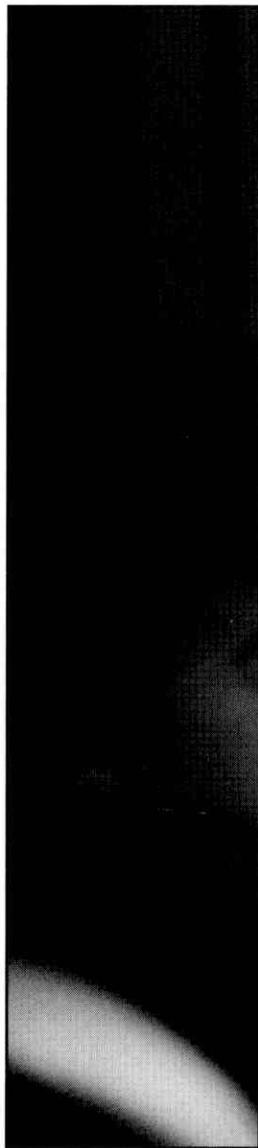


Introductory



Certificate of Achievement for Excellence in Financial Reporting

Presented to

Teachers' Retirement System of the State of Illinois

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2000

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.



James D. Greve
President

Jeffrey L. Esser
Executive Director



Teachers' Retirement System of the State of Illinois

- ♦ 2815 West Washington, P.O. Box 19253, Springfield, Illinois 62794-9253 ♦
- ♦ 4200 Commerce Court, Suite 100, Lisle, Illinois 60532-3611 ♦

Letter of Transmittal

December 1, 2001

Board of Trustees
Teachers' Retirement System
2815 West Washington, P.O. Box 19253
Springfield, IL 62794-9253

I am pleased to present the *Comprehensive Annual Financial Report* for the Teachers' Retirement System of the State of Illinois (TRS) for the fiscal year ended June 30, 2001. TRS management and staff are responsible for the accuracy and completeness of this report and for ensuring that all material disclosures have been made. To the best of our knowledge, the information presented is a fair and accurate portrayal of the financial position and operations of TRS as of June 30, 2001.

This report consists of five sections:

- ★ The Introductory Section contains the Certificate of Achievement for Excellence in Financial Reporting, this letter of transmittal, a message from our executive director that outlines the major activities of the past year and plans for the future, identification of the TRS Board of Trustees and organizational structure, and consulting and professional service providers.
- ★ The Financial Section contains the independent auditors' report, the financial statements and related notes, and required supplementary schedules.
- ★ The Investment Section contains information detailing TRS performance, investment managers, and the TRS investment portfolio.
- ★ The Actuarial Section contains the actuary's letter of certification, results of the latest actuarial valuation, certain statistical information on members and benefit recipients, and a plan summary including any changes in the plan.
- ★ The Statistical Section contains information and additional statistical data pertaining to benefit recipients and historical data on revenue and expenses.

Financial Information

A system of internal controls helps TRS to monitor and safeguard assets and promote efficient operations. An annual external audit is conducted by the Illinois Auditor General in addition to regular reviews by our internal auditor. The annual budget for TRS administrative expenses is approved by the Board of Trustees, and financial statements are prepared in accordance with generally accepted accounting principles (GAAP) within the guidelines established by the Governmental Accounting Standards Board (GASB).

♦
Telephone numbers

General information
(800) 877-7896

Fax
(217) 787-2269

Forms
Order Line
(800) 207-6948

TDD
(217) 753-0329

♦
Web site
www.trs.state.il.us

♦♦♦
Executive Director
Jon Bauman

♦
Board of Trustees

Glenn W. McGee
President
Springfield

James Bruner
Vice President
Jacksonville

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Carmi

William R. Enlow
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Lake Forest

Sharon Leggett
Evanston

Stuart Levine
Highland Park

Cynthia O'Neill
Carlyle

Molly Phalen
Rockford

Phillip Schmidt
Springfield

♦
TRS is an
AA, EEO, ADA
employer.



Revenues and Funding

The three sources of TRS funding include member contributions, investment income, and employer contributions through state appropriations and payments by school districts.

The first funding source is contributions from 150,783 active members who contributed 9 percent of their earnings through June 30, 2001. Members also may make contributions to purchase optional service credit, to upgrade their pre-July 1998 service credit to the 2.2 percent benefit formula, and for the Early Retirement Option (ERO). In FY01, member contribution revenue totaled \$643 million, a \$23 million increase from the previous year. Net investment income, the second funding source, decreased \$3,351 million to (\$1,015) million, a (4.2) percent total fund return for the year.

