FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

CliftonLarsonAllen

CliftonLarsonAllen LLP
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Independent Auditor's Report

The Honorable County Executive and
Members of County Council
Baltimore County, Maryland

We have audited the accompanying Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the Employees' Retirement System of Baltimore County, Maryland (the System), as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 audits provide a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2012 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United State of America require that the Management's Discussion and Analysis and Supplemental Schedules of Funding Progress and Required Employer Contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing stands generally accepted in the United State of America, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Introductory, Investment, Actuarial and Statistical sections, and the schedules of investment expenses and administrative expenses, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedules of investment expenses and administrative expenses have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The Introductory, Investment, Actuarial and Statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

CliftonLarsonAllen LLP

Baltimore, Maryland
December 19, 2012

Management's Discussion and Analysis

Our discussion and analysis of the financial performance of the Employees' Retirement System of Baltimore County (the "System") provides an overview of financial activities for the fiscal years ended June 30, 2012 (FY 2012) and June 30, 2011 (FY 2011). Please read it in conjunction with the transmittal letter in the Introductory Section beginning on Page 2 and the basic financial statements, which follow this discussion.

FINANCIAL HIGHLIGHTS

- The System's net assets held in trust at the close of FY 2012 and FY 2011 were $2.0 billion and $2.1 billion, respectively. This decrease was due to the increase in benefits payments and the reduction in investment income in FY 2012.
- The System's funding objective is to meet long-term benefit obligations through contributions and investment income. Based on the latest actuarial valuations, as of June 30, 2011 and 2010, the funded ratio was 77.3% and 80.0%, respectively. The decrease was primarily due to a scheduled increase in unfunded accrued liability and asset experience.
- Contributions for FY 2012 and FY 2011 were $104.6 million and $94.9 million, respectively, an increase of 10.2%. This increase was a result of negotiated increases in employee contributions and higher employer contributions primarily due to asset experience.
- Net investment income of $23.3 million resulted in a net of fee return of 1.1% for FY 2012 vs. $372.7 million for FY 2011with net of fee returns of 21.0%. The Comparative Balanced Index was 0.8% and 19.4% respectively, for the same periods.
- Total deductions increased from $169.9 million in FY 2011 to $215.6 million in FY 2012, an increase of 26.9%. The increase was primarily due to increased number of retirees and increased DROP payments.

THE STATEMENT OF PLAN NET ASSETS AND THE STATEMENT OF CHANGES IN PLAN NET ASSETS

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements: The Statement of Plan Net Assets (Page 18) and the Statement of Changes in Plan Net Assets (Page 19). These financial statements report information about the System as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better or worse off as a result of this year's activities? These statements include all assets and liabilities that are due and payable using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Plan Net Assets presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's assets available for benefits is improving or deteriorating. The Statement of Changes in Plan Net Assets presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedule of Funding Progress and Schedule of Employers' Contributions to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

FINANCIAL ANALYSIS

The System's overall funding objective is to accumulate sufficient assets over time to meet its long-term benefit obligations as they become due. In FY 2012, net asset held in trust for pension benefits decreased 4.2% over FY 2011.

Total liabilities that are due and payable as of June 30, 2012 and 2011 were $60.6 million and $250.2 million respectively, a decrease of 75.8% over FY 2011, and were comprised of payables for investment purchases, investment expenses, refunds payable and obligations under securities lending. In FY 2011 total liabilities increased 79.5% or $110.8 million from the prior year primarily due to an increase in payables for investments purchased and payables for collateral of loaned securities.

Management's Discussion and Analysis, continued

System assets exceeded its due and payable liabilities at the close of fiscal year 2012 and 2011 by $2.0 billion and $2.1 billion, respectively. In FY 2012, total net assets held in trust for pension benefits decreased 4.2% or $87.7 million from the previous year. This decrease was attributable to the increase in benefit payments due to the increased number of retirees, increased DROP payments and the relatively lower investments returns. In FY 2011, total net assets held in trust for pension benefits increased 16.7% or $297.7 million from the previous year. This increase was attributable to the improved performance in stocks, both foreign and domestic, global asset allocation funds and real estate, resulting in an overall investment return for FY 2011 of 19.4%.

BALTIMORE COUNTY EMPLOYEES' RETIREMENT SYSTEM
PLAN NET ASSETS
AS OF JUNE 30, 2012, 2011 AND 2010
(IN THOUSANDS)

