
FINANCIAL SECTION

TEACHERS' RETIREMENT & PENSION SYSTEMS

The Teachers' Retirement System was established by the General Assembly in 1927 and is the oldest plan administered by the State Retirement and Pension System of Maryland. Equally important to the retirement security of state and local teachers is the Teachers' Pension System which was established in 1980.

Today, the Teachers' Retirement and Pension Systems comprise state and local teachers of the public school systems, as well as certain employees of boards of education, public libraries and community colleges. Active membership involves over 95,000 participants. The combined systems provide survivor, disability and retirement benefits to plan members.



Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

INDEPENDENT AUDITOR'S REPORT

BOARD OF TRUSTEES
STATE RETIREMENT AND
PENSION SYSTEM OF MARYLAND

We have audited the accompanying statements of plan net assets of the State Retirement and Pension System of Maryland as of June 30, 2002 and 2001, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State Retirement and Pension System of Maryland as of June 30, 2002 and 2001, and the changes in plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2, the System has implemented the provisions of Government Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as of June 30, 2002.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the information and do not express an opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying required supplementary information and other supplementary information are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2002 on our consideration of the State Retirement and Pension System of Maryland's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations and contracts. This 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 audits.

The other data included in this report have not been audited by us and, accordingly, we express no opinion on such data.

Bruce A. Myers, CPA
Legislative Auditor

November 7, 2002

301 West Preston Street • Room 1202 • Baltimore, Maryland 21201
410-946-5900/301-970-5900 • FAX 410-946-5999/301-970-5999
Other areas in Maryland 1-877-486-9964

MANAGEMENT'S DISCUSSION AND ANALYSIS

To help facilitate a better understanding of the State Retirement and Pension System of Maryland's (the "System") financial condition as of June 30, 2002, the results of its operations for the fiscal year then ended and the fiscal policies that govern its significant business operations, management has prepared this narrative analysis. This narrative is intended to supplement the System's audited financial statements and, as such should be read in conjunction with these statements, which are presented beginning on page 18.

OVERVIEW OF THE FINANCIAL STATEMENTS

As required by Generally Accepted Accounting Principles, the System's basic financial statements comprise the comparative Statements of Plan Net Assets and Statements of Changes in Plan Net Assets, along with the related note disclosures. In addition, the System's financial statements include certain required supplementary information (e.g., schedules of funding progress, and employer contributions) as well as other supplementary schedules considered relevant to the financial statement user (e.g., schedules of fund balances, administrative and investment expenses, plan net assets and related changes by system). To better understand the relevance of the information presented in the System's financial statements and related notes and supplementary information, it is helpful to first consider what purpose each component is intended to serve.

The Statements of Plan Net Assets present a comparative, summary-level snapshot, as of a specific point in time (i.e., June 30th – the last day of the System's fiscal year), of the market value of the net assets available to pay future pension benefits to retirees and beneficiaries. To assist the reader in understanding the composition of the System's accumulated net assets the most significant components (e.g., cash and cash-equivalent securities, investments, net assets available) are separately disclosed. In this regard, cash and cash equivalents represent that portion of the System's assets which, as of the end of the fiscal year, reside in the form of actual cash or short-term, highly liquid, investment securities. This amount gives an indication of the System's liquidity at fiscal year end. Conversely, the amounts shown as investments represent those funds invested in longer-term securities (e.g., stocks, bonds, real estate) held for the purpose of generating investment income. The sum of these assets, reduced by any liabilities owed by the System at fiscal year-end, represents the net assets held in trust to pay pension benefits.

By contrast, the Statements of Changes in Plan Net Assets are intended to show, on a comparative basis, the major categories of income earned (additions to plan net assets) and expenses incurred (deductions from plan net assets) by the System during the previous fiscal year. As such, the System's net income or loss accounts for the entire change in the net assets held in trust to pay pension benefits during the fiscal year as a result of System operations. As with the System's assets and liabilities, significant categories of income and expense, as reported on the statement of changes in plan net assets, are separately disclosed to help clarify the major sources and uses of System resources.

Finally, the note disclosures are provided as an integral component of the financial statements to help explain in narrative form some of the more complex or less obvious elements of the statements. Further, the notes to the financial statements provide additional information (e.g., significant accounting policies, categorization of custodial credit risk) that is essential for a comprehensive understanding of the System's financial condition and the results of its operations.

Beyond the basic financial statements, the System provides certain required schedules and related note disclosures that collectively demonstrate the System's annual progress toward funding its actuarial accrued liability (i.e., Schedule of Funding Progress) and discloses a ten-year history of required employer contributions (i.e., Schedule of Contributions from Employers and Other Contributing Entity). The importance of these schedules is probably best explained by reference to the previously discussed basic financial statements.

The Schedule of Funding Progress, while similar in scope to the Statements of Plan Net Assets in that it is primarily focused on reporting on the accumulation of assets, differs from such statements both in its method for valuing such assets and in its approach to explaining their relevance to the liability they are being accumulated to satisfy. In this regard, the Schedule of Funding Progress first takes a long-term, actuarial view toward valuing the System's investment portfolio, as opposed to the market value approach reflected on the Statements of Plan Net Assets. Specifically,

the System's assets are valued (for funding purposes) using a methodology that distributes investment gains and losses over a five-year period in order to minimize the effects of annual market volatility on employer contribution rates. The schedule then discloses the total actuarial accrued liability as projected to reflect the estimated effects of actuarial assumptions about future membership, service credit and covered payroll. Thus computed, the actuarial value of assets and the actuarial accrued liability are compared to disclose both the changes in the amount of unfunded actuarial liability, over a ten-year period, and the System's progress toward accumulating the necessary assets. This final piece, progress toward funding the actuarial accrued liability, is measured on the schedule in two significant ways. First is the funded ratio, which measures the System's ability to pay all projected benefits as they become due. Second is the unfunded liability, as a percentage of covered payroll, which measures the participating employers' capacity to pay all contributions required to fund the actuarial liability.

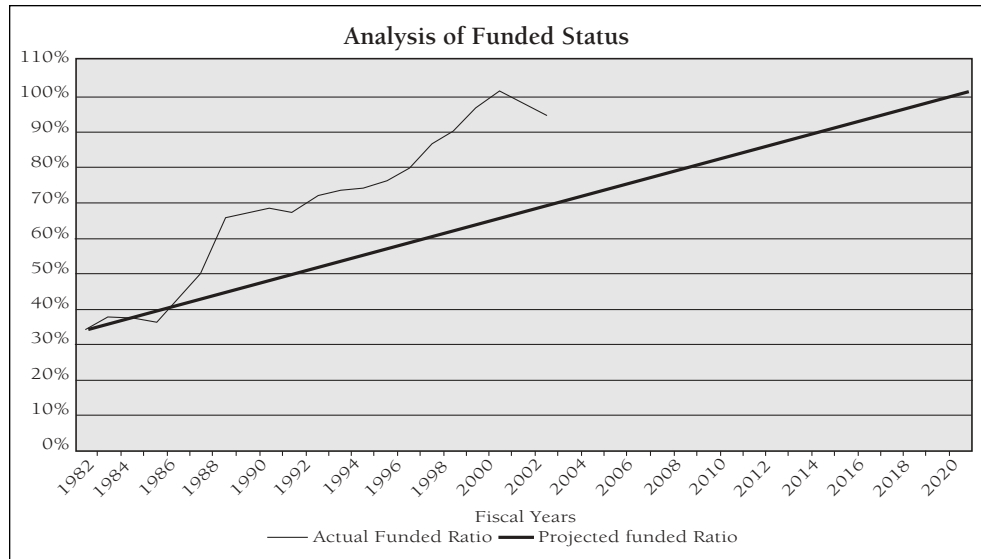
The Schedule of Contributions from Employers and Other Contributing Entity, much like the Schedule of Funding Progress, shares common characteristics with data disclosed in the basic financial statements. In this regard, both the Statements of Changes in Plan Net Assets and the Schedule of Contributions from Employers and Other Contributing Entity disclose the amount of contributions received from participating employers. However, the Schedule of Contributions from Employers and Other Contributing Entity differs from the Statements of Changes in Plan Net Assets in that the schedule's only focus is to disclose the contributions required to be made in accordance with the System's funding policy and the percentage of the required contributions actually made during the fiscal years presented.