Appropriations from the State of Illinois and employer contributions make up a third funding source. State appropriations for FY01 increased \$85 million to \$724 million while contributions from employers increased to \$98 million.

At June 30, 2001, net assets available to pay benefits decreased \$1.2 billion to \$23.3 billion. The decrease in net assets available to pay benefits is primarily attributable to a decrease in market value of equity investments.

Revenues (\$ millions)

Source	2001	2000	Increase/(Decrease)	
			Amount	% Change
Member contributions	\$643	\$620	\$23	3.7%
State of Illinois	724	639	85	13.3
Employer contributions	98	91	7	7.7
Net investment income	(1,015)	2,336	(3,351)	(143.5)
Total	\$450	\$3,686	(\$3,236)	(87.8%)

Expenses

Expenses include payments of benefits, refunds, and administrative expenses. Benefit payments increased from \$1,402 million to \$1,567 million in FY01. This 11.8 percent increase is the result of an increase in the number and final average salaries of members who retired during FY01, retirements using the 2.2 percent benefit formula, and annual increases in annuities as prescribed by law. Administrative expenses continued to constitute less than 1 percent of TRS expenses in FY01.

Expenses (\$ millions)

Source	2001	2000	Increase/(Decrease)	
			Amount	% Change
Benefits payments	\$1,567	\$1,402	\$165	11.8%
Refunds	36	29	7	24.1
Administrative/Other	13	12	1	8.3
Total	\$1,616	\$1,443	\$173	12.0%

Independent Audit

Each year TRS' financial statements, records, and internal controls are examined by special assistant auditors employed by the Illinois Auditor General. In addition, an annual compliance audit for the previous year is performed to review compliance with applicable statutes and codes. The independent auditors' report on TRS' financial statements is included in the Financial Section of this report.

GFOA Award

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to TRS for its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2000. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

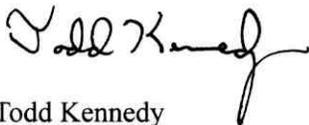
To be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for only one year. TRS has received a Certificate of Achievement for the last 12 years. We believe our current report continues to meet the Certificate of Achievement program requirements and are submitting it to the GFOA for consideration again this year.

Acknowledgments

Information for this report was gathered by and reflects the combined efforts of TRS staff under the leadership of the Board of Trustees and the executive director. It is intended to provide complete and reliable information as a basis for making management decisions, to determine our compliance with legal provisions, and as a means for determining responsible stewardship of the assets contributed by members and their employers.

This report is provided to members of the General Assembly, all participating employers, and to others by request. The participating employers of TRS form the link between TRS and its members. Their cooperation, for which we are grateful, contributes significantly to our success. We hope this report is both informative and helpful.

Respectfully submitted,



Todd Kennedy
Director of Finance

A Message from the Executive Director

Retirement Security for Illinois Educators.

Powerful thoughts are best expressed in simple, direct statements. My first annual message begins with just five words — the statement of purpose that we adopted just a few days following my appointment as executive director in August. We think these few words say a great deal about our purpose and what we should hold as our utmost priority in all we do on behalf of our members and employers. It will guide our thinking and it will focus our efforts as we actively seek to improve every aspect of TRS operations. We will phase in this statement on our publications, letterhead, Web site, and other communications in the future.

Before reviewing several accomplishments, issues, and matters of concern, I must tell you it is an extraordinary honor to direct the administration of the Teachers' Retirement System. I am indebted to the Board of Trustees for the confidence expressed and their resolve to foster excellence at TRS.

Improving Technology to Improve Service

Within the next several months, we will complete a massive re-engineering of our computer technology for the principal purpose of improving services and enhancing our efficiency. The project culminates years of self-study and systems development that called on staff to challenge existing processes and to implement the best practices available in the pension industry.

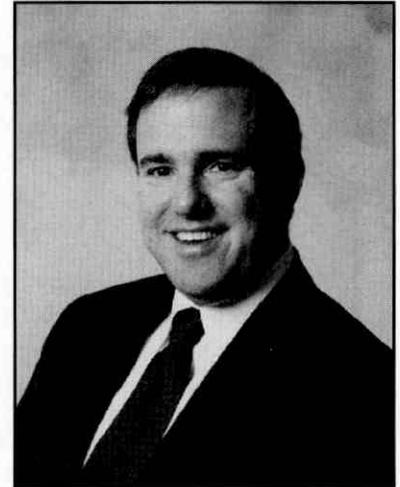
Investment Program

An extraordinary downturn in the capital markets resulted in the first instance of negative investment returns since 1984. The overall return on investments was (4.2) percent. Even though TRS outperformed our sister state-funded systems, the loss is a significant setback that has eroded much of the progress made in our funded status during the past several years. Our funded ratio dropped from 68.2 percent to 59.5 percent in just one year. We will redouble our efforts to outperform the capital markets and to select investment strategies that maximize returns consistent with an acceptable risk profile.

