# LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM
**(A DEPARTMENT OF THE CITY OF**
**LOS ANGELES, CALIFORNIA)**

## ANNUAL FINANCIAL REPORT

**JUNE 30, 2008**

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**

**ANNUAL FINANCIAL REPORT**

**JUNE 30, 2008**

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## INDEPENDENT AUDITOR'S REPORT

Board of Administration
Los Angeles City Employees' Retirement System
Los Angeles, California

We have audited the accompanying Retirement Plan and Postemployment Healthcare Plan Statement of Plan Net Assets of the Los Angeles City Employees' Retirement System (the System), a department of the City of Los Angeles, California, as of June 30, 2008, and the related Retirement Plan and Postemployment Healthcare Plan Statement of Changes in Plan Net Assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the System's 2007 financial statements and, in our report dated October 9, 2007 we expressed an unqualified opinion on those financial statements.

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

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

The Management's Discussion and Analysis (MD&A) and Required Supplementary Information (RSI) as listed in the Table of Contents are not required parts 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 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Supplemental Schedules 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 audit 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.

BROWN ARMSTRONG PAULDEN
McCOWN STARBUCK THORNBURGH & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
November 25, 2008

# MANAGEMENT’S DISCUSSION AND ANALYSIS

As management of the Los Angeles City Employees' Retirement System (LACERS), we are pleased to provide this overview and analysis of the financial activities of LACERS for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal in the Introductory Section of LACERS Comprehensive Annual Financial Report.

## FINANCIAL HIGHLIGHTS

- The plan net assets of LACERS as of June 30, 2008 were $10,372,194,000.
- Compared with the plan net assets of LACERS as of June 30, 2007, the value of the net assets decreased $699,425,000 or 6.3% during the reporting period.
- The plan assets under the Retirement Plan and Postemployment Healthcare Plan are pooled for investment purposes. Investment loss for the year was $646,393,000, as compared with an investment gain of $1,823,260,000 for the previous reporting period.
- Employer contributions made by the City of Los Angeles (the City) to both the Retirement Plan and the Postemployment Healthcare Plan were $411,658,000. This amount included annual contribution of $396,967,000, which was 22.79% of estimated City's covered payroll of $1,741,850,000, Member contribution defrayal of $14,486,000, and City's matching contribution for Family Death Benefit Insurance Plan in the amount of $205,000.
- The employer contributions to the Retirement Plan represented 100% of the Annual Required Contribution as defined by GASB Statements No. 25 and No. 27. The employer contributions to the Postemployment Healthcare Plan represented 100% of the Annual Required Contribution as defined by GASB Statements No. 43 and No. 45.
- Deductions from net assets of LACERS included benefit payments, refunds of Member contributions, and administrative expenses. The total deductions from net assets were $590,368,000, a 7.0% increase from the prior fiscal year.
- As of June 30, 2008, the date of our last actuarial valuation, the funded ratio for the Retirement Plan was 84.4% and the funded ratio for the Postemployment Healthcare Plan was 69.7%. The total funded ratio for LACERS was 82.2%. The funded ratio compares the actuarial value of assets to the actuarial accrued liabilities of a pension plan. The ratios change every valuation year, reflecting asset performance, demographic changes, actuarial assumption/method changes, benefit structure changes, or a variety of other actuarial gains and losses.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The following discussion and analysis are intended to serve as an introduction to LACERS financial statements and the accompanying notes thereto. The required supplementary information and supplemental schedules provide additional financial data of LACERS operations.

*Financial Statements.* There are two financial statements presented for LACERS. The Statement of Plan Net Assets indicates the net assets, being the difference between the assets and liabilities, available to pay future benefits and gives a snapshot of the account balances at year-end. Over time, increases or decreases in net assets may serve as a useful indicator of whether the net assets of LACERS are improving or deteriorating. The Statement of Changes in Plan Net Assets provides a view of current year additions to and deductions from the plan net assets during the most recent fiscal year. The two statements can be found on pages 12 and 13 of this report.

*Notes to Financial Statements.* The notes provide additional information that is essential for a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 14 – 29 of this report.

**OVERVIEW OF THE FINANCIAL STATEMENTS (continued)**

*Required Supplementary Information.* In addition to this Management's Discussion and Analysis, the other required supplementary information consists of a Schedule of Funding Progress, a Schedule of Employer Contributions, and the Notes to Required Supplementary Information for both the Retirement Plan and the Postemployment Healthcare Plan. They primarily present actuarially-determined information in a multiyear format as required by the applicable financial reporting standards. This required supplementary information can be found on pages 30 – 35 of this report.

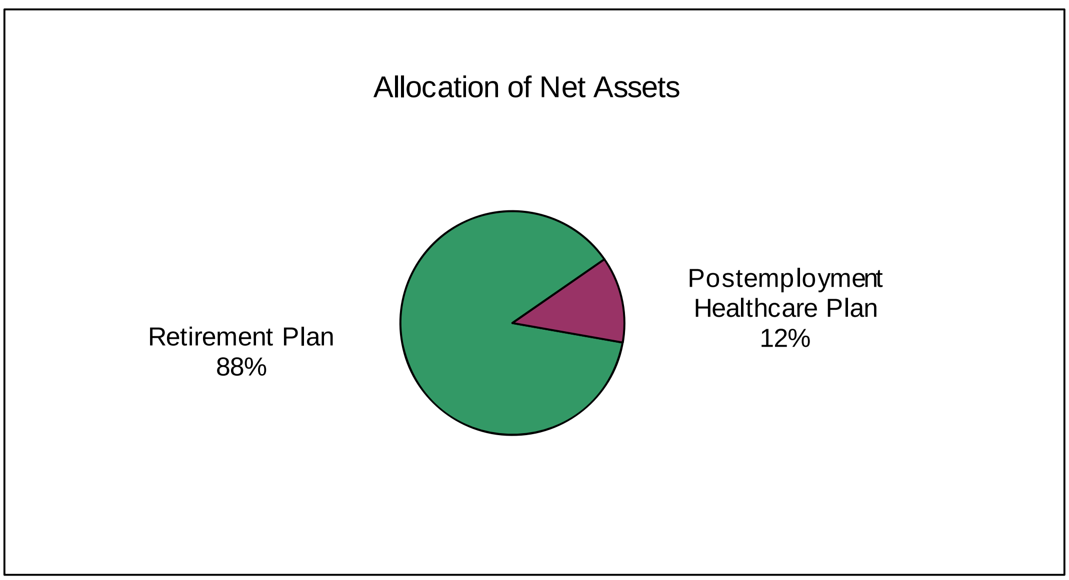
*Supplemental Schedules.* The supplemental schedules, including a Schedule of Administrative Expenses and a Schedule of Investment Expenses, are presented to provide additional financial information on LACERS operations for the current year. They can be found on pages 36 and 37 of this report.

**FINANCIAL ANALYSIS**

**Allocation of Net Assets**

The following information provides a brief description of the asset allocation between the Retirement Plan and the Postemployment Healthcare Plan as of June 30, 2008 (in thousands):

| | Net Assets | Percent |
|---|---|---|
| Retirement Plan | $ 9,083,168 | 87.6 % |
| Postemployment Healthcare Plan | 1,289,026 | 12.4 |
| Net Assets | $ 10,372,194 | 100.0 % |

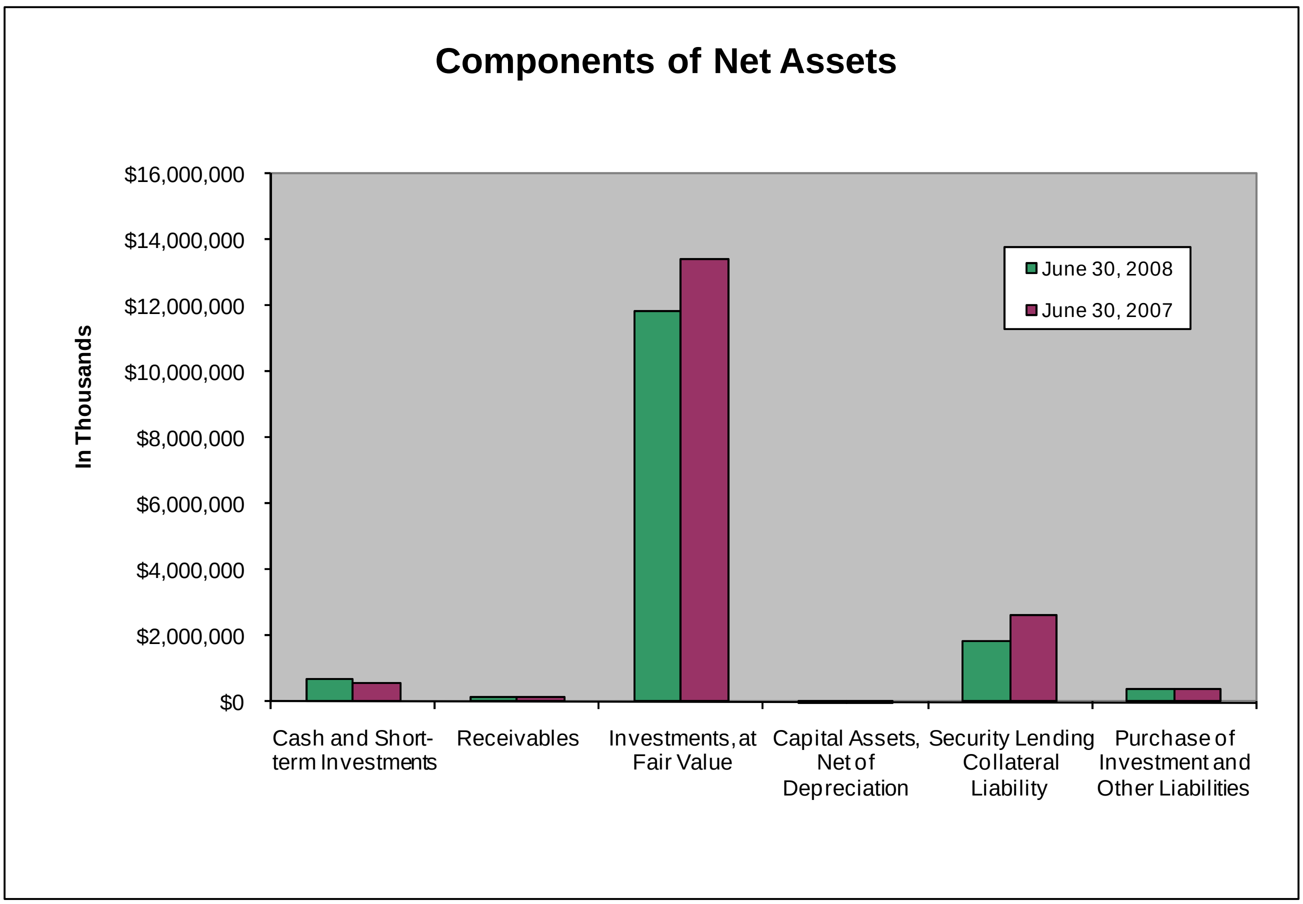



Net assets may serve over time as a useful indicator of a plan's financial position. In the case of LACERS, net assets were $10,372,194,000 at the close of the most recent fiscal year. The total plan net assets are allocated between the Retirement Plan and Postemployment Healthcare Plan, as required by the existing reporting standards. Net assets for the Retirement Plan and Postemployment Healthcare Plan are $9,083,168,000 and $1,289,026,000, respectively.

