

Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003

The Public School &
The Non-Teacher School Employee



M. Steve Yoakum
Executive Director

Prepared by:
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Mission Statement

The Public School Retirement System of Missouri and the Non-Teacher School Employee Retirement System of Missouri (PSRS and NTRS) work in partnership with the member school districts of this state to provide eligible employees and their beneficiaries with a significant source of income based on the employee's length of service and compensation in order to enhance retirement, disability and death benefits received from other sources.

It is the fiduciary responsibility of those charged with administration of PSRS and NTRS to:

- ❖ effectively collect contributions,
- ❖ prudently invest the assets to obtain optimum returns,
- ❖ equitably provide benefits, and
- ❖ impartially and in accordance with applicable law administer the benefit programs.

The Board of Trustees and staff are committed to providing services to the members and beneficiaries professionally, promptly, courteously, and efficiently.

Mission Statement Principles

- ❖ We will conduct the business of the retirement systems in accordance with the mission statement.
- ❖ We will act as fiduciaries in the management of all funds for the exclusive benefit of our members.
- ❖ We will adhere to our investment policy to ensure the highest possible investment return consistent with the prudent investment of plan assets.
- ❖ We will have as our goal the replacement of 80% of a member's final average salary after a 30-year career through the combination of income from public pensions and, where applicable, the federal Social Security system.
- ❖ We shall have as our goal the retention of purchasing power of the initial retirement benefit through the retirement years.
- ❖ We will maintain an independent retirement system that retains the power of the trustees to set actuarial assumptions, appoint consultants, employ staff, establish a budget and conduct all business of the retirement systems.
- ❖ We will prepare and distribute an annual financial report that adheres to generally accepted accounting principles.
- ❖ We will provide prompt, courteous and accurate service to our members.
- ❖ We will provide clear and complete information to the members and the districts through the use of a summary plan document, newsletters, an annual member account statement and any other documents deemed necessary.
- ❖ We will adhere to the highest standards of ethical conduct.

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Board of Trustees

Transmittal Letter

Certificate of Achievement in Financial Reporting

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Professional Services

INTRODUCTORY SECTION

Board of Trustees

As of June 30, 2003

Wayne Wheeler

Chair
Elected PSRS Member
Term Expires 6/30/04



Peggy Preston

Vice-Chair
Elected PSRS Member
Term Expires 6/30/04



Cheryl Boggess

Elected PSRS Member
Term Expires 6/30/06



J. Richard Franklin

Appointed Retired Member
Term Expires 6/30/07



Nancy Gaines

Elected NTRS Member
Term Expires 6/30/06



Lynn Harmon

Appointed Member
Term Expires 6/30/03



John Kruse

Appointed Member
Term Expires 6/30/06





December 1, 2003

TO: Board of Trustees and Members of the Retirement Systems:

I am pleased to present the *Comprehensive Annual Financial Report* of the Public School Retirement System of Missouri (PSRS) and the Non-Teacher School Employee Retirement System of Missouri (NTRS) for the fiscal year ended June 30, 2003. The management and staff of the Systems are responsible for the accuracy and completeness of this report and for ensuring that all material disclosures have been made. To the best of our knowledge, the information presented is a fair and accurate portrayal of the financial position and operations of PSRS and NTRS as of June 30, 2003.

Report Contents

This report is presented in five sections:

- The Introductory Section contains general information about the Retirement Systems;
- The Financial Section contains the independent auditors' report, management's discussion and analysis of the financial statements, the financial statements and related notes, and required supplemental schedules;
- The Investment Section contains a summary of the investment activities during the year, including investment performance;
- The Actuarial Section reports the funded condition of both Systems, including a summary of major actuarial assumptions; and
- The Statistical Section contains general information concerning members, benefit recipients and finances.

Overview of the Retirement Systems

The Public School Retirement System of Missouri, a cost-sharing multiple employer retirement system, was established in 1946 by an act of the Missouri legislature to provide retirement, disability and death benefits to full-time, certificated employees in the public schools and four-year regional universities. It has been amended to include part-time certificated employees of public schools and no longer accepts new employees of the regional colleges and universities.

