plans

Shown below is a condensed presentation of the Net Assets of the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and Deferred Compensation Plan (DCP) at June 30:

Net Assets
(Millions)

	ERS		RSP		DCP	
	2006	2005	2006	2005	2006	2005
Assets:						
Cash and investments	$ 2,633.0	$ 2,406.4	$ 89.2	$ 70.4	$ 212.4	$ 186.7
Receivables	14.4	11.9	1.0	0.8	0.9	0.8
Total assets	2,647.4	2,418.3	90.2	71.2	213.3	187.5
Liabilities	339.7	273.5	-	-	-	-
Total net assets	$ 2,307.7	$ 2,144.8	$ 90.2	$ 71.2	$ 213.3	$ 187.5

Shown below is a condensed summary of the Change in Net Assets of the ERS, RSP, and DCP for the years ended June 30:

Change in Net Assets (Millions)						
	ERS		**RSP**		**DCP**	
	2006	2005	2006	2005	2006	2005
Additions:						
Employer contributions	$ 88.2	$ 74.7	$ 9.4	$ 8.7	$ -	$ -
Member contributions	16.1	15.3	5.9	4.8	16.5	19.9
Net investment income	187.0	197.4	8.2	4.7	20.5	14.6
Total additions	291.3	287.4	23.5	18.2	37.0	34.5
Deductions:						
Benefits	125.9	115.6	-	-	-	-
Refunds	0.6	0.8	4.3	2.4	11.2	10.2
Administrative expenses	1.9	1.8	0.2	0.2	-	-
Movement of member account asset	-	-	-	-	-	77.8
Total deductions	128.4	118.2	4.5	2.6	11.2	88.0
Total change in net assets	$ 162.9	$ 169.2	$ 19.0	$ 15.6	$ 25.8	$ (53.5)

The following schedules provide a comparative summary and an analysis of each Plans' assets, liabilities and net assets, at June 30:

Employees' Retirement System Net Assets (Millions)			
	2006	**2005**	**Percentage Change**
Assets:			
Cash and investments	$ 2,633.0	$ 2,406.4	9.4 %
Receivables	14.4	11.9	21.0
Total assets	2,647.4	2,418.3	9.5
Liabilities:			
Benefits payable and other liabilities	3.1	2.7	14.8
Obligations under securities lending agreements	336.6	270.8	24.3
Total liabilities	339.7	273.5	24.2
Total plan net assets	$ 2,307.7	$ 2,144.8	7.6 %

The table shown above reflects an increase in the Employees' Retirement System's net assets of $162.9 million or 7.6 percent during fiscal year (FY) 2006. The increase reflects improved market conditions over the last twelve months resulting in increased investment earnings. During the previous year net assets increased by $169.2 million.

Retirement Savings Plan Net Assets (Millions)			
	2006	2005	Percentage Change
Assets:			
Cash and investments	$ 89.2	$ 70.4	26.7 %
Receivables	1.0	0.8	25.0
Total assets	90.2	71.2	26.7
Liabilities	-	-	
Total plan net assets	$ 90.2	$ 71.2	26.7 %

During FY 2006, net assets increased 26.7 percent to $90.2 million. The increase is attributable to increased investment earnings and an increase in contributions. Membership in the Retirement Savings Plan rose from 3,941 at June 30, 2005, to 4,371 at June 30, 2006.

Deferred Compensation Plan Net Assets (Millions)			
	2006	2005	Percentage Change
Assets:			
Investments	$ 212.4	$ 186.7	13.8 %
Receivables	0.9	0.8	12.5
Total assets and plan net assets	$ 213.3	$ 187.5	13.8 %

Net assets of the Deferred Compensation Plan increased 13.8 percent to $213.3 million during FY 2006. The increase is attributable to increased investment earnings and an increase in contributions.

Additions

The primary sources of additions for the Plans include member and employer (where applicable) contributions and investment income. The following tables compare the source and amount of additions for each Plan during FY 2006 and FY 2005.

Employees' Retirement System Contributions and Investment Income (Millions)			
	2006	2005	Percentage Change
Employer contributions	$ 88.2	$ 74.7	18.1 %
Member contributions	16.1	15.3	5.2
Net investment income	187.0	197.4	(5.3)
	$ 291.3	$ 287.4	1.4 %

During FY 2006, employer contributions to the Employees' Retirement System increased by 18.1 percent due to an increase in the actuarial required contribution based on covered payroll. Member contributions increased by 5.2 percent due to higher pay levels.

The net investment income for the Employees' Retirement System totaled $187.0 million for FY 2006, comprised of $139.1 million in net appreciation in fair value of investments, $55.2 million in dividends and interest, $12.7 million from securities lending activities, and $20.0 million related to investment expenses. This is compared to net investment income of $197.4 million in FY 2005. The decrease in earnings compared to the previous fiscal year is due to market conditions.

Retirement Savings Plan
Contributions and Investment Income
(Millions)

	2006	2005	Percentage Change
Employer contributions	$ 9.4	$ 8.7	8.0 %
Member contributions	5.9	4.8	22.9
Net investment income	8.2	4.7	74.5
	$ 23.5	$ 18.2	29.1 %

Employer contributions to the Retirement Savings Plan were $9.4 million in FY 2006, an increase of 8.0 percent from FY 2005. Member contributions were $5.9 million in FY 2006, an increase of 22.9 percent from FY 2005. The increase in contributions reflects the increase in the number of participants during FY 2006.

Appreciation in investments reflects the current market conditions.

Deferred Compensation Plan
Contributions and Investment Income
(Millions)

	2006	2005	Percentage Change
Member contributions	$ 16.5	$ 19.9	(17.1) %
Net investment income	20.5	14.6	40.4
	$ 37.0	$ 34.5	7.2 %

Member contributions to the Deferred Compensation Plan were $16.5 million for FY 2006, compared to $19.9 million for FY 2005.

Net investment income for the Deferred Compensation Plan was $20.5 million, compared to the investment income of $14.6 million in the previous fiscal year, which was primarily due to market conditions.

Deductions

The primary sources of deductions from the Plans include the payment of retiree and survivor benefits, participant refunds, and administrative expenses. The following tables show the use and amount of deductions for each plan during FY 2006 and 2005.

Employees' Retirement System
Deductions by Type
(Millions)

	2006	2005	Percentage Change
Benefits	$ 125.9	$ 115.6	8.9 %
Refunds	0.6	0.8	(25.0)
Administrative expenses	1.9	1.8	5.6
	$ 128.4	$ 118.2	8.6 %

During FY 2006, benefit payments increased by 8.9 percent over FY 2005 due primarily to an increase in the number of retirees and the annual cost-of-living increase. Refunds decreased 25 percent in 2006 from $0.8 million in FY 2005. Administrative expenses increased slightly in 2006 from $1.8 million in FY 2005 to $1.9 million in FY 2006.

Retirement Savings Plan
Deductions by Type
(Millions)

	2006	2005	Percentage Change
Refunds and administrative expenses	$ 4.5	$ 2.6	73.1 %

The expenses related to the Retirement Savings Plan are comprised of refunds and administrative costs. Expenses for FY 2006 totaled $4.5 million, an increase of 73.1 percent over FY 2005 levels due primarily to an increase in refunds.

Deferred Compensation Plan
Deductions by Type
(Millions)

	2006	2005	Percentage Change
Refunds and administrative expenses	$11.2	$10.2	9.8 %
Movement of member account asset balances	-	77.8	(100.0)
	$11.2	$88.0	(87.3) %

During FY 2006, refunds distributed from the Deferred Compensation Plan increased by 9.8 percent over the FY 2005 level.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2006

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ASSETS			
Equity in County's pooled cash and investments	$ 254,623	$ 611,204	$ -
Investments:			
U.S. Government and agency obligations	232,995,778	-	-
Asset-backed securities	64,293,203	-	-
Municipal/Provincial bonds	1,254,177	-	-
Corporate bonds	290,400,350	-	-
Collateralized mortgage obligations	14,495,328	-	-
Commerical mortgage-backed securities	17,596,302	-	-
Common and preferred stock	1,476,304,775	-	-
Mutual and commingled funds	850,557	88,570,836	212,366,121
Short-term investments	147,756,147	-	-
Cash collateral received under securities lending agreements	336,590,875	-	-
Real estate holdings	5,600,193	-	-
Alternative investments	44,610,809	-	-
Total investments	2,632,748,494	88,570,836	212,366,121
Dividends receivable and accrued interest	8,361,260	-	-
Contributions receivable	6,032,613	1,019,942	918,588
Total assets	2,647,396,990	90,201,982	213,284,709
LIABILITIES			
Payable for collateral received under securities lending agreements	336,590,875	-	-
Benefits payable and other liabilities	3,126,553	26,828	-
Total liabilities	339,717,428	26,828	-
Net assets held in trust for pension benefits	$ 2,307,679,562	$ 90,175,154	$ 213,284,709

(A schedule of funding progress for the Employees' Retirement System is presented on page 32.)

See accompanying notes to financial statements.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2006

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ADDITIONS			
Contributions:			
Employer	$ 88,184,159	$ 9,437,190	$ -
Members	16,084,999	5,860,277	16,562,414
Total contributions	104,269,158	15,297,467	16,562,414
Investment income	194,355,608	8,266,798	20,485,777
Less investment expenses	7,967,636	30,097	-
Net income from investment activities	186,387,972	8,236,701	20,485,777
Income from securities lending	12,706,126	-	-
Less securities lending expenses	12,089,748	-	-
Net income from securities lending	616,378	-	-
Total additions	291,273,508	23,534,168	37,048,191
DEDUCTIONS			
Retiree benefits	112,210,585	-	-
Disability benefits	12,124,706	-	-
Survivor benefits	1,483,035	-	-
Refunds	634,585	4,305,879	11,225,978
Administrative expenses	1,920,238	242,844	-
Total deductions	128,373,149	4,548,723	11,225,978
Net increase	162,900,359	18,985,445	25,822,213
Net assets held in trust for pension benefits:			
Beginning of year	2,144,779,203	71,189,709	187,462,496
End of year	$2,307,679,562	$ 90,175,154	$ 213,284,709

See accompanying notes to financial statements.

INTRODUCTION

The Montgomery County Employee Retirement Plans (Plans) are offered to Montgomery County (County) employees whose eligibility to participate is based on employment status and other factors. Each of the Plans described below was established under a separate section of the Montgomery County Code (Code). The accompanying notes summarize the significant accounting policies and plan provisions for each of the Plans, including the Employees' Retirement System, a defined benefit pension plan; the Retirement Savings Plan, a defined contribution plan; and the Deferred Compensation Plan, a plan established pursuant to Section 457 of the Internal Revenue Code.

EMPLOYEES' RETIREMENT SYSTEM - Defined Benefit Pension Plan

The Montgomery County Employees' Retirement System (System or Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the System in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to public employee retirement systems. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2006, the date of the latest actuarial valuation, membership in the System consisted of:

Retirees and beneficiaries receiving benefits	4,848
Terminated plan members entitled to but not yet receiving benefits	485
Active plan members	5,362

Plan Description. The System, a cost-sharing multiple-employer defined benefit pension plan, was established in 1965 and is sponsored by the County. Eight other agencies and political subdivisions have elected to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. All covered full-time employees of the County and participating agencies must become members of the System as a condition of employment. All covered career part-time employees of the County and participating agencies may become members on an individual basis.