**Net Assets**

The following table and graph represent the detailed information regarding the components of the net assets of LACERS as of June 30, 2008 and 2007 (in thousands):

| | June 30, 2008 | June 30, 2007 | Change | |
|---|---|---|---|---|
| Cash and Short-term Investments | $ 647,797 | $ 519,341 | $ 128,456 | 24.7 % |
| Receivables | 99,851 | 110,854 | (11,003) | (9.9) |
| Investments, at Fair Value | 11,826,510 | 13,400,885 | (1,574,375) | (11.7) |
| Capital Assets, Net of Depreciation | 386 | 306 | 80 | 26.1 |
| Total Assets | 12,574,544 | 14,031,386 | (1,456,842) | (10.4) |
| Security Lending Collateral Liability | (1,814,923) | (2,612,246) | (797,323) | (30.5) |
| Purchase of Investment and Other Liabilities | (387,427) | (347,521) | 39,906 | 11.5 |
| Total Liabilities | (2,202,350) | (2,959,767) | (757,417) | (25.6) |
| Net Assets | $10,372,194 | $11,071,619 | $ (699,425) | (6.3) % |




The largest portion of LACERS net assets is its investment portfolio, which includes cash and short-term investments, receivables, fixed income, equities, and other asset classes. Net assets decreased by $699,425,000, or 6.3%, during the report year. The decrease is primarily attributable to the investment loss.

**Change in Net Assets**

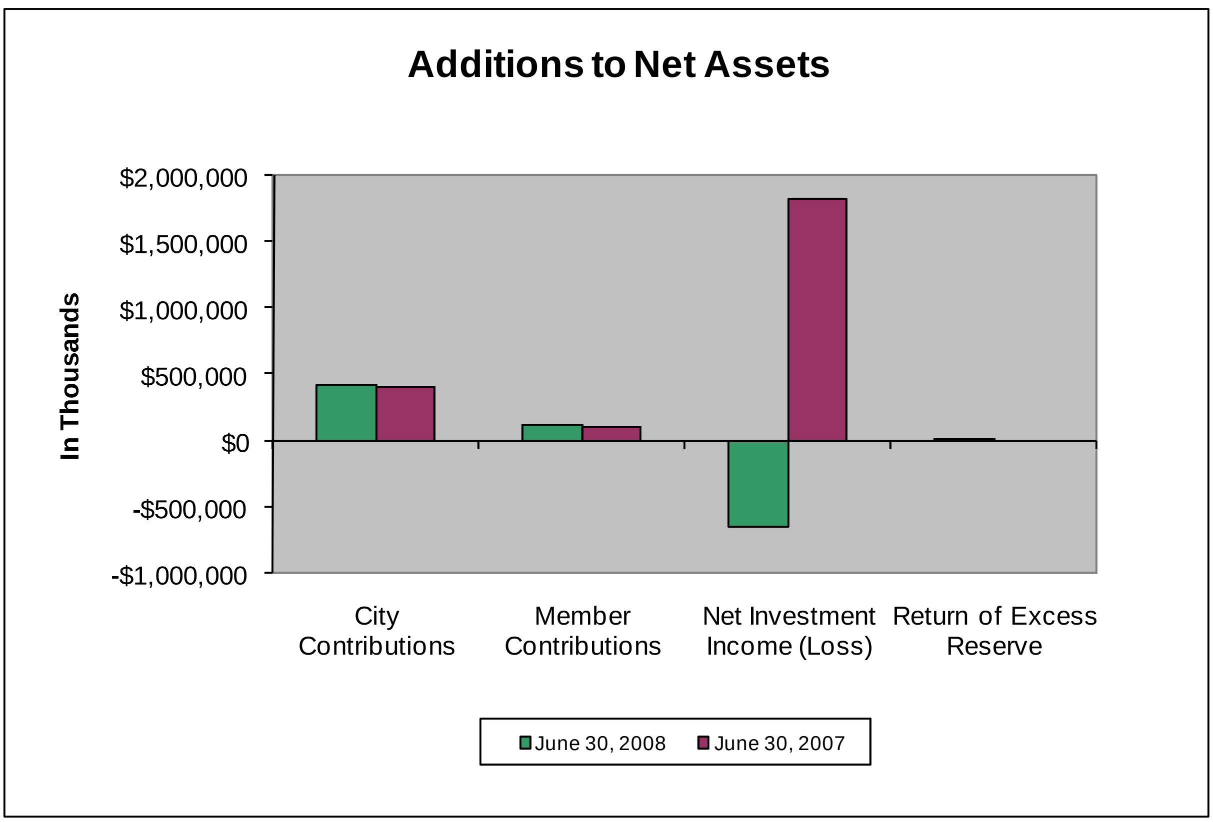
The decrease in net assets was a result of a combination of factors that either add to or deduct from the plan assets. The following table summarizes the change in net assets during the report year, as compared with the prior year (in thousands):

| | June 30, 2008 | June 30, 2007 | Change | |
|---|---|---|---|---|
| Additions | $ (109,057) | $ 2,337,887 | $(2,446,944) | (104.7) % |
| Deductions | (590,368) | (551,746) | (38,622) | (7.0) |
| Net Increase (Decrease) | (699,425) | 1,786,141 | (2,485,566) | (139.2) |
| Net Assets, Beginning of Year | 11,071,619 | 9,285,478 | 1,786,141 | 19.2 |
| Net Assets, End of Year | $ 10,372,194 | $ 11,071,619 | $ (699,425) | (6.3) % |

**Change in Net Assets – Additions to Net Assets**

The following table and graph represent the components that make up the additions to net assets for LACERS for the years ended June 30, 2008 and 2007 (in thousands):

| | June 30, 2008 | June 30, 2007 | Change |
|---|---|---|---|
| City Contributions | $ 411,658 | $ 408,393 | 0.8 % |
| Member Contributions | 114,678 | 106,234 | 7.9 |
| Net Investment Income (Loss) | (646,393) | 1,823,260 | (135.5) |
| Return of Excess Reserve | 11,000 | - | 100.0 |
| Additions to Net Assets | $ (109,057) | $ 2,337,887 | (104.7) % |



**Change in Net Assets – Additions to Net Assets (continued)**

The additions to LACERS net assets consist of City Contributions, Member Contributions, and Net Investment Income (Loss), which are the main funding sources that support LACERS benefits, and an one-time revenue of Return of Excess Reserve.

City Contributions to the Retirement Plan, the Postemployment Healthcare Plan and the Family Death Benefit Insurance Plan were $411,658,000 during the year, or $3,265,000 more than the prior fiscal year, due to an increased payroll base. The City contribution rate was 16.54% for Retirement Plan and 6.25% for the Postemployment Healthcare Plan, or 22.79% in total, of the City payroll for the fiscal year 2008, which was $1,741,850,000. The actual contribution to the Retirement Plan was equal to 100% of the Annual Required Contribution (ARC) of $288,119,000 as defined by GASB Statements No. 25 and No. 27. The actual contribution to the Postemployment Healthcare Plan was equal to 100% of the Annual Required Contribution (ARC) of $108,848,000 as defined by GASB Statements No. 43 and No. 45.

Factors that affect the amount of Member Contributions are the change in the number and the composition of Members and their salaries. During the year, Members contributed $114,678,000, which was $8,444,000 (7.9%) more than the prior year. The number of Members increased by 0.2%.

The net investment loss of $646,393,000, which included $939,839,000 of Net Depreciation in Fair Value, caused the Total Additions of the Net Plan Assets in this fiscal year to be a negative $109,057,000. The investment loss, due to the downturn in financial markets, is discussed in the next section with detailed information.

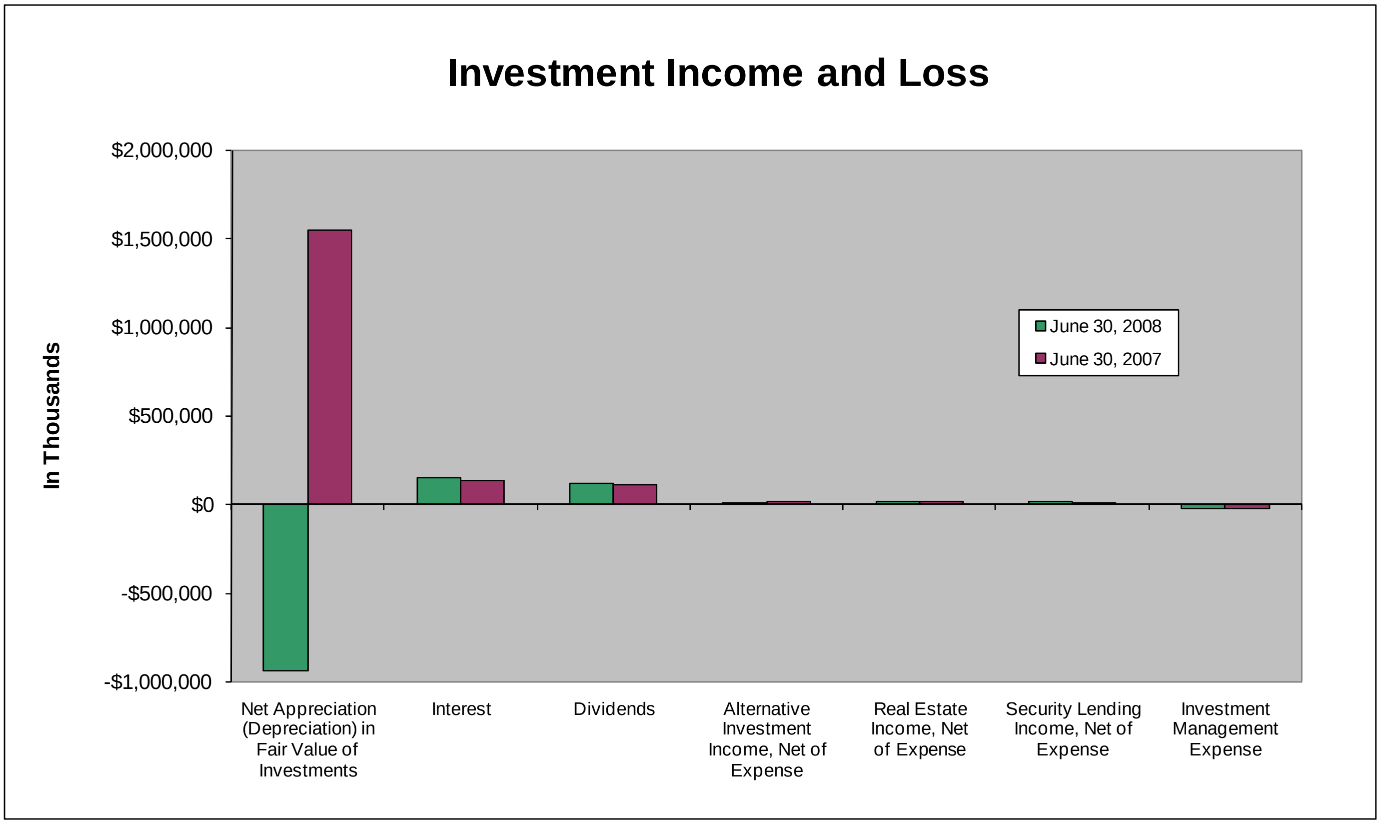
In this fiscal year, the System received $11,000,000 from one of the System's Healthcare providers, Blue Cross PPO, for the Return of Excess Reserve. The System evaluated the level of the premium stabilization reserve held by the PPO provider, and requested the return of $11,000,000 which was considered excessive and no longer needed as part of the premium stabilization reserve.

