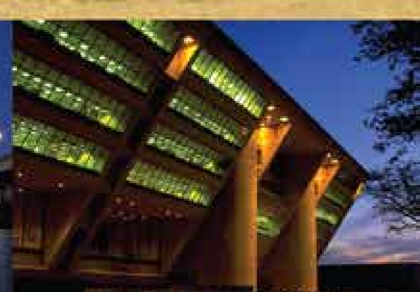
# Employees' Retirement Fund
## of the City of Dallas

## 2003 Comprehensive Annual Financial Report

**Fiscal Year Ended December 31, 2003**



# EMPLOYEES' RETIREMENT FUND
## OF THE CITY OF DALLAS

COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003

JOHN KLOEHR
ADMINISTRATOR

Office Location and Mailing Address
EMPLOYEES' RETIREMENT FUND
600 North Pearl, Suite 2450
Dallas, Texas 75201

Prepared by the Staff of The Employees' Retirement Fund

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# TABLE OF CONTENTS

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# INTRODUCTORY SECTION

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**Employees' Retirement Fund of the City of Dallas**

600 North Pearl Street
Suite 2450
Dallas, Texas 75201

Telephone 214-580-7700
FAX 214-580-3515

LETTER OF TRANSMITTAL

July 14, 2004

Board of Trustees
Employees' Retirement Fund
600 North Pearl St., Suite 2450
Dallas, Texas 75201

Dear Board Members:

The comprehensive annual financial report (CAFR) of the Employees' Retirement Fund (ERF) for the fiscal year ended December 31, 2003 is submitted herewith. Our commitment is to continue the efforts to improve the service to our members and benefit recipients. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation rests with me and the staff of ERF.

Report Contents

This CAFR is divided into five sections: an Introductory Section, which contains the administrative organization, a letter of transmittal, and the Plan Summary; a Financial Section, which contains the report of the Independent Auditors, the financial statements of ERF and certain required supplementary information; an Investment Section, which contains a report on investment activity, investment policies, investment results, and various investment schedules; an Actuarial Section, which contains an Actuary's Certification Letter and the results of the annual actuarial valuation; and a Statistical Section, which includes significant data pertaining to ERF. I trust that you and the members of ERF will find this CAFR helpful in understanding your retirement plan.

Plan Overview

ERF was established by ordinance in November 1943 and became effective in January 1944 after ratification by the voters of the City of Dallas. ERF is a single-employer defined benefit pension plan sponsored by the City of Dallas (the "City"), and it provides retirement, disability and death benefits to its members. All employees of the City are members except police officers, fire fighters, elected officers, non-salaried appointee members of administrative boards or commissions, part-time employees working less than one-half time, temporary employees, individuals working under contract, and individuals whose salaries are paid in part by another government agency. Members are entitled to retirement benefits at the date of eligibility for retirement after five years of service or to survivor benefits after two years of service.

Major Initiatives

Three major initiatives were under taken during the year. First, a new small cap manager search resulted in the hiring of Systematic Financial Management with the funding being provided from the liquidation of the Russell 2000 Small Cap Index fund. The second initiative was a rebalancing of the Fund's equity and fixed income accounts. Because of the strong equity markets in 2003 transfers from the equity managers to the global fixed income managers was necessary to keep the asset allocation policy in balance. The third initiative was the participation by two of the Trustees on the Study Committee the City Council appointed to look again at the under funded status of the Fund. The committee has completed its work and the City Council and the Board of Trustees voted to support its recommendation.

Investments

The Board of Trustees oversees the Fund's portfolio, managers, and performance. It also reviews and approves potential investment opportunities, with input from the investment consultant and staff. The Board follows the "prudent person rule" which states that fiduciaries shall discharge their duties solely in the interest of the fund and its participants and beneficiaries with the degree of diligence, care and skill which prudent men and women would ordinarily exercise under similar circumstances in a like position.

2003 was the first positive return since 1999. The total Fund return for 2003 was 26.66%. The Fund's total return for the past three years was 2.7%, and the last five years was 4.1%. ERF expects and assumes an investment rate of return of 8.5% over the long term, which encompasses many years in the future.

An integral part of the overall investment policy is the strategic asset allocation policy. This policy is designed to provide an optimal diversification to reduce risk and maximize total rate of return relative to risk. This emphasizes a maximum diversification of the portfolio that protects ERF from declines that a particular asset class may experience in a given period. Although traditional and alternative assets were incorporated into the asset allocation mix in 2003, the alternative venture capital asset class is being liquidated from ERF's portfolio, and is not a part of the strategic asset allocation policy. ERF has incorporated a restricted derivatives program in selected equity and fixed income portfolios as an investment technique to reduce volatility and enhance the portfolio returns over a full-market cycle.

Additions To Plan Net Assets

The collection of employer and member contributions, as well as income from investments, is intended to provide the reserves needed to finance retirement benefits. Contribution and investment income, including unrealized gains and losses for 2003, totaled $467,437,000. Member and employer contributions decreased $1,191,000 (5%) and $1,877,000 (5%) respectively.

Deductions To Plan Net Assets

The principal purpose for which ERF was established is to provide retirement benefits, survivor benefits, and total and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, refund of contributions to terminated employees, and the cost of administering ERF.

In 2003 expenses totaled $113,126,000. This represents an increase of $11,267,000 or 11%. Administrative expenses are controlled by a budget approved by the Board of Trustees, and these expenses increased $175,000 or 9%.

Accounting System And Internal Controls

This CAFR was prepared to conform with the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board (GASB) in Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," as well as generally accepted accounting principles that apply to government accounting for fiduciary funds. The accompanying financial statements are prepared using the accrual basis of accounting. Member and employer contributions are recognized in the period in which employee services are performed. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

In developing and evaluating ERF's accounting system, it was determined that internal controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Funding

A pension fund is well funded when it is receiving enough money to meet all expected future obligations to participants. ERF's funding objective is to meet long-term benefit payments through contributions that remain approximately level as a percent of member payroll. The advantage of a well-funded plan is that the participants can look at assets that are committed to the payment of benefits. The actuarial accrued liability and actuarial value of assets of ERF as of December 31, 2003 amounted to $2.5 billion and $1.8 billion, respectively. A detailed discussion of funding is provided in the Actuarial Section of this report.

Professional Services

Consultants are appointed by the Board of Trustees to perform professional services that are essential to the effective and efficient operation of ERF. An opinion from the certified public accounting firm of KPMG LLP and the actuarial firm of Gabriel, Roeder, Smith & Company are included in this report. The consultants appointed by the Board are listed in this Introductory Section.

Acknowledgments

The compilation of this report reflects the combined effort of the staff under the leadership of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the funds of ERF.

The report is available to all members of ERF.

I would like to express my gratitude to the staff, the advisors, and others who have worked so diligently to assure the successful operation of ERF.

Respectfully submitted,

John Kloehr
Administrator

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# Board of Trustees

As of December 31, 2003



# Administrative Staff

John Kloehr, Administrator

Gail Smith, Assistant Administrator

Newton Bruce, Assistant Administrator

Evelyn Thomas, Accounting Supervisor

Judith Greene, Accountant

Sheila Willis, Pension Benefit Specialist

Re’Gine Wallace, Pension Benefit Specialist

Berda Venerable, Management Assistant

Melissa Harris, Communication Specialist

Sharon Paukert, Management Assistant

Michelle Greer, Management Assistant

Duc Lam, Database Analyst

Jill Lang, Information Technology Analyst

Lisa Larry, Office Assistant

Beth Turner, Office Assistant

## Master Custodian

The Northern Trust Company

## Consulting Actuary

Gabriel, Roeder, Smith & Company

## Investment Consultants

Wilshire Associates, Inc.

## Investment Accounting Firm

Financial Control Systems, Inc.

