

*New York City Police
Department Police Superior
Officers' Variable
Supplements Fund*

Financial Statements
Years Ended June 30, 2003 and 2002
Independent Auditors' Report

**NEW YORK CITY POLICE DEPARTMENT
POLICE SUPERIOR OFFICERS'
VARIABLE SUPPLEMENTS FUND**

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
New York City Police Department Police Superior Officers'
Variable Supplements Fund

We have audited the accompanying statements of Plan net assets of New York City Police Department Police Superior Officers' Variable Supplements Fund (the "Plan") as of June 30, 2003 and 2002, and the related statements of changes in Plan net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such financial statements present fairly, in all material respects, the Plan net assets as of June 30, 2003 and 2002, and the changes in Plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Deloitte + Touche LLP

October 27, 2003

NEW YORK CITY POLICE DEPARTMENT POLICE SUPERIOR OFFICERS' VARIABLE SUPPLEMENTS FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) YEARS ENDED JUNE 30, 2003 AND 2002

The narrative discussion and analysis of the financial activities of New York City Police Superior Officers' Variable Supplements Fund (the "Fund" or the "Plan") for the fiscal year ended June 30, 2003 is presented by management as an introduction of the basic financial statements. It is meant to assist the reader in understanding the Fund's financial statements by providing an overall review of financial activities during the year and the effects of significant changes, as well as a comparison with the prior year's activities and results. This discussion and analysis is intended to be read in conjunction with the Plan's financial statements, which begin on page 6.

Overview of Basic Financial Statements

The following discussion and analysis are intended to serve as an introduction to the Plan's basic financial statements. The basic financial statements are:

- **The Statement of Plan Net Assets** - presents the financial position of the Plan at fiscal year end. It indicates the assets available for payment of future benefits and any current liabilities that are owed as of the statement date. Investments are shown at fair value. All other assets and liabilities are determined on an accrual basis.
- **The Statement of Changes in Plan Net Assets** - presents the results of activities during the year. All changes affecting the assets and liabilities of the Plan are reflected on an accrual basis when the activity occurred, regardless of the timing of the related cash flows. In that regard, changes in the fair values of investments are included in the year's activity as net appreciation (depreciation) in fair value of investments. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Fund is improving or deteriorating.
- **Notes to Financial Statements** - provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes present information about the Plan's accounting policies, significant account balances and activities, material risks, obligations, contingencies, and subsequent events, if any.

The financial statements are prepared in accordance with Governmental Accounting Standards Board Pronouncements.

Financial Highlights

- The Fund's total assets exceeded its liabilities by \$1,014.4 million as of June 30, 2003.
- The plan net assets held in trust for pension decreased by \$43.7 million or 4% compared to fiscal year 2002.
- Benefit payments totaled \$78.3 million, an increase of 43% over fiscal year 2002.

Financial Analysis

The Statement of Plan Net Assets for fiscal year 2003 showed total assets exceeding total liabilities by \$1.01 billion. This amount represents total plan net assets held in trust for benefits. This amount is available to cover the Fund's obligation to pay benefits to the Fund's beneficiaries. Compared with the previous fiscal year, plan net assets held in trust for benefits decreased by \$43.7 million or 4%. This change was a result of the fact that the investment portfolio did not perform to desired expectations, which was part of the result of a slowdown in the U.S. and international economies. The Fund's investment portfolio decreased by 2% during fiscal year 2003.

The Fund's outstanding liabilities of \$208.1 million increased 12% compared to fiscal year 2002. Total liabilities consist of outstanding securities lending transactions (39%) accrued benefits payable (20%), and payable for investment securities purchased (42%).

Additions

The overall activities of the Fund shown in the Statement of Changes in Plan Net Assets are reflected in the difference between total additions and total deductions which resulted in a net increase of \$43.7 million for fiscal year June 30, 2003. The following items represent this difference, total gain in investment \$34.7 million, and benefit payments \$78.3 million.

Deductions

Deductions from the Fund consist mainly of benefit payments to members. All administrative and investment expenses are paid by the City of New York (the "City"). For fiscal year 2003, deductions totaled \$78.3 million compared to \$54.8 million in fiscal year 2002, which is an increase of \$23.5 million or 43% this year compared to 2002. Benefits paid in fiscal year 2003 increased primarily as a result of the increase in the number of retirees.

