STATE EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS

FINANCIAL REPORT
YEAR ENDED JUNE 30, 2016

PERFORMED AS SPECIAL ASSISTANT AUDITORS
FOR THE AUDITOR GENERAL, STATE OF ILLINOIS

State Employees' Retirement System
of the State of Illinois

Financial Audit

For the Year Ended June 30, 2016

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State Employees' Retirement System
of the State of Illinois

Financial Statement Report
June 30, 2016

System Officials

Executive Secretary	Timothy B. Blair
Accounting Division Manager	Alan Fowler, CPA
Internal Audit	Casey Evans

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Summary

The audit of the accompanying financial statements of the State of Illinois, State Employees' Retirement System (System) was performed by RSM US LLP.

Based on their audit and the report of other auditors, the auditors expressed an unmodified opinion on the System's basic financial statements.

Summary of Findings

The auditors identified a matter involving the System's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying Schedule of Findings on page 39 of this report as item 2016-001 *Noncompliance with the Fiscal Control and Internal Auditing Act*.

Exit Conference

System management waived a formal exit conference in correspondence dated November 23, 2016. The responses to the recommendations were provided by Casey Evans, Internal Audit, in correspondence dated December 7, 2016.

RSM

RSM US LLP

Independent Auditor's Report

Honorable Frank J. Mautino, Auditor General – State of Illinois

Board of Trustees, State Employees' 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 Statement of Fiduciary Net Position of the State Employees' Retirement System of the State of Illinois (System), as of June 30, 2016, and the Statement of Changes in Fiduciary Net Position for the year then ended, 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 an opinion on these financial statements based on our audit. We did not audit the 2016 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 97 percent, 98 percent and (6) percent respectively 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 other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 entity'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 entity'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 opinion.

Opinion

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the System as of June 30, 2016, and the changes in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

The actuarially determined pension liability, calculated as required by GASB Statement No. 67, is dependent on several assumptions including the assumption that future required contributions from State sources are made based on statutory requirements in existence as of the date of this report. These assumptions are discussed in Note 6 of the financial statements on pages 26 through 28. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information:
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 6 and the required supplementary information as listed in the table of contents on pages 32 through 34 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We and other auditors 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 financial statements, and other knowledge we obtained during our audit of the 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 audit for the year ended June 30, 2016 was conducted for the purpose of forming an opinion on the System's financial statements. The supplementary financial information as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements.

The supplementary financial information as listed in the table of contents for the year then ended June 30, 2016 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements for the year ended June 30, 2016 and certain additional procedures, including comparing and reconciling such information directly to underlying accounting and other records used to prepare the financial statements, or to the 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, based on our audit and the report of other auditors, the supplementary financial information as listed in the table of contents is fairly stated in all material respects, in relation to the financial statements as a whole for the year ended June 30, 2016.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 4, 2017 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 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 its compliance.

SIGNED ORIGINAL ON FILE

Schaumburg, Illinois
January 4, 2017

This section presents management's discussion and analysis of the financial position and performance of the State Employees' Retirement Systems of Illinois (System) for the year ended June 30, 2016. 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 approximately 61,300 active state employees and 70,000 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 year ended June 30, 2016 basic financial statements are presented for the System. This information presents the fiduciary net position restricted for pensions for the System as of June 30, 2016. This financial information also summarizes the changes in fiduciary net position restricted for pensions for the year 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 three schedules and related notes concerning actuarial information, funded status, investment returns and actuarially determined contributions.
4. Other Supplementary Schedules. Other 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 fiduciary net position decreased by $220.4 million during fiscal year 2016. This change was primarily the result of a decrease in investments of $226.7 million.
- The System was funded at 30.6% as of June 30, 2016.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was a loss of 0.8% in fiscal year 2016. The System's annual money-weighted rate of return on its investment in the ISBI Commingled Fund was a loss of 0.86% for fiscal year 2016.

Condensed Statements of Fiduciary Net Position
(in millions)

	As of June 30		Increase/(Decrease) from
	2016	2015	2015 to 2016
Cash	$ 300.3	$ 170.6	$ 129.7
Receivables	86.5	128.8	(42.3)
Investments, at fair value *	14,805.4	15,032.0	(226.6)
Capital Assets, net	6.9	5.3	1.6
Total assets	15,199.1	15,336.7	(137.6)
Liabilities *	160.6	77.8	82.8
Total fiduciary net position	$ 15,038.5	$ 15,258.9	$ (220.4)

** Including securities lending collateral*

ADDITIONS TO FIDUCIARY NET POSITION

Additions to Fiduciary Net Position include employer and participant contributions and net income from investment activities. Participant contributions were approximately $256.2 million and $266.1 million for the years ended June 30, 2016 and June 30, 2015, respectively. Participant contribution rates are set by statute as a percentage of gross salary. For fiscal year 2016, employer contributions increased to approximately $1,882.2 million from $1,804.3 million in fiscal year 2015.

DEDUCTIONS FROM FIDUCIARY NET POSITION

Deductions from Fiduciary Net Position are primarily benefit payments. During fiscal years 2016 and 2015, the System paid out approximately $2,190.5 million and $2,034.9 million, respectively, in benefits. This increase in benefit payments of more than 7.7% from 2015 to 2016 is mainly the result of the annual scheduled 3% increase in retirement and other benefit payments. Also attributing to the increase was the increased number of beneficiaries, with more than a 3% increase from 2015 to 2016. Refunds were consistently just over 1% of the total deductions in each of the fiscal years presented and administrative costs of the System represented less than 1% of the total deductions in each of the fiscal years presented within the condensed statements.

Condensed Statements of Changes in Fiduciary Net Position
(in millions)

	For the Year Ended June 30, 2016	For the Year Ended June 30, 2015	Increase/(Decrease) from 2015 to 2016
Additions			
Participant contributions	$ 256.2	$ 266.1	$ (9.9)
Employer contributions	1,882.2	1,804.3	77.9
Net investment income (loss)	(125.5)	681.4	(806.9)
Total additions	2,012.9	2,751.8	(738.9)
Deductions			
Benefits	2,190.5	2,034.9	155.6
Refunds	26.7	23.1	3.6
Administrative expenses	16.1	16.5	(0.4)
Total deductions	2,233.3	2,074.5	158.8
Net increase\(decrease) in fiduciary net position	$ (220.4)	$ 677.3	$ (897.7)

FUNDED RATIO

The funded ratio of the plan measures the ratio of the fiduciary net position against the total pension liability 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 performed. The most recent available valuation showed the funded status of the System was 30.58% on June 30, 2016. The amount by which the total pension liability exceeded the fiduciary net position was $34.1 billion at June 30, 2016.

