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Pennsylvania Municipal Retirement System

Comprehensive Annual Financial Report
For the fiscal year ended December 31, 1996

George E. Gift, Jr.
Chairman
Pennsylvania Municipal Retirement Board

James B. Allen
PMRS Secretary

Report prepared by the Pennsylvania Municipal Retirement System staff

Larry E. Barbour
Accounting Division Chief

Jean A. Eckard
Information Specialist

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Introductory Section

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  - Administrative Staff
  - Professional Consultants
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- Chairman's Report
- Summary of Plan Provisions

Letter of Transmittal

Pennsylvania Municipal Retirement System

Commonwealth of Pennsylvania

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May 5, 1997

Members of the Pennsylvania Municipal Retirement Board
Pennsylvania Municipal Retirement System
P.O. Box 1165
Harrisburg, Pennsylvania 17108-1165

As part of our continuing commitment to complete financial reporting for the Pennsylvania Municipal Retirement System (the System), we are pleased to submit the System's Comprehensive Annual Financial Report for the fiscal year ended December 31, 1996. According to the requirements of the Pennsylvania Municipal Retirement Law, Act of 1974, P.L. 34, No. 15 (the Act) as amended, the System distributes the Comprehensive Annual Financial Report to our governing board, to the members of the General Assembly of Pennsylvania, to each participating municipal employer, and to all other interested parties upon request.

The System is solely responsible for the accuracy of the data in this report. As the individuals responsible for the System's financial records, we offer our assurance that we have made every effort to present a comprehensive report. To the best of our knowledge, the enclosed information is accurate in all material respects.

Overview of the System

The Pennsylvania Municipal Retirement System, which is an agent multiple-employer system, is headquartered in Harrisburg, Pennsylvania. It is a state retirement agency created by the Pennsylvania General Assembly in 1974. Responsibility for the organization and administration of the System is vested in the eleven-member Pennsylvania Municipal Retirement Board (the Board).

The System administers sound, cost-effective pension plans on a contracted basis for local government employees. Our services include accounting services, actuarial valuations, employee consulting and record keeping, and asset management. Any Pennsylvania county, city, town, township, borough, municipal authority, or institution supported and maintained by a municipality may participate. All participating public plans as of December 31, 1996 are listed in the Statistical Section of this report.

The System offers various plan designs: defined benefit, defined contribution, and hybrid. The annual benefit is dependent upon the individual municipality's contracted benefit package because of flexible pension plan design based on each municipality's individual needs. Benefits provided to participants in the System typically include both age and service retirements, vesting, disability benefits, survivor benefits, and death benefits. The plan cost is determined by individual plan characteristics. The System's individual plans may have a municipal contribution and an employee contribution or just an employee

Letter of Transmittal *(Continued)*

charge. Municipal contributions typically range from 1 to 14 percent of projected payroll for municipal employees and 9 to 40 percent for police and firefighters. The employee contribution is determined by plan contract. In 1996, plan requirements ranged from no employee contribution to as high as 10.0 percent of earnings.

1996 CAFR

The 1996 Comprehensive Annual Financial Report is presented in five sections: introductory, financial, actuarial, statistical, and investment. The Introductory Section contains this transmittal letter, the Certificate of Achievement for Excellence in Financial Reporting, the System's administrative organizational structure, the Board Chairman's report, and a summary of plan provisions; the Financial Section presents the opinion of the System's independent auditors, Ernst & Young, and the financial statements of the System; the Actuarial Section presents the opinion of the independent actuarial firm, The Segal Company, and the results of its annual actuarial valuation; the Statistical Section includes significant financial and demographic data generally presented on a multi-year basis and also the Schedule of Participating Employers; and the Investment Section contains an overview of the System's investment activities and policies.

Economic Environment

During the first half of 1996, the U.S. economic environment experienced a strong expansion. With the creation of new jobs in the service sector and sustained job growth, the unemployment rate dropped to 5.3 percent. The United States trade deficit rose to a record $10.88 billion in June, partially due to the increased price and volume of imported heating oil due to severe winter storms. Inflation remained well within the acceptable limits, with the CPI increasing at an annual 3.2 percent rate. The Federal Reserve kept short-term interest rates relatively high in order to fight inflation. During the remaining six months of 1996, the U.S. economy expanded at a more moderate pace. Inflation remained well within the acceptable limits, and short-term interest rates remained relatively high with no changes in the Fed funds rate.

The overall equity market reflected the strong corporate earnings and the massive amounts of cash flowing into mutual funds during January through June. In July, the stock market experienced a significant correction. Small cap technology stocks suffered most, dropping over 10 percent in less than two weeks. In August and September, strong corporate earnings and a resumption of cash flows into mutual funds pushed the market back up to record levels, and the market continued to soar during the last quarter of 1996. In 1996, all of the major common stock indices showed positive returns with larger stocks again outperforming smaller ones. For the trailing year, the Standard & Poor's 500 equity index was up 23.0 percent, and the Russell 2,000 index of smaller stocks produced a 16.5 percent return. The international equities market as represented by the Morgan Stanley Capital International World Index (MSCI) - Europe, Australia, and Far East stock index (EAFE) yielded an annual return of 6.4 percent.

Fixed income markets found the good news of strong economic growth and new job creation uncomfortable. This type of news typically portends a time of inflation which in turn causes interest rates to rise and bond prices to fall. It appears that the fixed income markets spent much of the year just trying to anticipate the Fed's next step. The bond market, as measured by the Lehman Brothers Aggregate Bond index, earned a modest 3.6 percent during the year. Overall, cash equivalents outperformed the bond market during 1996. From October through December, the "risk-free" Treasury bill return was 1.3 percent, producing a trailing twelve-month total return on cash and equivalents of 5.3 percent.

The anxiety in the fixed income markets did translate into stronger returns for the real estate class of assets. The year 1996 saw this asset class continuing a comeback started in 1994 and 1995. The median bank investment in real estate yielded 7.6 percent in 1996, and the insurance median produced an even stronger 10.8 percent. Much of the news in this asset class, however, was centered on the vehicles utilized: Real Estate Investment Trusts (REITs), real estate operating companies, direct investments, and/or commingled funds.

Financial Information

The report's financial statements were prepared in accordance with generally accepted accounting principles of government accounting and reporting as adopted by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants. The financial statements and the supplementary information in the report have been prepared in accordance with the standards for disclosure allowed by Statement No. 6 of the National Council on Governmental Accounting. The accrual basis of accounting is used to record all financial transactions including assets and liabilities as well as revenues and expenses. Gains and losses on sales and exchanges of investments are recognized on the transaction date. Significant accounting policies are detailed in the Financial Section under Note B of "Notes to Financial Statements".

The System's assets totaled $631,506,756 as of December 31, 1996. During 1996, the System's assets increased by $113,438,827 which included contributions of $28,391,042. Investment related income increased the portfolio by $67,760,075. Additional information on the System's assets is detailed in the Financial Section (Comparative Balance Sheets and Schedule 4 - Investment Summary).

The System has established internal computerized control policies and procedures for the review and verification of receipts and payments made to and from the fund. The System prepares a yearly budget which must be adopted by the Board. The budget is also presented to and reviewed by the Local Government Committees of the Pennsylvania House and Senate at least two months prior to the beginning of the fiscal year. The committees can approve the budget, reject it, or take no action by the end of the year in which case the proposed budget becomes final. Budgetary controls include monthly review and presentation by management with bimonthly Board reviews. For 1996, the adopted budget was $1,743,0[illegible] exclusive of investment fees; expenditures (exclusive of investment fees and depreciation) amounted to $1,580,853 allowing the System to end the year $162,197 under budget. More information on the System's budget is included in Schedule 3 of the Financial Section.

Revenues

The System was established by law to pay pension benefits when due. It accumulates sufficient funds to pay benefits through employee and employer contributions and through investment earnings. The following schedule presents a summary of revenues for the fiscal year ended December 31, 1996 and the amount and percentage of increases and decreases in relation to December 31, 1995 revenues.

