

SECTION 2

FINANCIAL SECTION

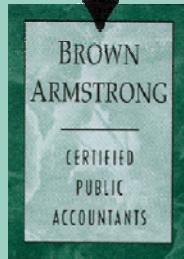
FINANCIAL SECTION

Caring For Your Future...



INDEPENDENT AUDITOR'S REPORT

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INDEPENDENT AUDITOR'S REPORT

To The Board of Retirement
 City of Fresno Employees Retirement System
 Fresno, California

We have audited the accompanying Statement of Plan Net Assets Available for Benefits of the City of Fresno Employees Retirement System as of June 30, 2009 and 2008, and the related Statement of Changes in Plan Net Assets Available for Benefits for the years then ended. These financial statements are the responsibility of the management of the City of Fresno Employees Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 2 to the financial statements, in 2008/09, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statements No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

In our opinion, the financial statements referred to above present fairly, in all material respects, the Plan Net assets of the City of Fresno Employees Retirement System, as of June 30, 2009 and 2008, and its Changes in Plan Net Assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information identified as Management's Discussion and Analysis (MD&A) and Required Supplementary Information (RSI) as listed in the table of contents are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the MD&A and express no opinion on it. The RSI has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Supplemental Schedules and the Investment, Actuarial, and Statistical Sections as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements of the System. The Supplemental Schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. We did not audit the information contained in the Investment, Actuarial and Statistical sections and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 25, 2009, on our consideration of the City of Fresno Employees Retirement System internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 25, 2009



MANAGEMENT'S DISCUSSION AND ANALYSIS

We are pleased to provide this overview and analysis of the financial activities of the City of Fresno Employees Retirement System for the fiscal year ended June 30, 2009. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the Letter of Transmittal beginning on page iii of this report.

FINANCIAL HIGHLIGHTS

The net assets of the System are held in trust for payment of pension benefits to participants and their beneficiaries and all of the net assets are available to meet the System's ongoing obligations.

At the close of the fiscal year 2009, the assets of the System exceed its liabilities by \$735,578,804; as of fiscal year 2008, the assets of the System exceeded its liabilities by \$969,030,584 and as of fiscal year 2007, the assets of the System exceeded its liabilities by \$1,068,859,346.

The System's total net assets held in trust for pension benefits decreased by \$233,451,780 or -24.09 percent for fiscal year 2009; decreased by \$99,828,762 or -9.34 percent for fiscal year 2008; and increased by \$122,990,498 or 13.0 percent for fiscal year 2007, primarily as a result of the performance of the investment markets.

The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2008, the date of the last actuarial valuation, the funded ratio for the Systems was 142.2 percent. In general, this indicates that for every dollar of benefits due we have approximately \$1.42 of assets available for payment as of that date.

As of the June 30, 2007, the date of the previous annual actuarial valuation, the funded ratio for the

System was 146.8 percent; and as of June 30, 2006, the funded ratio for the System was 138.1 percent.

REVENUES ARE ADDITIONS TO PLAN NET ASSETS

Revenues for the fiscal year 2009 decreased \$130,042,744 or 208.2 percent over the prior year from \$-62,461,336 to \$-192,504,080 which includes member contributions of \$5,845,044, employer contributions of \$1,345,274, a net investment income loss of \$200,504,487 and net securities lending income of \$810,089.

Prior fiscal year 2008 revenues decreased \$225,667,602 or 138.3 percent over the previous fiscal year 2007 from \$163,206,266 to \$-62,461,336 which includes member contributions of \$5,665,627, employer contributions of \$354,894, a net investment income of \$-69,498,414 and net securities lending income of \$1,016,557.

For fiscal year 2007 revenues increased \$58,476,243 or 55.8 percent from \$104,730,023 to \$163,206,266 which included member contributions of \$5,094,188, net investment income of \$156,000,084 and securities lending income of \$545,779.

EXPENSES ARE DEDUCTIONS IN PLAN NET ASSETS

Expenses for the fiscal year increased \$3,580,274 or 9.58 percent over the prior fiscal year from \$37,367,426 to \$40,947,700.

Prior fiscal year 2008 expenses decreased \$2,848,342 or 7.08 percent over the fiscal year 2007 from \$40,215,768 to \$37,367,426.

Fiscal year 2007 expenses increased approximately 28.00 percent from \$31,426,260 to \$40,215,768 over fiscal year 2006 expenses.

The current year increase in expenses is due primarily to the increases in retirees and the respective retirement

benefits paid in 2009 along with an increase in the Post Retirement Supplemental Benefits paid over the prior year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The following discussion and analysis are intended to serve as an introduction to the System's financial statements, which are comprised of these components:

1. Statement of Plan Net Assets Available for Benefits
2. Statement of Changes in Plan Net Assets Available for Benefits
3. Notes to the Financial Statements

Please note, however, that this report also contains other supplementary information in addition to the basic financial statements themselves.

The Statement of Plan Net Assets Available for Benefits is a point in time or a snapshot of account balances as of the fiscal year end. It indicates the assets available for future payments to retirees and any current liabilities.

The Statement of Changes in Plan Net Assets Available for Benefits, on the other hand, provides a view of current year additions to and deductions from the System. Both statements are in compliance with Governmental Accounting Standards Board (GASB) Pronouncements. These pronouncements require certain disclosures and require State and Local governments to report using the full accrual method of accounting. The System complies with all material requirements of these pronouncements.

The System's funding ratio at June 30, 2008 was 142.2 percent, which means the System's fund has approximately \$1.42 available for each \$1.00 of liability. The Statement of Plan Net Assets Available for Benefits and the Statement of Changes in Plan Net Assets Available for Benefits reports information about the System's activities.

These statements include all assets and liabilities, using the full accrual basis of accounting, which is similar to the accounting method used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid. All investment gains and losses are shown at trade date, not settlement date. In addition, both realized and unrealized gains and losses are shown on investments.

These two statements report the System's net assets held in trust for pension benefits (net assets), which is the difference between assets and liabilities. This is generally considered to be a good way to measure the System's financial position. Over time, increases and decreases in the System's net assets are indicators of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should be considered in measuring the System's overall health.

Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

OTHER INFORMATION

In addition to the financial statements and accompanying notes, this report presents certain required supplementary information concerning the System's progress in funding its obligations to provide pension benefits to members.

The schedules of administrative expenses, investment manager fees and other investment expenses, and payments to consultants are presented immediately following the required supplementary information.

FINANCIAL ANALYSIS

As previously noted, net assets may serve over time as a useful indication of the System's financial position. The assets of the System exceeded its liabilities at the close of the fiscal year 2009 by \$735,578,804. All of the net assets are available to meet the System's ongoing obligations to plan participants and their beneficiaries.

The fund's combined net assets held in trust for pension benefits have generally increased each fiscal year since 1995 with the exception of losses incurred in fiscal years 2001, 2002, 2008 and now 2009. In fiscal year 2009, net assets decreased by 24.09 percent; and in 2008, net assets decreased by 9.34 percent due to a declines in the global investment markets, while in 2007, net assets increased by 13.0 percent.

The System averaged an annualized investment return of 3.02 percent over the past ten years. While this means that the ten year annualized investment return has underperformed the actuarial assumption of 8.25 percent by 5.23 percent, it has exceeded the weighted policy benchmark for that same period by 0.09 percent.

