Judges' Retirement System of the State of Illinois

Auditor's Report and Financial Audit

For the Year Ended June 30, 2013

Performed as Special Assistant Auditors for the Auditor General, State of Illinois

BKD LLP

CPAs & Advisors

Judges' Retirement System of the State of Illinois

Financial Audit

For the Year Ended June 30, 2013

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Judges' Retirement System
of the State of Illinois
Financial Audit
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System Officials

Executive Secretary	Timothy B. Blair
Division Manager	Jayne Waldeck
Accounting Division Supervisor	David M. Richter, CPA
Internal Auditor	Staci A. Crane (effective 9/17/2012 – 11/15/13)

Office Locations

2101 South Veterans Parkway
P.O. Box 19255
Springfield, Illinois 62794-9255

State of Illinois Building
160 North LaSalle Street, Suite N725
Chicago, Illinois 60601

Judges' Retirement System
of the State of Illinois
Financial Statement Report Summary
For the Year Ended June 30, 2013

Summary

The audit of the accompanying financial statements of the Judges' Retirement System of the State of Illinois was performed by **BKD, LLP**.

Based on their audit, the auditors expressed an unmodified opinion on the Judges' Retirement System of the State of Illinois' financial statements.

BKD LLP
CPAs & Advisors

225 N. Water Street, Suite 400
P.O. Box 1580
Decatur, IL 62525-1580
217.429.2411 Fax 217.429.6109 www.bkd.com

Independent Auditor's Report

The Honorable William G. Holland
Auditor General
State of Illinois
and
Board of Trustees
Judges' Retirement System of the State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Judges' Retirement System of the State of Illinois (System) as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2013 and 2012 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 93 percent, 95 percent, and 42 percent, respectively in 2013, and 96 percent, 97 percent, and (.19) percent, respectively, in 2012 of total assets, net position restricted for pension benefits, and total additions of the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the System's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the plan net position of the System as of June 30, 2013 and 2012, and the respective changes in plan net position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of funding progress, the schedule of employer contributions and notes to required supplementary information listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the System's basic financial statements. The supplementary financial information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements.

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary financial information as listed in the table of contents has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America by us and other auditors. In our opinion, the supplementary financial information as listed in the table of contents is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2013 on our consideration of the System's 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 on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

BKD, LLP

Decatur, Illinois
December 20, 2013

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

This section presents management's discussion and analysis of the financial position and performance of the Judges' Retirement System of Illinois (System) for the years ended June 30, 2013 and 2012. It is presented as a narrative overview and analysis.

The System is a defined benefit, single-employer public employee retirement system. It provides services to 962 active judges and 1,078 benefit recipients. Throughout this discussion and analysis units of measure (i.e. billions, millions, thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the System's financial reporting which is comprised of the following components:

1. *Basic Financial Statements.* For the fiscal years ended June 30, 2013 and 2012, basic financial statements are presented for the System. This information presents the net position restricted for pension benefits for the System as of June 30, 2013 and 2012. This financial information also summarizes the changes in net position restricted for pension benefits for the years then ended.

2. *Notes to the Financial Statements.* The notes to the financial statements provide additional information that is essential to achieve a full understanding of the data provided in the basic financial statements.

3. *Required Supplementary Information.* The required supplementary information consists of two schedules and related notes concerning actuarial information, funded status and required contributions for the System.

4. *Other Supplementary Schedules.* Other supplementary schedules include more detailed information pertaining to the System, including schedules of revenues by source, cash receipts and disbursements, and payments to consultants.

FINANCIAL HIGHLIGHTS

- The System's net position increased by $65.4 million and decreased by $28.0 million during fiscal years 2013 and 2012, respectively. These changes were primarily due to a $12.4 million increase in cash and a $53.6 million increase in investments (excluding securities lending collateral) offset by a $0.6 million decrease in receivables during fiscal year 2013 and a $28.7 million decrease in investments (excluding securities lending collateral) offset by a $0.7 million increase in cash and receivables during fiscal year 2012.
- The System was actuarially funded at 28.3% as of June 30, 2013 a decrease from 29.7% as of June 30, 2012. For fiscal years 2013 and 2012, the actuarial value of assets equals the fair value of assets adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 14.1% for fiscal year 2013 compared to 0.1% for fiscal year 2012.

The condensed Statements of Plan Net Position reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the years reported. A summary of the System's Plan Net Position is presented below.

Condensed Statements of Plan Net Position
(in thousands)

	As of June 30, 2013	2012	2011	Increase/(Decrease) from 2012 to 2013	2011 to 2012
Cash	$ 23,059.6	$ 10,690.6	$ 18,015.8	$ 12,369.0	$ (7,325.2)
Receivables	7,621.8	8,211.6	221.3	(589.8)	7,990.3
Investments, at fair value *	629,286.6	565,084.3	595,055.6	64,202.3	(29,971.3)
Equipment, net	7.7	9.3	3.3	(1.6)	6.0
Total assets	659,975.7	583,995.8	613,296.0	75,979.9	(29,300.2)
Liabilities*	16,645.7	6,019.4	7,335.8	10,626.3	(1,316.4)
Total plan net position	$ 643,330.0	$ 577,976.4	$605,960.2	$ 65,353.6	$ (27,983.8)

** Including securities lending collateral*

ADDITIONS TO PLAN NET POSITION

Additions to Plan Net Position include employer and participant contributions and net income from investment activities. Participant contributions remained level at $16.4 million for the years ended June 30, 2013 and 2012. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions increased to $88.2 million in 2013 from $63.6 million in 2012. This increase was the result of the State's funding plan.

DEDUCTIONS FROM PLAN NET POSITION

Deductions from Plan Net Position are primarily benefit payments. During 2013 and 2012, the System paid out $115.3 million and $107.2 million, respectively, in benefits and refunds, an increase of approximately 7.5%. These higher payments were mainly due to an increase in the number of annuitants as well as a 3% automatic annuity increase paid each year. The administrative costs of the System represented less than 1% of total deductions in both 2013 and 2012.

FUNDED RATIO

The funded ratio of the plan measures the ratio of the actuarial value of assets against actuarially determined liabilities and is one indicator of the fiscal strength of a pension fund's ability to meet obligations to its members. An annual actuarial valuation is required by statute. The most recent available valuation showed the funded status of the System on June 30, 2013 decreased to 28.3% from 29.7% on June 30, 2012. The major reason for the decline was the lingering effect of prior investment performance on the smoothed market value of assets. The amount by which actuarially determined liabilities exceeded the actuarial value of assets was $1,546.6 million on June 30, 2013 compared to $1,420.5 million on June 30, 2012.

INVESTMENTS

Investments of the System are combined in a commingled investment pool with the State Employees' Retirement System, General Assembly Retirement System, and one other state agency. The investments of this other state agency are immaterial to the total commingled investment pool. Each participating entity owns an equity position in the pool and receives proportionate investment income from the pool in accordance with respective ownership percentage. Investment gains or losses are reported in the Statement of Changes in Plan Net Position of each participating entity.

