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, 2004

M S E R S

Prepared by:
Financial Services
for
Office of Retirement Services
P.O. Box 30171
Lansing, Michigan 48909-7671
517-322-5103
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INTRODUCTORY SECTION

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, 2003

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

President

Executive Director

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

JENNIFER M. GRANHOLM, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

December 3, 2004

The Honorable Jennifer M. Granholm
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 comprehensive annual financial report of the Michigan State Employees' Retirement System (System) for fiscal year 2004.

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 System was established by legislation under Public Act 240 of 1943 (the Michigan 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 provide benefits to members.

The 2004 comprehensive annual financial 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 auditor's 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

The Michigan Department of Management and Budget, Office of Retirement Services continues to provide high-quality services to a large membership at an affordable cost. This level of service is achieved with the combination of management and staff that persistently questions, redefines and refines processes to stay responsive and timely. Our daily business activities are tied to achieving our mission of delivering pensions, related benefits, and services to promote the future financial security of our customers.

In this fiscal year, we embraced the realities of our Vision ORS technology solutions, sought and achieved ways to manage cost while enhancing service, and supported staff as they adapted to fast-paced changes to tools and policy. Here are some of the highlights.

Focus on our Customer

During the 2004 fiscal year, ORS hosted 9,600 members at our pre-retirement information meetings and personally counseled 9,500 members. This is in addition to the 237,700 members who took advantage of our phone service for retirement information and services.

System members received a much revised, customer-friendly member statement that is a significant improvement over previous year's statements. These high-quality, data-rich member statements include information about service credit, contributions, service credit purchases and vesting. The statements also provided basic information about eligibility and insurances, and included an opportunity to update beneficiary information.

Customers are receiving more personal service faster when they call thanks to new interconnectivity between our toll-free phone service and our Customer Relationship Management network. This tool reduces call time by automatically populating the retirement representative's computer with the personal information of the incoming caller. The results are faster service for callers and more customers are able to resolve their questions each day.

This year, ORS addressed one of our most significant concerns about providing consistent information to our members: the HR office resource. We collaborated with the HR offices to identify the kinds of retirement transactions they need support for; then dedicated staff to developing educational materials to address those needs. By focusing on the HR staff as *customers* and as partners, we have produced an administrative seminar that improves the knowledge base of the HR staff, and helps them enter retirement transactions more effectively.

Continuously Improve Processes

This year, an independent actuarial firm reviewed the costs of service credit to confirm that the cost of service will support the eventual retirement benefit. This is essential to be certain that what we charge for service reflects the benefits purchased. As a result of this year's review, the State Employees' Retirement System Board of Directors determined that the cost structure for the tax-deferred payment program was still actuarially sound, but updated the program by authorizing the billing of 8% interest on all future tax-deferred payment purchases. Members and employers were notified of these changes, which will take effect October 1, 2004.

With the review of the tax-deferred payment purchases, staff took the opportunity to simplify the purchase process by including pre-numbered, personalized agreement forms with the service credit bills. This new system ties the agreement to the bill, simplifies accounting, and reduces the burden on employers.

Optimize Technology

Last year, in the beginnings of our Vision ORS project, we deployed document scanning in our mailroom to get the daily documents that drive our business processed faster. This year, ORS is expanding this technology to target some of the more recently retired members and those active members who will likely retire in the next few years.

Staff also expanded the use of videoconferencing to reach our HR offices in northern Michigan and the Upper Peninsula with the new administrative seminar. This effort will provide needed training while also saving thousands of state dollars in travel costs.

Letter Of Transmittal (Continued)

Member surveys and letters, conversations with members and member organizations, and regular discussions with our staff tell us that we are making great strides toward our vision. This success inspires us to continue to improve. The continued deployment of our Vision Project technology will provide even more opportunities to evaluate and improve ORS' service to customers.

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, 2003. 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.

FINANCIAL INFORMATION

Please refer to Management's Discussion and Analysis in the Financial Section for condensed financial information and activities of the current and prior years.

Accounting System

Transactions of the System are reported on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred. Participants' benefits are recorded when payable by law. We believe that the accounting and administrative internal controls established by the System provide reasonable assurance that the System is carrying out its responsibilities in safeguarding its assets, in the reliability of the financial records for preparing the financial statements, and in maintaining accountability for its assets.

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 assurance 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 12.4%. For the last five years, the System has experienced an annualized rate of return of 3.3%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

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

Letter Of Transmittal (Continued)

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, 2003. The actuarial value of the assets and actuarial accrued liability of the System were $10.4 billion and $11.8 billion, respectively, resulting in a funded ratio of 88.8% at September 30, 2003. 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, 2003, 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 $8.0 billion and the employer contribution for health care benefits would be 27.2% 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, 2003. 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.

Sincerely,

Mitch Irwin

Mitch Irwin, Director
Department of Management and Budget

Chris DeRose

Christopher M. DeRose, Director
Office of Retirement Services

Administrative Organization

Retirement Board Members *

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

Janet McClelland
Employee Member
Term Expires July 31, 2005

Calvin Frappier
Retiree Member
Term Expires July 31, 2006

George M. Elworth
Representing Attorney General
Statutory Member

Scott Strong
Representing Auditor General
Statutory Member

John Schoonmaker
Representing Commissioner of
Finance & Insurance Services
Statutory Member

D. Daniel McLellan
Representing State Personnel Director
Statutory Member

Mark Haas, Vice Chair
Representing State Treasurer
Statutory Member

Lynda Taylor-Lewis
Employee Member
Term Expires July 31, 2006

* Statute provides that board members may continue to serve after their term expires until they are either replaced or reappointed.

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

Legal Advisor
Mike Cox
Attorney General
State of Michigan

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

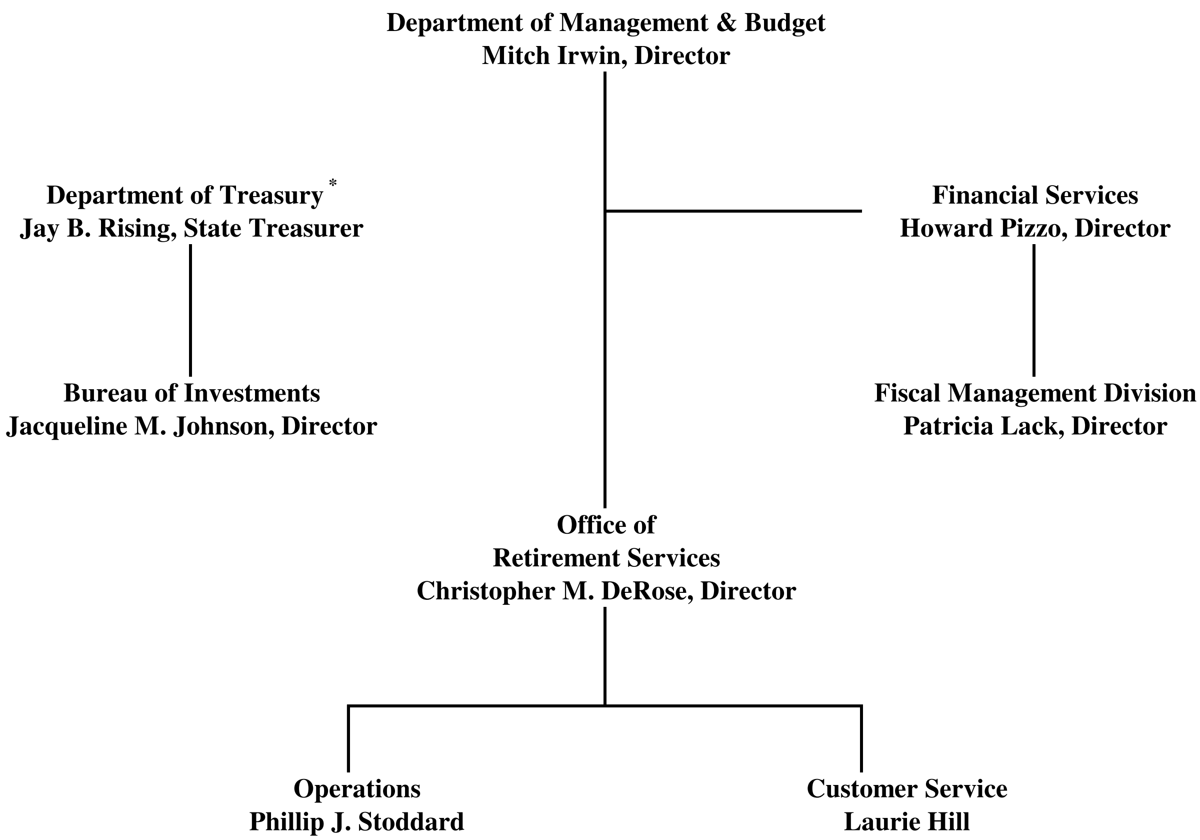
Andrews Hooper & Pavlik P.L.C.
Jeffrey J. Fineis, C.P.A.
Okemos, Michigan

Investment Manager and Custodian
Jay B. Rising
State Treasurer
State of Michigan

Investment Performance Measurement
State Street Corporation
State Street Analytics
Boston, MA

Administrative Organization (Continued)

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, Introduction. In addition, see the Investment Section, Schedule of Investment Fees and Schedule of Investment Commissions, for information regarding the investment fees and commissions paid as well as investment professionals utilized by the System.

FINANCIAL SECTION

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

FINANCIAL SECTION

Independent Auditor's Report

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

Mr. Mitch Irwin, Director, Department of Management and Budget
Mr. Christopher M. DeRose, Director, Office of Retirement Services
Mr. Thomas H. McTavish, CPA, Auditor General, Office of the 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, 2004 and 2003, 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, 2004 and 2003, 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 December 1, 2004 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.

Okemos, Michigan
December 1, 2004

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, 2004. 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 2004 by $9.5 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, 2003, the funded ratio was approximately 88.8%.

- Revenues for the year were $1,610.4 million, which is comprised of contributions of $508.8 million, investment gains of $1,077.1 million and transfers from Health Advance Funding SubAccount of $24.4 million.

- Expenses decreased in the current year from $1,136.6 million to $1,114.5 million or 1.9%. Most of this decrease represented a reduction in 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 18) and *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* (page 19). 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.

Management's Discussion and Analysis (Continued)

FINANCIAL ANALYSIS

System total assets as of September 30, 2004, were $10.0 billion and were mostly comprised of cash, investments, and contributions due from employers. Total assets increased $830.0 million or 9.0% between fiscal years 2003 and 2004 primarily due to an increase of invested assets, and increased $443.4 million or 5.1% between fiscal years 2002 and 2003 primarily due to increased investment earnings.

Total liabilities as of September 30, 2004, were $562.1 million and were mostly comprised of warrants outstanding, accounts payable, and obligations under securities lending. Total liabilities increased $334.1 million or 146.6% between fiscal years 2003 and 2004 primarily due to a increase in obligations under securities lending, and decreased $151.6 million or 39.9% between fiscal years 2002 and 2003 due to a decrease in obligations under securities lending and payables from the purchase of investments.

System assets exceeded its liabilities at the close of fiscal year 2004 by $9.5 billion, of which $33.9 million is for the Health Advance Funding SubAccount. Total net assets held in trust for pension and health benefits increased $495.8 million or 5.5% between fiscal years 2003 and 2004, primarily due to investment earnings and contributions for the year exceeding total deductions of the System. Net assets in fiscal year 2003 increased by $595.0 million or 7.1% from the prior year due to favorable market conditions and an increase in investment earnings.

Net Assets
(in thousands)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Assets					
Cash	$ 37,349	(9.9) %	$ 41,465	105.0 %	$ 20,224
Receivables	100,430	(12.0)	114,178	16.8	97,780
Investments	9,886,693	9.4	9,038,842	4.7	8,633,038
Total Assets	10,024,472	9.0	9,194,485	5.1	8,751,042
Liabilities					
Warrants outstanding	2,790	8.6	2,570	(10.9)	2,884
Accounts payable and other accrued liabilities	1,255	(78.7)	5,905	(42.6)	10,280
Obligations under securities lending	558,059	154.3	219,484	(40.1)	366,352
Total Liabilities	562,104	146.6	227,959	(39.9)	379,516
Net Assets - DC Savings SubAccount	-	-	-	(100.0)	1,156
Net Assets - Health Advance Funding SubAccount	33,905	(38.2)	54,888	(37.3)	87,486
Net Assets - Pension and Health Benefits	9,428,463	5.8	8,911,638	7.6	8,282,884
Total Net Assets	$ 9,462,368	5.5 %	$ 8,966,526	7.1 %	$ 8,371,526

Management's Discussion and Analysis (Continued)

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 2004 totaled $1,586.0 million. In fiscal year 2004 a transfer of $24.4 million was made from the Health Plan to the Pension Plan.