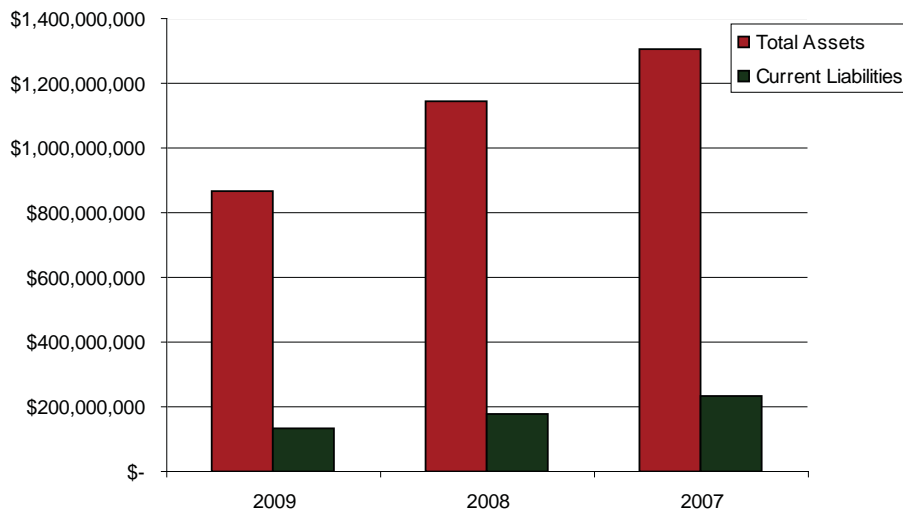
Despite volatility in the stock market, management and the System's actuary concur that the System remains in a very strong financial position to meet its obligations to the plan participants and beneficiaries. The System's current financial position is a result of a very sound and carefully managed investment and risk management program.

TABLE 1 - EMPLOYEES RETIREMENT SYSTEM NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2009, 2008 AND 2007

	FY 2009	FY 2008	FY 2009 Increase/ (Decrease) Amount	FY 2009 Increase/ (Decrease) Percent
Current and Other Assets	\$ 125,344,264	\$ 173,867,809	\$ (48,523,545)	-27.91%
Investments at Fair Value	742,266,253	972,609,226	(230,342,973)	-23.68%
Total Assets	\$ 867,610,517	\$1,146,477,035	\$ (278,866,518)	-24.32%
Current Liabilities	132,031,713	177,446,451	(45,414,738)	-25.59%
Net Assets	\$ 735,578,804	\$ 969,030,584	\$ (233,451,780)	-24.09%

	FY 2008	FY 2007	FY 2008 Increase/ (Decrease) Amount	FY 2008 Increase/ (Decrease) Percent
Current and Other Assets	\$ 173,867,809	\$ 222,908,068	\$ (49,040,259)	-22.00%
Investments at Fair Value	972,609,226	1,080,673,613	(108,064,387)	-10.00%
Total Assets	\$1,146,477,035	\$1,303,581,681	\$(157,104,646)	-12.05%
Current Liabilities	177,446,451	234,722,335	(57,275,884)	-24.40%
Net Assets	\$ 969,030,584	\$1,068,859,346	\$ (99,828,762)	-9.34%

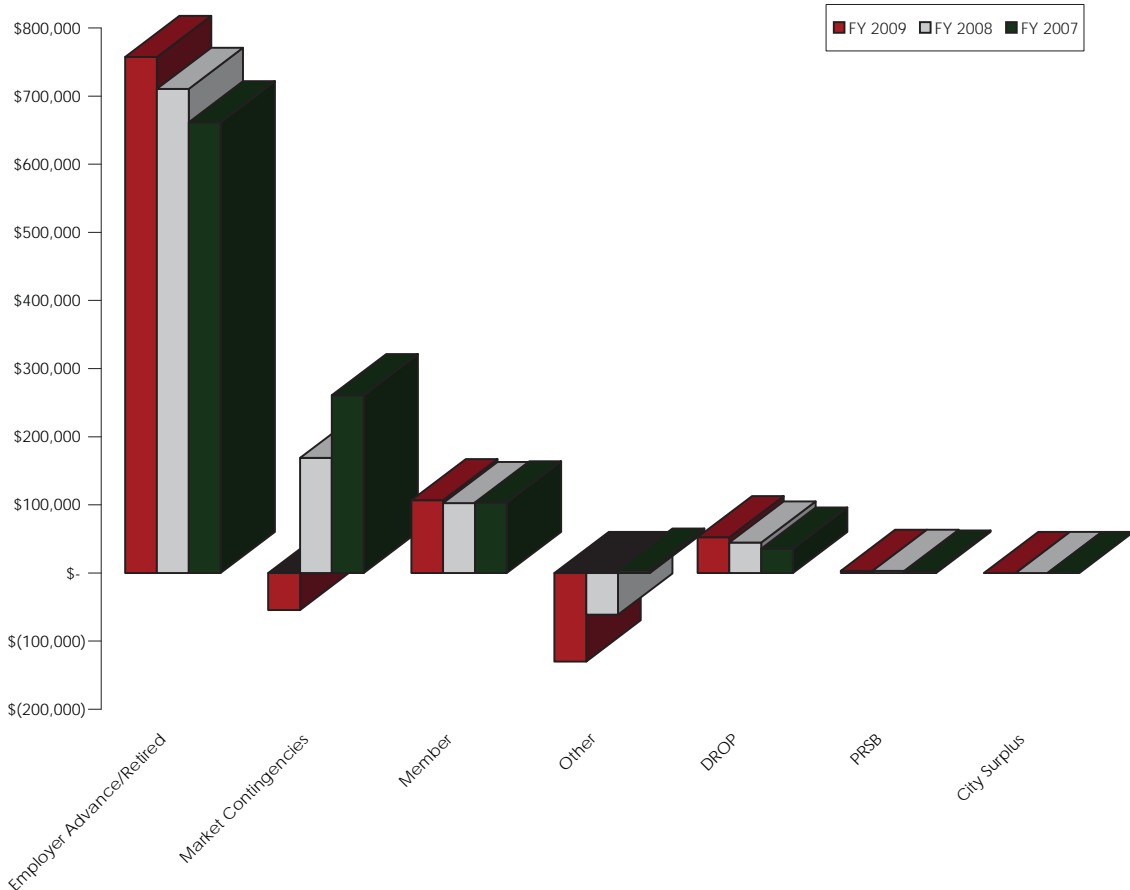


RESERVES

The System's reserves are established from contributions and the accumulation of investment income, after satisfying investment and administrative expenses. Under GASB Statement No. 25, investments are stated at fair value instead of at cost and fair value includes the recognition of unrealized gains and losses in the current period. These unrealized gains and losses are held in a reserve account called the Market Contingencies Reserve.

TABLE 2 – EMPLOYEES RETIREMENT SYSTEM'S RESERVES
FOR THE YEARS ENDED JUNE 30, 2009, 2008 AND 2007 (IN THOUSANDS)

	2009	2008	2007
Employer Advance/Retired Reserves	\$757,306	\$710,630	\$661,619
Member Reserves	106,844	102,672	103,769
DROP Reserves	52,494	44,812	35,813
PRSB Reserves	3,053	3,255	1,963
Market Contingencies Reserves	(54,225)	168,896	261,011
Other Reserves	(129,893)	(61,235)	4,684
City Surplus Reserves	-	-	-
Net Assets Available for Benefits	\$735,579	\$969,030	\$1,068,859



CAPITAL ASSETS

The capital assets of the System presently consist of furniture for the 7,900 square foot office space occupied by the Retirement Administrative Office.

SYSTEM'S ACTIVITIES

Primarily due to the downturn in performance of the global investment markets, the System's assets decreased \$233,451,780 for the fiscal year resulting in a 24.09 percent decrease in net assets for the fiscal year ended June 30, 2009. Due to the downturn in performance of the global investment markets in the prior fiscal year, the System's assets decreased \$99,828,762 resulting in a 9.34 percent decrease in net asset for the fiscal year ended June 30, 2008. While fiscal year ended June 30, 2007, due to steady growth in real estate and equity markets returns as well as an increase in revenue earned from securities lending, the System's assets increased \$122,990,498 for the fiscal year resulting in a 13.00 percent increase in net assets for the fiscal year ended June 30, 2007.

