City of Pontiac
General Employees' Retirement System

Financial Report
with Required Supplemental Information
December 31, 2010

City of Pontiac
General Employees' Retirement System

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Independent Auditor's Report

To the Retirement Board
City of Pontiac General Employees'
Retirement System

We have audited the accompanying statement of plan net assets of the City of Pontiac General Employees' Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2010 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the General Employees' Retirement Board of the City of Pontiac. 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. 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 financial position of the City of Pontiac General Employees' Retirement System as of December 31, 2010 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

June 20, 2011

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	2010	2009
Total assets	$ 499,037,719	$ 471,062,288
Total liabilities:		
Amounts due broker under securities lending agreement	78,272,910	84,041,640
Other liabilities	885,575	773,068
Total liabilities	79,158,485	84,814,708
Net assets held in trust for pension benefits	**$ 419,879,234**	**$ 386,247,580**
Net investment income	$ 54,659,564	$ 70,467,960
Net securities lending income (loss)	133,370	(5,818)
Other - Miscellaneous and litigation revenue	138,373	328,606
Retiree pension and annuity benefits	(20,624,034)	(19,992,272)
General and administrative expenses	(675,619)	(540,442)
Net increase in net assets held in trust	**$ 33,631,654**	**$ 50,258,034**

Overall Fund Structure and Objectives

The City of Pontiac General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

The System has established asset allocation policies that are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the adopted asset allocation (excluding the collateral pool) as of December 31, 2010:

Domestic equities	61%
Domestic fixed income	18%
International equities and fixed income	9%
Basket Clause Category Securities	8%
Cash	4%

Investment Results

2010 marked the second year of economic recovery from the great recession. Inflation was under control; however, commodity prices rose sharply during the second half of the year. Central banks maintained accommodative policies, holding interest rates down (at near historic low levels). The fixed-income market, as measured by the Barclays Aggregate Index, returned 6.5 percent for the year. The equity markets posted solid returns for the second consecutive year (albeit lower than 2009); the S&P 500 rose 15.1 percent, the Russell 2000 Index (a proxy for U.S. small-cap stocks) jumped 26.9 percent, and the MSCI EAFE Index (a proxy for international stocks) gained 7.8 percent. The total System gained 14.61 percent, net of related fees for the year ended December 31, 2010.

The total System's return must always be considered in a longer-term context. The System's investment horizon is long term, corresponding to the long-term nature of the System's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the System to pay the benefits promised to members and retirees. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.

City of Pontiac
General Employees' Retirement System

Statement of Plan Net Assets
December 31, 2010

Assets	
Cash (Note 3)	$ 100,175
Accrued interest and dividends receivable	1,491,760
Accounts receivable - Due from GERS VEBA	134,301
Cash and investments held as collateral for securities lending (Note 3):	
Repurchase agreements	21,157,168
Agency notes and bonds	15,404,109
Certificates of deposit	13,783,859
Time deposits	7,662,918
Asset-backed floating rate note	6,895,843
Commercial paper	5,267,767
Variable rate certificates of deposit	3,451,835
Variable rate notes and bonds	2,911,752
Sovereign guaranteed commercial paper	1,127,130
Sweep vehicle	430,501
Corporate bonds	180,028
Total cash and investments held as collateral for securities lending	78,272,910
Investments at fair value - Including loaned securities (Note 3):	
Money market funds	16,849,379
U.S. government agency notes and debentures	12,305,471
High-yield bonds	24,048,532
Corporate and other bonds	30,911,804
Equities	296,251,863
Private equities	5,036,119
U.S. government mortgage-backed securities	18,590,726
Commercial mortgage pools	6,515,646
Asset-backed securities	7,671,147
Other	857,886
Total investments	419,038,573
Total assets	499,037,719
Liabilities	
Due to City of Pontiac	126,012
Due to City of Pontiac Police and Fire Retirement System	4,589
Accounts payable	754,974
Amounts due broker under securities lending agreement (Note 3)	78,272,910
Total liabilities	79,158,485
Net Assets Held in Trust for Pension Benefits (a schedule of funding progress is presented in the required supplemental information)	**$ 419,879,234**

The Notes to Financial Statements are an
Integral Part of this Statement.

