Comprehensive Annual

Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2000 through

June 30, 2001

HOUSTON POLICE OFFICERS' PENSION SYSTEM
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SECTION ONE

INTRODUCTORY SECTION

HPOPS

FOR TODAY & TOMORROW

November 30, 2001

The Membership
Houston Police Officers' Pension System
Houston, Texas

The Comprehensive Annual Financial Report (CAFR) of the Houston Police Officers' Pension System (the System) for the fiscal year ended June 30, 2001 is submitted herewith. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of the System. This CAFR is divided into five sections:

- Introductory Section – This section contains the administrative organization, the letter of transmittal and Chairman's report.
- Financial Section – This section contains the report of the Independent Auditor, the financial statements of the System and certain required supplementary information
- Investment Section – This section contains a report on investment activity, investment policies, investment results, and various investment schedules.
- Actuarial Section – This section contains the Actuary's Certification Letter and the results of the annual actuarial valuation.
- Statistical Section – This section includes significant data pertaining to the System.

We trust that you will find this CAFR helpful in understanding your retirement system, a system that strives to provide responsible stewardship of assets contributed by the members and the City of Houston.

The System was established in 1947, funded by a $100,000 Treasury note, and offered retiring members a pension of $75 per month. Today, the System has investments in excess of $2 billion dollars and offers a variety of pension benefits to members and their dependents. Members may opt to defer their benefits, take a proportionate retirement benefit, or retire under a regular service retirement. Members also may access a disability retirement, both duty and non-duty connected.

Major Initiatives

The System has recently completed negotiations with the City of Houston, and as a result, benefits available to our members have increased. Notable enhancements include an increase in the benefit multiplier from 2.5% to 2.75% per year of service, a change in the definition of pensionable pay, creation of a new Back DROP option and a provision to recalculate retirement benefits based upon pensionable pay as of the member's retirement date, rather than as of the DROP entrance date.

The System ascribes to the "Life Cycle" planning concept in order to better meet the varying information and service needs of our members as they pass through various stages of their careers. In order to improve communication of benefits and services available to our members, we added a communications director. The web site, www.hpops.org, underwent a complete redesign, improving information and access to forms, publications, member statements, and a host of other services. Members may now check their career contributions and DROP balances over the Internet in a secure environment. Other new services include an educational series available to all members, with sessions discussing estate planning, using the Internet and investing, just to name a few. In an effort to help members use the Internet for rapid access to the

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System's services and information, we partnered with a major manufacturer to provide a System member discount on computer purchases.

Additions to Plan Net Assets

The System relies on the contributions of members and the City of Houston, as well as income generated from investments, to provide funds needed to finance retirement benefits. Total contributions and investment income for the fiscal year 2001 decreased by $372 million over 2000 as detailed below:

	$000's		Increase (Decrease)	Increase (Decrease)
	2001	2000	Amount	Percentage
Member contributions	$ 22,043	$ 21,761	$ 282	1%
Employer contributions	30,645	30,645	-	0%
Net investment income (loss)	(80,864)	291,777	(372,641)	-128%
Total	$ (28,176)	$ 344,183	$ (372,359)	-108%

Deductions to Plan Net Assets

The reason for the creation of the System was to provide retirement benefits to retired Houston Police Officers and their dependents. Although this is still the primary purpose of the System, over the course of 53 years the System has added survivor benefits as well as disability benefits for its members and their beneficiaries. The cost of these programs includes benefit payments and refunds of contributions to terminated employees. The cost of administering the System is also paid from System assets.

	$000's		Increase (Decrease)	Increase (Decrease)
	2001	2000	Amount	Percentage
Benefits paid to members	$ 60,328	$ 55,421	$ 4,907	9%
Refunds paid to members	884	1,545	(661)	-43%
Administrative expenses	2,854	2,216	638	29%
Total	$ 64,066	$ 59,182	$ 4,884	8%

Benefits paid to members continue to increase due to net additions to the number of retired members in addition to the effect of benefit increases achieved in recent negotiations with the City of Houston. Administrative expenses, while remaining at less than one basis point, have increased due to additions to staff and due to the cost of several one-time initiatives in the current year.

Investments

The System invests funds entrusted to it exclusively for the benefit of its members. It avows an investment rule commonly known as the "prudent man" rule, whereby from a procedural as well as substantive standpoint, it acts with the care, skill, prudence and diligence that a "prudent man" acting in a similar capacity would act under similar circumstances.

	2001		2000	
	(000's)	%	(000's)	%
Short-term investments	$ 48,527	2%	$ 135,125	6%
Fixed income	616,842	29%	537,436	23%
Equity securities	1,298,157	61%	1,476,026	65%
Alternative investments	172,842	8%	138,175	6%
Foreign currency contracts	509	0%	67	0%
Total	$ 2,136,877	100%	$ 2,286,829	100%

The Board of Trustees believes that the System's assets should be managed in a way that reflects the uniqueness of the System, and that the System's assets should be diversified over a spectrum of investment vehicles. The determination of the appropriate asset mix is based on capital market assumptions that incorporate historical returns, volatility and the correlation of various asset classes.

The bull market economy ended in the year 2000. The terrorist attack on the World Trade Center resulted in a new volatility in investments. The Board has reaffirmed its commitment to maintain a diversified portfolio and yet seek out solid investment opportunities.

Funding

It is the System's intention to have enough money in reserve to provide members with promised benefits upon their retirement. As of July 1, 2001, the System has an unfunded actuarial accrued liability (surplus) of $125.8 million. An actuarial accrued liability is the liability for service already rendered by former and present employees. An actuarial accrued surplus is the surplus in excess of the System's assets over the actuarial accrued liability. Any liability or surplus is amortized using a 30 year constant level percent of payroll method.

Professional Services

The Board of Trustees appoints professional consultants to perform services that are considered essential for the operation of the System. The independent auditor's report, issued by BDO Seidman, LLP, is included on page 9 of this report. The actuarial report, certified by Towers Perrin, is also included on page 31.

Acknowledgements

The compilation of this report reflects the combined effort of the System staff under the guidance of the Board of Trustees. Its goal is to provide complete and reliable information as a basis for

management decisions and compliance with legal provisions as well as responsible stewardship of funds contributed by its members and the City of Houston.

We would like to take this opportunity to express our gratitude to the staff, System advisors, and to the many other people who have contributed to the successful operation of the System.

Sincerely,

Board of Trustees

Board of Trustees

HPOPS
FOR TODAY & TOMORROW

November 30, 2001

To the Members
Houston Police Officers' Pension System
Houston, Texas

This has been an exciting and fulfilling year at HPOPS. We have successfully negotiated enhanced benefits for our members. These include:

- An increase in the pension multiplier
- A change in the definition of pensionable pay
- Minimum annual interest rate for our DROP and PROP programs
- Election to enter DROP retroactively (Back DROP)
- Increase in monthly health insurance stipend

While these increased benefits are important, we realize that they must be balanced with a fiscally sound investment structure. The nation left behind an old century and the high-rolling '90's and began the new century with more conservative investment attitudes. Our trained and diligent investment staff has continually monitored and adjusted our investment strategies so that your money will be there when you need it.

In order to better serve you, we have increased our benefits department staff this year. We have updated our website (www.hpops.org) so that you may access information about your pension whenever it is convenient for you. Many of you have worked with our on-staff financial planner in order to address the issues that are important to you.

As we look back at the year 2001, the tragic events of September 11th will be foremost in our minds. At HPOPS, we know it is our responsibility to continue to perform "business as usual" in the interest of our members and our country. Therefore, our goal this year, as in years past, is to provide our members the peace of mind that a secure and viable financial future awaits them upon retirement.

Sincerely,

J. Larry Doss
J. Larry Doss
Chairman

LIFE • CYCL

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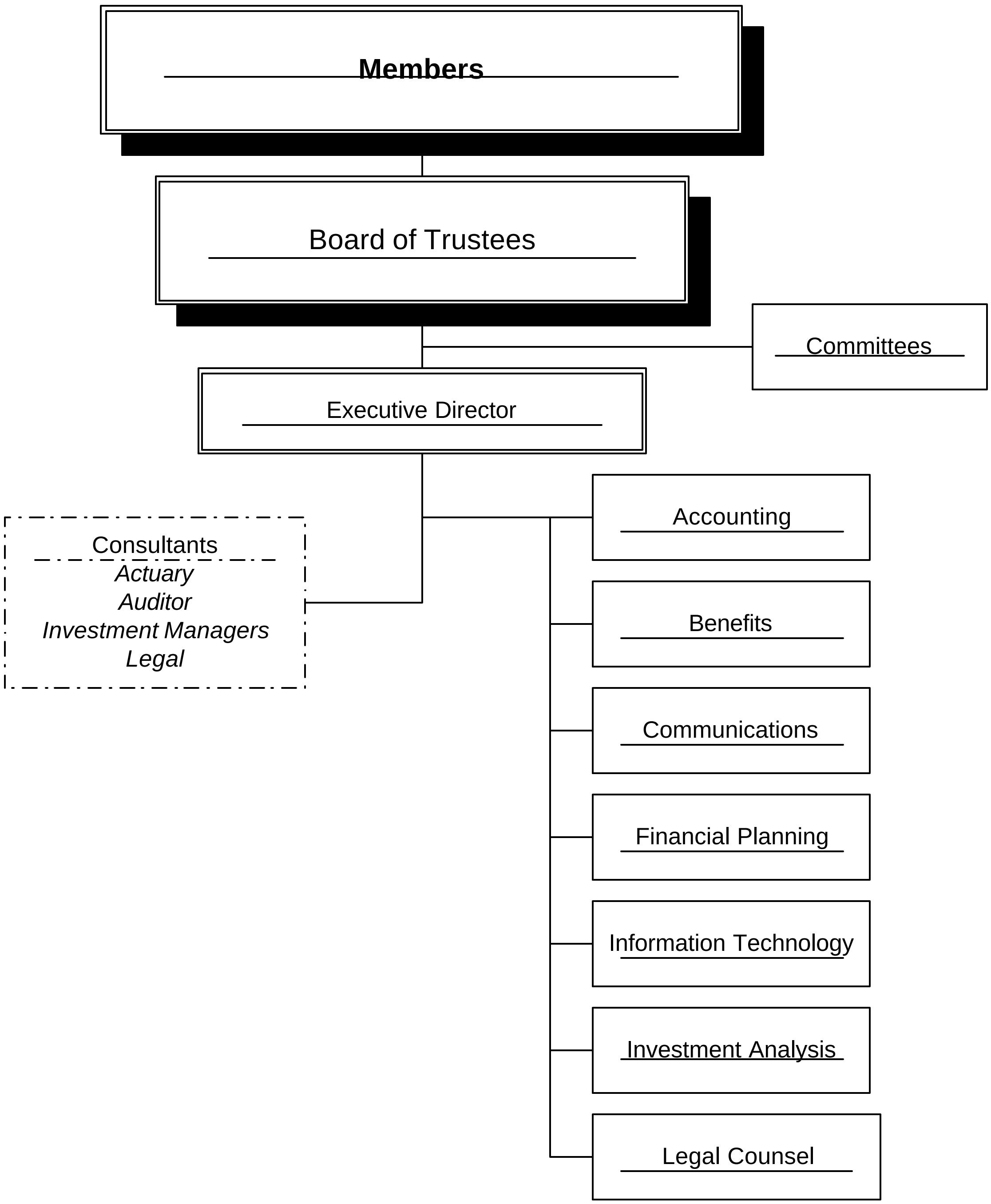
ORGANIZATION CHART



Certificate of Achievement for Excellence in Financial Reporting

Presented to

Police Officers Pension System of the City of Houston, Texas

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

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.

