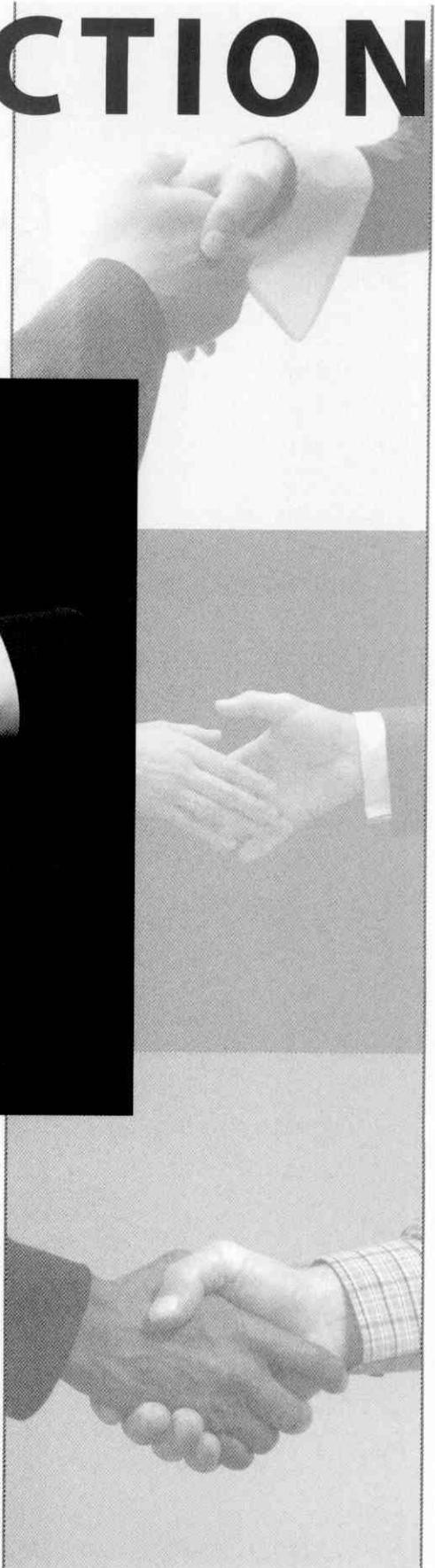


INTRODUCTION



Though force can protect in emergency, only justice, fairness, consideration and cooperation can finally lead men to the dawn of eternal peace.

Dwight David Eisenhower

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, 2002

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



President

Executive Director



Retirement Security for Illinois Educators

Teachers' Retirement System of the State of Illinois

Jon Bauman, Executive Director

2815 West Washington, P.O. Box 19253
Springfield, Illinois 62794-9253

LETTER OF TRANSMITTAL

December 15, 2003

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, 2003. 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, 2003.

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, actuarial assumptions and methods, 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).

Please refer to the Management Discussion and Analysis which contains an overview of the financial highlights and a financial analysis of TRS. Major TRS initiatives and accomplishments are contained in the executive director's message.

REVENUES AND EXPENSES

The three sources for TRS funding include member contributions, investment income, and employer contributions through state appropriations and payments by school districts. TRS expenses include payments of benefits, refunds, and administrative expenses. Negative amounts are enclosed in parentheses () throughout this report.

Revenues (\$ millions)

Source	2003	2002	Increase/(Decrease)	
			Amount	% Change
Member contributions	\$732	\$681	\$51	7.5%
State of Illinois	930	815	115	14.1
Employer contributions	91	93	(2)	(2.2)
Total investment income (loss)	1,061	(724)	1,785	246.5
Total	\$2,814	\$865	\$1,949	225.3%

Expenses (\$ millions)

Source	2003	2002	Increase/(Decrease)	
			Amount	% Change
Benefits payments	\$1,999	\$1,760	\$239	13.6%
Refunds	43	39	4	10.3
Administrative/Other	14	15	(1)	(6.7)
Total	\$2,056	\$1,814	\$242	13.3%

INVESTMENTS

TRS investments had a 4.9 percent return net of fees for the year. Total investment income for FY03 was \$1,061 million. The TRS trust fund is invested by authority of the Illinois General Assembly under the prudent person rule that requires investments to be managed solely in the interest of TRS members and beneficiaries. The portfolio is fully diversified across different asset classes. Within each asset class there are a number of investment managers to ensure the appropriate diversity across the various investment styles, allowing the portfolio to achieve broad exposure to the market, while minimizing risk. This broad diversification serves as the best defense against the uncertainty of volatile world markets.

The Investment Section of this report contains a summary of the portfolio and investment activities.

FUNDING

The actuarial value of assets (net assets at market value) was \$23.125 billion at June 30, 2003. Net assets increased \$759 million. TRS's actuarial accrued liability was \$46.933 billion at June 30, 2003, resulting in a funded ratio of 49.3 percent. This funded ratio is a decrease from the funding ratio of 52.0 percent for FY02.

The Actuarial Section of this report contains the actuary's letter and further information on TRS's funding.

