Montemayor Hill & Company, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
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, 2011, and 2010 and the related statements of changes in plan net assets for the year 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 audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the System as of December 31, 2011, and 2010 and the change in its financial status for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (MD&A) on pages 15 through 19 and the required supplementary information on page 39 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 the financial reporting for placing the basic financial statements in an appropriate operational, economic, and historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's response to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Montemayor Hill & Company, P.C.

15 August 2012
Austin, Texas

3001 SOUTH LAMAR BOULEVARD
SUITE 320
AUSTIN, TEXAS 78704
PHONE: 512.442.0380
FAX: 512.442.0817
www.montemayorhill.com

City of Austin Police Retirement System
Management 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 2011 and 2010. 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 decreased by ($8.5) million or negative (1.72%) in 2011 and increased by $60.58 million, or positive 14.0% in 2010. The asset decrease in 2011 is result of US security rating downgrade and Eurozone debt worries within the PIIGS (Portugal, Italy, Ireland, Greece and Spain) countries in 2011. The asset increase in 2010 is a direct result of global market equity recovery provided by economic stimulus packages, applied by the US Federal Reserve after the Great Global Recession December 2007- July 2009.

- Contributions increased by $3.6 million, or 8.88% in 2011 and increased by $1.63 million, or 4.25% in 2010. The increase in 2011 is due to increases in the City of Austin's required contributions to 20.63% effective October 1, 2011 from 19.63% , 3% general wage increase, and increase in number of participants. The increase in 2010 is due to increase in City of Austin's required contributions to 19.63% from 18.63% effective October 1, 2010, 3% general wage increase, and increase in number of participants.

- The amount of benefits paid to retired members, beneficiaries and refunded to terminating employees increased approximately $4.0 million, or 12.9% during 2011and $2.7 million, or 9.6% during 2010. The increase in 2011 is due to the increase in number of System retirees by 9.3% and increase in 2010 is due to the increase number of retirees by 7.0%.

- The System's rate of return on investments for the year ended December 31, 2011 was negative (2.7%) gross of fees and negative (3.1%) net of fees, on a market value basis, which was less than the return of 12.11% gross of fees and 10.86% net of fees for the year ended December 31, 2010.

- The funding objective of the System is to meet long-term benefit obligations through contributions and investment income. As of December 31, 2011, the date of the most recent actuarial valuation, the System's funding ratio of actuarial assets as a percentage of actuarial liabilities is 67.2% which is down from the 70.5% level at December 31, 2010. This is primarily due to unfavorable investment experience. The actuarial assumed rate of return is 8.00%, net of fees and administrative expenses.

City of Austin Police Retirement System
Management Discussion and Analysis

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.

Financial Analysis

Summary of Plan Net Assets

December 31, 2011, 2010 and 2009

Assets	2011	2010	2009
Cash, receivables and prepaids	$ 6,240,318	$ 2,490,384	$ 3,169,153
Investments, at fair value	477,832,263	489,900,855	428,570,639
Fixed assets, net	656,545	744,435	819,796
Total assets	484,729,126	493,135,674	432,559,588
Liabilities			
Total liabilities	640,495	590,455	532,034
Net assets held in trust for pension benefits	$484,088,631	$492,545,219	$432,027,554

