ILLINOIS STATE BOARD OF INVESTMENT

An Internal Investment Pool of the State of Illinois

Financial Statements
June 30, 2010
(With Independent Auditors' Report Thereon)
Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

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An Internal Investment Pool of the State of Illinois

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Financial Statement Report

Summary

The audit of the accompanying financial statements of the Illinois State Board of Investment (ISBI) was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the ISBI's basic financial statements.

McGladrey

Independent Auditor's Report

Honorable William G. Holland
Auditor General
State of Illinois

Board of Trustees
Illinois State Board of Investment:

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statements of Net Assets of the Illinois State Board of Investment (ISBI), an internal investment pool of the State of Illinois, as of June 30, 2010 and June 30, 2009, and the related Statements of Changes in Net Assets for the years then ended, as listed in the table of contents. These financial statements are the responsibility of the ISBI's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ISBI's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the ISBI and do not purport to, and do not present fairly the financial position of the State of Illinois as of June 30, 2010 and June 30, 2009, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the ISBI as of June 30, 2010 and June 30, 2009, and the changes in net assets for the years 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 our report dated January 12, 2011 on our consideration of the ISBI's internal control over financial reporting and 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 accompanying Management's Discussion and Analysis is not a required part of the basic financial statements but is 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 required supplementary information. However, we did not audit the information and express no opinion on it.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 12, 2011

Management's Discussion and Analysis

In October 1969, the Illinois State Board of Investment (ISBI or Board) was created by enactment of Article 22A of the Illinois Pension Code by the 76th General Assembly of Illinois. By statute, the Board was given the responsibility for management of the assets of the General Assembly Retirement System, the Judges' Retirement System of Illinois and the State Employees' Retirement System of Illinois. Board membership consists of five members appointed by the Governor and four ex officio members consisting of the State Treasurer and the Chairman of the Board of Trustees of each of the retirement systems. The Board maintains their office in Chicago, IL.

The following Management Discussion and Analysis (MD&A) provides an introduction and overview of the Illinois State Board of Investment (ISBI or Board) financial activities for the fiscal years ended June 30, 2010 and 2009.

Financial Highlights

The net assets of the Board totaled approximately $9.7 billion at fiscal year end June 30, 2010. The increase from the previous year is primarily the result of receiving $809 million in new funding as well as investment gains.

General Market Risk

ISBI is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on ISBI's investment portfolio depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact ISBI's financial condition. The readers of these financial statements are advised that financial markets continue to be volatile and are experiencing significant changes on almost a daily basis.

Overview of the Financial Statements

The Board's financial statements are prepared on an accrual basis in accordance with U. S. generally accepted accounting principles promulgated by the Governmental Accounting Standards Board and are comprised of the Statement of Net Assets, the Statement of Changes in Net Assets, and Notes to Financial Statements.

The Statement of Net Assets presents information on the Board's assets and liabilities and the resulting net assets. This statement also reflects the Board's investments along with the cash and short-term investments, receivables, and other assets and liabilities.

The gain in investments at June 30, 2010 is a result of an investment gain of 9.1% for the fiscal year, net of expenses which are shown in the Statement of Changes in Net Assets. The decrease in liabilities for fiscal 2010 compared with 2009 consisted mainly of a decrease in unsettled investment purchases as well as a decrease in the securities lending cash collateral obligation.

The Statement of Changes of Net Assets presents information regarding changes during the fiscal year ended June 30, 2010. This statement reflect additions and deductions, which include the investment income and losses derived from realized and unrealized gains/losses, member system contributions, and income received from securities lending activities. Also reflected in the statement are deductions, which include withdrawals from the member systems and operating expenses of the Board.

Condensed Summary of Net Assets

	June 30			2010/2009	2009/2008
	2010	2009	2008	Change	Change
	$	$	$	$	$
Cash	3,594,060	12,662,039	43,667,005	(9,067,979)	(31,004,966)
Receivables	68,431,963	186,099,275	187,106,001	(117,667,312)	(1,006,726)
Investments	9,665,737,091	8,735,057,063	11,429,528,114	930,680,028	(2,694,471,051)
Securities lending collateral	997,638,887	1,395,768,802	1,703,959,890	(398,129,915)	(308,191,088)
Prepaid Expenses	21,269	16,184	16,242	5,085	(58)
Capital Assets	50,391	57,635	52,797	(7,244)	4,838
Total assets	10,735,473,661	10,329,660,998	13,364,330,049	405,812,663	(3,034,669,051)
Liabilities	1,056,769,859	1,645,606,726	2,049,276,888	(588,836,867)	(403,670,162)
Total net assets	9,678,703,802	8,684,054,272	11,315,053,161	994,649,530	(2,630,998,889)

The net investment gains for the year ended June 30, 2010 were the result of upward movement in the securities markets. There was an increase in withdrawals by the member systems. Fiscal year 2010 withdrawals were $661.0 million compared with $277.0 million in fiscal year 2009. Withdrawals are determined by the member retirement systems based on the State's funding and the systems' benefit payment needs. The decrease in administrative expenses for fiscal year 2010 compared to 2009 was accomplished by across the board budget cuts in ISBI operating expenses and a decrease in investment management fees due to the renegotiation of fees with various investment managers and the decrease in the number of investment managers retained.

