

***MUNICIPAL FIRE AND POLICE
RETIREMENT SYSTEM OF IOWA***

***Financial Statements as of and for the
Years Ended June 30, 2005 and 2004 and Related
Independent Auditors' Reports***

MUNICIPAL FIRE AND POLICE RETIREMENT SYSTEM OF IOWA

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Municipal Fire and Police Retirement System of Iowa

We have audited the accompanying statements of plan net assets of Municipal Fire and Police Retirement System of Iowa (System) as of June 30, 2005 and 2004, and the related statement of changes in plan net assets for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Chapter 11 of the Code of Iowa. Those standards and Chapter 11 of the Code of Iowa 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 System'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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the plan net assets of the System as of June 30, 2005 and 2004, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the System adopted the provisions of Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

The management's discussion and analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the System's basic financial statements taken as a whole. The schedule of contributions from the employers and other contributing entities on page 18 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplementary information is the responsibility of the System's management. This supplementary information has been subjected to the auditing procedures applied by us in our audits 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. This supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2005, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

Des Moines, Iowa
September 23, 2005

Management's Discussion and Analysis

The following discussion and analysis of the Municipal Fire and Police Retirement System of Iowa's (System) financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2005 and 2004. Please read in conjunction with the basic financial statements, which follow this discussion. These statements represent the current condition from an accounting perspective, but do not reflect the System's actuarial status. Refer to the System's actuarial valuation for the System's funding status regarding long term benefit obligations.

FINANCIAL HIGHLIGHTS

- System assets exceeded its financial liabilities at the close of the fiscal years 2005 and 2004 by \$1,469,753,955 and \$1,323,691,524 (reported as plan net assets), respectively. Net assets are held in trust to meet future benefit payments.
- Revenues for the year ended June 30, 2005 were \$229,305,254, which is comprised of contributions of \$68,135,238, net investment income of \$161,161,757 and other income of \$8,259. Revenues for the year ended June 30, 2004 were \$264,633,963, which is comprised of contributions of \$56,386,664, net investment income of \$208,173,687 and other income of \$73,612.
- Benefits paid were \$80,930,453 and \$75,624,902 for the years ended June 30, 2005 and 2004, respectively, a 7.0% increase from year to year.

THE STATEMENTS OF PLAN NET ASSETS AND THE STATEMENTS OF CHANGES IN PLAN NET ASSETS

This Annual Financial Report consists of two financial statements; The Statements of Plan Net Assets and The Statements of Changes in Plan Net Assets. These financial statements report information about the System, as a whole, and financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this fiscal year's experience? These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, all revenue and expenses are taken into account regardless of when cash is received or paid.

The Statements of Plan Net Assets present all of the System's assets and liabilities, with the difference between assets and liabilities reported as plan net assets. Over time, increases and decreases in plan net assets is one way to measure whether the System's financial position is improving or deteriorating. The Statements of Changes in Plan Net Assets present the change in plan net assets during the fiscal year.

FINANCIAL ANALYSIS

System assets as of June 30, 2005 and 2004 were approximately \$1.66 billion and \$1.46 billion, respectively, and were primarily comprised of investments, cash, receivables from brokers, and contributions due from employers. The \$201,105,676, or 13.8%, increase in assets from June 30, 2004 to June 30, 2005 was primarily due to investment earnings and contributions.

Total liabilities as of June 30, 2005 and 2004 were \$192,226,375 and \$137,183,130, respectively, and were primarily comprised of payables for unsettled trades and obligations under securities lending. The \$55,043,245, or 40.1%, increase in liabilities from June 30, 2004 to June 30, 2005 was primarily due to an increase in payables from the purchase of investments and an increase in payables for securities lending.

System assets exceeded liabilities at the close of fiscal year 2005 by \$1,469,753,955. During the year ending June 30, 2005 plan net assets held in trust for pension benefits increased \$146,062,431, or 11.0%, from the previous fiscal year, primarily due to investment earnings and contributions. This is in comparison to the previous fiscal year, when net assets increased by \$186,588,891, or 16.4%, from the prior year.

