

State of Illinois
State Universities Retirement System
Compliance Examination
For the Year Ended June 30, 2005
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois



State of Illinois
State Universities Retirement System
Compliance Examination
For the Year Ended June 30, 2005

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State Universities Retirement System
Compliance Examination
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The financial statements of the State Universities Retirement System of Illinois for the year ended June 30, 2005, are published in a separate document and are supported herein by reference.

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

**State of Illinois
State Universities Retirement System**

Officials

June 30, 2005

Executive Director
Manager of Finance and Accounting
Legal Counsel
Internal Auditor
President
Vice President
Treasurer
Board of Trustees

Mr. James Hacking
Mr. William Jackson
Mr. Dan Slack
Mr. Steven Hayward
Dr. Stanley Rives
Ms. Pat McKenzie
Dr. Fred Giertz
Ms. Christine Boardman
Mr. Mark Donovan
Mr. Michael Mackey
Mr. Michael Pizzuto
Mr. Mitchell Vogel
Mr. John Schultz

State Universities Retirement System's office is located at:

1901 Fox Drive
Champaign, IL 61820



State Universities Retirement System of Illinois

Serving Illinois Community Colleges and Universities

1901 Fox Drive • Champaign, IL 61820-7333

1-800-ASK SURS

(217) 378-9800 (FAX)

(217) 378-8800 (C-U)

www.surs.org

October 27, 2005

BKD, LLP

Certified Public Accountants

225 North Water Street, Suite 400

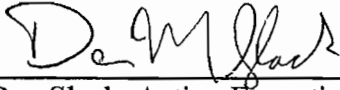
Post Office Box 1580

Decatur, IL 62525-1580

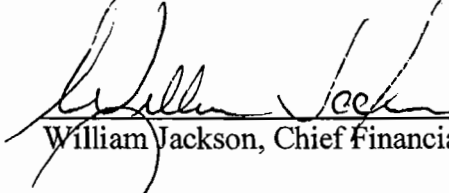
We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grants that could have a material effect on the operations of the State Universities Retirement System (SURS). We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of SURS' compliance with the following assertions during the year ended June 30, 2005. Based on this evaluation, we assert that during the year ended June 30, 2005, SURS has materially complied with the assertions below.

- A. SURS has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. SURS has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions, or mandatory directions imposed by law upon such obligation, expenditure, receipt, or use.
- C. SURS has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. The State revenues and receipts collected by SURS are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate, and in accordance with law.
- E. The money or negotiable securities or similar assets handled by SURS on behalf of the State or held in trust by SURS have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

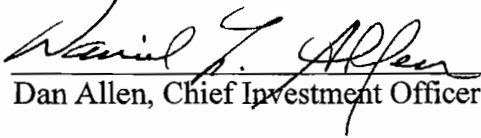
State Universities Retirement System



Dan Slack, Acting Executive Director,
General Counsel



William Jackson, Chief Financial Officer



Dan Allen, Chief Investment Officer

Compliance Report

State of Illinois
State Universities Retirement System
Compliance Report Summary
June 30, 2005

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

Auditors' Reports

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

Summary of Findings

Number of	This Audit	Prior Audit
Findings	1	1
Repeated findings	—	1
Prior recommendations implemented or not repeated	1	3

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

Summary of Findings and Recommendations

Item No.	Page	Description
Finding (State Compliance)		
05-01	10	Deposits Subject to Custodial Credit Risk
Prior Findings Not Repeated (Government Auditing Standards)		
05-02	11	Lack of Segregation of Duties Over Bank Reconciliation

Exit Conference

The results of our Compliance Examination were discussed with System personnel, but a formal exit conference was not considered necessary. The System's response to our recommendation was provided by Ms. Shelley Porter, Chief Financial Officer on March 28, 2006.



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

Honorable William G. Holland
Auditor General
State of Illinois

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State of Illinois, State Universities Retirement System's (System) compliance with the requirements listed below, as more fully described in the *Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies* (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2005. The management of the State of Illinois, State Universities Retirement System is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

- A. The System has obligated, expended, received and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. The System has obligated, expended, received and used public funds of the State in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. The System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. The State revenues and receipts collected by the System are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.
- E. Money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

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

In our opinion, the System complied, in all material respects, with the aforementioned requirements during the year ended June 30, 2005. However, the results of our procedures disclosed instances of noncompliance with these requirements, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of State findings and recommendation as finding 05-1. As required by the Audit Guide, immaterial findings relating to instances of noncompliance excluded from this report have been reported in a separate letter to your office.

Internal Control

The management of the System is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws and regulations. In planning and performing our examination, we considered the System's internal control over compliance with the aforementioned requirements in order to determine our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General.

Our consideration of internal control over compliance with the aforementioned requirements would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws and regulations that would be material in relation to one or more of the aforementioned requirements being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance that we consider to be material weaknesses. However, the results of our procedures disclosed other matters involving internal control which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of State findings and recommendations as finding 05-1. As required by the Audit Guide, immaterial findings relating to internal control deficiencies excluded from this report have been reported in a separate letter to your office.

Supplementary Information

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the System as of and for the year ended June 30, 2005, and have issued our report thereon dated October 27, 2005. The accompanying supplementary information, as listed in the table of contents as Supplementary Information for State Compliance Purposes, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. The 2005 Supplementary Information for State Compliance Purposes, except for that portion marked "unaudited" on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the System's basic financial statements for the year ended June 30, 2004. In our report dated November 10, 2004, we expressed an unqualified opinion on the financial statements. In our opinion, the 2004 Supplementary Information for State Compliance Purposes, except for the portion marked "unaudited" on which we express no opinion, is fairly stated, in all material respects, in relation to the basic financial statements for the year ended June 30, 2004, taken as a whole.

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

BKD, LLP

October 27, 2005



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

The Honorable William G. Holland
Auditor General
State of Illinois
and
The Board of Trustees
State Universities Retirement System (SURS)

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the State of Illinois, State Universities Retirement System (System), a component unit of the State of Illinois, as of and for the year ended June 30, 2005 and have issued our report thereon dated October 27, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. We noted certain immaterial instances of internal control deficiencies which we have reported to your office in a separate letter dated October 27, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain matters which are reported as State compliance findings in the schedule of findings. We also noted certain immaterial matters which we have reported to your office in a separate letter dated October 27, 2005.

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

BKD, LLP

October 27, 2005

State of Illinois
State Universities Retirement System
Findings and Recommendations
June 30, 2005

Finding — State Compliance

05-1.Finding — Deposits Subject to Custodial Credit Risk

The System did not have collateralization or insurance for all deposits.

As of June 30, 2005, the System had \$255.4 million in cash deposits of which \$2,596,590 was exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a financial institution failure, the System's deposits may not be returned.

The State Officers and Employees Money Disposition Act (30 ILCS 230/2c) provides that whenever funds deposited with a bank or savings and loan association exceed the amount of federal deposit insurance coverage, a bond, pledged securities, or other eligible collateral shall be obtained. Also, prudent business practices dictate that assets be protected from possible losses.

SURS personnel indicated they have researched the statute and believe that it does not apply to State of Illinois Pension Systems.