Total contributions and net investment income for fiscal year 2004 decreased $128.3 million from those of fiscal year 2003 primarily due to changes in market conditions and investment earnings. Total contributions and net investment income increased $2,193.4 million between fiscal years 2002 and 2003 for the same reasons. Total employer contributions increased between fiscal years 2003 and 2004 by $61.3 million or 15.3%, while member contributions decreased by $43.9 million or 48.1%. Total employer contributions increased between fiscal years 2002 and 2003 by $54.9 million or 15.9%, while member contributions decreased by $88.2 million or 49.1%.

The System is non-contributory; however, members may purchase service credit. The decrease in member contributions for fiscal year 2004 occurred because fewer individuals purchased service credit, similar to the decrease in member contributions between fiscal years 2002 and 2003, which occurred because more individuals purchased service credit as a result of the 2002 Early Out Retirement incentive. Net investment income decreased between fiscal years 2003 and 2004 by $145.7 million. Net investment income increased between fiscal years 2002 and 2003 by $2,226.7 million. Transfers to Pension/Health Benefit Plans increased $7.0 million or 40.3% between fiscal years 2003 and 2004. Transfers to Pension/Health Benefit Plans decreased $70.1 million or 80.2% between fiscal years 2002 and 2003 as a result of a change in legislation (Public Act 93 of 2002), which created the Health Advance Funding SubAccount. The notes to the financial statements describe these transfers in more detail. The Investment Section of this report reviews the results of investment activity for 2004.

Additions to Plan Net Assets
(in thousands)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Member contributions	$ 47,406	(48.1) %	$ 91,330	(49.1) %	$ 179,559
Employer contributions	461,428	15.3	400,130	15.9	345,217
Net investment income	1,077,138	(11.9)	1,222,811	221.8	(1,003,890)
Transfer from other systems	26	-	-	-	-
Transfer from pension/health benefit plan	24,364	40.3	17,365	(80.2)	87,486
Miscellaneous income	2	-	-	-	-
Total Assets	$ 1,610,364	(7.0) %	$ 1,731,636	542.2 %	$ (391,628)

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 2004 were $1,114.5 million, a decrease of 1.9% over fiscal year 2003 expenses. Total deductions for fiscal year 2003 were $1,136.6 million, an increase of 29.7% over fiscal year 2002 expenses.

The growth of health care expenses continued during the year and increased by $0.6 million or 0.2% from $354.1 million to $354.7 million during the fiscal year. This compares to an increase of $75.1 million or 26.9% from $279.0 million to $354.1 million between fiscal years 2002 and 2003. The payment of pension benefits increased by $29.3 million or 4.2% between fiscal years 2003 and 2004 and by $198.2 million or 39.4% between fiscal years 2002 and 2003. In fiscal year 2004, the increase in pension benefit expenses resulted from an increase in retirees (128) and an increase in benefit payments to retirees. In fiscal year 2003, the increase in pension benefit expenses resulted from an increase in retirees (5,825) and an increase in benefit payments to retirees. Refunds and transfers to other Plans or Systems decreased by $51.2 million or 67.8% between fiscal years 2003 and 2004. This compares to a decrease of $11.9 million between fiscal years 2002 and 2003 as a result of a change in legislation (Public Act 93 of 2002), which created the Health Advance Funding SubAccount. The notes to the financial statements describe these transfers in more detail. Administrative expenses decreased by $.9 million or 16.9% between fiscal years 2003 and 2004, primarily due to a decrease in professional services, technological support, and postage, telephone and other expenses. Administrative expenses decreased by $1.2 million or 19.3% between fiscal years 2002 and 2003, primarily due to a decrease in building rentals and postage, telephone and other expenses.

Deductions to Plan Net Assets
(in thousands)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Pension benefits	$ 731,009	4.2 %	$ 701,664	39.4 %	$503,454
Health care benefits	354,650	0.2	354,085	26.9	278,998
Refunds of member contributions	163	38.1	118	2,260.0	5
Transfer to pension/health benefit plans	24,364	(67.8)	75,576	(13.6)	87,486
Transfers to other systems	20	566.7	3	(76.9)	13
Administrative expenses	4,316	(16.9)	5,192	(19.3)	6,433
Total Deductions	$ 1,114,522	(1.9) %	$ 1,136,638	29.7 %	$876,389

Management's Discussion and Analysis (Continued)

RETIREMENT SYSTEM AS A WHOLE

The System's combined net assets experienced an increase for the second consecutive year, following a decrease in fiscal year 2002. This increase is a result of a moderate national economic upturn that resulted in investment income earnings. 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 has improved, in part, 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, 2004 and 2003

	September 30, 2004			September 30, 2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Assets:						
Equity in common cash	$ 37,214,607	$ 134,884	$ 37,349,491	$ 41,268,402	$ 196,346	$ 41,464,748
Receivables:						
Amounts due from employer	26,196,288	94,948	26,291,236	49,355,127	234,821	49,589,948
Amounts due from employer long term	74,115,051		74,115,051	42,130,383		42,130,383
Interest and dividends	23,893	87	23,980	21,943,727	104,403	22,048,130
Sale of investments			-	407,912	1,941	409,853
Total receivables	100,335,232	95,035	100,430,267	113,837,149	341,165	114,178,314
Investments:						
Short term investments/pools	222,174,284	805,268	222,979,552	426,136,586	2,027,461	428,164,047
Bonds and notes/fixed income pools	1,588,839,239	5,758,720	1,594,597,959	1,519,858,950	7,231,145	1,527,090,095
Common and preferred stock/pools	4,550,733,495	16,494,055	4,567,227,550	3,954,898,982	18,816,513	3,973,715,495
Real estate and mortgages/pools	721,075,650	2,613,526	723,689,176	849,315,486	4,040,851	853,356,337
Alternative investments/pools	1,195,249,305	4,332,161	1,199,581,466	1,175,783,248	5,594,110	1,181,377,358
International investments/pools	1,016,871,955	3,685,635	1,020,557,590	851,602,972	4,051,734	855,654,706
Cash Collateral on loaned securities	556,044,019	2,015,372	558,059,391	218,444,480	1,039,309	219,483,789
Total investments	9,850,987,947	35,704,737	9,886,692,684	8,996,040,704	42,801,123	9,038,841,827
Total assets	9,988,537,786	35,934,656	10,024,472,442	9,151,146,255	43,338,634	9,194,484,889
Liabilities:						
Warrants outstanding	2,779,568	10,076	2,789,644	2,558,149	12,171	2,570,320
Accounts payable and other accrued liabilities	1,250,675	4,533	1,255,208	5,877,025	27,962	5,904,987
Obligations under securities lending	556,044,019	2,015,372	558,059,391	218,444,480	1,039,309	219,483,789
Total liabilities	560,074,262	2,029,981	562,104,243	226,879,654	1,079,442	227,959,096
Net Assets - Health Advance Funding SubAccount		33,904,675	33,904,675		54,887,456	54,887,456
Net Assets - Pension and Health Benefits	9,428,463,524	-	9,428,463,524	8,924,266,601	(12,628,264)	8,911,638,337
Net Assets Held in Trust for Pension and Health Benefits*	$ 9,428,463,524	$ 33,904,675	$ 9,462,368,199	$ 8,924,266,601	$ 42,259,192	$ 8,966,525,793

*A schedule of funding progress is presented in the Required Supplementary Information of 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 Fiscal Years Ended September 30, 2004 and 2003

	September 30, 2004			September 30, 2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
Additions:						
Contributions:						
Member contributions	$ 37,682,883	$ 9,723,230	$ 47,406,113	$ 80,185,475	$ 11,144,737	$ 91,330,212
Employer contributions	103,873,294	357,554,699	461,427,993	79,291,845	320,838,540	400,130,385
Total contributions	141,556,177	367,277,929	508,834,106	159,477,320	331,983,277	491,460,597
Investment income (loss):						
Investment income (loss)	1,088,355,189		1,088,355,189	1,231,817,382		1,231,817,382
Interest income		3,380,735	3,380,735		7,793,128	7,793,128
Investment expenses:						
Real estate operating expenses	(70,151)		(70,151)	(283,623)		(283,623)
Other investment expenses	(15,195,862)		(15,195,862)	(17,330,493)		(17,330,493)
Securities lending activities						
Securities lending income	6,017,148		6,017,148	4,483,644		4,483,644
Securities lending expenses	(5,348,636)		(5,348,636)	(3,668,982)		(3,668,982)
Net investment income (loss)	1,073,757,688	3,380,735	1,077,138,423	1,215,017,928	7,793,128	1,222,811,056
Transfer from pension/health benefit plans	24,363,516		24,363,516		17,364,626	17,364,626
Transfers from other systems	25,926		25,926			-
Miscellaneous income	2,284		2,284	261		261
Total additions	1,239,705,591	370,658,664	1,610,364,255	1,374,495,509	357,141,031	1,731,636,540
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits	731,009,109		731,009,109	701,664,432		701,664,432
Health benefits		327,143,997	327,143,997		327,707,446	327,707,446
Dental/vision benefits		27,505,668	27,505,668		26,377,392	26,377,392
Refunds of member contributions	163,418		163,418	117,595		117,595
Transfer to pension/health benefit plans		24,363,516	24,363,516	17,364,626	58,211,100	75,575,726
Transfers to other systems	19,708		19,708	2,431		2,431
Administrative expenses	4,316,433		4,316,433	5,192,039		5,192,039
Total deductions	735,508,668	379,013,181	1,114,521,849	724,341,123	412,295,938	1,136,637,061
Net Increase (Decrease)	504,196,923	(8,354,517)	495,842,406	650,154,386	(55,154,907)	594,999,479
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	8,924,266,601	42,259,192	8,966,525,793	8,274,112,215	97,414,099	8,371,526,314
End of Year*	$ 9,428,463,524	$ 33,904,675	$ 9,462,368,199	$ 8,924,266,601	$ 42,259,192	$ 8,966,525,793

* A schedule of funding progress is presented in the Required Supplementary Information of 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, 2004 and 2003, the System's membership consisted of the following:

Retirees and beneficiaries currently receiving benefits:	**2004**	**2003 ***
Regular benefits	36,207	36,324
Survivor benefits	5,869	5,691
Disability benefits	3,543	3,476
Total	45,619	45,491
Current employees:		
Vested	30,197	30,189
Non-vested	4,579	6,347
Total	34,776	36,536
Inactive employees entitled to benefits and not yet receiving them	7,202	7,528
Total members	87,597	89,555

* Restated based on more complete information provided by actuary.

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

Health/Dental/Vision Plan	**2004**	**2003**
Eligible participants:	45,619	45,491
Participants receiving benefits:		
Health	41,397	41,288
Dental	41,164	40,999
Vision	41,286	41,128

Notes to Basic Financial Statements (Continued)

At September 30, 2003 the System recognized 116 participants in the Defined Contribution (DC) Plan who elected to retire under the Early Out Retirement program. This program provided a .25% incentive for those DC members who qualified, which will be provided by the System. These 116 participants have not been included in the pension membership schedule on the previous page.

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.

A member who has separated from employment may request a refund of his or her member contribution account. (The System is currently non-contributory.) A refund may cancel 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 (Continued)

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. COs 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. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of the pension benefit and increase the minimum annual payment. If the member is under age 60, the duty disability allowance is now a minimum 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. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of Duty Death benefits and redefines eligibility for deceased member's survivors. The new minimum duty-related death benefit has been increased to $6,000.

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 (Continued)

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 must have been 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.

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%, 10%, 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 13.05% and 12.5% for fiscal years 2004 and 2003, respectively.

Notes to Basic Financial Statements (Continued)

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.

Early Out Retirement

In February 2002, former Governor John Engler proposed an early out retirement for qualified State employees. Approximately 2,850 State Employees retired by the end of the fiscal year 2002 and an additional 5,160 State employees retired in fiscal year 2003 under this program. Among those members who qualify are Tier 1 (defined benefit) participants and those former members who made an election under section 50 of Public Act 240 of 1943, as amended, to terminate membership in Tier 1 and transfer to become a qualified participant in Tier 2 (defined contribution). Upon their retirement, qualified Tier 2 participants shall receive a retirement allowance equal to the member's number of years of service and fraction of a year of credited service multiplied by .25% of his or her final compensation. For purposes of this section, such individuals shall be considered members of Tier 1 for the limited purpose of receiving a retirement allowance calculated under this section and paid by the System. This allowance will be paid from employer contributions to the System.