## Auditors

KPMG LLP

## Legal Advisors

City Attorney's Office
Lawson and Fields

## PLAN SUMMARY

### SUMMARY OF KEY PROVISIONS
Employees' Retirement Fund of the City of Dallas

As of December 31, 2003

| | |
|---|---|
| Membership | An employee becomes a member upon permanent employment and contributes to the Retirement Fund. |
| Contributions | Member: 6.5% of compensation<br><br>City: The City contributes an amount not less than the amount contributed by its employees, currently 11.0% of member wages. |
| Definitions | Final Average Salary: Average monthly salary over the member's highest three years of service.<br><br>Credited Service: Length of time an employee of the City of Dallas and while making contributions to the Fund. Part-time employees receive proportional credited service only. |
| Retirement Pension | Eligibility:<br><br>a. Attainment of age 60; or<br>b. Attainment of age 55 (if credited service began before May 9, 1972); or<br>c. Completion of 30 years of credited service; or<br>d. At any age after completion of 30 years of credited service with a reduced benefit before age 50; or<br>e. Attainment of age 50, if the sum of an active member's age and credited service is at least 78. |
| Retirement Benefits | The retirement benefit equals 2-3/4% multiplied by average monthly earnings multiplied by credited service limited to a maximum of 36.3636 years plus $125 health supplement (prorated for service less than 5 years). |
| Form of Payment | An unreduced pension under a joint and one half survivor option or a ten-year certain and life option. An actuarially equivalent joint and full survivor option is also available. |
| Deferred Retirement | Eligibility: Deferred retirement pension commencing at age 60 or at age 55, if employment commenced prior to May 9, 1972, with at least five years of credited service, and accumulated contributions are left on deposit with the Fund.<br><br>Monthly Benefit: The deferred retirement is equal to the retirement pension based on earnings and credited service at the time of termination. |

| | |
|---|---|
| Disability Retirement Pension | Non-Service Disability: |
| | 1. Eligibility: Five years of service and totally and permanently incapacitated from procuring and retaining any type of employment for compensation. |
| | 2. Monthly Benefit: Computed based on average monthly earnings and credited service at time of disability but not less than 10 times the percentage multiplier multiplied by the average monthly earnings. |
| | Service Disability: |
| | 1. Eligibility: Totally and permanently incapacitated as a result of injury while in the course of employment for the City. |
| | 2. Monthly Benefit: Calculated as a non-service disability pension but not less than $500 per month. |
| Death Benefits | Form: Benefit paid in accordance with the option on file, or the eligible option, or if no eligible beneficiary, a lump sum equivalent of 10 years of benefit payments to the member's estate. If less than 2 years of service, contributions are refunded. |
| | Monthly Benefit: Based on average monthly earnings and credited service at death but not less than 10 times the percentage multiplier multiplied by the average monthly earnings. |
| | Minimum Service Death Benefit: Not less than $500 per month if death resulted from a service related injury. |
| Return of Accumulated Contributions | A member at the time of termination is entitled to be paid their accumulated contributions without interest. |
| Cost-of-Living Adjustments | A cost-of-living adjustment to the base pension shall be made based on the greater of: |
| | The percentage of change in the price index for October of the current year over October of the previous year up to 5%, or |
| | The percentage of annual average change in the price index for the 12 month period ending with the effective date of the adjustment, up to 5%. |

# FINANCIAL SECTION

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EMPLOYEES' RETIREMENT FUND OF THE CITY OF DALLAS

# Financial Statements
# As Of December 31, 2003 and 2002

With Independent Auditor's Report Thereon

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KPMG LLP
Suite 3100
717 North Harwood Street
Dallas, TX 75201-6585

**Independent Auditors' Report**

To the Board of Trustees of the
Employees' Retirement Fund of
the City of Dallas:

We have audited the accompanying statements of plan net assets of the Employees' Retirement Fund of the City of Dallas (the Plan) as of December 31, 2003 and 2002, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Employees' Retirement Fund of the City of Dallas as of December 31, 2003 and 2002, and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, the schedule of funding progress included in note 4, and the schedule of city contributions included in note 1(d) are not a required part of the basic financial statements of the Plan, 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 supplementary information. However, we did not audit this information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules listed in the financial section of the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These schedules are the responsibility of the Plan's management. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section, statistical section and actuarial section have not been subjected to the auditing procedures applied by us in the audits of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

May 27, 2004

# MANAGEMENT'S DISCUSSION AND ANALYSIS
(Required Supplementary Information)

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of the Employees' Retirement Fund of the City of Dallas' (The Fund) financial performance provides an overview of the financial activities and funding conditions for the fiscal years ended December 31, 2003, 2002 and 2001.

## FINANCIAL STATEMENTS

The Fund is a defined benefit plan. As such the Fund has two basic financial statements: a statement of plan net assets that provides information about the fair value and composition of plan assets, plan liabilities, and plan net assets; and a statement of changes in plan net assets that provides information about the year-to-year changes in plan net assets. Notes to the financial statements include a brief plan description, a summary of significant accounting policies, and information about contributions, legally required reserves, and investment concentrations.

## CONDENSED FINANCIAL INFORMATION

| | 2003 (in thousands) | 2002 (in thousands) | 2001 (in thousands) |
|---|---|---|---|
| Assets | $ 2,222,867 | $ 1,797,978 | $ 2,008,658 |
| Liabilities | 313,118 | 243,184 | 238,748 |
| Net Assets available for benefits | 1,909,749 | 1,554,794 | 1,769,910 |
| Contributions | 55,309 | 58,377 | 55,996 |
| Investment & other income (loss) | 412,772 | (171,634) | (103,438) |
| Benefit payments | 108,402 | 97,363 | 87,054 |
| Refund of contributions | 2,605 | 2,552 | 2,434 |
| Administrative expenses | 2,119 | 1,944 | 1,918 |

## FINANCIAL POSITION AND RESULTS OF OPERATIONS

The year 2003 was a welcome change from the prior three years for the stock markets. The Fund's total return was 26.7% as compared to a –9.7% in 2002 and –5.3% in 2001. As a result the Fund's net asset value at the end of 2003 was approximately $1.9 billion, an increase of $300 million from the 2002 year end value of approximately $1.6 billion. The net asset value at the end of 2001 was $1.8 billion.

Liabilities increased 29% in 2003 as compared to 2002. This is largely due to securities lending collateral. The volume of securities on loan in the Fund's security lending program for 2003 was higher than the 2002 volume. Year 2002 as compared to 2001 had a 1.9 % increase in liabilities. Benefit payments increased from $97.363 million to $108.402 million. This increase is attributable to the large number of retirements in 2003 and to the 1.897% cost-of-living-adjustment paid to retirees and beneficiaries. Year 2002 as compared to 2001 had a $10.3 million increase in benefit payments.

Although 2003 was extremely positive, the actuarial funding status continued to be adversely affected by the prior three negative return years as can be seen by the unfunded actuarial accrued liability of $646 million. The City and the members have contributed the legally required percentages established by Chapter 40A, however the actual contributions made by the City and the members have been less than the Actuarially Required Contribution (ARC) that is necessary to cover the amortization of the unfunded liability (as discussed in note 4) or the expense allowance components of the ARC for the previous five years. In 1999, a working group was established by the City Manager's Office and the ERF Board to evaluate strategies to address the additional funding requirements. The Working Group recommended contribution increases by the City and the employees and that an automatic contribution adjustment mechanism be incorporated into the Plan. The Board and the City Council adopted the recommendations of the working group, and in December 1999 the employee membership voted to increase their contributions to the Plan. These contribution increases began phasing in over a two-year period beginning October 1, 2000. Effective October 1, 2000 the City's contribution increased from 8.5% to 9.75% and the employee contribution increased from 5.0% to 5.75%. On October 1, 2001 the City's contribution increased from 9.75% to 11.0% and the employee contribution increased from 5.75% to 6.5%.

An additional recommendation made by the Working Group (which would require voter approval) was to put an automatic contribution adjustment mechanism in the Plan to adjust contribution rates by the City and the employees every three years based on a change of more than 2% in the actuarially required contribution rate. This recommendation was initially approved by the City Council. However, the recommended Plan change was not placed on a ballot for voter approval. A new Mayor and City Council became concerned with the size of the unfunded actuarial liability and recommended a new study be completed. A new study committee consisting of seven members was appointed in December 2003 to again study the unfunded liability issue and to make recommendations to the City Council on how to solve the problem. The Study Committee presented its report to the City Council at the May 12, 2004 Council Meeting. The Committee made several recommendations to the City Council. The primary recommendations were to issue pension obligation bonds to cover the current unfunded liability, increase the contributions of the city and employees, and place before the voters a plan change amendment that would put a modified automatic contribution adjustment mechanism in the Plan. The Council voted to support the recommendations of the Study Committee.

## CURRENT ENVIRONMENT

Due to the severe budget environment of the City of Dallas, the number of active participants in the Fund declined again in 2003. In addition 2003 saw another large number of retirements. The combination of fewer employees with lower average earnings and higher average pension payments paid to a larger number of retirees will result in a greater draw on the cash generated from investments in order to meet benefit payments and expenses.