City of Pontiac
General Employees' Retirement System

Statement of Changes in Plan Net Assets
Year Ended December 31, 2010

Additions	
Miscellaneous and litigation revenue	$ 138,373
Securities lending income:	
Interest and fees	244,864
Less borrower rebates and bank fees	(111,494)
Net securities lending income	133,370
Investment income:	
Interest and dividend income	9,801,576
Net appreciation in fair value	47,517,725
Investment advisor fees	(2,659,737)
Net investment income	54,659,564
Total additions	54,792,934
Deductions	
Retirees' pension benefits and retirement incentives	(20,624,034)
Other expenses	(420,578)
Charges from the City of Pontiac - Administrative expenses	(255,041)
Total deductions	(21,299,653)
Net Increase in Net Assets Held in Trust for Pension Benefits	33,631,654
Net Assets Held in Trust for Pension Benefits - January 1, 2010	386,247,580
Net Assets Held in Trust for Pension Benefits - December 31, 2010	**$ 419,879,234**

The Notes to Financial Statements are an Integral Part of this Statement.

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the General Employees' Retirement System (the "System") (a contributory single-employer retirement plan) that covers substantially all employees of the City, except police and fire employees.

Reporting Entity - The financial statements of the System are also included in the combined financial statements of the City as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City or any other related party.

Plan Sponsor Financial Condition - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 4 of 2011. The result is that the State has appointed an Emergency Manager to control the finances of the City. The plan is currently overfunded and no employer contributions are required at this time. Should a contribution be required in the future, there is uncertainty regarding the City's ability to make contributions to the plan.

Basis of Accounting - The System's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Methods Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals or audited financial statements. Investments that do not have an established market value are reported based at estimated fair values. These estimates are determined using financial statements issued by the private equity companies in which such investments are held, adjusted by management as deemed appropriate based on known circumstances.

Note 1 - Summary of Significant Accounting Policies (Continued)

At December 31, 2009, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving pension benefits and terminated employees entitled to benefits but not yet receiving them	1,302
Current employees:	
Fully vested	130
Nonvested	139
Total current employees	269

Note 2 - Plan Description and Contribution Information

Plan Description - The System provides retirement benefits, as well as death and disability benefits. Employees may receive cost of living adjustments as a percentage of their base amounts, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by City ordinance and negotiation with the employees' collective bargaining units.

Contributions - Plan members are not required to contribute. The City is required to contribute at an actuarially determined rate. In accordance with the actuary recommendation, the City did not make a contribution to the plan in the current year. Administrative costs are financed through investment earnings.

Annual Pension Costs - The annual contribution for the year ended December 31, 2010 was $0. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2007 using the entry age actuarial cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, (c) additional salary increases of 1.1 percent to 4.9 percent per year based on merit and/or longevity, (d) cost of living adjustments ranging from 2.0 percent to 2.5 percent per year, and (e) inflation of 4.5 percent. Both (a) and (b) are determined by using techniques that smooth the effects of short-term volatility over a three-year period. The unfunded actuarial liability is being amortized as a level of percent of payroll on an open basis. The remaining amortization period is 30 years.

Per the actuarial report dated December 31, 2009, all assumptions have remained consistent.

Note 2 - Plan Description and Contribution Information (Continued)

Funded Status and Funding Progress - As of December 31, 2009, the most recent actuarial valuation date, the plan was 158.5 percent funded. The actuarial accrued liability for benefits was $255,720,207 and the actuarial value of assets was $405,193,572, resulting in actuarial accrued assets of $149,473,365. The covered payroll (annual payroll for active employees covered by the plan) was $12,553,146 and the ratio for the unfunded AAL to the covered payroll was 0 percent given the funded status.

The schedule of funding progress, presented as required supplemental information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan net assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Three-year trend information as of December 31 is as follows:

	Fiscal Year Ended December 31		
	2008	2009	2010
Annual pension costs (APC)	$ -	$ -	$ -
Percentage of APC contributed	100%	100%	100%
Net pension obligation	$ -	$ -	$ -

See Note 4 for disclosures of required reserves.

