Financial

McGLADREY & PULLEN, LLP
Certified Public Accountants

INDEPENDENT AUDITORS' 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 of 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, 2001, and the related statement of changes in plan net assets for the year 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 audit. The financial statements of the Teachers' Retirement System of the State of Illinois for the year ended June 30, 2000 were audited by Friedman Eisenstein Raemer and Schwartz, LLP, independent accountants, certain of whose partners became members of McGladrey & Pullen, LLP on November 1, 2000. Friedman Eisenstein Raemer and Schwartz, LLP's report dated October 26, 2000 expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides 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, 2001, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we will also issue, under separate cover, our report dated November 1, 2001 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 audit was made for the purpose of forming an opinion on the financial statements of the System, taken as a whole. The required supplementary information, on pages 28 and 29 and other supplementary information on page 30, are presented for the purpose of additional analysis and are not a required part of the financial statements of the System. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole. The information for the years 1996 through 2000 has been derived from financial statements audited by other auditors whose reports thereon expressed an unqualified opinion.

The introductory, investment, actuarial and statistical information listed in the table of contents was not audited by us and, accordingly, we do not express an opinion thereon.

McGladrey & Pullen, LLP

Chicago, Illinois
November 1, 2001

Basic Financial Statements

Teachers' Retirement System of the State of Illinois
Statement of Plan Net Assets as of June 30, 2001, and 2000

	2001	2000
ASSETS		
Cash	$7,889,353	$3,213,679
Receivables and prepaid expenses		
Member payroll deduction	160,440,980	213,579,965
Member contributions	31,052,076	31,263,832
Employer Early Retirement Incentive	0	679,813
Employer contributions	7,379,527	9,203,574
State of Illinois	0	412,206
Investment income	202,756,810	232,706,956
Prepaid expenses	968,066	368,526
Total receivables and prepaid expenses	402,597,459	488,214,872
Investments, at fair value		
Fixed income	8,817,862,697	8,845,767,666
Equities	11,015,551,513	11,543,579,021
Real estate	2,424,554,513	2,428,110,937
Short-term investments	1,036,104,680	1,089,576,833
Private equity investments	689,740,876	877,028,687
Foreign currency	26,752,464	39,495,154
Total investments	24,010,566,743	24,823,558,298
Collateral from securities lending	2,288,995,477	1,952,295,799
Property and equipment, at cost, net of accumulated depreciation of $5,780,569 and $5,763,526 in 2001 and 2000, respectively	3,658,427	3,420,592
Total assets	**26,713,707,459**	**27,270,703,240**
LIABILITIES		
Benefits and refunds payable	5,694,934	6,179,594
Administrative and investment expenses payable	71,323,165	69,959,589
Payable to brokers for unsettled trades, net	1,032,047,800	760,855,651
Securities lending transactions	2,288,995,477	1,952,295,799
Total liabilities	**3,398,061,376**	**2,789,290,633**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A schedule of funding progress is presented on page 28.)	**$23,315,646,083**	**$24,481,412,607**

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, 2001, and 2000

	2001	2000
ADDITIONS		
Contributions		
Members	$643,563,304	$619,622,840
State of Illinois	724,007,792	639,298,949
Employers		
Early retirement	38,632,385	36,751,052
Federal funds	23,175,955	21,425,188
2.2 benefit formula	35,809,273	33,122,050
Total contributions	1,465,188,709	1,350,220,079
Investment income		
Net appreciation (depreciation) in fair value	(1,860,498,992)	1,451,074,361
Interest	565,646,688	559,584,336
Real estate operating income, net	190,286,928	243,815,891
Dividends	137,819,508	109,959,618
Private equity income	18,741,785	29,631,911
Securities lending income	145,941,616	106,909,999
Other investment income	3,193,440	2,183,038
	(798,869,027)	2,503,159,154
Less investment expense		
Securities lending expense	133,283,965	97,475,237
Investment activity expenses	83,102,245	69,466,794
Net investment income (loss)	(1,015,255,237)	2,336,217,123
Total additions	**449,933,472**	**3,686,437,202**
DEDUCTIONS		
Retirement benefits	1,475,489,564	1,317,841,317
Survivor benefits	74,630,874	68,797,583
Disability benefits	16,672,793	15,607,144
Refunds	35,849,079	28,797,054
Administrative expenses	12,640,595	11,680,647
Prior service credits and transfers	417,091	9,849
Total deductions	**1,615,699,996**	**1,442,733,594**
NET INCREASE (DECREASE)	**(1,165,766,524)**	**2,243,703,608**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
Beginning of year	24,481,412,607	22,237,708,999
End of year	**$23,315,646,083**	**$24,481,412,607**

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 and the Early Retirement Incentive 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 in FY00 and subsequent years. In addition, the State of Illinois provides employer contributions. For information about employer contributions made by the State of Illinois, see "Funding" on the following page.

