SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

Comprehensive Annual Financial Report

FOR THE YEAR ENDED JUNE 30, 2004

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FOR THE YEAR ENDED JUNE 30, 2004
PREPARED BY SERS STAFF
JAMES R. WINFREE, EXECUTIVE DIRECTOR

School Employees Retirement System of Ohio
300 East Broad Street, Suite 100
Columbus, Ohio 43215-3746
www.ohsers.org

"The mission of SERS is to enhance the well-being and financial security of our members, retirees and beneficiaries through benefit programs and services which are soundly financed, prudently administered, and delivered with a focus on understanding and responsiveness."

Left to right: *Standing* – James Winfree, Jeannie Knox, Attorney General's representative O'Neal Saunders, State Auditor's representative James Tilling, Darlene Mulholland, Orris Fields. *Seated* – Barbara Miller, Barbara Overholser.

SERS RETIREMENT BOARD

President:
Barbara Miller,
Malvern, Ohio
Term Expires June 30, 2004

Vice President:
Darlene Mulholland,
Cleveland, Ohio
Term Expires June 30, 2005

Employee-Member:
Barbara Overholser,
Columbus, Ohio
Term Expires June 30, 2005

Employee-Member:
Jeannie Knox,
Cincinnati, Ohio
Term Expires June 30, 2007

Retiree-Member:
Orris E. Fields,
Wilmington, Ohio
Term Expires June 30, 2004

ExOfficio Member:
Betty Montgomery
Auditor of State

ExOfficio Member:
Jim Petro
Attorney General

SERS EXECUTIVE STAFF

James R. Winfree
Executive Director

Virginia S. Brizendine
Director of Finance

Robert G. Cowman
Director of Investments

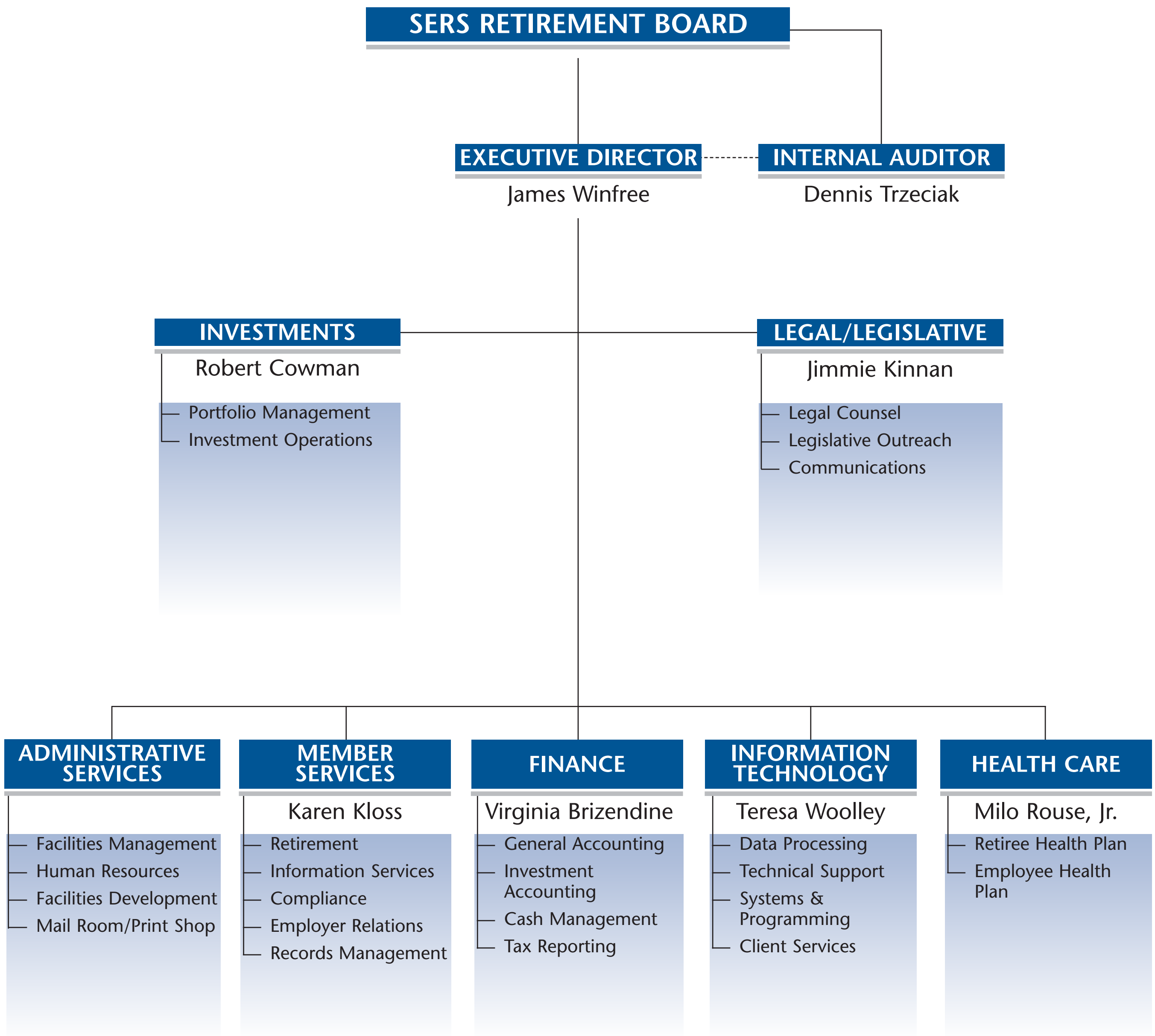
Jimmie L. Kinnan
General Counsel

Karen G. Kloss
Director of Member Services

Milo M. Rouse, Jr.
Director of Health Care Services

Teresa R. Woolley
Director of Information Technology

Left to right: *Standing* – Teresa Woolley, Milo Rouse, James Winfree, Jimmie Kinnan. *Seated* – Karen Kloss, Virginia Brizendine, Robert Cowman.



PROFESSIONAL CONSULTANTS

Medical Advisor
Dr. Edwin H. Season - Columbus, Ohio

Independent Auditor
KPMG LLP - Columbus, Ohio

Actuary
Mellon Human Resources & Investor Solutions - New York, New York

Investment Consultant, Investment Managers & Brokers' Fees
See pages 34, 45, 46 & 47

Certificate of Achievement for Excellence in Financial Reporting

Presented to

School Employees
Retirement System of Ohio

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

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

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

Edward Harrington
President

Jeffrey L. Esser
Executive Director

PPCC

Public Pension Coordinating Council
Public Pension Standards
2004 Award

Presented to

School Employees Retirement System of Ohio

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

Presented by the Public Pension Coordinating Council, a confederation of

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

Alan H. Winkle
Alan H. Winkle
Program Administrator

School Employees Retirement System

JAMES R. WINFREE
Executive Director

300 EAST BROAD ST., SUITE 100 • COLUMBUS, OHIO 43215-3746 • (614) 222-5853

VIRGINIA BRIZENDINE
Finance

ROBERT G. COWMAN
Investments

JIMMIE L. KINNAN
General Counsel

KAREN G. KLOSS
Member Services

MILO M. ROUSE, JR.
Health Care Services

TERESA R. WOOLLEY
Information Technology

December 3, 2004

Dear President and Members of the Retirement Board:

We are pleased to submit the Comprehensive Annual Financial Report of the School Employees Retirement System of Ohio (SERS) for the fiscal year ended June 30, 2004. The report provides information about the financial operations of the System, including management's stewardship of the funds entrusted to the System and compliance with all legal requirements placed on the System.

The report is divided into six sections:

- the *Introductory Section* contains the Letter of Transmittal, along with the identification of the administrative organization, awards and a summary of federal and state legislation affecting the System over the past year;
- the *Financial Section* contains the independent auditors' report from our certified public accountants, KPMG LLP; management's discussion and analysis, the financial statements of the System and required supplementary information;
- the *Investment Section* includes the investment report, portfolio performance and investment policy;
- the *Actuarial Section* has the letter expressing the opinion of our consulting actuaries, Mellon Human Resources & Investor Solutions, and the results of their annual actuarial valuation;
- the *Statistical Section* includes significant data pertaining to the System; and
- the *Plan Summary Section* explains membership eligibility and the various benefits that we provide to our members.

Since 1937 SERS has provided retirement benefits to public school employees who are not required to possess a certificate in order to perform their duties. By statute, benefit plans include retirement for age and service or disability; and survivor benefits that are paid upon the death of a member before retirement. A post-retirement health care program is also provided, although it is not required by law. SERS is governed by a Board comprised of elected active members and retirees and appointed experts. Members of the Board receive no compensation for their services other than reimbursement of personal expenses. The term of the office for elected Board members is four years.

The management of SERS is responsible for the accuracy of the contents and the completeness and fairness of the presentation, including disclosures. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position of the System. All disclosures necessary to enable the reader to gain an understanding of SERS' financial activities have been included. Management has provided a narrative introduction, overview and analysis to accompany the basic financial statements in the form of management's discussion and analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors in the Financial Section.

Management has established a system of internal accounting controls to ensure the security of member and employer contributions; and to provide reasonable, but not absolute, assurance that assets are properly safeguarded, transactions are properly executed and that financial statements are reliable. Our independent external auditors have conducted an audit of the basic financial statements in accordance with auditing standards generally accepted in the United States of America. They also have full and unrestricted access to the Board to discuss their audit and related findings concerning the integrity of the financial reporting and adequacy of internal controls.

MAJOR INITIATIVES AND HIGHLIGHTS

The initiative this year with the greatest impact on SERS was the introduction of two bills in the Ohio General Assembly that finally became Substitute Senate Bill 133. The bills were introduced in response to member and media investigations during 2003 of the operations of the five statewide retirement systems; and in its final version Sub. S.B. 133 made significant changes to the governance of the five retirement systems. It was passed by the Legislature on May 26, 2004 and signed by Governor Taft on June 16. For SERS, one of the many changes involved the make-up of the Retirement Board. Effective September 15, 2004, it was expanded from seven to nine members, by removing the Auditor and Attorney General and adding three appointed investment experts and an additional elected retiree member. For the first time, elected active members will not make up a majority of the Board. We supported the additional ethics reporting, and oversight and accountability measures in Sub. S.B. 133 and in fact, a number of these best practices had already been in place at SERS, or were adopted by the Board before the legislation was finished. And we have assured our public policy decision-makers that we will accomplish all that the legislation has set out for us to do, with the ultimate goal of restoring the confidence of all the state's public employees, retirees and stakeholders. More details of this bill can be found on page 11.

At the March 2003 meeting, the Board approved the increase to the employee contribution rate from 9% to 10%. This was the first contribution increase since 1989, and it applied to all earnings paid on and after July 1, 2003. Ten percent is the maximum statutory employee contribution rate; for 2004 the change added $25.2 million more to the pension fund. Employee contributions are held in trust pending refund or retirement. The employer contribution rate was set at the maximum statutory limit of 14% in 1983. Any future increases will require legislation.

As we reported last year, the Ohio Association of Public School Employees (OAPSE) filed suit in July 2003 alleging that the changes to the health care program violated the vested rights of SERS' retirees. These changes, which were effective January 2004, were approved by the Board after careful consideration of the options available to maintain the solvency of the health care program. On January 2, 2004, a court magistrate issued a temporary order granting OAPSE's request to halt SERS from implementing the 2004 retiree health care plan changes. Upon review, the judge assigned to the case rejected the magistrate's decision, lifted the temporary order and granted SERS' motion to dismiss the case. The judge ruled that SERS had the authority to modify its health care program, but also concluded that upon retirement an employee has vested rights in the health care program. Both parties have appealed the decision. Oral arguments were held in August before the 10th District Court of Appeals and we are awaiting the next stage of the appeals process. We believe that we will prevail in this matter.

INVESTMENTS

The primary objective of our investment policy is to assure that the System meets its responsibilities for providing retirement and other benefits. The portfolio is diversified to maximize total return on assets while operating within prudent parameters of risk, to protect principal from severe depreciation during adverse market conditions and to achieve investment results competitive with those of the broad market and of similar funds.

We did not change our current asset allocation this year, following the recommendation of our investment consultant, the Frank Russell Company. However we made several changes to the pool of investment managers to bring additional diversity to our portfolio. The fair value of the net investments in custody on an accrual basis was $8.28 billion at June 30, 2004, an increase of $1.04 billion from the previous fiscal year. With the rebound in the stock market and the efforts of our investment managers, the portfolio returned 16.5%, exceeding our investment policy benchmark of 16.1%. The strongest sectors of the portfolio were U.S. and international equities, and real estate.

FUNDING

SERS' objective is to establish and receive contributions when expressed in terms of percent of active member payroll will remain approximately level from one generation to the next; which combined with present assets and future investment return will be sufficient to meet present and future financial obligations. The annual actuarial valuation measures the progress toward funding pension obligations of SERS by comparing the actuarial assets to the actuarial liabilities. The actuarial accrued liability for pension benefits on June 30, 2004 increased 5.8% to $11.25 billion, the actuarial value of assets declined 1.2% to $8.67 billion and the funded ratio over a 30-year period decreased from 82.5% to 77.0%. Unfortunately, this year's result continues a trend in declining funded ratios that we have experienced since 2000.

The employer contribution rate of 14% is allocated by Board policy to cover the normal cost and amortization of the unfunded actuarial accrued liabilities for basic pension benefits. The remainder goes toward post-retirement health care benefits, which are funded on a pay-as-you-go basis. To provide additional funding for health care, employers pay a surcharge for members whose salary is less than a minimum amount. Although the plan changes that began in January have prolonged the life of the SERS health care program, the patient is still in critical condition. To further the analogy, SERS is just one patient in a hospital full of U.S. health care programs suffering from the same afflictions - the ever increasing cost of care, expensive drugs, an aging population and inefficiency in the health care delivery system. We continue to seek solutions to the health care crisis for SERS' retirees in order to preserve the program.

AWARDS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to SERS for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the nineteenth consecutive year that SERS has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government entity must publish an easily readable and efficiently organized comprehensive annual financial report, which 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 that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

SERS also received the Public Pension Coordinating Council's Public Pension Standards Award. This annual award recognizes SERS' achievement of high professional standards in the areas of benefits, actuarial valuations, financial reporting, investments and disclosures to members.

ACKNOWLEDGEMENTS

We take this opportunity to recognize three board members whose terms ended June 30, 2004. Barbara Miller served eight years on the Board, including two years as Board President. She retired on July 1, 2004. Orris Fields, Jr., the retiree member, 'retired' again when his term ended. Active member Darlene Mulholland also retired July 1, 2004, having served three years of her first term. We wish many years of active and enjoyable retirement to them all.

On October 25, James A. Rossler, Jr., treasurer of Rossford Exempted Village Schools, was appointed to fill Mrs. Mulholland's term. In March, one active member and one retiree member were elected to the Board. The terms of Mark Anderson (active member) and Catherine Moss (retiree member) began July 1, 2004 and continue to June 30, 2008.

Finally we acknowledge the departure of Thomas R. Anderson, who retired January 1, 2004. Tom's association with SERS began when he served as the Attorney General's representative on the Board. He then joined SERS as Executive Director in May 1979. Under Tom's leadership, SERS' assets grew from just under $1 billion in 1979 to more than $7.8 billion and annual benefit payments to retirees grew from $67 million to $635 million. Tom worked tirelessly to improve benefits for retirees by working with constituent groups, other Ohio retirement systems and legislators to support bills for ad hoc increases and improvements in the benefit formula, to name just a few. He frequently went to Washington DC to meet with Congressional representatives about eliminating the windfall provision and pension offset that penalizes the Social Security income of SERS' retirees. It is never easy to lose someone with Tom's talents, skill and longevity but we are confident that SERS' staff is up to the challenge to continue his legacy of providing the best possible service and benefits to SERS' members and retirees.

The preparation of this report is the combined effort of the System's staff under the direction of the Retirement Board. It will be mailed to all employer members of SERS and other interested parties and published on our website. Summary financial information will be distributed to active and retired SERS membership.

The cooperation of SERS' employers contributes significantly to the success of SERS and is greatly appreciated. We would also like to express our gratitude to the Board, the staff, consultants and others who help ensure the successful operation of the School Employees Retirement System of Ohio.

Respectfully submitted,

James R. Winfree
Executive Director

Virginia S. Brizendine
Director of Finance

LEGISLATIVE SUMMARY

SERS and its members can be significantly affected by legislation enacted by the Ohio General Assembly and Congress. The impact of legislation and federal regulatory activities on SERS and other public retirement systems has increased in recent years. SERS closely monitors legislative activities, and when appropriate, gives testimony or otherwise educates Ohio legislators, congressional representatives, and regulatory agencies on the impact of these proposals. The following bills either became effective or were introduced this legislative session.

STATE LEGISLATION

S.B. 133 (Effective 9/15/04; ARP provision effective 8/1/05)

Modified the ***governance of the five state retirement systems***. This bill expands the SERS Retirement Board from seven to nine members by removing the attorney general and state auditor, and replacing them with three appointed investment experts and an additional retiree. The system is required to set goals to increase utilization of Ohio investment managers and brokers. The bill also requires licensure of investment officers; requires SERS to develop travel and ethics policies in conjunction with the Ohio Ethics Commission and the Ohio Retirement Study Council; sets continuing education requirements for board members; requires a fiduciary performance audit every ten years; gives the attorney general the authority to sue board members for breach of fiduciary duty; requires candidates for board seats to file campaign finance reports with the secretary of state; mandates that board members and investment officers file annual financial disclosure statements; and makes any board member whose travel expenses averaged more than $10,000 a year in 2000, 2001 and 2002 ineligible to be reappointed or re-elected to the board. Other provisions that expand university alternative retirement plan options will become effective 8/1/05.

H.B. 98 (Passed House 6/25/03)

Addresses remaining ***Division of Property Order*** (DOPO) issues. The bill would authorize a new plan of payment that provides for two or more option beneficiaries to be named at retirement; require a member to select, pursuant to a court order, a retirement plan of payment that provides monthly benefits to a former spouse; and require that a cost of living increase be apportioned between the retiree and the alternate payee, pursuant to a DOPO. The bill is pending in the Senate.

H.B. 449 (Passed House 5/26/04)

Allows a retiree re-employed in a position covered by any state retirement system to receive a ***refund of contributions*** in lieu of a benefit for the period of re-employment. The bill is pending in the Senate.

H.B. 455 (Passed House 5/26/04)

Provides that a retiree who retires after the effective date of the bill may exercise the option to ***"pop-down"*** to cover a spouse after marriage or remarriage ***only within the one-year period*** after the date of the marriage or remarriage. The bill is pending in the Senate. A similar bill, S.B. 225, was introduced in the Senate on 4/8/04.

H.B. 32 (Introduced 2/3/03)

Changes membership of ***non-teaching employees of the University of Akron*** from SERS to Ohio Public Employees Retirement System (OPERS). SERS submitted opposition testimony on the adverse impact this bill would have on the retirement system's retiree health care fund. The bill had several hearings in the House Banking, Pensions and Securities Committee, and was continued.

FEDERAL LEGISLATION

Medicare Prescription Drugs (Effective 12/08/03)

H.R. 1 introduced by Rep. J. Dennis Hastert (R-IL) – became **Public Law 108-173.** The bill established a new voluntary prescription drug benefit under Medicare – Part D – to begin in 2006. The bill also included a temporary Medicare-endorsed drug discount card that became available to all beneficiaries in April 2004. Under Medicare Part D, participants will pay a $250 deductible and a $35 monthly premium. Coverage is at 75% of the cost of prescription drugs up to $2,250. When out-of-pocket expenses exceed $3,600, the plan will cover 95% of drug costs. Plan sponsors such as SERS are expected to be offered a federal subsidy that may equal 28% of their plan's prescription drug costs as an inducement to maintain prescription drug coverage.

Social Security Offset "Last Day Loophole" (Effective 3/2/04)

H.R. 743 introduced by Rep. E. Clay Shaw (R-FL) – became **Public Law 108-203.** The bill changed the Social Security offset's "last-day loophole" provision from one day in covered employment before exemption, to five years. The bill included a provision requiring all new public employees beginning in January 2005 to sign a form acknowledging their awareness of the Social Security offset and windfall penalties.