The Fund continues to be financially sound. The Fund's investments are well diversified, and we are meeting our obligations as they become due.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Statements of Plan Net Assets

As of December 31, 2003 and 2002
(In thousands)

| | 2003 | 2002 |
|---|---|---|
| ASSETS: | | |
| Cash and short-term investments | $ 298,612 | $ 210,206 |
| Receivables: | | |
| Currency contracts | - | 1,765 |
| Accrued dividends | 1,855 | 1,718 |
| Accrued interest | 6,968 | 7,243 |
| Accrued securities lending | 35 | 43 |
| Securities sold | 16,595 | 13,043 |
| Employer contributions | 997 | 660 |
| Employee contributions | 589 | 390 |
| Total receivables | 27,039 | 24,862 |
| Investments, at quoted market value: | | |
| Commingled index funds | 495,721 | 491,277 |
| Domestic equities | 464,058 | 265,621 |
| United States and foreign government securities | 185,790 | 214,381 |
| Domestic corporate fixed-income securities | 357,620 | 286,839 |
| International equities | 393,673 | 304,285 |
| Investments, at estimated fair value: | | |
| Venture capital funds | 354 | 507 |
| Total investments | 1,897,216 | 1,562,910 |
| Total assets | 2,222,867 | 1,797,978 |
| LIABILITIES: | | |
| Accounts payable | 3,414 | 4,295 |
| Payable for securities purchased | 68,260 | 69,306 |
| Investment fees payable | 1,615 | 1,163 |
| Currency contracts | - | 1,765 |
| Currency contracts loss | - | 67 |
| Securities lending collateral | 239,829 | 166,588 |
| Total liabilities | 313,118 | 243,184 |
| NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A Schedule of Funding Progress is included in footnote 4) | $1,909,749 | $1,554,794 |

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

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Statements of Changes in Plan Net Assets

For the Years Ended December 31, 2003 and 2002
(In thousands)

| | 2003 | 2002 |
|---|---|---|
| ADDITIONS: | | |
| Contributions: | | |
| Employer | $ 34,729 | $ 36,606 |
| Employee | 20,580 | 21,771 |
| Total contributions | 55,309 | 58,377 |
| Net investment income (loss): | | |
| Dividends | 15,997 | 11,644 |
| Interest | 26,732 | 31,196 |
| Real estate income (loss) | 17 | - |
| Net appreciation (depreciation) in fair value of investments | 374,416 | (210,330) |
| Securities lending income | 2,288 | 3,161 |
| Less investment expenses: | | |
| Investment management fees | (5,147) | (4,469) |
| Custody fees | (125) | (125) |
| Consultant fees | (230) | (217) |
| Securities lending borrower rebates | (1,620) | (2,427) |
| Securities lending management fees | (200) | (220) |
| Total investment expenses | (7,322) | (7,458) |
| Net investment income (loss) | 412,128 | (171,787) |
| Other income | 644 | 153 |
| Total increases (decreases) | 468,081 | (113,257) |
| DEDUCTIONS: | | |
| Benefit payments | 108,402 | 97,363 |
| Refund of contributions | 2,605 | 2,552 |
| Administrative expenses | 2,119 | 1,944 |
| Total deductions | 113,126 | 101,859 |
| Net increase (decrease) in net assets available for benefits | 354,955 | (215,116) |
| NET ASSETS HELD IN TRUST FOR PENSION BENEFITS | | |
| Beginning of year | 1,554,794 | 1,769,910 |
| End of year | $1,909,749 | $1,554,794 |

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

# EMPLOYEES' RETIREMENT FUND OF THE CITY OF DALLAS

## Notes to Financial Statements

## December 31, 2003 and 2002

(1) Description of the Plan

(a) General

The Employees' Retirement Fund of the City of Dallas (the "Plan") is a single-employer defined benefit pension plan that provides retirement, disability, and death benefits to its members, and it is sponsored by the City of Dallas (the "City"). All employees of the City are members in the Plan, except police officers, firefighters, elected officers, non-salaried appointee members of administrative boards or commissions, part-time employees working less than one-half time, temporary employees, individuals working under contract, and individuals whose salaries are paid in part by another government agency. Members are entitled to retirement benefits after five years of service and to survivor benefits after two years of service or at the date of eligibility for retirement. The Plan was established and derives its authority to continue in operation as Chapter 40A of the Dallas City Code. The description of the Plan provisions in this report is for financial disclosure only. It is not intended to create or reduce legal rights. The rights and responsibilities of the Board of Trustees, the Plan, the members and the retirees are governed by the Plan itself in Chapter 40A. As of December 3l, 2003 and 2002, the Plan's membership consisted of:

| | 2003 | 2002 |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits and inactive members entitled to benefits but not yet receiving them | 5,306 | 5,065 |
| Current members: | | |
| Vested | 5,337 | 5,288 |
| Nonvested | 2,201 | 2,300 |
| Total current members | 7,538 | 7,588 |
| Total membership | 12,844 | 12,653 |

(b) Pension Benefits

Effective November 7, 1989, members of the Plan are entitled to pension benefits equal to 2-3/4% of the average monthly earnings of the member for each year of credited service. Average monthly earnings are determined based on the member's earnings for the three highest years. Normal retirement age is 60. Members of the Plan employed prior to May 9, 1972 are entitled to pension benefits at age 55, determined as described in this note.

A member who has completed 30 years of credited service may elect retirement at age 50 and is entitled to full pension benefits. A member who has completed 30 years of service and elects retirement before age 50 is entitled to pension benefits at a percentage of normal retirement benefits ranging from 67.0% to 93.3%, depending upon the age of the member. Effective May 1993, active members may elect to retire after the attainment of age 50 once a combination of their age and years of service equal at least 78 ("Rule of 78"), and they are entitled to full pension benefits. The provisions of this amendment have been incorporated into the actuarial calculations reflected in these notes to the financial statements.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

Cost-of-living adjustments for retirees are made each year on the first of January by adjusting the pension base by the percentage change of the Consumer Price Index, not to exceed 5%. The cost-of-living adjustments in 2003 and 2002 were 1.89% and 3.08%, respectively.

In addition, the Plan provides retirees who have 5 or more years of service a flat taxable amount of $125 per month as a health premium subsidy. Payment of the health supplement will be prorated for each partial year of credited service.

(c) Disability and Death Benefits

Members that become totally and permanently disabled receive disability benefits equal to normal retirement benefits or a minimum of $500 per month for a service connected disability.

Upon the death of an active married member with less than 15 years of service, the joint and one-half survivor option is the automatic death benefit unless the member (with spousal consent) previously elected a different survivor option.

If an active member has at least 15 years of service or is eligible to retire, the member may elect the joint and full survivor option. Under this option, the member receives a reduced base pension payment which is actuarially computed based on the member's age, average monthly earnings, years of credited service at retirement, and the relative age of the spouse. Upon the death of the member, this option pays the full amount of the member's pension payment to the surviving spouse for life.

Upon the death of a member before retirement, death benefits equal to the normal retirement benefit will be paid to a qualified recipient: surviving spouse, minor child under age 18, a disabled child who became disabled before age 18, or a dependent parent. Death benefits vary depending on the beneficiary. The surviving spouse, the disabled child, or the dependent parent will receive a lifetime benefit unless the ten-year option is taken. The minor child under age 18 will receive the normal retirement benefit for ten years or until reaching age 18. If the member has less than two years of credited service, the member's contributions will be refunded.

Upon the death of a retired member, a death benefit is paid in accordance with the option selected by the member at retirement. If there are no qualified recipients at the time of death and benefits have not been paid for ten years, death benefits are paid to the designee (an estate, a person or an entity) named by the member. The designee will receive a lump-sum payment based on ten years of benefit payments when the member's death occurs before retirement. If death occurs after retirement, the designee will receive a commuted lump-sum payment representing the balance of a guaranteed ten-year period starting from the date of retirement.

If a member does not have an eligible beneficiary, death benefits will be paid to the designee or member's estate in one commuted value payment. Benefit payments will vary depending on whether death occurred before or after retirement. Upon the death of a member before retirement, the designee or member's estate will receive a lump-sum payment based on ten years of benefit payments. Upon the death of a retired member, the designee or estate will receive a commuted value lump-sum payment representing the balance of a guaranteed ten-year period starting from the date of retirement.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

(d) Contributions

If employment ends before attaining five years of service and before attaining eligibility for retirement, the member's contributions will be refunded upon written request to the Plan.

If a member's employment is terminated after five years of service, the member may elect a refund of contributions upon a written request, or the member may elect to receive pension benefits at normal retirement age equal to the amount accrued to the date of termination.

