

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION
AND
INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2007 AND 2006

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

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Montemayor Hill & Company, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the City of Austin Police Retirement System

We have audited the accompanying statements of plan net assets of the City of Austin Police Retirement System (System) as of December 31, 2007 and 2006, and the related statements of changes in plan net assets for the years then ended. These basic 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. Those standards require that we plan and perform the audits 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 status of the System as of December 31, 2007 and 2006, and the changes in its financial status for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis (MD&A) and the required supplementary information on pages 2 through 5 and 20 through 21 are not a required part of the basic financial statements of the System, but are supplementary information required by the accounting principles generally accepted in the United States of America. 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.

Montemayor Hill & Company, P.C.

August 15, 2008
Austin, Texas

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CITY OF AUSTIN POLICE RETIREMENT SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of Austin Police Retirement System's (the System) financial report presents our discussion and analysis of the System's financial performance during calendar years 2007 and 2006. We encourage readers to consider the information presented here in conjunction with our financial statements that follow.

Financial Highlights

- Plan net assets held in trust by the System increased by \$53.8 million, or 11.7%, in 2007 and increased by \$71.5 million, or 18.3%, in 2006. The increases are due to positive investment returns and contributions in excess of benefit payments.
- Contributions increased by \$4.6 million, or 17.1% in 2007 and increased by \$2.7 million, or 11.1% in 2006. The increase in 2007 is due to employee contributions increasing from 11% to 13% as of October 1, 2007, an increase of 5.5% in the number of participating members as well as an increase in officer general wages of 5.5%. The increase in 2006 is due to employee contributions increasing from 9% to 11% as of October 1, 2006, an increase of 2.0% in the number of participating members as well as an increase in officer general wages of 5.5%.
- The amount of benefits paid to retired members and beneficiaries and refunded to terminating employees increased approximately \$1.1 million, or 5.2%, during 2007 and \$2.1 million, or 11.3%, during 2006. The increase in 2007 and 2006 is due to the increase in the number of System retirees by 5.1% and 8.8%, respectively.
- The System's rate of return on investments for the year ended December 31, 2007 was 10.3% gross of fees and 9.8% net of fees, on a market value basis, which was less than the return of 17.5% gross of fees and 17.0% net of fees for the year ended December 31, 2006.
- The funding objective of the System is to meet long-term benefit obligations through contributions and investment income. As of December 31, 2007, the date of the most recent actuarial valuation, the System's funding ratio of actuarial assets as a percentage of actuarial liabilities is 75.6%, which is up from the 72.4% level at December 31, 2006. This is primarily due to favorable investment experience. The actuarial assumed rate of return is 8.00%, net of fees and administrative expenses.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Systems' financial statements, which are comprised of the following:

- **Statement of Plan Net Assets** - presents the Systems' assets and liabilities and the resulting net assets, which are held in trust for pension benefits. This statement reflects a year-end snapshot of the Plan's investments at fair value, along with cash and short-term investments, receivables and other assets and liabilities.
- **Statement of Changes in Plan Net Assets** - provides a view of current year additions to and deductions from the plan. These two statements report the System's net assets held in trust for pension benefits (net assets) – the difference between assets and liabilities – is one way to measure the Systems' financial position. Over time, increases and decreases in net assets are one indicator of whether its financial health is improving or deteriorating.
- **Notes to the Financial Statements** - provide additional information that is essential to a full understanding of the data provided in the financial statements.

Collectively, this information presents the net assets held in trust for pension benefits as of the end of each year, and summarizes the changes in net assets held in trust for pension benefits for the year.

CITY OF AUSTIN POLICE RETIREMENT SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Analysis

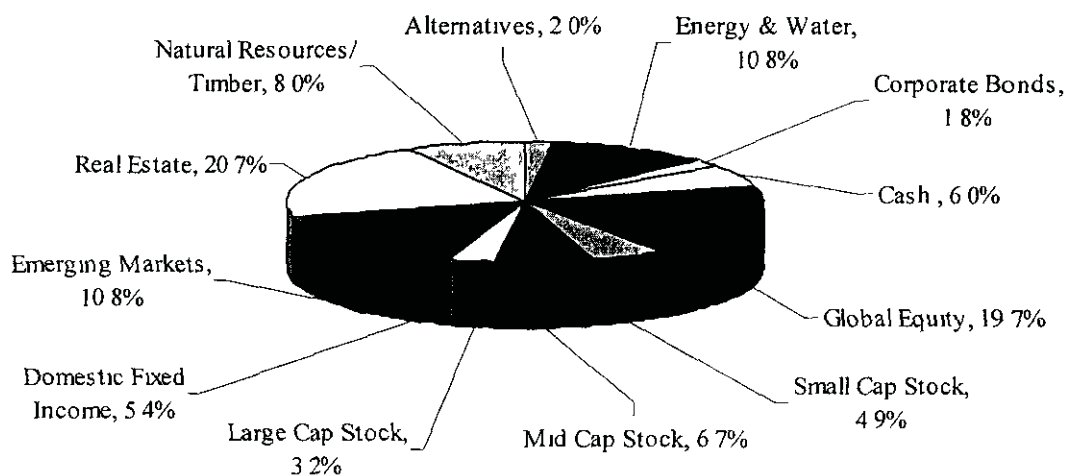
Summary of Plan Net Assets December 31, 2007, 2006 and 2005

