Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2001

A Pension Trust Fund of the State of Michigan

John Engler, Governor

Michigan State Employees Retirement System

Michigan State Employees' Retirement System

a Pension Trust Fund of the State of Michigan

Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2001

MSERS

Prepared by:
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Table of Contents

The cost of printing this report was $1,415.90 ($2.83 each), which was paid for by the System at no cost to taxpayers.

INTRODUCTORY SECTION

Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Michigan State Employees' Retirement System

For its Comprehensive Annual Financial Report for the Fiscal Year Ended September 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.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

Letter of Transmittal

State Employees' Retirement System
P.O. Box 30171
Lansing, Michigan 48909
Telephone 517-322-5103
Outside Lansing 1-800-381-5111

STATE OF MICHIGAN

JOHN ENGLER, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

February 25, 2002

The Honorable John Engler
Governor, State of Michigan,

Members of the Legislature
State of Michigan,

Retirement Board Members
and
Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the annual report of the Michigan State Employees' Retirement System for fiscal year 2001.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System.

The Michigan State Employees' Retirement System was established by legislation under Public Act 240 of 1943 (the State Employees' Retirement Act) and is administered by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System and a list of participating employers is presented in Note 1 of the financial statements in the Financial Section of this report. The purpose of the System is to provide benefits for all State Employees. The services performed by the staff provides benefits to members.

The 2001 annual report is presented in five sections. The Introductory Section contains the transmittal letter and identifies the administrative organization and professional consultants used by the System. The Financial Section contains the independent auditors' report, management's discussion and analysis, financial statements and notes of the System and certain supplemental schedules. The Investment Section summarizes investment activities. The Actuarial Section contains the independent consulting actuary's certification, an outline of actuarial assumptions and methods, and other actuarial statistics. The Statistical Section contains statistical tables of significant data pertaining to the System.

Letter of Transmittal (Continued)

MAJOR GOALS ACCOMPLISHED

Our Mission

The ORS mission is to deliver pensions, related benefits, and services to promote the future financial security of our customers. This year was one of continued service to the 378,247 working and 170,624 retired members of the four retirement systems we administer. In addition to delivering pension payments totaling $2,445,538,314, we have sought to protect and preserve the benefits of our members and ensure long-term solvency of the systems.

One of the year's significant accomplishments was the introduction of a new option for State employees to purchase service credit on a tax-deferred basis. The program's advantage to members can be illustrated by the fact that nearly 500 defined benefit plan members signed up in the first few months after it was announced. This program does not actually begin until fiscal year 2002.

Excellence in Service; Partners in Progress

The Department of Management and Budget (DMB) vision has guided our ORS focus on providing *fast, easy access to complete and accurate information and exceptional service.*

The year saw some very significant improvements in access to information and customer service. On a less visible but no less significant note, much energy this year was devoted to positioning the organization for future demands as well as investigating the increased capabilities offered by new technologies.

Fast, Easy Access

Recognizing that retirement applications will dramatically increase in the next decade as baby boomers leave the workforce, we've been undertaking an extensive examination of our existing capacities, the best practices in the field, and the array of new productivity tools and technologies. With customer needs guiding every decision, we have focused this past year on a technology partnership that can help us provide excellence in service, while preparing and streamlining key processes in anticipation of the plan rollout.

We have also successfully pared down our business operations to seven core processes where responsibility and accountability for every aspect of the business are "owned" by the people who understand the business best.

Moving to a process-based organization requires flexibility and planning, along with appropriate skills and knowledge of the process owners and leaders, open communication, and clear goals. To address these challenges, the following were implemented this year:

- Throughout the Department of Management and Budget, competency based training was implemented to identify and provide the skills and knowledge needed for staff to excel in their job tasks.
- Expanded communication channels across the organization help foster free idea sharing and problem solving among process owners and leaders.
- A department-wide Balanced Scorecard management tool was developed to track progress toward our strategic plan goals. Providing clear targets and metrics in such a way helps staff determine priorities and direction.

We already see results of these initiatives. Some "fast, easy access" accomplishments of the year include:

- A data purity effort for active State employee records was completed, enabling our customer service representatives to provide instant information when members inquire about service credit balances.

Letter of Transmittal (Continued)

- The ORS information and document management arena was restructured in preparation for online access to member information.
- Service level agreements were established with the many vendors that we partner with to define common understandings about services, expectations, and responsibilities, while also clarifying communication channels.

Complete and Accurate Information

Clear customer communication, with current and easily accessible information, remains a priority. Some highlights of the year's communication endeavors include:

- A newly launched ORS employer website provides up-to-date information, instructions, publications and forms, and answers to frequently asked questions to the human resource offices that employ our members.
- Under contract with CitiStreet, a new website for deferred compensation and defined contribution plan participants offers online access to personal account information along with the ability to activate, change, calculate, inquire, and assign with the click of a mouse.
- Expansions and improvements were also made to the main ORS website, with additional forms, publications, schedules, and information available.
- We reached out to customers in or near their communities, where ORS representatives presented programs to 8,909 members (a 7% increase over last year) during 177 pre-retirement information meetings throughout the State.
- Updates to our principal information manual—*Retirement Guidelines* that help members plan for retirement—was published.
- We maintained communication with our 170,624 retired customers via *ORS Connections*, a semiannual newsletter and financial update mailed in March and October.

Exceptional Service

We believe that our standard of exceptional service has not lagged even as we work toward increasing our capacity to further improve service. The ORS Customer Information Center fielded 211,353 phone calls this year, an average of 852 each day. Another 15,734 callers took advantage of a new automated phone service for certain frequently requested services.

Personalized service was also provided by ORS retirement counselors who met with 3,740 customers at our main office in Lansing. At our Holland and Detroit outreach offices, counselors met with another 2,119 customers, in between answering nearly 50 customer phone calls each day (12,375 for the year).

Ever greater numbers are taking advantage of email; we have experienced nearly a 50% increase each year since it became available. Our representatives met the goal of responding to the 7,479 email requests received this year within one working day, on average.

Other significant accomplishments during the year:

- Disability applications are processed in one-third less time than last year, thanks to a new partnership with Disability Determination Services and a reengineering of the claims process.
- Processing time for retirement applications has improved again this year, with 95% of our retirees now being entered into the pension payroll system before their retirement effective date.

Letter of Transmittal (Continued)

- An improved process for generating service credit statements allowed us to respond in an average of three days to more than 2,000 member inquiries received in a three-week period (after the new tax-deferred service credit purchase option was introduced).

Customer Satisfaction

In our ongoing efforts to improve customer service, we conduct semiannual customer satisfaction surveys. This year's surveys continued to show very positive results, with 95% of our retired respondents rating our services as good or excellent.

While the data tells us that we are making solid strides toward our vision, it also inspires us to work even harder. As our improvement plans take shape, our sights will continue to center on customer service—and we're confident that our customers' satisfaction will increase accordingly.

New Proposals

In February 2002, the State of Michigan announced plans for an early out retirement incentive for employees meeting certain age and service requirements. For this proposal to become law, it must be passed by both House and Senate and signed by the Governor.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the System for its comprehensive annual financial report for the fiscal year ended September 30, 2000. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

INTERNAL CONTROL

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The internal control structure is designed to provide reasonable ssurance regarding the safekeeping of assets and reliability of all financial records.

INVESTMENT

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of –11.5%. For the last five years, the System has experienced an annualized weight rate of return of 9.5%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

Letter of Transmittal (Continued)

FUNDING

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the "funded ratio." This ratio provides an indication of the funding status of the System and generally, the greater this percentage, the stronger the System. Effective in fiscal year 2001, the System used the valuation from the previous fiscal year for this report. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement Number 25. Consistent with this approach, the most recent actuarial valuation was performed as of September 30, 2000. The actuarial value of the assets and actuarial accrued liability of the System were $10.3 billion and $9.5 billion, respectively, resulting in a funded ratio of 109.1%. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

POSTEMPLOYMENT BENEFITS

The System also administers the postemployment health benefits (health, dental and vision) offered to retirees. The benefits are funded on a cash or "pay as you go" basis. An actuarial valuation was completed as of September 30, 2000 to determine the actuarial accrued liability if the benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability for these benefits would be approximately $6.6 billion and the employer contribution for health care benefits would be 18.62% of payroll. Only members of the defined benefit plan were included when calculating the actuarial accrued liability.

PROFESSIONAL SERVICES

An annual audit of the System was conducted by Andrews Hooper & Pavlik P.L.C., independent auditors. The independent auditor's report on the System's financial statements is included in the Financial Section of this report.

Statute requires an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer-funding rates for the subsequent year. This annual actuarial valuation was completed by The Segal Company for the fiscal year ended September 30, 2000. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

ACKNOWLEDGMENTS

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, the advisors and many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable the employers and plan members to better evaluate and understand the Michigan State Employees' Retirement System. Their cooperation contributes significantly to the success of the System.

Letter of Transmittal (Continued)

Sincerely,

Duane E. Berger, Director
Department of Management and Budget

Christopher M. DeRose, Director
Office of Retirement Services

Administrative Organization

Retirement Board Members

John Reurink
Retiree Member
Term Expires July 31, 2003

Janine Winters
Employee Member
Term Expires July 31, 2003

Janet McClelland
Employee Member
Term Expires July 31, 2002

Roy Pentilla, C.P.A.
Representing State Treasurer
Statutory Member

George M. Elworth
Representing Attorney General
Statutory Member

D. Daniel McLellan
Representing State Personnel Director
Statutory Member

Dr. James S. Neubecker, Chair
Representing Auditor General
Statutory Member

John Schoonmaker
Representing Commissioner
of Financial & Insurance Services
Statutory Member

Douglas Drake, Vice Chair
Retiree Member
Term Expires July 31, 2004

Administrative Organization

Department of Management and Budget
Office of Retirement Services
P.O. Box 30171
Lansing, Michigan 48909-7671
517-322-5103
1-800-381-5111

Advisors and Consultants

Actuary
The Segal Company
Michael J. Karlin, F.S.A., M.A.A.A.
New York, New York

Auditors
Thomas H. McTavish, C.P.A.
Auditor General
State of Michigan

Andrews Hooper & Pavlik P.L.C.
Jeffrey J. Fineis, C.P.A.
Okemos, Michigan

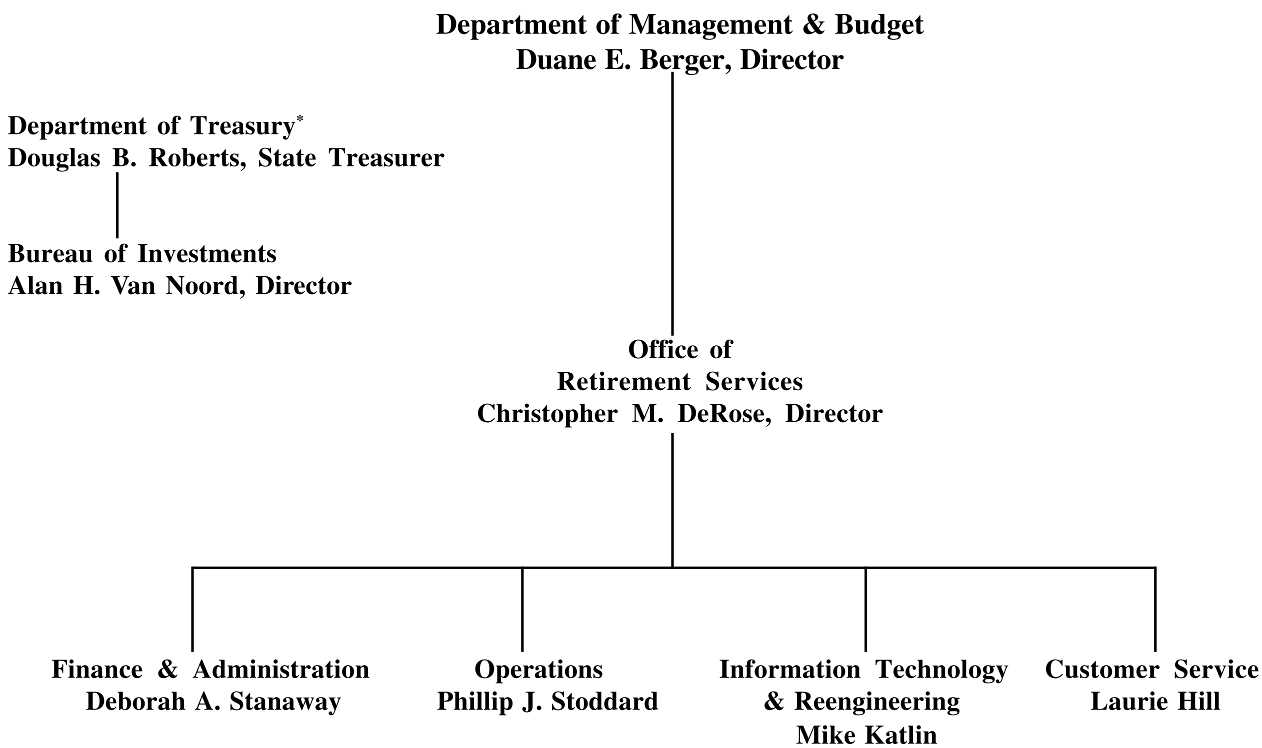
Investment Manager and Custodian
Douglas B. Roberts
State Treasurer
State of Michigan

Legal Advisor
Jennifer M. Granholm
Attorney General
State of Michigan

Investment Performance Measurement
Capital Resource Advisors
Chicago, Illinois

Administrative Organization

Organization Chart**



* The investments of the System are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section.

