

**MIDLAND FIREMEN'S RELIEF
AND RETIREMENT FUND**
Midland, Texas

ANNUAL FINANCIAL REPORT
December 31, 2013 and 2012

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Independent Auditor's Report

The Board of Trustees
Midland Firemen's Relief and Retirement Fund
Midland, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of Midland Firemen's Relief and Retirement Fund (the Plan), which comprise the statement of plan net position as of December 31, 2013, and the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Plan management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Plan's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the 2013 financial statements referred to above present fairly, in all material respects, the plan net position of the Plan as of December 31, 2013, and the changes in its plan net position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Plan as of December 31, 2012, were audited by other auditors whose report dated July 31, 2013, expressed an unmodified opinion on those statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, schedule of funding progress, schedule of employer contributions, schedule of actuarial methods and assumptions, and related notes on pages 4 through 8 and 25 through 28 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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.

Connor, McMullen, Mitchell & Shennum, PLLC

Midland, Texas
July 22, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Required Supplementary Information)

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2013 and 2012**

Introduction

The Midland Firemen's Relief and Retirement Fund (the Plan) is a single-employer, defined benefit pension plan covering substantially all firemen employed by the City of Midland, Texas. It is subject to the provisions of the Texas Local Firefighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

As management of the Plan, we offer readers of the Plan financial statements this narrative overview and analysis of the financial activities of the Plan for the fiscal years ended December 31, 2013, 2012, and 2011.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's financial statements. The Plan's financial statements are comprised of statements of plan net position, statements of changes in plan net position, and notes to the financial statements. This report also contains other required supplementary information in addition to the financial statements themselves.

Statement of Plan Net Position

The statement of plan net position is designed to provide readers with a broad overview of the Plan's finances in a manner similar to other pension funds.

The statement of plan net position presents the financial position of the Plan. The financial position is simply all of the Plan's assets and liabilities, with the difference between the two reported as net position restricted for pension benefits. Over time, increases or decreases in net position restricted for pension benefits may serve as a useful indicator of whether the financial position of the Plan is improving or deteriorating.

Statement of Changes in Plan Net Position

The statement of changes in plan net position presents the additions to and deductions from the Plan's net position during the year. The additions to position are divided into two types of categories, contributions and investment income (loss). Contributions are shown from both employer and plan members. Net investment income (loss) is broken down by net appreciation or depreciation in fair value of investments and interest and dividend income less investment expenses. The primary deductions are benefits paid, which is the Plan's primary purpose. Deductions also include refunds to members who leave the Plan and administrative expenses. The change in the Plan's net position during the year is added to or subtracted from the beginning balance of the Plan's net position to obtain the balance of plan net position at the end of the year. This figure ties directly to the last line of the statement of plan net position.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements. They provide additional information that is essential to a full understanding of the data provided in the

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED
December 31, 2013 and 2012**

financial statements. Among other matters, the notes describe: (a) the Plan's purpose and its membership, (b) the significant accounting policies used to prepare the financial statements, (c) the nature of the Plan, including the membership and benefit provisions and contribution requirements, and (d) the Plan's investment authority and policies, how investments and related documentation are safeguarded, and selected details about various investment activity and balances.

The notes to the financial statements can be found on pages 12 through 23 of this report.

Required Supplementary Information

To provide actuarially determined information about the Plan, this report includes schedules of historical trend information in the required supplementary information section. Those schedules, the schedule of funding progress, the schedule of employer contributions, and the schedule of actuarial method and assumptions provide actuarial information to help you understand the changes in the actuarial funding and the funded status of the Plan over time. Please note that the actuarial information is based upon assumptions about future events, and therefore, the figures presented are necessary estimates.

The schedule of funding progress provides information about the progress made to accumulate sufficient assets to pay benefits when due. It presents the funded status of the Plan by comparing the actuarial value of the assets to the actuarial accrued liability (AAL). The schedule of employer contributions presents information about the annual required contributions of the employer and the contributions the employer actually made so that you can see the performance of the employer in funding the Plan. The third schedule, the schedule of actuarial methods and assumptions, provides the actuarial information used to determine the information presented in the schedule of funding progress.

Statement of Plan Net Position Analysis

The following condensed statements of the plan net position and changes in plan net position present financial information comparing 2013, 2012, and 2011 information. This information comes from the statements of plan net position and changes in plan net position for the years then ended.

As noted earlier, net position may serve over time as a useful indicator of a pension fund financial position. The Plan's net position restricted for pension benefits were \$80,950,814, \$72,112,476, and \$65,724,726 as of 2013, 2012, and 2011, respectively. In 2013 there was an increase of \$8,838,338 or approximately 12% over the previous year's balance of \$72,112,476. In 2012 there was an increase of \$6,387,750 or approximately 10% over the previous year's balance of \$65,724,726. In 2011 there was a decrease of \$2,789,684 or approximately 4% under the previous year's balance of \$68,514,410.

