

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

**Comprehensive Annual Financial Report
for the Fiscal Year Ended September 30, 2003**



M S E R S

**Prepared by:
Financial Services
for
Office of Retirement Services
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INTRODUCTORY SECTION

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The cost of printing this report was \$1,761.03 (\$7.04 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 State Employees' Retirement System

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

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.



President

Executive Director

INTRODUCTORY SECTION

Letter of Transmittal

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

STATE OF MICHIGAN

JENNIFER M. GRANHOLM, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

December 5, 2003

The Honorable Jennifer M. Granholm
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 State Employees' Retirement System (System) for fiscal year 2003.

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 System was established by legislation under Public Act 240 of 1943 (the Michigan State Employees' Retirement Act) and is administered by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System and a list of participating employers 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 State Employees. The services performed by the staff provide benefits to members.

The 2003 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.

INTRODUCTORY SECTION

Letter Of Transmittal (Continued)

MAJOR GOALS ACCOMPLISHED

The Michigan Department of Management and Budget, Office of Retirement Services continues to be resourceful and to drive forward creative innovations that build on our dedication to customer service. Our daily business activities are tied to achieving our mission of delivering pensions, related benefits, and services to promote the future financial security of our customers. In this fiscal year, we have welcomed our new governor and director, deployed the beginnings of our Vision ORS technology solutions, responded to new policies and legislation, and energized and trained our staff on the new tools available to them. Here are some of the highlights.

Focus on our Customer

During the 2003 fiscal year, ORS hosted 9,282 members at our pre-retirement information meetings and personally counseled 7,632 members. This is in addition to the 242,000 members who took advantage of our toll-free phone service for advice and services.

An independently-conducted survey of 519 retirees and active members tells us that our services met or exceeded the expectations of 87% of our customers. This survey was the last in a series of four conducted over the course of a year. The scores for this most recent survey show that our services are more accurate, our information is more useful, and the knowledge of our counselors has risen. We continue to work on providing services faster and on delivering services at the time our customers most need them.

Early in this fiscal year, the legislature passed the Legislative Early Out, or LEO. The bill was signed into law on December 30 with an application deadline of December 31. It affected several hundred members. Within the day, ORS had established temporary headquarters at the House Office Building to distribute, assist with and accept LEO applications. Within 24 hours, ORS received 236 retirement applications, and conducted an informational seminar for 41 members.

A complete review and rewrite of the *State Employees' Retirement System Guidelines* has produced instructional and reference materials that grow with members as their State service matures. Designed sequentially for Defined Benefit Plan members, each book addresses a different employment stage: *Your Retirement Plan* provides an overview of the Defined Benefit Program for all members, *Enhancing Your Pension* is for vested members looking to transfer or buy service credit, *Retirement Readiness* starts the countdown to retirement, and *After You Retire* is delivered with the retirement award letter. A new overview book for Defined Contribution Plan members will be produced this fall. These products start ORS on a path of providing key information to our members at the stage of their employment when it is most needed.

The Health Insurance Portability and Accountability Act (HIPAA) triggered an important awareness of the large amount of private information we handle daily. It gave us the chance to evaluate existing policies and procedures and to ensure that member information is handled confidentially. Where needed, policies were revised and all ORS staff received training on HIPAA provisions.

Optimize Technology and Continuously Improve

State employees were supplied with a new investment tool: the CitiStreet Advisor. This web-based product helps customers set personal retirement goals and recommends savings and investment adjustments. It evaluates CitiStreet investments and allows customers to include spouse's investment information. This is the first of many retirement planning tools that will be offered to help customers plan for their financial future. CitiStreet is the third party administrator and custodian for the deferred compensation/defined contribution plans.

To get the documents that drive our business processed faster, ORS deployed document scanning in our mailroom. With this innovation, documents are received, scanned and indexed, then delivered into electronic in-baskets. Applications, correspondence, insurance changes and other requests are now delivered to the people who make the changes within four hours of receiving the mail.

The challenge of reaching our membership in northern Michigan with quality retirement planning information is now being met with the help of videoconferencing tools. Videoconferencing allows ORS staff to provide face-to-face

INTRODUCTORY SECTION

Letter Of Transmittal (Continued)

presentations for as many as three different locations at the same time. Attendees will be able to see the presenter, view the materials presented (such as Power Point slides and printed documents), and ask questions.

Member surveys and letters, conversations with members and member organizations, and regular discussions with our staff tell us that we are making great strides toward our vision. This success inspires us to continue to improve. The continued deployment of our Vision Project technology will provide even more opportunities to evaluate and improve ORS' service to customers.

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, 2002. 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.

FINANCIAL INFORMATION

Please refer to Management's Discussion and Analysis in the Financial Section for condensed financial information and activities of the current and prior years.

Accounting System

Transactions of the System are reported on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred. Participants' benefits are recorded when payable by law. We believe that the accounting and administrative internal controls established by the System provide reasonable assurance that the System is carrying out its responsibilities in safeguarding its assets, in the reliability of the financial records for preparing the financial statements, and in maintaining accountability for its assets.

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 14.7%. For the last five years, the System has experienced an annualized rate of return of 4.0%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

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

INTRODUCTORY SECTION

Letter Of Transmittal (Continued)

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. Effective in fiscal year 2001, the System used the valuation from the previous fiscal year for this report. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement Number 25. Consistent with this approach, the most recent actuarial valuation was performed as of September 30, 2002. The actuarial value of the assets and actuarial accrued liability of the System were \$10.6 billion and \$10.8 billion, respectively, resulting in a funded ratio of 98.7% at September 30, 2002. 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 retirees. The benefits are funded on a cash or “pay as you go” basis. An actuarial valuation was completed as of September 30, 2002, 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 \$7.8 billion and the employer contribution for health care benefits would be 23.4% of payroll. Only members of the defined benefit plan were included when calculating the actuarial accrued liability.

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 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 year ended September 30, 2002. 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, the 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 State Employees’ Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,



Mitch Irwin, Director
Department of Management and Budget



Christopher M. DeRose, Director
Office of Retirement Services

INTRODUCTORY SECTION

Administrative Organization

Retirement Board Members *

Douglas Drake, Vice Chair
Retiree Member
Term Expires July 31, 2004

George M. Elworth
Representing Attorney General
Statutory Member

D. Daniel McLellan
Representing State Personnel Director
Statutory Member

Janet McClelland
Employee Member
Term Expires July 31, 2005

Dr. James S. Neubecker, Chair
Representing Auditor General
Statutory Member

Mark Haas
Representing State Treasurer
Statutory Member

John Reurink
Retiree Member
Term Expires July 31, 2003

John Schoonmaker
Representing Commissioner of
Finance & Insurance Services
Statutory Member

Janine Winters
Employee Member
Term Expires July 31, 2003

* Statute provides that board members may continue to serve after their term expires until they are either replaced or reappointed.

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

Investment Manager and Custodian

Jay B. Rising
State Treasurer
State of Michigan

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

Legal Advisor

Mike Cox
Attorney General
State of Michigan

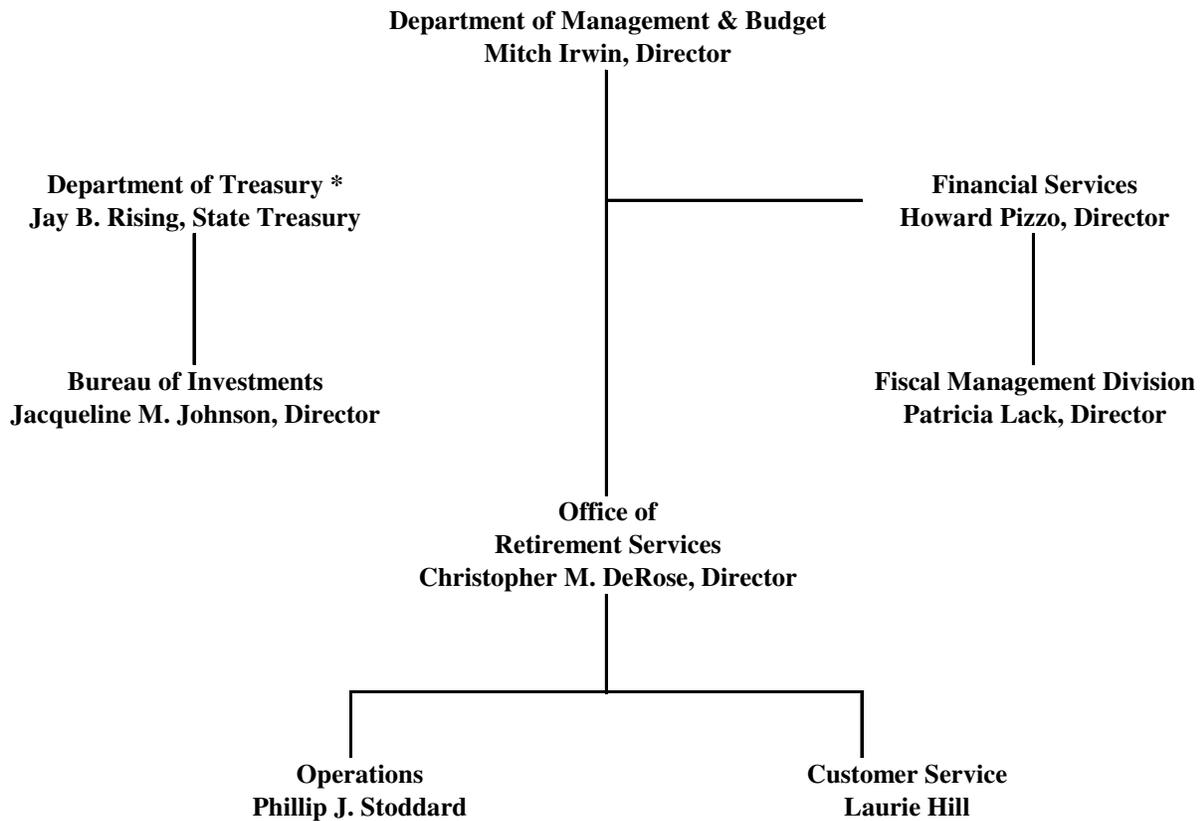
Investment Performance Measurement

CRA RogersCasey
Chicago, Illinois

INTRODUCTORY SECTION

Administrative Organization (Continued)

Organization Chart



* 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.

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

FINANCIAL SECTION

Independent Auditor's Report



ANDREWS HOOPER & PAVLIK P.L.C.
Certified Public Accountants

Mr. Mitch Irwin, Director, Department of Management and Budget
Mr. Christopher M. DeRose, Director, Office of Retirement Services
Mr. Thomas H. McTavish, CPA, Auditor General, Office of the Auditor General
Michigan Public School Employees' Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan Public School Employees' Retirement System, as of September 30, 2003 and 2002, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan Public School Employees' Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Michigan Public School Employees' Retirement System, as of September 30, 2003 and 2002, and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information and supporting schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The required supplementary information and supporting schedules are the responsibility of the Michigan Public School Employees' Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it. The Introductory, Investment, Actuarial, and Statistical Sections were not audited by us and, accordingly, we express no opinion on those sections.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 26, 2003 on our consideration of the Michigan Public School Employees' Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Andrews Hooper & Pavlik P.L.C.

Okemos, Michigan
November 26, 2003

4295 Okemos Road, Suite 200 • Okemos, Michigan 48864 • ph 517.487.5000 fx 517.487.9535 • www.ahpplc.com

Management's Discussion and Analysis

Our discussion and analysis of the Michigan State Employees' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2003. 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 2003 by \$9.0 billion (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 98.7%.
- Revenues for the year were \$1,731.6 million, which is comprised of contributions of \$491.5 million, investment gains of \$1,222.8 million and transfers to Health Advance Funding SubAccount of \$17.3 million.
- Expenses increased over the prior year from \$876.4 million to \$1,136.6 million or 29.7%. Most of this increase represented increased retirement benefits paid.

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 18) and *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* (page 19). 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 SECTION

Management's Discussion and Analysis (Continued)

FINANCIAL ANALYSIS

System total assets as of September 30, 2003, were \$9.2 billion and were mostly comprised of cash, investments, and contributions due from employers. Total assets increased \$443.4 million or 5.1% between fiscal years 2002 and 2003 primarily due to increased investment earnings, and decreased \$1.3 billion or 13.3% between fiscal years 2001 and 2002 primarily due to decreased investment earnings.

Total liabilities as of September 30, 2003, were \$228.0 million and were mostly comprised of warrants outstanding, accounts payable, and obligations under securities lending. Total liabilities decreased \$151.6 million or 39.9% between fiscal years 2002 and 2003 primarily due to a decrease in obligations under securities lending and a decrease in payables from the purchase of investments, and decreased \$74.2 million or 16.4% between fiscal years 2002 and 2001 due to a decrease in obligations under securities lending and payables from the purchase of investments.

System assets exceeded its liabilities at the close of fiscal year 2003 by \$9.0 billion, of which \$54.9 million is for Health Advance Funding SubAccount. Total net assets held in trust for pension and health benefits increased \$595.0 million or 7.1% between fiscal years 2002 and 2003, primarily due to favorable market conditions and an increase in investment earnings. This is in contrast with fiscal year 2002, when net assets decreased by \$1.3 billion or 13.2% from the prior year.