INVESTMENTS

Investments of the System are combined in a commingled investment pool held by the Illinois State Board of Investment (ISBI). The other entities participating in this commingled pool are the Judges' Retirement System, the 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 Net Position of each retirement system.

The net investment loss of the total ISBI Commingled Fund was approximately $133.7 million during fiscal year 2016, resulting in a negative return of 0.8%. The actual rate of return earned by the System will vary from the return earned on the total ISBI Commingled Fund as the 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, 2016, the ISBI Commingled Fund earned a compounded rate of return of 7.0%, 6.9%, and 5.0%, 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.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statement of Fiduciary Net Position
June 30, 2016

	2016
Assets	
Cash	$ 300,328,830
Receivables:	
Participants' contributions	11,893,976
Employer contributions	70,171,117
Other accounts	4,477,002
Total Receivables	86,542,095
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	14,741,054,632
Securities lending collateral with State Treasurer	64,256,000
Capital Assets, net	6,938,949
Total Assets	15,199,120,506
Liabilities	
Benefits payable	6,441,515
Refunds payable	1,141,622
Administrative expenses payable	1,768,589
Participants' deferred service credit accounts	316,145
Due to the State of Illinois	86,668,485
Securities lending collateral	64,256,000
Total Liabilities	160,592,356
Net position-restricted for pensions	$ 15,038,528,150

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statement of Changes in Fiduciary Net Position
for the Year Ended June 30, 2016

	2016
Additions:	
Contributions:	
Participants	$ 256,198,172
Employer	1,882,243,268
Total Contributions	2,138,441,440
Investment income:	
Net appreciation/(depreciation) in fair value of investments	(536,994,456)
Interest and dividends	447,100,539
Less investment expense, other than from securities lending	(38,394,629)
Net income/(loss) from investing, other than from securities lending	(128,288,546)
Net income from securities lending	2,845,614
Net investment income/(loss)	(125,442,932)
Total Additions	2,012,998,508
Deductions:	
Benefits:	
Retirement annuities	1,977,598,561
Survivor annuities	128,689,627
Disability benefits	64,057,780
Lump sum benefits	20,155,235
Total Benefits	2,190,501,203
Refunds *(including transfers to reciprocating systems)*	26,708,730
Administrative	16,126,997
Total Deductions	2,233,336,930
Net Increase/(Decrease)	(220,338,422)
Net position restricted for pensions	
Beginning of year	15,258,866,572
End of year	$15,038,528,150

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2016

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 State Employees' Retirement System of Illinois (System) is administered by a Board of Trustees consisting 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 for 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 contributing 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. Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System.

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 a pension trust fund 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 laws and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of disbursing benefits in accordance with Section 415 of the Internal Revenue Code. For fiscal year 2016, receipts were approximately $561,500 and disbursements were approximately $468,000. Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the financial statements of the System.

At June 30, 2016 participation levels in the System were as follows:

	2016
State agencies	40
State boards and commissions	39
TOTAL	79
Retirees and beneficiaries currently receiving benefits:	
Retirement annuities	56,825
Survivors' annuities	11,043
Disability benefits	2,163
TOTAL	70,031
Inactive employees entitled to benefits, but not yet receiving them	4,107
TOTAL	74,138
Current Employees:	
Vested: Coordinated with Social Security	36,167
Noncoordinated	1,613
Nonvested: Coordinated with Social Security	22,950
Noncoordinated	587
TOTAL	61,317

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 employees. The plan is comprised of two tiers of contribution requirements and benefit levels. The provisions below apply to both Tier 1 & 2 employees, except where noted. A summary of the plan provisions pertaining to eligibility and membership, contributions, and benefits are displayed in the table below:

a. Eligibility and Membership

Generally, anyone entering state service, except those in positions subject to membership in certain other state sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and other exceptions as indicated in state law, become members of the System immediately.

Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System.

b. Employee Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities in accordance with Chapter 40, Section 5/14-133 of the Illinois Compiled Statutes (ILCS).

Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rate is 4% if the member is covered by Social Security and 8% if the member is not covered. Certain employment categories which are eligible for benefits under alternative formulas contribute at the rate of 8 1/2% or 12 1/2 % depending upon whether or not the employee is covered by Social Security. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment.

Tier 1	Tier 2
No annual compensation limit on contributions.	Beginning on or after January 1, 2011, annual compensation on which contributions are taken cannot exceed $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less. The salary limit for calendar year 2016 is $111,572.

c. Employer Contributions

The State of Illinois is obligated to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

d. Retirement Annuity Benefits

The System is governed by Chapter 40, Article 5/14 of the ILCS. Vesting and benefit provisions of the System are defined in the ILCS. The retirement annuity is based on the member's final average compensation and the number of years of service credit that have been established. The retirement benefit formula available to general state employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. Alternative formula employees have a formula of 2.5% for covered service and 3.0% for noncovered service.

The maximum retirement annuity payable is 75% of final average compensation for regular employees and 80% for alternative formula employees. The minimum retirement annuity payable is $15.00 for each year of covered employment and $25.00 for each year of noncovered employment.

Regular Formula Tier 1

A member must have a minimum of eight years of service credit and may retire at:

• Age 60, with 8 years of service credit.

• Any age, when the member's age (years & whole months) plus years of service credit (years & whole months) equal 85 years (1,020 months) (Rule of 85) with eight years of credited service.

• Between ages 55-60 with 25-30 years of service credit (reduced 1/2 of 1% for each month under age 60).

The retirement benefit is based on final average compensation and credited service. Final average compensation is the 48 highest consecutive months of service within the last 120 months of service.

Under the Rule of 85, a member is eligible for the first 3% increase on January 1 following the first full year of retirement, even if the member is not age 60. If the member retires at age 60 or older, he/she will receive a 3% pension increase every year on January 1, following the first full year of retirement.

If the member retires before age 60 with a reduced retirement benefit, he/she will receive a 3% pension increase every January 1 after the member turns age 60 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.

Regular Formula Tier 2

A member must have a minimum of 10 years of credited service and may retire at:

• Age 67, with 10 years of credited service.

• Between ages 62-67 with 10 years of credited service (reduced 1/2 of 1% for each month under age 67).

