

2004

COMPREHENSIVE

ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2004



FAIRFAX COUNTY UNIFORMED RETIREMENT SYSTEM

A PENSION TRUST FUND OF FAIRFAX COUNTY, VIRGINIA

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FAIRFAX COUNTY

BOARD OF TRUSTEES
UNIFORMED RETIREMENT SYSTEM
10680 Main Street, Suite 280
Fairfax, Virginia 22030-3812

Telephone: (703) 279-8200 (800) 333-1633 FAX: (703) 273-3185

V I R G I N I A

September 15, 2003

Dear Members of the Board of Trustees:

I am pleased to submit to you the annual report of the Fairfax County Uniformed Retirement System (System) for the fiscal year ended June 30, 2004. This annual report is provided as an aid to understanding the structure and evaluating the status of the System. The System's management is responsible for the accuracy of financial information contained herein.

The annual report for fiscal 2004 consists of five sections: (1) an Introductory Section that contains this transmittal letter along with the organization structure and review of plan provisions; (2) a Financial Section that contains the opinion of the independent auditors, management's discussion and analysis, the financial statements of the System and required supplementary information; (3) an Investment Section that contains investment results; (4) an Actuarial Section that includes the independent actuary's certification letter, a summary of the results of the actuarial valuation, and actuarial procedures and assumptions; and (5) a Statistical Section that contains information regarding the System membership.

History

The Fairfax County Uniformed Retirement System was established on July 1, 1974, as a public employee retirement system providing defined benefit pension plan coverage for uniformed or sworn employees of the Fire and Rescue Department, helicopter pilots, the Sheriff's Department, the animal control division and certain park police officers. There were 1,654 active members and 766 retirees participating in the System as of June 30, 2004.

Benefit Provisions

The benefit provisions of the System are established by County Ordinance. The System provides normal service retirement and early service retirement benefits for members who attain age or service requirements. Coverage for service-connected disability benefits is immediate upon membership in the System. Ordinary (non-service related) disability benefits are provided after the attainment of five years of service. Members are vested after five years of service and are eligible for benefits at the early or normal service retirement date.

Capital Markets and Economic Conditions

Fiscal 2004 experienced a much-needed rebound in economic growth and worldwide equity markets after suffering three years of general market declines. Stimulative fiscal and monetary policies sent consumers on a buying spree which resulted in a surprising 8.2% increase in fiscal first-quarter Gross Domestic Product (GDP) growth. Investors responded by sending equity prices surging. The S&P 500 Index rose 19.1% during fiscal 2004, while the smaller-capitalization Russell 2000 Index advanced 33.4%. International equity returns also exceeded 30% for the fiscal-year period.

Bonds were flat on the year as the Federal Reserve made clear that it was planning to return short-term interest rates to higher, more normalized levels. With the market rally, the Uniformed Retirement System fund returned 14.5% for 2004, after management fees. This return placed the fund in the 81st percentile of the Russell/Mellon public fund universe and the fund's three-year return placed it in the 34th percentile. The returns for the total fund exceeded the policy benchmark for the year, and the returns of each major asset class exceeded the relevant indices, except for domestic equities.

After accounting for all cash flows, including contributions, expenses and benefit payments, the market value of the System's assets increased 14.9%, from \$657 million on June 30, 2003 to \$755 million on June 30, 2004.

Major Initiatives

In response to an application filed in 2002, the Internal Revenue Service issued a determination letter confirming that, subject to one technical wording change, the plan continues to qualify as an employee benefit plan under section 401(a) of the Internal Revenue Code. The necessary technical amendment was made within the required timeframe.

The System adopted and implemented a Deferred Retirement Option Plan (DROP). DROP provides an additional option to retirement eligible members and is a form of accruing a lump-sum benefit in lieu of continuing to earn service credit in the three years prior to actual retirement. The System website was enhanced to provide members the ability to obtain DROP estimates online, and individual counseling sessions were made available for eligible members.

Continuing the Retirement Agency's focus on providing excellent service to members, the benefits administration staff was restructured during fiscal 2004. The restructuring re-aligned the staff to create separate units focused on the different needs of active and retired members.

Following a review of the existing legacy computer systems and current and future data needs, a Request For Proposal was released to obtain bids on defined benefit administration software applications to replace and upgrade our existing systems. As the year closed, vendor responses were being reviewed.

With the expiration of the investment consulting contract with CRA/RogersCasey, a Request For Proposal (RFP) was released. After considering the responses to the RFP, New England Pension Consultants was retained as the new investment consulting firm for the plan.

Internal and Budgetary Controls

The System's management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America.

Funded Status

An actuarial valuation of the System to determine funding requirements is performed annually. The System's funding policy provides for periodic employer contributions at actuarially determined rates which will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the costs of benefit payments when due. The valuation of the System performed as of July 1, 2003 indicated that the ratio of assets accumulated by the System to total actuarial accrued liabilities for benefits decreased from 95.3% to 90.0%. The Actuarial Section contains further information on the results of the July 1, 2003 valuation.

Investment Policies and Strategies

The Board of Trustees has an adopted Statement of Investment Objectives and Policy. This Statement establishes the investment goals, guidelines, constraints and performance standards that the Board of Trustees uses when exercising its fiduciary duties to manage the investment assets of the System. The Board operates in conformity with the standard of care required in making investments as stated in the Code of Virginia §51.1-803.

The Board receives quarterly reporting to ensure compliance with its stated objectives and policy. Staff and the external investment consultant retained by the Board also monitor the performance of the System and its investment managers. Rate of return information is included in the Investment Section.

Securities of the System except for the mutual funds and the County's pooled cash and temporary investments are held by Mellon Global Securities Services as agent, in the System's name. Mellon Financial Corporation, the parent company, carries Financial Institution Bond insurance coverage including a Computer Crime Policy. An additional Excess Securities policy covers all risk of physical loss to securities.

Other Information

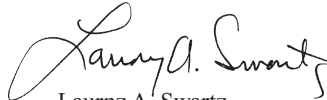
Independent Audit and Actuarial Certifications

The independent auditors' report and certifications from the actuary are included in this report.

Acknowledgements

The annual report of the Uniformed Retirement System was prepared by the System's staff under the leadership of the Board of Trustees. I would like to thank the entire staff who have worked hard throughout the year to provide service to members and to ensure the successful operation of the System. This report is intended to provide complete and reliable information for determining the financial status of the System. It is being submitted to the Board of Supervisors and other interested parties and is available to the public via the County's internet site located at www.fairfaxcounty.gov/retbrd/.

Respectfully submitted,



Lurnz A. Swartz
Executive Director

INTRODUCTORY SECTION

BOARD OF TRUSTEES

Vincent J. Bollon

Chairman

Board of Supervisors Appointee

Term Expires: August 31, 2004

Charles E. Formeck

Vice Chairman

Office of the Sheriff

Member Trustee

Term Expires: October 31, 2005

Robert L. Mears

Treasurer

Fairfax County Director of Finance

Ex officio Trustee

John R. Niemiec

Fairfax County Fire & Rescue Department

Member Trustee

Term Expires: June 30, 2008

Frank Henry Grace, III

Board of Supervisors Appointee

Term Expires: July 31, 2006

Donald F. Maddrey

Board of Supervisors Appointee

Term Expires: June 30, 2006

Kevin Kincaid

Fairfax County Fire & Rescue Department

Member Trustee

Term Expires: June 30, 2006

Peter J. Schroth

Fairfax County Human Services Director

Ex officio Trustee

ADMINISTRATIVE ORGANIZATION

Administrative Staff

Laurnz A. Swartz
Executive Director

Jeffrey A. Willison
Investment Manager

Philip R. Langham
Retirement Administrator

Professional Services

Actuary

CHEIRON - Actuaries
McLean, VA

Auditor

KPMG LLP - Certified Public Accountants
Washington, DC

Investment Managers

Barclays Global Investors
San Francisco, CA

Payden & Rygel Investment Counsel
Los Angeles, CA

Cohen & Steers Capital Management, Inc.
New York, New York

Peregrine Capital Management
Minneapolis, MN

HarbourVest Partners, LLC
Boston, MA

PIMCO
Newport Beach, CA

J. L. Kaplan Associates
Boston, MA

Standish Mellon Asset Management
Pittsburgh, PA

Lazard Asset Management
New York, NY

State Street Global Advisors
Boston, MA

Marathon Asset Management
London, England

Trust Company of the West
Los Angeles, CA

JP Morgan Investment Management, Inc.
New York, NY

UBS Realty Advisors LLC
Hartford, CT

Pantheon Ventures, Inc.
San Francisco, CA

Wasatch Advisors
Salt Lake City, UT

Investment Consultant

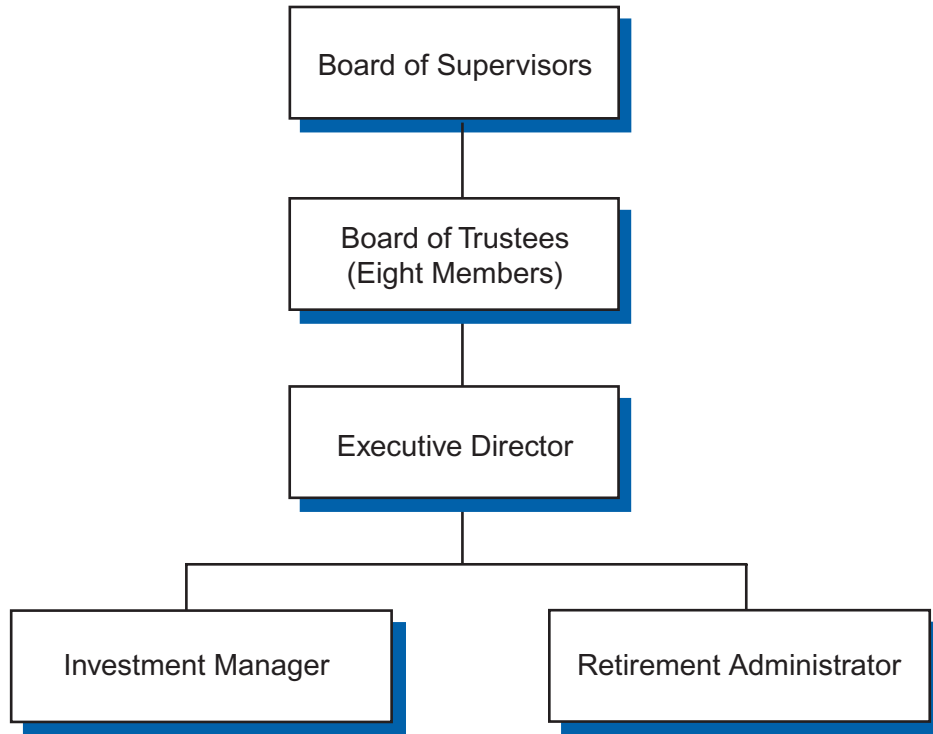
New England Pension Consultants
Cambridge, MA

Custodial Bank

Mellon Global Securities Services
Pittsburgh, PA

INTRODUCTORY SECTION

ORGANIZATIONAL CHART



SUMMARY OF PLAN PROVISIONS

Membership in the Fairfax County Uniformed Retirement System includes most uniformed or sworn employees of the Fire and Rescue Department, the Sheriff's Department, the Animal Control Division, helicopter pilots and former park police officers who elected to remain in the System rather than transfer to the Police Officers Retirement System. The System consists of four plans, Plan A, Plan B, Plan C, and Plan D which have different employee contribution rates and slightly different benefits. Plan A members were given the opportunity to join Plan B as of July 1, 1981 and to enroll in Plan C as of April 1, 1997. From July 1, 1981, until March 31, 1997, all members were enrolled in Plan B. Plan B members were given the opportunity to enroll in Plan D as of April 1, 1997. From April 1, 1997, forward, all new members are enrolled in Plan D. However, previous members of the Fairfax County Uniformed Retirement System who left their money in the system when their employment was terminated, upon return to service, must rejoin the plan that they were in during their previous period of membership.

The general provisions of the Uniformed Retirement System are as follows:

All Plans

Normal Retirement: is either age 55 with at least 6 years of service or any age with 25 years of service (including sick leave).

Deferred Retirement Option (DROP): Those eligible for normal retirement may enter DROP, during which time the member continues to work and receive a salary for up to three years. In lieu of continuing to earn service credit, DROP participants accumulate a lump sum, including interest, payable at retirement.

Early Retirement: 20 years of service (including sick leave). Reduction factors are applied to the basic formula for early retirement.

Deferred Vested Retirement: available for vested members (vesting is at 5 years of creditable service) who leave their contributions in the System when they terminate. These members are entitled to their normal retirement benefit based on service with the County at age 55.

Service-Connected Disability Retirement: available for members, regardless of their length of service, who become disabled as a result of a job-related illness or injury. Benefits are 40% of their final compensation less workers' compensation and 64% of any Social Security disability award. Benefits for members retired on a severe service-connected disability will be calculated at 90% of salary at time of retirement less the average monthly workers' compensation benefit and 64% of any Social Security disability benefits.

Ordinary Disability Retirement: available for vested members who become disabled due to an injury or illness that is not job-related. Normal retirement benefits are paid.

Death Benefits: *Before Retirement* — If the member is vested and the spouse is the beneficiary, the spouse may elect to receive 50% of the normal retirement benefit earned as of the date of the member's death. This benefit ceases if the spouse remarries before age 60. If this benefit is not elected, a refund of the member's contributions and interest is payable to the named beneficiary.

After Retirement — Refunds of any of the member's contributions and interest not already paid out in benefits will be paid to the named beneficiary(ies) unless the member has elected the irrevocable Joint and Last Survivor Option which provides a benefit to the member's spouse for life. At retirement, the member may choose to have his or her spouse receive 50%, 66²/₃%, 75% or 100% of the member's reduced annuity upon the member's death. The member's annuity is reduced by a percentage based on the difference in age between the member and his or her spouse. If the spouse pre-deceases the member, the annuity is restored to what it would have been if this option had not been elected.

Service-Connected Death Benefit — A \$10,000 lump-sum payment is made to the beneficiary if the member's death is due to a job-related illness or injury.

INTRODUCTORY SECTION

SUMMARY OF PLAN PROVISIONS

(Continued)

Normal Retirement Benefit:

Plans A and B — 2.0% of average final compensation (AFC) (highest consecutive three years) multiplied by the number of years of creditable service. The benefit is then increased by 3%.

A **supplemental benefit** is payable up to age 62. The amount of the supplemental benefit is based on the primary Social Security benefit the member would have been entitled to if the member were 65 on the date of retirement. For members hired on or after July 1, 1976, this basic amount is equal to a percentage of the Social Security benefit. That percentage is determined by dividing the member's creditable service by 25. The exact amount of this benefit also depends on the member's age and Plan (see below). The benefit is then increased by 3%.

Plan A Pre-62 Supplemental Benefit — If the member is less than age 55, no supplemental benefit is payable. From age 55 to 62, the full basic amount of the supplement is payable. After age 62, the benefit payable is any excess of the full basic amount which exceeds the member's actual earliest Social Security benefit payable.

Plan B Pre-62 Supplemental Benefit — If the member is less than age 55, one-half of the basic amount of the supplemental benefit is payable. From age 55 to 62, the full basic amount of the supplement is payable. After age 62, the benefit payable is any excess of the full basic amount which exceeds the member's actual earliest Social Security benefit payable.