The notes to the required supplementary information provide background information and explanatory detail to aid in understanding the required supplementary schedules. Finally, the other supplementary schedules, presented immediately after the required supplementary information, summarize the changes in fund balances, disclose major categories of operating and investment expenses, discuss the development of the System's statutory transfer refund rate and provide combining, plan-level detail related to asset, liability, income and expense amounts summarized in the basic financial statements.

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

The System's overall funding objective is to accumulate sufficient assets over time to meet its long-term benefit obligations as they become due. Accordingly, collecting employer and member contributions as well as earning an adequate long-term rate of return on its investments are essential components of the System's plan for accumulating the funds needed to finance future retirement benefits. In this regard, fiscal year 2002 was another difficult year both for the financial markets and the economy as a whole.

Contributions collected by the System continued to decline during fiscal year 2002, due primarily to a decrease in the actuarially determined employer contribution rates. Additionally, declining financial markets affected most of the economic sectors in which the System held investments during fiscal year 2002 thus producing the second consecutive year of negative investment returns for the System. As a result, the System experienced a net investment loss of \$2.3 billion for fiscal year 2002. This loss, when coupled with the \$600 million excess of benefits, refunds and administrative expenses incurred over employer and member contributions earned, resulted in a \$2.9 billion reduction in total plan net assets for fiscal year 2002. However, despite the negative investment returns for the past two years, the System remained financially sound as of June 30, 2002 and significantly ahead of its original actuarial funding schedule, which projected the System to be fully funded by the year 2020 as shown in the following chart.



In analyzing the System’s overall funded status, it is important to remember that a retirement system’s funding plan is based on a long time horizon, where temporary ups and downs in the market are expected. The more critical factor is that the System be able to meet an expected earnings yield of, on average, 8 percent annual return on investments.

REVENUES – ADDITIONS TO PLAN NET ASSETS

During fiscal year 2002, System revenues, which comprise employer and member contributions and earnings on investments, increased by \$830 million from \$(2.3) billion in fiscal year 2001 to just under \$(1.5) billion in fiscal year 2002. This positive change was due primarily to better investment performance during fiscal year 2002.

EXPENSES – DEDUCTIONS FROM PLAN NET ASSETS

The System was created to provide retirement, survivor and disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments as designated by the plan, refunds of contributions and related interest to members who either terminate employment with a participating employer or who make a qualifying transfer between certain contributory and non-contributory plans, and the cost of administering the System.

Expenses for fiscal year 2002 totaled \$1.4 billion, an increase of 7 percent (\$95 million) over fiscal year 2001. This increase was attributable to an increase in total benefit payments resulting from the steadily increasing number of retirees and beneficiaries in pay status. Expenses incurred to administer the System declined slightly in fiscal year 2002 after having remained fairly level for the past several years.

REQUESTS FOR INFORMATION

Members of the System’s Board of Trustees and senior management are fiduciaries of the pension trust fund, and as such, are charged with the responsibility of ensuring that the System’s assets are used exclusively for the benefit of plan participants and their beneficiaries. This financial report is designed to provide an overview of the System’s finances and to demonstrate accountability for the resources entrusted to the System for the benefit of all of the System’s stakeholders. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

State Retirement and Pension System of Maryland
 Finance Division
 120 E. Baltimore Street, Suite 1660
 Baltimore, Maryland 21202-1600

Statements of Plan Net Assets
as of June 30, 2002 and 2001
(Expressed in Thousands)

	<u>2002</u>	<u>2001</u>
Assets:		
Cash & cash equivalents (note 3)	\$ 1,141,644	\$ 919,888
Receivables:		
Contributions:		
Employers	10,228	10,104
Members	3,783	3,587
Accrued investment income	119,982	124,039
Investment sales proceeds	<u>176,658</u>	<u>56,032</u>
Total receivables	<u>310,651</u>	<u>193,762</u>
Investments, at fair value (notes 2 & 3):		
U.S. Government obligations	2,892,274	2,361,828
Domestic corporate obligations	2,743,183	3,036,115
International obligations	77,116	185,519
Domestic stocks	12,641,718	14,391,788
International stocks	4,715,043	5,632,416
Mortgages & mortgage related securities	2,005,226	2,503,790
Real estate	733,338	768,297
Alternative investments	82,090	60,280
Collateral for loaned securities	<u>2,304,930</u>	<u>2,623,837</u>
Total investments	<u>28,194,918</u>	<u>31,563,870</u>
Total assets	<u>29,647,213</u>	<u>32,677,520</u>
Liabilities:		
Accounts payable & accrued expenses	44,972	47,630
Investment commitments payable	709,284	523,553
Obligation for collateral for loaned securities	2,304,930	2,623,837
Other liabilities	<u>1,131</u>	<u>1,099</u>
Total liabilities	<u>3,060,317</u>	<u>3,196,119</u>
Net assets held in trust for pension benefits	<u>\$26,586,896</u>	<u>\$29,481,401</u>
<i>(A schedule of funding progress is presented on page 29)</i>		

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Plan Net Assets
for the Fiscal Years Ended June 30, 2002 and 2001
(Expressed in Thousands)

	2002	2001
Additions:		
Contributions (note 4):		
Employers	\$ 234,265	\$ 246,452
Members	199,304	189,769
Other	347,106	387,857
Total contributions	<u>780,675</u>	<u>824,078</u>
Investment income:		
Net depreciation in fair value of investments	(2,986,680)	(3,894,321)
Interest	467,733	531,407
Dividends	264,762	251,708
Real estate operating net income	29,161	28,048
Income before securities lending activity	<u>(2,225,024)</u>	<u>(3,083,158)</u>
Gross income from securities lending activity	67,493	146,066
Securities lending borrower rebates	(50,016)	(132,592)
Securities lending agent fees	(3,496)	(3,054)
Net income from securities lending activity	<u>13,981</u>	<u>10,420</u>
Total investment income	(2,211,043)	(3,072,738)
Less investment expenses (note 2f)	(54,272)	(66,025)
Net investment income	<u>(2,265,315)</u>	<u>(3,138,763)</u>
Total additions	<u>(1,484,640)</u>	<u>(2,314,685)</u>
Deductions:		
Benefit payments	1,372,325	1,272,804
Refunds (note 5)	17,476	16,977
Administrative expenses (note 2f)	20,064	24,823
Total deductions	<u>1,409,865</u>	<u>1,314,604</u>
Net decrease in plan assets	(2,894,505)	(3,629,289)
Net assets held in trust for pension benefits:		
Beginning of the fiscal year	29,481,401	33,110,690
End of the fiscal year	<u>\$26,586,896</u>	<u>\$29,481,401</u>

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS**I. GENERAL DESCRIPTION OF THE SYSTEM****a. Organization**

The State Retirement Agency (the “Agency”) is the administrator of the State Retirement and Pension System of Maryland (the “System”), an agent multiple-employer public employee retirement system. The System was established by the State Personnel and Pensions Article of the Annotated Code of Maryland to provide retirement allowances and other benefits to State employees, teachers, police, judges, legislators and employees of participating governmental units. Responsibility for the System’s administration and operation is vested in a 14-member Board of Trustees.