**Municipal Fire and Police Retirement System of Iowa
Condensed Statements of Plan Net Assets
(In Thousands)**

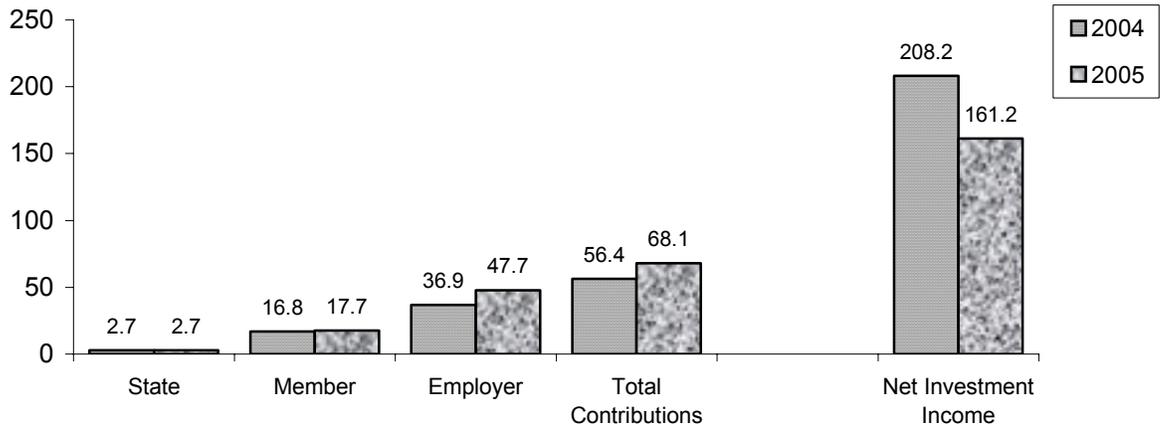
	2005	2004	Total Percentage Change
Assets:			
Cash	\$ 1,560	\$ 1,253	24.5 %
Investments	1,580,621	1,434,645	10.2 %
Receivables	79,565	24,832	220.4 %
Fixed assets	165	17	870.6 %
Other assets	69	127	(45.7)%
Total assets	<u>1,661,980</u>	<u>1,460,874</u>	<u>13.8 %</u>
Liabilities:			
Benefits and refunds payable	14	7	100.0 %
Investment management expenses payable	1,474	1,189	24.0 %
Administrative expenses payable	430	208	106.7 %
Payable for securities lending	112,315	94,111	19.3 %
Payable to brokers for unsettled trades	77,993	41,668	87.2 %
Total liabilities	<u>192,226</u>	<u>137,183</u>	<u>40.1 %</u>
Plan net assets	<u>\$ 1,469,754</u>	<u>\$ 1,323,691</u>	<u>11.0 %</u>

REVENUES – ADDITIONS TO PLAN NET ASSETS

Reserves needed to finance retirement benefits are accumulated through the collection of contributions and earnings on investments. Contributions and net investment income (losses) for the fiscal year 2005 totaled \$229,296,995.

Contributions increased from the previous year by \$11,748,574. This increase is primarily due to an increase in the employer contribution rate and increases in active members' earnable compensation. Net investment income decreased from the previous year by \$47,011,930. This change is primarily due to a smaller increase in the net appreciation in fair value of investments than the previous year.

Additions to Plan Net Assets (In Millions)