The retirement benefit is based on final average compensation and credited service. For regular formula employees, final average compensation is the average of the 96 highest consecutive months of service within the last 120 months of service. The retirement benefit is calculated on a maximum salary of $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less.

If the member retires at age 67 or older, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every year on January 1, following the first full year of retirement. The salary limit for calendar year 2016 is $111,572.

If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.

Alternative Formula Tier 1

Members eligible for the alternative formula may retire at age 50 with 25 years of service credit, or at age 55 with 20 years of service credit.

Final average compensation is figured one of three ways:

• The average of the highest 48 consecutive months over the last 120 months of service (for members in service prior to January 1, 1998).

• Average of last 48 months of service.

• Final rate of pay: cannot exceed the average of the last 24 months of pay by 115%.

Alternative formula retirees receive their first 3% pension increase on January 1 following the first full year of retirement after age 55. These increases are not limited by the 80% maximum.

Alternative Formula Tier 2

Members eligible for the alternative formula may retire at age 60 with 20 years of service.

Final average compensation is the average monthly salary during the 96 highest consecutive months of service within the last 120 months. The retirement benefit is calculated on a maximum salary of $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less. The salary limit for calendar year 2016 is $111,572.

Alternative formula retirees receive their first pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, following the first full year of retirement after age 60. These increases are not limited by the 80% maximum.

e. Disability & Death Benefits
Occupational and nonoccupational (including temporary) disability benefits are available through the System. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service with the System.

The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of state employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

Tier 1	**Tier 2**
For disability benefits, final average compensation is the rate of pay on the date of the disability, or the 48 highest consecutive months of service within the last 10 years, whichever is greater.	For disability benefits, final average compensation is the rate of pay on the date of the disability, or the 96 highest consecutive months of service within the last 10 years, whichever is greater. The disability benefit is calculated on a maximum salary of $106,800. The salary limit for calendar year 2016 is $111,572.

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. Employee 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. 72, "Fair Value Measurement and Application", addresses accounting and financial reporting issues related to fair value measurements. The statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The ISBI and the System have implemented this Statement for the year ended June 30, 2016.

GASB Statement No. 73, "Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68", establishes requirements for defined benefit pensions that are not within the scope of GASB 68 and amends certain provisions of Statement No. 67 and 68 related to accounting and reporting. The System has implemented this Statement for the year ended June 30, 2016.

GASB Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions", addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. The statement establishes standards for recognizing and measuring liabilities, deferred outflows / deferred inflows of resources and expense/expenditures. In the case of defined benefit OPEB, the statement also identifies methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosures and required supplementary information about defined benefit OPEB are also addressed. This GASB is effective for fiscal years beginning after June 15, 2017 (FY 2018) and the impact on the System's financial statements, if any, has not been determined, at this time.

GASB Statement No. 76, "The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments", reduces the GAAP hierarchy to two categories of authoritative GAAP. The Statement also addresses the use of authoritative and nonauthoritative literature if the accounting treatment for a transaction is not covered within a source of authoritative GAAP. The System has implemented this Statement for the year ended June 30, 2016.

GASB Statement No. 79, "Certain External Investment Pools and Pool Participants", establishes whether an external investment pool may elect to use an amortized cost exception to fair value measurement. This Statement has not been implemented as it is not applicable to the System's investments.

GASB Statement No. 82, "Pension Issues – Amendment to GASB 67 & 68", addresses the presentation of payroll related measures in the required supplementary information and the classification of payments made by employers to satisfy employee (plan member) contribution requirements. This GASB is effective for fiscal years beginning after June 15, 2016 (FY 2017) and the System is currently reviewing the Statement for the purpose of implementing it for FY 2017.

d. 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, Foreign 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 – amortized cost; (4) Real Estate Investments – fair values based on audited financial statements of the funds and then adjusted by the ISBI and its investment managers for activity from audit date to fiscal year end; (5) Alternative Investments (Private Equity, Hedge Funds, Bank Loans, and Real Assets) - fair values based on audited financial statements of the funds and then adjusted by the ISBI and its investment managers for activity from audit date to fiscal year end; (6) Commingled Funds - fair values based on audited financial statements of the funds and then adjusted by the ISBI and its investment managers for activity from audit date to fiscal year end.

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.

e. Actuarial Experience Review
In accordance with Illinois Compiled Statutes, an actuarial experience review is to be performed at least once every three 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 as of June 30, 2015 resulting in the adoption of new assumptions as of June 30, 2016.

f. 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.

g. 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 four fiscal years.

h. 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 fiduciary net position or the changes in fiduciary net position of the System.

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.

4. Investments

Introduction

Investments of the System are combined in a commingled investment pool and held by the Illinois State Board of Investment (ISBI). The System owns approximately 94% of the net position of the ISBI commingled fund as of June 30, 2016. 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, 2016. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

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

	June 30, 2016
U.S. govt. and agency obligations	$ 2,349,026,919
Foreign obligations	80,165,287
Corporate obligations	746,537,021
Common stock & equity funds	4,317,909,601
Commingled funds	961,730,986
Foreign equity securities	2,243,595,695
Foreign preferred stock	428,058
Hedge funds	1,181,203,258
Real estate funds	1,704,064,846
Private equity	582,943,357
Money market instruments	356,617,721
Real assets	592,736,380
Bank loans	449,925,261
Foreign currency forward contracts	(1,337,420)
Total investments	$ 15,565,546,970

Rate of Return

For the fiscal year ended June 30, 2016, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was (0.86) percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

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, 2016, the ISBI had a non-investment related bank balance of $393,683. 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 and Deutsche Bank AG, NY Branch. State Street Bank and Trust Company has an AA- Long-term Deposit/Debt rating by Standard & Poor's and an Aa1 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, 2016, the ISBI had an investment related bank balance of $5,602,210. This balance includes USD and foreign cash balances. 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 had total investment commitments of $561 million at the end of fiscal year 2016. 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 $489 million as of June 30, 2016. Also, at the end of fiscal year 2016, the ISBI had no outstanding commitments to separate real estate accounts. At the end of fiscal year 2016, the ISBI had an outstanding amount of $72 million 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. These investments are redeemable once the underlying assets are liquidated.

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.

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, 2016, real estate equities of approximately $1,704 million are reported at estimated fair value. Of this amount, $1,885 million is net assets and $181 million is long term debt.

