State of Illinois
State Employees' Retirement System

Compliance Examination

For the Year Ended June 30, 2009
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois

BKD LLP
CPAs & Advisors

State Employees' Retirement System of the State of Illinois

Compliance Examination

For the Year Ended June 30, 2009

Contents

Continued

The financial statements of the State Employees' Retirement System of Illinois for the year ended June 30, 2009, are published in a separate document and are supported herein by reference.

* Unaudited information is presented for informational purposes only and is not intended to be presented in conformity with accounting principles generally accepted in the United States of America.

State Employees' Retirement System of the State of Illinois

June 30, 2009

System Officials

Acting Executive Secretary	Timothy B. Blair
Accounting Division Manager	Nicholas C. Merrill, Jr., CPA
Legal Counsel	Attorney General's Office
Internal Auditor	Larry L. Stone

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

STATE RETIREMENT SYSTEMS

• State Employees' Retirement System of Illinois
• General Assembly Retirement System
• Judges' Retirement System of Illinois

Internet: *http://www.state.il.us/srs* E-Mail: *ser@mail.state.il.us*

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

April 6, 2010

BKD, LLP
Certified Public Accountants
225 North Water Street, Suite 400
Post Office Box 1580
Decatur, IL 62525-1580

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the System. We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of the System's compliance with the following assertions during period ended June 30, 2009. Based on this evaluation, we assert that during the year ended June 30, 2009 the System has materially complied with the assertions below.

A. The System has obligated, expended, received and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.

B. The System has obligated, expended, received and used public funds of the State in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.

C. The System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.

D. The State revenues and receipts collected by the system are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.

E. The money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Yours very truly,

State Employees' Retirement System of Illinois

Timothy B. Blair

Timothy B. Blair, Acting Executive Secretary

Nicholas C. Merrill

Nicholas C. Merrill, Jr., CPA, Accounting Division Manager

Compliance Report

State Employees' Retirement System of the State of Illinois

Compliance Report Summary

June 30, 2009

The compliance testing performed during this examination was conducted in accordance with *Government Auditing Standards* and in accordance with the Illinois State Auditing Act.

Accountants' Reports

The Independent Accountants' Report on State Compliance, on Internal Control Over Compliance, and on Supplementary Information for State Compliance Purposes does not contain scope limitations, disclaimers or other significant non-standard language.

Summary of Findings

Number of	Current Report	Prior Reports
Findings	1	2
Repeated findings	None	None
Prior recommendations implemented or not repeated	2	3

Details of the findings are presented in a separately tabbed report section.

Summary of Findings and Recommendations

Item No.	Page	Description	Finding Type
		Current Findings (State Compliance)	
09-1	7	Lack of Disaster Contingency Planning or Testing to Ensure Recovery of Computer Systems	Significant deficiency and non-compliance
		Prior Findings Not Repeated	
A	8	Journal Entry Review	
B	8	Credit Card Policy	

Exit Conference

System management reviewed the entire report and waived a formal exit conference. The response to the recommendation was provided by Nick Merrill, Accounting Division Manager, in a letter dated February 26, 2010.

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Independent Accountants' Report on State Compliance, on Internal Control Over Compliance, and on Supplementary Information for State Compliance Purposes

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

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State Employees' Retirement System of the State of Illinois' (System) compliance with the requirements listed below, as more fully described in the *Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies* (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2009. The management of the State Employees' Retirement System of the State of Illinois is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

A. The System has obligated, expended, received and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.

B. The System has obligated, expended, received and used public funds of the State in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.

C. The System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.

D. State revenues and receipts collected by the System are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.

E. Money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States; the Illinois State Auditing Act (Act); and the Audit Guide as adopted by the Auditor General pursuant to the Act; and, accordingly, included examining, on a test basis, evidence about the System's compliance with those requirements listed in the first paragraph of this report and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the System's compliance with specified requirements.

In our opinion, the System complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2009. However, the results of our procedures disclosed instances of noncompliance, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings as finding 09-1.

Internal Control

The management of the System is responsible for establishing and maintaining effective internal control over compliance with the requirements listed in the first paragraph of this report. In planning and performing our examination, we considered the System's internal control over compliance with the requirements listed in the first paragraph of this report as a basis for designing our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of the System's internal controls over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

A *deficiency* in an entity's internal control over compliance 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 noncompliance with the requirements listed in the first paragraph of this report on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a requirement listed in the first paragraph of this report will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance described in finding 09-1 in the accompanying schedule of findings that we consider to be significant deficiencies in internal control over compliance. A *significant deficiency* is a deficiency, or 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.

As required by the Audit Guide, immaterial findings excluded from this report have been reported in a separate letter to your office.

The System's response to the findings identified in our examination are described in the accompanying schedule of findings. We did not examine the System's response and, accordingly, we express no opinion on it.

