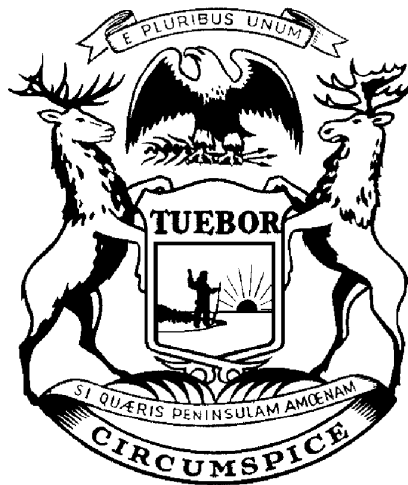


Michigan Judges' Retirement System
a Pension Trust Fund of the State of Michigan

**Comprehensive Annual Financial Report
for the Fiscal Year Ended September 30, 2002**



M J R S

**Prepared by:
Financial Services
For
Office of Retirement Services
P.O. Box 30171
Lansing, Michigan 48909-7671
517-322-5103
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The cost of printing this report was \$1,151.42 (\$3.07 each), which was paid for by the System at no cost to taxpayers.

INTRODUCTORY SECTION

Certificate of Achievement
Letter of Transmittal
Retirement Board Members
Advisors & Consultants
Organization Chart

INTRODUCTORY SECTION

Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Michigan Judges' Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



William Patrick Pate
President

Jeffrey L. Essler
Executive Director

INTRODUCTORY SECTION

Letter of Transmittal

Michigan Judges' Retirement System
P.O. Box 30171
Lansing, Michigan 48909-7671
Telephone 517- 322-5103
Outside Lansing 1-800-381-5111

STATE OF MICHIGAN

JOHN ENGLER, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

December 6, 2002

The Honorable John Engler
Governor, State of Michigan,

Members of the Legislature
State of Michigan,

Retirement Board Members
and
Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the comprehensive annual financial report of the Michigan Judges' Retirement System (System) for fiscal year 2002.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System.

The Michigan Judges' Retirement System was established by legislation under Public Act 234 of 1992 which consolidated the Judges' and former Probate Judges' retirement systems. The System is administered by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System is presented in Note 1 of the financial statements in the Financial Section of this report. The purpose of the System is to provide benefits for all judges. The services performed by the staff provide benefits to members.

The 2002 comprehensive annual financial report is presented in five sections. The Introductory Section contains the transmittal letter and identifies the administrative organization and professional consultants used by the System. The Financial Section contains the independent auditor's report, management's discussion and analysis, financial statements and notes of the System and certain supplemental schedules. The Investment Section summarizes investment activities. The Actuarial Section contains the independent consulting actuary's certification, an outline of actuarial assumptions and methods, and other actuarial statistics. The Statistical Section contains statistical tables of significant data pertaining to the System, and a schedule of participating employers.

INTRODUCTORY SECTION

Letter of Transmittal (Continued)

MAJOR GOALS ACCOMPLISHED

The Michigan Department of Management and Budget, Office of Retirement Services (ORS) is a customer-focused organization whose primary purpose is to deliver pensions, related benefits, and services that will enhance the future financial security of its customers. Five years ago, ORS acknowledged that the organization would need to transform itself in order to meet the challenges posed by a substantial increase in the number of new retirees without a corresponding increase in the size of the staff. Starting with a vision to provide *fast, easy access to complete and accurate information and exceptional service*, ORS developed a sound strategic plan that would strengthen the organization and foster financial stability, without losing sight of the needs of the customer.

The world has changed dramatically since the terrorist attacks on the United States on September 11, 2001. Faced with uncertainty in their personal lives, people are seeking some sense of stability and security, not only for themselves but for their financial future. ORS has been able to respond quickly and efficiently to the changing environment. Heightened security in government buildings has enhanced the safety and security of personnel and physical property, while new safeguards were added to protect vital records and other critical member data. For example, the State's Information Technology Services Division (ITSD) moved the web servers off-site to facilitate system recovery in the event of a disaster. To better safeguard ORS's employer web site and retirement member information, ITSD moved the employers' Member Inquiry System application to a more secure server and added a second level of firewall protection. In addition, ITSD implemented greater controls over content to restrict unauthorized changes to web content and applications.

Even before the 9-11 tragedy, ORS was learning to be adaptable and flexible when faced with a changing environment. In today's society little remains the same for very long, so ORS continues to be a proactive organization, rather than a reactionary one. However, through it all, ORS continues to focus on three primary interconnected objectives: *provide excellent customer service; improve business processes; and optimize technology*. Some of our accomplishments in these areas are presented below.

Provide Excellent Service to All Customers

Easily Accessible Information—ORS responded to customers' need for prompt, accurate information by offering several new and enhanced avenues for them to interact with their retirement system. In May 2002, ORS transitioned to a new www.michigan.gov web site that offers quick customer access to retirement information as well as smooth interface with all other State of Michigan web sites.

Personal Contact—Customers who preferred face-to-face interactions were able to visit the newly renovated main office at the Secondary Complex in the Lansing area, or meet with Detroit office staff in their new offices at the Cadillac Center in Detroit. In August 2002, CitiStreet placed several of its representatives at the ORS main office. CitiStreet is the third party administrator for the deferred compensation/defined contribution plans. Customers can now obtain information about their defined benefit *and* their deferred compensation/defined contribution retirement benefits in a single location.

Needs Assessment—ORS continues to assess customer needs and the quality of the service ORS offers by surveying both active employees and retirees. Depending on the audience being targeted, ORS conducts these surveys on a regular basis, annually, semiannually, or quarterly. The information gathered from these surveys results in changing the way we do business to improve services to our customers.

Enhanced Benefits—Long-Term Care Insurance—In early 2002, ORS joined with the Office of the State Employer to make available a group long-term care (LTC) insurance plan for both active State employees and all ORS retirees. LTC insurance provides one of the few available means by which individuals can protect themselves against the cost of long-term care. The addition of the LTC insurance program helps promote the future financial security of ORS' customers. MetLife, the selected LTC carrier, offered 57 informational seminars in Michigan along with two seminars in Florida

Letter of Transmittal (Continued)

and one seminar in Arizona over the course of 20 days. Approximately 1,345 interested retirees were able to learn more about this LTC insurance.

Tax Relief—The Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA, provided higher contribution limits and greater flexibility for deferred compensation retirement accounts. ORS implemented all of the major provisions of EGTRRA as of January 1, 2002, the earliest effective date allowed by law. These provisions include:

- Increases to the maximum contribution limits
- Removal of the coordination limits between 457 and 401(k) plans
- Addition of new age-50+ catch-up provisions
- Allowing the purchase of service credit with 457 and 401(k) funds
- Greater payout flexibility for those retirees with 457 plans
- Enhanced portability options

Continuously improve the processes that direct how ORS conducts its business

Several years ago, ORS began implementing a process-based approach to conducting business. By focusing on how to eliminate unnecessary steps in the process and consolidate other parts of the process, ORS gained efficiencies and improved service to customers in a number of areas. Some of these successes are highlighted below.

Employee Development—One of the strategic goals this year for the Department of Management and Budget (DMB) was to invest in the workforce—providing employees with the knowledge they need to be successful. Using a Competency Based Training (CBT) approach, staff and supervisors work together to design an individualized development plan that will provide training targeted at the individual needs of each employee.

ORS has already seen the positive effects of this CBT effort. Employees are being cross-trained to fill a variety of roles, learning new skills that make them more adaptable to new job tasks and responsibilities, while promoting greater employee satisfaction. Employees feel they are valued members of the organization, and it shows through their positive interactions with co-workers and customers.

Partnership Building—ORS is building cooperative relationships not only internally with other DMB offices, but also outside the department with other State agencies and external partners. These partnerships improve the efficiency and quality of the product or service being provided. For example, ORS strengthened its relationship with the legislative process to facilitate more uniformity and consistency between the various retirement systems ORS oversees. ORS extended its partnership-building outside of the State to work with a representative group of school administrators and payroll personnel to prepare for upcoming system changes and how public schools will report wage and service information and submit contribution payments to ORS. By working cooperatively, potential problems can be identified earlier and resolved more efficiently.

Records Consolidation—ORS is preparing for the implementation of new technology and changes to its processes as they relate to storage and retrieval of records. In anticipation of this, staff purged unnecessary documents from member files in preparation for the future transfer of data to electronic imaging. Streamlining of the records retention process is underway. ORS completed several data purity projects to standardize existing data into uniform fields and formats, thereby facilitating the conversion to automated processing of records and applications.

Measurement Tools—ORS is an organization adept at implementing its strategic plan. In order to measure its success, ORS established quantifiable performance measures for its organizational goals along with metrics to measure the progress made towards attaining those goals. ORS has a clear direction—we can clearly see where we have been, where we are now, and what is still left to accomplish.

INTRODUCTORY SECTION

Letter of Transmittal (Continued)

Optimize technology

ORS proceeded with its Vision ORS project to incorporate leading-edge technology into its process-based approach to business. As part of the implementation of the first stage of Vision ORS, the team introduced the Customer Relationship Management (CRM) tool. This tool assists in the capturing of data to determine who is calling ORS, for what purpose, and what additional requests for service were made previously.

The Vision ORS team also implemented the new stage 2 tool, the Retirement Processing Application (RPA), on a small scale, as a pilot project to help process a test group of retirement applications.

To improve efficiencies, ORS streamlined the Common Pension Payroll system to reduce the number of transactions required to process pension payments. In addition, ORS facilitated the electronic transmission of this pension data to the Department of Treasury, thereby enhancing the accuracy of the data records.

Looking to the future

In 1999, ORS embarked on a course of action that would produce an organization ready to provide for the changing needs of both active members and retirees. The plan requires ORS to invest in its *people*, its *processes*, and *technology*. By preparing staff for a changing environment through employee development, ORS invests in its *people*. By eliminating redundancies and becoming more efficient, ORS gains the benefits of a *process-based approach*. By implementing state-of-the-art *technology*, ORS has the tools it needs for the future. The future that ORS envisioned back in 1999 is nearly here, and ORS is well prepared to achieve its vision, to provide *fast, easy access to complete and accurate information and exceptional service*.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the System for its comprehensive annual financial report for the fiscal year ended September 30, 2001. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

INTERNAL CONTROL

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The internal control structure is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

INVESTMENT

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of -9.8%. For the last five years, the System has experienced an annualized rate of return of 2.8%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

Letter of Transmittal (Continued)

FUNDING

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the "funded ratio." This ratio provides an indication of the funding status of the System and generally, the greater this percentage, the stronger the System. As of September 30, 2002, the actuarial value of the assets and actuarial accrued liability of the System were \$291.7 million and \$229.2 million, respectively, resulting in a funded ratio of 127.3%. As of September 30, 2001, the amounts were \$291.0 million and \$224.7 million, respectively. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

POSTEMPLOYMENT BENEFITS

The System also administers the postemployment health benefits (health, dental, and vision) offered to eligible retirees. The benefits are funded on a cash or "pay as you go" basis. An actuarial valuation was completed to determine the actuarial accrued liability if the benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability for these benefits would be approximately \$4.8 million and the employer contribution for health care benefits would be 8.9%.

PROFESSIONAL SERVICES

An annual audit of the System was conducted by Andrews Hooper & Pavlik P.L.C., independent auditors. The independent auditor's report on the System's financial statements is included in the Financial Section of this report.

Statute requires that an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer-funding rates for the subsequent year. This annual actuarial valuation was completed by the Segal Company for the fiscal years ended September 30, 2002 and 2001. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

ACKNOWLEDGMENTS

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, advisors, and many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable the employers and plan members to better evaluate and understand the Michigan Judges' Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,



Duane E. Berger, Director
Department of Management and Budget



Christopher M. DeRose, Director
Office of Retirement Services

INTRODUCTORY SECTION

Administrative Organization

Retirement Board Members

Eric E. Doster, Vice Chair
Trustee (General Public)
Term Expires March 31, 2003

George M. Elworth
Representing Attorney General
Statutory Member

Roy A. Pentilla, C.P.A.
Representing State Treasurer
Statutory Member

Judge Robert Ransom
Active Judge
Term Expires March 31, 2005

Lyle Van Houten, Chair
Trustee (General Public)
Term Expires March 31, 2003

Administrative Organization

**Department of Management and Budget
Office of Retirement Services
P.O. Box 30171
Lansing, Michigan 48909-7671
517-322-5103
1-800-381-5111**

Advisors and Consultants

Actuary
The Segal Company
Michael J. Karlin, F.S.A., M.A.A.A.
New York, New York

Auditors
Thomas H. McTavish, C.P.A.
Auditor General
State of Michigan

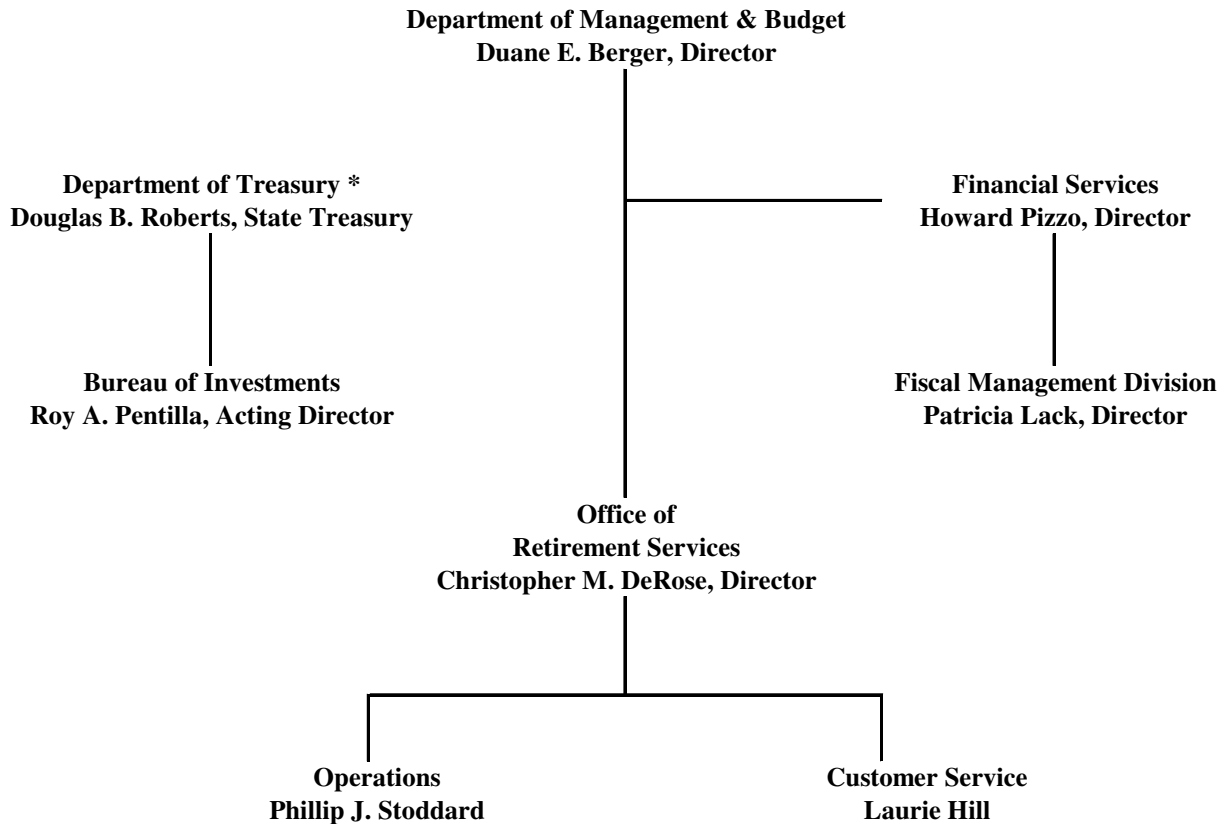
Andrews Hooper & Pavlik P.L.C.
Jeffrey J. Fineis, C.P.A.
Okemos, Michigan

**Investment Manager and
Custodian**
Douglas B. Roberts
State Treasurer
State of Michigan

Legal Advisor
Jennifer M. Granholm
Attorney General
State of Michigan

**Investment Performance
Measurement**
Capitol Resource Advisors
Chicago, Illinois

Administrative Organization (Continued)



* The investments of the System are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section, Introduction. In addition, see the Investment Section, Schedule of Investment Fees and Schedule of Investment Commissions for information regarding the investment fees and commissions paid as well as investment professionals utilized by the System.