The Non-Teacher School Employee Retirement System of Missouri, also a cost-sharing multiple employer retirement system, was established in 1965 by an act of the Missouri legislature to provide retirement, disability and death benefits to non-certificated school employees in the public schools, community colleges and junior colleges who have elected to join the System.

Financial Information

The Systems' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) within the guidelines established by the Governmental Accounting Standards Board (GASB). A system of internal

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controls is in place to help monitor and safeguard assets and promote efficient operations. An independent certified public accounting firm selected by the Board of Trustees performs a financial audit each year. In addition, the Systems employ an internal auditor who performs operational reviews to ensure that the internal controls are functioning effectively.

Please refer to the Management's Discussion and Analysis on pages 17 through 21 for an overview of additions to and deductions from the plans for the fiscal year.

Investment Activities

The past fiscal year proved to be a difficult period for all institutional investors, including PSRS/NTRS, as the equity markets continued to languish. However, our disciplined investment approach and conservative strategy (including a high allocation to bonds) allowed PSRS/NTRS to outperform most of our peers during this period. The combined investment portfolios generated a 4.8% return for the fiscal year. This return ranked in the top 35% of returns for large institutional pension systems.

Funding Status

PSRS and NTRS are defined benefit retirement systems. This means that a formula made up of credit (years of service) times final average salary, times a multiplier (2.5% for PSRS and 1.61% for NTRS) determines each member's retirement benefit. The actuarial accrued liability is calculated for each System using the plan provisions in effect at the time of the calculation. Actuarial assumptions used in the calculation are recommended by the system's outside actuary and are based upon prior experience of the plans.

To determine the relative health of the Systems, the actuarial accrued liability is compared to the actuarial value of assets to arrive at a funded percentage. As of June 30, 2003, PSRS was 81.1% funded, while NTRS was 81.9% funded. This is a reduction from the June 30, 2002 funded ratios of 95.3% for PSRS and 97.6% for NTRS. This substantial drop in funded percentages from the prior year is due primarily to the restatement of the actuarial value of assets to the market value of assets.

Previously, the actuarial value of assets was determined using a "smoothing" method that requires all gains (earnings in excess of 8%) and losses (earnings below 8%) to be recognized over a five-year period. If we earned the assumed rate of return each year, the actuarial value and the market value of assets would be equal. However, due to the unprecedented decline in the market since March 2000, the market value of assets declined at a faster rate than the actuarial value of assets. To more accurately reflect the funding status of the Systems, the actuarial value of assets was adjusted to equal the market value of assets for both Systems at June 30, 2003. We believe that this restatement presents a more accurate financial picture for our members and will not affect the required contribution rates.

Major Initiatives During 2002-2003

SCS for HCS for HB's 346 and 174 was enacted during the 2003 legislative session. This legislation affects both PSRS and NTRS as summarized below:

- **Partial Lump Sum Option (PLSO)**

Under this new benefit payment option, qualified members can elect to have their lifetime monthly benefits actuarially reduced in exchange for the right to also receive a one-time lump sum payment at retirement equal to 12, 24, or 36 times the Option 1, single-life benefit amount. To qualify to elect the PLSO, a member must have a minimum of 33 years of service, or be at least 63 with a minimum of 8 years of service, or have their years of service plus their age equal 86 or greater (Rule of 86).

- **25-and-Out Retirement**

The 25-and-Out window was extended through July 1, 2008. This provision was set to expire on July 1, 2003. This provision allows members with at least 25 years of service credit, who are not eligible to retire under the full formula, to retire using a reduced formula factor.

- **Credit Purchases**

Service credit purchases are now calculated using the highest salary on record multiplied by the total current contribution rate (for the employee and the employer). Previously, most calculations were made using actuarial assumptions and demographic information specific to the member, such as age and years of service. This method makes it easier for members to estimate the cost to purchase service now and in the future. In addition, the amount of supplemental credit that can be purchased was increased from four-tenths to five-tenths of a year of service.