Failure to ensure all funds are properly collateralized subjects them to a risk of loss in the event of a bank failure. (Finding Code No. 05-01)

Recommendation:

We recommend that SURS obtain additional collateral for all deposits that exceed federally insured limits.

System Response

The State Universities Retirement System (SURS) agrees with the recommendation of the Auditor General that collateralization should be sought for all deposits that exceed federally insured limits as a matter of prudent business practices.

In keeping with this recommendation, SURS has verified with our custodian that all cash deposits in U.S. FDIC member institutions are eligible for "pass-through" coverage under the Federal Deposit Insurance Act and the regulations of the Federal Deposit Insurance Corporation. However, SURS will continue to examine its cash deposits for exposure to non-collateralized credit risk, especially those deposited in foreign institutions not insurable by the FDIC, and seek collateralization accordingly.

SURS maintains the opinion that the State Officers and Employees Money Disposition Act (30 ILCS 230/2c) does not apply to assets held by SURS.

Auditors' Comment

The State Officers and Employees Money Disposition Act (30 ILCS 230/1 *et seq.*) (the "Act") applies to "[t]he officers of the Executive Department of State Government...and all other officers, boards, commissions, commissioners, departments, institutions, arms or agencies, or agents of the Executive Department of the State government..." 30 ILCS 230/1. SURS is created by State statute and performs essential State governmental functions. Therefore, the auditors believe that SURS is a part of the Executive branch of State government and is subject to the provisions of the Act. If SURS continues to disagree with the applicability of the Act to its operations, we further recommend it seek a formal, written Attorney General opinion on this matter.

State of Illinois
State Universities Retirement System
Findings and Recommendations
June 30, 2005

Prior Findings Not Repeated — Government Auditing Standards

05-02. Finding — Lack of Segregation of Duties Over Bank Reconciliation

During the previous audit, it was noted that bank reconciliations were not reviewed by a responsible official independent of the accounting function. (Finding Code No. 04-01, 03-02)

During the current year, we noted that the bank account reconciliation was reviewed by someone other than the person who is reconciling the account.

**Supplementary Information
for State Compliance Purposes**

State of Illinois
State Universities Retirement System
Supplementary Information for State Compliance Purposes
Summary
June 30, 2005

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

- Fiscal Schedules and Analysis:
 - Summary Schedule of Appropriations and Expenditures
 - Comparative Schedule of Revenues and Expenses
 - Analysis of Revenues and Expenses
 - Schedule of Administrative Expenses
 - Analysis of Administrative Expenses
 - Schedule of Changes in Property and Equipment
 - Schedule of Investment Portfolio
 - Schedule of Investment Expenses
 - Schedule of Investment Commissions
 - Selected Account Balances
 - Schedule of Accounts Receivable
 - Schedule of Changes in Reserves (Unaudited)
 - Description of Reserves (Unaudited)
- Analysis of Operations:
 - System's Functions and Planning Program
 - Locally Held Fund
 - System Funding Progress
 - Rate of Return (Unaudited)
 - Revenues and Expenses
 - Employer Contributions
 - Retirement Benefits
 - Survivors' Benefits
 - Disability Benefits
 - Investment Income
 - Emergency Purchases
 - Illinois First Program (Unaudited)
 - Benefit Costs
 - Member Contributions
 - Average Number of Employees (Unaudited)
 - Derivative Securities
 - Securities Lending
 - Self-Managed Plan Investments
 - Proceeds from General Obligation Bonds, Pension Funding Series June 2003
 - Future Funding and Benefit Calculations
 - Schedule of Contributions/Deductions and Effect on Investments
 - Selected Activity Measures and Service Efforts and Accomplishments (Unaudited)

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

Fiscal Schedules and Analysis

State of Illinois
State Universities Retirement System
Summary Schedule of Appropriations and Expenditures
For the Years Ended June 30, 2005 and 2004

	Appropriations 2005	Expenditures 2005	Appropriations 2004	Expenditures 2004
Appropriations made to the State Universities Retirement System from the State General Revenue Fund (001):				
Public Act #93-0842	\$ 51,610,628	\$ 51,610,628	\$ —	\$ —
Public Act #93-0842	3,268,700	3,268,700*	—	—
Public Act #93-0681	17,916,000	17,916,000	—	—
Public Act #93-0095	—	—	49,181,100	46,080,000
			—	3,101,100*
Appropriations made to the State Universities Retirement System from the Education Assistance Fund (007):				
Public Act #93-0842	47,352,000	47,352,000	—	—
Appropriations made to the State Universities Retirement System from the State Common School Fund (0412):				
Public Act #93-0095	—	—	250,000,000	250,000,000
Appropriations made directly to State Universities Retirement System from the State Pension Fund (054):				
Public Act #93-0842	153,103,372	153,103,372	—	—
Public Act #93-0062	—	—	15,660,000	15,660,000
Appropriations made directly to State Universities Retirement System from the State Pension Contribution Fund (0472):				
Public Act #93-0062	—	—	1,468,280,000	1,431,994,224
Total	\$ 273,250,700	\$ 273,250,700	\$ 1,783,121,100	\$ 1,746,835,324

* Transferred to the Community College Health Insurance Security Fund as the State's contribution for community college benefit recipients' health benefits.

Note: The above information is from Agency records, and it has been reconciled to the State Comptroller's records.

State of Illinois
State Universities Retirement System
Comparative Schedule of Revenues and Expenses
For the Years Ended June 30, 2005 and 2004

	2005	2004	Difference	
			Amount	Percent
Revenues				
Contributions				
Participants	\$ 285,585,320	\$ 275,144,174	\$ 10,441,146	3.8
Federal, trust fund and other State of Illinois	42,846,686	39,575,240	3,271,446	8.3
Employer units	47,352,000	1,728,074,225	(1,680,722,225)	(97.3)
Pension fund	222,630,000	15,660,000	206,970,000	1,321.6
Reciprocity	6,299	6,525	(226)	(3.5)
	<u>598,420,305</u>	<u>2,058,460,164</u>	<u>(1,460,039,859)</u>	
Investment Income				
Interest	137,186,111	132,573,212	4,612,899	3.5
Dividends	113,089,192	83,433,974	29,655,218	35.5
Net appreciation in fair value of investments	1,073,726,553	1,669,635,805	(595,909,252)	(35.7)
Securities lending	4,493,205	3,532,875	960,330	27.2
	<u>1,328,495,061</u>	<u>1,889,175,866</u>	<u>(560,680,805)</u>	
Less investment expense				
Asset management expense	25,473,352	23,067,221	2,406,131	10.4
Securities lending expense	1,056,901	804,062	252,839	31.4
	<u>1,301,964,808</u>	<u>1,865,304,583</u>	<u>(563,339,775)</u>	
Total revenues	<u>1,900,385,113</u>	<u>3,923,764,747</u>	<u>(2,023,379,634)</u>	
Expenses				
Benefits				
Retirement	903,350,085	822,611,476	80,738,609	9.9
Disability	20,534,216	19,315,984	1,218,232	6.3
Survivors	65,224,659	60,480,596	4,744,063	7.8
Death	14,125,789	11,744,848	2,380,941	20.3
Reversionary	1,025,172	966,552	58,620	6.1
Beneficiary	1,109,801	827,820	281,981	34.1
	<u>1,005,369,722</u>	<u>915,947,276</u>	<u>89,422,446</u>	
Refunds	43,156,780	39,134,993	4,021,787	10.3
Administrative Expense	12,087,116	11,516,494	570,622	5.0
Bond Interest Expense	692,750	821,110	(128,360)	(15.6)
Total expenses	<u>1,061,306,368</u>	<u>967,419,873</u>	<u>93,886,495</u>	
Excess of revenues over expenses	<u>\$ 839,078,745</u>	<u>\$ 2,956,344,874</u>	<u>\$(2,117,266,129)</u>	

