

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT DISCUSSION AND ANALYSIS	3
AUDITED FINANCIAL STATEMENTS	
Statements of Net Assets Available for Benefits	6
Statements of Changes in Net Assets Available for Benefits	7
Notes to Financial Statements	8
REQUIRED SUPPLEMENTARY INFORMATION	
Schedule of Funding Progress and Employer Contributions	14
Notes to Supplementary Information	15

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of the
**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI**

We have audited the accompanying statements of net assets available for benefits of the **PUBLIC SCHOOL RETIREMENT SYSTEM OF THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI** (Retirement System), created by the General Assembly of the State of Missouri, as of December 31, 2002 and 2001, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Retirement System's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, information regarding the Retirement System's Plan net assets available for benefits as of December 31, 2002 and 2001, and the changes in net assets available for benefits for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary management discussion and analysis on pages 3 and 4 and the supplementary schedules of funding progress and employer contributions on page 15 are not a required part of the basic financial statements of the Public School Retirement System, but are 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 the supplemental information. However, such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KANSAS CITY
16 MAY 2003
OUR 32nd YEAR

Ralph C. Johnson & Company, P.C.

MANAGEMENT DISCUSSION AND ANALYSIS

REQUIRED SUPPLEMENTARY INFORMATION
Management Discussion and Analysis

Our discussion and analysis of the **PUBLIC SCHOOL RETIREMENT SYSTEM OF THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI** (Retirement System) financial performance provides an overview of the Retirement System's financial activities for the year ended December 31, 2002.

FINANCIAL STATEMENTS

Statement of Net Assets Available for Benefits

The statement of net assets available for benefits reports the Retirement System's assets, liabilities, and resultant net assets available at the end of the year (Assets - Liabilities = Net Assets). All assets and liabilities are recorded using the accrual basis of accounting. The assets are generally made up of cash, investments (at market value), and contributions receivable from participating employers and employees. The liabilities include unpaid and/or accrued expenses for the year. Overall, this statement shows the financial position of the Retirement System at the specified year end date.

Statement of Changes in Net Assets Available for Benefits

The statement of changes in net assets available for benefits reports the transactions of the Retirement System that occurred during the year. All of the current year's revenue and expenses are taken into account when preparing this statement. This statement not only shows that Additions - Deductions = Net Changes in net assets, but it supports the change that has occurred to the prior year's net asset value on the statement of Net Assets Available for Benefits.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements and include additional information (including this management discussion and analysis) not readily evident in the statements themselves. The required supplementary information and other schedules following the notes to the financial statements provide historical and additional information considered useful in evaluating the condition of the plan administered by the Retirement System.

COMPARATIVE STATEMENTS

The following are summary comparative statements of the Retirement System. For the purpose of this report, these comparative statements have been condensed to give its users a quick overview of the Retirement System's net assets and changes in them. You can think of the Retirement System's net assets as one way to measure the Retirement System's financial health. Over time, increases or decreases in the Retirement System's net assets are indicators of whether its financial health is improving or deteriorating.

Summary Comparative Statement of Net Assets Available for Benefits

	<u>As of December 31, 2002</u>	<u>As of December 31, 2001</u>	<u>Percentage Change</u>
Investments	\$ 574,101,891	\$ 652,799,218	(12.06)%
Receivables	5,505,395	6,053,946	(9.06)
Cash	1,244,893	5,368,082	(76.81)
Other	<u>36,823</u>	<u>14,596</u>	<u>152.28</u>
Total assets	<u>580,889,002</u>	<u>664,235,842</u>	<u>(12.55)</u>
Securities purchased	984,517	1,834,395	(46.33)
Accounts payable	728,145	548,258	32.81
Accrued expenses	<u>112,242</u>	<u>172,698</u>	<u>(35.01)</u>
Total liabilities	<u>1,824,904</u>	<u>2,555,351</u>	<u>(28.58)</u>
Net assets available for benefits	<u>\$ 579,064,098</u>	<u>\$ 661,680,491</u>	<u>(12.49)%</u>