The net investment losses for the year ended June 30, 2009 were the result of a downward movement in the securities markets. The decrease in liabilities for fiscal 2009 compared with 2008 consisted mainly of a decrease in security lending collateral obligations and a decrease in unsettled investment purchases.

The Notes to the Financial Statements provide additional information, which is necessary to fully understand the data provided in the financial statements.

Condensed Statement of Changes in Net Assets

	Fiscal Years Ended June 30			2010/2009	2009/2008
	2010	2009	2008	Change	Change
	$	$	$	$	$
Additions:					
Net investment income (loss)	883,932,935	(2,312,726,206)	(695,792,364)	3,196,659,141	(1,616,933,842)
Member systems' contributions	809,401,372	-	-	809,401,372	-
Total additions	1,693,334,307	(2,312,726,206)	(695,792,364)	4,006,060,513	(1,616,933,842)
Deductions:					
Member systems' withdrawals	661,000,000	277,000,000	499,500,000	384,000,000	(222,500,000)
Administrative expenses	37,684,777	41,272,683	41,850,636	(3,587,906)	(577,953)
Total deductions	698,684,777	318,272,683	541,350,636	380,412,094	(223,077,953)
Increase (decrease) in net assets	994,649,530	(2,630,998,889)	(1,237,143,000)	3,625,648,419	(1,393,855,889)

Statement of Net Assets

JUNE 30, 2010

	2010	2009
	$	$
ASSETS		
Cash	3,594,060	12,662,039
Receivables:		
Foreign taxes	3,603,072	3,368,678
Accounts receivable	516,790	1,557,303
Investments sold	35,345,547	154,225,236
Interest and dividends	28,966,554	26,948,058
Total receivables	68,431,963	186,099,275
Prepaid expenses	21,269	16,184
Capital assets	50,391	57,635
Investments at fair value:		
Government and agency obligations	810,739,312	665,018,889
Foreign obligations	44,409,906	33,237,090
Corporate obligations	925,668,388	668,047,761
Common stock and equity funds	2,857,144,559	2,610,218,733
Commingled funds	270,510,642	335,484,184
Preferred stock	517,676	286,429
Foreign equity securities	1,733,177,670	1,482,594,431
Foreign preferred stock	179,924	47,856
Hedge funds	917,854,201	880,939,190
Real estate funds	750,210,957	875,929,700
Private equity	542,441,291	450,491,810
Money market instruments	270,231,935	235,126,490
Infrastructure funds	320,293,041	305,969,947
Bank loans	222,623,999	197,259,098
Forward foreign currency contracts	(266,410)	(5,594,545)
Total investments	9,665,737,091	8,735,057,063
Securities lending collateral	997,638,887	1,395,768,802
Total assets	10,735,473,661	10,329,660,998
LIABILITIES		
Payables:		
Investments purchased	40,837,912	173,277,766
Administrative expenses	5,816,888	5,077,999
Securities lending cash collateral obligation	1,010,115,059	1,467,250,961
Total liabilities	1,056,769,859	1,645,606,726
Net assets	9,678,703,802	8,684,054,272

See notes to financial statements, pages 7-19.

Statement of Changes in Net Assets

JUNE 30, 2010

	2010	2009
	$	$
ADDITIONS		
Investment income (loss):		
Net increase (decrease) in fair value of investments	634,013,226	(2,592,469,141)
Interest and other	128,588,561	145,432,334
Dividends	114,725,819	116,732,339
Securities lending income	6,125,355	28,308,215
Securities lending rebates	1,206,593	(8,690,202)
Securities lending expenses	(726,619)	(2,039,751)
Total investment income (loss)	883,932,935	(2,312,726,206)
Member systems' contributions	809,401,372	-
Total additions	1,693,334,307	(2,312,726,206)
DEDUCTIONS		
Administrative expenses:		
Salaries and benefits:		
Salaries	1,366,941	1,132,442
Benefits	579,934	514,691
Operating expenses:		
Rent and utilities	164,672	167,845
Audit	151,830	144,600
Other	210,664	244,346
External support:		
Custody	251,248	264,532
Consulting and professional	1,270,019	1,329,476
Investment advisors/managers	33,540,400	37,272,541
Investment services and research	149,069	202,210
Total expenses	37,684,777	41,272,683
Member systems' withdrawals	661,000,000	277,000,000
Total deductions	698,684,777	318,272,683
Increase (decrease) in net assets	994,649,530	(2,630,998,889)
Net assets at beginning of year	8,684,054,272	11,315,053,161
Net assets at end of year	9,678,703,802	8,684,054,272

See notes to financial statements, pages 7-19.