<u>Assets</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash, receivables and prepaids	\$ 1,831,107	\$ 2,513,761	\$ 4,619,073
Investments, at fair value	512,914,698	459,077,479	389,661,173
Fixed assets, net	961,989	405,217	435,166
Total assets	515,707,794	461,996,457	394,715,412
<u>Liabilities</u>			
Total liabilities	696,121	816,925	5,026,279
Net assets held in trust for pension benefits	<u>\$515,011,673</u>	<u>\$461,179,532</u>	<u>\$389,689,133</u>

Assets The Systems' net assets held in trust for pension benefits increased by \$53.8 million in 2007 and \$71.5 million in 2006. The 2007 and 2006 increases primarily reflect investment returns in the energy, emerging markets, real estate and timberland markets. The decrease in cash, receivables, and prepaids of approximately \$683 thousand in 2007 is primarily due to a decrease in the amount of cash carried in the operating account at year end. The decrease in cash, receivables, and prepaids of approximately \$2.1 million in 2006 is primarily due to a decrease in interest and dividends receivable at year end. Total investments were \$512.9 million at the end of fiscal year 2007 and \$459.1 million at the end of fiscal year 2006, which is an increase of \$53.8 million, or 11.7%, for fiscal year 2007.

Below is a chart of the System's asset allocation for fiscal year ending December 31, 2007.

APRS Asset Allocation Percentages as of 12/31/07



Liabilities. Liabilities decreased by \$121 thousand in 2007 and decreased by \$4.2 million in 2006. The decrease for 2007 is primarily due to less contribution refunds being due and payable at year end. The decrease for 2006 is primarily due to no investment commitments being due and payable at year end.

CITY OF AUSTIN POLICE RETIREMENT SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

Summary of Changes in Plan Net Assets

Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
<u>Additions</u>			
Contributions	\$ 31,444,215	\$ 26,857,508	\$ 24,167,426
Investment income	47,531,830	68,078,881	37,353,206
Investment expenses	(2,378,789)	(1,915,119)	(1,492,473)
Net investment income	45,153,041	66,163,762	35,860,733
Other income	49,461	182,742	193,315
Total additions	76,646,717	93,204,012	60,221,474
<u>Deductions</u>			
Benefit payments & contributions refunded	21,971,475	20,888,547	18,767,339
General and administrative expenses	843,101	825,066	780,062
Total deductions	22,814,576	21,713,613	19,547,401
Net increase	53,832,141	71,490,399	40,674,073
Net assets held in trust for pension beginning of year	461,179,532	389,689,133	349,015,060
Net assets held in trust for pension end of year	\$515,011,673	\$461,179,532	\$389,689,133

Additions Funds to pay benefits are accumulated through contributions and returns on invested funds. Member and City of Austin contributions for 2007 and 2006 totaled \$31.4 million and \$26.9 million, respectively. The 2007 contributions represent an increase of \$4.6 million, or approximately 17.1% above the 2006 level and the 2006 contributions represent an increase of \$2.7 million, or approximately 11.1% above the 2005 level. These increases are due to the number of participating members increasing by 5.5% in 2007 and 2.0% in 2006, an increase in officer general wages of 5.5% in both years and employee contributions being raised from 9% to 11% starting in October 2006 and then raised again from 11% to 13% starting in October 2007.

The System incurred a positive return on the market value of its investments during 2007. Net investment gain of \$45.2 million was due to performance of the portfolio assets, which decreased \$21.0 million from 2006. Interest, dividends and net securities lending income generated 2007 income of \$10.6 million, a slight decrease from the \$11.3 million received in 2006. The total rate of return for the System's investment portfolio in 2007 was 9.8% (net of investment fees) as compared to 17.0% (net of investment fees) for 2006.

Deductions. The expenses paid by the System include benefit payments, refunds of member contributions, and administrative expenses. Benefits paid to retirees in 2007 were \$21.6 million, an increase of \$1.5 million from payments made in 2006, consistent with the increase in the number of retirees to 443 in 2007 from 421 in 2006. Refunds to terminating employees decreased by \$376 thousand. Administrative expenses in 2007 were \$843 thousand, slightly more than those incurred in 2006.

Benefits paid to retirees in 2006 were \$20.1 million, an increase of \$1.8 million from payments made in 2005, consistent with the increase in the number of retirees to 421 in 2006 from 386 in 2005. Refunds to terminating employees increased by \$334 thousand. Administrative expenses in 2006 were \$825 thousand, slightly more than those incurred in 2005.