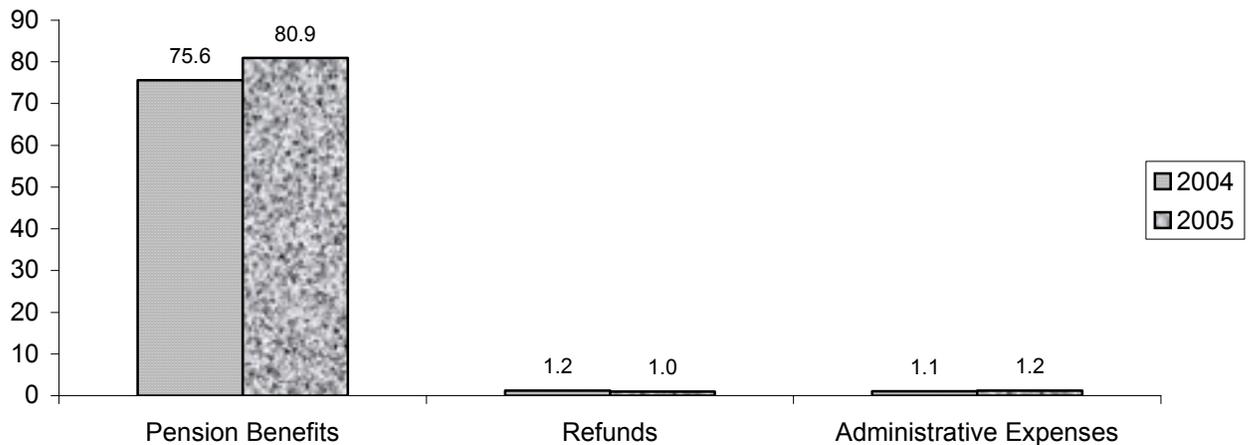


EXPENSES – DEDUCTIONS FROM PLAN NET ASSETS

The principal expenses of the System include the payment of pension benefits to retired members and beneficiaries, refund of contributions to former members, and the cost of administering the System. Total deductions for the fiscal year 2005 were \$83,242,823, an increase of 6.7% over fiscal year 2004 deductions.

Pension benefit payments increased by \$5,305,551, or 7.0%, from the previous year. Refund of contributions decreased by \$221,072, or 18.0%.

Deductions from Plan Net Assets (In Millions)



RETIREMENT SYSTEM AS A WHOLE

It is important to note the financial obligations established by the Iowa legislature in Iowa Code Chapter 411 are committed benefits, which are to be funded through the contributions made by the employers and the membership, in concert with the long-term return on investments. The “public policy” within Iowa has always been to meet the benefit commitments of the pension plans. The history of the plan benefits under Chapter 411 traces to 1934. The funding methods established by the legislature in the Iowa Code, whereby contributions are made from the individual employers and members, coupled with the “prudent person” concept for investment policy, provides the financial foundation for this public policy.

CONTACTING THE SYSTEM

This financial report is designed to provide the System’s Board of Trustees, membership, and cities a general overview of the System’s finances and to demonstrate accountability for assets. If you have any questions about this or need additional financial information, contact the System’s office, 2836 104th Street, Des Moines, IA 50322.

MUNICIPAL FIRE AND POLICE RETIREMENT SYSTEM OF IOWA

STATEMENTS OF PLAN NET ASSETS JUNE 30, 2005 AND 2004

ASSETS	2005	2004
Cash	\$ 1,560,474	\$ 1,253,329
Investments, at fair value:		
U.S. government obligations	63,660,614	95,093,618
U.S. corporate fixed income	99,571,070	60,002,226
U.S. equity securities	447,636,309	439,442,938
Foreign government obligations	3,329,407	8,309,015
Foreign corporate fixed income	5,818,952	11,592,897
Foreign equity securities	413,046,743	347,046,809
Commingled fixed income	160,350,931	161,688,281
Short-term investments and currency positions	120,578,383	63,366,877
Securities lending short-term collateral investment pool	112,315,472	94,110,571
Real estate	117,377,564	140,376,732
Private equity	36,935,162	13,615,423
Total investments, at fair value	<u>1,580,620,607</u>	<u>1,434,645,387</u>
Receivables:		
Contributions	2,370,859	1,821,494
Investment income	2,619,477	2,660,138
Receivable from brokers for unsettled trades, net	74,574,764	20,350,293
Total receivables	<u>79,565,100</u>	<u>24,831,925</u>
Fixed assets (net of accumulated depreciation of \$184,803 and \$245,718 in 2005 and 2004, respectively)	164,725	17,114
Other assets	<u>69,424</u>	<u>126,899</u>
Total assets	<u>1,661,980,330</u>	<u>1,460,874,654</u>
LIABILITIES		
Benefits and refunds payable	14,081	7,567
Investment management expenses payable	1,474,314	1,188,634
Administrative expenses payable	429,836	208,204
Payable for securities lending	112,315,472	94,110,571
Payable to brokers for unsettled trades, net	<u>77,992,672</u>	<u>41,668,154</u>
Total liabilities	<u>192,226,375</u>	<u>137,183,130</u>
Plan net assets held in trust for pension benefits	<u>\$ 1,469,753,955</u>	<u>\$ 1,323,691,524</u>

See notes to financial statements.