Revenues	Amount	Percent of Total	Increase (Decrease) from 1995	Percent of Increase (Decrease)
Member Contributions	$10,018,617	10.40%	$ 885,739	9.70%
Municipal Contributions	18,372,425	19.06	(35,454,356)	(65.87)
Assessments	226,240	.23	4,580	2.07
Investment Income	67,760,075	70.31	33,327,718	96.79
Total	**$96,377,357**	**100.00%**	**$ (1,236,319)**	

The decrease in 1996 municipal contributions was a result of a major contribution by one of the larger municipalities in 1995. Municipal contributions are based upon an actuarial valuation, using the Entry Age Normal Actuarial Cost Method, computed as a percentage of the total compensation of all active members during the period for which the amount is determined. Routine municipal contributions show an increase from 1995 because the System added thirty-four new member plans and had only one withdrawal of municipal plans. The growth in municipal plans added significantly to the 1996 municipal contributions.

Member contributions vary according to the type of pension plan. Under Articles II and III of the Act, members are required to contribute 3 to 8 percent of their salary. The amount a member contributes under Article IV of the Act is based upon contracted plan provisions and is principally expressed as a percent of compensation or salary. Member contributions show an increase from 1995 because of an increase in individual membership.

Investment revenues are a combination of earnings from bonds, equities, real estate, and a short-term cash management fund. During the year, the market value of the System's investment portfolio increased from $591,731,7[illegible] to $692,611,948. The largest portions of the investment revenue came from equities ($45,377,351) and bonds ($5,500,9[illegible]

The final portion of revenue is derived from assessments. Each municipality is charged a $20 assessment per member to help cover administrative expenses incurred by the System. The fluctuation in assessments is due to the number of members per municipality since this figure is $20 times the number of members.

Letter of Transmittal *(Continued)*

Ten-year historical trend information listing the System's revenues by source is presented in Schedule 2 of the Financial Section of this report.

Expenses

The System's primary expense represents the purpose for which it was created: payment of benefits. The following schedule presents a summary of the System's expenses for the fiscal year ended December 31, 1996 and the percentage of increases and decreases in relation to December 31, 1995 amounts.

Expenses	Amount	Percent of Total	Increase (Decrease) from 1995	Percent of Increase (Decrease)
Annuity benefits	$16,823,555	67.82%	$2,032,750	13.74%
Disability benefits	1,011,021	4.08	117,584	13.16
Terminations	3,285,072	13.24	(1,557,742)	(32.17)
Administrative	3,687,065	14.86	774,624	26.60
Total	**$24,806,713**	**100.00%**	**$1,367,216**	

The major expense-related items for 1996 were Payment of Benefits, Refunds of Contributions Due to Termination or Death, and administrative expenses. Fluctuations in benefit expenses from 1995 are due mainly to an increased number of retirees. Terminations decreased because a large municipality had withdrawn in 1995.

A breakdown of the System's expenses including ten-year historical trend information is presented in Schedules 2 and 3 of the Financial Section of this report.

Investment Highlights

The Board's investment objective is to benefit the System's member municipalities by adding value to their assets. Recognizing that inflation can erode value, the Board's goal is to have the fund earn at least 2 percent more annually than the average annual inflation rate over a long period of time. The System invests its assets in order to maximize current and future income yield and to provide long-term stability. For the fiscal year ended December 31, 1996, investments provided 70.31 percent of the System's total revenues.

On December 31, 1996, the market value of the System's investments was $692,611,948. This represents an increase of $100,880,200 over the previous year. For the last five years, the System's annualized return was 11.6 percent. At December 31, 1996, the System's investment portfolio was distributed as follows: 50.0 percent in domestic equities, 14.8 percent in international equities, 24.9 percent in bonds, 6.4 percent in real estate, and 3.9 percent in cash equivalents.

Additional information on the System's investments is provided in the Investment Section of this report.

Funding

The System's level of funding is based on the actuarial reserve method. Funds are derived from the excess of revenues over expenses and are accumulated by the System in order to meet current and future benefit obligations to retirees and beneficiaries. As the funding level increases, the assets accumulate and strengthen the investment income potential. Net operating income for the 1996 fiscal year was $71,570,644. This represents an increase in the fund balance of 13.9 percent over the 1995 fund balance.

To comply with GASB Statement No. 5 disclosure requirements, a pension benefit obligation (PBO) of $464.7 million was calculated during the most recent actuarial valuation dated January 1, 1996. The market value of the System's assets exceeds this amount by $231.8 million. This indicates that the contribution rates and the current assets of the System are adequate to fund the System's actuarial liabilities. Additional information on the System's pension benefit obligation, actuarial liability, and funding progress can be found in the Actuarial and Financial Sections of this report.

As an agent multiple-employer PERS, the System reports to each of the trustees of the plans it administers providing the governing authority of the member plans with complete actuarial, accounting, and funding data. PBOs for each plan are calculated and distributed. Detailed information on the funding level ranges of the System's plans can be found in the Actuarial Section of this report under "Schedule of Contribution Requirements vs. Actual Contributions."

Major Initiatives

During the 1996 financial year, the Board awarded excess investment monies at a rate of 8.37 percent on year-end 1995 account balances. Added to the 6.5 percent regular interest, the award produced a compounded rate of return of over [illegible] percent on each plan's December 31, 1995 asset balance. Total excess interest awarded to municipalities exceeded $[illegible] million. Because the award was substantial, the System published a special edition of the regular quarterly newsletter devoted entirely to explaining excess interest and various methods of allocating the award among each municipality's three accounts.

Initiatives concerning the investment portfolio included (1) rebalancing the bond portfolio to 50 percent active management and 50 percent passive management, (2) extra close monitoring of two of the System's money managers that recently merged with other firms: First Fidelity Bank merger with First Union National Bank and Newbold's Asset Management merger with Pilgrim Baxter, and (3) legal action involving one of the System's money managers stemming from a possible breach of the firm's fiduciary responsibility.

Under actuarial initiatives, the System's January 1, 1995 report was the first using new actuarial assumptions which were adopted in 1994. The valuation results were made known to the individual plans, and staff spent considerable time explaining the impact of the assumption changes. Changes included a redesign of the salary assumption (incorporating an age-based aspect) and updating to a more modern mortality table. The salary increase assumption begins with an inflation assumption of 4 percent per year. Added to this base is an age-specific increase reflecting merit and promotional increases. The mortality table was updated to the 1983 Group Annuity Table for Males with a set forward of six years for females. The newer table estimates one to two years longer of life remaining than the previous table that the System used. The changes in actuarial assumptions will impact the municipal plans' anticipated 1997 costs.

The year was also extremely active from a plan membership perspective. The System processed a record high of 34 new member plan contracts. The System also handled 53 plan amendments, and one withdrawal (due to a police department that was disbanded). Another first was the re-enrollment of a plan that had withdrawn from the System in 1977. As of December 31, 1996, the System had 563 defined benefit plans and 83 defined contribution plans. It administers to over 8,600 active employees, over 2,500 retirees and beneficiaries, and over 230 vested members. Most membership activity during the year was associated with benefit consulting, designing pension plans for new enrollments, redesigning existing plans for benefit upgrades, and exhibiting at local government conventions.

The System's major initiatives for 1997 include producing a cassette tape for use by members anticipating retirement. The tape will explain the System's various retirement options. A tape will be sent to each member municipality and will be available to all individual plan members. Another priority is the search for a well-qualified individual to fill the vacant position of Operations Division Chief. The new division chief will address some of the System's major internal functions such as revising and updating job descriptions and job performance standards for the entire staff. In addition, the Board has requested compilation of a loose-leaf policy manual on the System's standard operating procedures and policies.