Investment expenses increased by \$464 thousand in 2007 and increased by \$423 thousand in 2006. The increase in 2007 and 2006 is due to the growth of our investment assets under management and the increased investing in real estate, private equity and natural resources.

CITY OF AUSTIN POLICE RETIREMENT SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overall Analysis

As of December 31, 2007, net assets increased by \$53.8 million or 11.7% from the prior year, and over the five-year period ending December 31, 2007, net assets increased by 70.9%. The past five-year period growth reflects a solid market return above the 8% actuarial investment return.

Request for Information

This financial report is designed to provide a general overview of the finances of the City of Austin Police Retirement System for all parties with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to CEO, City of Austin Police Retirement System, P O Box 41089, Austin, Texas 78704-0019.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

**STATEMENT OF PLAN NET ASSETS
DECEMBER 31, 2007 AND 2006**

ASSETS

	<u>2007</u>	<u>2006</u>
Investments, at fair value		
Real estate interests	\$135,297,987	\$136,499,681
Corporate stocks	154,274,645	149,039,163
Government bonds	24,958,404	34,917,124
International government securities	55,239,814	49,266,965
International stocks	57,347,043	56,518,146
Short-term investment funds	46,287,210	12,200,417
Partnership interests	19,820,460	11,382,743
Corporate bonds	9,261,735	0
Alternatives	10,170,242	9,064,000
Retiree death benefit fund	<u>257,158</u>	<u>189,240</u>
Total investments	512,914,698	459,077,479
Cash	113,277	1,158,384
Interest and dividends receivable	860,033	683,149
City of Austin retirement contributions receivable	492,793	387,301
City of Austin death benefit contributions receivable	2,725	1,751
Participant contributions receivable	357,874	251,363
Fixed assets, net	961,989	405,217
Other	<u>4,405</u>	<u>31,813</u>
	<u>515,707,794</u>	<u>461,996,457</u>
LIABILITIES		
Accounts payable and accrued liabilities	644,505	543,256
Refunds payable	<u>51,616</u>	<u>273,669</u>
	<u>696,121</u>	<u>816,925</u>
NET ASSETS HELD IN TRUST AVAILABLE FOR PENSION BENEFITS (See schedule of funding progress on page 20)	<u>\$515,011,673</u>	<u>\$461,179,532</u>

The accompanying notes are an integral part of this financial statement presentation

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

STATEMENT OF CHANGES IN PLAN NET ASSETS
YEARS ENDED DECEMBER 31, 2007 AND 2006

ADDITIONS TO PLAN NET ASSETS	<u>2007</u>	<u>2006</u>
Contributions		
City of Austin retirement contributions	\$18,510,066	\$16,945,167
City of Austin death benefit contributions	84,170	88,302
Participant contributions	<u>12,849,979</u>	<u>9,824,039</u>
	<u>31,444,215</u>	<u>26,857,508</u>
Investment income		
Net increase in the fair value of investments	36,819,926	56,646,312
Interest and dividends	10,479,835	11,243,826
Securities lending	232,069	188,743
Rental and other income	<u>49,461</u>	<u>182,742</u>
Total investment gain before expenses	47,581,291	68,261,623
Investment expenses	<u>(2,378,789)</u>	<u>(1,915,119)</u>
Net gain from investments	<u>45,202,502</u>	<u>66,346,504</u>
Total additions to net assets available for benefits	<u>76,646,717</u>	<u>93,204,012</u>
 DEDUCTIONS FROM NET ASSETS AVAILABLE FOR BENEFITS		
Retirement benefit payments	21,544,800	20,108,420
Death benefit payments	30,000	7,500
Contributions refunded to terminating employees	396,675	772,627
General and administrative expenses	<u>843,101</u>	<u>825,066</u>
Total deductions from net assets available for benefits	<u>22,814,576</u>	<u>21,713,613</u>
 NET INCREASE IN NET ASSETS AVAILABLE FOR BENEFITS	53,832,141	71,490,399
 Beginning net assets available for benefits	<u>461,179,532</u>	<u>389,689,133</u>
ENDING NET ASSETS AVAILABLE FOR BENEFITS	<u>\$515,011,673</u>	<u>\$461,179,532</u>

The accompanying notes are an integral part of this financial statement presentation

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SYSTEM DESCRIPTION

The Board of Trustees (Board) of the City of Austin Police Retirement System (System) is the administrator of a single-employer defined benefit pension plan. The System is considered part of the City of Austin's (City) financial reporting entity and is included in the City's financial reports as a pension trust fund.

The System was originally established in 1979 by a City Council ordinance. Effective August 1991, the System is governed by state law with plan amendments made by the Legislature of the State of Texas. The System provides retirement, death, disability and withdrawal benefits. Benefits vest after 10 years of credited service. Participants may retire at (a) 23 years of service excluding any military service credit regardless of age, or (b) age 55 with 20 years of service excluding any military service or (c) age 62. The monthly benefit at retirement is payable as a life annuity (modified cash refund).

As of the actuarial valuation date of December 31, 2007, the monthly benefit is equal to 3.2% of the highest 36-month average salary multiplied by years and months of service.