The net investment income of the total ISBI Commingled Fund was approximately $1.6 billion during fiscal year 2013, versus $5.0 million during fiscal year 2012, resulting in returns of 14.1% and 0.1%, respectively. The actual rate of return earned by the System will vary from the return earned on the total ISBI Commingled Fund as a result of overall market conditions at the time of additional investments in or withdrawals from the ISBI Commingled Fund. For the three, five, and ten year period ended June 30, 2013, the ISBI Commingled Fund earned a compounded rate of return of 11.6%, 3.9%, and 6.6%, respectively.

The 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 the 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 the ISBI's financial condition.

Questions concerning any of the information provided in this report or requests for additional financial information should be sent to the Judges' Retirement System of Illinois, Accounting Division, 2101 S. Veterans Parkway, P. O. Box 19255, Springfield, Illinois 62794

The condensed Statements of Changes in Plan Net Position reflect the changes in the resources available to pay benefits to members, including retirees and beneficiaries.

Condensed Statements of Changes in Plan Net Position
(in thousands)

	For the Year Ended June 30, 2013	2012	2011	Increase/(Decrease) from 2012 to 2013	2011 to 2012
Additions					
Participant contributions	$ 16,368.6	$ 16,444.8	$ 16,725.2	$ (76.2)	$ (280.4)
Employer contributions	88,239.6	63,644.1	62,694.4	24,595.5	949.7
Investment income/(loss)	76,886.3	(69.1)	105,253.4	76,955.4	(105,322.5)
Other	–	–	5.0	–	(5.0)
Total additions	181,494.5	80,019.8	184,678.0	101,474.7	(104,658.2)
Deductions					
Benefits	113,557.4	106,653.1	100,719.8	6,904.3	5,933.3
Refunds	1,751.5	586.4	652.2	1,165.1	(65.8)
Administrative expenses	832.0	764.1	622.0	67.9	142.1
Total deductions	116,140.9	108,003.6	101,994.0	8,137.3	6,009.6
Net increase/(decrease) in plan net position	$ 65,353.6	$(27,983.8)	$82,684.0	$ 93,337.4	$ (110,667.8)

JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Position

June 30, 2013 and 2012

	2013	2012
Assets		
Cash	$ 23,059,590	$ 10,690,635
Receivables:		
Employer contributions	7,350,870	7,953,510
Participants' contributions	173,791	186,463
Refundable annuities	17,770	1,485
Interest on cash balances	7,956	4,155
Due from General Assembly Retirement System	71,442	65,961
Total Receivables	7,621,829	8,211,574
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	612,751,563	559,139,279
Securities lending collateral with State Treasurer	16,535,000	5,945,000
Equipment, net of accumulated depreciation	7,678	9,326
Total Assets	659,975,660	583,995,814
Liabilities		
Benefits payable	33,073	711
Refunds payable	2,066	–
Administrative expenses payable	75,553	73,736
Securities lending collateral	16,535,000	5,945,000
Total Liabilities	16,645,692	6,019,447
Net position - restricted for pension benefits	$ 643,329,968	$ 577,976,367

See accompanying notes to financial statements.

JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Position
Years Ended June 30, 2013 and 2012

	2013	2012
Additions:		
Contributions:		
Participants	$ 16,368,637	$ 16,444,796
Employer	88,239,564	63,644,099
Total contributions	104,608,201	80,088,895
Investments:		
Net investment income	16,083,537	13,408,141
Interest earned on cash balances	74,035	86,203
Net appreciation (depreciation) in fair value of investments	60,728,747	(13,563,440)
Total investment income (loss)	76,886,319	(69,096)
Total Additions	181,494,520	80,019,799
Deductions:		
Benefits:		
Retirement annuities	93,088,908	87,161,263
Survivors' annuities	20,468,521	19,491,832
Total benefits	113,557,429	106,653,095
Refunds of contributions	1,751,540	586,455
Administrative expenses	831,950	764,090
Total Deductions	116,140,919	108,003,640
Net Increase (Decrease)	65,353,601	(27,983,841)
Net position - restricted for pension benefits:		
Beginning of year	577,976,367	605,960,208
End of year	$ 643,329,968	$ 577,976,367

See accompanying notes to financial statements.

JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2013 and 2012

1. Reporting Entity

Generally accepted accounting principles require that the financial reporting entity include (1) the primary government (2) organizations for which the primary government is financially accountable and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The Judges' Retirement System of Illinois (System) is administered by a Board of Trustees consisting of five persons, which include the State Treasurer, the Chief of the Supreme Court, ex officio, and three participating judges appointed by the Supreme Court.

Based on the criteria of the Governmental Accounting Standards Board Statement No. 61, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System, however, the System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report.

Pursuant to federal tax law and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of paying benefits in accordance with Section 415 of the Internal Revenue Code. The receipts and disbursements from the fund for fiscal years 2013 and 2012 were each less than $760,000. Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the System's financial statements.

At June 30, 2013 and 2012, the System membership consisted of:

	2013	2012
Retirees and beneficiaries currently receiving benefits:		
Retirement annuities	755	725
Survivors' annuities	323	331
	1,078	1,056
Inactive participants entitled to benefits but not yet receiving them	22	15
Total	1,100	1,071
Current participants:		
Vested	665	627
Nonvested	297	341
Total	962	968

Operation of the System and the direction of its policies are the responsibility of the Board of Trustees.

2. Plan Description

The System is the administrator of a single-employer defined benefit public employee retirement system (PERS) established and administered by the State of Illinois to provide pension benefits for its participants. The plan is comprised of two tiers of contribution requirements and benefit levels. Tier 1 pertains to participants who first became a participant of the System prior to January 1, 2011. Tier 2 pertains to participants who first became a participant of the System on or after January 1, 2011.

a. Eligibility and Membership

The Judges' Retirement System covers Judges, Associate Judges and, under certain conditions, the Administrative Director of the Illinois courts. Participation by Judges, either appointed or elected, is mandatory unless the Judge files an election not to participate within thirty days of receipt of notice of this option.

b. Contributions

In accordance with Chapter 40, Section 5/18-133 of the Illinois Compiled Statutes, participants contribute specified percentages of their salaries for retirement annuities, survivors' annuities, and annual increases. Tier 1 participants contribute based on total annual compensation. Beginning January 1, 2011, Tier 2 participants contribute based on an annual compensation rate not to exceed $106,800 with limitations for future years increased by the lesser of 3% or the annual percentage increase in the Consumer Price Index. The calendar year 2013 and 2012 rate is $112,204 and $110,004, respectively. Contributions are excluded from gross income for Federal and State income tax purposes.

Participants who are eligible to receive the maximum rate of annuity may irrevocably elect to discontinue contributions and have their benefits "frozen" based upon the applicable salary in effect immediately prior to the effective date of such election.