Required repayment of real estate debt, which is non-recourse debt is as follows as of June 30, 2016:

Debt Maturities Year Ending June 30	2016
2016	$ –
2017	56,500,000
2018	22,500,000
2019	43,239,761
2020–2024	58,875,000
	$ 181,114,761

Fair Value Measurements

The recurring fair value measurements for the year ended June 30, 2016 are as follows:

	At June 30, 2016 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Totals
Investments by fair value level				
Debt securities				
Government and agency obligations	$ -	$ 2,349,026,919	$ -	$ 2,349,026,919
Foreign obligations	-	79,635,747	529,540	80,165,287
Corporate obligations	-	743,456,840	3,080,181	746,537,021
Bank loans	1,007,807	16,740	448,900,714	449,925,261
Total debt securities	$ 1,007,807	$ 3,172,136,246	$ 452,510,435	$ 3,625,654,488
Equity Securities				
Common stock and equity funds	$ 4,316,613,525	$ -	$ 1,296,076	$ 4,317,909,601
Foreign equity securities	2,236,025,790	4,728,166	2,841,739	2,243,595,695
Foreign preferred stocks	428,058	-	-	428,058
Total equity securities	$ 6,553,067,373	$ 4,728,166	$ 4,137,815	$ 6,561,933,354
Other				
Foreign curency forward contracts	$ -	$ -	$ (1,337,420)	$ (1,337,420)
Hedge funds (1)	-	376,979,363	11,659,156	388,638,519
Real estate funds (1)	-	-	534,162,163	534,162,163
Real assets (1)	-	-	2,563,610	2,563,610
Total other	$ -	$ 376,979,363	$ 547,047,509	$ 924,026,872
Total investments by fair value level	$ 6,554,075,180	$ 3,553,843,775	$ 1,003,695,760	$ 11,111,614,714
Investments measured at the Net Asset Value (NAV)				
Commingled funds				$ 961,730,986
Real estate				1,169,902,683
Private equity				582,943,357
Real assets				590,172,770
Hedge funds				792,564,739
Total investments measured at the NAV				$ 4,097,314,535
Investments not measured at fair value				
Money market instruments				$ 356,617,721
Total investments				$ 15,565,546,970
	Level 1	Level 2	Not Applicable	Total
Securities lending collateral	$ 8,832,036	$ 5,260,910	$ 2,030,705 (2)	$ 16,123,651

(1) Investments are held in separate accounts.

(2) Consists of cash, interest income and tri-party repos which are not subject to leveling.

Fair value is the amount that would be received to sell the investment in an orderly transaction between market participants at the measurement date (i.e. exit price). The fair value measurements are determined within a framework that utilizes a three-tier hierarchy, which maximizes the use of observable inputs and minimizes the use of unobservable inputs. Investments measured and reported at fair value are classified and disclosed in one of the following categories:

- Level 1 – Unadjusted quoted prices in active markets for identical assets.
- Level 2 – Inputs other than quoted prices that are observable for the asset, either directly or indirectly. These inputs include:
  a. quoted prices for similar assets in active markets;
  b. quoted prices for identical or similar assets in markets that are not active;
  c. inputs other than quoted prices that are observable for the asset;
  d. inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 – Inputs that are unobservable for the asset. The valuation of these investments requires significant judgement due to the absence of quoted market values, inherent lack of liquidity, and changes in market conditions.

The valuation methodologies are as follows:

- U.S. Treasuries and U.S. Agencies: quoted prices for identical securities in markets that are not active;
- Foreign Government Obligations and Foreign Corporate Obligations: Broker quote in an active market;
- Corporate Bonds: quoted prices for similar securities in active markets;
- Bank Loans: discounted cashflow, internal assumptions, weighting of the best available pricing inputs and third party pricing services;
- Common Stock and Equity Funds, Foreign preferred Stocks, Foreign Equity Securities and Commingled Funds-Domestic and Foreign: quoted prices for identical securities in an active market. Brokers quote in an active market;
- Money Market Funds: Average cost which approximates fair value;
- Derivative instruments: valued using a market approach that considers foreign exchange rates.

Investments valued using the net asset value (NAV) per share (or its equivalent) are considered "alternative investments" and, unlike more traditional investments, generally do not have readily obtainable market values and take the form of limited partnerships. The ISBI values these investments based on the partnerships' audited financial statements. If June 30 statements are available, those values are used preferentially. However, some partnerships have fiscal years ending at other than June 30. If June 30 valuations are not available, the value is adjusted from the most recently available valuation taking into account subsequent calls and distributions, adjusted for unrealized appreciation/depreciation, other income and fees. Certain alternative investments are categorized as Level 3 in instances where the ISBI owns substantially 100% of the applicable separate account.

The following table presents the unfunded commitments, redemption frequency (if currently eligible), and the redemption notice period for alternative investments measured at NAV:

	June 30, 2016			
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemtion Notice Period
Commingled Funds	$ 961,730,986	none	N/A	N/A
Real Estate	1,169,902,683	205.0 million	Quarterly	90 Days
Private Equity	582,943,357	284.0 million	Quarterly	90 Days
Real Assets	590,172,770	72.0 million	N/A	N/A
Total Investments measured at the NAV	$ 3,304,749,796			

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".

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, 2016, 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, 2016, the ISBI benchmarked its debt security portfolio to Barclay's U.S. Universal Index. At June 30, 2016, the effective duration of the Barclay's U.S. Universal Index was 5.4 years. The table below shows the detail of the duration by investment type as of June 30, 2016.

	2016	
Investment Type	Fair Value	Effective Weighted Duration Years
U.S. Govt. and Agency Obligations		
U.S. Government	$ 1,626,996,131	8.4
Federal Agency	722,030,788	1.8
Foreign Obligations	80,165,287	5.8
Corporate Obligations		
Bank & Finance	233,128,652	5.8
Industrial	388,110,620	5.2
Other	125,297,749	5.3
Total	$ 3,175,729,227	

For the ISBI's bank loan portfolio, the appropriate measure of interest rate risk is weighted average maturity. Weighted average maturity is the average time it takes for securities in a portfolio to measure weighted in proportion to the dollar amount that is invested in the portfolio. Weighted average maturity measures the sensitivity of fixed-income portfolios to interest rate changes. At June 30, 2016, the weighted average maturity of ISBI's bank loan portfolio was 4.8 years.

