

**EMPLOYEES' RETIREMENT SYSTEM  
OF THE CITY OF MILWAUKEE**

**Basic Financial Statements  
and Additional Information for the  
Year Ended December 31, 2006 and  
Independent Auditors' Report**

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

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# **INTRODUCTORY SECTION**



**Martin Matson**  
Deputy Director

**Thomas Rick, CFA**  
Chief Investment Officer

September 14, 2007

On behalf of the Annuity and Pension Board of the Employees' Retirement System (ERS) of the City of Milwaukee, I am pleased to present the Basic Financial Statements for the ERS for the year ending December 31, 2006. The ERS provides retirement and disability benefits, counseling and other services to over 27,000 members. The Employees' Retirement System was created under Chapter 396 of the Laws of Wisconsin of 1937 and the City of Milwaukee Charter, Chapter 36. This report fulfills the legal reporting requirements of those laws.

It is the responsibility of ERS management to present fairly all-financial information in conformity with generally accepted accounting principles. The ERS has internal controls in place that provide reasonable assurance that the financial statements are free from errors. An independent audit of the ERS' books and records allows the independent auditor to reasonably confirm that the statements are free from material misstatement. The independent auditor's report is found within the Financial Section of this report.

ERS continues to remain fully funded. The ERS actuarial funding level increased from 116.7% at January 1, 2005 to 122.9% at January 1, 2006 due to market increases in 2005. The funded status of the ERS is measured by comparing the actuarial value of plan assets with the actuarial accrued liability. The "schedule of funding progress" included in this report shows historical trend information about the system's actuarial value of assets, actuarial accrued liability and actuarial funded status.

Lastly, I would like to acknowledge the staff of the ERS for rising to meet all challenges we have faced and for their continuing dedicated effort in providing superior customer service to all of our members.

A handwritten signature in cursive script that reads "Martin Matson".

Martin Matson  
Deputy Director

## **LIST OF PRINCIPAL OFFICIALS**

### **ANNUITY & PENSION BOARD MEMBERS**

#### **W. Martin Morics, CPA, Board Chairman**

City Comptroller  
Ex-Officio Member

#### **William C. Carey - Board Vice Chairman**

Elected Representative – Retiree

#### **Sebastian Raclaw**

Milwaukee Police Association  
Elected Representative - Active

#### **Thomas Fischer**

Milwaukee Police Association  
Elected Representative – Active

#### **John Barmore**

Milwaukee Fire Department  
Elected Representative - Active

#### **Larry Holland**

Assurant  
Appointed by the President of the Common Council

#### **Alderman Michael J. Murphy**

10<sup>th</sup> Aldermanic District  
Appointed by the President of the Common Council

#### **Ronald Walter**

Milwaukee Bucks, Inc.  
Appointed by the President of the Common Council

### **ERS ADMINISTRATIVE PERSONNEL**

#### **Michael C. Dolsen**

Executive Director and Secretary

#### **Wayne F. Whittow**

City Treasurer  
Custodian of Funds

#### **Martin Matson**

Deputy Director

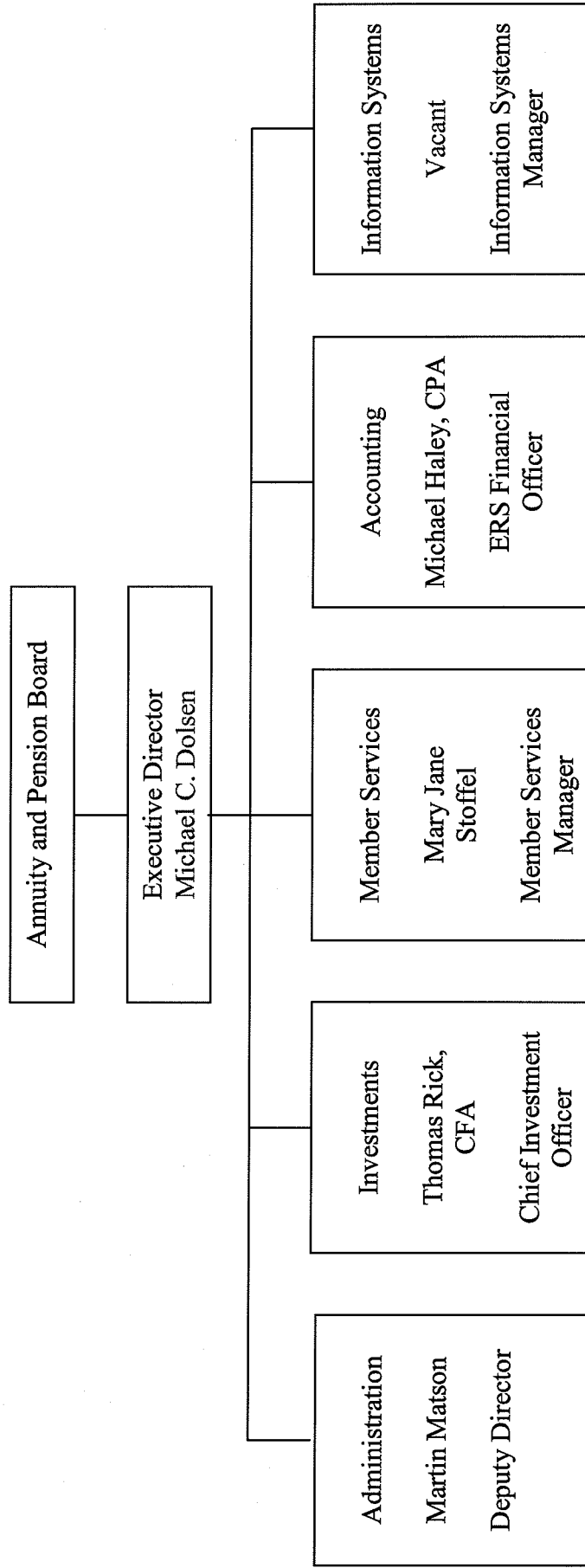
#### **Grant F. Langley**

City Attorney  
Legal Advisor

#### **Thomas Rick, CFA**

Chief Investment Officer

# Employees' Retirement System Organization Chart



# **FINANCIAL SECTION**





# Virchow Krause & company

## INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

To the Annuity and Pension Board of the Employees'  
Retirement System of the City of Milwaukee:

We have audited the accompanying basic financial statements of the Employees' Retirement System of the City of Milwaukee (the "Retirement System") as of December 31, 2006, and for the year then ended as listed in the Table of Contents. These financial statements are the responsibility of the Retirement System's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Retirement System as of December 31, 2006, and the changes in the plan net assets of the Retirement System for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2007 on our consideration of the Retirement System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts 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 the 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 and the required supplementary information other than Management's Discussion and Analysis on pages 7 through 16 and pages 31 through 35, respectively are not a required part of the basic financial statements of the Retirement System but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures to the 2006 information 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.

The additional information on pages 37 and 38 is not a required part of the basic financial statements of the Retirement System. This additional information is also the responsibility of the Retirement System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the additional information. However, we did not audit the information and express no opinion on it.

*VIRCHOW, KRAUSE & COMPANY, LLP.*

Milwaukee, Wisconsin  
September 14, 2007



## **Management Discussion and Analysis Section**

# **EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE Management's Discussion and Analysis**

*To help facilitate a better understanding of the Employees' Retirement System of the City of Milwaukee (ERS) financial condition as of December 31, 2006, the results of operations for the year then ended and the fiscal policies that govern its significant business operations, management has prepared this narrative analysis. This narrative is intended to supplement the audited financial statements and, as such should be read in conjunction with these statements, which are presented later in this document.*

The ERS is primarily responsible for administering retirement and disability benefits for employees of the City of Milwaukee, Milwaukee Metropolitan Sewerage District, the Wisconsin Center and the Milwaukee Housing and Redevelopment Authorities and some employees of the Milwaukee Board of School Directors and the Milwaukee Area Technical College. The ERS pension trust fund is a defined benefit pension plan that provides a fixed monthly benefit to retirees after reaching a minimum retirement age depending upon employment history.

The provisions of Chapter 396, laws of Wisconsin 1937, initially created the ERS. Funds have been established to comply with the legislation governing the ERS. In April of 2000, the Common Council of the City of Milwaukee adopted legislation (commonly referred to as the Global Pension Settlement or GPS) increasing benefits to current and future retirees in exchange for allowing for changes in the administration of the ERS including allowing for the use of ERS funds to pay for the cost of plan administration. Members enrolled prior to June 28, 2000 can elect whether to consent to GPS and accept its provisions, while members enrolled on or after that date are automatically subject to the provisions of GPS.