Social Security Offset and Windfall

H.R. 594 introduced by Rep. Howard McKeon (R-CA) and **S. 349** introduced by Sen. Dianne Feinstein (R-CA) – repeals the government pension offset and windfall elimination penalties. No action has been taken on either bill. In February 2004, Rep. Jim Turner (D-TX) introduced a discharge petition, **H.R. 523** to force H.R. 594 out of the Ways and Means Committee. The resolution has not obtained the required 218 signatures.

H.R. 887 introduced by Rep. William Jefferson (D-LA) – eliminates the offset penalty if a recipient's combined monthly Social Security and public pension benefit is $2,000 or less. **S. 363** introduced by Sen. Barbara Mikulski (D-MD) – eliminates the offset penalty where the combined Social Security and public pension monthly benefit is $1,200 or less. No action has been taken on either bill.

H.R. 2011 introduced by Rep. Barney Frank (D-MA) – eliminates the windfall penalty if a recipient's combined monthly Social Security and public pension benefit is $2,000 or less, with a graduated penalty over $2,000. Likewise, **H.R. 4234** introduced by Rep. Barney Frank, sets a limit of $2,500. Sen. John Kerry (D-MA) introduced **S. 1011** that eliminates the offset penalty if a recipient's combined monthly Social Security and public pension benefit is $2,000 or less, with a graduated penalty over $2,000. No action has been taken on any of these bills.

H.R. 75 introduced by Rep. E. Clay Shaw (R-FL) – reduces the offset penalty from two-thirds to one-third. No action has been taken on this bill.

H.R. 4391 introduced by Rep. Kevin Brady (R-TX) – eliminates the current windfall provision and replaces it with a new formula based on an individual's actual earnings during his/her years of work. In July 2004, a hearing was held on this bill in the House Ways and Means Social Security Subcommittee.

Social Security Number Privacy

H.R. 2971 introduced by Rep. E. Clay Shaw (R-FL) – prohibits the selling of Social Security numbers or display of them to the general public. It also requires organizations to safeguard Social Security numbers in their possession from unauthorized access by employees or others. This bill was passed by the House Ways and Means Committee in October 2004, and is now scheduled in the Judiciary Committee.

Mandatory Social Security

H.R. 3055 introduced by Rep. Nick Smith (R-MI) – forces all newly hired public employees to participate in Social Security. Also amends the Social Security Act to create an optional Individual Retirement Security Program within Social Security for personal retirement savings accounts. No action has been taken on this bill.

Pension Portability and Service Purchases

H.R. 1776 introduced by Rep. Rob Portman (R-OH) – encourages companies to keep, or establish, pension and retirement plans to encourage workers to save more. The bill makes today's retirement savings opportunities permanent, and expands and improves retirement savings vehicles. The bill was reported out of the House Ways and Means Committee.

S. 2424 introduced by Sen. Chuck Grassley (R-IA) – amends the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 to protect the retirement security of American workers by ensuring that pension assets are adequately diversified, and by providing workers with adequate access to, and information about, their pension plans. Also known as NESTEG, the bill includes a number of provisions regarding issues of interest to public plans, such as purchases of service credit. The bill was introduced in May 2004 and placed on the Senate Calendar.

Financial Section

KPMG

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Independent Auditors' Report

The Retirement Board
The School Employees Retirement System of Ohio

and

The Honorable Betty Montgomery
Auditor of State:

We have audited the accompanying statement of plan net assets of the School Employees Retirement System of Ohio (SERS) as of June 30, 2004, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of SERS' 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SERS as of June 30, 2004, and the changes in its plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 24, 2004, on our consideration of SERS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 16 through 19 and the schedules of funding progress and employer contributions on page 32 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial information included on pages 33 and 34 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit 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.

KPMG

The introductory section on pages 4 through 12, the investments section on pages 36 through 52, the actuarial section on pages 54 through 60, and the statistical section on pages 62 through 64 have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

November 24, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

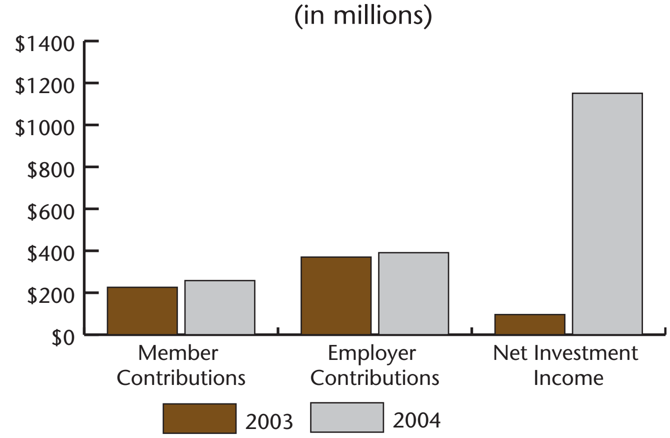
This discussion and analysis of the School Employees Retirement System's financial performance provides a narrative overview of financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with additional information that we have furnished in our Letter of Transmittal, which can be found in the Introductory Section of this report.

FINANCIAL HIGHLIGHTS

Results for 2004 reflect a substantial improvement over 2003, fueled mainly by the gain in net investment income. Items of note include:

- Total additions to plan net assets were $1.8 billion. Net investment income increased from $96 million in 2003 to $1.2 billion. Employee and employer contributions rose by $54 million.
- Total deductions from plan net assets for fiscal year 2004 totaled $762 million, an increase of 4.2% over fiscal 2003 deductions.
- Total plan net assets increased by $1.0 billion, a return to the positive side of the ledger after three straight years of decreases. All funds recorded increases in net assets, except the Health Care Fund.
- Administrative expenses dropped by 0.5%; however investment expenses, which include investment advisor fees, custodial and recordkeeping costs as well as salaries and benefits for investment staff, increased 1.1%.

COMPARATIVE ADDITIONS BY SOURCE
FY 2003 & 2004
(in millions)



OVERVIEW OF FINANCIAL STATEMENTS

Following the management's discussion and analysis are the financial statements: the *Statement of Plan Net Assets* and the *Statement of Changes in Plan Net Assets*. Reviewing these statements, along with the accompanying notes will give the reader a sense of SERS' financial position. SERS' financial statements are prepared using the accrual basis of accounting and are in compliance with applicable Governmental Accounting Standards Board statements.

The *Statement of Plan Net Assets* provides a view at the fiscal year end of the amount the plans have accumulated in assets to pay for benefits.

The *Statement of Changes in Plan Net Assets* shows what has happened to the plans during the fiscal year. If net assets increased, then additions to the plans were greater than the deductions. If net assets decreased, then additions to the plans were less than the deductions from plans.

The *Notes to Financial Statements* provide additional information that is essential for a full understanding of the data provided in the financial statements and include history and purpose of the plans, significant accounting policies; member, retiree and employer data; and disclosure of commitments and contingent liabilities that may significantly impact SERS' financial position.

CONDENSED SUMMARY OF TOTAL PLAN NET ASSETS
(in millions)

			Change	
ASSETS	2004	2003	Amount	Percent
Cash	$ 71.5	$ 59.1	$ 12.4	21.0%
Receivables	665.6	443.6	222.0	50.0
Investments	8,669.8	7,555.2	1,114.6	14.8
Property & Equipment	53.4	55.0	(1.6)	(2.9)
Other Assets	5.5	3.5	2.0	57.1
Total Assets	9,465.8	8,116.4	1,349.4	16.6
LIABILITIES				
Benefits & Accounts Payable	29.8	28.8	1.0	3.5
Investments Payable	870.5	565.2	305.3	54.0
Total Liabilities	900.3	594.0	306.3	51.6
Net Assets Held in Trust	$ 8,565.5	$ 7,522.4	$ 1,043.1	13.9%

CONDENSED SUMMARY OF CHANGES IN TOTAL PLAN NET ASSETS
(in millions)

			Change	
ADDITIONS	2004	2003	Amount	Percent
Contributions	$ 653.6	$ 599.3	$ 54.3	9.1%
Net Investment Income	1,151.4	95.8	1,055.6	1,101.9
Total Additions	1,805.0	695.1	1,109.9	159.7
DEDUCTIONS				
Benefits	714.4	687.6	26.8	3.9
Refunds & Transfers	28.3	24.5	3.8	15.5
Admin. Expenses	19.2	19.3	(0.1)	(0.5)
Total Deductions	761.9	731.4	30.5	4.2
Net Increase/(Decrease)	1,043.1	(36.3)	1,079.4	2,973.6
Balance, Beginning of Year	7,522.4	7,558.7	(36.3)	(0.5)
Balance, End of Year	$ 8,565.5	$ 7,522.4	$ 1,043.1	13.9%

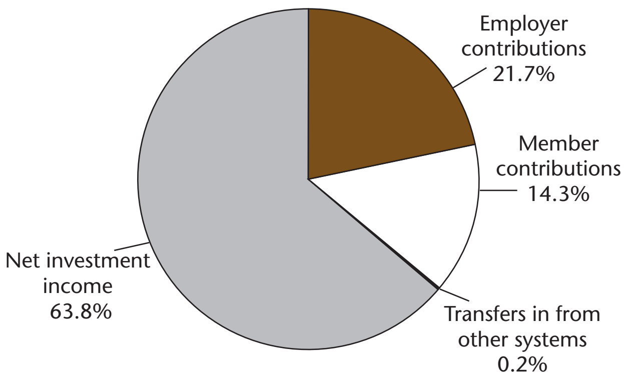
Required Supplementary Information – In addition to the financial statements and notes, certain required supplementary information (RSI) is provided. The Schedule of Funding Progress shows on an actuarial basis whether SERS' ability to pay for benefits is improving or deteriorating over time. Also included in the RSI is the Schedule of Employer Contributions and a note to the Schedule of Funding Progress. Both schedules provide data over the past six years.

Following the RSI is other supplementary information. These schedules include detailed information on investment and administrative expenses incurred by SERS.

FINANCIAL ANALYSIS

A cost-sharing defined benefit public retirement system, such as SERS, has a long-term perspective of financial activities. Pension benefits are funded on an actuarial basis, not by using today's inflow of contributions from members and employers to pay the pensions of current retirees. Instead, the contributions are set aside for investments that build a base so that members and retirees alike can feel secure that their pension benefits will be available when due. Investment income makes up the largest component of SERS' additions to net assets. Periods of flat or negative financial market performance, such as those of the last three years will impact the funding status of the System as depicted in the Schedule of Funding Progress.

ADDITIONS TO PLAN NET ASSETS



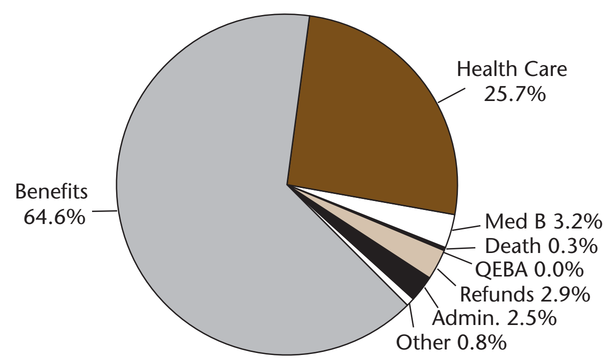
Additions – Benefit payments are funded from three sources: employee and employer contributions and investment income. Pension benefits are funded through a combination of employee and employer contributions and investment income. The Medicare Part B premium reimbursement and the death benefit are funded through employer contributions and investment income. The QEBA is funded by employer contributions. Funding for the health care program comes from employers, retiree premium payments and investment earnings.

Total plan additions increased by 159.7%, led by the increase in investment net income of $1.06 billion. This amount includes realized and unrealized investment gains and losses. Contributions from employees and employers grew 9.1% in 2004 due to the increases in the employee contribution rate, the number of active members, the average annual salary, and the employer's health care surcharge. The Board approved an increase in the employee contribution rate from 9% to 10% effective July 1, 2003. By statute this is the maximum contribution rate for employees. The employer rate is already set at the maximum statutory limit of 14%.

The Board approved the recommendation of the actuaries to increase the minimum salary of the calculation of the employer surcharge from $14,500 to $25,400 for fiscal year 2004. However, legislation enacted in 2001 limits the surcharge paid by an individual employer to 2.0% of payroll. Legislation also imposes a statewide cap of 1.5% of payroll to lessen the impact of the increase in the surcharge minimum salary. Without these caps, for 2004 the surcharge would have been $136 million, instead of $37.6 million. This year's surcharge increased 20.4%.

Deductions – Expenses are incurred primarily for the purpose for which SERS was created, the payment of benefits to non-teaching Ohio public school employees. SERS is comprised of five separate plans – the Pension Trust Fund, the Medicare B Fund, the Death Benefit Fund, the Qualified Excess Benefit Arrangement Fund and the Health Care Fund. Included in the deductions from plan assets for 2004 were benefit payments, refunds of contributions due to member terminations or deaths, transfers to other Ohio Systems to provide benefits for those members who had membership in more than one system, and administrative expenses.

DEDUCTIONS FROM PLAN NET ASSETS

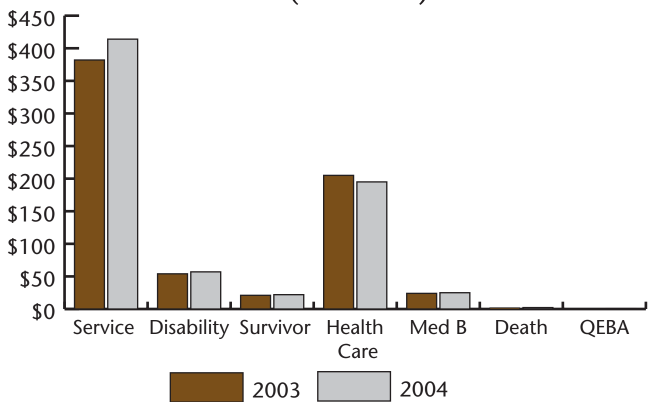


Payments to service, disability and survivor benefit recipients increased by $35.6 million, a 7.8% rise. This growth resulted from a larger number of retirees and an increase in the average annual retirement allowance. Retirees receive an annual 3% cost of living allowance on the anniversary of their retirement date.

SERS reimburses a portion of the Medicare Part B premium to retirees eligible for SERS' health care program and Medicare Part B. For calendar year 2004 the premium is $66.60, SERS reimburses $45.50. Any increase in the amount SERS reimburses must be enacted by the Ohio General Assembly. Medicare Part B expense increased 2.0% in fiscal 2004.

SERS pays a $1,000 death benefit to the designated beneficiary of service and disability retirees. Death benefit payments increased 8.5%.

COMPARATIVE BENEFIT PAYMENTS
FY 2003 & 2004
(in millions)



As reported in the letter of transmittal, substantial changes were made to SERS' health care program effective January 1, 2004 which resulted in a 4.6% decrease in health care expenses net of premiums paid by retirees. Gross health care expense increased 1.3% from $220.5 million to $223.4 million.

Much of the decrease in net health care expense resulted from higher premiums and out-of-pocket costs paid by retirees. Employers also saw their contributions increase, as the surcharge salary limit, $25,400, substantially exceeded the annual average salary ($19,442) of a SERS member. So, as noted above, the three components of health care funding (employer contributions, investment earnings and retiree premiums) increased in 2004; however we recorded a net decrease in the fund of $2.7 million compared to the 2003 net decrease of $31.7 million. SERS recognizes the importance of the health care program to our retirees, but it is likely that changes will be necessary in the future to preserve the program without adversely affecting the funding of pension benefits.

SERS obtained IRS approval of its Qualified Excess Benefit Arrangement for retirees whose benefits calculated under SERS' statutes exceed IRS 415(m) limits. Accordingly, the QEBA plan has been added to SERS' financial statements.

REQUEST FOR INFORMATION

This financial report is designed to provide the Retirement Board, our membership, employers and investment managers with a general overview of SERS' finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

School Employees Retirement System
Finance Department
300 East Broad Street, Suite 100
Columbus, Ohio 43215

STATEMENT OF PLAN NET ASSETS
AS OF JUNE 30, 2004

ASSETS	PENSION TRUST FUND	MEDICARE B FUND	DEATH BENEFIT FUND
Cash and Operating Short Term Investments	$ 64,447,114	$ 873,243	$ 152,654
Receivables			
Contributions			
Employer	96,334,404	7,004,931	405,139
Employee	12,794,590	–	–
Investments Receivable	427,315,677	5,593,802	1,078,055
Total Receivables	536,444,671	12,598,733	1,483,194
Investments, at Fair Value			
US Equity	3,807,954,894	49,848,268	9,606,910
Non-US Equity	1,447,266,855	18,945,536	3,651,241
Private Equity	120,322,655	1,575,091	303,556
Fixed Income	1,720,665,697	22,524,480	4,340,987
Real Estate	697,707,070	9,133,377	1,760,212
Short-Term	338,173,144	4,426,876	853,162
Total Investments	8,132,090,315	106,453,628	20,516,068
Securities Lending Collateral	177,514,953	2,323,771	447,844
Capital Assets			
Land	3,315,670	–	–
Property and Equipment, at Cost	59,564,436	–	–
Accumulated Depreciation	(9,440,187)	–	–
Total Capital Assets	53,439,919	–	–
Other Assets	4,785,260	–	–
TOTAL ASSETS	8,968,722,232	122,249,375	22,599,760
LIABILITIES			
Accounts Payable and Accrued Expenses	709,140	88,111	–
Benefits Payable	628,378	17,836	188,000
Investments Payable	656,815,282	8,598,081	1,657,048
Obligations under Securities Lending	177,514,953	2,323,771	447,844
TOTAL LIABILITIES	835,667,753	11,027,799	2,292,892
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POSTEMPLOYMENT BENEFITS	$8,133,054,479	$ 111,221,576	$ 20,306,868

(An unaudited Schedule of Funding Progress is presented on page 32.)

See accompanying notes to the financial statements.

QEBA FUND	HEALTH CARE FUND	TOTAL
$ 12,341	$ 5,953,994	$ 71,439,346
–	103,161,172	206,905,646
–	-	12,794,590
–	11,852,926	445,840,460
–	115,014,098	665,540,696
–	105,625,446	3,973,035,518
–	40,144,438	1,510,008,070
–	3,337,522	125,538,824
–	47,728,003	1,795,259,167
–	19,353,071	727,953,730
–	9,380,281	352,833,463
–	225,568,761	8,484,628,772
–	4,923,928	185,210,496
–	–	3,315,670
–	–	59,564,436
–	–	(9,440,187)
–	–	53,439,919
–	716,535	5,501,795
12,341	352,177,316	9,465,761,024
1,289	2,113,228	2,911,768
–	26,060,646	26,894,860
–	18,218,810	685,289,221
–	4,923,928	185,210,496
1,289	51,316,612	900,306,345
$ 11,052	$ 300,860,704	$8,565,454,679

STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2004

ADDITIONS	PENSION TRUST FUND	MEDICARE B FUND	DEATH BENEFIT FUND
Contributions			
Employer	$ 213,736,648	$ 17,390,201	$ 744,272
Employee	258,131,243	–	–
Transfers from other Ohio Systems	4,007,479	–	–
Total Contributions	475,875,370	17,390,201	744,272
Income from Investment Activity			
Interest and Dividends	154,066,403	2,114,371	408,751
Net Appreciation in Fair Value	973,754,362	13,292,781	2,579,721
	1,127,820,765	15,407,152	2,988,472
Investment Expenses	(30,538,591)	(432,045)	(79,920)
Net Income from Investment Activity	1,097,282,174	14,975,107	2,908,552
Income from Securities Lending Activity			
Gross Income	2,590,840	35,368	6,864
Brokers' Rebates	(784,359)	(10,707)	(2,078)
Management Fees	(237,799)	(3,246)	(630)
Net Income from Securities Lending Activity	1,568,682	21,415	4,156
Total Investment Income, Net	1,098,850,856	14,996,522	2,912,708
TOTAL ADDITIONS	1,574,726,226	32,386,723	3,656,980
DEDUCTIONS			
Retirement Benefits	413,743,800	21,742,514	–
Disability Benefits	56,956,255	1,216,754	–
Survivor Benefits	21,705,434	1,347,920	–
Health Care Expenses	–	–	–
Death Benefits	–	–	2,200,147
	492,405,489	24,307,188	2,200,147
Refunds and Lump Sum Payments	22,090,604	–	–
Administrative Expenses	17,402,953	338,990	47,202
Transfers to other Ohio Systems	6,251,974	–	–
	45,745,531	338,990	47,202
TOTAL DEDUCTIONS	538,151,020	24,646,178	2,247,349
NET INCREASE / (DECREASE)	1,036,575,206	7,740,545	1,409,631
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POSTEMPLOYMENT BENEFITS:			
Balance, Beginning of Year	7,096,479,273	103,481,031	18,897,237
Balance, End of Year	$8,133,054,479	$ 111,221,576	$ 20,306,868

See accompanying notes to the financial statements.

