

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

*Celebrating 60 Years
of Service*

1942-2002



AN INDEPENDENT AGENCY OF THE COMMONWEALTH OF VIRGINIA

Fiscal Year 2002 Financial and Statistical Highlights

All Pension Trust Funds

(Expressed in Thousands)

	2002	2001	% Change
For the Year			
Contributions	\$ 1,044,458	\$ 1,269,749	(17.7%)
Investment Income (Net of investment expenses)	\$ (2,752,870)	\$ (2,969,655)	7.3%
Retirement Benefits	\$ 1,437,791	\$ 1,298,627	10.7%
Refunds	\$ 73,451	\$ 80,622	(8.9%)
Administrative Expenses (Net of misc. income)	\$ 15,385	\$ 14,381	7.0%
Increase in Net Assets Held in Trust for Pension Benefits.....	\$ (3,237,488)	\$ (3,093,155)	(4.7%)
Retirement Benefits as a percentage of contributions	137.7%	102.3%	
Retirement Benefits as a percentage of contributions and investment income	(84.2%)	(76.4%)	
At Fiscal Year End			
Net Assets Held in Trust for Pension Benefits - VRS	\$ 32,448,309	\$ 35,619,620	(8.9%)
Net Assets Held in Trust for Pension Benefits - SPORS	\$ 423,242	\$ 464,215	(8.8%)
Net Assets Held in Trust for Pension Benefits - VaLORS	\$ 350,064	\$ 350,132	0.0%
Net Assets Held in Trust for Pension Benefits - JRS	\$ 234,214	\$ 259,350	(9.7%)
Investment Performance			
One-Year Return on Investments	(7.3%)	(7.4%)	
Three-Year Return on Investments	(0.3%)	6.2%	
Five-Year Return on Investments	5.6%	11.5%	
Participating Employers			
Counties/Cities/Towns	239	237	
Special Authorities	166	165	
School Boards	145	148	
State Agencies	238	235	
Total Employers	788	785	0.4%
Membership/Retirees			
Active Members	310,214	303,970	2.1%
Retired Members	103,622	99,497	4.1%

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

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Certificate of Achievement for Excellence in Financial Reporting

Presented to

Virginia Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2001

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.



William Patrick Harte
President

Jeffrey L. Esser
Executive Director

1942-2002



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The Library of Virginia



Created in 1942, the Virginia Retirement System—now an independent agency of the state—was the first retirement system in Virginia to cover public sector employees. Public school employees, state employees, and employees of participating political subdivisions—including teachers and state police officers—make up the membership today. Since 1942, the number of covered employees has grown to 310,000 today. VRS staff has grown too, moving from its original headquarters (middle row, left) to settle in 1985 in its current Main Street location (middle row, right).





Through a History of Change...A Single, Dedicated Mission for VRS

World War II and suburbia; Woodstock and a man on the moon; Vietnam, Watergate, and disco; computer technology and junk bonds; economic boom—and downturn—and September 11. The past six decades have been a time of great challenges, great strides, and great change for our country. As the Virginia Retirement System reflects on its 60th anniversary in 2002, we look with pride on the watershed events in our own history, from the founding of VRS in July 1942 to the honoring of our 100,000th retiree in 2001. VRS has grown and prospered—and weathered an economic storm or two itself—to become the strong, vigorous, reliable pension fund it is today.

With World War II little more than a year old for America, investments were chosen cautiously and with an eye toward the future—a strategy that has helped VRS grow to where it is today. Just two years into the 21st century, VRS is the 30th largest pension fund in the United States and the 41st largest in the world. For the fiscal year ended June 30, 2002, VRS had more than \$34.4 billion in assets and paid out more than \$1.4 billion in annual retirement benefits to 103,622 retirees.

It is not the investments alone that constitute member value, however; it is also the benefits the

fund offers to retirees. Over the years, VRS has worked diligently to provide its members—teachers, state employees, judges, state police officers, and other public employees—with benefit plans to enhance their retirement. The creation of the Group Life Insurance Program in 1960, for example, provided coverage to the majority of members participating

“Our mission is to administer pension benefits and associated services earned by participating Virginia public employees by serving as stewards of the funds in our care and providing superior service to our membership.”

in System-administered plans, as well as other qualifying employees. In 1966, death-in-service and death-in-the-line-of-duty benefits were added, and in 1995, the optional life insurance program supplemented the benefit. Most recently, in 2001, legislative initiatives added valuable new life insurance benefits to the package, including extending coverage to spouses and dependent children.

It is by programs like these that VRS measures its success over the past 60 years and charts its course for the decades to come—and stays true to its mission.

The 1940s and 1950s— Challenge, Hope, and Growth

Explosive change came about as Japan bombed Pearl Harbor, the United States entered World War II, and Rosie the Riveter bolstered the workforce. The Virginia Retirement System, created in 1942, changed as well, replaced a decade later by a new system covering state employees, teachers, and employees of participating political subdivisions. Under the new system, named the Virginia Supplemental Retirement System, Virginia public employees also became eligible for Social Security benefits.

1940–1959

July 1, 1942—The Virginia Retirement System, the first retirement system in Virginia to include public sector employees, is created to cover teachers and state employees.

July 1, 1944—The Virginia Retirement Act is amended to allow the employees of political subdivisions to join the system.

July 1, 1950—The State Police Officers' Retirement System is created.

February 1952—In advance of the signing of the Federal-State Social Security Agreement, Virginia becomes the first state to repeal its retirement system so that public employees may be covered under Social Security.

March 1, 1952—VRS is reactivated as the Virginia Supplemental Retirement System, covering state employees, teachers, and employees of participating political subdivisions.



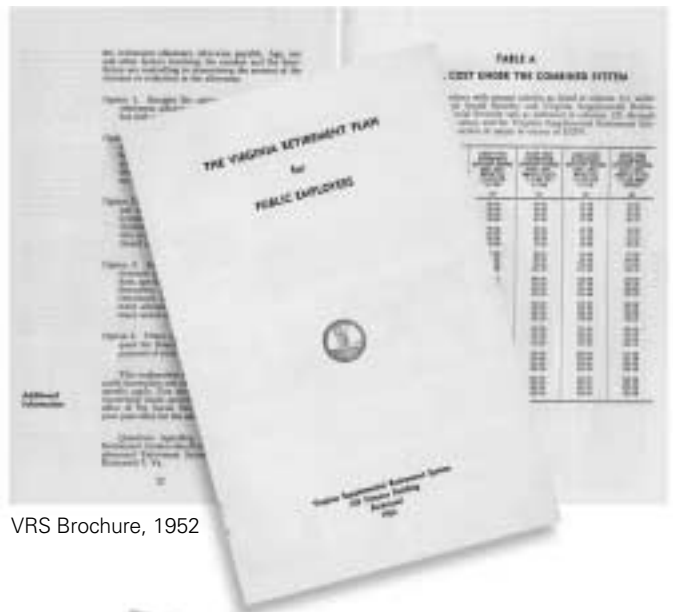
Portsmouth, Virginia classroom, c. 1950



State Police Officer, c. 1955



VRS headquarters, 1952



VRS Brochure, 1952

Elsewhere in the USA

Great movies—including *Citizen Kane*, *It's a Wonderful Life*, and *Casablanca*—premier. Fans watch Jackie Robinson break baseball's color barrier in 1947. The minimum wage in 1950 is 75 cents an hour. Youngsters don coonskin caps as they watch "Davy Crockett" on black-and-white TV. *Brown v. Board of Education* outlaws "separate but equal" school segregation. In 1955, a weary Rosa Parks refuses to go to the back of the bus, inspiring the civil rights movement. By 1958, a first-class stamp costs 4 cents.





INTRODUCTORY SECTION



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 15, 2002

The Honorable Mark R. Warner
Members of the General Assembly

The Virginia Retirement System (VRS) experienced negative returns for the second consecutive year as a result of the continued decline in global equity prices and lower returns for other asset classes. For the year ended June 30, 2002, returns for the fund were -7.3%. The value of the fund as of this date was \$34.4 billion.

In times such as these, it is critically important to remind ourselves of the long-term investment horizon that characterizes any pension fund. When viewed in this light, it is reassuring to know that past decisions have indeed been proven right. This is evidenced by the fact that fund returns for the last 5 and 10 years were 5.6% and 9.6%, respectively. Overall, the VRS remains one of the best-funded public plans in the country. This is undoubtedly the result of a consistent, steady-hand approach to managing the System and of the quality of the individuals charged with its day-to-day operations.

A number of challenges loom ahead for the VRS. The crisis of confidence that has struck the nation as the result of corporate wrongdoings continues to be a drag on investors. We are hopeful that recent congressional and regulatory actions, coupled with the actions of individual institutional investors, will start the process of rebuilding confidence in our capital markets.

To this end, during the past year, the Board established a Corporate Governance Task Force to examine VRS's corporate governance policy and procedures and make recommendations to ensure that VRS is doing all it can to protect the assets of the funds from corporate wrongdoing.

Although we are beginning to see signs that the worst of the economic slowdown is behind us, investment returns for fiscal 2003 are expected to significantly lag behind the fund's 8% actuarial assumption. While the investment staff is constantly examining ways to improve returns, it is critically important not to succumb to the temptation to take greater risks in an effort to reach for possible short-term gains. I am confident that the operating structure put in place in 1994, along with the dedication and professionalism of the staff, will continue to serve us well.

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

A handwritten signature in black ink, 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.

Back row (left to right):

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

Paul W. Timmreck
Virginia Commonwealth University

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

Vernard W. Henley
Retired, Consolidated Bank

Front row (left to right):

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

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

Alfonso I. Samper, Chairman
Wachovia Securities

Clifford A. Cutchins, III
Retired, Sovran Financial Corporation

Charles B. Walker, Vice Chairman
Albemarle Corporation

VRS Investment Advisory Committee



Left to right:

Doyle E. Hull

Retired, Sovran Financial Corporation

Stuart A. Sachs, Committee Chair

Retired, Sovran Capital Management

Sadie Gregory

Virginia State University

Joe Grills

Retired, IBM Retirement Funds

Raymond D. Smoot, Jr.

Virginia Polytechnic Institute

Not Pictured:

Hunter E. Craig

Hunter E. Craig Co.

Joseph W. Montgomery

Wachovia Securities

Alfonso I. Samper

Wachovia Securities

Charles B. Walker

Albemarle Corporation

VRS Executive Committee



Back row (left to right):

Donna M. Shumate
Chief Human Resource Officer

Barry C. Faison
Chief Financial Officer

J. Timothy Bass
Chief Technology Officer

James R. Templeton
Strategy and Innovation Director

Virginia L. Bomar
Chief Customer Programs Officer

Center (left to right):

Donna M. Blatecky
Deputy Director for Customer
Relationships

Wallace G. Harris
Senior Deputy Director

Front row (left to right):

Deardrian Scott
Chief Customer Support Officer

Franklin O. Berry
Internal Audit Director

Darla K. Glazier
Administrative Staff Assistant

W. Forrest Matthews, Jr.
Director

Not Pictured

Nancy C. Everett
Chief Investment Officer

Professional Consultants

Actuary:

W. Michael Carter
Gabriel, Roeder, Smith & Company

Auditor of Public Accounts:

Walter J. Kucharski
Commonwealth of Virginia

Life Insurance Carrier:

Joseph K. W. Chang
Minnesota Life Insurance Company

Master Custodian:

**Boston Safe Deposit and
Trust Company (Mellon Trust)**

Legal Counsel:

Stephanie L. Hamlett
Office of the Attorney General

Virginia Sickness and Disability
Program:

Lauren Biscotti
CORE, Inc.

W. Forrest Matthews, Jr.
Director

Letter of Transmittal

October 7, 2002

To: Members of the Board of Trustees

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the Virginia Retirement System (System) for the fiscal year ended June 30, 2002. This report has been prepared in accordance with Section 51.1-1003, *Code of Virginia*, (1950), as amended, which requires every retirement system to publish an annual report and in accordance with Section 4-9.00 of Chapter 899 of the 2002 Virginia Acts of Assembly, Commonwealth of Virginia. The reporting entity consists of four defined benefit pension plans administered by the System: the Virginia Retirement System (VRS), the State Police Officers' Retirement System (SPORS), the Virginia Law Officers' Retirement System (VaLORS), and the Judicial Retirement System (JRS) and three other employee benefit programs: the Group Life Insurance Program, the Retiree Health Insurance Credit Program, and the Virginia Sickness and Disability Program (VSDP).

The System was established on March 1, 1952 to administer a statewide multiple-employer public employee retirement system providing defined benefit pension plan coverage for state employees, teachers and nonprofessional employees of public school boards, and employees of participating political subdivisions. The System also administers separate retirement systems for state police officers, other state law enforcement and correctional officers, and judges, which were established on July 1, 1950, October 1, 1999, and July 1, 1970, respectively. There were 238 state agencies, 145 local school boards, and 405 political subdivisions participating in the retirement systems at June 30, 2002. In addition, 131 public school boards include their nonprofessional employees in the System.

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

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

The CAFR for FY 2002 consists of five sections:

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

Accounting System and Internal Control

The financial statements included in the CAFR for FY 2002 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 as pronounced or adopted by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

The accrual basis of accounting is used in the preparation of the financial statements. Revenues are taken into account when they are earned and become measurable, and expenses are recorded when the liabilities are incurred. Investments are reported at fair value, as determined by the System's master custodian. Fixed assets are capitalized at cost and depreciated over their estimated useful life. Contributions to the retirement systems are based on the principle of level cost funding and are developed using the entry age normal cost method with current service financed on a current basis and prior service amortized within a period of 30 years or less. In management's opinion, the financial statements fairly present the plan net assets of the System at June 30, 2002, 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 fiscal year. The letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditor in the Financial Section.

The System's management is also responsible for maintaining a system of adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements, in accordance with generally accepted accounting principles. The internal control system includes the organization plan, the appropriate segregation of duties and responsibilities, and sound practices in the performance of duties and personnel with capabilities commensurate with their responsibilities. There is an internal audit department that reports to the Audit Committee of the Board of Trustees, and the budget for the System's administrative expenses is approved by the Board and appropriated by the General Assembly of Virginia. In addition, the retirement funds held by the System are constitutionally established as independent trust funds dedicated to the exclusive benefit of its members, retirees and beneficiaries. We believe the internal controls in effect during the fiscal year ended June 30, 2002 adequately

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

Legislative Initiatives

The 2002 General Assembly initiated a variety of bills that enhanced and strengthened the benefits for Virginia's 310,000 active public employees and 103,000 retirees.

Virginia Sickness and Disability Program (VSDP)

Two identical bills, **House Bill 197** and **Senate Bill 120**, provided an open enrollment for certain state employees to participate in the Virginia Sickness and Disability Program (VSDP), unless they choose not to participate. Members of the Virginia Retirement System, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, certain part-time employees of the Commonwealth, and employees of higher education participating in the retirement system, who are not already participating in the program, will be automatically enrolled into the VSDP unless they provide written notice to VRS of their election not to participate. Coverage effective for new participants is January 10, 2003.

Deferred Compensation Plan

The Deferred Compensation and the Cash Match Plans, in **House Bill 71**, became two separate programs in the *Code of Virginia* so that the features of each are clearly defined. Effective July 1, 2002, salaried employees participating in the Deferred Compensation Plan no longer have to wait 12 months to become eligible to receive the cash match. This also applies to employees of colleges and universities whose eligibility for the cash match is based on their participation in a 403(b) tax-deferred savings plan.

Defined Benefit Plan

Under **House Bill 578** clarifications were provided that a VRS member may elect the partial lump-sum option (PLOP) distribution only once in a lifetime, and the amount paid comes from the defined benefit plan.

Senate Bill 565 made clear that individuals become eligible for the enhanced benefits provided under the Virginia Law Officers' Retirement System (VaLORS) only after earning five or more years

of service under the system. The bill also requires five years of service to be eligible for benefits under the State Police Officers' Retirement System (SPORS) or for law enforcement officers and firemen (LEOS/FIRE) whose employers have elected to provide similar benefits. Finally, this bill amends the LEOS/FIRE section of the Code so that the death benefits match those under SPORS and VaLORS.

Two bills, **House Bill 1137** and **House Bill 1320**, changed the return to work conditions slightly. Under these identical bills, teachers may return to work in a critical shortage area under a single one-year contract if they have been retired for at least 30 days. The teacher may have retired under an early retirement incentive program (ERIP) and returned to work under the provisions of this bill. The bill requires approval of this program from the Internal Revenue Service prior to implementation.

Life Insurance Changes

House Bill 80 makes technical corrections to the life insurance bills passed last year. This bill clarifies that reductions in life insurance begin one full year after retirement. It also emphasizes that the beneficiary of a pre-paid college tuition plan holds the tuition contract rather than VRS when a member's death results from a felonious assault. The bill also provides that life insurance and retirement benefits will be paid by order of precedence in the event a named beneficiary dies before the member and no other designation has been made.

Services Provided

VRS anticipates a wave of retirements in coming years that is unprecedented in its history as the baby boom generation begins to retire. Almost one-third of the total active VRS membership of about 300,000 are over the age of 50 and will reach the normal retirement age of 65 within the next 15 years, placing extraordinary demands on VRS staff and resources. A clear indication that the wave is already upon us could be seen in the tremendous increase in purchase of prior service applications. During fiscal year 2002, VRS saw a 500 percent increase in the number of applications received over the previous year.

To prepare for the wave ahead, VRS' new organizational structure includes a communications and processing model that focuses on the specific needs of

customers—employers, members and retirees—rather than on VRS products and administrative procedures. The new organization is customer-focused. It puts the focus on building relationships, opening channels of communication and creating opportunities for interaction that result in services that are need-specific and value-centered. The new organization is better able to identify customer needs and to adjust and adapt its business processes to support those needs.

A new position of Deputy Director of Customer Relationships was created to oversee all customer programs and support. Under the deputy, there are two positions—Chief Customer Programs Officer and Chief Customer Support Officer. The Customer Programs area is responsible for Member Services, Retiree Services, and Employer Services, as well as for administration of the group life insurance, Virginia Sickness and Disability Program, the defined benefit plan, and the defined contribution plan. The Customer Support department includes the Information Center, the Communications and Training unit, and Product and Service Trainers.

To further prepare for the wave ahead, VRS has taken significant initiatives to streamline operations and position the agency to meet the needs of a rapidly expanding customer base. In fiscal year 2002, VRS increased the number of employers reporting payrolls electronically to more than 70 percent. Also, in fiscal year 2002, VRS reached a milestone in the development of self-service benefits with the introduction of its first self-service application. QuickAccess, a Web-based tool, gives authorized employers secure access to member records from their desktop computers. In addition, through expanding and improving the VRS Web site, citizens have access to retirement information without ever having to make a phone call.

Customer Programs

The **Employer Reporting Unit** processes 990 employer payrolls each month for retirement, life insurance and health insurance credit contributions; maintains information on employer coverage and contribution rates; and maintains member records for service and contributions. During FY 2002, the unit processed 11,328 monthly employer payrolls, with 98.9% updated within 30 days of receipt. To facilitate reporting, 71.4% of member records were reported electronically by 554 employers. When WebER was implemented, 71.3% of active member records were transmitted electronically, exceeding the agency strate-

gic business objective of 65%. The unit updated 52,744 suspended records, processed 27,054 adjustments, enrolled 32,107 new members and processed 10,169 demographic changes. Most significantly, the unit added 7,431 contracts to purchase service via payroll deduction and processed 12,364 lump sum purchases, a 406% increase from fiscal year 2001. The increase was due to changes in service eligibility, state legislation, and federal legislation. The **Employer Representative Program** was a new initiative designed to improve services to employers and increase their understanding of VRS products. Representatives travel the state and meet with employers to improve service and develop relationships, which assists in improving customer service delivery.

The **Member Services Unit** received 28,650 purchase of prior service applications, an increase of over 500% from fiscal year 2001. The increase in the number of applications received was due to state and federal legislative changes.

During fiscal year 2002, the **Retiree Services Unit** processed 6,291 service retirement applications, 1,137 disability applications and 12,902 refunds. The Retiree Services unit exceeded the agency strategic business objective by processing 99.6% of applications within 90 days with a 98.1% accuracy rate. As of June 30, 2002, there were 103,841 benefit recipients, which was a 4.4% increase over fiscal year 2001.

Customer Support

In line with the reorganization, the **Information Center** refocused its customer service delivery on the three touch points—retiree, member, and employer. The center currently has two teams: the Member Team and the Retiree/Employer Team. The teams are responsible for answering both phone calls and agency e-mails in addition to providing counseling service to the membership.

The center's Strategic Business Objective (SBO) is to answer all telephone calls with accuracy and a high level of customer service and with no more than 15 percent of calls transferred to other departments. The Information Center answered 151,933 telephone calls, which reflects a slight decrease over last year's results. The Virginia Informational Phone System (VIPS), VRS' automated voice response system, responded to 37,774 calls with almost no intervention by the Information Center staff.

The Information Center assumed most of the duties performed by the former Field Services unit. The Member Counseling Team began preparing estimates in December 2001. From December 2001 until the end of the fiscal year, the team prepared 1,911 estimates. There was a change in the business rules regarding estimates. Members who are within 18 months of retirement receive an estimate from VRS; individuals who have more than 18 months before retirement are directed to the on-line service calculator, their employer's benefits administrator and the Member Benefit Profile. One of the tools used to prepare estimates is the Benefit ESTimator (BEST) which allows for the preparation of an estimate on a "first in, first out" basis. The estimate queue dropped to zero in May. The Member Counseling Team also conducted 27 group counseling sessions with 482 members attending. During the same seven-month period, the counselors also provided one-on-one counseling to 384 members who came to the VRS headquarters office with questions regarding their benefits.