State of Illinois
State Universities Retirement System
Analysis of Revenues and Expenses
For the Years Ended June 30, 2005 and 2004

The System's revenues and expenses have been analyzed for fluctuations greater than \$1 million and 20% from the previous year as follows:

State of Illinois — Employer Units

These employer contributions decreased from the previous year by \$1.68 billion or 97.3%. Of this decrease, \$1.43 billion was the special payment from the State of proceeds from General Obligation bonds issued in July, 2003, a one-time only contribution. The remainder represents the shift in state funding source from general revenue funds to the state pension fund.

State of Illinois Appropriation from State Pension Fund

These employer contributions increased from the previous year by \$207 million or 1,322%. This represents the shift from general revenue funds as the source of the majority of state-appropriated contributions to the state pension fund as the source.

Dividends

This category of investment income increased by \$29.7 million or 35.5%, based upon the performance of the related area of investments, as summarized in the investment section of the fiscal year 2005 CAFR.

Net Appreciation in Fair Value of Investments

This category of investment income decreased by \$596 million or 35.7%, based upon the decrease in the overall rate of return on investments from 17% to 10.4%.

Death Benefits

This expense increased by \$2.4 million, or 20.3%. The two components of this expense are the employer payment of death benefits for retiree deaths (equal to \$1,000) and active member deaths (equal match of contributions and interest paid to beneficiaries.) Overall, the total employer payments did not change significantly from fiscal year 2004 to 2005. However, the total death benefits paid representing the return of employee contributions plus interest in death of active members showed a 24.7% increase in the amounts paid, versus only a 4.7% increase in the number of active deaths. The result is a large increase in the average benefit payment, from \$56,435 to \$67,143. Upon review of the comparative listings, it can be seen that there were twice as many members with contribution and interest balances exceeding \$100,000 in 2005 compared to 2004, most notably two members with balances exceeding \$390,000. The largest contribution and interest balance in 2004 was approximately \$250,000.

State of Illinois
State Universities Retirement System
Schedule of Administrative Expenses
For the Years Ended June 30, 2005 and 2004

	2005	2004	Difference	
			Amount	Percent
Personnel Services				
Salary and wages	\$ 5,587,523	\$ 5,354,684	\$ 232,839	4.3%
Retirement contributions	590,008	578,627	11,381	2.0%
Insurance and payroll taxes	<u>1,379,793</u>	<u>1,090,331</u>	<u>289,462</u>	26.5%
	<u>7,557,324</u>	<u>7,023,642</u>	<u>533,682</u>	
Professional Services				
Computer services	553,737	409,999	143,738	35.1%
Medical consultation	38,206	54,068	(15,862)	(29.3)%
Technical and actuarial	569,332	457,504	111,828	24.4%
Legal services	<u>156,996</u>	<u>276,214</u>	<u>(119,218)</u>	(43.2)%
	<u>1,318,271</u>	<u>1,197,785</u>	<u>120,486</u>	
Communications				
Postage	277,650	261,614	16,036	6.1%
Printing and copying	123,864	134,476	(10,612)	(7.9)%
Telephone	<u>80,438</u>	<u>94,820</u>	<u>(14,382)</u>	(15.2)%
	<u>481,952</u>	<u>490,910</u>	<u>(8,958)</u>	
Other Services				
Equipment repairs, rental and maintenance	121,816	115,495	6,321	5.5%
Building operations and maintenance	220,608	221,273	(665)	(0.3)%
Surety bonds and insurance	33,168	42,449	(9,281)	(21.9)%
Memberships and subscriptions	36,564	23,654	12,910	54.6%
Transportation and travel	133,809	105,208	28,601	27.2%
Education	6,461	1,576	4,885	310.0%
Supplies	<u>87,091</u>	<u>69,996</u>	<u>17,095</u>	24.4%
	<u>639,517</u>	<u>579,651</u>	<u>59,866</u>	
Self-Managed Plan Administration				
Salary and wages	172,634	217,574	(44,940)	(20.7)%
Retirement contributions	19,067	23,785	(4,718)	(19.8)%
Insurance and payroll taxes	37,631	43,441	(5,810)	(13.4)%
Technical and actuarial	41,660	108,825	(67,165)	(61.7)%
Legal services	11,591	9,456	2,135	22.6%
Postage	26,180	33,330	(7,150)	(21.5)%
Printing	<u>10,470</u>	<u>17,276</u>	<u>(6,806)</u>	(39.4)%
	<u>319,233</u>	<u>453,687</u>	<u>(134,454)</u>	
Depreciation and Amortization	<u>1,770,819</u>	<u>1,770,819</u>	<u>—</u>	0.0%
Total Administrative Expenses	<u>\$ 12,087,116</u>	<u>\$ 11,516,494</u>	<u>\$ 570,622</u>	5.0%

State of Illinois
State Universities Retirement System
Analysis of Administrative Expenses
For the Years Ended June 30, 2005 and 2004

Administrative expenses reflect all costs incurred to manage the day to day operations of the State Universities Retirement System (System). Detail costs relating to benefits and refunds paid to recipients and administrative costs relating to investment expenses have been separated from the Schedule of Administrative Expenses. The total administrative expenses of \$12.1 million are approximately 1.1% of the total expenses of \$1.06 billion for fiscal year 2005. Fluctuations greater than \$50,000 and 20% were analyzed, excluding depreciation expense.

Insurance and Payroll Taxes

The increase of approximately \$290,000 or 26.5% in insurance and payroll taxes reflects the higher employer premiums for health and life insurance charged by Central Management Services of the State of Illinois, the administrator of the state employee benefits program.

Computer Services

The increase of approximately \$144,000 or 35.1% in computer services represents the purchase of approximately \$93,000 of new software for management of the document imaging system, and \$40,000 for internet connection improvements and various systems operations consulting services.

Technical and Actuarial

The increase of approximately \$112,000 or 24.4% is composed of an increase of \$71,000 in actuarial services, and an increase in \$40,000 in professional services. Actuary fees increased due to the number of special studies which were required to evaluate the funding proposals related to the fiscal year 2007 budget process. In the area of professional services, fees for an executive search firm were incurred to replace the Chief Investment Officer during fiscal year 2005.

Legal Services

The decrease of \$119,000 or 43.2% in legal services occurred in the area of litigation. This reduction in costs is due to the resolution of the Mattis case, a long-standing case resolved in SURS' favor during the first quarter of fiscal year 2005.