Legislation

For annuitants and many active teachers, resolution of the retired teacher health insurance crisis remained the most significant issue facing TRS during 2001. Subsequent to

fiscal year end, the General Assembly, meeting during the fall session, enacted measures that will enable the program to continue for the next few years. TRS will work with the legislature, the Governor, and each element of educational community to reach a permanent solution.



The General Assembly approved several items of interest to TRS annuitants, members, and employers.

- ★ The statutory re-employment limitation was increased to 120 days/600 hours for the next five school years. The change responds to increasing concerns about the shortage of qualified teachers and administrators by facilitating job-sharing or flextime employment of retired teachers.
- ★ Approximately 200 individuals who had more than 34 years of creditable service and who retired under the 2.2 formula between May 27, 1998 and June 5, 1999 received partial refunds of 2.2 upgrade charges so that their cost will be the same as persons who retired after June 5, 1999.
- ★ TRS members who are employed within security facilities of the Department of Human Services were permitted to transfer their retirement coverage to the State Employees' Retirement System.
- ★ Like their counterparts at all other major retirement systems in Illinois, newly hired TRS employees will now be members of TRS, the system they help administer.

Serving Illinois Educators and Schools

Each time an active member, an annuitant, or an employer contacts TRS, it is indeed our privilege to be of service. Among my primary goals, none is more important than providing consistently superior service to all of our constituencies. I am committed to a determined and visible program of continuous improvement in our services. As an organization, we will critique ourselves, seeking to meet or

exceed the expectations of our constituencies in all areas of our operation. We will also focus on the personal contact that has been the hallmark of our services to participants and employers.

For the second straight year, a study by Cost Effectiveness Measurement, Inc. (CEM) credited TRS with providing excellent services at a relatively low cost. Apart from the favorable evaluation, the report provides a wealth of information and resources for use in further improving our services. It is a task that we welcome.

Special Recognition

Kim Pollitt served as acting executive director from March 2001 through August, while concurrently performing the duties of acting chief investment officer. Both of these positions required many extra hours, loss of family time, and a tremendous commitment of intellectual energy. On behalf of the staff and our constituencies, our deepest appreciation to Kim.

Scott Eshelman retired following a 29-year career with the Elgin U-46 Schools and concluded his service as a member of the TRS Board of Trustees this summer. Scott's tenure was characterized by his dedication and determination to improve retirement security for Illinois educators. We thank him for his service and extend our best wishes for a long and enjoyable retirement.

"It is indeed our privilege to be of service"