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FINANCIAL SECTION

Independent Auditor's Report
Management's Discussion and Analysis
Basic Financial Statements
Notes to Basic Financial Statements
Required Supplementary Information
Notes to Required Supplementary Information
Supporting Schedules

Management's Discussion and Analysis

Our discussion and analysis of the Michigan Judges' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2002. Please read it in conjunction with the transmittal letter in the Introductory Section on page 5 and the basic financial statements, which follow this discussion.

FINANCIAL HIGHLIGHTS

- System assets exceeded liabilities at the close of fiscal year 2002 by \$234.8 million (reported as *net assets*). Net assets are held in trust to meet future benefit payments.
- The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of September 30, 2002, the funded ratio was approximately 127.3%. Revenues for the year were (\$22.7 million), which is comprised of member contributions of \$3.2 million, court fees of \$100.0 thousand, and investment losses of (\$26.0 million).
- Expenses decreased over the prior year from \$17.8 million to \$16.8 million or 5.6%

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

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements; *The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets* (page 20) and *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* (page 21). These financial statements report information about the System, as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedule of Funding Progress and Schedule of Employer Contributions to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

FINANCIAL ANALYSIS

System total assets as of September 30, 2002, were \$243.8 million and were mostly comprised of cash and investments. Total assets decreased \$41.3 million or 14.5% from the prior year primarily due to decreased investment earnings.

Total liabilities as of September 30, 2002, were \$9.0 million and were mostly comprised of warrants outstanding, administrative costs, and obligations under securities lending. Total liabilities decreased \$1.9 million or 17.2% from the prior year.

System assets exceeded its liabilities at the close of fiscal year 2002 by \$234.8 million. Total net assets held in trust for pension and health benefits decreased \$39.5 million or 14.4% from the previous year, primarily due to adverse market conditions and a decrease in investment earnings.

FINANCIAL SECTION

Management's Discussion and Analysis (Continued)

Michigan Judges' Retirement System
Net Assets
(In Thousands)

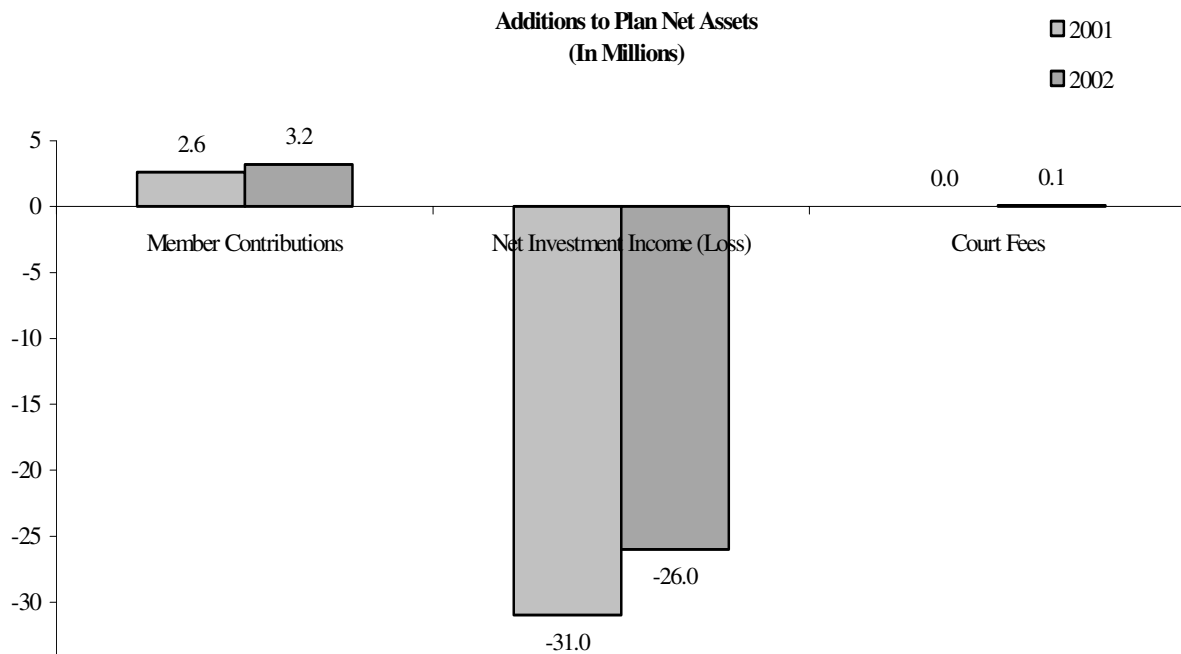
	<u>2002</u>	<u>2001</u>	<u>Total Percentage Change</u>
Assets			
Cash	\$ 3,223	\$ 4,326	(25.5) %
Receivables	1,128	1,156	(2.4)
Investments	239,402	279,609	(14.4)
Total Assets	<u>243,753</u>	<u>285,091</u>	<u>(14.5)</u>
Liabilities			
Warrants outstanding	67	64	4.7
Accounts payable and other accrued liabilities	203	1,071	(81.0)
Obligations under securities lending	8,723	9,731	(10.4)
Total Liabilities	<u>8,993</u>	<u>10,866</u>	<u>(17.2)</u>
Total Net Assets	<u>\$ 234,760</u>	<u>\$ 274,225</u>	<u>(14.4) %</u>

Management's Discussion and Analysis (Continued)

REVENUES - ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer and employee contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2002 totaled (\$22.7 million).

Total contributions and net investment losses decreased \$5.7 million or 20.0% from those of the prior year due primarily to changes in market conditions and investment earnings. Since the System was over funded and the total contribution rate was negative, there were no employer contributions during the year. Investment losses decreased from the previous year by \$5.0 million or 16.1%. New in fiscal year 2002, Court fees totaled \$100.0 thousand (see Note 1). The Investment Section of this report reviews the results of investment activity for 2002.



FINANCIAL SECTION

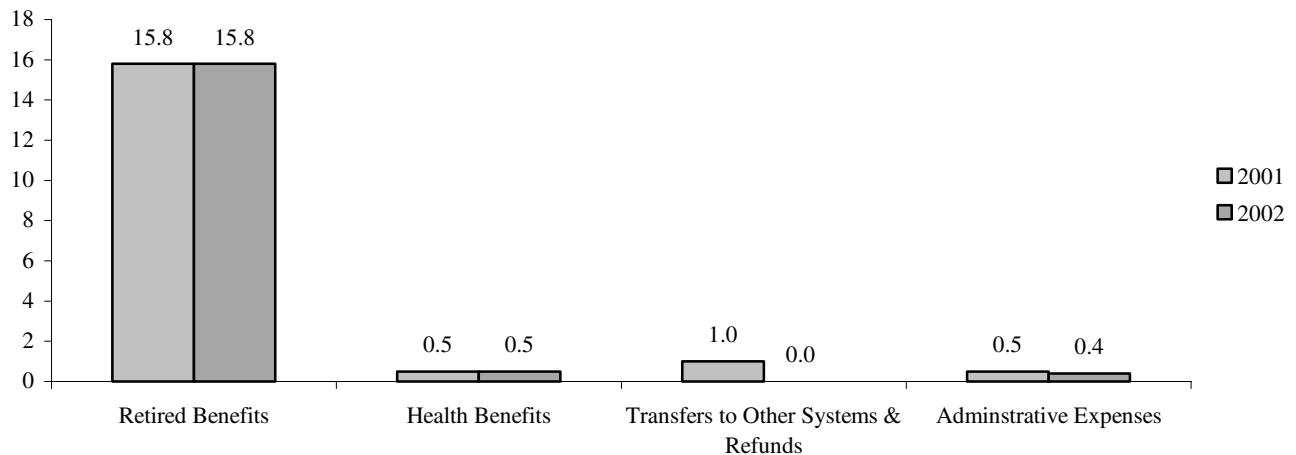
Management's Discussion and Analysis (Continued)

EXPENSES - DEDUCTIONS FROM PLAN NET ASSETS

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refund of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2002 were \$16.8 million, a decrease of 5.6% from year 2001 expenditures.

The growth of health, dental and vision care expenditures continued during the year and increased by \$14.2 thousand or 2.8% from \$505.5 thousand to \$519.7 thousand during the fiscal year. The payment of pension benefits increased by \$16.8 thousand or 0.1% from the previous year. Refunds of contributions to members decreased by \$12.1 thousand or 18.6%. Administrative expenses decreased by \$95.5 thousand or 19.1% from the previous year.

**Deductions in Plan Net Assets
(In Millions)**



Management's Discussion and Analysis (Continued)

RETIREMENT SYSTEM AS A WHOLE

The System's combined net assets have experienced three years of decreases over the last five years. Again, this decrease is due to a sluggish investment market and the decrease in the prior year due to the transfer of funds to the Defined Contribution Retirement Plan. The System is currently overfunded and Management believes the current financial position will continue to improve due to a prudent investment program, cost controls, and strategic planning.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

FINANCIAL SECTION

Statements of Pension Plan and Postemployment Healthcare Plan Net Assets

As of Fiscal Years Ending September 30, 2002 and 2001

	September 30, 2002			September 30, 2001		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Assets:						
Cash	\$ 3,223,202		\$ 3,223,202	\$ 4,326,653		\$ 4,326,653
Receivables:						
Amounts due from employers	72,358	\$ 173	72,531	105,079	\$ 193	105,272
Interest and dividends	1,016,968		1,016,968	1,047,380		1,047,380
Sale of investments	38,849		38,849	3,370		3,370
Total receivables	1,128,175	173	1,128,348	1,155,829	193	1,156,022
Investments:						
Short term investments	5,275,841		5,275,841	20,254,558		20,254,558
Bonds, notes, mortgages, and preferred stock	58,965,344		58,965,344	59,128,855		59,128,855
Common stock	98,103,876		98,103,876	109,530,587		109,530,587
Real estate	29,142,691		29,142,691	31,776,623		31,776,623
Alternative investments	23,817,881		23,817,881	33,243,384		33,243,384
International investments	15,373,340		15,373,340	15,943,367		15,943,367
Collateral on loaned securities	8,722,667		8,722,667	9,731,310		9,731,310
Total investments	239,401,640	-	239,401,640	279,608,684	-	279,608,684
Total assets	243,753,017	173	243,753,190	285,091,166	193	285,091,359
Liabilities:						
Warrants outstanding	67,152	160	67,312	64,021	118	64,139
Accounts payable and other accrued liabilities	203,018		203,018	1,070,367		1,070,367
Internal balances	(559,280)	559,280	-	(502,661)	502,661	-
Obligations under securities lending	8,722,667		8,722,667	9,731,310		9,731,310
Total liabilities	8,433,557	559,440	8,992,997	10,363,037	502,779	10,865,816
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits*	\$ 235,319,460	\$ (559,267)	\$ 234,760,193	\$ 274,728,129	\$ (502,586)	\$ 274,225,543

* A schedule of funding progress is presented in the Required Supplementary Information in the Financial Section. The accompanying notes are an integral part of these financial statements.

FINANCIAL SECTION

Statements of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

For the Fiscal Years Ending September 30, 2002 and 2001

	September 30, 2002			September 30, 2001		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Additions:						
Member contributions	\$ 2,857,224	\$ 362,987	\$ 3,220,211	\$ 2,304,041	\$ 345,851	\$ 2,649,892
Investment income (loss):						
Investment income (loss)	(25,792,190)		(25,792,190)	(30,751,715)		(30,751,715)
Securities lending income	229,142		229,142	322,960		322,960
Investment expenses:						
Real estate operating expenses	(3,506)		(3,506)	(13,743)		(13,743)
Securities lending expenses	(183,617)		(183,617)	(297,325)		(297,325)
Other investment expenses	(247,925)		(247,925)	(255,755)		(255,755)
Net investment income	(25,998,096)	-	(25,998,096)	(30,995,578)	-	(30,995,578)
Court Fees		100,000	100,000			-
Miscellaneous	-		-	16		16
Total additions	(23,140,872)	462,987	(22,677,885)	(28,691,521)	345,851	(28,345,670)
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement benefits	15,809,951		15,809,951	15,793,191		15,793,191
Health benefits		519,669	519,669		505,459	505,459
Return of contributions	52,862		52,862	64,954		64,954
Transfers to other systems			-	910,679		910,679
Administrative expenses	404,983		404,983	500,501		500,501
Total deductions	16,267,796	519,669	16,787,465	17,269,325	505,459	17,774,784
Net increase (decrease)	(39,408,668)	(56,682)	(39,465,350)	(45,960,846)	(159,608)	(46,120,454)
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:						
Beginning of year	274,728,129	(502,586)	274,225,543	320,688,975	(342,978)	320,345,997
End of year*	\$ 235,319,461	\$ (559,268)	\$ 234,760,193	\$ 274,728,129	\$ (502,586)	\$ 274,225,543

* A schedule of funding progress is presented in the Required Supplementary Information in the Financial Section.
The accompanying notes are an integral part of these financial statements.