The State of Maryland is the statutory guarantor for the payment of all pensions, annuities, retirement allowances, refunds, reserves and other benefits of the System. The Agency is legally authorized to use all assets accumulated for the payment of benefits to pay such obligations to any plan member or beneficiary as defined by the terms of the plan. Consequently, the System is accounted for as a single plan as defined in Governmental Accounting Standards Board (GASB) Statement No. 25, “*Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans.*” Additionally, the System is fiscally dependent on the State by virtue of the legislative and executive controls exercised with respect to its operations, policies and administrative budget. Accordingly, the System is included in the State’s reporting entity and disclosed in its financial statements as a pension trust fund.

The System comprises the Teachers’ Retirement and Pension Systems, Employees’ Retirement and Pension Systems, State Police Retirement System, Judges’ Retirement System, Law Enforcement Officers’ Pension System and the Local Fire and Police System.

b. Covered Members

The Teachers’ Retirement System was established on August 1, 1927 to provide retirement allowances and other benefits to teachers in the State. Effective January 1, 1980, the Teachers’ Retirement System was closed to new members and the Teachers’ Pension System was established. As a result, teachers hired after December 31, 1979 become members of the Teachers’ Pension System as a condition of employment. Members remaining in the Teachers’ Retirement System have the opportunity to irrevocably elect to transfer to the Teachers’ Pension System. For those transferring, all prior service credit and member contributions on earnings above the social security wage base are transferred from the Teachers’ Retirement System to the Teachers’ Pension System, with member contributions on earnings up to the social security wage base being refunded (see note 5).

On October 1, 1941, the Employees’ Retirement System was established to provide retirement allowances and other benefits to State employees, elected and appointed officials and the employees of participating governmental units. Effective January 1, 1980, the Employees’ Retirement System was essentially closed to new members and the Employees’ Pension System was established. As a result, State employees (other than correctional officers) and employees of participating governmental units hired after December 31, 1979 become members of the Employees’ Pension System as a condition of employment, while all State correctional officers and members of the Maryland General Assembly continue to be enrolled as members of the Employees’ Retirement System. State employees and employees of participating governmental units remaining in the Employees’ Retirement System have the opportunity to irrevocably elect to transfer to the Employees’ Pension System. For those transferring, all prior service credit and member contributions on earnings above the social security wage base are transferred from the Employees’ Retirement System to the Employees’ Pension System with member contributions on earnings up to the social security wage base being refunded (see note 5). Currently, 130 governmental units participate in the Employees’ Systems.

The State Police Retirement System was established on July 1, 1949 to provide retirement allowances and other benefits to any police employee or cadet of the Maryland State Police.

The Judges’ Retirement System was established on June 30, 1969 to provide retirement allowances and other benefits for State and local, appointed or elected judges.

The Law Enforcement Officers' Pension System was established on July 2, 1990 to provide retirement allowances and other benefits for certain State and local law enforcement officers. This System includes both retirement plan and pension plan provisions which are applicable to separate portions of this System's membership. The retirement plan provisions are only applicable to those members who, on the date they elected to participate in this System, were members of the Employees' Retirement System. This System's pension plan provisions are applicable to all other participating law enforcement officers.

The Local Fire and Police System was established on July 1, 1989 to provide retirement allowances and other benefits for law enforcement officers and fire fighters employed by participating governmental units. This System includes both retirement plan and pension plan provisions which are applicable to separate portions of this System's membership. The retirement plan provisions are only applicable to those officers and fire fighters who, on the date they elected to participate in this System, were members of the Employees' Retirement System. This System's pension plan provisions are applicable to all other participating governmental unit law enforcement officers and fire fighters.

The following table presents a summary of membership by system as of June 30, 2002, with comparative 2001 totals:

	Inactive & Deferred Vested	Retirees & Beneficiaries	Active Plan Participants		
			Vested	Non-vested	Total
Teachers' Retirement and Pension Systems	18,040	41,920	61,607	34,749	96,356
Employees' Retirement and Pension Systems	26,176	43,109	58,095	32,211	90,306
Judges' Retirement System	10	311	281	—	281
State Police Retirement System	27	1,598	1,186	403	1,589
Local Fire and Police System	36	26	123	58	181
Law Enforcement Officers' Pension System	66	403	966	444	1,410
Totals as of June 30, 2002	44,355	87,367	122,258	67,865	190,123
Totals as of June 30, 2001	43,199	84,185	120,856	63,744	184,600

c. Summary of Significant Plan Provisions

All plan benefits are specified by the State Personnel and Pensions Article of the Annotated Code of Maryland. Retirement allowances are computed using both the highest three years' average final salary (AFS) and the actual number of years of accumulated creditable service. Pension allowances are computed using both the highest three consecutive years' AFS and the actual number of years of accumulated creditable service. Various retirement options are available under each system which ultimately determine how a retiree's benefit allowance will be computed. Some of these options require actuarial reductions based on the retiree's and/or designated beneficiary's attained age and similar actuarial factors. A brief summary of the retirement eligibility requirements of, and the benefits available under, the various systems follows:

Service Retirement Allowances

A member of either the Teachers' or Employees' Retirement System is generally eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 30 years of eligibility service regardless of age. The annual retirement allowance equals 1/55 (1.8%) of the member's AFS multiplied by the number of years of accumulated creditable service.

A member of either the Teachers' or Employees' Pension System is eligible for full retirement benefits upon the earlier of attaining age 62, with specified years of eligibility service, or accumulating 30 years of eligibility service regardless of age. Generally, the annual pension allowance for a member of either the Teachers' or Employees' Pension System equals 1.2% of the member's AFS, multiplied by the number of years of creditable service accumulated prior to July 1, 1998, plus 1.4% of the member's AFS, multiplied by the number of

years of creditable service accumulated subsequent to June 30, 1998. However, the annual pension allowance for a member of the Employees' Pension System, who is employed by a participating governmental unit that does not provide the enhanced pension benefits, equals 0.8% of the member's AFS up to the social security integration level (SSIL), plus 1.5% of the member's AFS in excess of the SSIL, multiplied by the number of years of accumulated creditable service. For the purpose of computing pension allowances, the SSIL is the average of the social security wage bases for the past 35 calendar years ending with the year the retiree separated from service.

A member of the State Police Retirement System is eligible for full retirement benefits upon the earlier of attaining age 50 or accumulating 22 years of eligibility service regardless of age. The annual retirement allowance equals 2.55% of the member's AFS multiplied by the number of years of accumulated creditable service and may not exceed 71.4% of the member's AFS.

A member of the Judges' Retirement System is eligible for full retirement benefits upon attaining age 60. The annual retirement allowance for a member with at least 16 years of accumulated creditable service equals 2/3 (66.7%) of the salary of an active judge holding a comparable position. The annual retirement allowance is prorated if the member retires with fewer than 16 years of accumulated creditable service.

A member of the Law Enforcement Officers' Pension System is eligible for full retirement benefits upon the earlier of attaining age 50 or accumulating 25 years of eligibility service regardless of age. The annual retirement allowance for a member who is covered under the retirement plan provisions equals 1/50 (2.0%) of the member's AFS multiplied by the number of years of accumulated creditable service up to 30 years, plus 1/100 (1.0%) of the member's AFS multiplied by the number of years of accumulated creditable service in excess of 30 years. For members subject to the pension provisions, full service pension allowances equal 2.0% of AFS up to a maximum benefit of 60% (30 years of credit).