In addition, a **Pre-Social Security Supplement** is payable to members of Plans A & B until the first month after the member attains the age of eligibility for unreduced Social Security retirement benefits. The amount of the Pre-Social Security Supplement is 0.2% of AFC multiplied by the number of years of creditable service, increased by 3%.

Plans C and D — 2.5% of average final compensation (highest consecutive three years) multiplied by the number of years of creditable service. The benefit is then increased by 3%. No Pre-62 Supplemental Benefits are payable under plans C or D.

In addition, a **Pre-Social Security Supplement** is payable to members of Plans C & D until the first month after the member attains the age of eligibility for unreduced Social Security retirement benefits. The amount of the Pre-Social Security Supplement is 0.3% of AFC multiplied by the number of years of creditable service, increased by 3%.

Cost of Living Benefit: Annual cost-of-living adjustments (COLAs) are provided to retirees and beneficiaries equal to the lesser of 4 percent or the percentage increase in the Consumer Price index for the Washington Consolidated Metropolitan Statistical Area. Members of Plan A and C receive COLA increases beginning at age 55. Members of Plan B and D receive COLAs beginning at retirement.

Contribution Rates:

Plan A Contribution Rate: 4% of base salary up to the maximum Social Security wage base plus 5.75% of base salary over the wage base.

Plan B Contribution Rate: 7.08% of base salary up to the maximum Social Security wage base plus 8.83% of base salary over the wage base.

Plan C Contribution Rate: 4% of creditable compensation.

Plan D Contribution Rate: 7.08% of creditable compensation.



KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The Board of Supervisors
County of Fairfax, Virginia

The Board of Trustees
of the Fairfax County Uniformed Retirement System:

We have audited the statements of plan net assets of the Fairfax County Uniformed Retirement System (the System), a pension trust fund of the County of Fairfax, Virginia, as of June 30, 2004 and 2003, and the related statements of changes in plan net assets for the years then ended. These basic financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these basic 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 basic 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 basic financial statements referred to above present fairly, in all material respects, the plan net assets as of June 30, 2004 and 2003, and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 12 through 14 and the required supplementary information on pages 22 and 23 are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the System's basic financial statements. The introductory, investment, actuarial, and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The information in these sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on it.

KPMG LLP

September 24, 2004

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's discussion and analysis of the Fairfax County Uniformed Retirement System's ("System" or "plan") financial performance and provides an overview of the financial activities for the fiscal years ended June 30, 2004 and 2003. The information in this section should be reviewed in conjunction with the letter of transmittal provided in the Introductory Section of this report.

Overview of Financial Statements and Accompanying Information

Basic Financial Statements. The System presents Statements of Plan Net Assets as of June 30, 2004 and 2003 and Statements of Changes in Plan Net Assets for the years then ended. These statements reflect the resources available for the payment of benefits as of year-end and the sources and uses of those funds during the year.

Notes to Financial Statements. The Notes to Financial Statements are an integral part of the financial statements and include additional information and schedules to provide a better understanding of the financial statements. The Notes to Financial Statements immediately follow the basic financial statements.

Required Supplementary Information. The Required Supplementary Information and related notes provide information regarding the System's funding progress and employer contributions. The Required Supplementary Information and related notes are immediately following the Notes to Financial Statements.

Financial Analysis

Summary of Plan Net Assets. As indicated in the following Summary Statement of Plan Net Assets, the net assets held in the System increased \$97.9 million or 14.8% during fiscal 2004 and increased \$39.7 million or 6.4% during fiscal 2003. These changes are primarily due to increases in the fair value of investments during both fiscal years.

Return on Investments. The System's return on investments net of investment management fees for fiscal 2004 and 2003 were 14.5% and 5.6%, respectively. The System's domestic equities had a 19.6% total return in fiscal 2004, and a 0.3% total return in fiscal 2003. The international developed equity portfolios returned 32.4% for fiscal 2004 after a decline of 3.7% for fiscal 2003. Emerging market equities returned 42.7% for fiscal 2004 and 3.3% for fiscal 2003. The System's fixed income investments returned 0.4% for fiscal 2004 and 10.3% for fiscal 2003. The System's real estate portfolios returned 12.6% for fiscal 2004 and 7.5% for fiscal 2003. Additional investment market commentary is provided in the Investment Section of this document.

Additions. Total additions increased \$62.5 million from fiscal 2003 to 2004 primarily due to increases in investment returns. Employer contributions increased \$1.8 million or 7.8% from fiscal 2003 to 2004 and increased \$4.2 million or 22.6% from fiscal 2002 to 2003. The fiscal 2004 increase is due to the increase in the contribution rate from 21.9% of covered payroll in fiscal 2003 to 22.6% of covered payroll in fiscal 2004. The fiscal 2003 rate was due to an increase from the fiscal 2002 rate of 18.93% of covered payroll. Total contributions for both fiscal 2004 and fiscal 2003 were also impacted by the increases in covered payroll that occurred each year. Plan member contributions increased during both years as a result of the increase in covered payroll. The System experienced net investment gains during both fiscal 2004 and fiscal 2003. Net appreciation in the fair value of investments was \$79.0 million during fiscal 2004 and \$24.2 million during fiscal 2003. Interest and dividend income was \$18.9 million during fiscal 2004 and \$12.0 million during fiscal 2003, an increase of 57.5%.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Continued)

Investment activity expense increased \$1.1 million due to investment management fees computed on the increasing investment values and changes in investment strategies that resulted in higher fees. Net securities lending income decreased \$26 thousand in fiscal 2004 compared with the same period a year ago. This was primarily due to a lessening in demand for securities by borrowers, particularly in international markets. The System received an insurance reimbursement of \$150,859 replacing the amount misappropriated from the System by a former employee.

Deductions. Benefit payments increased 17.1% from fiscal 2003 to 2004 and 18.6% from fiscal 2002 to 2003. The number of retirees and beneficiaries collecting benefits and the amount of the average benefit increased in both years and were responsible for the increase in the expense. Retirees received cost of living increases of 3.6% as of July 1, 2003 and 3.0% as of July, 2002. Also, effective January 1, 2004, a special increase was granted to members who retired based on service prior to March 19, 2004. Plan A retirees received a 23% increase; Plan B retirees received a 15% increase; Plans C and D retirees received a 5% increase; and survivors of retirees received a 10% increase. Refunds and other expenses increased \$267 thousand from fiscal 2003 to 2004 and declined \$28 thousand from fiscal 2002 to 2003. The amount of refunds varies from year to year based on changes in employee turnover rates and decisions of terminated employees.

The actuarial valuation performed as of July 1, 2003 showed the system's funded status at 90.00%, a decrease of 5.30 percentage points from the July 1, 2002 funded percentage of 95.30%.

Contacting the System's Financial Management

This financial report is designed to provide our membership, the Board of Trustees and the County's Board of Supervisors with a general overview of the System's financial condition. If you have any questions about this report or need additional financial information, contact the Fairfax County Retirement Administration Agency, 10680 Main Street, Suite 280, Fairfax, Virginia 22030. This report can also be found on the County's internet site at www.fairfaxcounty.gov/retbrd/.

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Continued)

Summary Statement of Plan Net Assets

| | 2004 | 2003 | Difference | 2002 | Difference |
|----------------------------|----------------------|----------------------|---------------------|----------------------|---------------------|
| Assets | | | | | |
| Total cash and investments | \$824,490,139 | \$767,879,422 | \$56,610,717 | \$718,522,492 | \$49,356,930 |
| Total receivables | <u>32,200,551</u> | <u>49,621,578</u> | <u>(17,421,027)</u> | <u>17,041,544</u> | <u>32,580,034</u> |
| Total Assets | 856,690,690 | 817,501,000 | 39,189,690 | 735,564,036 | 81,936,964 |
| Liabilities | | | | | |
| | <u>101,401,995</u> | <u>160,139,822</u> | <u>(58,737,827)</u> | <u>117,938,633</u> | <u>42,201,189</u> |
| Net Assets | <u>\$755,288,695</u> | <u>\$657,361,178</u> | <u>\$97,927,517</u> | <u>\$617,625,403</u> | <u>\$39,735,775</u> |

Summary of Additions and Deductions

| | 2004 | 2003 | Difference | 2002 | Difference |
|------------------------------|---------------------|---------------------|---------------------|-----------------------|---------------------|
| Additions | | | | | |
| Contributions | | | | | |
| Employer | \$24,823,288 | \$23,027,237 | \$ 1,796,051 | \$18,778,608 | \$ 4,248,629 |
| Plan members | 7,649,425 | 7,478,708 | 170,717 | 6,892,667 | 586,041 |
| Other income | 150,859 | - | 150,859 | - | - |
| Net investment income (loss) | <u>94,008,180</u> | <u>33,576,497</u> | <u>60,431,683</u> | <u>(31,599,441)</u> | <u>65,175,938</u> |
| Total Additions | <u>126,631,752</u> | <u>64,082,442</u> | <u>62,549,310</u> | <u>(5,928,166)</u> | <u>70,010,608</u> |
| Deductions | | | | | |
| Benefit Payments | 27,954,431 | 23,863,933 | 4,090,498 | 20,116,400 | 3,747,533 |
| Refunds and other | <u>749,804</u> | <u>482,734</u> | <u>267,070</u> | <u>511,091</u> | <u>(28,357)</u> |
| Total Deductions | <u>28,704,235</u> | <u>24,346,667</u> | <u>4,357,568</u> | <u>20,627,491</u> | <u>3,719,176</u> |
| Net Change | <u>\$97,927,517</u> | <u>\$39,735,775</u> | <u>\$58,191,742</u> | <u>\$(26,555,657)</u> | <u>\$66,291,432</u> |

STATEMENTS OF PLAN NET ASSETS

as of June 30, 2004 and 2003

| Assets | 2004 | 2003 |
|--|-----------------------------|-----------------------------|
| Cash and short-term investments | | |
| Equity in County's pooled cash and temporary investments | \$ 4,590,676 | \$ 5,556,834 |
| Cash collateral received for securities on loan | 41,477,191 | 51,163,036 |
| Short-term investments | <u>67,296,287</u> | <u>64,700,914</u> |
| Total cash and short-term investments | <u>113,364,154</u> | <u>121,420,784</u> |
| Receivables | | |
| Contributions | 1,312,337 | 875,420 |
| Accrued interest and dividends | 1,862,106 | 1,811,095 |
| Securities sold | <u>29,026,108</u> | <u>46,935,063</u> |
| Total receivables | <u>32,200,551</u> | <u>49,621,578</u> |
| Investments, at fair value | | |
| U.S. Government obligations | 26,405,290 | 36,976,296 |
| Asset-backed securities | 132,300,060 | 147,090,208 |
| Corporate bonds | 32,140,644 | 31,745,149 |
| Common and preferred stock | 162,575,744 | 126,510,559 |
| Pooled and mutual funds | <u>357,704,247</u> | <u>304,136,426</u> |
| Total investments | <u>711,125,985</u> | <u>646,458,638</u> |
| Total assets | 856,690,690 | 817,501,000 |
| Liabilities | | |
| Cash collateral received for securities on loan | 41,477,191 | 51,163,036 |
| Purchase of investments | 58,837,967 | 107,998,834 |
| Accounts payable and accrued expenses | <u>1,086,837</u> | <u>977,952</u> |
| Total liabilities | <u>101,401,995</u> | <u>160,139,822</u> |
| Net assets held in trust for pension benefits | <u>\$755,288,695</u> | <u>\$657,361,178</u> |

(A schedule of funding progress is presented on page 22.)

See accompanying notes to financial statements.

FINANCIAL SECTION

STATEMENTS OF CHANGES IN PLAN NET ASSETS

For the Years Ended June 30, 2004 and 2003

| Additions | 2004 | 2003 |
|--|-----------------------------|-----------------------------|
| Contributions | | |
| Employer | \$ 24,823,288 | \$ 23,027,237 |
| Plan members | 7,649,425 | 7,478,708 |
| Other income | <u>150,859</u> | <u>-</u> |
| Total contributions | 32,623,572 | 30,505,945 |
| <i>Investment income from investment activities</i> | | |
| Net appreciation in fair value of investments | 79,040,406 | 24,262,226 |
| Interest | 15,974,619 | 9,719,912 |
| Dividends | <u>2,907,767</u> | <u>2,293,937</u> |
| Total investment income | 97,922,792 | 36,276,075 |
| Investment activity expense | | |
| Management fees | 3,664,001 | 2,530,256 |
| Custodial fees | 124,346 | 117,701 |
| Consulting fees | 148,402 | 126,424 |
| Allocated administrative expense | <u>122,527</u> | <u>96,468</u> |
| Total investment expense | <u>4,059,276</u> | <u>2,870,849</u> |
| Net income from investment activities | 93,863,516 | 33,405,226 |
| <i>From securities lending activities</i> | | |
| Securities lending income | 677,965 | 785,690 |
| Securities lending expenses | | |
| Borrower rebates | 468,409 | 543,329 |
| Management fees | <u>64,892</u> | <u>71,090</u> |
| Total securities lending activities expenses | <u>533,301</u> | <u>614,419</u> |
| Net income from securities lending activities | <u>144,664</u> | <u>171,271</u> |
| Total net investment income | <u>94,008,180</u> | <u>33,576,497</u> |
| Total additions | 126,631,752 | 64,082,442 |
| Deductions | | |
| Annuity benefits | 21,252,301 | 17,410,370 |
| Disability benefits | 6,307,390 | 6,076,207 |
| Survivor benefits | 394,740 | 377,356 |
| Refunds | 452,616 | 259,624 |
| Administrative expense | <u>297,188</u> | <u>223,110</u> |
| Total deductions | <u>28,704,235</u> | <u>24,346,667</u> |
| Net increase | 97,927,517 | 39,735,775 |
| Net assets held in trust for pension benefits | | |
| Beginning of fiscal year | <u>657,361,178</u> | <u>617,625,403</u> |
| End of fiscal year | <u>\$755,288,695</u> | <u>\$657,361,178</u> |

See accompanying notes to financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the Years Ended June 30, 2004 and 2003

The Fairfax County Uniformed Retirement System (“System” or “plan”) is considered part of the County of Fairfax, Virginia’s (“County”) reporting entity and its financial statements are included in the County’s basic financial statements as a pension trust fund.

A. Summary of Significant Accounting Policies

Basis of Accounting. The System’s financial statements have been prepared under the accrual basis of accounting in accordance with generally accepted accounting principles applicable to governmental units in the United States of America. Member and employer contributions to the plan are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the plan. The cost of administering the plan is paid by the System.

Method Used to Value Investments. Short-term investments are reported at cost, which approximates fair value. All other investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Asset-backed securities are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The System records investment purchases and sales as of the trade date. These transactions are not finalized until the settlement date, which occurs approximately three business days after the trade date. The amounts of trade receivables and payables are shown as receivables and payables on the Statements of Plan Net Assets. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County’s pooled cash and temporary investments. The System maintains cash with the County, which invests cash and allocates interest earned, net of a management fee, on a daily basis to the System based on the System’s average daily balance of equity in pooled cash. As of June 30, 2004 and 2003 the bank balance of the County’s public deposits was either insured by the Federal Deposit Insurance Corporation or through the State Treasury Board pursuant to the provisions of the Security for Public Deposit Act.