QEBA FUND	HEALTH CARE FUND	TOTAL
$ 18,600	$ 159,550,942	$ 391,440,663
–	–	258,131,243
–	–	4,007,479
18,600	159,550,942	653,579,385
–	4,872,912	161,462,437
–	30,607,591	1,020,234,455
–	35,480,503	1,181,696,892
–	(888,854)	(31,939,410)
–	34,591,649	1,149,757,482
–	81,437	2,714,509
–	(24,654)	(821,798)
–	(7,475)	(249,150)
	49,308	1,643,561
–	34,640,957	1,151,401,043
18,600	194,191,899	1,804,980,428
6,259	–	435,492,573
–	–	58,173,009
–	–	23,053,354
–	195,496,097	195,496,097
–	–	2,200,147
6,259	195,496,097	714,415,180
–	–	22,090,604
1,289	1,391,708	19,182,142
–	–	6,251,974
1,289	1,391,708	47,524,720
7,548	196,887,805	761,939,900
11,052	(2,695,906)	1,043,040,528
–	303,556,610	7,522,414,151
$ 11,052	$ 300,860,704	$8,565,454,679

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2004

1. Summary of Significant Accounting Policies

Basis of Accounting — SERS' financial statements are prepared using the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan. Administration costs are financed by investment earnings.

Employer Contributions Receivable — SERS recognizes long-term receivables from employers whose contributions are deducted from the money paid to them through the Ohio School Foundation Program, administered by the Department of Education. Employer contributions for fiscal year 2004 will be received by the end of calendar year 2004; the surcharge owed for fiscal year 2004 will be received by the end of calendar year 2005.

Health Care Benefits Incurred and Unpaid — Amounts accrued for health care benefits payable in the Health Care Fund are based upon estimates that have been developed from prior claims experience.

Allocation of Expenses to Plans — Direct expenses are charged to the plan for which they are incurred. All indirect expenses are paid by the Pension Trust Fund and are reimbursed by the Medicare B, Death Benefits and Health Care Funds.

Investments — Investment purchases and sales are recorded as of the trade date. Dividend income is recognized on the ex-dividend date. Other investment income is recognized when earned.

Plan investments are reported at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Fixed income securities and common and preferred stocks are valued based on published market prices and quotations from national security exchanges and securities pricing services. International stocks are then adjusted to reflect the current exchange rate of the underlying country. Securities not traded on a national security exchange, including real estate and private equity, are valued at fair value by the respective manager or independent appraisers and are reported by SERS one quarter in arrears. Short-term securities are valued at amortized cost, which approximates fair value.

Net appreciation (depreciation) is determined by calculating the change in the fair value of investments between the beginning of the year and the end of the year, less purchases of investments at cost, plus sales of investments at fair value. Investment expense consists of external expenses directly related to SERS' investment operations, as well as the internal administrative expenses associated with SERS' investment program.

The monies held by the Pension Trust, Medicare B, Death Benefit and Health Care Funds are pooled for the purpose of the investment of those plans. Each plan holds units of the investment pool, which are adjusted on a monthly basis. The value of one unit of the Pool on June 30, 2004 was $952.23586. The unit holdings and value of each of the funds at the close of the fiscal year were:

	Units	Value
Pension Trust Fund	8,330,148.06213	$7,932,265,685
Medicare B Fund	109,046.31523	103,837,811
Death Benefits Fund	21,015.73869	20,011,940
Health Care Fund	231,062.50776	220,026,005
Total	8,691,272.62381	$8,276,141,441

Office Building, Equipment and Fixtures (Non-Investment Assets) — Office building and equipment and fixtures in excess of $5,000 are capitalized at cost when acquired. Improvements that increase the useful life of the property are capitalized. Maintenance and repairs are charged to expense as incurred. Software costs in excess of $25,000 are also capitalized. Depreciation has been provided using the straight-line method over the following useful lives:

Description	Estimated Lives (years)
Furniture, equipment and software	3-10
Building and improvements	40

Reserves — State Statute (ORC 3309.60) establishes various reserves to account for future and current benefit payments. The state statutes give these reserves the title of “Funds”, but for accounting and reporting purposes they are treated as accounts.

These are:

- **The Employees' Savings Account** — Accumulated members' contributions are held in trust pending refund or transfer to a benefit disbursement account.
- **The Employers' Trust Account** — Accumulated employer contributions are held for future benefit payments.
- **The Annuity and Pension Reserve Account** — This reserve contains the monies set aside to pay all annuities and pensions. Money is transferred to this account from the Employees' Savings and Employers' Trust Accounts at the time of retirement.
- **The Survivors' Benefit Account** — Monies in this account are set aside to finance payments to beneficiaries of deceased members. Money is transferred to this account from the Employees' Savings and Employers' Trust Accounts in an amount to fund all liabilities at the end of each year.
- **The Guarantee Account** — Income derived from the investment pool and any gifts or bequests are accumulated in this account. The balance in this account is transferred to other reserve accounts to aid in the funding of future benefit payments and administrative expenses.
- **The Expense Account** — This account provides for the payment of administrative expenses with the necessary money allocated to it from the Guarantee Account.

The chart on the bottom of this page shows the balances of reserve accounts as of June 30, 2004.

2. Description of the System

Organization — The School Employees Retirement System of Ohio (SERS) is a cost-sharing multiple-employer defined benefit public employee retirement system established by the Ohio General Assembly in 1937 to provide retirement benefits to employees of Ohio public schools who are not required to possess a certificate in order to perform their duties.

Five separate plans comprise the SERS retirement system. The Pension Trust Fund, the Medicare B Fund, the Death Benefit Fund and the Qualified Excess Benefit Arrangement Fund are classified as pension plans for federal tax purposes. The Pension Trust Fund holds the funds to pay the basic retirement benefits authorized under Ohio Revised Code (ORC) 3309. The Medicare B Fund reimburses Medicare premiums paid by eligible retirees and beneficiaries as set forth in ORC 3309.69. The Death Benefit Fund (ORC 3309.50) pays $1,000 to a designated beneficiary upon the death of a retiree. The Qualified Excess Benefit Arrangement (QEBA) Fund was established this year for retirees whose benefits under SERS' statutes exceed IRS 415(m) limits. Money available for health care benefits is in a separate plan known as the Health Care Fund.

Responsibility for the organization and administration of SERS is vested in the Retirement Board. The Retirement Board is the governing body of SERS. As of June 30, 2004 it was comprised of four elected employee-members, one elected retiree-member and two statutory members.

Pension Benefits — Members are eligible for retirement benefits based upon age and service credit as follows: age 60 and earning 5 years of service credit; age 55 and earning 25 years of service credit; or earning 30 years of service credit at any age. The benefit is equal to 2.2% of the member's final average salary, or a minimum of $86, multiplied by the number of years of credited service. Members retir-

RESERVE ACCOUNT BALANCES AS OF JUNE 30, 2004

	Pension Trust Fund	Medicare B Fund	Death Benefits Fund	QEBA Fund	Health Care Fund	**Reserve Account Totals**
Employee's Svgs Acct.	$1,947,313,705	$ –	$ –	$ –	$ –	**$1,947,313,705**
Employer's Trust Acct.	1,229,871,928	–	–	–	300,860,704	**1,530,732,632**
Annuity and Pension Reserve Acct.	4,733,796,634	111,221,576	20,306,868	11,052	–	**4,865,336,130**
Survivors' Benefit Acct.	222,072,212	–	–	–	–	**222,072,212**
Guarantee Acct.	–	–	–	–	–	–
Expense Acct.	–	–	–	–	–	–
Fund Totals	**$8,133,054,479**	**$111,221,576**	**$20,306,868**	**$11,052**	**$300,860,704**	**$8,565,454,679**

ing with more than 30 years of service credit receive an increased benefit multiplier of 2.5% for each year of earned service in excess of 30 years. Death benefits of $1,000 are payable upon the death of a retiree to a designated beneficiary. Members are eligible for disability benefits after completion of 5 years of service. Qualified dependents of a deceased member are eligible for monthly survivor benefits.

Qualified benefit recipients who pay Medicare B premiums may apply for and receive a monthly reimbursement from SERS. The current reimbursement amount is $45.50.

Members with credited service in the State Teachers Retirement System (STRS) or Ohio Public Employees Retirement System (OPERS) are eligible to receive transferred credited service and funds from either or both of those systems. Any such service not concurrent with service within SERS will be included in the determination of retirement benefits. Similarly, a member with credited service and funds in SERS may transfer such service to STRS or OPERS upon retirement.

Retirees of any of the five state retirement systems must contribute to SERS if they are employed in a non-certificated position in the public schools. These contributions are credited to a separate money purchase annuity payable at age 65 in either monthly payments (if the monthly amount is $25 or more) or in a lump sum.

Employer and Employee Membership Data
(as of June 30, 2004)

Employer Members	
Local	371
City	194
Educational Service Center	61
Village	49
Higher Education	14
Vocational/Technical	50
Community Schools	138
Other	6
Total	883

Employee Members and Retirees	
Retirees and beneficiaries currently receiving benefits	60,569
Terminated employees entitled to but not yet receiving benefits	9,121
Total	69,690
Active Employees	
Vested active employees	70,279
Non-vested active employees	52,860
Total	123,139

Health Care Benefits — ORC 3309.375 and 3309.69 permit SERS to offer health care benefit programs to retirees and beneficiaries. SERS' pension benefits are mandated by statute; however SERS reserves the right to change or discontinue any health plan or program.

SERS offers several types of health plans from various vendors, including HMO's, PPO's and traditional indemnity plans. A prescription drug program is also available to those who elect health coverage. SERS employs two third-party administrators and a pharmacy benefit manager to manage the self-insurance and prescription drug plans, respectively. As of June 30, 2004, of the 62,182 covered benefit recipients and dependents, SERS self-insures 56,445.

Members retiring July 1, 1986 or later must have ten years of service credit to qualify for health care benefits. Effective January 1, 2004, all retirees and beneficiaries are required to pay a portion of their health care premium. The portion is based on years of service, Medicare eligibility and retirement status. A safety net is in place for retirees whose household income falls below federal poverty levels. Premiums are reduced by 50% for those who qualify.

The health care program is funded through employer contributions, premium payments and investment earnings. The portion of the employer contribution not required to actuarially fund the pension plans (Pension Trust Fund, Medicare B Fund and Death Benefit Fund) is available for the Health Care Fund. During fiscal year 2004, the amount of employer contributions directed to the Health Care Fund was 4.91% of covered payroll or $159.6 million.

An additional health care surcharge on employers is collected for employees earning less than an actuarially determined minimum compensation amount, pro-rated according to service credit earned. Statutes provide that no employer shall pay a health care surcharge greater than 2% of that employer's SERS-covered payroll; nor may SERS collect in aggregate more than 1.5% of total statewide SERS-covered payroll for the health care surcharge. For fiscal year 2004, the minimum compensation level was established at $25,400. The surcharge accrued for fiscal year 2004 and included in employer additions on the *Statement of Changes in Plan Net Assets* is $37.6 million.

Health care expenses are reported net of premiums paid by benefit recipients. Premiums paid in fiscal year 2004 and 2003 were $27.9 million and $15.6 million, respectively.

3. Contributions

The Ohio Revised Code requires contributions by active members and their employers. The Retirement Board establishes contribution rates within the allowable rates established by the Ohio Revised Code. The adequacy of employer contribution rates is determined annually by actuarial valuation using the entry age normal cost method. During fiscal year 2004, active members and their employers were required to contribute 10% and 14%, respectively, of active member payroll.

The Retirement Board, acting with the advice of the Actuary, allocates the current employer contribution rate among four of the plans of the system. For fiscal year 2004, the allocation of the employer contribution rate to pension plan benefits was established as the rate necessary to cover normal cost. Of the 14% contribution rate paid by employers, 9.09% was allocated to the pension plans in the following rates:

Pension Trust Fund	8.36%
Medicare B Fund	.70%
Death Benefit Fund	.03%

During fiscal year 2004, the remaining 4.91% of the 14% employer contribution rate was allocated to the Health Care Fund.

Employer and employee contributions were $353.4 million and $252.4 million, respectively, in 2004. The employee contribution amounts in the financial statements include employee contributions for purchased service credit.

4. Cash Deposits and Investments

Cash Deposits — By statute, the Treasurer of the State of Ohio (Treasurer) serves as custodian for all SERS' deposits. Deposits are classified into three categories of credit risk to give an indication of the level of custodial credit risk assumed by SERS. Category 1 includes deposits insured or collateralized with securities held by SERS or its agent in the name of SERS. Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the name of the Treasurer. Category 3 includes deposits that are uncollateralized.

As of June 30, 2004, the carrying amount of SERS' operating cash deposits was $2,984,966 and the bank balances were $9,327,385. Of the bank balances, the Federal Deposit Insurance Corporation insured $249,489. Additional bank balances of $4,855,232 were covered by collateral held in the name of SERS' pledging financial institutions, as required by state statute. Bank deposits of $4,222,664 were uncollateralized (category 3).

Investments — The Retirement Board has the responsibility to invest available funds of the system, in accordance with applicable state law and the guidelines set forth by the Board. SERS does not hold investments in any one organization representing five percent or more of plan net assets.

Ohio Revised Code Section 3309.15 and the Board's "Investment Objectives and Policies" (adopted September 2000) direct that the funds of the system will be invested following the "prudent expert standard." This fiduciary standard dictates that the Board consider the probable safety of investments, avoid speculative investments, and invest as persons of prudence, discretion, and intelligence would manage their own affairs. The Board accomplishes this through a combination of internal and external investment professionals.

The chart on page 28 is prepared in accordance with Statement No. 3 of the Governmental Accounting Standards Board, and shows SERS' investments categorized to give an indication of the level of custodial credit risk assumed by SERS at year-end. Category 1 includes investments that are insured or registered, with securities held by the Treasurer or custodial agent bank in SERS' name. Category 2 includes uninsured and unregistered investments, with securities held by the counterparty's trust department or agent in SERS' name. Category 3 includes uninsured and unregistered investments, with securities held by the counterparty, or by its trust department or agent, but not in SERS' name.

Non-US Securities — The system invests in the securities of non-US developed and emerging countries. The objective of these investments is to obtain the highest total return consistent with a reasonable degree of risk for this asset class. These investments are diversified by investment style, country, capitalization range and economic sector. Managers may occasionally use futures contracts, in the major non-US equity markets, to facilitate trading and temporarily invest cash.

Derivatives — Derivatives are generally defined as investment instruments whose cash flows or fair values are derived from the value of some other asset or index. SERS uses a variety of derivatives primarily to maximize yields and offset volatility due to interest rate and currency fluctuations. The system is exposed to various types of credit, market and legal risks related to these investments. Investment staff monitors these types of investments with extreme care and is not aware of any undue risks at this time.

Foreign exchange forward currency contracts are legal agreements between two parties to purchase and sell a foreign currency, for a price specified at the contract date, with delivery and settlement in the future. SERS enters into these contracts to hedge the foreign currency movements of assets held in the underlying funds. The contracts do not subject SERS to risk due to exchange rate movements as gains and losses on the contracts offset gains and losses on the transactions being hedged. SERS could be at risk for replacing these contracts at current market rates, should the counterparty default. SERS seeks to control this risk through contracting only with counterparties who meet credit guidelines.

The system hedges 50% of the fair value of its assets in non-US developed countries. As of June 30, 2004, SERS had outstanding contracts in the amount of $650,903,316, which had a latest settlement date of September 3, 2004, and a net loss on rejoined contracts of $35,425,960 for the fiscal year.

A futures contract is a contract to buy or sell units of an index or financial instrument on a specified future date at a price agreed upon when the contract is

The following investment summary identifies the level of custodial credit risk assumed by SERS as of June 30, 2004 (amounts expressed in thousands).

	Total Fair Value	Category 1	Category 2	Category 3	Non-Categorized
US Government & Agency Obligations	$1,154,262	$1,075,317	$ –	$ –	$ 78,945
US Corporate Bonds & Obligations	680,384	680,013			371
Non-US Bonds	34,455	34,455			
US Equities	1,900,891	1,856,883			44,008
Non-US Equities	514,283	458,100			56,183
Overnight Discount Notes	147,346	147,346			
Commercial Paper	116,976	116,976			
Repurchase Agreements	52,100	52,100			
Real Estate Investment Trusts	160,658	160,658			
Commingled funds:					
US Equity	2,071,940				2,071,940
Non-US Equity	995,934				995,934
Real Estate	567,296				567,296
Private Equity	125,539				125,539
Securities Lending collateral:					
Mutual Fund	185,210				185,210
Total investments, operating short-term securities, and securities lending collateral	**$8,707,274**	**$4,581,848**	**$ 0**	**$ 0**	**$4,125,426**

originated. SERS uses futures contracts in an effort to obtain an equity return for the entire equity allocation. The system also used equity and fixed income futures during a portion of fiscal 2004 to rebalance its asset allocation.

When SERS enters into a futures contract, the broker receives cash or US Government securities equal to the minimum "initial" margin. Each day thereafter, SERS receives or pays cash to the broker equal to the daily fluctuation in the contract's value. Collateral of 5% of the anticipated fair value is required as a good faith agreement. Only the most liquid equity futures are used by SERS to directly hedge the temporary and transactional cash held in domestic equity portfolios and to rebalance asset allocation between asset classes. The maximum risk from the purchase of a futures contract (long position) is the contract value. The risk from the sales of futures contracts (short positions) depends upon the amount that the contract increases in value.

As of June 30, 2004, SERS held S&P 500 and Russell 2000 equity index futures with the notional value of $26,450,700 and an expiration date of September 13, 2004. Equity futures realized a net loss of $4,936,555 during the fiscal year.

At the end of June 2004, SERS held various non-US equity index futures with the notional value of $(13,268,216) to gain exposure to markets in Canada, Western Europe, Japan and Hong Kong. These contracts had expiration dates ranging from July 16, 2004 to September 30, 2004. Non-US equity futures realized a net loss of $2,820,039 during fiscal year 2004.

The system also held fixed income futures at year-end. US Treasury Bond/Note futures with the notional value of $29,413,500 had an expiration date of September 21, 2004 or September 30, 2004 at the end of June. Fixed income futures realized a net loss of $3,743,468 during the fiscal year.

The system also has investments in various types of fixed income securities reported in the Statement of Plan Net Assets for which it does not hold the underlying securities. Funds are invested in mortgage-backed, asset-backed, interest-only strips, principal-only strips and adjustable-rate securities. These securities serve to maximize yields and to offset volatility in the fund due to interest rate fluctuations. The fair value of these securities totaled $666,769,349 at June 30, 2004, representing 8.1% of the fair value of all investments.

Securities Lending — SERS participates in two securities lending programs, as authorized by Board policy. SERS receives pro-rated income from participation in the securities lending programs of several commingled funds. SERS has no direct responsibility for these programs and the collateral held by these securities lending programs is not held in SERS' name. Total net proceeds from these commingled funds were $895,856 during fiscal year 2004.

SERS also has a securities lending program for the system's directly held equity, fixed income and REIT investments using Boston Global Advisors as a third-party lending agent. Securities are loaned to independent brokers/dealers in exchange for cash collateral equal to approximately 102% of the market value of domestic securities on loan and 105% of the market value of international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. SERS continues to recognize ownership of the loaned securities in the financial statements. At the same time, SERS records a liability for the collateral held by the system in the securities lending program. Total net proceeds from this program were $747,705 during fiscal year 2004.