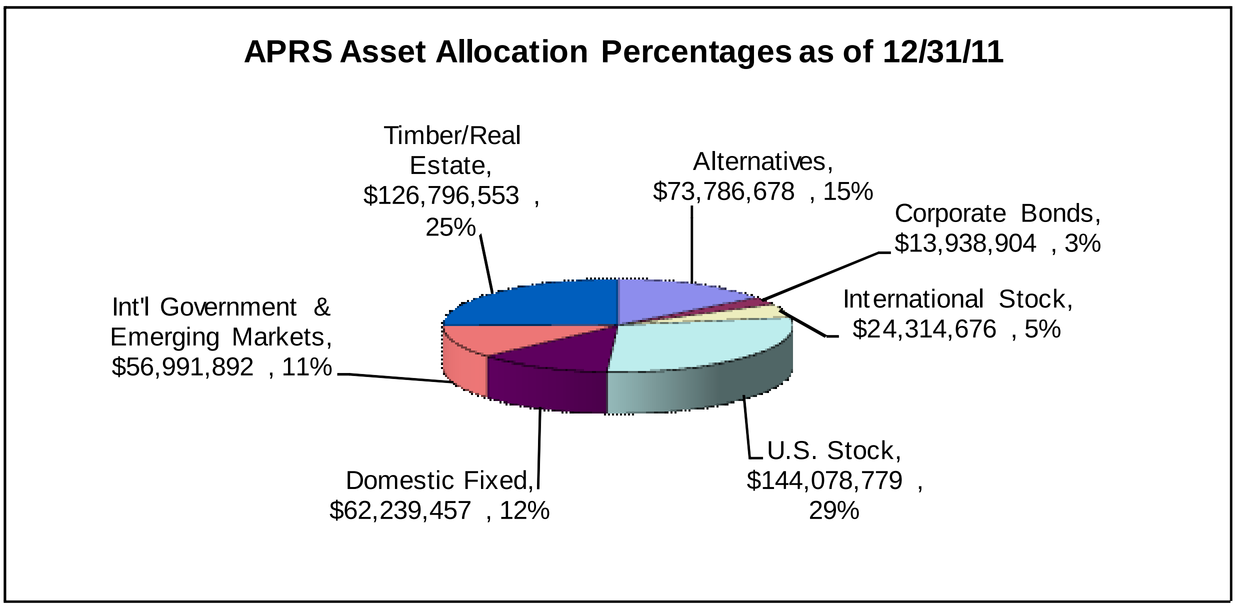
City of Austin Police Retirement System
Management Discussion and Analysis

Assets. The Systems' net assets held in trust for pension benefits decreased by ($8.5) million in 2011, increased by $60.5 million in 2010, and increased by $44.9 million in 2009. The 2011 decrease reflects the volatile global market brought on by Eurozone debt worries within the PIIGS (Portugal, Italy, Ireland, Greece and Spain) countries in 2011. The 2010 increase reflects the equity market rebound in the global economy brought on by stimulus packages provided in bailout monies and guarantees to the financial markets by the U.S. and other countries in order, to avert severe global recession.

The increase in cash, receivables and prepays of approximately $3.7 million in 2011 is primarily due to more interest, dividends receivables in global fixed income investment . The increase in cash, receivables and prepays of approximately $678 thousand in 2010 is primarily due to interest, dividends and contribution receivables at year end.

Total investments were $484.7 million at the end of fiscal year 2011, $493.1 million at the end of fiscal year 2010 and $432.6 million at the end of fiscal year 2009, which is a decrease of ($8.5) million, or negative (1.72%), for fiscal year 2011.

Below is a chart of the System's asset allocation for fiscal year ending December 31, 2011:



City of Austin Police Retirement System
Management Discussion and Analysis

Liabilities. Liabilities increased by $50 thousand in 2011 and increased by $58 thousand in 2010. The increase in 2011 is primarily due to more payables at year end. The increase in 2010 is primarily due to more contributions refunds being due and payable at year end.

Summary of Changes in Plan Net Assets

Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
Additions			
Contributions	$ 43,641,189	$ 40,081,162	$ 38,447,581
Investment income	(14,200,799)	54,287,435	37,460,898
Investment expenses	(2,179,850)	(2,143,930)	(2,007,344)
Net investment income	(16,380,649)	52,143,505	35,453,554
Other income	103,329	91,722	97,852
Total additions	27,363,869	92,316,389	73,998,987
Deductions			
Benefit payments & contributions refunded	34,862,987	30,875,847	28,173,153
General and administrative expenses	957,470	922,877	918,700
Total deductions	35,820,457	31,798,724	29,091,853
Net increase/decrease	(8,456,588)	60,517,665	44,907,134
Net assets held in trust for pension beginning of year	492,545,219	432,027,554	387,120,420
Net assets held in trust for pension end of year	$484,088,631	$492,545,219	$432,027,554

Additions. Funds to pay benefits are accumulated through contributions and returns on invested funds. Member and City of Austin contributions for 2011 and 2010 totaled $43.6 million and $40.0 million, respectively. The 2011 contributions represent an increase of $3.6 million, or approximately 8.88% above the 2010 level and the 2010 contributions represent an increase of $1.63 million, or approximately 4.25% above 2009 level. The increase in 2011 is due to City of Austin contributions increasing to 20.63% effective October 1, 2011 from 19.63%, 3% general wage increase and increase in members. The increase in 2010 is due to City of Austin contributions increasing to 19.63% from 18.63% effective October 1, 2010, 3% general wage increase.