The e-mail team in the Information Center is comprised of the counseling team and several members of the retiree team. The team, established in March 2002, responded to e-mails received within 48 hours and has handled over 400 e-mails per month.

The communications and training functions were combined into a new **Communications and Training** unit and a new documentation unit was created. The documentation unit will develop VRS training manuals and document the business processes VRS uses in its daily operations. Communications retooled to more closely target the three primary audiences. The unit analyzed feedback received from internal and external sources to develop a strategy to streamline the number of publications, while improving readability and effectiveness. All publications are being redesigned to provide a more consistent look and to increase readability and usefulness of information. Consistent with the agency's focus on its three primary audiences, the VRS Web site is being redesigned to improve navigation and to increase the functionality of the site.

The product and service trainers developed new training presentations and counseling presentations to ensure that all class presenters were providing consistent information and messages to VRS audiences. The trainers conducted 16 benefit administrator training sessions with 333 participants attending. There were 40 pre-retirement sessions presented in partnership

with the Virginia Community College System where 3,975 individuals learned more about their retirement benefits. In addition, the product and service trainers were instrumental in developing and presenting training to employers on the new BEST application.

Group counseling is a very important service to members who sometimes must make difficult and generally irreversible decisions related to their retirement. This year, the sessions were redesigned to accommodate up to 100 individuals. The class expansion was needed so the large “baby boomer” population could attend sessions across the state. Throughout the year, the trainers supported 828 members through attendance at these sessions. At the request of employers, the product and services trainers attended 67 employer-sponsored overviews where 4,698 participants received information concerning their VRS benefits. In addition, the trainers attended 15 benefit fairs where approximately 583 individuals inquired about benefits.

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. In addition, it retains a professional investment staff, as well as outside managers, to advise and assist in the implementation of these policies. Section 51.1-124.30(C) of the *Code of Virginia* states that “the Board shall invest the assets of the Retirement System with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.” Accordingly, the Board must sufficiently diversify the portfolio to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Virginia Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the 20th consecutive year that the VRS has achieved this

prestigious award. To be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

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

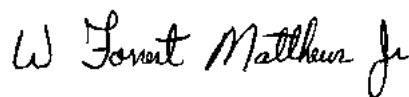
Acknowledgements

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

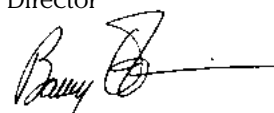
We also wish to express our special thanks and appreciation to the VRS staff, members of the Board of Trustees, and VRS business partners whose diligence and commitment have contributed significantly to another successful year.

Finally, we wish to thank Governor Mark R. Warner and the members of the Virginia General Assembly for their commitment and support to the public employers, employees, and retirees of the Virginia Retirement System. This report is being mailed to the Governor, each member of the General Assembly, the Cabinet, all participating employers, and other interested parties.

Respectfully submitted,



W. Forrest Matthews, Jr.
Director



Barry C. Faison
Chief Financial Officer

The 1960s— Scientific Advances, Stormy Social Change

In the turbulent 1960s, Americans grieved when President John F. Kennedy was assassinated in Dallas, swallowed hard as U.S. troops entered Vietnam, and marveled as astronaut Neil Armstrong became the first human to walk on the moon. In Virginia, the VRS plan was enhanced by the addition of group life insurance benefits and an amendment to allow members to become eligible for full benefits at age 60 if they have attained at least 30 years of service.



Benefit Program Staff, 1967

1960–1969

July 1, 1960—The Group Life Insurance Program is created to cover the majority of members participating in System-administered pension plans, as well as other qualifying employees.

July 1, 1962—Members become eligible for full retirement benefits at age 60 with 30 or more years of service.

July 1, 1966—A new amendment provides members with death-in-service benefits and death-in-the-line-of-duty benefits. In addition, the period of service required to receive a deferred service annuity is shortened from 15 years to 10.

September 1, 1966—Coverage under the Group Life Insurance Program is increased to approximately two times annual salary for members age 50 and under, decreasing by 5 percent for each year of age to about 1½ times annual salary at age 60; coverage then reduces 10 percent a year to the amount of annual salary at age 65.



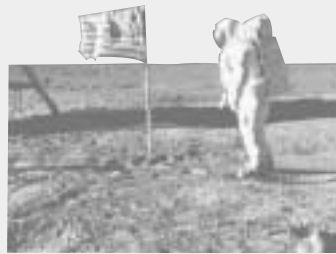
Death-in-the-line-of-duty benefits enacted, 1966



Director Charles H. Smith, 1965

Elsewhere in the USA

Eggs are 58 cents a dozen and a first-class stamp has gone up to 6 cents. President Kennedy and a worried nation weather the 1962 Cuban missile crisis. The Beatles take the U.S. by storm, while Bob Dylan's "Like a Rolling Stone" tops the charts. The minimum wage jumps to \$1.25 in 1965. The assassination of civil rights leader Martin Luther King sparks violence, introspection, and social change. Rachel Carson's *Silent Spring* launches the environmental protection movement, and Neil Armstrong makes "one small step for man, one giant leap for mankind."





FINANCIAL SECTION



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 18, 2002

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit and Review Commission

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 year ended June 30, 2002 and 2001, as listed in the Table of Contents. The 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, 2002, 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, 2002 and 2001, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 14, the Virginia Retirement System has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as of June 30, 2002.

In accordance with Government Auditing Standards, we have also issued our report dated October 18, 2002 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.

Our audit was made for the purpose of forming an opinion on the general-purpose financial statements. The supplementary information listed in the Financial Section of the Table of Contents is presented for the purpose of additional analysis and is not a required part of the general-purpose financial statements. This information, and not the information in the Introductory, Investment, Actuarial, and Statistical Sections, has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole. We express no opinion on the information in the Introductory, Investment, Actuarial, or Statistical Sections.

Auditor of Public Accounts

Management's Discussion and Analysis

This section presents management's discussion and analysis of the financial statements for the Virginia Retirement System (the "System") and the significant events and conditions that affected the operations and performance of the System for the year ended June 30, 2002. 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 (and other employee benefit) trust funds, which are classified as fiduciary funds.

Financial Highlights

- The combined total assets of the Pension Trust Funds decreased by \$3,237.5 million, or 8.8% during the fiscal year ended June 30, 2002. The decrease was primarily due to poor stock market returns and increased benefit payments as a percentage of contributions.
- The System's rate of return on investments during the fiscal year ended June 30, 2002, was a negative 7.3% compared with a return of a negative 7.4% for the fiscal year ended June 30, 2001. The decrease is primarily due to continued poor stock market returns.
- The VRS, SPORS, VaLORS, and JRS were actuarially funded at 107.3%, 88.9%, 62.6%, and 81.0% based on the actuarial valuation as of June 30, 2001. This was an increase over their funded ratios of 105.4%, 86.0%, 45.1%, and 74.2% based on the actuarial valuation as of June 30, 2000.
- During its 2002 Session, the General Assembly made a number of budgetary 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 reduced the employer contributions to the Pension Trust Funds for FY 2002 and will affect the employer contributions in FY 2003 and FY 2004.

Overview of the Financial Statements

1. Basic Financial Statements. The System presents the Statement of Plan Net Assets as of June 30, 2002 and 2001 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 System for the benefit of the plan members and beneficiaries. The basic financial statements are as follows:

- **Statement of Plan Net Assets—Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds and the Agency Fund.** This statement reflects the balance of the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal year.
- **Statement of Changes in Plan Net Assets—Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds.** This statement 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. The notes disclose the System's organization; the laws governing the administration of the plans, benefits, and contributions; how asset values are determined; a summary of the investment portfolio and description of the types of investments; and a description of other employee benefit programs.

3. Required Supplementary Information. The required supplementary information consists of two schedules and related notes. These schedules provide historical trends of the funded status of the System and employer contributions. 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. Other Supplementary Information. The other supplementary information consists of additional supporting data that are not part of the general purpose financial statements, but which supplement those statements. The other supplementary information is as follows:

- Statement of Changes in Assets and Liabilities—Agency Fund. This provides additional disclosure required for the Optional Life Insurance Fund.
- Schedule of Administrative Expenses. This schedule provides more detailed information on the System's administrative expenses and a reconciliation of the GAAP basis to the budgetary basis.
- Schedule of Investment Expenses. This schedule provides more detailed information on the System's investment expenses. It includes a breakdown of management fees, performance fees, and other fees and expenses.
- Schedule of Professional and Consulting Services. This schedule provides totals of payments made for various professional and consulting services. It shows the name of the vendor and the type of services provided.

Virginia Retirement System's Net Assets

	2002 (Millions)	2001 (Millions)	Increase/ (Decrease) Amount	Increase/ (Decrease) Percentage
Assets:				
Cash, Receivables and Fixed Assets	\$ 1,963.4	\$ 3,308.1	\$ (1,344.7)	(40.6)%
Investments	35,073.9	37,892.6	(2,818.7)	(7.4)%
Security Lending Collateral	2,766.0	2,139.1	626.9	29.3%
Total Assets	\$ 39,803.3	\$ 43,339.8	\$ (3,536.5)	(8.2)%
Liabilities:				
Accounts Payable	\$ 481.9	\$ 1,109.9	\$ (628.0)	(56.6)%
Investment Purchases Payable	2,126.9	2,359.3	(232.4)	(9.9)%
Obligations Under Security Lending	2,766.0	2,139.1	626.9	29.3%
Total Liabilities	5,374.8	5,608.3	(233.5)	(4.2)%
Total Net Assets	\$ 34,428.5	\$ 37,731.5	\$ (3,303.0)	(8.8)%

Virginia Retirement System's Changes in Net Assets

	2002 (Millions)	2001 (Millions)	Increase/ (Decrease) Amount	Increase/ (Decrease) Percentage
Member Contributions	\$ 159.1	\$ 119.2	\$ 39.9	33.5%
Member Contributions Paid by Employer	504.5	475.4	29.1	6.1%
Employer Contributions	562.7	864.9	(302.2)	(34.9)%
Net Investment Income	(2,833.9)	(3,052.6)	218.7	7.2%
Total Additions	\$ (1,607.6)	\$ (1,593.1)	\$ (14.5)	(0.9)%
Retirement Benefits	\$ 1,437.8	\$ 1,298.6	\$ 139.2	10.7%
Refunds of Member Contributions	73.5	80.6	(7.1)	(8.8%)
Insurance Premiums and Claims	95.6	88.2	7.4	8.4%
Retiree Health Insurance Reimbursements	57.6	54.6	3.0	5.5%
Long Term Disability Benefits	11.6	8.4	3.2	38.1%
Administrative and Other Expenses	19.3	16.1	3.2	19.9%
Total Deductions	1,695.4	1,546.5	148.9	9.6%
Net Increase (Decrease) in Net Assets	\$ (3,303.0)	\$ (3,139.6)	\$ (163.4)	(5.2)%

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 investments 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, 2002 and 2001 is presented below in Figure 1.

Figure 1. Active Membership Distribution at June 30

	2002	2001
State Employees (VRS)	78,655	78,022
Teachers (VRS)	129,795	126,764
Political Subdivision Employees (VRS)	89,588	86,628
State Police Officers (SPORS)	1,745	1,769
Virginia Law Officers (VaLORS)	10,025	10,383
Judges (JRS)	406	404
Total	310,214	303,970

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, 2002 amounted to a negative \$1,708.4 million. This was a decrease of \$8.8 million, or 0.5%, compared with FY 2001. This information is presented in Figure 2.

Member contributions, including those paid by employers, increased \$80.9 million, while employers' contributions decreased \$306.2 million for a net decrease in contributions of \$225.3 million, or 17.7%, from the prior fiscal year. Contributions provided the total addition to plan assets in FY 2002, as they did in FY 2001. Member contributions increased by \$51.8 million. This is primarily related to the dramatic increase in the number of members purchasing previously refunded and other qualified service. Employer contributions decreased, primarily due to the suspension of contributions for state employees beginning in January 2002.

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

	2002 (Millions)	2001 (Millions)	Increase (Decrease) Amount	Increase (Decrease) Percentage
Member Contributions	\$ 117.8	\$ 66.0	\$ 51.8	78.5%
Member Contributions paid by Employer	504.5	475.4	29.1	6.1%
Employer Contributions	422.1	728.3	(306.2)	(42.0)%
Investment Income*	(2,752.8)	(2,969.3)	216.5	7.3%
Total	\$ (1,708.4)	\$ (1,699.6)	\$ (8.8)	(0.5)%

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

Investments

There was a net investment loss for FY 2002; however, the decline was \$216.5 million less than the loss in FY 2001. The net investment loss was \$2,752.8 million, or a decrease of 7.3% for FY 2002 (Figure 2). Total pension trust fund investments decreased to \$34,056.7 million at fair value at June 30, 2002. This was a decrease of \$2,771.5 million, or 7.5%.

The total return on pension trust fund investments for the fiscal year ended June 30, 2002 was a negative 7.3%. The annualized return was -0.3% over the past three years and 5.6% over the past five years. An explanation of investment policies and strategies and the portfolio's composition is included in the Investment Section of this CAFR. In addition, a review of investment activity and results for FY 2002 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 retirement plans 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 2002 totaled \$1,529.1 million, an increase of \$135.5 million, or 9.7%, over the 2001 period. The details are presented below in Figure 3.

The increase in benefit payments to \$1,437.8 million in FY 2002 was due primarily to an increase in the number of retirees and beneficiaries receiving benefits and a cost-of-living adjustment (COLA) of 3.2% on July 1, 2001. The number of retirees and beneficiaries receiving benefit payments increased to approximately 103,622 at June 30, 2002. This is an increase of 4.1% from the 99,497 at June 30, 2001.

Refunds of contributions to members who terminated their employment during FY 2002 amounted to \$73.5 million (12,209 refunds), compared with \$80.6 million (14,004 refunds) refunded during the previous fiscal year. The decline in the number of refunds is attributed to employees remaining in current positions because of a tighter job market and fewer employment opportunities.

Administration and other expenses for FY 2002 were \$17.8 million, compared with \$14.4 million for the prior year. The increase in administration expenses was due primarily to an increase in staff salaries and related benefit costs.

Figure 3. Primary Expenses for the Years Ended June 30

	2002 (Millions)	2001 (Millions)	Increase/(Decrease) Amount	Increase/(Decrease) Percentage
Benefits	\$ 1,437.8	\$ 1,298.6	\$ 139.2	10.7%
Refunds	73.5	80.6	(7.1)	(8.8)%
Administration and other	17.8	14.4	3.4	23.6%
Total	\$ 1,529.1	\$ 1,393.6	\$ 135.5	9.7%

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 expenses exceeded revenues for FY 2002, there was a net decrease of \$3,237.5 million in the retirement reserves held by the plans. As noted above, the decrease was primarily related to the investment performance for the year. During the fiscal year, the amount of interest credited to member accounts was \$211.0 million. The amount of member balances transferred to employer reserves upon members' retirements was \$264.4 million. The member and employer balances in retirement reserves at June 30, 2002 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, 2001 by Gabriel, Roeder, Smith & Company indicated that the ratio of assets accumulated by the plans to their total actuarial accrued liabilities for benefits were 107.3% for VRS, 88.9% for SPORS, 62.6% 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 the 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 Programs

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 421,875 employees and 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 \$15.9 million in optional life premiums for approximately 49,652 employees during FY 2002.

During FY 2002, the System remitted \$111.6 million to the insurance company for premiums and claims (\$95.6 million for the group life insurance program and \$16.0 million for the optional life insurance program). The difference between the premiums 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 \$838.6 million at June 30, 2002 and experienced a net investment loss of \$72.0 million during the fiscal year.

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

Figure 4. Reserve Balances at June 30

	2002 (Millions)	2001 (Millions)	Increase/(Decrease) Amount	Increase/(Decrease) Percentage
Member Reserves	\$ 5,932.7	\$ 5,432.2	\$ 500.5	9.2%
Employer Reserves	27,523.1	31,261.1	(3,738.0)	(12.0)%
Total	\$ 33,455.8	\$ 36,693.3	\$ (3,237.5)	(8.8)%

the program was extended to retired teachers and employees of participating political subdivisions on July 1, 1993. During FY 2002, the System collected \$85.2 million in retiree health insurance credit contributions from participating employers and provided credits of \$57.6 million to approximately 58,229 eligible retirees. The Retiree Health Insurance Credit Fund reserve had net assets held in trust for benefits of \$76.2 million at June 30, 2002 and experienced a net investment loss of \$5.1 million during the fiscal year.

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 2002, the System collected \$27.8 million in VSDP contributions from participating employers and provided long-term disability benefits \$11.6 million to eligible employees. The Disability Insurance Trust Fund reserve had net assets held in trust for benefits of \$57.9 million at June 30, 2002 and experienced an investment loss of \$4.0 million during the fiscal year.

Budget

The System prepares a biennial budget for its administrative expenses in accordance with the Commonwealth of Virginia's budgetary system. The budget is prepared on the cash basis and must be approved by the Board of Trustees. It is incorporated as part of the biennial Appropriation Act passed by the General Assembly. During FY 2002, the System's original budget was \$23.7 million and was increased by the Commonwealth's Department of Planning and Budget by \$0.6 million to cover the expenses associated with moving the Investment Division to another building and by \$1.2 million for staff salary increases and benefit adjustments. The adjusted budget for the year was \$25.5 million. Included in the Other Supplementary Information of the Financial Section is the Statement of Administrative Expenses. It is prepared on the accrual basis of accounting and includes a reconciliation of the GAAP basis expenses to the expenses for the budget, which are cash basis. Administrative expenses are funded from the trust funds as nongeneral funds and have no effect on the Commonwealth of Virginia's general funds.

Request for Information

This financial report is designed to provide a general overview of the Virginia Retirement System's finances for all of those with an interest in the System and its operations. 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.

Virginia Retirement System

Statement of Plan Net Assets—Defined Benefit Pension Trust Funds and Other Employee Benefit Trust Funds and The Agency Fund

As of June 30, 2002 and 2001

	Pension Trust Funds				
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total Pension Trust Funds
Assets:					
Cash (Note 5)	\$ 2,517	\$ 3	\$ 3	\$ 1	\$ 2,524
Receivables:					
Contributions	86,924	185	754	100	87,963
Interest and dividends	118,368	1,541	1,274	852	122,035
Receivable for security transactions	1,363,864	17,759	14,678	9,819	1,406,120
Other receivables	256,593	3,328	2,751	1,840	264,512
Total receivables	1,825,749	22,813	19,457	12,611	1,880,630
Due from other funds	1,525	1,862	1,037	1,730	6,154
Investments: (Note 5)					
Bonds and mortgage securities....	9,142,650	119,051	98,392	65,822	9,425,915
Stocks	7,701,623	100,286	82,885	55,447	7,940,241
Fixed income commingled funds ...	280,621	3,654	3,020	2,020	289,315
Index and pooled funds	11,795,507	153,593	126,944	84,921	12,160,965
Real estate	1,140,931	14,856	12,279	8,214	1,176,280
Venture capital	2,063,561	26,871	22,208	14,856	2,127,496
Short-term investments	908,385	11,828	9,776	6,540	936,529
Total investments	33,033,278	430,139	355,504	237,820	34,056,741
Collateral on loaned securities	2,605,078	33,922	28,036	18,755	2,685,791
Property, plant, furniture and equipment (Note 6)	6,447	—	—	—	6,447
Total assets	37,474,594	488,739	404,037	270,917	38,638,287
Liabilities:					
Retirement benefits payable	129,089	1,814	904	1,576	133,383
Refunds payable	6,091	25	557	—	6,673
Accounts payable and accrued expenses	271,688	3,525	2,913	1,949	280,075
Compensated absences payable	1,121	—	—	—	1,121
Insurance premiums and claims payable	—	—	—	—	—
Payable for security transactions	2,003,153	26,084	21,558	14,420	2,065,215
Other payables	904	6	5	3	918
Obligations under security lending program	2,605,078	33,922	28,036	18,755	2,685,791
Due to other funds	9,161	121	—	—	9,282
Total liabilities	5,026,285	65,497	53,973	36,703	5,182,458
Net assets held in trust for benefits (Note 4)					
(See Required Supplemental Schedule of Funding Progress, page 49)	\$ 32,448,309	\$ 423,242	\$ 350,064	\$ 234,214	\$33,455,829

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

(Expressed in Thousands)