- **Contribution Rate Limits**

The Board of Trustees is now required to set the contribution rates based upon the annual actuarial valuations of the Systems. Although the maximum contribution rate cap was removed, annual contribution rate increases are limited to 1% for PSRS ($\frac{1}{2}\%$ for the employer and $\frac{1}{2}\%$ for the employee) and $\frac{1}{2}\%$ for NTRS ($\frac{1}{4}\%$ for the employer and $\frac{1}{4}\%$ for the employee). The total rates for the 2003-2004 school year remained at 21% for PSRS and 10.5% for NTRS.

Based upon the June 30, 2003 actuarial valuations, the Board of Trustees has set the 2004-2005 contribution rates at 22% for PSRS and 11% for NTRS. The annual required contribution rates recommended by the actuary were 27.75% for PSRS and 12.47% for NTRS. The approved rates were set in accordance with the annual contribution rate increase limits set forth in the statute.

All new provisions took effect August 28, 2003, except for the 25-and-Out provision which took effect July 1, 2003.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to PSRS and NTRS for the *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2002. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports. To be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for only one year. We believe our current report continues to meet the Certificate of Achievement program requirements and are submitting it to GFOA for consideration again this year.

Professional Services

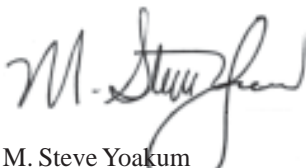
Certain professional services are provided to the Retirement Systems by retained consultants. The required opinion letters from two of those consultants, Gabriel, Roeder, Smith and Company, actuaries, and Williams Keepers LLC, independent certified public accountants, are contained elsewhere in this report.

Investment consulting services, as well as investment manager search assistance and investment performance analysis, has been provided by Strategic Investment Solutions of San Francisco, CA.

Acknowledgements

I would like to express my thanks and gratitude to the Board of Trustees, staff, and consultants who have worked diligently to produce this report and to ensure the successful operation of the Retirement Systems.

Respectfully submitted,



M. Steve Yoakum
Executive Director



Lori Woratzeck
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

The Public School Ret. System
of Missouri and the Non-Teacher
School Employee Ret. System

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

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



William Patrick Bate

President

Jeffrey R. Emer

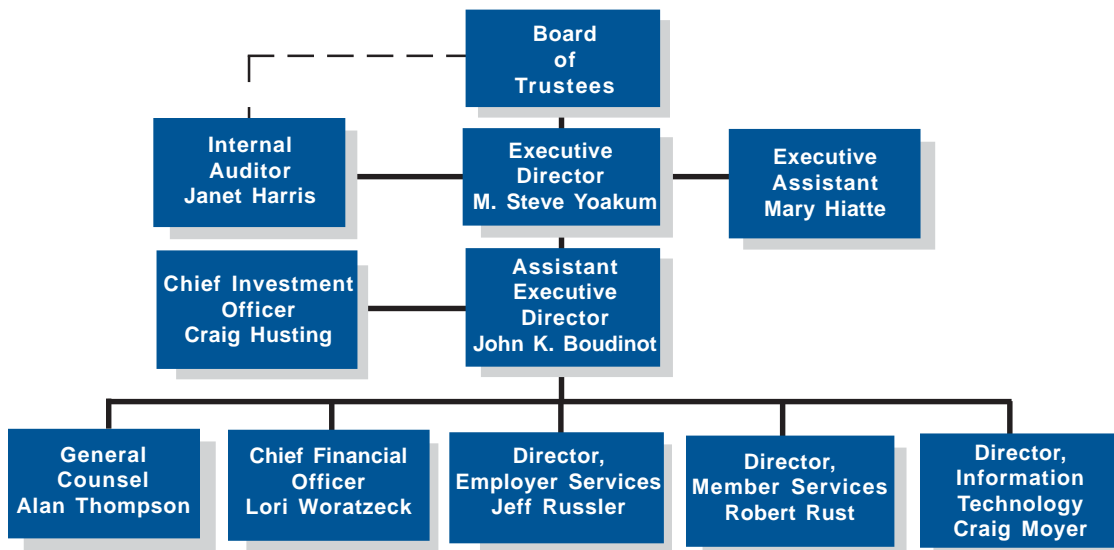
Executive Director

The Public School &
The Non-Teacher School Employee



Administrative Organization

June 30, 2003



Professional Services

June 30, 2003

Actuary

Gabriel, Roeder, Smith & Co.