City of Austin Police Retirement System
Management Discussion and Analysis

The System incurred a negative market to market value on its investments of negative (1.72%) during 2011 and positive return 14.01 % during 2010. The 2011 loss of $8.4 million was due to US and global market declines brought on by the debt worries and US security rating downgrade; 2010 gains of $60.5 million were due to recovery of the portfolio fund assets over previous year. Net investment income in 2009 of $44.9 million was due to massive economic stimulus provided by U.S. and other countries to prevent complete global financial collapse. Interest, dividend income generated in 2011 of $9.3 million was increase from the $5.7 million received in 2010. The total rate of return for the System's investment portfolio in 2011 was negative (3.1%) (net of investment fees) as compared to positive 10.6% (net of investment fees) for 2010.

Deductions. The expenses paid by the System include benefit payments, refunds of member contributions, and administrative expenses. Benefits paid to retirees, beneficiaries and alternate payees in 2011 were $34.3 million, an increase of $4.0 million over the $30.3 million paid in 2010. This is consistent with the increase in the number of retirees, beneficiaries and alternate payees to 585 in 2011 from 540 in 2010. Refunds to terminating employees in 2011 decreased by $28 thousand from 2010 refunds paid. Administrative expenses in 2011 were $957 thousand, approximately $34,500 more than those incurred in 2010.

Investment expenses paid by the System annually increased by $35.9 thousand in 2011 and increased by $136 thousand in 2010. The increase in 2011 is due to investment legal fees, and the increase in 2010 is due to market performance fee increases on investment assets.

Overall Analysis. As of December 31, 2011, net assets decreased by ($8.4) million or negative (1.72%) from prior year and over the five-year period ending December 31, 2011 the net assets were positive 2.15%. The past five-year period growth was dramatically impacted in 2008 by global market financial collapse at major banks, insurance, investment banks and brokerage firms, 2008 subprime liquidity crisis in the US mortgagee market, and 2011 sovereign debt crisis in U.S. and European countries.

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.

Statement of Plan Net Assets
December 31, 2011 and 2010

ASSETS

	2011	2010
Investments, at fair value		
Real estate interests	$126,796,553	$114,332,543
Corporate stocks	144,078,779	159,866,871
Government bonds	0	7,805,823
International government securities	32,677,216	53,346,493
International stocks	24,314,676	23,977,184
Short-term investment funds	14,285,087	10,647,971
Partnership interests	47,466,319	47,946,856
Corporate bonds	13,938,904	16,605,560
Alternatives	73,786,678	54,963,696
Retiree death benefit fund	488,051	407,858
Total investments	477,832,263	489,900,855
Cash	83,784	311,721
Interest and dividends receivable	4,422,524	801,965
City of Austin retirement contributions receivable	1,021,301	779,634
City of Austin death benefit contributions receivable	5,401	4,137
Deferred Revenue	0	(5,715)
Participant contributions receivable	667,356	565,892
Proportionate retirement program contributions receivable	32,341	27,197
Fixed assets, net	656,545	744,435
Other	7,611	5,553
	484,729,126	493,135,674
LIABILITIES		
Accounts payable and accrued liabilities	516,296	462,698
Refunds payable	124,199	127,757
	640,495	590,455
NET ASSETS HELD IN TRUST AVAILABLE FOR PENSION BENEFITS	$484,088,631	$492,545,219

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

Statement of Changes in Plan Net Assets
December 31, 2011 and 2010

	2011	2010
ADDITIONS TO PLAN NET ASSETS:		
Contributions:		
City of Austin retirement contributions	$25,948,297	$23,382,043
City of Austin death benefit contributions	140,482	119,860
Participant contributions	17,552,410	16,579,259
	43,641,189	40,081,162
Investment income:		
Net increase (decrease) in the fair value of investments	(23,588,309)	48,574,726
Interest and dividends	9,387,510	5,712,709
Securities lending	0	0
Rental and other income	103,329	91,722
Total investment gain (loss) before expenses	(14,097,470)	54,379,157
Investment expenses	(2,179,850)	(2,143,930)
Net gain (loss) from investments	(16,277,320)	52,235,227
Total additions (deletions) to net assets available for benefits	27,363,869	92,316,389
DEDUCTIONS FROM NET ASSETS AVAILABLE FOR BENEFITS:		
Retirement benefit payments	34,348,065	30,345,154
Death benefit payments	50,000	37,500
Contributions refunded to terminating employees	464,922	493,193
General and administrative expenses	957,470	922,877
Total deductions from net assets available for benefits	35,820,457	31,798,724
NET INCREASE (DECREASE) IN NET ASSETS AVAILABLE FOR BENEFITS	(8,456,588)	60,517,665
Beginning net assets available for benefits	492,545,219	432,027,554
ENDING NET ASSETS AVAILABLE FOR BENEFITS	$484,088,631	$492,545,219

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

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 to plan members and their beneficiaries. 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, 2011, 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.