B. Plan Description and Contribution Information

Membership. At July 1, 2003, the date of the latest actuarial valuation, membership in the System consisted of:

| | |
|--|--------------|
| Retirees and beneficiaries receiving benefits | 731 |
| Terminated plan members entitled to but not yet receiving benefits | 25 |
| Active plan members | <u>1,625</u> |
| Total | 2,381 |

Plan Description. The System is a single-employer defined benefit pension plan. The plan covers uniformed employees including non-clerical employees of the Fire and Rescue Department, Office of the Sheriff, park police, helicopter pilots, animal wardens and game wardens who are not covered by other plans of the County or the Virginia Retirement System. Benefit provisions are established and may be amended by County ordinance. All benefits vest at five years of service. To be eligible for normal retirement, an individual must meet the following criteria: (a) attain the age of 55 with six years of service, or (b) complete 25 years of service. The normal retirement benefit is calculated using

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

average final compensation (i.e., the highest consecutive three years) and years, (or partial years) of service at date of termination. The plan provides that unused sick leave credit may be used in the calculation of average final compensation by projecting the final salary during the unused sick leave period. Members eligible for normal retirement have the option of participating in a deferred retirement option program (DROP). Participating members continue working up to an additional three years after eligibility for normal retirement. In lieu of continuing to earn service credit, DROP members accrue a lump sum benefit payable at retirement. To be eligible for early retirement, the employee must have 20 years of service. The benefit for early retirement is actuarially reduced and payable at early termination.

Annual cost-of-living adjustments are provided to retirees and beneficiaries equal to the lesser of 4 percent or the percentage increase in the Consumer Price Index for the Washington Consolidated Metropolitan Statistical Area.

Contributions. The contribution requirements of the System members are established and may be amended by County ordinances. Plan A members were given the opportunity to join Plan B as of July 1, 1981 and to enroll in Plan C as of April 1, 1997. From July 1, 1981, until March 31, 1997, all new hires were enrolled in Plan B. Plan B members were given the opportunity to enroll in plan D as of April 1, 1997. From April 1, 1997, forward, all new hires are enrolled in Plan D. Plan A requires member contributions of 4 percent of compensation up to the Social Security wage base and 5.75 percent of compensation in excess of the wage base. Plan B requires member contributions of 7.08 percent of compensation up to the Social Security wage base and 8.83 percent of compensation in excess of the wage base. Plan C requires member contributions of 4 percent of compensation. Plan D requires contributions of 7.08 percent of compensation. The County is required to contribute at an actuarially determined rate; the rates for the fiscal years ended June 30, 2004 and 2003 were 21.90 percent and 21.65 percent of annual covered payroll, respectively.

Deductions. The deductions from the System include the payment of retiree and beneficiary payments, the refund of employee contributions to former members and other expenses.

C. Investments

The authority to establish the System is set forth in Section 51.1-800 *Code of Virginia* (Code). Section 51.1-803 of the Code authorizes fiduciaries of the System to purchase investments *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 like character and with the same aims. Such investments shall be diversified so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.*

The System does not have investments (other than U.S. Government and U.S. Government guaranteed obligations) in any one organization that represent 5 percent or more of net assets available for benefits. All investments, except for the mutual funds, short-term investment fund, and a short-term collateral investment pool, are held by an unaffiliated custodian in the name of the System. Investment decisions for these assets are made by the Board of Trustees or investment managers selected by the Board.

Derivative Financial Instruments. As permitted by the Code described above, the System holds off-financial-statement derivatives in the form of exchange-traded financial futures, interest rate swaps, options on futures and swaps, total return swaps, and spread locks in accordance with Board of Trustees' policy. These strategies are employed by one of the System's fixed income investment

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

managers. Use of these instruments may involve certain costs and risks, including the risk that a portfolio could not close out a position when it would be most advantageous to do so. Portfolios investing in derivatives could lose more than the principal amount invested.

An exchange-traded financial futures contract is a legally-binding agreement to buy or sell a financial instrument in a designated future month at a price agreed upon by the buyer and seller at initiation of the contract. Futures contracts are standardized according to quality, quantity and delivery time. The System uses Money Market Futures Contracts as a means of managing interest rate exposure at the short end of the yield curve in an efficient manner with low transaction costs. As of June 30, 2004, the notional value of Money Market Futures contracts was \$29,500,000, and the fair market value was \$28,508,437. These contracts mature in March of 2005, June of 2005, December of 2005, and December of 2006. The system also uses Government Futures Contracts as risk-neutral substitutes for the underlying physical securities. The System entered into contracts in April, May, and June of 2004, all of which will mature in September of 2004. As of June 30, 2004, the net notional value of the four Government Futures contracts was \$15,700,000, and the net fair market value was \$17,158,165. The market and interest rate risks of holding exchange-traded futures contracts arise from adverse changes in market prices and interest rates. These risks are equivalent to holding exposure to the underlying security. Counterparty credit risk is modest because the futures clearinghouse becomes the counterparty to all transactions.

An Options Contract is a financial instrument that, in exchange for the option price, gives the option buyer the right, but not the obligation, to buy (or sell) a financial asset at the exercise price from (or to) the option seller within a specified time period, or on a specified date (expiration date). The System employs Options on Treasury Futures as well as Options on Swaps (Swaptions). Options on Treasury Futures are used to manage interest rate and volatility exposure of the portfolio. Swaptions have similar investment characteristics to other options but have the advantage of being more customized instruments that can serve more specific applications in a portfolio. Swaptions are used in an attempt to generate income by writing puts and calls to manage swap rates or swap rate volatility. Options held in the portfolio as of June 30, 2004 had a notional value of \$13,200,000, a fair market value of \$16,268, maturing in August of 2004 and September through October of 2005. A most important characteristic of options is that they can cause the effective duration of a portfolio to change with movements in interest rates. To control interest rate risk, the duration change potential of options positions over a wide range of best and worst case interest rate scenarios are measured and controlled.

An interest rate swap is a binding agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. The System uses interest rate swaps as risk-neutral substitutes for physical securities, or to obtain non-leveraged exposure in markets where no physical securities are available, such as an interest rate index. In the System's interest rate swaps, the portfolio receives a fixed 4.0% in US dollars as well as a fixed 4.5% in Swedish Krona. Additionally, the system also entered in total return swaps contracts, which receive Lehman CMBS ERISA Eligible Index and pay out a 1-month LIBOR-63 bps. As of June 30, 2004, the notional amount of interest rate swaps totaled \$37,200,000, and the fair market value totaled (\$162,891). These swaps bear maturity dates ranging from September of 2004 to December of 2009. The counterparty credit risk is equal to the amount of profit or loss that has not yet been realized. This risk is controlled by the System's investment guidelines and limited by periodic resets to the swap that allow the unrealized profit and loss to be realized. The market risk is equivalent to holding the exposure to the index.

Credit spread swaps (Spread Locks) are swaps used to adjust exposure to specific sectors and risks in portfolios by the most effective means possible. Swap spreads can both reduce risk and enhance

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

portfolio management flexibility. The System employs spread locks as a potentially attractive means of gaining exposure to the interest rate differential between two market rates. The System has entered agreements to receive fixed amounts ranging from 31.50 basis points and 37.75 basis points over the reference 2-year and 10-year Treasury bonds respectively in anticipation that swap spreads will widen for the 10-year swap and narrow on the 2-year swap. With this, the entering party can lock in, paying a fixed amount less than the current swap rate or receiving a fixed amount more than the current swap rate. The spread locks agreements existing at June 28, 2004 were written in March 30, 2003 and matured on August 13, 2003. There were no spread lock agreements in the portfolio at June 30, 2004. Counterparty risk is limited by restricting eligible counterparties to the highest credit rating organizations in the industry. Risk is also limited to the exchange of net-interest payments, not the instrument's underlying notional value. In addition, there is a mutual collateral agreement that each party may exercise if the market value of the swap exceeds \$250,000.

Securities Lending. Board of Trustees' policies permit the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the plan's domestic securities for collateral of 102 percent and international securities for collateral of 105 percent. The custodian receives cash or securities as collateral. All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in the lending agent's collective collateral investment pool, which at June 30, 2004 had a weighted-average maturity and duration of 40 days and at June 30, 2003 had a weighted-average maturity and duration of 18 days. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool.

The System did not impose any restrictions during fiscal 2004 or 2003 on the amounts of loans the lending agent made on its behalf. The custodian provides full indemnification to the System for any losses that might occur in the program due to the failure of a broker/dealer to return a borrowed security or failure to pay the System for income earned on the securities while on loan. Securities on loan for securities collateral are classified in the following schedule of investments according to the category of the collateral received. Securities on loan at each year-end for cash collateral are unclassified as the cash collateral is invested in a collective collateral investment pool. At each year end, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceeded the amounts the borrowers owed the System.

As of June 30, 2004 and 2003, the market value of securities on loan was \$45,883,964 and \$53,504,766, respectively. Cash received as collateral and the related liabilities of \$41,477,191 as of June 30, 2004 and \$51,163,036 as of June 30, 2003 are shown on the Statements of Plan Net Assets. Securities received as collateral are not reported as assets since the System does not have the ability to pledge or sell the collateral absent borrower default.

Categorization. The System's investments are categorized to give an indication of the 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 or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty or its trust department or agent, but not in the System's name. All of the System's investments meet the criteria of category 1, except investments in mutual funds, a short-term investment fund, a short-term collateral investment pool and those securities on loan for which the cash collateral is invested in the collateral investment pool. These investments by their nature are not required to be categorized.

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

| Category 1 Investments <i>(Held by System's agent in System's name)</i> | 2004 | 2003 |
|--|-----------------------------|-----------------------------|
| Short-term investments | | |
| Commercial paper | \$ 36,627,212 | \$ - |
| Asset-backed securities | | |
| Not on securities loan | 10,284,690 | 22,512,167 |
| On securities loan for other collateral | 195,213 | - |
| Repurchase agreements | 9,986,044 | 25,258,045 |
| U.S. Government bonds | 5,713,204 | 1,101,020 |
| Corporate bonds | 3,251,864 | 11,336,353 |
| Time deposits | - | 1,000,000 |
| Subtotal | <u>66,058,227</u> | <u>61,207,585</u> |
| U.S. Government Obligations | | |
| Not on securities loan | 7,314,969 | 7,875,067 |
| On securities loan for other collateral | 1,238,156 | 6,946,830 |
| Asset-backed securities | | |
| Not on securities loan | 129,239,868 | 140,602,026 |
| On securities loan for other collateral | - | 661,186 |
| Corporate and other bonds | 26,418,042 | 26,254,480 |
| Common and preferred stock | | |
| Not on securities loan | 145,897,681 | 117,579,203 |
| On securities loan for other collateral | <u>536,548</u> | <u>285,527</u> |
| Total Category 1 Investments | <u>\$376,703,491</u> | <u>\$361,411,904</u> |
| Not Subject to Classification | | |
| Mutual funds | \$357,704,247 | \$304,136,426 |
| Short-term investment fund | 100,487 | - |
| Cash collateral for securities on loan | 41,477,191 | 51,163,036 |
| Investments held by broker-dealers under securities loans with cash collateral | | |
| Short-term investments | 1,137,573 | 3,493,329 |
| U.S. Government obligations | 17,852,165 | 22,154,399 |
| Asset-backed securities | 3,060,192 | 5,826,996 |
| Corporate and other bonds | 5,722,602 | 5,490,669 |
| Common and preferred stock | <u>16,141,515</u> | <u>8,645,829</u> |
| Total Uncategorized Investments | <u>443,195,972</u> | <u>400,910,684</u> |
| Total Investments | <u>\$819,899,463</u> | <u>\$762,322,588</u> |
| Reconciliation to Investments on Statement of Plan Net Assets | | |
| Total above | \$819,899,463 | \$762,322,588 |
| Less: short-term investments | | |
| Cash collateral for securities on loan | (41,477,191) | (51,163,036) |
| Short-term investments not on loan for cash collateral | (66,058,227) | (61,207,585) |
| Short-term investments on loan for cash collateral | (1,137,573) | (3,493,329) |
| Short-term investment fund | <u>(100,487)</u> | <u>-</u> |
| Investments on Statement of Plan Net Assets | <u>\$711,125,985</u> | <u>\$646,458,638</u> |

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

D. Income Taxes

The Internal Revenue Service issued a determination letter on November 24, 2003, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes.

REQUIRED SUPPLEMENTARY INFORMATION

Six-year historical trend information about the System is presented here as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability - AAL Entry Age (b) | Unfunded AAL-UAAL (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|--------------------------|-------------------------------|---|-------------------------|--------------------|---------------------|---|
| 7/1/1998 | \$487,989,565 | \$491,142,845 | \$ 3,153,280 | 99.36% | \$ 74,685,099 | 4.22% |
| 7/1/1999 | 560,044,161 | 531,788,754 | (28,255,407) | 105.31% | 78,622,337 | (35.94%) |
| 7/1/2000 | 624,297,885 | 614,242,665 | (10,055,220) | 101.64% | 87,943,499 | (11.43%) |
| 7/1/2001 | 666,599,019 | 651,840,288 | (14,758,731) | 102.26% | 93,577,081 | (15.77%) |
| 7/1/2002 | 687,093,049 | 720,995,743 | 33,902,694 | 95.30% | 99,200,254 | 34.18% |
| 7/1/2003 | 715,797,245 | 795,342,264 | 79,545,019 | 90.00% | 100,749,162 | 78.95% |

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing plan net assets as a percentage of the actuarial accrued liability provides one 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 system. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

| Fiscal Year Ended June 30 | Annual Required Contribution | Percentage Contributed |
|---------------------------|------------------------------|------------------------|
| 1999 | \$15,645,845 | 100% |
| 2000 | 16,489,406 | 100% |
| 2001 | 18,818,351 | 100% |
| 2002 | 16,834,252 | 112% |
| 2003 | 21,548,814 | 107% |
| 2004 | 25,186,003 | 99% |

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

| | |
|-------------------------------|------------------------------|
| Valuation date | July 1, 2003 |
| Actuarial cost method | Entry age |
| Amortization method | Level percent closed |
| Remaining amortization period | Weighted average of 15 years |
| Asset valuation method | 3-year smoothed market |
| Actuarial assumptions: | |
| Investment rate of return | 7.5% |
| Projected salary increases* | 4.1% - 8.5% |
| <i>*Includes inflation at</i> | 4.0% |
| Cost-of-living adjustments | 3.0% |

The actuarial assumptions used have been recommended by the actuary and adopted by the System's Board of Trustees based on the most recent review of the System's experience, completed in 2001.

The rate of employer contributions to the plan is composed of the normal cost, amortization of the unfunded actuarial accrued liability and an allowance for administrative expenses. The normal cost is a level percent of payroll cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial accrued liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial accrued liability. The allowance for administrative expenses is based upon the plan's actual administrative expenses.