Note 1
Summary of Significant Accounting Policies

Reporting Entity
The Illinois State Board of Investment (ISBI or Board) is considered to be an internal investment pool of the State of Illinois, operating solely from investment income. The ISBI manages and invests the pension assets of three separate public employee retirement systems: General Assembly Retirement System, the Judges' Retirement System of Illinois, and State Employees' Retirement System of Illinois.

The assets of the member systems are accounted for in a single Commingled Fund. Separate information on each system's participation is presented in Note 3.

Basis of Accounting
Accounting records are maintained on an accrual basis. Units are allocated monthly to member systems based upon percentage of ownership. Management expenses are deducted monthly from income before distribution.

Valuation of Investments
Investments owned are reported at fair value as follows: (1) U.S. Government and Agency, Foreign and Corporate Obligations, Convertible Bonds – prices quoted by a major dealer in such securities; (2) Common Stock and Equity Funds, Preferred Stock, Foreign Equity Securities, Forward Foreign Currency Contracts and Options: (a) Listed – closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter – bid prices; (3) Money Market Instruments – average cost which approximates fair values; (4) Real Estate Investments – fair values as determined by ISBI and its investment managers; (5) Alternative Investments (Private Equity, Hedge Funds and Infrastructure Funds) – fair values as determined by ISBI and its investment managers; (6) Commingled Funds – fair values as determined by ISBI and its investment managers.

Investment Transactions and Investment Income
Investment transactions are accounted for on a trade date (date order to buy or sell is initiated) and dividend income is recognized on the ex-dividend date. Interest income is recognized on an accrual basis.

Custody and Investment Management Fees
ISBI has contracted with Investment Managers approved by the Board of Trustees to make investment decisions based on investment guidelines provided to them by ISBI staff and consultants. The Investment Managers serve as Investment Advisors to ISBI. ISBI pays an investment management fee to each Investment Manager for these services on a quarterly basis. The investment management fee is based upon contractual agreement provisions and is computed as a percentage of each manager's portfolio market value.

Management fees paid to real estate funds and private equity funds are calculated based upon the terms of each individual fund agreement and are reported in Investment Income on the Statement of Changes in Net Assets. Management fees paid to hedge funds, infrastructure funds, commingled funds and bank loan funds are calculated based on each manager's portfolio market value or ISBI's capital commitment and are reported as Investment Manager/Advisor Fees on the Statement of Changes in Net Assets.

There are no base charges for custody fees. Custody fees paid to State Street are paid based on set quarterly amounts per the Custodian Contract for performance and analytics services and various accounting data interface feeds.

Risk Management
The ISBI, as part of the State, provides for risks of loss associated with workers' compensation and general liability through the State's self-insurance program. The ISBI obtains commercial insurance for fidelity and surety and property. There have been no commercial insurance claims in the past five years.

Risks and Uncertainties
ISBI invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Statement of Net Assets.

Use of Estimates

In preparing financial statements in conformity with U. S. generally accepted accounting principles, the Board makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates and assumptions and the differences may be material.

The determination of fair value for illiquid/alternative investments, such as investments in real estate and private equity funds, takes into account consideration of a range of factors, including but not limited to the price at which the underlying investments were acquired, the nature of the underlying investments, local market conditions, trading values on public exchanges for comparable underlying investments, current and projected operating performance of the underlying investments, and financing transactions subsequent to the acquisition of the investment. Determining fair value of such investments involves a significant degree of judgment by ISBI and its fund managers.

Because of the inherent uncertainty of the above referenced fair values, the estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

Compensated Absences

The liability for compensated absences consists of unpaid, accumulated vacation and sick leave balances for ISBI employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments, and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary and includes salary related costs (e.g., social security and Medicare tax). The liability is included in the Administrative expenses payable on the Statement of Net Assets and the annual increase or decrease in the liability is reflected in the Salaries expense on the Statement of Changes in Net Assets.

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

Subsequent Events

ISBI has evaluated subsequent events for potential recognition and/or disclosure through January 12, 2011, the date the financial statements were available to be issued.

Note 2
Deposits, Investments, and Investment Risk

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, ISBI's deposits may not be returned. All non-investment related bank balances at year-end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. As of June 30, 2010 and 2009, ISBI had non-investment related bank balances of $34,557 and $184,259. Cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of $250,000. During fiscal year 2007, a Credit Risk Policy was implemented by ISBI staff and formally adopted by the Board in July of 2007. The Policy outlines the control procedures used to monitor custodial credit risk. These assets are under the custody of State Street Bank and Trust. State Street Bank and Trust has an AA- Long-term Deposit/Debt rating by Standards & Poor and an Aa2 rating by Moody. Certain investments of ISBI with maturities of 90 days or less would be considered cash equivalents; these consist of short-term investment funds and U. S. Treasury bills with maturities of 90 days or less, which are not subject to the custodial credit risk. For financial statement presentation and investment purposes, ISBI reports these types of cash equivalents as Money Market Instruments in the Statement of Net Assets. As of June 30, 2010 and 2009, ISBI had investment related bank balances of $3,630,043 and $12,440,740, respectively. These balances had no exposure to custodial credit risk due to participation in the FDIC's Transaction Account Guarantee Program.