## **A Discussion of Funds Within the ERS Plan**

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### **Global Combined Fund**

The Global Combined Fund is used to provide retirement and disability benefits to all members who consented to GPS and all members enrolled on or after June 28, 2000. Approximately 97% of the total membership is accounted for in the Global Combined Fund.

### **Employers' Reserve Fund**

Agencies participating in the ERS may voluntarily contribute to the Employers' Reserve Fund. Agencies with funds on deposit in the Employers' Reserve Fund may use these funds to offset contributions required of them by adopting a formal resolution directing such a transfer.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE Management's Discussion and Analysis

## Securities Lending Fund

Northern Trust, the custodian for ERS, administers the securities lending program. In this program, ERS lends out securities and receives collateral from the borrowers in the form of either cash or high quality securities and charge the borrowers a fee.

Revenues generated from securities lending are deposited in the Securities Lending Fund and are restricted to pay expenses in connection with the administration and operation of the ERS. Revenues not expended by the close of the calendar year next following the calendar year in which it is deposited are transferred to the Retirement Fund.

## Non-Consenter Funds

The Non-Consenter Funds provide retirement and disability benefits for all members who have not consented to GPS. The benefits paid from these funds do not include enhanced benefits provided by GPS.

- **Retirement Fund:** The Retirement Fund provides for retirement and ordinary disability (non work related disability) benefits for non-consenting members enrolled prior to February 1, 1996.
- **Combined Retirement Fund:** The Combined Retirement Fund provides for retirement and disability benefits (both ordinary and duty related) for non-consenting members enrolled on or after February 1, 1996.
- **General Employees' Duty Disability Fund:** The General Employees' Duty Disability Fund provides for duty disability benefits for non-consenting general (non fire and police) members enrolled prior to February 1, 1996.

## Dormant Non-Consenter Funds

*A dormant fund has no members currently associated with it and as a result, no member balance amounts. Although these funds are not currently disclosed on the financial statements it is remotely possible that current non-consenting members could qualify for these funds in the future. As a result, the board has not officially closed the following 2 funds:*

- **Firemen and Policemen's Duty Disability Fund:** The Firemen and Policemen's Duty Disability Fund provides for duty disability benefits for non-consenting fire and police members enrolled prior to February 1, 1996. As of December 31, 2004 all former members have consented to the global settlement and all remaining balances were transferred to the Global Combined Fund. This fund, although still active, is not likely to ever be used again.
- **Firemen's Heart and Lung Fund:** Accounts for fire heart and lung duty disability benefits of non-consenters. As of December 31, 2002 all former members have either consented to the global settlement or are deceased. This fund, although still active, is not likely to ever be used again.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## Management's Discussion and Analysis

### Fiduciary Funds

Fiduciary Funds are used to report assets held in a trustee capacity for others and therefore can not be used to support the primary governments own interests.

- **Policeman's' Annuity and Benefit Fund:** As discussed in footnote 11, on December 14, 2005, the Policeman's Annuity and Benefit Fund (PABF) board adopted a resolution to dissolve and to liquidate all assets of the fund and transfer the assets and full administrative control to the ERS. All assets of the PABF were transferred to the systems custodian, Northern Trust, in early 2006 and the ERS board assumed custodial authority and responsibility for the funds assets as of January 3, 2006. These resources are disclosed in the financial records as a separate fiduciary fund and valuations are prepared by the PABF's own actuary. The only re-occurring revenues to the fund are in the form of an annual tax levy. The levy for 2006, to be collected in early 2007 amounts to \$307,582 . The benefits paid during 2006 were to some 152 annuitants and widows. Benefit payments amounted to \$1,515,000. Due to the materiality level of this fiduciary fund, it has not been included in the Analysis of Financial Position and Results of Operations section of this MD&A.

### Financial Highlights

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- Total assets of the ERS increased by \$483 million or 8.30% during 2006. The increase was primarily due to favorable conditions in the financial markets during 2006.
- As members of the plan consent to the Global pension Settlement their member balances are transferred from the appropriate "Non-consenter" fund to the Global Combined Fund. Total member balances transferred for 2006 amounted to \$3,561,000.
- As of January 1, 2006, the date of the latest actuarial valuation, the ERS actuarially funded ratio was 122.9%, an increase from the January 1, 2005 funding level of 116.7%. This increase reflects the strong positive investment returns experienced in 2005. The funded ratio based on the market value of assets increased to 124.2 % as of January 1, 2006 from 125.4% as of January 1, 2005.
- In 2006, Mercer Investment Consulting, ERS' consultant, reported a 15.4% annual gross of fees total fund return while in 2005 the return was 8.7%. As of December 31, 2006, the fund's 3-year performance ranks near the median and the 5-year performance ranks in the top third of the Mercer/Russell Mellon database. This database contains approximately 35 public pension funds that have assets of at least one billion dollars.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## Management's Discussion and Analysis

### Overview of the Financial Statements

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The Financial Statements of the ERS are comprised of the following components: 1) fund financial statements, 2) notes to basic financial statements, 3) required supplementary information, and 4) additional information. Collectively, this information presents the net assets held in trust for pension benefits for all funds under ERS administration. It should be noted that currently, the ERS board is responsible for the administration of the plan assets of the Employees' Retirement System and the Policeman's Annuity and Benefit Fund. The later is disclosed discreetly as a fiduciary fund on these statements.

- 1) Fund Financial Statements.** Fund Financial Statements consist of the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets.

Statement of Plan Net Assets contains cash balances, investments itemized by category and accounts receivable with a total of all assets. Liabilities include benefits payable, reimbursements due to the City for costs to administer the plan and amounts for investment purchases that have been initiated but not settled at year-end to arrive at total liabilities. The total assets minus the total liabilities equals end of year net assets held in trust for pension benefits equal to that found on the statement of changes in plan net assets.

Statement of Changes in Plan Net Assets reflects all contributions and net investment performance in the additions section and all expenses and benefit payments in the deductions section. Fund balance transfers are also shown as increases or decreases in fund balance to arrive at the end of year net assets held in trust for pension benefits. The Statement of Changes in Plan Net Assets explains the reasons why the net assets available for pension benefits changed from one year to the next.

- 2) Notes to Basic Financial Statements.** The financial statement notes provide additional information that is essential to understanding the data provided in the fund financial statements. Information in the notes is described below.

- Note 1: Provides a general description of the ERS as well as an overview of some of the common benefits available to various groups of members.
- Note 2: Summarizes significant ERS accounting policies.
- Note 3: Describes consent status changes in relation to the Global Pension Settlement.
- Note 4: Summarizes employer transactions in the Employers' Reserve Fund during 2006.
- Note 5: Summarizes the funding status of the ERS, actuarial assumptions, and employer contributions to the plan.
- Note 6: References ten-year historical trend information found within the Required Supplementary Information section.

**EMPLOYEES' RETIREMENT SYSTEM  
OF THE CITY OF MILWAUKEE  
Management's Discussion and Analysis**

**2) Notes to Basic Financial Statements (cont.)**

- Note 7: Discusses expenses paid as a part of administering the ERS including manager fees and administrative costs.
- Note 8: Discusses the ERS' tax status per Internal Revenue Service determination letter.
- Note 9: Discusses ERS investments and the associated types of risk that the system is exposed to. It also discusses securities lending requirements and amounts on loan.
- Note 10: Describes the contingencies involving the ERS.
- Note 11: Describes the transfer of fiduciary responsibility of the Policeman's Annuity and Benefit Fund to the ERS.

**3) Required Supplementary Information.** The required supplementary information consists of the management's discussion and analysis, as well as the Schedule of Funding Progress, the Schedule of Employer Contributions, and the Notes to Required Supplementary Information. These schedules give an indication of the actuarial performance of the fund and the health of the system.

**4) Additional Information.** Additional information includes the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets for all of the Non-Consenter retirement and disability funds individually.

