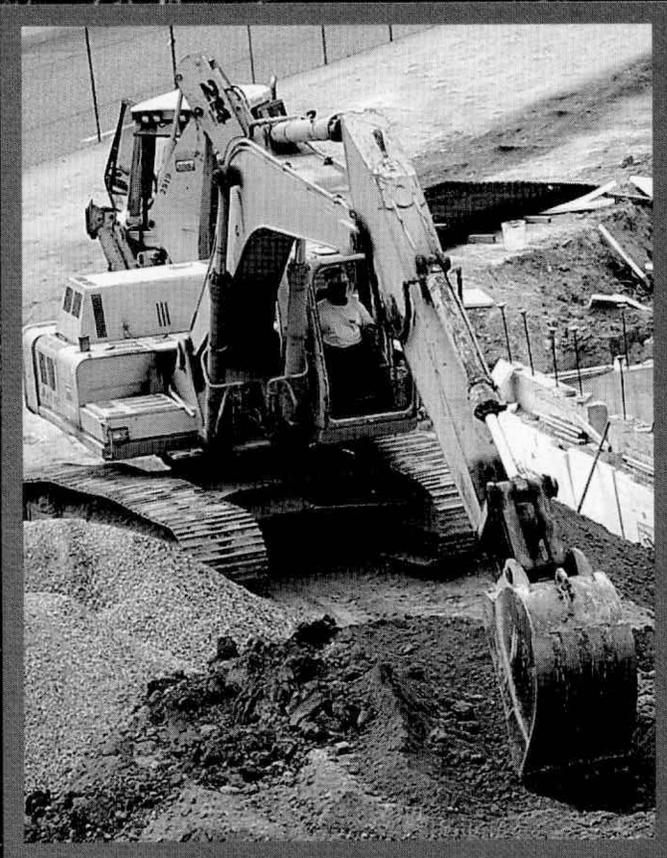


INTRODUCTION



He has the deed half
done who has made
a beginning.
- Horace

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, 2001

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



Timothy Druwe
President

Jeffrey L. Esser
Executive Director

LETTER OF TRANSMITTAL

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, 2002. 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, 2002.

TRS was established by the State of Illinois on July 1, 1939, to provide retirement, disability, and death benefits to teachers at Illinois public elementary and secondary schools outside the city of Chicago.

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, a Management Discussion and Analysis, 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 five-year experience analysis, 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).

REVENUES, EXPENSES, AND FUNDING

The three sources of TRS funding include member contributions, investment income, and employer contributions through state appropriations and payments by school districts. TRS investments had a (3.2) percent return net of fees for the year. Negative amounts are represented as () throughout this report.

REVENUES (\$ MILLIONS)

Source	2002	2001	Increase/(Decrease)	
			Amount	% Change
Member contributions	\$681	\$643	\$38	5.9%
State of Illinois	815	724	91	12.6
Employer contributions	93	98	(5)	(5.1)
Net investment loss	<u>(724)</u>	<u>(1,015)</u>	<u>291</u>	<u>28.7</u>
Total	\$865	\$450	\$415	92.2%

EXPENSES (\$ MILLIONS)

TRS expenses include payments of benefits, refunds, and administrative expenses.

Source	2002	2001	Increase/(Decrease)	
			Amount	% Change
Benefits payments	\$1,760	\$1,567	\$193	12.3%
Refunds	39	36	3	8.3
Administrative/Other	<u>15</u>	<u>13</u>	<u>2</u>	<u>15.4</u>
Total	\$1,814	\$1,616	\$198	12.3%

At June 30, 2002, net assets decreased \$949 million to \$22.4 billion. The decrease is primarily attributable to a decrease in market value of equity investments.

The Management Discussion and Analysis contains a discussion regarding TRS's investment activities and actuarial information.

INDEPENDENT AUDIT

Each year TRS's 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's financial statements is included in the Financial Section of this report.

GFOA AWARD

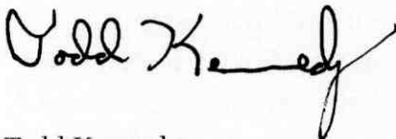
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to TRS for its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

To be awarded the certificate, 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. TRS has received a certificate for the last 13 years. We believe our current report continues to meet the 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 a 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.