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

Note 3 - Deposits and Investments (Continued)

The System is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed $250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all allowable investments under Michigan Public Act 314 of 1965, as amended. The System's deposits and investment policies are in accordance with statutory authority. The System's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. At year end, the System had no bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The System continues to evaluate each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities. At year end, the average maturities of investments are as follows:

Note 3 - Deposits and Investments (Continued)

Investment	Fair Value	Effective Duration
Asset-backed securities	$ 7,196,499	1.14 years
Asset-backed securities	474,648	Unavailable
Commercial mortgage pools	6,515,646	1.85 years
Corporate and other bonds	54,603,479	3.52 years
Corporate and other bonds	356,856	Unavailable
U.S. governmental investments:		
Government agencies	3,339,760	8.18 years
Government bonds	4,784,213	8.90 years
Government issued commercial mortgage backed	189,594	4.78 years
Government mortgage-backed securities	11,451,834	2.88 years
Government mortgage-backed securities	6,949,298	Unavailable
Nongovernment-backed CMOs	913,977	.15 years
Municipal/Provincial bonds	1,877,680	3.43 years
Municipal/Provincial bonds	2,303,819	Unavailable
Short-term bills and notes	1,189,836	.13 Years
Short-term investment funds	14,346,018	Unavailable
Collateral pool	78,272,910	.07 years

Note 3 - Deposits and Investments (Continued)

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System's investment policy limits investments in domestic fixed-income securities to not less than a CCC rating for an overall average quality of each high-yield portfolio; the overall quality rating of each high-grade portfolio must be AA or an equivalent rating; for domestic equity investments, the securities must be the equivalent of Standard & Poor's A1 or Moody's P-1; for global bonds, the overall average quality must be AA or higher. As of year end, the credit quality ratings of debt securities are as follows:

Investment Type	Fair Market Value	Moody's/S&P Rating
Asset-backed securities	$ 5,772,474	Aaa
Asset-backed securities	541,300	Aa
Asset-backed securities	245,876	A
Asset-backed securities	223,785	Ba
Asset-backed securities	474,648	Caa
Asset-backed securities	413,064	Unrated
Commercial mortgage-backed securities	3,408,141	Aaa
Commercial mortgage-backed securities	360,963	Aa
Commercial mortgage-backed securities	2,746,541	Unrated
Corporate bonds	530,858	Aaa
Corporate bonds	3,943,822	Aa
Corporate bonds	12,226,512	A
Corporate bonds	13,510,841	Baa
Corporate bonds	892,500	Ba
Corporate bonds	11,767,900	B
Corporate bonds	10,000,745	Caa
Corporate bonds	2,087,158	Unrated
U.S. governmental agencies	2,897,617	Aaa
U.S. governmental agencies	442,142	A
U.S. governmental agency mortgage-backed securities	108,603	Unrated
Nongovernment-backed CMOs	31,252	Aaa
Nongovernment-backed CMOs	882,725	Unrated
Municipal/Provincial bonds	968,611	Aaa
Municipal/Provincial bonds	551,222	Aa
Municipal/Provincial bonds	875,000	A
Municipal/Provincial bonds	1,786,666	Unrated
Short-term investment funds	14,346,018	Unrated
Collateral pool	78,272,910	A1+

Note 3 - Deposits and Investments (Continued)

Securities Lending

As permitted by state statutes and under the provisions of a securities lending authorization agreement, the System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The System's custodial bank manages the securities lending program and receives cash as collateral. Borrowers are required to deliver collateral for each loan equal to not less than 100 percent of the market value of the loaned securities. During the year ended December 31, 2010, only United States currency was received as collateral.

The System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank; however, losses resulted due to fair market value decline of the collateral held.

The General Employees' Retirement System and the borrower maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in an investment pool. The average duration of such investment pool as of December 31, 2010 was 25 days. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On December 31, 2010, the System had no credit risk exposure to borrowers. The fair market value of the collateral held and the underlying securities on loan for the System as of December 31, 2010 were $78,272,910 and $76,295,300, respectively.