Funding and Plan Benefits

New York City Police Pension Fund ("POLICE") is the source of funding for the Fund.

For fiscal years 2003, 2002 and 2001 there were no transfers from POLICE to the fund.

Eligible retirees were entitled to a benefit of \$9,500 for Calendar year 2002 which payable during December 2002. This benefit rate increases by \$500 per year to \$12,000 per year by Calendar year 2007. These benefits are reduced for certain supplementations and COLA from POLICE.

All data pertaining to benefits and other information concerning the Fund is discussed in detail in the Notes to the Financial Statements.

The Administrative Code of the City of New York ("ACNY") provides that POLICE transfer to the Fund an amount equal to certain excess earnings on equity investments, limited to the unfunded accumulated benefit obligation ("ABO") of the Fund. Excess earnings are defined as the amount by which earnings on equity investments of POLICE exceed what those earnings would have been had such funds been invested at a yield comparable to that available from fixed-income securities ("Hypothetical Fixed Income Security Earnings") less any cumulative deficiencies. The Fund also receives credit for investment earnings on Fund assets.

The calculation of the Hypothetical Fixed Income Security Earnings requires the determination of the Hypothetical Interest Rate ("HIR"), which is computed by the Comptroller (see note 4).

Effective fiscal year 2000, the Actuary recommended revisions to calculation of the HIR. This change in methodology makes the HIR for POLICE consistent with Chapter 255 of the Laws of 2000 that modified the methodology for the HIR used for developing the Transferable Earnings payable from the New York City Employees' Retirement System ("NYCERS") to certain VSFs.

Specifically, in recognition that 30-year U.S. Treasury securities may become less plentiful in the future and subject to market distortions, the Actuary proposed to determine the HIR for Fiscal Year 2000 and later by taking an average of the monthly yields of 10-year Treasury notes as published in Federal Reserve Statistical Release H.15 and increasing it by 15%.

At its March 14, 2001 meeting, the Board of Trustees of POLICE adopted this revised methodology for use in connection with the calculation of HIR for fiscal years 2000 and later.

Investments

The Board of Trustees of the Fund, in accordance with existing laws, has the authority to determine the manner in which the assets of the Funds are invested. Investments are made by the New York City Comptroller, who acts as custodian of the funds. The primary objectives of the Fund are to provide benefits for its members and provide for growth in membership and also be prepared for inflation. Investments are made with the objective to minimize risks and maintain a high competitive return. Diversification has increased investment results and provided security for the assets of the Fund. The Comptroller of the City of New York utilizes several investment advisors to manage long-term debt and equity portfolios. Advisors must obtain prior approval before each purchase or sale of a particular security. Investments are valued at fair value. Purchases and sales of securities are reflected on the trade date. No investment in any one organization represents 5% or more of the net assets held in trust for benefits.

The Fund is expected to earn a higher long-term rate of return than short-term cash accounts, due to the long-term nature of its liabilities and the diversification of its investment holdings. For the ten-year period ending June 30 2003, the Fund had an annualized return of 8%. Investments in assets that are expected to produce higher returns are also subject to greater volatility-large differences from average returns- and may also produce negative returns. That was the case in fiscal year 2003, which has been a difficult one for investors. Investments in stock markets within and outside the United States have generally lost value. For example, The Russell 3000 index, a broad measure of the U.S. stock market, gained 0.76% during this period, and the Europe, Australia and Far East (EAFE) Index, the most commonly used this measure of performance in developed international markets, lost 6%. Less-developed international markets gained 7%. Bonds were the brightest spot in the broad investment universe. The index used by the Fund for these fixed income investments returned 11% for the year, while lower-rated bonds ended the year with a gain of 22% in value. The returns of the Fund have been consistent with broad market trend, the asset allocation followed by the Fund produced a combined return of a 4% gain. For the three-year period ending June 30, 2003 the combined loss was 5% and for the five-year period it was a 1% gain. Our above-average allocation to stocks has also meant that in the short-run, the Fund's return have been lower returns than many public funds, which gained an average of 4% for the past year.