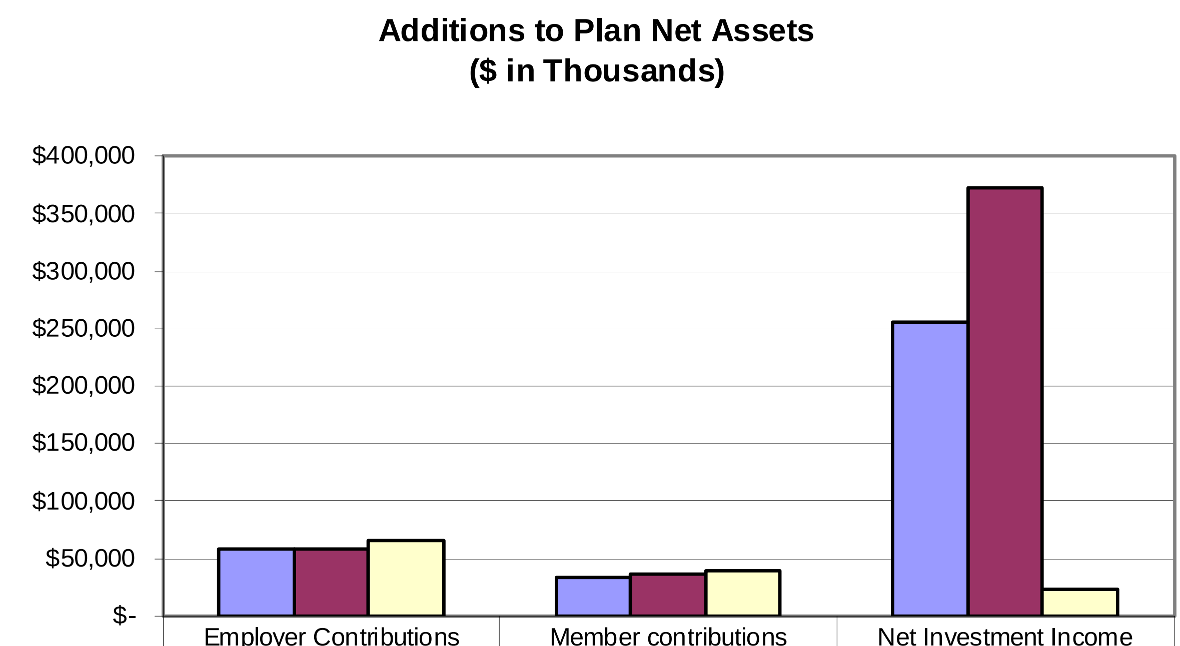
	2012	2011	2010	2012-2011 Total % Change	2011-2010 Total % Change
ASSETS					
Cash and Short Term Investments	$42,460	$96,815	$41,851	(56.1)%	131.3%
Collateral for Loaned Securities	22,676	117,672	89,734	(80.7)	31.1
Receivables	17,166	47,452	29,339	(63.8)	61.7
Investments	1,974,605	2,072,240	1,764,711	(4.7)	17.4
Total Assets	$2,056,907	$2,334,179	$1,925,635	(11.9)%	21.2%
LIABILITIES					
Accounts Payable and Other Accrued Liabilities	$35,871	$131,810	$47,915	(72.8)%	175.1%
Obligations Under Securities Lending	24,778	118,398	91,449	(79.1)	29.5
Total Liabilities	$60,649	$250,208	$139,364	(75.8)%	79.5%
Total Net Assets	$1,996,258	$2,083,971	$1,786,271	(4.2)%	16.7%

Management's Discussion and Analysis, continued

BALTIMORE COUNTY EMPLOYEES' RETIREMENT SYSTEM
CHANGES IN PLAN NET ASSETS
FOR THE FISCAL YEARS ENDED JUNE 30, 2012, 2011 AND 2010
(IN THOUSANDS)

	2012	2011	2010	2012-2011 Total % Change	2011-2010 Total % Change
ADDITIONS					
Contributions	$104,608	$94,907	$91,212	10.2%	4.1%
Investment Income	24,868	373,132	256,108	(93.3)	45.7
Net Loss from Security Lending	(1,547)	(417)	(1,303)	(271.0)	68.0
Total Net Investment Income	$23,321	$372,715	$254,805	(93.7)%	46.3%
Total Additions	$127,929	$467,622	$346,017	(72.6)%	35.1%
DEDUCTIONS					
Benefits	$209,673	$164,655	$150,704	27.3%	9.3%
Refunds of Contributions	3,640	2,726	2,235	33.5	22.0
Administrative Expenses	2,329	2,541	1,099	(8.3)	131.2
Total Deductions	$215,642	$169,922	$154,038	26.9%	10.3%
Net Increase (Decrease)	($87,713)	$297,700	$191,979	(129.5)%	55.1%
Net Assets Held in Trust for Pension Benefits					
Beginning of Year	2,083,971	1,786,271	1,594,292	16.7	12.0
End of Year	$1,996,258	$2,083,971	$1,786,271	(4.2)%	16.7%

Management's Discussion and Analysis, continued



	Employer Contributions	Member contributions	Net Investment Income
2010	$57,976	$33,236	$254,805
2011	$58,340	$36,567	$372,715
2012	$65,127	$39,481	$23,321

REVENUES – ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and earnings on investments. Contributions and net investment income for fiscal years 2012 and 2011 were $127.9 million and $467.6 million, respectively.

Additions decreased for FY 2012 by $339.7 million or 72.6% over FY 2011, due primarily to a decrease in investment income. Total additions for FY 2011 increased 35.1% over FY 2010, due to an increase in investment income. Total employer contributions for FY 2012 increased over FY 2011 by $6.8 million or 11.6%, while member contributions increased by $2.9 million or 7.9%. The increase in employee contributions was primarily due to higher contribution rates for all active members. Based on the latest available actuarial valuation, the fiscal years ended 2011 and 2010, rates of return were 4.3% and 0.9% respectively.

The overall System portfolio returned 1.7% for FY 2012. Contributing to the lower returns were losses of the non-US Equity Portfolio (12.3%) and the Hedge Fund of Funds portfolio (5.7%).

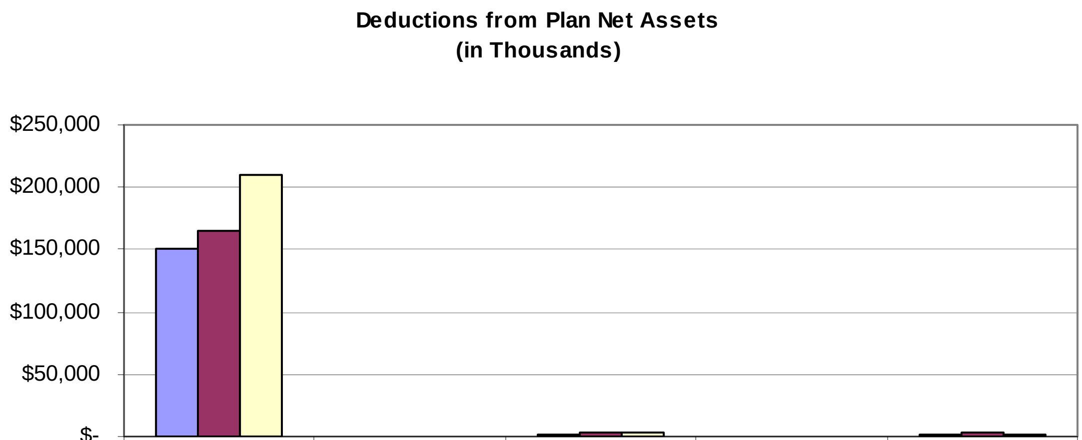
For FY 2011, the overall System portfolio returned 21.0%, which improved upon the 16.4% gains of FY 2010. All asset categories provided positive returns with the System's domestic equity portfolio leading the way with gains of 34.2%, followed closely by the non-US equity portfolio with gains of 28.6%. Other asset categories with sound returns were Real Estate with gains of 20.5%, Global Asset Allocation funds with gains of 20.4%, and Private Equity with gains of 14.6%.

