



Comprehensive Annual Financial Report

FOR THE YEAR ENDED JUNE 30, 2004



AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

Fiscal Year 2004
Financial and Statistical Highlights – All Pension Trust Funds

(Dollars in Thousands)

	2004	2003	% Change
For the Year			
Contributions	\$ 1,185,155	\$ 1,041,835	13.8%
Investment Income (Net of investment expenses)	\$ 5,937,777	\$ 969,638	512.4%
Retirement Benefits	\$ 1,760,992	\$ 1,597,735	10.2%
Refunds	\$ 84,966	\$ 72,150	17.8%
Administrative Expenses (Net of misc. income)	\$ 18,645	\$ 16,670	11.8%
Increase in Net Assets Held in Trust for Pension Benefits	\$ 5,258,329	\$ 324,918	1,518.4%
Retirement Benefits as a percentage of contributions	148.6%	153.4%	
Retirement Benefits as a percentage of contributions and investment income	24.7%	79.4%	
At Fiscal Year End			
Net Assets Held in Trust for Pension Benefits - VRS	\$ 37,784,408	\$ 32,726,882	15.5%
Net Assets Held in Trust for Pension Benefits - SPORS	\$ 485,743	\$ 423,814	14.6%
Net Assets Held in Trust for Pension Benefits - VaLORS	\$ 497,771	\$ 394,779	26.1%
Net Assets Held in Trust for Pension Benefits - JRS	\$ 271,154	\$ 235,272	15.3%
Investment Performance			
One-Year Return on Investments	17.90%	2.50%	
Three-Year Return on Investments	3.80%	-4.20%	
Five-Year Return on Investments	3.70%	2.60%	
Participating Employers			
Counties/Cities/Towns	243	241	
Special Authorities	176	172	
School Boards	145	145	
State Agencies	234	240	
Total Employers	<u>798</u>	<u>798</u>	0.0%
Membership/Retirees			
Active Members	317,203	311,811	1.7%
Retired Members	113,717	108,758	4.6%

Comprehensive Annual Financial Report

FOR THE YEAR ENDED JUNE 30, 2004



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:

In its day-to-day operations, VRS embraces a set of core values: customer service, productivity and quality management, teamwork, adapting to change and open communication. Embracing these core values, VRS promotes an environment where employees look beyond their own jobs and, in a spirit of teamwork and cooperation, pull together to help the agency achieve outstanding results and to set new standards of excellence.

Table of Contents

Introductory Section

Chairman's Letter	8
VRS Board of Trustees.	9
VRS Organization.	10
VRS Investment Advisory Committee	10
VRS Administration Executive Team	11
VRS Investment Executive Team	12
Professional Consultants	12
Letter of Transmittal	13

Financial Section

Independent Auditor's Report	21
Management's Discussion and Analysis.	22

Basic Financial Statements

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

Required Supplementary Information

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

Additional Financial Information

Statement of Changes in Assets and Liabilities – Agency Fund	49
Schedule of Administrative Expenses	50
Schedule of Investment Expenses	51
Schedule of Professional and Consulting Services.	52

Investment Section

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

Actuarial Section

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

Table of Contents (continued)

Statistical Section

Pension Trust Funds

Analysis of Changes and Growth in Plan Net Assets	88
Pension Trust Funds Additions Versus Deductions	88
Number of Active Members	89
Schedule of Retirement Contributions by System	89
Pension Trust Funds Additions by Source	90
Number of Retired Members	91
Retirement Benefits Paid	91
Pension Trust Funds Deductions by Type	92
Schedule of Retirement Benefits by System	93
Schedule of Retirement Benefits by Type	93
Schedule of Refunds by Type	93
Schedule of Retired Members by Type of Benefit and Option Selected	94
Schedule of Average Benefit Payments	94
Distribution of Retirees by Payment Option Selected	95
Distribution of Retirees by Years of Service	95
Distribution of Retirees by Age at Retirement	96
Distribution of Retirees by Average Final Salary	96

Other Employee Benefit Trust Funds

Schedule of Group Insurance Additions by Source	97
Schedule of Group Insurance Claims by Type	97
Schedule of Retiree Health Insurance Credit Additions and Reimbursements	97

Participating Employers List 98

Program with Oversight by VRS

Deferred Compensation Plan of the Commonwealth of Virginia

Statement of Changes in Plan Assets	101
Operational Overview	101
Deferred Compensation Program Assets	102
Contributions to the Deferred Compensation Plan	102
Distributions from the Deferred Compensation Plan	102
New Enrollments in the Deferred Compensation Plan	103
Active and Inactive Deferred Compensation Plan Participants	103
Total Participant Accounts in Each Fund Option	104
Plan Assets	105
Annuity Plan Assets	105
Accumulation Plan Assets	105
Description of Funds	106
Investment Option Performance Summary	108

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, 2003

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



President

Executive Director



Public Pension Coordinating Council
Public Pension Standards
2003 Award

Presented to

Virginia Retirement System

In recognition of meeting professional standards for
plan design and administration
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script that reads 'Alan H. Winkle'.

Alan H. Winkle
Program Administrator



INTRODUCTORY SECTION

Production and Quality Management

WORKING AT A HIGH LEVEL OF
PRODUCTIVITY AND QUALITY
NOT ONLY TO DO ONE'S OWN JOB
BETTER BUT TO HELP OTHERS
DO THEIR JOBS BETTER.

Chairman's Letter



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 5, 2004

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

I am pleased to announce that the Virginia Retirement System (VRS) fund earned 17.9 percent for fiscal year 2004. This extraordinary return reflected the improving capital markets and the strengthening economy during the year. VRS assets totaled just over \$40 billion at year-end.

Each of the fund's five asset classes had a positive return during the fiscal year. The private equity program led the way with the highest return at 27.8 percent followed by public equity at 24.1 percent.

I am pleased to relate such positive information about the portfolio and believe that the success of the entire agency would not be possible without the VRS staff. In every aspect, from administering benefits to serving our members, retirees and beneficiaries, the contributions of VRS employees have enabled the agency to excel in its mission and goals.

In closing, I would like to express my gratitude to the VRS Board of Trustees for their guidance and commitment, and to the VRS staff for their dedication and hard work. Also, I wish to thank you for your continued support and leadership.

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

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
Wachovia Securities



John M. Albertine, Ph.D.
Albertine Enterprises



Edwin T. Burton III, Ph.D
University of Virginia



Robert C. Carlson
Carlson Wealth Advisors, LLC



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



Judith Ewell, Ph.D
Retired,
College of William and Mary



Vernard W. Henley
Retired,
Consolidated Bank

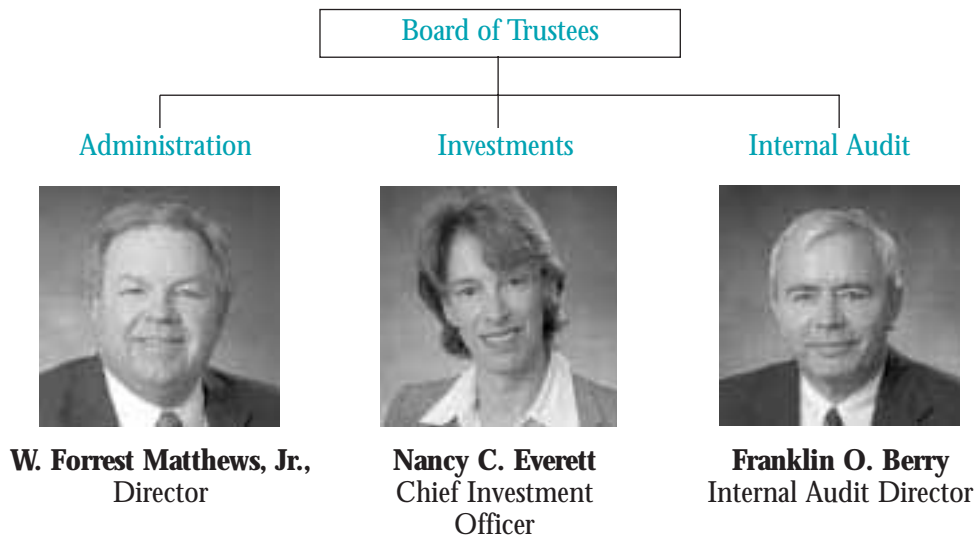


Paul W. Timmreck
Virginia
Commonwealth
University



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

VRS Organization



VRS Investment Advisory Committee



(left to right):

Stuart A. Sachs
Retired, Sovran Capital Management

Alice W. Handy
Investure

Joseph W. Montgomery
Wachovia Securities

Raymond D. Smoot, Jr., Ph.D.
Virginia Tech Foundation, Inc.
Chairman

Donald W. Lindsey
George Washington University

Joe Grills
Retired, IBM Retirement Funds

Not Pictured:
Deborah Allen-Hewitt, Ph.D.
Rutledge Research

Kenneth G. Lay
The World Bank

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

VRS Administration Executive Team



Back row (left to right)

W. Forrest Matthews, Jr.
Director

Wallace G. Harris
Senior Deputy Director

J. Timothy Bass
Chief Technology Officer

Deborah P. Burgess
Lead Engineer-Desktop/Telephony

Virginia L. Bomar
Chief Customer Programs Officer

Deardrian B. Scott
Chief Customer Support Officer

Rose Mary Smith
Director of Product and
Data Quality

Barry C. Faison
Chief Financial Officer

Front row (left to right)

Jeanne L. Chenault
Public Relations Director

LaShaunda B. King
Executive Assistant

Donna M. Blatecky
Deputy Director for
Customer Relationships

Marion W. Price
IT Manager

Donna M. Shumate
Chief Human Resource Officer

Linda F. Walker
IS Auditor/Manager

Kathryn A. Quiriconi
Controller

Not Pictured:

Franklin O. Berry
Internal Audit Director

VRS Investment Executive Team



Back row (left to right)
Brian J. Wade
Investment Funds Manager

Charles W. Grant
Investment Managing Director

R. Ruffin King
Investment Funds Manager

Kenneth C. Howell
Investment Funds Manager

John T. Grier
Investment Funds Manager

Front row (left to right)
Field H. Griffith
Investment Funds Manager

Nancy C. Everett
Chief Investment Officer

Steven C. Henderson
Investment Funds Manager

Larry D. Kicher
Chief Operations Officer

Stephen R. McClelland
Investment Funds Manager

Professional Consultants

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

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

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

Master Custodian:
Mellon Trust

Legal Counsel:
Stephanie L. Hamlett
Brian J. Goodman
Office of the Attorney General
Commonwealth of Virginia

Virginia Sickness and Disability
Program:
Melissa D. Lamm
UnumProvident Corporation

Letter of Transmittal



W. Forrest Matthews, Jr.,
Director

Date: November 22, 2004

To: Members of the Board and 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, 2004.

The System administers benefits and services for more than 521,000 members, retirees and beneficiaries covered under VRS, the State Police Officers' Retirement System (SPORS), the Virginia Law Officers' Retirement System (VaLORS), Special Benefits for Local Law Enforcement Officials and Firefighters (LEOS/FIRE) and the Judicial Retirement System (JRS). Benefits include the traditional defined benefit plan; defined contribution plans; the Basic Group Life Insurance Program and the Optional Group Life Insurance Program for members and retirees; the Retiree Health Insurance Credit Program; and the Virginia Sickness and Disability Program (VSDP) for state employees, which includes minimum employer-paid long-term care coverage. Nearly 800 state agencies, school

VRS Milestones

- 1908** – Retired Teachers Fund created.
- 1942** – VRS and JRS created.
- 1944** – Political subdivisions allowed to join VRS.
- 1950** – SPORS created.
- 1960** – Group life insurance established.
- 1970** – COLA established.
- 1989** – Health insurance credit for state retirees established.
- 1992** – Health insurance credit for retired teachers and political subdivision retirees established.
- 1995** – Optional group life insurance program established.
- 1999** – Virginia Sickness & Disability Program (VSDP) for state employees established. VaLORS created.
- 2002** – Long-term care benefit added to VSDP.

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

boards, political subdivisions and special authorities participate in VRS on behalf of their employees.

VRS' Comprehensive Annual Report for FY 2004 has been prepared in accordance with Section 51.1-1003 of the *Code of Virginia* (1950), as amended, and Section 4-9.00 of Chapter 1042 of the 2003 Virginia Acts of Assembly requiring every retirement system to publish an annual report. The report has been mailed to the Governor and the members of his Cabinet, the members of the Virginia General Assembly, VRS' participating employers and other interested parties. It also is available on the VRS Web site at www.varetire.org.

The report consists of the following sections:

- **Introductory Section:** letter from the Chairman of the VRS Board of Trustees; letter of transmittal; the identification of the organization.
- **Financial Section:** the opinion of the Auditor of Public Accounts; Management's Discussion and Analysis; the financial statements; required supplementary data; additional financial information.
- **Investment Section:** letter from the Chief Investment Officer; review of investment activity and performance for the fiscal year.
- **Actuarial Section:** certification letter of the independent consultant actuary, Gabriel, Roeder, Smith & Company; summary of the results of the most recent actuarial valuations; plan summary.
- **Statistical Section:** tables of significant data pertaining to the system; list of participating employers; information on other programs.

Accounting System and Internal Control

The financial statements included in the CAFR for FY 2004 are the responsibility of the System's management and have been prepared in accordance with generally accepted accounting principles (GAAP) for governmental accounting and reporting under 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; 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 System 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, 2004, 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 also is 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. In management's opinion, the internal controls in effect during the fiscal year ended June 30, 2004 adequately safeguard the System's assets and provide reasonable assurance regarding the proper recording of financial transactions.

Legislative Initiatives

The Virginia General Assembly enacted several bills during the 2004 session that affect benefits for Virginia's public employees and retirees:

Hazardous Duty

- *House Bill 334* removed the five-year hazardous-duty vesting requirement for members of SPORS, VaLORS and LEOS/FIRE who were in service on June 30 and July 1, 2002. Law enforcement officers with five or more years of creditable service are considered vested for hazardous duty regardless of whether the service was rendered under these plans.
- *Senate Bill 311* allows service rendered in hazardous-duty positions before October 1, 1999, which were not covered under SPORS or LEOS and for which there was no separate coverage under VaLORS, to be considered hazardous-duty service for purposes of determining eligibility for the supplement for members retiring under the provisions of these plans. It is retroactive for those who retired on or after October 1, 1999.

Basic Group Life Insurance

- *House Bill 199* provides retirees who have at least 20 years of creditable service and return to work in a covered position with life insurance coverage equal to either twice their annual salary or the amount for which they would have been eligible had they remained retired, whichever is greater. House Bill 199 also provides that active members with at least 20 years of creditable service will have their life insurance benefit based on their highest annual salary.

Defined Contribution Plans

- *House Bill 551* permits political subdivisions offering the deferred compensation program to collect the administrative fees that VRS charges from their employees participating in the plan.
- *House Bill 576* allows school boards to offer a new supplemental retirement benefit, called the Virginia Supplemental Retirement Plan (VSRP), to qualified employees who serve in under-achieving schools as "turnaround specialists" or members of the Middle School Teacher Corps. VSRP does not replace the defined benefit plan.

Virginia Sickness and Disability Program

- *Senate Bill 628* precludes short-term disability coverage for elective surgery during the first six months of the probationary period for new employees unless the employer approves it and the required leave of absence is coordinated between the employee and employer.

Virginia Retirement System

- *House Joint Resolution 34* establishes a joint subcommittee to conduct a study of the benefit structure and funding of retirement plans administered by VRS, including line-of-duty benefits for public safety officers.

VRS Service

The aging of the workforce will challenge public pension systems not only in terms of adequate funding of benefits but also in delivering appropriate and superior service to customers. As employers, public pension systems are facing the coming wave of baby-boom retirements among their own workforces, and VRS is no exception.

In FY 2004, the VRS retiree payroll was \$1,761,000,000, representing a 10.2 percent increase over FY 2003. This year, we received nearly 8,300 applications for retirement, an increase of 4 percent over the previous fiscal year. The total number of retirees receiving the health insurance credit was 66,039, a 6.2 percent increase.

The Customer Contact Center received 204,812 calls in FY 2004 compared to 180,976 calls in FY 2003, or a 13 percent increase. The Customer Contact Center also saw a 49 percent increase in e-mails and an 87 percent increase in walk-in sessions. In addition, approximately 5,600 customers attended Group Counseling Sessions and Retirement Education Seminars in FY 2004, compared to approximately 2,800 in FY 2003.

Overall, 30 percent of VRS' 317,000 active members are between the ages of 40 and 50 and 35 percent are age 50 or older. Between now and 2010, approximately 47,000 current VRS members will be eligible for an unreduced retirement benefit.

FY 2004 Accomplishments

The success of the agency will continue to depend on protecting the fund, not only through prudent fund management but also through a commitment to controlling costs. According to the Cost Effectiveness Measurement, Inc. annual benchmarking analysis, released in April 2004, VRS' benefits administration

operating costs are \$36 per active member and annuitant, well below the peer group average of \$65.

The agency's success also will continue to depend on employees' commitment to provide the highest level of service to members, employers, retirees and beneficiaries. Their accomplishments in FY 2004 are worthy of recognition.