Other Employee Benefit Trust Funds				Agency Fund	Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	Optional Life Insurance Fund	2002	2001
\$ 5	\$ —	\$ —	\$ 5	\$ 1,198	\$ 3,727	\$ 105,366
1,346	2,481	1,352	5,179	—	93,142	137,281
3,169	271	205	3,645	—	125,680	121,909
36,512	3,119	2,367	41,998	—	1,448,118	1,978,301
6,842	597	1,595	9,034	—	273,546	683,261
47,869	6,468	5,519	59,856	—	1,940,486	2,920,752
—	4,654	—	4,654	1,852	12,660	275,522
244,757	20,911	15,865	281,533	—	9,707,448	9,213,124
206,180	17,615	13,364	237,159	—	8,177,400	9,007,019
7,512	642	487	8,641	—	297,956	542,822
315,777	26,979	20,468	363,224	—	12,524,189	14,405,525
30,544	2,610	1,980	35,134	—	1,211,414	1,338,104
55,243	4,720	3,581	63,544	—	2,191,040	2,548,515
24,318	2,078	1,576	27,972	—	964,501	837,497
884,331	75,555	57,321	1,017,207	—	35,073,948	37,892,606
69,740	5,958	4,520	80,218	—	2,766,009	2,139,143
—	—	—	—	—	6,447	6,449
1,001,945	92,635	67,360	1,161,940	3,050	39,803,277	43,339,838
—	—	—	—	—	133,383	119,463
519	109	44	672	—	7,345	6,309
7,247	5,448	911	13,606	—	293,681	674,902
—	—	—	—	—	1,121	1,074
29,678	—	—	29,678	3,050	32,728	32,204
53,625	4,584	3,477	61,686	—	2,126,901	2,359,334
11	—	—	11	—	929	334
69,740	5,958	4,520	80,218	—	2,766,009	2,139,143
2,524	352	502	3,378	—	12,660	275,522
163,344	16,451	9,454	189,249	3,050	5,374,757	5,608,285
\$ 838,601	\$ 76,184	\$ 57,906	\$ 972,691	\$ —	\$ 34,428,520	\$ 37,731,553

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, 2002 and 2001

	Pension Trust Funds				
	Virginia Retirement System	State Police Officers' Retirement System	Virginia Law Officers' Retirement System	Judicial Retirement System	Total Pension Trust Funds
Additions:					
Contributions:					
Members	\$ 115,979	\$ 755	\$ 1,007	\$ 73	\$ 117,814
Member paid by employers	482,516	4,039	15,630	2,365	504,550
Employers	375,741	10,180	25,511	10,662	422,094
Total contributions	974,236	14,974	42,148	13,100	1,044,458
Investment income:					
Net appreciation/(depreciation) in fair value of investments	(3,272,370)	(42,433)	(38,428)	(23,609)	(3,376,840)
Interest, dividends and other investment income	690,798	8,958	8,112	4,984	712,852
Total investment income before investment expenses	(2,581,572)	(33,475)	(30,316)	(18,625)	(2,663,988)
Investment expenses	(101,235)	(1,313)	(1,189)	(730)	(104,467)
Net investment income	(2,682,807)	(34,788)	(31,505)	(19,355)	(2,768,455)
Security lending income:					
Gross income	66,642	864	783	481	68,770
Less: Borrower rebates and agent fees	(51,817)	(672)	(608)	(374)	(53,471)
Net security lending income	14,825	192	175	107	15,299
Miscellaneous revenue	286	—	—	—	286
Total additions	(1,693,460)	(19,622)	10,818	(6,148)	(1,708,412)
Deductions:					
Retirement benefits	1,389,815	20,607	8,485	18,884	1,437,791
Refunds of member contributions	69,235	559	3,657	—	73,451
Insurance premiums and claims	—	—	—	—	—
Retiree health insurance reimbursements	—	—	—	—	—
Long term disability benefits	—	—	—	—	—
Administrative expenses	15,039	185	57	104	15,385
Other expenses	2,449	—	—	—	2,449
Total operating expenses	1,476,538	21,351	12,199	18,988	1,529,076
Transfers	(1,313)	—	1,313	—	—
Net increase (decrease)	(3,171,311)	(40,973)	(68)	(25,136)	(3,237,488)
Net assets held in trust for benefits— Beginning of year	35,619,620	464,215	350,132	259,350	36,693,317
Net assets held in trust for benefits— End of year	\$ 32,448,309	\$ 423,242	\$ 350,064	\$ 234,214	\$ 33,455,829

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

(Expressed in Thousands)

Other Employee Benefit Trust Funds				Totals	
Group Life Insurance	Retiree Health Insurance Credit	Disability Insurance Trust Fund	Total Other Employee Benefit Trust Funds	2002	2001
\$ 41,282	\$ —	\$ —	\$ 41,282	\$ 159,096	\$ 119,189
—	—	—	—	504,550	475,393
27,518	85,209	27,850	140,577	562,671	864,925
68,800	85,209	27,850	181,859	1,226,317	1,459,507
(88,338)	(6,230)	(4,920)	(99,488)	(3,476,328)	(3,859,689)
18,648	1,315	1,039	21,002	733,854	908,522
(69,690)	(4,915)	(3,881)	(78,486)	(2,742,474)	(2,951,167)
(2,732)	(193)	(153)	(3,078)	(107,545)	(117,573)
(72,422)	(5,108)	(4,034)	(81,564)	(2,850,019)	(3,068,740)
1,799	127	100	2,026	70,796	149,291
(1,398)	(99)	(78)	(1,575)	(55,046)	(133,576)
401	28	22	451	15,750	15,715
—	—	—	—	286	381
(3,221)	80,129	23,838	100,746	(1,607,666)	(1,593,137)
—	—	—	—	1,437,791	1,298,627
—	—	—	—	73,451	80,622
95,625	—	—	95,625	95,625	88,179
—	57,590	—	57,590	57,590	54,628
—	—	11,578	11,578	11,578	8,336
474	335	491	1,300	16,685	15,932
198	—	—	198	2,647	170
96,297	57,925	12,069	166,291	1,695,367	1,546,494
—	—	—	—	—	—
(99,518)	22,204	11,769	(65,545)	(3,303,033)	(3,139,631)
938,119	53,980	46,137	1,038,236	37,731,553	40,871,184
\$ 838,601	\$ 76,184	\$ 57,906	\$ 972,691	\$ 34,428,520	\$ 37,731,553

Notes to Financial Statements

June 30, 2002 and 2001

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 programs established by the Commonwealth. The System is included in the general purpose 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 Boston Safe Deposit and Trust Company (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, respectively, 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 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 the employee services are performed and for the amounts due pursuant to statutes or other contractual commitments. Investment income is recognized as revenue when it is 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, Boston Safe Deposit and Trust Company (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

Fixed 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, 2002 and 2001 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, 2002 and 2001, the distribution of participating employers in the VRS was as follows:

VRS Employers

	2002	2001
Cities and Towns	147	145
Counties	92	92
School Boards*	145	148
Special Authorities	166	165
State Agencies	238	235
Total employers	788	785

**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

Membership Figures at June 30

	2002				2001
	VRS	SPORS	VaLORS	JRS	TOTAL
Retirees and beneficiaries receiving benefits	101,974	760	526	362	103,622
Terminated employees entitled to benefits but not yet receiving them	25,211	60	133	12	25,416
Total	127,185	820	659	374	129,038
Active plan participants:					
Vested	186,498	1,386	5,657	326	193,867
Nonvested	111,540	359	4,368	80	116,347
Total	298,038	1,745	10,025	406	310,214

The table above shows membership in VRS, SPORS, VaLORS, and JRS at June 30, 2002 and totals for 2001.

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 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. 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. VRS, SPORS, VaLORS, and JRS also provide death and disability benefits.

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 324,490 employees

and 97,385 retirees were covered under the program at June 30, 2002.

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 is reduced by 25% each year until its value reaches 25% of the value at retirement or termination (after age 65 for disability). These group life insurance benefit provisions and requirements are established by Title 51.1 of the *Code of Virginia* (1950), as amended.

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

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

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

ment benefit is payable for death or bodily injuries. Approximately 49,652 employees were covered under this program at June 30, 2002.

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 58,229 retired employees were covered under this program at June 30, 2002.

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 include 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 47,499 employees were covered under the program at June 30, 2002.

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 FY 2002 and FY 2001 was actuarially computed by Watson Wyatt & Company for state employees, each participating political subdivision, the State Police Officers' Retirement System, the Virginia Law Officers' Retirement System, and the

Contributions for the Years Ending June 30

(Expressed in Thousands)

	2002				2001	
	VRS	SPORS	VaLORS	JRS	TOTAL	TOTAL
Employer contributions	\$ 375,741	\$ 10,180	\$ 25,511	\$ 10,662	\$ 422,094	\$ 728,340
Employee contributions paid by employer	482,516	4,039	15,630	2,365	504,550	475,393
Employee contributions	115,979	755	1,007	73	117,814	66,016
Total contributions	\$ 974,236	\$ 14,974	\$ 42,148	\$ 13,100	\$1,044,458	\$ 1,269,749

Judicial Retirement System. In addition, a separate contribution requirement was computed for the teacher cost-sharing pool.

Contributions totaling \$1,044,458,000 and \$1,269,749,000 for the fiscal years ended June 30, 2002 and 2001, 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 \$422,094,000 for FY 2002. Included in total employer contributions were \$1,831,000 from school boards for payments toward the Early Retirement Program costs. Included in the employee contributions of \$117,814,000 were \$71,644,000 paid for the purchase of previously refunded service and other qualifying service.

Employer contributions to the VRS cost-sharing pool for teachers represented 3.60% of covered payrolls. Additionally, employer contributions to VRS by the state were 2.12% 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 12.50%, employer contributions to VaLORS by the state represented 8.08%, and employer contributions to JRS by the state represented 22.50% of covered payrolls. Employee contributions represented 5.00% of covered payrolls. Employer and employee contributions are required by Title 51.1 of the *Code of Virginia* (1950), as amended.

In addition to determining contribution requirements, the actuarial computations present an estimate of the discounted present value of the prospective accrued liability contributions that will have to be paid by employers in the future so that such contributions, together with the assets on hand, the normal contributions to be made in the future by employers and employees, and the income guaranteed by investing the funds will be sufficient to provide all benefits to be paid to present members in the future as well as to annuitants and their designated beneficiaries. Historical

trend information designed to provide information about the System's progress in accumulating sufficient assets to pay benefits when due is presented in the Required Supplemental Schedule of Funding Progress.

4. Reserve Accounts

The reserve account balances available for benefits at June 30, 2002 and 2001 are presented in the table below. These funds are required by Titles 51.1 and 2.1 of the *Code of Virginia* (1950), as amended, to provide for the payment of current and future benefits.

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

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

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

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

Reserve Balances Available for Benefits at June 30

(Expressed in Thousands)

	2002	2001
Virginia Retirement System:		
Member Reserve	\$ 5,723,813	\$ 5,240,175
Employer Reserve.....	26,724,496	30,379,445
Total VRS	32,448,309	35,619,620
State Police Officers' Retirement System:		
Member Reserve	57,736	55,390
Employer Reserve.....	365,506	408,825
Total SPORS	423,242	464,215
Virginia Law Officers' Retirement System:		
Member Reserve	124,566	112,598
Employer Reserve.....	225,498	237,534
Total VaLORS	350,064	350,132
Judicial Retirement System:		
Member Reserve	26,572	24,086
Employer Reserve.....	207,642	235,264
Total JRS	234,214	259,350
Group Life Insurance:		
Advance Premium Deposit Reserve	838,601	938,119
Retiree Health Insurance Credit Reserve.....	76,184	53,980
Virginia Sickness and Disability Program:		
Disability Insurance Trust Fund	57,906	46,137
Total Pension and Other Employee Benefit Reserve	\$ 34,428,520	\$ 37,731,553

5. Deposits and Investments

A. Deposits

Deposits of the System that are maintained by the Treasurer of Virginia at June 30, 2002 and 2001 were entirely insured under the Virginia Security for Public Deposits Act, Section 2.1-359 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, 2002 and 2001 consisted of the following (in thousands):

	2002	2001
Deposits	Carrying Amount	Carrying Amount
Treasurer of Virginia	\$ 3,507	\$ 104,757
Master Custodian	220	609
Total Deposits	\$ 3,727	\$ 105,366

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 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, 2002 and 2001 (in thousands):

	2002 Fair Value	% of Total Value	2001 Fair Value	% of Total Value
Bonds and Mortgage Securities:				
U.S. Government and agencies	\$ 2,561,278	7.30%	\$ 2,386,237	6.30%
Mortgage securities	3,833,426	10.93%	4,277,602	11.29%
Corporate and other bonds.....	3,312,744	9.45%	2,549,285	6.73%
Total bonds and mortgage securities	9,707,448	27.68%	9,213,124	24.32%
Common and Preferred Stocks	8,177,400	23.30%	9,007,019	23.77%
Index and Pooled Funds:				
Equity index and pooled funds.....	12,524,189	35.71%	14,405,525	38.02%
Fixed income commingled funds.....	297,956	0.85%	542,822	1.43%
Total index and commingled funds.....	12,822,145	36.56%	14,948,347	39.45%
Real Estate:				
Commingled funds.....	382,852	1.09%	444,177	1.17%
Properties	11,334	0.03%	11,334	0.03%
Real estate loans.....	3,595	0.01%	4,310	0.01%
Focused	813,633	2.32%	878,283	2.32%
Total real estate	1,211,414	3.45%	1,338,104	3.53%
Venture Capital	2,191,040	6.25%	2,548,515	6.73%
Short-Term Investments:				
Treasurer of Virginia—Local Government Investment Pool	150,142	0.43%	77,544	0.20%
TBC Pooled Employee Trust Funds.....	787,648	2.25%	727,920	1.92%
Foreign currencies.....	26,711	0.08%	32,033	0.08%
Total short-term investments	964,501	2.76%	837,497	2.20%
Total investments.....	\$ 35,073,948	100.00%	\$ 37,892,606	100.00%

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. As of June 30, 2002 and 2001, the equity interests of each fund were as follows:

	2002	2001
Virginia Retirement System.....	94.18%	95.06%
State Police Officers' Retirement System.....	1.23%	1.23%
Virginia Law Officers' Retirement System.....	1.01%	0.22%
Judicial Retirement System	0.68%	0.68%
Group Life Insurance Fund.....	2.52%	2.55%
Retiree Health Insurance Credit Fund.....	0.22%	0.14%
Disability Insurance Trust Fund.....	0.16%	0.12%
Total	100.00%	100.00%

2. Custodial Risk

Investments held by the System at June 30, 2002 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 securi-

ties. Securities lent at year end for cash collateral are presented as unclassified, while securities lent for noncash collateral are classified according to their custodial arrangements for the related non-cash collateral securities. The cash collateral is invested in instruments, such as commercial paper, repurchase agreements, asset-backed securities, certificates of deposit, and floating rate notes, in an agent-managed separate account.

3. Securities Lending

Under authorization of the Board, the System lends its fixed income and equity securities to various broker-dealers on a temporary basis. This program is administered through an agreement with the System's custodial agent bank. All security loan agreements are collateralized by cash, securities, or irrev-

Summary of Categorized Investments at Fair Value

As of June 30, 2002

(Expressed in Thousands)

	Category			Non-Categorized	Total Fair Value at June 30, 2002
	1	2	3		
Long-Term Investments					
Bonds and Mortgage Securities:					
U.S. Government and agencies.....	\$ 4,285,497	\$ —	\$ 78,665	\$ —	\$ 4,364,162
Corporate and other bonds.....	2,823,639	—	4,453	—	2,828,092
Held by brokers-dealers under securities lending program:					
U.S. Government and agencies.....	80,436	—	62,456	1,887,650	2,030,542
Corporate and other bonds.....	—	—	—	484,652	484,652
Common and preferred stocks.....	7,843,660	—	—	—	7,843,660
Held by brokers-dealers under securities lending program.....	—	—	—	333,740	333,740
Equity index and pooled funds.....	—	—	—	12,524,189	12,524,189
Fixed income commingled funds.....	—	—	—	297,956	297,956
Real estate investments.....	—	—	—	1,211,414	1,211,414
Venture capital.....	—	—	—	2,191,040	2,191,040
Total long-term investments.....	15,033,232	—	145,574	18,930,641	34,109,447
Short-Term Investments					
Investments held by Treasurer:					
Local Government Investment Pool.....	—	—	—	150,142	150,142
Investments held with Trustees:					
TBC Pooled Employees Trust Funds.....	—	—	—	787,648	787,648
Foreign currencies.....	—	—	—	26,711	26,711
Total short-term investments.....	—	—	—	964,501	964,501
Total Investments.....	\$ 15,033,232	\$ —	\$ 145,574	\$ 19,895,142	\$ 35,073,948
Securities Lending Separate Account.....	\$ —	\$ —	\$ —	\$ 2,766,009	\$ 2,766,009

ocable 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 53 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, 2002 and 2001 was \$2,848,935,000 and \$2,271,711,000, respectively. The value of collateral (cash and non-cash) at June 30, 2002 and 2001 was \$2,911,763,000 and \$2,342,115,000, 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, 2002 and 2001, respectively, include (1) receivables for deposits with brokers for securities sold short of \$736,544,000 and \$836,361,000 and (2) payables for securities sold short and not covered with market values of \$792,015,000 and \$703,435,000, 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 \$74,999,000 at June 30, 2002.

6. Forward, Futures, and Option Contracts

Forward contracts are contracts to purchase or sell, and futures contracts are contracts to deliver or receive financial instruments, foreign currencies, or commodities at a specified future date and at a specified price or yield. Futures contracts are traded on organized exchanges (exchange traded) and require initial margin (collateral) in the form of cash or marketable securities. The net change in

the futures contract value is settled daily, in cash, with the exchanges. Holders of futures contracts look to the exchange for performance under the contract and not to the entity holding the offsetting futures position. Accordingly, the amount at risk posed by nonperformance of counterparties to futures contracts is minimal. In contrast, forward contracts traded over the counter are generally negotiated between two counterparties. They are subject to credit risks resulting from nonperformance of one of the counterparties and to market risks resulting from adverse fluctuations in market prices, interest rates, and foreign exchange rates.

Options may be either exchange traded or negotiated directly between two counterparties over the counter. Options grant the holder the right, but not the obligation, to purchase or sell a financial instrument at a specified price and within a specified period of time from the “writer” of the option. As a purchaser of options, the System typically pays a premium at the outset. This premium is reflected as an asset on the financial statements. The System then retains the right but not the obligation to exercise the option and purchase the underlying financial instrument. Should the option not be exercised, it expires worthless and the premium is recorded as a loss. A writer of options assumes the obligation to deliver or receive the underlying financial instrument on exercise of the option. Certain option contracts may involve cash settlements based on specified indexes such as stock indexes. As a writer of options, the System receives a premium at the outset. This premium is reflected as a liability on the financial statements and 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, 2002, the System had purchased S&P and Russell Index futures and options on Eurodollar and Treasury bond note futures, including options on Eurodollar futures, with a notional value of \$1,060,556,000, and sold

S&P Index futures and options on Eurodollar and Treasury bond and note futures, including options on these futures, with a notional value of \$394,316,000. At June 30, 2002, the System had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of \$79,358,000 as the margin requirement for futures contracts.

7. Foreign Exchange Contracts

Foreign exchange contracts include forward, futures, and options contracts. They involve either the exchange of specific amounts of two currencies or the delivery of a fixed amount of a currency at a future date and specified exchange rate. Forward and futures contracts settle three or more business days from the contract date. Forward contracts are negotiated over-the-counter between two counterparties, while futures contracts are exchange traded. Foreign currency options, which are either negotiated between two counterparties or are exchanged traded, grant the buyer the right, but not the obligation, to purchase or sell at a specified price, a stated amount of an underlying currency at a future date. At June 30, 2002, the System had sold foreign currency contracts with a notional value of \$156,394,000 and had purchased foreign currency contracts with a notional value of \$157,721,000. In addition, the System had purchased options on foreign currency with a market value of \$353,000.

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, 2002, the System held CMO securities with a market value of \$301,643,000 and IO and PO securities with a market value of \$2,175,000.

The credit risks on the various asset-backed securities in which the System invests are usually very low. Many of the securities held by the System are issued by quasi-U.S. governmental agencies. Others are issued by organizations with AAA or AA credit ratings. The market risk of these securities depends on changes in interest rates and the level of the underlying prepayments (i.e., when the 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 2002, the System entered into interest rate and total return swaps with a total notional value of \$80,000,000. Swaps are used to manage risk and enhance returns. To reduce the risk of counterparty non-performance, the System generally requires collateral on any material gains from these transactions.

6. Property, Plant, Furniture, and Equipment

The summary of property, plant, furniture, and equipment at June 30, 2002 and 2001 is as follows (in thousands):

	June 30, 2002	Accumulated Depreciation	Net June 30, 2002	Net June 30, 2001
Land	\$ 1,368	\$ —	\$ 1,368	\$ 1,368
Building	4,632	(463)	4,169	4,285
Furniture and equipment	3,495	(2,585)	910	796
Total	\$ 9,495	\$ (3,048)	\$ 6,447	\$ 6,449

Depreciation expense amounted to \$407,000 and \$365,000 in 2002 and 2001, 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, 2002, was \$758,000. The System has, as of June 30, 2002, the following total future minimum rental payments due under the above leases (in thousands):

2003	\$ 707
2004	556
2005	178
Total future minimum rental payments	\$ 1,441

8. Defined Benefit Pension Plan

A. Contributions to Pension Plan

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

Note 2A provides information regarding types of employees covered, benefit provisions, employee eligibility requirements (including eligibility requirements for vesting), and the authority under which benefit provisions and employer/employee obligations to contribute are established. Additional information on funding policy and contributions required and made can be found in Note 3. Information on the actuarial method and assumptions can be found in the "Notes to Required Supplemental Schedules."

Historical trend information showing the Commonwealth of Virginia's progress in accumulating

sufficient assets to pay benefits when due is presented in the Commonwealth's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002.

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 97,857 state employees and 37,696 retirees in the program during FY 2002. 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, 2001, were \$1,657.4 million. The actuarial value of the program's assets available for benefits on that date was \$994.4 million, leaving a present value of future contributions of \$663.0 million.