The largest portion of the Plan's total assets is reflected in its mutual funds category. These assets are to be used for pension benefits in the future.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED
December 31, 2013 and 2012**

Statement of Plan Net Position Analysis (Continued)

CONDENSED STATEMENTS OF PLAN NET POSITION

	<u>2013</u>	<u>2012</u>	<u>2011</u>
ASSETS			
Cash and short-term investments	\$ 7,030,886	\$ 7,439,205	\$ 7,677,090
Investments	73,760,485	64,217,896	57,693,822
Receivables	<u>212,103</u>	<u>489,883</u>	<u>377,751</u>
Total assets	<u>81,003,474</u>	<u>72,146,984</u>	<u>65,748,663</u>
LIABILITIES			
Accounts payable	<u>52,660</u>	<u>34,508</u>	<u>23,937</u>
Total liabilities	<u>52,660</u>	<u>34,508</u>	<u>23,937</u>
NET POSITION RESTRICTED FOR PENSION BENEFITS	<u>\$ 80,950,814</u>	<u>\$ 72,112,476</u>	<u>\$ 65,724,726</u>

CONDENSED STATEMENTS OF CHANGES IN PLAN NET POSITION

	<u>2013</u>	<u>2012</u>	<u>2011</u>
ADDITIONS			
Contributions	\$ 4,574,540	\$ 4,538,410	\$ 4,070,434
Investment income (loss)	11,001,727	7,746,557	(1,349,496)
Other income	16,422	-	-
Less investment expenses:			
Investment fees	(329,824)	(276,793)	(401,227)
Bank trust fees	<u>(26,126)</u>	<u>(41,166)</u>	<u>(54,021)</u>
Total additions	<u>15,236,739</u>	<u>11,967,008</u>	<u>2,265,690</u>
DEDUCTIONS			
Benefits paid directly to participants	4,703,953	4,497,422	4,223,618
Lump sum distributions	1,485,909	853,878	643,982
Wages expense and taxes	128,573	127,821	95,128
Administrative expenses	<u>79,966</u>	<u>100,137</u>	<u>92,646</u>
Total deductions	<u>6,398,401</u>	<u>5,579,258</u>	<u>5,055,374</u>
NET INCREASE (DECREASE) IN PLAN NET POSITION	8,838,338	6,387,750	(2,789,684)
NET POSITION RESTRICTED FOR PENSION BENEFITS AT BEGINNING OF YEAR	<u>72,112,476</u>	<u>65,724,726</u>	<u>68,514,410</u>
NET POSITION RESTRICTED FOR PENSION BENEFITS AT END OF YEAR	<u>\$ 80,950,814</u>	<u>\$ 72,112,476</u>	<u>\$ 65,724,726</u>

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED
December 31, 2013 and 2012**

Statement of Plan Net Position Analysis (Continued)

As of December 2013, the Plan had 15 money managers managing seven different types of investment instruments within its investment portfolio. Each type of investment within the different asset classes had a target allocation of no more than 40% and not less than 1%. Total amount of each type of investment ranged from a high of \$21,944,092 in mutual funds to a low of \$485,515 in municipal bonds. The actuarial assumption used by the Plan is an 8% return.

As of December 2012, the Plan had 15 money managers managing seven different types of investment instruments within its investment portfolio. Each type of investment within the different asset classes had a target allocation of no more than 40% and not less than 1%. Total amount of each type of investment ranged from a high of \$17,452,011 in common stock to a low of \$1,663,230 in government and agency obligations. The actuarial assumption used by the Plan is an 8% return.

Financial Highlights

- The net position restricted for the pension benefits at the close of the fiscal years ended December 31, 2013, 2012, and 2011 were \$80,950,814, \$72,112,476, and \$65,724,726, respectively.
- The Plan's total net position increased in 2013 by \$8,838,338 increased in 2012 by \$6,387,750, and decreased in 2011 by \$2,789,684. The increases and the decreases were due mainly to the change in net depreciation/appreciation in fair value of investments.
- In 2013, 2012, and 2011 the Plan reported cash and short-term investments of \$7,030,886, \$7,439,205, and 7,677,090, respectively.
- Receivables at the end of the fiscal years 2013, 2012, and 2011 were \$212,103, \$489,883, and \$377,751, respectively.

