

Firemen's Relief and Retirement Fund
A Fiduciary Fund of the City of McAllen, Texas

Financial Statements and Required
Supplemental Information
and Independent Auditors' Report

September 30, 2012

**Firemen's Relief and Retirement Fund
of McAllen, Texas
September 30, 2012**

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Independent Auditors' Report

To the Pension Board of Trustees
Firemen's Relief and Retirement Fund
McAllen, Texas

We have audited the accompanying statement of plan net assets of the Firemen's Relief and Retirement Fund (the "Plan"), a fiduciary fund of the City of McAllen, Texas, as of September 30, 2012, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the management of the Plan. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

As discussed in Note 1, the financial statements present only the financial position of the Firemen's Relief and Retirement Fund, a fiduciary fund of the City of McAllen, Texas and are not intended to, and do not, present fairly, the financial position or changes in financial position of the City of McAllen, Texas. They do not purport to, and do not, present the financial position of the City of McAllen, Texas as of September 30, 2012, and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Plan as of September 30, 2012, and changes in its plan net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2013, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on

internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Funding Progress (Unaudited), Schedule of Employer Contributions (Unaudited), and Notes to Schedule of Funding Progress and Employer Contributions (Unaudited), as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Padgett, Stratemann & Co., L.L.P.

Certified Public Accountants
March 27, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis of the financial performance of the Firemen's Relief and Retirement Fund the ("Plan") of McAllen, Texas. It is presented as a narrative overview and analysis for the purpose of assisting the reader with interpreting key elements of the financial statements, notes to the financial statements, and required supplementary information.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's discussion and analysis is intended to serve as an introduction to the Plan basic financial statements, together with the related notes to the financial statements, required supplemental information, and the supporting schedules, all of which are described below:

Fund Financial Statements:

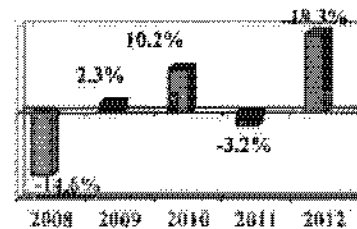
Statement of Plan Net Assets – This statement reports the Plan assets, liabilities, and resultant net assets held in trust for pension benefits. This statement should be read with the understanding that it discloses the Plan's financial position on September 30, 2012.

Statement of Changes in Plan Net Assets – This statement reports the results of operations during the years, categorically disclosing the additions to and deductions from plan net assets. The net increase to plan assets on this statement support the change in net assets held in trust for pension benefits on the Statement of Plan Net Assets.

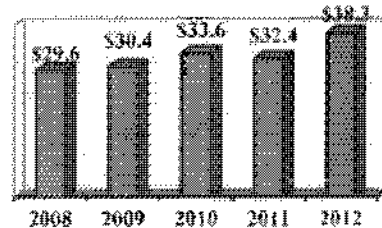
Notes to the Financial Statements:

The financial statement notes provide additional information that is essential to a full understanding of the date provided in the fund financial statements.

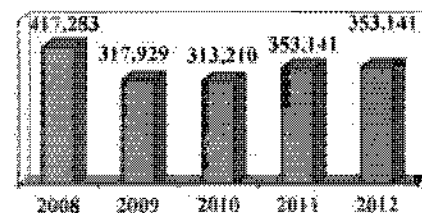
Investment Returns (2008-2012)



\$ Assets (millions)



Investments and administrative expenses



Firemen's Relief and Retirement Fund
of McAllen, Texas
Management's Discussion and Analysis
September 30, 2012

THE PLAN FINANCIAL ANALYSIS

The plan provides retirement benefits to essentially all eligible firefighter employees. These benefits are funded through member contributions, employer contributions, and earnings on investments. Total net assets held in trust for pension benefits at September 30, 2012 amounted to \$38,306,011.

Additions to Plan Net Assets

Additions to the Plan net assets held in trust for pension benefits include contributions from employees and employer, less an investment loss. Employee contributions totaled \$1,027,430 and employer contributions amounted to \$1,287,288. The Plan recognized a net investment gain of \$5,952,478. This net investment gain was attributable to a combination of the following: a market appreciation of \$6,064,633; interest and dividends of the portfolio in the amount of \$1,013,874; loss in the disposition of investments during the year amounting to \$872,929; and investment management expenses in the amount of \$253,100.

