FINANCIAL

The future belongs to those who believe in the beauty of their dreams.
- Eleanor Roosevelt

INDEPENDENT AUDITOR'S REPORT

Honorable William G. Holland
Auditor General
State of Illinois

Board of Trustees
Teachers' Retirement System of
The State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of plan net assets of the Teachers' Retirement System of the State of Illinois (the System), a component unit of the State of Illinois, as of June 30, 2002 and 2001, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 plan net assets of the Teachers' Retirement System of the State of Illinois as of June 30, 2002 and 2001, and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management discussion and analysis on pages 18 through 21 and the schedules of funding progress and contributions from employers and other contributing entities on pages 38 and 39 are not a required part of the basic financial statements but are supplementary 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 the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in Note B to the financial statements, the System adopted GASB Statements No. 34, 37 and 38, effective July 1, 2001.

In accordance with Government Auditing Standards, we will also issue, under separate cover, our report dated November 14, 2002 on our consideration of the System's internal control over financial reporting and 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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the System. The introduction section, other supplementary information on page 40, investments section, actuarial section and statistical section are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The other supplementary information on page 40 has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole. The introduction, investments, actuarial and statistical information sections listed in the table of contents were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

McGladrey & Pullen, LLP

Chicago, Illinois
November 14, 2002

We shall neither fail nor falter; we shall not weaken or tire...Give us the tools and we will finish the job.

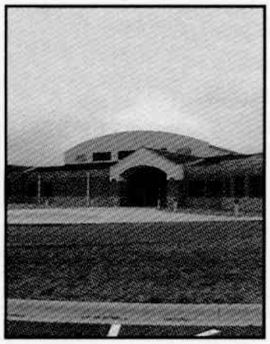
- Winston Churchill

MANAGEMENT DISCUSSION AND ANALYSIS

Our discussion and analysis of the Teachers' Retirement System of the State of Illinois provides an overview of the System's financial activities for the fiscal year ended June 30, 2002. Please read it in conjunction with the transmittal letter in the Introduction Section on page 5, and the Basic Financial Statements and related notes that follow this discussion.

FINANCIAL HIGHLIGHTS

- TRS's net assets at June 30, 2002, were $22.4 billion.
- During FY02, the System's net assets decreased $949 million.
- Contributions from members, employers, and the State of Illinois were $1,589 million, an increase of $123 million or 8.4 percent during the fiscal year.
- Net investment loss was ($724) million, an increase of $291 million or 28.7 percent compared to FY01.
- Benefits and refunds paid to members and annuitants were $1,799 million, an increase of $196 million or 12.2 percent compared to FY01.
- The System's pension benefit obligation or total actuarial accrued liability was $43 billion at June 30, 2002.
- The System's unfunded actuarial accrual liability increased from $15.85 billion at June 30, 2001 to $20.68 billion at June 30, 2002. The funded ratio decreased from 59.5 percent at June 30, 2001 to 52.0 percent at June 30, 2002.



Manteno Elementary School Manteno

The Basic Financial Statements contained in this section of the *Comprehensive Annual Financial Report* consist of:

Statement of Plan Net Assets. This section reports the pension trust funds assets, liabilities, and resultant net assets available to pay benefits at the end of the fiscal year. It is the balance sheet of TRS and reflects the financial position of the Teachers' Retirement System as of June 30, 2002.

Statement of Changes in Plan Net Assets. The changes in plan net assets report the System's transactions that occurred during the fiscal year. It is the income statement of TRS and reflects the revenues and expenses recorded throughout the fiscal year. The Statement of Changes in Plan Net Assets supports the change in the value of the net assets reported on the Statement of Plan Net Assets.

Notes to the financial statements. The notes are an integral part of the financial statements and include additional information not readily evident in the statements themselves. The required supplementary information and other schedules following the notes to the financial statements provide historical and additional detailed information considered useful in evaluating the financial condition of the Teachers' Retirement System. The following are condensed comparative financial statements of TRS's pension trust fund.

CONDENSED COMPARATIVE STATEMENT OF PLAN NET ASSETS

	As of June 30, 2002	As of June 30, 2001	Decrease/Increase Amount	Percentage Change
Cash	$6,039,088	$7,889,353	($1,850,265)	(23.5%)
Receivables and prepaid expenses	393,200,477	402,597,459	(9,396,982)	(2.3)
Investments	22,944,918,073	24,010,566,743	(1,065,648,670)	(4.4)
Invested securities lending collateral	1,897,635,461	2,288,995,477	(391,360,016)	(17.1)
Fixed assets	3,113,533	3,658,427	(544,894)	(14.9)
Total assets	**25,244,906,632**	**26,713,707,459**	**(1,468,800,827)**	**(5.5)**
Total liabilities	**2,878,621,920**	**3,398,061,376**	**(519,439,456)**	**(15.3)**
Net assets	**$22,366,284,712**	**$23,315,646,083**	**($949,361,371)**	**(4.1%)**

CONDENSED COMPARATIVE STATEMENT OF CHANGES IN PLAN NET ASSETS

	Year Ended June 30, 2002	Year Ended June 30, 2001	Decrease/Increase Amount	Percentage Change
Contributions	$1,588,509,682	$1,465,188,709	$123,320,973	8.4%
Net investment loss	(723,987,045)	(1,015,255,237)	291,268,192	28.7
Total additions	864,522,637	449,933,472	414,589,165	92.1
Benefits and refunds	1,798,504,272	1,602,642,310	195,861,962	12.2
Administrative expenses/transfers	15,379,736	13,057,686	2,322,050	17.8
Total deductions	1,813,884,008	1,615,699,996	198,184,012	12.3
Net decrease in net assets	**(949,361,371)**	**(1,165,766,524)**	**216,405,153**	**18.6**
Net assets beginning of year	**23,315,646,083**	**24,481,412,607**	**(1,165,766,524)**	**(4.8)**
Net assets end of year	**$22,366,284,712**	**$23,315,646,083**	**($949,361,371)**	**(4.1%)**

FINANCIAL ANALYSIS

TRS was created to provide retirement, survivor, and disability benefits to qualified members. Increases or decreases in plan net assets serve as useful indicators of the System's financial position. Net assets available to pay benefits were $22.4 billion at June 30, 2002. However, net assets decreased $949 million during the fiscal year.