Funding Progress

The Plan has a contract with John M. Crider, Jr., Consulting Actuary, who certifies that the contribution commitment by the firefighters and the City of Midland provides an adequate financing arrangement. This financing arrangement includes consideration of the Plan's funding status on a going-concern basis and progress made in accumulating sufficient assets to pay benefits when due. Using the entry age actuarial cost method, the Plan's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the Plan's unfunded actuarial accrued liability (UAAL), and the number of years needed to amortize the Plan's UAAL liability is determined using a level percentage of payroll method. For years in which actuarial valuations are not performed, estimates are made using the actuarial methods and principles. The following are summary results from the valuation of January 1, 2012, the latest version:

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED
December 31, 2013 and 2012**

Funding Progress (Continued)

- Using the market value of assets, the approximate annual rates of return for the years ended December 31, 2007, through 2011, were 10.9%, -20.0%, 12.9%, 11.9%, and -2.9%, respectively. The average rate of return for the five-year period ended December 31, 2011, was 2.6%
- The combined member and City of Midland contribution rates as of January 1, 2012, were not capable of amortizing the Plan's UAAL. The amortization period as of January 1, 2012, however, was 86.3 years. The amortization period increased due to the rate of return on the actuarial value of assets, which was lower than assumed. However, the Plan had favorable demographic experience.

If a plan's actuarial liabilities exceed the actuarial value of assets, the plan is said to have a UAAL. As of January 1, 2012, the Plan had a UAAL of \$28,091,967, an increase of \$8,308,722 compared to UAAL of \$19,783,245 as of January 1, 2010.

Capital Assets and Debt Administration

The Plan does not have any capital assets other than office equipment or have any outstanding debt as of December 31, 2013, 2012, and 2011.

Economic Factors

The Plan's Board is continuing to review asset allocation in order to continue to meet the actuarial assumption as currently established. In addition, each of the various money managers is being benchmarked to current market conditions. By performing this type of benchmarking, it helps ensure that the best returns are being earned given the appropriate risk factors of that type of investment.

Request for Information

This financial report is designed to provide a general overview of the finances of the Plan. As the City of Midland serves as fiscal agent for the Plan, questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Midland Firemen's Relief and Retirement Fund, P.O. Box 4296, Midland, Texas, 79704.

FINANCIAL STATEMENTS

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
STATEMENTS OF PLAN NET POSITION
December 31, 2013 and 2012

ASSETS	<u>2013</u>	<u>2012</u>
INVESTMENTS AT FAIR VALUE		
Common stocks	\$ 11,843,985	\$ 17,452,011
Foreign obligations	7,661,289	9,294,877
Mutual funds	21,944,092	16,866,137
Real estate	10,099,646	6,415,000
Other equity investments	19,722,056	12,526,641
Government and agency obligations	2,003,902	1,663,230
Municipal bonds	<u>485,515</u>	<u>—</u>
Total investments, at fair value	<u>73,760,485</u>	<u>64,217,896</u>
RECEIVABLES		
Accrued interest and declared dividends	212,103	315,027
Contributions from employer	—	105,751
Contributions from employees	<u>—</u>	<u>69,105</u>
Total receivables	<u>212,103</u>	<u>489,883</u>
CASH AND SHORT-TERM INVESTMENTS		
Total assets	<u>7,030,886</u>	<u>7,439,205</u>
Total assets	<u>81,003,474</u>	<u>72,146,984</u>
LIABILITIES		
ACCOUNTS PAYABLE		
Total liabilities	<u>52,660</u>	<u>34,508</u>
NET POSITION RESTRICTED FOR PENSION BENEFITS		
Total liabilities	<u>52,660</u>	<u>34,508</u>
NET POSITION RESTRICTED FOR PENSION BENEFITS		
Total assets	<u>\$ 80,950,814</u>	<u>\$ 72,112,476</u>

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

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
STATEMENTS OF CHANGES IN PLAN NET POSITION
Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ADDITIONS		
Investment income:		
Net appreciation in fair value of investments	\$ 8,945,738	\$ 5,909,175
Interest	531,620	677,985
Dividends	1,370,986	1,159,397
Partnership income	<u>153,383</u>	<u>—</u>
Total investment income	<u>11,001,727</u>	<u>7,746,557</u>
Less investment expenses		
Investment management service	<u>(355,950)</u>	<u>(317,959)</u>
Net investment income	<u>10,645,777</u>	<u>7,428,598</u>
Other cash receipts	16,422	—
Contributions:		
Employer	2,779,503	2,744,787
Employee	<u>1,795,037</u>	<u>1,793,623</u>
Total contributions	<u>4,574,540</u>	<u>4,538,410</u>
Total additions	15,236,739	11,967,008
DEDUCTIONS		
Benefits paid	6,189,862	5,351,300
Wages expense, benefits, and taxes	128,573	127,821
Administrative expenses	<u>79,966</u>	<u>100,137</u>
Total deductions	<u>6,398,401</u>	<u>5,579,258</u>
NET INCREASE IN PLAN NET POSITION	8,838,338	6,387,750
NET POSITION RESTRICTED FOR PENSION		
BENEFITS AT BEGINNING OF YEAR	<u>72,112,476</u>	<u>65,724,726</u>
NET POSITION RESTRICTED FOR PENSION		
BENEFITS AT END OF YEAR	<u>\$ 80,950,814</u>	<u>\$ 72,112,476</u>

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

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements of the Midland Firemen's Relief and Retirement Fund (the Plan) are prepared using the accrual basis of accounting. Employee and employer contributions are recognized when due and the employer and employee have made formal commitments to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

The Plan follows GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The Statement establishes a financial reporting framework for defined benefit pension plans, including current financial information about plan assets and financial activities and actuarially determined information about the funded status of the Plan and the progress being made in accumulating sufficient assets to pay benefits when due. GASB Statement No. 50 amended GASB Statement No. 25. The provisions of GASB Statement No. 50 generally are effective for periods beginning after June 15, 2007.