<u>Additions to Net Assets</u>	<u>2012</u>	<u>2011</u>
Employee contributions	\$ 1,027,430	\$ 985,340
Employer contributions	1,287,288	1,234,674
Net investment income(loss)	<u>5,952,478</u>	<u>(1,046,095)</u>
Total additions	<u>\$ 8,267,196</u>	<u>\$ 1,173,919</u>

Deductions From Plan Net Assets

Deductions from the Plan net assets held in trust for pension benefits are comprised primarily of retirement benefit payments to the Plan retirees, survivors, and beneficiaries. Administrative expenses and refunds of contributions are also included as deductions. For 2012, benefit payments to retirees, survivors, and beneficiaries amounted to \$2,001,400. The administrative expenses amounted to \$28,686; and refunds to terminated employees--\$108,237 and drop distribution--\$249,432. This combined amount totaled \$357,669. Normal monthly payments to pensioners continue to increase. Three retirees were added during the year, which will add approximately \$97,556 in additional benefits.

Firemen's Relief and Retirement Fund
of McAllen, Texas
Management's Discussion and Analysis
September 30, 2012

<u>Deductions From Net Assets</u>	<u>2012</u>	<u>2011</u>
Benefit payments	\$ 2,001,400	\$ 1,951,841
Refund to terminated employees	357,669	381,553
Administrative expenses	<u>28,686</u>	<u>13,978</u>
Total deductions	<u>\$ 2,387,755</u>	<u>\$ 2,347,372</u>

Investments

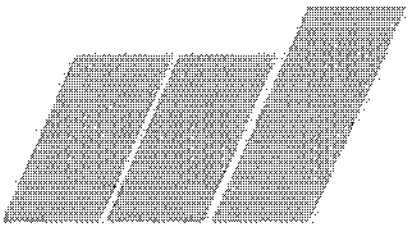
During the year, an international equity money manager was replaced within the same category by another money manager. Total investments amounted to \$35,241,999 at September 30, 2012. The estimated rate of return of the Plan was approximately 18.3% for the current year. For the year, the fund exceeded its actuarial rate of return of 8 percent by 10.3 percent. The Plan's board of trustees and its consultant remain confident in the long-term potential of the portfolio to deliver upon the desired results of performance in excess of the actuarial requirement with appropriate levels of risk. The approach has served the Plan well historically and sees no reason to believe it is not attainable going forward.

The following table represents the fair value of investments of the Plan.

	<u>2012</u>	<u>2011</u>
Cash equivalents	\$ 2,950,188	\$ 327,488
Accrued interest receivable	116,127	106,023
U.S. government securities	3,489,672	3,692,993
Corporate bonds and equities	28,149,033	24,943,028
Hedge funds	<u>3,603,294</u>	<u>3,357,038</u>
Total assets	<u>\$ 38,308,314</u>	<u>\$ 32,426,570</u>

REQUESTS FOR INFORMATION

This Annual Financial Report is designed to provide a general overview of the Firemen's Relief and Retirement Fund of McAllen, Texas finances for interested parties. Questions concerning any of the information provided herein, or requests for additional financial information, should be addressed to Firemen's Relief and Retirement Fund of McAllen, Texas, P.O. Box 220, McAllen, Texas 78505-0220.



Financial Statements

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Statement of Plan Net Assets

September 30, 2012

Assets:

Cash and cash equivalents	\$ 2,950,188
Accrued interest receivable	116,127
Investments at fair value:	
U.S. government securities	3,489,672
Corporate bonds and equities	28,149,033
Hedge funds	3,603,294
	<hr/>
Total assets	38,308,314
	<hr/>

Liabilities:

Accounts payable	2,303
	<hr/>
Total liabilities	2,303
	<hr/>
Net assets held in trust for pension benefits	\$ 38,306,011
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The accompanying notes are an integral part of these statements.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Statement of Changes in Plan Net Assets

Year Ended September 30, 2012

Additions to net assets attributed to:

Contributions:

Members	\$ 1,027,430
Employer	<u>1,287,288</u>

Total contributions	<u>2,314,718</u>
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Investment income:

