

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2003



AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

FISCAL YEAR 2003

FINANCIAL AND STATISTICAL HIGHLIGHTS – ALL PENSION TRUST FUNDS

(Dollars in Thousands)

| | 2003 | 2002 | % Change |
|---|---------------|----------------|----------|
| For the Year | | | |
| Contributions | \$ 1,041,835 | \$ 1,044,458 | -0.3% |
| Investment Income (Net of investment expenses) | \$ 969,638 | \$ (2,752,870) | 135.2% |
| Retirement Benefits | \$ 1,597,735 | \$ 1,437,791 | 11.1% |
| Refunds | \$ 72,150 | \$ 73,451 | -1.8% |
| Administrative Expenses (Net of misc. income) | \$ 16,670 | \$ 15,385 | 8.4% |
| Increase in Net Assets Held in Trust for Pension Benefits | \$ 324,918 | \$ (3,237,488) | 110.0% |
| Retirement Benefits as a percentage of contributions | 153.4% | 137.7% | |
| Retirement Benefits as a percentage of contributions and investment income | 125.9% | 118.8% | |
| At Fiscal Year End | | | |
| Net Assets Held in Trust for Pension Benefits - VRS | \$ 32,726,882 | \$ 32,448,309 | 0.9% |
| Net Assets Held in Trust for Pension Benefits - SPORS | \$ 423,814 | \$ 423,242 | 0.1% |
| Net Assets Held in Trust for Pension Benefits - VaLORS | \$ 394,779 | \$ 350,064 | 12.8% |
| Net Assets Held in Trust for Pension Benefits - JRS | \$ 235,272 | \$ 234,214 | 0.5% |
| Investment Performance | | | |
| One-Year Return on Investments | 2.50% | -7.3% | |
| Three-Year Return on Investments | -4.20% | -0.3% | |
| Five-Year Return on Investments | 2.60% | 5.6% | |
| Participating Employers | | | |
| Counties/Cities/Towns | 241 | 239 | |
| Special Authorities | 172 | 166 | |
| School Boards | 145 | 145 | |
| State Agencies | 240 | 238 | |
| Total Employers | <u>798</u> | <u>788</u> | 1.3% |
| Membership/Retirees | | | |
| Active Members | 311,811 | 310,214 | 0.5% |
| Retired Members | 108,758 | 103,622 | 5.0% |

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2003



AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

This report was prepared by VRS
Finance and Administrative Staff,
except for the Investment Section,
which was prepared by the VRS
Investment Department.

ABOUT THE THEME:

Commonwealth of Virginia public employees are a diverse group of more than 300,000 individuals who are dedicated to enforcing public safety, improving transportation, protecting the environment, providing education, and delivering essential personal services to the citizens of Virginia. Some work in traditional offices; others work on highways and perform their jobs in non-traditional settings. Whether they work for state agencies, school boards or political subdivisions, they demonstrate their dedication to their jobs every day. The 2003 Comprehensive Annual Financial Report highlights just a few of these public sector employees and the important services they perform.

TABLE OF CONTENTS

Introductory Section

| | |
|---|----|
| Chairman's Letter | 9 |
| VRS Board of Trustees | 10 |
| VRS Investment Advisory Committee | 11 |
| VRS Executive Committee | 12 |
| Professional Consultants | 12 |
| Letter of Transmittal | 13 |

Financial Section

| | |
|--|----|
| Independent Auditor's Report | 21 |
| Management's Discussion and Analysis | 22 |

Basic Financial Statements

| | |
|---|----|
| Statement of Plan Net Assets | 28 |
| Statement of Changes in Plan Net Assets | 30 |
| Notes to Financial Statements | 32 |

Required Supplementary Information

| | |
|--|----|
| Required Supplemental Schedule of Funding Progress | 46 |
| Required Supplemental Schedule of Employer Contributions | 47 |
| Notes to Required Supplemental Schedules | 48 |

Additional Financial Information

| | |
|--|----|
| Statement of Changes in Assets and Liabilities – Agency Fund | 49 |
| Schedule of Administrative Expenses | 50 |
| Schedule of Investment Expenses | 51 |
| Schedule of Professional and Consulting Services | 51 |

Investment Section

| | |
|---|----|
| Chief Investment Officer's Letter | 55 |
| Investment Account | 56 |
| Investment Results | 57 |
| Investment Performance Summary | 57 |
| Investment Summary | 58 |
| U.S. Equity | 59 |
| Non-U.S. Equity | 59 |
| Fixed Income | 60 |
| Short-Term Investments | 61 |
| Alternative Investments | 61 |
| Private Equity | 61 |
| Real Estate | 62 |
| VRS Money Managers | 63 |
| Top 25 VRS Brokers by Commissions | 65 |

Actuarial Section

| | |
|--|----|
| Actuary's Certification Letter | 68 |
| Solvency Test | 70 |
| Schedule of Active Member Valuation Data | 71 |
| Schedule of Retirants and Beneficiaries | 72 |
| Summary of Actuarial Assumptions and Methods | 73 |
| Summary of Benefit Plan Provisions | 79 |
| Summary of Plan Changes | 84 |

TABLE OF CONTENTS

Statistical Section

Pension Trust Funds

| | |
|--|----|
| Analysis of Changes and Growth in Plan Net Assets | 86 |
| Pension Trust Funds Additions Versus Deductions | 86 |
| Number of Active Members | 87 |
| Schedule of Retirement Contributions by System | 87 |
| Pension Trust Funds Additions by Source | 88 |
| Number of Retired Members | 89 |
| Retirement Benefits Paid | 89 |
| Pension Trust Funds Deductions by Type | 90 |
| Schedule of Retirement Benefits by System | 91 |
| Schedule of Retirement Benefits by Type | 91 |
| Schedule of Refunds by Type | 91 |
| Schedule of Retired Members by Type of Benefit and Option Selected | 92 |
| Schedule of Average Benefit Payments | 92 |
| Distribution of Retirees by Payment Option Selected | 93 |
| Distribution of Retirees by Years of Service | 93 |
| Distribution of Retirees by Age at Retirement | 94 |
| Distribution of Retirees by Average Final Salary | 94 |

Other Employee Benefit Trust Funds

| | |
|--|----|
| Schedule of Group Insurance Additions by Source | 95 |
| Schedule of Group Insurance Claims by Type | 95 |
| Schedule of Retiree Health Insurance Credit Additions and Reimbursements | 95 |

Participating Employers List 96

Program with Oversight by VRS

Deferred Compensation Plan of the Commonwealth of Virginia

| | |
|---|-----|
| Statement of Changes in Plan Assets | 99 |
| Operational Overview | 99 |
| Deferred Compensation Program Assets | 100 |
| Contributions to the Deferred Compensation Plan | 100 |
| Distributions from the Deferred Compensation Plan | 100 |
| New Enrollments in the Deferred Compensation Plan | 101 |
| Active and Inactive Deferred Compensation Plan Participants | 101 |
| Total Participant Accounts in Each Fund Option | 101 |
| Plan Assets | 102 |
| Annuity Plan Assets | 102 |
| Accumulation Plan Assets | 102 |
| Description of Funds | 103 |
| Investment Option Performance Summary | 105 |

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Virginia Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

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



A handwritten signature in black ink, appearing to read "William Patrick Wertz".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director



Alfonso I. Samper, Chairman
W. Forrest Matthews, Jr., Director
Nancy C. Everett, Chief Investment Officer

P.O. Box 2500, Richmond, Virginia 23218-2500
1200 East Main Street, Richmond, Virginia 23219
Telephone: (804) 649-8059 TDD: (804) 344-3190

November 10, 2003

The Honorable Mark R. Warner
Governor of Virginia
Members of the General Assembly

The economic slowdown of the past several years appears to be easing, and the Virginia Retirement System (VRS) is beginning to see some positive effects. The fund posted a positive 2.5 percent return for the 2003 fiscal year, ending the year at \$34.6 billion. The majority of the positive annual return came from the system's fixed income portfolio, which returned 10.4 percent and the real estate program, which posted a 7.4 percent return.

The best news is that through these difficult economic times, VRS has remained one of the most well funded systems in the nation. And while we must keep a watchful eye on growing liabilities, I am confident that by working together we will be able to fulfill our commitment to the system's beneficiaries, while continuing to enjoy this status among our peers.

As I advised in last year's Letter of Transmittal, the Board established the Corporate Governance Task Force, which completed its work earlier this year. Although the task force found existing VRS practices and procedures related to corporate governance to be comprehensive, it recommended the agency formalize some of its processes and facilitate the monitoring of governance-related activities by the Board. Among the recommendations of the task force were: developing formal proxy voting guidelines; reviewing on an annual basis the VRS Board proxy voting practices; participating in an institutional-investor organization; working with the Virginia Office of the Attorney General to review and evaluate potential securities litigation; and enlisting the services of a third-party monitoring service to look for potential litigation opportunities. Many of the task force recommendations already have been implemented.

One of the Board's responsibilities is to ensure that the system delivers on its promise to the beneficiaries in a manner that is timely, efficient and convenient. VRS projections indicate that there will be a 5 to 5.5 percent increase in the number of retirees receiving benefits each year through 2010. To meet these future demands and to position the agency to deal with these increases, VRS is undertaking initiatives now to meet future customer service needs. The agency is investing in technological improvements and placing more information on the VRS Web site so members, employers and retirees have direct access to information. Also, the agency is documenting processes and examining ways to streamline operations.

In closing, I would like to express my gratitude to the VRS Board of Trustees for their guidance and support, and to the VRS staff for their dedication and hard work. Also, I wish to thank Governor Warner and the members of the General Assembly for their continued support and leadership.

A handwritten signature in cursive script, appearing to read 'Alfonso I. Samper', written in dark ink.

Alfonso I. Samper
Chairman
Virginia Retirement System

VRS BOARD OF TRUSTEES

Nine members serve on the VRS Board of Trustees. The appointment of board members is shared between the executive and legislative branches of the state government. Five, including the chairman, are appointed by the governor, and four are appointed by the Joint Rules Committee of the General Assembly. All nine members are confirmed by the General Assembly.

Of the nine board members, four must be investment experts; one must be experienced in employee benefit plans; one must be a local government employee; one must be an employee of a state-supported institution of higher education; one must be a state employee and one must be a public school teacher. The public employee members of the board may be either active or retired.



Alfonso I. Samper
Chairman,
Wachovia Securities



Charles B. Walker
Vice Chairman,
Albemarle Corporation



John M. Albertine, Ph.D.
Albertine Enterprises



Robert C. Carlson
Carlson Wealth Advisory, LLC
and Center for Retirement
Security, Inc.



J. Douglas Conway, Jr.
County of Henrico
Division of Fire



W. Mark Crain, Ph.D.
George Mason University



Vernard W. Henley
Retired,
Consolidated Bank

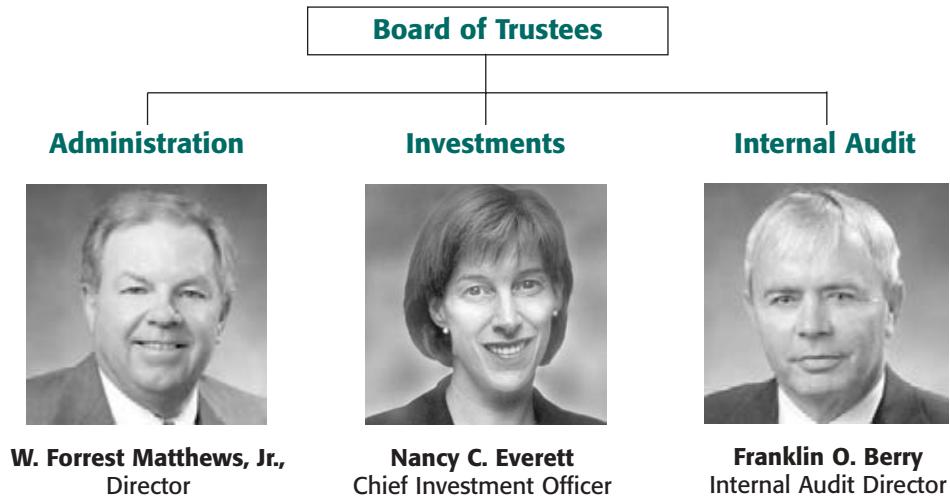


Paul W. Timmreck
Virginia Commonwealth
University



Raymond B. Wallace, Jr.
Retired Teacher,
Henrico County Public
Schools

VRS ORGANIZATION



VRS INVESTMENT ADVISORY COMMITTEE



Back Row (left to right)

Alice W. Handy
University of Virginia
Investment Management Co.

Joseph W. Montgomery
Wachovia Securities

Doyle E. Hull
Retired,
Sovran Financial Corporation

Deborah Allen-Hewitt, Ph.D.
Rutledge Research

Stuart A. Sachs
Retired,
Sovran Capital Management

Front Row (left to right)

Joe Grills
Retired,
IBM Retirement Funds

**Raymond D. Smoot, Jr., Ph.D.,
Chairman**
Virginia Polytechnic Institute and
State University

Katrina F. Sherrerd, Ph.D.
Association for Investment Management
and Research

Not Pictured:
Charles B. Walker,
Vice Chairman
Albemarle Corporation

VRS EXECUTIVE COMMITTEE



Back row (left to right)

Virginia L. Bomar
Chief Customer Programs Officer

Wallace G. Harris
Senior Deputy Director

James R. Templeton
Strategy and Innovation Director

Barry C. Faison
Chief Financial Officer

Franklin O. Berry
Internal Audit Director

Deardrian Scott
Chief Customer Support Officer

Jeanne Chenault
Public Relations Director

Front Row (left to right)

J. Timothy Bass
Chief Technology Officer

Donna M. Shumate
Chief Human Resource Officer

Donna M. Blatecky
Deputy Director for Customer Relationships

W. Forrest Matthews, Jr.
Director

Margaret Hughson
Administrative Staff Assistant

PROFESSIONAL CONSULTANTS

Actuary:
W. Michael Carter
Gabriel, Roeder, Smith & Company

Auditor of Public Accounts:
Walter J. Kucharski
Commonwealth of Virginia

Life Insurance Carrier:
Joseph K. W. Chang
Minnesota Life Insurance Company

Master Custodian:
Mellon Trust

Legal Counsel:
Stephanie L. Hamlett
Office of the Attorney General

Virginia Sickness and Disability Program:
Lauren Biscotti
CORE, Inc.



W. Forrest Matthews, Jr.,
Director

1200 East Main Street, P.O. Box 2500, Richmond, Virginia 23219
Telephone: (804) 649-8059 TDD: (804) 344-3190

LETTER OF TRANSMITTAL

November 7, 2003

To: Members of the Board of Trustees

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the Virginia Retirement System (System) for the fiscal year ended June 30, 2003. This report has been prepared in accordance with Section 51.1-1003, Code of Virginia, (1950), as amended, which requires every retirement system to publish an annual report in accordance with Section 4-9.00 of Chapter 1042 of the 2003 Virginia Acts of Assembly, Commonwealth of Virginia. The reporting entity consists of four pension plans administered by the System: the Virginia Retirement System (VRS), the State Police Officers' Retirement System (SPORS), the Virginia Law Officers' Retirement System (VaLORS) and the Judicial Retirement System (JRS); two post-employment benefit programs: the Group Life Insurance and Retiree Health Insurance Credit Programs; and the Virginia Sickness and Disability Program (VSDP).

The System was established on March 1, 1952 to administer a statewide multiple-employer public employee retirement system providing defined benefit pension plan coverage for state employees, teachers and nonprofessional employees of public school boards, and employees of participating political subdivisions. The System also administers separate retirement systems for state police officers, other state law enforcement and correctional officers, and judges, which were established on July 1, 1950, October 1, 2000, and July 1, 1970, respectively. There were 240 state agencies, 145 local school boards and 413 political subdivisions participating in the retirement systems at June 30, 2003. In addition, 131 public school boards include their nonprofessional employees in the System.

The System also administers a group life insurance program, providing active and postemployment insurance coverage for employees participating in the retirement systems as well as other qualifying employees. The group life insurance program was established on July 1, 1960. An optional life insurance program providing additional optional coverage for employees

participating in the group life insurance program and their families was established on November 1, 1995. A health insurance credit program was established on January 1, 1990 for eligible state retirees, and a similar program was established for retired teachers and employees of participating political subdivisions on July 1, 1993. On January 1, 1999 the System began administering a new sickness and disability program for participating state employees. A long-term benefit for state employees covered under the sickness and disability program became effective on March 1, 2002.

The CAFR for FY-2003 consists of five sections:

- An **Introductory Section** which contains a letter from the Chairman of the Board of Trustees, the letter of transmittal, and the identification of the organization;
- A **Financial Section** which contains the opinion of the Auditor of Public Accounts, management's discussion and analysis, the financial statements, and required supplementary data;
- An **Investment Section** which contains a review of investment activity and performance for the fiscal year;
- An **Actuarial Section** which contains the certification letter of the independent consulting actuary, Gabriel, Roeder, Smith & Company, as well as a summary of the results of the most recent actuarial valuations and a plan summary;
- A **Statistical Section** which contains tables of significant data pertaining to the System, a listing of participating employers, and information on other programs.

Accounting System and Internal Control

The financial statements included in the CAFR for FY 2003 are the responsibility of System's management and have been prepared in accordance with generally accepted accounting principles (GAAP) for governmental accounting and reporting

as pronounced or adopted by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

The accrual basis of accounting is used in the preparation of the financial statements. Revenues are taken into account when they are earned and become measurable, and expenses are recorded when the liabilities are incurred. Investments are reported at fair value, as determined by the System's master custodian. Capital assets are recorded at cost and depreciated over their estimated useful life. Contributions to the retirement systems are based on the principle of level cost funding and are developed using the entry age normal cost method with current service financed on a current basis and prior service amortized within a period of 30 years or less. In management's opinion, the financial statements fairly present the plan net assets of the System at June 30, 2003, and the changes in its plan net assets for the period then ended.

GASB Statement Number 34 requires the System to include additional information in the CAFR. This additional information is provided in the Management's Discussion and Analysis (MD&A) and includes a narrative introduction, overview, and analysis of the System's financial activities for the current fiscal year and the two preceding years. The letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditor in the Financial Section.

The System's management is also responsible for maintaining a system of 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 generally accepted accounting principles. The internal control system includes the organization plan, the appropriate segregation of duties and responsibilities, and sound practices in the performance of duties and personnel with capabilities commensurate with their responsibilities. There is an internal audit program that reports to the Audit Committee of the Board of Trustees, and the budget for the System's administrative expenses is approved by the Board and appropriated by the General Assembly of Virginia. In addition, the retirement funds held by the System are constitutionally established as independent trust funds dedicated to the exclusive benefit of its members, retirees, and beneficiaries. We believe the internal controls in effect during the fiscal year ended June 30, 2003 adequately

safeguard the System's assets and provide reasonable assurance regarding the proper recording of financial transactions.

Legislative Initiatives

The 2003 General Assembly initiated a variety of bills that enhance and strengthen the benefits for Virginia's public employees and retirees.

Administrative Changes

House Bill 1717 conforms the Virginia Retirement Act to federal law. The change allows members who take military leave and return to their covered positions beyond the cessation of hostilities to receive credit for their service.

House Bill 2122 allows school superintendents with five years of VRS service to purchase an additional 10 years of out of state service. The superintendent must be ineligible for an out-of-state benefit. The cost to purchase the service is 10 percent if purchased within one year of becoming eligible to purchase. If purchased after the first year of becoming eligible the cost moves to actuarial equivalent cost. The employer may purchase the service for the superintendent. If, after purchasing the service, the superintendent does not remain in employment for a period equal to the service purchased, the remaining service purchased is removed from the record and the contributions are refunded.

A new retirement option was created with the passage of **House Bill 2487**. This bill provides members with a temporarily increased retirement benefit. Members who retire from service on or after July 1, 2003 and who have not attained normal retirement age under the Social Security Act may elect to receive an increased retirement allowance based on their estimated Social Security benefit. This temporarily increased benefit begins on the effective date of retirement and continues to the age specified by the member for the benefit to reduce. The age specified by the member must be at least age 62, but no later than the retiree's normal retirement age under the Social Security Act. The legislation prohibits a benefit to decrease more than 50 percent of the member's basic benefit at the time the member attains the age chosen for the benefit to decrease. Cost-of-living allowance increases after retirement is calculated on the basic benefit amount. A member retiring under 50/10 is ineligible to elect this option. These payments cannot be rolled over to another qualified plan or IRA.

House Bill 2620 removes the current cap of \$120 on the monthly health premium credit for state employees. *This bill will not become effective unless it is reenacted by the 2004 General Assembly.*

Life Insurance Changes

This session made changes to the eligibility for post retirement life insurance. Currently, a member must have five consecutive years of coverage to be eligible for post retirement life insurance. **House Bill 1791** retains the requirement of five years of coverage; however, the five years do not have to be continuous.

Senate Bill 905 changes the basis for determining the amount of life insurance coverage in retirement from the final salary paid to an employee to the highest salary paid. The legislation also affects the amount of life insurance coverage for retirees who return to covered employment. The amount of life insurance will be based on the higher of the amount the individual was receiving in retirement or the amount the individual is eligible for based on the salary of the current position. An individual must have retired with 25 years or more of service and after July 1, 1999 to be eligible for the higher benefit.

Virginia Sickness and Disability Program (VSDP)

House Bill 1622 codifies the policy of the VRS Board of Trustees that military disability payments that are part of a regular military retirement benefit do not offset VSDP long-term disability payments.

Optional Retirement Plans and Defined Contribution Plans Changes

Senate Bill 849 allows colleges and universities to establish local optional retirement plans (ORPs) for faculty and provides that they are not required to cover eligible employees under the ORP administered by the VRS. Local ORPs must adhere to guidelines established by the VRS.

Working After Retirement

Senate Bill 812 allows retired state police officers who are at least 60 years of age to return to work without forfeiting their retirement benefit. If approved by the Internal Revenue Service, officers who have attained the age of 55 also will be allowed to return to work. Officers may return to work for a period of one year which may be extended for one additional year by the Secretary of Public Safety.

Under **House Bill 2438** retired teachers who are working after retirement under the teacher shortage provisions now

may be allowed to work under renewable one-year contracts instead of a single one-year contract.

VRS Services

VRS strives to provide superior service to its members, employers, and retirees. As we enter the new millennium, the focus on customer service becomes more critical. The audience's expectations and demands for service are impacted by technology and the way technology is employed to provide information and services to customers. Today's VRS members anticipate the ability to receive information more quickly and in different formats than in the past. VRS is gearing up to meet these expectations and is developing tools and methods to meet the future needs of its audience.

The Information Age has precipitated interest in receiving more information via the World Wide Web. Although VRS has had a Web site since 1996, the structure of the site and some of the latest features and enhancements needed to be incorporated. During this fiscal year, the agency launched a new, redesigned Web site. There are member, retiree, and employer tabs at the top of the homepage that link to information specific to each group. This assists the visitor in finding information quickly and enables the System to send out specific messages targeted to each group. Web activity has increased significantly. During the year there were over 466,206 visits to the VRS Web site. In addition, VRS received 5,545 e-mail messages via the Web e-mail address from members, employers, and retirees.

Another step toward meeting future customer service needs included the development of two on-line tools hosted on the VRS Web site. The first tool is a service retirement calculator that enables all members to enter data and generate a quick estimate of their projected retirement benefit. Providing this calculator allows members to put in all variables and to make determinations about their future retirement benefits under different scenarios. The second tool, called QuickAccess, is exclusive to employers using the convenience of their own desktop computers and Internet browser. This on-line, self-service tool allows employers to obtain pertinent retirement information and to provide immediate customer service for their employees using "live data" from the VRS mainframe. Using this Web-based application, employers can obtain information from member records and exchange information with VRS on-line. To provide employers instruction on the use of QuickAccess, VRS offered employers training through an on-line, Web training session. This is the first time the agency has used this format for training and it plans to develop additional training sessions for employers using this technology.

Development of these two on-line tools, along with other administrative changes, has assisted in reducing the number of estimates processed by VRS this fiscal year by 54 percent compared to last fiscal year. With the implementation of these tools, VRS saw the cost of producing estimates decline by 66 percent.

To continue building tools for members, retirees, and employers, VRS listens to and analyzes its audience. The VRS audience includes approximately 312,000 active members and almost 109,000 retirees at the end of fiscal year 2003. Teachers remain the largest group of active members covered by the system at over 132,000. For the first time, the number of active political subdivision employees exceeded the number of state employees. However, the real story lies with the increase in the number of retirees. There was a 5 percent increase in the number of retirees during 2003. VRS projections indicate that there will be a 5 to 5 1/2 percent increase in the number of retirees each year through 2010. This largely reflects the beginning of the "baby boom" generation entering retirement age.

The System has felt the increase in retirements through its processing area. During fiscal year 2003, VRS received 7,992 service retirement applications. This is an 18 percent increase over the previous fiscal year. However, there was a 22 percent increase in the actual number of retirement applications processed. Although the System experienced an increase in this area, Retiree Services introduced improvements to the retirement processing which led to 99.3 percent of retirement applications being processed within 90 days with an accuracy rate of 98.8 percent. During this fiscal year, Retiree Services also assisted retirees with updating health insurance credit information. There was a 167 percent increase over last year in the number of health credit changes processed. There was a corresponding 58 percent increase in the number of health insurance applications received.

The System's increased support to retirees is also reflected in the call volume experienced in the Customer Contact Center. The center averages about 15,000 calls per month with a total of 180,976 received during the fiscal year. Retirees comprised 40 percent of the calls received by the center. The retiree calls primarily relate to health insurance and health credit issues, but also relate to questions regarding taxes, forms and direct deposit dates. About 54 percent of calls received by the center are from members who call most often about purchasing service, receiving a refund, account balances, requirements regarding rollovers and receiving VRS forms.

A good portion of VRS' communications efforts are directed to members with the goal of providing them information on their current benefits and assisting them with preparing for retirement. VRS uses a variety of methods and tools to communicate with members. In addition to producing a newsletter and other publications for members, VRS holds Group Retirement Counseling (GRC) sessions and Retirement Education Seminars (RES) for members at community college sites and at VRS headquarters. Designed for those within five years of retirement, Group Retirement Counseling provides practical advice on subjects like purchasing service and completing retirement forms. Retirement Education Seminars assist members who are five or more years from retirement. These seminars focus on long-term financial planning. During the fiscal year, 1,933 members attended these counseling sessions and seminars. Both of these offerings have proven very important to members who sometimes must make very difficult and generally irreversible retirement decisions.

The most popular publication VRS produces for members is *The Pre-retirement Planning Guide*. This is available to members via the Web site and continues to be the most downloaded publication on the site. There were 186,601 downloads of this publication, exceeding the VRS Member Handbook with 105,940 downloads.

Members who want to purchase service receive information on purchasing through a variety of sources, including newsletters and the Web site. Keeping the purchase of service message before the member is very important since those employees in service on July 1, 2001 have until July 1, 2004 to purchase service at the 5 percent rate. After that date service purchases for this group of employees will be at actuarial cost. The number of applications VRS received reflects the effectiveness of reaching members with this message. Although the number of purchase of service applications received declined by 62 percent over last year, the total number received this fiscal year represents a 116 percent increase over 2001. As the deadline approaches, the agency will step up the communication with members and projects this figure will increase once again.

During the fiscal year, members who were state employees participated in an open enrollment for the Virginia Sickness and Disability Program (VSDP). State employees who were not VSDP members were enrolled in the program during the fall. Those who did not want to participate in the program could opt out. As a result of the enrollment, the VSDP participation rate among state employees increased to 73 percent, ending the year with 62,280 employees covered under the program.

Member participation also increased in the Commonwealth's 457 Deferred Compensation Plan (DCP) to 34,161 with 30,339 of these individuals receiving the cash match. The third-party administrator, Great West, developed a Web site especially for participants. This site, along with KeyTalk telephone access, provides participants with financial planning tools and allows them to access account information and to manage their accounts. In addition to providing individual counseling for members, regional enrollment meetings were held. A joint effort of VRS and Great West was the Investment Education Workshops. Two of these were held in Richmond with agency directors, human resources officers and finance officers in attendance. The Workshops won the National Association of Government Defined Contribution Administrators (NAGDCA) 2003 Leadership Recognition Award. More sessions are planned for the upcoming fiscal year. In addition, participants are provided with a summary of benefits, a folder with plan information and fund profiles, a quarterly newsletter, and quarterly statements.

While members and retirees comprise the largest portion of the VRS audience, employers play a vital role in transmitting information to support these groups since payroll information is used to determine member benefits, refund amounts, and retirement benefits. The agency set an objective of having 75 percent of payrolls transmitted electronically. By the end of the fiscal year, the agency had exceeded this goal by having 83.4 percent transmitted electronically. Providing methods for employers to electronically and securely submit payroll data helps VRS create a more efficient business environment for both the employer and VRS. At the end of the fiscal year, 124 employers representing 96,089 members were using the Web to transmit payroll information.

At the end of the fiscal year, VRS had made numerous accomplishments toward providing efficient, quality service to members. With the "baby boom" generation examining their retirement options and entering retirement, VRS will continue to develop methods to effectively handle this anticipated volume and work diligently to meet the ever-growing service needs presented by the members, employers, and retirees.

Fiduciary Responsibility

The VRS Board of Trustees (the "Board") has full power to invest and reinvest the trust funds of the System. To fulfill its responsibility, the Board has adopted various investment policies and guidelines. The Board's investment objective for the VRS portfolio is to maximize long term investment returns while targeting an acceptable level of risk. Primary risk measures are volatility in the plan's assets, funded status, and contribution rates. As set forth in Section 11 of Article X of the Constitution of Virginia, the funds of the retirement system shall be deemed separate and independent trust funds, shall be segregated from all other funds of the Commonwealth, and shall be invested and administered solely in the interests of the members and beneficiaries thereof. The Board retains a professional investment staff, as well as outside managers, to advise and assist in the implementation of these policies and objectives.

The assets of the System are invested in a prudent manner that is intended to provide for the anticipated growth of VRS' pension liability. Section 51.1-124.30(C) of the *Code of Virginia* states that ". . . the Board shall invest the assets of the Retirement System with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims." Accordingly, the Board must sufficiently diversify the portfolio to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Virginia Retirement System for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30 2002. This was the 21st consecutive year that the VRS has achieved this prestigious award. To be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

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

Acknowledgements

It is the intent of VRS management to provide complete and reliable information as a basis for making management decisions, and as a means of determining responsible stewardship for the assets contributed by the members and their employers. To that end, we express our thanks and appreciation to our affiliated employers and to the various employee organizations and associations for their continued cooperation and support.

We also wish to express our special thanks and appreciation to the VRS staff, members of the Board of Trustees, and VRS business partners whose diligence and commitment have contributed significantly to another successful year.

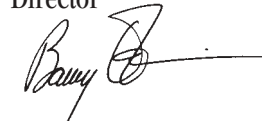
Finally, we wish to thank Governor Mark R. Warner and the members of the Virginia General Assembly for their

commitment and support to the public employers, employees, and retirees of the Virginia Retirement System. This report is being mailed to the Governor, each member of the General Assembly, the Cabinet, all participating employers, and other interested parties.

Respectfully submitted,



W. Forrest Matthews, Jr.
Director



Barry C. Faison
Chief Financial Officer



Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

October 28, 2003

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission

The Board of Trustees
Virginia Retirement System

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of the Virginia Retirement System, which is an independent agency of the Commonwealth of Virginia, as of and for the years ending June 30, 2003 and 2002, as listed in the Table of Contents. These financial statements are the responsibility of the Virginia Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 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 audit provides a reasonable basis for our opinion.

As discussed in Note 1, the basic financial statements of the System are intended to present the financial position and the changes in financial position of only that portion of the aggregate remaining fund information of the Commonwealth of Virginia that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the Commonwealth of Virginia's overall financial position as of June 30, 2003, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Virginia Retirement System as of June 30, 2003 and 2002, and the changes in plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis, funding progress, employer contributions, and actuarial methods and significant assumptions on pages 22 through 27 and 46 through 48 are not a required part of the basic financial statements, but are supplementary 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 the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Virginia Retirement System's basic financial statements. The Introductory, Investment, Actuarial, and Statistical Sections as well as the supplementary information listed in the Financial Section of the Table of Contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The supplementary information listed in the Financial Section of the Table of Contents has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion based on our audit, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. This Introductory, Investment, Actuarial, and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with Government Auditing Standards, we have also issued our report dated October 28, 2003, on our consideration of the Virginia Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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.

AUDITOR OF PUBLIC ACCOUNTS

Handwritten signature of Walter J. Kucharski in black ink.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's discussion and analysis of the Virginia Retirement System's (the "System") financial statements and the significant events and conditions that affected the operations and performance of the System for the year ended June 30, 2003. It is presented as a narrative overview and analysis. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our Letter of Transmittal.

The System is responsible for administering four defined benefit retirement plans – the Virginia Retirement System (VRS) for state employees, public school board employees, employees of participating political subdivisions, and other qualifying employees; the State Police Officers' Retirement System (SPORS) for state police officers; the Virginia Law Officers' Retirement System (VaLORS) for state law enforcement and correctional officers other than state police officers; and the Judicial Retirement System (JRS) for judges of courts of record or district courts of the state and other qualifying employees. All of these plans are defined as pension trust funds. The System also administers a Group Life Insurance Fund, a Retiree Health Insurance Credit Fund, and a Disability Insurance Trust Fund. All of these plans are defined as other employee benefit trust funds. The pension and other employee benefit trust funds are classified as fiduciary funds.

Financial Highlights

- The combined total net assets held in trust for benefits of the Pension Trust Funds increased by \$324.9 million, or 1.0% during the fiscal year ended June 30, 2003. The increase was due to improved market returns, however, these were partially offset by increased benefit payments as a percentage of contributions.
- The System's rate of return on investments during the fiscal year ended June 30, 2003, was 2.5% compared with a return of a negative 7.3% for the fiscal year ended June 30, 2002. The increase is due to improved returns on equity investments.
- The VRS, SPORS, VaLORS, and JRS were actuarially funded at 101.8%, 85.4%, 51.9%, and 79.8% based on the actuarial valuation as of June 30, 2002. This was a decline from their funded ratios of 107.3%, 88.9%, 62.6%, and 81.0% based on the actuarial valuation as of June 30, 2001. The decline was due to the impact of the significant investment losses in FY 2001 and FY 2002 on the actuarial value of assets used in the valuation process.