Government Finance Officers Association of the United States and Canada Corporation SEAL Chicago

President

Executive Director

SECTION TWO

FINANCIAL SECTION

BDO

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Accountants and Consultants

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Independent Auditors' Report

The Board of Trustees
Houston Police Officers' Pension System
Houston, Texas

We have audited the accompanying statements of plan net assets of the Houston Police Officers' Pension System (the System) as of June 30, 2001 and 2000, and the related statements of changes in plan net assets for the years then ended. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2001 and 2000, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits of the basic financial statements were performed for the purposes of forming an opinion on those financial statements taken as a whole. The supplemental information included in Schedules I through III on pages 26 through 28, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such 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 "Required Supplementary Information" on pages 24 and 25 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

August 24, 2001

BDO Seidman, LLP

Houston Police Officers' Pension System

Statements of Plan Net Assets ($000's)

June 30,	**2001**	2000
Assets		
Investments, at fair value (Notes 1, 2 and 4):		
Short-term investments	**$ 48,527**	$ 135,125
Fixed income	**616,842**	537,436
Equity securities	**1,298,157**	1,476,026
Alternative investments	**172,842**	138,175
Foreign currency contracts	**509**	67
Total investments	**2,136,877**	2,286,829
Invested securities lending collateral (Note 2)	**252,617**	216,913
Receivables:		
Members	**662**	1,152
Investments	**9,374**	8,577
Due from brokers	**6,748**	62,410
Other receivables	**366**	162
Total receivables	**17,150**	72,301
Cash	**38**	143
Total assets	**$ 2,406,682**	$ 2,576,186

Houston Police Officers' Pension System

Statements of Plan Net Assets ($000's)

June 30,		**2001**		2000
Liabilities and Plan Net Assets				
Liabilities:				
Due to brokers	**$**	**8,355**	$	122,952
Securities lending collateral (Note 2)		**252,617**		216,913
Accrued professional fees		**1,749**		1,495
Other liabilities		**1,182**		637
Total liabilities		**263,903**		341,997
Plan net assets held in trust for pension benefits (see Schedule of Funding Progress)	**$**	**2,142,779**	$	2,234,189

See accompanying notes to financial statements.

Houston Police Officers' Pension System

Statements of Changes in Plan Net Assets ($000's)

Years ended June 30,		**2001**		2000
Additions (Deductions):				
Contributions (Notes 1 and 3):				
City	**$**	**30,645**	$	30,645
Members		**22,043**		21,761
		52,688		52,406
Investment income (loss):				
Net appreciation (depreciation) in fair value of investments		**(130,063)**		252,445
Interest:				
Short-term investments		**5,729**		4,603
Fixed income		**35,583**		29,240
		(88,751)		286,288
Dividends		**14,293**		12,880
Alternative investments		**1,107**		440
Other		**326**		160
		(73,025)		299,768
Less – investment expense		**(7,839)**		(7,991)
Net income (loss) from investing activities		**(80,864)**		291,777
Securities lending activities (Note 2):				
Securities lending income		**1,283**		1,284
Securities lending expense		**(451)**		(458)
Net income from securities lending activities		**832**		826
Total additions (deductions)		**(27,344)**		345,009

Houston Police Officers' Pension System

Statements of Changes in Plan Net Assets ($000's)

Years ended June 30,	**2001**	2000
Deductions:		
Benefits paid to members	**60,328**	55,421
Refunds to members	**884**	1,545
Professional and administrative expenses	**2,854**	2,216
Total deductions	**64,066**	59,182
Net increase (decrease)	**(91,410)**	285,827
Plan net assets held in trust for pension benefits, beginning of year	**2,234,189**	1,948,362
Plan net assets held in trust for pension benefits, end of year	**$ 2,142,779**	$ 2,234,189

See accompanying notes to financial statements.

1. Plan Description and Contribution Information

General - The Houston Police Officers' Pension System (the System) was created in 1947 by an act of the fiftieth Legislature of the State of Texas, and is governed by Article 6243g-4, Vernons Texas Civil Statutes (the Governing Statutes). The System is a single employer defined benefit pension plan covering all police officers employed full time by the City of Houston (the City) that provides for service, disability and death benefits for eligible members. The System is a local governmental plan and, therefore, is not subject to the Employee Retirement Income Security Act of 1974.

At June 30, 2001, the System's membership consisted of the following:

Description	Number
Retirees and beneficiaries currently receiving benefits	1,786
Active members:	
Fully vested	1,275
Nonvested	4,015
Total members	7,076

Pension Benefits - Following are descriptions of benefits offered pursuant to the governing statute and the Agreement entered into with the City of Houston as described in the Changes in Actuarial Assumptions and Benefits section.

Eligibility - Members become eligible to receive a service pension upon retirement with twenty years of service. Members also have the option to select a Delayed Retirement, which allows for vesting after ten years of service with a pension benefit payable at age 60.

Benefits - Retirement benefits are equal to 2.75 percent of the member's average total direct pay for each of the member's first twenty years of service plus two percent of total direct pay for each year in excess of twenty years with no maximum percentage.

Retired members and surviving spouses are entitled to receive an additional $150.00 per month in order to defray group medical insurance costs.

Deferred Retirement Option Plan - The Deferred Retirement Option Plan (DROP) provides for an optional method of accruing pension benefits. Members with twenty years of service are eligible to participate in the DROP and upon termination of employment participating members receive their pension benefit in the form of a reduced annuity and a lump sum benefit. The reduced annuity is the member's pension benefit at the time of enrollment in the DROP plus any subsequent cost of living adjustments. The lump sum benefit is the accumulated balance in the member's notional DROP account which is equal to an amount calculated as if the member's reduced annuity, employee contribution and interest component had been deposited in a separate account in the member's name during the member's participation in DROP.

Effective May 1, 2001, a Back-DROP is available for all eligible participants. The DROP notional account may be recalculated based on what it would have been had the member elected DROP at a different date as elected by the member. The Back-DROP entry date cannot be prior to the latter of October 21, 1995 or the date the member attained 20 years of credited pension service.

DROP and Back DROP participants who terminate service receive the greater of the DROP or Back DROP monthly benefit, as applicable, or a recalculated monthly benefit amount. The recalculated monthly benefit amount is derived by multiplying the member's service percentage as of their DROP or Back DROP entrance date (plus any ad hoc increases in the multiplier) times the average total direct pay as of the member's termination (retirement) date from the Houston Police Department ("HPD").

Cost of Living Adjustments – Pension benefits and the monthly DROP benefits are adjusted each year equal to two-thirds of the percentage increase in the Consumer Price Index for all Urban Consumers for the preceding year subject to minimum and maximum increases of 3.0 percent and 8.0 percent, respectively.

Disability Benefits - Duty connected disability benefits are equal to the greater of fifty-five percent of average total direct pay or the accrued service pension. Disabled members who qualify for a Catastrophic Disability, as defined, receive a disability benefit equal to 100 percent of average total direct pay.

Members determined to be eligible for a non duty-connected disability benefit are entitled to a benefit of either 27.5% of average total direct pay, if the member has ten or fewer credited years of service, or 2.75% per year for credited service in excess of ten but less than twenty years.

Death Benefits - Death benefits are available to a surviving spouse, dependent children or a dependent parent in the event of the death of a member either after disability or service retirement, or prior to retirement.

Refunds of Member Contributions – A member with less than 20 years of credited pension service may elect to obtain a refund of member contributions upon termination of service with the HPD. This refund does not include interest. Members with at least ten but less than 20 years of credited pension service, who terminate service with the HPD, have the option of a Delayed retirement.

Delayed Retirement – A member with at least 10 but less than 20 years of credited pension service at termination of employment with the Houston Police Department has the option of either a refund of member contributions, without interest, or a Delayed retirement benefit. The Delayed benefit is payable at age 60 and is calculated at 2.75% of average total direct pay for each year of credited pension service.

Supplemental Monthly Benefit – In years in which certain investment performance and actuarial funding requirements are met the System issues a supplemental monthly benefit payment to retired members and a supplemental credit to DROP participant's accounts in an amount equal to their normal monthly benefit.

Lump Sum Benefit – Members retiring with a service or disability benefit receive a one-time $5,000 lump sum benefit.

Reciprocal Retirement Program – Members who have less than twenty years of service with the System but who have at least twenty years of cumulative service with the City of Houston are eligible to participate in the System's Reciprocal Retirement Program. This program allows members with less than twenty years of credited pension service with the System to combine their service credit with other City of Houston retirement systems. If the member has a cumulative twenty years of pension credit then they are eligible to receive a proportionate retirement benefit from the System.

Post Retirement Option Plan - This post-retirement option allows retired members to contribute all or a portion of their monthly retirement benefit and DROP lump sum to a notional account maintained by the System which accumulates interest and can be disbursed to the member under certain options as designated by the System.

Changes in Actuarial Assumptions and Benefits - The Board of Trustees voted to enter into an agreement with the City of Houston, effective May 1, 2001, wherein the Board agreed to change certain pension benefit provisions and to present additional proposed legislative changes to the Governing Statutes to the Texas Legislature.

- Increased service and disability benefit accruals for service less than or equal to 20 years from 2.5% to 2.75% for current active members and retirees. Current DROP accounts will be recalculated using the 2.75% accrual rate plus COLA adjustments from date of DROP participation.
- Provide active members, including current DROP members, an additional Back-DROP benefit option.
- Change the interest rate earned on the PROP accounts for retirees from the 30-year Treasury rate to the System's five-year average rate of return.
- Change the DROP and PROP interest rate to include a minimum rate of 0%.
- Allow members who have service credit in more than one City of Houston pension plan to use their combined service credit to qualify for DROP participation.
- Change the definition of Average Total Direct Pay from the average of the last 26 pay periods to the highest bi-weekly pay period during the last 26 pay periods.
- Eliminate the 10-year service eligibility requirement for off-duty disability and survivor benefits.
- Members who are eligible for disability benefits from another City of Houston Pension System are eligible to receive a proportionate disability benefit from HPOPS equal to 27.5% of average total direct pay.
- Increase the monthly insurance stipend from $88.05 to $150.00.
- Provide credited pension service to certain officers who were involuntarily transferred to the System from the Houston Municipal Employees Pension System.
- Recalculate the monthly benefit at retirement for retiring DROP and Back-DROP participants to equal the greater of the current monthly

DROP or BACK-DROP benefit or a recalculated monthly benefit based on service at the member's DROP entrance date and average total direct pay at the member's retirement date.

- Adoption of a 30-year constant level percent of payroll amortization method.
- Adoption of an assumed 9% investment return for the purpose of estimating DROP and PROP crediting rates.