Cash temporarily idle during the year is subject to conservative investment restrictions, and was invested in obligations of the U.S. Treasury and U.S. agency securities, commercial paper, medium-term notes, and repurchase agreements. The average maturity of these investments is 95 days. The Fund earned an average yield of 2% which compares with the average of 2% on three month Treasury Bills and 2% for a representative institutional money market fund. The Fund earned \$103 thousand in its short-term accounts during fiscal year 2003.

During the first quarter of fiscal year 2004 The Russell 3000 index gained 3%, and the EAFE international index gained 8%. The NYC bond index lost 0.27%. No prediction can be made as to the returns that will be achieved during the next fiscal year.

Assets are invested long-term for the benefit of the participants and their beneficiaries. All investments are managed by registered investment advisors, pursuant to applicable law and to guidelines issued by the Comptroller. The Fund utilizes one domestic equity manager, six domestic fixed-income managers and three international equity managers. Assets are allocated in accordance with plans adopted periodically by the Fund's Board of Trustees. The percentage in each category is determined based on a study indicating the probable rates of return and levels of risk for various assets allocations. The actual allocation may vary from this policy mix as market values shift and as investments are added or terminated.

Security Lending Transactions

The Board of Trustees permits the Fund to lend its securities to brokers, dealers and others with an agreement to return the collateral for the same securities in the future. In return, it receives collateral in the form of cash, treasury and US Government Securities at 100% to 105% of the principal plus accrued interest for reinvestment.

Other Matters

The Fund has a number of lawsuits pending against it. Management and legal counsel believe that such proceedings will not have a material effect on the plan net assets or changes in plan net assets.

Contact Information

This financial report is designed to provide our members and their beneficiaries and others with a general overview of the New York City Police Superior Officers' Variable Supplements Fund finances and show accountability for money it receives. Questions concerning any data provided in this report or request for additional information should be directed to the Chief Accountant, New York City Police Department Police Superior Officers' Variable Supplements Fund, 233 Broadway, 25th FL, New York, NY 10279.

**NEW YORK CITY POLICE DEPARTMENT POLICE SUPERIOR
OFFICERS' VARIABLE SUPPLEMENTS FUND**

**STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2003 AND 2002**

ASSETS	2003	2002
Cash	\$ 2,748,369	\$ 1,758,700
Receivables:		
Receivables from investment securities sold	21,241,599	21,268,567
Accrued interest and dividends receivable	<u>4,233,400</u>	<u>5,191,279</u>
Total receivables	<u>25,474,999</u>	<u>26,459,846</u>
Investments, at fair value (Notes 2 and 3):		
Short-term investments:		
Commercial paper	5,382,305	14,374,498
Other short-term investments	51,932,833	20,056,276
Discount notes	1,499,700	-
Debt securities:		
U.S. Government	166,084,216	211,027,849
Corporate	151,337,228	180,109,408
Other	23,320,059	23,671,044
Equity securities	489,705,546	485,065,994
Mutual funds - international equity	224,662,029	237,247,445
Collateral from securities lending transactions	<u>80,409,032</u>	<u>44,708,102</u>
Total investments	<u>1,194,332,948</u>	<u>1,216,260,616</u>
Total assets	<u>1,222,556,316</u>	<u>1,244,479,162</u>
LIABILITIES		
Payable for investment securities purchased	86,817,527	108,267,497
Accrued benefits payable (Note 2)	40,913,266	33,401,765
Securities lending transactions (Note 2)	<u>80,409,032</u>	<u>44,708,102</u>
Total liabilities	<u>208,139,825</u>	<u>186,377,364</u>
PLAN NET ASSETS HELD IN TRUST FOR BENEFITS	<u>\$1,014,416,491</u>	<u>\$1,058,101,798</u>

See notes to financial statements.