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the System as of and for the years ended June 30, 2009 and 2008, and have issued our report thereon dated February 2, 2010. The accompanying supplementary information, as listed in the table of contents as Supplementary Information for State Compliance Purposes, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. The Supplementary Information for State Compliance Purposes, except for that portion marked "unaudited" on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

BKD, LLP

April 6, 2010

Current Findings — *Government Auditing Standards*

09-1 Finding – Lack of Disaster Contingency Planning or Testing to Ensure Recovery of Computer Systems

The State Employees' Retirement System (System) had not updated its disaster recover plan since May 2006. For example, the employee roster includes retired employees and does not include the current CIO or IT Manager. Additionally, testing of the System's recovery plan had not been conducted in the audit period.

The System carries out its mission through the use of Information Technology.

Information technology guidance (including the National Institute of Standards and Technology and Government Accountability Office) endorse the formal development and testing of disaster recovery plans. Tests of disaster recovery plans (and the associated documentation of the test results) verify that the plan, procedures, resources provide the capability to recover critical systems within the required timeframe.

Without an adequately developed and tested contingency plan, the System cannot ensure its critical systems could be recovered within an acceptable period, and minimize the impact associated with a disaster.

Although a disaster recovery plan has been in existence for a number of years, the plan had not been updated since May 2006, due to the excessive workload on several key management employees in the Administrative Services and Information Technology (IT) Divisions. Two of these key management employees from the IT Division retired as of May 31, 2008.

Failure to adequately update and test the disaster recovery plans leaves the Department exposed to the possibility of major disruptions of services. A comprehensive test of the plan across all platforms utilized will assist management in identifying weaknesses to ensure recovery procedures are adequate in the event a disaster. Continuous reviews and tests of plans would help management ensure the plans are appropriately modified, as the Department's computing environment and disaster recovery needs change. (Finding Code No. 09-1)

Recommendation

The System should review and update its plan at least annually or when significant changes occur. The System should perform and document tests of its Plan at least once a year. In addition, the Plan should be continuously updated to reflect environmental changes and improvements identified from tests.

System Response:

The System agrees that an up-to-date Disaster Recovery plan is appropriate. The System will implement a plan to perform and document the tests of the Disaster Recovery plan on at least an annual basis.

State Employees' Retirement System of the State of Illinois

Schedule of Findings

June 30, 2009

Prior Findings Not Repeated

A. Finding – Journal Entry Review

During the prior audit, we noted the System did not have a process for review of financial journal entries by a person independent of the person that initiates them. (Finding Code No. 08-1)

During the current audit, we noted the System implemented a process to have all financial journal entries reviewed by an independent person.

B. Finding – Credit Card Policy

During the prior audit, we noted the System did not have a written policy relating to the use, reporting and safeguarding of their purchasing card. (Finding Code No. 08-2)

During the current audit, we noted the policy was approved and based upon our sample testing properly followed.

Supplementary Information
for State Compliance Purposes

State Employees' Retirement System of the State of Illinois

Supplementary Information for State Compliance Purposes

Summary

June 30, 2009

Supplementary Information for State Compliance Purposes presented in this section of the report includes the following:

- Fiscal Schedules and Analysis:

  Schedule of Appropriations, Expenditures and Lapsed Balances
  Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances
  Comparative Schedules of Revenues and Expenses
  Comments on Significant Variations Between Certain Revenue Accounts
  Comparative Schedules of Administrative Expenses
  Analysis of Significant Variations in Expenses
  Schedule of Changes in State Property
  Schedule of Reconciliation of Revenue to Cash Receipts and to Deposits Remitted to the State Comptroller
  Schedules of Funding Progress and Employer Contributions
  Analysis of Significant Statement of Plan Net Asset Accounts
  Analysis of Investment Performance (Unaudited)

- Analysis of Operations:

  System's Functions and Planning Program
  Progress in Funding the System
  Rates of Return (Unaudited)
  System Employees
  Comparison of Administrative Expenses to Total Expenses
  Proceeds from General Obligation Bonds, Pension Funding Series June 2003 (Unaudited)
  Schedule of Contributions/Deductions and Effect on Investments
  Service Efforts and Accomplishments (Unaudited)

The accountants' report that covers the Supplementary Information for State Compliance Purposes presented in the Compliance Report Section states that it has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in the accountants' opinion, except for that portion marked "unaudited," on which they express no opinion, it is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Fiscal Schedules and Analysis

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances

For the Fourteen Months Ended August 31, 2009

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2009	Lapse Period Expenditures July 1, 2009 through August 31, 2009	Total Expenditures	Balances Lapsed
Appropriated Funds					
General Revenue Fund for Administration of the Social Security Enabling Act (Public Act 95-0734)					
Personal services	$ 53,600	$ 35,844	$ 1,961	$ 37,805	$ 15,795
Employer retirement contributions	9,600	7,548	413	7,961	1,639
Social Security contributions	4,100	2,656	148	2,804	1,296
Contractual services	25,000	17,945	7,050	24,995	5
Travel	1,800	441	—	441	1,359
Commodities	200	166	9	175	25
Electronic data processing	1,500	—	—	—	1,500
Telecommunications	500	386	35	421	79
	96,300	64,986	9,616	74,602	21,698
General Revenue Fund					
Appropriation for Employee Retirement Contributions Paid by Employer for Prior Fiscal Years (Public Act 95-0734)	50,000	22,972	—	22,972	27,028
Total all appropriated funds	$ 146,300	87,958	9,616	97,574	$ 48,726
Nonappropriated Funds					
State Employee Retirement System Trust Fund					
Benefits and other nonadministrative expenditures					
Pensions and annuities	$ —	$1,283,336,279	$ —	$1,283,336,279	$ —
Nonrecurring refunds and distributions	—	15,580,345	399,211	15,979,556	—
Refunds of prior calendar year retirement contributions	—	218,383	—	218,383	—
Refunds, not classified elsewhere	—	15,979,556	(399,211)	15,580,345	—
Payments to General Obligation Retirement Fund	—	68,124,598	9,868,047	77,992,645	—
	—	1,383,239,161	9,868,047	1,393,107,208	—