The System's contribution requirements for its employees for the fiscal years ended June 30, 2002 and 2001 were \$56,000 and \$72,000, respectively. In April 2002, the General Assembly suspended contributions for the remainder of the current fiscal year and for FY 2003 and FY 2004.

B. Retiree Health Insurance Credits

The Commonwealth of Virginia provides health insurance credit reimbursements, in accordance with state statutes, against the monthly health insurance premiums of its retirees who have at least 15 years of service. The monthly credit

amounts to \$4.00 per year of service, not to exceed a maximum credit of \$120.00. All state agencies are required to contribute to the program at an actuarially determined percentage of their payroll. Contributions are being financed on a current disbursement basis. Approximately 26,725 state retirees were receiving health insurance credits at June 30, 2002. Note 2C contains information regarding eligibility requirements, benefit provisions, and contribution requirements.

For the fiscal year ended June 30, 2002, state agencies were required to contribute to the program at the actuarially determined rate of 1.21% of covered payroll. The System's contribution requirements for its employees for the fiscal years ended June 30, 2002 and 2001 were \$117,000 and \$101,000, 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, 2002 approximately 47,499 participants were enrolled in the program.

For the fiscal year ended June 30, 2002, state agencies were required to contribute to the program at the actuarially estimated rate of 0.83% of payroll for state employees and 1.10% 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, 2002 and 2001 were \$81,000 and \$75,000, 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, 2002. 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 2002 and the three preceding fiscal years.

12. Commitments

The System extends investment commitments in the normal course of business. At June 30, 2002 and 2001, these commitments amounted to \$1,615,000,000 and \$1,629,000,000, 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 2002 and will have an affect on FY 2003 and FY 2004. The changes made modify the contributions received for all state employee groups (state employees in the VRS plan as well as those in SPORS, VaLORS, and JRS) and teachers. The change did not impact the rates contributed by political subdivisions.

For FY 2002, the funded rate for teachers was retroactively reduced from 4.24% to 3.60%, the

rate recommended by the actuary to begin in FY 2003. For state employee groups, the funded rates were reduced to 0.00% (zero) in January 2002. The impact of the rate changes is shown in the Required Supplemental Schedule of Employer Contributions.

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

14. GASB Statement 34

The Government Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* was issued in June 1999 and is effective for the System for the fiscal year ended June 30, 2002. This Statement required changes in the System's financial statement presentation, specifically for the Disability Insurance Trust Fund. Previously, the System reported the Disability Insurance Trust Fund as an Internal Service Fund with the additional statements needed for adequate disclosure. Under GASB Statement No. 34, the Disability Insurance Trust Fund is classified as an "Other Employee Benefit Trust Fund" instead of an Internal Service Fund. The System has also restated the FY 2001 comparative information to reflect the change in presentation.

Required Supplemental Schedule of Funding Progress

(Dollars in Millions)

Actuarial Valuation Date June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)— Entry Age (b)	Unfunded AAL (UAAL) (a-b)	Funded Ratio (a/b)	Covered Payroll	UAAL as a Percentage of Covered Payroll (b-a)/(c)
Virginia Retirement System (VRS)						
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)						
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)						
2001	\$ 393	\$ 628	\$ 235	62.6%	\$ 320	73.4%
2000 ***	307	680	373	45.1%	315	118.4%
Judicial Retirement System (JRS)						
2001	\$ 247	\$ 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)				
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)				
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)				
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)				
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, and 2002 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, 2001
Actuarial Cost Method:	Entry Age Normal
Amortization Method:	
State Employees	Level percent, open
Political Subdivision Employees	Level percent, open
Teachers	Level percent, open
State Police /VA Law Officers /Judges	Level percent, closed
Payroll Growth Rate	3.00%
Remaining Amortization Period:	
State Employees	0 Years
Political Subdivision Employees	0 to 30 Years
Teachers	14 Years
State Police /VA Law Officers /Judges.....	25 Years
Asset Valuation Method:	Modified Market
Actuarial Assumptions:	
Investment Rate of Return *	8.00%
Projected Salary Increases *	
State /Political Subdivision Employees	4.25% to 6.10%
Teachers	4.00% to 6.10%
State Police /VA Law Officers.....	4.50% to 5.75%
Judges.....	5.00%
Cost-of-Living Adjustments	3.00%

* Includes inflation at 3.00%

Virginia Retirement System

Statement of Changes in Assets and Liabilities—Agency Fund

Optional Life Insurance Fund

For the Years Ended June 30, 2002 and 2001

(Expressed in Thousands)

	Balance July 1, 2001	Additions	Deductions	Balance June 30, 2002
Assets:				
Cash.....	\$ 1,221	\$ 15,947	\$ 15,970	\$ 1,198
Due from other funds	1,728	124	—	1,852
Total assets	\$ 2,949	\$ 16,071	\$ 15,970	\$ 3,050
Liabilities:				
Insurance premiums and claims payable	\$ 2,949	\$ 101	\$ —	\$ 3,050
Due to other funds	—	—	—	—
Total liabilities.....	\$ 2,949	\$ 101	\$ —	\$ 3,050

Schedule of Administrative Expenses

Years Ended June 30, 2002 and 2001

(Expressed in Thousands)

	Totals	
	2002	2001
Personal Services:		
Salaries and wages	\$ 10,898	\$ 9,993
Per diem services.....	301	225
Retirement contributions.....	730	962
Social Security.....	754	706
Group life and medical insurance	960	898
Compensated absences.....	190	194
Total personal services.....	13,833	12,978
Professional Services:		
Data processing.....	3,961	3,538
Actuarial and consulting.....	846	1,437
Legal	408	336
Medical	177	233
Management services.....	185	100
Public information services.....	81	19
Personnel development services	82	64
Total professional services.....	5,740	5,727
Communication Services:		
Media.....	95	67
Printing	616	688
Postal and delivery.....	705	478
Telecommunications.....	307	171
Total communication services	1,723	1,404
Rentals:		
Business equipment.....	524	305
Office space	234	125
Total rentals	758	430
Other Services and Charges:		
Skilled and clerical services	282	111
Depreciation.....	407	365
Dues and memberships.....	50	41
Building expense	409	338
Equipment	162	427
Insurance.....	24	63
Repairs and maintenance	116	57
Supplies and materials.....	174	170
Travel and transportation.....	668	766
Miscellaneous.....	122	43
Total other services and charges	2,414	2,381
Total Administrative Expenses (GAAP basis).....	24,468	22,920
Adjustments necessary to convert administrative expenses on the GAAP basis to the budgetary basis at year end (net)	149	(681)
Administrative Expenses (Budgetary basis)	\$ 24,617	\$ 22,239
Administrative Expenses Appropriated	\$ 25,544	\$ 24,959
Distribution of Administrative Expenses:		
Total Administrative Expenses (GAAP Basis).....	\$ 24,468	\$ 22,920
Less: In-house Investment Management.....	(7,783)	(6,988)
Net Administrative Expenses	\$ 16,685	\$15,932

Schedule of Investment Expenses

Year Ended June 30, 2002

(Expressed in Thousands)

Management fees:

Domestic managers.....	\$ 4,021	
Non-U.S. equity managers	9,267	
Fixed income managers.....	6,268	
Real estate managers	9,856	
Alternative investment managers	58,088	\$ 87,500

Performance fees		8,859
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Total management and performance fees		96,359
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Miscellaneous fees and expenses:

Custodial fees	\$ 3,295	
Legal fees	59	
Taxes and wire fees	11	
Other fees and expenses.....	38	3,403

In-House Investment Management:		7,783
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Total investment expenses		\$ 107,545
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Schedule of Professional and Consulting Services Year Ended June 30, 2002

(Expressed in Thousands)

Actuarial, Legal and Oversight Services:

Attorney General of Virginia	Legal Services	\$ 112
Gabriel, Roeder, Smith & Company	Actuarial Services	198
Joint Legislative Audit Review Commission	Oversight Responsibilities	79
Troutman Sanders Mays & Valentine, LLP	Legal Services	150
Watson Wyatt Worldwide	Actuarial Services	122

Subtotal Actuarial, Legal and Oversight Services..... **\$ 661**

Consulting Services:

Alongside Management, Inc.	Team Workshop/Staff & Board	\$ 11
Altius Associated Limited	Investment Consultant Services	52
Boynton Rothschild Rowland Architects, PC	Architectural Services	11
Cost Effectiveness Measurement Inc.	Cost Driver Benchmarking	40
Corvel	Disability Physician Referral Service	158
EEI	Editorial, Design & Preparation of Annual Report	44
Lane & Associates, PC	VSDP Policy Development	11
Medical Board	Medical Examiners	50
Palmer & Cay Consulting Group	Consulting Services	17
Pension Consulting Alliance Inc.	Real Estate Services	80
Social Security Disability Consultants	Social Security Advocacy	56
Strategic Economic Decisions, Inc.	Economic Advisory Services	20
Thomason Financial Investment Banking	Venture Capital Analytics	50
VCU Center for Public Policy	Strategic Planning Consultants	23

Subtotal Consulting Services..... **623**

Total **\$ 1,284**

The 1970s—Pressures of Energy Needs and a Troubled Economy

After Vietnam and Watergate, Americans regrouped with fresh political leadership, only to see inflation, oil embargoes, and energy shortages plague the nation. In Virginia, VRS expanded benefits by providing annual postretirement cost-of-living adjustments (COLAs) for retirees. The plan also began allowing employers to pay retirement contributions and group life premiums for their employees.

1970–1979

July 1, 1970—VRS introduces post-retirement supplements (COLAs) for retirees retroactive to 1952. Future increases are to occur every two years. The number of years of service required to receive a deferred service annuity is reduced from 10 years to 5. The Judicial Retirement System is created.

July 1, 1972—An amendment to the Group Life Program allows employers to pay premiums for covered employees.

July 1, 1974—The number of years used to calculate the Average Final Compensation is reduced from 5 years to the 36 highest consecutive months of creditable compensation.

July 1, 1976—Employers may now pay retirement contributions for their employees.

July 1, 1977—The early retirement age is reduced from age 60 to age 55 with five years of creditable service. Benefits are reduced from the earlier of age 65 or the date the member would have attained age 60 with 30 years of service.

July 1, 1978—COLAs begin to be awarded on an annual basis.



Judicial Retirement System created, 1970



Board of Trustees and VRS staff, 1978



Director Glen Pond, 1973–1991



First annual report, 1978

Elsewhere in the USA

1970 marks the first Earth Day. The number of Smiley buttons produced by 1972 hits 50 million; President Richard Nixon resigns in 1974. The minimum wage is \$2.00 an hour in 1975, and a loaf of bread costs 24 cents. A company called Microsoft is launched and the first personal computers are sold. The price of a first-class stamp rises throughout the decade, from 8 cents in 1971 to 15 cents in 1978. Elvis Presley dies, and the Sony Walkman appears. The decade closes on a somber note when Americans are taken hostage in Iran.



INVESTMENT SECTION

Investment Account

The information presented in the Investment Section was prepared by the VRS investment staff responsible for the various investment programs. The Investment Section was prepared under the direction of Nancy C. Everett, the VRS Chief Investment Officer.

The VRS investment account consists of funds contributed by both employers and employees of Virginia's state agencies, teachers, state police, law enforcement officers, judges, and many local governments. These contributions are pooled and invested to provide for the payment of current and future benefits to the participants when they retire. The VRS Board of Trustees 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 in order 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. Based on this analysis, 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

objectives serve as management tools to help judge the progress toward achieving long-term goals.

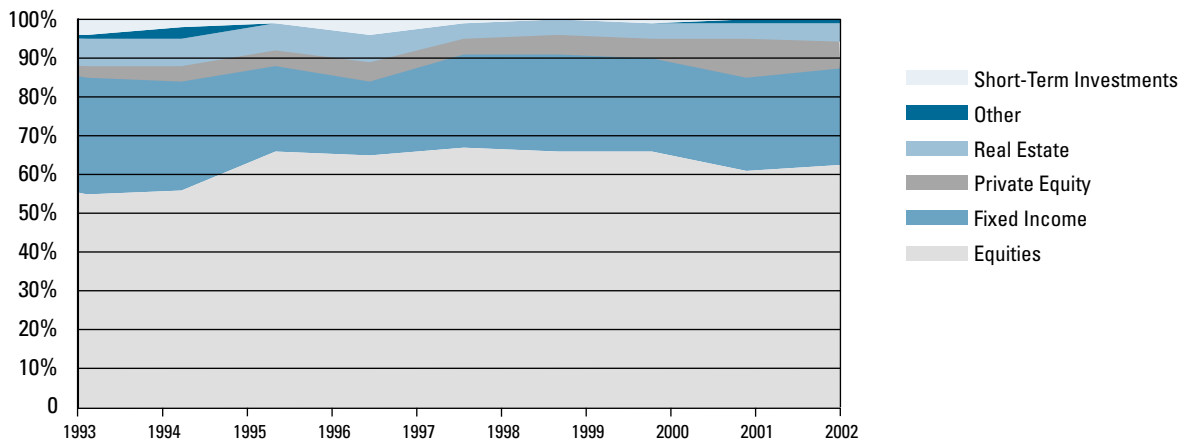
Investment Strategies

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's pension obligations.

Every four years, 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 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 that individually may be volatile in the short run provides a framework for this asset allocation strategy. The most recent study was completed in December 2000.

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

Investment Comparison at Fair Market Value



Investment Results

Poor stock market returns for the past two years, coupled with lower returns for all asset classes, have resulted in below-average returns for the fund over the short term. These negative equity returns have been tempered somewhat by the positive returns from the other asset classes in the diversified portfolio,

especially real estate and fixed income. Additionally, the fund's 9.6% annualized 10-year return remains ahead of the 8% actuarial assumption. This period of negative returns was not entirely unexpected, following on the heels of the best 20 years ever for the U.S. equity market.

Investment Performance Summary

Annualized Data for Periods Ending June 30, 2002

	1 Year	3 Years	5 Years
1. Total Fund Time Weighted Returns			
VRS	(7.3)%	(0.3)%	5.6%
Inflation (CPI)	1.1%	2.7%	2.3%
Actuarial Assumed Return	8.0%	8.0%	8.0%
2. Total U.S. Equity			
VRS	(16.6)%	(8.0)%	3.3%
Russell 3000	(17.2)%	(7.9)%	3.8%
3. Total Non-U.S. Equity			
VRS	(7.4)%	(5.9)%	(3.1)%
Salomon BMI Global ex US	(7.6)%	(5.8)%	(3.4)%
4. Total Fixed Income			
VRS	8.3%	8.1%	7.6%
Lehman Brothers VRS Benchmark	8.7%	8.1%	7.6%
5. Total Real Estate			
VRS	10.1%	11.5%	10.3%
Custom Benchmark	7.8%	11.4%	11.9%
6. Total Private Equity			
VRS	(9.1)%	24.2%	25.1%
Custom Benchmark	4.3%	1.4%	12.7%
7. Total High Yield			
VRS	0.8%	n/a	n/a
Custom Benchmark	(1.6)%	n/a	n/a

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

Portfolio Highlights

U.S. Equity

Publicly traded domestic stocks totaled \$15.2 billion at year-end, approaching 44% of the total fund. Sixty-nine percent of the portfolio was invested in passive strategies and 22% managed internally. The objective of the portfolio is to exceed the return of the Russell 3000 over three-year periods net of all costs.

The U.S. Equity program outperformed the benchmark Russell 3000 during the fiscal year by 0.66%. The market as a whole, however, had significant negative returns because of the events of September 11th and a continuing slow economy. During the year, the Russell 3000 was down 17.2% and the NASDAQ lost 32.3%.

Value stocks continued to outperform growth stocks, especially in the mid- and smaller capitalization companies.

	1-Year Total Return June 30, 2002
Russell Top 200 Growth	(26.5%)
Russell Top 200 Value	(13.3%)
Russell Midcap Growth	(26.3%)
Russell Midcap Value	1.9%
Russell 2000 Growth	(25.0%)
Russell 2000 Value	8.5%

The VRS portfolio remained fairly close to the market's exposure in individual economic sectors. At year-end the portfolio had a slight underweight in the Health Care and Financial sectors and the largest overweight in the Consumer Discretionary sector.

	VRS Exposure	Russell 3000	Total Return
Consumer Discretionary	14.1 %	13.7 %	(2.2%)
Consumer Staples	8.5 %	8.7 %	0.6%
Energy	6.1 %	5.9 %	(0.1%)
Financials	21.3 %	21.6 %	(1.2%)
Health Care	13.9 %	14.2 %	(2.4%)
Industrials	11.4 %	11.5 %	(1.3%)
Information Technology	13.9 %	14.0 %	(7.3%)
Materials	3.5 %	3.2 %	0.2%
Telecommunication Services	3.7 %	3.8 %	(2.2%)
Utilities	3.7 %	3.4 %	(1.1%)

The top 10 holdings in the U.S. Equity program comprised 17% of the program at year-end. In addition to representing a smaller portion of the total portfolio than last year's 18.9%, two companies have fallen from the list. AOL Time Warner Inc. and International Business Machines Corp. have been replaced by Wal-Mart Stores and Procter & Gamble.

Company	Market Value	Shares
General Electric Co.	\$375,793,720	12,936,101
Exxon Mobile Corp.	370,749,688	9,060,354
Microsoft Corp.	323,959,114	5,908,570
Pfizer Inc.	291,645,555	8,332,730
Citigroup Inc.	275,332,744	7,105,361
Johnson & Johnson	209,095,662	4,010,665
Wal-Mart Stores	205,838,402	3,741,836
American International Group	192,885,527	2,826,990
Procter & Gamble Co.	166,669,522	1,866,400
Intel Corp.	161,363,907	8,832,179

Non-U.S. Equity

Approximately 15.7% of the total portfolio was invested in foreign stocks at year-end. Fifty-one percent of this portfolio is managed passively, and all assets are managed externally. Ninety-three percent of the portfolio was invested in developed countries and 7% in emerging markets. The objective of the program is to exceed the return of the unhedged Salomon Smith Barney BMI Global ex US Index over three-year periods net of all costs.

Non-U.S. markets also had a negative return for the year. The VRS benchmark, the Salomon Smith Barney BMI Global ex US, lost 7.6% during this time.

Value stocks also mirrored the U.S. experience and outperformed growth in all regions of the developed markets. In addition, small capitalization stocks outperformed large.

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 a hedge in the event of a deflationary environment. At year-end, \$9.3 billion was invested in fixed-income assets, representing 27% of the VRS portfolio. Of this amount, approximately 60% was invested actively using outside investment managers, and 40% was invested passively, predominantly through internally managed accounts. The objective of the program is to control risk and exceed the return of the VRS Custom Lehman Brothers Index, net of all costs.

In a broad sense, conditions were very favorable for bond investments over the past year. Responding to

economic weakness, the Federal Reserve continued to cut the overnight rate, and market yields moved significantly lower, particularly for short- and intermediate-term Treasury securities. Despite this favorable backdrop, price gains from lower interest rates were partially offset by poor performance in the corporate bond sector caused by weak earnings, accounting questions, and deteriorating credit quality. The mortgage sector was able to beat Treasuries by a small margin, despite very high refinancing activity.

The fixed-income program return was 8.3% for the fiscal year, well above our long-term return assumption for bonds. The program lagged the benchmark return of 8.7% because of weak corporate sector performance in the active portion of the portfolio.

Fixed-Income Portfolio

As of June 30, 2002

Sector Allocation: Sector	Market Value (In millions)	% Portfolio
Treasury	\$ 1,338	14.4%
Agency	907	9.8%
Corporate	2,650	28.6%
Mortgage	3,580	38.7%
Asset Backed	202	2.2%
CMBS	222	2.4%
Foreign	160	1.7%
Other	202	2.2%
Total	\$ 9,261	100.0%

Credit Quality Breakdown: Rating	Market Value (in millions)	% Portfolio
Government	\$ 5,451	58.9%
AAA	1,256	13.6%
AA	472	5.1%
A	1,114	12.0%
BBB	787	8.5%
BB	150	1.6%
B	27	0.3%
Below B	4	0.0%
NR	—	0.0%
Total	\$ 9,261	100.0%

Portfolio Characteristics:

Characteristic	Value
Average Quality	AAA
Average Duration	4.3
Average Yield	5.5

VRS Fixed Income Top 10 Holdings by Market Value

As of June 30, 2002

Par	Security Description	Market Value
220,900,000	GNMA 6.500% 30-year MBS	\$225,318,000
102,765,000	U.S. Treasury Bonds 8.000% 11/15/2021	131,468,292
87,776,000	FNMA 5.125% 2/13/2004	90,994,746
64,470,000	GNMA 7.000% 3-year MBS	70,021,041
69,000,000	FNMA 6.000% 30-year MBS	68,956,654
65,800,000	FNMA 6.000% 30-year MBS	65,635,500
60,400,000	FNMA 7.000% 30-year MBS	62,551,750
60,000,000	FHLMC 7.000% 30-year MBS	62,165,625
57,795,480	GNMA 7.000% 6/15/2031	59,980,728
45,835,000	U.S. Treasury Bonds 10.375% 11/15/2012	58,906,682

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 2.66% over the past year.