Participants who have attained age 60 and are eligible to receive the maximum rate of annuity and have not elected to discontinue contributing to the System may irrevocably elect to have their contributions based only on the salary increases received on or after the effective date of such election rather than on the total salary received.

The total contribution rate is 11% if the participants elect to contribute for their spouse and dependents as shown below:

7.5%	Retirement annuity
2.5%	Survivors' annuity
1.0%	Automatic annual increases
11.0%	

The statutes governing the Judges' Retirement System provide for optional contributions by participants, with interest at prescribed rates, to retroactively establish service credits for periods of prior creditable service.

The Board of Trustees has adopted the policy that interest payments by a participant, included in optional contributions to retroactively establish service credits, shall be considered an integral part of the participant's investment in annuity expectancies and, as such, shall be included as a part of any refund payable.

The payment of (1) the required State contributions, (2) all benefits granted under the System and (3) all expenses in connection with the administration and operation thereof are the obligations of the State to the extent specified in Chapter 40, Article 5/18 of the Illinois Compiled Statutes.

c. Benefits

Retirement Annuity: Tier 1

Participants have vested rights to full retirement benefits beginning at age 60 with at least 10 years of credited service or reduced retirement benefits beginning at age 55. Participants also have vested rights to full retirement benefits at age 62 upon completing 6 years of credited service or at age 55 upon completing 26 years of credited service.

The retirement annuity provided is 3-1/2% for each of the first 10 years of service, plus 5% for each year of service in excess of 10, based upon the applicable final salary. The maximum retirement annuity is 85% of the applicable final salary. Annual automatic increases of 3% of the current amount of retirement annuity are provided.

Retirement Annuity: Tier 2

Participants have vested rights to full retirement benefits at age 67 with at least 8 years of credited service or reduced retirement benefits at age 62 with at least 8 years of credited service.

The retirement annuity provided is 3% for each year of service based upon the applicable final average salary. The maximum retirement annuity is 60% of the applicable final average salary. Annual automatic increases equal to the lesser of 3% or the annual change in the Consumer Price Index are provided.

Other Benefits:

The Judges' Retirement System also provides survivors' annuity benefits, temporary and/or total disability benefits and, under certain specified conditions, lump-sum death benefits.

Participants who terminate service and are not eligible for an immediate annuity may receive, upon application, a refund of their total contributions. Participants or annuitants who are not married are entitled to refunds of their contributions for survivors.

3. Summary of Significant Accounting Policies & Plan Asset Matters

a. Basis of Accounting

The financial transactions of the System are maintained and these financial statements have been prepared using the accrual basis of accounting in conformity with generally accepted accounting principles.

Participant and employer contributions are recognized as revenues when due pursuant to statutory requirements. Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plan.

b. Cash

The System retains all of its available cash in a commingled investment pool managed by the Treasurer of the State of Illinois (Treasurer). All deposits are fully collateralized by the Treasurer.

"Available cash" is determined to be that amount which is required for the current operating expenditures of the System. The excess of available cash is transferred to the Illinois State Board of Investment (ISBI) for purposes of long-term investment for the System.

c. Implementation of New Accounting Standards

GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position", provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. It also amends the net asset reporting requirements in certain previously issued pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The System implemented this Statement for the year ending June 30, 2013.

GASB Statement No. 64, "Derivative Instruments: Application of Hedge Accounting Termination Provisions – An Amendment to GASB Statement No. 53", was established to enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The ISBI implemented this Statement for the year ending June 30, 2012.

d. General Litigation
The System is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the plan net position or the changes in plan net position of the System.

e. Methods Used to Value Investments
Investments are managed by the ISBI pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes (ILCS) and are maintained in the ISBI Commingled Fund.

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 the ISBI and its investment managers; (5) Alternative Investments (Private Equity, Hedge Funds, Bank Loans, and Real Assets) - fair values as determined by the ISBI and its investment managers; and (6) Commingled Funds - fair values as determined by the ISBI and its investment managers.

Units of the ISBI Commingled Fund are issued to the participating entities on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the participating entities on the last day of the month on the basis of percentage of accumulated units owned by the respective systems. Management expenses are deducted monthly from income before distribution.

The investment authority of the ISBI is provided in Chapter 40, Section 5/22A-112 of the ILCS. Such investment authority requires that all opportunities be undertaken with care, skill, prudence and diligence given prevailing circumstances that a prudent person acting in like capacity and experience would undertake.

f. Actuarial Experience Review
In accordance with Illinois Compiled Statutes, an actuarial experience review is to be performed at least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System. An experience review was last performed for the period from July 1, 2006 to June 30, 2012 resulting in the adoption of new assumptions as of June 30, 2013.

g. Administrative Expenses
Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses are budgeted and approved by the System's Board of Trustees.

Administrative expenses common to the Judges' Retirement System and the General Assembly Retirement System are allocated 75% to the Judges' Retirement System and 25% to the General Assembly Retirement System. Invoices/vouchers covering common expenses incurred are paid by the Judges' Retirement System, and the appropriate amount is allocated to and reimbursed by the General Assembly Retirement System. Administrative expenses allocated to and reimbursed by the General Assembly Retirement System as of June 30, 2013 and 2012, were $239,405 and $224,439, respectively.

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

i. Use of Estimates
In preparing financial statements in conformity with U.S. generally accepted accounting principles, the System 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 revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

j. Reclassifications
Certain fiscal year 2012 amounts have been reclassified to conform to the fiscal year 2013 presentation. These reclassifications have not changed the fiscal year 2012 results.

4. Investments

Summary of the ISBI Fund's investments at fair value by type

	June 30, 2013	June 30, 2012
U.S. govt. and agency obligations	$ 887,400,073	$ 958,131,279
Foreign obligations	415,070,013	385,628,617
Corporate obligations	674,154,128	656,977,663
Common stock & equity funds	3,916,478,305	3,253,103,566
Commingled funds	317,408,396	225,608,712
Foreign equity securities	2,329,387,630	2,012,774,573
Foreign preferred stock	481,493	592,156
Hedge funds	1,166,602,482	1,026,725,785
Real estate funds	1,294,600,976	967,346,450
Private equity	643,775,529	679,423,383
Money market instruments	237,649,781	255,922,180
Real assets	550,739,042	507,019,665
Bank loans	416,649,247	328,593,596
Forward foreign currency contracts	(412,825)	(43,859)
Total investments	$12,849,984,270	$11,257,803,766

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System's and 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, 2013 and 2012, the ISBI had non-investment related bank balances of $449,417 and $25,096,663, respectively. Of the June 30, 2012 cash balance, $24,854,573 represents the transfer of the Illinois Power Agency Trust funds. This cash was held by the State Treasurer pending transfer to State Street Bank and Trust Company for investment. The transfer of these funds to State Street Bank and Trust for investment occurred on July 19, 2012. During fiscal year 2007, a Credit Risk Policy was implemented by the ISBI staff and formally adopted by the ISBI 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 Company. State Street Bank and Trust Company has an AA- Long-term Deposit/Debt rating by Standard & Poor's and an Aa2 rating by Moody. Certain investments of the 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, the ISBI reports these types of cash equivalents as Money Market Instruments within their investments. As of June 30, 2013 and 2012, the ISBI had investment related bank balances of $21,092,710 and $20,601,170, respectively. These balances include USD and foreign cash balances. The USD cash balances had no exposure to custodial credit risk as a result of the passage of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act) in July, 2010. The FDIC must provide unlimited deposit insurance coverage for balances held in US dollar non-interest bearing transaction accounts (DDAs) for a period of two years, beginning on December 31, 2010 and ending on December 31, 2012. As of January 1, 2013, cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of $250,000. At any given point and time, the foreign cash balances may be exposed to custodial credit risk.

