State of Illinois
State Employees' Retirement System

Compliance Examination

For the Year Ended June 30, 2008
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois

BKD LLP
CPAs & Advisors

State Employees' Retirement System of the State of Illinois
Compliance Examination
For the Year Ended June 30, 2008

Contents

State Employees' Retirement System of the State of Illinois

Compliance Examination

For the Year Ended June 30, 2008

Continued

The financial statements of the State Employees' Retirement System of Illinois for the year ended June 30, 2008, are published in a separate document and are supported herein by reference.

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

State Employees' Retirement System
of the State of Illinois
June 30, 2008

System Officials

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

Office Locations

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SRS STATE RETIREMENT SYSTEMS

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

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May 1, 2009

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

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the System. We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of the System's compliance with the following assertions during period ended June 30, 2008. Based on this evaluation, we assert that during the year ended June 30, 2008 the System has materially complied with the assertions below.

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

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

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

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

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

Yours very truly,

State Employees' Retirement System of Illinois

Timothy B. Blair

Timothy B. Blair, Acting Executive Secretary

Nicholas C. Merrill

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

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Compliance Report

State Employees' Retirement System of the State of Illinois

Compliance Report Summary

June 30, 2008

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

Accountants' Reports

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

Summary of Findings

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

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

Summary of Findings and Recommendations

Item No.	Page	Description	Finding Type
		Current Findings (*Government Auditing Standards*)	
08-1		Journal Entry Review	Significant deficiency and non-compliance
		Current Findings (State Compliance)	
08-2		Credit Card Policy	Non-compliance
		Prior Findings Not Repeated	
A		Lack of Segregation of Duties	
B		Follow-Up on Documentation Exception Identified During Internal Audit Self-Assessment	
C		Statements of Economic Interests Not Filed by Three Employees	

Exit Conference

The findings and recommendations appearing in this report were discussed with System personnel at an exit conference on April 23, 2009. Attending were Timothy Blair, Acting Executive Secretary, Nick Merrill, Accounting Division Manager, Paul Usherwood and Alison Schertz from the Office of the Auditor General, Troy Swinford, BKD, LLP and Heather Powell, BKD, LLP. The response to the recommendation was provided by Timothy Blair, Acting Executive Secretary, in a letter dated April 15, 2009.

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

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

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State Employees' Retirement System of the State of Illinois' (System) compliance with the requirements listed below, as more fully described in the *Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies* (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2008. The management of the State Employees' Retirement System of the State of Illinois is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

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

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

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

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

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

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

In our opinion, the System complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2008. However, the results of our procedures disclosed instances of noncompliance, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings as findings 08-1 and 08-2.

Internal Control

The management of the System is responsible for establishing and maintaining effective internal control over compliance with the requirements listed in the first paragraph of this report. In planning and performing our examination, we considered the System's internal control over compliance with the requirements listed in the first paragraph of this report 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, but not for the purpose of expressing an opinion on the effectiveness of the System's internal controls over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with the requirements listed in the first paragraph of this report on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to comply with the requirements listed in the first paragraph of this report such that there is more than a remote likelihood that noncompliance with a requirement that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings as item 08-1 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a requirement listed in the first paragraph of this report will not be prevented or detected by the entity's internal control. We did not consider any of the deficiencies described in the accompanying schedule of findings to be a material weakness.

Additionally, the results of our procedures disclosed another matter involving internal control over compliance, which is required to be reported in accordance with criteria established by the Audit Guide issued by the Illinois Office of the Auditor General and which is described in the accompanying schedule of findings as finding 08-2.

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

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

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the System as of and for the years ended June 30, 2008, and have issued our report thereon dated December 17, 2008. 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 fiscal year 2008 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 for the year ended June 30, 2008 taken as a whole.

The System's basic financial statements for the year ended June 30, 2007 were audited by other auditors whose report dated February 8, 2008, expressed an unqualified opinion on those statements. Their report on the 2007 supplementary information for State compliance purposes stated that, in their opinion, except for that portion marked unaudited, such information was fairly stated in all material respects in relation to the basic financial statements for the year ended June 30, 2007 taken as a whole.

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

BKD, LLP

May 1, 2009

State Employees' Retirement System of the State of Illinois

Schedule of Findings

June 30, 2008

Current Findings — *Government Auditing Standards*

08-1 Finding – Journal Entry Review

The State Employees' Retirement System (System) does not have a process for the review of financial journal entries by a person independent of the person that initiates them.