At June 30, 2004, SERS had no credit risk exposure on the securities lending collateral because the collateral exceeded the value of the securities loaned. Securities on loan at year-end totaled $179,506,745 and total collateral held for those securities was $185,210,496. Under the terms of the lending agreement, SERS is fully indemnified against losses that might occur in the program due to the failure of a broker to return a security that was borrowed where the collateral is inadequate to replace the security. SERS is also indemnified should the borrower fail to pay distributions of earnings on securities lent.

Securities on loan can be recalled on demand by SERS or returned by the borrower at any time. There is no matching of the securities lent with the invested cash collateral. The lending agent reinvests the cash collateral in accordance with contractual investment guidelines that are designed to ensure the safety of principal and obtain a moderate rate of return. Earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in the gross earnings from lending activities, which is then split on a 75/25% basis with the lending agent. SERS is at risk to contribute additional funds should the earnings from the invested SERS collateral not be sufficient to pay the negotiated dealer rebate. At June 30, 2004 the collateral portfolio had an average weighted maturity of 37 days.

Commitments — As of June 30, 2004, unfunded commitments related to the real estate and private equity investment portfolios totaled $567.4 million.

5. Capital Assets (Non-Investment Assets)

(See table at bottom of page.)

6. Pension Plan

For its employees, SERS contributes to the Ohio Public Employees Retirement System (OPERS), a cost-sharing multiple employer public employee retirement system comprised of three separate plans: the Traditional Plan – a defined benefit plan; the Combined Plan – a combination defined benefit/defined contribution plan; and the Member-Directed Plan – a defined contribution plan. Under the authority granted by Section 145 of the Ohio Revised Code, OPERS provides retirement, disability and survivor benefits for the public employees of Ohio. OPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing OPERS, 277 East Town Street, Columbus, Ohio 43215.

Plan members are required to contribute 8.5% of earnable salary and employers are required to contribute at an actuarially determined rate. The rate for miscellaneous employers during fiscal year 2004 was 13.55% of covered payroll. The contribution requirements for employees and employers are established and may be amended within statutory limits by the OPERS Board. The payroll for employees covered by OPERS for the year ended June 30, 2004 was $8,833,675; SERS' total payroll was $9,116,365. SERS' contributions to OPERS for the years ending June 30, 2004, 2003, and 2002 were $1,196,963, $1,118,934, and $995,759, respectively; equal to the required contributions for each year.

In addition to pension benefits, OPERS provides post-employment health care benefits, in accordance with state statutes, to all employees who retire with 10 or more years of qualifying Ohio service credit and to disability recipients. At December 31, 2003, the plan had 368,996 active participants.

A portion of each employer's contribution to OPERS is set aside for the funding of post-employment health care. The current rate is 5.0% of member covered payroll. For the year ended June 30, 2004, approximately $441,683 of employee payroll contributed by SERS to OPERS was the portion used to fund health care. Net assets held in trust at December 31, 2003 for post-employment health care benefits were $10.8 billion.

The actuarial present value of accrued post-employment benefits was determined based on the entry age normal method of funding. Significant actuarial assumptions used in the December 31, 2002 valuation (most recent available) were: an investment rate of return of 8.0%, investments valued at book value plus or minus realized or unrealized investment gains and losses amortized at 25% per annum over a four-year period, no change in the number of active employees, base pay rate increases of 4.0% and annual pay increases over and above the 4.0% base increase ranging from 0.5% to 6.3%.

CAPITAL ASSETS ACTIVITY FOR THE YEAR ENDED JUNE 30, 2004:

	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ 3,315,670	$ –	$ –	$ 3,315,670
Office building & improvements	50,735,765	796,848	–	51,532,613
Furniture & equipment	7,406,221	5,501	–	7,411,722
Computer hardware & software	160,271	369,856	–	530,127
Vehicles	118,459	–	28,485	89,974
	61,736,386	1,172,205	28,485	62,880,106
Less accumulated depreciation	6,785,288	2,673,355	18,456	9,440,187
	$54,951,098	$(1,501,150)	$ 10,029	$53,439,919

7. Compensated Absences

As of June 30, 2004, $1,271,600 was accrued for unused vacation and sick leave for SERS' employees. The net increase of $57,700 from June 30, 2003 included increases of $292,362 and decreases of $234,662. Employees who retire or resign are entitled to full compensation for all earned unused vacation. Unused sick leave pay is forfeited upon termination. However, employees who retire, become disabled or die after five years of service are entitled to receive payment for a percentage of unused sick leave.

8. Self-insured Health Care for Employees

SERS is self-insured for employee benefits for dental, general health and hospitalization. A third-party professional administrator administers the program. SERS holds a stop-loss policy of $150,000 per employee per year and places a maximum lifetime coverage limit per employee of $2,000,000.

9. Federal Income Tax Status

The SERS Pension Trust Fund is considered a qualified entity under Section 501(a) of the Internal Revenue Code (IRC) and is therefore exempt from federal income taxes. The Medicare B Fund is established pursuant to IRC Section 401(h). The Death Benefit Fund is an insurance fund and is in compliance with IRC 101(a). The QEBA Fund is a qualified entity, created in accordance with IRS 415(m) limits. The Health Care Fund is structured to meet the requirements of IRC Section 105(e).

10. Risk Management

SERS is exposed to various risks of loss from personnel actions, injuries to employees, theft or destruction of assets, and legal challenges to fiduciary decisions. To cover these risks, SERS maintains commercial insurance and holds fidelity bonds on employees. There was no reduction in coverage and no claims exceeded insurance coverage for the past three years. SERS is registered and insured through the Ohio Bureau of Workers' Compensation for injuries to employees. SERS maintains self-insured health care coverage for employees (see note 8).

11. Contingent Liabilities

On July 23, 2003, the Ohio Association of Public School Employees (OAPSE) and a number of individual members and retirees filed a suit in state court against the SERS Board, the System and its executive director alleging that changes to the SERS health care program approved by the Board violate vested rights. The suit is captioned Ohio Association of Public School Employees, et al. v. School Employees Retirement System Board, et al. The plaintiffs seek declaratory and injunctive relief to prevent the changes in the health care program from taking effect. The Court of Common Pleas ruled in SERS' favor January 2004. That decision has been appealed by OAPSE to the Ohio Appeals Court, where oral arguments have been made. An adverse ruling against SERS in this lawsuit could have a material adverse effect on the financial condition of the system. Management is of the opinion that the Ohio statutes are clear in this matter and that SERS' position will prevail.

SERS is also a defendant in various other cases relating to claims concerning individual benefits and accounts (denial of disability benefits or domestic relations suits to determine spousal interests). While the final outcome of these lawsuits cannot be determined at this time, management is of the opinion that the liability, if any, for these legal actions will not have a material adverse effect on SERS' financial position.

12. New Accounting Pronouncements

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. SERS will be required to implement this statement for the June 30, 2005 annual report.

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Post Employment Benefit Plans Other Than Pension Plans*. This Statement establishes uniform financial reporting standards for post employment benefits other than pension plans and supercedes the interim guidance included in Statement No. 26 *Financial Reporting for Post Employment Healthcare Plans Administered by Defined Benefit Plans*. SERS will be required to implement this statement for the June 30, 2006 annual report.

Management has not yet determined the impact that the two new GASB Statements will have on the Plan's financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress* (In Millions)

Valuation Year	Actuarial Accrued Liabilities (AAL)	Valuation Assets	Unfunded Actuarial Accrued Liabilities (UAAL)	Ratio of Assets to AAL	Active Member Payroll	UAAL as a % of Active Member Payroll
1999(2)	$ 7,535	$ 7,332	$ 203	97%	$ 1,768	11%
2000	8,100	8,281	(181)**	102	1,866	–
2001(1)(3)	9,257	8,791	466	95	1,974	24
2002	9,986	8,879	1,107	89	2,176	51
2003(1)	10,634	8,772	1,862	82	2,302	81
2004	11,251	8,667	2,584	77	2,394	108

* The amounts reported in this schedule do not include assets or liabilities for postemployment health care benefits.
** At June 30, 2000, valuation assets were in excess of AAL.
(1) After change in benefit provisions.
(2) After change in normal cost method.
(3) After change in actuarial assumptions.

Schedule of Employer Contributions*

Year Ended June 30	Actuarial Annual Required Contributions	Percentage Contributed
1999	$127,195,004	100%
2000	98,148,589	100
2001	78,459,360	100
2002	110,795,693	100
2003	181,236,112	100
2004	212,193,468	100

* The amounts reported in this schedule do not include contributions for postemployment health care benefits.

NOTE TO REQUIRED SUPPLEMENTARY SCHEDULES

Description of Schedule of Funding Progress

Each time a new benefit is added which applies to service already rendered, an "unfunded accrued liability" is created. Laws governing the System require that these unfunded accrued liabilities be financed systematically over a period of future years. Also, if actual financial experiences are less favorable than assumed financial experiences, the difference is added to unfunded accrued liabilities.

The Schedule of Funding Progress includes two ratios that provide information about whether the financial strength of the System is improving or deteriorating over time. An improvement is indicated when the funded ratio (assets expressed as a percentage of the actuarial accrued liability) is increasing and the ratio of the unfunded actuarial liability to payroll is decreasing.

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows:

Valuation date: June 30, 2004
Actuarial cost method: Entry age normal
Amortization method: Open basis as a level percent of active member payroll
Remaining amortization period: 30 years
Asset valuation method: 4 year smoothed market
Actuarial Assumptions:
Investment rate of return* - 8.25%
Projected salary increases* - 4.75% to 25.0%
Cost of living adjustments - 3% simple

*Includes inflation at 3.75%

SCHEDULE OF ADMINISTRATIVE EXPENSES FOR THE YEAR ENDED JUNE 30, 2004

	General Expenses	Investment Related Expenses	Total
Personnel Services			
Salaries	$ 8,079,581	$1,036,784	$ 9,116,365
Retirement contributions	1,058,521	138,442	1,196,963
Insurance	1,204,413	115,171	1,319,584
Total personnel services	10,342,515	1,290,397	11,632,912
Professional Services			
Medical	500,323	–	500,323
Technical	751,383	87,100	838,483
Actuarial	162,475	–	162,475
Auditing	142,332	–	142,332
Total professional services	1,556,513	87,100	1,643,613
Communications			
Postage	614,185	–	614,185
Telephone	133,712	–	133,712
Retirement counseling services	60,432	–	60,432
Printing and publications	264,180	–	264,180
Total communications	1,072,509	–	1,072,509
Other Services			
Computer support services	1,681,462	2,603	1,684,065
Equipment repairs and maintenance	101,053	–	101,053
Building occupancy and maintenance	896,785	–	896,785
Supplies	69,440	836	70,276
Employee training	142,840	20,504	163,344
Transportation and travel	137,918	95,872	233,790
Equipment rental	7,458	57,206	64,664
Property and fiduciary insurance	179,288	–	179,288
Memberships and subscriptions	62,152	15,583	77,735
Retirement study commission	49,765	–	49,765
Bank fees	166,501	–	166,501
Miscellaneous	47,442	5,285	52,727
Total other services	3,542,104	197,889	3,739,993
Total administrative expenses before depreciation	16,513,641	1,575,386	18,089,027
Depreciation (Non-Investment)			
Furniture and equipment	1,398,760	–	1,398,760
Building	1,269,741	–	1,269,741
Total depreciation	2,668,501	–	2,668,501
Total administrative expenses	$19,182,142	$1,575,386	$20,757,528

SCHEDULE OF INVESTMENT EXPENSES FOR THE YEAR ENDED JUNE 30, 2004

Description of Expense	Net Assets Under Management June 30, 2004	Direct Fees
US equity	$ 3,998,012,172	$ 8,318,174
Non-US equity	1,485,779,205	3,899,692
Private equity	125,538,825	5,661,375
Fixed income	1,854,493,030	3,068,256
Real estate	731,612,792	6,743,718
Short-term	80,585,146	–
Total investment management fees		27,691,215
Custody service fees		1,019,709
Master recordkeeper fees		1,027,401
Investment consultant fees		625,699
Investment pool administrative expenses (see page 33)		1,575,386
Total other investment expenses		4,248,195
Total investment expenses		$ 31,939,410

SCHEDULE OF PAYMENTS TO CONSULTANTS

SERS paid the following consulting fees in fiscal 2004:

Actuarial	$ 162,475
Audit	142,332
Legal counsel	257,753
Medical consultant	26,400
Information technology consultants	164,730
Health care consultants	61,647
Other consultants	354,353
Disability exams	473,923
Total	$1,643,613

Investment Section

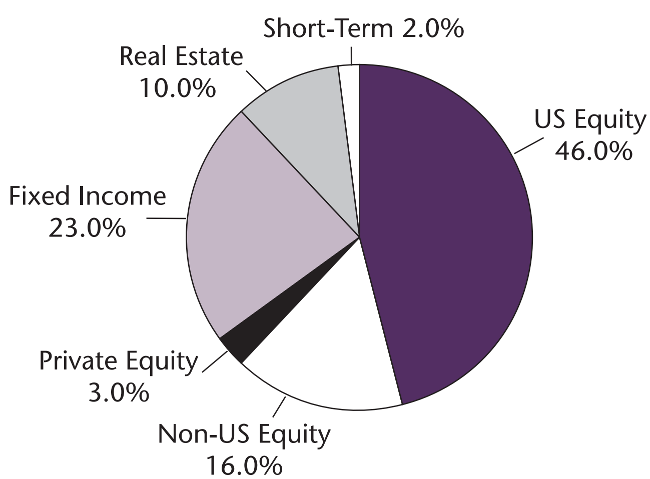
INVESTMENT SUMMARY AS OF JUNE 30, 2004

	Fair Value*	% of Total Fair Value	Target	Range
US Equity	$3,998,012,172	48.3%	46.0%	41% - 51%
Non-US Equity	1,485,779,205	18.0%	16.0%	11% - 21%
Private Equity	125,538,825	1.5%	3.0%	0% - 5%
Fixed Income	1,854,493,030	22.4%	23.0%	20% - 26%
Real Estate	731,612,792	8.8%	10.0%	5% - 15%
Short-Term	80,585,146	1.0%	2.0%	0% - 3%
Net Portfolio Value	$8,276,021,170	100.0%	100.0%	

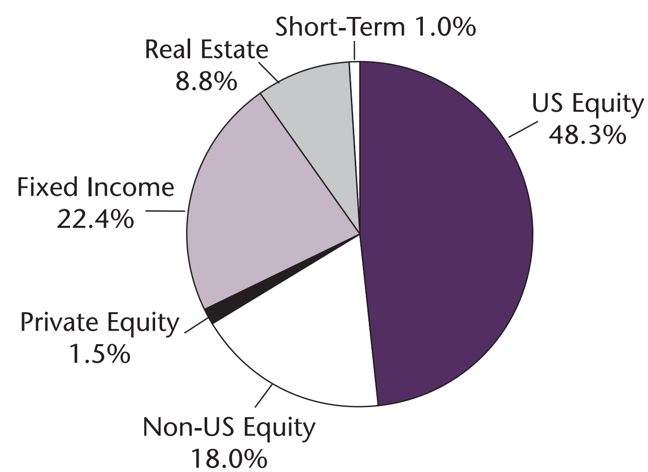
*Futures are reflected in fair value as follows:		Impact on Allocation:
Non-US Equity	$(27,872,406)	(0.34)%
Fixed Income	$29,413,500	0.36%
Short-Term	$(1,541,094)	(0.02)%

ASSET ALLOCATION – TOTAL FUND AS OF JUNE 30, 2004

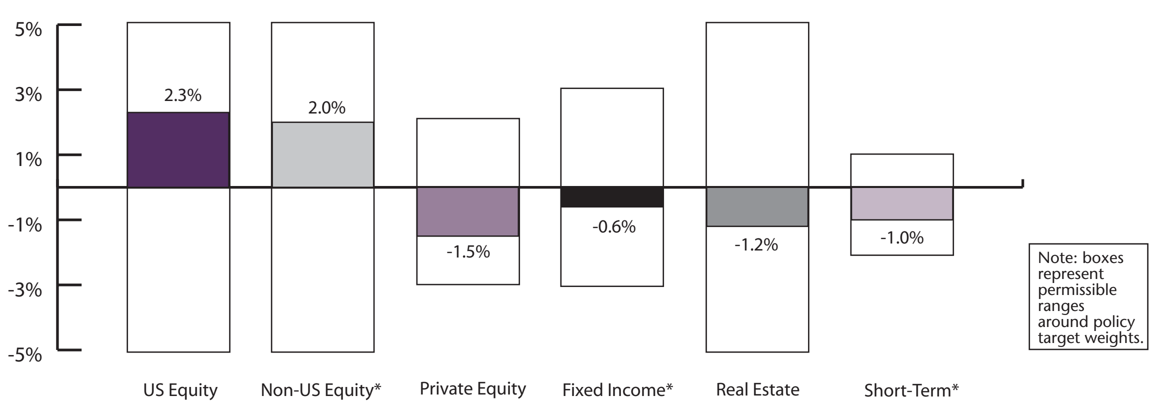
POLICY ALLOCATION



ASSET ALLOCATION



ASSET ALLOCATION VS. POLICY



*Non-US Equity, Fixed Income and Short-Term include futures.

School Employees Retirement System

JAMES R. WINFREE
Executive Director

300 EAST BROAD ST., SUITE 100 • COLUMBUS, OHIO 43215-3746 • (614) 222-5853

December 3, 2004

Board of Trustees
Members of the Retirement System

On behalf of the SERS Investment Department, I respectfully submit the Investment Section of the Comprehensive Annual Financial Report for the year ended June 30, 2004. Information in this section was compiled by our Investment Staff, members of SERS' Finance Department and Russell/Mellon Analytical Services.

US equities, Non-US equities and real estate each earned double digit returns during fiscal year (FY) 2004. Private equity and fixed income returns were also positive for the year, but the returns were lower than those generated by equities and real estate. Double digit returns generated by equities and real estate lead to a 16.5% return for the total fund.

In addition to the high investment returns, several important changes were made in SERS' Investment Department and the Total Fund during the year.

- Three new people were added to the Investment staff during the fiscal year to add depth to the Department.
- The Board approved terminating one Non-US equity manager and hiring twelve new Non-US equity managers to complete the diversification in that portfolio. These managers were funded shortly after the FY ended.
- The Board approved dismissing three US equity managers and hiring four new US equity managers during the year.
- The Board approved hiring three new private equity managers.
- The Board approved terminating one real estate manager and hiring one new real estate manager during the year.

Investment results provided by Russell/Mellon Analytical Services are made using a time-weighted rate of return methodology based on the market rate of return and are presented in a manner consistent with the Performance Presentation Standards of the CFA Institute, formerly known as the Association for Investment Management and Research (AIMR).

SERS' investment portfolio is diversified by asset class and by manager style. This disciplined investment approach should result in attractive long term results. The addition of personnel to the Department will provide the necessary depth and back up to our existing experienced staff. The Investment Staff appreciates the opportunity to work for the Retirement Board and its members. We take the responsibilities of the job very seriously and seek to maintain the confidence and respect of the Board and our members.

Respectfully,

Robert G. Cowman
Director of Investments

INVESTMENT REPORT

The Board of the School Employees Retirement System (SERS) of Ohio is responsible for managing the assets of the fund solely for the benefit of its participants and beneficiaries. Chapter 3309 of the Ohio Revised Code and the Board-adopted Investment Policy govern investment activity at SERS.

INVESTMENT POLICY

The purpose of SERS' statement of Investment Policy is to define its investment philosophy and objectives. The Policy establishes return objectives and risk tolerances within which the Fund is to be managed. The Policy goes on to define the responsibilities of the fiduciaries that implement the strategies and manage SERS' investment portfolio.