The Retroactive Deferred Retirement Option Plan (RETRO DROP) provisions require that a participant must have 23 years of creditable service with the retirement system excluding any military service credit on the date the participant elects for the RETRO DROP benefit computation date. Effective April 1, 2007, the RETRO DROP was amended to include FORWARD DROP participation. Further, the RETRO DROP provisions may be changed in the future by Board rule with approval by the System's actuary, except, the age 62 minimum eligibility regardless of services may not be changed.

The Post Retirement Option Plan (PROP) is an option allowing retiring officers to leave their RETRO DROP lump sum in the System for a period of time. The participant can elect to receive partial payments from the RETRO DROP lump sum account and can also elect to delay payment of the entire RETRO DROP lump sum. Effective April 1, 2006, this option was amended whereby retirees have the ability to defer their monthly annuity payments to an interest bearing PROP account. Effective October 1, 2007 this option was amended to include a partial deferral of a retiree's monthly annuity payment into an interest bearing PROP account. Interest credits will be paid on the participant's PROP account following the participant's retirement until the entire lump sum is paid. The interest credits will be granted based on an annual rate determined from time to time by Board Rule.

A \$10,000 post-retirement lump sum death benefit is payable from a separate Retiree Death Benefit Fund (account) administered by the System. As of December 31, 2007 and 2006, the assets of the Retiree Death Benefit Fund were \$257,158 and \$189,240, respectively, which are included in the System's total market value of Net Assets Held in Trust Available for Pension Benefits of \$515,011,673 and \$461,179,532, respectively.

Distributions to members or their beneficiaries are also available in the event of total and permanent disability, provided the member has completed 10 years of service or the injury was sustained during the performance of employment duties, or upon death. The terms of benefit payments are determined by certain elections made by the member, their level of earnings and length of service. Payments to members or their beneficiaries may be increased annually on an ad hoc basis, limited to 6% per year, and subject to the approval of the Retirement Board and the actuary.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SYSTEM DESCRIPTION

Participating members in the System include full-time police officers and cadets employed by the police department of the City and employees of the System. The following membership status of the System was reflected in the actuarial valuation as of December 31, 2007 and 2006:

Retirees and beneficiaries currently receiving benefits (443) and terminated employees entitled to future monthly benefits (11)	<u>2007</u> 454
Current participating members	<u>1,535</u>
2007 Total	<u>1,989</u>
Retirees and beneficiaries currently receiving benefits (421) and terminated employees entitled to future monthly benefits (11)	<u>2006</u> 432
Current participating members	<u>1,455</u>
2006 Total	<u>1,887</u>

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING

The System's financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of their trade date. Contributions are recognized as revenues in the period in which the related employees' payroll is earned. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

CONTRIBUTIONS RECEIVABLE

The final biweekly payroll contributions of employees for the years ended December 31, 2007 and 2006, and the City's related contributions were not deposited in the System by year end and are shown as contributions receivable in both years.

ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions to net assets held in trust available for pensions benefit during the reporting period. Actual results could differ from those estimates.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

METHOD USED TO VALUE INVESTMENTS

The System's investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value. The System's real estate investments are appraised periodically and the System receives audited financial statements from the real estate investment managers, which are used to estimate fair value. Investment income is recognized in the period earned, and purchases and sales of investments are recorded on a trade-date basis.

SYSTEM EXPENSES

All System administrative costs are the responsibility of the System and are financed through investment earnings.

NOTE 3: FIXED ASSETS

Fixed assets are recorded at cost. Depreciation is computed using the straight-line method over the asset's estimated useful life of 30 years for the building and 5 to 7 years for furniture and equipment. Fixed asset activity for the year ended December 31, 2007 consisted of

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Assets not being depreciated				
Land	\$150,000	\$0	\$0	\$150,000
Assets being depreciated				
Buildings and improvements	457,955	412,261	0	870,216
Furniture and equipment	294,802	208,081	(4,339)	498,544
Leasehold improvements	15,187	0	0	15,187
Accumulated depreciation	<u>(512,727)</u>	<u>(63,033)</u>	<u>3,802</u>	<u>(571,958)</u>
Net Fixed Assets	<u>\$405,217</u>	<u>\$557,309</u>	<u>(\$537)</u>	<u>\$961,989</u>

NOTE 4: FEDERAL INCOME TAXES

The System is a Public Employee Retirement System and is exempt from Federal income taxes. Favorable determination letters from the Internal Revenue Service were issued in September 1996 and in April 2007.