Education and Communication

- Self-service capabilities on the VRS Web site (www.varetire.org) were enhanced in FY 2004. They included a new online tool for employers to process Purchase of Prior Service (PPS) Credit applications and an easy-to-use online tutorial for QuickAccess, replacing the manual. An actuarial cost estimator for PPS also was added for members and employers. Overall, visits to the VRS Web site increased from an estimated 466,000 in FY 2003 to more than 620,000 in FY 2004. Between January and June 2004, visits to the VRS homepage exceeded 280,000. During the same period last year, visits totaled nearly 129,000.
- One of the most significant accomplishments of FY 2004 was the success of the VRS "Cost of Waiting" campaign, launched in January 2004 as a targeted program of publications and Web site marketing to members and employers. The campaign sought to remind members with eligible prior service before July 1, 2001 that the deadline to purchase that service at the 5 percent rate was June 30, 2004. After that date, the cost to these members would be at the higher actuarial rate. Between February and April 2004, total visits to the PPS homepage on the Web site numbered 3,332, a 43 percent increase over FY-2003. Total downloads of PPS forms and applications were 40,445, representing a dramatic 228 percent increase. The agency received more than 22,700 PPS applications, more than twice the number for FY 2003. Notwithstanding this increase, applications were processed within 30 days of receipt, exceeding agency expectations.
- Several publications were introduced or revised in FY 2004, enhancing VRS' support of human resource officers who administer benefits for their employees. The agency introduced a new comprehensive Employer Manual for benefits administrators and payroll officers. Revisions to the VRS, SPORS and VSDP Handbooks for Members and two new publications, Applying for Service Retirement and Applying for Disability Retirement Booklets, were published and made available on the VRS Web site.

In addition, all VRS forms were updated with the most current policies and procedures.

- VRS launched an Identity Theft Prevention project in FY 2004, which included removing social security numbers from external communications to members and retirees and from the Member Benefit Profile. The project also focused on in-house training regarding identity theft.
- More than 160 representatives from 85 school divisions attended eight employer forums in FY 2004. The agency also conducted 21 site visits with employers. Marketing efforts resulted in nearly 20 employers joining VRS or increasing the benefits they offer their employees.

Benefits Administration and Service

- Incoming calls to the Customer Contact Center were handled 94.9 percent of the time without having to transfer the caller, exceeding agency expectations.
- The agency exceeded its standard for accurate and timely retirement application processing, with 99.8 percent of applications processed within 90 days of receipt at an average accuracy rate of 99 percent. The agency also implemented First In First Out (FIFO), which decreased the retirement application processing time from 90 days to an average of 60 days during the peak period of July.
- Participation in the Commonwealth of Virginia Deferred Compensation Plan increased 12.1 percent over last fiscal year to 38,296 participants. Participation in the Virginia Cash Match Plan increased 13.8 percent to 34,517 participants. The Virginia Defined Contribution Plan Web site also was introduced in FY 2004 along with investment education seminars for employers and regional education and enrollment meetings for members.
- A new third-party administrator for the Virginia Sickness and Disability Program (VSDP) came on board effective January 1, 2004. The contract provided for several new features, including 24-hour access to claims information for participants, enhanced employer reporting and enhanced return-to-work services. The number of VSDP participants in FY 2004 was 64,715, representing 75 percent of those who are eligible to participate. Last year, 62,280 employees were participating in VSDP, representing 73 percent of those eligible for VSDP.
- In FY 2004, 99.1 percent of employer payroll reports were processed within 30 days, exceeding agency expectations.

Internal Support and Administration

- During FY 2004, the agency launched a comprehensive examination of business processes, many of which are carried out by employees who have a large amount of undocumented institutional knowledge. Twenty-nine essential business processes were documented in FY 2004, which included 117 separate procedures and flowcharts.
- The agency also completed 149 Client Readiness (system improvement) projects, resulting in improvements in the accuracy of work, the efficiency of benefits processing and the quality of customer service.
- One of VRS' major accomplishments during the fiscal year was the establishment of the VRS University to provide in-house training and professional and personal development for supervisors and employees.
- VRS formalized and streamlined its legislative review process with the establishment of the Legislative Review and Implementation Team (LRIT). LRIT is a cross-functional team that identifies, develops, assesses and implements all legislation affecting VRS and its members, employers, retirees and beneficiaries.
- In the area of technology, VRS achieved 99.48 percent system availability in FY 2004. The agency also carried out major upgrades to e-mail and antivirus capabilities, computer operations, data processing, servers and the imaging and workflow system. In addition, the agency's Security Policy was updated and a security awareness program implemented. Procurements also were developed for the Knowledge Management System, the Data Warehouse and a new telephony solution, which will integrate with the agency's other systems and applications to provide a more effective environment in support of customer service.

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.

**Achievement Award
from the Public Pension Coordinating Council**

VRS received the Achievement Award from the Public Pension Coordinating Council (PPCC). The award recognizes VRS for excellence in meeting professional standards for plan design and administration as set forth in the Public Pension Standards.

Developed by the PPCC to promote excellence among state and local public retirement systems, the Public Pension Standards are the benchmark for measuring defined benefit plans. The purpose of the award is to promote high professional standards for public employee retirement systems and to publicly commend the systems that adhere to the standards of excellence.

The PPCC is a coalition of the National Association of State Retirement Administrators (NASRA), the National Council on Teacher Retirement (NCTR) and the National Conference on Public Employee Retirement Systems (NCPERS).

**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, 2003. This was the 22nd consecutive year that VRS 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

The mission of the Virginia Retirement System calls upon us to provide the best service possible and to be responsible stewards of the funds in our care on behalf of VRS members, retirees and beneficiaries. This report provides complete and reliable information that supports management's decisions in carrying out that mission.

Responsible stewardship, however, is more than sound management. It also encompasses the outstanding commitment of VRS staff to excellence and the support of VRS' affiliated employers and partners as well as the guidance and dedication of the Board of Trustees. We would like to express our sincere thanks and appreciation to each of these exceptional individuals and representatives.

Finally, we wish to thank Governor Mark R. Warner and the members of the Virginia General Assembly for their continued commitment to the financial security of the employees and retirees of the Virginia Retirement System.

Respectfully submitted,



W. Forrest Matthews, Jr.
Director



Barry C. Faison
Chief Financial Officer

A close-up photograph of a person's hands holding a pair of glasses. The image is overlaid with a teal color. The text is centered on the image.

FINANCIAL SECTION

Adapting to Change

ACCEPTING THAT CHANGE HAPPENS
AND DOING EVERYTHING POSSIBLE TO
MAKE IT GO WELL.



Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

October 26, 2004

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
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, 2004 and 2003, 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, 2004 and 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, 2004 and 2003, 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 52 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 26, 2004, 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

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, 2004. 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 \$5,258.3 million, or 15.6% during the fiscal year ended June 30, 2004. The increase was due to significantly improved market returns; however, these were partially offset by the increased expense for benefit payments as a percentage of contributions.
- The System's rate of return on investments during the fiscal year ended June 30, 2004, was 17.9% compared with a return of 2.5% for the fiscal year ended June 30, 2003. The increase is due to greatly improved returns on equity investments.
- The VRS, SPORS, VaLORS, and JRS were actuarially funded at 96.4%, 82.6%, 53.6%, and 81.0% based on the actuarial valuation as of June 30, 2003. For the VRS and SPORS plans, this was a decline from their funded ratios of 101.8% and 85.4% based on the actuarial valuation as of June 30, 2002. For the VaLORS and JRS plans, there is a slight improvement from their June 30, 2002 funded ratios of 51.9% and 79.8%. All of the funded ratios continue to reflect the impact of the

significant investment losses recorded in FY 2001 and FY 2002 on the Actuarial Value of Assets.

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, 2004 and 2003 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, Other Employee Benefit Plans and 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 Supplemental 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**

Virginia Retirement System's Net Assets

(Expressed in Millions)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Assets:					
Cash, Receivables and Capital Assets	\$ 2,507.9	\$ 374.6	\$ 2,133.3	\$ 169.9	\$ 1,963.4
Investments	40,266.8	4,700.0	35,566.8	492.9	35,073.9
Security Lending Collateral	3,134.8	691.4	2,443.4	(322.6)	2,766.0
Total Assets	\$ 45,909.5	\$ 5,766.0	\$ 40,143.5	\$ 340.2	\$ 39,803.3
Liabilities:					
Accounts Payable	\$ 241.7	\$ 17.7	\$ 224.0	\$ (257.9)	\$ 481.9
Investment Purchases Payable	2,491.2	(281.8)	2,773.0	646.1	2,126.9
Obligations Under Security Lending	3,134.8	691.4	2,443.4	(322.6)	2,766.0
Total Liabilities	\$ 5,867.7	\$ 427.3	\$ 5,440.4	\$ 65.6	\$ 5,374.8
Total Net Assets	\$ 40,041.8	\$ 5,338.7	\$ 34,703.1	\$ 274.6	\$ 34,428.5

Virginia Retirement System's Change in Net Assets

(Expressed in Millions)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Additions:					
Member Contributions	\$ 87.7	\$ (41.5)	\$ 129.2	\$ (29.9)	\$ 159.1
Member Contributions paid by Employer	585.1	65.1	520.0	15.5	504.5
Employer Contributions	626.0	124.4	501.6	(61.1)	562.7
Net Investment Income	6,101.3	5,106.8	994.5	3,828.4	(2,833.9)
Total Additions	\$ 7,400.1	\$ 5,254.8	\$ 2,145.3	\$ 3,752.9	\$ (1,607.6)
Deductions:					
Retirement Benefits	\$ 1,761.0	\$ 163.3	\$ 1,597.7	\$ 159.9	\$ 1,437.8
Refunds of Member Contributions	85.0	12.8	72.2	(1.3)	73.5
Insurance Premiums and Claims	106.0	1.7	104.3	8.7	95.6
Retiree Health Insurance Reimbursements	64.9	3.9	61.0	3.4	57.6
Long Term Disability Benefits	23.8	7.0	16.8	5.2	11.6
Administrative and Other Expenses	20.7	2.0	18.7	(0.6)	19.3
Total Deductions	\$ 2,061.4	\$ 190.7	\$ 1,870.7	\$ 175.3	\$ 1,695.4
Net Increase (Decrease) in Net Assets	\$ 5,338.7	\$ 5,064.1	\$ 274.6	\$ 3,577.6	\$ (3,303.0)

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

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, 2004, 2003, and 2002 is presented below in Figure 1.

Figure 1.
Active Membership Distribution at June 30

	2004	2003	2002
State Employees (VRS)	76,911	76,161	78,655
Teachers (VRS)	135,130	132,656	129,795
Political Subdivision Employees (VRS)	93,436	91,340	89,588
State Police Officers (SPORS)	1,751	1,709	1,745
Virginia Law Officers (VaLORS)	9,573	9,538	10,025
Judges (JRS)	402	407	406
Total	317,203	311,811	310,214

Contributions and Investment 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, 2004 amounted to \$7,122.9 million. This was an increase of \$5,111.4 million compared with FY 2003. This is an improvement over the increase of \$3,719.9 million that was recorded in FY 2003. This information is presented below in Figure 2.

Member contributions, including those paid by employers, increased \$23.6 million, while employers' contributions increased \$119.7 million for a total increase in contributions of \$143.3 million from the prior fiscal year. Investment income also provided an increase to plan net assets in FY 2004. Member contributions paid by members decreased by \$41.5 million. This was caused mostly by the conversion of a large school system from withholding their employees' contributions on a pre-tax basis to having the school system pay the contributions on behalf of the employees. There was also continued activity among members purchasing previously refunded and other qualified service. Employer contributions increased due to the reinstatement of contributions for state employees in FY 2004. This is discussed further in Note 13 of the Notes to Financial Statements. During FY 2003 the System experienced growth in total member contributions of \$26.8 million and a decline in employer contributions of \$29.4 million. As in FY 2004, the member contributions paid by members were impacted by the number of members purchasing service. The decline in the employer contributions related to the suspension of contributions for state employees in FY 2003.

Figure 2.
Contributions and Investment Earnings for the Years Ended June 30

(Expressed in Millions)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Member Contributions	\$ 87.6	\$ (41.5)	\$ 129.1	\$ 11.3	\$ 117.8
Member Contributions Paid by Employer	585.1	65.1	520.0	15.5	504.5
Employer Contributions	512.4	119.7	392.7	(29.4)	422.1
Investment Income*	5,937.8	4,968.1	969.7	3,722.5	(2,752.8)
Total	\$ 7,122.9	\$ 5,111.4	\$ 2,011.5	\$ 3,719.9	\$ (1,708.4)

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

Investments

There was net investment income for FY 2004 of \$5,937.8 million. The net investment income increased \$4,968.1 million for FY 2004 (Figure 2). This compares to a net investment income increase of only \$3,722.5 million in FY 2003. Total pension trust fund investments increased to \$39,224.5 million at fair value at June 30, 2004. This was an increase of \$4,639.9 million over the fair value of \$34,584.6 million at June 30, 2003. The total pension trust fund assets also increased in FY 2003 by \$527.9, although not as much, from their fair value of \$34,056.7 at June 30, 2002.

The total return on pension trust fund investments for the fiscal year ended June 30, 2004 was a 17.9%. The annualized return was 3.8% over the past three years and 3.7% 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 2004 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 2004 totaled \$1,864.6 million, an increase of \$178.0 million, or 10.6%, over the 2003 period. The details are presented below in Figure 3.

The increase in benefit payments to \$1,761.0 million in FY 2004 was due to continued growth in the number of retirees and beneficiaries receiving benefits combined with a cost-of-living adjustment (COLA) of 1.6% on July 1, 2003. The number of retirees and beneficiaries receiving benefit payments increased to approximately 113,717 at June 30, 2004. This is an increase of 4.6% from the 108,758 at June 30, 2003. The increase in benefit payments for FY 2004 was \$163.3 million as compared to \$159.9 million for FY 2003.

Refunds of contributions to members who terminated their employment during FY 2004 amounted to \$85.0 million (15,328 refunds), compared with \$72.2 million (13,148 refunds) refunded during FY 2003 and \$73.5 million (12,902 refunds) refunded during FY 2002. There was an increase in the number of refunds during FY 2004 as well as an overall growth in the total value of those refunds.

Administration and other expenses for FY 2004 were \$18.6 million, compared with \$16.7 million for FY 2003 and \$17.8 million for FY 2002. The increase of \$1.9 million for FY 2004 is the result of an increase in administration expenses due mainly to an increase in staff salaries, related benefit costs (especially the resumption of the employer share of retirement), and other administrative costs.

Figure 3.
Primary Expenses for the Years Ended June 30

(Expressed in Millions)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Benefits	\$ 1,761.0	\$ 163.3	\$ 1,597.7	\$ 159.9	\$ 1,437.8
Refunds	85.0	12.8	72.2	(1.3)	73.5
Administration and Other	18.6	1.9	16.7	(1.1)	17.8
Total	\$ 1,864.6	\$ 178.0	\$ 1,686.6	\$ 157.5	\$ 1,529.1

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 2004, there was a net increase of \$5,258.3 million in the retirement reserves held by the plans. This compares to an increase of \$324.9 million in the retirement reserves in FY 2003. As noted above, the increase for FY 2004 was primarily related to the significantly improved investment performance for the year. During the fiscal year, the amount of interest credited to member accounts was \$248.2 million. The amount of member balances transferred to employer reserves upon members' retirements was \$341.0 million. The member and employer balances in retirement reserves at June 30, 2004 are presented below 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, 2003 by Gabriel, Roeder, Smith & Company, indicated that the ratio of assets accumulated by the plans to their total actuarial accrued liabilities for benefits were 96.4% for VRS, 82.6% for SPORS, 53.6% for VaLORS, and 81.0% 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 Required Supplemental Schedule of Funding Progress 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 331,897 employees and 106,933 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 \$16.7 million in optional life premiums for approximately 51,613 employees during FY 2004. This is a decrease from the \$17.6 million collected from approximately 50,958 employee during FY 2003 and reflects the reductions in premiums for certain age groups during the year.

During FY 2004, the System remitted \$122.8 million to the insurance company for premiums and claims (\$106.0 million for the group life insurance program and \$16.8 million for the optional life insurance program). This is a slight increase over the total premiums and claims of \$121.9 million remitted for FY 2003 and reflects the growth in claims expense in the basic offset by the lower optional insurance premiums noted above. 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 \$778.5 million at June 30, 2004 and experienced investment income (including net securities lending

Figure 4.
Reserve Balances at June 30

(Expressed in Millions)

	2004	Increase (Decrease)	2003	Increase (Decrease)	2002
Member Reserves	\$ 6,908.4	\$ 505.1	\$ 6,403.3	\$ 470.6	\$ 5,932.7
Employer Reserves	32,130.6	4,753.2	27,377.4	(145.7)	27,523.1
Total	\$ 39,039.0	\$ 5,258.3	\$ 33,780.7	\$ 324.9	\$ 33,455.8

income) of \$133.7 million during the fiscal year. For FY 2003, this reserve had an investment income of \$18.3 million and ended the year with a reserve balance of \$751.7 million down from \$838.6 at June 30, 2002. For FY 2004, the growth is the result of investment income. As was the case in FY 2003, there was a lack of contributions as a result of the premium holiday declared by the General Assembly beginning 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 2004, the System collected \$78.4 million in retiree health insurance credit contributions from participating employers and provided reimbursements of \$64.9 million to 65,153 eligible retirees. 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. The growth in contributions reflects general payroll increases since there were no rate changes during the year. The growth in retiree health insurance credits reflects the increase in the number of eligible retirees. The Retiree Health Insurance Credit Fund reserve had net assets held in trust for benefits of \$120.9 million at June 30, 2004 and experienced investment income (including net securities lending income) of \$15.6 million during the fiscal year. The reserve balances at June 30, 2003 and June 30, 2002 were \$92.2 million and \$76.2 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 2004, the System collected \$35.2 million in VSDP contributions from participating employers and provided long-term disability benefits \$23.8 million to eligible employees. This is an increase over the \$34.8 million in contributions collected and \$16.8 million in benefits paid in FY 2003. Contribution growth reflects increases in the covered payroll. There were no contribution rate changes during the year. The increase in benefits reflects growth in the number of employees receiving long-term disability benefits, the amount of those benefits, and the operating costs of the program. The Disability Insurance Trust Fund reserve had net assets held in trust for benefits of \$103.3 million at June 30, 2004 and experienced investment income (including net securities lending income) of \$14.2 million during the fiscal year. The reserve balances at June 30, 2003 and June 30, 2002 were \$78.4 million and \$57.9 million, respectively.