Notes to Financial Statements

Note 1: Organization and System Description

Permissive Service Delayed Retirement is an option allowing a member, with at least 20 years of credited pension service at termination of employment with the APD, the option to a Delayed Retirement benefit. The Delayed benefit is payable upon completion of purchase of service credit for each year of credited pension service. The maximum service credit purchase is 5 years.

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, 2011 and 2010, the assets of the Retiree Death Benefit Fund were $488,051 and $407,858, respectively, which are included in the System's total market value of Net Assets Held in Trust Available for Pension Benefits of $484,088,631 and $492,545,219, 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.

Beginning in 2009, the System and the city began participating in the Texas Statewide Proportionate Retirement Program (PRP). Service in other participating public employment retirement systems can be combined with service in the System to satisfy the System's requirements for service retirement eligibility and for eligibility for vested benefits for a terminated member. The participating systems, in addition to the System, are the six Texas statewide systems, the City of Austin Employees' Retirement System, and the systems for the City of El Paso employees.

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, 2011 and 2010:

	2011
Retirees and beneficiaries currently receiving benefits 585 and terminated employees entitled to future monthly benefits 20	605
Current participating members	1,690
2011 Total	2,295

Notes to Financial Statements

Note 1: Organization and System Description

	2010
Retirees and beneficiaries currently receiving benefits (543) and terminated employees entitled to future monthly benefits (21)	564
Current participating members	1,624
2010 Total	2,188

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, 2011 and 2010, 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.

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.

Notes to Financial Statements

Note 2: Summary of Significant Accounting Policies

SYSTEM EXPENSES

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

SUBSEQUENT EVENTS

Management has evaluated subsequent events as of August 15, 2012 the date the financial statements were available to be issued.

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, 2011 consisted of:

	Beginning Balance	Additions	Deletions	Ending Balance
Assets not being depreciated				
Land	$150,000	$	$	$150,000
Assets being depreciated				
Buildings and improvements	870,216			870,216
Furniture and equipment	478,954		(4,122)	474,832
Leasehold improvements	56,986			56,986
Accumulated depreciation	(811,721)	(87,890)	4,122	(895,489)
Net Fixed Assets	$744,435	($87,890)	$	$656,545

Notes to Financial Statements

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, April 2007 and July 2009.

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.

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, 2011 and 2010 are presented, by type, as follows:

Investment Type	2011	2010
Real Estate Interests	$126,796,553	$114,332,543
Corporate Stocks	144,078,779	159,866,871
Government Bonds		7,805,823
International Government Securities	32,677,216	53,346,493
International Stocks	24,314,676	23,977,184
Partnership Interests	47,466,319	47,946,856
Corporate Bonds	13,938,905	16,605,560
Alternatives	73,786,678	54,963,696
Short-term Investment Funds	14,737,138	11,055,829
Total Investments	$477,832,263	$489,900,855

Notes to Financial Statements

Note 5: Deposit and Investment Risk

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 $250,000 coverage by FDIC are covered by pledged securities held as collateral. As of December 31, 2011 and 2010, the System's operating bank balance of $83,784 and $311,721, 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, 2011 and 2010, 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.

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, 2011 and 2010, there is no security issued by a single issuer that holds more than 5% of the System's fund. However, as of December 31, 2011 & 2010 there is one organization – Rockspring Capital Land– that holds more than 5% of the System's total fund. As of December 31, 2011 and 2010, Rockspring Capital Land holds approximately 5.41% and 5.33% respectively.

Notes to Financial Statements

Note 5: Deposit and Investment Risk

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:

Class	Allowable Range	Target Asset Allocation
Equity	20% - 65%	40.00%
U.S. Large Cap	0% - 55%	
U.S. Small Cap	0% - 30%	
International	0% - 35%	
Special Situations	0% - 30%	
Fixed Income	10% - 70%	20.00%
Investment Grade	0% - 50%	
High Yield	0% - 25%	
International	0% - 30%	
Private	0% - 25%	
Real Estate	0% - 40%	25.00%
Real Estate	0% - 30%	
Timber	0% - 15%	
Alternatives	0% - 30%	15.00%
Hedge Funds	0% - 30%	
Private Equity	0% - 20%	

Notes to Financial Statements

Note 5: Deposit and Investment Risk

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.