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances

For the Fourteen Months Ended August 31, 2009

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2009	Lapse Period Expenditures July 1, 2009 through August 31, 2009	Total Expenditures	Balances Lapsed
Nonappropriated Funds					
State Employee Retirement System Trust Fund (continued)					
Administrative expenditures					
Personal services	$ —	$ 3,878,685	$ 169,631	$ 4,048,316	$ —
Employee retirement contributions paid by employer	—	51,893	2,217	54,110	—
Retirement contributions	—	817,062	35,746	852,808	—
Social Security contributions	—	289,014	12,694	301,708	—
Group insurance	—	911,467	38,876	950,343	—
Contractual services	—	1,638,025	150,276	1,788,301	—
Travel	—	29,475	1,106	30,581	—
Purchase of investments	—	—	—	—	—
Commodities	—	26,743	2,367	29,110	—
Printing	—	54,493	3,862	58,355	—
Equipment	—	26,777	7,039	33,816	—
Electronic data processing	—	2,126,751	152,274	2,279,025	—
Telecommunications	—	61,442	5,621	67,063	—
Automotive		16,621	2,921	19,542	—
	—	9,928,448	584,630	10,513,078	—
Total nonappropriated funds	$ —	1,393,167,609	10,452,677	1,403,620,286	$ —
Grand total, all Funds		$1,393,255,567	$ 10,462,293	$1,403,717,860	

Note: The above data was taken from System records which have been reconciled to those of the State Comptroller.

State Employees' Retirement System
of the State of Illinois

Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances
For the Years Ended June 30, 2009, 2008 and 2007

	Fiscal Year		
	2009 P.A. 95-0734	2008 P.A. 95-0348	2007 P.A. 94-0798
General Revenue Fund			
Appropriations (net after transfers)	$ 146,300	$ 207,300	$ 211,600
Expenditures			
Administration of the Social Security Enabling Act			
Personal services	37,805	52,794	46,800
Employer retirement contributions	7,961	8,746	5,394
Social Security contributions	2,804	3,912	3,459
Contractual services	24,995	17,500	17,300
Travel	441	1,200	1,143
Commodities	175	188	176
Electronic data processing	—	452	—
Telecommunications	421	400	535
	74,602	85,192	74,807
Employee retirement contributions paid by employer for prior fiscal years	22,972	45,661	37,212
Total expenditures	97,574	130,853	112,019
Lapsed balances	$ 48,726	$ 76,447	$ 99,581

State Employees' Retirement System
of the State of Illinois

Comparative Schedules of Revenues and Expenses

For the Years Ended June 30, 2009 and 2008

	2009	2008
Revenue		
Contributions		
Participants	$ 242,227,432	$ 249,955,208
Employing state agencies and appropriations	774,910,344	587,732,407
Total contributions	1,017,137,776	837,687,615
Investments		
Net investment income	224,823,314	274,524,210
Interest earned on cash balances	7,319,968	13,404,255
Net appreciation (depreciation) in fair value of investments	(2,441,040,917)	(968,688,184)
Total net investment gain (loss)	(2,208,897,635)	(680,759,719)
Total revenue	(1,191,759,859)	156,927,896
Expenses		
Benefits		
Retirement annuities	1,164,454,557	1,089,743,632
Survivors' annuities	73,697,450	68,770,552
Disability benefits	46,513,406	43,086,065
Lump-sum benefits	15,548,262	12,515,378
Total benefits	1,300,213,675	1,214,115,627
Refunds of contributions (including transfers to reciprocating systems)	14,859,487	16,817,433
Administrative expenses	10,681,376	9,537,305
Total expenses	1,325,754,538	1,240,470,365
Revenue over (under) expenses	$(2,517,514,397)	$(1,083,542,469)

State Employees' Retirement System
of the State of Illinois

Comments on Significant Variations Between Certain Revenue Accounts
For the Years Ended June 30, 2008 and 2007

	2009	2008	Increase (Decrease)	
Contributions from participants	$ 242,227,432	$ 249,955,208	$ (7,727,776)	(1)
Contributions by employing state agencies	774,910,344	587,732,407	187,177,937	(2)
Net investment income	224,823,314	274,524,210	(49,700,896)	(3)
Net appreciation (depreciation) in fair value of investments	(2,441,040,917)	(968,688,184)	(1,472,352,733)	(3)

(1) Total employee payroll increased form FY2008 to FY2009 by approximately 1.5% and employee contributions were basically flat; there was also a significant decrease in optional service purchases.