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,
Other Employee Benefit Trust Funds and Agency Fund

As of June 30, 2004 and 2003

	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).....	\$ 4,967	\$ 23	\$ 24	\$ 13	\$ 5,027
Receivables:					
Contributions	92,182	610	2,338	747	95,877
Interest and dividends.....	80,138	1,027	1,049	573	82,787
Receivable for security transactions	2,148,767	27,542	28,118	15,352	2,219,779
Other receivables.....	6,231	60	62	34	6,387
Total receivables.....	2,327,318	29,239	31,567	16,706	2,404,830
Due from other funds.....	5,885	2,305	2,329	1,831	12,350
Investments: (Note 5)					
Bonds and mortgage securities	6,757,560	86,617	88,428	48,281	6,980,886
Stocks	13,412,668	171,921	175,515	95,829	13,855,933
Fixed income commingled funds	1,155,781	14,815	15,124	8,258	1,193,978
Index and pooled funds	11,059,500	141,758	144,722	79,017	11,424,997
Real estate.....	1,029,870	13,201	13,477	7,358	1,063,906
Private equity.....	1,882,348	24,128	24,632	13,449	1,944,557
Hedge Funds	1,127,350	14,450	14,752	8,055	1,164,607
Short-term investments.....	1,544,556	19,797	20,211	11,034	1,595,598
Total investments	37,969,633	486,687	496,861	271,281	39,224,462
Collateral on loaned securities	2,955,932	37,888	38,681	21,119	3,053,620
Property, plant, furniture and equipment (Note 6)	6,089	-	-	-	6,089
Total assets.....	43,269,824	556,142	569,462	310,950	44,706,378
Liabilities:					
Retirement benefits payable.....	145,596	2,191	1,805	1,786	151,378
Refunds payable.....	5,560	19	268	-	5,847
Accounts payable and accrued expenses	15,714	184	188	103	16,189
Compensated absences payable.....	1,161	-	-	-	1,161
Insurance premiums and claims payable	-	-	-	-	-
Payable for security transactions.....	2,349,115	30,110	30,740	16,784	2,426,749
Other payables.....	1,045	7	7	4	1,063
Obligations under security lending program	2,955,932	37,888	38,681	21,119	3,053,620
Due to other funds.....	11,293	-	2	-	11,295
Total liabilities	5,485,416	70,399	71,691	39,796	5,667,302
Net assets held in trust for benefits (Note 4)					
(See Required Supplemental Schedule of Funding Progress, page 46.)	\$37,784,408	\$ 485,743	\$ 497,771	\$ 271,154	\$39,039,076

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

FINANCIAL SECTION

(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	2004	2003
\$ 40	\$ 6	\$ 5	\$ 51	\$ 1,604	\$ 6,682	\$ 50,609
1,214	5,141	1,488	7,843	-	103,720	110,936
1,734	247	219	2,200	-	84,987	101,737
46,485	6,629	5,875	58,989	-	2,278,768	1,836,743
102	34	1,268	1,404	-	7,791	4,542
49,535	12,051	8,850	70,436	-	2,475,266	2,053,958
360	5,264	12	5,636	1,815	19,801	22,509
146,188	20,849	18,477	185,514	-	7,166,400	8,313,309
290,160	41,381	36,675	368,216	-	14,224,149	8,657,200
25,003	3,566	3,160	31,729	-	1,225,707	104,739
239,253	34,121	30,240	303,614	-	11,728,611	12,890,439
22,280	3,177	2,816	28,273	-	1,092,179	1,098,165
40,721	5,808	5,147	51,676	-	1,996,233	2,177,483
24,388	3,478	3,083	30,949	-	1,195,556	-
33,415	4,766	4,223	42,404	-	1,638,002	2,325,445
821,408	117,146	103,821	1,042,375	-	40,266,837	35,566,780
63,947	9,120	8,082	81,149	-	3,134,769	2,443,399
-	-	-	-	-	6,089	6,270
935,290	143,587	120,770	1,199,647	3,419	45,909,444	\$40,143,525
-	-	-	-	-	151,378	138,221
95	93	162	350	-	6,197	7,341
312	5,516	2,089	7,917	-	24,106	17,107
-	-	-	-	-	1,161	1,167
34,900	-	-	34,900	3,059	37,959	36,715
50,819	7,248	6,423	64,490	-	2,491,239	2,773,030
11	2	1	14	-	1,077	937
63,947	9,120	8,082	81,149	-	3,134,769	2,443,399
6,742	713	691	8,146	360	19,801	22,509
156,826	22,692	17,448	196,966	3,419	5,867,687	5,440,426
\$ 778,464	\$ 120,895	\$ 103,322	\$ 1,002,681	\$ -	\$40,041,757	\$ 34,703,099

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, 2004 and 2003

	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.....	\$ 85,769	\$ 790	\$ 880	\$ 197	\$ 87,636
Member paid by employers.....	564,020	4,037	14,703	2,371	585,131
Employers.....	446,084	10,405	40,709	15,190	512,388
Total contributions.....	1,095,873	15,232	56,292	17,758	1,185,155
Investment income:					
Net appreciation/(depreciation) in fair value of investments.....	5,305,412	68,242	65,189	37,773	5,476,616
Interest, dividends and other investment income.....	554,731	7,135	6,816	3,950	572,632
Total investment income before investment expenses.....	5,860,143	75,377	72,005	41,723	6,049,248
Investment expenses.....	(119,070)	(1,531)	(1,463)	(849)	(122,913)
Net investment income.....	5,741,073	73,846	70,542	40,874	5,926,335
Security lending income:					
Gross income.....	35,607	458	438	254	36,757
Less: Borrower rebates and agent fees.....	(25,403)	(327)	(312)	(181)	(26,223)
Net security lending income.....	10,204	131	126	73	10,534
Miscellaneous revenue.....	908	-	-	-	908
Total additions.....	6,848,058	89,209	126,960	58,705	7,122,932
Deductions:					
Retirement benefits.....	1,692,166	26,336	19,784	22,706	1,760,992
Refunds of member contributions.....	80,237	731	3,998	-	84,966
Insurance premiums and claims.....	-	-	-	-	-
Retiree health insurance reimbursements.....	-	-	-	-	-
Long term disability benefits.....	-	-	-	-	-
Administrative expenses.....	18,119	213	196	117	18,645
Other expenses.....	-	-	-	-	-
Total operating expenses.....	1,790,522	27,280	23,978	22,823	1,864,603
Transfers.....	(10)	-	10	-	-
Net increase (decrease).....	5,057,526	61,929	102,992	35,882	5,258,329
Net assets held in trust for benefits - Beginning of year.....	32,726,882	423,814	394,779	235,272	33,780,747
Net assets held in trust for benefits - End of year.....	\$37,784,408	\$ 485,743	\$ 497,771	\$ 271,154	\$39,039,076

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

FINANCIAL SECTION

(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	2004	2003
\$ 12	\$ -	\$ -	\$ 12	\$ 87,648	\$ 129,174
-	-	-	-	585,131	519,954
8	78,383	35,247	113,638	626,026	501,687
20	78,383	35,247	113,650	1,298,805	1,150,815
123,349	14,375	13,097	150,821	5,627,437	411,449
12,897	1,503	1,369	15,769	588,401	671,074
136,246	15,878	14,466	166,590	6,215,838	1,082,523
(2,768)	(323)	(293)	(3,384)	(126,297)	(102,219)
133,478	15,555	14,173	163,206	6,089,541	980,304
828	96	88	1,012	37,769	45,885
(591)	(69)	(63)	(723)	(26,946)	(34,436)
237	27	25	289	10,823	11,449
-	-	-	-	908	2,682
133,735	93,965	49,445	277,145	7,400,077	2,145,250
-	-	-	-	1,760,992	1,597,735
-	-	-	-	84,966	72,150
106,031	-	-	106,031	106,031	104,275
-	64,920	-	64,920	64,920	61,027
-	-	23,835	23,835	23,835	16,780
615	372	671	1,658	20,303	18,428
372	-	-	372	372	276
107,018	65,292	24,506	196,816	2,061,419	1,870,671
-	-	-	-	-	-
26,717	28,673	24,939	80,329	5,338,658	274,579
751,747	92,222	78,383	922,352	34,703,099	34,428,520
\$ 778,464	\$ 120,895	\$ 103,322	\$ 1,002,681	\$40,041,757	\$34,703,099

Notes to Financial Statements

June 30, 2004 and 2003

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, 2004 and 2003 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, 2004 and 2003, the distribution of participating employers in the VRS was as follows:

VRS Employers		
	2004	2003
Cities and Towns	151	149
Counties	92	92
School Boards*	145	145
Special Authorities	176	172
State Agencies	234	240
Total employers	798	798

* 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.

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

Membership Figures at June 30

	2004				TOTAL	2003
	VRS	SPORS	VaLORS	JRS		TOTAL
Retirees and beneficiaries receiving benefits	111,484	866	979	388	113,717	108,758
Terminated employees entitled to benefits but not yet receiving them	27,538	67	254	13	27,872	26,783
Total	139,022	933	1,233	401	141,589	135,541
Active plan participants:						
Vested	196,178	1,392	6,540	323	204,433	198,193
Nonvested	109,299	359	3,033	79	112,770	113,618
Total	305,477	1,751	9,573	402	317,203	311,811

The table above shows membership in VRS, SPORS, VaLORS, and JRS at at June 30, 2004 and 2003.

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 331,897 employees and 106,933 retirees were covered under the program at June 30, 2004.

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 \$8,000, \$16,000, or \$24,000, depending on the option chosen by the employee. An additional accidental death and dismemberment benefit is payable for death or bodily injuries. Approximately 51,613 employees were covered under this program at June 30, 2004.

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 65,153 retired employees were covered under this program at June 30, 2004.

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 64,715 employees were covered under the program at June 30, 2004.

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 2004 and FY 2003 was actuarially computed by Gabriel, Roeder, Smith & Company during their valuation as of June 30, 2001. In addition, a separate contribution requirement was computed for the teacher cost-sharing pool by the actuary for each year.

Contributions totaling \$1,185,155,000 and \$1,041,835,000 for the fiscal years ended June 30, 2004 and 2003, 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 \$512,388,000 for FY 2004. Included in total employer contributions were \$1,086,000 from school boards for payments toward the Early Retirement Program costs and \$13,145,000 from state agencies for payments toward Workforce Transition Act (WTA) costs. Included in the employee contributions of \$87,636,000 were \$83,378,000 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.

Contributions for the Years Ending June 30

(Expressed in Thousands)

	2004					2003
	VRS	SPORS	VaLORS	JRS	TOTAL	TOTAL
Employer contributions	\$ 446,084	\$ 10,405	\$ 40,709	\$ 15,190	\$ 512,388	\$ 392,732
Employee contributions paid by employer	564,020	4,037	14,703	2,371	585,131	519,954
Employee contributions	85,769	790	880	197	87,636	129,149
Total contributions	\$1,095,873	\$ 15,232	\$ 56,292	\$ 17,758	\$1,185,155	\$1,041,835

Additionally, the employer contributions to VRS by the state for state employees was 3.77% 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 12.79%, employer contributions to VaLORS by the state represented 13.95%, and employer contributions to JRS by the state represented 32.03% 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 generated 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, 2004 and 2003 are presented in the table shown 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 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

Reserve Balances Available for Benefits at June 30

(Expressed in Thousands)

	2004	2003
Virginia Retirement System:		
Member Reserve	\$ 6,675,417	\$ 6,183,699
Employer Reserve	31,108,991	26,543,183
Total VRS	37,784,408	32,726,882
State Police Officers' Retirement System:		
Member Reserve	62,070	59,681
Employer Reserve	423,673	364,133
Total SPORS	485,743	423,814
Virginia Law Officers' Retirement System:		
Member Reserve	143,047	133,041
Employer Reserve	354,724	261,738
Total VaLORS	497,771	394,779
Judicial Retirement System:		
Member Reserve	27,900	26,865
Employer Reserve	243,254	208,407
Total JRS	271,154	235,272
Group Life Insurance:		
Advance Premium Deposit Reserve	778,464	751,747
Retiree Health Insurance Credit Reserve	120,895	92,222
Virginia Sickness and Disability Program:		
Disability Insurance Trust Fund	103,322	78,383
Total Pension and Other Employee Benefit Reserve	\$ 40,041,757	\$ 34,703,099

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, 2004 and 2003 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, 2004 and 2003 consisted of the following (in thousands):

	2004	2003
Deposits	Carrying Amount	Carrying Amount
Treasurer of Virginia	\$ 6,453	\$ 48,257
Master Custodian	229	2,352
Total Deposits	\$ 6,682	\$ 50,609

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 available 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, 2004 and 2003, the equity interests of each fund were as follows:

	2004	2003
• Virginia Retirement System	94.27%	94.22%
• State Police Officers' Retirement System	1.21%	1.22%
• Virginia Law Officers' Retirement System	1.24%	1.13%
• Judicial Retirement System	0.68%	0.67%
• Group Life Insurance Fund	2.04%	2.27%
• Retiree Health Insurance Credit Fund	0.30%	0.27%
• Disability Insurance Trust Fund	0.26%	0.22%
Total	100.00%	100.00%

2. Custodial Risk

Investments held by the System at June 30, 2004 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 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.

Summary of Categorized Investments at Fair Value

As of June 30, 2004

(Expressed in Thousands)

	Category			Non-Categorized	Total Fair Value at June 30 2004
	1	2	3		
Long-Term Investments					
Bonds and Mortgage Securities:					
U.S. Government and agencies	\$ 3,335,363	\$ -	\$ 85,929	\$ -	\$ 3,421,292
Corporate and other bonds	1,429,713	-	6,241	-	1,435,954
Common and preferred stocks	13,214,040	-	-	-	13,214,040
Equity index and pooled funds	-	-	-	11,728,611	11,728,611
Fixed income commingled funds	-	-	-	1,225,707	1,225,707
Real estate investments	-	-	-	1,092,179	1,092,179
Private equity	-	-	-	1,996,233	1,996,233
Hedge funds	-	-	-	1,195,556	1,195,556
Held by brokers-dealers under securities lending program:					
U.S. Government and agencies	102,976	-	82,598	1,984,678	2,170,252
Corporate and other bonds	-	-	-	138,902	138,902
Common and Preferred stocks	-	-	38,843	971,266	1,010,109
Total long-term investments	18,082,092	-	213,611	20,333,132	38,628,835
Short-Term Investments					
Investments held by Treasurer:					
Local Government Investment Pool	-	-	-	262,700	262,700
Investments held with Trustees:					
The Boston Company	-	-	-	1,336,210	1,336,210
Pooled Employee Trust Funds	-	-	-	39,092	39,092
Foreign currencies	-	-	-	-	-
Total short-term investments	-	-	-	1,638,002	1,638,002
Total Investments	\$ 18,082,092	\$ -	\$ 213,611	\$ 21,971,134	\$ 40,266,837
Securities Lending Separate Account	\$ -	\$ -	\$ -	\$ 3,134,769	\$ 3,134,769

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 84 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, 2004 and 2003 was \$3,319,263,000 and \$2,638,297,000, respectively. The value of collateral (cash and non-cash) at June 30, 2004 and 2003 was \$3,364,650,000 and \$2,697,437,000 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, 2004 and 2003, respectively, include (1) receivables for deposits with brokers for securities sold short of \$820,698,000 and \$785,703,000 and (2) payables for securities sold short and not covered with market values of \$796,912,000 and \$773,381,000, 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 \$412,888,000 at June 30, 2004 and \$276,828,000 at June 30, 2003.

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 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, 2004, the System had purchased S&P, Russell Index, Treasury bonds and notes, and global indices futures and options with a notional value of \$3,684,005,000, and sold Treasury bonds and notes, and global indices futures and options with a notional value of \$570,095,000. At June 30, 2003, the notional values of the balances purchased and sold were \$3,634,769,000 and \$1,248,932,000, respectively. At June 30, 2004, the System had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of \$92,170,000 as the margin requirement for futures contracts. At June 30, 2003, the market value of the pledged securities was \$147,183,000.

