

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%

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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.

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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

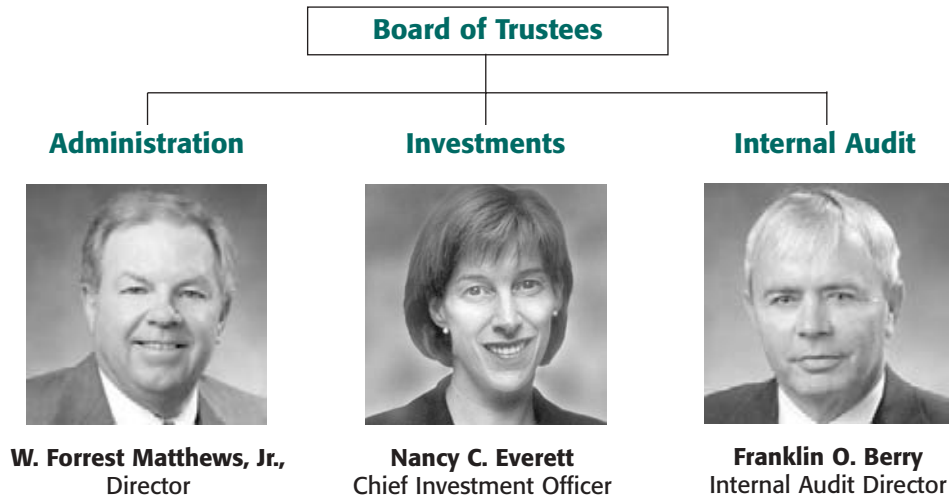


Paul W. Timmreck
Virginia Commonwealth
University



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

VRS ORGANIZATION



VRS INVESTMENT ADVISORY COMMITTEE



Back Row (left to right)

Front Row (left to right)

Alice W. Handy
University of Virginia
Investment Management Co.

Joe Grills
Retired,
IBM Retirement Funds

Joseph W. Montgomery
Wachovia Securities

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

Doyle E. Hull
Retired,
Sovran Financial Corporation

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

Deborah Allen-Hewitt, Ph.D.
Rutledge Research

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

Stuart A. Sachs
Retired,
Sovran Capital Management

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.

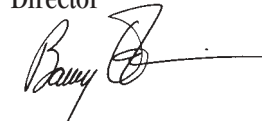
Finally, we wish to thank Governor Mark R. Warner and the members of the Virginia General Assembly for their

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	\$ 50,609	\$ 3,727

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	100.00%	100.00%

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	—	—	—	2,133,180	2,133,180
Pooled Employee Trust Funds	—	—	—	53,645	53,645
Foreign currencies	—	—	—	—	—
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 black ink, appearing to read 'N. Everett', is written over a light blue horizontal line.

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.

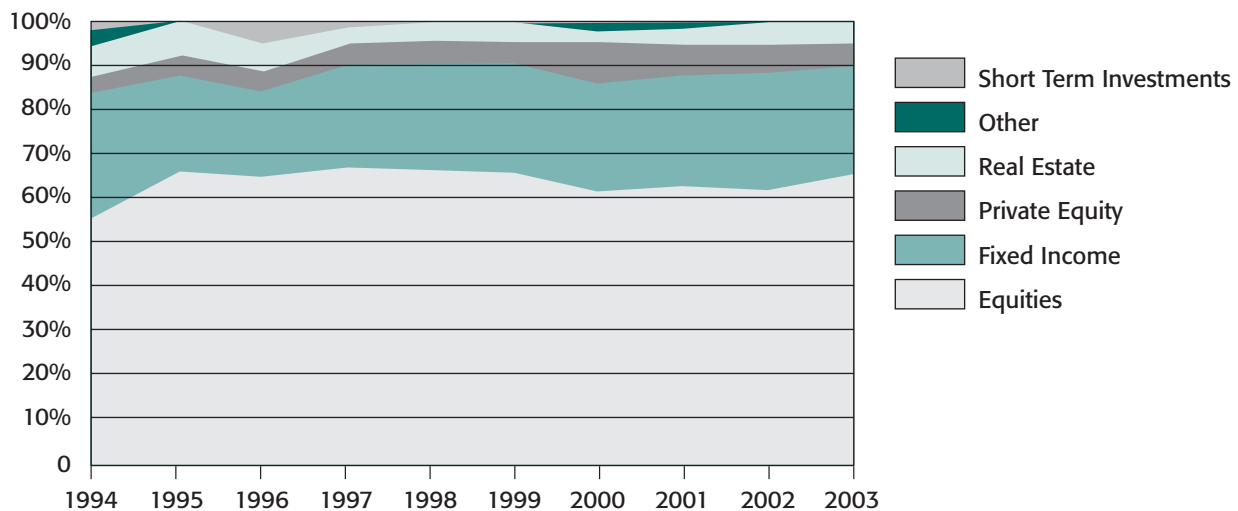
Investment Strategies

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	
<i>Sector Allocation:</i>	
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.