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 have one issuer investment that exceeded 5% of the total investments of the fund as of June 30, 2016. This security was U.S. Treasury Notes/Bills with a Moody's rating of Aaa. This investment represented 5.9% of the total investments of the fund. The table below presents the quality ratings of debt securities held by the ISBI as of June 30, 2016.

	Moody's Quality Rating	2016
U.S. Government and Agency obligations	AAA	$ 2,349,026,919
Foreign Obligations	AAA	$ 380,599
	AA	2,218,831
	A	15,233,213
	BAA	9,159,736
	BA	20,824,887
	B	21,451,133
	CAA	6,236,918
	Not rated	4,659,970
Total Foreign Obligations		$ 80,165,287
Corporate Obligations		
Bank and Finance	AA	$ 12,984,272
	A	87,259,544
	BAA	62,766,036
	BA	45,048,390
	B	14,003,148
	CAA	7,207,916
	Not Rated	3,859,346
Total Bank and Finance		$ 233,128,652
Industrial	AAA	$ 2,547,505
	AA	21,831,260
	A	36,110,999
	BAA	76,119,486
	BA	115,386,734
	B	117,195,788
	CAA	9,128,425
	CA	679,770
	Not Rated	9,110,653
Total Industrial		$ 388,110,620
Other	AAA	$ 2,329,295
	AA	13,443,171
	A	11,103,985
	BAA	20,849,512
	BA	33,367,395
	B	40,851,081
	CAA	3,353,310
Total Other		$ 125,297,749
Total Corporate Obligations		$ 746,537,021
Money Market	Not Rated	$ 356,617,721
Total Money Market		$ 356,617,721

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 $51,927,037 as of June 30, 2016. The table below presents the foreign currency risk by type of investment as of June 30, 2016.

	2016	
Currency	Foreign Equity Securities & Foreign Preferred Stock	Foreign Obligations
Australian Dollar	$ 90,105,481	$ -
Brazilian Real	20,706,299	-
Canadian Dollar	91,200,217	-
Colombian Peso	969,778	-
Czech Koruna	101,535	-
Danish Krone	26,423,355	-
Egyptian Pound	360,559	-
English Pound Sterling	279,258,238	-
Euro Currency	560,249,243	-
Hong Kong Dollar	135,746,604	-
Hungarian Forint	1,092,049	-
Indonesian Rupian	6,200,659	-
Israeli Shekel	1,248,503	-
Japanese Yen	379,507,896	-
Malaysian Ringgit	8,188,031	-
Mexican Peso	10,281,362	-
New Israeli Sheqel	889,951	-
New Zealand Dollar	3,935,677	-
Norwegian Krone	28,803,019	-
Philippine Peso	4,005,114	-
Qatari Rial	1,677,959	-
Singapore Dollar	31,698,390	-
South African Rand	15,942,233	-
South Korean Won	88,449,167	-
Swedish Krona	55,724,933	-
Swiss Franc	136,963,837	-
Thailand Baht	5,651,254	-
UAE Dirham	1,296,044	-
Foreign investments denominated in U.S. Dollars	257,346,362	80,165,287
Total	$ 2,244,023,753	$ 80,165,287

Securities Lending

The ISBI participates in a securities lending program with Deutsche Bank AG, New York Branch who acts as securities lending agent. Prior to June 22, 2015 the ISBI participated in a securities lending program with Credit Suisse AG, New York Branch, who acted 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, Deutsche Bank 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). Deutsche Bank 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, 2016, the collateral received exceeded the fair value of the securities loaned. As of June 30, 2016, there was an outstanding loaned investment securities having a fair value of $100,576,391 against which collateral was received with a fair value of $102,133,052. Collateral received at June 30, 2016 consisted of $16,123,651 in cash and $86,009,401 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 $16,123,651 as of June 30, 2016. This investment pool had an average duration of 12.13 days as of June 30, 2016. 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 Fiduciary 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 year 2016, 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 fair value of the loaned securities. Loans are marked to market daily. If the fair value of collateral falls below 100%, the borrower must provide additional collateral to raise the fair value to 100%.

The State Treasurer did not impose any restrictions during fiscal year 2016 on the amount of the loans available, eligible securities. In the event of borrower default, Deutsche Bank AG provides the State Treasurer with counterparty default indemnification. In addition, 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 year 2016 resulting from a default of the borrowers or Deutsche Bank AG.

During fiscal year 2016, 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, 2016 were $2,603,015,000 and $2,587,869,617, respectively. The System's portion of securities lending collateral that was invested in repurchase agreements as of June 30, 2016 was $64,256,000.

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, 2016.

	Changes in Fair Value	Fair Value at Year End	Notional Amount Number of Shares
	2016	2016	2016
FX Forwards	$ 4,304,099	$ (1,337,420)	n/a
Futures	n/a	n/a	(4,454,480)
Options	(8,063)	-	-
Rights	(16,571)	73,490	632,334
Warrants	(134,625)	-	67
	$ 4,144,840	$ (1,263,930)	(3,822,079)

The table below shows the futures positions held by the ISBI as of June 30, 2016.

	2016 Number of Contracts	2016 Contract Principal*
Equity Futures Purchased	472	$48,761,577
Fixed Income Futures Purchased	-	-
Fixed Income Futures Sold	1,541	138,538,104

** 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, 2016, 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 following table presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2016:

	2016			
Currency	FX Forwards	Rights	Warrants	Options
Australian Dollar	$ (241,193)	$ -	$ -	$ -
Canadian Dollar	(137,931)	-	-	-
Danish Krone	(20,836)	-	-	-
English Pound Sterling	(115,086)	-	-	-
Euro Currency	(317,667)	36,136	-	-
Hong Kong Dollar	(5,723)	-	-	-
Israeli Shekel	(13,812)	-	-	-
Japanese Yen	(95,125)	-	-	-
Malaysian Ringgit	2,833	-	-	-
Mexican Peso	(29,456)	-	-	-
New Zealand Dollar	(19,332)	1,213	-	-
Norwegian Krone	(55,740)	-	-	-
Singapore Dollar	(16,950)	34,703	-	-
South African Rand	(76,027)	-	-	-
Swedish Krona	(59,673)	-	-	-
Swiss Franc	(133,041)	-	-	-
Thailand Baht	(2,662)	-	-	-
Investments denominated in U.S. dollars	-	1,438	-	-
	$ (1,337,420)	$ 73,490	$ -	$ -

The ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The counterparties were not rated and the fair value and net exposure as of June 30, 2016 for these contracts were $678,644.