	Net Assets (In Thousands)				
	2003	Increase (Decrease)	2002	Increase (Decrease)	2001
Assets					
Cash	\$ 41,465	105.0 %	\$ 20,224	(54.9) %	\$ 44,800
Receivables	114,178	16.8	97,780	95.0	50,135
Investments	9,038,842	4.7	8,633,038	(13.7)	9,998,337
Total Assets	9,194,485	5.1	8,751,042	(13.30)	10,093,272
Liabilities					
Warrants outstanding	2,570	(10.9)	2,884	(25.1)	3,852
Accounts payable and other accrued liabilities	5,905	(42.6)	10,280	(75.0)	41,161
Obligations under securities lending	219,484	(40.1)	366,352	(10.4)	408,715
Total Liabilities	227,959	(39.9)	379,516	(16.4)	453,728
Net Assets - DC Savings					
SubAccount	-	(100.0)	1,156	-	1,156
Net Assets - Health Advance					
Funding SubAccount	54,888	(37.3)	87,486	-	-
Net Assets - Pension and					
Health Benefits	8,911,638	7.6	8,282,884	(14.1)	9,638,388
Total Net Assets	\$ 8,966,526	7.1 %	\$ 8,371,526	(13.2) %	\$ 9,639,544

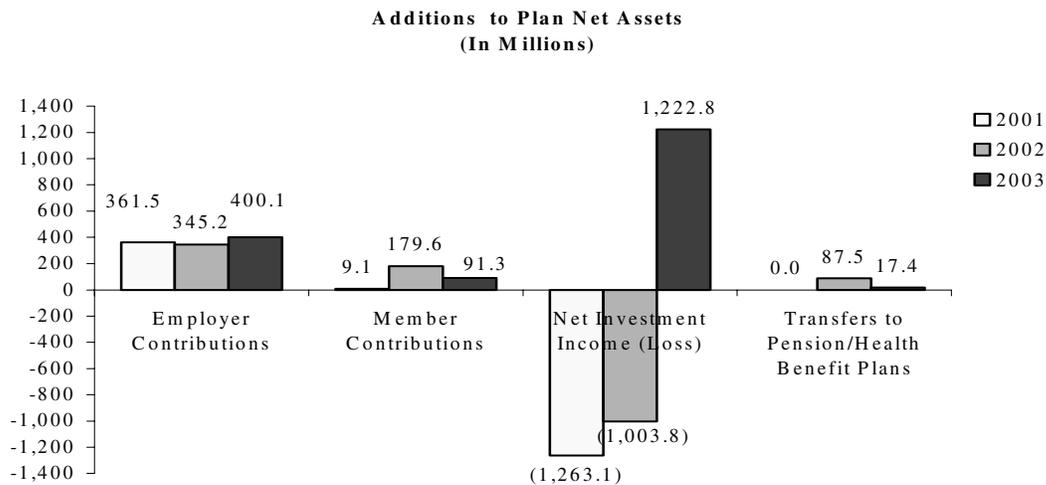
Management's Discussion and Analysis (Continued)

REVENUES - ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2003 totaled \$1,714.3 million. In fiscal year 2003 a transfer of \$17.4 million was made from the Pension Plan to the Health Plan in an effort to begin prefunding expected health care costs.

Total contributions and net investment income increased \$2,193.4 million from those of fiscal year 2002 primarily due to changes in market conditions and investment earnings. Total contributions and net investment income increased \$412.9 million or 46.3% between fiscal years 2001 and 2002 for the same reasons. Total employer contributions increased between fiscal years 2002 and 2003 by \$54.9 million or 15.9%, while member contributions decreased by \$88.2 million or 49.1%. Total employer contributions decreased between fiscal years 2001 and 2002 by \$16.3 million or 4.5%, while member contributions increased by \$170.4 million.

The System is non-contributory; however, members may purchase service credit. The decrease in member contributions for fiscal year 2003 occurred because fewer individuals purchased service credit, as opposed to the increase in member contributions between fiscal years 2001 and 2002, which occurred because more individuals purchased service credit as a result of the 2002 Early Out Retirement incentive. Net investment income increased between fiscal years 2002 and 2003 by \$2,226.7 million. Net investment income increased between fiscal years 2001 and 2002 by \$259.2 million or 20.5%. Transfers to Pension/Health Benefit Plans decreased \$70.1 million or 80.2% between fiscal years 2002 and 2003. Transfers to Pension/Health Benefit Plans increased \$87.5 million between fiscal years 2001 and 2002 as a result of a change in legislation (Public Act 93 of 2002), which created the Health Advance Funding SubAccount. There were no transfers in fiscal year 2001. The notes to the financial statements describe these transfers in more detail. The Investment Section of this report reviews the results of investment activity for 2003.



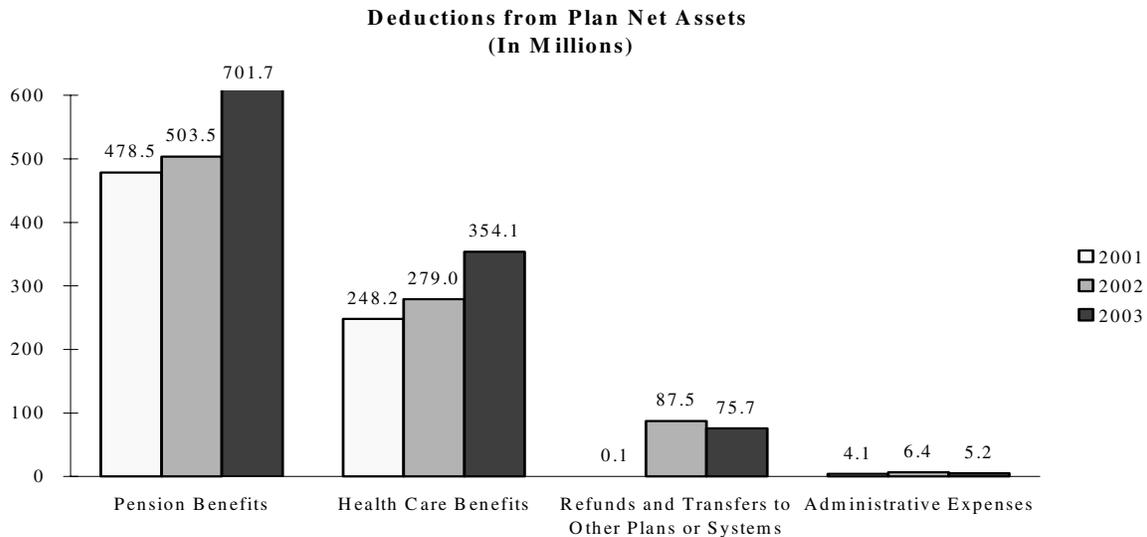
FINANCIAL SECTION

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, refunds of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2003 were \$1,136.6 million, an increase of 29.7% over fiscal year 2002 expenses. Total deductions for fiscal year 2002 were \$788.9 million, an increase of 7.9% over fiscal year 2001 expenses.

The growth of health care expenses continued during the year and increased by \$75.1 million or 26.9% from \$279.0 million to \$354.1 million during the fiscal year. This compares to an increase of \$30.8 million or 12.4% from \$248.2 million to \$279.0 million between fiscal years 2001 and 2002. The payment of pension benefits increased by \$198.2 million or 39.4% between fiscal years 2002 and 2003 and by \$25.0 million or 5.2% between fiscal years 2001 and 2002. In fiscal year 2003, the increase in pension benefit expenses resulted from an increase in retirees (5,825) and an increase in benefit payments to retirees. In fiscal year 2002, the increase in pension benefit expenses resulted from an increase in retirees (2,555) and an increase in benefit payments to retirees. Refunds and transfers to other Plans or Systems decreased by \$11.9 million or 13.6% between fiscal years 2002 and 2003. This compares to an increase of \$87.4 million between fiscal years 2001 and 2002 as a result of a change in legislation (Public Act 93 of 2002), which created the Health Advance Funding SubAccount. The notes to the financial statements describe these transfers in more detail. Administrative expenses decreased by \$1.2 million or 19.3% between fiscal years 2002 and 2003, primarily due to a decrease in building rentals and postage, telephone and other expenses. Administrative expenses increased by \$2.3 million or 55.0% between fiscal years 2001 and 2002, primarily due to an increase in technological/computer operations support and postage, telephone and other expenses.



Management's Discussion and Analysis (Continued)

RETIREMENT SYSTEM AS A WHOLE

The System's combined net assets have once again experienced an increase following decreases in the previous two years. This increase is a result of a moderate national economic upturn that resulted in investment income earnings. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position has improved, in part, 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, 2003 and 2002

	September 30, 2003			September 30, 2002		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Assets:						
Cash	\$ 41,268,402	\$ 196,346	\$ 41,464,748	\$ 19,987,171	\$ 236,347	\$ 20,223,518
Receivables:						
Amounts due from employer	49,355,127	234,821	49,589,948	27,388,034	323,862	27,711,896
Amounts due from employer long term	42,130,383	-	42,130,383	36,102,379	-	36,102,379
Interest and dividends	21,943,727	104,403	22,048,130	32,094,047	379,511	32,473,558
Sale of investments	407,912	1,941	409,853	1,475,184	17,444	1,492,628
Total receivables	113,837,149	341,165	114,178,314	97,059,644	720,817	97,780,461
Investments:						
Short term investments	426,136,586	2,027,461	428,164,047	135,253,542	1,599,367	136,852,909
Bonds and notes	1,519,858,950	7,231,145	1,527,090,095	1,984,066,368	23,461,496	2,007,527,864
Common and preferred stock	3,954,898,982	18,816,513	3,973,715,495	3,372,803,084	39,883,246	3,412,686,330
Real estate and mortgages	849,315,486	4,040,851	853,356,337	860,565,369	10,176,147	870,741,516
Alternative investments	1,175,783,248	5,594,110	1,181,377,358	1,205,401,921	14,253,825	1,219,655,746
International investments	851,602,972	4,051,734	855,654,706	611,985,038	7,236,696	619,221,734
Collateral on loaned securities	218,444,480	1,039,309	219,483,789	362,070,558	4,281,468	366,352,026
Total investments	8,996,040,704	42,801,123	9,038,841,827	8,532,145,880	100,892,245	8,633,038,125
Total assets	9,151,146,255	43,338,634	9,194,484,889	8,649,192,695	101,849,409	8,751,042,104
Liabilities:						
Warrants outstanding	2,558,149	12,171	2,570,320	2,850,426	33,706	2,884,132
Accounts payable and other accrued liabilities	5,877,025	27,962	5,904,987	10,159,496	120,136	10,279,632
Obligations under securities lending	218,444,480	1,039,309	219,483,789	362,070,558	4,281,468	366,352,026
Total liabilities	226,879,654	1,079,442	227,959,096	375,080,480	4,435,310	379,515,790
Net Assets - DC Savings SubAccount			-		1,156,400	1,156,400
Net Assets - Health Advance Funding SubAccount		54,887,456	54,887,456		87,486,128	87,486,128
Net Assets - Pension and Health Benefits	8,924,266,601	(12,628,264)	8,911,638,337	8,274,112,215	8,771,571	8,282,883,786
Net Assets Held in Trust for Pension and Health Benefits*	\$ 8,924,266,601	\$ 42,259,192	\$ 8,966,525,793	\$ 8,274,112,215	\$ 97,414,099	\$ 8,371,526,314

*A schedule of funding progress is presented in the Required Supplementary Information of 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 Fiscal Years Ended September 30, 2003 and 2002

	September 30, 2003			September 30, 2002		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Additions:						
Contributions:						
Member contributions	\$ 80,185,475	\$ 11,144,737	\$ 91,330,212	\$ 173,232,835	\$ 6,326,267	\$ 179,559,102
Employer contributions	79,291,845	320,838,540	400,130,385	87,486,128	257,730,817	345,216,945
Total contributions	159,477,320	331,983,277	491,460,597	260,718,963	264,057,084	524,776,047
Investment income (loss):						
Investment income (loss)	1,231,817,382		1,231,817,382	(989,642,419)		(989,642,419)
Interest income		7,793,128	7,793,128		1,842,164	1,842,164
Investment expenses:						
Real estate operating expenses	(283,623)		(283,623)	(110,434)		(110,434)
Other investment expenses	(17,330,493)		(17,330,493)	(17,873,614)		(17,873,614)
Securities lending activities						
Securities lending income	4,483,644		4,483,644	9,531,880		9,531,880
Securities lending expenses	(3,668,982)		(3,668,982)	(7,638,094)		(7,638,094)
Net investment income (loss)	1,215,017,928	7,793,128	1,222,811,056	(1,005,732,681)	1,842,164	(1,003,890,517)
Transfer to pension/health benefit plans						
		17,364,626	17,364,626		87,486,128	87,486,128
Miscellaneous income						
	261		261	245		245
Total additions	1,374,495,509	357,141,031	1,731,636,540	(745,013,473)	353,385,376	(391,628,097)
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits	701,664,432		701,664,432	503,453,879		503,453,879
Health benefits		327,707,446	327,707,446		257,587,230	257,587,230
Dental/vision benefits		26,377,392	26,377,392		21,411,103	21,411,103
Refunds of member contributions	117,595		117,595	4,870		4,870
Transfer from pension/health benefit plans						
	17,364,626	58,211,100	75,575,726	87,486,128		87,486,128
Transfers to other systems	2,431		2,431	13,461		13,461
Administrative expenses	5,192,039		5,192,039	6,432,819		6,432,819
Total deductions	724,341,123	412,295,938	1,136,637,061	597,391,157	278,998,333	876,389,490
Net Increase (Decrease)	650,154,386	(55,154,907)	594,999,479	(1,342,404,630)	74,387,043	(1,268,017,587)
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	8,274,112,215	97,414,099	8,371,526,314	9,616,516,845	23,027,056	9,639,543,901
End of Year*	\$ 8,924,266,601	\$ 42,259,192	\$ 8,966,525,793	\$ 8,274,112,215	\$ 97,414,099	\$ 8,371,526,314

* A schedule of funding progress is presented in the Required Supplementary Information of 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 State Employees' Retirement System (System) is a cost sharing, multiple-employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State) and created under Public Act 240 of 1943, as amended. The System was established by the State to provide retirement, survivor and disability benefits to the State's government employees. The System is a qualified trust fund under section 401(a) of the Internal Revenue Code. By statute, employees of the following employers are also covered by this plan: American Legion, American Veterans, Disabled American Veterans, Mackinac Island State Park, Marine Corps League, Michigan Bar Association, Military Order of the Purple Heart, Commission for Independent Vendors, Third Circuit Court, Records Court and 36th District Court. Michigan judges and elected officials, legislators, National Guard and state police officers are covered by separate retirement plans.