Management's Discussion and Analysis, continued

EXPENSES – DEDUCTIONS FROM PLAN NET ASSETS

The expenses of the System include pension payments to members and beneficiaries, refunds of contributions to former members, and the cost of administering the System. Total deductions for FY 2012 increased by 26.9% or $45.7 million over FY 2011 due to an increase in benefit payments. Total deductions for FY 2011 increased by 10.3% or $15.9 million over FY 2010 due to an increase in benefit payments and administrative expenses. Deductions for FY 2011 were $169.9 million, an increase of 10.3% over FY 2010, which was primarily related to an increase in the number of retirees.

The payment of pension benefits increased by 27.3% or $45 million in FY 2012 from the previous year. The increase in pension benefit expenditures in FY 2012 resulted from an increase in the number of retirees and increased DROP payments. The payment of pension benefits increased by 9.3% or $13.9 million in FY 2011 from the previous year. The increase in pension benefit expenditures in FY 2011 resulted from an increase in the number of retirees and increased DROP payments to public safety retirees.



	Pension Benefits		Refunds		Administrative Expenses
2010	$150,704		$2,235		$1,099
2011	$164,655		$2,726		$2,541
2012	$209,673		$3,640		$2,329

RETIREMENT SYSTEM AS A WHOLE

Net assets held in trust for pension benefits decreased by $87.7 million or (4.2%) in FY 2012. Based on the latest actuarial valuation available, the System's funding ratio, as determined by the County's actuary, was 77.3% at June 30, 2011 and 80.0% at June 30, 2010. The Board continues to utilize the concepts of prudent investment management, cost controls and strategic planning.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, please contact the Office of Budget and Finance, Mezzanine, Historic Court House, 400 Washington Avenue, Towson, Maryland 21204.

Employees' Retirement System of Baltimore County
Statements of Plan Net Assets
As of June 30, 2012 and 2011
(IN THOUSANDS)

	FY 2012	FY 2011
Assets:		
Cash and short term investments	$ 42,460	$ 96,815
Collateral for loaned securities	22,676	117,672
Receivables:		
Accrued interest and dividend income	2,291	2,675
Receivable for investments sold	13,793	43,681
Receivables - other	1,082	1,096
Total Receivables	17,166	47,452
Investments, at fair value		
U.S. Government and agency securities	130,226	183,950
Municipal Bonds	1,709	1,894
Foreign bonds	11,060	7,514
Corporate bonds	132,034	127,295
Stocks	388,670	451,504
Bond mutual funds	267,068	241,602
Stock mutual funds	350,795	360,022
Real estate equity funds	87,052	75,742
Hedge funds	96,431	101,190
Private equity funds	111,686	97,176
Real Assets	87,901	98,944
Global Asset Allocation	309,973	325,407
Total Investments	1,974,605	2,072,240
Total Assets	2,056,907	2,334,179
Liabilities:		
Investment expenses payable	2,265	2,494
Refunds payable	398	327
Payable for investments purchased	33,041	128,687
Payable for collateral for loaned securities	24,778	118,398
Payables - other	167	302
Total Liabilities	60,649	250,208
Net Assets Held in Trust for Pension Benefits	$1,996,258	$2,083,971

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

Employees' Retirement System of Baltimore County
Statements of Changes in Plan Net Assets
for the Years Ended June 30, 2012 and 2011
(IN THOUSANDS)

	FY 2012	FY 2011
Additions		
Contributions:		
Employers	$ 65,127	$ 58,340
Members	39,481	36,567
Total contributions	104,608	94,907
Investment Income:		
Net increase in the fair value of investments	1,120	349,491
Interest and dividends	38,070	37,478
	39,190	386,969
Less: Investment expenses	(14,322)	(13,837)
Investment Income	24,868	373,132
Securities Lending:		
Securities Lending Income	162	361
Less:		
Net decrease in the fair value of investments	(2,102)	(726)
Borrower Rebates	641	74
Agent Fees	(248)	(126)
Net Loss from Securities Lending	(1,547)	(417)
Total Net Investment Income	23,321	372,715
TOTAL ADDITIONS	127,929	467,622
Deductions		
Benefits	209,673	164,655
Refunds of contributions	3,640	2,726
Administrative expenses	2,329	2,541
TOTAL DEDUCTIONS	215,642	169,922
Net Increase (decrease)	(87,713)	297,700
Net assets held in trust for pension benefits		
Beginning of year	2,083,971	1,786,271
End of year	$1,996,258	$2,083,971

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

Notes to Financial Statements

1. Plan Description

The Employees' Retirement System of Baltimore County (the "System") is a cost-sharing multiple-employer defined benefit public employee retirement system that acts as a common investment and administrative agent serving five entities including Baltimore County (the "County") and certain employees of the Baltimore County Board of Education, Baltimore County Board of Library Trustees, the Community College of Baltimore County and the Baltimore County Revenue Authority. The System is not an employer. The System provides retirement and disability benefits, cost-of-living adjustments and death benefits to plan members and beneficiaries. The authority to establish and maintain the System is specified in Section 5-1-101 of the Baltimore County Code (the "Code").