Alternative Investments

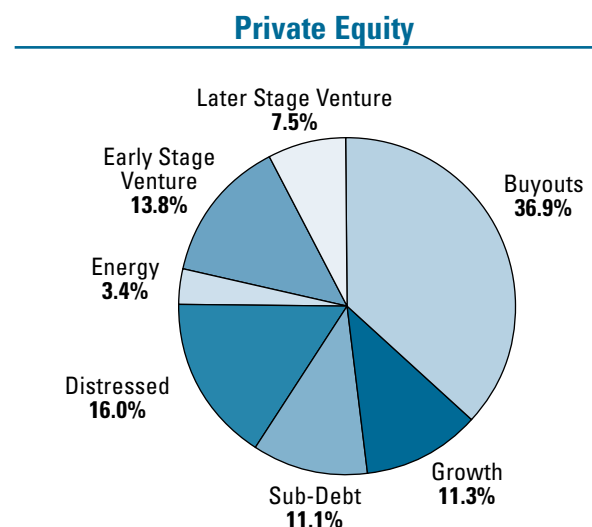
The VRS Board policy allows for up to 20% of the portfolio to be invested in an Alternative Investments program. The objective of the program is to improve the expected risk/return profile of the total fund. Currently the program has investments in Real Estate, Private Equity, and High Yield Bonds. At June 30, 2002, Alternative Investments comprised 13% of the total fund portfolio.

Private Equity

VRS invests in Private Equity in order to achieve returns greater than those available in the public equity markets. Specifically, the program seeks to outperform the Russell 3000 Index by 2.5% per year. The program's results are measured differently from the publicly traded investments, in that a dollar-weighted or internal rate-of-return (IRR) calculation is considered more appropriate. Based on this methodology, the Private Equity IRR since program inception (1989) was an annualized 25.8%. By comparison, a dollar-weighted return for the Russell 3000 Index over the same time frame would be 17.7%.

As of June 30, 2002, the appraised value of the program was approximately \$2.3 billion, or close to 6.6% of the total fund. The majority of the program is invested in limited partnerships that invest in buyouts and venture capital. Other sectors include growth, mezzanine, distressed, and energy.

The Private Equity program continues to be affected by the decline in public market valuations. While the time-weighted return for the program in 2000 was over 148%, it returned -15.2% in 2001 and this year returned -9.1%. The long-term returns remain strong, however, as evidenced by the three-year, five-year, and since-inception annualized returns of 24.2%, 25.1%, and 25.8%, respectively. The breakdown of the program by subclass was as follows:



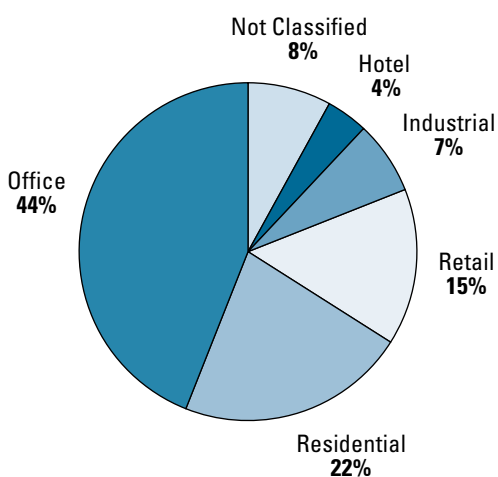
Real Estate

A portion of the Alternative Investments portfolio is invested in Real Estate in order to diversify the total fund and give it exposure to an asset class that has a low correlation with the public markets. The program was the best performing asset class in 2002, returning 10.1%. A significant portion of this performance came from Real Estate Investment Trusts (REITs), which returned 16.5% for the year.

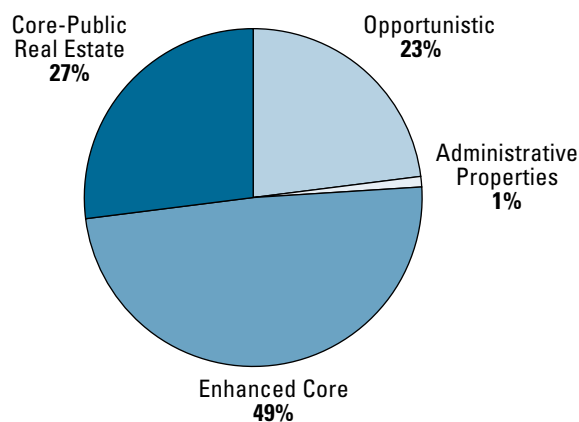
The characteristics of the Real Estate portfolio remained stable over the year. At year-end the portfolio comprised approximately 27% in public real estate and 73% in private assets. Debt as a percentage of total real estate assets remained at a conservative level of 31%.

Diversification Characteristics

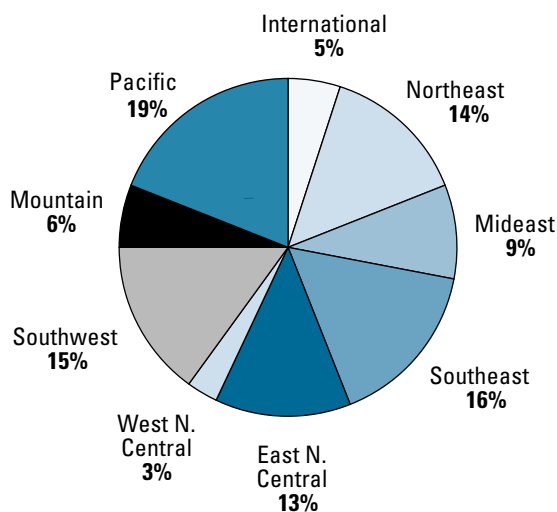
By property type



By risk and return



By region



VRS Money Managers

The diversified investment structure as of June 30, 2002 is reflected in the following table, which lists all VRS managers by investment program and style.

U.S. Equity	Style Description	VRS Assets Under Management as of June 30, 2002 (in millions)	VRS Management Fees Paid in FY2002 (in millions)
External Asset Management			
Aronson & Partners	Medium Small	\$ 69	\$ 0.2
Credit Suisse Asset Management	Broad Market	182	1.3
Fiduciary Asset Management	Broad Market	266	0.7
Franklin Portfolio Associates	Medium-Small	87	0.2
Freeman Associates Investment	Broad Market	299	0.6
Goldman Sachs Asset Management	Small	303	0.8
J.P. Morgan Investment Management	Broad Market	544	0.9
Progress Invest Management Company	Broad Market	141	0.5
State Street Global Advisors	Broad Market	9,577	0.3
Symphony Asset Management	Broad Market	389	1.0
Subtotal		11,857	6.5
Internal Asset Management*			
Chesapeake	Medium Growth	168	—
Dominion Growth	Large Growth	665	—
Equal Weighted S&P	Equal Weighted S&P 500	754	—
Potomac Core	Broad Market	878	—
Skyline Value	Mid Cap Value	243	—
Tidewater Value	Large Value	593	—
Subtotal		3,301	—
Total Incentive Fees (Current Managers)		—	8.9
Total Fees Paid (Terminated Managers)		—	1.5
Total U.S. Equity		\$ 15,158	\$ 16.9

VRS Money Managers, continued

		VRS Assets Under Management as of June 30, 2002 (in millions)	VRS Management Fees Paid in FY2002 (in millions)
Non-U.S. Equity			
Style Description			
Acadian Asset Management	Emerging Markets/SSB PMI Emerging Markets	\$ 202	\$ 0.5
Alliance Bernstein	Developed Markets/SSB PMI Developed Markets	372	0.8
Baillie Gifford	Developed Markets/SSB PMI Developed Markets	332	0.7
Blackrock International	International Small Cap/SSB EMI Global ex US	196	0.5
Capital Guardian	International Small Cap/SSB EMI Global ex US	343	1.4
GMO International	International Small Cap/SSB EMI World ex US	176	0.1
Nicholas Applegate	International Small Cap/SSB EMI Global ex US	150	0.3
Northern Trust	Developed Markets/SSB PMI Developed Markets	104	0.2
Robeco	Developed Markets/SSB PMI Developed Markets	265	0.5
State Street Global Advisors	Passive Emerging Markets/SSB PMI Emerging Markets and Passive Developed Markets/SSB PMI Developed Markets	2,769	0.3
T. Rowe-Price International	Emerging Markets/SSB PMI Emerging Markets & Developed Markets/SSB PMI Developed Markets	518	1.4
Subtotal		5,427	6.7
Total Incentive Fees (Current Managers)		—	3.5
Total Fees Paid (Terminated Managers)		—	0.5
Total Non-U.S. Equity		\$ 5,427	\$ 10.7
Fixed Income			
Agincourt	Core/External Active	\$ 263	\$ 0.2
BlackRock	Core/External Active	2,449	2.4
Wellington Capital	Core/External Active	1,359	1.5
Western Asset Management	Core/External Active	1,446	1.4
BlackRock	External Passive	576	0.3
VRS Internal	Internal Passive*	3,168	—
Total Fixed Income		\$ 9,261	\$ 5.8
High-Yield Bonds			
Wellington Capital	External High Yield	\$ 434	\$ 0.8
WR Huff	External High Yield	73	0.3
Total High-Yield Bonds		\$ 507	\$ 1.1
Private Equity			
Private Equity**		\$ 2,293	\$ 58.1
Cash			
VRS Cash		\$ 85	\$ —
Treasurer of Virginia		150	—
Total Cash		\$ 235	\$ —

VRS Money Managers, continued

Real Estate Program	Account	Year Funded or Committed	Market Value As of June 30, 2002 (in millions)	VRS Management Fees Paid FYE June 30, 2002 (in millions)
Core Private Real Estate				
J.P. Morgan	Real Estate Fund	1986	\$ —	\$ 0.5
Subtotal			—	\$ 0.5
Core Public Real Estate				
Clarion•CRA	REIT Portfolio	1995	448	0.6
Subtotal			448	0.6
Enhanced Core				
Koll Bren Schreiber	Fund IV	1997	34	0.2
Prudential	PRISA II	1981	374	2.8
Prudential	Separate Account	1997	228	1.8
Prudential	SPF-II	1997	43	0.4
Security Capital Group	European Realty	1998	39	0.0
TA Associates	Separate Account	1997	116	0.6
Subtotal			834	5.8
Opportunistic				
Colonnade Properties	MCPI	1997	71	0.4
Hines	1997 US Office Dev. Fund	1997	26	0.1
Hines	1999 US Office Dev. Fund	1999	—	—
JER Partners.	JER RE Partners, LP	1997	53	0.8
JER Partners	JER RE Partners II, LP	2000	73	1.0
Koll Bren Schreiber	Fund V	1998	43	0.3
Lazard Frères	Fund II	1997	38	0.2
Lazard Frères	LFSRI II	1998	33	0.6
Oaktree Capital Mgmt.	Fund B	1997	50	0.4
Subtotal			387	3.8
Directly Owned				
VRS	Ninth & Franklin Garage	1990	11	—
Total Management Fees			—	10.7
Total Incentive Fees Paid			—	—
VRS Real Estate Program Total			\$ 1,680	\$ 10.7

* No fees were paid on internally managed accounts with the exception of \$0.08 paid to BGI for index units held in the VRS Internal Corporate Transition account.

** Private Equity Management Fees are estimated due to structure of investment vehicle.

NOTE: Due to timing of bills, fees listed may not represent a full year.

Top 25 VRS Brokers By Commissions Fiscal Year 2002

VRS U.S. Equity Commissions

Broker Name	Commission
B Trades Services LLC	\$ 203,234
Bear Stearns Securities	223,870
BNP Paribas Securities Co.	190,067
Bridge Trading Company	163,835
Cantor Fitzgerald Co., Inc.	92,845
Credit Suisse First Boston	231,099
Croix Securities	411,815
Davenport & Co of Virginia	83,122
Deutsche Bank Secs	887,422
Goldman, Sachs & Co.	108,573
Instinet Corp.	690,239
Investment Tech Group Inc.	1,323,673
Jeffries & Co., Inc.	145,531
Lehman Brothers, Inc.	238,304
Merrill Lynch Pierce Fenner Smith, Inc.	677,451
Morgan Stanley & Co.	330,492
Pershing	370,814
Prudential Securities Inc.	176,518
R.A. Rosenblatt, Inc.	145,414
Salomon Smith Barney	349,652
Sanford C. Bernstein & Co.	145,125
Vector Securities Inc.	111,875
Warburg Dillon Read LLC	78,979
Weeden & Co.	148,598
Westminster Secs Corp.	142,762
Other Brokers	1,032,427
Total U.S. Commissions	\$ 8,703,736

VRS Non-U.S. Equity Commissions

Broker Name	Commission
ABN Amro	\$ 102,713
Bankers Trust Co.	58,823
Bear Stearns & Co., Inc.	58,333
Chevreux de Virieu SA	62,304
Credit Lyonnais Global Partners	1,387,715
Credit Suisse First Boston	265,694
Daiwa Europe, LTD	118,147
Deutsche Bk AG	187,689
Exane Limited	63,226
Goldman Sachs & Co.	363,458
Hoare Govett Secs. LTD	60,391
HSBC Inv BK PLC	70,695
J.P. Morgan Secs	222,241
James Capel	66,084
Kleinwort Benson LTD	56,635
Lehman Bros. Intl.	362,881
Merrill Lynch Pierce Fenner Smith Inc.	516,189
Morgan Grenfell Equities	336,565
Morgan Stanley & Co. Inc.	437,064
Nomura Intl.	66,964
Salomon Smith Barney, Inc.	641,748
Scotia Capital Mkts., Inc.	58,624
UBS Warburg	283,864
Union Bank of Switzerland	342,026
Warburg Dillon Read, LLC	330,289
Other Brokers	1,065,292
Total International Equity Commissions	\$ 7,585,654

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

The 1980s— Expanding Communication, Opportunity

By 1987, half of U.S. homes had cable TV. Other breakthroughs ranged from genetic fingerprinting of an individual's DNA to Sandra Day O'Connor becoming the first woman U.S. Supreme Court justice. In the retirement arena, VRS eased restrictions by removing the mandatory retirement age of 70 for state employees and teachers, and allowing members to retire at 55 with 30 years of service.

1980–1989

January 1, 1982—Coverage is increased under the Group Life Insurance Program for employees who remain in service after reaching age 70. Coverage is based on current salary rather than salary received at age 70.

January 1, 1987—VRS removes the mandatory retirement age of 70 for state employees and teachers.

March 1, 1987—State employees, teachers, and employees of electing political subdivisions may now retire at age 55 with full benefits if they are credited with as much as 30 years of service. In addition, employees will no longer be excluded from membership if they were age 60 or over when first employed or reemployed.

July 1, 1988—Annuities are now payable to qualifying survivors of members who die in service regardless of age. Previously, such benefits were payable only if members died in service after attaining age 55.



Retirement Planning Meeting, 1980s



New VRS headquarters renovation, 1985



Executive Committee, 1980s

Elsewhere in the USA

Virginia's L. Douglas Wilder becomes the nation's first elected African-American governor. The minimum wage reaches \$3.10 in 1980. The first space shuttle, *Columbia*, makes its maiden voyage. First-class stamps cost 18 cents in 1981, then 20, 22, and finally 25 cents in 1988. Diet Coke, *USA Today*, and Post-it Notes hit the marketplace. Henry Fonda and Katharine Hepburn win Academy Awards for *On Golden Pond*. The government bails out hundreds of federally insured savings and loan institutions.





ACTUARIAL SECTION



GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries

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(Temporary until 11/1/01)

October 15, 2001

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

Subject: Actuarial Valuation as of June 30, 2001

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, 2001, 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, 2001 actuarial valuation will be effective for the period beginning July 1, 2002 and ending June 30, 2004.

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.

Due to a statutory change, this actuarial valuation is now prepared one year after the previous valuation as of the last day of VRS's plan and fiscal year (June 30th).

Financing Objectives

The member contribution rates are established by statute. The employer contribution rates are calculated by the actuarial valuation. In consideration of the COLA implementation and the funded condition of the State Police, Virginia Law Officers, and State Judges Systems, the Board of Trustees has set the employer contribution rate 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 are continuing the policy begun with the June 30, 2000, valuation of calculating the contribution rate for the State Employees and Teachers by combining the liability and assets of the employee groups. The resulting "pooled" rate is tested to comply with GASB No. 27 requirements. The pooled rate is then the required contribution rate for each respective group.

The contribution rates are applicable for the two-year period beginning July 1, 2002, one year after the valuation date. The rates are intended to be sufficient to pay the normal cost and to amortize the unfunded actuarial accrued liability (UAAL) in level percentage of payroll payments over a period of 25 years from the current valuation date, July 1, 2001. We consider this period to be reasonable. Please note that we have recognized in the calculation of the contribution rates the one-year delay between the valuation date and the date the new rates become effective.

Significant and continuing adverse investments fluctuations have occurred since the effective date of this valuation. Because of unprecedented world events, the uncertain investment climate is likely to continue for much of the 2001/2002 fiscal year. Because of this uncertainty our calculations notwithstanding, it is our recommendation that the contribution rates not be reduced from their 2001/2002 level.

Progress Toward Realization of Financing Objectives

The funded ratio improved for all five groups since the last actuarial valuation. The improvement in the funded ratio is primarily due to asset gains on the actuarial value of assets. The funded ratios for the State Police, Virginia Law Officers, and the State Judges Systems also improved because the contribution rates set by the Board exceed the rates calculated using the 25 year funding period.

Likewise, the calculated employer contribution rates decreased for all of the groups. The calculated rates reflect full prefunding of the automatic COLA benefits, in compliance with the requirements of Governmental Accounting Standards Board Statement 25. The Commonwealth has been phasing into this prefunding rate over a period of five years starting on July 1, 1997. However, due to continued gains, the calculated rates in this valuation are now less than the previously scheduled phase-in rates for all four original groups. Thus, there is no further reason for the Commonwealth to continue to consider those phase-in rates to determine contribution rates.

Benefit Provisions

The actuarial valuation reflects the benefit provisions set forth in the Virginia statutes. There were two changes in these provisions over the last year. First, the State Police System had their temporary supplement starting at retirement extended from age 65 to their Social Security retirement age. Second, 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.

There are no ancillary benefits (such as cost-of-living increases 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 used in this valuation have been changed from those used for the 2000 valuation.

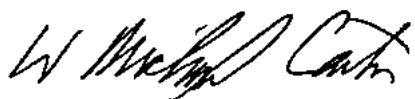
Data

Member data for retired, active, and inactive participants was supplied as of June 30, 2001, 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
Senior Consultant



Lewis Ward
Consultant

Solvency Test

(Expressed in Thousands)

Valuation Date (June 30)	Aggregate Accrued Liabilities for				Portion of Accrued Liabilities Covered by Assets		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members*	Valuation Assets	(1)	(2)	(3)
Virginia Retirement System (VRS)							
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)							
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)**							
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)							
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%	0.0%
1994	15,593	102,889	80,080	115,306	100.00%	96.91%	0.0%

Actuarial Assumptions and Methods:	1994/1996	1998/1999	2000/2001
Valuation interest rate.....	8%	8%	8%
Salary scale inflation factor.....	4%	4%	3%
Change in decremental assumptions.....	Yes	No	Yes
Value of ancillary benefits included.....	Yes	Yes	Yes
Value of post-retirement adjustments to date included.....	Yes	Yes	Yes
Assets valued at.....	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 of Employers
	Number	Annual Payrolls (000s)	Average Annual Pay	Annualized % Increase in Average Pay	
Virginia Retirement System (VRS)					
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)					
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)*					
2001	10,434	\$ 320,254	\$ 30,693	2.7%	1
2000	10,542	315,158	29,895	0.0%	1
Judicial Retirement System (JRS)					
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

Retired Members and Beneficiaries					
Valuation Date (June 30)	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)					
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)					
2001	26/11	712	\$ 18,748	8.0%	\$ 26,331
2000	38/8	697	17,362	9.9%	4,910
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)***					
2001	197/13	294	\$ 2,181	198.8%	\$ 7,418
2000	124/14	110	730	0.0%	6,636
Judicial Retirement System (JRS)					
2001	21/16	369	\$ 18,699	12.1%	\$ 97,571
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 FY00.

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

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

Summary of Actuarial Assumptions and Methods

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

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

Retirement Rates

State Employees and Employees of Political Subdivisions

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

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

Retirement Rates, continued

Teachers

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

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

Judicial Retirement System

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

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

Disability Rates

For selected ages.

State Employees and Employees of Political Subdivisions

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

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

Teachers

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

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

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

Judicial Retirement System

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

Termination Rates

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

State Employees and Employees of Political Subdivisions

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

Teachers

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

Judicial Retirement System

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

Salary Increase Rates

The sample salary increase rates are shown below.

State Employees and Employees of Political Subdivisions

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

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

Teachers

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

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

State Police Officers' and Virginia Law Officers' Retirement Systems

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

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

Judicial Retirement System

Salary increase rates are 5.00%.

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

Percent Electing a Deferred Termination Benefit

(Excludes Judicial Retirement System)

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

Provision for Expense

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

Asset Valuation Method

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

Actuarial Cost Method

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

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

Payroll Growth Rate

3.00% based on a zero population-growth assumption.

Funding Period

State employees 0 years; teachers 14 years; political subdivision employees 0 to 30 years (open amortization, computed as level percent of payroll). Calculation is pooled for state employees and teachers.

State police officers, Virginia law officers and judges 25 years (closed amortization, computed as a level percent of payroll).

Cost-of-Living Increase

3% per year compounded annually for the basic benefit. The temporary supplement is assumed to increase at the inflation rate (3% per year, compounded annually) for state police and Virginia law officers.

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 30.

Administration

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

Types 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 officers are eligible to become members of VaLORS.

Employee Contributions

All active members contribute 5% of their creditable compensation per year. The employer may “pick up” the member’s assessments under the provisions of Internal Revenue Code Section 414(h).