Investment Commitments

The ISBI's real estate and private equity investment portfolios consist of passive interests in limited partnerships. The ISBI had outstanding commitments to these limited partnerships of approximately $278 million and $478 million, as of June 30, 2013 and 2012, respectively. Also, at the end of fiscal year 2013 and 2012, the ISBI had outstanding commitments of $7 million and $196 million, respectively, to separate real estate accounts. Also at the end of fiscal year 2013 and 2012, the ISBI had outstanding amounts of $60 million and $63 million, respectively, committed to real assets. The ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.

Investment Liquidity

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

Alternative Investments

The ISBI's 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.

The ISBI's investments in Private Equity and Real Estate funds 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. In May, 2011, RLJ Lodging Fund II, a limited partnership investment, was exchanged by the ISBI for 1,035,092 shares of restricted common stock as a result of an initial public offering (IPO) transaction conducted by RLJ Lodging Trust. Due to the fact that this holding is currently restricted for sale as a result of a lock-up agreement in place that specifies that during the period that commences 180 days from the date of the initial IPO the holders of the shares will not, without prior written consent of the underwriting group, directly or indirectly offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant for sale of, or otherwise dispose or transfer such shares. As of June 30, 2011, this holding is an illiquid asset as a result of this restriction. During fiscal year 2012, the restriction attached to these shares expired and 1,043,923 in RLJ Lodging Trust shares were sold in March 2012. This included an additional amount of 8,831 shares received by the ISBI during fiscal year 2012.

Certain real estate investments are leveraged whereby partnerships have been established to purchase properties through a combination of contributions from the ISBI and through acquisition of debt. At June 30, 2013, real estate equities of approximately $1,295 million are reported at estimated fair value. Of this amount, $1,145 million is equity and $150 million is long term debt. At June 30, 2012 real estate equities of approximately $967 million were reported at estimated market value. Of this amount, $795 million was equity and $172 million was long term debt.

Required repayment of real estate debt, which is non-recourse debt is as follows as of June 30, 2013 and 2012:

Debt Maturities Year Ending June 30	2013	2012
2013	$ –	$ 38,336,179
2014	–	–
2015	–	39,603,847
2016	28,591,489	28,761,199
2017	56,179,026	64,845,576
2018–2022	43,165,198	–
2023–2026	22,382,920	–
	$ 150,318,633	$171,546,801

The ISBI's investments in Real Assets represent pooled investment vehicles used to seek capital appreciation and current income by acquiring, holding, financing, refinancing and disposing of infrastructure investments and farmland assets. Real 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 ISBI's portfolio of investments 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 ISBI did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2013 and 2012. The table to the right presents the quality ratings of debt securities held by the ISBI as of June 30, 2013 and 2012.

	Moody's Quality Rating	2013	2012
U.S. Government and	AAA	$ 874,539,113	$ 955,072,566
Agency obligations	AA	5,090,968	3,054,072
	Not Rated	7,769,992	4,641
Total U.S. govt. and agency obligations		$ 887,400,073	$ 958,131,279
Foreign Obligations	AAA	$ 76,120,555	$ 186,587,716
	AA	97,449,851	70,836,832
	A	22,791,044	38,941,615
	BAA	39,580,632	17,922,423
	BA	14,681,590	13,976,279
	B	22,678,015	16,044,688
	CAA	849,000	1,411,638
	Not rated	140,919,326	39,907,426
Total Foreign Obligations		$ 415,070,013	$ 385,628,617
Corporate Obligations			
Bank and Finance	AA	$ 2,299,452	$ 6,229,998
	A	61,974,814	65,118,722
	BAA	59,330,835	46,729,424
	BA	22,522,230	13,870,851
	B	20,262,545	17,295,104
	Not Rated	1,119	1,045
Total Bank and Finance		$ 166,390,995	$ 149,245,144
Collateralized Mortgage Obligations	AAA	$ 912,944	$ 1,076,456
Total Collateralized Mortgage Obligations		$ 912,944	$ 1,076,456
Industrial	AA	$ 13,517,204	$ 36,473,262
	A	35,977,341	29,602,573
	BAA	60,411,613	75,478,624
	BA	87,927,262	59,680,342
	B	188,374,139	193,691,505
	CAA	16,149,073	10,775,593
	Not Rated	6,775,458	6,530,791
Total Industrial		$ 409,132,090	$ 412,232,690
Other	AA	$ –	$ 1,127,225
	A	21,306,286	22,075,563
	BAA	9,007,159	7,428,269
	BA	23,383,605	19,369,553
	B	41,440,430	43,572,387
	Not rated	2,580,619	850,376
Total Other		$ 97,718,099	$ 94,423,373
Total Corporate Obligations		$ 674,154,128	$ 656,977,663
Money Market	Not Rated	$ 237,649,781	$ 255,922,180
Total Money Market		$ 237,649,781	$ 255,922,180

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, the 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, 2013 and 2012, there were no investments that were uninsured and unregistered, securities held by the counterparty or by its trust department or agent but not in the ISBI's name.

Interest Rate Risk

The 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, 2013 and 2012, the ISBI benchmarked its debt security portfolio to Barclay's Capital Intermediate U.S. Government/Credit Bond Index. At June 30, 2013 and 2012, the effective duration of the Barclay's Capital Intermediate U.S. Government/Credit Bond Index was 5.5 years and 3.9 years, repectively. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2013 and 2012 was 4.8 years and 4.6 years, respectively. The table below shows the detail of the duration by investment type as of June 30, 2013 and 2012.

	2013		2012	
Investment Type	Fair Value	Effective Weighted Duration Years	Fair Value	Effective Weighted Duration Years
U.S. Govt. and Agency Obligations				
U.S. Government	$ 381,380,855	5.8	$ 383,122,214	6.7
Agency	506,019,218	2.9	575,009,065	2.7
Foreign Obligations	415,070,013	6.0	385,628,617	6.1
Corporate Obligations				
Bank & Finance	166,390,995	5.4	149,245,144	3.9
Collateralized Mortgage Obligations	912,944	1.8	1,076,456	2.2
Industrial	409,132,090	4.8	412,232,690	4.0
Other	97,718,099	4.8	94,423,373	4.2
Total	$ 1,976,624,214		$2,000,737,559	

Foreign Currency Risk

The ISBI's 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 $56,700,762 and $53,539,234 as of June 30, 2013 and 2012, respectively. The table below presents the foreign currency risk by type of investment as of June 30, 2013 and 2012.