Funding Policy and Contributions. The System is a contributory plan with employees contributing a percentage of their base annual salary. Contribution rates range from 4 percent to 8.5 percent of regular earnings annually based on group classification and contributions earn interest at the rate of 4 percent per annum as specified under Section 33-39(b) of the Code. The County and each participating agency are required to contribute the remaining amounts necessary to fund the System using the actuarial basis as specified in Section 33-40 of the Code.

Benefit Provisions. Benefit provisions are established under the Code beginning with Section 33-35. All benefits vest at five years of service. There are different retirement groups within the System. Members enrolled before July 1, 1978, belong to either the optional non-integrated group or the optional integrated group. Members enrolled on or after July 1, 1978, belong to the mandatory integrated group. Within the groups are different retirement membership classes. The retirement group assigned depends upon the job classification of the member (i.e., non public safety, police, fire, sheriffs and correctional staff). Normal and early retirement eligibility, the formula for determining the amount of benefit, and the cost of living adjustment varies depending upon the retirement group and retirement membership class. Normal retirement is a percentage of earnings multiplied by years of credited service. Earnings for optional non-integrated group members and optional integrated group members is defined as the high 12 months and for mandatory integrated plan members, the high 36 months. The percentage of earnings, the maximum years of credited service and the cost of living adjustment varies depending upon the retirement membership class and group. Members who retire early receive normal retirement benefits reduced by a minimum of 2 percent to a maximum of 60 percent depending on the number of years early retirement precedes normal retirement. The System provides options for disability and death benefits to eligible participants. Annual cost-of-living adjustments are provided to retirees and beneficiaries based on the percentage increase in the Consumer Price Index.

Legislation enacted by the Montgomery County Council in November 1999 required the Chief Administrative Officer of the County to establish Deferred Retirement Option Plans, or DROP Plans, allowing any employee who is a member of a specified membership group or bargaining unit, and who meets certain eligibility requirements, to elect to "retire" but continue to work for a specified time period, during which pension payments are deferred. When the member's participation in the DROP Plan ends, the member must stop working for the County, draw a pension benefit based on the member's credited service and earnings as of the date that the member began to participate in the DROP Plan, and receive the value of the DROP Plan payoff.

B. Summary of Significant Accounting Policies

Basis of Accounting. The System's financial statements have been prepared under the accrual basis of accounting. Member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the System.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2006. Fair value for real estate investments is determined using unit values supplied by the issuers, which are based upon the issuers' appraisals of underlying real estate values. Such values involve subjective judgment and may differ from amounts which would be realized if such real estate was actually sold. The fair value for alternative investments is based on information provided by the fund managers. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County's Pooled Cash and Investments. The System maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the System based on the System's average daily balance of its equity in pooled cash. The County's policy is to fully collateralize the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the System to be responsible for the investment management of the System's assets for the exclusive benefit of the members. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-61 of the Code, authorizes the Board to purchase investments with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes. The Code also requires that such investments be diversified so as to minimize the risk of large losses unless it is clearly not prudent to diversify under the circumstances. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. The overall investment policies do not address specific levels of credit risk, interest rate risk or foreign currency risk. The Board believes that risks can be managed, but not eliminated, by establishing constraints on the investment portfolios and by monitoring the financial markets, the System's asset allocation and the investment managers hired by the System. Each investment manager has a specific benchmark and investment guidelines appropriate for the type of investments they are managing. Section 33-60 of the Code prohibits the Board from investing in any bonds, notes, or debt instruments issued by Montgomery County, any political subdivision within Montgomery County, any agency supported or financed wholly or partly by taxes levied by the Montgomery County Council, or any agency supported by bond issues underwritten by Montgomery County. Investments in real property are limited to a pooled investment arrangement in which the Board has no power or right to manage the real estate property, provided that the pooled arrangement does not invest more than 10 percent of its assets in real property located in Montgomery County.

Credit Risk/Concentration of Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Board's investment policies and guidelines limit the percentage of the total fund and individual manager's account which can be invested in fixed income securities rated below investment grade. In addition, the Board's investment policies and guidelines limit the percentage of each investment manager's account that may be allocated to any one security, position, issuer or affiliated issuer, to less than 5 percent of the fair value of the investment manager's account. The System does not have investments (other than those issued or explicitly guaranteed by the U.S. Government or pooled investments) in any one organization that represent 5 percent or more of net assets held in trust for pension benefits.

The quality ratings of investments in fixed income securities as described by nationally recognized rating organizations as of June 30, 2006 are as follows:

Type of Investment	Quality Rating	Fair Value	Percentage of Portfolio
U.S. Government Obligations*	AAA	$ 116,952,530	15.21%
Foreign Government Obligations	AAA	82,287,034	10.70%
	AA	16,157,351	2.10%
	A	1,991,858	0.26%
	BBB	7,493,455	0.97%
	BB	7,439,364	0.97%
	B	292,125	0.04%
	Unrated	382,061	0.05%
Asset-Backed Securities	AAA	22,607,162	2.94%
	A	1,519,518	0.20%
	B	7,411,314	0.96%
	CCC	2,447,178	0.32%
	Unrated	29,641,756	3.85%
Commercial Mortgage-Backed Securities	AAA	5,245,121	0.68%
	A	2,718,512	0.35%
	BBB	7,641,936	0.99%
	BB	1,707,005	0.22%
	B	283,728	0.04%
Collateralized Mortgage Obligations	BBB	515,278	0.07%
	BB	5,721,305	0.74%
	B	5,857,788	0.76%
	CCC	2,400,957	0.31%
Municipal /Provincial Bonds	AA	838,739	0.11%
	A	133,663	0.02%
	Unrated	281,775	0.04%
Corporate Bonds	AAA	11,231,603	1.46%
	AA	15,027,048	1.95%
	A	29,793,929	3.87%
	BBB	26,650,229	3.47%
	BB	30,191,753	3.93%
	B	56,201,257	7.31%
	CCC	10,711,252	1.39%
	CC	208,000	0.03%
	Unrated	21,313,423	2.77%
Fixed Income Pooled Funds	AAA	1,824,431	0.24%
	AA	87,913,700	11.43%
Short-term Investments and Other	AAA	12,945,472	1.68%
	AA	7,906,364	1.03%
	BBB	3,017,387	0.39%
	BB	10,432,714	1.36%
	B	14,445,466	1.88%
	NA	99,263,367	12.91%
Total Fixed Income Securities		$ 769,045,908	100.00%

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

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. The Board's investment policies and guidelines manage interest rate risk by establishing duration constraints on each fixed income manager's portfolio based on the duration of each manager's respective benchmark. Duration is a measure of interest rate risk based on a bond price's sensitivity to a 100-basis point change in interest rates. The greater the duration of a bond, or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Duration of eight would mean that, given a 100-basis point change up/down in rates, a bond's price would move up/down by 8 percent. As of June 30, 2006, the System's fixed income portfolio had the following sensitivity to changes in interest rates:

Type of Investment	Effective Duration in years	Fair Value	Percentage of Portfolio
U.S. Government Obligations	7.30	$ 116,952,530	15.21%
Foreign Government Obligations	11.06	116,043,248	15.09%
Asset-Backed Securities	9.54	63,626,928	8.27%
Commercial Mortgage-Backed Securities	13.91	17,596,302	2.29%
Collateralized Mortgage Obligations	16.04	14,495,328	1.88%
Municipal /Provincial Bonds	9.88	1,254,177	0.16%
Corporate Bonds	5.85	201,328,494	26.18%
Fixed Income Pooled Funds	0.03	89,738,131	11.67%
Short-term Investments and other	N/A	148,010,770	19.25%
Total Debt Securities		$ 769,045,908	100.00%

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Board's International Investing Policy's objective is to achieve long-term capital appreciation and current income by investing in diversified portfolios of non-U.S. equities and bonds. The System has indirect exposure to foreign currency risk as follows:

International Securities	Equity	Fixed Income	Short-term and other	Total Non-U.S. Dollar
Japanese Yen	$ 83,136,499	$ 26,487,775	$ 3,497,985	$ 113,122,259
British Pound Sterling	52,418,559	13,289,160	10,919,405	76,627,124
European Currency Unit	101,060,891	36,242,935	(92,156,543)	45,147,283
Swiss Franc	20,121,433	-	9,114,517	29,235,950
Hong Kong Dollar	21,862,860	-	-	21,862,860
Chinese Yuan Renminbi	-	-	13,104,458	13,104,458
Canadian Dollar	2,653,337	19,392,650	(10,350,599)	11,695,388
Swedish Krona	5,080,777	21,765,318	(18,984,138)	7,861,957
Australian Dollar	3,496,303	-	3,977,009	7,473,312
Thai Baht	4,172,714	-	-	4,172,714
Other Currencies	19,096,123	5,115,268	586,458	24,797,849
Total International Securities	$ 313,099,496	$ 122,293,106	$ (80,291,448)	$ 355,101,154

Derivatives. The System invests in derivative instruments on a limited basis in accordance with the Board's Derivatives Policy. During FY 2006, the System invested directly in various derivatives including asset-backed securities, collateralized mortgage obligations, exchanged-traded future contracts, forward currency contracts, swaps, and floating rate securities. Investment managers are specifically prohibited from purchasing securities on margin or leverage. The System entered into these investments either to increase earnings or to hedge against potential losses. These investments generally contain market risk resulting from fluctuations in interest and currency rates. The credit risk of these investments is associated with the creditworthiness of the related parties to the contracts. The System could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. The Board's Derivatives Policy seeks to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. In addition, the System has indirect exposure to market and credit risk through its ownership interests in certain mutual and commingled funds which may hold derivative financial instruments.

As permitted by the Board's policies, the System holds off-financial statement derivatives in the form of exchange-traded financial futures and options. The futures and options with fair values of approximately $354,579,000 are held for investment purposes and included within the financial statements at June 30, 2006. Gains and losses on futures and options are determined based upon fair market values and recorded in the Statements of Changes in Plan Net Assets.

Interest rate swaps and forward foreign currency exchange contracts are held for investment purposes. At June 30, 2006, the System had approximately $11,165,000 negative net exposure in interest rate swaps and $61,876,000 negative net exposure in forward foreign currency exchange contracts.

Securities Lending. Board policy permits the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the System's securities for collateral of 102 percent for domestic and 105 percent for international securities. The custodian receives cash, securities or irrevocable bank letters of credit as collateral. All securities loans can be terminated on demand by either the System or the borrower. Cash collateral received from the borrower is invested by the lending agent, as an agent for the System, in a short-term investment pool in the name of the System, with guidelines approved by the Board. Such investments are considered a collateralized investment pool. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool, which the System cannot determine. The System records a liability for the return of the cash collateral shown as collateral held for securities lending in the statement of net assets. The Board does not restrict the amount of loans the lending agent may make on its behalf. The agent indemnifies the System by agreeing to purchase replacement securities, or return the cash collateral thereof, in the event a borrower fails to return loaned securities or pay distributions thereon. There were no such failures by any borrower during the fiscal year, nor were there any losses during the period resulting from a default of the borrower or lending agent.