**Investment Income and Loss**

The following table and graph present the detail of investment income and loss, net of investment management expenses for the years ended June 30, 2008 and 2007 (in thousands):

| | June 30, 2008 | June 30, 2007 | Change |
|---|---|---|---|
| Net Appreciation (Depreciation) in Fair Value of Investment | $ (939,839) | $ 1,550,225 | (160.6) % |
| Interest | 153,068 | 139,223 | 9.9 |
| Dividends | 120,917 | 110,822 | 9.1 |
| Alternative Investment Income, Net of Expense | 11,642 | 17,484 | (33.4) |
| Real Estate Income, Net of Expense | 14,894 | 19,390 | (23.2) |
| Security Lending Income, Net of Expense | 16,057 | 7,177 | 123.7 |
| Investment Management Expense | (23,132) | (21,061) | 9.8 |
| Net Investment Income (Loss) | $ (646,393) | $ 1,823,260 | (135.5) % |

**Investment Income and Loss (continued)**




The net investment loss for the fiscal year, in the amount of $646,393,000, was the first one posted in six years. This was due to the financial market conditions, which tumbled sharply in the U.S. since October 2007 as the impact of the defaults of sub-prime mortgages grew and deepened further with the fears of a looming recession on the U.S. economy. The global financial markets also saw widespread deterioration and continued downward slide through the closing of the current fiscal year. The investment loss includes both realized and unrealized capital gain and loss.

Investment income in the Alternative Investment and Real Estate portfolios decreased from the fiscal year 2007 level by $5,842,000 (-33.4%) and $4,496,000 (-23.2%), respectively. The negative financial market conditions adversely affected the Alternative Investment income. The decreased Real Estate income was mainly due to the newly-invested Real Estate funds that have not generated a substantial amount of income to date, as the funds are still early along the "J-Curve", while management fees were being paid regardless of the income level.

Two major components of LACERS asset allocation are bonds and stocks. Interest and dividend income derived from these two investment classes increased by $13,845,000 (9.9%) and $10,095,000 (9.1%), respectively. The increases in interest and dividend income are due to larger portfolios exposure to the bonds and stocks during the current fiscal year than the previous year.

LACERS earns additional investment income by its custodian bank lending LACERS securities to borrowers. The borrowers provide cash or non-cash collateral to the System's custodial bank, which then invests the cash collateral in short and intermediate term fixed income securities. LACERS security lending income posted an increase of 123.7% compared to a year ago mainly due to an exclusive lending and guaranteed income agreement with a borrower, reduced rebate amount paid for the loaned securities, and improved revenue split (ratio from 80/20 to 85/15) initiated in December 2007.

An increased number of investment managers during the year lead to an increase in investment management expense for the current year by $2,071,000 (9.8%) from the previous year.

**Change in Net Assets – Deductions from Net Assets**

The following table and graphs provide information related to the deductions from net assets for the years ended June 30, 2008 and 2007 (in thousands):

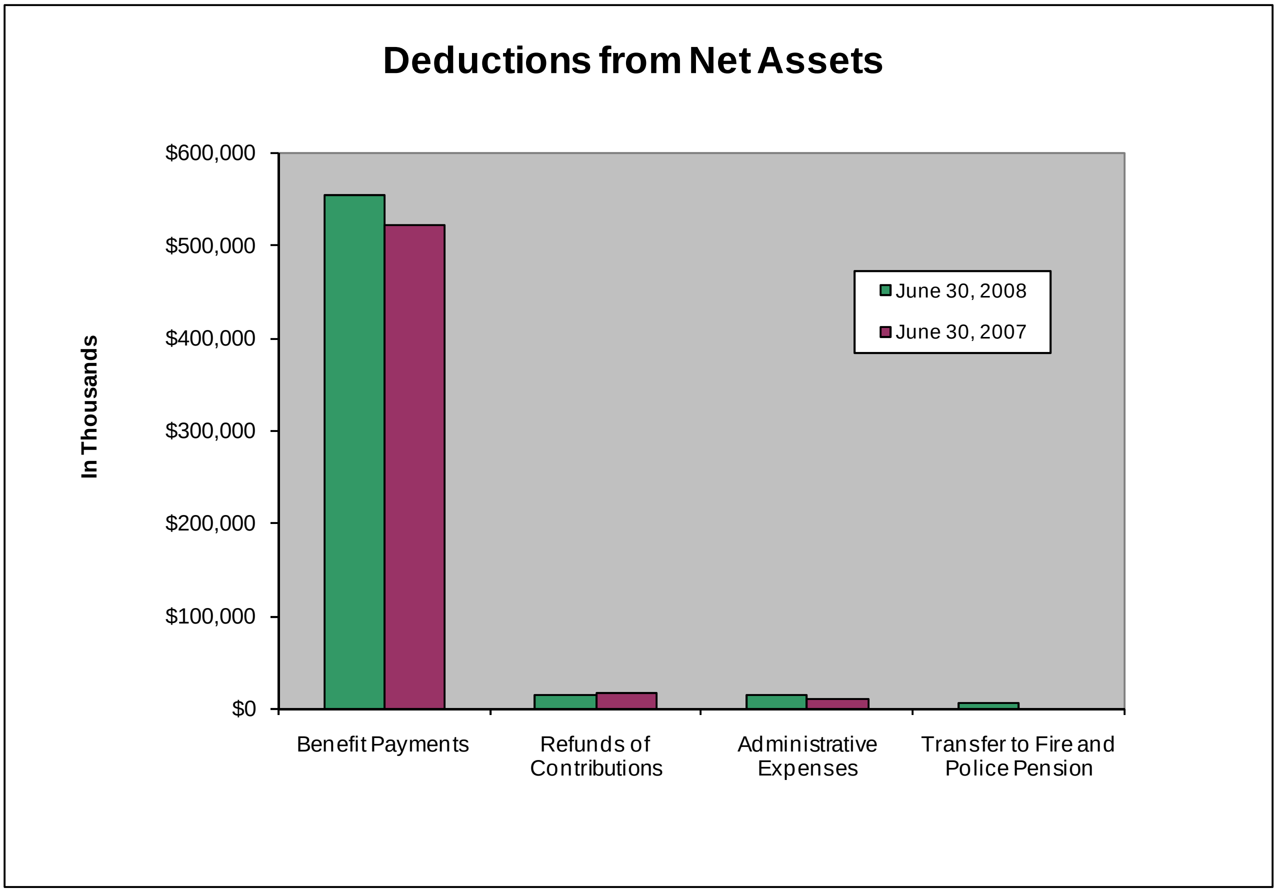
| | June 30, 2008 | June 30, 2007 | Change |
|---|---|---|---|
| Benefit Payments | $ 554,645 | $ 522,937 | 6.1 % |
| Refunds of Contributions | 15,149 | 17,452 | (13.2) |
| Administrative Expenses | 14,354 | 11,357 | 26.4 |
| Transfer to Fire and Police Pension | 6,220 | - | 100.0 |
| Deductions from Net Assets | $ 590,368 | $ 551,746 | 7.0 % |

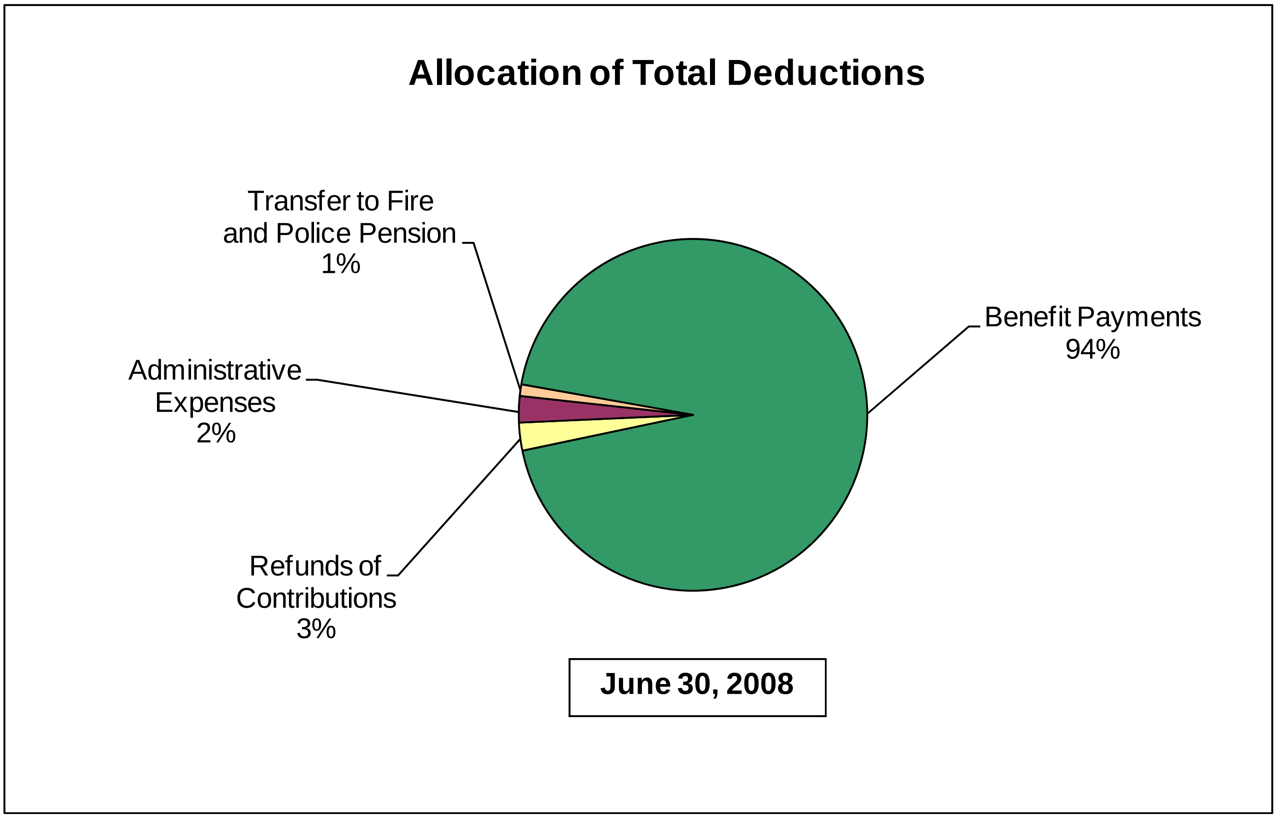
LACERS deductions from net assets in the reporting period can be summarized as Benefit Payments, Refunds of Contributions, Administrative Expenses, and a one-time Transfer to Fire and Police Pension. They represent the types of benefit delivery operations undertaken by LACERS and the cost associated with it. Total deductions increased by $38,622,000 or 7.0%. The benefit payments increased by $31,708,000 or 6.1% compared to the prior year. This increase is due to the increase in number of retirees by 0.9% and increase in the average monthly benefit amount by 4.1%, which includes the annual cost of living adjustment of approximately 3%. The refunds of contributions decreased by $2,303,000 or 13.2%.