FINANCIAL SECTION

Notes to Basic Financial Statements

NOTE 1 - PLAN DESCRIPTION

ORGANIZATION

The Michigan Judges' Retirement System (System) is a cost sharing, multiple employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State). The System, created under Public Act 234 of 1992, consolidated the former Judges' and Probate Judges' Retirement Systems into one retirement system. The System was established by the State to provide retirement, survivor and disability benefits to judges in the judicial branch of state government. There are 172 participating employers. The System also includes the Governor of the State of Michigan, Lieutenant Governor, Secretary of State, Attorney General, Legislative Auditor General, and the Constitutional Court Administrator.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State.

The System is administered by the Office of Retirement Services within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the Systems' Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

MEMBERSHIP

At September 30, 2002, and 2001, the System's membership consisted of the following:

Retirees and beneficiaries currently receiving benefits:	2002	2001
Regular benefits	353	372
Survivor benefits	177	169
Disability benefits	5	5
Total	535	546
 Current employees:		
Vested	270	268
Non-vested	97	112
Total	367	380
 Inactive employees entitled to benefits and not yet receiving them	16	15
 Total all members*	918	941

* Excluding members who transferred to the defined contribution plan in fiscal year 2001.

Plan 1 or 2 members (Supreme Court Justice, Court of Appeals, or elected officials) may enroll in the State Health Plan when they retire and their premium rate is subsidized. All other judges may enroll in the State Health Plan if they wish to, but they must pay the entire premium cost. There are a total of 535 retirees who may participate in the health plan. The number of participants is on the following page:

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

	<u>2002</u>	<u>2001</u>
Participants receiving benefits:		
Health	74	80
Dental	134	134
Vision	95	98

BENEFIT PROVISIONS

Benefit provisions of the defined benefit pension plan are established by State Statute, which may be amended. Public Act 234 of 1992, Michigan Judges' Retirement Act, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides disability and survivor benefits.

A member who leaves judicial service may request a refund of his or her member contribution account. A refund cancels a former member's rights to future benefits. Returning members who previously received a refund of their contributions may reinstate their service credit through repayment of the refund upon satisfaction of certain requirements. For salary, contribution and calculation of retirement benefit, the membership of the System is categorized into seven plans. The categories are based on the position to which the member was elected or appointed.

Public Act 523 of 1996, which was effective March 31, 1997, closed the plan to new entrants. Judges or State officials newly appointed or elected on or after March 31, 1997, become members of the defined contribution plan.

Regular Retirement

The retirement benefit or allowance is calculated in accordance with the formula of the plan which applies to the member. In all seven plans, the formula is based on a member's years of credited service (employment) and final compensation. The normal retirement benefit is payable monthly over the lifetime of a member.

A member may retire and receive a monthly benefit after attaining:

1. age 60 with 8 or more years of credited service; or
2. age 55 with 18 or more years of credited service (the last 6 years continuous); or
3. 25 or more years of service, the last 6 years continuous; no age requirement; or
4. age 60 with service of two full terms in the office of Governor, Lieutenant Governor, Secretary of State, or Attorney General, or one full term in the office of Legislative Auditor General.

Early Retirement

A member may retire with an early permanently reduced pension:

1. after completing at least 12 but less than 18 years of service, of which the last 6 years are continuous;
and
2. after attaining age 55.

The early pension is computed in the same manner as a regular pension but is permanently reduced 0.5% for each full and partial month between the pension effective date and the date the member will attain age 60.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Deferred Retirement

A member with 8 or more years of credited service who terminates judicial service before meeting the age requirements to receive a retirement allowance and who does not withdraw his or her contributions, is entitled to receive a monthly allowance upon reaching age 60 or age 55 with 18 years of service, the last 6 of which were continuous.

Disability Benefit

A member with 8 or more years of credited service, who is totally disabled from physically or mentally performing his or her duties, is eligible for a disability pension. The disability benefit is computed in the same manner as an age and service allowance based upon service and final salary at the time of disability.

Pension Payment Options

A pension is payable monthly for the lifetime of a System retiree and equals 3% of final salary times years of service for up to 12 years of service; or 50% of salary with 12 years, increased 2.5% for each additional year up to a maximum of 60% of salary. A former retiree of the Probate Judges' Retirement System receives 3% of salary times years of service, to a maximum of the greater of 40% of salary or \$15,000 but not to exceed 66 2/3% of final salary when added to a county pension; or 3.5% of salary times years of service with a maximum of two thirds of final salary, if elected.

Straight Life — This option provides the highest monthly retirement allowance. Surviving spouse receives a 50% survivor's benefit.

Option A — Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary.

Option B — Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is smaller than the factor used in Option A above.

Survivor Benefit

A survivor benefit may be paid if (i) a member who has 8 or more years of credited service dies while in office, (ii) a vested former member dies before retirement, or (iii) a retiree dies following retirement.

Contributions

Member Contributions — Members currently participate on a contributory basis. For contribution purposes, the membership of the System is categorized in seven plans, which are based on the position to which the member was elected or appointed. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or other public service. If a member terminates covered employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Publicly Financed Contributions — There are two public sources which fund retirement benefits: Court fees and State appropriations. The State contributes annually the greater of 3.5% of the aggregate annual compensation of State paid base salaries, or the difference between the total actuarial requirement of current service and unfunded accrued liabilities minus the revenues from court filing fees and member contributions. Since the system was fully funded, the appropriation was not requested for fiscal years 2002 and 2001. If the court fees deposited in the reserve for employer contributions equals the amount needed in addition to other publicly financed contributions to sustain the required level of publicly financed contributions, Section 304(4) requires court fees be deposited in the court fee fund. In accordance with Section 304(4) of the Judges' Retirement Act, the court fees are being deposited in the court fee fund in the State

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Treasury. A chart showing the publicly financed contribution rates is included in the Schedule of Revenue by Source in the Statistical Section.

Public Act 95 of 2002 authorizes the State Treasurer to, if funds remain in the court fee fund after transfers, transmit a portion of the money in the court fee fund and any earning on those amounts to the reserve for health benefits. The purpose of this transfer is to pay expected health care costs for the subsequent fiscal year that are not covered as a result of employee contributions, and to pay in an amount not to exceed \$100,000 in each fiscal year, any health care costs not paid from the reserve for health benefits since fiscal year 1996-1997.

Other Postemployment Benefits

Under the Michigan Judges' Retirement Act, Plan 1 or 2, members may enroll in the State Health Plan when they retire. Five percent of the health insurance premium is deducted from the monthly pension check until age 65, at which time Medicare provides primary health insurance coverage. All other members may enroll in the State Health Plan during an open enrollment period. The total premium is deducted from the monthly pension check. The active employee payroll contribution rate to fund health benefits for the Plan 1 or 2 members was 1.5% for 2002 and 2001. There are no required employer contributions to fund health benefits.

All retirees may enroll in the State Dental and/or Vision Plan during an open enrollment period. The cost of the premiums is deducted from the monthly pension check.

Retirees of Plan 1 and 2 are provided with life insurance coverage equal to 25% of the active life insurance coverage and \$1,000 for each dependent. Premiums are fully paid by the State for Plan 1 and 2 members. All others must pay the full premium.

Transfer to Defined Contribution Plan

During fiscal year 1998, the Judges' Retirement Act provided members an opportunity to transfer to the defined contribution plan. The decision was irrevocable and the transfer was completed by September 30, 1998. A total of 13 vested individuals with funds totaling \$6.6 million was transferred. Judges that were not vested were not transferred. With the passage of the legislation permitting the transfer, the System also became a closed system. All new judges and officials are members of the defined contribution plan.

During fiscal year 2000, a lawsuit, filed in connection with the defined contribution legislation, was settled. As a result, approximately 172 judges transferred to the defined contribution plan in fiscal year 2001. The amount of the transfer was \$77.8 million, representing employee and employer contributions of \$60 million and \$17.8 million, respectively. The transfer was accrued and membership statistics were adjusted to reflect the transfer as of the fiscal year ended 2000.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

These financial statements are prepared using the accrual basis of accounting. Court filing fees are recognized as revenue in the period received. Contributions from the State are recognized as revenue in the period in which employees provide service and expenses are recorded when incurred regardless of when payment is made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Reserves

Public Act 234 of 1992, as amended, created several reserve accounts. The reserves are described below.

Reserve for Employee Contributions — This fund represents active member contributions, payments for the purchase of service credit, repayment of previously refunded contributions and interest less amounts transferred to the Reserve for

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Retirement Benefits for regular and disability retirement, amounts refunded to terminated members, and transferring inactive accounts. At September 30, 2002, and 2001, the balance in this account was \$35.1 million and \$31.0 million, respectively.

Reserve for Employer Contributions — This reserve represents Court fees, late fees, interest payments, employer contributions, and State appropriations. Amounts are transferred annually from this reserve to the Reserve for Retirement Benefits to fund that reserve. In addition, the reserve transfers court fees to the Supreme Court in accordance with statutory requirements. At September 30, 2002, and 2001, the balance in this account was \$45.2 million and \$49.7 million, respectively.

Reserve for Retired Benefit Payments — This reserve represents the reserves for payment of future retirement benefits to current retirees. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Reserve for Member Contributions and the Reserve for Employer Contributions. Monthly benefits, which are paid to the member, reduce the reserve. At the end of each fiscal year, an amount is transferred from the Reserve for Employer Contributions to bring the reserve into balance with the actuarial present value of retirement allowances. At September 30, 2002, and 2001, the balance in this account was \$119.7 million and \$116.7 million, respectively.

Reserve for Undistributed Investment Income — This reserve is credited with all investment earnings, changes in fair values, gifts to the System, and forfeited contributions. All administrative expenses are paid from this reserve and interest is transferred annually to the other reserves. At September 30, 2002, and 2001, the balance in this account was \$35.3 million and \$77.4 million, respectively.

Reserve for Health Benefits — This reserve is credited with member contributions for health benefits. Health benefits are paid from this reserve. At September 30, 2002, and 2001, the balance in this account was (\$559.3 thousand) and (\$502.6 thousand), respectively.

Internal Balances — At September 30, 2002, the System reported a deficit in the Health Plan. As a result, amounts reported in the Statement of Plan Net Assets have been recognized and eliminated using the internal balances process described in GASB Statement No. 34. While this concept was devised to eliminate the "grossing-up" effect within the governmental and business-type activities columns of the primary government, because of the relationship of the Health Plan to the Pension Plan, the concept was deemed to be appropriate for System presentation.

Reporting Entity

The System is a pension trust fund of the State. As such, the System is considered part of the State and is included in the State's Comprehensive Annual Financial Report as a pension trust fund. The System and its Board are not financially accountable for any other entities. Accordingly, the System is the only entity included in this financial report.

Benefit Protection

Public Act 100 of 2002 was passed by the Michigan Legislature to protect pension benefits of public employees from alienation (being transferred). Alienation is attachment, garnishment, levy, execution, bankruptcy or other legal process except for divorce orders or eligible domestic relation orders. The statutes governing the System contained an "anti-alienation" clause to provide for this protection; however, many smaller public pension systems did not have the benefit of this protection. Therefore, Public Act 100 of 2002 was passed to establish legal protection of pension assets that encompasses all public employees.

Fair Value of Investments

Plan investments are presented at fair value, except for short-term investments. Short-term investments are carried at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

Investment Income

Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.

Costs of Administering the System

Each year a restricted general fund appropriation is requested to fund the on-going business operations of the System. These administrative costs are ultimately funded by the System through the regular transfer of funds from the System to the general fund appropriation based on either a direct cost or allocation basis depending on the nature of the expense.

Property and Equipment

Office space is leased from the State on a year to year basis. Office equipment is capitalized if the value exceeds \$5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension Plan and Postemployment Healthcare Plan Net Assets. Such assets are depreciated on a straight-line basis over 10 years. The System does not have equipment that falls within these parameters.

Related Party Transactions

Leases and services — The System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid. The following summarizes costs incurred by the System for such services.

	<u>2002</u>	<u>2001</u>
Building Rentals	\$ 4,220	\$ 1,785
Technological Support	17,491	8,123
Attorney General	11,331	42,838
Investment Services	64,315	77,953
Personnel Services	13,510	213,600

Commitment and Contingency – The State has signed a contract with a vendor for technological support through 2004. As of September 30, 2002, the System's portion of this commitment remaining is approximately \$40 thousand.

Cash – On September 30, 2002, and 2001, the System had \$3.2 million and \$4.3 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to \$41.9 thousand and \$251.9 thousand for the years ended September 30, 2002, and 2001, respectively.

Reclassification of Prior Year Amounts

Certain prior year amounts have been reclassified to conform with the current year presentation.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

NOTE 3 - CONTRIBUTIONS

Members' contributions range from 3.5% to 7% of their salary depending on the plan (described in statute). Contributions are tax deferred under Section 414(h)(2) of the Internal Revenue Code, except for probate judges whose contributions are tax deferred only if the local unit of government has adopted a resolution to do so. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

The State contributes annually the greater of 3.5% of the aggregate annual compensation of State paid base salaries, or the difference between the total actuarial requirement of current service and unfunded accrued liabilities minus the revenues from court filing fees and member contributions. Since the System was fully funded, the appropriation was not requested for fiscal years 2001 or 2002. If the court fees deposited in the reserve for employer contributions equals the amount needed in addition to other publicly financed contributions to sustain the required level of publicly financed contributions, Section 304(4) requires court fees be deposited in the court fee fund. In accordance with Section 304(4) of the Judges' Retirement Act, the court fees are being deposited in the court fee fund in the State Treasury. The State Treasurer transmits the money in the court fee fund, not exceeding \$2.2 million in any fiscal year, to the court equity fund for operational expenses of trial courts.

Employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles. Under this method, amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given period of time.

There were no actual or required employer contributions for the fiscal years 2001 or 2002 because the contribution rate was negative.

NOTE 4 – INVESTMENTS

Risks and Uncertainties

The System's investments are exposed to various risks, such as interest rate, market, credit, and other. Due to these various risks, it is at least reasonably possible that changes in market values will occur in the near term and that such changes could materially affect the System and the amount reported in the statement of net assets as available for benefits.

Investment Authority

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stock, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5% of the System's assets in small businesses having more than one-half of assets or employees in Michigan as described in section 20(a) of the act and up to 20% of the System's assets in investments not otherwise qualified under the act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock and direct investments.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Derivatives

The State Treasurer does not employ the use of derivatives in the investment of the Common Cash or the investment of trust funds other than the pension trust funds.

