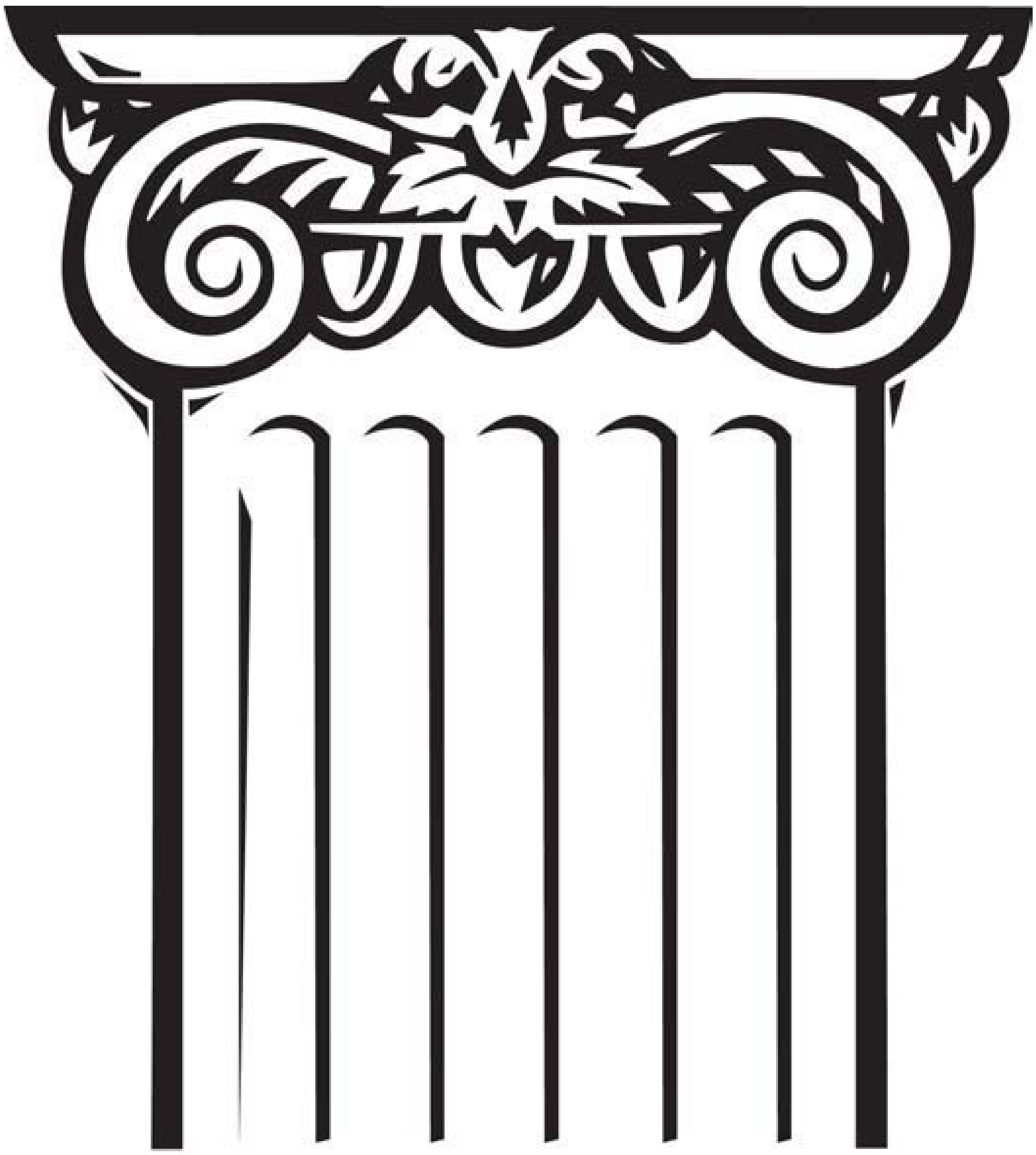
COMPREHENSIVE ANNUAL FINANCIAL REPORT



City of Austin
Employees' Retirement System

For the Year Ended December 31, 2003

Austin, Texas

City of Austin
Employees' Retirement System
2003 Annual Report

Comprehensive Annual Financial Report
for the Year ended December 31, 2003

Prepared by: City of Austin Employees' Retirement System, 418 E. Highland Mall Blvd., Austin, Texas 78752-3720

OUR MISSION

The mission of the City of Austin Employees' Retirement System is to provide reliable retirement benefits.

WE VALUE :

Accessibility

Accountability

Cooperation

Ethical Behavior

Fairness

Innovation

Integrity

Open Communication

Respect

Responsiveness

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INTRODUCTORY SECTION

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City of Austin Employees' Retirement System

June 30, 2004

TO: THE BOARD OF TRUSTEES AND MEMBERS OF THE
CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM
AUSTIN, TEXAS

Ladies and Gentlemen:

It is both a pleasure and privilege to submit to you the Comprehensive Annual Financial Report of the City of Austin Employees' Retirement System (COA ERS or System) for the year ended December 31, 2003. Information contained in this report is designed to provide a complete and accurate review of operations during the year and is the responsibility of COA ERS management. It has been prepared in accordance with generally accepted principles for accounting and reporting as established by the Governmental Accounting Standards Board (GASB) for governmental organizations and public employee retirement systems, including the financial reporting model required by GASB Statement No. 34 *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments"* and GASB Statement No. 38, *"Certain Financial Statement Note Disclosures"* effective January 1, 2001.

Structure of the Report

This report is divided in five sections:

- **Introductory Section** describes COA ERS management and organizational structure, highlights the year's activities, and provides a summary of the plan benefits.
- **Financial Section** contains the opinion of the independent auditor, KPMG LLP, the financial statements of COA ERS, various supplemental schedules and Management's Discussion and Analysis.
- **Investment Section** contains a report from the independent investment consultant, Summit Strategies Group, information on the COA ERS asset allocation, performance, and other schedules.
- **Actuarial Section** includes an actuarial valuation by the independent actuary, Gabriel, Roeder, Smith, & Company, along with supporting schedules and information.
- **Statistical Section** depicts the break down of revenues and expenses.

Certificate of Achievement

For the fifth consecutive year, COA ERS was awarded a Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report for the fiscal year ended December 31, 2002 by the Government Finance Officers' Association of the United States and Canada (GFOA). COA ERS is pleased to have achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized Comprehensive Annual Financial Report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current Comprehensive Annual Financial Report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Retrospective on 2003

Investment performance for the year ending 2003 was 24.0%, net of fees, which compared to a Policy index return of 22.6%. This was a welcome relief for the System, having previously endured three consecutive years of negative returns. Over longer periods of time, our relative performance improves. For the three-year period, COA ERS' portfolio returned (1.7 %), net of fees, as compared to (1.8%) for the Policy index. For the five-year period, COA ERS' 5.2%, net of fees, return exceeded that of the Policy index by 120 basis points (Policy index return for the five-year period was 4.0%). For actuarial purposes, the System's annual investment performance is measured over a five-year period, thereby smoothing annual variations in return. COA ERS is a long-term investor with a permanent fund, so performance over longer periods of time is the most important.

In January 2003, Catherine Harrington retired as Pension Director, having served in that capacity for the past six years. In mid-September, Stephen C. Edmonds joined COA ERS as Executive Director, following a nationwide search. The Annual Members' Meeting was held on October 8, 2003. Special emphasis was made of the funded status of COA ERS, including presentations by the System's investment consultant, independent external auditor, and actuary.

In 2003, the voters of Texas approved constitutional protections for members of most municipal pension systems in the State of Texas, including Austin. Retiree benefits cannot be reduced and vested benefits for active members cannot be reduced. Future benefits (not yet accrued) are not protected. Municipalities were given a one-time opportunity to call an election to opt-out of the constitutional protections. The City of Austin did not call for such an election.

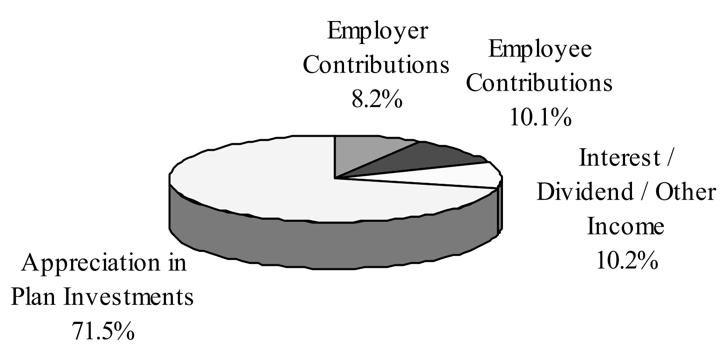
Financial Summary

Internal controls have been established by COA ERS management to provide reasonable assurance that the assets are properly safeguarded, the financial records are fairly and accurately maintained, and the governing statutes and policies are correctly followed. The governing statute requires an annual audit of the System's accounts by a Certified Public Accountant. The Board of Trustees has retained KPMG LLP as independent external auditor since 1997. KPMG's 2003 financial audit was conducted in accordance with generally accepted auditing standards and resulted in an unqualified opinion on the financial statements. The Financial Section contains KPMG's audit opinion letter and additional information including the Management's Discussion and Analysis.

The ***Additions to Plan Net Assets*** consists of employer and employee contributions, investment income, and realized and unrealized gain or loss on investments. For 2003, employer and employee contributions consisted of $55.4 million, investment income was $30.6 million, and net appreciation in plan investments net of investment expenses totaled $215.4 million, resulting in net additions to plan Net Assets of $301.4 million. The ***Deductions from Plan Net Assets,*** totaling $84.2 million, consist of $75,527,089 in annuity payments, refunds of $4,476,716, Deferred Retirement Option Program (DROP) disbursements of $847,111, retiree lump-sum annuity disbursements of $182,186, death benefits of $1,660,137, and administrative expenses of $1,552,770. This net increase of $217,180,045 results in total assets held in trust of $1,259,556,168.

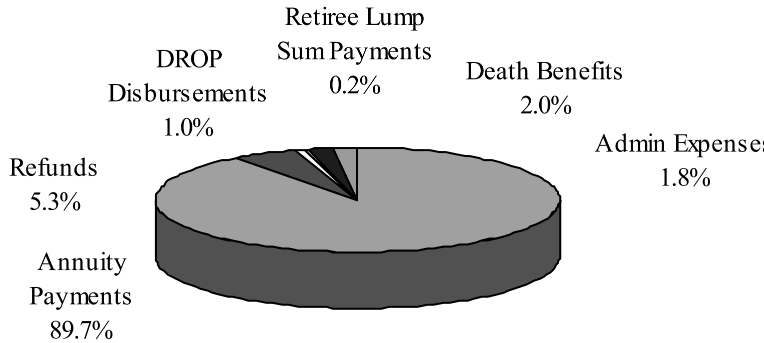
Additions to Plan Net Assets

Employer Contributions	$24,907,480
Employee Contributions	30,449,244
Interest/Dividend/Other Income	30,655,260
Appreciation in Plan Investments (net of investment fees)	215,414,070
Total Source of Funds	**$301,426,054**



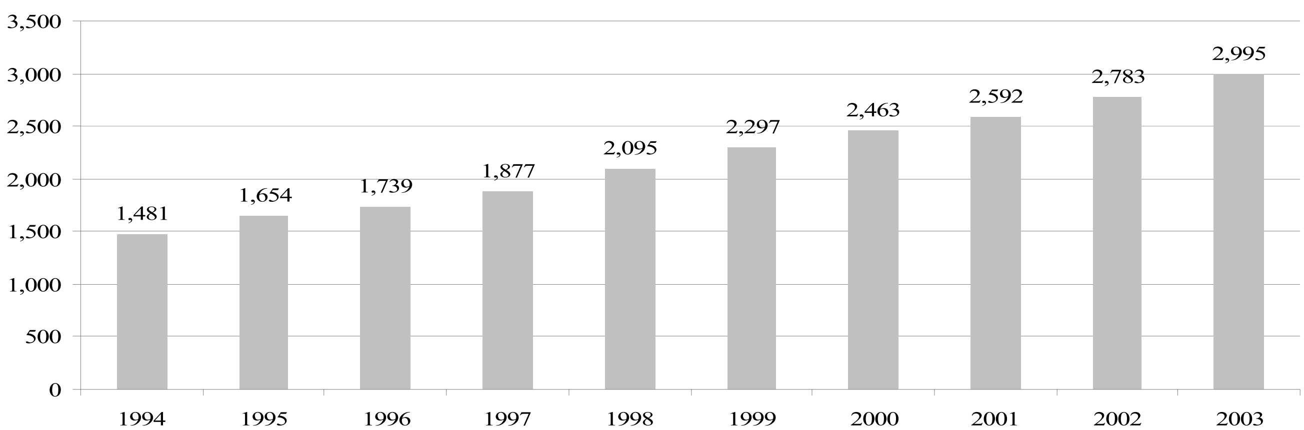
Deductions from Plan Net Assets

Annuity Payments	$75,527,089
Refunds	4,476,716
DROP Disbursements	847,111
Retiree Lump Sum Payments	182,186
Death Benefits	1,660,137
Administrative Expenses	1,552,770
Total Deduction from Plan Net Assets	**$84,246,009**

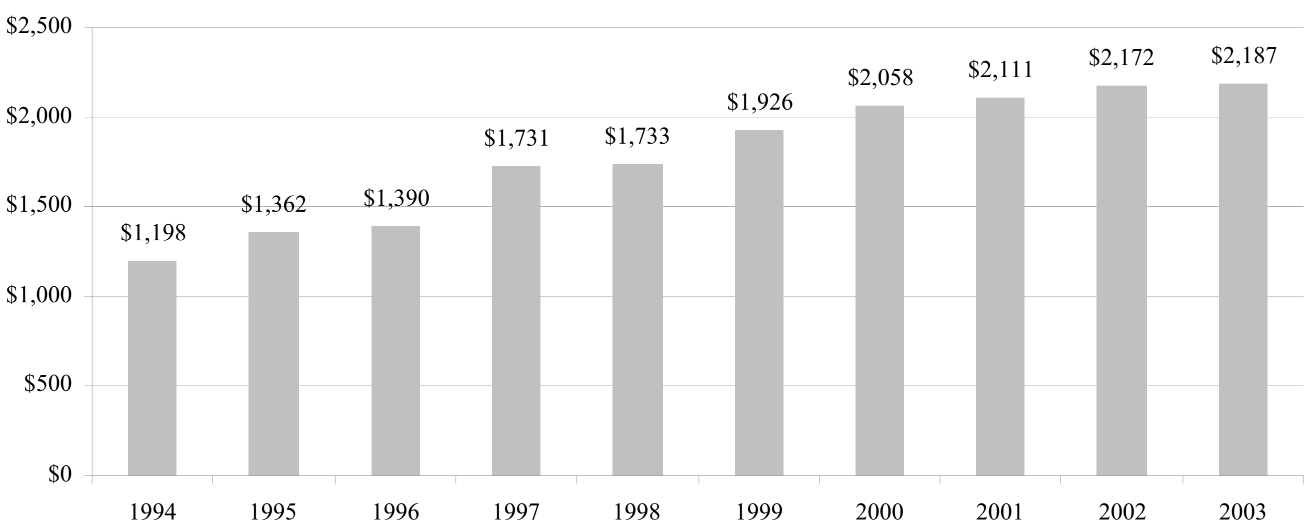


Retirement benefit payments continue to grow both in ***Number of Retired Members & Beneficiaries*** and ***Average Monthly Benefit*** as reflected in the following charts.

Number of Retired Members & Beneficiaries



Average Monthly Benefit

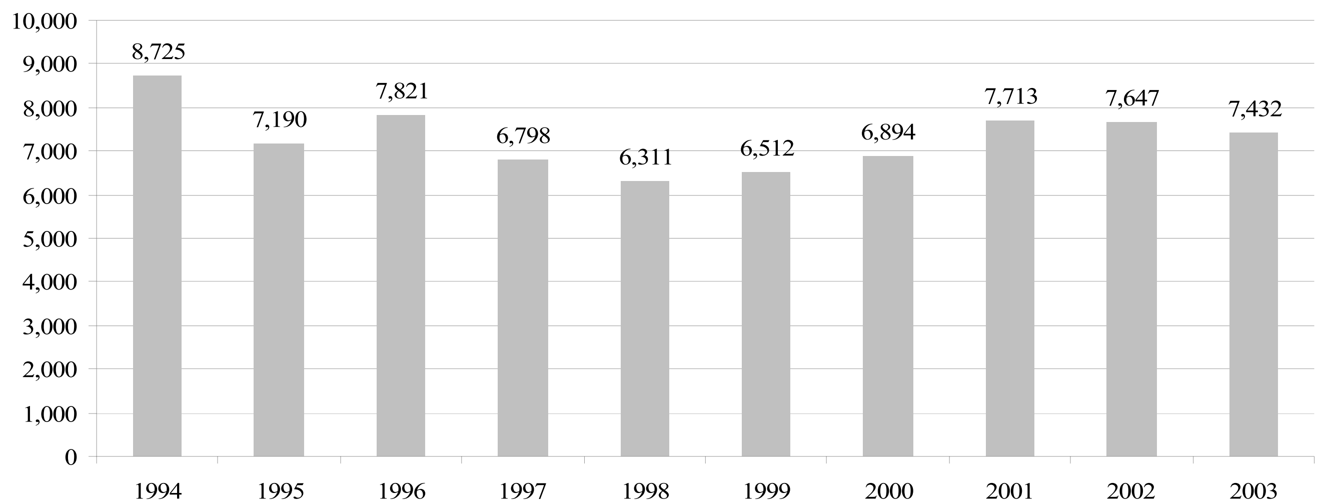


Economic Condition and Outlook

COA ERS assets are strategically allocated to maximize income and reduce risk by using diverse and complementary portfolio structures. The COA ERS Board has consistently followed a long range, conservative investment philosophy. The Board employs Summit Strategies Group for independent investment consulting and long range asset-liability analysis.

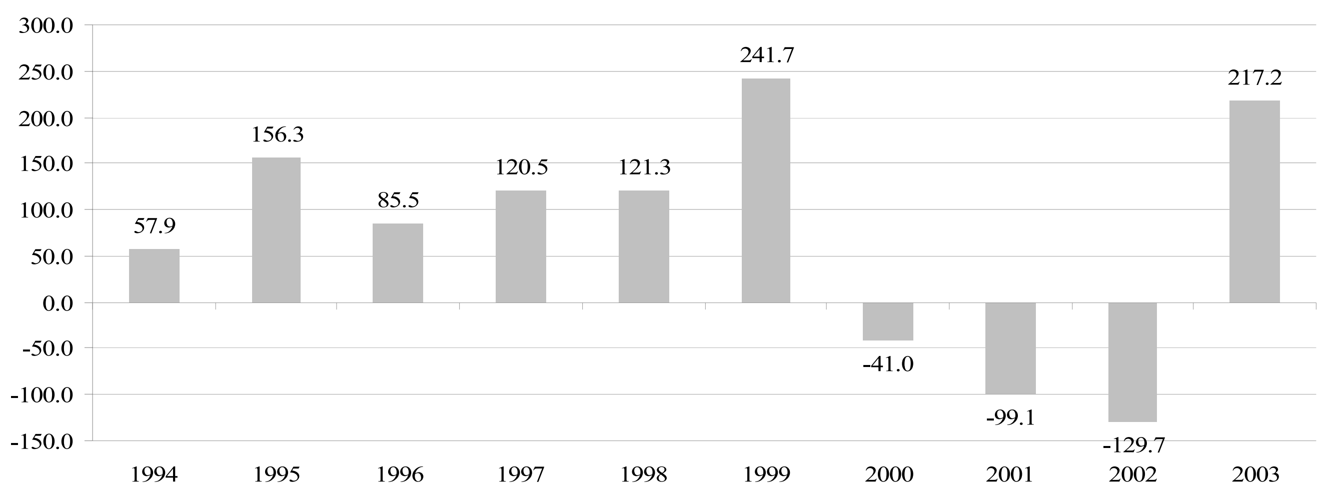
Data for the last ten years on the number of ***Active Contributing Members*** is depicted in the following chart. The number of contributing members has decreased slightly for the past two years.

Active Contributing Members

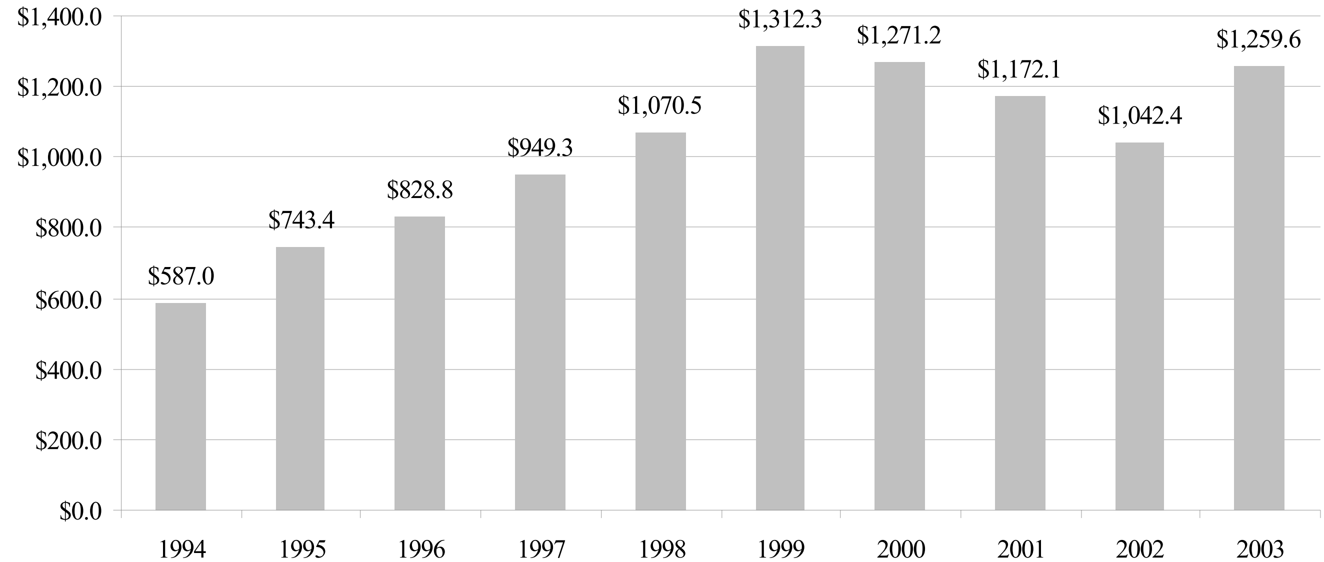


The following two charts show the ***Changes in Net Assets*** and ***Total Plan Net Assets*** at the end of each year since 1994. Net Assets increased by $217.2 million during 2003, and at December 31, 2003, the Plan totaled $1,259,556,168 in Total Plan Net Assets. As shown in the charts, despite three years of net asset loss (2000-2001), the plan has increased significantly in Total Plan Net Assets over the long term.

Changes in Net Assets (in millions)



Total Plan Net Assets (in millions)



Investments

Essential to the COA ERS' mission is the responsibility to ensure long term assets will meet long term liabilities. This ensures retirement and other benefits will be available for both current and future members. Investments are made with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Funds of COA ERS are invested solely in the interest of the membership and their beneficiaries, and for the exclusive purpose of providing benefits to such membership and their beneficiaries and defraying reasonable expenses of administering COA ERS. The Board of Trustees has established an investment policy and guidelines which provide for the delegation of investment authority to professional investment advisors. At December 31, 2003, the investment portfolio of COA ERS was managed by 10 investment managers. The Board has directed an asset allocation strategy as follows: Domestic Fixed Income (30%), International Equities (16.25%), US Equities (Large) (32.5%), and US Equities (Non-Large) (16.25%), and Real Estate (5%). As of December 31, 2003, the allocation to Real Estate has not been funded.

Funding and Actuarial Overview

In addition to investment income, the System is funded by contributions equal to 8 percent of basic compensation by the City of Austin employees and 8 percent of basic compensation by the City of Austin. State law requires that each plan of benefits adopted by the System be approved by a qualified actuary. The actuary certifies whether or not the contribution commitment by the participants and the City provides an adequate financing arrangement. 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, if any exists, and the number of years needed to amortize the System's unfunded actuarial liability is determined using a level percentage of payroll method.

As certified in this report by Gabriel, Roeder, Smith & Company, due to the significant asset losses that occurred in recent years, COA ERS' contributions are not currently sufficient to amortize the unfunded liability of the System. In the absence of significant actuarial gains, the current contribution rates will not be sufficient to support the current benefit structure of the Plan. The overall funded position of the System is 86.9%, unchanged from 2002. The actuarial accrued liability and the actuarial value of assets of COA ERS as of December 31, 2003, amounted to $1,551,830,802 and $1,348,790,502, respectively. A detailed discussion of funding is provided in the Actuarial Section of this report.

Acknowledgments

This report reflects the combined effort of the COA ERS staff under the leadership of the Board of Trustees. We would like to express our gratitude to the staff, advisors, and members of the Board who have contributed to the preparation of this report and to the continued successful operation of the City of Austin Employees' Retirement System.

On behalf of the Board of Trustees, we would also like to recognize City of Austin employees for the valuable contribution they make to their community.

Respectfully Submitted,

Cathy Rodgers

Cathy Rodgers
2003 Board Chair

Stephen Edmonds

Stephen C. Edmonds
Executive Director

Donna Durow Boykin

Donna Durow Boykin, CPA
Finance Manager

In Memoriam

Glen Bell
1953 - 2003

The City of Austin Employees' Retirement System lost a great friend and leader with the passing of Glen Bell on December 10, 2003.

Glen will always be remembered for his invaluable service on the Board of Trustees, especially as chair of the Investment Committee. But more importantly, we will forever remember his warm heart, friendly smile and genuine concern for others. He is sorely missed by his fellow board members and the staff of COA ERS.