Administrative expense grew by 26.4% over the prior year. This relatively large increase was mainly due to the lower base in the prior year resulting from an offset in administrative expense by a miscellaneous income received from a legal settlement. Without this offset, the current year's administrative expense would represent a 15.2% increase over the prior year. This 15.2% of increase in administrative expense was primarily attributable to the increase of salaries and wages, which included a retroactive cost of living adjustment.

During this fiscal year, the System transferred $6,220,000 to the Los Angeles Fire and Police Pension (LAFPP) System, one of the three Defined Benefit Pension Plans of the City. The amount represents the discounted present value of assets, $5,366,000 for the Retirement Plan and $854,000 for the Postemployment Healthcare Plan, associated with certain Harbor Port Police Officers who elected to transfer from LACERS to LAFPP based on an amendment to the Los Angeles City Administrative Code.

**Change in Net Assets – Deductions from Net Assets (continued)**



## REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of LACERS finances for all those with an interest in LACERS finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

LACERS
Fiscal Management Section
360 East Second Street, Eighth Floor
Los Angeles, California 90012

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**RETIREMENT PLAN AND POSTEMPLOYMENT HEALTHCARE PLAN**
**STATEMENT OF PLAN NET ASSETS**
**AS OF JUNE 30, 2008, WITH COMPARATIVE TOTALS**
***(IN THOUSANDS)***

| | *Retirement Plan* | *Postemployment Healthcare Plan* | *2008 Total* | *2007 Total* |
|---|---|---|---|---|
| ***Assets*** | | | | |
| Cash and Short-Term Investments | $ 567,291 | $ 80,506 | $ 647,797 | $ 519,341 |
| Receivables | | | | |
| Accrued Investment Income | 32,985 | 4,681 | 37,666 | 38,365 |
| Proceeds from Sales of Investments | 46,149 | 6,549 | 52,698 | 64,317 |
| Other | 8,308 | 1,179 | 9,487 | 8,172 |
| Total Receivables | 87,442 | 12,409 | 99,851 | 110,854 |
| Investments, at Fair Value | | | | |
| U.S. Government Obligations | 209,742 | 29,765 | 239,507 | 505,416 |
| Municipal Bonds | 1,044 | 148 | 1,192 | 1,833 |
| Domestic Corporate Bonds | 837,735 | 118,886 | 956,621 | 765,194 |
| International Bonds | 163,622 | 23,220 | 186,842 | 185,419 |
| Opportunistic Debt | 90,381 | 12,826 | 103,207 | - |
| Domestic Stocks | 3,410,240 | 483,960 | 3,894,200 | 4,554,623 |
| International Stocks | 1,917,103 | 272,064 | 2,189,167 | 2,608,588 |
| Mortgages | 733,033 | 104,028 | 837,061 | 756,506 |
| Government Agencies | 85,018 | 12,065 | 97,083 | 203,954 |
| Real Estate | 556,071 | 78,914 | 634,985 | 511,244 |
| Venture Capital and Alternative Investments | 763,387 | 108,335 | 871,722 | 695,862 |
| Security Lending Collateral | 1,589,369 | 225,554 | 1,814,923 | 2,612,246 |
| Total Investments | 10,356,745 | 1,469,765 | 11,826,510 | 13,400,885 |
| Capital Assets | | | | |
| Furniture, Fixtures and Equipment (Net of Depreciation) | 338 | 48 | 386 | 306 |
| Total Assets | 11,011,816 | 1,562,728 | 12,574,544 | 14,031,386 |
| ***Liabilities*** | | | | |
| Accounts Payable and Accrued Expenses | (22,214) | (3,153) | (25,367) | (29,262) |
| Purchases of Investments | (317,065) | (44,995) | (362,060) | (318,259) |
| Security Lending Collateral | (1,589,369) | (225,554) | (1,814,923) | (2,612,246) |
| Total Liabilities | (1,928,648) | (273,702) | (2,202,350) | (2,959,767) |
| ***Net Assets Held In Trust For Pension Benefits And Post-employment Healthcare Benefits (A Schedule of Funding Progress is Presented in the Required Supplementary Information Section)*** | $ 9,083,168 | $ 1,289,026 | $ 10,372,194 | $ 11,071,619 |

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

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**RETIREMENT PLAN AND POSTEMPLOYMENT HEALTHCARE PLAN**
**STATEMENT OF CHANGES IN PLAN NET ASSETS**
**FOR THE YEAR ENDED JUNE 30, 2008, WITH COMPARATIVE TOTALS**
***(IN THOUSANDS)***

| | *Retirement Plan* | *Postemployment Healthcare Plan* | *2008 Total* | *2007 Total* |
|---|---|---|---|---|
| ***Additions*** | | | | |
| Contributions | | | | |
| City Contributions | $ 302,810 | $ 108,848 | $ 411,658 | $ 408,393 |
| Member Contributions | 114,678 | - | 114,678 | 106,234 |
| Total Contributions | 417,488 | 108,848 | 526,336 | 514,627 |
| Investment Income (Loss) | | | | |
| Net Appreciation (Depreciation) in Fair Value of Investments Including Gain and Loss on Sales | (810,799) | (129,040) | (939,839) | 1,550,225 |
| Interest | 135,287 | 17,781 | 153,068 | 139,223 |
| Dividends | 106,871 | 14,046 | 120,917 | 110,822 |
| Alternative Investment Income, Net of Expense | 10,566 | 1,076 | 11,642 | 17,484 |
| Real Estate Operating Income, Net of Expense | 13,385 | 1,509 | 14,894 | 19,390 |
| Security Lending Income | 17,059 | 2,242 | 19,301 | 8,970 |
| Less: Security Lending Expense | (2,799) | (445) | (3,244) | (1,793) |
| Sub-Total | (530,430) | (92,831) | (623,261) | 1,844,321 |
| Less: Investment Management Expense | (19,956) | (3,176) | (23,132) | (21,061) |
| Net Investment Income (Loss) | (550,386) | (96,007) | (646,393) | 1,823,260 |
| Return of Excess Reserve | - | 11,000 | 11,000 | - |
| Total Additions | (132,898) | 23,841 | (109,057) | 2,337,887 |
| ***Deductions*** | | | | |
| Benefit Payments | (484,549) | (70,096) | (554,645) | (522,937) |
| Refunds of Contributions | (15,149) | - | (15,149) | (17,452) |
| Administrative Expenses | (11,987) | (2,367) | (14,354) | (11,357) |
| Transfer to Fire and Police Pension | (5,366) | (854) | (6,220) | - |
| Total Deductions | (517,051) | (73,317) | (590,368) | (551,746) |
| ***Net Increase (Decrease)*** | (649,949) | (49,476) | (699,425) | 1,786,141 |
| ***Net Assets Held in Trust for Pension Benefits and Postemployment Healthcare Benefits*** | | | | |
| ***Beginning of Year*** | 9,733,117 | 1,338,502 | 11,071,619 | 9,285,478 |
| ***End of Year*** | $ 9,083,168 | $ 1,289,026 | $ 10,372,194 | $ 11,071,619 |

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

## NOTE 1 – DESCRIPTION OF THE SYSTEM AND SIGNIFICANT ACCOUNTING POLICIES

### General Description

The Los Angeles City Employees' Retirement System (the System) is under the exclusive management and control of its Board of Administration (the Board), whose authority is granted by the Los Angeles City Charter (Article XI). The System is a department of the City of Los Angeles (the City). The System's financial statements are included in the City of Los Angeles' Annual Financial Report as a pension trust fund.

The System operates a single-employer defined benefit plan (the Retirement Plan) and Postemployment Healthcare Plan. A description of each Plan is located in Note 2 and Note 3. All Notes to the Financial Statements apply to both Plans unless indicated otherwise.

### Basis of Accounting

The financial statements are maintained on the accrual basis of accounting. Member contributions are recognized as revenues in the period in which compensation is paid to the Member by the employer. Because the employer has made a formal commitment to provide the contributions, employer contributions are recognized when due. Benefits and refunds are recognized when due and payable.

### Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, as outlined by the Governmental Accounting Standards Board (GASB).

The accompanying financial statements include certain prior year summarized comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States.

### Fair Value of Investments

Funds are invested pursuant to the Los Angeles City Charter and the System's investment policy established by the Board under Article XI Section 1106(d) of the City Charter. The System's investment portfolios are primarily composed of domestic and international equities, domestic and international bonds, real estate and alternative investment, and short-term investments that include obligations of the U.S. Treasury, agencies, commercial paper rated A-1, bankers acceptances, repurchase agreements and the short-term investment fund managed in-house by staff.

Securities traded on a national or international exchange are valued at the last reported sales price at the current exchange rates. Short-term investments, bonds, stocks, and alternative investments are reported at fair value. The fair values of real estate investment funds are provided by the individual real estate fund managers based on periodic appraisals, in the form of either annual in-house appraisals or longer-term appraisals by outside professionals, in accordance with the industry practice. The fair value determined as such is also evaluated by the Board's real estate consultant. The fair value of alternative investment funds is provided by the individual General Partners at a liquidating event or other significant events during the reporting period. The fair value of futures and forward contracts are determined using available market information. Debt rewrites are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Management's investment strategy, as it relates to the debt portfolio, is to achieve market appreciation and not hold bonds to their maturities.