During our testing, we noted the same individual prepares and posts the financial journal entries. During our testing of the System's accounts receivable we identified a journal entry did not include all the accrued payroll contributions that should have been recorded at June 30, 2008. As a result, the accounts receivable balance information originally presented to the auditors was understated by approximately $26.8 million as of June 30, 2008.

The Fiscal Control and Internal Auditing Act (Act) (30 ILCS 10/3001) notes agencies shall establish and maintain a system of internal and fiscal and administrative controls, which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

System personnel indicated the journal entry omission was the result of a formula error in a spreadsheet used to generate the amounts for the journal entry. System personnel went on to note the information provided to the auditors was not final and believed the omission of the payroll contributions would have been discovered during their review process of the System's financial statements.

Because of the significance of the omission and the lack of an independent review of journal entries, we are considering this to be a significant deficiency in the System's internal control. A significant deficiency is a control deficiency, or combination of control deficiencies that adversely affects the System's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles.

A lack of an independent review of journal entries leaves the System open to risks of error and material misstatement of financial information. (Finding Code No. 08-1)

<u>Recommendation</u>:

We recommend someone other than the person preparing and posting the journal entries review the journal entries and the related supporting documentation for accuracy and that the review be documented.

08-1 Finding – Journal Entry Review (Continued)

System Response:

As noted in the Finding, the financial information which was provided to the auditors was prepared on a preliminary basis and had not yet been finalized by a review of the various account balances by the System's staff. The preliminary financial information was given to the auditors in order to assist them getting the audit process started.

The System, however, concurs with the recommendation of the auditors and will institute a system to have all financial journal entries, and supporting documentation, reviewed by a person independent of the person that initiates them.

Current Findings — State Compliance

08-2 Finding – Credit Card Policy

The State Employees' Retirement System (System) does not have a written policy relating to the use, reporting and safeguarding of their purchasing card (credit card).

During our testing, we identified the System had made 14 payments for charges to the credit card during the fiscal year totaling $16,035. We noted the following deficiencies relating to the System's purchasing card process:

- The System does not have a formal written policy outlining the procedures over the use of the purchasing card.
- The System does not have a process in place to ensure IRS Form 1099's are completed for vendors paid over $600 when payment is made using the purchasing card. One vendor who was paid with the credit card should have received an IRS Form 1099, but did not.
- Eight (single) transactions paid for with the purchasing card were greater than the $500 limit as established in the State Finance Act.

The State Finance Act (Act) (30 ILCS 105/13.3 (b) notes the Comptroller may provide by rule for the use of purchasing cards by State agencies to pay for purchases that otherwise may be paid out of the agency's petty cash fund and that the rules impose a single transaction limit not to exceed $500. The Office of the Comptroller issued rules at 44 Illinois Administrative Code 1130 outlining the guidelines for proper controls and use of purchasing cards, including single item transaction limits of $500, as well as internal auditing requirements.

System personnel indicated the purchasing card is used exclusively by one individual in very specific circumstances with the transactions and payments reviewed by another independent person, therefore a written policy is not considered necessary. It was also noted that failure to prepare any necessary IRS Form1099's was an oversight.

The lack of a policy regarding the proper use of the purchasing card increases the potential for unauthorized usage and could lead to unapproved spending of System funds. Failure to file proper IRS Form 1099's could result in penalties from the Internal Revenue Service. (Finding Code No. 08-2)

Recommendation:

We recommend the System prepare a written policy in accordance with the Comptroller's rules to cover the overall purchasing card process, including, as applicable the proper and timely completion of IRS Form 1099.

Current Findings — State Compliance

08-2 Finding – Credit Card Policy (Continued)

System Response:

A written policy will be added to the Administrative Services Division procedure manual explaining the credit card process. At the end of each calendar year, all vouchers issued to the bank for credit card purchases will be reviewed for specific IRS Form 1099 reportable detail expenditures object codes. If a vendor has $600 of reportable expenses in a calendar year, an IRS Form 1099 will be mailed to both the vendor and the IRS by the required filing date.

State Employees' Retirement System
of the State of Illinois
Schedule of Findings
June 30, 2008

Prior Findings Not Repeated

A Finding – Lack of Segregation of Duties

During the prior examination, it was noted the System did not have an adequate segregation of duties for the approval and payment of contracts. (Finding Code No. 07-01)

During the current year, the System revised the policy to address the lack of segregation of duties. All contracts were signed prior to this change as the finding was not brought to the attention of the System until February 2008. However, at that time changes were made to ensure segregation of the duties.