	2013		2012	
Currency	Foreign Equity Securities & Foreign Preferred Stock	Foreign Obligations	Foreign Equity Securities & Foreign Preferred Stock	Foreign Obligations
Australian Dollar	$ 84,939,975	$ 17,798,299	$ 82,314,617	$ 16,469,771
Brazilian Real	35,504,150	–	49,364,844	–
Canadian Dollar	128,661,034	22,047,815	126,199,484	27,179,367
Chilean Peso	1,319,421	2,742,742	1,098,684	2,308,184
Czech Koruna	422,126	2,955,792	536,589	2,520,227
Danish Krone	34,412,484	4,925,465	27,321,050	4,165,438
Egyptian Pound	1,067,693	–	1,810,173	–
English Pound Sterling	423,002,548	23,463,993	374,618,002	32,868,184
Euro Currency	531,593,533	124,284,551	394,894,819	103,642,653
Hong Kong Dollar	145,893,712	1,991,143	127,339,809	2,384,108
Hungarian Forint	1,691,945	–	1,457,562	–
Indonesian Rupian	8,906,965	–	9,446,308	–
Israeli Shekel	2,992,079	45,464	2,619,603	28,742
Japanese Yen	273,783,526	65,746,192	191,615,229	65,481,682
Malaysian Ringgit	8,246,099	3,588,730	7,106,044	2,848,977
Mexican Peso	22,585,252	15,855,407	20,566,508	13,648,235
Moroccan Dirham	195,607	–	219,512	–
New Zealand Dollar	3,914,051	2,392,523	5,008,123	1,783,525
Norwegian Krone	27,605,678	7,137,733	24,657,161	6,403,137
Philippine Peso	2,511,702	–	2,219,444	–
Polish Zloty	3,126,169	6,352,962	2,949,201	8,408,688
Singapore Dollar	33,907,567	4,791,667	42,090,664	3,813,610
South African Rand	23,845,529	5,047,409	25,078,599	4,116,002
South Korean Won	84,875,633	18,591,249	71,317,427	13,526,890
Swedish Krona	32,302,268	9,448,272	27,254,280	10,680,201
Swiss Franc	218,884,679	8,538,778	138,838,635	7,455,551
Thailand Baht	4,935,467	5,425,631	3,954,203	4,274,188
Turkish Lira	3,301,243	–	2,811,622	–
Foreign investments denominated in U.S. Dollars	185,440,988	61,898,196	248,658,533	51,621,257
Total	$ 2,329,869,123	$ 415,070,013	$ 2,013,366,729	$ 385,628,617

Securities Lending

The ISBI participates in a securities lending program with Credit Suisse AG, New York Branch who acts as securities lending agent. Securities are loaned to brokers and, in return, the ISBI receives cash and non-cash collateral. All of the securities are eligible for the securities lending program. Collateral consists solely of cash 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 event of borrower default, Credit Suisse AG, New York Branch provides the ISBI with counterparty default indemnification. Investments in the cash collateral account represent securities that were distributed to the ISBI in connection with the in-kind redemption of the ISBI's ownership in the State Street Bank and Trust Company Quality Funds for Short-Term Investment (Quality D). Credit Suisse is not responsible for any losses with regards to these legacy investments. This arrangement subjects the ISBI to credit risk as the credit quality of these investments may decline over time. The credit risk on the legacy investments is the risk of a possible loss arising from the inability of a counterparty to meet its obligations. These losses could include the loss of principal, interest and/or decreased expected cash flows in any of the investments held in the ISBI's cash collateral account. In the event a counterparty defaults on its obligations, the ISBI would need to credit the cash collateral account with the amount of the default to make the account whole so that once loaned securities are returned, the cash pledged by borrowers can be returned to them. As of June 30, 2013 and 2012, respectively, the collateral received exceeded the fair value of the securities loaned. As of June 30, 2013 and 2012, there were outstanding loaned investment securities having fair values of $238,382,734 and $115,655,166, respectively; against which collateral was received with a fair value of $245,131,637 and $120,556,697, respectively. Collateral received at June 30, 2013 and 2012 consisted of $61,530,842 and $72,452,520, respectively, in cash and $183,600,796 and $48,104,177, respectively, in government securities for which the ISBI does not have the ability to pledge or sell.

The cash collateral received is invested in a short-term instrument having a fair value of $59,160,611 and $67,893,265 as of June 30, 2013 and 2012, respectively. This investment pool had an average duration of 29.80 days and 32.42 days as of June 30, 2013 and 2012, respectively. Any decrease in the fair value of invested cash collateral is recorded by the ISBI as unrealized losses and reported as a component of the investment income/loss on the ISBI's Statement of Changes in Net Position.

Cash and cash equivalents included in the System's Statement of Plan Net Position consist of deposits held in the State Treasury. The Illinois Office of the Treasurer invests the deposits held and allocates investment income on a monthly basis.

The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The State Treasurer has, through a Securities Lending Agreement, authorized Deutsche Bank AG to lend the State Treasurer's securities to broker–dealers and banks pursuant to a form of loan agreement.

During fiscal years 2013 and 2012, Deutsche Bank AG lent U.S. Treasury and U.S. Agency securities and received as collateral U.S. dollar denominated cash. Borrowers were required to deliver collateral for each loan equal to at least 100% of the aggregated market value of the loaned securities. Loans are marked to market daily. If the market value of collateral falls below 100%, the borrower must provide additional collateral to raise the market value to 100%.

The State Treasurer did not impose any restrictions during fiscal years 2013 and 2012 on the amount of the loans available or the eligible securities. In the event of borrower default, Deutsche Bank AG provides the State Treasurer with counterparty default indemnification. Deutsche Bank AG is obligated to indemnify the State Treasurer if the Deutsche Bank AG loses any securities, collateral or investments of the State Treasurer in Deutsche Bank AG's custody. Moreover, there were no losses during fiscal years 2013 and 2012 resulting from a default of the borrowers or Deutsche Bank AG.

During fiscal years 2013 and 2012, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in repurchase agreements with approved counterparties collateralized with securities approved by Deutsche Bank AG and marked to market daily at no less than 102%. Because the loans are terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. The State Treasurer had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. The securities lending cash collateral received that was invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2013 were $6,763,623,576 and $6,742,892,101, respectively. The securities lending cash collateral received that was invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2012 were $4,556,511,251 and $4,551,829,732, respectively. The System's portion of securities lending collateral that was invested in repurchase agreements as of June 30, 2013 and June 30, 2012 were $16,535,000 and $5,945,000, respectively.