Appreciation in fair value of investments	6,064,633
Loss on sale of investments	(872,929)
Interest and dividends	<u>1,013,874</u>

6,205,578

Less investment expense	<u>253,100</u>
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Net investment gain	<u>5,952,478</u>
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Total additions	<u>8,267,196</u>
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Deductions from net assets attributed to:

Benefits paid directly to participants or beneficiaries	2,001,400
Refunds to terminated employees	357,669
Administrative expense	<u>28,686</u>

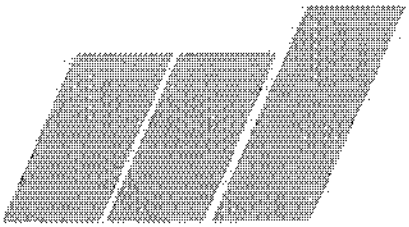
Total deductions	<u>2,387,755</u>
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Net increase	5,879,441
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Net assets held in trust for pension benefits at beginning of year	<u>32,426,570</u>
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Net assets held in trust for pension benefits at end of year	<u>\$ 38,306,011</u>
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The accompanying notes are an integral part of these statements.



Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2012

1. Plan Description

The provisions of Firemen's Relief and Retirement Fund of McAllen, Texas (the "Plan") are authorized by the Texas Local Fire Fighters' Retirement Act ("TLFFRA"). The following brief description of the Plan is provided for general information purposes only. The Plan agreement should be referred to for more complete information. The Plan has an actuarial valuation performed biennially in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The most recent actuarial valuation was performed as of September 30, 2010.

Reporting Entity

The plan is sponsored by the City of McAllen, Texas (the "City"). The Plan does not report to, and does not, present the financial position of changes in financial position of the City as of any time or for any period. The Plan meets the criteria of a "fiduciary fund" of the City as established by GASB, and certain information regarding the Plan is included in the City's financial statements.

Plan Membership

The Pension Board of Trustees is the administrator of the Plan, which consists of current and former fire fighters of the City of McAllen, Texas (the "City"), as well as certain beneficiaries of current and former fire fighters. The City is the only contributing employer. The fire fighters covered by the Plan also contribute to the Plan. The types of employees covered, as well as Plan membership data, are as follows:

	As of the most recent actuarial valuation date September 30, 2010
Number of participants:	
Actives below assumed retirement age	148
Actives at or above assumed retirement age	14
Retirees and beneficiaries entitled to benefits	77
Retirees and beneficiaries entitled to, but not yet receiving benefits	4
	<u>243</u>

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2012

1. Plan Description (continued)

Plan Benefits

Service Retirement Benefits

A member is eligible for service retirement upon completion of 20 years of service and attainment of age 50. A member who retires under the service retirement provisions of the fund will receive a monthly benefit equal to the sum of (a), (b), and (c) where: (a) equals to 2.9 percent of the member's average monthly compensation multiplied by the member's whole years and months of service not in excess of 20 years and (b) equals the greater of 2.9 percent of the member's average monthly salary, or \$58.00 per month for each of the member's 21st and 22nd years of service, and (c) equals \$58.00 per month for each year of service in excess of 22 years.

Disability Benefits

An active member who becomes disabled as defined in the plan will receive a monthly disability benefit. Separate disability benefits are provided for duty-related and off-duty disabilities. Disability benefits are payable in the same joint-and-survivor form as service retirement benefits. However, disability benefits stop if the member recovers to the point that he no longer meets the definition of disability under the fund. If the total monthly amount a disabled member receives from (a) the fund, (b) workers compensation, and (c) the City of McAllen, exceeds the member's monthly rate of pay as of his date of disability, the amount payable from the fund will be reduced so that the member's benefit from all three sources, combined, does not exceed such rate of pay.