Summary Comparative Statement of Changes in Net Assets Available for Benefits

	Year Ended December 31, 2002	Year Ended December 31, 2001	Percentage Change
Investment net income (loss)	\$ (62,696,947)	\$ (11,244,776)	457.57%
Securities lending income	30,601	26,338	16.19
Contributions	<u>26,892,669</u>	<u>25,017,150</u>	<u>7.50</u>
Total additions	<u>(35,773,677)</u>	<u>13,798,712</u>	<u>(359.25)</u>
Benefits paid	42,709,198	39,498,736	8.13
Refunds of contributions	2,899,463	3,691,837	(21.46)
Administrative expenses	<u>1,234,055</u>	<u>1,125,641</u>	<u>9.63</u>
Total deductions	<u>46,842,716</u>	<u>44,316,214</u>	<u>5.70</u>
Net increase (decrease)	(82,616,393)	(30,517,502)	170.72
Net assets available for benefits:			
Beginning of year	<u>661,680,491</u>	<u>692,197,993</u>	<u>(4.41)</u>
End of year	<u>\$ 579,064,098</u>	<u>\$ 661,680,491</u>	<u>(12.49)%</u>

For the year ending December 31, 2002, the funds of the Public School Retirement System took a major decrease with an overall downturn in the investment markets. The 2002 decrease in investments totaled \$78,697,327 compared to the \$34,072,042 decrease in 2001.

AUDITED FINANCIAL STATEMENTS

**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS
FOR THE YEARS ENDED DECEMBER 31**

	2002	2001
ASSETS		
INVESTMENTS, AT FAIR VALUE:		
Money Market Investments	\$ 28,159,498	\$ 36,609,142
Government bonds	302,228,926	55,603,666
Corporate bonds	1,044,700	92,277,413
Convertible bonds	822,899	701,250
Non convertible bonds	100,070,046	1,563,156
Global bonds	49,587,805	32,932,683
Other bonds	10,693,822	11,163,047
Common stocks	41,855,906	382,515,451
Pooled real estate funds	39,638,289	39,433,410
	574,101,891	652,799,218
RECEIVABLES:		
Contributions	1,186,465	346,529
Securities sold	632,260	2,122,699
Accrued interest and dividends	3,686,670	3,584,718
	5,505,395	6,053,946
Cash	1,244,893	5,368,082
Other assets	36,823	14,596
	1,281,716	5,382,678
TOTAL ASSETS	580,889,002	664,235,842
LIABILITIES		
Due to broker for securities purchased	984,517	1,834,395
Accounts payable	728,145	548,258
Accrued expenses	112,242	172,698
	1,824,904	2,555,351
NET ASSETS AVAILABLE FOR BENEFITS	\$ 579,064,098	\$ 661,680,491

See Independent Auditors' report and notes to financial statements.

**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
FOR THE YEARS ENDED DECEMBER 31**

	2002	2001
ADDITIONS TO NET ASSETS		
Investment Income:		
Net (depreciation) appreciation in fair value of investments	\$ (78,445,970)	\$ (27,915,847)
Interest	16,861,195	17,609,391
Dividends	1,364,779	1,788,169
Securities lending income	30,601	26,338
	(60,189,395)	(8,491,949)
Less: investment expense	2,476,951	2,726,489
	(62,666,346)	(11,218,438)
Contributions:		
Employers	13,514,997	12,176,329
Employees	13,377,672	12,840,821
	26,892,669	25,017,150
 TOTAL ADDITIONS TO NET ASSETS	 (35,773,677)	 13,798,712
DEDUCTIONS FROM NET ASSETS		
Benefits paid directly to participants	42,709,198	39,498,736
Refunds of contributions	2,899,463	3,691,837
Administrative expenses	1,234,055	1,125,641
	46,842,716	44,316,214
 TOTAL DEDUCTIONS FROM NET ASSETS	 46,842,716	 44,316,214
 NET (DECREASE) INCREASE	 (82,616,393)	 (30,517,502)
NET ASSETS AVAILABLE FOR BENEFITS		
Beginning of year	661,680,491	692,197,993
End of Year	\$ 579,064,098	\$ 661,680,491

See Independent Auditors' report and notes to financial statements.

**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI
NOTES TO FINANCIAL STATEMENTS
December 31, 2002**

1. **DESCRIPTION OF PLAN**

The following description of the **PUBLIC SCHOOL RETIREMENT SYSTEM OF THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI** (Retirement System) pension plan is provided for general informational purposes only. Member's of the Retirement System should refer to chapter 169 of the Revised Statutes of the State of Missouri for complete information.