**EMPLOYEES' RETIREMENT SYSTEM  
OF THE CITY OF MILWAUKEE  
Management's Discussion and Analysis**

**Analysis of Financial Position and Results of Operations**

**Changes in Assets**

*(Dollars in Thousands)*

	<u>2006</u>	<u>2005</u>	<u>Total Percentage Change</u>
<b>Assets</b>			
Cash and Cash Equivalents	\$ 109,931	\$ 164,926	-33.3%
Investments	5,007,432	4,547,799	10.1%
Receivables	165,413	122,110	35.5%
Software Devel & Equip Cost (net)	14,685	11,264	30.4%
Securities Lending Collateral	518,413	486,473	6.6%
<b>Total Assets</b>	<u>\$ 5,815,874</u>	<u>\$ 5,332,572</u>	<u>9.1%</u>
<b>Liabilities</b>			
Benefits Payable	\$ 1,392	\$ 861	61.7%
Due to City of Milwaukee	3,257	4,013	-18.8%
Investments purchased	204,336	234,863	-13.0%
Securities Lending Collateral	518,413	486,473	6.6%
<b>Total Liabilities</b>	<u>\$ 727,398</u>	<u>\$ 726,210</u>	<u>0.2%</u>
<b>Net Assets Held In Trust For Pension Benefits</b>	<u>\$ 5,088,476</u>	<u>\$ 4,606,362</u>	

Presented here are the amounts of total assets for 2006 and 2005 respectively. Cash and investments increased by approximately \$405million. This increase is primarily due to strong investment markets and improved investment opportunities in 2006.

Accounts receivable increases are primarily traceable to the increase in investment sales while accounts payable increases are primarily traceable to an increase in investment purchases that were initiated at the end of 2006, but not settled until the beginning of 2007.

In 2003, ERS began to capitalize its hardware and software development costs to better allocate these costs over their useful lives. The current year capitalization was \$4.39 million. In August of 2006 the MERITS System came on-line. As a result, capitalization of costs will end this year and all costs will be allocated over the remaining estimated life of the system.



**EMPLOYEES' RETIREMENT SYSTEM  
OF THE CITY OF MILWAUKEE  
Management's Discussion and Analysis**

**Analysis of Financial Position and Results of Operations**

**Analysis of Operations**

*(Dollars in Thousands)*

	<u>2006</u>	<u>2005</u>	<b>Total Percentage Change</b>
<b>Additions</b>			
Employer Contributions	\$ -	\$ 47	-100.0%
Member Contributions	31,979	32,084	-0.3%
Investment Income	606,413	318,139	90.6%
Interest & Dividends	85,642	69,890	22.5%
Less: Investment Expense	(17,648)	(20,033)	-11.9%
<b>Total Additions</b>	<u>\$ 706,386</u>	<u>\$ 400,127</u>	<u>76.5%</u>
<b>Deductions</b>			
Administrative expenses	\$ 7,623	\$ 5,794	31.6%
Benefits paid	215,275	204,721	5.2%
Refund of Contributions	1,373	1,190	15.4%
<b>Total Deductions</b>	<u>\$ 224,271</u>	<u>\$ 211,705</u>	<u>5.9%</u>
Net increase in assets held in trust for pension benefits	\$ 482,115	\$ 188,422	
Assets held in trust for benefits			
Beginning of year:	<u>\$ 4,606,361</u>	<u>\$ 4,417,939</u>	
End of year:	<u>\$ 5,088,476</u>	<u>\$ 4,606,361</u>	

Employer contributions decreased to zero in 2006 from \$47,000 in 2005 primarily because the City of Milwaukee did not transfer any voluntary contributions to the Employers' Reserve Fund in 2006. Net investment returns increased by \$306 million from amounts reported in 2005 due to very favorable performance during 2006.

Benefits paid increased to \$215 million in 2006 from \$205 million in 2005 due in large part to pension escalators. Administrative expenses increased by \$ 1.83 million in 2006 when compared to 2005 due largely to inflation and higher asset-based investment management fees.

The January 1, 2006 actuarial valuation also reallocated assets from the non-consenter funds to the Global Combined Fund as of January 1, 2006 for those individuals who were non-consenters as of January 1, 2005 and who then subsequently consented to GPS during 2006. The amount of \$3.561 million was transferred to the Global Combined Fund for this reallocation of assets.

**EMPLOYEES' RETIREMENT SYSTEM  
OF THE CITY OF MILWAUKEE  
Management's Discussion and Analysis**

**Analysis of Investment Position and Strategies**

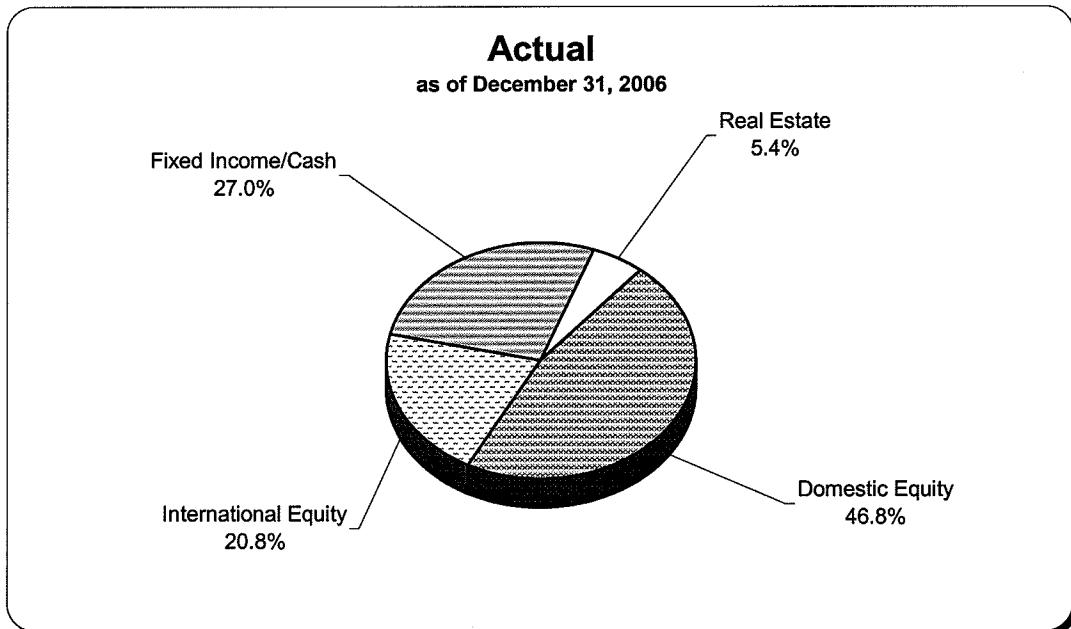
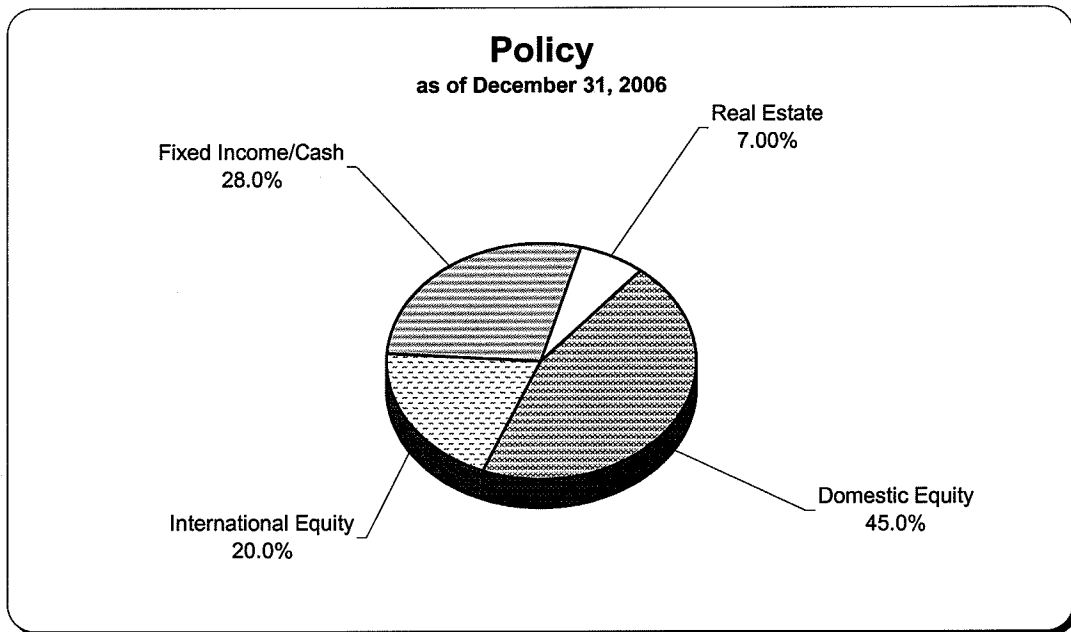
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ERS has one strategic asset allocation for all of its funds. Resources of all the funds are pooled together and invested consistent with this strategy. The return from investments is allocated to the individual funds based on fund balances at the beginning of the year. The table below reports returns for 2006 and 2005 categorized by asset class with the corresponding benchmark results (real estate results are lagged by one quarter). Mercer Consulting, ERS' consultant, provided the data. In 2006, investments in all asset classes produced positive returns, and every asset class except Domestic Equity beat its respective benchmark.