Death Benefits

Duty-related death benefits, payable to a member's spouse for as long as she is living, equal the sum of (a) 38.67% of the member's average monthly salary, (b) plus two-thirds of any additional service benefit earned by the member as of the date of his death. The widow's benefit is payable for life, but it ceases upon remarriage. Effective January 1, 2006 the widowed spouse of a member who completed 10 or more years of service prior to his death will have her death benefit payments terminated in the event of her remarriage. In the addition to the above widow's benefit, each unmarried child of the member will receive a monthly benefit of 7.73 percent of the fire fighter's average monthly salary. Orphan benefits continue until the child reaches age 18. However, benefits will continue until age 22 for a child who is full-time student. If the member's widow dies or remarries, or if the member has no spouse on the date of his death, each eligible orphan will receive a monthly benefit of 15.47 percent of the member's average monthly salary. Orphan benefits are continued for life to disabled children. The total of all benefits paid as a result of the death of an active fund member may not exceed the disability

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2012

1. Plan Description (continued)

Death Benefits (continued)

or retirement benefits such member had earned as of the date of his death. The total of all benefits paid as a result of the death of a retired member may not exceed the retirement benefit the member was receiving as of the date of his death. Benefits are reduced pro rata, if necessary, in order to satisfy these limitations.

Termination Benefits

Members who terminate employment with less than 10 years of service will be entitled to the return of the excess of their contributions to the fund over the amount of any benefits they have received from the Plan. Such refunds will not include any interest on the members' contributions. If members terminate on or after the date they have completed 10 years of service but prior to the date they complete 20 years of service, they will be entitled to receive a monthly benefit, starting on the date they would have both completed 20 years of service and attained age 50, had they remained in the service of the fire department. The amount the members will receive will equal the monthly service retirement benefit they had accumulated on the date they separated from service with the fire department, multiplied by the vested percentage of the members.

The Deferred Retirement Option Plan (DROP)

A member is eligible to receive his benefits under the plan's DROP provision after he has both completed 2 years of services and attained age 53. The election to participate in the DROP may be made at the time the member elects to retire. The monthly retirement income payable to a member who retires under the DROP will equal his service retirement benefits under the plan based on average monthly salary and years of service as of the member's DROP Eligibility Date. The member's benefit will be calculated, however using the benefit formula in effect on the member's actual date of retirement. A members DROP Eligibility Date is the later of (a) the date the member meets the eligibility requirements for the DROP or (b) the date which is two years prior to the member's actual retirement date. Upon retirement, the member will receive—in addition to his monthly retirement benefit—a single payment equal to the sum of: (a.) the total of the monthly retirement benefits the member would have received between his DROP Eligibility Date and the time he retired under the plan, and (b.) the amount of monthly contributions that the member has made to the fund between his DROP Eligibility Date and the time he retired under the plan.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2012

2. Summary of Significant Accounting Policies and Plan Asset Matters

Organization

The Plan was created pursuant to the TLFFRA. The Plan provides pension, disability, death, and severance benefits to employees of the City's fire department and former volunteer firemen eligible to receive benefits pursuant to a single-employer defined benefit pension plan.

Basis of Accounting

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America for local governmental units as prescribed by the GASB. The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

Cash Equivalents

For purposes of the statements of plan net assets, short-term, highly liquid investments are considered cash equivalents.

Valuation of Plan Investments

The Plan's investments are stated at fair value and, accordingly, unrealized appreciation and depreciation are reported in the statement of changes in plan assets. The fair value of money market funds is considered to be the same as the cost of these investments due to their nature. The fair value of common stocks and foreign equities are based on quoted market prices. The fair value of United States Government securities and corporate and foreign bonds are based on quotes from broker dealers. The Plan values investments in hedge funds based on its percentage investment in each such fund. The estimated fair value of each fund is based on market conditions and information reported by the fund manager, and is generally based on the estimated fair value of each funds' underlying investments at the end of the reporting period.

Purchases and sales of investments are recorded on a trade-date basis and, accordingly, the related receivables and payables for any unsettled trades are recorded. Interest income and dividends are recorded on the accrual basis.

Federal Income Tax

The Plan is exempt from federal income tax pursuant to applicable regulations.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2012

2. Summary of Significant Accounting Policies and Plan Asset Matters (continued)

Estimates

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

3. Fiduciary Fund of the City of McAllen, Texas

Due to the level of oversight responsibility exercised, the Plan is included in the City's basic financial statements in the fiduciary fund section. Certain administrative functions are performed for the Plan by the City at no cost.