**NEW YORK CITY POLICE DEPARTMENT POLICE SUPERIOR
OFFICERS' VARIABLE SUPPLEMENTS FUND**

**STATEMENTS OF CHANGES IN PLAN NET ASSETS
YEARS ENDED JUNE 30, 2003 AND 2002**

	2003	2002
ADDITIONS:		
Investment income (loss) (Note 2):		
Interest income	\$ 18,504,412	\$ 23,497,126
Dividend income	8,087,668	7,712,722
Net appreciation (depreciation) in fair value of investments	<u>7,965,950</u>	<u>(130,062,279)</u>
Total investment income (loss)	<u>34,558,030</u>	<u>(98,852,431)</u>
Less investment expenses	700	641
Net income (loss)	<u>34,557,330</u>	<u>(98,853,072)</u>
Securities lending transactions:		
Securities lending income	836,567	903,252
Securities lending fees	<u>(740,614)</u>	<u>(761,074)</u>
Net securities lending income	<u>95,953</u>	<u>142,178</u>
Net investment income (loss)	<u>34,653,283</u>	<u>(98,710,894)</u>
DEDUCTIONS:		
Benefit payments (Note 1)	<u>78,338,590</u>	<u>54,800,084</u>
DECREASE IN PLAN ASSETS	(43,685,307)	(153,510,978)
PLAN NET ASSETS HELD IN TRUST FOR BENEFITS:		
Beginning of year	<u>1,058,101,798</u>	<u>1,211,612,776</u>
End of year	<u>\$1,014,416,491</u>	<u>\$1,058,101,798</u>

See notes to financial statements.

NEW YORK CITY POLICE DEPARTMENT POLICE SUPERIOR OFFICERS' VARIABLE SUPPLEMENTS FUND

NOTES TO FINANCIAL STATEMENTS FISCAL YEARS ENDED JUNE 30, 2003 AND 2002

1. PLAN DESCRIPTION

The New York City (the "City") Police Pension Fund administers the Police Superior Officers' Variable Supplements Fund (the "Fund" or the "Plan") and the Police Officers' Variable Supplements Fund ("POVSF"). The Fund operates pursuant to the provisions of Title 13, Chapter 2 of the Administrative Code of the City of New York ("ACNY") and provides supplemental benefits to retirees of the uniformed force of the New York City Police Department who retired holding the rank of sergeant or higher, or detective and who are receiving benefits from the New York City Police Department, Subchapter One Pension Fund, or New York City Police Pension Fund ("POLICE"), also known as the New York City Police Department, Subchapter Two Pension Fund, and who retired on or after October 1, 1968.

Fund benefits are forfeitable upon separation from service except for service retirement.

The Fund is included in the City's Comprehensive Annual Financial Report as an other employee benefit trust fund.

The POVSF is maintained as a separate fund and is not included in these financial statements.

Under current law, the Fund is not to be construed as constituting a pension or retirement system. Instead, it provides defined supplemental payments, other than pension or retirement system allowances, in accordance with applicable statutory provisions. While the City guarantees these payments, the New York State Legislature has reserved to itself and the State of New York (the "State") the right and power to amend, modify, or repeal the Fund and the payments it provides.

At June 30, 2002 and June 30, 2001, the dates of the Fund's most recent actuarial valuations, the Fund's membership consisted of:

	<u>2002</u>	<u>2001</u>
Retirees currently receiving payments	10,556	9,092
Active members*	<u>13,811</u>	<u>14,549</u>
Total	<u>24,367</u>	<u>23,641</u>

* Represents the number of actively employed Police Superior Officers as of the June 30 valuation dates.

The Fund provides a guaranteed level of supplemental benefits for Police Superior Officers who retire (or have retired) as Police Superior Officers on service retirement with at least 20 years of service as follows:

- (a) A Police Superior Officer hired before July 1, 1988 who retires from service as a Police Superior Officer on or after October 1, 1988 receives a defined schedule of benefits starting at an annual rate of \$5,000 payable during December 1993 for the Calendar Year 1993 payment.

The benefit increases \$500 each year thereafter to a maximum of \$12,000 in the Calendar Year 2007 and thereafter.

For those who were members of POLICE prior to July 1, 1988 and who retire after Calendar Year 1993, the benefit for the first year of retirement is a proportion of the annual scheduled amount as described above for the year of retirement, and the full amount thereafter.

- (b) For those who become members of POLICE on or after July 1, 1988, the annual supplemental benefit is \$2,500 for the first twelve months of retirement, increasing by \$500 each year until a maximum of \$12,000 is payable in the twentieth and later years of retirement. This was later modified by Chapter 444 of the Laws of 2001 ("Chapter 444/01") as discussed below.