<u>Asset Class</u>	<u>Benchmark</u>	<u>2006 Returns</u>		<u>2005 Returns</u>	
		<u>Gross</u>	<u>Benchmark</u>	<u>Gross</u>	<u>Benchmark</u>
Domestic Equity	(Russell 3000 Index)	15.3%	15.7%	7.8%	6.1%
International Equity	(MSCI EAFE Index)	27.4%	26.9%	16.6%	14.0%
Fixed Income	(Lehman Aggregate)	6.7%	4.3%	3.4%	2.4%
Real Estate	(NCREIF Property Index)	24.3%	17.6%	26.0%	19.2%
Total Fund	(Reference Index)	15.4%	14.1%	8.7%	6.9%

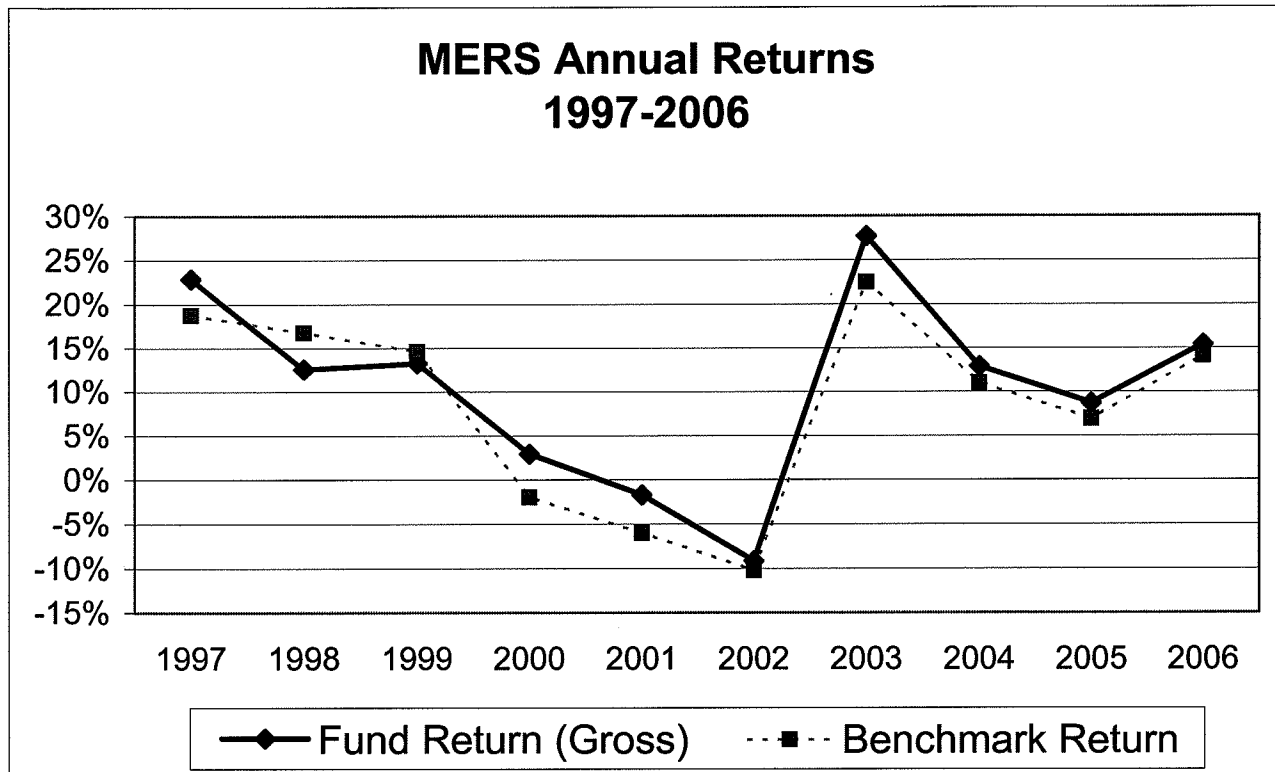
As of December 31, 2006, the Fund's actual asset allocation was within established policy allocation tolerance ranges.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE Management's Discussion and Analysis



# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE Management's Discussion and Analysis

Over the ten-year period ending December 31, 2006 the Fund returned 10.1% annually gross of fees while the benchmark returned 8.1%.



## Requests For Information

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Members of the retirement board and the senior management of the ERS are fiduciaries of the pension fund and, as such, are charged with the responsibility of ensuring that the system's assets are used exclusively for the benefit of the plan participants and their beneficiaries. This financial report is designed to provide an overview of ERS finances and to demonstrate accountability for resources entrusted to the system for the benefit of the stakeholders. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Martin Matson  
Deputy Director  
Employees' Retirement System - City of Milwaukee  
789 North Water Street, Suite 300  
Milwaukee, WI 53202

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE**

**STATEMENT OF PLAN NET ASSETS**  
December 31, 2006  
(in thousands)

	Employees' Retirement System Funds					Fiduciary Fund		Total
	Global Combined Fund	Non-consenter Retirement Funds	Employers' Reserve Fund	Securities Lending Fund	Employees' Retirement System 2006	Policemen's Annuity & Benefit Fund 2006	Total	
<b>ASSETS:</b>								
SHORT TERM CORPORATE NOTES, CERTIFICATES OF DEPOSITS, COMMERCIAL PAPER	\$ 105,170	\$ 1,926	\$ 1,438	\$ 1,396	\$ 109,930	\$ (1,221)	\$ 108,709	
<b>INVESTMENTS (Notes 2 and 9):</b>								
Bonds and collateralized mortgage obligations	974,834	5,466	4,321	-	984,621	1,278	985,899	
Common and preferred stocks	1,918,506	10,759	8,504	-	1,937,769	2,515	1,940,284	
Barclay Bond Index Funds	351,351	1,970	1,557	-	354,878	461	355,339	
DFA Small Cap Fund	308,534	1,731	1,368	-	311,633	404	312,037	
Northern Trust Company Collective Equity Index Fund	466,041	2,613	2,066	-	470,720	611	471,331	
Russell 1000 Alpha Value Fund	665,326	3,731	2,949	-	672,006	872	672,878	
Real Estate Investments	273,064	1,531	1,210	-	275,805	358	276,163	
<b>Total investments</b>	<b>4,957,656</b>	<b>27,801</b>	<b>21,975</b>	<b>-</b>	<b>5,007,432</b>	<b>6,499</b>	<b>5,013,931</b>	
<b>RECEIVABLES:</b>								
Employer (Note 2)	55	-	-	-	55	-	55	
Member (Note 2)	1,400	-	-	-	1,400	-	1,400	
Interest, dividends and foreign tax recoverable (Note 2)	14,060	79	62	-	14,201	-	14,201	
Investments sold	148,270	831	656	-	149,757	-	149,757	
Tax Levy (Note 11)	-	-	-	-	-	308	308	
<b>Total receivables</b>	<b>163,785</b>	<b>910</b>	<b>718</b>	<b>-</b>	<b>165,413</b>	<b>308</b>	<b>165,721</b>	
Software development and equipment (net of depreciation) (Note 2)	14,685	-	-	-	14,685	-	14,685	
Securities lending collateral (Note 9)	-	-	-	518,413	518,413	-	518,413	
<b>Total assets</b>	<b>5,241,296</b>	<b>30,637</b>	<b>24,131</b>	<b>519,809</b>	<b>5,815,873</b>	<b>5,586</b>	<b>5,821,459</b>	
<b>LIABILITIES:</b>								
Benefits payable	1,392	-	-	-	1,392	-	1,392	
City of Milwaukee (Note 7)	3,257	-	-	-	3,257	-	3,257	
Securities lending obligation (Note 9)	-	-	-	518,413	518,413	-	518,413	
Investments purchased	202,306	1,134	896	-	204,336	-	204,336	
<b>Total liabilities</b>	<b>206,955</b>	<b>1,134</b>	<b>896</b>	<b>518,413</b>	<b>727,398</b>	<b>-</b>	<b>727,398</b>	
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</b>	<b>\$ 5,034,341</b>	<b>\$ 29,503</b>	<b>\$ 23,235</b>	<b>\$ 1,396</b>	<b>\$ 5,088,475</b>	<b>\$ 5,586</b>	<b>\$ 5,094,061</b>	

(A schedule of funding progress and a schedule of employer contributions are included in this report)  
The accompanying notes are an integral part of the basic financial statements.