Key elements of these decreases are described in the sections below.

REVENUES - ADDITIONS TO SYSTEM'S NET ASSETS

The reserves needed to finance retirement benefits are normally accumulated through the collection of employer and employee contributions and through earnings on investment income [net of investment expense]. Revenues for the fiscal year ended June 30, 2009 totaled \$-192,504,080.

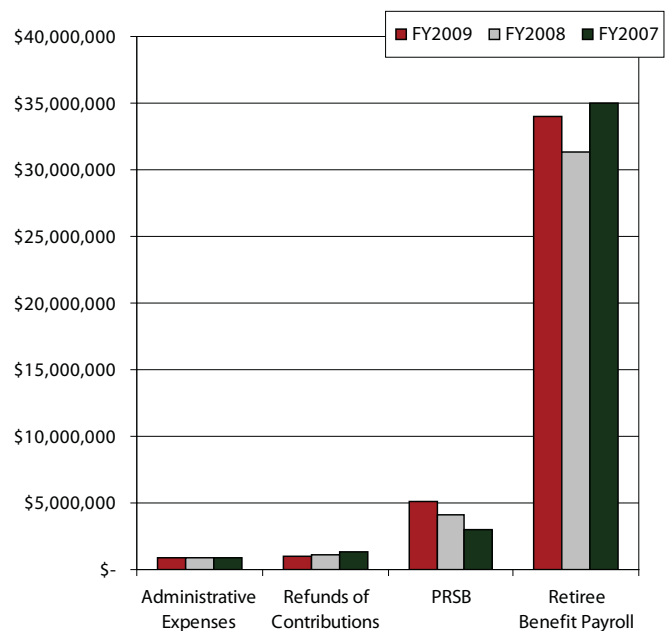
For the fiscal year ended June 30, 2009, overall revenues had decreased by \$130,042,744 or 208.20% percent from the prior year, primarily due to the performance of the investment markets; for fiscal year ended June 30, 2008, overall revenues decreased by \$225,667,602 or -138.27%; and for fiscal year ended June 30, 2007, overall revenues increased by \$58,476,243 or 55.84 percent from the prior year. The investment section of this report reviews the details of results of investment activity for the fiscal year ended June 30, 2009.

EXPENSES - DEDUCTIONS FROM SYSTEM'S NET ASSETS

The System was created to provide lifetime retirement annuities, survivor benefits and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, as designated by the plan, refunds of contributions to terminated employees, and the cost of administering the System.

Deductions for the fiscal year ended June 30, 2009, totaled \$40,947,700 which was an increase of 9.58 percent over the prior fiscal year. The decrease in benefits paid resulted primarily from a decrease in the amount of contributions refunded to terminated members and a one-time retroactive litigation settlement benefit payment paid in the prior year which significantly increased benefit payments in the prior year.

The System's decreases in total expenses are reflective of the decline in global investment markets and incorporate inflation and the growth in the membership and services provided. The System has consistently met its Administrative Expense Budget. There are no material variances between planned expenditures and actual expenditures.



CHANGES IN PLAN NET ASSETS (CONDENSED)

FOR THE YEARS ENDED JUNE 30, 2009, 2008 AND 2007

	FY 2009	FY 2008	FY 2009 Increase/(Decrease) Amount	FY 2009 Increase/(Decrease) Percent
Additions (Declines)				
Employee Contributions	\$5,845,044	\$5,665,627	\$179,417	3.17%
Employer Contributions	1,345,274	354,894	990,380	279.06%
Net Investment Income (Loss) *	(199,694,398)	(68,481,857)	(131,212,541)	-191.60%
Total Additions (Declines)	\$(192,504,080)	\$(62,461,336)	\$(130,042,744)	-208.20%
Deductions				
Retiree Benefit Payroll	33,946,712	31,285,999	2,660,713	8.50%
Refunds of Contributions	1,022,243	1,111,562	(89,319)	-8.04%
PRSB	5,084,478	4,071,510	1,012,968	24.88%
Administrative Expenses	894,267	898,355	(4,088)	-0.46%
Total Deductions	\$40,947,700	\$37,367,426	\$3,580,274	9.58%
Increase (Decrease) in Plan Net Assets	(233,451,780)	(99,828,762)	(133,623,018)	-133.85%
Beginning Plan Net Assets	969,030,584	1,068,859,346	(99,828,762)	-9.34%
Ending Plan Net Assets	\$735,578,804	\$969,030,584	\$(233,451,780)	-24.09%

* Net of investment expense of \$4,723,249 and \$5,955,230 for June 30, 2009 and 2008, respectively.

	FY 2008	FY 2007	FY 2008 Increase/(Decrease) Amount	FY 2008 Increase/(Decrease) Percent
Additions (Declines)				
Employee Contributions	\$5,665,627	\$5,094,188	\$571,439	11.22%
Employer Contributions	354,894	1,566,215	(1,211,321)	-77.34%
Net Investment Income *	(68,481,857)	156,545,863	(225,027,720)	-143.75%
Total Additions (Declines)	\$(62,461,336)	\$163,206,266	\$(225,667,602)	-138.27%
Deductions				
Retiree Benefit Payroll	31,285,999	34,981,738	(3,695,739)	-10.56%
Refunds of Contributions	1,111,562	1,350,623	(239,061)	-17.70%
PRSB	4,071,510	2,966,913	1,104,597	37.23%
Administrative Expenses	898,355	916,494	(18,139)	-1.98%
Total Deductions	\$37,367,426	\$40,215,768	\$(2,848,342)	-7.08%
Increase (Decrease) in Plan Net Assets	(99,828,762)	122,990,498	(222,819,260)	-181.17%
Beginning Plan Net Assets	1,068,859,346	945,868,848	122,990,498	13.00%
Ending Plan Net Assets	\$969,030,584	\$1,068,859,346	\$(99,828,762)	-9.34%

* Net of investment expense of \$5,955,230 and \$6,225,385 for June 30, 2008 and 2007, respectively.

SYSTEM'S FIDUCIARY RESPONSIBILITIES

The System's Board and management staff are fiduciaries of the pension trust fund. Under the California Constitution, the assets must be used exclusively for the benefit of plan participants and their beneficiaries.

REQUESTS FOR INFORMATION

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investment managers, and creditors with a general overview of the City of Fresno Employees Retirement System's finances, and to show accountability for the funds it receives. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to:

City of Fresno Employees Retirement System
2828 Fresno Street Suite 201
Fresno, California 93721-1327

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Stanley L. McDivitt', with a stylized flourish at the end.

Stanley L. McDivitt
Retirement Administrator

November 25, 2009

STATEMENT OF PLAN NET ASSETS AVAILABLE FOR BENEFITS

AS OF JUNE 30, 2009 AND 2008

	2009	2008
ASSETS		
Cash (Note 6)	\$ 862,300	\$ 1,925,327
Collateral Held for Securities Lent (Note 8)	107,455,620	159,026,067
Receivables		
Receivables for Investments Sold	8,065,297	7,413,664
Interest and Dividends	3,534,494	3,739,422
Other Receivables	5,256,254	1,596,003
Total Receivables	16,856,045	12,749,089
Prepaid Expenses	109,767	105,045
Total Current Assets	125,283,732	173,805,528
Investments at Fair Value (Note 6)		
(Cost of \$786,229,948 in 2009 and \$946,800,887 in 2008)		
Domestic Equity	193,087,111	351,169,481
International Equity	184,229,080	186,745,940
Government Bonds	113,517,600	135,495,656
Corporate Bonds	127,064,660	150,820,057
Real Estate	73,145,372	105,206,253
Emerging Market Equity	35,009,363	27,807,080
Short Term Investments	16,213,067	15,364,759
Total Investments	742,266,253	972,609,226
Capital Assets Net of Accumulated Depreciation (Note 11)	60,532	62,281
Total Assets	867,610,517	1,146,477,035
LIABILITIES		
Collateral Held for Securities Lent (Note 8)	107,455,620	159,026,067
Payable for Investments Purchased	13,447,754	11,233,459
Prepaid Employer Contributions (Note 4)	3,088,481	4,106,927
Other Liabilities	2,763,098	1,426,365
Payable for Foreign Currency Purchased	5,276,760	1,653,633
Total Liabilities	132,031,713	177,446,451
Net Assets Held In Trust for Benefits	\$735,578,804	\$ 969,030,584

The notes to the financial statements on pages 14 to 28 are an integral part of this statement.