A member of the Local Fire and Police System who is covered under the retirement plan provisions is eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 25 years of eligibility service regardless of age. The annual retirement allowance equals 1/50 (2.0%) of the member's AFS multiplied by the number of years of accumulated creditable service up to 30 years, plus 1/100 (1.0%) of the member's AFS multiplied by the number of years of accumulated creditable service in excess of 30 years. A member who is covered under the pension plan provisions is eligible for full pension benefits upon the earlier of attaining age 62 or accumulating 25 years of eligibility service regardless of age. The annual pension allowance equals 1.0% of the member's AFS up to the SSIL, plus 1.5% of the member's AFS in excess of the SSIL, multiplied by the number of years of accumulated creditable service.

Vested Allowances

Any member (other than a judge) who terminates employment before attaining retirement age but after accumulating 5 years of eligibility service is eligible for a vested retirement allowance. Judges have no minimum service requirements prior to vesting. A member who terminates employment prior to attaining retirement age and before accumulating 5 years of eligibility service receives a refund of all member contributions and interest.

Early Service Retirement

A member of either the Teachers' or Employees' Retirement System may retire with reduced benefits after completing 25 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree either attains age 60 or would have accumulated 30 years of eligibility service, whichever is less. The maximum reduction for a Teachers' or Employees' Retirement System member is 30%. A member of either the Teachers' or Employees' Pension System may retire with reduced benefits upon attaining age 55 with at least 15 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree attains age 62. The maximum reduction for a Teachers' or Employees' Pension System member is 42%. Members of the State Police, Judges', Law Enforcement Officers' and Local Fire and Police Systems are not eligible for early service benefits.

Disability and Death Benefits

Generally, a member covered under retirement plan provisions who is permanently disabled after 5 years of service receives a service allowance based on a minimum percentage (usually 25%) of the member's AFS. A member covered under pension plan provisions who is permanently disabled after accumulating 5 years of eligibility service receives a service allowance computed as if service had continued with no change in salary until the retiree attained age 62. A member (other than a member of the Maryland General Assembly or a judge, both of which are ineligible for accidental disability benefits) who is permanently and totally disabled as the result of an accident occurring in the line of duty receives 2/3 (66.7%) of the member's AFS plus an annuity based on all member contributions and interest. Death benefits are equal to a member's annual salary as of the date of death plus all member contributions and interest.

Adjusted Retirement Allowances

Retirement and pension allowances are increased annually to provide for changes in the cost of living according to prescribed formulae. Such adjustments for retirees are based on the annual change in the consumer price index. Generally, for Teachers' and Employees' Pension System retirees, the pension allowance adjustments are limited to 3% of the preceding year's allowance. However, annual increases to pension allowances for Employees' Pension System retirees who were employed by a participating governmental unit that does not provide enhanced pension benefits are limited to 3% of the initial allowance. Retirement allowances for legislators and judges are recalculated when the salary of an active member holding a comparable position is increased.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Accounting

The System's financial statements are prepared on the accrual basis of accounting. Accordingly, investment purchases and sales are recorded as of their respective trade dates and all contributions, benefits and refunds are recognized in the period when due. In accordance with GASB Statement No. 20, "**Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting**", the System has elected to apply all applicable GASB pronouncements and only Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989.

In June 1999 the GASB issued Statement No. 34, "**Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments**" (GASB 34). The requirements of this Statement are effective for periods beginning after June 15, 2001. In June 2001 the GASB issued Statement No. 37, "**Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus**" (GASB 37), which amended certain provisions of GASB 34. The adoption of GASB 34 and 37 requires the presentation of a Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements. The adoption of GASB 34 and 37 did not have any impact on the net plan assets available for pension benefits.

b. Investment Limitations

The State Personnel and Pensions Article of the Annotated Code of Maryland authorizes the System to invest plan assets in stocks, bonds, notes, certificates of indebtedness, mortgage notes, real estate, debentures or other obligations, subject to the terms, conditions, limitations and restrictions imposed by the Board of Trustees of the State Retirement and Pension System of Maryland. As such, no more than 25% of the assets invested in common stocks may be invested in non-dividend paying common stocks. In addition, no investment in any one organization may constitute more than 5% of the total assets of the System (valued at cost). The System did not exceed either of these investment limits.

c. Portfolio Valuation Method

The System investments are reported at fair value. For fixed income securities, fair value is based on quoted market prices provided by independent pricing services. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages and mortgage related securities are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. Fair value for real estate investments is based on estimated current values and independent appraisals. Fair value for alternative investments and mutual funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers. Investment amounts presented in the Statements of Plan Net Assets represent the fair value of the respective portfolios as of the fiscal year-end. Similarly, investment income amounts reported in the Statements of Changes in Plan Net Assets represent the income or loss derived from such investments for the year then ended. Accordingly, significant market fluctuations could periodically occur subsequent to the financial statement valuation date, which are not reflected in either the fair value of investments or the related investment income presented in these financial statements.

d. Securities Lending

The System's investment policies, as approved by the Board of Trustees, permit the System's custodial bank to lend System securities to broker-dealers and other entities. During fiscal year 2002, the System's custodial bank loaned securities of the type on loan at year-end for collateral in the form of cash (see note 3b), other securities, or letters of credit of at least 102% of the fair value of domestic securities and international fixed income securities and 105% of the fair value of international equity securities. Collateral is marked-to-market daily. If the market value of the pledged collateral falls below the specified levels, additional collateral is required to be pledged by the close of the next business day. Each such loan was executed with a simultaneous agreement to return the collateral for the same securities in the future. Securities on loan at year-end for cash collateral are presented as uncategorized in the schedule of custodial credit risk (see note 3). Securities on loan at year-end for collateral other than cash are categorized according to the custodial credit risk category applicable to the collateral received. In the event of a borrower's default, the System's custodial bank is obligated to indemnify the System if, and to the extent that, the fair value of collateral is insufficient to replace the loaned securities. Similarly, in the event of a borrower's failure to remit income distributions declared by the issuers of securities on loan, the System's custodial bank is obligated to indemnify the System for any portion of such distributions not recoverable from the borrower's collateral. The System has not experienced any loss due to credit or market risk on security lending activity since inception of the program. Further, as of June 30, 2002, the System had no credit risk exposure to borrowers because the fair value of collateral held exceeded the fair value of securities loaned.

Although the average term of the System's security loans is one week, each loan can be terminated at will by either the System or the borrower. Cash collateral is invested in one of the lending agent's short-term investment pools, which at June 30, 2002 had an average weighted maturity of one hundred forty-four days and an interest rate sensitivity duration of sixty-nine days. Because the relationship between the maturities of the investment pools and the System's security loans is affected by the maturities of the loans made by other entities that use the agent's pools, the System cannot match maturities. The System cannot pledge or sell collateral securities received unless and until a borrower defaults. Investments made with cash received as collateral and the corresponding liabilities are reported in the Statements of Plan Net Assets.

At June 30, 2002, the fair value of loaned securities and the related collateral were as follows (*expressed in thousands*):

	Fair Value	Collateral	Percent Collateralized
International equity securities	\$758,879	\$774,158	102.0%
Fixed and domestic equity securities	<u>1,586,094</u>	<u>1,626,670</u>	102.6%
Totals	<u>\$2,344,973</u>	<u>\$2,400,828</u>	

e. Derivatives

The System may invest in derivatives as permitted by guidelines established by the Board of Trustees. Compliance with these guidelines is monitored by Agency staff. Pursuant to such authority, the System invests in foreign currency forward contracts, options, futures, collateralized mortgage obligations, mortgage related securities, interest-only and principal-only securities. No derivatives were purchased with borrowed funds.