**The chart represents the organizational structure as of the fiscal year ended 2001. The Department of Management and Budget reorganized its divisional structure in early fiscal year 2002.

FINANCIAL SECTION

Independent Auditor's Report
Management's Discussion and Analysis
Basic Financial Statements
Notes to Basic Financial Statements
Required Supplementary Information
Supporting Schedules

FINANCIAL SECTION

Independent Auditor's Report

ANDREWS HOOPER & PAVLIK P.L.C.
Certified Public Accountants

Mr. Duane Berger, Director, Department of Management and Budget
Mr. Christopher M. DeRose, Director, Office of Retirement Services
Mr. Thomas H. McTavish, CPA, Auditor General
Michigan State Employees' Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan State Employees' Retirement System, as of September 30, 2001 and 2000, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan State Employees' Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Michigan State Employees' Retirement System, as of September 30, 2001 and 2000, and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information and supporting schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The required supplementary information and supporting schedules are the responsibility of the Michigan State Employees' Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it. The Introductory, Investment, Actuarial, and Statistical Sections were not audited by us and, accordingly, we express no opinion on those sections.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 30, 2002 on our consideration of the Michigan State Employees' Retirement System's internal control over financial reporting and on 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.

Andrews Hooper & Pavlik P.L.C.

January 30, 2002

4295 Okemos Road, Suite 200 • Okemos, Michigan 48864 • ph 517.487.5000 fx 517.487.9535 • www.ahpplc.com

Management's Discussion And Analysis

Our discussion and analysis of the Michigan State Employees' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2001. Please read it in conjunction with the transmittal letter in the Introductory Section on page 5 and the basic financial statements, which follow this discussion.

FINANCIAL HIGHLIGHTS

- System assets exceeded liabilities at the close of fiscal year 2001 by $9.6 billion (reported as *net assets*). Net assets are held in trust to meet future benefit payments.

- The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of September 30, 2000, the funded ratio was approximately 109.1%.

- Revenues for the year were ($892,055,414), which is comprised of contributions of $371,060,675 and investment losses of ($1,263,116,089).

- Expenses increased over the prior year from $671,608,539 to $731,012,691 or 8.8%. Most of this increase represented increased retirement benefits paid.

THE STATEMENT OF PLAN NET ASSETS AND THE STATEMENT OF CHANGES IN PLAN NET ASSETS

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements; *The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets* (page 19) and *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* (page 20). These financial statements report information about the System, as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedule of Funding Progress and Schedule of Employer Contributions to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

FINANCIAL ANALYSIS

System total assets as of September 30, 2001 were $10.1 billion and were mostly comprised of cash, investments, and contributions due from employers. Total assets decreased $1,322,510,245 or 11.6% from the prior year primarily due to decreased investment earnings.

Total liabilities as of September 30, 2001 were $453,728,265 and were mostly comprised of warrants outstanding, administrative costs, and obligations under securities lending. Total liabilities increased $300,557,860 or 196.2% from the prior year primarily due to an increase in obligations under securities lending and an increase in payables from the purchase of investments.

Mangement's Discussion and Analysis (Continued)

System assets exceeded its liabilities at the close of fiscal year 2001 by $9.6 billion, of which $1,156,400 is for Defined Contribution Benefit Plan Savings. Total net assets held in trust for pension and health benefits decreased $1,623,068,105 or 14.4% from the previous year, primarily due to adverse market conditions and a decrease in investment earnings. This is in contrast to the previous year, when net assets increased by $990,654,503 or 9.6% from the prior year.

Michigan State Employees' Retirement System
Net Assets
(In Thousands)

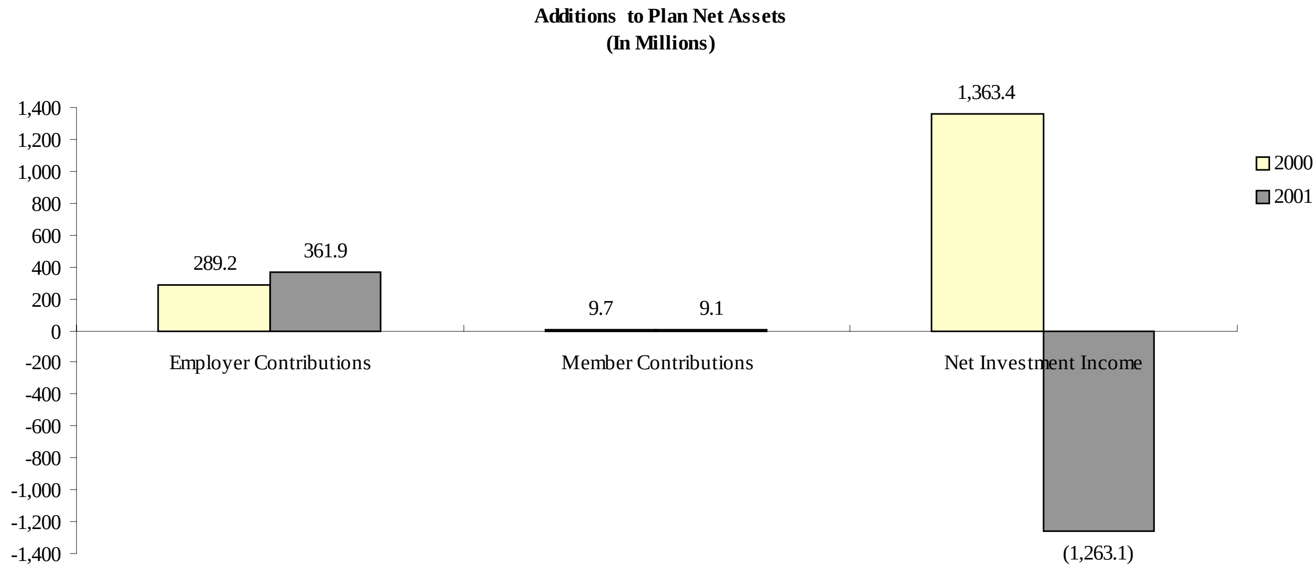
	2001	2000	Total Percentage Change
Assets			
Cash	$ 44,800	$ 65,104	(31.2) %
Receivables	50,135	111,595	(55.1)
Investments	9,998,337	11,239,084	(11.0)
Total Assets	10,093,272	11,415,783	(11.6)
Liabilities			
Warrants outstanding	3,852	1,777	116.8
Accounts payable and other accrued liabilities	41,161	5,566	639.5
Obligations under securities lending	408,715	145,828	180.3
Total Liabilities	453,728	153,171	196.2
Net Assets - DC Savings SubAccount	1,156	744	55.4
Net Assets - Pension and Health Benefits	9,638,388	11,261,868	(14.4)
Total Net Assets	$ 9,639,544	$ 11,262,612	(14.4) %

REVENUES - ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2001 totaled ($892,055,414).

Total contributions and net investment income decreased $2,554,318,456 or 153.7% from those of the prior year, due to a drastic decline in market conditions and investment earnings. Total employer contributions increased from the previous year by $72,862,871 or 25.2%, while member contributions decreased by $528,968 or 5.5%. The System is non-contributory; however, members may purchase service credit. The decrease in member contributions occurred because fewer individuals purchased service credit. Investment income decreased from the previous year by $2,626,490,959 or 192.6%. The Investment Section of this report reviews the results of investment activity for 2001.

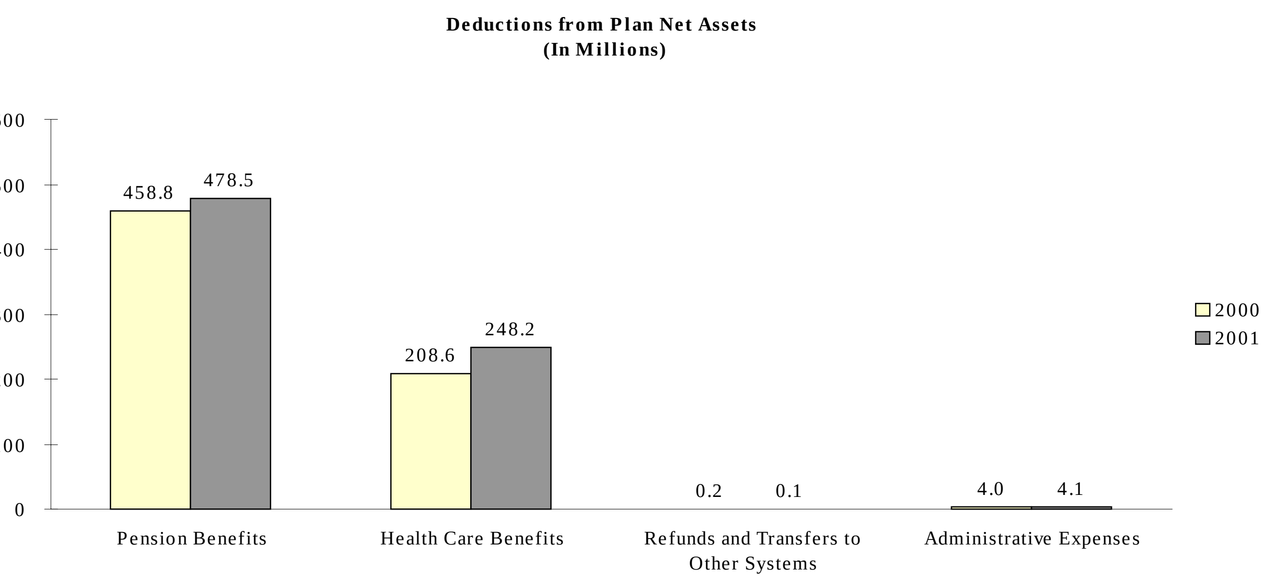
Management's Discussion and Analysis (Continued)



EXPENSES - DEDUCTIONS FROM PLAN NET ASSETS

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refunds of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2001 were $731,012,691, an increase of 8.8% over year 2000 expenditures.

The growth of health care expenditures continued during the year and increased by $39,618,778 or 19% from $208,627,602 to $248,246,380 during the fiscal year. The payment of pension benefits increased by $19,721,554 or 4.3% from the previous year. The increase in pension benefit expenditures resulted from an increase in retirees (328) and an increase in benefit payments to retirees. Administrative expenses increased by $194,292 or 4.9% from the previous year, primarily due to an increase in professional services for special actuarial studies, and an increase in technological/computer operations support.



Management's Discussion and Analysis (Continued)

RETIREMENT SYSTEM AS A WHOLE

The System's combined net assets have increased consistently over the last five years, with the exception of the decrease during the current fiscal year. Again, this decrease is a result of a national economic slowdown that resulted in investment income decreases. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position will continue to improve due to a prudent investment program, cost controls, and strategic planning.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

Statements of Pension Plan and Postemployment Healthcare Plan Net Assets

As of Fiscal Years Ending September 30, 2001 and 2000

	September 30, 2001			September 30, 2000		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Assets:						
Cash	$ 44,696,683	$ 103,626	$ 44,800,309	$ 65,018,976	$ 84,856	$ 65,103,832
Receivables:						
Amounts due from employers	13,379,313	762,950	14,142,263	11,551,620	15,076	11,566,696
Interest and dividends	35,570,053	82,466	35,652,519	41,014,141	53,527	41,067,668
Sale of investments	339,116	786	339,902	58,883,151	76,848	58,959,999
Total receivables	49,288,482	846,202	50,134,684	111,448,912	145,451	111,594,363
Investments:						
Short term investments	596,950,961	1,383,983	598,334,944	356,102,125	464,746	356,566,871
Bonds, notes, mortgages and preferred stock	1,989,633,023	4,612,805	1,994,245,828	2,230,817,140	2,911,421	2,233,728,561
Common stock	3,922,793,441	9,094,683	3,931,888,124	5,045,375,714	6,584,678	5,051,960,392
Real estate	936,361,734	2,170,880	938,532,614	954,304,019	1,245,454	955,549,473
Alternative investments	1,491,758,311	3,458,522	1,495,216,833	1,778,313,637	2,320,862	1,780,634,499
International investments	629,943,329	1,460,473	631,403,802	713,884,997	931,685	714,816,682
Collateral on loaned securities	407,769,647	945,381	408,715,028	145,637,667	190,071	145,827,738
Total investments	9,975,210,446	23,126,727	9,998,337,173	11,224,435,299	14,648,917	11,239,084,216
Total assets	10,069,195,611	24,076,555	10,093,272,166	11,400,903,187	14,879,224	11,415,782,411
Liabilities:						
Warrants outstanding	3,842,844	8,909	3,851,753	1,774,397	2,315	1,776,712
Accounts payable and other accrued liabilities	41,066,275	95,209	41,161,484	5,558,700	7,255	5,565,955
Obligations under securities lending	407,769,647	945,381	408,715,028	145,637,667	190,071	145,827,738
Total liabilities	452,678,766	1,049,499	453,728,265	152,970,764	199,641	153,170,405
Net Assets - DC Savings SubAccount		1,156,400	1,156,400		744,200	744,200
Net Assets - Pension and Health Benefits	9,616,516,845	21,870,656	9,638,387,501	11,247,932,423	13,935,383	11,261,867,806
Net Assets Held in Trust for Pension and Health Benefits*	$ 9,616,516,845	$ 23,027,056	$ 9,639,543,901	$ 11,247,932,423	$ 14,679,583	$ 11,262,612,006

*A schedule of funding progress is presented in the Required Supplementary Information in the Financial Section.