As of June 30, 2006, the fair value of securities on loan was $348,649,181. Cash received as collateral and the related liability of $336,590,875 as of June 30, 2006, is shown on the Statement of Plan Net Assets. Securities received as collateral are not reported as assets since the System does not have the ability to pledge or sell the collateral securities absent borrower default. Securities lending revenues and expenses amounting to $12,706,126 and $12,089,748, respectively, have been classified with investment income and investment expenses, respectively, in the accompanying financial statements.

The following represents the balances relating to the securities lending transactions at June 30, 2006:

Securities Lent	**Underlying Securities**	**Non-Cash Collateral Value**	**Cash Collateral Investment Value**
Lent for Cash Collateral:			
U.S. Government Obligations	$ 85,095,468	$ -	$ 86,540,889
Foreign Government Obligations	15,508,692	-	15,987,460
Corporate Bonds	49,566,798	-	50,368,911
Equities	179,902,319	-	183,693,615
Lent for Non-Cash Collateral:			
U.S. Government Obligations	4,989,819	5,073,665	-
Corporate Bonds	5,590,013	5,681,162	-
Equities	7,996,072	8,180,718	-
Total	$ 348,649,181	$ 18,935,545	$ 336,590,875

At year-end, the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers exceeded the amounts the borrowers owe the System. The System is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. At June 30, 2006, there were no funds held by a counterparty that was acting as the System's agent in securities lending transactions.

E. Allocated Insurance Contract

On August 1, 1986, the County entered into an agreement with Aetna Life Insurance Company (Aetna) wherein Aetna accepted future responsibility for monthly payments to all members retired prior to January 1, 1986, in exchange for a lump sum payment. The County is liable for cost of living increases effective January 1, 1986, and later. Monthly payments made under this agreement have not been recognized in the System's financial statements.

F. Income Taxes

The Internal Revenue Service issued a determination letter in January 2003, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the System and its underlying trust have operated within the terms of the System and are qualified under the applicable provisions of the Internal Revenue Code.

RETIREMENT SAVINGS PLAN - Defined Contribution Pension Plan

The Montgomery County Retirement Savings Plan (Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2006 membership in the Plan consisted of:

Active plan members	3,791
Inactive plan members	580

Plan Description. The Plan, a cost-sharing multiple-employer defined contribution plan, was established in 1994 and is sponsored by the County. Eight other agencies or political subdivisions have elected to participate. All non-public safety and certain public safety employees not represented by a collective bargaining agreement and hired on or after October 1, 1994 are covered by the Plan. Eligible employees covered by the Montgomery County Employees' Retirement System may make an irrevocable decision to transfer to this Plan.

Contributions. Under Section 33-116 of the Code, the Plan requires employees to contribute 3 percent of regular earnings up to the Social Security wage base and 6 percent above the Social Security wage rate. Section 33-117 of the Code requires the County to contribute 6 percent and 10 percent of regular earnings for non-public safety and public safety employees, respectively. In accordance with IRS regulations and the County Code, $800,000 in accumulated revenue was used to reduce employer contributions in FY 2006.

Benefit Provisions. Employee contributions vest immediately and employer contributions are vested after three years of service or upon death, disability, or reaching retirement age. Members are fully vested upon reaching normal retirement (age 62) regardless of years of service. At separation, a participant's benefit is determined based upon the account balance which includes contributions and investment earnings.

B. Summary of Significant Accounting Policies

Basis of Accounting. The Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the County and participating agencies.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2006.

Equity in County's Pooled Cash and Investments. The Plan maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the Plan based on the Plan's average daily balance of its equity in pooled cash. The County's policy is to fully collateralize the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the Trust to oversee the investment program. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-125 of the Code authorizes the Board to establish a diversified slate of mutual and commingled investment funds from which participants may select an option. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. As of June 30, 2006, the fair value of the mutual and commingled investment funds was $88,570,836. The fair value of the investments in international mutual funds was $3,110,779.

E. Income Taxes

The Internal Revenue Service issued a determination letter in December 2002, which stated that the Plan and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the Plan and its underlying trust have operated within the terms of the Plan and are qualified under the applicable provisions of the Internal Revenue Code.

DEFERRED COMPENSATION PLAN

During FY 2005, the Montgomery County Council passed legislation enabling the County to establish and maintain one or more additional deferred compensation plans for employees covered by a collective bargaining agreement. County non-represented employees, those County represented employees who elected to participate, and employees who were retired at the time of transfer, continue to participate in the Montgomery County Deferred Compensation Plan administered by the County (the County Plan). County represented employees who elected may participate in the newly created Montgomery County Union Employees Deferred Compensation Plan (the Union Plan) administered by the bargaining units. The purpose of these Plans is to extend to employees deferred compensation plans pursuant to Section 457 of the Internal Revenue Code of 1986, as amended.

The accompanying financial statements present only the operations of the County Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County. The assets of the Union Plan are not included in the accompanying financial statements since neither the County nor the Board of Investment Trustees (Board) have fiduciary or other responsibility for the Union Plan except as required by federal law, including any regulation, ruling, or other guidance issued under law.

A. Plan Description and Contribution Information

Plan Description and Contributions. During 1999, in accordance with Federal legislation, the assets were placed in Trust for the sole benefit of participants and their beneficiaries. Trust responsibilities for the County Plan are assigned to the Board. The Board has a third-party administrator contract to provide investment vehicles and administrative services to plan participants. Under the County Plan, contributions are sent to the providers for different types of investments as selected by the participants. A separate account, which reflects the monies deferred, investment of the monies, and related investment earnings is maintained for each participant by the third-party administrator. Withdrawals are made upon retirement, termination of employment, death, and/or in unforeseeable emergencies.

B. Summary of Significant Accounting Policies

Basis of Accounting. The County Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Distributions are recognized when paid in accordance with the terms of the County Plan, and administrative costs are recognized as incurred.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2006.

C. Trustees of the Plan

The County established a Board to oversee the investment program of the County Plan. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

The Board is required to establish a diversified slate of mutual and commingled funds from which participants may select investment options. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. As of June 30, 2006, the fair value of the mutual and commingled investment funds was $212,366,121. The fair value of the investments in international mutual funds included in the County Plan was $15,957,962.

REQUIRED SUPPLEMENTARY INFORMATION

Historical trend information about the Employees' Retirement System (System) defined benefit pension plan is presented below as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

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 Covered Payroll ((b-a)/c)
6/30/01	$ 1,990,882,017	$ 2,111,946,453	$ 121,064,436	94.3 %	$ 290,751,709	41.6 %
6/30/02	2,036,100,709	2,273,179,216	237,078,507	89.6	298,456,852	79.4
6/30/03	2,029,314,438	2,411,492,724	382,178,286	84.2	312,057,363	122.5
6/30/04	2,045,098,796	2,561,328,232	516,229,436	79.8	318,815,374	161.9
6/30/05	2,100,532,623	2,775,047,412	674,514,789	75.7	328,459,150	205.4
6/30/06	2,222,724,295	2,918,336,073	695,611,778	76.2	340,333,414	204.4

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2001	$ 43,345,296	100 %
2002	39,168,622	100
2003	55,205,855	100
2004	61,927,029	100
2005	74,655,371	100
2006	88,184,159	100

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

Valuation date	June 30, 2006
Actuarial cost method	Projected unit credit
Amortization method	Level dollar amount
Remaining amortization period	40 year period based on closed periods
Asset valuation method	5-Year phase-in of market gains/losses
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases depending on age	4.75% - 7.50%
Cost-of-living adjustments	3.5%
Post-Retirement Increases	Consumer Price Index - by Group
Mortality rates after retirement	RP 2000 projected 10 years, separate tables for males and females

The actuarial assumptions used have been recommended by the actuary and adopted by the County's Chief Administrative Officer based on the most recent review of the System's experience, completed as of June 30, 2005.

The rate of employer contributions to the plan is composed of the normal cost, amortization of the unfunded actuarial liability and an allowance for administrative expenses. The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial ability.

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES
EMPLOYEES' RETIREMENT SYSTEM
FOR THE YEAR ENDED JUNE 30, 2006

SCHEDULE OF ADMINISTRATIVE EXPENSES

Personnel Services:	
Salaries and wages	$ 636,600
Retirement contributions	74,584
Insurance	83,159
Social security	56,034
Total personnel services	850,377
Professional Services:	
Actuarial	253,913
Independent public accountants	30,320
Outside legal	47,465
Total professional services	331,698
Benefit Processing:	
Disbursement services	372,130
Disability management	217,050
Total benefit processing	589,180
Due diligence and continuing education	12,388
Office Management:	
Rent and related charges	3,863
Communications	23,496
Office equipment and supplies	107,723
Miscellaneous	1,513
Total office management	136,595
Total administrative expenses	$ 1,920,238

SCHEDULE OF INVESTMENT EXPENSES

Investment Management Fees:	
Aetna Life Insurance Company	$ 3,813
The Northern Trust Company	267,625
Marathon London	1,050,597
BlackRock Financial Management	474,641
Wellington Management	578,456
Bridgewater Associates	714,898
RhumbLine Advisors	81,364
Systematic Financial Management	595,856
Mondrian Investment Partners Ltd.	503,710
Barclays Global Investors	66,395
Numeric Investors	1,331,324
WR Huff Asset Management	291,255
JP Morgan Investment Management	491,313
Capital Guardian Trust Company	135,743
Goldman Sachs	476,895
Gryphon International Investment	435,387
Loomis Sayles & Co. L.P.	116,507
Nomura Corporate Research & Asset Management	116,171
Total investment management fees	7,731,950
Other Investment Related Expenses:	
Bloomberg Financial Systems	13,286
Wilshire Associates	222,400
Securities lending borrower rebates	11,825,844
Securities lending agent fees	263,904
Total other investment related expenses	12,325,434
Total investment expenses	$ 20,057,384

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
Equity in County's pooled cash and investments	$ 254,623	$ 607,687
Investments:		
U.S. Government and agency obligations	232,995,778	342,255,205
Asset-backed securities	64,293,203	30,034,502
Municipal/Provincial bonds	1,254,177	1,143,116
Corporate bonds	290,400,350	274,681,642
Collateralized mortgage obligations	14,495,328	9,603,250
Commerical mortgage-backed securities	17,596,302	13,576,170
Common and preferred stock	1,476,304,775	1,387,747,640
Mutual and commingled funds	850,557	697,725
Short-term investments	147,756,147	53,478,063
Cash collateral received under securities lending agreements	336,590,875	270,825,841
Real estate holdings	5,600,193	681,790
Alternative investments	44,610,809	21,090,370
Total investments	2,632,748,494	2,405,815,314
Dividends receivable and accrued interest	8,361,260	7,124,154
Contributions receivable	6,032,613	4,771,937
Total assets	2,647,396,990	2,418,319,092
LIABILITIES		
Payable for collateral received under securities lending agreements	336,590,875	270,825,841
Benefits payable and other liabilities	3,126,553	2,714,048
Total liabilities	339,717,428	273,539,889
Net assets held in trust for pension benefits	$ 2,307,679,562	$ 2,144,779,203