4. Funding Status and Progress

For 2012, the City's annual pension cost was equal to the City's actual and required contributions. The required contribution was established as part of the September 30, 2010 actuarial valuation using the entry-age actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return, compounded annually (b) projected salary increases of 4.25% per year, compounded annually, (c) inflation rate of 3.00% and (d) the amortization period is calculated from the rate contributed by the City. The investment rate of return and the projected salary increases both used the same assumptions with regard to inflation. The actuarial value of assets was determined using the smoothed market value technique, a technique that smooths the effect of short-term volatility in the market value over a four-year period. The unfunded actuarial liability is being amortized as a level percentage of projected payrolls on an open basis. The remaining amortization period at September 30, 2010 was 39.6 years. The amounts of the actuarial value of assets represent estimates based upon the assumptions described above. Changes in those estimates will result in changes in such estimates in the future. The amount of benefits ultimately to be paid could differ materially from the current estimates. The table in the following page reflects the funding progress of the Plan.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2012

Schedule of Actuarial Funding Progress

Actuarial Valuation Date	<u>09/30/10</u>
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent of Projected Payroll
Remaining amortization period	39.6 Years open period
Asset valuation method	5yr Smooth Market Value
Actuarial assumptions:	
Investment rate of return	8%
Projected salary increases --	
includes inflation at	4.25%
cost-of-living adjustments	None
Inflation rate	3%
Actuarial value of assets (Unaudited)	\$36,651,357
Actuarial accrued liability (Unaudited)	\$51,565,906
Percentage funded	71.1%
Unfunded actuarial accrued liability (UAAL)	\$14,914,549
Annual covered payroll	\$8,996,407
UAAL as a percentage of covered payroll	165.8%

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2012

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the profitability of occurrence of events far into the future. Examples include assumptions about future rates of retirement, mortality, and salary increases. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress (unaudited), presented as required supplementary information following the notes to financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The accompanying Schedule of Employer Contributions (unaudited) presents trend information about the amount contributed to the Plan by the employer in comparison to the annual required contributions ("ARC"), an amount that is actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

Projections of benefits for financial reporting purposes are based on the substantive Plan (the Plan as understood by the employer and Plan members) and include the types of benefits provided at the time of each valuation and the 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 actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial methods are noted above and in the Notes to Schedules of Funding Progress and Employer Contributions.

5. Benefits

Benefit provisions are established under authority of the TLFERRA. Specific plan provisions are governed by a Plan document and a trust agreement executed by the Board of Trustees. The Plan document may be amended as provided in Section 7 of the Texas Fire Fighters' Retirement Act (Article 6243e, V.T.C.S.). Amending the Plan requires approval of any proposed change by an eligible actuary and a majority of the participating members of the Plan. Both the City and the members of the Plan have specific authority to appoint members of the Board of Trustees under the TLFERRA.

6. Contributions

The Plan's minimum required contribution provisions are established under Title 8, Subtitle A, Chapter 802, Subchapter B, Section 802.101 of the Texas Government Code and under Texas Pension Review Board Guidelines for Actuarial Soundness. Specific Plan contribution rates are governed by the Plan document. Changes in the members' or the City's contribution rate requires a plan amendment.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2012

6. (Contributions – continued)

The contribution rates of the Plan members and the City are established under the terms of the Plan. An actuarial valuation is performed biennially to verify that Plan benefits and Plan contributions are in balance. Costs of administering the fund are paid from Plan assets.

Pursuant to the Plan document, a legal instrument binding both the City and its firefighters, the City of McAllen is required to match employee contributions. Benefits paid to former volunteer firefighters are funded by the City when paid to the former volunteer firefighters or beneficiaries. The City's contribution rate for the fiscal year ended September 30, 2012 was 12.5% of annual compensation. Contributions required and paid into the fund as of September 30, 2012 were \$1,027,430 (members) and \$1,284,288 (employer) and \$3,000 (100%) of volunteers' disbursement.

7. Deposits With Financial Institutions and Investments

The deposits and investments of the Plan are held separately from those of the City. The TLFFRA authorizes the Plan to invest in:

- Obligations and securities of the United States, the state of Texas, or any county, city, or other political subdivision of the state of Texas;
- Savings and loan association accounts insured by the Federal Deposit Insurance Corporation;
- First lien real estate mortgage securities insured by the Federal Housing Administration;
- Corporate bonds and stocks;
- Guaranteed investment contracts offered by insurance companies;
- Money market funds;
- Mutual funds and other pooled funds; and
- International stocks traded as American Depositary Receipts;
- Derivatives; and
- Hedge funds.