B Finding – Follow-Up on Documentation Exception Identified During Internal Audit Self-Assessment

During the prior examination, it was noted the System's Internal Audit function did not document steps/procedures to be performed during internal audits. (Finding Code No. 07-02)

During the current engagement, we noted no deficiencies during internal audit testing.

C Finding – Statements of Economic Interests Not File by Three Employees

During the prior examination, it was noted the System did not have statements of economic interests filed for all State Employees' Retirement System employees having responsibility for formulation, negotiation, issuance or execution of contracts. (Finding Code No. 07-03)

During the current year, the System obtained statements of economic interests for all employees tested having responsibility for formulation, negation, issuance or execution of contracts.

Supplementary Information for State Compliance Purposes

State Employees' Retirement System
of the State of Illinois
Supplementary Information for State Compliance Purposes
Summary
June 30, 2008

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

- Fiscal Schedules and Analysis:

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

- Analysis of Operations:

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

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

Fiscal Schedules and Analysis

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances

For the Fourteen Months Ended August 31, 2008

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2008	Lapse Period Expenditures July 1, 2008 through August 31, 2008	Total Expenditures	Balances Lapsed
Appropriated Funds					
General Revenue Fund for Administration of the Social Security Enabling Act (Public Act 95-0348)					
Personal services	$ 52,800	$ 50,562	$ 2,232	$ 52,794	$ 6
Employer retirement contributions	8,800	8,376	370	8,746	54
Social Security contributions	4,100	3,747	165	3,912	188
Contractual services	17,500	11,050	6,450	17,500	—
Travel	1,200	1,200	—	1,200	—
Commodities	200	85	103	188	12
Electronic data processing	1,500	452	—	452	1,048
Telecommunications	400	336	64	400	—
	86,500	75,808	9,384	85,192	1,308
General Revenue Fund Appropriation for Employee Retirement Contributions Paid by Employer for Prior Fiscal Years (Public Act 95-0348)	120,800	13,612	32,049	45,661	75,139
Total all appropriated funds	$ 207,300	89,420	41,433	130,853	$ 76,447
Nonappropriated Funds					
State Employee Retirement System Trust Fund					
Benefits and other nonadministrative expenditures					
Pensions and annuities		1,201,455,589	—	1,201,455,589	
Nonrecurring refunds and distributions		17,578,814	—	17,578,814	
Refunds of prior calendar year retirement contributions		207,627	—	207,627	
Refunds, not classified elsewhere		13,085,499	—	13,085,499	
Payments to General Obligation Retirement Fund		70,371,290	10,242,394	80,613,684	

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances

For the Fourteen Months Ended August 31, 2008

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2008	Lapse Period Expenditures July 1, 2008 through August 31, 2008	Total Expenditures	Balances Lapsed
Nonappropriated Funds					
State Employee Retirement System Trust Fund (continued)					
Administrative expenditures					
Personal services		$ 3,584,601	$ 155,883	$ 3,740,484	
Employee retirement contributions paid by employer		49,701	2,069	51,770	
Retirement contributions		594,265	25,849	620,114	
Social Security contributions		266,568	11,690	278,258	
Group insurance		864,652	38,545	903,197	
Contractual services		1,396,589	91,820	1,488,409	
Travel		35,943	1,011	36,954	
Commodities		24,166	2,760	26,926	
Printing		75,423	7,194	82,617	
Equipment		54,314	5,084	59,398	
Electronic data processing		2,024,464	303,444	2,327,908	
Telecommunications		51,420	10,921	62,341	
Automotive		15,107	3,145	18,252	
		9,037,213	659,415	9,696,628	
Total nonappropriated funds		1,311,736,032	10,901,809	1,322,637,841	
Grand total, all Funds		$1,311,825,452	$ 10,943,242	$1,322,768,694	

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

State Employees' Retirement System of the State of Illinois

Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances
For the Years Ended June 30, 2008, 2007 and 2006