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 exchange 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, 2004, the System had sold foreign currency contracts with a notional value of \$1,190,129,000 and had purchased foreign currency contracts with a notional value of \$1,127,966,000. At June 30, 2003, the notional values of the foreign currency contract sold and purchased were \$460,454,000 and \$462,032,000, 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, 2004, the System held CMO securities with a market value of \$217,916,000 and IO and PO securities with a market value of \$2,777,000. At June 30, 2003, the market value for CMO securities held was \$157,025,000 and the market value for IO and PO securities held was \$7,839,000.

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 underlying principal and interest are repaid by the mortgagors).

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 2004, the System entered into interest rate and total return swaps with a total notional value of \$126,500,000. For FY 2003, the total notional value was \$100,000,000. 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, 2004 and 2003 is as follows (in thousands):

	Balance June 30, 2003	Increases	Decreases	Balance June 30, 2004
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	3,783	178	-	3,961
Total depreciable capital assets	8,415	178	-	8,593
Less accumulated depreciation:				
Building	579	116	-	695
Furniture and equipment	2,934	243	-	3,177
Total accumulated depreciation	3,513	359	-	3,872
Total depreciable capital assets – Net	4,902	(181)	-	4,721
Total capital assets – Net	\$ 6,270	\$ (181)	\$ -	\$ 6,089

Depreciation expense amounted to to \$359,000 and \$417,000 in 2004 and 2003, 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, 2004, was \$1,301,000. The System has, as of June 30, 2004, the following total future minimum rental payments due under the above leases (in thousands):

Year	Amount
2005	\$ 655
2006	299
2007	92
Total future minimum rental payments	\$ 1,046

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.

B. Other Information:

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, 2004.

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 96,354 state employees and 42,316 retirees in the program during FY 2004. 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, 2003, were \$1,671.2 million. The actuarial value of the program's assets available for benefits on that date was \$902.1 million, leaving a present value of future contributions of \$769.1 million.

The System's contribution requirements for its employees for the fiscal years ended June 30, 2004 and 2003 were zero each year. In April 2002, the General Assembly suspended contributions for the Group Life insurance Program through June 30, 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 29,046 state retirees were receiving health insurance credits at June 30, 2004. Note 2C contains information regarding eligibility requirements, benefit provisions, and contribution requirements.

For the fiscal year ended June 30, 2004, state agencies were required to contribute to the program at the statutory rate of 0.89% of covered payroll. The System's contribution requirements for its employees for the fiscal years ended June 30, 2004 and 2003 were \$102,000 and \$96,000, 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, 2004 approximately 64,715 participants were enrolled in the program.

For the fiscal year ended June 30, 2004, 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, 2004 and 2003 were \$124,000 and \$116,000, 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, 2004. 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 2004 and the three preceding fiscal years.

12. Commitments

The System extends investment commitments in the normal course of business. At June 30, 2004 and 2003, these commitments amounted to \$1,829,000,000 and \$1,746,000,000, 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 FY 2004. The changes made modified 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 2004, 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. For FY 2004, the rate for state employees in the VRS plan was also 3.77%. FY 2004 rates for SPORS, VaLORS, and JRS were 12.79%, 13.95%, and 32.03%, respectively, or the rates 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) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a)/(c)
Virginia Retirement System (VRS)						
2003	\$ 39,243	\$ 40,698	\$ 1,455	96.4%	\$ 10,885	13.4%
2002	38,957	38,265	(692)	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)						
2003	\$ 509	\$ 616	\$ 107	82.6%	\$ 79	135.4%
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)						
2003	\$ 458	\$ 854	\$ 396	53.6%	\$ 292	135.6%
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)						
2003	\$ 282	\$ 348	\$ 66	81.0%	\$ 48	137.5%
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)				
2004 *	\$ 469,200	91.66%	\$ 430,064	100.00%
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)				
2004 *	\$ 20,187	51.16%	\$ 10,328	100.00%
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)				
2004 *	\$ 72,752	55.80%	\$ 40,596	100.00%
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)				
2004 *	\$ 21,341	71.18%	\$ 15,190	100.00%
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, 2003, and 2004 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, 2003
Actuarial Cost Method:	Entry Age Normal
Amortization Method:	
State Employees	Level percent, closed
Political Subdivision Employees.	Level percent, open
Teachers.	Level percent, closed
State Police /VA Law Officers /Judges	Level percent, closed
Payroll Growth Rate	3.00%
Remaining Amortization Period:	
State Employees	23 Years
Political Subdivision Employees.	0 to 30 Years
Teachers.	23 Years
State Police /VA Law Officers /Judges	23 Years
Asset Valuation Method:	Modified Market
Actuarial Assumptions:	
Investment Rate of Return *	8.00%
Projected Salary Increases *	
State /Political Subdivision Employees	4.25% to 6.30%
Teachers.	4.00% to 7.00%
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, 2004 and 2003

(Expressed in Thousands)

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Assets:				
Cash	\$ 1,171	\$ 20,747	\$ 20,314	\$ 1,604
Due from other funds.....	1,772	43	-	1,815
Total assets.....	<u>\$ 2,943</u>	<u>\$ 20,790</u>	<u>\$ 20,314</u>	<u>\$ 3,419</u>
Liabilities:				
Insurance premiums and claims payable.....	\$ 2,943	\$ 116	\$ -	\$ 3,059
Due to other funds.....	-	360	-	360
Total liabilities.....	<u>\$ 2,943</u>	<u>\$ 476</u>	<u>\$ -</u>	<u>\$ 3,419</u>

Schedule of Administrative Expenses
Years Ended June 30, 2004 and 2003

(Expressed in Thousands)

	Totals	
	2004	2003
Personal Services:		
Salaries and wages	\$ 12,440	\$ 11,937
Per diem services	309	282
WTA service costs	66	-
Retirement contributions	1,068	604
Social Security	876	838
Group life and medical insurance	1,296	1,129
Compensated absences	131	134
Total personal services	16,186	14,924
Professional Services:		
Data processing	4,853	4,071
Actuarial and consulting	596	699
Legal	1,081	623
Medical	196	255
Management services	263	43
Public information services	32	1
Personnel development services	13	48
Total professional services	7,034	5,740
Communication Services:		
Media	15	18
Printing	755	684
Postal and delivery	394	522
Telecommunications	343	365
Total communication services	1,507	1,589
Rentals:		
Business equipment	667	592
Office space	634	324
Total rentals	1,301	916
Other Services and Charges:		
Skilled and clerical services	216	262
Depreciation	359	417
Dues and memberships	115	110
Building expense	472	490
Equipment	156	533
Insurance	27	28
Repairs and maintenance	29	26
Supplies and materials	159	116
Travel and transportation	623	625
Miscellaneous	110	116
Total other services and charges	2,266	2,723
Total Administrative Expenses (GAAP basis)	28,294	25,892
Adjustments necessary to convert administrative expenses on the GAAP basis to the budgetary basis at year end (net)	(279)	(438)
Administrative Expenses (Budgetary basis)	\$ 28,015	\$ 25,454
Administrative Expenses Appropriated	\$ 30,930	\$ 29,402
Distribution of Administrative Expenses:		
Total Administrative Expenses (GAAP Basis)	\$ 28,294	\$ 25,892
Less: In-house Investment Management	(7,991)	(7,464)
Net Administrative Expenses	\$ 20,303	\$ 18,428

Schedule of Investment Expenses
for the Year Ended June 30, 2004

(Expressed in Thousands)

Management fees:		
Domestic managers	\$ 6,598	
Non-U.S. equity managers	16,527	
Fixed income managers	5,128	
Real estate managers	9,122	
Private equity managers	52,125	
Hedge fund managers	14,343	\$103,843
Performance fees		10,441
Total management and performance fees		114,284
Miscellaneous fees and expenses:		
Custodial fees	\$ 3,357	
Legal fees	170	
Other fees and expenses	495	4,022
In-House Investment Management:		7,991
Total investment expenses		\$126,297

Schedule of Professional and Consulting Services
for the Year Ended June 30, 2004

(Expressed in Thousands)

Actuarial, Legal and Oversight Services:			
Attorney General of Virginia	Legal Services	\$	176
Joint Legislative Audit Review Commission	Oversight Responsibilities		98
Troutman Sanders Mays & Valentine, LLP	Legal Services		157
Kaufman & Canoles	Legal Services		51
Gabriel, Roeder, Smith & Company	Actuarial Services		259
Watson Wyatt Worldwide	Disability Plan Consulting		5
Subtotal Actuarial, Legal, and Oversight Services		\$	746
Consulting Services:			
Bon Secours Memorial Regional Medical Center	Disability Medical Reviews	\$	84
Samuel R. Brown, PC	Fact Finding Hearing Officer for Disability Cases		2
Clear Management Human Resource Consultants	Organizational Consulting Services		7
CorVel Corporation	Physician Referral for Disability Cases		104
Cost Effectiveness Measurement Inc.	Cost Driver Benchmarking/Investment Cost Effectiveness Analysis		40
Carlos Deupi, AIA	Architectural Consulting Services		34
Genex/ROI	Disability Retirement Consulting Services		3
Georgeson Shareholder Communications, Inc.	Member Location Consulting Services		11
Katzen & Frye, PC	Fact Finding Hearing Officer for Disability Cases		11
McCaul, Martin, Evans & Cook, PC	Fact Finding Hearing Officer for Disability Cases		4
Medical Board	Medical Examiners		66
Mellon Consultants, LLC	Investment Consulting Services		82
Palmer & Cay Consulting Group	Consulting Services		115
Pension Consulting Alliance Inc.	Real Estate Services		65
Reed Smith, LLP	Professional Services		13
Steven P. Peterson, Independent Contractor	Systems Analysis for Public Equity Investments		73
Social Security Disability Consultants	Social Security Advocacy and Disability Tracking		523
Smartfish	Recruitment Consulting Services		204
Strategic Economic Decisions, Inc.	Economic Advisory Services		20
Virginia Commonwealth University Grants	Strategic Planning Consulting Services		65
Subtotal Consulting Services			1,526
Total		\$	2,272

A photograph of two people sitting at a table, engaged in a conversation. The person on the left is looking towards the person on the right. The person on the right is wearing glasses and has their hands clasped. A laptop is open on the table in front of them. The entire image has a teal color overlay.

INVESTMENT SECTION

Open Communication

NOT ONLY COMMUNICATING REGULARLY –
COMMUNICATING BETTER IN ORDER TO
SOLVE PROBLEMS.

Chief Investment Officer's Letter



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 18, 2004

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

The VRS investment fund posted a significantly above average return of 17.9% for the fiscal year. While much of the return was due to continuing improvement in both the domestic and international equity markets during the year, other asset classes such as real estate and hedge funds also had strong returns.

During the year, VRS continued to focus on its asset allocation policy. The Board completed its annual review of the policy, deliberating the appropriateness of its risk profile and adjusting capital market return expectations to reflect the current valuation framework. Based on results of this analysis, the fund will maintain a similar risk profile going forward but will continue to focus on diversifying its large equity exposure and slightly lowering its fixed income exposure in the face of rising interest rates.

There were relatively few changes in the management of the investment fund during the year. The new hedge fund program was gradually funded and now stands at 3% of the total portfolio. New tools are being developed in the area of risk management to allow the Board to better assess where it can add value for the risk it takes investing the portfolios. Additionally, VRS will complete a review of its Real Estate portfolio in the coming year.

This was another important year for VRS. The strong return will help to offset recent softness experienced in the markets. The asset allocation review has reaffirmed the objectives of the fund for the long-term with an eye toward current valuation issues and risks in the markets. The Board remains focused on other important issues, such as corporate governance, that can substantially impact the portfolio. All of these initiatives will serve to ensure the Board is continually working toward fulfilling its fiduciary responsibility to the participants and beneficiaries of the fund.

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 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 fiduciaries, 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.

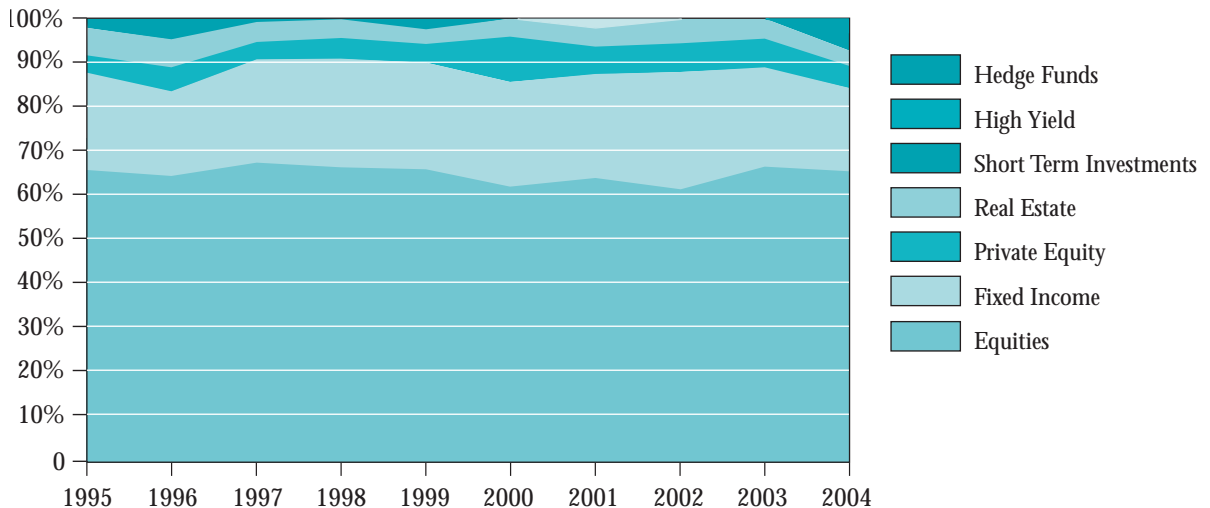
Investment Strategies

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, 2004.

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

Investment Comparison at Fair Market Value



Investment Results

Stock market returns were very strong during the year helping the fund achieve a positive return. Longer-term results are still impacted by the lower returns for the past several years. With the exception of fixed income, all asset classes posted strong returns for the year. Additionally, the fund's 10.3% annualized 10-year return remains well ahead of the 8% actuarial assumption.

Investment Performance Summary

Annualized Data for Period Ending June 30, 2004

	1 Year	3 Years	5 Years
1. Total Fund Time Weighted Returns			
VRS	17.9	3.8	3.7
Inflation (CPI)	2.1	2.1	2.4
Actuarial Assumed Return	8.0	8.0	8.0
2. Total Public Equity			
VRS	24.1	1.9	- 0.3
Custom Benchmark	24.0	1.8	- 0.3
3. Total Fixed Income			
VRS	1.0	6.5	7.1
Custom Benchmark.	0.3	6.3	6.9
4. Total Real Estate			
VRS	13.1	10.2	11.0
Custom Benchmark	13.9	8.8	10.5
5. Total Hedge Funds			
VRS	9.5	n/a	n/a
Custom Benchmark	8.1	n/a	n/a
6. Total Private Equity			
VRS	27.8	1.2	16.9
Custom Benchmark	41.0	4.6	2.8

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, 2004 and 2003 (in thousands):

	2004 Fair Value	% of Total Value	2003 Fair Value	% of Total Value
Bonds and Mortgage Securities:				
U. S. Government and agencies	\$ 2,284,001	5.67%	\$ 2,141,042	6.02%
Mortgage securities	3,307,543	8.21%	3,190,994	8.97%
Corporate and other bonds	1,574,856	3.91%	2,981,273	8.38%
Total bonds and mortgage securities	<u>7,166,400</u>	<u>17.79%</u>	<u>8,313,309</u>	<u>23.37%</u>
Common and Preferred Stocks	14,224,149	35.33%	8,657,200	24.34%
Index and Pooled Funds:				
Equity index and pooled funds	11,728,611	29.13%	12,890,439	36.24%
Fixed income commingled funds	1,225,707	3.04%	104,739	0.30%
Total index and pooled funds	<u>12,954,318</u>	<u>32.17%</u>	<u>12,995,178</u>	<u>36.54%</u>
Real Estate:				
Commingled funds	466,521	1.16%	415,365	1.17%
Properties	5,500	0.01%	11,335	0.03%
Real estate loans	459	0.00%	3,554	0.01%
Focused	619,699	1.54%	667,911	1.88%
Total real estate	<u>1,092,179</u>	<u>2.71%</u>	<u>1,098,165</u>	<u>3.09%</u>
Private Equity	1,996,233	4.96%	2,177,483	6.12%
Hedge Funds	1,195,556	2.97%	-	0.00%
Short-Term Investments:				
Treasurer of Virginia –				
Local Government Investment Pool	262,700	0.65%	138,620	0.39%
TBC Pooled Employee Trust Funds	1,336,210	3.32%	2,133,180	6.00%
Foreign currencies	39,092	0.10%	53,645	0.15%
Total short-term investments	<u>1,638,002</u>	<u>4.07%</u>	<u>2,325,445</u>	<u>6.54%</u>
Total investments	<u>\$ 40,266,837</u>	<u>100.00%</u>	<u>\$ 35,566,780</u>	<u>100.00%</u>

Portfolio Highlights

Public Equity

The Total Public Equity Program totaled \$26.9 billion at year-end, approaching 67% of the total fund. Approximately 71% was invested in Domestic Equity and 29% in International Equity. Fifty-six percent of the Total Public Equity portfolio was invested in passive strategies and 23% managed internally. The objective of the portfolio is to exceed the return of the Strategic Benchmark over 3 year periods net of all costs. At year-end, the Strategic Benchmark was comprised of 70% Russell 3000 and 30% of the S&P/Citigroup BMI Global x US.