The estimated effect of these benefit changes as of July 1, 2001, is estimated to increase the System's unfunded actuarial liability by $280.9 million from a surplus of $155.1 million to an unfunded actuarial liability of $125.8 million. This estimate is based on projecting assets and participant information from July 1, 2000 assuming an 8.5% return. Pursuant to the Governing Statute and the agreement with the City of Houston dated May 1, 2001 the City is required to make annual contributions to the System, as described in Note 3 of the financial statements, in amounts that will fund any unfunded actuarially accrued liability over an agreed-upon amortization period.

2. Summary of Significant Accounting Policies

Basis of Presentation - The accompanying financial statements are presented in accordance with Governmental Accounting Standards Board Statement No. 25 (GASB 25) and the Codification of Governmental Accounting and Financial Reporting Standards, which designate accounting principles and financial reporting standards applicable to state and local governmental units. The accompanying financial statements include solely the accounts of the System, which include all programs, activities and functions relating to the accumulation and investment of the assets and related income necessary to provide the service, disability and death benefits required under the terms of the Governing Statutes and amendments thereto. The System is a component unit of the City only to the extent the System receives contributions equal to the actuarially determined percentage of the total direct pay of active members.

Basis of Accounting - Basis of accounting is the method by which revenues and expenses are recognized in the accounts and are reported in the financial statements. The accrual basis of accounting is used for the System. Under the accrual basis of accounting, revenues are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability is incurred. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Investments - Investments are reported at fair market value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. Investments that do not have an established market value are reported at estimated fair market value.

Dividend income is recorded on the ex-dividend date. Income from other investments is recorded when earned. Gains and losses on sales of securities are recognized on the trade date. The cost of investments sold is determined using the first-in, first-out cost flow method.

Statutes of the State of Texas authorize the System to invest surplus funds in a manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. The System's investments have been categorized to indicate the level of risk assumed by the System at year-end.

Category one includes investments that are insured or registered, or for which the securities are held by the System or its agent in the System's name. Category two includes investments which are uninsured and unregistered, with securities held by the counter party's trust department or agent in the System's name. Category three includes investments which are uninsured and unregistered, with securities held by the counter party, or by its trust department or agent but not in the System's name. The System's investments in the United States government securities and corporate bonds meet the criteria of Category one. All other investments are in Category three except for commingled funds and alternative investments, which, by their nature, are not required to be so categorized.

Short-term investments include funds held in the Northern Trust Short Term Investment fund (STIF) and commercial paper with maturities not exceeding one year. Fixed income investments include government securities such as Treasury securities, Federally sponsored agency issued discount notes, bonds, agency pass-through securities and collateralized mortgage obligations; US corporate bonds such as term bonds and asset backed securities; and foreign securities such as dollar denominated and non-dollar denominated issues of non-US governments and private corporations. Call options on fixed income securities give the holder the right but not the obligation to purchase US Treasury securities during the term of the option contract. The holder pays a premium for this right, which is carried as an asset of the System, subject to daily mark-to-market adjustments, during the contract term. The issuer of the option has an obligation to the holder to settle the option position in cash at the fair market value of the underlying security in exchange for the price specified by the option, until the contract is exercised or expires. Equity securities consist of individual shares of equity securities plus units of commingled stock funds of both US and foreign entities. Alternative investments consist of investments in real estate and venture capital and private equity limited partnerships.

Securities Lending Program –

		Fair Value ($000's)
Investments held by System's agent in System's name:		
Cash equivalent securities	$	48,527
Fixed income		561,001
Equities		1,111,212
Alternative investments		172,842
Foreign currency contracts		509
Securities lending collateral investment pool		252,617
	$	2,146,708
Investments held by brokers under securities loans with cash collateral:		
Fixed income	$	55,841
Equities		186,945
	$	242,786

The System lends securities (domestic and international equities and domestic fixed income) to securities firms on a temporary basis through its custodian bank. The System receives fees for all loans and retains the right to all interest and dividend payments while the securities are on loan. All security loan agreements are collateralized by cash, letters of credit or various government securities having market values equal to or exceeding 102 and 105 percent of the value of the loaned securities for domestic and international securities, respectively. Whenever market value of the securities on loan changes, the borrower must adjust the collateral accordingly. At June 30, 2001, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers exceed the amounts the borrowers owe the System.

The System's bank pools all collateral received from securities lending transactions and invests any cash collateral. The System holds an undivided share of the collateral provided by the borrowers of the securities. At June 30, 2001 the weighted-average maturity of the collateral pool was 34 days. The relationship between the maturities of the collateral pool and the System's loans has not been determined. Cash collateral invested in the custodian bank collateral pool at June 30, 2001 of $251,258 thousand is not classified by category of custodial credit risk. The balance of the collateral at June 30, 2001 of $1,359 thousand consists of treasury securities and letters of credit and is classified in category one.

The System cannot sell or pledge the collateral unless the borrower fails to return the securities borrowed. The market value of securities on loan at June 30, 2001 and 2000 was $244,101 thousand and $210,583 thousand, respectively.

Derivatives – The System's investment managers may invest in derivatives if permitted by their guidelines. The guidelines are established by the System's Board of Trustees and compliance is monitored by the System's staff. From time to time the System's investment managers will invest in foreign currency contracts, options, collateralized mortgage obligations and mortgage-backed securities. No derivatives are purchased with borrowed funds.

The foreign currency contracts are used to hedge against the currency risk in the System's investments in foreign equity securities. The other derivatives are used to enhance yields and provide incremental income. Derivative securities are subject to changes in value due to changes in interest rates or currency valuations. The mortgage-backed securities are additionally subject to prepayment risk when interest rates are declining.

Futures on US government securities are used to take advantage of mis-pricing opportunities. When a position is taken in a futures contract, a margin is posted and the contract is subject to daily mark-to-market adjustments. To liquidate the contract prior to expiration an offsetting position in the same contract must be taken. At expiration the holder of the futures contract accepts delivery of the underlying asset at the agreed-upon price. The average balances outstanding of futures during the fiscal years-ending June 30, 2001 and 2000 were $6,651 thousand and $13,314 thousand, respectively. Futures outstanding at June 30, 2001 and 2000 were $494 thousand and $12,809 thousand, respectively.

Foreign Currency - The books and records of the System are maintained in US dollars. Foreign currencies and non-dollar denominated investments are translated into US dollars at the bid prices of such currencies against US dollars at each balance sheet date. Realized and unrealized gains and losses on investments which result from changes in foreign currency exchange rates have been included in the net appreciation (depreciation) in fair value of investments. Net realized foreign currency gains and losses resulting from changes in exchange rates include foreign currency gains and losses between trade date and settlement date of investment securities transactions, foreign currency transactions and the difference between the amounts of interest and dividends recorded on the books of the System and the amount actually received.

Administrative Costs –All administrative costs of the System are paid from the System's assets.

Cash – The System considers only demand deposits as cash. Short-term investments, classified on the balance sheet as "Investments", are composed of investments in short-term money market funds and commercial paper with maturities not exceeding one year and extended term money market funds with an average maturity not exceeding one year. Short-term investments meet the criteria of category three as described in paragraph one of Investments above.

As of June 30, 2001 and 2000, the System had cash of $38 thousand and $143 thousand, respectively, on deposit at a financial institution. Cash on deposit up to $100 thousand at this financial institution was covered by the Federal Depository Insurance Corporation. Cash on deposit with the System's custodian bank is collateralized by securities held in the custodian's name.

Federal Income Tax - A favorable determination that the System is qualified and exempt from Federal income taxes was received May 26, 1998. The determination letter is applicable for all amendments to the Governing Statutes through September 1, 1997. The Board believes that the System is designed and continues to operate in compliance with the applicable requirements of the Internal Revenue Code.

Reclassifications – Certain 2000 balances have been reclassified to conform to the 2001 financial statement presentation.

3. Contributions and Reserves

Contributions – Members are required to contribute 8.75% of their total direct pay to the System. Prior to June 1, 1996, contributions to the System were made on an after-tax basis. Subsequent to this date, contributions will be on a pre-tax basis pursuant to an amendment to the Governing Statutes passed by the Texas State Legislature in the 1995 legislative session.

Employer contribution rates are established and may be amended by the System's Board of Trustees, based on the results of actuarial valuations. The contribution rates are determined based on the benefit structure established by the Board of Trustees. The contribution rate has been determined to provide for normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability or surplus over thirty years (constant).

The City contributed $30,645 thousand for fiscal year 2001 as required in an agreement with the City of Houston agreement dated April 7, 1997. The City's actuarial contribution rate for the year ended June 30, 2001 was 16.3 percent. Pursuant to an agreement with the City of Houston dated May 1, 2001, the City agrees its contribution rate will be as follows:

FYE	Amount ($000's)
2002	$ 32,645
2003	34,645
2004	36,645
2005	16% of total direct pay (TDP)
2006 and thereafter	The greater of 16% of TDP or the actuarial determined rate.

4. Commitments and Contingencies

As described in Note 1, certain members of the System are entitled to refunds of their accumulated contributions, without interest, upon termination of employment with the City prior to being eligible for pension benefits. At June 30, 2001 and 2000, aggregate contributions from active members of the System were approximately $208,973 thousand and $190,862 thousand, respectively. The portion of these contributions which are refundable to members who may terminate with less than twenty years of service has not been determined.

At June 30, 2001 and 2000, the total accumulated lump sum benefit due to DROP members was approximately $211,161 thousand and 144,810 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $175,052 thousand and 145,593 thousand, as of June 30, 2001 and 2000, respectively.

Effective August 1, 1999 the System executed a five-year office lease renewal through July 31, 2004, at a monthly base rental of $15.6 thousand.

5. Subsequent Events

The terrorist attacks on the United States of September 11, 2001 have resulted in a volatility in the financial markets in the United States and around the world, which could result in continued depressed economic conditions in world markets. Despite these current market conditions, the Board believes that investments in both U.S. and non-U.S. markets is consistent with their fiduciary duty to maintain a diversified portfolio in order to protect the System from the risk of substantial loss.

Required Supplementary Information (Unaudited)

Schedule of Funding Progress *($000's)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus) (UAAL) (b-a)	Funded Ratio (%) (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 1994	$ 947,456	$ 984,495	$ 37,039	96	$162,143	23
July 1, 1995	1,038,256	1,000,423	(37,833)	104	174,761	(22)
July 1, 1996	1,168,056	1,199,748	31,692	97	182,251	17
July 1, 1997	1,329,570	1,258,217	(71,353)	106	187,134	(38)
July 1, 1998	1,518,081	1,549,341	31,260	98	196,364	16
July 1, 1999	1,746,312	1,773,829	27,517	98	246,569	11

Schedule of Employer Contributions *($000's)*

Years Ended June 30,	Annual Required Contribution	Percentage Contributed	Annual Required Contribution as a Percentage of Pay
1996	$ 31,563	100.0	18.0
1997	29,503	100.0	16.2
1998	30,564	100.0	16.2
1999	30,645	100.0	16.8
2000	30,645	100.0	16.3
2001	30,645	100.0	16.3

See accompanying independent auditors' report.

An actuarial valuation subsequent to July 1, 1999 has not been adopted by the Board of Trustees. See Note 1, Changes in Actuarial Assumptions and Benefits, for a description of actuarial funding levels and changes to assumptions since the most recent actuarial valuation.