(A) General

The Retirement System is a cost sharing multi-employer defined benefit pension plan (Plan) established by the General Assembly of the State of Missouri and is exempt from the provisions of the Employee Retirement Income Security Act of 1974. The Board of Trustees of the Retirement System administer and operate the Plan in accordance with the statutes of the State of Missouri. At December 31, 2002, participating employers consisted of the School District of Kansas City, Missouri; the Kansas City, Missouri Public Library District; the Retirement System; and eighteen charter schools.

(B) Eligibility

All eligible employees of the participating employers become members as a condition of employment. Employees hired after 1961 are members of Plan B. At January 1, 2002, the Retirement System's Membership consisted of:

Active Members	5,014
Retired Members and Beneficiaries	2,863
Inactive Members	<u>1,512</u>
	<u>9,389</u>

Inactive members include former members entitled to a refund of contributions.

(C) Service

Creditable service is membership service. This is service for which required contributions have been made. For members of Plan A, creditable service is limited to 40 years. Currently there is not a limit on creditable service for members of Plan B, however, prior to 1990, creditable service could not exceed 35 years.

(D) Compensation

Annual Compensation. For members of Plan A, annual compensation is limited to \$3,000. There is not a limitation on annual compensation for years after 1988 for members of Plan B. However, for years prior to 1989, members of Plan B annual compensation are limited to the scheduled compensation for a school principal with a master's degree. A member's annual compensation is the member's regular compensation.

Average Final Compensation. For members of Plan A, the average final compensation is the average annual compensation paid in the five years of creditable service when a member's compensation is greatest, subject to a maximum of \$3,000. For members of Plan B, the average final compensation is the highest average compensation paid during any four consecutive years of creditable service.

(E) Normal Retirement

Eligibility. A member of Plan A may retire after the completion of five years of creditable service provided such member has attained the age of 62. A member of Plan B may retire after, (a) the completion of five years of creditable service provided such member has attained the age of 60 or (b) accumulating a minimum of 75 credits (effective August 28, 1998), where each year of creditable service and each year of a member's age equal one credit.

Benefit. For a member of Plan A, the normal monthly retirement benefit equals the product of one twelfth of 1.25% of such member's average final compensation and their years of creditable service. For a member of Plan B, the normal monthly retirement benefit equals the product of one twelfth of 2.00% (1.75% for members who retired prior to June 30, 1999) of such member's average final compensation and their years of creditable service, subject to a maximum of 60% of their average final compensation. The normal monthly retirement benefit for a member of Plan B whose years of creditable service exceeded 34.25 years on August 28, 1993 shall equal the product of 1.75% and such member's years of creditable service on August 28, 1993.

Minimum Benefit. Effective January 1, 1996, any member with at least 20 years of creditable service at retirement is entitled to a minimum monthly retirement benefit of \$300 or the actuarial equivalent of \$300 if an option was elected. Any member with at least 10 years of creditable service, but less than 20 years, is entitled to a minimum monthly retirement benefit equal to the sum of \$150 and \$15 for each full year of creditable service in excess of ten years or the actuarial equivalent if an option was elected. Beneficiaries of deceased members who retired with at least ten years of creditable service and elected one of the optional plans for payment of benefits may receive the actuarial equivalent of the minimum monthly retirement benefit available for the option chosen.

Under either plan, if a member's accumulated contributions provide more than one-half of the member's monthly retirement benefit (under the actuarial assumptions adopted by the Board of Trustees), the member's benefit will be increased by this excess.

(F) Early Retirement

Eligibility. A member with five years of creditable service and a minimum age of 55 is eligible for early retirement, or a member with at least 30 years of creditable service may retire at any time regardless of age.

Benefit. A member eligible for early retirement will receive a reduced benefit, calculated as for normal retirement, which recognizes service and compensation to actual retirement date. The reduction in benefit will provide a benefit which is actuarially equivalent to the normal retirement benefit that would be payable at the member's normal retirement date.

(G) Disability Retirement

Eligibility. A member with a least five years of creditable service who is certified to be totally incapacitated for performance of duty by the Medical Board (as designated by the Board of Trustees) is eligible for disability retirement.

Benefit. A disabled member will receive an unreduced benefit, calculated as for normal retirement, based on service and average final compensation at actual retirement date. The minimum disability retirement allowance shall be lesser of :

- (1) Twenty-five percent of the person's average compensation; or
- (2) The members's service retirement allowance calculated based on the member's final average compensation and the maximum number of years of creditable service the member would have earned had the member remained an employee until attaining the age of sixty.