The System is considered part of the Baltimore County, Maryland reporting entity and its financial statements are included in the County's basic financial statements as a pension trust fund. The System is fiscally dependent on the County by virtue of the legislative and executive controls exercised with respect to its operations, policies and administrative budget. In accordance with Section 5-1-238 of the Code, responsibility for the proper operation of the System is vested in an eight-member Board of Trustees (the "Board"), comprised of a combination of ex-officio and elected representatives. The general administration of the System is vested in the Director of Budget and Finance.

As of June 30, 2011 and 2010, System membership consisted of:

	2011	2010
Retirees and beneficiaries currently receiving benefits		
General employees, correctional officers and deputy sheriffs	4,726	4,679
Firefighters and police officers	2,046	2,025
Total retirees and beneficiaries	6,772	6,704
Terminated employees entitled to benefits but not yet receiving them		
General employees, correctional officers and deputy sheriffs	541	465
Firefighters and police officers	42	52
Terminated employees entitled to benefits but not yet receiving	583	517
Current employees		
Vested - Full-time employees		
General employees, correctional officers and deputy sheriffs	4,125	4,028
Firefighters and police officers	2,452	2,399
Non-vested - Full-time employees		
General employees, correctional officers and deputy sheriffs	1,494	1,643
Firefighters and police officers	480	519
Part-time employees		
Vested - General employees	616	602
Non-vested - General employees	404	442
Total active members	9,571	9,633
Non-Vested Terminations with account balances	63	55
Members on leave of absence		
General employees, correctional officers and deputy sheriffs	34	29
Firefighters and police officers	10	6
Total members on leave of absence	44	35
Grand Total	17,033	16,944

Notes to Financial Statements, continued

The following is a brief description of the System's plan provisions. For a more complete description, see the Summary of Plan Provisions included in the Actuarial Section of this report.

Employees, exclusive of firefighters and police officers, may become System members at any time within the first two years of employment. Employees must become System members at the end of the two-year period as a condition of employment except for elected officials, employees appointed to certain non-merit positions and part-time employees who have the option to join the System within the first two years. Selection of the option must be made within two years of employment. Waived time is not eligible for buyback. Section 5-1-203 of the Code provides that System members contribute a percentage of their salary to the System (see Note 3 for additional information on contribution rates).

Employees who terminate employment or die in service prior to meeting vesting eligibility are entitled to a refund of their contributions. Interest is credited on member contributions at the rate of 5% per annum. Employers are required to contribute an actuarially determined amount annually to finance the System as specified by Sections 5-1-203 and 5-1-257 of the Code.

Members are eligible for a normal retirement for service based on age and/or years of creditable service. There is no mandatory retirement age for general employees, deputy sheriffs and correctional officers. Firefighters and police officers must retire at age 65 unless approved for continuation of service by the Board on an annual basis.

The County has adopted a Back DROP, for Police Officers and Firefighters under which eligible active members may elect to receive a lump sum payment at retirement in exchange for a reduced monthly benefit for life. The DROP period is between three and five years, effective with retirements that occurred on or after July 1, 2004. Police Officers and Firefighters hired on or after July 1, 2007 are not eligible to participate in the Back DROP.

The County has adopted a Back DROP for Correctional Officers and Deputy Sheriffs hired prior to July 1, 2007. Eligible active members may elect to receive a lump sum payment at retirement in exchange for a reduced monthly benefit. The Back DROP period is between three and five years, effective with retirements that occur on or after July 1, 2010. Correctional Officers and Deputy Sheriffs hired on or after July 1, 2007 are not eligible to participate in the Back DROP.

The County has adopted a Forward DROP for General Employees hired prior to July 1, 2007. Eligible active members may elect to receive a lump sum payment at retirement in exchange for a reduced monthly benefit. The Forward DROP period is between five and ten years, effective with retirements that occur on or after July 1, 2012. General Employees hired on or after July 1, 2007 are not eligible to participate in the Forward DROP.

An ordinary disability retirement may be granted to a member who can no longer perform their job due to a non-occupational related injury. Police officers and firefighters (“Group 4”), must have 5 years of creditable service, while the general, correctional officers and deputy sheriffs (“Group 3”), must have ten years of creditable service and be medically certified as incapacitated for continued performance of their duties. The ordinary disability retirement allowance is determined in accordance with Section 5-1-222 of the Code.

An accidental disability retirement may be granted to a member who has been incapacitated for duty as a result of an occupational related injury. Accidental disability payments are tiered (75%, 66.67%, or 50%), based upon the degree of disability. The accidental disability retirement allowance is determined in accordance with Section 5-1-226 of the Code.

An ordinary death benefit is granted as a result of a member's death from non-occupational causes. A member's designated beneficiary or estate receives a lump sum payment of the member's contributions plus interest. Additionally, after one year of creditable service, the member's designated beneficiary or estate may receive a minimum one-time payment equal to 100% of the member's annual earnable compensation. If a member was eligible for a service retirement or had 15 years of creditable service at the time of death, the spouse, if designated as beneficiary, may receive a retirement allowance based on service years equivalent to a 100% survivorship option (*Option 2*).

Notes to Financial Statements, continued

An accidental death benefit is granted as the result of death from an occupational related injury. The dependent beneficiary of a general employee may receive an allowance equal to $66^{2}/_{3}$% of average final compensation (AFC) plus the annuity as described below. The dependent beneficiary of a firefighter or police officer may receive an allowance equal to 100% of the annual earnable compensation at the time of death plus the annuity as described below.