MUNICIPAL FIRE AND POLICE RETIREMENT SYSTEM OF IOWA

STATEMENTS OF CHANGES IN PLAN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
ADDITIONS:		
Contributions:		
Member	\$ 17,672,155	\$ 16,772,145
Employer	47,717,299	36,868,735
State appropriations	2,745,784	2,745,784
Total contributions	<u>68,135,238</u>	<u>56,386,664</u>
Investment income:		
Interest	9,906,044	11,081,035
Dividends	11,386,028	14,600,575
Securities lending	2,399,118	1,078,430
Net appreciation in fair value of investments	146,446,519	188,373,224
Total investment income	<u>170,137,709</u>	<u>215,133,264</u>
Less investment expenses:		
Securities lending	2,124,290	788,830
Management fees and other	6,851,662	6,170,747
Net investment income	<u>161,161,757</u>	<u>208,173,687</u>
Service credit actuarial adjustments	-	72,247
Other income	8,259	1,365
Total additions	<u>229,305,254</u>	<u>264,633,963</u>
DEDUCTIONS:		
Benefit payments	80,930,453	75,624,902
Refund payments	1,005,990	1,227,062
Administrative expenses	1,210,123	1,095,066
Disability expenses	84,466	78,579
Other	11,791	19,463
Total deductions	<u>83,242,823</u>	<u>78,045,072</u>
Net increase	146,062,431	186,588,891
Plan net assets held in trust for pension benefits:		
Beginning of year	<u>1,323,691,524</u>	<u>1,137,102,633</u>
End of year	<u>\$ 1,469,753,955</u>	<u>\$ 1,323,691,524</u>

See notes to financial statements.

MUNICIPAL FIRE AND POLICE RETIREMENT SYSTEM OF IOWA

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2005 AND 2004

1. PLAN DESCRIPTION

General

The Municipal Fire and Police Retirement System of Iowa (System) was created under Chapter 411.35 of the Code of Iowa to replace 87 separate fire and police retirement systems from 49 cities and 1 county in Iowa (Separate Systems). Effective January 1, 1992, the Separate Systems were terminated, and the respective entities were required to transfer assets to the System equal to their respective accrued liabilities (as measured by the System's actuary). Upon transfer of the assets, the System assumed all membership, benefits rights and financial obligations of the Separate Systems.

The System is the administrator of a multi-employer, cost sharing, defined benefit pension plan for the exclusive benefit of eligible employees of participating cities (substantially all full-time employees of the respective cities' fire and police departments). It is governed by a nine-member Board of Trustees (Board) who are appointed to the Board by police and fire associations and by the Iowa League of Cities. The eight voting members select a private citizen to serve as the ninth voting member. The Board is authorized by the state legislature to make investments, pay benefits, set contributions rates, hire staff and consultants and perform all necessary functions to carry out the provisions of the Code of Iowa. The System is separate and apart from state government and is not included in the state's financial statements.

At June 30, 2005, the System was comprised of 49 cities covering 3,786 active members; 276 terminated members entitled to benefits; and 3,461 retired firefighters, police officers, bailiffs, and eligible beneficiaries across Iowa.

Funding

Member - Member contribution rates are set by state statute. In accordance with House File 2418, Act of the 1994 General Assembly, to establish compliance with the Federal Older Workers Benefit Protections Act, the contribution rate was 9.35% of earnable compensation for the years ended June 30, 2005 and 2004.

Employer - Employer contribution rates are based upon an actuarially determined normal contribution rate and set by state statute. The required actuarially determined contributions are calculated on the basis of the aggregate actuarial cost method set forth in Chapter 411 of the Code of Iowa. The normal contribution rate is provided by state statute to be the actuarial liabilities of the plan less current plan assets, with such total divided by 1 percent of the actuarially determined present value of prospective future compensation of all members, further reduced by member contributions and state appropriations. Under the Code of Iowa the employer's contribution rate cannot be less than 17% of earnable compensation. The contribution rate was 24.92% and 20.48% for the years ended June 30, 2005 and 2004, respectively.