Banked Leave Time

Public Act 33 of 2004 amended the State Employees' Retirement Act to include Banked Leave Time (BLT) for members. BLT is an extension of the State's current annual leave program, which banks a predetermined number of hours per pay period. However, the BLT program will not have an effect on a member's Final Average Compensation calculation.

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 when due and payable. 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.

Reserve for Employee Contributions — 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, 2004, and 2003, the balance in this account was $185.8 million and $152.5 million, respectively.

Reserve for Employer Contributions — 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, 2004, and 2003, the balance in this account was $1.4 billion and $3.0 billion, respectively.

Reserve for Retired Benefit Payments — 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 Employee 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 reserve into balance with the actuarial present value of retirement allowances. At September 30, 2004, and 2003, the balance in this account was $6.9 billion and $5.2 billion, respectively.

Notes to Basic Financial Statements (Continued)

Reserve for Undistributed Investment Income — 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 System. At September 30, 2004, and 2003, the net balance of these accounts was $931.2 million and $523.2 million, respectively.

Reserve for Health Related Benefits — 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, 2004, and 2003, the unrestricted balance in this reserve was $0.0 million and ($12.6) million, respectively.

Section 204 of Public Act 431 of 1984, as amended, provides management the ability to administer selected risk managment related programs for insurance or related services. In fiscal year 2004 the Reserve for Health Related Benefits expenses exceeded revenues by $11.4 million. As a result, excess premiums collected by the State Sponsored Group Insurance Fund, which bears the risk of such losses, returned sufficient revenue to make the Reserve whole.

Health Advance Funding SubAccount — This funding subAccount was created by Public Act 93 of 2002 as a means to begin pre-funding, on an actuarial basis, health benefits for participants in the System. Any amounts received in the Health Advance Funding SubAccount (HAFS) and accumulated earnings on those amounts shall not be expended until the actuarial accrued liability for health benefits is at least 100% funded. However, the System may transfer an amount from the HAFS to the employer's accumulation fund (reserve for employer contributions) under certain conditions described in the enabling legislation. At September 30, 2004, and 2003, the balance of this subAccount was $33.9 million and $54.9 million, 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.

Benefit Protection

Public Act 100 of 2002 was passed by the Michigan Legislature to protect pension benefits of public employees from alienation (being transferred). Alienation is attachment, garnishment, levy, execution, bankruptcy or other legal process except for divorce orders or eligible domestic relation orders. The statutes governing the System contained an "anti-alienation" clause to provide for this protection; however, many smaller public pension systems did not have the benefit of this protection. Therefore, Public Act 100 of 2002 was passed to establish legal protection of pension assets that encompasses all public employees.

Internal Fund Pools

On July 1, 2004, the System's assets were invested in internal fund pools. The pools own the assets and may hold an interest in the short-term investment pool. These investments in the short-term pool provide necessary liquidity and/or protection of principal during market reversals. The 2004 classification of investments on the Statement of Net Assets will not be entirely comparable with the prior year's classification because of the holding of short-term investment interests within the other investment pools.

Fair Value of Investments

For fiscal year 2004 plan investments are reported at fair value. For fiscal year 2003 investments are reported at fair value except for short term investments, which are carried at cost and 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.

Notes to Basic Financial Statements (Continued)

Investment Income

Dividend and interest income is recognized on the accrual basis. 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 transaction as of the settlement date does not materially affect the financial statements.

Cost of Administering the System

Each year a restricted general fund appropriation is requested to fund the on-going business operations of the System. These administrative costs are ultimately funded by the System through the regular transfer of funds from the System to the general fund appropriation based on either a direct cost or allocation basis depending on the nature of the expense.

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 Healthcare 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

Leases and services — 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.

	2004	2003
Building Rentals	$ 116,194	$ 133,113
Technological Support	1,338,956	1,473,399
Attorney General	253,266	241,452
Investment Services	1,790,222	1,956,201
Personnel Services	1,364,420	1,409,713

Commitment and Contingency – The State has signed a contract with a vendor for technological support through 2004. As of September 30, 2004, the System's portion of this commitment remaining is approximately $1.9 million.

Cash — On September 30, 2004, and 2003, the System had $37.3 million and $41.5 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 $.3 million and $.4 million for the years ended September 30, 2004, and 2003, respectively.

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.

Notes to Basic Financial Statements (Continued)

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 33-year period for the 2003 fiscal year and a 32-year period for the 2004 fiscal year. Actual employer contributions for retirement benefits were $103.9 million and $79.3 million for fiscal years 2004 and 2003, respectively, representing 4.3% of annual covered payroll for the year ended September 30, 2003. The fiscal year 2004 annual covered payroll is not yet available. Pursuant to Public Act 93 of 2002, a transfer was made from the Health Advance Funding SubAccount within the Health Plan in the amount of $24.4 million. The transfer would effectively bring the Pension Plan contributions to $128.3 at September 30, 2004. During fiscal year 2003 $58.2 million, the general fund portion of the $87.5 million transfer to the SubAccount, was returned to the State's general fund to assist in correcting a projected budget shortfall. In the 2003 fiscal year, pursuant to section 20d of the same Public Act, a transfer of $17.4 million was made from the pension plan into the health plan that represents the cost savings that have accrued to the State as a result of the implementation of Public Act 487 of 1996. This act created the Defined Contribution plan for State employees hired after March 31, 1997. Required employer contributions for pensions included:

1. $152.2 million and $172.9 million for fiscal years 2004 and 2003, respectively, for the normal cost of pensions representing 9.3% (before reconciliation) of annual covered payroll for fiscal year 2003.
2. $110.4 million and $11.3 million for fiscal years 2004 and 2003, respectively, for amortization of overfunded actuarial accrued liability representing .6% (before reconciliation) of annual covered payroll for fiscal year 2003.

The System is required to reconcile with actuarial requirements annually. Any funding excess or deficiency is smoothed over 5 years. One fifth (20%) of the funding excess or deficiency is included in the subsequent years' contribution, and is not recognized as a payable or receivable in the accounting records.

In March 2001, the Internal Revenue Service issued a private letter ruling allowing the System's members to purchase service credit and repay refunds using tax-deferred (pre-tax) dollars. The program was implemented and payments began in fiscal year 2002.

The program allows members to purchase service credit and repay refunds on a tax-deferred basis. Members sign an irrevocable agreement that identifies the contract duration, monthly payment, total contract amount and years of service credit being purchased. The duration of the contract can range from 1 to 20 years. The amounts are withheld from the members' paycheck and are treated as employer pick-up contributions pursuant to Internal Revenue Code Section 414(h). At September 30, 2004, and September 30, 2003 there were 6,804 and 4,125 agreements, respectively. Agreement amounts that will not be collected within 12 months are discounted using the assumed actuarial rate of return of 8%. The average length remaining of a contract was approximately 16 and 14 years for 2004 and 2003. The short-term receivable was $13.0 million and the discounted long-term receivable was $74.1 million at September 30, 2004. At September 30, 2003, the short-term receivable was $8.7 million and the discounted long-term receivable was $42.1 million.

NOTE 4 – INVESTMENTS

Risks and Uncertainties

The System's investments are exposed to various risks, such as interest rate, market, credit, and other. Due to these various risks, it is at least reasonably possible that changes in market values will occur in the near term and that such changes could materially affect the System and the amount reported in the statement of net assets as available for benefits.

Notes to Basic Financial Statements (Continued)

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 stocks, 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.

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 its 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 employs the use of derivatives in the investment of the pension trust funds.

Derivatives are used in managing pension trust fund pooled investments, but uses do not include speculation or leverage of investments. Less than 11.0% of the total pension trust fund's portfolio has been invested from time to time in futures contracts, collateralized mortgages and swap agreements. State investment statutes limit total derivative exposure to 15.0% of a fund's total invested 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 10.0% of market value of total pooled assets on September 30, 2004 and 9.0% of market value of total invested assets on September 30, 2003. Futures contracts represent the second largest category of derivatives used, and they represented .3% of market value of total pooled assets on September 30, 2004, and less than .1 % of market value of total invested assets on September 30, 2003.

To enhance management flexibility, the State Treasurer has purchased futures contracts tied to S&P indices. The futures contracts are combined with short-term investments to replicate the return of the S&P indices. The value of these synthetic equity structures is a combination of the value of the futures contract and the value of the dedicated short-term investments.

To diversify the pension trust fund's portfolio, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in the United States and twenty-two foreign countries. The notional amounts of the swap agreements at September 30, 2004, and 2003, were $844.8 million and $870.0 million, respectively. Approximately one half of the notional amount tied to foreign stock market indices 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 Inter Bank 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 investment pools will either receive the increase in the value of the equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturity dates range from October 2004 to September 2007. 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 on the intention to hold all swap agreements until maturity. Since the inception of equity investment programs involving swaps, over $134.6 million of gains on equity exposure and excess interest received have been realized on matured swap agreements.

The unrealized gain of $93.7 million at September 30, 2004, primarily reflects the increases in international stock indices and changes in currency exchange rates. The combined swap structure realizes gains and losses on a rolling three year basis.

Notes to Basic Financial Statements (Continued)

The respective September 30, 2004, and 2003 swap values are as follows:

	Notional Value	Current Value
9/30/2004 (dollars in millions)	$ 844.8	$ 936.9
9/30/2003 (dollars in millions)	870.0	801.3

The amounts shown above reflect both the total International Equity Pool swap exposure and the smaller swap exposure to the S&P 600 Small Cap Index Pool.

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, 2003.

On July 1, 2004, the System's investments were invested in internal pools, which own the investments. Through its investment in the pools, 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, 2004.

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 the 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 the 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, 2004, such investment pool had an average duration of 42 days and an average expected maturity of 546 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, 2004, the System had no credit risk exposure to borrowers. The cash and non-cash collateral held for securities on loan for the System as of September 30, 2004, were $558,059,391 and $6,184,396, respectively. The carrying amount, which is the fair market value, of securities on loan for the System as of September 30, 2004, was $551,792,094.

Gross income from security lending for the fiscal year was $6,017,148. Expenses associated with this income were the borrower’s rebate of $5,127,707 and fees paid to the agent of $220,929.

Notes to Basic Financial Statements (Continued)

Categories of Investment Risk

Investments are categorized to give an indication of the level of risk that is assumed. Category 1 includes investments insured, registered or held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counter party's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments held by the counterparty or by its trust department or agent, but not in the System's name.

At September 30, 2004, the System does not own any investments that are considered securities for purposes of assessing credit risk. All plan investments are held in State of Michigan – Department of Treasury investment administered pools.

In July 2004 the System's investments were contributed to an investment pool structure. In the table on the following page, 2004 amounts represent a pro rata share based on the System's ownership of the investment pools. For fiscal year 2004 reporting purposes the investment pools are presented on a comparative basis in the Non-Categorized section of the schedule of investment risk.

Notes to Basic Financial Statements (Continued)

Category 1	2004	2003
Prime Commercial Paper		$ 428,164,047
Government Securities		801,209,905
Corporate Bonds & Notes		605,932,406
Common Stock & Preferred Stock		3,870,055,613
Alternative Investments [2]		9,889,424
International Investments [3]		792,311,737
Total Category 1	-	6,507,563,132
Category 3		
Government Securities	-	10,121,938
Non-Categorized		
Real Estate & Mortgages [1]		853,356,337
Alternative Investments [2]		1,171,420,107
International Investments [3]		56,556,819
Cash Collateral on loaned securities	$ 558,059,391	219,483,789
Securities on Loan:		
Government Securities		91,508,864
Corporate Bonds & Notes		18,316,982
Alternative Investments [2]		67,827
International Investments [3]		6,786,150
Common Stock		103,659,882
Fixed Income:		
Government Bond Pool	793,715,902	
Corporate Bond Pool	800,882,057	
Equity Pools	4,567,227,550	
Real Estate Pools	723,689,176	
Alternative Investment Pool	1,199,581,466	
International Investment Pool	1,020,557,590	
Short Term Investments Pool	222,979,552	
Total Non-Categorized	9,886,692,684	2,521,156,757
Grand Total	$ 9,886,692,684	$ 9,038,841,827

1 Non-Categorized Real Estate consists of investments through various legal entities.

2 In Category 1, the Alternative Investments are small-cap equities. Non-Categorized Alternative Investments consist of limited partnerships and securities on loan.