Note 4 - Reserves

State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2010, the System's reserves have been fully funded as follows:

Reserved for employee contributions	$ 2,103,063
Reserved for retired employees	197,313,589

Required Supplemental Information

City of Pontiac
General Employees' Retirement System

Required Supplemental Information
Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/04	$ 394,807,254	$ 258,365,787	$ (136,441,467)	$ 153	$ 21,320,477	-
12/31/05	391,409,757	260,103,260	(131,306,497)	150.5	16,751,815	-
12/31/06	409,983,490	266,457,429	(143,526,061)	153.9	14,996,753	-
12/31/07	433,028,186	257,940,349	(175,087,837)	167.9	13,559,473	-
12/31/08	416,678,512	261,497,756	(155,180,756)	159.3	14,414,481	-
12/31/09	405,193,572	255,720,207	(149,473,365)	158.5	12,553,146	-

Required Supplemental Information
Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2005	$ 16,926	100.0
2006	15,695	100.0
2007	-	100.0
2008	-	100.0
2009	-	100.0
2010	-	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2009, the latest actuarial valuation, is as follows:

Actuarial cost method	Individual entry age actuarial cost
Amortization method	Level percent of payroll, open
Remaining amortization period	30 years
Asset valuation method	Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	5.6% to 9.4%
Cost of living adjustments	2% (2.5% Court/MAPE) of original amount, subject to a maximum that varies by group
*Includes inflation at	4.5%

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June 20, 2011

Mr. Charlie Harrison III, Chairman
c/o Ms. Ellen Zimmerman
City of Pontiac General Employees'
Retirement System
47450 Woodward Ave.
Pontiac, MI 48342

Dear Mr. Harrison:

Enclosed are your annual financial reports and management letters for the year ended December 31, 2010.

Thank you for the opportunity to serve as your auditors. Please contact us if you have any questions.

Very truly yours,

Plante & Moran, PLLC

Enclosures

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June 28, 2011

To the City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

We have audited the financial statements of the General Employees' Retirement System, the Police and Fire Retirement System, the General Employees' Prefunded Group Health Insurance Plan and Trust, and the Police and Fire Retiree Prefunded Group Health and Insurance Plan and Trust (the "Systems and Trusts") for the year ended December 31, 2010 and have issued our report thereon dated June 20, 2011. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Communications Required Under SAS 114

Section II - Other Recommendations

Section I includes information that current auditing standards require independent auditors to communicate to those individuals charged with governance. We will report this information annually to the boards of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts.

Section II presents recommendations related to internal controls and procedures noted during our current year audit. These comments are offered in the interest of helping the Systems and Trusts in their efforts toward continuous improvement, not just in the areas of internal control and accounting procedures, but also in operational or administrative efficiency and effectiveness.

We would like to take this opportunity to thank the Systems and Trusts' staff for the cooperation and courtesy extended to us during our audit. Their assistance and professionalism are invaluable.

This report is intended solely for the use of the boards and management of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts and is not intended to be and should not be used by anyone other than these specified parties.

To the City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

June 28, 2011

We welcome any questions you may have regarding the following communications, and we would be willing to discuss any of these or other questions that you might have at your convenience.

Very truly yours,

Plante & Moran, PLLC

Beth Bialy

Beth Bialy

Alisha Davis

Alisha Davis

To the City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

June 28, 2011

Section I - Communications Required Under SAS 114

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated April 26, 2011, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you as part of our planning process during May 2011.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts are described in Note 1 to the financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during 2010 for the Systems and the Trusts.

We noted no transactions entered into by the Systems and the Trusts during the year for which there is a lack of authoritative guidance or consensus.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements relate to the valuation of alternative investments and the valuation of the actuarial accrued liability. The valuation for certain alternative investments is based on unaudited financial statements or other valuation methods in use by the boards. The valuation of the actuarial accrued liability is based on third-party actuarial assumptions and methods. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole; with the exception of one investment within the Police and Fire Retiree Prefunded Group Health Insurance Plan and Trust and one investment within the General Employees' Retirement System for which documentation did not exist to verify that they were appropriately valued to market as of the end the year and thus are included in the listing of potential uncorrected misstatements included in this letter.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There are no sensitive disclosures affecting the financial statements.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit other than difficulties in auditing the valuation of an alternative investment in the Police and Fire Retiree Prefunded Group Health Insurance Plan and Trust which is reflected in the financial statements at $1,330,000.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

The attached schedule summarizes an uncorrected potential misstatement of the financial statements. Management has determined that the effect is immaterial to the financial statements taken as a whole.