Actuaries and Consultants
Norman S. Losk, F.S.A.
Alex Rivera, A.S.A.
Roseville, California

Auditor

Williams Keepers, LLC

Michael J. Oldelehr, CPA
Jill S. Hatfield, CPA
Jefferson City, Missouri

Computer Consultants

Huber & Associates, Inc.

James Huber
Jefferson City, Missouri

Mitten Software

Jim Morgan
Minnetonka, Minnesota

Total Network Integration

Kirt Dunwoody
Jefferson City, Missouri

Insurance Consultant

Charlesworth & Associates

Bob Charlesworth
Overland Park, Kansas

Legal Counsel

Thompson Coburn Attorneys at Law

Allen Allred
St. Louis, Missouri

Blackwell Sanders Peper Martin, LLP

Michael R. Annis
St. Louis, Missouri

Legislative Consultant

Jack Pierce
Jefferson City, Missouri

Medical Advisor

Dr. Robert H. Tanner
Jefferson City, Missouri

Investment Management Consultant*

Strategic Investment Solutions, Inc.

Michael R. Beasley
San Francisco, California

U.S. Equity Investment Advisors*

Alliance Capital Management

John A. Koltjes
Elizabeth Smith
Minneapolis, Minnesota

Aronson & Johnson & Ortiz, LP

Ted Aronson
Martha Ortiz
Philadelphia, Pennsylvania

Chartwell Investment Partners

Edward Antoian
Timothy Riddle
Berwyn, Pennsylvania

DSI International

John Holmgren, Jr.
Norwalk, Connecticut

State Street Global Advisors

Doug Holmes
Anne Eisenberg
Jim Thorsen
Boston, Massachusetts

Thomson, Horstmann & Bryant, Inc.

Richard Horstmann
Al Thomson
Saddle Brook, New Jersey

Trust Company of the West (TCW)

Glen Bickerstaff
Brian Beitner
Los Angeles, California

UBS Global Asset Management

John Leonard
Steven E. Wilde
Chicago, Illinois

International Investment Advisors*

Bank of Ireland Asset Management

Jane Neill
Lelia Long
Dublin, Ireland

BPI Global Asset Management

Dan Jaworski
Ryan Burrow
Orlando, Florida

INVESCO Global Asset Management

Erik Granade
Kirk Holland
Atlanta, Georgia

Oechsle International Advisors

Kathleen Harris
Jamie Macmillan
Boston, Massachusetts

Fixed Income Investment Advisors*

BlackRock Financial Management

Andy Phillips
Robert Capaldi
New York, New York

(continued)

Professional Services *(continued)*

NISA Investment Advisors

Jess Yawitz
Robert Krebs
St. Louis, Missouri

Payden & Rygel

Brian Matthews
Michael Salvay
Los Angeles, CA

State Street Global Advisors

Joe Marvan
Jim Thorsen
Boston, Massachusetts

Wellington Management Co., LLP

Tom Pappas
Alexander Grant
Boston, Massachusetts

Master Trustee/Custodian*

State Street Bank and Trust Company

R. Scott Paton
Steve Davies
Boston, Massachusetts

E-MAPU.S. Equity Advisors*

Analytic Investors, Inc.

Harindra de Silva
Los Angeles, California

Legg Mason Capital Management

Bill Miller
Baltimore, Maryland

New Amsterdam Partners

Michelle Clayman
New York, New York

Next Century Growth Investors, LLC

Tom Press
Minneapolis, Minnesota

Systematic Financial Management

D. Kevin McCreesh
Teaneck, New Jersey

Westwood Management Corporation

Susan Byrne
Dallas, Texas

Zevenbergen Capital, Inc.

Nancy Zevenbergen
Seattle, Washington

*Information on investment management and consulting fees can be found in the Schedule of Investment Expenses on page 60.