CONTRIBUTIONS

Contributions increased $123 million during FY02. Member contributions increased $38 million while employer contributions decreased $5 million. The decrease in the employer contribution is attributable to the mid-year decrease in the employer contribution rate. Contributions from the State of Illinois increased $91 million. The State of Illinois provides contributions through state appropriations. The increase in the state contributions were in accordance with actuarial funding requirements determined under Public Act 90-582 which provides for a 50-year funding plan that includes a 15-year phase in period.

INVESTMENTS

For FY02, investments had a (3.2) percent rate of return, net of fees. Total investments declined $1.1 billion from $24.0 billion at June 30, 2001 to $22.9 billion at June 30, 2002. TRS experienced its first back-to-back decline in market value ever. The impact of the equity market declines on the TRS portfolio was lessened by the System's investment diversification. While the recent declines in the equity markets are disappointing, TRS's five and 10-year returns are 5.8 percent and 9.1 percent, respectively. The 10-year return compares favorably to the actuarial investment rate of return assumption of 8.5 percent.

Fiscal year 2002 was another challenging year for world financial markets. U.S. and international fixed income markets provided a safe haven for investors while equity markets declined significantly. Due to TRS's solid, conservative investment approach and broad diversification, the TRS investment portfolio performed well compared to its peers. TRS surpassed the returns of over 80 percent of public retirement funds with assets over $1 billion.

Diversification is the cornerstone to the TRS investment philosophy. Investing in a number of broad asset classes helps to minimize the risk associated with a downturn in any single asset class, such as that seen in the equity markets over the past year. In particular, TRS investments in fixed income and real estate served to partially offset the negative returns experienced by equity markets in fiscal year 2002. An additional layer of diversification is provided by employment of multiple investment managers of varying investment styles within each asset class. This broad exposure to markets serves as the portfolio's best defense against market volatility.

BENEFITS AND REFUNDS

Survivor, disability, and retirement benefit payments increased $193 million, from $1,567 million with 64,877 recipients during FY01 to $1,760 million with 67,949 recipients during FY02. The increase in benefit payments is due mainly to an increase in retirement benefit payments. Retirement benefits increased as a result of an automatic 3 percent annual increase in retirement benefits, an increase in the number of retirees from 56,549 as of June 30, 2001 to 59,360 as of June 30, 2002, and an increase in the final average salaries of teachers that retired during the fiscal year.

Refunds of contributions increased $3 million, from $36 million during FY01 to $39 million during FY02. The increase in refunds is a result of increases in 2.2 upgrade contribution refunds, withdrawal of contributions by members leaving teaching, and an increase in survivor benefit refunds.

ACTUARIAL

The annual actuarial valuation measures the total liability for all benefits earned to date. The accrued liability is a present value estimate of all the benefits that have been earned to date. The actuarial accrued liability increased from $39.17 billion at June 30, 2001 to $43.05 billion at June 30, 2002. The unfunded liability is the present value of future benefits payable that are not covered by assets as of the valuation date. The unfunded liability increased from $15.85 billion at June 30, 2001 to $20.68 billion at June 30, 2002. The funded ratio reflects the percentage of the accrued liability covered by net assets at market value. The funded ratio decreased from 59.5 percent at June 30, 2001 to 52.0 percent at June 30, 2002. Increases in the unfunded liability and decreases in the funded ratio indicate a decline in a system's financial position.

In FY02, the System's actuaries conducted an experience analysis of the previous five-year period ended June 30, 2001. The analysis resulted in the following changes in assumptions.

- Decrease in the salary increase assumption from 7.0 percent to 6.5 percent.
- Decrease in the inflation rate assumption from 4.0 percent to 3.5 percent.
- Higher rates of retirement.
- Minor changes in several other assumptions.

The net effect of all the actuarial changes decreased the June 30, 2002, actuarial accrued liability by approximately $346 million compared to the accrued liability that would have been calculated under the old assumptions.

Robinson High School
Robinson

Mahomet-Seymour High School
Mahomet

BASIC FINANCIAL STATEMENTS

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
STATEMENT OF PLAN NET ASSETS AS OF
JUNE 30, 2002, AND 2001

	2002	2001
Assets		
Cash	$6,039,088	$7,889,353
Receivables and prepaid expenses		
Member payroll deduction	111,106,770	160,440,980
Member contributions	38,806,046	31,052,076
Employer contributions	8,811,602	7,379,527
State of Illinois	651,505	0
Investment income	233,414,394	202,756,810
Prepaid expenses	410,160	968,066
Total receivables and prepaid expenses	393,200,477	402,597,459
Investments, at fair value		
Fixed income	8,795,239,241	8,817,862,697
Equities	10,126,648,199	11,015,551,513
Real estate	2,202,925,998	2,424,554,513
Short-term investments	1,201,995,818	1,036,104,680
Private equity investments	594,153,359	689,740,876
Foreign currency	23,955,458	26,752,464
Total investments	22,944,918,073	24,010,566,743
Collateral from securities lending	1,897,635,461	2,288,995,477
Property and equipment, at cost, net of accumulated depreciation of $6,216,008 and $5,780,569 in 2002 and 2001, respectively	3,113,533	3,658,427
Total assets	**25,244,906,632**	**26,713,707,459**
Liabilities		
Benefits and refunds payable	7,204,169	5,694,934
Administrative and investment expenses payable	81,017,997	71,323,165
Payable to brokers for unsettled trades, net	892,764,293	1,032,047,800
Securities lending transactions	1,897,635,461	2,288,995,477
Total liabilities	**2,878,621,920**	**3,398,061,376**
Net assets held in trust for pension benefits	**$22,366,284,712**	**$23,315,646,083**

(A schedule of funding progress is presented on page 38.)