Professional Services

The financial information in this report has been audited by the independent accounting firm of Ernst & Young which is completing year one of a two-year renewal option. The actuarial information was prepared with the help of E. Greenblum, consulting actuary from The Segal Company. The firm is in the second year of a competitively bid five-year renewal contract for actuarial consulting. The investment information was prepared with the cooperation of the System's independent investment consultant, R. Dahab of Dahab Associates. This firm's competitively bid contract is from April 1, 1995 through December 31, 1999. The Board and staff appreciate the cooperation and commitment of these three advisors in providing information for the preparation of this report.

Letter of Transmittal *(Continued)*

Other Information

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Pennsylvania Municipal Retirement System for its comprehensive annual financial report for the fiscal year ended December 31, 1995. 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 CAFR 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 Pennsylvania Municipal Retirement System has received a Certificate of Achievement for the last six consecutive years (fiscal years ended December 31, 1990 - December 31, 1995). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Acknowledgements

We sincerely thank our Board members for their dedicated service to the System. Their keen interest, enthusiasm, and dependability are most appreciated. Of special note is the fact that they willingly serve the System without financial remuneration other than travel expenses for Board meetings, seminars, and conferences.

Thank you also to the System's staff for providing information needed to compile this financial report in a timely fashion. We commend staff for making every effort to meet required deadlines without detracting from the quality and accuracy of the report.

The final and most important thank you is for all of our individual plan members. Thank you for your continued support and trust. We appreciate the privilege of administering your pension needs.

Respectfully submitted,

Larry E. Barbour
Chief of Accounting

James B. Allen
Secretary

Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Pennsylvania Municipal Retirement System

For its Comprehensive Annual Financial Report for the Fiscal Year Ended December 31, 1995

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

Arthur R. Lynch

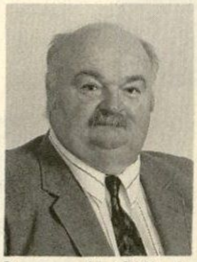
President

Jeffrey L. Esser

Executive Director

Administrative Organization

Pennsylvania Municipal Retirement Board as of December 31, 1996



George E. Gift, Jr.
Chairman
serves until replacement named
Pennsylvania State Fire Fighters Association

John G. Brown, III
Vice-Chairman
serves until replacement named
Pennsylvania State Association of Township Supervisors

Douglas K. Bowen
term expires March 15, 2000
Pennsylvania Municipal Authorities Association

Victor A. Cicero
term expires March 15, 2000
Chiefs of Police Association

David W. Hays
term expires February 24, 1997
First Class Township Commissioners

Yvette Kane
appointed by statute
Secretary of the Commonwealth
(ex-officio) represented by
John T. Henderson, Jr., Deputy Chief Counsel

Catherine Baker Knoll
appointed by statute
State Treasurer
(ex-officio) represented by
Duane M. Searle, Associate General Counsel

Paul S. McMillen
term expires March 15, 2000
Pennsylvania State Association of County Commissioners

Veronica T. Recker
term expires September 23, 1997
Pennsylvania Municipal Retirement System Retired Members

Robert T. Umstead
term expires March 15, 2000
Pennsylvania State Association of Boroughs

Vacant
Pennsylvania League of Cities

Administrative Organization *(Continued)*

Administrative Staff as of December 31, 1996

James B. Allen
Secretary

Edward L. Bechtel
Assistant Secretary

Larry E. Barbour
Accounting Division Chief

Benjamin F. Mader
Membership & Municipal Services Division Chief

Vacant
Operations Division Chief

Professional Consultants as of December 31, 1996

Actuary

The Segal Company
Washington, DC
Eli Greenblum
A.S.A., M.A.A.A.

Auditor

Ernst & Young LLP
Harrisburg, PA
Independent Auditors
Stephen A. Baloga

Comptroller

Commonwealth of Pennsylvania
Harrisburg, PA
Central Services
Bruno J. Chiesa

Investment Consultant

Dahab Associates, Inc.
Islip, NY
Richard E. Dahab, C.F.A.
President

Legal Counsel

Commonwealth of Pennsylvania
Harrisburg, PA
Thomas E. Ross
Chief Counsel

Investment Advisors

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Charlottesville, VA
Derwood S. Chase, Jr., President

CIGNA Investment Management Real Estate
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William J. Grady, Managing Director

First Union National Bank of North Carolina
Philadelphia, PA
Bruce J. Besecker, Vice President

Globalt Incorporated
Atlanta, GA
Angela Z. Allen, President

Heitman Capital Management
Chicago, IL
John A. Gorham, Vice President

Pilgrim Baxter & Associates
Bryn Mawr, PA
Stephen A. Mozur, Senior Vice President

Provident Capital Management, Inc.
Philadelphia, PA
Christian K. Stadlinger, Portfolio Manager

Prudential Real Estate Investors (PRISA)
Parsippany, NJ
Lester F. Lockwood, Vice President

The Putnam Companies, Inc.
Boston, MA
Richard M. Frucci, Senior Vice President

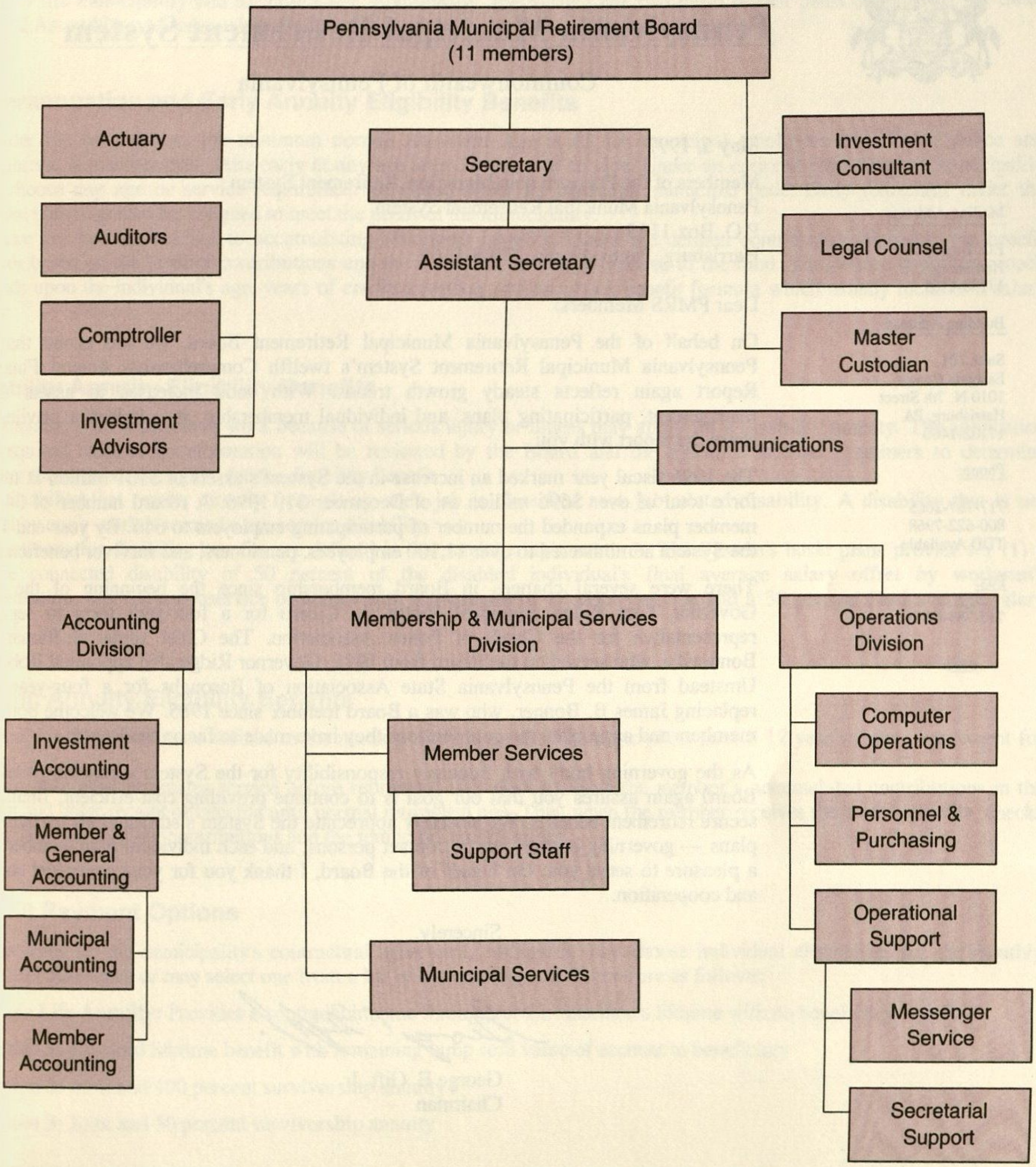
State Street Global Advisors
Boston, MA
Lynn S. Blake, Portfolio Manager