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
ADDITIONS		
Contributions:		
Employer	$ 88,184,159	$ 74,655,371
Members	16,084,999	15,325,785
Total contributions	104,269,158	89,981,156
Investment Income:		
Net appreciation in fair value of investments	139,140,738	156,359,022
Dividends and interest	55,214,870	47,688,935
Total income from investment activities	194,355,608	204,047,957
Less investment expenses	7,967,636	7,209,622
Net income from investment activities	186,387,972	196,838,335
Income from securities lending	12,706,126	6,289,677
Less securities lending expenses	12,089,748	5,695,038
Net income from securities lending	616,378	594,639
Total additions	291,273,508	287,414,130
DEDUCTIONS		
Retiree benefits	112,210,585	102,641,063
Disability benefits	12,124,706	10,906,765
Survivor benefits	1,483,035	2,086,755
Refunds	634,585	762,338
Administrative expenses	1,920,238	1,856,977
Total deductions	128,373,149	118,253,898
Net increase	162,900,359	169,160,232
Net assets - beginning of year	2,144,779,203	1,975,618,971
Net assets - end of year	$2,307,679,562	$2,144,779,203

RETIREMENT SAVINGS PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
Equity in County's pooled cash and investments	$ 611,204	$ 439,826
Investments	88,570,836	69,986,937
Contributions receivable	1,019,942	790,497
Total assets	90,201,982	71,217,260
LIABILITIES		
Accrued expenses	26,828	27,551
Net assets held in trust for pension benefits	$ 90,175,154	$ 71,189,709

RETIREMENT SAVINGS PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
ADDITIONS		
Contributions:		
Employers	$ 9,437,190	$ 8,758,520
Members	5,860,277	4,819,587
Total contributions	15,297,467	13,578,107
Investment income	7,205,725	4,517,843
Less investment expenses	30,097	24,654
Net investment income	7,175,628	4,493,189
Other income	1,061,073	175,080
Total additions	23,534,168	18,246,376
DEDUCTIONS		
Refunds	4,305,879	2,441,154
Administrative expenses	242,844	230,942
Total deductions	4,548,723	2,672,096
Net increase	18,985,445	15,574,280
Net assets - beginning of year	71,189,709	55,615,429
Net assets - end of year	$ 90,175,154	$ 71,189,709

DEFERRED COMPENSATION PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
Investments	$ 212,366,121	$ 186,691,687
Contributions receivable	918,588	770,809
Total assets and net assets held in trust for pension benefits	$ 213,284,709	$ 187,462,496

DEFERRED COMPENSATION PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
ADDITIONS		
Contributions - members	$ 16,562,414	$ 19,928,984
Investment income	20,485,777	14,587,449
Total additions	37,048,191	34,516,433
DEDUCTIONS		
Member refunds	11,225,978	10,216,108
Administrative expenses	-	16,194
Movement of member account asset balances	-	77,837,950
Total deductions	11,225,978	88,070,252
Net increase (decrease)	25,822,213	(53,553,819)
Net assets - beginning of year	187,462,496	241,016,315
Net assets - end of year	$ 213,284,709	$187,462,496

INVESTMENT SECTION

Employees' Retirement System

EMPLOYEES' RETIREMENT SYSTEM

INVESTMENT PERFORMANCE, POLICY, STATISTICS AND ACTIVITY

For the fiscal year, the System's investment return was 9.18 percent. Return data for the System was calculated on a time weighted basis in accordance with the standards of the Association of Investment Management & Research (AIMR) by the System's custodian bank, The Northern Trust Company. Valuations are based on published national securities exchange prices, where available, and all valuations are reconciled between the various investment managers and the custodian bank. The following pages were prepared by the Board of Investment Trustees (Board) staff.

In the investment of public funds, adequate funding of employee retirement benefits at a reasonable and affordable cost is a paramount concern. An appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the System. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets.

Specific investment objectives include:

- To realize the actuarial assumed rate of return of 8 percent, annually.
- To manage portfolio risk so as to limit potential downside fluctuations in the value of the total System assets.
- To realize as high a rate of total return as possible consistent with the above.

To achieve these objectives, the following investment policies are employed:

- Allocate System assets to a broad array of investment sectors as follows: domestic equities 40%, alternative investments 5%, international equities 20%, domestic fixed income 20%, real estate 5%, and inflation index bonds 10%.
- Maintain the asset allocation stated above, within a +/-3% range.
- Monitor the individual investment manager's market value to ensure compliance with the Board's Manager Funding Policy.
- Evaluate the performance of all investment managers against their specific performance and style objectives and against the returns achieved by other similar managers.
- Evaluate the System's overall risk exposure and modify investments through rebalancing when necessary.

Charts and tables are enclosed indicating the System's:

- Asset allocation
- Investment managers with assignments
- List of largest assets held
- Investment performance for various periods

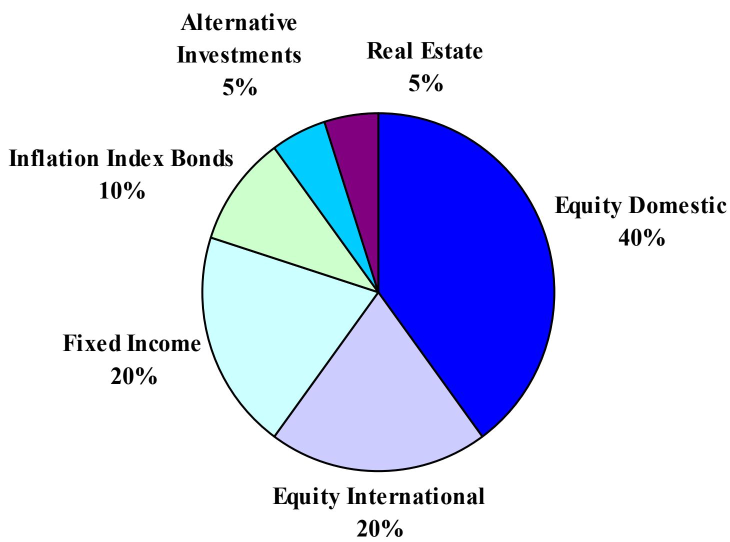
EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT SUMMARY
ASSET ALLOCATION BY CATEGORY AND INVESTMENT MANAGER
AS OF JUNE 30, 2006

Asset Class / **Manager**	**Investment Style**	**Fair Value $000**	**% of Total Fair Value**
Domestic Equities			
BGI Russell 1000 Fund*	Passive Russell 1000 Index	$ 211,358	9.2%
RhumbLine Advisors	Passive Russell 1000 Index	226,432	9.8%
Systematic Financial Mgt.	Active Large Cap Value	173,122	7.5%
Numeric Investors	Active Large Cap Core	167,718	7.3%
Goldman Sachs	Active Large Cap Growth	161,960	7.0%
Wellington	Active Small Cap Value	86,651	3.8%
Numeric Investors	Active Small Cap Growth	84,433	3.7%
Fidelity Investments*	Commingled Funds	850	0.0%
Alternative Investments			
Adams Street *	Private Equity Fund-of-Funds	23,304	1.0%
HabourVest *	Private Equity Fund-of-Funds	20,192	0.9%
Landmark*	Private Equity Fund-of-Funds	1,115	0.1%
International Equities			
Marathon	Active EAFE	209,665	9.1%
Gryphon	Active EAFE	123,919	5.4%
Mondrian*	Active Emerging Mkts. Fund	59,553	2.6%
BGI EAFE Fund*	Passive EAFE Index	1,197	0.1%
Real Estate			
Morgan Stanley*	Active Equity	46	0.0%
AEW Capital*	Private Real Estate Fund	5,554	0.2%
Fixed Income			
JP Morgan	Active Core Plus	185,107	8.0%
BlackRock	Active Core Plus	213,108	9.2%
Nomura	High Yield	53,392	2.3%
Loomis Sayles	High Yield	51,854	2.2%
BGI US Debt Fund*	Passive Lehman Aggregate Index	14,387	0.6%
Inflation Index Bond			
Bridgewater	Inflation Index Bonds	216,152	9.4%
Cash*	Active Short Term	13,704	0.6%
Total Assets**		$ 2,304,773	100.0%

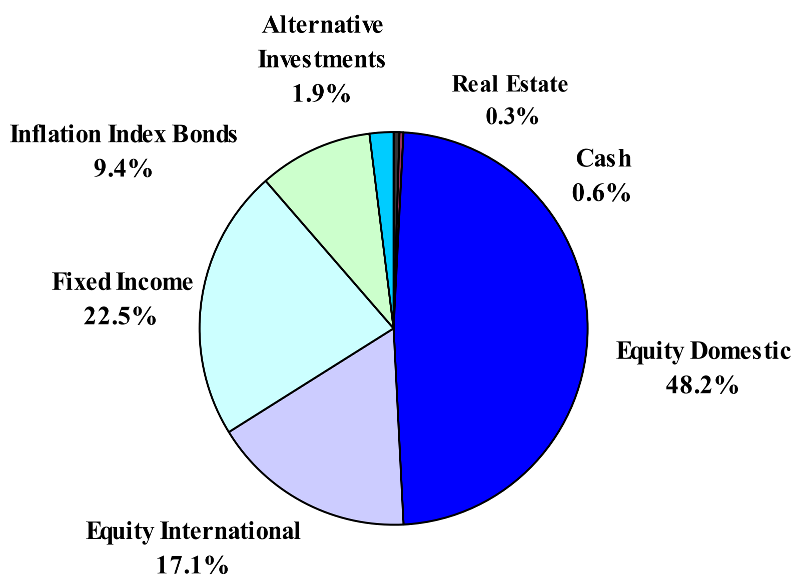
* Pooled Funds
**Without Cash Collateral and Contributions Receivable.