The following table lists (unaudited) required supplementary information related to City contributions (in thousands):

| Years Ended December 31 | Annual Actuarially Required Contribution | Percentage Contributed |
|---|---|---|
| 1998 | 47,338 | 50.2 |
| 1999 | 42,227 | 59.7 |
| 2000 | 33,682 | 82.7 |
| 2001 | 31,728 | 110.9 |
| 2002 | 49,475 | 74.0 |
| 2003 | 65,849 | 52.7 |

Although the City and the members have contributed the legally required percentages established by Chapter 40A, the actual contributions made by the City and the members have been less than the Actuarially Required Contribution (ARC) that is necessary to cover the amortization of the unfunded liability (see note 4) or the expense allowance components of the ARC for the previous five years. During 1999 a working group established by the City Manager's Office and the ERF Board completed their evaluation of strategies to address the additional funding requirements. The Working Group recommended contribution increases by the City and the employees and that an automatic contribution adjustment mechanism be incorporated into the Plan. The Board and the City Council adopted the recommendations of the working group, and in December 1999 the employee membership voted to increase their contributions to the Plan. These contribution increases began phasing in over a two-year period beginning October 1, 2000. Effective October 1, 2000 the City's contribution increased from 8.5% to 9.75% and the employee contribution increased from 5.0% to 5.75%. On October 1, 2001 the City's contribution increased from 9.75% to 11.0% and the employee contribution increased from 5.75% to 6.5%.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

The other recommendation made by the Working Group which would require voter approval was to put an automatic contribution adjustment mechanism in the Plan to adjust contribution rates by the City and the employees every three years based on a change of more than 2% in the actuarially required contribution rate. This recommendation was initially approved by the City Council. However, the recommended Plan change was not placed on a ballot for voter approval. A new Mayor and City Council became concerned with the size of the unfunded actuarial liability and recommended a new study be completed. A new study committee consisting of seven members was appointed in December 2003 to again study the unfunded liability issue and to make recommendations to the City Council on how to solve the problem. The Study Committee presented its report to the City Council at the May 12, 2004 Council Meeting. The Committee made several recommendations to the City Council. The primary recommendations were to issue pension obligation bonds to cover the current unfunded liability, increase the contributions of the city and employees, and place before the voters a plan change amendment that would put a modified automatic contribution adjustment mechanism in the Plan. The Council voted to support the recommendations of the Study Committee.

The percent contributed may vary from the legally required rate as the Annual Required Contribution is based upon covered payroll as of the actuarial valuation date, January 1, whereas contributions are calculated and paid based upon actual payrolls throughout the year.

Certain factors, such as changes in benefit provisions, the size or composition of the population covered by the system or the actuarial assumptions used, may significantly affect the identification of trends in the amounts reported in this schedule.

(e) Plan Administration

The Plan is governed by a five-member Board of Trustees (the "Board") consisting of two members appointed by the City Council who may be Council members, two employee members of the Plan (elected by the membership) and the City Auditor (serving ex officio). The Board has general powers and duties to administer the Plan, including appointing an administrator to carry out the business of the Board, investing the assets of the Plan, making expenditures from the Plan, and determining members' eligibility for benefits.

The Plan may be terminated only by ordinance recommended by the Board, adopted by the City Council, and approved by a majority of the voters of the City voting in a general or special election. The Plan does not address allocation of the net assets in the event of termination.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements are prepared on the economic resources measurement focus and accrual basis of accounting. Accordingly, interest earned but not received and dividends declared but not received as of the Plan's fiscal year-end are recorded as accrued interest and dividends receivable, respectively. Contributions owed but not received (approximately $1,586,000 and $1,050,000 at December 31, 2003 and 2002, respectively) as of the Plan's fiscal year-end are recorded as contributions receivable. In addition, unsettled investment purchases and sales are accrued.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

(b) Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires Plan management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(c) Investments

The Plan's investment policy requires investments comply at all times with applicable local, state and federal regulations. The Plan's investment policy is based upon an asset allocation study that considers the current and expected condition of the Plan, the expected long-term capital market outlook and the Plan's risk tolerance. Unless specifically permitted in the investment manager guidelines or other governing document, the investment policy prohibits the purchase of non-negotiable securities, short sales, selling on margin, puts, calls, straddles, options, or "letter" (restricted) stock. Also, unless specifically authorized in a manager's individual guidelines, the investment policy prohibits the use of derivatives.

Investments are valued at fair value based on quoted market prices, where available. The amount shown in the accompanying financial statements for real estate funds and venture capital funds represents estimated fair values. Estimated fair values of real estate funds and venture capital funds have been determined based upon appraised values or other comparable methods. Purchases and sales of securities and any resulting gain or loss are recorded on a trade-date basis.

(d) Foreign Currency Transactions

The Plan may enter into forward foreign currency exchange contracts for the purchase or sale of a specific foreign currency at a fixed price on a future date as a hedge against specific transactions or portfolio position to protect the Plan against adverse currency movements. Entering into these arrangements involves the risk of dealing with counter parties and their ability to meet the terms of the contracts. These contracts are valued at fair value at the financial statement date, and any realized and unrealized gains and losses are recorded when they are incurred.

Investments denominated in foreign currencies at December 31, 2003 and 2002 were converted to U.S. dollars at the foreign exchange rates quoted at December 31, 2003 and 2002. These foreign exchange gains and losses which were immaterial are included in net appreciation in fair value of investments in the accompanying statements of changes in net assets.

# EMPLOYEES' RETIREMENT FUND OF THE CITY OF DALLAS

## Notes to Financial Statements

## December 31, 2003 and 2002

(e) Cash, Investments, and Securities Lending

Investments as of December 31, 2003 and 2002 are as follows (in thousands):

| | Total Fair Value 12/31/03 | Total Fair Value 12/31/02 |
|---|---|---|
| Investments – Category 1 (Held by Plan's agent in Plan's name): | | |
| Cash and short-term investments | $ 58,783 | $ 43,618 |
| Commingled index funds | 495,721 | 491,277 |
| U.S. government, agency, and foreign government securities | | |
| Not on securities loan | 119,096 | 136,164 |
| On securities loan for securities collateral | 14,133 | 21,100 |
| Domestic corporate fixed-income securities | | |
| Not on securities loan | 286,782 | 235,447 |
| On securities loan for securities collateral | 6,933 | 3,395 |
| Domestic equities: | | |
| Not on securities loan | 362,301 | 229,017 |
| On securities loan for securities collateral | 5,955 | - |
| International equities | | |
| Not on securities loan | 370,817 | 283,372 |
| On securities loan for securities collateral | 1,836 | 43 |
| Subtotal Category 1 | 1,722,357 | 1,443,433 |
| Investments at fair value – Not Categorized: | | |
| Investments held by broker-dealers under securities loans with cash collateral: | | |
| U.S. government, agency, and foreign government securities | 52,560 | 57,117 |
| Domestic corporate fixed-income securities | 63,906 | 47,997 |
| Domestic equities | 95,803 | 36,604 |
| International equities | 21,019 | 20,870 |
| Securities lending short-term collateral investment pool | 239,829 | 166,588 |
| Real estate | - | - |
| Venture capital | 354 | 507 |
| Total Not Categorized | 473,472 | 329,683 |
| Total | $ 2,195,828 | $ 1,773,116 |

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

The Board has authorized the Plan to enter into an agreement with The Northern Trust Company ("Northern") for the lending of certain of the Plan's securities (the "Securities Lending Program" or "Program") including, but not limited to, stocks and bonds to counter party brokers and banks ("borrowers"), for a predetermined period of time and fee. Such transactions are not prohibited by state statute.

During the fiscal year, Northern lent, on behalf of the Plan, securities held by Northern, as Plan custodian, and received United States dollar cash, United States government securities, agency securities, and irrevocable bank letters of credit as collateral. Northern did not have the ability to pledge or sell collateral securities absent a borrower default. Borrowers were required to put up collateral for each loan equal to: (i) in the case of loaned securities, the collateral for which is all denominated in the same currency as the loaned securities, 102% of the fair market value of the loaned securities plus any accrued but unpaid distributions thereon, and (ii) in the case of loaned securities denominated in a different currency from the loaned securities, 105% of the fair market value of the loaned securities plus any accrued but unpaid distributions thereon. The following table shows for open loans at December 31, 2003 and 2002, the type of collateral held, the market value of the securities on loan, and the market value of the collateral held (in thousands except percents).

| Collateral Type | Market Value 12/31/2003 | Collateral Market Value 12/31/2003 | Collateral Percentage | Market Value 12/31/2002 | Collateral Market Value 12/31/2002 | Collateral Percentage |
|---|---|---|---|---|---|---|
| Cash | $233,289 | $239,829 | 103% | $162,588 | $166,588 | 102% |
| Non-cash | 28,857 | 29,620 | 103% | 24,538 | 25,013 | 102% |
| Total | $262,146 | $269,450 | | $187,126 | $191,601 | |

The Board did not impose any restrictions during the fiscal year on the amount of the loans that Northern made on its behalf. There were no failures by any borrowers to return the loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from default of the borrowers or Northern. Northern is contractually obligated to fully indemnify the Plan for a borrower's failure to return the loaned securities.

During the fiscal year, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral was invested, together with the collateral of other qualified tax-exempt plan lenders, in a collective investment pool maintained by Northern. The relationship between the average maturities of the investment pool and the Plan's loans was affected by the maturities of the loans made by other plans' entities that invested cash collateral in the collective investment pool, which the Board could not determine. On December 31, 2003 and 2002, the Plan had no credit risk exposure to borrowers.

Disclosure of securities lending revenue is shown gross with the associated reductions for investment expenses on the face of the Statements of Changes in Plan Net Assets, and the cash collateral and associated securities lending payable is shown on the face of the Statements of Plan Net Assets for December 31, 2003 and 2002.