(2) The employer contribution rate in FY2008 was 16.561%, and the employer contribution rate in FY2009 was 21.049%.

(3) Investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statues and were maintained in the ISBI Commingled Fund during the years ended June 30, 2009 and 2008.

Net appreciation (depreciation) in fair value was significantly greater than the previous fiscal year. The downward trend of the financial markets continued into the current fiscal year. These amounts may change significantly from year to year.

State Employees' Retirement System of the State of Illinois

Comparative Schedules of Administrative Expenses

For the Years Ended June 30, 2009 and 2008

	2009	2008
Nonappropriated Funds		
State Employees' Retirement Trust Fund		
Personal services	$ 4,044,917	$ 3,740,484
Employee retirement contributions paid by employer	51,206	26,145
Employer retirement contributions	852,808	620,113
Social Security contributions	301,708	278,258
Group insurance	950,343	903,197
Contractual services	1,746,425	1,438,261
Travel	30,581	32,450
Commodities	29,298	27,261
Printing	52,521	77,075
Electronic data processing	2,210,406	2,119,167
Telecommunications	67,063	62,341
Automotive	19,305	18,535
Depreciation	244,771	211,508
Other	80,024	(17,490)
Total	$ 10,681,376	$ 9,537,305
Appropriated Funds		
General Revenue Fund – Social Security Division		
Personal services	$ 37,805	$ 52,794
Employer retirement contributions	7,961	8,746
Social Security contributions	2,804	3,912
Contractual services	24,995	17,500
Travel	441	1,200
Commodities	175	188
Electronic data processing	421	452
Telecommunications	—	400
Total	$ 74,602	$ 85,192

State Employees' Retirement System of the State of Illinois

Analysis of Significant Variations in Expenses For the Years Ended June 30, 2009 and 2008

	2009	2008	Increase	
Retirement annuities	$ 1,164,454,557	$ 1,089,743,632	$ 74,710,925	(1)

(1) The increase is primarily due to a scheduled benefit increase of 3%, and a larger number of annuitants receiving payments.

State Employees' Retirement System of the State of Illinois

Schedule of Changes in State Property

For the Year Ended June 30, 2009

	Beginning Balance	Additions	Deletions	Ending Balance
State Employees' Retirement System Trust Fund				
Land	$ 655,241	$ —	$ —	$ 655,241
Land improvements	250,316	—	—	250,316
Building	3,352,428	—	—	3,352,428
Furniture and equipment	2,289,613	98,881	(443,363)	1,945,131
Total	6,547,598	98,881	(443,363)	6,203,116
Accumulated depreciation	(3,826,922)	(244,770)	443,335	(3,628,357)
Property and equipment – net	$ 2,720,676	$ (145,889)	$ (28)	$ 2,574,759
Social Security Contribution Fund				
Furniture and Equipment	$ 4,179	$ —	$ —	$ 4,179

This schedule has been reconciled to property reports submitted to the Office of the Comptroller.

State Employees' Retirement System
of the State of Illinois

Schedule of Reconciliation of Revenue to Cash Receipts and to Deposits Remitted to the State Comptroller

For the Years Ended June 30, 2009 and 2008

	2009	2008
Total revenue (loss) for the year	$(1,191,759,859)	$ 156,927,896
Add (deduct)		
Net (appreciation) depreciation in fair value of investments reinvested in the Illinois State Board of Investment (ISBI) Commingled Fund	2,441,040,917	968,688,184
Net investment income reinvested in the ISBI Commingled Fund	(224,823,314)	(274,524,210)
Transferred from ISBI	237,000,000	462,000,000
(Increase) decrease in receivables (employing state agencies, contributions and other)	(8,666,747)	(16,670,733)
Increase (decrease) in amount due to State of Illinois for bond principal and interest payments	(347,529)	1,102,066
Contribution credits earned by members during periods of disability	(6,927,654)	(5,930,382)
Cancellation or reimbursement of benefits and administrative expenses	6,283,274	6,435,920
Cancellation of Contribution refunds	56,314	40,844
Installment collections to establish service credits	120,403	214,168
Bond principal and interest payments collected and remitted to the State of Illinois	78,366,991	79,536,242
Other adjustments not affecting cash receipts	(96,123)	(92,731)
Total cash receipts	1,330,246,673	1,377,727,264
Add (deduct)		
Interest on cash balances	(7,782,920)	(13,825,554)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(6,025,888)	(6,002,287)
Cash in transit		
Beginning of year	382,165	146,708
End of year	(313,912)	(382,165)
Deposits in transit		
Beginning of year	1,320	1,500
End of year	(82,522)	(1,320)
Deposits remitted to the State Comptroller for order into the State Treasury	$ 1,316,424,916	$ 1,357,664,146
Fund 788	$ 62,810	$ 41,200
Fund 479	1,316,362,106	1,357,622,946
	$ 1,316,424,916	$ 1,357,664,146

State Employees' Retirement System of the State of Illinois

Schedules of Funding Progress and Employer Contributions For the Years Ended June 30, 2009 and 2008