Retirement allowances are comprised of an annuity equal to the actuarial equivalent of the accumulated contributions plus a pension which together with the annuity shall provide a total allowance as provided for in the System's plan. The retirement allowance is determined based on the AFC and number of years of creditable service. AFC is defined for the majority of the members as the rate of annual earnable compensation during the twelve or thirty-six consecutive calendar months of service affording the highest average. The normal retirement for service allowance is determined as follows:

Employee designation	Allowance formula for Vested Employees
General employees (Hired prior to July 1, 2007)	1.82% of AFC times the number of years of creditable service for: (i) 30 years of creditable service or (ii) Age 65 with 5 years of creditable service or, General employees hired prior to July 1, 2007, retiring at age 60 with less than 30 years of creditable service, will receive a blended benefit, (i.e. 1.82% of AFC times the number of years of creditable service earned prior to July 1, 2007, plus 1.43% of AFC times the number of years of creditable service earned on or after July 1, 2007.
General employees (Hired on or after July 1, 2007)	1.43% of AFC times the number of years of creditable service.
Appointed officials	2.5% of AFC times the number of years of creditable service.
Elected officials	5.0% of AFC times the number of years of creditable service. Any Council member who becomes a member of the retirement system on or after February 1, 2010 may not receive a retirement allowance in excess of 60% of the member's AFC.
Firefighters	2.5% of AFC times the number of years of creditable service up to 20 years, plus 2.0% of AFC for each year in excess of 20 years, and 3.0% of AFC for each year in excess of 30 years for service years on or after July 1, 2007. 2.0% of AFC times the number of years of creditable service – if less than 20 years of creditable service.
Correctional officers and Deputy Sheriffs	2.5% of AFC times the number of years of creditable service up to 20 years, plus 2.0% of AFC times the number of years of creditable service in excess of 20 years. <u>If hired prior to July 1, 2007, with less than 20 years of creditable service at retirement:</u> 1.82% of AFC times the number of years of creditable service earned prior to July 1, 2007, plus 1.43% of AFC times the number of years of creditable service earned after June 30, 2007. <u>If hired on or after July 1, 2007, with less than 25 years of creditable service at retirement:</u> 1.43% of AFC times the number of years of creditable service.
Police officers	2.5% of AFC times the number of years of creditable service up to 20 years, plus 2.0% of AFC for each year of creditable service in excess of 20 years, and 3.0% of AFC for each year of creditable service over of 25 years. The 3% accrual rate does not apply for years of creditable service earned prior to July 1, 2007. 2.0% of AFC times the number of years of creditable service – if less than 20 years of creditable service

Notes to Financial Statements, continued

In addition to the maximum retirement allowance, members may select one of six retirement allowance options to provide payments to a beneficiary upon the death of a retired member. A selection of an option reduces the maximum allowance. Eligible police officers and firefighters, may select a 7th option that allows 50% of member's retirement to continue to the original beneficiary at no cost to the employee.

In accordance with Section 5-1-235 of the Code, each July 1, post-retirement allowance adjustments may be granted to retirees who have been retired for more than 60 months. The post-retirement allowance adjustment is equal to the increase in the Consumer Price Index - All Urban Consumers (CPI-U) for the previous calendar year, in an amount not to exceed 3%, provided sufficient investment income in excess of valuation requirements has accumulated in the Post-Retirement Increase Fund Balance Account described in Note 2. The maximum Post-Retirement Increase Fund Account Balance is equal to twice the cost of a 3% COLA. Additional details regarding cost-of-living increases may be found in the Summary of Plan Provisions under the heading Post-Retirement Allowance Increases.

2. Summary of Significant Accounting Policies and Plan Asset Matters

Basis of Accounting - The financial statements of the System are presented using the economic resource measurement focus and the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employers' contributions are recognized when due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The System records investment purchases and sales on a trade-date basis. These transactions are not finalized until settlement date, which occurs approximately three business days after the trade date. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Method used to Value Investments - Plan investments are reported at fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. The fair value of real estate equity funds is based on independent appraisals. The fair value of real assets is based on their closing sales price on the market on which the securities primarily trade or, in the absence of a sale, at their last or most recently reported bid price. The fair value of mutual funds is based on the fair value of the underlying securities. Hedge fund of funds are valued based on information provided by the respective fund managers. The fair value for alternative investments which include private equity funds is based upon the partnership's most recent available financial information.

Administrative Costs - The System pays for the following administrative expenses: professional actuarial costs, pension consultant fees, data processing, medical board examinations, salaries, benefits, audit/legal fees, equipment and supplies, postage, printing and miscellaneous expenses. These administrative expenses are funded from employer contributions.

Net Asset Accounts - As provided by the Code, all assets of the System must be credited according to the purpose for which they are held to the annuity savings fund, the pension accumulation fund or the post-retirement increase fund. These funds are classified together as net assets held in trust for pension benefits for financial reporting purposes and are explained below:

> *Annuity Savings Fund Balance Account* - This Account records the accumulated contributions credited to individual members' accounts together with the interest thereon. Upon termination of employment, accumulated contributions plus interest are refunded from this fund. When a member retires, the member's accumulated contributions plus interest are transferred to the Pension Accumulation Fund Balance Account.
>
> *Pension Accumulation Fund Balance Account* - This Account records all accumulated reserves used to pay member pensions and other benefits. The reserves are accumulated from employer contributions, investment income, gains on sales of investments and amounts transferred from the Annuity Savings Fund Balance Account.

Notes to Financial Statements, continued

Post-Retirement Increase Fund Balance Account - This Account records all investment earnings in excess of valuation requirements transferred from the Pension Accumulation Fund Balance Account in order to finance post-retirement allowance increases to retired members.

At June 30, 2012 and 2011, the balances in the legally required accounts are as follows:

	2012 (in Thousands)	**2011** (in Thousands)
Annuity Savings Fund	$468,060	$473,082
Pension Accumulation Fund	1,517,672	1,600,363
Post-Retirement Increase Fund	10,526	10,526
Net Assets Held in Trust for Pension Benefits	$1,996,258	$2,083,971

3. Contributions

System members contribute a percentage of their salary to the System determined by County Code. The contribution rates for members hired prior to July 1, 2007 is actuarially determined based on the member's age at enrollment and employee classification. Contribution rates for members hired on or after July 1, 2007 are fixed based on employee classification. A chart of member contribution rates is provided in the Summary of Plan Provisions in the Actuarial Section of this report.