The accompanying notes are an integral part of these statements.

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
STATEMENT OF CHANGES IN PLAN NET ASSETS
YEARS ENDED JUNE 30, 2002, AND 2001

	2002	2001
Additions		
Contributions		
Members	$681,151,770	$643,563,304
State of Illinois	814,739,766	724,007,792
Employers		
Early retirement	41,347,938	38,632,385
Federal funds	26,282,792	23,175,955
2.2 benefit formula	24,987,416	35,809,273
Total contributions	1,588,509,682	1,465,188,709
Investment income		
Net depreciation in fair value	(1,461,163,444)	(1,860,498,992)
Interest	463,758,715	565,646,688
Real estate operating income, net	174,430,870	190,286,928
Dividends	132,356,304	137,819,508
Private equity income	28,036,960	18,741,785
Securities lending income	56,498,682	145,941,616
Other investment income	13,640,070	3,193,440
	(592,441,843)	(798,869,027)
Less investment expense		
Securities lending expense	45,237,012	133,283,965
Investment activity expenses	86,308,190	83,102,245
Net investment loss	(723,987,045)	(1,015,255,237)
Total additions	**864,522,637**	**449,933,472**
Deductions		
Retirement benefits	1,660,997,776	1,475,489,564
Survivor benefits	80,461,343	74,630,874
Disability benefits	18,289,549	16,672,793
Refunds	38,755,604	35,849,079
Administrative expenses	13,487,393	12,640,595
Prior service credits and transfers	1,892,343	417,091
Total deductions	**1,813,884,008**	**1,615,699,996**
Net decrease	**(949,361,371)**	**(1,165,766,524)**
Net assets held in trust for pension benefits		
Beginning of year	23,315,646,083	24,481,412,607
End of year	**$22,366,284,712**	**$23,315,646,083**

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

A. PLAN DESCRIPTION

1. *Reporting Entity*

The Teachers' Retirement System of the State of Illinois (TRS) is the administrator of a cost-sharing multiple-employer defined benefit public employee retirement system (PERS). Membership is mandatory for all full-time, part-time, and substitute public school personnel employed outside of Chicago in positions requiring certification. Persons employed at certain state agencies are also members. Established by the State of Illinois, TRS is governed by the Illinois Pension Code (40 ILCS 5/16). TRS is a component unit of the State of Illinois and is included in the state's financial statements as a pension trust fund.

TRS uses criteria established by the Governmental Accounting Standards Board (GASB) to determine whether other entities should be included within its financial reporting entity. Based on the criteria, TRS has no other entities included in these financial statements.

2. *Employers*

Members of TRS are employed by school districts, special districts, and certain state agencies. Each employer remits member contributions to TRS. Employers are responsible for employer contributions for teachers paid from federal funds and for the employer's portion of the Early Retirement Option contributions. Effective July 1, 1998, Public Act 90-582 required employers to pay an employer contribution equal to 0.3 percent of covered payroll in FY99 and 0.58 percent of covered payroll through December 31, 2001. Effective January 1, 2002, the employer contribution was reduced to 0.18 percent of covered payroll. In addition, the State of Illinois provides employer contributions. For information about employer contributions made by the State of Illinois, see "Funding" on page 26.

NUMBER OF EMPLOYERS (AS OF JUNE 30)

	2002	2001
Local school districts	890	892
Special districts	140	134
State agencies	27	28
Total	**1,057**	**1,054**

Dakota Elementary School
Dakota

3. *Members*

TRS MEMBERSHIP (AS OF JUNE 30)

	2002	2001
Retirees and beneficiaries receiving benefits	67,949	64,877
Inactive members entitled to but not yet receiving benefits	66,971	69,512
Active members	155,979	150,783
Total	**290,899**	**285,172**

4. *Benefit Provisions*

Governed by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the Governor, TRS provides retirement, death, and disability benefits. A member qualifies for an age retirement annuity after meeting one of the following requirements: age 62 with five years of service credit; age 60 with 10 years; or age 55 with 20 years. If a member retires between the ages of 55 and 60 with fewer than 35 years of service, the annuity will be reduced at the rate of 0.50 percent for each month the member is under age 60. A member who is age 55 and has fewer than 35 years of service credit may use the Early Retirement Option (ERO) to avoid a discount for early retirement if retirement occurs before July 1, 2005, and within six months of the last day of service requiring contributions, and if the member and employer both make a one-time contribution to TRS. However, both member and employer contributions are waived with 34 years of service. A member with fewer than five years of creditable service and service on or after July 1, 1947, is entitled to a single-sum benefit payable once he or she reaches age 65.

A retirement benefit is determined by the average salary of the four highest consecutive salary rates within the last 10 years of creditable service and the percentage of average salary to which the member is entitled. This percentage is determined by the following formula for service earned before July 1, 1998: 1.67 percent for each of the first 10 years, plus 1.9 percent for each of the next 10 years, plus 2.1 percent for each of the next 10 years, plus 2.3 percent for each year over 30 years. The maximum retirement benefit, 75 percent of average salary, is achieved with 38 years of service under the graduated formula.