**NOTE 1 – DESCRIPTION OF THE SYSTEM AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Fair Value of Investments (continued)**

Investment transactions are accounted for on the date the securities are purchased or sold (trade date). Unsettled investment trades as of fiscal year-end are reported in the financial statements on an accrual basis. The corresponding proceeds due from sales are reported on the statement of plan net assets as receivables and labeled proceeds from sales of investments, and amounts payable for purchases are reported as current liabilities and labeled purchases of investments. Dividend income is recorded on ex-dividend date, and interest income is accrued as earned.

**Concentrations of Market and Credit Risk**

The System's exposure to credit loss in the event of nonperformance of its investments is limited to the carrying value of such instruments. The System's concentrations of credit risk and market risk are dictated by the System's investment guidelines. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of these investments, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported in the statement of plan net assets and the statement of changes in plan net assets.

**Capital Assets**

Effective July 1, 2001, purchases of capital assets, consisting primarily of office furniture and computer equipment are capitalized upon acquisition and depreciated over five years. Prior to July 1, 2001, these purchases were recorded and expensed in the year acquired. Depreciation is calculated using the straight-line method.

**Administrative Expenses**

All administrative expenses are funded from the System's plan net assets, which include both the investment earnings and the contributions from employers and Members.

**Reserves**

As provided in the Los Angeles City Charter, the System is maintained on a reserve basis, determined in accordance with accepted actuarial methods. The Los Angeles City Charter establishes reserves for the following:

Member Contributions – Active Member contributions to the Retirement Plan and interest credited to Members' accounts, less refunds of Member contributions and transfers to the annuity reserve.

Employer Contributions – Consists of the following components:

Basic Pensions – City contributions and investment earnings (losses), accumulated to provide for the City's guaranteed portion of retirement benefits, less payments to retired Members.

Annuity – Member contributions transferred to the City and used to provide for the Members' share of retirement benefits and investment earnings (losses) excluding net appreciation (depreciation) in fair value of investments, less payments to retired Members.

Larger Annuity – Member's larger annuity account balances at retirement including IRS Section 457 deferred compensation and other rollovers, investment earnings (losses) including net appreciation (depreciation) in fair value of investments, less payments to retired participating Members.

Family Death Benefits – Member contributions, matching City contributions, and investment earnings (losses) excluding net appreciation (depreciation) in fair value of investments reserved to pay benefits under the family death benefits insurance plan established by the System, less payments to beneficiaries.

**NOTE 1 – DESCRIPTION OF THE SYSTEM AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Reserves (continued)**

Postemployment Health Benefits – City contributions and investment earnings (losses) accumulated to provide health care benefits for retirees, less payments to insurance providers and/or reimbursements to retired Members.

Reserve balances as of June 30, 2008, are as follows (in thousands):

| | | | |
|---|---|---|---|
| Member Contributions | $ | 1,425,845 | |
| Basic Pensions | | 7,182,528 | |
| Annuity | | 451,178 | |
| Larger Annuity | | 10,978 | |
| Family Death Benefits | | 12,638 | |
| Postemployment Health Benefits | | 1,289,027 | |
| Total Reserves | $ | 10,372,194 | * ** |

* During fiscal year 2008, the System's reserves were reduced by $6,220,000 due to the transfer of Harbor Port Police Officers from the System to the Los Angeles Fire and Police Pension Plan pursuant to a voter-approved City Charter Amendment.

** During fiscal year 2008, the System's Postemployment Health Benefits reserve was credited with $11,000,000 representing the return of excess premium stabilization reserve from a healthcare provider.

**Use of Estimates in Preparation of the Financial Statements**

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

**Implementation of New Accounting Pronouncement**

The System early implemented GASB Statement No. 50, Pension Disclosures, an Amendment of GASB Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans for its fiscal year ended June 30, 2007.

**NOTE 2 – RETIREMENT PLAN DESCRIPTION**

**Plan Description**

The Retirement Plan covers all full-time personnel and department-certified part-time employees of the City of Los Angeles, except for sworn employees of the Fire and Police departments, Department of Water and Power employees, elected officials who elected to participate in an alternative Defined Contribution Plan, and certain Port Police officers of the Harbor Department including those who elected to opt out of LACERS Plan.

Eligible employees contribute based on rates delineated in the City's Administrative Code. The City contributes to the Retirement Plan based upon rates recommended by an independent actuary and adopted by the Board. Contributions are invested and applied to benefit payments with accumulated investment earnings. The Retirement Plan provides for service and disability retirement benefits, as well as death benefits. Changes to the benefits provided require approval by the City Council.

**NOTE 2 – RETIREMENT PLAN DESCRIPTION (continued)**

**Plan Description (continued)**

At June 30, 2008, the components of the System's membership were as follows:

| | |
|---|---|
| Active: | |
| Vested | 20,600 |
| Nonvested | 9,636 |
| | 30,236 |
| Inactive: | |
| Nonvested | 2,951 |
| Terminated Entitled to Benefits, Not Yet Receiving Benefits | 1,322 |
| Retired | 14,975 |
| Total | 49,484 |

**Funding Policies and Funded Status and Progress**

The Plan's funding policy under Article XI Sections 1158 and 1160 of the Los Angeles City Charter provides for periodic employer contributions at actuarially-determined rates that, expressed as percentages of annual covered payroll together with certain fixed amounts, are sufficient to accumulate the required assets to pay benefits when due. For the year ended June 30, 2008, the annual required contribution to the Retirement Plan by the City was determined at 16.54% of covered payroll, determined by the June 30, 2006 actuarial valuation. The actual contribution made by the City for fiscal year 2007-08 was equal to the recommended rate as adopted by the Board of Administration, which is the recommended contribution rate set equal to the greater of the current funding policy or the minimum Annual Required Contribution (ARC) as determined under GASB Statements 25 and 27. Members who entered the System prior to February 1983 contribute from 8.22% to 13.33% of their salaries based upon their age when they entered the System; however, these contributions are subsidized by the City under a collective bargaining agreement (see Note 6). Members entering subsequent to January 1983 contribute a flat rate of 6%. Members of the System have a vested right to their own contribution and accumulated interest posted to their accounts. Generally after five years of employment, Members are eligible for future retirement benefits, which increase with length of service. If a Member with five or more years of service terminates employment, the Member has the option of receiving retirement benefits when eligible or withdrawing from the System, and having his or her contributions and accumulated interest refunded. Benefits are based upon age, length of service and compensation.

As of June 30, 2008, the most recent actuarial valuation date, the Plan was 84.4% funded. The actuarial accrued liability for benefits was $11,186,404,000 and the actuarial value of assets was $9,438,318,000, resulting in an unfunded actuarial accrued liability (UAAL) of $1,748,086,000. The covered payroll as of June 30, 2008 valuation was $1,977,645,000. The ratio of UAAL to the covered payroll was 88.4%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, inflation, and investment returns. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information on page 30 following the notes to financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

**NOTE 2 – <u>RETIREMENT PLAN DESCRIPTION</u> (continued)**

**Funding Policies and Funded Status and Progress (continued)**

**Actuarial Methods and Assumptions**

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan Members) and include the types of benefits provided at the time each valuation and historical pattern of sharing of benefit costs between the employer and plan Members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in the actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial methods and significant assumptions used in the valuation year of June 30, 2008 are summarized in this note to conform to the disclosure requirements for GASB No. 50.

| | |
|---|---|
| Valuation Date | June 30, 2008 |
| Actuarial-Cost Method | Projected Unit Credit Cost Method – assuming a closed group. |
| Amortization Method | Level Percent of Payroll – assuming a 4.25% increase in total covered payroll. |
| Remaining Amortization Period | Multiple layers. Actuarial gains/losses are amortized over 15 years, closed. Plan and assumption changes are amortized over 30 years, closed. The existing layers on June 30, 2005, except those arising from the phase-in of contribution rates for the May 30, 2002 experience study, were combined and amortized over 30 years. The amortization period may be adjusted to comply with GASB requirements on maximum amortization period for all layers combined. |
| Asset Valuation Method | Market value of assets less unrecognized returns in each of the last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five-year period. |
| Actuarial Assumptions: | |
| Investment Rate of Return | 8.00% |
| Includes Inflation at | 3.75% |
| Real Across-the-Board Salary Increase | 0.50% |
| Projected Salary Increases | Ranges from 12.25% to 6.75% for Members with less than 5 years of service. Ranges from 6.50% to 4.75% for Members with 5 or more years of service. |
| Cost of Living Adjustments | 3.00% |
| Mortality Table for Retirees and Beneficiaries | RP-2000 Combined Healthy Mortality Table, set back 1 year |
| Mortality Table for Disabled Retirees | RP-2000 Combined Healthy Mortality Table, set forward 7 years |

## NOTE 3 – <u>POSTEMPLOYMENT HEALTHCARE PLAN DESCRIPTION</u>

### Plan Description

The System provides Postemployment Healthcare benefits to eligible retirees of the Retirement Plan and their spouses/domestic partners. Generally the benefits of this single employer Postemployment Healthcare Plan are available to all employees who 1) participate in the Retirement Plan; 2) have at least 10 years of service with the System; and 3) enrolled in a System-sponsored medical or dental plan or are a participant in the Medical Premium Reimbursement Program (MPRP). The retiree or surviving spouse/domestic partner can choose from the health plans that are available, which include medical, vision, caregiver, and dental benefits, or participate in the MPRP if he/she resides in an area not covered by the available medical plans. The retiree or surviving spouse/domestic partner receives medical or dental subsidies based on years of service and the maximum subsidies are set annually by the Board.

### Funding Policies and Funded Status and Progress

The Plan's funding policy under Article XI Sections 1158 and 1160 of the Los Angeles City Charter provides for periodic employer contributions at actuarially-determined rates that, expressed as percentages of annual covered payroll together with certain fixed amounts, are sufficient to accumulate the required assets to pay benefits when due. The required contribution rate for the Postemployment Healthcare Plan for the fiscal year ended June 30, 2008, was 6.25% of covered payroll, determined by the June 30, 2006 actuarial valuation. As of June 30, 2008, the most recent actuarial valuation date, the Plan was 69.7% funded. The actuarial accrued liability for benefits was $1,928,043,000 and the actuarial value of assets was $1,342,920,000, resulting in an unfunded actuarial accrued liability (UAAL) of $585,123,000. The covered payroll as of June 30, 2008 valuation was $1,977,645,000. The ratio of UAAL to the covered payroll was 29.6%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, investment returns, and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information on page 33 following the notes to financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. However, funded ratios for years prior to June 30, 2005 were not calculated using the parameters required for GASB No. 43 because the Plan's funding policy excluded active employees with less than 10 years of service.

### Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan Members) and include the types of benefits provided at the time each valuation and historical pattern of sharing of benefit costs between the employer and plan Members to that point. The actuarial methods and assumptions used include techniques such as 5-year smoothing of assets and amortization of UAAL over 15 or 30 years, that are designed to reduce the effects of short-term volatility in funding, consistent with the long-term perspective of the calculations.

**NOTE 3 – POSTEMPLOYMENT HEALTHCARE PLAN DESCRIPTION (continued)**

**Actuarial Methods and Assumptions (continued)**

| | |
|---|---|
| Valuation Date | June 30, 2008 |
| Actuarial-Cost Method | Projected Unit Credit Cost Method – assuming a closed group. |
| Amortization Method | Level Percent of Payroll – assuming a 4.25% increase in total covered payroll. |
| Remaining Amortization Period | Multiple layers. Actuarial gains/losses are amortized over 15 years, closed. Plan changes are amortized over 30 years, closed. The existing layers on June 30, 2005 were combined and amortized over 30 years. The amortization period may be adjusted to comply with GASB requirements on maximum amortization period for all layers combined. |
| Asset Valuation Method | Market value of assets less unrecognized returns in each of the last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five-year period. |
| Actuarial Assumptions: | |
| Investment Rate of Return | 8.00% |
| Mortality Table for Retirees and Beneficiaries | RP-2000 Combined Healthy Mortality Table, set back 1 year |
| Mortality Table for Disabled Retirees | RP-2000 Combined Healthy Mortality Table, set forward 7 years |
| Marital Status | 65% of male and 40% of female retirees who receive a subsidy are assumed to be married or have a qualified domestic partner and elect dependent coverage. |
| Spouse Age Difference | Males are assumed to be 4 years older than their female spouses. |
| Surviving Spouse Coverage | With regard to Members who are currently alive, 100% of eligible spouses or domestic partners are assumed to elect continued health coverage after the Member's death. |
| Participation | 50% of inactive Members are assumed to receive a subsidy for a City approved health carrier.<br>100% of retirees becoming eligible for Medicare is assumed to be covered by both Parts A and B. |

**NOTE 3 – POSTEMPLOYMENT HEALTHCARE PLAN DESCRIPTION (continued)**

**Actuarial Methods and Assumptions (continued)**

Health Care Cost Trend Rates

Trend Rates to be applied in the following fiscal years, to all health plans. Trend Rate is to be applied to premium for shown fiscal year to calculate next fiscal year's projected premium.

Medical Premium Trend Rates to be applied to Fiscal Year 2008-2009 and later years are:

| First Fiscal Year (July 1, 2008 through June 30, 2009) | | |
|---|---|---|
| Carrier | Under Age 65 | Age 65 & Over |
| Kaiser HMO | 9.30% | N/A |
| Blue Cross HMO | 7.79% | N/A |
| Blue Cross PPO | 7.94% | 7.94% |
| Senior Advantage | 6.39% | |
| Secure Horizons | 11.06% | |

| Fiscal Year 2009 - 2010 and later | |
|---|---|
| Fiscal Year | Trend (Approx) |
| 2009 - 2010 | 8.75% |
| 2010 - 2011 | 8.25% |
| 2011 - 2012 | 7.75% |
| 2012 - 2013 | 7.25% |
| 2013 - 2014 | 6.75% |
| 2014 - 2015 | 6.25% |
| 2015 - 2016 | 5.75% |
| 2016 - 2017 | 5.25% |
| 2017 - 2018 & later | 5.00% |

Dental Premium Trend to be applied is 5.00% for all years.

Medicare Part B Premium Trend to be applied is 1.53% for the Fiscal Year 2008-2009, and 5.00% in the Fiscal Year 2009-2010 and later.

## NOTE 4 – CONTRIBUTIONS REQUIRED AND CONTRIBUTIONS MADE

The System currently uses the projected unit credit cost method to determine the required annual contribution amount for the Retirement Plan and the Postemployment Healthcare Plan. The required annual contribution amount is composed of two components, (1) normal cost, which is the cost of the portion of the benefit that is allocated to a given year, and (2) the payment to amortize the unfunded actuarial accrued liability (UAAL) which is the difference between LACERS actuarial liabilities and assets.

For the valuation as of June 30, 2008, the components of the UAAL are amortized as a level percent of pay. Based on the System's amortization policy, increases or decreases in the UAAL due to plan or assumption changes are amortized over 30 years. Experience gains and losses are amortized over 15 years, subject to adjustments to comply with GASB requirements on maximum amortization period for all layers combined. The amortization periods are considered "closed" as the amounts calculated annually are amortized over either a 15- or 30-year period.

The contributions to the System for the year ended June 30, 2008, of approximately $526,336,000 ($417,488,000 for the Retirement Plan and $108,848,000 for the Postemployment Healthcare Plan), were made in accordance with actuarially-determined requirements computed through the actuarial valuation dated June 30, 2006.

Contributions to the System consisted of the following for the year ended June 30, 2008 (in thousands):

| | Retirement Plan | Postemployment Healthcare Plan |
|---|---|---|
| City Contributions: | | |
| Required Contribution | $ 288,119 | $ 108,848 |
| Defrayal Portion of Member Contributions | 14,486 | - |
| Family Death Benefits Insurance Plan | 205 | - |
| Total City Contributions | 302,810 | 108,848 |
| Member Contributions | 114,678 | - |
| Total Contributions | $ 417,488 | $ 108,848 |

The amount of the contributions made for the Retirement Plan under the Required Contribution category ($288,119,000) were equal to 100% of the Annual Required Contributions (ARC) of the employer as defined by GASB Statements No. 25 and No. 27. The contributions made for the Postemployment Healthcare Plan, in the amount of $108,848,000, represents 100% of the ARC as defined by GASB No. 43 and No. 45.

## NOTE 5 – HISTORICAL TREND INFORMATION

Historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented on pages 30 through 32 for the Retirement Plan and pages 33 through 35 for the Postemployment Healthcare Plan.

## NOTE 6 – DEFRAYAL PORTION OF MEMBER CONTRIBUTIONS-RETIREMENT PLAN

For Members who entered the System prior to February 1983, the City subsidizes a portion of Member contributions. Payments made by the City based on the subsidy are not refundable to Members upon their withdrawal from the System prior to retirement.

The subsidized amount paid by the City was approximately 4.8% of total City contributions paid for the Retirement Plan for the year ended June 30, 2008, or $14,486,000 for the year ended June 30, 2008.

**NOTE 7 – CASH AND SHORT-TERM INVESTMENTS AND INVESTMENTS**

The Board has the responsibility for the investment of the System's funds with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims, as prescribed by Article XI Section 1106(c) of the City Charter.

The System considers investments purchased with maturity of 12 months or less to be short-term investments. The carrying value of cash and short-term investments at June 30, 2008, on the Retirement Plan and Postemployment Healthcare Plan Statement of Plan Net Assets includes approximately $667,000 held in the System's general operating accounts with the City Treasurer and short-term investments funds (STIF) of $647,130,000 for a total of $647,797,000. The amounts held by the City Treasurer are pooled with the monies of other City agencies and invested by the City Treasurer's office. These assets are not individually identifiable. At June 30, 2008, short-term investments included collective STIF of $124,943,000, international STIF of $326,807,000, financial paper of $179,982,000 and future initial margin of $15,398,000.

Credit Risk

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The System seeks to maintain a diversified portfolio of fixed income instruments in order to obtain the highest total return for the fund at an acceptable level of risk within this asset class. The credit quality ratings of investments in fixed income securities by a nationally recognized statistical rating organization as of June 30, 2008 are as follows (dollars in thousands):

| Quality Ratings | Fair Value | Percentage |
|---|---|---|
| AAA | $ 1,017,021 | 47.28 % |
| AA | 70,146 | 3.26 |
| A | 268,822 | 12.50 |
| BBB | 334,172 | 15.53 |
| BB | 120,874 | 5.62 |
| B | 100,388 | 4.67 |
| CCC | 23,812 | 1.10 |
| Not Rated | 215,986 | 10.04 |
| | 2,151,221 | 100.00 % |
| U.S. Government Guaranteed Securities * | 270,292 | |
| Total Fixed Income Securities | $ 2,421,513 | |

* Consists of U.S. Government Bonds and GNMA Mortgage-Backed Securities which had the AAA rating.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a financial institution's failure of depository financial institution, the System would not be able to recover its deposits or would not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. As of June 30, 2008, the System has exposure to such risk in the amount of $14,113,000, or 0.63% of the fair value of total international investments. The amount represents non-invested cash denominated in foreign currencies, managed by 14 different investment managers, and held outside of the System's custodial bank. The System's policy requires each individual publicly traded equities investment managers to hold no more than 10% of their portfolios in the form of cash. The plan is in compliance with the policy.

Custodial Credit Risk (continued)

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not insured, or are not registered in the System's name, and held by the counterparty. The System's investments are not exposed to custodial credit risk if they are insured or registered in the System's name. The System's investments were not exposed to custodial credit risk because all securities were held by the System's custodial bank in the System's name.

Concentration of Credit Risk

The investment portfolio as of June 30, 2008 contained no concentration of investments in any one entity that represented 5 percent or more of the total investment portfolio.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. One of the ways the System manages its exposure to interest rate risk is by requiring the fixed income investment managers to maintain their portfolio effective duration within a specified range of the Lehman U.S. Universal Bond Index, the Lehman Intermediate Government Credit Index, or the Lehman Aggregate Bond Index, depending on the Board's mandates. The effective duration is a measure, in years, of interest-rate sensitivity in debt investments. The longer the effective duration, the greater the sensitivity to interest rate changes. Information about the sensitivity of the fair values of the System's investments to market interest rate fluctuations is provided by the following table that shows the weighted average effective duration of the System's fixed income securities by investment type (dollars in thousands):

| Investment Type | Amount | Weighted Average Duration (in Years) |
|---|---|---|
| Asset-Backed Securities | $ 50,679 | 1.34 |
| Commercial Mortgage-Backed Securities | 121,874 | 4.82 |
| Corporate Bonds | 971,473 | 6.20 |
| Government Agencies | 110,870 | 3.70 |
| Government Bonds | 239,703 | 6.00 |
| Government Mortgage-Backed Securities | 714,995 | 4.50 |
| Gov't-issued Commercial Mortgage-Backed | 191 | 4.09 |
| Index Linked Government Bonds | 28,673 | 7.72 |
| Municipal/Provincial Bonds | 2,585 | 2.23 |
| Non-Government Backed C.M.O.s | 77,263 | 2.03 |
| Opportunistic Debt | 103,207 | 3.30 |
| Total Fixed Income Securities | $ 2,421,513 | |

Highly Sensitive Investments

Highly Sensitive Investments are certain debt investments whose terms may cause their fair value to be highly sensitive to market interest rate changes. Terms include such information as embedded options, coupon multipliers, benchmark indexes, and reset dates. The System's asset-backed investments have embedded prepayment options that will typically cause prepayments by the obligees of the underlying investments when interest rates fall. Prepayments eliminate the stream of future interest payments and, therefore, diminish the fair value of the asset-backed investment. The following table shows the fair value of the System's asset-backed investments by investment type (in thousands):

**NOTE 7 – CASH AND SHORT-TERM INVESTMENTS AND INVESTMENTS (continued)**

Highly Sensitive Investments (continued)

| Investment Type | Amount |
|---|---|
| Asset-Backed Securities | $ 50,679 |
| Commercial Mortgage-Backed Securities | 121,874 |
| Government Agencies | 110,870 |
| Government Mortgage-Backed Securities | 714,995 |
| Gov't-issued Commercial Mortgage-Backed | 191 |
| Non-Government Backed C.M.O.s | 77,263 |
| Total Asset-Backed Investments | $ 1,075,872 |

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The System's Asset Allocation policy sets a target of 20% of the total portfolio for non-U.S. investments in equities. In addition, fixed income, real estate, and alternative investment managers may hold non-U.S. investments depending on their individual mandates. Forward currency contracts and currency futures are permitted primarily to reduce the foreign currency risk (refer to Note 9 - Futures and Forwards Contracts).