STATEMENT OF CHANGES IN PLAN NET ASSETS AVAILABLE FOR BENEFITS

FOR THE YEARS JUNE 30, 2009 AND 2008

	2009	2008
ADDITIONS		
Contributions		
Employer	\$ 1,345,274	\$ 354,894
System Members	5,845,044	5,665,627
Total Contributions	7,190,318	6,020,521
Investment Income		
Net Appreciation (Depreciation) in Value of Investments	(223,121,456)	(92,114,521)
Interest	16,671,904	16,492,071
Dividends	10,595,933	11,984,326
Other Investment Related	72,381	94,940
Total Investment Income (Loss)	(195,781,238)	(63,543,184)
Less: Investment Expense	(4,723,249)	(5,955,230)
Total Net Investment Income (Loss)	(200,504,487)	(69,498,414)
Securities Lending Income		
Securities Lending Earnings (Note 8)	1,731,978	7,596,520
Less: Securities Lending Expense	(921,889)	(6,579,963)
Net Securities Lending Income	810,089	1,016,557
Total Additions (Declines)	(192,504,080)	(62,461,336)
DEDUCTIONS		
Benefit Payments	33,946,712	31,285,999
Post Retirement Supplemental Benefits	5,084,478	4,071,510
Refunds of Contributions	1,022,243	1,111,562
Administrative Expense	894,267	898,355
Total Deductions	40,947,700	37,367,426
Net Increase (Decrease)	(233,451,780)	(99,828,762)
NET ASSETS HELD IN TRUST FOR BENEFITS		
July 1	969,030,584	1,068,859,346
June 30	\$ 735,578,804	\$ 969,030,584

NOTES TO FINANCIAL STATEMENTS

1 DESCRIPTION OF THE SYSTEM

The Employees Retirement System ("System") was established on June 1, 1939, and is governed by Article 5 of Chapter 3 of the City of Fresno Municipal Code. It is administered by the Retirement Board but not under the control of the City Council. The System is a single employer public employee retirement system that includes substantially all full-time employees, other than sworn officers of the Fire and Police Departments.

Total participants of the System were comprised as follows at June 30, 2009 and 2008:

	2009	2008
Active Members		
Vested	1,657	1,626
Non-vested	840	889
Total Active Members	<u>2,497</u>	<u>2,515</u>
Retirees and Beneficiaries of Deceased Retirees		
Currently Receiving Benefits	1,402	1,363
Inactive Vested Members	184	192
Total	<u>4,083</u>	<u>4,070</u>

Pension benefits are based upon a combination of age, years of service, monthly salary, and the option selected by the participant. Death and disability benefits are additionally based upon whether the death occurred before or after retirement. Members' contributions, including interest, are 100 percent vested at all times. Employer contributions do not become vested until completion of 5 years of credited service when they become 100 percent vested, but are not payable until the member attains the age of 55.

Contributions are made by the members and the employer at rates recommended by the System's independent actuary and adopted by the Retirement Board. Employee contribution rates vary according to age and are designed to provide funding for approximately one-third of retirement benefit basic normal costs and one-half of the cost of living component.

The City's contribution rate is designed to provide funding for the remaining regular retirement and cost-of-living benefits, as well as all regular disability and survivors' benefits.

Cost-of-living increases for retirees under the Employees Retirement System are provided for in the Municipal Code, and are determined by changes in the Consumer Price Index.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Retirement System, with its own governing board, is an independent governmental entity separate and distinct from the City of Fresno. The System's annual financial statements are included in the City of Fresno Annual Financial Report as a pension trust fund.

Basis of Accounting

The System uses the accrual basis of accounting. Investment income is recognized when it is earned and expenses are recognized when they are incurred. Contributions are recognized when due. Benefits and refunds are recognized when due and payable under the terms of the Plan per Section 3-523 and 3-529 of the Municipal Code.

Securities lending transactions are accounted for in accordance with GASB Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, which establishes reporting standards for securities lending transactions. In accordance with Statement No. 28, cash received as collateral on securities lending transactions and investments made with that cash are reported as assets, and liabilities resulting from these transactions are reported in the Statement of Plan Net Assets. In addition, the costs of securities lending transactions are reported as an expense in the Statement of Changes in Plan Net Assets.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Valuation of Investments

System investments are reported at fair value, calculated as cost plus unrealized gains or losses. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments in both bonds and mortgage-backed pass-through certificates are carried at fair value.

Cost values, as shown, are derived from Master Custodial Transaction Records. The fair value of real estate investments is based on independent appraisals. Investments that do not have an established market are reported at estimated fair values.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the System administrator to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results may differ from those estimates.

New Accounting Pronouncements

The provisions of Governmental Standards (GASB) Statement No. 52, Land and other Real Estate held as Investments by Endowments, is to be implemented as of June 30, 2009, however, this provision is not applicable to the City of Fresno Employees Retirement System.

Governmental Standards (GASB) Statements No. 55 and 56 were also implemented as of June 30, 2009. Statement No. 55, incorporating the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature, did not cause any real changes to the preparation process of the financial statements and did not have a significant impact on the financial statements, thus the Board does not expect this statement will result in a change in

current practice. Statement No. 56, incorporating into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards, did not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) into the GASB standards. Thus, this provision did not cause any real changes to the preparation process of the financial statements and did not have a significant impact on the financial statements.

For the prior fiscal year ended June 30, 2008, the System implemented the provisions of Governmental Standards (GASB) Statement No. 50 Pension Disclosures – the objective of which is to amend note disclosure and required supplementary information (RSI) standards of GASB Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and No. 27, Accounting for Pensions by State and Local Governmental Employers, to conform with applicable changes adopted in Statements No. 43, Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans, and No. 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions. GASB Statement No. 50 is intended to improve the transparency and decision usefulness of reported information about pensions by state and local governmental plans and employers.

For defined benefit pension plans, GASB Statement No. 50 requires disclosure of the funded status of the plan as of the most recent actuarial valuation date in the Notes to Financial Statements section and a reference linking the funding status disclosure in the notes to financial statements to the required schedule of funding progress in the Required Supplemental Schedules. It also requires defined benefit pension plans to disclose in the notes to financial statements the methods and assumptions used to determine the fair value of investments, if the fair value is based on other than quoted market prices.

GASB Statement No. 50 also amends Statement No. 27 to require note disclosure of the required contribution rates of the employer(s) in dollars and the percentage of that amount contributed for the current year and each of the two preceding years, how the contractually required contribution rate is determined (for example, by statute or by contract, or on an actuarially determined basis) or if that cost-sharing plan is financed on a pay-as-you-go basis.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Reclassifications

Certain amounts in the financial statements have been reclassified to be consistent and comparable from year to year.

3 CONTRIBUTIONS

Authority to Collect

The responsibility for both City and employee contributions to the System is mandated by the City of Fresno Municipal Code Sections 3-523 and 3-529.