No other misstatements were identified during the course of our audit procedures.

Disagreements with Management

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 20, 2011.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the government's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Section II - Other Recommendations

During our audit, we noted areas where we believe there are opportunities for the Systems and Trusts to further strengthen internal controls or to increase operating efficiencies. Our observations on those areas are presented for your consideration below.

Alternative Investments

During our review of the board minutes over the past few years for the Systems and Trusts, we noted many discussions concerning alternative investments. Additionally, the Systems and Trusts have realized significant write-offs over the past couple of years related to alternative investments. As the Systems and Trusts get larger, it is not unusual for them to add alternative investments to their portfolio. We suggest that the Systems and Trusts fully review these investment opportunities and follow an established, formal due diligence process to document items such as the following:

- Assertions made by managers of the investments
- Review of incorporation and other contractual documents by third-party expertise to identify and report to the Systems and Trusts any matters that may impact valuation of investments going forward
- A detailed and independent analysis of financial projections
- A summarization of the reasons why the particular investments meet the Systems and Trusts' investment objectives

Once an investment has been entered into, the agreement should be very clear regarding periodic reporting, annual audits, etc. Alternative investments can present challenges with respect to obtaining sufficient appropriate audit evidence in support of the existence and valuation assertions because of the lack of a readily determinable fair value for the investments and the limited investment information generally provided by the managers of the investments.

As noted above, this proved to be the case during the current year audit with an investment held by the General Employees' Retirement System and another investment held by the Police and Fire Retiree Prefunded Group Health and Insurance Plan and Trust, resulting in the related uncorrected potential misstatements attached to this letter. Some of the processes that should be documented for audit purposes going forward to mitigate such occurrences include:

- Documentation of management site visits or telephone calls
- Review by the Systems and Trusts of periodic statements from the fund or trustee reflecting investment activity. This review should be very comprehensive and address discrepancies between actual performance and the performance set forth in earlier financial projections.

- Establishment of controls related to periodic draws and whether they meet an established timetable or have otherwise been deemed appropriate

- Use of an investment advisor to monitor the alternative investments, including the underlying investments, and/or to monitor markets or market indicators and their effect on the estimated fair values of the Systems and Trusts' investment

- The availability of audited financial statements for the alternative investments and whether such statements are as of the same date as the Systems and Trusts' financial statements, the timing of when such audited financial statements become available, and whether the audits are conducted by qualified and reputable independent audit firms. Timely and reliable financial statements are critical to the Systems and Trusts' financial reporting and valuation process; therefore, we suggest that the Systems and Trusts' consider imposing some form of penalty or other repercussion to encourage timely reporting by the alternative investment managers.

State Initiatives Impacting Local Units of Government

Economic Vitality Incentive Program

Governor Snyder has begun his tenure with several significant initiatives, and he is moving his agenda forward at a quick pace. One of these initiatives is to improve the transparency and efficiency of local units - cities, townships, villages, and counties. More specifically, one of his current local government initiatives includes replacing "statutory revenue sharing" with a newly named "Economic Vitality Incentive Program" that will be reduced by approximately 1/3 and require local units to compete for the remaining $200 million by demonstrating best practices in the following areas:

1. Transparency - provide more accessible financial information to citizens
2. Service sharing - consolidation or collaboration with other units of government
3. Employee benefits - slimmed down pension and health care benefits

The due date for the transparency tools is October 1, 2011. Communities must have a citizens' guide and performance dashboard. The dashboard must include unfunded liabilities related to pension and retiree healthcare.

By January 1, 2012, communities must produce a plan with one or more proposals to increase existing levels of cooperation, collaboration, and consolidation within their jurisdiction or with other jurisdictions. The plan must list previous efforts of cooperation, collaboration, and consolidation and any cost savings and estimates of any potential savings of future efforts.

The major provision impacting the pension and VEBA plans relates to some of the criteria surrounding best practices for employee compensation, which has an implementation date of May 1, 2012. Communities must certify they intend to implement the following employee compensation criteria for any new, modified, or extended contract or employment agreements for employees not covered under contract or employment contract:

- New hires eligible for retirement plans will be placed in retirement plans that cap annual employer contributions to:
  - 10 percent of base salary if they are eligible for Social Security
  - 16.2 percent of base salary if they are not eligible for Social Security

  This provision appears to still allow for a defined benefit plan; however, the employer could not pay more than the percentages noted above.