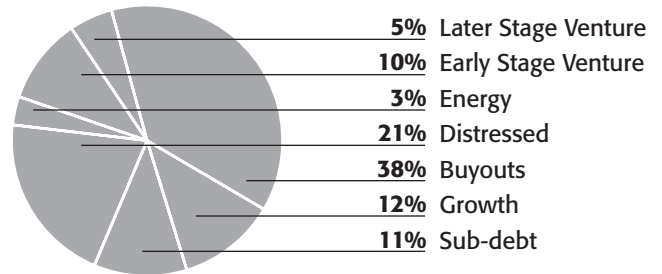
Private Equity

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:

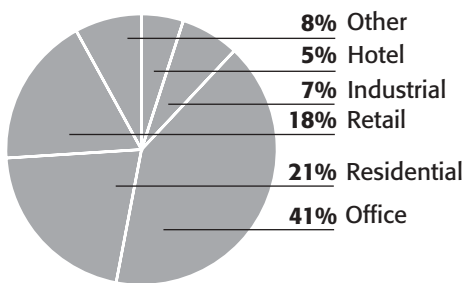


Real Estate

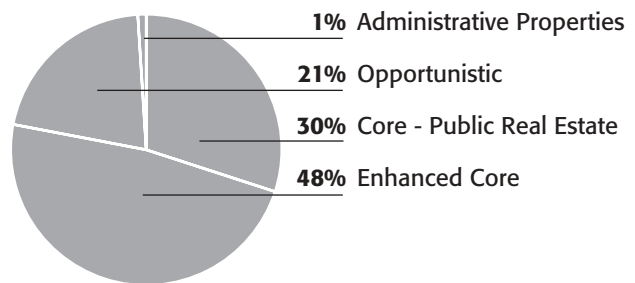
A portion of the Alternative Investments portfolio is invested in Real Estate in order to diversify the total fund by providing exposure to an asset class that has a low correlation with the public markets. Real estate produced a 7.4% return for the fiscal year and 10.5% for three years, outperforming 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%.

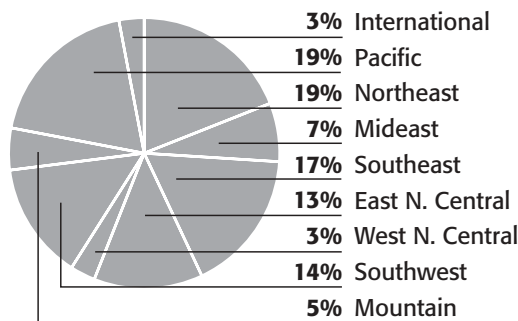
By Property Type



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.

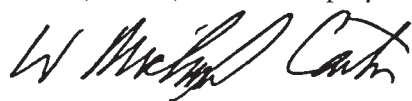
Data

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	
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 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

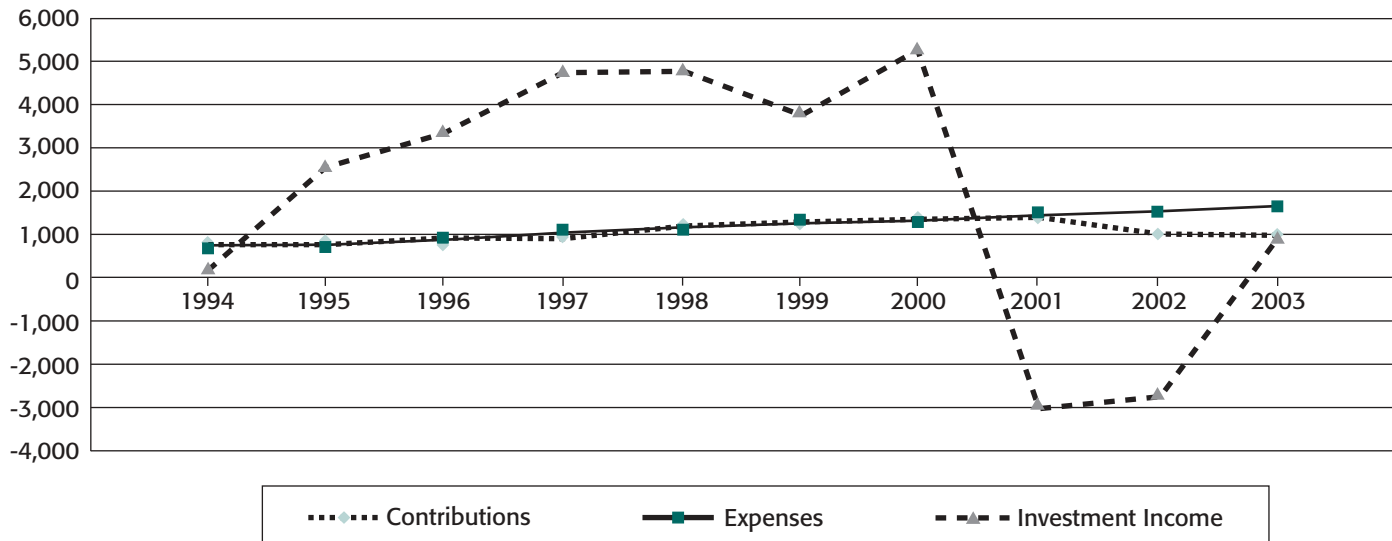
FY 1995 and 1996 Net Appreciation were restated to reflect adjustments from conversion to GASB 25 presentation.