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2012

Investments

Investments at fair value as of September 30, 2012 are as follows:

	<u>Fair Value</u>	<u>% of Portfolio</u>	<u>Investment Policy of Asset Allocation</u>
Equities:			
Domestic	\$ 16,517,100	46.87%	30-60%
International	<u>3,275,077</u>	9.29%	10-30%
Total equities	<u>19,792,177</u>		
Fixed income:			
Treasury and agency securities	8,916,915		
Corporate bonds	<u>2,929,613</u>		
Total fixed income	<u>11,846,528</u>	33.61%	20-30%
Hedge funds	<u>3,603,294</u>	10.22%	0-20%
Total investment portfolio	<u><u>\$ 35,241,999</u></u>	100.00%	

Because of the complexity of the portfolio, the Board of Trustees uses a consultant to provide the guidance to accomplish the Plan's objectives. The Board also understands that return objectives can be achieved while assuming "market" volatility. The Board is willing to forgo potential return in strong markets in return for protection against a severe decline during weak periods.

Concentration of credit risk. As noted in the above schedule, none of the sectors exceed their percentage of asset allocation. The Plan is diversified; with no one issue exceeding 5%. Under normal market conditions, the portfolio can be liquidated within one to two days if so desired. Hedge funds can only be liquidated quarterly.

Interest rate risk. Only the fixed income securities of the Plan are subject to interest rate risk due to the possibility that prevailing interest rates could change before the securities reach maturity. Securities that are subject to interest rate risk as of September 30, 2012 amount to \$6,205,448 and have weighted-average duration of 6.64 years. Durations is defined as the change in the value of a fixed income security that will

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2012

result from a 1% change in interest rates. Duration is stated in years. For example, five year duration means the bond will decrease in value by 5% if interest rates rise 1% and increase in value by 5% if interest rates fall 1%. The investment policy is silent on the subject of interest risk. Securities that are subject to interest rate risk are shown in the following table.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Percentage of Total</u>	<u>Weighted-Average Duration (Years)</u>
Corporate bonds	\$ 797,327	12.85%	5.69
Government agencies	1,767	0.03%	2.34
Government bonds	5,394,584	86.93%	6.78
Government Mortgage Back Securities	966	0.02%	3.73
Supranationals	10,802	0.17%	8.05
Municipals & Derivatives	2	0.00%	-0.49
Total fixed income investments	<u>\$ 6,205,448</u>	<u>100.00%</u>	<u>6.64</u>

Credit risk. Using Standard and Poor's rating system for fixed income securities as of September 30, 2012 the Plan's fixed income investments were rated as noted below. The investment policy is silent on the subject of credit risk.

<u>Fair Value</u>	<u>Percentage of Total</u>	<u>S&P Rating</u>
\$ 24,782	0.40%	AAA
61,832	1.00%	AA
335,856	5.41%	A
2,861,483	46.11%	BBB
1,478,639	23.83%	BB
1,155,860	18.63%	B
14,288	0.23%	CCC
272,708	4.39%	Not rated
Total fixed income investments	<u>\$ 6,205,448</u>	<u>100.00%</u>

Foreign currency risk. The Plan has two equity investment managers that have direct foreign currency exposure. The investment policy is silent on the subject of foreign currency risk. The table that follows represents a summary of the country/currency allocations as of September 30, 2012.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