Some effect of investment losses from fiscal 2001 and 2002 are being felt for determining the employer contribution rate developed during the July 1, 2003 valuation. The impact of these losses and changes made to benefits resulted in the computation of a contribution rate of 26.03% for fiscal 2005, per the GASB methodology, an increase of 3.81% over the GASB computed rate of 22.22% for fiscal 2004. Beginning with fiscal 2003, the funding policy was revised to further stabilize the contribution rate. The methodology now in place sets the employer contribution rate equal to the normal cost and allowance for administrative expense. Amortization of the unfunded liability is included in the contribution rate only for benefit changes or if the actuarial funding ratio falls outside a corridor of 90% and 120%. Use of the corridor method, which serves to stabilize the contribution rate, and inclusion of a benefit change results in an adopted rate of 24.30% for fiscal 2005, an increase of 2.40% over the fiscal 2004 adopted rate of 21.90%.

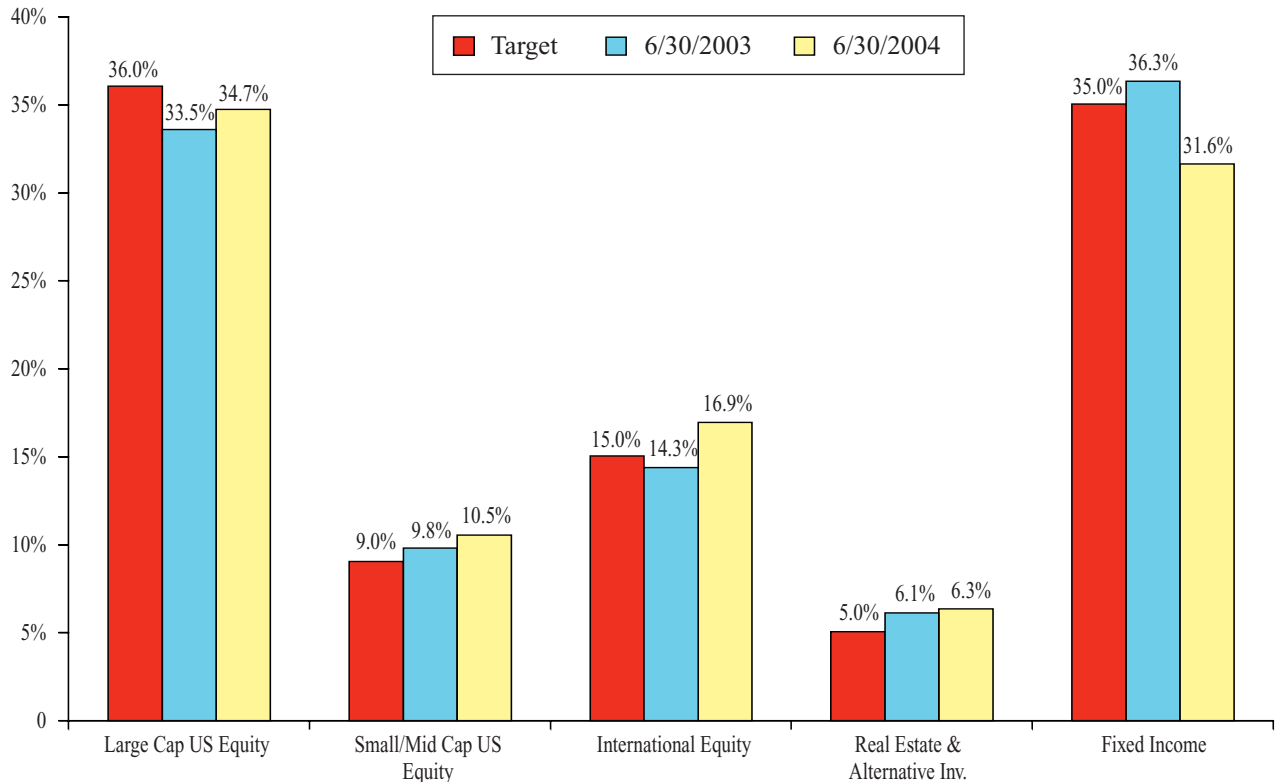
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OVERVIEW

The Board of Trustees has established an investment policy for the System to identify investment objectives, guidelines and performance standards for the assets of the System. The objectives are formulated in response to the anticipated needs of the System, the risk tolerance of the System and the desire of the Board of Trustees to define and fulfill their fiduciary responsibility over System assets.

With the assistance of its investment consultant, the Board has established its asset class strategic target allocations which it believes will achieve the return requirements of the fund at an appropriate level of risk and maintain a comfortable risk tolerance. Further, a disciplined rebalancing policy was adopted to ensure that market movements do not cause asset class weightings to unintentionally stray too far from the target percentages. The actual asset allocation at market is reviewed monthly and if asset class weightings fall outside the “no rebalancing range”, transfers between asset classes are initiated to rebalance the asset allocations to within the target ranges. The following graph shows the target and actual asset allocations as of June 30, 2004 and 2003.



The Board of Trustees hires investment management firms and provides each firm with a mandate, and benchmark index or a blend of indices against which the performance of the account is measured. Each managed account has its own investment guidelines outlining the nature of the investments to be held in the account and detailing allowed and/or prohibited transactions. Investment managers are requested to submit a written statement describing their proposed investment strategy and tactics for achieving the investment goals and objectives that are required by their guidelines. Investment manager performance is monitored by staff and reviewed by the Board of Trustees quarterly.

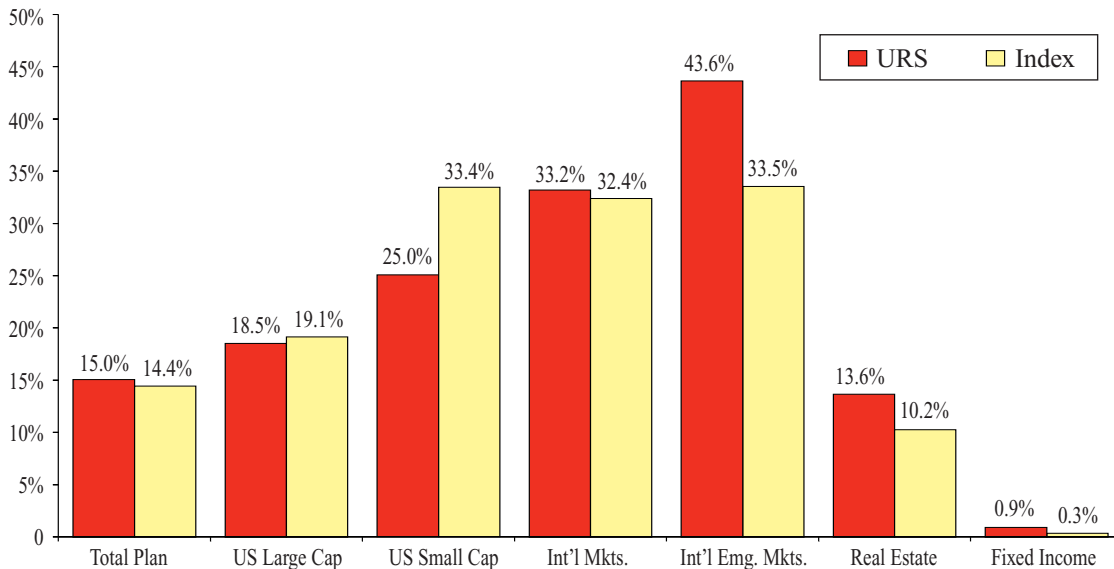
INVESTMENT SECTION

CAPITAL MARKETS AND ECONOMIC CONDITIONS

Financial and Economic Summary

Equity markets achieved very positive results in 2004, bouncing back from three years of post-bubble, bear-market swoon and tepid economic growth. Triggering these good results was a surprising jump in economic fundamentals to lead off the fiscal year. The prevailing view a year ago was that the economy was mired in a lingering recession (or at best a jobless recovery) and deflation was a significant threat. But the Administration stepped up to the plate and implemented the most expansionary macro-economic policies in history. The Jobs and Growth Tax Relief Reconciliation Act (JAGTRRA) reduced tax rates on stock dividends as well as long-term capital gains. It also provided most middle-income families with a \$400 per-child tax credit. In addition, Federal spending went into overdrive. The Federal Reserve did its part to maintain a hyper-stimulative monetary policy by dropping its Fed Funds Rate to 1%, the lowest rate in 45 years. With money in their pockets, and incredibly low interest rates, consumers got the message and went on a spending spree, buying houses and automobiles, and pushing GDP growth up +8.2% in the first fiscal quarter of 2004. This economic boom continued over the remaining three quarters of 2004, with the resulting 5% GDP growth ranking as the strongest 12-month growth spurt in the past 20 years. During the second half of the fiscal year job growth and business capital spending finally began to pick up. Over 1.3 million jobs were created during the last six months of the fiscal year, while unemployment fell from 6.3% at June 30, 2003 to 5.6% at year-end 2004. Businesses, fueled by record corporate profits, began spending for capital equipment, non-defense goods and the rebuilding of inventories. By year-end's close in June, consumer confidence had hit a 2-year high, and skyrocketing housing prices had replaced some of the household wealth drained away by the stock market during the previous three years. By the end of the fiscal year, however, much of the improving economic fundamentals had been priced into the markets. By June, after four strong quarters of GDP growth, the Federal Reserve became convinced that the economic expansion was self-sustaining, and that the recovery was more broad-based. In Congressional testimony Chairman Alan Greenspan reported that inflation was now a greater threat than deflation, thus broadcasting that the Federal Reserve would begin moving short-term interest rates back up to a more normalized level, presumably between 2.0% and 2.75%. On the last day of the fiscal year, the Federal Open Market Committee, in a much-anticipated move, raised the Federal Funds Rate by 25 basis points to 1.25%.

One-Year Asset Class Returns



CAPITAL MARKETS AND ECONOMIC CONDITIONS

(Continued)

Equity Markets

Major equity markets posted robust rebounds in fiscal 2004 following three consecutive years of negative or flat equity returns. The powerful 8.2% GDP growth generated in the first fiscal quarter of 2004 sparked four consecutive quarters of upward stock prices in the US equity markets. The S&P 500 Index rose 19.1% in fiscal 2004. Small-capitalization stocks achieved their third-best fiscal year return in history as the Russell 2000 Index increased 33.4%. Although style leadership alternated back and forth over the last four quarters, value stocks finished the year with an advantage over growth stocks in all three capitalization segments. The Energy (+31.3%), Industrials (+29.0%) and Information Technology (+25.5%) sectors led the market's advance, while the Health Care (+5.6%) and Telecom Services (+7.0%) sectors were a drag on performance.

International stock markets, both developed and emerging, easily outpaced the broad US markets for the fiscal year. Riding the wave of improving US economic fundamentals and investors' increased appetite for risk, the MSCI EAFE Index rose 32.4% in US dollar terms in fiscal 2004 and the MSCI Emerging Markets Free Index earned 33.2%. The majority of the return for the year was captured during the first three quarters, due in large part to the broad-based depreciation of the US dollar against foreign currencies. Japan, experiencing the combined benefit of renewed economic vigor and financial reform, jumped 46.3% during the year. Emerging markets shrugged off bombings and terrorist threats to generate improving materials-based fundamentals and robust growth. Following three strong quarters of market returns, the fiscal fourth quarter ending June 30, 2004 was difficult for all asset classes including international developed equity, but was especially tough for emerging markets equity. This occurred for two reasons: the US dollar stopped its downward slide during the quarter and certain emerging market economic recoveries slowed significantly. As the market's expectations of a restrained Fed reversed course in April, international markets and commodities sold off abruptly as investors began to return to US-based investments. This benefited the US dollar. International emerging equity markets fell nearly 10% during the fourth quarter of the fiscal year on concerns that China's torrid pace would slow in the second half of calendar year 2004 and into 2005.

Bond Markets

Bonds took investors on a tumultuous ride during 2004. In July, bonds produced their worst monthly return in more than 20 years as the economy proved much stronger than expected. Evidence of the improving economy relieved deflationary fears, sending bond yields soaring from forty year lows. Long-term Treasury bonds lost upwards of 10% in July alone as yields rose sharply from 4.2% to 5.4%. The bond market rebounded, however, in the third quarter of the fiscal year as investors moved from complacency into a combination of disappointment and fear, pushing the 5-year Treasury yield down by 60 basis points as investors sought shelter in safety. The Lehman Aggregate Bond Index posted a 2.7% advance. By May, however, the bond market again turned bearish in anticipation of an imminent interest rate move upwards by the Federal Reserve based on the strong emerging jobs data for March and April. As a result, the yield curve rose across the board during the fourth quarter of the fiscal year and markets priced in an unrealistic 125 basis point rise in rates. The Lehman Aggregate Bond Index of investment grade bonds finished the year with a meager 0.3% gain for the year. Lower-quality, High Yield bonds generated the best fixed income returns, with the Lehman High Yield Index earning 10.33% for the year ended June 30, 2004. Due to the negative convexity of mortgages, they were quite volatile during the year, finishing with a 2.2% gain.

INVESTMENT SECTION

CAPITAL MARKETS AND ECONOMIC CONDITIONS

(Continued)

Rising global interest rates and a strengthening US dollar in the fourth quarter of the fiscal year hit non-US bonds harder than their domestic counterparts. Despite falling 3.3% in the fourth quarter, the S&P Citigroup World Government Bond Index generated a strong return for the fiscal year, posting a gain of 5.7% and outperforming its domestic counterpart by 5.4 percentage points.

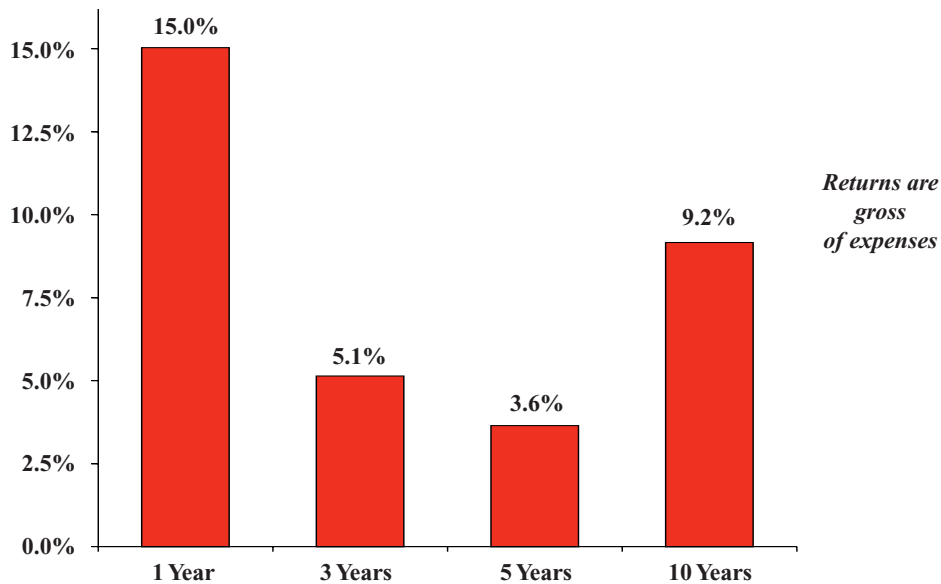
Real Estate

The public real estate market (REITs) had another stellar year, as evidenced by the 27.1% return of the NAREIT Equity REIT Index. In an environment of 2% - 4% coupon yields, investors hungered after the 5% - 6% payouts offered by REITs. This marks the fifth-consecutive year that the REIT market has outperformed the S&P 500 Index. The private real estate market had a more moderate performance, returning 10.2% while still feeling the effects of low office occupancy rates and the gradual recovery of leisure travelers following 9/11.