EMPLOYEES' RETIREMENT SYSTEM

Target Asset Allocation



Asset Allocation June 30, 2006



EMPLOYEES' RETIREMENT SYSTEM
LIST OF LARGEST ASSETS HELD
JUNE 30, 2006

Fifteen Largest Equity Holdings	Shares		Value
Exxon Mobil	319,900	$	19,625,865
Bank of America	351,009		16,883,533
General Electric	409,100		13,483,936
Citigroup	277,902		13,405,992
Pfizer	492,700		11,563,669
Ches Energy	321,920		9,738,080
Microsoft	413,370		9,631,521
AT&T	337,213		9,404,871
Altria Group	118,200		8,679,426
Pepsico	127,662		7,664,826
Schlumberger LTD	117,720		7,664,749
FHLMC	133,970		7,637,630
First Data	167,754		7,555,640
IBM	96,300		7,397,766
Wal-Mart	151,200		7,283,304

Fifteen Largest Fixed Income Holdings	Interest Rate	Maturity Date		Fair Value
United States Treasury Bonds				
Inflation Index Linked	3.875 %	April 15, 2029	$	21,681,720
Federal National Mortgage Assn.				
30 year Pass-Throughs	6.500	June 1, 2036		13,052,806
Federal National Mortgage Assn.				
Gold Participation Certificate	6.000	August 14, 2033		11,604,592
United States Treasury Notes	4.875	May 31, 2008		10,714,811
Federal National Mortgage Assn.				
Gold Participation Certificate	6.000	July 15, 2034		9,253,125
Canada Index Linked Government Bonds	3.000	January 12, 2036		8,856,603
United States Treasury Notes				
Inflation Index Linked	2.000	January 15, 2014		8,102,770
Federal National Mortgage Assn.				
30 year Pass-Throughs	5.500	May 1, 2036		7,346,412
Federal National Mortgage Assn.				
Single Family Mortgage 30 year	6.000	January 15, 2014		7,331,262
Federal National Mortgage Assn.				
TBA Pool 15 year	5.500	April 1, 2021		7,256,662
Federal National Mortgage Assn.				
Single Family Mortgage 15 year	6.000	July 15, 2019		7,024,066
France Government OATEI	3.150	July 25, 2032		6,817,695
United States Treasury Inflation Linked Bonds	2.350	January 15, 2025		6,760,819
United States Treasury Notes				
Inflation Index Linked	2.153	July 15, 2014		6,689,458
Italy Repurchase BTPI Linked	2.150	September 15, 2014		6,616,864

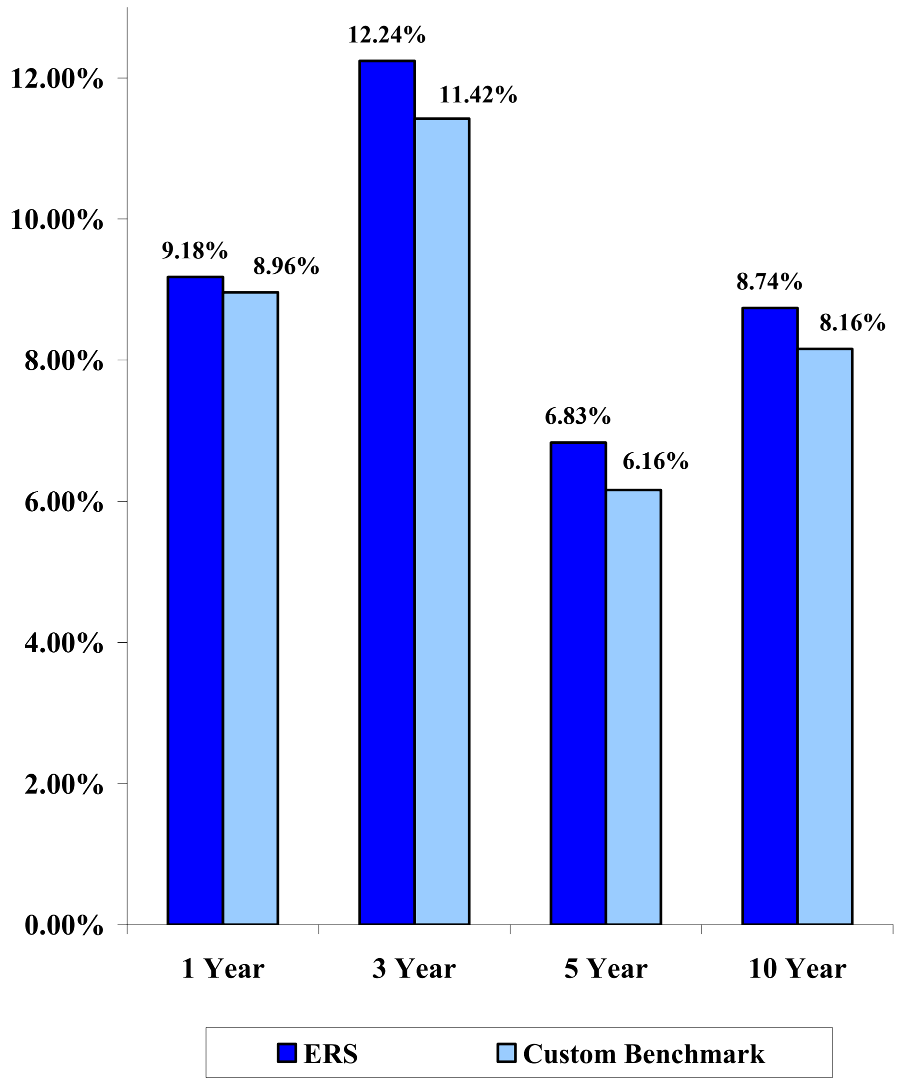
A complete list of the portfolio holdings can be obtained by contacting the Board of Investment Trustees office.

EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF INVESTMENT RESULTS
JUNE 30, 2006

Asset Class **Manager**	**1 Year**		**3 Year**		**5 Year**	
Domestic Equities						
RhumbLine Advisors	8.96	%	12.02	%	3.17	%
BGI Russell 1000 Fund*	-		-		-	
Systematic Financial Mgt.	13.38		16.9		7.61	
Numeric Investors-Core	8.96		14.42		5.98	
Goldman Sachs*	5.55		7.36		-	
Numeric Investors-Small Cap	15.1		19.96		9.79	
Wellington*	11.27		-		-	
Combined Domestic Equities	**9.87**		**13.65**		**5.10**	
****Russell 3000**	**9.56**		**12.56**		**12.56**	
Alternative Investments (a)						
Adams Street*	10.62		6.68		-	
HarbourVest*	16.49		-		-	
Landmark*	-		-		-	
****Russell 3000 + 300 Bpts**	**12.56**		**15.56**		-	
International Equities						
Marathon*	28.22		28.36		-	
Gryphon*	-		-		-	
Mondrian *	24.67		-		-	
BGI EAFE Fund*	26.90		24.28		-	
Combined International Equities	**26.08**		**25.35**		**11.73**	
****MSCI All Country World X US**	**28.40**		**25.78**		**11.85**	
Real Estate						
AEW Capital*	-		-		-	
Morgan Stanley	1.05		(11.17)		(7.34)	
Combined Real Estate Funds	**1.03**		**(11.18)**		**(7.34)**	
Fixed Income						
JP Morgan	0.19		2.84		5.56	
BlackRock	0.21		2.75		5.61	
Nomura*	-		-		-	
Loomis Sayles*	-		-		-	
BGI US Debt Fund*	-0.77		2.08		-	
Combined Fixed Income	**0.13**		**3.78**		**5.83**	
****Policy Benchmark**	**0.38**		**3.46**		**5.92**	
Inflation Index Bonds						
Bridgewater*	1.60		6.12		-	
****Custom IIB Benchmark**	**0.28**		**5.10**		**7.82**	
Total Fund	**9.18**		**12.24**		**6.83**	
****Policy Benchmark**	**8.96**	%	**11.42**	%	**6.16**	%

Returns are calculated on a time weighted
*Returns are not available for years indicated.
** Benchmark indexes.
(a) Returns in the early years of private equity are not generally meaningful due to accepted industry valuation standards. Negative performance in the early stages of private equity investing may occur due to the long term nature of the investment.

EMPLOYEES' RETIREMENT SYSTEM
Compound Annual Return
As of June 30, 2006



ACTUARIAL SECTION

Employees' Retirement System

MERCER
Human Resource Consulting

1255 23rd Street NW, Suite 500
Washington. DC 20037-1198
202 331 5200 Fax 202 296 0909
www.mercerHR.com

November 21, 2006

Board of Investment Trustees
Montgomery County Government Retirement System
101 Monroe Street
Rockville, MD 20850

Subject:
July 1, 2006 Actuarial Valuation Report

Dear Members of the Board:

Mercer Human Resource Consulting annually performs an actuarial valuation of the Montgomery County Employees' Retirement System for the Montgomery County Government. The most recent actuarial valuation performed was as of July 1, 2006. The purpose of this valuation was to:

- Review experience under the Plan for the year ending June 30, 2006
- Determine the liabilities of the Plan as of June 30, 2006
- Determine the contribution to be paid biweekly during the fiscal year ending June 30, 2008.

The actuarial information in this letter is provided in detail in our valuation report.

Valuation Results

Sections II through IV of the valuation report detail the results of the 2006 valuation, including a breakdown by employee group and plan. This valuation reflects the cost of demographic assumption changes as approved by the County resulting from an experience study conducted by Mercer after the 2005 valuation.

County Contributions

Contributions are computed using the Projected Unit Credit method of funding. The objective of this method is to fund each participant's benefits under the Plan, as they would accrue, taking into consideration future salary increases. Thus the total pension to which each participant is expected to become entitled is broken down into units; each associated with a year of past or future credited service.

If all actuarial assumptions are met in the future and if there are no plan changes, the plan contribution as a percentage of the payroll covered by this plan is expected to increase. This is because the Optional Plans are closed to new non-public safety members; hence, the average age of active members is expected to increase in the future. Normal cost per active member in the closed groups will increase at roughly the valuation interest rate, which is higher than the assumed salary scale.

The July 1, 2006 actuarial valuation sets the County's contribution rates for the fiscal year ending June 30, 2008. The rates are set separately for public safety and non-public safety employee groups and will be applied to each group's total covered payroll for the fiscal year 2008. Thus, the exact dollar amount of the required contribution will not be known until the end of the fiscal year 2008. The contribution rates for fiscal year 2008 were determined based on the total payroll at July 1, 2006, taking into account the general wage adjustments for FY07 on July 9, 2006, and January 7, 2007.

Investments

During the 2005-2006 plan year, the rate of return after investment expenses on the market value of assets was 8.8%. On a market value basis, the return was $16.4 million more than the 8% assumed rate of return. This $16.4 million gain is phased in over a five-year period. Gains and losses from 2005-2006 and prior years produced a net loss on an actuarial value of assets basis. As of July 1, 2006, net investment gains of $85.0 million had not yet been recognized in the actuarial value of assets.

The 2006 valuation was based on an actuarial value of assets of $2,222,724,295.

We used the financial information provided by the County without further audit.

Aetna Contract

The value of the Aetna non-participating group-annuity contract is excluded from all calculations.

Actuarial Assumptions and Plan Provisions

Changes in actuarial assumptions since the last actuarial valuation as of July 1, 2005 are described in. the July 1, 2006 valuation report. There were no changes in plan provisions since the July 1, 2005 actuarial valuation.

Participant Data

Between June 30, 2005 and June 30, 2006, there was a 0.2% increase in the number of plan members. However, the number of active members decreased by 4.7%, from 5,628 to 5,362. The total payroll increased by 0.6%, from $355.1 million to $357.4 million.

Aetna provided the retiree data, including benefits. The County provided data on active and terminated vested members. This information would customarily not be verified by a plan's actuary. We have reviewed the information for internal consistency and we have no reason to doubt its substantial accuracy.

Supplementary Information

The July 1, 2006 actuarial valuation report also provides supplemental information, including the schedule of funding progress. This schedule is presented in the financial section of the County's Comprehensive Annual Financial Report (CAFR). This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and to provide a means for making comparisons with other public employee retirement systems.