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

For the Fiscal Years Ended September 30, 2001 and 2000

	September 30, 2001			September 30, 2000		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Additions:						
Member contributions	$ 3,341,381	$ 5,793,284	$ 9,134,665	$ 4,606,662	$ 5,056,971	$ 9,663,633
Employer contributions	112,299,808	249,214,002	361,513,810	121,817,366	166,833,573	288,650,939
DC Savings SubAccount		412,200	412,200		573,600	573,600
Investment income (loss):						
Investment income (loss)	(1,249,999,446)		(1,249,999,446)	1,373,692,210		1,373,692,210
Securities lending income	13,564,316		13,564,316	15,447,180		15,447,180
Investment expenses:						
Real estate operating expenses	(423,619)		(423,619)	(602,289)		(602,289)
Securities lending expenses	(12,487,632)		(12,487,632)	(14,452,406)		(14,452,406)
Other investment expenses	(14,945,646)		(14,945,646)	(14,478,754)		(14,478,754)
Interest income		1,174,367	1,174,367		3,766,152	3,766,152
Miscellaneous income	1,571		1,571	2,777		2,777
Total additions	(1,148,649,267)	256,593,853	(892,055,414)	1,486,032,746	176,230,296	1,662,263,042
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement allowances	478,525,328		478,525,328	458,803,774		458,803,774
Employer share of health insurance		229,870,026	229,870,026		193,427,912	193,427,912
Employer share of dental/vision insurance		18,376,354	18,376,354		15,199,690	15,199,690
Refunds of member contributions	14,900		14,900	43,486	8	43,494
Transfers to other systems	76,799		76,799	178,677		178,677
Administrative expenses	4,149,284		4,149,284	3,954,992		3,954,992
Total deductions	482,766,311	248,246,380	731,012,691	462,980,929	208,627,610	671,608,539
Net Increase (Decrease)	(1,631,415,578)	8,347,473	(1,623,068,105)	1,023,051,817	(32,397,314)	990,654,503
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	11,247,932,423	14,679,583	11,262,612,006	10,224,880,606	47,076,897	10,271,957,503
End of Year*	$ 9,616,516,845	$ 23,027,056	$ 9,639,543,901	$ 11,247,932,423	$ 14,679,583	$ 11,262,612,006

*A schedule of funding progress is presented in the Required Supplementary Information in the Financial Section.

The accompanying notes are an integral part of these financial statements.

Notes to Basic Financial Statements

NOTE 1 - PLAN DESCRIPTION

ORGANIZATION

The Michigan State Employees' Retirement System (System) is a cost sharing, multiple employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State) and created under Public Act 240 of 1943, as amended. The System was established by the State to provide retirement, survivor and disability benefits to the State's government employees. The System is a qualified trust fund under section 401(a) of the Internal Revenue Code. By statute, employees of the following employers are also covered by this plan: American Legion, American Veterans, Disabled American Veterans, Mackinac Island State Park, Marine Corps League, Michigan Bar Association, Military Order of the Purple Heart, Commission for Independent Vendors, Third Circuit Court, Recorders Court and 36th District Court. Michigan judges and elected officials, legislators, national guard and state police officers are covered by separate retirement plans.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State.

The System is administered by the Office of Retirement Services, within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the System's Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

MEMBERSHIP

At September 30, 2001 and 2000, the System's membership consisted of the following:

	2001	2000
Retirees and beneficiaries currently receiving benefits:		
Regular benefits	28,401	28,350
Survivor benefits	5,410	5,267
Disability benefits	3,300	3,088
Total	37,111	36,705
Current employees:		
Vested	36,175	37,290
Non-vested	8,792	10,488
Total	44,967	47,778
Inactive employees entitled to benefits and not yet receiving them	4,865	7,556
Total All Members	86,943	92,039

Enrollment in the health care plan is voluntary. The number of participants is as follows:

Health/Dental/Vision Plan	2001	2000
Eligible participants	37,111	36,705
Participants receiving benefits:		
Health	33,963	33,700
Dental	33,375	33,028
Vision	33,505	33,158

FINANCIAL SECTION

Notes to Basic Financial Statements

BENEFIT PROVISIONS

Introduction

Benefit provisions of the defined benefit pension plan are established by State statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability and survivor benefits.

Members who have separated from employment may request a refund of his or her member contribution account. (The System is currently non-contributory.) A refund cancels a former member's rights to future benefits. However, former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution plan. The Public Act allows returning employees and members who left state employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

Regular Retirement

The retirement benefit is based on a member's years of credited service (employment) and final average compensation. The normal benefit equals 1.5% of a member's final average compensation multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Final average compensation is the average of a member's monthly pay during 36 consecutive months of credited service. The 36 consecutive month period producing the highest monthly average is used. For most members, this is the last three years of employment.

A member may retire and receive a monthly benefit after attaining:

1. age 60 with 10 or more years of credited service; or
2. age 55 with 30 or more years of credited service; or
3. age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

1. age 51 with 25 or more years in a covered position; or
2. age 56 with 10 or more years in a covered position.

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

Employees of closing Department of Community Health facilities are eligible for retirement under one of the following conditions:

1. age 51 with 25 years of service, the last 5 of which were rendered in the closing facility;
2. age 56 with 10 years of service, the last 5 of which were rendered in the closing facility; or
3. 25 years of service at the closing facility regardless of age.

Notes to Basic Financial Statements

Employees of the State Accident Fund, Michigan Biologic Products or Liquor Control Commission who were terminated as the result of privatization may retire if the member's age and length of service was equal to or greater than 70 on the date of transfer or termination.

Conservation Officers (CO) with a hire date on or before April 1, 1991, are eligible to retire after 25 years of service, 20 of which must have been rendered as a CO. CO's hired after April 1, 1991 and before March 31, 1997, must have 23 years of service as a CO to be eligible for a full retirement with only 25 years of service. In either case, 2 years immediately preceding retirement must be as a CO.

Deferred Retirement

Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after 5 years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Department of Community Health employees subject to reduction in force lay-offs by reason of deinstitutionalization.

Non-Duty Disability Benefit

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a State employee is eligible for a non-duty disability pension. The non-duty disability benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.

Duty Disability Benefit

A member who becomes totally and permanently disabled from performing duties as a State employee as a direct result of State employment and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. If the member is under age 60, the duty disability allowance is a maximum payment of $6,000 payable annually. At age 60 the benefit is recomputed under service retirement.

Survivor Benefit

Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit.

Pension Payment Options

When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75% or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

<u>Regular Pension</u> — The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

<u>100% Survivor Pension</u> — Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Notes to Basic Financial Statements

75% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 75% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension — Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% or 75% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension — An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75% or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the Social Security Administration Office. In order to calculate this benefit, members choosing this option must provide ORS with an estimate from the Social Security Administration Office. The actual amount received from social security may vary from the estimate.

Post Retirement Adjustments

One time upward benefit adjustments were made in 1972, 1974, 1976, 1977 and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of $25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987, are not eligible for the supplemental payment.

Contributions

Member Contributions — Members currently participate in the System on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates the System employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Employer contributions — The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles so the contribution rates do not have to increase over time.

Transfers to Defined Contribution Plan

During fiscal year 1998, the Michigan State Employees' Retirement Act provided members an opportunity to transfer to the Defined Contribution Plan. This was a one-time opportunity and the decision is irrevocable. The transfer was completed by September 30, 1998. With the passage of the legislation permitting the transfer, the System also became a closed system. All new employees are members of the Defined Contribution Plan.

Notes to Basic Financial Statements

Other Postemployment Benefits

Under the Michigan State Employees' Retirement Act, all retirees have the option of receiving health, prescription, dental, and vision coverage. The employer funds health benefits on a pay-as-you-go basis. Retirees with this coverage contribute 5% and 10% of the monthly premium amount for the health (including prescription coverage), dental and vision coverage, respectively. The employer's payroll contribution rate to provide this benefit was 8.75% and 6.0% for fiscal years 2001 and 2000, respectively.

Retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage, $1,000 for spouse and $1,000 for each dependent under age 23. Premiums are fully paid by the State.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

The System's financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue in the period in which employees provide service. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Reserves

Public Act 240 of 1943, as amended, created the employees' savings reserve, pension reserve, employer's accumulation reserve, income account and expense account, and health insurance reserve. The financial transactions of the System are recorded in these accounts as required by Public Act 240 of 1943, as amended.

Employees' Savings Reserve — Members no longer contribute to this fund except to purchase eligible service credit or repay previously refunded contributions. This fund represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members and unclaimed amounts transferred to the income account. At September 30, 2001, and 2000, the balance in this account was $38.9 million and $39.1 million, respectively.

Pension Reserve — This represents the reserves for payment of future retirement benefits to current retirees. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Employees' Savings Reserve. Monthly benefits, which are paid to the retiree, reduce the reserve. At the end of each fiscal year, an amount determined by an annual actuarial valuation is transferred from the Employer's Accumulation Reserve to this reserve to bring the balance into balance with the actuarial present value of retirement allowances. At September 30, 2001 and 2000, the balance in this account was $4.5 billion and $4.4 billion, respectively.

Employer's Accumulation Reserve — All employer contributions are credited to this reserve. Interest from the income account is credited annually. Amounts are transferred annually from this reserve to the Pension Reserve to fund that reserve. At September 30, 2001 and 2000, the balance in this account was $3.5 billion and $3.3 billion, respectively.

Income Account and Expense Account — The income account is credited with all investment earnings. Interest is transferred annually to the reserves. Administrative expenses are paid from the expense account. The legislature appropriates the funds necessary to defray and cover the administrative expenses of the plan. At September 30, 2001 and 2000, the net balance of these accounts was $1.6 billion and $3.5 billion, respectively.

Health Insurance Reserve — This fund is credited with employee and employer contributions for retirees' health (including prescription coverage), dental, and vision benefits and interest is allocated on the beginning balance. Premiums for health, dental, and vision benefits are paid from this fund. At September 30, 2001 and 2000, the unrestricted balance in this account was $21.9 million and $13.9 million, respectively.

Notes to Basic Financial Statements

<u>DC Savings SubAccount</u> — The savings in employer contributions attributable to the transfer to the Defined Contribution Retirement Plan are contributed to this subaccount. Interest will also be allocated to this subaccount. The subaccount is restricted because the statute stipulates that the funds cannot be used until health benefits are fully funded. As of September 30, 2001 and 2000, the balance in this account was $1,156,400 and $744,200, respectively.

Reporting Entity

The System is a pension trust fund of the State. As such, the System is considered part of the State and is included in the State's Comprehensive Annual Financial Report as a pension trust fund. The System and its Board are not financially accountable for any other entities or other organizations. Accordingly, the System is the only entity included in this financial report.

Fair Value of Investments

Plan investments are reported at fair value, except for short-term investments. Short-term investments are carried at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

Investment Income

Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.

Property and Equipment

Office space is leased from the State on a year to year basis. Office equipment is capitalized if the value exceeds $5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension and Postemployment Heathcare Plan Net Assets. Such assets are depreciated on a straight line basis over 10 years. As of September 30, 1998, all capitalized equipment was fully depreciated. No additional equipment has been capitalized for the System since that date.

Related Party Transactions

<u>Leases and services</u> — The System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid. The following summarizes costs incurred by the System for such services.

	2001	2000
Building Rentals	$ 172,959	$ 102,555
Technological Support	875,238	779,970
Attorney General	205,454	226,471
Investment Services	2,067,022	1,698,100

Notes to Basic Financial Statements

Cash — On September 30, 2001 and 2000, the System had $45 million and $65 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to $1.1 million for the years ended September 30, 2001 and 2000.

Reclassification of Prior Year Amounts

Certain prior year amounts have been reclassified to conform with the current year presentation.

NOTE 3 - CONTRIBUTIONS

Members currently participate in the System on a non-contributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service such as military service or maternity leave. Effective August 1, 1998, the retirement act was amended to permit a “universal buy-in”. With a universal buy-in, a member may elect to purchase no more than 5 years of service credit (less other service credit purchased). The State is required by Public Act 240 of 1943, as amended, to contribute amounts necessary to finance the benefits of its employees. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. The unfunded (overfunded) actuarial accrued liability is amortized over a 36 year period for the 2000 fiscal year and a 35-year period for the 2001 fiscal year.