Creditable Compensation

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

Service

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

Average Final Compensation

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

Normal Retirement

Eligibility

Members of VRS and JRS may retire under Normal Retirement on or after age 65 with five years of service credit. A member of SPORS or 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 are 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. See below for optional forms of payment.

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. A member of SPORS or 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. No reduction applies if: (1) a member of VRS has credit for 30 years of service at retirement and is at least age 50, (2) a member of SPORS or VaLORS has 25 years of service and is at least age 50, and (3) a member of JRS has 30 years of service and is at least age 60. 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 years (age 60 with service less than 25 years for members of SPORS and VaLORS). For members of VRS younger than 55 at retirement, the reduction factor determined as though the member were 55 is further reduced by multiplying it by a second factor, to reflect a 0.6% reduction for each month retirement precedes age 55.

Supplement

Members of SPORS and VaLORS 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 employees and SPORS and VaLORS members hired prior to January 1, 1999 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 the minimum guaranteed benefit, which is 50% (66⅔% if work-related disability) of AFC if member does not qualify for primary Social Security and 33⅓% of AFC (50% if work-related disability) if member qualifies for primary Social Security; or 1.7% of AFC times service credit. The work-related benefit is reduced by Workers' 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. A disability benefit is 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 contribution account is paid for work-related disability.)

Virginia Sickness and Disability Program (VSDP)

In lieu of the above benefits, VRS state employees and 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 members). 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 (AFC) 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 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, nonretired member.

Benefit

Upon the death of a nonvested 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 place 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 33⅓% 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 the member's death, 100% of the benefit continues to the contingent annuitant.

Variable Survivor Option

Upon the member's death, a designated percentage of the benefit continues to the contingent annuitant.

Leveling Option*

Upon this non-level annuity payable to the member, the member receives higher payments in the early years of retirement and smaller payments at a date the member specifies.

**This option is no longer available for retirements after July 1, 2001.*

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 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 Officers' Retirement System had their temporary supplement starting at retirement extended from age 65 to their Social Security retirement age.
2. The Virginia Law Officers' Retirement 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.

The 1990s—Prosperity in a Digital World

Half a world away, the United States drove Saddam Hussein's troops out of Kuwait. At home, Americans saw prosperity, a rush of dot-com start-ups, and the Dow topping 10,000. In Virginia, a constitutional amendment passes, making VRS an independent trust fund, separate from the executive branch of state government. The decade also sees the start of the early retirement trend and workforce downsizing.

1990–1999

January 1, 1990—A health insurance credit program is created for state retirees.

July 1, 1990—The word “Supplemental” is dropped and the name of the retirement system is officially changed to Virginia Retirement System.

July 1, 1991—The System's first Early Retirement Plan is enacted, allowing state employees who attained age 50 with 25 or more years of service to retire with full benefits.

July 1, 1992—The health insurance credit for eligible retired state employees is increased and expanded to include school boards and political subdivisions that elect to provide the credit.

February 28, 1994—VRS becomes an independent agency outside the executive, legislative, or judicial branches of state government. This legislation also changes the size and composition of the Board of Trustees and the methods by which members are appointed.

July 1, 1994—The Joint Legislative Audit and Review Commission (JLARC) is established as the oversight body for the VRS.

July 1, 1995—State employees are allowed to purchase optional life, accidental death, and dismemberment insurance in amounts up to four times the amount of their salary, as well as optional insurance on their spouses and minor dependents.

July 1, 1997—Participation in the State Deferred Compensation Plan is extended to include political subdivision employers, subject to VRS approval.

July 1, 1998—Teachers retired under VRS who have at least 15 years of creditable service now receive a health insurance credit of \$1.50 per month per year of service, to a maximum of \$45 per month, paid by the Commonwealth. The locality may provide an additional credit of \$1 per month per year of service, to a maximum of \$30 per month.

January 1, 1999—A sickness and disability program is established for state employees hired on this date and thereafter. State employees hired before this date have the option of participating in this plan or remaining with the current sick leave and disability retirement programs. The Virginia Law Officers' Retirement System is established, and the Volunteer Firefighters' and Rescue Squad Workers' Pension Fund is authorized.

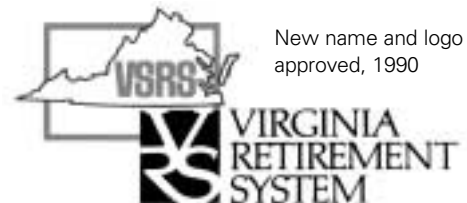


Director Herb Alcox,
1992–1995

Memo to Members
inaugurated, 1996



VRS Web site
debuts, 1996



New name and logo
approved, 1990

Elsewhere in the USA

The Alfred P. Murrah building in Oklahoma City is bombed, killing 169 people. Legendary shortstop Cal Ripken, Jr., breaks the record for consecutive games played. The minimum wage hits \$4.75 in 1996, then \$5.15 in 1997. President Bill Clinton is impeached. Computer users flock to the Internet to communicate, get information, and share digital photos. A first-class stamp sells for 29 cents, then 32 cents, then 34 cents. Golfer Tiger Woods, 21, wins the Masters. Jerry Seinfeld and Harry Potter become household names.





STATISTICAL SECTION

Pension Trust Funds

Analysis of Changes and Growth in Plan Net Assets

(Millions of Dollars)

For the Years Ended June 30	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Net Assets Available,										
Beginning of Year	13,554	15,262	15,449	18,215	21,460	26,057	30,784	34,634	39,786	36,693
Employee and Employer										
Contributions.....	718	758	900	879	913	1,131	1,141	1,291	1,270	1,044
Benefit and Administration										
Expenses	(711)	(748)	(834)	(934)	(1,017)	(1,090)	(1,176)	(1,282)	(1,394)	(1,529)
Net Funding	7	10	66	(55)	(104)	41	(35)	9	(124)	(485)
Investment Income:										
Interest, Dividends, and										
Other Investment Income	629	891	707	413	504	534	551	705	785	624
Net Appreciation (Depreciation)										
in Fair Value	1,072	(714)	1,993	2,887	4,197	4,152	3,334	4,438	(3,754)	(3,376)
Net Investment Income	1,701	177	2,700	3,300	4,701	4,686	3,885	5,143	(2,969)	(2,752)
Net Assets Available,										
End of Year	15,262	15,449	18,215	21,460	26,057	30,784	34,634	39,786	36,693	33,456

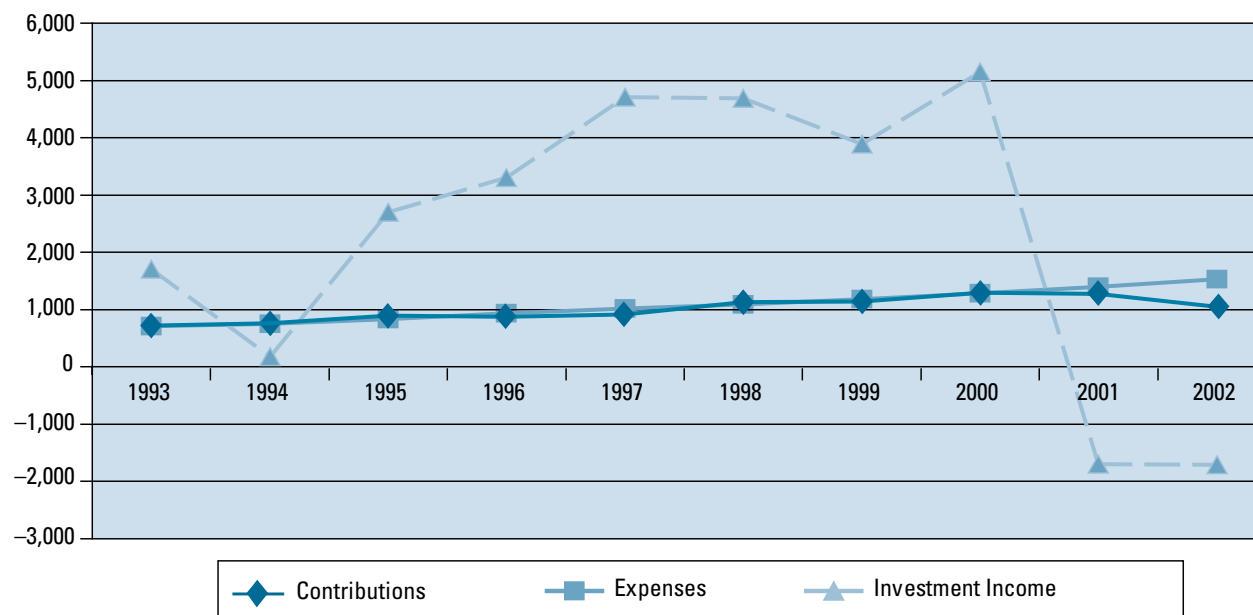
FY 1995 and 1996 Net Appreciation were restated to reflect adjustments from conversion to GASB 25 presentation.

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

Pension Trust Funds Additions Versus Deductions

Fiscal Years 1993–2002

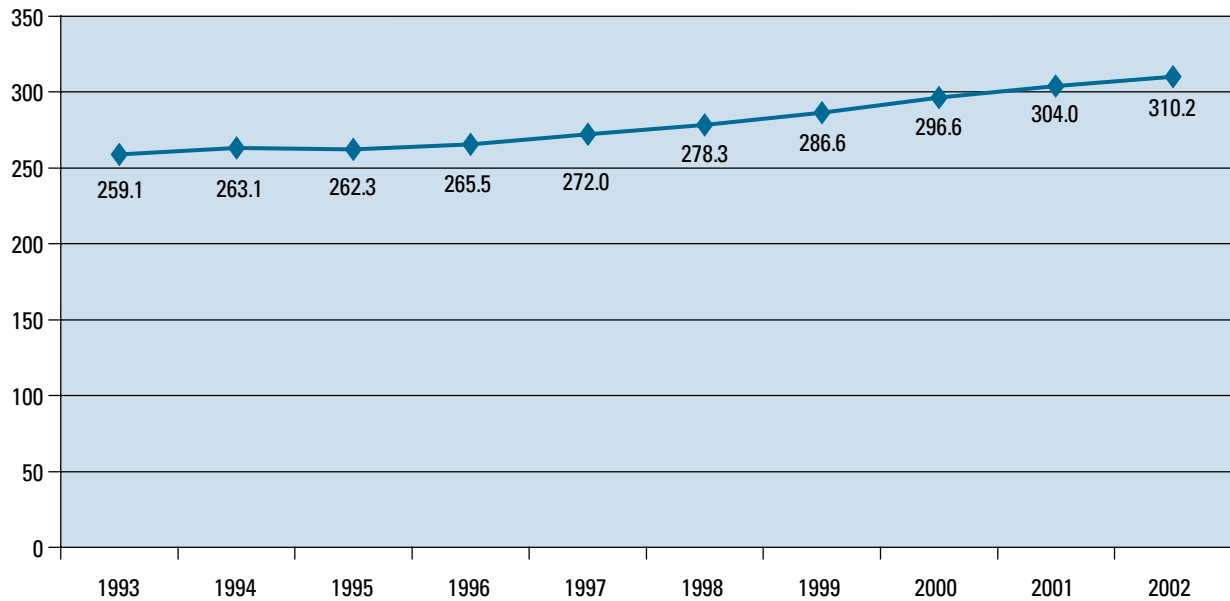
(Millions of Dollars)



Number of Active Members

Fiscal Years 1993–2002

(Expressed in Thousands)



Schedule of Retirement Contributions by System

Fiscal Years 1993–2002

(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				
2002	\$ 234,992	\$ 455,488	\$ 283,756	\$ 974,236	\$ 14,974	\$ 42,148	\$ 13,100	\$ 1,044,458
2001	299,079	591,620	264,229	1,154,928	24,632	67,040	23,149	1,269,749
2000	314,044	631,344	284,641	1,230,029	19,170	25,192 ****	17,131	1,291,522
1999	296,748	556,712	257,140	1,110,600	15,298	—	15,034	1,140,932
1998 ***	265,364	603,579 **	237,736	1,106,679	11,767	—	13,107	1,131,553
1997	242,380	439,490	203,427	885,297	16,035 **	—	11,957	913,289
1996	240,393	442,600 **	176,545	859,538	8,330	—	11,087	878,955
1995	308,978 **	406,670 **	166,497	882,145	7,603	—	10,614	900,362
1994	218,998	365,339	154,634	738,971	8,431	—	10,088	757,490
1993 *	209,375	345,033	146,662	701,070	7,968	—	9,565	718,603

* Decreased by a change in actuarial assumptions and methods used to value plan assets.

** 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.

Pension Trust Funds Additions by Source

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Member Contributions	Employer Contributions		Investment Income	Other	Total
		For Members	Employer Share			
Virginia Retirement System (VRS)						
2002	\$ 115,979	\$ 482,516	\$ 375,741	\$ (2,667,982)	\$ 286	\$ (1,693,460)
2001	65,810	453,133	635,985	(2,907,769)	381	(1,752,460)
2000	68,208	426,088	735,733	5,042,490	269	6,272,788
1999	55,710	406,543	648,347	3,809,905	703	4,921,208
1998****	57,032	379,953	669,694	4,594,358	116	5,701,153
1997	58,003	356,759	470,535	4,608,323	—	5,493,620
1996	51,595	340,645	467,298	3,235,211	—	4,094,749
1995**	50,376	331,880	499,889	2,645,875	—	3,528,020
1994	49,391	315,725	373,855	173,918	33	912,922
1993*	47,373	299,470	354,227	1,667,447	2	2,368,519
State Police Officers' Retirement System (SPORS)						
2002	\$ 755	\$ 4,039	\$ 10,180	\$ (34,596)	\$ —	\$ (19,622)
2001	125	4,087	20,420	(37,192)	—	(12,560)
2000	192	3,922	15,056	63,638	—	82,808
1999	179	3,548	11,571	47,974	—	63,272
1998	121	3,152	8,494	58,661	2	70,430
1997***	136	2,923	12,976	58,840	—	74,875
1996	270	2,984	5,076	41,865	—	50,195
1995	18	2,965	4,620	33,965	—	41,568
1994	45	2,827	5,559	2,194	—	10,625
1993*	17	2,680	5,271	21,837	—	29,805
Virginia Law Officers' Retirement System (VaLORS)						
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)						
2002	\$ 73	\$ 2,365	\$ 10,662	\$ (19,248)	\$ —	\$ (6,148)
2001	4	2,315	20,830	(20,637)	—	2,512
2000	16	2,180	14,935	35,297	—	52,428
1999	6	2,049	12,979	26,569	—	41,603
1998	49	1,892	11,166	32,637	—	45,744
1997	25	1,780	10,152	32,952	—	44,909
1996	10	1,745	9,332	23,492	—	34,579
1995	—	1,662	8,952	19,194	—	29,808
1994	—	1,575	8,513	1,259	—	11,347
1993*	1	1,492	8,072	12,529	—	22,094

* In fiscal year 1993, changes in the method used to value plan assets had the effect of reducing employer contributions by \$96.3 million for VRS, \$1.2 million for SPORS, and \$993 thousand for JRS.

** 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.

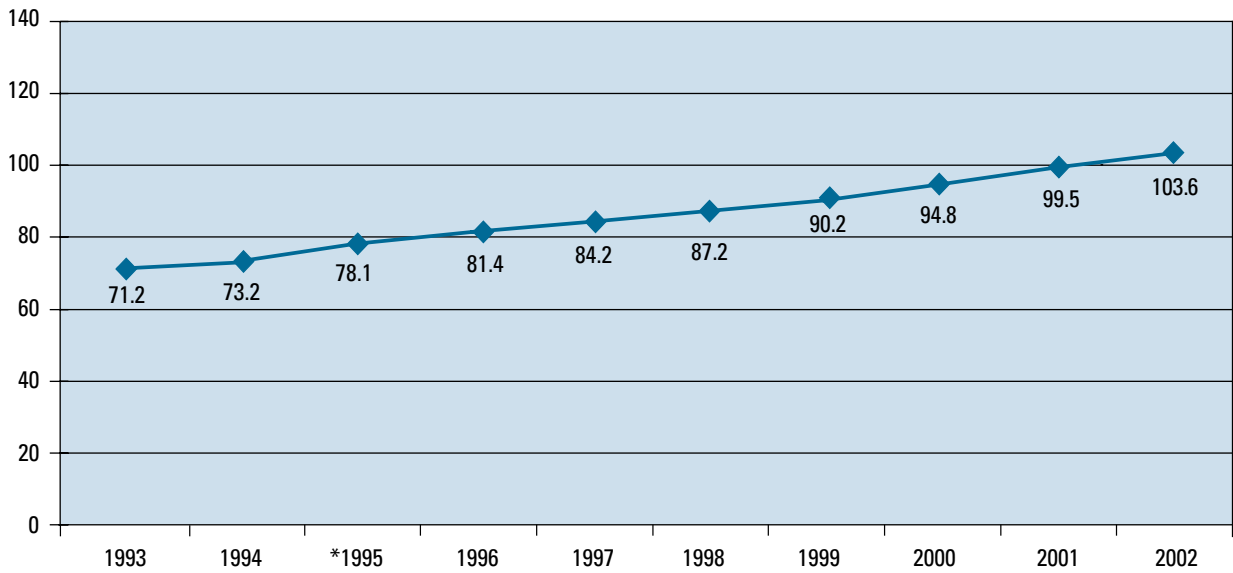
**** In fiscal year 1998, employer contributions increased to begin prefunding cost of living adjustments (COLAs) for retirees.

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

Number of Retired Members

Fiscal Years 1993–2002

(Expressed in Thousands)

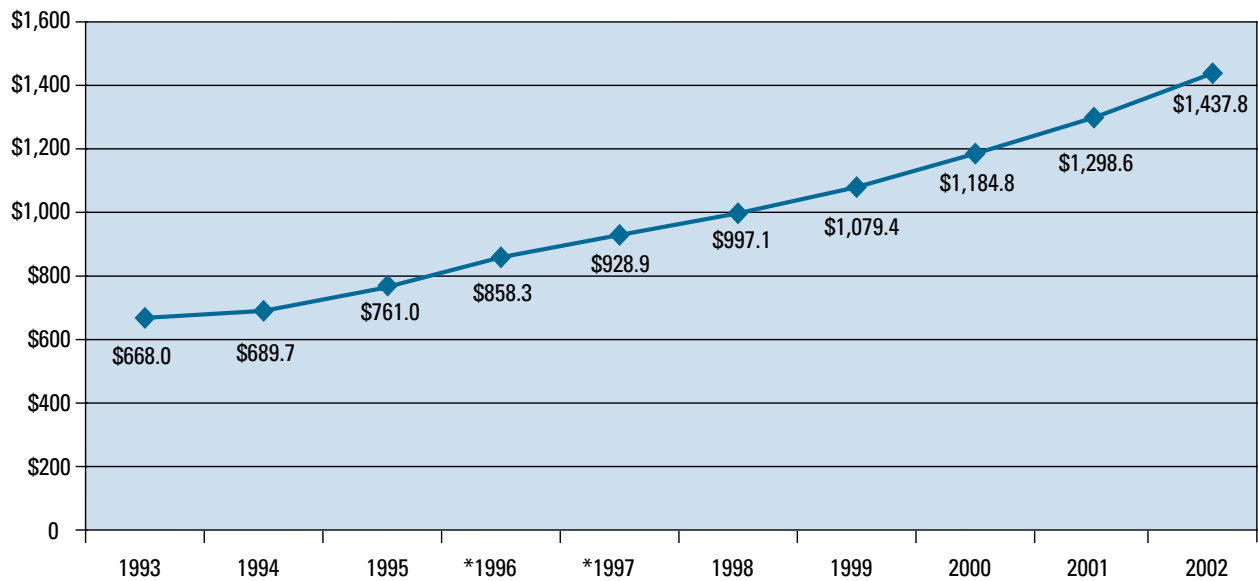


* Increased by the Workforce Transition Act of 1995 for state agencies.

Retirement Benefits Paid

Fiscal Years 1993–2002

(Millions of Dollars)



* Increased by the Workforce Transition Act of 1995 for state agencies.