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

(f) Administrative Expenses

Expenses (excluding investment related expenses) totaling approximately $2,119,000 and $1,944,000 for the years ended December 31, 2003 and 2002, respectively, reflected as a portion of the administrative expenses included in the accompanying financial statements for professional services and office administration costs, are paid from the Plan's investment income only when the Plan's actuary certifies that payment will not have an adverse effect on the payment of benefits.

## (3) Investments

The Board has contracted with investment managers to manage the investment portfolio of the Plan, subject to the policies and guidelines established by the Board. Northern Trust as the Plan's custodian bank had responsibility for the safekeeping of certain investments, handling of transactions based on the instructions of investment managers, and accounting for the investment transactions.

Investments that individually represent 5% or more of the net assets available for benefits and the total of investments that individually represent less than 5% of the net assets available for Plan benefits at December 31, 2003 and 2002 are as follows (in thousands except per share amounts):

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | Number of Shares/Units | Fair Value | Number of Shares/Units | Fair Value |
| Investments greater than 5% of net assets, at fair value: | | | | |
| NTGI S&P 500 Equity Index Fund | 84,065 | $239,443 | 84,065 | $185,885 |
| NTGI Collective Russell 1000 | 458,735 | 256,277 | 531,949 | 228,496 |
| Investments less than 5% of net assets: | | | | |
| At fair value | | 1,699,754 | | 1,358,228 |
| At estimated fair value | | 354 | | 507 |
| Total investments | | $2,195,828 | | $1,773,116 |

In 2003 and 2002, the Plan's investments, including investments bought, sold, and held during the year, appreciated (depreciated) in value as follows (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Investments, at fair value: | | |
| Commingled index funds | $ 86,465 | $ (113,968) |
| Domestic equities | 145,289 | (63,475) |
| United States and foreign government securities | 571 | 15,483 |
| Corporate bonds and notes | 22,093 | (3,995) |
| International equities | 120,050 | (43,233) |
| Short-term investments | 200 | 143 |
| Currency contracts | (193) | (1,198) |
| | 374,475 | (210,243) |
| Investments, at estimated fair value: | | |
| Venture capital funds | (59) | (87) |
| | $ 374,416 | $ (210,330) |

EMPLOYEES' RETIREMENT FUND OF
THE CITY OF DALLAS

Notes to Financial Statements

December 31, 2003 and 2002

(4) Funding Status and Progress

The actuarial information presented is determined by an actuarial valuation that results from applying various assumptions with regard to termination, disability, retirement, mortality, and the time value of money to the accumulated plan benefits.

Actuarial methods used are entry age normal for actuarial cost method and level percent open for amortization method. The remaining amortization period is 30 years. Significant actuarial assumptions used include: (a) an annual rate of return on the investment of present and future assets of 8.5% in 2003 and 2002, respectively, compounded annually; (b) projected salary increases based on graded rates in 2003 and 2002, with 2003 rates higher than 2002, compounded annually, attributable to inflation; (c) post retirement benefit increases of 4% in 2003 and 2002 calculated annually; and (d) asset valuation method three year smoothed market.

(Unaudited) required supplementary information related to the Plan's funding progress is as follows (in millions):

| 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) |
|---|---|---|---|---|---|---|
| 12/31/98 | 1,617 | 1,750 | 133 | 92% | 276 | 48.2% |
| 12/31/99 | 1,863 | 1,874 | 11 | 99% | 282 | 4.0% |
| 12/31/00 | 1,998 | 2,038 | 40 | 98% | 298 | 13.5% |
| 12/31/01 | 2,017 | 2,276 | 259 | 89% | 333 | 77.9% |
| 12/31/02 | 1,864 | 2,400 | 536 | 78% | 325 | 165.0% |
| 12/31/03 | 1,843 | 2,489 | 646 | 74% | 318 | 202.8% |

Certain factors, such as changes in benefit provisions, the size or composition of the population covered by the system, or the actuarial assumptions used, may significantly affect the identification of trends in the amounts reported in this schedule.

(5) Federal Income Tax Status

The Internal Revenue Service issued a determination letter dated January 14, 2003, stating that the Plan was designed in accordance with applicable Internal Revenue Code requirements as of that date. The Plan administrator believes that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, the Plan was qualified and the related trust was taxexempt as of the financial statement dates.

# SCHEDULE OF ADMINISTRATIVE EXPENSES

Year Ended December 31, 2003

| | |
|---|---|
| Personal Services: | |
| Salaries | $937,408 |
| Retirement | 115,377 |
| Insurance | 54,949 |
| Total Personal Services | 1,107,734 |
| Professional Services: | |
| Actuarial | 89,844 |
| Accounting | 38,000 |
| Legal | 42,280 |
| Medical | 7,995 |
| Total Professional Services | 178,119 |
| Operating Services: | |
| Supplies and Services | 104,606 |
| Printing | 21,136 |
| Travel and Training | 48,924 |
| Data Processing | 257,665 |
| Election | 7,036 |
| Indirect and Other Costs | 376,105 |
| Total Operating Services | 815,472 |
| Furniture and Fixtures: | |
| Furniture | 18,006 |
| Total Furniture and Fixtures | 18,006 |
| Total Administrative Expenses | 2,119,331 |

## SCHEDULE OF INVESTMENT EXPENSES
## Year Ended December 31, 2003

| | |
|---|---|
| Manager fees | $5,146,948 |
| Custodian fees | 125,000 |
| Securities lending fees | 1,819,988 |
| Investment consultant fees | 230,000 |
| Total Investment Expenses | $7,321,936 |

*Securities lending fees include broker rebates and the lending agent's fees.

## SCHEDULE OF PAYMENTS TO CONSULTANTS
## Year Ended December 31, 2003

| | |
|---|---|
| Accounting and Audit: | |
| Financial Control Systems | $38,000 |
| Actuarial: | |
| Gabriel, Roeder, Smith, & Company | $ 89,844 |
| Election: | |
| Voice Retrieval & Informaton Services | $7,036 |
| Legal: | |
| Various | $42,280 |
| Medical: | |
| Various | $7,995 |
| Investments: | |
| Wilshire Associates, Inc. | $230,000 |
| Total Consultant Expenses | $415,155 |

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# INVESTMENT SECTION

## INVESTMENT POLICIES SUMMARY

### Statement of Goals

The general investment goals are broad in nature to encompass the purpose of the Fund and its investments. They articulate the philosophy by which the Board will manage the Fund's assets within the applicable regulatory constraints.

1. The overall goal of the Fund is to provide benefits, as anticipated under the Plan document, Dallas City Code, Chapter 40A, to its participants and their beneficiaries through a carefully planned and executed investment program.

2. The Fund seeks to produce the highest return on investment which is consistent with sufficient liquidity and investment risk that are prudent and reasonable, given prevailing capital market conditions. While the importance of the preservation of capital is recognized, the theory of capital market pricing which maintains that varying degrees of investment risk should be rewarded with compensating returns is also recognized. Consequently, prudent risk taking is reasonable and necessary.

3. The Fund investment program shall at all times comply with existing and applicable local, state and federal regulations.

### Investment Philosophy

The Fund is long term in nature, and the selection of investments is regulated by: the investment time horizon; the limits of acceptable risk; and the objective of optimizing the total rate of return. Each investment manager is authorized to execute investment transactions on behalf of the Board.

Investment decisions are made under the framework of the goal established for the rate of return, limits of acceptable risk, and Fund objectives. The goal is to optimize the return of the portfolio, as opposed to maximizing the rate of return.

The optimal portfolio mix is one that carefully equates expected rate of return with expected risk of all investment categories utilized in the portfolio. In setting the optimal mix of assets for the portfolio, the Board has developed a strategic asset allocation policy which incorporates a diversified asset mix. The strategic asset allocation is designed to provide an optimal diversification to reduce risk and maximize total rate of return relative to risk and the existing and projected liability structure.

The Board bases its investment strategy and goals on advice obtained from the investment consultant, the staff, and the external investment managers. The Board uses the annual external audit and annual actuarial valuation in its evaluation of the Fund's performance each year.

### Corporate Governance

Article XVI, Section 67 of the Texas Constitution and Chapter 40A of the Dallas City Code, give complete responsibility for the management and investment actions of the Employees' Retirement Fund to the Board of Trustees. The Board is held to the standard of conduct of fiduciaries in discharging their responsibilities. According to Chapter 40A the Trustees, as fiduciaries, must carry out their functions solely in the interest of the members and beneficiaries.

The Board considers the active voting of proxies an integral part of the investment process. Proxy voting may be delegated to the discretion of investment managers retained by the Board. The managers shall be required to establish a proxy voting policy and maintain records of proxy votes, and shall make these records available quarterly to the Board or its designee. The Board may at its discretion establish an overall policy of voting proxies in which case the managers' proxy voting policy shall be in accordance with that of the Board's. The Board recognizes that in certain non-U.S. markets, investment managers may, balancing the costs and benefits, not exercise proxy voting.