Sincerely,



Jon Bauman
Executive Director

Board of Trustees

Glenn W. McGee

President

★ Springfield



Sharon Leggett

★ Evanston



James Bruner

Vice President

★ Jacksonville



Stuart Levine

★ Highland Park



Jan Cleveland

★ Carmi



Cynthia O'Neill

★ Carlyle



William R. Enlow

★ Springfield



Molly Phalen

★ Rockford



John E. Glennon

★ Lake Forest



Phillip Schmidt

★ Springfield



Thank You

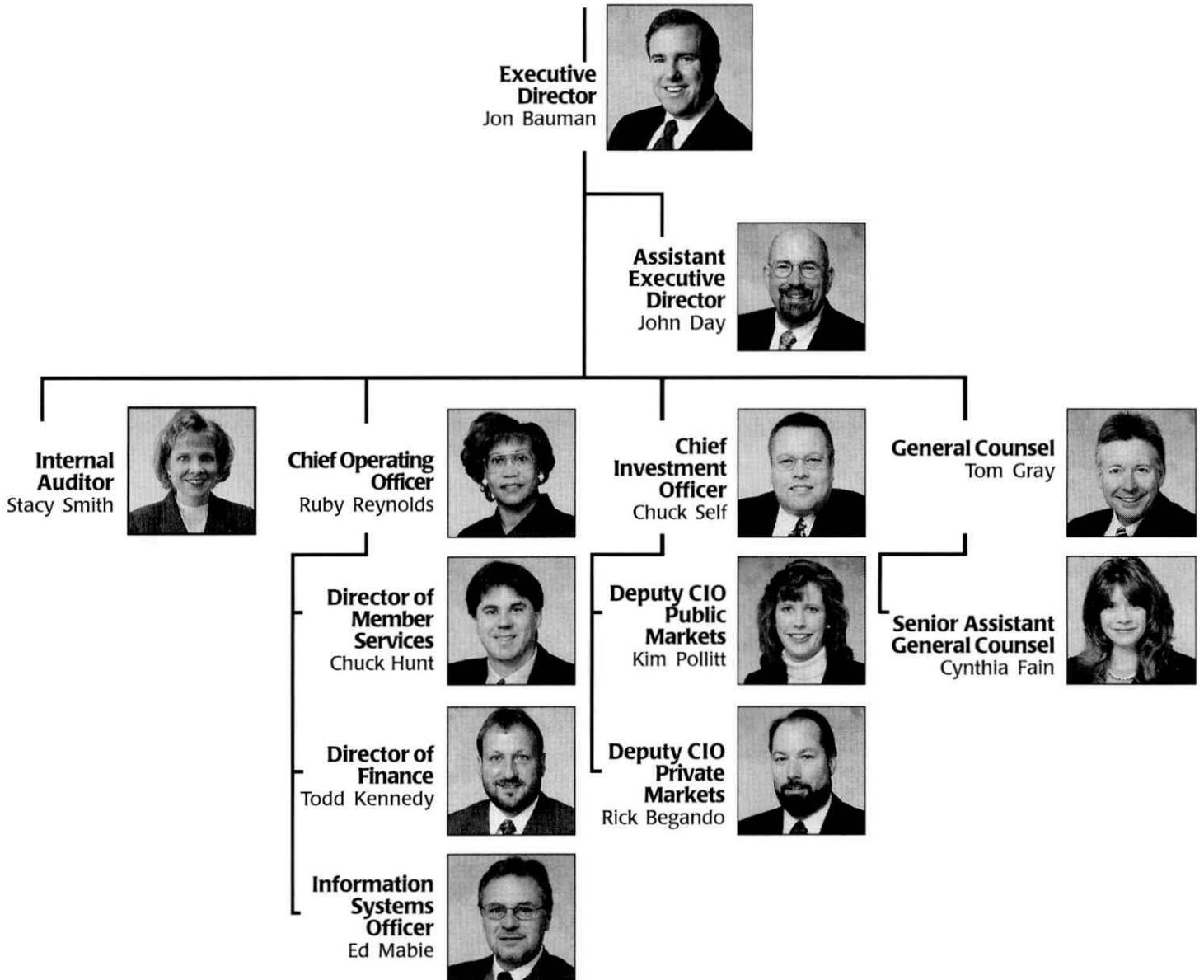
Scott Eshelman served with dedication, determination, and devotion.

Served as a trustee from 1995 to 2001

Organizational Structure

As of December 10, 2001

Board of Trustees



Introductory Section

Consulting and Professional Services

Actuary

Buck Consultants, Inc.
Chicago, Illinois

Benchmarking

Cost Effectiveness Measurement
Toronto, Ontario

Executive Director Search

Kennedy & Company
Chicago, Illinois

External Auditors

as special assistants to the Office of the Auditor General

McGladrey & Pullen, LLP
Chicago, Illinois

Information Systems

Kestner Consulting Inc.
Springfield, Illinois

Levi, Ray and Shoup Inc.
Springfield, Illinois

Metamor Industry Solutions, Inc.
Springfield, Illinois

Sentinel Technologies
Springfield, Illinois

Investment Consultants

(Investment management firms are listed throughout the Investment Section.)

J.W. Flynn Company (real estate insurance)
Indianapolis, Indiana

Joseph J. Blake and Associates, Inc. (real estate appraisals)
Chicago, Illinois

Strategic Investment Solutions, Inc. (general consultant)
San Francisco, California

External Legal Counsel

Heyl Royster Voelker & Allen
Springfield, Illinois

Hinshaw and Culbertson
Springfield, Illinois

Jones, Day, Reavis & Pogue
Cleveland, Ohio

Lowenstein, Hagen & Smith, P.C.
Springfield, Illinois

Piper Marbury Rudnick & Wolfe
Chicago, Illinois

Master Trustee

The Northern Trust Company
Chicago, Illinois