State Appropriations - State appropriations are approved by the state legislature and may further reduce the employer's contribution rate, but not below the minimum statutory contribution rate of 17.00% of earnable compensation.

Benefits

Participating members are entitled to the benefit provisions in effect on the member's date of termination. The following is a summary of the System benefit provisions as of June 30, 2005 and 2004:

Retirement - Members with 4 or more years of service are entitled to pension benefits beginning at age 55. Full service retirement benefits are granted to members with 22 years of service, while partial benefits are available to those members with 4 to 22 years of service based on the ratio of years completed to years required (22 years). Members with less than 4 years of service are entitled to a refund of their contribution only, with interest for the period of employment.

Benefits are calculated based upon the member's highest 3 years of compensation. The average of these 3 years becomes the member's average final compensation. The base benefit is 66 percent of the member's average final compensation. Additional benefits are available to members who perform more than 22 years of service (2 percent for each additional year of service, up to a maximum of 8 years). Survivor benefits are available to the beneficiary of a retired member according to the provisions of the benefit option chosen plus an additional benefit for each child. Survivor benefits are subject to a minimum benefit for those members who chose the basic benefit with a 50 percent surviving spouse benefit.

Disability and Death - Disability coverage is broken down into two types, accidental and ordinary. Accidental disability is defined as permanent disability incurred in the line of duty, with benefits equivalent to the greater of 60 percent of the member's average final compensation or the member's service retirement benefit calculation amount. Ordinary disability occurs outside the call of duty and pays benefits equivalent to the greater of 50 percent of the member's average final compensation, for those with 5 or more years of service, or the member's service retirement benefit calculation amount, and 25 percent of average final compensation for those with less than 5 years of service.

Death benefits are similar to disability benefits. Benefits for accidental death are 50 percent of the average final compensation of the member plus an additional amount for each child, or the provisions for ordinary death. Ordinary death benefits consist of a pension equal to 40 percent of the average final compensation of the member plus an additional amount for each child, or a lump-sum distribution to the designated beneficiary equal to 50 percent of the previous year's earnable compensation of the member or equal to the amount of the member's total contributions plus interest.

Benefits are increased (escalated) annually in accordance with Iowa Code Chapter 411.6 which states a standard formula for the increases.

Traumatic Personal Injury - The surviving spouse or dependents of an active member who dies due to a traumatic personal injury incurred in the line of duty receives a \$100,000 lump-sum payment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The System has elected to apply only applicable Financial Accounting Standards Board (FASB) Statements and interpretations issued on or before November 30, 1989, that do not contradict Governmental Accounting Standards Board (GASB) pronouncements.

The System prepared its financial statements using the accrual basis of accounting. It recognizes member and employer contributions as revenues in the month member earnings are paid. Benefits and refunds are recognized as expenses when payable. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

New Accounting Pronouncements – The System has adopted GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures*. GASB 40 requires the System to include new disclosures for investments that have fair values that are highly sensitive to changes in interest rates. Adoption of this pronouncement had no impact on the operations or financial position of the System.

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ from those estimates.

Investments - The System’s securities are reported at fair value. Where appropriate, the fair value includes estimated disposition costs. Interest income is recognized when earned. Dividend income is recognized on the ex-dividend date. Gains or losses on stocks and bonds are recognized on an average cost basis calculated separately for each investment manager. Other gains and losses are recognized on an identified cost basis. Gains and losses on sales and exchanges are recognized on the trade date. The fair values of securities held at June 30 are determined by using the closing price listed on national securities exchanges and quoted market prices provided by independent pricing services. For commingled funds, the net asset value is determined and certified by the commingled fund manager. Investments in real estate and private equities are valued based on amounts established by fund managers which are subject to annual audit.

Fixed Assets - Fixed assets are stated at cost, net of accumulated depreciation. Depreciation is recognized on a straight-line basis over estimated useful lives of three to ten years.

Income Taxes – The System has a tax determination letter from the Internal Revenue Service stating that it qualifies under the provision of Section 401 of the Internal Revenue Code and is exempt from federal and state income taxes.