	Fiscal Year		
	2008 P.A. 95-0348	2007 P.A. 94-0798	2006 P.A. 94-0015
General Revenue Fund			
Appropriations (net after transfers)	$ 207,300	$ 211,600	$ 220,450
Expenditures			
Administration of the Social Security Enabling Act			
Personal services	52,794	46,800	43,809
Employer retirement contributions	8,746	5,394	3,413
Social Security contributions	3,912	3,459	3,238
Contractual services	17,500	17,300	17,750
Travel	1,200	1,143	1,167
Commodities	188	176	188
Electronic data processing	452	—	—
Telecommunications	400	535	354
	85,192	74,807	69,919
Employee retirement contributions paid by employer for prior fiscal years	45,661	37,212	150,000
Total expenditures	130,853	112,019	219,919
Lapsed balances	$ 76,447	$ 99,581	$ 531

State Employees' Retirement System of the State of Illinois

Comparative Schedules of Revenues and Expenses

For the Years Ended June 30, 2008 and 2007

	2008	2007
Revenue		
Contributions		
Participants	$ 249,955,208	$ 224,722,599
Employing state agencies and appropriations	587,732,407	358,786,650
Total contributions	837,687,615	583,509,249
Investments		
Net investment income	274,524,210	266,766,628
Interest earned on cash balances	13,404,255	12,633,405
Net appreciation (depreciation) in fair value of investments	(968,688,184)	1,500,507,144
Total net investment gain (loss)	(680,759,719)	1,779,907,177
Total revenue	156,927,896	2,363,416,426
Expenses		
Benefits		
Retirement annuities	1,089,743,632	1,030,284,942
Survivors' annuities	68,770,552	65,215,133
Disability benefits	43,086,065	43,053,148
Lump-sum benefits	12,515,378	22,737,815
Total benefits	1,214,115,627	1,161,291,038
Refunds of contributions (including transfers to reciprocating systems)	16,817,433	14,261,872
Administrative expenses	9,537,305	8,807,627
Total expenses	1,240,470,365	1,184,360,537
Revenue over (under) expenses	$(1,083,542,469)	$ 1,179,055,889

State Employees' Retirement System
of the State of Illinois
Comments on Significant Variations Between Certain Revenue Accounts
For the Years Ended June 30, 2008 and 2007

	2008	2007	Increase (Decrease)	
Contributions from participants	$ 249,955,208	$ 224,722,599	$ 25,232,609	(1)
Contributions by employing state agencies	587,732,407	358,786,650	228,945,757	(2)
Net investment income	274,524,210	266,766,628	7,757,582	(3)
Net appreciation (depreciation) in fair value of investments	(968,688,184)	1,500,507,144	(2,469,195,328)	(3)

(1) Total employee payroll increased from FY2007 to FY2008 by approximately 5.4%, and employee contributions rose by nearly 10.9% in relation to the increase, as well as an increase in optional service purchases.

(2) The employer contribution rate in FY2007 was 11.525%, and the employer contribution rate in FY2008 was 16.561%.

(3) Investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes and were maintained in the ISBI Commingled Fund during the years ended June 30, 2008 and 2007.

These variations are due to the net change in overall market performance, especially in the equity market. Overall, the ISBI's rate of return decreased to a negative 6.2 percent during the fiscal year ended June 30, 2008, from 17.1 percent during the fiscal year ended June 30, 2007.

State Employees' Retirement System
of the State of Illinois
Comparative Schedules of Administrative Expenses
For the Years Ended June 30, 2008 and 2007

	2008	2007
Nonappropriated Funds		
State Employees' Retirement Trust Fund		
Personal services	$ 3,740,484	$ 3,450,579
Employee retirement contributions paid by employer	26,145	39,467
Employer retirement contributions	620,113	397,983
Social Security contributions	278,258	255,791
Group insurance	903,197	850,328
Contractual services	1,438,261	1,338,551
Travel	32,450	43,884
Commodities	27,261	21,472
Printing	77,075	31,553
Electronic data processing	2,119,167	2,048,396
Telecommunications	62,341	63,704
Automotive	18,535	16,686
Depreciation	211,508	278,553
Other	(17,490)	(29,320)
Total	$ 9,537,305	$ 8,807,627
Appropriated Funds		
General Revenue Fund – Social Security Division		
Personal services	$ 52,794	$ 46,800
Employer retirement contributions	8,746	5,394
Social Security contributions	3,912	3,459
Contractual services	17,500	17,300
Travel	1,200	1,143
Commodities	188	176
Electronic data processing	452	—
Telecommunications	400	535
Total	$ 85,192	$ 74,807

State Employees' Retirement System
of the State of Illinois
Analysis of Significant Variations in Expenses
For the Years Ended June 30, 2008 and 2007

	2008	2007	Increase (Decrease)	
Retirement annuities	$ 1,089,743,632	$ 1,030,284,942	$ 59,458,690	(1)
Lump-sum benefits	12,515,378	22,737,815	(10,222,437)	(2)

(1) The increase is primarily due to a scheduled benefit increase of 3%, and an increase in the number of annuitants receiving payments, new annuitants tend to receive higher monthly benefits than the annuitants removed during the year.