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

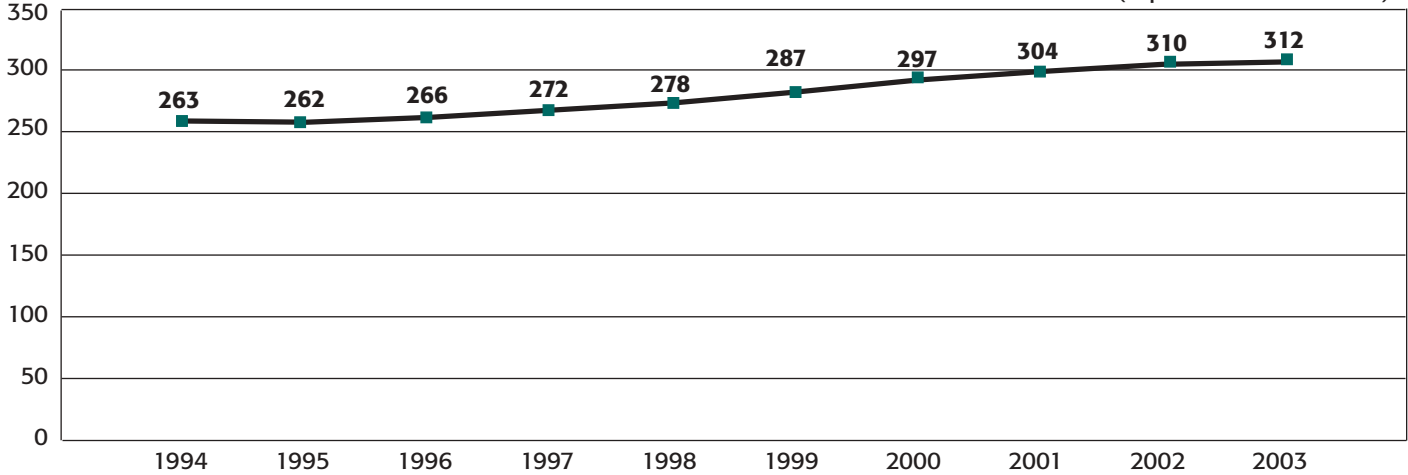
(Millions of Dollars)



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.

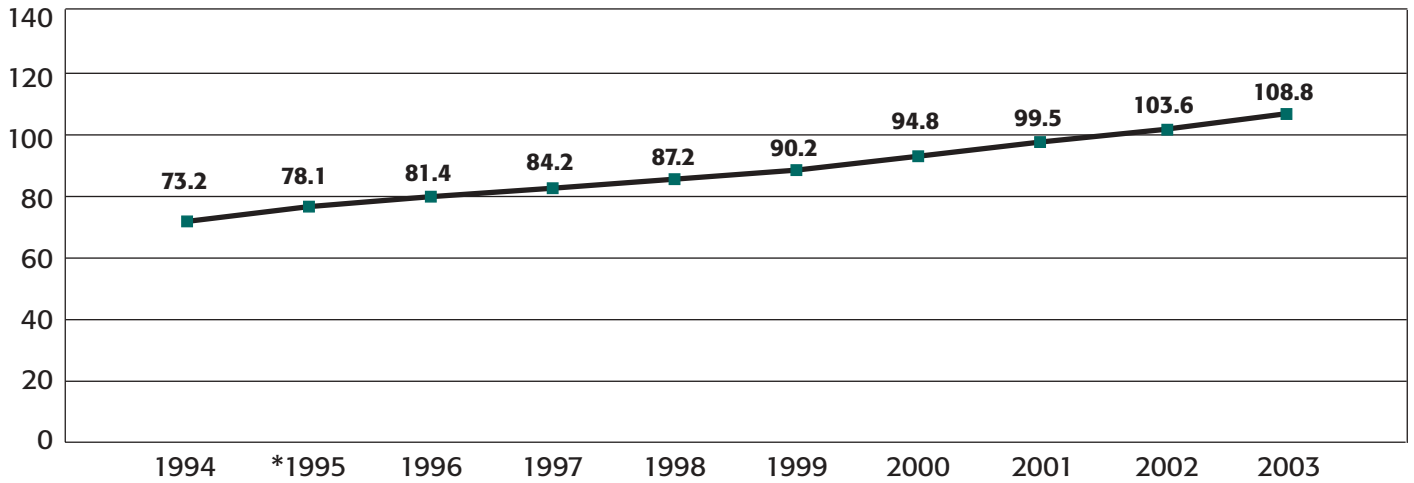
*** In fiscal year 1998, employer contributions increased to begin prefunding cost of living adjustments (COLAs) for retirees.