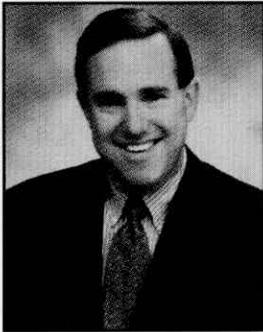


Todd Kennedy
Director of Finance

A MESSAGE FROM THE EXECUTIVE DIRECTOR

Educators invest their lives in the future, seeing the next generation of workers, leaders, parents, and our country in the faces of the young people they mentor daily. In this annual report, *Building the Future*, we salute the spirit that builds the future today.

Our inspiration comes from the remarkable upsurge in new and renovated schools throughout Illinois. The bricks and mortar, steel, stone, and glass are tangible evidence of the value Illinoisans place on education. As you read this report, be heartened that our communities esteem education and are willing to sacrifice today for the good things that will occur in these buildings for years to come. We trust that you will be encouraged as you see the photographs of new buildings and will treasure the civic spirit that underlies our communities' investment in public education.



*Executive Director
Jon Bauman*

A DIFFICULT PERIOD

The path to excellence is seldom without difficulty. Your retirement fund recorded a loss on investment activity for a second consecutive year, the first such occurrence since the legislature granted prudent person investment authority to the fund in the early 1980s. Our total return after investment expenses was (3.2) percent.

Even in the face of an adverse economy, our commitment to excellence shows. In fiscal year 2002, TRS ranked near the top, with a total return that exceeded the returns of over 80 percent of public retirement funds with assets over \$1 billion. To put this achievement in perspective, this is the best relative return ever reported in TRS history. In a year characterized by market volatility, substantial drops in major market indices, and investor distrust, our solid, conservative investment approach protected fund assets and produced results of which we can all be proud. Over the long term, our performance remains solidly over our actuarial assumption, with a 10-year return of 9.1 percent. Our hard work will doubtless pay future dividends as markets return to more normal patterns.

SEEKING THE BEST

In the year I have been your director, I have made a conscious decision to seek to be the best in all that we do.

Building the best team means seeking and retaining qualified individuals who have a heart for the membership of our system. We have earned your trust by our high levels of personal, professional, and caring service. It is essential that we retain our caring character as we build retirement security and continuously improve to meet your expectations. I chose seasoned TRS veterans as the initial members of my executive staff and outside expertise was recruited as necessary

to build a talented staff. At the same time, our commitment to diversity was demonstrated through our equal opportunity hiring process. In the coming months, we will continue a nationwide search for a chief investment officer and two additional investment positions. Caring and competence will be watchwords as we fill these essential positions.

The TRS commitment to excellence extends to the professional investment management firms we select and retain. Our selection process is conducted with substantial input from our external consultant, Callan Associates. Using both qualitative and quantitative measures, we seek firms with a strong potential to perform in the top quartile of their peer investment group. During the past year, we completed evaluations of all managers and took appropriate action to retain only the best. I am pleased to note that 17, or nearly one-third of our investment management firms, are based in Illinois.

A RECORD OF SUCCESS

Every section of our organization contributed to a successful year. Here are some highlights:

MEMBER SERVICES

Our Member Services Department paid over \$1.7 billion to nearly 68,000 annuitants and beneficiaries during the past year. This represents a record both in terms of the number of members served and the total dollars expended for benefit payments. Teacher retirements continued to grow, with a total of 4,200 retirements in FY02. Staff worked diligently to process this increasing volume capably. Both active and retired teachers were served through an enhanced program of meetings and teleconferences held throughout the state. Over 14,000 members received personal counseling. Our toll free telephone service remains popular with over 200,000 calls received last year.

MAJOR INITIATIVES

At the outset of my administration, I made a commitment to complete several key initiatives. We began training our staff in September on the use of our new information system, TRS STAR (Serving Teachers and Retirees). Beginning with its very name, STAR exemplifies our commitment to service. We will fully implement this new tool this winter. Patiently and carefully designed, it provides our staff with the resources they need to serve you better. By automating administrative details, we will work more accurately and quickly. The time saved will be well spent in providing ever-greater levels of personalized, caring service.