(2) The lump-sum benefits paid in FY08 were lower than the FY07 amount primarily due to the Alternative Retirement Cancellation Payment (ARCP) which was in effect in FY07. Any members taking advantage of this benefit had to file a written application to the Board by August 31, 2006, and terminate employment within one month of approval of their request, but in no event any later than September 30, 2006. The FY07 amount of ARCP payments (including both the refund amount and the matching state potion) was $10.4 million.

State Employees' Retirement System of the State of Illinois

Schedule of Changes in State Property

For the Year Ended June 30, 2008

	Beginning Balance	Additions	Deletions	Ending Balance
State Employees' Retirement System Trust Fund				
Land	$ 655,241	$ —	$ —	$ 655,241
Land improvements	250,316	—	—	250,316
Building	3,352,428	—	—	3,352,428
Furniture and equipment	2,115,547	279,706	(105,640)	2,289,613
Total	6,373,532	279,706	(105,640)	6,547,598
Accumulated depreciation	(3,703,116)	211,508	87,702	(3,826,922)
Property and equipment – net	$ 2,670,416	$ 68,198	$ (17,938)	$ 2,720,676
Social Security Contribution Fund				
Furniture and Equipment	$ 3,987	$ 452	$ (260)	$ 4,179

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

State Employees' Retirement System of the State of Illinois

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

For the Years Ended June 30, 2008 and 2007

	2008	2007
Total revenue for the year	$ 156,927,896	$ 2,363,416,426
Add (deduct)		
Net (appreciation) depreciation in fair value of investments reinvested in the Illinois State Board of Investment (ISBI) Commingled Fund	968,688,184	(1,500,507,144)
Net investment income reinvested in the ISBI Commingled Fund	(274,524,210)	(266,766,628)
Transferred from ISBI	462,000,000	612,000,000
(Increase) decrease in receivables	(16,670,733)	(1,146,119)
Increase (decrease) in amount due to State of Illinois for bond principal and interest payments	1,102,066	231,594
Contribution credits earned by members during periods of disability	(5,930,382)	(5,873,143)
Cancellation or reimbursement of benefits and administrative expenses	6,435,920	4,909,785
Cancellation of Contribution refunds	40,844	193,162
Installment collections to establish service credits	214,168	311,049
Bond principal and interest payments collected and remitted to the State of Illinois	79,536,242	72,488,118
Other adjustments not affecting cash receipts	(92,731)	(9,297)
Total cash receipts	1,377,727,264	1,279,247,803
Add (deduct)		
Interest on cash balances	(13,825,554)	(12,495,855)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(6,002,287)	(4,563,876)
Cash in transit		
Beginning of year	146,708	182,585
End of year	(382,165)	(146,708)
Deposits in transit		
Beginning of year	1,500	87,257
End of year	(1,320)	(1,500)
Deposits remitted to the State Comptroller for order into the State Treasury	$ 1,357,664,146	$ 1,262,309,706
Fund 788	$ 41,200	$ 53,675
Fund 479	1,357,622,946	1,262,256,031
	$ 1,357,664,146	$ 1,262,309,706

State Employees' Retirement System
of the State of Illinois
Schedules of Funding Progress and Employer Contributions
For the Years Ended June 30, 2008 and 2007

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/03	$ 7,502,111,416	$ 17,593,980,039	$ 10,091,868,623	42.6%	$3,639,334,000	277.3%
6/30/04	9,990,186,874	18,442,664,834	8,452,477,960	54.2	3,439,251,000	245.8
6/30/05	10,494,147,953	19,304,646,648	8,810,498,695	54.4	3,475,528,000	253.5
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2
6/30/07	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1
6/30/08	10,995,366,485	23,841,280,102	12,845,913,617	46.1	3,967,704,000	323.8

Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25[1]	Percentage Contributed	Annual Required Payroll Contribution per State Statute[2]	State Pension Fund Contribution	Total required State Contribution	Percentage Contributed
2003	$ 449,348,569	88.1%	$ 375,615,662	$ 17,195,000	$ 392,810,662	100%
2004	576,219,951	83.1	462,200,942	15,150,000[3]	477,350,942	100
2005	727,428,010	58.8	425,682,669	—	425,682,669	100
2006	672,555,569	31.3	207,814,710	—	207,814,710	101
2007	823,802,760	43.6	361,113,709	—	361,113,709	99
2008	986,410,891	59.6	576,626,422	—	576,626,422	102

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

(2) Employer required contribution determined in accordance with HB110 (P.A. 90-0065) and SB533 (P.A. 88-0593). These amounts reflect only payroll required contributions.

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

State Employees' Retirement System of the State of Illinois

Schedules of Funding Progress and Employer Contributions For the Years Ended June 30, 2008 and 2007

Notes to Required Supplementary Information

Valuation date	June 30, 2008
Actuarial cost method	Projected Unit Credit
Amortization method:	
(a) For GASB Statement No. 25 reporting purposes	Level percent of payroll
(b) Per State Statute	15-year phase-in to a level percent of payroll unit a 90% funding level is achieved
Remaining amortization period:	
(a) For GASB Statement No. 25 reporting purposes	30 years, open
(b) Per State Statute	37 years, closed
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	8.5 percent
Projected salary increases	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate	3.0 percent
Group size growth rate	0.0 percent
Postretirement increase	3.0 percent – compounded
Mortality table	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

State Employees' Retirement System
of the State of Illinois
Analysis of Significant Statement of Plan Net Asset Accounts
For the Years Ended June 30, 2008 and 2007

Cash Balances

	2008	2007
State Treasury	$ 306,223,083	$ 250,063,178
Vouchers in transit	(77,405)	(351,390)
Deposit and cash in transit	382,165	146,708
	306,527,843	249,858,496
Petty cash fund	200	200
	$ 306,528,043	$ 249,858,696

Receivables

	2008	2007
Participants' contributions	$ 16,249,569	$ 12,023,467
Employing State agencies	26,290,400	13,421,494(1)
Other accounts	5,921,504	5,452,610
	$ 48,461,473	$ 30,897,571

(1) The amount due from Employing State agencies was higher in FY2008 due to a higher employer contribution rate than in FY2007. The FY2008 rate was 16.561% and the FY2007 rate was 11.525%.

Investments

General Information:

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of Illinois are managed by the ISBI and are held in the ISBI Commingled Fund. Units of the ISBI Commingled Fund are issued to the member systems on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems.

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

State Employees' Retirement System
of the State of Illinois
Analysis of Significant Statement of Plan Net Assets Accounts
For the Years Ended June 30, 2008 and 2007

Investments (continued)

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2008 and 2007 is summarized as follows:

	2008	2007
Balance at beginning of year, at fair value	$ 11,810,137,495	$ 10,654,863,723
Net cash added (withdrawn) to/from investments	(462,000,000)	(612,000,000)
	11,348,137,495	10,042,863,723
Investment income		
Interest, dividends and other	313,924,157	304,940,692
Expenses	(39,399,947)	(38,174,064)
	274,524,210	266,766,628
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sale of investments	559,623,090	798,735,493
Net unrealized gain (loss) on investments	(1,528,311,274)	701,771,651
	(968,688,184)	1,500,507,144
Total net investment income	(694,163,974)	1,767,273,772
Balance at end of year, at fair value	$ 10,653,973,521	$ 11,810,137,495

State Employees' Retirement System of the State of Illinois

Analysis of Investment Performance (Unaudited)

For the Years Ended June 30, 2008

An analysis of investment performance for the years ended June 30, 2008 and 2007 is summarized as follows:

	2008	2007
Total return*	$ (6.2)%	17.1%

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

Analysis of Operations

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

System's Functions and Planning Program

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

The System is governed by Article 14 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2008, the System had approximately 56,000 benefit recipients and 66,200 active members.

Management of the System is vested in a Board of Trustees (Board) consisting of seven persons, as follows: (1) the Director the Governor's Office of Management and Budget; (2) the Comptroller; (3) one trustee, not a State employee, who shall be Chairman, to be appointed by the Governor for a five-year term; (4) two members of the System, one of whom shall be an annuitant age 60 or over, having at least eight years of creditable service, to be appointed by the Governor for terms of five years; (5) one member of the System having at least eight years of creditable service, to be elected from the contributing membership of the System by the contributing members; (6) one annuitant of the System who has been an annuitant for at least one full year to be elected from and by the annuitants of the System. The administration of the detailed affairs of the System is vested in the Executive Secretary, under the direction of the Board. General policy relating to the administration of the System is stated in the minutes of the Board meetings.