INVESTMENT RESULTS

Investment Summary

The investment managers and the returns by investment category are shown in the following tables.

| INVESTMENT CATEGORY | 2003 RATE OF RETURN |
|---|---|
| Domestic Equities | 30.98% |
| International Equities | 41.70% |
| Fixed Income | 5.02% |
| High Yield Bonds | 20.64% |
| Real Estate Securities | 35.66% |
| Cash Equivalents | 1.15% |
| Venture Capital | -20.52% |
| Total Portfolio | 26.66% |

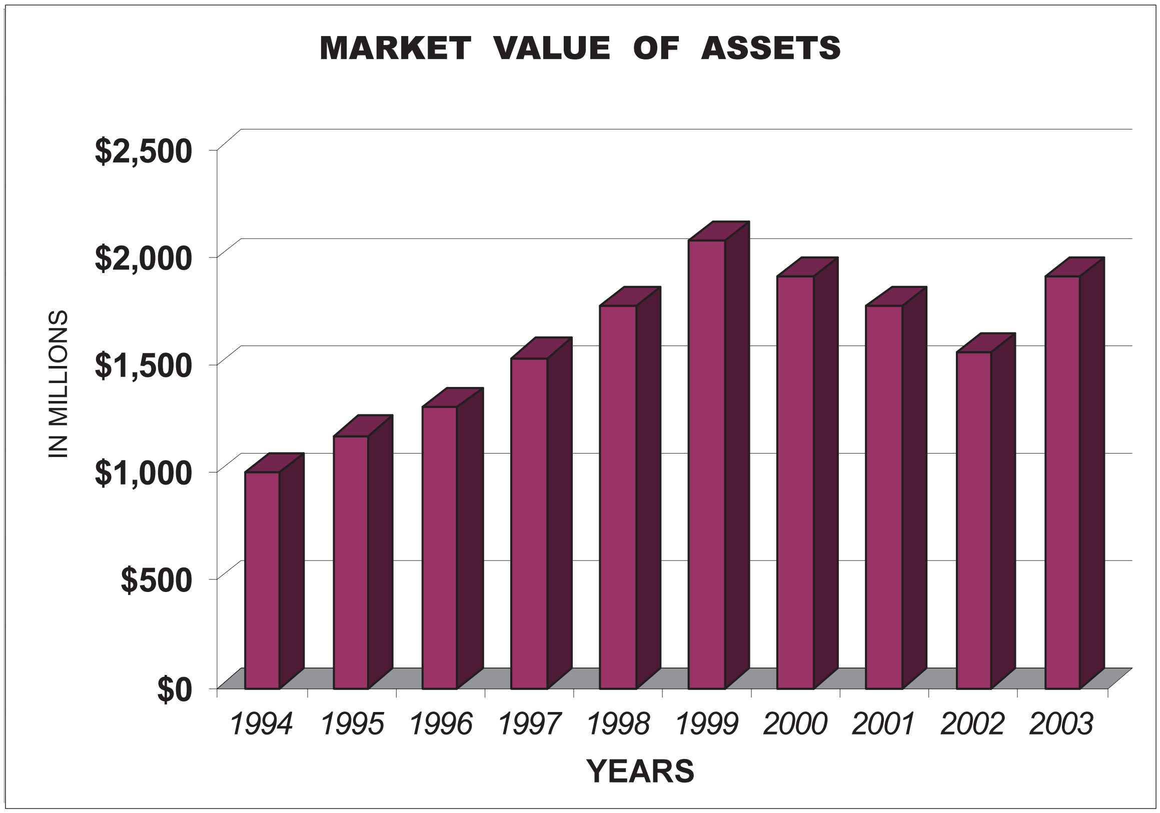
## Investment Managers

| Domestic Equities, REITs and Commingled Index Funds |
|---|
| NTGI S&P 500 Index |
| NTGI Russell 1000 |
| Systematic Financial |
| Lend Lease Rosen |
| Goldman Sachs |
| Security Capital |
| **International Equities** |
| Acadian |
| Bank of Ireland |
| Baring |
| **Fixed Income** |
| Loomis Sayles |
| Payden & Rygel |
| W.R. Huff |
| Oaktree |
| **Cash Equivalents** |
| The Northern Trust Company |
| **Venture Capital** |
| Alliance Capital |
| Brinson Partners |

## Total Fund Results

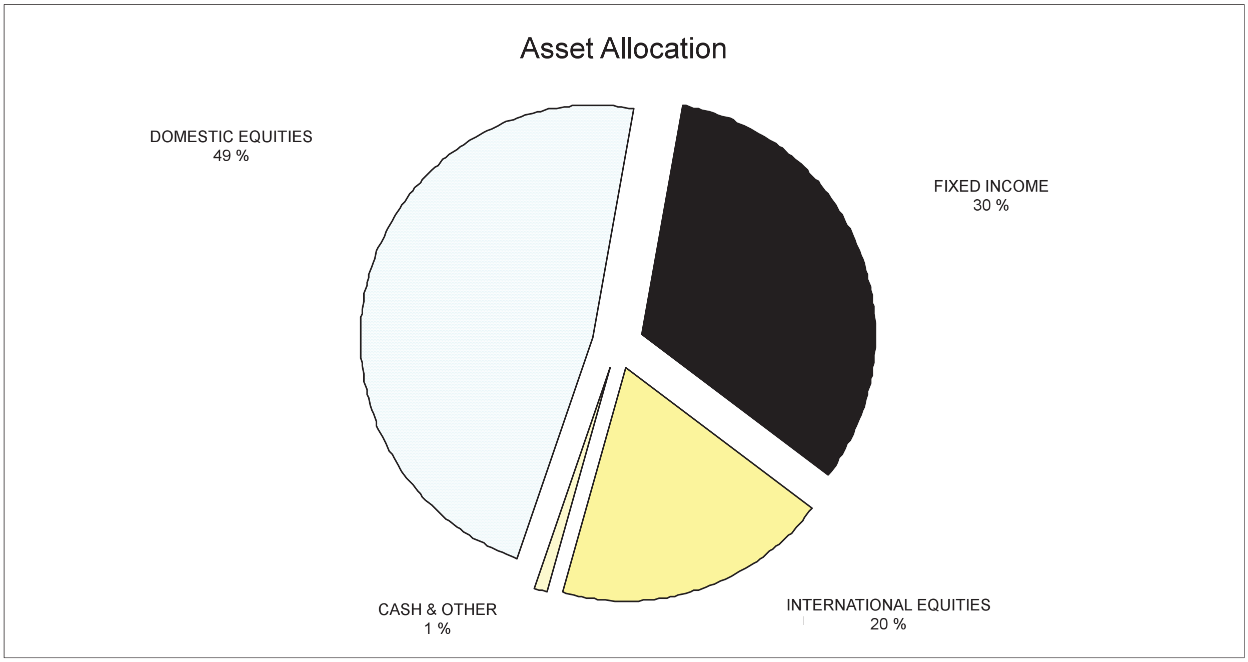
The world equity markets as measured by various indices were positive for 2003 with the MSCI ACWIFr ex US (G) Index returning 41.40% and the Wilshire 5000 returning 31.64%. The Lehman Aggregate was up 4.11%. The Citigroup High Yield Cash Pay Index was up 29.36% for the year.

At December 31, 2003, the net asset value of the Fund was $1.9 billion. This value represents a 22.83% or $355 million increase over last year's value of $1.6 billion. The Net Assets of the Fund graph below provides a pictorial history of the Fund's growth over the past 10 years.




## ASSET ALLOCATION

The Fund's long-term strategic asset allocation policy sets the following targets: 50% in domestic equity including REIT securities; 20% in international equity; 20% in global fixed income; and 10% in high yield fixed income. The chart on the next page shows the investments by asset class at year-end. Venture capital had a small allocation (less than 1%) at year-end and will continue to have some level of investment during the next 2-3 years as the asset class is liquidated. Although no specific allocation to cash and equivalents is targeted, cash must be available for the payment of benefits and other expenses of the Fund. To accommodate constantly changing market values, the Board has approved ranges for each of the asset classes.




Domestic Equity

The Fund's allocation to domestic equity is targeted at 50% of the Fund's total assets including 10% ultimately allocated to REITs. Passively managed index funds totaled 52% of domestic equity assets at year end, and actively managed portfolios represented the remaining 48%. The domestic equity and REIT's segment returned 30.98% and 35.66% respectively for the year while the benchmark Wilshire 5000 Index had a return of 31.64% and the Wilshire Real Estate Securities index returned 37.08%. The S&P 500 index returned 28.69% for the year.

International equity has a target allocation of 20%, and it is split between three active managers. ERF's international equity composite return was 41.70% while the MSCI ACWIFr ex US (G) Index reported a return of 41.40% for the year.