COA ERS 2003 BOARD OF TRUSTEES

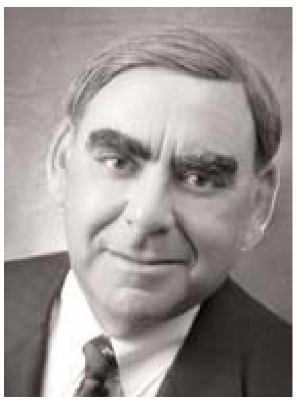
Cathy Rodgers
Board Chair

Reagan David
Board Vice Chair

Janet Bartles
Trustee

Glen Bell
Trustee

Eyna Canales-Zarate
Trustee



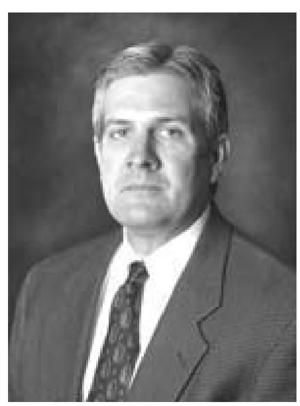
Ed Golden
Trustee

Elizabeth S. Gonzales
Trustee

Jackie Goodman
Mayor Pro Tem
Trustee

Delia Hernandez
Trustee

Sheila (Matthews) Hale
Trustee



Dennis Waley
Trustee

COA ERS 2003 STAFF

Stephen C. Edmonds
Executive Director

Rhonda Helm
Operations Manager

Donna Durow Boykin
Finance Manager

Jesse Ortega
Administrative Supervisor

Melissa Adams
IT Coordinator

Johne Behner
Member Services Specialist

Teresa Cantu
Member Services Coordinator

Lee DeGaugh
Office Coordinator

Craig Finkelstein
Member Services Coordinator

Laura L. Fugate
Member Services Specialist

Korrie Hoskins
Office Assistant

Zandra Mencer-Jones
Member Services Specialist

Cheryl Nelson
Executive Assistant





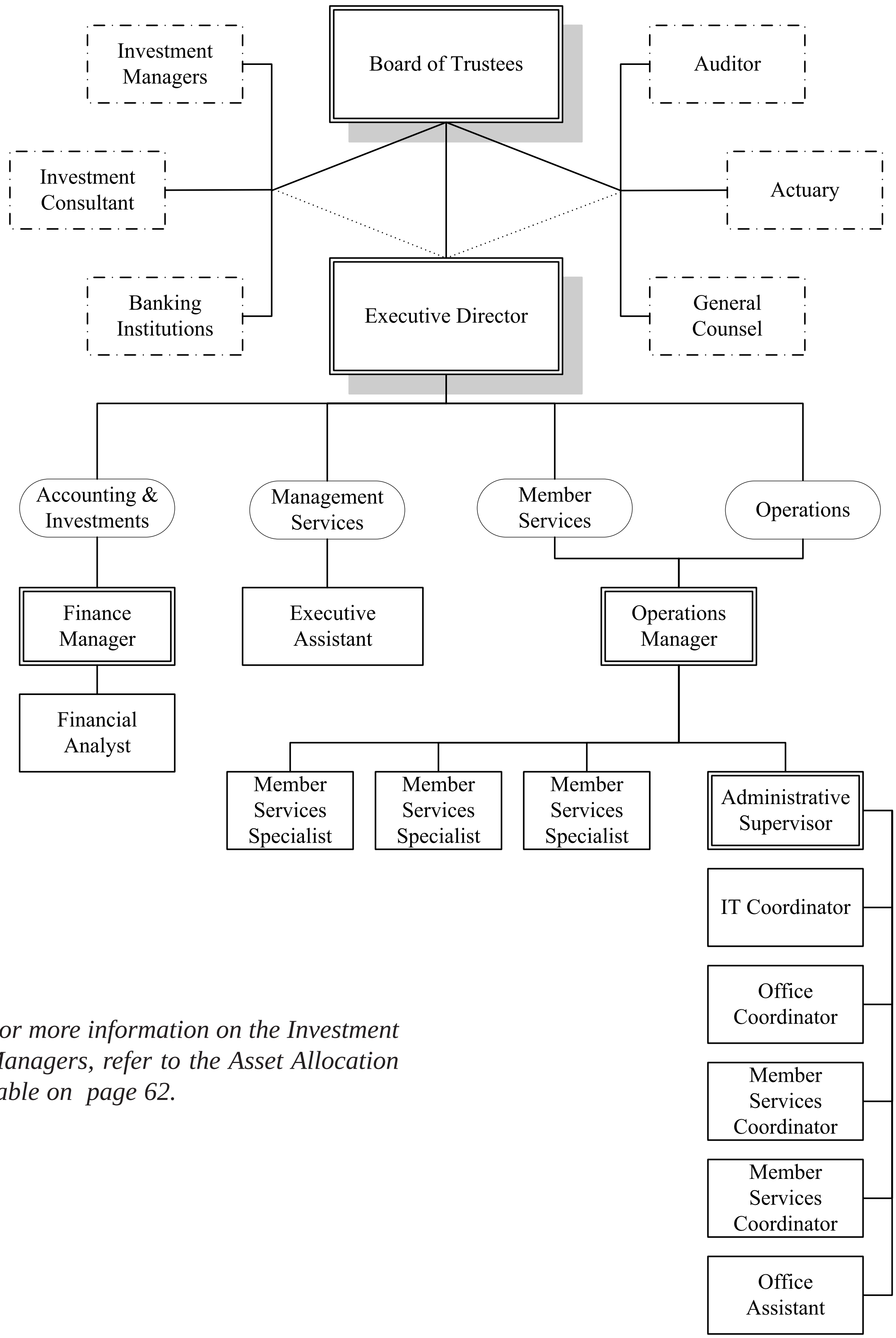








COA ERS ORGANIZATIONAL CHART



For more information on the Investment Managers, refer to the Asset Allocation Table on page 62.

PROFESSIONAL SERVICE PROVIDERS

Investment Consultant
Summit Strategies Group

Custodian Bank
The Northern Trust Company

Independent Auditor
KPMG LLP

Actuary
Gabriel, Roeder, Smith & Company

General Counsel
Barney L. Knight & Associates

Operating Bank
JP Morgan Chase

INVESTMENT MANAGERS

Fixed Income
Agincourt Capital Management LLC
NTGI Aggregate Bond Index Fund

International Equity
Sprucegrove Investment Management, Ltd.
Walter Scott and Partners, Ltd.

U.S. Equity
Alliance Capital Management L.P.
Aronson + Johnson + Ortiz
Driehaus Capital Management
Eubel, Brady, & Suttman Asset Management Inc.
NTGI S&P 500 Index Fund
Sterling Capital Management
Wall Street Associates

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Austin

Employees' Retirement System, Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

SUMMARY OF PLAN PROVISIONS

INTRODUCTION

COA ERS is:

- *an IRS tax qualified defined benefit plan*
- *governed by Texas Government Code Article 6243n.*

The COA ERS Board of Trustees:

- *provides oversight*
- *sets policy*

The COA ERS Staff:

- *provides service to all Members*
- *ensures compliance with policies and procedures*

Members of COA ERS:

- *are the reason we are here*
- *are welcome to attend all Board meetings*

PURPOSE

The City of Austin Employees' Retirement System (COA ERS or System), is a public employee retirement system established in 1941 by City ordinance and governed since 1991 by the State of Texas. COA ERS' purpose is to provide retirement, disability, and death benefits for COA ERS Members. All references to City of Austin employees as Members of COA ERS also include COA ERS employees. All references to the City of Austin as an employer also includes COA ERS. An eleven-member Board of Trustees oversees COA ERS. The Board appoints an Executive Director who is charged with responsibility for day-to-day management, except investment operations. The Board also engages firms for legal counsel, actuary services, independent auditing, investment management services, investment consulting and performance measurement services. From time to time, the Board may retain professional firms to provide consulting services in specialty areas.

MEMBERSHIP

City of Austin regular employees working 30 or more hours per week become Members of COA ERS on their date of employment. Members employed on October 1, 1995 are given service credit for one prior probationary period of up to six months. Members do not include:

- *Temporary employees*
- *Part-time employees working less than 30 hours per week*
- *Civil service employees of the Fire Department and the Police Department*
- *The Mayor and Members of the City Council*

CONTRIBUTIONS

Members of COA ERS currently contribute 8% of their base pay, calculated on a 40-hour work week. Contributions are made through payroll deduction each pay period; the City of Austin contributes an amount equal to the amount contributed by Member employees.

RETIREMENT ELIGIBILITY

Members are eligible for retirement when they meet one of the following age and service requirements:

- *An active Member having any number of years creditable service at age 62*
- *20 years creditable service at age 55*
- *23 years creditable service at any age*

CREDITABLE SERVICE

There are seven types of creditable service.

For information on Creditable Service Purchases, see section on "Buying Creditable Service" (page 25).

1. Membership Service

The employment period during which a Member makes payroll contributions to the Fund.

2. Reinstated Membership Service

Credit allowed for any previous membership in the COA ERS. Credit is established by repaying the System the amount of accumulated deposits refunded at termination of employment, multiplied by an actuarial factor.

3. Credit for Federal Active Duty Military Service

a. Prior Federal Active Duty Military Service

At any time before a Member's actual retirement date, a Member can establish up to 48 months creditable service for prior military service. Military service eligible for purchase is active federal duty service in the armed forces of the United States performed before the beginning of a Member's most recent period of COA ERS membership.

b. Military Leave of Absence

Members who are called to active duty and who are on approved military leave of absence may establish creditable service for the leave of absence if they return to City employment within 90 days of discharge. This purchase must occur within five years after return to City employment; alternatively, Members may choose to make ongoing contributions during their military leave of absence. In the aforementioned circumstances, the City of Austin matches the Member's contributions.

4. Non-Contributory Service Credit

Members may purchase service credit for the following non-contributory categories:

- *Non-contributory service, such as temporary or part time service*
- *Approved leave of absence*
- *Workers' compensation leave due to an injury sustained in the course and scope of employment with the City of Austin*

5. Permissive Time

Members may purchase up to five years of creditable service to advance their retirement eligibility date and increase the amount of their monthly annuity upon retirement. Only vested Members (five or more years of creditable service) are eligible to purchase permissive time. Age, salary, earliest retirement date, and an actuarial factor determine the cost.

6. Sick Leave Conversion

Retiring Members may convert sick leave hours to increase creditable service time. Converted sick leave hours cannot be used to reach retirement eligibility. Sick leave must be converted in pay period (80-hour) increments. Both the Member and the City must pay the current contribution rate to convert hours. Members must begin the conversion process 60 days prior to their retirement date.

7. Service prior to 1941

Additional service credit is allowed for Members with service performed before 1941, when the System came into existence. Two percent is applied for the number of years (prior to 1941) times the average salary for the years 1946 - 1950.

RETIREMENT OPTIONS

Life Annuity

Basic monthly benefit payable throughout the Retiree's lifetime. Any balance of the Retiree's deposits (including interest) remaining at the Retiree's death will be paid in a lump sum to the Retiree's designated beneficiary.

Option I: 100% Joint and Survivor

A reduced monthly benefit payable throughout the Retiree's lifetime. At the Retiree's death, the survivor beneficiary will continue to receive 100% of the benefit being paid prior to the Retiree's death throughout his or her lifetime.

Option II: 50% Joint and Survivor

A reduced monthly benefit payable throughout the Retiree's lifetime. At the Retiree's death, the survivor beneficiary will continue to receive 50% of the benefit being paid prior to the Retiree's death throughout his or her lifetime.

Option III: 66 2/3% Joint and Survivor

A reduced monthly benefit payable throughout the Retiree's lifetime. At the Retiree's death, the survivor beneficiary will continue to receive 66 2/3% of the benefit being paid prior to the Retiree's death throughout his or her lifetime.

A "Pop-up" Benefit is provided for Retirees choosing Option I, II, or III. The "Pop-up" increases the Retiree's benefits to the Life Annuity level if the survivor beneficiary predeceases the Retiree on or after October 1, 1999.

Option IV: 66 2/3% Joint and Last Survivor

A reduced monthly benefit payable throughout the Retiree's or the survivor beneficiary's lifetime. After the death of the Retiree or the survivor beneficiary, the last survivor of the two will receive 66 2/3% of the benefit throughout his or her lifetime.

Option V: Fifteen Year Certain and Life Annuity (180 monthly payments guaranteed)

A reduced monthly benefit payable throughout the Retiree's lifetime. If the Retiree's death occurs before 180 payments are made, the Retiree's beneficiary will receive the remaining monthly payments until a total of 180 payments have been made. If the Retiree is still living after receiving all 180 payments, payments will continue throughout the Retiree's lifetime.

Option VI: Actuarial Equivalent of Life Annuity

This option allows the Member to develop his/her own benefit payment plan, with the approval of the System's actuary. The Member has maximum flexibility to design a benefit option that is most appropriate for the Member and his or her beneficiary's needs after retirement, as long as the plan is determined to be actuarially equivalent to the Life Annuity option.

BACKWARD DROP PROGRAM

DROP stands for Deferred Retirement Option Program. This option allows the Member to receive a lump sum DROP payment in addition to receiving a monthly annuity based on Final Average Earnings and years of service at the beginning of the DROP period.

Members who have already reached retirement eligibility, excluding proportionate service, and who continue to work and contribute to COA ERS may elect to "DROP Back" a portion of their creditable service time. Members may "DROP Back" to the most recent of the following:

- *No more than 60 months (in one month increments) prior to retirement,*
- *No earlier than the date of first retirement eligibility, or*
- *No earlier than the date of last service purchase*

The DROP account is credited with 90% of the monthly benefit based on the Life Annuity option. DROP accounts may be rolled over to other qualified plans, paid in one lump sum to the Member or a combination of both. The DROP payment is issued at the same time as the first monthly benefit check.

Cost of Living Adjustments (COLAs), interest, or Member or City contributions do not increase the monthly amount credited to the DROP.

RETIREMENT DATE

The effective date of retirement is always the last calendar day of the month. After his or her retirement date, a newly Retired Member will receive the first retirement annuity payment on the last working day of the month after the month in which he or she retired.

DISABILITY RETIREMENT BENEFITS

Members may apply for disability retirement benefits if:

- They are mentally or physically incapacitated for the performance of all employment duties as a result of an injury or illness prior to the time the Member is eligible to receive retirement benefits, and
- the incapacity is likely to be permanent.

Disability Retirement Eligibility

All disability retirement applicants must prove they are incapacitated for the performance of all employment duties and that the incapacity is likely to be permanent. Members are considered to remain in the same membership category in effect on the date of termination for 90 days following termination. This allows Members to apply for disability retirement for up to 90 days following termination for inability to perform all employment duties.

On the Job: Members must show that the injury came as a direct and proximate result of the performance of the Member's employment duties with the employer.

Off the Job: Members with five or more years of service may apply for disability retirement as a result of illness or injury off the job.

Disability Retirement Options

A Member approved for disability retirement may choose a Life Annuity benefit or a benefit described in Options I, II, or III.

Applying for Disability Retirement

Applications for Disability Retirement are available from the Retirement Office. The Board of Trustees reviews all applications and has final authority in granting disability retirement benefits.

Disability Retirees are periodically required to provide proof of continued disability and are annually required to provide income documentation to the Board of Trustees.

DEATH AND SURVIVOR BENEFITS

Retired Members

At the death of a Retiree, a death benefit of $10,000 is paid by COA ERS to the designated beneficiary(ies) of the deceased. This $10,000 death benefit is paid to the beneficiary(ies) in addition to any of the following benefits that are applicable:

> *If the Retired Member chose the Basic Life Annuity*, the monthly benefit stops at the death of the Member. However, if death occurs before the Member's accumulated deposits have been paid out, the Member's remaining deposits will be paid in a lump sum to the Member's designated beneficiary(ies) or estate.
>
> *If the Retired Member chose an Option providing benefits to a survivor beneficiary*, on-going benefits will be paid to the survivor beneficiary based on the Option selected by the Member. If the survivor beneficiary does not survive the Member, and the Member's accumulated deposits have not been paid out, the Member's remaining accumulated deposits will be paid in a lump sum to the Member's designated beneficiary(ies) or estate.

Active Members

At the death of an active Member, if the active Member was not yet eligible for retirement, the designated beneficiary(ies) receives a lump sum payment of the Member's accumulated deposits and a death benefit from the System of an amount equal to the Member's deposits. If the active Member also had un-matched contributions, for example contributions for non-contributory time, prior military service purchases, or permissive time purchases, these contributions will be refunded but will not be matched by the System.

If the active Member was eligible for retirement prior to death, and had not yet retired, a surviving spouse may choose any retirement option that would have been available to the Member. Alternatively, a surviving spouse may choose to receive a lump sum payment of the Member's deposits, as described above. *If there is no spouse*, the deceased Member's designated beneficiary(ies) may choose to receive payments under Option V (see Optional Forms of Payment) or receive a lump sum payment as described above. When monthly benefits are selected in lieu of a lump sum, a $10,000 death benefit will be paid to the beneficiary(ies).

Vested Inactive Members

The beneficiary(ies) of a vested inactive Member who has terminated employment and has left his or her contributions in the Fund waiting to become eligible for retirement, receives the same death benefits as beneficiaries of an active Member as described above.

VESTING ELIGIBILITY

When a Member has five 5 years creditable service in COA ERS, he or she is a vested Member. A vested Member may leave the City before reaching retirement eligibility, leave their contributions in the System, and receive a monthly annuity when their years of service and age combine to achieve retirement eligibility.

BUYING CREDITABLE SERVICE

A Member may choose to purchase or reinstate all or a part of available creditable service, in increments of one-month. The Board may establish policies governing the purchase of creditable service. No more than two purchases of creditable service may be completed in a calendar year. All creditable service purchases must be purchased by lump sum payment and purchases must be completed prior to retirement.

Reinstated Membership Service

If a Member has left City employment, withdrawn his or her accumulated deposits, and later returns to City employment, he or she may reestablish, or buy back, his or her forfeited creditable service in the System by paying the System the amount of accumulated deposits that were refunded, multiplied by an actuarial factor. The actuarial factor is determined by how long the deposits have been out of the Fund; specifically, the number of months between the refund and the reinstatement of creditable service.

Prior Military Active Duty Service

A Member may establish up to 48 months creditable service in the System for active federal duty in the armed forces of the United States performed before the beginning of the Member's most recent period of membership in the System. An original DD214 must be presented, and must show discharge under conditions other than dishonorable.

Military Leave of Absence

Members who are called to active duty and are on approved military leave of absence may establish creditable service for the leave of absence if they return to City employment within 90 days of discharge. This purchase must occur within five years of military service after return to City employment; alternatively, Members may choose to make ongoing contributions during their military leave of absence. In the aforementioned circumstances, the City of Austin matches the Member's contributions.

Non-Contributory Service Credit

At any time before a Member's actual retirement date, a Member may purchase service credit for the following non-contributory service credit categories:

- *service in a position that is ineligible for creditable service, such as temporary or part-time service (less than 30 hours per week)*
- *approved leave of absence such as medical or maternity leave (other than military leave)*
- *workers' compensation leave due to an injury sustained in the course and scope of employment with the City of Austin*

Proportionate Retirement

In 1991, the Texas Legislature established a proportionate retirement program for the benefit of Members of participating public retirement systems. A Member of two or more of the following participating retirement systems may be eligible for proportionate benefits:

- *Teachers' Retirement System of Texas,*
- *Employees' Retirement System of Texas,*
- *Judicial Retirement System of Texas I & II,*

- *Texas Municipal Retirement System - TMRS (umbrella system for Texas municipalities),*
- *Texas County and District Retirement System - TCDRS (umbrella system for Texas subdivisions),*
- *City of Austin Employees' Retirement System,*
- *El Paso Employees' Retirement System, and*
- *El Paso Fire and Police Retirement System.*

Systems participating in the proportionate program recognize service in other participating systems. A Member with service credit in more than one participating retirement system may request each of the proportionate systems in which they have creditable service to recognize the service in other proportionate systems in order to meet creditable service requirements for retirement.

Members participating in proportionate systems may retire from each of the systems once they meet eligibility for that system.

Retirement benefits will be paid separately from each system, based on the Member's salary history, creditable service, and benefits provided by that system. Members' funds are not moved from one proportionate system to another. Credit for military service may only be recognized in one proportionate system in determining the Member's total creditable service in all of the proportionate systems combined.

Member deposits must remain on deposit in each of the proportionate systems in order to be recognized by other proportionate systems with the following exception: TMRS municipalities and TCDRS subdivisions may certify former members (without contributions currently on deposit) for the purpose of meeting eligibility requirements in other participating proportionate systems. Individual TMRS municipalities and TCDRS subdivisions may determine whether to allow former members to purchase and reinstate forfeited prior service, as provided by Texas Government code Chapter 803.

COA ERS RETIREMENT FUND INVESTING

COA ERS funds are invested according to requirements of Article 6243n and the COA ERS Investment Policy (see Investment Section of this report). The investment returns help fund monthly retirement allowances and other System expenses. The Fund's asset allocation is 30% fixed income, 32.50% large U.S. equities, 16.25% non-large U.S. equities, 16.25% international equities, and 5% Real Estate.

RETIREMENT FUND WITHDRAWALS AND LOANS

Federal law does not allow Members to withdraw portions of contributions or to receive loans from their retirement funds. Members may not transfer or assign any of their deposits or retirement benefits to anyone except pursuant to an authorized tax levy or qualified domestic relations order entered by a proper court of record.

COA ERS COMPLIANCE WITH STATE AND FEDERAL LAW

Texas Government Code Article 6243n, the Internal Revenue Code, and other state and federal laws are applicable to the operation and management of, and the benefits provided by, COA ERS. Such laws place limitations on retirement systems, and may directly or indirectly affect Member benefits and options. These laws protect Members and preserve the tax exempt status of the System.

DETERMINING INTEREST ON YOUR CONTRIBUTIONS

The Board of Trustees annually determines the amount of interest paid on Members' accumulated deposits, taking into consideration the current yield of the 10-year U.S. Treasury notes and System actuary recommendations. Because the System is a defined benefit and not a defined contribution plan, interest is set conservatively. It is based on fixed income type returns and not returns earned by the entire fund or other more aggressive investment vehicles. This ensures the System can meet its lifetime obligations to current as well as future Retirees and their beneficiaries.

Interest is determined at the end of the calendar year based on the amount that each Member had in the System on the first day of that calendar year. For example, if you had $1,000 on January 1, and December 31, you had $1,500, your interest for that year would be based on the $1,000 you had in the System on January 1. In order to obtain interest, your money must remain on deposit for the entire calendar year. Interest is added to Member accounts in January after the amount is established on December 31.

HISTORY OF BENEFIT IMPROVEMENTS

1941

City Council established the City of Austin Employees' Retirement System.

Original City Ordinance provided a maximum annuity of $100 per month at age 65.

Contributions to retirement system set at 4.0%.

No survivor options, no early retirement eligibility, no vesting, no disability benefits, and no death benefits.

1951

Established two options for survivor benefits:
   Option I - 100% Joint and Survivor
   Option II - 66 2/3% Joint and Survivor

Established eligibility for early retirement.

Vested benefits after 15 years service.

Disability benefits established.

Contribution rate increased to 5.0%.

1962

Two additional options for survivor benefits:
   Option III - 50% Joint and Survivor, and
   Option IV - 66 2/3% Joint and Last Survivor.

1967

Multiplier increased from 1.125% to 1.25%.

Active Member death benefit set at $2,000.

1969

Provisions for Cost-of-Living Adjustment established.

Retired Member death benefit set at $2,000.

1971

Multiplier increased from 1.25% to 1.5%.

Unreduced retirement benefits at age 62 (lowered from age 65) with any number of years of service.

Free Health Insurance Benefits ages 62 - 65.

Contribution rate increased to 6.0%.

1972

Vested Benefits after 10 years of service.

Employees working 30 or more hours began retirement contributions.

Members eligible for early retirement benefits eligible to choose Option I to provide survivor benefits.

1973

Multiplier increased from 1.5% to 1.75%.

Final Average Earnings based on highest 60 months of contributing service.

Members eligible for retirement may select option to provide survivor benefit before actually retiring.

Disability retirement available for line of duty disabilities regardless of creditable service. Disability retirement available for any disability after 10 years of service. Disability benefits based on age and years of service at time of disability retirement; no penalty based on age.

DECEMBER 1977

Deletion of $2,000 death benefit for Active Members, continued for Retirees.

Active Member's Designated Beneficiary(ies) receives contributions and interest plus an equal amount from the System if the Member dies prior to retirement eligibility.

SEPTEMBER 1978

Additional retirement options available.

DECEMBER 1979

Medical insurance payment discontinued for Retirees between ages 62 - 65.

JULY 1981

Contributions now required after age 62 until retirement. Members older than age 62 have option to make up missed contributions to benefit from higher salary averaging for retirement benefits.

Salary averaging period reduced from 60 to 36 months.

OCTOBER 1982

Contribution rate increased to 6.6%, matched by City.

NOVEMBER 1982

Unreduced retirement benefits for Members age 55 or older with 20 years service.

MARCH 1984

Unisex option factors adopted by Board. The sex of the Member and the beneficiary no longer considered in the determination of any System benefits.

DECEMBER 1984

Member contribution rate increased from 6.6% to 7.0%, matched by the City.

Multiplier increased from 1.75% to 1.85%.

Special increase granted to retirees based on the number of years retired. The increase recognized actual increases in the cost of living above cost of living adjustments granted previously.

Surviving spouse may select an optional benefit if Active Member dies who was already eligible to retire and had not yet selected a benefit option.

Plan qualified with Internal Revenue Service. Member contributions after January 1, 1985 not taxed until time benefits are paid to the Member.

Limited "Prior Service" Buy Backs - Former Members who forfeited membership service by taking a refund when they left City employment may buy back their prior creditable service. Current Members are allowed six months to reinstate former credit by repaying withdrawn deposits plus interest. Only former Members who had been reemployed by the City before December 20, 1984 are eligible.

The 36 months of salary used to calculate monthly benefits need not be consecutive. Highest 36 months of salary during last ten years of creditable service are averaged to determine Final Average Earnings.

OCTOBER 1985

Multiplier increased from 1.85% to 2.0%.

FEBRUARY 1986

One Board Member position designated for Retired Member to be elected by Retired Members.