Overview of the Financial Statements and Accompanying Information

1. **Fund Financial Statements.** The System presents the Statement of Plan Net Assets as of June 30, 2003 and 2002 and the Statement of Changes in Plan Net Assets for the years then ended. The statements were prepared on the accrual basis of accounting and are used to account for resources administered by the VRS for the benefit of the plan members and beneficiaries. These statements are as follows:
 - Statement of Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Plans and a Balance Sheet for the Agency Fund. This statement reflects the balance of the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal year.
 - Statement of Changes in Plan Net Assets – Defined Benefit Pension Trust Funds and Other Employee Benefit Plans. This reflects the changes in the resources available to pay benefits to members, including retirees and beneficiaries, during the fiscal year.
2. **Notes to Financial Statements.** The notes to financial statements are an integral part of the financial statements and contain additional detailed information and schedules to provide a better understanding of the financial statements.
3. **Required Supplementary Information.** The required supplementary information consists of two schedules and related notes. The required supplementary schedules are as follows:
 - Required Supplement Schedule of Funding Progress
 - Required Supplemental Schedule of Employer Contributions
 - Notes to Required Supplemental Schedules Actuarial Methods and Significant Assumptions
4. **Statement of Changes in Assets and Liabilities Agency Fund – Optional Life Insurance Fund**
5. **Other Supplementary Schedules.** Other schedules are included which provide more detailed information not provided in the basic financial statements. The other supplementary schedules are as follows:
 - Schedule of Administrative Expenses
 - Schedule of Investment Expenses
 - Schedule of Professional and Consulting Services

VIRGINIA RETIREMENT SYSTEM'S NET ASSETS

(Expressed in Millions)

| | 2003 | Increase (Decrease) | 2002 | Increase (Decrease) | 2001 |
|---|--------------------|------------------------|--------------------|------------------------|--------------------|
| Assets: | | | | | |
| Cash, Receivables and Capital Assets | \$ 2,133.3 | \$ 169.9 | \$ 1,963.4 | \$ (1,344.7) | \$ 3,308.1 |
| Investments | 35,566.8 | 492.9 | 35,073.9 | (2,818.7) | 37,892.6 |
| Security Lending Collateral | 2,443.4 | (322.6) | 2,766.0 | 626.9 | 2,139.1 |
| Total Assets | 40,143.5 | 340.2 | 39,803.3 | (3,536.5) | 43,339.8 |
| Liabilities: | | | | | |
| Accounts Payable | 224.0 | (257.9) | 481.9 | (628.0) | 1,109.9 |
| Investment Purchases Payable | 2,773.0 | 646.1 | 2,126.9 | (232.4) | 2,359.3 |
| Obligations Under Security Lending | 2,443.4 | (322.6) | 2,766.0 | 626.9 | 2,139.1 |
| Total Liabilities | 5,440.4 | 65.6 | 5,374.8 | (233.5) | 5,608.3 |
| Total Net Assets | \$ 34,703.1 | \$ 274.6 | \$ 34,428.5 | \$ (3,303.0) | \$ 37,731.5 |

VIRGINIA RETIREMENT SYSTEM'S CHANGE IN NET ASSETS

(Expressed in Millions)

| | 2003 | Increase (Decrease) | 2002 | Increase (Decrease) | 2001 |
|--|-----------------|------------------------|---------------------|------------------------|---------------------|
| Additions: | | | | | |
| Member Contributions | \$ 129.2 | \$ (29.9) | \$ 159.1 | \$ 39.9 | \$ 119.2 |
| Member Contributions paid by Employer | 520.0 | 15.5 | 504.5 | 29.1 | 475.4 |
| Employer Contributions | 501.6 | (61.1) | 562.7 | (302.2) | 864.9 |
| Net Investment Income | 994.5 | 3,828.4 | (2,833.9) | 218.7 | (3,052.6) |
| Total Additions | 2,145.3 | 3,752.9 | (1,607.6) | (14.5) | (1,593.1) |
| Deductions: | | | | | |
| Retirement Benefits | 1,597.7 | 159.9 | 1,437.8 | 139.2 | 1,298.6 |
| Refunds of Member Contributions | 72.2 | (1.3) | 73.5 | (7.1) | 80.6 |
| Insurance Premiums and Claims | 104.3 | 8.7 | 95.6 | 7.4 | 88.2 |
| Retiree Health Insurance Reimbursements | 61.0 | 3.4 | 57.6 | 3.0 | 54.6 |
| Long Term Disability Benefits | 16.8 | 5.2 | 11.6 | 3.2 | 8.4 |
| Administrative and Other Expenses | 18.7 | (0.6) | 19.3 | 3.2 | 16.1 |
| Total Deductions | 1,870.7 | 175.3 | 1,695.4 | 148.9 | 1,546.5 |
| Net Increase (Decrease) in Net Assets | \$ 274.6 | \$ 3,577.6 | \$ (3,303.0) | \$ (163.4) | \$ (3,139.6) |

Analysis of Financial Activities – Pension Plans

The System’s funding objective is to meet its long-term benefit obligations through investment income and contributions. Accordingly, the collection of contributions and the income from investment provide the reserves needed to finance the benefits provided under the plans.

Membership

As discussed earlier, the System administers retirement plans for a variety of employee groups. The distribution of the active membership as of June 30, 2003, 2002, and 2001 is presented below in Figure 1.

**Figure 1.
PENSION PLANS
ACTIVE MEMBERSHIP
DISTRIBUTION AT JUNE 30**

| | 2003 | 2002 | 2001 |
|--------------------------------|-----------------------|-----------------------|-----------------------|
| State Employees (VRS) | 76,161 | 78,655 | 78,022 |
| Teachers (VRS) | 132,656 | 129,795 | 126,764 |
| Political Subdivision | | | |
| Employees (VRS) | 91,340 | 89,588 | 86,628 |
| State Police Officers (SPORS) | 1,709 | 1,745 | 1,769 |
| Virginia Law Officers (VaLORS) | 9,538 | 10,025 | 10,383 |
| Judges (JRS) | 407 | 406 | 404 |
| Total | <u>311,811</u> | <u>310,214</u> | <u>303,970</u> |

Contributions and Earnings

Pension trust fund revenue is used to finance the retirement benefits provided by the retirement plans. The primary sources of revenue for the retirement plans include contributions from both active members and employers, and investment income generated from the investment of plan assets. Total contributions and investment earnings for the

fiscal year ended June 30, 2003 amounted to \$2,011.5 million. This was an increase of \$3,719.9 million compared with FY 2002. This is a significant improvement over the decrease of \$8.8 million that occurred in FY 2001. This information is presented below in Figure 2.

Member contributions, including those paid by employers, increased \$26.8 million, while employers’ contributions decreased \$29.4 million for a net decrease in contributions of \$2.6 million from the prior fiscal year. Investment income provided the increase to plan net assets in FY 2003. Member contributions increased by \$11.3 million. This was related to the continued increase in the number of members purchasing previously refunded and other qualified service. Employer contributions decreased due to the continued suspension of contributions for state employees in FY 2003. This is discussed further in Note 13 of the Notes to Financial Statements. During FY 2002 the system experienced growth in total member contributions of \$80.9 million and a decline in employer contributions of \$306.2 million. As in FY 2003, the member contribution increase was the result of the increase in the number of members purchasing service and the decline in the employer contributions related to the suspension of contributions for state employees beginning in January 2002.

Investments

There was net investment income for FY 2003 of \$969.7 million. The net investment income increased \$3,722.5 million for FY 2003 (Figure 2). This compares to a net investment income increase of only \$216.5 million in FY 2002. Total pension trust fund investments increased to \$34,584.6 million at fair value at June 30, 2003. This was an increase of \$527.9 million over the fair value of \$34,056.7 million at June 30, 2002. The total pension trust fund

**Figure 2.
PENSION PLANS CONTRIBUTIONS AND INVESTMENT EARNINGS
FOR THE YEARS ENDED JUNE 30**

(Expressed in Millions)

| | 2003 | Increase (Decrease) | 2002 | Increase (Decrease) | 2001 |
|---------------------------------------|--------------------------|--------------------------|----------------------------|------------------------|----------------------------|
| Member Contributions | \$ 129.1 | \$ 11.3 | \$ 117.8 | \$ 51.8 | \$ 66.0 |
| Member Contributions Paid by Employer | 520.0 | 15.5 | 504.5 | 29.1 | 475.4 |
| Employer Contributions | 392.7 | (29.4) | 422.1 | (306.2) | 728.3 |
| Investment Income* | 969.7 | 3,722.5 | (2,752.8) | 216.5 | (2,969.3) |
| Total | <u>\$ 2,011.5</u> | <u>\$ 3,719.9</u> | <u>\$ (1,708.4)</u> | <u>\$ (8.8)</u> | <u>\$ (1,699.6)</u> |

* Net of investment expenses, including net securities lending income and miscellaneous income.

investments declined in FY 2002 by \$2,771.5 million from their fair value of \$36,828.2 million at June 30, 2001.

The total return on pension trust fund investments for the fiscal year ended June 30, 2003 was 2.5%. The annualized return was a negative 4.2% over the past three years and a positive 2.6% over the past five years. An explanation of investment policies and strategies and the portfolio's composition is included in the Investment Section of this CAFR. In addition, a review of investment activity and results for FY 2003 is provided in that section.

The System's investment portfolio consists of funds contributed by both employers and employees of Virginia's state agencies, teachers, state police and law enforcement officers, and many local governments. These contributions are combined in a commingled pool and invested to provide for the payment of current and future benefits to participants when they retire. Each plan owns an equity position in the pool and receives a proportionate share of the total investment income/loss from the pool.

Expenses – Deductions from Plan Net Assets

The primary expenses of the pension trust funds include annuity benefits for retirees and beneficiaries, refunds of contributions to former members, and expenses associated with the administration of the retirement plans. Expenses for FY 2003 totaled \$1,686.6 million, an increase of \$157.5 million, or 10.3%, over the 2002 period. The details are presented below in Figure 3.

The increase in benefit payments to \$1,597.7 million in FY 2003 was due to an increase in the number of retirees and beneficiaries receiving benefits and a cost-of-living adjustment (COLA) of 2.8% on July 1, 2002. The number of retirees and beneficiaries receiving benefit payments

increased to approximately 108,758 at June 30, 2003. This is an increase of 5.0% from the 103,622 at June 30, 2002. The increase in benefit payments for FY 2003 was \$159.9 million as compared to \$139.2 million for FY 2002.

Refunds of contributions to members who terminated their employment during FY 2003 amounted to \$72.2 million (13,148 refunds), compared with \$73.5 million (12,902 refunds) refunded during FY 2002 and \$80.6 million (14,004 refunds) refunded during FY 2001. The relative stability in the number of refunds is attributed to employees remaining in current positions because of a tighter job market and fewer employment opportunities.

Administration and other expenses for FY 2003 were \$16.7 million, compared with \$17.8 million for FY 2002 and \$14.4 million for FY 2001. The total decline of \$1.1 million for FY 2003 is the result of an increase in administration expenses due mainly to an increase in staff salaries and related benefit costs, offset by a decline in other expenses of \$2.4 million.

Retirement Reserves

Funds are derived from the excess of revenues over expenses and are accumulated by the pension plans to meet current and future obligations to retirees and beneficiaries. The higher the level of funding, the larger the accumulation of assets and the greater the investment income potential.

Since revenues exceeded expenses for FY 2003, there was a net increase of \$324.9 million in the retirement reserves held by the plans. This compares to a \$3,237.5 million decline in the retirement reserves in FY 2002. As noted above, the increase for FY 2003 was primarily related to the improved investment performance for the year. During the fiscal year, the amount of interest credited to member accounts was \$228.1 million. The amount of member balances transferred

Figure 3.

PENSION PLANS PRIMARY EXPENSES FOR THE YEARS ENDED JUNE 30

| | (Expressed in Millions) | | | | |
|--------------------------|-------------------------|------------------------|-------------------|------------------------|-------------------|
| | 2003 | Increase (Decrease) | 2002 | Increase (Decrease) | 2001 |
| Benefits | \$ 1,597.7 | \$ 159.9 | \$ 1,437.8 | \$ 139.2 | \$ 1,298.6 |
| Refunds | 72.2 | (1.3) | 73.5 | (7.1) | 80.6 |
| Administration and Other | 16.7 | (1.1) | 17.8 | 3.4 | 14.4 |
| Total | \$ 1,686.6 | \$ 157.5 | \$ 1,529.1 | \$ 135.5 | \$ 1,393.6 |

Figure 4.

PENSION PLANS RESERVE BALANCES AT JUNE 30

(Expressed in Millions)

| | 2003 | Increase (Decrease) | 2002 | Increase (Decrease) | 2001 |
|-------------------|--------------------|------------------------|--------------------|------------------------|--------------------|
| Member Reserves | \$ 6,403.3 | \$ 470.6 | \$ 5,932.7 | \$ 500.5 | \$ 5,432.2 |
| Employer Reserves | 27,377.4 | (145.7) | 27,523.1 | (3,738.0) | 31,261.1 |
| Total | \$ 33,780.7 | \$ 324.9 | \$ 33,455.8 | \$ (3,237.5) | \$ 36,693.3 |

to employer reserves upon members' retirements was \$321.9 million. The member and employer balances in retirement reserves at June 30, 2003 are presented in Figure 4.

Actuarial Valuations and Funding Progress

Actuarial valuations of VRS, SPORS, VaLORS, and JRS are performed at least every two years to determine funding requirements by the System's actuarial firm, Gabriel, Roeder, Smith & Company. The funding policy provides for periodic employer contributions at actuarially determined rates that will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the costs of all basic benefits when due.

The latest valuations of the four pension plans performed as of June 30, 2002 by Gabriel, Roeder, Smith & Company, indicated that the ratio of assets accumulated by the plans to their total actuarial accrued liabilities for benefits were 101.8% for VRS, 85.4% for SPORS, 51.9% for VaLORS, and 79.8% for JRS. The valuations reflect full prefunding of the statutory cost-of-living adjustment (COLA) for retirees. Funding progress for the pension plans is presented in Schedule 1 in the Financial Section. Additional information on the plans' funding progress is contained in the Actuarial Section of this CAFR.

**Analysis of Financial Activities –
Other Employee Plans****Group and Optional Life Insurance Program**

The group life insurance program, enacted by the General Assembly on July 1, 1960, provides life insurance and accidental death and dismemberment coverage to the majority of members participating in the System-administered pension plans as well as other qualifying employees. Group life insurance premiums are paid by covered employees and/or employers to fund the program. Approximately 326,599

employees and 102,244 retirees were covered by the group life insurance program at the end of the fiscal year.

The optional life insurance program, enacted by the General Assembly of Virginia on November 1, 1995, provides life insurance and accidental death and dismemberment coverage to employees covered under the group life insurance program as a supplement to that program. Employees may also cover their spouses and children under this program. Optional life insurance premiums are paid by the covered employees. The System collected \$18.3 million in optional life premiums for approximately 50,958 employees during FY 2003. This is an increase over the \$15.9 million collected from approximately 49,652 employees during FY 2002.

During FY 2003, the System remitted \$122.7 million to the insurance company for premiums and claims (\$104.3 million for the group life insurance program and \$18.4 million for the optional life insurance program). This is an increase over the total premiums and claims of \$111.6 million remitted for FY 2002. The difference between the amounts collected and paid by the System for the group life insurance program comes out of the reserve established to prefund death benefits for retirees. This reserve had net assets held in trust for benefits of \$751.7 million at June 30, 2003 and experienced investment income (including net securities lending income) of \$18.3 million during the fiscal year. For FY 2002, this reserve had an investment loss of \$72.0 million and ended the year with a reserve balance of \$838.6 million down from \$938.1 at June 30, 2001. The decline in FY 2002 was the result of the negative investment income. The decline in FY 2003 was caused primarily by the lack of contributions resulting from a premium holiday declared by the General Assembly effective in April 2002 and continuing through June 30, 2004.

Retiree Health Insurance Credit Program

The retiree health insurance credit program was established by the General Assembly of Virginia on January 1, 1990 and provides credits against health insurance premiums for eligible state retirees. Coverage under the program was extended to retired teachers and employees of participating political subdivisions on July 1, 1993. During FY 2003, the System collected \$74.1 million in retiree health insurance credit contributions from participating employers and provided reimbursements of \$61.0 million to approximately 62,196 eligible retirees. During FY 2002, the System collected \$85.2 million in retiree health insurance credit contributions from participating employers and provided reimbursements of \$57.6 million to approximately 58,229 eligible retirees. The majority of the decline in contributions resulted from a reduction in the contribution rate for state employees from 1.21% to 0.89% of covered payroll. The Retiree Health Insurance Credit Fund reserve had net assets held in trust for benefits of \$92.2 million at June 30, 2003 and experienced investment income (including net securities lending income) of \$3.3 million during the fiscal year. The reserve balances at June 30, 2002 and June 30, 2001 were \$76.2 million and \$54.0 million, respectively.

Virginia Sickness and Disability Program

The Disability Insurance Trust Fund, also known as the Virginia Sickness and Disability Program (VSDP) was established by the General Assembly of Virginia on January 1, 1999 and provides sick leave, family and personal leave and short-term and long-term disability benefits to eligible state employees. The System is responsible for the administration of the program and the payment of the long-term disability benefits. Sick leave and short-term disability benefits are paid to eligible employees directly by the employer. During FY 2003, the System collected \$34.8 million in VSDP contributions from participating

employers and provided long-term disability benefits \$16.8 million to eligible employees. This is an increase over the \$27.8 million in contributions collected and \$11.6 million in benefits paid in FY 2002. The Disability Insurance Trust Fund reserve had net assets held in trust for benefits of \$78.4 million at June 30, 2003 and experienced investment income (including net securities lending income) of \$3.2 million during the fiscal year. The reserve balances at June 30, 2002 and June 30, 2001 were \$57.9 million and \$46.1 million, respectively.

Budget

The Virginia Retirement System prepares a biennial budget for its administrative expenses in accordance with the Commonwealth of Virginia's budgetary system. The System's budget is prepared on the cash basis and must be approved by the Board of Trustees. It is incorporated as part of the biennial Appropriation Act passed by the General Assembly. During FY 2003, the original budget was \$29.4 million. Included in the Other Supplementary Information of the Financial Section is the Statement of Administrative Expenses. It is prepared on the accrual basis of accounting and includes a reconciliation of the GAAP basis expenses to the expenses for the budget, which are cash basis. Administrative expenses are funded from the System's trust funds as non-general funds and have no effect on the Commonwealth of Virginia's general funds.

Request for Information

This financial report is designed to provide a general overview of the Virginia Retirement System's finances for all of those with an interest in the System's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Financial Officer of the Virginia Retirement System, P.O. Box 2500, Richmond, VA 23218-2500.

FINANCIAL SECTION

Virginia Retirement System

STATEMENT OF PLAN NET ASSETS –
DEFINED BENEFIT PENSION TRUST FUNDS AND OTHER
EMPLOYEE BENEFIT TRUST FUNDS AND THE AGENCY FUND

As of June 30, 2003 and 2002

| | Pension Trust Funds | | | | Total Pension Trust Funds |
|---|----------------------------------|---|---|----------------------------------|------------------------------------|
| | Virginia Retirement System | State Police Officers' Retirement System | Virginia Law Officers' Retirement System | Judicial Retirement System | |
| Assets: | | | | | |
| Cash (Note 5) | \$ 46,967 | \$ 520 | \$ 483 | \$ 288 | \$ 48,258 |
| Receivables: | | | | | |
| Contributions | 101,071 | 526 | 2,017 | 674 | 104,288 |
| Interest and dividends | 95,852 | 1,239 | 1,150 | 686 | 98,927 |
| Receivable for security transactions | 1,730,489 | 22,368 | 20,770 | 12,392 | 1,786,019 |
| Other receivables | 3,013 | 16 | 15 | 9 | 3,053 |
| Total receivables | 1,930,425 | 24,149 | 23,952 | 13,761 | 1,992,287 |
| Due from other funds | 9,763 | 2,033 | 1,423 | 1,727 | 14,946 |
| Investments: (Note 5) | | | | | |
| Bonds and mortgage securities | 7,832,386 | 101,242 | 94,008 | 56,088 | 8,083,724 |
| Stocks | 8,156,385 | 105,430 | 97,896 | 58,408 | 8,418,119 |
| Fixed income commingled funds | 98,679 | 1,276 | 1,184 | 707 | 101,846 |
| Index and pooled funds | 12,144,733 | 156,982 | 145,766 | 86,969 | 12,534,450 |
| Real estate | 1,034,637 | 13,374 | 12,418 | 7,409 | 1,067,838 |
| Private equity | 2,051,517 | 26,518 | 24,623 | 14,691 | 2,117,349 |
| Short-term investments | 2,190,919 | 28,320 | 26,297 | 15,689 | 2,261,225 |
| Total investments | 33,509,256 | 433,142 | 402,192 | 239,961 | 34,584,551 |
| Collateral on loaned securities | 2,302,050 | 29,756 | 27,630 | 16,485 | 2,375,921 |
| Property, plant, furniture and equipment (Note 6) | 6,270 | – | – | – | 6,270 |
| Total assets | 37,804,731 | 489,600 | 455,680 | 272,222 | 39,022,233 |
| Liabilities: | | | | | |
| Retirement benefits payable | 133,132 | 2,068 | 1,336 | 1,685 | 138,221 |
| Refunds payable | 6,291 | 53 | 339 | – | 6,683 |
| Accounts payable and accrued expenses | 10,709 | 123 | 114 | 68 | 11,014 |
| Compensated absences payable | 1,167 | – | – | – | 1,167 |
| Insurance premiums and claims payable | – | – | – | – | – |
| Payable for security transactions | 2,612,611 | 33,771 | 31,358 | 18,709 | 2,696,449 |
| Other payables | 914 | 5 | 4 | 3 | 926 |
| Obligations under security lending program | 2,302,050 | 29,756 | 27,630 | 16,485 | 2,375,921 |
| Due to other funds | 10,975 | 10 | 120 | – | 11,105 |
| Total liabilities | 5,077,849 | 65,786 | 60,901 | 36,950 | 5,241,486 |
| Net assets held in trust for benefits (Note 4) | | | | | |
| (See Required Supplemental Schedule of Funding Progress, page 46.) | \$32,726,882 | \$ 423,814 | \$ 394,779 | \$ 235,272 | \$33,780,747 |

The accompanying notes to financial statements are an integral part of this statement.

(Expressed in Thousands)

| Other Employee Benefit Trust Funds | | | | Agency Fund | Totals | |
|------------------------------------|---------------------------------|---------------------------------|--|------------------------------|---------------------|---------------------|
| Group Life Insurance | Retiree Health Insurance Credit | Disability Insurance Trust Fund | Total Other Employee Benefit Trust Funds | Optional Life Insurance Fund | 2003 | 2002 |
| \$ 968 | \$ 117 | \$ 95 | \$ 1,180 | \$ 1,171 | \$ 50,609 | \$ 3,727 |
| 1,207 | 4,003 | 1,438 | 6,648 | — | 110,936 | 93,142 |
| 2,305 | 279 | 226 | 2,810 | — | 101,737 | 125,680 |
| 41,608 | 5,035 | 4,081 | 50,724 | — | 1,836,743 | 1,448,118 |
| 30 | 26 | 1,433 | 1,489 | — | 4,542 | 273,546 |
| 45,150 | 9,343 | 7,178 | 61,671 | — | 2,053,958 | 1,940,486 |
| 1 | 5,790 | — | 5,791 | 1,772 | 22,509 | 12,660 |
| 188,321 | 22,791 | 18,473 | 229,585 | — | 8,313,309 | 9,707,448 |
| 196,111 | 23,733 | 19,237 | 239,081 | — | 8,657,200 | 8,177,400 |
| 2,373 | 287 | 233 | 2,893 | — | 104,739 | 297,956 |
| 292,006 | 35,339 | 28,644 | 355,989 | — | 12,890,439 | 12,524,189 |
| 24,876 | 3,011 | 2,440 | 30,327 | — | 1,098,165 | 1,211,414 |
| 49,326 | 5,969 | 4,839 | 60,134 | — | 2,177,483 | 2,191,040 |
| 52,677 | 6,375 | 5,168 | 64,220 | — | 2,325,445 | 964,501 |
| 805,690 | 97,505 | 79,034 | 982,229 | — | 35,566,780 | 35,073,948 |
| 55,351 | 6,698 | 5,429 | 67,478 | — | 2,443,399 | 2,766,009 |
| — | — | — | — | — | 6,270 | 6,447 |
| 907,160 | 119,453 | 91,736 | 1,118,349 | 2,943 | 40,143,525 | 39,803,277 |
| — | — | — | — | — | 138,221 | 133,383 |
| 246 | 135 | 277 | 658 | — | 7,341 | 7,345 |
| 229 | 5,196 | 668 | 6,093 | — | 17,107 | 293,681 |
| — | — | — | — | — | 1,167 | 1,121 |
| 33,772 | — | — | 33,772 | 2,943 | 36,715 | 32,728 |
| 62,817 | 7,602 | 6,162 | 76,581 | — | 2,773,030 | 2,126,901 |
| 9 | 1 | 1 | 11 | — | 937 | 929 |
| 55,351 | 6,698 | 5,429 | 67,478 | — | 2,443,399 | 2,766,009 |
| 2,989 | 7,599 | 816 | 11,404 | — | 22,509 | 12,660 |
| 155,413 | 27,231 | 13,353 | 195,997 | 2,943 | 5,440,426 | 5,374,757 |
| \$ 751,747 | \$ 92,222 | \$ 78,383 | \$ 922,352 | \$ — | \$34,703,099 | \$34,428,520 |

Virginia Retirement System

**STATEMENT OF CHANGES IN PLAN NET ASSETS -
DEFINED BENEFIT PENSION TRUST FUNDS
AND OTHER EMPLOYEE BENEFIT TRUST FUNDS**

For the Years Ended June 30, 2003 and 2002

| | Pension Trust Funds | | | | Total Pension Trust Funds |
|--|----------------------------------|---|---|----------------------------------|------------------------------------|
| | Virginia Retirement System | State Police Officers' Retirement System | Virginia Law Officers' Retirement System | Judicial Retirement System | |
| Additions: | | | | | |
| Contributions: | | | | | |
| Members..... | \$ 127,578 | \$ 556 | \$ 927 | \$ 88 | \$ 129,149 |
| Member paid by employers..... | 499,077 | 3,972 | 14,559 | 2,346 | 519,954 |
| Employers..... | 335,404 | 8,777 | 34,947 | 13,604 | 392,732 |
| Total contributions..... | 962,059 | 13,305 | 50,433 | 16,038 | 1,041,835 |
| Investment income: | | | | | |
| Net appreciation/(depreciation) in fair value of investments..... | 388,076 | 4,949 | 5,422 | 2,714 | 401,161 |
| Interest, dividends and other investment income..... | 632,955 | 8,071 | 8,843 | 4,427 | 654,296 |
| Total investment income before investment expenses..... | 1,021,031 | 13,020 | 14,265 | 7,141 | 1,055,457 |
| Investment expenses..... | (96,412) | (1,229) | (1,347) | (674) | (99,662) |
| Net investment income..... | 924,619 | 11,791 | 12,918 | 6,467 | 955,795 |
| Security lending income: | | | | | |
| Gross income..... | 43,277 | 552 | 605 | 303 | 44,737 |
| Less: Borrower rebates and agent fees..... | (32,481) | (414) | (454) | (227) | (33,576) |
| Net security lending income..... | 10,796 | 138 | 151 | 76 | 11,161 |
| Miscellaneous revenue..... | 2,682 | - | - | - | 2,682 |
| Total additions..... | 1,900,156 | 25,234 | 63,502 | 22,581 | 2,011,473 |
| Deductions: | | | | | |
| Retirement benefits..... | 1,537,762 | 23,594 | 15,020 | 21,359 | 1,597,735 |
| Refunds of member contributions..... | 67,473 | 863 | 3,763 | 51 | 72,150 |
| Insurance premiums and claims..... | - | - | - | - | - |
| Retiree health insurance reimbursements..... | - | - | - | - | - |
| Long term disability benefits..... | - | - | - | - | - |
| Administrative expenses..... | 16,201 | 205 | 151 | 113 | 16,670 |
| Other expenses..... | - | - | - | - | - |
| Total operating expenses..... | 1,621,436 | 24,662 | 18,934 | 21,523 | 1,686,555 |
| Transfers..... | (147) | - | 147 | - | - |
| Net increase (decrease)..... | 278,573 | 572 | 44,715 | 1,058 | 324,918 |
| Net assets held in trust for benefits - Beginning of year..... | 32,448,309 | 423,242 | 350,064 | 234,214 | 33,455,829 |
| Net assets held in trust for benefits - End of year..... | \$ 32,726,882 | \$ 423,814 | \$ 394,779 | \$ 235,272 | \$ 33,780,747 |

The accompanying notes to financial statements are an integral part of this statement.

(Expressed in Thousands)

| Other Employee Benefit Trust Funds | | | | Totals | |
|------------------------------------|---------------------------------|---------------------------------|--|---------------------|---------------------|
| Group Life Insurance | Retiree Health Insurance Credit | Disability Insurance Trust Fund | Total Other Employee Benefit Trust Funds | 2003 | 2002 |
| \$ 25 | \$ - | \$ - | \$ 25 | \$ 129,174 | \$ 159,096 |
| - | - | - | - | 519,954 | 504,550 |
| 19 | 74,123 | 34,813 | 108,955 | 501,687 | 562,671 |
| 44 | 74,123 | 34,813 | 108,980 | 1,150,815 | 1,226,317 |
| 7,591 | 1,355 | 1,342 | 10,288 | 411,449 | (3,476,328) |
| 12,380 | 2,209 | 2,189 | 16,778 | 671,074 | 733,854 |
| 19,971 | 3,564 | 3,531 | 27,066 | 1,082,523 | (2,742,474) |
| (1,886) | (337) | (334) | (2,557) | (102,219) | (107,545) |
| 18,085 | 3,227 | 3,197 | 24,509 | 980,304 | (2,850,019) |
| 847 | 151 | 150 | 1,148 | 45,885 | 70,796 |
| (635) | (113) | (112) | (860) | (34,436) | (55,046) |
| 212 | 38 | 38 | 288 | 11,449 | 15,750 |
| - | - | - | - | 2,682 | 286 |
| 18,341 | 77,388 | 38,048 | 133,777 | 2,145,250 | (1,607,666) |
| - | - | - | - | 1,597,735 | 1,437,791 |
| - | - | - | - | 72,150 | 73,451 |
| 104,275 | - | - | 104,275 | 104,275 | 95,625 |
| - | 61,027 | - | 61,027 | 61,027 | 57,590 |
| - | - | 16,780 | 16,780 | 16,780 | 11,578 |
| 644 | 323 | 791 | 1,758 | 18,428 | 16,685 |
| 276 | - | - | 276 | 276 | 2,647 |
| 105,195 | 61,350 | 17,571 | 184,116 | 1,870,671 | 1,695,367 |
| - | - | - | - | - | - |
| (86,854) | 16,038 | 20,477 | (50,339) | 274,579 | (3,303,033) |
| 838,601 | 76,184 | 57,906 | 972,691 | 34,428,520 | 37,731,553 |
| \$ 751,747 | \$ 92,222 | \$ 78,383 | \$ 922,352 | \$34,703,099 | \$34,428,520 |

NOTES TO FINANCIAL STATEMENTS

June 30, 2003 and 2002

1. Summary of Significant Accounting Policies**A. The Financial Reporting Entity**

The Virginia Retirement System (the "System") is an independent agency of the Commonwealth of Virginia that administers defined benefit pension plans, other employee benefit plans, and other funds established by the Commonwealth. The System is included in the basic financial statements of the Commonwealth of Virginia. As required by generally accepted accounting principles (GAAP), these financial statements include all of the funds for which financial transactions are recorded in the System's accounting system and for which its Board of Trustees exercises administrative responsibility.

Defined Benefit Pension Plans:

Virginia Retirement System (VRS)
 State Police Officers' Retirement System (SPORS)
 Virginia Law Officers' Retirement System (VaLORS)
 Judicial Retirement System (JRS)

Other Employee Benefit Plans:

Group Life Insurance Fund
 Retiree Health Insurance Credit Fund
 Disability Insurance Trust Fund
 (also known as the Virginia Sickness and Disability Program [VSDP])

Agency Fund:

Optional Life Insurance Fund

Effective January 1, 1997, the Constitution of Virginia was amended to strengthen the independence of the Virginia Retirement System and to protect its funds by requiring that they be separate and independent trust funds segregated from all other funds of the Commonwealth and administered solely in the interest of the members and beneficiaries thereof.

B. Administration

The responsibility for general administration and operation of the defined benefit pension plans, other employee benefit plans, and other funds is vested in the Board of Trustees. The board consists of five members appointed by the Governor and four members appointed by the Joint Rules Committee, all subject to confirmation by the General Assembly of Virginia. A director is

appointed by the Board of Trustees to serve as the chief administrative officer of the retirement systems. A chief investment officer is employed by the board to direct, manage, and administer the investment of the System's funds. Full power to invest and reinvest the assets of the defined benefit pension plans, other employee benefit plans, and other funds is vested in the board. The Board of Trustees has appointed Mellon Trust as the custodian of designated assets of the System.

The Virginia Retirement System, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, and the Judicial Retirement System are administered in accordance with Title 51.1, Chapters 1, 2, 2.1, 3, and 4 of the *Code of Virginia* (1950), as amended.

The Group Life Insurance Fund, the Retiree Health Insurance Credit Fund, and the Disability Insurance Trust Fund are administered in accordance with Title 51.1, Chapter 5; Title 51.1, Chapter 14; and Title 51.1, Chapter 11, respectively, of the *Code of Virginia* (1950), as amended.

The Optional Life Insurance Fund is administered in accordance with Section 51.1-512 and 51.1-512.1 of the *Code of Virginia* (1950), as amended.

Other programs of the Commonwealth of Virginia for which the Board of Trustees has oversight responsibility but has little administrative involvement and does not perform the investment function include the following: the Commonwealth's Deferred Compensation Plan (IRC Section 457) and its Cash Match Plan for state employees and employees of participating political subdivisions; Defined Contribution Plans for political appointees, employees of institutions of higher education, and certain employees of public school divisions and teaching hospitals; the Commonwealth Health Research Fund, which provides financial support for research efforts that may maximize human health benefits for citizens of the Commonwealth; and the Volunteer Firefighters' and Rescue Squad Worker's Service Award Fund, which provides service awards to eligible volunteer firefighters and rescue squad workers. Because the Board of Trustees has a limited administrative role for these programs (it neither owns the assets nor does it have custody of them) and their financial transactions are not recorded in the

System's accounting system, these programs are not included in the System's financial statements.

C. Basis of Accounting

The accounts of the defined benefit pension plans and the other employee benefit plans, are accounted for and presented using the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when the liability is incurred, regardless of the timing of related cash flows. Employee and employer contributions are recognized as revenues in the period in which employee services are performed and investment income is recognized as earned by the plans. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans.

The agency fund is accounted for using the accrual basis of accounting; however, because it is purely custodial, it does not recognize revenues and expenditures and does not have a fund balance. The agency fund accounts for assets received and disbursed by the System in its capacity as an agent for the Commonwealth of Virginia.

D. Investments

1. Investment Valuation

Investments are reported at fair value as determined by the System's master custodian, Mellon Trust, from its Global Pricing System. This system assigns a price source, based on asset type and the vendor pricing products to which the master custodian subscribes, for every security held immediately following its acquisition. Prices supplied by these sources are monitored daily by the master custodian.

When a pricing source is unable to provide a price, quotes are sought from major investment brokers and market-making dealers, or internal calculations are applied if feasible. As a last resort, the master custodian will contact investment managers for a price. Commingled funds, partnerships, and real estate assets are priced by the master custodian from statements received from the funds, partnerships, or investment managers.

The pricing sources used by the master custodian provide daily prices for equity securities; corporate, government, and mortgage-backed fixed income securities; private placement securities; futures and

options on futures; open-ended funds; and foreign exchange rates. Depending on the vendor, collateralized mortgage obligations (CMOs), adjustable rate mortgages (ARMs), and asset-backed securities are priced either daily, weekly, or twice a month and at month end. Municipal fixed income securities and options on U.S. Treasury/GNMA securities are priced at month end.

2. Investment Transactions and Income

Security transactions and related gains and losses are recorded on a trade date basis. The cost of investments sold is the average cost of the aggregate holding of the specific investment sold. Dividend income is recorded on the ex-dividend date, and interest income is accrued as earned. Futures contracts are valued daily, with the resulting adjustments recorded as realized gains or losses arising from the daily settlement of variation margin. Gains and losses related to forward contracts and options are recognized at the time the contracts are settled. Investments in limited partnerships are accounted for on the equity method of accounting, and their earnings (losses) for the period are included in investment income using the equity method.

E. Property, Plant, Furniture, and Equipment

Capital assets are recorded at cost at the time of acquisition and are reported net of accumulated depreciation. The system capitalizes all property, plant, and equipment that have a cost or value greater than \$5,000. Depreciation is computed on the straight-line basis over the estimated useful life of the property, ranging from 5 to 40 years.