Use of Estimates

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

Investments

Investments in equity securities traded on international and national securities exchanges are valued based on the latest quoted market price as of each year-end. Investments that are not traded on a national securities exchange are valued at their fair values determined by the Trustees based on the market values of similar investments or on the basis of information obtained from qualified sources such as the custodial bank trust department, brokers, pricing services or appraisers. Fixed income securities are valued at broker quotes.

The Plan's investments in limited partnerships (reported in real estate and other equity investments) are valued at estimated fair value based on the Plan's proportionate share of the partnerships' fair value as recorded by the partnership. The Plan uses information provided by the limited partnership, such as audited financial statements of the limited partnership and other information accumulated by management pertinent to the investment, to estimate fair value. The limited partnerships allocate gains, losses, and expenses to the partners based on the ownership percentage as described in the partnership agreements. The Plan uses cost on some limited partnerships because management has determined this is the best indicator of fair market value. Estimates are used by management in determining the fair value of the Plan's investments in limited partnerships. The amount received upon sale of the investments may differ significantly from the recorded amount.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments (Continued)

There are certain market risks, credit risks, foreign exchange currency risks, or events that may subject the Plan's investment portfolio to economic changes occurring in certain industries, sectors, or geographies.

In accordance with the policy of stating investments at current market value, the amount reflected as the net appreciation (depreciation) in fair value represents the net changes in market values from the beginning of the year or date of purchase (whichever is later) to the end of the year, adjusted for securities sold during the year.

Cash and Cash Equivalents

For financial reporting purposes a portion of the investment portfolio is classified as equivalent to cash. Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less which present an insignificant risk of changes in value because of changes in interest rates.

Interest and Dividends Receivable

Interest income is recorded on an accrual basis. Dividends are recorded on the ex-dividend date. Recording activity in such a manner results in interest and dividends receivable.

Reclassification

Certain amounts in the 2012 financial statements have been reclassified to conform with the 2013 presentation.

NOTE 2 - DESCRIPTION OF PLAN

The following description of the Plan provides only general information. Participants should refer to the Plan document for a more complete description of the Plan's provisions.

General

The Midland Firemen's Relief and Retirement Fund (the Plan) is a single-employer, defined benefit pension plan covering substantially all firemen employed by the City of Midland, Texas (the City). It is subject to the provisions of the Texas Local Firefighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

Membership

All firemen become members of the Plan as a condition of their appointment unless they are more than 35 years of age at the time they enter service.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - DESCRIPTION OF PLAN (CONTINUED)

Contributions

All members are required to contribute a percentage of their salary to the Plan. The member contribution rate was 13.2% for 2013 and 2012. The City's contribution rate was 20.2% through October 2013 and increased to 21.2% starting in November 2013.

For the year 2013, employee and employer contributions of \$1,795,037 and \$2,779,503, respectively, were required. For the year 2012, employee and employer contributions of \$1,793,623 and \$2,744,787, respectively, were required.

Administration

The Plan is administered by a Board of Trustees (the Board) which is authorized to determine all retirement applications, disability claims, and beneficiary designations.

Federal Income Taxes

Under the provisions of Sections 401 and 501 of the Internal Revenue Code, defined benefit pension plans are not subject to taxation; therefore, no federal income tax provision is made in the financial statement.

Pension Benefit Provisions

A member is eligible for service retirement upon completion of 20 years of service and attainment of age 50. Service retirement benefits are payable for the member's lifetime. Service retirement benefits are calculated as 75% of the retiree's highest 60-month average salary while employed and \$80 per month for each whole year of service in excess of 20 years of service. In the event that the member's death precedes that of the member's spouse, 75% of the member's pension will be continued to the spouse for the spouse's lifetime. A member who has completed at least 25 years of service is also eligible for the above service retirement benefit even though he or she has not yet attained age 50.

In addition to the regular service retirement benefit, a member who retires after attaining age 50 and completing 20 years of service will also receive a supplemental benefit of \$500 per month. The supplemental benefit is payable for the member's lifetime. In the event the member's death precedes that of his or her spouse, 75% of the supplemental benefit will be continued to the spouse for the spouse's lifetime. However, the supplemental benefit is not payable to members who take service retirement prior to age 50. In lieu of the monthly service retirement benefit described above, a member may elect to receive his or her benefits under one of the Deferred Retirement Option Plan (DROP) provisions.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - DESCRIPTION OF PLAN (CONTINUED)

Pension Benefit Provisions (Continued)

Effective October 1, 2008, the participating members of the Plan voted to amend the plan document. The new plan provides that eligible firefighters and beneficiaries who are entitled to the cost of living adjustment will become payable to these individuals on August 1 following the fifth full audited year of receipt of benefits by a firefighter and following a firefighter's physical departure from the Fire Department.