NOTE 5: DEPOSIT AND INVESTMENT RISK

The System is authorized as an independent, defined benefit plan as described in Article 6243n-1, Vernon's Annotated Texas Civil Statutes, that was signed into law on June 11, 1991. The Board is the trustee of System funds and has the power to invest and reinvest such funds in instruments or investments the Board considers prudent in accordance with the System's investment policy.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

The Board has adopted an Investment Policy Statement (IPS) to set forth the factors involved in the management of investment assets for the System and the IPS is included with every investment manager's agreement. The fair values of the System's investments at December 31, 2007 and 2006 are presented, by type, as follows:

<u>Investment Type</u>	<u>2007</u>	<u>2006</u>
Real Estate Interests	\$135,297,987	\$136,499,681
Corporate Stocks	154,274,645	149,039,163
Government Bonds	24,958,404	34,917,124
International Government Securities	55,239,814	49,266,965
International Stocks	57,347,043	56,518,146
Partnership Interests	19,820,460	11,382,743
Corporate Bonds	9,261,735	0
Alternatives*	10,170,242	9,064,000
Short-term Investment Funds	46,544,368	12,389,657
Total Investments	<u>\$512,914,698</u>	<u>\$459,077,479</u>

* The 2007 and 2006 amount represents an offshore, multi-strategy, pooled investment

CUSTODIAL CREDIT RISK

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are uninsured and uncollateralized. While the System has no formal policy regarding custodial credit risk, operating bank account deposits in excess of the \$100,000 coverage by FDIC are covered by pledged securities held as collateral. As of December 31, 2007 and 2006, the System's operating bank balance of \$113,277 and \$1,158,384, respectively, was not exposed to custodial credit risk.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the System and are held by either the counterparty or the counterparty's trust department or agent but not in the System's name. As of December 31, 2007 and 2006, the System's investment securities are not exposed to custodial credit risk because all securities are held by the System's custodial bank in the System's name and securities on loan with brokers are fully insured for cash collateral.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools and other pooled investments are excluded from this requirement. As of December 31, 2007 and 2006, there is no security issued by a single issuer that holds more than 5% of the System's fund. However, as of December 31, 2007 and 2006, there are 2 organizations – McAlister Real Estate and RMK Timberland Group - that hold more than 5% of the System's total fund. As of December 31, 2007, McAlister and RMK hold approximately 6.18% and 5.11%, respectively. As of December 31, 2006, McAlister and RMK held approximately 8.04% and 7.42%, respectively.

The Board and Investment Policy Statement (IPS) adopts the philosophy that the most effective risk control procedure is to adequately diversify the investments of the Fund among different asset classes with differing risk profiles. Diversification is achieved through providing a wide variety of investment classes in which to invest the Systems' funds. The IPS sets the following allowable ranges and target asset allocations for the Systems' funds:

<u>Class</u>	<u>Allowable Range</u>	<u>Target Asset Allocation</u>
Equity	20% - 65%	40.00%
Large Cap	10% - 55%	
Small Cap	0% - 30%	
International	10% - 35%	
Special Situations	0% - 20%	
Fixed Income	15% - 70%	20.00%
Investment Grade	5% - 50%	
High Yield	0% - 25%	
International	0% - 30%	
Private	0% - 25%	
Real Estate	0% - 30%	20.00%
Alternatives	0% - 30%	20.00%

The allowable range means the minimum and maximum percentage of each asset class allowed. The target asset allocation is the average allocation desired over time. The Board has the ability to make the decision to deviate from these ranges when it deems necessary based on the market conditions.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

Along with diversification, the Board and IPS set investment goals and guidelines as follows

Return Objective

- To exceed the actuarial target rate of return
- To manage the asset mix and outside professional money managers in a manner that provides the maximum likelihood of achieving this objective each year within an acceptable level of market risk

Manager risk guidelines

- No manager will be allocated more than 25% of the Fund's assets, to avoid undue manager concentration
- APRS's allocation to any manager will not represent more than 20% of the assets that the manager is managing in the same strategy

Security concentration guidelines

- No single stock position or corporate debt instrument should represent more than 10% of a manager's portfolio at market
- No industry (as defined by each investment managers appropriate benchmark) should represent more than 2 times its weighting in the corresponding market index or 20%, whichever is greater

Volatility guidelines

- The primary concern for the Board is return but the Board does not want to assume excessive risk in its search for return
- One form of measurement of the risk inherent in the portfolio is the volatility or annualized standard deviation of the portfolio's returns as measured on a quarterly basis
- The Board will seek to achieve its return objective with no more than 75% of the volatility exhibited by the S&P 500 index

In conjunction with these goals and guidelines are responsibilities of the investment committee, third party consultants, custodians and money managers. The IPS also outlines the review and control procedures that the Board will monitor for compliance.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

INTEREST RATE RISK

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

As of December 31, 2007, the System had the following investments and maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Less than 1 year</u>	<u>1 to 6 years</u>	<u>6 to 10 years</u>
Corporate Bonds	\$9,261,735	\$0	\$0	\$9,261,735
International Securities	36,969,028	0	6,022,070	30,946,958
Government Bonds	24,958,404	0	24,958,404	0
Totals	<u>\$71,189,167</u>	<u>\$0</u>	<u>\$30,980,474</u>	<u>\$40,208,693</u>