Self-Managed Plan Administration-Technical and Actuarial

The decrease of \$67,000 or 61.7% is due to the decrease in administrative fees paid to SMP providers resulting from the discontinuation of ING as a provider, and the negotiation of lower administrative fees with Fidelity, one of the two remaining providers.

State of Illinois
State Universities Retirement System
Schedule of Changes in Property and Equipment
For the Year Ended June 30, 2005

	Balance at June 30, 2004	Additions	Deletions	Balance at June 30, 2005
Capital Assets				
Land	\$ 531,834	\$ —	\$ —	\$ 531,834
Building	6,308,951	14,959	—	6,323,910
Furniture and fixtures	<u>17,232,696</u>	<u>167,320</u>	<u>395,467</u>	<u>17,004,549</u>
Total	<u>24,073,481</u>	<u>182,279</u>	<u>395,467</u>	<u>23,860,293</u>
Allowance for Depreciation				
Building	1,386,212	126,019	—	1,512,231
Furniture and fixtures	<u>12,200,969</u>	<u>1,644,800</u>	<u>395,275</u>	<u>13,450,494</u>
Total allowance for depreciation	<u>13,587,181</u>	<u>1,770,819</u>	<u>395,275</u>	<u>14,962,725</u>
Net capital assets	<u>\$ 10,486,300</u>	<u>\$ (1,588,540)</u>	<u>\$ 192</u>	<u>\$ 8,897,568</u>

Note: Property balances were obtained from System records and have been reconciled to property reports submitted to the Office of the Comptroller.

State of Illinois
State Universities Retirement System
Schedule of Investment Portfolio
June 30, 2005 and 2004

	2005			
	Cost		Fair Value	
	Amount	Percentage of Portfolio	Amount	Percentage of Portfolio
Equities				
Common Stocks				
U.S. equities	\$ 6,779,814,930	55.0%	\$ 7,894,794,205	56.3%
Non-U.S. equities	1,016,495,416	8.2%	1,149,799,293	8.2%
Mutual funds	69,494,376	.6%	93,597,553	.7%
Preferred Stocks	<u>20,984,824</u>	<u>.2%</u>	<u>22,404,978</u>	<u>.2%</u>
Total equities	<u>7,886,789,546</u>	<u>64.0%</u>	<u>9,160,596,029</u>	<u>65.4%</u>
Fixed Income				
Government Obligations				
Government agencies	141,613,150	1.1%	143,176,032	1.0%
U.S. Government	1,182,737,281	9.6%	1,227,195,886	8.8%
Corporate Obligations	1,211,583,565	9.8%	1,249,191,033	8.9%
Miscellaneous				
Asset backed	242,795,991	2.0%	240,364,973	1.7%
Commingled funds	—	—	—	—
Mortgage backed	1,156,540,949	9.4%	1,166,672,676	8.3%
Municipal bonds	22,928,296	.2%	25,003,645	.2%
Non-U.S. bonds	130,185,896	1.1%	138,506,732	1.0%
Options	(765,646)	0.0%	(759,123)	0.0%
Swaps	<u>249,032</u>	<u>0.0%</u>	<u>1,247,197</u>	<u>0.0%</u>
Total Fixed Income	<u>4,087,868,514</u>	<u>33.2%</u>	<u>4,190,599,051</u>	<u>29.9%</u>
Short Term Investments	266,118,476	2.2%	262,061,668	1.9%
Real Estate	42,149,814	.3%	43,258,905	.3%
Self-Managed Plan Funds	—	0.0%	317,175,851	2.3%
Accrued Investment Income	<u>34,029,516</u>	<u>.3%</u>	<u>34,029,516</u>	<u>.2%</u>
Total investments	<u>\$12,316,955,866</u>	<u>100.0%</u>	<u>\$14,007,721,020</u>	<u>100.0%</u>

2004

Cost		Fair Value	
Amount	Percentage of Portfolio	Amount	Percentage of Portfolio
\$ 3,069,648,091	26.4%	\$ 3,137,673,880	23.9%
868,409,423	7.5%	963,970,847	7.3%
3,227,059,806	27.8%	4,287,826,932	32.7%
18,808,990	0.2%	20,201,894	0.2%
<u>7,183,926,310</u>	<u>61.9%</u>	<u>8,409,673,553</u>	<u>64.1%</u>
157,073,274	1.4%	155,592,324	1.2%
1,323,102,373	11.4%	1,344,455,580	10.2%
526,345,269	4.5%	515,406,947	3.9%
—	—	—	—
141,113,719	1.2%	139,442,644	1.0%
842,120,384	7.3%	841,199,298	6.4%
962,101,883	8.3%	968,991,637	7.4%
77,096,636	0.6%	75,737,599	0.6%
111,173,166	1.0%	114,938,372	0.9%
(1,343,965)	0.0%	(590,918)	0.0%
<u>542,672</u>	<u>0.0%</u>	<u>542,141</u>	<u>0.0%</u>
<u>4,139,325,411</u>	<u>35.7%</u>	<u>4,155,715,624</u>	<u>31.6%</u>
257,332,789	2.2%	257,301,092	2.0%
317,830	0.0%	313,773	0.0%
—	0.0%	273,466,040	2.1%
<u>27,485,586</u>	<u>0.2%</u>	<u>27,485,586</u>	<u>0.2%</u>
<u>\$11,608,387,926</u>	<u>100.0%</u>	<u>\$13,123,955,668</u>	<u>100.0%</u>

State of Illinois
State Universities Retirement System
Schedule of Investment Expenses
For the Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Master Trustee and Custodian		
The Northern Trust Company	\$ <u>125,000</u>	\$ <u>125,000</u>
Investment Manager		
Adams Street Partners	1,952,480	1,904,651
American Express Asset Management	—	297,056
Ariel Capital Management	110,217	99,900
Barclays Global Investors	3,036,604	2,066,444
BlackRock Financial Management	1,495,389	1,494,119
Capital Guardian Trust Company	1,219,147	766,287
Clarion CRA Securities	765,494	571,996
Fidelity Management Trust Co.	456,646	259,000
Genesis Capital Management	362,951	377,397
Globe Flex Capital	262,313	30,983
Manager Development Program	56,349	—
Martin Currie, Inc.	1,636,509	1,681,695
Metropolitan West Asset Management	434,526	348,125
Mondrian Investment Partners	298,583	122,106
New Amsterdam Partners	309,665	284,056
Northern Trust Global Advisors	928,897	836,693
Northern Trust Investments	254,292	256,891
Oechsle International Advisors	—	60,742
Pacific Investment Management Company	2,730,111	3,415,177
Pantheon Ventures	1,409,515	730,769
Payden & Rygel	138,432	290,846
Progress Investment Management Company	1,089,520	1,004,042
Rasara Strategies	344,591	319,630
Rhumblin Advisors	43,564	—
Rosenberg Real Estate Equity Funds	1,804,599	1,243,279
Van Wagoner	1,307,995	2,337,641
Wellington Management Company	1,316,546	891,363
Western Asset Management	<u>732,617</u>	<u>373,382</u>
	<u>24,497,552</u>	<u>22,064,270</u>
Investment Consultant, Measurement & Counsel		
Ennis, Knupp & Associates, Inc.	267,159	297,352
Mayer, Brown, Rowe & Maw	<u>54,123</u>	<u>56,389</u>
	<u>321,282</u>	<u>353,741</u>

State of Illinois
State Universities Retirement System
Schedule of Investment Expenses
For the Years Ended June 30, 2005 and 2004

	2005	2004
(Continued)		
Investment Administrative Expenses		
Personnel	\$ 424,432	\$ 457,813
Resources, board and travel	54,209	49,146
Performance measurement and database	<u>50,877</u>	<u>17,251</u>
	<u>529,518</u>	<u>524,210</u>
Total investment expenses	\$ <u>25,473,352</u>	\$ <u>23,067,221</u>

Investment expenses include fees paid to the System's master trustee, various investment managers and their investment consultant and investment brokerage firms. Fees are negotiated based primarily on market values and the manager's portfolio performance. A graduated scale is used for most managers based upon various increments per million dollars of market value. Investment expenses also include administrative expenses relating to the operation of the Investment Division of SURS.