Derivatives are used in managing pension trust fund portfolios, but uses do not include speculation or leverage of investments. Less than 8% of the total pension trust fund's portfolio has been invested from time to time in futures contracts, collateralized mortgages and swap agreements. State investment statutes limit total derivative exposure to 15% of a fund's total asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 6.6% of market value of total assets on September 30, 2002, and 5.6% of market value of total assets on September 30, 2001.

To diversify the pension fund's portfolio into international equities, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in twenty-three foreign countries. The notional amounts of the swap agreements at September 30, 2002, and 2001, were \$21.7 million and \$19.6 million, respectively. Approximately one half of the notional amount is hedged against foreign currency fluctuations. The swap agreements provide that the System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London InterBank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the international equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturity dates range from October 2002 to September 2005. U.S. domestic LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes. The book value represents the cost of the notes. The current value represents the current value of the notes and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based on the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over \$6.1 million of gains on international equity exposure and excess interest received have been realized. The unrealized loss of \$6.8 million at September 30, 2002, reflects the decline in international stock indices and changes in currency exchange rates. Many of the international indices peaked in 1999 and 2000, and the combined swap structure realizes gains and losses on a rolling three-year basis.

To complete domestic market exposure, in June 2002, the State Treasurer entered into two swap agreements, which are tied to the S&P 600 Small Cap index. The notional and current values of these swaps are \$590 and \$447, in thousands, respectively, as of September 30, 2002.

The unrealized loss of \$143 thousand on September 30, 2002 reflects the decline in the S&P 600 Small Cap index due to market conditions. The swap agreements provide that the System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London InterBank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the international equity indices from the level at the inception of the agreements, or pay the decrease in the value of the index. U.S. domestic LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

The respective September 30, 2002 and 2001 values are on the following page:

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

	<u>Notional Value</u>	<u>Current Value</u>
9/30/2002 (dollars in millions)	\$ 21.7	\$ 14.9
9/30/2001 (dollars in millions)	19.6	15.5

The amounts shown for September 30, 2002, reflect both the total international swap exposure, and the smaller derivative exposure to the S&P 600.

Investments Exceeding 5% of Plan Net Assets

The System did not hold an individual investment (other than U.S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 2002, or 2001.

Securities Lending

State statutes allow the System to participate in securities lending transactions, and the System has, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the retirement system, the System's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to (i) at least 102% of the market value of the loaned securities in the case of loaned securities denominated in the United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in the United States dollars or whose primary trading market was not located in the United States.

The System did not impose any restrictions during the fiscal year on the amount of the loan that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the System and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral or qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2002, such investment pool had an average duration of 66 days and an average weighted maturity of 471 days. Because the loans were terminable at will their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2002, the System had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the System as of September 30, 2002, were \$8,866,046 and \$8,552,153 respectively.

Gross income from security lending for the fiscal year was \$229,142. Expenses associated with this income amounted to \$168,258 for the borrower's rebate and \$15,359 for fees paid to the agent.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Categories of Investment Risk

Investments made by the fund are summarized on the following page. The investments that are represented by specific identifiable investment securities are classified as to credit risk in three categories.

Category 1 includes investments insured, registered, or held by the System or its agent in the System's name. Category 3 includes uninsured and unregistered investments held by the counterparty, its trust department, or agent, but not in the System's name.

At September 30, 2002, all investments of the System were classified as Category 1 or Category 3, except for certain investments not categorized.

The table on the following page summarizes the investments at fair value:

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

<u>Category 1</u>	<u>2002</u>	<u>2001</u>
Prime Commercial Paper	\$ 5,275,841	\$ 18,654,558
Short Term Investments	-	1,000,000
Government Securities	30,733,502	23,693,779
Corporate Bonds & Notes	22,223,606	27,475,098
Preferred Stock	7,782	15
Common Stock	95,167,577	107,528,479
Real Estate	-	721,816 ¹
Alternative Investments	472,570	1,438,433 ³
International Investments	14,807,753	15,943,367
Total Category 1	<u>\$ 168,688,631</u>	<u>\$ 196,455,545</u>
<u>Category 3</u>		
Government Securities	<u>\$ 500,000</u>	<u>\$ 408,525</u>
<u>Non-Categorized</u>		
Short Term Investments	\$ -	\$ 600,000 ²
Mortgages	17,146	114,887
Real Estate	29,142,691	31,054,807 ¹
Alternative Investments	23,345,311	31,804,951 ³
International Investments	565,587	-
Cash Collateral	8,722,667	9,731,310
Securities on Loan:		
Government Securities	5,012,859	7,137,847
Corporate Bonds & Notes	470,449	298,704
Common Stock	2,936,299	2,002,108
Total Non-Categorized	<u>\$ 70,213,009</u>	<u>\$ 82,744,614</u>
Grand Total	<u>\$ 239,401,640</u>	<u>\$ 279,608,684</u>

¹ In Category 1, the Real Estate investments are all publicly traded real estate investment trusts. Non-Categorized Real Estate consists of investments in real estate through various legal entities.

² Non-Categorized Short-Term Investments relate to an STIF (Short-Term Investment Fund).

³ In Category 1, the Alternative Investments are small-cap equities. Non-Categorized Alternative Investments consist of limited partnerships.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

NOTE 5 - COMMITMENT AND CONTINGENCIES

Michigan Judges' Association et al v. State Treasurer et al

In accordance with Public Act of 1999, and the terms of the May 2000 Settlement Agreement, most trial judges remaining in the Defined Benefit (DB) plan (Tier 1) after the 2000 Defined Contribution (DC) (Tier 2) election window were given the option to purchase the actuarial value of standardized local salary previously unconverted to the State base salary for computation of a retirement benefit from the System. (Plan 3 members were given a choice to convert part of the State salary standardization payment on or after September 30, 1981). Following purchase, member contributions and retirement benefits are determined from total judicial salary.

A favorable IRS determination in October 2000 allowed the "buy-in" election program to open June 15, 2001. Currently, valid elections allow payment through transfer of funds from another qualified plan, a "rollover IRA" (consisting only of funds previously transferred from another qualified plan), a lump-sum payment by the member on a post-tax basis, or any combination thereof. IRS approval of payment through pre-tax payroll deductions is currently pending; the election program will end 60 days following IRS notification.

The Settlement Agreement also calls for administration of a "medical benefit account" under Section 401(h) of the Internal Revenue Code. Plan participants will use pre-retirement savings, adjusted by investment experience, to defray eligible post-retirement medical expenses. Self-funding is required under statute; administrative expenses for the 401(h) plan are funded by up to 25 percent of the absolute value of investment experience. The System is currently seeking IRS approval for implementation of this program on a pre-tax basis.

Harvey et al v. Judges' Retirement System

The System is named as defendant in a State case that alleges the statute discriminates against certain members as a result of differences in contribution rates and benefit allowances. The State's summary motion for disposition argued that the alleged inequity between out-state judges and 36th District Judges is not unconstitutional due to the interaction between the Judges' Retirement System and local government retirement plans, which are available to out-state judges and which can grant more benefits to out-state judges than are available to 36th District Judges.

Subsequent to a March 29, 2000, Circuit Court opinion for the System, an order was issued granting the System's motion for summary disposition and dismissing the case. Petitioners appealed this decision. Oral arguments were heard on January 9, 2002, and the Circuit Court's order was reversed on May 5, 2002, by the Court of Appeals. The State appealed to the Supreme Court on May 31, 2002, and is awaiting word from the Supreme Court on acceptance of the appeal.

Ernst et al v. Roberts et al

On September 5, 2001, legal action was initiated in U.S. District Court against members of the Judges Retirement Board named as defendants. Plaintiffs were seeking monetary damages, and injunctive and declaratory relief for alleged equal protection violations, violations of common law wasting trust doctrine, and breach of fiduciary duties. In a motion for abstention, the State argued that equal protection complaints are essentially the same as those currently involved at the State appellate court in the Harvey case. Arguments supporting the State's motion for dismissal/summary judgment include State immunity from civil suits under the Eleventh Amendment, rejection of equal protection violations due to dissimilarities among plaintiffs, and defects within claims of wasting trust and breach of fiduciary duties.

On September 30, 2002, the Court dismissed all of Plaintiff's claims. Plaintiffs have not advised the State of their intentions regarding an appeal.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Other

Under the Administrative Procedures Act, members may appeal a decision made by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. The cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

Required Supplementary Information

Schedule of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the System's funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

Retirement Benefits (\$ in Millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1992	\$ 172.0	\$ 179.5	\$ 7.5	95.8 %	\$ 43.8	17.2 %
1993	187.7	193.0	5.2	97.3	44.5	11.8
1993 +	189.1	192.4	3.3	98.3	44.5	7.4
1994	202.4	197.0	(5.4)	102.7	46.3	(11.6)
1995	222.2	204.3	(17.9)	108.8	48.2	(37.1)
1996	243.2	211.5	(31.7)	115.0	49.4	(64.3)
1997	271.5	230.5	(40.9)	117.8	49.0	(83.6)
1998	288.7	236.5	(52.2)	122.0	48.9	(106.7)
1998 *	288.7	230.3	(58.4)	125.3	48.9	(119.4)
1999	320.9	243.5	(77.4)	131.8	49.6	(155.9)
2000	274.8	204.2	(70.6)	134.6	37.0	(190.7)
2001	291.0	224.7	(66.3)	129.5	42.5	(155.7)
2002	291.7	229.2	(62.5)	127.3	42.4	(147.3)

+ Revised actuarial assumptions and asset valuation method

* Revised actuarial assumptions

FINANCIAL SECTION

Required Supplementary Information (Continued)

Schedule of Employer Contributions

<u>Fiscal Year Ended Sept. 30</u>		<u>Actuarial Required Contribution (ARC)*</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
1993	*	\$ 7,112,624	\$ -	0.0 %
1993		6,661,731	7,690,115	115.4
1994		6,638,110	6,576,996	99.1
1995		6,559,552	6,228,812	95.0
1996		5,992,698	6,191,607	103.3
1997		5,527,350	5,673,583	102.6
1998		5,040,121	246,659	4.9
1999		4,673,433	-	0.0
1999	*	1,260,694	58,499	4.6
2000	**	(411,879)	-	0.0
2001	**	(955,186)	-	0.0
2002		(476,491)	-	0.0

* Revised actuarial assumptions

** ARC is calculated as percentage of payroll reported to actuary.

FINANCIAL SECTION

Notes to Required Supplementary Information

NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the System is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension benefits as they become due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

The Schedule of Funding Progress and Schedule of Employer Contributions are reported as historical trend information. The Schedule of Funding Progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedule of Employer Contributions is presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

NOTE B - SUMMARY OF ACTUARIAL ASSUMPTIONS

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

Valuation Date	9/30/2002
Actuarial Cost Method	Entry Age, Normal
Amortization Method	Level Percent of Payroll, Closed
Remaining Amortization Period	34 years
Asset Valuation Method	5-Year Smoothed Market
Actuarial Assumptions:	
Inflation Rate	4%
Investment Rate of Return	8%
Projected Salary Increases	4.5%
Cost-of-Living Adjustments	None

FINANCIAL SECTION

Supporting Schedules

Comparative Summary Schedule of Pension Plan Administrative Expenses For the Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Personnel Services:		
Staff Salaries	\$ 9,322	\$146,350
Retirement and Social Security	2,428	45,188
Other Fringe Benefits	1,760	22,062
Total	<u>13,510</u>	<u>213,600</u>
Professional Services:		
Actuarial	64,308	67,358
Attorney General	11,331	42,838
Audit	28,500	18,963
Consulting	135,039	135,655
Medical	3,563	-
Total	<u>242,741</u>	<u>264,814</u>
Building and Equipment:		
Building Rentals	4,220	1,785
Equipment Purchase, Maintenance and Rentals	574	572
Total	<u>4,794</u>	<u>2,357</u>
Miscellaneous:		
Travel and Board Meetings	5,623	322
Office Supplies	178	302
Postage, Telephone and Other	116,369	7,627
Printing	4,277	3,356
Technological Support	17,491	8,123
Total	<u>143,938</u>	<u>19,730</u>
Total Administrative Expenses	<u>\$404,983</u>	<u>\$500,501</u>

Supporting Schedules (Continued)

Schedule of Investment Expenses

	<u>2002</u>	<u>2001</u>
Securities Lending Expenses	\$ 183,617	\$ 297,325
Real Estate Operating Expenses	3,506	13,743
Other Investment Expenses*	<u>247,925</u>	<u>255,755</u>
Total Investment Expenses	<u><u>\$ 435,048</u></u>	<u><u>\$ 566,823</u></u>

* See Investment Section for fees paid to investment professionals

Schedule of Payments to Consultants

	<u>2002</u>	<u>2001</u>
Independent Auditors	\$ 28,500	\$ 18,963
Attorney General	11,331	42,838
Actuary	64,308	67,358
Consulting	135,039	135,655
Medical	<u>3,563</u>	<u>-</u>
Total Payment to Consultants	<u><u>\$ 242,741</u></u>	<u><u>\$ 264,814</u></u>

FINANCIAL SECTION

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits) For the Year Ended September 30, 2002

	Employee Contributions	Employer Contributions	Retired Benefits Payments	Undistributed Investment Income	Health Benefits	Total
Additions:						
Member contributions	\$ 2,857,224				\$ 362,987	\$ 3,220,211
Investment income (loss):						
Investment income (loss)				\$ (25,792,190)		(25,792,190)
Securities lending income				229,142		229,142
Investment expenses:						
Real estate operating expenses				(3,506)		(3,506)
Securities lending expenses				(183,617)		(183,617)
Other investment expenses				(247,925)		(247,925)
Net investment income	-	-	-	(25,998,096)	-	(25,998,096)
Court fees				-	100,000	100,000
Miscellaneous				-		-
Total additions	2,857,224	-	-	(25,998,096)	462,987	(22,677,885)
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement benefits			\$ 15,809,951			15,809,951
Health benefits					519,669	519,669
Return of contributions	52,862					52,862
Transfers to other systems						-
Administrative expenses				404,983		404,983
Total deductions	52,862	-	15,809,951	404,983	519,669	16,787,465
Net increase (decrease)	2,804,362	-	(15,809,951)	(26,403,079)	(56,682)	(39,465,350)
Other changes in net assets:						
Interest allocation	2,325,370	\$ 3,972,651	9,334,143	(15,632,164)		-
Transfers upon retirement	(1,060,571)	(8,420,170)	9,480,741			-
Transfers of employer shares						-
Total other changes in net assets	1,264,799	(4,447,519)	18,814,884	(15,632,164)	-	-
Net Increase (Decrease) After Other Changes	4,069,161	(4,447,519)	3,004,933	(42,035,243)	(56,682)	(39,465,350)
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:						
Beginning of year	31,034,518	49,658,134	116,676,786	77,358,691	(502,586)	274,225,543
End of year	\$ 35,103,679	\$ 45,210,615	\$ 119,681,719	\$ 35,323,448	\$ (559,268)	\$ 234,760,193