As of December 31, 2006, the System had the following investments and maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Less than 1 year</u>	<u>1 to 6 years</u>	<u>6 to 10 years</u>
International Securities	\$33,464,308	\$0	\$ 5,320,053	\$28,144,255
Government Bonds	34,917,124	0	22,955,559	11,961,565
Totals	<u>\$68,381,432</u>	<u>\$0</u>	<u>\$28,275,612</u>	<u>\$40,105,820</u>

CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the System. While the System has no formal investment policy regarding credit quality rating guidelines, the IPS allows investment managers full discretion in adopting investment strategies to deal with these risks and the portfolios are monitored quarterly by the investment committee.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations at December 31, 2007, are as follows

<u>Quality Rating</u>	<u>Total Fair Value</u>	<u>Int'l Securities</u>	<u>Corporate Bonds</u>	<u>Government Bonds</u>
A1/A+	\$1,124,027	\$1,124,027		
A2/A	807,283	807,283		
A3/A-	1,181,698	1,181,698		
Aa3/AA-	124,086	124,086		
B1/B+	5,693,604	4,471,055	\$1,222,549	
B2/B	3,482,016	3,194,902	287,114	
B3/B-	6,855,207	4,595,344	2,259,863	
Ba1/BB+	1,779,141	1,779,141		
Ba2/BB	10,312,350	10,312,350		
Ba3/BB-	4,566,263	3,695,660	870,603	
Baa1/BBB+	2,054,557	2,054,557		
Baa2/BBB	5,392,633	5,392,633		
Baa3/BBB-	1,302,070	1,302,070		
Caa1/CCC+	1,806,038		1,806,038	
Caa2/CCC	1,261,423	1,827	1,259,596	
AA+*	7,441,400			\$ 7,441,400
AA*	17,517,004			17,517,004
Not Rated	15,860,933	14,304,961	1,555,972	
Unrated	898,220	898,220		
Total	<u>\$89,459,953</u>	<u>\$55,239,814</u>	<u>\$9,261,735</u>	<u>\$24,958,404</u>

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations at December 31, 2006, are as follows

<u>Quality Rating</u>	<u>Total Fair Value</u>	<u>Int'l Securities</u>	<u>Government Bonds</u>
A1/A+	\$ 680,879	\$ 680,879	
A3/A-	918,345	918,345	
B1/B+	2,612,686	2,612,686	
B2/B	4,420,259	4,420,259	
B3/B-	5,229,530	5,229,530	
Ba1/BB+	942,793	942,793	
Ba2/BB	11,686,430	11,686,430	
Ba3/BB-	3,250,871	3,250,871	
Baa1/BBB+	2,520,959	2,520,959	
Baa2/BBB	5,317,449	5,317,449	
Baa3/BBB-	1,470,328	1,470,328	
Caa1/CCC+	215,927	215,927	
AAA*	11,961,565		\$11,961,565
AA+*	22,955,559		22,955,559
Not Rated	7,550,236	7,550,236	
Unrated	2,450,273	2,450,273	
Total	<u>\$84,184,089</u>	<u>\$49,266,965</u>	<u>\$34,917,124</u>

* Average Quality Rating – credit quality of the holdings in an open-end institutional mutual fund

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

FOREIGN CURRENCY RISK

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. Although the System does not have a formal investment policy governing foreign currency risk, the System does manage its exposure to fair value loss by requiring their international investment managers to maintain diversified portfolios to limit foreign currency risk.

The System holds investments in ADRs (American Depository Receipts) which are not included in the schedule below since they are denominated in US dollars and accounted for at fair market value.

The System's exposure to foreign currency risk as of December 31, 2007, is as follows:

<u>Currency</u>	<u>Gov't Bonds (1)</u>	<u>Int'l Stocks</u>	<u>Int'l Gov't Securities</u>	<u>Corp Stocks (2)</u>	<u>Other (3)</u>
Euro	\$2,368,742	\$24,545,092	\$ 255,791	\$3,651,880	
Mexican Peso			197,965		
Hong Kong Dollar			529,853	371,979	
Japanese Yen		15,065,775		1,384,148	
Turkish New Lira			359,625		
Norwegian Krone				1,042,622	
British Pound					
Sterling		7,363,317	102,316	3,056,430	
Brazilian Real			1,898,904		
Swiss Franc		743,612		672,178	
Australian Dollar				458,386	\$5,678,384
Singapore Dollar			1,172,529	602,545	
South African Rand			624,262		
Polish Zloty			2,715,007		
Russian Rouble			1,985,701		
South Korean Won		2,004,190	168,091	753,615	
Canadian Dollar				4,664,095	
Other	1,024,678		9,348,890	609,553	531,631
Totals	<u>\$3,393,420</u>	<u>\$49,721,986</u>	<u>\$19,358,934</u>	<u>\$17,267,431</u>	<u>\$6,210,015</u>

- (1) Represents an open-end institutional mutual fund
- (2) Represents a commingled pool in global equity investments
- (3) Represents a commingled timberfund and a real estate partnership interest