3 In Category 1, the International Investments consist of International Swap Derivatives and ADRs (American Depository Receipts). The Non-Categorized International Investments consist of Primary Market and Extended Market Index Funds and securities on loan.

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)
1994 [3]	$ 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	18.7
1997	7,516	8,213	697	91.5	2,273	30.7
1997 [2]	8,834	8,101	(733)	109.0	2,273	(32.2)
1998	9,109	8,374	(735)	108.8	2,108	(34.9)
1998 [2]	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)
2001	10,633	9,878	(755)	107.6	2,231	(33.8)
2002	10,616	10,753	137	98.7	2,133	6.4
2003	10,441	11,761	1,320	88.8	1,860	71.0

(1) Based on entry age normal actuarial method.

(2) Revised actuarial assumptions and revised asset valuation method.

(3) Revised actuarial assumptions.

Required Supplementary Information (Continued)

Schedule of Employer Contributions

Fiscal Year Ended Sept. 30	Actuarial Required Contribution (ARC)	Actual Contribution	Percentage Contributed
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
2002	111,551,549	87,486,128 [1]	78.4
2003	184,214,419	79,291,845	43.0 [2]
2004	262,546,900	103,873,294 [3]	39.6

[1] Employer contributions for fiscal year 2002 were transferred at year-end into the Health Advance Funding SubAccount established under Public Act 93 of 2002. PA 93 states in part that, "For each fiscal year that begins on or after October 1, 2001, if the actuarial valuation prepared … demonstrates that as of the beginning of the fiscal year, and after all credits and transfers required by this act for the previous fiscal year have been made … the annual level percent of payroll contribution rate … may be deposited into the Health Advance Funding SubAccount…" Pursuant to this legislation, a transfer was made into the subAccount in the amount of $87.5 million. The transfer would effectively bring the contribution percentage to 0.0% for the fiscal year ended September 30, 2002.

[2] The ARC and percentage contributed are due to the $87.5 million transfer in fiscal year 2002 and an additional transfer of $17.4 million into the Health Advance Funding SubAccount in fiscal year 2003.

[3] In fiscal year 2004, $24.4 million was transferred from the Health Advance Funding SubAccount to the Pension Plan at the request of the State Budget Director and with the approval of the legislature. The purpose of this transfer was to reduce the contribution rates charged to State agencies for fiscal year 2003-2004 to help bring the general fund budget back into balance.

Notes to Required Supplementary Information

NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the 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	9/30/2003
Actuarial Cost Method	Entry Age, Normal
Amortization Method	Level Percent of Payroll, Closed
Remaining Amortization Period	33 years
Asset Valuation Method	5-Year Smoothed Market
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 Schedule of Pension Plan Administrative Expenses For the Years Ended September 30, 2004 and 2003

	2004	2003
Personnel Services:		
Staff Salaries	$ 961,284	$ 1,042,927
Retirement and Social Security	225,593	217,904
Other Fringe Benefits	177,542	148,882
Total	1,364,419	1,409,713
Professional Services:		
Accounting *	162,338	
Actuarial	97,000	120,195
Attorney General	253,266	241,452
Audit	35,952	40,763
Consulting	75,510	239,655
Medical	265,917	348,983
Total	889,983	991,048
Building Equipment		
Building Rentals	116,194	133,113
Equipment Purchase, Maintenance, and Rentals	6,199	37,447
Total	122,393	170,560
Miscellaneous:		
Travel and Board Meetings	2,894	6,824
Office Supplies	14,130	12,170
Postage, Telephone and Other	516,469	1,065,288
Printing	67,189	63,037
Technological Support	1,338,956	1,473,399
Total	1,939,638	2,620,718
Total Administrative Expenses	$ 4,316,433	$ 5,192,039

* In 2003 accounting services were included as a component of Postage, Telephone and Other within the Miscellaneous section of this schedule.

Supporting Schedules (Continued)

Schedule of Investment Expenses

	2004	2003
Real Estate Operating Expenses	$ 70,151	$ 283,623
Securities Lending Expenses	5,348,636	3,668,982
Other Investment Expenses*	15,195,862	17,330,493
Total Investment Expenses	$ 20,614,649	$ 21,283,098

* Refer to Investment Section for fees paid to investment professionals.

Schedule of Payments to Consultants

	2004	2003
Independent Auditors	$ 35,952	$ 40,763
Consulting	75,510	239,655
Medical	265,917	348,983
Attorney General	253,266	241,452
Accounting	162,338	
Actuary	97,000	120,195
Total Payment to Consultants	$ 889,983	$ 991,048

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)
For the Year Ended September 30, 2004

	Employee Contributions	Employer Contributions	Retired Benefit Payments	Undistributed Investment Income	Health Related Benefits *	Total
Additions:						
Contributions:						
Member contributions	$ 37,682,883				$ 9,723,230	$ 47,406,113
Employer contributions		$ 103,873,294			357,554,699	461,427,993
Total Contributions	37,682,883	103,873,294	-	-	367,277,929	508,834,106
Investment income (loss):						
Investment income (loss)				$ 1,088,355,189		1,088,355,189
Interest Income					3,380,735	3,380,735
Investment expenses:						
Real estate operating expenses				(70,151)		(70,151)
Other investment expenses				(15,195,862)		(15,195,862)
Securities lending activities:						
Securities lending income				6,017,148		6,017,148
Securities lending expenses				(5,348,636)		(5,348,636)
Net investment income (loss)	-	-	-	1,073,757,688	3,380,735	1,077,138,423
Transfer from pension/health benefit plans		24,363,516				24,363,516
Transfer from other systems	25,926					25,926
Miscellaneous income				2,284		2,284
Total additions	37,708,809	128,236,810	-	1,073,759,972	370,658,664	1,610,364,255
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			$ 731,009,109			731,009,109
Health benefits					327,143,997	327,143,997
Dental/vision benefits					27,505,668	27,505,668
Refunds of member contributions	72,838	90,580				163,418
Transfer to pension/health benefit plans					24,363,516	24,363,516
Transfers to other systems	19,708					19,708
Administrative expenses				4,316,433		4,316,433
Total deductions	92,546	90,580	731,009,109	4,316,433	379,013,181	1,114,521,849
Net Increase (Decrease)	37,616,263	128,146,230	(731,009,109)	1,069,443,539	(8,354,517)	495,842,406
Other Changes in Net Assets:						
Interest allocation	1,580,303	417,845,366	242,039,298	(661,464,967)		-
Transfers upon retirement	(5,894,269)		5,894,269			-
Transfers of employer shares		(2,163,395,324)	2,163,395,324			-
Total other changes in net assets	(4,313,966)	(1,745,549,958)	2,411,328,891	(661,464,967)	-	-
Net Increase (Decrease) After Other Changes	33,302,297	(1,617,403,728)	1,680,319,782	407,978,572	(8,354,517)	495,842,406
Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:						
Beginning of Year	152,471,433	3,025,491,222	5,223,067,079	523,236,867	42,259,192	8,966,525,793
End of Year	$ 185,773,730	$ 1,408,087,494	$ 6,903,386,861	$ 931,215,439	$ 33,904,675	$ 9,462,368,199

* Includes Health Advance Funding SubAccount

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)
For the Year Ended September 30, 2003

	Employee Contributions	Employer Contributions	Retired Benefit Payments	Undistributed Investment Income	Health Related Benefits *	Total
Additions:						
Contributions:						
Member contributions	$ 80,185,475				$ 11,144,737	$ 91,330,212
Employer contributions		$ 79,291,845			320,838,540	400,130,385
Total Contributions	80,185,475	79,291,845	-	-	331,983,277	491,460,597
Investment income (loss):						
Investment income (loss)				$ 1,231,817,382		1,231,817,382
Interest Income					7,793,128	7,793,128
Investment expenses:						
Real estate operating expenses				(283,623)		(283,623)
Other investment expenses				(17,330,493)		(17,330,493)
Securities lending activities:						
Securities lending income				4,483,644		4,483,644
Securities lending expenses				(3,668,982)		(3,668,982)
Net investment income (loss)	-	-	-	1,215,017,928	7,793,128	1,222,811,056
Transfer from Health Advance Funding SubAccount					17,364,626	17,364,626
Miscellaneous income				261		261
Total additions	80,185,475	79,291,845	-	1,215,018,189	357,141,031	1,731,636,540
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			$ 701,664,432			701,664,432
Health benefits					327,707,446	327,707,446
Dental/vision benefits					26,377,392	26,377,392
Refunds of member contributions	60,536	57,059				117,595
Transfer to Health Advance Funding SubAccount		17,364,626			58,211,100	75,575,726
Transfers to other systems	2,431					2,431
Administrative expenses				5,192,039		5,192,039
Total deductions	62,967	17,421,685	701,664,432	5,192,039	412,295,938	1,136,637,061
Net Increase (Decrease)	80,122,508	61,870,160	(701,664,432)	1,209,826,150	(55,154,907)	594,999,479
Other Changes in Net Assets:						
Interest allocation	475,622	363,825,854	285,117,574	(649,419,050)		-
Transfers upon retirement	(127,616,295)		127,616,295			-
Transfers of employer shares		(964,174,470)	964,174,470			-
Total other changes in net assets	(127,140,673)	(600,348,616)	1,376,908,339	(649,419,050)	-	-
Net Increase (Decrease) After Other Changes						
Net Assets (Liabilities) Held in Trust for Pension & Health Benefits:	(47,018,165)	(538,478,456)	675,243,907	560,407,100	(55,154,907)	594,999,479
Beginning of Year	199,489,598	3,563,969,678	4,547,823,172	(37,170,233)	97,414,099	8,371,526,314
End of Year	$ 152,471,433	$ 3,025,491,222	$ 5,223,067,079	$ 523,236,867	$ 42,259,192	$ 8,966,525,793

* Includes Health Advance Funding SubAccount

INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments
Jaqueline M. Johnson, CFA, Director

INVESTMENT SECTION

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 plan 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 judgment, 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 Labor and Economic Growth and the Director of the Department of Management and Budget are ex-officio members. In fiscal 2004, the members of the Committee were as follows: James B. Henry, PhD (public member), Robert E. Swaney, CFA (public member), David G. Sowerby, CFA (public member), David Hollister (ex-officio member), and Mitch Irwin (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

INVESTMENT POLICY & GOALS

Investment policy states that the fiduciary will operate within standard investment practices of the prudent person. The fiduciary is authorized to invest in government obligations, corporate obligations, various short-term obligations, corporate (domestic and international) stocks, venture capital interests, mutual funds, real estate interests, and other investments subject to specific parameters. Above all, pension fund assets are to be invested for the exclusive benefit of the members of the plan.

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

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 System are:

1. Assure the availability of sufficient assets to pay benefits.
2. Maintain sufficient diversification to avoid large losses and preserve capital.
3. Meet or exceed the actuarial assumption over the long term.
4. Achieve the optimal rate of return possible within prudent levels of risk and liquidity.
5. Perform in the top half of the public plan universe over the long term.
6. Exceed individual asset class benchmarks over the long term.
7. Operate 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 provide for a well-diversified portfolio.

Report on Investment Activity (Continued)

Asset Allocation
(Excludes Collateral on Loaned Securities)

Investment Category	As of 9/30/04 Actual %		Five-Year Target %
Domestic Equity - Active	32.8%		33.0%
Large Cap Value Pool		16.8%	
Large Cap Growth Pool		15.6%	
Small Cap Pool		0.4%	
Domestic Equity - Passive	16.1%		16.0%
S&P 500 Index Pool		13.9%	
S&P MidCap Index Pool		1.9%	
S&P Small Cap Index Pool		0.3%	
International Equity Pool	10.9%		10.0%
Alternative Investments Pool	12.9%		14.0%
Real Estate Pool	7.8%		10.0%
Fixed Income	17.1%		15.0%
Government Bond Pool		8.5%	
Corporate Bond Pool		8.6%	
Short Term Investment Pool	2.4%		2.0%
Total	**100.0%**		**100.0%**

INVESTMENT AUTHORITY

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, 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 Acts 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.

INVESTMENT RESULTS

Total Portfolio Results

For the fiscal year ended September 30, 2004, the total System's rate of return was 12.4% as compiled by State Street Analytics. Annualized rates of return for the three-year period ending September 30, 2004, were 5.0%; for the five-year period were 3.3%; and for the ten-year period were 9.3%.

Returns were calculated using a time-weighted rate of return in accordance with standards of the CFA Institute, unless a modification is described in the discussion of the reported return.