Effective November 1, 2002, the participating members of the Plan voted to amend the plan document. The new plan provides that under the DROP, and DROP Plan Benefits, Option 1 (Forward DROP), a firefighter must retire within three years of DROP election.

Upon retirement under Option 2 (Reverse DROP) of the DROP Plan Benefits, a firefighter may elect to receive 90% of his regular monthly benefit, including the Supplemental Retirement Benefit, if applicable (with all survivor benefits appropriately reduced) for life and a lump sum equal to 24 times this reduced benefit. This amount must be paid within three years in no more than three installments.

Under a third Option (Retroactive DROP) to the DROP Plan Benefits, the Retroactive DROP provides that if a firefighter has at least 20 years of service and is at least 50 years old the firefighter may, at any time after that, elect to retire and have his "effective retirement date" no earlier than the date he actually had at least 20 years of service and was at least 50 years old.

The period of time between his "effective retirement date" and his actual retirement date will be the DROP period and will not exceed three years. His monthly benefit will be calculated based upon his salary and service at the time of his "effective retirement date."

The sum of his employee contributions during the DROP period plus the product of his monthly benefit amount times the number of months of the DROP period will be paid to him on his actual retirement date or, at his election, within three years in no more than three installments. This amount will include interest at 4% compounded annually. Interest will be calculated using the balance at year-end.

The new plan also provides a fourth Option Combined (Forward and Retroactive) DROP Plan Benefit. The Combined (Forward and Retroactive) DROP option states that the firefighter must retire within three years of his Combined (Forward and Retroactive) DROP. The monthly benefit he will receive from the Plan will be determined based upon his salary and service at the beginning of his DROP period. At the conclusion of the DROP period, the firefighter will be paid an amount which is the sum of his employee contributions from the Forward DROP portion of the period plus the product of his monthly benefit amount (including the Supplemental Retirement Benefit, if applicable) times the number of months of the Forward DROP portion of the Combined (Forward and Retroactive) DROP period. In addition, a monthly benefit calculated based upon the firefighter's salary and service at the time of his "effective retirement

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - DESCRIPTION OF PLAN (CONTINUED)

Pension Benefit Provisions (Continued)

date" consisting of his contributions during the Retroactive portion of the Combined (Forward and Retroactive) DROP period plus the product of his monthly benefit amount (including the Supplemental Retirement Benefit, if applicable) times the number of months of the Retroactive DROP period.

This Combined (Forward and Retroactive) DROP amount shall include interest at an annual rate of 4% determined as of the end of each year or partial year of the Combined (Forward and Retroactive) DROP period and may be paid to the retired firefighter on his actual retirement date or, at his election, within three years in no more than three installments. Interest will be calculated using the balance at year-end. No interest shall be paid after the conclusion of the DROP period.

A member is eligible for early retirement upon completion of 20 years of service and attainment of age 45. Early retirement benefits are payable for the member's lifetime. Early retirement benefits are calculated as a percentage of the retiree's highest 60-month average salary while employed and an additional benefit each month for each year of service in excess of 20 years of service. In the event the member's death precedes that of his spouse, 75% of the member's pension will be continued to the member's spouse for the spouse's lifetime. The supplemental benefit is not payable to members who take early retirement.

An active member who becomes disabled for either physical or mental reasons (except for a pre-existing condition) may receive a monthly disability benefit. Disability benefits are payable in the same form as service retirement benefits. However, disability benefits stop if a member recovers to the point the member no longer meets the definition of disability under the Plan.

If a member dies while in active service, the widow (or widower) will receive an immediate monthly benefit, payable for as long as the widow (or widower) is living. The amount of the benefit will be equal to 75% of the service retirement the member would have been entitled to receive based on the member's salary and service at the time of the member's death. In addition, a \$10,000 lump sum benefit is payable to the designated beneficiary of a member who dies before retirement.

A Plan member who terminates employment after completing at least ten years of service, but prior to the date the member completes 20 years of service, will be entitled to receive a monthly benefit starting on the date the member would have both attained age 50 and completed 20 years of service had the member remained in active service with the fire department. However, this benefit will not commence later than the date the member reaches age 60. A Plan member who terminates employment prior to completing ten years of service will be entitled to the return of the excess of the member's contributions to the fund over the amount of any benefits the member has received from the fund.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - DESCRIPTION OF PLAN (CONTINUED)

Pension Benefit Provisions (Continued)

In lieu of the monthly service, disability or vested termination benefit described above, a member may elect to receive a modified monthly retirement benefit payable for his or her lifetime with 100% of such modified monthly amount continued for as long as either the member or the member's spouse is living. Such election does not affect the supplemental benefit, 75% of which is continued to the surviving spouse for the lifetime of the surviving spouse.