Funding Status & Method

The funding ratio as of June 30, 2008 was 142.2% using the projected unit credit cost method. The System's actuary uses a five year smoothing of market gains and losses to derive the actuarial value of assets. As of the fiscal year ended June 30, 2008, the actuarial value of assets was \$980.9 million. The Schedule of Funding Progress provided by the actuary (as shown on page 17 and on page 31) does not include other designated reserves (other reserves) and the liabilities associated with these reserves.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multi-year trend information about whether actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liabilities for benefits.

The liability is being funded on the Projected Unit Credit Cost method and currently has a Prefunded Actuarial Accrued Liability (PAAL). Under this method, the employer contribution rate provides for the current cost (normal cost) plus a level percentage of payroll to amortize any prefunded actuarial accrued liability (PAAL). Actuarial gains and losses are incorporated into the PAAL and are amortized over a 15-year period.

The progress being made towards meeting the System's funding objective through June 30, 2008 is illustrated in the Schedule of Funding Progress shown on page 17 and in the Required Supplemental Schedule on page 31.

Funding Policy

The City currently funds, at a minimum, the amounts recommended by the actuary and approved by the Retirement Board. Such amounts are determined using the projected unit credit method. This method produces an employer contribution rate consisting of amounts for (a) normal cost and (b) amortization of any unfunded or prefunded actuarial accrued liability. However, prefunded actuarial accrued liability or excess earnings and prepaid City contributions deposited into the System have funded the fiscal year 2009, 2008 and 2007 City contributions.

These minimum contributions are recognized currently in the statement of changes in net assets available for benefits. Employees' contributions are funded and recognized currently through payroll deductions in amounts recommended by the actuary. Costs of administering the System are charged against System assets.

Total contributions to the System for fiscal year 2009 totaled \$7,190,318. Employees contributed \$5,845,044 and the City contributions of \$1,345,274 came from prepaid contributions on deposit with the System. The remaining employer contributions were offset by the prefunded actuarial accrued liability of the System.

Contributions aggregating \$7,190,318 (\$1,345,274 employer prepaid contributions and \$5,845,044 employee contributions) were made in fiscal year 2009, based on an actuarial valuation determined as of June 30, 2007, which became effective for the year ended June 30, 2009. During fiscal year 2009, the employer contribution rate was set at 10.56%; however, no cash contributions were required from the City as the employer contribution came from prepaid contributions of \$1,345,274 on deposit with the System and the prefunded actuarial accrued liability of the System. Employer and System member contributions represented 1.02 percent and 4.41 percent, respectively, of the fiscal year 2009 covered payroll.

3 CONTRIBUTIONS CONTINUED

SCHEDULE OF FUNDING PROGRESS

FOR THE THREE YEARS ENDING JUNE 30, 2009

(Dollars in Millions)

Actuarial Valuation Date	(1) *Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL)	(3) Percentage Funded (1) / (2)	(4) (Prefunded) / Unfunded AAL (2) - (1)	(5) Annual Covered Payroll	(6) (Prefunded) / Unfunded AAL Percentage of Covered Payroll (4) / (5)
2006	\$848	\$614	138.1%	\$(234)	\$111	(209.7)%
2007	\$927	\$631	146.8%	\$(295)	\$122	(241.5)%
2008	\$981	\$690	142.2%	\$(291)	\$133	(218.7)%

The valuation interest rate is 8.25%; total salary scale increases of 3.75% (3.75% for inflation) plus 0.25% across the board salary increase; plus merit and promotion increases based on completed years of service were based on the June 30, 2006 Experience

Analysis and the June 30, 2007 Economic Assumptions Report. These actuarial assumptions were adopted by the Retirement Board on January 14, 2009, for implementation as of July 1, 2009.

LATEST ACTUARIAL VALUATION METHODS AND ASSUMPTIONS

Valuation Date	June 30, 2008
Actuarial Cost Method	Projected Unit Credit Actuarial Cost Method Normal Cost and Actuarial Accrued Liability are calculated on an individual basis and are allocated by service.
Asset Valuation Method	Actuarial Value, 5 year Smoothed Market Value recognizing differences between the total market value and the expected investment return.
Actuarial Assumptions	
Investment Rate of Return	8.25%
Projected Salary Increases	4.30% to 12% Plus Merit and Promotion increases (Service and Age)
Attributed to Inflation	3.75%
Cost of Living Adjustments	3.75%

3 CONTRIBUTIONS CONTINUED

Contributions aggregating \$6,020,521 (\$354,894 employer prepaid contributions and \$5,665,627 employee contributions) were made in fiscal year 2008, based on an actuarial valuation determined as of June 30, 2006, which became effective for the year ended June 30, 2008. During fiscal year 2008, the Employer contribution rate was set at 10.93%; however, no cash contributions were required from the City as the employer contribution came from prepaid contributions of \$354,894 on deposit with the System and the prefunded actuarial accrued liability of the System. Employer and System member contributions represented 0.27 percent and 4.37 percent, respectively, of the fiscal year 2008 covered payroll.

Contributions Required and Contributions Made

The City's required normal contributions to the System for 2009, were offset by the System's prefunded actuarial accrued liability in accordance with actuarially determined requirements computed through an actuarial valuation performed as of June 30, 2007, as follows:

Normal Cost:

Annual Required Contribution Amount	\$ 13,944,718
Less: Prefunded Actuarial Accrued Liability Applied	(12,599,444)
Net Annual Required Contributions	\$ 1,345,274
Pensionable Payroll Amount (Fiscal Year 2009)	\$ 132,511,895

4 PREPAID EMPLOYER CONTRIBUTIONS

In July of 1994, the City of Fresno deposited \$5,524,810 as prepaid contributions to the Employees Retirement System. The balance of the prepayment earns annual interest at the rate of 8.25 percent until prepaid contributions are used to fund the City's required normal contributions to the System. When prepaid contributions are used the amount of the annual revenue recognition is credited to the employer contributions.

For fiscal year 2009, a portion of the City's required normal contributions were offset by prepaid employer contributions of \$1,345,274. The City's prepaid contribution balance as of June 30, 2009, \$3,088,481, is classified as prepaid employer contributions to the System.

Balance June 30, 2008	\$4,106,927
Prepaid Employer Contributions Used	(1,345,274)
Interest Credited for Fiscal Year 2009	326,828
Balance at June 30, 2009	\$3,088,481

5 NET ASSETS AVAILABLE FOR BENEFITS

Net assets available for benefits are segregated into Active Members Reserve (members' accumulated contributions) and reserves established by the Board for various benefit payments.

Reserves are established by the System from member and employer contributions and the accumulation of investment income after satisfying investment and administrative expenses. Note: The reserves do not represent the present value of assets needed, as determined by actuarial valuation, to satisfy retirements and other benefits as they become due.

The System's major reserves are as follows:

ACTIVE MEMBER RESERVES represent the total accumulated member contributions. Additions include member contributions and investment earnings; deductions include refunds of member contributions and transfers to Employer Advance/Retired Reserves.

5 NET ASSETS AVAILABLE FOR BENEFITS CONTINUED

EMPLOYER ADVANCE/RETIRED RESERVES represent the total accumulated employer contributions for future retirement payments to current active and vested terminated members and the total accumulated transfers from Active Member Reserves and investment earnings, less payments to retired members and transfers to the DROP Reserve. Additions include contributions from the employer, transfers from Active Member Reserve and investment earnings; deductions include payments to retired members and transfers to the DROP Reserve.

DEFERRED RETIREMENT OPTION PROGRAM RESERVE ("DROP RESERVE") represents funds reserved for Deferred Retirement Option Benefits accumulated by members.