The Total Public Equity Program outperformed the Strategic Benchmark during the fiscal year by 0.15%. During the year, the Russell 3000 was up 20.5% and the BMI Global x US was up 34.0%.

Value stocks gained ground, especially in the mid and smaller capitalization companies both internationally and domestically.

	VRS Return*	Benchmark Return*	VRS Weight	Benchmark Weight
Russell 1000	20.2%	19.5%	48.1%	52.4%
Russell 2000	30.2%	33.4%	4.7%	4.5%
Russell 3000	19.9%	20.5%	5.3%	5.4%
Russell Special Small Cap	32.3%	28.7%	1.0%	0.9%
S&P 500	20.3%	19.1%	4.6%	4.4%
S&P/Citigroup PMI World	N/A	24.2%	12.1%	8.1%
S&P/Citigroup PMI Emerging	41.2%	32.7%	4.3%	2.4%
S&P/Citigroup EMI World ex US	48.6%	44.4%	5.8%	4.9%
S&P/Citigroup PMI World ex US	30.4%	31.2%	14.1%	17.0%
Total Program	24.1%	24.0%	<u>100.0%</u>	<u>100.0%</u>

*1-Year Total Return June 30, 2004

Weights as of June 30, 2004

The VRS portfolio remained fairly close to the Strategic Benchmark Sectors and Region weights.

Sectors**	Strategic		Regions **	Strategic	
	VRS	BM		VRS	BM
Energy	9.1%	9.4%	Americas	72.8%	71.1%
Materials	4.8%	4.6%	Europe	16.0%	17.9%
Capital Equipment	12.1%	11.7%	Pacific Rim	10.4%	10.5%
Consumer Goods	19.8%	20.3%	Middle East /Africa	0.8%	0.5%
Services	27.3%	28.0%			
Finance	22.2%	22.8%			
Multi-Industry	2.9%	2.9%			
Gold Mines	0.1%	0.3%			
Other	1.7%	0.0%			

**Barra Sectors, Regions & Weights

The top 10 holdings in the Total Public Equity program comprised 12.4% of the program at year-end. In comparison to last year, three companies have fallen from the list. Merck & Co., International Business Machines and WAL-MART Stores were replaced with American International Group, Bank of America and Cisco Systems.

Company	Market Value	Shares
General Electric Co	\$ 468,633,406	14,475,665
Microsoft Corp.	404,837,457	14,174,981
Pfizer Inc.	400,730,149	11,689,911
Exxon Mobil Corp.	399,905,078	9,004,843
Citigroup Inc.	399,002,505	8,580,699
Intel Corp.	285,036,102	10,327,395
Bank of America Corp.	278,822,477	3,294,995
Cisco Sys Inc.	245,880,011	10,374,684
Johnson & Johnson	231,132,775	4,149,601
American Intl Group Inc.	223,135,054	3,130,402

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 20% 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 37% 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.

Interest rates increased moderately over the last fiscal year as economic growth accelerated and the Federal Reserve began to remove the stimulative monetary policy that had been in place for several years. Despite the defensive interest rate environment, corporate bonds and other types of spread products continued to look relatively attractive to investors, and the extra yield on these investments helped offset the erosion in prices resulting from higher interest rates. While in the short run higher interest rates create a drag on total return, the portfolio will benefit from higher interest rates over the long term.

The fixed income program return was 1.0% for the fiscal year. This was below our long-term expected return for bonds, but well ahead of the program benchmark of 0.3%.

VRS Fixed Income Top 10 Holdings By Market Value		
As of June 30, 2004		
Par	Security Description	Market Value
47,383,245 shares	SSGA Intermediate Credit Index SL Fund	\$ 813,143,873
13,006,795 shares	SSGA Long SL Fund	226,357,254
12,924 shares	PRIVEST Commingled Fund	186,332,638
153,000,000	FNMA 5.5000% 30-year MBS	152,576,649
101,200,000	GNMA 5.50% 30-year MBS	101,010,250
93,000,000	FHLMC 5.5000% 30-year MBS	92,772,150
81,400,000	FNMA 5.5000% 30-year MBS	80,980,285
76,620,000	FNMA 6.000% 30-year MBS	78,176,344
65,000,000	FNMA 6.000% 30-year MBS	66,455,610
40,015,000	U.S. Treasury Bonds 8.125% due 8/15/2019	40,015,000
50,860,000	U.S. Treasury Notes 2.500% due 5/31/2006	50,684,532

Fixed Income Portfolio	
As of June 30, 2004	
<i>Sector Allocation:</i>	
Sector	% Portfolio
Treasury	18.1%
Agency	10.5%
Corporate	29.3%
Mortgage	33.6%
Asset Backed	1.3%
CMBS	2.3%
Foreign	1.6%
Other	3.3%
Total	<u>100.0%</u>
<i>Credit Quality Breakdown:</i>	
Sector	% Portfolio
Government	63.1%
AAA	6.6%
AA	2.4%
A	17.9%
BBB	7.2%
BB	1.5%
B	0.6%
Below B	0.1%
NR	0.6%
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 .98% over 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 Private Equity, Hedge Funds and Real Estate. At June 30, 2004, Alternative Investments comprised 11.5% of the total fund portfolio.

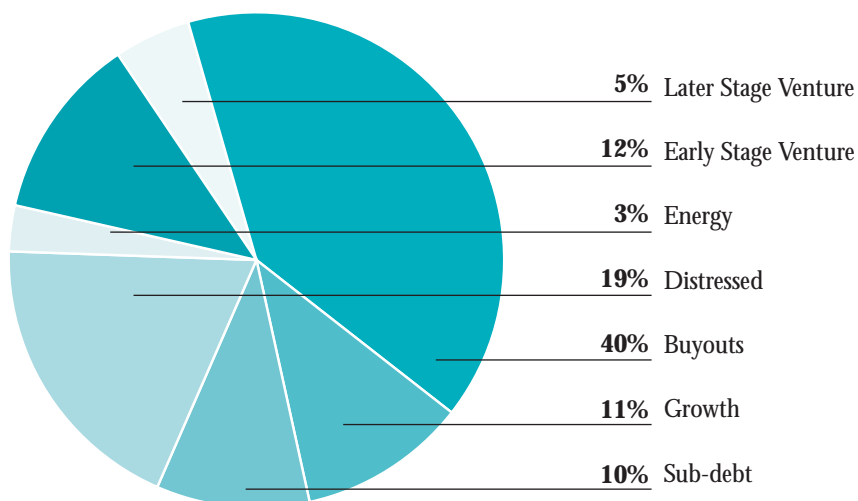
Private Equity

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 dollar weighted 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 17.2%.

As of June 30, 2004, the appraised value of the program was approximately \$2.0 billion. The majority of the program is invested in limited partnerships. Other sectors include growth, mezzanine, distressed, and energy.

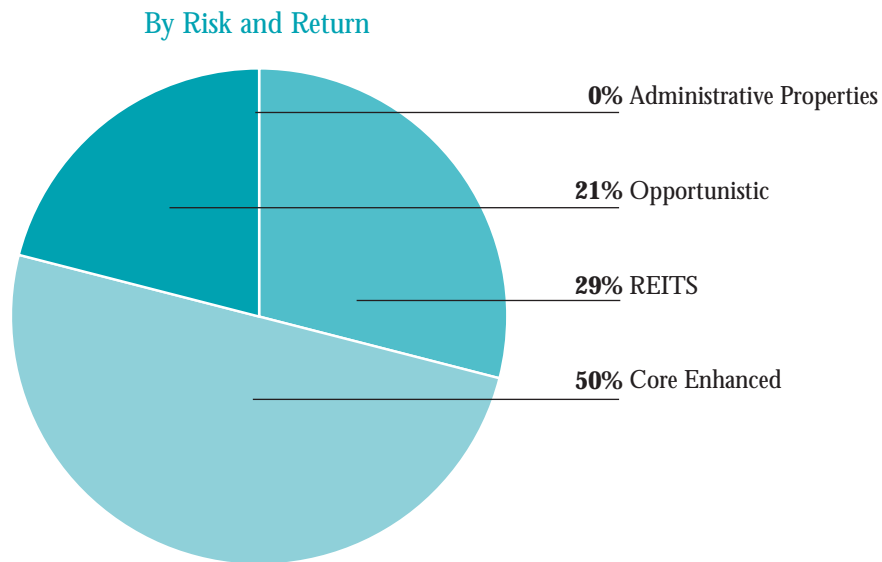
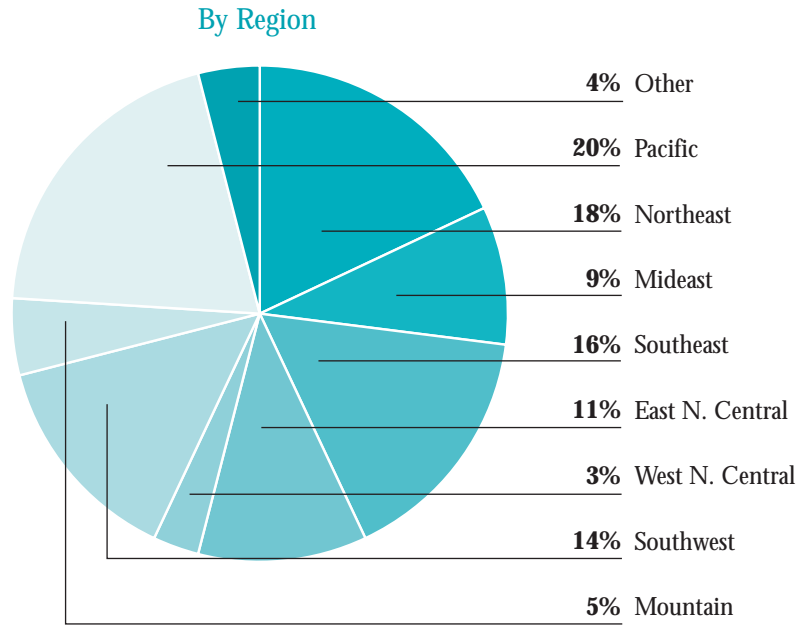
The Private Equity program rebounded substantially over the past twelve months, due primarily to a relaxation in debt capital markets and a more favorable macro-economic climate. The one-year time-weighted return as for 2004 was 27.8%, versus a negative 10.8% for 2003. Long-term returns remain strong, as evidenced by the five-year time-weighted return of 16.9% and the since inception annualized return of 16.2%. The breakdown of the Program by sub-class was as follows:



Real Estate

A portion of the portfolio is invested in real estate to help diversify the total fund by providing exposure to an asset class that has a low correlation with the public markets. Real estate produced a 13.1% return for the fiscal year, 10.2% over the past three years and 11.0% over five years, underperforming its benchmark by 81 basis points for the fiscal year, and outperforming by 143 basis points for three years and 49 basis points over the five-year period.

Over the course of the year, the percentage of the total fund represented by the real estate portfolio was reduced from 4.5% to 3.7% as our managers found better opportunities to sell properties than to buy and the total fund grew. At fiscal year end, the composition of the portfolio was approximately 29% public real estate (mostly REITs) and 71% in private assets. Debt as a percentage of total real estate assets remained at a conservative level of 32.4%.



VRS Money Managers

The diversified investment structure as of June 30, 2004 is reflected in the following table, which lists VRS managers by investment program and style.

<i>VRS Public Equity Money Managers</i>	
<i>External</i>	<i>Style Description</i>
Acadian Asset Management	Non U.S. Small & Emerging Markets
Alliance Bernstein	Global
Aronson + Johnson + Ortiz	U.S. Small & U.S. Large
Arrowstreet Capital	Global
Ashmore Investment Management	Emerging Markets
BlackRock	Non U.S. Small
Capital Guardian Trust Company	Global
Credit Suisse Asset Management	U.S. Large
Franklin Portfolio Associates	U.S. Small
Freeman Associates Investment Management	U.S. Large
Fuller & Thaler Asset Management	U.S. Large
Goldman Sachs Asset Management	U.S. Small & Global
Grantham, Mayo and Van Otterloo & Company	Non U.S. Small
Hermes Focus Asset Management	Non U.S. Large
J.P. Morgan Investment Management	U.S. Large
LSV Asset Management	Non U.S. Small
Relational Investors	U.S. Large
State Street Global Advisors	U.S. Large & Non U.S. Large
Symphony Asset Management	U.S. Large
T. Rowe Price	Emerging Markets
The Boston Company	Emerging Markets
TimesSquare Capital Management	U.S. Small
Wellington Management	Non U.S. Large & Global
<i>Internal</i>	<i>Style Description</i>
Potomac Core	U.S. Large
Madison	U.S. Large
York Value	U.S. Large
<i>Fixed Income</i>	<i>Style Description</i>
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

<i>Real Estate Program</i>	
Public Real Estate Securities	Account
ING • Clarion	REIT Portfolio
Private Real Estate	Account
Blackstone Real Estate Partners Colonnade Capital Hines JER Partners Koll Bren Schreiber Lazard Frères Oaktree Capital Management Prudential Security Capital TA Associates	Fund IV MCPI 1997 and 1999 US Office Dev. Funds Funds I, II & III Funds IV & V Fund II and Strategic Realty Investors II Fund B PRISA II, Separate Account and SPF-II European Realty Separate Account
Directly Owned	Account
VRS	Parking Garage

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

Virginia Retirement System
Top Brokers by Commissions
Fiscal Year 2004

Broker name	Commission
Merrill Lynch Pierce Fenner Smith Inc.	\$ 3,446,308
Investment Tech Group Inc.	2,375,860
Deutsche Banc Alex Brown Inc.	2,141,799
Union Bank Switzerland Secs	2,087,681
Citigroup GBL Mkts/Salomon	2,032,270
Credit Lyonnais	2,010,028
Lehman Brothers, Inc.	1,421,614
Morgan Stanley & Co.	1,133,204
Goldman, Sachs & Co.	1,113,121
Banc of America Secs LLC	687,687
Weeden & Co.	606,042
Credit Suisse First Boston Corp	510,360
JP Morgan Chase	465,522
Bear Stearns & Co. Inc.	414,493
Instinet Corp. Institutional	323,588
SBC Warburg Dillon Read	151,566
Hong Kong & Shanghai BKG Corp.	150,612
Neuberger and Berman	147,438
Prudential Securities Inc.	117,426
Jeffries & Co. Inc.	112,057
Samsung Secs	106,259
Schwab Charles & Co Inc.	100,956
Other Brokers	2,459,640
Total U.S. Commissions	<u>\$ 24,115,531</u>

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



ACTUARIAL SECTION

Teamwork

DOING MORE THAN ONE'S PART OF
THE TEAM -DOING EVERYTHING POSSIBLE
TO MAKE THE ENTIRE TEAM SUCCEED.

**GABRIEL, ROEDER, SMITH & COMPANY**

Consultants & Actuaries

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

November 6, 2003

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

Subject: Actuarial Valuation as of June 30, 2003

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, 2003, 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 to be effective for the two-year period beginning one year after the valuation date. In other words, the employer contribution rate determined by the June 30, 2003 actuarial valuation will be effective for the period beginning July 1, 2004 and ending June 30, 2006.

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 valuation report are (i) to determine the 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. Please note that if the “pooled” rate is contributed then the contribution to the Teacher’s Plan will be less than the Annual Required Contribution (ARC).

The contribution rates determined by this valuation are applicable for the two-year period beginning July 1, 2004, one year after the valuation date. The rates in this valuation are intended to be sufficient to pay the normal cost and to amortize the unfounded actuarial accrued liability (UAAL) in level percentage of payroll payments over a period of 23 years from the current valuation date, June 30, 2003. 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 off- number 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 the State Employees, Teachers, and State Police plans since the last actuarial valuation. The decrease in the funded ratio is primarily due to asset losses on the actuarial value of assets. The Judicial and Virginia Law Officers plans saw their funded ratios improve slightly. These plans also suffered losses on the actuarial value of assets, but they also had large actuarial gains on the liability side that more than offset the asset losses from a funded ratio point of view.

The calculated employer contribution rates increased for all of the groups except for the Judicial plan which decreased slightly. The calculated rates reflect the full pre-funding 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. There were several technical changes to the statutes along with a couple of minor benefit provision changes. None of the changes were material from an actuarial viewpoint.

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

Assumptions and Methods

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan’s actuary. No assumptions in this valuation have been changed from those used for the 2002 valuation.