Investment Policy

ISBI's investment authority and responsibilities are specified in the Illinois Compiled Statutes, 40ILCS 5/22A. These statutes provide ISBI with the authority to manage and invest the assets of any Illinois pension or education fund.

As described in Note 1, ISBI currently manages and invests the assets of the General Assembly Retirement System, Judges' Retirement System, and State Employees' Retirement System. All investments undertaken by ISBI are governed by 40ILCS 5 adopted by the General Assembly in 1982, and other standards codified in the above reference to the statutes.
40ILCS 5/1-109 requires all members of the Board and other fiduciaries to "… discharge his or her duties with respect to the retirement system or pension fund solely in the interest of the participants and beneficiaries and: With the care, skill, prudence and diligence…By diversifying the investments of the retirement system or pension fund so as to minimize the risk of large losses…"

Investment Commitments

Real estate and private equity investment portfolios consist of passive interests in limited partnerships. ISBI had outstanding commitments to these limited partnerships of approximately $463 million and $486 million as of June 30, 2010 and 2009, respectively. At the end of fiscal year 2010 and 2009, the Board had outstanding commitments of $154 million and $159 million to separate real estate accounts respectively. Also at the end of fiscal year 2010 and 2009, the Board had outstanding amounts of $147 million and $155 million to infrastructure funds. ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.

Investment Summary

The following table presents a summary of ISBI's investments at fair value by type at June 30, 2010 and 2009:

	2010	2009
	$	$
Government & agency obligations	810,739,312	665,018,889
Foreign obligations	44,409,906	33,237,090
Corporate obligations	925,668,388	668,047,761
Common stock & equity funds	2,857,144,559	2,610,218,733
Commingled funds	270,510,642	335,484,184
Preferred stock	517,676	286,429
Foreign equity securities	1,733,177,670	1,482,594,431
Foreign preferred stock	179,924	47,856
Hedge funds	917,854,201	880,939,190
Real estate investments	750,210,957	875,929,700
Private equity	542,441,291	450,491,810
Money market instruments	270,231,935	235,126,490
Infrastructure funds	320,293,041	305,969,947
Bank loans	222,623,999	197,259,098
Forward foreign currency contracts	(266,410)	(5,594,545)
Total investments	9,665,737,091	8,735,057,063

Investments in Hedge funds are structured to achieve a diversified hedged equity fund-of-funds portfolio. Capital is allocated to a select group of hedge fund managers that invest predominately in equity securities, both long and short. The investments shall be managed with the intent of preserving capital in a declining market and in a rising market they will generate a smaller return than the overall equity market.

ISBI's investments in Private Equity and Real Estate represent investment vehicles used for making investments in various equity and debt securities according to the investment strategies as determined by the fund managers at the commencement of the fund.

Investment strategies of Private Equity funds include, but are not limited to, leveraged buyouts, venture capital, growth capital and mezzanine capital.

Investment strategies of Real Estate investments include, but are not limited to, the purchase, development, ownership, management, rental and/or sale of real estate for profit.

ISBI's investments in Infrastructure funds represent pooled investment vehicles used to seek capital appreciation and current income by acquiring, holding, financing, refinancing and disposing of infrastructure investments and related assets. Infrastructure assets include various public works (e.g. bridges, tunnels, toll roads, airports, public transportation and other public works) that are made typically as a part of a privatization initiative on the part of a government entity.

A Commingled fund is a kind of mutual fund or common trust fund which consists of multiple kinds of assets from several accounts combined together. 'Commingling' these separate assets mitigates risk for the trader through investment diversification and reduces the cost of managing each account separately. Commingled funds are also called "pooled funds" and "master trusts."

Concentration of Credit Risk and Credit Risk for Investments

The portfolio is managed by professional investment management firms. These investment management firms are required to maintain diversified portfolios. Each investment manager must comply with risk management guidelines individually assigned to them as part of their investment management agreement. The Board did not have any single issuer investment that exceeded 5% of the total net assets of the Board as of June 30, 2010 and 2009. The following table presents the quality ratings of debt securities held by ISBI as of June 30, 2010 and 2009:

	Moody's Quality Rating	2010	2009
		$	$
Government and agency obligations			
U.S. Government obligations and Federal agency obligations	AAA	785,753,044	653,019,129
	AA	-	11,999,760
	A	11,999,760	-
	Not rated	12,986,508	-
Total Government and agency obligations		810,739,312	665,018,889
Foreign obligations	AAA	-	7,009,777
	AA	1,601,595	3,433,768
	A	13,951,076	-
	BAA	10,708,205	1,899,728
	BA	11,475,920	10,915,077
	B	5,659,170	7,765,165
	CAA	-	1,609,335
	C	-	604,240
	Not rated	1,013,940	-
Total foreign obligations		44,409,906	33,237,090
Corporate obligations	AAA	43,798,021	39,162,888
	AA	78,359,254	56,839,344
	A	272,476,793	209,758,077
	BAA	201,122,004	99,409,888
	BA	85,333,142	79,410,130
	B	188,825,884	132,204,912
	CAA	38,250,212	39,940,421
	CA	-	977,375
	Not rated	17,503,078	10,344,726
Total corporate obligations		925,668,388	668,047,761

Note 2 (continued)
Deposits, Investments, and Investment Risk

Custodial Credit Risk for Investments

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, ISBI will not be able to recover the value of investments or collateral securities that are in the possession of a counterparty. As of June 30, 2010 and 2009, investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Board's name in common stock totaling $0 and $2,529,488 respectively.

Interest Rate Risk

ISBI manages its exposure to fair value losses arising from interest rate risk by diversifying the debt securities portfolio and maintaining the debt securities portfolio to an effective weighted duration between 80% and 120% of the benchmark index.

Duration is the measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's fair value. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. As of June 30, 2010 and 2009, ISBI benchmarked its debt security portfolio to Barclay's Capital Intermediate U.S. Government/Credit Bond Index. At June 30, 2010 and 2009, the effective duration of the Barclay's Capital Intermediate U.S. Government/Credit Bond Index was 3.9 years. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2010 and 2009 was 3.8 years.

	2010		2009	
	Fair Value	Effective Weighted Duration	Fair Value	Effective Weighted Duration
Investment Type	$	Years	$	Years
Government & Agency Obligations				
U.S. Government	155,303,411	4.8	75,529,694	5.3
Federal Agency	655,435,901	2.3	589,489,195	2.9
Foreign Obligations	44,409,906	4.9	33,237,090	4.7
Corporate Obligations				
Bank and Finance	246,087,134	4.8	159,283,917	4.0
Collateralized Mortgage Obligations	39,240,826	3.0	19,360,918	2.8
Industrials	496,856,383	4.8	425,239,911	4.4
Other	143,484,045	5.0	64,163,015	4.7
	1,780,817,606		1,366,303,740	

Foreign Currency Risk

The international portfolio is constructed on the principles of diversification, quality growth, and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion. Certain investments held in infrastructure funds trade in a reported currency of Euro-based dollars valued at $34,896,279 and $38,643,067 as of June 30, 2010 and 2009, respectively. The following table presents the foreign currency risk by type of investment as of June 30, 2010 and 2009:

	2010		2009	
	Foreign Equity Securities and Foreign Preferred Securities	Foreign Obligation	Foreign Equity Securities and Foreign Preferred Securities	Foreign Obligations
	$	$	$	$
Australian Dollar	80,124,165	-	64,845,908	-
Brazilian Real	52,217,836	-	33,224,878	-
Canadian Dollar	97,585,461	-	47,104,026	-
Danish Krone	29,767,544	-	22,597,007	-
Egyptian Pound	2,121,276	-	631,787	-
English Pound Sterling	333,465,799	-	291,255,325	-
Euro Currency	401,821,017	-	407,541,247	-
Hong Kong Dollar	60,278,477	-	39,652,995	-
Hungarian Forint	266,743	-	-	-
Indonesian Rupian	992,274	-	-	-
Japanese Yen	222,916,572	-	221,156,513	-
Mexican Peso	5,584,047	-	2,121,876	-
New Zealand Dollar	3,181,046	-	1,076,827	-
Norwegian Krone	15,111,055	-	9,277,231	-
Singapore Dollar	35,452,297	-	30,234,461	-
South African Rand	8,691,759	-	3,495,645	-
South Korean Won	39,303,338	-	21,353,474	-
Swedish Krona	21,927,042	-	15,868,385	-
Swiss Franc	121,970,148	-	124,169,874	-
Thailand Baht	1,081,519	-	-	-
Foreign Investments denominated in U.S. dollars	199,498,179	44,409,906	147,034,828	33,237,090
	1,733,357,594	44,409,906	1,482,642,287	33,237,090

Securities Lending

ISBI participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, ISBI has rights to a portion of a collateral pool. All of the securities are eligible for the securities lending program. Collateral consists solely of cash, letters of credit, commercial paper, and government securities having a fair value equal to or exceeding 102% of the value of the loaned securities (105% for non-U.S. securities). In the

Note 2 (continued)
Deposits, Investments, and Investment Risk

event of borrower default, State Street provides ISBI with counterparty default indemnification. ISBI had no credit risk as a result of its securities lending program as the collateral received exceeded the fair value of the securities loaned. As of June 30, 2010 and 2009, there were outstanding loaned investment securities having fair values of $1,055,476,733 and $1,476,903,266, respectively; against which collateral was received with a fair value of $1,091,589,381 and $1,528,744,414, respectively. Collateral received at June 30, 2010 and 2009 consisted of $1,010,115,059 and $1,467,250,961, respectively, in cash and $81,474,322 and $61,493,453, respectively, in securities for which the Board does not have the ability to pledge or sell.