Master Custodian

State Street Bank & Trust Company
Boston, MA
James F. Sheridan
Client Service Manager

Administrative Organization *(Continued)*

Organizational Chart



Chairman's Report

Pennsylvania Municipal Retirement System

Commonwealth of Pennsylvania

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May 5, 1997

Members of the Pennsylvania Municipal Retirement System
Pennsylvania Municipal Retirement System
P.O. Box 1165
Harrisburg, Pennsylvania 17108-1165

Dear PMRS Members:

On behalf of the Pennsylvania Municipal Retirement Board, we are proud that the Pennsylvania Municipal Retirement System's twelfth Comprehensive Annual Financial Report again reflects steady growth trends. With solid increases in assets under management, participating plans, and individual membership, it is indeed a privilege to share the report with you.

The 1996 fiscal year marked an increase in the System's assets of $101 million at market for a total of over $696 million as of December 31, 1996. A record number of 34 new member plans expanded the number of participating employers to 646. By year-end 1996, the System administered to over 11,100 employees, pensioners, and survivor beneficiaries.

There were several changes in Board membership since the beginning of the year. Governor Tom Ridge appointed Victor A. Cicero for a four-year term to serve as representative for the Chiefs of Police Association. The Chief replaced Richard G. Bonneville, who served on the Board from 1991. Governor Ridge also appointed Robert T. Umstead from the Pennsylvania State Association of Boroughs for a four-year term replacing James B. Bonner, who was a Board member since 1985. We welcome both new members and appreciate the contributions they have made so far on the Board.

As the governing body with fiduciary responsibility for the System's pension plans, the Board again assures you that our goal is to continue providing cost-efficient, financially secure retirement benefits. We sincerely appreciate the System's staff and all participating plans — governing boards, staffs, contact persons, and each individual plan member. It is a pleasure to serve you. On behalf of the Board, I thank you for your continued support and cooperation.

Sincerely,

George E. Gift, Jr.
Chairman

Summary of Plan Provisions*

The System offers a variety of alternative pension plans. Municipalities may design their own pension benefit structures. Most municipalities select this option and work with the System to create a combination of benefits that meet the individual needs of the municipality and its employees. Additionally, the System has two basic benefit plans designed by the State General Assembly: one for municipal employees and one for police and firefighters.

Superannuation and Early Annuity Eligibility Benefits

Under the basic plans, the minimum normal retirement age is 65 for municipal employees and 55 for police and firefighters. A member may retire early at any age after 24 years of service. Under an optional plan design, a municipality may choose any age or service requirement permitted under its particular municipal code. Early retirement under the optional plan may also be designed to meet the needs of the municipality.

There are two approaches to accumulating retirement benefits. Under the defined contribution approach, the benefit accrues based on the level of contributions and the investment earnings credited to the fund. The defined benefit approach depends upon the individual's age, years of credited service, and an actual benefit formula which usually includes a salary factor.

Disability Annuity Eligibility Benefits

A member who is unable to work because of serious injury or illness may apply for a disability annuity. The application and required medical documentation will be reviewed by the Board and the System's medical examiners to determine whether the member is eligible for the disability benefit.

A disability that results directly from doing one's job is classified as a job-related disability. A disability that is not caused by one's work is termed a nonservice disability.

Conditions for disability benefits are defined in the municipality's contract. The System's basic plans provide for (1) a service connected disability of 50 percent of the disabled individual's final average salary offset by workmen's compensation, and (2) a nonservice disability with a minimum of 10 years' service and a 30 percent final average salary annuity.

Vesting Annuity Eligibility Benefits

Conditions for vesting are defined in the municipality's contract. The basic plans have a 12 year service requirement for vesting.

A member who terminates service before retirement may elect to leave the member's accumulated contributions in the System and defer receipt of benefits until normal retirement age. Then when the member receives the vested benefits, checks will include the member contributions and the municipal contributions.

Benefit Payment Options

Depending on the municipality's contractual agreement, employees may choose individual alternatives for the monthly retirement allowance or may select one from a list of options. Typical options are as follows:

- **Single Life Annuity:** Provides a continual income throughout the annuitant's lifetime with no beneficiary benefit
- **Option 1:** Reduced lifetime benefit with remaining lump sum value of account to beneficiary
- **Option 2:** Joint and 100 percent survivorship annuity
- **Option 3:** Joint and 50 percent survivorship annuity

** Descriptions are not identical to those in the audit report. Information has been rewritten for ease of understanding.*

Continued on next page

Summary of Plan Provisions *(Continued)*

Death Benefit Eligibility

A death benefit provides some continuation of payment or presentation of benefits to a beneficiary given certain eligibility requirements of the covered individual. If an active member or vestee with minimum years of service dies, the death benefit goes into effect provided the municipality has included this feature in its plan.

Termination of Service

A member always receives his accumulated deductions and interest earned at the regular rate of interest, currently 6.5 percent. Depending upon the municipality's contract structure, the member might also receive excess investment monies upon withdrawal.

If a member terminates employment and goes to work for another municipality which is a member of the System, the employee may transfer his service credits unimpaired to the new municipal employer.

Pennsylvania Municipal Retirement System

pmrs 1996

Financial Section

- Report of Independent Auditors
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  - Revenues by Source and Expenses by Type
  - Administrative Expenses
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Report of Independent Auditors

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Report of Independent Auditors

Board of Directors
Pennsylvania Municipal Retirement System

We have audited the accompanying balance sheets of the Pennsylvania Municipal Retirement System (the System) as of December 31, 1996 and 1995, and the related statements of revenues, expenses, and changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pennsylvania Municipal Retirement System at December 31, 1996 and 1995 and the results of its operations and cash flows for the years then ended, in conformity with generally accepted accounting principles.

As reported in Note D to the financial statements, in 1996 the System adopted Governmental Accounting Standards Board Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions."

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedules of Funding Progress, Ten-Year Historical Information, Administrative Expenses, and Investment Summary Information are presented in accordance with Statement No. 5 of the Governmental Accounting Standards Board for purposes of additional analysis and are not a required part of the financial statements. Such information for the years 1988 through 1995 has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole. Such information for 1987 has been derived from financial statements audited by other auditors whose report thereon expressed an unqualified opinion.

Ernst + Young LLP

April 25, 1997

Ernst & Young LLP is a member of Ernst & Young International, Ltd.

Comparative Balance Sheets
December 31, 1996 and 1995

	1996	1995
Assets:		
Cash	$ 3,461	$ 3,698
Short-term investments	26,993,000	58,546,000
Total cash and short-term investments	**26,996,461**	**58,549,698**
Securities lending short-term collateral investment pool	42,251,461	0
Contributions receivable	1,362,003	1,987,538
Accrued investment income	2,075,088	3,090,092
Investment sales receivable	342,682	2,021,253
Investments:		
Bonds, at cost (market value $172,150,704 in 1996 and $168,588,496 in 1995)	165,200,905	154,859,352
Common and preferred stocks, at cost (market value $448,899,704 in 1996 and $321,233,716 in 1995)	343,732,211	248,356,050
Real estate mutual funds, at cost (market value $44,568,540 in 1996 and $43,363,536 in 1995)	49,415,998	49,059,632
Total investments	**558,349,114**	**452,275,034**
Fixed assets	129,947	144,314
Total assets	**$631,506,756**	**$518,067,929**
Liabilities and Fund Balance:		
Liabilities:		
Accounts payable and accrued expenses	$ 1,295,944	$ 861,238
Investment purchases payable	587,290	1,405,274
Collateral held under securities lending program	42,251,461	0
Total liabilities	**44,134,695**	**2,266,512**
Fund Balance:		
Members' Reserve Account	139,507,193	119,811,233
Municipal Accounts	282,124,768	237,378,294
Retired Members' Reserve Account	179,840,192	158,869,909
Disability Reserve Account	380,348	954,943
Undistributed earnings (deficit)	(14,480,440)	(1,212,962)
Total fund balance	**587,372,061**	**515,801,417**
Total liabilities and fund balance	**$631,506,756**	**$518,067,929**

See notes to financial statements.