F. Accumulated Vacation, Sick Leave, and Disability Credits

Employees of the System participate in the Commonwealth's accumulated vacation program and in either its sick leave or the Virginia Sickness and Disability Program (VSDP), which is administered by the System. Unused vacation may be accumulated and is paid at the time of permanent separation from service up to the maximum calendar year limit. Unused sick leave may be accumulated. If the member is vested, unused sick leave is paid at the rate of 25% of the amount accumulated not to exceed \$5,000 at the time of permanent separation from service. Unused VSDP disability credits converted from unused sick leave are paid in the same manner as unused sick leave at the time of permanent separation. The accrued liability for unused vacation, sick leave, or disability credits

reflected in the accompanying statements at June 30, 2003 and 2002 was computed using salary rates in effect at those times and represents vacation and sick leave earned up to the allowable ceilings as well as unused, converted disability credits.

G. Administrative Expenses and Budget

The administrative expenses related to the System’s administration and trust fund management activities are approved by the Board of Trustees and included in a budget prepared in compliance with the Commonwealth’s biennial budgetary system (cash basis). Appropriations are controlled at the program level and lapse at the end of the fiscal year. Administrative expenses are funded exclusively from investment income. Expenses for goods and services received but not paid for prior to the System’s fiscal year-end are accrued for financial reporting purposes in accordance with generally accepted accounting principals (GAAP). A reconciliation of the difference between the GAAP basis and budgeted basis is presented in the Schedule of Administrative Expenses.

H. Investment Income Allocation

Income earned on investments is distributed monthly to the Virginia Retirement System, the State Police Officers’ Retirement System, the Virginia Law Officers’ Retirement System, the Judicial Retirement System, the Group Life Insurance Fund, the Retiree Health Insurance Credit Fund, and the Disability Insurance Trust Fund. Distribution of investment income is based on the respective equity of each trust fund in the common investment pool.

The retirement plans distribute their cumulative investment income, net of administrative expenses, in the following manner:

1. Investment income is distributed to each of the individual member accounts based on a rate of 4% applied to each member’s cumulative balance as of the close of the preceding fiscal year.
2. The remaining portion is allocated quarterly to the participating employer accounts based on the ratio of their member account and employer account balances to the total of all such balances.

2. Plan Description

A. Retirement Plans

The Virginia Retirement System (System) was established on March 1, 1952, as the administrator of the Virginia Retirement System (VRS), a qualified governmental retirement plan, that provides defined benefit coverage for state employees, public school board employees, employees of participating political subdivisions, and other qualifying employees. The VRS is a mixed agent and cost-sharing, multiple-employer retirement plan. The plan’s accumulated assets may legally be used to pay all plan benefits provided to any of the plan members or beneficiaries.

The System also administers single-employer retirement plans for state police officers, who are covered under a separate State Police Officers’ Retirement System (SPORS) established on July 1, 1950; state law enforcement and correctional officers other than state police officers, who are covered under the Virginia Law Officers’ Retirement System (VaLORS) established on October 1, 1999; and judges of a court of record or a district court of the state and other qualifying employees, who are covered under the Judicial Retirement System (JRS) established on July 1, 1970.

At June 30, 2003 and 2002, the distribution of participating employers in the VRS was as follows:

VRS EMPLOYERS

| | 2003 | 2002 |
|------------------------|------------|------------|
| Cities and Towns | 149 | 147 |
| Counties | 92 | 92 |
| School Boards* | 145 | 145 |
| Special Authorities | 172 | 166 |
| State Agencies | 240 | 238 |
| Total employers | 798 | 788 |

** Of the 145 school boards, 131 also provide coverage for their nonprofessional employees and are treated as political subdivisions by the System.*

All full-time, salaried, permanent employees of participating employers must participate in VRS, SPORS, VaLORS, or JRS, with these exceptions: (1) certain full-time faculty and administrative staff of state colleges and universities and (2) eligible classified employees of the two state teaching hospitals. These employees have the option not to participate in the systems. Benefit provisions and all other requirements are established by Title 51.1 of the *Code of Virginia* (1950), as amended.

MEMBERSHIP FIGURES AT JUNE 30

| | 2003 | | | | 2002 | |
|--|----------------|--------------|--------------|------------|----------------|----------------|
| | VRS | SPORS | VaLORS | JRS | TOTAL | TOTAL |
| Retirees and beneficiaries receiving benefits | 106,794 | 814 | 774 | 376 | 108,758 | 103,622 |
| Terminated employees entitled to benefits but not yet receiving them | 26,480 | 82 | 210 | 11 | 26,783 | 25,416 |
| Total | 133,274 | 896 | 984 | 387 | 135,541 | 129,038 |
| Active plan participants: | | | | | | |
| Vested | 190,470 | 1,371 | 6,028 | 324 | 198,193 | 193,867 |
| Nonvested | 109,687 | 338 | 3,510 | 83 | 113,618 | 116,347 |
| Total | 300,157 | 1,709 | 9,538 | 407 | 311,811 | 310,214 |

The table above shows membership in VRS, SPORS, VaLORS, and JRS at June 30, 2003 and 2002.

Benefits vest after five years of service. Employees are eligible for an unreduced retirement benefit at age 65 if they have five years of service (age 60 for participating law enforcement officers and firefighters) or at age 50 with at least 30 years of service if elected by the employer (age 50 with at least 25 years of service for participating law enforcement officers and firefighters). Employees may retire with a reduced benefit at age 50 if they have at least 10 years of credited service or at age 55 (age 50 for participating law enforcement officers and firefighters) if they have at least five years of credited service.

Annual retirement benefits are payable monthly for life in an amount equal to 1.7 % of their average final salary (AFS) for each year of credited service. AFS is defined as the highest consecutive 36 months of salary. Benefits are actuarially reduced for members who retire prior to becoming eligible for full retirement benefits. Members of SPORS and VaLORS and participating law enforcement officers and firefighters may receive a monthly benefit supplement if they retire prior to age 65. Members of VaLORS hired before July 1, 2001 were allowed to make a one-time election to increase the multiplier from 1.7% to 2.0% instead of receiving the supplement. Members of VaLORS hired after June 30, 2001 have their benefit computed using the 2.0% multiplier and are not eligible for the supplement. Members of JRS receive weighted years of creditable service for each year of actual service under JRS. VRS, SPORS, VaLORS, and JRS also provide death and disability benefits. Cost-of-living increases, based on changes in the Consumer Price Index and limited to 5% per year, are granted in the second year of retirement and in every year thereafter.

Employees are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual salary to the retirement plans. This 5% member contribution may be assumed by the employer. If an employee leaves covered employment, the accumulated contributions plus earned interest may be refunded to the employee. Each participating employer is required by state statute to contribute the remaining amounts necessary to fund the retirement plans using the Entry Age Normal actuarial cost method adopted by the Board of Trustees. State statute may be amended only by the General Assembly of Virginia.

B. Group and Optional Life Insurance Programs

The Group Life Insurance Fund was established on July 1, 1960, for state employees, teachers, employees of political subdivisions participating in the VRS; state police officers; other state law enforcement and correctional officers; judges; and other qualifying employees. The program provides life insurance for natural death coverage equal to an employee's annual salary rounded to the next highest \$1,000, and then doubled. Accidental death coverage is double the natural death coverage. The program also provides coverage for accidental dismemberment and accidental blindness as well as an accelerated death benefit for terminal conditions. Approximately 326,599 employees and 102,244 retirees were covered under the program at June 30, 2003.

Employees who retire or terminate from service after age 50 with at least 10 years of service (including five years of continuous service) or at age 55 with at least five years of continuous service (age 50 for state police officers, other state law enforcement and correctional officers, and participating law enforcement officers and firefighters of

political subdivisions), or who retire because of disability, are entitled to post-employment life insurance benefits. At retirement or termination accidental benefits cease, and natural death coverage reduces at a rate equal to 25% on January 1 of the first full year following retirement or termination and each year thereafter, until it reaches 25% of its original value. These group life insurance benefit provisions and requirements are established by Title 51.1 of the *Code of Virginia* (1950), as amended.

Participating employers and their covered employees are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute to the cost of group life insurance benefits. Retirees are not required to contribute, and employers may assume the employees' contributions.

Contribution requirements are determined on the aggregate actuarial cost method adopted by the Board of Trustees. Since 1960, when the group life insurance program was first established, a portion of the premium contributions collected during employees' active careers has been placed in an Advance Premium Deposit Reserve, which was established to prefund death benefits to members after retirement.

An Optional Group Life Insurance Fund was established on November 1, 1995 for all employees currently covered under the basic group life program as a supplement to that plan. Employees may also purchase optional life insurance on their spouses and children. The optional program provides natural death coverage for the employee equal to one, two, three, or four times annual salary rounded to the next highest \$1,000, up to a maximum of \$500,000. Spouse coverage is available up to one-half of the employee's optional insurance amount, and children can be insured for \$5,000, \$10,000, or \$15,000, depending on the option chosen by the employee. For children under two years of age, coverage is limited to \$2,000, \$4,000, or \$6,000. An additional accidental death and dismemberment benefit is payable for death or bodily injuries. Approximately 50,958 employees were covered under this program at June 30, 2003.

Optional group life insurance coverage ends for employees when they retire, or terminate their employment, or when their basic coverage ends. Employees who retire for disability may continue their optional coverage until age 65 provided they continue to pay the required insurance premiums. Spouse coverage terminates should a couple divorce or when the employee leaves employment.

Children's coverage ends with the termination of the employee's coverage or when the child marries or turns 21 years of age (25 years of age for full-time college students).

Premiums for optional life insurance coverage are the responsibility of the covered employees and are deducted from their salaries by their employers as required by Title 51.1 of the *Code of Virginia* (1950), as amended. Premium requirements are based on the age of the covered employee and are determined by the Board of Trustees.

C. Retiree Health Insurance Credit Program

The Retiree Health Insurance Credit Fund was established on January 1, 1990 and provides benefits for retired state employees, state police officers, other state law enforcement and correctional officers, and judges who have at least 15 years of creditable service under the retirement plans. The program provides a maximum credit reimbursement of \$120.00 against the monthly health insurance premiums of eligible retirees.

A similar program was established on July 1, 1993 to provide benefits for retired teachers and employees of participating local governments with at least 15 years of creditable service under the retirement plans. Retired teachers may receive a monthly credit ranging from a maximum of \$75.00 to \$105.00, and local government retirees may receive a maximum credit of \$45.00.

Benefit provisions and eligibility requirements are established by Title 51.1, Chapter 14 of the *Code of Virginia* (1950), as amended. The amount required to fund all credits is financed on a current disbursement basis by the employers based on contribution rates determined by the System's actuary. Approximately 62,196 retired employees were covered under this program at June 30, 2003.

D. Virginia Sickness and Disability Program

The Disability Insurance Trust Fund, also known as the Virginia Sickness and Disability Program (VSDP), was established on January 1, 1999 and provides benefits for all full-time, classified state employees hired on or after January 1, 1999. Classified state employees includes state police officers and other state law enforcement and correctional officers. Part-time, classified state employees who work at least 20 hours a week on a salaried basis and who accrue leave are also covered.

Eligible state employees and state police officers of the Commonwealth employed prior to January 1, 1999 had the option during an open enrollment period to elect to participate in the VSDP or to remain under the Commonwealth's existing sick leave program and retain their eligibility for disability retirement benefits under VRS and SPORS. Eligible employees enrolled in VSDP are not eligible for disability retirement benefits under the VRS, SPORS, or VaLORS.

Teaching, administrative, and research faculty of Virginia institutions of higher education hired or appointed on or after January 1, 1999 who elected VRS as their retirement plan must make an irrevocable election to participate in the VSDP or in the institution's disability program. If there is no institution program, the faculty member is covered under the VSDP.

By providing sick leave, family and personal leave, and short-term and long-term disability benefits, the VSDP gives its members income protection from their very first day on the job. After a seven-calendar-day waiting period following the first incident of disability, full-time and eligible part-time classified employees receive short-term disability benefits from 60% to 100% of compensation, for a maximum of 125 work days, based on months of state service. After a 180-calendar-day waiting period (125 work days of short-term disability), full-time and eligible part-time classified employees receive long-term disability benefits equal to 60% of compensation until they return to work, until age 65 (age 60 for state police officers and other state law enforcement and correctional officers), or until death. Approximately 62,280 employees were covered under the program at June 30, 2003.

State agencies are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute to the cost of providing long-term disability benefits and of administering the program. Initial contribution

requirements to fund the program were determined by the System's actuary using an estimate of the amount of liability for disability benefits that would transfer from VRS, SPORS, and VaLORS to VSDP for the anticipated participants in VSDP.

3. Contributions – Retirement Plans

The funding policy of the retirement plans provides for periodic employer contributions at actuarially determined rates, which will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the cost of all basic benefits when due. Contribution rates are developed using the entry age normal cost method for both normal cost and amortization of the unfunded actuarial accrued liability. Gains and losses are reflected in the unfunded actuarial accrued liability that is being amortized as a level percentage of payroll within 30 years or less.

The amount of contributions to be provided by employers for state employees, each participating political subdivision, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, and the Judicial Retirement System for FY 2003 was actuarially computed by Gabriel, Roeder, Smith & Company and for FY 2002 was actuarially computed by Watson Wyatt & Company. In addition, separate contribution requirement was computed for the teacher cost-sharing pool by the actuaries for each year.

Contributions totaling \$1,041,835,000 and \$1,044,458,000 for the fiscal years ended June 30, 2003 and 2002, respectively, were made by employers and employees in accordance with statutory requirements. These contributions covered employers' normal costs and amortization of unfunded actuarial accrued liabilities.

Total employer contributions were \$392,732,000 for FY 2003. Included in total employer contributions were

CONTRIBUTIONS FOR THE YEARS ENDING JUNE 30

(Expressed in Thousands)

| | 2003 | | | | 2002 | |
|---|-------------------|------------------|------------------|------------------|--------------------|--------------------|
| | VRS | SPORS | VaLORS | JRS | TOTAL | TOTAL |
| Employer contributions | \$ 335,404 | \$ 8,777 | \$ 34,947 | \$ 13,604 | \$ 392,732 | \$ 422,094 |
| Employee contributions paid by employer | 499,077 | 3,972 | 14,559 | 2,346 | 519,954 | 504,550 |
| Employee contributions | 127,578 | 556 | 927 | 88 | 129,149 | 117,814 |
| Total contributions | \$ 962,059 | \$ 13,305 | \$ 50,433 | \$ 16,038 | \$1,041,835 | \$1,044,458 |

\$1,490,000 from school boards for payments toward the Early Retirement Program costs and \$29,456,000 from state agencies for payments toward Workforce Transition Act (WTA) costs. Included in the employee contributions of \$129,149,000 were \$81,680,000 paid for the purchase of previously refunded service and other qualifying service.

Employer contributions to the VRS cost-sharing pool for teachers represented 3.77% of covered payrolls. Additionally, employer contributions to VRS by the state were zero (0.00%) of covered payroll, and each political subdivision's contributions ranged from zero (0.00%) to 22.00% of covered payrolls. Employer contributions to SPORS by the state represented 11.05%, employer contributions to VaLORS by the state represented 12.00%, and employer contributions to JRS by the state represented 29.00% of covered payrolls. Employee contributions represented 5.00% of covered payrolls. Employer and employee contributions are required by Title 51.1 of the *Code of Virginia* (1950), as amended.

In addition to determining contribution requirements, the actuarial computations present an estimate of the discounted present value of the prospective accrued

liability contributions that will have to be paid by employers in the future so that such contributions, together with the assets on hand, the normal contributions to be made in the future by employers and employees, and the income guaranteed by investing the funds will be sufficient to provide all benefits to be paid to present members in the future as well as to annuitants and their designated beneficiaries. Historical trend information designed to provide information about the System's progress in accumulating sufficient assets to pay benefits when due is presented in the Required Supplemental Schedule of Funding Progress.

4. Reserve Accounts

The reserve account balances available for benefits at June 30, 2003 and 2002 are presented in the table below. These funds are required by Titles 51.1 and 2.1 of the *Code of Virginia* (1950), as amended, to provide for the payment of current and future benefits.

Member and employer reserves are funded by member and employer contributions and investment income. Each member has an account that accumulates member contributions plus annual interest. Each employer has an

RESERVE BALANCES AVAILABLE FOR BENEFITS AT JUNE 30

(Expressed in Thousands)

| | 2003 | 2002 |
|---|----------------------|----------------------|
| Virginia Retirement System: | | |
| Member Reserve | \$ 6,183,699 | \$ 5,723,813 |
| Employer Reserve | 26,543,183 | 26,724,496 |
| Total VRS | 32,726,882 | 32,448,309 |
| State Police Officers' Retirement System: | | |
| Member Reserve | 59,681 | 57,736 |
| Employer Reserve | 364,133 | 365,506 |
| Total SPORS | 423,814 | 423,242 |
| Virginia Law Officers' Retirement System: | | |
| Member Reserve | 133,041 | 124,566 |
| Employer Reserve | 261,738 | 225,498 |
| Total VaLORS | 394,779 | 350,064 |
| Judicial Retirement System: | | |
| Member Reserve | 26,865 | 26,572 |
| Employer Reserve | 208,407 | 207,642 |
| Total JRS | 235,272 | 234,214 |
| Group Life Insurance: | | |
| Advance Premium Deposit Reserve | 751,747 | 838,601 |
| Retiree Health Insurance Credit Reserve | 92,222 | 76,184 |
| Virginia Sickness and Disability Program: | | |
| Disability Insurance Trust Fund | 78,383 | 57,906 |
| Total Pension and Other Employee Benefit Reserve | \$ 34,703,099 | \$ 34,428,520 |

account that accumulates employer contributions, transfers of investment income reduced by the administrative expenses incurred in operating the retirement plans, and transfers of member contributions and interest upon a member's retirement. Employer accounts are charged with benefit payments.

The Advance Premium Deposit Reserve accumulates a portion of insurance premium contributions collected during an employee's active career and investment earnings thereon and is charged for death benefits paid and expenses incurred in operating the group life insurance program.

The Retiree Health Insurance Credit Reserve is funded by employer contributions and investment income. It is charged for credit reimbursements applied to the monthly health insurance premiums of eligible retired employees and for expenses incurred in operating the Retiree Health Insurance Credit Fund program.

The Disability Insurance Trust Fund is funded by employer contributions and investment income. It is charged for long-term disability benefits and for expenses incurred in operating the Virginia Sickness and Disability Program.

5. Deposits and Investments

A. Deposits

Deposits of the System that are maintained by the Treasurer of Virginia at June 30, 2003 and 2002 were entirely insured under the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the *Code of Virginia* (1950), as amended, which provides for an assessable multiple financial institution collateral pool. Deposits with the System's master custodian, Mellon Trust, were entirely insured by federal depository insurance coverage.

The carrying amounts of these deposits at June 30, 2003 and 2002 consisted of the following (in thousands):

| | 2003 | 2002 |
|-----------------------|-------------------------|------------------------|
| Deposits | Carrying Amount | Carrying Amount |
| Treasurer of Virginia | \$ 48,257 | \$ 3,507 |
| Master Custodian | 2,352 | 220 |
| Total Deposits | <u>\$ 50,609</u> | <u>\$ 3,727</u> |

B. Investments

1. Authorized Investments

The Board of Trustees of the System has full power to invest and reinvest the trust funds in accordance with Section 51.1-124.30 of the *Code of Virginia* (1950), as amended. This section requires the board to discharge its duties solely in the interest of the beneficiaries and to invest the assets with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The board must also diversify such instruments so as to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so. There is no concentration of investments in any one organization that represents 5% or more of plan net assets held in trust for benefits.

Investment value and earnings of the investment pool are proportionally allocated among the System's trust funds on the basis on each fund's equity interest in the common investment pool. An Investment Summary is included in the Investment Section of this report. As of June 30, 2003 and 2002, the equity interests of each fund were as follows:

| | 2003 | 2002 |
|--|-----------------------|-----------------------|
| • Virginia Retirement System | 94.22% | 94.18% |
| • State Police Officers' Retirement System | 1.22% | 1.23% |
| • Virginia Law Officers' Retirement System | 1.13% | 1.01% |
| • Judicial Retirement System | 0.67% | 0.68% |
| • Group Life Insurance Fund | 2.27% | 2.52% |
| • Retiree Health Insurance Credit Fund | 0.27% | 0.22% |
| • Disability Insurance Trust Fund | 0.22% | 0.16% |
| Total | <u>100.00%</u> | <u>100.00%</u> |

2. Custodial Risk

Investments held by the System at June 30, 2003 have been categorized according to the level of credit risk associated with its custodial arrangements at fiscal year-end. Category 1 includes investments that are insured or registered or for which securities are held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which securities are held by the counterparty, or by its trust

SUMMARY OF CATEGORIZED INVESTMENTS AT FAIR VALUE

As of June 30, 2003

(Expressed in Thousands)

| | Category | | | Non-Categorized | Total Fair Value at June 30 2003 |
|---|----------------------|-------------|-------------------|----------------------|----------------------------------|
| | 1 | 2 | 3 | | |
| Long-Term Investments | | | | | |
| Bonds and Mortgage Securities: | | | | | |
| U.S. Government and agencies | \$ 3,465,722 | \$ — | \$ 99,444 | \$ — | \$ 3,565,166 |
| Corporate and other bonds | 2,628,749 | — | 6,855 | — | 2,635,604 |
| Common and preferred stocks | 8,133,047 | — | — | — | 8,133,047 |
| Equity index and pooled funds | — | — | — | 12,890,439 | 12,890,439 |
| Fixed income commingled funds | — | — | — | 104,739 | 104,739 |
| Real estate investments | — | — | — | 1,098,165 | 1,098,165 |
| Private equity | — | — | — | 2,177,483 | 2,177,483 |
| Held by brokers-dealers under securities lending program: | | | | | |
| U.S. Government and agencies | 113,299 | — | 109,024 | 1,544,547 | 1,766,870 |
| Corporate and other bonds | — | — | — | 345,669 | 345,669 |
| Common and Preferred stocks | — | — | 25,714 | 498,439 | 524,153 |
| Total long-term investments | 14,340,817 | — | 241,037 | 18,659,481 | 33,241,335 |
| Short-Term Investments | | | | | |
| Investments held by Treasurer: | | | | | |
| Local Government Investment Pool | — | — | — | 138,620 | 138,620 |
| Investments held with Trustees: | | | | | |
| The Boston Company | | | | | |
| Pooled Employee Trust Funds | — | — | — | 2,133,180 | 2,133,180 |
| Foreign currencies | — | — | — | 53,645 | 53,645 |
| Total short-term investments | — | — | — | 2,325,445 | 2,325,445 |
| Total Investments | \$ 14,340,817 | \$ — | \$ 241,037 | \$ 20,984,926 | \$ 35,566,780 |
| Securities Lending Separate Account | \$ — | \$ — | \$ — | \$ 2,443,399 | \$ 2,443,399 |

department or agent, but not in the System's name. Certain investments cannot be categorized because they are not evidenced by physical securities. Securities lent at year-end for cash collateral are presented as unclassified, while securities lent for non-cash collateral are classified according to their custodial arrangements for the related non-cash collateral securities. The cash collateral is invested in instruments, such as commercial paper, repurchase agreements, asset-backed securities, certificates of deposit, and floating rate notes, in an agent-managed separate account.

3. Securities Lending

Under authorization of the Board, the System lends its fixed income and equity securities to various broker-dealers on a temporary basis. This program is administered through an agreement with the System's

custodial agent bank. All security loan agreements are collateralized by cash, securities, or irrevocable letter of credit issued by major banks, and have a market value equal to at least 102% of the market value for domestic securities and 105% for international securities. Securities received as collateral cannot be pledged or sold by the System unless the borrower defaults. Contracts require the lending agents to indemnify the System if the borrowers fail to return the securities lent and related distributions, and if the collateral is inadequate to replace the securities lent.

All security loans can be terminated on demand by either the System or the borrowers. The majority of loans are open loans – meaning the rebate is set daily, which results in a maturity of one or two days on average, although securities are often on loan for longer periods.

The maturity of loans generally does not match the maturity of collateral investments, which averages 87 days. At year-end, the System has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. The market value of securities on loan at June 30, 2003 and 2002 was \$2,638,297,000 and \$2,848,935,000, respectively. The value of collateral (cash and non-cash) at June 30, 2003 and 2002 was \$2,697,437,000 and \$2,911,763,000, respectively.

Securities on loan are included with investments on the statement of net assets and are classified in the summary of custodial risk (see note 5B2. Custodial Risk). The invested cash collateral is included in the statement of net assets as an asset and corresponding liability. The invested cash collateral is also classified in the summary of custodial risk.

4. **Accounts Receivable/Accounts Payable for Security Transactions**

In addition to unsettled purchases and sales, accounts receivable and accounts payable for security transactions at June 30, 2003 and 2002, respectively, include (1) receivables for deposits with brokers for securities sold short of \$785,703,000 and \$736,544,000 and (2) payables for securities sold short and not covered with market values of \$773,381,000 and \$792,015,000, respectively.

5. **Derivative Financial Instruments**

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. They include futures, forwards, options, and swap contracts. Some traditional securities, such as structured notes, can have derivative-like characteristics. In this case, the return may be linked to one or more indexes and asset-backed securities such as collateralized mortgage obligations (CMOs), which are sensitive to changes in interest rates and prepayments. Futures, forwards, options, and swaps are generally not recorded on the financial statements, whereas structured notes and asset-backed investments generally are recorded.

The System is a party, both directly and indirectly, to various derivative financial investments that may or may not appear on the financial statements and that are used in the normal course of business to enhance returns on investments and manage risk exposure to changes in value

resulting from fluctuations in market conditions. These investments may involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the financial statements. Credit risk is the possibility that loss may occur from the failure of a counterparty to perform according to the terms of the contract. Market risk arises from adverse changes in market prices, interest rates, and foreign exchange rates that may result in a decrease in the market value of a financial investment or an increase in its funding cost, or both.

In addition to risk exposure from directly held derivative financial instruments, the System may have indirect exposure to risk through its ownership interests in commingled investment funds that use, hold, or write derivative financial instruments. Indirect exposure may also arise from stock lending programs in which the commingled funds participate. Such programs usually reinvest a portion of their cash collateral holdings in derivative instruments. The System's pro rata share of the contractual or notional amounts of outstanding derivative transactions in commingled investment funds and their related security lending programs approximated \$276,828,000 at June 30, 2003 and \$74,999,000 at June 30, 2002.

6. **Forward, Futures, and Option Contracts**

Forward contracts are contracts to purchase or sell, and futures contracts are contracts to deliver or receive financial instruments, foreign currencies, or commodities at a specified future date and at a specified price or yield. Futures contracts are traded on organized exchanges (exchange traded) and require initial margin (collateral) in the form of cash or marketable securities. The net change in the futures contract value is settled daily, in cash, with the exchanges. Holders of futures contracts look to the exchange for performance under the contract and not to the entity holding the offsetting futures position. Accordingly, the amount at risk posed by nonperformance of counterparties to futures contracts is minimal. In contrast, forward contracts traded over-the-counter are generally negotiated between two counterparties. They are subject to credit risks resulting from nonperformance of one of the counterparties and to market risks resulting from adverse fluctuations in market prices, interest rates, and foreign exchange rates.

Options may be either exchange traded or negotiated directly between two counterparties over the counter. Options grant the holder the right, but not the obligation,

to purchase or sell a financial instrument at a specified price and within a specified period of time from the “writer” of the option. As a purchaser of options, the System typically pays a premium at the outset. This premium is reflected as an asset on the financial statements. The System then retains the right but not the obligation to exercise the option and purchase the underlying financial instrument. Should the option not be exercised, it expires worthless and the premium is recorded as a loss. A writer of options assumes the obligation to deliver or receive the underlying financial instrument on exercise of the option. Certain option contracts may involve cash settlements based on specified indexes such as stock indexes. As a writer of options, the System receives a premium at the outset. This premium is reflected as a liability on the financial statements and the System bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

Forward, futures, and options contracts provide the System with the opportunity to build passive benchmark positions, manage portfolio duration in relation to various benchmarks, adjust portfolio yield curve exposure and gain market exposure to various indexes in a more efficient way and at lower transaction costs. Credit risks depend on whether the contracts are exchange traded or exercised over-the-counter. Market risks arise from adverse changes in market prices, interest rates, and foreign exchange rates. At June 30, 2003, the System had purchased S&P and Russell Index futures and options on Eurodollar and Treasury bond note futures, including options on Eurodollar futures, with a notional value of \$3,634,769,000, and sold S&P Index futures and options on Eurodollar and Treasury bond and note futures, including options on these futures, with a notional value of \$1,248,932,000. At June 30, 2002, the notional values of the balances purchased and sold were \$1,060,556,000 and \$394,316,000, respectively. At June 30, 2003, the System had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of \$147,183,000 as the margin requirement for futures contracts. At June 30, 2002, the market value of the pledged securities was \$79,358,000.

7. Foreign Exchange Contracts

Foreign exchange contracts include forward, futures, and options contracts. They involve either the exchange of specific amounts of two currencies or the delivery of a fixed amount of a currency at a future date and specified

exchange rate. Forward and futures contracts settle three or more business days from the contract date. Forward contracts are negotiated over-the-counter between two counterparties, while futures contracts are exchange traded. Foreign currency options, which are either negotiated between two counterparties or are exchanged traded, grant the buyer the right, but not the obligation, to purchase or sell at a specified price, a stated amount of an underlying currency at a future date. At June 30, 2003, the System had sold foreign currency contracts with a notional value of \$460,454,000 and had purchased foreign currency contracts with a notional value of \$462,032,000. At June 30, 2002, the notional values of the foreign currency contracts sold and purchased were \$156,394,000 and \$157,721,000, respectively.

Foreign exchange contracts are used by the System to effect settlements and to protect the base currency (\$US) value of portfolio assets denominated in foreign currencies against fluctuations in the exchange rates of those currencies. The credit risk of currency contracts that are exchange traded lies with the clearinghouse of the exchange where the contracts are traded. The credit risk of currency contracts traded over-the-counter lies with the counterparty, and exposure is usually equal to the unrealized profit on in-the-money contracts. The market risk in foreign currency contracts is related to adverse movements in currency exchange rates.

8. Asset-Backed Securities

Among the instruments with derivative-like characteristics that the System invests in and that appear on the financial statements are various asset-backed securities such as collateralized mortgage obligations (CMOs), principal-only strips (POs) and interest-only strips (IOs). These instruments are used primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets. CMO securities are bonds collateralized by mortgage-backed securities and issued in several tranches that represent a reallocation of the underlying mortgage-backed securities cash flows. Both PO and IO securities are created by splitting the asset-backed securities into principal-only and interest-only portions. At June 30, 2003, the System held CMO securities with a market value of \$157,025,000 and IO and PO securities with a market value of \$7,839,000. At June 30, 2002, the market value for CMO securities held was \$301,643,000 and the market value for IO and PO securities held was \$2,175,000.

The credit risks on the various asset-backed securities in which the System invests are usually very low. Many of the securities held by the System are issued by quasi-U.S. governmental agencies. Others are issued by organizations with AAA or AA credit ratings. The market risk of these securities depends on changes in interest rates and the level of the underlying prepayments, i.e., when the mortgagors repay the underlying principal and interest.

9. Swap Agreements

Swaps are negotiated contracts between two

counterparties for the exchange of payments at certain intervals over a predetermined time frame. The payments are based on a notional principal amount and calculated using either fixed or floating interest rates or total returns from certain instruments or indices. During FY 2003, the System entered into interest rate and total return swaps with a total notional value of \$100,000,000. For FY 2002 the total notional value was \$80,000,000. Swaps are used to manage risk and enhance returns. To reduce the risk of counterparty non-performance, the System generally requires collateral on any material gains from these transactions.

6. Property, Plant, Furniture, and Equipment

The summary of property, plant, furniture, and equipment at June 30, 2003 and 2002 is as follows (in thousands):

| | Balance June 30, 2002 | Increases | Decreases | Balance June 30, 2003 |
|---|--------------------------|-----------------|--------------|--------------------------|
| Nondepreciable capital assets: | | | | |
| Land | \$ 1,368 | \$ — | \$ — | \$ 1,368 |
| Total nondepreciable capital asset | 1,368 | — | — | 1,368 |
| Depreciable capital assets: | | | | |
| Building | 4,632 | — | — | 4,632 |
| Furniture and equipment | 3,495 | 472 | 184 | 3,783 |
| Total depreciable capital assets | 8,127 | 472 | 184 | 8,415 |
| Less accumulated depreciation: | | | | |
| Building | 463 | 116 | — | 579 |
| Furniture and equipment | 2,585 | 499 | 150 | 2,934 |
| Total accumulated depreciation | 3,048 | 615 | 150 | 3,513 |
| Total depreciable capital assets – Net | 5,079 | (143) | 34 | 4,902 |
| Total capital assets – Net | \$ 6,447 | \$ (143) | \$ 34 | \$ 6,270 |

Depreciation expense amounted to \$417,000 and \$407,000 in 2003 and 2002, respectively.

7. Operating Leases

The System has commitments under various operating leases for equipment and office space for some staff. In general, the leases are for a three-year term. In most cases, the System expects that in the normal course of business, these leases will be replaced by similar leases. Total rental expense for the fiscal year ended June 30, 2003, was \$916,000. The System has, as of June 30, 2003, the following total future minimum rental payments due under the above leases (in thousands):

| Year | Amount |
|---|-----------------|
| 2004 | \$ 712 |
| 2005 | 336 |
| 2006 | 65 |
| Total future minimum rental payments | \$ 1,113 |

8. Defined Benefit Pension Plan

A. Contributions to Pension Plan:

All full-time, salaried, permanent employees of the System are employees of the Commonwealth and are included in the Commonwealth's participation in the Virginia Retirement System (VRS), a defined benefit pension plan administered by the System. The Commonwealth, not the System, has overall responsibility for contributions to this plan and other employee benefit plans.

Note 2A provides information regarding types of employees covered, benefit provisions, employee eligibility requirements (including eligibility requirements for vesting), and the authority under which benefit provisions

and employer/employee obligations to contribute are established. Additional information on funding policy and contributions required and made can be found in Note 3. Information on the actuarial method and assumptions can be found in the “Notes to Required Supplemental Schedules.”

Historical trend information showing the Commonwealth of Virginia’s progress in accumulating sufficient assets to pay benefits when due is presented in the Commonwealth’s Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003.

9. Other Employee Benefit Programs

A. Life Insurance Benefits

The Commonwealth of Virginia participates in the System-administered group life insurance program, which provides postemployment life insurance benefits, in accordance with state statutes, to eligible retired and terminated employees. There were approximately 95,229 state employees and 40,164 retirees in the program during FY 2003. Information regarding eligibility requirements and benefit provisions as well as contribution requirements can be found in Note 2B.

Postemployment life insurance benefits are advance-funded based on biennial actuarial computations using the aggregate cost actuarial method. The significant actuarial assumptions used were the same as those used to prepare actuarial valuations of the System-administered pension plans at June 30, 2001, and the modified market value of plan assets was used for valuation purposes.

Separate measurements of assets and actuarial accrued liabilities are not made for individual employers participating in the program. The accrued liabilities for postemployment death benefits actuarially determined through an actuarial valuation performed as of June 30, 2002, were \$1,787.3 million. The actuarial value of the program’s assets available for benefits on that date was \$1,006.3 million, leaving a present value of future contributions of \$781.0 million.

The System’s contribution requirements for its employees for the fiscal years ended June 30, 2003 and 2002 were zero and \$56,000, respectively. In April 2002, the General Assembly suspended contributions for FY 2003 and FY 2004.

B. Retiree Health Insurance Credits

The Commonwealth of Virginia provides health insurance credit reimbursements, in accordance with state statutes, against the monthly health insurance premiums of its retirees who have at least 15 years of service. The monthly credit amounts to \$4.00 per year of service, not to exceed a maximum credit of \$120.00. All state agencies are required to contribute to the program at an actuarially determined percentage of their payroll. Contributions are being financed on a current disbursement basis. Approximately 28,334 state retirees were receiving health insurance credits at June 30, 2003. Note 2C contains information regarding eligibility requirements, benefit provisions, and contribution requirements.