MAY 1987

Members laid off during the period from September 30, 1986 through October 1, 1989, who are eligible for retirement, received an unreduced current service annuity.

OCTOBER 1987

Member and City contribution rates to the System reduced temporarily from 7.0% to 6.2% of basic compensation for the period from October 1, 1987 to September 30, 1988.

MARCH 1988

Survivor benefit options available to disability Retirees effective March 1, 1988.

AUGUST 1988

Vested benefits after five years of service.

Extension of "Prior Service Buy Backs" - Former Members who forfeited membership service by taking a refund of their retirement contributions when they left City employment and have returned to City employment, may buy back their prior creditable service. The "buy back" window must be reopened each year by Board action.

For purposes of calculating benefits and determining eligibility, three years were added to both age and service for all Members retiring between September 1, 1988 and December 31, 1988.

SEPTEMBER 1988

Member and Employer contributions rates restored to 7.0% from 6.2% of basic earnings effective September 30, 1988.

DECEMBER 1989

Retiree Member of the Board elected by Retired Members to a four-year term.

FEBRUARY 1990

Unreduced retirement benefits for Members at any age with 30 years service.

Multiplier increased from 2.0% to 2.1%.

OCTOBER 1990

Limits on income of Social Security disability benefits adopted for System disability Retirees.

AUGUST 1991

System governed by Article 6243n of Texas State Law effective August 26, 1991.

System becomes Member of Proportionate Retirement Program with five other statewide retirement systems. Membership service may be combined with other participating systems for meeting service requirements for retirement eligibility.

JULY 1993

Multiplier increased from 2.1% to 2.2% and commensurate increase for Retirees.

Unreduced retirement benefits for Members at any age with 25 years of service.

Buy backs allowed for up to 24 months of former active duty U.S. military service.

OCTOBER 1995

Multiplier increased from 2.2% to 2.3% and commensurate increase for Retirees.

New City of Austin employees become Members of COA ERS at date of employment and current employees given retirement service credit for one probationary period, of up to six months.

Change in composition of Board of Trustees; Place 3, Director of Finance Designee, replaced with additional Retired Member to be elected by Retired Members.

Death benefit for Retirees increased from $2,000 to $10,000.

OCTOBER 1997

Multiplier increased from 2.3% to 2.6% and commensurate increase for Retirees.

Unreduced retirement benefits for Members at age 55 with 20 years service.

Buy backs of former active duty U.S. military service increased from 24 to 48 months.

New buy back option allows purchase of creditable service for non-contributory time including time spent on workers' compensation, leaves of absence, part time service, and temporary status.

New buy back option allows the City of Austin to purchase service credit for Members.

OCTOBER 1999

Multiplier increased from 2.6% to 2.7% and commensurate increase for Retirees.

Member contribution rate increased from 7.0% to 8.0% following vote by active Members.

Unreduced retirement benefits for Members at any age with 23 years of service.

New limits on Retirees returning to work for the City.

"Pop-up" benefit added for Retirees choosing Option I, II, or III (Joint and Survivor Annuities) or Option VI with Option I, II, or III underlying, to increase Retiree benefits if the Survivor Beneficiary predeceases the Retiree on or after October 1, 1999.

Board granted authority to authorize certain benefit improvements subject to Statute guidelines.

The Board was given the ability to make an additional payment to members in payment status in the form of a 13th check. The additional payment would be a percentage of the current monthly payment with a maximum percentage of 100%.

APRIL 2000

Multiplier increased from 2.7% to 2.98% and commensurate increase for Retirees.

Employer contribution rate increased from 7.0% to 8.0%, matching Member contribution rate.

DECEMBER 2000

415 Restoration of Retirement Income Plan established.

JANUARY 2002

Multiplier increased from 2.98% to 3.00% and commensurate increase for Retirees.

Purchases of permissive creditable service of up to 60 months available to vested Members, based on EGTRRA federal law.

Proportionate Retirement Program provided by Texas Government Code Chapter 803 amended to allow former Members of participating proportionate systems to reestablish creditable service previously forfeited in that system without returning to membership in that system.

APRIL 2002

Sick Leave Conversion benefit established. Allows Members to pay current contribution rate on accumulated sick leave balances to convert sick leave balances to creditable service. City of Austin matches the amount contributed by Members. Convertible in pay-period increments. May be used to increase creditable service; may not be used to reach retirement eligibility.

DROP (Deferred Retirement Option Program) established. Allows Members eligible for retirement to "drop" up to five years creditable service and receive a lump sum payment of 90% of the retirement benefit that would otherwise have been payable during the DROP period. Creditable service may be dropped in increments of one month up to 60 months, back to the date of retirement first eligibility, date of last purchase of creditable service, or 60 months, whichever is most recent.

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Financial Section

KPMG LLP
Suite 1100
111 Congress Avenue
Austin, TX 78701

Independent Auditors' Report

The Board of Trustees of
The City of Austin Employees' Retirement System:

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

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

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

The management's discussion and analysis on pages 35 through 38 and the schedules of funding progress and employer contributions on pages 53 through 55, respectively, are not a required part of the basic financial statements of the System, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The supplementary information on page 56 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit 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, actuarial section, investment section and statistical section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we express no opinion on them.

KPMG LLP

March 19, 2004

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2003 and 2002

This section of the City of Austin Employees' Retirement System's (COA ERS or the System) financial report presents our discussion and analysis of the System's financial performance during calendar years 2003 and 2002. We encourage readers to consider the information presented here in conjunction with our financial statements that follow.

Financial Highlights

- Plan net assets held in trust by the System increased by $217.2 million, or 20.8%, in 2003 and decreased by $129.7 million or 11.1% in 2002. The increase in 2003 was due primarily to positive investment returns. The decrease in 2002 was due to negative investments returns.

- Contributions decreased by $4.8 million, or 8.0% in 2003 and increased by $9.1 million, or 17.8% in 2002. The 2003 decrease was due to City and employee monthly contributions being $2.9 million less than in 2002 based on a reduced payroll. Another $1.9 million reduction was realized in service purchases that had been higher in 2002, when it first became allowable to rollover funds from other qualified retirement plans for this purpose. The 2002 increase was primarily due to $6.1 million in service purchases that, beginning in 2002, could be made with funds rolled-over from other qualified retirement plans.

- The amount of benefits paid to retired members and beneficiaries and refunded to terminating employees increased approximately $7.4 million, or 9.9%, during 2003 and $5.2 million or 7.5%, during 2002. Benefit payments exceeded employee and City contributions by $27 million in 2003 and by $15 million in 2002.

- The System's rate of return on investments for the year ended December 31, 2003 was 24%, net of fees, on a market value basis which was greater than the return of (9.7%) for the year ended December 31, 2002.

- The funding objective of COA ERS is to meet long-term benefit obligations through contributions and investment income. As of December 31, 2003, the date of the most recent actuarial valuation, the System's funding ratio of actuarial assets as a percentage of actuarial liabilities is 86.9%, which is unchanged from the 86.9% level at December 31, 2002.

Overview of the Financial Statements

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

- Statement of Plan Net Assets
- Statement of Changes in Plan Net Assets
- Notes to the Financial Statements

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2003 and 2002

Collectively, this information presents the net assets held in trust for pension benefits and other purposes as of the end of each year, and summarizes the changes in net assets held in trust for retirement benefits and other purposes for the year. The information available in each of these components is briefly summarized below:

- **Financial Statements**

  The *Statement of Plan Net Assets* presents the System's assets and liabilities and the resulting net assets, which are held in trust for retirement 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.

  The *Statement of Changes in Plan Net Assets*, on the other hand, 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 retirement benefits (net assets) – the difference between assets and liabilities – as one way to measure the COA ERS' 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.

Financial Analysis

Summary of Plan Net Assets
December 31, 2003, 2002 and 2001

Assets		2003	2002	2001
Cash and Receivables	$	6,778,351	7,426,870	9,064,063
Investments		1,255,601,924	1,035,242,762	1,162,843,922
Invested securities lending collateral		103,030,695	124,622,294	81,137,677
Capital assets		1,315,624	1,356,344	1,383,816
Total assets		1,366,726,594	1,168,648,270	1,254,429,478
Liabilities				
Total liabilities		107,170,426	126,272,147	82,340,940
Net assets held in trust for pension benefits	$	1,259,556,168	1,042,376,123	1,172,088,538

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2003 and 2002

Assets. As shown in the table, COA ERS' net assets increased by $217.2 million in 2003 and decreased by $129.7 million in 2002. The 2003 increase primarily reflects investment returns in positive financial markets. The 2002 decrease primarily reflects the negative investment returns due to the conditions encountered in the financial markets. The decrease in cash and receivables of approximately $649,000 in 2003 is primarily due to the non-recurrence of contributions receivable from the City of Austin for the final pay period of each year. As of December 31, 2002, the contributions had not been paid and were therefore recorded as a receivable at year-end; however, as of December 2003, the contributions had been paid and therefore, no receivable was required. The decrease in cash and receivables of $1.6 million in 2002 was primarily due to a decrease in operating cash and in the receivable from brokers for unsettled trades at year-end. The decrease in securities lending collateral of $21.6 million in 2003 and increase in securities lending collateral of $43.5 million in 2002 is relative to the net change number of securities on loan at each fiscal year end. There were minimal additions to and no retirements of fixed assets in 2003, so the decrease reflects depreciation. There were approximately $30,000 in additions and no retirements to capital assets in 2002.

Liabilities. Liabilities decreased by $19.1 million in 2003 which is primarily due to decreased securities lending collateral. Liabilities increased by $43.9 million in 2002 which is primarily due to increased trades pending and securities lending collateral.

Summary of Changes in Plan Net Assets
Years Ended December 31, 2003, 2002 and 2001

		2003	2002	2001
Additions:				
Contributions	$	55,356,724	60,168,994	51,069,055
Investment income (loss)		248,816,550	(110,516,439)	(76,720,095)
Investment expenses		2,749,856	2,478,807	2,168,050
Net investment income (loss)		246,066,694	(112,995,246)	(78,888,145)
Other income		2,636	2,223	1,530
Total additions		301,426,054	(52,824,029)	(27,817,560)
Deductions:				
Benefit payments		82,693,239	75,246,711	70,004,506
General and administrative expenses		1,552,770	1,641,675	1,305,222
Total deductions		84,246,009	76,888,386	71,309,728
Net increase (decrease)		217,180,045	(129,712,415)	(99,127,288)
Net assets held in trust for pension benefits beginning of year		1,042,376,123	1,172,088,538	1,271,215,826
Net assets held in trust for pension benefits end of year	$	1,259,556,168	1,042,376,123	1,172,088,538

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2003 and 2002

Additions. Additions needed to fund benefits are accumulated through contributions and returns on invested funds. Member and City of Austin contributions for 2003 and 2002 totaled $55.4 million and $60.2 million, respectively. The 2003 contributions represent a decrease of $4.8 million, or approximately 8.0% below 2002. Contributions based on payroll were reduced $2.9 million from the 2002 level as the City pared its workforce. Additionally, $1.9 million less was generated by service purchases than in 2002. As mentioned in Financial Highlights, 2002 was the first year that the IRS allowed for service purchases to be made on a tax-exempt basis with funds rolled-over from qualified retirement plans that generated a high level of initial activity. In 2002, the System saw an increase of $9.1 million, or approximately 17.8% over 2001, primarily due to employer service purchases of $6.1 million.

COA ERS incurred a positive return on the market value of its investments during 2003. Net investment gain of $246.1 million was $359.1 million greater than in 2002 due to performance of the equity markets. Interest, dividends and net securities lending income generated 2003 income of $30.7 million, a decrease from the $32.3 million received in 2002. The total rate of return for the System's investment portfolio in 2003 was 24% as compared to (9.7%) for 2002.

Deductions. The expenses paid by COA ERS include benefit payments, refunds of member contributions, and administrative expenses. Benefits paid to retirees in 2003 were $78.2 million, an increase of $6.9 million from payments made in 2002, consistent with the increase in the number of retirees to 2,995 in 2003 from 2,783 in 2002. Refunds to terminating employees increased by $0.5 million. Administrative expenses in 2003 were $1.6 million, a decrease of 5.4% from those incurred in 2002.

Benefits paid to retirees in 2002 were $71.3 million, an increase of $5.2 million from payments made in 2001, consistent with the increase in the number of retirees to 2,783 in 2002 from 2,592 in 2001. Refunds to terminating employees remained stable at $4.0 million. Administrative expenses in 2002 were $1.6 million, an increase of 25.8% over those incurred in 2001. Additional expenditures authorized by the Board of Trustees in 2002 budget included additional employees, salary increases and administrative consulting services.

Overall Analysis. Overall, as of December 31, 2003, net assets increased by $217.2 million or 20.8% from the prior year, and over the five-year period ending December 31, 2003, net assets increased by 17.7%. The overall slow growth within the last five-year period was due to disappointing market returns to the investment portfolio.

Request for Information

This financial report is designed to provide a general overview of the finances of the City of Austin Employees' 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 Finance Manager, City of Austin Employees' Retirement System, 418 E. Highland Mall Blvd., Austin, Texas 78752.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Plan Net Assets

December 31, 2003

Assets	**Retirement Plan**	**Restoration Plan**	**Total**
Cash and cash equivalents	$ 2,366,498	15,000	2,381,498
Interest and dividends receivable	2,798,221	—	2,798,221
Trades pending settlement	1,598,632	—	1,598,632
Investments, at fair value (note 3):			
United States Government securities	331,360,638	—	331,360,638
Corporate bonds	61,534,797	—	61,534,797
Corporate stocks	610,305,292	—	610,305,292
Municipal bonds	1,237,312	—	1,237,312
International stocks	238,525,956	—	238,525,956
International short-term funds	763,390	—	763,390
Short-term investment funds	11,874,539	—	11,874,539
Total investments	1,255,601,924	—	1,255,601,924
Invested securities lending collateral (note 3)	103,030,695	—	103,030,695
Capital assets, net (note 5)	1,315,624	—	1,315,624
Total assets	1,366,711,594	15,000	1,366,726,594
Liabilities			
Accrued expenses	694,989	—	694,989
Trades pending settlement	2,912,739	—	2,912,739
Securities lending collateral (note 3)	103,030,695	—	103,030,695
Refunds and death benefits payable	532,003	—	532,003
Total liabilities	107,170,426	—	107,170,426
Net assets held in trust for pension benefits (a schedule of funding progress is presented on page 53)	$ 1,259,541,168	15,000	1,259,556,168

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Plan Net Assets

December 31, 2002

Assets	**Retirement Plan**	**Restoration Plan**	**Total**
Cash and cash equivalents	$ 2,405,505	5,000	2,410,505
Interest and dividends receivable	2,804,080	—	2,804,080
Trades pending settlement	184,367	—	184,367
Employer contributions receivable (note 4)	1,013,597	—	1,013,597
Employee contributions receivable (note 4)	1,013,597	—	1,013,597
Retiree overpayments receivable	724	—	724
Investments, at fair value (note 3):			
United States Government securities	103,501,239	—	103,501,239
Corporate bonds	248,372,400	—	248,372,400
Corporate stocks	462,516,917	—	462,516,917
Municipal bonds	1,260,601	—	1,260,601
International stocks	201,952,788	—	201,952,788
International short-term funds	1,267,785	—	1,267,785
Short-term investment funds	16,371,032	—	16,371,032
Total investments	1,035,242,762	—	1,035,242,762
Invested securities lending collateral (note 3)	124,622,294	—	124,622,294
Capital assets, net (note 5)	1,356,344	—	1,356,344
Total assets	1,168,643,270	5,000	1,168,648,270
Liabilities			
Accrued expenses	683,881	—	683,881
Trades pending settlement	371,812	—	371,812
Securities lending collateral (note 3)	124,622,294	—	124,622,294
Refunds and death benefits payable	594,160	—	594,160
Total liabilities	126,272,147	—	126,272,147
Net assets held in trust for pension benefits (a schedule of funding progress is presented on page 53)	$ 1,042,371,123	5,000	1,042,376,123

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year Ended December 31, 2003

	Retirement Plan	Restoration Plan	Total
Additions:			
Contributions:			
Employer contributions (note 4)	$ 24,851,500	55,980	24,907,480
Employee contributions (note 4)	30,449,244	—	30,449,244
	55,300,744	55,980	55,356,724
Investment income:			
Net appreciation in plan investments	218,163,926	—	218,163,926
Interest	17,690,299	—	17,690,299
Dividends	12,728,314	—	12,728,314
Investment income before expenses and securities lending	248,582,539	—	248,582,539
Securities lending income	451,107	—	451,107
Securities lending fees	(217,096)	—	(217,096)
Net securities lending income	234,011	—	234,011
Investment expenses	2,749,856	—	2,749,856
Net investment income	246,066,694	—	246,066,694
Other income	2,636	—	2,636
Total additions	301,370,074	55,980	301,426,054
Deductions:			
Benefit payments	75,481,109	45,980	75,527,089
Contributions refunded to terminating employees	4,476,716	—	4,476,716
DROP disbursements	847,111	—	847,111
Retiree lump-sum annuity	182,186	—	182,186
Death benefits	1,660,137	—	1,660,137
General and administrative expenses	1,552,770	—	1,552,770
Total deductions	84,200,029	45,980	84,246,009
Net increase	217,170,045	10,000	217,180,045
Net assets held in trust for pension benefits, beginning of year	1,042,371,123	5,000	1,042,376,123
Net assets held in trust for pension benefits, end of year	$ 1,259,541,168	15,000	1,259,556,168

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year Ended December 31, 2002

	Retirement Plan	Restoration Plan	Total
Additions:			
Contributions:			
Employer contributions (note 4)	$ 26,372,600	2,674	26,375,274
Employee contributions (note 4)	33,793,720	—	33,793,720
	60,166,320	2,674	60,168,994
Investment income:			
Net depreciation in plan investments	(142,862,245)	—	(142,862,245)
Interest	21,384,197	—	21,384,197
Dividends	10,752,723	—	10,752,723
Investment loss before expenses and securities lending	(110,725,325)	—	(110,725,325)
Securities lending income	400,446	—	400,446
Securities lending fees	(191,560)	—	(191,560)
Net securities lending income	208,886	—	208,886
Investment expenses	2,478,807	—	2,478,807
Net investment loss	(112,995,246)	—	(112,995,246)
Other income	2,223	—	2,223
Total additions	(52,826,703)	2,674	(52,824,029)
Deductions:			
Benefit payments	70,091,186	2,674	70,093,860
Contributions refunded to terminating employees	3,957,964	—	3,957,964
DROP disbursements	106,258	—	106,258
Retiree lump-sum annuity	159,899	—	159,899
Death benefits	928,730	—	928,730
General and administrative expenses	1,641,675	—	1,641,675
Total deductions	76,885,712	2,674	76,888,386
Net decrease	(129,712,415)	—	(129,712,415)
Net assets held in trust for pension benefits, beginning of year	1,172,083,538	5,000	1,172,088,538
Net assets held in trust for pension benefits, end of year	$ 1,042,371,123	5,000	1,042,376,123

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

(1) Plan Description

Retirement Plan

The Board of Trustees of the City of Austin Employees' Retirement System (the System) is the administrator of a single-employer defined benefit pension plan (the Plan). Participating employees include all regular, full time employees, except for civil service firefighters and civil service police officers, who work at least 30 hours per week. At December 31, 2003 and 2002, membership consisted of the following:

	2003	2002
Retirees and beneficiaries currently receiving benefits	2,995	2,783
Terminated members entitled to but not yet receiving benefits	624	604
Current employees	7,432	7,647
Total	11,051	11,034

The System provides service retirement, death, disability and withdrawal benefits. Benefits vest after 5 years of credited service. Participants may retire with 23 years of service regardless of age, or at age 62. Prior to October 1, 1999, active member contributions to the Plan were 7 percent. Effective October 1, 1999, active member contributions increased to 8 percent. Prior to October 1, 1999, the monthly benefit was equal to 2.6 percent of the highest 36-month average annual salary of the last ten years multiplied by years and months of service. Effective October 1, 1999, the monthly benefit multiplier was increased to 2.7 percent. Effective April 1, 2000, the monthly benefit multiplier was increased to 2.98 percent. Effective January 1, 2002, the monthly benefit multiplier was increased to 3.0 percent. Effective January 1, 2001, the System approved a 3.5 percent ad hoc retiree increase and a 2.5 percent increase effective January 1, 2002.

Effective in 2002, a member may elect to retroactively participate in the System's DROP (Deferred Retirement Option Program). DROP programs benefit employees by allowing a lump sum payment in lieu of additional credible service time after reaching retirement eligibility. The member would receive a lump sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date.

In 1995, the Lump-Sum Death Benefit payable upon the death of a retiree increased from $2,000 to $10,000.

Participants are required to contribute 8 percent of their basic compensation to the Plan. The City of Austin (the City) was required to make contributions equal to 7 percent of basic compensation through March 31, 2000 and 8 percent of basic compensation beginning April 1, 2000. The benefit and contribution provisions of this plan are governed by state law. Amendments may be made by the Legislature of the State of Texas. Should the Plan fully terminate at some future time, the retirement allowance of a member would be determined by reference to the member's average final compensation as if the member had attained normal retirement age on that date.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

The System is participating in the Proportionate Retirement Program through which a member of the System may combine his membership service with service credit in a participating entity in any of the state-wide retirement systems covering state employees, teachers, county and district employees, and municipal employees, or, any of the El Paso public employee pension funds, for meeting service requirements for service retirement eligibility.

Under the terms of the Plan, the System's employees obtain membership in the Plan on the same basis as City employees. The System contributes to the Plan the same amount of 8 percent of basic compensation, as described above, for its fourteen current employees as the City does for its 7,418 current employees. The System's employees are also required to contribute 8 percent of their basic compensation to the Plan. Since there is only one Plan, all actuarial calculations are provided on an aggregate basis. The System's annual pension cost for its employees and related contributions made for the past three years are:

	Annual Pension cost	Contributions made
2003	$ 43,234	43,234
2002	41,447	41,447
2001	33,709	33,709

Restoration Plan

On December 19, 2000, the Board adopted a resolution to establish a "Restoration of Retirement Income Plan for Certain Participants in the City of Austin Employees' Retirement System" (Restoration Plan). This Restoration Plan is effective as of January 1, 2000 and is intended to be a "qualified governmental excess benefit arrangement" within the meaning of Section 415(m) of the Internal Revenue Code, and shall be construed, interpreted and administered in accordance with such provision. The Restoration Plan shall be administered as an unfunded plan which is not intended to meet the qualification requirements of Section 401 of the Internal Revenue Code. Eligible members are those who are members in the Basic Plan whose pension or pension-related benefits under the Basic Plan are limited due to the provision of Section 415 of the Internal Revenue Code.

All benefits payable under this Restoration Plan shall be paid by the City of Austin Employees' Retirement System from contributions provided by the Employer and not from the Fund or any other trust unless such trust is maintained solely for the purpose of providing benefits from this Restoration Plan. Benefits due for the years ended December 31, 2003 and 2002 for this Restoration Plan were $0. Net assets remaining in this plan as of December 31, 2003 and 2002 were $15,000 and $5,000, respectively.

At December 31, 2003 and 2002, membership in the Restoration Plan included the following:

	2003	2002
Retirees and beneficiaries currently receiving benefits	5	1
Terminated members entitled to but not yet receiving benefits	—	—
Current employees	—	—
Total	5	1

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

Other Information

The System is required by statute to maintain three separate funds in its internal accounting records. The first fund, defined in the statute as "Fund 1", shall be maintained to account for all accumulated deposits (contributions and interest) of members who have not withdrawn from the System. The second fund, defined as "Fund 2", shall be maintained to account for all other net assets of the System less the amount held in the third fund, defined as "Fund 3", which shall be maintained to account for accumulated contributions by the employer for the Restoration Plan. At December 31, 2003, the balances of Fund 1, Fund 2 and Fund 3 were $252,182,700; $1,007,358,468 and $15,000, respectively. At December 31, 2002, the balances of Fund 1, Fund 2 and Fund 3 were $259,364,044; $783,007,079; and $5,000, respectively.

(2) Summary of Significant Accounting Policies and System Asset Matters

(a) Basis of Accounting

The System's financial statements are prepared using the current financial resources measurement focus and the accrual basis of accounting. Contributions are recognized as revenues in the period in which the related employee payroll is earned. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

The System is not included in any other governmental "reporting entity" as defined by the Governmental Accounting Standards Board.

(b) Investments

The System's investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value. Investment income is recognized in the period earned and purchases and sales of investments are recorded on a trade-date basis. Net appreciation / depreciation in Plan investments includes both realized and unrealized gains and losses.

(c) Contributions Receivable

The final biweekly payroll contributions of employees for the year ended December 31, 2003, and the City's related contributions were deposited in the System prior to year end. Therefore, no contribution receivable is needed as of December 31, 2003. The employee and City contributions for the year ended December 31, 2002 were not deposited in the System by year end and are shown as contributions receivable.

(d) Capital Assets

Capital assets are recorded at cost. Depreciation is computed using the straight-line method over the assets' estimated useful lives of:

Furniture and fixtures	3-12 Years
Building	40 Years

(e) System Expenses

Substantially all System administrative costs are the responsibility of the System. The administrative costs are funded through the investment income.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

(f) Cash and Cash Equivalents

Cash and cash equivalents include demand deposit accounts and money market checking accounts. As of December 31, 2003 and 2002, respectively, cash in demand deposit accounts were fully collateralized by federal depository insurance. As of December 31, 2003 and 2002, the book balances of the money market mutual fund accounts totaled $2,814,403 and $2,575,438, respectively, and controlled disbursement checking accounts totaled ($562,772) and ($205,164), respectively.

(g) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

(h) Budgets and Budgetary Accounting

The System is not legally required to adopt a budget.