Actual employer contributions for retirement benefits were $112.3 million and $121.8 million for fiscal years 2001 and 2000, respectively, representing 5.4% of annual covered payroll for the year ended September 30, 2000. The fiscal year 2001 annual covered payroll is not yet available. Required employer contributions for pensions included:

1. $173.9 million and $171.5 million for fiscal years 2001 and 2000, respectively, for the normal cost of pensions representing 7.61% (before reconciliation) of annual covered payroll for fiscal year 2000.

2. ($70.9) million and ($50.6) million for fiscal years 2001 and 2000, respectively, for amortization of overfunded actuarial accrued liability representing (2.25%) (before reconciliation) of annual covered payroll for fiscal year 2000.

The System is required to reconcile actuarial requirements annually. Any funding excess or deficiency is included in the subsequent years appropriation request, and is not recognized as a payable or receivable in the accounting records. Based on this reconciliation and other adjustments, the differences are smoothed over 5 years.

NOTE 4 - INVESTMENTS

Investment Authority

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stock, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

Notes to Basic Financial Statements

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5.0% of the System's assets in small businesses having more than one-half of it's assets or employees in Michigan as described in section 20(a) of the act and up to 20.0% of the System's assets in investments not otherwise qualified under the act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock, and direct investments.

Derivatives

The State Treasurer does not employ the use of derivatives in the investment of Common Cash or the investment of trust funds other than the pension trust funds.

Derivatives are used in managing pension trust fund portfolios, but uses do not include speculation or leverage of investments. Less than 7.0% of the total pension trust fund's portfolio has been invested from time to time in future contracts, collateralized mortgages, and swap agreements. State investment statutes limit total derivative exposure to 15.0% of a fund's total asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 6.4% of market value of total assets on September 30, 2001 and 6.2% of market value of total assets on September 30, 2000.

To diversify the pension fund's portfolio into international equities, the State Treasurer has entered into swap agreements with investment grade counterparties which are tied to stock market indices in twenty foreign countries. The notional amounts of the swap agreements at September 30, 2001 and 2000, were $776.8 million and $622.0 million, respectively. Approximately one half of the notional amount is hedged against foreign currency fluctuations. The swap agreements provide that the System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London InterBank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the international equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturities range from October 2001 to October 2004. U.S. domestic LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes. The book value represents the cost of the notes. The current value represents the current value of the notes and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based upon the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over $227.4 million of gains on international equity exposure and excess interest received have been realized. The unrealized loss of $164.5 million at September 30, 2001 reflects the decline in international stock indices and changes in currency exchange rates.

The respective September 30, 2001 and 2000 values are as follows:

	Notional Value	Current Value
9/30/01 (dollars in millions)	$776.8	$614.9
9/30/00 (dollars in millions)	622.0	690.1

Investments Exceeding 5% of Plan Net Assets

The System did not hold an individual investment (other than U.S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 2001 or 2000.

Notes to Basic Financial Statements

Securities Lending

State statutes allow the System to participate in securities lending transactions, and the System has, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the System, the System's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: (i) at least 102% of the market value of the loaned securities in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States.

The System did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the System and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2001, such investment pool had an average duration of 75 days and an average weighted maturity of 551 days. Because the loans were terminable at will their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2001, the System had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the System as of September 30, 2001 were $432,164,471 and $415,258,430, respectively.

Gross income from security lending for the fiscal year was $13,564,316. Expenses associated with this income amounted to $12,128,637 for the borrower's rebate and $358,995 for fees paid to the agent.

Categories of Investment Risk

Investments made by the fund are summarized below. The investments represented by specific identifiable investment securities are classified as to credit risk in three categories.

Category 1 includes investments insured, registered, or held by the System or its agent in the System's name. Category 3 includes uninsured and unregistered investments held by the counterparty, its trust department, or agent, but not in the System's name.

At September 30, 2001, all investments of the System were classified as Category 1 or Category 3, except for certain investments not categorized.

The following table summarizes the investments at market value:

Category 1	2001	2000 (Reclassified)
Prime Commercial Paper	$ 535,584,944	$ 313,967,311
Short Term Investments	41,750,000	42,599,560
Government Securities	691,758,129	1,217,116,265
Corporate Bonds & Notes	968,730,878	908,224,609 [2]
Preferred Stock	404	331
Common Stock	3,847,799,644	5,013,248,625
Real Estate	20,612,208	56,099,807 [1]
Alternative Investments	62,379,491	177,644,998 [3]
International Investments	631,403,802	714,816,682
Total Category 1	$ 6,800,019,500	$ 8,443,718,188
Category 3		
Government Securities	$ 16,953,788	$ -
Non-Categorized		
Short Term Investments	$ 21,000,000	$ -
Mortgages	4,467,432	5,166,117
Real Estate	917,920,406	899,449,666 [1]
Alternative Investments	1,432,837,342	1,602,989,501 [3]
Cash Collateral	408,715,028	145,827,738
Securities on Loan:		
Government Securities	299,789,594	99,088,854
Corporate Bonds & Notes	12,545,603	4,132,385
Common Stock	84,088,480	38,711,767
Total Non-Categorized	$ 3,181,363,885	$ 2,795,366,028
Grand Total	$ 9,998,337,173	$ 11,239,084,216

[1] In Category 1, the Real Estate investments are all publicly traded real estate investment trusts. Non-Categorized Real Estate consists of investments through various legal entities.

[2] Private Placements were reclassified from Non-Categorized to Corporate Bonds and Notes Category 1 in the amount of $65,186,820 for FYE 2000.

[3] Alternative investments were reclassified in the amount of $35,418,394 from Non-Categorized to Category 1 for FYE 2000.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Under the Administrative Procedures Act, members may appeal a decision made by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. These cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

Required Supplementary Information

Schedule of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the System's funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System.

Retirement Benefits ($ in Millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability[1] (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1991[@]	$ 4,347	$ 4,939	$ 592	88.0 %	$ 2,315	25.6 %
1992	4,534	5,480	946	82.7	2,266	41.8
1993[+]	5,043	6,172	1,129	81.7	2,261	49.9
1994[*]	5,476	6,560	1,084	83.5	2,351	46.1
1995	6,090	6,861	771	88.8	2,431	31.7
1996	6,678	7,147	469	93.4	2,515	18.6
1997	7,515	8,213	698	91.5	2,273	30.7
1997[#]	8,834	8,100	(734)	109.1	2,273	(32.3)
1998	9,109	8,374	(735)	108.8	2,108	(34.9)
1998[#]	9,109	8,497	(612)	107.2	2,108	(29.0)
1999	9,648	9,029	(619)	106.9	2,214	(28.0)
2000	10,337	9,474	(863)	109.1	2,254	(38.3)

(1) Based on entry age normal actuarial method.

@ Benefits amended.

+ Revised asset valuation method.

Revised actuarial assumptions and revised asset valuation method.

* Revised actuarial assumptions.

Required Supplementary Information (Continued)

Schedule of Employer Contributions

Fiscal Year Ended Sept. 30	Actuarial Required Contribution (ARC)*	Actual Contribution**	Percentage Contributed
1992	$ 215,470,500	$ 187,004,712	86.8 %
1993	219,912,052	247,047,499	112.3
1994	230,231,706	263,791,739	114.6
1995	260,769,716	306,488,437	117.5
1996	262,458,665	285,766,953	108.9
1997	244,102,003	288,366,799	118.1
1998	126,396,181	145,734,677	115.3
1999	111,415,984	121,119,857	108.7
2000	120,906,261	121,817,366	100.8
2001	102,989,963	112,299,808	109.0

* The ARC has been recalculated based on the covered payroll for each year.

** The actual contributions have been recalculated based on the same measure of covered payroll utilized to calculate the ARC.

Notes to Required Supplementary Information

NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the Michigan State Employees' Retirement System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the System is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension benefits as they become due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

The Schedule of Funding Progress and Schedule of Employer Contributions are reported as historical trend information. The Schedule of Funding Progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedule of Employer Contributions is presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

NOTE B - SUMMARY OF ACTUARIAL ASSUMPTIONS

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	09/30/00
Actuarial Cost Method	Entry Age, Normal
Amortization Method	Level Percent of Payroll, Closed
Remaining Amortization Period	36 Years
Asset Valuation Method	5-Year Smoothed Market Value
Actuarial Assumptions:	
Inflation Rate	4%
Investment Rate of Return	8%
Projected Salary Increases	4% - 16%
Cost-of-Living Adjustments	3% Annual Non-Compounded with Maximum Annual Increase of $300 for those Eligible

Supporting Schedules

Comparative Summary of
Pension Plan Administrative Expenses
For the Years Ended September 30, 2001 and 2000

	2001	2000
Personnel Services:		
Staff Salaries	$ 1,168,426	$ 1,174,625
Retirement and Social Security	249,401	226,794
Other Fringe Benefits	195,929	180,277
Total	1,613,756	1,581,696
Professional Services:		
Actuarial	123,102	67,890
Attorney General	205,454	226,471
Audit	25,523	44,325
Consulting	164,469	127,437
Medical	370,410	355,822
Total	888,958	821,945
Building and Equipment:		
Building Rentals	172,959	102,555
Equipment Purchase, Maintenance and Rentals	55,236	96,592
Total	228,195	199,147
Miscellaneous:		
Travel and Board Meetings	14,789	11,696
Office Supplies	29,220	21,066
Postage, Telephone, and Other	452,618	474,394
Printing	46,510	65,078
Technological Support	875,238	779,970
Total	1,418,375	1,352,204
Total Administrative Expenses	$ 4,149,284	$ 3,954,992

Supporting Schedules (Continued)

Schedule of Investment Expenses

	2001	2000
Real Estate Operating Expenses	$ 423,619	$ 602,289
Securities Lending Expenses	12,487,632	14,452,406
Other Investment Expenses*	14,945,646	14,478,754
Total Investment Expenses	$ 27,856,897	$ 29,533,449

* See Investment Section for fees paid to investment professionals

Schedule of Payments to Consultants

	2001	2000
Independent Auditors	$ 25,523	$ 44,325
Consulting	164,469	127,437
Medical	370,410	355,822
Attorney General	205,454	226,471
Actuary	123,102	67,890
Total Payment to Consultants	$ 888,958	$ 821,945

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)

For the Year Ended September 30, 2001

	Employee Savings	Pension Reserve	Employer Accumulation	Income	Health Insurances	Total
Additions:						
Member contributions	$ 3,341,381				$ 5,793,284	$ 9,134,665
Employer contributions			$ 112,299,808		249,214,002	361,513,810
DC Savings SubAccount					412,200	412,200
Investment income (loss):						
Investment income (loss)				$ (1,249,999,446)		(1,249,999,446)
Securities lending income				13,564,316		13,564,316
Investment expenses:						
Real estate operating expenses				(423,619)		(423,619)
Securities lending expenses				(12,487,632)		(12,487,632)
Other investment expenses				(14,945,646)		(14,945,646)
Interest income					1,174,367	1,174,367
Miscellaneous income				1,571		1,571
Total additions	3,341,381		112,299,808	(1,264,290,456)	256,593,853	(892,055,414)
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement allowances		$ 478,525,328				478,525,328
Employer share of health insurance					229,870,026	229,870,026
Employer share of dental/vision insurance					18,376,354	18,376,354
Refunds of member contributions	14,900					14,900
Transfers to other systems	24,644		52,155			76,799
Administrative expenses				4,149,284		4,149,284
Total deductions	39,544	478,525,328	52,155	4,149,284	248,246,380	731,012,691
Net Increase (Decrease)	3,301,837	(478,525,328)	112,247,653	(1,268,439,740)	8,347,473	(1,623,068,105)
Other Changes in Net Assets:						
Interest allocation	1,256,495	354,656,980	264,466,019	(620,379,494)		-
Transfers upon retirement	(4,787,481)	4,787,481				-
Transfers of inactive balances						-
Transfers of employer shares		226,108,610	(226,108,610)			-
Total other changes in net assets	(3,530,986)	585,553,071	38,357,409	(620,379,494)		-
Net Increase (Decrease) After Other Changes	(229,149)	107,027,743	150,605,062	(1,888,819,234)	8,347,473	(1,623,068,105)
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	39,129,838	4,401,144,522	3,305,825,234	3,501,832,829	14,679,583	11,262,612,006
End of Year	$ 38,900,689	$ 4,508,172,265	$ 3,456,430,296	$ 1,613,013,595	$ 23,027,056	$9,639,543,901

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Heathcare Benefits)

For the Year Ended September 30, 2000 (Reclassified)

	Employee Savings	Pension Reserve	Employer Accumulation	Income	Health Insurances	Total
Additions:						
Member contributions	$ 4,606,662				$ 5,056,971	$ 9,663,633
Employer contributions			$ 121,817,366		166,833,573	288,650,939
DC Savings SubAccount					573,600	573,600
Investment income (loss):						
Investment income (loss)				$1,373,692,210		1,373,692,210
Securities lending income				15,447,180		15,447,180
Investment expenses:						
Real estate operating expenses				(602,289)		(602,289)
Securities lending expenses				(14,452,406)		(14,452,406)
Other investment expenses				(14,478,754)		(14,478,754)
Interest income					3,766,152	3,766,152
Miscellaneous income				2,777		2,777
Total additions	4,606,662		121,817,366	1,359,608,718	176,230,296	1,662,263,042
Deductions:						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement allowances		$ 458,803,774				458,803,774
Employer share of health insurance					193,427,912	193,427,912
Employer share of dental/vision insurance					15,199,690	15,199,690
Refunds of member contributions	43,486				8	43,494
Transfers to other systems	17,674		161,003			178,677
Administrative expenses				3,954,992		3,954,992
Total deductions	61,160	458,803,774	161,003	3,954,992	208,627,610	671,608,539
Net Increase (Decrease)	4,545,502	(458,803,774)	121,656,363	1,355,653,726	(32,397,314)	990,654,503
Other Changes in Net Assets:						
Interest allocation	1,152,182	350,481,636	247,481,077	(599,114,895)		-
Transfers upon retirement	28,379,460	(28,379,460)				-
Transfers of inactive balances						-
Transfers of employer shares		156,825,665	(156,825,665)			-
Total other changes in net assets	29,531,642	478,927,841	90,655,412	(599,114,895)		-
Net Increase (Decrease) After Other Changes	34,077,144	20,124,067	212,311,775	756,538,831	(32,397,314)	990,654,503
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	5,052,694	4,381,020,455	3,093,513,459	2,745,293,998	47,076,897	10,271,957,503
End of Year	$39,129,838	$4,401,144,522	$3,305,825,234	$3,501,832,829	$14,679,583	$11,262,612,006

INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments

Alan H. Van Noord, Director

Report on Investment Activity

INTRODUCTION

The State Treasurer reports quarterly the investment activity to the Investment Advisory Committee, which reviews the investments, goals and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The Investment Advisory Committee may also, by a majority vote, direct the State Treasurer to dispose of any holdings that, in the Committee's judgement, are not suitable for the funds involved, and may, by unanimous vote, direct the State Treasurer to make specific investments.