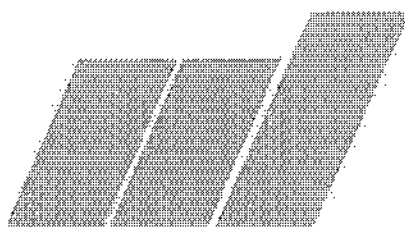
September 30, 2012

<u>Country</u>	<u>Fair Value</u>	<u>Percentage of Total</u>
Brazil	\$ 127,802	3.90%
Canada	147,464	4.50%
China	255,603	7.80%
Denmark	98,309	3.00%
Europe (forwards)	1,387	0.04%
France	232,665	7.10%
Germany	412,898	12.61%
Hong Kong	68,816	2.10%
Ireland	75,370	2.30%
Israel	104,863	3.20%
Japan	291,650	8.91%
Mexico	45,878	1.40%
Netherlands	75,370	2.30%
Russia	16,385	0.50%
South Korea	91,755	2.80%
Sweden	88,478	2.70%
Switzerland	252,326	7.70%
United States	150,740	4.60%
United Kingdom	<u>737,318</u>	<u>22.51%</u>
Totals	<u><u>\$ 3,275,077</u></u>	100.00%

8. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market rate, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the value of investment securities will occur in the near term and those changes could materially affect the amounts reported in the statements of plan net assets.

Plan contributions are made and the actuarial present value of accumulated plan benefits are reported based on certain assumptions pertaining to interest rates, inflation rates, and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.



Required Supplemental Information

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

**Schedule of Funding Progress
(Unaudited)**

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability ("AAL")	Unfunded AAL ("UAAL") (3)-(2)	Funded Ratio (2)/(3)	Covered Payroll	UAAL as a Percentage of Covered Payroll (3)-(2)/(6)
September 30, 2010	\$ 36,651,357	\$ 51,565,906	\$ 14,914,549	71.1%	\$ 8,996,407	165.8%
September 30, 2008	34,588,465	45,073,090	10,484,625	76.7%	8,199,849	127.8%
September 30, 2006	29,226,476	38,659,974	9,433,498	75.6%	6,817,267	138.4%
September 30, 2004	25,433,339	33,227,793	7,794,454	76.5%	5,818,893	134.5%
September 30, 2002	21,116,716	28,141,949	7,025,233	75.0%	5,190,836	135.1%
September 30, 2000	18,173,765	21,576,631	3,402,866	84.2%	4,263,430	79.8%

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use UAAL as a factor. Isolated analysis of the dollar amounts of actuarial value of assets, UAAL, and unfunded UAAL can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides an indication of the Plan's funding status on a going concern basis. Analysis of this percentage over time indicates whether the Plan is becoming financially stronger or weaker. Generally, the greater this percentage is, the stronger the public employee retirement system. Trends in UAAL and annual covered payroll are both affected by inflation. Expressing the UAAL as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage is, the stronger the public employee retirement system.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Schedule of Funding Progress and Employer Contributions (Unaudited)

<u>Year-End</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
September 30, 2003	\$ 656,026	100%
September 30, 2004	701,898	100%
September 30, 2005	805,822	100%
September 30, 2006	821,685	100%
September 30, 2008	994,434	100%
September 30, 2010	1,071,252	100%

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Schedule of Employer Contributions (Unaudited)

Notes to the required supplemental information:

The information presented in the required supplemental information was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial evaluation follows:

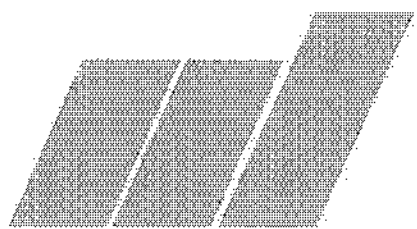
Valuation date	September 30, 2010
Actuarial cost method	Entry-age
Amortization method	Level percent of projected payroll
Amortization period	39.6 years open period
Asset valuation method	5yr smoothed market value

Actuarial assumptions:

Investment rate of return	8.0%
Projected salary increases	4.25%
Inflation rate	3.00%

See accompanying independent auditors' report.

Government Auditing Standards



Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance With *Government Auditing Standards*

To the Pension Board of Trustees
Firemen's Relief and Retirement Fund
McAllen, Texas

We have audited the accompanying statement of plan net assets of the Firemen's Relief and Retirement Fund (the "Plan"), a fiduciary fund of the City of McAllen, Texas, as of September 30, 2012, and the related statement of changes in plan net assets for the year then ended, and have issued our report thereon dated March 27, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Plan is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, others within the Plan, and the Pension Board of Trustees, and is not intended to be, and should not be, used by anyone other than these specified parties.

Padgett, Stratemann & Co., L.L.P.

Certified Public Accountants

March 27, 2013