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 System's 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, 2003 and 2002, the System's membership consisted of the following:

Retirees and beneficiaries currently receiving benefits:		
	2003	2002
Regular benefits	36,324	30,737
Survivor benefits	5,691	5,541
Disability benefits	3,476	3,388
Total	<u>45,491</u>	<u>39,666</u>
Current employees:		
Vested	30,346	35,062
Non-vested	6,356	8,002
Total	<u>36,702</u>	<u>43,064</u>
Inactive employees entitled to benefits and not yet receiving them	7,103	7,917
Total members	<u><u>89,296</u></u>	<u><u>90,647</u></u>

Enrollment in the health plan is voluntary. The number of participants is as follows:

Health/Dental/Vision Plan	2003	2002
Eligible participants:	45,491	39,666
Participants receiving benefits:		
Health	41,288	36,209
Dental	40,999	35,734
Vision	41,128	35,856

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

At September 30, 2003, the System recognized 116 participants in the Defined Contribution (DC) Plan who elected to retire under the Early Out Retirement program. This program provided a .25% incentive for those DC members who qualified, which will be provided by the System. These 116 participants have not been included in the pension membership schedule on the previous page.

BENEFIT PROVISIONS

Introduction

Benefit provisions of the defined benefit pension plan are established by State statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average 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 duty disability, non-duty disability and survivor benefits.

A member who has separated from employment may request a refund of his or her member contribution account. (The System is currently non-contributory.) A refund may cancel a former member's rights to future benefits. However, former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution plan. The Public Act allows returning employees and members who left State employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

Regular Retirement

The retirement benefit is based on a member's years of credited service (employment) and final average compensation. The normal benefit equals 1.5% of a member's final average compensation multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Final average compensation is the average of a member's monthly pay during 36 consecutive months of credited service. The 36 consecutive month period producing the highest monthly average is used. For most members, this is the last three years of employment.

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

1. age 60 with 10 or more years of credited service; or
2. age 55 with 30 or more years of credited service; or
3. age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

1. age 51 with 25 or more years in a covered position; or
2. age 56 with 10 or more years in a covered position.

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

Employees of closing Department of Community Health facilities are eligible for retirement under one of the following conditions:

1. age 51 with 25 years of service, the last 5 of which were rendered in the closing facility;
2. age 56 with 10 years of service, the last 5 of which were rendered in the closing facility; or
3. 25 years of service at the closing facility regardless of age.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Employees of the State Accident Fund, Michigan Biologic Products, or Liquor Control Commission who were terminated as the result of privatization may retire if the member's age and length of service was equal to or greater than 70 on the date of transfer or termination.

Conservation Officers (CO) with a hire date on or before April 1, 1991, are eligible to retire after 25 years of service, 20 of which must have been rendered as a CO. COs hired after April 1, 1991, and before March 31, 1997, must have 23 years of service as a CO to be eligible for a full retirement with only 25 years of service. In either case, 2 years immediately preceding retirement must be as a CO.

Deferred Retirement

Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after 5 years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Department of Community Health employees subject to reduction in force lay-offs by reason of deinstitutionalization.

Non-Duty Disability Benefit

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a State employee is eligible for a non-duty disability pension. The non-duty disability benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.

Duty Disability Benefit

A member who becomes totally and permanently disabled from performing duties as a State employee as a direct result of State employment and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. If the member is under age 60, the duty disability allowance is a maximum payment of \$6,000 payable annually. At age 60 the benefit is recomputed under service retirement.

Survivor Benefit

Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit.

Pension Payment Options

When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75% or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

Regular Pension — The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

100% Survivor Pension — 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. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

75% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 75% 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. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension — 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 lower than the factor used in the 100% or 75% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension — An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75% or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the Social Security Administration Office. In order to calculate this benefit, members choosing this option must provide ORS with an estimate from the Social Security Administration Office. The actual amount received from social security may vary from the estimate.

Post Retirement Adjustments

One-time upward benefit adjustments were made in 1972, 1974, 1976, 1977 and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of \$25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987, are not eligible for the supplemental payment.

Contributions

Member Contributions — Members currently participate in the System on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates the System 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.

Employer Contributions — The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles so the contribution rates do not have to increase over time.

Transfers to Defined Contribution Plan

During fiscal year 1998, the Michigan State Employees' Retirement Act provided members an opportunity to transfer to the Defined Contribution Plan. This was a one-time opportunity and the decision is irrevocable. The transfer must have been completed by September 30, 1998. With the passage of the legislation permitting the transfer, the System also became a closed system. All new employees are members of the Defined Contribution Plan.

Other Postemployment Benefits

Under the Michigan State Employees' Retirement Act, all retirees have the option of receiving health, prescription, dental, and vision coverage. The employer funds health benefits on a pay-as-you-go basis. Retirees with this coverage contribute 5% and 10% of the monthly premium amount for the health (including prescription coverage), dental and

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

vision coverage, respectively. The employer's payroll contribution rate to provide this benefit was 12.5% and 9.0% for fiscal years 2003 and 2002, respectively.

Retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage, \$1,000 for spouse and \$1,000 for each dependent under age 23. Premiums are fully paid by the State.

Early Out Retirement

In February 2002, former Governor John Engler proposed an early out retirement for qualified State employees. Approximately 2,850 State Employees retired by the end of the fiscal year 2002 and an additional 5,160 State employees retired in fiscal year 2003 under this program. Among those members who qualify are Tier 1 (defined benefit) participants and those former members who made an election under section 50 of Public Act 240 of 1943, as amended, to terminate membership in Tier 1 and transfer to become a qualified participant in Tier 2 (defined contribution). Upon their retirement, qualified Tier 2 participants shall receive a retirement allowance equal to the member's number of years of service and fraction of a year of credited service multiplied by .25% of his or her final compensation. For purposes of this section, such individuals shall be considered members of Tier 1 for the limited purpose of receiving a retirement allowance calculated under this section and paid by the System. This allowance will be paid from employer contributions to the System.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

The System's financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue when due and payable. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Reserves

Public Act 240 of 1943, as amended, created the employees' savings reserve, pension reserve, employer's accumulation reserve, income account and expense account, and health insurance reserve. The financial transactions of the System are recorded in these accounts as required by Public Act 240 of 1943, as amended.

Reserve for Employee Contributions — Members no longer contribute to this fund except to purchase eligible service credit or repay previously refunded contributions. This fund represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members and unclaimed amounts transferred to the income account. At September 30, 2003, and 2002, the balance in this account was \$152.5 million and \$199.5 million, respectively.

Reserve for Employer Contributions — All employer contributions are credited to this reserve. Interest from the income account is credited annually. Amounts are transferred annually from this reserve to the Pension Reserve to fund that reserve. At September 30, 2003, and 2002, the balance in this account was \$3.0 billion and \$3.6 billion, respectively.

Reserve for Retired Benefit Payments — This 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 Employee Savings Reserve. Monthly benefits, which are paid to the retiree, reduce the reserve. At the end of each fiscal year, an amount determined by an annual actuarial valuation is transferred from the Employer's Accumulation Reserve to this reserve to bring the reserve into balance with the actuarial present value of retirement allowances. At September 30, 2003, and 2002, the balance in this account was \$5.2 billion and \$4.5 billion, respectively.

Reserve for Undistributed Investment Income — The income account is credited with all investment earnings. Interest is transferred annually to the reserves. Administrative expenses are paid from the expense account. The legislature appropriates the funds necessary to defray and cover the administrative expenses of the System. At September 30, 2003, and 2002, the net balance of these accounts was \$523.2 million and (\$37.2 million), respectively.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Reserve for Health Related Benefits — This fund is credited with employee and employer contributions for retirees' health (including prescription coverage), dental, and vision benefits and interest is allocated on the beginning balance. Premiums for health, dental, and vision benefits are paid from this fund. At September 30, 2003, and 2002, the unrestricted balance in this reserve was (\$12.6) million and \$8.8 million, respectively.

Health Advance Funding SubAccount — This funding subaccount was created by Public Act 93 of 2002 as a means to begin pre-funding, on an actuarial basis, health benefits for participants in the System. Any amounts received in the Health Advance Funding Subaccount (HAFS) and accumulated earnings on those amounts shall not be expended until the actuarial accrued liability for health benefits under section 20d of PA 93 is at least 100% funded. However, the System may also transfer an amount from the HAFS to the employer's accumulation fund (reserve for employer contributions) under certain conditions described in the enabling legislation. At September 30, 2003, and 2002, this amount was \$54.9 million and \$87.5 million, respectively.

DC Savings SubAccount — The savings in employer contributions attributable to the transfer to the Defined Contribution Retirement Plan were recorded in this subaccount for fiscal years prior to 2003. Public Act 93 of 2002 created the Health Advance Funding SubAccount (HAFS) and changed the statute to require any transfers of savings to be placed in the HAFS. As of September 30, 2003, and 2002, the balance in this subaccount was \$0 and \$1.2 million, respectively.

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 or other organizations. 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 reported 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 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.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Cost 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 and Postemployment Healthcare Plan Net Assets. Such assets are depreciated on a straight line basis over 10 years. As of September 30 1998, all capitalized equipment was fully depreciated. No additional equipment has been capitalized for the System since that date.

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>2003</u>	<u>2002</u>
Building Rentals	\$ 133,113	\$ 392,866
Technological Support	1,473,399	1,668,565
Attorney General	241,452	141,206
Investment Services	1,956,201	2,065,440
Personnel Services	1,409,713	1,760,220

Commitment and Contingency — The State has signed a contract with a vendor for technological support through 2004. As of September 30, 2003, the System's portion of this commitment remaining is approximately \$2.3 million.

Cash — On September 30, 2003, and 2002, the System had \$41.5 million and \$20.2 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 \$.4 million and \$.5 million for the years ended September 30, 2003, and 2002, respectively.

Reclassification of Prior Year Amounts

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

NOTE 3 - CONTRIBUTIONS

Members currently participate in the System on a non-contributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service such as military service or maternity leave. Effective August 1, 1998, the retirement act was amended to permit a "universal buy-in." With a universal buy-in, a member may elect to purchase no more than 5 years of service credit (less other service credit purchased). The State is required by Public Act 240 of 1943, as amended, to contribute amounts necessary to finance the benefits of its employees. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. The unfunded (overfunded) actuarial accrued liability is amortized over a 34-year period for the 2002 fiscal year and a 33-year period for the 2003 fiscal year.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Actual employer contributions for retirement benefits were \$79.3 million and \$87.5 million for fiscal years 2003 and 2002, respectively, representing 4.1% of annual covered payroll for the year ended September 30, 2002. The fiscal year 2003 annual covered payroll is not yet available. Pursuant to Public Act 93 of 2002, a transfer was made into the Health Advance Funding SubAccount within the Health Plan in the amount of \$87.5 million. The transfer would effectively bring the Pension Plan contributions to \$0 at September 30, 2002. During fiscal year 2003 \$58.2 million, the general fund portion of the \$87.5 million transfer to the subaccount, was returned to the State's general fund to assist in correcting a projected budget shortfall. In addition, pursuant to section 20d of the same Public Act, a transfer of \$17.4 million was made from the pension plan into the health plan that represents the cost savings that have accrued to the State as a result of the implementation of Public Act 487 of 1996. This act created the Defined Contribution plan for State employees hired after March 31, 1997. Required employer contributions for pensions included:

1. \$172.9 million and \$173.8 million for fiscal years 2003 and 2002, respectively, for the normal cost of pensions representing 8.1% (before reconciliation) of annual covered payroll for fiscal year 2002.
2. \$11.3 million and (\$62.3) million for fiscal years 2003 and 2002, respectively, for amortization of overfunded actuarial accrued liability representing (2.9%) (before reconciliation) of annual covered payroll for fiscal year 2002.

The System is required to reconcile with actuarial requirements annually. Any funding excess or deficiency is smoothed over 5 years. One fifth (20%) of the funding excess or deficiency is included in the subsequent years' contribution, and is not recognized as a payable or receivable in the accounting records.

In March 2001, the Internal Revenue Service issued a private letter ruling allowing the System's members to purchase service credit and repay refunds using tax-deferred (pre-tax) dollars. The program was implemented and payments began in fiscal year 2002.

The program allows members to purchase service credit and repay refunds on a tax-deferred basis. Members sign an irrevocable agreement that identifies the contract duration, monthly payment, total contract amount and years of service credit being purchased. The duration of the contract can range from 1 to 20 years. The amounts are withheld from the members' paycheck and are treated as employer pick-up contributions pursuant to Internal Revenue Code Section 414(h). At September 30, 2003, and September 30, 2002 there were 4,125 and 4,195 agreements, respectively. Agreement amounts that will not be collected within 12 months are discounted using the assumed actuarial rate of return of 8%. The average length of a contract was approximately 14 and 11.5 years for 2003 and 2002. The short-term receivable was \$8.7 million and the discounted long-term receivable was \$42.1 million at September 30, 2003. At September 30, 2002, the short-term receivable was \$12.2 million and the discounted long-term receivable was \$36.1 million.