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

NUMBER OF RETIRED MEMBERS

Fiscal Years 1994–2003

(Expressed in Thousands)

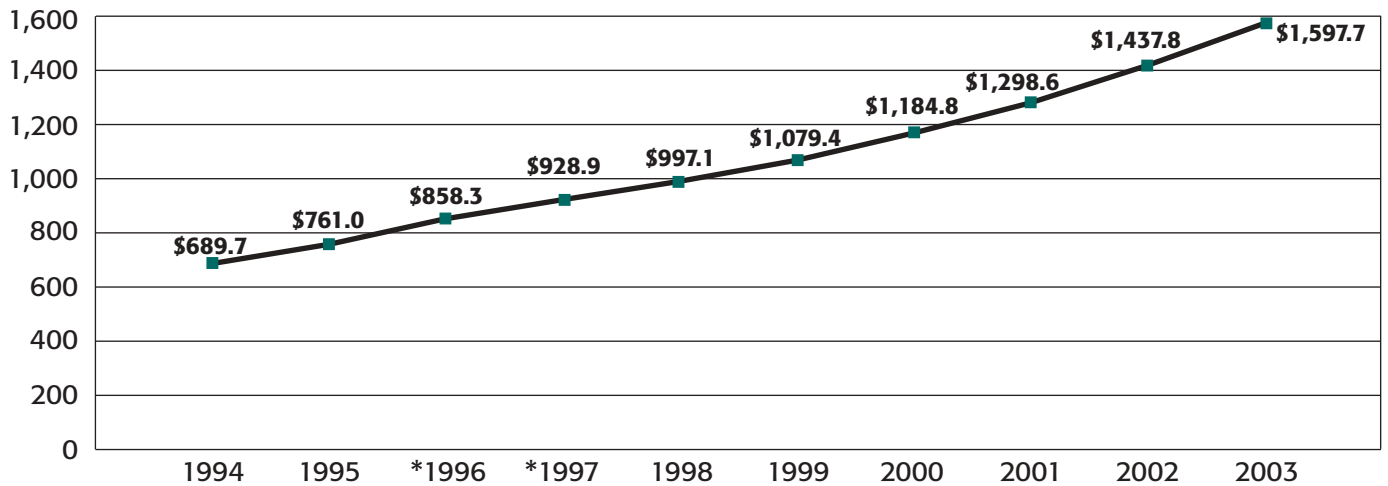


* Increased by the Workforce Transition Act of 1995 for State Agencies

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.

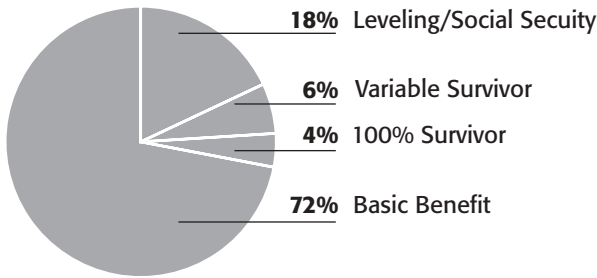
SCHEDULE OF AVERAGE BENEFIT PAYMENTS

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

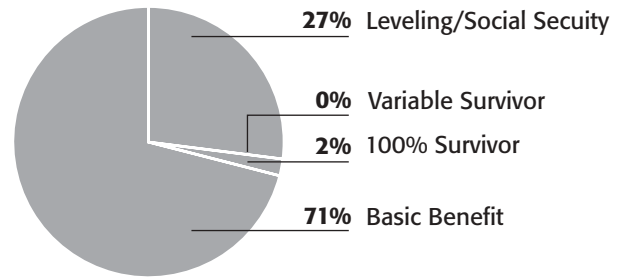
		Years of Credited Service					
		1–10	11–15	16–20	21–25	26–30	Over 30
FY 2003	Average Monthly Benefit	\$ 326.30	\$ 473.50	\$ 686.13	\$1,052.83	\$ 1,739.64	\$ 2,389.74
	Number of Active Retirants	659	794	798	958	1,575	2,904
FY 2002	Average Monthly Benefit	\$ 294.63	\$ 450.29	\$ 671.40	\$1,010.69	\$ 1,757.42	\$ 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:

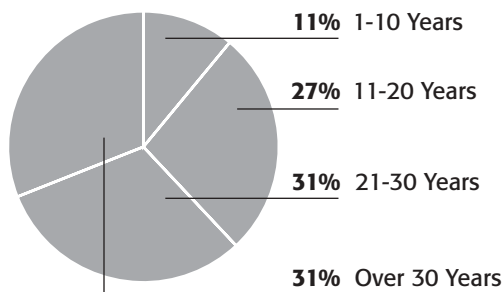
Allows an advance on the benefit; therefore, the retiree receives a higher benefit in the early years of retirement. The advance is paid from retirement date until the age specified by the retiree (between 59½ and 70½, or age 65 under the Social Security option). This benefit reduces at the level age.