FINANCIAL SECTION

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits) For the Year Ended September 30, 2001

	Employee Contributions	Employer Contributions	Retired Benefits Payments	Undistributed Investment Income	Health Benefits	Total
Additions:						
Member contributions	\$ 2,304,041				\$ 345,851	\$ 2,649,892
Investment income (loss):						
Investment income (loss)				\$ (30,751,715)		(30,751,715)
Securities lending income				322,960		322,960
Investment expenses:						
Real estate operating expenses				(13,743)		(13,743)
Securities lending expenses				(297,325)		(297,325)
Other investment expenses				(255,755)		(255,755)
Net Investment income	-	-	-	(30,995,578)	-	(30,995,578)
Miscellaneous				16		16
Total additions	2,304,041	-	-	(30,995,562)	345,851	(28,345,670)
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement benefits			\$ 15,793,191			15,793,191
Health benefits					505,459	505,459
Return of contributions	51,373		13,581			64,954
Transfers to other systems	(309,505)	\$ 683,422	536,762			910,679
Administrative expenses				500,501		500,501
Total deductions	(258,132)	683,422	16,343,534	500,501	505,459	17,774,783
Net increase (decrease)	2,562,173	(683,422)	(16,343,534)	(31,496,063)	(159,608)	(46,120,454)
Other changes in net assets:						
Interest allocation	(613,333)	3,922,944	9,428,911	(12,738,522)		-
Transfers upon retirement	(3,111,838)		3,111,838			-
Transfers of employer shares		(2,618,182)	2,618,182			-
Total other changes in net assets	(3,725,171)	1,304,762	15,158,931	(12,738,522)	-	-
Net Increase (Decrease)						
After Other Changes	(1,162,998)	621,340	(1,184,603)	(44,234,585)	(159,608)	(46,120,454)
Net Assets (Liabilities) Held in Trust						
for Pension and Health Benefits:						
Beginning of year	32,197,516	49,036,794	117,861,389	121,593,276	(342,978)	320,345,997
End of year	\$ 31,034,518	\$ 49,658,134	\$ 116,676,786	\$ 77,358,691	\$ (502,586)	\$ 274,225,543

INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments
Roy A. Pentilla, Acting Director

Report on Investment Activity
Asset Allocation
Investment Results
List of Largest Stock Holdings
List of Largest Bond Holdings
Schedule of Investment Fees
Schedule of Investment Commissions
Investment Summary

INVESTMENT SECTION

Report on Investment Activity

INTRODUCTION

The State Treasurer reports quarterly the investment activity to the Investment Advisory Committee, which reviews the investments, goals and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The Investment Advisory Committee may also, by a majority vote, direct the State Treasurer to dispose of any holdings that, in the Committee's judgment, are not suitable for the funds involved, and may, by unanimous vote, direct the State Treasurer to make specific investments.

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Consumer and Industry Services and the Director of the Department of Management and Budget are ex-officio members. The members of the Committee are as follows: James B. Henry, PHD (public member), Robert E. Swaney, CFA (public member), David G. Sowerby (public member), Noelle Clark (ex-officio member), and Duane E. Berger (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

INVESTMENT POLICY & GOAL

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment rate of return, at a reasonable cost achieved by cultivating a motivated team of dedicated professionals. The goals of the fund are:

1. Assure the availability of sufficient assets to pay benefits.
2. Achieve the optimal rate of return possible within prudent levels of risk and liquidity.
3. To outperform the actuarial assumption over the long term.
4. To perform in the top half of the Capital Resource Advisors public plan universe.
5. To exceed individual asset class benchmarks over the long term.
6. To produce competitive results while operating in a cost-effective manner relative to peers.
7. Maintain sufficient diversification to avoid large losses and preserve capital.

The strategy for achieving these goals is carried out by investing the assets of the System according to a five-year asset allocation model. The System currently has six different asset classes, which provides for a well-diversified portfolio.

Asset Allocation **(Excludes Collateral on Loaned Securities)**

<u>Investment Category</u>	<u>As of 9/30/02 Actual %</u>	<u>Five-Year Target %</u>
International Equities-Passive	6.6%	8.0%
Real Estate	12.5%	10.0%
Alternative Investments	10.2%	8.0%
Short Term Investments	3.6%	1.0%
Fixed Income	25.2%	24.0%
Domestic Equity	41.9%	49.0%
TOTAL	100.0%	100.0%

INVESTMENT SECTION

Report on Investment Activity (Continued)

STATE LAW

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System, Michigan State Employees' Retirement System, Michigan State Police Retirement System, and Michigan Judges' Retirement System.

Act No. 314 of the Public Acts of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the State or any political subdivision.

PROXY VOTING POLICY

The System's Proxy Voting Policy sets forth directives on the following issues: Board of Directors, corporate governance, social issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the above-mentioned items.

INVESTMENT RESULTS

Total Portfolio Result

For the fiscal year ended September 30, 2002, the total portfolio returned -9.8% as compiled by Capital Resource Advisors. Annualized for the three-year period, the fund returned -2.8%; for the five-year period, the fund returned 2.8%; and for the ten-year period, the fund returned 8.1%.

During the fiscal year ending September 30, 2002, the nation's economy experienced a slow economic recovery and reduced consumer spending with corporate earnings slowly recovering. The real economy is doing better than the financial markets. Uncertainty caused by the possibility of war in Iraq and the frauds and accounting irregularities are all negatively impacting the markets.

As a result of the economic conditions, the broad based S&P 500 index declined -20.5% over the fiscal year with the Dow Jones Industrial Average off -12.5%. Growth stocks outperformed value stocks during this period. Given an accommodative Federal Reserve, the Lehman Brothers Government/Corporate bond index appreciated 9.2%.

The returns were calculated using a time-weighted rate of return in accordance with standards of the Association for Investment Management and Research (AIMR), unless a modification is described in the discussion of the return.

The System is well-diversified among asset classes. As of September 30, 2002, the portfolio consisted of 41.9% domestic equities, 25.2% fixed income, 10.2% alternative investments, 12.5% real estate, 3.6% short-term investments, and 6.6% international equities.

Domestic Stocks – Active

The objective of actively managed domestic stock investments is long-term capital appreciation by investing in publicly traded stocks of primarily US-based companies. Monies are invested in a portfolio of large company value stocks and a portfolio of large company growth stocks. Since historical rates of return for value and growth strategies have been negatively correlated, this allows for further diversification and focused selection of investments. Value investing derives its returns from the market's tendency to periodically undershoot a stock's fair value and then eventually corrects to fair value. Growth stock returns accrue from longer-term broad themes from which companies evolve that will grow faster than the economy. Both portfolios are diversified among various securities and industries.

INVESTMENT SECTION

Report on Investment Activity (Continued)

The U.S. economy began fiscal year 2002 on the heels of a recession marked by three consecutive quarters of negative real GDP and reeling from the terrorist attacks of September 11, 2001. Corporate earnings continued the double-digit declines begun in fiscal 2001, finally showing positive comparisons in the quarter ending March of 2002. The Federal Reserve lowered rates four times between September 2001 and December 2001, taking the Federal Funds rate from 3.50% to 1.75%. Inflation, as measured by the CPI, remained subdued at an annualized rate of 1.5%. Interest rates plummeted, with ten-year U.S. Treasury notes yielding 3.60% by the end of fiscal 2002 compared to 4.59% at the end of the prior fiscal year. A number of retailers even offered 0% financing.

The U.S. economy staged a modest recovery and U.S. equity markets bounced back remarkably from the lows reached after the events of September 11, 2001. However, incessant news of accounting fraud and management scandals, combined with escalating fears of military action against Iraq, rocked the equity markets throughout the remainder of the year. Total return for the Dow Jones Industrial Average was -12.5% for the 12 months ending September 2002, while return for the broader S&P 500 was -20.5%. The NASDAQ's price fell by 21.8% during the fiscal year.

The System's large company Value portfolio achieved a total rate of return of -15.1% for fiscal 2002. This compared favorably with -22.2% for the S&P 500 BARRA Value Index due to the fund's investments in defense and financial stocks and little exposure to technology and telecommunication stocks. The large company Growth portfolio's total rate of return was -25.4% for the fiscal year versus -19.3% for the S&P 500 BARRA Growth Index. Relative underperformance can be attributed to positioning the portfolio for strong economic and market recoveries that failed to materialize before the end of the fiscal year. Because these two portfolios were created effective January 31, 2000, three-year or five-year rates of return are not available.

On a consolidated basis, the actively managed large company domestic stock portfolio had a total rate of return of -20.3% for fiscal year 2002 compared to -20.5% for the S&P 500 Index. Three-year and five-year annualized returns were -12.3% and -3.3%. This compared with -12.9% and -1.6% for the S&P 500.

At the close of fiscal year 2002, large company value stocks represented 14.2% of total investments versus 13.1% at the end of fiscal year 2001. Large company growth stocks represented 13.6% of total investments versus 12.5% at the end of fiscal 2001. Consolidated actively managed large company domestic stocks represented 27.8% of total investments, compared to 25.6% at the end of fiscal year 2001.

The System established an investment position with the small company growth managers at Delaware Investment Advisors (Delaware) and Putnam Investments (Putnam). An initial investment of \$300,000 was placed with each of these managers as of October 1, 2001.

The System's small company growth portfolio invested with Delaware achieved a total rate of return of -8.0% for fiscal 2002. This compares favorably with -18.2% for the Russell 2000 Growth Index. An underweight and positive selectivity in the technology sector provided much of the outperformance. This positive result was partially offset by underperformance in the consumer/retail sector in which the fund had an overweight position.

The System's small company growth portfolio invested with Putnam achieved a total rate of return of -18.5% for fiscal 2002. This compares unfavorably with -18.2% for the Russell 2000 Growth Index. Performance was negatively impacted by two sectors: financials in which the portfolio was under weighted and technology in which underperformance was the culprit. This was offset somewhat by strength in the portfolio's investments in consumer cyclicals.

At the close of fiscal year 2002, small company growth stocks represented 0.22% of total investments.

Domestic Stocks - Passive

The objective of the enhanced S&P 500 and S&P MidCap Index Funds is to closely match the return performance of their benchmarks, and use low risk strategies to offset transaction costs and add to performance when possible. The

INVESTMENT SECTION

Report on Investment Activity (Continued)

S&P 500 Index Fund return for the fiscal year was -20.0% versus the benchmark's -20.5%. The S&P MidCap Index Fund return for the fiscal year was -4.9% versus its benchmark's -4.7%. The relative enhancement to the S&P 500 index Fund return was the result of strategic allocations of additional funds to passive equity investments during market corrections and the opportunistic use of derivative programs. During fiscal year 2002, \$1.3 million was added to US index funds. An S&P Small Cap Index Fund was established in June of 2002 to match the return of that targeted benchmark. At the end of the fiscal year, passive domestic stock portfolios represented 14.0% of total assets, the S&P 500 Index Fund accounting for 12.3%, the S&P MidCap Index Fund 1.5%, and the S&P Small Cap Index Fund 0.2% of total investment assets. Indexed stock portfolios also represented 14.0% of total investment assets at the end of the prior fiscal year.

International Equities - Passive

The objective of passive international equity portfolios is to match the return performance of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. Dollar and the other half is impacted by foreign currency exchange rate changes. The total passive international return of -16.0% in the fiscal year approximately matched the Salomon Smith Barney BMI-EPAC return of -15.5%. The passive international return of -12.2% for three years approximately matched the benchmark's return of -12.3% over the same period.

Core passive exposure to international equity returns is achieved primarily by investing in a combination of fixed income notes and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in related indices. Use of swap agreements for a core position began in 1993, and an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase management flexibility, and a country fund portfolio was added in September of 2002 to improve exposure to the smallest companies in the BMI index. During fiscal year 2002, \$2.7 million of exposure was added, raising passive international investments to 6.6% of total investment assets.

The combination of fixed income LIBOR notes and equity swap agreements was valued at \$14.4 million on September 30, 2002. That valuation included a net unrealized loss of \$6.8 million on equity index exposures and an unrealized gain of \$76 thousand on LIBOR note investments held. The combined swap agreement and LIBOR portfolio structure continues to perform like a stock index fund that realizes all gains and losses on a rolling three-year basis. During fiscal year 2002, \$673 thousand of losses on equity exposures were realized, \$205 thousand of interest in excess of obligations on completed swaps and \$14.8 thousand of gains on LIBOR notes were realized. At the end of the fiscal year, total realized gains and net interest received in excess of counterparty obligations on completed agreements were \$6.1 million since the program began.

Fixed Income (Excluding Mortgages)

For the fiscal year ending September 30, 2002, the fixed income portfolio returned 7.4% as compiled by Capital Resource Advisors. The portfolio also returned 8.8% for three years, and 7.2% for five years.

Rates continued to decline during the year in response to the Federal Reserve's repeated reductions in rates and the flight to quality in view of stock market declines. In addition to rates declining in all maturities there was also the continuation of a steep yield curve. Given the mathematics of bond calculation, long-term government bonds tended to outperform most other sectors.

As rates approached their lowest levels in forty or more years, a defensive reinvestment program concentrating on shorter-term intermediate issues and floating rate securities was chosen. While offering greater liquidity and protection from rising rates they tend to under perform in a declining rate market.

Fixed income represented 25.2% of the total portfolio compared with 21.6% last year. The corporate sector represented 38.5% of fixed income securities with government securities accounting for 61.5%. Last year corporates were 47.1% of

INVESTMENT SECTION

Report on Investment Activity (Continued)

the total with government securities representing 52.9%. The increased level of government securities was in response to increased uncertainty and volatility in the corporate sector.

Real Estate (including Mortgages)

A majority of the direct mortgage holdings were sold in 1997 and 1998, and the equity real estate portfolio and mortgage portfolio were, therefore, combined into a single "Real Estate" allocation during the current fiscal year. For the fiscal year ending September 30, 2002, 12.5% of the System's total investment portfolio was invested in real estate. This compares to 11.6% and 8.2%, for the fiscal years ending September 30, 2001, and 2000, respectively. The current target allocation to real estate is 10%, and the five-year target asset allocation for real estate is 10%.