Public Act 90-582 improved retirement benefits for TRS members by changing the rate at which members accrue benefits beginning July 1, 1998, from a graduated rate to a flat rate equal to 2.2 percent of final average salary. Members may attain the maximum 75 percent benefit with

34 years of service under the 2.2 benefit formula. Members retiring on or after the effective date have the option of upgrading their service earned prior to July 1, 1998, to the flat 2.2 percent formula by making a payment to TRS. Additionally, for members who continue to teach, every three full years worked after July 1, 1998, count toward a full one-year reduction of the years to be upgraded.

A money purchase (actuarial) benefit is payable if it results in a higher annuity than either the graduated or 2.2 formula. The 75 percent cap does not apply to the money purchase benefit.

Essentially all retirees receive an annual 3 percent increase in the current retirement benefit beginning January 1 following the attainment of age 61 or January 1 following the first anniversary in retirement, whichever is later.

If a member leaves covered employment, TRS will refund a member's retirement contributions upon request. The refund consists of actual contributions, excluding the 1 percent death benefit contribution.

On June 25, 2002, Governor Ryan signed the State Employee 5&5 Early Retirement Incentive (Public Act 92-0566) into law.

Under the terms of this legislation, a TRS member employed by a state agency may elect to purchase five years of service credit and enhanced age. The member must pay TRS an employee contribution based on the member's highest annual salary rate used in the determination of final average salary. The required 5&5 contribution must be deducted from any lump-sum payment at termination.

If there is no lump sum or if the lump sum is less than the contribution required, the remaining amount due will be treated as a reduction from the retirement annuity in 24 equal monthly installments. A member must retire between August 1, 2002 and December 31, 2002 unless extended by the agency director to a date no later than April 30, 2003.

5. *Funding*

Member, employer, and state contributions are statutorily defined by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the Governor.

Effective July 1, 1998, member contributions increased from 8 percent to 9 percent of salary. These contributions are allocated as follows: 7.5 percent for retirement, 0.50 percent for post-retirement increases, and 1 percent for death benefits.

Employer contributions are made by or on behalf of the employers from several sources. The State of Illinois provides a large source of contributions through state appropriations from the Common School Fund and Education

Assistance Fund. Additional sources of state contributions are the State Pensions Fund and the General Revenue Fund. Effective July 1, 1998, the state began making contributions for the 2.2 benefit formula that are included in statutorily specified minimum state contribution rates. Employers also make contributions for the 2.2 benefit formula and for teachers who are paid from federal funds. Additionally, employers contribute their portion of the cost of the Early Retirement Option.

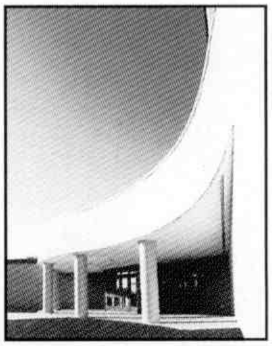
The actuarial funding requirements for FY02 and FY01 were determined under Public Act 90-582. State funding law provides for a 50-year funding plan that includes a 15-year phase-in period. Minimum state contribution rates are specified in the statute for FY99 through FY10. Employer contributions, as a percentage of active member payroll, will be gradually increased until FY10 and remain at a level percentage for the following 35 years. TRS's funded ratio will be 90 percent at the end of the 50-year period. Beginning July 1, 1995, state contributions have been made through a continuing appropriation instead of through the appropriations process.

Administrative expenses are budgeted and approved by the TRS Board of Trustees. Funding for these expenses is included in the employer contribution, as determined by the annual actuarial valuation.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. *Basis of Accounting*

TRS's financial statements are prepared using the accrual basis of accounting. Member and employer contributions are recognized as revenues in the period in which member services are performed. Benefits and refunds are recognized as expenditures when they are due and payable in accordance with the terms of the plan.



Beecher High School
Beecher

2. *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions to and deductions from net assets during the reporting period. Actual results could differ from those estimates.

3. *New Accounting Pronouncements*

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (GASB 34). In June 2001, the GASB issued Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, which amended certain provi-

sions of GASB 34. Also in June 2001, the GASB issued Statement No. 38, *Certain Financial Statement Note Disclosures*, which modified, established, and rescinded certain financial statement note disclosures. The adoption of GASB 34 required TRS to present Management's Discussion and Analysis. The Management's Discussion and Analysis is considered to be required supplementary information and precedes the financial statements. The adoption of GASB 34, 37, and 38, effective July 1, 2001, had no impact on TRS's basic financial statements or its net assets.

4. Method Used to Value Investments

TRS reports investments at fair value. Fair value for equities is determined by using the closing price listed on national and over-the-counter securities exchanges as of June 30. Fair value for fixed income securities is determined principally by using quoted market prices provided by independent pricing services. Fair value for real estate investments is determined by appraisals. Fair value for private equity assets is determined by the general partner in accordance with the provisions of the individual equity agreements.

5. Property and Equipment

Equipment is stated on the basis of historical cost. Depreciation is computed using the straight-line method based upon the estimated useful lives of the assets. Office furniture and equipment are assigned a useful life of three to 10 years while vehicles are assigned a five-year life. TRS's office building is depreciated over 40 years.

6. Accrued Compensated Absences

When they terminate employment, TRS employees are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned through December 31, 1997. (Lump-sum payments for sick leave earned prior to January 1, 1984, are subject to a maximum of 60 days or 420 hours.) Accrued compensated absences as of June 30, 2002, and 2001 totaled $1,360,953 and $1,357,443, respectively, and are included as administrative and investment expenses payable.

7. Receivables

Receivables consist primarily of 1) member and employer contributions owed and yet to be remitted by the employing districts as of June 30 and 2) interest, dividends and real estate income owed to TRS as of June 30.