The participating employers are required to contribute on an actuarially determined basis. Per Section 5-1-203 of the Code, contribution requirements of the plan members and the participating employers are established and may be amended by the Board. The FY 2012 Schedule of Employers' Contributions is shown below.

Schedule of Employers' Contributions

Fiscal Year Ended June 30	Annual Required Contribution (in Thousands)	Percentage Contributed
2012	$65,127	100%

4. Funding Policy

A pension plan is considered adequately funded when sufficient assets are available to meet all expected future obligations to participants. The System funding objective is to meet long-term benefits through annual employer contributions that remain approximately level as a percentage of covered payroll. The greater the level of funding, the larger the ratio of assets accumulated to the actuarial accrued liability and the greater the level of investment potential. The advantage of a well-funded plan is that participants are confident that sufficient assets are available for the payment of current and future member benefits. Based on the latest actuarial valuation, the FY 2011 Schedule of Funding Progress is shown on the next page in thousands.

Notes to Financial Statements, continued

Schedule of Funding Progress
(in Thousands)

Actuarial Valuation Date June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Excess of) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL (Excess of) as a % of Covered Payroll ((b-a)/c)
2011	$2,213,858	$2,863,853	$649,995	77.3%	$525,322	123.7%

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

The County's commitment to provide a financially sound retirement plan for its members is illustrated on two schedules contained in this report. The six year "Schedule of Funding Progress," providing historical trend information, found in the Required Supplementary Information of the Financial Section, expresses plan net assets as a percentage of the actuarial accrued liability, providing one indication of the System's funding status on a going-concern basis.

Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Trends in the unfunded actuarial accrued liability (or excess of) as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the System's progress made in accumulating sufficient assets to pay benefits when due. The six year "Schedule of Employer Contributions" found in the Required Supplementary Information of the Financial Section, includes historical trend information about the annual required contributions (ARC) of the employers and the contributions made by the employers in relation to the ARC. The System's percentages indicate a financially sound retirement system.

Information about the actuarial methods and assumptions used to determine the funded status and the ARC is presented below:

Valuation Date:	June 30, 2011
Actuarial Cost Method[1]:	Projected Unit Credit
Normal Cost Allocation:	Service
Amortization Method:	Level percent closed
Remaining Amortization Period:	27 Years
Asset Valuation Method[2]:	10-year smoothed market without corridor
Actuarial Assumptions:	
-Investment Rate of Return[3]	7.875%
-Projected Salaried Increases[3]	3.00% – 7.50%
-Cost-of-Living Adjustments[4]	None
-Mortality Rates[5]	Based on the 1995 George B. Buck Mortality Table +1

1. Cost Method changed to Projected Unit Credit for June 30, 2005 valuation.
   All pre-FY07 contributions determined using Entry Age Normal.
2. Actuarial Asset Method change: The Smoothing period was changed from 5 to 10 years for the June 30, 2010 valuation.
3. Includes Inflation at 3%.
4. Increases equal to the CPI up to a maximum of 3% are granted only if sufficient reserves have accumulated in the Post-Retirement Increase Fund Balance Account.
5. The mortality rates based on the 1995 George B. Buck Mortality Table is presented on Page 52 in the Actuarial Section of this report.

Notes to Financial Statements, continued

5. Cash Deposits, Investments and Securities Lending

Custodial Credit Risk – For Cash Deposits, Investments and Securities Lending, custodial credit risk is the risk that, in the event of the failure of the bank or counterparty, the System will not be able to recover the deposits, value of its investments or collateral securities that are in possession of an outside party. The System cash deposits are fully covered by FDIC insurance and/or collateral pledged to the System's account held by the System's agent in the System's name at year-end. The collateral pledged and held consists of obligations issued by the U.S. government and agencies. Investment securities are registered in the name of the System. As of June 30, 2012, the carrying amount of cash was $0.2 million.

Investment Policy – Pursuant to Section 5-1-247 of the Baltimore County Code, the Board of Trustees utilizes the "prudent person" standard for managing the assets of the System. The Board has established the following policies:

1) Assure that the System's investment policy has been designed to provide broad diversification among asset classes in order to maximize return at an appropriate level of risk and minimize the risk of large losses to the System.

2) Employ a diversity of investment managers with different investment styles on how to obtain their investment objective.

3) Closely monitor the performance of all investment managers not only in relation to specific objectives, but also in relation to other fund managers following the same investment objectives.

The System is currently invested in stocks (domestic and foreign), fixed income securities, private equity funds, real estate, hedge fund of funds, global asset allocation funds and real assets. The Code provides for full power to hold, purchase, sell, assign, transfer and dispose of any of the securities and investments in any of the System's funds.

For the year ended June 30, 2012, the System has operated in all material respects accordance with the System's investment policy.

Investment

The following is a maturity schedule of the System's fixed income investments of bonds and short term investments as of June 30, 2012.

Investment Maturities (in Years)
(Expressed in Thousands)

Investment Type	Fair Value	Less than 1	1 - 4.9	5 - 9.9	10-19.9	20-30	More Than 30
U.S. Govt. Obligations	$ 61,278	$ 3,035	$ 15,070	$ 2,480	$ 13,106	$20,098	$ 7,489
U.S. Agency Securities	68,948	11,999	-	7,273	14,814	25,012	9,850
Municipals	1,709	888	-	119	131	186	385
Corporate Debt	132,034	24,729	35,612	34,505	15,495	15,186	6,507
Bond Mutual Funds	267,068	-	-	267,068	-	-	-
Foreign Debt	11,060	7,456	1,216	1,755	-	633	-
Total	$542,097	$48,107	$51,898	$313,200	$43,546	$61,115	$24,231

Interest Rate Risk – The Employees' Retirement System of Baltimore County policy guidelines do not specifically address limits on maturities as a means of managing its exposure to fair value losses arising from changing interest rates. The manager of each fixed income portfolio is responsible for determining the average maturity of their portfolio.