Houston Police Officers' Pension System

Required Supplementary Information (Unaudited)

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

Valuation date	July 1, 1999
Actuarial cost method	Entry age
Amortization method	Level percent of payroll Closed amortization period ending December 31, 2022
Remaining amortization period	23.5 years
Asset valuation method	5 year smoothed market
Actuarial assumptions: Investment rate of return	8.5%
Payroll growth rate, attributable entirely to inflation	2.0%
Annual cost of living adjustment	3.0%
Projected salary increases	4.0% - 9.0%

See accompanying independent auditors' report.

Houston Police Officers' Pension System

Schedule I - Investment, Professional and Administrative Expenses ($000's)

Year ended June 30,		**2001**		2000
Investment services	**$**	**7,839**	$	7,991
Professional services:				
Actuarial services		**233**		85
Auditing services		**28**		25
Election audit services		**11**		40
Legal services		**291**		264
Lobbyist services		**73**		82
Total professional services		**636**		496
Administrative expenses:				
Education and due diligence		**70**		62
Fiduciary insurance		**56**		56
Office rent		**223**		155
Other office costs		**1,869**		1,447
Total administrative expenses		**2,218**		1,720
	$	**10,693**	$	10,207

See accompanying independent auditors' report.

Year ended June 30, 2001

Type of Investment[1]	Market Value June 30, 2000	Purchases	Sales and Redemptions
Fixed income	$ 537,436	$ 1,174,133	$ 1,093,330
Equity securities	1,476,026	865,085	921,121
Alternative investments	138,175	56,372	19,357
Short-term investments	135,125	225,281	310,780
	$ 2,286,762	$ 2,320,871	$ 2,344,588
		Sales	Deliveries
Foreign currency contracts	$ 67	$ 1,889,647	$ 1,885,819

[1]*Space and cost restriction make it impractical to print the entire investment portfolio in this report. A portfolio listing is available for review at the System's office.*

Schedule II - Summary of Investments (000's)

	Net Appreciation (Depreciation)	*Market Value June 30, 2001*
	$ (1,397)	$ 616,842
	(121,833)	1,298,157
	(2,348)	172,842
	(1,099)	48,527
	$ (126,677)	$ 2,136,368
	$ (3,386)	$ 509

See accompanying independent auditors' report

Schedule III - Summary of Investment and Professional Services ($000's)

Year ended June 30, 2001	Official System Position	Payments	Nature of Services
Abbott Capital Management	Consultant	$ 250	Consulting
The Northern Trust Company	Custodian	193	Custodian
American Express Asset Management	Money manager	1,097	Money management
Barclays Global Investors	Money manager	1,147	Money management
Brandes Investment Partners	Money manager	951	Money management
Cowen Asset Management	Money manager	696	Money management
Delaware International Advisors	Money manager	146	Money management
Donald Smith & Co.	Money manager	390	Money management
Iridian Asset Management	Money manager	545	Money management
MacKay-Shields Financial Corp.	Money manager	614	Money management
Pacific Investment Management Co.	Money manager	292	Money management
Walter Scott Partners	Money manager	380	Money management
Seneca Capital Management	Money Manager	232	Money Management
Credit Suisse Asset Management	Money Manager	211	Money Management
Loomis Sayles & Co.	Money Manager	185	Money Management
Shenkman Capital Management	Money Manager	189	Money Management
Towers Perrin	Actuary	233	Actuarial

Houston Police Officers' Pension System

Schedule III - Summary of Investment and Professional Services ($000's)

Year ended June 30, 2001	System Position	Payments	Nature of Services
BDO Seidman, LLP	Auditors	28	Auditing
Lawson & Fields	Attorneys	199	Legal Service
Gibbs & Bruns	Attorneys	68	Legal Services
Lock Liddell Sapp	Attorneys	73	Lobbyists
Bickley Prescott & Co.	Consultant	11	Election Auditing
Other	Other	91	Other
Subtotal		8,221	
Accrued at June 30, 2000		1,495	
Accrued at June 30, 2001		1,749	
Total investment and professional services		$ 8,475	

See accompanying independent auditors' report.

SECTION THREE

ACTUARIAL SECTION

1 Houston Center
1221 McKinney, Suite 2600
Houston, TX 77010-1006
713 754-5400
Fax: 713 754-5462

Towers Perrin

February 8, 2000

Board of Trustees
Houston Police Officers
Pension System
602 Sawyer, Suite 640
Houston, Texas 77007

Dear Board Members:

We certify that the information contained in this July 1, 1999 Actuarial Report for the Houston Police Officers Pension System has been prepared in accordance with generally accepted actuarial principles and practices. To the best of our knowledge, the information is accurate and fairly presents the actuarial position of the Pension System as of July 1, 1999.

In preparing the actuarial results, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets and other matters. Historical information for years prior to 1986 was prepared by the prior actuaries and was not subjected to our actuarial review.

Financing Objective of the System

Actuarial contribution rates are established that, over time, will remain level as a percentage of payroll. The actuarial contribution rate has been determined to provide for normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability (or surplus) over 40 years from January 1,1983.

Progress Toward Realization of Financing Objective

The summary of accrued and unfunded accrued liabilities in on page 33 of the report illustrates the progress toward realization of the financing objective.

Disclosure of Pension Information

Effective for the fiscal year beginning July 1, 1994, the Board of Trustees has adopted compliance with the requirements of Governmental Accounting Standards Board (GASB) Statement No. 25. The information in this report has been determined in accordance with GASB No. 25.

Data

In preparing the July 1,1999 actuarial valuation, we relied upon data provided by the Board. As part of this valuation, we tested the data for reasonableness. We did not, however, subject this data to any auditing procedures.

Actuarial Methods and Assumptions

The actuarial methods and assumptions described in Section VI of the report were selected by the Board of Trustees. The Board has sole authority to determine the actuarial assumptions. Changes in the actuarial methods and assumptions since the prior valuation are also described on page 40.

A study of actuarial experience was last conducted for the period from September 1, 1983 to June 30, 1997. In our opinion, the actuarial assumptions used are appropriate for purposes of the valuation and, in the aggregate, are reasonably related to the experience of the System and to reasonable expectations.

Plan Provisions

The plan provisions used in the actuarial valuation are described beginning on page 41 of the report. Changes in the plan provisions since the prior valuation are also described on page 48.

We are available to answer any questions on the information contained in the report, or to provide any additional information you may need.

Sincerely,

Adam

Adam S. Berk, A.S.A., CFA
Consultant

Historical Unfunded Actuarial Accrued Liability (Surplus)
($000)

Valuation Date	Actuarial Accrued Liability (AAL)	Actuarial Value of Assets (AVA)	AVA as a % of AAL	Unfunded AAL (Surplus)	Covered Payroll	UAAL (Surplus) as a % of Covered Payroll
September 1, 1972	$95,753	$21,770	23%	$73,982	$22,210	333%
January 1, 1976	188,600	38,300	20	150,300	39,503	380
January 1, 1978	245,100	59,600	24	185,500	50,040	371
January 1, 1980	301,585	90,226	30	211,359	58,169	363
January 1, 1982	412,298	139,976	34	272,322	89,529	304
July 1, 1984	507,883	230,143	45	277,740	111,489	249
July 1, 1986	454,067	420,487	93	33,580	*125,963	27
July 1, 1987	488,387	505,483	104	(17,096)	126,960	(13)
July 1, 1988	524,894	516,177	98	8,717	121,667	7
July 1, 1989	581,681	585,358	101	(3,677)	122,803	(3)
July 1, 1990	663,278	676,684	102	(13,406)	**126,665	(11)
July 1, 1992	853,975	774,785	91	79,190	143,020	55
July 1, 1993	936,674	857,535	92	79,139	159,321	50
July 1, 1994	984,495	947,456	96	37,039	162,143	23
July 1, 1995	1,000,423	1,038,256	104	(37,833)	174,761	(22)
July 1, 1996	1,199,748	1,168,056	97	31,692	182,251	17
July 1, 1997	1,258,217	1,329,570	106	(71,353)	187,134	(38)
July 1, 1998	1,549,341	1,518,081	98	31,260	196,364	16
July 1, 1999	1,773,829	1,746,312	98	27,517	***246,569	11

* Reflects the July 5, 1986 pay decrease.
** Reflects the November 1, 1990 pay increase.
***Definition of covered payroll changed from base pay to total direct pay less overtime.

Historical Solvency Test
($000's)

	Actuarial Accrued Liability for:						
Valuation Date	Employee Contributions (1)	Retirees, Beneficiaries, and DROP Participants (2)	Active Participants (City-Financed Portion) (3)	Actuarial Value of Assets	Portion of Actuarial Accrued Liability Covered by Assets (1)	(2)	(3)
Jan. 1, 1982	$38,045	$112,614	$261,639	$139,976	100%	91%	0%
July 1, 1984	51,699	186,459	269,725	230,143	100	98	0
July 1, 1986	67,572	157,943	228,552	420,487	100	100	85
July 1, 1987	72,603	164,367	251,417	505,483	100	100	100
July 1, 1988	77,404	196,547	250,943	516,177	100	100	97
July 1, 1989	82,919	222,585	276,177	585,358	100	100	100
July 1, 1990	87,430	261,114	314,734	676,684	100	100	100
July 1, 1991	98,099	338,914	416,962	774,785	100	100	81
July 1, 1992	105,464	372,674	458,536	857,535	100	100	83
July 1, 1993	114,279	401,989	468,227	947,456	100	100	92
July 1, 1994	123,471	416,053	460,899	1,038,256	100	100	100
July 1, 1995	91,687	764,518	343,543	1,168,056	100	100	91
July 1, 1996	95,615	812,498	350,104	1,329,570	100	100	100
July 1, 1998	99,298	1,017,723	432,320	1,518,081	100	100	93
July 1, 1999	107,008	1,157,882	508,939	1,746,312	100	100	95

Historical Active Participant Data
($000's)

Valuation Date	Number of Participants	Average Age	Annual Covered Payroll ($000)	Average Annual Covered Payroll	Percentage Increase in Average Covered Payroll
September 1, 1972	2,062	N/A	$ 22,200	$ 10,771	N/A
January 1, 1976	2,622	N/A	39,500	15,066	39.9%
January 1, 1978	2,877	N/A	50,040	17,393	15.4
January 1, 1980	3,029	N/A	58,169	19,204	10.4
January 1, 1982	3,243	N/A	89,529	27,607	43.8
July 1, 1984	3,997	N/A	111,489	27,893	1.0
July 1, 1986	4,526	33.5	125,963*	27,831	(0.2)
July 1, 1987	4,494	34.4	126,960	28,251	1.5
July 1, 1988	4,239	35.0	121,667	28,702	1.6
July 1, 1989	4,105	35.7	122,803	29,915	4.2
July 1, 1990	4,073	36.2	126,665**	31,099	4.0
July 1, 1992	4,120	36.8	143,020	34,714	11.6
July 1, 1993	4,498	36.7	159,321	35,420	2.0
July 1, 1994	4,705	36.8	162,143	34,462	(2.7)
July 1, 1995	4,921	36.9	174,761	35,513	3.0
July 1, 1996***	4,395	35.1	150,903	34,335	(3.3)
July 1, 1997***	4,282	35.5	149,631	34,944	1.8
July 1, 1998***	4,247	35.9	153,479	36,138	3.4
July 1, 1999***	4,253	36.3	187,967****	44,196****	22.3****

* Reflects the July 5, 1986 pay decrease.
** Reflects the November 1, 1990 pay increase.
*** Includes those participants currently accruing benefits (excludes current DROP participants).
**** Definition of covered payroll changed from base pay to total direct pay less overtime.