TRS assesses penalties for late payment of contributions and may collect any unpaid amounts from the employing districts by filing a claim with the regional superintendent of education or the Office of the Comptroller against future state aid payments to the employer. TRS considers these amounts to be fully collectible.

Members may enter into Payroll Deduction Program agreements with their employers to pay for their optional service balances, to repay refunds previously taken from TRS, or to pay for their 2.2 benefit formula upgrade balances. Terms and conditions of the agreements are:

- A member must be employed full time.
- The agreement is irrevocable and can be terminated only upon full payment of the member's balance or upon the member's death, disability, retirement, or termination of employment.
- The amount deducted must be a minimum of $50 per month and cannot be changed during the term of the agreement.
- Agreements may begin at the beginning of each calendar year quarter.
- The member may not make direct payments to TRS to reduce the balance under which an agreement has been entered.

If the agreement is to pay for a 2.2 formula upgrade balance, the maximum length of the agreement is 60 months. TRS had outstanding balances in payroll deduction agreements totalling $111,106,770 and $160,440,980 as of June 30, 2002, and 2001, respectively.

8. Prior Period Reclassification

Certain prior year amounts have been reclassified on a basis consistent with the current year presentation.

C. CASH

The bank balance and carrying amount of TRS's deposits were $2,281,489 and $6,039,088 at June 30, 2002, and $2,009,923 and $7,889,353 at June 30, 2001. Of the bank balance, $303,041 and $107,531 were on deposit with the state treasurer at June 30, 2002, and 2001, respectively. Bank balances are either insured or collateralized with securities held by the state treasurer or agents in the name of the state treasurer or are collateralized with securities held by TRS or its agents in the name of TRS. Cash equivalents are classified as short-term investments in the Statement of Plan Net Assets.

INVESTMENT SUMMARY

	Fair Value 2002	2001
Category 1		
Government obligations	$4,943,310,948	$3,889,687,839
Corporate obligations	2,345,278,328	2,960,222,604
Preferred stock	100,963,556	112,594,835
Short-term investments		
Commercial paper		
(including short-term collateral and other)	38,255,078	39,179,749
U.S. Treasury bills	77,397,673	98,932
Common stock	4,843,826,185	6,659,594,148
	12,349,031,768	**13,661,378,107**
Not Categorized		
Investments held by broker-dealers under securities loans		
Government obligations	1,201,846,412	1,193,721,879
Corporate obligations	229,571,417	168,941,773
Common stock	894,790,840	1,373,267,578
Real estate equity	2,134,439,485	2,302,779,529
Mutual funds	4,355,554,131	3,601,165,085
Private equity investments		
Limited partnerships	594,153,359	689,740,876
Foreign currency	23,955,458	26,752,464
Collective investment funds (U.S. dollars)	1,163,740,739	996,924,930
Security lending short-term collateral investment pool	1,895,469,925	2,284,889,999
Investments and collateral from securities lending	24,842,553,534	26,299,562,220
Less collateral from securities lending	(1,897,635,461)	(2,288,995,477)
Total investments*	**$22,944,918,073**	**$24,010,566,743**

* *This total does not include accrued income.*

D. INVESTMENTS

1. *Investment Policies*

Through the Board of Trustees, as authorized in the Illinois Pension Code, TRS serves as fiduciary for the members' trust funds and is responsible for investment of those funds by authority of the "prudent person rule." This rule establishes a standard for all fiduciaries by specifying fiduciary responsibility with regard to the members' trust funds.

2. *Investment Summary*

The Investment Summary table presents a summary of TRS's investments and related category of custodial credit risk at June 30, 2002, and 2001. TRS's investments are categorized to give an indication of the level of risk at year end.

Category 1 includes investments that are insured or registered, or for which the securities are held by TRS or its agent in the name of TRS. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department in TRS's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty but not in TRS's name. As of June 30, 2002, and 2001, TRS holds no securities classified in either Category 2 or Category 3.

TRS has nonrecourse mortgages totalling $292,888,883 and $294,646,716 on real estate equities at June 30, 2002, and 2001, respectively. The amount reported for real estate equity is net of these mortgages, which mature on various dates through the year 2018.

Cary Grove High School
Cary

The real estate equity category includes $31,212,240 and $50,374,838 of mortgages receivable which are fully secured by the properties at June 30, 2002, and 2001, respectively.

At June 30, 2002, and 2001, TRS did not have any investments with one organization that exceeded 5 percent of net assets held in trust for pension benefits.

3. *Securities Lending Program*

The Board of Trustees' policies permit TRS to use investments to enter into securities lending transactions—loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. TRS's master trustee is the agent in lending the plan's domestic securities for cash collateral of 102 percent of the market value of the securities and international securities for cash collateral of 105 percent of the market value of the securities. Securities on loan at year-end are presented as not categorized in the preceding schedule of custodial credit risk.

At year-end, TRS has no credit risk exposure to borrowers because the amount TRS owes the borrowers exceeds the amount the borrowers owe TRS. The contract with TRS's lending agent requires the agent to indemnify TRS if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay TRS for income distributions by the securities issuers while the securities are on loan. All securities loans can be terminated on demand either by TRS or the borrower, although the average term of the loans is 104 days. In lending domestic securities, cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted average maturity of 48 days. There were no significant violations of legal or contractual provisions, and there were no borrower or lending agent default losses known to the securities lending agent.

As of June 30, 2002, and 2001, TRS had outstanding loaned investment securities having a market value of $2,326,208,668 and $2,735,931,230, respectively, against which it had received collateral of $2,419,253,253 and

$2,880,112,714, respectively. Collateral from securities lending reflected on the Statement of Plan Net Assets consists primarily of collateral received in the form of cash.