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

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

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

Program planning activities of the System are under the direct supervision of the Executive Secretary and involve coordination between the governing Board and other executive staff of the System. The current planning program identifies various operational projects for fiscal year 2008. The planning summary for each project includes the project scope and objectives, implementation phases and timing, resource application and expected benefits. Each project is assigned to a divisional level manager who acts as project leader during all implementation phases of the project. Implementation progress is reported to the Executive Secretary, who in turn reports such progress directly to the System's Board of Trustees.

The operational plan for fiscal year 2008 included several of the fiscal year 2007 projects continued into fiscal year 2008.

New projects for fiscal year 2008 include: a) quick hits; b) active statement redesign; c) network project; d) upgrade temperature control system; e) application documentation update.

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

OPERATIONAL PLAN
Projects for FY2008

FY 07 Continued in FY 08

A. Expansion of Internet Services – Field Services
B. Internet Usage Study – Field Services
C. Staff Training – Human Resources
D. E-mail Information Study – EDP
E. Automated Error Processing – Accounting
F. Review of Tax Information Brochure – Claims
G. Toll-Free Telephone Service Study – Field Services
H. Trustee Election Review – Field Services

New Projects for FY 08

I. Quick Hits – Field Services
J. Relational Data Base Reformat – EDP
K. Active Statement Redesign – Administrative Services
L. Network Project – EDP
M. Upgrade Temperature Control System – Administrative Services
N. Application Documentation Updates - EDP

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

OPERATIONAL PLAN
Projects for FY2009

FY 08 Continued in FY 09

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

New Projects for FY 09

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

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

Progress in Funding the System

The actuarial accrued liability of the System as of June 30, 2008 amounted to approximately $23.8 billion. The actuarial value of the assets as of June 30, 2008 amounted to approximately $11.0 billion, leaving an unfunded actuarial liability of approximately $12.8 billion.

The Illinois Pension Code, 40 ILCS 5/14-131 (Code), as amended by Public Act 88-0593, provides a 15-year phase-in to a 35-year plan that will amortize the unfunded liability faced by the System. In general, the Code provides that:

- For fiscal years 1996 through 2010, the contribution to the System, as a percentage of payroll shall be increased in equal annual increments so that by fiscal year 2011, the State is contributing at the rate required in this Section of the law.
- For fiscal years 2011 through 2045, the minimum contribution to the System for each fiscal year shall be an amount determined to be sufficient to bring the total assets of the System up to 90 percent of the total actuarial liabilities of the System by the end of fiscal year 2045. In making these determinations, the required contribution shall be calculated each year as a level percentage of payroll over the years remaining to and including fiscal year 2045 and shall be determined under the projected unit credit actuarial cost method.
- The funding legislation also provided for the establishment of a continuing appropriation of the required employer contributions to the System. This will, in effect, remove the appropriation of these funds from the annual budgetary process.

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

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

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

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

Effective July 30, 2004, Public Act 93-0839 requires the System to include an additional amount in the employer contribution rate to be paid over the General Obligation Bond Retirement and Interest Fund to be used to pay principal and interest on the General Obligation Bonds pension Funding Series of June 2003.

In June 2005, Public Act 94-0004 became law. This legislation further modified the funding plan by reducing the amount of required employer contributions for fiscal years 2006 and 2007 that would have otherwise been required under Public Act 88-0593, as modified by Public Act 93-0002. Under Public Act 94-0004 contributions from employing State agencies and appropriations approximated $358.8 million and $210.5 million for fiscal years 2007 and 2006, respectively. The required State contributions for fiscal years 2008 through 2010 will then be increased incrementally as a percentage of the participant payroll so that by fiscal year 2011 the State is contributing at the required level contribution rate to achieve the financing objective of a 90% funded status by the end of fiscal year 2045.

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

System Employees

System Employees' Retirement System Trust Fund

The average number of employees (not including the General Revenue Fund – Social Security Division) during the years ended June 30, 2008 and 2007 is summarized by functional classification as follows:

	2008	2007
Executive and administrative	13	13
Accounting, bookkeeping and clerical	32	28
Other office employees	23	24
Electronic data processing	13	15
Total	81	80

Social Security Contribution Fund

The Social Security Contribution Fund had one employee for both the years ended June 30, 2008 and 2007.