System

The Uniformed Retirement System operates a sound and diversified investment program with disciplined asset re-balancing to achieve strategic long-term goals. That disciplined investment process has been effective in achieving a long-term record of consistent asset growth.

Compound Annual Return on Investment Portfolio

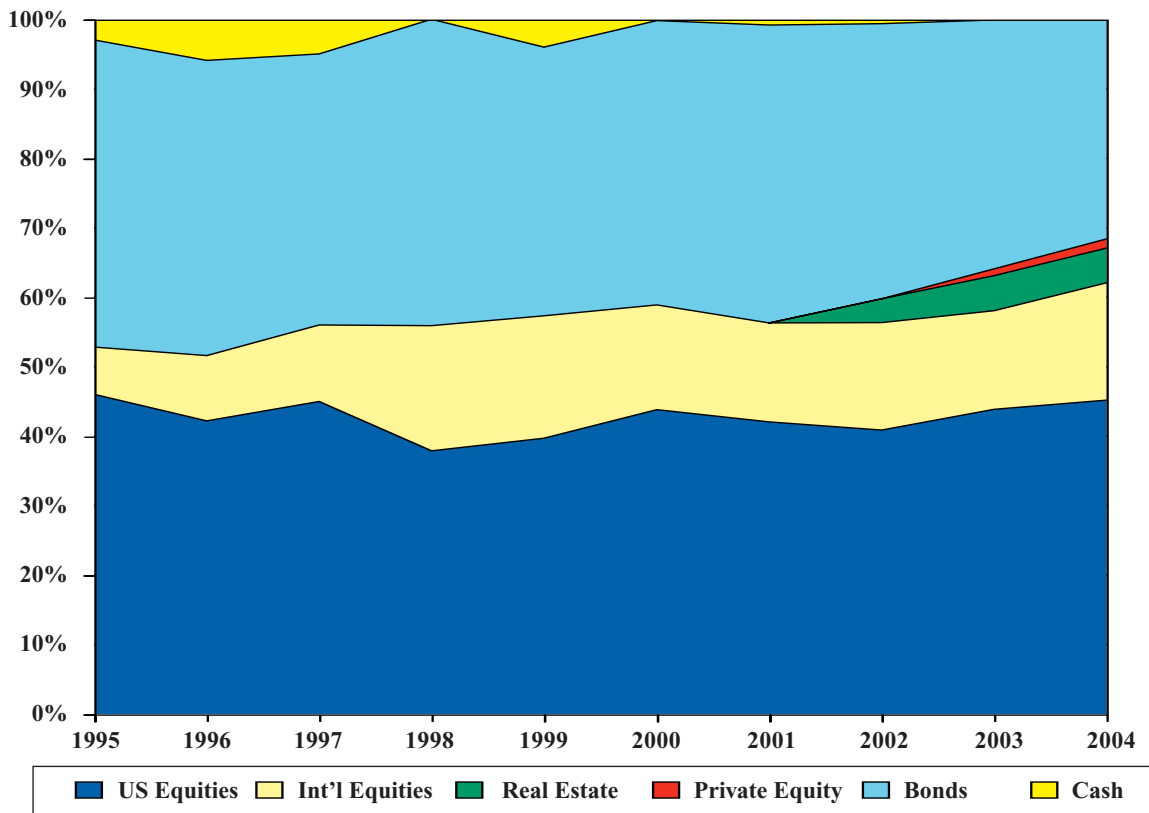


CAPITAL MARKETS AND ECONOMIC CONDITIONS

(Continued)

On a market value basis, the total net assets held in trust rose from \$657.4 million at June 30, 2003 to \$755.3 million at June 30, 2004. For fiscal 2004, investments provided a return of +14.5%, net of fees, reflecting a sharply improved economic environment. The System's annualized rate of return, net of fees, was +4.8% over the last three years and +3.3% over the last five years. These System investment returns ranked in the fourth quartile of a universe of public plan sponsors during fiscal 2004, were in the top quartile of public funds in 2003, and were in the top third in fiscal 2002. The Uniformed Retirement System's annualized net return over the last five years has trailed the rate of 7.5%, the long-term return used for actuarial purposes. At year-end 2004, the System's assets were allocated by manager mandate as follows: domestic equities — 45%; international equities — 17%; fixed income securities — 32%; real estate — 5%; and private equity — 1%.

Asset Allocation 1995 - 2004



INVESTMENT SECTION

ASSET ALLOCATION BY CATEGORY AND INVESTMENT MANAGER

June 30, 2004

| Asset Class Manager | Investment Style | Total Assets | % of Total Net Assets |
|---|-------------------------------|-------------------------|----------------------------------|
| Domestic Equities | | | |
| BGI Alpha Tilts Fund * | Enhanced S&P 500 Index | \$174,225,804 | 23.1% |
| SSGA S&P 500 Fund * | S&P 500 Index | 86,051,556 | 11.4% |
| J.L. Kaplan | Small Cap Value | 43,355,212 | 5.7% |
| Wasatch Advisors | Small Cap Growth | 35,560,844 | 4.7% |
| Pantheon Private Equity * | Private Equity | 6,551,849 | 0.9% |
| J.P. Morgan Private Equity * | Private Equity | 2,525,802 | 0.3% |
| Harbourvest Private Equity * | Private Equity | 671,492 | 0.1% |
| International Equities | | | |
| Marathon Asset Management | Developed Markets | 50,582,984 | 6.7% |
| BGI Emerging Markets Fund * | Emerging Markets Index | 44,438,708 | 5.9% |
| Lazard International | Developed Markets | 31,651,691 | 4.2% |
| Global Fixed Income | | | |
| Payden & Rygel | Domestic Core Plus Bonds | 80,687,585 | 10.7% |
| PIMCO | Total Return | 80,229,783 | 10.6% |
| Peregrine Capital | Duration Management | 37,694,518 | 5.0% |
| Trust Company of the West | Mortgage-Backed Securities | 38,187,320 | 5.1% |
| Real Estate | | | |
| UBS Realty * | Direct Real Estate | 29,694,728 | 3.9% |
| Cohen & Steers | Real Estate Investment Trusts | 7,649,100 | 1.0% |
| Short-term | | | |
| Standish Mellon Enhanced STIF - Fund portion | Short-Term Cash Management | 689,251 | 0.1% |
| Cash Held at County Treasurer | Short-Term Cash Management | 4,614,968 | 0.6% |
| Net Assets** | | \$755,063,195 | 100.0% |

* Pooled Fund

** Without deduction for accounts payable and accrued liabilities.

INVESTMENT SECTION

LIST OF LARGEST HOLDINGS FOR ACTIVE (NON-POOLED) ACCOUNTS

as of June 30, 2004

| Asset Class Manager Security | Market Value | % of Account |
|---|-------------------------|-------------------------|
| Domestic Equities | | |
| J.L. Kaplan | | |
| Ametek Inc. | \$2,206,260 | 5.10% |
| Smithfield Foods Inc. | \$1,587,600 | 3.67% |
| Cooper Companies Inc. | \$1,579,250 | 3.65% |
| Ross Stores Inc. | \$1,552,080 | 3.58% |
| Renaissance Re Holdings Ltd. | \$1,521,390 | 3.51% |
| Wasatch Advisors | | |
| Accredo Health Inc. | \$3,020,066 | 8.49% |
| UT Starcom Inc. | \$1,781,725 | 5.01% |
| United Surgical partners Int'l Inc. | \$1,453,482 | 4.09% |
| American Healthways Inc. | \$1,263,119 | 3.55% |
| Wireless Facilities Inc. | \$1,224,424 | 3.44% |
| International Equities | | |
| Marathon Asset Management | | |
| Royal Dutch Petroleum Co. | \$ 543,973 | 1.07% |
| Shell Transport & Trading | \$ 506,156 | 1.00% |
| Jardine Matheson Holdings | \$ 484,088 | 0.96% |
| BAE Systems | \$ 479,771 | 0.95% |
| Nippon Telephone & Telecom Corp. | \$ 470,182 | 0.93% |
| Lazard International | | |
| Royal Dutch Petroleum Co. | \$1,211,111 | 3.87% |
| Vodafone Group Plc. | \$1,175,485 | 3.76% |
| GlaxoSmithKline | \$1,113,126 | 3.56% |
| HSBC Holdings | \$1,110,856 | 3.55% |
| Nokia AB | \$1,049,022 | 3.35% |

INVESTMENT SECTION

LIST OF LARGEST HOLDINGS FOR ACTIVE (NON-POOLED) ACCOUNTS

(Continued)

| Asset Class Manager Security | Market Value | % of Account |
|---|-------------------------|-------------------------|
| Global Fixed Income | | |
| Payden & Rygel | | |
| U.S. Treasury Note, 2.50%, 5/31/2006 | \$5,443,074 | 5.43% |
| FNMA TBA, 6.50%, 7/1/2034 | \$5,329,999 | 5.31% |
| FNMA TBA, 5.00%, 8/1/2019 | \$4,917,675 | 4.90% |
| U.S. Treasury Bill, 7/8/2004 | \$4,590,654 | 4.58% |
| FNMA TBA, 6.00%, 8/1/2034 | \$4,523,007 | 4.51% |
| PIMCO | | |
| FNMA TBA, 5.00%, 7/1/2034 | \$3,380,507 | 3.78% |
| FNMA TBA, 5.00%, 8/1/2019 | \$2,992,500 | 3.34% |
| FNMA TBA, 5.50%, 7/1/2034 | \$2,984,531 | 3.33% |
| U.S. Treasury Note, 1.625%, 4/30/2005 | \$2,493,750 | 2.79% |
| FHLMC Discount Note, 4/30/2005 | \$2,194,425 | 2.45% |
| Peregrine Capital | | |
| Federal Home Loan Bank Bonds, 1.75%, 8/12/2005 | \$2,735,813 | 7.28% |
| FHLMC Notes, 2.70%, 4/28/2006 | \$2,690,010 | 7.16% |
| Federal Home Loan Bank Bonds, 2.25%, 1/30/2006 | \$2,681,370 | 7.14% |
| FNMA Notes, 2.50%, 4/28/2006 | \$2,680,965 | 7.14% |
| FNMA Notes, 2.40%, 4/28/2006 | \$2,676,645 | 7.13% |
| Trust Company of the West | | |
| FHLMC, 6.50%, 2/15/2032 | \$3,031,869 | 8.04% |
| Master Asset Securitization 2A1, 5.50%, 7/25/2033 | \$1,889,595 | 5.01% |
| FHLMC, Variable rate, 7/15/2033 | \$1,864,564 | 4.95% |
| GSR Mortgage Loan Trust, Variable rate, 9/25/2032 | \$1,769,891 | 4.70% |
| Master Asset Securitization 5A1, 5.50%, 7/25/2033 | \$1,742,820 | 4.62% |
| Real Estate - REITs | | |
| Cohen & Steers | | |
| Vornado Realty Trust | \$ 314,105 | 4.13% |
| Archstone Smith Trust | \$ 272,769 | 3.59% |
| Arden Realty Group Inc. | \$ 261,749 | 3.44% |
| Reckson Associates Realty Corp. | \$ 260,870 | 3.43% |
| Avalonbay Communities Inc. | \$ 259,992 | 3.42% |



Classic Values, Innovative Advice

April 29, 2004

Fairfax County Uniformed
Retirement System
10680 Main Street, Suite 280
Fairfax, Virginia 22030-3812

Dear Members of the Board:

At your request, we have conducted our annual actuarial valuation of the Fairfax County Uniformed Retirement System as of July 1, 2003. The results of the valuation are contained in this report.

Funding Objective

The funding objective of the System is to establish contribution rates which, over time, will remain level as a percent of payroll. In order to achieve a more stable contribution rate the County implemented a Corridor Funding Method on July 1, 2001. Under this approach the contribution rate is based on the normal cost rate and expense rate on July 1, 2001 and will remain at this level as long as the actuarial funded ratio remains within a corridor of 90% to 120%. Furthermore any plan changes are amortized over 15 years. This funding objective is currently being realized.

Assumptions

The actuarial assumptions used in performing the July 1, 2003 valuation were recommended by the actuary and adopted by the Board of Trustees based on the prior actuary's most recent review of the System's experience for the five year period ending June 30, 2000. The assumptions reflect our understanding of the likely future experience of the System and the assumptions as a whole represent our best estimate for the future experience of the System. The results of this report are dependent upon future experience conforming to these assumptions. To the extent that future experience deviates from these assumptions, the true cost of the System could vary from our results. No assumption changes were made since the prior valuation.

The assumptions and methods used in performing this valuation meet the parameters set by Government Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans*.

Reliance on Others

In preparing our report, we relied without audit, on information (some oral and some written) supplied by the System's staff. This information includes, but is not limited to, plan provisions, employee data, and financial information. The census data provided was reviewed for reasonableness and for consistency with prior year's data.

Supporting Schedules

We were responsible for all supporting schedules to be found in the Actuarial Section.

We were responsible for the most recent year of the Schedule of Funding Progress, Schedule of Employer Contributions and Notes to Trend Data shown in the Financial Section.



Fairfax County Uniformed Retirement System
Page 2

Compliance with Code of Virginia §51.1-800

Code of Virginia §51.1-800 requires that the benefits provided to a retiree at age 65 from a local retirement system equal or exceed two-thirds of the allowance to which the employee would be entitled under the provisions of the Virginia Retirement System (VRS). The Board of Trustees of the VRS is to determine whether a local system satisfies this condition, taking into account differences in member contributions between the local system and the VRS.

Although there is no formal procedure for making this comparison, we compared the least valuable rate under the Uniformed System to the most valuable accrual rate under the VRS, making adjustments for the fact that employee contributions are required in excess of the VRS 5% rate. The employer provided accrual rates do exceed two-thirds of the employer provided accrual rates under the VRS plan.

I certify that, to the best of my knowledge and understanding, the Fairfax County Uniformed Retirement System satisfies the requirements of the Code of Virginia §51.1-800.

Certification

I, Fiona Liston, am a consulting actuary for CHEIRON. I am also a member of the American Academy of Actuaries and meet their Qualification Standards to render the actuarial opinion contained herein.

I hereby certify that, to the best of my knowledge, this report is complete and accurate and was prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the applicable Guides to Professional Conduct, Amplifying Opinions, and Supporting Recommendations and Interpretations of the American Academy of Actuaries.

Sincerely,
CHEIRON



Fiona E. Liston, FSA
Consulting Actuary



SUMMARY OF VALUATION RESULTS

Overview

This report presents the results of the July 1, 2003 actuarial valuation of the Fairfax County Uniformed Retirement System. The primary purposes of performing the annual actuarial valuation are to:

- Measure and disclose, as of the valuation date, the financial condition of the Plan;
- Indicate trends in the financial progress of the Plan;
- Determine the contribution rate to be paid by the County for Fiscal Year 2005;
- Provide specific information and documentation required by the Governmental Accounting Standards Board (GASB).

This section of the report presents a summary of the above information in the form of:

- The actuary's comments;
- The prior year's experience of the System's assets, liabilities, contributions, and membership;
- A series of graphs which highlight key trends experienced by the System; and
- A summary of all principal results from this year's valuation, compared to last year's, in a single table, intended for quick reference purposes.