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)
6/30/04	$ 9,990,186,874	$ 18,442,664,834	$ 8,452,477,960	54.2%	$3,439,251,000	245.8%
6/30/05	10,494,147,953	19,304,646,648	8,810,498,695	54.4	3,475,528,000	253.5
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2
6/30/07	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1
6/30/08	10,995,366,485	23,841,280,102	12,845,913,617	46.1	3,967,704,000	323.8
6/30/09	10,999,953,527	25,298,346,092	14,298,392,565	43.5	4,027,263,000	355.0

* 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 was 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(1)	Percentage Contributed	Annual Required Payroll Contribution per State Statute(3)	State (4) Pension Fund Contribution	Total required State Contribution	Percentage Contributed
2004	$ 576,219,951	83.1% (2)	$ 462,200,942	$ 15,150,000	$ 477,350,942	100% (2)
2005	727,428,010	58.8	425,682,669	—	425,682,669	100
2006	672,555,569	31.3	207,814,710	—	207,814,710	100
2007	823,802,760	43.6	361,113,709	—	361,113,709	99
2008	986,410,891	59.6	576,626,422	—	576,626,422	102
2009	1,003,432,849	77.2	769,851,595	—	769,851,595	101

(1) This amount includes both payroll and nonpayroll employer required contributions.

(2) This percentage excludes the additional employer contributions from the State of Illinois General Obligation bonds. These processed were not part of the current fiscal year required contributions.

(3) Employer required contribution determined in accordance with P.A. 88-0593 and P.A. 94-0004 (for Fiscal Years 2006 and 2007 only). These amounts reflect only payroll required contributions.

(4) The actual distribution from the State Pensions Fund was $5,970,645; the additional amount of $9,179,355 was received in accordance with HB585 (P.A. 93-0665) as a distribution from the Pension Contribution Fund.

State Employees' Retirement System of the State of Illinois

Schedules of Funding Progress and Employer Contributions For the Years Ended June 30, 2009 and 2008

Notes to Required Supplementary Information

Valuation date	June 30, 2009
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 unit a 90% funding level is achieved
Remaining amortization period:	
(a) For GASB Statement No. 25 reporting purposes	30 years, open
(b) Per State Statute	36 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	8.5 percent
Projected salary increases	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate	3.0 percent
Group size growth rate	0.0 percent
Postretirement increase	3.0 percent – compounded
Mortality table	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

State Employees' Retirement System of the State of Illinois

Analysis of Significant Statement of Plan Net Asset Accounts

For the Years Ended June 30, 2009 and 2008

Cash Balances

	2009	2008
State Treasury	$ 232,376,854	$ 306,223,083
Vouchers in transit	(11,897)	(77,405)
Deposit and cash in transit	313,912	382,165
	232,678,869	306,527,843
Petty cash fund	200	200
	$ 232,679,069	$ 306,528,043

Receivables

	2009	2008
Participants' contributions	$ 16,280,628	$ 16,249,569
Employing State agencies	35,390,539	26,290,400 (1)
Other accounts	5,764,303	5,921,504
	$ 57,435,470	$ 48,461,473

(1) The amount due from Employing State agencies was higher in FY2009 due to a higher employer contribution rate than in FY2008. The FY2009 rate was 21.049% and the FY2008 rate was 16.561%.

Investments

General Information:

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of Illinois are managed by the ISBI and are held in the ISBI Commingled Fund. Units of the ISBI Commingled Fund are issued to the member systems 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 member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems.

Investment portfolio management and performance are the direct responsibility of the ISBI which establishes investment policy and strategy.

State Employees' Retirement System
of the State of Illinois
Analysis of Significant Statement of Plan Net Assets Accounts
For the Years Ended June 30, 2009 and 2008

Investments (continued)

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2009 and 2008 is summarized as follows:

	2009	2008
Balance at beginning of year, at fair value	$ 10,653,973,521	$ 11,810,137,495
Net cash added (withdrawn) to/from investments	(237,000,000)	(462,000,000)
	10,416,973,521	11,348,137,495
Investment income		
Interest, dividends and other	263,734,307	313,924,157
Expenses	(38,910,993)	(39,399,947)
	224,823,314	274,524,210
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sales of investments	(1,229,510,422)	559,623,090
Net unrealized gain (loss) on investments	(1,211,530,495)	(1,528,311,274)
	(2,441,040,917)	(968,688,184)
Total net investment income	(2,216,217,603)	(694,163,974)
Balance at end of year, at fair value	$ 8,200,755,918	$ 10,653,973,521

State Employees' Retirement System of the State of Illinois

Analysis of Investment Performance (Unaudited)

For the Years Ended June 30, 2009

An analysis of investment performance for the years ended June 30, 2009 and 2008 is summarized as follows:

	2009	2008
Total return*	(20.1)%	(6.2)%

* Total return is the combined effect of income earned and market appreciation (depreciation).