100% Survivor:

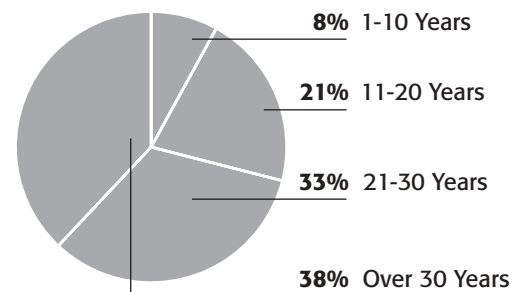
The basic benefit is reduced during the member's lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

DISTRIBUTION OF RETIREES BY YEARS OF SERVICE

All Retirees at June 30, 2003

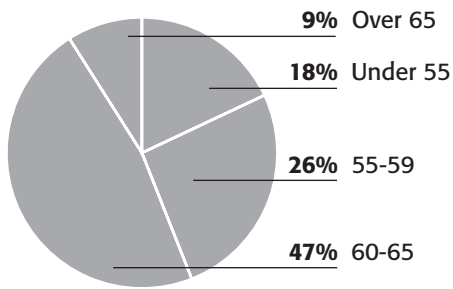


2003 Retirees

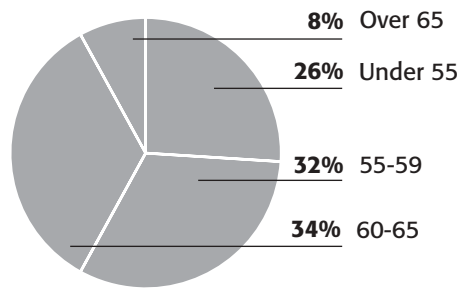


DISTRIBUTION OF RETIREES BY AGE AT RETIREMENT

All Retirees at June 30, 2003

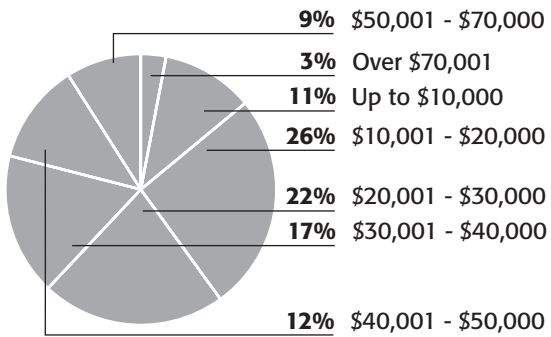


2003 Retirees

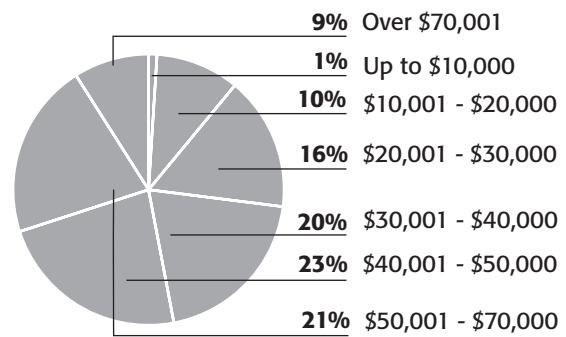


DISTRIBUTION OF RETIREES BY AVERAGE FINAL SALARY

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.