4. *Derivatives*

TRS invests in derivative securities. A derivative security is an investment whose return depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to the established terms. To eliminate credit risk, derivative securities are generally acquired through a clearinghouse that guarantees delivery and accepts the risk of default by either party.

Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing limits on the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a regular basis to monitor compliance with the limits.

During the year, TRS's derivative investments included foreign currency forward contracts, futures, and options. Derivative contracts are used by experienced investment personnel to implement tactical strategies upon the portfolios in a cost-effective manner. Foreign currency forward contracts are used to hedge against the currency risk in TRS's foreign stock and fixed income security portfolios. The remaining derivative securities are used to improve yield, adjust the duration of the fixed income portfolio, or hedge changes in interest rates.

Foreign currency forward contracts are agreements to buy or sell a specific amount of a foreign currency at a specified delivery date or maturity date for an agreed upon price. Fluctuations in the fair value of foreign currency forward contracts are recognized in TRS's financial statements as incurred rather than at the maturity or settlement date of the contract. Foreign currency forward contracts represent an off-balance sheet obligation because there are no balance sheet assets or liabilities associated with those contracts.

Financial futures are agreements to buy or sell a specific amount of an asset at a specified delivery or maturity date for an agreed upon price. As the market value of the futures

Centennial Elementary School Polo

contract varies from the original contract price, a gain or a loss is recognized and paid to the clearinghouse. Financial futures represent an off-balance sheet obligation because there are no balance sheet assets or liabilities associated with those contracts.

Financial options are agreements that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, TRS receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. Accordingly, it is against TRS policy to invest in any uncovered options. Premiums received are recorded as a liability when the financial option is written.

Fluctuations in the fair value of financial options are recognized in TRS's financial statements as incurred rather than at the time the options are exercised or when they expire. As of June 30, 2002, and 2001, the fair value of option contracts written was ($664,528) and ($793,894), respectively. The fair value represents the amount needed to close all positions as of that date.

The Derivatives Contracts table presents the aggregate contractual principal amount of TRS's outstanding contracts at June 30, 2002, and 2001. Contractual principal amounts are often used to express the volume of these transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk.

DERIVATIVES CONTRACTS

Type	FY02 No. of Contracts	FY02 Contractual Principal*	FY01 No. of Contracts	FY01 Contractual Principal*
Domestic Interest Rate Products				
Index fixed income futures (net)	2,087	$224,125,141	765	$78,699,926
Fixed income written call options	343	14,110,800	1,690	33,188,100
Fixed income written put options	3,300	0	3,300	10,312,500
Domestic Equity Products				
S&P 500 Index futures (net)	3,175	785,891,875	2,298	707,611,650
Foreign Currency Products				
Currency futures (net)	461	112,576,600	2,121	502,302,575
Currency written put options	6,161	84,581,500	1,665	73,994,750

* *The contractual principal amounts listed above represent the market value of the underlying assets that the derivative contracts control. Contractual principal values do not represent actual values in the Statement of Plan Net Assets.*

E. RESERVES

TRS maintains statutory reserve accounts in accordance with the provisions of 40 ILCS 5/16-101 *et seq.* In 1997, the Illinois General Assembly passed legislation that allowed the crediting of income at fair value, as opposed to book value, to the Employer's Contribution Reserve.

1. Members' Contribution

	2002	2001
Balances at June 30	$9,167,409,595	$8,271,682,135

This reserve accumulates, with 6 percent interest, the contributions by members prior to retirement. Contributions have been 7.5 percent of salary since July 1, 1998. Contributions are fully refundable upon withdrawal from TRS, excluding interest credited thereon. The interest accrued is refundable only in the event of death. Interest is credited as of the date of retirement or death of those retiring or dying during the year and as of the end of the fiscal year for all other members. Interest is computed annually based upon the individual member's balance in the reserve at the beginning of the fiscal year. This reserve is fully funded.

2. Minimum Retirement Annuity

	2002	2001
Balances at June 30	$3,479,416	$3,269,192

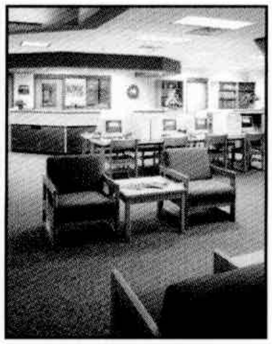
The minimum annuity is set by law at $25 per month for each year of creditable service to a maximum of $750 per month after 30 or more years of creditable service. To qualify, annuitants are required to make a one-time contribution that is credited to the reserve. Interest at 6 percent is credited to the reserve annually based upon the average reserve balance. The State of Illinois also appropriated funds necessary to pay the minimum benefits provided in the legislation. All benefits paid under this program are charged to the reserve. This reserve is fully funded.

3. Supplementary Annuity

	2002	2001
Balances at June 30	$0	$893,336

In 1961, legislation was enacted to provide for increased annuities to retired members who met certain specified requirements. Annuitants were required to make a one-time contribution, which was credited to this reserve. The State of Illinois also appropriated funds that were credited to the reserve through FY00. Interest at 6 percent was credited to the reserve annually based upon the average reserve balance. The annuity expenses resulting from this legislation were charged to the reserve.

During fiscal year 2002, this reserve was dissolved and the remaining funds were transferred to the Employer's Contribution Reserve. Beginning July 1, 2001, the supplementary annuity expenses were charged to the Employer's Contribution Reserve.