These results were driven by double-digit returns from the Domestic and International Equity pools and from the Alternative Investments pool as markets continued their rebound early in the fiscal year. Later in the year, equity markets flattened out when they encountered slower economic growth, higher energy prices and continuing geopolitical worries. For those same reasons, bond markets were very volatile during fiscal 2004. Real estate and alternative investments experienced favorable environments in which they realized gains.

Report on Investment Activity (Continued)

The U.S. economy grew at a rate of 4.5% in fiscal year 2004 as measured by real gross domestic product. The first half was stronger while the second half of the year was buffeted by escalating oil prices, slower retail sales, slow job growth and a series of hurricanes that hit the Southeast. Corporate earnings remained robust, helped by several years of cost-cutting and clean balance sheets. Inflation, as measured by the consumer price index, increased only 2.5% as higher commodity prices were, for the most part, absorbed by producers.

The Federal Reserve began its "measured pace" of monetary tightening by raising the Fed Funds rate by 0.25% at each of its Federal Open Market Committee meetings in June, August and September of 2004. This resulted in a Fed Funds rate of 1.75% by the end of fiscal 2004, up from its 50-year low of 1.00% last spring.

For the fiscal year, the Dow Jones Industrial Average provided a total return of 11.0%, while the broader S&P 500 returned 13.9%. The Lehman Brothers U.S. Aggregate Bond Index appreciated 3.7%.

The System remains well diversified, both across and within asset classes, and positioned to benefit from moderate economic growth.

On July 1, 2004, the System's assets were invested in internal fund pools. The pools own the assets and may hold an interest in the short-term investment pool. These investments in the short-term pool provide necessary liquidity and/or protection of principal during market reversals. Because prior year results only include returns on assets and not the pools, results are not entirely comparable.

Large Cap Value Pool

The primary objective of the pool of large company value stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S & P Barra Value Index. A second objective is to generate a rate of return that exceeds the annualized median return of the State Street public plan universe of large-cap value equity managers.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than $5 billion that are significantly under-priced as measured by price-to-earnings and/or price-to-book value ratios and below fair value as determined by quantitative and qualitative models. The focus is on companies with a strong presence in depressed categories, experienced management and conservative accounting practices. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S & P Barra Value Index. The following summarizes the weightings of the pool as of September 30, 2004:

Finance	39.8 %
Energy	13.3
Consumer Non-Durable	11.2
Short Term Investments	8.1
Manufacturing	5.0
Consumer Durable	5.0
Basic Industries	4.7
Utilities	4.6
Technology	3.8
Capital Goods	3.0
Other	1.5
Total	**100.0** %

Report on Investment Activity (Continued)

Three Small Cap Value managers were selected at the end of the fiscal year to manage money for the System beginning October 1, 2004. They will be funded from short term investments out of the Large Cap Value pool. Their primary investment objective will be to generate a rate of return from investment in common stocks and equivalents that exceeds the Russell 2000 Value Index.

The System's Large Cap Value pool achieved a total rate of return of 19.3% for fiscal 2004. This compared with 20.5% for the S&P 500 Barra Value Index.

At the close of fiscal year 2004, the Large Cap Value pool represented 16.8% of total investments. This compares to 14.8% for fiscal year 2003. The following summarizes the System's 19.8% ownership share of the Large Cap Value pool at September 30, 2004:

Large Cap Value Pool
(in thousands)

Short Term Pooled investments	$ 113,217
Equities	1,449,675
Settlement Principal Payable	(345)
Settlement Proceeds Receivable	676
Accrued dividends	1,350
Total	**$ 1,564,573**

Large Cap Growth Pool

The primary investment objective is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S & P Barra Growth Index. A second objective is to generate a rate of return that exceeds the annualized median return of the State Street public plan universe of large-cap growth equity managers.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than $5 billion whose earnings growth rates are expected to exceed the growth rate of the S & P 500 Index by at least 50% and are priced at or below fair value as determined by quantitative and qualitative models. The focus is on companies with a strong presence in categories anticipated to be fast growing, with high rates of unit sales growth and seasoned management. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S & P Barra Growth Index. The following summarizes the weightings of various sectors in the pool as of September 30, 2004:

Consumer Non-Durable	42.6 %
Technology	29.8
Manufacturing	11.1
Basic Industries	5.1
Short Term Investments	3.5
Capital Goods	2.5
Energy	2.0
Finance	2.0
Other	1.4
Total	**100.0 %**

Report on Investment Activity (Continued)

The Large Cap Growth Pool's total rate of return was 6.7% for the fiscal year versus 7.5% for the S&P 500 Barra Growth Index.

At the close of fiscal year 2004, the Large Cap Growth pool represented 15.6% of total investments. This compares to 14.6% for fiscal year 2003. The following summarizes the System's 20.2% ownership share of the Large Cap Growth pool at September 30, 2004:

Large Cap Growth Pool
(in thousands)

Short Term Pooled investments	$	49,223
Equities		1,400,063
Settlement Principal Payable		(2,625)
Settlement Proceeds Receivable		8,209
Accrued dividends		1,537
Total	**$**	**1,456,407**

Small Cap Pools

The primary investment objective is to generate a rate of return from investment in common stocks and equivalents that exceeds the Russell 2000 Growth Index.

The System invests in the Delaware and Putnam pools. These are investment positions with the small company growth managers at Delaware Investment Advisors (Delaware) and Putnam Investments (Putnam).

The System's Small Cap pool invested with Delaware achieved a total rate of return of 14.0% for fiscal 2004, while Putnam's total rate of return was 9.5% resulting in a combined return of 12.5%. This compares favorably with the Russell 2000 Growth Index total return of 11.9%.

At the close of fiscal year 2004, the two Small Cap pools represented 0.4% of total investments. This compares to 0.4% for fiscal year 2003. The following summarizes the System's ownership share and composition of the two Small Cap pools at September 30, 2004:

Small Cap Pools
(in thousands)

	Delaware	Putnam
Total Equities	$28,390	$13,065
Ownership share	20.9%	21.0%

S&P 500 Index Pool

The objective of the enhanced S&P 500 Index pool is to closely match the return performance of its benchmark, the S&P 500 Index, and to use low risk strategies to offset transaction costs and add to performance when possible. The pool generally holds all 500 stocks that make up the Standard & Poor's 500 Index in proportion to their weighting in the index.

Report on Investment Activity (Continued)

The following summarizes the sector weightings of the pool as of September 30, 2004:

Financials	20.8 %
Information Technology	15.7
Health Care	13.1
Industrials	11.6
Consumer Discretionary	11.0
Consumer Staples	10.7
Energy	7.4
Telecomm. Services	3.7
Materials	3.1
Utilities	2.9
Total	**100.0** %

The S&P 500 Index pool return for the fiscal year was 13.9% versus the benchmark's 13.9%.

At the close of fiscal year 2004, the S&P 500 Index pool represented 13.9% of total investments. This compares to 13.1% for fiscal year 2003. The following summarizes the System's 19.7% ownership share of the S&P 500 Index pool at September 30, 2004:

S&P 500 Index Pool
(in thousands)

Short Term Pooled investments	$	28,139
Equities		1,269,988
Hedge Contracts		(7)
Settlement Principal Payable		(29)
Accrued dividends		1,479
Total	**$**	**1,299,570**

S&P MidCap Pool

The objective of the S&P MidCap Index pool is to closely match the return performance of its benchmark, the S&P MidCap, and use low risk strategies to offset transaction costs and add to performance when possible. The pool invests in equities of mid-size firms.

The S&P MidCap Index pool return for the fiscal year was 17.6% versus its benchmark’s 17.6%.

At the close of fiscal year 2004, the S&P MidCap Index pool represented 1.9% of total investments. This compares to 1.7% for fiscal year 2003. The following summarizes the System's 21.2% ownership share of the S&P MidCap Index pool at September 30, 2004:

S&P MidCap Pool
(in thousands)

Short Term Pooled investments	$	3,688
Equities		178,183
Hedge Contracts		21
Settlement Principal Payable		(1,554)
Settlement Proceeds Receivable		163
Accrued dividends		117
Total	**$**	**180,618**

Report on Investment Activity (Continued)

S&P Small Cap Index Pool

The objective of the S&P Small Cap Index pool is to match the return of its benchmark, the S&P 600 Small Cap Index. The S&P Small Cap Index pool return for the fiscal year was 24.6% versus the benchmark's 24.6%.

The pool achieves exposure to small cap equity returns primarily by investing in a combination of fixed income notes and equity swap agreements tied to the S&P 600 index. The total notional amount of the S&P 600 swap agreements is invested in dedicated fixed income notes. Interest from the dedicated notes is exchanged for S&P 600 stock returns. Use of swap agreements for a core position began in 2002, and an S&P 600 Exchange Traded Fund was added to this pool in 2004 to enhance management flexibility.

At the close of fiscal year 2004, the S&P Small Cap Index pool represented 0.3% of total investments. This compares to 0.2% for fiscal year 2003. The following summarizes the System's 20.8% ownership share of the S&P Small Cap Index pool at September 30, 2004:

S&P Small Cap Index Pool
(in thousands)

Short Term Pooled investments	$	142
Equities		3,204
Debt Securities		20,753
Hedge Contracts		472
Accrued dividends		34
Total	**$**	**24,605**

International Equities Pool - Passive

The objective of the International Equities Pool – Passive is to match the return performance of the S&P Citigroup 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 impacted by foreign currency exchange rate changes. The total passive international return of 19.3% in the fiscal year approximately matched the Citigroup BMI-EPAC return of 19.5%.

Core passive exposure to international equity returns is achieved primarily 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 S&P Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in related indices. Use of swap agreements for a core position began in 1993, an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase management flexibility, and a country fund portfolio was added in September of 2002 to improve exposure to the smallest companies in the BMI index. During fiscal year 2004, $8.5 million was withdrawn, bringing passive international investments to 10.9% of total investment assets.

The combination of fixed income LIBOR notes and equity swap agreements was valued at $915.3 million on September 30, 2004. That valuation included a net unrealized gain of $92.9 million on equity index exposures and an unrealized loss of $0.1 million on LIBOR note investments held. The combined swap agreement and LIBOR portfolio structure continues to perform like a stock index fund that realizes all gains and losses on a rolling three year basis. During fiscal year 2004, $25 million of losses on equity exposures were realized, $17 million of interest in excess of obligations on completed swaps was recognized, and $16 thousand of gains on LIBOR notes were realized. At the end of the fiscal year, total realized gains and net interest received in excess of counterparty obligations on completed agreements were $131.1 million since the program began.

Report on Investment Activity (Continued)

At the close of fiscal year 2004, the International Equities – Passive pool represented 10.9% of total investments. This compares to 9.7% for fiscal year 2003. The following summarizes the System's 20.5% ownership share of the International Equities Pool – Passive at September 30, 2004:

International Equities Pool - Passive
(in thousands)

Short Term Pooled investments	$ 10,810
Equities	92,121
Debt Securities	822,371
Hedge Contracts	92,920
Accrued dividends and interest	2,336
Total	**$ 1,020,558**

Alternative Investments Pool

The Alternative Investments pool objective is to meet or exceed the S&P 500 plus 300 basis points for all private equity pools over long time periods.

Alternative Investments are investments in the private equity market, primarily through limited partnerships. Of the investments, approximately 61.8% were in partnerships investing in buyouts, 16.2% in venture capital, 10.4% in special situations, and 4.3% in mezzanine. The remaining 7.3% were investments in fund of funds, hedge funds, and short term. The asset allocation range for alternative investments is 12.0% to 15.0%, while the long-term target asset allocation target is 14.0%.

The Alternative Investments pool had a return of 22.7% for the fiscal year ended September 30, 2004 as compiled by State Street Analytics versus the S&P 500 Index plus 300 basis points of 16.9%.

Credit Suisse Asset Management (CSAM) manages the stock distributions of the Alternative Investments. The CSAM return for the fiscal year ending September 30, 2004 was 6.0%.

At the close of fiscal year 2004, the Alternative Investments pool represented 12.8% of total investments and Credit Suisse Asset Management represented 0.1% of total investments. This compares to 13.2% for Alternative and 0.1% for CSAM for fiscal year 2003. The following summarizes the System's ownership share and composition of the Alternative Investments pool and the Credit Suisse Asset Management pool at September 30, 2004:

Alternative Investments Pool
(in thousands)

	Alternative	CSAM
Short Term Pooled	$ 14,752	$ 170
Equities	1,177,343	7,316
Total	**$ 1,192,095**	**$ 7,486**
Ownership Share	19.5%	17.0%

Real Estate Pool

The Real Estate pool seeks favorable risk-adjusted returns through rental income and appreciation of real estate investments. Real estate investments are typically held through various legal investment entities, such as limited partnerships or limited liability companies, established for the specific purpose of owning, leasing, managing, financing, or developing real estate and real estate related investments. Independent third parties regularly value the real estate investments to establish current market values.