Chapter 503 of the Laws of 1995 ("Chapter 503/95") amended the ACNY in relation to the transfer of assets, liabilities, and administration of certain pension funds in the New York City Police Department. In addition, this law permits certain active employees with prior service credit before entering POLICE to utilize their original dates of hire for determining benefits from the Fund.

In the past, the New York State Legislature, in recognition of inflation, has increased retirement benefits to retirees of its public pension systems. Any increase in Supplementation or automatic Cost-of-Living Adjustments ("COLA") benefits payable from POLICE for retirees of the Fund under legislation enacted after 1993 will reduce benefits payable from the Fund until the later of: (a) age 62, or (b) Calendar Year 2007 (the twentieth year of retirement in the case of new members on and after July 1, 1988).

Chapter 119 of the Laws of 1995 ("Chapter 119/95") provides additional benefits payable on and after December 1, 1996 for Supplementation for certain retirees of POLICE effective as elected by the City Council on October 25, 1995.

Chapter 444/01 provides that Police Superior Officers who became members of the Fund on and after July 1, 1988 will receive the maximum \$12,000 benefit beginning Calendar Year 2008.

Chapter 390 of the Laws of 1998 ("Chapter 390/98") provides increases in Supplementation from POLICE payable on and after September 1, 1998 (with a second increase commencing September 1, 1999).

Chapter 125 of the Laws of 2000 ("Chapter 125/00") provides Supplementation benefits from POLICE for certain retirees who retired before Calendar Year 1997 effective September 2000. In addition, Chapter 125/00 provides future COLA increases from POLICE beginning September 2001 and on each subsequent September to these retirees.

Chapter 125/00 also provides for a five-year phase-in schedule for funding the additional liabilities created by benefits provided by Chapter 125/00.

Chapter 278 of the Laws of 2002 ("Chapter 278/02") revises the phase-in period from five years to ten years for funding the additional liabilities of POLICE created by the benefits provided under Chapter 125/00.

Chapter 278/02 provides that, for the June 30, 2000 actuarial valuation of POLICE, the Actuary is required to recognize, on a theoretical basis, only 10% of the additional liabilities created by the benefits provided by Chapter 125/00 for determining Fiscal Year 2001 POLICE contributions.

For each of the next eight June 30 actuarial valuations (i.e., June 30, 2001 to June 30, 2008), the Actuary is required to recognize progressively increasing percentages (i.e., 20% to 90%) of the additional Actuarial Present Value of Benefits ("APVB") attributable to Chapter 125/00 for determining the Fiscal Year 2009 POLICE contributions.

For the June 30, 2009 and later actuarial valuations, the Actuary is required to recognize the full amount of the additional APVB attributable to Chapter 125/00 for determining Fiscal Year 2010 and later POLICE contributions.

Note, the liabilities shown herein reflect the full impact of offset for Supplementation and COLA benefits payable under Chapter 125/00. The liabilities do not reflect the phase-in schedule of Chapter 278/02 for funding the additional liabilities created by the benefits provided by Chapter 125/00.

Chapter 216 of the Laws of 2002 ("Chapter 216/02") provides that participants of the Fund who retire on and after January 1, 2002 from POLICE with 20 or more years of service are entitled to an additional one-time special lump sum payment in the first year following retirement equal to the Fund benefits that would have been paid after January 1, 2002 had they retired at the completion of their 20th year of service.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The Fund is accounted for on an accrual basis where the measurement focus is on the flow of economic resources. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

Method Used to Value Investments - Investments are valued at fair value. Trading securities are stated at the last reported sales price on a national securities exchange on the last business day of the fiscal year. Securities purchased pursuant to agreements to resell are carried at the contract price, exclusive of interest, at which the securities will be resold. Fair value is defined as the quoted market value on the last trading day of the period, except for the Short-Term Investment Fund (the "STI") (a money market fund) and the International Investment Funds (the "IIF"). The IIF's are privately traded funds, which are managed by various investment managers on behalf of the Plan. Plan management determines fair value of the IIF's based on information provided by the various investment managers. Management records the STI at cost, which approximated fair value.

Purchases and sales of securities are reflected on the trade date. Gains or losses on sales of securities are based on the average cost of securities.