For the fiscal year ended June 30, 2003, state agencies were required to contribute 0.89% of covered payroll. The System’s contribution requirements for its employees for the fiscal years ended June 30, 2003 and 2002 were \$96,000 and \$117,000, respectively.

C. Virginia Sickness and Disability Program

By providing sick leave, family and personal leave, and short-term and long-term disability benefits, the VSDP gives its members income protection from their very first day on the job. At June 30, 2003 approximately 62,280 participants were enrolled in the program.

For the fiscal year ended June 30, 2003, state agencies were required to contribute to the program at the actuarially estimated rate of 1.07% of payroll for state employees and 1.42% for state police officers and state law enforcement and correctional officers other than state police officers. The System’s contribution requirements for its employees for the fiscal years ended June 30, 2003 and 2002 were \$116,000 and \$81,000, respectively.

10. Litigation

The System, its Board of Trustees, officers, and employees are defendants in claims and lawsuits that are either pending, in progress, or have been settled since June 30, 2003. It is not reasonably possible at the present time to estimate the ultimate outcome or the System’s liability, if any, with respect to the various proceedings. However, on the basis of advice received from the Attorney General and outside counsel who have reviewed the status of these claims and lawsuits, it is the opinion of management that such liability, if any, would not have a material adverse effect on the System’s financial condition.

11. Risk Management

In order to cover its exposures to various risks of loss, the System, an independent agency of the Commonwealth of Virginia, participates in the Commonwealth's self-insurance programs for state employee health care and risk management. The latter program includes property, general (tort) liability, medical malpractice, and automobile plans. The System's employees are covered by the Commonwealth's Worker's Compensation program administered by the Department of Human Resources. In addition, the System is self-insured for fiduciary liability and director's and officer's liability under a program administered by the Commonwealth's Division of Risk Management. There were no claims in excess of coverage and no reductions in coverage during FY 2003 and the three preceding fiscal years.

12. Commitments

The System extends investment commitments in the normal course of business. At June 30, 2003 and 2002, these commitments amounted to \$1,746,000,000 and \$1,615,000,000, respectively.

13. Statutory Contribution Adjustment

During its 2002 Session, the General Assembly made a number of adjustments to reduce funded employer contributions for the defined benefit retirement plans to levels below those recommended by the VRS actuary and approved by the Board of Trustees. Those changes affected FY 2003 and will also have an effect on FY 2004. The changes made modify the contributions received for

all state employee groups (state employees in the VRS plan as well as those in SPORS, VaLORS, and JRS) and teachers. The change did not impact the rates contributed by political subdivisions.

For FY 2003 and FY 2004 the rates computed by the actuary were 3.60%, 3.60%, 12.11%, 13.22%, and 30.61% for state employees, teachers, SPORS, VaLORS, and JRS, respectively. The VRS Board of Trustees approved a rate of 4.24% (the actuarial rate for FY 2002) for state employees and teachers in anticipation of future rate increases. The Board certified a rate of 25.00% for SPORS and VaLORS, and a rate of 45.00% for JRS. These rates reflect efforts by the Board to raise the funding ratios of these plans to a 90% funded level.

For FY 2003, the funded rate for teachers was reduced from 4.24% to 3.60%, plus 0.17% to offset the impact of early implementation of the rate in FY 2002. The teacher rate is scheduled to remain at that level in FY 2004. For FY 2003, the rate for state employees in the VRS plan remained at 0.00% (zero); however, it is scheduled to increase to 3.77%, the same rate as the teachers, in FY 2004. FY 2003 rates for SPORS, VaLORS, and JRS were 11.05%, 12.00%, and 29.00%, respectively, or slightly less than the rates recommended by the actuary. For FY 2004, contribution rates for SPORS, VaLORS, and JRS are scheduled to be at the levels recommended by the actuary, plus an amount to offset the impact of early implementation of the rate in FY 2002.

REQUIRED SUPPLEMENTAL SCHEDULE OF FUNDING PROGRESS

(Dollars in Millions)

| Biennial Actuarial Valuation Date June 30 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded AAL (UAAL) (a-b) | Funded Ratio (a/b) | Covered Payroll | UAAL as a Percentage of Covered Payroll (b-a)/(c) |
|--|-------------------------------|---|---------------------------|--------------------|-----------------|---|
| Virginia Retirement System (VRS) | | | | | | |
| 2002 | \$ 38,957 | \$ 38,265 | \$ (682) | 101.8% | \$ 10,669 | (6.5%) |
| 2001 | 37,968 | 35,384 | (2,584) | 107.3% | 10,145 | (25.5%) |
| 2000 ** | 34,392 | 32,643 | (1,749) | 105.4% | 9,529 | (18.4%) |
| 1999 | 29,804 | 31,419 | 1,615 | 94.9% | 9,138 | 17.7% |
| 1998 * | 25,481 | 29,027 | 3,546 | 87.8% | 8,638 | 41.1% |
| 1996 ** | 19,032 | 23,842 | 4,810 | 79.8% | 7,769 | 61.9% |
| 1994 | 14,891 | 20,405 | 5,514 | 73.0% | 7,274 | 75.8% |
| State Police Officers' Retirement System (SPORS) | | | | | | |
| 2002 | \$ 508 | \$ 595 | \$ 87 | 85.4% | \$ 81 | 107.4% |
| 2001 | 495 | 557 | 62 | 88.9% | 83 | 74.7% |
| 2000 ** | 441 | 513 | 72 | 86.0% | 81 | 88.9% |
| 1999 | 377 | 463 | 86 | 81.4% | 77 | 111.7% |
| 1998 * | 322 | 425 | 103 | 75.8% | 65 | 158.5% |
| 1996 ** | 243 | 371 | 128 | 65.5% | 60 | 213.3% |
| 1994 | 201 | 277 | 76 | 72.6% | 58 | 131.0% |
| Virginia Law Officers' Retirement System (VaLORS) | | | | | | |
| 2002 | \$ 418 | \$ 806 | \$ 388 | 51.9% | \$ 306 | 126.8% |
| 2001 | 393 | 628 | 235 | 62.6% | 320 | 73.4% |
| 2000 *** | 307 | 680 | 373 | 45.1% | 315 | 118.4% |
| Judicial Retirement System (JRS) | | | | | | |
| 2002 | \$ 281 | \$ 352 | \$ 71 | 79.8% | \$ 48 | 147.9% |
| 2001 | 277 | 342 | 65 | 81.0% | 47 | 138.3% |
| 2000 ** | 245 | 330 | 85 | 74.2% | 45 | 188.9% |
| 1999 | 210 | 302 | 92 | 69.5% | 42 | 219.0% |
| 1998 * | 180 | 274 | 94 | 65.7% | 39 | 241.0% |
| 1996 ** | 138 | 243 | 105 | 56.8% | 36 | 291.7% |
| 1994 | 115 | 199 | 84 | 57.8% | 33 | 254.5% |

* Change in benefit formula, unreduced early retirement age, and in the actuarial amortization method.

** Revised economic and demographic assumptions due to experience study.

*** The first actuarial valuation for the Virginia Law Officers' Retirement System, established on October 1, 1999, was performed as of June 30, 2000.

REQUIRED SUPPLEMENTAL SCHEDULE OF EMPLOYER CONTRIBUTIONS

(Dollars in Thousands)

| Year Ended June 30 | Annual Required Contribution | Percentage Contributed | Statutory Required Contribution | Percentage Contributed |
|--|------------------------------------|---------------------------|---------------------------------------|---------------------------|
| Virginia Retirement System (VRS) | | | | |
| 2003 * | \$ 450,766 | 67.61% | \$ 304,784 | 100.00% |
| 2002 * | 459,613 | 79.68% | 366,239 | 100.00% |
| 2001 * | 630,458 | 99.99% | 630,370 | 100.00% |
| 2000 * | 785,376 | 93.24% | 732,273 | 100.00% |
| 1999 * | 738,051 | 85.64% | 632,084 | 100.00% |
| 1998 * | 757,164 | 71.06% | 538,016 | 100.00% |
| 1997 ** | 720,436 | 61.91% | 446,005 | 100.00% |
| State Police Officers' Retirement System (SPORS) | | | | |
| 2003 * | \$ 19,866 | 44.20% | \$ 8,781 | 100.00% |
| 2002 * | 20,190 | 50.00% | 10,095 | 100.00% |
| 2001 | 20,420 | 100.00% | 20,420 | 100.00% |
| 2000 * | 17,684 | 85.07% | 15,044 | 100.00% |
| 1999 * | 16,088 | 69.87% | 11,241 | 100.00% |
| 1998 * | 11,764 | 71.70% | 8,435 | 100.00% |
| 1997 ** | 11,099 | 64.69% | 7,180 | 100.00% |
| Virginia Law Officers' Retirement System (VaLORS) | | | | |
| 2003 * | \$ 72,699 | 48.00% | \$ 34,895 | 100.00% |
| 2002 * | 77,417 | 32.30% | 25,006 | 100.00% |
| 2001 | 51,072 | 100.00% | 51,072 | 100.00% |
| 2000 *** | 16,216 | 84.81% | 13,753 | 100.00% |
| Judicial Retirement System (JRS) | | | | |
| 2003 * | \$ 21,110 | 64.44% | \$ 13,604 | 100.00% |
| 2002 * | 21,282 | 50.00% | 10,641 | 100.00% |
| 2001 | 20,822 | 100.00% | 20,822 | 100.00% |
| 2000 * | 15,075 | 99.07% | 14,935 | 100.00% |
| 1999 * | 14,118 | 91.64% | 12,938 | 100.00% |
| 1998 * | 12,873 | 86.74% | 11,166 | 100.00% |
| 1997 ** | 12,378 | 83.43% | 10,327 | 100.00% |

* Contributions made by employers during the fiscal years ended June 30, 1998, 1999, 2000, 2001, 2002, and 2003 were not in all cases in accordance with the actuarially determined Annual Required Contribution (ARC), but they did meet the statutory requirements. Beginning with FY 1998, all employers were provided an option to elect an annual contribution that met the parameters of the ARC which includes full pre-funding of the automatic cost-of-living increases (COLAs) for retirees, or an annual contribution that would phase in the parameters over a five-year period ending with FY 2002.

** Contributions made by employers during the fiscal year ended June 30, 1997, were in accordance with statutory requirements that differ from the actuarially determined Annual Required Contributions (ARC) primarily because statutory required contributions funded cost-of-living increases (COLAs) for retirees on a current disbursement basis. Contribution information that meets the ARC parameters of GASB Statement No. 25 is unavailable for fiscal years prior to FY 1997.

*** The VaLORS program was effective on October 1, 1999.

**NOTES TO REQUIRED SUPPLEMENTAL SCHEDULES
ACTUARIAL METHODS AND SIGNIFICANT 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: | June 30, 2002 |
| Actuarial Cost Method: | Entry Age Normal |
| Amortization Method: | |
| State Employees | Level percent, open |
| Political Subdivision Employees | Level percent, open |
| Teachers | Level percent, open |
| State Police /VA Law Officers /Judges | Level percent, closed |
| Payroll Growth Rate | 3.00% |
| Remaining Amortization Period: | |
| State Employees | 24 Years |
| Political Subdivision Employees | 0 to 30 Years |
| Teachers | 24 Years |
| State Police /VA Law Officers /Judges | 24 Years |
| Asset Valuation Method: | Modified Market |
| Actuarial Assumptions: | |
| Investment Rate of Return * | 8.00% |
| Projected Salary Increases * | |
| State /Political Subdivision Employees | 4.25% to 6.10% |
| Teachers | 4.00% to 6.10% |
| State Police /VA Law Officers | 4.50% to 5.75% |
| Judges | 5.00% |
| Cost-of-Living Adjustments | 3.00% |

* Includes inflation at 3.00%

Virginia Retirement System

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES - AGENCY FUND
OPTIONAL LIFE INSURANCE FUND

For the Years Ended June 30, 2003 and 2002

(Expressed in Thousands)

| | Balance July 1, 2002 | Additions | Deductions | Balance June 30, 2003 |
|---|----------------------------|-------------------------|-------------------------|-----------------------------|
| Assets: | | | | |
| Cash | \$ 1,198 | \$ 18,323 | \$ 18,350 | \$ 1,171 |
| Due from other funds..... | 1,852 | – | 80 | 1,772 |
| Total assets | <u>\$ 3,050</u> | <u>\$ 18,323</u> | <u>\$ 18,430</u> | <u>\$ 2,943</u> |
| Liabilities: | | | | |
| Insurance premiums and claims payable | \$ 3,050 | \$ – | \$ 107 | \$ 2,943 |
| Total liabilities | <u>\$ 3,050</u> | <u>\$ –</u> | <u>\$ 107</u> | <u>\$ 2,943</u> |

**SCHEDULE OF ADMINISTRATIVE EXPENSES
YEARS ENDED JUNE 30, 2003 AND 2002**

(Expressed in Thousands)

| | Totals | |
|--|------------------|------------------|
| | 2003 | 2002 |
| Personal Services: | | |
| Salaries and wages | \$ 11,937 | \$ 10,898 |
| Per diem services | 282 | 301 |
| Retirement contributions | 604 | 730 |
| Social Security | 838 | 754 |
| Group life and medical insurance | 1,129 | 960 |
| Compensated absences | 134 | 190 |
| Total personal services | 14,924 | 13,833 |
| Professional Services: | | |
| Data processing | 4,071 | 3,961 |
| Actuarial and consulting | 699 | 846 |
| Legal | 623 | 408 |
| Medical | 255 | 177 |
| Management services | 43 | 185 |
| Public information services | 1 | 81 |
| Personnel development services | 48 | 82 |
| Total professional services | 5,740 | 5,740 |
| Communication Services: | | |
| Media | 18 | 95 |
| Printing | 684 | 616 |
| Postal and delivery | 522 | 705 |
| Telecommunications | 365 | 307 |
| Total communication services | 1,589 | 1,723 |
| Rentals: | | |
| Business equipment | 592 | 524 |
| Office space | 324 | 234 |
| Total rentals | 916 | 758 |
| Other Services and Charges: | | |
| Skilled and clerical services | 262 | 282 |
| Depreciation | 417 | 407 |
| Dues and memberships | 110 | 50 |
| Building expense | 490 | 409 |
| Equipment | 533 | 162 |
| Insurance | 28 | 24 |
| Repairs and maintenance | 26 | 116 |
| Supplies and materials | 116 | 174 |
| Travel and transportation | 625 | 668 |
| Miscellaneous | 116 | 122 |
| Total other services and charges | 2,723 | 2,414 |
| Total Administrative Expenses (GAAP basis) | 25,892 | 24,468 |
| Adjustments necessary to convert administrative expenses on the GAAP basis to the budgetary basis at year end (net) | (438) | 149 |
| Administrative Expenses (Budgetary basis) | \$ 25,454 | \$ 24,617 |
| Administrative Expenses Appropriated | \$ 29,402 | \$ 25,544 |
| Distribution of Administrative Expenses: | | |
| Total Administrative Expenses (GAAP Basis) | \$ 25,892 | \$ 24,468 |
| Less: In-house Investment Management | (7,464) | (7,783) |
| Net Administrative Expenses | \$ 18,428 | \$ 16,685 |

SCHEDULE OF INVESTMENT EXPENSES FOR THE YEAR ENDED JUNE 30, 2003

(Expressed in Thousands)

| | | | |
|--|--|----------|------------------|
| Management fees: | | | |
| Domestic managers | | \$ 4,680 | |
| Non-U.S. equity managers | | 8,539 | |
| Fixed income managers | | 6,003 | |
| Real estate managers | | 9,939 | |
| Alternative investment managers | | 52,293 | \$ 81,454 |
| | | | |
| Performance fees | | | 10,080 |
| Total management and performance fees | | | 91,534 |
| Miscellaneous fees and expenses: | | | |
| Custodial fees | | \$ 2,807 | |
| Legal fees | | 62 | |
| Taxes and wire fees | | 10 | |
| Other fees and expenses | | 342 | 3,221 |
| | | | |
| In-House Investment Management: | | | 7,464 |
| Total investment expenses | | | \$102,219 |

SCHEDULE OF PROFESSIONAL AND CONSULTING SERVICES FOR THE YEAR ENDED JUNE 30, 2003

(Expressed in Thousands)

| | | | |
|--|---|--------|-----------------|
| Actuarial, Legal and Oversight Services: | | | |
| Attorney General of Virginia | Legal Services | \$ 146 | |
| Joint Legislative Audit Review Commission | Oversight Responsibilities | 96 | |
| Troutman Sanders Mays & Valentine, LLP | Legal Services | 129 | |
| Gabriel, Roeder, Smith & Company | Actuarial Services | 315 | |
| Watson Wyatt Worldwide | Actuarial Services | 118 | |
| Subtotal Actuarial, Legal, and Oversight Services | | | \$ 804 |
| Consulting Services: | | | |
| Bon Secours Memorial Regional Medical Center | Disability Medical Reviews | \$ 101 | |
| Samuel R. Brown, PC | Hearing Officer for Disability Cases | 3 | |
| Clear Management Human Resource Consultants | Consulting Services | 37 | |
| CorVel Corporation | Physician Referral for Disability Cases | 143 | |
| Cost Effectiveness Measurement Inc. | Cost Driver Benchmarking/Investment Cost Effectiveness Analysis | 25 | |
| Medical Board | Medical Examiners | 51 | |
| Pension Consulting Alliance Inc | Real Estate Services | 62 | |
| Peoplewise LLC | Employment Screening Service | 5 | |
| Steven P. Peterson, Independent Contractor | Systems Analysis for Public Equity Investments | 35 | |
| Social Security Disability Consultants | Social Security Advocacy and Disability Tracking | 237 | |
| Strategic Economic Decisions, Inc. | Economic Advisory Services | 20 | |
| Subtotal Consulting Services | | | 719 |
| Total | | | \$ 1,523 |



Nancy C. Everett, CFA
Chief Investment Officer

1200 East Main Street, P.O. Box 2500, Richmond, Virginia 23219
Telephone: (804) 649-8059 TDD: (804) 344-3190

October 15, 2003

Members of the Board of Trustees and Participants of the
Virginia Retirement System

The VRS investment fund posted a positive return for the fiscal year due to the improving equity markets in the last half of the year. After over two years of decline, the fund was up 2.5% for the year ending June 30, 2003.

During the year, VRS focused on its asset allocation policy in conjunction with the actuarial valuation of the funds' liabilities. Given the experience of the past few years, the Board of Trustees considered the appropriateness of its risk profile and adjusted its analysis of capital market return expectations to reflect a current valuation framework. Based on results of this analysis, the fund will maintain a similar risk profile going forward but will increase its focus on diversifying its large equity exposure.

In response to the highly publicized corporate scandals, the Board of Trustees appointed a special committee to consider current VRS corporate governance policies. The committee was given three objectives including the review and evaluation of the existing practices at VRS with respect to corporate governance issues, the examination of methods to improve accountability of public companies and the identification of appropriate actions to safeguard the assets of the fund. The committee made its final report in February with recommendations for a new Corporate Governance Policy Statement and Guidelines that were adopted by the Board of Trustees in March.

In addition to these major initiatives, several changes were incorporated into the management of the investment fund during the year. A new program, designed to invest in certain strategies usually characterized as hedge funds, was approved with initial funding to begin in the new fiscal year. Numerous policy changes were made to improve the efficiency and effectiveness of both the public equity and fixed income programs. Additionally, VRS will undertake a review of its Real Estate portfolio in the coming year.

This was an important year for VRS. The asset allocation review has reaffirmed the objectives of the fund for the long-term. This work, coupled with a renewed focus on corporate governance will serve to ensure the Board of Trustees is continually working toward fulfilling its fiduciary responsibility going forward.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read 'N. Everett', is written in dark ink.

Nancy C. Everett, CFA
Chief Investment Officer

INVESTMENT ACCOUNT

The VRS investment account consists of funds contributed by both employers and employees of Virginia’s state agencies, teachers, state police, law enforcement officers, judges and many local governments. These contributions are pooled and invested to provide for the payment of current and future benefits to these participants. The VRS Board of Trustees, as fiduciary, has the responsibility to invest the account solely in the interest of the beneficiaries of the system.

Account Objectives

Each individual’s retirement benefit is based on a formula and takes into account years of service and salary. VRS utilizes an actuarial process to estimate what the aggregate of these benefit payments will look like into the future. This process includes certain assumptions about the long-term rate of return necessary to meet the liabilities along with other assumptions about the demographics of the workforce and the growth of salaries. One of the objectives of the account is to meet the long-term actuarial return assumption, currently 8%. Meeting this objective will help maintain the stability of the required contributions and the System’s funded status.

The Board of Trustees has also established intermediate-term objectives related to certain benchmark indices to measure the ongoing success of the investment program over 5 to 10 year periods. These serve as management tools to help judge the progress toward achieving long-term goals.

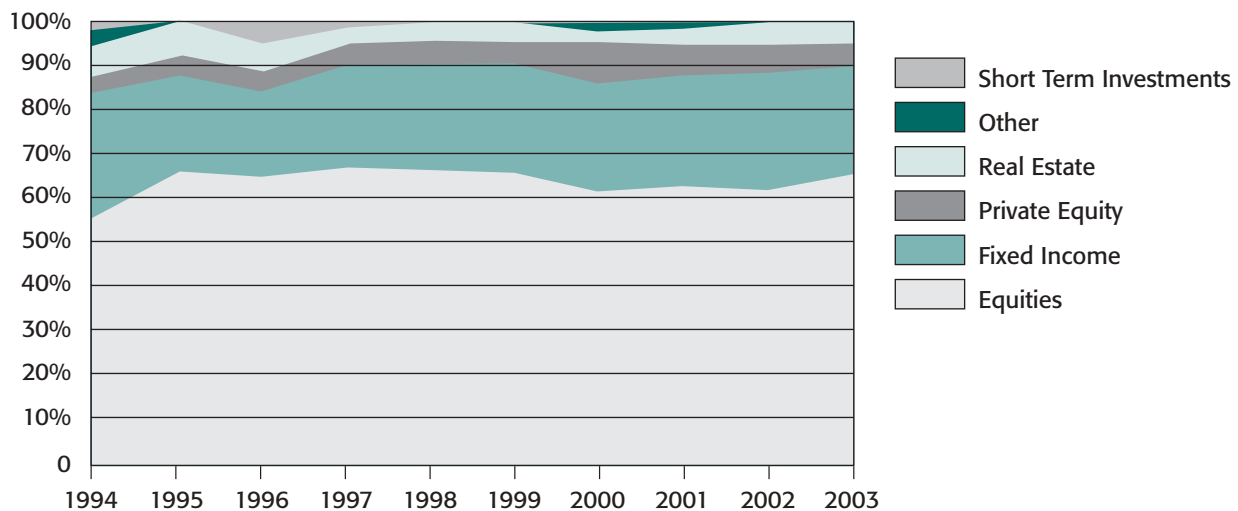
Investment Strategies

In order to achieve these objectives, The Board of Trustees has adopted various investment policies and guidelines and retains a professional investment staff, as well as outside managers, to advise and assist in the implementation of its policies. As established by the *Code of Virginia*, “the Board shall invest the assets of the Retirement System with the care, skill, prudence, and due diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.” The investment horizon of the fund’s portfolio reflects the long-term nature of VRS’ pension obligations.

Every year, the Board conducts an asset allocation study, incorporating an analysis of the long-term liabilities of the plan. The results of this study help the Board to determine its long-term risk tolerance and devise a strategic asset allocation strategy designed to maximize the expected return of the fund while controlling risk. Diversification among investments, which individually may be volatile in the short run, provides a framework for this asset allocation strategy. The most recent study was completed in June, 2003.

The chart below illustrates the long-term nature of the evolution of asset allocation.

INVESTMENT COMPARISON AT FAIR MARKET VALUE



Investment Results

Stock markets rebounded in the second half of the year helping the fund achieve a positive return. Longer-term results still reflect the negative markets over the past 2 years. Once again lower returns in the equity markets were somewhat offset by strong returns in fixed income and real estate. Additionally, the fund's 8.7% annualized 10-year return remains ahead of the 8% actuarial assumption.

INVESTMENT PERFORMANCE SUMMARY

Annualized Data for Period Ending June 30, 2003

| | 1 Year | 3 Years | 5 Years |
|--|---------|---------|---------|
| 1. Total Fund Time Weighted Returns | | | |
| VRS | 2.5 % | (4.2)% | 2.6 % |
| Inflation (CPI) | 2.1 % | 2.1 % | 2.4 % |
| Actuarial Assumed Return | 8.0 % | 8.0 % | 8.0 % |
| 2. Total U.S. Equity | | | |
| VRS | 0.5 % | (9.7)% | (1.6)% |
| Russell 3000 | 0.8 % | (10.5)% | (1.1)% |
| 3. Total Non U.S. Equity | | | |
| VRS | (3.4)% | (12.6)% | (2.3)% |
| Citigroup BMI Global ex U.S. | (2.6)% | (11.2)% | (1.6)% |
| 4. Total Fixed Income | | | |
| VRS | 10.4 % | 10.1 % | 7.5 % |
| Lehman Brothers VRS Benchmark | 10.3 % | 10.1 % | 7.5 % |
| 5. Total Real Estate | | | |
| VRS | 7.4 % | 10.5 % | 9.0 % |
| Custom Benchmark | 4.7 % | 9.2 % | 10.0 % |
| 6. Total Private Equity | | | |
| VRS | (10.8)% | (11.8)% | 14.6 % |
| Custom Benchmark | (22.2)% | (13.3)% | (1.2)% |

Investment return calculations were prepared using a time-weighted rate of return based on AIMR's performance presentation standards.

INVESTMENT SUMMARY

In accordance with Section 51.1-124.31 of the *Code of Virginia* (1950), as amended, the Board of Trustees has pooled substantially all assets of the Virginia Retirement System, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, the Judicial Retirement System, the Group Life Insurance Fund, the Retiree Health Insurance Credit Fund, and the Disability Insurance Trust Fund into a common investment pool. The common investment pool held the following composition of investments at June 30, 2003 and 2002 (in thousands):

| | 2003 Fair Value | % of Total Value | 2002 Fair Value | % of Total Value |
|--|----------------------|---------------------|----------------------|---------------------|
| Bonds and Mortgage Securities: | | | | |
| U. S. Government and agencies | \$ 2,141,042 | 6.02% | \$ 2,561,278 | 7.30% |
| Mortgage securities | 3,190,994 | 8.97% | 3,833,426 | 10.93% |
| Corporate and other bonds | 2,981,273 | 8.38% | 3,312,744 | 9.45% |
| Total bonds and mortgage securities | 8,313,309 | 23.37% | 9,707,448 | 27.68% |
| Common and Preferred Stocks | 8,657,200 | 24.35% | 8,177,400 | 23.30% |
| Index and Pooled Funds: | | | | |
| Equity index and pooled funds | 12,890,439 | 36.24% | 12,524,189 | 35.71% |
| Fixed income commingled funds | 104,739 | 0.29% | 297,956 | 0.85% |
| Total index and commingled funds | 12,995,178 | 36.53% | 12,822,145 | 36.56% |
| Real Estate: | | | | |
| Commingled funds | 415,365 | 1.17% | 382,852 | 1.09% |
| Properties | 11,335 | 0.03% | 11,334 | 0.03% |
| Real estate loans | 3,554 | 0.01% | 3,595 | 0.01% |
| Focused | 667,911 | 1.88% | 813,633 | 2.32% |
| Total real estate | 1,098,165 | 3.09% | 1,211,414 | 3.45% |
| Private Equity | 2,177,483 | 6.12% | 2,191,040 | 6.25% |
| Short-Term Investments: | | | | |
| Treasurer of Virginia – | | | | |
| Local Government Investment Pool | 138,620 | 0.39% | 150,142 | 0.43% |
| The Boston Company Pooled Employee Trust Funds | 2,133,180 | 6.00% | 787,648 | 2.25% |
| Foreign currencies | 53,645 | 0.15% | 26,711 | 0.08% |
| Total short-term investments | 2,325,445 | 6.54% | 964,501 | 2.76% |
| Total investments | \$ 35,566,780 | 100.00% | \$ 35,073,948 | 100.00% |

PORTFOLIO HIGHLIGHTS

U.S. Equity

Publicly traded domestic stocks totaled \$16.4 billion at year-end, approaching 47% of the total fund. Seventy-three percent of the U. S. Equity portfolio was invested in passive strategies and 21% managed internally. The objective of the portfolio is to exceed the return of the Russell 3000 over three year periods net of all costs.

The U.S. Equity program underperformed the benchmark Russell 3000 during the fiscal year by 0.24%. During the year, the Russell 3000 was up 0.8% and the NASDAQ gained 11.4%.

Growth stocks gained ground, especially in the mid and smaller capitalization companies.

| | 1-Year Total Return June 30, 2003 |
|------------------------|--------------------------------------|
| Russell Top 200 Growth | 1.8 % |
| Russell Top 200 Value | (1.2)% |
| Russell Midcap Growth | 7.4 % |
| Russell Midcap Value | (0.6)% |
| Russell 2000 Growth | 0.7 % |
| Russell 2000 Value | (3.7)% |

VRS economic sector exposures remained fairly close to that of the market. At year-end the portfolio had a slight underweight in Consumer Staples and the Financials sectors and the largest overweight was in the Consumer Discretionary sector.

| | VRS Exposure | Russell 3000 |
|----------------------------|-----------------|-----------------|
| Consumer Discretionary | 11.9% | 11.6% |
| Consumer Staples | 10.1% | 10.5% |
| Energy | 5.6% | 5.7% |
| Financials | 21.5% | 21.7% |
| Health Care | 15.3% | 15.2% |
| Industrials | 10.2% | 10.0% |
| Information Technology | 15.8% | 15.5% |
| Materials | 2.8% | 3.0% |
| Telecommunication Services | 3.7% | 3.6% |
| Utilities | 3.1% | 3.2% |

The top 10 holdings in the U.S. Equity program comprised 19% of the program at year-end. In addition to representing a larger portion of the total portfolio than last year's 17%, two companies have fallen from the list. American International Group and Proctor & Gamble Corp. have been replaced by Merck & Co. and International Business Machines (IBM).

| Company | Market Value | Shares |
|----------------------|----------------|------------|
| General Electric Co. | \$ 434,380,543 | 13,793,393 |
| Pfizer Inc. | 410,649,913 | 11,229,640 |
| Microsoft Corp. | 374,019,813 | 13,229,649 |
| EXXON Mobil Corp. | 373,725,178 | 9,421,942 |
| Citigroup Inc. | 350,582,703 | 7,957,485 |
| Johnson & Johnson | 234,372,595 | 4,276,535 |
| Intel Corp. | 225,556,027 | 9,701,217 |
| Merck & CO. | 222,855,276 | 3,528,022 |
| IBM | 218,922,261 | 2,304,491 |
| WAL-MART Stores | 215,473,219 | 3,668,733 |

Non U.S. Equity

Approximately 25% of the public equity portfolio was invested in foreign stocks at year-end. Fifty-two percent of this non-U.S. portfolio is managed passively and all assets are managed externally. Eighty nine percent of the portfolio was invested in developed countries and 11% in emerging markets. The objective of the program is to exceed the return of the unhedged Citigroup BMI Global ex-U.S. Index over three year periods net of all costs.

The Non-U.S. Equity program underperformed the benchmark Citigroup BMI Global ex-U.S. during the fiscal year by 0.77%. The VRS benchmark, the Citigroup BMI Global ex-U.S., lost 2.6% during this time.

Emerging markets outperformed the developed regions. In addition, small outperformed large capitalization stocks.

Fixed Income

VRS invests a portion of its portfolio in fixed income investments in order to reduce total fund volatility, produce income, and provide for some protection in the event of a deflationary environment. At year-end, approximately \$8 billion was invested in fixed-income assets, representing 24% of the VRS portfolio. Of this amount, approximately 50% was invested actively using outside investment managers, and 50% was invested passively. Internally managed accounts made up approximately 72% of the passive portion of the portfolio. The objective of the program is to control risk and exceed the return of the VRS Custom Lehman Brothers Index, net of all costs.

Bonds continued to provide above average returns over the last fiscal year. Interest rates declined to levels not seen in over 40 years, as the Federal Reserve adopted aggressive monetary policies designed to stimulate the economy and prevent a deflationary environment. In addition to strong price gains due to falling interest rates, risk premiums in credit instruments contracted significantly in the latter half of the fiscal year, leading to additional excess returns.

The fixed income program return was 10.4% for the fiscal year, slightly ahead of the program benchmark, and well ahead of our long-term expected return for bonds.

**VRS FIXED INCOME
TOP 10 HOLDINGS BY
MARKET VALUE**

As of June 30, 2003

| Par | Security Description | Market Value |
|--------------|-----------------------------|----------------|
| 145,810,000 | GNMA 6.000% 30-year MBS | \$ 152,758,751 |
| 135,000,000 | FNMA 5.500% 30-year MBS | 139,685,943 |
| 7,447 shares | PRIVEST Commingled Fund | 104,732,423 |
| 86,870,000 | GNMA 6.500% 30-year MBS | 91,213,500 |
| 72,225,000 | GNMA 6.000% 30-year MBS | 75,872,926 |
| 70,000,000 | FHLMC 5.000% 15-year MBS | 72,368,711 |
| 53,100,000 | FNMA 6.000% 30-year MBS | 55,174,219 |
| 53,000,000 | FHLMC 5.500% 30-year MBS | 54,739,208 |
| 50,000,000 | FNMA 5.500% 15-year MBS | 51,929,690 |
| 45,700,000 | GNMA 7.000% 30-year MBS | 48,299,188 |

FIXED INCOME PORTFOLIO

As of June 30, 2003

Sector Allocation:

| Sector | % Portfolio |
|--------------|----------------------|
| Treasury | 15.9% |
| Agency | 9.9% |
| Corporate | 30.8% |
| Mortgage | 34.4% |
| Asset Backed | 1.0% |
| CMBS | 1.9% |
| Foreign | 3.6% |
| Other | 2.5% |
| Total | <u>100.0%</u> |

| <i>Credit Quality Breakdown: Rating</i> | % Portfolio |
|---|----------------------|
| Government | 62.3% |
| AAA | 7.8% |
| AA | 6.2% |
| A | 13.8% |
| BBB | 7.3% |
| BB | 1.9% |
| B | 0.4% |
| Below B | 0.0% |
| NR | 0.3% |
| Total | <u>100.0%</u> |

Short-Term Investments

As a general rule, VRS desires to remain fully invested at all times and seeks to minimize its holdings of cash investments. Temporary cash balances are invested in short-term money market instruments with the goal of maintaining high credit quality and liquidity. The return on such investments approximates the return on 90-day U.S. Treasury bills, which was 1.53% over the last year.

Alternative Investments

The VRS Board policy allows for up to 20% of the portfolio to be invested in an Alternative Investments program. The objective of the program is to improve the expected risk/return profile of the total fund. Currently the program has investments in Real Estate and Private Equity. At June 30, 2003, Alternative Investments comprised 10.6% of the total fund portfolio.

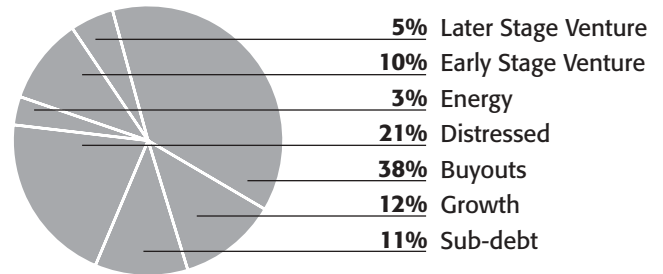
Private Equity

VRS invests in Private Equity in order to achieve returns greater than those available in the public equity markets. Specifically, the program seeks to outperform the Russell 3000 Index by 2.5% per year. The program’s results are measured differently from the publicly traded investments, in that a dollar-weighted or internal rate-of-return (IRR) calculation is considered more appropriate. Based on this

methodology, the Private Equity IRR since program inception (1989) was an annualized 23.8%. By comparison, a dollar-weighted return for the Russell 3000 Index over the same time frame would be 17.0%.