Derivative Securities

In fiscal year 2010, the ISBI implemented GASB Statement No. 53 Accounting and Financial Reporting for Derivative Instruments 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. The ISBI invests in derivative instruments including forward foreign currency contracts, futures, rights and warrants. The ISBI's derivatives are considered investment derivatives.

Foreign currency forward contracts (FX forwards) are used to protect against the currency risk in the 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 ISBI's Statement of Net Position. 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 ISBI's Statement of Changes in Net Position. In May 2011, the ISBI removed language from the investment management agreements allowing managers to hedge foreign currencies and/or to hedge equity positions.

The ISBI's 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). Additionally, financial futures are used in the ISBI's fixed income portfolio to adjust portfolio strategy and overall portfolio duration. 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. As 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 ISBI's Statement of Changes in Net Position. 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 ISBI's investment portfolio.

The ISBI's investment managers use options in an attempt to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, the ISBI receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. All written financial options are recognized as a liability in the ISBI's Statement of Net Position. As a purchaser of financial options, the ISBI pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option. The gain or loss associated with options is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Position.

Rights and warrants allow the ISBI's 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 (P-Notes) are used in the portfolio by the ISBI's investment managers that are not registered to trade in domestic Indian Capital Markets. P-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 ISBI's Statement of Net Position 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 ISBI's Statement of Changes in Net Position.

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 table below presents the investment derivative instruments aggregated by type that were held by the ISBI as of June 30, 2013 and 2012.

	Changes in Fair Value		Fair Value at Year End		Notional Amount Number of Shares	
	2013	2012	2013	2012	2013	2012
FX Forwards	$ (2,963,240)	$ (1,693,910)	$ (412,825)	$ (43,859)	n/a	n/a
Futures	n/a	n/a	n/a	n/a	25,076,117	(16,717,412)
Options	6,068,549	2,744,205	9,078,690	2,811,004	8,040,934	27,000
Rights	(655,303)	(166,937)	22,104	30,249	35,139	153,435
Warrants	3,331,121	(9,022,293)	18	68,676,781	1	7,663,933
	$ 5,781,127	$ (8,138,935)	$ 8,687,987	$ 71,474,175	33,152,191	(8,873,044)

The table below shows the futures positions held by the ISBI as of June 30, 2013 and 2012.

	2013		2012	
	Number of Contracts	Contract Principal*	Number of Contracts	Contract Principal*
Equity Futures Purchased	1,398	$113,135,073	1,410	$92,997,500
Fixed Income Futures Purchased	723	94,816,672	382	48,411,940
Fixed Income Futures Sold	371	66,975,628	421	63,940,695

** Contract principal amounts shown represent the market value of the underlying assets the contracts control. These are shown to present the volume of the transactions but do 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 recorded values reported in the ISBI's Statement of Net Position.*

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 the 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, 2013 and 2012, respectively, the ISBI held futures contracts whose underlying instruments were exposed to interest risk but there were no GASB 53 reportable elements. The ISBI has not adopted a formal policy specific to master netting arrangements.

The ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The credit ratings and net exposure as of June 30, 2013 and 2012 for the counterparties are as follows:

	2013			2012		
Moody's Rating	Fair Value	Net Exposure	Percentage of Net Exposure	Fair Value	Net Exposure	Pecentage of Net Exposure
Aa3	$ 196,480	$ 196,480	26.97%	$ 45,189	$ 45,189	11.57%
Aa2	68,353	68,353	9.39%	46,885	46,885	12.00%
A3	198,724	198,724	27.28%	84,367	84,367	21.59%
A2	106,379	106,379	14.61%	64,971	64,971	16.62%
A1	92,066	92,066	12.64%	3,119	3,119	0.80%
Baa1	66,323	66,323	9.11%	146,228	146,228	37.42%
	$ 728,325	$ 728,325	100.00%	$ 390,759	$ 390,759	100.00%

The following table presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2013 and 2012:

	2013				2012			
Currency	FX Forwards	Rights	Warrants	Options	FX Forwards	Rights	Warrants	Options
Australian Dollar	$ 7,424	$ 1,571	$ –	$ –	$(85,578)	$ –	$ –	$ –
Brazilian Real	7,385	–	–	–	1,589	–	–	–
Canadian Dollar	(43,143)	–	–	397,444	(13,256)	10,733	–	–
Chilean Peso	6,394	–	–	–	1,450	1,296	–	–
Columbian Peso	–	–	–	–	(15,312)	–	–	–
Czech Koruna	7,402	–	–	–	9,411	–	–	–
Danish Krone	9,832	–	–	–	(30)	–	–	–
Egyptian Pound	(137)	–	–	–	(148)	–	–	–
English Pound Sterling	(99,137)	–	–	2,107,735	49,917	–	–	–
Euro Currency	95,900	18,101	–	2,062,912	118,889	18,220	6,103	–
Hong Kong Dollar	321	3	–	–	234	–	–	–
Indonesian Rupiah	–	–	–	–	(619)	–	–	–
Israeli Shekel	1,440	–	–	–	–	–	–	–
Japanese Yen	(533,639)	–	–	–	(19,071)	–	–	–
Malaysian Ringgit	2,157	–	–	–	(1,234)	–	–	–
Mexican Peso	14,205	–	–	–	27,008	–	–	–
New Zealand Dollar	25,808	–	–	–	46,885	–	–	–
Norwegian Krone	48,222	–	–	–	4,157	–	–	–
Polish Zloty	(6,005)	–	–	–	(32,461)	–	–	–
Singapore Dollar	(25,115)	–	–	–	(13,207)	–	–	–
South African Rand	11,768	–	–	–	14,798	–	–	–
South Korean Won	(31,319)	–	–	–	23,502	–	–	–
Swedish Krona	16,622	–	–	–	(154,835)	–	–	–
Swiss Franc	72,344	–	–	–	(5,251)	–	–	–
Thailand Baht	(1,555)	–	–	–	(697)	–	–	–
Investments denominated in U.S. dollars	–	2,429	18	4,510,599	–	–	68,670,678	2,806,363
	$ (412,825)	$ 22,104	$ 18	$9,078,690	$(43,859)	$ 30,249	$68,676,781	$2,806,363

Other Information

The System owns approximately 5% of the net position of the ISBI Commingled Fund as of June 30, 2013 and 2012. A schedule of investment expenses is included in the ISBI's annual report.

For additional information on ISBI's investments, please refer to their Annual Report as of June 30, 2013. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

5. Administrative Expenses

A summary of the administrative expenses for the Judges' Retirement System for fiscal years 2013 and 2012 are listed below.