Number of Employers (as of June 30)

	2001	2000
Local school districts	892	893
Special districts	134	137
State agencies	28	29
Total	**1,054**	**1,059**

3. Members

TRS Membership (as of June 30)

	2001	2000
Retirees and beneficiaries receiving benefits	64,877	62,122
Inactive members entitled to but not yet receiving benefits	69,512	66,025
Active members	150,783	144,975
Total	**285,172**	**273,122**

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 ½ 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.

Each annuitant who retired after 1969 or made a qualifying contribution receives 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.

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: 7½ percent for retirement, ½ 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. 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 as well as the Early Retirement Incentive. Employer Early Retirement Incentive contributions could be made in either a lump sum, over five years in equal quarterly installments, or under a different schedule approved by the TRS Board of Trustees. Employee contributions were paid in full during FY98 and employer contributions were paid in full during FY01.

The actuarial funding requirements for FY01 and FY00 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' 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' 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.

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. *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.

4. *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 3 to 10 years while vehicles are assigned a 5-year life. TRS' office building is depreciated over 40 years.

5. *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, 2001, and 2000 totaled $1,357,443 and $1,342,863, respectively, and are included as administrative and investment expenses payable.

6. *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 is allowed by law to assess penalties for late payment of contributions and to 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.

Effective July 1, 1998, 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 $160,440,980 and $213,579,965 as of June 30, 2001, and 2000, respectively.

7. *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' deposits were $2,009,923 and $7,889,353 at June 30, 2001, and $2,599,992 and $3,213,679 at June 30, 2000. Of the bank balance, $107,531 and $191,743 were on deposit with the state treasurer at June 30, 2001, and 2000, 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 2001	Fair Value 2000
Category 1		
Government obligations	$3,889,687,839	$3,646,643,656
Corporate obligations	2,960,222,604	3,196,644,170
Preferred stock	112,594,835	98,489,595
Short-term investments		
Commercial paper (including short-term collateral and other)	39,179,749	232,214,720
U.S. Treasury bills	98,932	0
Common stock	6,659,594,148	6,943,339,184
	13,661,378,107	14,117,331,325
Not Categorized		
Investments held by broker-dealers under securities loans		
Government obligations	1,193,721,879	1,122,543,214
Corporate obligations	168,941,773	139,462,003
Common stock	1,373,267,578	1,287,322,671
Real estate equity	2,302,779,529	2,224,267,524
Mutual funds	3,601,165,085	4,164,365,921
Private equity investments		
Limited partnerships	689,740,876	877,028,687
Foreign currency	26,752,464	39,495,154
Collective investment funds (U.S. dollars)	996,924,930	857,362,112
Security lending short-term collateral investment pool	2,284,889,999	1,946,675,486
Investments and collateral from securities lending	26,299,562,220	26,775,854,097
Less collateral from securities lending	(2,288,995,477)	(1,952,295,799)
Total investments*	**$24,010,566,743**	**$24,823,558,298**

* *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' investments and related category of custodial credit risk at June 30, 2001, and 2000. TRS' 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' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty but not in TRS' name. As of June 30, 2001, and 2000, TRS holds no securities classified in either Category 2 or Category 3.

TRS has nonrecourse mortgages totalling $294,646,716 and $296,463,504 on real estate equities at June 30, 2001, and 2000, respectively. The amount reported for real estate equity is net of these mortgages, which mature on various dates through the year 2018.

The real estate equity category includes $50,374,838 and $52,763,477 of mortgages receivable which are fully secured by the properties at June 30, 2001, and 2000, respectively.

At June 30, 2001, and 2000, TRS did not have any investments with one organization that exceeded 5 percent of net assets available for 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' 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' 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 35 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 43 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, 2001, and 2000, TRS had outstanding loaned investment securities having a market value of $2,735,931,230 and $2,549,327,888, respectively, against which it had received collateral of $2,880,112,714 and $2,622,441,800, 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' 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' 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 an agreement 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' financial statements as incurred rather than at the maturity or settlement date of the contract.

Derivatives Contracts

Type	FY01 No. of Contracts	FY01 Contractual Principal*	FY00 No. of Contracts	FY00 Contractual Principal*
Domestic Interest Rate Products				
Index fixed income futures (net)	765	$78,699,926	450	$41,893,591
Fixed income written call options	1,690	33,188,100	1,477	129,505,000
Fixed income written put options	3,300	10,312,500	3,762	782,005,000
International Interest Rate Products				
International fixed income futures (net)	0	0	337	74,602,432
Domestic Equity Products				
S&P 500 Index futures (net)	2,298	707,611,650	1,903	698,448,575
Foreign Currency Products				
Currency futures (net)	2,121	502,302,575	329	76,406,138
Currency written put options	1,665	73,994,750	0	0

* *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.*

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 an agreement 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 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 an agreement 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' financial statements as incurred rather than at the time the options are exercised or when they expire. As of June 30, 2001, and 2000, the fair value of option contracts written was ($793,894) and ($2,441,338), 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' outstanding contracts at June 30, 2001, and 2000. 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.