Retirees, Beneficiaries, Disabled and DROP Participants Added to and Removed from Rolls
($000's)

Period Ended	Added to Rolls: Number	Added to Rolls: Annual Benefits ($000)	Removed from Rolls: Number	Removed from Rolls: Annual Benefits ($000)	Rolls at the End of the Year: Number	Rolls at the End of the Year: Annual Benefits ($000)	Percentage Increase in Annual Benefits	Average Annual Benefit
December 31, 1976	41	$ 472	17	$ 94	395	$ 2,588	18.5%	$ 6,551
December 31, 1977	62	520	18	55	439	2,979	15.1	6,785
December 31, 1978	66	779	13	80	492	3,653	22.6	7,425
December 31, 1979	68	845	12	126	548	4,370	19.6	7,974
December 31, 1980	73	1,120	19	123	602	5,389	23.3	8,951
December 31, 1981	81	1,191	17	184	666	6,499	20.6	9,759
December 31, 1982	104	1,106	24	240	746	7,842	20.7	10,513
December 31, 1983	82	967	35	362	793	8,931	13.9	11,262
June 30, 1984	53	779	18	150	855	4,760	6.6	11,095
June 30, 1985	83	1,141	42	259	896	10,166	6.8	11,346
June 30, 1986	44	530	37	431	903	10,939	7.6	12,114
June 30, 1987	42	585	36	421	909	11,321	3.5	12,455
June 30, 1988	138	2,668	25	243	1,022	14,069	24.3	13,766
June 30, 1989	89	1,349	46	502	1,065	16,127	14.6	15,142
June 30, 1990	105	1,811	29	457	1,141	18,029	11.8	15,801
June 30, 1992	222	4,662	75	1,127	1,288	22,999	27.6	17,857
June 30, 1993	105	2,012	16	205	1,377	25,474	10.8	18,500
June 30, 1994	106	2,172	64	953	1,419	27,286	7.1	19,229
June 30, 1995	107	2,425	48	847	1,478	29,464	8.0	19,935
June 30, 1996*	893	19,109	36	602	2,335	48,624	65.0	20,824
June 30, 1997	182	3,481	29	618	2,488	52,772	8.5	21,211
June 30, 1998	159	3,483	28	589	2,619	63,957	21.2	24,420
June 30, 1999	150	3,770	46	1,001	2,723	70,432	10.1	25,866

* Reflects implementation of the DROP effective September 1, 1995.

Summary of Actuarial Methods and Assumptions

Actuarial Methods

Actuarial Value of Assets — Gains and losses in the market value of assets, based on the difference between the actual rate of return and the assumed rate of return, are recognized in the actuarial value over five years.

Actuarial Cost Method — Entry Age Method with liabilities allocated from date of entry to age 65. The Unfunded Actuarial Accrued Liability (Surplus), including the effects of actuarial gains and losses, is amortized as a level percentage of base pay ending December 31, 2022. The contribution is increased for interest for one-half of a year to reflect timing of payments.

Economic Assumptions

- Investment Return — 8.5% per year, net of expenses
- Payroll Growth Rate/Inflation — 2.0% for fiscal years ending in 2000 and 2001 (to reflect contractual non-merit increase). 4.0% per year, thereafter.
- Individual Merit Increase Rate

Age	*Increase*
20	5.00%
25	4.30
30	1.80
35	0.55
40	0.25
45	0.25
50	0.00
55	0.00
60	0.00

- Individual Pay Increase Rate — Inflation plus merit

Demographic Assumptions

- Entry Age — Date sworn.

Summary of Actuarial Methods and Assumptions (cont.)

- Retirement and DROP Participation Rates

Rates are service related.

Number of Years of Service	*Probability of Retiring Within One Year*	*Probability of Electing the DROP Within One Year*
20	16%	64%
21-29	2	8
30-34	4	16
35+	20	80

- DROP Duration

Number of Years in DROP	*Probability of Retiring from DROP Within One Year*
0-2	5%
3	10
4	20
5-9	50
10+	100

- Mortality Rates
  - — Active participants and nondisabled retirees: 1983 Group Annuity Mortality Table (see table below for sample rates).
  - — Disabled retirees: 1987 Commissioners Group Disabled Mortality Table (see table below for sample rates).

- Disability Rates: Graduated rates (see table below for sample rates).

- Percentage of Deaths and Disabilities in the Line of Duty: 100%.

- Termination Rates and Terminated Vested Pension Benefit Election: Graduated rates (see table below for sample rates). Prior to eligibility for service retirement, 50% of members eligible to receive a terminated vested pension are assumed to elect the pension at age 60 instead of a refund of contributions.

- Marital Status at Benefit Eligibility
  - — Percentage married: 90%. (No beneficiaries other than the spouse assumed).
  - — Age difference: Husbands assumed to be three years older than wives.

- Valuation Earnings: Average total direct pay less overtime over the 12 months (26 pay periods) preceding the valuation date, increased for one-half year of assumed pay increases.

Summary of Actuarial Methods and Assumptions (cont.)

Sample Rates

	Sample Rates per 100 Participants					
	Nondisabled Mortality		Disabled Mortality (Ultimate)	Termination	Disability	
Age	Male	Female	All	All	Male	Female
20	0.04	0.02	0.00	4.44	0.00	0.00
25	0.05	0.03	0.00	3.99	0.00	0.00
30	0.06	0.03	2.82	3.02	0.08	0.12
35	0.09	0.05	2.82	1.92	0.10	0.16
40	0.12	0.07	2.82	0.92	0.14	0.22
45	0.22	0.10	2.82	0.21	0.21	0.30
50	0.39	0.16	2.82	0.00	0.37	0.54
55	0.61	0.25	2.82	0.00	0.79	1.08
60	0.92	0.42	3.14	0.00	2.15	2.86

Changes in Methods and Assumptions Since the Prior Valuation

The actuarial methods and assumptions used in this valuation are the same as those used in the prior valuation except:

- The payroll growth rate/inflation was changed from 4.5% to 2.0% for fiscal years ending in 2000 and 2001 (to reflect contractual non-merit increases) and 4.0% per year, thereafter.

- Prior to eligibility for service retirement, 50% of members eligible to receive a terminated vested pension are assumed to elect the pension benefit instead of a refund of contributions.

Summary of Plan Provisions

- **Covered Members**

  All police officers sworn before September 1, 1975 are covered under Plan 1, except those who elected by December 31, 1981 to participate in Plan 3.

  All police officers sworn on or after September 1, 1975, but before September 1, 1981 are covered under Plan 2, except those who elected by December 31, 1981 to participate in Plan 3 and those from Police Cadet Classes 70 and 71 who elected to transfer to Plan 1.

  All other police officers are covered by Plan 3, except those from Police Cadet Classes 70 and 71 who elected to pay additional contributions and transfer to Plan 1.

- **Final Compensation**

  — Prior to November 28, 1998: Monthly base salary paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base salary for the 3 years prior to retirement.

  — After November 28, 1998: Monthly total direct pay less overtime paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base pay for the 3 years prior to retirement plus the other current components of total direct pay.

- **Service Retirement**

  — Eligibility:

  Plan 1: 20 years of service.

  Plan 2: 20 years of service.

  Plan 3: 20 years of service.

  — Benefit:

  Retirement prior to November 1, 1955: $75 per month plus $2 per month for each year of service in excess of 25 years.

  Retirement on or after November 1, 1955 but prior to January 13, 1968: 30% of final compensation plus 1% of final compensation for each year of service in excess of 20 years.

Summary of Plan Provisions (cont.)

Retirement on or after January 13, 1968 but prior to July 1, 1986:

- Plans 1 and 2: 30% of final compensation plus 2% of final compensation for each year of service in excess of 20 years.
- Plan 3: 2% of final compensation for each year of service up to 40 years, reduced 0.42% for each month benefit commencement precedes age 55.

Retirement on or after July 1, 1986 but prior to July 1, 1988: 2% of final compensation for each year of service up to 40 years.

Retirement on or after July 1, 1988 but prior to September 1, 1997: 45% of final compensation plus 2% of final compensation for each year of service in excess of 20 years; maximum 80% of final compensation. Benefit based on prior formula is payable until July 1, 1991 and recomputed benefit is payable thereafter.

Retirement on or after September 1, 1997: 50% of final compensation plus 2% of final compensation for each year of service in excess of 20 years; maximum 80% of final compensation.

Effective September 1, 1997, the Pension System recomputed the benefit of each person who retired before September 1, 1997. The retiree's benefit was increased by the result of multiplying the difference between 50% and the percentage used at the time of retirement in computing the retiree's benefit for the first 20 years of service by the base salary of the retiree at the time of retirement. This recomputed benefit is effective for all payments on or after September 1, 1997.

Effective September 1, 1999, the first five years of payments are guaranteed.

Additional benefits: An extra monthly benefit of $88.05 is payable for life. Effective November 28, 1998, a $5,000 lump sum is payable upon retirement.

- Terminated Vested Pension Benefit
  - Eligibility — More than 10 but less than 20 years of service. Termination on or after November 28, 1998.
  - Benefit — 2.5% of final compensation times years of service. This benefit commences at age 60 or at termination of service if later.

Summary of Plan Provisions (cont.)

- Deferred Retirement Option Plan (DROP)

  — Eligibility: 20 years of service.

  — Benefit: Effective September 1, 1995, eligible participants may elect to participate in the DROP until they leave active service. The member's retirement pension will be calculated based on service and earnings at the time the DROP is elected.

  Effective September 1, 1997, the Pension System recomputed the benefit of each person who entered the DROP before September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.

  Effective December 1, 1998, the Pension System recomputed the benefit of each person who entered the DROP before December 1, 1998. The benefit was recalculated based on Total Direct Pay less overtime upon entry to the DROP. This recomputed benefit is effective for all payments on or after December 1, 1998.

  A notional account will be maintained for each DROP participant. This account will be credited with the following amounts while the member is participant of the DROP:

  — The member's monthly retirement pension, including applicable cost-of-living adjustments,

  — The member's contribution to the Pension System, and

  — Investment earnings/losses at the rate of the Pension System's earnings/losses averaged over a five-year period.

  A benefit equal to the DROP account balance would be paid at the time the member leaves active service. The payment would be made as a single lump sum.

  If a DROP participant suffers an on-duty disability resulting in the inability to perform his/her usual and customary duties as a police officer or dies in the line of duty, he (or his survivors) would be allowed to revoke the DROP election and to receive the more generous on-duty disability or death benefits.

  Effective November 28, 1998, a retired member is allowed to leave all or a portion of their DROP account in the System. these accounts are credited every calendar year with the 30-year Treasury bond rate as of June of the preceding year.

Summary of Plan Provisions (cont.)