The cash collateral received is invested in a short term investment pool having a fair value of $997,638,887 and $1,395,768,803 as of June 30, 2010 and 2009, respectively. This investment pool had an average duration of 12.45 days and 42.64 days as of June 30, 2010 and 2009, respectively. Any decrease in the fair value of invested cash collateral is recorded as unrealized losses and reported as a component of the investment income/loss on the Statement of Changes in Net Assets. Regarding the investment pool, at the time of purchase, all securities with maturities of 13 months or less must qualify as first-tier securities and all securities with maturities in excess of 13 months will be rated A or better by at least one nationally recognized statistical rating organization (NRSROs) or if unrated, be determined by State Street to be of comparable quality.

Derivative Securities

During the year ended June 30, 2010, the ISBI implemented GASB Statement No. 53 *Accounting and Financial Reporting for Derivative Instrument*s with respect to investments held in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. ISBI invests in derivative instruments including forward foreign currency contracts, futures, rights and warrants. ISBI's derivatives are considered investment derivatives. The fair value of all derivative financial instruments is reported in the Statement of Net Assets as either assets or liabilities, and the change in the fair value is recorded in the Statement of Changes in Net Assets as net increase/decrease in fair value of investments.

Foreign currency forward contracts are used to protect against the currency risk in ISBI's foreign equity portfolio. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis. These investments are reported at fair value in the investment section of the Statement of Changes in Net Assets. The gain or loss arising from the difference between the original contracts and the closing of such contracts is recognized in the net increase/decrease in the fair value of investments in the Statement of Changes in Net Assets.

ISBI investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. The fair values of the futures contract vary from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The gain or loss is recognized in the net increase/decrease in the fair value of investments in the Statement of Change in Net Assets. Financial futures represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The cash or securities to meet these obligations are held in the investment portfolio.

Rights and warrants allow ISBI investment managers to replicate an underlying security they wish to hold (sell) in the portfolio. Rights and warrants provide the holder with the right, but not the obligation, to buy or sell a company's stock at a predetermined price. Rights usually expire after a few weeks and warrants can expire from one to several years. Under certain circumstances, a type of warrant called Participatory Notes or P-Notes are used in the portfolio by ISBI investment managers that are not registered to trade in domestic Indian Capital Markets. Participatory Notes are issued by Indian based brokerage firms against an underlying Indian security permitting holders to get a share in the income from the security. These investments are reported at fair value in the investment section of the Statement of Net Assets within the common stock and foreign equity classifications. The gain or loss associated with rights and warrants is recognized in the net increase/decrease in the fair value of investments in the Statement of Changes in Net Assets.

The fair values of the forward contracts are estimated based on the present value of their estimated future cash flows.

Futures contracts are exchange traded instruments where the fair value is determined by the equilibrium between the forces of supply and demand. The fair value of a right or warrant closely tracks the intrinsic value of the underlying stock and can be determined either by formulaic methodology (most commonly Black-Scholes) or intrinsic value methodology.

The following table presents the investment derivative instruments aggregated by type that were held by ISBI as of June 30, 2010:

	Changes in Fair Value		Fair Value at Year End		Notional Amount	
	2010	2009	2010	2009	2010	2009
	$	$	$	$	$	$
FX Forwards	4,751,552	3,509,993	(266,410)	(5,594,545)	N/A	N/A
Futures	11,874,002	(31,537,188)	(2,586,651)	(1,415,899)	51,300	81,300
Rights	1,184,339	544,848	227,807	465,233	905,044	581,222
Warrants	12,100,555	(6,839,300)	65,373,110	41,247,000	3,391,468	4,259,850
	29,910,448	(34,321,647)	62,747,856	34,701,789	4,347,812	4,922,372

The table below shows the futures positions held by ISBI as of June 30, 2010 and 2009.

	2010			2009		
	Number of Contracts	Contract Principal*	Fair Value	Number of Contracts	Contract Principal*	Fair Value
		$	$		$	$
Equity futures purchased	1,026	52,664,580	(2,586,651)	1,626	74,430,150	(1,415,899)

*Contract principal amounts shown represent the market value of the underlying assets the contracts control. Contract principal is shown to present the volume of the transactions but does not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Contract principal values also do not represent actual values reported in the Statement of Net Assets.