Pension Trust Funds Deductions by Type

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Retirement Benefits	Refunds	Administrative Expenses	Other	Total
Virginia Retirement System (VRS)					
2002	\$ 1,389,815	\$ 69,235	\$ 15,039	\$ 2,449	\$ 1,476,538
2001	1,261,348	79,439	14,100	—	1,354,887
2000	1,150,694	83,412	12,613	—	1,246,719
1999	1,047,362	84,797	11,359	—	1,143,518
1998	966,876	81,168	10,980	123	1,059,147
1997	900,241 **	76,884	10,395	—	987,520
1996	833,927 **	65,157	10,189	3	909,276
1995	740,639 *	63,182	8,801	12	812,634
1994	671,983	49,741	7,902	—	729,626
1993	651,061	35,383	7,785	—	694,229
State Police Officers' Retirement System (SPORS)					
2002	\$ 20,607	\$ 559	\$ 185	\$ —	\$ 21,351
2001	17,980	289	170	—	18,439
2000	16,946	314	137	—	17,397
1999	16,020	420	141	—	16,581
1998	15,324	474	139	—	15,937
1997	14,634	465	131	—	15,230
1996	11,039 **	420	134	—	11,593
1995	8,448 *	457	109	—	9,014
1994	7,214	375	99	—	7,688
1993	6,638	158	94	—	6,890
Virginia Law Officers' Retirement System (VaLORS)					
2002	\$ 8,485	\$ 3,657	\$ 57	\$ —	\$ 12,199
2001	1,511	862	17	—	2,390
2000 ***	330	149	2	—	481
Judicial Retirement System (JRS)					
2002	\$ 18,884	\$ —	\$ 104	\$ —	\$ 18,988
2001	17,788	32	94	—	17,914
2000	16,872	24	105	—	17,001
1999	16,050	6	79	—	16,135
1998	14,856	—	78	—	14,934
1997	13,986	—	74	—	14,060
1996	13,380	—	74	—	13,454
1995	11,893 *	56	62	—	12,011
1994	10,498	5	56	—	10,559
1993	10,272	—	56	—	10,328

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

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

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

Schedule of Retirement Benefits by System

Fiscal Years 1993–2002

(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				
2002	\$ 454,123	\$ 710,538	\$ 225,154	\$1,389,815	\$ 20,607	\$ 8,485	\$ 18,884	\$ 1,437,791
2001	421,033	639,760	200,555	1,261,348	17,980	1,511	17,788	1,298,627
2000	394,601	575,876	180,217	1,150,694	16,946	330 ***	16,872	1,184,842
1999	372,503	514,124	160,735	1,047,362	16,020	—	16,050	1,079,432
1998	354,862	467,367	144,647	966,876	15,324	—	14,856	997,056
1997	339,687 **	429,892	130,662	900,241	14,634 **	—	13,986	928,861
1996	317,398 **	400,111	116,418	833,927	11,039 **	—	13,380	858,346
1995 *	267,238	370,088	103,313	740,639	8,448	—	11,893	760,980
1994	242,104	339,410	90,469	671,983	7,214	—	10,498	689,695
1993	239,148	327,076	84,837	651,061	6,638	—	10,272	667,971

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

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

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

Schedule of Retirement Benefits by Type

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Service Benefits	Disability Benefits	Survivor Benefits	Total
2002	\$ 1,242,235	\$ 184,582	\$ 10,974	\$ 1,437,791
2001	1,121,588	167,931	9,108	1,298,627
2000	1,021,185	155,450	8,207	1,184,842
1999	928,862	143,181	7,389	1,079,432
1998	861,377	128,637	7,042	997,056
1997	805,391 **	117,133	6,337	928,861
1996	745,864 **	106,449	6,033	858,346
1995 *	661,231	94,239	5,510	760,980
1994	604,791	79,905	4,999	689,695
1993	588,267	74,876	4,828	667,971

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

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

Schedule of Refunds by Type

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Separations	Death	Total
2002	\$ 65,893	\$ 7,558	\$ 73,451
2001	73,659	6,963	80,622
2000	77,027	6,872	83,899
1999	78,530	6,693	85,223
1998	74,731	6,911	81,642
1997	72,077	5,272	77,349
1996	61,126	4,451	65,577
1995	59,225 *	4,470	63,695
1994	46,519	3,602	50,121
1993	32,510	3,031	35,541

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

Schedule of Retired Members by Type of Benefit and Option Selected

As of June 30, 2002

Amount of Retirement Benefit	Number of Retirants	Type of Retirement							
		Service	Early Retirement Window	Regular Disability	Survivor Payment—Death in Service	Line-of-Duty Disability	Survivor Payment—Death in Line-of-Duty	50/10 Provision	50/30 Service Retirement
\$ 1 – 200	15,223	13,100	1	1,115	496	85	5	421	—
201 – 400	17,918	14,287	87	2,455	375	147	22	545	—
401 – 600	14,228	10,624	300	2,571	190	228	24	289	2
601 – 800	10,757	7,772	401	1,924	107	335	19	189	10
801 – 1,000	8,408	5,824	529	1,426	63	326	8	183	49
1,001 – 1,200	6,595	4,445	620	991	49	210	5	158	117
1,201 – 1,400	5,275	3,479	639	711	18	176	3	130	119
1,401 – 1,600	4,638	2,992	688	509	27	127	2	121	172
1,601 – 1,800	4,302	2,726	613	367	12	112	2	104	366
1,801 – 2,000	4,108	2,589	512	299	11	106	—	80	511
Over 2,001	12,170	8,700	1,154	566	39	220	2	145	1,344
Totals	103,622	76,538	5,544	12,934	1,387	2,072	92	2,365	2,690

Amount of Retirement Benefit	Number of Retirants	Option Selected										
		Basic Benefit	Increased Basic Benefit	100% Survivor Benefit	50% Survivor Benefit	Soc. Sec. Leveling Benefit	Special Survivor Option	Lump Sum	Min. Guar. Disability Basic Benefit	Min. Guar. Disability Survivor	Leveling Benefit	Leveling Benefit Rollover
\$ 1 – 200	15,223	12,269	123	557	293	1,290	23	1	92	8	562	5
201 – 400	17,918	14,164	54	650	533	1,077	69	—	778	45	542	6
401 – 600	14,228	10,310	51	565	606	1,005	64	1	1,095	99	428	4
601 – 800	10,757	7,565	36	455	608	843	76	—	788	76	305	5
801 – 1,000	8,408	5,619	15	395	637	760	98	—	558	49	272	5
1,001 – 1,200	6,595	4,224	16	370	586	722	90	—	312	36	228	11
1,201 – 1,400	5,275	3,449	15	294	496	510	59	22	191	26	198	15
1,401 – 1,600	4,638	3,030	10	285	434	470	100	—	128	7	166	8
1,601 – 1,800	4,302	2,963	14	216	407	376	92	—	55	6	161	12
1,801 – 2,000	4,108	2,898	27	165	372	322	82	—	45	5	183	9
Over 2,001	12,170	8,033	106	599	1,149	618	457	—	61	13	958	176
Totals	103,622	74,524	467	4,551	6,121	7,993	1,210	24	4,103	370	4,003	256

Retirement Breakdown: During fiscal year 2002, 88% of all retirements were service retirements, and 12% were certified as disability retirements by the Medical Board.

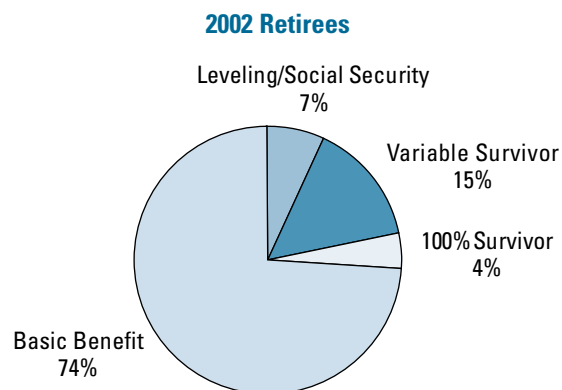
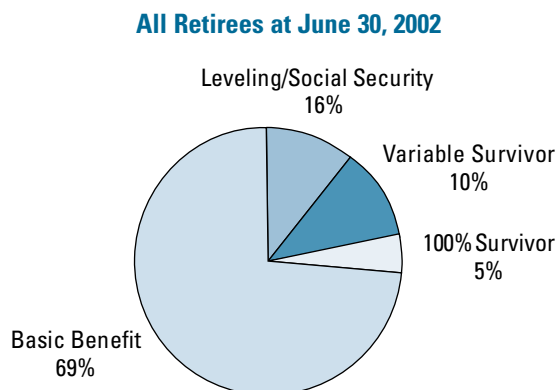
Schedule of Average Benefit Payments

Retirement Effective Date July 1, 1997, to June 30, 2002

		Years of Credited Service					
		1–10	11–15	16–20	21–25	26–30	Over 30
FY 2002	Average Monthly Benefit	\$294.63	\$450.29	\$671.40	\$1,010.69	\$1,757.42	\$2,316.68
	Number of Active Retirants	627	715	743	988	1,538	2,277
FY 2001	Average Monthly Benefit	\$306.46	\$452.17	\$678.20	\$999.05	\$1,689.12	\$2,302.94
	Number of Active Retirants	623	803	805	1,037	1,504	2,453
FY 2000	Average Monthly Benefit	\$ 234.76	\$ 414.85	\$ 686.39	\$ 911.42	\$ 1,587.73	\$ 2,218.68
	Number of Active Retirants	673	742	762	1,039	1,385	2,482
FY 1999	Average Monthly Benefit	\$ 351.22	\$ 444.94	\$ 651.13	\$ 927.54	\$1,577.71	\$2,215.74
	Number of Active Retirants	651	696	761	923	937	1,650
FY 1998	Average Monthly Benefit	\$ 413.88	\$ 538.80	\$ 711.86	\$ 876.36	\$1,576.32	\$2,053.74
	Number of Active Retirants	761	687	920	1,023	1,138	1,444
FY 1997 *	Average Monthly Benefit	\$ 556.40	\$ 484.48	\$ 679.48	\$ 901.10	\$1,507.76	\$2,279.31
	Number of Active Retirants	1,444	737	904	959	774	1,051

* Average monthly benefit and years of service reflect impact of 1995 Workforce Transition Act for state agencies.

Distribution of Retirees by Payment Option Selected



Options for Retirement

VRS offers several options for retirement:

Basic Benefit:

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

Variable Survivor:

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

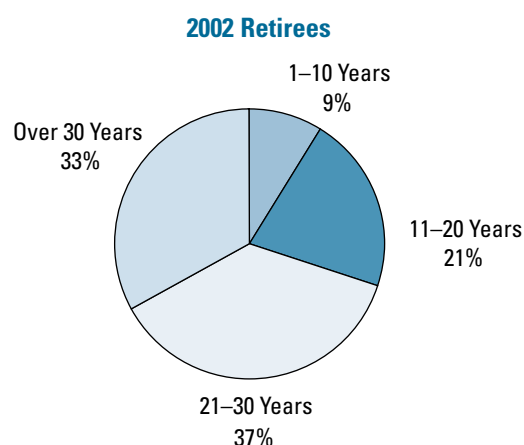
Leveling/Social Security:

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

100% Survivor:

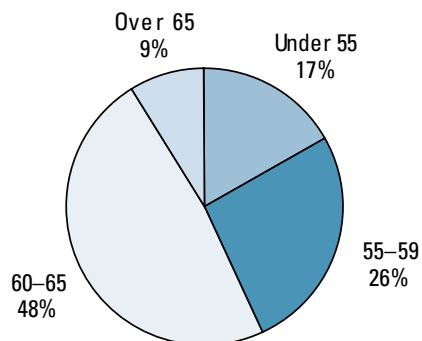
The basic benefit is reduced during the member's lifetime. At death, the benefit is continued in the same amount to the designated contingent annuitant.

Distribution of Retirees by Years of Service

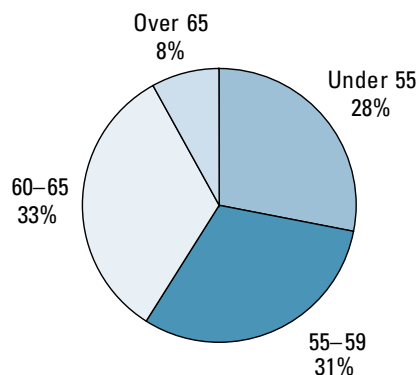


Distribution of Retirees by Age at Retirement

All Retirees at June 30, 2002

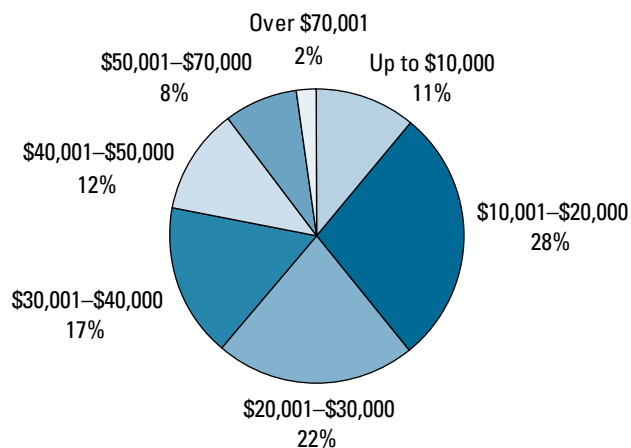


2002 Retirees

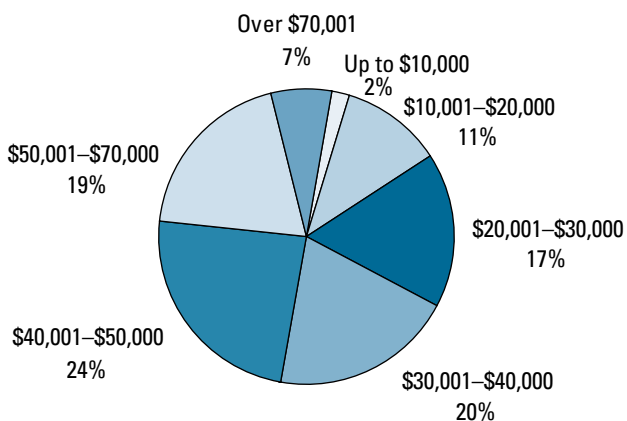


Distribution of Retirees by Average Final Salary

All Retirees at June 30, 2002



2002 Retirees



Other Employee Benefit Trust Funds

Schedule of Group Insurance Additions by Source

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Contributions				Investment Income	Other	Total
	State	Teacher	Political	Sub-Total			
2002	\$ 22,919	\$ 28,267	\$ 17,614	\$ 68,800	\$ (72,021)	\$ —	\$ (3,221)
2001	29,703	37,027	21,894	88,624	(77,363)	—	11,261
2000*	1	2	41	44	139,707	277	140,028
1999*	(1)	1	22	22	110,393	—	110,415
1998	8,973	10,958	6,435	26,366	145,280	—	171,646
1997*	12	(39)	33	6	154,091	—	154,097
1996	9,904	12,136	6,924	28,964	116,840	—	145,804
1995	5,025	5,853	3,311	14,189	95,497	—	109,686
1994*	(25)	2	5	(18)	5,392	—	5,374
1993	23,002	26,182	14,836	64,020	74,394	—	138,414

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

Schedule of Group Insurance Claims by Type

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Active Claims	Retired Claims	Total
2002	\$ 39,617	\$ 56,008	\$ 95,625
2001	36,899	51,280	88,179
2000	34,113	48,912	83,025
1999	23,309	36,772	60,081
1998	26,854	45,919	72,773
1997	27,461	44,644	72,105
1996	25,081	40,095	65,176
1995	28,659	35,372	64,031
1994	25,884	36,163	62,047
1993	21,649	32,964	54,613

Schedule of Retiree Health Insurance Credit Additions and Reimbursements

Fiscal Years 1993–2002

(Expressed in Thousands)

Year Ended June 30	Additions				Health Insurance Reimbursements
	Contributions	Investment Income	Other	Total	
2002	\$ 85,209	\$ (5,080)	\$ —	\$ 80,129	\$ 57,590
2001	73,901	(3,089)	—	70,812	54,628
2000***	17,592	6,323	—	23,915	50,456
1999**	35,260	7,689	1	42,950	30,254
1998	22,123	7,637	14	29,774	17,372
1997	20,357	7,158	—	27,515	16,810
1996	20,180	3,592	—	23,772	13,594
1995	20,057	3,023	—	23,080	13,652
1994*	11,652	97	—	11,749	12,551
1993	10,374	1,304	—	11,678	7,894

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

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

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

Participating Employers as of June 30, 2002

Political Subdivisions (405)

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

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

Virginia Coalfield Economic Development Authority
 Virginia Highlands Airport Commission
 Virginia Peninsulas Public Service Authority
 Virginia Peninsula Regional Jail
 Washington County Service Authority
 Waynesboro Redevelopment & Housing Authority
 Western Tidewater Community Services
 Western Tidewater Regional Jail
 Wise County Redevelopment & Housing Authority
 Wythe-Grayson Regional Library
 Wytheville Redevelopment & Housing Authority

***Public School Boards—
Professional Employees***

City Schools (39)
 Alexandria City Schools*
 Bristol Schools*
 Buena Vista City Schools*
 Charlottesville Schools*
 Chesapeake Public Schools*
 Colonial Beach Schools
 Colonial Heights City Schools*
 Covington City Schools*
 Danville Schools*
 Fairfax City Schools
 Falls Church Schools
 Franklin City Schools*
 Fredericksburg City Schools*
 Galax City Schools*
 Hampton City Schools*
 Harrisonburg City Schools*
 Hopewell Schools*
 Lexington City Schools*
 Lynchburg Schools*
 Manassas City Schools*
 Manassas Park City Schools*
 Martinsville City Schools*
 Newport News Schools
 Norfolk Public Schools*
 Norton City Schools*
 Petersburg Public Schools*

Poquoson City Schools*
 Portsmouth 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 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*
 Greenville County Schools*
 Halifax County Schools*
 Hanover County Schools*
 Henrico County Schools*
 Henry County Schools*
 Highland County Schools*
 Isle of Wight County Schools*
 King George County Schools*
 King & Queen County Schools*
 King William County Schools*
 Lancaster County Schools*
 Lee County Schools*
 Loudoun County Schools*
 Louisa County Schools*
 Lunenburg County Schools*
 Madison County Schools*
 Mathews County Schools*
 Mecklenburg County Schools*
 Middlesex County Schools*
 Montgomery County Schools*
 Nelson County Schools*
 New Kent County Schools*
 Northampton County Schools*
 Northumberland County Schools*
 Nottoway County Schools*
 Orange County Schools*
 Page County Schools*
 Patrick County Schools*
 Pittsylvania County Schools*
 Powhatan County Schools*
 Prince Edward County Schools*
 Prince George County Schools*
 Prince William County Schools*
 Pulaski County Schools*
 Rappahannock County Schools*
 Richmond County Public 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 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 (238)***

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.

Combined Statement of Changes in Plan Assets

Years Ended June 30, 2002 and 2001

	2002	2001
Plan Assets on July 1	\$ 456,036,860	\$ 456,797,671
Contributions	60,560,320	52,207,301
Distributions	(24,509,175)	(12,160,707)
Plan Transfers ¹	216,542	279,976
Third Party Administration Fees ²	(1,221,805)	(1,402,796)
Period Earnings	(39,709,769)	(38,744,316)
Net Decrease/Increase in the Present Value of Annuitants' Future Benefits	(1,089,244)	(940,269)
Plan Assets on June 30	\$ 450,283,729	\$ 456,036,860

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

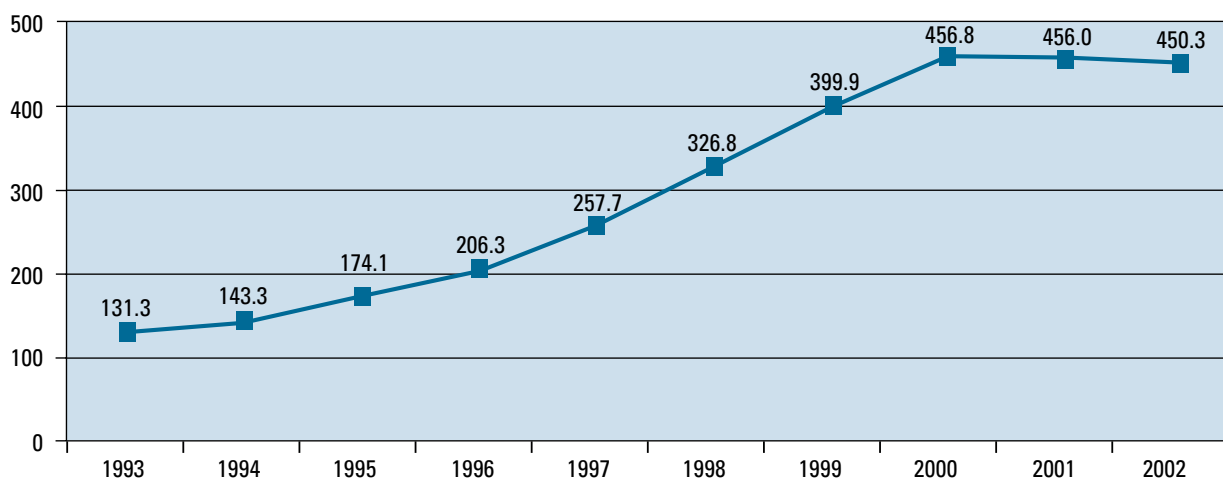
² The current third party administrator (Great-West) is compensated based on an annual fee of 30 basis points capped at account balances of \$150,000 on total non-annuitized assets.

Deferred Compensation Plan—Operational Overview

A total of 2,822 employees enrolled in the Commonwealth's 457 Deferred Compensation Plan during the 2001–2002 fiscal year. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became effective January 1, 2002, allowing increased tax deferred savings and increased portability of benefits. By removing the coordination between 457 Plans and 403(b) tax deferred accounts, EGTRRA made the 457 Plan attractive for employees of colleges and universities. Between the effective date of EGTRRA and the end of the fiscal year, participation in the 457 Plan by higher education employees increased from 417 to 987. EGTRRA also allowed 457 Plan participants to use their accounts to purchase service in the defined benefit plan. During the fiscal 536 participants used the trustee-to-trustee transfer provision to move \$3,471,949 from their 457 Plan accounts to VRS for the purchase of service credit.