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE**

**STATEMENT OF CHANGES IN PLAN NET ASSETS  
YEAR ENDED DECEMBER 31, 2006  
(in thousands)**

	Employees' Retirement System Funds					Fiduciary Fund		Total
	Global Combined Fund	Non-consenter Retirement Funds	Employers' Reserve Fund	Securities Lending Fund	Employees' Retirement System 2006	Policeamans' Annuity & Benefit Fund 2006	Total	
<b>ADDITIONS:</b>								
Contributions:								
Employer (Note 5)	\$ 31,602	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Member	-	377	-	-	-	-	-	31,979
Tax Levy	-	-	-	-	-	-	-	308
Total contributions	31,602	377	-	-	-	-	-	31,979
Investment income:								
Net appreciation in fair value of investments	600,386	3,365	2,661	-	606,412	794	794	607,206
Interest, dividends and other investment income	82,779	464	366	2,033	85,642	127	127	85,769
Less investment expense (Note 7)	683,165	3,829	3,027	2,033	692,054	921	921	692,975
Net investment income	17,011	-	-	637	17,648	37	37	17,685
Total additions	666,154	3,829	3,027	1,396	674,406	884	884	675,290
	697,756	4,206	3,027	1,396	706,385	1,192	1,192	707,577
<b>DEDUCTIONS:</b>								
Administrative expenses (Note 7)	5,915	-	-	1,708	7,623	69	69	7,692
Benefits paid	215,072	203	-	-	215,275	1,515	1,515	216,790
Refunds of contributions	1,307	66	-	-	1,373	-	-	1,373
Total deductions	222,294	269	-	1,708	224,271	1,584	1,584	225,855
NET INCREASE (DECREASE) BEFORE TRANSFERS	475,462	3,937	3,027	(312)	482,114	(392)	(392)	481,722
TRANSFERS (Notes 3 and 4)	3,561	(3,561)	-	-	-	-	-	-
NET INCREASE (DECREASE) IN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	479,023	376	3,027	(312)	482,114	(392)	(392)	481,722
Net assets held in trust for pension benefits:								
Beginning of year	4,555,318	29,127	20,208	1,708	4,606,361	5,978	5,978	4,612,339
End of year	5,034,341	29,503	23,235	1,396	5,088,475	5,586	5,586	5,094,061

The accompanying notes are an integral part of the basic financial statements.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## NOTES TO BASIC FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 2006

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### 1. DESCRIPTION OF RETIREMENT SYSTEM

The following brief description of the more common provisions of the Employees' Retirement System of the City of Milwaukee (the "Retirement System") is provided for financial statement purposes only. The provisions described reflect changes to the Retirement System enacted in 2000 as part of what is known as the Global Pension Settlement (GPS). GPS increased benefits to all members who consented to the settlement in exchange for allowing the City to make certain changes in plan administration, including allowing the use of Retirement System assets to pay for all costs to administer the System. Over 97% of the existing members have consented to GPS and are accounted for in the Global Combined Fund. Members who have not consented are accounted for in one or more of the non-consenter funds. Participants should refer to the Retirement Act (Chapter 36 of the City of Milwaukee Charter) for more complete information.

The Employees' Retirement System was established pursuant to the Retirement Act (Chapter 396 of the Laws of Wisconsin of 1937) to provide the payment of retirement and other benefits to employees of the City of Milwaukee (the "City"). Chapter 441 of the Laws of Wisconsin of 1947 made the benefits contractual and vested. The Retirement System is a multi-employer plan, which also provides benefits to employees of the Milwaukee Metropolitan Sewerage District, the Wisconsin Center and the Milwaukee Housing and Redevelopment Authorities and some employees of the Milwaukee Board of School Directors and the Milwaukee Area Technical College (the "Agencies"). City employees comprise approximately 56% of the active participants in the Retirement System.

Full-time employees, part-time employees who are eligible under adopted rules and regulations and elected officials who have evidenced their intent to join are members of the Retirement System.

Plan members are required to contribute, or have contributed on their behalf, a percentage of pensionable earnings equal to 5.5%, 7%, 7%, 7% for general city employees, police officers, fire fighters, and elected officials, respectively. Pensionable earnings are essentially comprised of amounts paid as the regular base salary and specifically excludes overtime. The City and other participating city agencies fund these member contributions on behalf of each participating employee. Contributions of one dollar per year per member are made by police officers on their own behalf. In addition, contributions of one dollar of each police officer's longevity pay per year, excluding sergeant of police, detective lieutenant and ranks above same, are made by police officers on their own behalf.

In addition to the above percentage contributions, additional contributions are required of general city employees who are enrolled as active members after January 1, 2000. To participate in the Global Combined Fund, each new member is required to contribute 1.6% of his or her pensionable earnings for a period of eight years. These contributions are taken to fund the improved escalator benefits resulting from the GPS for these new members.

On an annual basis, the City and city agencies are required to contribute amounts determined actuarially in the annual valuation. The contributions required are to bring the expected actuarial funded status of the fund, as of the date the contributions is payable, to a percentage in excess of 100%.



## 1. DESCRIPTION OF RETIREMENT SYSTEM (cont.)

The normal retirement benefit is a monthly pension for the life of the member. A service retirement allowance is payable to any member who elects to retire after attaining the minimum service retirement age 60, for general employees and age 57 for police officers and firefighters. General City employees who have attained age 55 and completed 30 years of creditable service are eligible for service retirement. Police officers of any age with 25 years of creditable service and firefighters who have attained age 49 and completed 22 years of creditable service are eligible for service retirement.

For general employees, the amount of a member's service retirement allowance is equal to 2% of final average salary (the highest average of earnable compensation during any 3 years preceding retirement, death or termination) for each year of creditable service. The service retirement allowance for general employees who retire after January 1, 1989 cannot exceed 70% of final average salary. For police officers and firefighters, the retirement allowance is 2.5% of the final average salary (computed on the year of creditable service during which earnable compensation was highest) for each year of creditable service. The retirement allowance for firefighters hired after March 1, 1989 and police officers hired after July 1, 1989 is limited to 90% of final average salary (excluding any imputed service credit provided under the GPS). For elected officials of the City of Milwaukee, the retirement allowance is 2.6% of final average salary for each year of creditable service prior to January 1, 1996. After January 1, 1996; the retirement allowance is 2.0% of final average salary for the mayor and 2.5% of final average salary for all other elected officials for each year of creditable service.

The Retirement Act provides for escalators to nearly all retirees. General City employees participating in the Global Combined Fund retiring on a service retirement allowance on or after January 1, 2000 are eligible for a pension escalator of 1.5% on the second, third and fourth anniversaries of their retirement and 2% on each anniversary thereafter. Police officers and firefighters participating in the Global Combined Fund retiring on a service retirement allowance on or after January 1, 2000 are eligible for a pension escalator based upon the percentage increase in the prior year's Consumer Price Index-All Urban Consumers (CPI-U) effective with their first anniversary and each anniversary thereafter. The percentage increase is determined annually by measuring the change in the Index from November of one year to November of the following year. This escalator is guaranteed to be at least two percent but is capped at three percent.

Rules governing escalators provided to retirees retiring prior to January 1, 2000 under the Retirement Act before the GPS differ from those described herein. In addition, a one-time "catch up" adjustment was provided in January of 1996 to employees who retired on a service retirement allowance on or before September 30, 1987 to partially offset the increase in inflation. For a complete description of the escalator rules, see the Retirement Act.

The Retirement System also provides for ordinary and duty disability benefits as well as ordinary and duty death benefits.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- a. *Basis of Accounting* - The financial statements are prepared using the accrual basis of accounting. Retirement and other contributions are recorded when due. Investment income is recognized when earned and expenditures are recorded when incurred.
- b. *Contributions* - The Retirement System records employee contributions as earned. Contributions earned but not yet received from the City, participating city agencies and members are reflected as contributions receivable.

At January 1, 2007, the number of participants in the Retirement System was as follows:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	<u>14,700</u>
Current employees:	
Vested	10,191
Nonvested	<u>1,824</u>
Total current employees	<u>12,015</u>
Total participants	<u>26,715</u>

- c. *Investments* - Investments of the Retirement System are recorded at fair value as determined by quoted prices in active markets. Short-term investments are reported at cost, which approximates fair value. Receivables and payables relating to investment transactions entered into prior to year-end, but not completed until after year-end, are recorded as assets or liabilities.