5. 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 year 2016 the actuary used the projected unit credit actuarial method for determining the proper employer contribution rate and amount.

For fiscal year 2016 the required employer contributions 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 provided 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 employer contributions associated with the payrolls from the general revenue fund are paid in equal installments each month to the System based on the projected payroll for the year. At the end of the fiscal year, a reconciliation is performed with the State Comptroller's Office to calculate the actual general revenue wages subject to retirement and actual employer contributions due the System from the general revenue fund. If this calculation is greater than the general revenue employer contributions paid, an employer contribution receivable is accrued. If this calculation is less than the general revenue employer contributions paid, a Due to the State of Illinois (General Revenue Fund) is accrued. For Fiscal Year 2016, a Due to the State of Illinois was accrued in the amount of $83,722,028.

The total amount of statutorily required employer contributions, net of the debt service contributions, for fiscal year 2016 was $1,879,978,178. The total amount of employer contributions received from the State and other sources during fiscal year 2016 was $1,882,243,268.

6. Net Pension Liability of the State

The components of the State's net pension liability for this plan at June 30, 2016 are as follows:

Total Pension Liability (TPL)	Plan Fiduciary Net Position (FNP)	Net Pension Liability	Plan FNP as % of TPL
$49,183,947,656	$15,038,528,150	$34,145,419,506	30.58%

The System is significantly underfunded which raises concerns about its future financial solvency should there be a significant market downturn coupled with the State's inability or unwillingness to pay the employer contributions.

Actuarial assumptions

The total pension liability was determined by an actuarial valuation as of June 30, 2016, using the following actuarial assumptions, which were based on the results of an actuarial experience study for the period from July 1, 2012 to June 30, 2015, applied to all periods included in the measurement:

Actuarial Cost Method:	Entry Age Normal
Mortality:	105 percent of the RP2014 Healthy Annuitant mortality table, sex distinct, with rates projected to 2015; generational mortality improvement factors were added for 2016 valuation.
Inflation:	2.75 percent
Investment rate of return:	7.00 percent
Salary increases:	Salary increase rates based on age-related productivity and merit rates plus inflation. Post-retirement benefit increases of 3.00 percent, compounded, for Tier 1 and 3.00 percent or one-half of the annual increase in the Consumer Price Index, whichever is less, simple, for Tier 2.
Retirement age:	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.

Long-term expected return on plan assets

The long-term expected rate of return on pension plan investments was determined based on information provided by the Illinois State Board of Investments (ISBI) in conjunction with its investment consultant, Meketa Investment Group. The ISBI and Meketa Investment Group provided the simulated average 20-year annualized geometric return for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rate of return by the target asset allocation percentage and by adding expected inflation. For each major asset class that is included in the pension plan's target asset allocation as of June 30, 2016, the 20-year simulated real rates of return are summarized in the following table:

	Asset Allocation	
Asset Class	Target Allocation	20 Year Simulated Real Rate of Return
U.S. Equity	23%	5.8%
Developed Foreign Equity	13%	6.1%
Emerging Market Equity	7%	8.5%
Private Equity	9%	7.4%
Hedge Funds	3%	3.6%
Intermediate Investment Grade Bonds	11%	1.6%
Long-term Government Bonds	3%	1.6%
TIPS	5%	1.3%
High Yield and Bank Loans	5%	4.8%
Opportunistic Debt	4%	4.8%
Emerging Market Debt	2%	4.1%
Real Estate	10%	4.5%
Infrastructure	5%	5.9%
Total	100%	5.04%

Discount Rate

A single discount rate of 6.64% was used to measure the total pension liability as of June 30, 2016. The single discount rate was based on the June 30, 2016 expected rate of return on pension plan investments of 7.00%, and a municipal bond rate, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve, of 2.85% as of June 30, 2016. The projection of cash flows used to determine the single discount rates assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between the statutory contributions and the member rate. Based on these assumptions, the pension plan's fiduciary net position and future contributions were sufficient to finance the benefit payments through the year 2072 at June 30, 2016. As a result, for fiscal year 2016, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through 2072, and the municipal bond rate was applied to all benefit payments after that date.

Sensitivity of the net pension liability to changes in the discount rate

For fiscal year 2016, the following table presents the plan's net pension liability using a single discount rate of 6.64%, as well as what the plan's net pension liability would be if it were calculated using a single discount rate that is 1-percentage point lower or 1-percentage point higher.

	June 30, 2016		
	1% decrease (5.64%)	Current Discount Rate (6.64%)	1% increase (7.64%)
State's net pension liability	$41,210,301,546	$34,145,419,506	$28,380,269,649

7. Compensated Absences

Employees of the System are entitled to receive compensation for all accrued but unused vacation time upon termination of employment. Additionally, employees of the System are entitled to receive compensation for one-half of the unused sick days that were earned on and after January 1, 1984 and before January 1, 1998, upon termination of employment. The accrued compensated absences as of June 30, 2016 totaled $1,020,014, and is included in Administrative Expenses Payable.

8. Collection and Remittance of Bond and Interest Payments

On April 7, 2003, House Bill 2660 was signed into law as Public Act 93-0002. This legislation authorized the State to issue $10 billion in general obligation bonds for the purpose of making required contributions to the five state-funded retirement systems, including the State Employees' Retirement System. On July 1, 2003, the net bond proceeds were allocated and distributed to each of the five state-funded retirement systems based on each system's relative percentage of the total unfunded liability at June 30, 2002. The State Employees' Retirement System received an allocation of bond proceeds totaling $1,385,895,278 and deposited all of the proceeds into the Illinois State Board of Investment Commingled Fund on July 2, 2003.

Public Act 93-0839, effective July 30, 2004, requires that employer contributions to the System shall include an additional amount to be paid over to the General Obligation Bond Retirement and Interest Fund to pay principal of and interest on those general obligation bonds due that fiscal year. This debt service payment is to be made on the first day of each month, or as soon thereafter as practical.

The total debt service payments received for all fiscal year 2016 payrolls amounted to $24.9 million. The total amount remitted to the State of Illinois as of June 30, 2016 was $21.9 million.

As of June 30, 2016, the following amounts are included in the System's Statement of Plan Net Position regarding the collection of bond principal and interest payments:

	2016
Cash - payments collected but not yet remitted to the State of Illinois	$ (2,389,249)
Accounts receivable - for June payrolls received in July & August	$ (557,208)
Due to the State of Illinois	$ (2,946,457)

9. Administrative Expenses & Other Post-Employment Benefits

Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses which are budgeted and approved by the System's Board of Trustees, are displayed in the table below for June 30, 2016.