Dividend income is recorded on the ex-dividend date. Interest income is recorded as earned on an accrual basis.

No investment in any one organization of funding and for information represents 5% or more of the plan net assets held in trust for benefits.

Contributions - POLICE is the source of funding for the Fund. Section 13-232 of the ACNY states, among other things, how amounts transferred into the Fund shall be computed.

Income Taxes - Income earned by the Fund is not subject to Federal income tax.

Accrued Benefits Payable -Accrued benefits payable represent either: (1) benefits due and unpaid from the preceding payment date of December 15 or (2) benefits deemed incurred and unpaid (an accrual for a portion of the current Calendar Year benefit) for the Fiscal Year end of June 30.

Securities Lending Transactions – State Statutes and the Board of Trustees policies permit the Fund to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Fund's custodian lends the following types of securities: short-term securities, common stock, long-term corporate bonds, U.S. Government and U.S. Government agencies bonds, asset-backed securities, and international equities and bonds held in collective investment funds. In return, it receives collateral in the form of cash and treasury and U.S. Government agency securities at 100% to 105% of the principal plus accrued interest for reinvestment. At year-end, the Fund had no credit risk exposure to borrowers because the amounts the Fund owes the borrowers exceed the amounts the borrowers owe the Fund. The contracts with the Fund custodian require borrowers to indemnify the Fund if the borrowers fail to return the securities and if the collateral is inadequate to replace the securities loaned or fail to pay the Fund for income distributions by the securities' issuers while the securities are on loan. All securities loans can be terminated on demand within a period specified in each agreement by either the Fund or the borrowers. Cash collateral is invested in the lending agents' short-term investment pools, which have a weighted average maturity of 90 days. The underlying fixed income securities which comprise these pools have an average maturity of ten years.

The securities lending program in which the Fund participates only allows pledging or selling securities in the case of borrower default. Accordingly, the Fund is fully indemnified against any loss of value between the securities lent and the securities held as collateral.

Governmental Accounting Standards Board (GASB) Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, requires that securities loaned as assets be reported in the statements of plan net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are also reported as assets if the government entity has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions will be reported in the Statements of Plan Net Assets. Accordingly, the Fund recorded the investments purchased with the cash collateral as collateral from securities lending transactions with a corresponding liability as securities lending transactions.

Pronouncement Issued But Not Yet Effective – In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3*. Statement No. 40 establishes and modifies Note disclosure requirements related to investment risks, which includes credit risk, interest rate risk, and foreign currency risk. The implementation of Statement No. 40 will expand Note disclosure regarding the Plan's investments and their related investment and deposit risks. Statement No. 40 will not impact the Plan's financial statements. Statement No. 40 is effective for

financial statement periods beginning after June 15, 2004, which requires the Plan to implement its requirements for the Plan's fiscal year ending June 30, 2005.

3. DEPOSITS AND INVESTMENTS

The ACNY authorizes the investment of Fund assets subject to the same terms and conditions as POLICE. These investments primarily include domestic and foreign fixed-income and equity securities.

Cash deposits are fully insured by the Federal Deposit Insurance Corporation for up to \$100,000 per Fund member and therefore are fully insured. All investments of the Fund for the years ended June 30, 2003 and 2002 were held by the Fund or by its custodial agent in the Fund's name (Category 1 custodial credit risk). Category 1, the lowest risk, includes investments that are insured or registered or for which the securities are held by the entity or its agent in the entity's name.

For the years ended June 30, 2003 and 2002, Citibank, N.A. was the primary custodian for substantially all of the securities of the Plan.

Investments owned by the Fund, including the collateral from securities lending transactions of \$80,409,032 and \$44,708,102 for the years ended June 30, 2003 and 2002, respectively, are listed according to their investment classification in the following table:

	2003	2002
Categorized (A):		
Securities purchased under agreements to resell	\$ -	\$ 8,324,329
Commercial paper	5,382,305	15,423,668
Short-term investments	133,841,565	28,503,747
Debt securities:		
U.S. Government	166,084,216	211,027,849
Corporate	151,337,228	189,204,540
Other	23,320,059	23,671,044
Equities – domestic	<u>489,705,546</u>	<u>485,065,994</u>
Subtotal	<u>969,670,919</u>	<u>961,221,171</u>
Noncategorized (B):		
Mutual fund - international equities	224,662,029	237,247,445
Mutual fund - equity	-	17,000,000
Guaranteed investment contracts	<u>-</u>	<u>792,000</u>
Subtotal	<u>224,662,029</u>	<u>255,039,445</u>
Total	<u>\$ 1,194,332,948</u>	<u>\$ 1,216,260,616</u>

(A) These securities are considered Category 1 risk.