Data

Member data for retired, active, and inactive participants was supplied as of June 30, 2003, 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



Joe Newton
Senior Analyst

Solvency Test

(Expressed in Thousands)

Valuation Date (June 30)	Aggregate Accrued Liabilities for			Valuation Assets	Portion of Accrued Liabilities Covered by Assets		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members*		(1)	(2)	(3)
Virginia Retirement System (VRS)							
2003	\$ 5,703,557	\$ 17,223,070	\$ 17,770,944	\$ 39,242,624	100.00%	100.00%	91.81%
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)							
2003	\$ 59,097	\$ 277,282	\$ 279,243	\$ 508,576	100.00%	100.00%	61.67%
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)**							
2003	\$ 135,144	\$ 195,554	\$ 523,138	\$ 457,615	100.00%	100.00%	24.26%
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)							
2003	\$ 28,766	\$ 198,005	\$ 121,265	\$ 282,326	100.00%	100.00%	45.81%
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	2002/2003
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)					
2003	300,612	\$ 10,884,629	\$ 36,208	1.1%	559
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)					
2003	1,727	\$ 79,020	\$ 45,756	(1.3%)	1
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)*					
2003	9,626	\$ 291,801	\$ 30,314	(0.6%)	1
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)					
2003	408	\$ 47,568	\$ 116,588	0.0%	1
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)					
2003	7,920/3,554	106,418	\$ 1,537,902	11.8%	\$ 14,452
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)					
2003	63/25	810	\$ 23,737	18.2%	\$ 29,305
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)***					
2003	248/10	765	\$ 15,982	72.7%	\$ 20,892
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)					
2003	35/26	375	\$ 20,488	8.3%	\$ 54,635
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.
<ul style="list-style-type: none"> • Pre-Retirement • Post-Retirement • Post-Disablement 	<p>1994 Group Annuity Mortality Table for males and females.</p> <p>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).</p> <p>70% of PBGC Disabled Mortality Table 5a for Males. 90% of PBGC Disabled Mortality Table 6a for Females.</p>

Retirement Rates

State Employees and Employees of Political Subdivisions

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

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

Retirement Rates, continued

Teachers

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

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

Judicial Retirement System

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

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

Disability Rates

As shown below for selected ages.

State Employees and Employees of Political Subdivisions

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

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

Teachers

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

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

Disability Per 100 Members		
Age	Male	Female
20	–	–
30	0.019	–
40	0.400	–
50	1.350	–
60	–	–

Judicial Retirement System

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

Termination Rates

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

State Employees and Employees of Political Subdivisions

Probability of Decrement Due to Withdrawal										
Years of Service—Male Members						Years of Service—Female Members				
Age	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										
Years of Service—Male Members						Years of Service—Female Members				
Age	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										
Years of Service—Male Members						Years of Service—Female Members				
Age	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 23 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% of the larger of current credible compensation or final average compensation times the number of years to be purchased or actuarial cost). 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

Eligibility

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

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.

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.

2003 Valuation

No actuarially material changes were made in the plan provisions. Listed below are two minor changes of note.

1. School superintendents with five years of service may now purchase an additional ten years of out-of-state service. The superintendent must not be eligible for an out-of-state benefit.
2. The leveling option was restored as an optional form of payment. Benefits may be leveled to age 62 or older, and the benefits cannot reduce more than 50%. Any COLAs are calculated on the basic benefit amount.

A woman is shown in profile, resting her chin on her hand. The image is overlaid with a teal color. The text is centered on the image.

STATISTICAL SECTION

Customer Service

NOT ONLY MEETING EXPECTATIONS
IN CUSTOMER SERVICE BUT
SETTING NEW BENCHMARKS.

Pension Trust Funds

Analysis of Changes and Growth in Plan Net Assets

For the Years Ended June 30

(Expressed in Millions)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Net Assets Available, Beginning of Year	15,449	18,215	21,460	26,057	30,784	34,634	39,786	36,693	33,456	33,781
Employee and Employer Contributions	900	879	913	1,131	1,141	1,291	1,270	1,044	1,042	1,185
Benefit and Administration Expenses	(834)	(934)	(1,017)	(1,090)	(1,176)	(1,282)	(1,394)	(1,529)	(1,687)	(1,865)
Net Funding	66	(55)	(104)	41	(35)	9	(124)	(485)	(645)	(680)
Investment Income:										
Interest, Dividends, and Other Investment Income	707	413	504	534	551	705	785	624	569	461
Net Appreciation (Depreciation) in Fair Value	1,993	2,887	4,197	4,152	3,334	4,438	(3,754)	(3,376)	401	5,477
Net Investment Income	2,700	3,300	4,701	4,686	3,885	5,143	(2,969)	(2,752)	970	5,938
Net Assets Available, End of Year	18,215	21,460	26,057	30,784	34,634	39,786	36,693	33,456	33,781	39,039

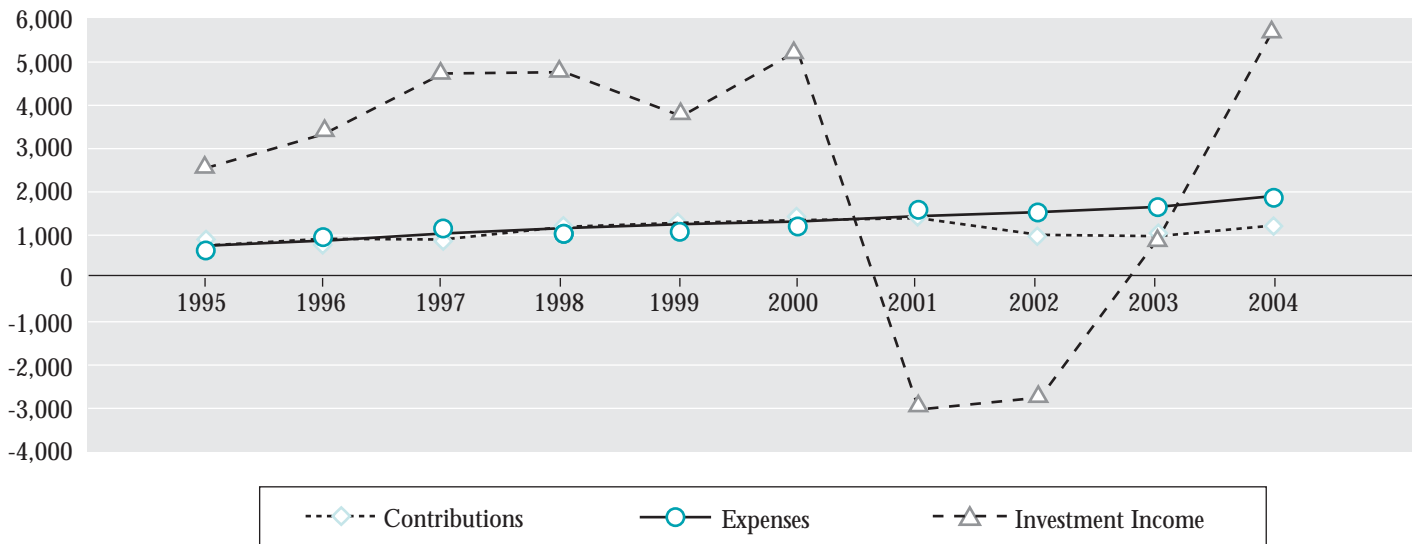
FY 1995 and 1996 Net Appreciation was restated to reflect adjustments from conversion to GASB 25 presentation.

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

Pension Trust Funds Additions Versus Deductions

Fiscal Years 1995 – 2004

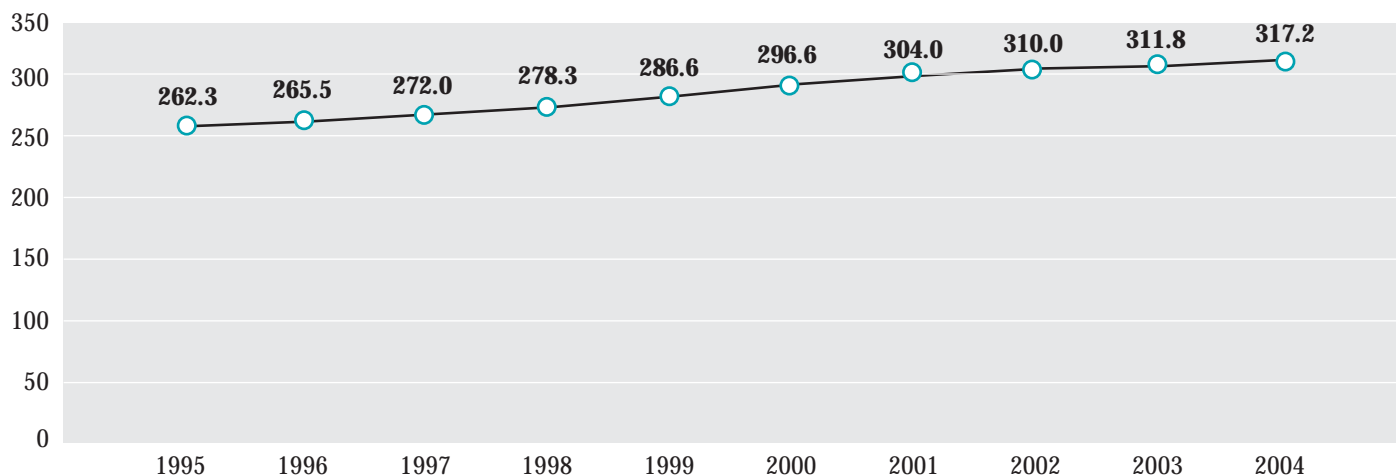
(Millions of Dollars)



Number of Active Members

Fiscal Years 1995 – 2004

(Expressed in Thousands)



Schedule of Retirement Contributions by System

Fiscal Years 1995 – 2004

(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				
2004	\$ 292,895	\$ 515,750	\$ 287,228	\$ 1,095,873	\$ 15,232	\$ 56,292	\$ 17,758	\$ 1,185,155
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

* 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 and State in July 2003.

STATISTICAL SECTION

Pension Trust Funds Additions by Source

Fiscal Years 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Member Contributions	Employer Contributions		Investment Income	Other	Total
		For Members	Employer Share			
Virginia Retirement System (VRS)						
2004	\$ 85,769	\$ 564,020	\$ 446,084	\$ 5,751,277	\$ 908	\$ 6,848,058
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
State Police Officers' Retirement System (SPORS)						
2004	\$ 790	\$ 4,037	\$ 10,405	\$ 73,977	\$ –	\$ 89,209
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
Virginia Law Officers' Retirement System (VaLORS)						
2004	\$ 880	\$ 14,703	\$ 40,709	\$ 70,668	\$ –	\$ 126,960
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)						
2004	\$ 197	\$ 2,371	\$ 15,190	\$ 40,947	\$ –	\$ 58,705
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

* 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.

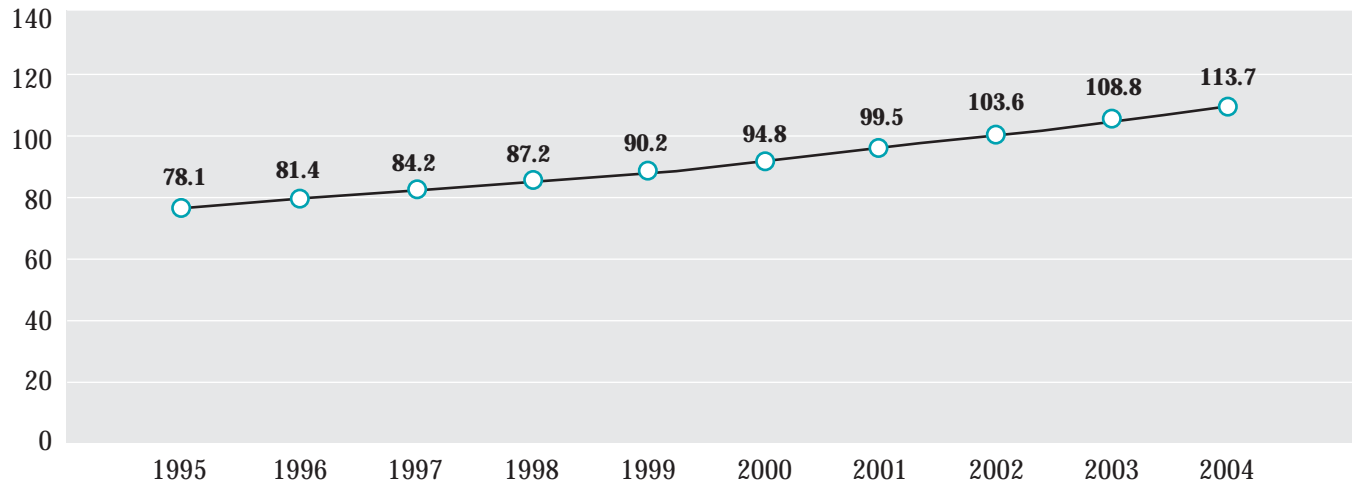
*** In fiscal year 1998, employer contributions increased to begin prefunding cost of living adjustments (COLAs) for retirees.

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

Number of Retired Members

Fiscal Years 1995 – 2004

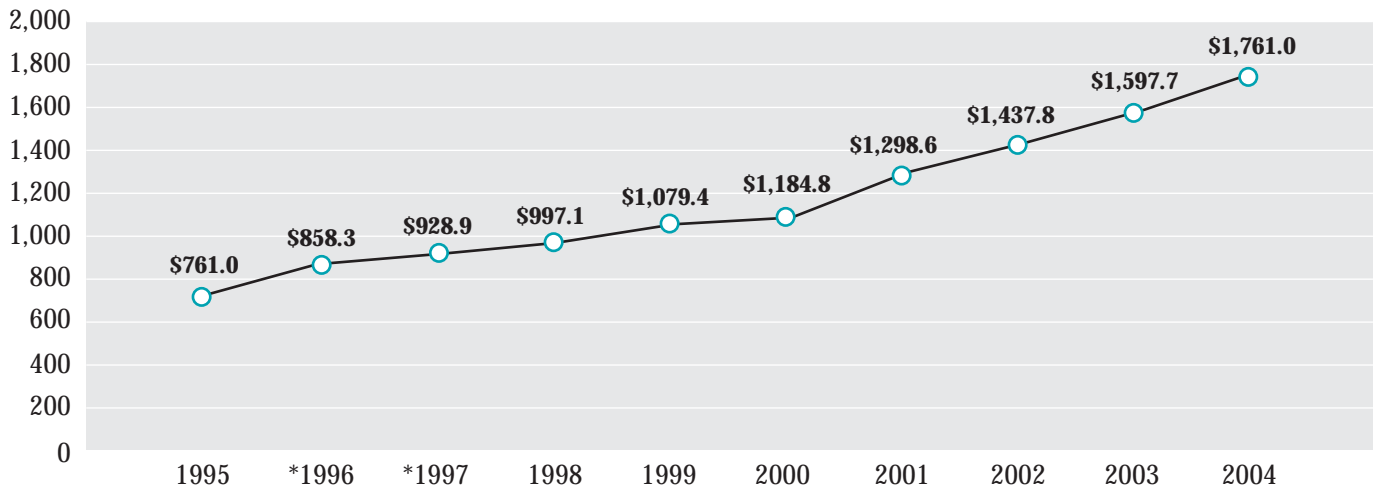
(Expressed in Thousands)



Retirement Benefits Paid

Fiscal Years 1995 – 2004

(Millions of Dollars)



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

STATISTICAL SECTION

Pension Trust Funds Deductions by Type

Fiscal Years 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Retirement Benefits	Refunds	Administrative Expenses	Other	Total
Virginia Retirement System (VRS)					
2004	\$ 1,692,166	\$ 80,237	\$ 18,119	\$ –	\$ 1,790,522
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
State Police Officers' Retirement System (SPORS)					
2004	26,336	\$ 731	\$ 213	\$ –	\$ 27,280
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
Virginia Law Officers' Retirement System (VaLORS)					
2004	\$ 19,784	\$ 3,998	\$ 196	\$ –	\$ 23,978
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)					
2004	\$ 22,706	\$ –	\$ 117	\$ –	\$ 22,823
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

* 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 1995 – 2004

(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				
2004	\$ 552,282	\$ 855,113	\$ 284,771	\$ 1,692,166	\$ 26,336	\$ 19,784	\$ 22,706	\$ 1,760,992
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

* 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 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Service Benefits	Disability Benefits	Survivor Benefits	Total
2004	\$ 1,537,173	\$ 210,385	\$ 13,434	\$ 1,760,992
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

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

Schedule of Refunds by Type

Fiscal Years 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Separation	Death	Total
2004	\$ 73,715	\$ 11,251	\$ 84,966
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

Schedule of Retired Members by Type of Benefit and Option Selected

As of June 30, 2004

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	14,120	12,019	3	-	1	1,013	520	68	4	492
201 - 400	18,185	14,396	132	-	-	2,394	391	136	19	717
401 - 600	14,711	10,866	358	4	-	2,612	208	238	28	397
601 - 800	11,507	8,170	463	19	1	2,100	131	354	21	248
801 - 1,000	9,272	6,366	608	67	3	1,555	79	357	8	229
1,001 - 1,200	7,448	4,962	661	177	3	1,136	65	252	5	187
1,201 - 1,400	6,092	4,011	629	215	16	831	30	200	4	156
1,401 - 1,600	5,435	3,574	616	282	25	590	35	164	3	146
1,601 - 1,800	5,037	3,257	496	544	37	424	19	135	1	124
1,801 - 2,000	5,122	3,322	375	799	37	357	22	128	-	82
Over 2,001	16,788	12,296	752	2,309	175	731	59	285	2	179
Totals	113,717	83,239	5,093	4,416	298	13,743	1,559	2,317	95	2,957

Min. Guar. Amount of Retirement Benefit

Min. Guar. Amount of Retirement Benefit	Option Selected																	
	A	B	C	D	E	F	G	H	K	L	M	N	R	V	X	Y	Z	
\$ 1 - 200	11,190	102	542	234	1,203	3	1	90	6	-	2	656	11	72	1	6	1	
201 - 400	14,277	42	624	460	1,040	7	-	824	34	2	19	651	5	175	6	15	4	
401 - 600	10,736	41	521	522	977	15	-	1,161	77	-	27	450	3	152	7	18	4	
601 - 800	8,036	30	442	553	879	13	-	893	69	-	38	334	4	170	14	24	8	
801 - 1,000	6,243	10	371	584	841	23	-	598	45	1	22	292	3	178	8	41	12	
1,001 - 1,200	4,835	2	352	535	768	16	-	381	30	1	14	225	5	192	14	59	19	
1,201 - 1,400	4,002	3	288	461	521	21	-	235	23	1	10	178	11	199	15	89	35	
1,401 - 1,600	3,575	1	283	419	424	34	-	145	6	-	5	161	4	221	18	115	24	
1,601 - 1,800	3,488	-	208	379	292	35	-	66	5	-	1	142	6	199	14	160	42	
1,801 - 2,000	3,615	-	166	362	219	37	-	56	5	-	1	161	7	190	21	228	54	
Over 2,001	11,086	1	556	1,107	372	201	-	71	12	-	1	716	135	1,037	195	1,010	288	
Totals	81,083	232	4,353	5,616	7,536	405	1	4,520	312	5	140	3,966	194	2,785	313	1,765	491	

- 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
- X = Advance Pension Option
- Z = PLOP with survivor

Retirement Breakdown: During fiscal year 2004, 90% of all retirements were service retirements, and 10% were certified as disability retirements by the Medical Board.