State of Illinois
State Universities Retirement System
Schedule of Investment Commissions
For the Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Bear Sterns	\$ 133,795	\$ 40,195
Citigroup Global	99,310	99,310
Citigroup Global Markets, Inc.	96,570	21,630
Credit Suisse First Boston	116,782	156,957
Deutsche Bank Securities	101,381	150,038
Goldman Sachs International	73,673	87,581
JP Morgan	136,674	112,429
Legg Mason Wood Walker, Inc.	88,671	31,860
Montrose Securities	119,040	56,911
Nomura Securities	87,176	28,118
All others	<u>2,866,222</u>	<u>2,901,229</u>
 Total Commissions	 \$ <u>3,919,294</u>	 \$ <u>3,686,258</u>

Commissions relate to fees paid to investment brokerage firms for purchases and sales of investments.

State of Illinois
State Universities Retirement System
Selected Account Balances
June 30, 2005 and 2004

	Defined Benefit Plan	Self Managed Plan	Reporting Entity Totals	
			2005	2004
Assets				
Cash and short-term investments	\$ 255,363,578	\$ —	\$ 255,363,578	\$ 257,301,092
Receivables				
Participants	15,649,400	964,244	16,613,644	19,468,178
Federal, trust funds and other	582,764	880,562	1,463,326	1,120,083
Notes receivable, long-term	1,857,590	—	1,857,590	605,860
Pending investment sales	380,222,473	—	380,222,473	261,070,448
Interest and dividends	34,029,516	—	34,029,516	27,485,586
Total receivables	<u>432,341,743</u>	<u>1,844,806</u>	<u>434,186,549</u>	<u>309,750,155</u>
Prepaid Expenses	19,530	—	19,530	14,455
Investments, at fair value				
Equity investments	9,139,550,158	21,045,874	9,160,596,032	8,425,888,500
Fixed income investments	4,187,209,930	10,087,208	4,197,297,138	4,163,615,140
Real estate investments	43,231,995	26,910	43,258,905	317,832
Mutual funds and variable annuities	—	317,175,851	317,175,851	249,347,518
Total investments	<u>13,369,992,083</u>	<u>348,335,843</u>	<u>13,718,327,926</u>	<u>12,839,168,990</u>
Securities lending collateral	2,167,043,809	—	2,167,043,809	1,945,631,693
Capital Assets, at cost, net of accumulated depreciation of \$13,587,181 and \$15,063,698, respectively	8,897,568	—	8,897,568	10,486,300
Total assets	<u>16,233,658,311</u>	<u>350,180,649</u>	<u>16,583,838,960</u>	<u>15,362,352,685</u>
Liabilities				
Benefits payable	7,755,235	—	7,755,235	3,566,926
Refunds payable	3,597,736	—	3,597,736	3,498,570
Securities lending collateral	2,167,043,809	—	2,167,043,809	1,945,631,693
Payable to brokers for unsettled trades	683,582,010	—	683,582,010	530,592,835
Bonds and interest payable	9,820,360	—	9,820,360	9,127,610
Administrative expenses payable	11,581,532	—	11,581,532	8,555,518
Total liabilities	<u>2,883,380,682</u>	<u>—</u>	<u>2,883,380,682</u>	<u>2,500,973,152</u>
Net assets held in trust for pension benefits	<u>\$ 13,350,277,629</u>	<u>\$ 350,180,649</u>	<u>\$ 13,700,458,278</u>	<u>\$ 12,861,379,533</u>

State of Illinois
State Universities Retirement System
Schedule of Accounts Receivable
June 30, 2005 and 2004

	2005	2004
Employees:		
Salary deduction (1)	\$ 15,544,958	\$ 18,380,563
Overpaid benefits (2)	1,068,685	1,087,615
Other	1,857,590	605,860
Total employee receivables	18,471,233	20,074,038
Employers:		
Federal and trust funds	1,463,326	1,120,083
Total employer receivables	1,463,326	1,120,083
Total	\$ 19,934,559	\$ 21,194,121

- (1) Salary deductions receivable decreased by \$2.8 million or 15.4% from fiscal year 2004. This is primarily due to a decrease of \$2.4 million in the Purchased Service Credit-Installment receivables at year end. There was a high initial demand for this program when it began in fiscal year 2002. This demand is lessening, and many of the early contracts are being paid off.
- (2) Overpaid benefits receivable represent benefits which have been overpaid to a member and are due back to the System. The majority of this receivable relates to disability payments made to members who later received worker's compensation benefits. Thus, some of the disability benefits received from the System must be repaid. The System records the receivable as soon as they are notified by the employer of the worker's compensation payment. If the member does not repay the overpayment prior to retirement or withdrawing from the System, the refund or retirement annuity is reduced by the amount of the overpayment plus interest. Because of this, an aging of the accounts receivable is not available and an allowance for doubtful accounts is not necessary. All other receivable amounts are expected to be collected within one year or less.

State of Illinois
State Universities Retirement System
Schedule of Changes in Reserves (Unaudited)
For the Year Ended June 30, 2005

	Defined Benefit Plan			Self-Managed Plan
	Total	Participants' Contributions	Benefits from Employee and Employer Contributions	Total
Balance, June 30, 2004	\$ 12,861,379,533	\$ 4,529,601,978	\$ 8,056,702,685	\$ 275,074,870
Revenue				
Contributions	598,420,305	251,939,562	285,423,310	61,057,433
Investment income	254,768,508	—	254,768,508	—
Net increase in fair value of investments	1,073,726,553	—	1,051,379,820	22,346,733
Expenses				
Benefit payments	(1,005,369,722)	(16,127,310)	(988,324,912)	(917,500)
Refunds	(43,156,780)	(29,908,760)	(5,867,133)	(7,380,887)
Administrative and investment expenses	(39,310,119)	—	(39,310,119)	—
Interest credited to reserves, net of forfeits	(5,604,172)	337,258,292	(342,862,464)	—
Transfers	5,604,172	(346,661,988)	352,266,160	—
Net Increases	839,078,745	196,499,796	567,473,170	75,105,779
Balance, June 30, 2005	<u>\$ 13,700,458,278</u>	<u>\$ 4,726,101,774</u>	<u>\$ 8,624,175,855</u>	<u>\$ 350,180,649</u>

State of Illinois
State Universities Retirement System
Description of Reserves (Unaudited)
For the Year Ended June 30, 2005

Participants' Contributions

This reserve accumulates the contributions made by participants plus earned interest. Under the traditional option, participants contribute 8 percent of their gross earnings; 6 ½ percent of the 8 percent contributions are designed for retirement annuities, ½ percent for automatic annual increases and 1 percent for survivor benefits. Police officers and firefighters contribute 9 ½ percent of earnings; the additional 1 ½ percent is a normal retirement contribution. Under the portable option, the participants contribute the same percent of earnings as above, but there is no contribution for survivor benefits. Instead, 1 percent of earnings is contributed to fund an enhanced refund which allows for the distribution of member earnings, all interest earned and a one-to-one match of employer contributions. The refund available under the traditional option is member contributions plus interest at 4 ½ percent.