Analysis of Operations

State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2009 and 2008

System's Functions and Planning Program

The State Employees' Retirement System of Illinois was established on January 1, 1944 for the purpose of providing an orderly means whereby aged or disabled employees may be retired from active service, without prejudice or hardship, and to enable the employees to accumulate reserves for themselves and their dependents for old age, disability, death and termination of employment, thus affecting economy and efficiency in the administration of the State government.

The System is governed by Article 14 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2009, the System had approximately 57,000 benefit recipients and 65,600 active members.

The State Employees' Retirement System of Illinois is administered by a Board of Trustees of thirteen persons, which includes: a. the Comptroller, who shall be the Chairperson; b. six persons appointed by the Governor with the advice and consent of the Senate who may not be members of the system or hold an elective State office and who shall serve a term of 5 years, except that the terms of the initial appointees under the amendatory act of the 96th General Assembly shall be as follows: 3 for a term of 3 years and 3 for a term of 5 years; c. four active participants of the System having at least 8 years of creditable service, to be elected from the contributing members of the System by the contribution members; and d. two annuitants of the System who have been annuitants for at least one full year, to be elected from and by the annuitants of the System. The administration of the detailed affairs of the System is vested in the Executive Secretary, under the direction of the Board. General policy relating to the administration of the System is stated in the minutes of the Board meetings.

The System also administers the Social Security Enabling Act, Article 21 of the Illinois Pension Code, which makes coverage under the Federal Social Security Program available to employees of the State and its political subdivisions. The purpose of the Social Security Contribution Fund of the System was to collect FICA contributions from employees, employing State agencies and various political subdivisions and remitting these contributions to the Federal government for calendar years prior to 1987. The responsibility of collecting and remitting Social Security contributions to the Federal government was transferred from this office to the Office of the Comptroller effective January 1, 1987. All adjustments for wages paid prior to January 1, 1987 were processed through this office. The Social Security Contribution Fund is an agency fund. The administrative expenses of the fund were appropriated by the General Assembly on a line item basis and, as such, always had a zero fund balance at year end.

The System is also responsible for the general administration of the State Employees Group Insurance Program as it applies to eligible annuitants. This includes enrollment, processing life insurance claims and other administrative details related to that program.

State Employees' Retirement System
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Analysis of Operations
For the Years Ended June 30, 2009 and 2008

Program planning activities of the System are under the direct supervision of the Executive Secretary and involve coordination between the governing Board and other executive staff of the System. The current planning program identifies various operational projects for fiscal year 2009. The planning summary for each project includes the project scope and objectives, implementation phases and timing, resource application and expected benefits. Each project is assigned to a divisional level manager who acts as project leader during all implementation phases of the project. Implementation progress is reported to the Executive Secretary, who in turn reports such progress directly to the System's Board of Trustees.

The operational plan for fiscal year 2009 included several of the fiscal year 2008 projects continued into fiscal year 2009.

New projects for fiscal year 2009 include: a) quick hits; b) active statement redesign; c) network project; d) upgrade temperature control system; e) application documentation update.

The information above constitutes System representations and no attempt has been made to evaluate the technical details of the planning or the System's progress toward implementation of these programs.

OPERATIONAL PLAN
Projects for FY2009/FY2010

FY 08 Continued in FY 09

A. Expansion of Internet Services – Field Services
B. Internet Usage Study – Field Services
C. Staff Training – Human Resources
D. E-mail Information Study – EDP
E. Automated Error Processing – Accounting
F. Review of Tax Information Brochure – Claims
G. Toll-Free Telephone Service Study – Field Services
H. Trustee Election Review – Field Services
I. Quick Hits – Filed Services
J. Relational Data Base Reformat – EDP
K. Network Project – EDP
L. Application Documentation Updates - EDP

New Projects for FY 09

M. Collective Bargaining Unit Project – Human Resources
N. Exterior Building Maintenance

FY10 IT projects include Domain upgrade, UPS upgrade, electrical upgrade, System Center Essentials implementation, Microsoft Exchange implementation, Migration from Lotus Notes to Outlook for e mail, Backup strategy analysis, conversion of Key Entry III data entry software to Viking software, conversion of Ami Pro dictation and automated letter generation to Microsoft Word, PC refresh completion, laptop computer refresh, encryption of all agency laptops, re-write of the external facing Reciprocal system from java WebSphere to Microsoft .net, adoption of Scrum-based application development methodology for new application development, adoption of project management practices, development of Human Resources application, and initiation of Employee Attendance System application development.

Progress in Funding the System

In August 1994, Senate Bill 533 was signed into law as Public Act 88-0593. This funding legislation, which became effective July 1, 1995, 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 percent. In addition, the funding plan provides for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Once the 15-year phase-in is complete, the State's contribution will then remain at a level percentage of payroll for the next 35 years until the 90 percent funded level is achieved.

The funding legislation also provides for the establishment of a continuing appropriation of the required employer contributions to the System. This, in effect, removed the appropriation of those funds from the annual budgetary process.

Public Act 92-0566 became effective June 25, 2002, and provided an early retirement incentive (ERI) for those participants under the State Employees' Retirement System who terminated service before December 31, 2002 (or April 30, 2003, for certain cases). The increase in the unfunded actuarial accrued liability due to the ERI was originally to be amortized over ten years. The law, as modified, now requires that, in addition to any employer contributions required above, the State shall pay an amount equal to $70,000,000 for fiscal years 2004 and 2005; and in each fiscal year 2006 through 2015, a level-dollar payment based upon the increase in the present value of future benefits provided by the early retirement incentives amortized at 8.5 percent interest.