(3) Investments

The System is authorized to invest in the following:

Domestic Fixed Income Investments

Total fixed income investments may be no less than twenty-seven percent (27 percent) and no more than thirty-three percent (33 percent) of the investment portfolio measured at fair value. The assets of the System are to be invested only in the following fixed income securities:

1. United States Treasury notes, bonds, and bills;
2. United States government agency obligations;
3. Investment grade corporate bonds (however, the average rating of all corporate bonds held in any investment portfolio, taken together, may not fall below AA);
4. Preferred stocks;
5. Investment grade foreign bonds payable in United States dollars;
6. Cash equivalents in the form of commercial paper rated as A1 by Moody's or P1 by Standard & Poor's;
7. Other corporate obligations with an equivalent or higher rating than items 1 through 6 above; or
8. Obligations backed by United States government and investment grade municipal funds.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

Domestic Equity Investments

Total investments in domestic common stock may be no less than forty-four percent (44 percent) and no more than fifty-three percent (53 percent) of the total investment portfolio measured at fair value less international equities. The assets of the System are invested only in the domestic common stocks listed on the following exchanges:

1. The New York Stock Exchange;
2. The American Stock Exchange; or
3. The National Association of Securities Dealers Automated Quotation (NASDAQ) System.

International Investments

Any international investments must be investment grade and payable in United States dollars. However, such international investments should total no less than fifteen percent (15 percent) and no more than eighteen percent (18 percent) of total value of the System's investments at fair value.

Other Investment Information

As of December 31, 2003 and 2002, respectively, investments in any one organization, other than the United States Government, did not represent five percent or more of net assets available for benefits.

The System is authorized under its investment policy to participate in securities lending programs through The Northern Trust under which, for an agreed-upon fee, system-owned investments are loaned to a borrowing financial institution. Under this agreement, when the loan closes the borrowed securities are returned to the System and the collateral is returned to the borrower. The lending agreement requires securities on loan be collateralized by cash, U.S. Government securities, or irrevocable letters of credit with a total market value of at least 102 percent of the loaned System securities. For global securities pledged as collateral, total market value shall not be less than 105 percent. The System is not exposed to credit risk at December 31, 2003 and 2002, respectively, as the collateral held exceeded the market value of the securities lent. The System cannot sell or pledge the non-cash collateral unless a default of the securities lending agreement has occurred.

Cash collateral can be invested in a short-term investment pool or in term loans. The term loans can be terminated on demand by either lender or borrower.

At December 31, 2003 and 2002, System investments that were in possession of a borrowing financial institution were collateralized by cash and irrevocable letters of credit. The cash collateral was invested in a short-term investment pool with an average weighted maturity less than the maturity of the loaned securities.

There were no significant violations of legal or contractual provisions and no borrower or lending agent default for fiscal years 2003 and 2002.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

As of December 31, 2003 and 2002, respectively, the System owned the following investments that were in possession of a borrowing financial institution:

2003	Fair Value of Loaned Securities	Cash/Securities Collateral Value	Cash Collateral Investment Value
Loans for cash collateral:			
U.S. Agencies	$ 7,421,918	7,598,996	7,598,996
Corporate bonds	8,597,525	8,835,855	8,835,855
Corporate stocks	53,850,144	55,305,770	55,305,770
International stocks	25,498,316	26,785,850	26,785,850
U.S. Government Securities	4,413,563	4,504,224	4,504,224
	$ 99,781,466	103,030,695	103,030,695
Loans for letters of credit collateral:			
U.S. Government securities	4,409,427	4,528,544	—
U.S. Agencies	9,780,013	10,044,214	—
Corporate stocks	3,334,418	3,435,586	—
Corporate bonds	2,376,954	2,439,267	—
	$ 19,900,812	20,447,611	—
Total	$ 119,682,278	123,478,306	103,030,695

2002	Fair Value of Loaned Securities	Cash/Securities Collateral Value	Cash Collateral Investment Value
Loans for cash collateral:			
U.S. Agencies	$ 23,313,823	23,750,027	23,750,027
Corporate bonds	7,790,285	7,948,101	7,948,101
Corporate stocks	68,129,339	69,705,497	69,705,497
International stocks	21,946,480	23,218,669	23,218,669
	$ 121,179,927	124,622,294	124,622,294
Loans for letters of credit collateral:			
U.S. Government securities	12,677,650	12,888,837	—
U.S. Agencies	5,314,122	5,415,051	—
Corporate stocks	1,085,829	1,106,770	—
	$ 19,077,601	19,410,658	—
Total	$ 140,257,528	144,032,952	124,622,294

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

The System's investments are categorized below to give an indication of the level of custodial risk (Category 1-lowest level of risk to Category 3-highest level of risk), assumed by the System at year end. Category 1 includes investments that are insured or registered, or for which the securities are held by the System's agent in the System's name. Category 2 includes uninsured and unregistered investments, with the securities held by the counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments, with securities held by the broker or dealer, or by the System's agent but not in the System's name.

2003	Category 1	Category 2	Category 3	Carrying Value
Investments:				
United States Government securities	$ 124,258,010	—	—	124,258,010
Corporate bonds	61,534,797	—	—	61,534,797
Corporate stocks	398,764,926	—	—	398,764,926
Municipal bonds	1,237,312	—	—	1,237,312
International stocks	238,525,956	—	—	238,525,956
	824,321,001	—	—	824,321,001
Investments not categorized:				
Short-term investment funds				11,874,539
International short-term funds				763,390
Index funds				418,642,994
Total				$ 1,255,601,924

2002	Category 1	Category 2	Category 3	Carrying Value
Investments:				
United States Government securities	103,501,239	—	—	103,501,239
Corporate bonds	53,180,818	—	—	53,180,818
Corporate stocks	293,094,440	—	—	293,094,440
Municipal bonds	1,260,601	—	—	1,260,601
International stocks	201,952,788	—	—	201,952,788
	652,989,886	—	—	652,989,886
Investments not categorized:				
Short-term investment funds				16,371,032
International short-term funds				1,267,785
Index funds				364,614,059
Total				$ 1,035,242,762

Investments in mutual funds are not categorized because they are not evidenced by securities that exist in physical or book entry form.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

Foreign Currency Options

The System periodically invests in foreign currency options in order to hedge the value of a portion of its investments denominated in foreign currencies. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price on or before a specified expiration date. The foreign currency options held by the System entitle the System to convert the value of certain foreign equities into U.S. Dollars at an agreed rate. The System held no foreign currency options at December 31, 2003 or December 31, 2002.

(4) Contributions Required and Contributions Made

The System's funding policy as guided by state law requires contributions equal to 8 percent, as of December 31, 2003 and 2002, of basic compensation by the participants and by the City.

While the contribution requirements 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 participants and the City provides an adequate financing arrangement. 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, if any exists, and the number of years needed to amortize the System's unfunded actuarial accrued liability is determined using a level percentage of payroll method.

Significant actuarial assumptions used to assess the adequacy of the financing arrangement are the same as those used to compute the unfunded actuarial accrued liability below. The latest actuarial valuation was as of December 31, 2003. In that valuation, the Plan had an unfunded actuarial accrued liability of $203,040,300. At December 31, 2003 and 2002, contributions totaling $55,300,744 and $60,166,320, respectively, were required and paid into the System. The funding objective of the system is for contribution rates to be sufficient to cover the normal cost of the Plan and to amortize any unfunded actuarial accrued liabilities over a period not to exceed 30 years. Due to significant net depreciation in the fair value of the Plan investments caused by the continued downturn in the financial markets, the System's Actuary has reported that the Plan's contribution rate is not sufficient to amortize the System's unfunded liabilities as of December 31, 2003; therefore, the System's funding objective is not being met.

(5) Capital Assets

Capital assets for the years ended December 31, 2003 and 2002 consisted of:

		2003	2002
Land	$	249,964	249,964
Furniture and fixtures		430,976	405,297
Building		1,184,560	1,184,560
Total		1,865,500	1,839,821
Accumulated depreciation		(549,876)	(483,477)
Net capital assets	$	1,315,624	1,356,344

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

The following summarizes the change in capital assets for the year ended December 31, 2003:

Capital assets, not being depreciated:

		Balance December 31, 2002	Additions	Transfers/ Deletions	Balance December 31, 2003
Land	$	249,964	—	—	249,964
Total	$	249,964	—	—	249,964

Capital assets, being depreciated:

		Balance December 31, 2002	Additions	Transfers/ Deletions	Balance December 31, 2003
Furniture and fixtures	$	405,297	25,679	—	430,976
Building		1,184,560	—	—	1,184,560
Total	$	1,589,857	25,679	—	1,615,536

Less accumulated depreciation for:

		Balance December 31, 2002	Additions	Transfers/ Deletions	Balance December 31, 2003
Furniture and fixtures	$	291,109	36,785	—	327,894
Building		192,368	29,614	—	221,982
Total	$	483,477	66,399	—	549,876

The following summarizes the change in capital assets for the year ended December 31, 2002:

Capital assets not being depreciated:

		Balance December 31, 2001	Additions	Transfers/ Deletions	Balance December 31, 2002
Land	$	249,964	—	—	249,964
Total	$	249,964	—	—	249,964

Capital assets, being depreciated:

		Balance December 31, 2001	Additions	Transfers/ Deletions	Balance December 31, 2002
Furniture and fixtures	$	374,930	30,367	—	405,297
Building		1,184,560	—	—	1,184,560
Total	$	1,559,490	30,367	—	1,589,857

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2003 and 2002

Less accumulated depreciation for:

	Balance December 31, 2001	Additions	Transfers/ Deletions	Balance December 31, 2002
Furniture and fixtures	$ 262,884	28,225	—	291,109
Building	162,754	29,614	—	192,368
Total	$ 425,638	57,839	—	483,477

(6) Federal Income Taxes

The Plan is a Public Employee Retirement System and is exempt from Federal income taxes. A favorable determination letter from the Internal Revenue Service was issued in November 1984, with additional letters received December 1999 and March 2003.

(7) Risk Management

The System is exposed to various risks of loss related to torts, errors and omission, violation of civil rights, theft of, damage to, and destruction of assets, and natural disaster. These risks are covered by insurance purchased by the System. This coverage is in compliance with the workers' compensation laws of the State of Texas with no accident or aggregate deductibles. Property physical damage is insured to replacement value with a $250 deductible and a building limit of $888,600 with contents of $203,931. Automobile limits are set at $1,000,000 per occurrence. Insurance coverage by major category of risk has remained relatively constant as compared to the prior fiscal year. Insurance settlements have not exceeded insurance coverage for any of the past three years. The System obtains Workers Compensation and Employers Liability coverage through Texas Mutual Insurance Company.

The System maintains a pension and welfare fund fiduciary responsibility insurance policy with an aggregate limit of liability of $10,000,000.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Schedule of Funding Progress (Unaudited)

For the Years Ended December 31, 1991 through 2003

Actuarial Valuation Date (*)	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (3)-(2)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
12/31/1991	$ 470.7	404.4	(66.3)	116.4	194.6	(34.1)
12/31/1993	579.1	541.2	(37.9)	107.0	235.2	(16.1)
12/31/1995	707.3	623.0	(84.3)	113.5	221.0	(38.1)
12/31/1997	856.4	832.1	(24.3)	102.9	219.2	(11.1)
12/31/1998	952.6	877.8	(74.8)	108.5	219.3	(34.1)
12/31/1999	1,105.1	1,044.5	(60.6)	105.8	244.5	(24.8)
12/31/2000	1,231.0	1,212.6	(18.4)	101.5	268.6	(6.8)
12/31/2001	1,311.3	1,360.3	49.0	96.4	316.8	15.5
12/31/2002	1,250.9	1,440.2	189.3	86.9	322.0	58.8
12/31/2003	1,348.8	1,551.8	203.0	86.9	312.8	64.9

Note: Dollar amounts in millions.

* Valuations were generally performed on a biennial basis through fiscal year 1998. Beginning in fiscal year 1999, valuations will be performed on an annual basis.

See accompanying independent auditors' report.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Schedule of Employer Contributions (Unaudited)

For the Years Ended December 31, 1998 through 2003

Fiscal Year	Annual Required Contribution	Employer Contributions	Percentage Contributed
(1)	(2)	(3)	(4)
1998	$ 16,126,014	$ 16,126,014	100.0%
1999	$ 18,224,558	$ 18,224,558	100.0%
2000	$ 21,531,859	$ 21,531,859	100.0%
2001	$ 24,831,016	$ 24,831,016	100.0%
2002	$ 26,375,274	$ 26,375,274	100.0%
2003	$ 30,660,538	$ 24,851,500	81.05%

See accompanying independent auditors' report.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Schedule of Funding Progress

For the Years Ended December 31, 1991 through 2003

(1) Description of Funding Progress

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the actuarial accrued liability as a factor. Isolated analysis of the dollar amounts of actuarial value of assets, actuarial accrued liability and unfunded actuarial accrued liability can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides an indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the public employee retirement system. Trends in assets in excess of pension benefit obligation and annual covered payroll are both affected by inflation. Expressing the assets in excess of actuarial accrued liability and annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the progress made in accumulating sufficient assets to pay benefits when due. Generally, the higher this percentage, the stronger the public employee retirement system.

(2) Actuarial Assumptions and Methods

Funding Method - An entry age normal actuarial cost method of valuation is used in determining benefit liabilities and normal cost. Differences between assumed and actual experience (actuarial gains and losses) become part of unfunded actuarial accrued liabilities. The System has a fixed contribution rate greater than the normal cost and the System is currently unfunded. Therefore, the contributions received in excess of the normal cost are used to amortize the unfunded liabilities. Due to the significant asset losses caused by the continued downturn in the financial markets, the plan's contribution rate is not sufficient to amortize the System's unfunded liabilities; therefore, the funding objective is not being met. In the absence of significant actuarial gains, the current contribution rates will not be sufficient to support the current benefit structure of the Plan. Significant actuarial assumptions employed by the actuary as of December 31, 2002 for fiscal year 2003, the date of the latest actuarial study, include:

Amortization method	Level percent of pay, open
Payroll growth rate for amortization	3.5%
Remaining amortization period	Infinite
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	4.0% to 14.0%
Includes inflation at	3.5%
Cost-of-living adjustments	None assumed

See accompanying independent auditors' report.

Supplementary Information

Investment Expenses

	2003	2002
Custodial Fees		
The Northern Trust Bank	$210,000	$222,192
Total	**210,000**	**222,192**
Investment Managers		
Agincourt Capital Management	310,934	184,332
Aronson + Johnson + Ortiz	224,113	24,672
Driehaus Capital Management	161,944	0
Eubel, Brady & Suttman	474,499	652,025
Northern Trust NTGI Funds	102,857	124,943
Pilgrim Baxter	11,656	68,939
Sprucegrove Investment Mgmt.	509,595	505,966
Sterling Capital Management	46,567	43,008
Wall Street Associates	89,294	67,313
Walter Scott & Associates	467,009	464,545
Miscellaneous	1,386	0
Total	**2,399,856**	**2,135,743**
Investment Consulting Fees		
Summit Strategies Group	140,000	141,222
Total	**140,000**	**141,222**
Total	**$2,749,856**	**$2,449,157**

Note: These expenses are presented on an accrual basis.

Administrative Expenses

Actuary	$136,903	$95,994
Administrative	981,089	950,804
Administrative Consultant	0	112,204
Attorney	65,949	48,390
Auditing	42,855	36,750
Bank Fees	11,261	8,624
Computer Support	65,087	125,924
Cont. Ed. & Due DiligenceVisits	67,425	103,820
Depreciation	66,399	57,839
Executive Search	34,602	0
Insurance	56,093	53,838
Member Communications	25,107	47,488
Total	**$1,552,770**	**$1,641,675**

Consultant Expenses

	2003	2002
Actuary		
Gabriel, Roeder & Smith	$85,011	$95,994
Milliman	51,892	0
	136,903	**95,994**
Administrative Consulting		
Jefferson Wells	0	112,204
	0	**112,204**
Attorney		
Barney L. Knight, & Assciates	56,352	36,161
Lawson & Fields, PC	9,597	12,229
	65,949	**48,390**
Auditing		
KPMG LLP	42,855	36,750
	42,855	**36,750**
Banking Services		
JP Morgan Chase Bank	10,658	8,297
National Payment Corp.	613	327
	11,261	**8,624**
Computer Services		
DeRosa Mangold	3,353	0
Levi, Ray & Shoup	31,838	85,280
Riata	22,819	35,899
	58,010	**121,179**
Executive Search		
Bennett & Associates	26,744	0
Other Expenses	7,858	0
	34,602	**0**
Medical		
Michael Perkins, MD	930	5,348
	930	**5,348**
Total	**$350,510**	**$428,489**

INVESTMENT SECTION

Summit Strategies
Group

January 1, 2004

The Board of Trustees
City of Austin Employees' Retirement System
418 E. Highland Mall Boulevard
Austin, TX 78752-3720

After three consecutive down years, the COA ERS investment portfolio rebounded this past year, posting a positive return of 24.3% for the fiscal year ending December 31, 2003. After posting a remarkable investment return of 24.8% in the fiscal year ended December 31, 1999, the investment portfolio suffered losses of -1.4%, -6.1%, and -9.5% in the fiscal years ended December 31, 2000, December 31, 2001 and December 31, 2002, respectively. That being said, the COA ERS investment portfolio held up remarkably well in very difficult times, and the longer-term results remain strongly positive. Since reaching their all-time highs in March 2000, the major equity markets have fallen hard. Since establishing a record high close of 1,527.46 on March 24, 2000, the S&P 500 Index of large capitalization US stocks fell by almost 50% to a low of 776.76 on October 9, 2002. Since that time the S&P 500 has risen 43% to 1,111.92 on December 31, 2003, levels not seen since April of 2002.

As detailed earlier, the COA ERS investment portfolio gained 24.3% for the year ending December 31, 2003. This exceeded the fund's Policy Benchmark and the Median Public Fund in the ICC sample. Specifically, the investment portfolio beat its Policy Benchmark return of 22.6% by 1.7%, and exceeded the Median Public Fund return of 22.1% by 2.2%, ranking in the 16th percentile. This is largely attributable to COA ERS' larger weighting or percentage of equities versus other Public Funds. During the fiscal year, all COA ERS investment portfolio asset class composites, with the exception of the International Equity Composite, exceeded their benchmarks. Strong performance by small cap equities and value added by several managers played a role in the strength at the Total Fund level. Longer-term results are good as well and in fact quite impressive. For the 5-year period, the fund returned 5.4% annualized. In this case, the return exceeded the Policy Benchmark and more than 74% of the public funds in our sample. All rates of return were calculated in accordance with AIMR performance presentation standards.

Early in fiscal year 2003, Driehaus Capital Management was added as a small cap growth manager. Driehaus replaced Pilgrim Baxter, who offered little down market protection and negatively impacted the total fund return. In the spring, a review of the asset allocation was completed and in the fall the search for the mandated real estate manager began. On a more personal note the professionals of Summit were greatly saddened by the loss of Glen Bell in December. Glen not only served the Board well through his professional and consummate leadership of the Investment Committee, but he was truly a gentleman in every sense of the word. We are better off for knowing him and he will be missed.

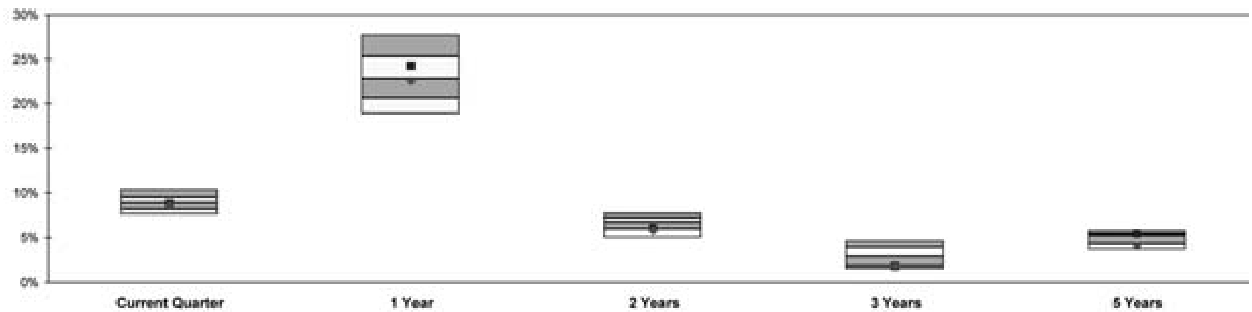
The results for the past year did achieve the fund's actuarial assumption for long-term investment results. The investment markets, however while not collapsing, are not expected to reward investors as handsomely for taking risk in the future as they have in the past. We are heartened to see such positive returns for a change, but look to the future with a tempered perspective. The long-term results are excellent and the hard work of the Board and staff during the trying times of the past few years are to be commended. We continue to believe that the fund is in a very good position to capture consistent, quality results in the years to come. All of us at Summit Strategies Group have enjoyed our COA ERS experience and look forward to continued service and success. Thank you.

Sincerely,

Eric J. Ralph, CFA
Senior Vice President

TOTAL FUND VS. THE NORTHERN TRUST PUBLIC FUND UNIVERSE

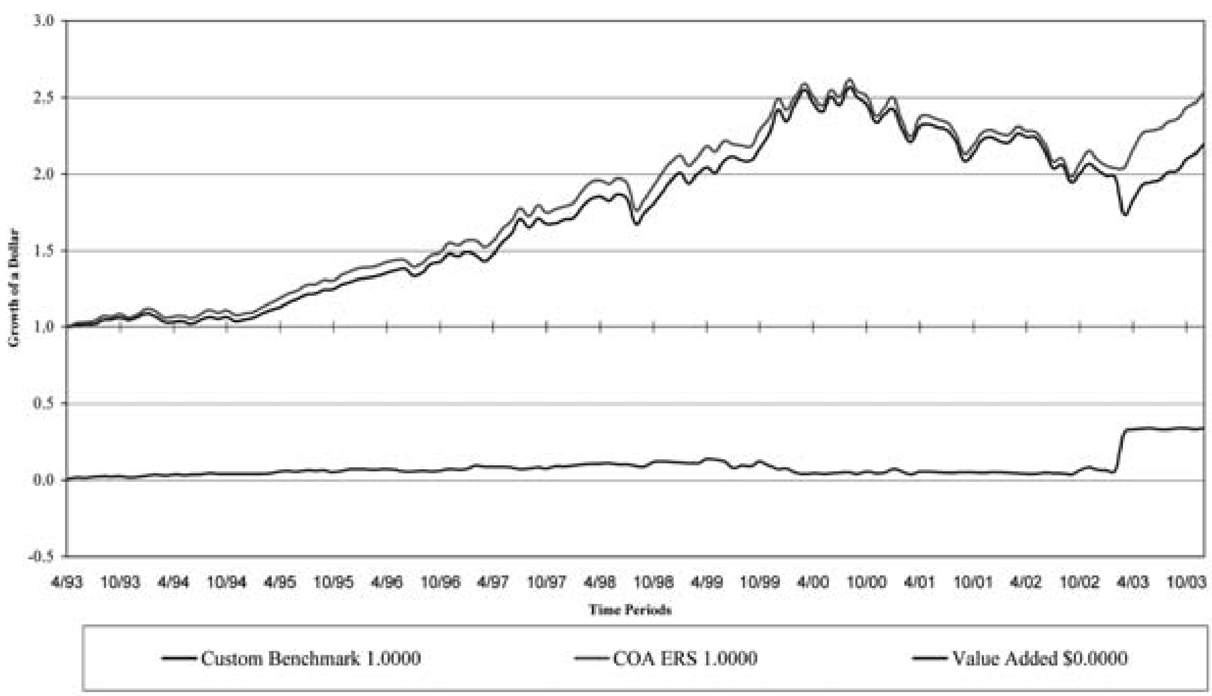
Market Value: $1.257 Billion
The Custom Benchmark consists of 33% S&P500, 14% Russell 2500, 15% EAFE, and 38% Lehman Aggregate.



	Current Quarter	1 Year	2 Years	3 Years	5 Years
■ COA ERS (gross of fees)	8.8%	24.3%	6.0%	1.8%	5.4%
♦ Custom Benchmark	8.6%	22.6%	5.8%	1.8%	4.0%
Observations	34	31	28	25	18
10th Percentile	10.4%	27.7%	7.7%	4.6%	5.8%
1st Quartile	9.5%	25.3%	7.3%	3.9%	5.4%
Median	8.9%	22.8%	6.7%	2.8%	5.3%
3rd Quartile	8.2%	20.6%	6.0%	1.8%	4.3%
90th Percentile	7.6%	18.9%	5.0%	1.5%	3.6%

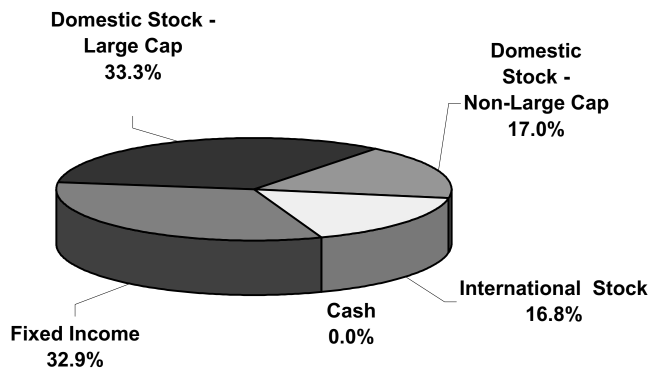
GROWTH OF A DOLLAR/TOTAL FUND

The Custom Benchmark consists of 33% S&P 500, 14% Russell 2500, 15% MSCI EAFE, and 38% Lehman Aggregate.