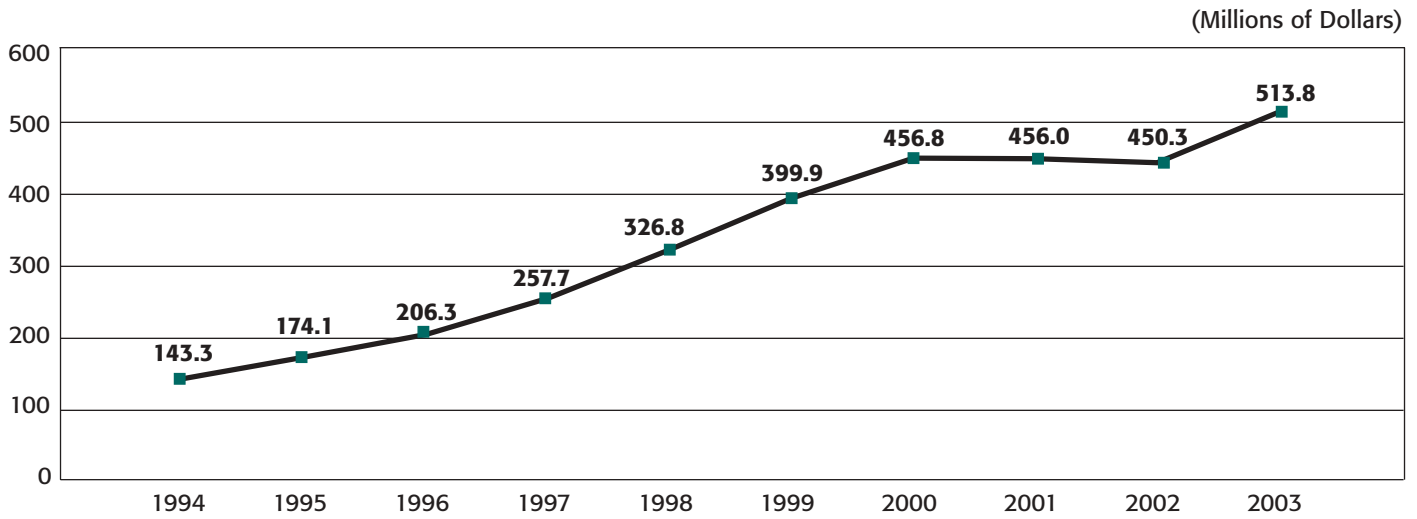
DEFERRED COMPENSATION PLAN—OPERATIONAL OVERVIEW

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.

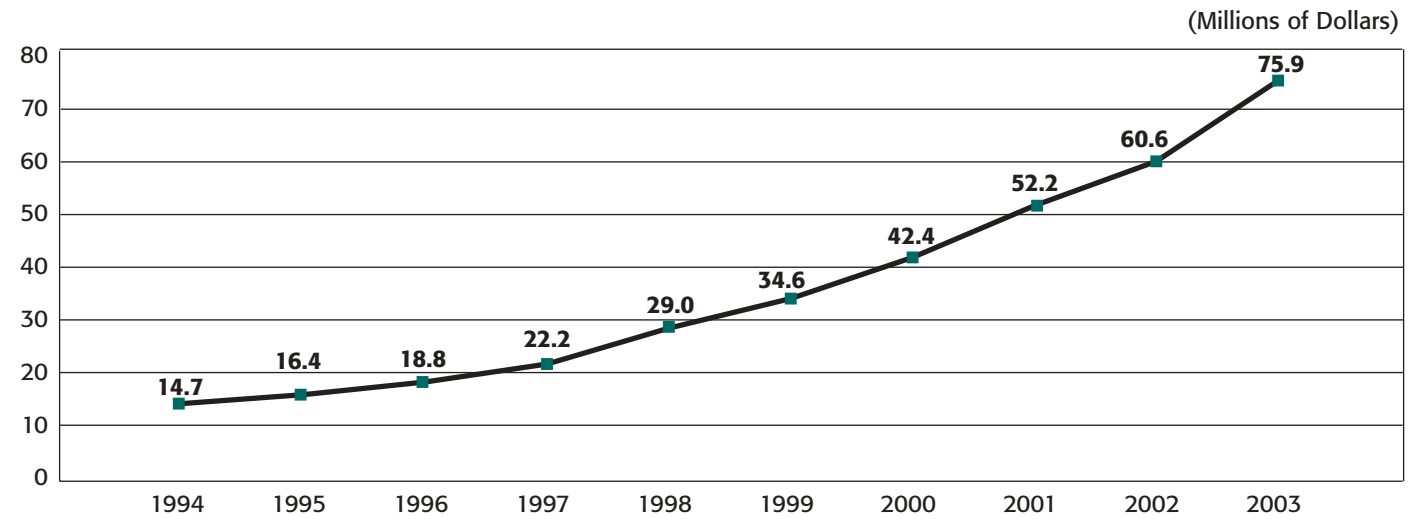
EGTRRA also made the 457 Plan attractive for employees of colleges and universities by removing the coordination between 457 plans and 403(b) tax-deferred accounts. The number of college and university employee Plan accounts increased from 417 in the month prior to EGTRRA implementation to 1,786 by June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