Public Act 93-0002 became law on April 7, 2003, and authorized the State to issue $10 billion in general obligation bonds for the purpose of making contributions to the retirement systems. On June 12, 2003, the State issued $10 billion in General Obligation Bonds, Pension Funding Series of June 2003.

Commencing with fiscal year 2005, the maximum State contribution under Public Act 93-0002 equals the State contribution that would have been required if the general obligation bond contribution had not been made, reduced – but not below zero – by the State's debt service on each system's respective portion of the full $10 billion of General Obligation Bond, Pension Funding Series of June 2003.

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2009 and 2008

In June 2005, Public Act 94-0004 became law. This legislation further modified the funding plan by reducing the amount of required employer contributions for fiscal years 2006 and 2007 that would have otherwise been required under Public Act 88-0593, as modified by Public Act 93-0002. This act specified the appropriation amounts for fiscal years 2006 and 2007. The required State contributions for fiscal years 2008 through 2010 will then be increased incrementally as a percentage of the participant payroll so that by fiscal year 2011 the State is contributing at the required level contribution rate to achieve the financing objective of a 90% funded status by the end of fiscal year 2045.

Public Act 96-0043 became law on July 15, 2009. As required under PA 96-0043, the method for determining the actuarial value of assets used to determine the employer contribution rate was changed beginning with the June 30, 2009 valuation. The method was changed from the market/fair value to a smoothed value. The smoothed value recognizes actuarial investment gains or losses for each fiscal year, beginning with FY09, in equal amounts over the ensuing five-year period. The System incurred an actuarial loss of $3.0 billion in FY09. Per statutory requirement, 20% is recognized in the actuarial value of assets as of June 30, 2009, and recognition of the remaining 80%, or $2.4 billion, will be deferred and recognized in equal amounts over the next four valuations. Depending on whether the total net deferral is an investment gain or loss, the smoothing method will produce a contribution rate that is more or less than the rate based on the market/fair value. As of the June 30, 2009 valuation the total net deferral is a $2.4 billion loss, resulting in a contribution that is lower than it would be if the assets were valued at market/fair value.

The actuarial accrued liability of the System at June 30, 2009, amounted to approximately $25.3 billion. The actuarial value of assets (at smoothed value) at June 30, 2009 amounted to approximately $11.0 billion. The difference between the actuarial accrued liability and the actuarial value of assets of $14.3 billion reflects the unfunded actuarial accrued liability of the System at June 30, 2009. The System had a funded ratio (at smoothed value) of 43.5% at June 30, 2009.

The value of assets at June 30, 2009 using the market/fair value (valuation method used June 30, 2008) would have been $8.5 billion, giving rise to an unfunded accrued liability of approximately $16.8 billion. When using the market/fair value the System would have had a funded ratio of 33.5% at June 30, 2009.

The market/fair value of the assets of the fund, that were available for benefits, had decreased from $11.0 billion as of June 30, 2008 to $8.5 billion as of June 30, 2009. This decrease is due to the unfavorable return on fund assets. The actuarial value of the assets of $11.0 billion at June 30, 2009, is $2.5 billion higher than the market/fair value of the assets due to recognition of only 20% of the actuarial loss in fiscal year 2009.

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2009 and 2008

The Governmental Accounting Standards Board (GASB) has promulgated Statements No. 25 and 27 that mandate, among other things, the use of market or market related (actuarial) asset value. Prior to the valuation as of June 30, 2009, it was agreed that market/fair value, without adjustment, would be used for all actuarial purposes. Under Public Act 96-0043, effective in the June 30, 2009 valuation, the contribution projections would be set based on the actuarial value of assets. Funding status determinations and the Annual Required Contributions (ARC) were calculated based on the actuarial value of assets. Had this change not been enacted, the ARC and the statutory contribution would have been higher and as noted, the funding status would be 33.5% rather than the 43.5%.

State required contributions to the System for the next five fiscal years are noted in the table below.

Year Ended June 30	Required State Contribution (in millions)
2010	$ 1,167.1
2011	1,268.9
2012	1,361.7
2013	1,456.5
2014	1,551.1

The Schedule of Funding Progress (in millions) for fiscal years ending June 30, 2008 and 2009 are noted in the table below.

Actuarial Valuation Date	Actuarial Value of Assets*	Accrued Liability (AAL-Projected Unit Credit)	Funded Ratio	Unfunded Actuarial Accrued Liability (UAAL)	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered payroll
6/30/08	$ 10,995	$ 23,841	46.1%	$ 12,846	$ 3,968	323.8%
6/30/09	11,000	25,294	43.5	14,298	4,027	355.0

*Market value through FY08. Five-year smoothing beginning in FY09

The Schedule of Employer Contributions (in millions) for the fiscal years ending June 30, 2008 and 2009 are noted in the table below.