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Consumer and Industry Services and the Director of the Department of Management and Budget are ex-officio members. The members of the committee are as follows: James B. Henry, PHD (public member), Robert E. Swaney, CFA (public member), David G. Sowerby (public member), Kathleen M. Wilbur (ex-officio member), and Duane E. Berger (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

INVESTMENT POLICY & GOAL

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment rate of return, at a reasonable cost achieved by cultivating a motivated team of dedicated professionals. The goals of the fund are:

1. To achieve a balance between risk and return.
2. To outperform the actuarial assumptions over the long term.
3. To perform in the top half of the Capital Resource Advisors public plan universe.
4. To exceed individual asset class benchmarks over the long term.
5. Seek to maintain a fully funded position.
6. To produce competitive results while operating in a cost-effective manner relative to peers.

The strategy for achieving these goals is carried out by investing the assets of the System according to a five-year asset allocation model. The System currently has seven different asset classes which provides for a well-diversified portfolio.

Asset Allocation
(Excludes Collateral on Loaned Securities)

Investment Category	As of 9/30/01 Actual %	Five-Year Target %
Mortgages	0.0%	0.0%
International Equities-Passive	6.6%	10.0%
Real Estate	9.7%	10.0%
Alternative Investments	15.5%	14.5%
Short Term Investments	6.7%	2.0%
Fixed Income	20.7%	18.0%
Domestic Equity	40.8%	45.5%
TOTAL	100.0%	100.0%

Report on Investment Activity

STATE LAW

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System; Michigan State Employees' Retirement System; Michigan State Police Retirement System; and Michigan Judges' Retirement System.

Act No. 314 of the Public Act of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the State or any political subdivision.

PROXY VOTING POLICY

The System's Proxy Voting Policy sets forth directives on the following issues: Board of Directors, corporate governance, social issues, corporate restructures and defenses. All proxies are reviewed and voted in accordance with the above mentioned items.

INVESTMENT RESULTS

Total Portfolio Result

For the fiscal year ended September 30, 2001, the total portfolio returned -11.5%, as compiled by Capital Resource Advisors. Annualized for the three-year period, the fund returned 5.7%, and for the five-year period, the fund returned 9.5%.

During the fiscal year ending September 30, 2001, the nation's economy experienced an economic slowdown, rising unemployment, reduced consumer spending, and corporate earnings that did not meet expectations. On September 11, 2001, all hopes of an economic recovery were dashed by terrorist attacks on New York City and Washington, D.C. As a result, the economy experienced a decline in the nation's real gross domestic product of -0.4% for the fourth quarter of the fiscal year. In hopes of stimulating the economy, the Federal Reserve reduced rates by three and one-half percent over eight different occasions throughout the fiscal year.

As a result of the economic conditions, the broad based S&P 500 index declined 26.6% over the fiscal year with the Dow Jones Industrial Average off 15.5%. Value stocks, in turn, outperformed growth stocks during this period. Given the reductions in interest rates by the Federal Reserve, the Lehman Brothers Government/Corporate bond index appreciated 13.2%.

The returns were calculated using a time-weighted rate of return in accordance with standards of the Association for Investment Management and Research (AIMR), unless a modification is described in the discussion of the return.

The System is well diversified among asset classes. As of September 30, 2001, the portfolio consisted of 40.8% domestic equities, 20.7% fixed income, 15.5% alternative investments, 9.7% real estate, 6.7% short-term investments, and 6.6% international equities.

Domestic Stocks - Active

The objective of actively managed domestic stock investments is long-term capital appreciation by investing in publicly traded stocks of primarily U.S.-based companies. Monies are invested in a portfolio of large company Value stocks and a portfolio of large company Growth stocks. Since historical rates of return for value and growth strategies have been negatively correlated, this allows for further diversification and focused selection of investments. Value investing derives its returns from the market's tendency to periodically undershoot a stock's fair value and then eventually corrects back to fair value. Growth stock returns accrue from longer-term broad themes from which companies evolve that will grow faster than the economy. Both portfolios are diversified among various securities and industries.

Investment Section

Report on Investment Activity

As we reported one year ago, the Federal Reserve took action to put the brakes on a rapidly expanding economy. The Federal Reserve raised rates six times between June 1999 and June 2000, taking the Fed Funds rate from 4.75% to 6.5%. As a result, both U.S. real Gross Domestic Product (GDP) and corporate earnings growth came to a screeching halt. Real GDP finally fell into negative territory in the September 2001 quarter, declining .4%, while corporate earnings realized negative year-over-year comparisions for the entire fiscal year. Operating earnings for the S&P 500 declined 26.6% for the 12-month period ending September 2001. Obviously, the terrorist acts of September 11 had a significant negative impact on the U.S. economy for the final month of the fiscal year.

As a result of the dismal state of the economy, equity markets continued the declines begun in the spring of 2000. Total return for the Dow Jones Industrial Average was -15.5% for the 12 months ending September 2001, while the broader S&P 500 was -26.6%. The NASDAQ's price fell by more than half at -59.2%. No S&P 500 sector produced positive returns during the fiscal year. Technology was the most impacted, declining 59%.

On a positive note, the Federal Reserve reversed course quickly, lowering short-term rates eight times between January 2001 and September 2001, for a total reduction of 3.50 percentage points. Congress moved to stimulate the economy by enacting over $1 trillion in federal tax cuts, including rebate checks. Energy prices declined and inflation fell to an annual rate of 2.6% as measured by the CPI.

The System's large company Value portfolio achieved a total rate of return of -3.2% for fiscal 2001. This compared very favorably with -16.9% for the S&P 500 BARRA Value Index due to the fund's significant investment in financial stocks and little exposure to technology and telecommunication stocks. The large company Growth portfolio's total rate of return was -34.7% for the fiscal year versus -35.7% for the S&P 500 BARRA Growth Index. The fund performed better than the index because of positions in the healthcare sector and less-than-average exposure to the technology group. Because these two portfolios were created effective January 31, 2000, we do not have three-year or five-year rates of return.

On a consolidated basis, the actively managed domestic stock portfolio had a total rate of return of -20.1% for fiscal year 2001 compared to -26.6% for the S&P 500 Index. Three-year and five-year annualized returns were 2.4% and 9.2%. This compared with 2.0% and 10.2% for the S&P 500.

At the close of fiscal year 2001, large company Value stocks represented 13.8% of total investments; large company Growth stocks represented 13.0%. Consolidated actively managed domestic stocks represented 26.8% of total investments, compared to 29.9% at the end of fiscal year 2000.

Domestic Stocks - Passive

The objective of the enhanced S&P 500 and S&P MidCap Index Funds is to closely match the return performance of their benchmarks, and use low risk strategies to offset transaction costs and add to performance when possible. The S&P 500 Index Fund return for the fiscal year was -26.2% versus its benchmark's -26.6%. The S&P MidCap Index Fund return for the fiscal year was -17.7% versus its benchmark's -19.0%. The relative enhancements to the returns were the result of strategic allocations of additional funds to passive equity investments during market corrections and the opportunistic use of derivative programs. During fiscal 2001, $119.3 million was added to U.S. index funds. At the end of the fiscal year, passive domestic stock portfolios represented 14.1% of total assets, the S&P 500 Index Fund accounting for 12.9% and the S&P MidCap Index Fund 1.2%. Indexed stock portfolios represented 15.2% of total investment assets at the end of the prior fiscal year.

International Equities - Passive

The objective of passive international equity portfolios is to match the return performance of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. Dollar and the other half is affected by foreign currency exchange rate changes. The

Report on Investment Activity

total passive international return of -27.1% in the fiscal year compared favorably with the Salomon Smith Barney Index BMI-EPAC return of -27.7%. The passive international return of 2.0% for three years compared well with the benchmark's return of 1.6% over the same period.

Core passive exposure to international equity returns is achieved by investing in a combination of fixed income notes and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in those country indices. Use of swap agreements for a core position began in 1993, and an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase management flexibility. During Fiscal Year 2001, $165.9 million of exposure was added, raising passive international investments to 6.6% of total investment assets.

The combination of fixed income LIBOR notes and equity swap agreements was valued at $614.9 million on September 30, 2001. That valuation included a net unrealized loss of $164.5 million on equity index exposures and an unrealized loss of $0.4 million on LIBOR note investments held. During fiscal year 2001, $17.2 million of gains on equity exposures were realized, and $5.9 million of interest in excess of obligations on completed swaps was also recognized. At the end of the fiscal year, total realized gains and net interest received in excess of counterparty obligations on completed agreements reached a record $227.4 million since the program began.

Fixed Income (Excluding Mortgages)

For the fiscal year ending September 30, 2001, the fixed income portfolio had a 12.2% rate of return as compiled by Capital Resource Advisors. The portfolio also returned 6.4% for three years, and 7.9% for five years.

Rates continued to decline during the year in response to the Federal Reserve's repeated reductions in rates and the Treasury's intention to cease further issuance of thirty-year bonds. In addition to rates declining in all maturities there was also a significant steepening of the yield curve. Given the mathematics of bond calculation, long-term government bonds tended to outperform most other sectors.

As rates approached their lowest levels in twenty of more years, a defensive reinvestment program concentrating on shorter-term intermediate issues and floating rate securities was opted. While offering greater liquidity and protection from rising rates they tend to under perform in a declining rate market.

Fixed income represented 20.7% of the total portfolio compared with 20.0% last year. The corporate sector represented 49.3% of fixed income securities with government securities accounting for 50.7%. Last year corporate securities were 40.9% of the total with government securities representing 59.1%. The increased level of corporate securities was the result of quality spreads widening.

Real Estate Equity

For the fiscal year ending September 30, 2001, 9.7% of the total investment portfolio was invested in equity real estate. This compares to 8.6% and 7.7% for the fiscal years ending September 30, 2000, and 1999, respectively. The five-year target asset allocation for equity real estate investments is 10.0%.

The one-year, three-year and five-year total equity real estate net returns for the fiscal year ending September 30, 2001, were 9.3%, 11.3% and 11.9%, respectively, as compiled by Capital Resource Advisors. This compares to the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index returns of 9.4%, 10.6% and 11.9% relating to the same time periods. As of September 30, 2001, the NCREIF portfolio of properties is more weighted in the office sector at 42.0% versus the System portfolio at 24.0%. The historical volatility of the office sector returns makes it generally a more risky property type, especially during economic downturns. Because the NCREIF returns are quoted before advisor fees/overhead and the System's returns are quoted after all advisor fees/overhead, the NCREIF returns stated above have been adjusted downward by 75 basis points to approximate comparable returns.

Report on Investment Activity

The real estate investments are broadly diversified geographically across the country, by type of property and class of property, to reduce risk. Major property types as of September 30, 2001, included apartments (42%), retail centers, including regional malls and grocery anchored neighborhood/community shopping centers (28%); commercial office buildings (24%); and miscellaneous other property types, such as industrial and self storage (6%). The System, through its advisors and operating joint ventures, acquires, develops, redevelops and disposes of real estate with the goal of maximizing returns while maintaining an ***acceptable*** level of risk. The properties are held in various investment vehicles: partnerships, LLC's, trusts, commingled funds, and REIT stock. These legal entities allow the System to enjoy the benefits of real estate ownership while limiting the liability associated with this asset class. In all new investments, the System negotiates approval rights over critical decisions in order to further mitigate risk. The properties are regularly valued by independent appraisers to establish market values.