Real estate consists of equity participation in diversified real estate investments. The majority of properties in the portfolio are offices, industrial warehouses and shopping centers. The equity participations are carried at market value, which approximates fair value, as of December 31, 2006. An annual review performed by independent professional appraisers is used to assess the market value.

All investments are made in accordance with the provisions of Section 36-09 of Chapter 36 of the Milwaukee City Charter. In accordance with these provisions, the several funds of the Retirement System are invested within the requirements of ss. 40.03(1)(n) and 62.63 (3) Wisconsin Statutes. The Retirement System did not invest more than 69% of the total assets, as measured by their cost, in stocks of corporations.

The Retirement System has investments in certain financial instruments such as U.S. Treasury Strips, collateralized mortgage obligations and asset backed securities. These investments are made in compliance with the Annuity and Pension Board Investment Policy and Guidelines. The Retirement System's investment managers may temporarily invest small amounts of available cash in short-term investments prior to purchasing securities consistent with their investment strategy.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

The Retirement System's international equity managers may invest in warrants and foreign exchange forward contracts as a hedge to foreign currency fluctuations. These investments are not significant to the financial position of the Retirement System and are carried at fair value.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall *market* volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of net assets available for benefits.

- d. *Investment Income* - Dividends and interest are recorded as earned. All dividend and interest income, and all realized investment gains and losses, are allocated to the individual funds based on fund balances at the beginning of the year.
- e. *Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
- f. *Capitalization* - ERS capitalizes hardware and software development costs to better allocate these costs over their useful lives. Amounts spent for hardware (including but not necessarily limited to servers, printers, monitors, disk drives, network infrastructure, switches) are capitalized in a yearly hardware pool and depreciated over a life of three years. One half a year's depreciation is expensed in the year of acquisition. Amounts spent toward the development of a new Pension Management Information System have been capitalized as Software development costs. The system went live in 2006. The new system will be depreciated over its estimated useful life of eight years.

## 3. CONSENT STATUS CHANGES

Members who have not consented to the GPS are comprised of those who have objected to the settlement as well as those who never responded at all. The previous deadline to consent of April 24, 2004 has been extended indefinitely to those who have not responded. Often, non-responders are members with vested rights who separated from service years ago. These members often express an interest in consenting to GPS at the time they are applying for benefits.

As of the January 1, 2006 actuarial valuation, 644 Retirement System members were identified as being non-consenting. Of this number, 262 were active members, 355 were inactive members, and 27 were benefit recipients. During 2006, 77 of these members elected to consent to the GPS resulting in a transfer of \$3,561,000 to the Global Combined Fund from the non-consenter funds.

#### 4. EMPLOYERS' RESERVE FUND

The City of Milwaukee and other agencies participating in the System may voluntarily contribute to the Employers' Reserve Fund established in Section 36-08-8 of Chapter 36. This enables agencies to participate in the earnings of the investments of the retirement system. Agencies having such funds on deposit may use them to offset required contributions by adopting a formal resolution directing such a transfer. As of December 31, 2006, the City of Milwaukee is the only agency choosing to participate in this fund.

#### 5. FUNDING STATUS AND PROGRESS

The pension benefit obligation was determined as part of an actuarial valuation at January 1, 2006. Significant actuarial assumptions used in the January 1, 2006 valuation include (a) a rate of return on the investment of present and future assets of 8.5% per year compounded annually, (b) projected salary increases of between 3.5% and 7.5% for General City and between 4.0% and 14.0% for Fire and Police employees per year compounded annually, (c) normal retirement ages ranging from ages 44 to 70 depending on the class of employee, and (d) mortality assumption – the UP-94 Mortality Table, with mortality improvements projected to the year 2000.

The excess of net assets available for projected benefits over the present value of the accrued pension benefit obligation as of January 1, 2006 was as follows (in thousands):

Net assets available for benefits (actuarial basis)	<u>\$4,556,371</u>
Pension benefit obligation:	
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	2,229,797
Current employees:	
Member contributions	472,403
Employer financed portion	<u>1,003,998</u>
Total pension benefit obligation	<u>3,706,198</u>
Excess of net assets available for projected benefits over the present value of the accrued pension benefit obligation	<u>\$ 850,173</u>

The Retirement System's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. Employer contribution rates are determined using the projected unit credit method.

Employer contributions are funded based on an actuarial valuation report. The significant actuarial assumptions used to compute the contribution requirements are the same as those used to compute the pension benefit obligation.

**5. FUNDING STATUS AND PROGRESS (cont.)**

The GPS, effective January 1, 2000, effectively merged funding for duty disability and retirement benefits for consenting Retirement System members in the Global Combined Fund resulting in no employer contribution being due for this group for 2006. The 2006 employer contribution for non-consenting members totaling \$0.00 was determined in accordance with existing statutory requirements using the projected unit credit method as of January 1, 2006. This contribution, due January 31, 2006, was payable to the Combined Retirement Fund and General City Duty Disability Fund within the Retirement System.

All actuarial computations were made by an independent consulting actuary to satisfy the requirements of 36.08(2) of the Milwaukee Charter.

**6. TEN-YEAR HISTORICAL TREND INFORMATION**

Ten-year historical trend information is designed to provide information about progress made in accumulating sufficient assets to pay benefits when due. A schedule of funding progress and a schedule of employer contributions is included in this report.

**7. EXPENSES**

Under the Milwaukee City Charter, as provided in the GPS, all administrative and investment expenses of the Retirement System are the direct obligation of the Global Combined Fund. Expenses are normally paid through the City of Milwaukee accounting system and reimbursed by the System to the City. Money manager fees of \$12,128,000, real estate manager fees of \$4,883,000 and administrative expenses of \$5,915,000 were charged to the Global Combined Fund in 2006.

In addition, the Annuity and Pension Board authorized the payment of \$1,708,000 of administrative costs from the Securities Lending Fund during 2006. This reduced the amounts needed from the Global Combined Fund to fund the costs to administer the Retirement System (see Note 9).

**8. INCOME TAXES**

The Retirement System obtained its latest determination letter on November 3, 1996, in which the Internal Revenue Service stated that the Retirement System, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code. The Retirement System's management believes that the plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been reflected in the accompanying basic financial statements.

## 9. INVESTMENTS

### Deposits and Custodial Credit Risk

Custodial credit risk is the risk that, in the event a financial institution or counterparty fails, the Retirement System will not be able to recover the value of its deposits, investments, or securities. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the Retirement Systems name, and held by the counterparty. As of December 31, 2006, no investments or securities were exposed to custodial credit risk. The Retirement System is exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by federal depository insurance. This amount was \$2,334,000 as of December 31, 2006.

### Investment Policies

The Retirement System was established to provide for the present and future retirement, disability, and death and survivor benefit payments for all city and city agency employees. All of the funds of the Retirement System taken in the aggregate constitute a special trust subject to applicable local, state, and federal laws, including but not limited to sections 36-15, 36-09-1, and 36-09-6 of the Milwaukee City Charter. As of December 31, 2006 the fair market carrying value of the investments are as follows (in thousands):

	<u>Carrying Value</u>
	<u>2006</u>
Common Stock	\$ 1,915,209
Preferred Stock	3,503
Convertible Equity	4,260
Corporate Convertible Bonds	17,311
Barclay Bond Index Fund	355,340
COLTV Stock Index Fund	471,331
DFA Small Cap Fund	312,036
Russell 1000 Fund	672,878
Government Bonds	220,974
Government Agencies	63,264
Municipal/Provincial Bonds	70,204
Corporate Bonds	429,316
Gov Mortgage Backed Sec	120,864
Gov-Iss Comm Mort	1,546
Comm Mortgage Backed Sec	23,610
Asset Backed Securities	40,062
Non-Gov Backed C.M.O.S.	12,321
Index Linked Government Bonds	3,738
Real Estate Investments	276,164
Total Investments	\$ <u>5,013,931</u>

9. INVESTMENTS (cont.)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Retirement System's investment guidelines limit how much each fixed income manager may deviate duration from their respective benchmarks. Duration is the approximate percentage change in price for a 100-basis-point change in yield. Although the exact range allowed in the guidelines varies slightly for each manager, the duration of the Retirement Systems active fixed income managers must be between 75% and 150% of the duration of the Lehman Aggregate Index. As of December 31, 2006, the segmented time distribution of the various investment types of debt securities for the Retirement System is as follows (in thousands):