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.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5.0% of the System's assets in small businesses having more than one-half of its assets or employees in Michigan as described in section 20(a) of the act and up to 20.0% 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.

Derivatives

The State Treasurer does not employ the use of derivatives in the investment of 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 10.0% 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 15.0% 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 9.0% of market value of total assets on September 30, 2003, and 7.5% of market value of total assets on September 30, 2002.

To diversify the pension fund's portfolio, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in the United States and twenty-two foreign countries. The notional amounts of the swap agreements at September 30, 2003, and 2002 were \$870.0 million and \$875.1 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 maturities range from October 2003 to September 2006. 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 upon the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over \$139.1 million of gains on equity exposure and excess interest received have been realized on matured swap agreements. The unrealized loss of \$69.0 million at September 30, 2003, 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.

The respective September 30, 2003, and 2002 values are as follows:

	<u>Notional Value</u>	<u>Current Value</u>
9/30/2003 (dollars in millions)	\$ 870.0	\$ 801.3
9/30/2002 (dollars in millions)	875.1	599.3

The amounts shown above 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, 2003, or 2002.

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

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 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 loans 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 of other qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2003, such investment pool had an average duration of 81 days and an average weighted maturity of 420 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, 2003, the System had no credit risk exposure to borrowers. The cash collateral, non-cash collateral, and market value of securities on loan for the System as of September 30, 2003, was \$219,483,789, \$6,725,702 and \$220,339,705, respectively.

Gross income from security lending for the fiscal year was \$4,483,644. Expenses associated with this income amounted to \$3,408,849 for the borrower's rebate and \$260,133 for fees paid to the agent.

Categories of Investment Risk

Investments made by the fund are summarized on the following page. The investments 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, 2003, 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 market value:

FINANCIAL SECTION

Notes to Basic Financial Statements (Continued)

<u>Category 1</u>	<u>2003</u>	<u>2002</u>
Prime Commercial Paper	\$ 428,164,047	\$ 136,852,909
Government Securities	801,209,905	958,640,784
Corporate Bonds & Notes	605,932,406	797,838,148
Common Stock & Preferred Stock	3,870,055,613	3,289,361,791
Alternative Investments ²	9,889,424	15,875,556
International Investments ³	792,311,737	599,320,743
Total Category 1	\$ 6,507,563,132	\$ 5,797,889,931
<u>Category 3</u>		
Government Securities	\$ 10,121,938	\$ 20,750,001
<u>Non-Categorized</u>		
Real Estate & Mortgages ¹	\$ 853,356,337	\$ 870,741,516
Alternative Investments ²	1,171,420,107	1,203,780,190
International Investments ³	56,556,819	19,900,991
Cash Collateral	219,483,789	366,352,026
Securities on Loan:		
Government Securities	91,508,864	210,540,069
Corporate Bonds & Notes	18,316,982	19,758,862
Alternative Investments ²	67,827	-
International Investments ³	6,786,150	-
Common Stock	103,659,882	123,324,539
Total Non-Categorized	\$ 2,521,156,757	\$ 2,814,398,193
Grand Total	\$ 9,038,841,827	\$ 8,633,038,125

¹ Non-Categorized Real Estate consists of investments through various legal entities.

² In Category 1, the Alternative Investments are small-cap equities. Non-Categorized Alternative Investments consist of limited partnerships and securities on loan.

³ In category 1, the International Investments consist of International Swap Derivatives and ADRs (American Depository Receipts). The Non-Categorized International Investments consist of Primary Market and Extended Market Index Funds and securities on loan.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

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. These 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 ⁽¹⁾ (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)
1993 ⁽²⁾	\$ 5,044	\$ 6,173	\$ 1,129	81.7 %	\$ 2,261	49.9 %
1994 ⁽⁴⁾	5,476	6,560	1,084	83.5	2,351	46.1
1995	6,090	6,861	771	88.8	2,431	31.7
1996	6,678	7,147	469	93.4	2,515	18.7
1997	7,516	8,213	697	91.5	2,273	30.7
1997 ⁽³⁾	8,834	8,101	(733)	109.0	2,273	(32.2)
1998	9,109	8,374	(735)	108.8	2,108	(34.9)
1998 ⁽³⁾	9,109	8,497	(612)	107.2	2,108	(29.0)
1999	9,648	9,029	(619)	106.9	2,214	(28.0)
2000	10,337	9,474	(863)	109.1	2,254	(38.3)
2001	10,633	9,878	(755)	107.6	2,231	(33.8)
2002	10,616	10,753	137	98.7	2,133	6.4

⁽¹⁾ Based on entry age normal actuarial method.

⁽²⁾ Revised asset valuation method.

⁽³⁾ Revised actuarial assumptions and revised asset valuation method.

⁽⁴⁾ 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 Contribution</u>	<u>Percentage Contributed</u>
1994	\$ 230,231,706	\$ 263,791,739	114.6 %
1995	260,769,716	306,488,437	117.5
1996	262,458,665	285,766,953	108.9
1997	244,102,003	288,366,799	118.1
1998	126,396,181	145,734,677	115.3
1999	111,415,984	121,119,857	108.7
2000	120,906,261	121,817,366	100.8
2001	102,989,963	112,299,808	109.0
2002	111,551,549	87,486,128 *	78.4
2003	184,214,419	79,291,851	43.0 **

* Employer contributions for fiscal year 2002 were transferred at year-end into the Health Advance Funding SubAccount established under Public Act 93 of 2002. PA 93 states in part that, "For each fiscal year that begins on or after October 1, 2001, if the actuarial valuation prepared ... demonstrates that as of the beginning of the fiscal year, and after all credits and transfers required by this act for the previous fiscal year have been made ... the annual level percent of payroll contribution rate ... may be deposited into the Health Advance Funding Subaccount..." Pursuant to this legislation, a transfer was made into the subaccount in the amount of \$87.5 million. The transfer would effectively bring the contribution percentage to 0.0% for the fiscal year ended September 30, 2002.

** The ARC and percentage contributed are due to the \$87.5 million transfer in fiscal year 2002 and an additional transfer of \$17.4 million into the Health Advance Funding Subaccount in fiscal year 2003.

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% - 16%
Cost-of-Living Adjustments	3% Annual Non-Compounded with Maximum Annual Increase of \$300 for those eligible

FINANCIAL SECTION

Supporting Schedules

Pension Plan Administrative Expenses For the Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Personnel Services:		
Staff Salaries	\$ 1,042,927	\$ 1,403,102
Retirement and Social Security	217,904	194,325
Other Fringe Benefits	148,882	162,793
Total	<u>1,409,713</u>	<u>1,760,220</u>
Professional Services:		
Actuarial	120,195	97,919
Attorney General	241,452	141,206
Audit	40,763	38,446
Consulting	239,655	138,191
Medical	348,983	376,780
Total	<u>991,048</u>	<u>792,542</u>
Building Equipment		
Building Rentals	133,113	392,866
Equipment Purchase, Maintenance, and Rentals	37,447	221,192
Total	<u>170,560</u>	<u>614,058</u>
Miscellaneous:		
Travel and Board Meetings	6,824	10,860
Office Supplies	12,170	33,377
Postage, Telephone and Other	1,065,288	1,457,627
Printing	63,037	95,570
Technological Support	1,473,399	1,668,565
Total	<u>2,620,718</u>	<u>3,265,999</u>
Total Administrative Expenses	<u>\$ 5,192,039</u>	<u>\$ 6,432,819</u>

Supporting Schedules (Continued)

Schedule of Investment Expenses

	<u>2003</u>	<u>2002</u>
Real Estate Operating Expenses	\$ 283,623	\$ 110,434
Securities Lending Expenses	3,668,982	7,638,094
Other Investment Expenses*	<u>17,330,493</u>	<u>17,873,614</u>
Total Investment Expenses	<u>\$ 21,283,098</u>	<u>\$ 25,622,142</u>

* See Investment Section for fees paid to investment professionals.

Schedule of Payments to Consultants

	<u>2003</u>	<u>2002</u>
Independent Auditors	\$ 40,763	\$ 38,446
Consulting	239,655	138,191
Medical	348,983	376,780
Attorney General	241,452	141,206
Actuary	<u>120,195</u>	<u>97,919</u>
Total Payment to Consultants	<u>\$ 991,048</u>	<u>\$ 792,542</u>

FINANCIAL SECTION

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits) For the Year Ended September 30, 2003

	Employee Contributions	Employer Contributions	Retired Benefit Payments	Undistributed Investment Income	Health Related Benefits *	Total
Additions:						
Contributions:						
Member contributions	\$ 80,185,475				\$ 11,144,737	\$ 91,330,212
Employer contributions		\$ 79,291,845			320,838,540	400,130,385
Total Contributions	<u>80,185,475</u>	<u>79,291,845</u>	-	-	<u>331,983,277</u>	<u>491,460,597</u>
Investment income (loss):						
Investment income (loss)				\$ 1,231,817,382		1,231,817,382
Interest Income					7,793,128	7,793,128
Investment expenses:						
Real estate operating expenses				(283,623)		(283,623)
Other investment expenses				(17,330,493)		(17,330,493)
Securities lending activities:						
Securities lending income				4,483,644		4,483,644
Securities lending expenses				(3,668,982)		(3,668,982)
Net investment income (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,215,017,928</u>	<u>7,793,128</u>	<u>1,222,811,056</u>
Transfer to pension/health benefit plans					17,364,626	17,364,626
Miscellaneous income				261		261
Total additions	<u>80,185,475</u>	<u>79,291,845</u>	<u>-</u>	<u>1,215,018,189</u>	<u>357,141,031</u>	<u>1,731,636,540</u>
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			701,664,432			701,664,432
Health benefits					327,707,446	327,707,446
Dental/vision benefits					26,377,392	26,377,392
Refunds of member contributions	60,536	57,059				117,595
Transfer from pension/health benefit plans		17,364,626			58,211,100	75,575,726
Transfers to other systems	2,431					2,431
Administrative expenses				5,192,039		5,192,039
Total deductions	<u>62,967</u>	<u>17,421,685</u>	<u>701,664,432</u>	<u>5,192,039</u>	<u>412,295,938</u>	<u>1,136,637,061</u>
Net Increase (Decrease)	<u>80,122,508</u>	<u>61,870,160</u>	<u>(701,664,432)</u>	<u>1,209,826,150</u>	<u>(55,154,907)</u>	<u>594,999,479</u>
Other Changes in Net Assets:						
Interest allocation	475,622	363,825,854	285,117,574	(649,419,050)		-
Transfers upon retirement	(127,616,295)		127,616,295			-
Transfers of employer shares		(964,174,470)	964,174,470			-
Total other changes in net assets	<u>(127,140,673)</u>	<u>(600,348,616)</u>	<u>1,376,908,339</u>	<u>(649,419,050)</u>	<u>-</u>	<u>-</u>
Net Increase (Decrease) After Other Changes	<u>(47,018,165)</u>	<u>(538,478,456)</u>	<u>675,243,907</u>	<u>560,407,100</u>	<u>(55,154,907)</u>	<u>594,999,479</u>
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:						
Beginning of Year	<u>199,489,598</u>	<u>3,563,969,678</u>	<u>4,547,823,172</u>	<u>(37,170,233)</u>	<u>97,414,099</u>	<u>8,371,526,314</u>
End of Year	<u>\$ 152,471,433</u>	<u>\$ 3,025,491,222</u>	<u>\$ 5,223,067,079</u>	<u>\$ 523,236,867</u>	<u>\$ 42,259,192</u>	<u>\$ 8,966,525,793</u>

* Includes Health Advance Funding SubAccount

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 Benefit Payments	Undistributed Investment Income	Health Related Benefits *	Total
Additions:						
Contributions:						
Member contributions	\$ 173,232,835				\$ 6,326,267	\$ 179,559,102
Employer contributions		\$ 87,486,128			257,730,817	345,216,945
Total Contributions	<u>173,232,835</u>	<u>87,486,128</u>	-	-	<u>264,057,084</u>	<u>524,776,047</u>
Investment income (loss):						
Investment income (loss)				\$ (989,642,419)		(989,642,419)
Interest Income					1,842,164	1,842,164
Investment expenses:						
Real estate operating expenses				(110,434)		(110,434)
Other investment expenses				(17,873,614)		(17,873,614)
Securities lending activities:						
Securities lending income				9,531,880		9,531,880
Securities lending expenses				(7,638,094)		(7,638,094)
Net investment income (loss)	-	-	-	<u>(1,005,732,681)</u>	<u>1,842,164</u>	<u>(1,003,890,517)</u>
Transfer to Health Advance						
Funding SubAccount					87,486,128	87,486,128
Miscellaneous income				245		245
Total additions	<u>173,232,835</u>	<u>87,486,128</u>	<u>-</u>	<u>(1,005,732,436)</u>	<u>353,385,376</u>	<u>(391,628,097)</u>
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			\$ 503,453,879			503,453,879
Health benefits					257,587,230	257,587,230
Dental/vision benefits					21,411,103	21,411,103
Refunds of member contributions	4,870					4,870
Transfer from Health Advance						
Funding SubAccount		87,486,128				87,486,128
Transfers to other systems	13,461					13,461
Administrative expenses				6,432,819		6,432,819
Total deductions	<u>18,331</u>	<u>87,486,128</u>	<u>503,453,879</u>	<u>6,432,819</u>	<u>278,998,333</u>	<u>876,389,490</u>
Net Increase (Decrease)	<u>173,214,504</u>	<u>-</u>	<u>(503,453,879)</u>	<u>(1,012,165,255)</u>	<u>74,387,043</u>	<u>(1,268,017,587)</u>
Other Changes in Net Assets:						
Interest allocation	850,368	276,514,424	360,653,781	(638,018,573)		-
Transfers upon retirement	(13,475,963)		13,475,963			-
Transfers of employer shares		(168,975,042)	168,975,042			-
Total other changes in net assets	<u>(12,625,595)</u>	<u>107,539,382</u>	<u>543,104,786</u>	<u>(638,018,573)</u>	<u>-</u>	<u>-</u>
Net Increase (Decrease) After Other Changes	160,588,909	107,539,382	39,650,907	(1,650,183,828)	74,387,043	(1,268,017,587)
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:						
Beginning of Year	<u>38,900,689</u>	<u>3,456,430,296</u>	<u>4,508,172,265</u>	<u>1,613,013,595</u>	<u>23,027,056</u>	<u>9,639,543,901</u>
End of Year	<u>\$ 199,489,598</u>	<u>\$ 3,563,969,678</u>	<u>\$ 4,547,823,172</u>	<u>\$ (37,170,233)</u>	<u>\$ 97,414,099</u>	<u>\$ 8,371,526,314</u>