The County extracted the information from the July 1, 2006 valuation report for the following schedules in the actuarial section and the statistical section of County's Comprehensive Annual Financial Report.

- Summary of Results
- System Contribution
- Membership
- Actuarial Assumptions and Methods
- Solvency Test

Actuarial Certification

All costs, liabilities, and other factors under the Plan were determined in accordance with generally accepted actuarial principles and procedures. The information provided has been determined in accordance with the provisions of Statement Numbers 25 and 27 of the

MERCER
Human Resource Consulting

Governmental Accounting Standards Board. The costs are calculated using an actuarial cost method that we believe is appropriate. The actuarial assumptions are reasonable in our opinion and represent our best estimate of the anticipated experience under the Plan.

The undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.

Respectfully submitted,

Aquil Ahmed

Aquil Ahmed, ASA, EA

Douglas L. Rowe

Douglas L. Rowe, FSA, EA

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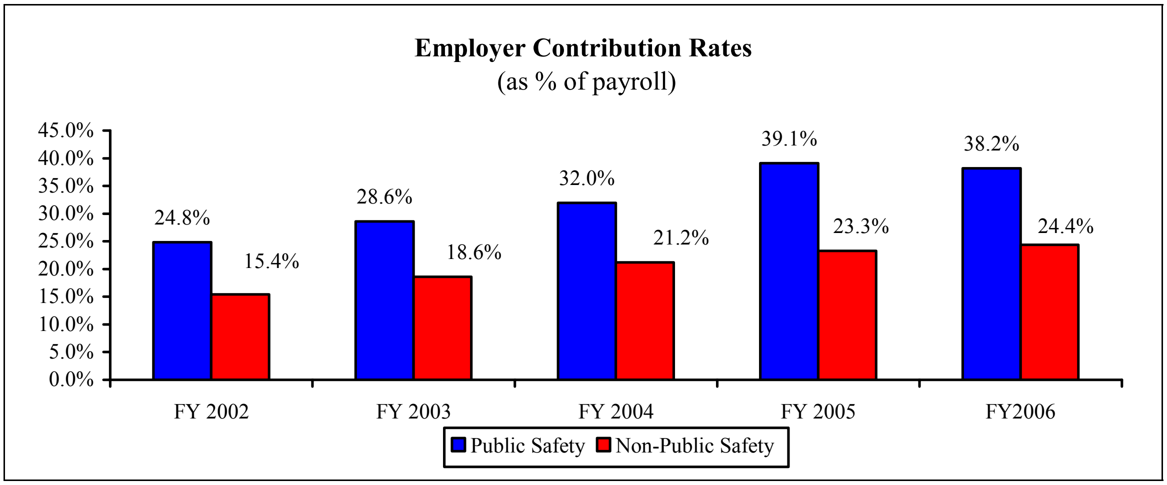
SUMMARY OF VALUATION RESULTS
EMPLOYEES' RETIREMENT SYSTEM

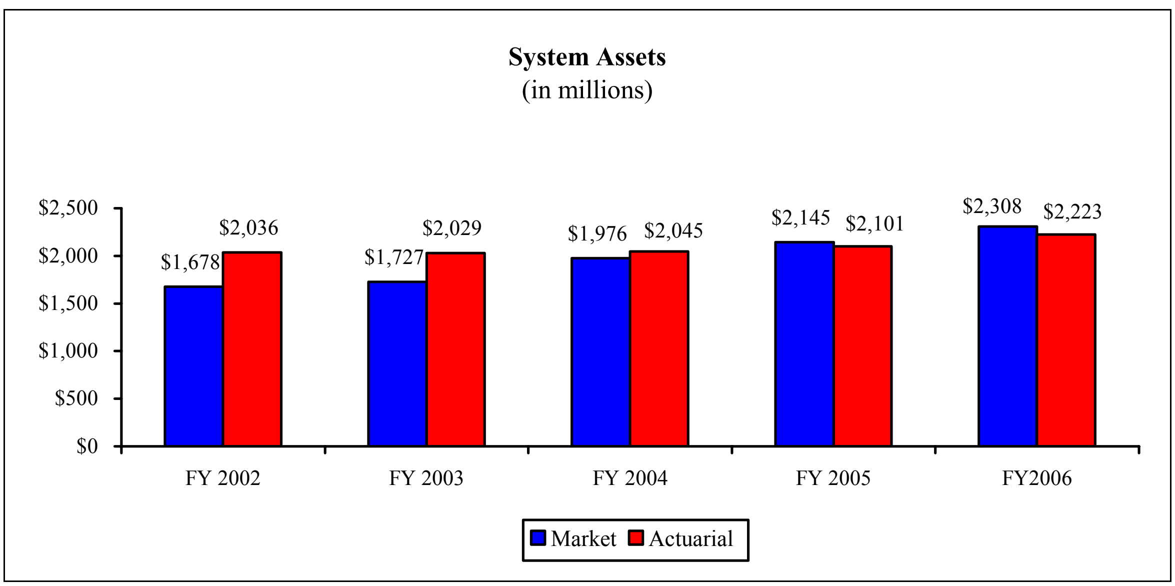
A. Overview

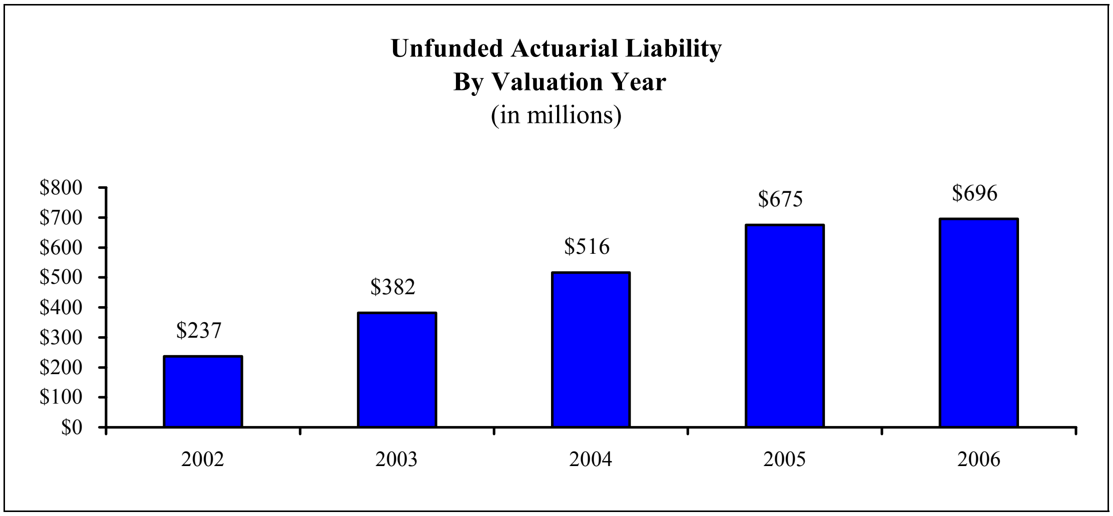
This report presents the results of our June 30, 2006 actuarial valuation of the Montgomery County Employees' Retirement System.

The major findings of the valuation are summarized in the following charts:

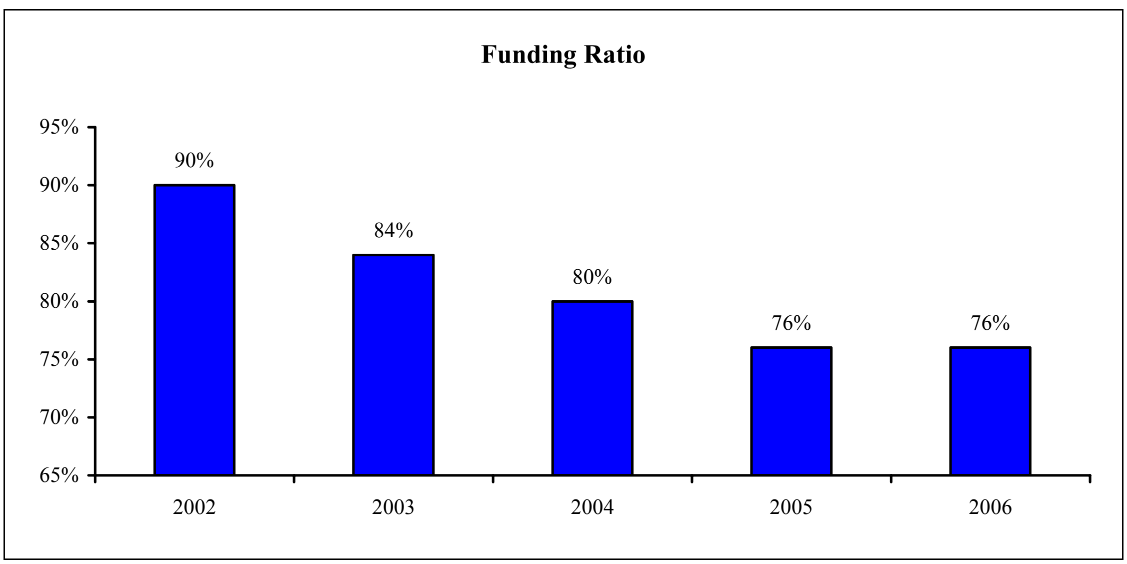


The change in the employer contribution rate in FY 2006 for Public Safety was primarily due to assumption changes. The change in the employer contribution rate in FY 2006 for Non-Public Safety was due to actual System experience versus actuarial assumptions.





The unfunded actuarial liability increased in FY 2006 due to the loss on the actuarial value of assets, demographic factors, normal cost, interest, and contributions.



The ratio of actuarial assets to the actuarial accrued liability remained below 100% this year.

B. Summary of Results

	July 1, 2005	July 1, 2006
Actuarial Liability		
a. Active Members	$ 1,349,017,411	$ 1,339,632,483
b. Retired Members and Beneficiaries	1,404,858,151	1,555,403,374
c. Vested Former Members	21,171,850	23,300,216
d. Total	$ 2,775,047,412	$ 2,918,336,073
Valuation Assets	$ 2,100,532,623	$ 2,222,724,295
Unfunded Actuarial Liability	$ 674,514,789	$ 695,611,778
Normal Cost		
a. Gross Normal Cost	$ 68,807,766	$ 69,137,093
b. Anticipated Employee Contributions	$ 15,952,772	$ 16,098,352
c. County Normal Cost (a -b)	$ 52,854,994	$ 53,038,741
Amortization Payment	$ 57,029,177	$ 59,259,804
County Contribution at date shown	$ 109,884,171	$ 112,298,545
County FY 2007/FY 2008 Contribution		
(as a % of covered payroll)		
Public Safety Employee	39.11%	38.17%
Non-Public Safety Employees	23.28%	24.41%

C. Valuation Highlights

1. System Assets

As of June 30, 2006, the System had assets, valued at market, of $2.308 billion, as compared to $2.145 billion at June 30, 2005. The increase of $163 million was attributable to the following:

a. An increase of $104 million from employer and employee contributions;
b. An increase of $187 million from investment income; and
c. A decrease of $128 million due to the payment of benefits to System participants and administrative expenses.