(B) These securities are not categorized because they are not evidenced by securities that exist in physical or book-entry form.

4. FUNDING

The ACNY provides that POLICE transfer to the Fund an amount equal to certain excess earnings on equity investments, limited to the unfunded accumulated benefit obligation ("ABO") of the Fund. Excess earnings are defined as the amount by which earnings on equity investments of POLICE exceed what those earnings would have been had such funds been invested at a yield comparable to that available from fixed-income securities ("Hypothetical Fixed Income Security Earnings") less any cumulative deficiencies. The Fund also receives credit for investment earnings on Fund assets.

Hypothetical Interest Rate Method - The calculation of the Hypothetical Fixed Income Security Earnings requires the determination of the Hypothetical Interest Rate ("HIR"), which is computed by the Comptroller.

For Fiscal Year 2003, earnings on POLICE equity investments were less than the Hypothetical Fixed Income Security Earnings, which will result in no transfer due from POLICE to the Fund as of June 30, 2003.

For Fiscal Year 2002, earnings on POLICE equity investments are expected to be less than the Hypothetical Fixed Income Security Earnings and, therefore, no transfer was due from POLICE to the Fund as of June 30, 2002.

In addition, Chapter 479 of the Laws of 1993 states that if the assets of the Fund are less than the amount required to pay the beneficiaries' guaranteed scheduled annual supplemental benefit payments, then the City is required by law to fund the difference. However, it is not anticipated that the City will be required to contribute directly to the Fund.

The amount shown below as the ABO is the measure of the present value of supplemental benefits estimated to be payable in the future as a result of employee service-to-date. The ABO is calculated as the actuarial present value of credited projected benefits, prorated on service, and is intended to help users assess the funded status of the Fund on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among variable supplements funds.

Actuarial valuations are performed annually as of June 30.

A comparison of the ABO as calculated by the Fund's Chief Actuary of the Office of the Actuary (the "Actuary") with the plan net assets held in trust for benefits as of June 30, 2002 and June 30, 2001 follows:

	Amount as of June 30	
	2002	2001
	(in millions)	
Accumulated benefit obligation for:		
Retirees currently receiving benefits	\$ 968.0	\$ 752.3
Active members	<u>766.2</u>	<u>661.4</u>
Total accumulated benefit obligation*,**	<u>1,734.2</u>	<u>1,413.7</u>
Plan net assets held in trust for benefits***	<u>1,058.1</u>	<u>1,211.6</u>
(Unfunded) accumulated benefit obligation	<u>\$ (676.1)</u>	<u>\$ (202.1)</u>

* The June 30, 2002 and June 30, 2001 ABOs decreased by approximately \$159.2 million and \$176.6 million, respectively, compared to those projected prior to the enactment of Chapters 119/95, 390/98 and 125/00.

As of June 30, 2002, there was an increase of approximately \$84.9 million in to the ABO of active members due to Chapter 216/02.

** These total ABOs have been reduced by accrued benefits payable. This basis of reporting the total ABO is consistent with that used to report plan net assets held in trust for benefits in these financial statements, but may differ from the bases used for other purposes.

*** See note 2 for valuation of investments in the calculation of plan net assets held in trust for benefits.

For purposes of the June 30, 2002 and June 30, 2001 actuarial valuations of the Fund, Chapter 125/00 has been taken into account in the determination of the unfunded ABO relative to the Supplementation benefit increases that began fiscal year 2001 and to the automatic COLA benefits estimated to begin fiscal year 2002 and each future year (see Note 1).

The actuarial valuation as of June 30, 2002, used to determine the ABO, is based on the same actuarial assumptions and methods as were used in the actuarial valuation as of June 30, 2001.