The System's non-U.S. currency investment holdings as of June 30, 2008, which represents 19.0% of fair value of total investments, are as follows (in thousands):

**NOTE 7 – CASH AND SHORT-TERM INVESTMENTS AND INVESTMENTS (continued)**

Foreign Currency Risk (continued)

| Foreign Currency Type | Cash and Adjustments to Cash | Equity | Fixed Income | Other Investments | Total Fair Value in USD |
|---|---|---|---|---|---|
| Argentine peso | $ 146 | $ - | $ 219 | $ - | $ 365 |
| Australian dollar | 2,878 | 100,995 | 7,655 | - | 111,528 |
| Brazilian real | 412 | 10,070 | - | 4 | 10,486 |
| British pound sterling | (10,776) | 335,931 | - | 33,314 | 358,469 |
| Canadian dollar | 798 | 51,774 | 6,677 | - | 59,249 |
| Chilean peso | 924 | 1,044 | - | - | 1,968 |
| Czech koruna | 5 | 983 | - | - | 988 |
| Danish krone | 392 | 20,736 | - | - | 21,128 |
| Egyptian pound | 11 | - | 758 | - | 769 |
| Euro | 37,618 | 548,485 | 2,762 | 102,744 | 691,609 |
| Hong Kong dollar | 1,831 | 94,584 | - | - | 96,415 |
| Hungarian forint | 125 | 1,311 | - | 11 | 1,447 |
| Indian rupee | 67 | 14,782 | - | - | 14,849 |
| Indonesian rupiah | 137 | 6,027 | - | - | 6,164 |
| Japanese yen | (1,834) | 347,118 | - | 19,053 | 364,337 |
| Malaysian ringgit | 603 | 12,628 | - | - | 13,231 |
| Mexican peso | 709 | 9,200 | 12,237 | - | 22,146 |
| New Israeli shekel | 30 | 1,792 | - | - | 1,822 |
| New Taiwan dollar | 2,945 | 47,817 | - | - | 50,762 |
| New Zealand dollar | 94 | 667 | - | - | 761 |
| Norwegian krone | (3,257) | 45,937 | - | - | 42,680 |
| Peruvian nuevo sol | - | - | 513 | - | 513 |
| Philippine peso | 74 | 22,937 | - | 1 | 23,012 |
| Polish zloty | (155) | 8,514 | - | 6 | 8,365 |
| Russian ruble | - | - | 544 | - | 544 |
| Singapore dollar | 800 | 42,821 | 19,614 | - | 63,235 |
| South African rand | 303 | 15,228 | - | - | 15,531 |
| South Korean won | 1,318 | 63,316 | - | - | 64,634 |
| Swedish krona | 5,078 | 19,353 | - | 51 | 24,482 |
| Swiss franc | (632) | 142,583 | - | 3,235 | 145,186 |
| Thai baht | 36 | 28,522 | - | - | 28,558 |
| Turkish lira | 86 | 3,247 | - | - | 3,333 |
| Total Investments Held in Foreign Currency | $ 40,766 | $ 1,998,402 | $ 50,979 | $ 158,419 | $ 2,248,566 |

**NOTE 8 – SECURITIES LENDING AGREEMENT**

The System has entered into various short-term arrangements with its custodian under Article XXXIV Section 504 of the City Charter, whereby securities are lent to various brokers. The custodian determines which lenders' accounts to lend securities from by using an impartial sequential system that matches loan requests with various lenders' accounts. All lenders are deemed to have relatively equal opportunity to profit from the lending of securities. Therefore, should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency is allocated pro rata among all lenders.

Minimum collateralization is 102% of fair value of the borrowed U.S. securities and 105% for international securities. Collateral consists of cash, government securities, and irrevocable bank letters of credit. Cash collateral may be invested separately or pooled in a separate fund for investing in money market or cash equivalent investments.

The borrower has all incidents of ownership with respect to borrowed securities and collateral, including the right to vote and transfer or loan borrowed securities to others. The System is entitled to receive all distributions, which are made by the issuer of the borrowed securities, directly from the borrower. Under the agreement, the custodian will indemnify the System as a result of the custodian's failure to: 1) make a reasoned determination of the creditworthiness of a potential borrower before lending and, during the term of the loan or loans, the borrower files a petition of bankruptcy or similar action; 2) demand adequate collateral; or 3) otherwise maintain the securities lending program in compliance with the Federal Financial Institutions Examination Council Supervisory Policy on Securities Lending.

These agreements provide for the return of the securities and revenue determined by the type of collateral received. The cash collateral values of securities on loan to brokers are shown at their fair value on the statement of plan net assets.

As of June 30, 2008, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceed the amounts the borrowers owed the System. The System had no losses on securities lending transactions resulting from default of a borrower or lending agent. However, there is credit risk exposure due to impairment of securities purchased with the cash collateral.

All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in a collateral account consisting of short and intermediate term investments. The System cannot pledge or sell non-cash collateral unless the borrower defaults.

The following represents the balances relating to the security lending transactions as of June 30, 2008 (in thousands):

Fair value of collateral received for loaned securities as of June 30, 2008:

| Securities Lent | Cash | Non-Cash | Total Collateral Value |
|---|---|---|---|
| U.S. Government and Agency Securities | $ 313,087 | $ 32,682 | $ 345,769 |
| Domestic Corporate Fixed Income Securities | 76,337 | - | 76,337 |
| International Fixed Income Securities | 22,004 | - | 22,004 |
| Domestic Stocks | 1,242,324 | - | 1,242,324 |
| International Stocks | 161,171 | 223,384 | 384,555 |
| | $ 1,814,923 | $ 256,066 | $ 2,070,989 |

**NOTE 8 – SECURITIES LENDING AGREEMENT (continued)**

Fair value of loaned securities as of June 30, 2008:

| Securities Lent | Cash | Non-Cash | Total Fair Value of Underlying Securities |
|---|---|---|---|
| U.S. Government and Agency Securities | $ 306,376 | $ 29,713 | $ 336,089 |
| Domestic Corporate Fixed Income Securities | 74,265 | - | 74,265 |
| International Fixed Income Securities | 20,886 | - | 20,886 |
| Domestic Stocks | 1,213,031 | - | 1,213,031 |
| International Stocks | 153,401 | 211,218 | 364,619 |
| | $ 1,767,959 | $ 240,931 | $ 2,008,890 |

As of June 30, 2008, the fair value of the lent securities was $2,008,890,000. The fair value of associated collateral was $2,070,989,000. Of this amount, $1,814,923,000 represents the fair value of cash collateral and $256,066,000 represents the fair value of the non-cash collateral. Non-cash collateral, which the System does not have the ability to sell unless the borrower defaults, is not reported in the statement of plan net assets. The System's income and expenses related to securities lending were $19,301,000 and $3,244,000, respectively, for the year ended June 30, 2008.

**NOTE 9 – FUTURES AND FORWARD CONTRACTS**

The System uses derivative financial instruments, primarily to manage portfolio risk. Futures contracts are used to provide equity exposure for uninvested cash, and forward contracts are used to hedge against fluctuation in foreign currency-denominated assets primarily in trade settlements. Futures and forward contracts are marked to market and are recorded in the statement of plan net assets at fair value. Futures contracts have little credit risk, as organized exchanges are the guarantors. Forward agreements are subject to the creditworthiness of the counterparties, which are principally large financial institutions.

At June 30, 2008, the System had outstanding futures contracts for foreign currencies and the Standard and Poor's 500 Index with an aggregate notional amount of $13,585,000. In addition, at June 30, 2008, the System had outstanding forward purchase commitments with a notional amount of $108,078,000 and offsetting forward sales commitments with notional amounts of $108,078,000, which expire through September 2008. The System maintains margin collateral on the positions with brokers, consisting of cash and U.S. Treasury bills. The total collateral margin was $15,398,000 as of June 30, 2008.

The realized gain on foreign currency translation was $121,979,000 for the year ended June 30, 2008.

**NOTE 10 – COMMITMENTS AND CONTINGENCIES**

At June 30, 2008, the System was committed to future purchases of real estate and alternative investments at an aggregate cost of approximately $890,939,000.

**NOTE 11 – SUBSEQUENT EVENTS**

Events or transactions that occur subsequent to the balance sheet date, but prior to the issuance of the financial statements, that have a potential material effect on the financial statements require adjustments or disclosure in the statements. The following are disclosures of conditions, which impacted the System that did not exist as of June 30, 2008, but arose subsequent to that date.

**NOTE 11 – SUBSEQUENT EVENTS (continued)**

**Recent Market Events**

Subsequent to June 30, 2008, the global investment markets have been experiencing unprecedented, adverse events. Such events include restricted availability of capital, the continued write-down of mortgage-related assets led by defaults in sub-prime mortgages, and the declining U.S. housing market. These events resulted in federal intervention due to the failure of several large domestic financial institutions. The markets continue to suffer significant turmoil from a general uncertainty about how to best address the expanded global credit crisis and losses that financial institutions are facing.

It is management's opinion that while the value of the System's fund has been affected by the turbulent market environment, the System's investment portfolio is structured to focus on the long-term and designed to weather periods of market turbulence. Because the values of individual investment fluctuate based on volatile market conditions, the amount of losses that the System will recognize in its future financial statements, if any, cannot be determined. Market fluctuations are a normal investment risk for a pension fund. However, the collapse of major financial institutions and lack of liquidity in short-term markets, due to the recent market downturn, increased the credit risk in our security lending program.