INVESTMENT OBJECTIVES

The primary objective of the investment portfolio is to achieve investment returns exceeding the weighted return of our investment policy portfolio within prudent risk parameters. On June 30, 2004, the composition of SERS' policy portfolio and its corresponding benchmark was as follows:

- 46% US Equities – Russell 3000 Index
- 16% Non-US Equities – MSCI-All Country World Ex-US Index
- 3% Private Equity – S&P 500 + 3%
- 23% Fixed Income – Lehman Brothers Aggregate Index
- 2% Short-Term – 30-day Treasury Bill
- 10% Real Estate – 80% NCREIF Property Index & 20% NAREIT Index

INVESTMENT STRATEGIES

Asset Allocation

No changes were made to the asset allocation structure during the fiscal year. SERS' investment consultant, the Frank Russell Company, conducted a formal asset liability study in FY 2003 and recommended maintaining the current asset allocation targets. Asset liability studies are generally conducted every three to five years unless the Board requests one to be done sooner. The next study is scheduled for FY 2006.

Diversification

Broad diversification within an investment portfolio is used to control the level of risk and volatility within the portfolio. SERS has broadly diversified the assets within its portfolios; and the strategies used in each portfolio also have been purposely diversified.

Besides the broad diversification of assets and strategies within SERS' portfolio, SERS also employs a diverse group of investment managers. The purpose of employing multiple managers within SERS' portfolio is to further reduce risk and volatility within the portfolio.

INVESTMENT PERFORMANCE

Long-Term Investment Performance

Long-term performance continues to compare quite favorably with the Fund's Policy Benchmark Return. Ten year performance for the period ended June 30, 2004, was a positive 9.5% which matched its Policy Benchmark Return for ten years. Three and five year returns for the Fund were ahead of the Policy Benchmark Returns.

The *Schedule of Investment Results* on the following page summarizes fund versus benchmark performance for the total fund and each asset class over selected periods.

Fiscal Year 2004 Results

Strong returns in the US equity, Non-US equity and real estate portfolios enabled SERS' Total Fund to return 16.5% for the fiscal year ended June 30, 2004. The return of the fund was slightly ahead of the Policy Benchmark Return for the Total Fund.

SCHEDULE OF INVESTMENT RESULTS FOR THE YEARS ENDED JUNE 30

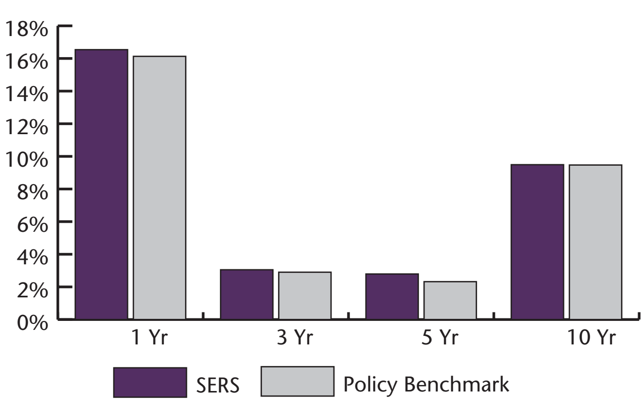
	2004	2003	2002	2001	2000	Annualized Rates of Return 3 Years	5 Years	10 Years
US Equity								
SERS (1)	21.4%	0.2%	(15.6)%	(15.4)%	11.6%	0.6 %	(0.7)%	11.5%
Russell 3000 Index	20.5	0.8	(17.2)	(13.9)	9.6	0.2	(1.1)	11.7
Non-US Equity								
SERS	27.6	(8.1)	(11.9)	(17.4)	18.4	1.1	0.2	–
Custom Non-US Equity Benchmark (2)	27.8	(8.7)	(12.9)	(18.8)	18.6	0.6	(0.2)	–
Private Equity								
SERS (3)	8.5	(18.0)	(30.9)	(32.7)	118.5	(13.1)	(0.7)	14.9
Custom Private Equity Benchmark (4)	38.1	(21.8)	3.3	(11.8)	11.4	1.5	0.4	15.5
Fixed Income								
SERS	1.3	11.1	9.1	12.5	4.8	7.1	7.7	7.7
Lehman Bros. Aggregate Bond Index	0.3	10.4	8.6	11.2	4.6	6.4	7.0	7.4
Real Estate								
SERS (5)	13.2	5.6	(1.2)	12.4	12.9	5.7	8.4	9.8
Custom Real Estate Benchmark (6)	13.2	6.6	6.4	12.0	11.2	8.7	9.9	10.5
Short-Term								
SERS (7)	1.0	1.3	2.6	9.1	5.6	1.6	3.9	4.7
Citigroup 30 Day Treasury Bill Index	0.9	1.4	2.3	5.2	4.9	1.5	2.9	3.9
Total Fund								
SERS (8)	16.5	1.8	(7.8)	(6.8)	12.1	3.1	2.8	9.5
Policy Benchmark (9)	16.1	1.7	(7.8)	(6.3)	9.7	2.9	2.3	9.5

Source: Russell/Mellon Analytical Services

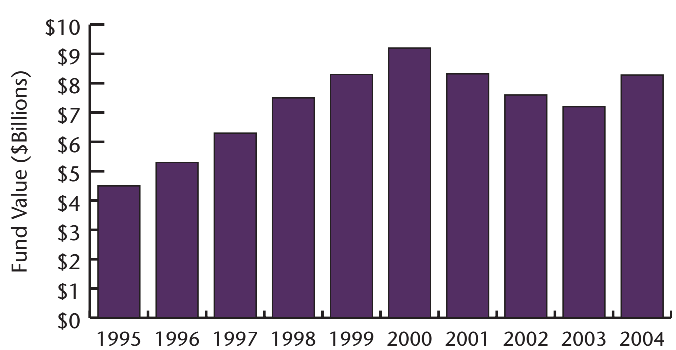
All returns are reported gross of fees, unless otherwise indicated, using a time-weighted rate of return methodology based on the market rate of return in accordance with the Performance Presentation Standards of the CFA Institute.

*See footnotes to table on page 48.

TOTAL FUND RATES OF RETURN VS POLICY BENCHMARK



TOTAL FUND AT FAIR VALUE



US EQUITY

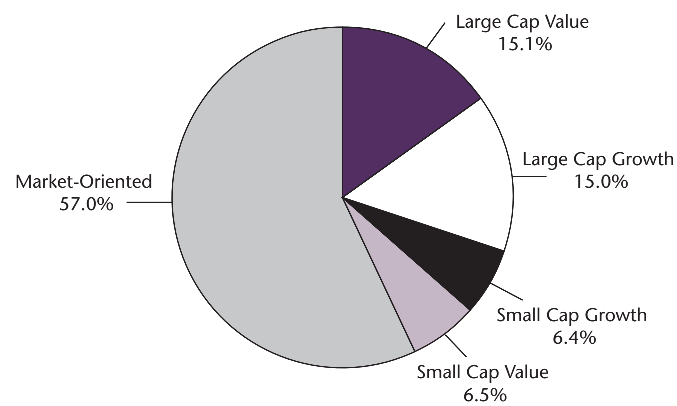
For the fiscal year ending June 30, 2004 the SERS US equity portfolio returned 21.36%, outperforming the benchmark Russell 3000 Index by 0.90%. On an annualized basis, the portfolio has outperformed its benchmark by 0.40% over the last three and five years.

The US equity market rose 20.46% this fiscal year compared to one year ago, when it gained only 0.77%. The US equity market surged forward as the Federal Reserve kept the federal funds rate at a 40 year low of 1% through June 2004. As a result, consumers supported the economy with housing and retail purchases. The markets experienced a slowdown during the spring of 2004 as problems continued with Iraq, oil prices surged and employment worries lingered. Small capitalization stocks outperformed large by 13.88% and value outperformed growth by 3.33% during the FY 2004.

In an effort to select the best external managers for the US equity portfolio while maintaining market size and style neutrality, SERS completed a restructuring of its large cap growth portfolio during September 2003. Staff began to implement the Board approved lower passive allocation by moving the passive allocation from 63% down to 57% by funding four new managers while terminating three. Staff has targeted a US equity passive allocation of 50% for the next fiscal year.

US EQUITY RETURNS

SMALL CAP VS LARGE CAP STOCKS



LARGEST INDIVIDUAL US EQUITY HOLDINGS AS OF JUNE 30, 2004

	Description	Shares*	Market Price	Fair Value
1	GENERAL ELECTRIC CO.	3,025,716	$32.40	$98,033,195
2	MICROSOFT CORP.	3,415,086	28.56	97,534,864
3	PFIZER, INC.	2,685,374	34.28	92,054,629
4	EXXON MOBIL CORP.	1,795,549	44.41	79,740,347
5	CITIGROUP, INC.	1,658,990	46.50	77,143,023
6	WAL-MART STORES, INC.	1,179,903	52.76	62,251,688
7	INTEL CORP.	2,208,010	27.60	60,941,062
8	BANK OF AMERICA CORP.	679,429	84.62	57,493,267
9	AMERICAN INTL GROUP, INC.	773,700	71.28	55,149,321
10	CISCO SYSTEMS, INC.	2,293,676	23.70	54,360,116

All monetary values stated in US Dollars.
A complete listing of holdings is available upon request.
**Includes shares owned directly and indirectly via commingled funds.*

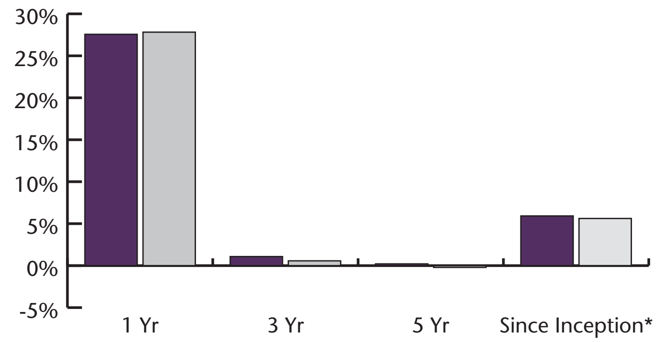
NON-US EQUITY

For the fiscal year ending June 30, 2004, SERS Non-US equity portfolio returned 27.6%, underperforming its policy benchmark (MSCI All Country World Excluding the US Index with developed countries 50% hedged) by 0.2%. On an annualized basis, the portfolio has outperformed its benchmark by 0.5% over the past three years, and outperformed its benchmark by 0.4% over the past five years.

During the fiscal year the economic recovery spread globally. Even the Japanese economy began to improve led by increased demand from the United States and China. As a result, investors began to return to the Japanese stock market which posted a 46.4% gain for the fiscal year. Higher energy prices and slower growth in China began to weigh on the global economy by the fourth quarter of the fiscal year, causing emerging markets stocks to post a negative return in that quarter. On an unhedged basis, stocks in developed markets rose 32.9% and those in emerging markets rose 33.5% for the fiscal year.

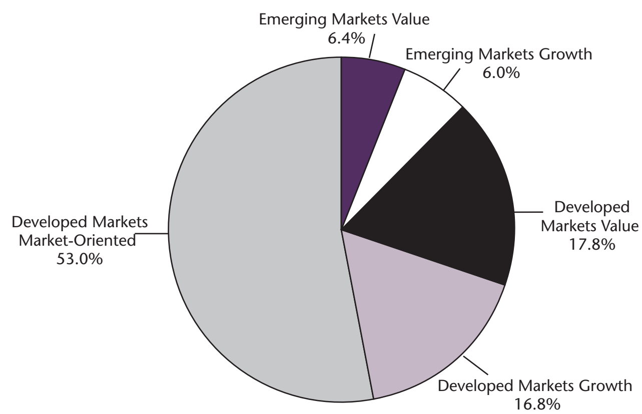
Value outperformed growth by 11.5% during the fiscal year. SERS maintained its style-neutral strategy through two portfolio rebalancings. Staff began to implement the Board approved lower passive allocation by lowering passive to 53.0% from 56.0% a year earlier and hiring six large cap (replacing one that was terminated in May), and six small cap developed markets managers. The new external managers were not funded until after the end of the fiscal year.

NON-US EQUITY RETURNS



*Inception date December 1994

NON-US EQUITY ALLOCATIONS



LARGEST INDIVIDUAL NON-US EQUITY HOLDINGS AS OF JUNE 30, 2004

	Description	Country	Shares*	Market Price	Fair Value
1	BP PLC	United Kingdom	2,702,821	$8.83	$23,870,622
2	VODAFONE GROUP PLC	United Kingdom	10,353,964	2.19	22,673,121
3	TOTAL FINA ELF SA	France	107,942	190.65	20,578,970
4	GLAXOSMITHKLINE PLC	United Kingdom	901,492	20.24	18,244,986
5	HSBC HOLDINGS PLC	United Kingdom	1,209,244	14.87	17,982,296
6	NESTLE SA	Switzerland	63,483	266.69	16,930,172
7	ROYAL DUTCH PETROLEUM	Netherlands	303,734	51.32	15,587,106
8	TOYOTA MOTOR CORP.	Japan	369,740	40.51	14,977,312
9	ENI SPA	Italy	729,706	19.86	14,488,845
10	CANON, INC.	Japan	245,754	52.70	12,950,449

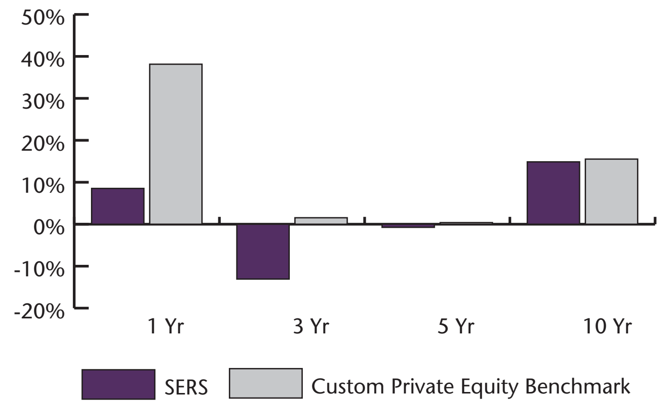
All monetary values are stated in US Dollars.
A complete listing of holdings is available upon request.
**Includes shares owned directly and indirectly via commingled funds.*

PRIVATE EQUITY

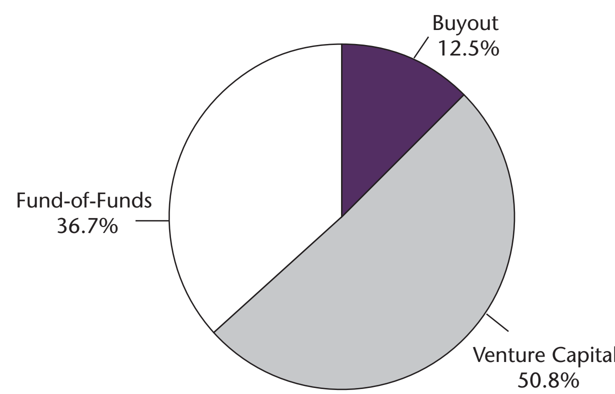
SERS invests in private equity to provide returns in excess of those provided by stocks, bonds, and real estate. Private equity consists of investments in venture capital limited partnerships, buyout limited partnerships, and other "non-public" investments. Private equity also includes investments in fund-of-funds, which invest in a diversified portfolio of venture capital, buyout limited partnerships, and other non-public investments.

SERS' target allocation to private equity is 3% of the total fund. As of June 30, 2004, SERS' private equity portfolio was $126 million, or 1.5% of the total fund. Total commitments to private equity were $519 million, of which $305 million remains to be funded. Over the past fiscal year, SERS targeted buyout funds in order to further diversify the types of businesses and to add more stable and mature companies to the portfolio. As the new commitments to the buyout funds are drawn down, the portfolio will become more evenly balanced between venture capital and buyout.

PRIVATE EQUITY RETURNS



ALLOCATION BY STRATEGY



LARGEST INDIVIDUAL PRIVATE EQUITY HOLDINGS AS OF JUNE 30, 2004

	Description	Fair Value
1	GS PRIVATE EQUITY PARTNERS 2000-MANAGER FUND, LP	$11,991,868
2	LINSALATA CAPITAL PARTNERS IV, LP	10,938,899
3	THE PEPPERTREE FUND, LP	10,364,164
4	PRIMUS CAPITAL V, LP	9,982,078
5	MORGENTHALER PARTNERS VI, LP	9,961,783
6	MORGENTHALER PARTNERS VII, LP	8,404,197
7	HORSLEY BRIDGE INTERNATIONAL FUND II, LP	8,188,704
8	HORSLEY BRIDGE FUND VII, LP	7,942,153
9	PRIMUS CAPITAL IV, LP	7,007,071
10	BRANTLEY VENTURE PARTNERS III, LP	6,642,678

All monetary values are stated in US Dollars.
A complete listing of holdings is available upon request.

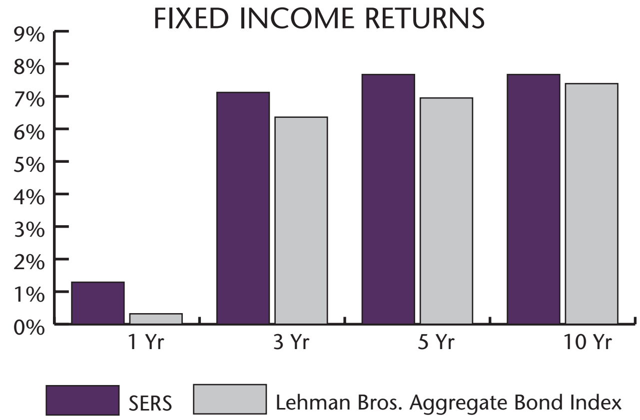
FIXED INCOME

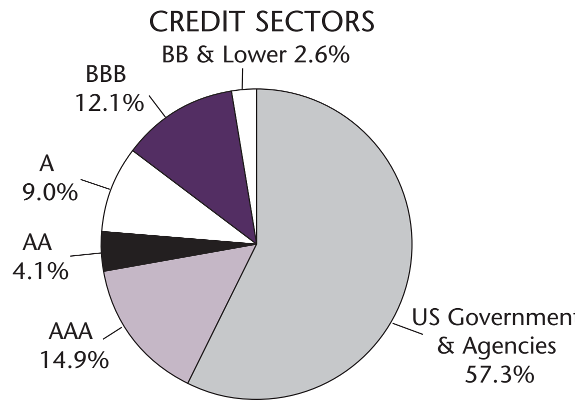
Characterized as an active core bond portfolio, the SERS fixed income portfolio is comprised principally of low-risk, high-quality debt securities. The portfolio is managed by a diverse group of active bond managers employing proven investment strategies to help SERS meet its goals and objectives.

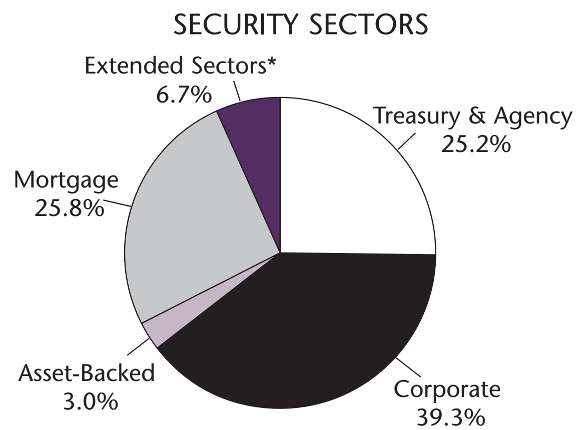
Fixed income returns paled in comparison to last year's double-digit performance. For the fiscal year ending June 30, 2004, SERS' fixed income portfolio outperformed the benchmark Lehman Aggregate Index by 97 basis points, returning 1.29% against the index return of 0.32%. Relative to the benchmark, SERS' Fixed Income Managers strategically tend to underweight government bonds (treasuries and agencies) and mortgage-backed securities; and overweight corporate bonds, commercial mortgages, asset-backed securities and private placements. The portfolio maintained an average S&P quality rating of AA- or higher.

Yields rose across the entire yield curve during the fiscal year, depressing bond prices and contributing to higher return volatility. Intermediate yields saw the greatest increase at nearly 150 basis points, while long term yields rose over 100 basis points. Managers generally were neutral-to-slightly defensive on duration, seeking whatever returns they could glean from rapidly tightening spreads in the corporate and ABS sectors. Extended sectors, which include high yield, emerging market, and non-dollar bonds, provided good relative returns throughout much of the year, but by year-end few sectors offered notable relative value.