Interest is credited annually to the participants' accounts based on the balance at the beginning of the academic year. The credited interest rate is determined by the Board of Trustees and was 8 percent for the year ended June 30, 2005. Upon retirement or death, the participants' accumulated contributions are transferred to the appropriate reserve accounts for payment of benefits.

Benefits from Employee and Employer Contributions

This reserve accumulates employer contributions from state appropriations and federal and trust funds with designated uses of paying retirement and reversionary annuities for benefits in force, death and survivor benefits, disability benefits, variations in actuarial experience and the administrative costs of the System. The reserve also accumulates participant contributions transferred when the participant retires or dies and the amount of investment income earned but not yet distributed to the participant contribution reserve according to the effective interest rate. The final component of this reserve is the difference between the total net assets of the System and the actuarial requirement to fund the System's benefits. The amount presented in this report is computed using a unit credit actuarial method. Illinois statutes provide that any potential unfunded liability be an obligation of the State of Illinois. The System must annually have an actuarial determination of its liabilities and reserves and the amount and distribution of the required employer contribution.

Self-Managed Plan

This account holds employee contributions of 8 percent of earnings, employer contributions of 6.6 percent of earnings and the investment gains or losses earned to date. This plan is a defined contribution plan with the System acting as sponsor. All contributions are placed with service providers approved by the Board of Trustees, with individual investment choices among these providers made by the member.

Analysis of Operations

State of Illinois
State Universities Retirement System
Analysis of Operations
For the Year Ended June 30, 2005

System's Functions and Planning Program

The State Universities Retirement System of Illinois (the "System") is the administrator of a cost-sharing multiple-employer public employee retirement system established July 21, 1941. The System was established to provide retirement annuities and other benefits for staff members and employees of the state universities, certain affiliated organizations and certain other state educational and scientific agencies and for survivors, dependents and other beneficiaries of such employees. The System is governed by Article 15 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2005 the System's defined benefit plan had 136,320 active and inactive participants and 39,800 annuity benefit recipients, while the self-managed plan had 13,631 active and inactive participants and 11 annuity benefit recipients.

Management of the System is vested in a nine-member Board of Trustees appointed by the Governor. At the time of appointment, two trustees designated are participants of the System and two are benefit recipients. The five remaining trustees may, but need not, be participants or annuitants of the System. The term of office of trustees is six years. However, due to the reorganization of the Board in conjunction with the passing of Public Act 89-196 in 1995, the initial terms were staggered. Of the initial trustees appointed, three were appointed for terms of two years, three were appointed for terms of four years and three were appointed for terms of six years.

The administration of the detailed affairs of the System is vested in the Executive Director, James Hacking, under direction from the Board. General policy relating to the administration of the System is stated in the minutes of the Board meetings. The System's official offices are located at 1901 Fox Drive, Champaign, Illinois.

Program planning activities of the System are under the direct supervision of the Executive Director and involve coordination between the Board and other administrative staff of the System. Periodic status reviews are performed by the Executive Director and his administrative staff to determine the progress made toward accomplishing established goals and objectives. The status of and achievement of these goals and objectives are monitored quarterly by the Board of Trustees. Major goals and objectives were as follows:

- Development of a Web Based Retirement Application Process

Develop and implement a web based series of screen dialog to collect information from the member for their application for refund. The web programs will lead the member through a series of questions obtaining answers to fill a printed Turnaround Application. Depending on the demographics of member, screens will be presented with questions that pertain to the member's situation. The web programs will collect and edit the information, record it, and merge it with the application form for printing.

State of Illinois
State Universities Retirement System
Analysis of Operations
For the Year Ended June 30, 2005

- Complete insurance file update to Automatically update CMS system

Develop a new automated process for updating the Central Management Services (CMS) Membership System with data from the SURS Pay Benefits System. This new process will allow the insurance team to update one system, instead of both systems independently. Twelve different types of insurance updates have been identified by the project. The first update actually retrieves information from CMS files and updates PEP records within Pay Benefits. An overall design will be developed for the changes required to Pay Benefits, in order to provide all the new fields necessary to update CMS. Once, the data based changes are made to Pay Benefits, the CMS update can be worked on and implemented one at a time.

- Involuntary SMP distributions for inactive members

SURS initiated distributions for inactive non-vested SMP member accounts with balances less than \$5,000. The distributions help the plan in two ways: 1) Return the funds to the non-vested member, before the contact with the member is lost and, 2) Raise the average account balance lowering the cost of the plan.

- Disability Program Review

SURS employed a consultant to review the administration of Disability benefits and make suggestions for improvements. The consultant's recommendations were presented in June and are being considered for implementation during FY 2006.

- Report of Death Process

A series of computerized process changes were implemented to improve the report of death processing from the time the initial report of death is taken to the time the Death claim is initiated. Hardcopy forms have been eliminated and computerized applications are used to control the workflow of information through the various SURS departments.

- Investment Manager to Manager Program

SURS has initiated a multi-phased investment manager development program to identify, select and fund minority and women-owned investment managers in three asset classes (domestic equities, fixed income and global equities).

- Verification of high-risk annuitants

Evaluate potential pools of high-risk annuitants for verification and follow-up to insure they are still alive and well. The 18 oldest US annuitants were verified by home visits. All foreign annuitants were contacted and asked to visit the US Consulate for verification.

State of Illinois
State Universities Retirement System
Analysis of Operations
For the Year Ended June 30, 2005

Auditor's Assessment of Planning Program

The System appears to have established adequate operating programs to meet its defined goals and objectives.

Locally Held Fund

The System uses a locally held fund "State Universities Retirement System" (pension trust fund No. 1178) held at the Northern Trust Company in Chicago, Illinois to account for and process all transactions of the System. The System also has an account at JP Morgan Chase Bank, NA in Springfield, Illinois for processing certain administrative transactions. The Illinois State Treasurer is not the legal custodian of the System's assets.

System Funding Progress

The actuarial accrued liability of SURS at June 30, 2005 amounted to approximately \$20.3 billion. The net assets available at June 30, 2005 amounted to approximately \$13.3 billion, resulting in an unfunded accrued actuarial liability of \$7.0 billion.