As of June 30, 2003, the appraised value of the program was approximately \$2.1 billion. The majority of the program is invested in limited partnerships.

The Private Equity program continues to be impacted by the decline in public market valuations. The time-weighted return for the program in 2002 was 15.2%, and this year it returned a negative 10.8%. The long-term returns remain strong, however, as evidenced by the five-year return of 14.6% and since inception annualized return of 23.8%. The breakdown of the Program by sub-class was as follows:

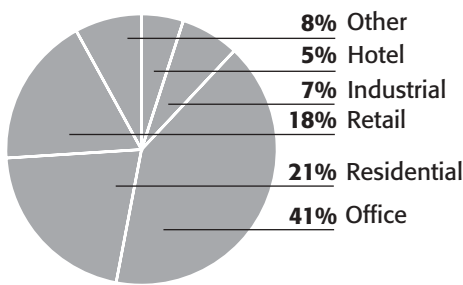


Real Estate

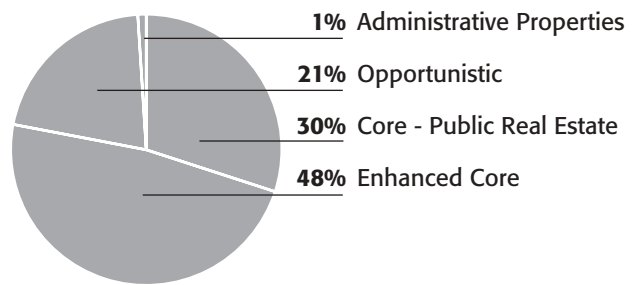
A portion of the Alternative Investments portfolio is invested in Real Estate in order to diversify the total fund by providing exposure to an asset class that has a low correlation with the public markets. Real estate produced a 7.4% return for the fiscal year and 10.5% for three years, outperforming its benchmarks by 272 and 127 bps respectively and continued to make progress in achieving its five-year benchmark.

The characteristics of the Real Estate portfolio remained stable over the year. At year-end Real Estate comprised 4.5% of the total fund and the portfolio was composed of approximately 30% in public real estate and 70% in private assets. Debt as a percentage of total real estate assets remained at a conservative level of 30%.

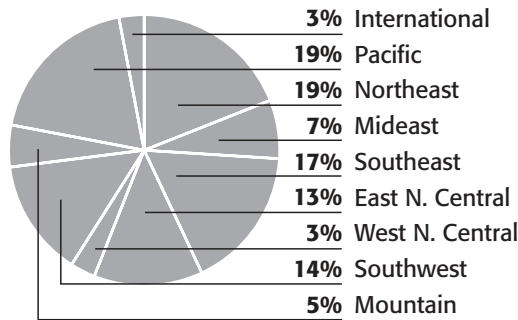
By Property Type



By Risk and Return



By Region



VRS MONEY MANAGERS

The diversified investment structure as of June 30, 2003 is reflected in the following table, which lists VRS managers by investment program and style.

| U.S. Equity | Style Description |
|------------------------------------|---|
| External Asset Management | |
| Aronson + Johnson + Ortiz | Medium-Small/Broad Market |
| Credit Suisse Asset Management | Broad Market |
| Edgar Lomax Co. | Broad Market |
| Fiduciary Asset Management | Broad Market |
| Franklin Portfolio Associates | Medium-Small |
| Freeman Associates Investment Mgmt | Broad Market |
| Fuller & Thaler Asset Management | Broad Market |
| Goldman Sachs Asset Management | Small |
| J.P. Morgan Investment Management | Broad Market |
| State Street Global Advisors | Broad Market |
| Symphony Asset Management | Broad Market |
| TimesSquare Capital Management | Small |
| Wellington Management | Broad Market |
| Internal Asset Management | |
| Madison | Broad Market |
| Potomac Core | Broad Market |
| York Value | Broad Market |
| Non-U.S. Equity | |
| Style Description | |
| Acadian Asset Management | Emerging Markets/Citigroup PMI Emerging Markets |
| Alliance Bernstein | Developed Markets/Citigroup PMI Developed Markets |
| Baillie Gifford | Developed Markets/Citigroup PMI Developed Markets |
| Blackrock International | International Small Cap/Citigroup EMI World ex US |
| The Boston Company | Emerging Markets/Citigroup PMI Emerging Markets |
| GMO International | International Small Cap/Citigroup EMI World ex US |
| LSV Asset Management | International Small Cap/Citigroup EMI World ex US |
| State Street Global Advisors | Passive Emerging Markets/Citigroup PMI Emerging Markets and Passive Developed Markets/Citigroup PMI Developed Markets |
| T. Rowe-Price International | Emerging Markets/Citigroup PMI Emerging Markets & Developed Markets/Citigroup PMI Developed Markets |
| Fixed Income | |
| Style Description | |
| Agincourt | Core/External Active |
| BlackRock | Core/External Active |
| Prudential | Core/External Active |
| Wellington Capital | Core/External Active |
| Western Asset Management | Core/External Active |
| W.R. Huff | Core/External Active |
| State Street Global Advisors | External Passive |
| VRS Internal | Internal Passive |

VRS MONEY MANAGERS, continued

| Real Estate Program | Account |
|--------------------------------|--------------------------|
| Core Public Real Estate | |
| ING•Clarion | REIT Portfolio |
| Enhanced Core | |
| Koll Bren Schreiber | Fund IV |
| Prudential | PRISA II |
| Prudential | Separate Account |
| Prudential | SPF-II |
| Security Capital | European Realty |
| TA Associates | Separate Account |
| Opportunistic | |
| Blackstone | BREP IV |
| Colonnade Properties | MCPI |
| Hines | 1997 US Office Dev. Fund |
| Hines | 1999 US Office Dev. Fund |
| JER Partners | JER RE Partners, LP |
| JER Partners | JER RE Partners II, LP |
| Koll Bren Schreiber | Fund V |
| Lazard Frères | Fund II |
| Lazard Frères | LFSRI II |
| Oaktree Capital Mgmt. | Fund B |
| Directly Owned | |
| VRS | Ninth & Franklin Garage |

| Private Equity – Top 10 Managers | Style - Description |
|---------------------------------------|----------------------|
| Welsh, Carson, Anderson & Stowe | Buyout and Sub-Debt |
| Oaktree Capital Management LLC | Distressed |
| Joseph Littlejohn & Levy | Turnaround |
| Madison Dearborn | Buyout |
| Charterhouse Development Capital Ltd. | International Buyout |
| Angelo Gordon & Co. | Distressed |
| First Reserve | Energy |
| Summit Partners | Growth and Sub-Debt |
| TA Associates | Growth and Sub-Debt |
| The Banc Funds | Growth |

**TOP 25 VRS BROKERS BY COMMISSIONS
FISCAL YEAR 2003**

VRS U.S. Equity Commissions

| Broker name | Commission |
|---|-----------------------------|
| B Trade Services, LLC | \$ 166,554 |
| Bank of America Securities, LLC | 62,069 |
| Bear Stearns Securities | 253,540 |
| BNP Paribas Securities, Corp | 75,621 |
| Bridge Trading Co | 114,840 |
| Cantor Fitzgerald & Co Inc. | 110,902 |
| Citigroup Global Markets, Inc. | 2,036,472 |
| Credit Suisse First Boston Corp. | 176,532 |
| Croix Securities | 305,445 |
| Deutsche Bank Securities | 2,207,445 |
| Goldman Sachs & Co | 595,722 |
| Instinet Corp. | 456,412 |
| Investment Technology Group | 961,831 |
| Jefferies & Co., Inc. | 139,166 |
| Knight Security Broadcort | 73,147 |
| Lehman Brothers, Inc. | 548,898 |
| Merrill Lynch Pierce Fenner Smith, Inc. | 634,898 |
| Morgan Stanley & Co. Inc. | 393,397 |
| Pulse Trading, LLC | 95,830 |
| SBC Warburg Dillon Read | 195,766 |
| Standard & Poors Securities Inc. | 178,634 |
| UBS Securities, LLC | 137,644 |
| Wachovia Securities, LLC | 88,421 |
| Weeden & Co. | 474,610 |
| Westminster Securities Corp. | 121,540 |
| Other Brokers | 1,283,056 |
| Total U.S. Commissions | <u>\$ 11,888,392</u> |

VRS Non-U.S. Equity Commissions

| Broker name | Commission |
|---|----------------------------|
| Bank of America Securities | \$ 27,563 |
| Bear Stearns & CO., Inc. | 42,795 |
| Bleichroeder AS & Co. | 30,749 |
| BNP Paribas Securities Corp. | 247,302 |
| BNY Clearing Services Int'l., Ltd. | 32,114 |
| Citigroup Global Markets, Inc. | 562,366 |
| Credit Lyonnais | 1,135,395 |
| Credit Suisse First Boston | 158,259 |
| Daiwa Secs | 43,882 |
| Deutsche Bank AG | 214,305 |
| Exane | 27,943 |
| Goldman Sachs & Co. | 301,984 |
| Hoare Govett Securities | 30,089 |
| HSBC Securities Inc. | 33,561 |
| Jardine Fleming | 25,935 |
| JP Morgan Chase | 115,905 |
| Kleinwort Benson, LTD | 40,011 |
| Lehman Brothers, Inc. | 94,260 |
| Merrill Lynch Pierce Fenner Smith, Inc. | 332,732 |
| Morgan Grenfell Equities | 88,672 |
| Morgan Stanley & Co., Inc. | 471,251 |
| Nomura Securities Int'l., Inc. | 38,471 |
| Royal Bank of Canada | 32,666 |
| State Street Brokerage Services | 25,956 |
| Union Bank Switzerland Securities | 731,463 |
| Other Brokers | 491,830 |
| Total Non-U.S. Commissions | <u>\$ 5,377,459</u> |

NOTE: A complete list of the Investment Portfolio is available on request.



GABRIEL, ROEDER, SMITH & COMPANY

Consultants & Actuaries

5605 N. MacArthur Blvd. • Suite 870 • Irving, Texas 75038-2631 • 469-524-0000 • fax 469-524-0003

November 15, 2002

Board of Trustees
Virginia Retirement System
P. O. Box 2500
Richmond, VA 23218-2500

Subject: Actuarial Valuation as of June 30, 2002

Dear Members of the Board:

We certify that the information contained in this report is accurate and fairly presents the actuarial position of the Virginia Retirement System (VRS) as of June 30, 2002, with respect to the Virginia Retirement System (State Employee and Teacher members), the State Police Officers' Retirement System, the Judicial Retirement System, and the Virginia Law Officers' Retirement System. Separate reports will be issued later for each of the local employer units which participate in VRS.

Rates shown in this report exclude the cost of the health care credit and the group life insurance program. The employer contribution rates calculated in this report are hypothetical rates that will never actually go into effect. The actual contribution rates are set by the odd-numbered year valuations for the two-year period beginning one year after the valuation date.

The hypothetical contribution rates in this report were determined as if they would be effective beginning in fiscal year 2004-2005. While they will never actually go into effect, they give an indication of the current actuarial status of the System and the direction that the next applicable set of rates will follow.

Our firm, as actuary for the System, supplied the data presented in the schedule of funding progress in the financial section of the Comprehensive Annual Financial Report (CAFR) as well as the supporting schedules in the actuarial section of the CAFR.

All calculations have been made in conformity with generally accepted actuarial principles and practices, and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion the results presented also comply with the Virginia statutes and, where applicable, the Internal Revenue Code, ERISA, and the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries and all are experienced in performing valuations for large public retirement systems.

Actuarial Valuation

The primary purposes of the even-numbered year valuation report are (i) to determine the hypothetical employer contribution rate, (ii) to describe the current financial condition of VRS, and (iii) to analyze changes in VRS's condition. In addition, the report provides information required by VRS in connection with Governmental Accounting Standards Board Statement No. 25 (GASB No. 25), and it provides various summaries of the data.

Financing Objectives

The member contribution rates are established by statute. The employer contribution rates are intended to be calculated by the actuarial valuation. In consideration of the COLA implementation and the funded condition of the State Police, Virginia Law Officers, and the State Judges Systems, the Board of Trustees has set the employer contribution rate for these Systems to 25%, 25%, and 45% of annual payroll respectively. The Board mandated these rates to be effective until these Systems have funded ratios (the ratio of the actuarial value of assets to the actuarial accrued liability) of 90% or greater. None of these funds has achieved a 90% funded ratio as of the valuation date.

We have calculated the contribution rate for the State Employees and Teachers independently and on a “pooled” basis. The “pooled” rates are calculated by combining the liabilities and assets of the employee groups. The resulting “pooled” rate is tested to comply with GASB No. 27 requirements. Since the current contribution rates actually being contributed to the Systems are not identical we are calculating both the independent rates and the “pooled” rates, in case the Board decides that it would like to certify independent rates for the State Employees and Teachers in the future.

The contribution rates determined by this valuation are hypothetical rates that will never actually be contributed. The contribution rates for the two-year period July 1, 2002 to June 30, 2004 were supposed to be determined by the 2001 valuation. The 2003 valuation will determine the contribution rates to be effective July 1, 2004. These hypothetical rates in this valuation are intended to be sufficient to pay the normal cost and to amortize the unfunded actuarial accrued liability (UAAL) in level percentage of payroll payments over a period of 24 years from the current valuation date, June 30, 2002. We consider this amortization period to be reasonable. Please note that we have recognized in the calculation of the contribution rates the delay (one-year for odd-numbered valuations and two-years for even-numbered valuations) between the valuation date and the date the new rates become effective.

The contribution rates currently being contributed to the Systems are not the rates that were established by the Board. Instead the General Assembly legislated that lower rates be contributed for fiscal years 2002, 2003, and 2004 than the rates specified by the Board.

Progress Toward Realization of Financing Objectives

The funded ratio decreased for all five groups since the last actuarial valuation. The decrease in the funded ratio is primarily due to asset losses on the actuarial value of assets. The calculated employer contribution rates increased for all the groups. The calculated rates reflect the full prefunding of the automatic COLA benefits, in compliance with the requirements of Governmental Accounting Standards Board Statement 25.

Benefit Provisions

The actuarial valuation reflects the benefit provisions set forth in the Virginia statutes. Other than the legislated changes in the contribution rates there was only one change in the provisions since last year. The period of time a teacher must be retired before the teacher may be rehired and continue to receive his or her annuity was reduced to 30 days. However, VRS has not implemented this provision because VRS is seeking technical guidance from the Internal Revenue Services on this provision. Since the provision has not yet been implemented, we have not reflected the provision in this valuation.

There are no ancillary benefits (such as cost-of-living increases to retirees) funded by a source independent of VRS.

Assumptions and Methods

Actuarially assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan’s actuary. No assumptions used in this valuation have been changed from those used for the 2001 valuation.

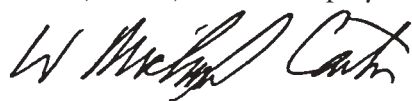
Data

Member data for retired, active, and inactive participants was supplied as of June 30, 2002, by the staff of VRS.

We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior valuation’s data. The VRS staff also supplied required asset information.

Sincerely,

Gabriel, Roeder, Smith & Company



W. Michael Carter, FSA
Senior Consultant



Lewis Ward
Consultant

SOLVENCY TEST

(Expressed in Thousands)

| Valuation Date (June 30) | Aggregate Accrued Liabilities for | | | | Portion of Accrued Liabilities Covered by Assets | | |
|--|---------------------------------------|--------------------------------------|------------------------|---------------------|--|---------|---------|
| | (1) Active Member Contributions | (2) Retirees and Beneficiaries | (3) Active Members* | Valuation Assets | (1) | (2) | (3) |
| Virginia Retirement System (VRS) | | | | | | | |
| 2002 | \$ 5,285,338 | \$ 15,878,494 | \$ 17,101,328 | \$ 38,957,256 | 100.00% | 100.00% | 104.05% |
| 2001 | 4,847,656 | 14,411,943 | 16,119,211 | 37,967,820 | 100.00% | 100.00% | 116.06% |
| 2000 | 4,639,007 | 12,652,663 | 15,350,685 | 34,392,303 | 100.00% | 100.00% | 111.40% |
| 1999 | 4,240,017 | 11,820,608 | 15,358,116 | 29,803,990 | 100.00% | 100.00% | 89.49% |
| 1998 | 3,937,941 | 10,732,243 | 14,359,783 | 25,480,634 | 100.00% | 100.00% | 75.28% |
| 1996 | 3,202,232 | 9,213,095 | 11,426,575 | 19,031,780 | 100.00% | 100.00% | 57.90% |
| 1994 | 2,842,030 | 7,257,368 | 10,305,790 | 14,890,663 | 100.00% | 100.00% | 46.49% |
| State Police Officers' Retirement System (SPORS) | | | | | | | |
| 2002 | \$ 57,152 | \$ 253,687 | \$ 283,797 | \$ 507,889 | 100.00% | 100.00% | 69.43% |
| 2001 | 54,507 | 215,658 | 286,463 | 494,952 | 100.00% | 100.00% | 78.47% |
| 2000 | 50,044 | 199,822 | 262,761 | 440,903 | 100.00% | 100.00% | 72.70% |
| 1999 | 45,516 | 200,288 | 217,252 | 376,780 | 100.00% | 100.00% | 60.29% |
| 1998 | 42,154 | 190,196 | 192,348 | 321,696 | 100.00% | 100.00% | 46.45% |
| 1996 | 37,715 | 139,258 | 193,888 | 243,066 | 100.00% | 100.00% | 34.10% |
| 1994 | 37,211 | 80,867 | 158,520 | 201,149 | 100.00% | 100.00% | 52.40% |
| Virginia Law Officers' Retirement System (VaLORS)** | | | | | | | |
| 2002 | \$ 127,975 | \$ 110,426 | \$ 567,716 | \$ 418,518 | 100.00% | 100.00% | 31.73% |
| 2001 | 111,143 | 5,639 | 510,857 | 392,815 | 100.00% | 100.00% | 54.03% |
| 2000 | 108,538 | 27,356 | 543,943 | 307,301 | 100.00% | 100.00% | 31.51% |
| Judicial Retirement System (JRS) | | | | | | | |
| 2002 | \$ 28,089 | \$ 186,886 | \$ 137,029 | \$ 281,056 | 100.00% | 100.00% | 48.22% |
| 2001 | 23,595 | 176,142 | 142,095 | 276,542 | 100.00% | 100.00% | 54.05% |
| 2000 | 24,079 | 191,146 | 115,127 | 244,721 | 100.00% | 100.00% | 25.62% |
| 1999 | 20,978 | 171,136 | 110,328 | 209,992 | 100.00% | 100.00% | 16.20% |
| 1998 | 19,239 | 152,557 | 102,629 | 179,693 | 100.00% | 100.00% | 7.69% |
| 1996 | 16,885 | 140,964 | 84,918 | 137,886 | 100.00% | 85.80% | 0.00% |
| 1994 | 15,593 | 102,889 | 80,080 | 115,306 | 100.00% | 96.91% | 0.00% |

Actuarial Assumptions and Methods:

| | 1994/1996 | 1998/1999 | 2000/2001 | 2002 |
|--|--------------------|--------------------|--------------------|--------------------|
| Valuation interest rate | 8% | 8% | 8% | 8% |
| Salary scale inflation factor | 4% | 4% | 3% | 3% |
| Change in decremental assumptions..... | Yes | No | Yes | No |
| Value of ancillary benefits included..... | Yes | Yes | Yes | Yes |
| Value of post-retirement adjustments to date included..... | Yes | Yes | Yes | Yes |
| Assets valued at..... | Modified Market | Modified Market | Modified Market | Modified Market |

Aggregate Accrued Liabilities determined under the entry age normal cost method (system funded method used to determine employer contribution requirements).

The progress of a retirement system in accumulating assets to pay benefits when due can be measured by examining the extent to which assets accumulated for benefits cover 1) active member contributions to the system, 2) liabilities for future benefits to retirants and beneficiaries, and 3) liabilities for the employer-financed portion of service already rendered by active members. In a system receiving actuarially determined employer contributions, the liabilities for member contributions and future benefits to retirants and beneficiaries will generally be fully covered by accumulated assets. In addition, the liabilities for service already rendered will be partially covered by the remainder of accumulated assets and will increase over time.

* Employer-financed portion.

** Virginia Law Officers' Retirement System was effective October 1, 1999.

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

| Valuation Date (June 30) | Active Members | | | | |
|---|----------------|------------------------------|--------------------------|--|------------------------|
| | Number | Annual Payrolls (000s) | Average Annual Pay | Annualized % Increase in Average Pay | Number of Employers |
| Virginia Retirement System (VRS) | | | | | |
| 2002 | 297,921 | \$ 10,668,980 | \$ 35,811 | 2.9% | 551 |
| 2001 | 291,621 | 10,145,212 | 34,789 | 3.9% | 551 |
| 2000 | 284,486 | 9,528,666 | 33,494 | 4.7% | 545 |
| 1999 | 285,596 | 9,138,060 | 31,996 | 2.7% | 532 |
| 1998 | 277,223 | 8,638,414 | 31,161 | 6.2% | 519 |
| 1996 | 264,656 | 7,769,043 | 29,355 | 5.9% | 513 |
| 1994 | 262,512 | 7,274,210 | 27,710 | 5.4% | 504 |
| State Police Officers' Retirement System (SPORS) | | | | | |
| 2002 | 1,740 | \$ 80,680 | \$ 46,368 | (1.5%) | 1 |
| 2001 | 1,771 | 83,339 | 47,058 | 2.7% | 1 |
| 2000 | 1,768 | 80,977 | 45,801 | 5.3% | 1 |
| 1999 | 1,761 | 76,628 | 43,514 | 11.9% | 1 |
| 1998 | 1,682 | 65,427 | 38,898 | 4.7% | 1 |
| 1996 | 1,604 | 59,599 | 37,156 | 3.2% | 1 |
| 1994 | 1,607 | 57,838 | 35,991 | 6.5% | 1 |
| Virginia Law Officers' Retirement System (VaLORS)* | | | | | |
| 2002 | 10,036 | \$ 306,024 | \$ 30,493 | (0.7%) | 1 |
| 2001 | 10,434 | 320,254 | 30,693 | 2.7% | 1 |
| 2000 | 10,542 | 315,158 | 29,895 | 0.0% | 1 |
| Judicial Retirement System (JRS) | | | | | |
| 2002 | 408 | \$ 47,568 | \$ 116,588 | 0.0% | 1 |
| 2001 | 404 | 47,125 | 116,646 | 2.5% | 1 |
| 2000 | 399 | 45,394 | 113,769 | 6.7% | 1 |
| 1999 | 390 | 41,590 | 106,641 | 3.8% | 1 |
| 1998 | 383 | 39,332 | 102,695 | 8.5% | 1 |
| 1996 | 378 | 35,783 | 94,664 | 4.7% | 1 |
| 1994 | 362 | 32,716 | 90,376 | 4.4% | 1 |

* Virginia Law Officers' Retirement System was effective October 1, 1999.

SCHEDULE OF RETIRANTS AND BENEFICIARIES

| Valuation Date (June 30) | Retired Members and Beneficiaries | | | | |
|---|---|-------------------------------------|--------------------------------|--|---------------------------------|
| | Retirees and Beneficiaries Added/Removed* | Total Retirees and Beneficiaries | Annual Allowances (000)s | Annualized % Increase in Annual Allowances | Average Annual Allowances |
| Virginia Retirement System (VRS) | | | | | |
| 2002 | 7,451/3,496 | 102,052 | \$ 1,375,777 | 6.7% | \$ 13,481 |
| 2001 | 7,962/3,337 | 98,097 | 1,289,657 | 12.1% | 13,147 |
| 2000 | 7,932/3,685 | 93,472 | 1,150,213 | 8.6% | 12,305 |
| 1999 | | 89,225 | 1,059,602 | 16.4%** | 11,786 |
| 1998 | | 88,500 | 896,409 | 3.4% | 10,129 |
| 1996 | | 80,499 | 838,147 | 8.9% | 10,412 |
| 1994 | | 72,422 | 711,518 | 7.9% | 9,825 |
| State Police Officers' Retirement System (SPORS) | | | | | |
| 2002 | 72/12 | 772 | \$ 20,077 | 7.1% | \$ 26,006 |
| 2001 | 26/11 | 712 | 18,748 | 8.0% | 26,331 |
| 2000 | 38/8 | 697 | 17,362 | 9.9% | 24,910 |
| 1999 | | 667 | 15,793 | 23.2%** | 23,678 |
| 1998 | | 668 | 12,844 | 15.1% | 19,227 |
| 1996 | | 572 | 9,865 | 14.5% | 17,247 |
| 1994 | | 470 | 7,649 | 11.9% | 16,275 |
| Virginia Law Officers' Retirement System (VaLORS)*** | | | | | |
| 2002 | 251/18 | 527 | \$ 9,252 | 324.2% | \$ 17,556 |
| 2001 | 197/13 | 294 | 2,181 | 198.8% | 7,418 |
| 2000 | 124/14 | 110 | 730 | 0.0% | 6,636 |
| Judicial Retirement System (JRS) | | | | | |
| 2002 | 14/17 | 366 | \$ 18,918 | 1.2% | \$ 51,689 |
| 2001 | 21/16 | 369 | 18,699 | 7.6% | 50,675 |
| 2000 | 21/9 | 364 | 17,373 | 4.3% | 47,728 |
| 1999 | | 352 | 16,659 | 11.1%** | 47,327 |
| 1998 | | 347 | 14,787 | 4.1% | 42,615 |
| 1996 | | 330 | 13,666 | 12.4% | 41,412 |
| 1994 | | 305 | 10,944 | 5.9% | 35,882 |

* Number of retirees and beneficiaries added and removed is unavailable prior to FY2000.

** Increase in annual allowances due to 2% ad hoc increase in retiree benefit allowances effective January 1, 1999 and an increase in the benefit formula multiplier.

*** Virginia Law Officers' Retirement System was effective October 1, 1999.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

The following actuarial assumptions and methods were adopted by the VRS Board of Trustees on November 15, 2000 on the recommendation of its actuary. Assumptions were changed effective for the June 30, 2000 valuation based upon an analysis of plan experience for the four years then ending.

- Investment Return Rate** 8.00% per annum, compounded annually, composed of an assumed 3.00% inflation rate and a 5.00% real rate of return. Benefits are assumed to increase by 3.00% annually due to the COLA.
- Mortality Rates** Virginia Retirement System, State Police Officers' Retirement System, Virginia Law Officers' Retirement System, and Judicial Retirement System.
 - **Pre-Retirement** 1994 Group Annuity Mortality Table for males and females.
 - **Post-Retirement** 1994 Group Annuity Mortality Table for males and females (set back two years for male teachers, one year for female teachers, and three years for state police officers and other law enforcement and corrections officers).
 - **Post-Disablement** 70% of PBGC Disabled Mortality Table 5a for Males.
90% of PBGC Disabled Mortality Table 6a for Females.

RETIREMENT RATES

State Employees and Employees of Political Subdivisions

Sample rates of retirement are shown below for members eligible to retire.

| Retirement Per 100 Members | | | | |
|----------------------------|--------------------|--------|----------------------|--------|
| Age | Reduced Retirement | | Unreduced Retirement | |
| | Male | Female | Male | Female |
| 50 | 1.00 | 1.25 | 10.00 | 5.00 |
| 55 | 2.25 | 3.00 | 10.00 | 5.00 |
| 59 | 6.00 | 4.25 | 6.50 | 7.50 |
| 60 | 4.00 | 7.50 | 11.50 | 10.00 |
| 61 | 12.50 | 12.50 | 20.00 | 20.00 |
| 62 | 20.00 | 20.00 | 30.00 | 25.00 |
| 64 | 20.00 | 20.00 | 29.00 | 20.00 |
| 65 | — | — | 42.00 | 45.00 |
| 67 | — | — | 28.00 | 15.00 |
| 70 | — | — | 100.00 | 100.00 |

RETIREMENT RATES, continued

Teachers

Sample rates of retirement are shown below for members eligible to retire.

| Retirement Per 100 Members | | | | |
|----------------------------|--------------------|--------|----------------------|--------|
| Age | Reduced Retirement | | Unreduced Retirement | |
| | Male | Female | Male | Female |
| 50 | 1.0 | 1.5 | 7.5 | 6.5 |
| 55 | 2.0 | 2.0 | 22.5 | 19.5 |
| 59 | 5.0 | 5.0 | 22.5 | 19.5 |
| 60 | 6.0 | 6.0 | 30.0 | 19.5 |
| 61 | 8.0 | 8.0 | 30.0 | 26.0 |
| 62 | 20.0 | 20.0 | 52.5 | 45.5 |
| 64 | 20.0 | 20.0 | 30.0 | 32.5 |
| 65 | — | — | 90.0 | 58.5 |
| 67 | — | — | 30.0 | 39.0 |
| 70 | — | — | 100.0 | 100.0 |

State Police Officers' and Virginia Law Officers' Retirement Systems

| Retirement Per 100 Members | | |
|----------------------------|--------------------|----------------------|
| Age | Reduced Retirement | Unreduced Retirement |
| 50 | 3.0 | 18.0 |
| 55 | 6.0 | 27.0 |
| 56 | 6.0 | 36.0 |
| 60 | — | 100.0 |

Judicial Retirement System

50% of members are assumed to retire after age 60 when they reach the maximum benefit accrual.

| Retirement Per 100 Members | | | | |
|----------------------------|--------------------|--------|----------------------|--------|
| Age | Reduced Retirement | | Unreduced Retirement | |
| | Male | Female | Male | Female |
| 50 | 5.0 | 5.0 | — | — |
| 55 | 5.0 | 5.0 | 5.0 | 5.0 |
| 65 | — | — | 5.0 | 5.0 |
| 70 | — | — | 100.0 | 100.0 |

DISABILITY RATES

As shown below for selected ages.

State Employees and Employees of Political Subdivisions

14% of disability cases are assumed to be service-related.

| Disability Per 100 Members | | |
|----------------------------|-------|--------|
| Age | Male | Female |
| 20 | 0.030 | 0.009 |
| 30 | 0.120 | 0.036 |
| 40 | 0.270 | 0.081 |
| 50 | 1.020 | 0.306 |
| 60 | 3.000 | 0.900 |

Teachers

5% of disability cases are assumed to be service-related.

| Disability Per 100 Members | | |
|----------------------------|-------|--------|
| Age | Male | Female |
| 20 | — | — |
| 30 | 0.026 | 0.016 |
| 40 | 0.052 | 0.093 |
| 50 | 0.299 | 0.326 |
| 60 | 0.845 | 0.884 |

State Police Officers' and Virginia Law Officers' Retirement Systems

60% of disability cases are assumed to be service-related.

| Disability Per 100 Members | | |
|----------------------------|-------|--------|
| Age | Male | Female |
| 20 | — | — |
| 30 | 0.019 | — |
| 40 | 0.400 | — |
| 50 | 1.350 | — |
| 60 | — | — |

Judicial Retirement System

| Disability Per 100 Members | | |
|----------------------------|-------|--------|
| Age | Male | Female |
| 20 | — | — |
| 30 | 0.007 | 0.007 |
| 40 | 0.142 | 0.090 |
| 50 | 0.480 | 0.397 |
| 60 | — | — |

TERMINATION RATES

Withdrawal rates are based on age and service. Sample rates for selected ages and years of service are shown below (for causes other than death, disability, or retirement).

State Employees and Employees of Political Subdivisions

| Probability of Decrement Due to Withdrawal | | | | | | | | | | |
|--|-------------------------------|--------|--------|--------|--------|---------------------------------|--------|--------|--------|--------|
| Age | Years of Service–Male Members | | | | | Years of Service–Female Members | | | | |
| | 1 | 3 | 6 | 9 | 10+ | 1 | 3 | 6 | 9 | 10+ |
| 25 | 0.1637 | 0.1170 | 0.0704 | 0.0433 | 0.0386 | 0.1847 | 0.1404 | 0.1110 | 0.0602 | 0.0533 |
| 35 | 0.1296 | 0.0925 | 0.0684 | 0.0433 | 0.0294 | 0.1366 | 0.1069 | 0.0802 | 0.0534 | 0.0393 |
| 45 | 0.0994 | 0.0663 | 0.0558 | 0.0354 | 0.0171 | 0.1052 | 0.0762 | 0.0574 | 0.0392 | 0.0218 |
| 55 | 0.0848 | 0.0518 | 0.0347 | 0.0226 | 0.0107 | 0.0924 | 0.0587 | 0.0381 | 0.0223 | 0.0110 |

Teachers

| Probability of Decrement Due to Withdrawal | | | | | | | | | | |
|--|-------------------------------|--------|--------|--------|--------|---------------------------------|--------|--------|--------|--------|
| Age | Years of Service–Male Members | | | | | Years of Service–Female Members | | | | |
| | 1 | 3 | 6 | 9 | 10+ | 1 | 3 | 6 | 9 | 10+ |
| 25 | 0.1302 | 0.1028 | 0.0565 | 0.0384 | 0.0643 | 0.1130 | 0.1053 | 0.0762 | 0.0891 | 0.0919 |
| 35 | 0.1174 | 0.0824 | 0.0567 | 0.0381 | 0.0280 | 0.1133 | 0.0932 | 0.0669 | 0.0494 | 0.0325 |
| 45 | 0.1030 | 0.0652 | 0.0480 | 0.0312 | 0.0117 | 0.0929 | 0.0634 | 0.0449 | 0.0292 | 0.0130 |
| 55 | 0.1051 | 0.0605 | 0.0322 | 0.0187 | 0.0074 | 0.0929 | 0.0532 | 0.0308 | 0.0197 | 0.0067 |

State Police Officers’ and Virginia Law Officers’ Retirement Systems

| Probability of Decrement Due to Withdrawal | | | | | | | | | | |
|--|-------------------------------|--------|--------|--------|--------|---------------------------------|--------|--------|--------|--------|
| Age | Years of Service–Male Members | | | | | Years of Service–Female Members | | | | |
| | 1 | 3 | 6 | 9 | 10+ | 1 | 3 | 6 | 9 | 10+ |
| 25 | 0.0569 | 0.0535 | 0.0485 | 0.0199 | 0.0240 | 0.0888 | 0.0698 | 0.0682 | 0.0362 | 0.0292 |
| 35 | 0.0624 | 0.0515 | 0.0343 | 0.0215 | 0.0165 | 0.0958 | 0.0664 | 0.0447 | 0.0399 | 0.0405 |
| 45 | 0.0681 | 0.0481 | 0.0292 | 0.0195 | 0.0094 | 0.0781 | 0.0656 | 0.0513 | 0.0426 | 0.0394 |
| 55 | 0.0766 | 0.0479 | 0.0278 | 0.0149 | 0.0065 | 0.0382 | 0.0682 | 0.1859 | 0.0447 | 0.0274 |

Judicial Retirement System

There are no assumed rates of withdrawal prior to service retirement (for causes other than death, disability, or retirement).

SALARY INCREASE RATES

The sample salary increase rates are shown below.