Investment	2006						Maturity Not Determined
	Fair Value	Less than 1 Year	1-5 Years	6-10 Years	10+ Years		
Government Bonds	\$ 220,974	\$ 10,170	\$ 76,636	\$ 37,951	\$ 96,217	\$ -	
Government Agencies	418,604	4,717	50,356	-	8,191	355,340	
Municipal/Provincial Bonds	70,204	-	54,403	12,054	3,747	-	
Corporate Bonds	429,316	14,271	81,279	80,010	227,090	26,666	
Gov Mortgage Backed Sec	120,864	19	2,963	23,602	53,754	40,526	
Gov-Iss Comm Mort	1,546	1,034	512	-	-	-	
Comm Mortgage Backed Sec	23,610	-	-	-	23,610	-	
Asset Backed Securities	40,062	2,516	36,022	624	900	-	
Non-Gov Backed C.M.O.S.	12,321	-	-	2,009	10,312	-	
Index Linked Government Bonds	3,738	-	1,874	1,864	-	-	
Corporate Convertible Bonds	17,311	2,767	588	-	13,956	-	
Short-Term Bills and Notes	-	-	-	-	-	-	
Short-Term Investment Funds	40,861	-	-	-	-	40,861	
Totals	\$ 1,399,411	\$ 35,494	\$ 304,633	\$ 158,114	\$ 437,777	\$ 463,393	



## 9. INVESTMENTS (cont.)

### Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment or deposit. The Retirement System's investment guidelines allow foreign currency contracts for defensive hedging purposes only and limit the total exposure of all currency hedges to 100% of the manager's total portfolio value. In addition, the guidelines recommend adequate diversification by country and currency. As of December 31, 2006, the Retirement System's exposure to foreign currency risk, expressed in U.S. Dollars, is as follows (in thousands):

<u>Foreign Currency</u>	<u>Fair Market Value</u>
Australian dollar	\$ 15,348
Brazilian real	3,303
British pound sterling	165,782
Canadian dollar	108,235
Euro	305,344
Hong Kong dollar	10,398
Indonesian rupiah	5,459
Japanese yen	153,509
Mexican peso	24,761
New Zealand dollar	27,866
Singapore dollar	27,560
South African rand	6,604
South Korean won	13,487
Swedish krona	7,233
Swiss franc	53,580
Thai baht	8,718
Total	\$ <u><u>937,187</u></u>

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of The Retirement System's investment in a single issuer. As of December 31, 2006, the Retirement System did not hold any investments in any one issuer that would represent 5% or more of plan assets. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from this requirement.

### Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Retirement System's investment guidelines require its fixed income managers to have an Investment Grade average portfolio. The Retirement System's active fixed income managers are allowed to hold a maximum of 20% of their respective portfolio's market value in issues rated B- or B3, and an additional 5% may be invested in non-rated issues. The quality ratings of investments in fixed income securities of the Retirement System as described by Standard & Poors (S&P) as of December 31, 2006 are as follows (in thousands):

Investment Type	AAA	AA	A	BBB	BB	B	CCC	Not Rated		US Government Guaranteed
								Quality Rating Not Available	Quality Rating Not Available	
Asset Backed Securities	\$ 37,350	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	2,712	\$ -	-
Comm Mortgage Backed Sec	22,376	-	-	-	-	-	-	1,235	-	-
Corporate Bonds	3,403	11,801	53,856	156,772	76,836	75,371	718	50,557	-	-
Corporate Convertible Bonds	-	4,849	7,290	2,313	91	2,767	-	-	-	-
Gov Mortgage Backed Sec	1,744	-	-	-	-	-	-	-	-	119,119
Government Agencies	63,265	-	-	-	-	-	-	-	-	355,340
Government Bonds	83,235	-	20,227	-	26,123	-	-	10,173	-	81,217
Gov-Iss Comm Mort	-	-	-	-	-	-	-	-	-	1,546
Index Linked Government Bonds	-	-	-	-	-	-	-	-	-	3,738
Municipal/Provincial Bonds	13,541	50,908	2,007	3,747	-	-	-	-	-	-
Non-Gov Backed C.M.O.S.	2,427	-	-	-	-	-	-	-	9,894	-
Short-Term Bills and Notes	-	-	-	-	-	-	-	-	-	-
Short-Term Investment Funds *	-	-	-	-	-	-	-	40,861	-	-
<b>Total Value by Rating</b>	<b>\$ 227,341</b>	<b>\$ 67,558</b>	<b>\$ 83,380</b>	<b>\$ 162,832</b>	<b>\$ 103,050</b>	<b>\$ 78,138</b>	<b>\$ 718</b>	<b>\$ 115,432</b>	<b>\$ -</b>	<b>\$ 560,960</b>

Note: The Retirement System held no investments in the CC, or C quality ratings at the end of 2006.

\* FDIC cash balances are invested in the Short-term Investment Fund by the Retirement Systems custodian, The Northern Trust Company. This Fund is not rated by Standard & Poors.

## 9. INVESTMENTS (cont.)

### Derivatives

A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. ERS only allows the use of derivatives to hedge currency risk or to equitize cash. ERS did not invest or hold any derivatives as of 12/31/2006.

### Securities Lending

In November 1993, the Retirement System began generating revenue through securities lending. Eligible securities are loaned out through the Retirement System's custodian, The Northern Trust Company. The Retirement System earns a daily fee for all securities out on loan. The Retirement System incurs a reduction in earnings for an indemnification agreement with the custodian. Each security loan is initially collateralized by securities or cash for at least 102% of its market value. All collateral is held by the custodian. Revenue earned from securities lending is to be used to offset expenses of the Retirement System. If the revenues are not expended within one calendar year following receipt, all remaining amounts are distributed to the Non-Consenter Retirement Fund. For the year ended December 31, 2006, the Retirement System earned revenue from securities lending of \$2,033,000, paid custodian fees of \$637,000 and disbursed \$1,708,000 to pay administrative costs. As of December 31, 2006, the fair value of securities on loan was \$503,690,000. The value of collateral held for securities on loan was \$518,413,000 as of December 31, 2006 which consisted of approximately 34.7% U.S. Equities, 29.2% U.S. Government fixed obligations, 11.2% Global Equities, U.S. Corporate Fixed 14.4% and 10.5% other securities.

The main risk in securities lending is counterparty risk. Counterparty risk is the risk that the borrower defaults on a loan and the collateral on hand is less than the value of the borrowed security. ERS has a contract with Northern Trust that indemnifies ERS of any losses it suffers from its securities lending program. Northern Trust has never experienced an investment loss or negative spreads in any of its Securities Lending pools.

## **10. CONTINGENCIES**

The Employees' Retirement System is involved in certain litigation and disputes arising during the normal course of operations. Management does not believe the settlement of such matters will have a material impact on the Retirement System's basic financial statements.

## **11. FIDUCIARY RESPONSIBILITY OF THE POLICEMAN'S ANNUITY & BENEFIT FUND**

On December 14, 2005, the Policeman's Annuity and Benefit Fund (PABF) board adopted a resolution to dissolve and to liquidate all assets of the fund and transfer the assets and full administrative control to the ERS. Charter Ordinances ss. 35-01-3-b and 36-15-1-e, enacted under common council file #050744, and transferred the administrative and managerial responsibilities of the PABF to the ERS authorizing the ERS Annuity and Pension Board to invest the assets of the PABF and to manage its operations. All assets of the PABF were transferred to the systems custodian, Northern Trust, in early 2006 and the ERS board assumed custodial authority and responsibility for the funds assets as of January 3, 2006. These resources are disclosed in the financial records as a separate fiduciary fund.

The plan's funding policy is specified in the Milwaukee City Charter, Chapter 35, as amended by Charter Ordinances, Numbers 356 and 357. The annual requirement consists of an amount sufficient to amortize the present value of benefits to all active and retired employees less the value of actuarial assets in the Fund by a series of level payments over the remainder of the funding period. File numbers 950930 and 970052 provide that the Board shall adopt the assumptions which the actuary uses in the annual valuation and tax levy certification. This contribution will comply with GASB, which requires that the annual required contribution of the employer (ARC) should be actuarially determined and have a provision for amortizing the unfunded liability. In general, GASB allows an amortization period of up to 40 years, but 10 years is appropriate for this Fund. The Tax Levy for 2006 (to be collected in early 2007) would amount to \$307,582 plus budgeted administrative expenses.