Comparison of Administrative Expenses to Total Expenses

	2008	2007
Total expenses		
Benefits	$ 1,214,115,627	$ 1,161,291,038
Refunds of contributions, including transfers to reciprocating systems	16,817,433	14,261,872
Administrative expenses	9,537,305	8,807,627
	$ 1,240,470,365	$ 1,184,360,537
Administrative expenses as a percentage of total expenses	0.8%	0.7%

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

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

State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2008 and 2007

On June 12, 2003, the State of Illinois issued $10 billion of General Obligation Bonds, Pension Funding Series June 2003. The net bond proceeds were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act.

The State Employees' Retirement System received their allocation of bond proceeds on July 1, 2003. The State Employees' Retirement System's portion of the allocation was $1,385,895,278. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment (Board) on July 2, 2003. The Board initially approved investing the pension bond proceeds in separate index funds. These index funds were subsequently liquidated and combined with the Board's other investments and invested in accordance with the asset allocation policy of the Board during the year ended June 30, 2004. The Board estimates return on the pension bond proceeds earned an annual rate of return of negative 6.2% during the year ended June 30, 2008, which is the same as the overall return for the Board's investment portfolio.

Schedule of Contributions/Deductions and Effect on Investments

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

	2008	2007
Contributions		
Participant Contributions	$ 249,955,208	$ 224,722,599
State of Illinois Employer Contributions	587,732,407	358,786,650
Total Contributions	837,687,615	583,509,249
Deductions		
Retirement Benefits	1,089,743,632	1,030,284,942
Survivor Benefits	68,770,552	65,215,133
Disability Benefits	43,086,065	43,053,148
Lump-Sum Death Benefits	12,515,378	22,737,815
Refunds (including transfers to reciprocating systems)	16,817,433	14,261,872
Administrative Expenses	9,537,305	8,807,627
Total Deductions	1,240,470,365	1,184,360,537
Investments Used to Pay Benefits and Expenses	$ (402,782,750)	$ (600,851,288)

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2008 and 2007

Service Efforts and Accomplishments (Unaudited)

	2008	2007
Membership data		
Coordinated members	84,453	86,094
Noncoordinated members	3,172	3,227
Total members	87,625	89,321
Active members	66,237	67,699
Benefit payments processed		
Recurring		
Retirement annuities	43,781	42,979
Survivors' annuities	10,104	10,074
Disability benefits	2,226	2,212
Total	56,111	55,265
Termination refunds processed	1,598	1,660
Retirement counseling		
Preretirement sessions		
Number of sessions	185	256
Number of attendees	7,532	6,275
Postretirement seminars		
Number of sessions	37	37
Number of attendees	1,275	1,169
Regional and other meetings		
Number of sessions	475	103
Number of attendees	14,812	8,540

State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2008 and 2007

Subsequent Events

Transfer of Funds

On February 27, 2009, Governor Pat Quinn signed House Bill 1027 into law as Public Act 96-0003. This new law required a transfer of $175,000,000, from the Systems' funds into the Hospital Provider Fund. The law also required the transfer of these funds back to the System by April 14, 2009.

On March 2, 2009, two transfers in the amounts of $90,000,000 and $85,000,000 (for a total of $175,000,000), were made to the Hospital Provider Fund from the Systems' account. On March 24, 2009, two transfers in the amounts of $90 000,000 and $85,000,000 (for a total of $175, 000, 000), were made from the Hospital Provider Fund back into the Systems' account.

This legislation also called for the State Treasurer to calculate the amount of interest that would have accrued to the System had the transfer not occurred, and be remitted over to the System.

Composition of Board of Trustees

On April 3, 2009, Governor Pat Quinn signed Senate Bill 0364 into law as Public Act 96-0006. Among a number of other changes, this new law provided for the termination of the terms of board trustees appointed by the previous Governor and required the appointment of their successors, as well as making a change in the composition of the Board.

Prior to the new law, the Board was comprised of seven trustees. The new law expands the Board to include thirteen trustees; a) the Comptroller, who shall serve as the Chairperson; b) six persons appointed by the Governor with the advice and consent of the Senate; 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; and d) two annuitants of the System who have been annuitants for at least one full year, to be elected by the annuitants of the System.