The funding policy of the Plan requires contributions by the firefighters and the City, see Note 2 - Contributions.

While the contribution requirements are not actuarially determined, state law requires that each plan of benefits adopted by the Plan must be approved by a qualified actuary. The actuary certifies that the contribution commitment by the firefighters and the City provides an adequate financing arrangement. This financing arrangement includes consideration of the Plan's funding status on a going-concern basis and progress made in accumulating sufficient assets to pay benefits when due. Using the entry age actuarial cost method, the Plan's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the Plan's UAAL, and the number of years needed to amortize the Plan's UAAL is determined using a level percentage of payroll method. For years in which actuarial valuations are not performed, estimates are made using the actuarial methods and principles.

The table below summarizes the membership of the Plan at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	142	142
Current employees:		
Vested	100	104
Non-vested	<u>78</u>	<u>72</u>
Total participants	<u>320</u>	<u>318</u>

Termination of the Plan

While the City has not expressed any intent to discontinue its contributions, it may terminate the Plan at any time.

A retirement system for a fire department not consisting exclusively of volunteers may not be terminated or merged into another retirement system without the approval of the Board of Trustees of the retirement system and the approval of the participating members of the system

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - DESCRIPTION OF PLAN (CONTINUED)

Termination of the Plan (Continued)

in the manner described by Subdivision (2) of Subsection (b) of Section 7 of this Act provided 51% of the volunteers first petition the Board for such a change.

The priority order of participants' claims to the Plan's assets upon Plan termination are pursuant to the Texas Local Fire Fighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

NOTE 3 - CASH AND INVESTMENTS

Substantially all of the Plan's investments are held by its trustee/custodian. The Plan's Board of Trustees authorizes various portfolio managers to manage investments within certain policies as set forth by the Board. These policies mandate a diversified portfolio, which includes investments, either directly or in commingled accounts, in real estate, cash, money market funds, bonds, alternative investments, and equity securities.

Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment to GASB Statement No.3 (GASB 40)*, addresses common deposit and investment risks including custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Required disclosures related to these risks are presented below.

As required by GASB 40, investments included in assets whose use is limited and long-term investments are categorized by investment type. As of December 31, 2013 and 2012, the Plan had the following investments and maturities, respectively:

<u>Investments</u>	<u>2013 Fair Value</u>	<u>2012 Fair Value</u>	<u>S&P Rating</u>	<u>Effective Duration</u>
Common stocks	\$ 11,843,985	\$ 17,452,011	–	–
Foreign obligations	7,661,289	9,294,877	AAA-CCC+	1 month to 20 years
Mutual funds	21,944,092	16,866,137	–	–
Real estate	10,099,646	6,415,000	–	–
Other equity securities	19,722,056	12,526,641	–	–
Government and agency obligations	2,003,902	1,663,230	AAA-BBB+	9 months to 6 years
Municipal bonds	<u>485,515</u>	<u>–</u>	<u>AA</u>	<u>10 years</u>
TOTAL FAIR VALUE	<u>\$ 73,760,485</u>	<u>\$ 64,217,896</u>		
Portfolio duration				1 month to 20 years

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - CASH AND INVESTMENTS (CONTINUED)

The Plan's investments policies are governed by state statutes and by Board adoption. Cash funds are deposited in Federal Deposit Insurance Corporation insured banks. The Plan is authorized to use demand accounts and certificates of deposit. Permissible investments include obligations of the U.S. Treasury and government agencies, commercial paper, and certain repurchase agreements.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of failure of the counterparty, the Plan would not be able to recover the value of its investments. The Plan does not have a formal policy for custodial credit risk. As of December 31, 2013, all investments are registered in the name of the Midland Firemen's Relief and Retirement Plan or in the name of the Plan's custodian, established through a master trust custodial agreement, with the exception of investments in alternative investments and commingled funds, which are recorded as other equity investments in the accompanying statements of plan net position.

Interest Rate Risk

In compliance with the Plan's investment policy as of December 31, 2013, the Plan minimized the interest rate risk related to the decline in market value of securities due to rising interest rates in the portfolio by structuring the investment portfolio so that securities matured to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the secondary market prior to maturity and monitoring credit ratings of portfolio positions.

The Plan's investments in U.S. and foreign government agency obligations are subject to credit risk. Under the Texas Local Firefighters' Retirement Act, the Board's general investment policy is to apply the following prudent-person rule: Investments are made as a prudent-person would be expected to act, with discretion and intelligence, to seek reasonable income and preserve capital. In terms of diversification, the Plan should not invest more than 5% of the total assets in the stock or bonds of one company.