Senate Bill 533 was signed into law on August 22, 1994. This law (Public Act 88-0593) provides a 15-year phase-in to a 35-year plan that will amortize the unfunded liability faced by SURS. This law provides for a continuing appropriation. The continuing appropriation provision removes pension funding from the General Assembly's annual budget negotiations. The payment becomes an automatic contribution and is not subject to the appropriations process. In fiscal year 2005, the continuing appropriation is \$269.9 million. On June 1, 2005, the Governor signed a new funding bill into law. This law (Public Act 94-0004) called for a reduction in the state pension contributions from the prior funding bill provisions. This reduction will total \$719 million between fiscal years 2006 and 2010. Under PA 94-0004, the state appropriation for fiscal year 2006 will be \$166.6 million.

Rate of Return (Unaudited)

Taken as a whole, SURS' investment portfolio produced a market rate of return of 10.4 percent and 17.0 percent for fiscal years 2005 and 2004, respectively.

Revenues and Expenses

SURS defined benefit plan is financed by employee member contributions, employer contributions (State appropriations and contributions from trust and federal funds) and investment earnings. All cash received from these sources is deposited with the Northern Trust Company, which acts as the System's master trustee. SURS self-managed plan is financed by employee and employer contributions and investment earnings, but the funds are held by the two service providers approved by the Board of Trustees: Fidelity Investments and TIAA/CREF.

State of Illinois
State Universities Retirement System
Analysis of Operations
For the Year Ended June 30, 2005

Approximately 98.8 percent of the total expenses for fiscal years 2005 and 2004 are related to benefits and refunds to members. Benefits include retirement, disability and survivors payments. Details of benefit recipients, benefit expenses and summaries of new benefit payments and average benefit payments can be found in the SURS Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2005.

Employer Contributions

Contributions received from federal grants, trust funds and other such sources were approximately \$42.8 million and \$39.6 million for the years ended June 30, 2005 and 2004, respectively. This amount varies from year to year, depending on the level of federal and grant funding obtained by the universities and community colleges, as well as the normal cost rate established by the actuary.

Retirement Benefits

Benefits have increased from approximately \$822.6 million to approximately \$903.4 million for the years ended June 30, 2004 and 2005, respectively, for an increase of 9.8 percent. This increase is due to a 3.9 percent increase in the number of recipients from 30,795 in fiscal year 2004 to 32,002 in fiscal year 2005. Also impacting the total benefits expense is the 3 percent automatic annual increase and an increase in the average monthly annuity paid to recipients related to the annual average salary increase paid to active members.

Survivors' Benefits

Benefits have increased from approximately \$60.5 million to \$65.2 million for the years ended June 30, 2004 and 2005, respectively. This increase of 7.8 percent is due to a 1.9 percent increase in the number of recipients, the 3 percent automatic annual increase, and the higher average annuity payments related to higher ending salary rates.

Disability Benefits

Benefits have increased from approximately \$19.3 million to \$20.5 million for the years ended June 30, 2004 and 2005, respectively. This increase of 6.3 percent is due to a 4.2 percent decrease in the number of recipients, offset by the 3% annual automatic increase and higher average monthly payments based upon higher active member salary rates.

Investment Income

Net investment income was approximately \$1.3 billion and \$1.9 billion for the years ended June 30, 2005 and 2004, respectively. The investment return (unaudited) for these years was 10.4 percent and 17 percent. In general, the System's investment strategy has been to maintain the investment allocation as stated by the Board of Trustees. The portfolio policy allocation consists of 66 percent equity securities, 4.5 percent real estate investment trust, 23.5 percent fixed income and 6 percent Treasury inflation-protected securities and opportunity fund. A more detailed explanation of the System's investment portfolio can be obtained from the 2005 CAFR.

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Emergency Purchases

The System did not execute any emergency purchases during the fiscal year ended June 30, 2005.

Illinois First Program (Unaudited)

The System did not participate in or receive any funds as part of the Illinois First Program during the year ended June 30, 2005.

Benefit Costs

The System's costs to recipients include retirement, survivors and disability benefits. The following is the benefit cost per monthly annuity recipient for the years ended June 30, 2005 and 2004.

	<u>Number</u>	<u>Amount paid (in millions)</u>	<u>Average Monthly Benefit Per Recipient</u>
Retirement			
2004	30,795	\$ 822.6	\$ 2,230
2005	32,002	903.4	2,358
Survivors			
2004	6,427	60.5	784
2005	6,550	65.2	829
Disability			
2004	902	19.3	1,783
2005	864	20.5	1,977

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Member Contributions

Employee contributions are established by the Illinois Pension Code as 8 percent of earnings for both the defined benefit and self-managed plans. Police officers and fire fighters contribute 9 ½ percent of earnings for the defined benefit plan and 8 percent for the self-managed plan. Employee contributions are collected through payroll deductions and are submitted by the participating employers directly to the System for credit to each participant's accumulated contributions account for those in the defined benefit plan, or transmitted daily to the service providers for the members in the self-managed plan. The numbers of members having contributions credited to their accounts at June 30, 2005 and 2004 are as follows:

	2004	2005
Current Members – Defined Benefit Plan		
Active members (currently contributing)	72,992	71,662
Inactive members (not currently contributing)	62,113	64,658
Current Members – Self-Managed Plan		
Active members (currently contributing)	8,250	8,440
Inactive members (not currently contributing)	4,614	5,191

Members payrolls totaled approximately \$2.94 billion and \$2.81 billion for the years ended June 30, 2005 and 2004, respectively.

Average Number of Employees (Unaudited)

The average numbers of SURS employees for the last two fiscal years are as follows:

	2004	2005
Administration	9.75	9.75
Human Resources	2.00	2.00
Member Services	62.75	62.75
Support Services	10.75	10.00
Finance	6.50	6.50
Self-Managed Plan	3.50	3.50
Information Systems — Operations	12.00	12.00
Information Systems — Applications	10.00	10.75
Investments	4.75	4.05
Totals	122.00	121.30

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Derivative Securities

The System invests in derivative securities. A derivative security is an investment whose value or payoff depends upon the value of other assets such as commodity prices, bond and stock prices or a market index. The System's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. 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. Market risk is the possibility that a change in interest or currency rates 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 senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, SURS' derivative investments included foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), options and futures.

Foreign currency forward contracts are used to hedge against the currency risk in SURS' foreign stock and fixed income security portfolios. 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.

SURS fixed income managers invest in CMOs to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2005, the carrying value of the System's CMO holdings totaled \$140,691,723.

Treasury inflation protected securities (TIPS) are used by SURS' fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). In addition, SURS employs TIPS at the total fund level in order to utilize their diversification benefits. As of June 30, 2005, the carrying value of the System's TIPS holdings totaled \$559,615,253.

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SURS' 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, SURS' investment managers use futures contracts to improve the yield or adjust the duration of the fixed income portfolio. 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. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearing house. The cash or securities to fulfill these obligations are held in the investment portfolio.

SURS' 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 System 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. As a purchaser of financial options, the System 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.