	2016
Personal Services	$ 5,353,647
Employee Retirement Pickup	32,838
Retirement Contributions	2,444,984
Social Security Contributions	396,106
Group Insurance	1,569,781
Contractual Services	1,768,448
Travel	12,209
Commodities	12,380
Printing	36,832
Electronic data processing	3,800,444
Telecommunications	59,466
Automotive	4,992
Depreciation/Amortization	651,528
Other (net)	(16,658)
Total	$ 16,126,997

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 Employees' 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. 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.

10. Social Security Division - Administrative Expenses

The Social Security Division of the State Employees' Retirement System was created by 40 ILCS 5/21, to administer the state's responsibilities under Title II Section 218 of the Federal Social Security Act and the master federal-state agreement.

The state's responsibilities include extending Social Security coverage by agreement to any of the state's retirement systems or units of local government requesting social security or medicare only coverage for their members or employees.

In addition, the Social Security Division was responsible for collecting wage information and contribution payments from covered retirement systems and units of local government on wages paid prior to January 1, 1987. Administrative expenses for the Social Security Division are appropriated annually by the State Legislature and are as follows for fiscal year 2016:

	2016
Personal services	$ 38,509
Social Security contributions	2,871
Total	$ 41,380

11. Capital Assets

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, (3) automobiles and certain electronic data processing equipment - 3 years, (4) building - 30 years, (5) land improvements - 15 years, and (6) capitalized software - 20 years. Land is carried at its original cost, including applicable legal fees, surveying costs, etc. This is a summary of changes in capital assets for 2016:

	2016			
	Beginning Balance	Additions	Deletions	Ending Balance
Assets				
Land	$ 655,241	$ –	$ –	$ 655,241
Land improvements	315,779	–	–	315,779
Building	3,859,820	185,751	–	4,045,571
Equipment	2,398,907	464,105	(79,810)	2,783,202
Capitalized software costs	2,751,441	1,669,491	–	4,420,932
TOTAL	9,981,188	2,319,347	(79,810)	12,220,725
Accumulated depreciation/ amortization				
Land Improvements	(11,090)	(2,337)	–	(13,427)
Building	(2,766,569)	(141,755)	–	(2,908,324)
Equipment	(1,733,848)	(286,388)	78,386	(1,941,850)
Capitalized software costs	(197,128)	(221,047)	–	(418,175)
TOTAL	(4,708,635)	(651,527)	78,386	(5,281,776)
Net capital assets	5,272,553	1,667,820	(1,424)	6,938,949

SCHEDULE OF CHANGES IN THE STATE'S NET PENSION LIABILITY AND RELATED RATIOS
Fiscal Years Ended June 30, 2016 through 2014

	2016	2015	2014
Total pension liability			
Service Cost	$ 843,376,643	$ 847,997,030	$ 776,487,959
Interest	2,989,387,125	2,912,736,360	2,754,121,665
Difference between expected and actual experience	(730,622,389)	(464,942,210)	150,997,067
Assumption changes	5,048,087,579	360,713,498	3,142,466,514
Benefit payments	(2,190,501,203)	(2,034,858,435)	(1,917,062,639)
Refunds	(26,708,730)	(23,128,975)	(23,082,814)
Administrative expense	(16,126,997)	(16,547,823)	(16,615,105)
Net change in total pension liability	5,916,892,028	1,581,969,445	4,867,312,648
Total pension liability - beginning	43,267,055,628	41,685,086,183	36,817,773,535
Total pension liability - ending (a)	$49,183,947,656	$43,267,055,628	$41,685,086,183
Plan fiduciary net position			
Contributions - employer	$ 1,882,243,268	$ 1,804,319,356	$ 1,699,447,826
Contributions - participant	256,198,172	266,139,156	269,232,241
Net investment income	(125,442,932)	681,377,052	2,169,346,258
Benefit payments	(2,190,501,203)	(2,034,858,435)	(1,917,062,639)
Refunds	(26,708,730)	(23,128,975)	(23,082,814)
Administrative expense	(16,126,997)	(16,547,823)	(16,615,105)
Net change in plan fiduciary net position	(220,338,422)	677,300,331	2,181,265,767
Plan fiduciary net position - beginning	15,258,866,572	14,581,566,241	12,400,300,474
Plan fiduciary net position - ending (b)	$15,038,528,150	$15,258,866,572	$14,581,566,241
State's net pension liability - ending (a)-(b)	$34,145,419,506	$28,008,189,056	$27,103,519,942
Plan fiduciary net position as a percentage of the total pension liability	30.58%	35.27%	34.98%
Covered-employee payroll	$ 4,284,362,301	$ 4,453,683,664	$ 4,416,152,691
State's net pension liability as a percentage of covered employee payroll	796.98%	628.88%	613.74%

Notes to the Schedule of Changes in the State's Net Pension Liability and Related Ratios

Valuation Date: June 30, 2016

This Schedule is intended to show information for ten (10) years. Information prior to 2014 is not available. The additional years will be added, prospectively, as they become available.

2016 Changes in Assumptions:

- The rate of inflation decreased from 3.00 percent to 2.75 percent.
- The investment return assumption was decreased from 7.25 percent to 7.00 percent.
- The payroll growth assumption was decreased from 3.5 percent to 3.25 percent.
- Separate Tier 2 turnover rates were implemented for members eligible for regular formula and alternative formula benefits. The new rates increased the expected turnover.
- Generational mortality improvement factors were added to reflect future mortality improvements. The new mortality tables move from a single dimensional age-based table to a two dimensional table where the year of a person's birth influences their mortality rate.
- An assumption was added that all current and future active members would increase service by 4.5 months upon retirement due to the optional service purchase of unused sick and vacation leave upon leaving state employment.

SCHEDULE OF INVESTMENT RETURNS

	2016	2015	2014
Annual money-weighted rate of return, net of investment expense	(0.86)%	4.79%	17.9%

*** NOTE:** This Schedule is intended to show information for ten (10) years. Information prior to 2014 is not available. The additional years will be added, prospectively, as they become available.