We completed a project to ensure compliance with Section 415 of the Internal Revenue Code. This provision governs the amount of after-tax contributions that we can accept annually for the purchase of certain types of optional service. Our team consisted of experienced staff and knowledgeable consultants

who together crafted a workable program and informational campaign to inform members affected by the requirements.

TRS worked collaboratively with state government leaders, organizations representing active and retired teachers, and the school management community to achieve an interim solution to the funding crisis facing the TRIP retiree health insurance program. In the coming year, we will continue our efforts to achieve a permanent solution. We understand the anxiety resulting from the current, uncertain status of the program. We will do our best to achieve a viable health insurance program for retired teachers.

COMMUNICATIONS

I made a significant commitment to improve communication with our members, retirees, and constituent groups. Our core publications, including *Topics and Report* and our employer and information bulletins, have been redesigned and improved. The TRS Web site has been completely redesigned and is now accessible to the disabled. The site will continue to feature timely topics and important news as we embrace state-of-the-art technology to better serve our members.



*William
Enlow*

SPECIAL RECOGNITION

William Enlow concluded six years of service as a member of the TRS Board of Trustees. Bill served as vice president of the board. We thank him for his service, counsel, and wisdom.



*Glenn
McGee*

Dr. Glenn "Max" McGee served as state superintendent of education and ex-officio president of the Board of Trustees for a three-year period ending December 2001. We appreciate his leadership, commitment to public education, and dedication to the children of Illinois.

Respicio Vasquez served as interim state superintendent and TRS Board president during 2002. We appreciate his energy, his willingness to serve TRS, and his leadership during important times for TRS and the State Board of Education.



*Respicio
Vasquez*

IN CLOSING

This initial year of service as your executive director has included remarkable challenges, successes, and opportunities for improvement. I have enjoyed the opportunity to meet and to hear from many TRS members and annuitants in my first year as executive director. As we go forward, I thank you for your support and trust. I pledge my best to you in the years ahead.

A handwritten signature in cursive script that reads "Jon Bauman".