Derivatives are generally used to hedge against foreign currency risk and changes in interest rates, improve yield and adjust the duration of the System's fixed income portfolio. These securities are subject to changes in value due to changes in interest rates or currency valuations. Additionally, mortgage related securities are subject to prepayment risk when interest rates are falling. Credit risk for derivatives results from the same considerations as other counterparty risk assumed by the System, which is the risk that the counterparty might be unable to meet its obligations.

The System invests in foreign currency forward contracts to hedge the currency risk in its international and global portfolios. Because the fair value of foreign currency forward contracts is not included in the fair value of investments reported on the Statements of Plan Net Assets, the following schedule is presented to summarize the fair value of all foreign currency forward contracts outstanding as of June 30, 2002 (*expressed in thousands*):

Purchases			Sales		
Currency	Amount (local currency)	Fair Value	Currency	Amount (local currency)	Fair Value
Australian dollar	13,898	\$ 7,795	Australian dollar	7,503	\$ 4,206
Euro currency	100,412	98,873	Canadian dollar	23,507	15,441
Japanese yen	512,879	4,283	Japanese yen	15,921,675	133,147
U.S. dollar	67,618	<u>67,618</u>	Pound sterling	11,966	18,124
Total purchases		<u>\$178,569</u>	U.S. dollar	8,773	<u>8,773</u>
			Total sales		<u>\$179,691</u>

f. Administrative and Investment Expenses

All of the System's administrative and investment expenses (e.g., salaries of Agency employees, investment advisory fees) are incurred centrally and charged to each individual retirement or pension system on the basis of its percentage ownership in the System's net assets. All of the System's administrative and investment

expenses are funded from investment income. See pages 33 and 34 for detailed schedules of administrative and investment expenses, respectively.

g. Federal Income Tax Status

During the fiscal years ended June 30, 2002 and 2001, the System qualified under Section 401(a) of the Internal Revenue Code and was exempt from federal income taxes under Section 501(a) of the Code.

h. Reclassifications

Certain reclassifications were made to the 2001 financial statements to conform to the 2002 financial statement presentation.

3. CASH DEPOSITS AND INVESTMENTS

Cash and cash equivalents totaled \$1,141,644,000 and \$919,888,000 as of June 30, 2002 and 2001, respectively. Included as cash equivalents for financial statement presentation purposes were certain short-term investments (e.g., commercial paper, repurchase agreements) which are categorized in note 3b for custodial credit risk purposes as investments. These cash equivalent investments totaled \$1,104,467,000 and \$886,841,000 as of June 30, 2002 and 2001, respectively.

a. Cash Deposits

Cash deposits are categorized to give an indication of the level of custodial credit risk assumed by the System. Category 1 includes deposits insured or collateralized with securities held by the System or its agent in the System's name. Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the System's name. Category 3 includes deposits which are uncollateralized. As of June 30, 2002, the carrying amount of both the System's uninsured and uncollateralized deposits and bank balance was \$37,177,000 and comprises the System's Category 3 assets. Due to significantly higher cash flows at certain times of the year, the System's uninsured and uncollateralized deposits and bank balances increased significantly; as a result, the amounts of uninsured and uncollateralized deposits and bank balances at those times were significantly higher.

b. Investments

The System's investments are categorized to give an indication of the level of custodial credit risk assumed by the System. Category 1 includes investments insured or registered or for which the securities are held by the System's custodial bank in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counterparty, its trust department or its agent, but not in the System's name.

All of the System's investments that are eligible for categorization meet the criteria of Category 1. All other investments are not categorized because they are not evidenced by securities that exist in physical or book entry form.

FINANCIAL SECTION

The following table presents a summary of the System's investments, by category of custodial credit risk as of June 30, 2002, with comparative 2001 totals (*expressed in thousands*):

	Category 1	Carrying Value	
		2002	2001
Investments			
Commercial paper	\$ 323,667	\$ 323,667	\$ 336,236
Repurchase agreements	0	0	8,549
U.S. Government obligations	1,687,211	1,687,211	1,196,979
Domestic corporate obligations	2,701,177	2,701,177	2,953,636
Mortgage related securities	2,002,347	2,002,347	2,500,014
Domestic stocks	9,067,542	9,067,542	10,245,420
International obligations	4,847	4,847	69,737
International stocks	3,956,873	3,956,873	4,095,778
Total investments to be categorized	<u>\$19,743,664</u>	<u>19,743,664</u>	<u>21,406,349</u>
Mutual funds		3,400,318	4,507,766
Real estate		733,338	768,297
Mortgages		2,879	3,776
Alternative investments		82,090	60,280
Global pooled short-term investments		780,800	542,056
Investments held by borrowers under securities loans with cash collateral:			
U.S. Government obligations		1,205,063	1,164,849
Domestic corporate obligations		42,006	82,479
Domestic stocks		246,127	222,017
International stocks		758,170	1,069,005
Collateral for loaned securities		2,304,930	2,623,837
Total invested assets		<u>\$29,299,385</u>	<u>\$32,450,711</u>

4. CONTRIBUTIONS

The State Personnel and Pensions Article requires both active members and their respective employers to make contributions to the System. Rates for required contributions by active members are established by law. Members of the Teachers' and Employees' Retirement Systems are required to contribute 7% or 5% of earnable compensation depending upon the retirement option selected. Members of the State Police and Judges' Retirement Systems are required to contribute 8% and 6% of earnable compensation, respectively. Generally, members of the Teachers' and Employees' Pension Systems are required to contribute 2% of earnable compensation. However, members of the Employees' Pension System who are employed by a participating governmental unit that does not provide the enhanced pension benefits are required to contribute 5% of earnable compensation in excess of the social security taxable wage base.

Contribution rates for employer and other "non-employer" contributing entities are established by annual actuarial valuations using the entry age normal cost method with projection and other actuarial assumptions adopted by the Board of Trustees. These contribution rates have been established as the rates necessary to fully fund normal costs and amortize the unfunded actuarial accrued liability.

The unfunded actuarial liability is being amortized in distinct layers. The unfunded actuarial accrued liability which existed as of the June 30, 2000 actuarial valuation is being amortized over a 40-year period (as provided by law) from July 1, 1980. Also as provided by law, any new unfunded liabilities or surpluses arising during the fiscal year ended June 30, 2001, or any fiscal year thereafter, will be amortized over a 25-year period from the end of the fiscal year in which the liability or surplus arose.

Effective July 1, 2002, the law provides that the contribution rates may be more or less than the actuarially determined rates as described above for the Employees' Retirement and Pension Systems and the Teachers' Retirement and Pension Systems. When the funding ratio for each of the combined Systems is at least 90% but not more than 110%, the contribution rate will be the rate certified by the Board of Trustees for the previous fiscal year, adjusted to reflect legislative changes that result in changes to the normal cost. If the funding ratio is below 90%, the contribution rate will be the sum of the contribution rate for the previous fiscal year and 20% of the difference between the full funding rate for the current fiscal year and the contribution rate for the previous fiscal year. If the funding ratio is above 110%, the contribution rate will be the difference between 1.) the contribution rate for the previous fiscal year and 2.) 20% of the difference between the contribution rate for the previous fiscal year and the full funding rate for the current fiscal year.

The State of Maryland (which is also a non-employer contributor to the Teachers' Retirement and Pension Systems and the Judges' Retirement System), the Maryland Automobile Insurance Fund, the Injured Workers' Insurance Fund and 130 participating governmental units make all of the employer and other (non-employer) contributions to the System.