In July 2003, shortly after the end of FY03, TRS received \$4.330 billion in funding resulting from the sale of general obligation bonds by the state of Illinois. Discussion regarding this subsequent event may be found in the Management Discussion and Analysis and in the Notes to the Financial Statements.

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

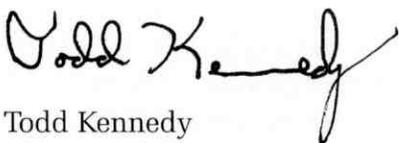
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to TRS for its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2002. The Certificate of Achievement is a prestigious 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 14 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

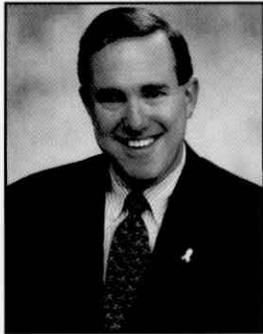
Information for this report was gathered by and reflects the combined efforts of TRS staff under the leadership of the Board of Trustees and the executive director. It is intended to provide complete and reliable information as a basis for making management decisions, to determine our compliance with 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



*Executive Director
Jon Bauman*

December 15, 2003

We make many promises throughout our lives. Some are easy to keep and quickly fulfilled. Others require determination, conviction, and sustained effort. In marriage, we make a life-long commitment to our partner. As parents, we promise love, nurturing, discipline, and sustenance. In our working lives, we dedicate ourselves to difficult tasks.

As a retirement system, we have dedicated ourselves to protecting the essential promise of retirement security for over 311,000 teachers and retired teachers in Illinois. Illinois educators are fortunate to be served by a defined benefit plan that assures that benefits are never reduced in times of economic crisis, budget woes, or market declines.

During the past year, we opposed proposals to consolidate the investment of the TRS retirement trust fund with other statewide systems. We feel our record of top quartile performance in tough economic times merits the continued independent investment of TRS assets.

A PROMISE OF SERVICE

Within the TRS organization, substantially all of our employees are dedicated to direct service to members and employers, or to supporting those activities. Our recent strategic planning process identified our mission as, "Deliver superior service through skilled staff, innovative technology, and careful investment." It is not accidental that the very first words are "deliver superior service." It is the central focus of all that we do at TRS.

As part of our planning process, we completed several "breakthrough" projects to quickly implement improvements benefiting those we serve. A new *Member Guide* was published and mailed to all active and retired members. A new *Employer Guide* was provided to all TRS employers. Many of our brochures were revised to better target the information to specific needs. A new, Web-based employer remittance system is much easier to use than the phone-based remittance system or the obsolete paper-based remittance system.

Our service statistics are impressive. For example, we received over 171,000 inquiries through our toll free call center. We held over 140 large group meetings, provided in-office counseling to 7,229 members, and conducted numerous teleconferences to provide individual counseling to members across the state. The annual summer retirement season once again required maximum effort from our staff and technology to initiate 4,300 retirements during a compressed timeframe.

Our efforts will not be successful if they do not meet our members' expectations. During February, we offered 15,000 randomly selected members the opportunity to rate their satisfaction with TRS member services. Overall, respondents viewed our services as either "Excellent" or "Good." In keeping with our determination to provide personalized service in an era of computers and technology, our individual conferences received the highest rating. Over 70 percent characterized this service as excellent. We will work hard to continue to earn your confidence.

A PROMISE OF STEWARDSHIP

Whether the markets are strong or weak, your retirement system seeks to preserve the value of the fund. Our emphasis on capital preservation has been rewarded. As we awaited the return of market stability, the TRS fund maintained its conservative, risk-aware approach, minimized fund losses during an extremely difficult period, and placed well into the top quartile of large public funds in both 2001 and 2002. Our proactive steps to position the fund for the market's return to more normal times was rewarded as well. For FY03, our total return after expenses was 4.9 percent, placing TRS in the top 16 percent of large public pension plans.

Our long-term performance rankings are consistently in the top quartile. Our 10-year return is in the top 10 percent of large public funds. The overall return is 9.0 percent before investment expenses.

Concurrent with the market's return to positive territory, the General Assembly enacted a \$10 billion pension obligation bond program. The program provides the state with a measure of relief with respect to funding of state contributions for the 2004 fiscal year, while simultaneously providing TRS with an additional \$4.3 billion for immediate investment. The monies, which were received and invested on July 2, 2003, have improved our financial position and funded ratio, which stood at 49.3 percent on June 30, and rose to an estimated 58.5 percent on July 2.

To invest this substantial cash infusion prudently, our investment staff, in consultation with our external investment counsel, conducted performance reviews of all TRS investment managers. The TRS Board of Trustees has approved a strategy to invest the additional monies with many existing active managers that meet our performance expectations, to seek additional firms as appropriate, and to invest a significant portion in index funds offered by The Northern Trust Company. To ensure accountability of the additional assets entrusted to our stewardship, TRS will maintain separate reports covering the performance of pension obligation bond assets.