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 5: DEPOSIT AND INVESTMENT RISK

The System's exposure to foreign currency risk as of December 31, 2006, is as follows

<u>Currency</u>	<u>Partnership Interest (1)</u>	<u>Int'l Stocks</u>	<u>Int'l Gov't Securities</u>	<u>Corp Stocks (2)</u>	<u>Gov't Bonds (3)</u>
Euro		\$25,776,175	\$368,202	\$371,415	\$987,178
Mexican Peso			2,999,675		
Hong Kong Dollar			233,879	20,215	
Japanese Yen		8,826,168			803,002
Turkish New Lira			629,215		
Norwegian Krone				101,138	
British Pound					
Sterling		10,827,933		323,583	
Brazilian Real			2,770,341		
Swiss Franc		3,100,205	118,206		
Australian Dollar	\$4,712,027			127,607	
Singapore Dollar			802,488		
South African Rand			1,224,863		
Polish Zloty			1,712,272		
Russian Rouble			1,576,170		
South Korean Won		99,000	453,244		
Canadian Dollar				5,381,708	399,831
Other			5,425,272		556,037
Totals	<u>\$4,712,027</u>	<u>\$48,629,481</u>	<u>\$18,313,827</u>	<u>\$6,325,666</u>	<u>\$2,746,048</u>

- (1) Represents a commingled timberfund
- (2) Represents a commingled pool in global equity investments
- (3) Represents an open-end institutional mutual fund

NOTE 6: SECURITIES LENDING

The System participates in a securities lending program sponsored by its custodian, The Northern Trust Company under which, for an agreed-upon fee, System owned investments are lent to a borrowing financial institution. Under this agreement, the borrowed securities are ultimately returned to the System and the collateral is returned to the borrower. Securities are loaned versus collateral that may include cash, U S government securities and irrevocable letters of credit. U S securities are loaned versus collateral valued at 102% of the market value of the securities plus any accrued interest. Non-U S securities are loaned versus collateral valued at 105% of the market value of the securities plus any accrued interest.

The System is not exposed to credit risk at December 31, 2007 and 2006, respectively, as the collateral held exceeded the market value of the securities lent. All security loans can be terminated on demand by either the lender or the borrower. The average number of days that the System's securities were borrowed was approximately 109 days and 104 days as of December 31, 2007 and 2006, respectively.

Non-cash collateral cannot be pledged or sold unless the borrower defaults. Cash collateral is invested in a short-term investment pool, the Core USA Collateral Section, which has an average weighted maturity less than the maturity of the loaned securities. Cash collateral may also be invested separately in "term loans", in which case the investments match the loan term. These loans can be terminated on demand by either lender or borrower.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 6: SECURITIES LENDING

There were no significant violations of legal or contractual provisions and no borrower or lending agent default for fiscal years 2007 and 2006. There are no dividends or coupon payments owing to the securities lent. Securities lending earnings are credited to the System's account on approximately the fifteenth day of the following month.

Indemnification deals with the situation in which a client's securities are not returned due to the insolvency of a borrower and Northern Trust has failed to live up to its contractual responsibilities relating to the lending of those securities. Northern Trust's responsibilities include performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable Department of Labor and Federal Financial Institutions Examination Council regulations concerning securities lending.

As of December 31, 2007 and 2006, respectively, the System owned the following investments that were in possession of a borrowing financial institution:

<u>2007</u>	<u>Market Value of Loaned Securities Collateralized by Cash Collateral</u>	<u>Cash Collateral</u>	<u>Market Value of Loaned Securities Collateralized by Non-Cash Collateral</u>	<u>Non-Cash Collateral</u>
Security Type				
US Equities	\$26,358,975	\$27,046,686	\$ 66,091	\$ 67,705
Global Equities	487,534	513,315	147,373	146,959
Total	<u>\$26,846,509</u>	<u>\$27,560,001</u>	<u>\$213,464</u>	<u>\$214,664</u>
<u>2006</u>	<u>Market Value of Loaned Securities Collateralized by Cash Collateral</u>	<u>Cash Collateral</u>	<u>Market Value of Loaned Securities Collateralized by Non-Cash Collateral</u>	<u>Non-Cash Collateral</u>
Security Type				
US Equities	\$29,044,650	\$29,864,558	\$233,425	\$239,921
Global Equities	1,422,153	1,470,009	0	0
Total	<u>\$30,466,803</u>	<u>\$31,334,567</u>	<u>\$233,425</u>	<u>\$239,921</u>

NOTE 7: CONTRIBUTIONS

The System is funded by biweekly contributions from the basic compensation, consisting of base pay and longevity pay, of police officers and by contributions from the City. Under the provisions that were in effect on December 31, 2007, participants were required to contribute 13% of their basic compensation to the System, effective October 1, 2007.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

NOTES TO FINANCIAL STATEMENTS

NOTE 7: CONTRIBUTIONS

The City is required to make contributions equal to 18% of basic compensation and could authorize additional contributions. Since September 1, 2003, a portion of the City's total 18% contribution has been allocated to the Retiree Death Benefit Fund. This portion, redetermined annually, was 0.081% for 2007 based on the December 31, 2005 actuarial valuation and is 0.100% for 2008 based on the December 31, 2006 actuarial valuation. This portion was redetermined based on the December 31, 2007 actuarial valuation to be 0.091% for 2009.