* Includes Health Advance Funding SubAccount

INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments
Jaqueline M. Johnson, 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 (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, CFA (public member), David Hollister (ex-officio member), and Mitch Irwin (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. Maintain sufficient diversification to avoid large losses and preserve capital.
3. Achieve the optimal rate of return possible within prudent levels of risk and liquidity.
4. Meet or exceed the actuarial assumption over the long term.
5. Perform in the top half of the CRA RogersCasey public plan universe over the long term.
6. Exceed individual asset class benchmarks over the long term.
7. Operate in a cost-effective manner relative to peers.

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>	As of 9/30/03		<u>Five-Year Target %</u>
	<u>Security Type</u>	<u>Strategy *</u>	
Domestic Equity	44.8%	46.1%	45.0%
International Equities - Passive	9.7%	9.7%	9.0%
Fixed Income	17.3%	18.1%	21.0%
Real Estate and Mortgages	9.6%	9.7%	10.0%
Alternative Investments	13.3%	13.5%	12.0%
Short Term Investments	<u>5.3%</u>	<u>2.9%</u>	<u>3.0%</u>
TOTAL	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

* The Strategy column reflects the investment strategies and includes allocated short term, which is directly comparable to the Five-Year Target.

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 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 Act 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 restructures 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, 2003, the total fund's rate of return was 14.7% as compiled by CRA RogersCasey. Annualized rates of return for the three-year period ending September 30, 2003, were -3.1%; for the five-year period were 4.0%; and for the ten-year period were 8.3%.

Returns were calculated using a time-weighted rate of return based on the market 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 reported return.

The solid returns were the result of strong performance by our equity portfolios. At the end of fiscal year 2002 and the first quarter of fiscal year 2003, investment staff increased the fund's weightings in depressed equity markets. This allowed the fund to benefit from the significant recovery experienced in equity markets as the year unfolded.

The U.S. economy gathered momentum in fiscal year 2003, except for the March quarter, which was buffeted by the headwinds of severe weather, the threat of war, high energy prices, and SARS. Growth resumed in the June quarter when weather patterns normalized, Baghdad fell quickly, energy prices stabilized, and SARS appeared contained. The economy was supported by the American consumer who took advantage of rising home values and very low interest rates. Corporate earnings rebounded at a double-digit rate, boosted by relentless cost cutting.

The Federal Reserve provided stimulus by lowering interest rates in November 2002 and again in June 2003, taking the Fed Funds rate to 1.00%, a level not seen since the 1950s. Inflation, as measured by the CPI, remained low at an annualized rate of 2.3%.

For the fiscal year, the Dow Jones Industrial provided a total return of 25.1%, while the broader S&P 500 returned 24.4%. The Lehman Brothers U.S. Aggregate Bond Index appreciated 6.5%.

The fund is well-positioned to benefit from continued economic recovery. It remains well-diversified both across and within asset classes.

Domestic Stocks - Active

The objective of actively managed domestic stock investments is long-term capital appreciation by investing in publicly traded stocks of primarily U.S.-based companies. Monies are invested in a portfolio of large company Value stocks, large company Growth stocks, and small 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

INVESTMENT SECTION

Report on Investment Activity (Continued)

eventually correct 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.

The U.S. economy slumped early in fiscal year 2003 as a dockworker's strike in Los Angeles, rising energy prices and the prospects of war in Iraq weighed on both consumer and business spending. The weakness carried into the new calendar year as concerns over imminent war with Iraq grew. This was compounded by an outbreak of SARS in China, which slowed Asian markets. By late March, the economy began to recover as Baghdad fell, energy prices stabilized, and SARS appeared contained. The consumer drove economic growth as low interest rates allowed for cash out refinancing, putting money into the consumer's pocket. This was followed by the tax rebate checks sent in July and August, which further increased the cash holdings for consumers.

Early in the fiscal year, corporate earnings began to recover as companies relentlessly cut costs. The earnings recovery picked up steam later in the fiscal year as the economic recovery gained momentum. This provided a solid base for the positive performance in the equity markets in the second half of the fiscal year. The total return for the Dow Jones Industrial Average was 25.1% for the 12 months ending September 2003, while the return for the broader S&P 500 was 24.4%. The NASDAQ's price rose 52.5% during the fiscal year. The Federal Reserve lowered interest rates first in November and again in June, bringing the Federal Funds rate down to 1.00%. Inflation remained subdued during the period as the CPI held at an annualized rate of 2.3%

The System's large company Value portfolio achieved a total rate of return of 26.4% for fiscal 2003. This compared favorably with 26.5% for the S&P 500 BARRA Value Index due to the fund's investment in defense and financial stocks and little exposure to technology and telecommunication stocks. The large company Growth portfolio's total rate of return was 25.7% for the fiscal year versus 22.5% for the S&P 500 BARRA Growth Index. Relative over-performance can be attributed to positioning the portfolio for strong economic and market recoveries that began to materialize in the second half of the fiscal year.

On a consolidated basis, the domestic actively managed large capitalization stock portfolio had a total rate of return of 26.1% for fiscal year 2003 compared to 24.4% for the S&P 500 Index. Three-year and five-year annualized returns were -7.0% and 1.6%. This compared with -10.1% and 1.0% for the S&P 500.

At the close of fiscal year 2003, large company Value stocks represented 14.8% of total investments versus 13.7% at the end of fiscal year 2002. Large company Growth stocks represented 14.6% versus 13.2% at the end of fiscal year 2002. Consolidated actively managed large company domestic stocks represented 29.4% of total investments, compared to 26.9% at the end of fiscal year 2002.

The System maintains an investment position with the small company growth managers at Delaware Investments Advisors (Delaware) and Putnam Investments (Putnam).

The System's small company growth portfolio invested with Delaware achieved a total rate of return of 32.5% for fiscal year 2003. This under-performed the Russell 2000 Growth Index, which was 41.7% for the same period.

The System's small company growth portfolio invested with Putnam achieved a total rate of return of 41.7% for fiscal year 2003. This compares favorably with 41.7% for the Russell 2000 Growth Index. Performance was positively impacted by selectivity and an overweight in technology.

At the close of fiscal year 2003, small company growth stocks represented 0.4% 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 S&P 500 Index Fund return for the fiscal year was 24.4% versus the benchmark's 24.4%. The S&P MidCap Index Fund return for the fiscal year was 26.8% versus its benchmark's 26.8%. During fiscal year 2003, \$130.1 million was

INVESTMENT SECTION

Report on Investment Activity (Continued)

withdrawn from U.S. index funds. An S&P Small Cap Index Fund was established in June of 2002 to match the return of that targeted benchmark. The S&P Small Cap Index Fund return for the fiscal year was 26.6% versus the benchmark's 26.9%. At the end of the fiscal year, passive domestic stock portfolios represented 15.0% of total assets, the S&P 500 Index Fund accounting for 13.1%, the S&P MidCap Index Fund 1.7%, and the S&P Small Cap Index fund 0.2%. Indexed stock portfolios represented 14.1% 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 Citigroup 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 22.0% in the fiscal year approximately matched the Citigroup BMI-EPAC return of 21.3%. The passive international return of -9.3% for three years approximately matched the benchmark's return of -9.5% 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 Citigroup 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, 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 2003, \$88.7 million was invested, raising passive international investments to 9.7% of total investment assets.

The combination of fixed income LIBOR notes and equity swap agreements was valued at \$781.6 million on September 30, 2003. That valuation included a net unrealized loss of \$68 million on equity index exposures and an unrealized loss of \$0.2 million 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 2003, \$85.3 million of losses on equity exposures were realized, \$11.8 million of interest in excess of obligations on completed swaps was recognized, and \$377 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 was \$139.1 million since the program began.

Fixed Income

For the fiscal year ending September 30, 2003, the Fixed Income portfolio returned 5.4% as compiled by CRA RogersCasey. For three years the return was 8.4% and 6.4% for five years.

Rates continued to decline during the year in response to the Federal Reserve's repeated reduction in rates until the middle of June. Bond prices peaked on June 13 and rates, which are inversely related to prices, rose irregularly through the end of the fiscal year validating the fund's earlier shift to a defensive policy.

Fixed Income represented 17.3% of the total portfolio compared with 24.2% last year. Corporates represented 40.9% of fixed income securities and governments accounted for 59.1%. Last year corporates were 40.7% of the total and governments were 59.3%. Government securities continued to outweigh corporates as corporate spreads continued to be narrow.

Real Estate and Mortgages

The System, through real estate advisors and operating joint ventures, acquires, develops, redevelops, and disposes of real estate related investments with the goal of maximizing returns while maintaining an acceptable level of risk. The investments are held in various investment vehicles that allow the System to enjoy the benefits of real estate ownership

INVESTMENT SECTION

Report on Investment Activity (Continued)

while limiting the liability associated with the asset class. The real estate is regularly valued by independent third parties to establish fair market values.

For the fiscal year ending September 30, 2003, 9.6% of the System's total investment portfolio was invested in real estate. This compares to 10.5% and 9.7%, for the fiscal years ending September 30, 2002, and 2001, respectively.

The real estate portfolio is broadly diversified geographically across the country, by type of property and by class of property. Major property types as of September 30, 2003, included apartments (39%); commercial office buildings (23%); retail centers, including regional malls and grocery-anchored neighborhood shopping centers (20%); and industrial buildings (7%). The remaining 11% of the real estate portfolio was invested in: for sale housing, senior living facilities, hotels, land, and self-storage facilities. For comparison purposes, the System benchmarks its real estate portfolio against the National Council of Real Estate Investment Fiduciaries Property Index (NPI), which is comprised of commercial office buildings (39%), retail centers (20%), apartments (20%), industrial buildings (19%), and hotels (2%).

The one-year, three-year, five-year, and ten-year net real estate returns for the fiscal year ending September 30, 2003, were 6.6%, 8.0%, 9.8%, and 8.8% respectively, as compiled by CRA RogersCasey. This compares to NPI returns of 7.1%, 7.1%, 8.7%, and 9.0% relating to the same periods. NPI returns are calculated before advisor fees/overhead while the System's returns are calculated after all advisor fees/overhead, therefore, the NPI returns stated above have been adjusted downward by 75 basis points to approximate comparable industry returns.

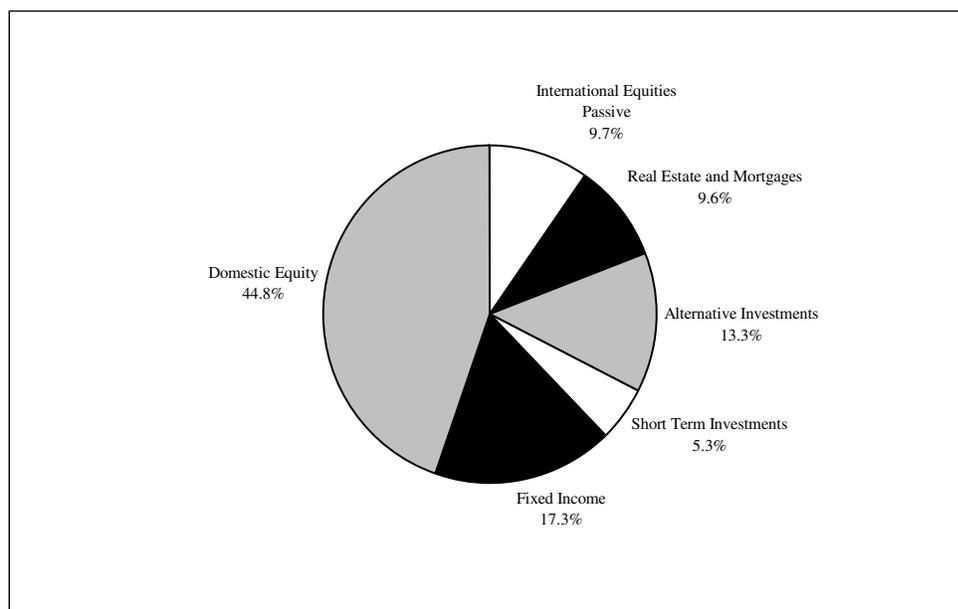
Alternative Investments

Alternative Investments are investments in the private equity market, primarily through limited partnerships. Of the investments in limited partnerships, approximately 61% were in partnerships investing in buyouts, 15% in venture capital, 11% in special situations, and 6% in mezzanine. The remaining 7% were investments in fund of funds, hedge funds, and cash. The percentage of assets in alternative investments as of September 30, 2003, is 13.3%. The asset allocation range for alternative investments is 11% to 16%, while the long-term target asset allocation target is 12.0%.