(H) Termination Benefits - Vested

Eligibility. A member who has at least five years of creditable service, earns a vested interest in their accrued benefit, provided the member leaves their contributions in the Plan.

Benefit. The vested benefit is calculated as a normal retirement benefit based on a member's creditable service and average final compensation on the termination date. The benefit is payable at minimum on the member's normal retirement date.

(I) Termination Benefits - Nonvested

If the member's termination is for reasons other than death or retirement and if the member has not met the vesting or retirement requirements, only the member's contributions with interest will be refunded.

(J) Death Benefit

Prior to Retirement. For a member who pass away while actively employed, the member's accumulated contributions with interest will be paid to the member's beneficiary. The beneficiary of a member of Plan B has the option to receive a monthly retirement benefit or a refund of the member's contributions with interest. The beneficiary is guaranteed to receive at least the member's accumulated contributions at retirement, if a member pass away before electing an option.

Post Retirement. The optional form of benefit payment selected under either Plan A or Plan B will determine what, if any, benefits are payable upon death after retirement.

Option 1. The retiree's beneficiary will receive for life, the same level of monthly retirement benefit. In the event the retiree's beneficiary predeceases the retiree, the retiree's monthly retirement benefit will be adjusted to the amount it would have been, had the retiree not elected option 1.

Option 2. The retiree's beneficiary will receive for life, a monthly retirement benefit equal to one-half of the retiree's benefit. In the event the retiree's beneficiary predeceases the retiree, the retiree's monthly retirement benefit will be adjusted to the amount it would have been, had the retiree not elected option 2.

Option 3. No benefits are payable to the retiree's estate or any beneficiary. Retirement benefits payable under this option will be actuarially increased from the normal formula.

If the death of any retiree who has not elected an option occurs before they have received total benefits at least as large as their accumulated contributions, the difference shall be paid to the deceased beneficiary, if living, or to their estate.

(K) Cost-of-Living Allowances

The Board of Trustees shall determine annually whether or not the system can provide an increase in benefits for those retirees who, as of January 1 preceding the date of such increase, have been retired at least one (1) year (3 years prior to January 1, 2002). Any increase also applies to optional retirement allowances paid to a retiree's beneficiary. Before any increase are made, the following requirements must be satisfied:

- (a) The System's funded ratio as of January 1st of the year preceding the year of the proposed increase must be at least 100% after adjusting for the effect of proposed increase. The funded ratio is the ratio of assets to the pension benefit obligation.
- (b) The actuarially required contribution rate, after adjusting for the effect of the proposed increase, may not exceed the statutory contribution rate.
- (c) The actuary must certify that the proposed increase will not impair the actuarial soundness of the Retirement System.

In accordance with the Cost-of-Living Adjustment (COLA) Policy, if an increase is permissible, the amount of the increase will be equal to the lesser of 3% or the percentage increase in the

CPI for the preceding year, subject to a cumulative increase of 100% subsequent to December 31, 2000.

The Board of Trustees reserves the right, at its sole discretion, not to award any COLA increases or other supplements for any year even if the statutory requirements for an increase are satisfied, or to provide increases in greater or lesser amounts than prescribed by this policy.

(L) Administration of the Retirement System

The Board of Trustees is responsible for the general administration and proper operation of the Retirement System. The Board consists of 12 members - four members appointed by the Board of Education, one member appointed by the Board of Trustees of the Library District, four members elected by and from the members of the Retirement System, two members elected by and from the retirees of the Retirement System, and the Superintendent of Schools of the School District of Kansas City, Missouri.

(M) Contributions

Employee. Members of Plan A contribute 5% of annual compensation up to \$3,000, for a maximum annual contribution of \$150. For years beginning after 1989, members of Plan B contribute 5.9% of annual compensation. Effective January 1, 1999, members of Plan B contribute an additional 1.6%, for a total of 7.5%. For years beginning before 1990 they would contribute 5% of annual compensation plus an additional 2% of annual compensation in excess of \$6,500.

Employer. Participating employers contributed 1.99% of annual compensation beginning July 1, 1993, 3.99% of annual compensation beginning July 1, 1995, 5.99% of annual compensation beginning July 1, 1996, and 7.50% of annual compensation beginning January 1, 1999. Prior to July 1, 1993, employer contributions were actuarially determined.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

(A) Basis of Accounting

The financial statements for the Plan are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

(B) Investments

Investments are stated at market value based on quoted market prices. The net unrealized appreciation or depreciation in market value of investments for the period reflects the net increase or decrease in the market value of investments, on an aggregate basis, between the beginning and the end of the reporting period. The net realized gain or loss on sale of investments is the difference between the proceeds received and the cost of the investment sold. The net realized gains and losses have been combined with the net unrealized appreciation and depreciation for purposes of this report.