Statements of Revenues, Expenses, and Changes in Fund Balance
Years Ended December 31, 1996 and 1995

	1996	1995
Operating Revenues:		
Member contributions	$ 10,018,617	$ 9,132,878
Municipal contributions	18,372,425	53,826,781
Assessments	226,240	221,660
Investment income	67,760,075	34,432,357
Total operating revenues	96,377,357	97,613,676
Operating Expenses:		
Annuity benefits	16,823,555	14,790,805
Disability benefits	1,011,021	893,437
Terminations	3,285,072	4,842,814
Administrative	3,687,065	2,912,441
Total operating expenses	24,806,713	23,439,497
Net operating income	71,570,644	74,174,179
Fund balance, beginning of year	515,801,417	441,627,238
Fund balance, end of year	$587,372,061	$515,801,417

See notes to financial statements.

Statements of Cash Flows

Years Ended December 31, 1996 and 1995

	1996	1995
Operating Activities:		
Net operating income	$ 71,570,644	$ 74,174,179
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation/amortization	30,586	30,672
Investment income	(67,760,075)	(34,432,357)
Gain on sale of investments	(54,656,800)	(23,567,040)
Loss on sale of investments	6,803,520	5,440,760
Changes in operating assets and liabilities:		
Decrease (increase) in contributions receivable	625,535	(812,132)
Decrease (increase) in accrued investment income	1,015,004	(1,011,601)
Decrease in investment sales receivable	1,678,571	545,090
(Decrease) in accounts payable and other liabilities	(383,278)	(156,349)
Net cash provided by (used in) operating activities	**(41,076,293)**	**20,211,222**
Investing Activities:		
Purchases of investments	(412,138,381)	(277,492,854)
Proceeds from sale of investments	353,917,581	263,786,392
Investment income	67,760,075	34,432,357
Net cash provided by investing activities	**9,539,275**	**20,725,895**
Capital and Related Financing Activities:		
Acquisition of capital assets	(16,219)	(13,185)
Net cash used in capital and related financing activities	(16,219)	(13,185)
(Decrease) increase in cash and cash equivalents	**(31,553,237)**	**40,923,932**
Cash and cash equivalents at beginning of year	**58,549,698**	**17,625,766**
Cash and cash equivalents at end of year	**$ 26,996,461**	**$ 58,549,698**

See notes to financial statements.

Notes to Financial Statements
Years Ended December 31, 1996 and 1995

(A)
Organization and Description of the System

Organization

The Pennsylvania Municipal Retirement System (the System) was created by the Pennsylvania General Assembly in 1974 with the passage of the Pennsylvania Municipal Retirement Law, Act of 1974, P.L. 34, No. 15 (the Act). The System is an agent multiple-employer system, and its designated purpose is to administer sound, cost-effective pensions for local government employees. Responsibility for the organization and administration of the System is vested in the eleven-member Pennsylvania Municipal Retirement Board (the Board).

Membership in the System is optional for Pennsylvania's local governments. When a municipality joins the System, its permanent employees contractually become members. Seasonal and temporary employees as well as elected officials may also become members through contractual agreement. At January 1, 1996, the date of the most recent actuarial valuation, there were 560 municipalities with defined benefits and 81 with defined contributions.* Membership consisted of:

Participating Local Government Employers

	Defined Benefits	Defined Contributions
Counties	4	0
Cities	20	0
Boroughs	132	10
Townships of the First Class	22	0
Townships of the Second Class	97	44
Authorities and Other Units	134	25
Police	142	2
Firefighters	9	0
Total	**560**	81

Individual Membership

Active Members	
Defined Benefit Plans	
Municipal	6,710
Police	806
Firefighters	148
Total	**7,664**

This includes twenty-three defined benefit plans and two defined contribution plans in which there were no active participants as of the valuation date.

Notes to Financial Statements *(Continued)*

Individual Membership (Continued)

Defined Contribution Plans	
Municipal	426
Police	3
Firefighters	0
Total	**429**
Total active members	**8,093**
Retirees and Beneficiaries	
Retirees	2,091
Beneficiaries	341
Total	**2,432**
Inactive participants with rights to deferred pension (vested)	
Defined Benefit	190
Defined Contribution	40
Total	**230**
Inactive participants with rights to return of contributions (nonvested)	
Defined Benefit	120
Defined Contribution	9
Total	**129**
Total individual memberships	**10,884**

Benefits

The System has the broad authority of enabling a municipality to design its own retirement benefit structure. As an alternative, the System has two basic benefit plans: one for municipal employees (Article II of the Act) and one for uniformed employees (Article III of the Act). Members are eligible for monthly retirement benefits upon reaching the age of 65 and 55, under Articles II and III, respectively, or upon accumulating 24 years of service. Under Articles II and III of the Act, vesting occurs after 12 years of service.

Such benefits under Articles II and III are generally equal to (a) the actuarial value of the members' contributions and (b) a municipal annuity which is based upon a percentage of a member's salary or compensation.

The plans also provide death, disability, and early retirement benefits. These benefit provisions and all other requirements are established under Articles II and III of the Act.

Under Article IV of the Act, municipalities may provide for benefits different from those available under Articles II and III. Vesting provisions, if any, under Article IV may vary.

Contributions

Contributions to the System are made by members and municipalities. Under Articles II and III of the Act, members are required to contribute 3 to 8 percent of their salary. The amount a member contributes under Article IV of the Act is based upon contracted plan provisions and is principally expressed as a percent of compensation or salary. The contributions required of municipalities are based upon an actuarial valuation, using the Entry Age Normal Actuarial Cost Method, computed as a percentage of the total compensation of all active members during the period for which the amount is determined. The required contributions from municipalities for the year ended December 31, 1996 consisted of the following:

Notes to Financial Statements *(Continued)*

Municipality normal cost	$11,921,166
Amortization of unfunded actuarial accrued liability	3,388,725
Total*	**$15,309,891**

Total contributions to the System during 1996 amounted to $28,391,042 of which $10,018,617 and $18,372,425 were made by its members and municipalities, respectively. The difference between the municipalities' required and actual contributions is due to the municipalities transferring state aid money to the System as required under the Municipal Pension Plan Funding Standard and Recovery Act of 1984 (Act 205).

Each municipality is also charged a $20 assessment per member to help cover administrative expenses incurred by the System.

Contributions Required and Contributions Made

The System's funding policy requires actuarially determined contributions at rates that accumulate sufficient assets to pay benefits when due. The System's actuary used the Entry Age Normal Actuarial Cost Method to determine plan liabilities and normal cost. Under this method, a normal cost is calculated that would fund each employee's benefits during the employee's career as a level percent of pay.

At each valuation date, the unfunded actuarial accrued liability is calculated as the present value of all plan benefits, less the present value of future normal cost accruals, less current assets (actuarial value).

The normal cost rate is applied to the projected payroll, and projected employee contributions are deducted. Actuarial gains (or losses) are reflected by decreases (or increases) in the unfunded actuarial accrued liability. Under Act 205, the unfunded accrued liability is being amortized as a level dollar amount over the lesser of:

1. a. 30 years with respect to the initial liability as of January 1, 1985 (or first valuation),
   b. 20 years with respect to changes due to plan provisions and actuarial assumptions,
   c. 15 years with respect to actuarial gains and losses, or
2. the average assumed working lifetime of active employees as of the date the liability was established.