Year Ended June 30	Employer Contributions	Annual Required Contribution per GASB Statement #25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
2008	$ 587.7	$ 986.4	59.6%	$ 576.6	102.0%
2009	774.9	1,003.4	77.2	769.9	101.0

State Employees' Retirement System
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For the Years Ended June 30, 2009 and 2008

The Government Accounting Standards Board (GASB) requires disclosure of the Annual Required Contribution (ARC) under a standard funding methodology. Amounts shown as the ARCs for each year are different from the contributions required by State statute. The cumulative difference between the ARC and the annual required contribution per State statute represents the net pension obligation (NPO). The NPO is $1,814.5 million at June 30, 2009, which is an increase of $259.9 million from the June 30, 2008 NPO of $1,554.6 million.

Rates of Return (Unaudited)

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of Illinois are managed by the Illinois State Board of Investment (ISBI) and are held in the ISBI Commingled Fund. ISBI operates under a long-range investment plan with the objective to maximize the total rate of return. The objectives set forth are as follows:

At least equal to the assumed actuarial interest rate, currently 8.5% per year.

At least equal to the return of a composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets

The investment return for FY08 and FY09, net of fees, was (5.73%) and 2.89% respectively. The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was (20.1%) for fiscal year 2009 compared to (6.2%) for fiscal year 2008. The ISBI's total fund performance lagged the composite benchmark by (3.1%) for the year ended June 30, 2009. The investment return also lagged the 8.5% actuarial return assumption.

State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2009 and 2008

System Employees

System Employees' Retirement System Trust Fund

The average number of employees (not including the General Revenue Fund – Social Security Division) during the years ended June 30, 2009 and 2008 is summarized by functional classification as follows:

	2009	2008
Executive and administrative	14	13
Accounting, bookkeeping and clerical	28	32
Other office employees	26	23
Electronic data processing	13	13
Total	81	81

Social Security Contribution Fund

The Social Security Contribution Fund had one employee for both years ended June 30, 2009 and 2008.

Comparison of Administrative Expenses to Total Expenses

	2009	2008
Total expenses		
Benefits	$1,300,213,675	$1,214,115,627
Refunds of contributions, including transfers to reciprocating systems	14,859,487	16,817,433
Administrative expenses	10,681,376	9,537,305
	$1,325,754,538	$1,240,470,365
Administrative expenses as a percentage of total expenses	0.8%	0.8%

Proceeds from General Obligation Bonds, Pension Funding Series June 30, 2003 (Unaudited)

Public Act 93-0002 (Act) became effective on April 7, 2003, and authorized the State of Illinois to issue $10 billion of General Obligation Bonds for the purpose of making contributions to designated retirement systems. The State Employees' Retirement System was a "designated retirement system" for the purpose of this law.

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2009 and 2008

On June 12, 2003, the State of Illinois issued $10 billion of General Obligation Bonds, Pension Funding Series June 2003. 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 received their allocation of bond proceeds on July 1, 2003. The State Employees' Retirement System's portion of the allocation was $1,385,895,278. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment (Board) on July 2, 2003. The Board initially approved investing the pension bond proceeds in separate index funds. These index funds were subsequently liquidated and combined with the Board's other investments and invested in accordance with the asset allocation policy of the Board during the year ended June 30, 2004. The Board estimates return on the pension bond proceeds earned an annual rate of return of negative 20.1% during the year ended June 30, 2009, which is the same as the overall return for the Board's investment portfolio.

Schedule of Contributions/Deductions and Effect on Investments

Below is a schedule of contributions received by the System and expenditures of the System for benefits and operations and the effect of these transactions on the System's investments.

	2009	2008
Contributions		
Participant Contributions	$ 242,227,432	$ 249,955,208
State of Illinois Employer Contributions	774,910,344	587,732,407
Total Contributions	1,017,137,776	837,687,615
Deductions		
Retirement Benefits	1,164,454,557	1,089,743,632
Survivor Benefits	73,697,450	68,770,552
Disability Benefits	46,513,406	43,086,065
Lump-Sum Death Benefits	15,548,262	12,515,378
Refunds (including transfers to reciprocating systems)	14,859,487	16,817,433
Administrative Expenses	10,681,376	9,537,305
Total Deductions	1,325,754,538	1,240,470,365
Investments Used to Pay Benefits and Expenses	$ (308,616,762)	$ (402,782,750)

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2009 and 2008

Service Efforts and Accomplishments (Unaudited)

	2009	2008
Membership data		
Coordinated members	83,365	84,453
Noncoordinated members	3,091	3,172
Total members	86,456	87,625
Active members	65,599	66,237
Benefit payments processed		
Recurring		
Retirement annuities	44,566	43,781
Survivors' annuities	10,236	10,104
Disability benefits	2,297	2,226
Total	57,099	56,111
Termination refunds processed	1,387	1,598
Retirement counseling		
Preretirement sessions		
Number of sessions	181	185
Number of attendees	6,847	7,532
Postretirement seminars		
Number of sessions	33	37
Number of attendees	1,217	1,275
Regional and other meetings		
Number of sessions	294	475
Number of attendees	8,283	14,812