The one-year, three-year, five-year, and ten-year total alternative investment returns for the fiscal year ending September 30, 2003, were 0.5%, -11.2%, 2.3%, and 11.7%, respectively.

INVESTMENT SECTION

Asset Allocation – Security Type Only



Investment Results for the Period Ending September 30, 2003

<u>Investment Category</u>	<u>Current Year</u>	<u>Annualized Rate of Return ¹</u>		
		<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
Total Portfolio	14.7 %	(3.1) %	4.0 %	8.3 %
Domestic Equities Stock - Active	26.1	(7.0)	1.6	9.2
Domestic Equities Stock - Passive ²	24.7	(9.0)	2.2	10.4
Standard & Poor's (S&P 500)	24.4	(10.1)	1.0	10.1
Standard & Poor's (MidCap)	26.8	(0.7)	12.0	12.8
International Equities	22.0	(9.3)	1.7	4.1
Net Citigroup BMI - EPAC 50/50	21.3	(9.5)	1.5	3.7
Fixed Income Bonds (U.S. Corp and Govt)	5.4	8.4	6.4	7.1
Citigroup Broad Investment Grade Bond Index	5.5	8.9	6.6	6.9
Lehman Brothers Government/Corporate	6.5	9.6	6.7	7.0
Real Estate and Mortgages	6.6	8.0	9.8	8.8
NCREIF minus 75 Basis Points	7.1	7.1	8.7	9.0
Alternative Investments	0.5	(11.2)	2.3	11.7

¹ Calculations used a time-weighted rate of return based on the market rate of return in accordance with AIMR's Performance Presentation Standards.

² 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.

INVESTMENT SECTION

Largest Assets Held

Largest Stock Holdings (By Market Value)* September 30, 2003

<u>Rank</u>	<u>Shares</u>	<u>Stocks</u>	<u>Market Value</u>
1	3,165,575	Citigroup Incorporated	\$ 144,065,312
2	5,171,481	Microsoft Corporation	143,715,461
3	4,558,683	General Electric Corporation	135,894,350
4	4,382,639	Pfizer Incorporated	133,144,567
5	2,066,781	Wal-Mart Stores Incorporated	115,429,712
6	2,882,503	Exxon Mobil Corporation	105,499,623
7	1,409,904	Wells Fargo & Company	72,610,046
8	926,994	Bank of America Corporation	72,342,609
9	2,591,677	Intel Corporation	71,297,022
10	955,060	Federal National Mortgage Association	67,045,240

Largest Bond Holdings (By Market Value)* September 30, 2003

<u>Rank</u>	<u>Par Amount</u>	<u>Bonds & Notes</u>	<u>Market Value</u>
1	\$ 45,953,598	U.S. Treasury Strip 0% COUPON Due 11/15/2011	\$ 43,076,902
2	40,487,751	FHLB FRN Due 1/12/2007	40,478,208
3	32,294,447	U.S. Treasury TIGER 0% COUPON Due 8/15/2004	31,920,445
4	20,853,359	Caterpillar Financial Services FRN Due 8/15/2006	20,850,752
5	20,243,876	FHLMC 6 1/2% Due 5/23/2011	20,825,077
6	20,243,876	FHLB 2.2% Due 5/25/2018	20,282,339
7	20,243,876	FHLB FRN Due 7/19/2007	20,237,066
8	20,243,876	FHLB FRN Due 2/3/2006	20,231,393
9	20,243,876	FHLB FRN Due 8/1/2017	20,229,008
10	20,243,876	FHLMC FRN Due 10/28/2014	20,225,597

*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 13.9% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisors' 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 \$1,956.2 thousand or less than three basis points (.03%) of the market value of the portfolio.

State law created an Investment Advisory Committee (Committee) comprised of the directors of the Department of Consumer and Industry Services and Department of 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:

	Assets under Management (in thousands)	Fees (in thousands)	Basis Points*
State Treasurer	\$ 7,631,965.7	\$ 1,956.2	2.7
Outside Advisors			
Alternative	1,181,377.4	14,925.4	126.3
Real Estate	47,479.7	-	-
Total	\$ 8,860,822.8		

Other Investment Services Fees:

Assets in Custody	\$ 8,859,455.8	\$ 448.8
Securities on Loan	220,339.7	3,669.0

* 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 fees range from 25 to 90 basis points and are netted against current year's income.

INVESTMENT SECTION

Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2003		
	Commissions	Number of	Average Commission
	Paid ⁽¹⁾	Shares Traded	Rate Per Share
Investment Brokerage Firms:			
Citigroup Global Markets, Inc.	\$ 108,769	2,795,031	\$ 0.04
Lehman Brothers, Inc.	90,532	2,143,550	0.04
Morgan Stanley	76,089	1,731,067	0.04
Merrill Lynch & Co. Pierce, Fenner & Smith Inc.	66,016	1,588,037	0.04
Bernstein Investment Research & Management	60,871	1,285,660	0.05
Bridge Treading, A Feuters Company	55,366	1,306,903	0.04
Bear, Stearns & Co. Inc.	54,797	1,238,062	0.04
Prudential Securities, Inc.	49,221	996,410	0.05
Credit Suisse First Boston Corporation	48,485	1,003,017	0.05
Goldman, Sachs & Co.	41,948	921,883	0.05
UBS Financial Securities	36,729	766,876	0.05
J. P. Morgan Securities, Inc.	32,769	655,387	0.05
Deutsche Bank Securities	18,463	369,269	0.05
SG Cowen Securities Corporation	17,594	351,873	0.05
International Strategy & Investment Group Inc.	13,642	272,844	0.05
Banc of America Securities, LLC	12,555	251,103	0.05
OTA LLC	9,544	233,772	0.04
Charles Schwab & Co., Inc.	7,948	158,960	0.05
Cantor Fitzgerald & Co.	7,169	238,954	0.03
Keefe Bruyette & Woods, Inc.	4,941	98,811	0.05
Howard, Weil, Labouisse, Friedrichs Inc.	3,966	79,320	0.05
CL Global	7	373	0.02
Total	\$ 817,421	18,487,162	\$ 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, 2003

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (c)	Percent of Investment & Interest Income
Fixed Income:				
Government Bonds	\$ 902,840,689	10.2%	\$ 30,300,308	2.4%
Corporate Bonds	624,249,406	7.1%	59,209,668	4.8%
Total Fixed Income	1,527,090,095	17.3%	89,509,976	7.2%
Common Stock & Preferred Stock	3,973,715,495	44.8%	870,504,405	70.2%
Real Estate & Mortgages	853,356,337	9.6%	55,832,088	4.5%
Alternative Investments	1,181,377,358	13.3%	67,647,786	5.5%
International Equities - Passive	855,654,706	9.7%	151,229,953	12.2%
Short Term Investments (b)	469,628,795	5.3%	4,886,302	0.4%
Total	\$ 8,860,822,786	100.0%	\$ 1,239,610,510	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 the fiscal year. Amount also excludes \$219,483,789 in cash collateral for security lending for fiscal year 2003.

(c) Total Investment & Interest Income excludes net security lending income of \$814,662 for fiscal year 2003.

INVESTMENT SECTION

Investment Summary (Continued)

Fiscal Year Ended September 30, 2002

	<u>Market Value (a)</u>	<u>Percent of Total Market Value</u>	<u>Investment & Interest Income (c)</u>	<u>Percent of Investment & Interest Income</u>
Fixed Income:				
Government Bonds	\$ 1,189,930,855	14.3%	\$ 82,051,259	-8.3%
Corporate Bonds	817,597,009	9.9%	69,840,985	-7.1%
Total Fixed Income	<u>2,007,527,864</u>	<u>24.2%</u>	<u>151,892,244</u>	<u>-15.4%</u>
Common & Preferred Stock	3,412,686,330	41.2%	(829,820,387)	84.0%
Real Estate & Mortgages	870,741,516	10.5%	69,902,987	-7.0%
Alternative Investments	1,219,655,746	14.7%	(274,821,642)	27.8%
International Equities - Passive	619,221,734	7.5%	(113,524,063)	11.5%
Short Term Investments (b)	<u>157,076,427</u>	<u>1.9%</u>	<u>8,570,606</u>	<u>-0.9%</u>
Total	<u><u>\$ 8,286,909,617</u></u>	<u><u>100.0%</u></u>	<u><u>\$ (987,800,255)</u></u>	<u><u>100.0%</u></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 the fiscal year. Amount also excludes \$366,352,026 in cash collateral for security lending for fiscal year 2002.

(c) Total Investment & Interest Income excludes net security lending income of \$1,893,786 for fiscal year 2002.

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



Actuary's Certification



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Michael J. Karlin, F.S.A., M.A.A.A.
Senior Vice President & Actuary
mkarlin@segalco.com

November 12, 2003

Mr. Mitch Irwin
Director
Department of Management and Budget
and
Retirement Board
Michigan Public School Employees Retirement System
P.O. Box 30176
Lansing, Michigan 48909

Ladies and Gentlemen:

The Michigan Public School Employees Retirement System (MPERS) is funded on an actuarial reserve basis. The basic financial objective of MPERS is to establish and receive contributions that remain approximately level as a percentage of active member payroll over a long period of years.

Actuarial valuations are prepared annually to determine MPERS's actuarial liabilities and the employer contributions required to fund the System in accordance with the actuarial reserve funding provisions of the governing State Statute. The most recent actuarial valuation as of September 30, 2002 included a total of 476,030 members of MPERS. The actuarial value of MPERS's assets amounted to approximately \$38.38 billion on September 30, 2002.

The actuarial assumptions used in the 2002 valuation are the same as those used in the previous annual actuarial valuation. These assumptions produce valuation results which we consider to be reasonably indicative of the plan's underlying cost. Also, in our opinion, the actuarial assumptions and methods used for funding purposes meet the parameters for the disclosures presented in the financial section by GASB Statement No. 25.

Our actuarial valuation of MPERS as of September 30, 2002 was performed by qualified actuaries in accordance with accepted actuarial procedures. In our opinion, the calculated contribution rate meets the fundamental objectives of State law. Based on the 2002 valuation results, it is also our opinion that the Michigan Public School Employees Retirement System continues in sound condition, in accordance with actuarial principles of level cost financing.

Most of the information used in the supporting schedules in the Actuarial and Statistical Sections, as well as the Schedules of Funding Progress and the employer contributions shown in the Schedules of Employer Contributions in the Financial Section of this report were provided by our firm.

Sincerely,

Michael Karlin, F.S.A., M.A.A.A.
Senior Vice President & Actuary

Benefits, Compensation and HR Consulting ATLANTA BOSTON CHICAGO CLEVELAND DENVER HARTFORD HOUSTON LOS ANGELES MINNEAPOLIS
NEW ORLEANS NEW YORK PHILADELPHIA PHOENIX SAN FRANCISCO SEATTLE TORONTO WASHINGTON, DC



Multinational Group of Actuaries and Consultants AMSTERDAM BARCELONA GENEVA HAMBURG LONDON MELBOURNE MEXICO CITY OSLO PARIS

ACTUARIAL SECTION

Summary of Actuarial Assumptions and Methods

1. 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. The real rate of return is the rate of investment return in excess of the inflation rate. Considering other financial assumptions, this investment return rate translates to an assumed long term real rate of return of 4%. Adopted 1994.
2. 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.
3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 1998.
4. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page of this report. Adopted 1998.
5. Total active member payroll is assumed to increase 4% per year. This represents the portion of the individual pay increase assumptions attributable to inflation. Adopted 1994.
6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Adopted 1975. Unfunded actuarial accrued liabilities are financed over a period of 50 years and over a declining 40 year period for years beginning October 1, 1996. Adopted 1996.
7. The Department of Management and Budget approved the use of market value of assets as of September 30, 1997, for valuation purposes. For investment gains and losses that occur after that date, a 5-year smoothing technique will be used. Specifically, 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 1997.
8. 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 Each Year

<u>Retirement Ages</u>	<u>Correction Officers</u>	<u>Conservation Officers</u>	<u>Other Members</u>
45		16 %	
48		16	
51	25 %	16	
55	15	16	20 %
58	12	15	15
61	15	15	15
64	22	22	22
67	25	25	25
70	50	50	50
75	100	100	100

SCHEDULE 2

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

<u>Sample Ages</u>	<u>Years of Service</u>	<u>Percent of Active Members Withdrawing Within Next Year (Men and Women)</u>	<u>Percent of Active Members Becoming Disabled Within Next Year</u>	<u>Percent Increase In Pay During Next Year</u>
All	0	20.00 %		
	1	14.00		
	2	9.00		
	3	7.00		
	4	5.50		
25	5 & Over	5.50	0.01 %	11.50 %
35		3.50	0.04	5.70
45		2.25	0.26	4.75
55		1.75	0.65	4.24
60		1.75	0.90	4.00

ACTUARIAL SECTION

Actuarial Valuation Data

Schedule of Active Member Valuation Data

<u>Valuation Date Sept. 30</u>	<u>Number</u>	<u>Reported Annual Payroll*</u>	<u>Average Annual Pay</u>	<u>% Increase</u>	<u>Average Age</u>	<u>Average Service</u>
1993	63,906	\$ 2,185,036	\$ 34,191	0.3 %	42.6	12.1
1994	64,923	2,271,158	34,982	2.3	43.1	12.6
1995	65,133	2,348,534	36,058	3.1	43.2	12.7
1996	63,807	2,515,420	39,422	9.3	43.8	13.0
1997	55,434	2,273,203	41,007	4.0	43.7	13.1
1998	49,717	2,107,996	42,400	3.4	44.8	14.8
1999	49,612	2,213,851	44,623	5.2	45.9	15.8
2000	47,778	2,253,818	47,173	5.7	46.7	16.7
2001	45,852	2,230,562	48,647	3.1	47.4	17.7
2002	43,064	2,133,477	49,542	1.8	48.0	18.6

* In thousands of dollars. Base pay only excluding 3 1/2% for overtime and shift differentials through 1995. Greater of base pay or prior year actual earnings beginning in 1996.