Actuary's Comments

Fairfax County's annual contribution to this System is determined by using a Corridor Funding Method. Under this funding approach, the County's contribution rate is based on the normal cost rate determined as of the implementation date of the corridor method (July 1, 2001) 18.95% of payroll plus an expense rate currently 0.25% of payroll. This rate will remain the same as long as the System's actuarial funded ratio remains within a corridor of 90% to 120%.

The County's contribution rate will change when benefits are increased or modified. The new rate will reflect the change in normal cost rate and the change in actuarial liability amortized over 15 years. Since the inception of the Corridor Funding Method benefit changes have added 2.70% to the contribution rate, for a total Corridor Funding Contribution of 21.90% of payroll. The normal cost rate and actuarial accrued liability will continue to be measured using the entry age funding method. If the funded status falls outside the corridor, a credit (if above 120%) or charge (if below 90%) will be established based on a 15-year amortization equal to the amount necessary to re-enter the corridor. Once the funded status is within the corridor, the contribution rate will return to normal cost rate plus expense rate.

The valuation as of July 1, 2003 shows that the actuarial funded ratio (including a credit for the amortization piece of prior benefit increases) remains within the corridor so there is no required increase in the rate at this time.

Since performing this valuation, there were two benefit increases passed by the Board of Supervisors which will result in increases to the County contribution. There was an ad hoc increase for current retired members and the County implemented a DROP component to the System. The County's contribution rate for FY 2005 will therefore increase from 21.90% of payroll to 24.30% of payroll.

ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS

(Continued)

Trends

The financial markets performed below expectation during the fiscal year ending in 2003, which again produced actuarial losses on the asset side of the System. The actual return on a market value basis was approximately 5.4%. On an actuarial value basis, the assets returned 3.3% compared with an assumed rate of return of 7.5%. The loss recognized for funding purposes was \$29.2 million.

The measurement of liabilities also produced a loss this year in the amount of \$14.8 million. This loss was largely due to increases in pay which exceeded those assumed. Part of the loss was attributable to a retiree COLA in excess of the 3% assumed and a data inconsistency with prior year's valuations.

The combination of liability and investment experience over the last year produced deterioration in the System's funding ratio (actuarial value of assets over actuarial accrued liability) from 95% at July 1, 2002 to 90% at July 1, 2003. For purposes of measuring whether the System remains within the funding corridor, an adjusted funding ratio is used. In this ratio there is an additional asset recognized in the amount of the Unfunded Actuarial Liability (UAL) payments being made by the County to pay for benefit increases. On this basis, the System's actuarial funded ratio also decreased from 100% at July 1, 2002 to 94% at July 1, 2003.

It is important to take a step back from the latest results and view them in the context of the System's recent history. On the next page we present a series of charts which display key factors in the valuations over the last ten years. After the historical review we present a few projection graphs, showing the possible condition of the System over the next ten years under various market return scenarios.

The following is a key to the abbreviations used in the actuarial graphs:

MVA - Market value of assets

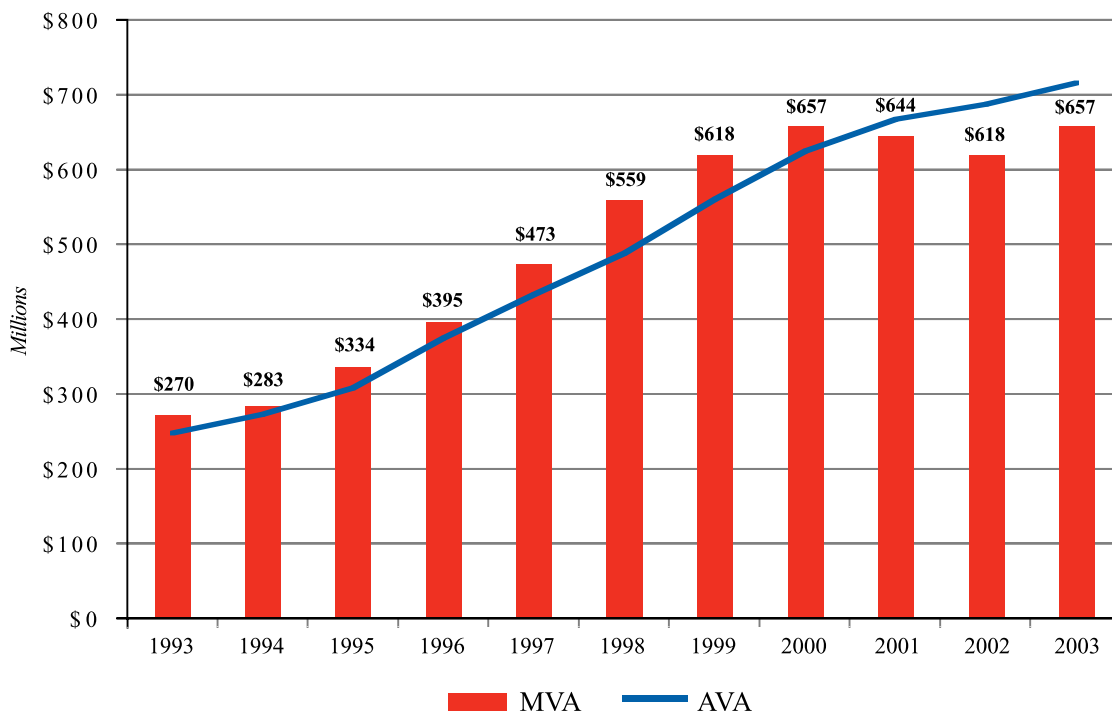
AVA - Actuarial value of assets

PVAB - Present value of accrued benefits

PSL - Past service liability

PVFB - Present value of future benefits

Growth in Assets



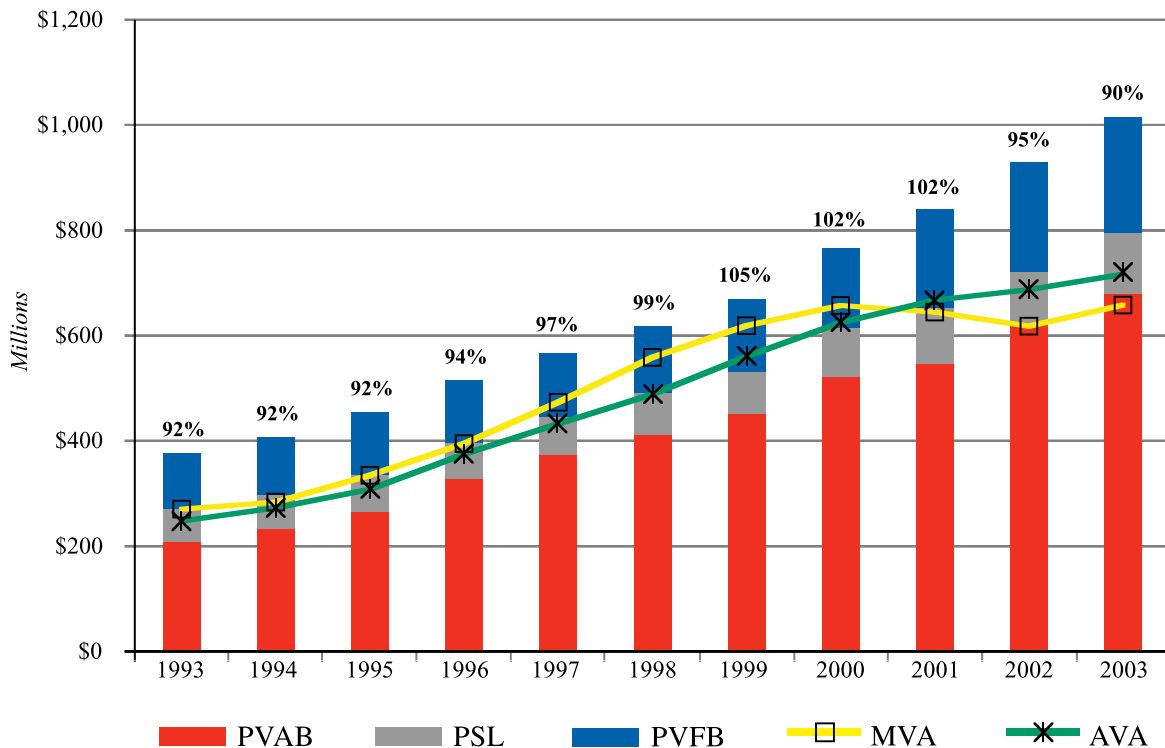
SUMMARY OF VALUATION RESULTS

(Continued)

The upward trend in market value of assets was reversed over the last two years as the equity bull market turned into a bear market. Due to the asset smoothing method in place, the actuarial value of assets did increase slightly over the year.

Over the period July 1, 1993 to June 30, 2003 the System's assets returned approximately 7.8% per year measured at Market Value, compared to a valuation assumption of 7.5% per year.

Assets and Liabilities



The three-colored bars represent the three different measures of liability mentioned in this report. For funding purposes, the target amount is represented by the top of the gray bar. We compare the actuarial value of assets to this measure of liability in developing the funded percent. These are the percentages shown in the graph labels.

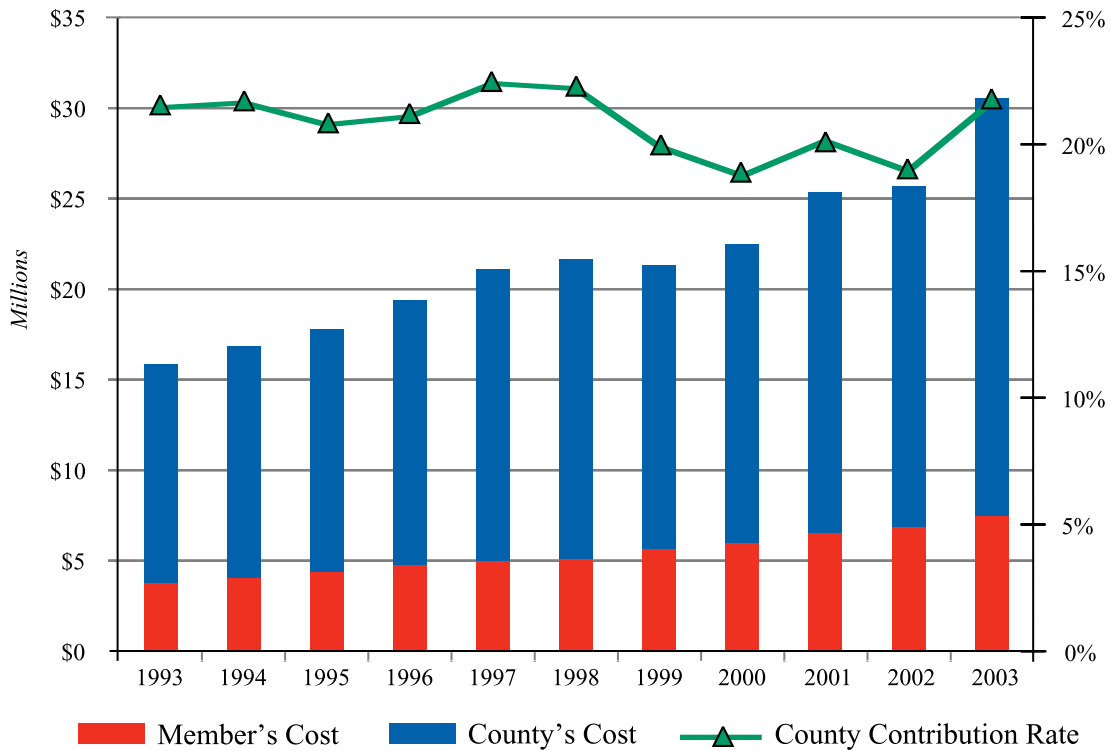
As you can see, the System had its highest funded percentage (105%) at July 1, 1999, before a combination of benefit improvements and the recent slide in the market. The amount represented by the top of the blue bars, the Present Value of Future Benefits (PVFB), is the amount needed to provide all benefits for the current participants and their beneficiaries. If the System had assets equal to the PVFB no contributions would, in theory, be needed for the current members.

ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS

(Continued)

Contribution Rates



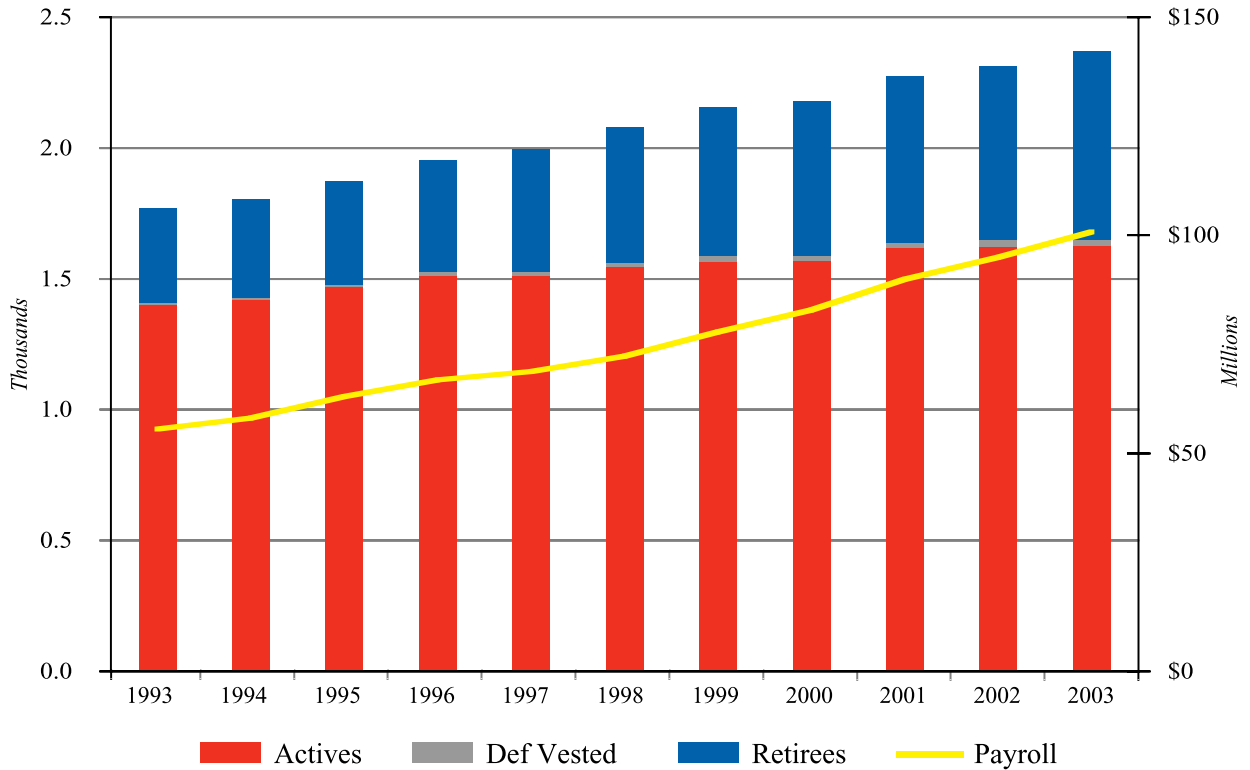
The stacked bars in this graph show the contributions made by both the County and the members in dollar terms. The line shows the County contribution rate as a percent of payroll.