- Disability Retirement
  - Eligibility: Participant partially or totally disabled as a result of the performance of duty. If disability not duty-connected, 10 years of service required. Effective September 1, 1997 disability for all plans is defined as follows:
    - Total: Disability is defined as "unable to perform his/her usual and customary duties as a police officer".
    - Partial: Disability is an impairment which renders the participant unable to work as a police officer and which is expected to last 12 months.
  - Benefit: If duty-connected prior to July 1, 1986:
    - Plans 1 and 2: 30% of final compensation plus 2% of final compensation for each year of service over 20; adjusted by degree of disability.
    - Plan 3: 50% of final compensation or service retirement benefit if greater. A partially disabled participant is entitled to 35% of final compensation payable for a maximum of 2 years or service retirement benefit if eligible.

    If duty-connected on or after July 1, 1986 but prior to September 1, 1997:
    - Plans 1 and 2: The service retirement benefit accrued to date of disability (or 20 years, if greater), times the percentage of disability.
    - Plan 3: The service retirement benefit accrued to date of disability (or 50% of final compensation, if greater) is payable to a totally disabled participant. A partially disabled participant is entitled to 35% of final compensation payable for life or as long as he remains incapacitated.

    If duty-connected on or after September 1, 1997:
    - All Plans: The service retirement benefit accrued to date of disability (or 20 years, if greater) is payable to a totally disabled participant. A partially disabled participant is entitled to 35% of final compensation payable for life or as long as he remains incapacitated.

Summary of Plan Provisions (cont.)

If not duty-connected on or after July 1, 1986:

- Total: The accrued service retirement benefit to date of disability.
- Partial: 20% of final compensation payable for a maximum of 2 years.

■ Survivor Benefits

— Eligibility

Surviving spouses and dependent children and parents of participants, including surviving spouses of retired or disabled participants who were not married at the time of retirement or disability, provided the spouse was married to the participant for at least 5 years at the time of death:

- After disability or service retirement.
- As a result of the performance of duty.
- After 10 years of service, if death is not duty connected.

— Benefit

Spouse's benefit upon death before retirement:

- If duty-connected: Monthly lifetime benefit equal to 100% of final compensation at date of death.
- If not duty-connected: Monthly lifetime benefit equal to 100% of the service retirement benefit the participant had accrued at the time of death.

Spouse's income upon death after retirement: Monthly lifetime benefit equal to actual benefit payable at time of death.

Dependent children's benefit: If there is no surviving spouse, the benefit that would have been payable to the spouse is divided equally among the dependent children. Dependent children include unmarried children who are under age 18, and for Plan 3, full-time students under age 22, or permanently disabled children. If there is a surviving spouse, dependent children of Plan 1 and Plan 2 participants receive $25 per month.

Dependent parent's income: If there is no surviving spouse nor children, but there is a dependent parent, the benefit that would have been payable to the spouse will be paid to the dependent parent.

Summary of Plan Provisions (cont.)

Effective September 1, 1997, the Pension System recomputed the benefit of each survivor whose original benefit was computed prior to September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.

Additional benefits: Effective September 1, 1997, an extra monthly benefit of $88.05 is payable for life. Children receiving equivalent of the widow's benefit do not receive this additional benefit. Effective December 1, 1998, a $5,000 lump sum is paid upon the death of an active member.

- **Benefit Adjustments**

Monthly benefits for participants receiving payments are adjusted each April 1 according to change in the Consumer Price Index for All Urban Consumers (CPI-U) for the preceding calendar year with a benefit increase each year of two-thirds of the CPI-U increase, compounded, subject to a minimum of 3.0% per year compounded (effective September 1, 1997) and a maximum increase of 8.0% per year compounded.

Effective November 28, 1998, a 13th benefit check is paid to current retirees and DROP members when:

- The assets on the fund equal or exceed the liabilities after the 13th benefit check is paid.
- The return on investments for the preceding fiscal year exceeds 9.25%.
- The payment of the benefit will not cause the City of Houston's contribution to the System to increase.

- **Employee Contributions**

Prior to December 1, 1998, each participant contributes 8.75% of base salary. After December 1, 1998, each participant contributes 8.75% of average total direct pay less overtime.

Refunds of contributions are made if (i) the participant dies before 10 years of service and the death is not duty-connected, (ii) the participant dies with no eligible survivor, (iii) a Plan 1 or 2 participant leaves service before eligibility for retirement after completing 5 years of service, or (iv) a Plan 3 participant leaves service with less than 20 years of service. Contributions are refunded without interest.

Summary of Plan Provisions (cont.)

- **Employer Contribution** — This amount will be $30,645,000 through fiscal year ending June 30, 2001. For the fiscal year ending June 30, 2002, this amount will be the actuarial determined rate. For fiscal years ending after June 30, 2002, if the actuarial rate is less than 16%, then the City will contribute an additional $2,000,000 multiplied by the number of fiscal years that have ended since June 30, 2002 until the floor of 16% is reached. If the actuarial rate is higher than 16%, then the City will contribute the higher rate.

- **Service Adjustments** — Effective November 28, 1998, participants with previous service with the City in non-classified positions may use that service to satisfy the service requirement of 20 years for retirement purposes only.

Changes in Plan Provisions Since the Prior Valuation

The following changes were made to the plan provisions since the prior valuation:

- The definition of final compensation for active members not in the DROP was changed from base pay to total direct pay and the maximum cap on benefits of 80% of final compensation was eliminated. Total direct pay is defined as W-2 pay plus Section 457 and Section 125 contributions, but excluding overtime. For calculation purposes in the benefit formula, total direct pay for an employee will be averaged over the last 12 months (26 pay periods) prior to retiring or entering the DROP.

- Benefits for active members in the DROP were recalculated based on total direct pay, excluding overtime, as of the DROP participation date and the maximum cap on benefits of 80% of final compensation was eliminated.

- A potential 13th benefit check to current and future retirees and DROP members was added. This benefit will only be paid when:

  (a) the assets on the fund equal or exceed the liabilities after the 13th benefit check is paid,
  (b) the return on investments for the proceeding year exceed 9.25%, and
  (c) the payment of the benefit will not cause the City of Houston's contribution to the System to increase.

- A $5,000 lump sum upon service retirement, exit from the DROP, disability retirement, or death of an active member was added.

- A pension benefit commencing at age 60 (or at termination of service if later) to members who terminate after ten years of service prior to eligibility for service retirement (20 years) was added. The amount of this "terminated vested pension benefit" is equal to 2.5% times years of service times the member's total direct pay. The pension benefit is payable in the same form of payment as a service retirement pension and is eligible for the annual COLA. In the event the member elects to take a refund of his or her contributions, this pension amount is forfeited.

- The form of payment was changed from 100% joint and survivor to five-year certain 100% joint and survivor with the first five years of payments guaranteed.

- This amount will be $30,645,000 through fiscal year ending June 30, 2001. For the fiscal year ending June 30, 2002, this amount will be the actuarial determined rate. For fiscal years ending after June 30, 2002, if the actuarial rate is less than 16%, then the City will contribute an additional $2,000,000 multiplied by the number of fiscal years that have ended since June 30, 2002 until the floor of 16% is reached. If the actuarial rate is higher than 16%, then the City will contribute the higher rate.

Changes in Plan Provisions Since the Prior Valuation (cont.)

- Retired members are allowed to leave all or a portion of their DROP account in the System. These accounts are credited every calendar year with the 30-year Treasury Bond rate as of June of the preceding year. In addition, a retired member is allowed to leave all or a portion of his or her monthly pension benefit with the System in a DROP account credited at the rate specified above.

- Active or inactive members who are eligible to participate in the Executive Official Pension Plan of the Houston Municipal Pension System are permitted to participate in the Houston Police Officer's Pension System and make one of the following elections:

  (a) If an active member with twenty or more years of service, receive an immediate pension benefit or enter the DROP.
  (b) If an inactive member, begin receiving an immediate pension benefit based on years of service multiplied by 2.5% of total direct pay.

Actuarial Methods and Assumptions

The actuarial methods and assumptions described in Section VI of the report were selected by the Board of Trustees. The Board has sole authority to determine the actuarial assumptions. Changes in the actuarial methods and assumptions since the prior valuation are also described on page 40.

A study of actuarial experience was last conducted for the period from September 1, 1983 to June 30, 1997. In our opinion, the actuarial assumptions used are appropriate for purposes of the valuation and, in the aggregate, are reasonably related to the experience of the System and to reasonable expectations.

Plan Provisions

The plan provisions used in the actuarial valuation are described beginning on page 41 of the report. Changes in the plan provisions since the prior valuation are also described on page 48.

We are available to answer any questions on the information contained in the report, or to provide any additional information you may need.

Sincerely,

Adam S. Berk, A.S.A., CFA

Consultant

SECTION FOUR

INVESTMENT SECTION

Responsibilities of the Board of Trustees

The primary fiduciary fiscal responsibility of the Board of Trustees is to insure that the retirement plan assets are responsibly managed in accordance with the actuarial needs of the System, and also with sound, generally accepted financial investment procedures. The determination of the appropriate asset mix is based on capital market assumptions, which incorporate historical returns, volatility and correlation of various asset classes.

The Standard of Investment for the System in making investments is to exercise the judgment and care in the circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs. The Trustees' responsibility is to invest the System's funds solely in the interest of the membership and their beneficiaries, and for the exclusive purpose of providing benefits to the membership and their beneficiaries and defraying reasonable expenses of administering the System.

Investment Philosophy and Objectives

The Board of Trustees believes that the System's assets should be managed in a way that reflects the uniqueness of the System. The System's assets should be diversified over a spectrum of investment vehicles. Specifically, the Board recognizes and adheres to the following philosophical positions:

- Over the long term, the risk of owning equities has been, and should continue to be, rewarded with a somewhat greater return than that available from fixed income investments.

- Fixed income investments provide the System with an investment vehicle that contributes diversification, liquidity and a predictable stream of income, and that dampens volatility in investment returns.

- Diversification into alternative investments provides the System with an opportunity to enhance returns and to achieve broader diversification of the System's assets.

The long-term objectives established by the Board of Trustees are to achieve a real rate of return of 7.3 percent and a nominal rate of return of 9.5 percent.

Investment Strategy and Performance

During fiscal year 2001, the System hired TT International to replace Walter Scott & Partners in the international equity asset class. The Board approved a new proposal on domestic equity investment structure and new managers will be hired in the first half of fiscal year 2002.

Financial assets in general declined in value as a result of corrections in the stock markets. The System's investments suffered a loss of 3.96% in fiscal 2001 as compared to a loss of 9.05% on the System's policy benchmark. Investment returns included herein are time-weighted and include income and capital appreciation. Total assets amounted to $2.14 billion at year-end, down from $2.29 billion at the end of the prior year, for a decrease of $150 million.

Domestic Equity

The bull market in the U.S. equity market finally ended in March 2000. The meltdown in technology stocks continued to have a negative impact on the stock market in general. The Russell 3000 Index declined 13.93% for the year ended June 30, 2001. The System's equity investments showed a modest decrease of 3.87% as three of the System's five active managers outperformed the general stock market by a very large margin.

International Equity

International equity markets under performed the U.S. equity market. The System's international equity investments returned –14.09%, significantly outperforming the –23.32% return on the MSCI EAFE benchmark for the year.

High Yield

High yield investment has reached the target allocation of 10 percent of the System's total investments as a result of fully funding the two new managers, Credit Suisse Asset Management and Shenkman Capital. This asset class had a return of 2.67% for the fiscal year, compared to a negative retum of .76% on the Salomon Brothers High Yield Market Index.