Staff reorganized the fixed income portfolio during the second quarter of the fiscal year, allocating approximately 25% of the assets to intermediate duration mandates and roughly 40% to core plus mandates. No policy changes affecting total fixed income allocations occurred this fiscal year.







*High yield (rated BB and lower) corporate issues are included in Extended Sectors.

LARGEST INDIVIDUAL FIXED INCOME HOLDINGS AS OF JUNE 30, 2004

	Description	Rating	Shares/ Par Value	Market Price	Fair Value
1	GNMA TBA 5.0% 7/15/2034	AAA	$54,100,000	96.91	52,426,254
2	US TREASURY NOTES 2.5% 5/31/2006	AAA	$32,460,000	99.70	32,361,127
3	WELLINGTON TRUST CO. CORE BOND PLUS/MBS POOL	AAA	2,605,512	11.84	30,849,257
4	WESTERN ASSET MGMT OPPORTUNISTIC INTL INVESTMENT GRADE	AA	1,633,081	17.81	29,088,439
5	FNMA TBA 5.5% 7/1/2034	AAA	$23,000,000	99.53	22,892,176
6	US TREASURY NOTES 2.625% 5/15/2008	AAA	$21,430,000	96.89	20,764,513
7	US TREASURY NOTES 1.625% 3/31/2005	AAA	$20,000,000	99.84	19,967,200
8	US TREASURY NOTES 1.5% 2/28/2005	AAA	$20,000,000	99.83	19,966,420
9	US TREASURY NOTES 5.625% 5/15/2008	AAA	$18,000,000	107.67	19,380,942
10	US TREASURY BONDS 8.125% 8/15/2019	AAA	$14,340,000	131.00	18,785,400

All monetary values are stated in US Dollars. A complete listing of holdings is available upon request.

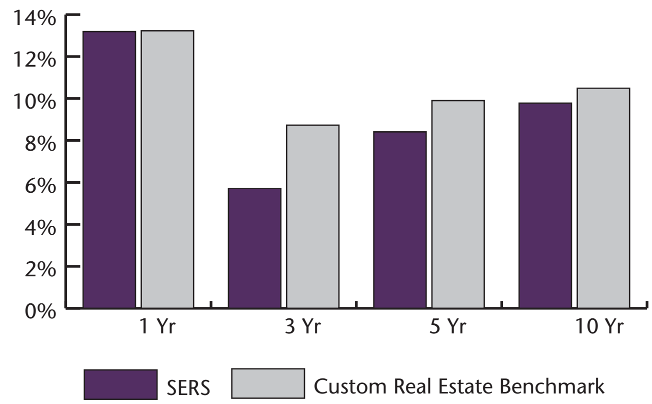
REAL ESTATE

SERS invests in real estate to provide stable long-term rates of returns and to diversify its assets in order to reduce total fund volatility. SERS' real estate portfolio consists primarily of investments in office buildings, shopping centers, apartment communities, and industrial parks as well as shares of publicly traded real estate investment trusts (REITs).

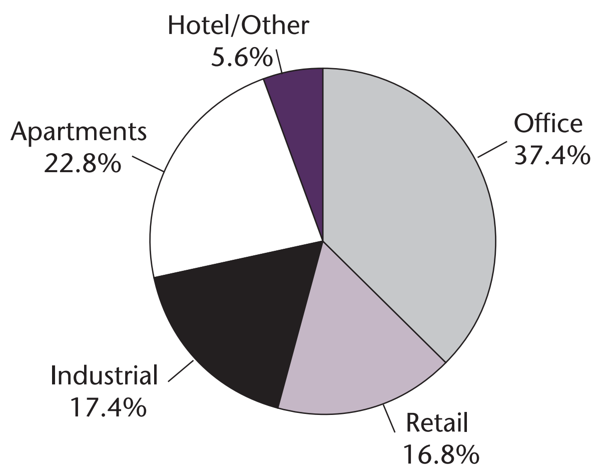
For fiscal 2004, private real estate assets as measured by the NCREIF Property Index (one quarter in arrears) returned 9.7%, consisting of 7.8% income and 1.9% appreciation. The real estate market recorded strong performance during fiscal 2004 led by the retail and apartment sectors. There was strong investor demand for properties during the period, especially for regional malls. Additionally, rental properties continued to provide stable income. REITs, as measured by the NAREIT Equity Index, returned 27.1% during fiscal 2004.

During the fiscal year, SERS' real estate portfolio produced a total return of 13.2% vs. the custom real estate benchmark of 13.2%. For three-, five-, and ten-year periods, the real estate portfolio produced annualized returns of 5.7%, 8.4%, and 9.8% respectively. All returns are reported one quarter in arrears.

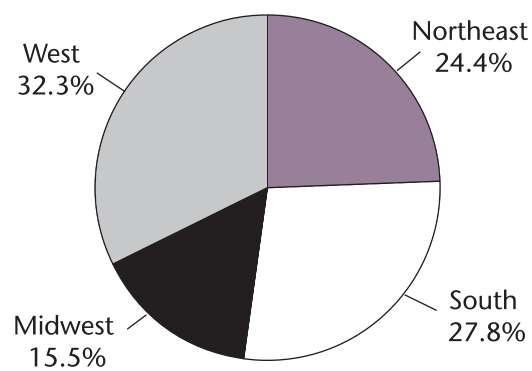
REAL ESTATE RETURNS



PROPERTY TYPE DIVERSIFICATION



REGIONAL DIVERSIFICATION



LARGEST INDIVIDUAL REAL ESTATE HOLDINGS AS OF JUNE 30, 2004

	Description	Fair Value
1	JP MORGAN STRATEGIC PROPERTY	$96,739,864
2	UBS REALTY SEPARATE ACCOUNT	91,561,198
3	ING CLARION LION PROPERTIES FUND	75,129,289
4	INVESCO REALTY	65,496,075
5	INVESCO TAKEOVER ACCOUNT	52,937,878
6	SENTINEL REAL ESTATE FUND	30,896,514
7	UBS REALTY ALLEGIS MULTIFAMILY TRUST	25,443,715
8	KOLL BREN V	21,207,341
9	KOLL BREN VI	21,075,735
10	JP MORGAN TAKEOVER ACCOUNT	20,509,905

All monetary values are stated in US Dollars.
A complete listing of holdings is available upon request.

INVESTMENT CONSULTANT & INVESTMENT MANAGERS

Investment Consultant

Frank Russell Company – Tacoma, WA

Investment Managers – US Equity

Aronson + Johnson + Ortiz – Philadelphia, PA
DePrince, Race & Zollo – Orlando, FL
Duncan-Hurst Capital Management, Inc. – San Diego, CA
Fuller & Thaler Asset Management – San Mateo, CA
Geewax, Terker & Co. – Chadds Ford, PA
Jacobs Levy Equity Management – Florham Park, NJ
Lord, Abbett & Co. – Jersey City, NJ
MacKay Shields Financial Corporation – New York, NY
Montag & Caldwell Investment Counsel – Atlanta, GA
State Street Global Advisors – Boston, MA
Transamerica Investment Management – Los Angeles, CA

Investment Managers – Non-US Equity

F&C Emerging Markets – London, England
Oechsle International Advisors – Boston, MA
Alliance Capital Management – New York, NY
State Street Global Advisors – Boston, MA

Investment Manager – Futures

Frank Russell Securities – Tacoma, WA

Investment Manager – Foreign Currency

State Street Global Advisors – Boston, MA

Investment Managers – Private Equity

Alpha Capital Partners – Chicago, IL
Blue Chip Venture Company – Cincinnati, OH
Brantley Partners – Cleveland, OH
CID Equity Partners – Indianapolis, IN
FS Equity Partners LP – Los Angeles, CA
Goldman Sachs & Co. – New York, NY
Horsley Bridge Partners – San Francisco, CA
J.P. Morgan Investment Management – New York, NY
Linsalata Capital Partners – Cleveland, OH
Morgenthaler Venture Partners – Cleveland, OH
Peppertree Partners – Cleveland, OH
Primus Venture Partners – Cleveland, OH
Swander Pace Capital Partners – San Francisco, CA
Transportation Resource Partners – Secaucus, NJ

Investment Managers – Fixed Income

BlackRock Financial Management – New York, NY
Dodge & Cox, Inc. – San Francisco, CA
Johnson Investment Counsel, Inc. – Cincinnati, OH
Weiss Peck & Greer Investments – New York, NY
Wellington Management Company – Boston, MA
Western Asset Management Company – Pasadena, CA

Investment Managers – Real Estate

AEW Capital Management – Boston, MA
CB Richard Ellis Investors – Los Angeles, CA
ING Clarion Real Estate – New York, NY
INVESCO Realty Advisors – Dallas, TX
J.P. Morgan Investment Management, Inc. – New York, NY
Koll Bren Schreiber Realty Advisors – Newport Beach, CA
Morgan Stanley US Real Estate – New York, NY
Sentinel Real Estate – New York, NY
UBS Realty Investors – Hartford, CT

Master Custodians

Huntington National Bank – Columbus, OH
State Street Global Advisors – Boston, MA

Master Recordkeeper

Mellon Bank – Pittsburgh, PA

Investment Analytics

Russell/Mellon Analytical Services – Pittsburgh, PA

SUMMARY SCHEDULE OF BROKERS' FEES FOR US EQUITY TRANSACTIONS FOR THE YEAR ENDED JUNE 30, 2004

Brokerage fees on US equity transactions for the fiscal year ended June 30, 2004:

Broker Name	Fees Paid	# of Shares Traded	Avg. Commission per Share
State Street Brokerage	$ 351,348	30,582,411	$ 0.011
Merrill Lynch, Pierce, Fenner and Smith, Inc.	349,898	8,205,416	0.043
Investment Technology Group, Inc.	310,820	23,255,930	0.013
B-Trade Services, LLC	257,192	9,699,327	0.027
Deutsche Banc Alex Brown, Inc.	175,498	9,097,681	0.019
Correspondent Service Corp.	157,727	4,459,662	0.035
Lehman Brothers, Inc.	122,761	3,322,173	0.037
Jefferies and Co.	105,422	3,043,523	0.035
Lynch, Jones and Ryan, Inc.	95,551	3,103,154	0.031
Bear Stearns and Co., Inc.	88,110	1,846,110	0.048
First Boston	87,759	1,883,933	0.047
Goldman Sachs and Co.	84,623	3,494,745	0.024
Smith Barney	81,576	2,389,970	0.034
Instinet	78,665	4,638,082	0.017
Prudential Equity Group	77,698	1,471,900	0.053
Weeden	77,695	3,021,290	0.026
Liquidnet, Inc.	67,519	3,375,960	0.020
Cantor Fitzgerald and Co.	67,480	2,707,982	0.025
Unterberg Harris	64,170	1,760,850	0.036
UBS Warburg, LLC	58,572	1,410,420	0.042
Legg, Mason, Wood, Walker, Inc.	51,784	1,053,055	0.049
Interra Clearing Services, Inc.	48,514	1,106,077	0.044
Morgan Stanley and Co., Inc.	45,065	3,135,444	0.014
Wave Securities, LLC	43,988	2,215,217	0.020
US Bancorp Piper Jaffray, Inc.	39,764	941,662	0.042
JP Morgan Securities, Inc.	38,919	2,256,100	0.017
Charles Schwab	33,906	821,165	0.041
Pacific Growth Equities	33,145	1,034,144	0.032
Knight Securities	32,487	1,144,635	0.028
Southwest Securities, Inc.	32,135	1,447,629	0.022
Miller, Tabak and Hirsch	30,766	1,069,860	0.029
Oppenheimer	30,434	665,655	0.046
Banc of America Securities	29,029	680,920	0.043
Cap Institutional Services, Inc.	28,352	796,500	0.036
First Union Capital Markets	26,534	585,790	0.045
Abel Noser Corp.	23,801	1,090,700	0.022
Bridge Trading Co.	22,446	460,814	0.049
McDonald and Co. Securities, Inc.	22,135	471,600	0.047
Robert W. Baird and Co., Inc.	22,052	521,450	0.042
Standard and Poors Securities, Inc.	21,032	426,900	0.049
Jones and Associates, Inc.	20,435	605,700	0.034
Brokers less than $20,000 (130)	576,509	16,162,118	0.036
Total US	$4,013,316	161,463,654	$ 0.025

SUMMARY SCHEDULE OF BROKERS' FEES FOR NON-US EQUITY TRANSACTIONS FOR THE YEAR ENDED JUNE 30, 2004

Brokerage fees on non-US equity transactions for the fiscal year ended June 30, 2004:

Broker Name	Fees Paid	# of Shares Traded	Avg. Commission per Share
Merrill Lynch International	$ 105,074	5,356,927	$ 0.020
Morgan Stanley and Co., Inc.	94,495	4,270,195	0.022
Citigroup Global Markets, Inc.	85,981	5,690,091	0.015
Goldman Sachs and Co.	74,202	12,150,207	0.006
Lehman Brothers, Inc.	52,004	2,946,319	0.018
ABN Amro Securities, Inc.	49,905	2,089,347	0.024
UBS Securities, Inc.	44,340	2,610,410	0.017
Credit Suisse First Boston Corp.	37,485	4,117,881	0.009
Deutsche Bank AG	36,442	2,626,311	0.014
Credit Lyonnais Securities	32,279	1,378,067	0.023
Dresdner Kleinwort Benson	31,436	1,794,682	0.018
UBS Warburg, LLC	20,400	1,297,456	0.016
Nomura International, PLC	16,750	1,580,540	0.011
Cantor Fitzgerald and Co.	16,241	968,515	0.017
JP Morgan Securities, Inc.	16,081	1,247,914	0.013
Cazenove and Co.	13,862	2,459,068	0.006
Pershing Securities, Ltd.	13,167	2,394,544	0.005
Warburg Dillon Read, Ltd.	12,671	872,532	0.015
Instinet Clearing Services, Inc.	12,321	1,730,000	0.007
Daiwa Securities, Inc.	11,689	575,648	0.020
Carnegie Fondkomission	9,190	431,092	0.021
Julius Baer	8,702	127,912	0.068
Main First Bank	8,355	101,861	0.082
Brockhouse & Cooper, Inc.	8,143	572,481	0.014
HSBC Securities, Inc.	7,306	939,299	0.008
ABG Securities, Inc.	6,589	311,035	0.021
Sanford C. Bernstein and Co., LLC	6,277	131,671	0.048
Mizuho Securities, Inc.	5,937	278,759	0.021
Kleinwort Benson Securities, Ltd.	5,487	489,486	0.011
CDC Ixis Securities	5,243	34,100	0.154
Credit Agricole Indosuez Cheuvreux	4,433	114,989	0.039
SG Cowen Securities Corp.	3,530	83,210	0.042
Svenska Handelsbanken	2,793	70,000	0.040
Banco Santander Central Hispano	2,785	57,639	0.048
ING Baring Securities	2,464	37,000	0.067
Chase Manhattan	2,402	34,647	0.069
BHF Securities Corp.	1,988	114,635	0.017
Scotia Capital, Inc.	1,851	53,400	0.035
SG Securities, Ltd.	1,346	98,061	0.014
Collins, Stewart and Co.	1,244	31,587	0.039
CI Nordic Securities AB	1,169	28,029	0.042
Brokers less than $1,000 (17)	6,240	708,600	0.009
Total Non-US	$ 880,299	63,006,147	$ 0.014

INVESTMENT NOTES

Investment Summary

Portfolio Type	Fair Value*	% of Total Fair Value
US Equity	$3,998,012,172	48.3%
Non-US Equity	1,485,779,205	18.0%
Fixed Income	1,854,493,030	22.4%
Real Estate	731,612,792	8.8%
Private Equity	125,538,825	1.5%
Short-Term	80,585,146	1.0%
Net Portfolio Value	$8,276,021,170	100.0%

Reconciliation to Statement of Plan Net Assets

Net Portfolio Value	$8,276,021,170
Accrued Income	120,272
Accounts receivable, securities sold	(445,840,460)
Accounts payable, securities purchased	685,289,221
Cash and STIF	(30,961,431)
Investments per Statement of Plan Net Assets	$8,484,628,772

*Futures are reflected in fair value as follows:		Impact on Allocation:
Non-US Equity	$(27,872,406)	(0.34)%
Fixed Income	$29,413,500	0.36%
Short-Term	$(1,541,094)	(0.02)%

INVESTMENT RESULTS

FOOTNOTES TO INVESTMENT RESULTS TABLE ON PAGE 39:

(1) This composite includes cash equitization as of November 1998. Prior to October 1994, the US Equity benchmark was the S&P 500.

(2) From inception to 7/97 100% MSCI EAFE (50% hedged); 8/97 to 6/99 96.7%MSCI EAFE (50% hedged) and 3.3% MSCI EMF; 7/99 to 12/99 93.3% MSCI EAFE (50% hedged) and 6.7% MSCI EMF; 1/00 to current 100% MSCI ACWF x/US (Dev Mkts 50% Hedged).

(3) Private Equity returns are reported one quarter in arrears beginning with quarter ending June 30, 2002. To implement quarter in arrears reporting, returns for private equity were recorded as zero for the quarter ending June 30, 2002.

(4) From inception to December 1999, the Custom Private Equity Benchmark consists of S&P 500 Index plus 500 basis points annualized. From January 2000 to current, Custom Private Equity Benchmark consists of S&P 500 Index plus 300 basis points annualized. Custom Benchmark is reported one quarter in arrears June 30, 2002 to current. Methodology change results in a 0% return for June 30, 2002.

(5) Real Estate composite returns are reported one quarter in arrears beginning with the quarter ending June 30, 2002. To implement quarter in arrears reporting, returns for private real estate assets were recorded as zero for the quarter ending June 30, 2002. Public Real Estate assets are reported in the current quarter.

(6) From inception to June 2002, the benchmark consisted of 100% NCREIF Property Index (arrears). Starting in July 2002, the benchmark consists of 80% NCREIF Property Index (arrears) and 20% NAREIT Index.

(7) For fiscal year 2001, the Short-Term return was impacted by cash flows from different asset classes in addition to overnight investments.

(8) Composite includes net of fee Real Estate and Venture Capital history prior to July 1, 1999. Real Estate and Private Equity classes are reported one quarter in arrears beginning with the quarter ending June 30, 2002. Total fund is impacted beginning June 30, 2002 with Real Estate and Private Equity March 31, 2002 market values impacted with flows for the quarter ending June 30, 2002.

(9) As of 07/01/02, the Policy Benchmark consists of: 46% Russell 3000, 16% MSCI AC World Free ex US (50% Hedged), 23% Lehman Brothers Aggregate, 10% SERS Real Estate Custom Benchmark , 3% S&P 500 + 300bps, 2% CitiGroup 30 Day T-Bill. For the quarter ended June 30, 2002, Private Equity Benchmark (one quarter in arrears) reflects 0% return.

INVESTMENT POLICY

PURPOSE

The purpose of this Statement of Investment Policy is to define the Retirement Board's investment philosophy and objectives for the School Employees Retirement System of Ohio. This statement sets forth policies and describes the organization and division of responsibilities to prudently implement the Board's philosophy and objectives in accordance with Section 3309.15 of the Ohio Revised Code. It also establishes the framework and specific objectives to monitor investment performance and proxy voting, and to promote effective communication between the Board, the Investment Staff, and Investment Managers.

The contents of this Statement of Investment Policy and the associated Guidelines and Objectives are subject to change at any time by the Board. The Statement will be reviewed and revised periodically to assure that it continues to reflect the attitudes, expectations and objectives of the Board.

BACKGROUND

The School Employees Retirement System of Ohio was established by the state legislature to provide retirement and disability benefits for all non-certificate holding persons employed by the state's school districts. This purpose is sustained by the member and employer contributions and returns realized from investment of those contributions.