Global Fixed Income

Global fixed income has a target of 20% of total assets. This allocation is split evenly between two investment managers. During the year the global fixed income returned 5.02% while the Citigroup Non-US Government Bond Index returned 18.52% and the Lehman Aggregate Index returned 4.11%.

High Yield Fixed Income

High yield fixed income has a target of 10%. This allocation is also evenly split between two investment managers. The high yield return for 2003 was 20.64% and the Citigroup High Yield Cash Pay Index returned 29.36%.

Alternative Investments

Although venture capital is no longer a part of the long-term strategic asset allocation policy, residual values did remain at year-end as this investment is in liquidation status. The venture capital investments had a -20.52% return versus the S&P 500 Index's return of 28.69%.

SCHEDULES

## Annualized Returns

| Category | 2003 | 3-year | 5-year |
|---|---|---|---|
| Total Fund | 26.66% | 2.69% | 4.10% |
| Domestic Equity | 30.98 | -1.72 | 2.02 |
| S&P 500 Index | 28.69 | -4.06 | -.59 |
| Wilshire 5000 Index | 31.64 | -2.47 | .42 |
| International Equity | 41.70 | .28 | 2.76 |
| MSCI ACWIFr ex US (G) Index | 41.40 | -.96 | 1.55 |
| MSCI EAFE Index | 38.58 | -2.91 | -.05 |
| Global Fixed Income | 5.02 | 8.03 | 6.09 |
| Lehman Aggregate Index | 4.11 | 7.57 | 6.62 |
| Citigroup Non - US Government Bond Index | 18.52 | 11.73 | 5.20 |
| High Yield Fixed Income | 20.64 | 9.88 | 6.39 |
| Citigroup High Yield Cash Pay Index | 29.36 | 11.20 | 5.79 |
| Venture Capital | -20.52 | -18.02 | -8.55 |
| Cash Equivalents | 1.15 | 2.44 | 3.59 |
| T-Bill | 1.15 | 2.44 | 3.60 |
| Real Estate Securities | 35.66 | NA | NA |
| Wilshire REIT Index | 37.08 | 15.83 | 14.50 |

## Investment Management Fees

| Investment Manager Fees | Assets Under Management | Fees | Basis Points |
|---|---|---|---|
| Domestic equity | $962,007,688 | $1,930,436 | 20.1 |
| International equity | $394,783,585 | $1,556,070 | 39.4 |
| Global fixed income | $407,523,988 | $760,823 | 18.7 |
| High yield fixed income | $179,748,362 | $896,422 | 49.9 |
| Venture capital | $353,550 | $3,197 | 90.4 |
| Cash Equivalents | $11,581,973 | N/A | N/A |
| Total investment managers | $1,955,999,146 | $5,146,948 | 26.3 |
| | | | |
| Other Investment Services | | | |
| Custodian | | $125,000 | |
| Securities lending | | $1,819,988* | |
| Investment consultant | | $230,000 | |
| Total investment services | | $2,174,988 | |
| Total investment management fees | | $7,321,936 | |

*Securities lending fees include broker rebates and the lending agent's fees.

## Largest Assets Holdings December 31, 2003

| | Equity Holdings | Shares | Market Value |
|---|---|---|---|
| 1 | MFB NTGI GM COLTV DAILY RUSSEL | 458,735.07 | 256,277,393 |
| 2 | MFB NTGI QM COLTV DAILY S&P 500 | 84,064.81 | 239,443,311 |
| 3 | JAPAN MSCI INDEX | 3,668,313.63 | 25,524,126 |
| 4 | UK MSCI INDEX | 399,316.75 | 17,033,255 |
| 5 | AVALONBAY CMNTYS INC | 217,790.00 | 10,410,362 |
| 6 | SIMON PPTY GROUP INC NEW | 217,400.00 | 10,074,316 |
| 7 | MSCI CONSUMER DISCRETIONARY | 1,103,290.32 | 10,046,562 |
| 8 | SPAIN MSCI INDEX | 270,154.05 | 9,770,932 |
| 9 | VIACOM INC COM NON - VTG | 218,000.00 | 9,674,840 |
| 10 | MSCI MATERIALS SECTOR INDEX | 662,377.86 | 9,660,781 |

| | Fixed Income Holdings | Par Value | Market Value |
|---|---|---|---|
| 1 | U.S.A. TREASURY NOTES 1.250 % due 5/31/2005 | 11,830,000 | 11,798,580 |
| 2 | FNMA 15 YR PASS-THROUGHS 5.000% due 1/15/2018 | 10,620,000 | 10,829,087 |
| 3 | FNMA 30 YR PASS-THROUGHS 6.500% due 4/15/2030 | 9,520,000 | 9,954,350 |
| 4 | FHLMC 15 YR GOLD PARTN CTF 5.000% due 1/15/2019 | 9,570,000 | 9,746,471 |
| 5 | U.S.A. TREASURY NOTES 3.000% due 2/15/2008 | 9,110,000 | 9,152,343 |
| 6 | FNMA 30 YR PASS-THROUGHS 7.000% due 1/15/2034 | 7,910,000 | 8,374,713 |
| 7 | FNMA POOL #648944 4.821% due 11/01/2032 | 7,245,551 | 7,450,962 |
| 8 | U.S.A. TREASURY NOTES 4.375% due 8/15/2012 | 7,280,000 | 7,424,464 |
| 9 | FNMA TBA POOL 5.5 30 YR JAN 5.500% due 1/1/2033 | 6,310,000 | 6,390,844 |
| 10 | CITIBANK CR CARD ISSUANCE TR N 6.875 % due 11/16/2009 | 4,300,000 | 4,896,427 |

A complete list of portfolio holdings is available upon request.

## Investment Holdings Summary at December 31, 2003

| Investment Type | Market Value | Percent of Total Market Value |
|---|---|---|
| Fixed Income: | | |
| Government bonds | 185,790,235 | 9.50 |
| Corporate bonds | 357,620,536 | 18.28 |
| Total Fixed Income | 543,410,771 | 27.78 |
| Equity: | | |
| Common stock | 857,731,173 | 43.85 |
| Index funds | 495,720,704 | 25.34 |
| Total Equity | 1,353,451,877 | 69.19 |
| Alternative Investments: | | |
| Real estate | 0 | 0.00 |
| Venture capital | 353,549 | 0.02 |
| Total Alternative Investments | 353,549 | 0.02 |
| Cash and Equivalents: | | |
| Cash | 325,388 | 0.02 |
| Short term notes and paper | 58,457,561 | 2.99 |
| Total Cash and Equivalents | 58,782,949 | 3.01 |
| Total Fund | 1,955,999,146 | 100.00 |

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# ACTUARIAL SECTION

The Report of the
December 31, 2003 Actuarial Valuation

of the Employees' Retirement Fund
of the City of Dallas

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May 12, 2004

Board of Trustees
Employees' Retirement Fund of the City of Dallas
600 North Pearl Street
Suite 2450
Dallas, Texas 75201

Dear Members of the Board:
We are pleased to present the report of the actuarial valuation of the Employees' Retirement Fund of the City of Dallas ("ERF") as of December 31, 2003.

This valuation provides information on the funding status of ERF. In addition, it includes a determination of the actuarially calculated contribution level for the 2004 calendar year.

This valuation is based on the provisions of ERF in effect as of the valuation date, data on the ERF membership and information on the asset value of the trust fund as of that date. All member data and asset information were provided by ERF staff. While certain checks for reasonableness were performed, the data used was unaudited.

The actuarial assumptions and cost method are those used in the prior actuarial valuation of ERF.

To the best of my knowledge, this report is complete and accurate and was conducted in accordance with standards of practice by the Actuarial Standards Board and in compliance with the provisions of the ordinance. The actuarial assumptions used for the valuation produce results which, in the aggregate, are reasonable. The valuation was produced under the supervision of a Member of the American Academy of Actuaries with significant experience valuing public employee retirement systems.

Respectfully submitted,

| | |
|---|---|
| **Norman S. Losk, F.S.A.** | **Lewis Ward** |
| **Senior Consultant** | **Consultant** |

# SUMMARY OF THE VALUATION

**Purposes of the Actuarial Valuation**

At your request we have performed the actuarial valuation of the Employees' Retirement Fund of the City of Dallas ("ERF") as of December 31, 2003.

The purposes of an actuarial valuation are as follows:

- To determine the funding status of ERF as of the valuation date, and
- To develop the actuarially determined level of contributions for ERF for the calendar year 2004.