5. REFUNDS

Member contributions plus interest may be refunded to a member who withdraws from the System, or to the designated beneficiary following a member's death. In addition, members of the Teachers' and Employees' Retirement Systems who elect to transfer to the corresponding pension system receive refunds of all or part (if earnings have been greater than the social security taxable wage base) of their contributions plus interest. That portion of any member's contributions not refunded is transferred with credited interest to the applicable pension system. Employer contributions may also be refunded with interest to any participating governmental unit electing to withdraw from the System. For the fiscal years ended June 30, 2002 and 2001, refunds to members and withdrawing employers were as follows (*expressed in thousands*):

	2002	2001
Member refunds	\$ 16,344	\$16,977
Employer refunds	<u>1,132</u>	<u>-</u>
Total refunds	<u>\$ 17,476</u>	<u>\$16,977</u>

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress (Expressed in Thousands)

Actuarial Valuation Date June 30,	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) b	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll c	UAAL as a Percentage of Covered Payroll [(b - a) / c]
1993	\$15,684,924	\$21,175,256	\$5,490,332	74.07%	\$5,064,529	108 %
1994	16,272,577	21,875,463	5,602,886	74.39	5,246,249	107
1995	17,666,582	23,092,537	5,425,955	76.50	5,532,150	98
1996	19,455,280	24,240,883	4,785,603	80.26	5,640,834	85
1997	21,920,696	25,383,206	3,462,510	86.36	5,657,385	61
1998	24,850,355	27,416,935	2,566,580	90.64	5,900,456	43
1999*	27,646,579	28,475,380	828,801	97.09	6,312,417	13
2000	30,649,380	30,279,866	(369,514)	101.22	6,725,870	(5)
2001	31,914,778	32,469,942	555,164	98.29	7,255,036	8
2002	32,323,263	34,131,284	1,808,121	94.70	7,867,794	23

*The 1999 actuarial accrued liability does not include an additional \$153 million liability due to municipal employers voluntarily electing enhanced benefits during the period July 1, 1999 to December 31, 1999.

Schedule of Contributions from Employers and Other Contributing Entity (Expressed in Thousands)

Fiscal Year Ended June 30,	Annual Required Contributions	Percentage Contributed
1993	\$667,553	100 %
1994	657,429	100
1995	689,342	100
1996	721,615	100
1997	740,258	100
1998	735,788	100
1999	693,353	100
2000	682,422	100
2001	634,309	100
2002	581,371	100

NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION**1. DESCRIPTION OF SCHEDULE OF FUNDING PROGRESS**

The Schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial accrued liability as of June 30, 2002 and each of the nine preceding fiscal years. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

The schedule is presented to provide a consistent basis for measuring the System's annual progress toward funding its actuarial accrued liability in accordance with its actuarial funding method. The primary measure of funding progress is the System's funded ratio (i.e., actuarial value of assets expressed as a percentage of the actuarial accrued liability). An increase in the funded ratio indicates improvement in the System's ability to pay all projected benefits as they become due. The System is fully funded if the funded ratio is greater than or equal to 100 percent. During the year ended June 30, 2002, the System's funded ratio decreased from 98.29 percent to 94.70 percent.

The Schedule of Funding Progress also discloses the relationship between the System's covered payroll (i.e., all elements included in compensation paid to active members on which contributions are based) and the unfunded actuarial accrued liability. This relationship, expressed as a ratio, is a measure of the significance of the unfunded actuarial accrued liability relative to the capacity to pay all contributions required to fund the liability. A decrease in this ratio indicates improvement in the System's strength. During the year ended June 30, 2002, the System's ratio of the unfunded actuarial accrued liability to its covered payroll went from 8 percent to 23 percent.

2. ACTUARIAL METHODS AND ASSUMPTIONS**a. Funding Method**

The System uses the entry age normal cost method with projection to determine the actuarial accrued liability on which future employer contribution rates will be based. Under this funding method, a total contribution rate is determined which consists of two elements, the normal cost rate and the unfunded actuarial liability rate (see note 4).

The unfunded actuarial accrued liability (UAAL) is being amortized, as a level percentage of payroll, in distinct pieces. The UAAL which existed as of the June 30, 2000 actuarial valuation is being amortized over the remaining 18-year period to June 30, 2020. Each new layer of UAAL arising subsequent to the year ended June 30, 2000 is being amortized in separate annual layers over a 25-year period.

b. Asset Valuation Method

Assets are valued for funding purposes using a five-year moving average. Under this method, the year end actuarial asset value equals 1/5 of the current fiscal year end fair value, as reported in the financial statements, plus 4/5 of the "expected market value". For purposes of this calculation, the "expected market value" is the preceding fiscal year's actuarial asset value, adjusted for the current fiscal year's cash flows with interest accumulated at the actuarial assumed rate of return on investments.

c. Actuarial Assumptions

The assumptions used for the actuarial valuation were recommended by the System's independent actuary, based upon periodic analyses of the System's experience, and adopted by the Board of Trustees. Differences between assumed and actuarial experience (i.e., actuarial gains and losses) are part of the unfunded actuarial liability. The following significant assumptions were used in the actuarial valuation as of June 30, 2002:

- a rate of return on investments of 8 percent compounded annually (adopted June 30, 1998);
- projected salary increases of 5 percent compounded annually, attributable to inflation (adopted June 30, 1988);

- additional projected salary increases ranging from 0.94 percent to 6.82 percent per year attributable to seniority and merit (adopted June 30, 1988);
- post-retirement benefit increases ranging from 3 percent to 6 percent per year depending on the system (adopted June 30, 1982);
- rates of mortality, termination of service, disablement and retirement based on actual experience during the period from 1981 through 1996 (adopted June 30, 1998); and
- an increase in the aggregate active member payroll of 5 percent annually (adopted June 30, 1988).

OTHER SUPPLEMENTARY INFORMATION

Fund Balance Accounts

As provided by law, all System assets must be credited, according to the purpose for which they are held, to either the Annuity Savings Fund, the Accumulation Fund or the Expense Fund. These funds are classified as accounts for financial reporting purposes and are further explained as follows:

a. Annuity Savings Fund:

Members' contributions together with interest thereon, at statutory interest rates, are credited to the Annuity Savings Fund. Upon retirement, members' accumulated contributions and interest are transferred from the Annuity Savings Fund to the Accumulation Fund.

b. Accumulation Fund:

Contributions made by employers, other contributions and investment income are credited to the Accumulation Fund. All retirement, disability and death benefits are paid from this Fund.

c. Expense Fund:

All expenses for the administration and operation of the System are recorded in the Expense Fund. During the year, funds are transferred from the Accumulation Fund to the Expense Fund to cover expenses incurred.

Schedule of Fund Balances
for the Fiscal Year Ended June 30, 2002 (with Comparative 2001 Totals)
(Expressed in Thousands)

	Annuity Savings Fund	Accumulation Fund	Expense Fund	Totals	
				2002	2001
Fund balances, beginning of year	<u>\$1,752,988</u>	<u>\$27,728,413</u>	<u>\$ -</u>	<u>\$29,481,401</u>	<u>\$33,110,690</u>
Additions:					
Net investment income	-	(2,211,043)	(54,272)	(2,265,315)	(3,138,763)
Contributions (note 4):					
Employers	-	234,265	-	234,265	246,452
Members	199,304	-	-	199,304	189,769
Other	-	347,106	-	347,106	387,857
Deductions:					
Benefit payments	-	(1,372,325)	-	(1,372,325)	(1,272,804)
Refunds (note 5)	(16,344)	(1,132)	-	(17,476)	(16,977)
Administrative expenses (note 2f)	-	-	(20,064)	(20,064)	(24,823)
Transfers:					
From the Accumulation Fund to the Annuity Savings Fund for interest credited to members' accounts	78,726	(78,726)	-	-	-
To the Accumulation Fund from the Annuity Savings Fund for contributions of retiring members	(155,893)	155,893	-	-	-
From the Accumulation Fund to the Expense Fund for administrative and investment expenses	-	(74,336)	74,336	-	-
Net changes in fund balances	<u>105,793</u>	<u>(3,000,298)</u>	<u>-</u>	<u>(2,894,505)</u>	<u>(3,629,289)</u>
Fund balances, end of year	<u>\$1,858,781</u>	<u>\$24,728,115</u>	<u>\$ -</u>	<u>\$26,586,896</u>	<u>\$29,481,401</u>