The one-year, three-year, five-year, and ten-year net real estate returns for the fiscal year ending September 30, 2002, were 8.2%, 9.6%, 10.5%, and 9.0% respectively, as compiled by Capital Resource Advisors. This compares to the National Council of Real Estate Investment Fiduciaries Property Index (NCREIF) returns of 4.8%, 8.4%, 10.6%, and 8.0% relating to same periods. As of September 30, 2002, the NCREIF portfolio of properties is more weighted in the office sector at 42%, versus the System's portfolio at 25%. Because the NCREIF returns are calculated before advisor fees/overhead and the System's returns are calculated after all advisor fees/overhead, the NCREIF returns stated above have been adjusted downward by 75 basis points to approximate comparable returns.

The real estate portfolio is broadly diversified geographically across the country, by type of property and class of property, to reduce risk. Major property types as of September 30, 2002, included apartments (44%); retail centers, including regional malls and grocery-anchored neighborhood/community shopping centers (23%); commercial office buildings (25%); and miscellaneous other property types, such as industrial and self storage (8%). The System, through its advisors and operating joint ventures, acquires, develops, redevelops, and disposes of real estate with the goal of maximizing returns while maintaining an *acceptable* level of risk. The properties are held in various investment vehicles: partnerships, LLCs and trusts. These legal entities allow the System to enjoy the benefits of real estate ownership while limiting the liability associated with the asset class. In all new investments, the System negotiates key terms in order to further mitigate risk. The properties are regularly valued by independent third parties to establish fair market values.

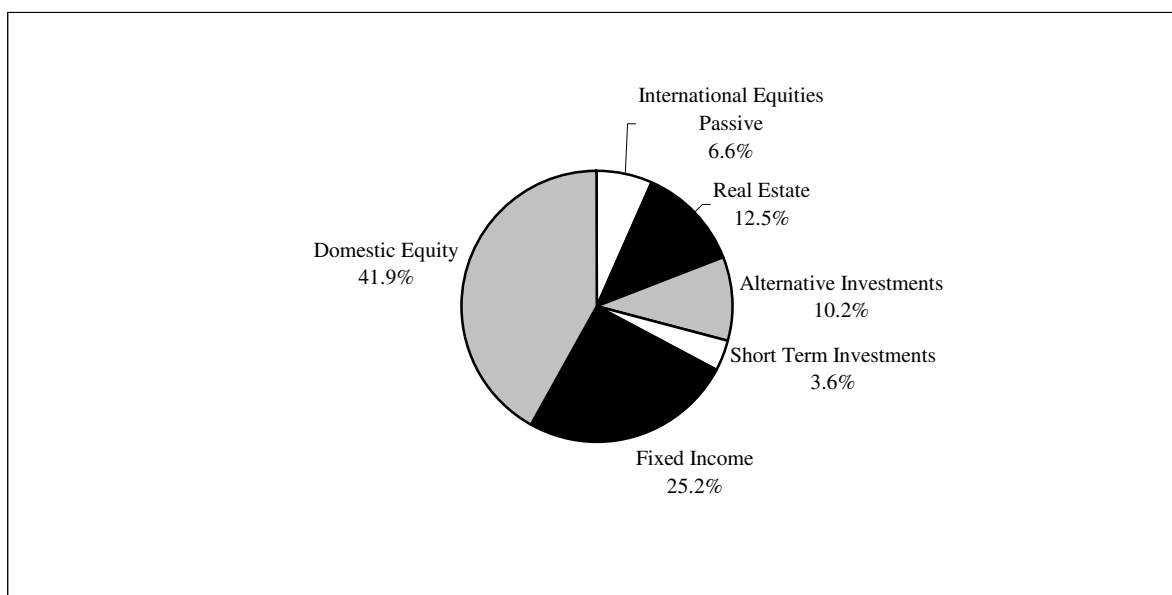
Alternative Investments

Alternative Investments are investments in the private equity market, either directly in companies or indirectly through limited partnerships. Through September 30, 2002, approximately 92% of alternative investments were made through limited partnerships. Of the investments in limited partnerships, approximately 14% were in partnerships investing internationally, 15% in venture capital and 63% in special situations/LBOs. The remaining 8% were direct private equity investments and public stock distributions received from the limited partnerships. The percentage of assets in alternative investments has consistently increased from 4.8% as of September 30, 1993, to 10.2% as of September 30, 2002. The asset allocation range for alternative investments is 9.5% to 20% while the long-term target asset allocation is 8%.

The one-year, three-year, five-year, and ten-year total alternative investment returns for the fiscal year ending September 30, 2002, were -16.3%, -0.1%, 7.1%, and 12.9%, respectively.

INVESTMENT SECTION

Asset Allocation



Investment Results for the Period Ending September 30, 2002

<u>Investment Category</u>	<u>Current Year</u>	<u>Annualized Rate of Return</u>		
		<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
Total Portfolio	(9.8) %	(2.8) %	2.8 %	8.1 %
Domestic Equities Stock - Active	(20.3)	(12.3)	(3.3)	8.7
Domestic Equities Stock - Passive*	(18.7)	(11.3)	(0.7)	9.8
Standard & Poor's (S&P 500)	(20.5)	(12.9)	(1.6)	9.0
Standard & Poor's (MidCap)	(4.7)	(3.4)	5.4	12.6
International Equities - Passive	(16.0)	(12.2)	(3.2)	N/A
Net Salomon BMI - EPAC 50/50	(15.5)	(12.3)	(4.0)	N/A
Fixed Income Bonds (U.S. Corp and Govt)	7.4	8.8	7.2	7.5
Salomon Smith Barney Broad Investment Grade Bond Index	8.4	9.4	7.8	7.4
Lehman Brothers Government/Corporate	9.2	9.7	7.9	7.4
Real Estate**	8.2	9.6	10.5	9.0
NCREIF minus 75 Basis Points	4.8	8.4	10.6	8.0
Alternative Investments	(16.3)	(0.1)	7.1	12.9

* Passive portfolio consists of a S&P 500 fund and a S&P Midcap fund. The return is a weighted average of the two funds.

**Real Estate includes mortgages.

N/A Not available.

INVESTMENT SECTION

Largest Assets Held

Largest Stock Holdings (By Market Value)* September 30, 2002

<u>Rank</u>	<u>Shares</u>	<u>Stocks</u>	<u>Market Value</u>
1	351,505	I Shares S&P 500 Index	\$ 28,784,744
2	35,122	I Shares S&P Midcap 400	3,402,981
3	93,075	Pfizer Incorporated	2,701,037
4	51,944	Microsoft Corporation	2,272,031
5	91,177	General Electric Corporation	2,247,513
6	45,620	Wal-Mart Stores Incorporated	2,246,329
7	72,319	Citigroup Incorporated	2,144,258
8	58,132	Exxon Mobil Corporation	1,854,411
9	34,354	Wells Fargo & Company	1,654,489
10	24,679	Federal National Mortgage Association	1,469,388

Largest Bond Holdings (By Market Value)* September 30, 2002

<u>Rank</u>	<u>Par Amount</u>	<u>Bonds & Notes</u>	<u>Market Value</u>
1	\$ 5,181,000	U.S. Treasury Bonds at 9.125% Due 5-15-2009	\$ 5,793,394
2	2,145,000	U.S. Treasury 0% Coupon Strips Due 8-15-2003	2,122,542
3	1,770,600	U.S. Treasury 0% Coupon Strips Due 11-15-2011	1,656,219
4	1,244,000	U.S. Treasury Tiger 0% Coupon Due 8-15-2004	1,197,300
5	1,180,000	FHLB 2.51% FRN Due 1-12-2007	1,178,914
6	800,000	Bank One NA Chicago ILL MTN 2.026% Due 3-16-2004	800,408
7	761,280	U.S. Treasury 0% Coupon Strips Due 5-15-2009	741,639
8	698,521	First Chicago Corp FRN 4.25% Due 7-28-2003	711,835
9	645,000	VW Credit Inc FRN 2.14% Due 1-21-2005	646,000
10	621,150	Chase Manhattan Bank FRN 4.20% Due 7-29-2003	633,095

* A complete list of stock and bond holdings is available from the Michigan Department of Treasury.

INVESTMENT SECTION

Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to State law. Outside advisors are utilized to augment the State Treasurer's internal staff in the real estate and alternative investment markets. Only 10.8% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisor's fees are netted against the partnership or trust fund income. The Michigan Department of Treasury's cost of operations applicable to the System for the fiscal year amounted to \$64.3 thousand or less than three basis points (.03%) of the market value of the portfolio.

State law created an Investment Advisory Committee comprised of the directors of the Department of Consumer and Industry Services and Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but are paid actual and necessary travel and other expenses. The committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The committee may also, by a majority vote, direct the State Treasurer to dispose of any holding which in the committee's judgment is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

Schedule of Investment Fees

Investment Managers' Fees:

	<u>Assets under Management (in thousands)</u>	<u>Fees (in thousands)</u>	<u>Basis Points*</u>
State Treasurer	\$ 208,532.0	\$ 64.3	3.1
Outside Advisors - Alternative	23,817.9	172.1	72.2
Real Estate	1,552.3	-	-
Total	<u>\$ 233,902.2</u>		

Other Investment Services Fees:

Assets in Custody	\$ 227,563.2	\$ 11.5
Securities on Loan	8,552.2	183.6

9. Outside Advisors Fees are netted against the income of the partnership and trust income. The partnership agreements define the management fees, which range from 150 to 250 basis points of the committed capital; in most cases the fees are netted against income. For Real Estate the asset management fee ranges from 25 to 90 basis points and is netted against current year's income.

INVESTMENT SECTION

Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2002		
	Commissions Paid ⁽¹⁾	Number of Shares Traded	Average Commission Rate Per Share
Investment Brokerage Firms:			
Salomon Smith Barney, Inc.	\$ 4,866	158,271	\$ 0.03
Bear Stearns & Co.	3,639	89,535	0.04
Bridge Trading Company	3,257	65,132	0.05
C.S. First Boston Corporation	3,050	71,112	0.04
Lehman Brothers, Inc.	2,955	76,983	0.04
Goldman, Sachs & Co.	2,754	59,966	0.05
Merrill Lynch & Co.	2,024	72,944	0.03
Morgan Stanley Dean Witter & Co.	1,938	41,707	0.05
J. P. Morgan Securities, Inc.	1,857	37,149	0.05
UBS Warburg LLC.	1,473	29,462	0.05
Deutsche Bank	760	15,208	0.05
Sanford C. Bernstein & Co.	669	13,380	0.05
ISI Group, Inc.	631	12,558	0.05
S.G. Cowen & Company	609	12,184	0.05
Prudential Securities, Inc.	599	11,980	0.05
Charles Schwab & Co., Inc.	553	11,068	0.05
OTA Research	343	6,861	0.05
Soundview Financial	309	6,183	0.05
CIBC World Markets Corp.	303	6,069	0.02
Instinet Group Inc.	252	10,130	0.05
Banc of America Securities, LLC.	214	4,272	0.05
Barrington Research	152	3,043	0.05
Keefe Bruyette	97	1,935	0.05
Howard Weil	96	1,922	0.05
Total	\$ 33,400	819,054	\$ 0.04 ⁽²⁾

⁽¹⁾ These amounts are included in purchase and sale prices of investments.

⁽²⁾ The average commission rate per share for all brokerage firms.

INVESTMENT SECTION

Investment Summary

Fiscal Year Ended September 30, 2002

	<u>Market Value</u> ^(a)	<u>Percent of Total Market Value</u>	<u>Investment & Interest Income</u> ^(c)	<u>Percent of Investment & Interest Income</u>
Fixed Income:				
Government Bonds	\$ 36,246,361	15.5%	\$ 2,376,814	-9.2%
Corporate Bonds & Preferred Stocks	22,701,837	9.7%	1,984,487	-7.7%
Mortgages	17,146	0.0%	1,764	0.0%
Total Fixed Income	<u>58,965,344</u>	<u>25.2%</u>	<u>4,363,065</u>	<u>-16.9%</u>
Common Stocks	98,103,876	41.9%	(24,335,763)	94.3%
Real Estate	29,142,691	12.5%	2,353,077	-9.1%
Alternative	23,817,881	10.2%	(5,768,807)	22.4%
International Equities	15,373,340	6.6%	(2,789,851)	10.8%
Short Term Investments ^(b)	<u>8,499,043</u>	<u>3.6%</u>	<u>386,089</u>	<u>-1.5%</u>
Total	<u>\$ 233,902,175</u>	<u>100.0%</u>	<u>\$ (25,792,190)</u>	<u>100.0%</u>

^a Short Term Investments are at cost, which approximates market value.

^b Excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for each fiscal year. Amount also excludes \$8,722,667 in cash collateral for security lending for fiscal year 2002.

^c Total Investment & Interest Income excludes net security lending income of \$45,526 for fiscal year 2002.

INVESTMENT SECTION

Investment Summary (Continued)

Fiscal Year Ended September 30, 2001

	Market Value ^(a)	Percent of Total Market Value	Investment & Interest Income ^(c)	Percent of Investment & Interest Income
Fixed Income:				
Government Bonds	\$ 31,240,151	11.5%	\$ 5,017,886	-16.3%
Corporate Bonds & Preferred Stocks	27,773,818	10.1%	2,911,906	-9.5%
Mortgages	114,886	0.0%	10,461	0.0%
Total Fixed Income	59,128,855	21.6%	7,940,253	-25.8%
Common Stocks	109,530,587	39.9%	(30,293,334)	98.5%
Real Estate	31,776,623	11.6%	2,988,784	-9.7%
Alternative	33,243,384	12.1%	(7,132,922)	23.2%
International Equities	15,943,367	5.8%	(5,783,392)	18.8%
Short Term Investments ^(b)	24,581,211	9.0%	1,528,896	-5.0%
Total	\$ 274,204,027	100.0%	\$ (30,751,715)	100.0%

^a Short Term Investments are at cost, which approximates market value.

^b Excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for each fiscal year. Amount also excludes \$9,731,310 in cash collateral for security lending for fiscal year 2001.

^c Total Investment & Interest Income excludes net security lending income of \$25,635 for fiscal year 2001.