SCHEDULE OF STATE CONTRIBUTIONS

Fiscal Year Ended June 30	Actuarially determined contribution	Contributions received	Contribution (deficiency) excess	Covered Employee Payroll	Contributions received as a percentage of covered employee payroll
2007	$ 823,802,760	$ 358,786,650	$ (465,016,110)	$ 3,762,777,000	9.54%
2008	986,410,891	587,732,407	(398,678,484)	3,967,704,000	14.81%
2009	1,003,432,849	774,910,344	(228,522,505)	4,027,263,000	19.24%
2010	1,177,313,343	1,095,545,856	(81,767,487)	4,119,360,842	26.60%
2011	1,289,002,005	1,127,886,796	(161,115,209)	4,211,186,269	26.78%
2012	1,614,834,808	1,391,416,375	(223,418,433)	4,329,083,716	32.14%
2013	1,741,286,416	1,531,932,137	(209,354,279)	4,236,191,257	36.16%
2014	1,956,841,419	1,699,447,826	(257,393,593)	4,416,152,691	38.48%
2015	2,045,354,223	1,804,319,356	(241,034,867)	4,453,683,664	40.51%
2016	2,019,691,233	1,882,243,268	(137,447,965)	4,284,362,301	43.93%

Notes to Schedule of State Contributions:

Valuation Date:	June 30, 2014
Notes	Actuarially determined contribution rates are calculated as of June 30, which is 12 months prior to the beginning of the fiscal year in which the contributions will be made.

Methods and Assumptions as of the Valuation Date:

Actuarial Cost Method:	Projected Unit Credit
Amortization Method:	Normal cost plus a level percentage of capped payroll amortization of the unfunded accrued liability.
Remaining Amortization Period:	30 years, open
Asset Valuation Method:	5 year smoothed market
Inflation:	3.00 percent
Salary Increases:	Salary increase rates based on age-related productivity and merit rates plus inflation.
Post Retirement Benefits:	Post-retirement benefit increases of 3.00 percent, compounded, for Tier 1 and 3.00 percent or one-half of the annual increase in the Consumer Price Index whichever is less, simple, for Tier 2.
Investment Rate of Return:	7.25 percent
Retirement Age:	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.
Mortality:	105 percent of the RP2014 Healthy Annuitant table, sex distinct

SUMMARY OF REVENUES BY SOURCE

	2016
Contributions:	
Participants	$ 249,748,087
Interest paid by participants	5,570,530
Repayment of refunds	879,555
Total participant contributions	256,198,172
Employer:	
General Revenue Fund	1,245,448,022
Employing state agencies and appropriations	635,433,973
Paid by participants	1,361,273
Total employer contributions	1,882,243,268
Total contributions	2,138,441,440
Investment income:	
Net appreciation/(depreciation) in fair value of investments	(536,994,456)
Interest and dividends from investments	446,344,050
Interest earned on cash balances	756,489
Less investment expense, other than from securities lending	(38,394,629)
Net income/(loss) from investing, other than from securities lending	(128,288,546)
Net securities lending income	2,845,614
Net investment income/(loss)	(125,442,932)
Total revenues	$2,012,998,508

SUMMARY SCHEDULE OF CASH RECEIPTS & DISBURSEMENTS

	2016
Cash balance, beginning of year	$ 170,646,535
Receipts:	
Participant contributions	247,670,465
Employer contributions (net of bond principal and interest transfers)	645,258,707
General Revenue Fund/Pension Contribution Fund	1,359,109,815
Transfers from Illinois State Board of Investment	100,000,000
Interest income on cash balance	703,936
Claims receivable payments	5,546,060
Installment payments	3,120,620
Other	211,061
Total cash receipts	2,361,620,664
Disbursements:	
Annuity payments:	
Retirement annuities	1,978,200,485
Widow's and Survivor's annuities	128,848,275
Disability benefits	59,829,576
Lump Sum benefits	19,574,428
Refunds (including transfers to reciprocal systems)	27,112,773
Refund to the General Revenue Fund	-
Administrative expenses	18,372,832
Total cash disbursements	2,231,938,369
Cash balance, end of year	$ 300,328,830

SCHEDULE OF PAYMENTS TO CONSULTANTS & ADVISORS

	2016
Legal Services	$ 59,683
Actuarial Costs	166,892
Audit Expense	71,897
Physicians and Disability Inspections	202,356
Financial Planning	51,217
Management Consultants	830,312
TOTAL	$ 1,382,357

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

Honorable Frank J. Mautino
Auditor General, State of Illinois

Board of Trustees
State Employees' 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 State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2016, and the related notes to the financial statements as listed in the table of contents and have issued our report thereon dated January 4, 2017. 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

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) 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, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings as item 2016-001 that we consider to be a significant deficiency.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether the System's financial statements are free from 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*.

Response to Findings
The System's response to the finding identified in our audit is described in the accompanying schedule of findings. The System's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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 an 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.

SIGNED ORIGINAL ON FILE

Schaumburg, Illinois
January 4, 2017

Government Auditing Standards

Finding No. 2016-001 Noncompliance with the Fiscal Control and Internal Auditing Act

The State Employees' Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act).

The Act (30 ILCS 10/2003) requires the chief executive officer to ensure that internal audits of all major systems of internal control are conducted at least once every two years. The System was unable to complete internal audits of all major systems of internal control at least every two years as required by the Act.

System officials indicated the System was not able to provide additional resources to the internal audit function and therefore the current internal auditor did not have adequate time during the fiscal year to complete internal audits as required.

Failure to comply with the Act increases the risk that fraud, misuse of funds, or internal control weaknesses would not be detected on a timely basis (Finding Code No. 2016-001, 2015-001, 2014-001).

Recommendation:

We recommend System management develop a plan to ensure the internal audit function has the resources necessary to comply with the Act.

Response:

The System accepts the finding. The SERS Board of Trustees has created and funded an additional internal auditor position in fiscal year 2017 to aid the Chief Internal Auditor in performing audit duties. The new position has been posted and candidates have been interviewed.

State Employees' Retirement System
of the State of Illinois

Prior Finding Not Repeated

Year Ended June 30, 2016

Government Auditing Standards

A. Finding - Controls over Census Data

In the prior year, the State Employees' Retirement System of the State of Illinois (System) had weaknesses in controls over creditable earnings and member census data reported by its participating State agencies (Finding Code No. 2015-002, 2014-002).

During the current fiscal year, the System implemented a risk assessment and sampling plan to establish a schedule to perform audits of census data at the participating State agencies. In addition, the System performed audits at a sample of agencies to verify census data utilized by the System.