POST RETIREMENT SUPPLEMENTAL RESERVE represents surplus earnings that have been allocated but not distributed to eligible retirees in accordance with Municipal Code Section 3-567 "Post-Retirement Supplemental Benefit."

CITY SURPLUS RESERVE represents surplus earnings that have been allocated but not used as a reduction to offset or eliminate the City's pension contributions in accordance with the conditions and requirements of Municipal Code Section 3-567 "Post-Retirement Supplemental Benefit."

MARKET STABILIZATION RESERVE represents accumulated unrealized gains or losses recognized in the financial statements as a result of reporting investments at fair value instead of cost. This unrealized appreciation or depreciation of assets is recorded in the Market Stabilization Reserve to reflect market fluctuations and is reported in accordance with Government Accounting Standards Board Statement No. 25.

OTHER RESERVE represents an accumulation of the market appreciation in the value of the System's assets less investment income and charged with investment and other investment related expenses. The Other Reserve is funded entirely from these investment earnings. Transfers of undistributed earnings from the Other Reserve account to reserve accounts are made at an annual rate of 8.25 percent of the average of the beginning and ending balances in the transferee reserve.

Interest is allocated at an actuarially determined interest rate as approved by the Board and is credited monthly to the Active Member Reserve and the Employer Advance/Retired Reserves. Active members in the Deferred Retirement Option Program accrue interest on their accumulated DROP accounts monthly at an interest rate annually adopted by the Board. Any remaining net investment earnings are allocated to Other Reserve.

The amount of reserves for the year ended June 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008
Employer Advance/Retired Reserves	\$ 757,306	\$ 710,630
Active Member Reserves	106,844	102,672
DROP Reserve	52,494	44,812
Reserve for PRSB	3,053	3,255
Reserve for Market Contingencies	(54,225)	168,896
Other Reserves	(129,893)	(61,235)
Net Assets Available for Benefits	\$ 735,579	\$ 969,030

6 DEPOSITS AND INVESTMENTS

The System's investment guidelines reflect the duties imposed by an investment standard known as the "prudent expert rule." The prudent expert rule establishes a standard for all fiduciaries which includes anyone who has discretionary authority with respect to the System's investments.

Northern Trust serves as custodian of the System's investments. The System's asset classes include U.S. Equity, International Equity, Emerging Market Equity, U.S. Fixed Income, and Real Estate. Any class may be held in direct form, pooled form, or both. The System has eighteen external investment managers, managing twenty individual portfolios.

Investments at June 30, 2009 and 2008 consist of the following:

	2009	2008
Investments at Fair Value		
Domestic Equity	\$ 193,087,111	\$ 351,169,481
International Equity	184,229,080	186,745,940
Government Bonds	113,517,600	135,495,656
Corporate Bonds	127,064,660	150,820,057
Real Estate	73,145,372	105,206,253
Emerging Market Equity	35,009,363	27,807,080
Short Term Investments	16,213,067	15,364,759
Total Investments at Fair Value	\$ 742,266,253	\$ 972,609,226

The Board has established a policy for investing, specifying the following target allocations with a minimum and maximum range for each of these asset classes:

Asset Class	Minimum	Target	Maximum
Large Cap Equities	18.5%	22.5%	26.5%
Small Capital Equities	4.5%	7.5%	10.5%
International Equities	21.0%	25.0%	29.0%
Emerging Market Equities	0.0%	5.0%	7.0%
Real Estate	8.0%	10.0%	12.0%
Domestic Fixed Income	20.0%	25.0%	30.0%
High Yield Bonds	0.0%	5.0%	8.0%
Cash	0.0%	0.0%	2.0%
		100%	

Allowable securities must meet the reporting requirements of the Securities and Exchange Commission and must meet a "prudent expert" standard for investing. In no case may the System have five or more percent of System net assets invested in any one organization.

The Board's investment policies and guidelines permit investment in numerous specified asset classes to take advantage of the non correlated economic behavior of diverse asset classes. The result is a well-diversified portfolio.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Retirement System investment securities are not exposed to custodial credit risk since all securities are registered in the Systems' name and held by the Systems' custodial bank.

6 DEPOSITS AND INVESTMENTS CONTINUED

Custodial credit risk for deposits is the risk that, in the event of the failure of depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. Any cash associated with the System's investment portfolios not invested at the end of a day are temporarily swept overnight to Northern Trust Collective Short-Term Investment Fund.

That portion of the System's cash held by the City as part of the City's cash investment pool totaled \$22,140 and \$269,352 at June 30, 2009 and 2008, respectively. Accordingly the System's Investments in the pool are held in the name of the City and are not specifically identifiable.

Disclosure of the legal and contractual provisions of the City's investment policy and carrying amounts by type of investments may be found in the notes to the City's separate Comprehensive Annual Financial Report for the fiscal year ended June 30, 2009.

Credit and Interest Rate Risk

Credit risk associated with the System's debt securities is identified by their ratings in the table below. Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. The System has no general policy on credit and interest rate risk. The System limits its investments in below investment grade bonds and monitors the interest rate risk inherent in its portfolio by measuring the duration of its portfolio.

The average duration of the System's debt portfolios in years is also listed in the table below:

Type of Investment	Fair Value	Credit Quality	Duration
Asset Backed Securities	\$ 4,244,873	A	1.21
Commercial Mortgage-Backed	9,960,626	AA+	4.96
Corporate Bonds	102,753,864	BBB-	5.59
Corporate Convertible Bonds	3,422,404	CCC-	3.70
Guaranteed Fixed Income	807,496	AAA	2.44
Other Fixed Income	33,651	NR	0.00
Convertible Equity	350,954	B-	10.80
Preferred Stock	133,059	CC	0.00
Government Agencies	7,408,810	AAA	4.37
Government Bonds	25,853,115	AAA	5.05
Government Mortgage Backed Securities	72,250,091	AAA	3.57
Index Linked Government Bonds	83,928	BB-	1.08
Municipal/Provincial Bonds	4,015,238	A+	7.74
Non-Government backed C.M.O.s	9,264,151	BBB	1.54
<u>Total Credit Risk Fixed Income</u>	<u>\$ 240,582,260</u>		

6 DEPOSITS AND INVESTMENTS CONTINUED

Per section 5.4(6) of the System's Investment Policy Statement, no more than 5 percent of an investment manager's fixed income portfolio may be invested in below investment grade rated securities (BB or B rated bonds). No securities rated below single B may be purchased at any time. Therefore, at least 95 percent of the manager's fixed income portfolio must be invested in investment grade securities. Long duration bond portfolios shall maintain an average credit quality of AA- or better. Intermediate Bond portfolios shall maintain an average credit quality of AA or better.

High yield fixed income portfolios, in accordance with section 5.4(7) of the System's Investment Policy Statement, shall maintain an average credit quality rating of at least B1/B+ at all times. No more than 20 percent of a high yield manager's portfolio may be invested in bonds rated Caa1/CCC+ or lower with non-rated bonds being limited to 5 percent of the portfolio with both limits subject to maintaining the average portfolio credit quality requirement of B1/B+.

Firms that manage fixed income portfolios will continually monitor the risk associated with their fixed income investments. They will be expected to report

as a component of their quarterly report, a risk/reward analysis of the management decisions relative to their benchmarks. Statistics that relate performance variance to effective duration decisions will be included in each quarterly report.

Concentration Risk

The Investment portfolio as of June 30, 2009 contained no concentration of investments in any one entity (other than those issued or guaranteed by the U.S. Government) that represented 5 percent or more of the total investment portfolio.