Jon Bauman
Executive Director

BOARD OF TRUSTEES

As of December 1, 2002

ROBERT
SCHILLER
PRESIDENT
Springfield



PHILLIP
SCHMIDT
VICE PRESIDENT
Springfield



JAMES BRUNER
Jacksonville



SHARON
LEGGETT
Evanston



JAN CLEVELAND
Carmi



STUART LEVINE
Highland Park



MICHAEL
COLSCH
Springfield



CYNTHIA O'NEILL
Carlyle



JOHN E.
GLENNON
Lake Forest

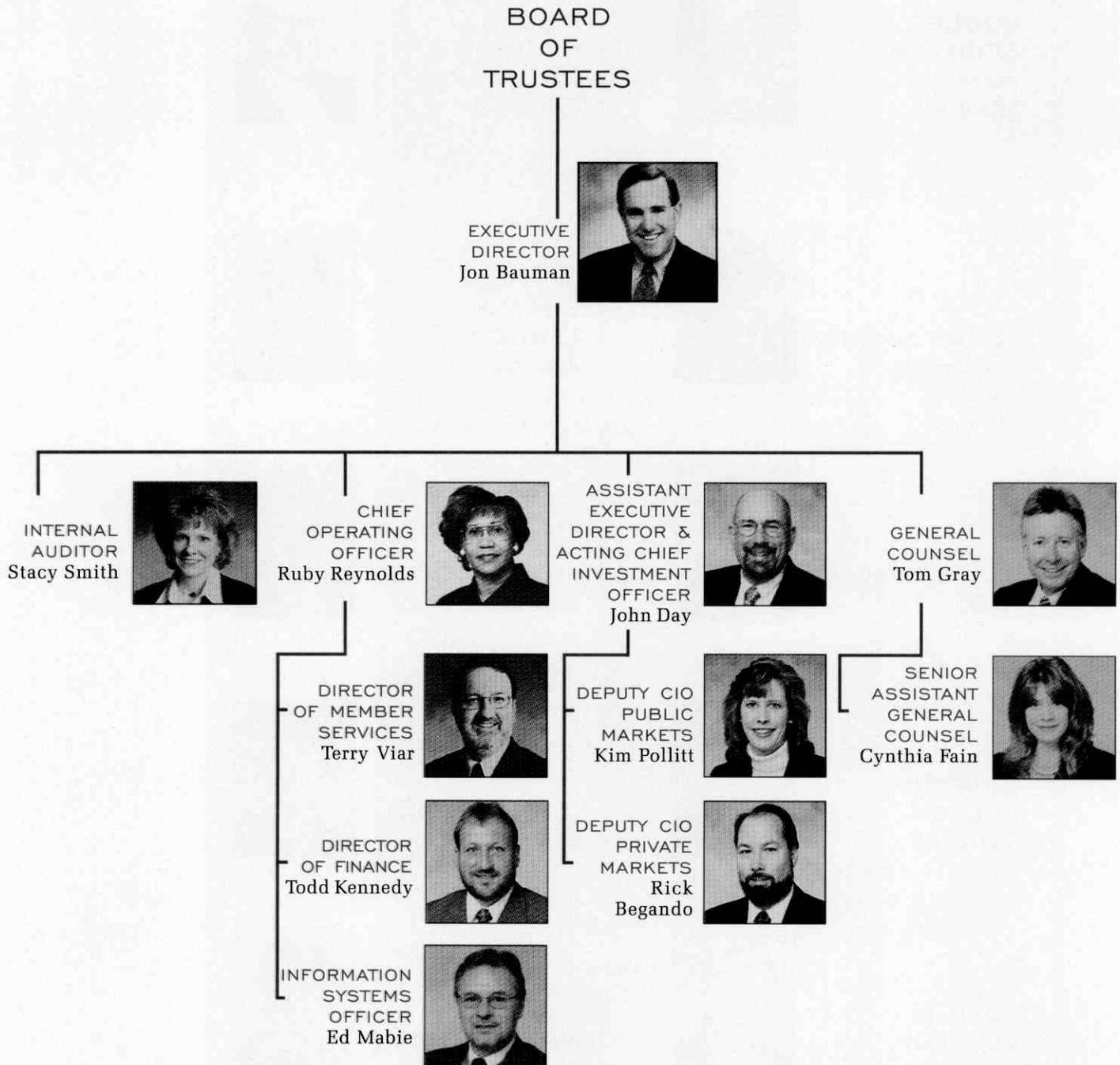


MOLLY PHALEN
Rockford



ORGANIZATIONAL STRUCTURE

As of December 1, 2002



CONSULTING AND PROFESSIONAL SERVICES

ACTUARY

Buck Consultants, Inc.
Chicago, Illinois

EXTERNAL AUDITORS

(As special assistants to the Office of the Auditor General)

McGladrey & Pullen, LLP
Chicago, Illinois

INFORMATION SYSTEMS

Ashbaugh and Associates
Springfield, Illinois

Ciber (formerly Metamor)
Springfield, Illinois

Engineered Designed Facilities
Maryland Heights, Missouri

Hupp Information Technologies
Springfield, Illinois

Kestner Consulting Inc.
Springfield, Illinois

Sentinel Technologies
Chicago, Illinois

Sikich Gardner & Company, LLP
Springfield, Illinois

INVESTMENT CONSULTANTS

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

Callan Associates Inc.
(general consultant)
San Francisco, California

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

Risk Resources
(real estate insurance)
Elmhurst, Illinois

EXTERNAL LEGAL COUNSEL

Calhoun Law Group, P.C.
Washington, D.C.

Heyl Royster Voelker & Allen
Springfield, Illinois

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

Piper Rudnick
Chicago, Illinois

MASTER TRUSTEE

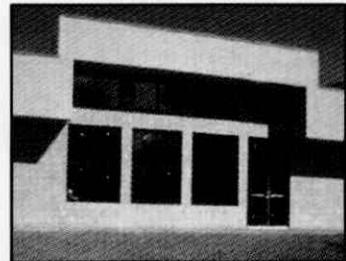
The Northern Trust Company
Chicago, Illinois



*Liberty High/
Elementary School
Liberty*



*Lincoln Elementary School
River Forest*



*West Side Primary School
Harrisburg*