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The following table presents the derivative positions held by SURS as of June 30, 2005:

	Number of Contracts	2005 Contractual Principal^(a)	Carrying Value^(b)
Domestic Index Products			
Equity futures purchased	1,714	\$ 522,458,225	\$ 522,458,225
Derivative offset	—	—	(522,458,225)
Domestic Interest Rate Products			
Fixed income futures purchased	1,036	103,600,000	136,483,934
Derivative offset	—	—	(136,483,934)
Fixed income futures sold	677	67,700,000	(127,695,594)
Derivative offset	—	—	127,695,594
Fixed income written put options	860	86,000,000	(123,315)
Fixed income written call options	1,092	109,200,000	(711,443)
Fixed income purchased put options	107	10,700,000	21,735
Fixed income purchased call options	70	7,000,000	24,532
International Interest Rate Products			
International fixed income futures purchased	3,508	3,441,200,940	834,668,742
Derivative offset	—	—	(834,668,742)
International fixed income futures sold	135	16,343,774	(18,899,941)
Derivative offset	—	—	18,899,941
International fixed income purchased put options	37	37,000,000	18,963
International fixed income purchased call options	37	37,000,000	10,406
Foreign Currency Products			
Foreign forward currency purchases	—	—	78,374,426
Foreign forward currency sales	—	—	(77,256,870)

(a) The contractual principal amounts listed above represent the market value of the underlying assets the derivative contracts control. Contractual principal amounts are often used to express the volume of the transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the generally smaller amounts potentially subject to risk. Contractual principal values do not represent actual recorded values.

(b) Carrying value for futures in the table above, while shown as zero, is recorded in the financial statements as an asset in an amount equal to the contractual principal and is offset by a corresponding liability.

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Securities Lending

The SURS Board of Trustees policies permit the System to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Northern Trust Company, the System's custodian, lends securities of the type on loan at year end for collateral in the form of cash, irrevocable letters of credit or other securities of 102%, and international securities for collateral of 105%. Cash collateral is shown on the System's financial statements. Securities lent are included in the Statement of Plan Net Assets. At year end, the System has no credit risk exposure to borrowers because the amount the System owes to the borrowers exceeds the amounts the borrowers owe to the System. The contract with the System's custodian requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are out on loan.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loans is 114 days. Cash collateral is invested in the lending agent's short-term investment pool, which at year end has a weighted average maturity of 28 days. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the System cannot determine. The System cannot pledge or sell collateral securities received unless the borrower defaults.

Loans outstanding as of June 30, 2005 were (in millions):

Market value of securities loaned	\$2,111.5
Market value of collateral received from borrowers	\$2,167.0

Self-Managed Plan (SMP) Investments

The SMP participants have the ability to invest their account balances in 35 mutual and variable annuity funds. These funds are offered by two providers: Fidelity Investments and Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA/CREF). As of June 30, 2005, the SMP had investments of \$348,335,843. A detailed schedule (unaudited) of the funds and balances at June 30, 2005 is located in the Investment Section of The Comprehensive Annual Financial Report.

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Proceeds from General Obligation Bonds, Pension Funding Series June 2003

Public Act 93-0002 (Act) became effective on April 7, 2003 and authorized the State of Illinois to issue \$10 billion of General Obligation Bonds for the purpose of making contributions to designated retirement systems. The State Universities Retirement System is one of the “designated retirement systems” for the purpose of this new law. In addition the “Pension Contribution Fund” was created as a special fund in the State Treasury.

On June 12, 2003, the State of Illinois issued \$10 billion of General Obligation Bonds, Pension Funding Series June 2003, and deposited the net bond proceeds of \$7,317,292,916 into the Pension Contribution Fund. Bond proceeds of \$2,682,707,084 were utilized (1) to reimburse the General Revenue Fund for the last quarter of the State’s fiscal year 2003 required contributions and the total fiscal year 2004 required contributions to the designated retirement systems (\$2,160,00,000); (2) to fund interest payments due December 1, 2003 and June 1, 2004 on the General Obligation Bonds, Pension Funding Series June 2003 (\$481,038,334); and (3) bond issuance and other costs (\$41,668,750).

The net bond proceeds of \$7,317,292,916 were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act. Pursuant to the amendments to the General Obligation Bond Act (30 ILCS 330/7.2) contained in the Act, the Governor’s Office of Management and Budget determined the percentage distribution of the proceeds. The allocation of the proceeds was based on the percentage distribution of the State’s total actuarial reserve deficiency as of June 30, 2002.

The State Universities Retirement System received an allocation of bond proceeds equal to \$1,431,994,224 on July 1, 2003.

The State Universities Retirement System Board of Trustees approved investing the pension bond proceeds in its then existing long-term strategic asset allocation, which consisted of:

U.S. Equities	42%
Non U.S. Equities	19%
Private Equities	3%
Fixed Income	29%
Real Estate	2%
Opportunity	5%

The pension bond proceeds earned an annual rate of return equal to that of all assets managed by the System during fiscal year 2005. The System’s rate of return during fiscal year 2005, was, net of all fees, 10.4 percent.

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Future Funding and Benefit Calculations

On June 1, 2005, the Governor signed Public Act 94-0004 which will impact state funding and retirement benefit calculations in fiscal year 2006 and beyond. This public act authorizes the following changes. First, it eliminates the money purchase calculation formula for Illinois higher education institution employees hired after June 30, 2005. Second, it transfers responsibility for determining the annual effective rate of interest from the SURS Board of Trustees to the State Comptroller. Third, it shifts from the state to the SURS employers the pension costs that result from employers granting annual compensation increases in excess of 6% in any year that is included in the final rate of earnings calculation. Finally, it reduces the state contribution to SURS by approximately \$200 million in fiscal year 2006 and \$180 million in fiscal year 2007 from the amounts that would be called for under the prior funding plan.

Schedule of Contributions/Deductions and Effect on Investments

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

	<u>2005</u>	<u>2004</u>
Contributions		
Members/Participants	\$ 251,939,562	\$ 243,823,966
State of Illinois	247,418,620	1,722,363,055
Federal/Trust and other sources	<u>38,004,690</u>	<u>35,183,869</u>
Total contributions	<u>537,362,872</u>	<u>2,001,370,890</u>
Deductions		
Retirement Benefits	904,876,232	823,953,436
Survivor Benefits	65,224,658	60,480,596
Disability Benefits	20,302,548	19,092,180
Lump-Sum Death Benefits	14,048,784	11,696,282
Refunds	35,775,893	34,453,381
Administrative Expenses	12,087,116	11,516,494
Bond Interest Expense	<u>692,750</u>	<u>821,110</u>
Total deductions	<u>1,053,007,981</u>	<u>962,013,479</u>
Contributions Available to Invest/(Investments Used to Pay Benefits and Expenses)	<u>\$ (515,645,109)</u>	<u>\$ 1,039,357,411</u>

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Selected Activity Measures and Service Efforts and Accomplishments (Unaudited)

	<u>Fiscal Year 2005</u>	<u>Fiscal Year 2004</u>
Total office counseling visits	3,181	2,789
Total telephone calls	104,489	104,041
Benefit applications received		
Retirement	2,600	2,598
Disability	518	476
Death and survivor	1,143	1,238
Refunds	<u>4,047</u>	<u>4,082</u>
Total benefit applications received	<u>8,308</u>	<u>8,394</u>
Benefit payments		
Number of refunds	4,003	4,221
Number of benefit claims	463,064	441,895
Information collection		
Employer payrolls processed	1,823	1,805