Administrative expenses for fiscal years 2013 and 2012

	2013	2012
Personal services	$380,374	$366,182
Employee retirement contributions paid by employer	6,628	6,582
Employer retirement contributions	144,707	125,275
Social security contributions	28,060	27,118
Group insurance	107,810	83,480
Contractual services	135,033	127,216
Travel	5,511	3,585
Printing	4,111	3,025
Commodities	725	713
Telecommunications	2,572	2,705
Information technology	4,600	8,367
Automotive	1,113	2,871
Depreciation	1,974	1,766
Change in accrued compensated absences	8,732	5,064
Loss on disposal of equipment	–	141
Total	$831,950	$764,090

6. Funding - Statutory Contributions Required & Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal years 2013 and 2012, the actuary used the projected unit credit actuarial method for determining the proper employer contribution amount.

For fiscal years 2013 and 2012, the required employer contribution was computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90%.

In addition, the funding plan provides for a 15 year phase-in period to allow the state to adapt to the increased financial commitment. Since the 15-year phase-in period ended June 30 2010, the state's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved.

The total amount of statutorily required employer contributions for fiscal years 2013 and 2012 was $88,210,000 and $63,628,000, respectively. The total amount of employer contributions received from the state during fiscal years 2013 and 2012 was $88,210,000 and $63,628,000, respectively.

The funded status of the System as of June 30, 2013, the most recent actuarial valuation date, is listed below:

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
$610,195,584	$2,156,804,991	$1,546,609,407	28.3%	$177,006,000	873.8%

Additional information on the latest actuarial valuation is as follows.

Valuation date: June 30, 2013

Actuarial cost method: Projected Unit Credit

Amortization method:
a. For GASB Statement No. 25 reporting purposes: Level percent of payroll
b. Per state statute: 15-year phase-in to a level percent of payroll until a 90% funding level is achieved

Remaining amortization period:
a. For GASB Statement No. 25 reporting purposes: 30 years, open
b. Per state statute: 32 years, closed

Asset valuation method:
Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.

Actuarial assumptions:

Investment rate of return:	7.0 percent per year, compounded annually
Projected salary increases:	3.75 percent per year (consisting of an inflation component of 3.0% per year, a productivity component of .60% per year, and a merit/promotion component of .15% per year), compounded annually
Assumed inflation rate:	3.0 percent
Group size growth rate:	0.0 percent
Post-retirement increase:	Tier 1: 3.0 percent per year, compounded annually Tier 2: 3.0 percent per year or the annual change in the Consumer Price Index, whichever is less, compounded annually

Mortality Rates:
Post-retirement mortality rates are based on the RP-2000 Combined Healthy Mortality Table, sex distinct, projected to 2015, setback 3 years for males and 2 years for females. Pre-retirement mortality rates are based on 85 percent for males and 70 percent for females of post-retirement mortality.

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

7. Pension Plan & Other Post-Employment Benefits

Plan Description. All of the System's full-time employees who are not eligible for participation in another state-sponsored retirement plan 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 2013 and 2012 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the years ended June 30, 2013 and 2012, respectively. The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 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 St., Springfield, Illinois, 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. The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2013, 2012, and 2011 the employer contribution rates were 37.987%, 34.190%, and 27.988%, respectively. The System's contributions to SERS for fiscal years 2013, 2012, and 2011 were $144,707, $125,275, and $85,811, respectively, and were equal to the required contributions for each fiscal year.

Other Post-Employment Benefits. The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by 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 and dependents 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 Employee's Retirement System do not contribute towards 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.

However, Public Act 97-0695, effective June 30, 2012, alters the contributions to be paid by the State, annuitants, survivors and retired employees under the State Employees Group Insurance Act. This Act requires the Director of Central Management Services to, on an annual basis, determine the amount that the State should contribute. The remainder of the cost of coverage shall be the responsibility of the annuitant, survivor or retired employee. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The State pays the System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-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 costs 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 Central Management Services. A copy of the financial statements of the Department of Central Management Services may be obtained by writing to the Department of Central Management Services, Stratton Office Building, 401 South Spring Street, Springfield, Illinois, 62706.

8. Analysis of Changes in Reserve Balances

The funded statutory reserves of the Judges' Retirement System are composed of the following:

a. Reserve for Participants' Contributions
This reserve consists of participants' accumulated contributions for retirement annuities, survivors' annuities and automatic annual increases.

b. Reserve for Future Operations
This reserve is the balance remaining in the Judges' Retirement System from State of Illinois contributions and revenue from investments after consideration of charges for payouts by the Judges' Retirement System.

9. Accrued Compensation Absences

Employees of the Judges' Retirement System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned after December 31, 1983 and prior to January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2013 and 2012 total $68,347 and $59,615, respectively and are included in administrative expenses payable.

Statements of Changes in Reserve Balances
Years Ended June 30, 2013 and 2012

	Participants' Contributions	Future Operations	Total Reserve Balances
Balance at June 30, 2011	$ 167,567,660	$ 438,392,548	$ 605,960,208
Add (deduct):			
Excess of revenues over (under) expenses	15,858,341	(43,842,182)	(27,983,841)
Reserve transfers:			
Accumulated contributions of participants who retired or died with eligible survivor during the year	(5,879,351)	5,879,351	–
Balance at June 30, 2012	$ 177,546,650	$ 400,429,717	$ 577,976,367
Add (deduct):			
Excess of revenues over expenses	14,800,459	50,553,142	65,353,601
Reserve transfers:			
Accumulated contributions of participants who retired or died with eligible survivor during the year	(12,273,939)	12,273,939	–
Balance at June 30, 2013	$ 180,073,170	$ 463,256,798	$ 643,329,968

10. Equipment

Capital assets over $100 are capitalized at their cost at the time of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the asset. The estimated useful lives are as follows: (1) office furniture - 10 years, (2) equipment - 6 years, and (3) certain electronic data processing equipment - 3 years.

Summary of the changes in equipment for fiscal years 2013 and 2012

2013

	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	$ 29,295	$ 326	$ (880)	$ 28,741
Accumulated depreciation	(19,969)	(1,974)	880	(21,063)
Equipment, net	$ 9,326	$(1,648)	$ –	$ 7,678

2012

	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	$ 30,838	$ 7,856	$(9,399)	$ 29,295
Accumulated depreciation	(27,461)	(1,766)	9,258	(19,969)
Equipment, net	$ 3,377	$ 6,090	$ (141)	$ 9,326

11. New Accounting Pronouncement

GASB Statement No. 65, "Items Previously Reported as Assets and Liabilities", establishes accounting and financial reporting standards that reclassify and recognize, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. The Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term "deferred" in financial statement presentations. The System is required to implement this Statement for the year ending June 30, 2014.