Credit Risk

Under the Texas Local Firefighters' Retirement Act, the Board's general investment policy is to apply the prudent-person rule. As a matter of course, the Board expects to be notified promptly of the following:

- 1) A significant change in investment strategy and portfolio structure.
- 2) A material change in the ownership, personnel, financial condition, or investment approach of the organization.
- 3) Any changes in the regulatory environment that would affect the Plan or organization's role in its management.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - CASH AND INVESTMENTS (CONTINUED)

Credit Risk (Continued)

4) Any litigation or violation of securities regulation in which the investment manager is involved.

The Plan has investments that represent 5% or more of the Plan's net position which are \$4,047,541 and \$3,605,624 for 2013 and 2012, respectively. The investments are as follows:

	<u>2013</u>		<u>2012</u>	
	<u>Shares</u>	<u>Fair Value</u>	<u>Shares</u>	<u>Fair Value</u>
<u>Government Obligations</u>				
Westwood Trust SMID Cap Equity	*	\$ *	11,849	\$ 6,207,903
Federated International Small Company Fund	96,347	4,212,310	96,347	3,744,062
2514 Multi-Strategy Fund LP	*	*	6,651,898	6,651,898
2514 Select Portfolio, Ltd	4,318,257	4,318,257	*	*
Loomis Sayles Multi-Sector Trust	374,251	6,220,060	374,251	5,872,006

* Not greater than 5% in the respective year.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Plan's investment policy addresses concentration limits on a manager basis.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchanged rates will adversely affect the fair value of an investment or deposit.

All 2013 assets were priced in U.S. dollars. The Plan's exposure to foreign currency risk for 2012 is presented below:

	<u>Debt</u>	<u>Equity</u>	<u>Total</u>
<u>December 31, 2012</u>			
British Pound Sterling	\$ 219,418	\$ -	\$ 219,418
Euro Currency Unit	588,703	-	588,703
Total securities subject to foreign currency risk	<u>\$ 808,121</u>	<u>\$ -</u>	<u>\$ 808,121</u>

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - CASH AND INVESTMENTS (CONTINUED)

Commitments

As of December 31, 2013, the Plan has additional commitments to one fund manager in the amount of \$440,000.

NOTE 4 - FUNDED STATUS AND FUNDING PROGRESS

The funded status of the Plan as of January 1, 2012, the most recent actuarial valuation date, is as follows:

Actuarial value of assets <u>(a)</u>	Actuarial accrued liability (AAL) - entry age <u>(b)</u>	Unfunded AAL (UAAL) <u>(c)=(b)-(a)</u>	Funded ratio <u>(d)=(a)÷(b)</u>	Covered payroll <u>(e)</u>	UAAL as a percentage of covered payroll <u>(f)=(c)÷(e)</u>
\$ 73,066,776	\$ 101,158,743	\$ 28,091,967	72.2%	\$ 12,720,340	220.8%

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of the plan assets are increasing or decreasing over time relative to the AALs for benefits.

NOTE 5 - TAX STATUS

The Plan obtained its latest determination letter on October 25, 2011, in which the Internal Revenue Service stated that the Plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code. The Plan has been amended since the date of the determination letter; however, management believes the Plan is operating within the guidelines of the Internal Revenue Code.

NOTE 6 - ADMINISTRATION

The financial affairs of the Plan are administered by a bank trust department and multiple investment managers engaged by the Plan's Board of Trustees. Investments are held at a separate institution for safekeeping. The expense of such services, and legal, actuarial and a portion of the auditing costs are paid by the Plan. Other expenses of administering the Plan, including the services to the City's Department of Human Resources and Accounting, are absorbed by the City and are not reflected in these financial statements.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 7 - RISKS AND UNCERTAINTIES

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the Statements of Plan Net Position.

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.

NOTE 8 - ACTUARIAL METHODS AND ASSUMPTIONS

The UAAL is the actuarial present value of credited projected benefits and is intended to help users assess the Plan's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems. This measure is independent of the actuarial funding method used to perform the actuarial valuation.

The UAAL as of January 1, 2012, is based on the Entry Age Normal Cost Method, with entry age based on age at hire, an open amortization of the UAAL as of January 1, 2012, of the plan in effect on that date. Significant actuarial assumptions used include: (1) a rate of return on the investment of present and future assets equal to 8.00% per year compounded annually, (2) projected individual salary increases of 11.5% to 6.0% graded by years of service, including inflation of 3.0%, (3) the increase in aggregate payroll to be 4.5% per year, compounded annually, and (4) cost of living adjustment of zero.

A significant change in actuarial assumptions in the January 1, 2012, actuarial report was a change in the mortality table from the RP-2000 Mortality Table, with separate rates for males and females, to employee and health annuitant combined rates from the R-2000 Mortality Table, projected to 2015 using Scale AA, with separate rates for males and females. Based on using these tables, the unfunded liability is effectively amortized over a period of 86.3 years.