Extraordinary circumstances that occurred subsequent to the balance sheet date, but prior to the issuance of financial statements, are disclosed because they could have a material impact on the value of investments after the date of the financial statements. Negative returns on the System's assets through November 25, 2008 could affect the funded status of the System. The ultimate impact on the funded status will be determined based on market conditions in effect when the actuarial annual valuation for the year ended June 30, 2009 is performed.

# REQUIRED SUPPLEMENTARY INFORMATION

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**REQUIRED SUPPLEMENTARY INFORMATION**
**RETIREMENT PLAN**
**SCHEDULE OF FUNDING PROGRESS**
***(DOLLARS IN THOUSANDS)***

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Underfunded or (Overfunded) AAL (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | Underfunded or (Overfunded) AAL as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| June 30, 2003 | $ 6,999,647 | $ 7,659,846 | $ 660,199 | 91.4 % | $ 1,405,058 | 47.0 % |
| June 30, 2004 | 7,042,108 | 8,533,864 | 1,491,756 | 82.5 | 1,575,285 | 94.7 |
| June 30, 2005 | 7,193,142 | 9,321,525 | 2,128,383 | 77.2 | 1,589,306 | 133.9 |
| June 30, 2006 | 7,674,999 | 9,870,662 | 2,195,663 | 77.8 | 1,733,340 | 126.7 |
| June 30, 2007 | 8,599,700 | 10,526,874 | 1,927,174 | 81.7 | 1,896,609 | 101.6 |
| June 30, 2008 | 9,438,318 | 11,186,404 | 1,748,086 | 84.4 | 1,977,645 | 88.4 |

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**REQUIRED SUPPLEMENTARY INFORMATION**
**RETIREMENT PLAN**
**SCHEDULE OF EMPLOYER CONTRIBUTIONS**
***(DOLLARS IN THOUSANDS)***

| | Employer Contributions Total | |
|---|---|---|
| Year Ended June 30: | Annual Required Contribution | Percentage Contributed |
| 2003 | $ 51,604 | 100 % |
| 2004 | 159,083 | 63 |
| 2005 | 183,241 | 86 |
| 2006 | 227,741 | 100 |
| 2007 | 277,517 | 100 |
| 2008 | 288,119 | 100 |

## NOTE 1 – DESCRIPTION

The historical trend information about the System is presented as required supplementary information. The information is intended to help users assess the funding status of the Plan on a going-concern basis and to assess progress made in accumulating assets by paying benefits when due.

## NOTE 2 – SIGNIFICANT FACTORS AFFECTING TREND IN ACTUARIAL INFORMATION AND EMPLOYER CONTRIBUTIONS

Due to the deferred investment gains accumulated in the previous four years under the 5-year "asset smoothing" method, the actuarial investment rate of return exceeded the 8% assumption for the third time in a row despite the net investment loss of $646,393,000 in current year. However, there is an unrecognized investment loss as of June 30, 2008 in the amount of $433,647,000 for the Retirement Plan and the Postemployment Healthcare Plan. This investment loss will be recognized in the determination of the actuarial value of assets for funding purposes in the next few years. This implies that earning the assumed rate of investment return of 8% per year (net of expenses) on a market value basis will result in investment losses on the actuarial value of assets in the next few years. Therefore, the contribution requirements would increase in the next few years even if the actual market return is equal to the assumed 8% rate and all other actuarial assumptions are met.

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**REQUIRED SUPPLEMENTARY INFORMATION**
**POSTEMPLOYMENT HEALTHCARE PLAN**
**SCHEDULE OF FUNDING PROGRESS**
**(*DOLLARS IN THOUSANDS)***

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Underfunded or (Overfunded) AAL (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | Underfunded or (Overfunded) AAL as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| June 30, 2003 | $ 848,983 | $ 1,205,811 | $ 356,828 | 70.4 % | $ 1,405,058 | 25.4 % |
| June 30, 2004 | 858,997 | 1,419,813 | 560,816 | 60.5 | 1,575,285 | 35.6 |
| June 30, 2005 | 893,378 | 1,718,899 | 825,521 | 52.0 | 1,589,305 | 51.9 |
| June 30, 2006 | 990,270 | 1,730,799 | 740,529 | 57.2 | 1,733,340 | 42.7 |
| June 30, 2007 | 1,185,544 | 1,730,400 | 544,856 | 68.5 | 1,896,609 | 28.7 |
| June 30, 2008 | 1,342,920 | 1,928,043 | 585,123 | 69.7 | 1,977,645 | 29.6 |

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**REQUIRED SUPPLEMENTARY INFORMATION**
**POSTEMPLOYMENT HEALTHCARE PLAN**
**SCHEDULE OF EMPLOYER CONTRIBUTIONS**
***(DOLLARS IN THOUSANDS)***

| | Employer Contributions Total | |
|---|---|---|
| Year Ended June 30: | Annual Required Contribution | Percentage Contributed |
| 2003 | $ 26,608 | 100 % |
| 2004 | 20,144 | 100 |
| 2005 | 53,190 | 100 |
| 2006 | 76,116 | 100 |
| 2007 | 115,233 | 100 |
| 2008 | 108,848 | 100 |

## NOTE 1 – DESCRIPTION

The historical trend information about the System is presented as required supplementary information. The information is intended to help users assess the funding status of the Plan on a going-concern basis and to assess progress made in accumulating assets by paying benefits when due. As the Board decided to comply with the requirements in GASB No. 43 and No. 45 for the actuarial valuation of the Postemployment Healthcare Plan as of June 30, 2005, the funded ratios for years prior to June 30, 2005 were not calculated using the parameters required by GASB No. 43 and No. 45 because the plan's funding policy excluded active employees with less than 10 years of service. Similarly, the annual required contribution (ARC) for fiscal year ended June 30, 2006 was determined in the June 30, 2004 valuation and it was not calculated using the parameters required by GASB No. 43 and No. 45.

## NOTE 2 – SIGNIFICANT FACTORS AFFECTING TREND IN ACTUARIAL INFORMATION AND EMPLOYER CONTRIBUTIONS

Due to the deferred investment gains accumulated in the previous four years under the 5-year "asset smoothing" method, the actuarial investment rate of return exceeded the 8% assumption for the third time in a row despite the net investment loss of $646,393,000 in current year. However, there is an unrecognized investment loss as of June 30, 2008 in the amount of $433,647,000 for the Retirement Plan and the Postemployment Healthcare Plan. This investment loss will be recognized in the determination of the actuarial value of assets for funding purposes in the next few years. This implies that earning the assumed rate of investment return of 8% per year (net of expenses) on a market value basis will result in investment losses on the actuarial value of assets in the next few years. Therefore, the contribution requirements would increase in each of the next few years even if the actual market return is equal to the assumed 8% rate and all other actuarial assumptions are met.

# SUPPLEMENTAL SCHEDULES

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**SCHEDULE OF ADMINISTRATIVE EXPENSES**
**YEAR ENDED JUNE 30, 2008**
***(IN THOUSANDS)***

| | Retirement Plan | Postemployment Healthcare Plan | Total |
|---|---|---|---|
| Personnel Services: | | | |
| Staff Salaries | $ 7,677 | $ 1,222 | $ 8,899 |
| Staff Benefits | 1,092 | 174 | 1,266 |
| Total Personnel Services | 8,769 | 1,396 | 10,165 |
| Professional Services: | | | |
| Actuarial | 195 | 31 | 226 |
| Data Processing | 646 | 103 | 749 |
| Audit | 83 | 13 | 96 |
| Retirees' Health Consulting | - | 458 | 458 |
| Legal Counsel | 476 | 76 | 552 |
| Medical for Temporary Disability | 106 | 17 | 123 |
| Total Professional Services | 1,506 | 698 | 2,204 |
| Communication: | | | |
| Printing | 113 | 18 | 131 |
| Telephone | 5 | 1 | 6 |
| Postage | 230 | 37 | 267 |
| Member Outreach Program | 71 | 11 | 82 |
| Travel | 94 | 15 | 109 |
| Total Communication | 513 | 82 | 595 |
| Rentals: | | | |
| Office Space | 883 | 141 | 1,024 |
| Equipment Leasing | 33 | 5 | 38 |
| Total Rentals | 916 | 146 | 1,062 |
| Miscellaneous: | | | |
| Office | 206 | 33 | 239 |
| Depreciation | 77 | 12 | 89 |
| Total Miscellaneous | 283 | 45 | 328 |
| | $ 11,987 | $ 2,367 | $ 14,354 |

**LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM**
**(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)**
**SCHEDULE OF INVESTMENT EXPENSES**
**YEAR ENDED JUNE 30, 2008**
***(IN THOUSANDS)***

| | Assets Under Management | Fees |
|---|---|---|
| Retirement Plan | | |
| Investment Management Expense: | | |
| Fixed Income Managers | $ 2,120,575 | $ 2,717 |
| Equity Managers | 5,327,343 | 15,700 |
| Subtotal Investment Management Expense | 7,447,918 | 18,417 |
| Other Investment Expense: | | |
| Alternative Investments Consulting Fee | - | 1,022 |
| Real Estate and Other Consulting Fee | - | 518 |
| Subtotal Other Investment Expense | - | 1,540 |
| Postemployment Healthcare Plan | | |
| Investment Management Expense: | | |
| Fixed Income Managers | 300,938 | 432 |
| Equity Managers | 756,024 | 2,499 |
| Subtotal Investment Management Expense | 1,056,962 | 2,931 |
| Other Investment Expense: | | |
| Alternative Investments Consulting Fee | - | 163 |
| Real Estate and Other Consulting Fee | - | 82 |
| Subtotal Other Investment Expense | - | 245 |
| Total Investment Management Expense and Other Investment Expense, Excluding Alternative Investments, Real Estate and Securities Lending | $ 8,504,880 | $ 23,132 |
| Alternative Investments Managers' Fees: | | |
| Retirement Plan | $ 763,387 | $ 11,276 |
| Postemployment Healthcare Plan | 108,335 | 1,794 |
| Total Alternative Investments Managers' Fees | $ 871,722 | $ 13,070 |
| Real Estate Managers' Fees: | | |
| Retirement Plan | $ 556,071 | $ 9,007 |
| Postemployment Healthcare Plan | 78,914 | 1,434 |
| Total Real Estate Managers' Fees | $ 634,985 | $ 10,441 |
| Security Lending Fees: | | |
| Retirement Plan | $ 1,589,369 | $ 2,799 |
| Postemployment Healthcare Plan | 225,554 | 445 |
| Total Security Lending Fees | $ 1,814,923 | $ 3,244 |