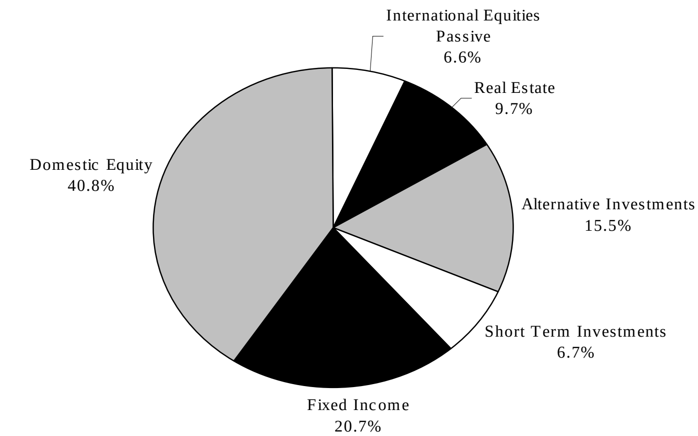
Real Estate Debt (Mortgages)

For the fiscal year ending September 30, 2001, less than 0.1% of the total investment portfolio was invested in direct mortgages. The asset allocation objective is to reduce mortgage holdings to 0.0% over time, and a majority of the mortgage portfolio was sold in 1997 and 1998. The one-year, three-year and five-year total returns for the mortgage portfolio for the fiscal year ending September 30, 2001, were 6.7%, -3.1% and 1.3%, respectively.

Alternative Investments

Alternative Investments are investments in the private equity market, either directly in companies or indirectly through limited partnerships. Through September 30, 2001, approximately 96.0% of alternative investments were made through limited partnerships. Of the investments in limited partnerships, approximately 12.0% were in partnerships investing internationally. The remaining 4.0% were direct private equity investments and public stock distributions received from the limited partnerships. The percentage of assets in alternative investments has consistently increased from 4.8% as of September 30, 1993, to 15.5% as of September 30, 2001. The asset allocation range for alternative investments is 15% to 20% while the long-term targe asset allocation is 14.5%. The one-year, three-year and five-year total alternative investment returns for the fiscal year ending September 30, 2001, were -16.9%, 10.0% and 14.4%, respectively.

Asset Allocation



Investment Results for the Period Ending September 30, 2001

Investment Category	Current Year	3 Years	5 Years	10 Years
		Annualized Rate of Return		
Total Portfolio	(11.5) %	5.7 %	9.5 %	10.2 %
Domestic Equities Stock - Active	(20.1)	2.4	9.2	11.9
Domestic Equities Stock - Passive*	(25.7)	3.2	10.7	13.3
Standard & Poor's (S&P 500)	(26.6)	2.0	10.2	12.7
Standard & Poor's (MidCap)	(19.0)	13.3	13.7	14.5
Standard & Poor's (S&P 1500)	(25.7)	3.0	10.2	N/A
International Equities - Passive	(27.1)	2.0	3.7	N/A
Net Salomon BMI - EPAC 50/50	(27.7)	1.6	2.4	N/A
Fixed Income Bonds (U.S. Corp and Govt)	12.2	6.4	7.9	8.1
Salomon Smith Barney Broad Investment Grade Bond Index	13.1	6.4	8.1	7.8
Lehman Brothers Government/Corporate	13.2	5.9	8.0	7.8
Mortgages	6.7	(3.1)	1.3	4.9
Salomon Smith Barney Broad Investment Grade Bond Index	13.1	6.4	8.1	7.8
Real Estate - Equity	9.3	11.3	11.9	7.2
NCREIF minus 75 Basis Points	9.4	10.6	11.9	6.7
Alternative Investments	(16.9)	10.0	14.4	14.4

* Passive portfolio consists of a S&P 500 fund and a S&P Midcap fund. The return is a weighted average of the two funds.

N/A Not available.

Largest Assets Held

Largest Stock Holdings (By Market Value)*
September 30, 2001

Rank	Shares	Stocks	Market Value
1	4,110,423	Pfizer Incorporated	$ 164,827,962
2	4,076,757	General Electric Corporation	151,655,360
3	2,423,527	Microsoft Corporation	124,011,877
4	3,013,177	Citigroup Incorporated	122,033,669
5	2,771,826	Exxon Mobil Corporation	109,209,944
6	2,085,330	Wal-Mart Stores Incorporated	103,223,835
7	963,156	Federal National Mortgage Association	77,110,269
8	1,624,865	Wells Fargo & Company	72,225,249
9	1,346,370	Tyco International Limited	61,259,835
10	622,606	International Business Machines	57,466,534

Largest Bond Holdings (By Market Value)*
September 30, 2001

Rank	Par Amount	Bonds & Notes	Market Value
1	$ 85,815,000	U.S. Treasury Bonds at 9.125% Due 5-15-2009	$ 97,708,101
2	59,950,000	U.S. Treasury 0% Coupon Strips Due 8-15-2003	56,819,411
3	43,400,000	Ford Motor Credit Corp FRN 6.59125% Due 10-9-2001	43,400,000
4	49,486,000	U.S. Treasury 0% Coupon Strips Due 11-15-2011	40,375,627
5	33,200,000	Bank One NA Chicago ILL MTN 3.35% Due 3-16-2004	33,241,500
6	34,777,000	U.S. Treasury Tiger 0% Coupon Due 8-15-2004	31,443,972
7	26,178,995	First Chicago Corp FRN 6.8375% Due 7-28-2003	26,270,621
8	25,474,810	Chemical Bank FRN 6.775% Due 7-29-2003	25,538,497
9	22,825,000	MTN Nations Bank FRN 6.76% Due 1-05-2004	22,813,588
10	21,800,000	Chemical Bank New York 4.12% Due 5-5-2003	22,075,334

*A complete list of stock and bond holdings is available from the Michigan Department of Treasury.

Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to State law. Outside advisors are utilized to augment the State Treasurer's internal staff in the real estate and alternative investment markets. Only 15.5% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisors' fees are netted against the partnership or trust fund income. The Michigan Department of Treasury's cost of operations applicable to the System for the fiscal year amounted to $2,067.0 thousand or less than three basis points (.03%) of the market value of the portfolio.

State law created an Investment Advisory Committee comprised of the directors of the Department of Consumer and Industry Services and Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but are paid actual and necessary travel and other expenses. The committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The committee may also, by a majority vote, direct the State Treasurer to dispose of any holding which in the committee's judgement is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

Schedule of Investment Fees

Investment Managers' Fees:

		Assets under Management (in thousands)	Fees (in thousands)		Basis Points*
State Treasurer		$ 8,141,692.7	$ 2,067.0	**	2.5
Outside Advisors -	Alternative	1,448,119.0	12,512.3		86.4
	Real Estate	44,610.8	-		-
	Total	$ 9,634,422.5			

Other Investment Services Fees:

Assets in Custody	$ 6,706,023.7	$ 366.3
Securities on Loan	415,258.4	12,487.6

* Outside Advisors Fees are netted against the income of the partnership and trust income. The partnership agreements define the management fees, which range from 150 to 250 basis points of the committed capital, in most cases the fees are netted against income. For Real Estate the asset management fees range from 25 to 90 basis points and are netted against current year's income.

** State Treasurer fees (2,067.0) include prior year adjustments due to return of excess funds. In fiscal year 2001, the System received $1.3 thousand and $1.4 thousand for fiscal year 2000 and 1999, respectively. Actual State Treasurer fees for fiscal year 2001 were $2,069.7 thousand.

Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2001		
	Commissions Paid [1]	Number of Shares Traded	Average Commission Rate Per Share
Investment Brokerage Firms:			
Salomon Smith Barney, Inc.	$ 145,873	3,654,082	0.04
Merrill Lynch & Co.	130,249	2,634,872	0.05
Morgan Stanley Dean Witter & Co.	114,607	2,294,490	0.05
Lehman Brothers, Inc.	101,425	2,159,328	0.05
Goldman, Sachs & Co.	71,290	1,427,081	0.05
Paine Webber, Inc.	67,956	1,379,870	0.05
Bear Stearns & Co.	67,017	1,452,631	0.05
Bridge Trading Company	64,960	1,465,740	0.04
Prudential Securities, Inc.	59,209	1,184,182	0.05
C.S. First Boston Corporation	54,805	1,163,009	0.05
Sanford C. Bernstein & Co.	48,064	961,277	0.05
J.P. Morgan Securities, Inc.	30,116	602,317	0.05
S.G. Cowen & Company	29,030	580,606	0.05
OTA Research	26,217	524,342	0.05
Oppenheimer & Company	24,515	490,302	0.05
Cantor Fitzgerald & Co.	21,533	541,450	0.04
Deutsche Bank	20,128	402,550	0.05
BancBoston Robertson Stephens	19,107	380,059	0.05
Banc of America Securities, LLC	14,441	288,820	0.05
ISI Group, Inc	8,566	171,312	0.05
First Union Securities	7,453	149,068	0.05
Barrington Research	7,412	148,238	0.05
Wit Capital Corp	6,392	127,836	0.05
Instinet Group Inc.	6,194	160,024	0.04
Charles Schwab & Co., Inc.	5,610	112,195	0.05
Subtotal (25 highest)	$ 1,152,169	24,455,681	0.05 [2]
All Other Brokerage Firms	11,254	224,646	0.05 [3]
Total	$ 1,163,423	24,680,327	0.05 [4]

(1) These amounts are included in purchase and sale prices of investments.

(2) The average commission rate per share for the top 25 brokerage firms.

(3) The average commission rate per share for all other brokerage firms, excluding the top 25 brokerage firms.

(4) The average commission rate per share for all brokerage firms.

Investment Summary

	Fiscal Year Ended September 30, 2001				Fiscal Year Ended September 30, 2000			
	Market Value *	Percent of Total Market Value	Investment & Interest Income ***	Percent of Investment & Interest Income	Market Value *	Percent of Total Market Value	Investment & Interest Income ***	Percent of Investment & Interest Income
Fixed Income:								
Government Bonds	$ 1,008,501,510	10.5%	$ 160,003,561	-12.8%	$ 1,316,205,120	11.8%	$ 92,073,008	6.7%
Corporate Bonds & Preferred Stocks	981,276,886	10.2%	99,177,964	-7.9%	912,357,324	8.2%	52,524,201	3.8%
Mortgages	4,467,432	0.0%	367,278	0.0%	5,166,117	0.0%	(301,002)	0.0%
Total Fixed Income	1,994,245,828	20.7%	259,548,803	-20.7%	2,233,728,561	20.0%	144,296,207	10.5%
Common Stock	3,931,888,124	40.8%	(1,107,114,215)	88.6%	5,051,960,392	45.2%	563,924,360	40.9%
Real Estate	938,532,614	9.7%	89,056,173	-7.1%	955,549,473	8.6%	93,476,943	6.8%
Alternative Investments	1,495,216,833	15.5%	(290,494,502)	23.2%	1,780,634,499	16.0%	498,580,169	36.2%
International Equities - Passive	631,403,802	6.6%	(221,640,944)	17.7%	714,816,682	6.4%	59,060,171	4.3%
Short Term Investments **	643,135,253	6.7%	21,819,606	-1.7%	421,670,703	3.8%	18,120,512	1.3%
Total	$ 9,634,422,454	100.0%	$ (1,248,825,079)	100.0%	$ 11,158,360,310	100.0%	$ 1,377,458,362	100.0%

* Short Term Investments are at cost, which approximates market value.

** Excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for each fiscal year. Amount also excludes $408,715,028 and $145,827,738 in cash collateral for security lending for fiscal year 2001 and 2000, respectively.

*** Total Investment & Interest Income excludes net security lending income of $1,076,684 and $994,774 for fiscal year 2001 and 2000, respectively.

ACTUARIAL SECTION

Actuary's Certification

SEGAL

THE SEGAL COMPANY
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January 18, 2001

Mr. Duane E. Berger
Director
Department of Management and Budget
and
Retirement Board
Michigan State Employees Retirement System
P.O. Box 30176
Lansing, Michigan 48909

Ladies and Gentlemen:

The Michigan State Employees Retirement System (MSERS) is funded on an actuarial reserve basis. The basic financial objective of MSERS is to establish and receive contributions that remain approximately level as a percentage of active member payroll over a long period of years.

Actuarial valuations are prepared annually to determine MSERS's actuarial liabilities and the employer contributions required to fund the System in accordance with the actuarial reserve funding provisions of the governing State Statute. The most recent actuarial valuation as of September 30, 2000 included a total of 92,039 members of MSERS. The actuarial value of MSERS's assets amounted to approximately $10.34 billion on September 30, 2000.

The actuarial assumptions used in the 2000 valuation are the same as those used in the previous annual actuarial valuation. These assumptions produce valuation results which we consider to be reasonably indicative of the plan's underlying cost. Also, in our opinion, the actuarial assumptions and methods used for funding purposes meet the parameters for the disclosures presented in the financial section by GASB Statement No. 25.