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	1,105	\$ 18,468	786	\$ 4,887	29,175	\$ 257,193	5.6 %	\$ 8,816
1994	1,888	22,636	1,101	6,442	29,962	273,387	6.3	9,124
1995	1,566	23,575	966	6,268	30,562	290,694	6.3	9,512
1996	1,595	24,527	1,064	7,288	31,093	307,933	5.9	9,904
1997	6,098	121,005	1,068	7,878	36,123	421,060	36.7	11,656
1998	1,279	21,085	1,217	9,689	36,185	432,456	2.7	11,951
1999	1,409	21,227	1,248	9,516	36,346	444,167	2.7	12,221
2000	1,540	22,421	1,181	2,619	36,705	463,969	4.5	12,640
2001	1,648	22,501	1,242	15,063	37,111	471,407	1.6	12,703
2002	3,806	80,871	1,251	5,310	39,666	546,968	16.0	13,789

* In thousands of dollars

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 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) are 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 by-product 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 Sept. 30	Actuarial Present Value of Actuarial Accrued Liability (\$ in Millions)			Valuation Assets	Portion of Present Value Covered by Assets			
	(1)	(2)	(3)		(1)	(2)	(3)	(4) ³
	Active Member Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)					
1993 ¹	\$ 72	\$ 2,561	\$ 3,540	\$ 5,043	100 %	100 %	68.1 %	81.7 %
1994 ²	73	2,778	3,709	5,476	100	100	70.8	83.5
1995	72	2,751	4,038	6,090	100	100	80.9	88.8
1996	55	2,844	4,248	6,678	100	100	89.0	93.4
1997 ^{1,2}	3	4,300	3,798	8,834	100	100	119.3	109.0
1998	27	4,360	3,987	9,109	100	100	118.4	108.8
1998 ²	27	4,484	3,986	9,109	100	100	115.4	107.2
1999	35	4,538	4,456	9,648	100	100	113.9	106.9
2000	29	4,659	4,786	10,337	100	100	118.0	109.1
2001	34	4,677	5,167	10,633	100	100	114.6	107.6
2002	123	5,512	5,043	10,616	100	100	96.8	98.7

¹ Revised asset valuation method.

² Revised actuarial assumptions.

³ Percents funded on a total valuation asset and total actuarial accrued liability basis.

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.	(\$102,704,717)
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.	16,866,339
3. Pay Increases. If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	75,819,398
4. Investment Income. If there is greater investment income than assumed, there is a gain. If less income, a loss.	(523,563,989)
5. Death After Retirement. If retirants live longer than assumed, there is a loss. If not as long, a gain.	(12,998,239)
6. New entrants. New Entrants into the System will generally result in an actuarial loss. This does not apply to plans closed to new entrants.	(6,435,936)
7. Other. Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	<u>(511,072)</u>
8. Composite Gain (or Loss) During Year	<u><u>(\$553,528,216)</u></u>

ACTUARIAL SECTION

Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2002, is based on the present provisions of the Michigan State Employees' Retirement Act, which are summarized in this section.

Regular Retirement (no reduction factor for age)

Eligibility — Age 55 with 30 years service, or age 60 with 10 or more years service. Corrections Officers may retire at age 51 with 25 or more years service, or age 56 with 10 or more years service. Conservation Officers may retire after 25 years of service regardless of age.

Final Average Compensation — Regular retirement benefit is based on final average compensation (FAC), which is the average of highest 3 consecutive years (2 years for Conservation Officers).

Annual Amount — Total service times 1.5% of FAC. For members with 20 or more years of service, a \$3,000 minimum annual benefit is payable. Corrections Officers receive an additional temporary supplement to age 62 equal to the product of supplemental service times 0.5% of FAC. Conservation Officers retiring after 25 years receive a benefit equal to 60% of FAC.

Early Retirement (age reduction factor used)

Eligibility — Age 55 with 15 or more years service.

Annual Amount — Computed as regular retirement benefit but reduced by 0.5% for each month under age 60.

Deferred Retirement (vested benefit)

Eligibility — 10 years of service (5 years for unclassified persons in the executive or legislative branch). Benefit commences at age 60.

Annual Amount — Computed as regular retirement benefit based on service and FAC at termination.

Duty Disability Retirement

Eligibility — No age or service requirement.

Annual Amount — Disability after age 60: Computed as regular retirement benefit with minimum benefit based on 10 years service. Disability prior to age 60: To age 60, benefit is two-thirds of FAC but limited to \$6,000 per year. Additional limitation such that benefit plus workers' compensation does not exceed final compensation. After age 60, benefit is recomputed as a regular retirement benefit with service granted for period in receipt of disability benefit before age 60 (benefit not reduced after age 60).

Non-Duty Disability Retirement

Eligibility — 10 years of service.

Annual Amount — Computed as regular retirement benefit based on service and FAC at time of disability. Minimum annual benefit is \$600.

ACTUARIAL SECTION

Summary of Plan Provisions (Continued)

Duty Death Before Retirement

Eligibility — No age or service requirement. Also applies to duty disability retiree who dies within 3 years of disability and before age 60.

Annual Amount — Accumulated employee contributions are refunded. Surviving spouse receives annual benefit of one-third of final compensation until death. Unmarried children under age 18 each receive an equal share of one-fourth of final compensation (if no spouse each child receives one-fourth, to a maximum of one-half for all children). If no spouse or eligible children, each dependent parent receives one-sixth of final compensation. Total benefits payable are limited to \$2,400 per year. Additional limitation such that benefits plus workers' compensation does not exceed final compensation.

Non Duty Death Before Retirement

Eligibility — 10 years of service. In the case of a deceased vested former member, the survivor benefit commences when the deceased former member would have attained age 60.

Annual Amount — Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Post-Retirement Cost-of-Living Adjustments

One-time upward adjustments have been made in 1972, 1974, 1976, 1977 and 1987. Beginning in 1983, some benefit recipients share in a distribution of a portion of investment income earned in excess of 8% annually (supplemental payment). Beginning in 1988, all benefit recipients are eligible for automatic 3% annual (non-compounded) benefit increases, with a maximum \$300 annual increase. Eligibility for the above benefits:

Retired before October 1, 1987	Greater of supplemental payment or the combination of the 1987 onetime adjustment and the automatic increases.
Retired on or after October 1, 1987	Automatic increases only.

Post-Retirement Health Insurance Coverage

Persons in receipt of retirement allowance (including members who did not retire directly from the System, but come from a vested deferred status), and their dependents, are eligible for 95% System paid health insurance coverage and 90% System paid dental and vision insurance.

Member Contributions

None.

Defined Contribution

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

ACTUARIAL SECTION

Summary of Plan Provisions (Continued)

2002 Early Out Window

Members retiring between April 1, 2002 and November 1, 2002 whose combined age and service equals 80 points, or who are age 60 or older with 10 or more years of service are eligible to receive a benefit equal to 1.75% of final average compensation multiplied by years of credited service. Members who had previously transferred to the Defined Contribution plan, are eligible to receive a benefit equal to 0.25% of final average compensation multiplied by years of credited service.

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

STATISTICAL SECTION

Schedule of Revenues by Source

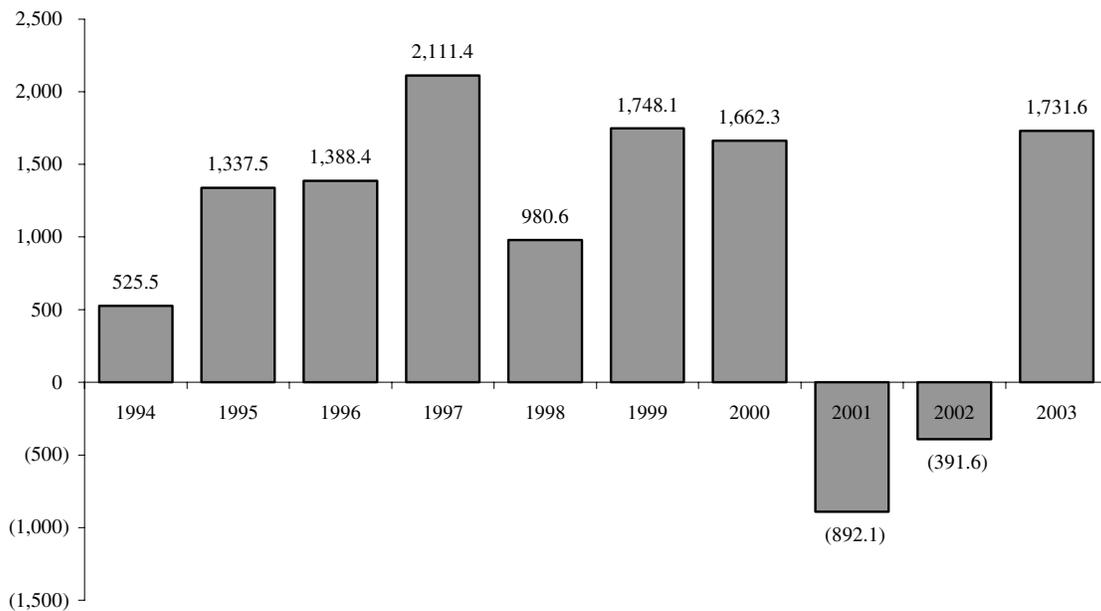
Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions		Net Investment, Transfers & Misc. income	Total
		Dollars*	% of Annual Covered Payroll		
1994	\$ 2,257,216	\$389,728,590	16.58 %	\$ 133,510,369	\$ 525,496,175
1995	2,260,510	422,294,609	17.37	912,938,131	1,337,493,250
1996	2,619,067	431,094,371	17.14	954,696,384	1,388,409,822
1997	15,858,366 **	410,231,627	18.05	1,685,326,508	2,111,416,501
1998	9,777,845	259,799,179	12.32	711,056,989	980,634,013
1999	11,047,645	265,806,232	12.01	1,471,244,852	1,748,098,729
2000	9,663,633	289,224,539	12.83	1,363,374,870	1,662,263,042
2001	9,134,665	361,926,010	16.22	(1,263,116,089)	(892,055,414)
2002	179,559,102	345,216,945	16.18	(916,404,144)	(391,628,097)
2003	91,330,212	400,130,385	N/A	1,240,175,943	1,731,636,540

* Includes financing for early retirement pensions. Fiscal year 1999 and 2000 also includes amount received for DC Savings (see Note 2 to the financial statements in the Financial Section).

** Increase is attributable to purchase of service credit in connection with "early out" retirement.

N/A Not available.

Total Revenues
Year Ended September 30
(In Millions)



STATISTICAL SECTION

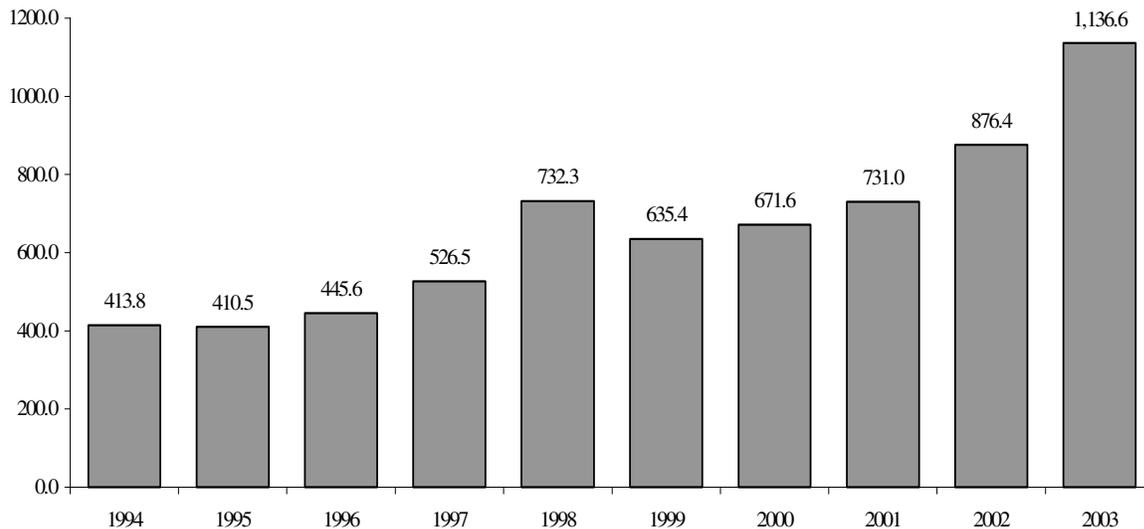
Schedule of Expenses by Type

Fiscal Year Ended Sept. 30	Benefits *	Refunds and Transfers	Administrative & Other Expenses	Total
1994	\$ 409,975,308	\$ 92,153	\$ 3,777,812	\$ 413,845,273
1995	406,140,322	80,453	4,268,833	410,489,608
1996	439,056,397	30,082	6,489,761	445,576,240
1997	513,359,239	7,848,649 **	5,247,943	526,455,831
1998	593,453,930	134,533,763 **	4,297,092	732,284,785
1999	630,346,729	728,366	4,330,623	635,405,718
2000	667,431,376	222,171	3,954,992	671,608,539
2001	726,771,708	91,699	4,149,284	731,012,691
2002	782,452,212	87,504,459	6,432,819	876,389,490
2003	1,055,749,270	75,695,752	5,192,039	1,136,637,061

* Includes health, dental and vision benefits.