Notes to Financial Statements, continued

Credit Risk - The System's investment policy is to apply the prudent-person rule: Investments are made as a prudent person would be expected to act with discretion and intelligence, to seek reasonable income, preserve capital and in general, avoid speculative investments. Investment in high yield securities are limited to 20% in the guidelines for core and core plus fixed income managers. Pimco Diversified Fixed Income Fund targets 1/3 of their portfolio in high yield securities. Loomis may invest up to 25% of their portfolio in high yield securities. Seix may invest between 20% and 60% of their portfolio in high yield securities. Stone Harbor may invest up to 100% of their portfolio in high yield securities.

As of June 30, 2012, the System's fixed income investments had the following risk characteristics:

Moody's Ratings or Comparable	Fair Value (in Thousands)	Percent of Fixed Income Investments
AAA	$ 141,320	26.07%
AA	8,217	1.52
A	29,610	5.46
BBB	40,372	7.45
BB	5,432	1.00
B	4,120	0.76
CCC	461	0.09
CC	3,942	0.73
NR*	308,623	56.92
Total	$542,097	100.00%

*NR represents securities not rated, primarily made up of swaps and commingled funds, which by their nature do not have credit quality ratings.

Investments in Excess of 5% of Net Assets Held in Trust for Pension Benefits

The System had no investments at fair value in excess of 5% of the System's net assets held in trust for pension benefits as of June 30, 2012.

Investment Commitments

As of June 30, 2012, the System had $70.7 million in outstanding private equity commitments.

Notes to Financial Statements, continued

Foreign Currency Risk

The System's exposure to foreign currency risk is derived from its positions in foreign currency-denominated common stock and fixed income investments. The Systems exposure to foreign currency risk as of June 30, 2012 is as follows:

Currency	Fair Value (in Thousands)
Australian Dollar	$4,299
British Pound Sterling	15,264
Danish Krone	538
Euro Currency Unit	45,702
Hong Kong Dollar	5,872
Israeli Shekel	822
Japanese Yen	26,858
Norwegian Krone	949
Singapore Dollar	1,653
South Korean Won	5,532
Swedish Krona	3,756
Swiss Franc	8,921
Total	$120,166

Future contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Because of daily settlement, the futures contracts have no fair value. The System entered into certain futures contracts of which the notional value at June 30, 2012 are as follows:

Futures Contracts Exposure as of June 30, 2012
(in Thousands)

Currency	Long Contracts	Short Contracts
US Treasury Bond Future (CBT)	$7,259	$ -
US 10YR Treasury Note Future (CBT)	4,521	-
US Ultra Bond (CBT)	1,935	-
US 5YR Treasury Note Future (CBT)	-	(11,279)
US 2YR Treasury Note Future (CBT)	-	(10,213)

The System utilizes certain derivative instruments for the purpose of obtaining income or profit. The derivatives are subject to credit risks, interest rate risk, and foreign currency risk. The fair value balances and notional amounts of derivative instruments outstanding at June 30, 2012, classified by type and the changes in fair value of such derivative instruments for the year then ended are as follows:

	Changes in Fair Value (in Thousands)			Fair Value as of June 30, 2012 (in Thousands)	
Investment Derivatives:	Classification	Amount		Amount	Notional Value
Futures	Investment Revenue	$ -		$ -	($7,777)
Options	Investment Revenue	(41)		20	(3,350)
Swaps	Investment Revenue	25		79	(502)
Mortgage Derivatives	Investment Revenue	(87)		2,163	2,163
TBA Transactions	Investment Revenue	29		10,727	10,727

Notes to Financial Statements, continued

Rationale for Derivative strategies:

The purpose of using futures and options is to hedge the portfolio to reduce risk and adjust exposure along the yield curve. A short position in total options reduces the portfolio's convexity in exchange for higher yield. A long position increases convexity in exchange for lower yields.

The effect of long and short treasury notes and bond futures is to shift the portfolio's duration to its target position.

The combined effect of Eurodollar and Euribor futures and options is to adjust exposure to the front portion of the yield curve.

Long and short call and put options on notes and bond futures are used to adjust portfolio convexity in exchange for higher yields.

Credit default indices and credit default swaps on individual names are used as an efficient, low cost way of adjusting credit exposure on the margin.

Securities Lending Transactions **-** The Board’s policies permit the System to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The System’s custodian lends U.S. government and agency securities, corporate bonds and stocks for collateral in the form of cash, other securities and irrevocable bank letters of credit. Collateral securities, letters of credit and cash are initially pledged at 102% of the market value of the securities lent. Additional collateral is to be provided by the next business day if the collateral value falls to less than 100% of the market value of the securities lent. The System did not impose any restrictions during the fiscal year on security loans the custodian made on its behalf. At June 30, 2012, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers exceed the amounts the borrowers owe the System. The System cannot pledge or sell collateral securities received unless the borrower defaults. All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in both a separately managed fixed income account and a cash collateral pool, which at year-end has a weighted-average maturity of 12 days. The collateral held as of June 30, 2012 and 2011 was $46.9 million and $122.0 million, respectively. The fair value of securities on loan as of June 30, 2012 and 2011 totaled $46.5 million and $119.7 million, respectively. At June 30, 2012, the cash collateral pool had an unrealized loss of approximately $2.1 million which is recorded in the Statement of Changes in Plan Net Assets as a decrease in the fair value of investments for securities lending.

6. Risk Management

The County bears any risk of loss related to the System (e.g. torts, theft of, damage to, or destruction of assets; errors or omissions, job-related illnesses, or injuries to employees; and natural disasters). The County manages its risks internally and sets aside assets for claims settlement in an internal service fund.