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 15% of the Fund's assets, to avoid undue manager concentration, unless that manager is assigned an investment grade core bond mandate, whereby it may be permitted to manage up to 25% of the fund's assets
- 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

Notes to Financial Statements

Note 5: Deposit and Investment Risk

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.

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, 2011, the System had the following investments and maturities:

Investment Type	Fair Value	Less than 1 year	1 to 6 years	6 to 10 years	Over 10 years
Corporate Bonds	$13,468,534	$5,000,000	$6,834,830	$758,735	$874,969
International Securities	37,059,389	36,679,439	379,950		
Government Bonds					
Totals	$50,527,923	$41,679,439	$7,214,780	$758,735	$874,969

Notes to Financial Statements

Note 5: Deposit and Investment Risk

As of December 31, 2010, the System had the following investments and maturities:

Investment Type	Fair Value	Less than 1 year	1 to 6 years	6 to 10 years	Over 10 years
Corporate Bonds	$16,605,560	$66,567	$6,544,159	$6,681,119	$3,313,715
International Securities	36,386,291	35,962,985	423,306		
Government Bonds	7,805,823	47,071			7,758,752
Totals	$60,797,674	$36,076,623	$6,967,465	$6,681,119	$11,072,467

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.

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, 2011, are as follows:

Quality Rating	Total Fair Value	Int'l Securities	Corporate Bonds	Government Bonds
A1/A+	$903,930	$903,930		
A2/A	388,100	388,100		
A3/A-	461,790	461,790		
Aa2/AA	105,622	105,622		
Aaa	115,448	115,448		
B1/B+	3,132,651	2,239,816	892,835	
B2/B	746,403		746,403	
B3/B-	2,777,294		2,777,294	
Ba1/BB+	3,180,268	2,967,120	213,148	
Ba2/BB	3,755,853	3,755,853		
Ba3/BB-	3,843,174	1,732,969	2,110,205	
Baa1/BBB+	4,750,264	4,750,264		
Baa2/BBB	1,518,880	1,518,880		
Baa3/BBB-	4,887,878	4,887,878		
B2//B and below	9,769,802	9,711,556	58,246	
Caa1/ CCC+	438,898		438,898	
Caa2/CCC	418,170		418,170	
Not Rated	24,246,535	18,591,539	5,654,996	
US Gov't Guaranteed				
Cash & Equivalent	539,164	539,164		
Total	$65,980,124	$52,669,929	$13,310,195	$

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, 2010, are as follows:

Quality Rating	Total Fair Value	Int'l Securities	Corporate Bonds	Government Bonds
A1/A+	$1,304,355	$726,553	$577,802	
A2/A	2,177,132	322,150	1,854,982	
A3/A-	1,422,209	68,200	1,354,009	
Aa2/AA	4,750	4,750		
Aaa	4,119,062	52,550		$4,066,512
A3/A-	495,792	495,792		
B1/B+	4,845,096	3,924,856	920,240	
B2/B	40,320		40,320	
B3/B-	1,754,996		1,754,996	
Ba1/BB+	2,765,078	2,557,578	207,500	
Ba2/BB	3,552,016	3,354,766	197,250	
Ba3/BB-	3,786,882	2,908,512	878,370	
Baa1/BBB+	4,236,788	3,386,176	850,612	
Baa2/BBB	3,248,374	1,183,195	2,065,179	
Baa3/BBB-	4,979,643	3,889,328	1,090,315	
B2//B and below	8,403,643	8,403,643		
Caa1/ CCC+	2,047,918		2,047,918	
C/C	478,764		478,764	
Not Rated	24,191,645	22,235,686	1,955,959	
US Gov't Guaran-teed	3,692,240			3,692,240
Cash & Equivalent	970,626	592,211	331,344	47,071
Total	$78,517,329	$54,105,946	$16,605,560	$7,805,823

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, 2011, is as follows:

Currency	-Int'l Stocks	Int'l Gov't Securities	Corp Stocks (1)	Other (2)
Euro	($958,455)	$3,935		
Mexican Peso		719,846		
Indonesia Rupiahs		273,683		
Hong Kong Dollar	1,851,216	581,582		
Japanese Yen				
Turkish New Lira		332,504		
Norwegian Krone				
British Pound	126,954	454,267		
Philipines Pesos				
Brazilian Real	2,491,469	1,621,287		
Danish Krone				
Swiss Franc	2,732,503			
Australian Dollar	1,337,335			1,715,143
Colombian Peso		198,165		
Chilean Peso		2,456		
Russian Ruble		1,312		
South Korean Won				
Canadian Dollar	2,148,633			
India Rupees		638,471		3,594,632
Nigeria Nairas				
China Yuan Renminbi		501,230		
Thailand, Thai Baht				
United Arab Emirates Dirhams		865,979		
Other		825,203		
Totals	$9,729,655	$7,019,920	$	$5,309,775

(1) Represents a commingled pool in global equity investments
(2) Represents a commingled timberfund and a real estate partnership interest.

Notes to Financial Statements

Note 5: Deposit and Investment Risk

The System's exposure to foreign currency risk as of December 31, 2010, is as follows:

Currency	-Int'l Stocks	Int'l Gov't Securities	Corp Stocks (1)	Other (2)
Euro	$611,939	$14,427		
Mexican Peso		566,620		
Indonesia Rupiahs		615,594		
Hong Kong Dollar	1,053,918	125,662		
Japanese Yen	189,990			
Turkish New Lira				
Norwegian Krone		408,512		
British Pound	2,012,802	293,781		
Philipines Pesos		196,564		
Brazilian Real	1,805,955	2,387,615		
Danish Krone				
Swiss Franc	2,303,591			
Australian Dollar	1,335,408			$1,720,896
Swedish Krona				
Singapore Dollar				
Russian Ruble				
South Korean Won		192,957		
Canadian Dollar	1,755,893		$40,512	
India Rupees		618,959		3,243,821
Nigeria Nairas				
China Yuan Renminbi		279,874		
Thailand, Thai Baht		326,720		
United Arab Emirates Dirhams		718,028		
Other		1,313,151		
Totals	$11,069,486	$8,058,464	$40,512	$4,964,717

(1) Represents a commingled pool in global equity investments

(2) Represents a commingled timberfund and a real estate partnership interest.

Notes to Financial Statements

Note 6: 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, 2011, participants were required to contribute 13% of their basic compensation to the System, effective October 1, 2007.

The City's required contributions were equal to 18.25% of basic compensation effective January 1, 2009 and increased to 18.63% effective October 1, 2009 and to 18.63% effective October 1, 2009. The City's contribution rate increased to 19.63% on October 1, 2010 and to 20.63% effective October 1, 2011.

Since September 1, 2003, a portion of the City's total contribution has been allocated to the Retiree Death Benefit Fund. This portion, redetermined annually, was 0.091% for 2009 based on the December 31, 2007 actuarial valuation; was 0.092% for 2010 based on the December 31, 2008 actuarial valuation; was 0.098% for 2011 based on the December 31, 2009 actuarial valuation; is 0.102% for 2012 based on the December 31, 2010 actuarial valuation. This portion was redeterimed based on the December 31, 2011 valuation to be 0.103% for 2013.

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, and codified in to law in September 2011. 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, 2011 and the plan provisions recognized in that valuation, the normal cost was 23.242% of pay and the amortization period was 30.7 years.

Notes to Financial Statements

Note 7: Commitments and Contingencies

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, 2011 and 2010 of approximately $8.8 million and $23.9 million, respectively, pursuant to the terms of the respective interests.

At December 31, 2011 and 2010, the total accumulated lump sum benefit due to forward DROP participants was $2,545,058 and $1,856,241, respectively.

At December 31, 2011 and 2010, the total accumulated lump sum benefit due to PROP participants was $13,046,718 and $10,801,564, respectively.

Note 8: Funded Status and Funding Progress Pension Plans

The funded status of each plan as of December 31, 2011, the most recent actuarial valuation date, is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Of Covered Payroll ((b-a)/c)
12/31/11	$553,701,976	$824,462,075	$270,760,099	67.2%	$135,264,530	200.2%

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.