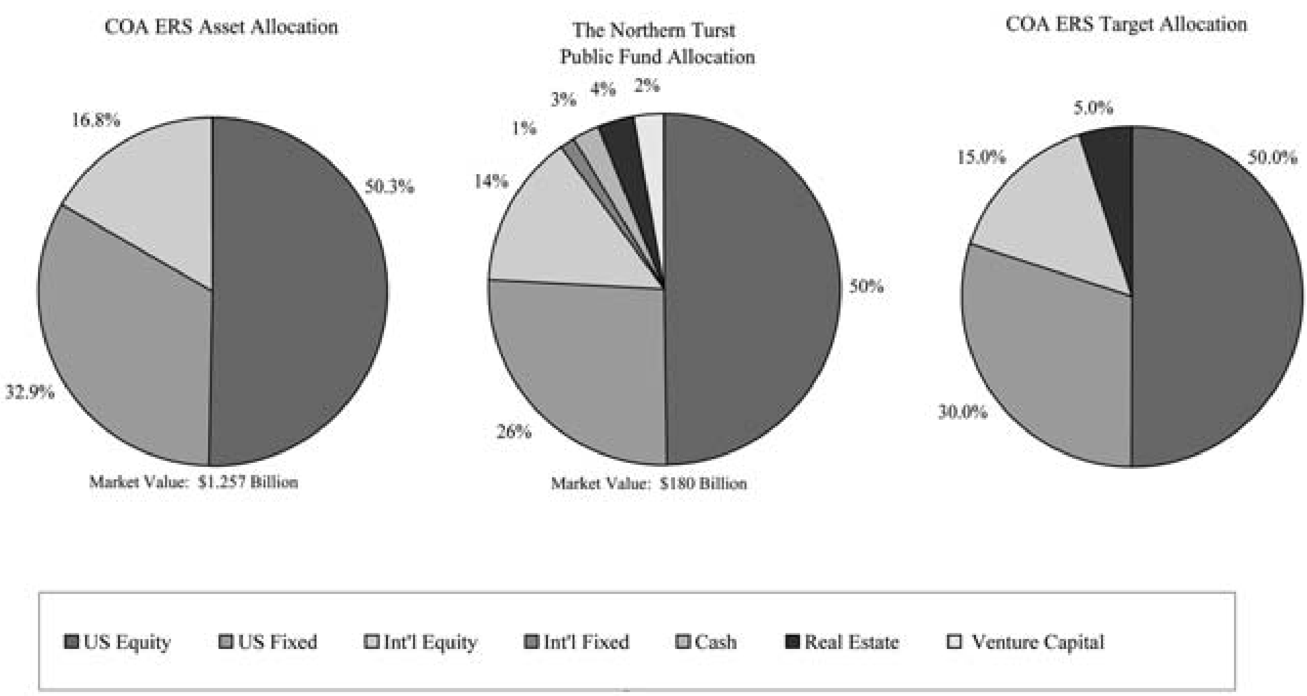


INVESTMENT SUMMARY AT FAIR MARKET VALUE

	Fair Value	Percentage of Total Fair Value
Fixed Income	413,547,506	32.9%
Domestic Stock - Large Cap	418,238,935	33.3%
Domestic Stock- Non-Large Cap	214,172,123	17.0%
International Stock	211,038,212	16.8%
Cash	89,263	0.0%
Total Investments	**1,257,086,038**	**100.0%**



ALLOCATION BY SECTOR



ASSET ALLOCATION

Manager/Asset Class	Current Value	Minimum %	Minimum Target	Normal %	Normal Target	Maxium %	Maxium Target	Difference from Target	% of Fund
DOMESTIC FIXED INCOME	**413,547,506**	**31.85%**	**400,381,903**	**35.00%**	**439,980,113**	**38.15%**	**479,578,323**	**(26,432,608)**	**32.90%**
AGINCOURT CAPITAL MGMT LLC	206,444,877	15.93%	200,190,951	17.50%	219,990,057	19.08%	239,789,162	(13,545,179)	16.43%
NTGI AGGREGATE BOND INDEX FUND	207,102,628	15.93%	200,190,951	17.50%	219,990,057	19.08%	239,789,162	(12,887,428)	16.47%
INTERNATIONAL	**211,038,212**	**14.79%**	**185,891,598**	**16.25%**	**204,276,481**	**17.71%**	**222,661,364**	**6,761,731**	**16.79%**
WALTER SCOTT & PARTNERS LTD	102,559,180	7.39%	92,945,799	8.13%	102,138,241	8.86%	111,330,682	420,939	8.16%
SPRUCEGROVE INVESTMENT MGMT LTD	108,479,032	7.39%	92,945,799	8.13%	102,138,241	8.86%	111,330,682	6,340,791	8.63%
US EQUITIES (Large)	**418,238,935**	**29.58%**	**371,783,196**	**32.50%**	**408,552,962**	**35.43%**	**445,322,729**	**9,685,972**	**33.27%**
NTGI S&P 500 INDEX FUND	210,041,492	14.79%	185,891,598	16.25%	204,276,481	17.71%	222,661,364	5,765,011	16.71%
ALLIANCE CAPITAL MGMT LP	101,715,190	7.39%	92,945,799	8.13%	102,138,241	8.86%	111,330,682	(423,050)	8.09%
ARONSON+PARTNERS	106,482,253	7.39%	92,945,799	8.13%	102,138,241	8.86%	111,330,682	4,344,012	8.47%
US EQUITIES (Non-Large)	**214,172,123**	**14.79%**	**185,891,598**	**16.25%**	**204,276,481**	**17.71%**	**222,661,364**	**9,895,642**	**17.04%**
DRIEHAUS CAP MGMT(small cap - growth)	54,638,068	3.70%	46,472,899	4.06%	51,069,120	4.43%	55,665,341	3,568,948	4.35%
STERLING CAP MGMT(small cap - value)	52,845,325	3.70%	46,472,899	4.06%	51,069,120	4.43%	55,665,341	1,776,205	4.20%
WALL STREET ASSOC (mid cap - growth)	51,873,049	3.70%	46,472,899	4.06%	51,069,120	4.43%	55,665,341	803,929	4.13%
EBS ASSET MGMT INC (mid cap - value)	54,815,680	3.70%	46,472,899	4.06%	51,069,120	4.43%	55,665,341	3,746,560	4.36%
CASH	**89,263**	**0.00%**	**0**	**0.00%**	**0**	**0.00%**	**0**	**89,263**	**0.00%**
CASH	**89,263**	**0.00%**		**0.00%**		**0.00%**		**89,263**	**0.00%**
TOTAL	**1,257,086,038**								

TOP TEN EQUITY HOLDINGS

Security Description	CUSIP/SEDOL	Country	Market Value	% of Fund
Citigroup Inc Com	172967101	USA	$8,115,888	0.65%
Microsoft Corp. Com	594918104	USA	$5,926,608	0.47%
Intel Corp. Com	458140100	USA	$5,058,620	0.40%
Pfizer Inc. Com	717081103	USA	$4,596,433	0.37%
Gen Elec Co. Com	369604103	USA	$4,327,906	0.34%
Amern Intl Grp Com	26874107	USA	$4,043,080	0.32%
MBNA Corp. Com	55262L100	USA	$3,951,150	0.31%
Viacom Com Cl B	925524308	USA	$3,923,192	0.31%
Cisco Sys Inc. Com	17275R102	USA	$3,811,101	0.30%
Wal-Mart Stores Com	931142103	USA	$3,623,315	0.29%
Total Top 10 Holdings			**$47,377,293**	3.77%
Total Investments			**$1,257,086,038**	100.00%

BROKER COMMISSIONS OVER $10,000

Broker Name	Commissions Paid	# of Shares Traded	Cost per Share
Banc America Secur. Montgomery Div.	$13,872	262,334	0.0529
Brockhouse & Cooper Montreal	11,912	296,447	0.0402
CIBC World Markets Corp. New York	10,716	220,425	0.0486
Credit Suisse First Boston Corporation	18,640	394,825	0.0472
Deutsche Bank Securities Inc.	57,129	2,864,730	0.0199
Goldman Sachs & Company	45,036	1,667,775	0.0270
Imperial Capital LLC	30,639	612,775	0.0500
Investment Technology Group Inc.	40,118	1,999,300	0.0201
J.P. Morgan Securities Inc	16,824	339,450	0.0496
Jefferies & Company	12,431	282,200	0.0441
Lehman Brothers Inc.	17,405	344,570	0.0505
Lynch Jones & Ryan	82,860	2,010,890	0.0412
Merrill Lynch Capital Markets	10,811	125,860	0.0859
Merrill Lynch Pierce Fenner & Smith	168,963	4,527,920	0.0373
Morgan Stanley & Co Inc. New York	17,927	356,775	0.0502
Neuberger and Berman	1,625,956	23,578,892	0.0690
PXP Securities Corp	25,034	1,128,537	0.0222
Smith Barney Inc	28,067	720,300	0.0390
UBS Securities LLC New York	16,068	311,850	0.0515
Weeden and Co.	10,454	395,530	0.0264
Minor Brokers - 137 total	249,581	8,778,971	0.0284
Total Broker Commissions	**$2,510,440**	**51,220,356**	**$0.0490**

COMPARISON OF INVESTMENT MANAGER PERFORMANCE

Manager	Balance 12/31/02	Balance 12/31/03	2003 Gross Return (%)	2003 Mgmt Fees (Cash Basis)	After-Fees Return (%)		
					2003	3-years	5-years
FIXED INCOME GROUP	**$372,975,027**	**$413,547,505**	**4.6%**	**37067612.0%**	**4.5%**	**$ 0**	**6.8%**
AGINCOURT CAPITAL MANAGEMENT	177,783,445	206,444,877	5.1%	31715200.0%	4.9%	0	6.8%
Benchmark - LB Aggregate			*4.1%*		*4.1%*	*0*	*6.6%*
NTGI AGGREGATE BOND INDEX FUND	195,191,582	207,102,628	4.0%	5352412.0%	4.0%	0	N/A
Benchmark - LB Aggregate			*4.1%*		*4.1%*	0	6.6%
INTERNATIONAL EQUITIES	**$181,381,800**	**$211,038,212**	**30.6%**	**94948500.0%**	**29.9%**	**$ 0**	**6.2%**
WALTER SCOTT & PARTNERS	87,985,454	102,559,180	27.0%	44975200.0%	26.4%	(0)	5.7%
Benchmark-MCSI EAFE			*39.2%*		*39.2%*	*(0)*	*0.3%*
SPRUCEGROVE INVESTMENT MGMT	93,396,346	108,479,032	33.8%	49973300.0%	33.1%	N/A	N/A
Benchmark-MCSI EAFE			*39.2%*		*39.2%*	*(0)*	*0.3%*
US EQUITIES LARGE	**$340,033,193**	**$418,238,935**	**29.9%**	**27262460.0%**	**29.8%**	**$ (0)**	**-0.6%**
ALLIANCE CAPITAL MANAGEMENT	81,945,270	101,715,190	26.7%	0.0%	26.7%	N/A	N/A
Benchmark-Russell 1000 Growth			*29.7%*		*29.7%*	*(0)*	*-5.1%*
ARONSON & PARTNERS	89,328,472	106,482,253	35.3%	22411300.0%	34.9%	N/A	N/A
Benchmark-Russell 1000 Value			*30.0%*		*30.0%*	*0*	*3.6%*
NTGI S&P 500 INDEX FUND	168,759,451	210,041,492	28.8%	4851160.0%	28.8%	(0)	N/A
Benchmark-S&P 500			*28.7%*		*28.7%*	*(0)*	*-0.6%*
US EQUITIES NON-LARGE	**$142,036,462**	**$214,172,122**	**51.7%**	**71627028.0%**	**51.2%**	**$ 0**	**11.7%**
PILGRIM BAXTER	28,186,140	N/A	N/A	2632000.0%	N/A	N/A	N/A
Benchmark-Russell 2000 Growth			*48.5%*		*48.5%*	*(0)*	*0.9%*
DRIEHAUS CAPITAL MANAGEMENT	N/A	54,638,068	N/A	10850100.0%	N/A	N/A	N/A
Benchmark-Russell 2000 Growth			*48.5%*		*48.5%*	*(0)*	*0.9%*
STERLING CAPITAL MANAGEMENT	38,862,638	52,845,325	43.1%	4343578.0%	43.0%	0	N/A
Benchmark-Russell 2000 Value			*46.0%*		*46.0%*	*0*	*12.3%*
EBS ASSET MANAGEMENT	46,496,253	54,815,680	32.3%	45973775.0%	31.0%	N/A	N/A
Benchmark-Russell Mid Cap Value			38.1%		38.1%	*0*	*8.7%*
WALL STREET ASSOCIATES	28,491,431	51,873,049	45.7%	7827575.0%	45.5%	N/A	N/A
Benchmark-Russell Mid Cap Growth			*42.7%*		*42.7%*	*(0)*	*2.0%*
CASH	**$1,432,915**	**$89,263**	**1.1%**	**0.0%**	**1.1%**	**0**	**3.7%**
Benchmark - 90-day T-bill			*1.2%*		*1.2%*	*0.02*	*3.7%*
TOTAL INVESTMENTS	**$1,037,859,397**	**$1,257,086,038**	**24.2%**	**230905600.0%**	**24.0%**	**$0**	**5.2%**
Benchmark - COA ERS Policy Benchmark			*22.6%*	*(Cash Basis)*	*22.6%*	0.02	0.04

Note: The basis for calculation is the Modified Dietz Method applied monthly, which is in accordance with the Performance Presentation Standards of the Association for Investment and Research (AIMR_PPS®).

SUMMARY OF INVESTMENT POLICY

The City of Austin Employees' Retirement System Board of Trustees, which has the fiduciary duty of overseeing the pension fund investments, has adopted a Statement of Investment Policy and Objectives. This summary includes the major elements of this annually reviewed document. A copy, in its entirety, is available upon request.

INVESTMENT GOALS

The purpose of the Fund is to accumulate the financial reserves necessary to provide for the retirement or pensioning of eligible Members of the City of Austin Employees' Retirement System and their beneficiaries. Given this purpose, the System's liquidity requirement, and the source and predictability of contributions, the Board elects to assume normal pension fund risk in pursuing an investment program. A primary objective of the investment management of the Fund is to emphasize consistency of growth in a manner that protects the Fund from excessive volatility in market value from year to year.

The Board, with consultation, advice and assistance from the investment consultant, will use the Fund's asset allocation as the primary tool to achieve this goal. As this is a long-term projection and investments are subject to short-term volatility, the main investment review focus of the Board will be to emphasize total return of the Fund versus its absolute and relative targets, each asset segment's composite performance versus appropriate market benchmarks, and each money manager's performance versus a specified asset class style benchmark and style peer comparison over relevant time periods. Each manager is expected to maintain a consistent philosophy and style, perform well versus others utilizing the same style, add incremental value after costs and provide investment management in compliance with this document and the manager's contract with the System.

INVESTMENT PHILOSOPHY

The Fund is a permanent one.

The benefit obligations of the System must be met on a timely and regular basis.

There is currently no expectation of a need for significant liquidity from the Fund's portfolio.

The Fund shall be considered a total return fund, with appropriate recognition given to both current income and capital appreciation. Taxes shall not be a consideration. As such, market value will be the only relevant basis for investment value.

In the long run, ownership (equity investment) is a prudent investment vehicle for preservation of real values. The purpose of fixed income investments is to protect the principal and provide a measure of stability to the portfolio.

As a long-term fund with a commitment to funding the full benefits of the participants, cash flow considerations shall take precedence over the liability stream when considering overall asset allocation of fund assets.

IDENTIFICATION OF DUTIES

There are several parties acting as fiduciaries regarding the investment program for the Fund. This document will set out specific duties and responsibilities for the investment-related parties as they carry out their specific roles towards achieving the objectives of the Fund.

PERMISSIBLE INVESTMENTS

Listed below are the investment vehicles specifically permitted currently under this Statement of Investment Policies and Objectives. They are categorized as equity or fixed income to indicate how they are classified for purposes of the asset-mix guidelines in a subsequent section. Unless given authorization in writing, managers are allowed to invest only in the security types listed below for the asset class for which they have been hired.

Equities	***Fixed Income***	***Real Estate***
Common Stocks	Domestic and Yankee Bonds	Open-Ended Commingled Funds
Convertible Bonds	Mortgages and Mortgage-Backed Securities	
Preferred Stocks	Asset-Backed Securities	
	Cash-Equivalent Securities	
	Money Market Funds, Bank STIF and STEP Funds	

1. The above assets can be held in co-mingled (mutual) funds as well as privately managed separate accounts. If held in a co-mingled account or mutual fund, the prospectus or Declaration of Trust takes precedence over this document.

2. Private placement bonds are not permitted. 144(a) fixed income securities are allowable.

3. Investments may not be made in any investment that is prohibited by the Internal Revenue Service, the Department of Labor or statutory restrictions.

4. For purposes of definition, cash equivalent securities are any fixed income investment with less than one year to maturity or reset date.

5. The securities representing equity of any one company shall not exceed 4% of the cost basis or 6% of the market value of any manager's portfolio. Fixed income securities of any one corporation shall be limited to 4% at cost of a portfolio and may not exceed 6% at market. This restriction also applies to asset backed securities, non-agency mortgage-backed securities (including commercial mortgage-backed securities) and taxable municipals. The total holdings of an agency-issued mortgage-backed security of the same coupon and maturity series of the same agency shall not exceed 20% of the portfolio at cost (agency-issued mortgage-backed securities to include GNMA's). The direct debt of the federal government (treasury bonds, bills and notes) shall not be restricted as a percentage of the portfolio.

6. The Fund will be invested in a manner consistent with all applicable local, state and federal laws.

7. International equity managers may invest in depository receipts as long as the underlying security is permissible within these guidelines and the investment does not expose the Fund to any greater risk than the risk from holding the underlying security.

8. Domestic equity managers are allowed to invest in dollar-denominated, SEC registered stock of foreign domiciled companies traded on the NYSE, AMEX or OTC markets. Concentration restrictions for the above securities are the same as for any other security.

TOTAL PENSION FUND INVESTMENT OBJECTIVES

Both relative and absolute results will be considered in the evaluation of the total Fund's performance. The following are the performance expectations for the Fund.

The Fund's total return after fees should exceed the total return of an index composed of a mix of asset class benchmarks in proportions set out in the Statement of Investment Policies and Objectives.

The time period for this objective is one market cycle or five years, whichever is shorter.

ASSET CLASS DIVERSIFICATION

Within the broad definition of equities and fixed income for allocation purposes, the Board with advice from the consultant, believe it is prudent to diversify within asset classes. The intra-asset class categories and their proportion of the total asset class allocation shall be:

Equities:	**65%**	**Fixed Income:**	**30%**	**Real Estate:**	**5%**
Large Cap Domestic	50%	Core Fixed Income	100%	Real Estate	100%
Non-Large Cap Domestic	25%	Cash	0%		
International	25%				

While the Board with advice from the consultant, believes that diversification is prudent, they also believe that over-diversification is detrimental to the System. Therefore, the Board shall not consider an asset segment for inclusion in the portfolio that does not warrant a 5% allocation of the total fund.

Rebalancing will take place when the broad asset class trigger percentages have been reached.

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Actuarial Section

GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries
5605 N. MacArthur Blvd. • Suite 870 • Irving, Texas 75038-2631 • 469-524-0000 • fax 469-524-0003

March 23, 2004

Mr. Stephen Edmonds
Executive Director
City of Austin Employees' Retirement System
418 E. Highland Mall Blvd.
Austin, TX 78752

Dear Mr. Edmonds:

Subject: Actuarial Valuation as of December 31, 2003

We are pleased to present our report on the actuarial valuation of the City of Austin Employees' Retirement System. Based upon this actuarial valuation as of December 31, 2003, it is our opinion that these results reasonably reflect the funding status of the System. The previous actuarial valuation of the City of Austin Employees' Retirement System was prepared as of December 31, 2002. Valuations are prepared annually by Gabriel, Roeder, Smith & Company.

As you know, the employee and employer contribution rates are set by statute. It is expected that these contribution rates will remain level as a percentage of payroll. The funding objective of the plan is for the contribution rates to be sufficient to cover the normal cost of the plan and to amortize any unfunded actuarial accrued liabilities over a period not to exceed 30 years. Due to continued recognition of the significant asset losses from 2000, 2001 and 2002 the plan's contribution rate is not sufficient to amortize the System's unfunded liabilities; therefore the funding objective is not currently being met.

New actuarial assumptions were adopted in October of 2002 by the Board and were further modified in June 2003, to be effective as of December 31, 2002, as recommended by the actuary. Further detail on the assumptions and methods may be found in Table 14 of this report. The assumptions are internally consistent and are reasonably based on the actual experience of the Plan. These assumptions and methods are in full compliance with all parameters established by GASB No. 25.

Member Data for retired, active and inactive participants was supplied as of December 31, 2003, by the City of Austin Employees' Retirement System staff. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior year's data. Asset information was also supplied by the City of Austin Employees' Retirement System staff.

Mr. Stephen Edmonds
March 23, 2004
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In addition to the actuarial valuation results, various accounting and statistical tables are also included which should help you compare the results of this plan year with prior years. The trend data schedules of the financial section of the COA ERS Comprehensive Annual Financial Report (CAFR) were prepared by Gabriel, Roeder, Smith & Company. Information in these schedules for years 1993 though 2000 was prepared by Watson Wyatt & Company. Information in these schedules prior to 1993 was determined by another actuarial firm.

The following tables contained in this actuarial valuation report were prepared by Gabriel, Roeder, Smith & Company and will be included in the COA ERS 2003 actuarial section:

Table 1 – Summary of Cost Items
Table 2 – Analysis of Normal Cost by Component
Table 3 – Actuarial Present Value of Future Benefits and Calculation of Actuarial Accrued Liability
Table 4 – Development of Actuarial Value of Assets
Table 5 – Calculation of Excess Investment Income for Actuarial Value of Assets
Table 6 – Change in Net Assets
Table 7 – Actual Versus Expected Actuarial Assets
Table 8 – Actuarial Gain or Loss as of December 31, 2003
Table 9 – Relative Size of Unfunded Actuarial Accrued Liability
Table 10 – Schedule of Active Member Valuation Data
Table 11 – Schedule of Retirants & Beneficiaries Added to and Removed from Rolls
Table 12 – Solvency Test
Table 13a – Schedule of Funding Progress
Table 13b – Schedule of Employer Contributions
Table 13c – Notes to Required Supplemental Information
Table 14 – Statement of Actuarial Methods and Assumptions
Table 15 – Summary of Benefit Provisions
Table 16 – Definition of Terms
Table 17 – Distribution of Active Participants by Age and Length of Service
Table 18 – Distribution of Active Participants by Service and Current Rate of Pay
Table 19 – Average Benefit Payment Amount
Table 20 – Distribution of Retired Members by Type of Benefit
Table 21 – Schedule of Participating Employers
Table 22 – Benefit Expenses by Type

We would like to thank you and your staff for their assistance in providing all necessary information to complete this valuation. Their courteous help is very much appreciated. We look forward to discussing this actuarial valuation report with you at your convenience. Please do not hesitate to let us know if you have any questions or need additional information.

Sincerely,

W. Michael Carter, FSA, MAAA
Senior Conultant

Lewis Ward
Consultant

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EXECUTIVE SUMMARY

The key results from the valuation of the City of Austin Employees' Retirement System as of December 31, 2003, may be summarized as follows:

	December 31, 2003 (1)	December 31, 2002 (2)
• Members		
— Actives	7,432	7,647
— Retirees and beneficiaries	2,995	2,783
— Vested - terminated	624	604
— Total	11,051	11,034
• Covered payroll	$ 312,790,966	$ 322,007,672
• Normal cost	$ 45,338,049	$ 47,612,726
— As % of payroll	14.32%	14.79%
• Actuarial accrued liability	$ 1,551,830,802	$ 1,440,198,646
• Present actuarial value of assets	$ 1,348,790,502	$ 1,250,851,348
• Unfunded actuarial accrued liability (UAAL)	$ 203,040,300	$ 189,347,298
• Estimated yield on assets		
— actuarial value basis	10.13%	-3.48%
— market value basis	23.77%	-9.84%
• Contribution rate		
— Employee	8.00%	8.00%
— Employer	8.00%	8.00%
• Benefit and refund payments	$ 82,693,239	$ 75,244,037
• Amortization period of unfunded actuarial accrued liability	Infinite	Infinite
• GASB No. 25 disclosure		
— UAAL as a % of Payroll	64.9%	58.8%
— GASB funded ratio	86.9%	86.9%

INTRODUCTION

This December 31, 2003, actuarial valuation of the City of Austin Employees' Retirement System has been prepared by Gabriel, Roeder, Smith & Company. The primary purpose of the valuation is to value the liabilities of the System as of December 31, 2003, determine the funding period of any unfunded liability for the plan year beginning January 1, 2004, and to provide certain required disclosure information. We are pleased to have the privilege of working for the Board, and look forward to discussing the results with you at your convenience.

The last actuarial valuation of the City of Austin Employees' Retirement System was prepared as of December 31, 2002 by Gabriel, Roeder, Smith & Company. Valuations are prepared annually as of December 31st.

This valuation reflects the assumption changes adopted by the Board in October of 2002, as a result of the 2002 Experience Study. These changes were further modified last year by reducing the assumptions for the interest crediting rate on employee contributions. The assumption was lowered from 8% to 6%. Board also adopted a temporary modification to the salary increase assumption to reflect the freeze in general wage increases in 2003 and 2004.

Section C of this report provides the current funded status of the plan and reviews the valuation results. Assets are discussed in Section D, while Section E contains an analysis of the actuarial gains and losses during the past year.

Section F discusses some of the historical comparisons and statistical summaries for the plan. Governmental Accounting Standards Board Statement No. 25 (GASB No. 25) information in the report is discussed in Section G, and Section H provides a summary of the valuation results along with other comments.

Various tables supporting the report are contained in Sections I and J, including any change in benefit provisions since the last valuation.

FUNDED STATUS OF THE PLAN

The funded status of the plan is shown in Table 1, Table 2, and Table 3. Table 1 summarizes the various cost items from the current year's and prior year's actuarial valuations, while Table 2 provides an allocation of the normal cost by its various components. Table 3 shows the components of the actuarial liability.

Reviewing the composition of normal cost of the System, Table 2 indicates that the employer normal cost as of December 31, 2003, is 14.32% of pay. This compares with 14.79% of pay as of the last valuation of December 31, 2002. This normal cost is developed based on the entry-age-normal (EAN) actuarial cost method. As may be seen in Item 1, the normal cost for the retirement benefits is 9.83% of pay. The normal cost for the vested termination benefits is 1.82% and 2.04% for refunds of nonvested terminated employees. The normal cost for disability benefits is 0.31%, and the normal cost for death benefits is 0.32%.