Notes to Financial Statements, continued

7. Litigation

The U.S. Equal Employment Opportunity Commission (EEOC) has sued Baltimore County and six (6) County Unions claiming that they violated the Age Discrimination in Employment Act (ADEA) by requiring employees who join the retirement system as older workers to contribute more than workers who joined at a younger age. The United States District Court for the District of Maryland granted Baltimore County's Motion for Summary Judgment on January 21, 2009. The Fourth Circuit Court of Appeals reversed and remanded the case to the District Court. By Order entered on October 17, 2012, the District Court reversed itself and found the County liable for age discrimination. The County has moved for permission to file an interlocutory appeal to the Fourth Circuit before determination of the issue of damages by the District Court. That motion was granted on December 7, 2012. The County believes that it will ultimately prevail in this litigation. The County has also called upon its long-term actuary, Buck Consultants, to defend, indemnify and hold the County harmless in the action. EEOC's claim for "excess contributions" by older workers is estimated to be $17 million to $19 million. The Employees' Retirement System of Baltimore County would absorb any potential liability through higher member contributions.

8. Subsequent Events

Employee Contribution Rate Increase Effective July 1, 2011 (Bill No. 65-12):

The rate of regular contribution for Correctional Officers hired on or after July 1, 2011 increased from 8% to 10% of earnable compensation, retroactive to July 1, 2011.

Separate Plans (Bill No. 65-12):

The County Council passed Bill No. 65-12 on October 15, 2012 that formally closed the System for members hired on or before July 1, 2007, will be known as “Plan A.” Members hired on or after July 1, 2007 will be considered members of “Plan B.”

Reduction in Valuation Rate and Pension Obligation Bond Issuance

On July 10, 2012, the Board of Trustees of the Employee Retirement System reduced the actuarial valuation rate from 7.785% to 7.25% beginning with the June 30, 2012 valuation, which increased the present value of the liabilities of the Plan by approximately $275 million as calculated by the System’s actuary. Under Maryland State law, the County has the authority to issue pension obligation bonds for a closed plan. Of the $275 million increase, the actuary attributed $255 million of this increase to the closed plan (Plan A). The County issued $256,290,000 taxable pension obligation bonds (POBs) on December 13, 2012 to pay for the increased liabilities of Plan A and deposited the bond proceeds into the County’s retirement system, invested with other funds in the System. The annual County contribution to the System plus debt service on the POBs is expected to be less than what the annual County contribution would have been in the absence of the POBs. As a result of the POB issuance, the County expects to save $343 million in contributions to the System over the next 30 years.

Required Supplementary Information
(Unaudited)

Six-year historical trend information about the System is presented herewith as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due and make comparisons with other public employee retirement systems.

Schedule of Funding Progress
(in Thousands)

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Excess of) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	
2006	$1,938,817	$2,078,812	$139,995	93.3%	$425,400	32.9%
2007(1)	2,101,023	2,289,452	188,429	91.8	439,913	42.8
2008(2)	2,191,623	2,491,342	299,719	88.0	479,654	62.5
2009(3)	2,143,616	2,599,670	456,054	82.5	506,908	90.0
2010(4)	2,196,915	2,746,016	549,101	80.0	515,125	106.6
2011	2,213,858	2,863,853	649,995	77.3	525,322	123.7

(1) Assumption changes recommended in 2006 experience study were adopted, plus plan changes to all groups including implementation of DROP programs for general employees, correctional officers and deputy sheriffs.
(2) Amortization period was changed to 30 years. The amendments of GASB Statement No. 50 were recognized, but they had no impact on the information disclosed.
(3) Actuarial Asset Method is revised to remove 14% Corridor Around Market Value and the smoothing period was changed from 4 to 5 years. Salary increase rates for all members are reduced.
(4) Actuarial Asset Method change: The Smoothing period was changed from 5 to 10 years.

Schedule of Employers' Contributions
(in Thousands)

Fiscal Year	Annual Required Contribution	
2007	$40,065	100%
2008	44,168	100
2009	49,763	100
2010	57,976	100
2011	58,340	100
2012	65,127	100

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information regarding the assumptions and methods used as of the latest actuarial valuation may be found in "Note 4 – Funding Policy" in the notes to the financial statements, and in the Actuarial Section of this report.

Supplementary Supporting Schedules

Investment Fees and Expenses
(in Thousands)
For the Years Ended June 30, 2012 and 2011

	FY 2012	FY 2011
Investment Managers:		
Domestic Equity managers	$ 2,680	$ 2,779
International Equity managers	1,804	1,588
Fixed Income managers	2,304	2,006
Private Equity managers	1,865	1,569
Real Estate managers	1,006	916
Hedge Fund managers	966	1,038
Global Asset Allocation managers	2,398	2,533
Real Asset managers	713	886
Total manager fees	13,736	13,315
Investment Service Fees:		
Custodian fees	302	303
Consultant fees	284	219
Total service fees	586	522
Subtotal - Investment Expenses	14,322	13,837
Security Lending Fees:		
Agent fees	248	126
Borrower rebates	(641)	(74)
Total Security Lending fees	(393)	52
Total Investment Fees and Expenses	$13,929	$13,889

Schedule of Administrative Expenses
(in Thousands)
For the Years Ended June 30, 2012 and 2011

	FY 2012	FY 2011
Personal Services:		
Salaries	$ 626	$ 501
Employee Fringe benefits	175	168
Total Personal Services	801	669
Professional Services:		
Actuarial	142	207
Legal and Financial	14	18
Data Processing*	1,227	1,506
Medical	54	50
Audit	22	29
Total Professional Services	1,459	1,810
Communication:		
Printing	11	13
Telephone	2	2
Postage	36	36
Total Communication	49	51
Miscellaneous:		
Equipment and Supplies	20	11
Total administrative expenses	$2,329	$2,541

***Includes costs associated with new contract to replace the current Data Processing System with a Web Based System.**

Board of Trustees

The members of the Board serve without compensation.