- For defined benefit plans:
  - A maximum 1.5 percent multiplier if the employee is eligible for Social Security. If there is no retiree health care, a maximum 2.25 percent multiplier
  - A maximum 2.25 percent multiplier if the employee is not eligible for Social Security. If there is no retiree health care, a maximum 3.0 percent multiplier

- Also for defined benefit plans, the final average compensation shall be computed using at a minimum three years' compensation and cannot include more than 240 hours of paid leave. It also cannot include overtime.
- Healthcare premium costs for new hires shall include a minimum employee share of 20 percent, or the employer's share shall be cost competitive with the new state-preferred provider organization health plan on a per-employee basis.

Retro-Pay Prohibition

Public Act 54 of 2011, which was signed by the governor on June 7, prohibits retroactive pay on an expired contract and calls for employees working under an expired agreement to bear the cost of any increased healthcare costs until a new contract is in effect. During that period, the public employer is authorized to make payroll deductions necessary to pay the increased cost of maintaining those benefits. This Act was ordered to take effect immediately.

Retiree Healthcare Valuation

As you are aware, the Systems and Trusts obtain new valuations each year to measure the unfunded actuarial accrued liabilities. As part of those valuations, various significant assumptions are made, including an assumption about the investment rate of return. For plans that are being funded on an actuarial basis (i.e., fully funded) and have built up a significant amount of funds and are expected to continue to do so going forward, a higher rate of return would be assumed. However, for plans that are not being funded on an actuarial basis (i.e., partial funding or "pay-as-you-go"), a lower rate of return should be used as there are not significant assets built up that are available for investment at higher returns. We encourage management to work with the actuary to re-evaluate investment rates of return in new valuations received as some of the plans may need to use a lower investment rate of return assumption going forward.

Plan Sponsor Financial Condition: Impact on the Systems

As you are aware, the City of Pontiac (the plans' sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 4 of 2011. The result is that the State has appointed an Emergency Manager to control the finances of the City. In effect, the City is in receivership. There is uncertainty regarding the City's ability to provide essential services in the future. The following contributions were originally expected to be paid by the City to the various Trusts but ultimately were not paid and it is our understanding that the payments will not be forthcoming. As a result, these contributions were removed from the financial statements:

- General Employees Retiree Health and Insurance Benefits trust $167,949
- Police and Fire Retirement System $448, 541
- Police and Fire Retiree Prefunded Group Heath and Insurance Trust $2,104,382

Given the financial condition of the City, and circumstances surrounding the current receivership, we encourage the System and Trusts' boards to give some consideration to the continuity of the Pension Systems and Retiree Health and Insurance Trusts. Regardless of the City's financial condition, the Pension Systems and the Police and Fire VEBA have accumulated significant assets that will be paid out to retirees for decades to come. The boards should consider formalizing a continuity plan for the Systems in the event that the City declares bankruptcy. As fiduciaries, the boards have the responsibility to ensure efficient and effective administration of the plan assets and benefit payments for many years to come. This involves ensuring that resources (staffing, training, monitoring, etc.) continue to be available.

To the City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

June 28, 2011

Client: **City of Pontiac General Employees Retirement System**
Y/E: **12/31/2010**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

The effect of misstatements and classification errors identified would be to increase (decrease) the reported amounts in the financial statement categories identified below:

Ref. #	Description of Misstatement	Assets	Liabilities	Net Assets	Additions	Deductions	Change in Net Assets
KNOWN MISSTATEMENTS:							
A1							
A2							
ESTIMATE ADJUSTMENTS:							
B1	To write off Nexos investment	$ (2,096,462)				$ 2,096,462	$ (2,096,462)
B2							
IMPLIED ADJUSTMENTS:							
C1							
C2							
		-	$ -	$ -	$ -	-	-
	Total	**$ (2,096,462)**	**$ -**	**$ -**	**$ -**	**$ 2,096,462**	**$ (2,096,462)**