Guidelines published by the Texas State Pension Review Board specify that the amortization period should never exceed 40 years, with a 25- to 30-year period being preferable. The amortization period as of January 1, 2012, of 86.3 is greater than the Pension Review Board Guidelines.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 2012 the GASB issued Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, which replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements. The Statement requires defined benefit pension plans to present two financial statements – a statement of fiduciary net position and a statement of changes in fiduciary net position. In addition, the Statement requires certain new note disclosures as well as required supplementary information. Statement No. 67 is effective for the Plan's 2014 fiscal year, implementation of which is currently being evaluated.

In June 2012 the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*, which establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about pensions also are addressed. Statement No. 68 is effective for the 2015 fiscal year, implementation of which is currently being evaluated.

NOTE 10 - SUBSEQUENT EVENTS

The Plan evaluated subsequent events through July 22, 2014, the date the financial statements were available to be issued.

This information is an integral part of the accompanying financial statements.

**REQUIRED SUPPLEMENTARY INFORMATION
(UNAUDITED)**

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
REQUIRED SUPPLEMENTARY INFORMATION -
SCHEDULE OF FUNDING PROGRESS (UNAUDITED)
December 31, 2013**

	(a)	(b)	(c) = (b) – (a)	(d) = (a) ÷ (b)	(e)	(f) = (c) ÷ (e)	
Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll	Additional Contributions to Produce 30-Year Amortization Period
01/01/04	\$ 51,129,274	\$ 68,671,011	\$ 17,541,737	74.5%	\$ 8,790,657	199.5%	\$ N/A*
01/01/05			Not calculated				
01/01/06	58,778,124	80,119,856	21,341,732	73.4%	9,007,688	236.9%	N/A*
01/01/07			Not calculated				
01/01/08	67,386,648	93,411,551	26,024,903	72.1%	10,352,485	251.4%	253,072
01/01/09			Not calculated				
01/01/10	70,554,953	90,338,198	19,783,245	78.1%	11,901,777	166.2%	157,348
01/01/11			Not calculated				
01/01/12	73,066,776	101,158,743	28,091,967	72.2%	12,720,349	220.8%	481,963
01/01/13			Not calculated				

*Maximum amortization period is 30 years for periods after January 1, 2007

See notes to required supplementary information.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
 REQUIRED SUPPLEMENTARY INFORMATION -
 SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)
 December 31, 2013**

<u>Year Ended</u>	<u>Employer Contribution</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
12/31/08	\$ 2,220,869	\$ 2,344,274	94.7%
12/31/09	2,348,033	2,601,105	90.2%
12/31/10	2,331,557	2,485,070	93.8%
12/31/11	2,461,760	2,632,404	93.5%
12/31/12	2,744,787	3,279,412	83.7%
12/31/13	2,779,503	3,261,466	85.2%

See notes to required supplementary information.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
 REQUIRED SUPPLEMENTARY INFORMATION -
 SCHEDULE OF ACTUARIAL METHODS AND ASSUMPTIONS (UNAUDITED)
 DECEMBER 31, 2013**

The information presented in the required supplementary schedules was determined as part of the biennial actuarial valuations. Additional information as of the latest actuarial valuation follows:

Valuation date	1/1/12
Actuarial cost method	Entry age normal actuarial cost method
Amortization method	Level percent projected payroll
Remaining amortization period	86.3 years
Asset calculation method	Smoothed market value method

Actuarial assumptions:

Investment rate of return	8.0%
Projected increases in total payroll	4.5% per year
Projected individual salary increases	11.5% – 6% based on service
Contribution rate:	
City of Midland	20.2%
Employees	13.2%
Mortality rate	RP-2000 mortality table, projected to 2015 Scale AA, male and female rates

See notes to required supplementary information.

This information is an integral part of the accompanying financial statements.

MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)
December 31, 2013

NOTE 1 - EMPLOYER CONTRIBUTIONS

The purpose of the Schedule of Employer Contributions required under GASB Statement No. 25 as amended by GASB Statement No. 50, is to disclose the extent to which employers are fulfilling their responsibilities to provide resources to the Plan, by comparing the employer's annual required contributions (ARC) to amounts actually paid. Under the Statement, the ARC of the employer should be actuarially computed and should include the employer's normal cost plus a provision for amortizing the UAAL. Requirements applying to the amortization of the UAAL include (1) a maximum amortization period of 30 years (up to 40 years through the year 2006), (2) a minimum amortization period of 10 years for any significant decrease in the UAAL generated by a change in actuarial cost methods, and (3) allocation to years determined by level dollar amounts or by a level percentage of projected payroll assuming no increase in the number of Plan members.

At January 1, 2012, based on the Plan in effect and a continuation of the City's current 20.2% contribution rate, there is a UAAL of \$28,091,967.

Covered compensation was approximately \$14,100,000 and \$13,600,000 for calendar years 2013 and 2012, respectively. The City made payments of approximately \$2,800,000 and \$2,700,000 for 2013 and 2012, respectively.

For 2013, the member contribution rate was 13.2% of pay.

This information is an integral part of the accompanying financial statements.