Table 1 illustrates a number of the key actuarial items for the 2003 valuation. As mentioned above, the employer normal cost rate is 14.32% of covered payroll. The actuarial accrued liability is $1,551.8 million as shown in Item 5 and as detailed in Table 3. The actuarial value of assets equals $1,348.8 million, as shown in Item 6. Item 7 of Table 1 shows that the plan has a $203.0 million unfunded liability (i.e. liabilities exceed plan assets) as of the valuation date. As of the last valuation (December 31, 2002), the System was underfunded by $189.3 million.

The average age for active plan participants is 42.8 years, and average service is 8.8 years. This compares with an average age of 42.2 years and an average service of 8.3 years at the prior valuation one year ago. Average covered pay is $42,087, which is slightly less than the average one year ago of $42,109 (see Table 10).

The City and the employees are both currently contributing 8% of payroll. Combining the employees' contributions with the City contribution, the System has 16% of payroll to fund benefits. The current normal cost of the plan is 14.32%, which means that the System is receiving contributions in excess of the normal cost equal to 1.68% of pay (16.00% less 14.32). These excess contributions are available to amortize any unfunded actuarial accrued liability. If all assumptions are exactly met then the current unfunded liabilities will never be fully amortized.

CHANGE IN ASSETS

Table 4 and Table 5 show the development of the actuarial value of assets. Item 6 of Table 4 shows the actuarial value of assets as of December 31, 2003, is $1,348.8 million.

Table 4 develops the actuarial value of assets under the actuarial asset valuation method adopted by the Board in conjunction with the change to reporting the System's disclosure information under GASB No. 25. This method begins with the market value of assets and is modified by the "Excess (Shortfall)" between expected investment return and actual income. Only 20% of this Excess (Shortfall) is recognized in the valuation immediately following the year in which the Excess (Shortfall) occurs. The remaining 80% of the Excess (Shortfall) is deferred until future years, with an additional 20% recognized in each subsequent year until 100% of the difference is recognized in the fifth year.

The total deferral of all Excess (Shortfall) investment income for the year (shown in Item 2e) is ($89.2) million. Table 5 shows the development of the Excess (Shortfall) of investment income for the past four years.

An analysis of the change in the System's market value of assets for the last two plan years and an estimate of the return on assets for the System are included in Table 6. The estimated average annual rate of return for the year ending December 31, 2003, assuming that income, revenue, and expenditures are evenly distributed throughout the year is 23.77% on a market value of assets basis. The rate of return for the year ending December 31, 2002, on an actuarial value basis was 10.13%. This compares with the actuarial assumed investment return of 7.75%.

Table 7 shows the development of the gain/(loss) on the actuarial value of assets for the prior plan year. As may be seen in Item 8, the System had an asset gain of $29 million in 2003. This compares to the $147 million loss in 2002.

ACTUARIAL GAINS AND LOSSES

An important part of the change in unfunded actuarial accrued liability from year to year is due to the impact of actuarial gains and losses of the System. This section summarizes the combined asset and liability experience changes since the prior valuation on December 31, 2002.

As can be seen in Item 7 of Table 8, the expected value of the unfunded actuarial accrued liability as of December 31, 2003, is an underfunded position of $198.0 million, before recognition of any assumption changes. This expected value reflects an assumed investment return assumption of 7.75% on the beginning of year unfunded actuarial accrued liability, normal cost, and contributions during 2003.

Since the actual unfunded actuarial accrued liability as of December 31, 2003 is $203.0 million, it represents a total net loss for the period of $5.0 million, as shown in Item 9 of Table 8. That is, the funded status is less than expected. The net actuarial loss includes an asset gain of $29.1 million as shown in Table 7 and a loss on the liability side equal to $34.2 million. The liability loss is broken out by source in Items 16-23 of Table 8. As can be seen on Table 8 the largest portion of the liability loss was due to lower than expected turnover.

There have been no changes to the plan provisions since the prior year. Please see Table 15 for a more detailed description of the plan provisions.

The actuarial assumptions used in this valuation are the same as used in the prior year. These assumptions are detailed in Table 14.

HISTORICAL COMPARISONS AND STATISTICAL SUMMARIES

Various statistical data on the System is shown in the tables contained in Section J. In addition, Tables 9 through 12 of Section I contain certain actuarial trend information which may be of interest.

Table 9 relates the size of the unfunded actuarial accrued liability (UAAL) to three different measurements. In Columns 3 and 4 the UAAL is related to the covered payroll of the System. Columns 5 and 6 relate the UAAL to the actuarial value of assets, while Columns 7 and 8 relate the UAAL to the total actuarial liabilities of the System.

Tables 10 through 12 provide information which should be included in your annual report. Table 10 provides a schedule of active member valuation data. Table 11 provides a schedule of retirants and beneficiaries added to and removed from payments rolls. Solvency test results are presented in Table 12.

GASB NO. 25 DISCLOSURE

The Governmental Accounting Standards Board (GASB) has issued Statement No. 25 which provides the manner in which the actuarial condition of a public sector retirement plan is to be disclosed. COA ERS was required to comply with GASB No. 25 beginning January 1, 1997.

The required schedule of funding progress is shown in Table 13a. Table 13b is the schedule of annual required contributions required by GASB No. 25. Table 13c provides notes to the required supplementary information.

Assets used for GASB No. 25 disclosure are based on the actuarial value used for this valuation. Plan liabilities are based on the Entry Age Normal (EAN) funding method which is the same method used for determining plan liabilities for valuation purposes, as required by GASB No. 25.

SUMMARY AND CLOSING COMMENTS

It is our opinion that the results of this valuation provide a reasonable reflection of the funded status of the System. Due to the significant asset losses that have occurred in recent years the System's contributions are not currently sufficient to amortize the unfunded liability of the System. In the absence of significant actuarial gains the current contribution rates will not be sufficient to support the current benefit structure of the Plan.

The overall funded position of the System remains unchanged from the prior valuation.

It should also be noted that while the System's funded position has not changed since the prior valuation, the large asset losses (on a market value basis) from 2000, 2001 and 2002 have only been partially recognized. In the absence of any other actuarial gains or a continuation of the turn around in the financial markets, the funded position of the System will continue to decrease over the next several years.

As noted above, in the absence of significant actuarial gains either the contribution rates to the Plan will need to increase or the future benefits promised under the Plan will need to be reduced to a level that can be supported by the contribution rates.

ACTUARIAL TABLES

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 1

SUMMARY OF COST ITEMS

	December 31, 2003 Cost Item	December 31, 2003 Cost as % of Pay		December 31, 2002 Cost Item	December 31, 2002 Cost as % of Pay
	(1)	(2)		(3)	(4)
1. Participants					
a. Active	7,432			7,647	
b. Terminated vested	624			604	
c. Retired participants and beneficiaries	2,944			2,730	
d. Disabled	51			53	
e. Total	11,051			11,034	
2. Covered Payroll	$ 312,790,966			$ 322,007,672	
3. Averages for Active Participants					
a. Average age	42.8			42.2	
b. Average years of service	8.8			8.3	
c. Average pay	$ 42,087			$ 42,109	
4. Employer Normal Cost	$ 45,338,049	14.32%	*	$ 47,612,726	14.79%
5. Actuarial Accrued Liability					
a. Active participants	$ 734,484,685			$ 685,562,117	
b. Terminated vested participants	33,719,572			30,467,231	
c. Refunds of terminated nonvested participants	6,525,720			5,981,712	
d. Retired participants and beneficiaries	768,804,704			709,512,896	
e. Disabled participants	8,296,121			8,674,690	
f. Total	$ 1,551,830,802	496.12%		$ 1,440,198,646	447.26%
6. Present Actuarial Assets	$ 1,348,790,502	431.21%		$ 1,250,851,348	388.45%
7. Unfunded Actuarial Accrued Liability	$ 203,040,300	64.91%		$ 189,347,298	58.80%
8. Relative Size of Unfunded Actuarial Accrued Liability					
a. As percent of actuarial assets	15.05%			15.14%	
b. As percent of covered payroll	64.91%			58.80%	

* as % of expected payroll

ANALYSIS OF NORMAL COST BY COMPONENT

	Cost as % of Pay	
Benefit Component	December 31, 2003	December 31, 2002
(1)	(2)	(3)
1. Retirement Benefits	9.83%	10.17%
2. Vested Termination Benefits	1.82%	2.98%
3. Refunds of Nonvested Terminations	2.04%	1.00%
4. Disability Benefits	0.31%	0.31%
5. Death Benefits	0.32%	0.33%
6. Normal Cost	14.32%	14.79%

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 3

ACTUARIAL PRESENT VALUE OF FUTURE BENEFITS AND CALCULATION OF ACTUARIAL ACCRUED LIABILITY

	December 31, 2003 (1)	December 31, 2002 (2)
A. Present Value of Future Benefits		
1. Active participants		
a. Retirement benefits	$ 904,079,832	$ 860,722,035
b. Deferred termination benefits	105,104,263	129,745,573
c. Refund of nonvested terminations	33,458,871	8,129,874
d. Disability benefits	17,664,738	15,347,795
e. Death benefits	15,933,889	17,103,806
f. Total	$ 1,076,241,593	$ 1,031,049,083
2. Retired participants		
a. Service retirements and beneficiaries	$ 768,804,704	$ 709,512,896
b. Disability retirements	8,296,121	8,674,690
c. Total	$ 777,100,825	$ 718,187,586
3. Inactive participants		
a. Vested terminations with deferred benefits	$ 33,719,572	$ 30,467,231
b. Nonvested terminations with refunds payable	6,525,720	5,981,712
c. Total	$ 40,245,292	$ 36,448,943
4. Total actuarial present value of future benefits	$ 1,893,587,710	$ 1,785,685,612
B. Present Value of Future Pay	$ 2,311,065,498	$ 2,335,949,736
C. Normal Cost Rate	14.32%	14.79%
D. Present Value of Future Normal Costs	$ 341,756,908	$ 345,486,966
E. Actuarial Accrued Liability for Active Members		
1. Present value of future benefits (Item A.1.f.)	$ 1,076,241,593	$ 1,031,049,083
2. Less present value of future normal costs (Item D)	341,756,908	(345,486,966)
3. Actuarial accrued liability	$ 734,484,685	$ 685,562,117
F. Total Actuarial Accrued Liability(Item A.2.c + Item A.3.c + Item E.3)	$ 1,551,830,802	$ 1,440,198,646

DEVELOPMENT OF ACTUARIAL VALUE OF ASSETS

Item		Valuation as of December 31, 2003
(1)		(2)
1. Excess (shortfall) of investment income for current year and previous three years (see Table 5):		
a. Current year	$	164,524,777
b. Current year -1		(205,130,274)
c. Current year -2		(181,365,035)
d. Current year -3	$	(126,149,883)
2. Deferral of excess (shortfall) of investment income for:		
a. Current year (80% deferral)	$	131,619,822
b. Current year -1 (60% deferral)		(123,078,164)
c. Current year -2 (40% deferral)		(72,546,014)
d. Current year -3 (20% deferral)		(25,229,977)
e. Total deferred for year	$	(89,234,333)
3. Market value of plan assets, end of year	$	1,259,556,169
4. Preliminary actuarial value of plan assets, end of year (Item 3 – Item 2e)	$	1,348,790,502
5. Actuarial value of assets corridor		
a. 80% of market value of assets, end of year	$	1,007,644,935
b. 120% of market value of assets, end of year	$	1,511,467,403
6. Final actuarial value of plan assets, end of year (Item 4, but not less than Item 5.a., or greater than Item 5.b.)	$	1,348,790,502

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 5

CALCULATION OF EXCESS INVESTMENT INCOME FOR ACTUARIAL VALUE OF ASSETS

Item	Plan Year Ending December 31, 2003	2002	2001	2000
(1)	(2)	(3)	(4)	(5)
1. Net Investment Income				
a. Interest and Dividends	$ 30,655,364	$ 32,348,029	$ 39,315,709	$ 40,567,011
b. Realized and unrealized gains and losses*	215,414,069	(145,341,052)	(118,202,326)	(61,082,591)
c. Administrative expenses	(1,552,770)	(1,641,675)	(1,305,222)	(1,212,179)
d. Total	244,516,663	(114,634,698)	(80,191,839)	(21,727,759)
2. Market value of assets, beginning of year	1,042,376,123	1,172,088,538	1,271,215,828	1,312,254,779
3. Contributions during year	55,356,622	60,166,320	51,069,055	44,945,823
4. Benefits and refunds paid during year	(82,693,239)	(75,244,037)	(70,004,506)	(64,257,015)
5. Expected net investment income at 8%	7.75%	7.75%	8.00%	8.00%
a. Market value of assets, beginning of year	80,784,150	90,836,862	101,697,266	104,980,382
b. Contributions	2,145,069	2,331,445	2,042,762	1,797,833
c. Benefits and refunds	(2,937,333)	(2,672,731)	(2,566,832)	(2,356,091)
d. Total	79,991,886	90,495,576	101,173,196	104,422,124
6. Excess investment income for year(Item 1.d. - Item 5.d.)	$ 164,524,777	$ (205,130,274)	$ (181,365,035)	$ (126,149,883)

*Includes investment expenses

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 6

CHANGE IN NET ASSETS

		Valuation Period Ending December 31, 2003 (1)	Valuation Period Ending December 31, 2002 (2)
1.	Assets in plan at beginning of year **(A)**	$ 1,042,376,123	$ 1,172,088,538
2.	Employer contributions	24,907,480	26,372,600
3.	Employee contributions	30,449,142	33,793,720
4.	Benefit payments made	78,216,523	71,286,073
5.	Refunds of contributions	4,476,716	3,957,964
6.	Expenses paid from trust	1,552,770	1,641,675
7.	Investment return	246,069,433	(112,993,023)
8.	Assets in plan at end of year **(B)** (1 + 2 + 3 - 4 - 5 - 6 + 7)	$ 1,259,556,169	$ 1,042,376,123
9.	Approximate rate of return on average invested assets		
	a. Net investment income (7 - 6 = **I**)	$ 244,516,663	$ (114,634,698)
	b. Estimated yield based on **(2I/(A + B - I))**	23.77%	-9.84%

TABLE 7

ACTUAL VERSUS EXPECTED ACTUARIAL ASSETS

	Plan Year Ending	
Item	December 31, 2003	December 31, 2002
(1)	(2)	(3)
1. Actuarial assets, beginning of year	$ 1,250,851,348	$ 1,311,288,668
2. Contributions during year	$ 55,356,622	$ 60,166,320
3. Benefits paid during year	($78,216,523)	($71,286,073)
4. Refunds paid during year	($4,476,716)	($3,957,964)
5. Assumed net investment income at	7.75%	7.75%
a. Beginning of year assets	$ 96,940,979	$ 101,624,872
b. Contributions	2,145,069	2,331,445
c. Benefits	(2,778,316)	(2,532,141)
d. Refunds	(159,017)	(140,590)
e Total	$ 96,148,715	$ 101,283,586
6. Expected actuarial assets, end of year	$ 1,319,663,446	$ 1,397,494,537
(Sum of Items 1 through 5)		
7. Actuarial assets, end of year	$ 1,348,790,502	$ 1,250,851,348
8. Asset gain/(loss) (Item 7 – Item 6)	$ 29,127,056	$ (146,643,189)

ACTUARIAL GAIN OR LOSS AS OF DECEMBER 31, 2003

	CALCULATION OF TOTAL ACTUARIAL GAIN OR LOSS		
1.	Unfunded actuarial accrued liability (UAAL) as of December 31, 2002	$	189,347,298
2.	Normal cost as of December 31, 2002		47,612,726
3.	Subtotal (1 + 2)	$	236,960,024
4.	Interest at prior valuation's rate of 8.0%		16,519,409
5.	Contributions during year ending December 31, 2003		(53,416,620)
6.	Interest on contributions for one-half year		(2,069,894)
7.	Expected UAAL as of December 31, 2003 (3 + 4 + 5 + 6)	$	197,992,919
8.	Actual UAAL as of December 31, 2003		203,040,300
9.	Actuarial gain/(loss) for the period (7 – 8)	$	(5,047,381)
	SOURCE OF GAINS AND LOSSES		
10.	Asset gain/(loss) (See Table 7)	$	29,127,056
11.	Total liability gain/(loss) for the period (9-10)		(34,174,437)
12.	Gain/(loss) due to benefit enhancements		0
13.	Gain/(loss) due to retiree ad hoc increases		0
14.	Gain/(loss) due to assumption changes		0
15.	Liability experience gain/(loss) (11 - 12 – 13 - 14)	$	(34,174,437)
	SOURCE OF LIABILITY GAINS AND LOSSES		
16.	Salary Increases	$	4,443,986
17.	Service Retirement		(4,411,938)
18.	Withdrawal		(15,449,722)
19.	Disability Retirement		(210,940)
20.	Active Mortality		(81,348)
21.	Retiree Mortality		(2,718,396)
22.	New Entrants		(4,198,798)
23.	Other (Data)		(11,547,281)
24.	Total Liability Expereince Gain/(Loss)	$	(34,174,437)

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 9

RELATIVE SIZE OF UNFUNDED ACTUARIAL ACCRUED LIABILITY

		Relative to Covered Payroll		Relative to Actuarial Value of Present Assets		Relative to Total Actuarial Accrued Liability	
Valuation as of December 31	Unfunded/ (Overfunded) Actuarial Accrued Liability	Covered Payroll	Percent of Covered Payroll	Present Assets	Percent of Present Assets	Actuarial Accrued Liability	Percent of Actuarial Accrued Liability
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1990	(38,568,183)	$ 171,738,189	(22.5%)	$ 410,546,517	(9.6%)	$ 362,978,334	(10.6%)
1991	(66,275,489)	194,588,280	(34.1%)	470,664,195	(14.1%)	404,388,706	(16.4%)
1993	(37,919,161)	235,227,565	(16.1%)	579,092,507	(6.5%)	541,173,346	(7.0%)
1995	(84,343,636)	221,001,903	(38.2%)	707,317,679	(11.9%)	622,974,043	(13.5%)
1997	(24,282,232)	219,207,826	(11.1%)	856,422,516	(2.8%)	832,140,284	(2.9%)
1998	(74,816,812)	219,326,742	(34.1%)	952,634,480	(7.9%)	877,817,668	(8.5%)
1999	(60,632,797)	244,538,110	(24.8%)	1,105,121,657	(5.5%)	1,044,488,860	(5.8%)
2000	(18,353,201)	268,635,564	(6.8%)	1,230,971,746	(1.5%)	1,212,618,545	(1.5%)
2001	48,980,941	316,793,390	15.5%	1,311,288,668	3.7%	1,360,269,609	3.6%
2002	189,347,298	322,007,672	58.8%	1,250,851,348	15.1%	1,440,198,646	13.1%
2003	203,040,300	312,790,966	64.9%	1,348,790,502	15.1%	1,551,830,802	13.1%

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 10

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Year Ending December 31	Active Participants	Covered Payroll	Average Salary	Percent Increase
(1)	(2)	(3)	(4)	(5)
1990	6,626	$171,738,189	$25,918	4.9%*
1991	6,968	$194,588,280	$27,926	7.7%
1993	7,761	$235,227,565	$30,309	4.2%*
1995	7,190	$221,001,903	$30,737	0.7%*
1997	6,798	$219,207,826	$32,246	2.4%*
1998	6,311	$219,326,742	$34,753	7.8%
1999	6,512	$244,538,110	$37,552	8.1%
2000	6,894	$268,635,564	$38,967	3.8%
2001	7,713	$316,793,390	$41,073	5.4%
2002	7,647	$322,007,672	$42,109	2.5%
2003	7,432	$312,790,966	$42,087	-0.1%

* Average annual increase/(decrease) over two-year period.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 11

SCHEDULE OF RETIRANTS AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

	Added to Rolls		Removed from Rolls		Rolls-End of Year			
Year Ending December 31	Number	Annual Allowances	Number	Annual Allowances	Number	Annual Allowances	% Increase in Annual Allowances	Average Annual Allowances
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1995	279	$ 4,787,640	88	$ 1,214,255	1,654	$ 27,032,976	16.4%*	$ 16,344
1997	328	7,714,560	105	1,192,120	1,877	38,989,044	20.1%*	20,772
1998	243	5,409,180	25	830,604	2,095	43,567,620	5.7%	20,796
1999	259	10,757,697	57	1,152,275	2,297	53,097,238	21.9%	23,116
2000	241	5,552,629	75	1,403,412	2,463	60,817,825	14.5%	24,693
2001	224	5,278,490	95	2,046,233	2,592	65,647,094	7.9%	25,327
2002	309	7,754,803	118	2,534,050	2,783	72,520,159	10.5%	26,058
2003	271	7,706,066	59	1,502,757	2,995	78,596,302	10.5%	26,243

* Average annual increase/(decrease) over two-year period.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 12

SOLVENCY TEST

	Aggrgated Accrued Liabilities for				Portions of Accrued Liabilities Covered by Reported Assets		
Valuation Date	Active and Inactive Members Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)	Reported Assets	(5)/(2)	(5)/[(2)+(3)]	(5)/ [(2)+(3)+(4)]
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
December 31, 1995	169,715,854	281,857,452	171,400,737	707,317,679	100.0%	100.0%	100.0%
December 31, 1997	157,311,099	385,407,128	289,422,057	856,422,516	100.0%	100.0%	100.0%
December 31, 1998	178,757,374	442,732,833	256,327,461	952,634,480	100.0%	100.0%	100.0%
December 31, 1999	230,542,295	536,835,240	277,111,325	1,105,121,657	100.0%	100.0%	100.0%
December 31, 2000	221,908,346	629,257,941	361,452,258	1,230,971,746	100.0%	100.0%	100.0%
December 31, 2001	248,579,180	654,307,118	457,383,311	1,311,288,668	100.0%	100.0%	96.4%
December 31, 2002	265,812,595	718,187,586	456,198,465	1,250,851,348	100.0%	100.0%	86.9%
December 31, 2003	252,182,701	777,100,825	522,547,276	1,348,790,502	100.0%	100.0%	86.9%

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 13a

SCHEDULE OF FUNDING PROGRESS
(As required by GASB #25)

Valuation Date	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (3) - (2)	Funded Ratio (2)/(3)	Annual Covered Payroll	UAAL as % of Payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
December 31, 1990	$ 410.5	$ 363.0	$ (38.6)	113.1%	$171.7	(22.5%)
December 31, 1991	470.7	404.4	(66.3)	116.4%	194.6	(34.1%)
December 31, 1993	579.1	541.2	(37.9)	107.0%	235.2	(16.1%)
December 31, 1995	707.3	623.0	(84.3)	113.5%	221.0	(38.1%)
December 31, 1997	856.4	832.1	(24.3)	102.9%	219.2	(11.1%)
December 31, 1998	952.6	877.8	(74.8)	108.5%	219.3	(34.1%)
December 31, 1999	1,105.1	1,044.5	(60.6)	105.8%	244.5	(24.8%)
December 31, 2000	1,231.0	1,212.6	(18.4)	101.5%	268.6	(6.8%)
December 31, 2001	1,311.3	1,360.3	49.0	96.4%	316.8	15.5%
December 31, 2002	1,250.9	1,440.2	189.3	86.9%	322.0	58.8%
December 31, 2003	1,348.8	1,551.8	203.0	86.9%	312.8	64.9%

Note: Dollar amount in millions.

SCHEDULE OF EMPLOYER CONTRIBUTIONS
(as required by GASB #25)

Fiscal Year	Annual Required Contribution	Percentage Contributed
(1)	(2)	(3)
1992	$14,266,156	100.00%
1993	$15,653,339	100.00%
1994	$17,005,695	100.00%
1995	$16,983,178	100.00%
1996	$15,738,068	100.00%
1997	$15,313,819	100.00%
1998	$16,126,014	100.00%
1999	$18,224,558	100.00%
2000	$21,531,859	100.00%
2001	$24,831,016	100.00%
2002	$26,375,274	100.00%
2003	$30,660,538	81.05%

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

Valuation Date	December 31, 2003
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent of Pay, open
Payroll growth rate for amortization	3.50%
Remaining amortization period	Infinite
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	7.75%
Projected salary increases	4.00% to 14.00%
*Includes inflation at	3.50%
Cost-of-living adjustments	None assumed

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS (EFFECTIVE AS OF December 31, 2003)

A. ACTUARIAL ASSUMPTIONS

1. Investment Return Rate

7.75% per annum, compounded annually.

2. Mortality

a. Nondisabled

Rate of Decrement: 1994 Group Annuity Mortality Table for males and females. No age setbacks.

b. Disabled

Mortality tables from Revenue Ruling 96-7 for males and females disabled after December 31, 1994. No age setbacks.