Schedule of Administrative Expenses
for the Fiscal Years Ended June 30, 2002 and 2001
(Expressed in Thousands)

	2002	2001
Personnel services:		
Staff salaries	\$ 9,240	\$ 8,736
Fringe benefits	<u>2,372</u>	<u>2,190</u>
Total personnel services	<u>11,612</u>	<u>10,926</u>
 Professional and contractual services:		
Actuarial	163	221
Legal and financial	364	187
Data processing	3,882	9,117
Other contractual services	<u>392</u>	<u>371</u>
Total professional and contractual services	<u>4,801</u>	<u>9,896</u>
 Miscellaneous:		
Communications	1,146	1,074
Rent	1,475	1,314
Equipment and supplies	282	887
Other	<u>748</u>	<u>726</u>
Total miscellaneous	<u>3,651</u>	<u>4,001</u>
Total administrative expenses	<u><u>\$20,064</u></u>	<u><u>\$24,823</u></u>

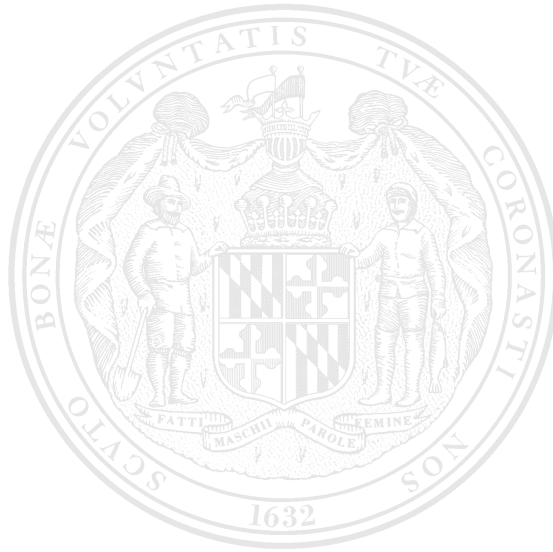
Schedule of Investment Expenses
for the Fiscal Years Ended June 30, 2002 and 2001
(Expressed in Thousands)

	<u>2002</u>	<u>2001</u>
Investment advisors:		
Equity managers	\$35,340	\$48,869
Fixed managers	8,157	8,117
Real estate managers	<u>9,368</u>	<u>7,748</u>
Total investment advisory fees	<u>52,865</u>	<u>64,734</u>
 Other investment service fees:		
Master custody	821	634
Income verification services	284	259
Other investment expenses	<u>302</u>	<u>398</u>
Total other investment service fees	<u>1,407</u>	<u>1,291</u>
 Total investment expenses	 <u><u>\$54,272</u></u>	 <u><u>\$66,025</u></u>

Transfer Refund Rate

Members of the Teachers' and Employees' Retirement Systems who elect to transfer to the corresponding pension systems receive transfer refunds. Such refunds include interest calculated using the transfer refund rate in effect for the calendar year in which the transfer becomes effective. The transfer refund rate is determined at the end of each fiscal year for the upcoming calendar year in accordance with Title 22 of the State Personnel and Pensions Article of the Annotated Code of Maryland and the related regulations. Accordingly, the refund interest rate is required to be calculated using realized investment income and total investments valued at their historical cost. The transfer refund rates in effect for calendar years 2002 and 2001 were 10.2 and 11.7 percent, respectively. For purposes of computing the 2002 and 2001 transfer refund rates, the following cost basis financial data, in addition to certain preceding years' cost basis financial data, were used (*expressed in thousands*):

	<u>Fiscal year</u> <u>2001 data</u>	<u>Fiscal year</u> <u>2000 data</u>
Realized investment income	\$ 951,358	\$ 2,641,213
Cost basis of investments	26,773,752	26,374,554



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SCHEDULE OF PLAN NET
AS OF JUNE 30, 2002
(Expressed in Thousands)

	Teachers' Retirement and Pension Systems	Employees' Retirement and Pension Systems	Judges' Retirement System
Assets:			
Cash & cash equivalents (note 3)	\$ 703,400	\$ 361,292	\$ 10,740
Receivables:			
Contributions:			
Employers	2	8,894	25
Members	301	3,121	2
Accrued investment income	74,037	40,940	742
Investment sales proceeds	106,676	60,711	1,335
Due from other systems	175	809	-
Total receivables	<u>181,191</u>	<u>114,475</u>	<u>2,104</u>
Investments, at fair value (notes 2 & 3):			
U.S. Government obligations	1,828,780	981,270	12,456
Domestic corporate obligations	1,721,602	931,116	13,840
International obligations	46,711	26,231	654
Domestic stocks	7,484,443	4,390,210	104,502
International stocks	2,791,325	1,637,631	38,952
Mortgages & mortgage related securities	1,273,783	680,123	7,713
Real estate	434,602	254,220	6,119
Alternative investments	48,612	28,496	680
Collateral for loaned securities	1,376,368	784,689	22,647
Total investments	<u>17,006,226</u>	<u>9,713,986</u>	<u>207,563</u>
Total assets	<u>17,890,817</u>	<u>10,189,753</u>	<u>220,407</u>
Liabilities:			
Accounts payable & accrued expenses	28,237	14,244	468
Investment commitments payable	433,469	242,041	5,091
Obligation for collateral for loaned securities	1,376,368	784,689	22,647
Other liabilities	671	392	10
Due to other systems	-	989	-
Total liabilities	<u>1,838,745</u>	<u>1,042,355</u>	<u>28,216</u>
Net assets held in trust for pension benefits	<u>\$ 16,052,072</u>	<u>\$ 9,147,398</u>	<u>\$ 192,191</u>
(A schedule of funding progress is presented on page 29)			

* Intersystem due from/due to have been eliminated in the financial statements.

FINANCIAL SECTION

ASSETS BY SYSTEM

State Police Retirement System	Local Fire and Police System	Law Enforcement Officers' Pension System	Subtotal	Eliminations*	Total
\$ 47,787	\$ 1,676	\$ 16,749	\$ 1,141,644	\$ -	\$ 1,141,644
257	-	1,050	10,228	-	10,228
261	-	98	3,783	-	3,783
3,562	28	673	119,982	-	119,982
6,757	54	1,125	176,658	-	176,658
2	1	2	989	(989)	-
<u>10,839</u>	<u>83</u>	<u>2,948</u>	<u>311,640</u>	<u>(989)</u>	<u>310,651</u>
57,512	427	11,829	2,892,274	-	2,892,274
62,713	485	13,427	2,743,183	-	2,743,183
2,830	24	666	77,116	-	77,116
582,688	4,573	75,302	12,641,718	-	12,641,718
217,361	1,703	28,071	4,715,043	-	4,715,043
36,152	260	7,195	2,005,226	-	2,005,226
33,723	272	4,402	733,338	-	733,338
3,782	30	490	82,090	-	82,090
97,096	841	23,289	2,304,930	-	2,304,930
<u>1,093,857</u>	<u>8,615</u>	<u>164,671</u>	<u>28,194,918</u>	<u>-</u>	<u>28,194,918</u>
<u>1,152,483</u>	<u>10,374</u>	<u>184,368</u>	<u>29,648,202</u>	<u>(989)</u>	<u>29,647,213</u>
1,778	13	232	44,972	-	44,972
23,706	193	4,784	709,284	-	709,284
97,096	841	23,289	2,304,930	-	2,304,930
51	-	7	1,131	-	1,131
-	-	-	989	(989)	-
<u>122,631</u>	<u>1,047</u>	<u>28,312</u>	<u>3,061,306</u>	<u>(989)</u>	<u>3,060,317</u>
<u>\$ 1,029,852</u>	<u>\$ 9,327</u>	<u>\$ 156,056</u>	<u>\$ 26,586,896</u>	<u>\$ -</u>	<u>\$ 26,586,896</u>