Report on Investment Activity (Continued)

The Real Estate pool may invest in each of the following four quadrants of the real estate capital markets:

- Private equity markets - An ownership interest in stabilized real estate assets, which may also include development and redevelopment of real estate.
- Public equity markets - Securities of publicly traded equity real estate companies whose primary purpose is to own, lease, manage, and develop real estate.
- Private debt markets - Mortgage loans secured by real estate.
- Public debt markets - Publicly traded commercial mortgage-backed securities market.

The Real Estate pool diversifies its holdings by:

- Geographic region - The pool is broadly diversified geographically across the country. Emphasis is placed upon U.S. real estate investments, but may also include foreign real estate investments. Foreign investments are currently less than one percent of the total equity value of the pool, and are not expected to exceed ten percent of the total equity value of the pool.
- Property (size and value) - The pool diversifies its holdings so that it is not concentrated in a few large real estate assets.
- Property type - The pool is diversified by type of property and by class of property.

Major property types as of September 30, 2004:

Description	Percent
Multi-family apartments	41.3 %
Commercial office buildings	21.5
Retail shopping centers	14.5
Industrial warehouse buildings	8.5
For sale housing, senior living facilities, land, hotels and self-storage facilities	14.2
Total	**100.0** %

The net total return for the fiscal year ending September 30, 2004, was 8.0%, as compiled by State Street Analytics. This compares to the benchmark return of 11.7%. The benchmark is the National Council of Real Estate Investment Fiduciaries Property Index (NPI) less 75 basis points. The adjustment to the NPI is made to approximate industry comparable returns due to the fact that the Real Estate pool’s returns are calculated net of all overhead and management fees, while the NPI calculates returns on a gross property level basis before overhead and standard investment management fees.

At the close of fiscal year 2004, the Real Estate pool had a total net equity value of $724 million that represented 7.8% of total investments. This compares to 9.6% for fiscal year 2003. The following summarizes the System's 22.2% ownership share of the Real Estate pool at September 30, 2004:

Real Estate Pool
(in thousands)

Short Term Pooled investments	$ 8,079
Equities	715,050
Debt Securities	557
Accrued Interest	3
Total	**$ 723,689**

Report on Investment Activity (Continued)

Government Bond Pool

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the benchmark, Lehman Brothers Government Index.

The pool invests in a diversified portfolio of government bonds including, but not limited to, treasuries, agencies, and government sponsored enterprises. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk reward relationship relative to historical norms and the outlook for interest rates.

For the fiscal year ending September 30, 2004, the Government Bond Pool returned 3.1% compared to the Lehman Brothers Government Index of 2.5%.

During the year rates were somewhat volatile reaching a low point in mid-March, increasing more than one hundred basis points by mid-June and finally declining again through September. In addition to the general volatility of rates, the yield curve flattened with short and intermediate rates rising while longer term rates remained constant or exhibited a modest decline, all of which tended to favor longer term portfolios.

At the close of fiscal year 2004, the Government Bond pool represented 8.5% of total investments. This compares to 10.2% for fiscal year 2003. The following summarizes the System's 19.8% ownership share of the Government Bond pool at September 30, 2004:

Government Bond Pool
(in thousands)

Short Term Pooled investments	$	108,120
Debt Securities		683,043
Settlement Principal Payable		(2,345)
Accrued dividends		4,898
Total	**$**	**793,716**

Corporate Bond Pool

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Credit Index.

The pool invests in a diversified portfolio of investment grade corporate issues. Such issues are rated in the top four categories by nationally recognized rating agencies. Non-rated bonds are acceptable if they are determined to be of comparable quality. To achieve above average returns the pool emphasizes those sectors exhibiting the best risk reward relationship relative to historical norms and the outlook for interest rates.

For the fiscal year ending September 30, 2004 the Corporate Bond pool returned 4.1% compared to the Lehman Brothers Credit Index of 4.4%.

During the year rates were somewhat volatile reaching a low point in mid-March, increasing more than one hundred basis points by mid-June and finally declining again through September. In addition to the general volatility of rates, the yield curve flattened with short and intermediate rates rising while longer term rates remained constant or exhibited a modest decline, all of which tended to favor longer term portfolios.

Report on Investment Activity (Continued)

At the close of fiscal year 2004, the Corporate Bond pool represented 8.6% of total investments. This compares to 7.1% for fiscal year 2003. The following summarizes the System's 19.2% ownership share of the Corporate Bond pool at September 30, 2004:

Corporate Bond Pool
(in thousands)

Short Term Pooled investments	$	29,325
Debt Securities		794,042
Settlement Principal Payable		(31,915)
Aintransit Interest Receivable		223
Accrued dividends		9,207
Total	**$**	**800,882**

Short Term Investments Pool

The objective of the Short Term Investment pool is to closely match the return performance of its benchmark, the 91 day Treasury bill. The Short Term Investment pool return for the fiscal year was 1.1% versus the benchmark's 1.1%.

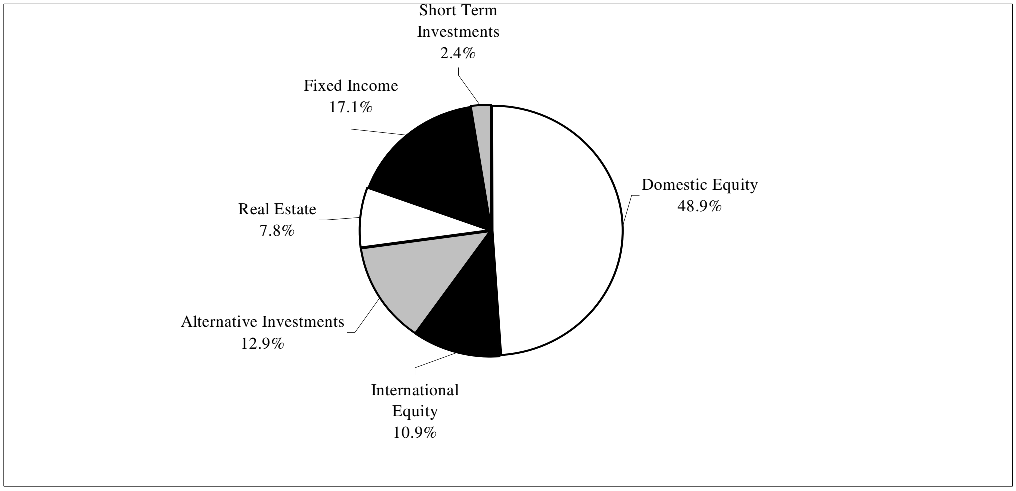
Potential areas of investment are:

- Obligations of the United States or its agencies.
- Banker's acceptances, commercial accounts, certificates of deposit or depository receipts.
- Repurchase agreements for the purchase of securities issued by the US government or its agencies.
- Commercial paper rated at the time of purchase within the two highest classifications established by not less than two national rating services as determined by the State Treasurer.

As of September 30, 2004, the Short Term Investment pool was 100% invested in commercial paper because of its advantages in yield and flexibility in maturities.

At the close of fiscal year 2004, the Short Term Investment pool represented 2.4% of total investments. This compares to 5.3% for fiscal year 2003. The System's 15.9% ownership share of the Short Term Investment Pool at September 30, 2004, was $222,979,552 composed of debt securities.

Asset Allocation – Security Type Only



Investment Results for the Period Ending September 30, 2004

Investment Category	Current Year	Annualized Rate of Return 1 3 Years	5 Years	10 Years
Total Portfolio	12.4 %	5.0 %	3.3 %	9.3 %
Total Domestic Equity	13.4	4.8	(0.2)	10.8
S&P 1500 Index	14.6	5.1	(0.1)	N/A
Large Cap Value Pool	19.3			
Large Cap Growth Pool	6.7			
Small Cap Pools	12.5			
S&P 500 Index Pool	13.9			
S&P MidCap Index Pool	17.6			
S&P Small Cap Index Pool	24.6			
International Equity Pool - Passive	19.3	6.9	(0.3)	6.0
S&P Citigroup BMI - EPAC - 50/50	19.5	7.0	(0.4)	5.0
Alternative Investments Pool	22.7	1.1	4.2	12.1
S&P 500 Index plus 300 Basis Points	16.9	7.1	1.7	14.1
Credit Suisse Asset Management (Stock Distributions)	6.0			
Real Estate Pool	8.0	7.6	8.7	10.0
NCREIF Property Index minus 75 Basis Points	11.7	7.9	8.8	9.8
Total Fixed Income	3.6	5.6	7.1	7.7
Lehman Brothers Government/Credit	3.3	6.3	7.7	7.8
Government Bond Pool	3.1			
Corporate Bond Pool	4.1			
Short Term Investment Pool	1.1	1.7	3.3	4.6
91 Day Treasury Bill	1.1	1.5	3.1	4.3

[1] Calculations used a time-weighted rate of return based on the market rate of return in accordance with AIMR's Performance Presentation Standards.

Largest Assets Held

Largest Stock Holdings (By Market Value)*
September 30, 2004

Rank	Shares	Stocks	Market Value
1	4,602,651	General Electric Corporation	$ 153,592,898
2	5,418,076	Microsoft Corporation	148,992,265
3	3,039,605	Exxon Mobil Corporation	144,231,055
4	3,215,418	Citigroup Incorporated	139,330,013
5	4,381,808	Pfizer Incorporated	133,455,010
6	1,690,107	Wal-Mart Stores Incorporated	89,299,950
7	2,060,394	Bank of America Corporation	87,661,732
8	1,413,609	Wells Fargo & Company	82,809,729
9	1,137,576	American International Group	75,929,179
10	1,250,715	BP PLC	70,914,921

Largest Bond Holdings (By Market Value)*
September 30, 2004

Rank	Par Amount	Description	Market Value
1	$ 45,028,197	U.S. Treasury Strip 0% Coupon Due 11-15-2011	$ 42,596,674
2	40,258,650	US Bank NA 2.0275% FRN Due 4-5-2007	40,257,269
3	39,672,420	FHLB 2.71% FRN Due 1-12-2007	39,672,499
4	31,831,947	Wells Fargo & Company 1.72% FRN Due 8-4-2006	31,826,762
5	30,805,110	Bayerische Landesbank NY 1.91313 FRN Due 3-17-2006	30,798,712
6	29,447,060	Canadian Imperial Bank 2.0775% FRN Due 1-5-2007	29,446,047
7	28,768,035	Wells Fargo & Company 2.03% FRN Due 9-28-2007	28,768,035
8	26,697,762	Citigroup Global Markets 1.75% FRN Due 1-30-2007	26,694,206
9	25,670,925	Key Bank NA 1.73% FRN Due 7-31-2006	25,667,303
10	25,670,925	JPMorgan Chase & Co 1.76188% FRN Due7-28-2006	25,667,254

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

* The System's Investments are commingled in various pooled accounts. Shares, par and market value represent the System's pro-rata ownership through its ownership of the pools.

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 12.7% 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 $1.8 million or less than three basis points (.024%) of the market value of the portfolio.

State law created an Investment Advisory Committee (Committee) comprised of the directors of the Department of Labor and Economic Growth and Department of 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 judgment 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	$ 7,405,922.0	$ 1,790.2	2.4
Outside Advisors -			
Small Cap Growth - Delaware	28,389.7	153.8	54.2
Small Cap Growth - Putnam	13,065.4	119.7	91.6
International	71,233.0	18.1	2.5
Alternative	1,184,659.0	12,992.0	110.3
Real Estate	625,364.2		
Total	$ 9,328,633.3		
Other Investment Services Fees:			
Assets in Custody	$ 9,105,647.9	$ 413.7	
Securities on Loan	551,792.1	220.9	

* Outside Advisors Fees are netted against income for Small Cap Growth and International. For Alternative partnership agreements that 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.

Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2004		
	Commissions Paid [1]	Number of Shares Traded	Average Commission Rate Per Share
Investment Brokerage Firms:			
Alex Brown and Sons	$ 2,858	71,457	$ 0.04
Banc America Securities	15,164	303,282	0.05
Bear Stearns & Co Inc	57,800	1,233,371	0.05
Bridge Trading	104,333	2,115,782	0.05
B-Trade Services LLC	324	16,216	0.02
Cantor Fitzgerald & Co.	10,820	349,257	0.03
Cap Institutional Services Inc	92	1,836	0.05
Charles Schwab Co Inc	16,153	323,052	0.05
CIBC World Markets Corp	288	7,200	0.04
Citigroupglobal Markets Inc	152,646	3,858,767	0.04
Credit Suisse First Boston Corporation	59,834	1,196,681	0.05
Davidson D.A. & Company Inc	414	13,815	0.03
Deutsche Bank Securities Inc	43,526	987,843	0.04
First Albany Corp.	645	12,910	0.05
Goldman Sachs & Co	99,765	2,204,421	0.05
Griswold Company	28,032	1,274,188	0.02
Howard Weil	5,267	105,348	0.05
Investment Technology Group Inc.	225	11,257	0.02
ISI Group Inc	26,326	526,530	0.05
J P Morgan Securities Inc	53,269	1,068,467	0.05
Jefferies Company Inc	1,411	28,211	0.05
Knight Securities	475	11,872	0.04
Lehman Brothers Inc	91,847	2,127,084	0.04
Liquidnet Inc	920	45,997	0.02
OTA Research	19,854	397,077	0.05
Merrill Lynch, Pierce, Fenner & Smith, Inc	61,504	1,345,636	0.05
Morgan Stanley Co Inc	47,439	948,785	0.05
Piper Jaffray & Co.	213	4,260	0.05
Prudential Equity Group	48,197	963,934	0.05
Raymond James & Associates Inc	648	12,954	0.05
S.G. Cowen & Co., LLC	13,049	260,977	0.05
Salomon Smith Barney	272	8,085	0.03
Sanders Morris Mundy	1,299	25,977	0.05
Sanford C Bernstein Co., LLC	29,589	591,788	0.05
State Street Brokerage Services	169	3,637	0.05
Thinkequity Partners LLC	732	14,634	0.05
Thomas Weisel Partners	4,478	99,011	0.05
UBS Securities LLC	51,673	1,099,987	0.05
Wachovia Capital Markets, LLC	728	14,564	0.05
Weeden & Co.	5,075	106,352	0.05
Wells Fargo Securities LLC	723	16,498	0.04
Total	$ 1,058,076	23,809,000	$ 0.04 [2]

[1] Commissions are included in purchase and sale prices of investments. The commissions and shares represent the pro-rata shares of commission and share transactions based on ownership in the investment pools.

[2] The average commission rate per share for all brokerage firms.

Investment Summary

Fiscal Year Ended September 30, 2004

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (b, c)	Percent of Investment & Interest Income
Fixed Income:				
Government Bonds	$ 793,715,902	8.5%	$ 23,682,529	2.2%
Corporate Bonds	800,882,057	8.6%	30,433,494	2.8%
Total Fixed Income	1,594,597,959	17.1%	54,116,023	5.0%
Equity Pools	4,567,227,550	48.9%	532,884,321	48.8%
Real Estate Pools	723,689,176	7.8%	61,703,126	5.7%
Alternative Investment Pool	1,199,581,466	12.9%	255,742,373	23.4%
International Equities Pool	1,020,557,590	10.9%	181,527,874	16.6%
Short Term Investments Pool	222,979,552	2.4%	5,762,207	0.5%
Total	$ 9,328,633,293	100.0%	$ 1,091,735,924	100.0%

(a) Market value excludes $37,349,491 and $558,059,391 in equity in common cash and cash collateral for security lending for fisc

(b) Total Investment & Interest Income excludes net security lending income of $668,512.

(c) Effective July 1, 2004, the System's investments were contributed to the various investment pools listed above. The income on investments for the first nine months of the fiscal year is reported as income for the pool to which the security was contributed.

Investment Summary (Continued)

Fiscal Year Ended September 30, 2003

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (c)	Percent of Investment & Interest Income
Fixed Income:				
Government Bonds	$ 902,840,689	10.2%	$ 30,300,308	2.4%
Corporate Bonds	624,249,405	7.1%	59,209,668	4.8%
Total Fixed Income	1,527,090,094	17.3%	89,509,976	7.2%
Common & Preferred Stock	3,973,715,495	44.9%	870,504,405	70.2%
Real Estate & Mortgages	853,356,337	9.6%	55,832,088	4.5%
Alternative Investments	1,181,377,358	13.3%	67,647,786	5.5%
International Equities - Passive	855,654,706	9.7%	151,229,953	12.2%
Short Term Investments (b)	469,628,795	5.3%	4,886,302	0.4%
Total	$ 8,860,822,785	100.0%	$ 1,239,610,510	100.0%

(a) Short Term Investments are at cost, which approximates market value.

(b) Excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for the fiscal year. Amount also excludes $219,483,789 in cash collateral for security lending for fiscal year 2003.

(c) Total Investment & Interest Income excludes net security lending income of $814,662 for fiscal year 2003.

ACTUARIAL SECTION

ACTUARIAL SECTION

Actuary's Certification

SEGAL

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November 10, 2004

Mr. Mitch Irwin
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, 2003 included a total of 89,555 members of MSERS. The actuarial value of MSERS's assets amounted to approximately $10.44 billion on September 30, 2003.

The actuarial assumptions used in the 2003 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, 2003 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 2003 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

Benefits, Compensation and HR Consulting ATLANTA BOSTON CHICAGO CLEVELAND DENVER HARTFORD HOUSTON LOS ANGELES MINNEAPOLIS NEW ORLEANS NEW YORK PHILADELPHIA PHOENIX SAN FRANCISCO SEATTLE TORONTO WASHINGTON, DC

Multinational Group of Actuaries and Consultants AMSTERDAM BARCELONA GENEVA HAMBURG LONDON MELBOURNE MEXICO CITY OSLO PARIS

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 probabilities 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. 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. Adopted 1997.

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
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
2001	45,852	2,230,562	48,647	3.1	47.4	17.7
2002	43,064	2,133,477	49,542	1.8	48.0	18.6
2003	36,536	1,859,555	50,897	2.7	47.7	17.9

* 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	Added to Rolls		Removed from Rolls		Rolls–End of Year		% Increase in Annual	Average Annual
Sept. 30	No.	Annual Allowances*	No.	Annual Allowances*	No.	Annual Allowances*	Allowances	Allowances
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
2001	1,648	22,501	1,242	15,063	37,111	471,407	1.6	12,703
2002	3,806	80,871	1,251	5,310	39,666	546,968	16.0	13,789
2003	6,448	163,673	623	6,935	45,491	708,607	29.6	15,577

* 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) are 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) [3]
1994 [2]	$ 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 [1, 2]	3	4,300	3,798	8,834	100	100	119.3	109.0
1998	27	4,360	3,987	9,109	100	100	118.4	108.8
1998 [2]	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
2001	34	4,677	5,167	10,633	100	100	114.6	107.6
2002	123	5,512	5,118	10,616	100	100	97.3	98.7
2003	57	7,386	4,318	10,441	100	100	69.4	88.8

[1] Revised asset valuation assumptions.

[2] Revised asset valuation method.

[3] Percents funded on a total valuation asset and total actuarial accrued liability basis.

Analysis of Financial Experience

Gains/(Losses) in Accrued Liabilities During Year Ended September 30, 2003
Resulting from Differences Between Assumed Experience & Actual Experience

	Type of Activity	Gain/(Loss)
1.	**Retirements (including Disability Retirement).** If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pays, a loss.	$ (109,121)
2.	**Withdrawal From Employment** (including death-in-service). If more liabilities are released by withdrawals and deaths than assumed, there is a gain. If smaller releases, a loss.	(7,507,416)
3.	**Pay Increases.** If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	30,429,393
4.	**Investment Income.** If there is greater investment income than assumed, there is a gain. If less income, a loss.	(442,911,378)
5.	**Death After Retirement.** If retirants live longer than assumed, there is a loss. If not as long, a gain.	(34,715,996)
6.	**New entrants.** New entrants into the System will generally result in an actuarial loss. This does not apply to plans closed to new entrants.	(7,146,926)
7.	**Other.** Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	1,056,771
8.	**Composite Gain (or Loss) During Year**	$ (460,904,673)

Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2003, 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.

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.

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).

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 onetime 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.

Summary of Plan Provisions (Continued)

2002 Early Out Window

Members retiring between April 1, 2002 and November 1, 2002 whose combined age and service equals 80 points, or who are age 60 or older with 10 or more years of service are eligible to receive a benefit equal to 1.75% of final average compensation multiplied by years of credited service. Members who had previously transferred to the Defined Contribution plan, are eligible to receive a benefit equal to 0.25% of final average compensation multiplied by years of credited service.

STATISTICAL SECTION

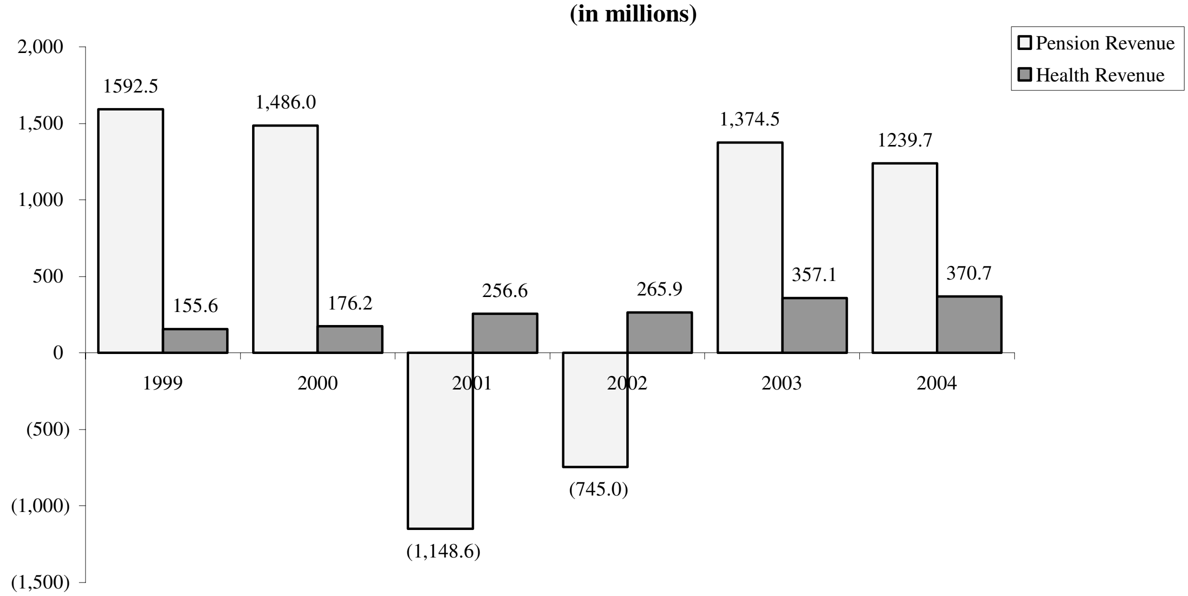
Schedule of Pension Plan Revenues by Source

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions Dollars	Employer Contributions % of Annual Covered Payroll	Net Investment & Other Income	Total
1999	$ 6,186,018	$ 121,119,857	5.5 %	$ 1,465,196,232	$ 1,592,502,107
2000	4,606,662	121,817,366	5.4	1,359,608,718	1,486,032,746
2001	3,341,381	112,299,808	5.0	(1,264,290,456)	(1,148,649,267)
2002	173,232,835	87,486,128	4.1	(1,005,732,436)	(745,013,473)
2003	80,185,475	79,291,845	4.3	1,215,018,189	1,374,495,509
2004	37,682,883	103,873,294	N/A	1,098,149,414	1,239,705,591

Schedule of Health Revenues by Source

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions Dollars	Employer Contributions % of Annual Covered Payroll	Net Investment & Other Income	Total
1999	$ 4,861,628	$ 144,515,766	6.5 %	$ 6,219,220	$ 155,596,614
2000	5,056,971	166,833,573	7.4	4,339,752	176,230,296
2001	5,793,284	249,214,002	11.2	1,586,567	256,593,853
2002	6,326,267	257,730,817	12.1	1,842,164	265,899,248
2003	11,144,737	320,838,540	17.2	25,157,754	357,141,031
2004	9,723,230	357,554,699	N/A	3,380,735	370,658,664

Total Revenue
Year Ended September 30
(in millions)