	Rates of Mortality					
	Nondisabled					
	Rate of Decrement		Post-Retirement		Disabled	
Age	Male	Female	Male	Female	Male	Female
20	.000507	.000284	.000507	.000284	.024583	.009650
25	.000661	.000291	.000661	.000291	.027457	.011974
30	.000801	.000351	.000801	.000351	.030661	.014843
35	.000851	.000478	.000851	.000478	.034184	.017654
40	.001072	.000709	.001072	.000709	.038373	.020579
45	.001578	.000973	.001578	.000973	.043033	.023988
50	.002579	.001428	.002579	.001428	.048004	.027961
55	.004425	.002294	.004425	.002294	.053120	.032594
60	.007976	.004439	.007976	.004439	.058118	.037993
65	.014535	.008636	.014535	.008636	.063669	.044287
70	.023730	.013730	.023730	.013730	.073284	.051331

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(EFFECTIVE AS OF December 31, 2003)
(Continued)

3. Retirement Rates: The following rates of retirement are assumed for members eligible to retire.

Age	Rates of Retirement	
	Males	Females
45 & under	35.0%	35.0%
46	35.0%	27.5%
47	35.0%	27.5%
48	40.0%	27.5%
49	45.0%	27.5%
50	45.0%	27.5%
51	45.0%	35.0%
52	45.0%	35.0%
53	45.0%	35.0%
54	40.0%	35.0%
55	40.0%	35.0%
56	35.0%	30.0%
57	35.0%	30.0%
58	35.0%	35.0%
59	35.0%	35.0%
60	35.0%	40.0%
61	35.0%	15.0%
62	50.0%	42.5%
63	30.0%	35.0%
64	30.0%	25.0%
65	45.0%	35.0%
66	25.0%	25.0%
67	25.0%	25.0%
68	20.0%	25.0%
69	20.0%	25.0%
70 & older	100.0%	100.0%

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS (EFFECTIVE AS OF December 31, 2003) (Continued)

4. Rates of Decrement Due to Withdrawal

Males

	Years of Service					
Age	0	1	2	3	4	5+
25	0.2214	0.1936	0.1860	0.1568	0.1402	0.0923
30	0.2013	0.1760	0.1691	0.1425	0.1274	0.0839
35	0.1915	0.1674	0.1491	0.1171	0.1002	0.0680
40	0.1736	0.1518	0.1296	0.1008	0.0883	0.0529
45	0.1570	0.1372	0.1158	0.0925	0.0844	0.0385
50	0.1444	0.1263	0.1100	0.0912	0.0837	0.0268
55	0.1368	0.1196	0.1123	0.0958	0.0835	0.0208
60	0.1406	0.1229	0.1216	0.1053	0.0835	0.0233

Females

	Years of Service					
Age	0	1	2	3	4	5+
25	0.2181	0.2038	0.1956	0.1873	0.1281	0.1256
30	0.2118	0.1980	0.1899	0.1818	0.1233	0.1130
35	0.2105	0.1968	0.1837	0.1567	0.1079	0.0827
40	0.1939	0.1812	0.1649	0.1394	0.0990	0.0649
45	0.1728	0.1615	0.1495	0.1309	0.0990	0.0594
50	0.1454	0.1359	0.1341	0.1251	0.1004	0.0546
55	0.1399	0.1333	0.1269	0.1168	0.1067	0.0560
60	0.1478	0.1408	0.1340	0.1289	0.1238	0.0596

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS (EFFECTIVE AS OF December 31, 2003) (Continued)

5. Disability Rates*

Sample rates are shown below:

Age	Rates of Decrement Due to Disability All Participants
20	.00014
25	.00019
30	.00031
35	.00052
40	.00092
45	.00209
50	.00379
55	.00490
60	.00911

* Rates are for disability due to all causes, occupational disability rates are assumed to be 10% of the all causes rates.

6. Rates of Salary Increase

Years of Service	Promotional Rate of Increase	Total Annual Rate of Increase Including 3.50% Inflation Component and 0.50% Productivity Component
0	10.00%	14.00%
1	8.50%	12.50%
2	6.75%	10.75%
3	4.25%	8.25%
4	3.75%	7.75%
5	2.25%	6.25%
6	1.75%	5.75%
7	1.50%	5.50%
8	1.50%	5.50%
9	1.50%	5.50%
10	1.00%	5.00%
11 - 19	0.75%	4.75%
20 or more	0.00%	4.00%

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(EFFECTIVE AS OF December 31, 2003)
(Continued)

7. DROP Participation:

   It was assumed that 20% of retiring active members would elect a "Back-end" DROP.

8. Married Percentage:

   100% of the active members are assumed to be married. Spouses are assumed to be the same age as the member.

9. Normal Form of Payment:

   It is assumed that all retiring members will elect the Life only form of payment.

10. Interest Crediting Rate on Employee Contributions:

    It is assumed that the interest credit rate on employee contributions will be 6.0%.

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS (EFFECTIVE AS OF DECEMBER 31, 2003) (Continued)

B. ACTUARIAL VALUE OF ASSETS

The actuarial value of assets is equal to the market value of assets less a five-year phase in of the Excess (Shortfall) between expected investment return and actual income with the resulting value not being less than 80% or more than 120% of the market value of assets.

C. ACTUARIAL FUNDING METHOD

The funding period required to amortize the unfunded actuarial accrued liability is determined using the entry-age normal actuarial cost method. This method assigns the System's total actuarial present value of future benefits to various periods. The actuarial accrued liability is assigned to years prior to the valuation, the normal cost is assigned to the year following the valuation. The remaining costs are assigned to future years.

The normal cost is determined on an individual basis. The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability is the excess of the actuarial accrued liability over the actuarial value of assets.

D. CHANGES IN ASSUMPTIONS SINCE LAST VALUATION

The following changes in assumptions were made since the previous valuation:

- The investment return assumption was lowered from 8.00% to 7.75%.
- The disabled mortality tables were changed to the more modern tables described in A.2.b.
- A separate set of retirement rates were adopted for female members of the System. These rates are generally lower than the corresponding male rates.
- The inflation component of the salary increase assumption was lowered from 4.0% to 3.5% thereby decreasing all of the individual salary increase assumptions by 0.5%.
- The DROP election assumption was decreased from 100% to 20%.
- The interest crediting rate on member contributions was decreased from 8.0% to 6.0%.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003

A. EFFECTIVE DATE

January 1, 1941.

B. ELIGIBILITY AND PARTICIPATION

Any regular and permanent employee of the City of Austin, excluding all civil service commissioned police officers and firefighters, the Mayor and members of the City Council and all part-time employees who work less than 75 percent of a normal work week.

C. MEMBERSHIP SERVICE

The period of time during which an eligible employee pays into and keeps on deposit the contribution prescribed to be paid by the employee into the System.

D. AVERAGE FINAL COMPENSATION

The average of the monthly compensation up to $16,666 ($12,500 for persons who first become members after 1995), for the 36 calendar months of highest compensation during the last 120 months prior to termination.

E. MEMBER AND EMPLOYEE CONTRIBUTION RATES:

The City currently contributes 8.00% of pay for each active member. Each active member contributes 8.00% of pay. These contributions are made under a pre-tax 401(h) pick-up arrangement.

F. RETIREMENT BENEFITS

1. Normal Retirement

   Eligibility: A participant may retire upon attaining age 62, or 23 years of service, or attaining age 55 with 20 years of service.

   Monthly Benefit: 3.00% of average final compensation times years of Membership Service.

   a. Payment Form: Benefits are paid as a monthly life annuity to the participant, with a provision that should the participant die prior to receiving monthly payments whose sum is greater than or equal to the participant's accumulated employee contributions, then the participant's beneficiary shall receive a lump sum equal to the excess of the participant's accumulated employee contributions with interest over the sum of the monthly payments received.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003 (Continued)

2. Early Retirement

   a. Eligibility: Currently there are no reduced retirement benefits under the plan. See Normal Retirement.

3. Optional Forms of Payment

   a. Joint and contingent annuity with either 100%, 66 2/3%, or 50% of the reduced retirement income payable for the life of the contingent annuitant upon the death of the retiring participant, with the provision that, should the contingent annuitant predecease the participant, the monthly annuity will revert to the amount that would have been payable under the normal form of payment,

   b. Period certain and life annuity with 15 years of payments guaranteed, or

   c. Life annuity with modified cash refund.

   d. 66 2/3% joint and last survivor with the reduced retirement income payable throughout the retiring participant or contingent annuitant's lifetime. Upon the death of either the retiring participant or contingent annuitant, the last survivor of the two will receive 66 2/3% of the retirement income payable for his or her life,

   e. Deferred Retirement Option Program. A member may elect to retroactively participate in the System's DROP (ie. a Back End DROP). The member would receive a lump sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date. No COLA's are included but changes in the benefit multiplier are reflected.

G. DISABILITY RETIREMENT

1. Eligibility: If the employee is terminated by reason of a total and permanent disability which prevents the employee from engaging in any substantial gainful employment with the City. If the employee has less than five years of service the disability must be job related.

2. Monthly Benefit: Same as Normal Retirement benefit using pay and service at date of disability.

3. Form of Payment: Same as Normal Retirement above.

SUMMARY OF BENEFIT PROVISIONS
OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003
(Continued)

H. VESTING OF BENEFITS

1. Vesting

An employee is vested according to the following schedule:

Years of Vesting Service	Vested Percentage
Less than 5	0%
5 or more	100%

2. Benefits Upon Vesting

A vested participant is entitled to the retirement benefit payable at normal retirement earned to the date of participant's termination multiplied by his/her vested percentage, or a refund of the employee's accumulated employee contributions with interest.

I. DEATH IN SERVICE

1. Eligibility: All active members.

2. Benefit: The amount of the benefit payable to the beneficiary is:

a. Employee eligible for retirement at date of death:

The surviving spouse if any may elect to receive an annuity equal to the monthly benefit as if the member had retired under the Joint and 100% Contingent Option at the end of the month in which the member died. If there is no surviving spouse then the beneficiary may elect to receive a 15 years certain and life annuity. The surviving spouse or beneficiary instead of electing the annuity may elect to receive a benefit equal to twice the member's accumulated employee contributions with interest.

b. Employee not eligible for retirement at date of death:

A benefit equal to twice the member's accumulated employee contributions with interest.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003 (Continued)

J. RETIREE LUMP-SUM DEATH BENEFIT

Upon death of a retired member a $10,000 lump-sum death benefit is payable. This benefit is also payable upon the death of an active member eligible for retirement whose surviving spouse or beneficiary elects to receive an annuity.

K. COST-OF-LIVING ADJUSTMENT (COLA)

On January 1 of each year the Board may approve a cost-of-living increase for those retirees who retired on or before December 31 of the previous year. The maximum increase which can be approved is 6%. The amount of the increase is set by the Board. The increase is prorated for any benefit which has been in effect for less than a year, with the proration being 1/12 for each monthly payment received during the prior year.

L. 13th CHECK

Once each year the Board may approve a 13th check to be paid to those members currently in payment status. The additional check would be equal to a percentage of the member's monthly annuity with a maximum percentage of 100%.

M. LEGISLATED PLAN CHANGES ENACTED BY 1995 LEGISLATURE

1. 2.3% Multiplier

   The benefit multiplier was increased from 2.2% per year of service to 2.3% per year of service effective October 1995.

2. 2.3% Retiree Gross-up

   Effective October 1995, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.3% multiplier.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003 (Continued)

3. $10,000 Retiree Lump-Sum Death Benefit

   The Lump-sum death benefit payable upon the death of a retiree was increased from $2,000 to $10,000.

4. Plan Participation Begins at Date of Hire

   The six-month service requirement for participation was eliminated. Current active members were granted service for the six-month period between their date of hire and their date of participation.

N. LEGISLATED PLAN CHANGES ENACTED BY 1997 LEGISLATURE

1. 2.6% Multiplier

   The benefit multiplier was increased from 2.3% per year of service to 2.6% per year of service effective October 1997.

2. 2.6% Retiree Gross-up

   Effective October 1997, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.6% multiplier.

3. Military Service Purchase

   Increase the number of months of military service that may be purchased from 24 to 48.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003 (Continued)

4. Noncontributory Service Purchase

Allow an employee to purchase noncontributory service for the following periods of time: (1) while employee was on workers' compensation leave, (2) while employee was on an authorized leave of absence, and (3) while employee performed service for the employer in a position for which the service was not otherwise creditable. The employee pays the full actuarial cost of the service purchase.

5. Employer Purchase of Unreduced Retirement Eligibility

Allow the employer to purchase the amount of service required to qualify an employee for an unreduced retirement benefit at age 55. To be eligible for the purchase, the employee must never have been a highly compensated employee within the meaning of IRC Section 414(q). The cost of the service purchase is the full actuarial cost of both the benefit and the retirement eligibility.

O. LEGISLATED PLAN CHANGES ENACTED BY 1999 LEGISLATURE

1. 2.7% Multiplier

The benefit multiplier was increased from 2.6% per year of service to 2.7% per year of service effective October 1999.

2. 2.7% Retiree Gross-up

Effective October 1999, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.7% multiplier.

3. 23 & Out Provision

The service requirement at which a participant may retire with an unreduced retirement benefit was decreased from 25 years of creditable service to 23 years of creditable service.

SUMMARY OF BENEFIT PROVISIONS
OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003
(Continued)

4. Pop-Up Provisions for Joint Payment Options

   The optional forms of payment which extend coverage to a joint annuitant were amended so that, should the contingent annuitant predecease the participant, the monthly annuity will revert to the amount that would have been payable under the normal form of payment.

5. 13th Check

   The Board was given the ability to make an additional payment to members in payment status in the form of a 13th check. The additional payment would be a percentage of the current monthly payment with a maximum percentage of 100%.

P. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2000

1. 2.98% Multiplier

   The benefit multiplier was increased from 2.7% per year of service to 2.98% per year of service effective April 2000.

2. 2.98% Retiree Gross-up

   Effective April 2000, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.98% multiplier.

Q. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2001

None

R. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2002

1. 3.00%Multiplier

   The benefit multiplier was increased from 2.98% per year of service to 3.00% per year of service effective January 2002.

2. 3.00% Retirees Gross-up

   Effective January 2002, current retirees received an increase in their benefit amount to bring their

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2003 (Continued)

3. Deferred Retirement Option Program

A "Back End" DROP was added as an optional form of retirement effective in 2002. The retiring member may elect to retroactively participate in a DROP. The member would receive a lump sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date. No COLA's are included but changes in the benefit multiplier are reflected.

4. Purchase of Permissive Service Credit

A member may purchase up to five years of permissive service credit. The purchase price charged to the member is the anticipated actuarial cost to the System for the additional service.

5. Conversion of Unused Sick Leave

At retirement an employee may elect to purchase creditable service for unused sick leave. The purchase price is equal to 16.0% of the employee's highest annual rate of pay multiplied by the number of years of service conversion. An employee must already be eligible for retirement to purchase the service.

S. BENEFITS ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2003

None

DEFINITION OF TERMS

1. ***Actuarial Cost Method***

   A method for determining the actuarial present value of future benefits and allocating such value to time periods in the form of a normal cost and an actuarial accrued liability.

2. ***Present Value of Future Benefits***

   This is computed by projecting the total future benefit cash flow from the System, using actuarial assumptions, and then discounting the cash flow to the valuation date.

3. ***Normal Cost***

   Computed differently under different actuarial cost methods, the normal cost generally represents the value of the portion of the participant's anticipated retirement, termination, and/or death and disability benefits accrued during a year.

4. ***Actuarial Accrued Liability***

   Computed differently under different actuarial cost methods. Generally actuarial accrued liability represents the value of the portion of the participant's anticipated retirement, termination, and/or death and disability benefits accrued as of the valuation date.

5. ***Entry Age Actuarial Cost Method***

   A method under which a participant's actuarial present value of future benefits is allocated on a level basis over the earnings of the participant between his/her entry into the System and his/her assumed exit.

6. ***Unfunded Actuarial Accrued Liability***

   The difference between total actuarial present value of future benefits over the sum of the tangible assets of the System and the actuarial present value of the members' future normal costs. The System is underfunded if the difference is positive and overfunded if the difference is negative.

7. ***Actuarial Value of Assets***

   The value of cash, investments, and other property belonging to the System, as valued by the actuary for purposes of the actuarial valuation.

DEFINITION OF TERMS
(Continued)

8. ***Actuarial Gain or Loss***

From one valuation to the next, if the experience of the plan differs from that anticipated by the actuarial assumptions, an actuarial gain or loss occurs. For example, an actuarial gain would occur if the assets in the trust had a yield of 12% based on actuarial value, while the assumed yield on the actuarial value of assets was 7.75%.

STATISTICAL TABLES

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 17

DISTRIBUTION OF ALL ACTIVE PARTICIPANTS BY AGE AND LENGTH OF SERVICE AS OF DECEMBER 31, 2003

Attained Age	0	1	2	3	4	5-9	10-14	15-19	20-24	25-29	30-34	35 & Over	Number of Employees	Average Annual Salary
Under 25	50	41	41	30	9	2	0	0	0	0	0	0	173	25,125
25-29	77	121	122	115	67	85	1	0	0	0	0	0	588	30,395
30-34	94	120	140	131	122	242	80	0	0	0	0	0	929	35,021
35-39	66	93	110	112	64	291	196	81	7	0	0	0	1,020	39,854
40-44	65	87	111	119	96	328	280	242	112	2	0	0	1,442	44,400
45-49	40	71	104	105	64	252	280	245	157	26	1	0	1,345	46,319
50-54	31	49	62	73	72	186	195	169	130	38	9	0	1,014	47,857
55-59	14	28	48	46	50	102	136	129	60	22	9	2	646	46,864
60-64	4	9	15	21	8	37	59	42	18	5	3	0	221	44,959
65 & Over	0	0	2	4	3	19	11	7	4	2	2	0	54	43,047
All Ages	441	619	755	756	555	1,544	1,238	915	488	95	24	2	7,432	42,087

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 18

DISTRIBUTION OF ALL ACTIVE PARTICIPANTS BY SERVICE AND CURRENT RATE OF PAY AS OF DECEMBER 31, 2003

Completed Years of Service	Number of Employees	Total Average Salary
0	441	$ 33,352
1	619	34,565
2	755	35,137
3	756	38,038
4	555	38,261
5-9	1,544	41,274
10-14	1,238	47,551
15-19	915	50,447
20-24	488	50,470
25-29	95	57,030
30-34	24	53,001
35+	2	47,310
All Years	7,432	$ 42,087

AVERAGE BENEFIT PAYMENT AMOUNT

Year Ending	Average Monthly Benefit Payment
December 31, 1993	$1,148
December 31, 1995	$1,362
December 31, 1997	$1,731
December 31, 1998	$1,733
December 31, 1999	$1,926
December 31, 2000	$2,058
December 31, 2001	$2,111
December 31, 2002	$2,172
December 31, 2003	$2,187

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2003

TABLE 20

DISTRIBUTION OF RETIRED MEMBERS BY TYPE OF BENEFIT

Benefit Type	Number of Participants*
Life Only	805
100% Joint & Survivor	746
50% Joint & Survivor	180
66 2/3% Joint & Survivor	170
66 2/3% Joint & Last Survivor	40
Life Only Level Income	244
66 2/3% Joint & Survivor Level Income	184
15 Year Certain & Life	79
Joint & 100% Survivor Level Income	188

*The counts reflect only current retired members. Beneficiaries and disabled retirees are not included.

SCHEDULE OF PARTICIPATING EMPLOYERS

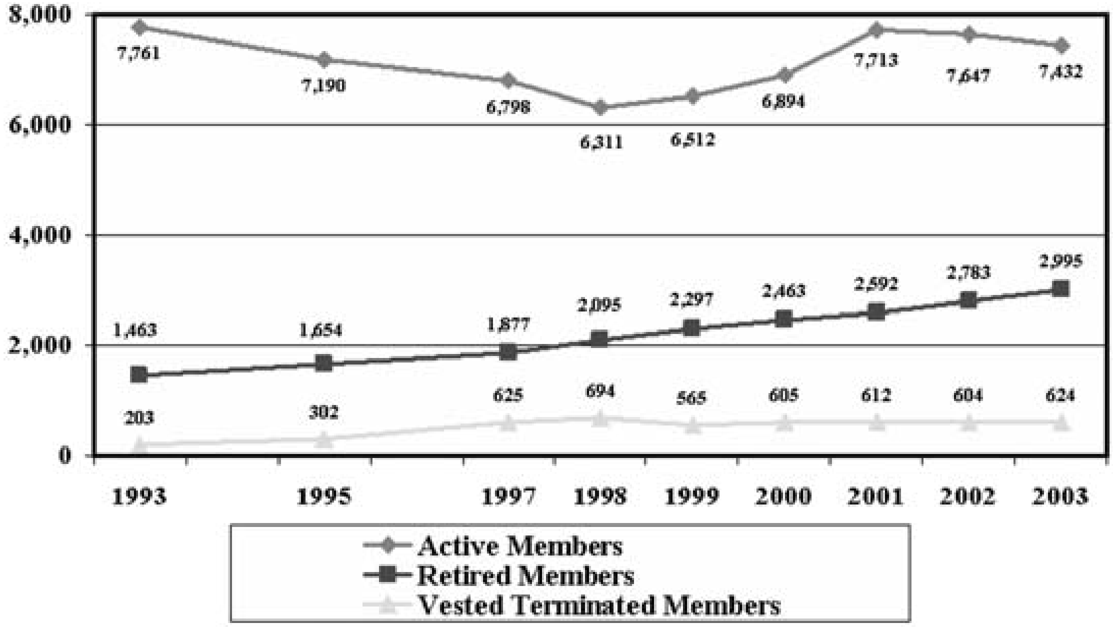
The City of Austin and the City of Austin Employees' Retirement System are the only participating employers in the plan.

BENEFIT EXPENSES BY TYPE

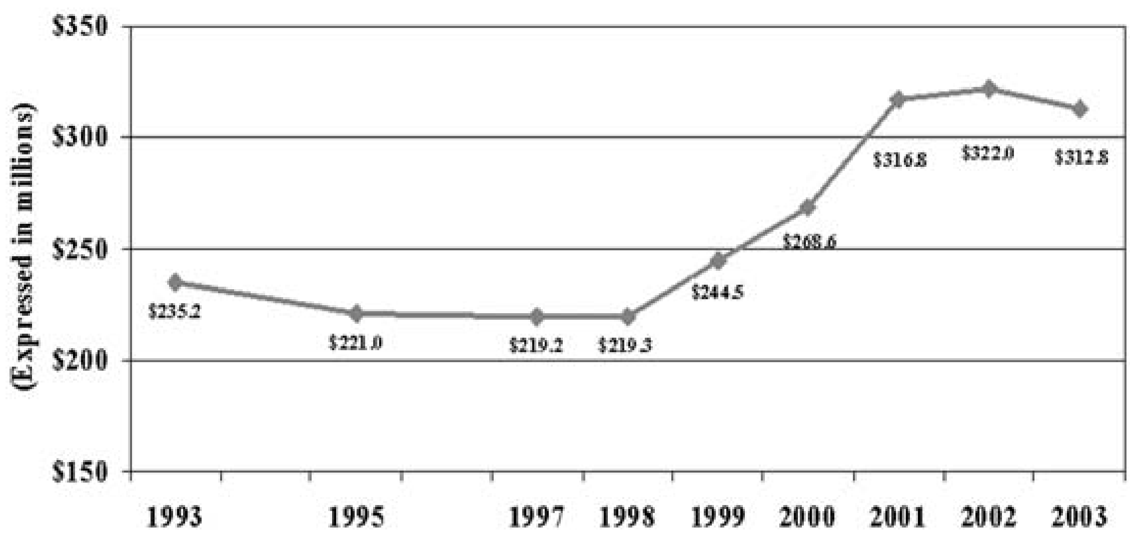
Year Ending	Retiree Annuities*	Refunds	Death Benefits
December 31, 1993	$16,438,998	$3,277,066	$708,755
December 31, 1994	$20,715,787	$4,340,500	$575,988
December 31, 1995	$23,205,043	$7,991,565	$486,267
December 31, 1996	$28,179,046	$7,854,935	$822,568
December 31, 1997	$32,515,281	$6,123,471	$1,224,799
December 31, 1998	$42,093,743	$6,423,115	$1814,121
December 31, 1999	$48,073,639	$4,867,018	$1,751,643
December 31, 2000	$58,111,905	$4,945,186	$1,184,034
December 31, 2001	$64,597,837	$3,991,123	$1,415,546
December 31, 2002	$70,360,017	$3,957,964	$928,730
December 31, 2003	$76,556,386	$4,476,716	$1,660,137

*Includes lump sum payments due to DROP and PLSO elections.