State Employees and Employees of Political Subdivisions

Inflation rate of 3.00% plus productivity component of 1.25% plus step-rate/promotional component as shown.

| Years of Service | Annual Step Rate/Promotional Rates of Increase | Total Annual Rate of Increase |
|------------------|--|-------------------------------|
| 1 | 1.85% | 6.10% |
| 3 | 1.25% | 5.50% |
| 6 | 0.95% | 5.20% |
| 9 | 0.50% | 4.75% |
| 11-19 | 0.15% | 4.40% |
| 20 or more | 0.00% | 4.25% |

Teachers

Inflation rate of 3.00% plus productivity component of 1.00% plus step-rate/promotional component as shown.

| Years of Service | Annual Step Rate/Promotional Rates of Increase | Total Annual Rate of Increase |
|------------------|--|-------------------------------|
| 1 | 2.10% | 6.10% |
| 3 | 2.00% | 6.00% |
| 6 | 1.60% | 5.60% |
| 9 | 1.50% | 5.50% |
| 11-19 | 1.00% | 5.00% |
| 20 or more | 0.00% | 4.00% |

State Police Officers' and Virginia Law Officers' Retirement Systems

Inflation rate of 3.00% plus productivity component of 1.50% plus step-rate/promotional component as shown.

| Years of Service | Annual Step Rate/Promotional Rates of Increase | Total Annual Rate of Increase |
|------------------|--|-------------------------------|
| 1 | 1.25% | 5.75% |
| 3 | 1.25% | 5.75% |
| 6 | 0.90% | 5.40% |
| 9 | 0.90% | 5.40% |
| 11-19 | 0.50% | 5.00% |
| 20 or more | 0.00% | 4.50% |

Judicial Retirement System

Salary increase rates are 5.00%.

It is assumed state employees covered under the Virginia Sickness and Disability Program (VSDP) receive a 4.25% annual increase in pay and state police and Virginia law officers receive a 4.50% annual increase in pay while disabled. This adjusted pay is used to determine deferred retirement benefits.

Percent Electing a Deferred Termination Benefit

(Excludes Judicial Retirement System)

Terminating members are assumed to elect a return of contribution or a deferred annuity, whichever is the most valuable benefit at the time of termination. Termination benefits are assumed to commence at the first age at which unreduced benefits are available.

Provision for Expense

The assumed investment return represents the anticipated net rate of return after payment of all administrative expenses.

Asset Valuation Method

The actuarial value of assets is equal to the market value of assets less a five-year phase in of the excess (shortfall) between expected investment return and actual income (both based on market value), with the resulting value not being less than 80% or more than 120% of the market value of assets.

Actuarial Cost Method

The funding period required to amortize the unfunded actuarial accrued liability (UAAL) is determined using the Entry Age Normal actuarial cost method. This method assigns the plan's total actuarial present value of future benefits to various periods. The actuarial accrued liability is assigned to years prior to the valuation, and the normal cost is assigned to the year following the valuation. The remaining costs are assigned to future years.

The normal cost rate is determined based on a group of new entrants. The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability (UAAL) is the excess of the actuarial accrued liability over the actuarial value of assets.

Payroll Growth Rate

3.00% based on a zero population growth assumption.

Funding Period

State employees, teachers, State police officers, Virginia law officers and judges 24 years (closed amortization, computed as a level percent of payroll). Calculation is pooled for state employees and teachers.

Political subdivision employees 0 to 30 years (open amortization, computed as level percent of payroll)

Cost of Living Increase

3.00% per year compounded annually for the basic benefit. The temporary supplement for state police and Virginia law officers is assumed to increase at the inflation rate (3.00% per year, compounded annually).

SUMMARY OF BENEFIT PLAN PROVISIONS

Retirement Plans

- Virginia Retirement System (VRS), effective March 1, 1952
- State Police Officers' Retirement System (SPORS), effective July 1, 1950
- Judicial Retirement System (JRS), effective July 1, 1970
- Virginia Law Officers' Retirement System; (VaLORS), effective October 1, 1999

Plan Year

Twelve-month period ending June 30th.

Administration

Plans are administered by the Board of Trustees of the Virginia Retirement System.

Type of Plans

- VRS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered an agent multiple-employer Public Employee/Retirement System (PERS) for participating Virginia cities, counties, towns and political subdivisions, with separate cost-sharing pools for state employees and teachers.
- SPORS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.
- JRS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.
- VaLORS is a qualified governmental defined benefit retirement plan. For Governmental Accounting Standards Board purposes, it is considered a single-employer PERS.

Eligibility

All full-time, salaried, permanent employees of the Commonwealth of Virginia and all full-time, salaried, permanent employees of local Virginia school boards, or any participating Virginia county, city, town or political subdivision are eligible to become members of VRS. All state police officers of the Commonwealth of Virginia are eligible to become members of SPORS. All full-time judges of the Commonwealth of Virginia are eligible to become members of JRS. All full-time, salaried permanent Virginia law enforcement officers and correctional officers other than state police officers are eligible to become members of VaLORS.

Employee Contributions

All active members contribute 5.00% of their creditable compensation per year. The employer may "pick-up" the member's assessments under the provisions of Internal Revenue Code Section 414(h).

Creditable Compensation

Annual salary minus any overtime pay, payments of a temporary nature, or payments for extra duties.

Service

Employees, state police and Virginia law officers receive credit of one month of service for each month a contribution is made on their behalf to VRS, SPORS and VaLORS. Judges receive credit of one month of service multiplied by a weighting factor of 3.5 (2.5 for judges entering JRS on or after January 1, 1995) for each month a contribution is made to JRS on their behalf. A member may also purchase credit for certain periods, such as time spent in the military, by paying a purchase rate (5% or 15% of the larger of current credible compensation or final average compensation times the number of years to be purchased). Special rules and limits govern the purchase of additional service.

Average Final Compensation

The average of the member's highest consecutive 36 months of creditable compensation.

Normal Retirement

Eligibility

Members of VRS and JRS may retire under Normal Retirement on or after age 65 with five years of service credit. A member of SPORS and VaLORS may retire under Normal Retirement on or after age 60 with five years of service credit.

Annual Benefit

For members of VRS and SPORS, 1.7% of average final compensation (AFC) times years of service. Members of VaLORS hired before July 1, 2001 were allowed to make a one-time election to have their benefit based on 2.0% of average annual compensation (AFC) instead of receiving a supplement. For members of JRS, 1.7% of average final compensation (AFC), times years of service, not to exceed 78% of AFC.

Supplement

Members of SPORS with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receive an additional allowance payable annually from the date of retirement to their Social Security normal retirement age. This supplement is adjusted biennially based upon increases in Social Security benefits during the interim period. Electing members of VaLORS hired before July 1, 2001 with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974, receive an additional allowance payable annually from the date of retirement to age 65.

Payment Form

Benefits are paid as a monthly life annuity, with a guarantee that if the payments made do not exceed the member's contributions plus interest, determined as of the date of retirement, the balance will be paid in a lump-sum to the member's beneficiary.

Early Retirement

Eligibility

A member of VRS may retire early after reaching age 50 with credit for 10 years of service, or age 55 with credit for five years of service. Members of SPORS and VaLORS may retire early after reaching age 50 with credit for five years of service. A member of JRS may retire early after reaching age 55 with credit for five years of service.

Annual Benefit

- Calculated the same as the normal retirement benefit, using actual service at retirement and multiplied by a reduction factor. For members of VRS no reduction applies if the member has credit for 30 years of service at retirement and is at least age 50 (25 years of service and is at least age 50 for members of SPORS and VaLORS, and 30 years of service and is at least age 60 for a member of JRS).
- For members of VRS and JRS at least age 55 (at least age 50 for members of SPORS and VaLORS), the reduction is 0.5% per month for the first 60 months and 0.4% per month for the next 60 months. This reduction is applied for each month the retirement age precedes 65 or, if more favorable, for each month the service at retirement is less than 30 (age 60 with service less than 25 for members of SPORS and VaLORS).
- For members of VRS younger than 55 at retirement, the reduction factor determined as though the member were 55 is further reduced by multiplying it by a second factor, to reflect a 0.6% reduction for each month retirement precedes age 55.

Supplement

Members of SPORS with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974 receives an additional allowance payable annually from the date of retirement to their Social Security normal retirement age. This supplement is adjusted biennially based upon increases in Social Security benefits during the interim period. Electing members of VaLORS hired before July 1, 2001 with 20 or more years of service in a hazardous position or with a hire date prior to July 1, 1974, receive an additional allowance payable annually from the date of retirement to age 65.

Payment Form

Same as for Normal Retirement above.

Disability Retirement**Eligibility**

VRS teacher and political subdivision members and JRS members are eligible from the first day of employment. VRS state employee, SPORS and VaLORS members hired prior to January 1, 1999 and who declined coverage under the Virginia Sickness & Disability Program (VSDP) are eligible from the first day of employment.

Annual Benefit

Members with less than five years of service credit receive the minimum guaranteed benefit. Members with more than five years of service credit receive the greater of (1) the minimum guaranteed benefit, which is 50% (66 2/3% if work related disability) of AFC if member does not qualify for primary Social Security and 33 1/3% of AFC (50% if work-related disability) if member qualifies for primary Social Security, or (2) 1.7% of AFC times service credit. The work-related benefit is reduced by Worker's Compensation (if any).

Service Credit

If a disability occurs before age 60, service is the lesser of (1) twice actual service, or (2) rendered service plus the number of years remaining between member's age at disability retirement and age 60.

Payment Form

The disability benefit commences immediately upon the member's retirement. Benefits cease upon recovery or reemployment. Disability benefits are payable as a monthly life annuity. If, at the member's death, payments made have not exceeded the sum of the member's contributions plus interest as of the date of retirement, the balance is paid in a lump-sum to the member's beneficiary. The 50% and 100% Survivor Options are also permitted for disability retirement. (A refund of the member's contribution account is paid for work-related disability.)

Virginia Sickness & Disability Program (VSDP)

In lieu of the above benefits, VRS state employee, VaLORS and SPORS members who elected this benefit (which is automatic for any new employee since January 1, 1999) are covered by the Virginia Sickness and Disability Program. These members will receive a deferred service retirement benefit payable at 65 (age 60 for SPORS and VaLORS). The deferred benefit will be computed like a normal retirement benefit. For this calculation, a member's creditable service will include the period of disability, and the Average Final Compensation will be adjusted to reflect increases in the cost of living between the date of disability and age 65. If the member dies while disabled, a death benefit will be determined as though the employee were an active member.

Deferred Retirement Benefit

Eligibility

A member with at least five years of service who does not withdraw his or her contributions from the fund is eligible for a deferred retirement benefit.

Annual Benefit

The annual benefit is the same as normal retirement benefit, but both AFC and service are determined at the time the member leaves active employment. Reduced benefits may commence at or after age 55 with at least five years of service, or at age 50 with 10 years of service (age 50 with at least five years of service for members of SPORS and VaLORS).

Payment Form

The form of payment is the same as for Normal Retirement above.

Death Benefit

The beneficiary of a member who dies after leaving active service but before retiring is entitled to receive a lump-sum distribution of the deceased member's contribution account.

Withdrawal (Refund) Benefit

Eligibility

All members leaving covered employment are eligible. Vested members (those with five or more years of service) may withdraw their contributions plus interest instead of receiving the deferred retirement benefits otherwise due.

Benefit

A member who takes a refund receives a lump-sum payment of his/her member contributions, plus the interest credited on these contributions. Interest is credited at 4%, compounded annually on contributions in the account for at least one year.

Death Benefit

Eligibility

Death must have occurred while a member is an active or an inactive, non-retired member.

Benefit

Upon the death of a non-vested active or inactive member, a refund of the member's contributions and interest is paid to the beneficiary. Upon the death of a vested active member, if the named beneficiary is the spouse, minor child, mother or father of the member, the beneficiary is eligible to receive a monthly benefit under the 100% Survivor Option. If death occurs before age 55 (age 50 for members of SPORS and VaLORS), the member is assumed to be age 55 (age 50 for members of SPORS and VaLORS) for benefit calculation purposes. A beneficiary may elect to receive a refund of the member's contributions plus interest in lieu of the monthly benefit.

Work-related Death

If the member's death is work-related, the surviving spouse, minor child or parent is eligible to receive 50% of AFC if the survivor does not qualify for Social Security survivor benefits or $33 \frac{1}{3}\%$ of AFC if the survivor does qualify for Social Security survivor benefits. This benefit is reduced by Worker's Compensation. The named beneficiary receives a refund of the member's contributions and interest. Benefits paid to a spouse cease upon remarriage.

Optional Forms of Payment

There are optional forms of payment available on an actuarially equivalent basis, as follows:

100% Survivor Option

This option is payable for the member's life. Upon member's death, 100% of the benefit continues to the contingent annuitant.

Variable Survivor Option

For the member, the benefit is more than the 100% survivor option. Upon the member's death, a designated percentage of the benefit continues to the contingent annuitant.

Leveling Option

Allows an advance on future benefits. The member receives the higher payments in the early years of retirement, and smaller payments at a future date the member specifies. (This option is no longer available for retirements after July 1, 2001).

Partial Lump Sum Option

This option allows the member with earned service beyond their normal retirement date to elect a lump sum payment equal to the sum of 12, 24, or 36 payments of the standard monthly life annuity. The member's monthly benefit will be actuarially reduced to reflect the lump sum payment. The member may then elect to receive the reduced monthly annuity under any of the other optional forms of payment.

Cost-of-Living Increases

Members qualify for cost-of-living increases on July 1 of the second calendar year after retirement. Automatic cost-of-living increases are calculated as the first 3% of the Consumer Price Index increase plus half of each percentage increase from 3% to 7%. Cost-of-living increases are capped at 5%.

SUMMARY OF PLAN CHANGES

1996 Valuation

1. Any member with at least 25 years of service may purchase up to three years of prior service credit for a) active duty military service in the armed forces of the United States, b) certified creditable service in the retirement system of another state, or c) both, at the rate of 5% of current compensation or average final compensation, if greater, times years of service purchased.
2. VRS may enter into an agreement with any political subdivision of the Commonwealth of Virginia which has a defined benefit plan that is not supplemental to VRS to permit portability of service credit on a cost-neutral basis.
3. Early retirement is allowed at age 50 with 10 years of service. The early retirement benefit is determined as if the member is age 55 (but using actual service and AFC), reduced by 6/10% for each month the member is younger than age 55. This benefit can be no smaller than the value of the member's contributions and interest paid in monthly installments over the member's lifetime.
4. The service multiplier for judges entering the Judicial Retirement System after January 1, 1995 is 2.5.
5. Effective July 1, 1998, a health insurance credit of \$1.50 per month per year of service (up to 30 years) is automatically provided to teachers in VRS who retire with at least 15 years of service. At local option, an additional credit of \$1.00 per month per year of service (up to 30 years) can be provided.

1998 Valuation

1. Effective January 1, 1999, the retirement benefit became 1.7% of average final pay times years of service. The 3% benefit adjustment was eliminated for future retirees. A 2% ad hoc benefit increase was provided for all retirees and beneficiaries receiving benefits as of December 31, 1998.
2. On January 1, 1999, the Virginia Sickness and Disability Program (VSDP) became effective. All future new members will be covered by this program; and thus will only receive a deferred retirement benefit from VRS. Members joining before 1999 were allowed to make a one-time irrevocable election to join this program. (Applies to State Employees and State Police.)
3. Effective July 1, 1999, state employees, teachers and employees of participating local units that had not elected out of this benefit may retire with an unreduced benefit if they are at least 50 years old and they have earned at least 30 years of service.

1999 Valuation

1. 100% Joint and Survivor Option is payable in the case of a death of a member who dies while in active service.
2. 100% Joint and Survivor Option is payable for disability retirement.

2000 Valuation

1. On October 1, 1999, the Virginia Law Officers' Retirement System became effective.
2. On November 15, 2000 the VRS Board of Trustees adopted the recommended economic and demographic assumptions proposed by the actuary as a result of the June 2000 actuarial experience study.
3. The Board of Trustees adopted the use of a "pooled" contribution rate for State Employees and Teachers.

2001 Valuation

1. The State Police System had their temporary supplement starting at retirement extended from age 65 to their Social Security retirement age.
2. The Virginia Law Officers' System has changed their benefit multiplier from 1.7% to 2.0% of pay with no temporary supplement for all new hires and rehires after July 1, 2001 as well as for current participants who have made an election to change formulas.
3. The Partial Lump Sum Option was added as an additional optional form of payment. This option provides the retiring member with a lump sum payment equal to the sum of either 12, 24, or 36 payments of the standard monthly life annuity. The member's monthly annuity is actuarially reduced to reflect the lump sum payment.

2002 Valuation

No material changes were made in the plan provisions.

PENSION TRUST FUNDS

ANALYSIS OF CHANGES AND GROWTH IN PLAN NET ASSETS

For the Years Ended June 30

(Expressed in Millions)

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|--------|--------|--------|---------|---------|---------|---------|---------|---------|---------|
| Net Assets Available, Beginning of Year | 15,262 | 15,449 | 18,215 | 21,460 | 26,057 | 30,784 | 34,634 | 39,786 | 36,693 | 33,456 |
| Employee and Employer Contributions | 758 | 900 | 879 | 913 | 1,131 | 1,141 | 1,291 | 1,270 | 1,044 | 1,042 |
| Benefit and Administration Expenses | (748) | (834) | (934) | (1,017) | (1,090) | (1,176) | (1,282) | (1,394) | (1,529) | (1,687) |
| Net Funding | 10 | 66 | (55) | (104) | 41 | (35) | 9 | (124) | (485) | (645) |
| Investment Income: | | | | | | | | | | |
| Interest, Dividends, and Other Investment Income . . | 891 | 707 | 413 | 504 | 534 | 551 | 705 | 785 | 624 | 569 |
| Net Appreciation (Depreciation) in Fair Value | (714) | 1,993 | 2,887 | 4,197 | 4,152 | 3,334 | 4,438 | (3,754) | (3,376) | 401 |
| Net Investment Income | 177 | 2,700 | 3,300 | 4,701 | 4,686 | 3,885 | 5,143 | (2,969) | (2,752) | 970 |
| Net Assets Available, End of Year | 15,449 | 18,215 | 21,460 | 26,057 | 30,784 | 34,634 | 39,786 | 36,693 | 33,456 | 33,781 |

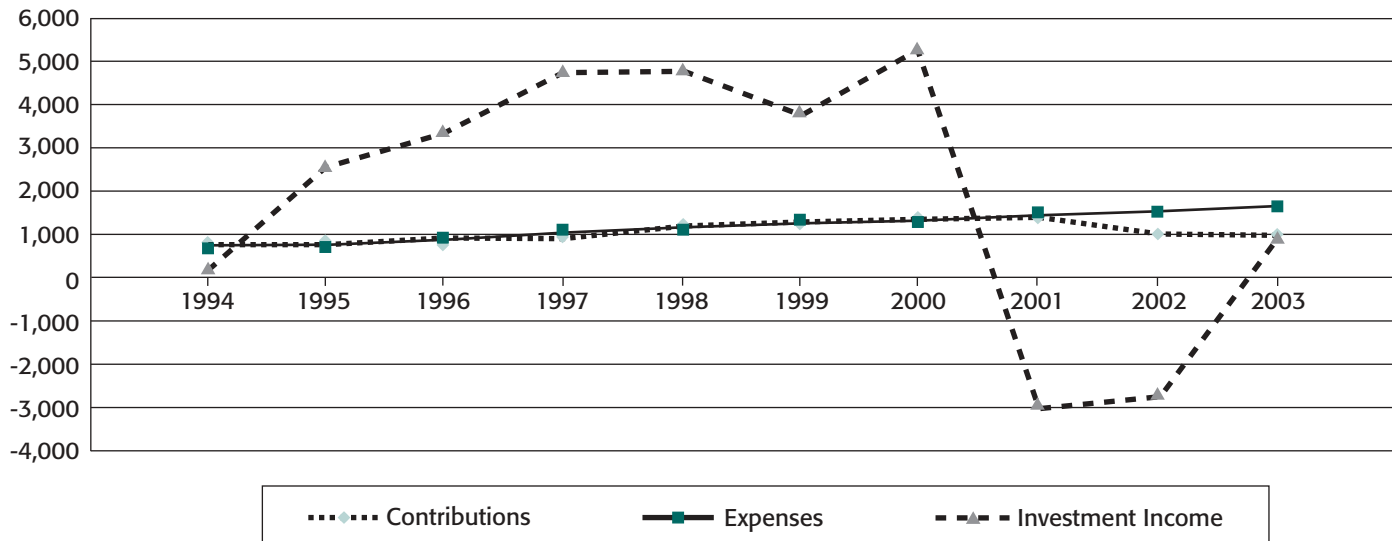
FY 1995 and 1996 Net Appreciation were restated to reflect adjustments from conversion to GASB 25 presentation.

FY 1996 Investment Income categories were restated to reflect recategorization of Index Fund, Real Estate, and Venture Capital income as Net Appreciation (Depreciation) in Fair Value.

PENSION TRUST FUNDS ADDITIONS VERSUS DEDUCTIONS

Fiscal Years 1994–2003

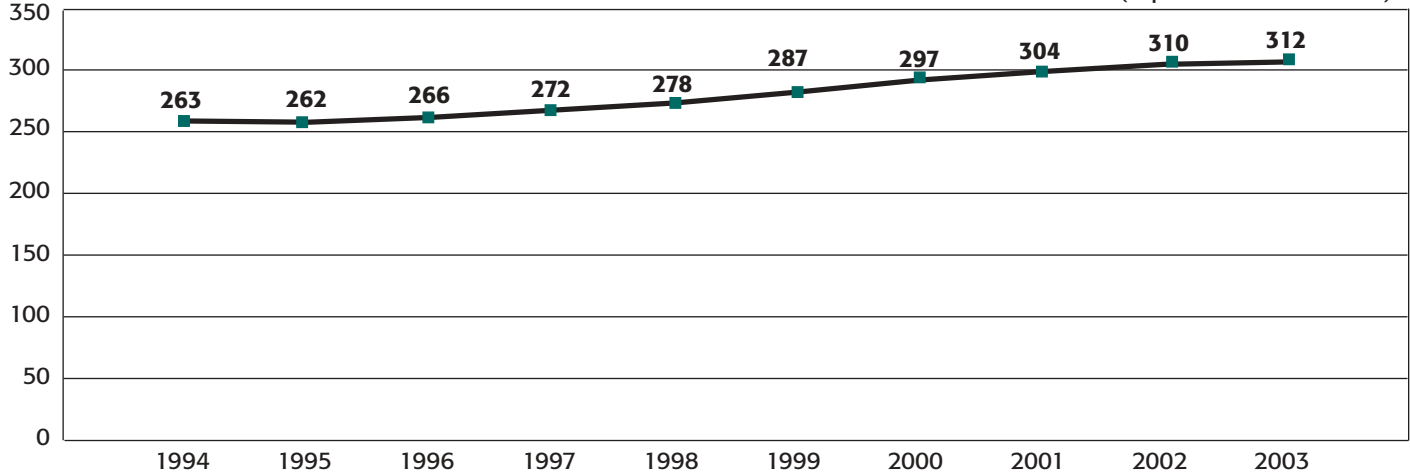
(Millions of Dollars)



NUMBER OF ACTIVE MEMBERS

Fiscal Years 1994–2003

(Expressed in Thousands)



SCHEDULE OF RETIREMENT CONTRIBUTIONS BY SYSTEM

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Virginia Retirement System | | | | State Police Officers' Retirement System | Virginia Law Officers' Retirement System | Judicial Retirement System | Total |
|-----------------------|----------------------------|------------|------------|------------|---|---|----------------------------------|--------------|
| | State | Teacher | Political | Sub-Total | | | | |
| 2003**** | \$ 199,217 | \$ 492,562 | \$ 270,280 | \$ 962,059 | \$ 13,305 | \$ 50,433 | \$ 16,038 | \$ 1,041,835 |
| 2002**** | 234,992 | 455,488 | 283,756 | 974,236 | 14,974 | 42,148 | 13,100 | 1,044,458 |
| 2001 | 299,079 | 591,620 | 264,229 | 1,154,928 | 24,632 | 67,040 | 23,149 | 1,269,749 |
| 2000 | 314,044 | 631,344 | 284,641 | 1,230,029 | 19,170 | 25,192*** | 17,131 | 1,291,522 |
| 1999 | 296,748 | 556,712 | 257,140 | 1,110,600 | 15,298 | — | 15,034 | 1,140,932 |
| 1998** | 265,364 | 603,579* | 237,736 | 1,106,679 | 11,767 | — | 13,107 | 1,131,553 |
| 1997 | 242,380 | 439,490 | 203,427 | 885,297 | 16,035* | — | 11,957 | 913,289 |
| 1996 | 240,393 | 442,600* | 176,545 | 859,538 | 8,330 | — | 11,087 | 878,955 |
| 1995 | 308,978* | 406,670* | 166,497 | 882,145 | 7,603 | — | 10,614 | 900,362 |
| 1994 | 218,998 | 365,339 | 154,634 | 738,971 | 8,431 | — | 10,088 | 757,490 |

* Increased as a result of the Workforce Transition Act of 1995 for state agencies and school board contributions for the 1991 early retirement program.

** In fiscal year 1998, employer contributions increased to begin prefunding cost of living adjustments (COLAs) for retirees.

*** The Virginia Law Officers' Retirement System was effective on October 1, 1999.

**** The General Assembly suspended employer contributions for all State employees effective January, 2002. Employer contributions for SPORS, VaLORS, and JRS were resumed in July 2002.

STATISTICAL SECTION

PENSION TRUST FUNDS ADDITIONS BY SOURCE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Member Contributions | Employer Contributions | | Investment Income | Other | Total |
|--|-------------------------|------------------------|-------------------|----------------------|----------|--------------|
| | | For Members | Employer Share | | | |
| Virginia Retirement System (VRS) | | | | | | |
| 2003 | \$ 127,578 | \$ 499,077 | \$ 335,404 | \$ 935,415 | \$ 2,682 | \$ 1,900,156 |
| 2002 | 115,979 | 482,516 | 375,741 | (2,667,982) | 286 | (1,693,460) |
| 2001 | 65,810 | 453,133 | 635,985 | (2,907,769) | 381 | (1,752,460) |
| 2000 | 68,208 | 426,088 | 735,733 | 5,042,490 | 269 | 6,272,788 |
| 1999 | 55,710 | 406,543 | 648,347 | 3,809,905 | 703 | 4,921,208 |
| 1998*** | 57,032 | 379,953 | 669,694 | 4,594,358 | 116 | 5,701,153 |
| 1997 | 58,003 | 356,759 | 470,535 | 4,608,323 | — | 5,493,620 |
| 1996 | 51,595 | 340,645 | 467,298 | 3,235,211 | — | 4,094,749 |
| 1995* | 50,376 | 331,880 | 499,889 | 2,645,875 | — | 3,528,020 |
| 1994 | 49,391 | 315,725 | 373,855 | 173,918 | 33 | 912,922 |
| State Police Officers' Retirement System (SPORS) | | | | | | |
| 2003 | \$ 556 | \$ 3,972 | \$ 8,777 | \$ 11,929 | \$ — | \$ 25,234 |
| 2002 | 755 | 4,039 | 10,180 | (34,596) | — | (19,622) |
| 2001 | 125 | 4,087 | 20,420 | (37,192) | — | (12,560) |
| 2000 | 192 | 3,922 | 15,056 | 63,638 | — | 82,808 |
| 1999 | 179 | 3,548 | 11,571 | 47,974 | — | 63,272 |
| 1998 | 121 | 3,152 | 8,494 | 58,661 | 2 | 70,430 |
| 1997** | 136 | 2,923 | 12,976 | 58,840 | — | 74,875 |
| 1996 | 270 | 2,984 | 5,076 | 41,865 | — | 50,195 |
| 1995 | 18 | 2,965 | 4,620 | 33,965 | — | 41,568 |
| 1994 | 45 | 2,827 | 5,559 | 2,194 | — | 10,625 |
| Virginia Law Officers' Retirement System (VaLORS) | | | | | | |
| 2003 | \$ 927 | \$ 14,559 | \$ 34,947 | \$ 13,069 | \$ — | \$ 63,502 |
| 2002 | 1,007 | 15,630 | 25,511 | (31,330) | — | 10,818 |
| 2001 | 77 | 15,858 | 51,105 | (4,057) | — | 62,983 |
| 2000**** | 33 | 11,405 | 13,754 | 690 | — | 25,882 |
| Judicial Retirement System (JRS) | | | | | | |
| 2003 | \$ 88 | \$ 2,346 | \$ 13,604 | \$ 6,543 | \$ — | \$ 22,581 |
| 2002 | 73 | 2,365 | 10,662 | (19,248) | — | (6,148) |
| 2001 | 4 | 2,315 | 20,830 | (20,637) | — | 2,512 |
| 2000 | 16 | 2,180 | 14,935 | 35,297 | — | 52,428 |
| 1999 | 6 | 2,049 | 12,979 | 26,569 | — | 41,603 |
| 1998 | 49 | 1,892 | 11,166 | 32,637 | — | 45,744 |
| 1997 | 25 | 1,780 | 10,152 | 32,952 | — | 44,909 |
| 1996 | 10 | 1,745 | 9,332 | 23,492 | — | 34,579 |
| 1995 | — | 1,662 | 8,952 | 19,194 | — | 29,808 |
| 1994 | — | 1,575 | 8,513 | 1,259 | — | 11,347 |

* In fiscal year 1995, employer contributions increased by \$75.6 million for state agencies as a result of the Workforce Transition Act of 1995, and by \$31.7 million for school boards toward the cost of the 1991 early retirement program.

** In fiscal year 1997, employer contributions increased by \$5.9 million for SPORS as a result of the Workforce Transition Act of 1995.

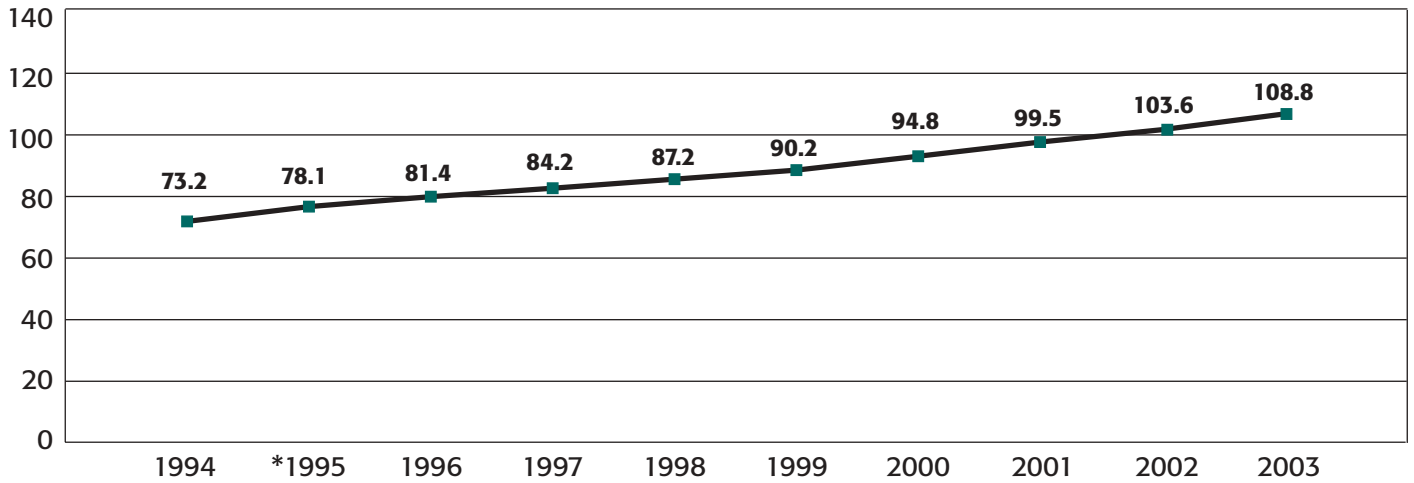
*** In fiscal year 1998, employer contributions increased to begin prefunding cost of living adjustments (COLAs) for retirees.

**** The Virginia Law Officers' Retirement System was effective on October 1, 1999.

NUMBER OF RETIRED MEMBERS

Fiscal Years 1994–2003

(Expressed in Thousands)

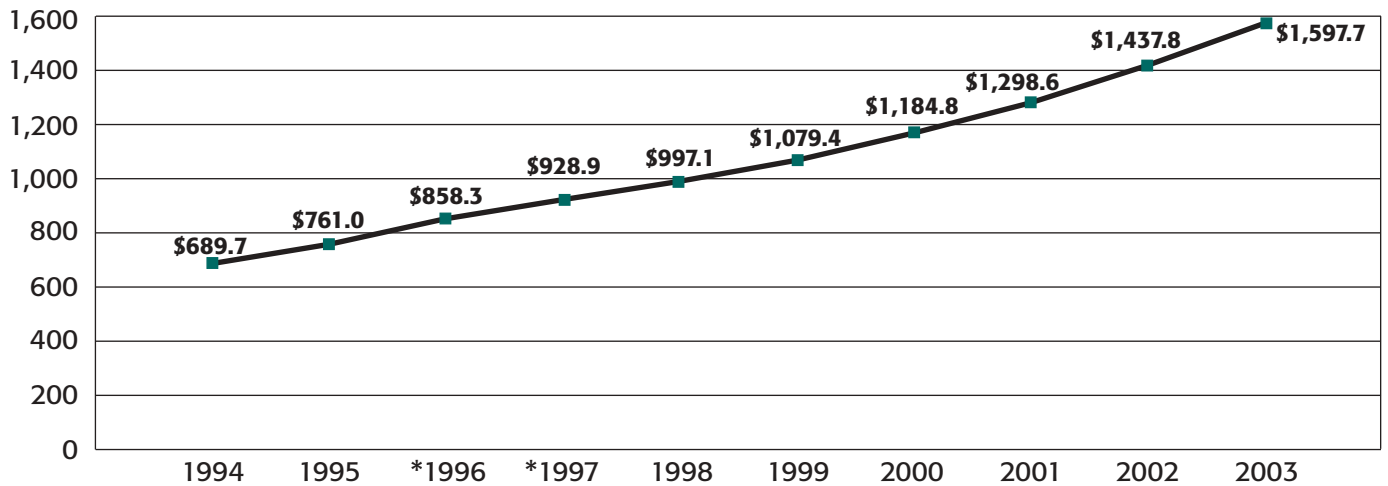


* Increased by the Workforce Transition Act of 1995 for State Agencies

RETIREMENT BENEFITS PAID

Fiscal Years 1994–2003

(Millions of Dollars)



* Increased by the Workforce Transition Act of 1995 for State Agencies

STATISTICAL SECTION

PENSION TRUST FUNDS DEDUCTIONS BY TYPE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Retirement Benefits | Refunds | Administrative Expenses | Other | Total |
|--|------------------------|-----------|----------------------------|-------|--------------|
| Virginia Retirement System (VRS) | | | | | |
| 2003 | \$ 1,537,762 | \$ 67,473 | \$ 16,201 | \$ — | \$ 1,621,436 |
| 2002 | 1,389,815 | 69,235 | 15,039 | 2,449 | 1,476,538 |
| 2001 | 1,261,348 | 79,439 | 14,100 | — | 1,354,887 |
| 2000 | 1,150,694 | 83,412 | 12,613 | — | 1,246,719 |
| 1999 | 1,047,362 | 84,797 | 11,359 | — | 1,143,518 |
| 1998 | 966,876 | 81,168 | 10,980 | 123 | 1,059,147 |
| 1997 | 900,241** | 76,884 | 10,395 | — | 987,520 |
| 1996 | 833,927** | 65,157 | 10,189 | 3 | 909,276 |
| 1995 | 740,639* | 63,182 | 8,801 | 12 | 812,634 |
| 1994 | 671,983 | 49,741 | 7,902 | — | 729,626 |
| State Police Officers' Retirement System (SPORS) | | | | | |
| 2003 | \$ 23,594 | \$ 863 | \$ 205 | \$ — | \$ 24,662 |
| 2002 | 20,607 | 559 | 185 | — | 21,351 |
| 2001 | 17,980 | 289 | 170 | — | 18,439 |
| 2000 | 16,946 | 314 | 137 | — | 17,397 |
| 1999 | 16,020 | 420 | 141 | — | 16,581 |
| 1998 | 15,324 | 474 | 139 | — | 15,937 |
| 1997 | 14,634 | 465 | 131 | — | 15,230 |
| 1996 | 11,039** | 420 | 134 | — | 11,593 |
| 1995 | 8,448* | 457 | 109 | — | 9,014 |
| 1994 | 7,214 | 375 | 99 | — | 7,688 |
| Virginia Law Officers' Retirement System (VaLORS) | | | | | |
| 2003 | \$ 15,020 | \$ 3,763 | \$ 151 | \$ — | \$ 18,934 |
| 2002 | 8,485 | 3,657 | 57 | — | 12,199 |
| 2001 | 1,511 | 862 | 17 | — | 2,390 |
| 2000*** | 330 | 149 | 2 | — | 481 |
| Judicial Retirement System (JRS) | | | | | |
| 2003 | \$ 21,359 | \$ 51 | \$ 113 | \$ — | \$ 21,523 |
| 2002 | 18,884 | — | 104 | — | 18,988 |
| 2001 | 17,788 | 32 | 94 | — | 17,914 |
| 2000 | 16,872 | 24 | 105 | — | 17,001 |
| 1999 | 16,050 | 6 | 79 | — | 16,135 |
| 1998 | 14,856 | — | 78 | — | 14,934 |
| 1997 | 13,986 | — | 74 | — | 14,060 |
| 1996 | 13,380 | — | 74 | — | 13,454 |
| 1995 | 11,893* | 56 | 62 | — | 12,011 |
| 1994 | 10,498 | 5 | 56 | — | 10,559 |

* Retirement benefits increased as a result of a one-time 3% increase in retirement allowances on October 1, 1994, provided by SB2008.