Reclassifications – Certain amounts have been reclassified in the 2004 financial statements to conform with the 2005 presentation.

3. CASH

For cash deposits, custodial credit risk is the risk that in the event of a bank failure, the System’s deposits may not be returned. The table below presents a summary of cash balances of the System at June 30, 2005 and 2004:

	2005	2004
Bank balance at June 30:		
Insured	\$ 100,000	\$ 100,000
Uninsured and uncollateralized	<u>1,460,474</u>	<u>1,153,329</u>
Carrying amount at June 30	<u>\$1,560,474</u>	<u>\$1,253,329</u>

4. INVESTMENTS

Investment Policy

The investment authority, as prescribed by the Code of Iowa, is governed by the “prudent person rule.” This rule requires that an investment be made with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an entity of a like character with like aims. Within the “prudent person” framework, the Board has adopted investment guidelines for the System’s investment program.

The following investment vehicles are permitted by the System’s investment policy and may be considered for the System’s funds:

Stocks and Bonds (Domestic, International & Emerging Markets):

- Securities issued by and the obligations of or guaranteed by the United States of America or U.S. government sponsored enterprises or by the Dominion of Canada or any province thereof, financial futures and options;
- Bonds issued by the State of Iowa or its political subdivisions;
- Common stock, American Depository Receipts, corporate bonds or other evidences of indebtedness issued under the laws of the Dominion of Canada or any province thereof;
- Common stock, bonds or other evidences of indebtedness issued under the laws of selected foreign countries or their political subdivisions;
- Debt instruments issued by multinational organizations, on behalf of selected nations or groups of nations, such as Brady Bonds, whether in U.S. dollars or foreign currencies;
- Mutual funds, commingled funds, or private equity which are, comprised of stocks, equity and or debt instruments, including those which hold positions in emerging markets, whether in U.S. dollars or foreign currencies;
- Derivative instruments, such as futures and options, can be utilized as an alternative to a stock or bond position, as specified.

Other Asset Classes

The currency positions of the System include the currency of a group of selected nations, which have well established and stable economic and political structures. Currency positions are only taken in countries or in multinational currencies (for examples, Euros) in which the System has determined to invest the System's assets. The currency assets of the System are represented within the individual portfolios of the investment managers, which have mandates, which include international bonds or stocks. The benchmark against which these managers run the portfolios shall include a zero percent hedged position to the U. S. dollar for the international portions of the mandate.

Derivative Instruments

Derivative instruments, such as futures and options, may be utilized in selected portfolios for the following purposes:

- 1) As an alternative to maintaining a selected asset position,
- 2) To maintain the duration of securities in a portfolio,
- 3) To gain exposure in a time of dollar strength to a foreign bond market with minimal exposure to the currency of the country,
- 4) To hedge or otherwise protect existing or anticipated portfolio positions,
- 5) To establish and maintain the currency positions for the currency overlay portfolio and for the individual currency activities of the individual portfolios, and
- 6) Not to speculate or leverage (gear-up) the portfolio.

Derivative instruments are generally defined as contracts whose value depends on ("derives" from) the value of an underlying asset, reference rate, or index. Derivative instruments include both of the following:

- a) "Over the counter" (OTC) derivatives: privately negotiated contracts provided directly by dealers to end-users; which include swaps, futures and options, based upon interest rates, currencies, equities, and commodities; and
- b) Standardized contracts sold on exchanges: futures and options.

Real Estate

The real estate positions of the System may include domestic or international real estate investments in individual properties or groups of properties, through one or more of the following: direct purchase or mortgage of individual properties, participation in a commingled fund (open-ended or closed-ended) or in a trust or a partnership, which has positions in one or more properties.

The real estate positions of the System may include investment in securitized real estate, via publicly traded or privately held Real Estate Investments Trusts (REITS).