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

	2001	2000
Balances at June 30	$8,271,682,135	$7,425,218,715

This reserve accumulates, with 6 percent interest, the contributions by members prior to retirement. Contributions have been 7½ 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

	2001	2000
Balances at June 30	$3,269,192	$3,045,425

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

	2001	2000
Balances at June 30	$893,336	$857,477

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 is credited to the reserve annually based upon the average reserve balance. The annuity expenses resulting from this legislation are charged to the reserve. This reserve is fully funded.

During fiscal year 2002, this reserve will be dissolved and the remaining funds will be transferred to the Employer's Contribution Reserve.

4. Employer's Contribution

	2001	2000
Balances at June 30	$15,039,801,420	$17,052,290,990

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 $15,851,051,000 in 2001 and $11,404,991,000 in 2000.

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' financial position and results of operations for fiscal years 2001 and 2000 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the years ended June 30, 2001, and 2000, 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.

Effective in FY97, SERS implemented Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans.* Also effective in FY97, the State of Illinois implemented GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers.* These GASB standards supersede all previous authoritative guidance on accounting and financial reporting for defined benefit pension plans of state and local governmental entities.

A summary of SERS' 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 FY01 and FY00, the SERS employer contribution rates were 9.944 percent and 9.714 percent, 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 in FY01 and 8 percent for TRS members in FY00) was included in the FY01 and FY00 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, 2001, and 2000. 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

On August 9, 2001, Jon Bauman was appointed as the TRS Executive Director.

TRS had a decline in its investment portfolio subsequent to year end due in part to the events of September 11, 2001. As of September 30, 2001, TRS had incurred an approximate $1,418,792,000 (5.8%) decrease in its investment portfolio since June 30, 2001, due to declines in the domestic and international equity markets.

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)
06/30/96	$15,103,927,000	$26,141,794,000	57.8%	$11,037,867,000	$4,734,250,000	233.1%
06/30/97	17,393,108,000	26,951,585,000	64.5	9,558,477,000	5,013,583,000	190.7
06/30/98	19,965,887,000	29,908,241,000	66.8	9,942,354,000	5,323,403,000	186.8
06/30/99	22,237,709,000	33,205,513,000	67.0	10,967,804,000	5,698,117,000	192.5
06/30/00	24,481,413,000	35,886,404,000	68.2	11,404,991,000	6,062,884,000	188.1
06/30/01	**23,315,646,000**	**39,166,697,000**	**59.5**	**15,851,051,000**	**6,430,612,000**	**246.5**

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%
1997	377,969,000	17,379,000	395,348,000	927,842,000	42.6	395,269,000	100
1998	460,439,000	17,246,000	477,685,000	983,312,000	48.6	478,439,000	100
1999	567,068,000	36,535,000	603,603,000	932,909,000	64.7	592,547,000	102
2000	634,039,000	54,547,000	688,586,000	1,003,612,000	68.6	686,384,000	100
2001	**719,357,000**	**58,985,000**	**778,342,000**	**1,102,441,000**	**70.6**	**775,732,000**	**100**

1 *For consistency with figures reported by TRS' 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.*

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

See accompanying independent auditors' report.

Notes to Required Supplementary Information

Valuation Dates	**June 30, 2001**	**June 30, 2000**
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 2.2 benefit formula change as a level percent of payroll	Minimum state contribution rates in statute include cost of 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	44 years, closed	45 years, closed
Asset valuation method:	Fair value	Fair value
Actuarial assumptions:		
Investment rate of return	8.5%	8.5%
Projected salary increases	6.0-9.3%, composite 7.0%	6.0-9.3%, composite 7.0%
Group size growth rate	0%	0%
Assumed inflation rate	4%	4%
Post-retirement increase	3% compounded	3% compounded
Mortality table	1995 Buck Mortality Tables (rated forward one year for beneficiaries only).	1995 Buck Mortality Tables (rated forward one year for beneficiaries only).

See accompanying independent auditors' report.

Other Supplementary Information

Schedule of Administrative Expenses (for years ended June 30)

	2001	2000
Personal services	$9,195,997	$8,521,781
Professional services	844,265	714,495
Postage	414,273	295,742
Machine repair and rental	409,675	422,198
Other contractual services	769,075	811,625
Commodities	270,924	257,348
Occupancy expense	168,563	175,305
Depreciation	561,158	465,024
Loss on disposal of equipment	6,665	17,129
Total administrative expenses	**$12,640,595**	**$11,680,647**

Schedule of Investment Activity Expenses (for years ended June 30)

	2001	2000
Investment manager fees	$71,154,807	$62,357,317
Private equity investment expense	10,192,514	5,427,871
Miscellaneous	1,754,924	1,681,606
Total investment activity expenses	**$83,102,245**	**$69,466,794**

Schedule of Payments to Consultants (for years ended June 30)

	2001	2000
Actuarial services	$94,273	$173,829
External auditors	104,882	106,764
Legal services	141,820	21,248
Management consultants		
Information systems	428,881	330,597
Actuarial review	0	35,000
Benchmarking	25,000	25,000
Strategic planning	0	10,860
Executive search	42,999	0
Publication design	0	1,095
Other	6,410	10,102
Total payments to consultants	**$844,265**	**$714,495**

See accompanying independent auditors' report.