Eastland High School
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4. Employer's Contribution

	2002	2001
Balances at June 30	$13,195,395,701	$15,039,801,420

This reserve serves as a clearing account for TRS income and expenses. The reserve is credited with contributions from the State of Illinois that are not specifically allocated to other reserves, member and employer contributions, income from TRS invested assets, the interest portion of the accumulated contributions of members who are granted refunds, and contributions from annuitants who qualify for automatic annual increases in annuity. The reserve is charged with amounts necessary to be transferred to the Members' Contribution Reserve, all amounts necessary to be refunded to withdrawing members, all retirement annuity payments except as provided by other reserve accounts, all benefits that are paid to temporarily or accidentally disabled members, all death benefits that are paid, and all survivor benefit contributions that are refunded to annuitants.

This reserve does not equal the present value of expected benefit payments. The additional amount needed (the unfunded actuarial accrued liability) as calculated by the actuary was $20,681,389,000 in 2002 and $15,851,051,000 in 2001.

F. TRS EMPLOYEE PENSION BENEFITS

1. Plan Description

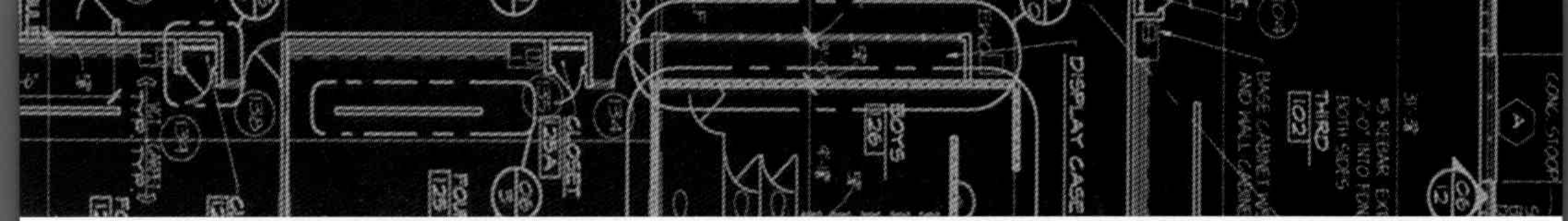
All full-time TRS employees who are not eligible to participate in TRS participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. SERS is a single-employer defined benefit public employee retirement system (PERS) in which state employees participate, except those who are covered by the State Universities Retirement System, Teachers' Retirement System, General Assembly Retirement System, and Judges' Retirement System. SERS's financial position and results of operations for fiscal years 2002 and 2001 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the years ended June 30, 2002, and 2001, respectively. SERS also issues a separate CAFR that may be obtained by writing to SERS, 2101 South Veterans Parkway, Springfield, Illinois 62794-9255 or by calling (217) 785-7444. The State of Illinois CAFR may be obtained by writing to Office of the Comptroller, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois 62704-1858 or by calling (217) 782-2053.

A summary of SERS's benefit provisions; changes in benefit provisions; employee eligibility requirements, including eligibility for vesting; and the authority under which benefit provisions are established are included as an integral part of the SERS CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

2. *Funding Policy*

TRS pays employer retirement contributions to SERS based on an actuarially determined percentage of the TRS employee payroll representing TRS employees who are members of SERS. For FY02, FY01, and FY00, the SERS employer contribution rates were 10.040 percent, 9.944 percent, and 9.714 percent, respectively. TRS contributions for the years ending FY02, FY01, and FY00 were \$529,400, \$523,129, and \$484,575, respectively. Effective for pay periods beginning after July 1, 1993, the TRS Board of Trustees opted to pay the employee contribution for all employees. The contribution pickup (4 percent for SERS members, 9 percent for TRS members beginning in FY01 and 8 percent for TRS members in prior years) was included in the FY02 and FY01 administrative budgets approved by the board.

TRS pays an employer contribution for its employees who are also members of TRS. Additional employer contributions for these employees are paid by the State of Illinois and are included in the annual state contribution to TRS.



3. *Post-Employment Benefits – TRS Employees*

In addition to providing pension benefits, the State Employees Group Insurance Act of 1971 requires certain health, dental, and life insurance benefits be provided by the state. Substantially, all TRS employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for TRS retirees under the state's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to $5,000 per annuitant who is age 60 or older.

Costs incurred for health, dental, and life insurance for annuitants and their dependents were not separated from benefits that were provided to active employees and their dependents for the years ended June 30, 2002, and 2001. However, post-employment costs for the state as a whole for all state agencies or departments for dependent health, dental, and life insurance for annuitants and their dependents are disclosed in the state's Comprehensive Annual Financial Report. Cost information for retirees by individual state agency is not available. Payments are made on a "pay-as-you-go" basis.

G. SUBSEQUENT EVENTS

TRS suffered a decline in its investment portfolio subsequent to year end. As of October 31, 2002, TRS has incurred an approximate $1,221,079,000, 4.9 percent, decrease in its investment portfolio since June 30, 2002.

Happiness lies in the joy of achievement and the thrill of creative effort.

- Franklin D. Roosevelt

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS[1]

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL-Projected Unit Credit) (b)	Funded Ratio (a)/(b)	Unfunded Actuarial Accrued Liability (UAAL) (b) - (a)	Covered Payroll (c)	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll (b-a)/(c)
6/30/96	$15,103,927,000	$26,141,794,000	57.8%	$11,037,867,000	$4,734,250,000	233.1%
6/30/97	17,393,108,000	26,951,585,000	64.5	9,558,477,000	5,013,583,000	190.7
6/30/98	19,965,887,000	29,908,241,000	66.8	9,942,354,000	5,323,403,000	186.8
6/30/99	22,237,709,000	33,205,513,000	67.0	10,967,804,000	5,698,117,000	192.5
6/30/00	24,481,413,000	35,886,404,000	68.2	11,404,991,000	6,062,884,000	188.1
6/30/01	23,315,646,000	39,166,697,000	59.5	15,851,051,000	6,430,612,000	246.5
6/30/02	**22,366,285,000**	**43,047,674,000**	**52.0**	**20,681,389,000**	**6,785,236,000**	**304.8**