INVESTMENT OBJECTIVES

1. Return Requirements

The Board realizes that its primary objective is to assure that the Fund meets its responsibilities for providing retirement and other benefits. In defining investment objectives the Board seeks to enhance the investment returns of the fund in order to permit higher benefits and to achieve lower costs. Therefore, it adopts the following general investment objectives:

a. Maximize Total Return on Assets: Recognizing that the System's obligations will increase as a result of inflation, to maximize the total return on assets available for the provision of benefits while operating in accordance with applicable regulatory restrictions and within prudent parameters of risk.

b. Preservation of Principal: To protect the System from severe depreciation in asset value during adverse market conditions. Broad diversification of assets and careful review of risks will be employed toward this objective.

c. Competitive Results: To achieve investment results competitive with those of the broad market and of similar funds. Over the long term, the investment objective of the Fund is to meet or exceed the actuarial assumed rate of return.

2. Risk Tolerance

The Board believes that over the long term there exists a relationship between the level of investment risk taken and rates of investment return realized. The Board further believes that the assumption of a moderate level of risk associated with investments is reasonable and justified in order to enhance potential long-term investment results. It shall always act to assure that the level of investment risk in the portfolio shall be prudent and shall not jeopardize the primary objective of assuring retirement and other benefits.

a. Stability: While the Board seeks higher long-term investment results, it also seeks to avoid major fluctuations in year-to-year results.

b. Risk Level: The Board seeks to maintain a reasonable degree of total portfolio risk, defined by what would be experienced by similar retirement systems.

The Board seeks diversification by asset class and by investment approach and individual investments within asset classes to reduce overall portfolio risk.

INVESTMENT CONSTRAINTS

1. Liquidity Requirements

The System anticipates positive cash flow over the near-term and intermediate-term. Liquidity, for the purpose of immediate and intermediate-term benefit payments, is therefore not a major consideration in the investment of funds for the foreseeable future.

2. Time Horizon

Retirement systems invest over the long term. The SERS time horizon is assumed to be 30 years.

3. Laws & Regulations

A seven-member board governs the System, including the Ohio Attorney General and State Auditor, with responsibility for the investment function as set forth in the Ohio Revised Code. In addition to the investment function, the Ohio Revised Code also sets forth the fiduciary responsibility of the Board and of other fiduciaries in discharging their duties with respect to the fund. This Statement of Investment Policy incorporates and is subject to all restrictions, guidelines and obligations set forth by the Ohio Revised Code.

4. Taxes

The SERS falls under IRS code 401(a) as a qualified retirement plan. Thus, under IRS code 501(a), SERS enjoys a tax-exempt status.

5. Unique Preferences and Circumstances

Ohio Investments: Where investment characteristics, including return, risk, and liquidity, are equivalent, the Board will give careful consideration to investments which will have a positive impact on the economy of Ohio.

IMPLEMENTATION APPROACH

In order to monitor and control the activities within the investment function, the Board has reserved certain responsibilities for itself. It has also delegated certain responsibilities to the Investment Staff, to organizations serving as Investment Managers and, from time to time, to other consultants or advisors. These are enumerated in the Investment Organization and Responsibilities section.

In fulfilling its fiduciary duties, the Retirement Board employs a competent and qualified Investment Staff. Investment Staff members are assigned oversight of professional external Investment Managers. These Investment Managers have expertise in the management of their specialized portions of SERS asset portfolio for which they are responsible. Criteria to be used in the selection of such Investment Managers are also enumerated in the Investment Organization and Responsibilities section. The Retirement Board authorizes the Investment Staff to direct funds in accordance with this investment policy.

The Board has also established a reporting process for regular and timely review and evaluation of investment results. The Asset Strategy Statement covers each asset class and each investment management accountability unit within those asset classes. This strategy also specifies long-term target ratios for asset allocation, as well as permissible ranges related to those target allocations. This Strategy Statement is regularly evaluated and updated based on market conditions, investment results and the recommendations of the Investment Staff, Investment Managers and other consultants or advisors.

INVESTMENT ORGANIZATION AND RESPONSIBILITIES

1. Responsibilities of the Retirement Board

The Retirement Board recognizes its responsibility to ensure that the assets of the Fund are managed effectively and prudently, in full compliance with all applicable laws, and for the exclusive benefit of participants and beneficiaries. The Board believes it can best manage those responsibilities by delegating certain specific duties to others, as described below. In addition, the Board may designate certain of its members to act as an Investment Committee or a Subcommittee from time to time, and may delegate certain decision-making or fact-finding responsibilities to that committee or subcommittee.

Specific responsibilities of the Retirement Board or its Investment Committee or Subcommittee are as follows:

a. Ensure that all fiduciaries comply with the Ohio Revised Code and any other applicable regulations and legislation.

b. Establish investment policies, guidelines and objectives for the assets of the Fund and communicate them to the Investment Staff and Investment Managers.

c. Appoint and discharge those with responsibility for managing the Fund's assets, including Investment Managers, consultants and any others involved.

d. Establish a proxy policy; review proxy governance issues and reports from the Investment Staff and Investment Managers at least annually.

e. Request, receive and review reports from the Investment Staff and Investment Managers.

f. Review and approve the Annual Plan.

2. Responsibilities of the Investment Staff

The Investment Staff, headed by the Executive Director and the Director of Investments, has the following responsibilities.

The Executive Director has the following responsibilities:

a. Obtain necessary reports on the investment results of the Fund's assets on a timely basis as specified in the Review and Evaluation section.

b. Retain any consultants or advisors deemed necessary or desirable for assistance in the investment of Fund assets, and for meeting his responsibilities.

c. Oversee the investment function.

The Director of Investments has the following responsibilities:

a. Administer the policies, guidelines and objectives adopted by the Retirement Board of the School Employees Retirement System of Ohio in compliance with the relevant sections of the Ohio Revised Code.

b. Inform and communicate to other Fund fiduciaries, including all Investment Managers, the requirements of the Ohio Revised Code and the policies, guidelines and objectives adopted by the Retirement Board including the proxy policy, and monitor their compliance.

c. Prepare and recommend an Annual Plan for the investment of the Fund's assets with recognition of the target asset mix ratios and the permissible ranges for asset allocation established by the Board.

d. Implement the Annual Plan, exercising the judgments allowed by the Board as to the asset allocation ranges for that year.

e. Report to the Board or its Investment Committee any intra-year changes in the Annual Plan, in the asset allocation among managers, or proposed changes in the policy, guidelines or objectives which the Investment Staff deems desirable or which are recommended by an Investment Manager or other consultants or advisors.

f. Oversee the activities of the Investment Staff.

3. Responsibilities of the Investment Managers

Each Investment Manager, including any Investment Staff member when internally managing assets, is responsible for the specified investment management accountability unit which it manages.

a. Manage the assets and the allocation of those assets within its control in compliance with the relevant sections of the Ohio Revised Code and with the policies, guidelines and objectives adopted by the Retirement Board.

b. Exercise investment discretion within the guidelines and objectives specified, including decisions to buy, hold or sell securities based on the manager's current investment strategy and outlook and compatible with such objectives.

c. Inform the Retirement Board or the Investment Committee of any substantial changes in investment strategy, portfolio structure, value of assets, and of any organizational changes, including that of ownership, affiliation, organizational structure, financial condition, or changes in professional personnel staffing the investment management organization.

d. Prepare reports for the Board or Investment Committee prior to any scheduled meetings but at least on a quarterly basis.

e. Recommend to the Board or Investment Committee any changes in policy, guidelines or objectives which the Investment Manager believes to be desirable.

4. Criteria for Investment Managers

In instances where the Retirement Board has determined it is desirable to employ the services of an outside Investment Manager, the following criteria shall be used in the selection of such firms:

a. Organizational Qualifications: To be selected, the organization shall be qualified to serve as a fiduciary to the System, shall comply with all applicable nondiscrimination and affirmative action requirements, shall adequately address potential conflicts of interest and shall have a history of professionalism and ethical performance.

b. Investment Approach: The approach utilized by the organization shall be compatible with the System's objectives and guidelines. It shall also be complementary to the System's other Investment Managers.

c. Personnel: The organization shall have an experienced professional staff with adequate research and support personnel and a credible program or history demonstrating the ability to retain key personnel.

d. Performance: The organization and/or its personnel shall have demonstrated the ability to achieve above average performance in implementing the investment approach for which it is being considered. Satisfactory client references shall also be available.

5. Responsibilities of the Custodian

By law, the custodian for the School Employees Retirement System Fund is the Treasurer for the State of Ohio. As custodian, the Treasurer may contract the custodian duties to one or more financial institutions. Each contracted Custodian is responsible for the management and accountability for the units that it manages.

a. Settle security trades as authorized by the Investment Managers and accurately record all transactions.

b. Safehold all assets within its control in compliance with the relevant sections of the Ohio Revised Code.

c. Capture and record all monies due SERS from investment activities and investment income.

6. Responsibilities of the Finance Director

The Finance Director has the following responsibilities:

a. Review of all policy, plan, guideline, and objective changes made in the Investment Department and report any anomalies, foreseeable problems, or conflicts to both the Investments Director and the Retirement Board.

b. Oversee financial staff in the recording and reconciliation of investment account records in relationship with our custodians.

c. Oversee financial staff in the recording and reconciliation of investment account records in relationship with our Investment Managers.

d. Report calculated performance of each investment account and the overall performance of the fund.

7. Responsibilities of the Investment Consultant

Serves as fiduciary to the Board for independent outside performance reviews, manager searches, assists in defining the investment objectives and policies, and makes recommendations concerning the structure and diversification of the investments within the public securities market. The consultant makes recommendations for US equities, non-US equities, fixed income, real estate and variations of such markets (tactical asset allocation, currency management, etc.).

REVIEW AND EVALUATION

The Board shall review and evaluate periodic reports on the investment results of the Fund's assets. In these reviews, it is intended that greater emphasis shall be given to long-term results than to short-term results. The following is the intended frequency for review and evaluation, although the Board, as deemed necessary, may alter these:

1. Quarterly

Summary Investment Reports – including highlights and commentary of investment performance, asset composition and holdings for each asset class and each investment management accountability unit. These reports shall identify any results requiring the attention of the Board.

Investment Policy was adopted September 2000.

Actuarial Section

Mellon

Human Resources & Investor Solutions

November 30, 2004

Board of Trustees
School Employees Retirement System of Ohio
300 East Broad Street
Columbus, OH 43215

Dear Board Members:

The basic financial objective of the School Employees Retirement System of Ohio (SERS) is to establish and receive contributions which when expressed in terms of percents of active member payroll will remain approximately level from generation to generation of Ohio citizens, and which when combined with present assets and future investment return will be sufficient to meet the present and future financial obligations of SERS.

In order to measure progress toward this fundamental objective, SERS has an actuarial valuation performed each year. The valuation (i) measures present financial position, and (ii) establishes contribution rates that provide for the current cost and level percent of payroll amortization of the unfunded actuarial accrued liability over a reasonable period. The valuation performed as of June 30, 2004 indicates that a contribution rate of 10.57% of payroll for 123,139 school employees meets the basic financial objective.

The statutory employer contribution is 14% of pay. A SERS policy decision now provides the following allocations of that contribution:

- to basic benefits, the post-retirement death benefit and the Medicare Part-B supplement, the portion which will pay normal cost and 30 year amortization of unfunded actuarial accrued liabilities; and

- to health care benefits, the remainder of employer contributions.

The actuarial valuation of the basic benefits, the post-retirement death benefit and the Medicare Part-B supplement is based upon financial and participant data which is prepared by Retirement System staff, assumptions regarding future rates of investment return and inflation, and rates of retirement, turnover, death, and disability among SERS members and their beneficiaries. The data is reviewed by us for internal and year-to-year consistency as well as general reasonableness prior to its use in the actuarial valuations. It is also summarized and tabulated for the purpose of analyzing trends. The assumptions were adopted by the Board of Trustees and were based upon actual experience of SERS during the fiscal years 1996-2000. Assets are valued according to a method that fully recognizes expected investment return and averages unanticipated market return over a four-year period. The assumptions and methods utilized in this valuation, in our opinion, meet the parameters established by Governmental Accounting Standards Board Statement No. 25.

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Board of Trustees
School Employees Retirement System of Ohio
November 30, 2004
Page 2

The financial condition of health care benefits is different and is being significantly affected by the provisions of Act 290 of 1988 and Act 270 of 2001. Act 290 established a health care surcharge, a program to determine a minimum annual pay for use in calculating employer contribution dollars. Act 270 placed limits on the amount of health care surcharge that can be assessed to each employer and in total.

On the basis of projections of health care fund activity and the surcharge limit established by Act 270, the allocated contributions are insufficient in the long-term to provide for a health care reserve equal to at least 150% of estimated annual claim costs, the funding target established by the Board in 1995. As of June 30, 2004, the value of the health care fund was equal to about 135% of total health care costs incurred during the year ending on that date.

The current benefit structure is outlined in the Plan Summary. There have been no changes made since the last valuation.

We provided information used in the schedules of Actuarial Accrued Liabilities, Active Member Valuation Data, Retirees and Beneficiaries Added to and Removed From Rolls, Analysis of Financial Experience, and the Short-Term Solvency Test for basic benefits that are found in the Actuarial Section, and the Schedule of Funding Progress in the Financial Section. For fiscal years prior to June 30, 2002, the information was provided by the previous actuary.

Based upon the results of the valuation of the basic benefits, the post-retirement death benefit and Medicare Part-B supplement, it is our opinion that the School Employees Retirement System of Ohio continues in sound condition in accordance with actuarial principles of level percent of payroll financing.

Sincerely yours,

Thomas J. Cavanaugh, FSA, FCA, MAAA, EA
Principal, Consulting Actuary

Philip Bonanno, MAAA, EA
Director, Consulting Actuary

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ACTUARIAL COST METHOD AND ASSUMPTIONS

The following methods and assumptions used for the actuarial valuation were adopted by the Retirement Board after consulting with the actuary. The actuarial assumptions used in the valuation were revised as set forth in the Gabriel, Roeder, Smith & Company Review of Actuarial Assumptions dated June 15, 2001 and were adopted for use in the valuation as of June 30, 2001. All historical information and data shown in this report with a valuation date prior to June 30, 2002 were obtained from the previous actuary's, Gabriel, Roeder, Smith & Company, valuation report.

Basic Retirement Benefits

Employer contribution rates for basic benefits are determined using the entry age normal actuarial cost method. This method produces an employer contribution rate consisting of (1) an amount for normal cost (the estimated amount necessary to finance benefits earned by employees during the current service year), and (2) the amount for amortization of the unfunded actuarial accrued liability. The maximum statutory rate is 14%.

The present employer contribution rate of 14% is allocated between basic benefits and health care on the basis of SERS' policy decision. For the year ended June 30, 2004, the policy required the determination of a rate for basic benefits which will amortize the unfunded actuarial accrued liabilities over a 30-year period, with the remainder of the employer contribution rate allocated to providing health care benefits. The rate determined for the funding of basic retirement benefits for the year ended June 30, 2004 is 9.09%.

Health Care Benefits

Initially, in 1974, the contribution rate for health care benefits was established at 0.75%, included in a total employer contribution rate of 12.5%. Health care contribution rates have since been increased at various times, and the total employer contribution rate has been increased to the statutory 14% maximum. The portion of the employer contribution rate allocated to health care for the year ended June 30, 2004 is 4.91%. Effective with the 1995 fiscal year, the Retirement Board replaced the level cost financing of health care with pay-as-you-go financing. To provide program security and stability, the asset target level for the health care fund is 150% of annual health care claims. For 2004, this resulted in a health care reserve of $300.9 million versus a targeted level of $335.2 million.

In 1988, House Bill 290 provided for an employer contribution surcharge as an additional source of funding for health care. The surcharge is equal to 14% of the difference between the minimum pay and the member's pay, pro-rated for partial service credit. For the fiscal year 2004, the minimum pay has been established as $24,500. The surcharge, added to the unallocated portion of the 14% employer contribution rate, provides for maintenance of the asset target level for the health care fund. Senate Bill 270, effective April 2001, caps the employer surcharge at 2.0% of each employer's payroll and 1.5% statewide.

Actuarial Assumptions

Differences between assumed and actual experience (actuarial gains and losses) become part of unfunded actuarial accrued liabilities. When these differences between assumed and actual experience have been observed to be sizable and persistent, a change is made to the actuarial assumptions.

Actuarial value of assets as of June 30, 2004 is based on a four-year average of adjusted market value returns. The difference between the actual returns at market value for the year and expected returns is determined. Twenty-five percent (25%) of that difference is added to the expected value along with corresponding amounts from each of the prior three years.

The following significant assumptions were used in the actuarial valuation as of June 30, 2004.

(1) A rate of return on the investments of 8.25% compounded annually (net after all System expenses) is assumed. The real rate of return is the portion of total investment return which is more than the inflation rate. Considering inflation recognition of 3.75 percent, the 8.25 percent investment return rate translates to an assumed real rate of return of 4.5 percent.

(2) Salary increases of 4.25%, attributable to wage inflation, are projected and compounded annually.

(3) Additional projected salary increases ranging from .5% to 20.75% per year are attributable to senior-

ity and merit. Pay increase assumptions for individual active members are shown for service durations in the following table.

Years of Service	Merit & Seniority	Salary Inflation	Total
0	20.75%	4.25%	25.00%
1	13.25	4.25	17.50
2	10.75	4.25	15.00
3	8.75	4.25	13.00
4	7.75	4.25	12.00
5	5.75	4.25	10.00
6	4.75	4.25	9.00
7	3.75	4.25	8.00
8	2.75	4.25	7.00
9	1.75	4.25	6.00
10-14	0.75	4.25	5.00
15+	0.50	4.25	4.75

(4) Eligibility for service retirement was assumed to be: age 50 with 30 or more years of service, age 55 with 25 or more years of service, or age 60 with 5 or more years of service. Representative values of the assumed annual rates of service retirement are as follows.

Age	Male	Female
50	45%	36%
55	30	27
60	11	23
65	35	30
70	25	38
75	100	100

(5) Rates of separation from active service are for reasons other than retirement, disability or death. Representative values of the assumed annual rates of withdrawal are as follows.

Years of Service	Rate of General Termination
0	50.00%
1	24.00
2	14.00
3	9.00
4	8.00
5	7.50
10	4.25
15	2.50
20	1.75

(6) Representative values of the assumed annual rates of disability are as follows.

Age	Male	Female
30	.15%	.10%
35	.49	.10
40	.54	.21
45	.67	.25
50	1.10	.52
55	1.10	.810

(7) Mortality Rates for retirees and survivors are based on the 1994 Group Annuity Mortality Table with male ages set back three years and female ages set back one year. Mortality for active members is 70% of the retiree table for males and 55% for females. Mortality for disabled members is developed from experience.

Representative values of the assumed annual rates of retiree mortality are as follows.

Service Retired Members, Beneficiaries and Survivors
1994 Group Annuity Mortality Table (-3,-1)

Age	Male	Female
20	.043%	.028%
30	.072	.033
40	.089	.065
50	.188	.131
60	.558	.386
70	1.803	1.270
80	4.517	3.536

Disability Retired Members

Age	Male	Female
40	2.257%	.745%
50	2.897	1.153
60	4.204	2.183
70	6.258	3.763
80	10.937	7.231

Marriage Assumption: 80% married with the husband three years older than his wife.

Valuation Method: Entry Age Normal cost method. Entry age is established on an individual basis.

(8) As a result of cost-of-living adjustments, benefits will increase 3% per year after retirement.

ACTUARIAL ACCRUED LIABILITIES

Accrued liabilities are the present value of plan promises to pay benefits in the future, based upon service already rendered. A liability has been established (accrued) because the service has been performed, but the resulting monthly cash benefit may not be payable until years in the future.

Accrued liabilities are the result of complex mathematical calculations performed by a group of specialists, the plan's actuaries. The results of the computed actuarial accrued liabilities, using the entry age normal actuarial cost method, are disclosed in the following schedule.