Our actuarial valuation of MSERS as of September 30, 2000 was performed by qualified actuaries in accordance with accepted actuarial procedures. In our opinion, the calculated contribution rate meets the fundamental objectives of State law. Based on the 2000 valuation results, it is also our opinion that the Michigan State Employees Retirement System continues in sound condition, in accordance with actuarial principles of level cost financing.

Most of the information used in the supporting schedules in the Actuarial and Statistical Sections, as well as the Schedules of Funding Progress and the employer contributions shown in the Schedules of Employer Contributions in the Financial Section of this report were provided by our firm.

Sincerely,

Michael Karlin

Michael Karlin, F.S.A., M.A.A.A.
Senior Vice President & Actuary

Summary of Actuarial Assumptions and Methods

1. The investment return rate used in making the valuations was 8% per year, compounded annually. This rate of return is not the assumed real rate of return. The real rate of return is the rate of investment return in excess of the inflation rate. Considering other financial assumptions, this investment return rate translates to an assumed long term real rate of return of 4%. Adopted 1994.

2. The mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table, set forward one year for both men and women. Adopted 1998.

3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 1998.

4. Sample probabililties of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page of this report. Adopted 1998.

5. Total active member payroll is assumed to increase 4% per year. This represents the portion of the individual pay increase assumptions attributable to inflation. Adopted 1994.

6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Adopted 1975. Unfunded actuarial accrued liabilities are financed over a period of 50 years and over a declining 40 year period for years beginning October 1, 1996. Adopted 1996.

7. During 1998, the Department of Management and Budget approved the use of market value of assets as of September 30, 1997 for valuation purposes. For investment gains and losses that occur after that date, a 5-year smoothing technique will be used. Specifically, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over five years.

8. The data about persons now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data was not audited by the actuary.

9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's Board after consulting with the actuary.

Summary of Actuarial Assumptions and Methods (Continued)

SCHEDULE 1

Percent of Eligible Active Members Retiring Each Year

Retirement Ages	Correction Officers	Conservation Officers	Other Members
45		16 %	
48		16	
51	25 %	16	
55	15	16	20 %
58	12	15	15
61	15	15	15
64	22	22	22
67	25	25	25
70	50	50	50
75	100	100	100

SCHEDULE 2

Separation From Active Employment Before

Age & Service Retirement & Individual Pay Increase Assumptions

Sample Ages	Years of Service	Percent of Active Members Withdrawing Within Next Year (Men and Women)	Percent of Active Members Becoming Disabled Within Next Year	Percent Increase In Pay During Next Year
All	0	20.00 %		
	1	14.00		
	2	9.00		
	3	7.00		
	4	5.50		
25	5 & Over	5.50	0.01 %	11.50 %
35		3.50	0.04	5.70
45		2.25	0.26	4.75
55		1.75	0.65	4.24
60		1.75	0.90	4.00

Actuarial Valuation Data

Schedule of Active Member Valuation Data

Valuation Date Sept. 30	Number	Reported Annual Payroll*	Average Annual Pay	% Increase	Average Age	Average Service
1991	65,595	$2,236,336	$34,093	6.5 %	42.1	11.9
1992	64,248	2,189,752	34,083		42.2	11.9
1993	63,906	2,185,036	34,191	0.3	42.6	12.1
1994	64,923	2,271,158	34,982	2.3	43.1	12.6
1995	65,133	2,348,534	36,058	3.1	43.2	12.7
1996	63,807	2,515,420	39,422	9.3	43.8	13.0
1997	55,434	2,273,203	41,007	4.0	43.7	13.1
1998	49,717	2,107,996	42,400	3.4	44.8	14.8
1999	49,612	2,213,851	44,623	5.2	45.9	15.8
2000	47,778	2,253,818	47,173	5.7	46.7	16.7

* In thousands of dollars. Base pay only excluding 3 1/2% for overtime and shift differentials through 1995. Greater of base pay or prior year actual earnings beginning in 1996.

Schedule of Changes in the Retirement Rolls

Year Ended Sept. 30	Added to Rolls		Removed from Rolls		Rolls–End of Year		% Increase in Annual Allowances	Average Annual Allowances
	No.	Annual Allowances*	No	Annual Allowances*	No.	Annual Allowances*		
1991	1,493	$ 20,168	790	$5,936	25,566	$194,928	7.9 %	$ 7,624
1992	4,177	55,336	887	6,652	28,856	243,612	25.0	8,442
1993	1,105	18,468	786	4,887	29,175	257,193	5.6	8,816
1994	1,888	22,636	1,101	6,442	29,962	273,387	6.3	9,124
1995	1,566	23,575	966	6,268	30,562	290,694	6.3	9,512
1996	1,595	24,527	1,064	7,288	31,093	307,933	5.9	9,904
1997	6,098	121,005	1,068	7,878	36,123	421,060	36.7	11,656
1998	1,279	21,085	1,217	9,689	36,185	432,456	2.7	11,951
1999	1,409	21,227	1,248	9,516	36,346	444,167	2.7	12,221
2000	1,540	22,421	1,181	2,619	36,705	463,969	4.5	12,640

* In thousands of dollars

Prioritized Solvency Test

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due, the ultimate test of financial soundness. Testing for level contribution rates is the long term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired lives; and (3) the liabilities for service already rendered by active and inactive members. In a system following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) is normally partially covered by the remainder of present assets. Generally, if the System has been using level-cost financing, the funded portion of liability 3 will increase over time. Liability 3 being fully funded is not necessarily a by-product of level percent of payroll funding methods.

The schedule below illustrates the history of the liabilities of the System and is indicative of the System's policy of following the discipline of level percent of payroll financing.

	Actuarial Present Value of Actuarial Accrued Liability ($ in Millions)				Portion of Present Value Covered by Assets			
Valuation Date Sept. 30	(1) Active Member Contributions	(2) Retirants and Beneficiaries	(3) Active and Inactive Members (Employer Financed Portion)	Valuation Assets	(1)	(2)	(3)	(4)***
1991#	$ 82	$ 1,870	$ 2,987	$ 4,347	100 %	100 %	80.2 %	88.0 %
1992	83	2,413	2,984	4,533	100	100	68.3	82.7
1993+	72	2,561	3,540	5,043	100	100	68.1	81.7
1994@	73	2,778	3,709	5,476	100	100	70.8	83.5
1995	72	2,751	4,038	6,090	100	100	80.9	88.8
1996	55	2,844	4,248	6,678	100	100	89.0	93.4
1997	3	4,300	3,910	7,516	100	100	82.2	91.5
1998	27	4,360	3,987	9,109	100	100	118.4	108.8
1998@	27	4,484	3,986	9,109	100	100	115.4	107.2
1999	35	4,538	4,456	9,648	100	100	113.9	106.9
2000	29	4,659	4,786	10,337	100	100	118.0	109.1

*** Percents funded on a total valuation asset and total actuarial accrued liability basis.

@ Revised actuarial assumptions.

+ Revised asset valuation method.

Benefits amended

Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2000 is based on the present provisions of the Michigan State Employees' Retirement Act, which are summarized in this section.

Regular Retirement (no reduction factor for age)

Eligibility — Age 55 with 30 years service, or age 60 with 10 or more years service. Corrections Officers may retire at age 51 with 25 or more years service, or age 56 with 10 or more years service. Conservation Officers may retire after 25 years of service regardless of age.

Final Average Compensation — Regular retirement benefit is based on final average compensation (FAC), which is the average of highest 3 consecutive years (2 years for Conservation Officers).

Annual Amount — Total service times 1.5% of FAC. For members with 20 or more years of service, a $3,000 minimum annual benefit is payable. Corrections Officers receive an additional temporary supplement to age 62 equal to the product of supplemental service times 0.5% of FAC. Conservation Officers retiring after 25 years receive a benefit equal to 60% of FAC.

Early Retirement (age reduction factor used)

Eligibility — Age 55 with 15 or more years service.

Annual Amount — Computed as regular retirement benefit but reduced by 0.5% for each month under age 60.

Deferred Retirement (vested benefit)

Eligibility — 10 years of service (5 years for unclassified persons in the executive or legislative branch). Benefit commences at age 60.

Annual Amount — Computed as regular retirement benefit based on service and FAC at termination.

Duty Disability Retirement

Eligibility — No age or service requirement.

Annual Amount — Disability after age 60: Computed as regular retirement benefit with minimum benefit based on 10 years service. Disability prior to age 60: To age 60, benefit is two-thirds of FAC but limited to $6,000 per year. Additional limitation such that benefit plus workers' compensation does not exceed final compensation. After age 60, benefit is recomputed as a regular retirement benefit with service granted for period in receipt of disability benefit before age 60 (benefit not reduced after age 60).

Non-Duty Disability Retirement

Eligibility — 10 years of service.

Annual Amount — Computed as regular retirement benefit based on service and FAC at time of disability. Minimum annual benefit is $600.

Summary of Plan Provisions (Continued)

Duty Death Before Retirement

Eligibility — No age or service requirement. Also applies to duty disability retirant who dies within 3 years of disability and before age 60.

Annual Amount — Accumulated employee contributions are refunded. Surviving spouse receives annual benefit of one-third of final compensation until death. Unmarried children under age 18 each receive an equal share of one-fourth of final compensation (if no spouse each child receives one-fourth, to a maximum of one-half for all children). If no spouse or eligible children, each dependent parent receives one-sixth of final compensation. Total benefits payable are limited to $2,400 per year. Additional limitation such that benefits plus workers' compensation does not exceed final compensation.

Non Duty Death Before Retirement

Eligibility — 10 years of service. In the case of a deceased vested former member, the survivor benefit commences when the deceased former member would have attained age 60.

Annual Amount — Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Post-Retirement Cost-of-Living Adjustments

One-time upward adjustments have been made in 1972, 1974, 1976, 1977 and 1987. Beginning in 1983, some benefit recipients share in a distribution of a portion of investment income earned in excess of 8% annually (supplemental payment). Beginning in 1988, all benefit recipients are eligible for automatic 3% annual (non-compounded) benefit increases, with a maximum $300 annual increase. Eligibility for the above benefits:

Retired before October 1, 1987	Greater of supplemental payment or the combination of the 1987 one-time adjustment and the automatic increases.
Retired on or after October 1, 1987	Automatic increases only.

Post-Retirement Health Insurance Coverage

Persons in receipt of retirement allowance (including members who did not retire directly from the System, but come from a vested deferred status), and their dependents, are eligible for 95% System paid health insurance coverage and 90% System paid dental and vision insurance.

Member Contributions

None.

Defined Contribution

New employees hired on or after March 31, 1997, become participants in Tier 2 (i.e., the defined contribution plan) rather than Tier 1 (i.e., the above described defined benefit plan).

Active members on March 30, 1997, had an opportunity to irrevocably elect to terminate membership in Tier 1 and become participants in Tier 2. Elections were in writing and submitted between January 2, 1998 and April 30, 1998. Such members became Tier 2 participants on June 1, 1998, and had the actuarial present value of their Tier 1 accrued benefit transferred into Tier 2 by September 30, 1998.

STATISTICAL SECTION

Schedule of Revenues by Source

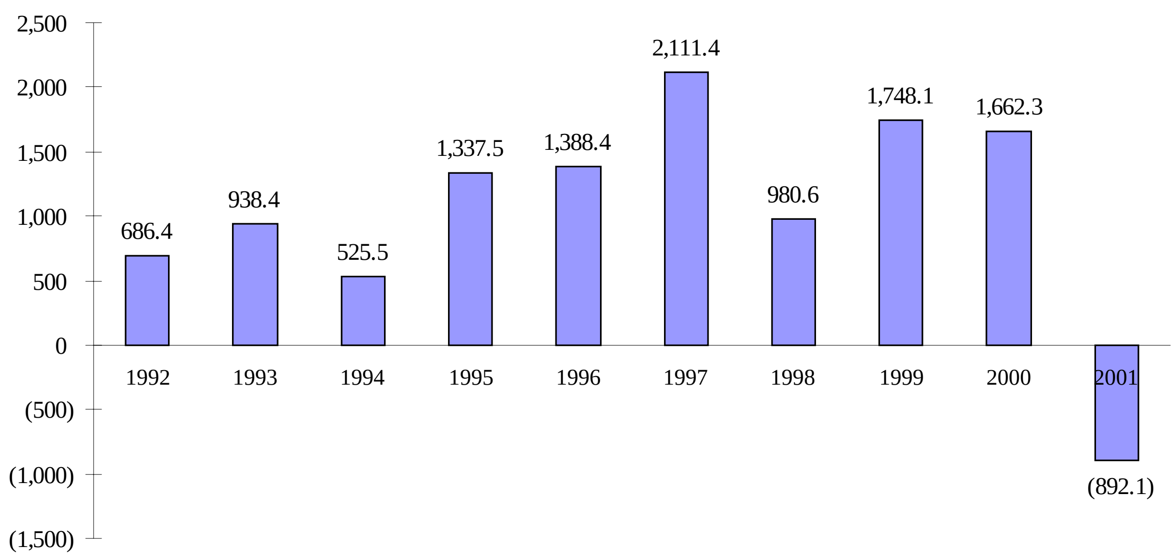
Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions Dollars*	Employer Contributions % of Annual Covered Payroll	Net Investment & Misc. income	Total
1992	$ 4,810,700	$ 285,424,393	12.59 %	$ 396,188,599	$ 686,423,692
1993	4,068,696	371,902,232	16.45	562,436,683	938,407,611
1994	2,257,216	389,728,590	16.58	133,510,369	525,496,175
1995	2,260,510	422,294,609	17.37	912,938,131	1,337,493,250
1996	2,619,067	431,094,371	17.14	954,696,384	1,388,409,822
1997	15,858,366 **	410,231,627	18.05	1,685,326,508	2,111,416,501
1998	9,777,845	259,799,179	12.32	711,056,989	980,634,013
1999	11,047,645	265,806,232	12.01	1,471,244,852	1,748,098,729
2000	9,663,633	289,224,539	12.83	1,363,374,870	1,662,263,042
2001	9,134,665	361,926,010	N/A	(1,263,116,089)	(892,055,414)

* Includes financing for early retirement pensions. Fiscal year 1999 and 2000 also includes amount received for DC Savings (see Note 2 to the financial statements in the Financial Section).