Money Management Letter, a publication of Institutional Investor, named me as Public Plan Sponsor of the Year. The award reflects the collective achievements of the TRS Board and staff, our investment consultant, and external money managers. In this and the coming years, we pledge to apply our skills, resources, and energy to secure excellent returns and to minimize risk. We will maintain our diversified portfolio approach and our commitment to employing only the best external money managers.

A PROMISE OF INNOVATION

Each year we undertake and complete significant projects to enhance our delivery of services to the membership.

- In January, we inaugurated a new information system. In naming the system, we chose STAR, which stands for "Serving Teachers And Retirees." The effort represents a total re-examination of our business practices to provide technology to meet the needs of our members for many years into the future. Developed primarily by our information technology staff, STAR will improve productivity and will enable us to further improve member services and operational economies.

- We will continue to work with the Governor, the legislature, and our constituent groups to secure permanent funding for the retired teacher health insurance program. The current law will sunset on June 30, 2004, making an early, effective resolution imperative.
- Active teachers who have been employed continuously with the same school district since March 31, 1986, will have a one-time opportunity to make a voluntary decision to pay Medicare taxes to gain program eligibility. The option will be particularly attractive to singles and those married to persons without Social Security coverage who have been unable to earn sufficient Medicare credits. We will provide extensive education materials over the next few months to all members affected.
- We are continuing with phase II of a program to develop a voluntary, TRS-sponsored 403(b) retirement savings plan. Initial surveys of members and employers showed interest that warrants further investigation.

SPECIAL RECOGNITION

Michael Colsch resigned as a member of the TRS Board of Trustees in April concurrent with beginning a key position with the Illinois Toll Highway Authority. A valued member of the Board, Mike brought a special expertise in budgeting and public policy.

In addition, six of the TRS staff elected to retire this year. Their collective service to TRS was 109 years. They are recognized on page 104. I appreciate their dedicated service to the members of TRS and their many contributions to our success.

IN CLOSING

During the past year, we have worked hard to demonstrate that retirement security is a vibrant, meaningful promise. Though the work is often demanding, it is rewarding as well. On behalf of the TRS Board and staff, thank you for your support and trust.



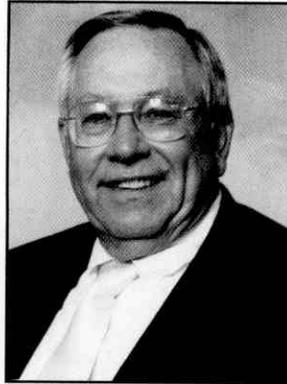
Jon Bauman
Executive Director

BOARD OF TRUSTEES

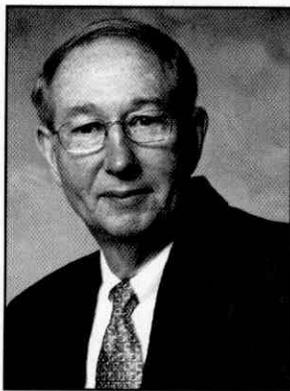
As of December 1, 2003



Robert Schiller
President
Springfield



Phillip Schmidt
Vice President
Springfield



James Bruner
Jacksonville



John Glennon
Lake Forest



Sharon Leggett
Evanston



Cynthia O'Neill
Carlyle



Jan Cleveland
Carmi



Cinda Klickna
Rochester



Stuart Levine
Highland Park



Molly Phalen
Rockford

ORGANIZATIONAL STRUCTURE

As of December 1, 2003

BOARD OF TRUSTEES



Jon Bauman
Executive Director



Ruby Reynolds Taylor
Chief Operating Officer



Tom Gray
General Counsel



Mike Bartletti
Director of Real Estate



Terry Viar
Director of Member Services



Kathleen Farney
Director of Research



Stan Rupnik
Director of Investments



Todd Kennedy
Director of Finance



Gina Larkin
Director of Human Resources



Stacy Smith
Internal Audits Manager



Ed Mabie
Information Systems Officer



Kathy Pearce
Communications Supervisor



Nick Yelverton
Government Affairs Officer

CONSULTING AND PROFESSIONAL SERVICES

ACTUARY

Mellon Human Resources & Investor Solutions
(formerly Buck Consultants, Inc.)
Chicago, Illinois

EXTERNAL AUDITORS

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

McGladrey & Pullen, LLP
Schaumburg, Illinois

INFORMATION SYSTEMS

Accuvoice Inc.
Northbrook, Illinois

Ashbaugh and Associates
Springfield, Illinois

Ciber
Springfield, Illinois

Hupp Information Technologies
Springfield, Illinois

Kestner Consulting Inc.
Springfield, Illinois

King Technology, Inc.
Springfield, Illinois

Sentinel Technologies
Chicago, 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

Cavanagh & O'Hara
Springfield, Illinois

Chapman and Associates
Granite City, Illinois

Gardner Carton & Douglas
(beginning October 2002)
Chicago, Illinois

Heyl Royster Voelker & Allen
Springfield, Illinois

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

Milberg Weiss Bershad Hynes & Lerach
San Diego, California

Piper Rudnick
(through October 2002)
Chicago, Illinois

MASTER TRUSTEE

The Northern Trust Company
Chicago, Illinois