When measured on an actuarial basis, System assets were $2.223 billion at June 30, 2006, and $2.101billion at June 30, 2005. The asset valuation method smoothes the fluctuations generated by intermittent market gains and losses. This method phases-in investment gains and losses arising during and after the 1994 fiscal year over a five-year period from the date established. Effective July 1, 1997, the calculation of the actuarial value of assets was changed to exclude the present value of estimated accrued contributions.

2. System Liabilities

The Unfunded Actuarial Liability increased $21.1 million, from $674.5 million at July 1, 2005, to $695.6 million at July 1, 2006, as follows:

Actual Unfunded Liability at beginning of year	$	674,514,789
Actual Unfunded Liability at end of year		695,611,778
Increase in Actual Unfunded Liability	$	(21,096,989)

The increase in Actual Unfunded Liability for the year ended June 30, 2006, is comprised of the following:

Increase due to loss on actuarial value of assets	$	(20,801,336)
Increase due to demographic loss and other factors		(31,916,191)
Increase due to normal cost, interest and contributions		31,620,538
Increase in Actual Unfunded Liability	$	(21,096,989)

3. System Contributions

Contributions to the System include a "normal cost" rate which covers the portion of projected liabilities related to service of members. In addition, an amortization payment is made to fund the unfunded liability related to changes made to benefits in previous years which are being funded over a specific period of time.

The increase in the employer contribution rate is attributable to the following:

	Public Safety		Non-Public Safety	
Employer contribution rate - June 30, 2005	39.11	%	23.28	%
Increase due to loss on actuarial value of assets	0.35		0.47	
Increase due to actuarial gains & losses	0.99		1.50	
Increase (decrease) due to assumption changes	(2.28)		(0.84)	
Employer contribution rate - June 30, 2006	38.17	%	24.41	%

4. Membership

The active membership of the System decreased from 5,628 at June 30, 2005 to 5,362 at June 30, 2006. The System was closed to all new employees hired after October 1, 1994, except public safety bargaining unit employees. Inactive members, including retirees and beneficiaries, increased from 4,665 at June 30, 2005 to 4,848 at June 30, 2006 and the number of former members with vested rights increased from 381 to 485.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS
EMPLOYEES' RETIREMENT SYSTEM

A. Funding Method

The funding method used for the System's valuation is the "projected unit credit" actuarial cost method. The objective of this method is to allocate the total pension benefit to which each participant is expected to become entitled at retirement to the participant's past and future service. The allocation is accomplished by applying the plan's accrual formula to projected final salary at retirement. An actuarial liability is calculated at the valuation date as the present value of benefits allocated to service prior to that date. The unfunded actuarial liability at the valuation date is the excess of the actuarial liability over the assets of the System.

B. Actuarial Value of Assets

The actuarial value of assets is used for purposes of determing the County's contribution to the System. The asset adjustment method dampens the volatility of asset values that could occur because of short term fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process. Assets are valued at market value but with a phase-in of investment gains and losses arising after July 1, 1994, over a 5-year period. The gains and losses are net of expenses. Effective July 1, 1997, the calculation of the actuarial value of assets does not include the present value of accrued contributions.

ACTUARIAL ASSUMPTIONS AND METHODS
EMPLOYEES' RETIREMENT SYSTEM

A. Demographic Assumptions

1. Mortality

RP2000 projected 10 years, separate tables for males and females
Annual Deaths per 1,000 Members

Age	Male Deaths	Female Deaths	Age	Male Deaths	Female Deaths
20	0	0	65	11	9
25	0	0	70	19	16
30	0	0	75	33	26
35	1	0	80	58	43
40	1	1	85	103	73
45	1	1	90	176	128
50	2	1	95	262	191
55	3	3	100	341	235
60	6	5	105	398	293

2. Termination of Employment (prior to retirement eligibility)

Annual Terminations per 1,000 Members

Years of Service	Non-Public Safety	Public Safety
0 – 4	35	80 – 29
5 – 9	35	22 – 14
10 – 14	17	13 – 6
15 – 19	17 – 11	5 – 3
20 – 25	11 – 6	2
26+	6	

It is assumed that 15% of all vested participants who terminate elect to receive a refund of their contributions with interest instead of a deferred benefit regardless of their age when they terminate employment.

3. Disability

Age	Annual Disabilities per 1,000 Members: Non-Public Safety Employees: Male	Female	Public Safety Employees: Male	Female
20	1	1	1	1
25	2	1	3	3
30	2	2	6	8
35	3	3	8	12
40	3	3	10	16
45	6	3	19	22
50	7	5	32	29
55	5	6	39	31
60	9	6	47	32
65	0	0	0	0

4. Deaths

Age	Annual Deaths per 1,000 Disabled Members: Male	Female
20	0	0
25	0	0
30	1	0
35	1	1
40	2	1
45	2	2
50	4	3
55	7	5
60	13	10
65	22	17

5. Retirement

Age	Non-Public Safety Employees	Public Safety Employees Other than Group G
Under 40	0%	3%
41	0%	3%
42	0%	3%
43	0%	3%
44	0%	3%
45	1%	3%
46	1%	10%
47	1%	10%
48	1%	10%
49	1%	10%
50	5%	15%
51	5%	15%
52	5%	30%
53	5%	30%
54	5%	30%
55	8%	75%
56	8%	75%
57	8%	75%
58	8%	75%
59	8%	75%
60	15%	100%
61	15%	100%
62	15%	100%
63	15%	100%
64	15%	100%
65	40%	100%
66	40%	100%
67	40%	100%
68	40%	100%
69	40%	100%
70	100%	100%

Note: Rates apply only when an employee is eligible to retire based on age and service.

6. Sick Leave Credit

Sick leave: Service credit is increased by 2.5% to account for additional credit from unused sick leave. Sick leave is capped at 2 years.

7. Marital assumption

80% of active participants are assumed to be married. Women are assumed to be three years younger than their spouses**.**

8. Assumption Changes

In October 2005, the System's actuary, Mercer Human Resource Consulting completed an experience study of the actuarial assumptions used for the five-year period ending June 30, 2005. All recommended assumptions were approved by management at that time.

B. Economic Assumptions

1. Investment Return: 8.0% compound per annum
2. Cost-of-Living Increases: 3.5% compound per annum
3. Increase in Social Security Wage Base: 4.5% compound per annum
4. Expense load: Anticipated administrative expense equal to the average of the prior three years of administrative expenses adjusted for anticipated changes (which equates to a $200,000 reduction for FY2008). FY2008, this figure is $1,750,000.
5. Salary Increase: Merit and promotional increases assumed to be based on age as shown below:

Age	**Salary Scale**
18 – 34	7.50%
35 – 44	6.50%
45 onwards	4.75%

ANALYSIS OF FINANCIAL EXPERIENCE

Gains and Loss in Accrued Liability During Years Ended June 30
Resulting from Differences Between Assumed Experience and Actual Experience

Type of Activity	2003	2004	2005	2006
Investment loss	$ (135,222,000)	$ (107,257,715)	$ (80,722,008)	$ (20,801,336)
Combined liability experience	(16,450,593)	(23,042,239)	(57,173,555)	(62,484,214)
Loss during year	$ (151,672,593)	$ (130,299,954)	$ (137,895,563)	$ (83,285,550)

SOLVENCY TEST

Aggregate Accrued Liabilities

Valuation Date	(1) Active Member Contributions	(2) Retirees, Vested Terms, Beneficiaries	(3) Active Members (Employer Financed Portion)	Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets (1)	(2)	(3)
6/30/2000	$ 136,181,427	$ 1,014,314,792	$ 781,418,094	$ 1,911,114,401	100 %	100 %	97 %
6/30/2001	143,356,036	1,029,982,653	938,607,764	1,990,882,017	100	100	87
6/30/2002	146,500,545	1,125,070,362	1,001,608,309	2,036,100,709	100	100	76
6/30/2003	155,686,014	1,247,359,872	1,008,446,838	2,029,314,438	100	100	62
6/30/2004	160,523,789	1,354,272,329	1,046,532,114	2,045,098,796	100	100	51
6/30/2005	166,078,802	1,426,030,001	1,182,938,609	2,100,532,623	100	100	43
6/30/2006	177,391,695	1,578,703,590	1,162,240,788	2,222,724,295	100	100	40

SCHEDULE OF RETIREES AND SURVIVORS
During Years Ended June 30

	New Retirees and Disableds	Survivors	Total
July 1, 2000	**3,565**	**304**	**3,869**
New retirements & disabilities	217	0	217
Deaths with beneficiaries	(20)	20	0
Deaths/benefits ended	(85)	(12)	(97)
July 1, 2001	**3,677**	**312**	**3,989**
New retirements & disabilities	244	0	244
Deaths with beneficiaries	(28)	28	0
Deaths/benefits ended	(108)	(10)	(118)
July 1, 2002	**3,785**	**330**	**4,115**
New retirements & disabilities	336	0	336
Deaths with beneficiaries	(30)	30	0
Deaths/benefits ended	(71)	(10)	(81)
July 1, 2003	**4,020**	**350**	**4,370**
New retirements & disabilities	304	0	304
Deaths with beneficiaries	(26)	26	0
Deaths/benefits ended	(99)	(16)	(115)
July 1, 2004	**4,199**	**360**	**4,559**
New retirements & disabilities	216	0	216
Deaths with beneficiaries	(20)	20	0
Deaths/benefits ended	(99)	(11)	(110)
July 1, 2005	**4,296**	**369**	**4,665**
New retirements & disabilities	266	0	266
Deaths with beneficiaries	(22)	22	0
Deaths/benefits ended	(57)	(26)	(83)
July 1, 2006	**4,483**	**365**	**4,848**

SCHEDULE OF ANNUAL ALLOWANCE
During Years Ended June 30

	New Retirees and Disableds	Survivors	Total
July 2000	**$ 83,375,421**	**$ 3,496,903**	**$ 86,872,324**
Average Annual Allowance	23,387	11,503	22,453
Annual Allowance Added	7,606,633	509,798	8,116,431
Annual Allowance Removed	(1,453,840)	(261,006)	(1,714,846)
July 2001	**$ 89,528,214**	**$ 3,745,695**	**$ 93,273,909**
Average Annual Allowance	24,348	12,005	23,383
Annual Allowance Added	8,191,629	499,438	8,691,067
Annual Allowance Removed	(1,908,620)	(231,142)	(2,139,762)
July 2002	**$ 95,811,223**	**$ 4,013,991**	**$ 99,825,214**
Average Annual Allowance	25,313	12,164	24,259
Annual Allowance Added	11,401,243	551,410	11,952,653
Annual Allowance Removed	(1,479,300)	(159,196)	(1,638,496)
July 2003	**$ 105,733,166**	**$ 4,406,205**	**$ 110,139,371**
Average Annual Allowance	26,302	12,589	25,204
Annual Allowance Added	11,570,789	572,318	12,143,107
Annual Allowance Removed	(2,180,663)	(308,637)	(2,489,300)
July 2004	**$ 115,123,292**	**$ 4,669,886**	**$ 119,793,178**
Average Annual Allowance	27,417	12,972	26,276
Annual Allowance Added	10,396,825	797,535	11,194,360
Annual Allowance Removed	(1,963,577)	(313,742)	(2,277,319)
July 2005	**$ 123,556,540**	**$ 5,153,679**	**$ 128,710,219**
Average Annual Allowance	28,761	13,967	27,591
Annual Allowance Added	14,424,755	305,259	14,730,014
Annual Allowance Removed	(1,611,828)	(127,575)	(1,739,403)
July 2006	**$ 136,369,467**	**$ 5,331,363**	**$ 141,700,830**
Average Annual Allowance	**$ 30,419**	**$ 14,606**	**$ 29,229**

Schedule of Active Member Valuation Data

Valuation Date	Number	Annual Payroll [a]	Annual Average Pay	% Increase in Average Pay
July 1, 2000	6,093	$307,367,030	$50,446	4.617%
July 1, 2001	6,023	$318,682,907	$52,911	4.887%
July 1, 2002	5,983	$333,449,862	$55,733	5.333%
July 1, 2003	5,876	$336,019,788	$57,185	2.606%
July 1, 2004	5,670	$341,629,327	$60,252	5.363%
July 1, 2005	5,628	$355,105,993	$63,096	4.721%
July 1, 2006	5,362	$357,361,131	$66,647	5.627%

(a) Total payroll for active participants under retirement age was used for years prior to July 1, 2002. Beginning July 1, 2002 payroll for all active participants was used.