**Report Highlights**

The following is a set of key results for the prior year valuation and for the current year:

| **Contribution Rates (% of Payroll)** | **2003** | **2004** |
|---|---|---|
| Normal Cost (including administrative expense) | 17.12% | 17.37% |
| Total Actuarial Contribution Rate | 27.03% | 29.55% |
| Total Support Rate | 17.50% | 17.50% |
| Excess of Actuarial Contribution over Support Rate | 9.53% | 12.05% |
| Total Projected Actuarial Contribution | $86,429 | $92,278 |
| **Funding Status** | **12-31-02** | **12-31-03** |
| Actuarial Accrued Liability | $2,399,569 | $2,489,071 |
| Actuarial Value of Assets | 1,863,701 | 1,843,099 |
| Unfunded Actuarial Accrued Liability | 535,868 | 645,972 |

**Total Actuarial Contribution**

The Total Actuarial Contribution Rate developed in this actuarial valuation, based on "All Assumptions", is 29.55% of active member payroll. This rate is 2.52% higher than that developed in the prior valuation.

Funding Process

Based on the work of the Joint ERF/City Working Group that has been ratified by both the ERF membership and the City Council, a new funding process commenced October 1, 2000. As of that date, the City contribution rate increased from 8.50% of pay to 9.75% and the member contribution rate increased from 5.00% to 5.75%. On October 1, 2001, the City contribution rate increased to 11.00% of pay and the member contribution rate increased to 6.50%.

Subject to voter approval, member and City contribution rates may be adjusted as of October 2003 based on the results of the actuarial valuation as of December 31, 2002. The contribution rates will be adjusted upward if that valuation produces a total contribution level exceeding 19.50%. They will be adjusted downward if that valuation produces a contribution rate less than 15.50%. About 63% of the change will be borne by the City and the remaining 37% by the members.

This process will recur every three years thereafter.

At its January 2003 meeting, the Board acted to change the October 2003 date to October 2005. However, this action has not as yet been addressed by the City Council, pending disposition of the report of the Employees' Retirement Fund Study Committee.

Actuarial Assumptions

The actuarial method and actuarial assumptions used in this valuation are identical to those disclosed in the prior valuation report. During early 2004, the Employees' Retirement Fund Study Committee has been reviewing the operations of ERF. Among its recommendations is a change in the economic assumptions used in the actuarial valuations of the system. While it is anticipated that the Committee recommendation will be to change these assumptions effective for the actuarial valuation as of December 31, 2004, if the Board adopts this new set of assumptions, we will prepare a supplement to this valuation which will include the results of this valuation using those assumptions.

ERF Benefits

There have been no changes in the benefit provisions of ERF since the prior valuation.

Experience During 2003

Actuarial Gain and Loss Analysis reviews the effects of experience that differs from that assumed on actuarial results. If such a difference increases assets or reduces liabilities, we have an actuarial gain. The reverse is an actuarial loss.

ERF experienced an overall actuarial loss in 2003. This year's overall ERF actuarial loss amounted to about $68 million.

The total actuarial loss is the net of the gain from assets and the loss from liabilities. The total loss is broken down as follows ($ in millions):

| | | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| 1. | Actuarial (Gain)/Loss on Assets | $(20.0) | $113.8 | $279.54 | $118.79 |
| 2. | Actuarial (Gain)/Loss on Liabilities | 51.4 | 109.9 | (21.08) | (51.16) |
| 3. | Total Actuarial (Gain) or Loss (1+2) | 31.4 | 223.7 | 258.46 | 67.63 |

There was an actuarial loss of $119 million from investment return. For the first time in four years, the fund earned positive returns at market value. The rate of return at actuarial value for 2003 was 2.03%. This result was less than the 8.50% assumption due to significant deferred asset losses due to the prior two years. When these losses are combined with the year's market gain, the net result still a loss in investment returns.

In addition, during 2003, there was an actuarial gain of $51 million from demographic assumptions and non-investment economic assumptions. This gain includes a gain from salary increases of over $52 million.

It should be noted that the actuarial gain from liabilities amounts to only about 2.25% of actuarial accrued liabilities at the beginning of the year.

**Asset Information**

The market value of the assets of the fund, which are available for benefits, has not increased substantively on the last three years from $1,908 million as of December 31, 2000 to $1,910 million as of December 31, 2003. The markets, which turned downward significantly in the prior three years, reversed to produce a significant gain in the calendar year.

The assets recognized for actuarial purposes (actuarial value of assets) are the product of a smoothing technique. The purpose of such a technique is to allow the use of market values, but to dampen the effect of market volatility. See Table 3 for the determination of the actuarial value of assets.

The actuarial value of assets has been reduced from $1,864 million to $1,843 million during 2003. The rate of investment return for 2003 on actuarial value of assets was 2.03% compared to -5.37% in 2001 and 2.76% in 2000 and 9.6% in 1999. The detailed determinations of asset values utilized in this valuation and asset growth in the last year are set out in Appendix A.

**Funding Status**

The funding status of ERF is measured by the Funding Ratio and the Unfunded Actuarial Accrued Liability (UAAL). The Funding Ratio is the ratio of the actuarial value of assets available for benefits to the actuarial accrued liability (AAL) of the Fund. Thus, it reflects the portion of the AAL that is covered by ERF assets. The UAAL is the difference between these items.

A funding ratio of 100% means that the funding of ERF is precisely on schedule. By monitoring changes in the funding ratio each year we can determine whether or not funding progress is being made.

Based on the actuarial value of assets, the ERF funding ratio fell from 98.0% at December 31, 2000 to 88.6% as of December 31, 2001, to 77.7% as of December 31, 2002 and to 74.05% as of December 31, 2003.

The UAAL increased from $40 million at December 31, 2000 to $259 million at December 31, 2001 to $ 536 million at December 31, 2002 to $646 million at December 31, 203.

**GASB Disclosure**

GASB Statements Numbers 25 and 27 set out the current accounting standards for ERF. Tables 11, 12, and 13 in Appendix D provide footnotes and/or Required Supplemental Information tables required to be disclosed by those statements.

**NOTE: Copies of the complete actuarial valuation including appendixes A-G are available at the Fund's office.**

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# STATISTICAL SECTION

### Schedule of Revenue by Source

| Year Ending | Member Contributions ($'s 000) | Employer Contributions ($'s 000) | % of Annual Covered Payroll | Investment Income ($'s 000) | Total ($'s 000) |
|---|---|---|---|---|---|
| 1997 | 13,193 | 22,404 | 8.4 | 262,475 | 298,072 |
| 1998 | 14,001 | 23,762 | 9.0 | 258,591 | 296,354 |
| 1999 | 14,932 | 25,217 | 8.9 | 290,691 | 330,833 |
| 2000 | 16,460 | 27,847 | 9.3 | (68,847) | (24,540) |
| 2001 | 20,814 | 35,182 | 10.6 | (103,558) | (47,562) |
| 2002 | 21,771 | 36,606 | 8.9 | (171,787) | (113,410) |
| 2003 | 20,580 | 34,729 | 9.2 | 412,128 | 467,437 |

### Schedule of Expenses by Type

| Year Ending | Benefit Payments ($'s 000) | Administrative Expenses ($'s 000) | Refunds ($'s 000) | Investment Professional Expenses ($'s 000) | Total ($'s 000) |
|---|---|---|---|---|---|
| 1997 | 65,636 | 1,415 | 2,640 | 7,133 | 76,824 |
| 1998 | 69,111 | 1,138 | 3,020 | 8,411 | 81,680 |
| 1999 | 73,530 | 1,470 | 2,706 | 11,168 | 88,874 |
| 2000 | 81,006 | 1,860 | 2,971 | 16,212 | 102,049 |
| 2001 | 87,054 | 1,918 | 2,434 | 12,237 | 103,643 |
| 2002 | 97,363 | 1,944 | 2,552 | 7,458 | 109,317 |
| 2003 | 108,402 | 2,119 | 2,605 | 7,322 | 120,448 |

### Schedule of Benefit Expenses by Type

| Year Ending | Retiree ($'s 000) | Beneficiary ($'s 000) | Disability ($'s 000) | Supplement ($'s 000) | Total ($'s 000) |
|---|---|---|---|---|---|
| 1997 | 53,961 | 3,795 | 1,956 | 5,924 | 65,636 |
| 1998 | 57,299 | 3,713 | 2,111 | 5,988 | 69,111 |
| 1999 | 61,730 | 3,461 | 2,204 | 6,135 | 73,530 |
| 2000 | 67,714 | 4,563 | 2,427 | 6,302 | 81,006 |
| 2001 | 73,963 | 4,076 | 2,554 | 6,431 | 87,054 |
| 2002 | 82,918 | 5,012 | 2,753 | 6,681 | 97,363 |
| 2003 | 93,859 | 4,562 | 2,951 | 7,030 | 108,402 |

| Statistics Summary | | | |
|---|---|---|---|
| | Members Only Statistics | Survivors Only Statistics | Members and Survivors Statistics |
| Average Age | 67.9 | 71.2 | 68.5 |
| Average Pension | $2,074.86 | $1,143.53 | $1,895.92 |
| Average Age at Retirement | 57.9 | N/A | N/A |


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