The City contribution rate is required by the state law governing the System and may be changed by amendment made by the Legislature of the State of Texas. The participant contribution rate must be at least 6% but was increased from 9% to 11% effective October 2006 and to 13% effective October 2007 by a recommendation of the Retirement Board and an approving vote of the participating members in accordance with the state law governing the System. The participant contribution rate may be changed by amendment made by the Legislature of the State of Texas or by appropriate actions of the Board and the participating members in accordance with the state law governing the System.

While contribution rates are not actuarially determined, state law requires that each plan of benefits adopted by the System must be approved by a qualified actuary. The actuary certifies that the contribution commitment by the police officers and the City provides an adequate financing arrangement at the time any change is made. Using the entry age actuarial cost method, the System's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the System's unfunded actuarial accrued liability, and the number of years needed to amortize the System's unfunded actuarial accrued liability is determined using an open, level percentage of payroll method. Based on the actuarial valuation as of December 31, 2007 and the plan provisions recognized in that valuation, the normal cost was 21.839% of pay and the amortization period was 23.8 years.

NOTE 8: COMMITMENTS

The System's investments in real estate and partnership interests are included in the table appearing in note 5. In connection with those investments, the System has remaining commitments as of December 31, 2007 and 2006 of approximately \$63.1 million and \$34.0 million, respectively, pursuant to the terms of the respective interests.

NOTE 9: SUBSEQUENT EVENTS

On January 4, 2008, the APRS's investment in Edisons, L.P., Bobcat Inns, was sold and a 15% General Partner fee was paid out of the proceeds.

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

DISCLOSURES IN ACCORDANCE WITH GASB STATEMENT NO 25
REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

I. Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Entry Age Actuarial Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a/b)	Annual Covered Payroll ¹ (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
12/31/02 ²	\$298,781,560	\$384,991,799	\$86,210,239	77.6%	\$79,236,366	108.8%
12/31/03	320,354,298	413,964,994	93,610,696	77.4	80,958,862	115.6
12/31/04 ³	343,446,574	451,579,880	108,133,306	76.1	86,673,590	124.8
12/31/05 ³	371,504,533	494,640,856	123,136,323	75.1	93,428,957	131.8
12/31/06 ^{3,4}	417,283,844	576,125,324	158,841,480	72.4	100,090,151	158.7
12/31/07 ³	482,303,290	637,559,674	155,256,384	75.6	111,809,091	138.9

¹The covered payroll is based on the annual rate of base pay and longevity pay used in the valuation

²Reflects changes in plan benefit provisions effective September 1, 2003

³Some of the actuarial assumptions were revised

⁴Reflects changes in plan benefit provisions effective September 1, 2007 and December 1, 2007

II. Schedule of Employer Contributions

Plan Year Ended December 31	Annual Contribution As a Fixed Percentage of Payroll	Annual Required Contribution ¹	Percentage Contributed
2002	18%	\$12,566,293	100%
2003	18.000/17.906 ²	13,929,724 ³	100
2004	17.906	14,714,174 ⁴	100
2005	17.902	15,754,922 ⁵	100
2006	17.906	16,945,167 ⁶	100
2007	17.919	18,510,066 ⁷	100

¹ The annual required contribution is based on actual covered payroll

² Effective September 1, 2003, a portion of the Employer's total 18% contribution is allocated to a Retiree Death Benefit Fund

³ The employer's total contribution during 2003 including the Retiree Death Benefit Fund was \$13,950,555

⁴ The employer's total contribution during 2004 including the Retiree Death Benefit Fund was \$14,794,834

⁵ The employer's total contribution during 2005 including the Retiree Death Benefit Fund was \$15,840,395

⁶ The employer's total contribution during 2006 including the Retiree Death Benefit Fund was \$17,033,469

⁷ The employer's total contribution during 2007 including the Retiree Death Benefit Fund was \$18,594,236

**CITY OF AUSTIN
POLICE RETIREMENT SYSTEM**

**DISCLOSURES IN ACCORDANCE WITH GASB STATEMENT NO 25
REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)**

III. Notes to Required Supplementary Information

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

Valuation date	December 31, 2007
Actuarial cost method	Entry Age
Amortization method	Level percentage of projected payroll, open
Amortization period	23.8 years
Asset valuation method	Market value smoothed by a 5-year deferred recognition method with a 80%/120% corridor on market
Actuarial assumptions	
- Investment rate of return, net of expenses	8.0%
- Projected salary increases including promotion and longevity	4.0% to 22.0% per year, averaging 6.8%
- Inflation rate per year	4.0%
- Postretirement cost-of-living adjustments	None