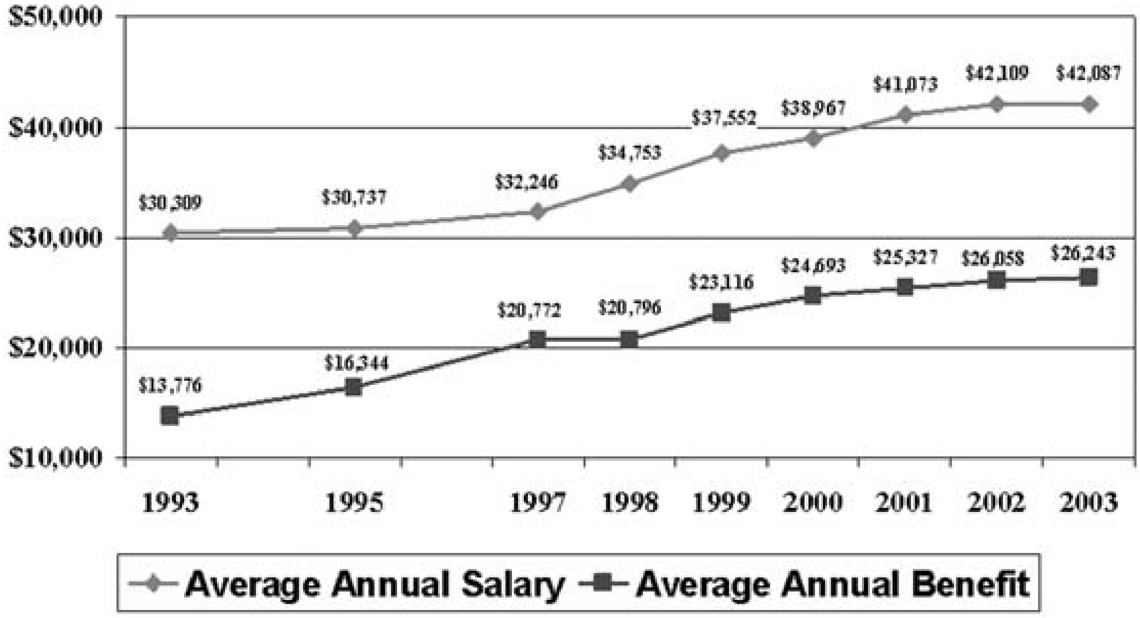
ACTIVE MEMBERS AND RETIRED MEMBERS



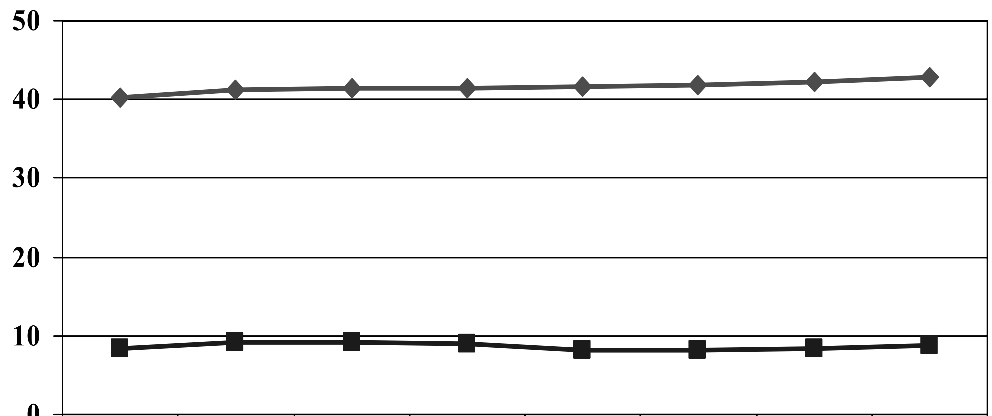
ACTIVE PAYROLL



AVERAGE SALARY AND AVERAGE BENEFIT



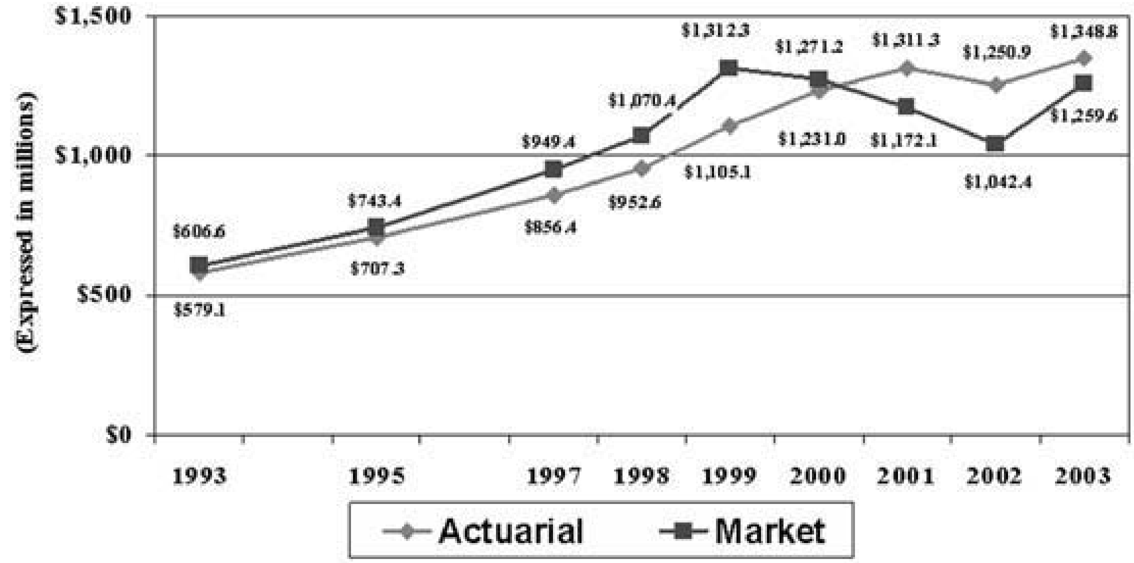
AVERAGES FOR ACTIVE PARTICIPANTS



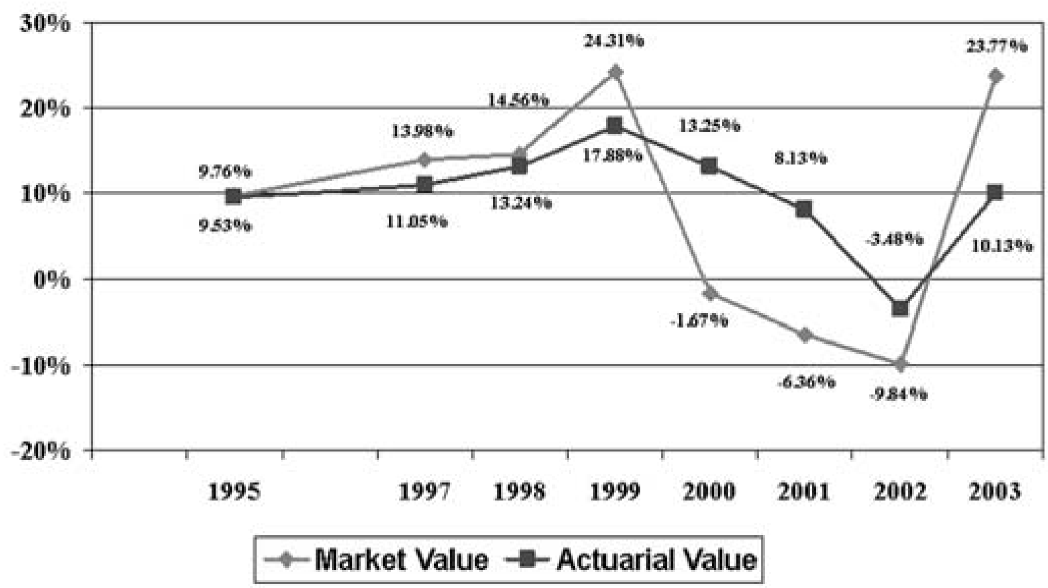
	1995	1997	1998	1999	2000	2001	2002	2003
Average Age	40.3	41.3	41.4	41.5	41.6	41.8	42.2	42.8
Average Service	8.3	9.2	9.1	8.9	8.1	8.1	8.3	8.8

Average Age — Average Service

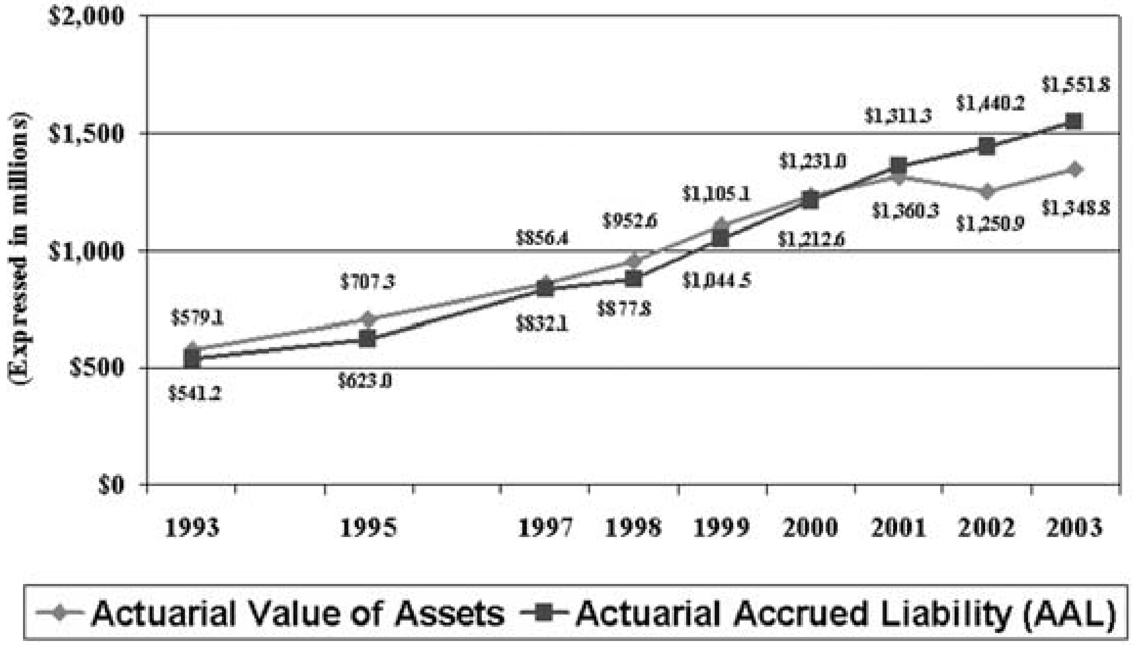
MARKET AND ACTUARIAL VALUE OF ASSETS



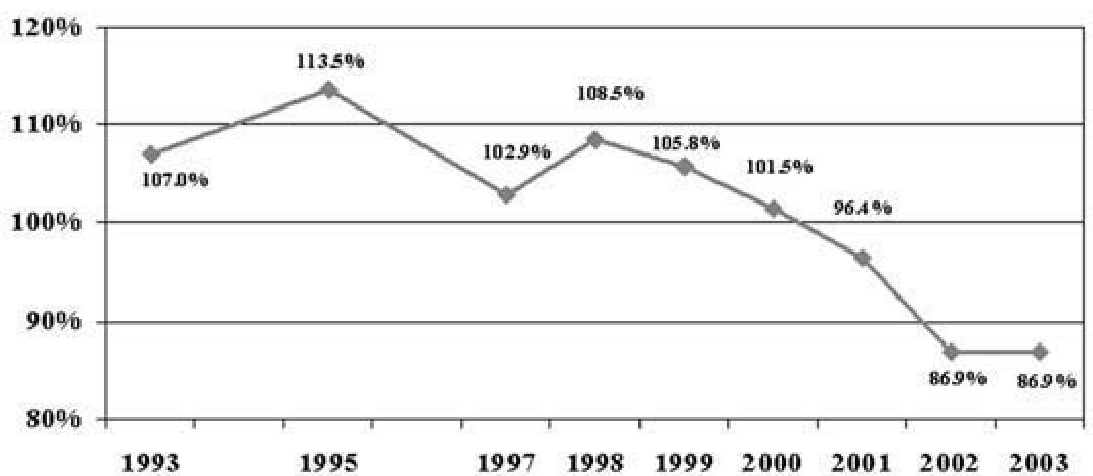
ESTIMATED YIELDS BASED ON MARKET VALUE OF ASSETS



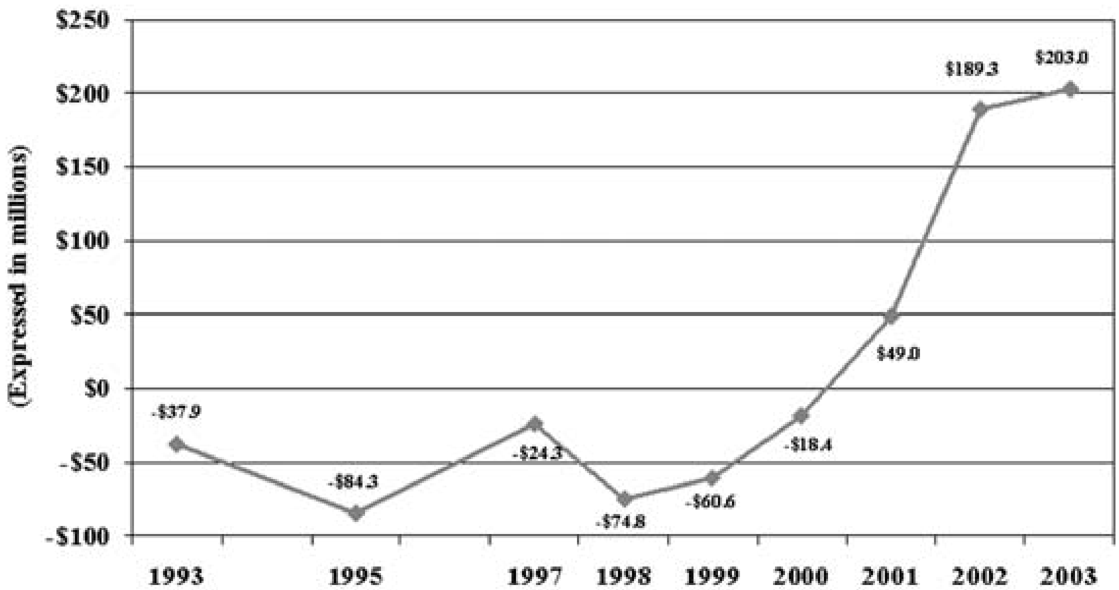
ACTUARIAL ACCRUED LIABILITY VS. ACTUARIAL ASSETS



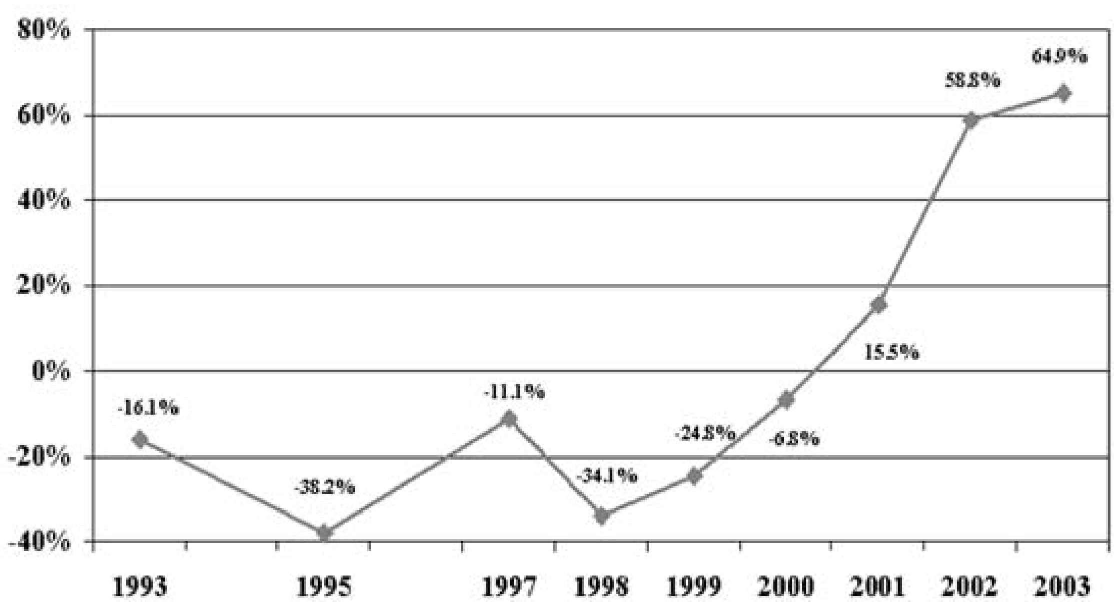
GASB #25 FUNDED RATIO OF ACTUARIAL VALUE OF ASSETS TO ACTUARIAL ACCRUED LIABILITY



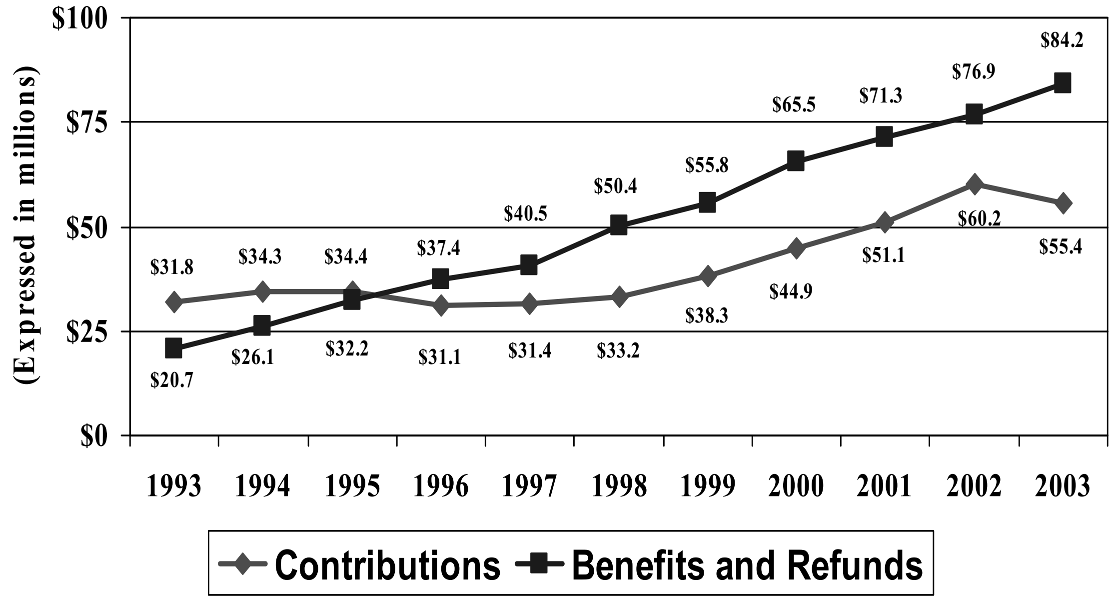
UNFUNDED ACTUARIAL ACCRUED LIABILITY



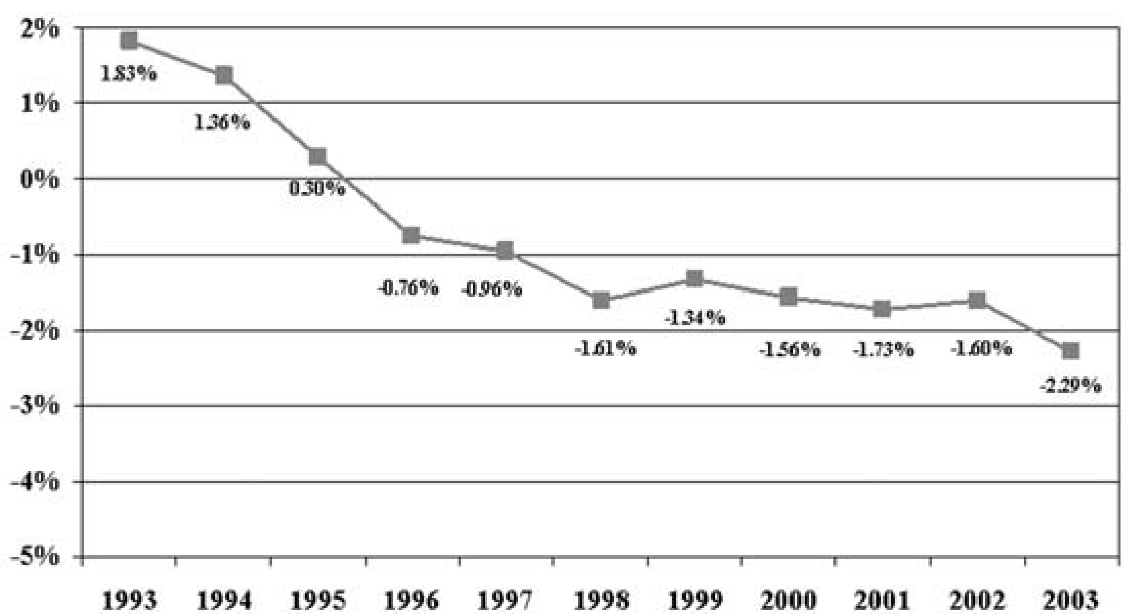
UAAL AS PERCENT OF PAYROLL



CONTRIBUTIONS VS. BENEFITS AND REFUNDS



EXTERNAL CASH FLOW AS A PERCENTAGE OF MARKET VALUE



SOURCE OF ACTUARIAL GAINS AND LOSSES

	2003	2002
1. Asset Gain/(Loss)	$ 29.1	$(146.6)
2. Liability Experience Gain/(Loss)	(34.1)	(15.1)
3. Assumption Changes	0.0	13.3
4. Benefit Enhancements	0.0	(0.0)
5. Retiree Ad Hoc	0.0	(0.0)
6. Total Actuarial Gain/(Loss)	$ (5.0)	$(148.4)

ANALYSIS OF LIABILITY GAIN/LOSS BY SOURCE

	2003
1. Salary Increases	$ 4.4
2. Service Retirement	(4.4)
3. Withdrawal	(15.4)
4. Disability Retirement	(0.2)
5. Active Mortality	(0.1)
6. Retiree Mortality	(2.7)
7. New Entrants	(4.2)
8. Other (Data)	(11.5)
9. Total Liability Experience Gain/(Loss)	$(34.1)

Statistical Section

STATISTICAL SECTION

SCHEDULE OF PARTICIPATING EMPLOYERS

The City of Austin and the City of Austin Employees' Retirement System are the only participating employers in the Plan.

SCHEDULE OF REVENUES BY SOURCE

	Member Contributions	Employer Contributions	Investment Income	**Total**
2003	30,449,244	24,907,480	246,069,330	**301,426,054**
2002	33,793,720	26,375,274	(112,995,246)	**(52,824,029)**
2001	26,238,039	24,831,016	(78,888,145)	**(27,817,560)**
2000	23,413,964	21,531,859	(20,508,518)	**24,437,675**
1999	20,051,951	18,224,558	259,254,974	**297,531,483**
1998	17,121,110	16,126,014	138,464,428	**171,711,552**
1997	16,119,300	15,322,964	129,813,501	**161,255,765**
1996	15,404,002	15,738,068	91,754,296	**122,896,366**
1995	17,420,925	16,983,178	137,707,650	**172,111,753**
1994	17,310,502	17,005,695	49,708,596	**84,024,793**

SCHEDULE OF EXPENSES BY TYPE

	Benefit Payments	Death Benefits	Refunds	Admin Expense	Lump Sum Payments	**Total**
2003	75,527,089	1,160,137	4,476,716	1,552,770	1,029,297	**84,246,009**
2002	70,093,860	928,730	3,957,964	1,641,675	266,157	**76,888,386**
2001	64,597,837	1,415,546	3,991,123	1,305,222		**71,309,728**
2000	58,127,795	1,184,034	4,945,185	1,219,614	* Prior to 2001 Lump Sump Payments were reported with the Benefit Payments.	**65,476,628**
1999	48,073,639	1,751,643	4,867,018	1,133,482		**55,825,782**
1998	42,093,743	814,121	6,423,115	1,105,405		**50,436,384**
1997	32,515,281	1,230,044	6,123,471	936,098		**40,804,894**
1996	28,179,046	822,568	7,854,935	572,744		**37,429,293**
1995	23,205,043	486,267	7,991,565	496,969		**32,179,844**
1994	20,715,787	575,988	4,340,500	504,674		**26,136,949**

SCHEDULE OF AVERAGE MONTHLY BENEFIT PAYMENTS

2003	2,187
2002	2,172
2001	2,122
2000	2,058
1999	1,926
1998	1,733
1997	1,731
1996	1,390
1995	1,362
1994	1,198

EXAMPLES OF MONTHLY BENEFIT PAYMENTS BASED ON FINAL AVERAGE SALARY AND YEARS OF CREDITABLE SERVICE

Final Average Monthly Salary	Years of Creditable Service						
	5	**10**	**15**	**20**	**23**	**25**	**30**
$2000	$300	$600	$900	$1200	$1380	$1500	$1800
$3000	$450	$900	$1350	$1800	$2070	$2250	$2700
$4000	$600	$1200	$1800	$2400	$2760	$3000	$3600

NUMBER OF RETIRED MEMBERS BY TYPE OF BENEFIT

Life Only	805
100% Joint & Survivor	746
50% Joint & Survivor	180
66 2/3% Joint & Survivor	170
66 2/3% Joint & Last Survivor	40
15 Year Certain & Life	79
Life Only Level Income	244
100% Joint & Survivor Level Income	188
66 2/3% Joint & Survivor Level Income	184
Disabled Retirees	51
Beneficiaries & Others	308
Total	**2,995**

HISTORY OF CONTRIBUTIONS, INTEREST PAID, MULTIPLIER, AND COST OF LIVING INCREASES

Year	Employer Contribution Rate	Member Contribution Rate	Interest Paid on Member Deposits	Benefits Multiplier Increase	Cost of Living Increase	Year	Employer Contribution Rate	Member Contribution Rate	Interest Paid on Member Deposits	Benefits Multiplier Increase	Cost of Living Increase
1941	4.00%	4.00%	-	1.125%	-	1972	-	-	6.043%	-	-
1942	5.00%	-	-	-	-	1973	-	-	6.219%	1.750%	-
1943	-	-	-	-	-	1974	-	-	6.330%	-	-
1944	-	-	-	-	-	1975	-	-	6.823%	-	-
1945	-	-	2.000%	-	-	1976	-	-	6.941%	-	-
1946	-	-	2.000%	-	-	1977	-	-	6.509%	-	-
1947	-	-	2.000%	-	-	1978	-	-	6.658%	-	-
1948	-	-	2.000%	-	-	1979	-	-	7.843%	-	-
1949	-	-	2.000%	-	-	1980	-	-	8.010%	-	-
1950	-	-	2.000%	-	-	1981	-	-	8.135%	-	-
1951	5.00%	5.00%	2.000%	-	-	1982	6.60%	6.60%	8.208%	-	-
1952	-	-	2.000%	-	-	1983	-	-	8.386%	-	-
1953	-	-	1.910%	-	-	1984	-	-	8.289%	1.850%	-
1954	-	-	2.460%	-	-	1985	7.00%	7.00%	8.222%	2.000%	-
1955	-	-	2.520%	-	-	1986	-	-	8.000%	-	3.00%
1956	-	-	2.600%	-	-	1987	6.20%	6.20%	8.000%	-	1.50%
1957	-	-	2.000%	-	-	1988	7.00%	7.00%	8.000%	-	3.00%
1958	-	-	2.620%	-	-	1989	-	-	8.000%	-	3.00%
1959	-	-	2.794%	-	-	1990	-	-	8.000%	2.100%	3.00%
1960	-	-	3.270%	-	-	1991	-	-	6.500%	-	3.00%
1961	-	-	2.770%	-	-	1992	-	-	6.000%	-	4.00%
1962	-	-	3.649%	-	-	1993	-	-	5.000%	2.200%	3.10%
1963	-	-	3.762%	-	-	1994	-	-	6.000%		6.00%
1964	-	-	3.309%	-	-	1995	-	-	6.750%	2.300%	6.00%
1965	-	-	3.247%	-	-	1996	-	-	6.750%	-	6.00%
1966	-	-	3.564%	-	-	1997	-	-	6.750%	2.600%	6.00%
1967	-	-	3.681%	1.250%	-	1998	-	-	5.000%	-	5.00%
1968	-	-	4.245%	-	-	1999	-	-	6.250%	2.700%	3.00%
1969	-	-	4.658%	-	-	2000	8.00%	8.00%	5.750%	2.980%	-
1970	-	-	4.983%	-	-	2001	-	-	4.250%	-	3.50%
1971	6.00%	6.00%	5.434%	1.500%	-	2002	-	-	3.750%	3.000%	2.50%
						2003	-	-	3.750%	-	-

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