Investment Risk Disclosure

Credit Risk

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations as of June 30, 2005 are as follows:

Quality Rating	Fair Value	Percentage of Portfolio
AAA	\$ 154,691,027	46.50 %
AA	64,360,344	19.34 %
A	9,264,012	2.78 %
BBB	10,792,778	3.24 %
BB	20,674,976	6.21 %
B	5,981,293	1.80 %
CCC	190,000	0.06 %
Unrated	<u>3,115,930</u>	<u>0.94 %</u>
Total credit risk debt securities	269,070,360	80.87 %
U.S. Government Fixed Income Securities*	<u>63,660,614</u>	<u>19.13 %</u>
Total fixed income securities	<u>\$ 332,730,974</u>	<u>100.00 %</u>

*Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.

The System does not have a formal policy that limits the quality grade in which the System may invest.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the pension fund will not be able to recover the value or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the System, and are held by either the counterparty or the counterparty's trust department or agent but not in the System's name.

Iowa Code 411.7 establishes the secretary of the Board as the custodian of the fund and provides for the System to select master custodian banks to provide custody of the System's assets. The System has arranged for Mellon Trust of New England, N.A. to act as the master custodian bank. The master custodian bank may hold System property in the name of its nominee, bearer form, or in book entry form, so long as the Custodian's records clearly indicate that such property is held as part of the System's account.

Concentration of Credit Risk

The System is guided by statute and policy in the selection of security investments. No investments in any one organization represent 5% or more of plan assets.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment.

	Fair Value	Duration
Investment type:		
Short-term	\$ 120,578,383	0.0697
Fixed income	172,380,043	4.4875
Commingled	<u>160,350,931</u>	<u>4.5391</u>
Total fair value	<u>\$ 453,309,357</u>	
Portfolio modified duration		<u>3.3306</u>

Duration is a measure of interest rate risk. The greater the duration of a bond, or portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Duration is the measure of a bond price's sensitivity to a 100-basis point change in interest rates. Duration of eight would mean that, given a 100-basis point change up/down in rates, a bond's price would move up/down by 8%.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The System had exposure to foreign currency fluctuations as follows:

	Fair Value	Percentage of Holdings
Currency:		
Euro Currency Unit	\$ 55,399,153	28.56 %
British Pound Sterling	47,867,235	24.68 %
Japanese Yen	26,988,020	13.92 %
Australian Dollar	19,258,638	9.93 %
Swiss Franc	8,996,779	4.64 %
Canadian Dollar	7,057,894	3.64 %
Chinese Yuan Renminbi	6,696,899	3.45 %
Swedish Krona	6,387,436	3.29 %
Other	<u>15,297,341</u>	<u>7.89 %</u>
Total foreign currency holdings	<u>\$ 193,949,395</u>	<u>100.00 %</u>

Commitments

The System is committed, as of June 30, 2005, to invest approximately \$188,317,000 in certain private equity, real estate, and commingled funds.

5. SECURITIES LENDING PROGRAM

Under the provisions of state statutes and the System's investment policy, the System lends securities, both equity and fixed income, to securities firms on a temporary basis primarily through the master trustee, Mellon Trust of New England, N.A. The System receives a portion of the earnings (split) for all loans and retains the right to amounts equal to all interest and dividend payments while securities are on loan.

Security loan agreements are collateralized by cash, U.S. government issued securities or irrevocable bank letters of credit. Domestic loans are initially collateralized at 102 percent of the market value plus any accrued interest. If the loans fall below 100 percent collateralization, the loan is marked back to 102 percent. Loans of non-U.S. securities are initially collateralized at 105 percent and are marked back to 105 percent if they fall below 105 percent. Notwithstanding the forgoing, however, standard industry practices may from time to time preclude the lending agent from obtaining additional collateral in connection with loans of global securities by the close of the next business day, unless the value of collateral held by the lending agent in connection with such loans is less than 100 percent.

Mellon Bank Global Securities Lending, a division of Mellon Trust of New England, N.A., invests all of the cash collateral generated from the System's securities loans into a collective cash collateral pool. The System holds an undivided share of the collateral provided by the borrower of its securities. The System cannot pledge nor sell the collateral unless the borrower fails to return the securities borrowed.

All securities loans can be terminated on demand by either the lender or the borrower. When a loan is closed, the securities on loan are returned to the System and the collateral associated with the loan is returned to the borrower. The lending agent shall hold the System harmless for any losses, cost or expenses arising as a result of negligence, misconduct or fraud by the lending agent.