Note 2 (continued)
Deposits, Investments, and Investment Risk

Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Derivatives which are exchange traded are not subject to credit risk. No derivatives held are subject to custodial credit risk. Market risk is the possibility that a change in interest (interest rate risk) or currency rates (foreign currency risk) will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and management of ISBI and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. As of June 30, 2010 and June 30, 2009, ISBI held no derivatives subject to interest rate risk. The ISBI has not adopted a formal policy specific to master netting arrangements.

The following table presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2010 and 2009:

	2010			2009		
	FX Forwards	Rights	Warrants	FX Forwards	Rights	Warrants
	$	$	$	$	$	$
Australian Dollar	367,196	-	-	-	111,868	-
Brazilian Real	(510,309)	-	-	(166,466)	-	-
Canadian Dollar	(81,756)	-	-	-	-	-
Euro Currency	293,614	191,452	722	(133,149)	19,242	2,251
English Pound Sterling	(603,992)	-	-	(4,268,060)	297,813	-
Hong Kong Dollar	-	31,000	18,357	-	1,363	-
Indian Ruppe	625,478	-	-	(190,655)	-	-
Janpanese Yen	(2,226)	-	-	11,990	-	-
Norwegian Krone	-	5,355	-	-	7,157	-
Singapore Dollar	(991)	-	-	106	7,076	-
South Korean Won	841	-	-	(257,427)	-	-
Swedish Krona	(768)	-	-	-	-	-
Swiss Franc	(353,497)	-	-	(590,884)	362	-
Investments denominated in U. S. dollars	-	-	65,354,031	-	20, 352	41,244,749
	(266,410)	227,807	65,373,110	(5,594,545)	465,233	41,247,000

ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The credit ratings and net exposure as of June 30, 2010 for the counterparties are as follows:

Moody's Rating*	Fair Value	Net Exposure	Percentage of Net Exposure
	$	$	%
A	2,478,451	2,478,451	97
AA	69,204	69,204	3
	2,547,655	2,547,655	100

*Ratings as of June 30, 2009 are not available.

Investment Liquidity

ISBI holds investments in hedge funds, real estate funds, private equity funds and infrastructure funds that are considered illiquid by the very nature of the investment. Market risk exists with respect to these investments as ISBI may not be able to exit from the investments during periods of significant market value declines.

Note 3
Member Systems' Participation

	General Assembly	Judges'	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2010	$	$	$	$
Interest and dividends	1,328,731	12,492,628	229,493,021	243,314,380
Net securities lending income	35,978	336,363	6,232,988	6,605,329
Net increase in fair value of investments	3,590,964	31,522,768	598,899,494	634,013,226
Total investment income	4,955,673	44,351,759	834,625,503	883,932,935
Administrative expenses	(207,114)	(1,952,648)	(35,525,015)	(37,684,777)
Net investment income	4,748,559	42,399,111	799,100,488	846,248,158
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2010				
Net assets at beginning of year	47,693,753	435,604,601	8,200,755,918	8,684,054,272
Member systems' net contributions/(withdrawals)	(803,726)	28,459,810	120,745,288	148,401,372
Net investment income	4,748,559	42,399,111	799,100,488	846,248,158
Net assets at end of year	51,638,586	506,463,522	9,120,601,694	9,678,703,802

The source of net assets of the member systems since inception at June 30, 2010, is as follows:

Member systems' net withdrawals	(55,563,222)	(72,372,920)	(1,424,341,468)	(1,552,277,610)
Accumulated net investment income	107,201,808	578,836,442	10,544,943,162	11,230,981,412
Net assets at fair value	51,638,586	506,463,522	9,120,601,694	9,678,703,802

** Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.*

Note 3 (continued)
Member Systems' Participation

	General Assembly	Judges'	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2009	$	$	$	$
Interest and dividends	1,549,538	13,449,740	247,165,395	262,164,673
Net securities lending income	104,640	904,710	16,568,912	17,578,262
Net decrease in fair value of investments	(16,141,323)	(135,286,901)	(2,441,040,917)	(2,592,469,141)
Total Investment loss	(14,487,145)	(120,932,451)	(2,177,306,610)	(2,312,726,206)
Administrative expenses	(243,045)	(2,118,645)	(38,910,993)	(41,272,683)
Net investment loss	(14,730,190)	(123,051,096)	(2,216,217,603)	(2,353,998,889)
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2009				
Net assets at beginning of year	71,923,943	589,155,697	10,653,973,521	11,315,053,161
Member systems' net withdrawals	(9,500,000)	(30,500,000)	(237,000,000)	(277,000,000)
Net investment loss	(14,730,190)	(123,051,096)	(2,216,217,603)	(2,353,998,889)
Net assets at end of year	47,693,753	435,604,601	8,200,755,918	8,684,054,272

The source of net assets of the member systems since inception at June 30, 2009, is as follows:

	General Assembly	Judges'	State Employees'	Combined*
Member systems' net withdrawals	(54,759,496)	(100,832,730)	(1,545,086,756)	(1,700,678,982)
Accumulated net investment income	102,453,249	536,437,331	9,745,842,674	10,384,733,254
Net assets at fair value	47,693,753	435,604,601	8,200,755,918	8,684,054,272

** Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.*

Note 4
Pensions

Plan Description

All of the ISBI employees participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer, defined benefit, public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal years 2010 and 2009 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR). The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 Veterans Parkway, Springfield, IL 62794-9255 or by calling 217/785-7202. The State of Illinois CAFR may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, IL 62704-1858 or by calling 217/782-2053.