SCHEDULE OF CHANGES IN PLAN NET
FOR THE FISCAL YEAR ENDED
(Expressed in Thousands)

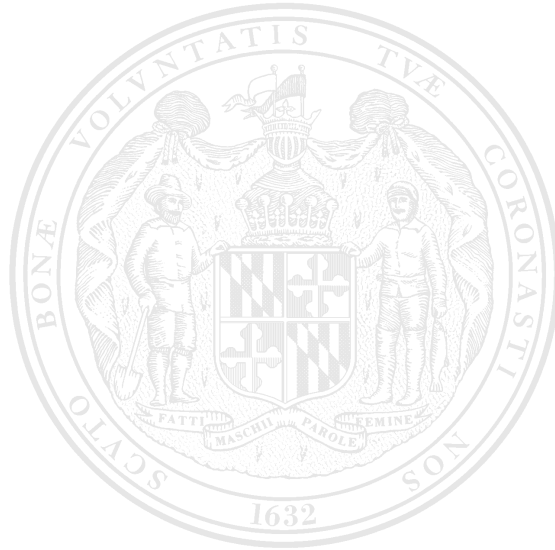
	Teachers' Retirement and Pension Systems	Employees' Retirement and Pension Systems	Judges' Retirement System
Additions:			
Contributions (note 4):			
Employers	\$ 14,020	\$ 180,198	\$ 13,183
Members	109,140	79,285	1,399
Other	346,913	-	193
Total contributions	<u>470,073</u>	<u>259,483</u>	<u>14,775</u>
Investment income:			
Net depreciation in fair value of investments	(1,746,166)	(1,051,693)	(23,033)
Interest	290,588	158,585	3,505
Dividends	157,247	91,511	2,130
Real estate operating net income	17,943	9,400	345
Income before securities lending activity	<u>(1,280,388)</u>	<u>(792,197)</u>	<u>(17,053)</u>
Gross income from securities lending activity	39,703	23,242	907
Securities lending borrower rebates	(29,423)	(17,224)	(672)
Securities lending agent fees	(2,056)	(1,204)	(47)
Net income from securities lending activity	<u>8,224</u>	<u>4,814</u>	<u>188</u>
Total investment income	<u>(1,272,164)</u>	<u>(787,383)</u>	<u>(16,865)</u>
Less investment expenses:			
Investment advisory fees	(31,905)	(18,173)	(391)
Other investment expenses	(849)	(486)	(10)
Total investment expenses	<u>(32,754)</u>	<u>(18,659)</u>	<u>(401)</u>
Net investment income	<u>(1,304,918)</u>	<u>(806,042)</u>	<u>(17,266)</u>
Transfers from other systems	<u>8,402</u>	<u>4,602</u>	<u>-</u>
Total additions	<u>(826,443)</u>	<u>(541,957)</u>	<u>(2,491)</u>
Deductions:			
Benefit payments	848,419	450,556	16,343
Refunds (note 5)	10,190	7,062	2
Administrative expenses (note 2f)	12,103	6,924	140
Transfers to other systems	8,193	9,535	1
Total deductions	<u>878,905</u>	<u>474,077</u>	<u>16,486</u>
Net increase (decrease) in plan assets	<u>(1,705,348)</u>	<u>(1,016,034)</u>	<u>(18,977)</u>
Net assets held in trust for pension benefits:			
Beginning of the fiscal year	17,757,420	10,163,432	211,168
End of the fiscal year	<u>\$16,052,072</u>	<u>\$ 9,147,398</u>	<u>\$ 192,191</u>

* Intersystem transfers have been eliminated in the financial statements.

FINANCIAL SECTION

ASSETS BY SYSTEM
JUNE 30, 2002

State Police Retirement System	Local Fire and Police System	Law Enforcement Officers' Pension System	Subtotal	Eliminations*	Total
\$ 4,907	\$ 1,200	\$ 20,757	\$ 234,265	\$ -	\$ 234,265
6,793	5	2,682	199,304	-	199,304
<u>-</u>	<u>-</u>	<u>-</u>	<u>347,106</u>	<u>-</u>	<u>347,106</u>
<u>11,700</u>	<u>1,205</u>	<u>23,439</u>	<u>780,675</u>	<u>-</u>	<u>780,675</u>
(148,115)	(842)	(16,831)	(2,986,680)	-	(2,986,680)
12,998	212	1,845	467,733	-	467,733
12,237	94	1,543	264,762	-	264,762
<u>1,218</u>	<u>23</u>	<u>232</u>	<u>29,161</u>	<u>-</u>	<u>29,161</u>
<u>(121,662)</u>	<u>(513)</u>	<u>(13,211)</u>	<u>(2,225,024)</u>	<u>-</u>	<u>(2,225,024)</u>
3,168	55	418	67,493	-	67,493
(2,347)	(41)	(309)	(50,016)	-	(50,016)
<u>(164)</u>	<u>(3)</u>	<u>(22)</u>	<u>(3,496)</u>	<u>-</u>	<u>(3,496)</u>
<u>657</u>	<u>11</u>	<u>87</u>	<u>13,981</u>	<u>-</u>	<u>13,981</u>
<u>(121,005)</u>	<u>(502)</u>	<u>(13,124)</u>	<u>(2,211,043)</u>	<u>-</u>	<u>(2,211,043)</u>
(2,087)	(18)	(291)	(52,865)	-	(52,865)
<u>(55)</u>	<u>-</u>	<u>(7)</u>	<u>(1,407)</u>	<u>-</u>	<u>(1,407)</u>
<u>(2,142)</u>	<u>(18)</u>	<u>(298)</u>	<u>(54,272)</u>	<u>-</u>	<u>(54,272)</u>
<u>(123,147)</u>	<u>(520)</u>	<u>(13,422)</u>	<u>(2,265,315)</u>	<u>-</u>	<u>(2,265,315)</u>
<u>291</u>	<u>4</u>	<u>4,824</u>	<u>18,123</u>	<u>(18,123)</u>	<u>-</u>
<u>(111,156)</u>	<u>689</u>	<u>14,841</u>	<u>(1,466,517)</u>	<u>(18,123)</u>	<u>(1,484,640)</u>
49,014	472	7,521	1,372,325	-	1,372,325
181	-	41	17,476	-	17,476
790	6	101	20,064	-	20,064
<u>216</u>	<u>1</u>	<u>177</u>	<u>18,123</u>	<u>(18,123)</u>	<u>-</u>
<u>50,201</u>	<u>479</u>	<u>7,840</u>	<u>1,427,988</u>	<u>(18,123)</u>	<u>1,409,865</u>
(161,357)	210	7,001	(2,894,505)	-	(2,894,505)
<u>1,191,209</u>	<u>9,117</u>	<u>149,055</u>	<u>29,481,401</u>	<u>-</u>	<u>29,481,401</u>
<u>\$1,029,852</u>	<u>\$ 9,327</u>	<u>\$ 156,056</u>	<u>\$ 26,586,896</u>	<u>\$ -</u>	<u>\$ 26,586,896</u>



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