Fixed Income

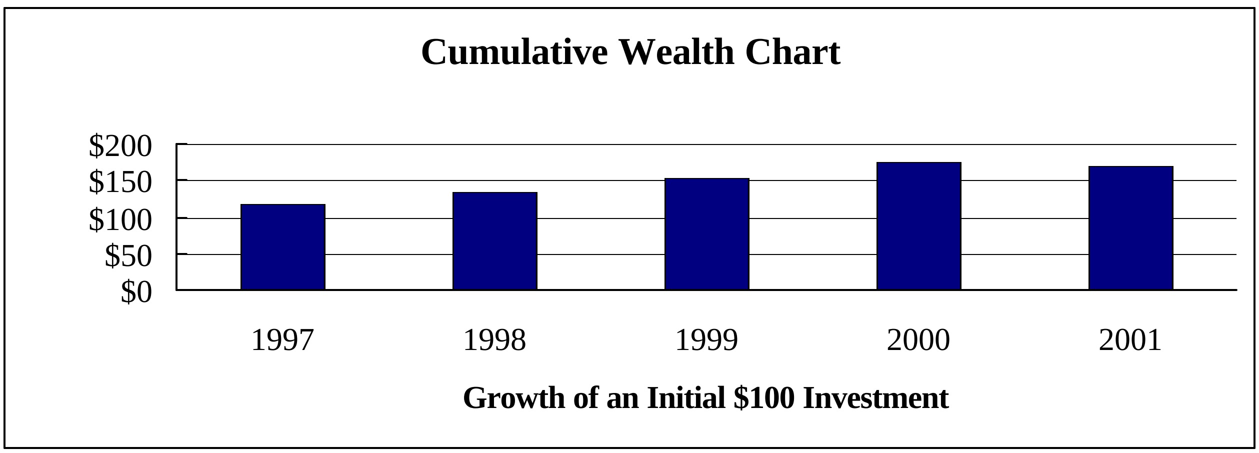
The System's two global fixed income managers were terminated during the fiscal year. Funds from the liquidation of these two managers were invested in the Lehman Brothers Aggregate Bond Index Fund. The System will engage in a search for an international bond manager and an emerging market debt manager during the incoming fiscal year. The fixed income investment had a return of 5.30% for the fiscal year, well below the 11.23% on the Lehman Brothers Aggregate Bond Index.

Alternative Investments

Continuation of the aggressive investment program for the System's alternative investments has brought this asset class to 8.11% of the System's total assets, compared to the 10.0% target. This asset class had a return of -5.86%, outperforming the -9.83% return on the benchmark.

Rates of Return by Year (%)
Years Ended June 30

Year	System Total	Domestic Equity	S & P 500	International Equity	MSCI EAFE	Fixed Income	Lehman Brothers Aggregate	High Yield	Alternative Investment
1997	17.1	26.0	34.7	18.0	13.2	9.9	8.2	na	na
1998	14.2	30.0	30.3	-0.3	6.4	7.8	10.5	15.9	na
1999	15.0	16.4	22.8	25.1	8.0	3.5	3.1	8.9	6.1
2000	14.8	11.4	7.2	31.5	17.4	1.1	4.6	5.7	54.8
2001	-4.0	-3.9	-14.8	-14.1	-23.3	5.3	11.2	2.7	-5.9



Compound Annualized Rates of Return by Year (%)
Years Ended June 30, 2001

Years	System Total	Domestic Equity	Russell 3000	International Equity	MSCI EAFE	Fixed Income	Lehman Brothers Aggregate	High Yield	Alternative Investment
2	5.0	3.5	-2.9	6.3	12.6	3.2	7.8	4.2	14.5
3	8.2	7.6	4.2	12.2	10.5	3.3	6.2	5.7	13.4
5	11.2	15.3	13.8	10.7	11.6	5.5	7.5	na	8.8
10	11.3	15.2	15.0	10.3	6.7	8.3	7.9	na	na

Schedule of Ten Largest Domestic Equity Holdings
As of June 30, 2001

Shares	Description	Market Value ($000's)
991,500	K Mart Corp	$ 10,036
470,000	USX-US Steel Group	9,471
400,000	Visteon Corp	7,352
117,200	TYCO International Ltd	6,387
360,050	KLM Royal Dutch Airlines ADR	6,355
305,000	Northeast Utilities	6,329
117,311	Legg Mason Inc	5,837
181,000	Unumprovident Corp	5,814
77,500	Everest Re Group Ltd	5,797
138,975	Paychex, Inc	5,559

Schedule of Ten Largest Non-U.S. Equity Holdings
As of June 30, 2001

Shares	Description	Market Value ($000's)
1,465,400	Unilever PLC	$ 12,345
2,509,200	Marks & Spencer	9,412
475,000	Danske Bank	8,553
23,250	Zurich Financial Systems	7,929
1,610,000	Mitsubishi Heavy Industries	7,345
1,161,885	British Telecom	7,304
662,688	Diageo	7,269
710,500	Hitachi	6,979
1,147,000	Southwest Wirerope	5,941
477,108	ENI Corp	5,816

Schedule of Ten Largest Domestic Fixed Income Holdings

As of June 30, 2001

Par Value	Description	Market Value ($000's)
2,352,160	GNMA Pool 6.5% due 5-15-2029	$ 2,328
2,250,000	Aztar CORP 8.875% due 5-15-2007	2,278
2,710,000	National Westminster CAP FRN 'C' USD(VAR)	2,221
2,132,500	FHLMC Gold Pool 7.5% due 8-1-2027	2,182
2,000,000	Limestone Electron 8.625% due 3-15-2003	2,085
1,950,000	US Treasury 6.25% due 5-15-2030	2,065
2,000,000	Allied Waste 10.0% due 8-01-2009	2,055
2,000,000	Echostar Corp 9.375% due 2-01-2009	1,950
1,958,501	FNMA Pool 6.0% due 12-01-2028	1,887
5,880,000	US Treasury Stripped Prinicpal due 5-15-2020	1,877

Schedule of Ten Largest Non-U.S. Fixed Income Holdings

As of June 30, 2001

Par Value	Description	Market Value ($000's)
3,000,000	U.K./ Sutton Bridge 7.97% due 6/30/2022	$ 3,012
2,000,000	Brazil/ (Federal Republic of) 8.0% due 4-15-2014	1,819
1,500,000	Cayman Islands/ PDVSA Fin 7.4% due 8-15-2016	1,287
1,500,000	Venezuela/ Petrozuata 8.22% due 4-1-2017	1,238
1,000,000	Mexican UTD STS 8.5% due 1-2-2006	1,054
1,250,000	Mexico/ TFM SA DE CV 11.75% due 06-15-2009	1,050
1,020,000	Canada/ Canwest Media 10.625% due 5-15-2011	1,033
1,175,000	U.K./ Telewest Com 9.875% due 2-1-2010	975
2,680,000	Austria/ UTD Pan-European 11.25% due 2-1-10	965
1,250,000	Canada/ Microcell Telecom Disc Note 12-1-01	944

Schedule of Brokerage Commissions Paid

Domestic Trades - Ten Largest by Total Commissions Paid

For the year ended June 30, 2001

Brokers	Shares	Commissions	Principal	Commissions Per Share
Lynch. Jones & Ryan	2,152,580	$159,584	$84,027,408	$0.07
Smith Barney, Inc	806,937	37,598	33,281,419	0.05
Lehman Brothers, Inc	530,752	34,637	14,397,201	0.07
First Boston Corp	758,832	34,424	32,758,357	0.05
Bear, Stearns, Securities Group	368,017	22,329	15,215,167	0.06
Montgomery Securities	364,700	20,574	13,776,263	0.06
Prudential Securities Inc	496,662	19,572	14,810,262	0.04
Goldman Sachs & Company	497,756	19,220	18,208,422	0.04
Morgan Stanley & Co, Inc	749,743	18,667	22,299,184	0.02
UBS Warburg Dillion Read LLC	380,901	17,596	19,030,705	0.05

International Trades - Ten Largest by Total Commissions Paid

For the year ended June 30, 2001

Brokers	Shares	Commissions	Principal	Commissions In Basis Points
SBC Warburg & Co, LTD London	7,826,988	$337,461	$133,804,204	25.22
UBS AG London	3,974,433	158,573	62,351,743	25.43
Merrill Lynch International London	5,352,087	102,647	67,117,312	15.29
Morgan Stanley International London	3,805,340	54,862	44,927,322	12.21
Duetsche Morgan Grenfell	1,569,118	53,088	25,932,311	20.47
Salomon Brothers International	2,709,707	51,366	27,480,442	18.69
Goldman Sachs International	1,372,057	50,372	23,996,011	20.99
CSFB (Europe) LTD London	3,270,029	50,115	23,000,459	21.79
Lehman Brothers International Europe	2,804,556	49,918	40,147,887	12.43
ABN AMRO Equities LTD London	2,635,183	37,333	20,157,444	18.52

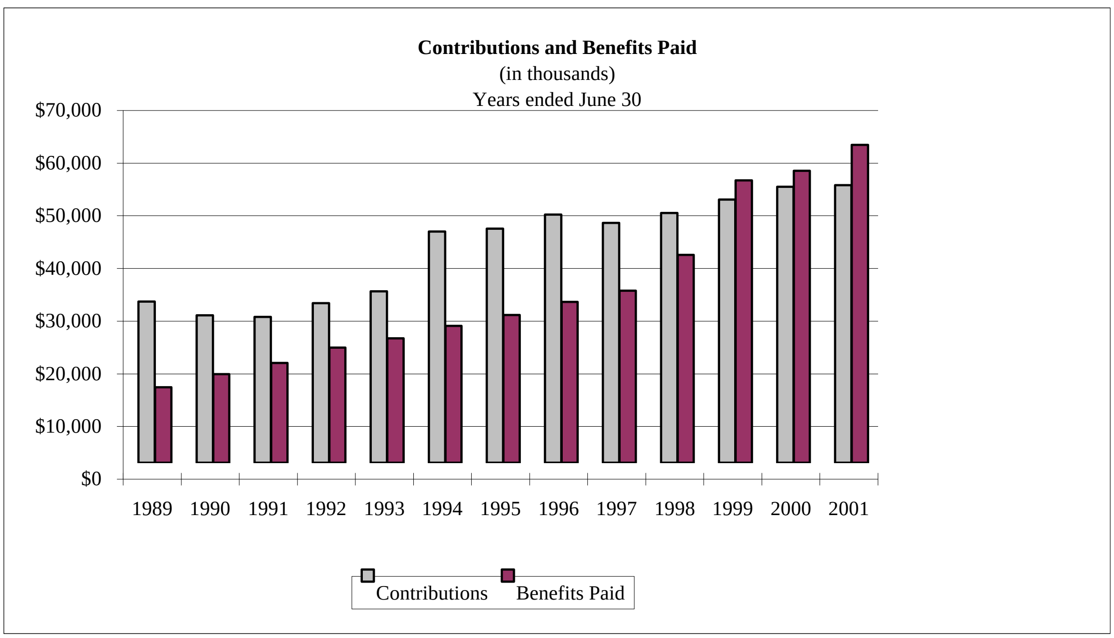
SECTION FIVE

STATISTICAL SECTION

Schedule of Revenue by Source and Expenses by Type
(000's)
For years ended June 30