ACTUARIAL SECTION



Actuary's Certification
Summary of Actuarial Assumptions and Methods
Schedule of Active Member Valuation Data
Schedule of Changes in the Retirement Rolls
Prioritized Solvency Test
Analysis of Financial Experience
Summary of Plan Provisions

ACTUARIAL SECTION

Summary of Actuarial Assumptions and Methods

9. The investment return rate used in making the valuations was 8% per year, compounded annually. This rate of return is not the assumed real rate of return. Considering other financial assumptions, the 8% investment return rate translates to an assumed real rate of 4%. Adopted 1981.
9. The mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table, set forward one year for both men and women. Adopted 1998.
9. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 1998.
9. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page. Adopted 1998.
9. Total active member payroll is assumed to increase 0% per year, because new employees participate in the defined contribution program. Adopted 1996.
9. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Unfunded actuarial accrued liabilities, including actuarial gain and losses, are financed over a period of 40 years on a declining basis beginning October 1, 1996. Adopted 1996.
9. Valuation assets (cash and investment) were valued using a five-year smoothed market value method. For the 1993 valuation and later, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over five years. Adopted 1993.
9. The data about persons now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data was not audited by the actuary.
9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's Board after consulting with the actuary.

ACTUARIAL SECTION

Summary of Actuarial Assumptions and Methods (Continued)

SCHEDULE 1

Percent of Eligible Active Members Retiring Within Next Year

Retirement Ages	Percent of Eligible Active Members Retiring Within Next Year
55-59	8 %
60-64	12
65-69	12
70	20
71	30
72	40
73	50
74	75
75	100

SCHEDULE 2

Separation From Active Employment Before Age & Service Retirement & Individual Pay Increase Assumptions

Sample Ages	Percent of Active Members Withdrawing Within Next Year (Men and Women)	Percent of Active Members Becoming Disabled Within Next Year (Men and Women)	Percent Increase In Pay During Next Year
20		0.00 %	4.5 %
25		0.01	4.5
30	1.5 %	0.02	4.5
35	1.5	0.04	4.5
40	1.5	0.11	4.5
45	1.5	0.26	4.5
50	1.5	0.45	4.5
55	1.5	0.65	4.5
60	1.5	0.90	4.5

ACTUARIAL SECTION

Actuarial Valuation Data

Schedule of Active Member Valuation Data

<u>Valuation Date Sept. 30</u>	<u>Inactive Members Number</u>	<u>Active</u>					
		<u>Members Number</u>	<u>Reported Annual Payroll</u>	<u>Average Annual Payroll</u>	<u>% Increase</u>	<u>Average Age</u>	<u>Average Service</u>
1993	25	611	\$ 44,472,833	\$ 72,787	0.2 %	52.8	10.5
1994	26	608	46,276,785	76,113	4.5	53.4	10.5
1995	26	614	48,195,528	78,494	3.1	52.8	10.9
1996	28	610	49,350,572	80,903	3.1	53.6	11.7
1997	25	609	49,000,856	80,461	(0.5)	52.8	11.4
1998	24	600	48,865,572	81,443	1.2	53.6	12.2
1999	22	573	49,626,160	86,608	6.3	54.8	13.5
2000	17	399	37,022,723	92,789	7.1	54.0	11.0
2001	15	380	42,543,811	111,957	20.7	54.4	11.7
2002	16	367	42,441,201	115,644	3.3	55.3	12.4

Schedule of Changes in the Retirement Rolls

<u>Year Ended Sept. 30</u>	<u>Added to Rolls</u>		<u>Removed from Rolls</u>		<u>Rolls—End of Year</u>		<u>% Increase in Annual Allowances</u>	<u>Average Annual Allowances</u>
	<u>No.</u>	<u>Annual Allowances</u>	<u>No.</u>	<u>Annual Allowances</u>	<u>No.</u>	<u>Annual Allowances</u>		
1993	29	\$ 1,023,871	1	\$ 16,135	434	\$ 10,831,553	10.3 %	\$ 24,957
1994	24	794,810	12	303,091	446	11,323,272	4.5	25,389
1995	50	1,700,945	15	409,064	481	12,615,153	11.4	26,227
1996	19	708,409	19	424,164	481	12,899,398	2.3	26,818
1997	40	1,663,656	9	359,441	512	14,203,613	10.1	27,741
1998	26	696,745	24	556,833	514	14,343,525	1.0	27,906
1999	35	1,182,957	18	514,936	531	15,011,546	4.7	28,270
2000	16	656,659	12	449,123	535	15,219,082	1.4	28,447
2001	30	1,027,902	19	399,313	546	16,027,671	5.3	29,355
2002	9	310,381	19	659,722	535	15,678,330	(2.2)	29,305

Prioritized Solvency Test

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due, the ultimate test of financial soundness. Testing for level contribution rates is the long term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired lives; and (3) the liabilities for service already rendered by active and inactive members. In a system that has been following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) is normally partially covered by the remainder of present assets. Generally, if the System has been using level-cost financing, the funded portion of liability 3 will increase over time. Liability 3 being fully funded is not necessarily a byproduct of level percent of payroll funding methods.

The schedule below illustrates the history of the liabilities of the System and is indicative of the System's policy of following the discipline of level percent of payroll financing.

Valuation Date	Actuarial Present Value of Actuarial Accrued Liability (\$ in Millions)				Valuation Assets	Portion of Present Value Covered by Assets			
	(1)	(2)	(3)	Valuation Assets		(1)	(2)	(3)	(4)**
	Active Member Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)						
Sept. 30									
1993	\$ 28,922	\$ 89,163	\$ 74,878	\$ 187,737	100 %	100 %	93.0 %	97.3 %	
1993 *	28,922	89,163	74,342	189,134	100	100	95.6	98.3	
1994	32,364	89,649	74,978	202,371	100	100	107.2	102.7	
1995	34,358	96,574	73,395	222,230	100	100	124.4	108.8	
1996	38,766	96,633	76,102	243,248	100	100	141.7	115.0	
1997	39,637	118,717	72,157	271,458	100	100	156.7	117.8	
1998	43,378	116,264	76,879	288,671	100	100	167.8	122.0	
1998 ***	43,378	116,645	70,294	288,671	100	100	183.0	125.3	
1999	43,047	121,856	78,600	320,869	100	100	198.4	131.8	
2000	28,812	120,480	54,933	274,843	100	100	228.6	134.6	
2001	29,469	125,097	70,171	290,998	100	100	194.4	129.5	
2002	33,457	120,456	75,309	291,730	100	100	183.0	127.3	

* Revised actuarial assumptions and asset valuation method.

** Percents funded on a total valuation asset and total actuarial accrued liability basis.

*** Revised actuarial assumptions

ACTUARIAL SECTION

Analysis of Financial Experience

Gains/(Losses) in Accrued Liabilities During Year Ended September 30, 2002 Resulting from Differences Between Assumed Experience & Actual Experience

<u>Type of Activity</u>	<u>Gain/(Loss)</u>
1. Retirements (including Disability Retirement). If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pays, a loss.	\$ 276,679
2. Withdrawal From Employment (including death-in-service). If more liabilities are released by withdrawals and deaths than assumed, there is a gain. If smaller releases, a loss.	2,491,779
3. Pay Increases. If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	1,764,799
4. Investment Income. If there is greater investment income than assumed, there is a gain. If less income, a loss.	(9,021,776)
5. Death After Retirement. If retirants live longer than assumed, there is a loss. If not as long, a gain.	171,430
6. New entrants. New entrants into the plan will generally result in an actuarial loss. This does not apply to plans closed to new entrants.	-
7. Other. Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	<u>420,000</u>
8. Composite Gain (or Loss) During Year	<u><u>\$ (3,897,089)</u></u>

Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2002 is based on the present provision of Public Act No. 234 of 1992.

Regular Retirement

Eligibility — Age 60 with 8 years credited service; or age 55 with 18 years credited service, or 25 years with no age requirement.

Annual Amount — If less than 12 years of credited service, 3% of final annual compensation times years of credited service; for 12 or more years of credited service, 50% of final annual compensation plus 2.5% of such compensation for each year of credited service in excess of 12 years to a maximum of 60%. Former System members receive 3% of final annual compensation times years of credited service to a maximum of the greater of 40% of final annual compensation or \$15,000, but not to exceed 66 2/3% of final annual compensation when added to a local retirement system benefit; or 3.5% of final annual compensation times years of credited service to a maximum of 66 2/3% of final annual compensation if elected.

Final Annual Compensation — Annual State salary at time of retirement plus State salary standardization, if any. For former System members, final annual compensation is member's certified salary at time of retirement. For 36th District Court judges, final annual compensation is total State and district control unit salary at time of retirement. For probate judges serving in a single county of less than 15,000 population, final annual compensation is total judicial salary at the time of retirement.

Early Retirement (age reduction factor used)

Eligibility — Age 55 with 12 but less than 18 years credited service.

Annual Amount — Regular retirement benefit, reduced by 1/2% for each month by which the commencement age is less than 60.

Deferred Retirement (vested benefit)

Eligibility — 8 years of credited service.

Annual Amount — Regular retirement benefit. If less than 12 years of credited service, payable at age 60; if 18 or more years of credited service payable at age 55; if more than 12 but less than 18 years of credited service reduced amount payable at age 55.

Disability Retirement

Eligibility — 8 years of credited service.

Annual Amount — Regular retirement benefit, based upon member's credited service and final salary at time of disability.

Death Before or After Retirement (Spouse or Dependent Children)

Eligibility — 8 years of credited service.

Annual Amount — 50% of the member's accrued pension.

ACTUARIAL SECTION

Summary of Plan Provisions (Continued)

Post Retirement Cost-of-Living Adjustments

None, except that judges who were active judges prior to September 8, 1961 (and their survivors) have their benefits adjusted as active judges' salaries change.

Member Contributions

Non-Trial Judges: 5% of salary (1.5% for health benefits).

Trial Judges with Full Standardization: 7% of salary.

Trial Judges without Full Standardization: 3.5% of salary.

Probate Judges under 3% Formula: 7% of salary to maximum of \$980.

Probate Judges under 3.5% Formula: 7% of salary (no maximum).

District Court Judges of the Thirty-sixth District: 3.5% of salary.

Defined Contribution Legislation — Public Act 523 of 1996

New employees hired on or after March 31, 1997, become participants in Tier 2 (i.e. a defined contribution plan) rather than Tier 1 (the above described defined benefit plan).

Active members on March 30, 1997, had an opportunity to irrevocably elect to terminate membership in Tier 1 and become participants in Tier 2. Elections were in writing and submitted between January 2, 1998 and April 30, 1998. Such members became Tier 2 participants on June 1, 1998, and had the actuarial present value of their Tier 1 accrued benefit transferred into Tier 2 by September 30, 1998.

On June 30, 1998, a case was filed by various Judges' Associations and Judges in connection with the Defined Contribution Plan. On November 22, 1999, a tentative settlement was read into the record. This settlement includes resolutions regarding the participation of trial judges in the DC plan, as well as a number of enhancements which have been thoroughly discussed with the Office of Retirement Services and are supported by the Governor's office. The proposed settlement was effectuated through passage of legislation. Approximately \$76.9 million was transferred to the Defined Contribution Retirement Plan in October 2000. The transfer is reflected in the financial statements and the actuarial valuation.

STATISTICAL SECTION

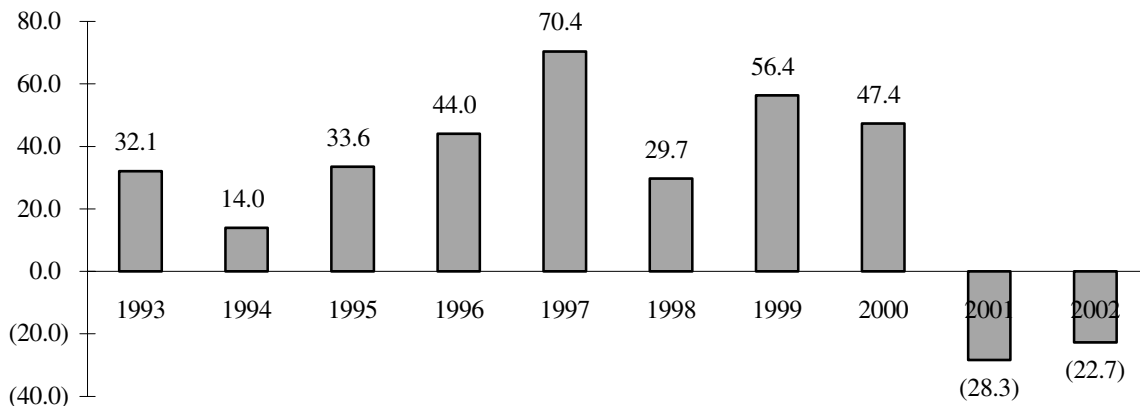
Schedule of Revenues by Source
Schedule of Expenses by Type
Schedule of Benefit Expenses by Type
Schedule of Retired Members by Type of Benefit
Schedule of Average Benefit Payments
Ten Year History of Membership
Schedule of Participating Employers

STATISTICAL SECTION

Schedule of Revenues by Source

Fiscal Year Ended Sept 30	Member Contributions	Net Court Fees	Employer Contributions		Net Investment & Other Income	Total
			Dollars	% of Annual Covered Payroll		
1993	\$ 2,833,083	\$6,101,841	\$1,588,274	3.57	\$ 21,551,382	\$ 32,074,580
1994	2,811,231	4,926,397	1,650,598	3.57	4,598,657	13,986,883
1995	2,915,335	5,263,144	1,614,633	3.35	23,803,055	33,596,167
1996	2,975,239	4,635,563	1,556,044	3.15	34,867,041	44,033,887
1997	3,208,635	4,080,730	1,592,853	3.25	61,494,465	70,376,683
1998	3,214,706	-	246,659	0.50	26,250,205	29,711,570
1999	3,316,840	-	58,499	0.12	53,008,576	56,383,915
2000	3,199,407	-	-	0.00	44,164,101	47,363,508
2001	2,649,892	-	-	0.00	(30,995,562)	(28,345,670)
2002	3,220,211	100,000	-	0.00	(25,998,096)	(22,677,885)

Total Revenues
Year Ended September 30
(In Millions)



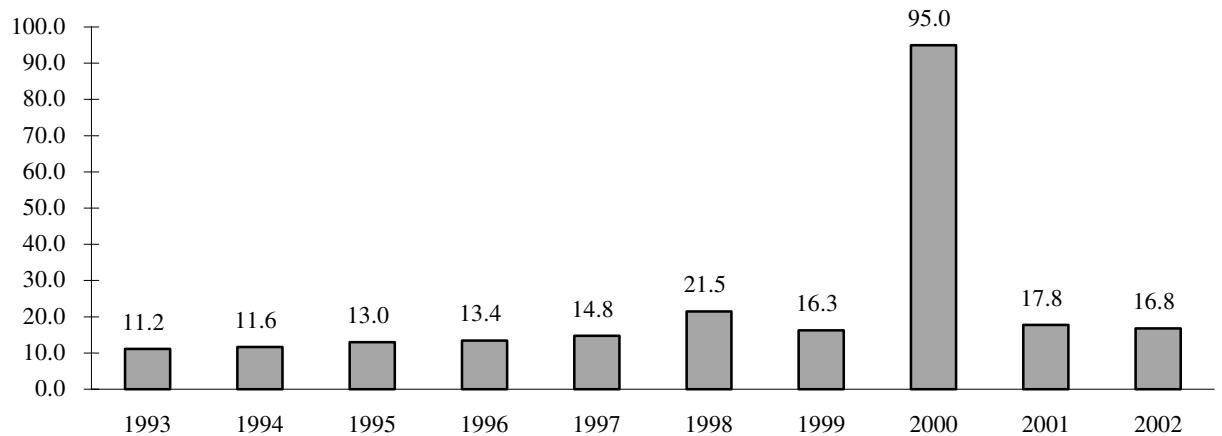
STATISTICAL SECTION

Schedule of Expenses by Type

<u>Fiscal Year Ended Sept. 30</u>	<u>Benefit Payments*</u>	<u>Refunds and Transfers</u>	<u>Administrative Expenses</u>	<u>Total</u>
1993	\$ 10,733,285	\$ 25,639	\$ 399,530	\$ 11,158,454
1994	11,173,171	28,444	436,764	11,638,379
1995	12,404,307	91,861	470,760	12,966,928
1996	12,877,528	16,266	514,406	13,408,200
1997	14,157,040	236,326	395,428	14,788,794
1998	14,660,076	6,641,662	197,743	21,499,481
1999	15,231,572	913,381	148,116	16,293,069
2000	15,711,223	78,765,632	517,046	94,993,901
2001	16,298,650	975,633	500,501	17,774,784
2002	16,329,620	52,862	404,983	16,787,465

*Includes health, dental and vision benefits.