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS AND OTHER CONTRIBUTING ENTITIES[1]

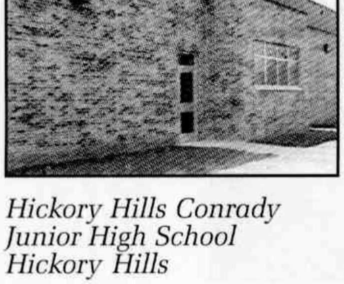
Year Ended June 30	State Contributions[2]	Federal and Employer Contributions[2]	Total	Annual Required Contribution per GASB Statement #25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
1996	$324,276,000	$16,997,000	$341,273,000	$1,350,997,000	25.3%	$341,276,000	100.0%
1997	377,969,000	17,379,000	395,348,000	927,842,000	42.6	395,269,000	100.0
1998	460,439,000	17,246,000	477,685,000	983,312,000	48.6	478,439,000	99.8
1999	567,068,000	36,535,000	603,603,000	932,909,000	64.7	592,547,000	101.9
2000	634,039,000	54,547,000	688,586,000	1,003,612,000	68.6	686,384,000	100.3
2001	719,357,000	58,985,000	778,342,000	1,102,441,000	70.6	775,732,000	100.3
2002	**810,619,000**	**51,270,000**	**861,889,000**	**1,163,262,000**	**74.1**	**872,283,000**	**98.8**

1 *For consistency with figures reported by TRS's actuaries, the amounts have been rounded to the nearest thousand. Actual contributions varied slightly from contributions that are required by statute mainly because of differences between estimated and actual federal contributions.*

In FY02, the annual contribution required per state statute is the state funding requirement certified before Public Act 92-505 was enacted. This act allowed districts to reduce their contributions to TRS by the amount they contribute to the Teachers' Health Insurance Security Fund. The diversion is effective January 1, 2002 through June 30, 2003.

2 *Excludes ERO, ERI, minimum retirement, and supplemental contributions. Beginning in FY01, the supplemental appropriation was not requested. These amounts are not counted for actuarial purposes.*

See accompanying Independent Auditors' Report.



Hickory Hills Conrady Junior High School Hickory Hills

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

Valuation Dates	June 30, 2002	June 30, 2001
Actuarial cost method:	Projected unit credit	Projected unit credit
Amortization method:		
a) For GASB Statement #25 reporting purposes	Level percent of payroll	Level percent of payroll
b) Per state statute	15-year phase-in to a level percent of payroll until a 90% funding level is achieved	15-year phase-in to a level percent of payroll until a 90% funding level is achieved
	Minimum state contribution rates in statute include cost of of 2.2 benefit formula change as a level percent of payroll	Minimum state contribution rates in statute include cost 2.2 benefit formula change as a level percent of payroll
Remaining amortization period:		
a) For GASB Statement #25 reporting purposes	40 years, open	40 years, open
b) Per state statute	43 years, closed	44 years, closed
Asset valuation method:	Fair value	Fair value
Actuarial assumptions:		
Investment rate of return	8.5%	8.5%
Projected salary increases	5.9-10.1% composite 6.5%	6.0-9.3%, composite 7.0%
Group size growth rate	0%	0%
Assumed inflation rate	3.5%	4%
Post-retirement increase	3% compounded	3% compounded
Mortality table	1995 Buck Mortality Tables (rated forward three years for male benefit recipients only)	1995 Buck Mortality Tables (rated forward one year for beneficiaries only)

See accompanying Independent Auditors' Report.

Roscoe Middle School
Roscoe

OTHER SUPPLEMENTARY INFORMATION

SCHEDULE OF ADMINISTRATIVE EXPENSES
(FOR YEARS ENDED JUNE 30)

	2002	2001
Personal services	$9,328,695	$9,195,997
Professional services	1,434,574	844,265
Postage	390,748	414,273
Machine repair and rental	473,750	409,675
Other contractual services	657,504	769,075
Commodities	396,268	270,924
Occupancy expense	174,040	168,563
Depreciation	631,520	561,158
Loss on disposal of equipment	294	6,665
Total administrative expenses	**$13,487,393**	**$12,640,595**

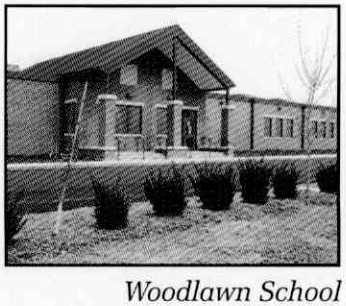
SCHEDULE OF INVESTMENT ACTIVITY EXPENSES
(FOR YEARS ENDED JUNE 30)

	2002	2001
Investment manager fees	$62,293,193	$71,154,807
Private equity investment expense	22,606,797	10,192,514
Miscellaneous	1,408,200	1,754,924
Total investment activity expenses	**$86,308,190**	**$83,102,245**

SCHEDULE OF PAYMENTS TO CONSULTANTS
(FOR YEARS ENDED JUNE 30)

	2002	2001
Actuarial services	$187,558	$94,273
External auditors	108,127	104,882
Legal services	244,016	141,820
Management consultants		
Information systems	774,452	428,881
TRS STAR audit	61,989	0
Benchmarking	0	25,000
Salary review	15,190	0
Executive search	37,708	42,999
Other	5,534	6,410
Total payments to consultants	**$1,434,574**	**$844,265**

See accompanying Independent Auditors' Report.



Woodlawn School
Woodlawn