** Retirement benefits increased as a result of the Workforce Transition Act of 1995 for state agencies.

*** The Virginia Law Officers' Retirement System was effective on October 1, 1999.

SCHEDULE OF RETIREMENT BENEFITS BY SYSTEM

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Virginia Retirement System | | | | State Police Officers' Retirement System | Virginia Law Officers' Retirement System | Judicial Retirement System | Total |
|-----------------------|----------------------------|------------|------------|--------------|---|---|----------------------------------|--------------|
| | State | Teacher | Political | Sub-Total | | | | |
| 2003 | \$ 503,249 | \$ 782,652 | \$ 251,861 | \$ 1,537,762 | \$ 23,594 | \$ 15,020 | \$ 21,359 | \$ 1,597,735 |
| 2002 | 454,123 | 710,538 | 225,154 | 1,389,815 | 20,607 | 8,485 | 18,884 | 1,437,791 |
| 2001 | 421,033 | 639,760 | 200,555 | 1,261,348 | 17,980 | 1,511 | 17,788 | 1,298,627 |
| 2000 | 394,601 | 575,876 | 180,217 | 1,150,694 | 16,946 | 330*** | 16,872 | 1,184,842 |
| 1999 | 372,503 | 514,124 | 160,735 | 1,047,362 | 16,020 | — | 16,050 | 1,079,432 |
| 1998 | 354,862 | 467,367 | 144,647 | 966,876 | 15,324 | — | 14,856 | 997,056 |
| 1997 | 339,687** | 429,892 | 130,662 | 900,241 | 14,634** | — | 13,986 | 928,861 |
| 1996 | 317,398** | 400,111 | 116,418 | 833,927 | 11,039** | — | 13,380 | 858,346 |
| 1995* | 267,238 | 370,088 | 103,313 | 740,639 | 8,448 | — | 11,893 | 760,980 |
| 1994 | 242,104 | 339,410 | 90,469 | 671,983 | 7,214 | — | 10,498 | 689,695 |

* Increased as a result of a one-time 3% retirement allowance increase under SB2008.

** Increased as a result of the Workforce Transition Act of 1995 for state agencies.

*** The Virginia Law Officers' Retirement System was effective on October 1, 1999.

SCHEDULE OF RETIREMENT BENEFITS BY TYPE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Service Benefits | Disability Benefits | Survivor Benefits | Total |
|-----------------------|---------------------|------------------------|----------------------|--------------|
| 2003 | \$ 1,386,236 | \$ 199,391 | \$ 12,108 | \$ 1,597,735 |
| 2002 | 1,242,235 | 184,582 | 10,974 | 1,437,791 |
| 2001 | 1,121,588 | 167,931 | 9,108 | 1,298,627 |
| 2000 | 1,021,185 | 155,450 | 8,207 | 1,184,842 |
| 1999 | 928,862 | 143,181 | 7,389 | 1,079,432 |
| 1998 | 861,377 | 128,637 | 7,042 | 997,056 |
| 1997 | 805,391** | 117,133 | 6,337 | 928,861 |
| 1996 | 745,864** | 106,449 | 6,033 | 858,346 |
| 1995* | 661,231 | 94,239 | 5,510 | 760,980 |
| 1994 | 604,791 | 79,905 | 4,999 | 689,695 |

* Increased as a result of a one-time 3% retirement allowance increase under SB2008.

** Increased as a result of the Workforce Transition Act of 1995 for state agencies.

SCHEDULE OF REFUNDS BY TYPE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Separations | Death | Total |
|-----------------------|-------------|----------|-----------|
| 2003 | \$ 64,203 | \$ 7,947 | \$ 72,150 |
| 2002 | 65,893 | 7,558 | 73,451 |
| 2001 | 73,659 | 6,963 | 80,622 |
| 2000 | 77,027 | 6,872 | 83,899 |
| 1999 | 78,530 | 6,693 | 85,223 |
| 1998 | 74,731 | 6,911 | 81,642 |
| 1997 | 72,077 | 5,272 | 77,349 |
| 1996 | 61,126 | 4,451 | 65,577 |
| 1995* | 59,225* | 4,470 | 63,695 |
| 1994 | 46,519 | 3,602 | 50,121 |

* Increased as a result of the Workforce Transition Act of 1995 for state agencies.

STATISTICAL SECTION

SCHEDULE OF RETIRED MEMBERS BY TYPE OF BENEFIT AND OPTION SELECTED

As of June 30, 2003

| Amount of Retirement Benefit | Number of Retirants | Service | Type of Retirement | | | | | | | |
|------------------------------|---------------------|---------------|-------------------------|--------------------------|-----------------------------------|--------------------|-----------------------------------|-------------------------|--|-----------------|
| | | | Early Retirement Window | 50/30 Service Retirement | 1991 Fac. Early Retirement Window | Regular Disability | Survivor Payment-Death in Service | Line-of-Duty Disability | Survivor Payment-Death in Line-of-Duty | 50/10 Provision |
| \$ 1 – 200 | 16,156 | 14,033 | 2 | – | 1 | 1,063 | 505 | 83 | 5 | 464 |
| 201 – 400 | 18,069 | 14,348 | 114 | – | – | 2,425 | 379 | 144 | 21 | 638 |
| 401 – 600 | 14,483 | 10,746 | 334 | 2 | – | 2,593 | 204 | 230 | 26 | 348 |
| 601 – 800 | 11,164 | 7,984 | 436 | 14 | 1 | 2,023 | 117 | 351 | 21 | 217 |
| 801 – 1,000 | 8,849 | 6,084 | 556 | 58 | 3 | 1,516 | 72 | 344 | 8 | 208 |
| 1,001 – 1,200 | 6,988 | 4,681 | 645 | 141 | 3 | 1,067 | 57 | 224 | 5 | 165 |
| 1,201 – 1,400 | 5,676 | 3,730 | 624 | 164 | 15 | 784 | 24 | 189 | 3 | 143 |
| 1,401 – 1,600 | 5,044 | 3,269 | 647 | 232 | 24 | 561 | 31 | 142 | 3 | 135 |
| 1,601 – 1,800 | 4,613 | 2,954 | 532 | 446 | 37 | 393 | 16 | 119 | 2 | 114 |
| 1,801 – 2,000 | 4,284 | 2,619 | 430 | 654 | 37 | 329 | 17 | 117 | – | 81 |
| Over 2,001 | 13,432 | 9,502 | 842 | 1,779 | 178 | 647 | 48 | 265 | 2 | 169 |
| Totals | 108,758 | 79,950 | 5,162 | 3,490 | 299 | 13,401 | 1,470 | 2,208 | 96 | 2,682 |

| Min. Guar. Amount of Retirement Benefit | Option Selected | | | | | | | | | | | | | | | |
|---|-----------------|------------|--------------|--------------|--------------|------------|----------|--------------|------------|----------|-----------|--------------|------------|--------------|------------|------------|
| | A | B | C | D | E | F | G | H | K | L | M | N | R | V | Y | Z |
| \$ 1 – 200 | 13,203 | 115 | 551 | 270 | 1,242 | 3 | 1 | 89 | 6 | – | 1 | 612 | 11 | 48 | 2 | 2 |
| 201 – 400 | 14,254 | 47 | 627 | 502 | 1,057 | 7 | – | 796 | 40 | 2 | 10 | 608 | 6 | 105 | 6 | 2 |
| 401 – 600 | 10,528 | 43 | 552 | 564 | 989 | 15 | – | 1,132 | 87 | 1 | 19 | 448 | 4 | 93 | 6 | 2 |
| 601 – 800 | 7,841 | 33 | 445 | 580 | 865 | 13 | – | 854 | 73 | – | 26 | 314 | 5 | 101 | 12 | 2 |
| 801 – 1,000 | 5,943 | 11 | 386 | 603 | 797 | 23 | – | 592 | 45 | 1 | 12 | 276 | 3 | 134 | 17 | 6 |
| 1,001 – 1,200 | 4,487 | 4 | 365 | 559 | 752 | 16 | – | 351 | 33 | 1 | 7 | 227 | 9 | 138 | 31 | 8 |
| 1,201 – 1,400 | 3,723 | 3 | 293 | 475 | 517 | 22 | – | 216 | 24 | 1 | 7 | 191 | 13 | 134 | 40 | 1 |
| 1,401 – 1,600 | 3,316 | 1 | 285 | 428 | 451 | 35 | – | 150 | 6 | – | 3 | 164 | 4 | 140 | 49 | 12 |
| 1,601 – 1,800 | 3,232 | – | 210 | 398 | 323 | 36 | – | 62 | 5 | – | 1 | 151 | 8 | 104 | 62 | 21 |
| 1,801 – 2,000 | 2,975 | – | 162 | 367 | 272 | 37 | – | 51 | 5 | – | – | 175 | 7 | 107 | 98 | 28 |
| Over 2,001 | 8,723 | 1 | 562 | 1,135 | 463 | 204 | – | 68 | 13 | – | – | 836 | 154 | 659 | 454 | 160 |
| Totals | 78,225 | 258 | 4,438 | 5,881 | 7,728 | 411 | 1 | 4,361 | 337 | 6 | 86 | 4,002 | 224 | 1,763 | 777 | 260 |

- A = Basic Benefit
- B = Increased Basic Benefit
- C = 100% Survivor Benefit
- D = 50% Survivor Benefit
- E = Social Security Leveling Benefit
- F = Special Survivor Option
- G = Lump Sum
- H = Minimum Guaranteed Disability Basic Benefit
- K = Minimum Guaranteed Disability - 50% Survivor
- L = 100% Survivor - Disability
- M = Special Survivor Option - Disability
- N = Leveling Benefit
- R = Leveling Benefit - Rollover
- V = Survivor Option
- Y = PLOP Basic
- Z = PLOP with survivor

Retirement Breakdown: During fiscal year 2003, 88% of all retirements were service retirements, and 12% were certified as disability retirements by the Medical Board.

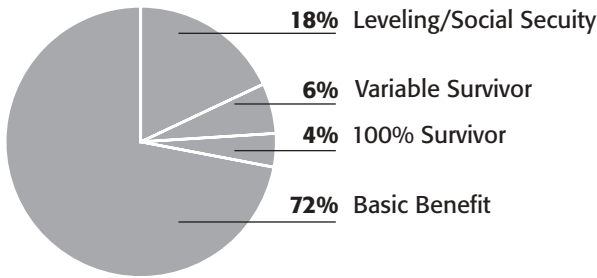
SCHEDULE OF AVERAGE BENEFIT PAYMENTS

Retirement Effective Date July 1, 1998, to June 30, 2003

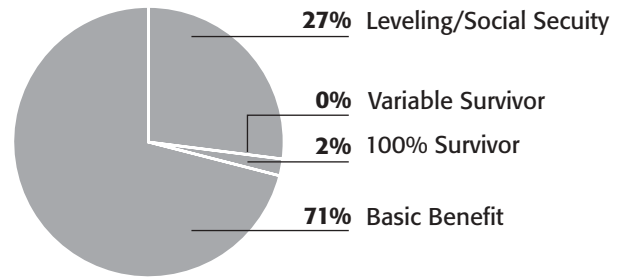
| | | Years of Credited Service | | | | | |
|---------|----------------------------------|---------------------------|-----------|-----------|------------|-------------|-------------|
| | | 1–10 | 11–15 | 16–20 | 21–25 | 26–30 | Over 30 |
| FY 2003 | Average Monthly Benefit | \$ 326.30 | \$ 473.50 | \$ 686.13 | \$1,052.83 | \$ 1,739.64 | \$ 2,389.74 |
| | Number of Active Retirants | 659 | 794 | 798 | 958 | 1,575 | 2,904 |
| FY 2002 | Average Monthly Benefit | \$ 294.63 | \$ 450.29 | \$ 671.40 | \$1,010.69 | \$ 1,757.42 | \$ 2,316.68 |
| | Number of Active Retirants | 627 | 715 | 743 | 988 | 1,538 | 2,277 |
| FY 2001 | Average Monthly Benefit | \$ 306.46 | \$ 452.17 | \$ 678.20 | \$ 999.05 | \$1,689.12 | \$ 2,302.94 |
| | Number of Active Retirants | 623 | 803 | 805 | 1,037 | 1,504 | 2,453 |
| FY 2000 | Average Monthly Benefit | \$ 234.76 | \$ 414.85 | \$ 686.39 | \$ 911.42 | \$ 1,587.73 | \$ 2,218.68 |
| | Number of Active Retirants | 673 | 742 | 762 | 1,039 | 1,385 | 2,482 |
| FY 1999 | Average Monthly Benefit | \$ 351.22 | \$ 444.94 | \$ 651.13 | \$ 927.54 | \$ 1,577.71 | \$ 2,215.74 |
| | Number of Active Retirants | 651 | 696 | 761 | 923 | 937 | 1,650 |

DISTRIBUTION OF RETIREES BY PAYMENT OPTION SELECTED

All Retirees at June 30, 2003



2003 Retirees



OPTIONS FOR RETIREMENT

VRS offers several options for retirement:

Basic Benefit:

Monthly annuity payments are based on the normal benefit formula. Any accumulated contributions that have not been used between the date of contributions and the date of death are paid in a lump sum to the designated beneficiary.

Variable Survivor:

For the retiree, the benefit is more than the 100% survivor option benefit. At death, a percentage of the monthly benefit is continued to the designated contingent annuitant.

Leveling/Social Security:

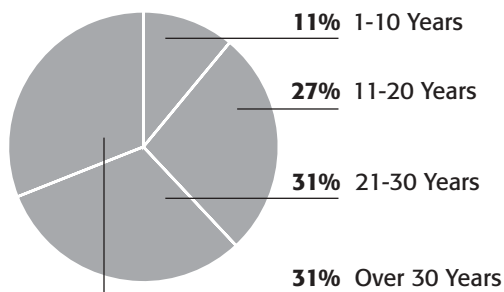
Allows an advance on the benefit; therefore, the retiree receives a higher benefit in the early years of retirement. The advance is paid from retirement date until the age specified by the retiree (between 59½ and 70½, or age 65 under the Social Security option). This benefit reduces at the level age.

100% Survivor:

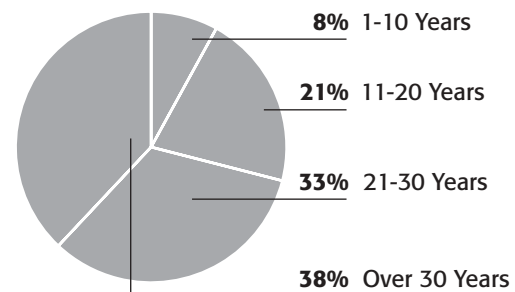
The basic benefit is reduced during the member’s lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

DISTRIBUTION OF RETIREES BY YEARS OF SERVICE

All Retirees at June 30, 2003

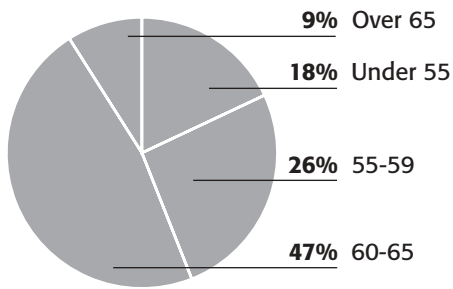


2003 Retirees

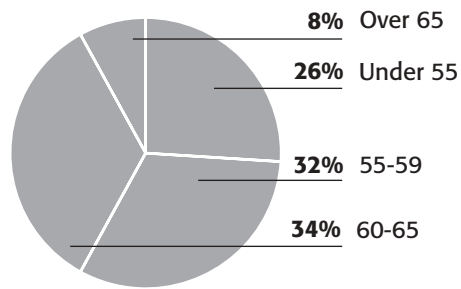


DISTRIBUTION OF RETIREES BY AGE AT RETIREMENT

All Retirees at June 30, 2003

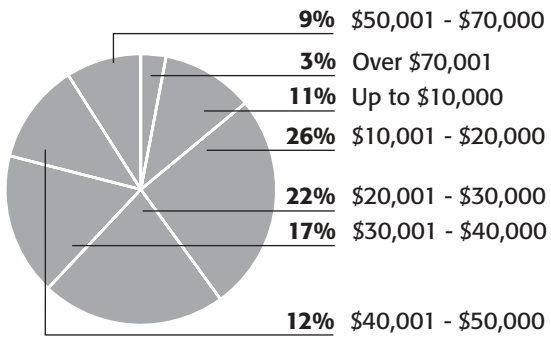


2003 Retirees

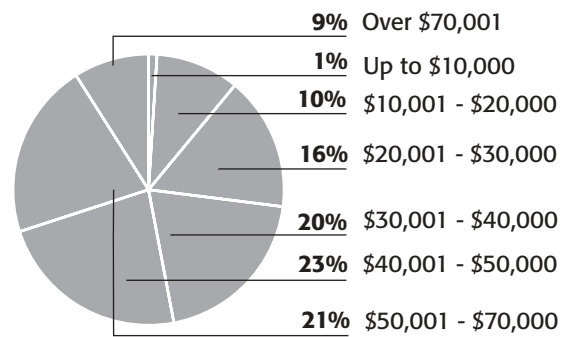


DISTRIBUTION OF RETIREES BY AVERAGE FINAL SALARY

All Retirees at June 30, 2003



2003 Retirees



OTHER EMPLOYEE BENEFIT TRUST FUNDS

SCHEDULE OF GROUP INSURANCE ADDITIONS BY SOURCE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Contributions | | | | Investment Income | Other | Total |
|-----------------------|---------------|---------|-----------|-----------|----------------------|-------|-----------|
| | State | Teacher | Political | Sub-Total | | | |
| 2003* | \$ 5 | \$ 22 | \$ 17 | \$ 44 | \$ 18,297 | \$ — | \$ 18,341 |
| 2002* | 22,919 | 28,267 | 17,614 | 68,800 | (72,021) | — | (3,221) |
| 2001 | 29,703 | 37,027 | 21,894 | 88,624 | (77,363) | — | 11,261 |
| 2000* | 1 | 2 | 41 | 44 | 139,707 | 277 | 140,028 |
| 1999* | (1) | 1 | 22 | 22 | 110,393 | — | 110,415 |
| 1998 | 8,973 | 10,958 | 6,435 | 26,366 | 145,280 | — | 171,646 |
| 1997* | 12 | (39) | 33 | 6 | 154,091 | — | 154,097 |
| 1996 | 9,904 | 12,136 | 6,924 | 28,964 | 116,840 | — | 145,804 |
| 1995 | 5,025 | 5,853 | 3,311 | 14,189 | 95,497 | — | 109,686 |
| 1994* | (25) | 2 | 5 | (18) | 5,392 | — | 5,374 |

* The group life insurance contribution rates for fiscal years 2003, 2000, 1999, 1997 and 1994 were zero. Amounts shown are adjustments and contributions for new employers. A statutory change in the actuarial period for prefunding postemployment life insurance benefits eliminated contribution requirements for fiscal year 1994. For fiscal years 2000, 1999 and 1997 the rate change was the result of a statutory premium holiday. There was also a premium holiday beginning in April 2002.

SCHEDULE OF GROUP INSURANCE CLAIMS BY TYPE

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Active Claims | Retired Claims | Total |
|-----------------------|------------------|-------------------|------------|
| 2003 | \$ 44,614 | \$ 59,661 | \$ 104,275 |
| 2002 | 39,617 | 56,008 | 95,625 |
| 2001 | 36,899 | 51,280 | 88,179 |
| 2000 | 34,113 | 48,912 | 83,025 |
| 1999 | 23,309 | 36,772 | 60,081 |
| 1998 | 26,854 | 45,919 | 72,773 |
| 1997 | 27,461 | 44,644 | 72,105 |
| 1996 | 25,081 | 40,095 | 65,176 |
| 1995 | 28,659 | 35,372 | 64,031 |
| 1994 | 25,884 | 36,163 | 62,047 |

SCHEDULE OF RETIREE HEALTH INSURANCE CREDIT ADDITIONS AND REIMBURSEMENTS

Fiscal Years 1994–2003

(Expressed in Thousands)

| Year Ended June 30 | Additions | | | Total | Health Insurance Reimbursements |
|-----------------------|---------------|-----------------------------|-------|-----------|---------------------------------------|
| | Contributions | Investment Income (Loss) | Other | | |
| 2003 | \$ 74,123 | \$ 3,265 | \$ — | \$ 77,388 | \$ 61,027 |
| 2002 | 85,209 | (5,080) | — | 80,129 | 57,590 |
| 2001 | 73,901 | (3,089) | — | 70,812 | 54,628 |
| 2000*** | 17,592 | 6,323 | — | 23,915 | 50,456 |
| 1999** | 35,260 | 7,689 | 1 | 42,950 | 30,254 |
| 1998 | 22,123 | 7,637 | 14 | 29,774 | 17,372 |
| 1997 | 20,357 | 7,158 | — | 27,515 | 16,810 |
| 1996 | 20,180 | 3,592 | — | 23,772 | 13,594 |
| 1995 | 20,057 | 3,023 | — | 23,080 | 13,652 |
| 1994* | 11,652 | 97 | — | 11,749 | 12,551 |

* The retiree health insurance credit was increased on July 1, 1993, from \$1.50 to \$2.50 per month and the maximum from \$45.00 to \$75.00 per month.

** Data for FY 1999 reflect extension of coverage to all teachers on July 1, 1998, and a premium holiday for state agencies in May and June, 1999.

*** No contributions were paid for state employees during FY 2000. The maximum health credit increased for state employees to \$120.00 per month and for teachers to \$75.00 effective July 1, 1999.

PARTICIPATING EMPLOYERS AS OF JUNE 30, 2003

Political Subdivisions (413)

| | | | |
|----------------------|--------------------------|------------------------|------------------------|
| Accomack County | Montgomery County | City of Petersburg | Town of Halifax |
| Albemarle County | Nelson County | City of Poquoson | Town of Hamilton |
| Alleghany County | New Kent County | City of Portsmouth | Town of Herndon |
| Amelia County | Northampton County | City of Radford | Town of Hillsville |
| Amherst County | Northumberland County | City of Richmond | Town of Hurt |
| Appomattox County | Nottoway County | City of Roanoke | Town of Independence |
| Augusta County | Orange County | City of Salem | Town of Iron Gate |
| Bath County | Page County | City of Staunton | Town of Jarratt |
| Bedford County | Patrick County | City of Suffolk | Town of Jonesville |
| Bland County | Pittsylvania County | City of Virginia Beach | Town of Kenbridge |
| Botetourt County | Prince Edward County | City of Waynesboro | Town of Kilmarnock |
| Brunswick County | Prince George County | City of Williamsburg | Town of La Crosse |
| Buchanan County | Prince William County | City of Winchester | Town of Lawrenceville |
| Buckingham County | Pulaski County | Town of Abingdon | Town of Leesburg |
| Campbell County | Rappahannock County | Town of Alberta | Town of Louisa |
| Caroline County | Richmond County | Town of Altavista | Town of Luray |
| Carroll County | Roanoke County | Town of Amherst | Town of Madison |
| Charles City County | Rockbridge County | Town of Appomattox | Town of Marion |
| Charlotte County | Rockingham County | Town of Ashland | Town of McKenney |
| Chesterfield County | Russell County | Town of Berryville | Town of Middleburg |
| Clarke County | Scott County | Town of Big Stone Gap | Town of Middletown |
| Craig County | Shenandoah County | Town of Blacksburg | Town of Montross |
| Culpeper County | Smyth County | Town of Blackstone | Town of Mt. Jackson |
| Cumberland County | Southampton County | Town of Bluefield | Town of Narrows |
| Dickenson County | Spotsylvania County | Town of Bowling Green | Town of New Market |
| Dinwiddie County | Stafford County | Town of Boyce | Town of Onancock |
| Essex County | Surry County | Town of Boydton | Town of Onley |
| Fauquier County | Sussex County | Town of Bridgewater | Town of Orange |
| Floyd County | Tazewell County | Town of Broadway | Town of Parksley |
| Fluvanna County | Warren County | Town of Brookneal | Town of Pearisburg |
| Franklin County | Washington County | Town of Burkeville | Town of Pembroke |
| Frederick County | Westmoreland County | Town of Cape Charles | Town of Pennington Gap |
| Giles County | Wise County | Town of Chase City | Town of Pound |
| Gloucester County | Wythe County | Town of Chatham | Town of Pulaski |
| Goochland County | York County | Town of Chilhowie | Town of Purcellville |
| Grayson County | City of Alexandria | Town of Chincoteague | Town of Quantico |
| Greene County | City of Bedford | Town of Christiansburg | Town of Remington |
| Greensville County | City of Bristol | Town of Clarksville | Town of Rocky Mount |
| Halifax County | City of Buena Vista | Town of Clifton Forge | Town of Round Hill |
| Hanover County | City of Chesapeake | Town of Coeburn | Town of Rural Retreat |
| Henrico County | City of Colonial Heights | Town of Colonial Beach | Town of Saltville |
| Henry County | City of Covington | Town of Courtland | Town of Scottsville |
| Highland County | City of Danville | Town of Craigsville | Town of Shenandoah |
| Isle of Wight County | City of Emporia | Town of Crewe | Town of Smithfield |
| James City County | City of Fairfax | Town of Culpeper | Town of South Boston |
| King George County | City of Falls Church | Town of Dayton | Town of South Hill |
| King & Queen County | City of Franklin | Town of Dillwyn | Town of St. Paul |
| King William County | City of Fredericksburg | Town of Dublin | Town of Stanley |
| Lancaster County | City of Galax | Town of Dumfries | Town of Strasburg |
| Lee County | City of Hampton | Town of Edinburg | Town of Stuart |
| Loudoun County | City of Harrisonburg | Town of Elkton | Town of Tappahannock |
| Louisa County | City of Hopewell | Town of Exmore | Town of Tazewell |
| Lunenburg County | City of Lexington | Town of Floyd | Town of Timberville |
| Madison County | City of Lynchburg | Town of Front Royal | Town of Urbanna |
| Mathews County | City of Manassas | Town of Gate City | Town of Victoria |
| Mecklenburg County | City of Manassas Park | Town of Glasgow | Town of Vienna |
| Middlesex County | City of Martinsville | Town of Gretna | Town of Vinton |
| | City of Norfolk | Town of Grottoes | Town of Wakefield |
| | City of Norton | Town of Grundy | Town of Warrenton |

| | | | |
|--|---|---|--|
| Town of Warsaw | Colonial Soil & Water Conservation District | Holston River Soil & Water Conservation District | Piedmont Regional Jail |
| Town of Waverly | Covington Redevelopment & Housing Authority | Hopewell Redevelopment & Housing Authority | Piedmont Regional Juvenile Detention Center |
| Town of Weber City | Crater Juvenile Detention Home Commission | Industrial Development Authority of Henrico County | Pittsylvania County Service Authority |
| Town of West Point | Culpeper Soil & Water Conservation District | James City Service Authority | Planning District One |
| Town of Wise | Cumberland Mountain Community Services Board | John Marshall Soil & Water Conservation District | Community Services Board |
| Town of Woodstock | Cumberland Plateau Regional Housing Authority | Lee County Redevelopment & Housing Authority | Potomac and Rappahannock Transportation Commission |
| Town of Wytheville | Daniel Boone Soil & Water Conservation District | Lee County Public Service Authority | Potomac River Fisheries Commission |
| Accomack-Northampton Planning District Commission | Danville-Pittsylvania Community Services Board | Lenwisco Planning District Commission | Prince William Soil & Water Conservation District |
| Albemarle County Service Authority | Danville Redevelopment & Housing Authority | Lonesome Pine Regional Library | Rappahannock Area Community Services Board |
| Albermarle-Charlottesville Regional Jail | Dinwiddie County Water Authority | Loudoun County Sanitation Authority | Rappahannock Juvenile Center |
| Alexandria Redevelopment & Housing Authority | District 19 Mental Health & Mental Retardation Services Board | Massanutten Regional Library | Rappahannock-Rapidan Community Services Board |
| Alexandria Sanitation Authority | Eastern Shore Community Services Board | Meherrin Regional Library | Rappahannock-Rapidan Planning District Commission |
| Alleghany Highlands Community Services Board | Eastern Shore Public Library | Middle Peninsula-Northern Neck Community Services | Rappahannock Regional Jail |
| Amherst County Service Authority | Evergreen Soil and Water Conservation District | Middle Peninsula Regional Security Center | Region Ten Community Services Board |
| Anchor Commission | Fauquier County Water & Sanitation Authority | Monacan Soil & Water Conservation District | Richmond Metropolitan Authority |
| Appomattox Regional Library | Ferrum Water & Sewage Authority | Montgomery Regional Solid Waste Authority | Richmond Redevelopment & Housing Authority |
| Appomattox River Water Authority | Franklin Redevelopment & Housing Authority | Nelson County Service Authority | Richmond Regional Planning District Commission |
| Augusta County Service Authority | Frederick County Sanitation Authority | New River Resource Authority | Rivanna Solid Waste Authority |
| Bedford County Public Service Authority | Fredericksburg-Stafford Park Authority | New River Soil & Water Conservation District | Rivanna Water & Sewer Authority |
| Bedford Public Library | Giles County Public Service Authority | New River Valley Juvenile Detention Home Commission | Riverside Regional Jail |
| Big Walker Soil & Water Conservation District | Goochland-Powhatan Community Services Board | New River Valley Planning District Commission | Roanoke Higher Education Authority |
| Blacksburg-Christiansburg-VPI Water Authority | Great Southwest Regional Group Home Commission | New River Valley Regional Jail | Roanoke River Service Authority |
| Blacksburg-VPI Sanitation Authority | Greensville County Water & Sewer Authority | Norfolk Airport Authority | Robert E. Lee Soil & Water Conservation District |
| Blue Ridge Juvenile Detention Center | Greensville-Emporia Department of Social Services | Norfolk Redevelopment & Housing Authority | Rockbridge Area Community Services Board |
| Blue Ridge Regional Jail Authority | Hampton-Newport News Community Services Board | Norfolk Redevelopment & Housing Authority | Rockbridge Area Social Services Department |
| Bristol Redevelopment & Housing Authority | Hampton Redevelopment & Housing Authority | Northern Neck-Essex County Group Home Commission | Rockbridge County Public Service Authority |
| Brunswick Industrial Development Authority | Hampton Roads Planning District Commission | Northern Neck Planning District Commission | Rockbridge Regional Library |
| Campbell County Utilities & Service Authority | Hampton Roads Regional Jail | Northern Neck Regional Jail | Russell County |
| Capital Regional Airport Commission | Hampton Roads Sanitation District | Northern Shenandoah Valley Regional Commission | Water & Sewage Authority |
| Central Rappahannock Regional Library | Handley Library Board | Northern Virginia Health Care Center Commission | Scott County Public Service Authority |
| Central Virginia Community Services Board | Harrisonburg-Rockingham Community Services Board | Northern Virginia Juvenile Detention Home | Scott County Redevelopment and Housing Authority |
| Central Virginia Regional Jail | Harrisonburg-Rockingham Regional Sewer Authority | Northwestern Community Services Board | Scott County Soil & Water Conservation District |
| Central Virginia Waste Management Authority | Henricopolis Soil & Water Conservation District | Opportunity Inc. of Hampton Roads | Shenandoah Valley Juvenile Detention Home Commission |
| Charles Pickney Jones Memorial Library | Henry County Public Service Authority | Pamunkey Regional Jail | South Central Wastewater Authority |
| Charlottesville-Albemarle Airport Authority | Highlands Juvenile Detention Center Commission | Peaks of Otter Soil & Water Conservation District | Southeastern Virginia Public Services Authority |
| Charlottesville Redevelopment & Housing Authority | | Peninsula Ferry Commission | Southside Community Services Board |
| Chesapeake Bay Bridge & Tunnel District | | Pepper's Ferry Regional Wastewater Authority | Southside Planning District Commission |
| Chesapeake Redevelopment & Housing Authority | | Peter Francisco Soil & Water Conservation District | Southside Regional Jail |
| Chesterfield County Health Center Commission | | Petersburg Redevelopment & Housing Authority | Southside Regional Juvenile Group Home Commission |
| Coeburn-Norton-Wise Regional Water Treatment Authority | | Peumansend Creek Regional Jail | Southside Regional Library Board |
| Colonial Services Board | | Piedmont Planning District Commission | Spotsylvania-Stafford-Fredericksburg Group Home Commission |
| | | | Staunton Redevelopment & Housing Authority |

Suffolk Redevelopment & Housing Authority
 Sussex Service Authority
 Tazewell Soil & Water Conservation District
 Thomas Jefferson Planning District Commission
 Thomas Jefferson Soil & Water Conservation District
 Tidewater Regional Group Home
 Tidewater Transportation District Commission
 Tri-County/City Soil & Water Conservation District
 Upper Occoquan Sewage Authority
 Valley Community Services Board
 Virginia Biotechnology Research Park Authority
 Virginia Coalfield Economic Development Authority
 Virginia Highlands Airport Commission
 Virginia Peninsulas Public Service Authority
 Virginia Peninsula Regional Jail
 Washington County Service Authority
 Waynesboro Redevelopment & Housing Authority
 Western Tidewater Community Services
 Western Tidewater Regional Jail
 Wise County Public Service Authority
 Wise County Redevelopment & Housing Authority
 Wythe-Grayson Regional Library
 Wytheville Redevelopment & Housing Authority

Public School Boards—Professional Employees

City/Town Schools (39)
 Alexandria City Schools*
 Bristol City Schools*
 Buena Vista City Schools*
 Charlottesville Public Schools*
 Chesapeake Public Schools*
 Colonial Beach Schools
 Colonial Heights City Schools*
 Covington City Schools*
 Danville City Schools*
 Fairfax City Schools
 Falls Church Public Schools
 Franklin City Schools*
 Fredericksburg City Schools*

Galax City Schools*
 Hampton City Schools*
 Harrisonburg City Schools*
 Hopewell City Schools*
 Lexington City Schools*
 Lynchburg Public Schools*
 Manassas City Schools*
 Manassas Park City Schools*
 Martinsville City Schools*
 Newport News Public Schools
 Norfolk Public Schools*
 Norton City Schools*
 Petersburg City Schools*
 Poquoson City Schools*
 Portsmouth City Schools*
 Radford City Schools*
 Richmond Public Schools*
 Roanoke City Schools
 Salem City Schools*
 Staunton City Schools*
 Suffolk City Schools*
 Virginia Beach City Schools*
 Waynesboro City Schools*
 West Point Schools
 Williamsburg-James City County Schools*
 Winchester Public Schools*

County Schools (94)

Accomack County Schools*
 Albemarle County Schools*
 Alleghany County Schools*
 Amelia County Schools*
 Amherst County Schools*
 Appomattox County Schools*
 Arlington County Schools*
 Augusta County Schools*
 Bath County Schools*
 Bedford County Schools*
 Bland County Schools*
 Botetourt County Schools*
 Brunswick County Schools*
 Buchanan County Schools*
 Buckingham County Schools*
 Campbell County Schools*
 Caroline County Schools*
 Carroll County Schools*
 Charles City County Schools*
 Charlotte County Schools*
 Chesterfield County Schools*
 Clarke County Schools*
 Craig County Schools*
 Culpeper County Schools*

Cumberland County Schools*
 Dickenson County Schools*
 Dinwiddie County Schools*
 Essex County Schools*
 Fairfax County Schools
 Fauquier County Schools*
 Floyd County Schools*
 Fluvanna County Schools*
 Franklin County Schools*
 Frederick County Schools*
 Giles County Schools*
 Gloucester County Schools*
 Goochland County Schools*
 Grayson County Schools*
 Greene County Schools*
 Greensville County Schools*
 Halifax County Schools*
 Hanover County Schools*
 Henrico County Schools*
 Henry County Schools*
 Highland County Schools*
 Isle of Wight County Schools*
 King George County Schools*
 King & Queen County Schools*
 King William County Schools*
 Lancaster County Schools*
 Lee County Schools*
 Loudoun County Schools*
 Louisa County Schools*
 Lunenburg County Schools*
 Madison County Schools*
 Mathews County Schools*
 Mecklenburg County Schools*
 Middlesex County Schools*
 Montgomery County Schools*
 Nelson County Schools*
 New Kent County Schools*
 Northampton County Schools*
 Northumberland County Schools*
 Nottoway County Schools*
 Orange County Schools*
 Page County Schools*
 Patrick County Schools*
 Pittsylvania County Schools*
 Powhatan County Schools*
 Prince Edward County Schools*
 Prince George County Schools*
 Prince William County Schools*
 Pulaski County Schools*
 Rappahannock County Schools*
 Richmond County Schools*
 Roanoke County Schools*
 Rockbridge County Schools*

Rockingham County Schools*
 Russell County Schools*
 Scott County Schools*
 Shenandoah County Schools*
 Smyth County Schools*
 Southampton County Schools*
 Spotsylvania County Schools*
 Stafford County Schools*
 Surry County Schools*
 Sussex County Schools*
 Tazewell County Schools*
 Warren County Schools*
 Washington County Schools*
 Westmoreland County Schools*
 Wise County Schools*
 Wythe County Schools*
 York County Schools*

Other Schools (12)

Amelia-Nottoway Vocational Center
 Appomattox Region Governor's School
 Charlottesville-Albemarle Vocational Technical Center
 Governor's School for Global Economics and Technology
 Jackson River Vocational Technical Center*
 Maggie Walker Governor's School for Government and International Studies
 New Horizons Technical Center*
 Northern Neck Regional Special Education Program
 Northern Neck Regional Vocational Center*
 Rowanty Vocational Technical Center
 The Pruden Center for Industry and Technology*
 Valley Vocational Technical Center*

*Non-Professional employees also covered (131 School Boards)

Agencies of the Commonwealth of Virginia (240)

PROGRAM WITH OVERSIGHT BY VRS

Deferred Compensation Plan of the Commonwealth of Virginia

The Deferred Compensation Plan is regulated by Chapter Six of Title 51.1 of the *Code of Virginia* and is intended to be an eligible plan within the meaning of Internal Revenue Code Section 457(b). The purpose of the Plan is to provide participants with a convenient way to save for retirement through deferrals of compensation. The Plan is available, on a voluntary basis, to all employees, including elected and appointed officials providing services to the Commonwealth, and to eligible employees of participating political subdivisions.