Significant actuarial assumptions used to compute the actuarially determined contribution requirement include (a) a rate of return on the investment of present and future assets of 6.5 percent a year (net of investment and certain administrative expenses) compounded annually, (b) projected salary increases of 4 percent a year compounded annually for inflation, with an additional age-based component to reflect merit/seniority, (c) post-retirement cost-of-living increases of 4 percent per annum until maximum is reached (optional in contracts), and (d) pre- and post-retirement mortality based on the 1983 Group Annuity Mortality Table for Males set back 6 years for females and an additional set forward of 10 years for disabled lives.

(B)
Significant Accounting Policies

Basis of Accounting

The System's financial statements are prepared using the accrual basis of accounting and in accordance with NCGA Statement No. 6. Employee and employer contributions are recognized as revenues in the same period that services are performed. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

In November 1994, the Government Accounting Standards Board (GASB) issued Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans." Statement No. 25 will supersede most of the existing standards currently followed by the System in presenting its financial statements, including requiring the use of fair value to report system assets. The System has not completed the analyses required to estimate the financial statement impact of this new statement, which is effective for the System's 1997 fiscal year.

* *Total does not include $20.00 per member administrative charges to municipalities.*

Notes to Financial Statements *(Continued)*

Statements of Cash Flows

The System has adopted GASB Statement No. 9 which permits the presentation of a "Statement of Cash Flows." Cash equivalents for purposes of the Statements of Cash Flows are defined as short-term investments with a maturity at the date of acquisition of three months or less.

Fund Balance

Details concerning the pension benefit obligation have not been disclosed in the fund balance section of the balance sheets as required by NCGA Statement No. 6, since such actuarial information is not available as of December 31, 1996. Such information as of January 1, 1996 and 1995 is disclosed in Note E to the financial statements.

Methods Used to Value Investments

Corporate and government bonds with fixed maturities are reported at amortized cost. Investments in common and preferred stocks are carried at cost. Gains and losses on stock sales are recognized on the basis of the average cost of stocks sold. Real estate mutual funds are carried at cost. Gains and losses on sales and exchanges of investments are recognized on the transaction date.

Short-term investments, which include investments in the state treasury pool, U.S. Treasury bills, and other short-term investment vehicles are carried at cost which approximates market value.

Fixed Assets

Fixed assets, primarily office furniture and equipment, are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, typically eight years.

Excess Interest

In addition to regular interest, the System may also award excess interest. Excess interest is investment earnings on the System's assets in excess of that required for allocation to regular interest and administrative expenses.

Rates for excess interest are determined yearly by the Board with advice from the System's actuary. The excess interest is distributed to the member accounts, the municipal accounts, and the retiree accounts as directed by the municipality.

Federal Income Tax Status

During the years ended December 31, 1996 and 1995, the System qualified under the provisions of the Internal Revenue Code and was exempt from federal income taxes.

(C)
Description of Funds

The Act defines the following funds to be maintained by the System:

Members' Reserve Account

The Members' Reserve Account is credited with all contributions made by active members of the System. Interest is added to each member's individual account at an annual rate determined by the Board. The System's current interest rate is 6.5 percent.

Upon retirement or disability of an active member, the member's accumulated contributions plus interest are transferred to the Retired Members' Reserve Account or the Disability Reserve Account for subsequent benefit payments. Withdrawals of members' contributions not eligible for benefits are paid from this reserve.

Municipal Accounts

Separate municipal accounts are maintained for each municipality. The Municipal Reserve Account is credited with each municipality's contributions toward the superannuation retirement and death benefits of its members. Annual interest is added to each separate municipal account at the current rate of 6.5 percent.

Notes to Financial Statements *(Continued)*

Retired Members' Reserve Account

The Retired Members' Reserve Account represents the amounts transferred from the Members' Reserve Account, the Municipal Accounts, and the Disability Reserve Account. All retirement and retirees' death benefits plus voluntary and involuntary early retirements are paid from this reserve. Annual interest is credited to the Retired Members' Reserve Account at the current rate of 6.5 percent.

Disability Reserve Account

The Disability Reserve Account is credited with the contributions made by municipalities toward the disability retirement of member employees.

Undistributed Earnings (Deficit)

The System approved a distribution of excess interest at a rate of 8.37 percent during 1996. Such calculation, as described in Note B, was prepared in accordance with a Board approved formula and was based on the actuarial value (market value) of the System's assets as of December 31, 1995 and the expected cash flows of the System for 1996. This distribution, which amounted to $43,072,000, combined with the excess of regular interest at 6.5 percent (distributed directly from undistributed earnings) and administrative costs over the investment income during 1996 resulted in a deficit in undistributed earnings of $14,480,440 at December 31, 1996. No such distribution occurred during 1995.

(D) Investments

Members of the Board are trustees of the System's assets. They have exclusive responsibility for the management of such assets and have full power to invest the System's assets, subject to the terms, conditions, limitations, and restrictions imposed by law upon fiduciaries.

The Board has authorized investments in U.S. government and agency securities, foreign government bonds denominated in U.S. dollars and rated "AA," corporate bonds rated "A" or better, equity securities, and real estate commingled funds allowing for equity participation. The Board specifically prohibits investments in commodities, mineral rights, and options. Additionally, short-selling and margin purchase transactions are prohibited.

The Board achieves day-to-day management of the investment portfolio through the use of investment advisors. Restrictions concerning diversification within each advisor and among advisors are provided by adopted investment policy.

The System invests in the Commonwealth of Pennsylvania Treasury Department's short-term cash management fund. The fund comprises various short-term investments, including repurchase agreements. Restrictions on these repurchase agreements are outlined below.

Repurchase agreements with nonbanking institutions are allowable if (a) the institution has a minimum of $50 million in capital, (b) the collateral that is pledged to the Treasury is composed of U.S. government securities with a maturity of four years or less, (c) the collateral's market value equals or exceeds the amount invested by the Treasury, and (d) the collateral is delivered to Treasury's Book Entry Account at the Philadelphia Federal Reserve Bank.

Repurchase investments in banking institutions are subject to identical restrictions as those noted above for non-banking institutions.

The System also invests in mortgage-backed securities such as GNMA and FNMA obligations. These securities are sensitive to prepayments by mortgagees, which may result from a drop in interest rates. The carrying and market values of such securities, which are reported with "Bonds" in the System's balance sheet, approximated $33.5 million and $33.5 million, respectively, at December 31, 1996, and $27.0 million and $27.2 million, respectively, at December 31, 1995.

The System's investments are categorized below to give an indication of the level of risk assumed by the System at December 31, 1996. In accordance with a contractual relationship between the Commonwealth's Treasury Department and a custodial agent, substantially all investments subject to categorization, except those subject to securities lending, are held in book entry form via a unique account so as to be identified at all times as the possession of the Commonwealth. Therefore, all such investments are reflected in Category 1, which is defined as investments which are insured or registered or securities held by the System or its agent in the System's name. Investments may also be categorized as Category 2, which is defined as investments which are uninsured and unregistered, with the securities held by the System's master custodian (bank) or agent in the System's name, and Category 3, which is defined as investments which are uninsured and unregistered, with the securities held by the System's master custodian (bank) or agent but not in the System's name. The System also has investments which are not in any of the three defined categories, because the securities are not used as evidence of the investment. Such investments are separately identified.