** Increase is attributable to purchase of service credit in connection with "early out" retirement.

N/A Not available

Total Revenues
Year Ended September 30
(In Millions)



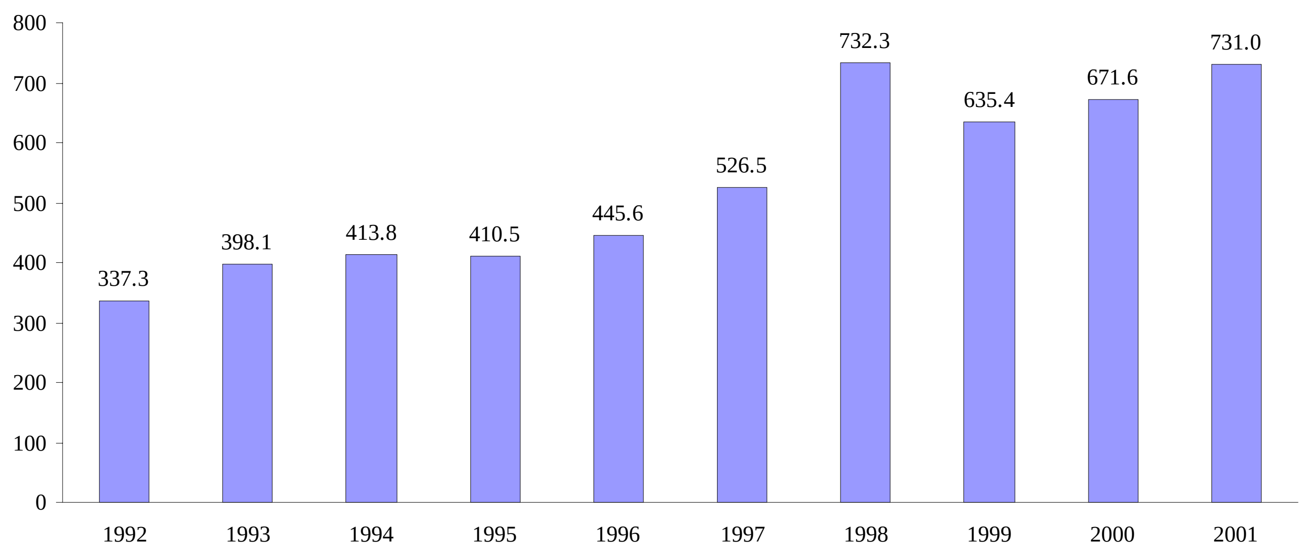
Schedule of Expenses by Type

Fiscal Year Ended Sept. 30	Benefits *	Refunds and Transfers	Administrative & Other Expenses	Total
1992	$ 333,082,770	$ 123,792	$ 4,047,661	$ 337,254,223
1993	394,557,537	99,369	3,412,142	398,069,048
1994	409,975,308	92,153	3,777,812	413,845,273
1995	406,140,322	80,453	4,268,833	410,489,608
1996	439,056,397	30,082	6,489,761	445,576,240
1997	513,359,239	7,848,649 **	5,247,943	526,455,831
1998	593,453,930	134,533,763 **	4,297,092	732,284,785
1999	630,346,729	728,366	4,330,623	635,405,718
2000	667,431,376	222,171	3,954,992	671,608,539
2001	726,771,708	91,699	4,149,284	731,012,691

* Includes health, dental and vision benefits.

** Includes transfers to defined contribution plan in connection with the "early out" retirement.

Total Expenses
Year Ended September 30
(In Millions)

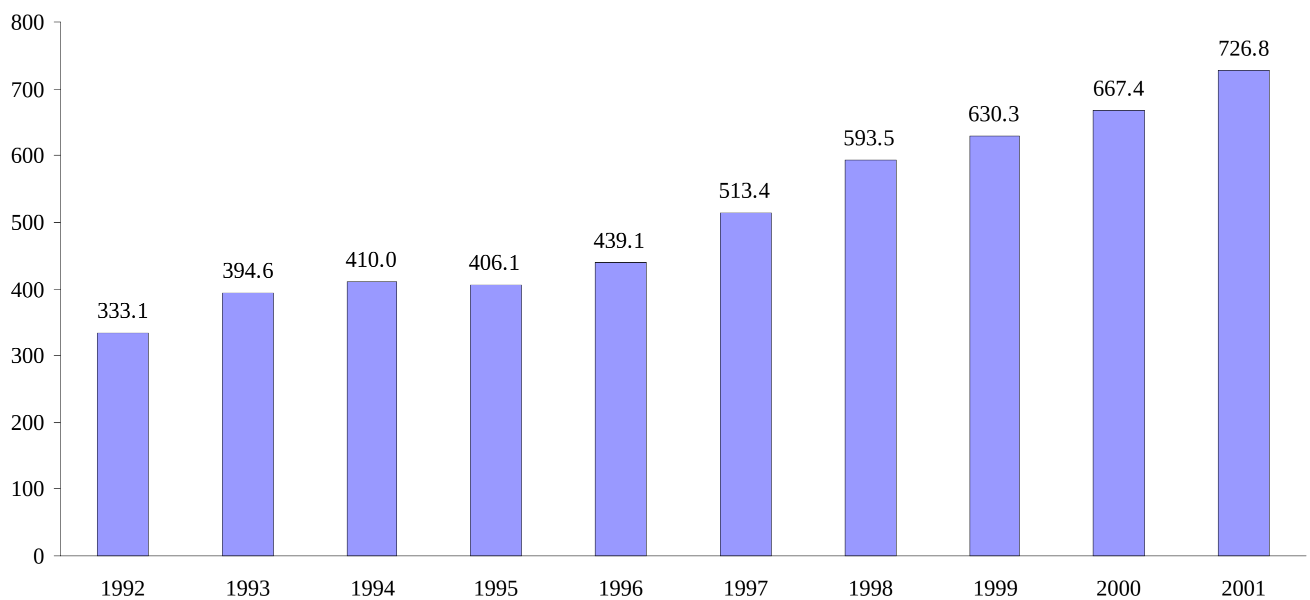


Schedule of Benefit Expenses by Type

Fiscal Year Ended Sept. 30	Regular Allowances	Disability Allowances	13th Check	Health Insurance*	Total
1992	$ 212,280,362	$ 13,850,266		$ 106,952,142	$ 333,082,770
1993	245,615,207	14,725,503		134,216,826	394,557,536
1994	256,660,402	16,672,201		136,642,705	409,975,308
1995	269,206,552	20,494,647		116,439,123	406,140,322
1996	284,061,320	22,017,877	$ 15,234,884	117,742,316	439,056,397
1997	331,964,200	26,069,505	24,832,674	130,492,860	513,359,239
1998	401,855,102	28,024,773		163,574,055	593,453,930
1999	417,313,133	28,227,807	678,314	184,127,475	630,346,729
2000	427,500,808	30,867,062	435,904	208,627,602	667,431,376
2001	444,244,814	33,902,047	378,467	248,246,380	726,771,708

* Includes vision and dental benefits.

Benefit Expenses
Year Ended September 30
(In Millions)



Schedule of Retired Members by Type of Benefit
September 30, 2000

Amount Monthly Benefit	Number of Retirees	Type of Retirement * 1	2	3	4	5	6	7	8	Selected Option** Reg.	Opt. A	Opt. B	Opt. C	Opt. E	Opt. E1	Opt. E2
$ 1 - 200	1,348	721	422	12	138	12	20	1	22	534	345	318	1	120	15	15
201 - 400	4,475	2,637	909	25	637	20	142	1	104	1,783	1,304	872	3	368	74	71
401 - 600	5,743	3,160	711	408	905		294	2	263	2,721	1,584	944	6	359	55	74
601 - 800	4,653	2,934	378	1	708		260	39	333	2,051	1,315	894	5	278	55	55
801 - 1,000	4,019	2,563	234		492		192	46	492	1,812	1,168	765	4	173	42	55
1,001 - 1,200	3,719	2,514	185		286		142	41	551	1,570	1,110	733	4	171	65	66
1,201 - 1,400	3,286	2,381	126		114		100	40	525	1,260	1,013	717	5	186	40	65
1,401 - 1,600	2,406	1,897	86		62		53	45	263	917	749	488	6	148	40	58
1,601 - 1,800	1,854	1,560	45		28		30	70	121	606	581	346	8	161	65	87
1,801 - 2,000	1,471	1,259	44		10		17	81	60	427	512	298	4	130	45	55
Over 2,000	3,731	3,376	61		8		38	189	59	1,095	1,134	804	12	333	162	191
Totals	36,705	25,002	3,201	446	3,388	32	1,288	555	2,793	14,776	10,815	7,179	58	2,427	658	792

* Type of Retirement
1 - Normal retirement for age & service
2 - Survivor payment - normal or early retirement
3 - Duty disability retirement (incl. survivors)
4 - Non-duty disability retirement (incl. survivors)
5 - Survivor payment - duty death in service
6 - Survivor payment - non-duty death in service
7 - Retirees with supplemental benefits for early retirement incentive factors
8 - Retirees with reduced benefits for early retirement reduction factors

**Selected Option
Reg. - Straight life allowance
Opt. A - 100% survivor option
Opt. B - 50% survivor option
Opt. C - 75% survivor option
Opt. E - Social Security equated
Opt. E1 - Social Security equated w/100% survivor
Opt. E2 - Social Security equated w/50% survivor option

Schedule of Average Benefit Payments

Retirement Effective Dates	Years Credited Service							
	0-5	5-10	10-15	15-20	20-25	25-30	30+	Total
Period 10/1/94 to 9/30/95:								
Average Monthly Benefit	$ 288	$ 333	$ 358	$ 549	$ 765	$ 1,015	$ 1,284	$ 793
Average Final Average Salary	13,523	25,006	20,192	22,356	24,419	26,336	27,548	24,115
Number of Active Retirants	313	414	5,939	6,198	5,575	5,075	7,048	30,562
Period 10/1/95 to 9/30/96:								
Average Monthly Benefit	$ 316	$ 343	$ 375	$ 571	$ 793	$ 1,045	$ 1,340	$ 825
Average Final Average Salary	12,260	25,997	21,206	23,275	25,383	27,175	28,936	25,142
Number of Active Retirants	341	429	5,977	6,311	5,636	5,149	7,250	31,093
Period 10/1/96 to 9/30/97:								
Average Monthly Benefit	$ 367	$ 357	$ 400	$ 632	$ 877	$ 1,272	$ 1,536	$ 971
Average Final Average Salary	11,007	26,932	22,665	25,373	27,707	32,426	33,096	28,415
Number of Active Retirants	396	440	6,207	6,947	6,410	7,030	8,693	36,123
Period 10/1/97 to 9/30/98:								
Average Monthly Benefit	$ 373	$ 369	$ 414	$ 651	$ 901	$ 1,298	$ 1,571	$ 996
Average Final Average Salary	10,322	28,458	23,509	26,087	28,395	33,076	33,906	29,148
Number of Active Retirants	411	449	6,246	6,906	6,389	7,074	8,710	36,185
Period 10/1/98 to 9/30/99:								
Average Monthly Benefit	$ 375	$ 379	$ 433	$ 673	$ 926	$ 1,329	$ 1,600	$ 1,018
Average Final Average Salary	9,939	29,279	24,597	26,881	29,163	33,685	34,435	29,846
Number of Active Retirants	432	457	6,328	6,939	6,421	7,091	8,678	36,346
Period 10/1/99 to 9/30/00:								
Average Monthly Benefit	$ 398	$ 390	$ 453	$ 694	$ 952	$ 1,388	$ 1,656	$ 1,053
Average Final Average Salary	9,908	30,734	25,784	27,734	29,943	34,218	35,149	30,620
Number of Active Retirants	450	454	6,476	6,984	6,488	7,145	8,708	36,705

STATISTICAL SECTION

10 Year History of Membership
Fiscal Year Ended September 30