STATISTICAL SECTION

Employees' Retirement System

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF CHANGE IN NET ASSETS
JUNE 30, 2006
LAST TEN FISCAL YEARS
(dollars in thousands)

	Fiscal Year				
	1997	1998	1999	2000	2001
Additions					
Member contributions	$ 10,271	$ 10,520	$ 10,477	$ 10,924	$ 11,292
Employer contributions	49,763	51,098	47,463	44,347	43,345
Investment income (net of expenses)	241,045	270,973	165,710	135,338	(81,375)
Total additions	301,079	332,591	223,650	190,609	(26,738)
Deductions					
Benefit payments	64,065	67,656	71,473	76,387	78,434
Refunds	891	1,058	828	861	1,067
Administrative expenses	1,111	1,177	1,297	1,220	1,689
Total deductions	66,067	69,891	73,598	78,468	81,190
Change in net assets	$ 235,012	$ 262,700	$ 150,052	$ 112,141	$ (107,928)

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF BENEFIT AND REFUND DEDUCTIONS FROM NET ASSETS BY TYPE
JUNE 30, 2006
LAST TEN FISCAL YEARS
(dollars in thousands)

	Fiscal Year				
	1997	1998	1999	2000	2001
Type of Benefit					
Service benefits:					
Retirees	$ 43,547	$ 46,448	$ 49,533	$ 53,463	$ 58,415
Survivors	2,582	2,840	3,100	3,188	3,785
Disability benefits	12,338	12,940	13,624	14,717	16,234
Total benefits	$ 58,467	$ 62,228	$ 66,257	$ 71,368	$ 78,434
Refund of Contributions	$ 891	$ 1,058	$ 828	$ 861	$ 1,067

* Allocation among retirees, disabilities, and survivors are actual amounts. Allocations for FY 1997-2004 were based on estimates.

2002	2003	2004	2005	2006
$ 12,944	$ 14,770	$ 14,762	$ 15,326	$ 16,085
39,168	55,206	61,927	74,655	88,184
(124,177)	82,174	286,895	197,433	187,004
(72,065)	152,150	363,584	287,414	291,273
85,323	100,381	111,646	115,635	125,818
681	739	796	762	635
2,092	2,007	2,066	1,857	1,920
88,096	103,127	114,508	118,254	128,373
$ (160,161)	$ 49,023	$ 249,076	$ 169,160	$ 162,900

2002	2003	2004	2005*	2006*
$ 64,030	$ 77,009	$ 87,123	$ 102,641	$ 112,210
4,041	4,811	5,032	2,087	1,483
17,251	18,560	19,491	10,907	12,125
$ 85,322	$ 100,380	$ 111,646	$ 115,635	$ 125,818
$ 681	$ 739	$ 796	$ 762	$ 635

EMPLOYEES' RETIREMENT SYSTEM
PRINCIPAL PARTICIPATING EMPLOYERS,
CURRENT YEAR AND ONE YEAR AGO
JUNE 30, 2006

Participating Government	2006 Covered Employees	2006 Percentage of Total System	2005* Covered Employees	2005* Percentage of Total System
Montgomery County	5,193	96.3%	5,427	96.4%
Town of Chevy Chase	5	0.1%	5	0.1%
Strathmore Hall	7	0.1%	7	0.1%
Housing Opportunities Commission	157	2.9%	159	2.8%
Revenue Authority	17	0.3%	17	0.3%
Washington Suburban Transit Commission	2	0.1%	2	0.1%
State Department of Assessment and Taxation	5	0.1%	6	0.1%
District Court	5	0.1%	5	0.1%
Total	5,391	100%	5,628	100%

*The information for principal participating employers is not available for 2004 and prior.

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE
JUNE 30, 2006

Fiscal Year	Retiree	Disability	Survivor	Total
1997	2,601	623	242	3,466
1998	2,675	648	262	3,585
1999	2,763	694	278	3,735
2000	2,831	734	304	3,869
2001	2,918	759	312	3,989
2002	3,002	783	330	4,115
2003	3,203	817	350	4,370
2004	3,348	851	360	4,559
2005*	3,443	853	369	4,665
2006*	3,564	919	365	4,848

* Allocation among retirees, disabilities, and survivors are actual amounts. Allocations for FY 1997-2004 were based on estimates.

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF AVERAGE BENEFIT AMOUNTS
JUNE 30, 2006

Fiscal Year	Retiree	Disability	Survivor	Total
1997	$ 16,743	$ 19,804	$ 10,668	$ 16,869
1998	17,364	19,968	10,841	17,358
1999	17,927	19,632	11,152	17,740
2000	18,885	20,050	10,488	18,446
2001	20,019	21,389	12,132	19,663
2002	21,329	22,031	12,247	20,734
2003	24,043	22,717	13,747	22,970
2004	26,022	22,904	13,978	24,489
2005*	29,812	12,786	5,655	24,788
2006*	31,484	13,193	4,063	25,953

* Allocation among retirees, disabilities, and survivors are actual amounts. Allocations for FY 1997-2004 were based on estimates.

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF RETIRED MEMBERS BY TYPE OF RETIREMENT
AS OF JUNE 30, 2006

Amount of Monthly Benefit	Number of Retired Members	Type of Retirement [a]			Option Selected [b]					
		1	2	3	1	2	3	4	5	6
Deferred	485									
$ 1 – $ 250	203	171	28	4	110	50	28	3	8	4
251 – 500	282	214	62	6	145	73	56	-	2	6
501 – 750	260	203	48	9	129	65	44	5	8	9
751 – 1,000	311	233	52	26	134	76	63	14	7	17
1,001 – 1,250	316	243	37	36	141	82	59	8	9	17
1,251 – 1,500	277	189	33	55	100	76	55	15	12	19
1,501 – 1,750	269	190	24	55	111	72	47	17	3	19
1,751 – 2,000	267	188	23	56	90	86	38	19	9	25
Over 2,000	2,663	1,933	58	672	865	951	213	227	68	339
Total	5,333	3,564	365	919	1,825	1,531	603	308	126	455

Notes:

[a] Type of retirement:

1—Retiree
2—Beneficiary
3—Disabled Retiree

[b] Option selected:

Option 1—Modified Cash Refund
Option 2—-Certain and Continuous
Option 3—Life Annuity
Option 4—Joint and Survivor 50%
Option 5—Joint and Survivor 100%
Option 6—Other Joint and Survivor Percentage

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF AVERAGE BENEFIT PAYMENTS AND AVERAGE FINAL VALUATION PAY
LAST SIX FISCAL YEARS

	Years Credited Service						
Retirement Effective Dates	0–5	5–10	10–15	15–20	20–25	25–30	30+
Period 7/1/2000 to 6/30/2001							
Average monthly benefit*	$ 2,418	$ 481	$ 1,651	$ 1,756	$ 2,418	$ 3,109	$ 4,082
Average final valuation pay**	$ 38,508	$ 52,243	$ 58,018	$ 51,584	$ 59,523	$ 62,719	$ 67,932
Number of retired members***	1	3	25	21	33	40	32
Period 7/1/2001 to 6/30/2002							
Average monthly benefit*	$ -	$ 1,206	$ 1,622	$ 1,534	$ 2,196	$ 3,587	$ 3,676
Average final valuation pay**	$ -	$ 42,726	$ 52,332	$ 59,283	$ 58,039	$ 72,284	$ 67,564
Number of retired members***	-	7	22	24	28	58	39
Period 7/1/2002 to 6/30/2003							
Average monthly benefit*	$ 2,701	$ 1,623	$ 1,413	$ 1,737	$ 1,833	$ 3,490	$ 3,750
Average final valuation pay**	$ 44,695	$ 44,840	$ 56,082	$ 59,937	$ 56,253	$ 71,048	$ 68,955
Number of retired members***	1	7	29	35	28	91	79
Period 7/1/2003 to 6/30/2004							
Average monthly benefit*	$ 1,156	$ 915	$ 1,809	$ 1,420	$ 2,549	$ 3,406	$ 4,337
Average final valuation pay**	$ 37,309	$ 45,048	$ 55,552	$ 60,530	$ 65,550	$ 65,919	$ 72,119
Number of retired members***	2	4	15	43	34	69	79
Period 7/1/2004 to 6/30/2005							
Average monthly benefit*	$ 2,521	$ 1,984	$ 1,479	$ 1,870	$ 2,573	$ 3,371	$ 4,392
Average final valuation pay**	$ 48,620	$ 50,470	$ 59,743	$ 63,910	$ 64,026	$ 72,618	$ 75,577
Number of retired members***	2	4	21	37	23	35	66
Period 7/1/2005 to 6/30/2006							
Average monthly benefit*	$ 2,491	$ 2,801	$ 1,752	$ 2,356	$ 2,928	$ 3,649	$ 4,594
Average final valuation pay**	$ 43,375	$ 55,641	$ 55,619	$ 67,299	$ 68,683	$ 73,731	$ 77,143
Number of retired members***	2	6	28	58	49	55	50

* Based on current benefits only. Does not take into account any future benefits.
** Pay used for last valuation (when member was an active employee).
*** Only includes participants who changed from active to retiree status.
Note: Information is not available for periods prior to July 1, 2000.

SCHEDULE OF PARTICIPATING AGENCIES AND POLITICAL SUBDIVISIONS

Montgomery County Revenue Authority
Housing Opportunities Commission of Montgomery County
Town of Chevy Chase
Strathmore Hall Foundation, Inc.
Washington Suburban Transit Commission
Independent Fire/Rescue Corporations

Certain employees of the:
State Department of Assessments and Taxation
District Court of Maryland