The System had no credit risk as a result of its securities lending program as the collateral held exceeded the market value of the securities lent.

6. DERIVATIVES

The System's investment managers may invest in derivative securities as permitted by their contracts. A derivative security is an investment whose payoff depends upon the value of an underlying asset such as bond and stock prices or a market index. Derivative financial instruments involve, to varying degrees, credit risk and market risk.

Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. To limit credit risk, each investment manager screens potential counter-parties and establishes and maintains an approved list of acceptable firms which meet a high level of credit-worthiness.

Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is managed by imposing contractual requirements on the investment managers as to the types, amounts and degree of risk they may undertake. Investment managers' derivative activities are reviewed on a periodic basis to monitor compliance with the contracts. The System does not purchase derivatives with borrowed funds and does not allow the leveraging of the portfolios.

The System's derivative investments may include foreign currency forward contracts, options, futures, and collateralized mortgage obligations. Foreign currency forward contracts are used to hedge against the currency risk in foreign stock and fixed income security portfolios. The remaining derivative securities are used to improve yield, adjust the duration of the fixed income portfolio, or to hedge changes in interest rates.

A forward contract is an agreement to buy or sell a specific currency position or security at a specified delivery or maturity date for an agreed-upon price. As the fair value of the forward contract fluctuates, the System records an unrealized gain or loss. A summary of net forward currency contracts outstanding at June 30, 2005 and 2004, are as follows:

	2005	2004
Long forward currency positions	\$ 37,325,037	\$ 56,941,267
Short forward currency positions	<u>37,220,030</u>	<u>57,747,094</u>
Unrealized gain (loss)	<u>\$ 105,007</u>	<u>\$ (805,827)</u>

A financial option is an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. The same leverage prohibitions which apply to forwards and futures are applicable to options. There were no financial options outstanding at June 30, 2005 or 2004.

Contractual amounts, which represent the fair value of the underlying assets the derivative contracts control, are often used to express the volume of these transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Every position which is sold or purchased must be backed by assets, since the investment managers are not allowed to leverage the portfolio.

Required Supplementary Information

Schedule of Contributions from the Employers and Other Contributing Entities

Year Ended June 30,	Annual Required Contributions			Percentage Contributed		
	<u>Employer</u>	<u>Member</u>	<u>State</u>	<u>Employer</u>	<u>Member</u>	<u>State</u>
2005	\$47,717,299	\$17,672,155	\$2,745,784	100%	100%	100%
2004	36,868,735	16,772,145	2,745,784	100%	100%	100%
2003	28,857,743	15,871,489	2,816,189	100%	100%	100%
2002	28,542,482	15,696,746	2,816,189	100%	100%	100%
2001	27,345,914	15,039,155	2,942,724	100%	100%	100%
2000	26,170,758	14,393,323	2,942,724	100%	100%	100%

Notes to Required Supplementary Information

Valuation Date July 1, 2005 and 2004
 Actuarial cost method Aggregate

Asset valuation method Fair value adjusted for a four-year amortization of asset gains (losses)

Note: The System is not required to present the schedule of funding progress under the requirements of Governmental Accounting Standards Board Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," because the System uses the aggregate cost method to determine its aggregate actuarial liabilities. This method does not identify or separately amortize unfunded actuarial liabilities.

Actuarial assumptions:

Investment rate of return	7.50 percent
Projected salary increases	4.50 to 12.59 percent

Mortality table Effective with the July 1, 1999 actuarial valuation, the System began a 12 year phase-in of the 1994 Group Annuity Mortality Table from the 1971 Group Annuity Mortality Table. However, if the Cities' Contribution Rate exceeds 17% after reflecting an additional year of the phase-in, the phase-in will be deferred one year.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Trustees
Municipal Fire and Police Retirement System of Iowa

We have audited the financial statements of Municipal Fire and Police Retirement System of Iowa (System) as of and for the year ended June 30, 2005, and have issued our report thereon dated September 23, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Chapter 11 of the Code of Iowa.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the System'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 the Board of Trustees, management, and regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

Des Moines, Iowa
September 23, 2005