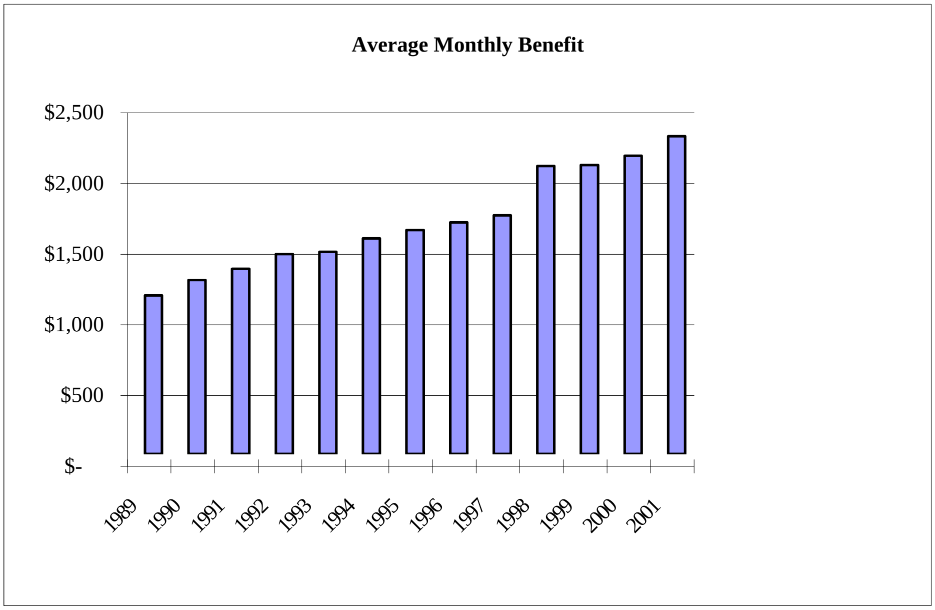
Fiscal Year	Member Contributions	City Contributions	Investment Income (Loss)	Total Additions (Deductions)	Benefits Paid	Administrative Expenses	Refunds	Total Deductions	Net Increase (Decrease)
1989	$ 9,600	$ 20,983	$ 29,186	$ 59,769	$ 14,331	$ 231	$ 1,365	$ 15,927	$ 43,842
1990	9,522	18,480	55,430	83,432	16,842	187	1,421	18,450	64,982
1991	9,830	17,857	33,358	61,045	18,948	266	883	20,097	40,948
1992	10,652	19,623	66,739	97,014	21,851	235	880	22,966	74,048
1993	11,404	21,156	73,011	105,571	23,608	292	410	24,310	81,261
1994	13,895	29,980	12,362	56,237	25,961	619	629	27,209	29,028
1995	14,498	29,929	111,194	155,621	28,061	885	744	29,690	125,931
1996	15,533	31,562	186,111	233,206	30,552	886	829	32,267	200,939
1997	16,012	29,503	216,567	262,082	32,676	1,272	946	34,894	227,188
1998	16,832	30,564	214,448	261,844	39,440	1,166	986	41,592	220,252
1999	19,347	30,645	251,412	301,404	53,626	1,678	1,127	56,431	244,973
2000	21,761	30,645	292,603	345,009	55,421	2,216	1,545	59,182	285,827
2001	22,043	30,645	(80,232)	(27,344)	60,328	2,854	884	64,066	(91,410)

Effective July 1, 1994 the System adopted GASB 25 which requires that the net appreciation or depreciation in the fair value of investments be reported as a component of investment income. Prior to adoption of GASB 25, investment income included only realized gains and losses from investments. GASB 25 also requires that investment expenses be reported as a deduction from investment income rather thatn as a separate component of expense. Information in the schedule above for years prior to 1994 have not been restated for the effect of the previously unrecognized unrealized gains and losses. These years prior to 1994 have, however, been restated to conform with GASB 25 presentation for the effect of each years' investment expenses.

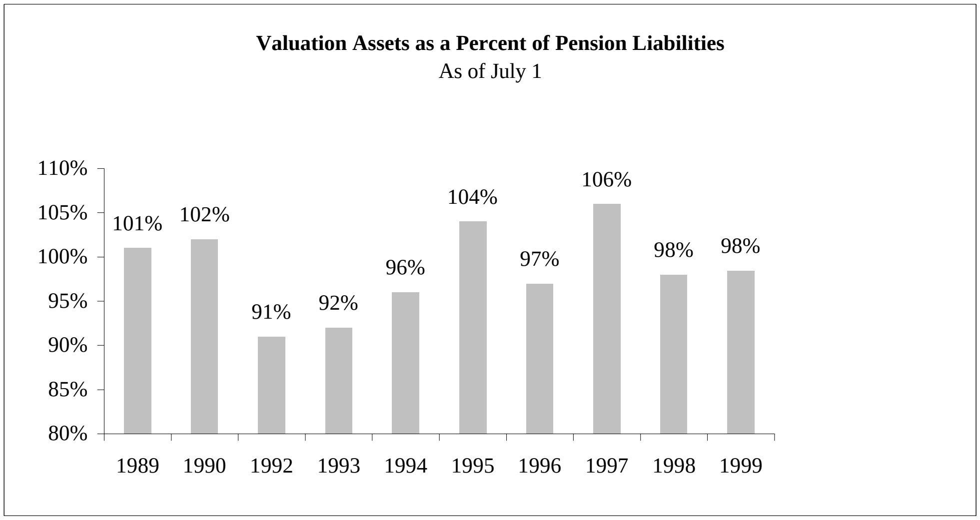


Average Monthly Benefit
Years Ended June 30,

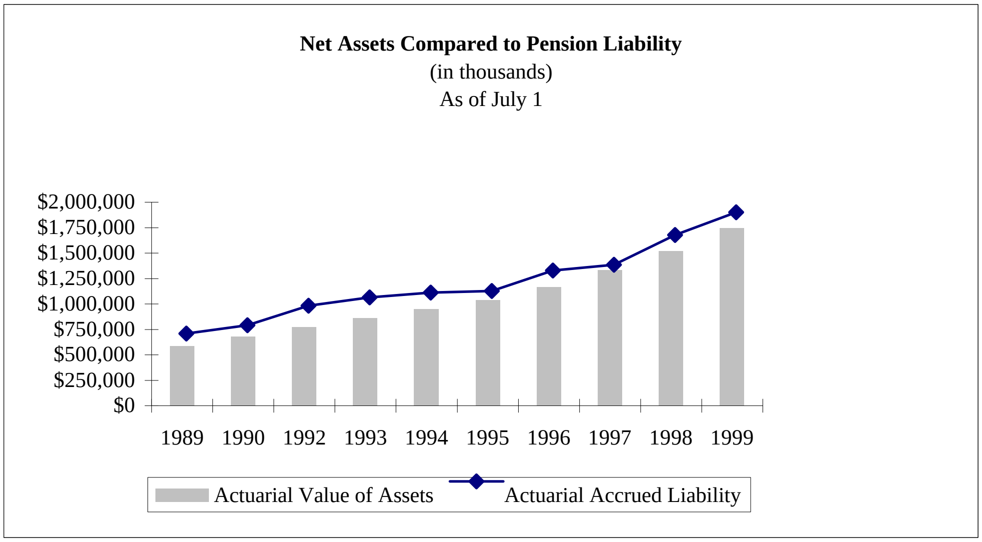
Year	Retirees and Beneficiaries at Year End	Total Benefits Paid	DROP Distributions	Average Monthly Benefit	
1989	1,065	$ 14,330,638	-	$ 1,121	
1990	1,141	16,841,907	-	1,230	
1991	1,206	18,948,267	-	1,309	
1992	1,288	21,851,259	-	1,414	
1993	1,377	23,607,919	-	1,429	
1994	1,419	25,960,618	-	1,525	
1995	1,478	28,061,493	-	1,582	
1996	1,548	30,415,628	136,791	1,637	
1997	1,582	32,042,856	633,520	1,688	
1998	1,614	39,440,091	1,801,464	2,036	
1999	1,658	48,676,297	4,948,733	2,043	*
2000	1,723	47,401,683	8,019,553	2,108	*
2001	1,786	51,961,507	8,366,211	2,246	*



* The Average Monthly Benefit has been computed by deducting, from Total Benefits Paid, the amounts attributable to the $5,000 lump sum payments and the "13th" check, where applicable.



Valuation Assets as a Percent of Pension Liabilities
As of July 1
110%
105%
100%
95%
90%
85%
80%
101%
102%
91%
92%
96%
104%
97%
106%
98%
98%
1989
1990
1992
1993
1994
1995
1996
1997
1998
1999



Net Assets Compared to Pension Liability
(in thousands)
As of July 1
$2,000,000
$1,750,000
$1,500,000
$1,250,000
$1,000,000
$750,000
$500,000
$250,000
$0
1989
1990
1992
1993
1994
1995
1996
1997
1998
1999
Actuarial Value of Assets
Actuarial Accrued Liability

STATISTICAL SECTION

Pensions Awarded by Type and by Age

Year Ended June 30, 2001

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	10	2	4	4
40-44	18	11	6	1
45-49	17	12	2	3
50-54	17	12	3	2
55-59	18	17	1	-
60-64	9	8	-	1
65-69	1	1	-	-
70-74	2	2	-	-
75 and over	1	-	-	1
Total	93	65	16	12

Pensions in Force by Type and by Age

June 30, 2001

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	31	-	9	22
40-44	33	10	13	10
45-49	138	108	8	22
50-54	288	235	17	36
55-59	271	227	4	40
60-64	296	232	6	58
65-69	281	225	5	51
70-74	206	148	2	56
75-79	144	76	4	64
80-84	68	18	2	48
85 and over	30	8	-	22
Total	1,786	1,287	70	429

Pensions Awarded by Type and by Monthly Amount

Year Ended June 30, 2001

		Type of Pension		
Monthly Amount	Total	Service	Disability	Survivor
Under $1000	2	1	-	1
$1,000-1,500	3	3	-	-
$1,500-2,000	16	11	2	3
$2,000-2,500	37	35	-	2
$2,500-3,000	20	10	8	2
$3,000 and over	15	5	6	4
Total	93	65	16	12

Benefit Expenses by Type
(dollars in thousands)
Years ended June 30,

Year	Service Retirement	Disability	Survivor	Children	DROP Distributions	PROP Distributions	Total Benefits Paid
1997	24,828	1,025	6,118	71	634		32,676
1998	28,811	1,237	7,550	41	1,801		39,440
1999	39,057	997	8,555	68	4,949		53,626
2000	36,984	1,179	9,149	89	8,020		55,421
2001	38,078	1,608	12,077	102	8,366	97	60,328

DROP Activity
(dollars in thousands)
Years ended June 30

	DROP Accounts			DROP Participants		
Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
1997	$ 23,617	$ (634)	$ 35,675	137	(22)	905
1998	31,751	(1,801)	65,625	133	(31)	1,007
1999	40,262	(4,949)	100,938	115	(56)	1,066
2000	51,892	(8,020)	144,810	179	(56)	1,189
2001	74,717	(8,366)	211,161	136	(50)	1,275