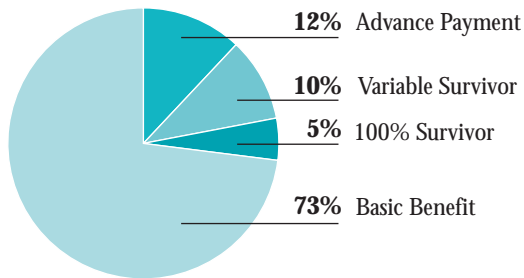
Schedule of Average Benefit Payments

Retirement Effective Date July 1, 1999, to June 30, 2004

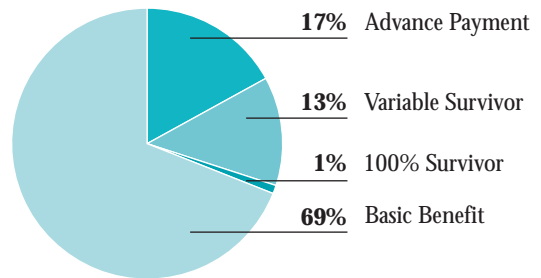
		Years of Credited Service					
		1-10	11-15	16-20	21-25	26-30	Over 30
FY 2004	Average Monthly Benefit.....	\$ 311.29	\$ 492.98	\$ 716.50	\$ 1,057.30	\$ 1,726.91	\$ 2,396.00
	Number of Active Retirants.....	694	711	867	851	1,582	2,935
FY 2003	Average Monthly Benefit.....	\$ 326.30	\$ 473.50	\$ 686.13	\$ 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

Distribution of Retirees by Payment Option Selected

All Retirees at June 30, 2004



2004 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.

Advance Payment:

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.

Partial Lump Sum

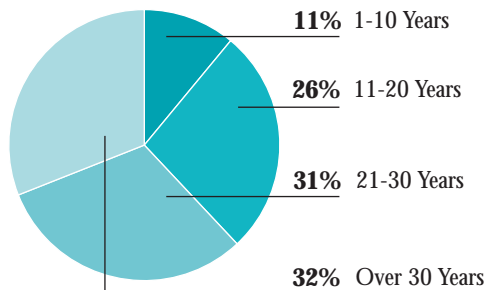
This option allows the member with earned service beyond their normal retirement date to elect a lump sum payment equal to the sum of 12, 24, or 36 payments of the standard monthly life annuity. The member's monthly benefit will be actuarially reduced to reflect the lump sum payment.

100% Survivor:

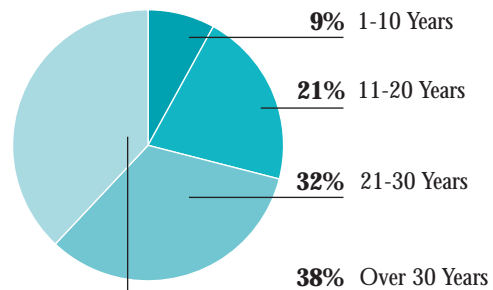
The basic benefit is reduced during the member's lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

Distribution of Retirees by Years of Service

All Retirees at June 30, 2004

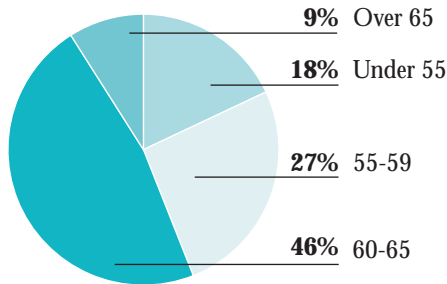


2004 Retirees

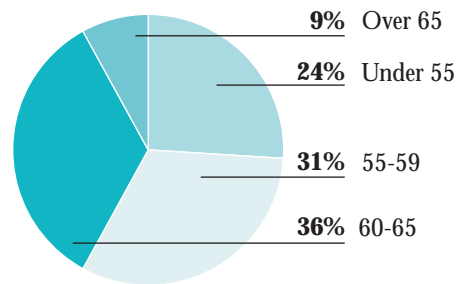


Distribution of Retirees by Age at Retirement

All Retirees at June 30, 2004

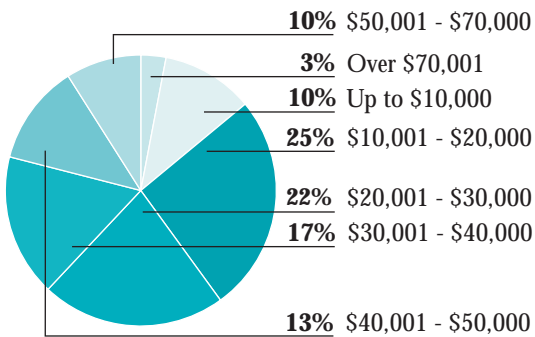


2004 Retirees

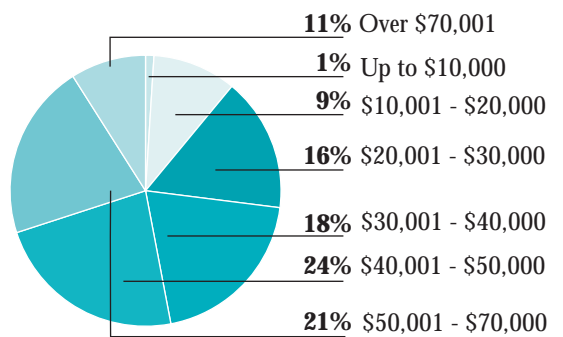


Distribution of Retirees by Average Final Salary

All Retirees at June 30, 2004



2004 Retirees



Other Employee Benefit Trust Funds

Schedule of Group Insurance Additions by Source

Fiscal Years 1995–2004

(Expressed in Thousands)

Year Ended June 30	Contributions				Investment Income (Loss)	Other	Total
	State	Teacher	Political	Sub-Total			
2004*	\$ 1	\$ –	\$ 19	\$ 20	\$ 133,715	\$ –	\$ 133,735
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

* The group life insurance contribution rates for fiscal years 2004, 2003, 2000, 1999 and 1997 were zero. Amounts shown are adjustments and contributions for new employers. 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 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Active Claims	Retired Claims	Total
2004	\$ 42,290	\$ 63,741	\$ 106,031
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

Schedule of Retiree Health Insurance Credit Additions and Reimbursements

Fiscal Years 1995 – 2004

(Expressed in Thousands)

Year Ended June 30	Additions			Total	Health Insurance Reimbursements
	Contributions	Investment Income (Loss)	Other		
2004	\$ 78,383	\$ 15,582	\$ –	\$ 93,965	\$ 64,920
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

* 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, 2004

Political Subdivisions (419)

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

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

Southside Planning
District Commission
Southside Regional Jail
Southside Regional Juvenile
Group Home Commission
Southside Regional Library Board
Southwest Virginia Regional Jail
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 Commission
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 Peninsula Regional Jail
Virginia Peninsulas
Public Service Authority
Washington County Service Authority
Waynesboro Redevelopment &
Housing Authority
Western Tidewater
Community Services Board
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 & Queen County Schools*
King George 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 (234)**

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 salaried (full-time or part-time) 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, 2004 and 2003

	2004	2003
Plan Assets on July 1	\$ 513,766,036	\$ 450,283,729
Contributions	81,146,682	75,891,469
Distributions	(30,962,780)	(25,947,422)
Plan Transfers ¹	492,087	155,412
Third Party Administration Fees ²	(1,615,771)	(1,279,994)
Period Earnings	69,344,804	15,365,921
Net Decrease/Increase in the Present Value of Annuitants' Future Benefits	(748,846)	(703,079)
Plan Assets on June 30	<u>\$ 631,422,212</u>	<u>\$ 513,766,036</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 5,505 employees enrolled in the Commonwealth's 457 Deferred Compensation Plan during the 2003–2004 fiscal year. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became effective January 1, 2002, allowing increased tax deferred savings and to have 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 2004 increased to \$81,146,682 from \$75,891,469 in FY 2003.

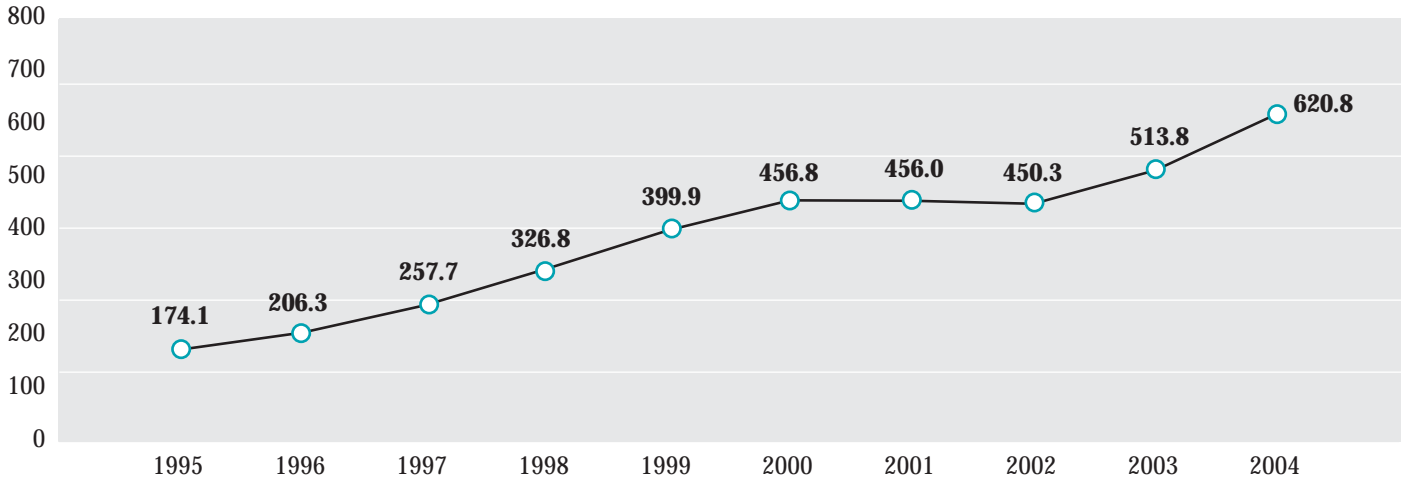
EGTRRA also made the 457 Plan attractive for employees of colleges and universities by removing the coordination between 457 Plans and 403(b) tax-deferred accounts. From the effective date of EGTRRA to June 30, 2004 the number of college and university employee Plan accounts increased from 287 in FY 2001* to 2,203 in FY2004.

*2001 is the baseline year. EGTRRA was effective January 1, 2002.

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, 2004, 1,121 Plan participants used the trustee to trustee transfer provision to buy VRS service credit with \$5,273,742 transferring from the 457 Plan to the defined benefit plan.

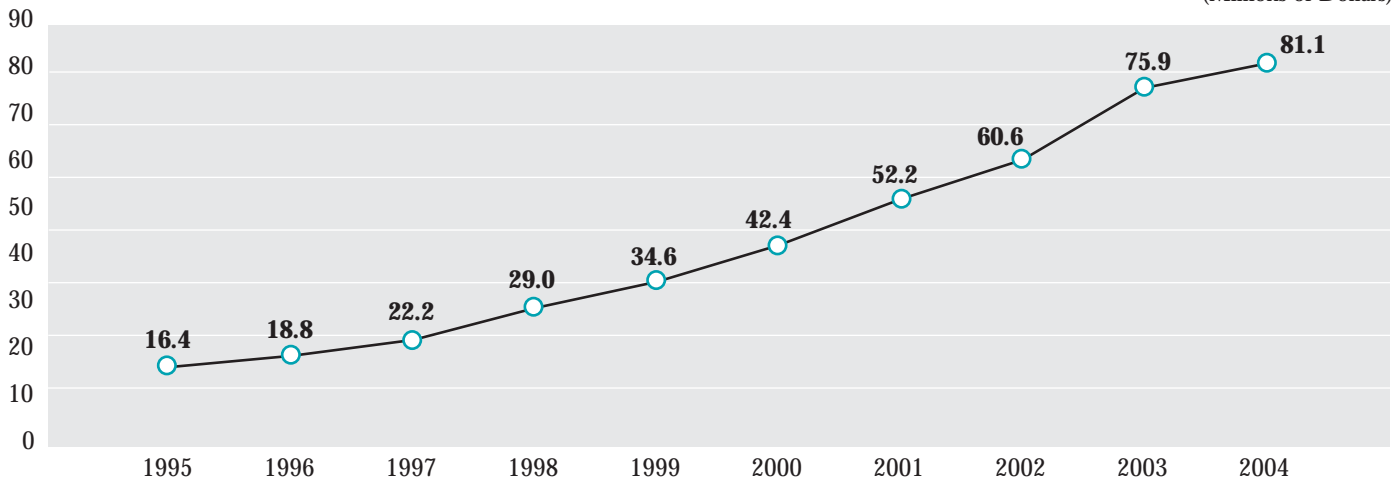
Deferred Compensation Program Assets

(Millions of Dollars)



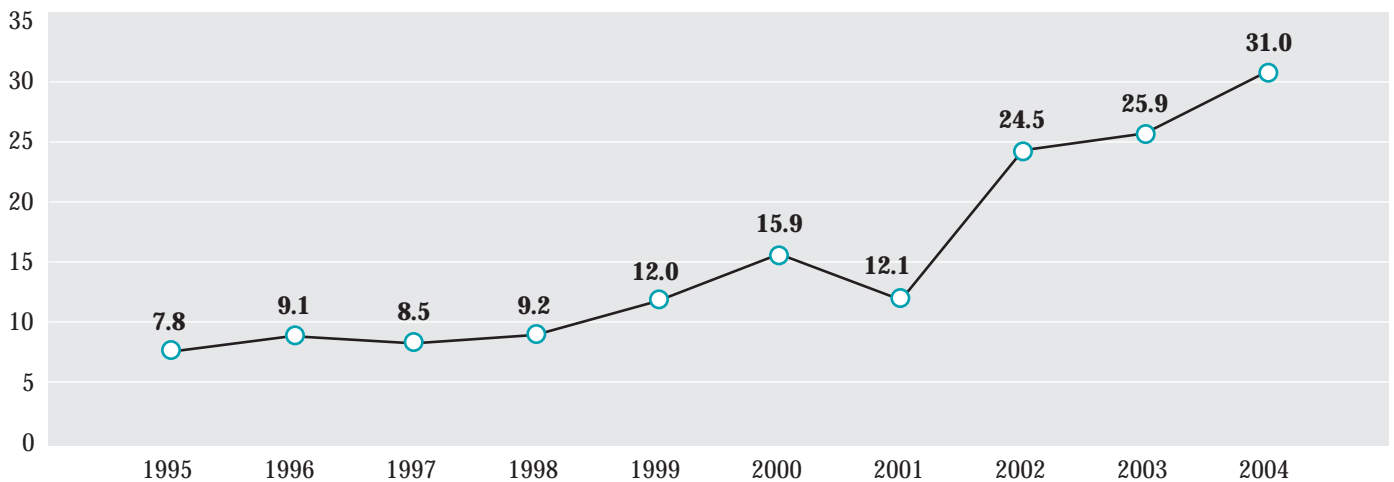
Contributions to the Deferred Compensation Plan

(Millions of Dollars)