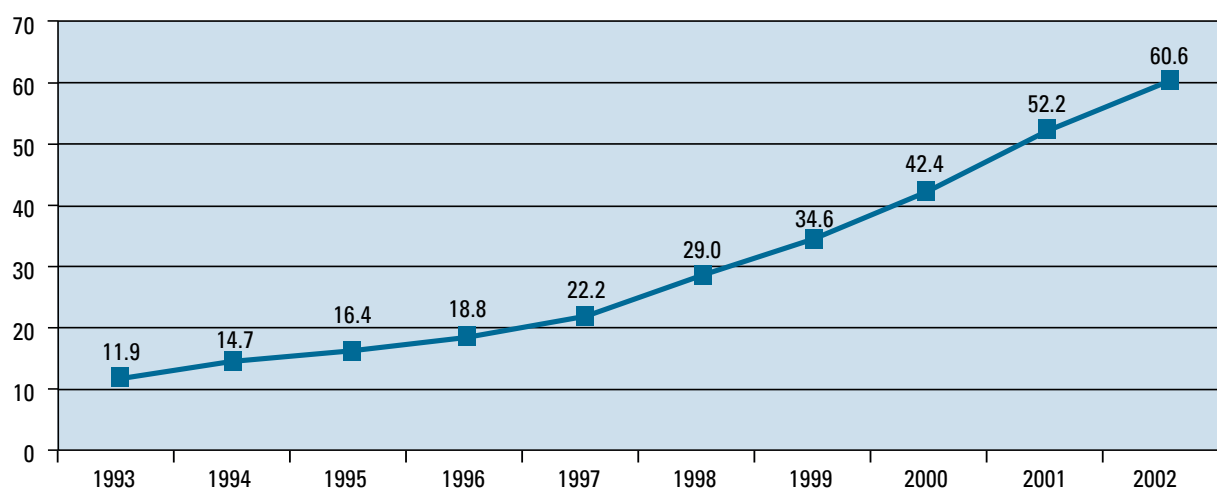
Deferred Compensation Program Assets

(Millions of Dollars)



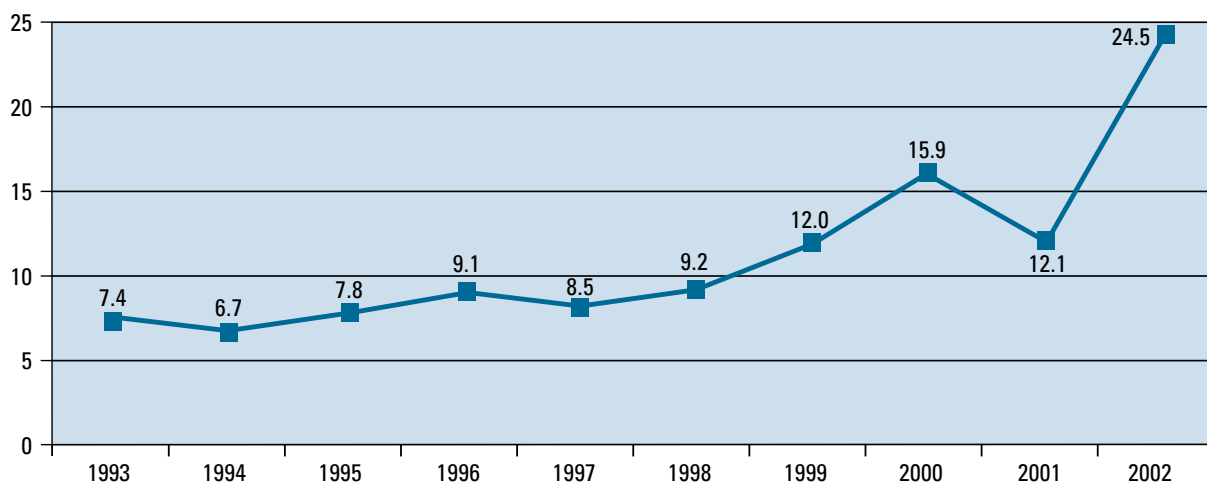
Contributions to the Deferred Compensation Plan

(Millions of Dollars)

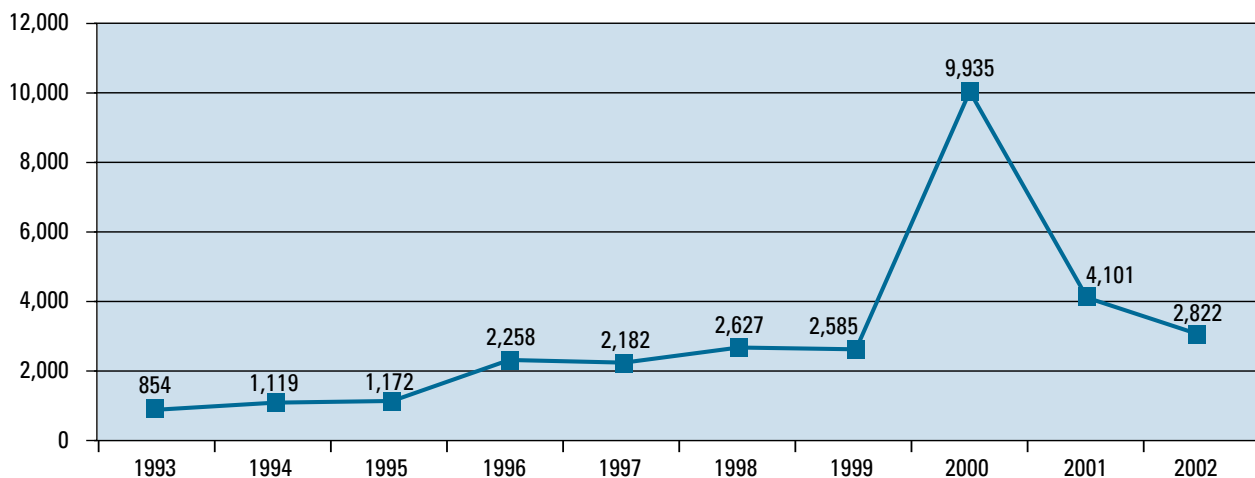


Distributions from the Deferred Compensation Plan

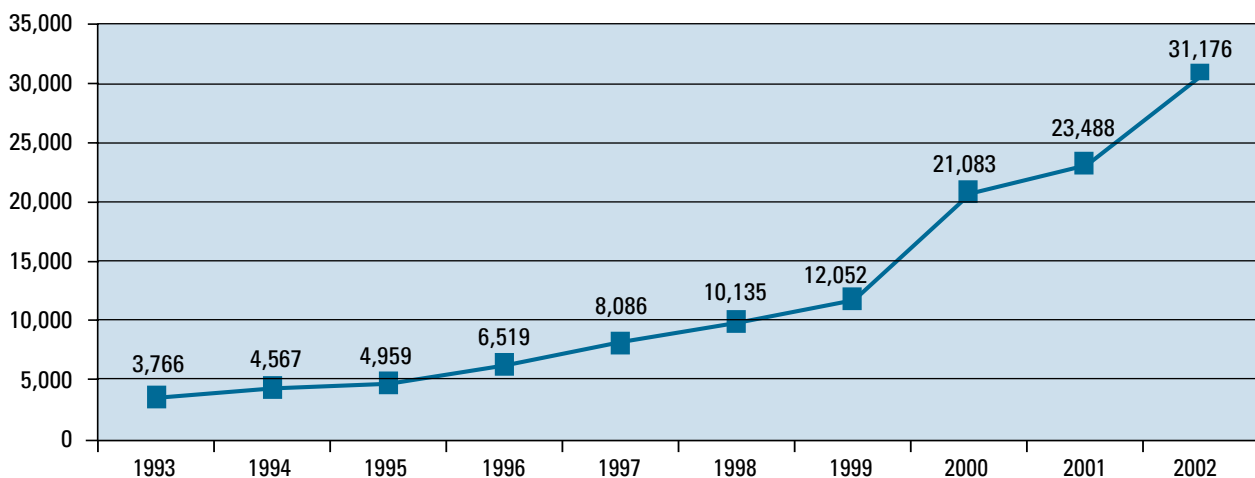
(Millions of Dollars)



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	4,053
Harrisdirect SDB Securities	37
International Equity Index Fund	1,732
Money Market Fund	1,730
Russell 1000 Growth Index Fund	1,650
Russell 1000 Value Index Fund	1,926
S&P 500 Index Fund	15,227
Small/Mid Cap. Equity Index Fund	4,228
Stable Value Fund	9,739
VRS Balanced Growth Fund	8,949
VRS Bond Fund	2,965
VRS Income & Growth Fund	2,488
VRS International Equity Fund	3,661
VRS Large Cap. Equity Fund	13,396
VRS Long-Term Growth Fund	4,270
VRS Small/Mid Cap Equity Fund	5,772

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 15 core investment options, the self-directed brokerage option, and funds providing systematic withdrawal distribution payments.

Annuity Plan Assets

The Hartford Life Insurance Company Annuity Plan Assets at June 30, 2002

\$ 9,207,196

Metropolitan Life Annuity Plan Assets at June 30, 2002

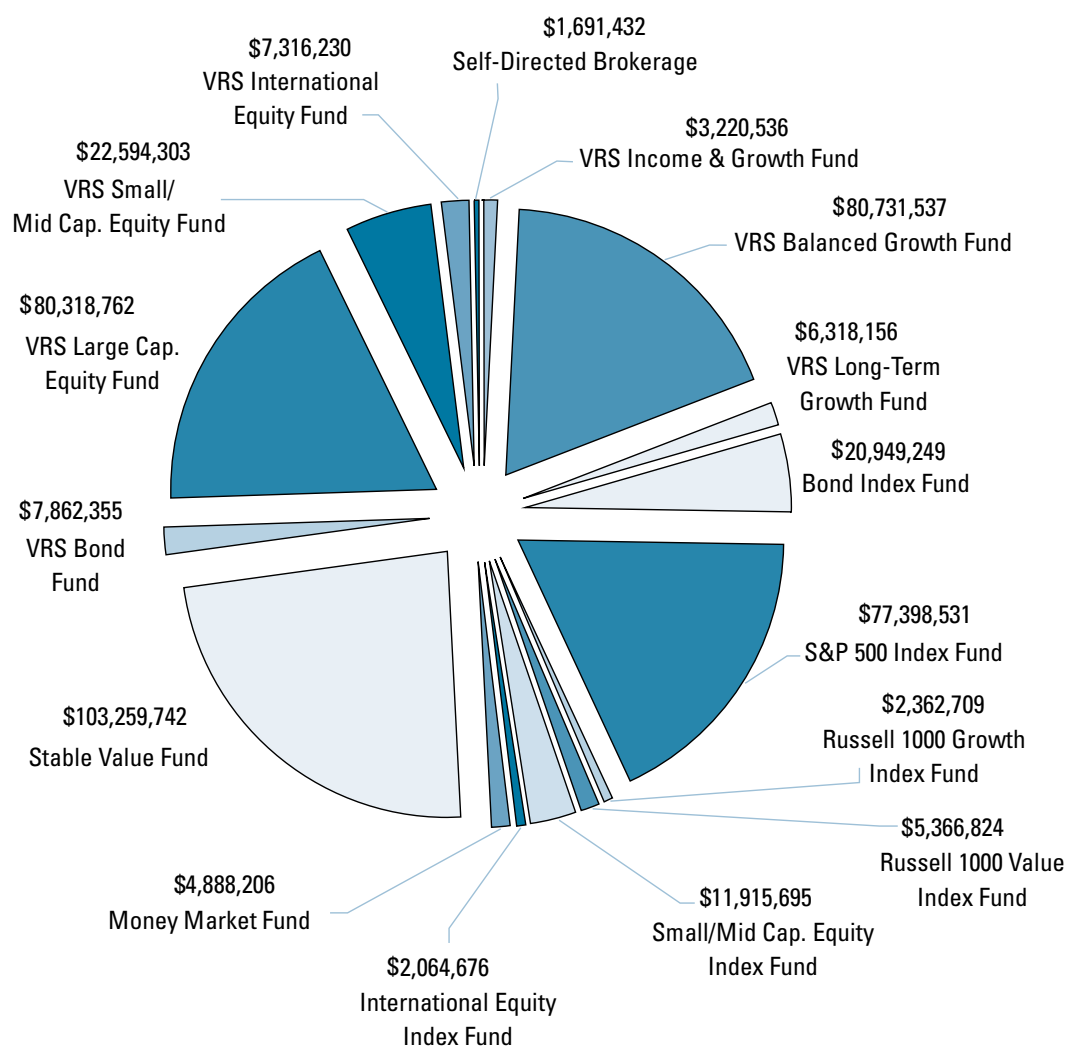
2,817,590

Total at June 30, 2002

\$ 12,024,786

Accumulation Plan Assets

Total at June 30, 2002—\$438,258,943



Description of Funds

Tier I: Asset Allocation Funds

VRS 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%

VRS 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%

VRS 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	Agency – 12%
Securities – 36%	CMBS – 2%
Corporate – 26%	Other – 3%
Treasury – 21%	

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

Financials – 20%	Energy – 8%
Health Care – 14%	Telecommunication
Information Technology – 14%	Services – 4%
Consumer Discretionary – 13%	Basic Materials – 3%
Industrials – 11%	Utilities – 3%
Consumer Staples – 10%	

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 – 25%	Consumer Staples – 12%
Information Technology – 23%	Financials – 10%
Consumer Discretionary – 15%	Other – 2%
Industrials – 13%	

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

Financials – 33%	Utilities – 7%
Consumer Discretionary – 12%	Consumer Staples – 6%
Energy – 11%	Information Technology – 5%
Industrials – 9%	Materials – 5%
Telecommunication	Health Care – 4%
Services – 8%	

Small/Mid Capitalization Equity Index Fund:

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

Financials – 26%	Consumer Staples – 4%
Consumer Discretionary – 18%	Energy – 4%
Information Technology – 14%	Materials – 4%
Health Care – 13%	Utilities – 4%
Industrials – 12%	Other – 1%

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

Financials – 23%	Materials – 7%
Consumer Discretionary – 14%	Information Technology – 6%
Energy – 10%	Telecommunication
Health Care – 10%	Services – 5%
Consumer Staples – 9%	Utilities – 4%
Industrials – 9%	Other – 3%

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, – 45%	Bank Notes, Corporates,
Notes – 2%	Medium-Term Adjustable
Floating Rate Corporate	Rate ABS – 30%
Notes – 12%	Repurchase Agreements – 2%
Agency – 5%	Other – 1%
Treasury – 3%	

Stable Value Fund: Seeks to provide attractive credited rates and competitive market returns relative to the Lehman Brothers Intermediate Government/Corporate Index. Principal and interest are guaranteed by MetLife for participant accounts during the active life of the Fund. (Rates are reset every six months.)

U.S. Government – 34%	Mortgages – 13%
Corporate – 30%	Other – 5%
ABS – 18%	

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

Mortgage-Backed	Other – 12%
Securities – 39%	U.S. Treasury/Agency – 10%
Foreign – 21%	Emerging Markets – 3%
Corporate – 15%	

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

Financials – 20%	Energy – 8%
Technology – 14%	Communication Services – 4%
Health Care – 14%	Basic Materials – 3%
Consumer Staples – 13%	Utilities – 3%
Consumer Cyclical – 11%	Other – 1%
Capital Goods – 9%	

VRS Small/Mid Capitalization Equity Fund:

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

Financials – 25%	Basic Materials – 4%
Consumer Cyclical – 16%	Energy – 4%
Technology – 14%	Transportation – 3%
Consumer Staples – 12%	Utilities – 3%
Capital Goods – 9%	Communication Services – 1%
Health Care – 9%	

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

Financials – 23%	Industrials – 8%
Consumer Discretionary – 17%	Consumer Staples – 8%
Health Care – 12%	Telecommunication
Energy – 9%	Services – 8%
Information Technology – 9%	Materials – 3%
Other – 3%	

Tier IV: Self-Directed Brokerage Option

This option is for knowledgeable investors who acknowledge and understand the risks associated with the mutual fund investments contained within the option. Eligible participants are allowed to select from thousands of mutual funds in addition to the Plan's core investment options. (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, 2002

(Returns greater than one year are annualized)

Investment Options	1 Year	3 Years	5 Years	Expense Ratio
Tier I: Asset Allocation Funds				
VRS Income & Growth Fund¹	2.20%	4.27%	6.83%	0.07%
Benchmark (75% Lehman Bros. Aggregate Bond Index, 22% Russell 3000, 3% MSCI EAFE)	2.17%	4.23%	6.81%	
VRS Balanced Growth Fund¹	-4.09%	0.38%	5.83%	0.07%
Benchmark (50% Lehman Bros. Aggregate Bond Index, 43% Russell 3000, 7% MSCI EAFE)	-4.07%	0.30%	5.77%	
VRS Long-Term Growth Fund¹	-10.24%	-3.61%	4.58%	0.07%
Benchmark (25% Lehman Bros. Aggregate Bond Index, 64% Russell 3000, 11% MSCI EAFE)	-10.16%	-3.68%	4.53%	
Tier II: Passively Managed Funds				
Bond Index Fund	8.73%	8.15%	7.63%	0.05%
Lehman Bros. Aggregate Bond Index	8.63%	8.11%	7.57%	
S&P 500 Index Fund	-18.02%	-9.19%	3.67%	0.02%
S&P 500 Index	-17.99%	-9.18%	3.66%	
Russell 1000 Growth Index Fund	-26.63%	-16.12%	-0.24%	0.08%
Russell 1000 Growth Index	-26.49%	-16.15%	-0.28%	
Russell 1000 Value Index Fund	-9.18%	-3.04%	6.44%	0.08%
Russell 1000 Value Index	-8.95%	-2.92%	6.53%	
Small/Mid Cap Equity Index Fund	-14.94%	-4.12%	4.00%	0.08%
Russell Small Cap Completeness Index	-14.94%	-4.37%	3.61%	
International Equity Index Fund	-10.18%	-7.45%	-1.89%	0.20%
MSCI EAFE Index	-9.49%	-6.75%	-1.53%	
Tier III: Actively Managed Funds				
Money Market Fund	2.68%	4.86%	5.12%	0.09%
91-Day Treasury Bill	2.27%	4.50%	4.74%	
VRS Bond Fund	11.00%	8.79%	8.28%	0.43%
Lehman Bros. Aggregate Bond Index	8.63%	8.11%	7.57%	
VRS Large Cap Equity Fund²	-19.34%	-9.78%	3.62%	0.48%
S&P 500 Index	-17.99%	-9.18%	3.66%	
VRS Small/Mid Cap Equity Fund²	-11.08%	-3.28%	4.83%	0.65%
Russell Small Cap Completeness Index	-14.94%	-4.37%	3.61%	
VRS International Equity Fund	-10.28%	-7.02%	-2.24%	0.91%
MSCI EAFE Index	-9.49%	-6.75%	-1.53%	
Stable Value Fund	The credited rate from 7/1/2001 through 12/31/2001 was set at 5.90%. The credited rate from 1/1/2002 through 6/30/2002 was set at 5.60%.			0.36%

¹ Investment operations for the VRS Asset Allocation Funds began 11/1/99. Returns prior to this date are a simulation based upon the historical performance of the Funds' indices according to the Funds' target allocation, and therefore do not reflect the Funds' actual historical performance.

² Investment operations for the VRS Large Cap Equity Fund and the VRS Small/Mid Cap Equity Fund began 11/1/99. Returns prior to this date are simulated and are for illustrative purposes only.

The 2000s—Terror, Uncertainty, Renewed Community Ties

Little more than a year after the nation and the world joyfully welcomed the new millennium, the September 11 terrorist attacks on New York and Washington rocked the nation. But in the wake of anxiety and fear was a renewed sense of patriotism and community. In Virginia, VRS received the U.S. Senate Productivity Award for the third straight year. VRS enhanced its life insurance options, including coverage for spouses and optional coverage into retirement, and welcomed a new Chairman, Alfonso I. Samper, and a new director, W. Forrest Matthews, Jr. . The System also addressed the teacher shortage by allowing retirees to work and continue to draw benefits under certain conditions.



Director W. Forrest Matthews, Jr.



Chairman Alfonso I. Samper

2000–2002

2001—Major enhancements in life insurance benefits give employees greater options. Additional benefits are paid if an employee dies while wearing a seat belt, as the result of an accident more than 75 miles from home, or due to a felonious assault in the workplace. VRS retirees gain the option to continue optional life insurance coverage into retirement; the coverage also extends to spouses and dependent children. The existing reduction in the regular group life insurance coverage that occurs after retirement is simplified.

2001—Purchase of service is streamlined. Employees are encouraged to purchase service early in their careers, when it is less costly for them and for the retirement system.

2001—Under new retirement options, retired teachers and school administrators are allowed to work full time and still draw benefits under limited circumstances. Employers gain a new tool to retain their “best and brightest” by offering a partial lump-sum option payment (PLOP) to members who work beyond normal retirement age.

August 22, 2001—A retired teacher’s aide with Hanover County Public Schools is honored as VRS’s 100,000th retiree.

March 2002—A new long-term care program was added to the Virginia Sickness & Disability Program. The program was expanded to include all state employees.



2002 Virginia Sickness & Disability Program Handbook



A new look for the Member Bulletin



Former Director Bill Leighty receives 2001 Senate Productivity Award.

Elsewhere in the USA

As the year 2000 approaches, companies and organizations gear up for Y2K technological snafus—but the New Year’s transition is relatively uneventful. San Francisco Giants player Barry Bonds hits 73 home runs, establishing record. The charm of dot-coms wears thin. Record low unemployment at the start of the decade gives way to a slumping economy, shrunken portfolios, and several indicted CEOs. The price of a first-class postage stamp reaches 37 cents in 2002. Millions watch the White House drama *West Wing*. Biometrics—confirming your identity with an iris scan or electronic fingerprint—gains credence.



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