Sections 13-270 and 13-280 of the ACNY provide that the Boards of Trustees of the POVSF and the Fund shall adopt, upon the recommendation of the Actuary, actuarial assumptions as to interest rate, mortality of beneficiaries, and number of active members of POLICE in service as of each June 30, who will retire for service with 20 or more years of service as Police Officers and Police Superior Officers, for use in making annual valuations of liabilities.

The following actuarial assumptions represent the recommendations of the Actuary and were used in the actuarial calculations to determine the ABO as of June 30, 2002 and June 30, 2001, respectively:

	June 30, 2002	June 30, 2001
Investment rate of return	8.0% per annum. ⁽¹⁾	8.0% per annum. ⁽¹⁾
Post-retirement mortality	Tables based on recent experience of POLICE.	Tables based on recent experience of POLICE.
Active service: withdrawal, death, and disability	Tables based on recent experience of POLICE.	Tables based on recent experience of POLICE.
Service retirement	Tables based on recent experience of POLICE.	Tables based on recent experience of POLICE.
Percentage of all active POLICE members estimated to retire for service with 20 or more years of service as Police Superior Officers	50%	50%
Percentage of all active Police Superior Officers estimated to retire for service with 20 or more years of service as Police Superior Officers	100%	100%
Cost-of-Living Adjustments	1.3% per annum. ⁽¹⁾	1.3% per annum. ⁽¹⁾
Actuarial Asset Valuation Method	Fair Market Value	Fair Market Value

⁽¹⁾ Developed assuming a long-term Consumer Price Inflation assumption of 2.5% per year.

5. INVESTMENT ADVISORS

The Comptroller of the City (the "Comptroller") utilizes several investment advisors to manage long-term debt and equity portfolios. Advisors must obtain prior approval before each purchase or sale of a particular security. To be eligible for consideration, investments must meet criteria set forth in governing laws and regulations.

6. RELATED PARTIES

Administrative expenses are paid by the City. The Comptroller provides certain administrative services to the Fund. The Actuary is appointed to be the technical advisor to the Fund and the Office of the Actuary provides related actuarial services to the Fund. The City's Corporation Counsel provides legal services to the Fund. The City also provides other administrative services.

The Comptroller has been appointed by law as the custodian for monies and assets of the Plans with revocable discretionary authority. Securities are held by certain banks under custodial agreements with the Comptroller.

7. CONTINGENT LIABILITIES

From time to time the Fund has a number of claims pending against it and has been named as defendant in a number of lawsuits. The Fund also has certain other contingent liabilities. Management of the Fund, on the advice of legal counsel, believes that such proceedings and contingencies generally do not have a material effect on the plan net assets or changes in the plan net assets of the Fund. Under the State statutes and City laws that govern the functioning of the Fund, increases in the obligation of the Fund to members and beneficiaries ordinarily result in increases to the future potential obligations of POLICE.

8. OTHER ACTUARIAL INFORMATION

Actuarial Audit - Pursuant to Section 96 of the New York City Charter, a study of the actuarial assumptions used to value liabilities of the five actuarially funded New York City Retirement Systems ("NYCRS") is conducted by an independent actuarial firm every two years. The most recent study was completed October 1999. Currently, Gabriel, Roeder, Smith & Co. ("GRS") is preparing a study for Fiscal Years 1998 through 2001. It is anticipated that the GRS study will be released by Fall 2003.

Revised Actuarial Assumptions and Methods - In accordance with the ACNY and with appropriate practice, the Boards of Trustees of the five actuarially funded NYCRS are to periodically review and adopt actuarial assumptions as recommended by the Actuary for use in the determination of employer contributions.

Based on a review of the latest independent actuarial study, the Actuary proposed changes to certain actuarial assumptions and methods to be used by the NYCRS for Fiscal Years beginning on and after July 1, 1999 (i.e., Fiscal Years beginning 2000).

Where required, the Board of Trustees of POLICE adopted those changes to the actuarial assumptions and methods that required Board approval, and the New York State Legislature and Governor enacted Chapter 85 of the Laws of 2000 to provide for those changes of the actuarial assumptions and methods that required legislation, including the investment rate of return assumption of 8.0% per annum.

Effective with the June 30, 1999 actuarial valuation of the Fund, the Actuary uses, where applicable, the recommended actuarial assumptions that were adopted for POLICE.

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