Pooled real estate funds consist of funds invested in income producing real estate. These pooled real estate funds are valued at current value based on information received from the sponsor. The value of underlying real estate is generally determined by independent appraisal. Such value may differ from a price at which the real estate could be sold because market prices are negotiated by willing buyers and sellers. The Retirement Systems has no plans to liquidate these investments.

Investments are categorized, in accordance with Governmental Accounting Standards Board Statement Number 3, to give an indication of the level of risk as of December 31, 2002. Category 1 includes investments that are insured or registered, or securities held by the Retirement System or its agent in the Retirement System's name. Category 2 includes

uninsured and unregistered investments or securities held by a broker's or dealer's trust department or agent in the Retirement System's name. Category 3 includes uninsured and unregistered investments which are held by the broker or dealer or by its trust department or agent, but not in the Retirement System's name.

All of the Retirement System's investments subject to categorization are category 1 investments.

(C) Securities Lending Program

The board of trustees entered into a securities lending agreement and guarantee with BNY Midwest Trust Company (bank) under which certain securities which are owned by the Retirement System are loaned to brokers (borrowers) which participate in the bank's securities lending program. The borrower shall provide collateral in the form of government securities, letters of credit and/or cash in an amount equal to 102% of the then current market value of loaned securities which are the subject of loans as of the close of trading on the preceding business day. On December 31, 2002 securities with a total market value of \$74,612,403 were on loan to participating brokers. Collateral in support of these loaned securities had a total adjusted market value of \$76,690,8530 or 102.79% of the market value of the loaned securities

(D) Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

3. FUNDING POLICY

As a condition of participation, employees are required to contribute 7.5% of their salary to the Plan. The Plan's funding policy is to make annual contributions to the Plan in amounts that are estimated to remain a constant percentage of employees' compensation each year, such that, when combined with employees' contributions, all employees benefits will be fully provided for by the time they retire.

4. INCOME TAX STATUS

The Retirement System is exempt from federal income tax under Section 501 of the Internal Revenue Code.

REQUIRED SUPPLEMENTARY INFORMATION

**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI
REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2002**

SCHEDULES OF FUNDING PROGRESS

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (A)</u>	<u>Actuarial Accrued Liability (B)</u>	<u>Unfunded Actuarial Accrued Liability (UAAL) (B-A)</u>	<u>Funded Ratio (A/B)</u>	<u>Covered Payroll (C)</u>	<u>UAAL as a Percentage of Covered Payroll (B-A)/(C)</u>
1/1/1997	428,419,710	429,517,108	1,097,398	99.74%	161,802,480	0.68%
1/1/1998	482,599,919	442,614,693	(39,985,226)	109.03%	168,328,728	-23.75%
1/1/1999	624,225,667	564,056,509	(60,169,158)	110.67%	153,733,920	-39.14%
1/1/2000	660,830,255	640,614,688	(20,215,567)	103.16%	151,091,616	-13.38%
1/1/2001	696,071,310	682,531,577	(13,539,733)	101.98%	165,795,367	-8.17%
1/1/2002	718,703,692	701,725,938	(16,977,754)	102.42%	171,523,233	-9.90%

SCHEDULES OF EMPLOYERS' CONTRIBUTIONS

<u>Year Ended 12/31</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1997	7,055,431	121.0%
1998	5,999,525	166.6%
1999	5,249,589	189.6%
2000	9,309,354	154.3%
2001	10,996,382	110.7%
2002	12,133,966	111.4%

**PUBLIC SCHOOL RETIREMENT SYSTEM OF
THE SCHOOL DISTRICT OF KANSAS CITY, MISSOURI
NOTES TO SUPPLEMENTARY INFORMATION
DECEMBER 31, 2002**

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	January 1, 2002
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level dollar, open amortization period
Remaining Amortization	Period 30 years
Asset Valuation Method	Assumed yield method (See section 3 of Actuarial report)
Actuarial Assumptions:	
Investment Rate of Return*	8.00%
Projected Salary Increases*	Age related rates, ranging from 9.0% at age 20 down to 5.0% at ages 60 and above.

* Includes inflation