Total Expenses
Year Ended September 30
(In Millions)



STATISTICAL SECTION

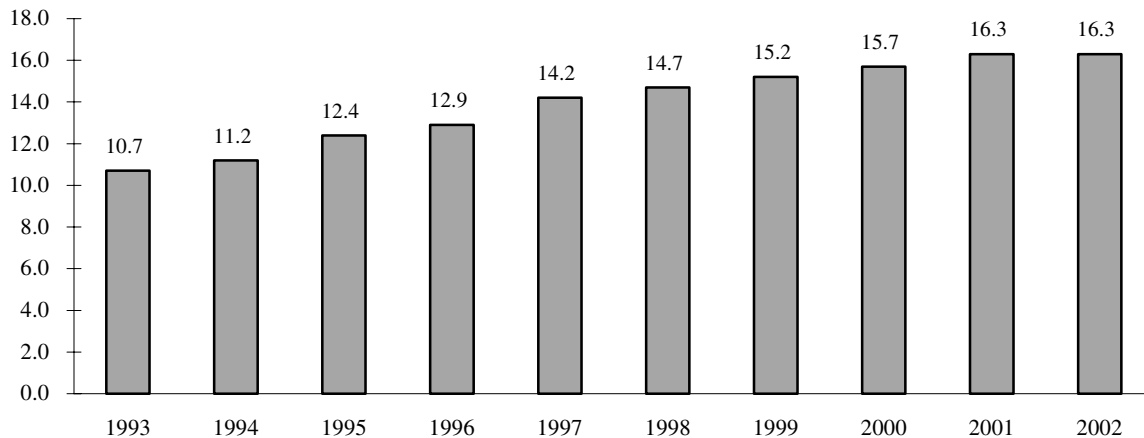
Schedule of Benefit Expenses by Type

<u>Fiscal Year Ended Sept. 30</u>	<u>Regular Benefits</u>	<u>Disability Benefits</u>	<u>Health Benefits**</u>	<u>Total</u>
1993	\$ 10,598,915	*	\$ 134,370	\$ 10,733,285
1994	11,041,755	*	131,416	11,173,171
1995	12,012,426	\$ 273,424	118,457	12,404,307
1996	12,464,285	294,976	118,267	12,877,528
1997	13,491,097	348,192	317,751	14,157,040
1998	13,922,718	381,835	355,523	14,660,076
1999	14,435,420	397,155	398,997	15,231,572
2000	14,818,706	442,172	450,345	15,711,223
2001	15,352,750	440,441	505,459	16,298,650
2002	15,375,626	434,325	519,669	16,329,620

* Disability benefits included with regular benefits

** Includes dental and vision benefits

Total Benefit Expenses
Year Ended September 30
(In Millions)



STATISTICAL SECTION

Schedule of Retired Members by Type of Benefit September 30, 2002

Amount Monthly Benefit	Number of Retirees	Type of Retirement*					Selected Option**		
		1	2	3	4	5	Opt 1	Opt 2	Opt 3
\$ 0-400	9	3	3	3	0	0	9	0	0
401-800	61	15	40	6	0	0	55	6	0
801-1,200	50	26	16	5	3	0	37	12	1
1,201-1,600	61	29	25	7	0	0	49	10	2
1,601-2,000	63	30	21	10	2	0	55	8	0
2,001-2,400	33	17	12	2	2	0	16	17	0
2,401-2,800	40	32	7	0	1	0	33	6	1
2,801-3,200	31	28	2	0	1	0	19	12	0
3,201-3,600	54	49	5	0	0	0	38	15	1
3,601-4,000	66	61	2	1	1	1	57	8	1
Over 4,000	67	63	1	1	2	0	64	3	0
Totals	535	353	134	35	12	1	432	97	6

* Type of Retirement

- 1 - Normal retirement for age & service
- 2 - Survivor payment - Normal retirement
- 3 - Survivor payment - Death in service
- 4 - Non-duty disability retirement
- 5 - Survivor payment - Disability retirement

**Selected Option

- Opt. 1. - Straight life allowance
- Opt. 2 - 100% survivor option
- Opt. 3 - 50% survivor option

Source: Segal Company

STATISTICAL SECTION

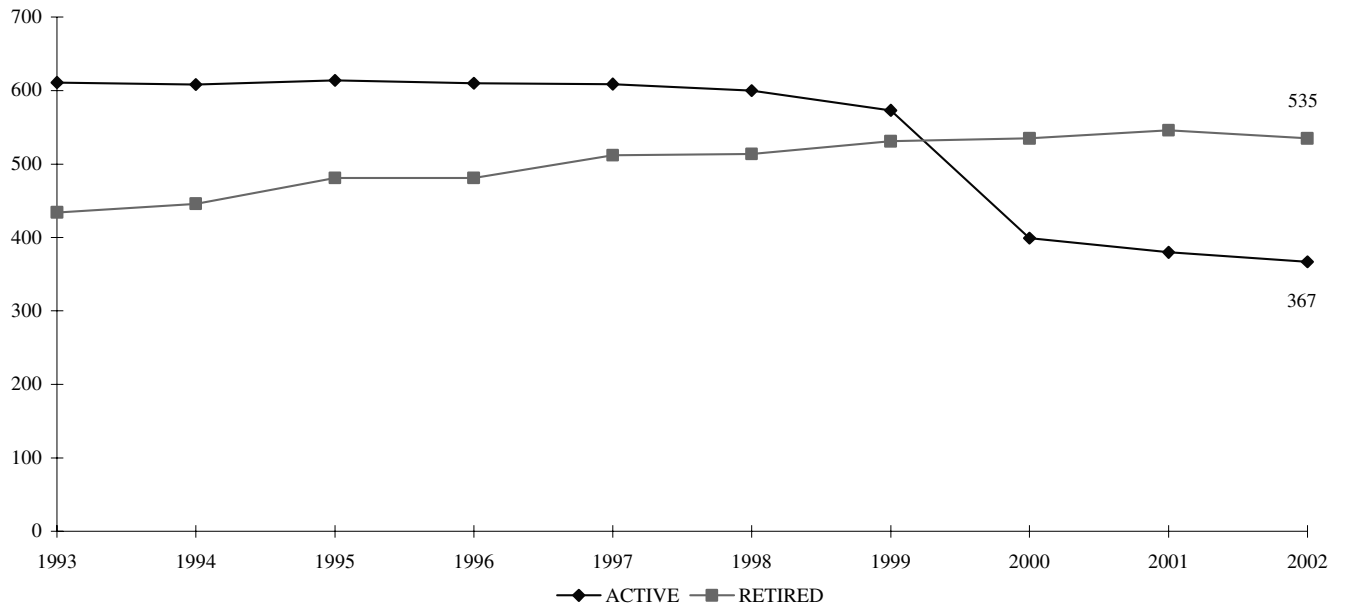
Schedule of Average Benefit Payments

Retirement Effective Dates	Years Credited Service							Total
	0-5	5-10	10-15	15-20	20-25	25-30	30+	
Period 10/1/95 to 9/30/96:								
Average Monthly Benefit	\$ 824	\$ 1,197	\$ 1,555	\$ 2,396	\$ 2,844	\$ 2,327	\$ 2,624	\$ 2,228
Average Final Average Salary	3,900	51,478	46,294	53,387	61,170	52,693	54,972	52,911
Number of Active Retirants	5	26	108	172	108	46	16	481
Period 10/1/96 to 9/30/97:								
Average Monthly Benefit	\$ 911	\$ 1,228	\$ 1,561	\$ 2,472	\$ 2,883	\$ 2,439	\$ 3,089	\$ 2,312
Average Final Average Salary	3,250	54,667	47,584	56,426	62,947	56,764	64,058	55,663
Number of Active Retirants	6	26	110	181	118	50	21	512
Period 10/1/97 to 9/30/98:								
Average Monthly Benefit	\$ 860	\$ 1,161	\$ 1,568	\$ 2,478	\$ 2,942	\$ 2,499	\$ 3,113	\$ 2,325
Average Final Average Salary	2,437	53,853	49,030	57,069	64,355	76,821	63,379	58,228
Number of Active Retirants	8	26	110	180	119	51	20	514
Period 10/1/98 to 9/30/99:								
Average Monthly Benefit	\$ 908	\$ 1,148	\$ 1,630	\$ 2,522	\$ 2,948	\$ 2,476	\$ 3,409	\$ 2,356
Average Final Average Salary	1,950	55,804	50,535	59,340	65,753	76,643	68,504	68,504
Number of Active Retirants	10	29	113	181	127	52	19	531
Period 10/1/99 to 9/30/00:								
Average Monthly Benefit	\$ 923	\$ 1,240	\$ 1,637	\$ 2,588	\$ 2,990	\$ 2,429	\$ 3,477	\$ 2,371
Average Final Average Salary	1,147	58,188	49,653	58,814	66,470	77,869	68,504	58,893
Number of Active Retirants	17	30	112	184	124	49	19	535
Period 10/1/00 to 9/30/01:								
Average Monthly Benefit	\$ 1,144	\$ 1,365	\$ 1,668	\$ 2,618	\$ 3,080	\$ 2,628	\$ 3,761	\$ 2,446
Average Final Average Salary	7,066	59,526	51,362	60,795	67,803	83,459	73,014	60,618
Number of Active Retirants	23	31	109	188	128	47	20	546
Period 10/1/01 to 9/30/02:								
Average Monthly Benefit	\$ 1,144	\$ 1,363	\$ 1,712	\$ 2,618	\$ 3,015	\$ 2,718	\$ 3,904	\$ 2,442
Average Final Average Salary	7,066	60,075	53,476	62,450	67,578	84,054	76,199	61,683
Number of Active Retirants	23	32	109	180	125	47	19	535

Source: Segal Company

STATISTICAL SECTION

Ten Year History of Membership Fiscal Years Ended September 30



Source: Segal Company

STATISTICAL SECTION

Schedule of Participating Employers through 9/30/02

Elected Offices

Supreme Court
Court Of Appeals
Recorders Court
02nd Circuit Court
03rd Circuit Court
04th Circuit Court
05th Circuit Court
06th Circuit Court
07th Circuit Court
08th Circuit Court
09th Circuit Court
10th Circuit Court
12th Circuit Court
13th Circuit Court
14th Circuit Court
15th Circuit Court
16th Circuit Court
17th Circuit Court
18th Circuit Court
20th Circuit Court
21st Circuit Court
22nd Circuit Court
24th Circuit Court
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32nd Circuit Court
34th Circuit Court
35th Circuit Court
36th Circuit Court
37th Circuit Court
38th Circuit Court
39th Circuit Court
41st Circuit Court
40th Circuit Court
42nd Circuit Court
46th Circuit Court
56th Circuit Court
57th Circuit Court
01st District Court
03rd District Court
05th District Court
07th District Court
08th District Court
09th District Court
10th District Court
12th District Court

14th District Court
15th District Court
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17th District Court
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64th District Court
65th District Court
66th District Court
67th District Court
68th District Court
70th District Court
71st District Court
72nd District Court

STATISTICAL SECTION

Schedule of Participating Employers through 9/30/02 (Continued)

73rd District Court	Macomb Probate Court
74th District Court	Mason Probate Court
75th District Court	Mecosta Probate Court
76th District Court	Monroe Probate Court
77th District Court	Montcalm Probate Court
78th District Court	Muskegon Probate Court
79th District Court	Oceana Probate Court
80th District Court	Ogemaw Probate Court
81st District Court	Ontonagon Probate Court
82nd District Court	Oscoda Probate Court
84th District Court	Ottawa Probate Court
85th District Court	Presque Isle Probate Court
86th District Court	Sanilac Probate Court
87th District Court	Shiawassee Probate Court
88th District Court	St Clair Probate Court
90th District Court	St Joseph Probate Court
91st District Court	Washtenaw Probate Court
92nd District Court	Wayne Probate Court
93rd District Court	Wexford Probate Court
94th District Court	
95th District Court	
97th District Court	
98th District Court	
Alcona Probate Court	
Alpena Probate Court	
Barry Probate Court	
Bay Probate Court	
Berrien Probate Court	
Branch Probate Court	
Calhoun Probate Court	
Cass Probate Court	
Chippewa Probate Court	
Clare Probate Court	
Clinton Probate Court	
Crawford Probate Court	
Emmet Probate Court	
Genesee Probate Court	
Gogebic Probate Court	
Houghton Probate Court	
Huron Probate Court	
Ionia Probate Court	
Iosco Probate Court	
Iron Probate Court	
Isabella Probate Court	
Jackson Probate Court	
Kalamazoo Probate Court	
Kent Probate Court	
Lake Probate Court	
Leelanau Probate Court	
Lenawee Probate Court	
Livingston Probate Court	
Mackinac Probate Court	