The member contribution rate is set by the County Ordinance, depending on which plan the member elects to participate in. The County contribution rate is set by the actuarial process, as constrained by the Corridor Method. Please note there is a lag in the rate shown. For example, the 2003 value is the rate prepared by the 2001 valuation and implemented for the period July 1, 2002 to June 30, 2003.

SUMMARY OF VALUATION RESULTS

(Continued)

Participant Trends



As with many funds in this country, there has been a steady growth in the number of retired members as the System has matured.

The chart also shows that the number of actives covered by the plan has increased slightly over the ten-year period.

ACTUARIAL SECTION

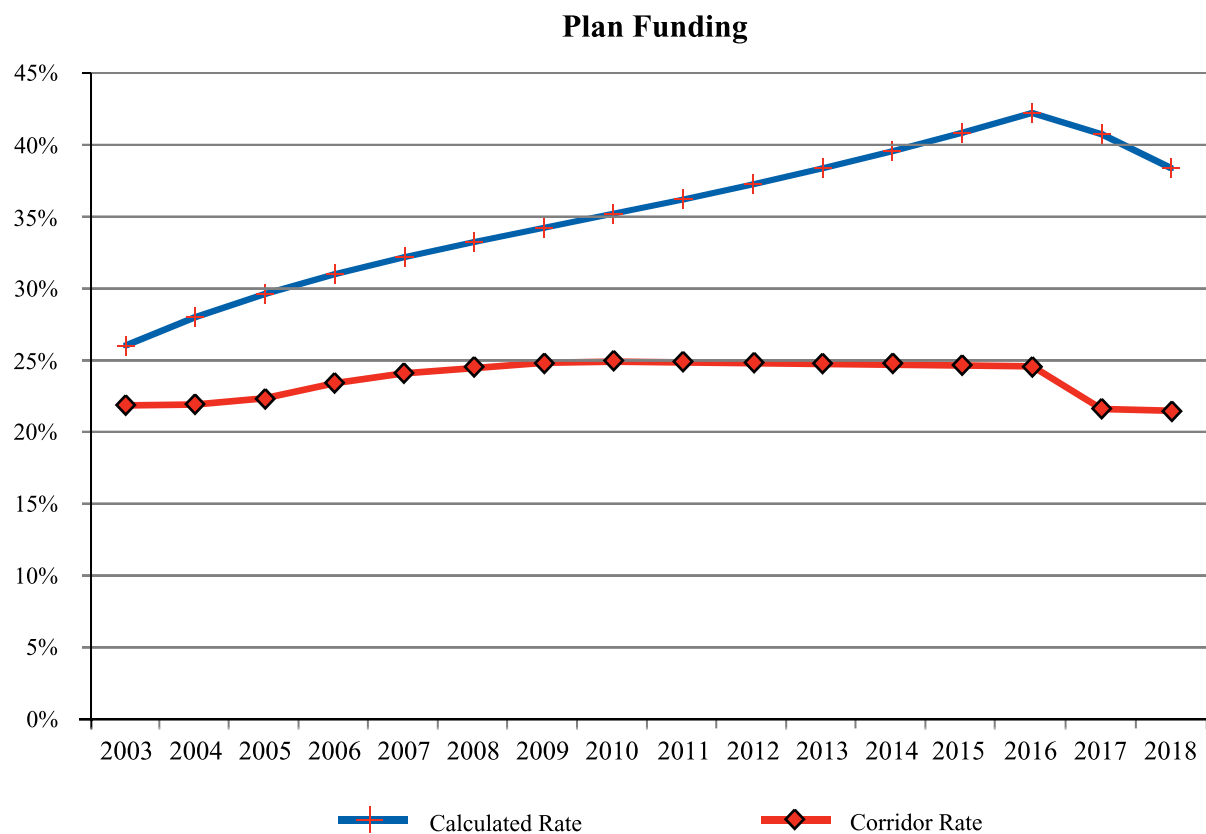
SUMMARY OF VALUATION RESULTS

(Continued)

Future Outlook

Baseline Projections

The following two charts show the expected progress of the plan over the next 15 years assuming the System's assets earn 7.5% on their *market value*. The chart entitled "Plan Funding" shows that the corridor is likely to be breached with the 2005 valuation (if all other actuarial assumptions are met as well as the 7.5% interest rate). The blue line shows the actuarially calculated rate if the corridor were not in place.

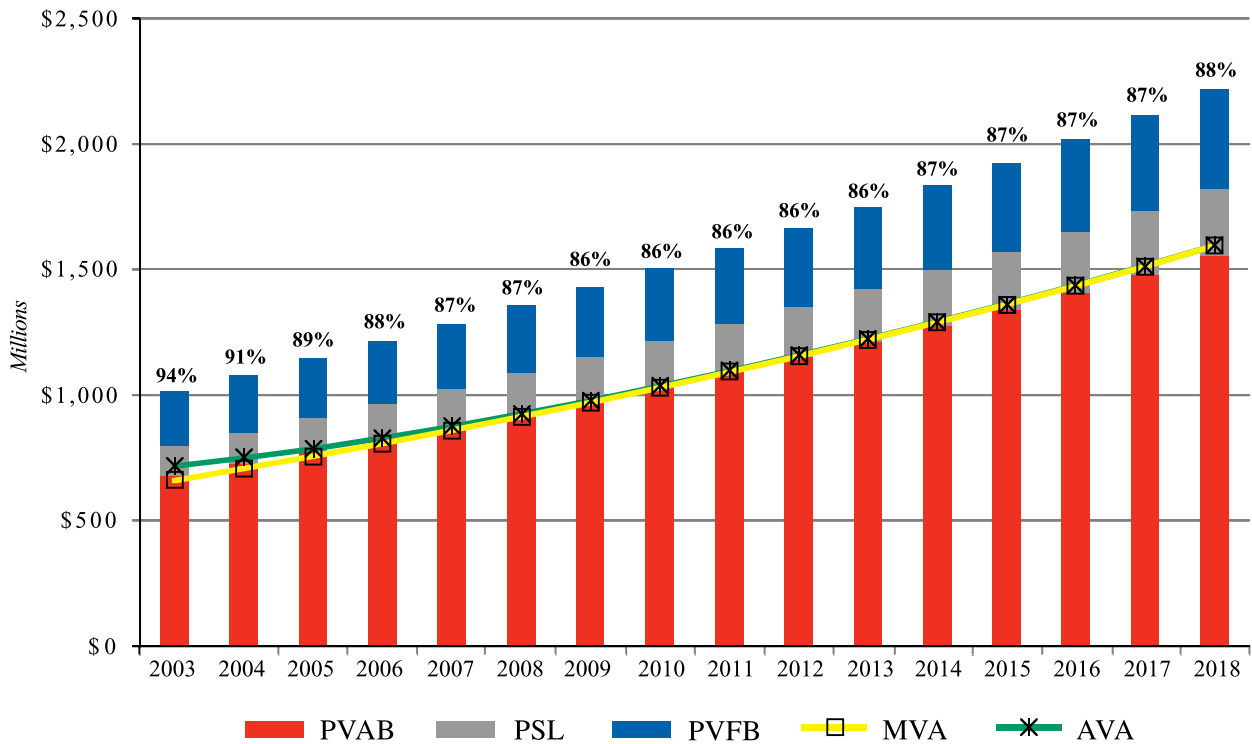


SUMMARY OF VALUATION RESULTS

(Continued)

The Assets and Liabilities chart shows the projected funding status over the next decade. This is the funded status adjusted by plan improvements, which is the basis used in the corridor method. If the currently unrecognized investment losses are allowed to flow into the calculation, the System's funded status is projected to drop from the current level of 94% down to around 86%. Once outside of the 90% corridor floor, the County's Rate will increase.

Assets and Liabilities



ACTUARIAL SECTION

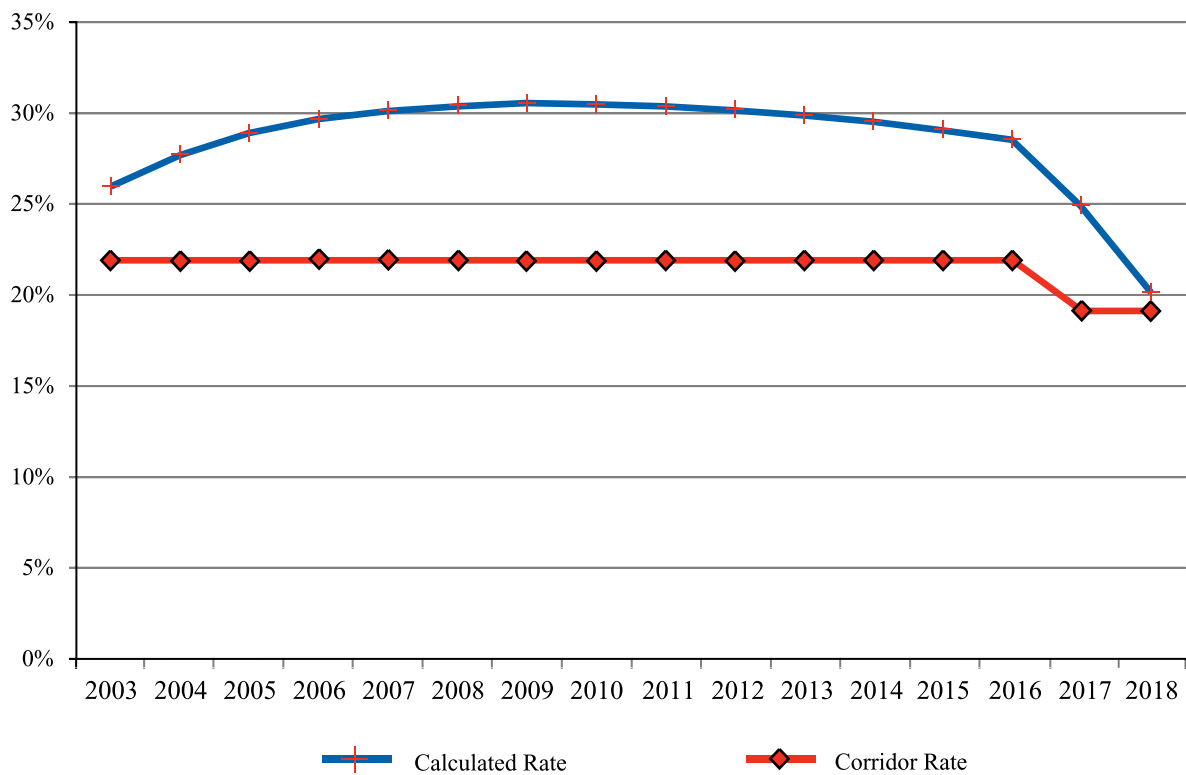
SUMMARY OF VALUATION RESULTS

(Continued)

Projections with asset returns of 9.0%

The future funding of this System will be largely driven by the investment earnings. Due to the size of assets, as compared to liabilities, the System is in a highly leveraged position. This means that relatively minor changes in the market returns can have significant effects on the System's status. The next two charts show what the coming decade would look like with a 9% annual return.

Plan Funding

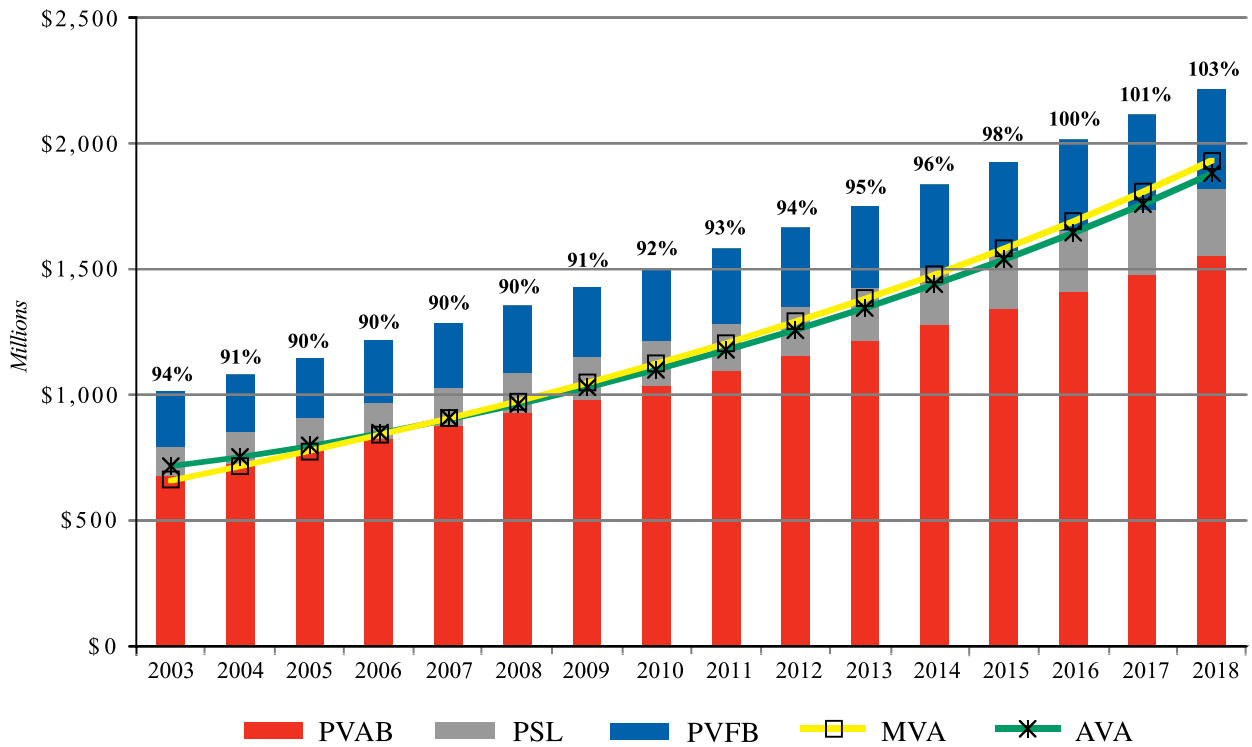


SUMMARY OF VALUATION RESULTS

(Continued)

As you can see, the corridor contribution rate would remain adequate for the entire 15 year period and the System would return to its fully funded position.