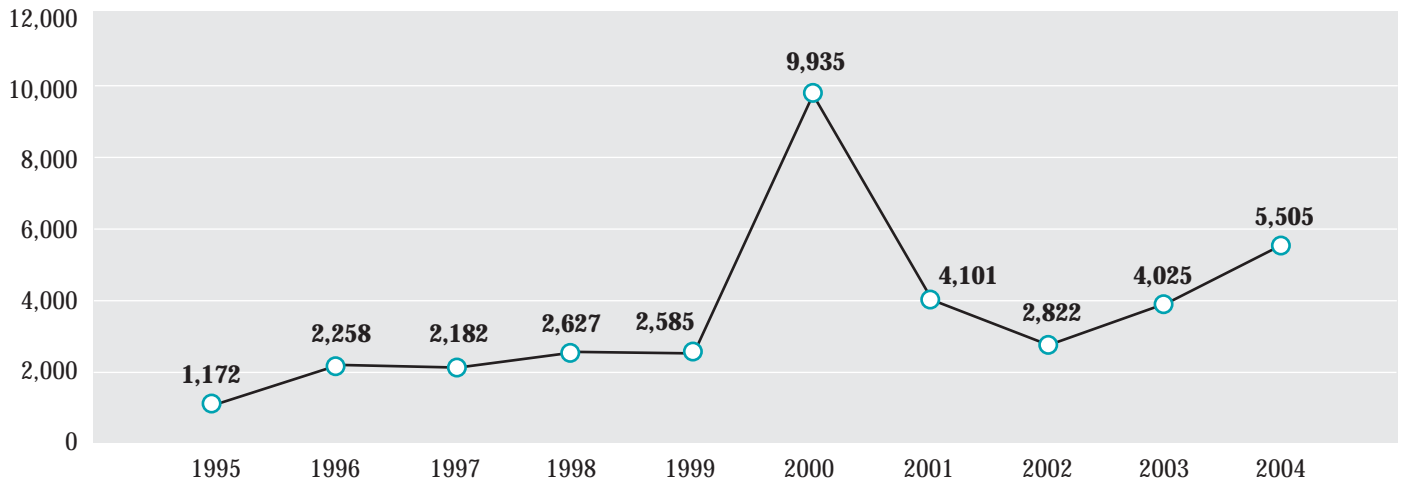


Distributions from the Deferred Compensation Plan

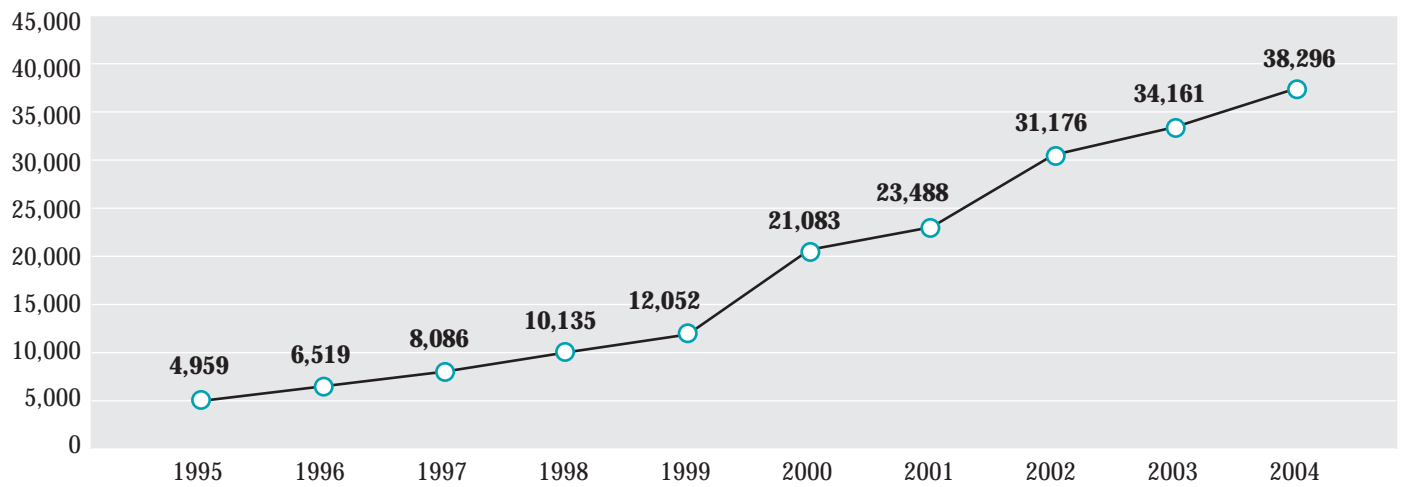
(Millions of Dollars)



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	5,238
Real Estate Investment Trust	2,236
Harris Direct Money Market	48
Harris Direct Self-Directed	49
International Equity Index Fund	5,598
Money Market Fund	2,369
Russell 1000 Growth Index Fund	2,599
Russell 1000 Value Index Fund	3,670
S&P 500 Index Fund	22,301
Small/Mid Cap Equity Index Fund	5,583
Stable Value Fund	14,763
Active Inflation-Protected Bond	966
Active Bond Fund	4,034
Active High Yield Bond Fund	603
Active Large Cap Equity	0*
Active International Equity	0**
Balanced Growth Fund	9,203
Income & Growth Fund	3,778
Long-Term Growth Fund	5,351
Active Small/Mid Cap Equity Fund	6,064

* The Active Large Cap Equity fund closed on June 1, 2004; account balances in that fund were transferred into the S&P 500 Index Fund.

** The Active International Equity fund closed on June 1, 2004; account balances in that fund were transferred into the International Equity Index Fund

Plan Assets

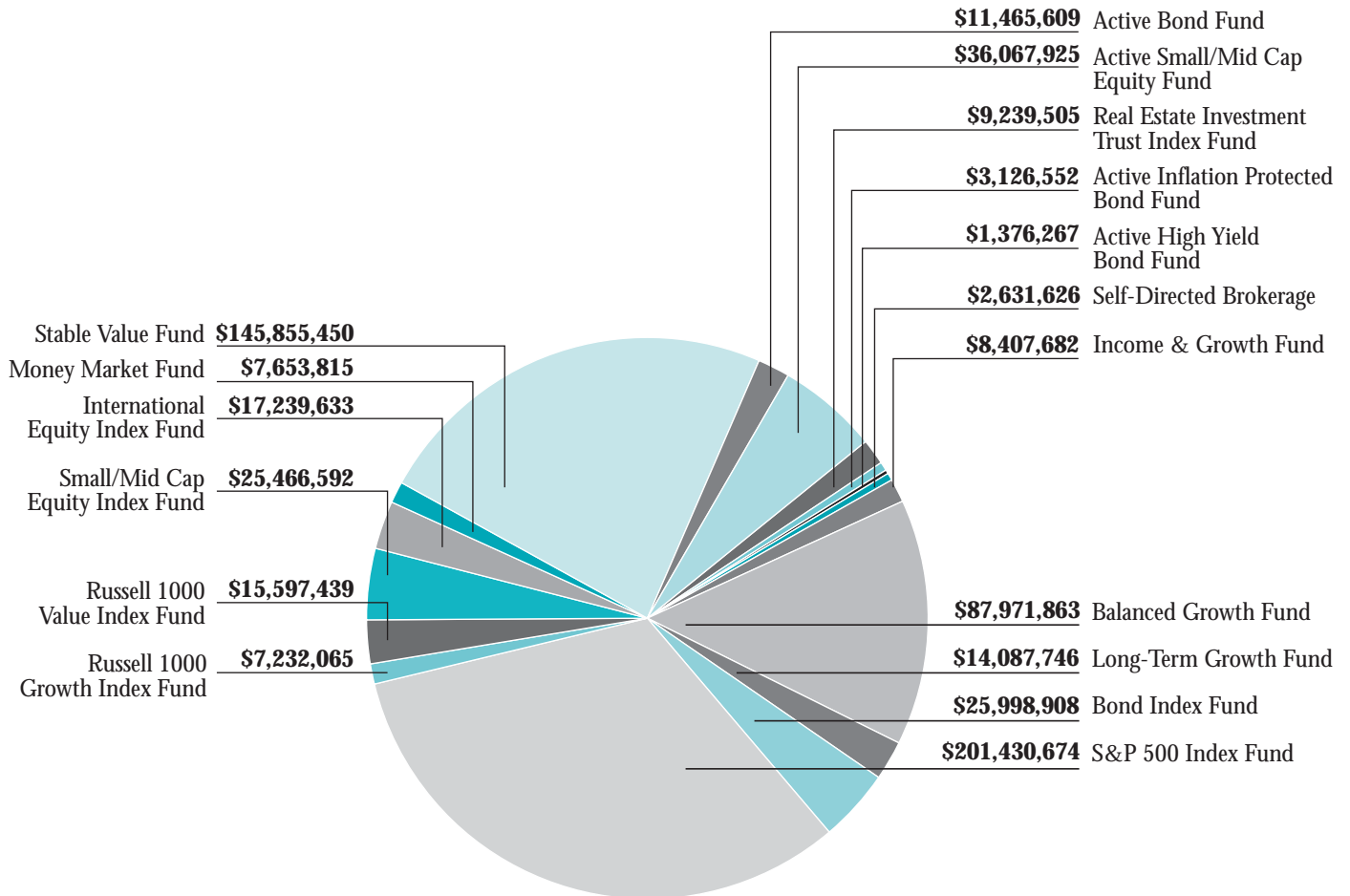
Plan Assets are divided into two categories—Annuity Plan Assets and Accumulation Plan Assets. Annuity Plan Assets represent the present value of future benefits for those participants who chose an annuity as a distribution payment. Accumulation Plan Assets represent funds invested among the 18 core investment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

Annuity Plan Assets

The Hartford Life Insurance Company Annuity Plan Assets at June 30, 2004	\$ 8,096,154
Metropolitan Life Annuity Plan Assets at June 30, 2004	2,476,707
Total at June 30, 2004	\$ 10,572,861

Accumulation Plan Assets

Total at June 30, 2004 – \$620,849,351



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.

Mortgage-Backed Securities – 36%	Corporate – 24%
Treasury – 24%	Agency – 11%
CMBS – 3%	Asset-Backed – 2%

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%	Information Technology – 17%
Consumer Discretionary – 13%	Health Care – 13%
Industrials – 12%	Energy – 6%
Telecommunication Services – 4%	Materials – 3%
Consumer Staples – 9%	Utilities – 3%

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 – 24%	Consumer Staples – 11%
Energy – 1%	Financials – 9%
Industrials – 9%	Information Technology – 28%
Utilities – 1%	Telecommunication Services – 1%
Consumer Discretionary – 16%	

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.

Consumer Discretionary – 11%	Consumer Staples – 6%
Energy – 11%	Financials – 33%
Health Care – 4%	Industrials – 12%
Information Technology – 6%	Materials – 5%
Telecommunication Services – 6%	Utilities – 6%

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.

Consumer Discretionary – 18%	Consumer Staples – 3%
Energy – 4%	Financials – 24%
Health Care – 14%	Industrials – 12%
Information Technology – 16%	Materials – 4%
Telecommunication Services – 1%	Utilities – 4%

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.

Consumer Discretionary – 13%	Consumer Staples – 9%
Energy – 8%	Financials – 26%
Health Care – 9%	Industrials – 9%
Information Technology – 7%	Materials – 7%
Telecommunication Services – 7%	Utilities – 5%

Real Estate Investment Trust Index Fund: The Fund seeks to track the performance of the Dow Jones 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.

Apartments – 17%	Diversified- 7%
Factory Outlets – 2%	Hotels – 5%
Industrial – 9%	Local Retail – 13%
Manufactured Homes – 1%	Office - 24%
Regional Retail – 18%	Storage – 4%

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, – 37%	Floating Rate Agencies – 4%
Floating Rate Corporate Notes – 23%	Repurchase Agreements – 14%
Agency – 4%	Other 1%
	Commercial Paper – 17%

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 – 28%
AIG Financial Products Security Backed Contract – 25%
JP Morgan Chase Bank Security Backed Contract – 23%
Union Bank of Switzerland AG Security Backed Contract – 24%

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. This Index is a measure of the inflation-indexed sector of the U.S. Bond Market.

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 a custom benchmark consisting of 95% Lehman Brothers High yield ex-CCC Index and 5% Lehman Brothers 1-3 Year Treasury Index.

Basic Industry – 16%	Capital Goods – 9%
Communication- 19%	Consumer Cyclical – 16%
Consumer Non-cyclical – 9%	Energy – 6%
Finance – 2%	Industrial/Other – 2%
Technology – 6%	Treasury/Agency – 6%
Transportation – 1%	Utilities – 8%

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.

Corporate – 3%	Emerging Markets – 2%
Foreign – 13%	Mortgage-Backed
Other – 10%	Securities – 19%
U.S. Treasury/Agency – 53%	

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.

Consumer Discretionary – 20%	Consumer Staples – 5%
Energy – 6%	Financials – 24%
Health Care – 13%	Information Technology – 13%
Industrials – 11%	Materials – 3%
Telecommunication Services – 1%	Transportation – 1%
	Utilities – 3%

Tier IV: Self-Directed Brokerage Option

The Self-Directed Brokerage (SDB) Option from Harris *direct* 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, 2004

(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	5.31%	5.19%	n/a	0.07%
Benchmark (75% Lehman Bros. Aggregate Bond Index, 22% Russell 3000, 3% MSCI EAFE)	5.45%	5.23%	5.25%	
Balanced Growth Fund	10.67%	3.80%	n/a	0.07%
Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE)	10.81%	3.92%	3.37%	
Long-Term Growth Fund	16.22%	2.19%	n/a	0.07%
Benchmark (25% Lehman Bros. Aggregate Bond Index, 64% Russell 3000, 11% MSCI EAFE)	16.42%	2.43%	1.34%	
Tier II: Passively Managed Funds ^{1,2}				
Bond Index Fund	0.25%	6.43%	7.00%	0.06%
Lehman Bros. Aggregate Bond Index	0.33%	6.36%	6.95%	
S&P 500 Index Fund	19.08%	-0.70%	-2.20%	0.02%
S&P 500 Index	19.11%	-0.69%	-2.20%	
Russell 1000 Value Index Fund	21.04%	2.87%	1.79%	0.09%
Russell 1000 Value Index	21.13%	2.96%	1.87%	
Russell 1000 Growth Index Fund	17.65%	-3.90%	-6.52%	0.10%
Russell 1000 Growth Index	17.89%	-3.74%	-6.48%	
Real Estate Investment Trust Index Fund	26.75%	14.59%	n/a	0.25%
Dow Jones Wilshire REIT Index	27.16%	15.26%	15.14%	
Small/Mid Cap Equity Index Fund ³	28.34%	3.96%	3.09%	0.10%
Russell Small Cap Completeness Index	28.68%	4.12%	3.02%	
International Equity Index Fund ^{4,5}	32.11%	2.46%	-1.03%	0.15%
MSCI EAFE Index	32.35%	3.87%	0.06%	
Tier III: Actively Managed Funds				
Money Market Fund	1.01%	1.72%	3.40%	0.11%
91-Day Treasury Bill	1.00%	1.54%	3.16%	
Active Inflation-Protected Bond Fund	3.55%	9.08%	n/a	0.18%
Lehman Bros. US Treas. Inflation Notes Index	3.86	9.26%	9.58%	
Active Bond Fund	1.03%	7.64%	7.67%	0.43%
Lehman Bros. Aggregate Bond Index	0.33%	6.36%	6.95%	
Active High-Yield Bond Fund	7.05%	6.71%	4.52%	0.23%
Benchmark (95% Lehman Bros. High Yield ex-CCC, 5% Leman Bros. 1-3 Year Treasury Index)	8.62%	8.04%	4.93%	
Active Small/Mid Cap Equity Fund ^{1, 3}	32.22%	6.34%	n/a	0.57%
Russell Small Cap Completeness Index	28.68%	4.12%	3.02%	
Stable Value Fund ⁶	5.04%	5.33%	5.69%	0.20%
The projected estimated yield range from 7/1/04 - 9/30/04 is 4.75% - 5.00%. ⁷				

¹ The VRS Defined Contribution Plans purchase units in various State Street Global Advisors (SSgA) Series A or Series T collective trust funds in order to provide plan participants with the ability to purchase and redeem units on a daily basis. SSgA Series A or Series T Funds invest in other SSgA collective trust funds referred to as Base Funds.

² Inception dates shown reflect the inception dates of the Base Funds. Performance returns for the Series A Funds have been linked to those Base Funds' returns. The actual performance for the Base Funds have been restated to reflect the Plans' investment management fees. Inception dates for the Series A Funds commenced as follows:

SSgA Bond Index Series A	10/97	SSGA REIT Index Series A	5/01
SSGgA S&P Index Series A	3/96	SSgA Russell Small Cap Completeness Index Series A	9/97
SSGgA Russell 1000 Value Index Series A	3/99	SSgA EAFE Index Series A	1/97
SSGgA Russell 1000 Growth Index Series A	8/99		

³ Equity Securities of companies with relatively small market capitalization may be more volatile than securities of larger, more established companies.

⁴ Foreign investments involve special risks, including currency fluctuations and political developments.

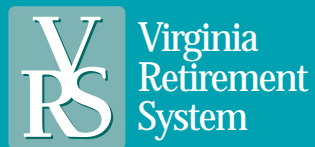
⁵ The inception date shown reflects the inception date of the Base Fund. Performance returns for the Series T Fund have been linked to the returns of the Series A and Base Funds. The actual performance for the Base Fund has been restated to reflect the Plans' investment management fees. The inception date of VRS' participation in the Series T Fund was April 21, 2003.

⁶ Performance returns have been linked to the previous investment manager. Returns prior to May 5, 2003 represent performance by MetLife.

⁷ The estimated yield range is provided to help participants make choices concerning their investment options. **There is no guarantee that the Fund will earn the projected estimated yield.**

Report design and production:

Diana Plasberg
Office of Graphic Communications,
Virginia Department of General Services



WWW.VARETIRE.ORG • 1/888/827-3847 (VA-RETIR) • 804/649-8059
1200 EAST MAIN STREET, P.O. BOX 2500 RICHMOND, VIRGINIA 23218-2500