GASB Statement No. 67, "Financial Reporting for Pension Plans", was established to provide improved financial reporting by state and local governmental pension plans. The scope of the Statement addresses accounting and financial reporting for the activities of pension plans that are administered through trusts that have the specific characteristics. For defined benefit pension plans, the Statement establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the pension liability for benefits provided through the pension plan. The System is required to implement this Statement for the year ending June 30, 2014.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets * (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
6/30/08	$ 612,680,574	$ 1,457,336,054	$ 844,655,480	42.0%	$ 143,700,000	587.8%
6/30/09	616,849,071	1,548,509,535	931,660,464	39.8	155,645,000	598.6
6/30/10	619,925,786	1,819,447,826	1,199,522,040	34.1	161,164,000	744.3
6/30/11	614,596,203	1,952,539,400	1,337,943,197	31.5	169,155,000	791.0
6/30/12	601,219,999	2,021,715,796	1,420,495,797	29.7	171,498,000	828.3
6/30/13	610,195,584	2,156,804,991	1,546,609,407	28.3	177,006,000	873.8

** For fiscal years prior to 2009, the actuarial value of assets was equal to the fair value of assets. Beginning in fiscal year 2009, the actuarial value of assets is equal to the fair value of assets adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.*

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
2008	$ 75,134,070	62.4%	$ 46,872,500	100.0%
2009	78,386,597	76.5	59,983,000	100.0
2010	86,916,418	90.3	78,832,000	99.6
2011	95,490,182	65.4	62,377,000	100.1
2012	110,923,357	57.4	63,628,000	100.0
2013	125,576,795	70.2	88,210,000	100.0

Notes to Required Supplementary Information

Valuation date	June 30, 2013	June 30, 2012
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method:		
GASB Statement 25 reporting purposes	Level percent of payroll	Level percent of payroll
Per State statute	15 year phase-in to a level percent of payroll until a 90% funding level is achieved	15 year phase-in to a level percent of payroll until a 90% funding level is achieved
Remaining amortization period:		
GASB Statement 25 reporting purposes	30 years, open	30 years, open
Per State statute	32 years, closed	33 years, closed
Asset valuation method	Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized over a 5 year period at a rate of 20 percent per year.	Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized over a 5 year period at a rate of 20 percent per year.
Actuarial assumptions:		
Investment rate of return	7.0 percent per year, compounded annually	7.0 percent per year, compounded annually
Projected salary increases	3.75 percent per year (consisting of an inflation component of 3.0 percent per year, a productivity component of .60 percent per year, and a merit/ promotion component of .15 percent per year), compounded annually.	4.0 percent per year (consisting of an inflation component of 3.0 percent per year, a seniority/merit component of 1.0 per year), compounded annually
Assumed inflation rate	3.0 percent	3.0 percent
Group size growth rate	0.0 percent	0.0 percent
Post-retirement increase	Tier 1: 3.0 percent per year, compounded annually. Tier 2: 3.0 percent per year or the annual change in the Consumer Price Index, whichever is less, compounded annually.	Tier 1: 3.0 percent per year, compounded annually. Tier 2: 3.0 percent per year or the annual change in the Consumer Price Index, whichever is less, compounded annually.
Mortality rates	Post-retirement: RP-2000 Combined Healthy Mortality Table, sex distinct, projected to 2015, setback 3 years for males and 2 years for females. Pre-retirement: 85 percent of post-retirement mortality for males and 70 percent of post-retirement mortality for females.	Active and retired members: The UP-1994 Mortality Table for Males, rated down 4 years. Survivors: The UP-1994 Mortality Table for Females, rated down 1 year.

SUMMARY OF REVENUES BY SOURCE
Years Ended June 30, 2013 and 2012

	2013	2012
Contributions:		
Participants:		
Participants	$ 16,034,232	$ 16,305,260
Interest paid by participants	235,076	63,644
Receipts from reciprocal systems	25,542	75,892
Repayment of refunds	73,787	–
Total participant contributions	16,368,637	16,444,796
Employer:		
General Revenue Fund	88,210,000	63,628,000
Received from reciprocal systems	–	16,099
Paid by participants	29,564	–
Total employer contributions	88,239,564	63,644,099
Total contributions revenue	104,608,201	80,088,895
Investments:		
Net investment income	16,083,537	13,408,141
Interest earned on cash balances	74,035	86,203
Net appreciation (depreciation) in fair value of investments	60,728,747	(13,563,440)
Total investment revenue (loss)	76,886,319	(69,096)
Total revenues	$ 181,494,520	$ 80,019,799

SCHEDULE OF PAYMENTS TO CONSULTANTS
Years Ended June 30, 2013 and 2012

	2013	2012
Actuary	$ 40,555	$ 26,000
Audit fees	37,959	39,932
Legal services	61	2,012
Financial planner	–	703
Medical services	2,730	94
Total	$ 81,305	$ 68,741

SUMMARY SCHEDULE OF CASH RECEIPTS AND DISBURSEMENTS
Years Ended June 30, 2013 and 2012

	2013	2012
Cash balance, beginning of year	$ 10,690,635	$ 18,015,766
Receipts:		
Participant contributions	16,066,771	16,312,068
Employer contributions:		
General Revenue Fund	88,812,640	55,674,490
Received from reciprocal systems	–	16,099
Paid by participants	29,564	–
Interest income on cash balances	70,234	90,309
Reimbursements from General Assembly Retirement System	233,924	214,000
Transfers from reciprocal systems	25,542	75,892
Cancellation of annuities, net of overpayments	62,088	33,538
Cancellation of refunds	82,022	–
Cancellation of administrative expenses	163	–
Tax-deferred installment payments	111,796	19,010
Repayment of refunds	177,200	–
Transfers from Illinois State Board of Investment	23,200,000	28,500,000
Miscellaneous	100	100
Total cash receipts	128,872,044	100,935,506
Disbursements:		
Benefit payments:		
Retirement annuities	93,148,675	87,184,592
Survivors' annuities	20,454,764	19,499,251
Refunds	1,831,497	586,981
Administrative expenses	1,068,153	989,813
Total cash disbursements	116,503,089	108,260,637
Cash balance, end of year	$ 23,059,590	$ 10,690,635

BKD LLP
CPAs & Advisors

225 N. Water Street, Suite 400
P.O. Box 1580
Decatur, IL 62525-1580
217.429.2411 Fax 217.429.6109 www.bkd.com

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

The Honorable William G. Holland
Auditor General
State of Illinois
and
The Board of Trustees
Judges' Retirement System of the State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the 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, the financial statements of the Judges' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 20, 2013. Our report includes a reference to other auditors who audited the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, as described in our report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

Management of the System is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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, misstatement 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 System's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System'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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Decatur, Illinois
December 20, 2013

Prior Finding Not Repeated – *Government Auditing Standards*

A. Finding – Noncompliance with Fiscal Control and Internal Auditing Act

The Judges' Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act). (Finding Code No. 12-1)

During the current year audit, we noted the System hired a full-time internal auditor. As a result, the System was able to complete audits in accordance with its current two-year plan for fiscal years 2013-2014. The System also prepared and transmitted to the Auditor General a certification that the systems of internal fiscal and administrative controls of the System complied with the requirements of the Act (30 ILCS 10/1003) within the required timeframe.