A summary of SERS' benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established, are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute, and the authority under which those obligations are established.

Funding Policy

ISBI pays employer retirement contributions based upon an actuarially determined percentage of payroll. For fiscal year 2010 and 2009, the employer contribution rates were 28.377% and 21.049%, respectively. ISBI contributions to SERS for fiscal years 2010 and 2009 were $313,798 and $241,690, respectively, and were equal to the required contributions for each fiscal year.

Effective for pay periods beginning after December 31, 1991, the Board opted to pay the employee portion of retirement for ISBI employees covered by the State Employees' Retirement Systems. Generally, this pickup of employee retirement was part of the budget process and was, in part, a substitute for salary increases. ISBI contributions to SERS for the employee portion for fiscal years 2010 and 2009 were $43,776 and $44,104, respectively.

Member System Contributions and Withdrawals

Member systems' contributions are comprised solely of bond proceeds. As required by Public Act 96-0043, the State of Illinois issued $3.466 billion of General Obligation Bonds, Taxable Bond Series January 2010 on January 2010 at an interest rate of 3.854%. The net bond proceeds were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act. The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System received an allocation of bond proceeds equal to $809,401,372 on January 20, 2010. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment the same day. The monies were combined with ISBI's other investments and invested in accordance with the asset allocation policy of ISBI during the year ended June 30, 2010. There were no contributions during fiscal year 2009. Member systems' withdrawals are determined by the member retirement systems based on the State's funding, the systems' benefit payment needs and the ability for ISBI to liquidate available assets. The total withdrawals for fiscal years 2010 and 2009 were $661,000,000 and $277,000,000, respectively.

Post-retirement Benefits

The State provides health, dental, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental and vision benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees' Retirement System, do not contribute toward health, dental and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefits become $5,000.

The total cost of the State's portion of health, dental, vision and life insurance benefits of all members including post-

Note 4 (continued)
Pensions

employment health, dental, vision and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the cost on a pay-as-you-go basis. The total costs incurred for health, dental, vision and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois 62763-3838.

Note 5
New Governmental Accounting Standards

Statement No. 59, *Financial Instruments Omnibus*, was established to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. ISBI is required to implement this Statement for the year ending June 30, 2011.

Statement No. 62, *Codification of Accounting and Financial Reporting Guidance contained in pre-November 1989 FASB and AICPA Pronouncements*, was established to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in certain FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. ISBI is required to implement this Statement for the year ending June 30, 2013.

Management has not yet completed its assessment of these Statements; however, it is not expected to have a material effect on the overall financial statement presentation.

McGladrey

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Honorable William G. Holland
Auditor General, State of Illinois
Springfield, Illinois

Board of Trustees
Illinois State Board on Investment

As Special Assistant Auditors for the Auditor General, we have audited the Statements of Net Assets and Statements of Changes in Net Assets of the Illinois State Board of Investment (ISBI), as of and for the years ended June 30, 2010 and June 30, 2009, and have issued our report thereon dated January 12, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the ISBI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, and not for the purpose of expressing an opinion on the effectiveness of the ISBI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the ISBI's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the ISBI's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, ISBI's Board of Trustees and the ISBI's management, and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 12, 2011

Prior Findings Not Repeated

Year Ended June 30, 2010

A. Securities Lending

During the previous audit, the Illinois State Board of Investment (ISBI) did not have adequate controls over financial reporting for its securities lending transactions. The ISBI's did not record the fair value of the investment of cash collateral received for securities lending transactions and an adjustment was required to be recorded. During the current audit, the ISBI updated its internal control procedures to incorporate a monthly closing process for securities lending that records all securities lending assets and obligations at fair value. Therefore, this finding will not be repeated. (Finding Code No. 09-1)

B. Alternative Investments

During the previous audit, the Illinois State Board of Investment (ISBI) did not have adequate procedures over determining and reviewing the fair value measurements and disclosures used for reporting its alternative investments on a timely basis. As a result, alternative investment balances were required to be adjusted prior to the issuance of the financial statements. During the current audit, the ISBI has updated its internal control procedures to include the process of performing a retroactive look back process that would require a restatement if changes occur that exceed 2% in a particular asset class and to send annual communications on the importance of timely reporting to its investment advisors. Additionally, the ISBI has revised the footnote disclosure regarding the accounting policy for the use of estimates to clarify the process used to value alternative investments. Therefore, this finding will not be repeated. (Finding Code No. 09-2)