Notes to Financial Statements *(Continued)*

In 1996, the System adopted GASB Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions." In accordance with a contract between the Treasurer of the Commonwealth and the Treasurer's custodial agent, the System participates in a securities lending program. Under this program, the custodial agent, acting as the lending agent, lends securities (equities, fixed income, and money market instruments) to independent brokers and dealers in exchange for collateral in an amount not less than 102 percent of the fair value of any securities lent except equity securities of non-U.S. corporations for which 105 percent of the fair value is required. Collateral is marked-to-market daily. If the fair value of the collateral held falls below the minimum guidelines for securities lent, additional collateral is obtained. In lieu of securities or cash, the borrower may deliver to the lending agent irrevocable bank letters of credit, government securities, or repurchase agreements as collateral. If the collateral obtained consists in whole or in part of cash, the lending agent may use or invest the cash in accordance with reinvestment guidelines approved by the State Treasurer.

All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in the lending agent's short-term investment pool. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of the securities loans made by other entities that use the lending agent's pool, which the System cannot determine. The System cannot pledge or sell collateral securities received unless the borrower defaults.

As of December 31, 1996, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers exceed the amounts the borrowers owe the System. Under the securities lending program, the lending agent provides indemnification to the Commonwealth if the borrowers fail to return the underlying securities (and the collateral is inadequate to replace the securities lent) or fail to pay income distribution on them. As of December 31, 1996, the System's carrying value and fair value of lent securities was $51,456,085 and $59,767,561, respectively. The fair value of associated collateral was $61,465,982. The System's income, net of expenses, from securities lending was $146,458 for 1996. Securities lent at year-end for cash collateral are presented as unclassified in the following schedule of custodial credit risk; securities lent for repurchase agreements or securities collateral are classified according to the category for the collateral.

As of December 31, 1996, the System had $42,251,461 of cash collateral invested in the custodial agent's short-term collateral investment pool. As of December 31, 1995, the amount of cash collateral held in the short-term collateral investment pool was not available since the recordkeeping requirements for GASB Statement No. 28 were not implemented at that date.

Investments (Book Value)	**Category 1**	**Category 3**	**Not Categorized**	**Total**
U.S. government and agency bonds (market value $156,096,239)....	$122,093,666	$10,001,224	$18,372,792	$150,467,682
Corporate bonds and notes (market value $16,054,465)...............	14,733,223	0	0	14,733,223
Common and preferred stocks (market value $448,899,704)............	320,650,143	7,037,898	16,044,170	343,732,211
Real estate mutual funds (market value $44,568,540)...............	0	0	49,415,998	49,415,998
State Treasury short-term investment fund (market value $26,993,000)...............	0	0	26,993,000	26,993,000
Securities lending short-term collateral investment pool (market value $42,251,461)...............	0	0	42,251,461	42,251,461
Total (market value $734,863,409).....	**$457,477,032**	**$17,039,122**	**$153,077,421**	**$627,593,575**

Notes to Financial Statements *(Continued)*

Investments that represented 5 percent or more of the plan's net assets at December 31, 1996 and 1995 were:

Security	Rate	Due Date	Book Value	Market V
1996				
State Street Index Fund	Variable	Variable	$198,272,833	$242,86
1995				
Prudential Real Estate Investors (PRISA)	Variable	Variable	$ 31,038,955	$ 25,20
State Street Index Fund	Variable	Variable	$ 98,041,284	$125,654

(E) Funding Status and Progress

The amount shown below as "pension benefit obligation" is a standardized disclosure measure of the present value of p benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee to date. This measure is the actuarial present value of credited projected benefits and is intended to (a) help users System's funding status on a going-concern basis, (b) assess progress being made in accumulating sufficient assets to pay when due, and (c) allow for comparisons among public employee retirement plans. The measure is independent of the funding method used to determine contributions to the System.

The pension benefit obligation which was determined for the most recent actuarial valuation, dated January 1, 1996, was so in compliance with GASB Statement No. 5. Significant actuarial assumptions used include (a) a 7.0 percent discount year (assumed net rate of return on the investment of present and future assets) compounded annually, (b) projected increases of 4 percent per year compounded annually for inflation, with an additional age-base component merit/seniority, (c) post-retirement cost-of-living increases of 4 percent per annum until maximum is reached (op contracts), and (d) pre- and post-retirement mortality based on the 1983 Group Annuity Mortality Table for Males se years for females, and an additional set forward of 10 years for disabled lives.

The System's assets in excess of the pension benefit obligation were as follows at January 1:

	Benefit Information Date	
Pension benefit obligation:	**January 1, 1996**	January 1, 19
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	$162,864,500	$149,161,1
Current employees		
Accumulated employee contributions including allocated investment income	111,462,700	103,727,9
Employer-financed vested	159,284,500	150,939,2
Employer-financed nonvested	31,156,400	29,712,4
Total pension benefit obligation	**464,768,100**	433,540,6
Net assets available for benefits, at cost (market value is $596,712,000 in 1996 and $449,030,006 in 1995)	**515,801,417**	441,627,2
Assets in excess of pension benefit obligation	**$ (51,033,317)**	$ (8,086,6

Notes to Financial Statements *(Continued)*

(F) Relationships with Other Commonwealth Agencies

Responsibility for the organization and administration of the System is vested in the eleven-member Pennsylvania Municipal Retirement Board. The State Treasurer and the Secretary of the Commonwealth serve on the Board by virtue of statute. Eight Board members are also appointed by the Governor after being nominated by their respective organizations. One member each represents the Chiefs of Police Association, Pennsylvania League of Cities, Pennsylvania Municipal Authorities Association, Pennsylvania State Association of Boroughs, Pennsylvania State Association of County Commissioners, Pennsylvania State Association of Township Commissioners, Pennsylvania State Association of Township Supervisors, and the Pennsylvania State Fire Fighters Association. In addition, one Board position is filled by a retired member of the Pennsylvania Municipal Retirement System. Interested individuals submit an application, and then the Governor appoints someone from the list of applicants.

The System is not included as a component unit of the Commonwealth of Pennsylvania for financial reporting purposes because the System is not financially accountable to the Commonwealth as there is no imposition of will, no financial benefit/burden, nor fiscal dependency associated with the System toward the Commonwealth.

(G) Litigation and Contingencies

The System is subject to various threatened and pending lawsuits which generally deal with issues concerning upgrading of benefits. Management does not anticipate that the ultimate liability arising from such litigation and threats of litigation will have a material effect on the financial statements of the System.

(H) Plan Termination

Member municipalities may withdraw from the System if the conditions for withdrawal under the Act have been met. Requirements include a minimum of five years of membership and approval of the Board. In the event of withdrawal, a municipality is entitled to receive a net refund of the amount then standing to the credit of the municipality in the municipal account, the member employees' account, and the retired members' reserve account. In no event shall the municipality refund exceed the pro rata interest of the withdrawing municipality in the net assets of the entire fund based on market value of the fund investments. Liability for any continuation of retirement or disability benefits being paid from the System shall attach to the withdrawing municipality.

(I) Historical Trend Information

Historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay pension benefits when due is presented immediately following the Notes to Financial Statements in Schedules 1 and 2.

Schedule 1
Analysis of Funding Progress
for Last 10 Years

Valuation as of 1/1	(1) Net Assets Available for Benefits at Cost	(2) Pension Benefit Obligation	(3) Percentage Funded (1) ÷ (2)	(4) Unfunded (Assets in Excess of) Pension Obligation (2) – (1)	(5) Annual Covered Payroll	(6) Unfunded (Assets in Excess of) Pension Obligation as % of Covered Payroll (4) ÷ (5)
1996	$515,801,417	$464,768,100	111.0%	$(51,033,317)	$231,172,800	(22.1%)
1995	441,627,238	433,540,600	101.9%	(8,086,638)	220,896,500	(3.7%)
1994	395,643,341	378,638,500	104.5%	(17,004,841)	205,576,600	(8.3%)
1993	346,811,732	353,092,100	98.2%	6,280,368	199,520,300	3.1%
1992	308,188,187	306,891,400	100.4%	(1,296,787)	183,077,135	(0.7%)
1991	280,860,370	276,842,300	101.5%	(4,018,070)	169,014,027	(2.4%)
1990	259,678,437	242,959,900	106.9%	(16,718,537)	154,392,434	(10.8%)
1989	233,842,678	227,907,400	102.6%	(5,935,278)	148,709,536	(4.0%)
1988	215,563,330	227,201,900	94.9%	11,638,570	139,935,278	8.3%
1987	175,901,000	208,149,600	84.5%	32,248,600	132,969,603	24.3%

Analysis of the dollar amounts of net assets available for benefits, pension benefit obligation, and unfunded (assets in excess of) pension obligation in isolation can be misleading. Expressing the net assets available for benefits as a percentage of the pension obligation provides one indication of funding status on a going-concern basis. Analysis of this percentage over time indicates whether the fund is becoming financially stronger or weaker with a greater percentage indicating a stronger pension fund. Trends in unfunded (assets in excess of) pension obligation as a percentage of annual covered payroll approximately adjust for the effects of inflation and aid analysis of progress made in accumulating sufficient assets to pay benefits when due with a smaller percentage indicating the stronger pension fund.