STATEMENT OF CHANGES IN PLAN ASSETS

Years Ended June 30, 2003 and 2002

| | 2003 | 2002 |
|--|------------------------------|------------------------------|
| Plan Assets on July 1 | \$ 450,283,729 | \$ 456,036,860 |
| Contributions | 75,891,469 | 60,560,320 |
| Distributions | (25,947,422) | (24,509,175) |
| Plan Transfers ¹ | 155,412 | 216,542 |
| Third Party Administration Fees ² | (1,279,994) | (1,221,805) |
| Period Earnings | 15,365,921 | (39,709,769) |
| Net Decrease/Increase in the Present Value of Annuity's' Future Benefits | (703,079) | (1,089,244) |
| Plan Assets on June 30 | <u>\$ 513,766,036</u> | <u>\$ 450,283,729</u> |

¹ Represents plan transfers from other eligible Section 457(b) plans into the Commonwealth's Plan.

² The current third party administrator, Great-West/BenefitsCorp. Corporation, is compensated based on an annual recordkeeping and communication fee of 30 basis points (0.30%) capped at account balances of \$150,000 on total non-annuitized assets.

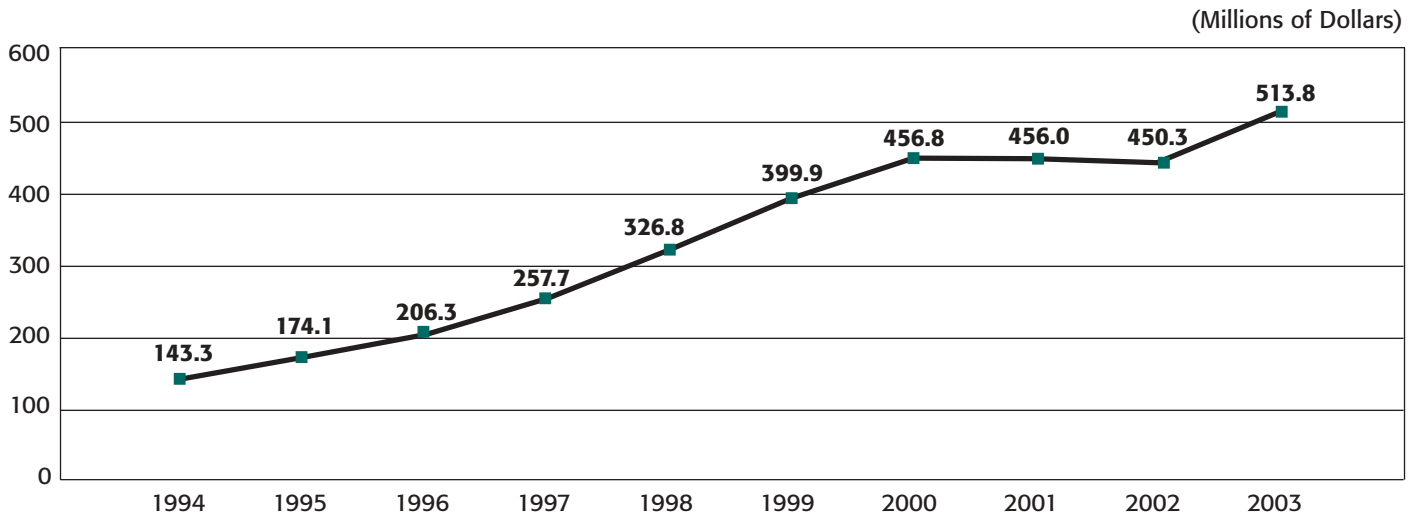
DEFERRED COMPENSATION PLAN—OPERATIONAL OVERVIEW

A total of 4,025 employees enrolled in the Commonwealth's 457 Deferred Compensation Plan during fiscal year 2003. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became effective January 1, 2002, allowing increased tax deferred savings and increased portability of benefits. In addition, during the year the Plan was modified to allow employee bonuses, as well as unused vacation and sick leave payments to be contributed to the Plan. Contributions to the Plan during FY 2003 increased to \$75,891,469 from \$60,560,320 in FY 2002.

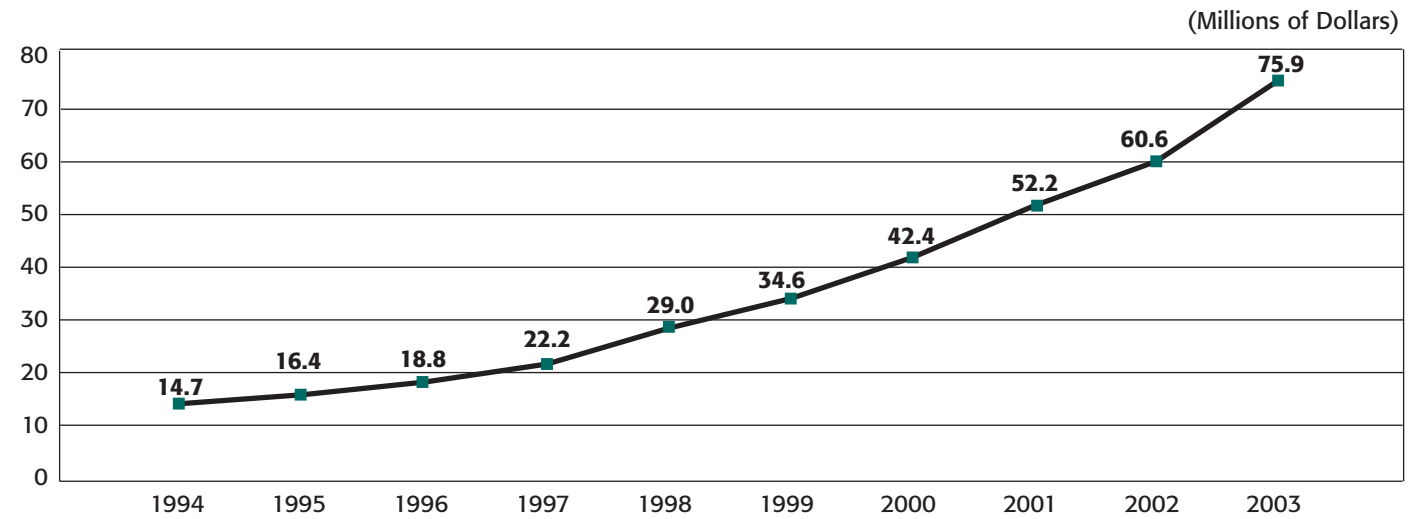
EGTRRA also made the 457 Plan attractive for employees of colleges and universities by removing the coordination between 457 plans and 403(b) tax-deferred accounts. The number of college and university employee Plan accounts increased from 417 in the month prior to EGTRRA implementation to 1,786 by June 30, 2003.

The 2001 legislation also allowed 457 Plan participants to use monies in their accounts to purchase permissive service credit in the defined benefit plan. During the fiscal year ended June 30, 2003, 829 Plan participants used the trustee to trustee transfer provision to buy VRS service credit with \$3,917,135 transferring from the 457 Plan to the defined benefit plan.

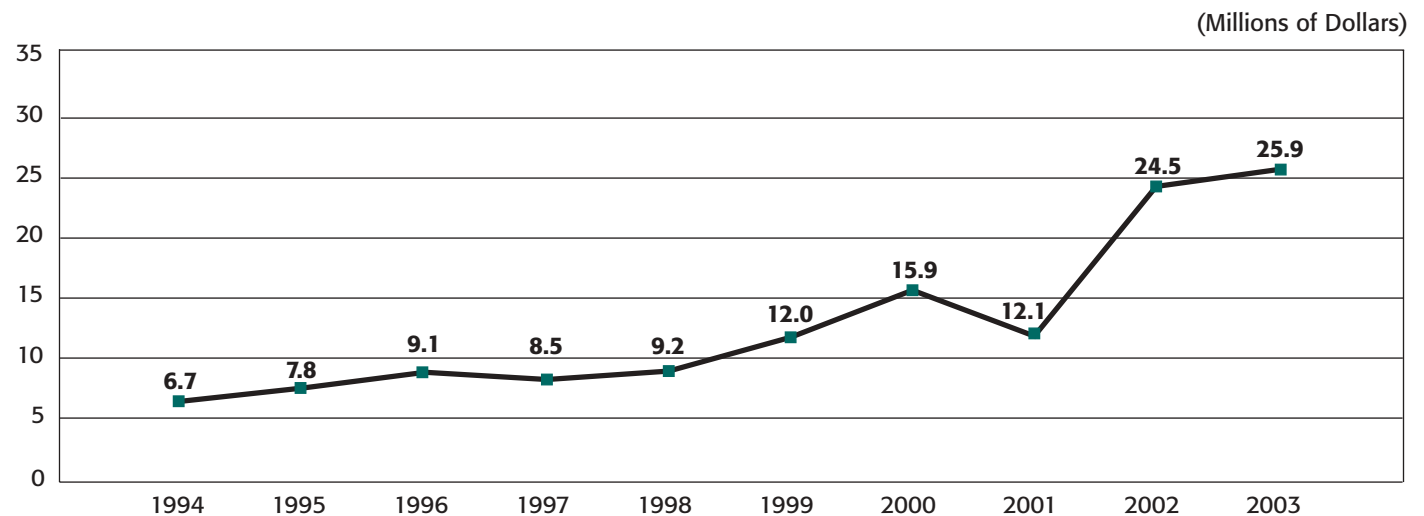
DEFERRED COMPENSATION PROGRAM ASSETS



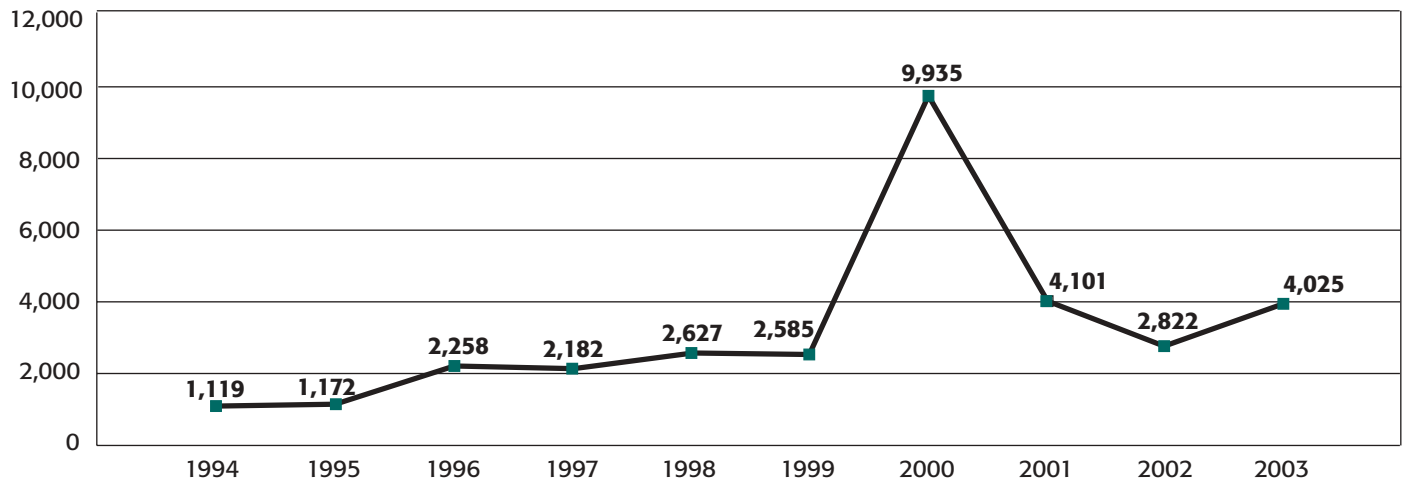
CONTRIBUTIONS TO THE DEFERRED COMPENSATION PLAN



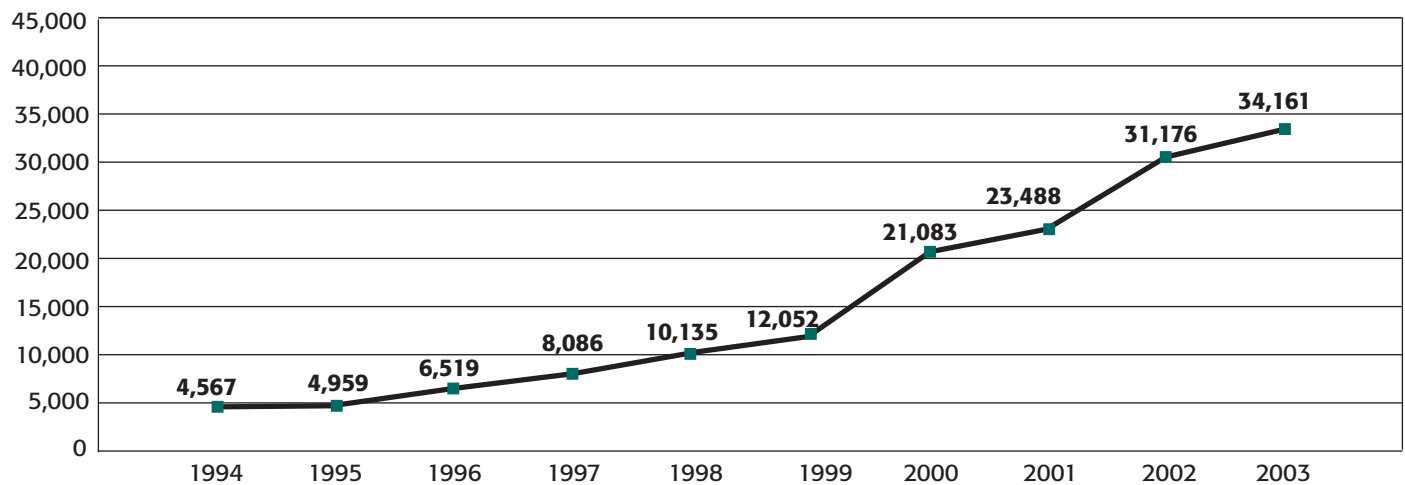
DISTRIBUTIONS FROM THE DEFERRED COMPENSATION PLAN



NEW ENROLLMENTS IN THE DEFERRED COMPENSATION PLAN



ACTIVE AND INACTIVE DEFERRED COMPENSATION PLAN PARTICIPANTS



TOTAL PARTICIPANT ACCOUNTS IN EACH FUND OPTION

| Fund Name | Total Participant Accounts |
|----------------------------------|----------------------------|
| Bond Index Fund | 5,234 |
| Real Estate Investment Trust | 412 |
| Harris Direct Money Market | 39 |
| Harris Direct Self-Directed | 40 |
| International Equity Index Fund | 1,851 |
| Money Market Fund | 2,226 |
| Russell 1000 Growth Index Fund | 1,994 |
| Russell 1000 Value Index Fund | 2,591 |
| S&P 500 Index Fund | 15,143 |
| Small/Mid Cap. Equity Index Fund | 4,444 |
| Stable Value Fund | 12,618 |
| Active Inflation-Protected Bond | 435 |
| Active Bond Fund | 3,976 |
| Active High Yield Bond Fund | 225 |
| Active Large Cap Equity | 12,292 |
| Active International Equity | 3,525 |
| Balanced Growth Fund | 8,745 |
| Income & Growth Fund | 3,089 |
| Long-Term Growth Fund | 4,463 |
| Active Small/Mid Cap Equity Fund | 5,577 |

PLAN ASSETS

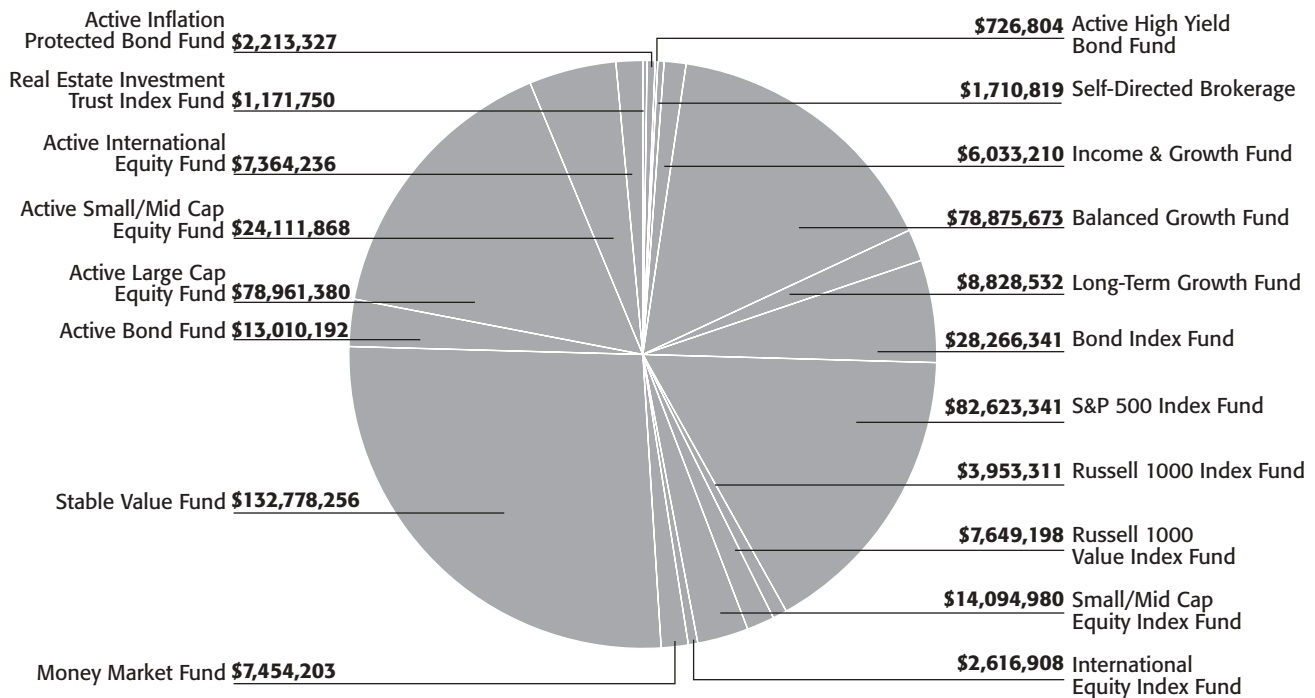
Plan Assets are divided into two categories – Annuity Plan Assets and Accumulation Plan Assets. Annuity Plan Assets represent the present value of future benefits for those participants who chose an annuity as a distribution payment. Accumulation Plan Assets represent funds invested among the 18 core investment options and two self-directed brokerage options.

ANNUITY PLAN ASSETS

| | |
|---|----------------------|
| The Hartford Life Insurance Company Annuity Plan Assets at June 30, 2003 | \$ 8,581,222 |
| Metropolitan Life Annuity Plan Assets at June 30, 2003 | 2,740,485 |
| Total at June 30, 2003 | \$ 11,321,707 |

ACCUMULATION PLAN ASSETS

Total at June 30, 2003 – \$502,444,329



DESCRIPTION OF FUNDS

Tier I: Asset Allocation Funds

Income & Growth Fund: Seeks to provide income and a modest level of capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term total returns that are slightly higher than inflation with the possibility of occasional short-term losses.

U.S. Bonds – 75%
 U.S. Stocks – 22%
 Foreign Stocks – 3%

Balanced Growth Fund: Seeks to provide income and a modest level of capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term total returns that are higher than inflation with the possibility of short-term losses.

U.S. Bonds – 50%
 U.S. Stocks – 43%
 Foreign Stocks – 7%

Long-Term Growth Fund: Seeks to provide capital growth by investing in a combination of bonds and stocks that is anticipated to provide long-term returns that are higher than inflation with the possibility of significant short-term losses.

U.S. Stocks – 64%
 U.S. Bonds – 25%
 Foreign Stocks – 11%

Tier II: Passively Managed Funds

Bond Index Fund: Seeks to track the performance of the Lehman Brothers Aggregate Bond Index. This Index is a combination of government, corporate, mortgage-backed, and asset-backed bonds.

| | |
|----------------------------------|-------------------|
| Agency – 13% | Asset-Backed – 2% |
| CMBS – 2% | Corporate – 27% |
| Mortgage-Backed Securities – 34% | Treasury – 22% |

S&P 500 Index Fund: Seeks to track the performance of the Standard & Poor's 500 Index. This Index comprises 500 widely held U.S. stocks chosen by Standard & Poor's.

| | |
|------------------------------|---------------------------------|
| Financials – 20% | Energy – 6% |
| Health Care – 15% | Telecommunication Services – 4% |
| Information Technology – 15% | Basic Materials – 3% |
| Consumer Discretionary – 11% | Utilities – 3% |
| Industrials – 11% | |
| Consumer Staples – 12% | |

Russell 1000 Growth Index Fund: Seeks to track the performance of the Russell 1000 Growth Index. This Index comprises stocks in the Russell 1000 that have higher price-to-book ratios and higher forecasted growth values.

| | |
|------------------------------|------------------------|
| Health Care – 26% | Consumer Staples – 14% |
| Information Technology – 24% | Financials – 10% |
| Consumer Discretionary – 12% | Energy – 2% |
| Industrials – 11% | Other – 1% |

Russell 1000 Value Index Fund: Seeks to track the performance of the Russell 1000 Value Index. This Index comprises stocks in the Russell 1000 that have lower price-to-book ratios and lower forecasted growth values.

| | |
|---------------------------------|-----------------------------|
| Financials – 34% | Utilities – 7% |
| Consumer Discretionary – 12% | Consumer Staples – 6% |
| Energy – 10% | Information Technology – 6% |
| Industrials – 9% | Materials – 5% |
| Telecommunication Services – 7% | Health Care – 4% |

Small/Mid Capitalization Equity Index Fund: Seeks to track the performance of the Russell Small Capitalization Completeness Index. This Index is a measure of the small to mid-capitalization sector of the U.S. stock market.

| | |
|------------------------------|-----------------------|
| Financials – 25% | Consumer Staples – 4% |
| Consumer Discretionary – 20% | Energy – 4% |
| Information Technology – 15% | Materials – 3% |
| Health Care – 14% | Utilities – 4% |
| Industrials – 11% | |

International Equity Index Fund: Seeks to track the performance of the Morgan Stanley Capital International Europe, Australasia, Far East Index (MSCI EAFE). This Index comprises approximately 1,000 stocks in 20 countries in Europe and the Pacific Basin.

| | |
|------------------------------|---------------------------------|
| Financials – 25% | Materials – 6% |
| Consumer Discretionary – 13% | Information Technology – 7% |
| Energy – 9% | Telecommunication Services – 8% |
| Health Care – 10% | Utilities – 5% |
| Consumer Staples – 9% | |
| Industrials – 8% | |

Real Estate Investment Trust Index Fund: The Fund seeks to track the performance of the Wilshire REIT Index. The Index is a market capitalization weighted index of publicly traded REITs whose charter is the equity ownership and operation of commercial real estate.

| | |
|-------------------------|----------------------|
| Office – 21% | Apartments – 20% |
| Regional Retail – 15% | Local Retail – 13% |
| Diversified – 12% | Industrial – 8% |
| Hotels – 4% | Storage – 4% |
| Manufactured Homes – 2% | Factory Outlets – 1% |

Tier III: Actively Managed Funds

Money Market Fund: Seeks to provide short-, medium-, and long-term returns that provide for a high level of current income while preserving capital.

| | |
|-------------------------------------|---|
| CDs, ECDs, TDs, BAs, – 35% | Bank Notes, Corporate, Medium-Term Adjustable Rate ABS – 1% |
| Floating Rate Corporate Notes – 11% | Repurchase Agreements – 14% |
| Agency – 10% | Other – 1% |
| Commercial Paper – 28% | |

Stable Value Fund: The Fund seeks to provide safety of principal and a stable credited rate of interest, while generating competitive returns over time compared to other conservative investments, such as money market funds or short-term yields available in the fixed-income (bond) market.

| |
|--|
| Wells Fargo Stable Return Fund – 66% |
| AIG Financial Products Security Backed Contract – 26% |
| JP Morgan Chase Bank Security Backed Contract – 4% |
| Union Bank of Switzerland AG Security Backed Contract – 4% |

Active Inflation-Protected Bond Fund: The Fund seeks to provide inflation protection and income consistent with investment in inflation-indexed securities and seeks to provide long-term returns that exceed the performance of the Lehman Brothers U.S. Treasury Inflation Notes Index.

Treasury 100%

Active High-Yield Bond Fund: The Fund seeks to provide a high level of current income and provide long-term returns that exceed the performance of the Lehman Brothers High-Yield Index.

| | |
|-------------------------|----------------------------|
| Basic Industry – 21% | Communication- 11% |
| Consumer Cyclical – 11% | Capital Goods – 9% |
| Industrial – 9% | Consumer Non-cyclical – 7% |
| Technology – 6% | Utilities – 6% |
| Treasury – 5% | Energy – 5% |
| Telecommunications – 5% | Finance – 4% |
| Other 1% | |

Active Bond Fund: Seeks to provide long-term returns that exceed the performance of the Lehman Brothers Aggregate Bond Index. This Index is a combination of government, corporate, mortgage-backed, and asset backed bonds.

| | |
|----------------------------------|----------------------------|
| Mortgage-Backed Securities – 30% | Other – 31% |
| Foreign – 5% | U.S. Treasury/Agency – 21% |
| Corporate – 10% | Emerging Markets – 3% |

Active Large Capitalization Equity Fund: Seeks to provide long-term returns that exceed the performance of the Standard & Poor's 500 Index. This Index comprises 500 widely held U.S. stocks chosen by Standard & Poor's.

| | |
|-------------------------|-----------------------------|
| Financials – 20% | Energy – 6% |
| Technology – 17% | Communication Services – 4% |
| Health Care – 15% | Basic Materials – 2% |
| Consumer Staples – 14% | Utilities – 3% |
| Consumer Cyclical – 10% | Transportation – 1% |
| Capital Goods – 8% | |

Active Small/Mid Capitalization Equity Fund: Seeks to provide long-term returns that exceed the performance of the Russell Small Capitalization Completeness Index. This Index is a measure of the small to mid-capitalization sector of the U.S. stock market.

| | |
|-------------------------|-----------------------------|
| Financials – 25% | Basic Materials – 3% |
| Consumer Cyclical – 17% | Energy – 5% |
| Technology – 14% | Transportation – 1% |
| Consumer Staples – 13% | Utilities – 3% |
| Capital Goods – 7% | Communication Services – 1% |
| Health Care – 11% | |

Active International Equity Fund: Seeks to provide long-term returns that exceed the performance of the Morgan Stanley Capital International Europe, Australasia, Far East Index (MSCI EAFE). This Index comprises approximately 1,000 stocks in 20 countries in Europe and the Pacific Basin.

| | |
|------------------------------|----------------------------------|
| Financials – 20% | Industrials – 7% |
| Consumer Discretionary – 17% | Consumer Staples – 9% |
| Health Care – 12% | Telecommunication Services – 11% |
| Energy – 10% | Materials – 3% |
| Information Technology – 7% | Other – 3% |
| Utilities – 1% | |

Tier IV: Self-Directed Brokerage Option

The Self-Directed Brokerage (SDB) Option from Harrisdirect allows investors to elect from thousands of mutual funds in addition to the core investment options in Tier I, Tier II, and Tier III. The SDB option is for knowledgeable investors who acknowledge and understand the risks associated with the mutual fund investments contained within the option. (Participants cannot invest in individual securities such as stocks, bonds, or options.)

In addition to the annual record keeping and communication services fee, there is a plan fee of \$15 per quarter as well as transaction fees charged by the brokerage provider and investment management fees charged by the investment managers.

INVESTMENT OPTION PERFORMANCE SUMMARY

Below are the totals for the period ending June 30, 2003

(Returns greater than one year are annualized)

| Investment Options | 1 Year | 3 Years | 5 Years | Expense Ratio |
|--|--------|---------|---------|---------------|
| Tier I: Asset Allocation Funds ¹ | | | | |
| Income & Growth Fund ² | 8.15% | 4.88% | n/a | 0.07% |
| Benchmark (75% Lehman Bros. Aggregate Bond Index, 22% Russell 3000, 3% MSCI EAFE) | 8.17% | 4.87% | 5.62% | |
| Balanced Growth Fund ² | 5.37% | -0.44% | n/a | 0.08% |
| Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE) | 5.58% | -0.40% | 3.45% | |
| Long-Term Growth Fund ² | 2.31% | -5.78% | n/a | 0.08% |
| Benchmark (25% Lehman Bros. Aggregate Bond Index, 64% Russell 3000, 11% MSCI EAFE) | 2.76% | -5.66% | 1.07% | |
| Tier II: Passively Managed Funds | | | | |
| Bond Index Fund | 10.59% | 10.15% | 7.62% | 0.06% |
| Lehman Bros. Aggregate Bond Index | 10.40% | 10.08% | 7.55% | |
| S&P 500 Index Fund | 0.31% | -11.19% | -1.59% | 0.02% |
| S&P 500 Index | 0.26% | -11.20% | -1.61% | |
| Russell 1000 Value Index Fund | -0.96% | -0.22% | 1.00% | 0.10% |
| Russell 1000 Value Index | -1.02% | -0.19% | 1.06% | |
| Russell 1000 Growth Index Fund | 2.81% | -21.53% | -5.01% | 0.11% |
| Russell 1000 Growth Index | 2.93% | -21.54 | -5.03% | |
| Real Estate Investment Trust Index Fund ⁴ | 2.94% | n/a | n/a | 0.28% |
| Wilshire REIT Index | 3.73% | 14.77% | 8.05% | |
| Small/Mid Cap Equity Index Fund | 2.92% | -10.07% | 0.39% | 0.13% |
| Russell Small Cap Completeness Index | 3.13% | -10.23% | 0.16% | |
| International Equity Index Fund | -9.35% | -14.91% | -4.86% | 0.16% |
| MSCI EAFE Index | -6.45% | -13.52% | -4.00% | |
| Tier III: Actively Managed Funds | | | | |
| Money Market Fund | 1.49% | 3.40% | 4.26% | 0.11% |
| 91-Day Treasury Bill | 1.35% | 3.05% | 3.93% | |
| Active Inflation-Protected Bond Fund ³ | 15.32% | 12.17% | n/a | 0.22% |
| Lehman Bros. US Treas. Inflation Notes Index | 15.40% | 12.34% | 9.64% | |
| Active Bond Fund ² | 11.22% | 10.91% | 8.32% | 0.43% |
| Lehman Bros. Aggregate Bond Index | 10.40% | 10.08% | 7.55% | |
| Active High-Yield Bond Fund | 13.06% | 4.52% | 3.50% | 0.26% |
| Lehman Bros. High Yield Index | 22.76% | 5.43% | 2.94% | |
| Active Large Cap Equity Fund ^{1, 2} | -0.11% | -11.45% | n/a | 0.37% |
| S&P 500 Index | 0.26% | -11.20% | -1.61% | |
| Active Small/Mid Cap Equity Fund ^{1, 2} | 2.28% | -9.61% | n/a | 0.57% |
| Russell Small Cap Completeness Index | 3.13% | -10.23% | 0.16% | |
| Active International Equity Fund ² | -8.41% | -15.95% | -4.76% | 0.98% |
| MSCI EAFE Index | -6.45% | -13.52% | -4.00% | |
| Stable Value Fund | 5.19% | 5.74% | 6.01% | 0.23% |
| The projected estimated yield range from 7/1/03 - 9/30/03 is 4.75% - 5.00%. | | | | |

¹ Investment operations for the VRS Asset Allocation Funds, the Active Large Cap Equity Fund, and the Active Small/Mid Cap Equity fund began 11/1/1999 and do not have 5 years return data.

² Effective October 31, 2002, the following funds were renamed as indicated below:

| | | | |
|---------------------------|-----------------------|-------------------------------|----------------------------------|
| VRS Income & Growth Fund | Income & Growth Fund | VRS Large Cap Equity Fund | Active Large Cap Equity Fund |
| VRS Balanced Growth Fund | Balanced Growth Fund | VRS Small/Mid Cap Equity Fund | Active Small/Mid Cap Equity Fund |
| VRS Long-Term Growth Fund | Long-Term Growth Fund | VRS International Equity Fund | Active International Equity Fund |
| VRS Bond Fund | Active Bond Fund | | |

³ The investment operations of the Active Inflation Protected Bond Fund began 6/29/2000.

⁴ The investment operations of the Real Estate Investment Trust Index Fund began 4/1/2001.

For more detailed fund information, visit the Web site at www.vadcp.com and click on "Fund Profile Sheets."