Foreign Currency Risk

Foreign Currency Risk is the risk that changes in foreign exchange rates will adversely affect the fair value of an investment or deposit. The System has no general investment policy with respect to foreign currency risk. The System's investment policy guidelines allow international developed and emerging equity managers to hedge their currency risks in foreign countries through the purchase of derivatives. Used as a defensive measure and in an effort to control the risks associated with international portfolios, international equity investment managers are permitted to invest in forward currency contracts, swaps currency futures, and exchanged-traded index futures that represent broad equity exposure to countries represented in their respective benchmark index.

6 DEPOSITS AND INVESTMENTS CONTINUED

The following positions represent the System's exposure to foreign currency risk as of June 30, 2009.

Equities:				
Base Currency:		Fair Value in USD	Cash and Cash Equivalents:	Fair Value in USD
Australian Dollar	AUD	\$ 12,192,089	Australian Dollar	\$ 362
Brazilian Real	BRL	2,642,208	Canadian Dollar	17,722
Canadian Dollar	CAD	4,450,809	Swiss Franc	85,268
Swiss Franc	CHF	10,554,938	Danish Krone	2,868
Colombian Peso	COP	113,086	Euro	245,742
Danish Krone	DKK	2,794,921	British Pound Sterling	52,048
Egyptian Pound	EGP	519,505	Hong Kong Dollar	66,830
Euro	EUR	50,313,581	Indonesian Rupiah	1,072
British Pound Sterling	GBP	31,468,764	Iceland Krona	4,058
Hong Kong Dollar	HKD	12,726,662	Japanese Yen	198,265
Hungarian Forint	HUF	197,863	Malaysian Ringgit	145
Indonesian Rupiah	IDR	611,328	Norwegian Krone	92,718
New Israeli Shekel	ILS	78,558	New Zealand Dollar	9,456
Indian Rupee	INR	1,266,000	Swedish Krona	67,156
Japanese Yen	JPY	37,343,903	Singapore Dollar	57,874
South Korean Won	KRW	4,789,547	South African Rand	8,289
Mexican Peso	MXN	338,243		
Malaysian Ringgit	MYR	287,209	Total Non-USD Cash (in USD)	\$ 909,873
Norwegian Krone	NOK	2,640,830		
New Zealand Dollar	NZD	406,273		
Swedish Krona	SEK	3,747,223		
Singapore Dollar	SGD	5,218,195		
Thai Baht	THB	557,552		
Turkish Lira	TRY	1,329,789		
New Taiwan Dollar	TWD	2,990,530		
South African Rand	ZAR	3,595,085		
Total Non-USD Equities (in USD)		\$193,174,691		

6 DEPOSITS AND INVESTMENTS CONTINUED

Per section 5.4(5) of the System's Investment Objectives and Policy Statement, assets in international equity portfolios will be primarily composed of foreign ordinary shares and ADR's. Primarily large capitalization securities may be held, although investments in small and mid capitalization securities are also allowed. Firms will continually monitor their country, currency, sector and security selection risks associated with their international portfolios. All of the risks will be included in the manager's quarterly reports and performance attribution based on these factors will also be included.

The System's complete Investment Objectives and Policy Statement can be found on the System's website at www.CFRS-CA.org or by contacting the Retirement Office at 2828 Fresno Street Suite 201, Fresno, CA 93721.

7 DERIVATIVES

The Retirement Board has authorized certain investment managers to invest in or otherwise enter into transactions involving derivative financial instruments when, in the judgment of management, such transactions are consistent with the investment objectives established for a specific investment manager's assignment. The acceptable investment purposes for the use of derivatives are as follows:

- a. Mitigation of risk (or risk reduction).
- b. A useful substitute for an existing, traditional investment.
- c. To provide investment value to the portfolio while being consistent with the System's overall and specific investment policies.
- d. To obtain investment exposure which is appropriate for the manager's investment strategy and the System's investment guidelines, but which could not be made through traditional investment securities.

The Retirement Board monitors and reviews each investment manager's securities and derivative position as well as the manager's performance relative to established benchmark rates of return and risk measures. In management's opinion, derivative activities must be evaluated within the context of the overall portfolio performance and cannot be evaluated in isolation.

Derivative financial instruments held by the System consist of the following:

Cash securities that contain derivative features, include callable bonds, structural notes and collateralized mortgage obligations (CMO's). These instruments are generally traded in over-the-counter bond markets.

Financial instruments whose value is dependent upon a contractual price or rate relative to one or more reference prices or rates, applied to a notional amount, including interest rate futures, options, swaps and caps, and foreign currency futures and forward contracts. Some of these instruments are exchange-traded and others are traded over-the-counter (OTC).

Market Risk

Market risk is the risk of change in value of an instrument in response to changes in a market price or index. While all investments are subject to market risk, derivatives often have a higher degree of market risk than other types of investment instruments. Values of cash securities containing derivative features are often more susceptible to market risk than other types of fixed income securities, because the amounts and/or timing of their scheduled cash flows may fluctuate under changing market conditions, according to their contractual terms. For other types of derivatives, amounts of contractual cash flows may be either positive or negative depending upon prevailing market conditions relative to the reference prices or rates, and thus the values of such instruments may be positive or negative, despite the fact that little or no cash is initially exchanged to enter into such contracts.

7 DERIVATIVES CONTINUED

Credit Risk

Credit risk of cash securities containing derivative features, as explained, is based upon the credit worthiness of the issuers of such securities. The Retirement Board establishes minimum credit requirements for such securities. The other derivative instruments described above are subject to credit risk to the extent their value is a positive market value, and the counter party to such contract fails to perform under the terms of the instrument.

Exchange traded derivatives are generally considered to be of lower credit risk than OTC derivatives due to the exchanges margin requirements. Equity Index Swaps are derivatives and represent an agreement between two parties to swap two sets of equity values.

Equity Futures are contracts used to replicate an underlying stock market index. These futures can be used for hedging against an existing equity position, or speculating on future movements of the index.

As of June 30, 2009, the Employees Retirement Systems held a total value of \$450,684 in derivative holdings. These holdings consisted of the S&P 500 Equity Futures as a component of the System's investments in Barclay's Global Investors (BGI) S&P 500 Equity Index, BGI's Alpha Tilts and BGI's Russell 2000 Growth Funds, and Swaps held in BGI's Securities Lending Cash Collateral Funds for the S&P 500 Equity Index and Russell 2000 Growth Funds.

The sum of all counterparty exposure for which there is a positive replacement cost to the fund is \$12,654; the amount of collateral held by the fund to secure the sum of all counterparty exposure is \$437; and the net exposure is \$12,217.

The details of these derivative holdings are as follows:

S&P 500 Equity Futures (as a component of Barclays Global Investors Equity Index Fund A)		\$ 17,752
Swaps held in Securities Lending Cash Collateral Funds of Barclays Global Investors Equity Index Fund A		
Total Return Swap	\$1,415	
Credit Derivative Swap	<u>1,162</u>	
Total Swaps		2,577
S&P 500 Equity Futures (as a component of Barclays Global Investors Alpha Tilts Fund)		152,335
S&P 500 Equity Futures (as a component of Barclays Global Investors Russell 2000 Growth Fund)		261,109
Swaps held in Securities Lending Cash Collateral Funds of Barclays Global Investors Russell 2000 Growth Fund		
Total Return Swap	\$9,287	
Credit Derivative Swap	<u>7,624</u>	
Total Swaps		16,911
Fair Value of Derivatives Held at June 30, 2009		<u>\$ 450,684</u>

8 SECURITIES LENDING

The City of Fresno Municipal Code and the Retirement Board's policies permit the Retirement Board of the City of Fresno Fire and Police Retirement System and the City of Fresno Employees Retirement System to use investments of both Systems to enter into securities lending transactions, i.e., loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. The Systems have contracted with Northern Trust, their custodian, to manage the securities lending program for the Systems and all securities held in a separately managed account are available for lending. As securities lending agent, Northern Trust calculates collateral margins and accepts collateral in the form of cash or marketable securities and irrevocable bank letters of credit for all securities lending transactions. Transactions are collateralized at 102 percent of market value (contract value) for domestic securities and 105 percent of market value (contract value) for international securities. Collateral is marked to market daily. When a loan is secured by cash, a rebate is negotiated and the cash collateral is invested according to the guidelines in the collateral pool.