Schedule 2
Revenues by Source and Expenses by Type
for Last 10 Years

Revenues by Source

Fiscal Year	Member Contributions	Municipal Contributions[1]	Municipal Assessments[2]	Investment Income[3]	Total Revenue
1996	$10,018,617	$18,372,425	$226,240	$67,760,075	$96,377,357
1995	9,132,878	53,826,781	221,660	34,432,357	97,613,676
1994	8,692,966	20,803,673	212,360	35,856,385	65,565,384
1993	8,005,897	17,393,710	213,540	45,673,490	71,286,637
1992	7,691,304	17,455,364	205,900	30,442,797	55,795,365
1991	7,049,195	14,175,058	200,520	25,317,942	46,742,715
1990	6,511,819	13,609,021	195,460	17,379,987	37,696,287
1989	5,983,693	17,457,290	198,460	20,488,089	44,127,532
1988	5,630,152	13,657,999	192,800	14,620,070	34,101,021
1987	5,570,496	24,008,631	181,920	25,445,009	55,206,056

(1) Contributions were made in accordance with actuarially determined contribution requirements.

(2) Municipal assessments are receipts but not assets of the plans.

(3) The investment income does not include any unrealized gains or losses resulting from changes in market movements in the System's portfolio.

Expenses by Type

Fiscal Year	Total Benefit Expenses	Administrative Expenses		Total Expenses
		Operational Expenses	Investment Management Fees	
1996	$21,119,648	$1,611,439	$2,075,626	$24,806,713
1995	20,527,056	1,523,433	1,389,008	23,439,497
1994	16,936,489	1,519,615	1,125,383	19,581,487
1993	20,093,174	1,299,410	1,062,444	22,455,028
1992	14,912,545	1,300,173	959,102	17,171,820
1991	17,456,476	1,169,439	788,983	19,414,898
1990	14,723,270	1,132,739	658,345	16,514,354
1989	16,570,180	1,129,091	592,502	18,291,773
1988	14,360,550	923,046	538,077	15,821,673
1987	13,917,366	943,489	541,004	15,401,859

Continued on next page

Schedule 2 *(Continued)*

Expenses by Type (Continued)

Benefit Expenses

Fiscal Year	Annuity Benefits	Disability Benefits	Terminations	Total Benefit Expenses
1996	$16,823,555	$1,011,021	$3,285,072	$21,119,648
1995	14,790,805	893,437	4,842,814	20,527,056
1994	13,432,442	851,135	2,652,912	16,936,489
1993	12,144,279	760,676	7,188,219	20,093,174
1992	11,288,793	658,263	2,965,489	14,912,545
1991	10,438,173	592,732	6,425,571	17,456,476
1990	8,992,091	632,732	5,098,447	14,723,270
1989	8,365,751	659,164	7,545,265	16,570,180
1988	7,406,401	489,130	6,465,019	14,360,550
1987	6,332,690	395,846	7,188,830	13,917,366

Schedule 3
Administrative Expenses
Comparative Two-Year Schedule
Years Ended December 31, 1996 and 1995

	1996 Actual	1996 Budget	1995 Actual	1995 Budget
Personnel costs:				
Salaries and wages	$ 713,917		$ 653,263	
Social security contributions	53,984		49,511	
Retirement contributions	60,240		54,382	
Insurance contributions	127,217		147,593	
Other employee benefits	5,273		4,117	
Total personnel costs	**960,631**	**$1,023,350**	**908,866**	**$ 984,800**
Professional costs:				
Performance evaluation	48,000		45,250	
Actuarial	204,577		196,024	
Data processing	5,427		7,576	
Audit	22,000		21,000	
Legal	62,125		67,697	
Security movement & control	3,400		2,747	
Investment advisors	2,075,626		1,389,008	
Miscellaneous professional	88,855		75,596	
Total professional costs	**2,510,010**	**2,547,726**	**1,804,898**	**1,824,308**
Communication costs:				
Printing	25,602		18,675	
Telephone	11,018		10,502	
Postage	29,640		27,359	
Travel	19,536		16,377	
Advertising	2,431		2,431	
Total communication costs	**88,227**	**86,750**	**75,344**	**81,500**
Other services and charges:				
Office space rental	75,000		75,000	
Equipment leasing	7,238		3,379	
Supplies	10,543		10,710	
Maintenance	2,420		1,438	
Bonding & insurance	598		637	
Dues & subscriptions	1,812		1,497	
Total other services & charges	**97,611**	**123,350**	**92,661**	**150,950**
Depreciation	**30,586**		**30,672**	
Total administrative expenses	**$3,687,065**	**$3,781,176**	**$2,912,441**	**$3,041,558**

Schedule 4
Investment Summary
Year Ended December 31, 1996

	January 1, 1996		
Type of Investment	Book Value	Market Value	Purchases
Corporate and government bonds:			
U.S. Government bonds	$129,343,907	$140,179,081	$141,464,535
Corporate bonds	25,515,445	28,409,415	0
Total bonds	154,859,352	168,588,496	141,464,535
Common stock	248,356,050	321,233,716	268,015,978
Real estate equity	49,059,632	43,363,536	2,657,868
Cash equivalents	58,546,000	58,546,000	193,637,000
Total investments	$510,821,034	$591,731,748	$605,775,381

Investment Summary (Continued)
Year Ended December 31, 1995

	January 1, 1995		
Type of Investment	Book Value	Market Value	Purchases
Corporate and government bonds:			
U.S. Government bonds	$114,534,128	$113,227,495	$102,813,867
Corporate bonds	21,022,026	20,952,633	4,493,419
Total bonds	135,556,154	134,180,128	107,307,286
Common stock	236,865,105	251,468,924	168,090,574
Real estate equity	48,021,033	42,196,008	2,094,994
Cash equivalents	17,622,000	17,622,000	123,237,000
Total investments	$438,064,292	$445,467,060	$400,729,854

Schedule 4
Investment Summary (Continued)
Year Ended December 31, 1996

Sales and Redemptions	December 31, 1996 Book Value	Market Value	% of Total Market Value
$120,340,760	$150,467,682	$156,096,239	23%
10,782,222	14,733,223	16,054,465	2
131,122,982	165,200,905	172,150,704	25%
172,639,817	343,732,211	448,899,704	65%
2,301,502	49,415,998	44,568,540	6%
225,190,000	26,993,000	26,993,000	4%
$531,254,301	$585,342,114	$692,611,948	100%

Investment Summary (Continued)
Year Ended December 31, 1995

Sales and Redemptions	December 31, 1995 Book Value	Market Value	% of Total Market Value
$ 88,004,088	$129,343,907	$140,179,081	24%
0	25,515,445	28,409,415	5
88,004,088	154,859,352	168,588,496	29%
156,599,629	248,356,050	321,233,716	54%
1,056,395	49,059,632	43,363,536	7%
82,313,000	58,546,000	58,546,000	10%
$327,973,112	$510,821,034	$591,731,748	100%

Pennsylvania Municipal Retirement System

pmrs 1996

Actuarial Section

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