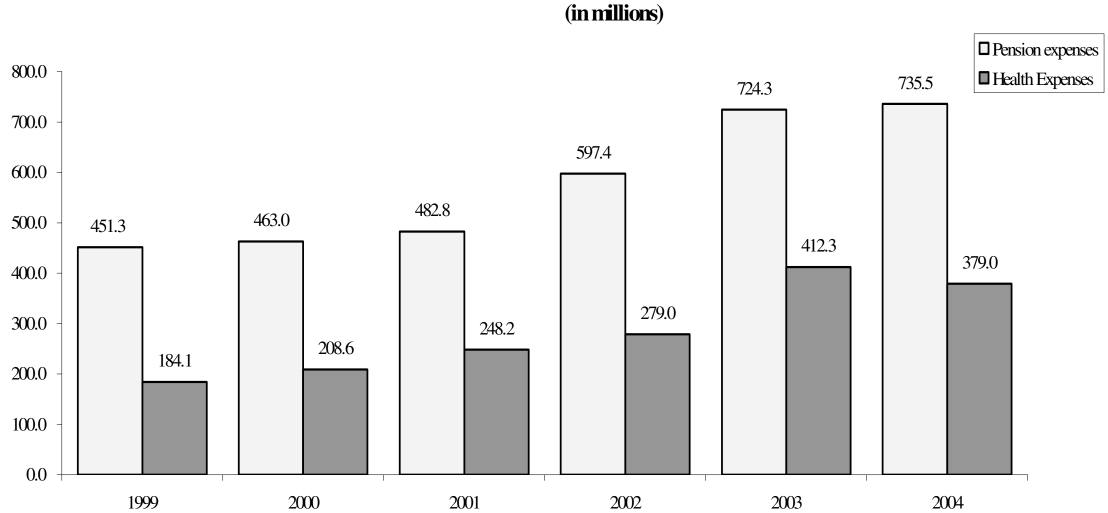
Schedule of Pension Plan Expenses by Type

Fiscal Year Ended Sept. 30	Benefit Payments	Refunds and Transfers	Administrative and Other Expenses	Total
1999	$ 446,219,254	$ 728,366	$ 4,330,623	$ 451,278,243
2000	458,803,774	222,163	3,954,992	462,980,929
2001	478,525,328	91,699	4,149,284	482,766,311
2002	503,453,879	87,504,459	6,432,819	597,391,157
2003	701,664,432	17,484,652	5,192,039	724,341,123
2004	731,009,109	183,126	4,316,433	735,508,668

Schedule of Health Plan Expenses by Type

Fiscal Year Ended Sept. 30	Benefit Payments	Refunds and Transfers	Administrative and Other Expenses	Total
1999	$ 184,127,475			$ 184,127,475
2000	208,627,602	$ 8		208,627,610
2001	248,246,380			248,246,380
2002	278,998,333			278,998,333
2003	354,084,838	58,211,100		412,295,938
2004	354,649,665	24,363,516		379,013,181

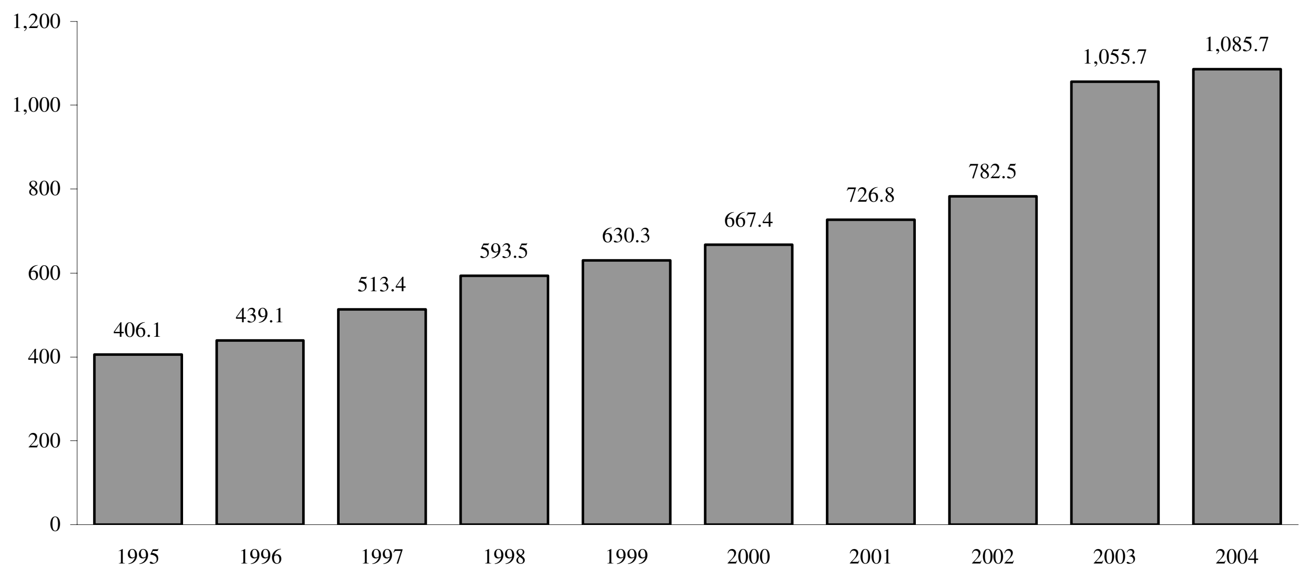
Total Expenses
Year Ended September 30
(in millions)



Schedule of Benefit Expenses by Type

Fiscal Year Ended Sept. 30	Regular Benefits	Disability Benefits	Supplemental Check	Health Benefits	Total
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
2002	467,909,032	35,544,847		278,998,333	782,452,212
2003	664,188,203	37,476,229		354,084,838	1,055,749,270
2004	690,942,422	40,066,687		354,649,665	1,085,658,774

Total Benefit Expenses
Year Ended September 30
(in millions)



Schedule of Retired Members by Type of Benefit

September 30, 2003

Amount Monthly Benefit	Number of Retirees	Type of Retirement * 1	2	3	4	5	6	7	8
$ 1 - 200	1,324	419	465	24	191	6	186	3	30
201 - 400	3,847	2,325	833	18	496	16	83	3	73
401 - 600	5,726	3,300	680	432	847	-	240	7	220
601 - 800	4,902	3,059	463	1	811	-	208	22	338
801 - 1,000	4,201	2,641	314	-	590	-	188	45	423
1,001 - 1,200	3,863	2,490	214	2	445	-	148	68	496
1,201 - 1,400	3,893	2,753	194	-	217	-	106	58	565
1,401 - 1,600	3,273	2,559	117	-	96	-	79	55	367
1,601 - 1,800	2,930	2,481	77	-	65	-	41	81	185
1,801 - 2,000	2,668	2,358	58	-	23	-	23	119	87
Over 2,000	8,864	8,148	104	-	15	-	51	449	97
Totals	45,491	32,533	3,519	477	3,796	22	1,353	910	2,881

* 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

Source: The Segal Company

Schedule of Retired Members by Type of Benefit (Continued)

September 30, 2003

Amount Monthly Benefit	Number of Retirees	Selected Option **						
		Reg.	Opt. A	Opt. B	Opt. C	Opt. E	Opt. E1	Opt. E2
1 - 200	1,324	303	561	334	9	92	15	10
201 - 400	3,847	1,595	1,003	738	26	347	69	69
401 - 600	5,726	2,695	1,463	878	47	463	77	103
601 - 800	4,902	2,243	1,279	862	36	366	46	70
801 - 1,000	4,201	1,883	1,174	786	40	217	36	65
1,001 - 1,200	3,863	1,775	1,098	713	36	138	39	64
1,201 - 1,400	3,893	1,653	1,150	805	44	142	37	62
1,401 - 1,600	3,273	1,229	1,015	694	100	118	43	74
1,601 - 1,800	2,930	1,093	847	582	120	137	53	98
1,801 - 2,000	2,668	866	732	550	102	199	71	148
Over 2,000	8,864	2,786	2,218	1,708	528	816	279	529
Totals	45,491	18,121	12,540	8,650	1,088	3,035	765	1,292

**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

Source: The Segal Company

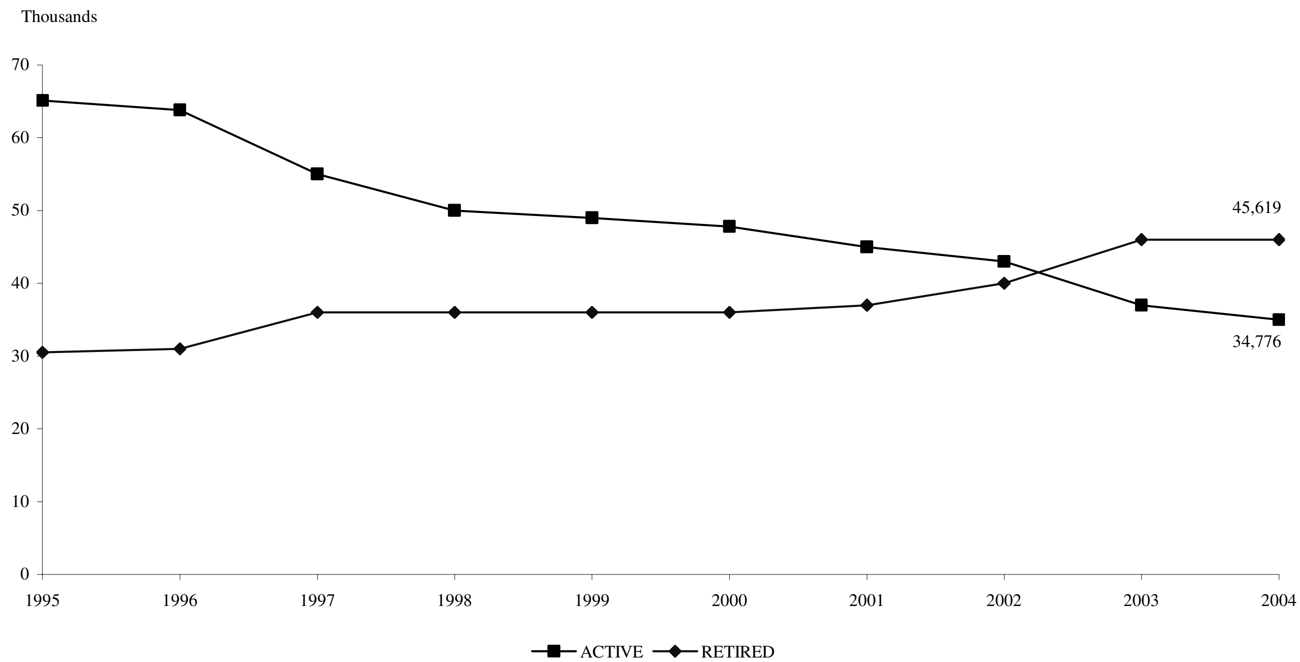
Schedule of Average Benefit Payments

Retirement Effective Dates	Years Credited Service							
	0-5	5-10	10-15	15-20	20-25	25-30	30+	Total
Period 10/1/97 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
Period 10/1/00 to 9/30/01								
Average Monthly Benefit	$ 663	$ 578	$ 474	$ 711	$ 970	$ 1,373	$ 1,653	$ 1,059
Average Final Average Salary	22,101	29,518	26,928	28,637	30,998	34,818	35,868	31,509
Number of Active Retirants	771	697	6,429	6,929	6,485	7,204	8,598	37,113
Period 10/1/01 to 9/30/02								
Average Monthly Benefit	$ 670	$ 542	$ 491	$ 733	$ 1,007	$ 1,460	$ 1,789	$ 1,149
Average Final Average Salary	18,504	31,089	27,935	29,554	32,211	36,772	38,742	33,313
Number of Active Retirants	827	626	6,505	6,962	6,710	7,985	10,051	39,666
Period 10/1/02 to 9/30/03								
Average Monthly Benefit	$ 731	$ 559	$ 510	$ 758	$ 1,074	$ 1,573	$ 1,990	$ 1,298
Average Final Average Salary	23,640	29,738	28,338	29,985	33,205	39,023	42,071	35,175
Number of Active Retirants	1,056	653	6,632	7,036	7,221	9,889	13,004	45,491

Source: The Segal Company

STATISTICAL SECTION

Ten Year History of Membership
Fiscal Year Ended September 30



Source: The Segal Company

ACKNOWLEDGMENTS

The *Michigan State Employees' Retirement System Comprehensive Annual Financial Report* is prepared by Financial Services, Fiscal Management Division. Staff of the division for the fiscal year 2003-2004 report included:

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The report may be viewed on-line at: www.michigan.gov/ors