As designated by the Board, cash collateral is invested in Northern Trust's Core U.S.A. Collateral Section (short-term investment pool), which, as of June 30, 2009 had a weighted average duration of 15 days, average maturity is 169 days and an average monthly yield of 0.622 percent. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of the security loans made by other entities that use the Northern Trust Core U.S.A. Collateral Section and a definitive statement of that relationship cannot be formulated by the System. As of June 30, 2009, the CORE USA Cash Collateral Fund had 0.663% exposure in subprime residential mortgage-backed securities, in the first-pay triple A tranches (as rated by at least one rating agency) and there were no known credit risks related to the securities lending transactions.

Northern Trust will ensure that, in any agreement with a borrower, it retains its absolute right to terminate the agreement without cause, upon short notice and without any penalty. The System cannot pledge or sell collateral securities received unless the borrower defaults. In the event of a borrower

default, Northern Trust indemnifies the System against losses and will replace or reimburse the System for any borrowed securities not replaced. In general, the average term of all System loans is overnight or "on demand". All securities loans can be terminated on demand by either the lender or the borrower, although the average term of the System's loans was approximately 59 days as of June 30, 2009.

Prior to June 30, 2008, due to the nature of the securities lending program and Northern Trust's collateralization of loans at 102 percent and 105 percent plus accrued interest for fixed income securities, we believed that there were no material credit risks to the System as defined in GASB Statement No. 28 and GASB Statement No. 40 by our participation in the securities lending program. However, with the short-term illiquid and volatile environment for fixed income markets, we believe that there is more risk in the credit quality of the collateral pool than previously anticipated. Reduced demand in securities lending given recent brokerage firm failures is an indication of the overall increasing risks associated with securities lending.

As of September 2008, the System's securities lending account contained a total collateral deficiency of \$1.8 million. The collateral deficiency in the securities lending collateral pool was determined following the bankruptcy of Lehman Brothers. The amount of the aggregate collateral deficiency was based on the difference between the market value of the collateral pool's cash investment assets as of the close of business on September 18, 2008, and the book value of the assets. This value also includes realized losses from the segregation or sale of impaired or distressed assets.

Details of the securities lending collateral deficiency as of June 30, 2009, are as follows:

Total Collateral Deficiency Amount:	\$1,773,173
Total Realized Losses to Date:	\$ 242,996
Purchase of Sub-Fund Unit Assets to Date:	\$ 29,436
Amount Due to Custodian for Realized Losses and Purchases for Sub-Fund Unit Assets:	\$ 272,432
Remaining Collateral Deficiency Amount:	\$1,500,741

8 SECURITIES LENDING CONTINUED

The remaining Collateral Deficiency amount may be subject to relief through potential future positive changes in the difference between the market value of the collateral pool's cash investment assets and the book value of those assets.

The System's securities lending income is as follows:

	2009	2008
Gross Income	\$ 1,731,978	\$ 7,596,520
Expenses:		
Borrower Rebates	754,110	6,301,785
Bank Fees	167,779	278,178
Total Expenses	921,889	6,579,963
Net Income from Securities Lending	\$ 810,089	\$ 1,016,557

FAIR VALUE OF LOANED SECURITIES AS OF JUNE 30, 2009

Collateralized by	Cash	Securities	Total
U.S. Government & Agency	\$ 23,670,677	\$ 320,357	\$ 23,991,034
Domestic Equities	49,252,792	(65,624)	\$ 49,187,168
Domestic Fixed	10,535,107	(194,420)	\$ 10,340,687
International Equities	23,688,201	248,530	\$ 23,936,731
Total Value	\$ 107,146,777	\$ 308,843	\$ 107,455,620

FAIR VALUE OF COLLATERAL RECEIVED FOR LOANED SECURITIES AS OF JUNE 30, 2009

Collateralized by	Cash	Securities	Total
U.S. Government & Agency	\$ 23,133,141	\$ 312,160	\$ 23,445,301
Domestic Equities	47,805,525	(65,229)	\$ 47,740,296
Domestic Fixed	10,260,084	(190,972)	\$ 10,069,112
International Equities	22,326,896	234,490	\$ 22,561,386
Total Value	\$ 103,525,646	\$ 290,449	\$ 103,816,095

9 ADMINISTRATIVE EXPENSES

Section 3-532 of the Fresno Municipal Code provides that all administrative costs of the System shall be a charge against the assets of the System. Per the Municipal Code, the Administrative expenses are a component of the City's contribution calculation.

10 POST RETIREMENT SUPPLEMENTAL BENEFIT PROGRAM (PRSB)

The System is not obligated to provide for or fund any other post-employment benefits as retirees do not receive paid healthcare benefits from the Systems. The Post-Retirement Supplemental Benefit ("PRSB") Program was created as a contingent program to provide supplemental distributions to eligible retirees which they could use to pay for various post-retirement expenses. The Retirement Board will annually review the actuarial valuation report and declare an actuarial surplus, if available, in accordance with the procedures in Municipal Code Section 3-567.

If an actuarial surplus is declared by the Board, the surplus is allocated into two components. One component composed of two-thirds of the declared surplus shall be used to reduce or eliminate the City's pension contributions. Any unused portion shall be reserved in the City Surplus Reserve and drawn upon in subsequent years if needed. The remaining one-third component shall be distributed among eligible post-retirement supplemental benefit recipients in accordance with procedures in Municipal Code Section 3-567(f)(4). Any unused portion shall be reserved in the PRSB Reserve and drawn upon in subsequent years if needed.

For the fiscal year ended June 30, 2009, the System distributed PRSB benefits in the amount of \$5,084,478 to eligible retirees and offset required City pension contributions by \$12,599,444. As of June 30, 2009, the City Surplus Reserve balance was \$0 and the PRSB Reserve balance was approximately \$3,052,799, of which \$2,580,234 is committed for PRSB distribution for the months of July through December 2009.

11 CAPITAL ASSETS

Capital assets are carried at cost, net of accumulated depreciation. Capital assets with an initial cost of \$250 or more and an estimated useful life in excess of one year are capitalized and depreciated using the straight-line method. Capital assets presently consist of furniture for the System's Retirement Offices located at 2828 Fresno Street, Fresno, California.

12 LEASES

Under the lease agreement with CFRS Realty Holding Corporation, the holding corporation formed jointly by the Retirement Boards to take ownership of the building, effective September 19, 2005, the City of Fresno Employees and City of Fresno Fire and Police Retirement Boards and their staff occupy approximately 7,900 square feet of the second floor of the renovated building at 2828 Fresno Street. The term of the lease is ten years with an option for two additional five year extensions.

Under the terms of the lease agreement the Systems share equally a base rent of \$10,706 per month which amounts to \$1.35 per square foot per month, triple net.

13 RELATED PARTY TRANSACTIONS

The Retirement System is involved in various business transactions with the City of Fresno, the primary plan sponsor. These include reimbursement to the City for the salary and benefits of Retirement Staff members paid through the City, reimbursement to the City Human Resources Department for personnel consulting services, and reimbursement to the City Information Services Department for computer and telephone support.

The Retirement Systems lease office space from the CFRS Realty Holding Corporation, a title holding company controlled jointly by the City of Fresno Employees and City of Fresno Fire and Police Retirement Systems. See note 12 for a description of this arrangement.