Notes to Financial Statements

Note 8: Funded Status and Funding Progress Pension Plans

Additional information as of the latest actuarial valuation follows:

Valuation date	December 31, 2011
Actuarial cost method	Entry age
Amortization method	Level percentage of projected payroll, open
Remaining amortization period	30.7 years
Asset valuation method	Market value smoothed by a 5-year deferred recognition method with a 80%/120% corridor on the market
Actuarial assumptions:	
Investment rate of return, net of expenses	8.0%
Projected salary increases	4.0 % to 22.0% per year, averaging 6.8%
Inflation rate per year	3.75%
Postretirement cost-of-living adjustments	None

Note 9: Subsequent Events

As of June 18, 2012, the System was made aware the HR Huff Energy Fund investment was successfully sued in Zavala County, TX. The System's investment in the HR Huff Energy Fund is $14,855,384. The amount awarded by the jury is yet to be determined, but is expected to range from $10.5 million to $162.5 million for the HR Huff Energy Fund in total, with the System's share of the award expected to range from $2.1 million to $3.2 million.

As of June 18, 2012, the System was made aware Land Barron Real Estate investment partnership management was being terminated and CDK Real Estate and Cushman Real Estate hired to manage partnership investments of approximately $1.3 million.

Disclosures in Accordance with GASB Statement No. 50
Required Supplementary Information

I. Schedule of Funding Progress

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

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage Of Covered Payroll ((b-a)/c)
12/31/06(3)	$417,283,844	$576,125,324	$158,841,480	72.4%	$100,090,151	158.7%
12/31/07(2)	482,303,290	637,559,674	155,256,384	75.6	111,809,091	138.9
12/31/08(2,4)	464,230,585	693,202,499	228,971,914	67.0	122,735,216	186.6
12/31/09(2)	518,111,923	733,634,660	215,522,737	70.6	122,928,285	175.3
12/31/2010 (2)	546,956,628	776,231,027	229,274,399	70.5	127,731,696	179.5
12/31/2011 (2)	553,701,976	824,462,075	270,760,099	67.2	135,264,530	200.2

1 The covered payroll is based on the annual rate of base pay and longevity pay assumed for the year following the valuation date.
2 Some of the actuarial assumptions were revised.
2 Reflects changes in plan benefit provisions effective September 1, 2007 and December 1, 2007.
3 Reflects changes in plan benefit provisions effective January 2009.

II. Schedule of Employer Contributions

Plan Year Ended December 31	Annual Contribution as a Fixed Percentage of Payroll	Actual Contribution Amount		Annual Required Contribution		Percent of ARC Contributed
			Date	AP	Rate	
2006	17.906%(2)	16,945,167(3)	12/31/2004	32.0	17.906%	100.0%
2007	17.919(2)	18,510,066(4)	12/31/2005	30.0	18.775	95.4
2008	17.900(2)	20,060,458(5)	12/31/2006	30.0	17.846	100.3
2009	18.254(6)	22,159,076(7)	12/31/2007	30.0	16.776	108.8
2010	18.788(8)	23,382,043(9)	12/31/2008	30.0	20.291	92.6
2011	19.782 (10)	25,888,511 (11)	12/31/09	30.0	19.360	102.2

1. The ARC is based on a one-year lag between the date of the actuarial valuation ("Date") and the beginning of the plan year. The ARC is expressed as a contribution rate ("Rate") that is a percent of covered payroll. An amortization period (AP) for the ARC of up to 40 years was compliant with GASB parameters through the 2006 plan year. After the 2006 plan year, an AP of up to 30 years is compliant.
2. A portion of the Employer's total 18% contribution is allocated to a Retiree Death Benefit Fund.
3. The employer's total contribution during 2006 including the Retiree Death Benefit Fund (RDBF) was $17,033,469.
4. The employer's total contribution during 2007 including the RDBF was $18,594,236.
5. The employer's total contribution during 2008 including the RDBF was $20,171,151.
6. The employer's total contribution rate was 18.25% January-September 2009 and 18.63% October-December 2009. The average contribution rate was 15.254% (18.345% total average—0.091% for the RDBF)
7. The employer's total contribution during 2009 including the RDBF was $22,272,667.
8. The employer's total contribution rate was 18.63% January-September 2010 and 19.63% October-December 2010. The average contribution rate was 18.788% (18.88% total average—0.092% for the RDBF)
9. The employer's total contribution during 2010 including the RDBF was $23,501,903.
10. The employer's total contribution rate was 19.63% January-September 2011 and 20.63% October-December 2011. The average contribution rate was 19.782% (19.88% total average—0.098% for the RDBF)
11. The employer's total contribution during 2010 including the RDBF was $26,028,992.

See independent auditor's report