** Includes transfers to defined contribution plan in connection with the "early out" retirement.

Total Expenses
Year Ended September 30
(In Millions)

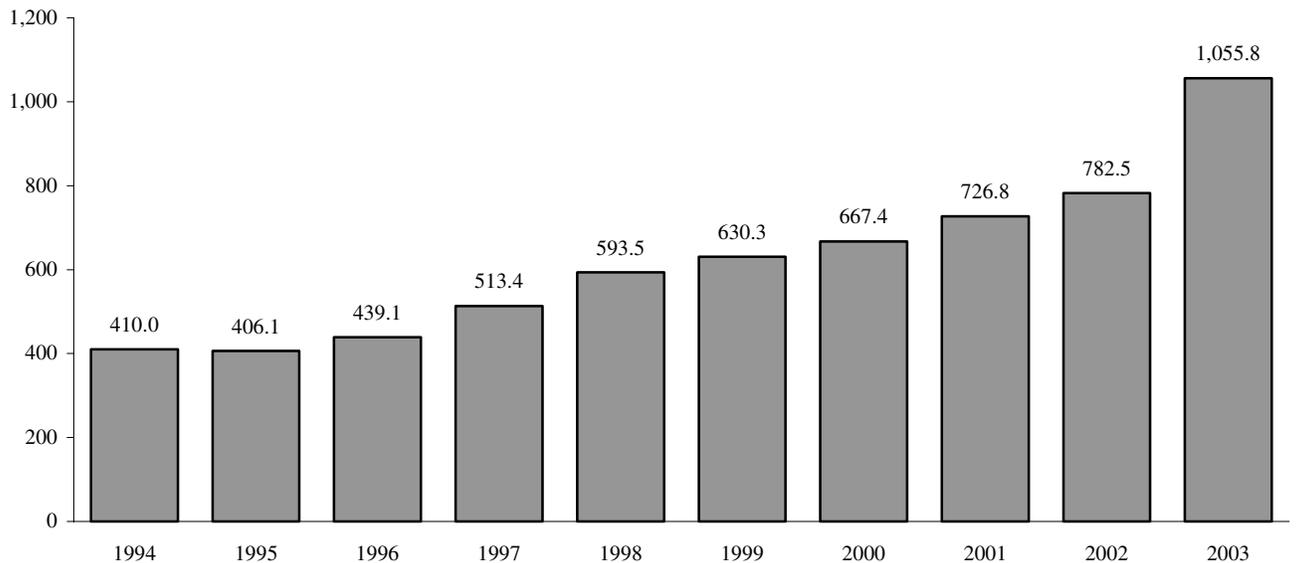


STATISTICAL SECTION

Schedule of Benefit Expenses by Type

<u>Fiscal Year Ended Sept. 30</u>	<u>Regular Allowances</u>	<u>Disability Allowances</u>	<u>Supplemental Check</u>	<u>Health Insurance</u>	<u>Total</u>
1994	\$ 256,660,402	\$ 16,672,201		\$ 136,642,705	\$ 409,975,308
1995	269,206,552	20,494,647		116,439,123	406,140,322
1996	284,061,320	22,017,877	\$ 15,234,884	117,742,316	439,056,397
1997	331,964,200	26,069,505	24,832,674	130,492,860	513,359,239
1998	401,855,102	28,024,773	-	163,574,055	593,453,930
1999	417,313,133	28,227,807	678,314	184,127,475	630,346,729
2000	427,500,808	30,867,062	435,904	208,627,602	667,431,376
2001	444,244,814	33,902,047	378,467	248,246,380	726,771,708
2002	467,909,032	35,544,847	-	278,998,333	782,452,212
2003	664,188,203	37,476,229	-	354,084,838	1,055,749,270

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 *							
		1	2	3	4	5	6	7	8
\$ 1 - 200	1,270	417	453	10	176	4	177	3	30
201 - 400	4,079	2,472	840	19	554	17	98	2	77
401 - 600	5,741	3,306	629	435	879	-	248	6	238
601 - 800	4,812	3,064	411	1	767	-	215	26	328
801 - 1,000	4,131	2,584	294	-	556	-	183	47	467
1,001 - 1,200	3,738	2,441	191	1	409	-	147	50	499
1,201 - 1,400	3,590	2,527	169	-	183	-	98	48	565
1,401 - 1,600	2,768	2,128	101	-	87	-	67	48	337
1,601 - 1,800	2,274	1,875	64	-	58	-	42	73	162
1,801 - 2,000	1,849	1,573	52	-	19	-	19	110	76
Over 2,000	5,414	4,832	90	-	15	-	47	346	84
Totals	<u>39,666</u>	<u>27,219</u>	<u>3,294</u>	<u>466</u>	<u>3,703</u>	<u>21</u>	<u>1,341</u>	<u>759</u>	<u>2,863</u>

* Type of Retirement

- 1 - Normal retirement for age & service
- 2 - Survivor payment - normal or early retirement
- 3 - Duty disability retirement (incl. survivors)
- 4 - Non-duty disability retirement (incl. survivors)
- 5 - Survivor payment - duty death in service
- 6 - Survivor payment - non-duty death in service
- 7 - Retirees with supplemental benefits for early retirement incentive factors
- 8 - Retirees with reduced benefits for early retirement reduction factors

Source: The Segal Company

STATISTICAL SECTION

Schedule of Retired Members by Type of Benefit (Continued)

September 30, 2002

Amount Monthly Benefit	Number of Retirees	Selected Option **						
		Reg.	Opt. A	Opt. B	Opt. C	Opt. E	Opt. E1	Opt. E2
1 - 200	1,270	271	542	329	1	104	16	7
201 - 400	4,079	1,703	1,076	771	17	369	69	74
401 - 600	5,741	2,759	1,470	895	35	431	64	87
601 - 800	4,812	2,207	1,291	843	19	335	50	67
801 - 1,000	4,131	1,848	1,154	799	32	203	35	60
1,001 - 1,200	3,738	1,674	1,089	695	23	147	45	65
1,201 - 1,400	3,590	1,448	1,094	756	29	161	38	64
1,401 - 1,600	2,768	1,040	882	566	43	129	37	71
1,601 - 1,800	2,274	790	729	462	52	117	48	76
1,801 - 2,000	1,849	539	588	382	41	147	56	96
Over 2,000	5,414	1,578	1,578	1,095	199	475	187	302
Totals	39,666	15,857	11,493	7,593	491	2,618	645	969

****Selected Option**

- Reg. - Straight life allowance
- Opt. A - 100% survivor option
- Opt. B - 50% survivor option
- Opt. C - 75% survivor option
- Opt. E - Social Security equated
- Opt. E1 - Social Security equated w/100% survivor
- Opt. E2 - Social Security equated w/50% survivor option

Source: The Segal Company

STATISTICAL SECTION

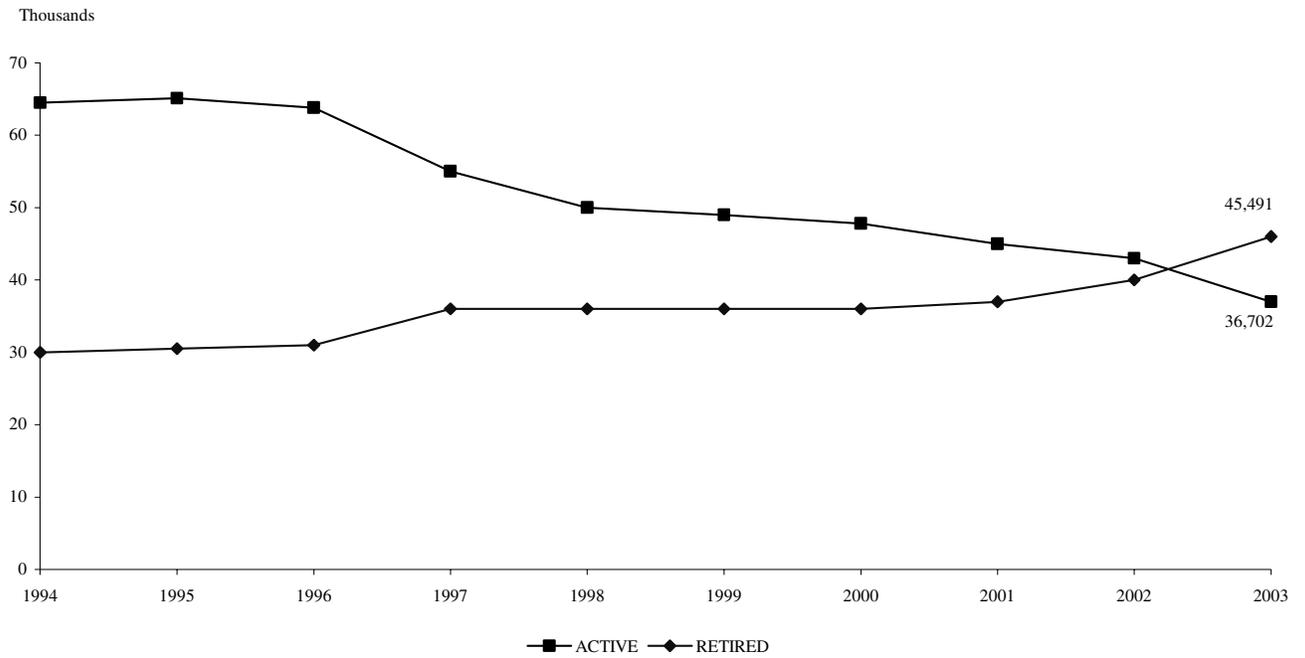
Schedule of Average Benefit Payments

Retirement Effective Dates	Years Credited Service							Total
	0-5	5-10	10-15	15-20	20-25	25-30	30+	
Period 10/1/96 to 9/30/97:								
Average Monthly Benefit	\$ 367	\$ 357	\$ 400	\$ 632	\$ 877	\$ 1,272	\$ 1,536	\$ 971
Average Final Average Salary	11,007	26,932	22,665	25,373	27,707	32,426	33,096	28,415
Number of Active Retirants	396	440	6,207	6,947	6,410	7,030	8,693	36,123
Period 10/1/97 to 9/30/98:								
Average Monthly Benefit	\$ 373	\$ 369	\$ 414	\$ 651	\$ 901	\$ 1,298	\$ 1,571	\$ 996
Average Final Average Salary	10,322	28,458	23,509	26,087	28,395	33,076	33,906	29,148
Number of Active Retirants	411	449	6,246	6,906	6,389	7,074	8,710	36,185
Period 10/1/98 to 9/30/99:								
Average Monthly Benefit	\$ 375	\$ 379	\$ 433	\$ 673	\$ 926	\$ 1,329	\$ 1,600	\$ 1,018
Average Final Average Salary	9,939	29,279	24,597	26,881	29,163	33,685	34,435	29,846
Number of Active Retirants	432	457	6,328	6,939	6,421	7,091	8,678	36,346
Period 10/1/99 to 9/30/00:								
Average Monthly Benefit	\$ 398	\$ 390	\$ 453	\$ 694	\$ 952	\$ 1,388	\$ 1,656	\$ 1,053
Average Final Average Salary	9,908	30,734	25,784	27,734	29,943	34,218	35,149	30,620
Number of Active Retirants	450	454	6,476	6,984	6,488	7,145	8,708	36,705
Period 10/1/00 to 9/30/01								
Average Monthly Benefit	\$ 663	\$ 578	\$ 474	\$ 711	\$ 970	\$ 1,373	\$ 1,653	\$ 1,059
Average Final Average Salary	22,101	29,518	26,928	28,637	30,998	34,818	35,868	31,509
Number of Active Retirants	771	697	6,429	6,929	6,485	7,204	8,598	37,111
Period 10/1/01 to 9/30/02								
Average Monthly Benefit	\$ 670	\$ 542	\$ 491	\$ 733	\$ 1,007	\$ 1,460	\$ 1,789	\$ 1,149
Average Final Average Salary	18,504	31,089	27,935	29,554	32,211	36,772	38,742	33,313
Number of Active Retirants	827	626	6,505	6,962	6,710	7,985	10,051	39,666

Source: The Segal Company

STATISTICAL SECTION

Ten Year History of Membership Fiscal Year Ended September 30



Source: The Segal Company

STATISTICAL SECTION

ACKNOWLEDGMENTS

The *Michigan State Employees' Retirement System Comprehensive Annual Financial Report* is prepared by Financial Services, Fiscal Management Division. Staff of the division for the fiscal year 2002-2003 report included:

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Special thanks are also extended to the Office of Retirement Services personnel, accounting and support personnel throughout Financial Services, DMB Print & Graphic Services, Investments Division of Treasury, Office of the Auditor General, Andrews Hooper & Pavlik P.L.C., The Segal Company, and the staff at the Office of Financial Management. Preparation of this report would not have been possible without the efforts of these individuals.

The report may be viewed on-line at: www.michigan.gov/ors