Actuarial Accrued Liabilities June 30, 2004

Present value of:	Basic Pension	Medicare Part B	Death Benefit	Total
Future benefits to present retirees and survivors	$ 4,955,868,846	$ 197,050,568	$ 20,346,277	$ 5,173,265,691
Monthly benefits and refunds to present inactive members	328,805,454	7,433,213	982,868	337,221,535
Allowances to present active members:				
Service	5,329,566,877	84,734,930	4,518,232	5,418,820,039
Disability	356,887,110	3,835,256	564,403	361,286,769
Survivor benefits	77,293,312	283,597	—	77,576,909
Refunds	(122,340,545)	4,984,028	64,849	(117,291,668)
Total AAL for active members	5,641,406,754	93,837,811	5,147,484	5,740,392,049
Total AAL	$10,926,081,054	$ 298,321,592	$ 26,476,629	$11,250,879,275

ACTIVE MEMBER VALUATION DATA

Actuarial Valuation as of June 30	Number of Active Members	Annual Payroll (millions)	Average Annual Salary	% Increase in Average Salary
1999	110,175	$ 1,768.1	$ 16,048	3.8%
2000	113,811	1,866.3	16,398	2.1
2001	115,684	1,974.1	17,064	4.0
2002	120,254	2,175.7	18,093	6.0
2003	122,315	2,302.3	18,823	4.0
2004	123,139	2,394.1	19,442	3.3

RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

	Added to Rolls		Removed from Rolls		Rolls at end of year		Percent increase	Average
Year	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	in Annual Allowances	Annual Allowances
1999	4,127	$ 24,975,211	3,058	$ 2,665,604	56,632	$ 350,581,393	6.8%	$ 6,191
2000	4,647	29,849,378	3,455	3,775,345	57,824	376,655,426	7.4	6,514
2001	4,051	30,406,522	3,080	2,555,087	58,795	404,506,861	7.4	6,880
2002	4,468	31,076,560	3,914	3,366,365	59,349	432,217,056	6.9	7,283
2003	4,131	31,177,197	3,481	2,182,240	59,999	461,212,013	6.7	7,687
2004	4,300	32,500,992	3,730	2,094,156	60,569	491,618,849	6.6	8,117

ANALYSIS OF FINANCIAL EXPERIENCE

Gains & Losses in Accrued Liabilities Resulting From Differences Between Assumed Experience & Actual Experience

	Gain/(Loss) For Year In Millions					
Type of Risk Area	**2003**	**2002**	**2000**	**1999**	**1998**	**1997**
Age & Service Retirements If members retire at older ages than assumed, there is a gain. If younger ages, a loss.	$ (29.7)	$ 41.5	$ 27.4	$ 24.4	$ 20.1	$ (8.1)
Disability Retirements If disability claims are less than assumed, there is a gain. If more claims, a loss.	(0.3)	0.2	0.5	2.7	(0.2)	(2.4)
Death-In-Service Benefits If claims costs are less than assumed, there is a gain. If more claims, a loss.	(0.3)	1.6	(0.4)	(0.7)	(0.0)	0.6
Pay Increases If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	28.0	(151.3)	(22.8)	47.3	50.5	76.1
Investment Return If there is greater investment return than assumed, there is a gain. If less return, a loss.	(781.4)	(533.6)	465.6	487.7	486.6	256.1
Withdrawal If more liabilities are released by other separations from active membership than assumed, there is a gain. If smaller releases, a loss.	38.8	(9.8)	(5.7)	(18.0)	(20.0)	3.1
New Members Additional unfunded accrued liability will produce a loss.	(37.1)	(38.6)	*	*	*	*
Death After Retirement If retirees live longer than assumed, there is a loss. If not as long, a gain.	30.0	44.1	14.4	1.0	(1.3)	(1.4)
Other Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	(24.7)	35.5	(136.2)	(84.6)	(75.9)	(34.2)
Non-Recurring Items Adjustments for plan amendments, assumption changes, or method changes.	31.7					
Total Gain/(Loss) During Year	$(745.0)	$(610.4)	$342.8	$459.8	$459.8	$289.8

* Included in "Other" risk area prior to 2002.
2001 data not available.

SHORT-TERM SOLVENCY TEST

The SERS financing objective is to pay for the benefits through contributions that remain approximately level from year to year as a percent of member payroll.

If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due - the ultimate test of financial soundness. Testing for level contribution rates is the long-term test.

A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets (cash and investments) are compared with:

1) Active member contributions on deposit;

2) The liabilities for future benefits to present retired lives;

3) The liabilities for service already rendered by active members.

In a system that has been following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) will be partially covered by the remainder of present assets. The larger the funded portion of liability 3, the stronger the condition of the system. Liability 3 being fully funded is rare.

Basic Benefits ($ In Millions)

June 30	(1) Member Contributions	(2) Retired Lives	(3) Present Members (Employer Portion)	(4) Valuation Assets	(1)	(2)	(3)
1999	$1,341	$3,469	$2,725	$7,332	100%	100%	93%
2000	1,429	3,734	2,937	8,281	100	100	106
2001	1,407	4,294	3,555	8,791	100	100	87
2002	1,525	4,599	3,862	8,879	100	100	71
2003	1,643	4,881	4,110	8,772	100	100	55
2004	1,785	5,173	4,293	8,667	100	100	40

Statistical Section

ADDITIONS BY SOURCE

Table I

Fiscal Year	Employer Contributions	Member Contributions	Other Revenues	Investment Income/(Loss)	Total
1999	$283,227,401	$166,864,847	$3,170,634	$ 865,332,342	$1,318,595,224
2000	303,129,460	179,646,558	3,194,230	949,985,546	1,435,955,794
2001	331,307,417	192,563,026	2,660,220	(632,419,714)	(105,889,051)
2002	337,924,392	210,098,081	4,780,142	(646,957,544)	(94,154,929)
2003	370,314,918	225,014,540	3,968,047	95,819,531	695,117,036
2004	391,440,663	258,131,243	4,007,479	1,151,401,043	1,804,980,428

DEDUCTIONS BY TYPE

Table II

Fiscal Year	Benefits	Refunds	Administrative Expenses	Transfers to other Ohio Retirement Systems	Total
1999	$507,255,292	$22,177,533	$14,491,266	$3,444,287	$547,368,378
2000	528,461,302	22,332,580	15,716,748	4,123,815	570,634,445
2001	617,167,500	21,817,451	16,004,407	4,198,302	659,187,660
2002	634,202,580	19,212,728	18,386,076	4,414,555	676,215,939
2003	687,618,942	19,575,616	19,289,261	4,885,777	731,369,596
2004	714,415,180	22,090,604	19,182,142	6,251,974	761,939,900

PAYMENTS BY TYPE

Table III

Year Ending June 30	Service Benefits	Disability Benefits	Survivor Benefits	Health Care Expenses	Death Benefits and Refunds	Total
1999	$317,125,829	$44,116,363	$18,127,793	$126,380,984	$23,681,856	$529,432,825
2000	321,397,961	46,244,407	18,315,432	140,696,340	24,139,742	550,793,882
2001	381,682,104	50,904,070	21,128,389	161,439,934	23,830,454	638,984,951
2002	376,557,926	52,236,511	20,556,083	182,946,777	21,118,011	653,415,308
2003	403,666,557	55,023,480	21,970,746	204,930,737	21,603,038	707,194,558
2004	435,492,573	58,173,009	23,053,354	195,496,097	24,290,751	736,505,784

NUMBER OF BENEFIT RECIPIENTS BY TYPE

Table IV

Years Ending June 30	Service	Disability	Survivor	Total
1999	47,959	4,859	3,814	56,632
2000	48,956	4,975	3,893	57,824
2001	49,776	5,052	3,967	58,795
2002	50,253	5,091	4,005	59,349
2003	50,840	5,126	4,033	59,999
2004	51,323	5,180	4,066	60,569

NUMBER OF BENEFIT RECIPIENTS

Table V

Amount of Monthly Benefit	Service	Disability	Survivor	Total
$ 1 — 250	20,115	1,019	2,109	23,243
251 — 500	11,850	1,169	1,093	14,112
501 — 750	7,391	962	499	8,852
751 — 1,000	4,359	719	183	5,261
1,001 — 1,500	4,430	805	117	5,352
1,501 — 2,000	1,768	324	39	2,131
over 2,000	1,410	182	26	1,618
	51,323	5,180	4,066	60,569

RETIREMENT AVERAGES

Table VI

Service Retirement

Year Ending June 30	Service Credit	Monthly Amount	Age	Salary
1999	21.505	$716.38	63.68	$19,419
2000	21.957	761.47	63.51	20,230
2001	22.128	851.00	62.31	21,125
2002	22.414	892.11	62.28	22,065
2003	22.189	915.76	62.20	22,965
2004	22.452	957.36	62.44	24,132

Disability Retirement

Year Ending June 30	Service Credit	Monthly Amount	Age	Salary
1999	16.014	$ 897.75	56.28	$20,252
2000	16.058	1,004.00	55.85	21,807
2001	20.124	1,123.46	52.35	21,668
2002	21.210	1,047.52	52.24	22,637
2003	21.439	1,126.90	52.72	24,557
2004	20.780	1,090.08	52.45	24,096

SCHEDULE OF AVERAGE BENEFIT PAYMENTS

Table VII

Retirement Effective Dates July 1, 1998 to June 30, 2004	Years Credited Service 5-9	10-14	15-19	20-24	25-29	30+
Period 7/1/98 to 6/30/99						
Average Monthly Benefit	$ 214	$ 286	$ 472	$ 631	$ 797	$1,470
Average Final Average Salary*	1,005	1,271	1,501	1,558	1,655	2,301
Number of Retirees	201	337	349	352	689	406
Period 7/1/99 to 6/30/00						
Average Monthly Benefit	$ 238	$ 287	$ 483	$ 677	$ 805	$1,496
Average Final Average Salary*	995	1,270	1,562	1,690	1,685	2,322
Number of Retirees	192	356	403	389	780	518
Period 7/1/00 to 6/30/01						
Average Monthly Benefit	$ 306	$ 308	$ 522	$ 707	$ 887	$1,670
Average Final Average Salary*	1,030	1,335	1,593	1,674	1,756	2,474
Number of Retirees	190	326	358	399	696	526
Period 7/1/01 to 6/30/02						
Average Monthly Benefit	$ 156	$ 333	$ 560	$ 752	$ 958	$1,653
Average Final Average Salary*	1,057	1,368	1,690	1,747	1,895	2,426
Number of Retirees	162	313	355	351	666	548
Period 7/1/02 to 6/30/03						
Average Monthly Benefit	$ 148	$ 317	$ 552	$ 755	$ 983	$1,780
Average Final Average Salary*	1,015	1,373	1,686	1,811	1,988	2,663
Number of Retirees	204	285	328	346	618	533
Period 7/1/03 to 6/30/04						
Average Monthly Benefit	$ 168	$ 370	$ 572	$ 809	$1,011	$1,731
Average Final Average Salary*	1,192	1,611	1,777	1,941	2,037	2,612
Number of Retirees	207	284	336	318	606	613

* Final average salary is presented on a monthly basis for ease of comparison.

NUMBER OF PARTICIPATING EMPLOYERS

Table VIII

Year	Total	Educational Service Centers	Local School Districts	City School Districts	Exempted Village Districts	Higher Education	Vocational/ Technical Schools	Community Schools	Other
1999	760	61	370	193	49	14	50	17	6
2000	795	60	372	192	49	14	51	51	6
2001	821	59	371	194	49	14	51	77	6
2002	853	62	371	194	49	14	50	107	6
2003	871	61	371	194	49	14	50	126	6
2004	883	61	371	194	49	14	50	138	6

PLAN SUMMARY

Purpose

The School Employees Retirement System of Ohio was established in 1937 by the state legislature to provide retirement and disability benefits for all non-certificated persons employed by the state's 883 school districts and community schools. This purpose is sustained by the member and employer contributions and the income realized from investment of those contributions.

Administration

The administration of SERS is supervised by a seven member Board which works in conjunction with the System's Executive Director. Four of the seven Board members are elected by the general membership (those who contribute to SERS) and one is elected by retirees. The Ohio Attorney General and State Auditor, by virtue of their elected office, serve as the remaining two Board members in an ex officio capacity.

The Executive Director is appointed by the Board. This person oversees the administrative operation of the System, and is aided by six directors. Their areas of responsibility are finance, legal and legislation, investments, member services, health care, and information technology.

Employer Participation

The school employers served by SERS include public schools within the state's cities, villages and counties, as well as local districts, vocational and technical schools, community schools, and The University of Akron.

Employers contribute to SERS at the rate of 14.0% of payroll. Some employers pay the System directly on a monthly, quarterly, or annual basis, while others make payments through participation in the Ohio Department of Education's School Foundation Fund.

In addition to forwarding appropriate contribution amounts to SERS, it is the responsibility of the employers to supply SERS with new membership records, members' contribution information, and any data needed at the time of a member's application for benefits or refund of deposits on termination of employment.

Employee Participation

Membership in SERS is divided into several groups based on the activity of a member's SERS account. Member groups are:

A. Active Members - These are persons currently employed by a school employer. Membership is required for most employees working in a position that does not require certification by the Ohio Department of Education. These persons include clerical workers, maintenance personnel, bus drivers, food service workers, playground supervisors, data processing personnel, etc. Two exceptions to the membership requirements are: (1) persons with student status within a school district may choose to become members of SERS; and (2) temporary employees for emergency purposes. Active members have an amount equal to 10.0% of their earnings deducted from their gross salaries for each payroll period. These amounts are then forwarded to SERS by the payroll officer and applied to the member's account at SERS.

B. Inactive Members - These are persons who have contributions on deposit with SERS, but are not currently employed by a school district in the state of Ohio.

C. Retired/Disabled Members - These are persons who have either (1) met the age and service requirements for retirement from service; or (2) become eligible to receive benefits as a result of an injury or illness that prevents the member from performing regularly assigned duties.

D. Member's Survivors - When a member dies before retirement, the qualified beneficiaries become eligible for monthly benefits from SERS.

Refund of Contributions

A member is entitled to a full refund of contributions with SERS upon termination of school employment. Only the money the member has contributed is refundable.

In accordance with the Ohio Revised Code, there is a 90-day waiting period after the member's last day of service before the refund can be paid. A refund cancels any claim to benefits offered by SERS.

The refunded amount, plus interest, may be redeposited if, at some later date, the member returns to school service or to any other public service with the state of Ohio. This purchase may be made after the member has been credited with 1.5 years of contributing service.

Service Retirement

Members may retire from school employment if they have attained one of three combinations of age or service:

1. Five years of service and age 60; or
2. Twenty-five years of service and age 55; or
3. Thirty years of service at any age.

A member's age is defined to be the actual age a person has reached on the day of retirement. Any change of the date of birth on our records must be substantiated by submitting proof of date of birth to the System.

Service Credit

Service credit is the actual number of years or fraction thereof a person worked within a school district or districts in Ohio schools, plus any other free or purchased service the System recognizes.

Free service is service for which no contributions are required. This includes military service performed while on leave from the school district; and service granted for a period (three years or less) spent off the district's payroll while drawing state worker's compensation for a school job-related accident.

Purchased service is service for which payment plus interest is required. The interest rate is 7.5%. Service must be purchased before the date of retirement if it is to be considered in calculating the member's benefits. Payment may be made in a lump sum, in multiples of one month or more, or by tax deferred payroll deduction. The types of service that can be purchased are:

Military - A member may purchase up to five years of credit in SERS for active service in the armed forces of the U.S. There is no restriction placed on time elapsed between school employment and the time spent in the military.
A member may purchase additional service credit if the military service includes prisoner of war time. Purchased credit may not be greater than the member's actual Ohio contributing credit.

Federal, Other State, or School Service - The member may purchase credit for service rendered in a school or government position outside the State of Ohio. The service cannot be greater than the member's contributing service nor can it exceed five years.

Refunded Service - Service lost due to the payment of a refund may be restored after the member has returned to work and accrued 1.5 years of service covered by SERS, State Teachers Retirement System (STRS), Ohio Public Employees Retirement System (OPERS), Ohio Police & Fire Pension Fund (OP&F), or State Highway Patrol Retirement System (SHPRS). An interest charge is payable in addition to the restored funds.

Compulsory Service - This is service for which the member should have made contributions while working, but did not, for whatever reason.

Optional Service - This is service during a period when the member was given a choice of contributing. The member must pay back contributions and may be responsible for the employer’s share.

Leave of Absence - A member returning to work after a period of authorized leave may purchase service credit for the period involved. An employer contribution is required for this service to be granted, but the employer is under no obligation to make payment.

A member who has contributions not only at SERS, but also at STRS or OPERS is eligible to receive transferred credit from either or both of those systems. Any service which is not concurrent with (served at the same time as) SERS service will be included in determination of retirement benefits.

Early Retirement Credit

Employers may purchase up to five years of service credit for their eligible employees under an early retirement incentive plan authorized by 1983 legislation.

Adoption of a plan is optional and only employers may purchase up to five years of such credit.

Benefit Calculation

The final average salary is the average of the member's highest three years of earnings while in the school service.

The benefit amount is calculated in this way:

The final average salary amount is multiplied by 2.2% to determine the value of a year of service credit. The formula is 2.5% for credit over 30 years. This value cannot be less than $86. If it is, $86 is used. The value is then multiplied by the number of years of service credit. This calculation yields the annual retirement benefit amount for a person who is 65 at retirement time.

For "early retirement" (the member is under age 65 or has less than 30 years of service) there is a corresponding percentage of decrease in the benefit amount to allow for an extended period of retirement. Reduction factors are required by Ohio state law.

Retirement Options

Should the retiring member wish to provide a benefit amount for a beneficiary upon the retiree's death, this may be done by the selection of one of the optional retirement plans provided for this purpose. Optional plans may be altered by the retired member should the beneficiary die before the retiree or in the event of a divorce, with consent of the ex-spouse or a court order.

Disability Retirement

A member prevented from performing regular duties on the job after incurring an injury or illness may apply for monthly disability benefits. To qualify, the member must have at least 5 years of service credit. In addition to the age and service requirements, the member must:

- Have developed the disabling illness or injury after last becoming a member of SERS;
- Have been recommended for approval by a SERS-sponsored medical review board;
- Have applied for benefits within 2 years of the last day of service with the school district;
- Not have withdrawn contributions or retired on service retirement.

There are two disability plans with differing benefits. All new members are under the new plan. Benefits range from 30% of final average salary to 75%. Benefits are lifetime under the old plan, subject to re-examination; and may be converted to service retirement under the new plan.

Death Benefits

The designated beneficiary of any SERS retiree will receive a $1,000 lump sum payment upon the retiree's death. If there is no beneficiary, payment is made to the person responsible for the burial expenses or to the retiree's estate.

Survivor Benefits

Qualified dependents of a deceased member may apply for monthly survivor benefits. Such benefits are payable if the member had at least 18 months of Ohio service credit, three of which were served in the 2.5 years prior to the member's death, or if the member was receiving a disability benefit.

If the member was eligible for service retirement but had not yet applied for benefits, the surviving spouse or other single dependent beneficiary of any age can draw a monthly lifetime benefit known as the joint survivor option.

Health Care and Other Benefits

Eligible benefit recipients currently receive medical insurance from SERS. SERS reserves the right to change or discontinue any health plan or program.

Coverage for a spouse and/or dependent children can be provided by means of a monthly deduction from the benefit. Coverage is offered by the selection of the Aetna or Medical Mutual plans, AultCare, or HMOs available in certain counties.

If the benefit recipient participates in Medicare B, SERS reimburses the recipient $45.50 per month.

A prescription drug program is available to benefit recipients of SERS and their dependents who are covered under one of the health plans. Participants may either choose to obtain prescription drugs from a participating local pharmacy and pay 20% of the cost or they may elect to receive the drugs by mail from a licensed mail order pharmacy for a minimal fee per medication.

Members retiring after June 1, 1986 must have 10 or more years of service credit to qualify for the health care benefits.

All benefit recipients enrolled in one of the health plans pay a monthly premium. The premium ranges from 15% to 100% of the cost, depending upon qualified years of service credit.

Cost of Living Increases

After 12 months on the benefit rolls, and each year thereafter, SERS retirees are entitled to an automatic cost of living increase of 3%. In addition, the legislature has granted several permanent ad hoc increases to SERS retirees, the last such increase being in 1988.

Re-Employed Retirees' Annuity

Ohio public system retirees who work in a SERS covered position are entitled to an annuity at age 65. The annuity is based on a money purchase formula and may be paid in monthly payments if the monthly amount is $25 or more. If the monthly amount is less than $25, the annuity will be paid in a lump sum.

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