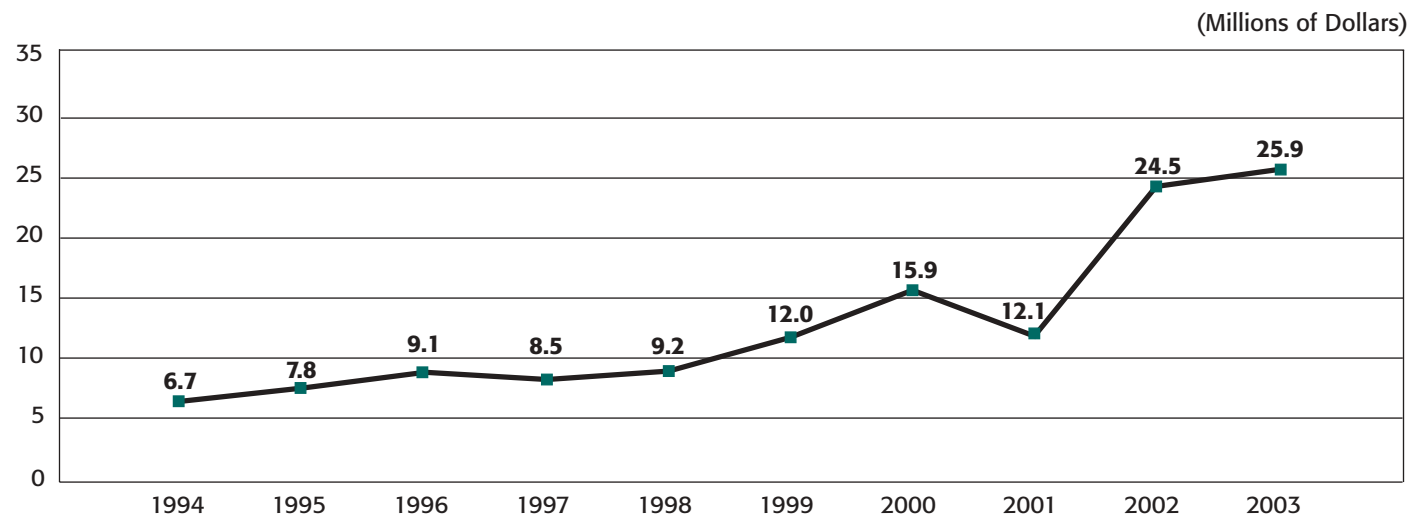
DEFERRED COMPENSATION PROGRAM ASSETS



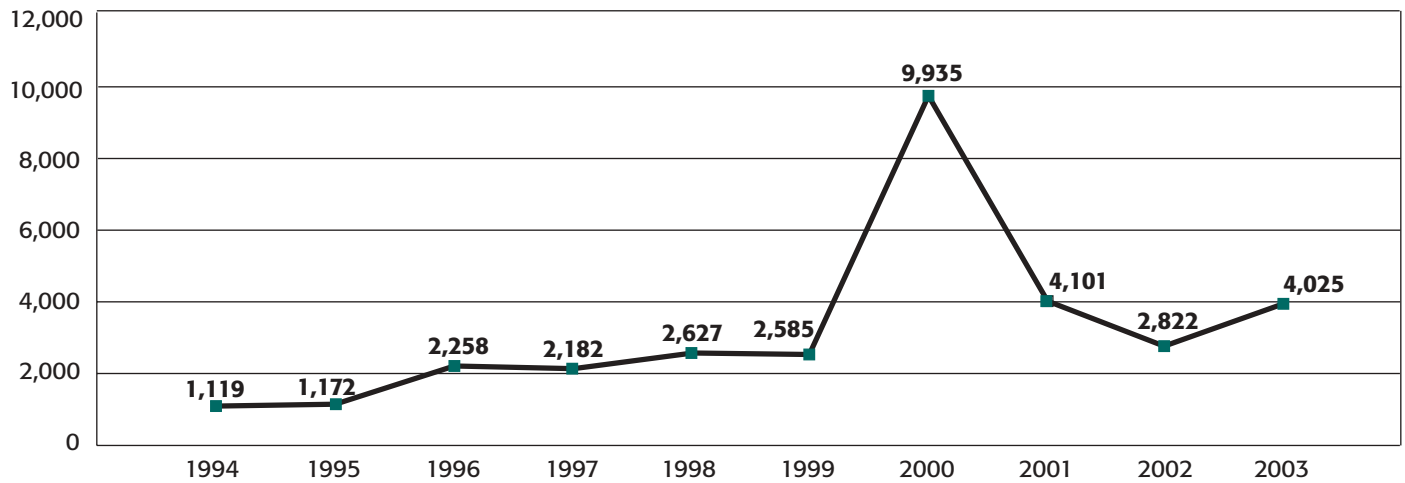
CONTRIBUTIONS TO THE DEFERRED COMPENSATION PLAN



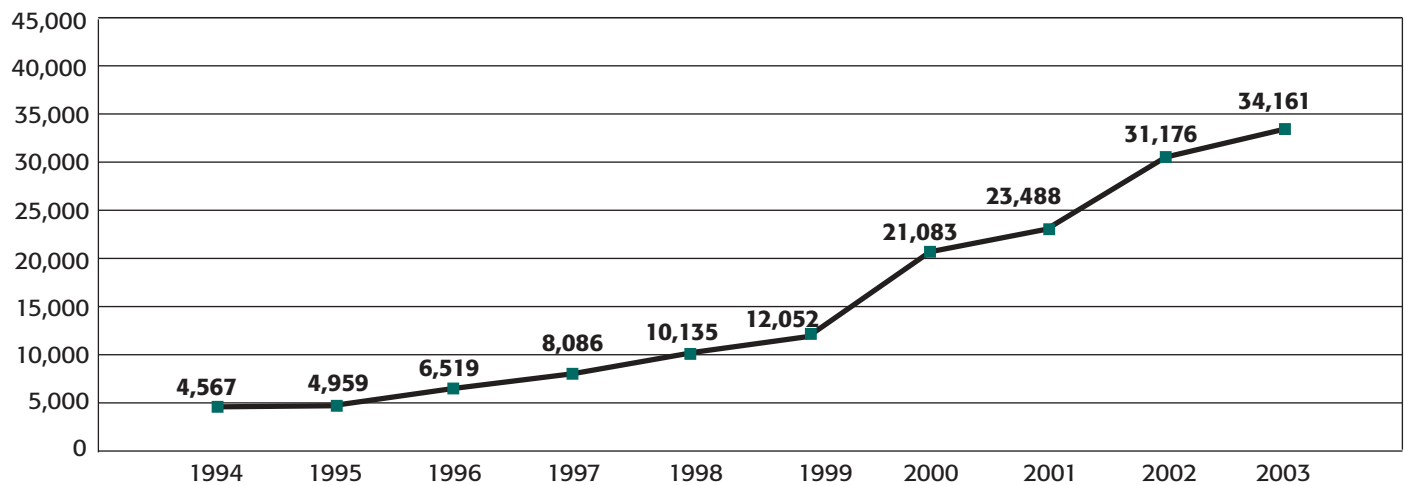
DISTRIBUTIONS FROM THE DEFERRED COMPENSATION PLAN



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

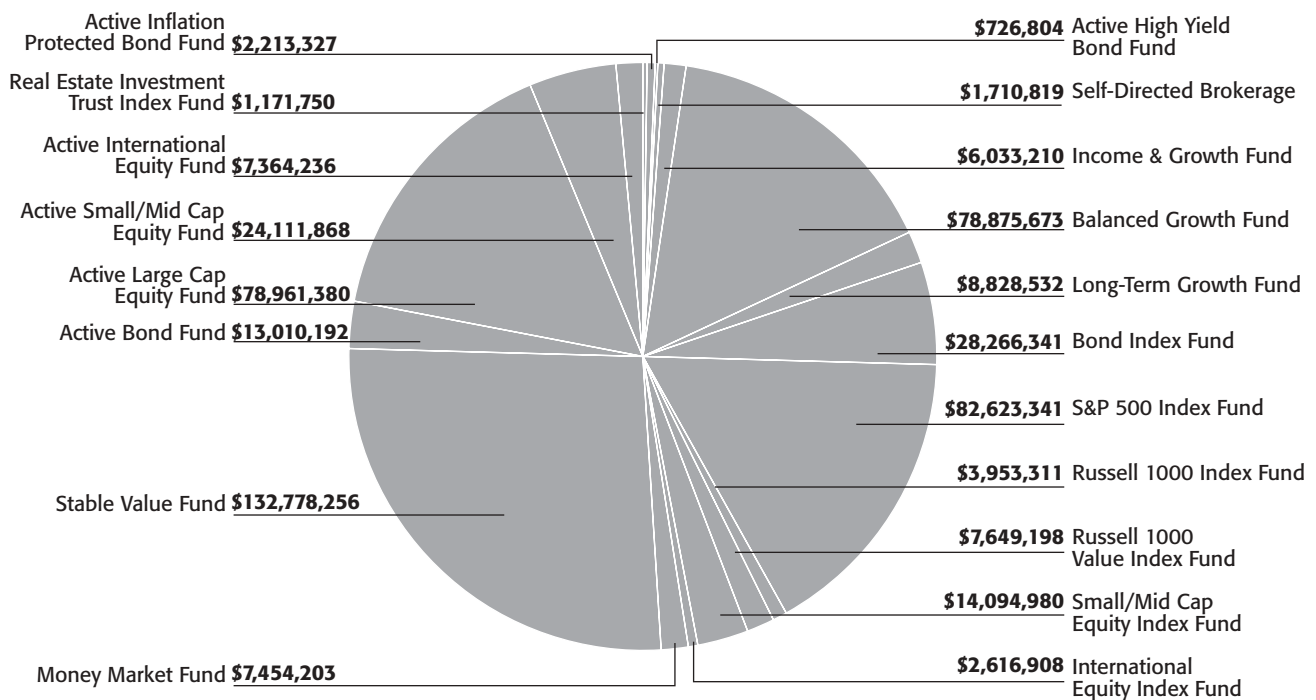
Plan Assets are divided into two categories – Annuity Plan Assets and Accumulation Plan Assets. Annuity Plan Assets represent the present value of future benefits for those participants who chose an annuity as a distribution payment. Accumulation Plan Assets represent funds invested among the 18 core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