As of December 31, 2006 the composition of the fund consisted of 50 annuitants and 102 widows. Once all annuitants and widows are deceased the fund is to be closed and any remaining monies are to be remitted back to the City of Milwaukee.

\* \* \* \* \*

# **REQUIRED SUPPLEMENTARY INFORMATION**

**(See Independent Auditors' Report on Page 6)**

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## Required Supplementary Information SCHEDULE OF FUNDING PROGRESS

(In thousands)

Actuarial Valuation Date Beginning of Fiscal Year	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL)	(3) Assets in Excess of Actuarial Accrued Liability (EAAL) (1) - (2)	(4) Funded Ratios (1) / (2)	(5) Annual Covered Payroll	(6) EAAL as a Percentage of Covered Payroll (3) / (5)
2006	\$ 4,556,371	\$ 3,706,198	\$ 850,173	122.9 %	\$ 515,934	164.8 %
2005	4,112,558	3,523,179	589,379	116.7 %	505,609	116.6 %
2004	3,909,085	3,370,923	538,162	116.0 %	486,384	110.6 %
2003	3,689,981	3,204,247	485,734	115.2 %	480,800	101.0 %
2002	4,242,333	3,091,511	1,150,822	137.2 %	466,757	246.6 %
2001	4,202,023	2,988,140	1,213,883	140.6 %	459,271	264.3 %
2000	4,088,042	2,979,234	1,108,808	137.2 %	466,732	237.6 %
1999	3,748,894	2,435,776	1,313,118	153.9 %	448,972	292.5 %
1998	3,346,051	2,322,020	1,024,031	144.1 %	443,357	231.0 %
1997	2,728,480	2,280,975	447,505	119.6 %	431,364	103.7 %

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

See notes to required supplemental information.

# EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## Required Supplementary Information SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended December 31	Member Contributions	Employer Contributions	Total Required	Percentage Contributed	Contributions Employers' Reserve Fund *	Total All Contributions
2006	\$ 31,979,995	\$ 0	\$ 31,979,995	100%	0	\$ 31,979,995
2005	32,084,484	47,000	32,131,484	100%	0	32,131,484
2004	30,699,729	46,000	30,745,729	100%	5,450,000	36,195,729
2003	31,054,000	78,000	31,132,000	100%	0	31,132,000
2002	28,970,054	32,000	29,002,054	100%	3,179,000	32,181,054
2001	25,595,454	144,000	25,739,454	100%	0	25,739,454
2000	28,424,609	238,000	28,662,609	100%	0	28,662,609
1999	27,047,371	6,806,000	33,853,371	100%	0	33,853,371
1998	26,450,367	6,050,230	32,500,597	100%	0	32,500,597
1997	26,186,655	5,079,000	31,265,655	100%	0	31,265,655
1996	26,346,135	2,962,630	29,308,765	100%	0	29,308,765

\* Employer voluntary contributions have only been permitted since the Global Pension Settlement became effective.



# EMPLOYES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

## NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

Valuation date	January 1, 2006	
Actuarial cost method	Projected Unit Credit	
Asset valuation method	3 Year Market-Related Value	
Amortization method	Closed, Level Dollar	
Remaining amortization period	9 - 18 Years	
Actuarial Assumptions:		
Investment Rate of Return	8.5 %	
Projected Salary Increases	<u>General City</u> 3.5% - 7.5%	<u>Police &amp; Fire</u> 4% - 14%
Inflation Assumption	3.0 %	
Cost of Living Adjustments	Vary by employee group as explained in the summary of plan provisions	

**POLICEMANS ANNUITY AND BENEFIT FUND - THE CITY OF MILWAUKEE**

**Required Supplementary Information  
SCHEDULE OF FUNDING PROGRESS**

(In thousands)

Actuarial Valuation Date End of Fiscal Year	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL)	(3) Assets in Excess of Actuarial Accrued Liability (E/AAL) (1) - (2)	(4) Funded Ratios (1) / (2)	(5) Annual Covered Payroll	(6) E/AAL as a Percentage of Covered Payroll (3) / (5)
2006	\$ 5,607,772	\$ 7,007,494	\$ (1,399,722)	80.0 %	\$ 1,514,653	(92.4)%
2005	5,977,606	8,241,433	(2,263,827)	72.5 %	2,006,273	(112.8)%

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

See notes to required supplemental information.

# POLICEMANS ANNUITY AND BENEFIT FUND - THE CITY OF MILWAUKEE

## NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

Valuation date	December 31, 2006
Actuarial cost method	Projected Unit Credit
Asset valuation method	Market Value of Assets
Amortization method	Level Dollar
Remaining amortization period	10 Years
Actuarial Assumptions:	
Investment Rate of Return	6.0 %
Status	All participants are retired
Interest Rate	6.0 %
Mortality	1994 Group Annuity Reserving Table

## **ADDITIONAL INFORMATION**

(See Independent Auditors' Report on Page 6)

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE**

**STATEMENT OF PLAN NET ASSETS**

December 31, 2006

(in thousands)

**NON-CONSENTER RETIREMENT FUNDS**

	Retirement Fund	Combined Retirement Fund	General Employees' Disability Fund	Firemen's Disability Fund	Firemen's Heart and Lung Fund	Firemen and Policemen's Survivorship Fund	Total 2006
<b>ASSETS:</b>							
SHORT TERM CORPORATE NOTES, CERTIFICATES OF DEPOSITS, COMMERCIAL PAPER	\$ 1,639	\$ 279	\$ 9	\$ -	\$ -	\$ -	\$ 1,927
INVESTMENTS (Notes 2 and 9):							
Bonds and collateralized mortgage obligations	5,017	413	36	-	-	-	5,466
Common and preferred stocks	9,874	813	72	-	-	-	10,759
Barclay Bond Index Funds	1,808	149	13	-	-	-	1,970
DFA Small Cap Fund	1,588	131	12	-	-	-	1,731
Northern Trust Company Collective Equity Index Fund	2,399	197	17	-	-	-	2,613
Russell 1000 Alpha Value Fund	3,424	282	25	-	-	-	3,731
Real Estate Investments	1,405	116	10	-	-	-	1,531
Total investments	25,515	2,101	185	-	-	-	27,801
<b>RECEIVABLES:</b>							
Employer (Note 2)	-	-	-	-	-	-	-
Interest, dividends and foreign tax recoverable (Note 2)	72	6	1	-	-	-	79
Investments sold	762	63	6	-	-	-	831
Total receivables	834	69	7	-	-	-	910
Total assets	27,988	2,449	201	-	-	-	30,638
<b>LIABILITIES:</b>							
Investments purchased	1,040	86	8	-	-	-	1,134
Total liabilities	1,040	86	8	-	-	-	1,134
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</b>	\$ 26,948	\$ 2,363	\$ 193	\$ -	\$ -	\$ -	\$ 29,504

(A schedule of funding progress and a schedule of employer contributions are included in this report)

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE**

**STATEMENT OF CHANGES IN PLAN NET ASSETS  
YEAR ENDED DECEMBER 31, 2006  
(in thousands)**

	Retirement Fund	Combined Retirement Fund	General Employees' Duty Disability Fund	Firemen and Policemen's Disability Fund	Firemen's Heart and Lung Fund	Firemen and Policemen's Survivorship Fund	Total 2006
<b>ADDITIONS:</b>							
Contributions:							
Employer (Note 5)	\$ 214	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Member	214	163	-	-	-	-	377
Total contributions	214	163	-	-	-	-	377
Investment income:							
Net appreciation in fair value of investments	3,090	254	21	-	-	-	3,365
Interest, dividends and other investment income	426	35	3	-	-	-	464
	3,516	289	24	-	-	-	3,829
Less investment expense	-	-	-	-	-	-	-
Net investment income	3,516	289	24	-	-	-	3,829
Total additions	3,730	452	24	-	-	-	4,206
<b>DEDUCTIONS:</b>							
Benefits paid	191	12	-	-	-	-	203
Refunds of contributions	55	10	-	-	-	-	65
Total deductions	246	22	-	-	-	-	268
NET INCREASE (DECREASE) BEFORE TRANSFERS	3,484	430	24	-	-	-	3,938
TRANSFERS (Note 3)	(3,042)	(485)	(34)	-	-	-	(3,561)
NET INCREASE (DECREASE) IN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	442	(55)	(10)	-	-	-	377
Net assets held in trust for pension benefits:							
Beginning of year	26,506	2,418	203	-	-	-	29,127
End of year	\$ 26,948	\$ 2,363	\$ 193	\$ -	\$ -	\$ -	\$ 29,504