Assets and Liabilities



ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS

(Continued)

SUMMARY OF PRINCIPAL RESULTS

This table compares the principal results from the 2002 and 2003 valuations.

| <u>Participant Data</u> | <u>July 1, 2002</u> | <u>July 1, 2003</u> | <u>Percent Change</u> |
|---|---------------------|---------------------|-----------------------|
| Active members | 1,625 | 1,625 | 0.0% |
| Vested former members | 24 | 25 | 4.2% |
| Retired members and beneficiaries | <u>663</u> | <u>719</u> | 8.4% |
| Total | 2,312 | 2,369 | 2.5% |
| Annual salaries of active members | \$ 94,942,958 | \$100,749,162 | 6.1% |
| Annual retirement allowances for retired members and beneficiaries (Base amount only - not supplemental) | \$ 21,345,172 | \$ 23,946,156 | 12.2% |

| <u>Assets and Liabilities</u> | <u>July 1, 2002</u> | <u>July 1, 2003</u> | <u>Percent Change</u> |
|-----------------------------------|---------------------|---------------------|-----------------------|
| Total actuarial liability | \$720,995,743 | \$795,342,264 | 10.3% |
| Assets for valuation purposes | <u>687,093,049</u> | <u>715,797,245</u> | 4.2% |
| Unfunded actuarial liability | \$ 33,902,694 | \$ 79,545,019 | 134.6% |
| Funded ratio | 95.30% | 90.00% | |
| Present value of accrued benefits | \$624,043,025 | \$678,696,202 | |
| Market value of assets | <u>617,625,403</u> | <u>657,361,178</u> | |
| Unfunded FASB accrued liability | \$ 6,417,622 | \$ 21,335,024 | |
| Accrued benefit funding ratio | 98.97% | 96.86% | |

Contributions (as a percentage of payroll) **Fiscal Year 2004** **Fiscal Year 2005**

GASB Method:

| | | |
|---|--------------|--------------|
| Normal cost contribution | 18.95% | 18.95% |
| Unfunded actuarial liability contribution | 3.02% | 6.83% |
| Administrative expense | <u>0.25%</u> | <u>0.25%</u> |
| Total employer contribution – GASB method | 22.22% | 26.03% |

Corridor Method:

| | | |
|---|--------------|---------------------|
| Employer normal cost rate | 18.95% | 18.95% |
| Increase due to ad-hoc COLA & plan changes | 2.70% | 2.70% |
| Administrative expense | <u>0.25%</u> | <u>0.25%</u> |
| Total employer contribution – corridor method | 21.90% | 21.90% ¹ |

¹The budgeted FY 2005 rate is 24.30% to reflect an additional 0.70% for the DROP plan and 1.70% for the recently approved increase to retiree benefits.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

Funding Method

The funding method used for GASB disclosure purposes is the “aggregate accrual modification of the entry age normal cost method.” Under this method, the employer contribution has three components – the normal cost, the payment toward the unfunded actuarial liability, and the expense rate.

The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The level percent developed is called the normal cost rate and the product of that rate and payroll is the normal cost.

The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and funds accumulated as of the same date is referred to as the unfunded actuarial liability.

The expense rate is added to cover the System’s administrative expenses.

The County contributions are calculated using the same basic actuarial method (EAN). However, in order to produce a more level contribution rate, the System has adopted a Corridor Funding Method.

Under the Corridor Funding Method, the County’s total contribution rate is equal to the normal cost rate plus rate changes due to amendments passed since June 30, 2002 plus the expense rate as long as the System’s actuarial funded status remains within a corridor of 90% to 120%. If the funded status falls outside the corridor, a credit (if above 120%) or charge (if below 90%) will be established based on a 15-year amortization equal to the amount necessary to re-enter the corridor. Once the funded status is within the corridor, the contribution rate will return to normal cost rate plus expense rate, plus amortization of post-2002 plan changes.

Actuarial Value of Assets

For purposes of determining the County contribution to the plan, we use an actuarial value of assets. The asset adjustment method dampens the volatility in asset values that could occur because of fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process.

In determining the actuarial value of assets, we calculate an expected actuarial value based on cash flow for the year and imputed returns at the actuarial assumption. This expected value is compared to the market value and one-third of the difference is added to the preliminary actuarial value to arrive at the final actuarial value.

Changes Since Last Valuation

There have been no changes since the last valuation.

ACTUARIAL SECTION

ACTUARIAL ASSUMPTIONS AND METHODS

Long Term Assumptions Used to Determine System Costs and Liabilities

Demographic Assumptions

Mortality

1994 Uninsured Pensioners Mortality Table Annual Deaths Per 1,000 Members*

| <u>Age</u> | <u>Male Deaths</u> | <u>Female Deaths</u> | <u>Age</u> | <u>Male Deaths</u> | <u>Female Deaths</u> |
|------------|--------------------|----------------------|------------|--------------------|----------------------|
| 20 | 1 | 0 | 65 | 16 | 9 |
| 25 | 1 | 0 | 70 | 26 | 15 |
| 30 | 1 | 0 | 75 | 40 | 24 |
| 35 | 1 | 1 | 80 | 67 | 42 |
| 40 | 1 | 1 | 85 | 105 | 73 |
| 45 | 2 | 1 | 90 | 164 | 125 |
| 50 | 3 | 2 | 95 | 251 | 200 |
| 55 | 5 | 2 | 100 | 341 | 297 |
| 60 | 9 | 5 | 105 | 441 | 415 |

*5% of deaths are assumed to be service-connected.

Termination of Employment: (Prior to Normal Retirement Eligibility)

Annual Terminations per 1,000 Members

| <u>Age</u> | <u>Male</u> | <u>Female</u> |
|------------|-------------|---------------|
| 20 | 60 | 50 |
| 25 | 50 | 50 |
| 30 | 30 | 50 |
| 35 | 15 | 50 |
| 40 | 13 | 50 |
| 45 | 10 | 50 |
| 50 | 8 | 50 |

It is assumed that members who terminate before normal or early retirement age elect to receive a refund of contributions instead of vested benefits.

ACTUARIAL ASSUMPTIONS AND METHODS

(Continued)

Disability

| Annual Disabilities per 1,000 Members* | | Annual Deaths Per 1,000 Disabled Members 1994 Uninsured Pensioners Mortality Table +5 | | |
|--|------------------------|--|-------------|---------------|
| <u>Age</u> | <u>Male and Female</u> | <u>Age</u> | <u>Male</u> | <u>Female</u> |
| 25 | 2 | 40 | 2 | 1 |
| 30 | 2 | 45 | 3 | 2 |
| 35 | 3 | 50 | 5 | 2 |
| 40 | 4 | 55 | 9 | 5 |
| 45 | 6 | 60 | 16 | 9 |
| 50 | 10 | 65 | 26 | 15 |
| 55 | 17 | 70 | 40 | 24 |
| 60 | 24 | 75 | 67 | 42 |
| | | 80 | 105 | 73 |

*Disabilities are assumed to be all service-connected. Of these, 30% are assumed to receive Social Security benefits and 38% are assumed to receive Workers Compensation benefits.

Retirement

Annual Retirement per 1,000 eligible

| <u>Age</u> | <u>Early</u> | <u>Age</u> | <u>Normal</u> |
|------------|--------------|------------|---------------|
| 40 | 38 | 45-64 | 750 |
| 41 | 40 | 65 | 1,000 |
| 42 | 43 | | |
| 43 | 45 | | |
| 44 | 48 | | |
| 45 | 50 | | |
| 46 | 58 | | |
| 47 | 63 | | |
| 48 | 68 | | |
| 49 | 75 | | |
| 50 | 150 | | |
| 51 | 40 | | |

ACTUARIAL SECTION

ACTUARIAL ASSUMPTIONS AND METHODS

(Continued)

Merit/Seniority Salary Increase (In addition to across-the-board increase)

| <u>Age</u> | <u>Merit/Seniority Increase</u> |
|------------|---------------------------------|
| 25 | 4.5% |
| 30 | 4.0% |
| 35 | 2.8% |
| 40 | 1.7% |
| 45 | 0.7% |
| 50 | 0.4% |
| 55 | 0.1% |

Family Composition

For purposes of valuing the pre-retirement death benefit, an assumption concerning how many employees are married is needed. The assumption used in this valuation is that 80% of employees are married at death while active and that the female spouse is 3 years younger than the male spouse.

Sick Leave Credit

It is assumed that retirees, deferred vested terminations, and deceased members receive an additional 3% of service credit due to sick leave.

Economic Assumptions

Investment Return: 7.50% compounded per annum.

Rate of General Wage Increase: 4.00% compounded per annum.

Rate of Increase in Cost-of-Living: 4.00% compounded per annum.

(Benefit increases are limited to 4% per year. Post-retirement cost-of-living increases are assumed to be 3% per year.)

Total Payroll Increase (for amortization): 4.00% compounded per annum.

Administrative Expenses: 0.25% of payroll.

Changes Since Last Valuation

There have been no changes since the last valuation.

ANALYSIS OF FINANCIAL EXPERIENCE

Gain and Loss in Accrued Liability During Years Ended June 30 Resulting from Differences Between Assumed Experience and Actual Experience

| Type of Activity | <i>Gain (or Loss) for Year ending June 30,</i> | | | |
|---|--|---------------------|-----------------------|-----------------------|
| | 2000 | 2001 | 2002 | 2003 |
| Investment income | \$16,102,586 | (\$11,208,979) | (\$34,733,822) | (\$29,218,034) |
| Combined liability experience | (4,031,117) | (3,258,857) | 14,531,375 | (16,189,649) |
| Gain (or loss) during year from financial experience | \$12,071,469 | (\$14,467,836) | (\$20,202,447) | (\$45,407,683) |
| Non-recurring items | (32,173,276) | 17,110,280 | (30,388,171) | 0 |
| Composite gain (or loss) during year | (\$20,101,807) | \$ 2,642,444 | (\$50,590,618) | (\$45,407,683) |

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

| Year Ended June 30 | Added to Rolls | | Removed From Rolls | | On Rolls @ Yr. End | | % Increase Allowance | Average Allowance |
|--------------------------|----------------|---------------------|--------------------|---------------------|--------------------|---------------------|-------------------------|----------------------|
| | No. | Annual Allowance | No. | Annual Allowance | No. | Annual Allowance | | |
| 1998 | 57 | \$1,977,416 | 6 | \$221,966 | 518 | \$13,283,425 | 15.23% | \$25,644 |
| 1999 | 55 | 2,148,156 | 7 | 248,459 | 566 | 15,183,122 | 14.30% | 26,825 |
| 2000 | 29 | 1,982,436 | 6 | 234,523 | 589 | 16,931,035 | 11.51% | 28,745 |
| 2001 | 56 | 2,688,692 | 9 | 232,369 | 636 | 19,387,358 | 14.51% | 30,483 |
| 2002 | 34 | 2,152,809 | 7 | 241,817 | 663 | 21,298,350 | 9.86% | 32,124 |
| 2003 | 85 | 4,795,387 | 17 | 589,036 | 731 | 25,504,699 | 19.75% | 34,890 |

SOLVENCY TEST

Aggregate Accrued Liabilities For

| Valuation Date | (1) Active Member Contributions | (2) Retirees Vested Terms, Beneficiaries | (3) Active Members (Employer Financed Portion) | Reported Assets | Portion of Accrued Liabilities Covered by Reported Assets | | |
|-------------------|--|---|---|--------------------|---|------|------|
| | | | | | (1) | (2) | (3) |
| 7/1/1998 | \$53,335,936 | \$186,017,535 | \$251,789,374 | \$487,989,565 | 100% | 100% | 99% |
| 7/1/1999 | 56,975,778 | 211,276,417 | 263,536,559 | 560,044,161 | 100% | 100% | 111% |
| 7/1/2000 | 62,528,390 | 231,064,298 | 320,649,967 | 624,297,885 | 100% | 100% | 103% |
| 7/1/2001 | 63,630,360 | 267,348,939 | 320,860,989 | 666,599,019 | 100% | 100% | 105% |
| 7/1/2002 | 72,967,375 | 290,395,797 | 357,632,571 | 687,093,049 | 100% | 100% | 91% |
| 7/1/2003 | 75,564,839 | 347,474,506 | 372,302,919 | 715,797,245 | 100% | 100% | 79% |

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SCHEDULE OF ADDITIONS BY SOURCE

| Fiscal Year | Plan Member Contributions | Employer Contributions | Employer Contributions % of Covered Payroll | Net Investment Income (loss) | Total Additions |
|-------------|---------------------------|------------------------|---|------------------------------|-----------------|
| 1999 | \$5,680,758 | \$15,645,845 | 19.90% | \$ 53,829,235 | \$ 75,155,838 |
| 2000 | 6,002,735 | 16,489,406 | 19.90% | 32,133,144 | 54,625,285 |
| 2001 | 6,525,647 | 18,818,351 | 20.11% | (18,768,044) | 6,575,954 |
| 2002 | 6,892,667 | 18,778,608 | 18.93% | (31,599,441) | (5,928,166) |
| 2003 | 7,478,708 | 23,027,237 | 21.65% | 33,576,497 | 64,082,442 |
| 2004 | 7,800,284 | 24,823,288 | 21.90% | 94,008,180 | 126,631,752 |

SCHEDULE OF DEDUCTIONS BY TYPE

| Fiscal Year | Benefit Payments | Refunds of Contributions | Administrative Expenses | Total Deductions |
|-------------|------------------|--------------------------|-------------------------|------------------|
| 1999 | \$14,519,619 | \$625,970 | \$151,801 | \$15,297,390 |
| 2000 | 15,696,421 | 670,016 | 200,089 | 16,566,526 |
| 2001 | 18,341,664 | 336,462 | 219,827 | 18,897,953 |
| 2002 | 20,116,400 | 290,966 | 220,125 | 20,627,491 |
| 2003 | 23,863,933 | 259,624 | 223,110 | 24,346,667 |
| 2004 | 27,954,431 | 452,616 | 297,188 | 28,704,235 |

STATISTICAL SECTION

SCHEDULE OF BENEFIT PAYMENTS BY TYPE

| Fiscal Year Ended June 30 | Annuity | Service- Connected Disability | Ordinary Disability | Survivor | Total |
|---------------------------------|--------------|-------------------------------------|------------------------|-----------|--------------|
| 1999 | \$ 9,317,650 | \$4,731,370 | \$203,537 | \$267,062 | \$14,519,619 |
| 2000 | 10,217,461 | 5,002,237 | 213,311 | 263,412 | 15,696,421 |
| 2001 | 12,521,546 | 5,283,214 | 222,066 | 315,838 | 18,342,664 |
| 2002 | 13,996,618 | 5,546,273 | 244,173 | 329,336 | 20,116,400 |
| 2003 | 17,410,370 | 5,806,457 | 269,750 | 377,356 | 23,863,933 |
| 2004 | 21,252,301 | 6,148,149 | 159,241 | 394,740 | 27,954,431 |

SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE

| Fiscal Year Ended June 30 | Annuity | Service- Connected Disability | Ordinary Disability | Survivor | Total |
|---------------------------------|---------|-------------------------------------|------------------------|----------|-------|
| 1999 | 347 | 188 | 15 | 17 | 567 |
| 2000 | 368 | 188 | 15 | 18 | 589 |
| 2001 | 411 | 191 | 15 | 19 | 636 |
| 2002 | 437 | 191 | 15 | 20 | 663 |
| 2003 | 503 | 191 | 17 | 20 | 731 |
| 2004 | 533 | 194 | 17 | 22 | 766 |

SCHEDULE OF AVERAGE MONTHLY BENEFIT AMOUNTS

| Fiscal Year Ended June 30 | Annuity | Service- Connected Disability | Ordinary Disability | Survivor | Average |
|---------------------------------|---------|-------------------------------------|------------------------|----------|---------|
| 1999 | \$2,534 | \$2,183 | \$1,186 | \$1,188 | \$2,342 |
| 2000 | 2,532 | 2,325 | 1,232 | 1,315 | 2,396 |
| 2001 | 2,697 | 2,419 | 1,276 | 1,356 | 2,540 |
| 2002 | 2,853 | 2,527 | 1,368 | 1,436 | 2,683 |
| 2003 | 3,166 | 2,659 | 1,460 | 1,477 | 2,948 |
| 2004 | 3,529 | 2,684 | 1,442 | 1,735 | 3,221 |



**FAIRFAX COUNTY RETIREMENT
ADMINISTRATION AGENCY**

10680 MAIN STREET, SUITE 280 ★ FAIRFAX, VIRGINIA 22030